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Europe Organizing Cordon Sanitaire Against Dollar

FOREIGN EXCHANGE

The U.S. dollar kept falling against *all* the major foreign currencies after the long Easter weekend. Meanwhile the price of gold closed at $152.95 an ounce in London on April 13, to consolidate at above $152 an ounce on April 14, up from $148.70 an ounce on April 8.

The renewed weakness of the dollar against even Europe's weakest currencies, the British pound, French franc and Italian lira, reflects "continued doubts about the ability of President Carter's Administration to bring U.S. inflation under control," according to London dealers. Beyond that broadly shared opinion, it reflects a deliberate choice by European governments to organize a "cordon sanitaire" against the dollar in support of their self-interest as a whole economic unit.

The New York financial press tries to rationalize the run out of the dollar as in part a strategic move by the New York based banks to force an upward revaluation of the yen and the West German mark while sending under the "sick men of Europe," Italy, Great Britain and France. But the upvaluation of the mark has now nothing to do with maneuvers organized in New York. As for the yen, the Wall Street institutions are caught in a contradictory situation where their acknowledged purpose — to send the yen up — is countered by their political pressures on the Japanese government, notably their threat of a trade war, which tends to send the yen down. Moreover, the"sick"currencies are conspicuously failing to go under.

The reality of the market is that the U.S. monetary authorities have lost control of their formerly dependent currencies. Federal Reserve Board Chairman Arthur Burns' declaration urging "nations in large account surplus to let their currencies appreciate" to help out the dollar have nothing to do with the upvaluation of the mark. There is, in fact, no "upvaluation of the mark," but only a *devaluation of the dollar.* A simple examination of the European "snake" — an agreement between Central Banks of West Germany, the Netherlands, Belgium and the Scandinavian countries to keep their currencies within 2.25 percent margin variations — shows that over the past few trading sessions, the Scandinavian currencies and the Dutch guilder have been at or near their *ceilings* in relation to the mark!

What the Bundesbank is really doing is to maintain interest rates in Euro-marks and domestic deposits at a low level to foster capital flows out of the mark and into the "weak" European currencies, thus making the European monetary system function somewhat as a whole, the mark acting as a bridge for currencies into and out of the snake. It is therefore as a whole that the European currencies are moving up against the dollar. This implies that the Bundesbank does not need to buy dollars to avoid a too sudden upvaluation detrimental to West German foreign trade — because it is relatively "stabilized" by the other weaker currencies. Those currencies are in turn "bailed out" against the dollar. For example, Britain has been holding sterling at close to $1.72 for weeks and amassing substantial reserves in the process.

There is now widespread speculation in Europe that the abovementioned agreement will be soon formalized by bringing the British pound, the Swiss franc and the French franc into the snake — this of course implying a relative revaluation of both the mark and the guilder, not as a concession to the dollar, but on the contrary, as a move against the U.S. currency.

The upvaluation of the yen was originally imposed by the Carter Administration to curtail Japanese exports and throw Japan into current-account deficit. As a consequence, the Japanese steel industry already faces a deep crisis: the competiveness of Japanese steel exports is so damaged that industrialists have to sell at dumping prices, losing ten percent per ton sold! But as the dollar was about to drop below 270 yen at the beginning of the week, the Bank of Japan began intervening in the market to avoid the total collapse of Japanese small and medium size exporters. Teichiro Morinaga, governor of the Bank of Japan, warned that "the yen's recent rapid rise did not seem to reflect the conditions in Japan and overseas," stressing that "some speculative factor is at work." Following this declaration, the Bank of Japan intervened on the market for the first time, buying around $80 million on a total turnover of $278 million on April 12. Meanwhile, to keep the Japanese in line, the U.S. Customs Court issued a ruling the same day that could result in the imposition of new import duties on Japanese electronic products. The U.S. duties "would be designed to offset tax rebates on exports given by the Japanese government." Such a tax procedure being in conformity with the rules of the General Agreement on Tariffs and Trade, the U.S. decision was perfectly illegal and provocative. As a threat, it nonetheless worked, fostering a dollar upswing in Tokyo on April 13 to 272.35 yen from 270.73 yen — while the dollar continued to slump against all other major currencies. This situation induced a Japanese trader to comment that "judo was after all made in Japan," referring to the finally favorable consequence obtained for the Japanese interest out of an otherwise adverse U.S. operation.

The fall of the dollar was reflected on the commodity

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market, according to a leading New York house, in the weakness of the soybeans market. Soya, cocoa, and coffee turned weak, since speculation in these commodities depended on excess dollar liquidity in the international markets. In a parallel move, the price of precious metals went up as a hedge against the dollar, among new rumors of Arab funds moving into gold, along with traditional inflation hedges such as copper.

The decision of President Carter to drop his planned tax rebates, criticized as demagogical and inflationary, has temporarily slowed the fall of the dollar on April 14, but his announced energy policies are bound to reaccelerate, both domestically and internationally, the lack of confidence in his Administration.

European Bankers See Major Eurodollar Market Shakeout In Third Quarter

BANKING

Leading Swiss and British bankers expect a major shakeout on the Eurodollar markets by the third quarter of 1977 resulting from the probable failure of Carter Administration efforts to have the International Monetary Fund (IMF) take over a major portion of Third World debts. According to estimates previously circulated by the Swiss Banking Corporation, non-oil producing Third World countries must meet $17 billion in principal repayments alone — not to mention interest — during 1977, the bulk of which falls due during the second and third financial quarters. The Swiss and British bankers surveyed this week now believe that it will be impossible for private international banks to handle this volume of refinancing. The giant New York commercial banks, which have the heaviest exposure, may not survive the third quarter crisis.

Any U.S. Federal Reserve attempt to rescue the New York banks without European support is, moreover, likely to backfire against the U.S. dollar. As a high-level official of one of the three largest Swiss Banks remarked, a single-handed Federal Reserve intervention, which would turn on the printing presses for new dollars, would only trigger a general crisis of "confidence" involving several times more funds than what the Fed is able to mobilize. "How can people conceive of such a scenario conserving their financial holdings!" the Swiss bank official declared.

One source close to the Swiss central bank reported that the Saudis will not give a penny towards an expanded IMF, unless the U.S. government supplies an equivalent amount — and, in Riyadh, it is believed that the U.S. Congress will effectively prevent this. Thus the Carter Administration will accomplish nothing at the April 28 IMF Interim Committee meeting or at the May Economic Summit in London. The entire IMF bail-out package will just fall flat. The following events will then unfold according to this source: "By the second or third quarter, there will be a big contraction in international finance, moratoriums, call it what you will. The United Kingdom and France will push for more stimulation, but it won't help. Confidence will be shattered and exchange rates will move against the dollar."

In London, a spokesman for a leading British merchant bank, with credentials going back to the eighteenth century, attacked the IMF's austerity policies as the reason why the bail-out is getting short shrift. "Either the IMF employs new people, or they get less power — in any case, they're not able to play it as central banker," the spokesman said. "In the United Kingdom, the IMF team behaved like the most extreme type of Montagu Norman bankers — cut, cut, cut — the cuts were all far too severe, and with the funding of the sterling balances we've tied our hands for ten years...If the non-recovery goes on, or becomes negative, the commercial banks in the U.S., who have the prime responsibility for their overexposure, will be in trouble. European bankers have been far more cautious...Major write-offs will be possible, but even with Federal Reserve funding, it'll be too late — there will be withdrawals, a major collapse. The asset side has gone so far that nothing the IMF can do can salvage the situation." He then confirmed reports that the Saudis are opposed to the $16 billion IMF special fund proposed by the Fund's managing director Witteveen.

Other City of London spokesmen expressed a similar lack of sympathy for the plight of New York's commercial banks. Said one merchant banker: "If the U.S. banks are going to collapse, I could not care less. The Fed will help them. Big effects on the dollar too, sure. So what?"

Only N.M. Rothschild and Sons dissented from the general view that the New York banks are likely to be badly shattered. "There will be a major banking and liquidity crisis but not a breakdown crisis," protested the Rothschilds' LDC debt expert De Carvalho.

In West Germany, opposition to the IMF expansion is nearly as strong as among British financial circles but is complicated by fear of a break with the U.S. A representative of a West German business association expressed it best: "Not everyone wants to help the U.S. banks that made so much profit on the LDC lending operations," but the West Germans hope for some kind of "compromise" on the IMF issue to delay having to come to grips with the larger strategic question of a collapse of New York financial power.

As word of the impending third quarter payments debacle spreads, the *Wall Street Journal* has been forced