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European-Japanese Gold Moves Put London In Policy Tailspin

Interviews from a comprehensive cross-section of Britsh, American, West German, and Japanese bankers and officials, and the international financial press this week showed clearly that the City of London's drive for world reflation to prop up the rotten pound sterling, recently pushed by the Warburg family (as reported last week) under the "Roosa Plan" rubric, has collapsed. Instead, sterling and W. Michael Blumenthal's dollar head for another round of foreign exchange market crisis, the Europeans and Japanese stand ready to exercise their financial "Option A": as announced at the January meeting of the Bank for International Settlements, they will force the remonetization of gold by asking the United States to support the dollar through gold swaps at market prices.

In response to the political failure of their initiatives and the oncoming demise of the Federal Reserve-Bank of England control of world monetary policy, the City of London has within the last few days printed a flock of new and even more unsound scenarios — outright calls for deflation, U.S. bank failures, and mass runs on the European currencies to halt the continent's political unity. So far, international response has been summed up by a New York foreign exchange trader who, when told the British are trying to talk the pound up to $2.00, replied: "Baloney!" (see *Foreign Exchange*).

The best evidence on the European and Japanese coalition to force the U.S. into a gold-backed monetary stabilization of the dollar in spite of itself came directly from the offices of Robert Roosa at Brown Brothers Harriman and the research department of Lazard Freres. Roosa's aide, questioned about what Japanese Premier Fukuda meant by endorsing a "Roosa Plan return to fixed rates," angrily said that what Japan — and West Germany — are talking about when they say "Roosa Plan" is not at all reflation and central bank coordination of monetary policy. Rather, the aide complained, Fukuda endorsed precisely what the Europeans and Japanese threatened at the January Bank for International Settlements (BIS) meeting: a move to stabilize the dollar through the reintroduction of gold at market prices, and the expansion of industrial exports to the Third World. Japanese industrialists are demanding this of Fukuda, he said.

A review of the Japanese press explains the commotion. The *Asahi Evening News* this week, under the headline "What is the Roosa Plan?", runs an analysis by former IMF Director Hideo Suzuki that openly says that the "Roosa Plan" called for by Japan's corporations means stabilization of the yen-dollar parity and all foreign exchange relationships through comprehensive central bank support agreements — emphatically including gold swaps at market prices. The question, writes Suzuki, is "Will the U.S. agree to this?" Suzuki also notes that real expansion of world trade is the only way to give such an agreement a sound economic basis — but urged that the monetary actions be taken promptly, rather than waiting for the trade expansion to be negotiated. The *Yomiuri Daily* warned the same day that unless Fukuda moves quickly on real economic development programs for Japan, the country's industrialists intend to have his government replaced.

A top partner in the research department of Lazard Freres investment bank said the same: Gold and the swaps are a real alternative if the dollar continues to erode. He cited this week's London *Economist's* egregious blowout article on gold, "Now They're Fleecing the Golden Sheep," which documents extensive moves into the gold market by French, Greman, Swiss, and other investors and governments. He warned that London can opt to destroy the gold market by forcing South Africa to dump gold to pay its debts. If that fails, the *Economist* fulminates, then London's own G.W. Miller can always dump U.S. gold when he takes over at the Federal Reserve. A likely threat, as many economists who read the article pointed out — because this is exactly what the Europeans want the U.S. to do; any sale of gold at market prices plays right into remonetization and currency stabilization.

Similarly, a large cross-section of bankers and European government officials denounced reflation and the Roosa Plan in interviews with NSIPS. One West German official openly mooted the introduction of gold as a force for "discipline."

British Scenarios Rampant

In response to the strengthening European political situation, the City of London forces have outdone themselves with vicious plans for chaos and confusion — anything to regain the political initiative. If allowed to have their way, they could repeat their triggering of the 1929 crisis.

One option floated by Lazard's research department is, if the West Germans and Japanese won't reflate, and insist on going to gold when the dollar falls as a result, then the U.S. must *deflate*. Lazard cited the hike in U.S. interest rates, forced through by Treasury Secretary Blumenthal, as their faction's single most important accomplishment this year. The dollar can be stabilized, Lazard research said, by hiking rates up high enough so that dollar bank deposits look more attractive than German mark or Japanese yen deposits, even with a $30

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billion annual U.S. trade deficit — which will take a lot of interest rate hiking. Even if this means the U.S. economy will go into "negative growth," with a "rather prolonged recession," said the Lazard spokesman, anything will do, just so the Europeans and Japanese are not presented with an immediate choice between reflation, dollar collapse, or gold (and choose the latter).

The other major scenario presented — aside from a flopped one-day attempt to talk up the pound (see *Foreign Exchange*) — was announced by a limited partner of a top British merchant bank after he was told that no one in the U.S. would buy the deflation scenario above. The main problem, then, he pointed out, is that from the British standpoint the European *political* situation needs "a blowoff...a little bit of bloodshed." Since the overriding threat to Britain's policy goals is the European-Japanese political solidarity for expanded industrial development, trade, and a gold-backed monetary system to back this up, then this political configuration must be ruthlessly attacked and destroyed.

The British intend, he said, to start a general currency destabilization in Europe which would make their attack on the French franc last week look mild. "The $64 question is, if French, Italian, and Netherlands investors — that began just last week — start to get out of their own country's securities, it would counteract what the Swiss and Germans are trying to do." Pushing Fabian Socialist Mitterand in the French elections, he said, would start a run on the French franc that would turn into a general run on European currencies. The perception that West Germany would also suffer from the general European crisis would quickly bring on an attack even on the mark — and the entire political situation would be so disfigured that Britain would be able to take over in the chaos.

If carried out, however, this dangerous scenario would hit sterling too. It need only be taken seriously to the extent that the United States and its European and Japanese allies sit still for this kind of threat from the City of London — and that is a political question.

'Mr. Roosa Is Upset About How His Plan Is Being Used'

The following are excerpts from an interview with an aide to Robert Roosa at Brown Brothers, Harriman:

Q: What does Japanese Prime Minister Fukuda mean by endorsing the "Roosa Plan" as a return to fixed rates?

A: Look, the entire discussion of Mr. Roosa's plan has gotten out of hand. People are going way beyond his meaning. What Mr. Fukuda said could not be further from the truth. The Roosa Plan is a system for coordinating central bank policy explicitly within floating rates, including reflation of the major economies.

Q: Wasn't Mr. Fukuda perhaps referring to the "BIS scenario" arrived at at the Bank for International Settlements at Basel last month, where European and Japanese central banks demanded support for the dollar and reintroduction of gold into the system?

A: It may well be. Mr. Roosa is upset about the way his plan is being used. Fukuda is under mounting pressure from Japanese industrialists to go to fixed rates. Furthermore, the Bundesbank (West German central bank—ed) was asked at a press conference last week if they had been discussing the Roosa Plan. They denied it, but we don't even know what they mean. We do know the Germans demand maintaining control over their own national economy, and that they certainly don't feel that the time is right for the Roosa Plan now, or in the near or even medium-term future at all. I can tell you further that no one in the U.S. is discussing the Roosa Plan as we see it, as a real option.

It's Only A Short-Term Tactic

A spokesman for the research department at Lazard Freres had this to say:

Q: Will Germany and Japan go for the "Roosa Plan" with reflation?

A: Ridiculous—Germany and Japan will never reflate.

Q: Well, if Fukuda and the Bundesbank mean going to remonetization of gold when they say "Roosa Plan", then isn't that their intention?

A: Yes, supporting the dollar using gold swaps is the obvious alternative if we keep on like the Carter Administration would like to keep on. If the U.S. continues to reflate, to run a deficit, to keep domestic demand high through printing money, and to insist—and fail—at German-Japanese reflation, then we have a real crisis and gold is the obvious action; a real potential development. Look at the *Economist* this week. They really think it might happen, not like the stupid *Wall Street Journal*'s editorial comment two weeks ago, which said people would be too stupid to remonetize gold. The Japanese, for example, have their trading companies buying gold for the Finance Ministry.

Q. Then we're headed for a gold-backed system, since they won't reflate?

A: No, not unless the U.S. deflates. This is, in fact, what will occur. Instead of what the Administration would like to see, which would cause a gold move in short order, we have already begun to defend the dollar with the single most important thing we could have done: *raise interest rates*. This will stop imports, by stopping economic growth here, thus slowing down world trade and causing a rather prolonged recession. Just by having the economy grow slowly is in fact the best way to have a Roosa Plan. Look at Anthony Solomon (U.S. Treasury—ed.) and Henry Wallich's (U.S. Federal Reserve—ed.) testimonies in Washington this week. They said that intervention at any given level does not imply the dollar is being held to that level—that is, we will not support the dollar by intervention, but through higher interest rates.

Q: But won't a fallout of the U.S. economy weaken the dollar and make the Europeans jump into gold anyway?

A: Sure, in the long run. All I'm saying is that if we raise interest rates the situation will look better, the dollar will be stabilized, by the time of the heads of state economic summit in Bonn this summer. *But it will only be artificial and short-term improvements.* Then we can put less pressure on them to reflate, and in return they will pull back from gold for awhile.

"We Have to Have a Little Bloodshed"

Here, an interview with a limited partner of a top British merchant bank:

Q: Our reading of the figures is that off-budget financing, particularly to support FNMA and the other real estate agencies, will bring the federal deficit up to about $140 billion. Do you agree?
A: Yes, the deficit will be in the range of $120 billion to $140 billion. The total financing requirements of the economy will be $350 to $360 billion.

Q: Rothschild sources in Europe projected a two-tier credit system geared towards real estate. Is that what we're seeing?
A: What do you mean by Rothschild? There is a vague sort of network people call 'Rothschild,' but I don't know what you're referring to.

Q: N.M. Rothschilds and Sons and the Lambert people in Brussels.
A: Oh, right. The Federal government will do everything available to support the real estate market. We have had a two-tier system for some time, and this will certainly increase the trend.

Q: The scenario we are projecting is that if the dollar collapses—as a result of the deficit we are talking about—the Europeans will remonetize their gold reserves, and London will be collapsed.
A: Oh, not necessarily. The Europeans may want to do that. But there are $350 to $400 billion, and the market for that is in London and will continue to be. Inflation will ensure that the market will continue growing at at least the rate it has in the past. Most of the money that comes through London isn't of British origin—London is the financial center because it has the best transportation, communications, restaurants, and whorehouses in Europe.

Q: What the French, Swiss, and Germans have in mind is to use European gold reserves to take command of capital flows — for example the plan to create a parallel gold and deposit market in Luxembourg and draw funds out of London. That would eliminate London.
A: I wouldn't say 'eliminate.' There are numerous private investors moving into the Eurodollar market. Those securities and time deposits mature constantly and will have to be turned over. There is a secondary market that will have to remain in Britain. The prime market may be dominated by the European banks and controlled by the central banks. But private funds—and you can count them in the hundreds of billions—will stay in London and some in Zürich. The $64 question is if French, Italian, and Netherlands investors—that began just last week—start to get out of their own country's securities, it would counteract what the Swiss and Germans are trying to do. The French elections are extremely important. It may surprise you, but I am in favor of a socialist government in France. There are huge amounts of franc-denominated funds held by investors outside France...

Q: French Socialist leader Mitterand last night put the figure at 400 billion francs.
A: That's right. There is also a growing perception in West Germany that a non-growth Europe can't survive without a readjustment of the mark. That will mean a shift back to dollars. It would only be a transfer—it would not help the U.S. balance of payments, since the central bank would buy up the deutschemarks going out and sell dollars, so it would only move dollars from one place to another. But this will stabilize the dollar against the mark and the Swiss franc.

We Want Socialism In France

Q: Our estimate is that it won't happen that way. Schroeders, Warburgs, and a few other organized the run out of the franc last Thursday...
A: When you say "organized," you seem to imply that a group of men in black hats get together for lunch and plan what will happen. I've been in the banking business for 30 years, and you won't find anyone more cynical and suspicious than me, but it doesn't happen that way.

Q: Henry Simon Bloch (of Warburg, Pincus) has been talking. In any case, Giscard and Schmidt met on Tuesday and held the franc together and rapped the speculators' knuckles.
A: Giscard has been tough on speculators. They're starting to put speculators in jail. They never used to do that before. But we'll know on the 12th — the first round will go socialist.

Q: If the Socialists win, Giscard will stage a De Gaulle-type coup. The Socialists won't be allowed into the government. This is what Debré has been saying.
A: Maybe so, maybe so — perhaps that would be best...

Q: I thought you wanted the Socialists in the government.
A: Let me tell you! We want the Socialists to win the elections for even more insidious reasons that you would suspect. A Socialist government would be a capitalist-oriented conservative government. It would get it all over with. We need a blowoff. To get back on the track we are going to have to have a little bit of bloodshed. Then we can go back to capitalist-oriented free enterprise.

West Germany Wants 'Nothing Connected to Inflation'

Here, comments from a West German economics official:

Q: What is your opinion of the "Roosa Plan"?
A: Roosa spoke before the Banking Committee of the Senate early December, and issued his proposal for a basket of currencies there. Our reaction? It is not at all favorable. The problem with the proposal is that it is the same as Bretton Woods: fixing of rates without any coordination of inflation problems or coordination of economic policy.

Q: What kind of coordination are you speaking about? Would you accept any kind of coordination which involves stimulating or inflating the West German economy?

A: Nothing connected to inflation. Central banks are faced with a wave of attacks from speculators. If intervention is done, there must be concerted action. We defend the dollar all day in West Germany, the exchange closes, and then speculators go to New York and by the next morning the dollar has fallen again. The U.S. must intervene here. There is definitely discussion occurring on using gold as a disciplining factor in international currencies.

Franc Attack Judoed Against Pound

The London-orchestrated speculative attack against the French franc was signally reversed last week and the pound took a licking in reprisal at the hands of European bankers. On Feb. 7, before the joint Paris press conference by French President Valéry Giscard d'Estaing and West German Chancellor Helmut Schmidt, the franc had sunk to 4.94 against the dollar. The day after the press conference, in which Giscard announced that he had instructed Premier and Economics Minister Raymond Barre to "take every necessary technical step to oppose the depreciation of the franc," the currency reached 4.87 without direct support purchases by either the French or West German central bank.

FOREIGN EXCHANGE

Indeed, the only central bank visible in the markets that day was the Bank of England, trying to keep the pound above \$1.91; news that a miners' strike had been averted only nudged sterling up half an American penny, even though London bank representatives in New York were euphoric at a token of the resilience of the government's pay restraint and thus the future of the government bond market and the sterling crossrate.

Not only was this mania derided by the majority of international bankers, both pro-sterling strategists like Lazards and "neutral" short-term operators at the New York commercial banks; the Europeans made the defense of the franc into more than a mere tactical victory by "banging sterling in revenge," as one trader put it Feb. 8.

When Chancellor Schmidt was asked in a West German television interview about support for the franc, he commented that he had not discussed the subject with Giscard because it was already a bilateral matter-of-course; what they had talked about, he said, was "a more important currency," that is, the dollar — thereby putting Treasury Secretary Werner Blumenthal and other London satraps in Washington and New York on notice that no further monkey business like the franc stunt will be tolerated.

From Franc to Dollar

The run on the franc had amounted to a new attack on the dollar. Aside from purely technical reasons, involving dollar sales required to perform franc support, the Warburg, Rothschild, and Schroder group of London banks were racing to draw international funds out of the franc, the dollar, and other "weak" currencies into a wild, reflation-hyped deutschemark-Swiss franc-yen axis including the pound as a major reserve currency, despite the sub-Dickensian state of Britain's material assets. (See *Executive Intelligence Review* Vol. V, No. 5.)

In the wake of the European counterattack, the Rothschild strategists have lost an important margin of credibility. The next time they want to use their powers of persuasion to direct central bank and other major depositors in or out of a currency through hoked-up rumors (like the "certain" March victory of the French left) they may be left talking to themselves.

The State of Sterling

The other immediate deflator of London's pretensions is the state of sterling finance itself. Having sucked in continuing piles of international funds through high long-term interest rates, and with the expectation of launching a new imperial re-lending drive abroad, the City is now forced to tacitly acknowledge that it lacks the political clout to abandon its exchange controls and funnel others' liquidity into anti-growth channels of its choice. Lazards confirms that to lift controls at this point would simply mean a £10 billion outflow to safer shelters with no London control of the funds. In fact, the tremors of an anticipated run out of sterling investment that surfaced in the London *Financial Times* at the end of last month are growing louder. The *Los Angeles Times* reports British bankers are protesting a bit too loudly that OPEC holdings will never be withdrawn from the pound; Citibank derided British backpatting over the miners' settlement; off the record, Lazards admitted that all the "fundamentals" point downward — the City's antagonism to industrial expansion is catching up with it at home.

In expectation of Bank of England chief Gordon Richardson's Feb. 9 policy speech, the British press is clamoring for action to curb the domestic money supply, swollen by inflows London hasn't figured out how to put to use at a 24 percent annualized rate in December. On Feb. 3, the stock and "gilts" markets had both tumbled due to the money-supply announcement, and the *Financial Times* expects real estate to remain the only point of foreign interest. No one proposes to encourage real investment in the U.K., but the expectation is rather a reimposition of a "corset" on clearing bank deposits, and hence, a new IMF-style tightening of domestic credit, the remedy for inflation whose inefficacy deters its advocates no less than its austere discomforts. The importance of this bind, however, is the opportunity for European and American strategists to make a terminating, victorious onslaught against pretentious sterling swindles so that the bank edifices and the skilled British labor force can be put to use by wiser directors in the aftermath.