Click here for Full Issue of EIR Volume 5, Number 7, February 21, 1978

Blumenthal's Bear Raid Reviewed

The dollar hit record lows on Feb. 16 and again Feb. 17 against the West German mark, Swiss franc, and Japanese yen. The bear impetus came first from Energy Secretary Rodney Schlesinger's domestic operations around the coal strike, which promise economic indicators far worse than the January drops in U.S. industrial output of .7 percent, the sharpest since March 1975, and in retail sales of 3.1 percent, the sharpest in 13 years. The expansive, developmental national energy policy that would reverse the slide has not been forthcoming; the consequent general lack of confidence set the stage for the second bear impetus, from W. Michael Blumenthal.

FOREIGN EXCHANGE

Currency dealers and bank economists had their chins on the floor all last week wondering how the Treasury Secretary could be so stupid as to armtwist the West Germans once more during his weekend European trip when it was obvious that they would not budge from their refusal to grossly "reflate" their economy. Blumenthal, in truth, was far more nimble than his New York second-guessers. He went to Bonn *intending* to throw the West Germans into a degree of frustration and outrage that would impel withdrawal of market and moral support for the dollar.

In the short run, he had a degree of success, though the returns are far from tallied. What is clear is that Blumenthal does not simply want a return to "malign neglect" of the depreciating dollar; on behalf of the London channels who have shaped his career, he is attempting to regain his slipping leverage with the White House in order to force through murderous trade-war, international austerity, and financial reorganization policies in the wake of a dollar breakdown. The "1979 protectionism" dimension of the scenario was spelled out on the front page of the Feb. 16 issue of the conservative French daily *Le Figaro* by the well-known economics editor, Alain Vernay.

Secondly, it is clear to everyone as well — as it was in 1968-1979 — that if Japan, West Germany and Switzerland merely try to buy all the dollars they can to maintain the dollar's value as a reserve currency, they will bloat their money supplies to no avail. Hence the proliferation of soft-sell London-sponsored proposals for "diversification" of reserves and investments.

On Thursday, Feb. 16, amidst rumors of heavy Mideast selling of dollars the day before, the dollar closed at record lows against the Swiss franc and deutschemark, with no evidence of the kind of heavy central bank intervention that had bolstered the dollar in earlier crises, nor of extensive moves by the U.S. Federal Reserve. The markets broke into panicky disarray when the wires carried a statement by Blumenthal's deputy Anthony Solomon at a Paris press conference that the Fed had not intervened in the markets in three weeks — which traders naturally took as a signal of a return to the dollar slide policy. Solomon's subsequent comment that he had only meant to indicate that the markets were so stable that the authorities had not needed to intervene only compounded the mistrust and confusion. Traders and investors, as the Feb. 17 *Journal of Commerce* put it, were "disheartened to see the government ineptitude reflected in such statements." New York dealers who usually keep their political curiosity under wraps, in the past couple of days showed uncommon interest in this publication's explanation of how such stunning "gaffes" can systematically recur on the part of officials whose links to international, London-based operations remain generally unknown.

On the Western European side, both in the press and from highly placed Frankfurt bankers, a wave of outrage followed Blumenthal's speedy departure from Bonn. By no means does this mean that the Schmidt government and financial policymakers have fallen into Blumenthal's let-the-dollar-go-to-hell trap. After modest interventions in support of the dollar this week ,the West German central bankers at the Bundesbank appear to have bought a higher level of dollars on Feb. 17. There was also an unconfirmed report that day on the Agence France Presse wire that the Bundesbank had announced its determination not to let the mark move higher than 2.05 to the dollar. The dollar continued to depreciate, suggesting either that the report was unfounded, or that speculators rushed to test the Bundesbank. New dollar lows of $1.87 and $2.054 were registered before the closing, in New York, along with another spectacular yen jump to 237, despite at least $150 million worth of dollar-buying to hold down the yen cross rate by the Bank of Japan and Japanese private banks, who had already spent over $200 million the day before.

Amidst well-informed reports of State Department pressures on Blumenthal to actively defend the dollar, Blumenthal partisans in State's Economic Affairs section were pleased with the course of events (see interview). And the preconditions for Blumenthal's scuttling of the snake have been modified, not eliminated.

Following the devaluation of the Norwegian crown, grudgingly accepted by snake leader West Germany as an alternative to Norway's leaving the joint float altogether, the French franc was bolstered by Middle East purchases through Swiss banks, purchases which, moreover, were relent in the Eurofranc market, providing an increment in the liquidity increasingly trammeled by Premier Barre's defensive credit-restriction measures. The French stock market was also bolstered by significant foreign interest (despite continued ravings by London banks in New York and abroad about how France "absolutely stinks").

© 1978 EIR News Service Inc. All Rights Reserved. Reproduction in whole or in part without permission strictly prohibited.

The January industrial production figures showed an ominous 3 percent decline, but the government appointed commission on investment backed up Barre's public-private investment proposals for key sectors by advising that funds be guided from speculative real-estate into productive equities. The franc, of course, is not formally in the snake, but as *Le Figaro* pointed out, its health is a key to the prosperity of Franco-West German trade and thus to European growth.

The Germans Will Give In

The following is an interview with an official in the State Department division of monetary affairs, Feb. 19, provided by a free-lance financial journalist:

Q: I understand there is a good deal of State Department concern about the effects on our allies of Mr. Solomon's statements in Paris. In fact, sources have told me that they're convinced Blumenthal and Solomon are deliberately trying to create a breach between the U.S. and West Germany, and that's why there was a special State-Treasury meeting yesterday.

A: I wasn't at the meeting — there may have been some words from Dick Cooper to Blumenthal about Tony's putting his foot in it, but there is total agreement between State and Treasury on the specific issue of intervention. The policy is that under floating rates, there's no way to keep the dollar from continuing to go. What Solomon is saying is that we will continue to intervene to prevent large jumps in thin markets.

Q: There are reports that after Blumenthal's visit, West Germans are saying, forget it, if you won't actively support the dollar we'll have to gear up for trade war.

A: Eventually the U.S. may not have much choice about protectionism. But I think at a certain point the Germans will give in on reflation, when the unemployment is bad enough. There's been so much international pressure, they want to save face at the moment.

Publicly the Carter Administration has always been against protectionism, it is not our first option, but...

Battle Over World Credit Markets As U.S. Banks Decline

A recent report of the Bank for International Settlements (BIS) concerning Eurocurrency market development in the third quarter of 1977 has revealed a major shift in the pattern of world credit flows. For the first time since controls on U.S. capital exports were lifted in 1974, banks in the U.S. have emerged as net borrowers rather than suppliers of funds to the international markets.

BANKING

This startling development reflects both the severity of the dollar crisis — as foreign investors ran down their deposits at banks in the U.S., forcing U.S.-based banks to import funds from their offshore branches to shore up their positions — and the reduced share of U.S.-based banks in international lending activity. Moving into the breach were banks in the London and Luxembourg Eurocurrency markets, which accounted for the lion's share of international credit expansion during the third quarter and attracted the bulk of the new deposits.

In a nutshell: several tens of billions of dollars of deposit and lending activity have shifted from New York to London, from the domain of the Federal Reserve to the domain of the Bank of England. There are several, interconnected reasons for the shift, which is the most dramatic development on the international markets of the past year:

1) The profit-squeeze on international lenders due to the collapse of spreads on syndicated Eurocredits, much publicized over the past months, has compelled American banks to conduct a greater portion of their activity without reserve requirements that apply in the domestic market in order to compensate.

2) Fear of capital controls has kept a marginal, but important stratum of depositors leery of keeping balances in New York — although for the most part, the shift involves the same suppliers and takers of funds.

3) Higher interest rates on Eurocertificates of Deposit have accelerated the process — ironically, due to additional risk factors. The spread between comparable Euro-CDs and domestic CDs has risen to three-eighths of one percent, several times the usual difference. Partly this is the result of competition for funds in London. But, according to British banking sources, the premium is largely due to sovereign risk factors affecting the London Eurodollar market. There is a fear that the Bank of England, which has virtually totalitarian powers over London-domiciled banks, might impose controls on dollar outflows in the event of a run against sterling. In that event over one quarter of the Eurodollar market would be frozen in London. The effect this would have on the Eurodollar market stands in relation to the Herstatt collapse the way a modern thermonuclear device compares to the Hiroshima bomb. Extremely tight political coordination between leading central banks would be required to prevent a catastrophe.

According to the BIS, foreign claims on banks in the U.S. rose by a whopping $6.5 billion during the third quarter, $3.9 billion of which represented funds transferred from U.S. bank branches in the offshore centers of the Caribbean and the Far East back to the parent banks. Since U.S. banks' net external liabilities rose only $2.4 billion (see Table) compared to the $6.5 billion rise in total foreign claims, withdrawals of funds in the U.S. by