**Foreign Exchange** by Richard Katz

# The dollar's deepening slide

*An interest rate decline has invited outflows from the U.S. currency, but without reversing the business squeeze.*

The past two weeks' drop in U.S. interest rates has sharply accelerated the decline of the dollar. Over this period, the dollar has lost more than 5 percent of its value vis-à-vis other major currencies (with the exception of sterling, classified as a "high-inflation" currency, like the dollar). Unfortunately, this is not a tradeoff between a credit upturn and a dollar downturn. We are looking at the worst of both worlds.

Short-term rates have eased dramatically as the Federal Reserve this week allowed overnight interbank money to dip as low as 10 percent from its recent 20 percent levels. Treasury bills lost about half a percentage point in one day on April 30—spurred by foreign central bank purchases of a whopping $1.2 billion in U.S. Treasury paper to help bolster the dollar! Private demand for Treasuries, which helped drive down rates this month, also has ironic origins in investors' fear of other placements.

The prime rate for favored corporate customers has been stickier. This week, seeking to reassure the business community that some relief is in sight from impending chain-reaction bankruptcies, the ultraconservative Morgan Guaranty Bank took the lead in lowering its prime rate to 18½ percent. Fortune 500 companies are getting a break, but psychologically geared pullbacks of this small magnitude won't pay the nation's bills. The U.S. lending structure remains locked into the Carter administration's credit crunch for industrial and agricultural purposes.

The recently announced downturns in U.S. loan demand *reflect no decline* in aggregate requirements for funds. Rather, banks have lent up to the credit-corset "base ratios" imposed by Volcker in March. And the obvious effect of lower short-term U.S. rates is to heighten the potential for speculative outflows that will deepen the overall liquidity crisis here.

West German central bank chief Karl-Otto Poehl announced recently that the Federal Republic is out to "attract foreign capital." French and Belgian interest rates began to come down this week in reaction to the U.S. situation. But on April 30, the Bundesbank hiked interest rates. The cost of discount borrowing was raised half a percentage point to 7½ percent, its highest in 10 years, and the lombard rate (on loans from the central bank collateralized by securities) went up 1 percent to 9½ percent.

Unlike the U.S. Fed, however, the Bundesbank also cut reserve requirements 8 percent and expanded rediscount borrowing quotas by $2.6 billion for German banks. The net effect is not a straight tightening, but, as a Deutsche Bank official characterized it for *EIR*, "increased liquidity at a higher cost." The Bundesbank has taken into account the foreign-trade effects of the deutschemark appreciation encouraged by this move. Upward pricing of exports is expected to be outweighed by decreases in import costs, the costs that have most fueled German inflation. Meanwhile, the funds inflow is intended to cover the current accounts deficit.

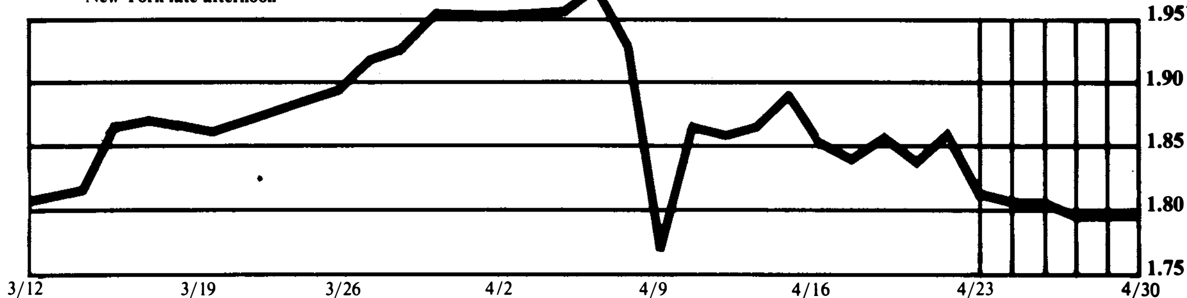
While the Bundesbank promotes inflows into the mark, the Federal Reserve acted to curb inflows to the United States. On April 22, Fed Chairman Paul Volcker told leading foreign central bank governors to prohibit private banks from lending to U.S. corporations, on the grounds that such lending undermines Volcker's credit cutoffs. The Bundesbank and Bank of Japan replied that they will try to do so; the Banque de France refused, saying it lacks the legal authority.

Outright dollar panic never materialized this week despite the U.S.-Iran crisis, basically thanks to restraint by American allies. However, foreign exchange traders say they see no turnaround coming in the dollar's slide, and no basis for one. As "long" positions mature, they expect increasing movement out of dollars. "The recession is supposed to help the dollar," commented Barclays Bank this week, referring to the conventional wisdom that "recession" will lick inflation. "But that really doesn't make sense."

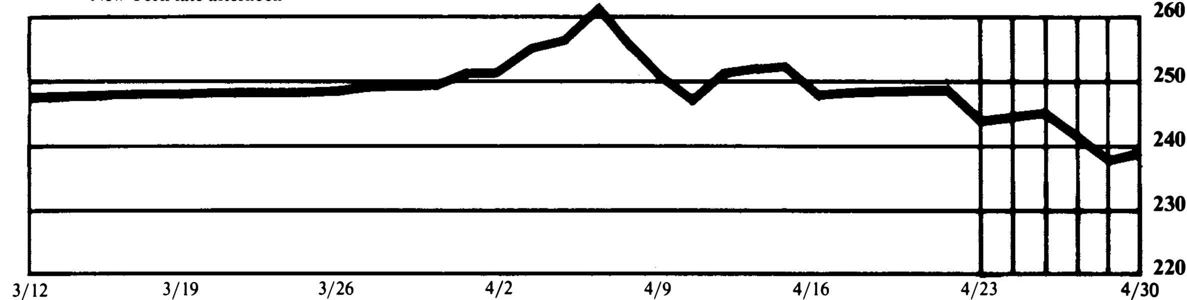


© 1980 EIR News Service Inc. All Rights Reserved. Reproduction in whole or in part without permission strictly prohibited.

## The dollar in deutschmarks
New York late afternoon




## The dollar in yen
New York late afternoon




## The dollar in Swiss francs
New York late afternoon

## The British pound in dollars
New York late afternoon