Foreign Exchange by Richard Katz

Would Mideast war aid the dollar?

Chase Manhattan says so; meanwhile, the currency marketsf are edgy in anticipation of the upcoming OPEC meeting.

Currency traders had said it might be a crazy week while their chiefs were off in Singapore at the *Financial Times*'s Forex Conference. Maneuvers were in fact swung in a thin market June 3, but the craziest was the analysis put forward in Singapore by Chase Manhattan's Robert Slighton. His view, as reported by the *Financial Times*'s conference correspondent, was that "if oil prices rise more steeply than expected for reasons other than political disruption of supply, there is likely to be a weakening of the dollar against European currencies.

"But internal problems within an oil exporter or armed conflict between oil exporters could lead to general strengthening of the dollar as a haven currency. 'What is new is the increased likelihood that this sort of event may occur,' " Slighton concluded.

Leaving Slighton's possible geopolitical motives aside, the dollar's record since the installation of the Khomeini regime contests Slighton's view from many angles. For one thing, the dollar's strength through mid-June 1979 was not as "a haven" from the Iran crisis, but reflected oil-payments demand, and European Monetary System resolve in tandem with OPEC not to let the International Monetary Fund demote the dollar. Investment inflows based on long-term "buy America cheap" and resource-control strategies occurred during that period, but did not determine the exchange-rate picture.

Mainly, the U.S. economy now is a different one. Investment inflows are checked by the productivity collapse and consequent low or negative return on capital. And short-term "hot-money" inflows of the kind Slighton presumably means make little sense when gold is available as a hedge and a "haven"—and possibly soon as backing for long-term securities on a significant scale. As noted in our Gold column, the London Rothschilds politely reminded Slighton and the Singapore audience of this dimension of the matter when gold director for N.M. Rothschild, Robert Guy, came out with a "French position"—proposing a return to the gold standard and debunking "paper money" strategies.

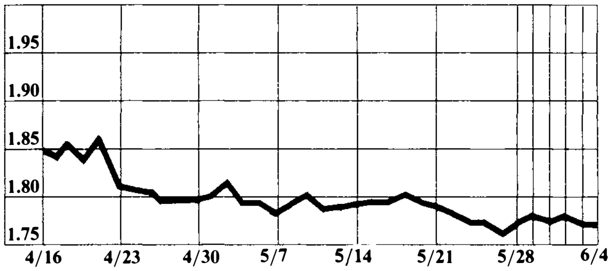
Currently, the foreign exchange climate is still marked by interest-rate sensitivity, with the yen's strength against the dollar reflecting a widening differential there. Bolstering the dollar, there are still plenty who are undaunted by the devastating U.S. industrial figures who believe a collapse will straighten out the trade deficit and markedly cut American inflation. At the International Monetary Conference this week in New Orleans, Swiss central bank chief Fritz Leutwiler disgraced himself by welcoming the dive in the U.S. leading economic indicators as the best news he's heard yet, on these grounds. Even Milton Friedman had felt obliged to protest at the conference that Fed Chairman Paul Volcker's "incredibly restrictive" policies have wrecked the economy.

The dollar may be subjected to further instability as the June 9 OPEC price meeting approaches, with markets jockeyed by advocates of the "basket of currency" oil-pricing system which will be on the agenda. No big trends are supposed to emerge until after the meeting. In New Orleans, the governor of the Saudi Arabian Monetary Agency, Abdul Azia al Quraishi, stressed that oil payments will continue to be made in dollars whatever the decision on the numeraire.

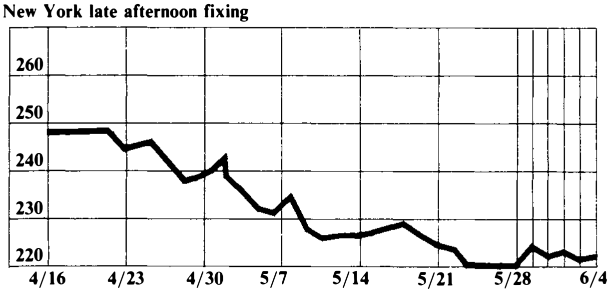
The most spectacular foreign exchange instability as of June 4 was in the pound sterling, however, which began sinking the day before on Prime Minister Margaret Thatcher's announcement that lessened European Community budget obligations would finally enable the UK to cut its 17 percent minimum lending rate. Sterling swung down to $228.70 on this expectation, then back up to $233.70.

In between it became apparent that nothing would be cut immediately, because gilts' prices rose only an eighth of a percentage point, much less than they would have in the event of an actual government decision on the MLR. (Falling interest rates enhance the attractiveness of fixed-interest securities like government-debt gilts, and thus their prices.) Somebody made a bundle buying sterling at the bottom, in a market of only a quarter of a million volume.

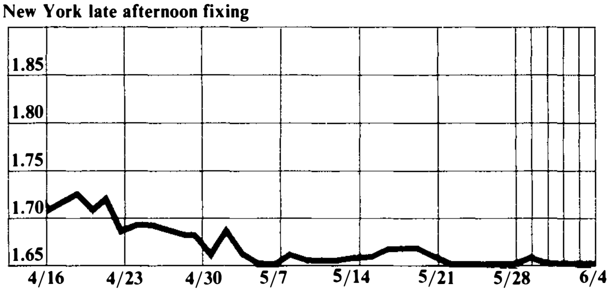
The dollar in deutschemarks
New York late afternoon fixing



The dollar in yen
New York late afternoon fixing



The dollar in Swiss francs
New York late afternoon fixing



The British pound in dollars
New York late afternoon fixing