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# Foreign Exchange by David Goldman

## Europeans issue storm warnings

*A new interest-rate war would unsettle the currency markets and once again, the cause would be Volcker.*

The threat of a long-term renewed rise in U.S. and international interest rates and the instability this will cause in international lending markets will probably mean turmoil in world currency rates, European financial circles warned this week. Fritz Leutwiler, president of the Swiss National Bank, told the Alpbach European Forum at Alpbach, Austria Sept. 1 that while growth of the Eurocurrency markets will increase through 1980 in all currencies, "susceptibility to crisis will also increase."

The U.S. dollar has already felt this susceptibility, falling from its summer-long range of DM 1.80 to almost DM 1.77 before a slight recovery during the post-Labor Day market reopening. The pound sterling meanwhile topped its pre-1967 devaluation high of $2.40, reaching to levels of $2.42.

Fundamentally, the market is concerned that interest rates must rise because, not in spite of, the deepening world recession. "The quality of borrowers is deteriorating," as Leutwiler expressed it. Increasing numbers of LDC debtors are demanding large-scale debt refinancing, just as industrial countries and industrial corporations are also being forced back onto the capital markets to cover cash flow depressed by the prolonged downturn in world business.

The acute competition for funds could lead to a fresh world interest rate competition in which no currency can be sure of maintaining any stability for long, the Swiss banker indicated.

Even the proverbially stable Swiss franc is not safe, in Leutwiler's opinion. The Swiss bank official announced that measures announced to liberalize the Swiss capital markets in August were actually designed to gain further control over Euro-Swiss francs now outside the bank's watchful eye. Current strategy, he said, is to "attract directly to Swiss banks some of the Swiss-franc financing that had moved out to the Euromarkets." The new measures boiled down to Swiss bank payment for the first time of interest to foreign depositors, which Crédit Suisse reports is already pulling "significant" funds out of Euro-Swiss francs into Zurich.

An interest-rate differential is slowly developing, with Euromarket banks forced to quote three-month Euro-Swiss rates of 5⅞ and more this week compared to the domestic Swiss rate for foreigners of 5⅝ percent.

Political instability around the world also took its toll on the dollar this week. The dollar was artificially strengthened specifically against the deutschemark by the Polish crisis, as international "hot" money fled Frankfurt when the Bonn government seemed threatened by the collapse of its East Bloc détente policy.

As quickly as these political issues cooled after Labor Day, there was a reflow out of the dollar again. Even the Italian lira, which has been rumored ripe for devaluation, is now given a new lease on current rates because of dollar weakness. Forward discounts on the lira relative to the dollar fell as investors rushed to cover their long-dollar positions against the lira.

In a world where the U.S. government has neither foreign diplomacy nor competent monetary policy, this see-saw could be repeated many times during the fourth quarter. In a highly unusual commentary on European frustration at continued high U.S. interest rates in the teeth of the world recession, the West German financial daily *Handelsblatt* Sept. 2 hit the "monetarists" of the Fed. Attacking U.S. Federal Reserve Chairman Volcker by name, the journal editorialized that Volcker is fixating on monetary aggregates to the complete disregard of the ravages of his policy on the real world of the market.

"For monetarists, interest rates jump around in the markets joyfully, like a young filly in the meadow. . . . The monetarists accomplish a stability which is a fiction . . . by abandoning the stability of a real economic factor," the editorial said. "A crucial example of this is the United States. . . . Just as economic growth was already down to zero, the eminent Mr. Volcker forced interest rates up into the sky. A little later, he relaxed. . . . Such interest rate 'exercises' have considerable impact on Europe, particularly Germany," the paper protested, pointing to renewed fears of an interest rate contest between the United States and West Germany.



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