

Foreign Exchange by David Goldman

No German break from the EMS

The deutschemark's problems have been exaggerated. Its future depends on Schmidt's export push.

The communiqué last week by French President Valéry Giscard d'Estaing and West German Chancellor Helmut Schmidt affirmed the two countries' commitment to the European Monetary System, indicating that both countries would give priority to maintaining currency stability. In this case, that means strengthening the West German mark, which lost 20 percent against the dollar in the last six months.

Barring a Soviet invasion of Poland—which would prompt security-related capital flight out of West Germany—the West German mark is poised to recover slightly from its most recent dip, which brought it down from around 2 marks to the dollar at year-end to 2.14 on Feb. 12. U.S. commentaries have underestimated the speed with which the West Germans can correct their payments imbalance (now estimated at \$9 billion for 1981) through stepped-up industrial exports. In major deals with the Gulf oil-producing states and the Soviet Union (see page 6), the Germans have racked up export orders exceeding DM 100 billion.

The firmness of the Japanese yen and the French franc is attributable to capital inflows to Japan of about \$20 billion, and inflows into France of about \$13 billion, during 1980. Although West Germany obtained some substantial direct placements of Arab funds (in the range of \$6 billion), that was not sufficient to compensate for interest

rate-related capital outflows. Nonetheless, the combination of a further influx of Arab official funds, and a new resolve to export out of recession, augur well for the mark.

"There are no reasons to wallow in pessimism," Chancellor Helmut Schmidt told a meeting of the German Federation of Chambers of Industry and Commerce in Bonn Feb. 10. "As we have in the past, we will in the future master the structural adjustment process required to strengthen our competitive position."

However, for largely political reasons, the American and British financial press have tended to overplay West Germany's immediate difficulties, allying with Schmidt's internal opposition. From the European side, the Swiss financial organ *Neue Zürcher Zeitung* offered this prediction concerning the health of the mark and Germany's willingness to back it up: "In light of economic news that becomes worse every day—unemployment at 1.3 million and rising, a short-term inflation rate of 6 percent, and the still-unchecked fall of the mark against the dollar—the leadership of the German trade union confederation called last weekend for a fight against unemployment. Similar calls in the past have produced no results. First, it appears that the paralyzing crisis in the governing coalition has eliminated room for new economic policy initiatives.

"Second, room for maneuver through the traditional means, fiscal and monetary policy, has long been constricted. The Bundesbank is caught between two goals. Support of the mark . . . has been bought at the price of higher domestic interest rates. These could only strengthen the present recessionary course."

This deceptively simple equation of currency support—maintaining the German mark in the European Monetary System—with a deepening recession prompted a call by one of West Germany's five big economic institutes for a temporary suspension of the mark's role in the EMS, in order to provide room for antirecession policy.

However, Schmidt has opened a fight inside the Bundesbank itself over what means should be employed to strengthen the mark. His proposal (see Special Report) is to enlist the help of the Reagan administration in bringing all international interest rates own, taking much of the pressure off the mark and consequently off German capital markets. Some Bundesbank officials have balked at Schmidt's implied attack on monetarism.

But, says a top German banker, some members of the Bundesbank directorate are enraged at accommodating to Volcker at their own expense. "The Bundesbank is tired of being the good boy all the time, and then getting punished anyway," the banker said.

Schmidt has an unbroken record of facing down the Bundesbank on issues of policy disagreement. His problem is not ideological monetarists at the Bundesbank, but maintaining stability on the Eastern Europe and Mideast fronts.