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Foreign Exchange by David Goldman

The Soviets' dollar card

A near-term dollar collapse triggered by Moscow would, among other things, force slashes in the U.S. military budget.

Western European financial weakness and stable or rising U.S. interest rates will force the dollar higher during the next several months. But a dollar crisis—widely predicted by financial journalists in Lord Carrington's entourage—is likely for early spring, and is possible at any moment. What is less widely recognized is the Soviet potential for triggering such a crisis.

Former New York Fed foreign exchange chief Scott Pardee stated at a Philadelphia financial conference Dec. 6 that the Soviets are "massively buying dollars . . . in the wake of their withdrawal from the Geneva disarmament talks. . . . One of the concerns of foreign exchange dealers in the interbank market right now is the trading behavior of the Soviet Union's banking arm in London. Ask a trader why the dollar is up and he will answer, 'The Russians bought dollars today.'
needs dollars to buy grain and other things in the West, but I have to believe that its current mode of operation is politically inspired. The Soviets can be very unobtrusive in markets when they want to be, even when they have big amounts to do.

"The tactics the Russians use in calling a bank and buying $50 to $100 million dollars from him are sledgehammer blows to the market. The Russians were particularly active as a buyer of dollars after the Soviet Union walked out of the Geneva talks on intermediate-range missiles. Traders can only guess why. Perhaps the Soviets want the dollar higher so that they can get more for the gas and oil they sell to the West to the extent they might be paid in dollars for these exports.

"Perhaps they want the dollar higher so as to place greater pressure on the governments of the LDCs which are struggling to solve their debt problems, perhaps igniting a revolution or two. This is the guess of most foreign exchange traders today.

"Perhaps they want the dollar higher so as to further embarrass our allies in Western Europe and Japan, as could be read into the Geneva walkout," the speech continued. On the phone, Pardee elaborated:

"It's embarrassing to the governments of Europe to have their currencies declining against the dollar. They are already annoyed with the United States for not having provided leadership on international monetary questions. Domestic political pressures will develop against those governments."

Thus the strength of the dollar constitutes a major wedge of division in the Atlantic Alliance. However, Pardee's proposed solution was to accede to Soviet-inspired demands in European capitals, i.e., to cut the U.S. defense budget, and accept supranational surveillance over the dollar exchange rate. He warned, "The debate about deficits in Washington is unreal. . . . Anyone who sits in the trading room of a primary dealer of U.S. government securities while bidding is going on would see the damage that the fiscal deficits are already doing."

With the U.S. trade deficit running at a $100 billion annual rate, capital flows into the United States are financing both an unmanageable trade deficit as well as the federal budget deficit. Reversal of such flows, Carrington mouthpiece Sam Brittan warned recently, would produce a "dollar crash" and force huge U.S. budget cuts.

Carrington's move to the NATO top position will consolidate a European "third force," or neutralist, group including West German Foreign Minister Hans-Dietrich Genscher and his Italian counterpart Giulio Andreotti. This political faction and associated financiers are looking for an opportunity to break the Reagan administration's defense posture and American power generally. Dissipation of the "recovery" myth during next year's first quarter, along with unraveling of the debt-refinancing packages for Brazil and other major debtors, could trigger such a crisis.

This combination would be a bludgeon in the hands of IMF managing director Jacques de Larosière, who (see article, page 4) reiterated demands that the U.S. accept big—i.e., defense—budget cuts, in a Washington speech on Dec. 5. New York Fed president Tony Solomon, a political ally of the Carrington group, not only warned on the same day that the Fed would "tilt toward restraint" if the President did not cut the budget, but predicted European exchange controls against the dollar if the "whipsaw" continued.

The U.S. interest-rate structure is now on a ratchet; high rates are required to keep capital flows coming in, but high rates destroy the levels of world trade required to generate future capital flows.

When the dollar crisis is triggered, the President will have to use emergency powers to stabilize the U.S. financial situation, possibly in context of financing a defense mobilization—or accept the dissolution of his defense budget and strategic disaster.

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