

Dollar Gains Brief Respite ... at U.S. Credit Market's Expense

FOREIGN EXCHANGE

The U.S. dollar's slight recovery on foreign exchange markets during the last two weeks has been largely predicated on an upward shift in the U.S. interest rate structure — sparking the worst bond market crunch in two years.

Although the dollar has regained 2.5 per cent of its previous loss against the deutschemark, the .5 per cent jump in corporate bond yields — threatening another scale-down in already dismal U.S. capital spending plans — is a heavy price to pay.

The new Administration's dilemma was aptly characterized by a Jan. 10 London Times editorial entitled "Risking the Dollar" warning that Jimmy Carter's plans to reflate the U.S. economy would spell dollar disaster. But as the last two weeks' events have shown, any attempt by Federal Reserve Chairman Arthur Burns to slow the printing presses takes an immediate toll on U.S. credit markets. In the longer run, the dollar is just as dead.

Redeployment of Dollar Reserves

It is therefore doubly ironical that the recent

European-Arab rapprochement, which could ultimately strike the death-blow to dollar hegemony, has not meant OPEC disengagement from the dollar as such but a major *redeployment* of existing OPEC dollar reserves into the economies of Britain, Italy, France, and Scandinavia.

This is "petrodollar recycling" with a twist not intended by the original coiners of that phrase. By providing footloose Eurodollars with a more firm foundation in real trade flows, OPEC has *temporarily* stabilized the dollar as well as the weaker European currencies.

To sum up the latest developments:

1) Saudi Arabia has established a \$6 billion fund for Denmark, to facilitate the shipment of agricultural machinery and fertilizers to the Saudis. (None of the monies are to be used for financing Denmark's huge foreign debt, Saudi officials have stipulated.)

2) According to a New York oil analyst, the Saudis have recently injected \$5 billion into France, and are backing the French government's move to hand state oil companies the majority share of the French market at the expense of U.S. multinationals. The sudden recovery of the French franc has been traced to Arab capital inflows, and a new-found confidence in French industry

FOREIGN EXCHANGE
(Exchange Rates Quoted in U.S. Dollars)*

COUNTRY	JAN. 19	JAN. 12	JAN. 5	% CHANGE IN TWO-WEEK PERIOD
Belgium (Franc) (commercial rate)	.027050	.027360	.027885	- 3.0
Britain (Pound)	1.7198	1.7105	1.7115	+ 0.5
Canada (Dollar)	.9905	.9946	.9966	- 0.6
Denmark (Krone)	.1680	.1705	.1721	- 2.4
France (Franc)	.2008	.2014	.2022	- 0.7
Italy (Lira)	.001135	.001142	.001144	- 0.8
Japan (Yen)	.003457	.003421	.003423	+ 1.0
Netherlands (Guilder)	.3963	.4015	.4085	- 1.7
Norway (Krone)	.1879	.1903	.1934	- 2.8
Sweden (Krona)	.2351	.2389	.2421	- 2.9
Switzerland (Franc)	.3988	.4038	.4078	- 2.2
West Germany (Mark)	.4149	.4205	.4255	- 2.5

*Selling prices for bank transfers in the U.S. for payment abroad, as quoted at 3 p.m. Eastern Time.

Source: Bankers Trust Co., New York.

The U.S. dollar's marginal gains against most major currencies in the last two weeks has been closely correlated with the rise in domestic interest rates. On Jan. 20, Federal Reserve efforts to

aid U.S. bond markets by easing credit erased part of the dollar's gains against European continental currencies.

based on high-technology exports to the Middle East.

3) The recent sterling balance agreement has precipitated further Arab capital flows into Britain, the same oil analyst noted, since Arab sterling holders who got into sterling at \$2.40 are not about to get out at \$1.70. Instead, they are investing in British industrial recovery, accounting for much of the recent British stock market climb and the heavy demand for this week's record \$1.25 billion Treasury offering.

This European-Arab rapprochement helps to stabilize the dollar *only as long as* the dollar is still accepted as the international reserve currency — only up to that point when OPEC and the Europeans decide to accept the Soviet Union's offer to replace the remains of the Bretton Woods monetary system with a gold-backed system incorporating the transfer ruble. As the Journal of Commerce reported this week, British banks, as well as the Italian state industry, are enthralled with the prospects for trade-financing in the "Euro-Ruble."

Nor will Europe tolerate the inflationary growth of dollar reserves indefinitely. Noted the Journal of Commerce in its Dec. 17 editorial: "One central banker present at Basel said last week, not completely in jest, that the U.S. might have made too much of a point about the importance of funding sterling. If the talk turns to funding dollars held as international reserves, the amounts involved will be infinitely greater than the \$3 billion and the complexities far more trying."

Respite for European Austerity

OPEC reserve redeployment has been a major prop for

the European debtor nations, relieving them of the necessity to implement more severe austerity programs. This is a slap in the face to U.S. international banks, who had hoped that the deutschemark's decline against the dollar would be complemented by even greater devaluations of other Western European currencies against the deutschemark. Instead, the deutschemark, due to its de facto secondary reserve currency role, has been forced to take the brunt of the dollar's two-week gain. Every major Western European currency, except the Belgian franc, Swedish kroner, and Norwegian kroner, have shown positive *gains* against the deutschemark. Not surprisingly, those sectors which have seen the greatest Arab capital inflow — Britain, France, and Italy — have shown the greatest currency strength.

New York foreign exchange traders have expressed their exasperation over the relative buoyancy of the French franc in particular: "It should be trading below 20 cents... This is only the quiet before the harsh storm in February." Commented one chief trader at a major New York commercial bank, "The Scandinavian currencies have been riding high in the snake. There has been no necessity for central bank intervention... Of course, distortions could occur later in the year."

The Japanese yen has also been the beneficiary of OPEC oil-for-technology deals. A heavy inflow of foreign funds into Japanese bonds, much of it Arab, has lifted the yen to its highest level against the dollar since mid-October. Japan has just extended \$1 billion in credits to Iraq for industrial projects in exchange for a stable supply of oil.

Forlani Trip to USSR Seals Multi-Level Economic Agreements

WORLD TRADE

Last week's meeting between Italian Foreign Minister Arnaldo Forlani and Soviet Premier Leonid Brezhnev in Moscow took place on the financial level as well as the political. Forlani was accompanied by the foreign ministry's economics advisor, Mario Mondello, who began working out the concrete details of large-scale Soviet-Italian economic collaboration.

The economic agreements themselves have multiple levels as well: strict barter arrangements which will provide nearly 50 per cent of Italy's natural gas import needs; technological exchange which the USSR financed through conventional channels by the Banca d'Italia, the country's central bank; and \$7 billion worth of industrial deals whose financing is still the subject of discussion.

The deals could be financed by short-term Soviet promissory notes, discounted in the West on a longer-term basis at the virutally prohibitive rate of 10 per cent, as Trade Minister Rinaldo Ossola has mooted. Two other possibilities would be more acceptable to both sides, and indeed would be ground-breaking contributions to a new international monetary system. One is the use of OPEC "hard currency" holdings presently put to no productive use, and the other would be the East-West trade bank

proposed by the foreign affairs spokesman of the Montedison chemical conglomerate, Giuseppe Ratti, using transferable Soviet rubles. Soviet rubles would probably be utilized in tandem with the pooled Western European gold reserves that will facilitate clearing transactions between the European Economic Community and Comecon.

Meanwhile, specific projects have been delineated which if consummated will require the full \$7 billion. The Jan. 13 issue of *La Repubblica* published a list of Italian corporations involved, though not the price tag on each deal.

* ENI (the state petroleum enterprise, Ente Nazionale Idrocarburi) — increased gas and oil imports, plus investment in USSR petrochemical facilities.

* Finsider — construction of a Soviet coal duct for \$303 million and subsequent purchase of the coal involved by the Italian government.

* Finmeccanica-Breda thermonuclear division — USSR nuclear technology and supplies.

* Montedison — petrochemical plant construction at Tomsk in the USSR.

* FIAT — expansion of the present Togliatti plant for bulldozer production as well as sale of gas turbines.

* Pirelli rubber and petrochemicals — unspecified.

* Fincantieri — sale of ships and floating basins.