A New Context

Up until about February of this year the Bank of Japan had resisted the so-called internationalization of the yen for the same reason that Chase Manhattan, the Brookings Institution et al. had pushed it: the yen would have thus served as a buffer for the Eurodollar market. Throughout 1976 as part of its strategy for a dollar-mark-yen axis, the New York banks had pushed yen-denominated trade. They urged the BOJ to increase yen credits to enable Japanese firms to increase imports for key debt-laden developing nations, even going so far as to suggest the government finance stockpiles of redundant raw materials. Then, the developing nations could take the yen income, exchange it for dollars and pay their debts. In effect, the Japanese banks would have taken a second mortgage on the insecure dollar debt of these nations, exactly the kind of scheme that Chase Manhattan is trying to peddle with its current Witteveen plan. Just as the BOJ opposes the Witteveen plan, so they opposed the internationalization of the yen *in that context* as inflationary and as likely to subject the yen to speculative hot money flows. In contrast, the Ministry of Finance was more willing to cooperate with the idea, as with Chase's and Brookings' reflation notions generally.

According to Japanese banking sources, this situation changed sometime in February. Intervention by Japanese bankers and industrialists persuaded the Finance Ministry to take a strong line against any kind of bailout for the New York banks. Assured that internationalization of the yen would not be used as a bailout, the BOJ then agreed to change its policy on yen-financed trade.

Record U.S. Trade Deficit Highlights Vulnerability Of Dollar

FOREIGN EXCHANGE

The Commerce Department's announcement that the U.S. economy ran a record monthly trade deficit of $2.4 billion in March sent shivers through the international foreign exchange markets last week.

The ever-widening U.S. deficit has awakened memories of the early 1970s dollar crises and forced foreign governments, in particular Japan and the OPEC nations, to rethink their present policy of holding the bulk of their reserves in dollars or U.S. Treasury Securities.

The U.S. trade deficit is feeding the Eurodollar market — already awash with funds without any profitable investment outlet. The flood of dollar deposits into Eurodollar banks is provoking a lending rate war between these international banks, who are now competing for business from a limited and tightening group of so-called prime borrowers.

At the same time, there is a continual threat of default by major Third World debtors whose credit lines have been cut. This combination of a mushrooming mass of footloose dollars and the specter of a major banking collapse is, understandably, encouraging governments and other investors to "diversity portfolios" by branching into other currencies and gold.

On Wednesday, April 27, immediately following the release of the trade figures, the U.S. dollar nosedived against most of the major currencies, and the Bank of England was forced to buy a substantial amount of dollars to keep the pound sterling below $1.72. The West German central bank was also enlisted in the dollar's support.

The flurry of dollar dumping allowed the Swiss franc to recoup its losses of the previous day, when news concerning the Credit Suisse financial troubles sent the franc sharply lower.

The British pound's strength, meanwhile, fed rumors that the Bank of England will slice its minimum lending rate once again, which could be a boon for the relatively stagnant British industry. The British central bank's rate has already been cut from a high of 15 percent six months ago — a draconian level which was set in order to brake the pound's then-precipitous decline — to 8.75 percent at present, as the Bank of England attempts to keep the pound artificially low to boost exports.

The U.S. trade deficit bears dramatic testimony to the failure of the Carter Administration's international economic policy — that is, a reflationary U.S. policy in conjunction with import-slashing austerity regimes in much of Western Europe and the non-oil-producing Third World.

The deficit for the first three months of 1977 totaled $5.9 billion, greater than the entire 1976 deficit and close to the record yearly deficit of $6.4 billion in 1972. While U.S. exports remained sluggish in March, failing to regain their December 1976 peak of $10.4 billion, imports surged to a new record of $12.5 billion. One-third of all U.S. imports in March, of $4.1 billion, were petroleum or petroleum products, reflecting restocking in the wake of this winter's cold spell.

"Diversification"

The current policy of the Japanese government serves as a leading example of the struggle by other countries to free themselves from the perils of the dollar.

Reflecting industrialist pressures, the Bank of Japan recently decided to deliberately encourage the internationalization of the yen for trade-financing purposes. According to one Japanese banker, the Japanese no longer look upon the creation of a yen zone as providing a "buffer" for the dollar but rather as a "safeguard" against future dollar crises.

Although the OPEC countries are not yet ready to consider the possibility of accepting large scale payments for oil in yen, Arab governments are definitely increasing the proportion of their reserves invested in yen. This week a large Arab order was placed for medium to long-term Japanese Treasury bonds.

Arab petrofunds have also been flowing freely into the French franc, foreign exchange traders say, based on favorable deposit agreements with the French banks. This accounts for the unusual stability of the French franc for the past several months, although the new activist and dangerous African policy of the Giscard government could endanger this inflow.

The Kuwaiti oil sheiks have been taking elaborate precautions to cover themselves in the event of a dollar collapse.

Kuwaiti loans to other governments now include a special clause, stating that should the dollar and gold be eliminated as a "unit of reference," the conditions of the loan must be renegotiated. This is a highly unusual practice and indicates the Kuwaitis are expecting a major monetary crisis.

Furthermore, gold experts believe the Kuwaitis have been accumulating a huge gold hoard through the intermediation of a leading West German bank.

The split within the ruling Saudi family — between pro and anti-Rockefeller factions — has slowed Kuwaiti-backed efforts to link the recently formed Arab Monetary Fund to the establishment of a common gold-backed Arab dinar. The Saudis are acting too much like "lackeys of the U.S.," a well-known U.S. gold analyst remarked.

According to this analyst, the recent decline in the London gold price to the $145 range represents a "healthy selling-off" and profit taking following a speculative surge. Large-scale Soviet and Chinese selling in order to obtain Western currencies has frightened off some investors, even though it is known that the Soviets do not sell gold below $150.

Nevertheless, the source complained, it would be wiser for the Soviets to "make agreements with the Arabs" in the direction of a gold-backed monetary system than to continue raising cash through this method.

The gold market may also have been depressed by fears concerning a Swiss banking crisis.

On April 26, the Swiss central bank publicized the fact that an emergency $1.2 billion standby credit had just been made available to Credit Suisse, one of the three largest Swiss banks. Since the $1.2 billion was a much greater sum than the recently reported losses incurred by one of Credit Suisse's branches, the announcement only tended to exacerbate the flight out of Swiss bank stocks and Swiss francs.

Whatever the acutal dimensions of the Credit Suisse crisis, it is undoubtedly dwarfed by the largely hidden difficulties of the New York banks — in any event, the Swiss franc bounced back later in the week.

West Germany Pursues Growth-Oriented Economic Goals

SPECIAL REPORT

The West German government will be spending $1.9 billion on nuclear energy research during the next three years, according to a proposed budget released this week by the Ministry for Research and Technology. In contrast to the Carter Administration's energy proposals, the West German energy research budget, which totals $2.74 million, puts primary emphasis on the need to develop fast breeder nuclear reactors and complementary nuclear fuel reprocessing facilities.

At the same time, the program still does not express a priority commitment to the development of nuclear *fusion* power, allocating about $43 million for the controversal European JET project. In addition, it makes a concession to Carter supporters within the government by earmarking $840 million for the development of coal gasification technology. But, as is shown by a recently concluded coal gasification deal between West Germany and Poland, even this technology will be used to significantly expand East-West trade relations.

The energy research program has been hailed by the West German press as a counterattack against Carter's zero growth policies. "This report is a defense attorney's statement in favor of the reprocessing plants and breeders that Carter wants to forbid," said the *Frankfurter Allgemeine Zeitung.* In the U.S., the *New York Times* has featured West Germany's position as diametrically opposed to Carter's.

Shortly before the program was announced, West German Foreign Minister Hans Dietrich Genscher stated in New Delhi that "West Germany favors unlimited technology transfers to the Third World with no discrimination...remember that stable economic growth in the industrial countries is the precondition for accelerated development of the Third World in order to overcome starvation and need."

West German Chancellor Helmut Schmidt met last week with Spain's King Juan Carlos to discuss expanding nuclear cooperation. According to *Der Spiegel* magazine, Spain is currently considering ordering 39 reactors from the West Germans, which would dwarf Brazil's $4 billion deal with Kraftwerke-Union. Spain recently canceled its first order with the U.S. for eight reactors at $1 billion each, the day after Carter announced his ban on fast breeders and plutonium.

Industrial Alliance

Behind West Germany's vigorous defense of its nuclear commitments is a growing alliance between the Social Democratic-Free Democratic governing coalition and parts of the opposition Christian Democratic Union (CDU). Minister-President Gerhard Stoltenberg of the