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FOREIGN EXCHANGE

A new sterling bloc?

Well-informed London bankers with lines into the new Thatcher Government in Great Britain report that Thatcher aims to revive the long-bankrupt Sterling bloc among the Commonwealth countries. Even the serious mooting of the creation of a non-dollar currency area centered on the world's most crisis-prone currency indicates how strong the centrifugal forces in the world monetary system are, despite the dollar's temporary continued strength.

According to these sources, the principal foreign economic policy orientation of the new Tory Government will be to draw the developing-sector countries of the British Commonwealth together, emphasizing raw materials trade and investment, and to use this revival to recreate the old sterling area. The sterling area, which went down for the last time in 1976, imposed a sterling reserve basis on developing-country central banks whose raw materials trade was denominated in sterling.

What stands out in these discussions is not so much the ultimate feasibility of reviving sterling's reserve status, which sounds absurd on the face of it, but rather the proliferation of debate on the dollar's ultimate funeral. The London *Financial Times'* columnist Samuel Brittan gave a similar, but fairer, prognosis of Thatcher's option in a May 9 article, in which he predicted that Thatcher would return to the Chamberlain and Milner policies of "Imperial preference." Thatcher will be unable to combine "Cobden Club Free Trade" and a promised defense buildup, Brittan predicted, and pointed instead to a return to British Imperial reliance on protected Commonwealth trade.

DOMESTIC CREDIT

Traditionalists pulled into 'regulatory reform' game plan

The "Eurocurrency Market Control Act of 1979" was introduced into the House of Representatives May 7 by Jim Leach (D-Iowa), ranking minority member of the House Banking Subcommittee on International Trade. Discussions with Leach's staff and House minority banking personnel indicate that they have not thought through the domestic or international implications of the bill.

The bill calls for phased-in-reserve requirements on all Euromarket transactions by branches or agencies of any financial entity operating in the U.S. One hundred percent of domestic reserve levels would be imposed by the end of four years. Leach stated in a May 4 press conference that this will (a) curb multinational banks' foreign exchange speculation, and (b) "restrict the inflationary impact of credit creation in the U.S. and abroad." The first issue has been concocted by former Citibanker David Edwards, a stringer for Samuel Montagu and the London financial warfare control center, to whip up populist sentiment permitting supranational IMF control of banking. The second issue is also bogus. In point of fact, as American history shows, it is not *credit* which is inflationary, but speculative credit drawing funds away from the technological innovations constantly needed to cheapen the costs of production, consumption, and energy.

In its present form, the Leach bill also calls for prohibition of Federal Reserve approval of any "international banking facility," or "free zone," until December 1980. Indicating Leach's earnest desire to curb "excess liquidity" across the board, this may, however, end up deleted in Hill bargaining and ease the way for the full Miller-*Financial Times* package of "bringing the Euromarkets back home." In any case, the bill commits the U.S. to urge other central banks to join the reserve control plan, and would not take effect "until such time as countries representing 75 percent of all Eurocurrency deposits have agreed."

Meanwhile the crunch-credit profile was further played on in a

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Sterling is clearly in no position to assume any significant burden whatever. It fell on May 10 to $2.05 from $2.07 after British engineers went on strike, the first fruits of the Tory "get tough with the unions" tactic. Brittan's notion that Thatcher could persuade the Commonwealth to return to an "Imperial preference" system implies a deterioration of world trade to the point that the advantages of open trade would already have disappeared. Under such circumstances the damage sustained by the now-dominant currencies in world trade might be great enough to permit sterling to back up from the monetary sewer.

American money managers are already bracing for the next major shock to the American dollar. During the past two weeks, money managers at large American financial institutions have been making informal commitments to European investment fund managers to revive the currency diversification in their investments that prevailed during 1978. Last year, at the dollar's trough, a handful of American institutions, including Morgan Guaranty Trust and Drexel Burnham Lambert, began making foreign investments for portfolios that had formerly restricted themselves to domestic assets, including pension funds. The two-month stability of the dollar against the West German mark at roughly DM 1.89-DM 1.90 to the dollar almost wiped out the purchase of foreign securities, leaving some of the leading New York-based foreign brokerage houses with little to do. Looking six months down the road, however, both American and Western European fund managers have decided that the dollar will be dumped again.

How uncertain the dollar's momentary strength is shown up in the last two weeks' behavior of the dollar-yen parity. From a low of ¥225 to the dollar, the yen rose sharply to ¥214 on May 11. The rise began after Prime Minister Ohira's statement May 4 that the yen should settle at about 200 to the dollar. However, prior to that statement, the Japanese central bank had spent over $6 billion in a futile attempt to stop the fall of the yen, leaving the market suspicious of Japanese government capacity to make parities behave according to its wishes. The Ohira statement could not have provoked the yen's spectacular rise on its own. Rather, it intersected continuing lack of confidence in the dollar, turning the delicate speculative balance in the yen's favor.

—David Goldman

May 9 *Wall Street Journal* op-ed by Allen Meltzer, co-chairman of the Shadow Open Market Committee, an offshoot of the Mont Pelerin Society. Banking regulations must be made "uniform" and Euromarkets curbed to forestall "financial panic," writes Meltzer.

As part of this regulatory blitz, G. William Miller announced in a May 8 Columbia University speech that he has given up on mandatory Fed membership for U.S. banks and will entice them toward "voluntary" membership through lowered reserve requirements. He did not add that once they are in, they will be hit by a simultaneous jackup of both domestic and Euromarket requirements.

—Susan Johnson

GOLD

Ye olde gold reserve standard

Gold rose to $252.25 May 10, close to its record high reached on Feb. 22 this year of $252.35, and is expected to break the record within the next few trading days.

The reason, at least the rationale of the psychology of the markets, was summed up by the gold desk at NMR Metals, the New York subsidiary of London's N.M. Rothschild & Sons. "The new rise in the gold price simply reflects a general disenchantment with all currencies alike."

Led by Britain's new Thatcher government advisors at the St. James Society, this is the latest word being put out to the world's supporters of hard money by the British gold bug circuit. The dollar is through, they say, it can't be saved; the new European Monetary System can't save Europe's currencies; Japan is about to go under in a sea of Iranian oil cutbacks; and we need a return to the old gold reserve standard of the pre-1914 era. Any American or continental European gold afficionado who buys this routine is digging his nation's grave in favor of a return to the pre-1914 British dominance of world money markets.

—Kathy Burdman