

Foreign Exchange by Richard Katz

Currency turmoil shakes the EMS

If the havoc in the currency market continues, and if the long-term capital flight from Japan is extended to other countries, it may become impossible for the EMS to continue.

The European Monetary System (EMS) is like a bunch of Sicilian peasants living on the slopes of Mount Etna, according to the imagery of the Dec. 1 London *Financial Times* piece "Living on a Volcano: All Seems well, and then. . .

U.S., European, and Japanese currency rates all erupted last week—uncorked not by long-building financial pressures but by political decisions in London, Geneva, and Teheran. The dollar fell to record lows against both the German mark and the Swiss franc by Dec. 3, 1.709 and 1.57 respectively. The pound rose 2 percent from the week before, as did the French franc. On the other hand, the Danish Krone was devalued 5 percent, and the Norwegians escaped a similar fate only by raising their discount rate by 2 points to 13 percent. Japan managed to inch up the yen—temporarily—only by spending several hundred million dollars per day in central-bank intervention.

If the currency turmoil continues and if the long-term capital flight now experienced by Japan is extended to other countries, then it will become well nigh impossible for the European Monetary System to continue, as long as it restricts its function to currency-stabilization; the techniques used are easily overwhelmed by engineered massive currency hot money flows.

France's President Giscard d'Estaing has insisted that a new world monetary system be put in place by April. The object of those interests based in London and Geneva is to upset the EMS long before April.

The French franc. Over the past year the Eurofranc market has become larger than the Eurosterling market, primarily because of OPEC deposits, and this fact has given France and the EMS tremendous financial and political power. Khomeini's decision to demand payment for oil in francs means that from now on increasing portions of francs will be held in non-French banks in London, outside of the control of French government or banks. Not only the franc rate, but France's internal money supply can be held hostage to London and Teheran. Moreover, the rush into francs and marks separates these currencies from those of weaker European economies, breaking the cohesion of the EMS.

The opposite side is the attack on the Danish and Norwegian Kroner. These currencies were shoved under in September.

Swiss franc. The Swiss just repealed a number of measures previously aimed at curbing hot money inflows. The most important measures had imposed a negative interest rate through taxation on

foreigners' bank deposits in Switzerland. The Swiss claimed they were simply fine-tuning the inflows to "adjust" parities. The fine-tuning turned into a 5 percent rise in the franc's value in only a week—to a record high against the dollar. Swiss officials, such as central bank head Fritz Leutwiler, advocates replacing the dollar with a diversified currency block system.

Japanese Yen. Wherever other currencies are going, Japan's yen will get there first.

Up to now, despite wild rate fluctuations, the volume of trading of most currencies has not been strikingly large, nor have short-term flows been joined by the long-term capital shift that true diversification requires. The exception is Japan.

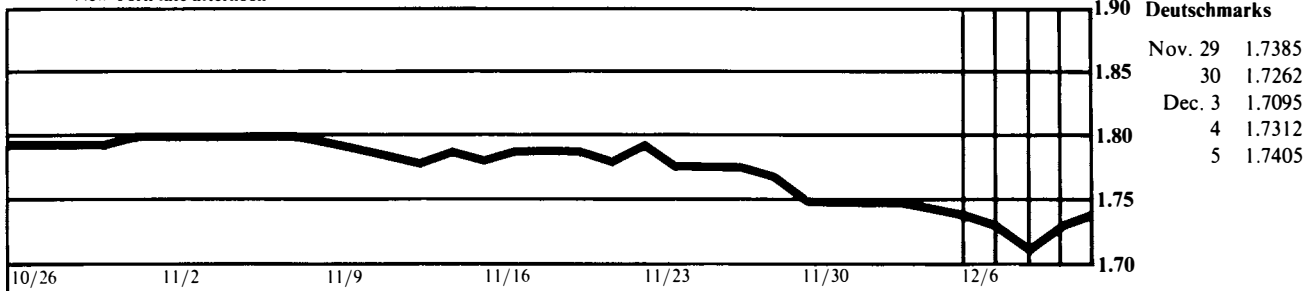
Over the past week Japan succeeded in inching up the yen rate; lost in the headlines was the fact that long-term capital is fleeing Japan. After months of foreign investor inflows into Japan, despite a sinking yen, in September Japan lost \$470 million in foreign long-term investment and another \$770 million in October. The not-yet-released November figures are expected to be worse.

The long-term capital flight on top of short-term speculative outflows and intervention by the central bank lowered Japan's foreign exchange reserves by over \$3 billion in November to only \$20 billion, compared to almost \$40 billion last November.

Despite the battering the dollar is taking, the yen will get it even worse; there is no evidence that the week-long stabilization of the yen can continue for any substantial period of time.

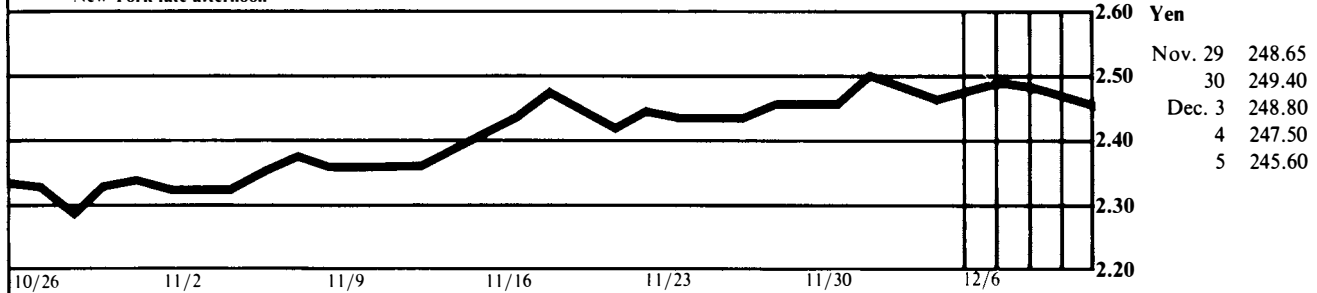
The dollar in deutschmarks

New York late afternoon



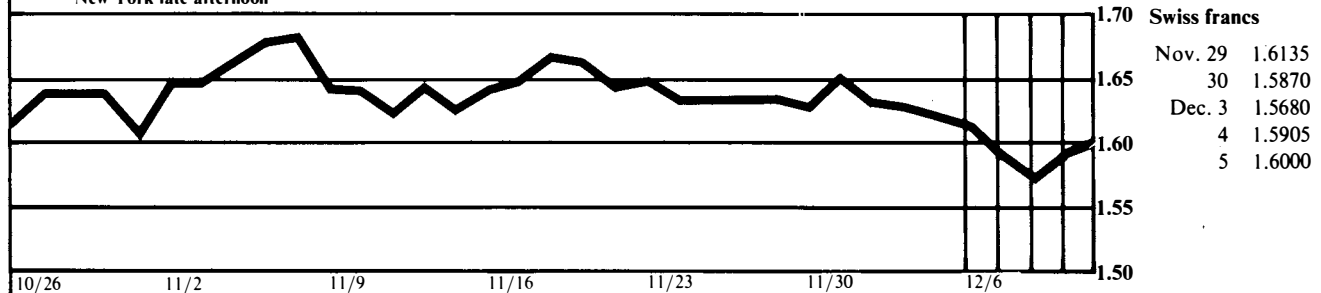
The dollar in yen

New York late afternoon



The dollar in Swiss francs

New York late afternoon



The British pound in dollars

New York late afternoon

