Foreign Exchange by David Goldman

Dollar instability returns

As EIR *predicted, the U.S. dollar has apparently been caught in the world economic crisis.*

The U.S. dollar was hit with a round of sharp selling during the last week in April for the first time in many months, falling against every major currency including the British pound sterling, itself weakened from the Falklands crisis. During the week of April 26-30, the dollar dropped 2 percent against the German mark from DM 2.40 to DM 2.35; 3 percent against the Japanese yen from ¥ 243 per dollar to ¥ 236 per dollar; and similarly against the Swiss franc. Sterling rose from $1.77 to $1.78. "They're kicking the dollar in the head," one foreign exchange trader stated.

Several factors of the world economic downturn combined to produce the dollar's drop. First, speculation is rampant on the foreign exchange markets that the interest rates will not keep foreign investments flowing into the dollar. U.S. economic production is collapsing at so fast a rate that demand for credit could collapse faster than the Federal Reserve can keep tightening.

Short-term developments seem to bear this out, for interest rates did drop sharply at the beginning of the week, with the U.S. Federal Funds rate falling from its 15 percent levels of the previous week down below 13 percent for several days. The Federal Reserve, in fact, seemed to be trying to feed money into the system by its short-term actions. Rather than tightening up, the Fed injected almost $1 billion in repurchase credits into the banking system April 27 and 28, which leads some traders to believe the Fed is trying to lower rates to keep the economy from total free-fall. Upon seeing this short-term action of lower rates, speculators began selling in waves.

As well, the U.S. announced a widened trade deficit for March of $2.65 billion the last week in April up from February's $1.2 billion deficit, which also hurt the dollar. In spite of the sharp drop in U.S. oil imports due to the recession and the oil price fall, U.S. imports of goods now manufactured more cheaply elsewhere rose rapidly.

These, however, are in fact quite short-term developments, and say little in the end about whether the dollar will continue to fall or stabilize. "We see the dollar stabilizing from here," Chase Manhattan Bank told *EIR*, "with the floor being about DM 2.30 or higher. There is no major reason to continue to sell dollars."

For one thing, U.S. interest rates may have been temporarily weak, but it will be a long time before they will fall anywhere nearly sharply enough to create a continuing fall in the dollar rate, I believe. As explained in our Domestic Credit column, Paul Volcker has been quite clear in his recent messages to Congress and to President Reagan. The Fed intends to do everything in its power to continue to drain credit from the economy and maintain tight money, and is ready to continue accepting major corporate bankruptcies as the direct result. While at some point this policy will certainly produce a full-blown 1930s depression in which credit demand will completely drop off, that point may not come for some months yet.

The view of the long-term, older family money in Europe remains very pro-dollar. "The collapse of world trade will hurt the U.S. economy and thus the dollar, but it's relative. It will hurt Europe even more," one top private banker in Frankfurt told me. "So why dump the dollar as a long-term investment? The French economy is being completely destroyed. Britain may be finished as a world financial center if Argentina defaults. Germany has no economic leadership and when the dust settles, the U.S. may be the best of all bad places for investments."

One leading German commercial banker told me in fact that almost 25 percent of German private portfolio investment has been diversified *into* dollars during the past three months as a hedge. The vast bulk of this, he said, is in long-term U.S. triple A corporate bonds, thus locking in high interest rates yields for the long-term. "Even if the dollar does fall a little, this will only be because interest rates fall, and with the dollar bonds, we still get the locked-in higher previous rates," the banker explained. "On any balance, the dollar is the best of all risks."

For the near term, however, instability will be the watchword for the dollar. As the world plunges into economic crisis, no one can call short term foreign exchange movements.