Deutschemark collapse: a blow against NATO

by Kathy Burdman and David Goldman

Federal Reserve officials in the United States, as well as their former boss Arthur F. Burns, now U.S. ambassador to Bonn, are predicting that the West German mark will collapse from the present DM 2.83 to the dollar—a six-year low—to less than 3.20 during the first months of this year. This widely circulated forecast, itself an aggravating factor in the mark's continuing decline, bespeaks a judgement which Burns has issued in private discussions: that the present West German government will collapse, that financial and political warfare will erupt between Europe and the United States, and that America's most important military ally will lapse into neutrality.

Capital flight out of West Germany since early November, spurred by fear of Soviet designs against that country, has been supplemented by Soviet short sales against the mark and French franc, accumulating dollars at an estimated rate of $1.4 billion a day during the first two weeks of December, and $500 million a day after the new year. Net Soviet dollar purchases are estimated in excess of $30 billion, a devastating blow against already weak European currencies.

Further financial drains out of the West German banking system will produce banking failures on the scale of 1931, Federal Reserve officials suggest, multiplying the impact of the November bankruptcy at Schroeder-Münchmeyer-Hengst, one of West Germany's largest private banks. Arthur Burns has told associates that German exchange controls—already threatened by former Chancellor Helmut Schmidt in December—will be the inevitable consequence, i.e., transatlantic financial warfare, resulting in the return of the neutralist Social Democrats to power in Bonn.

Even a partial reversal of capital flows now headed toward the United States would dynamite the American capital markets, raising American interest rates and undermining Washington's capacity to finance its budget deficit. What the Soviets and their partners in Western Europe have set in motion is a wave that will ruin West Germany on the way in, and ruin the United States (and President Reagan's re-election) on the way out).

Viennese-born Arthur F. Burns, who rose to prominence through the sponsorship of "Pan-Europe" enthusiasts at Columbia University, is pouring gasoline on the fire. The former Fed chairman put out the word in a page-two Jan. 5 interview with the *New York Times* that the mark will collapse further. Said a Fed official, "This tells the market 'Arthur's got some questions about these people [Germany] just like we do.'"

Burns is creating panic by predicting that Willy Brandt's Socialists will topple the Kohl government and pull Germany out of NATO. The U.S. ambassador has so persistently foreseen West German reunification with East Germany that "he's been sounding like *Neues Deutschland* lately," one diplomat said. (*Neues Deutschland* is the newspaper of East Germany's communist party.)

If the Social Democrats return, Fed officials said, the mark would get "the same treatment as the French franc under Mitterrand." It would collapse by 50 percent.

Soviet and Swiss operations

A Fed official said Jan. 11 of the Soviet dumping of such vast quantities of marks, "If they are doing a tenth of what they are reported to be doing, then they are one of the biggest traders in the world," he said. "You hear of them buying $100 million or $300 million or $500 million in a day" and dumping marks to do it. "The reason would be political," he agreed. "Obviously the strength of the dollar is divisive in the West."

In a recent Philadelphia speech, Scott Pardee, former New York Fed foreign-exchange operations director, stated that the Soviets are dumping European currencies to inflame European sentiment against the United States and collapse NATO ally governments. "The Soviets' current mode of operation is politically inspired. The Russians were particularly active as a buyer of dollars after the Soviet Union walked out of the Geneva missile talks. . . . They want the dollar higher so as to further embarrass our allies in Europe and Japan, as could be read into the Geneva walkout. It's embarrassing to the governments of Europe to have their currencies declining against the dollar. Domestic political pressures will develop against those governments."

As *EIR* reported Dec. 27, Soviet liquid assets in the West are in excess of $50 billion, and Soviet credit lines are in excess of $100 billion. But the structure of Soviet financial operations, conducted through the "joint venture banks" such as Moscow Narodny and Banque pour L'Europe du Nord, reveals a system of joint enterprises with Swiss and British partners. In particular, the same financier group which founded the Bank for International Settlements in 1931, and used its offices to make liquid gold extracted from the teeth of Nazi concentration camp victims, became the principal Western partners of the Soviets during the early 1970s. This financier group, represented by such luminaries as the incoming secretary-general of NATO, Lord Peter Carrington, and Swiss National Bank president Fritz Leutwiler, has already cut its deal with the Russians.

The Chamberlainesque deal envisions a "neutral" zone in what they call "*Mitteleuropa*," centered in Germany. The Swiss, who never shook their Nazi sympathies of 40 years ago, as well as their business partners in German and British banks, believe they can live on as satraps for the Russian Empire.

Asked who else beside the Russians had dumped dollars during the past weeks' slaughter, a Federal Reserve official said, "Central banks, plural. In the decade of the 1970s there was a lot of talk amongst central banks about 'reserve diversification' (i.e., diversifying out of dollars). They bought marks, yen, sterling, Swiss francs. I'm talking about the Monetary Authority of Singapore, the central bank of Sri Lanka, everybody out there who holds reserves; they diversified. Now're you're hearing the new word 'reversification.' Reserve asset holders have shifted somewhat back toward dollar-denominated assets. Where as they might have been 65 percent in dollars in 1980, they'd be back to 85 percent dollars now."

The Swiss press is quite blunt concerning Soviet military threat to West Germany to fuel panic against the mark. The Swiss paper *Neue Zürcher Zeitung* reported on Jan. 11 that money is fleeing the mark "because of the political situation in the Federal Republic," and noted that the dollar "is more secure above all in the political sense." *NZZ* predicted that having fallen below the "psychological barrier" of 2.8 marks per dollar, the German mark could fall "considerably further."

The BIS itself deliberately contributed to the panic Jan. 9 by leaking from its Basel headquarters that there would be "no concerted intervention" support for the Germans from the Swiss, the Volcker Fed, and other central banks.

Burns fuels panic

As *EIR* reported last issue, aides to Arthur Burns are warning of an "August 1971" for Europe—just as in that year the U.S. dollar collapsed while Burns was running the Fed.

Capital flight out of Germany, Burns's aide said, "will continue and there's no way you can staunch the flow. . . if you're getting the kinds of exchange rates you have and the interest rates you have on the dollar."

Burns is predicting that Europe, led by West Germany, will be driven into capital controls. That will mean the decoupling of Europe from the United States as in the 1930s, when trade between Europe and the United States was shut down. This is because controls would prevent Germans from obtaining dollars and Americans from obtaining marks for the first time since the end of World War II.

Said Burns's aide, "The thing he's most concerned about is that Europeans will take protective measures of their own to staunch the flow of capital out, capital controls.

"This will be blamed on the United States, Burns believes, because of the U.S. budget deficit," he said. "The deficit causes high interest rates and will continue to pull capital out of Europe and out of Germany."

Burns and the Fed are also predicting mass bankruptcies in Germany, spreading fear among investors. The Fed official predicted more bank collapses following the Schroeder Münchmeyer bank failure late last year and major bankruptcies in the steel and other heavy industrial sectors to come.

The Fed official noted that the current financial scandals about Free Democratic Economics Minister Count Otto von Lambsdorff might eventually be connected to the SMH bankruptcy. This would force Lambsdorff out of the cabinet, and collapse the Kohl government.

The Swiss daily *Neue Zürcher Zeitung* reported Jan. 9: "Central bankers fear that the result of the dollar's ascent will be an equally rapid and steep decline of the dollar in the near future." Burns's personal prediction, according to aides, is that the introduction of capital controls in West Germany will spread the European depression back to the United States—the opposite of the administration's official view that U.S. "recovery" will spread to Europe.

Internally, the Fed's outlook for the U. S. economy in 1984 are grim. Said one Fed economist, "We've got a problem on interest rates. You will start seeing more market pressure, predominantly expectational, but nevertheless very real. You're going to have a political problem [for Reagan and the Republicans] if you have falling [Treasury] bond prices in the summer of 1984. . . Volcker won't change his policy. If the deficit is high, and rates rise, Volcker won't loosen up. Volcker is putting Ronald Reagan in a box and he's going to have to find a way out of it, because rates will be way up in the middle of an election year."

Fed: Soviets biggest movers in currency markets

From an interview with a U.S. Federal Reserve official conducted on Jan. 11 by EIR*'s Kathy Burdman:*

Q: What's your explanation for the fall in the DM? The IMF says the German economy looks fine.
A: I wouldn't say fine. . . . There is a sense in the market that the steel industry in Germany, corporate enterprises in general, are not as healthy as they are in this country, that there is a sense based in economics, and also in political and psychological factors, that corporate and political leadership in Germany is not doing as well as elsewhere. . . . There may be some risk of further bankruptcies of major companies, perhaps in the steel industry. . . . The events in the banking sector show that the moral rectitude which Germans pride themselves on has been shaken by the SMH [Schroeder Muenchmeyer Hengst] thing. . . . How deep does the rot go in Germany, that's a rhetorical question the markets are asking. When a very highly respected institution like that shows itself to have feet of clay, and when you have political leaders, ministerial figures, involved in shady dealings, even indicted, people begin to ask how many are involved?. . . A lot of what is happening to the mark now is psychology. . . .

Q: What about the report yesterday that the Soviets are dumping DM?
A: If they are doing a tenth of what they are reported to be doing then they are one of the biggest traders in the world. You hear them reportedly doing transactions in the tens and hundreds of millions, into the billions, over fairly short periods of times. You hear of them buying a hundred or three hundred or five hundred in a day. If they're even doing a tenth, then they are the most active trader in the world. I don't see that it makes any sense from a common-sense point of view. The risks are too high for them to be trading that aggressively to make money. The other reason would be political. . . . Obviously, the strength of the dollar is divisive in the Western community.

Q: Who is moving money out of the mark?
A: Everybody. There are guys in Germany making a living these days selling [U.S.] Treasury bills to dentists in Düsseldorf. It used to be the dentist in Des Moines who did this, now it's the dentist in Düsseldorf. German banks are selling dollar paper to housewives in Hamburg. It's very broad. It's corporations, portfolio managers, international accounts [at banks], it's central banks, it's small-denomination accounts of ordinary people in Germany.

Q: Central banks?
A: Sure. Central banks plural. In the 1970s there was a lot of talk amongst central banks about "reserve diversification." They bought marks, yen, sterling, Swiss francs. I'm talking about the Monetary Authority of Singapore, the central bank of Sri Lanka, everybody out there who holds reserves, they diversified.

Now're you're hearing the new word "reversification." Reserve asset holders have shifted somewhat back toward dollar-denominated assets. Whereas they might have been 65 percent in dollars in 1980, they'd be back to 85 percent dollars now.

Q: The Arabs?
A: Sure.

Q: Burns is saying the Kohl government could fall and the Social Democrats come in.
A: It would seem inconsistent with the last election, but who knows. . . .

Q: What effect will that have on the market?
A: Well, the mark would get weaker!. . . down the line it would depend upon what they did. Currencies weak on the election of leftist governments. Look what happened to the French franc [in 1982]. . . .

But these levels for the dollar are very, very pricey. The sense that we have is that people are buying because they think it's going to go up a while longer before it turns lower, but everyone in the market place thinks the dollar is going to come back down off these levels. It's not going to stay permanently up there.

Q: How bad will the DM get before the dollar starts to come off?
A: I think at these levels there are so many non-economic elements in the equation that it's likely a turn is precipitated by a non-economic event. . . . Predicting a non-economic event and a level that would obtain at the time it occurred is crazy. These markets are extremely risky. . . . You've got a lot of guys out there who are saying 3.00, 3.20 [marks to the dollar]. If enough people believe that, it's going to happen.

. . .You may think [the U.S. recovery] is a pack of lies but the market believes it's real. . . the U.S. economy looks vastly better positioned for the next decade than the German economy. We have freed up our labor market better than any other country.