Foreign Exchange by David Goldman

Propping the dollar

The dollar will remain strong, at least until the election, but only if the Reagan administration makes major concessions to the gnomes of Europe.

Outgoing Swiss National Bank President Fritz Leutwiler made the following remarkable statement at his International Monetary Fund press conference in Washington, D.C., on Sept. 26:

"Three illusions must be avoided: that of a prompt builddown of the U.S. deficit; that of a prompt decline of U.S. interest rates; and that of a rapid decrease of the dollar parity." In fact, he added that he "would not be surprised if the dollar hit 3 Swiss Francs"!—the current rate is 2.50.

Leutwiler is talking about a 16% appreciation within the next few weeks or months! Since his statement is out of line with current-wisdom expectations, it bears some investigation, especially since we know that top Swiss banking figures are expecting, not to mention counting on, a giant dollar crash sometime in 1985.

It appears that the same European banking cartel which plans a "monetary Pearl Harbor" against the United States has cut a deal with the Reagan administration: The dollar will remain strong, at least through the election, provided the United States 1) can use the full power of the State Department to terrorize the restive Ibero-American debtors, and 2) will agree to accept a major degree of supranational surveillance in the context of next April's super-meeting of the International Monetary Fund's Interim Committee (see lead article, this section).

This may be viewed in the context of the fact that Moscow was massively selling dollars on Sept. 19, the same day the West German Bundesbank began a major program of intervention on the dollar's behalf. Profit-taking? Perhaps, but more importantly, they were testing the present market reaction patterns. The press is waking up to the remarkable spree of Euro-market borrowing and immediate redepositing that the Soviets have been involved in since April-May. This spree shows that Moscow is committed to a maximization of the Soviet cash and liquidity position. When an actual, full-scale Soviet operation to dump the dollar could happen is another question. Leutwiler's statement indicates that the Swiss want to puff up the dollar for a little while more.

If Ronald Reagan et al. intended to present a strong dollar, they have reached their goal, with the fluctuation band now at DM 3.03-3.17. The Federal Reserve has temporary leeway to marginally ease credit market conditions at home. The Fed's intensive open market operations during September had, as of late September, brought down the Federal Funds below 11%. The deliberate, large-scale injection of funds also drove Certificate of Deposit rates down, and bond prices up. The prime rate was cut by Morgan on Sept. 28, with most banks following Morgan's lead.

Now, European central bankers and finance ministers and bitter at the United States, after a conflict erupted last week between Deutschesbank president Hans-Otto Pöhl and the Treasury on the question of intervention: Regan denied that market conditions were 'disorderly' on Friday, Sept. 19, the very day the dollar rose to 3.1625 ratio to the DM and then plummeted to 3.05, all within a few hours.

On the other hand, Pöhl charged that the Treasury's hands-off attitude violated the spirit and intent of the Williamsburg gentlemen's agreement, and reiterated his oft-repeated prediction of a "dramatic overshooting downwards" of the dollar.

Britain's Finance Minister Nigel Lawson minced no words at the Toronto Commonwealth meeting, charging the United States with "abusing a special privilege [which] greatly exacerbates the international debt problem . . . the deficit must be curbed, or the debt crisis will end up in tears. . . . The Williamsburg rules must be adhered to. . . . Let not our leaders load us with perpetual debt. . . ."

The Bundesbank probably spent approximately $2-3 billion to support the deutschemark, to which Banque de France and Bank of England intervention in the same direction must be added. What might be emerging is a "European bloc," arrayed against the dollar and for post-electoral times.

The most interesting echo of the European complaints is a London *Times* commentary, "The Dollar Standard is Doomed," on Sept. 28 by Tim Congdon, one of the main monetarist spokesmen in the City. Congdon wrote: "Whatever the gyrations in the next few months, the dollar is steadily being disqualified from a reserve currency role . . . [because of] the most financially irresponsible administration in American peacetime history. . . ." Congdon spelled out the details: The U.S. current account deficit will remain at $100-150 billion per year from 1984 through 1987; the external U.S. debt will bulge; the invisible income will vanish as foreign investment in the U.S. increases; and the trade balance will also worsen.

© 1984 EIR News Service Inc. All Rights Reserved. Reproduction in whole or in part without permission strictly prohibited.