

Foreign Exchange by David Goldman

Dollar slide continues after summit

It is not Japanese investments, but dirty money, that threatens the dollar.

The U.S. dollar fell to 164.30 yen May 8, yet another postwar record low against the Japanese currency, and swung wildly on European markets, in the wake of the May 6 declaration of heads of state and government at Tokyo. It appears that the foreign-exchange markets will re-stage the response to the April 10-11 International Monetary Fund meetings, which prepared the Tokyo summit, namely, push the dollar down a further ratchet. The IMF meetings, which made clear that the U.S. had no intention of supporting the dollar on the foreign-exchange markets, and that the Germans and Japanese had even less intention of inflating their economies to help the dollar's supposed fundamentals. This amounted to an agreement to force the dollar down further.

The West Germans and Japanese were reluctant to accept the inane policy guidelines demanded by the Treasury Department, i.e., the "locomotive theory" circulated in 1978 by the Carter administration, the last time the dollar was in deep trouble. According to this, other countries should pump their economies full of hot air, along with the U.S., to help stabilize currencies. The consequences of the Tokyo agreement will hurt them just as badly.

As noted elsewhere in this issue, the Tokyo communiqué screens but thinly a repetition of this perverse agreement. More than that, it makes a matter of international policy, the receivership of the United States at the hands of its creditors. The form of this

receivership is emerging to be an old-fashioned foreign-exchange crisis, in which the falling currency forces the monetary authorities into ever-more-bitter austerity measures.

In the fortnight preceding the summit, most financial press and commentators speculated that the Japanese would cease to invest in U.S. Treasury securities at a \$50 billion annual rate, following the 35% decline of the dollar. Fears of a Japanese withdrawal from U.S. markets were supposedly behind the 7% fall in the value of U.S. long-term government securities during the week ended April 25.

In reality, the Japanese have less intention of withdrawing support for the dollar, and dollar markets, than anyone else in the world. The same institutions that invest in dollar securities are tied to industrial firms who export manufactures to the U.S. They dread a dollar collapse, a point underscored in repeated public statements by Prime Minister Nakasone, for obvious reasons.

In fact, the leading Japanese securities houses have given strong assurances that they will continue to bid for U.S. Treasury securities.

The actual source of problems for U.S. securities markets lies not in Japan's \$50 billion per annum contribution to the financing of the \$150 billion U.S. current-account deficit, but to the \$80 billion in international hot money which finances most of the rest of it.

Since \$50 billion of the \$150 billion shows up in "errors and omis-

sions," i.e., untraceable reflows of narcotics and other criminal revenues, it is hard to tell what the underworld's currency advisers are saying. However, the United States borrows over \$30 billion a year in the Eurobond market, largely from numbered Swiss bank accounts which hide the income of what we call "Dope, Inc."

A subtle shift away from dollar paper has been under way in the Eurobond market for weeks, as the holders of those Swiss bank accounts shy away from the dollar. This is particularly marked in the Floating Rate Note market, i.e., long-term bonds whose interest rate varies according to the current London dollar interest rate. For overseas investors, floating-rate securities represent the purest form of dollar investment. Fixed-rate securities may appreciate when interest rates fall, and therefore may have an additional speculative value, since conventional wisdom associates the falling dollar with lower interest rates. But floating-rate securities lose their worth along with the falling dollar.

During the first quarter of 1986, the issuance of Eurodollar floating-rate notes fell to about \$6 billion, or roughly half of the average quarterly level for 1985. Salomon Brothers commented on April 29, "In particular, U.S. banking institutions shied away from the primary market, as credit considerations forced their debt to trade at substantially depressed levels in the secondary area."

That is, the Swiss bank accounts did not want dollar paper, and least of all did they want the long-term paper of U.S. banks, given the state of the U.S. banking system. These are shots over the Treasury's bow, from America's primary creditors. America is dependent on inflows of dirty money, and the owners of dirty money are sitting at the head of the table at the creditors' committee.