Foreign Exchange by David Goldman

The next round of dollar collapse

Although the dollar gained some ground, the reasons only portend a new decline.

The New York Stock Exchange's crash on Sept. 11 pushed gold back up to the top of its trading range of the past several weeks, namely $419.60 an ounce at the London morning fixing Sept. 12.

The dollar nonetheless gained ground, allegedly because traders expected higher U.S. interest rates; the same expectations, supposedly, pushed the stock market down.

The truth is a great deal more complicated. The preceding weekend, Japanese Finance Minister Miyazawa met his American colleague, Treasury Secretary James Baker III. Significantly, the meeting's venue changed at the last minute to San Francisco, more convenient to the Japanese creditor, from Washington, more convenient to the American debtor; America borrows $50 billion per year from the Japanese.

Following the meeting, Baker said nothing, and Miyazawa said bluntly that he had no intention of reducing Japanese interest rates further—as the Reagan administration has been demanding.

Then, on Thursday, Sept. 11, the West German Bundesbank Council announced, after its regular meeting, that West Germany had no intention of reducing rates, either—sinking the coffin of the monetary diplomacy that began at New York's Plaza Hotel in September 1985.

Under the assumptions prevailing in the foreign-exchange market until very recently, the collapse of American efforts to persuade the West Germans and Japanese to join the Federal Reserve's money-printing exercise, would have sunk the dollar like a rock.

For weeks, the market has seesawed (mostly sawed), on rumors of central bank discussions on joint efforts to lower interest rates. Now that the last illusions are gone, the dollar has steadied (although not risen significantly). From its five-year low of about DM 2.03, the mark has inched down to about 2.07 as of Sept. 12.

The dollar rate has reached a certain point of singularity; the currency itself is more worthless than ever, most of all with the collapse of the U.S. securities markets, which reduces the speculative compensation our trading partners receive, for exchanging their goods for our unsecured paper.

However, both Germany and Japan work in a dollar-based monetary system. If the dollar falls further, their exports to the United States, which have accounted for the only apparent growth those economies have had, will disappear. Therefore, the underlying value of the mark and yen will deteriorate along with the dollar.

That, of course, is why no equity market in the world is safe when Wall Street goes down. Apart from the mammoth growth of American imports, world trade has collapsed since 1980.

Without the parasitical absorption of the rest of the world's products by the United States, world trade would have fallen by almost a fifth in dollar terms since 1980.

That is, of course, why gold and platinum have done so well in the past couple of weeks; gold represents not merely real value, but a means of escaping the dilemma of accepting additional paper from either the United States or its trading partners.

It is also why the West German Bundesbank suddenly intervened to push the dollar down by 2 pfennigs on the morning of Sept. 12, to the utter astonishment of traders, who were accustomed to seeing the Bundesbank intervene to keep the dollar up. Traders speculated that the Bundesbank was merely trying to keep markets orderly, given the wild events on Wall Street; but the point is that the rules have not changed.

What can be expected from this singular situation? For the relatively near future, another ratchet-drop of the dollar, for a simple reason: The American banking system is in desperate condition, and the Federal Reserve will have no choice but to open the monetary floodgates.

That is the conclusion offered by Salomon Brothers' Dr. Henry Kaufman, whose pronouncements derive from somewhere close to Paul Volcker's telephone.

That is particularly true, also, given the embarrassment of the U.S. federal government, which will have to market not the $225 billion of debt-securities projected by the Conference Board, but closer to $270 to $300 billion.

In the past, the U.S. Treasury was perfectly willing to soak up the world's available capital with deficit-financing securities. That was before the American banking system itself came to the brink of failure.

Although the Germans and Japanese may fear the consequences of the present parity-structure for their own economies, the Federal Reserve will nonetheless succeed in driving them out of the dollar before long.