Sterling Stabilized As British, West Germans Say No to Dollar

FOREIGN EXCHANGE

The major development in the foreign exchange markets this week was the international agreement to stabilize Britian's sterling balances with a $3 billion credit line, and eventually fund them if need be by converting them into foreign-currency securities. The Jan. 10 agreement marks the withdrawal of the pound from its status as a reserve currency supplementary to the inflated U.S. dollar, and the elimination of one major source of sterling's vulnerability. The pound remained quite strong this week by 1976 standards at around $1.70 to the dollar.

This week's markets also saw the recent dollar slide taper off. Traders explained this in terms of slight downward movements in Western European interest rates alongside a slight upward movement in U.S. short-term lending rates — and a certain relief that Jimmy Carter had not announced immediate hyperinflation of the world economy.

Sterling Plan

Arranged through the European central banks' headquarters, the Bank for International Settlements in Geneva, the new sterling settlement represents a tactical victory for Britain's Labour government and its Social Democratic collaborators in Bonn. According to the West German newspaper of record, the *Frankfurter Allgemeine Zeitung*, Prime Minister Callaghan and Chancellor Schmidt pressed through the plan "around the flank" of U.S. Treasury Undersecretary Edmund Yeo. Yeo used the Jan. 12 *Journal of Commerce* to lament his inability to exact austerity from the British as part of the deal, and taunted the British with a feeble threat, that Arab oil producers may no longer hold sterling.

The settlement does not directly fund the $4 million in "official" pound deposits held by foreigners, who have in the past driven down sterling's exchange rate by speculative selling of the currency. Funding — that is, total conversion of pounds into another land's paper — becomes a future option for holders who will be offered bonds denominated in non-pound currencies, serviced by the British Treasury, in exchange for their pound assets. What goes into effect at once is a form of safety net; the $3 billion medium-term credit line is available to help Britain defend the pound's parities by buying sterling if a selling wave begins to drive it down. Hence, one form of potential blackmail against the British government is removed, the goal of Callaghan's and Schmidt's mobilization of mainly West German, Swiss and Japanese funds, to which the U.S. was compelled to add a billion dollars.

There has been little expectation of a run on the pound in any case. Government securities ("gilts") are selling so well that the consequent liquidity absorption obliged the Bank of England to release approximately 1.5 billion pounds to the commercial banks, who can now somewhat increase their lending to credit-starved corporations. The minimum lending rate is therefore expected to fall further, and tax cuts are being mooted.

These steps correspond to Callaghan's determination, affirmed yesterday, to direct industrial recovery with a strong personal rein over the Treasury; the government's austerity exponent, Chancellor of the Exchecquer Denis Healy, has lost his chief justification for deflation and belt-tightening, namely, the threat of an assault against the pound.

The Dollar And The Mark

West German spokesmen, who have a slightly different form of the same dollar problem, have made it clear that, while marginal interest-rate realization can occur, they do not intend to expand either the money supply or public spending in a fashion that would among other things, weaken the mark. The Chancellor's office stated this week that no matter what the Carter administration may do, West Germany will concentrate on promoting capital-intensive investment; Economics Minister Hans Friedrichs and banking-industrial spokesman Otto Wolff von Amerongen publicly rejected any "ad hoc counter-cyclical programs" to stimulate the economy; and Development Minister Marie Schlei, a close collaborator of Chancellor Schmidt's, suggested that expanded Third World trade could eliminate half West Germany's 1 million unemployment.

Foreign Exchange in Dollar Rates

	Jan. 7	Jan. 14
British pound	1.7050	1.7115
French Franc	.2020	.2010
Italian lira	.001150	.001141
Swiss franc	.4075	.4027
West German mark	.4253	.4190

Prospects are thus unfavorable for what New York Times columnist Leonard Silk recently described as a Trilateral Commission Carter cabinet effort to "goose Germany and Japan into expanding faster." One Brookings Institution senior fellow intimately involved in this campaign privately expressed demoralization this week; the West Germans, he said, have accepted the fact that the mark will appreciate against the dollar (thus keeping up West German export prices —Ed.) and agreed that this would do no great damage to the Federal Republic so long as the mark remained stable against other currencies in Western Europe, their major trading partner. "Who knows, maybe they're right," the Brookings spokesman said despondently about West Germany's commitment to investment growth.

Another development affecting the dollar's medium-term prospects is the continued dollar selling by the Soviet Union, according to *The Guardian*, which has continued since Dec. 20's surprise "bear coup" against the U.S. currency. The Soviets' maneuver — generally considered an effort to boost gold prices and, more fundamentally, the status of gold for a new world monetary system — has involved sales of $5 billion by the end of last week.

Paris Bourse Leads European Markets; Economic Entente with Arabs in Offing

INTERNATIONAL STOCKS

French stocks have rallied over the past month, with the Paris index rising 14.9 per cent from the beginning of December to the close of trading on Friday Jan. 14. The Paris market is now the most upbeat outside the U.S., compared to rates of rise of the Frankfurt Commerzbank index of 2.5 per cent, United Kingdom Financial Times Industrial Ordinaries Index of 2.3 per cent, and the Tokyo Dow Jones by 0.1 per cent over the same period.

In particular, oil and chemical shares have far outstripped the other industrial sectors. The French government-related companies Aquitaine and Compagnie Française des Pétroles have risen 24.8 per cent and 16 per cent during December and January. Michelin, Pechiney, and Rhône Poulenc rose 15.6 per cent, 21.5 per cent, and 17.8 per cent respectively.

This fact, plus the unusual rise in the market generally have led to speculation that French corporations, may be about to receive significant inflows of *Arab capital*, especially the oil and chemical sectors which have been historically tied to the Arab sector.

In particular, the market showed strong resilience during the week just ended, when the dollar strengthened again internationally due to U.S. Federal Reserve intervention on the Eurodollar market and in France due to capital inflows which led to a weakening in the call money rate (equivalent of Federal funds) from 10 per cent to 9.75 per cent in the course of the week. The overall Paris index slumped 2.5 per cent during Tuesday through Thursday (from 58.4 at Monday's close to 57 on Thursday) but bounced back again on Friday for an overall rise of 2 per cent on the week.

The immediate stimulus for Friday's enthusiasm was the announcement by Mr. Barre of a 34 per cent increase in government subsidies for the state sector industries — electricity, gas, transport, postal services, etc. Very important within this is the nuclear development program component of the government electrical industry. Barre, with strong backing from the RPR (Gaullist party) has made the expansion of this industry a priority for French industry. The French government-controlled NOVATOME corporation is going ahead with its contract with the NERSA consortium of European state electrical companies to construct the Super Phoenix fast breeder fission reactor at a cost of 5 billion francs, *Le Monde* reported Jan. 13. The future of the reactor, to be the most advanced in Europe, had previously been in doubt due to the anti-industrial growth policy of French President Giscard d'Estaing.

PARIS EQUITIES

	Dec. 1	Friday Jan. 7	Friday Jan. 14	Percent Week	Change for December-January
Paris Index	51.8	58.4	59.5	+2.0	+14.9
Aquitaine	253.0	313.0	315.8	+0.9	+24.8
CFP	95.0	111.3	110.2	-1.0	+16.0
Michelin	1112.0	1285.0	1285.0	0	+15.6
Pechiney	65.0	82.6	79.0	+0.6	+21.5
Rhône Poulenc	67.6	82.0	79.6	-2.9	+17.8
Esso Standard	49.1	56.1	55.5	-1.1	+13.0
Peugeot-Citroën	NA	242.9	260.0	+7.0	+15.0 (since
St. Gobain	109.8	118.7	115.9	-2.4	+5.6 merger)
Schneider	125.1	141.8	138.0	-2.7	+10.4
Sacilor	33.6	36.0	36.0	0	+7.1
Usinor	35.9	34.5	35.2	+2.0	-1.9

The government also announced this week the total computerization of the government's administration functions, which would mean 9 billion francs of orders to the flagging computer industry over the next two years.