Dollar Weakens Before London Summit

FOREIGN EXCHANGE

The dollar weakened abruptly in the latter part of this week against most Western European currencies as well as the Japanese yen. In the space of two days — May 4-5 — the U.S. currency dropped 2.5 pfennigs vis-a-vis the deutschemark. It also depreciated in terms of the Dutch guilder and Swiss franc in particular, and this general climate allowed the Belgian franc to hold steady despite an unexpected cut in the central bank lending rate of half a percent to 6.5 percent. The Bank of England was obliged to intervene to keep sterling from rising above the $1.72 level.

The proximate cause of the dollar's new slide appeared to be the sheer volume of essentially non-investible dollars in circulation at a conjuncture of uncertainty and mistrust regarding U.S. policy. The *Journal of Commerce* even reported May 5 that an "avalanche of dollar selling" is anticipated for May 6, the last trading day before President Carter meets other Western leaders at the London summit. Traders around the world, at any event, quickly decided that the dollar confidence following Federal Reserve Chairman Arthur Burns' May 2 pledge to counteract inflationary dangers had been an unwarranted reflex.

At the same time, rumors have persisted that the London summit will see some sort of agreement to officially encourage the appreciation of the deutschemark and the yen, in accordance with U.S. demands for a reduction in the trade surpluses of West Germany and Japan. The new head of the West German central bank, the Bundesbank, Otmar Emminger, has repeatedly indicated that he would agree to a revaluation policy for the mark. It is quite likely that some realignment of the mark-dollar relationship will soon take place; there are two distinctly different forms this realignment could take.

The first, of course, would be a degree of appreciation of the mark, and with it probably the Dutch guilder, that would widen these currencies' spread against the others so far as to make the joint-float "snake" itself no longer viable, with immediate chaotic side-effects for sterling and the French franc as well. This has been the explicit hope of Wall Street banking strategists since they developed the "two-tier" policy of deflation for the weaker Western European economies plus a combination of inflation and export curbs for West Germany and Japan. The *Journal of Commerce* claimed May 5 that it is widely believed that "the market can expect the break-up" of the snake very soon.

The second possible kind of realignment would involve the appreciated mark and guilder bringing the other snake currencies upward with them — a de facto devaluation of the dollar. This option would portend less damage to West German export competitiveness, since so much of its trade is with European partners; beyond this, the shifted relationship to the dollar would take on political significance.

Meanwhile, the mark has already reached the floor of the snake in terms of its Dutch guilder parity, burdening the rather strict central-bank intervention controls that have thus far sustained the snake's narrow fluctuation band. Market-watchers agree that the upward pressure on the mark this week was an operation conducted by a relatively small group of traders betting on a mark-yen appreciation. Given the atmosphere of skepticism toward the dollar, the maneuver had magnified effects. In one of the petty ironies of the markets, this operation, described by the Bank of America as an "essentially political" thrust on behalf of the trade- and snake-wrecking scenario, was fueled by reports of the improved payments surpluses of West Germany and Holland, as well as the 12 percent increase in Japan's letters of credit since last April.

Gold remained basically stable at a London price in the $147-149 range. Swiss sources confirmed New York reports that various non-Wall Street investors in the U.S. have been liquidating portions of their dollar-denominated holdings in favor of gold. It was also notable that, at the Puerto Rico conference of the Bankers Association for Foreign Trade this week, the director of the central bank of Belgium, Cecil de Stryker, made a call for a return to fixed foreign-exchange parities and added that "the United States must accept discipline" with reference to the world inflationary threat. Officials at the New York Federal Reserve, while hoping that the London summit could force the deutsche mark up at the expense of the snake, confirmed that they see the dollar as gravely worrisome because — by contrast with what they described as the political questions affecting the lira and French franc — its fundamental economic position is so shaky.

Inflation Fears Depress Capital Spending Plans

BUSINESS OUTLOOK

Fears of an inflationary upsurge prevailed in the money markets this week, and continued to throw a large damper over business plans for capital expansion.

The increase registered for March of the nation's factory orders by 5.2 percent and construction spending by 5.6 percent — is, if fact, a key index of the overall problem: an even moderate increase in U.S. economic activity requires a corresponding tremendous increase in money supply to finance and circulate the large