As the OECD meeting on steel opens in Paris, the U.S. is expected to give the European governments a hard time for limiting foreign (Japanese) steel imports into the European Economic Community under an EEC-Japan "gentleman's agreement," and thus diverting exports to the U.S. markets. But it is clear that "free trade" advocates such as Special Trade Negotiator Robert Strauss do not mind "orderly market agreements" per se; they want them to be international agreements. According to a report in the *New York Times* on Sept. 29, the U.S. will seek the creation of an international "monitoring" body at the OECD meeting. The article also noted that there is one feature of the Europeans' steel rationalization program that the U.S. delegation will give its wholehearted approval to — a proviso which forbids the building of new plants, unless old plants of equivalent size are dismantled.

Gold Up, As Dollar Down

Gold hit its 1977 high of $154.50 per ounce in London last week as the U.S. dollar fell to new lows and the British pound sterling began to shake under the weight of contradiction between falling industrial production and speculative money printing. U.S. Treasury Secretary Michael Blumenthal's taunt to the world's financial leaders at the Washington International Monetary Fund conference that the U.S. trade deficit will run to $30 billion and the current account deficit (trade plus short-term capital flows) will run to $20 billion has brought the dollar to new lows against the Swiss franc and German mark. U.S. Federal Reserve Chairman Arthur Burns' attempts to cushion the dollar's fall by shoving up U.S. short-term interest rates will, if continued, spell early doom for the speculative rush into sterling and the British stock market.

FOREIGN EXCHANGE

Gold's rise, which coincided with the beginning of the dollar slide in mid-June, is due to the perception in both Europe and the U.S. that "the U.S. cannot continue debasing its currency and calling on the rest of the world to debase theirs without serious dents in general confidence in paper money," one trader said.

Sources in Johannesburg, meanwhile confirmed that both the setting up of a new gold market in Luxemburg, where the government has already agreed to revamp tax structures at the behest of the major German banks who want more gold business, and Kuwait's hiring of a West German advisor on international investments, are not unrelated to the South African government's announcement that a new gold marketing strategy is underway.

The Swiss central bank, said the source, has twice this year "swapped" excess dollars to the South African central bank for gold, government to government, to keep the deal from weakening the gold price, and passed the gold on in turn to Arab buyers. The big West German banks: led by the late Jürgen Ponto's Dresdner Bank, may wish to use the Luxemburg market or direct deals with South Africa to get the Arabs on the track to a gold monetary system, he said. Reached for comment at the embassy in Washington, South African Finance Minister Horwood said, "I can't go into that now."

U.S. Demand Dollar Support

This week's dollar decline was largely touched off by Treasury Secretary Blumenthal's threat to Europe and Japan that the U.S. will bloody well run its $30 billion deficit. The rest of the world had better not let it hurt the dollar, "whose health is in the interest of the world," or else the U.S. will let loose a wave of protectionism to shut down European and Japanese export industries. U.S. Commerce Secretary Juanita Kreps in Tokyo bluntly told the Japanese government that Japan's healthy trade surplus is "unacceptable, economically and politically." But the increasing amount of gold buying and dollar dumping *in the U.S. itself* shows that Blumenthal's threats, even if carried out, cannot hold the dollar.

At the same time, President Carter told the press Sept. 29 that the U.S. will double its oil trade deficit this year, from $23 billion in 1976 to $45 billion — a statement which immediately hit the dollar on the markets — and tried to use this prospect to insist the Administration's worn-out no-energy conservation cutbacks be enacted. Morgan Guaranty's latest *World Financial Markets* similarly warned that the U.S. deficit "carries the risk of triggering major dollar weakness...(this) could have serious inflationary overtones...and major destabilizing effects on the international economic and monetary situation."

Finally, the spread between Eurodollar and Eurodeutschemark rates reached what John van Eck of *International Investors* called a "crisis level" this week, with banks paying depositors 25 percent to put their money in 6-month Eurodollars while Eurodeutschemarks are so much more highly valued that depositors received only 4 percent. This spread of more than 3 percent between the two currencies foreshadows a major shift from dollars into marks in the coming weeks. The last time these two barometers of confidence diverged so widely was the height of the Herstatt Euromarket crisis in 1974 when Eurodollars paid 12 percent and Eurodeutschemarks paid 9 percent.

Adding to the dollar crisis from the trade deficit is the growth of money supply and banking reserves in the U.S., particularly of short-term monetary fluff, which led several market participants to comment this week that the money supply "is out of the Fed's control." Since the dollar began dropping in mid-June, the Fed has raised the U.S. central bank "Fed funds" rate from below 5.5 percent to this week's level of 6.5 percent to attract money into dollars. However, with the total lack of long-term borrowing due to no plans whatsoever for capital spending in the U.S. economy, short-term rates are rising with the Fed funds rate up over 6 percent, while long-term rates have stayed flat at 7.5 percent for months.

As a result, both funds, already in the long-term portion of U.S. banking such as parts of M-2 time deposits and foreign funds such as oil dollars, have fled from long-term investments into short-term demand deposits, creating a self-feeding bulge in M-1 which feeds fear of inflation and thus further forces Federal Reserve Chairman Burns to hike interest rates indefinitely to protect the dollar from inflation fears. The incoming short-term deposits, particularly short-term Eurodollar deposits, have also been hastily acquired by the Euromarket banks to roll over non-paying Third World loans now coming due; as the banks borrow more reserves to meet the new deposits and loans on their balance sheets, M-1 rises.

North Sea Oil Bubble Hitting The Rocks

The City of London stock and government debt market bubbles, premised on "confidence in sterling" as North Sea oil is pawned abroad to give Britain a new balance of payments surplus, are fast heading for the rocks. The boom began last summer when Britain's payments went into the black, but with industrial production at 1970 levels, unemployment growing, and personal consumption expenditures dropping monthly, the payments picture is a purely cosmetic financial papering-over of an underlying mess. "Nothing's changed," editorialized the respected London *Investors Chronicle* this week to that effect.

To keep the initial inflows coming, the Bank of England since summer has promoted a regular North Sea bubble modelled on the disastrous 18th-century South Sea Bubble speculation of the stock of the South Sea Company to fantastic heights, and then fantastic depths. The Bank of England has been concerned to bring plenty of money in to finance Britain's huge government deficit through sales of government "gilts" (treasury bills), and is being pressed by Morgan Grenfell and other Lazard-influenced British banks to bring in enough foreign reserves so that sterling can rise from its current \$1.74 level to \$1.80 or higher.

This new, more solid sterling would then be used, according to a scenario circulated by Schroeders Bank, to force the BOE to loosen exchange controls so that an international boom in loans to European and Third World governments in sterling rather than dollars can begin, and bring back 19th century finance. Consortia to float sterling loans to the European Economic Community and World Bank are already being formed, Schroeders says, even though the exchange laws have not been modified. Since December 1976, over \$12 billion has flowed into Britain this way.

The Bank's strategy has been nominally simple. Short-term rates have been lowered, with the British central bank rate now at 6 percent, below the U.S. Fed Funds rate of 6.5 percent, for the first time since N.Y. Federal Reserve chief Benjamin Strong and Bank of England head Montagu Norman agreed in 1920 to keep the geriatric pound alive as a handmaiden to the dollar by maintaining London rates above those in New York to discourage movement out of sterling into dollars. With these cheap short-term rates, U.S., European, Arab and British investors are furiously borrowing short-term at 6 percent and then buying stocks and government bonds at 8 to 12 percent rates of return — in the case of government gilts, doubling their money. In the past two weeks, the Bank has further encouraged these moves by removing tax exemptions on foreign funds brought in, encouraging foreigners to borrow more of the 6 percent sterling. The Bank has also issued a large amount of "part paid" government debt, i.e., margin paper bought for a fraction of its value and paid for on installment, which has further gunned the rise in the gilts market.

"Sobering Effects"

But the game is coming to a halt. First, the stock market, which rose from the mid-300's on the *Financial Times* Industrial Ordinary index this spring to an all-time high of 545 on Sept. 14, a 60 percent increase, did so only due to a total lack of corporate capital stock issued, which were chased by all the hot money. With no incentive for capital spending in the sagging world economy, British corporations plan to raise less than £600 million this year, of which £500 million has already been raised, compared to £1 billion raised in 1976 and £1.2 billion in 1975. Even so, last week, the *Financial Times* index plummeted to the 500 level in two days after Dunlop, Vickers, and GKN and other major corporations reported "dangerously low" profit figures for the first half of this year, reflecting poor "industrial performance," the *Financial Times* warned Sept. 24. At this writing the *Financial Times* index has recouped to the 514 level but is expected to fallthrough the 500 psychological "floor" next week.

The government debt market is headed for "the same