

Dollar Chaos Brings New Collapse Of Credit, Investment

The rapid fall of the U.S. dollar and the general turbulence on the international foreign exchange markets set off a round of credit, trade, and capital investment cuts which threatens a devastating new phase of the current depression.

While new loans to the Third World during the second

BANKING

and third quarters of 1977 fell dramatically enough (to \$2.2 billion — see Figure 1), the Bank for International Settlements reported this week that, when deposits of Third World countries in Euromarket banks are also taken into account, the *new* credit transfer to the Third World was a piddling \$0.3 billion during the second quarter. Simultaneously, the Union Bank of Switzerland announced that the western industrial nations are now *underspending* on capital investment relative to replacement needs at the annual rate of \$100 billion.

The dollar collapse — perhaps best described for posterity as the “Blumenthal Memorial Collapse” — began at the end of June, as funds fled Eurodollar bank deposits into the London stock market bubble, and into U.S. Treasury bills via massive intervention by Japan, West Germany, and Britain, who then built up Treasury

bill reserves. The London bubble took perhaps \$5 billion, and other central bank intervention perhaps another \$5-10 billion in the third quarter alone.

This produced a tightening of Eurodollar market banks' deposits at precisely the time those banks were looking nervously at the already massive amounts which the Third World had borrowed in the fourth quarter of 1976 through the first half of this year (see Figure 2). Countries such as Brazil and Mexico had up to \$7 billion apiece in combined debt principle and interest payments due this year — almost twice the amount due last year. Much of this could be rolled over, but a large part had to be refinanced.

It was the run out of the dollar deposits, according to several bankers, which caused the banks to cut lending drastically in the third quarter. As Figure 2 shows, the total combined Euromarket bank credits and long-term Euro- and international bond lending fell from a high of \$18.2 billion in the last quarter of 1976 to an average \$15.8 billion in the first two quarters of 1977, and then down to \$14.3 billion in the third quarter. Both non-oil exporting third World countries (LDCs) and industrial countries such as France and Sweden who had been financing their trade deficits took the brunt of the fall-off.

The uncertainty element in this affair should not be underestimated. It is impossible for lenders, or borrowers, to make competent business decisions under conditions when the values of currencies over a year

Figure 1

DOWNTURN IN BORROWING ON WORLD FINANCIAL MARKETS
(Including total borrowing, Eurocredits, and all foreign bonds)
In billions of U.S. dollars

COUNTRY TYPE	1976			1977							
	I	II	III	IV	I	II	III	IV*			
Industrial	23.6	21.3	31.5	9.0	7.3	7.1	8.0	9.1	8.6	6.9	4.9
Non-Oil LDCs	9.0	10.3	15.4	2.4	3.0	3.5	6.4	3.1	2.5	2.2	0.3
OPEC	1.1	2.9	4.0	0.5	1.0	1.0	1.5	1.6	2.0	2.5	0.5
TOTAL:	40.8	43.3	62.8	15.8	14.7	14.1	18.2	15.7	15.9	14.3	6.7

SOURCE: World Bank, Morgan Guaranty

* Based on October figures only.

Figure 2

Int'l Comparison of Investment Ratios: 1970-1977

Country	Investment Ratio in %			
	Average 1970-1974	1975	1976	1977 ²
Austria	28.1	26.7	26.0	26.5
Belgium	21.8	20.7	21.4	20.9
Fed. Rep. of Germany	24.9	20.8	20.8	21.1
France	23.8	23.3	23.1	22.7
Great Britain	19.1	19.9	19.0	17.9
Italy	20.9	20.8	20.3	20.2
Japan	34.9	30.8	29.9	32.3
Netherlands	24.0	21.3	19.8	20.6
Norway	39.2	35.4	36.3	34.9
Sweden	22.0	20.9	20.5	19.9
Switzerland	28.7	24.0	21.5	21.3
USA	18.8	15.6	17.1	18.4

¹ Percentage share of gross investment for plant and equipment in GNP
² Estimates

Source: Union Bank of Switzerland

period is totally unpredictable.

World trade similarly suffered from the chaos and uncertain payments problems (see trade article, page 1). In a situation where manufacturers and importers have no idea what their profits will look like if they have a given currency in which to pay or be paid in three months, many will decide not to trade, or will cut back on volume because of the cost of hedging foreign exchange fluctuations.

The \$300 Billion Capital Investment Shortfall

But, the consequence which will haunt the world economy for years to come is what the Union Bank of

Switzerland (UBS) described this week as a \$100 billion dollar per year shortfall in capital spending for 1975, 1976, and 1977 worldwide. Floating rates, as shown by a capital investment survey in the latest UBS *Business Facts and Figures* monthly, make investment decisions difficult if not impossible in many cases. The dollar problem is felt as a worldwide damper on investment since so much trade and payment takes place in dollars.

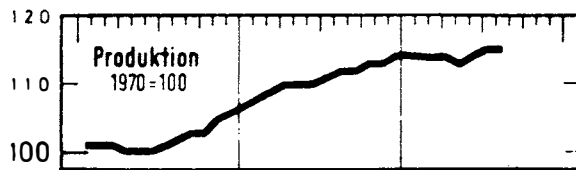
The countries which have suffered most from the floating rates are the stronger economies whose currencies have been wracked by the foreign exchange turmoil: the U.S., Japan, and Germany. Chase's *Business in Brief* reports that the U.S. actually had a capital investment shortfall of \$125 billion during 1975, 1976, and the first half of 1977, which 'is currently widening at a rate of close to \$1 billion a week.' Chase calculates the shortfall based on a recent U.S. Commerce Department study which indicates, taking into account the growing pressure on business to divert funds into antipollution and other nonproductive investment, that actual investment in real plant and equipment should average at least 12 percent of the Gross National Product each year. Based on actual investment figures, Chase comes up with the \$125 billion shortfall. Bankers Trust predicted last week that annual growth of real U.S. manufacturing investment in 1978 will fall from 6-7 percent this year to 2-4 percent.

As Figure 3 shows, the 1975-1977 annual rate of capital expenditure on plant and equipment in the Federal Republic of Germany, Japan, and Switzerland has fallen off even more. Although the U.S. 1970-1974 figures seem much lower in relation to the other countries than they are due to differences in statistical compilation, Figure 3 shows correctly that, among the major economies, West Germany, Japan, and Switzerland have historically had the highest standards of capital formation—and have taken the biggest fall in 1975-1977. While the investment ratio in the U.S. fell by 3.2 percent from 18.8 percent to

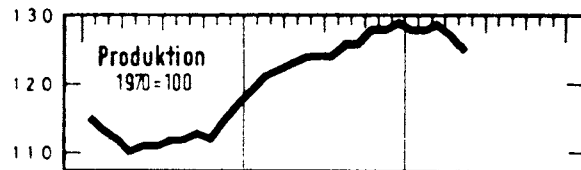
Figure 3

Industrial Production in the EEC

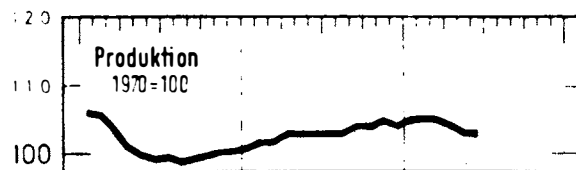
BR Deutschland (BRD)



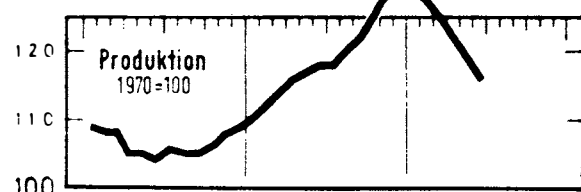
Frankreich (FRANCE)



Großbritannien (BRITAIN)



Italien (ITALY)



Source: Economic Institute, Munich

15.6 percent in 1975, and then revived, the German, Japanese, and Swiss ratios fell by 4.1 percent, 4.1 percent, and 4.7 percent respectively during 1975, and then remained stagnant or fell even further in 1976 and 1977.

UBS, in its latest *Business Facts and Figures*, minces no words in stating that the further cuts in German, Japanese, and Swiss exports being demanded by Blumenthal and Co. to "stabilize" the currency situation will further cut capital investment and thus trade: "A decline in earning power in the export sector due to exchange rates and uncertain exports prospects is likely to lead to reductions in inventories, declines in capital spending, and to a drop in the volume of imports."

Japan

In Japan, a public outcry is beginning over the effects of the collapse of the dollar-yen rate on Japanese exports and thus directly on prospects for capital investment. "Capital expenditures to Slow Down More due to Surge in Yen" was the headline of his week's *Japan Economic Journal*. Real capital investment in plant and equipment for the fiscal year April 1977 to March 1978 is now estimated to *decrease* absolutely by 0.9 percent by the government Economic Planning Agency's November survey. Previous estimates had been for a rise of 5.6 percent (estimated in July), of 4.6 percent (estimated in August), and 6.0 percent by the government as recently as Sept. 3 on the basis of its then newly announced deflation program.

Especially horrible is the new prediction that investment in the manufacturing sector (i.e., excluding services) will fall by a full 7.6 percent in the year to next March. Actual machinery orders in the quarter July-September 1977 have already fallen 5.7 percent from the previous quarter.

Europe

In Western Europe, the situation is no better. The year

of 1977 was a continuing disaster for investment, especially compared to the depression levels of 1975 and 1976. The West German IFO Economic Institute's European Economic Community composite business indexes for the third quarter of this year are headed back to their 1975 historical lows. The Business Climate Index, a preview of corporations' intentions to invest and expand operations, particularly shows the investment downturns; industrial production (Figure 3) is already feeling it.

In West Germany, the investment situation is totally politicized. The latest Dresdner Bank Economic Quarterly reports that fully 20 billion deutschemarks (\$9 billion) worth of planned investment in the energy and transportation sector has been blocked by court suits brought by the "Citizens' Initiatives," West Germany's environmentalists; *total* investment in West German manufacturing industry in all of 1976 is only DM 34 billion! As in Japan, previous government and economic thinktank estimates of real overall investment for 1977 and 1978 have recently been sharply revised downward. Overall capital investment is now put for 1977-78 in real terms at a mere 3-3.5 percent, compared to 5 percent in 1976. Broken down, industrial investment in new machinery in particular is set to fall from a real growth of 7 percent in 1976 to 3.5 percent in 1977 and 3.5 percent in 1978 — not even enough to make up the loss for 1975, as pointed out by the Union Bank of Switzerland.

In France, the same process is going on. Last summer's estimates of a 4 to 5 percent rise in real capital investments for 1977 and 1978 have been scaled down by the government to, first, a 1.4 percent rise for 1977, and then to a 0.6 percent for 1977. The government is still claiming that 1978 will see an "upturn" to a whopping 2.9 percent rise in real capital investment, but the OECD has just announced the figure will be more like 0.25 percent.

— Kathy Burdman