Europeans Ponder Gold Money System, Fixed Rates

Exclusive to the Executive Intelligence Review

Despair of getting U.S. cooperation in stabilizing the foreign exchange markets has prompted Western European and Japanese governments to consider instituting a fixed-rate currency system, with a major role for revalued central bank gold reserves.

GOLD

According to banking and official sources in Western Europe and the United States, the French, West German, and Japanese governments are now in negotiations for a three-way fixed rate arrangement, excluding the U.S. dollar.

In addition, both private and central banks are accumulating gold positions in anticipation of a return to gold's central reserve status in international monetary affairs.

The Europeans and Japanese are playing a tough, sophisticated game that does not show up on the free market in gold, according to authoritative sources. A principal in the transactions says that the dominating influence in the price fluctuations on the gold market—which has swung wildly in the $158-$167 range during the last three weeks—is Soviet sales and Saudi Arabian purchases. This source, the former chairman of a Western European bank involved in these events, reports that the range of the market has been determined in the following fashion: at every strong peak of the gold price, the Soviet Union has sold substantial quantities of gold. The sales are not directly related to the recent purchases of grain required by the disappointing Soviet grain harvest, but are an ongoing necessity due to the deterioration of the Soviet payments balance due to world trading conditions. Under European guidance, the Saudi Arabian Monetary Agency purchased gold at every trough of the market, and only at the trough of the market, to avoid bidding the gold price up higher than the market will sustain. In this fashion the Soviets have earned considerable foreign exchange and the Saudis accumulated substantial gold reserves, with the rest of the market, in effect, acting as a buffer.

Knowledgeable European banking sources report that there have been discussions about bypassing the market through direct Soviet sales to the Saudis, through the mediation of Swiss banks, but there is no confirmation that such sales have taken place.

Strong Gold Positions

In the private banking sector, some of the key European institutions are taking strong gold positions. According to reliable sources, the board of West Germany's Dresdner Bank has decided to invest half of the bank's foreign deposits in gold.

Senior Western European officials explain the swing towards gold as an inevitable consequence of the dollar collapse. "There is no question that not only individuals, but central banks, will grab for gold, if the dollar continues to fall," said a top Western European central banker. "I personally am distressed by this. I am an SDR man (Special Drawing Rights). But there is no question that this is what will happen."

For the first time since the dollar was unpegged from gold in 1971, strong sentiment has emerged in Japan for a return to the gold standard. In November, the respected weekly *Japan Economist* proposed that Japan return to the gold standard. Authoritative Japanese banking sources report that the big Japanese trading companies are already accumulating gold on their own account. The two largest, Mitsui and Mitsubishi, are involved in this activity, which is mediated through Japanese brokerage houses with international presence, the sources said. According to Japan specialists at a large New York commercial bank, who substantiated this report, the trading companies are probably acting for the Bank of Japan itself.

Policy circles in the United States are aware, broadly, that these manuevers are underway. Said the chief of international operations at one of the top U.S. multinational corporations, "I wouldn't be a bit surprised if the Europeans turn toward gold. It's the only thing they can do. In the eyes of our sophisticated international trading partners, this Administration appears naive and unreliable. They are late to respond. When they do respond, it's usually ludicrous." One of the country's top-name consulting firms believes that if the Administration continues on its present course, a "catastrophic run against the dollar is a real possibility," and that if this happens, "the Europeans will fall back on gold."

End-of-the-week events on the foreign exchange market, in which the dollar fell from above 2.23 to 2.2050 German marks, indicate that the hoped-for lull in the dollar's decline has not materialized. Earlier in the week, the dollar gained against the Japanese yen and stabilized against other leading currencies as the market—gullibly—discounted Japanese official statements that the country would reduce its trade deficit and take pressure off the dollar. However, the dollar fell on Friday from 246 yen to 244 yen, and declined even more sharply against the West German mark and the Swiss franc.

Contrary to past experience, the gold price has not gained at the expense of the dollar. Given the strong political control over the market, there is no reason to expect a direct relationship between a weak dollar and a high gold market price, not, in any case, in the short run.

There has been no firm decision taken as to how to proceed to return gold to its old monetary role, although the way is made considerably clearer by the expiration of the Jamaica International Monetary Fund meeting's ban on central bank gold trading during 1978. One suggestion that has been floated is that central banks will intervene in the market sufficiently to stabilize gold's trading price, giving the private sector the opportunity to denominate payments in gold, which would become more stable than the dollar. Reportedly, the Bank of England is especially terrified of this prospect, because a numeraire role for gold would undermine the reserve value of both sterling and the dollar.

— David Goldman

London Exploits Dollar Downfall

FOREIGN EXCHANGE

The French financial journal *Les Echoes* has provided new evidence that the Bank of England and allied British merchant banking interests are manipulating the latest round of international monetary chaos so that London can "come out on top" and restore the faded glories of the British Empire. *Les Echoes* revealed on Nov. 29 that the Bank of England itself has led the recent dollar-dumping, driving the speculative momentum which has brought the U.S. currency to record lows against the Japanese yen, West German mark, and Swiss franc.

"Hot money" flows into Britain as a result of the dollar's weakness and the short-lived "bubble" in British securities markets have allowed the Bank of England to add a full $16 billion to its reserves this year. The British central bank has reinvested the bulk of its huge dollar hoard — the second largest in the world after Saudi Arabia — into U.S. Treasury IOUs. The Bank of England has therefore gained strategic leverage not only over the fate of the dollar, but over the financing of the Carter Administration's budget deficit! According to *Les Echoes*, the central bank has been "trying, on and off, to get rid of its dollars" — ostensibly because it fears the depreciation of its dollar holdings — and has been joined in the dumping by "commercial banks and Arab dollar holders."

Admittedly, those New York-centered financial interests which have backed the wing of the Carter Administration centered around Treasury Secretary Blumenthal and Special Trade Negotiator Strauss — especially the British-linked investment banks, such as Lazard Freres, but also factions within the major commercial banks — share the responsibility for the dollar's precipitous decline. The commercial banks' view has been that the dollar drop is "not calamitous" since it will bludgeon the Japanese and West Germans into reducing their industrial exports and "solve" the problem of a $30 billion U.S. trade deficit.

The debilitating effects of dollar instability on world trade, however, will undermine U.S. industry, and London banks will be the prime beneficiaries in the end. Many commecial bankers have realized this belatedly, as reflected in a Dec. 1 *Wall Street Journal* feature which reported that many foreigners will no longer accept payment in dollars, forcing U.S. corporations to take the foreign exchange risks.

Japanese Feint

This week's Japanese cabinet shakeup, and the apparent "capitulation" of Japan to Special Trade Representative Strauss's demand that definite steps be taken to reduce the country's trade surplus, have momentarily buoyed the dollar against the yen. On Nov. 30, the dollar rebounded to ¥244.20 in Tokyo against -241.88 the previous day. But seasoned observers say the Japanese have no intention of carrying out measures which would cripple export-based industry and send their economy into a major recession.

New York Federal Reserve officials and some foreign exchange experts say that the dollar could strengthen between now and the end of December, if only for technical, end-of-year book-balancing reasons. Although the Fed spent only $365 million in support of the dollar during the third quarter, New York Fed vice president Scott Pardee has promised that: "We have done a lot and are prepared to do more. We aren't sitting on our hands." Nevertheless, by Dec. 1, the "confidence game" appeared to have already evaporated as the dollar slipped to new lows against the West German mark and Swiss franc, 2.2144 DM and 2.1415 respectively.

Eurodollar Explosion

The rapid multiplication of excess dollars abroad insures that — without a U.S. government-backed high-technology export policy — no *long-term* stabilization is possible. As a Nov. 23 Dow Jones special report on the Eurodollar market documented, the "explosion in Eurodollar bank credit," which began in the third quarter, so as to cover national trade deficits and debts, has seriously aggravated the pressure on the dollar.