Click here for Full Issue of EIR Volume 5, Number 1, January 10, 1978

International Pressure Reversed Administration's Dollar Policy

FOREIGN EXCHANGE

An international coalition led by Arab oil-producing nations and West European governments succeeded this week in forcing a dramatic about-face by the Carter Administration on the issue of support for the U.S. dollar. Abandoning — for the moment — its previous "malign neglect" policy, the U.S. Treasury announced on the afternoon of Jan. 4 that it would conduct "joint intervention" to prop the dollar's value in close coordination with the U.S. Federal Reserve Bank, the West German Bundesbank, and other leading central banks.

Immediately prior to the Treasury's announcement, the dollar had plummeted to record lows against all other major currencies — as Arab, European, and Japanese investors registered vehement disapproval of the nomination of the Lazard Frères-linked G.W. Miller as the new Federal Reserve chairman. It now appears that an important element in the successful "arm-twisting" of Carter was the threat that Arab and European central banks would stock up on gold and move to impose a gold-based monetary arrangement in the event that the dollar's free-fall continued.

The central bank intervention, however, will prove a short-term palliative at best. Long-term stabilization of the U.S. currency will require strong measures to halt the deindustrialization of the U.S. and step up capital goods exports, thereby erasing the nation's enormous trade gap.

If followed up in this way, this week's dollar support operation could spell a decisive setback for City of London merchant banking interests who have been deliberately encouraging the dollar's decline so as to resurrect the faded pre-eminence of the pound sterling. In the days and hours preceding the unveiling of the U.S. intervention policy, the British press openly gloated about the "inherent strength of the pound sterling" while lecturing the U.S. on its lack of "a dominant intellectual figure" in any key economic post (see excerpts, above).

According to the Jan. 5 *New York Times*, Saudi Arabia's King Khalid, who met with Carter in Riyadh, played a major role in the U.S. policy reversal. "King Khalid was reported to have served notice that his country could no longer be a force for moderation in international oil price diplomacy if the dollar, the currency in which virtually all oil contracts are involved, continued to depreciate."

Following his talks with Khalid, Carter proceeded to Paris the same day, where, according to French radio reports, Giscard also raised the issue of dollar support with Carter. In his speech in Paris, Carter stated that "America's efforts will be directed toward maintaining the strength of the dollar" but, aside from implementation of "a major tax cut," Carter gave no indication of how this would be achieved.

An article in the Jan. 5 *Chicago Daily News* entitled "Armtwisting by Arabs Seen in Aid to Dollar" provides further confirmation that Saudi and French influence had been instrumental in Carter's decision to launch the intervention. According to the Chicago daily, Carter's decision wasn't "entirely voluntary." It was "more than a coincidence that this happened while Carter was abroad," a foreign-exchange chief at a major U.S. bank was quoted. The *Daily News* indicated that the Arab petro-dollar holders had threatened Carter with an end to their investments in the U.S.

Moreover, a leading New York gold analyst reported that in the four days preceding the intervention, investors "principally from the Middle East" but also West Europeans massively switched out of dollars into gold. "They were moving into gold merely for its measure of value. They're not speculators. They've just had it with paper and the dollar in particular."

The Arabs and Europeans were not alone in their concern for dollar stability. According to the Dow Jones news service, unidentified "New York money managers had been urging the New York Federal Reserve for some time to push in Washington for stronger dollar support...this urging plus similar counsel from German Chancellor Helmut Schmidt and probably from Mideast leaders apparently produced a top-level decision in favor of more aggressive intervention."

Rothschilds Exploit Weakness

Although the Federal Reserve was reported to be intervening "aggressively" on Jan. 5, offering packets of "20 million marks or more" to every major New York bank, U.S. policymakers have yet to detail the extent to which they are prepared to go in defense of the dollar. So far, all that is known is that the Fed and Treasury will "actively" avail themselves of pre-existing swap lines — lines of credit — from 15 central banks, totaling $20 billion. The Treasury will also draw on its Exchange Stabilization Fund of about $4 billion, now consisting mainly of dollars, and for this purpose, has opened an additional $2 billion swap line with the Bundesbank. But as long as the fundamental questions — such as the negative impact of Carter's "no-growth" energy program on U.S. industrial capital formation and the stagnation of U.S. exports — are not addressed, it can only be a matter of time before the swap lines are used up. The antidollar City of London faction is already maneuvering to take advantage of this fact. A top official of a Rothschild-linked European bank argued this week that the swap arrangement would make no fundamental difference for the dollar, since the U.S. has been reduced to the status of a debtor nation — an estimation potentially even more damaging. "The U.S. is past its peak of

© 1978 EIR News Service Inc. All Rights Reserved. Reproduction in whole or in part without permission strictly prohibited.

pre-eminence. It is at its end as a power." According to this official, the dollar could conceivably stabilize and the world economy "recover" during 1978, if European governments are forced to reflate, Carter's energy program is passed, and U.S. interest rates are hiked, but this will only lead to a bigger "collapse" in 1979.

Recognition of the temporary character of the present measures has already begun to depress U.S. capital markets. On Jan. 5, the Dow Jones industrial average rose 7 points in the morning, only to close more than 8 points down on the day.

Helping to spark the market's decline was a *Wall Street Journal* lead article indicating that some leading New York commercial bankers are less than enthusiastic about the effectiveness of the intervention. David Rockefeller, chairman of Chase Manhattan Bank, was quoted: "Market intervention can't stop a trend, but it can damp the amplitude of swings." Morgan Guaranty's chief economist Rimmer deVries stated: "A little extra intervention isn't going to have a lasting impact." Worse, deVries contended that the former Blumenthal policy of intervening only when markets are disorderly had not been changed.

Herstatt Casts Its Shadow

During the last week, foreign exchange markets have been more volatile than in any period since the chaos following the August 1971 floating of the dollar. The rapid currency shifts, *Le Monde* economic columnist Paul Fabra warns, could set off another "Herstatt" crisis — a reference to the 1974 failure of a small West German bank due to foreign exchange losses which nearly brought down the entire Eurodollar market.

Before the intervention, Dow Jones reported a rumor that Dresdner Bank, the second largest German bank, had suffered major foreign exchange losses. The rumor was denied by a Dresdner spokesman. A New York foreign-exchange chief indicated that "two or three" German banks might be in trouble, both big and small, especially those which had invested heavily in dollar-denominated Eurobonds. There is also the danger of major losses incurred as a result of the central banks' "bear squeeze" operation against those who speculated on a further dollar decline.

Whether the rumors are well-founded or not, the table below demonstrates the risks inherent in the current monetary crisis.

—Alice Blythe

Run Into Gold Puts Pressure On U.S.

GOLD

Gold bullion not only served as the key short-term lever for Western European and Mideast financial leaders during last week's dollar crisis, but it appears that the crisis is speeding up these policymakers' timetable for restoring gold's role as a stabilizing medium of world reserves and trade payments. The Jan. 4 modification of the U.S. Treasury's dollar sabotage was in large measure forced by what New York's best-informed gold dealers described as a heavy Arab switch from dollar holdings into gold — not, these sources emphasized, as a speculative attack against the U.S. currency, but "merely for gold's measure of value. They've just had it with paper (investments) and the dollar in particular." One analyst described the moves as the first time since the 1974 oil crisis that gold was used as "an alternative to money" rather than just a hedge against currency depreciation. Moreover, the relative stabilization of the dollar toward week's end allowed Mideastern and European holders of dollars to buy gold without disrupting the exchange rates or taking fire-sale losses.

The international role of gold was further underscored by two financially significant trade deals — the USSR's swap of gold for wheat with the U.S.-based Continental Grain Co., and Kuwait's agreement to take South African gold in payment for petroleum. On the central bank level, Japanese monetary authorities were reported to be buying gold to beef up the slim bullion portion of Japan's resources, despite contrary pressure from the U.S. Treasury. In this connection, the trip of Swiss central bank chief Fritz Leutwiler to Japan last week to beef up dollar-support coordination takes on added importance.

But little more has surfaced regarding the West German, Swiss and French central banks' intentions to remonetize gold, an option intricately bound up with NATO and Arab-Israeli negotiations.

The U.S. and GOLD

After the "swap" activations, there were various press speculations that, in order to repay the foreign currency the U.S. had borrowed from central banks abroad in order to perform support purchases of dollars, the U.S. Treasury might have to sell gold, since — as the need for the swaps implies — the Treasury has so little foreign exchange holdings of its own. Thus the U.S. would be put in the position of an Italy or Portugal, under pressure to pawn its bullion to pay its debts, and confidence in the dollar would erode further.

A former linchpin official in the Nixon Treasury Department, however, commented on Jan. 6 that Congressional traditionalists would be unlikely to permit American gold reserves to be bled away. Instead, he suggested, they would legislate a change in the present official price of $42 to the market price of currently $170 an ounce — giving the U.S. a soundly-based total of over $50 billion in non-dollar reserves, enough to quash the prospect of a speculative run against the dollar. Moreover, having ended the quite nonsensical U.S. refusal to acknowledge the higher value of gold, the U.S. would then be in a position to more or less willingly join the international gold-clearing arrangements blueprinted by the assassinated West German banking leader