Europe Fuels U.S. Rally, But Insists That Backup's Needed

Western European purchases of dollars and dollar-denominated securities were a decisive element in the market recoveries that began April 14. Operating on the basis of an agreement between French President Valéry Giscard d'Estaing and West German Chancellor Helmut Schmidt the weekend of April 8 to seek what an official Bonn spokesman termed "an overhaul of the entire international monetary system," European muscle was applied to help give export-drive advocates in and around the Carter administration an energizing atmosphere in which to plow under their factional opponents, headed by Treasury Secretary Blumenthal.

FOREIGN EXCHANGE

But in the absence of a decisive favorable resolution of this internal fight, continental bankers privately expressed their fear during the week of April 17-21 that Washington may be taken over altogether by the Mondale group — "Carter won't last out his first term" — and "Europe will have to find 'European' solutions, which will be a disaster."

The European and American dollar defenders followed up their bull raid with a partial victory when de facto U.S. gold swaps were announced. Schmidt and Giscard, rejecting any currency reforms that exclude the dollar or presume its perpetual weakness, want gold to play a role in backing a strong dollar. West German sources say the details of the Treasury gold sales and the indirect West German central bank gold purchases were worked out between Bundesbank president Otmar Emminger and Federal Reserve governor Henry Wallich during the latter's visit to Europe the week before the gold announcement. While the Bundesbank's international affairs chief is spending at least two weeks in Washington, a number of West German signals preceded the announcement. Finance Minister Hans Matthoefer commented publicly that the Federal Republic would welcome a U.S. use of gold for dollar defense, and Chancellory spokesman Klaus Bölling revealed that Helmut Schmidt had given President Carter a long, "very relaxed" telephone briefing on his parliamentary call for a revival of the 1976 United Nations Colombo meeting resolutions on disarmament and Third World industrialization. Schmidt, in an otherwise rather squinty-minded April 20 *Washington Post* interview, again stressed the need for detente and for monetary solutions to be worked out with, not against, the U.S. In Tokyo, Foreign Minister Hans-Dietrich Genscher urged West German-Japanese-U.S. cooperation on monetary reform.

At the same time, the Japanese industry and trade ministry announced the formation of a private corporation to stockpile gold bullion, using central bank dollar reserved funded through Japan's export-import bank. This will provide, not merely a boost for the market price of gold, but a step toward international remonetization of gold.

Other international deployments on behalf of the dollar include a forceful essay by Gaullist elder statesman Michel Debré in the April 13 *Le Monde* of Paris. Instead of indulging in anti-U.S. rhetoric, Debré made an explicit pitch for Franco-American cooperation on the basis of a gold-backed dollar that could play the role of the development-promoting dollar reserves — a role, Debré writes, for which Europeans were grateful until dollars piled up as mere speculative instruments, feeding inflation and forcing an end to gold convertibility. Another *Le Monde* piece by Paul Fabra April 19 called for France to provide an international example by withdrawal from the International Monetary Fund and restoring gold backing for the franc. It seems that the French Assembly will vote up its quota increase for the IMF, ensuring that it keeps its seat on the Fund's board, but will vote down ratification of the floating currency rate amendments to the IMF charter drawn up in Jamaica in 1975.

The Bull Impetus

Coinciding with these Franco-German diplomatic forays was the European intervention into the currency markets and U.S. securities markets. Some dealers emphasized heavy Swiss purchases of American corporate bonds, others a French rush into the stock market, and others West German importers' buying of dollars. European dollar purchases have started to reverse the "leads and lags" to a more favorable balance for the dollar. (During the dollar depreciation, importers had postponed conversion of their currencies into dollars as long as possible, betting that when they had to do so to use dollars for payments, the dollar would be still weaker.) The rallies drove existing dollar short-sellers for cover, and deterred others from taking new short positions, while enabling trade-involved corporations, who previously "hedged" dollar deals not from speculative malevolence but from necessity, to free up some of their working capital. A good chunk of the $40 billion total previously tied up in these speculative or defensive borrowings will now be freed; in addition to crippling the London bears, the dollar rally should thus help to lower U.S. rates and increase the liquidity available for productive purposes. The stubbornest dollar bears on Wall Street who mumbled in telephone interviews that the European angle on the dollar and stock-market rally was simply "bargain-hunting in a depressed market" are now admitting that their explanation of "the dollar bottoming out" was a silly tautology which obscures the European political commitment to the dollar.

The combination of European dollar-gold initiatives and the French-West German campaign for East-West economic buildup and North-South nuclear exports has incited every British stringer and shellshocked cynic in the West German press, meanwhile. The message in both *Die Welt* and the financial daily *Handelsblatt* during April 19-20, for example, was the impossibility of an export push by either Washington or Bonn, the futility of industrial development negotiations with the Soviets, and the fragility of the U.S. market rally. *Die Welt*, while claiming that reflation proponent and British understudy Lambsdorff has gained new domestic power, headed an editorial April 20 in all seriousness "U.S. Oil Imports: Source of All World Evils."

The climate of uncertainty and cynicism has been allowed to build partly because, as one senior Frankfurt banker put it, Schmidt is playing some games around the European monetary bloc proposals sponsored by London and the London officials in the European Economic Community apparatus. While informed sources say the recent meeting of EEC finance ministers took no concrete steps toward a larger role for the European Unit of Account (a regional version of special drawing rights), and the April 20 New York *Journal of Commerce* once more enumerated the objective obstacles to "European monetary union" on the British model, West Germany is trying to put pressure on Washington by playing along with such discussions to some extent, using the threat of some new Eurostructure or pegged-rate system as "a bargaining chip" to reach the solution Schmidt and Giscard really want, a gold backing for dollar reserves.

— Susan Johnson

Miller 'Anti-Inflation' Plan Snagged

The Carter Administration has announced its commitment to a $25 billion tax cut bill just moments after the Commerce Department announced that first quarter GNP had dropped 0.6 percent.

BUSINESS OUTLOOK

The tax cut proposal is a "safe" but incompetent issue, likely to win Republican Party and business community support, but unlikely to have any but the most minor positive effect on the economy. While the tax cuts do theoretically free liquidity, this does not mean that the liquidity will go into high-technology capital investment, as opposed to real-estate swindles and other outright speculation.

Miller's Attack

The GNP drop, which was largely attributed to bad weather and the prolonged coal strike in the first quarter of the year, was the signal for the British and their sympathizers in the U.S. Administration to begin to call for higher interest rates to prevent an "outbreak of inflation."

On April 19, the Anglophile chairman of the Federal Reserve Board, G. William Miller, entered the federal funds (interbank) market at 12:30 pm and drained reserves from the banking system. This occured, oddly enough, just one hour before the Treasury was scheduled to make a Treasury note sale.

The market generally interpreted this as a tightening move. In response, the price of interest rates futures contracts traded on the Chicago Board plummeted. One trader commented, "It seemed as though the Fed wanted to notch up the market. Nobody knew for sure, but nobody wanted to stick around and find out. There was a lot of panic and everybody bailed out."

Two-year Treasury notes that had been anticipated to sell at 7.60 percent or slightly less actually sold at 7.80 percent, 20 basis points higher. Corporate bond rates as well as the rates on General Motors Acceptance Corporation paper were also pushed higher.

Miller's actions were explained by Albert Sommers, the chief economist of the British-linked Drexel Burnham investment bank, in that bank's April 10 newsletter. Sommers, who also doubles as the chief economist for the Conference Board businessmen's organization, predicted that a White House "policy shift could be the engaging of the Federal Reserve in a brief, but significant 'crunch'," whose probable outcome, Sommers added, "would be a much slower growth of output or earnings." This "crash" perspective Sommers justified on the basis of the need to "fight inflation."

Immediate cover for Miller and Sommers was provided by the *New York Times* April 19, whose lead editorial, "The Inflation Strategy and Its Hasty Critics," proclaimed that "the President is wise to hold to a moderately stimulative course and to fight inflation with a variety of selective and voluntary pressures," which excluded a large tax cut, but included higher interest rates. The *Times* added that there are those who "doubt that the President has the will or the muscle to battle the Congress if it tries to pass inflationary legislation."

Wrong Signals

Yet despite the British push to blow out the U.S. economy through an "anti-inflation" strategy featuring higher interest rates, the U.S. business community, along with the European and Arab allies of the U.S. who started the current stock market boom, have other

The insanity of the Miller strategy was pointed out by the Research Director of government securities of a major New York commercial bank, who stated April 20, "No one believes Miller, because the Fed never does this (i.e., raising interest rates) amid a government funding operation, and the government has a lot of funding to do."

Since Miller announced his intention to raise interest rates two weeks ago: (a) the Arab world continued its long-standing commitment to purchase U.S. Treasury securities in record volumes, which has kept Treasury interest rates down; and (b) the Europeans, along with the New York banks, organized the current bull market and dollar support operations, which have likewise