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BRD plans U.S. credit reform

Eurodollar market's task is world development

West Germany is in "collusion" with the Swiss and Japanese governments to place centralized government control over the Eurodollar markets and turn dollar credit there into long-term productive investment in the developing sector. West German Finance Minister Hans Matthoefer's trip to the United States, Jan. 29-31, is part of that collusion, said London's **Financial Times.**

On Jan. 30, Matthoefer told a startled New York Council on Foreign Relations meeting that the West German government of Chancellor Schmidt intends to impose upon the unstable Eurodollar market and the U.S. credit system a thoroughgoing reform of "transparency and control" to produce a lower tier of dollar interest rates. The aim is "to arrest the central bank diversification trend out of the dollar," which Matthoefer said was "under valued," and to create "a stable dollar."

As Matthoefer spoke, Chase Manhattan and several Midwestern banks lowered the U.S. prime lending rate from 11.75 percent to 11.5 percent, the first U.S. interest rate drop in two years.

West Germany, Switzerland, and Japan, together with France, represent the political leadership and support for the new European Monetary System (EMS). These governments announced last fall in the Japanese financial press a visionary "Consolidation Plan" for the entire world dollar credit system, which would be the "globalization of the EMS." It's that plan they are now implementing.

In an exclusive background briefing on Jan. 29 with Executive Intelligence Review, the West German Bundesbank explained the entire plan.

The Consolidation Plan

The Consolidation Plan, or "transparency and control" by concerned governments, as the Germans refer to it, is based on U.S. Labor Party Chairman Lyndon H. LaRouche's summer 1977 proposal for an international "two-tier credit system," in which governments politically direct their surplus dollars toward Export-Import Bank type of subsidized credits for large-scale export of high-technology goods from the advanced to the developing sector. These "development dollars" represent a lower tier of interest rates than the remaining speculative dollars, both internationally and within the U.S., that are invested in low-quality real estate, commodity, and unpayable Third World debt. The development dollars become the most profitable sector of investment in the world. Funds flow into the dollar, stabilizing it, in LaRouche's estimate, at the three Deutchemark, three Swiss franc and 300 yen level.

According to international banking sources, the Consolidation Plan, negotiated during West German Chancellor Helmut Schmidt's October 1978 summit with then Japanese Premier Takeo Fukuda in Tokyo, envisions interest rates for lower tier dollars matched to internal German-Japanese interest rates — some 4-5 percent, compared with the recent Eurodollar high of 12 percent. This would be accomplished by the West German and allied central banks of France, Switzerland, and Japan, primarily, depositing their excess dollar reserves into the private banking system — cheaply, so that banks could begin to make development dollar loans below prevailing Euromarket rates.

As we have reported since October, Japanese and, recently, West German banks have begun to issue billions of dollars in such loans.

While the rate of issue of such "development loans" is estimated as high as $10 billion in the last three quarters, the Schmidt government and its cothinkers found that additional, direct action on dollar market rates themselves was necessary. The stiff-necked U.S. banking community, instead of joining the Japanese and German consortia receiving central bank dollar deposits and demanding such deposits from their own government, had not only refused, but complained of "dumping." This attitude, which ensured the "containment" of the development loan policy to a limited area, was encouraged by U.S. Assistant Treasury Secretary C. Fred Bergston. In collaboration with the British Exchequer, Bergston denounced the concept to the West German and Japanese governments and to the U.S. banking community.

Why the prime rate fell

The direct action, then, by the governments on world dollar rates was kicked off by West German Bundesbank Vice President Karl Otto Poehl in a controversial Berlin speech on Jan. 17. The next day's **Financial Times** of London reported with horror that "Germany and U.S. seek Euromarket control to steady dollar."

Poehl, in initiating the call for "transparency and control," stated that the sheer amount of the $700 billion in Eurodollars that now is composed solely of dollars created to speculate against the dollar means that to safeguard international trade, governments must coordinate activities among themselves and the private banks on the market.

While the three-month London Eurodollar interbank rate (LIBOR) had in fact eased from its recent late-December peak of 11.81 percent to 11.21 percent on the day of Poehl's speech,

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from that point to now it has tumbled at double the rate to 10 1/16 and continues to fall. It was these changes in international dollar rates — not what the Anglophile New York press is reporting as a collapse in U.S. domestic credit demand — which caused the break in the U.S. prime rate.

What happened to LIBOR was that the West German central bank (at least) began a two-series set of open-market operations on the Eurodollar market.

First, during the period from the end of 1978 to Jan. 17, concerted West German, Japanese, Swiss, and grudging U.S. intervention strengthened the dollar from DM 1.83 to the DM 1.84 level. It is a slow, but inexorable squeezing of the billions in short dollar positions being taken because City of London speculators loudly predicted a "Herstatt"-style dollar crunch for the first quarter of 1979 to be ticked off by an Iranian default, oil crisis, or some other "unstoppable" rush out of the dollar. They lost their bets, foreign exchange traders reported this week, because the European central banks overwhelmed them.

While this pressure on the "short-term" dollar-deutschemark-yen relationship has been continued, pushing the dollar up to DM 1.8730 and yen 201.43 on Jan. 31, the shift in the Euromarket metastability into a rising dollar mode had already by Jan. 18 allowed the Bundesbank to implement "phase two."

This was a direct open market operation on the long-term Eurodollar bond segment of the market. The day after Poehl's Berlin speech, the Bundesbank began to raise its Lombard rate, from 3.5 to 4 percent, while the Japanese and Swiss authorities — in "collusion," charged the **Financial Times** — made equivalent moves by loosening restrictions on foreigners' ability to invest in their domestic bond markets.

These moves ordinarily would have weakened the dollar exchange rate, encouraging short term funds to move into the DM, yen, and Swiss franc, but the central banks' previous intervention pressure had so stabilized the dollar exchange rate that the effect was a sudden boom in the Eurodollar bond market. The Cedel index of Eurodollar bond turnover rose by 50 percent in the week to Jan. 26, while that of all other Eurocurrency bonds (i.e., the mark, yen, and Swiss franc) fell by 50 percent.

This happened because while the Bundesbank-led moves made investment in those countries' domestic bond markets somewhat more attractive, it did so at the expense of constraining their Eurocurrency bond markets relative to the Eurodollar bonds. The Bundesbank et al. have begun to phase out their currencies' use in the Euromarkets in favor of an increased role for the dollar as the reserve currency.

The combination of a healthy dollar bond market and a rising dollar exchange rate was enough to break the dollar interest rate in Europe, and cause the LIBOR fall. This affected Euromarket dollar certificates of deposit rates, which fell, causing New York certificate of deposit rates to fall and the prime rate to soften by Jan. 30.

An unstoppable decline

As much as Walter Wriston, the Citibank chairman, Leonard Santow, Schröder Bank's chief economist, Federal Reserve chief G. William Miller, and others might rail, as they did in the Jan. 31 **New York Times,** against the "prematurity" of the Chase prime rate cut, it is, to the contrary, based on firm economic — and political — reality. As the Jan. 31 West German financial daily **Handelsblatt** said, reporting on Matthoefer's New York speech, "The Euromarket shows signs ... of an evidently unstoppable decline in dollar interest rates, which is not seasonable, but rather a fundamental change in the dollar rate climate."

Matthoefer, in his speech to the Council on Foreign Relations, reiterated nearly the entirety of Poehl's Jan. 17 Berlin speech, putting the full weight of the German government behind the actions already taken by the Bundesbank. He also added, according to West German press accounts, that the Bundesbank and other foreign central banks cannot stabilize the Eurodollar markets without the United States. "Active U.S. participation" is needed and is being politically demanded by the U.S.'s allies.

The long-term significance of the Bundesbank strategy should also be pointed out, particularly in their handling of the bond market, long-term capital section of the world dollar market. The aim of the European Monetary System in establishing a new gold-dollar fund for foreign exchange stabilization is to begin to issue 20-year, gold-backed dollar bonds to soak up dollars and redeploy them for export financing. By introducing mechanisms to stabilize the existing international dollar bond market, the EMS governments make it all the easier to move toward increasing emphasis on the preponderance of long-term, low-interest investment vehicles in international markets, as opposed to the currently overwhelming short-term mix.

The reaction of the Blumenthal Treasury to this cluster of events should be enough to make any red-blooded American businessman rush to Bonn, or better, to U.S. Labor Party Chairman LaRouche for advice on how the U.S. ought properly to respond. In the face of this major effort by our allies to save the dollar as the world's reserve currency, U.S. Treasury Secretary Blumenthal told the Joint Economic Committee of Congress on Jan. 31 that the U.S. "is ready to consider proposals for the evolution of the international reserve system" because the Administration "isn't interested in maintaining an artificial role for the dollar" and was "quite prepared to contemplate a reduction in its relative role in the international monetary system." The irony of Blumenthal's attempt at an abortion of the new world role for the dollar in its ninth month will certainly not go without comment in Europe.

—Kathy Burdman