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International Credit by Peter Rush

Volcker's policy comes to Europe

The Bank of Italy's recent discount rate hike is just the latest skirmish of an interest rate war battering the EMS.

On Dec. 5, the Bank of Italy raised its discount rate 3 percent to 15 percent—making it second only to the United Kingdom's 17 percent minimum lending rate. Italian authorities were coerced into the move by the continued oil war destabilization of the Middle East, the day before the lira collapsed and trading had to be halted in the foreign exchange markets when the Saudi Arabian oil authority, Petromin, cancelled a crucial 30-day supply agreement with the Italian oil giant after the latter was hit by a corruption scandal.

But Italy is just the latest in a series of European casualties of this sort. Over the past several weeks, one after another European country has been forced to raise its domestic interest rate structure. In line with U.S. Federal Reserve Chairman Volcker's rate hiking operation, they are tightening the credit noose another notch or two and patching and repatching the shaky European Monetary System (EMS) currency parities.

What is unfolding now is precisely the "interest rate warfare" that such opponents of the EMS (from the outset a prodollar plan) as the New York Schröder Bank's Geoffrey Bell are so eagerly "predicting."

• A week before the Italian move, Norway raised its discount rate a full 2 percent, in an attempt to avoid a currency devaluation and attendant austerity measures.

• Denmark, on Nov. 30, announced a 5 percent devaluation of the krona and last week followed it up with an austerity program, including wage and price controls, which is expected to cause a 5 percent real wage drop in 1980 and a 3 percent drop in real consumption.

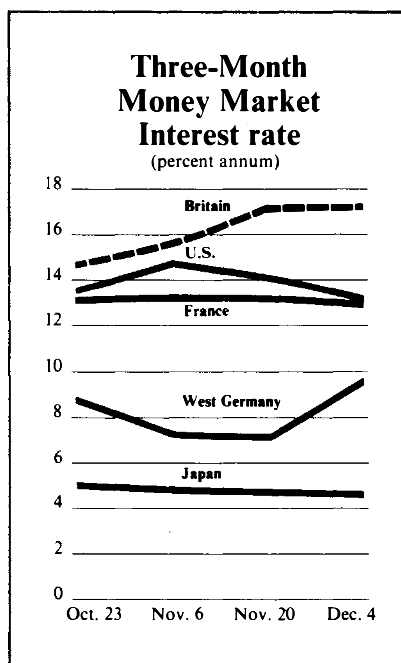
• On Nov. 28, the Dutch central bank raised its discount rate one point, from 8.5 percent to 9.5 percent—on top of a 1.5 percent increase just three weeks earlier. Commercial banks followed with a rise of 1 percent in the surcharge on loans, now at 3 percent. Top quality customers now pay at least 15.5 percent to borrow money. Furthermore, authorities announced that growth in private-sector lending will be held to 8 percent in 1980, compared to 9 percent in 1979.

• West German short-term rates are rising, as they have been consistently, and now top 9 percent. One month and three month rates are at 9.85 and 9.55 respectively.

• Britain earlier set the pace with its 17 percent minimum lending rate.

At present Europe is on the defensive. But as the EMS now stands as a mere currency stabilization apparatus, the price of European noncompliance with the credit squeeze is just more interest rate and inflation pressures generated by the Volcker measures in the United States. Short-term Eurodollar rates show what is in store.

As First Pennsylvania Bank's current newsletter emphasizes, there is every indication that "international considerations" will fuel Mr. Volcker's chicken game of interes rates from the U.S. side. "The combination of factors outlined above (i.e., interest rate increases) together with the perception that the Fed had eased in its resolve to fight inflation, " wrote First Penn, "undoubtedly triggered the latest run on the dollar." They continue to draw the interest rate hike-inflation-currency collapse syndrome full circle: "Subsequent Fed moves do not confirm that the Fed has, in fact, eased. Fed Funds were allowed to trade as high as 14.5 percent before the Fed supplied temporary reserves."



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