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Volcker's policy has above all undermined the corporate sector by *intensifying* inflation. High interest rates have caused the collapse of key industries and massive unemployment. This has required a huge flow of unemployment insurance benefits and other automatic anti-recession expenses of the federal government. These outlays, along with the $5 billion Social Security increase in July, sent the money supply soaring by $8.9 billion for the week ending Aug. 6.

Second, Carter killed dams and water projects in 1977 that would have been necessary to counter the effects on farmers of severe drought, compounded by Volcker's restriction of credit.

The combination of these policies caused food prices to jump on a wholesale level by 3.8 percent in July, pushing up the overall producer price index by 1.7 percent.

Credit constriction

On top of inflation's damper on corporate bond possibilities, many corporations such as Chrysler and entire industries such as consumer goods are scheduled by Volcker to get scant funds.

Under these circumstances, not only will borrowing for corporations be hard and/or expensive, but there will be the additional factor that the U.S. government, with its huge deficit, will need to go to market for over $100 billion (under the most optimistic scenario) between now and the end of 1981. For example, on Aug. 25-27, the Treasury will auction $650 million in 90- and 180-day bills and $3 billion in five-year-and-over notes.

The prospect of crowding out industrial firms is real. The retort to this is that insurance companies and pension funds are rich with cash. This overlooks two important developments.

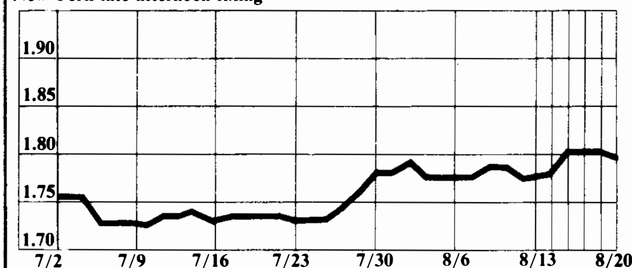
First, half the volume of new publicly offered corporate bonds in May and June was medium term: investors are unwilling to invest long-term in corporate bonds during a period of high inflation, when the yield curve is out of whack (i.e., short-term bonds may fetch more than long-term bonds).

Second, the individual investor, who comprised a healthy segment of the purchasers of corporate long-term bonds, is now going into the glamor money market funds and money market savings certificates. Overall, the market for long-term corporate bonds is not as flush as it looks on the surface.

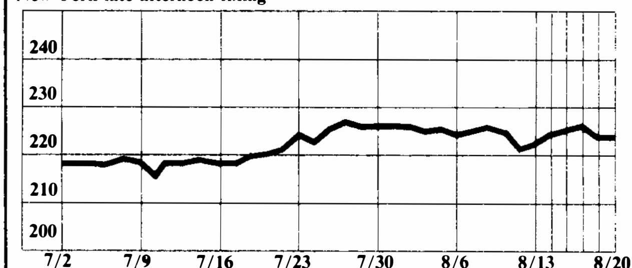
The solution to this problem of restoring corporate liquidity is not an easy one. But already there appears to be a faction that plans to solve it in the worst way possible. According to one of the most influential economists on Wall Street, "What this means is that balance sheets will be restored through forced liquidation if the adverse economic environment prevails."

Foreign Exchange

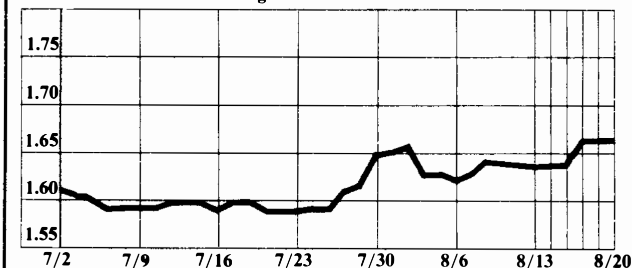
The dollar in deutschemarks
New York late afternoon fixing



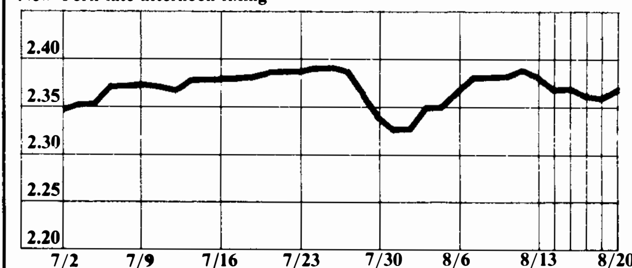
The dollar in yen
New York late afternoon fixing



The dollar in Swiss francs
New York late afternoon fixing



The British pound in dollars
New York late afternoon fixing



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Foreign Exchange by David Goldman

DM revaluation rumors premature

Why the European Monetary System has been able to stabilize the cross-rates.

Most American and British commentary predicts a revaluation of the West German mark inside the European Monetary System early this fall. However, continental foreign exchange specialists point to the opposite trend in recent weeks, i.e., stabilization of the cross-rates of European currencies within the EMS "snake." They believe that expectations of an early DM revaluation are overblown.

The major concern that Western European bankers have for the EMS is not inflation or relative interest rates differentials, but is a strategic one. Their view is that the against frequent revaluations.
has kept a large volume of hedge funds in the American dollar, because any adverse development for the flow of Mideast oil would impact the Western European economies more than the American.

Two major factors are at work for the stability of the EMS.

First, the gold-reserve system established by the EMS, under which central banks may repay swap credits used for currency market intervention through transfers of European Currency Units, has worked far better than critics of the EMS had imagined. EMS gold contributions made by members are matched against a volume of ECU drawing rights defined by the market price of gold.

Since the founding of the EMS, the market value of the EMS gold reserve has more than doubled to about $60 billion, about one-third of which has already been drawn into foreign exchange market activity. This enables EMS members to intervene heavily without excessive drains of their foreign exchange reserves, and buffers the system against frequent revaluations.

Critics of the system, including former Bundesbank President Otmar Emminger, have complained that this permits EMS members to evade necessary domestic economic adjustments. However, the current view of the European monetary authorities is that the strains on currency parities are heavily influenced by speculative and other exogenous factors, which should have no business dictating harsh domestic policy measures.

In a commentary Aug. 15, the Swiss financial daily *Neue Zürcher Zeitung* commented on the unusual stability of the habitual candidates for devaluation against the mark, namely the Benelux currencies, and on the determination of the Benelux monetary authorities to avoid devaluation.

"The European Monetary System has portrayed an unusual situation since March of this year," wrote *NZZ*. "The previous engine of all European currency systems since 1972, the D-mark, has been the caboose of the EMS for several months. Less spectacular but still noteworthy is the simultaneous upswing of the D-mark's old 'sidecars' from the days of the old European snake, the Dutch guilder and the Belgian franc. As long as the D-mark basked in the inflow of foreign funds and ran from one revaluation to another, the troubled Benelux currencies constantly threatened to fall by the wayside."

"Now," *NZZ* concludes, "the D-mark's smaller neighbors have gotten time to breathe."

The Swiss newspaper attributes this strength to the success of economic and monetary policy in both countries and to the central banks' determination to avoid further devaluation. Previously, *NZZ* writes, the close tie between the Benelux currencies and the mark was maintained "at sometimes considerable cost both in terms of foreign exchange reserves and unwanted austerity measures in the home economies." In the last several months, both the Dutch and Belgians have managed to lower their interest rates.

German bankers simultaneously predict a gradual easing of credit market conditions in West Germany starting with this week's central bank council meeting.

In any event, *NZZ* concludes, both the Dutch and Belgians will place currency stability above other goals. "In Amsterdam," the Swiss newspaper writes, "the advantages of a stable guilder are valued more highly than all the disadvantages of the effects of high interest rates," and other measures to protect the guilder rate.

In Belgium, *NZZ* reports, "the National Bank shows itself to be decisively committed to use its gold reserves to the last kilogram, if need be, to prevent a devaluation of the franc."