New central bank actions threaten DM

The Swiss and the British have joined the Fed's 'nonintervention' and the push against Schmidt.

Central bankers introduced new technical procedures this week as part of a coordinated operation by the Bank for International Settlements to keep interest rates high, and at the same time, closely monitor potentially sharp instabilities on foreign exchange markets. The currency that could weaken most rapidly as a result of recent adjustments is the German mark.

The measures were announced in rapid succession by the central banks of Switzerland, Britain, and the United States. In a speech before the Swiss General Assembly on April 23, Swiss central bank chief Fritz Leutwiler reported that the Swiss central bank will no longer intervene to support the exchange rate of the franc. This policy of "benign neglect" is modeled exactly on the announcement by the U.S. Treasury in early April that the dollar would only be supported by the Federal Reserve in the event of an extreme political emergency.

Meanwhile in London on April 27, the Bank of England released a notice that a new reporting procedure has gone into effect for British banks. British financial institutions are now required to disclose their foreign exchange and gold holdings as a percentage of their total shareholders' capital.

New York's *Journal of Commerce*, one of the only financial papers to take note of the highly interesting London move, summarized the Bank of England's motivation as follows: "Currency operations give rise to risks which, although not unique, are probably more pronounced than in other markets."

Following these measures, market analysts now view the deutschemark as the most suspect currency for 1981—both for political and economic reasons.

On the economic front, the Swiss move is a direct affront to German financial stability. Leutwiler's decision to go with "nonintervention" puts an end to a years' long informal fixed exchange rate between the franc and the mark. Since the 1970s, top German companies increased their borrowings from Swiss banks in order to take advantage of lower Swiss interest rates. This led, in 1978, to a "gentleman's agreement" between the German and Swiss central banks to keep the parities of the two currencies within a narrow band of fluctuation, thereby eliminating any foreign exchange risk in these generally medium-term credit deals.

Giving some clues as to why the Swiss are breaking up this arrangement, one Swiss banker based in New York asserted that the German economy is about to enter a serious structual tailspin. Chancellor Schmidt, he claimed, has made too many concessions to the trade-union base of the social democracy, putting a heavy social cost on the German economy. Switzerland, he noted, has no intention of seeing its currency go down with the mark; in contrast, Switzerland has an "engineerable" labor force, in which guest foreign workers can be sent home on short notice through the revocation of work passes.

The *JOC* asserts that Swiss gnomes think the mark could drop as low as 2.25 before year's end.

Just as important as possible currency warfare against the mark is the central bank's commitment to strengthen German central bank chief Karl-Otto Poehl, who has been heavily attacked by Schmidt for refusing to lower interest rates. The moves to back up Poehl are being coordinated by the BIS.

With their recent announcements, the Swiss and British are carrying out the gameplan of the BIS to upgrade the power of central banks worldwide. The Swiss-London policy changes conform to the recommendations of the BIS Committee on Banking Regulations and Supervisory Practices (also known as the Cooke Committee, after its chairman, former Bank of England Governor Peter Cooke) to expand central bank powers, step by step, so that any Euromarket disruption can be held up as an excuse to put international credit transactions tightly under BIS regulatory control. Schmidt's recent forays against Poehl constitute an ongoing threat to the BIS that its grab for regulatory power could be thwarted by European leaders' political intervention.

In addition, Swiss warnings of a mark downturn may prove groundless. Reports that German companies will be getting over $8 billion in annual capital-equipment export orders from the Middle East following a Schmidt tour in Saudi Arabia mean the mark may hold its own despite BIS maneuvers.