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Dollar collapse is crisis endpoint

Professional investors are certain the dollar will be the hardest-hit victim of current chaos.

The election of François Mitterrand to the French presidency triggered—as expected—a precipitous downturn in the exchange rates of both the French franc and German mark this week. Mitterrand's enmity to the credit and trade needs of basic industry slates France for serious economic stagnation. From the day of his victory, a steady flow of capital has fled the country.

Rumors are widespread Mitterrand may devalue the franc to 6 to the dollar or even impose exchange controls. The defeated Giscard administration has beefed up customs monitoring to prevent a wholesale panic capital flight. On May 11, the Banque de France jacked its seven-day treasury bill rate up 2.5 points in a single day, and sold over 1 billion German marks to put a floor on the franc's collapse in the European Monetary System.

The current travails of the franc, however, obscure the underlying trend that is actually driving the increasingly chaotic market. By autumn, it is the U.S. dollar which is expected to take the full brunt of the global economic downturn which the Second International victory in France introduces.

The franc is merely the first in a series of dominoes poised on a playing board; at the end of the row is the U.S. dollar, and when it tips over, it is expected to fall to about DM 2.00.

"We don't think the program of the [Reagan] administration will work," Bankers Trust foreign exchange advisory service reports. "The honeymoon" between Reagan and the business community "will come to an end before long." At that point, European currencies will simply stop falling because the dollar will go under.

A leading British merchant bank reports that it began moving funds out of France three months ago in anticipation of the collapse of the franc. Now the firm is massively hedged into short-term U.S. paper, but has no intention of making any long-term investments in the United States, because by mid-year, it expects the dollar to be in the barrel.

A Swiss investment banker from one of Zürich's leading private firms concurs he is doing the same. All investment funds, he reports, have been put into Swiss and U.S. Treasury bills and gold. "Everything else will go bankrupt," he predicted.

The arrangement which currently ensures a dollar crisis is the fact that the world is operating in an "interest-rate-controlled" global foreign exchange market.

Ever since the U.S. Treasury announced mid-April that the United States would no longer intervene in behalf of "orderly" exchange rates, interest-rate manipulation has become the single and only monetary mecanism affecting placement of international capital flows.

Following the Treasury implementation of this policy of "benign neglect" of currencies, both Germany and France were forced to hike interest rates another ratchet to halt capital outflows. Had they not done that, their governments would have been forced to cast billions of dollars worth of central bank reserves against speculators, with no prospect of actually stemming the tide of speculation.

Presently, in the U.S. and Germany, "real" interest rates—that is interest earnings above the rate of inflation—are at record highs. Manufacturers Hanover economists point out that with a prime rate of 19.5 percent, interest on these loans is 10 percent over the most recent change in the personal consumption expenditures deflator, which is at 9 percent.

During the 1970-80 decade, this differential was on average only 2.11 points.

This differential is even larger now in Germany. For the real economies in the industrialized nations, this interest-rate penalty induces an extraordinary toll on production, orders, and investment. *Fortune* magazine reports that U.S. companies have slashed their second-quarter spending plans to zero in response to the credit crunch.

The outstanding question that remains is: if the dollar starts falling, after Europe's currencies are hit, then where will international capital seek a haven?

Our Swiss and British investment sources see gold, the Asian stock markets, raw materials, and buildup of positions in "newly industrializing countries" in the developing sector as the safehouse of the future.

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