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Dirty politics fuel the currency crisis

by David Goldman

The European currency crisis which broke July 29, presumably triggered by a sharp rise in interest rates on the New York market, is in fact propelled by strategic considerations. There are two levels of cover story at work.

The first is that European investors are simply responding to higher dollar interest rates. That is not true: as the London *Financial Times* broadcast Aug. 1, Europeans think the dollar is overvalued and are awaiting the chance to pull out some of the several score billions moved into dollar securities during the past two years. The second is that flight capital is fleeing West Germany for fear of the Green movement's peace demonstrations and the "erosion of Germany as the bastion of Europe."

Gerassimos Arsenis, social democratic finance minister and central bank governor of Greece, gave a better indication of the nasty side of these developments Aug. 2, de-linking the Greek drachma from the dollar in a flourish of anti-American rhetoric. In a recent conversation, Arsenis predicted the disintegration of the world into currency blocs, with a Soviet-oriented Western European bloc, including a major combined West German and East German role in the Mediterranean, which Arsenis is trying to negotiate. Ibero-America might splinter off, or become part of a U.S. zone, while Japan would take the Pacific, Arsenis concluded. His action of Aug. 2 is doubtless consistent with this strategic view.

Another Mediterranean development, the appointment of Venetian banking figure Bruno Vizentini as Socialist Bettino Craxi's finance minister, is ominous in this context. Vizentini, long the public proponent of a "government of technocrats" to replace political parties, comes from the open sewer of illicit financial relations that extend, through old Austro-Hungarian and Ottoman imperial channels, to the Soviet Union. His collaborators in the now-successful venture of placing Craxi, the aspiring Mussolini, in Italy's top political office are the northern Italian industrialists who signed an agreement last month to build three giant industrial complexes in the Soviet Union.

The collapse of the German mark in the past six weeks (from DM 2.45 to the dollar to DM 2.67 Aug. 4) represents less a flight out of European currencies than the beginnings of a European monetary reorganization around a central European bloc. In the process, the dollar stands to suffer the worst of any major currency once this business is over—perhaps by the turn of the year.

Political rupture between the United States and Europe is expected to be the result of the failure of the much-publicized "joint intervention" in the foreign exchange markets by Western central banks. To the extent that this intervention has been represented as a symbol of the alliance's strength, its inevitable lack of success will make matters that much worse.

The *New York Times* reported Aug. 4, " 'With the strategic arms talks going on and with the deployment of the cruise missiles in Europe coming up in the fall,' said a former State Department official with close ties to the administration [read Henry Kissinger—D.G.], 'it's very important to nurture the sense of unity in the Alliance. We have to be seen as being "on the team".' The official added, 'I suspect that the President got a call' from Chancellor Helmut Kohl in Bonn."

This and similar American press comments disguise the fact, now a matter of scandal in the European news media, that the European right wing is moving eastward faster than the German Greens, for example, would consider doing publicly. Exemplary is the late-July visit of Bavarian strongman Franz-Josef Strauss to East Germany, Poland, and Czechoslovakia, during which Strauss argued for a relationship between

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Germany and the Soviet Union like the one Germany now has with France; East Germany, he argued, will become like Austria.

This open move by Bavarian finance (i.e., Merck und Finck, the Bankhaus Thurn und Taxis, Allianz Versicherung [Insurance Alliance]) corresponds to major capital shifts by Strauss's financial sponsors. The chief of foreign exchange at a large European bank gave *EIR* his gloss on the subject, as follows:

"It's not economic. Capital is leaving Germany because of the Euromissiles and will leave even more so as we get closer to their deployment date. Things are undergoing a fundamental change in Germany. Germany is going through the same changes that the U.S. underwent during the Vietnam war. There are going to be huge anti-Euromissile demonstrations, and the government has passed laws to allow them to hold people in jail who have been in the demonstrations. Rich Germans are moving a portion of their money out because they realize the proximity of Germany and Europe to the Soviet's border and they see the advent of the Euromissiles. As troubles flare up, as the installation of the Euromissiles approaches, there will be an even greater flow of money out of Germany. There's not a snowflake's chance in hell that currency market intervention by the central banks will succeed. The mark will go to 2.80. Germany's role as the bastion of Europe is eroding."

The problem with this analysis is that the same people who are taking their money out are arranging matters nicely with the Russians, as well as funding the peace movement (see article, page 37).

And, much of the money leaving Germany is not necessarily moving into the dollar (although Euromarket deposit rates at just-worse-then-best-address banks are very attractive at 12.5 to 13 percent). Some of it is moving into Vizentini's Italy.

"This was *not* a disorderly market. This is politics, in the aftermath of the Williamsburg summit, to show there is some unity in the West," said the economist of one of the major Swiss commercial banks. "There are definitely reverse flows now occurring out of the dollar. The reason is simple. The market potential by now is much greater in Milan and Tokyo than it is in the United States. The Milan bourse is 37 percent of its all-time high. The Tokyo bourse is undervalued. But the Dow Jones is close to its record, and it's not going to go much higher. The Italian subterranean economy is the second strongest economy in Europe next to the British economy. It is much stronger than the German economy, which is very weak; the German economy is one of the weakest in Europe."

The Swiss banker added that disinvestments out of the dollar were also being encouraged by two additional things: 1) that there are tax advantages to liquidating in August; and 2) that were inflation to pick up in the United States, and the dollar to fall, then those who already had their dollar investments placed will lose with a "double hit."

Bank of England sources believe that the major European investment funds are waiting for dollar interest rates to peak before moving out in a big way, an event the London *Financial Times* warned about Aug. 1, and the Swiss daily *Neue Zürcher Zeitung* advertised Aug. 2. At the moment, dollar rates are, of course, doing no such thing. Paul Volcker's slow tightening has intersected growing liquidity pressures on the Euromarket. Much of the present upward movement in interest rates is the result of panic borrowing by Europeans who have dollar obligations coming due, and are seeking to lock in money at current interest rates before rates go higher.

We can expect another 150-200 basis point rise between now and the end of the quarter (if not more), following the 170 point rise in both long and short rates since mid-May. This is due to factors we cited last week:

- Latin American capital flows into the United States, a major depressant on U.S. interest rates, have dried to a trickle since the financial crisis makes it hard to bring money out.
- European portfolio managers have stopped shifting money into long-term dollar bonds and are shortening maturities of their existing dollar paper, anticipating higher rates.
- OPEC deposit attrition from the Euromarket continues.
- European borrowers are still heavy users of the interbank market to finance payments deficits.
- Treasury revenue and outlay data released July 25 show worsening deficit prospects, not the "improvement" due to "recovery" presented in some inaccurate media reports of an OMB mid-year review that, in fact, contained no new information whatever.

In short, the supply of funds to the market is dwindling, while the demand for funds—due to depression-level government deficits here and abroad—continues to increase.

A crescendo of European protests concerning higher American interest rates and the rising dollar will then intersect such voices as that of Henry Kissinger's friend Alan Greenspan in the United States, calling for drastic (defense) budget cuts in the United States. *The New York Times* drew the astonishing editorial conclusion that the Zürich gnomes should dictate American priorities:

"The governors of the United States and the banking gnomes of Zürich now send Washington the same message: You can't walk away from those looming budget deficits. . . .

"Those high interest rates, now edging higher, are also the primary force behind the recent spectacular surge in the dollar's value. The Zürich gnomes and other investors put their money where it earns the most, so they buy dollars and sell other currencies and further distort the world economy. Belatedly, the administration has jointed with other governments to resist this trend by selling dollars in international markets. But such intervention is a weak and transient remedy that doesn't get at fundamentals."

Fundamentals, to the *New York Times,* mean eliminating parts of the defense budget in the midst of a storm over U.S. defense policy in Europe, so that the *Mitteleuropäer* who have arranged the storm may make their own arrangements with Yuri Andropov.