Foreign Exchange by David Goldman

The dollar as a 'doomsday machine'

The latest rachet-decline of the American currency pops the "recovery" bubble.

What was, until the week of April 21, a recovery only in the securities market, is now no recovery at all. Following the West German central bank's refusal to man the money-pumps in tempo with the Federal Reserve, the dollar fell by roughly 12% against the German mark since April 11, the date of the International Monetary Fund conference in Washington at which the German attitude became clear.

The "doomsday machine" produces a vicious cycle of declining U.S. output due to a declining dollar, and a decling dollar, due to declining U.S. economic output. It was kicked on last week, and the Reagan administration has no means to turn it off.

The 7% decline in 30-year U.S. government bonds during the week of April 21 may well have reflected traders' panic that foreign investors might pull funds out, more than an actual withdrawal of funds. Nonetheless, the 18-month-long bond market rally, fueled by $50 billion a year in foreign purchases of U.S. government securities, has disintegrated. The point registered forcefully on the New York Stock Exchange on April 29 and April 30, when the stock market index fell by 57 points. That decline is small (3%) compared to the slaughter on the bond market, but it included a 42-point decline of the Dow-Jones industrial average, its single worst day in absolute terms.

There may well be a period of deceptive calm in the foreign-exchange markets until after the Tokyo summit, where world leaders will agree to disagree about America's so-called locomotive theory. America generated a "world recovery," according to U.S. officials, by ruining its own economy, subjecting the rest of the world to usurious interest rates, forcing up the value of the dollar, and importing roughly one-sixth of its entire physical consumption bill.

Other nations had the privilege of subsidizing America's economic decline, in the official U.S. view. Now, "other nations should stimulate their economies in a non-inflationary way to promote worldwide economic recovery and bring trade among nations into better balance," Commerce Secretary Malcolm Baldrige said April 30.

The Japanese and West Germans will tell President Reagan, as politely as possible, that he is off his rocker. Don't blink after the summit, or you will miss the dollar as it falls.

Wall Street bond traders have reportedly programmed their office computers to continuously display the dollar-yen rate, in belated recognition that the financing of America's payments balance determines what will happen in domestic markets.

We read in Dr. Henry Kaufman's "Comments on Credit" of April 25: "A sharp plunge in the value of the U.S. dollar sparked a huge bond market selloff this week. The events that produced this decline cast doubt on the continued viability of the rally; it is not clear, however, that the rally is finished. That view would have to be confirmed by an improving outlook for economic growth. . . ."

Dr. Kaufman suggests that bonds will crash unless the economy does so faster, eliminating demand for credit, and permitting interest rates to sink even further. He does not appear to ask himself what America's creditors will think of the collapse of the economic recovery; almost certainly, they will decide that the dollar is a bad risk, liquidate investments in the bond market, and propel securities values downward and interest rates upward, despite the decline of the economy.

Making matters worse was the Commerce Department's report April 30 that the U.S. merchandise trade deficit is running at an annualized $174 billion rate as of March. Despite lower oil prices, which lower the cost of U.S. imports, American imports grew to a record, including a record $23.5 billion in manufactured products. In all probability, the huge number reflects a slightly lower volume of physical goods imports, particularly from Japan and other nations whose currencies have appreciated so strongly against the dollar. But the dollar's 30% decline since last September drastically increases the prices of goods we import.

Exactly the opposite of what the administration predicted from the dollar's decline has happened. Rather than stimulate domestic output, the rising cost of imports is suppressing domestic output. General Motors, for example, announced April 30 an 8% cutback in third-quarter production plans, precisely at the point at which higher import prices supposedly should permit GM to sell more cars. The secret is that higher import costs hit first at the industrial component level, forcing up manufacturing costs in areas such as auto and electronics, in which much of manufacturing has been degraded to a domestic assembly operation.