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Foreign Exchange by David Goldman

Washington's crisis and the dollar

The rate of unraveling in the United States will make the dollar the principal victim for the immediate future.

While the dollar's fall Nov. 26 to less than DM 1.99 was widely attributed to the worst-on-record durable goods orders in October, there is no reason to attribute the erosion of the U.S. currency's October gains to any particular economic news.

The Oct. 31 "economic cooperation agreement" announced by U.S. Treasury Secretary Baker and Japanese Finance Minister Miyazawa had no discernible economic content. It reflected a political decision by Japan's government to give the White House a reported 12 months to stabilize its economic position.

Extreme skepticism on the part of the Japanese, who were muscled into the deal against their better judgment, was matched by contempt on the part of the West German monetary authorities, who seem more occupied with cobbling together an anti-dollar bloc in Europe, than in supporting the failing U.S. currency.

As late as Nov. 25, the West German Bundesbank denounced as "mere speculation" reports circulating in Japanese newspapers, to the effect that the Germans would join a global deal with the United States after the elections. The content of the deal would be that the foreign trading partners of the United States would continue to buy dollars on the open market when no one else wanted them, printing their own currency to do so, and invest the purchased dollars in U.S. Treasury securities, financing both the U.S. current-account external deficit, and the Treasury's mammoth internal deficit.

When Assistant Treasury Secretary David C. Mulford, the White Weld veteran who runs the international show at Treasury, warned Nov. 12 of an "unsustainable economic scenario," in which American deficits cannot be financed forever, he referred to the inability of the Japanese and West Germans to bail the United States out forever.

The West Germans are being asked to print money to bail out the dollar; the cosmetic version of this argument is to demand that they print money to stimulate their home economy. U.S. officials regularly embarrass themselves when discussing the topic; Mulford, in the Nov. 12 speech, said, "There seems to be a continuing misunderstanding about the nature of U.S. expectations for Germany. We have not been asking Germany to stimulate growth through pump-priming and increased government expenditures. Rather, we have urged structural reforms, including tax, labor, and financial reforms, as well as reduced subsidies, that will provide longer term incentives for growth."

In short, the United States is applying political pressure against friendly governments, demanding that they eliminate social programs, in particular, on which those governments' political stability is founded.

While the American recommendations are hypocritical nonsense, the problem is that the West German economy is, in fact, falling. In a report to the Bonn government Nov. 25, regarded as a "surprise," the "five economic wise men," heads of the major economic institutes, estimated fourth-quarter economic performance much lower than in previous forecasts. The sharp appreciation of the deutschemark because of dollar policy is cited as a major factor affecting export orders. The Munich IFO Institute reports their projection "shows an actual stagnation in total demand of combined domestic and exports for industry since the middle of 1985."

Japan and, to a smaller extent, West Germany, have enjoyed a relative stability in a world trading environment, in which the only growth since 1980 has come from the U.S. trade deficit. The 40% appreciation of the mark and yen over the past 18 months has hurt both countries badly. The U.S. administration's continuing threat to force the dollar downward, if its trading partners do not accept its demands, represents a devastating political weapon against West Germany in particular. The Kohl government is facing elections early next year in which the economic decline will be a principal issue.

However, the net effect of Treasury Department policy is to strengthen the hand of the monetary decouplers at the Bundesbank, who look toward a European monetary zone opposed to the United States; they are joined in this by former Chancellor Helmut Schmidt, who is pressing monetary decoupling in the context of a projected "Grand Coalition" to follow next year's elections.

Whatever these machinations imply, the currency markets are reflecting the chaos in the American economy and in Washington. Under present world circumstances, no economy is secure, and no currency represents a haven. However, the rate of unraveling in the United States will make the dollar the principal victim for the immediate future.

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