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IPS Weekly Financial Newsletter

International Market News

Europe, Third World, NY Banks Betting Against the Dollar

Oct. 17 (IPS) -- The less than 1 per cent appreciation of continental currencies against the dollar and the $3.50 per ounce increase in the price of gold this week hide the real significance of the general lack of confidence in the dollar that became apparent later in the week.

While European, Arab, and Japanese capital flowed into the high interest dollar sector in billions, the forward market in currencies reflected exactly the reverse. Knowledgable forex traders indicated that non-U.S. investors who were depositing their money in short-term dollar instruments were at the same time buying continental currencies in huge amounts more than sufficient to compensate for the expected depreciation of the dollar.

The lure of short-term dollar instruments in obvious. While 30-day deposits earned 5 and 7/8 per cent in New York, and even more in the Eurodollar market, they earned only 1.25 per cent in Switzerland. At the beginning of the week, the three-month forward cover for the Swiss Franc against the dollar was at a premium of 4.1 per cent, while that on Deutsch Marks was 3.9 per cent.

Although on Thursday, major New York banks were still accumulating cash funds to meet their immediate obligations and cover for loan defaults, they were also contracting for millions of dollars worth of forward Deutsch Marks and Swiss Francs. In other words, the banks are betting that the forward premiums on continentals will not cover the actual expected depreciation of the dollar internationally subsequent to either a direct U.S. government bailout of New York City or the more likely bailout of the banks through the Federal Reserve's discount window in the eventof a default by the city on its obligations. This accumulation of funds in dollars, accompanied by substantial interventions by European central banks on behalf of the dollar, was theonly reason the dollar has stayed as relatively stable on the surface as it has.

The Dollar's Balancing Act

The precariousness of the dollar became much more evident today when the threatened default by New York City virtually closed international foreign exchanges worldwide. The three-month forward premium on the Deutsch Mark jumped to 4 per cent, and traders increased the spreads between their bid and asked prices by as much as 100 per cent to deter both sales of continentals and purchases of dollars. This latter action on the part of forex traders, unprecedented in foreign exchange trading history, all but brought trading to a standstill. With no foreign exchange changing hands, international trade financing also came to a grinding halt.

The dramatic drop in short-term Eurodollar rates, resulting in a 1 per cent drop over the last two weeks (.7 per cent over last week alone) on 6-month interbank money, was suddenly reversed today. The six-month Eurodollar CD rate, which had fallen to 7 per cent by this morning, shot up by 3/8 of a percentage point in the aftermath of a desperate hunt for funds by the European subsidiaries of U.S. banks who were awaiting news about New York City. The interest rates had initially started their fall due to premature judgment on the part of these banks that they were sufficiently liquid to face the default. European banking sources who thought differently report that interbank lending activity on the Eurocollar market came to a virtual halt. An identical development occurred at the time of the Herstatt bankruptcy last year.

Why Gold Isn't Rising

The only reason the price of gold has not gone higher is because of the existing possibility for investors to make tidy profits in short-term dollar instruments. Meanwhile, the Soviet Union and the Comecon bloc, who have taken out $1.6 billion in Eurocurrency loans in the first half of this year and are expected to take out even more in the second half for purchases of Western grain and technology, have been avoiding sales of Soviet gold so as not to disrupt the market price of gold.

Reportedly, the IMF board of directors have been holding serious discussions about the remonetization of gold this week. Nobody has taken the proposal to demonetize gold and issue highly inflationary gold-backed SDRs made by Jacques De Groot, the IMF director for Belgium, very seriously at all. Rep. Henry Reuss' (D-Wisc.) proposed congressional bill aimed at annulling the European-Mexican gold-for-development plan which was agreed to by the IMF members in Washington last month, will do little to stop the pro-gold motion in Europe. Europe is moving towards the remonetization of gold and fixed parities with the Soviet transfer ruble - irrespective of what the U.S. does or doesn't do.

Europe Bolts U.S.

The Europeans openly sided with the Algeria-led Third World bloc at this week's producers-consumers meeting in Paris. The uppermost thing in the minds of Europeans and Third World nations is a restructured international monetary system centered around the Soviet transfer ruble and a new International Central bank.

West German Chancellor Helmut Schmidt and Bundesbank Vice President Ottmar Emminger have both blasted the unstable dollar in major speeches this week. Newspapers allied with the Eugenio Cefis-led Italian pro-development and East-West trade faction have demanded new monetary and economic orders free of the bankrupt dollar. The Cefis-allied daily Il Globo today covers French proposals made by Jacques Reuff, monetary spokesman for the French Gaullists, for a gold standard favorably, and advocates going beyond it so that real production, development and trade can be carried on. The current issue of the West German Social Democratic Party monthly, Neue Gesellschaft carries a major article on the transfer ruble by former Finance Minister Alex Moeller, which all but advocates a new monetary system centered around the transfer ruble.