

## Soviet Initiatives Undermine An Already Shaky Dollar

### FOREIGN EXCHANGE

Dec. 16 — The offer of Comecon's central bank, the International Bank for Economic Cooperation (IBEC), to open up the Soviet transfer-ruble for international use as a world reserve currency threatens to critically undermine the U.S. dollar, at the point when it is most vulnerable. Until this week, the factors contributing to dollar weakness have been two: 1) The steady decline in dollar sector interest rates; reflecting both the deterioration of the domestic economy, and Federal Reserve Chairman Arthur Burns' decision to facilitate the free flow of U.S. bank funds into the Eurodollar markets to refinance Third World and European debt; and 2) The OPEC countries' efforts to "diversify" their investments, including a shift out of short-term Eurodollar deposits into gold and European equities.

The Arab League's decision this week to go ahead with the long-awaited Arab monetary union, when viewed *in conjunction* with the IBEC initiative, indicates that a much more fundamental dollar crisis is at hand.

A highly placed source at a leading London bank known for its Mideast connections, indicated the forthcoming Arab monetary union will center around a gold-backed pan-Arab currency, providing a potential direct link-up with the gold-backed transferable ruble: "Call it an Arab dinar or a pan-Arab Riyal; this kind of monetary union is going to take place in 1977. Starting from the Gulf, led by the Kuwaitis, the monetary unit will be backed in gold or Kuwaiti dinars...The Arabs are very worried about Carter and that's why they are going for other options. They don't want to be caught with their trousers down."

Should the Arabs proceed to demand payment for their oil only in such a gold-backed Arab currency, Western Europe and Japan would be *compelled* to join a gold-based clearing system along with Comecon and the oil producers. Under these circumstances, the U.S. would either be shut out of world markets, or would be forced to agree to a substantial dollar devaluation as a necessary condition for joining the new monetary arrangement.

The above assessment has been confirmed by a number of well-informed sources:

\* The New York Federal Reserve Bank held an emergency meeting of its staff this week to map out contingency plans in the event of OPEC withdrawal of funds from U.S. banks.

\* A spokesman for a leading Swiss bank revealed that it is premising its own investment portfolio on the accelerating Arab shift into European equities and gold and expectations of a European gold clearing-system.

\* According to Midlands Bank, a major City of London

institution, trade which can no longer be financed in sterling, due to the excessive sterling sector interest rates, will in the future be financed either in deutschmarks or transfer rubles.

\* Another British bank, Schroeder Trust, expects a major run on the dollar in the next "two or three years," forcing Europe to revert to its own currency arrangements.

\* The Soviet journal *Economic Gazette* asks "rhetorically" this week what would happen if the \$130 billion in short-term U.S. liabilities held by foreigners were presented for payment all at once!

The true import of Arab "diversification" is just beginning now to affect the markets. The dollar fell to a record low for the year against the deutschmark today following reports of an OPEC price increase. In 1973-74, the oil price hike *benefited* the dollar, but now everyone realizes that OPEC will not invest its new oil earnings in dollar assets any longer.

#### *West German, Japanese Resist Reflation*

The Bundesbank announced today that it is reducing the annual rate of West German money supply expansion from about 10 per cent at present, to 6 to 7 per cent in 1977, while West German Chancellor Schmidt's standby public spending program allows for only minimal growth. West German short-term interest rates have already surpassed U.S. rates for the first time this year; any further tightening by the Bundesbank will speed the withdrawal of funds from the dollar sector in search of higher investment returns in West Germany and elsewhere.

Last weekend, Morgan Guaranty was forced to lead the drop of the U.S. prime rate to 6 per cent, from 6.5 per cent only two weeks ago, because its loan customers, the large U.S. multinationals, can obtain easier credit terms on the Eurodollar markets than in the U.S. The multinationals have been soaking up tens of billions of Eurodollars and reinvesting them in the Third World, taking advantage of the latest wave of currency devaluations (for example in Mexico and Australia) to buy up foreign assets cheaply, while assisting the banks in the refinancing of some Third World debt. However, "safe" outlets for multinational investments of this character are strictly limited, and their demand for Eurodollar loans will shortly dry up. The shrinkage of U.S. banks' profit margins due to the drying up of domestic loan business and the collapse of the prime rate could force Arthur Burns to lower the "Fed funds" rate still further, putting even more pressure on the dollar.

Although the position of the Japanese yen relative to the dollar is not as strong as the deutschmark, due to the more rapid decline of Japanese exports, the yen was

bolstered this week by a sudden inflow of \$40 million in Arab funds, indicating that the Japanese also are involved in negotiations with the Arabs.

#### *Italy Torpedoes U.S. Bail-Out Schemes*

The U.S. Treasury Department's efforts to persuade the West Germans and Japanese to print up more money for international bail-out loans have been met with stony silence. *Journal of Commerce* columnist Alena Welles leaked today that the U.S. will push for a "super-tranche" system for countries like Italy, and a reinvoking of the General Agreement to Borrow (GAB) for Britain, at the Group of 10 meeting in Washington next week.

Italy has chosen this moment to announce that the \$500 million loan it had previously requested from the

European Economic Community is "no longer urgent". Italy's move effectively torpedoes the austerity-based "super-tranche" scheme, allowing the West Germans et al. to argue that Italy "no longer needs the money."

In reality, Italy's new found "confidence" in its financial strength is based entirely on the sheer magnitude of its projected trade deals with the Soviets — including the Italian proposal for an "international rediscount bank" to finance East-West trade, dovetailing neatly with IBEC's plans for the transfer ruble.

Italy's campaign for a new world economic order will have to be realized quickly; U.S. Treasury officials are predicting a run on the Italian lira beginning in mid-February, when the 7 per cent foreign exchange tax expires. Italian importers have been circumventing the tax by arranging four-month suppliers' credits, which will come up for payment in February.

## Gold Strength Based on Use for New Monetary System

### GOLD

The strength of gold today does not stem from what most gold newsletters describe as "industrial demand" for the metal. Rather — as events over this week have confirmed — this so-called industrial demand or purchases of the metal by speculators in anticipation of a continued rise in the market price, is coming mainly from the correct perception that the metal is bound to become a major monetary asset in the immediate future.

The Moscow Narodny Bank's press bulletin issued Dec. 8 proposed the much-awaited expanded utilization of the gold-backed Transfer Ruble by non-IBEC (COMECON's International Bank for Economic Cooperation) members for international settlement of commercial and non-commercial accounts. Authoritative City of London sources report that the Pan-Arab gold-backed currency under discussion for two years is to be launched early next year.

These steps by the Arabs and the Soviets will accelerate the ongoing conversion of dollar reserve assets into gold by Western European and Japanese central banks. This will have to be followed shortly by the pegging of the currencies of these nations to gold. The reason for this is straightforward. Under the present conditions of collapse of Western European and Japanese trade — at an approximate 15 per cent annual rate — and wild currency fluctuations, the only out for these trade-dependent economies is the emerging

pattern of heavily-weighted trade in the direction of the petrodollar rich oil-producing nations and the vast trade markets for high technology goods in the Soviet sector. Both Western Europe and Japan will have to agree to the stated preference of the oil producing and Soviet sector nations for a gold-backed monetary regime in order to seize these new opportunities.

The Soviets have backed up their transfer ruble proposal with a major attack on the International Monetary Fund-U.S. Treasury operation to demonetize gold in the latest issue of the *Economic Gazette*. The Gazette bluntly points out that the U.S. statements on the demonetization of gold are absurd when the rest of the capitalist world fully understands that gold must continue to function as a reserve asset in the interest of stable world trade.

The Gulf states' unity on currency does not bode well for the dollar based financial system; this unit will clearly be backed by gold. This monetary union will mean that their oil will be paid for in either the gold-backed Arab monetary unit or other gold-backed currencies having a stable relationship with that unit. The Arabs see a gold-backed monetary arrangement as the best guarantor for stable prices for their oil as well as their imports of technology from the industrialized nations.

Otherwise, the market price of gold is holding well as today's London closing price, \$134.40 per ounce shows. However, the market has yet to realize the implications of the Soviet-Arab moves towards a gold-backed monetary system.