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portfolios, according to New York dealers who expect the banks to take losses on future sales.

The Eurobond market was swamped in January and new issues tended to do poorly, a situation which continued this week in all sectors. January volume was $1.5 billion, with yields up owing to the rising trend in U.S. interest rates; competition has intensified among underwriters and national sectors, as a greater proportion of business is taken by continental banks (authorized to both underwrite and make retail sales) from U.S. and British merchant and investment banks. The Union Bank of Switzerland handling of a Mobil private placement, instead of Mobil's usual dealer Morgan Stanley, and the Deutsche Bank handling of an Imperial Chemicals issue instead of S. G. Warburg, are cited by Business Week as exemplary. At the borrowing end, Luxembourg dealers fear that U.S. corporations may start squeezing out European issues while the U.S. and British financial press deplores the quality of names coming to the market, and tends to bad-mouth French dollar-denominated Eurobond issues which have, thus far, sold relatively well. Forecasters expect upward pressures on interest rates to discourage short-term 1977 Eurobond investment and help the market's long-term end; the former could, however, occur without the latter, drying up a comparatively cheap source of state and corporate financing.

Both Eurobond issues denominated marks and the domestic West German bond market are in a state of depressed uneasiness. In the Euromarket, a Bergen, Norway bond issued below par is doing poorly; $400 million in new issues scheduled for this month on behalf of mostly Scandinavian borrowers are expected to sit heavily, along with a low-interest private placement for the Austrian government.

The decisive elements for the West German bond market are a healthy margin of foreign buying and a lack of competition between public and private borrowers. The first is now lacking, as the dollar gains vis-a-vis the mark, and the second may be imperiled.

In 1976 the domestic bond market saw a generally smooth turnover of public debt at lower interest rates and longer maturities with few private issues, and a had a short, hectic boom during the turn-of-the-year dollar sag, with dealers clamoring for more government debt to sell. Now, the state rail issue is selling at a .75 per cent discount, and the bank purchasers are apparently holding off from the market, despite their relatively high liquidity. Both the Munich Bond Advisory Service and the Deutsche Bank foresee a squeeze coming if private borrowers, absent up to now because of low investment activity and or alternate financing sources, return to the market at the same time as the public sector's financing mounts: "In the near future there is going to be an avalanche-like increase of bonds maturing and in need of fresh financing," warns the Deutsche Bank. Since 1972, German corporations have stopped trying to borrow in this bond market, but a large retail company ventured in this December with a ten-year 7.5 per cent coupon offering.

In the French bond market, January issues were almost wholly from the public sector, and sold on average a quarter per cent below par. The secondary market, however, showed an upward trend last month for both private and public obligations. British government securities, or "gilts," continue to enjoy international demand sufficient to permit further lowering of the minimum lending rate and expansion of banking reserves.

Markets Await European Action On New Monetary System

FOREIGN EXCHANGE

Behind the relative quiescence of international foreign markets this week — and the seeming stability of the U.S. dollar — is a raging policy debate at the highest levels of European government and industry concerning the future of the present dollar-based world monetary system. The outcome of this policy debate — rather than any simple linear projection of present trade and interest rate trends — will be the primary determinant of foreign exchange market swings over the next three-month period.

The West German business daily *Handelsblatt* this week provided the first major European press coverage of an article published in the Soviet journal *International Affairs* in January proposing to replace the crisis-ridden Bretton Woods structure and its "floating rates" sequel with a system based on the Comecon's transfer-ruble. Signalling intense European interest in the Soviet offer, *Handelsblatt* reported that the Soviet's willingness to use the transfer-ruble to finance "continent-wide projects" could result in "billions of deustchemarks in new orders" for export starved West German industry.

Saudi demands for fundamental reform of the monetary system, including a "freeze" on Third World debt payments, was a major agenda item at the EEC Foreign Ministers meeting in London this week, according to a New York oil specialist. The Saudis realize that much of their present Eurodollar market deposits would be wiped out in a Third World debt moratorium, the source said, but they "do not expect to get this money back" anyway and are more concerned about establishing sound alternative monetary arrangements. U.S. government pressure forced the EEC ministers to put off action on this question for the moment. Further delays , however, could wreck the fledgling export-led European recovery and with it European currency stability.

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To Reflate or Not to Reflate

Although Vice President Mondale's efforts to persuade the West German government to reflate their economy proved to be a stunning failure, the limitations of the West Germans "Maginot Line" anti-inflation position became clear at the international bankers' forum in London this week. While British Treasury Secretary Healey and Bank of England head Richardson echoed U.S. demands for a more stimulative West German policy, Bundesbank chief Emminger complained of inflation and argued incredibly that bad credit risks were limited only to a few "isolated cases." Similarly, West German Finance Minister Apel attacked reflation but rejected recent French-Italian initiatives for European monetary union and a return to fixed exchange rates.

Ironically, the most fervent proponents of reflation — the New York commercial banks — are themselves the worst "isolated cases." Morgan Guaranty Trust Company, in its monthly World Financial Markets newsletter, admitted publically that U.S. private banks can no longer handle the financing of immense Third World and European payments deficits and called for large-scale U.S., West German, and Japanese contributions to the International Monetary Fund to bail the banks out of this predicament.

West German Economy Hits Skids

Although West German monetary authorities may be correct in rejecting such flagrantly inflationary underwriting of New York's bad investments, the decline of their export markets in Western Europe and the non-oil producing Third World countries — *in the absence of any alternative credit system* — is bound to result. West German industrialists foreign orders fell 1.5 per cent in November-December, with overall orders showing only a 2 per cent rise. This was immediately reflected in a 10.6 per cent plunge in the preliminary (unadjusted) industrial production index in December and a jump in January unemployment from 1.09 to 1.25 million workers. Consumer prices also took a leap forward in January, rising 1 per cent in a month, the worst showing in a year.

This week's outcry from the West German financial press and several economic institutes, pinpointing the recent metalworkers' wage pact as a precedent-setting "threat" to the economy and business capital investment plans, misses the real issue. The decline in real incomes during 1976 has already eaten heavily into the country's retail sales, and holding back wage increases will not improve the situation.

The real potential for West German economic renaissance, as everyone admits, lies in capital goods exports. While the government has greatly expanded the export guarantee program and encouraged private company oil-for-technology barter deals, only a limited volume of trade can be financed through such mechanisms — precisely why the use of the Comecon transfer ruble is being actively considered by the West German industrialists at this time!

U.S. Energy Shortage Threatens Dollar

The West German economy's turn for the worse, among other factors, has given the U.S. dollar a continued reprieve this week despite even worse economic news emanating from the U.S. itself. When word of how bad weather and natural gas "shortages" were damaging U.S. economic prospects — to the point of wiping out entirely the stimulative effects of Jimmy Carter's budget — reached Europe on Monday, Jan. 31, European banks unloaded their dollar holdings onto the markets driving the dollar down nearly 1 per cent against the deutschemark. Central bank interventions and "technical corrections" later wiped out most of the deutschemark's gain. However, traders report that the U.S. energy crisis could force the Federal Reserve to ease up further on money to prop the U.S. economy, leading to a surge in inflation, and a resultant flow out of the dollar.

Another short-term plus for the dollar has been the flow of speculative capital out of the deutschemark back into the British pound, following last month's sterling balances agreement, and the Bank of England's large-scale acquisition of dollars to rebuild its reserves. British central bank reserves jumped a record $3.06 billion during January to a total of $7.19 billion.