'Support' for the dollar . . . from a Swiss gibbet

by David Goldman in Frankfurt

Top-level European banking sources warn that a European banking crisis in the wake of Brazilian and other Ibero-American debt defaults would be disastrous for the Atlantic Alliance.

European central banks are "making strenuous efforts and strong exhortations to persuade commercial banks not to get scared and reduce their credit lines to one another," said the chief of one European central bank. "It is no longer just a matter of pulling money out of Brazil, but of pulling money out of banks that are heavily exposed in Brazil."

Italy, Sweden, Belgium, and other European countries borrowed close to $100 billion through their banking systems—on top of $300 billion borrowed by their governments—to finance deficits which grew out of control after the quadrupling of oil prices in 1979. According to data just released by the Bank for International Settlements, they borrowed $7 billion during the first half of this year alone.

The $100 billion time bomb in the European banking system consists mainly of borrowings from American banks—the same big banks that are in trouble over loans to Brazil and other Ibero-American countries which have paid no interest on their debts for months. The Bundesbank is pushing the German banks to stay in the $6.5 billion lending package which supposedly will bail out Brazil; it is terrified of the consequences of Brazilian default for the European banking system, and not without justification.

What the European central banks fear is a chain-reaction crisis bigger than September 1931: If Brazil, Argentina, and other Ibero-American debtors go under, the American banks will be in trouble, possibly losing deposits of terrified investors. Under pressure, the American banks would then cut off credit lines to European banks, and hell would break loose. "I wouldn't be surprised to see a weak European bank forced into trouble" by a cutoff of American funds, a Federal Reserve official commented Nov. 2 in Washington, D.C.

"We are talking about the possibility of another Kreditanstalt," he said, referring to the 1931 Austrian bank disaster which brought down the German banking system, and led to the installation of Hjalmar Schacht at the helm of the German central bank, and then to Hitler at the Chancellory.

Transatlantic warfare

Swiss National Bank officials have been predicting for weeks with satisfaction that a financial crisis would lead to a "European autarchy" opposed to the United States—in fact, under the thumb of the Soviet Union.

In a discussion Nov. 2, one of the best-known figures in European central banking warned that European countermeasures might well bankrupt the U.S. Treasury, were American banks to cut off their European borrowers in the midst of a Third World default crisis.

"The most important point is that, as a whole, Europe is not overindebted. On a net basis it is the United States which is overindebted. The United States is becoming more and more indebted to Japan and Europe. Some of this comes in the form of portfolio investment, and some of this is capital flight from other countries. Just in the first eight months of this year there has been a capital outflow from West Germany of DM 14 billion. It is a safe bet that most of this has been invested into dollar assets.

"The United States has a current account deficit of $35 billion. There are no oil country deposits to finance this any more, because the OPEC countries themselves are running a deficit of $25 billion, so they are liquidating assets, and this means downward pressure on the dollar," the banker concluded.

The United States, in fact, owes $150 billion to European central banks, whose monetary reserves are held in the form of U.S. government securities. Were the Europeans forced to bail out banks short of dollars in a crisis, they would dump these securities on the market, collapsing not only the dollar, but also the market for U.S. Treasury securities, provoking the worst financial crisis the United States had ever seen.

In a sense, this bitter old European financier is right: Under the present world financial crisis, everyone is bankrupt. The United States has drained $100 billion in flight capital out of Ibero-America during the past three years, financing, in part, the gigantic American federal government borrowing requirement at the expense of countries which can least afford it. Much of this money has been recycled to the weaker European countries, which can afford neither $32 per barrel oil nor double-digit dollar interest rates. Money borrowed by European governments as well as European banks has, in turn, flowed back into the United States, sucked back by Volcker's impossibly high interest rates.

The present mess is not much different from 1931, when Germany borrowed vast amounts of short-term capital from London, which borrowed it in turn from the United States. The Germans used the short-term money to pay interest on the $11 billion in war debts imposed by the onerous Versailles Treaty. When the American stock market collapsed in 1929, the entire mass of debt paper among New York, London, and central Europe came crashing down, and world trade dropped by two-thirds.

All the flight capital and refinancing transactions now in jeopardy are conducted through the trillion-dollar "Eurodollar interbank market," where money is lent for hours or days. If one bank defaults, other banks which depended on its payments would default in sequence, wiping out hundreds of billions of dollars of banking assets.

The central banks are supposed to intervene on behalf of banks in trouble, to prevent such a chain-reaction crisis. But as the European central banker quoted earlier warned, the rescue operation might cause an entirely new, and possibly worse, financial crisis—one that could tear the Atlantic Alliance apart. It is not a matter of American or European gain or loss in such a situation: The bankruptcy of the global banking system creates the conditions in which an annihilating financial war could level most of the institutions of the Western economies.

Swiss 'double whammy'

The Swiss intend to first push the dollar through the ceiling—then trigger a general run against the dollar. The collapse of the dollar, scheduled for early 1984, will float a "Middle European" currency bloc dominated by the Swiss National Bank, and also cut Japan loose from the dollar-based credit system, which is the last thing that the Japanese want. The consequences for the U.S. Treasury, dependent as it is on foreign capital inflows for a significant portion of deficit financing, would be devastating; the consequences for the American economy, heavily dependent upon a wide range of imports for day-to-day production requirements, equally dreadful, as the cost of such imports dominated in dollars went through the roof.

In a public statement Nov. 1, the Swiss National Bank twisted the tail of the West German Bundesbank, making clear that Swiss-controlled financial flows determine exactly to what extent West Germany will tighten credit, and, by implication, force credit tightening on the rest of Western Europe.

The SNB announced that it would hold Swiss monetary expansion to a mere 3 percent per year, the rate of expansion over the past 12 months; it would have achieved a growth rate of money supply of only 2.5 percent, except for purchases of West German currency, which the Swiss had supported on the market. The Swiss would not continue such intervention in previous amounts, the announcement continued, since it was clearly not worth the trouble.

Since West German monetary policy is now dictated by the rate of capital exodus out of Germany, these announcements amount to an order to further squeeze credit inside West Germany. For most of 1983, West German money growth had been in double digits for the first time in decades, as the West German monetary authorities, in effect, replaced through the West German printing press the capital that had left Western Europe for the dollar. Following months in which the German mark collapsed, frustrating Germany's efforts to reflate the rest of Western Europe, the Bundesbank had announced a return to a tight monetary policy in early September. On this basis, the mark improved for a few weeks, only to begin falling again in late October.

With 2.5 million German unemployed, no one but a handful of maniacs wants a general credit crunch in Germany; however, to the extent that the Bundesbank cannot prevent money from leaving, it has no choice but to push interest rates up further.

The Swiss commercial banks, meanwhile, are mediating a great deal of the capital leaving Germany. Swiss bank officers report that they are putting 70 percent of new client funds into dollars, up from 50 percent a year ago, and that they expect a sharp rise in the dollar during the next few weeks to force budget cuts and monetary stringency throughout Europe.

Europe's crisis would bankrupt the dollar

The present strength of the dollar reflects decisions by Swiss and other European portfolio managers to put 70 percent of their new funds into the dollar, against perhaps 50 percent a year ago. What the Swiss money managers do is merely smoke with respect to the actual fire: The Swiss National Bank is playing both sides of a projected currency war between Western Europe and the United States. The object of the war is less financial than political: It reflects the breakaway objectives of the Swiss-based oligarchical group in Europe with respect to the United States.

The dollar has been placed in the deadly position of parasite with respect to other currencies, and faces devastating repercussions once the flight of capital from other countries forces a break in the global chain of payments. Reading between the lines of the just-published Bank for International Settlements report on the Eurodollar market during the second quarter, it is evident that flight capital into the dollar accounted for extraordinary inflows into Eurodollar deposits during the second quarter. Non-bank funds worth $7 billion flowed in, reflecting both legal and illegal flight capital, against a withdrawal of $8.1 billion from OPEC countries during the first quarter and by $7.1 billion during the second quarter. In other words, flight capital out of European and Latin American sources balanced the OPEC deposit withdrawals (we are talking here about the Eurodollar monetary base, on which the multiplier proceeds; the small sums therefore are highly relevant marginally important shifts).

As authoritative central banking sources explain it, the transfer of domestic funds into Eurodollar deposits provided the principal source of Eurodollar market liquidity through the first half of the year, and is apparently continuing. As noted above, the European central banks, the Bundesbank in particular, dealt with this situation first by printing money (and letting the European currencies collapse), and elsewhere by adopting really nasty austerity measures which have substantially reduced the European payments deficits, but shut down the European economies. Since international lending continued to slow to only half of what it had been in the second quarter of 1982, this liquidity transfer from Europe to the Eurodollar market merely replaced OPEC deposit withdrawals.

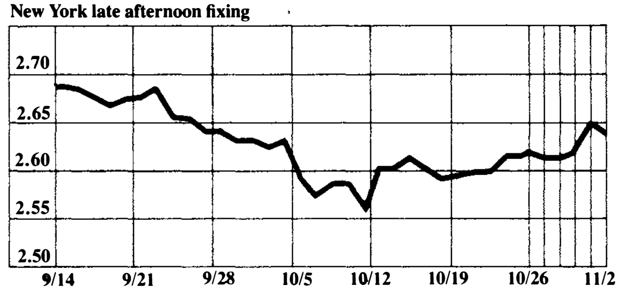
The outlook is that world trade will continue to decline, i.e., that European countries continue to cut their deficits (and eliminate their foreign borrowing requirements as well as domestic borrowing requirments) and that no net credit whatever will go to the Third World—further destroying the income-base for any further debt payments. That is, even if the present Brazilian refunding goes through, the next crisis will be all the more monstrous.

Thus the Swiss banks are betting that the balancing act will not work, that the combination of financial and political destabilization will make life impossible for the Europeans and push the dollar through the ceiling within the next several weeks. But this will produce a disaster for the dollar worse than the July 1931 collapse of the British pound. The United States will then have only two alternatives: Either introduce a dirigistic credit policy, including top-down reorganization of the Ibero-American debt, or let the Swiss inherit what remains of the financial system.

Currency Rates

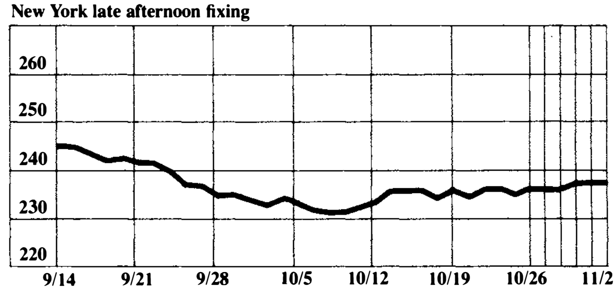
The dollar in deutschemarks

New York late afternoon fixing



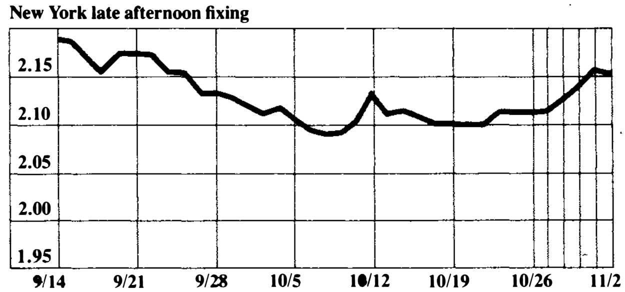
The dollar in yen

New York late afternoon fixing



The dollar in Swiss francs

New York late afternoon fixing



The British pound in dollars

New York late afternoon fixing