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What's ahead for the U.S. dollar?

by David Goldman

Top-level Washington sources are worried that the long-awaited turnaround in capital inflows to the United States may have already begun. The three-week drop in the stock market, the $382 London early gold fixing on Feb. 2, and the sudden weakness of the dollar suggest the possibility. Another spike upward is possible; the next few days will tell. *EIR* had expected a break in March rather than February, but at this point timing is a purely subjective matter. The single most important question may well be when the Soviets cover a $30 billion long position with respect to the dollar built up during November and December.

The stock market is usually well worth ignoring as an indicator of anything, but the nearly 80-point decline as of *EIR*'s Feb. 4 deadline since mid-January suggests trouble, particularly since foreign stock markets have continued to rise.

The dollar's weakness upon the release of the Reagan 1985 budget is remarkable. Normal logic would have dictated that higher budget deficits = higher interest rates = a strong dollar. That is especially true at a time when the Fed (as we have warned repeatedly) has recently made clear that it will give Reagan no breathing room to finance the budget deficit.

This logic has been fallacious from the beginning. On the contrary, since the United States has been dependent on capital inflows, high interest rates have been the risk premium the United States has had to pay for such inflows. A turnaround now will, as we have emphasized, mean both a collapsing dollar and rising interest rates, especially on the long side.

The dollar may continue strong for some weeks, however, perhaps very strong, in consideration of 1) continuing liquidity pressures on the interbank market (which create an apparent dollar shortage); 2) political instability and fear over West Germany; and 3) the Fed's continuing unyielding monetary stance as of the Feb. 2 Federal Reserve Open Market Committee meeting.

Implications of the federal budget

Investment analysts are painfully aware that the likelihood of a major rise in interest rates, given Fed chairman Paul Volcker's open determination to lean against public financing requirements, is greater than the President's budget message implied. The $180 billion budget deficit which the President announced for fiscal year 1985, itself based on fallacious revenue-growth assumptions, understates Federal borrowing requirements by one-third.

As *EIR* has reported since June 1983, the Reagan administration, i.e., Treasury Secretary Regan and Fed chairman Volcker, bought the appearance of recovery in the housing and other consumer-durables sectors through such off-budget financing. The additional deficit was paid for by part of the quarter trillion in capital inflows the United States has absorbed during the past two years. The federally-financed consumer boom was transformed, courtesy of the forgery department at the Federal Reserve System's economics bureau, into a generalized production increase during 1983. No such rise occurred, outside of the subsidized sectors, as *EIR* has documented exhaustively.

The budget data just made available by the administration show (buried in section F-5 of the *Special Analyses* of the budget) that the administration plans to increase the rate of

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such off-budget subsidies. Spending plans (for calendar years) are stated as follows:

Year	Off-budget borrowing
1978	$58.4 billion
1979	$72.9
1980	$79.9
1981	$86.5
1982	$87.6
1983	$86.5
1984	$88.5
1985	$94.8

This is the sort of scam that formerly produced screams of outrage from former presidential advisor Alan Greenspan and the economics department of Greenspan's bank, Morgan Guaranty Trust. There has not been much talk about it lately, but the implications of this further effort to puff the economy are known to all the major institutions.

Since Volcker is committed to turning the screws on the credit system, to produce sufficient pain to motivate budget cuts, it is not surprising that the expectation of higher interest rates is now dominant and the stock market has been weak. The fact that the dollar fell upon the budget announcement demonstrates that high American interest rates do not automatically attract more foreign capital.

In the New York banking community, the small group of commercial-bank fund managers who accurately foresaw the dollar spike as a function of an international liquidity crisis now believe that the end has come.

Doom-and-gloom forecasts about the dollar are now standard in Europe. The influential Edinburgh, Scotland brokerage house Wood, McKenzie, said in its latest *International Economic Review*: "The U.S. budget deficit will provoke a fall of the dollar; since the United States will still need to import capital, interest rates will rise, but will not prevent a further fall of the dollar; the U.S. economy will collapse and the administration will be forced to take action on the budget deficits."

The Soviet angle

Soviet diplomatic personnel have been spreading the word during the past 10 days that a developing sector debt crisis and a collapse of the American dollar will ruin President Reagan's re-election chances. This view was made explicit in *Pravda* and *Isvestiya* commentaries.

Izvestiya's commentator V. Matveyev argued Jan. 30 that Latin American countries "have to pay for the vicious defects of the [capitalist] system" and refers to the explosive power of the developing sector's combined $700 billion foreign debt. Matveyev even quotes the *Time* magazine New Year's feature on "The Debt Bomb" (New Year 1983, not 1984) which, according to Matveyev, "is ticking ever louder and more sinisterly under the building of contemporary capitalism."

Izvestiya further states that "the financial oligarchy of the U.S. and its partners fear the consequences of a sharp cut or a halt of [debt] payments altogether," which "would be unpredictable for the finances, trade and industry of the creditor countries."

In the Soviet party paper *Pravda*, commentator L. Strzhizhovskii asserted Jan. 30 that President Reagan is artificially keeping the dollar's value high, because a "strong dollar" will strengthen Reagan's chances to be re-elected. Needless to say, *Pravda's* story omits to report that the Soviets have bought $30 billion on the forward market, conniving with Swiss circles to inflate the dollar's value so that it may be crashed at a politically convenient moment (see *EIR*, Jan. 31). Strzhizhovskii plays up European voices calling for financial as well as political decoupling from the United States, such as the West German Social Democratic Party's call for a "European battle front against the American monetary policy" and French Finance Minister Jacques Delors' demand to stop the European capital outflow to the United States.

European circles aligned with the Soviets agree with this estimation. A high-ranking official of the Brandt Commission, the International Monetary Fund's planning arm, says that the United States would be the next nation to suffer a debt crisis. The official, an aide to Brandt Commissioner and former British Prime Minister Edward Heath, is also a close associate of Lord Peter Carrington, the new secretary-general of NATO.

The official said, "The dollar is going to come down like a thump. The evidence concerning the debt crisis is extremely disturbing. Look at the deficit-and-debt ratios of Western nations, like the United States, or Sweden, and you will understand. Which country is it that is going to be the next to suffer a debt crisis? It is the United States!"

In less outspoken terms, the same view was published in the new U.S. economic forecast issued by the Organization for Economic Cooperation and Development, a supranational organization dominated by Carrington's associates from the British Foreign Office.

We reported last week the outbreak of an interbank market crisis in response to Citibank's freezing of $500 million in bank deposits at its Manila branch, apparently in response to Philippine central bank rules preventing transfer of foreign exchange out of the country. Some well-placed administration sources, however, believe that Citibank could have dampened the impact of the Philippines problem, avoiding a direct refusal to pay its interbank market creditors. Citibank's unexplained decision not to do so has led to suspicion that Walter Wriston, aware that the recent Brazil refunding is the "last hurrah" of the 18-month long refinancing cliffhanger, prefers to have the crisis occur now. The argument is that the major banks would prefer an election-year bailout through the Federal Reserve to the slow but sure death of continued bookkeeping chicanery to keep the appearance of solvency among their biggest debtors.

The U.S. economy, now obviously weakening, and the LDC debt timebomb cited by the Russians, remain the principal detonators for a dollar crisis, probably during the second quarter of this year.