A dollar recovery... without a support operation

At deadline on the afternoon of Oct. 4, the U.S. dollar stood at 1.7650 to the West German mark and 1.5835 to the Swiss Franc, a recovery of almost two percent from lows scored earlier in the week. This occurred despite the fact that the Federal Reserve Board announced no measures to support the American dollar, which had been widely expected after discussions to this end between American and West German officials during the International Monetary Fund's Annual Meeting in Belgrade. Such a package had been anticipated especially after the flight home from the meeting on Tuesday of Fed Chairman Paul Volcker. However, the Bundesbank met today and dispersed without making an announcement, and Bundesbank officials said privately they expected no package to be forthcoming.

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Nonetheless, a strong move out of short positions against the dollar began this morning in continental Europe, which pushed the dollar higher, while the gold price fell dramatically to $381 by the New York opening. New York market operators were entirely taken aback by the dollar's sharp improvement.

There are important background factors which make these events comprehensible. The most important question asked about the anticipated support package was, why would a repeat of November 1978's $30 billion intervention fund affect the market, particularly when the Fed has repaid most of the swaps drawn down during that period of dollar weakness, and has ample intervention resources? That point was made by West German Finance Minister Hans Matthoefer, in a discussion with the *Journal of Commerce* of Oct. 4.

In fact, additional monetary austerity in the United States—the "steady course" promised by Treasury Secretary Miller in his speech to the Belgrade meeting—could have a perverse effect upon the dollar, according to some European analysts. The chief of foreign exchange at a major Swiss bank warned that a rise in the American discount rate above the 12 percent level might make the dollar into an "exotic currency like the Brazilian cruzeiro," with ever-higher rates of inflation following rising interest rates in a self-feeding spiral.

Now that the American capital markets (see DOMESTIC CREDIT) are groaning under the weight of a $15 billion Treasury financing schedule during the fourth quarter, and cringing from the threat of liquidation of bond portfolios on the part of some cash-short financial institutions, a rise in rates that could precipitate trouble on the bond markets would unquestionably have a perverse effect on the dollar.

From this standpoint, a dollar support package of the usual kind would either do nothing whatsoever or create problems worse than those it proposed to solve.

An increasing number of financial community and official sources are discussing direct action on the gold market as a principal means of supporting the dollar. Some European foreign exchange sources, in fact, believe that the mere threat of the creation of a European gold pool—proposed today in the editorial column of the respected Paris financial daily *Les Echoes de la Bourse*—will be adequate. The Swiss foreign exchange source cited above suggested that the European central banks will have to go into the gold market and control the price. However, he warned, if they did this in an organized fashion, it would mean the re-establishment de facto of an official gold price and the remonetization of gold through the European Monetary System. He hoped, rather, that the Europeans would merely sell off some gold to depress the price.

According to Paul Fabra in *Le Monde* today, Swiss National Bank Governor Fritz Leutwiler is eager to go along, but the French will not. French Finance Minister Monory told Fabra, "We will not sell off gold on the market to depress the price. Why should we?" But the French may *buy and sell gold to stabilize the price.*

Some longstanding opponents of gold remonetization in the United States are now willing to throw in the towel. Citibank economist Harold van Cleveland now suggests that the United States agree to the use of gold as a monetary asset in central banking.

It seems clear that some form of gold remonetization on behalf of the European Monetary System, but not prejudicial to the dollar, is underway. And it is entirely possible that word of this caused the dollar's sharp recovery this morning.

—*David Goldman*