

TRANSMITTAL SLIP		DATE	27 Sep 82
TO: Richard Perle, Ass't Sec. (ISP)			
ROOM NO.	BUILDING		
4E838	Pentagon		
REMARKS:			
<p>Here's more on prospects for the franc and the Kissinger article I told you about.</p>			
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INTERNATIONAL MONEY MANAGEMENT

# How long can the franc hold on?

The wave of speculation that sent the French franc to a record low of 7.13 to the dollar on Sept. 13 and forced the French government to seek \$4 billion in international standby credit just two days later could rout the European Monetary System. Only three months after its last realignment, the EMS is again under intense pressure. Small and medium-size companies are pulling out of francs as quickly as possible. European officials say a suitcase flight from the currency by French citizens has reached the same pell-mell tempo as before the franc was devalued 10% against the Deutschemark on June 13.

But unlike three months ago, many seasoned money market professionals are parked on the sidelines this time. Treasurers of some of the largest U.S. multinationals also are refusing to join the run.

**Squeezing the speculators.** "The professionals see this as a dangerous market and not one in which to be too much against the franc," warns Friedrich W. Menzel, managing director for Citicorp in Frankfurt. Although France's double-digit inflation rate and accelerating balance-of-payments deficit make the franc a prime candidate for devaluation against the D-mark and Dutch guilder before yearend, the major players believe Paris is locked in a stubborn battle of political prestige with speculators and would be willing to exhaust its foreign currency reserves before throwing in the towel. "By deferring any adjustment, France makes it expensive to near-term speculators," says the foreign exchange manager of a major U.S. multinational. "If speculators against the franc are forced to hold their positions for several months, then they pay dearly for their gamble in terms of high inter-

est rates on French money instruments and other investments."

If that view proves correct, European money markets could remain tumultuous as a threatened, but unfulfilled, devaluation hangs over the French, Danish, Belgian, Irish, and Italian currencies. Denmark's new right-of-center government under Prime Minister Poul Schlüter faces such deep economic trouble that the Danes could trigger a third wholesale realignment of European currencies in little more than a year, no matter how hard the French try to thwart it. "Denmark will act as the detonator," warns a senior Italian monetary official.

The Danes, meanwhile, have been waiting for Sweden's national election on Sept. 18 to see whether a new government—the country is not a member of the EMS—will devalue the krona. Many analysts believe Stockholm will do so to regain export competitiveness with Norway, which devalued its currency 6% this summer. If the Swedes move, the Danes are likely to act, predicts Poul Mathiesen, director of foreign operations for Copenhagen Handelsbank.

**Hoping for time.** West German Chancellor Helmut Schmidt's shaky coalition government also will pose a critical threat to the EMS, following state elections in Hesse on Sept. 26. If the right-of-center Christian Democratic Union wins, that could strengthen the D-mark at a time when the Danish krone and French franc are weakening, forcing a devaluation of the two currencies.

French officials are hoping to buy time for their currency by committing the country to an austerity program of wage and price controls through 1983. But foreign exchange markets are skeptical that prolonged controls, which

would spell a fall in French living standards, will be maintained. For that reason, they expect the government of President François Mitterrand to accept a devaluation of at least 5% to 6%. "I would not be surprised if the French government swallowed its pride and accepted a realignment before yearend," says David Kern, manager of economic analysis for National Westminster Bank in London. "But they do not want to act under pressure."

**Weekly pattern.** Many U.S. corporations that bet against the franc in June are thus refusing to gamble either for or against the currency, and French-based companies are nervously selling francs on Thursdays and buying them back on Mondays to protect themselves against a

## Even if French pride resists devaluation, Denmark could force a European realignment

possible weekend devaluation. "Each weekend the franc comes under pressure—in a thin market," says a U.S. corporate treasurer. "Each week the process repeats itself; a devaluation can become a self-fulfilling prophecy." Nearly all companies doing business in France are delaying converting foreign currency earnings into francs while speeding up payments to suppliers outside the country.

Despite France's big international loan, treasurers will continue to watch closely the level of Paris' foreign exchange reserves. Without the \$4 billion, the Banque de France's reserves would have lasted only another two months at its current rate of spending to defend the franc. France could still borrow from the European Community and raise interest rates to support its currency, but the economic cost would be high. While no country can hold out indefinitely against massive speculation, France's latest moves make the gamble against the franc that much riskier, notes Menzel of Citicorp.

### Foreign exchange trader

	PERCENT					FOREIGN UNITS PER U.S. DOLLAR (top)/ U.S. DOLLARS (bottom)						
	U.S. TREASURY BILLS	CERTIFICATES OF DEPOSIT			EUROMARKET TIME DEPOSITS*	GERMAN MARK	SWISS FRANC	JAPANESE YEN	CANADIAN DOLLAR	FRENCH FRANC	BRITISH POUND	ITALIAN LIRA
	U.S.	U.S.	EUROMARKET	SINGAPORE								
SPOT	X	X	X	X	X	2.51	2.15	263	1.23	7.10	5858	1414
						3980	4657	003797	8105	1409	17070	000707
THREE-MONTH	7.87	11.00	11.50	11.65	12.13	2.49	2.11	260	1.24	7.22	5839	1444
						4024	4749	003841	8077	1386	17127	000693
SIX-MONTH	9.52	11.90	12.35	12.50	13.06	2.46	2.07	257	1.24	7.33	5800	1475
						4071	4837	003898	8055	1365	17242	000678
ONE-YEAR	10.02	12.50	12.85	13.00	13.50	2.40	1.99	250	1.25	7.53	5734	1527
						4167	5019	003998	8003	1329	17440	000655
BANK PRIME	13.50%	X	X	X	X	12.00%	7.50%	5.75%	15.50%	13.25%	10.50%	20.75%

Data: First Boston Corp., Irving Trust Co.

As of Sept. 14, 1982

\*At London interbank offered rates