The President's Daily Brief

12 July 1973

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CENTRAL INTELLIGENCE AGENCY
WASHINGTON, D.C. 20505

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July 12, 1973

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THE PRESIDENT'S DAILY BRIEF

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PRINCIPAL DEVELOPMENTS

On *Page 1* we detail and discuss the rise of the dollar in international monetary markets this week.

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Laotian Prime Minister Souvanna has made some major concessions in an apparent attempt to speed implementation of the peace accord of last February. *(Page 5)*

At Annex, we examine some of the factors behind the continuing turmoil in international money markets and its impact on world trading patterns.

INTERNATIONAL MONETARY DEVELOPMENTS

The dollar rose in international money markets yesterday for the third straight day. Since the beginning of the week, the dollar has recorded a 6- to 7-percent rise relative to the European joint float currencies and 4 percent relative to the yen.

The dollar strengthened yesterday on the announcement that US swap lines with foreign central banks had been substantially enlarged. Many traders interpreted this announcement as a signal that the United States was preparing to intervene in support of the dollar. Bundesbank president Karl Klasen added to this sentiment on Tuesday when he announced that the Americans were prepared to act and wanted to see the dollar supported.

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Intervention alone is unlikely to lead to a sustained dollar recovery in 1973, although the longer-term outlook is somewhat more favorable. Intervention has proved only a temporary solution to international currency instability in the past and progress toward resolving US political and economic problems will remain foremost in traders' eyes.

The Committee of Twenty, the forum established by the International Monetary Fund to devise a monetary reform program, is meeting again in Washington. Although the group has been wrestling with the problem of reform since last fall, there are still wide differences among the major powers. The recurring monetary crises have not made agreement any easier. An analysis of the implications of the current monetary crisis is at Annex.

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USSR-CHINA

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Predictably, Soviet media have criticized the test--particularly in broadcasts directed at countries affected by its fallout--charging that Peking's leaders are "blind and deaf" to protests against radioactive pollution. Moscow has contrasted the event with the trend toward international detente and, in particular, with the recent US-Soviet treaty on preventing nuclear war.

Although Soviet media have reported France's forthcoming nuclear test in the Pacific, the Soviets have avoided criticizing the French.

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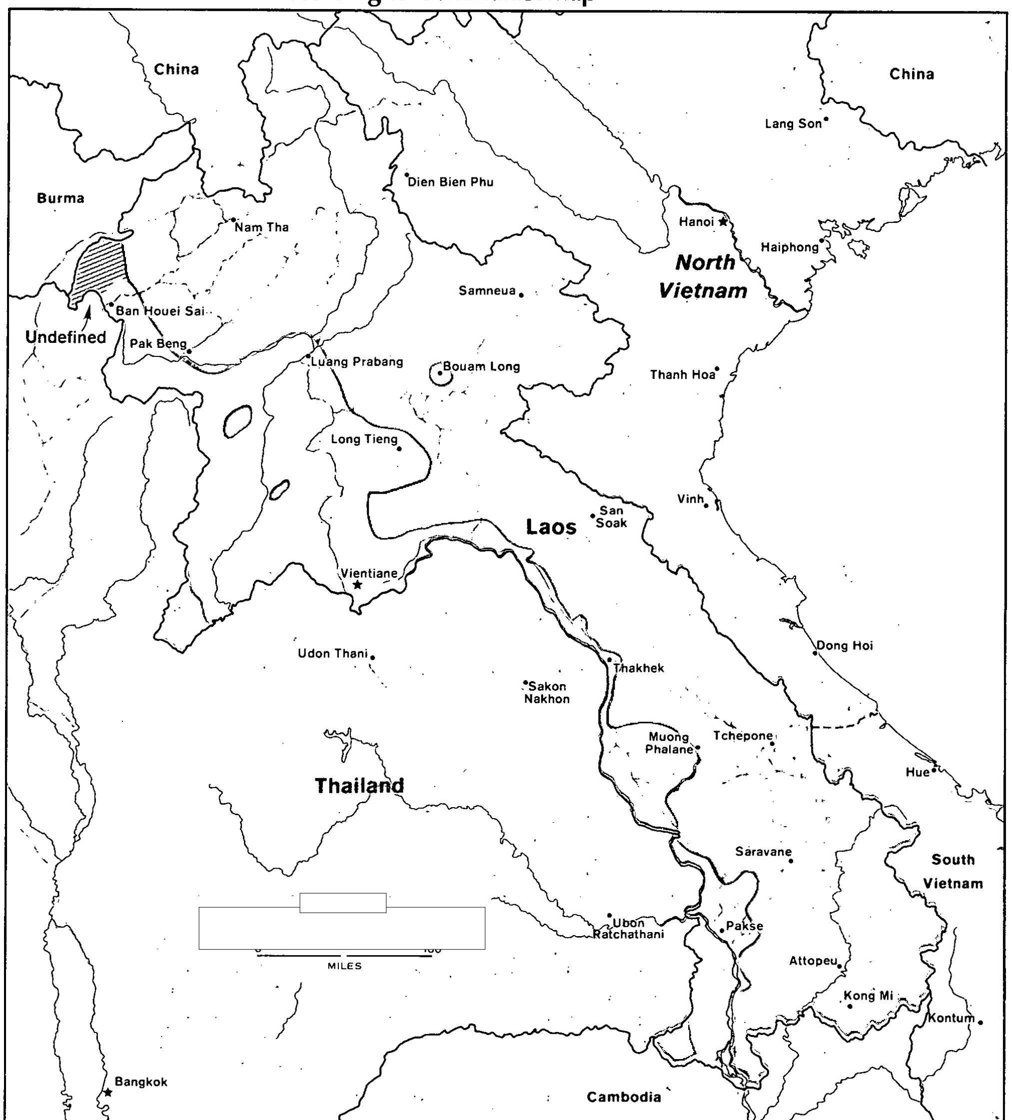
Laos: Zones of Control According to Communist Map



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LAOS

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Prime Minister Souvanna has made some major concessions in an apparent attempt to speed implementation of the peace accord of last February. [redacted]

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The Communist delineation plan requires the Vientiane government to give up a small amount of additional territory, abandon most of its enclaves within Communist-controlled areas, recognize Communist enclaves within its own area of control, and accept Communist territorial conquests made since the cease-fire. Souvanna's acceptance of such a limited number of teams with no mobility would preclude effective supervision of any North Vietnamese withdrawal.

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Other obstacles still stand in the way of a settlement. The two sides have not yet grappled seriously with the Communist demands for a minimal International Control Commission role or the disbanding of the former irregular forces and the dismantling of their bases. [redacted]

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ANNEX

IMPLICATIONS OF THE CURRENT MONETARY CRISIS

The current turmoil in international money markets is the fourth in a series of crises that have come with increasing rapidity since 1971, when the Smithsonian Agreement was concluded.

The monetary crises last year and this reflect in part not only continuing US payment problems, but also a change in the psychology of international currency traders. Money managers, representing the large multinational firms and commercial banks and some less developed countries including the oil producers, came to believe that further currency realignments were likely. Windfall profits could be made with limited risk or the value of assets protected by shifting from dollars into the stronger currencies. To the extent that traders acted on their belief it became a self-fulfilling prophecy.

The repeated money market crises have not produced the worldwide recession that many feared. Despite continuing international monetary instability and the growing weakness of the dollar, world trade is expanding rapidly. Indeed it has accelerated in line with the current worldwide economic boom. Exporters and importers have taken steps to reduce their exchange risks through contract adjustments or dealings in the exchange market, but this has generally resulted in only a small increase in trading costs.

Continuing international monetary instability has, however, exacerbated the inflation problem in countries that are the object of speculative capital inflows. West Germany in particular has had to absorb massive currency inflows--first dollars and then guilders, French francs, and Danish crowns--and this has complicated Bonn's policy of slowing the growth in the money supply. Because of the anti-inflationary consequences of revaluation and subsequent monetary stability, Germany has generally been more willing to revalue than other countries.

The impact of the dollar's continuing devaluation on the trade balances of our major trading partners has so far been small. In part this is because most of their trade is not with the United States and because of lags in the adjustment process. The dollar's devaluation lowers the price of US exports in foreign markets, but this leads to an increase in US sales only after consumers adjust their purchases to the new prices.

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The current worldwide boom has also reduced and masked the impact of the continuing currency realignments. The US economy and the economies of most of our major trading partners are expanding rapidly--too rapidly in some cases. This has lessened concern about the potential impact of cheaper US goods.

These factors explain the lack of strong countermeasures so far against the devaluation. Only a handful of new foreign export subsidies and tax incentives have been introduced. Nevertheless, some Europeans, the French in particular, feel that the dollar has been devalued too far and that the United States has been given an unfair competitive advantage.

The United States, after an adjustment period, will benefit from the increased foreign demand for our exports now made cheaper by devaluation. Investment in this country also has become more attractive to foreigners. Both of these factors will help create jobs and reduce unemployment in the US. To a lesser extent the UK and Italy, whose currencies also have depreciated, will similarly benefit.

On the other hand, US imports are more expensive because of devaluation and this contributes to domestic inflation. The price of oil imports in particular has increased because of successful contract renegotiation by the oil-producing countries as well as through the direct effects of the devaluation.

The price advantage gained by US agricultural and other raw material exports through devaluation and what apparently has been a desire to convert unwanted dollars into commodities has probably also played a role in the disruption of world commodity markets. The resultant introduction of controls on US commodity exports has dampened US balance of payments prospects and intensified pressures for a further dollar devaluation.

Some of the advantages of the dollar depreciation to Washington are disadvantages for our trading partners. Although their trade position has been little damaged so far, in the longer term cheaper US goods and increased investment in the US rather than in their domestic economies mean domestic job opportunities forgone.

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Our trading partners will consequently become more agitated about continuing international monetary instability and the weakness of the dollar when their current economic boom comes to an end. A downturn is inevitable if only because of foreign governments' action to slow down the accompanying domestic inflation. Then, a slowdown in their exports and an increase in their imports and foreign investment (because of the currency realignment) will exacerbate the slowdown in their domestic economies.

The growing concern of our trading partners will adversely affect progress toward trade and monetary reform. The monetary situation has clearly helped Paris in its insistence that the multilateral trade talks take account of the advantages Washington may gain from a devalued dollar, and this could stall the talks indefinitely. Progress toward international monetary reform in the ongoing discussions under the auspices of the International Monetary Fund already has been made more difficult by foreign concerns resulting from the dollar's decline. Difficulties in the economic negotiations will complicate our political and military negotiations. In the case of Europe in particular, the continuing monetary crises are likely to make achievement of US political objectives more difficult.

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