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Fears Of War And Economic Collapse Precipitate U.S. Market Plunge

The recent steep descent of the New York stock market, which closed below 900 on May 27 for the first time in 16 months, should serve as a dash of cold water in the faces of the world financial and political leaders.

The market plunged, losing over 40 points in 7 sessions, when it perceived the twin dangers of a new war in the Mideast and economic downturn brought on by the Federal Reserve's tightening of interest rates, as the *Wall Street Journal* reported freely in its market column last week. The stock market implicitly recognizes what most American and Western European political leaders still do not — that the inflationary debt refinancing game could be up at any point, unleashing economic chaos and increasing the war danger.

The Fed's recent decision to tighten interest rates ever so slightly to bring U.S. double-digit inflation under control will not only terminate the U.S. economic "recovery." Already commodities prices — the source of debt service payments for Third World debtors — are headed downward; the bursting of the inflationary bubble in the U.S. will hasten that process. The "excess liquidity" in the banking system, which has been generated as a by-product of the inflationary economic expansion in the U.S., could turn into illiquidity overnight — ushering in a deflationary collapse replete with uncontrollable Third World debt defaults.

In this crisis, the world's leading international bankers who gathered at last week's International Monetary Conference in Tokyo are deliberating on ways to perpetuate the present bankrupt monetary system — and hence the threat of economic collapse and war. At the Tokyo conference, the first large public meeting of international bankers who want to survive Chase Manhattan's bankruptcy, European, Japanese and American financiers huddled around the still-warm cadaver of the International Monetary Fund. West German and Swiss bankers debated ways of raising money for the IMF to refinance unpayable Third World debt, while reports trickled into the meeting that Turkey had defaulted on payments for imports — only the most obvious sign of monetary collapse. The public statements of the bankers in Tokyo are backed up by the recent wave of new Third World loan syndications: West German, Swiss, and U.S. regional bankers are currently doing a spate of lending to the more "credit-worthy" Third World countries to bail out their — and the Rockefeller's — previous lending. Their strategy is epitomized by the attitude of the Rothschild family financial interests, who are talking in private about collecting enough of their present debt-holdings to survive a general monetary collapse.

The demonstrated ineptitude of those leading financial groups who might be constructing a working alternative to the IMF's bankruptcy has created a situation in which the U.S. Labor Party Chairman Lyndon LaRouche's proposal for a private-sector gold-backed development bank has become the going alternative in the eyes of a growing number of more rational bankers and industrialists.

Deflationary Tendencies

On May 6 the Federal Open Market Committee, the Federal Reserve's chief policy making body, voted in favor of Fed Chairman Arthur Burn's recommendation to raise the upper end of the Federal funds target range to 5.5 percent. The decision was made public when the minutes of the April 19 FOMC meeting, to which the minutes of the May 6 emergency meeting were appended, were released last week; but the market had been aware of the Fed's decision to tighten credit for over two weeks.

The Fed moved to raise the Federal funds rate, the interest rate which determines all other short-term rates, in early May, in spite of the deflationary consequences, to prevent the inflationary cycle from running out of control. In April, continuing the first quarter's trend, the wholesale price index rose at 13.2 percent annual rate, while consumer prices rose at nearly a 10 percent annual rate; the basic money supply grew at a 20 percent annual rate. Consumer installment credit, which has increased by record jumps since December, increased by $2.7 billion in March alone.

The revised first quarter Gross National Product figures were the final straw. The upward revision of the growth of real GNP from 5.2 percent to 6.4 percent reflected a much greater change in the value of inventories than was previously estimated. The change in inventories was revised from a $7.5 billion annual rate to a $13.8 billion rate, following a $1.7 billion rate of accumulation in the fourth quarter of 1976! The "strength" of the inventory building, however, represented substantial price mark-ups on a small volume of inventory accumulation.

Given the glut of debt and profit obligations overhanging the corporate sector, even a minor upturn in production — such as took place in the first quarter of the year — can only be financed through substantial price increases. The price indexes; the hefty, near $6 billion expansion in short-term business credit thus far this year; and the explosive growth of the money supply attest to this point.

Over the first four months of this year, corporations were borrowing to maintain artificially high prices — that is, to stave off a collapse of corporate profits. Midwestern wheat growers, for example, borrowed heavily in the first quarter of the year to keep wheat off

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the market — in the hope of stopping the collapse of its price.

In the industrial sector, inventory building was fueled by fears of inflation and possible strikes and shortages. Steel companies, perceiving threatened coal shortages later in the year, took in whatever inventories they could find, in spite of the fact that the price of anthracite doubled during the winter cold wave, which disrupted the mining and shipment of coal. In anticipation of a July 1 copper strike, refiners and consumers of copper built up inventories of the metal, though hedge buying was limited by the existence of massive worldwide stocks of the metal.

But as the case of copper illustrates, first quarter inventory building wasn't sufficient to hold up the prices of industrial raw materials — and hence corporate profits. Phelps Dodge and Asarco, two of the leading U.S. copper producers, cut their prices 3 cents per pound to 71 cents in late April in spite of the blow to their earnings, because at that time the London Metals Exchange price was already heading towards 60 cents. The other copper producers held out as long as they could hoping that stockpiling in anticipation of a copper strike would offset the continued erosion of world demand and obviate the need for a price cut. However, prices on the LME were falling too fast to allow U.S. producers to hold their prices. According to copper market sources, the 71 percent price which was adopted by all U.S. producers last week, is below the cost of production and will mean bankruptcy for some producers.

Last week North American zinc producers were also forced to cut their prices. Noranda, the major Canadian producer, is simultaneously cutting back its capacity from 80 percent to 65 percent.

Even in April, the increase in industrial prices was already slowing. That month the industrial price component of the wholesale price index slowed to a 0.6 percent increase from 0.8 percent in February and March. The *Journal of Commerce's* index of 15 industrial materials has been losing ground steadily since March, and at the end of last week stood at a level below where it was on the same date last year.

Burns' decision to step on the monetary brakes can only aggravate this deflationary process, weakening the liquidity of the entire industrial sector.

Trade Collapse, Protectionism

In anticipation of the unraveling of the consumer-based "recovery" in the U.S., protectionist sentiments are reaching a new peak. On May 25 the American Iron and Steel Institute, the lobbyist for the industry, released a major white paper on foreign imports. The study singles out Japanese producers and charges that they are selling steel in the U.S. at $35 to $45 a ton below their cost of production — qualifying them for the charge of "dumping." The study argues that if imports increase above last year's 14.3 million tons, they could threaten the U.S. steel industry's ability to finance new steel making capacity and lead to a major steel "shortage" in the 1980s and a U.S. dependency on foreign steel!

But the steel industry, by and large reconciled to the inevitability of shrinking world markets, has been cancelling expansion plans left and right.

In releasing the white paper, Edgar Speer, chairman of U.S. Steel and the AISI, clearly felt obliged to answer the undercurrent of feeling that he is doing everything to conciliate the Administration to get it to take up protectionism. Speer protested U.S. Steel "didn't make a deal" with Carter for protectionism when it undercut other U.S. steelmakers by announcing an average 6 percent increase on steel products in early May.

Treasury Secretary Michael Blumenthal has been trying to reassure Europe and Japan that the growing U.S. trade deficit will not aggravate protectionist sentiments in the U.S., however this has become an impossible job. On May 26 the Commerce Department announced that the U.S. ran another record trade deficit in April. The $2.62 billion deficit in April brings the deficit for the first four months of the year to $8.55 billion — already far surpassing the deficit for the whole of 1976. This time the Administration couldn't pin the deficit on the growth of oil imports: exports declined one percent as agricultural exports remained unchanged, and exports of manufactured goods declined.

In the first two months of the year U.S. exports to Europe and Japan were actually up noticeably. In the case of Japan, the 36 percent increase in February compared with February 1976 was facilitated by the appreciation of the yen against the dollar. The move of the U.S. into European and Japanese markets — fueling the potential for trade war — is contrasted by the declines in U.S. exports to the developing sector and the Communist countries. Exports to those sectors were off 3.5 percent and 29.5 percent respectively February to February, a direct result of New York bank-IMF credit policies. Underlining the precipitous collapse of world trade, West Germany announced on May 27 that its exports plunged 15 percent in April from the previous month, while its imports declined 12 percent.