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Miller hints at recession, signs of credit tightening

David Rockefeller, chairman of Chase Manhattan Bank, announced in a Feb. 22 *Wall Street Journal* interview that he foresaw U.S. interest rates reversing direction and shooting upward again, indicating that the push for upward interest rates of Federal Reserve Board chairman G. William Miller had indeed won out as U.S. policy.

Rockefeller's announcement came as Miller was busy selling the U.S. a Bank of England-authored package deal. In exchange for higher U.S. interest rates, Miller and his understudies have assured the capital markets, the U.S. dollar will for the moment remain a stable currency because the economies and therefore currencies of Europe and Japan will be crippled by the "oil shortage" (see Foreign Exchange).

In exchange for this deal, Chase and other money center banks have abandoned their fight to lower interest rates — Chase had lowered its prime to 11.5 percent just three weeks ago — and instead turned over the management of the economy into Miller's eager hands.

Moving toward recession

In testimony before the Senate Banking Committee Feb. 19, Miller stated that the availability of credit to industry and agriculture must be cut back if the U.S. is to halt inflation. This, he emphasized, means slashing U.S. money supply growth.

Miller projected that U.S. monetary aggregates must be brought within much more narrow bands than previously this year, forecasting increases in money supply for 1979 of the following magnitudes: M1, 1.5 to 4.5 percent; M2, 5.0 to 8.0 percent; and M3, 6.0 to 9.0 percent.

Of particular importance, Miller laid stress on limiting the growth of M3. In order to slow M3 growth, a number of economists, such as Fidelity Bank's Lacey Hunt, have demanded a sharp increase in the reserve requirements on large Certificates of Deposit (CDs), which make up a large portion of M3 money supply. This would not only force a new regime of higher CD rates, but would force U.S. banks into competitive bidding for large CDs with each other and European banks. Such competition was a major source of the run-up in interest rates during 1978.

While Miller assured the Senate Committee that, by moving toward a credit crunch, he was not trying to trigger a recession, he did admit that his policies may knock out the props of the consumer sector — which is the single force holding up the U.S. economy. "Higher costs of credit," Miller testified, "will cause land developers and builders to put aside marginally profitable projects and the combination of higher house prices and mortgage rates will lead some families to defer home purchases."

As Miller spoke, it was announced that U.S. housing starts in January had fallen 20 percent from the level of the month before. Some of this fall was due to bad weather. But most was caused by the catch-up effect that higher interest rates are having on the real estate and housing market bubble.

Within hours of Miller's announcement, interest rates were being triggered upward on the domestic credit market. For example, the latest 13 week U.S. Treasury bill auction closed Feb. 20 at 9.39, up 10 basis points from the previous offering. Also on Feb. 20, the General Motors Acceptance Corporation (GMAC), the largest trader of commercial paper, raised the rate on its 90 to 179 day paper from 9 5/8 percent to 9 3/4 percent.

The financial press has predicted worse to come. On Feb. 21, Lawrence Kudlow, vice-president of Paine Webber Jackson & Curtis, predicted a steep run-up in American consumer prices in the range of 10 to 12 percent over the next six months on an annual basis, because of "continuing Middle East turmoil." This, stated Kudlow, would lead U.S. interest rates to move up by a percentage point.

Some of the press even went so far as to report a possible repeat of 1929. Leonard Silk, the *New York Times* economics writer, wrote in that newspaper Feb. 21, "President Carter faces a plight similar to that of Herbert Hoover, the one-term Republican President who had the misfortune to arrive in the White House just before the Depression."

Yet, there are still some signs of healthy resistance to Miller's Bank of England-authored package deal. U.S. corporations were back in the Eurobond market in full force, with almost $400 million of new offerings scheduled last week. The Eurodollar bond market was booming, reported the Feb. 21 *Financial Times*, because the Europeans continue to keep rates attractively low there, part of a larger European strategy to lower world lending rates for high-technology trade.

—*Richard Freeman*

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