

DOMESTIC CREDIT

Interest rates have not peaked

In a Nov. 7 speech before the Money Marketeers meeting, Alan Lerner, senior vice president of Bankers Trust told the assembled bankers that "U.S. interest rates will reach their peak within the next four to eight weeks."

Lerner's predictions were seconded by the Morgan Guaranty Trust Weekly Money Market Bulletin, which stated it did "not foresee any further credit tightening by the monetary authorities in the near future."

By these assertions, Bankers Trust and Morgan Guaranty intend to assure an extremely jittery market that Fed Chairman Paul Volcker will ease the monetary restraints he had imposed. These restraints, which have pushed the prime interest rate to its current level of 15.5 percent, have produced signs of economic collapse throughout the economy which is becoming very worrisome to most.

Anyone falsely assured by the Bankers Trust and Morgan predictions had better look more deeply at the credit system. The U.S. economy shows no sign of letting off on its need for credit by which it staves off collapse and Volcker shows no indication of easing off on credit tightening.

The first tip-off came in the October figures for issuance of new commercial paper, which were released on Nov. 12, showing that in October issuance of new commercial paper shot up at a rate of 25 percent per annum against a 5 percent per

annum rate the previous month. This heavy borrowing reflected mostly auto companies' "finance company" arms which were desperately issuing new debt to car dealerships to finance cars that could not be sold because of the cut-off of consumer credit!

While steel and a few other industries have purposely kept inventories very low, in expectation of a sharp economic slow-down, other sectors of the economy, such as retail trade are not so fortunate requiring a high level of inventory financing. Furthermore, while inventory-to-sales ratios for the whole economy are lower now than in the period immediately preceding the 1973-'74 depression, the absolute volume of inventories is higher and must be financed at higher interest rates or be totally liquidated at which point a full-fledged crash is on.

Not if, but when

News emerging from the tickertapes Nov. 15 further indicated that the primary question concerning Paul Volcker's policy is not if he will raise interest rates further, but when.

On Nov. 15, the Bank of England suddenly raised its Minimum Lending Rate (at which the BOE lends to the clearing house banks) by a full 3 percentage points to 17 percent. Since Volcker has been determining U.S. credit policy as a predicate of British policy, this will almost certainly be followed by an increase in the Fed's discount rate from its 12 percent level, which will kick off a ratchet-increase of interest rates throughout the economy. Adding fuel for a credit tightening,

the Nov. 15 *Journal of Commerce*, in its lead editorial, "Lowering the Discount Windows," repeats the call last week of House Banking Committee Chairman Henry Reuss (D-Wis.) for shutting down the discount window. This would mean that the source of funds of last resort of the banking system would be shut off.

The same day, the Fed announced the monetary figures for the latest reporting week, which conveniently will provide the pretext for further tightening and make a mockery out of the famous "reporting error" of two weeks back. M1 shot up by \$3.1 billion while M2 increased by \$4 billion.

The monetary figures knocked the wind out of the sails of a mild stock market rally.

Ultimately, the report of credit easing is a myth created for the unsophisticated on and off Wall Street. In less kind words, the First Pennsylvania Bank labeled this myth, "the Greater Fool's Theory." In its latest weekly market newsletter, the First Pennsylvania wrote:

"Bond prices have moved up sharply on at least four occasions as the 'street' (a pseudonym for brokers and dealers) tried to scare retail institutional investors into buying for fear of missing the interest rate peak. Each rally seems to sputter and die whenever speculators finish covering their short sales, as retail investors refuse to play the 'greater fool' role."

The only ones deceived by the report that interest rates will peak are those who would believe a bright, rosy future for the U.S. economy. The announcement that Ford Motor Company will lose \$1 billion on their North American operations, made Nov. 12, puts that company in the same league as Chrysler Corporation. The only valid reason that interest rates would have peaked is that the bottom fell out of the U.S. economy and nobody noticed.

—Richard Freeman