Rising U.S. interest rates belie the economic recovery

by Richard Freeman

The six-month Treasury bill rate hit its highest level of the year on June 7—8.87 percent—en route to what many Wall Steet analysts are predicting will be a 10 percent level by the end of the summer. The June 7 rate is the highest of the year. As *EIR* predicted in April, U.S. interest rates were artificially depressed by Federal Reserve Board money printing for an interval, before moving up past March's previous high point.

For President Reagan, the rise is the wrong thing at the wrong time. Increasing rates will crush a very fragile economic "recovery," a so-called recovery which is still 25 to 40 percent below 1979 output levels. Desperation buying by consumers, which has increased household appliances sales for the first five months of the year at a 26 percent annual rate above 1982 levels, will be shattered. Home sales, which have fallen for the past three months, but are still one of the elements of the "recovery," will fall further and much faster. A short-term interest rate increase will put an end to whatever long-term borrowing by businesses has taken place. In short, it will destroy the President's dream of riding an economic recovery, however anemic, into a second four-year White House term.

Moreover, there are several strategic issues, including European support for the President's emplacement of Pershing II missiles in Europe, which are bound up with interest rates staying relatively low.

But if the President chooses to forestall rate increases, in the "tight versus loose money" atmosphere in which American Presidents have allowed themselves to be maneuvered during this century, his only alternative would be to order the Fed to accommodate greater money printing. Neither tight nor loose money works per se—only a *directed* credit policy favoring productive industry can succeed. Loose money now will just finance debt refinancing and the burgeoning government deficit.

At the moment the President has a domestic dilemma which the gnomes of Switzerland, starting with Bank for International Settlements head Fritz Leutwiler, would love to exploit.

Up, up and away

The interest rate level in the United States is currently set at an artificially high level. And, starting at that level, under current policies there is little that can be done to prevent them from moving higher. The reasons for this are fairly clear. First, there is a U.S. budget deficit that is running out of control. Whereas in April of 1982—the month in which taxes are collected—the nation ran a monthly federal budget surplus of $7.3 billion, this April it ran a deficit of $3.5 billion, the first such deficit since 1963, because *tax revenues were running 20 percent below last year's levels*. This means that the recovery is a chimera: revenues are falling because taxable wages and profits are falling.

Corporations have borrowed heavily in the first five months of the year via the long-term market—$23.6 billion compared with $9.3 billion for the first five months of 1982. Along with increased consumer demand for funds to buy bare necessities, this pushes the cost of funds—hence interest rates—upward. Most of this funding is to pay off interest debt service or attempt to convert short-term debt into long.

Normally, relief for the U.S. budget deficit might be found in purchase of U.S. government securities from the Arab world. But for this year, banking sources estimate that the Organization of Petroleum Exporting Countries (OPEC), on account of falling oil prices, is running a $35 to $50 billion deficit. One New York bank estimates the deficit at $53 billion. The leading OPEC nations are either not buying or selling off their holdings of U.S. Treasury securities.

OPEC nations are also withdrawing their deposits from Eurodollar banks, putting extreme pressure on these banks to get new deposits. The scramble has led these banks to raise interest rates, sending the three-month Eurodollar rate up 40 to 50 basis points since the start of June. The Eurodollar rate helps pull up U.S. domestic rates.

Another feature influencing Eurodollar rates, and hence exercising an upward pull on American rates, is the flight capital leaving Latin America and Europe for the United States, at an estimated level of $50 billion this year. By depleting deposits in the Eurodollar market, this invites banks to raise interest rates to attract funds. A spokesman for one of New York's top five banks told *EIR* June 8, "the funding crisis and flight capital will continue to send interest rates in the Eurodollar market higher and push up U.S. rates."

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Third, there is the demand for credit tightening from the Swiss-based Mont Pelerin Society's men. The monetarist crew around the President, such as the CEA's Martin Feldstein (as well as Treasury Secretary Donald Regan, who on May 30 called for halving money supply growth), demands credit tightening at the exact moment that interest rates have been moving higher. That would send interest rates through the ceiling and blow out the U.S. credit markets.

In this conjuncture, the President finds himself attempting to get rid of Federal Reserve Board chairman Paul Volcker, whose term expires the first week of August. Volcker is reportedly still being considered for reappointment, but one unidentified Treasury official—widely believed to be Donald Regan—told the international press at Williamsburg May 31, that "Volcker should not be reappointed."

The Swiss gnomes are putting President Reagan into a box from which he can't escape without perceiving that the choice is not between 'tight' and 'loose' money, but between direction of credit according to the wishes of the central bankers, and direction of credit according to the needs of industrial and military strength. The latest rate increase is part of the patient Swiss game of ruining the United States as anything more than a 'buy-up-cheap' arena.

While the President clearly can call the shots on Volcker, there are threats from international banking sources to the President that if Volcker is not maintained there will be a financial crisis. If this blackmail doesn't succeed, the choice most often discussed to replace Volcker is Alan Greenspan, former CEA head under Ford, and a board member of Morgan Guaranty Bank—a selection that would be as dangerous to the country as Volcker himself (see article in National).

The wily Swiss

Swiss financiers are immensely enjoying the President's economic discomfiture.

The Swiss are exercising two options. First, they plan to do everything possible to keep U.S. interest rates high. Just as high interest rates can make the dollar strong by attracting investment into the dollar, the strong dollar's relative attractiveness can raise dollar-based interest rates. The Swiss are boosting the dollar by pushing the price of gold down.

In this process, the Swiss are collaborating with their favorite friends of late, the Soviets. According to one top-level source, the Soviets are dumping large amounts of gold onto the Swiss market, thus depressing the price at a time when global instability would normally raise it. This Soviet gold-selling is taking place through Geneva. Thus, gold fell below the $400 "psychological barrier" on June 9, pushing through several "stops" set in the market. As frightened novices bail out of the gold market, the Swiss will corner the metal.

The falling gold price, helping the dollar rise, also, among other things, puts tremendous pressure on the French franc, which fell to 7.70 to the dollar June 8. One Swiss banking source reported that same day that "France's financial and political institutions are on the verge of disintegration." This could obviously undermine French Socialist President François Mitterrand, who surprised everyone, including some of his own countrymen, by breaking profile and strongly backing the U.S. President's defense strategy at the Williamsburg summit. The Swiss would dearly love to undermine that support for Reagan.

Bundesbank head Karl Otto Poehl has attacked high U.S. interest rates for potentially aborting Germany's economic recovery as well. This becomes a strategic issue for the President. Reagan needs West Germany to back him on the placement of Pershing II missiles in Germany this fall, and cannot afford to antagonize Germany on the economic front.

Above and beyond these maneuvers, the Swiss are contemplating with pleasure the kind of financial and political crises that will wreck the Reagan presidency. A source at Lombard Odier, top bastion of the Swiss oligarchy, boasting June 9 that "a strong dollar will push up interest rates," added: "The only thing that Reagan can do is to let M-1 go up in smoke in an attempt to bring interest rates down," which would create a monetary explosion and infuriate Reagan's so-called conservative base.

Ultimately, the Swiss are preparing for a 1929-32-style banking crisis that will leave none of the major American financial institutions standing, except those that the Swiss choose to buy up for a dime on the dollar. The Lombard Odier source not only predicted that the world financial system would collapse, but stated that in the event of a Brazilian debt moratorium, which he views as likely, "The Swiss would benefit, because we have good trading relations with Brazil and would continue to have them." Thus, once American banks are blown sky high, the wily Swiss "allies" would conclude deals, after stepping over the American debris.