EIR Economics

Greenspan isn't preparing for Christmas

by Chris White

Alan Greenspan's Federal Reserve suddenly dropped interest rates on Nov. 22, pumping money into the banking system to bring its overnight lending rate, the Fed Funds rate, down below 8.25%. This was the second time in two weeks that Greenspan and his money managers have lowered interest rates. The rate the Fed charges for overnight borrowings has fallen from 9.75% earlier in the year. Now the expectation is that commercial banks will, starting by early December, begin to follow the Fed's lead by reducing their prime rate, the rate they charge their borrowers.

Some might think that in lowering interest rates, Greenspan's Federal Reserve is attempting to steer the financial system through the Christmas sales period by creating easier terms for consumer purchases. Since Christmas sales account for roughly 50% of the annual turnover of U.S. retailers, and since retail sales, and retailers, have been especially hard hit by the collapse of household disposal income, and the collapse of the market in junk bonds, which has become evident since August and September, there is indeed good reason for such concerns.

But Alan Greenspan's Federal Reserve is not cast for the role of Santa Claus. The Thanksgiving week interest rate reductions are not so much directed at the Christmas sales period, but at what will surely come afterwards. Christmas sales generate the revenues which permit debt-strapped department store and retail chains, like Robert Campeau's $12 billion in the hole, Allied and Federated Department Stores, the holding company for Bloomingdale's and others, to service their debt. Collapsed retail sales over the Christmas period will collapse the funds available for that purpose. Action on the interest rate front now is directed at foreseeable worsening problems for the rotten, bankrupt financial system emerging in the early weeks of 1990. Greenspan is slowly edging crabwise toward the full-blown hyperinflationary explosion that jailed economist and political leader Lyndon LaRouche warned of in September, in the aftermath of the Sept. 15 default and near collapse of Robert Campeau's retail empire.

More significant in this respect than the decrease in interest rates was the news, leaked almost simultaneously with the reduction, from the Federal Reserve that Greenspan and company have decided to move to end a fight that has been raging in government and regulatory agencies since September over the matter of the capital reserves of the banking system. In that fight the Office of Comptroller of the Currency, located in the Treasury Department, has been pitted against William Seidman's Federal Deposit Insurance Corporation. Robert Clarke, the head of the Comptroller's office, demanded that the minimum reserve requirement for banks be dropped from a proposed level of 6% coverage of liabilities—i.e. $6 in stock and cash for every $100 of liabilities—to 3%. Seidman favored the higher standard. Over Thanksgiving (Nov. 23), Fed officials leaked out that they had decided to back the Comptroller's side of the dispute. The decision clears the way for regulatory changes to be adopted in the upcoming period which will indeed cut the reserve requirements of the commercial banks in half.

The Fed regulates the 1,100 or so banks which are members of the Federal Reserve system. The Comptroller is responsible for another 4,000 nationally chartered banks. The FDIC is responsible for about 8,000 smaller, mostly state-chartered banks, which are not part of the Federal Reserve system. An FDIC spokeswoman told the *Wall Street Journal* Nov. 24, "We will probably go along with whatever the Fed agrees to." The higher, 6% level, had been established in the so-called thrift bailout package, as one of the means by which savings and loans might be more efficiently shut down. It was intended to apply to the banking sector as a whole.

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On paper, if the reduction in reserve coverage is adopted, commercial banks which report to the Fed could expand their liabilities from the present $3 trillion or so, which are secured against about $210 billion, to $6 trillion secured, against the same $210 billion. Rather than reduce their reserve coverage, the banks would, of course, expand the liabilities covered by existing reserves to the new limit. Adding in a proportional increase in bank holdings of off-balance sheet liabilities, and other forms of securitized paper held by banks, would make the effects of the shift an order of magnitude or so worse. Banks like Citibank and Chase which are already bankrupt 6-8 times over, would rapidly be bankrupt 12-16 times over, and would no doubt still claim that they were doing better than ever before.

LaRouche called the shots

Since the mid-September default and near collapse of Campeau, the big commercial banks and investment houses have found themselves in a worsening capital crunch. At that time LaRouche pointed out from his jail cell in Rochester, Minnesota, that when Campeau defaulted, he collapsed the approximately $200 billion per annum market in so-called "junk bonds"—sub-investment grade securities—and that collapse in turn collapsed the book value of all the so-called securitized paper held by the banks. The collapse, he reported, set off an accelerating deflationary spiral, heading, depending on the rate of acceleration of that spiral to a non-linear discontinuity where the spiral becomes hyperbolic in form, like a shock front. At that point the economy would enter a physical phase change, characterized, if present policies continue by either accelerating slide into bottomless depression, or Weimar, Germany-style hyperinflation, or some combination of the two.

The capital crunch which has intensified bank lobbying for the reduction in reserve requirements, and the corollary collapse of the investment houses, reflect the development of the deflationary spiral set off with the Sept. 15 Campeau default. The Fed's move in backing the 3% standard is a powerful signal of the drift, as well as the intent, toward the hyperinflationary explosion warned of by LaRouche.

Since the close of business Oct. 12—the day before the Friday the 13th stock market crash—the nation's major banks have posted substantial losses in the values of their stocks, and thus in their capital. Comparing Oct. 12 to the close of business Nov. 22, the collapses range from 13% and 16% in the respective cases of Citicorp and Chase Manhattan, to 20% for Bank of America and Bank of Boston, and 22% for the Bank of New England.

The investment houses are not doing much better. Merrill Lynch, Shearson Lehman, Drexel Burnham, Goldman Sachs, and Salomon Brothers, have all recently announced new layoffs, cutbacks in employee bonuses and commissions, and are heading into further retrenchments. For them, the collapse of the junk bond market was the beginning of the end. The investment houses finance the takeovers of the junk bond buyouts. They extend what they call "bridge loan" financing, temporary financing, pending the completion of buyout packages. The collapse of Campeau has left them with short-term bridge loans outstanding, and dim prospects of ever completing the deals under negotiation. The bridge loans are financed at higher interest rates than the long-term packages. So sensitive has the investment houses' exposure become that they have mounted extensive lobbying campaigns to block congressional efforts to secure disclosure of the amounts involved. Merrill Lynch, First Boston, Morgan Stanley, and Goldman Sachs are known to have been involved in such lobbying.

The next phase of the mess

Lower interest rates, and lower reserve requirements are part of the preparations going on at the Fed for dealing with the next phase of the mess. So far this year the Federal Reserve claims to have restricted the growth of credit to a level which keeps the growth of reported total credit market debt outstanding at a level of $1 trillion per year, and has done this even while its Fed Funds rate has come down by 1.5%. Supposedly, then, this year's reduction in interest rates has only maintained the increase of credit, or indebtedness. Since the approximately $12 trillion of debt has been growing by the same $1 trillion, or $1.1 trillion for each of the last five years, the steady increment actually represents a slowing in the rate of growth. This is what came to an end in September.

Now either the policy under which the usurious debt has piled up is junked, in favor of a turn toward the kind of emergency technological and economic productivity-enhancing recovery program LaRouche has outlined, or the spiral of deflationary collapse continues to accelerate toward the point of hyperbolic discontinuity and relatively bottomless depression.

Suppose, in the weeks after Christmas, Campeau's Allied and Federated Department Stores, with the $12 billion of debt incurred in their takeover, do collapse; or Kolhberg Kravis Roberts is unable to make early January payments coming due to service the $25 billion financing of the RJR Nabisco buyout; or some other combination of debt-strapped takeover victims, aggregating to roughly the same amount, runs into problems. The ratios of leveraging of such debt, between five and nine to one, through the banking system are known, and some of the further indirect effects are known. Looked at in light of the changes required to shift the rate of growth of debt into an accelerating, rather than decelerating mode, Greenspan's tentative moves of Nov. 22 are preparatory to the shocks that will come, when on short notice something like $800 billion to $1 trillion has to be made available to try to prevent an overdue run against the banks. Knowing Greenspan, he'll probably still be claiming that the fight against inflation is his number-one priority, even as he is doing it.