

Federal Reserve hikes rates to save the bubble

by Anthony K. Wikrent and Chris White

The U.S. Federal Reserve raised interest rates for the first time in exactly five years on Feb. 4, nudging the Federal Funds rate (the rate applied to banks borrowing money overnight) from 3.00% to 3.25%. Prompted by the intense political pressure of House Banking Committee Chairman Henry Gonzalez (D-Tex.), the Fed departed from its 80-year history of secrecy, with Fed Chairman Alan Greenspan issuing a public statement explaining the hike, "so as to avoid any misunderstanding of the [Federal Open Market] Committee's purposes, given the fact that this is the first firming" of the Fed Funds rate since February 1989.

Much mystery is being made of the intent behind the Fed's action, which apparently will not become clear until some time passes and we see whether the Fed continues to raise the Fed Funds rate incrementally, or holds steady at 3.25% or perhaps 3.5%. Leaving that aside, let's look at two elements at play in the increase.

The first impetus is domestic, and has more to do with massaging the psychology of the financial markets than anything else. The second is far more important, and is largely, but not exclusively, external to the United States.

Contorted logic

First, the domestic considerations. Since early 1989, the Fed has held the Fed Funds rate at artificially low levels—at times just at or even below the official rate of inflation—with the objective being to prevent a full-scale collapse of Citicorp, Chase Manhattan, and the other large U.S. money-center banks which were on the brink of insolvency in 1989-90. The Fed did this by maintaining record-low interest rates, allowing the banks an easy four-point spread, by borrowing from the Fed at 3%, while buying U.S. government securities paying 7%. The results are clearly seen, with the large banks reporting record, multibillion profits over the past several quarters. They are fortunate that they no longer require

wheel-barrow or trucks to move around paper printed with the latest quarter's array of extra zeros. They now have computers and derivatives markets instead.

Thanks to this effort, Greenspan's Fed has created the worst speculative bubble in world financial history, with the Dow nearing 4,000 points at the beginning of February, and financial derivatives growing 30-40% a year, in trillion-dollar increments. Trading in the London and Chicago derivatives markets doubled in volume over the past year.

Federal Reserve Chairman Greenspan has attempted to play a clever game with financial markets: Over the past six months, he repeatedly stated that he expected that short-term interest rates would have to rise "at some point," hoping to prepare the markets for higher interest rates.

Wall Street's economists had been predicting, even urging, an increase in interest rates to forestall the re-ignition of inflation by what they assert is a "booming economy"—another example of the imbecility that results when financial considerations come to predominate over physical economic considerations. As *EIR* has documented for the past two decades, most recently in our "1993 in Review" issue (Jan. 1, 1994), the U.S. physical economy is mired in a deepening depression, with per capita, per household, and per kilometer measures of real economic activity, such as machine tool production and freight transportation, at levels one-half to one-third lower than 1967.

But these yahoos cannot see what is crumbling beneath their very noses. The Jan. 26 bulletin of Kemper Securities chief economist David Hale is typical. According to Hale, "The credit crunch that inhibited the economy's response to falling interest rates during 1991 and 1992 has now passed." The resulting "upturn in the U.S. economy . . . has greatly reduced its resource slack," with capacity utilization now at a worrisome 82.7% compared to an April 1991 trough of 76.6%. Hale also noted that with the U.S. manufacturing

work week at a post-World War II record 41.7 hours, "there appears to be a pent-up demand for labor. . . . If the work week were still at its previous 1980s peak of 41.2 hours, there would be about 250,000 more manufacturing jobs in the U.S. economy."

In the contorted logic of financial speculators, increased economic activity means more people are put to work, which means more demand, which means prices are bid higher and higher, which means the spread between inflation and the interest rates earned on financial paper will decline, which means investors will not make the same rate of "profit" on the financial paper they hold, which means that the "value" of that paper will fall.

For example, Jeff Kirinsky, a portfolio manager at Massachusetts Financial Services of Boston, told the *Wall Street Journal* of Nov. 22, 1993: "People are starting to get scared here. We had a discussion about macroeconomics [and saw] the evidence beginning to mount [that economic growth is increasing]. We're starting to get more and more concerned that this is a general economic pickup." The *Journal* writer added, "Bond investors dread rapid economic growth because it can lead to higher inflation, which eats away at the value of investments with a fixed rate of return."

Indeed, Greenspan said in his Feb. 4 statement that "the decision was taken to move toward a less accommodative stance in monetary policy in order to sustain and enhance the economic expansion," while U.S. Treasury Secretary Lloyd Bentsen, who spent the weekend playing tennis with Greenspan, declared that the rate hike was a "preemptive strike" against inflation.

But, this booming recovery is not happening. And if it isn't happening, it would be absurd to take at face value the Fed's rationalizations for what it is doing. Congressman Gonzalez has recently proven that the lie is no stranger to the mouths of the members of the Fed.

Once again, the Fed's action is aimed not so much at controlling the various bubbles as it is aimed at *saving them*, especially at the expense of the countries of western Europe and Japan.

More lies

Part of the evidence cited for the booming U.S. recovery is the outflow of mutual fund money seeking so-called "higher returns" in markets abroad. Any country that can cough up \$90 billion for mutual fund speculation, of which about \$40 billion is sent abroad, must be in terrific shape, right? This line has been retailed in Europe and Japan since last summer, to raise the bogeyman of what happens when the flows reverse.

The mutual fund story is a coverup. Since 1984, the United States has been a net debtor nation, owing more to the rest of the world, than the world owes it. Last year's current account deficit was in the range of \$140 billion. If a country running a \$140 billion current account deficit is also

sending out \$90 billion or so, there has to be an incoming flow to balance both. Let's say, some \$230 billion, has to be accounted for as an inflow to cover the deficit and the cash exports of mutual funds.

And, that is how the Fed is lying again. Higher interest rates will increase inflation, promote the cancerous metastasis of dollar-based instruments through derivatives markets, and constrict economic activity everywhere. In particular, higher rates will encourage an outflow of funds, from first western Europe, especially the German mark, and later the Japanese yen, into the dollar.

Financial warfare

In this light, Greenspan's interest rate increase marks the beginning of Round Three of Anglo-American financial warfare against especially western Europe. Round One occurred in August and September 1992, when the pound, the lira, and the Scandinavian currencies were devalued massively against other members of the European Exchange Rate Mechanism, and Citibank and George Soros, among others, made billions. Round Two was fought out in July 1993, when the French franc was put through the mill, that country's central bank forced onto futures markets to cover the depletion of its currency reserves, and the Exchange Rate Mechanism was smashed.

Now, in Round Three, the ghouls at Merrill Lynch, Lehman Brothers, and other such hang-outs, are talking about a coming, more than 10% devaluation of the German mark against the "mighty" and resurgent bubble dollar, with more to come.

This is the financial continuation of the British-authored geopolitical strategy which has been promoted by Thatcher and company since the fall of the Berlin Wall in November 1989. It is the traditional British policy, responsible for two world wars in this century, which insanely insists that no "German power" be allowed to consolidate in the middle of Europe, and that no alliance including Germany and Russia be permitted to commit to policies aimed at the economic development of the countries of all of Eurasia. The ghouls' aim: asset stripping the bankruptcies of weakened sections of German industrial capabilities in metals and chemical processing, and various classes of capital goods.

What will they get? Something probably very different than the "enhanced returns" for holders of dollars which Greenspan and company must be thinking about. They may well have set off already an upward spiral of all international interest rates, as countries prepare to defend currencies from the threat of dollar appreciation.

Germany's new central bank chief, Herr Tietmeyer, has begun to talk about how he, in his turn, is prepared to raise German interest rates to defend the deutschemark. Japan's Long Term Credit Banks have begun to lobby their central bank to begin to increase its interest rates.

That's only one of the ways in which the house of cards that Greenspan built will surely come tumbling down.