Click here for Full Issue of EIR Volume 15, Number 35, September 2, 1988

EIR Economics

Interest rates and prices skyrocket

by Chris White

The U.S. government's fiscal and financial expectations have been shattered once again by the resurgence of what the financial crowd calls inflation.

Two sets of recently produced reports did the trick. The first, publishing the official version of price inflation, including food price inflation, for the month of July, makes a mockery of what the U.S. Department of Agriculture has repeatedly assured everybody would be the effect of the drought disaster on food prices. Running at just under 2% for the month, according to the Commerce Department, the July report portends a more than 20% annual rate of increase in the price of foods. This is more than a sixfold increase over what the USDA has projected to be the effect of the drought.

More substantial in its import was the subsequent release of the Commerce Department's adjusted series for the second quarter of the year. Though these numbers show the Gross National Product continuing to grow, and the trade deficit being reduced, numbers from which the foolhardy only take heart, again price inflation for the quarter was running at an adjusted 5.1% annual rate, more than double the 1.7% of the first quarter.

That rate of increase has set off a new case of the jitters among the financial boys. "Once you cross the 5% mark in price increases you have to start waving the red flags," Donald Ratajczak, a Georgia state economist, told the *Wall Street Journal*. "We are approaching our destination at too fast a speed, and there is a risk now that we may crash."

The official numbers on inflation aren't going to come as too much of a surprise for anyone who does their own shopping, spending their own money, and thus knowing how far it actually does go. In some supermarket chains, price tags are being replaced on perishable food products such as meats two or three times before the "sell before" expiration tag expires. In some areas of the country, food prices increased by more than 7% in the last two weeks of July, setting a triple-digit rate of increase against the official double-digit rate.

'Greedy' farmers blamed

On the food side of these increases, the television and print media have begun to drum up a campaign to identify the "greedy" farmers and distributor chains, as responsible for the increases. The *Wall Street Journal* has promoted this line, arguing that such increases are not caused by the drought, but by farmers and distributors taking advantage of "uncertainty" about the drought, to jam through price increases while they can. To fall for this kind of garbage is to strain credulity too far.

The common so-called wisdom is that interest rate increases choke off inflationary growth in money and credit. Therefore, when price inflation threatens to take off, or does take off, slam on the brakes, cool off the overheating economy, and restrain the growth that's threatening to get out of control, by increasing borrowing costs.

The only problem with the conventional wisdom is, it's all wrong. Interest rate increases don't reduce inflationary tendencies, they increase the rate at which speculative liabilities are increasing against the collapse of the physical assets of the economy. The now-exploding wave of price increases is only secondarily related to such phenomena as the disastrous drought; the driver behind the price increases is, in actuality, the monetary and credit policy that has been followed since the Black Monday market meltdown of October 1987.

Over the intervening 10 months, the financial boys in the

© 1988 EIR News Service Inc. All Rights Reserved. Reproduction in whole or in part without permission strictly prohibited.

backroom determined to act such that no repeat of last October's stock market crash would be permitted to occur, at least not before the November elections. They have therefore implemented a variety of financial and accounting tricks to preserve the usuriously and speculatively inflated book value of assets and liabilities in the economy at all costs. By so doing, they have increased the volume of claims against the assets of the economy, while simultaneously shrinking the actual assets.

Maintaining "stability" in this way has made matters much, much worse.

Now the combination of price increases, and the deepening international interest rate war, is pushing the financial system into a new zone of instability.

There was one sure way to prevent any recurrence of the shattering developments of last October. Admit the reality that the dollar credit system is bankrupt, that the dollar banking system, with earnings 0.13% of assets for last year, is bankrupt; put the financial system and banking system through top-down bankruptcy reorganization, modeled on the Chapter 11 procedures adopted for individual companies, and provide credit, in the form of gold-backed Treasury notes, to put idled productive capacity—in the form of plant, equipment, and labor—back to work producing the wealth necessary to reverse the crisis, not just in the United States, but globally.

Presidential candidate and economist Lyndon H. LaRouche, Jr. designed this kind of bankruptcy reorganization solution many years ago, but the Wall Street boys in the backroom, who insist that they know better, obsessively maintain that their way of doing things is better. "Look, it hasn't collapsed yet, we must be doing something right," they insist.

The savings and loan crisis

Well, take a look at the kind of thing they are doing, and it becomes clear where the inflation driver comes from. It's well known that technically, the thrift system, the savings and loan associations, are goners. One thousand of the more than 3,000 individual thrifts are bankrupt. The system as a whole lost $13 billion last year. It was losing another $1 billion a month through May. The Texas thrifts lost $2.1 billion, on their own, in June. The system's insurance fund is empty. Against the losses, Congress, in its infinite wisdom, last year voted up a three-year "rescue" program, under which the bankrupt system could borrow a bit more than $2 billion per annum for the next three years.

Now, the Federal Home Loan Bank Board is taking over failing thrifts on its own. In the 10 days from Aug. 15-25, nearly $10 billion of notes have been issued by the Federal Home Loan Bank Board and FSLIC, in multi-state so-called rescue operations. The notes provide the basis for recapitalizing the thrifts. They are collateral for borrowing, etc. But, the FHLBB and the FSLIC don't have any money. They are simply issuing promises to pay, in the future, to permit their insolvent charges to keep borrowing so that the financial assets and liabilities of the system don't have to be written off. And these promissory notes are not backed by the full faith and credit of the U.S. government, since the FHLBB doesn't have the power to issue debt, but by a "sense of the Senate resolution" rammed through by Sen. William Proxmire (D-Wis.) at the beginning of August, that they *should* be backed by the full faith and credit of the U.S. government.

And thanks to the miracles of the credit system, these unsecured notes, backed by the threat that at some point taxpayers will have to make them good, then leverage in some further increases in paper claims.

Set to explode

Apply the same kind of approach to the banking system as a whole, as Federal Reserve chairman Alan Greenspan and former Treasury Secretary James Baker have been doing for the last 10 months, and it becomes clear where the "inflationary threat" comes from. The rising U.S. interest rates of the period from early June through the present, have attracted perhaps as much as $100 billion of speculative capital into the U.S. banking system, deployed on the calculation that more money can be made on the rate differential between the U.S. and European money centers, over any 90-day period, than in any other way. The inflow has permitted Baker and Greenspan to claim that they have maintained the stability of the banking system. That's like some crazy terrorist claiming that he's improved the stability of his bomb by fitting a better detonator to it.

So now, as the U.S. price explosion begins to get noticed by officialdom, the Europeans, in coordinated fashion, respond to Greenspan's latest shot in the interest rate war. Across Europe borrowing costs were increased by central banks, by 0.5-0.7%, and in the case of the British and Italians, by more. The increase was sufficient to send the dollar back down from its heights, undoing the effect of the rate increases in the United States the week before, and thereby signaling to the speculators who control the $100 billion hot money pile, that for the next 90 days, there's more money to be made outside the United States.

For Greenspan and company, the alternatives will seem to be further increases in interest rates, to attempt to keep that speculative source of funds within the dollar system, or submitting to efforts to pull the money out. The alternative beyond that, is to unleash a hyperinflationary explosion of paper, which will set off a further increase in the volume of the paper claims outstanding against the economy as a whole.

Either way, Greenspan will still be expecting you and your family to surrender your standard of living in order to pay for the incompetence of himself and the financial crowd who back him. And either way, it won't change the end result: the aggravation of the worst financial collapse in history.