Price Spiral to Turn U.S. Into Banana Republic

by Ali Baz

Aug. 8 (IPS)—It is no exaggeration that unless immediate steps are taken to declare an orderly debt moratorium, the currently unfolding price increases in theU.S. will culminate, by early 1976 at the latest, in hyperinflation of a magnitude not encountered in the advanced sector since the dark days of Weimar Germany.

Despite Federal Reserve chairman Arthur Burns' publicly stated commitment to hold down monetary expansion to the 5 to 7.5 per cent range, the Federal Reserve will have to print upwards of $50 billion greenbacks in 1975 to rescue Treasury bond issues from a dried up government bond market. The alternative, to date followed by the pipe-smoking Burns, is to batten the hatches and drive the economy right over the cliff into massive bankruptcies and the worst deflationary collapse in 400 years.

In the wake of eroding revenues from corporate and personal incomes, not to mention the mounting wave of cash redemptions of Treasury securities by foreign central banks, the Treasury's need for funds is multiplying geometrically. The nation's commercial banking network, the Treasury's traditional financing resource, is presently saddled with an unprecedented 50 per cent "soft" loans on its book and cannot begin to meet the Treasury's needs. Rather, the banks will commit every dollar they can get hold to financing an upward price spiral in the expectation of thereby recovering former losses. The government will be left with no other recourse than to crank up the Federal Reserve printing presses to finance at least $50 to $60 billion worth of the federal government's cumulative budget deficit for calendar year 1975.

The resulting 25-plus per cent rate of increase in the money supply—cash in circulation plus checking accounts—will simply blow the economy to bits via the hyperinflationary route. Internationally, the dollar will be certified as worthless scrap of paper instantaneously.

Hyperinflationary Drivewheel

Highlights from reported economic activity for this week alone underscore the seething tumult in the capital markets and throughout the economy. The 14.4 per cent per annum jump in the wholesale price index for July already outstrips the peak rate of inflation registered in 1974. The significance of this figure, however, lies in what it does not account for: it is simply a reflection of increases in the prices of pre-processed foods and petroleum distillates and does not include the dramatic hikes in the prices of industrial raw materials or, for that matter, the decontrol of petroleum prices. The announced and as yet unannounced price increases in Rockefeller-owned investments in gasoline, steel, aluminum, and industrial materials connected with the oil industry, will within a matter of days and weeks be followed by an avalanche of "me too" price hikes by other capitalists, as one capitalist's price increases become another's added costs.

Behind the price spiral is the unprecedented illiquidity of the corporate sector. By late 1974, the net earnings to sales ratio for all corporations was already down to 0.4 per cent. Over the past year the corporate liquidity to debt ratio has slumped to its nadir and short-term debt to long-term debt has reached historic highs. Armco Steel, only one of a number of steel companies to raise prices, declared a 9 per cent price rise for rolled steel effective this week, claiming losses of $2 million a month since the beginning of the year. Under these circumstances, the corporate sector—which has, incredibly, been paying dividends to its stockholders from borrowed capital in lieu of non-existent earnings—is being denied access to the "quality-conscious" bond market, the source of long-term capital that is a pre-requisite for any productive investment to take place at all. This week New Jersey Bell, Consolidated Edison, Wisconsin Power and three other corporate bond issues were withdrawn from the market for lack of investor interest.

The central feature of this corporate squeeze, from the standpoint of the process of production, is the hundreds of billions of dollars worth of still-unsold inventories corporations are sitting on. Price hikes are a desperate corporate "alternative" to the prospect of liquidating these inventories at devastating losses, a course of action which the embattled auto industry's vaunted rebate sales campaigns proved an unqualified disaster. Raising prices will not, of course, make it possible for corporations to unload their inventories. On the contrary, by increasing the "book value" of their assets and thereby their nominal ability to get loans and float bond issues, it will simply allow them to continue and even accelerate the inventory stockpiling on a scale that will pale that of 1974.

Rockefeller's banks, for their part, are faced with a complementary dilemma. Saddled with uncollectable loans to the myriad New York Cities, the Argentinas and the Egypts, the North Sea and Alaskan energy boondoggles, the Continental and Chase Mortgage Investors (REITs) and the Chryslers, their only alternative to a massive write-off of this paper is to jump onto the hyperinflationary bandwagon themselves. This week's decision by the New York banks to roll over $500 million in New York City debt coming due between October, 1975 and June, 1976, together with the $51 million increase in commodity loans for the week ending Aug. 6—loans channeled to commodity futures market speculation—indicate the direction they're heading.

The Firestorm Effect

As this insanity unfolds and the competition for funds accelerates, the "favorable" rates offered by banks on their corporate deposits (technically, Certificates of Deposit) under conditions of a generalized skyrocketing of interest rates, will result in a phenomenon broadly reminiscent of the "firestorm" effect associated with the U.S. bombing of Dresden during World War II. The banks will such nearly all available capital from insurance companies, Savings and Loan associations, corporations, and pension and trust funds to finance the hyperinflationary spiral—finally leaving the economy a mass of rubble.

In this game nobody will win, the banks least of all. The further stockpiling of unsaleable inventories on top of the yet-to-be-depleted stocks left from the 1974 vintage speculative binge, at a time when liquidity in the economy is stretched to the limit, when unemployment is soaring and prices are outstripping incomes, guarantees the rapid destruction of the U.S. economy as well as its dollar-based satraps.

NET ACQUISITIONS OF U.S. TREASURY SECURITIES FOR CALENDAR YEARS 1974 AND 1975 ESTIMATED IN BILLIONS OF DOLLARS

	1974	1975
Commercial Banks	-2.9	15
Non-bank Finance	2.6	3
Corporations	1.2	1.5
State and Local Governments	2.6	0
Households	3.4	6.5
Foreigners	3.9	4
Federal Reserve Bank	4.1	60
TOTAL ACQUISITIONS	14.9	90

This chart presents a breakdown of Treasury financing. The estimated distribution of Treasury security sales among the various traditional purchasers for calendar year 1975, as compared to calendar year 1974, is based on the analysis of these various sectors' current and projected capacity to expand their holdings of Treasury debt presented above. The inescapable conclusion is that, at current levels of production and general economic collapse compounded by an inflationary surge already underway, the Fed itself will be forced to crank up its printing presses to finance the overwhelming bulk of the soaring government debt.

Source: FRB, **Flow of Funds**, MHTCo. estimates, and NCLC **Financial Intelligence** estimates.

As for the Treasury, a combination of factors will geometrically increase its financing needs between now and the end of the year. On top of its rapidly shrinking tax base, the approach of an election year, the multiplying need to bail out defense-related industries—illustrated by this week's $250 million rescue of Litton Industries—the inevitability of directly bailing out the banks holding municipal bonds, or bailing out entire cities directly, will further the Treasury's appetite for cash. This week the Treasury announced that it will raise $11 billion in new money in the next five weeks, compared to earlier estimates of $8 billion — the process of upward revision which will push total second-half Treasury borrowing to $50 to $60 billion, compared to the $40 billion raised in the first half of the year.

With a step-up commercial and industrial loan demand to finance inflated inventories and commodity speculation, the market for Treasury securities faces the prospect of implosion—Treasury securities may simply be "crowded out" of the market. Unless the Fed indeed opens the spiggots of new credit, it will be increasingly impossible to control the leapfrogging of interest rates as the Treasury competes with banks and corporations etc. for limited funds. The very anticipation of inflation precipitates and fuels this process, already underway as indicated by an across-the-board increase in short-term interest rates this week. Ironically, as interest rates are forced up on Treasury securities, the Treasury must sell more and more bonds at a higher and higher cost for less and less cash—feeding its own cash flow crisis, directly forcing the issue of a Federa Reserve hyperinflationary transfusion with renewed urgency.