

## Business Week Blows The Whistle On Federal Reserve Chief Burns

The recent spurts in the U.S. money supply, which have been engineered by Federal Reserve Chairman Arthur Burns and the New York-centered "toilet paper dollar" financier faction, are coming under bitter attack.

"The Federal Reserve has backed itself into an awkward corner," *Business Week's* Friedmanite editor William Wolman wrote in a scathing attack on the money supply balloon in the Sept. 19 issue of that publication, "and it may have no way of getting out of it without putting the U.S. economy through another painful bout of accelerating inflation, a recession, or both."

### BUSINESS OUTLOOK

The news that the country's basic money supply surged ahead another \$2 billion in the week ending Sept. 14 will no doubt kindle more fears about the inflationary potential of this money supply expansion. During the last four weeks both M1 and M2 have risen at an annual rate of nearly 11 percent — well above the Fed's upper target. The accelerating growth of the money supply, now coupled with the Fed's own belated and half-hearted attempt to check the money supply growth that it has unleashed by raising interest rates, have helped to push the Dow Jones industrial average to below 840 to the lowest levels since late December 1975.

Central to feeding the inflationary potential is Burns' role in pumping reserves into the banking system to keep the money center-Eurodollar banks liquid and prevent the U.S. economy from going through the floor. Burns, Treasury Secretary Michael W. Blumenthal, Assistant Treasury Secretary for International Affairs C. Fred Bergsten, and other Administration economic officials have been trying to pressure West Germany and Japan to reflate their economies fast enough to take the burden of sustaining the bankrupt dollar monetary system off the United States. In the face of continued European and Japanese resistance to go all out for reflation, the U.S. Federal Reserve has been working overtime pumping out reserves to be multiplied several times over in the economy and the Eurodollar market.

Now *Business Week* and other business community spokesmen have blown the whistle on Burns — who has been raising interest rates and "fighting inflation" with one hand, and pouring out liquidity in the form of bank reserves with the other. Burns's efforts to drown the U.S. with banking reserves has led some economists to rechristen the U.S. currency the "toilet paper dollar."

#### *Production Plummets*

In spite of the explosive money supply growth, output

levels in the U.S. economy are trailing off, and basic industry, led by steel, is suffering from the depressed state of capital goods orders.

\* Industrial production fell 0.5 percent for August, the first such drop since January.

\* In the most drastic cutback yet announced in the steel industry's current self-triage, Lyke Steel Corporation stated Sept. 20 that it will slash its steelmaking operations in Youngstown, Ohio reducing its total steel capacity 27 percent and cutting 5,000 jobs. Lyke's long-term debt had ballooned up to \$690 million by the end of the first half of the year, up 30 percent from \$526 million at the beginning of 1976.

\* On Sept. 22 Armco Steel announced that it was eliminating 600 workers, or about 8 percent of the workforce, at the company's Middletown and New Miami works. The plants produce flat rolled steel used in autos and appliances; until recently orders for that product had been holding up. U.S. Steel also said that it is reducing steel rolling operations at its Youngstown plant because of the lack of orders.

\* Unemployment in August climbed back to a 7.1 percent rate, as 103,000 production workers lost their jobs. For manufacturing workers overall, the Department of Labor's Hourly Earnings Index in dollars of constant purchasing power rose on a year-to-year basis ending July by a minuscule 0.3 percent.

\* With manufacturing income down, workers have turned to record consumer borrowing, an increasingly risky proposition. Between April 1975 and June 1977 new debt as a percentage of after tax income jumped from 14 percent to 17 percent. The maturity on car loans has lengthened more than 50 percent during the last two years, demonstrating the disregard of prudent lending risks by credit companies desperate to make car sales.

But without the incredibly built-up pyramiding of consumer credit, the auto and housing sales spurt — which has held up the economy — would have died on the vine, and the economy would have collapsed months ago.

#### *Root problem: Capital Spending Lag*

At the root of the production collapse now unfolding is the absence for the last 18-24 months of capital spending for long-term industrial growth.

The lack of such spending is further exacerbated by both the collapse in U.S. trade levels, and a new binge of hyperinflation, prompting industrially linked interests to launch their counterattack against Arthur Burns this week.

First, the drop in U.S.-world trade levels, fed by the leap of indebtedness which has crippled Third World nations' ability to import U.S. high-technology goods, has pushed export-led capital spending plans further onto the

back burner.

Second, in response to the explosive growth in money supply which he created, Fed chairman Burns has had to raise interest rates. Whereas such moves normally dampen borrowing and lending, and therefore money supply growth, the reverse has thus far happened.

Nonetheless, short-term money market instruments, whose interest rates Burns pushed up, have suddenly become very attractive investments. Money is flowing increasingly into speculative sink-holes, which drain funds from needed real capital investment, and actually feeds inflation.

During this period industrial expenditures for new added capacity, when corrected for inflation, are virtually flat. At the same time, approximately one-half of all business spending for new equipment has in fact been for the purchase of new truck and car fleets, the purchase of computers, and used for paperwork, not production. The remaining equipment purchases went for machinery replacement, but not expansion.

### *Dollar on the Block*

The offshoot of these developments is another run against the dollar. Gold, the hard-commodity fallback option against the dollar, has risen in price dramatically over the last few weeks: from \$144 an ounce two weeks ago, to \$151 an ounce today. At the same time, *Handelsblatt*, the German industry newspaper, warned this week that continued U.S. hyperinflation will lead the Arabs to accelerate their flight out of dollar holdings, and all the nasty repercussions that follow.

Within the U.S., Irving Kristol, a member of the *Wall Street Journal's* board of contributors, soberly wrote this week, "If the American economy should now slump, the world economy would come close to collapse. International trade and investment — the major force behind our postwar economic expansion — will dry up. Protectionism will become rampant. Many of the poorer countries will demand a moratorium on their debts. Bankers will become more nervous than they are now."

## Citibank, Swiss Gain Edge In Race For Euro-Funds; Commentators Moot 'Cold, Hard Reality'

The \$300 million medium-term Eurobond to be floated Sept. 29 to raise funds for the New York-based commercial banking giant Citibank is being watched with exceptional interest. It will be the biggest issue ever for a non-governmental borrower; moreover, it has been tailored by its lead managers, Citicorp International and White Weld-Crédit Suisse, to draw OPEC and Western European placements. The bond comes in the \$1,000 slices preferred by these investors, while its spreads — the amount of interest paid by the borrower above the

European financiers want to use their funds to enhance their own deposit bases. For their part, the New York banks are forced to hustle for volume Eurolending, as witness Chemical's willingness to put more stakes into the hapless London Multinational in order to possess itself of a fully-owned London merchant bank. In this scramble, Citibank's attempt, through its Swiss connections, to shore up its assets against imminent loan losses on bad Third World debt and domestic holdings of the shaky real estate type, is a decidedly defensive move; but it has the corollary effect of pushing Chase Manhattan and London's lifeboats into even stormier waters.

### BANKING

London interbank lending rate — are extremely low, to Citibank's advantage. Citibank is expected to mop up the brimming liquidity on the Euromarkets to an extent which may well make things tougher for subsequent borrowers, including the prospective Eurosterling bond issuers newly mobilized by the City of London, as well as the City's Eurodollar bond clients. "Citibank is coming into the market just in time," said several top bond international bond analysts; if Chase and Bankers Trust et. al., try it next, they will have problems.

At the same time, along with Barings of London and Northern Trust, Crédit Suisse has just happily relinquished to chemical Bank its share in an unprofitable Euromarket operation, the London Multinational Bank. Crédit Suisse "prefers its other connection," observed one analyst, "I mean White Weld" — the London-based money-market bank with ties to Citibank. Recently, the British-bank Kleinwort and Benson and the French bank Paribas also sold their interest in Bank of America Ltd., another European-U.S. joint venture. In perilous times,

The Swiss banks will have extra resources to aid their allies, because of this very instability. Last week U.S. money-supply hypertrophy and Mideast war signals impelled a significant flow of short-term investment into both gold and swiss francs (also creating a bull market for gold mining shares). Swiss central bank chief Fritz Leutweiler announced Sept. 23 that his governing board is "quite willing to see a further appreciation of the franc" — an invitation to further speculative outflows from London, New York, and Frankfurt. The City of London, counting on a strong pound sterling to backstop domestic deflation and heightened international lending, could face a sinking pound instead.

The necessity of broad international monetary and credit solutions was meanwhile acknowledged from diverse quarters last week. A most uncharacteristic feature article appeared in the Oct. 3 issue of *Business Week*, headlined "Floating Rates — Invitation to an Economic Storm"... without the *pro forma* question mark. Despite recent calm on the foreign exchange markets, warns *Business Week*, "cold, harsh reality" must be itemized, including grave unemployment, in-