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End to dollar reflow means interest rates have not peaked

In an atmosphere one trader described as "panicky," institutional investors rushed into the bond market en masse last week, gobbling up new issues and pushing up prices on older bonds a half to a full point on June 6 alone.

It would be hasty to conclude that smart portfolio managers think U.S. interest rates have peaked, however. Institutions have build up enormous cash reserves over the last couple of years of stagnant capital formation. Merrill Lynch estimated last fall that the cash reserves of pension funds alone were approaching $50 billion or enough to supply the taxable long-term bond market for an entire year, and they are currently committing only a small portion of their accumulated cash to the fixed-income market. Moreover, unlike indidivual investors, institutions are continuing to select higher-yielding short term investments, issues maturing in less than a year, presumably so that their funds will be available for reinvestment later on at yields even higher than the 9.37 to 11.16 percent recent industrial offerings have garnered.

DOMESTIC CREDIT

At the present juncture a myriad of factors are working together to put renewed pressure on domestic interest rates in the months ahead, even if the economy slides into a recession first. They include the growing illiquidity of the corporate sector—and growing reliance on short-term borrowed funds; steeply rising energy costs and unabating inflation, which are prompting corporations to stockpile goods that consume a lot of energy in production; and a hefty calendar of borrowing by the U.S. Treasury in the second half of the year. The Treasury will be in the market for some $23 billion compared with $12 billion in the January through June period, according to Bankers Trust estimates, at the same time that corporate demand for credit is rising.

Probably the most important element to factor into U.S. interest rate projections at this time is an international one—the dollar reflow situation. For the last several months domestic interest rates have been kept artificially low—compared to where they would have been otherwise—by the reflow of international funds into U.S. dollars. Despite the fact that the only change in U.S. economic "fundamentals"—productivity, exports, capital investments, etc.—has been for the worse, the hike in U.S. interest rates last Nov. 1 and more recently the escalating world oil bill, which is largely paid for in dollars, have had their intended effect of strengthening the dollar. The extent of the demand for dollars abroad has forced foreign central banks to liquidate their holdings of nonmarketable Treasury securities, where they had previously invested dollars purchased in support operations, to the tune of $17 billion over the last few months to supply the foreign exchange markets with dollars.

Once in the hands of private banks and investors, the dollars were rechanneled into the Eurodollar market, where they eased the upward pressure of certificate of deposit (C.D.) interest rates and made borrowing in that market more attractive. The plans by General Motors Acceptance Corp.'s foreign unit to float $100 million of seven-year notes in the Euromarket, the first time a GMAC unit has ever borrowed Eurodollars, typifies the exodus of U.S. corporations and banks into the Euromarket for cheaper funds that began late last year.

The dollar reflow has also had a spillover effect in the domestic credit markets, however, where short-term interest rates have been lower than one would expect them to be, given the magnitude of short-term credit demand. Various money market analysts have pointed out that interest rates on domestic C.D.s are only a shade higher than rates on U.S. Treasury bills, which is extremely unusual given the high volume of credit demand by corporations.

The situation which prevailed through the first five months of this year may be up, however. Market observers report that there has been no further

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liquidation of Treasuries by the foreign central banks over the last three weeks, and that the bulk of the reflow into the dollar appears to have run its course. If true, this means there will be no cushioning of the sizeable future credit demand.

The main debate over where U.S. interest rates are now headed revolves around when when the high interest rate-oil price-induced recession will kill demand for credit—immediately or after a lag of some months. The second scenario, which is the more likely, entails an imminent run up in short-term rates, as corporations scramble to get funds to finance a voluntary and involuntary increase in inventories. Manufacturers Hanover economist Irving Kellner said last week that although the economy may have already entered a recession, he expects demand for commercial and industrial loans to continue to increase for a least the next several months because of the erosion of corporate profits and liquidity and their increasing dependence on external funds. On top of that, the sharp escalation of energy prices this year, beside being a major added cost of doing business, has prompted corporations to begin to stockpile goods such as plastics, chemicals and other products that have a high energy content as a hedge against further energy price increase. This, of course, increases the demand for short-term borrowed funds.

The administration, whose economic, energy, and foreign policy are responsible for the impending economic catastrophe, is holding in reserve various tools for "dealing with" the problem of inflation. Council on Wage and Price Stability chief Barry Bosworth became the first administration official last week to broach the subject of mandatory wage and price controls. And at hearings of the Senate Banking Committee on May 24 on a bill to repeal the Credit Control Act of 1969, Treasury Secretary Blumenthal argued for preserving the president's standby authority to selectively ration credit in the economy. "This is not because we see a need to exercise such authority now or in the forseeable future," Blumethal maintained. "But the economic situation can change rapidly. It is only prudent, therefore, that the president retain the authority to respond promptly, and if need be selectively, to disruptive changes in the composition of credit demand." Federal Reserve Governor Nancy Teeters backed him up with a speech on the impracticality and free-market undesirability of controls—which ended by advocating them in case of "emergency."

—*Lydia Schulman*

OPEC-Third World split

In a series of editorials and news commentaries on the fifth conference of the United Nations Conference on Trade and Development (UNCTAD), the British and American press have advertised the following strategy: pit the oil-producing countries and the rest of the Third World against each other and institutionalize the Third World's "dashed hopes" and "changed assumptions" about industrialization prospects. On the eve of the U.N.'s Third Development Decade, the intention is to make the developing sector safe for "appropriate technologies" and, "collective self-reliance" genocide.

Detailed evaluation of the proceedings of the Manila conference that ended June 2, one day behind schedule after seemingly endless deadlocks, awaits further information and cross-checking of on-the-scene reports. As we have reported, the "North" positions were set by the International Monetary Fund and Organization for Economic Cooperation and Development to prevent any discussion of a new world economic order and aggravate Third World divisions by manipulting the oil-price issue.

This was and is designed to sabotage the negotiations for an international conference of energy producers and consumers, a proposal fielded by Mexican President Lopez Portillo with the support of French President Giscard and other Western and East bloc leaders. The agenda would include overhauling the world system of energy production, distribution, and consumption as the practical kernal of a program for global high-technology investment.

The Portillo proposal will be formally presented at the fall United Nations General Assembly session launching the Third Development Decade, and Cuban President Fidel Castro has also requested that Portillo, whose country is not a member of the non-aligned group, present the proposal to the non-aligned summit that will meet to prepare for the U.N. General Assembly in Havana this fall.

A World Bank mercenary

The most elaborate statement of the current Anglo-American tack was featured in the New York *Journal of Commerce* editorial of June 5, pompously titled "The Third World Shifts." "Mahub Ul Haq has changed his mind," begins the Journal, introducing the Cambridge-Yale product whose promotion as "the most articulate and persuasive spokesman of the Third World" is based on the facility and conviction with which he now relays the formulas of Milton Friedman's Mont Pelerin Society.

Central to World Bank planner Haq's new pose is his assertion that, contrary to what he once believed,