Domestic Credit by Richard Freeman

Rubbing Congress's nose in the dirt

Interest rates will move higher; the prime could be 12 percent by the end of the summer.

On Aug. 11, Chase Manhattan led the way for the country's large banks in raising the prime rate from 10.5 to 11.0 percent. This is likely to be the first of several increases.

Monte Gordon, chief economist for Dreyfus in New York, reported, "The prime will probably go to 12 percent or higher. Based on market conditions, the prime should be 12 percent right now. The prime is lagging behind the other short-term rates.

"The banks waited to raise the prime. They couldn't do that while Congress was voting the IMF subscription increase. That would be like the banks rubbing Congress's nose in the dirt. So, the minute Congress recesses, bingo, the banks raise the prime."

The Dow Jones industrial average plunged 20.23 points Aug. 9, resting at 1163 at day's end. From the Dow's high of 1248 the first week of June, the steady rise in interest rates across the board has lopped 85 points off the Dow average. Dreyfus's Gordon believes the Dow could soon go down to 1050.

Three things are forcing up the prime.

First, there is the the policy decision reached by Federal Reserve Board chairman Paul Volcker to threaten President Reagan with destruction of the phony recovery through higher interest rates, and thus confront the President with a domestic economic crisis at the same time that the President is hit with crises abroad.

The newly reappointed Volcker told Congress in hearings July 28 that he thought interest rates would move higher, sending a shock through the markets. Then, as I reported last week, Volcker, in order to drain liquidity, sold Treasury securities by invitation to individual banks, rather than a general offering. As one New York banker said at the time, "By conducting federal funds operations on a customer-by-customer basis, the Fed was giving a signal that it was pleased with the rise in the federal funds rate." Federal funds set the base level for other interest rates.

On the same day that Volcker spoke, his alter ego, Henry Kaufman of Salomon Brothers, predicted higher interest rates. On Aug. 5, First Boston economist Henry Wojnilower—he and Kaufman are known on Wall Street as "Dr. Death and Dr. Gloom"—predicted 13 percent Treasury bond rates before the end of the year.

The second factor in the interest-rate increases is a tremendous demand for dollars internationally, which is pushing up interest rates.

Ibero-American nations service their $300-billion-plus debts in dollars; Western Europe's debt must also be paid for the most part in dollars (see Special Report). This demand for dollars has pushed the six-month Eurodollar rate to above 11 percent, more than a percentage point above the comparable six-month rate in the United States. The higher interest rates in the Eurodollar market can be expected to contribute to the upward pressure on rates across the Atlantic.

Finally, there is the tremendous financing required to cover the U.S. budget deficit, which will be $210 billion for fiscal year 1983, despite administration claims to the contrary. This too requires dollars.

What about the "recovery"? McGraw-Hill economist Joe Speers reported Aug. 9, "I believe that the increase in interest rates will hurt housing pretty bad.

"I think that all the people who could buy homes at 13 percent interest rates have already bought them. Now rates are above that level [13.75 percent]. The multi-unit housing complexes have already gotten their money to be built. They won't be able to borrow much new money."

Chris Palmer, editor of the Birmingham, Alabama-based newsletter "Palmer's Lumber and Plywood Forecast," told *EIR* Aug. 12, "I'm looking for housing starts to slow down to 1.5 million or even 1.4 million on an annual basis." Housing starts were reported to be 1.7 million units in July.

The slowdown is already foreshadowed in the decline in lumber prices, which reflect the level of homebuilding activity.

The benchmark price for softwood lumber, which stood at $243 a thousand board feet at the beginning of June, fell to $195 July 31, and to $178 on Aug. 5. Chris Palmer predicted that the price could fall to year earlier levels of $130 per thousand board feet within 30 days.

As for auto, the other side the Treasury-debauching Keynesian recovery this spring, General Motors Acceptance Corporation has announced that it must pay 9.5 percent for its commercial paper, which dooms its 9.9 percent consumer loan interest rate for selected auto models. Since the auto boom is attributable in the main to such programs, their termination will also terminate the eight-month auto recovery.