

A may-fly market rally for a June summit

by Chris White

The stock market ended what looked like its most successful week in quite a while on June 3, with an uptick of over 100 points on the Dow-Jones index. The bubble-brained, perhaps influenced by the sales lines of brokerage houses like Merrill Lynch to the effect that "the summer rally" is here, might now consider things poised to bust through the 2100 barrier again. They'd be crazy to do so.

Here we are, at the beginning of June, a few weeks away from the Toronto Economic Summit, which will bring together the heads of state of the Group of Seven Nations, namely, the United States, Canada, Britain, France, Germany, Italy, and Japan, with their economic and finance ministers, and the other camp followers and assorted retainers deemed vital for such international gatherings. The stock market uptick is quite closely related to the political-psychological warfare preparations for such gatherings. Since the custom is that the heads of state assemble to solemnly reaffirm their mutual faith in their own wisdom, and the efficacy of the policy prescriptions of themselves and their advisers, it wouldn't quite be the thing to have the proceedings wrecked by a repeat of what happened last October.

So speculative flows are being arranged to help keep up appearances for the next couple of weeks. The trickery and fakery are what one should expect from the sclerotic institutions which insist that their sacred policies need not be changed to address the worst financial crisis in human history, and that all blemishes can be brushed aside with the psychological warfare equivalent of the photographer's airbrush.

In the United States, the speculative uptick was fueled by the nonsense that the in-progress tightening of interest rates had peaked. Therefore, the hype went, investors who had

stayed on the sidelines were making a re-appearance in the rallying market. It mattered not an iota that even while this nonsense was being spread, the Federal Funds Rate, the rate at which banks lend to each other for overnight clearance, was being inched up, for the third time in as many months, to a new range of 7.25-7.5%. Nor that the bond markets, with ups and downs over the week, continued to see slippage, such that rates on Treasury bills and notes are now back to their highest levels since the October Crash.

The word was, "Rates have peaked," so peak they must have. That type of idiocy was singularly fed by the reports emanating from the Bush family compound in Kennebunkport, Maine. There, candidate George was meeting with a group of financial and economic advisers, including the incredible Martin Feldstein and others of that ilk. Coming out of the meetings, Bush told the press that he had "a lot of confidence" in the Federal Reserve, "but I would not want to see them step over some [line] that would ratchet down, tighten down economic growth."

In keeping with this transparently political expression of self-interest, the Bush group put forward their approach to dealing with the budget deficit. Excluded were tax increases. Instead, a "real dialogue" with Congress, from the start of the budget process, would prove that the deficit really would be cut, and a two-point reduction in interest rates would knock \$55 billion off the deficit.

These people are more crazy than those who are slated to be the suckers in the summer rally shell-game.

Speculative money flows

The market uptick was not internally generated, but trig-

gered by a British and Japanese shift of funds into U.S. markets in expectation of increased yields, i.e., higher interest rates, inside the United States. In Britain, the speculators' view is that there is more money to be made from being in the U.S. markets right now, so, it is said, British financial institutions wound down positions in Japan, and shifted to the United States. On the Japanese side, remarks by that country's central bank chief, Sumito, that "the dollar is now considered a high-yield currency, and that the recent commodity price rise is not believed to be sustainable," were supposedly the trigger for an outflow of speculative funds.

Behind the speculative money flows stand the outlines of a renewed agreement among especially U.S. creditors, to maintain the dollar at about current levels, through renewed interest rate tightening and cuts in domestic U.S. consumption. What is being discussed internationally is diametrically opposite to the bull that's being fed to the mickeys inside the United States. And, of course, the U.S. financial "insider" crowd is fully involved.

U.S. Treasury official David Mulford told a gathering of 1,300 foreign exchange dealers in Honolulu, Hawaii over the last weekend in May, not to speculate against the dollar in the run-up to the Toronto summit. He told conference participants that the Group of Seven nations were committed to stable exchange rates, and would continue to buy and sell the dollar to keep it within relatively narrow ranges, according to the London *Financial Times* of May 31. The same views were echoed during the week by the finance ministers of France and West Germany, Pierre Berégovoy and Gerhard Stoltenberg, during their get-together during the first week in June.

Slashing domestic consumption

The talk about currency stability is actually predicated on further increases in U.S. interest rates, to choke off domestic consumption, and help continue to slow the level of imports. This was the approach recommended in a report on the U.S. economy issued May 31 by the Organization for Economic Cooperation and Development (OECD). As regards expectations of where the United States is headed, the report is well-hedged. The deficit is either to be a permanent feature of the world economy, or it will disappear by about 1993. The economy will either "over-heat" in a resurgence of inflation, or will plunge into a recession.

If the ends are defined with such lack of clarity, the means to be adopted to achieve those ends are not. For the OECD there should be no further devaluations of the dollar. This, it is reported by the *Financial Times*, "would risk inflation inside the United States and recession in other countries, and would be dangerous given the present fragility of the financial markets." The deficit should be tackled by budget cuts and reduced consumer borrowing. In which connection it is recommended that U.S. authorities act to stop the use of home equity borrowing to finance consumer spending.

The conclusions of the report are in line with the prevailing international expectation, that far from having peaked, U.S. interest rates, driven upward by the gradual tightening of the Fed Funds rate, will soon hit 10% and, not so long afterward, 11%. Far, then, from a rally over the summer, this kind of approach is exactly what will exacerbate the instabilities that are already aggravating the worst financial crisis in history.

Inside the United States, pundits like Philip Braverman of Irving Securities are expecting the same, yields in the 10-11% range to choke off domestic consumer demand. Braverman asserts that such an interest rate tightening will not result in a recession for the economy until some time next year. As usual, the crazies don't know what kind of explosive mixture they are dealing with.

The significance of the current interest rate creep on one of the most explosive components of the U.S. credit system was highlighted by the *Wall Street Journal* on June 3. One of the "innovations" of the last years of financial insanity has been the proliferation of variable interest rates on a variety of the sources of consumer borrowing. An increase in interest rates to the 10-11% range will have dramatic consequences for the financial system as a whole. "An increase in the prime rate to just 10% would set off a ripple effect that could cost consumers more than the 20% base lending rate of 1980," says Paul Getman of the WEFA group in Bala Cynwyd, Pennsylvania. Anything beyond 10%, and we would be living on borrowed time, he says. And William F. Schuman of Insured Credit Services Inc. says, "People are in for a shock if rates rise to around 12%. There will be bankruptcies and delinquencies will increase."

The magnitudes involved are enough to help bring down everything—like \$70 billion of home equity loans, pegged to the prime rate and adjusted monthly. Where home equity loans used to function to consolidate borrowings, now the *Journal* reports, it is estimated that 60% represent new borrowings. And \$423 billion in adjustable rate mortgages, with the variable rate kind now accounting for 70% of new mortgage lending. Nearly \$630 billion of consumer installment credit is outstanding, an amount which has doubled since 1981.

Behind the figures stand the families and households that will lose everything as the demanded interest rate squeeze also translates into increased unemployment. But this seems to be exactly what the crazies who drafted the OECD report want.

Since the growth of especially consumer debt has papered over the actual decline in living standards within the United States, the collapse of the ability to service that debt will demonstrate what reduction actually has been brought about. Just like the 1930s, the attempt to maintain the speculative income from a bankrupt financial system is going to shortly become a horrendous depression. That's still the reality, despite Merrill Lynch's bull.