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New Solidarity International Press Service

Domestic Market News

U.S. Economic Forecast: Washington Vs. Bank of America

NEW YORK, Oct. 25 (IPS) -- In an interview with IPS this Friday, Walter Hoady, the chief economist of Bank of America, said of the 50 corporate executives he recently surveyed, only one took exception to his forecast that the U.S. economy will experience a short-term boom followed by a major depression. Corporate executives, Hoady explained, are expecting a hyperinflationary explosion throughout the advanced sector during the pre-1976 election period. Such a Weimar-like explosion , fueled mostly by political considerations, would be followed immediately by a major depression. Hoady indicated that 98 per cent of all corporate planners are operating on the expectation of a major depression and not on the spurious predictions peddled by the gaggle of clucking White House economists that recovery is at hand.

"The major reason I'm telling things the way they are is because I want everybody to know how bad things are," Hoady stated. "It is only in crisis situations that people really act." Briefed on the ICLC's proposal for the creation of an International Development Bank to replace the dollar-based institutions of international monetary and trade matters, Hoady responded, "Why I find that very commendable. We need people like yourselves who are preparing the way for a solution before the situation gets completely out of hand." On the question of debt moratoria: "It makes sense to me but my concern is that it will tie up liquidity, which will not be available for municipalities and governments." However he responded with interest to the proposal for new credit instruments to avoid such a freeze.

Bank Arbitrage Profits About to End

During the past month and a half the bouyancy of the US credit markets and the profit-making operations of the New York banks have been based on the easy money policy of the Federal Reserve, the collapse of production, and indirectly, the printing press operations of the Bundesbank (the W. German central bank) in support of the dollar.

To summarize briefly:

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The Fed's easy money policy, combined with the huge supply of Treasury bills, had the direct effect of driving down the Fed Funds rate (inter-bank overnight money to invest in Treasury bills and run up tremendous, predictable arbitrage profits.

The banks' ability to reap arbitrage profits has now come to an end.

Last week, the Treasury bill rate dropped 30 basis points, while the Fed funds rate dropped only 9 basis points, virtually eliminating the spread between the two. The reason for the more rapid drop of the Treasury rate is directly attributable to the increasing rate of collapse of actual production and its intersection with the outbreak of major financial crisis. Savings banks, trust departments of commercial banks, and insurance companies are going heavily into Treasury securities because they represent a safe asset and investment outlet when productive investment and loan outlets collapse, become risky, and produce little return.

A spokesman at Morgan Guaranty Trust in New York confirmed this flight into safe Treasuries. Over the past three weeks, according to the Government Securities Department at Morgan, investors have been moving out of commercial paper and corporate bonds and into Treasuries. This week alone commercial and industrial loans at the New York banks dropped by $253 million.

However, this rush into Treasuries has driven down the Treasury rate too low to represent a profitable investment for commercial banks. With the simultaneous collapse in loans to commerce and industry -- normally the most profitable side of banking activity -- it becomes clear that a geometrically increasing proportion of bank reserves and deposits are not being turned into profit-making assets. If the Fed attempts to bail out the banks through liquidity and reserve infusions, it will not solve the problem. Such an infusion will simply clog the banking system with a mass of paper reserves incapable of being turned into profitable assets.

Ramifications in the Current Crisis

The above developments are precisely why both George Ball and Peter Peterson of Lehman Brothers in New York are so opposed to letting New York City default. At a time when the last profit making outlet of the New York banks -- arbitrage -- isfolding, a default on their New York City assets would just about finish off the New York banks.

In contrast, the Chicago and California banks do not seem upset that the Rockefeller-controlled New York banks may be forced to take it on the chin.

It seems clear now that the various New York City bailout proposals do not stand a chance of being passed by Congress in time to stop a default on Dec. 1. Fed Chairman Arthur Burns in testimony at the Seante Banking Committee last week predicted that a default is now inevitable. Burns' own response, according to traders at Morgan Guaranty and Irving Trust, will be a lowering of the discount rate. This proposal is in line with Burns' consistent position that whatever happens to New York City, New York banks will be bailed out.

The New York bankers, however, are not the least bit calmed by Burns' assurances. As several have indicated, as far as they are concerned, the Burns action is too little and far too late.