Mr. Carter's Deficit And The Financial Markets

BUSINESS OUTLOOK

The $19 billion increase in the government deficit presented to Congress and the nation by Jimmy Carter on Feb. 22 has haunted the financial markets for the last two weeks. Previously, the financial community had known that Carter's economic stimulus package would explode the fiscal 1977 and fiscal 1978 deficits, but it took Carter's public commitment to such an inflationary budget policy, which is bound to push interest rates higher and undermine real economic growth, to send jitters through Wall Street.

Federal Reserve Chairman Arthur Burns' own performance before the Joint Economic Committee of Congress Feb. 23 didn't help matters either. "I don't want to criticize anyone." Burns puffed, "but in all humility I have to say that the increase in the federal budget is stirring up new fears and expectations of inflation that in some degree may turn out to be a self-fulfilling prophecy." Everyone's fears and expectations of inflation rose.

The primary concern on Wall Street centers on the question of "timing" — i.e. fears that the Treasury will bungle into the market at the same time that corporations are endeavoring to do balance sheet restructuring. As soon as the Carter budget was out, David Jones of Aubrey Lanston estimated that Treasury borrowing in the present calendar year would be $85 billion (on and off-budget financing) and predicted that rates on three-month Treasury bills would increase to 6 percent by mid-year. (Average yields were 4.67 percent at the time of Jones' prediction and have since edged up to 4.7 percent.)

The projected deficit has not resulted in escalating interest rates over the last two weeks only because of a combination of ominous economic signs. For one thing, the spate of bad economic statistics, which stem in large part from the January-February cold wave, consoled investors that the economy was not overheating. In addition, the low corporate bond calendar in March has pushed bond yields down to where they were in early January. Corporations have only scheduled about $1.6 billion in debt obligations for sale in March, compared to a recently monthly average of $2.1 billion. According to Henry Kaufman of Salomon Brothers, industrial companies are decreasing their offerings to about $4.26 million this month, compared to $571 million last month and $2 billion in January (the large increase in January was in part seasonal). This week, for example, there were no new debt offerings by industrial companies, perhaps the key factor in the improvement of the market.

Similarly, the stock market is gaining some ground, but no one on Wall Street will say that it is headed for a rally. The Dow Jones average closed at 954 Friday afternoon, after gaining about 20 points over the week. However, continuing low volume reflects the underlying fears of inflation.

The Administration, as one would expect, has been going out of its way to try to reassure the financial markets — after releasing its whopping budget deficit last month. In a speech in New York on Thursday Treasury Secretary Michael Blumenthal commented, the projected budget deficits "needn't be inflationary in an economy with so much unused capacity, nor need it lead to appreciably higher interest rates in an economy currently awash in liquidity." Blumenthal likewise made some reassuring noises about capital formation and said that federal spending continued to run under projections in the first four months of fiscal 1977 (Oct-Jan, the final months of President Ford's tenure) and as a result the actual deficit is likely to be smaller that the $68 billion projected in Carter budget. Blumenthal conveniently did not discuss what his own administration's tax rebate and spending program would do to the deficit over the next few months. The bond and stock markets also decided to ignore reality and thus staged a rally following his speech.

What's Behind The Wave Of Merger Bids?

CORPORATE AFFAIRS

The background to the failed bid by Standard Chartered Bank of London to take over the French Rothschild-controlled Bank of California is the scramble for control of the Pacific Basin market. According to Morgan Stanley, Standard Chartered's New York investment banker in the Feb. 22 bid, the bank now wants a "strong position around the Pacific rim." Standard Chartered presently has substantial interests in the Far East (the old Cartered interests) and hoped to complete the circle by merging Bank of California with the 19-branch, California-based Chartered Bank.

Bank of California, the major extention of the Rockefeller-allied French Rothschilds in the U.S., also has ambitions in the Far East. In an interview published in the Feb. 24 Financial Times of London, Chauncey Schmidt, chairman of BanCal, said he believed the bank would carve out a comfortable share of the growing Pacific Basin market — the "new frontier" of banking. BanCal presently has branches in Tokyo, Manila, and Taipei.

BanCal has resisted the bid to take over its assets

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and thereby gain full control of the bank, but the publicity surrounding the bid called attention to BanCal's weak financial position — its unprofitable nonbanking subsidiaries and its discounted bad loans. Chauncey Schmidt, who only last year moved to BanCal from First National Bank of Chicago, flatly rejected the bid Feb. 23, saying the shareholders, customers, and employees would be best served if BanCal remained "an independent institution with its roots in the United States" — BanCal an independent bank with 28 percent owned by Baron Edmund de Rothschild? Schmidt added that shareholders representing 40 percent of the bank's capital were opposed to the offer.

The political ramifications of the takeover bid involve the conflicting Rockefeller versus British (Callaghan government) strategic deployments around the globe. Consistent with the Callaghan government efforts to achieve peace in southern Africa, Lord Barber, Standard Chartered's chairman, emphasized in an interview that his bank has excellent relations with black Africa and intends to expand its operations there. Edmund de Rothschild, a member of the Rockefeller family's private Bilderberg group, clearly represents contrary interests.

The Scramble For U.S. Equity

There are a number of related developments which reflect, in an ironic way, the bankruptcy of the dollar. One is the large flow of foreign money into U.S. Treasury bills since the beginning of the year — some $4 billion according to Henry Kaufman of Salomon Brothers, compared to $9 billion in all of 1976. This flow may reflect a decision by the Arabs and the West Germans, who are said to account for most of the inflow, that it is safer to hold dollars in U.S. government securities than in unstable Eurodollar deposits. Another noteworthy development is the flow of foreign capital into U.S. equity, in particular, the equity of financial corporations — insurance companies, banks, real estate trusts — which control more cash and investments. These capital flows are in part a spillover from around six months ago when the outlook for most European currencies looked bleak and investors with assets in, say, Britain or Italy, sought the relative stability of dollar-denominated financial assets. Recent developments in Europe — namely, the active discussions by the British merchant banks and others over the prospects for transferable ruble-financed East-West trade — may reverse the capital flows into U.S. equity.

A great many U.S. firms are using their large cash reserves, built up over the last two years of balance sheet restructuring, to acquire other firms. The Wall Street Journal proclaimed recently that a new wave of mergers is taking place, spurred on in part by corporations' large cash reserves which are not going into new capital investment. According to W.T. Grimm and Co., a Chicago consulting firm that does statistical studies of merger patterns, in 1976 there were 39 announcements of mergers or acquisitions in which the purchase price exceeded $100 million, three times the number of such transactions as in 1975. Asked about the new round of merger activity, an FTC official commented that the development was determined by "a strange cyclical force, which produces recurrent periods of merger activity."

The new wave of mergers is a reflection of the real state of bankruptcy of the U.S. economy. The present inflationary environment has precluded any new long-term capital investment — despite the fact that many businessmen are becoming horrified about the outmoded condition of U.S. industry as they apply the new replacement-cost accounting procedures. The relatively better-off corporations are looking to mergers as a way of expanding without assuming the risks of capital investment. In this context, the lesser-rated corporations, which couldn't get into the bond market to restructure their debt, are prime targets for takeover. Amidst the merger activity, one trend is very clear: the two largest recent mergers, GE-Utah International and ARCO-Anaconda, reflect the philosophy that "assets in the ground are best."

In addition, "the government appears to be inadvertently fostering takeovers" through the multitude of environmental regulations, according to the Journal. As the EIR has documented elsewhere, the effects of NEPA are not "inadvertent" in the least and are, in fact, a key tool for discouraging new investment and wiping out smaller pro-technology firms.

Carter's Offensive Against U.S. Industry

Carter's recent nomination of Michael Pertschuk, chief counsel for the Senate Commerce Committee, as Chairman of the Federal Trade Commission marked a further step by the Carter-Rockefeller forces to unleash a populist movement against potential industrialist opponents. Pertschuk, a central figure in the Capitol Hill "Nader network," worked hand in glove with Nader in drafting the original auto "safety" legislation, which inaugurated the anti-growth "consumerist" movement in the late 1960s. From there Pertschuk went on to draft numerous pieces of consumerist legislation such as the Natural Gas Pipeline Safety Act, bills against radiation use, flammable fabrics, unsafe products, deceptive advertising, and so forth — pieces of legislation intended to galvanize the public against further technological development and industrial growth in the U.S. If confirmed, Pertschuk can be expected to use the broad powers of the FTC to prosecute ad infinitum unfair trade practices, anti-competitive pricing mergers, etc. — of the corporate opponents of he Carter-Rockefeller no-growth program.

As a result of the change in administration, on the other hand, Watson-family controlled IBM, at the center of the Rockefeller financial and private intelligence empire, is expected to achieve a very favorable settlement in the Justice Department antitrust case now in trial in Southern District Court of New York. At least one leading Wall Street firm expects an early settlement of the case,

on the basis of some form of divestiture that would be extremely favorable to IBM — possibly a divestiture into established divisions, which would divide the company into units even more "competitive" and profitable than the company as it now stands. Of course, such a settlement would be portrayed to the public as the breaking up of the largest monopoly in the world — along the lines of the 1911 "divestiture" of the Standard Oil trust.

The Carter cabinet is stacked with three ex-IBM board members; the new Attorney General, Griffin Bell, was a partner of King and Spalding, a law firm that does legal work for IBM. To avoid a public outcry of "undue influence," Mr. Bell says he is disqualifying himself from handling the Justice Department antitrust case. The main sign that the case is headed for early settlement was the unexpected, mid-January meeting between representatives of IBM and the Antitrust Division. In attendance were Nicholas Katzenbach, partner of Cravath, Swaine and Moore and general counsel for IBM; Lloyd Cutler, partner of Wilmer, Cutler and Pickering, a Washington law firm with close ties to Cravath, Swaine and Moore; Donald Baker, assistant attorney general in charge of the Antitrust Division; and Raymond Carlson, lead counsel for Justice in the case. One of the noteworthy facts about Cravath, Swaine and Moore in this context is the firm's close relations with leading congressional "anti-monopolist" Sen. Frank Church of Idaho: the firm provided the legal personnel for the writing of the Church Committee Report on the CIA.

IBM just squeezed out of another pending antitrust suit. The decision in the Calcomp case surprised many Wall Street observers, because it was regarded as the strongest antitrust suit yet waged against IBM; Calcomp provided substantial evidence that IBM dominates 60 to 70 percent of the market for general purpose digital computers. The company is now left with million of dollars in legal expenses to pay.

The above developments shed light on IBM's recent decision to invest some of its huge cash reserves in its own stock, the best investment around, now that the antitrust actions are out of the way. The company is offering to purchase up to 4 million shares or 2.7 percent of the 150.7 million shares outstanding, at a potential cost of $1.12 billion, thereby reducing the number of shares outstanding.