INTERNATIONAL CREDIT MARKETS

Interest rates tightened in Europe and Japan

Federal Reserve chief G. William Miller's decision to delay for the moment any further increases in U.S. interest rates reflects not only mounting domestic opposition to tight credit but strong pressures from America's Western European and Japanese trading partners. The capital markets of the former "hard currency" countries, West Germany and Japan, have already been badly destabilized by the heavy outflow of funds into higher interest-bearing dollar-denominated securities. Another upward ratchet in U.S. rates would attract still larger hot money flows and might pull the plug on the highly vulnerable Japanese and European credit structures, throwing these economies into a deep recession.

"International developments seem to be working against a move to raise domestic interest rates," First Pennsylvania Bank economist Joseph Bench stated in the April 12 issue of the bank's "Money Markets" newsletter. "A Fed tightening move would undoubtedly invite considerable criticism from our trading partners who worked so hard to stem the dollar's fall last year."

Morgan Guaranty's chief economist Rimmer de Vries also agrees that international considerations played a role in Miller's decision not to tighten. Asked whether he thought the Fed was getting a lot of flak from the Europeans and Japanese on the question of U.S. rates, de Vries responded, "I wouldn't say Miller was getting a lot of flak. My view is that the Fed thought it just wouldn't look right to force the Bank of Japan into raising its discount rate and then turn around and raise rates here."

On Monday, April 16, the Bank of Japan announced that it had raised its minimum
financial institutions from 3.5 to 4.25 percent, the first such rate hike in four years. The Bank of Japan's hand was forced by the near-collapse of the government bond market which resulted last week in the Finance Ministry's decision to cancel its plans to issue 1.3 trillion yen in new government bonds this month. Investors have been steering clear of yen-denominated bonds because of fears of rapidly accelerating Japanese inflation brought about
the price of imported energy and raw materials and aggravated by the yen's recent sharp depreciation on international currency markets. Wholesale prices registered a sharp 0.9 percent rise in both February and March.

Significantly, Bank of Japan head Morinaga raised the discount rate in the face of strong protests from leading industrialists, top officials in the ruling Liberal Democratic Party, and other government agencies, such as the Ministry of International Trade and Industry, all of whom are warning of a Japanese economic slowdown. For example, Seishi Kato, president of Toyota Motor Company's sales arm, criticized the central bank for relying too much on "deflationary policies to control inflation." Japanese industry is being squeezed by the simultaneous shrinking of its export markets due to the Carter Administration's protectionist policies and rising raw materials costs. Ample low-interest credit is the Japanese economy's major remaining prop.

According to an article in the April 18 issue of the West German financial daily *Handelsblatt*, Morinaga decided to flout adverse government and business opinion because he believes the Bank of Japan must assert an "independent" authority. Bundesbank chief Otmar Emminger has also argued recently that the West German cental bank's supposed constitutional independence allows him to tighten credit despite the opposition of Chancellor Schmidt and much of his cabinet. Thus, it would appear that both Emminger and Morinaga have been manipulated by the Anglo-American faction into believing that they can stabilize their respective capital markets through small upward adjustments in interest rates. However, if Miller had raised U.S. rates this week as Blumenthal suggested, the interest rate differentials with West Germany and Japan would have again been disrupted and Morinaga and Emminger would be right back where they started. The Morinaga-Emminger approach to tackling inflation would have been discredited.

If the Fed does tighten, the British and their allies in the U.S. financial community risk blowing the deals that they have negotiated with the Western European and Japanese governments over the recent period. For example, the Schmidt government and the West German banking establishment have reportedly agreed to delay for two years their plans to establish the European Monetary Fund as an international development bank, after being told by the British that any opposition to the International Monetary Fund and its zero-growth austerity policies would be considered a "threat to NATO." In return, the Germans have been reassured that the Carter Administration intends to induce only a "mild recession" in U.S. economic growth. If Miller had imposed a harsh credit crunch here, this would mean that the Anglo-American faction was "dropping the mask," leaving little doubt that their actual goal is a controlled depression and the Schachtian restructuring of the world economy.

—*Alice Roth*