Reserves are fleeing the system

Volcker's pulling a new credit crunch that will undermine economic recovery potential.

In the week ending Jan. 14, the adjusted bank reserves of the U.S. banking system jumped by $1.3 billion over the previous week's level to $47 billion. Most, and probably all, of this jump was due to the "adjustment" the banking system had to make due to the inclusion for the first time of many new financial institutions into the Federal Reserve's data base.

This includes savings and thrift institutions and smaller commercial banks which joined the Fed System in line with the Monetary Deregulation and Control Act of 1980, after the law made membership in the Federal Reserve System mandatory.

As a result, M1-A jumped by $1.6 billion in the week ending Jan. 14 and M1-B jumped $11.4 billion. But the most remarkable behavior is that of adjusted reserves. This is the raw stuff out of which new loans are made.

If the $1.3 billion increase in adjusted reserves is treated as real, it can be seen that between Nov. 26, when adjusted reserves were $47.1 billion, and Jan. 7, when they were $47.0, there have been no changes: a freeze for six weeks.

If the $1.3 billion is attributed to the increase in the number of banks in the Fed System, as it should be, it can be seen that since Nov. 26 there has been a decline of up to $1.2 billion.

Yet, during this time, the contraction of reserves has been even more severe.

The large New York banks accounted for most of the widely reported $500 to $850 million excess free-reserve position among some banks.

When the excess-reserve position of the New York banks is subtracted, the contraction in adjusted reserves for the *non-New York bank* part of the banking system has amounted to between $1.5 and $2.0 billion.

It is convenient for many people to say that when watching Fed Chairman Paul Volcker, one shouldn't pay attention to what his mouth is doing, but rather to his hands and feet.

If this is true, then it must be concluded that Volcker together with the large New York banks is pulling a credit crunch more severe than even his March 14 imposition of credit controls.

This reality is already catching up with the rest of the banking system and the level of loan generation. The rush toward business loans that characterized the latter part of 1980 has been choked off. Business loans nationally were at the level of $171,905 million for the week ending Dec. 10.

Four weeks later, they were $172,158 million. It is also the case that consumer borrowing, despite occasional blips, is going nowhere, after being flat (unadjusted for inflation) during 1980.

In addition, corporate and municipal bonds are not moving, not at the near record rates for these two markets.

Altogether, new credit flows for at least the last four weeks have been shut down.

The cutoff of reserves and the shutdown of credit flows to the real economy by Volcker, and Volcker's extra effort to dry out the system of credit, is an attempt to act in advance to derail whatever efforts Reagan may make to start up the economy once again.

Already, housing starts fell 1 percent in December, the first official fall since May. The Chrysler Corporation is still not out of the woods on its loan guarantees, which have neither cleared the U.S. Congress nor gotten the approval of the Canadian government.

An MIT auto analyst reported Jan. 19 that Chrysler will have to make an additional 20,000 permanent layoffs on top of those already laid off; there is no indication that Chrysler will not fold within weeks. Caterpillar Tractor announced a new round of several thousand layoffs for 1981. Braniff, Eastern and Pan Am Airlines are all on the verge of bankruptcy, due to the effects of the credit crunch on top of fuel cost hikes and airline deregulation.

White Motors Company is attempting to negotiate new loans to keep itself functioning; the Canadian agricultural implements firm, which employs a large number of Americans, has just undergone another debt restructuring.

Thus there is a tier of corporations which could go under for lack of liquidity to perform rollovers. It is in this situation that the super-tight crunch of the last four weeks is now being applied by Mr. Volcker and the Fed's governors.