Click here for Full Issue of EIR Volume 8, Number 42, October 27, 1981

Interview

Fed sees loan demand disappearing fast

Federal Reserve Chairman Paul Volcker has won "a big victory" over President Ronald Reagan, a Federal Reserve source close to the Chairman said in an Oct. 13 interview, because Volcker has succeeded in imposing an economic recession, but "of the right sort." Excerpts follow.

EIR: You said this August that Fed Chairman Volcker would back off and print money if the White House quit backing the Fed and instead backed congressional calls for lower interest rates. Has the time come?
A: No.

EIR: Is the fight between Donald Regan and Volcker, with Regan calling for lower rates on behalf of the White House, phony then?
A: Absolutely not, it's for real. Beryl Sprinkel is still endorsing us, and Regan endorses us personally, and yet he's giving us real trouble. That means it's political—Regan is being made to act politically.

EIR: Who's behind the attack on the Fed?
A: The President, Ronald Reagan. He's using Regan, he's very disappointed in the state of the economy. The Republicans in Congress are really pressing him [to get interest rates down]. Ronald Reagan, personally. But it hasn't affected us yet. Congress hasn't moved.

EIR: But you say you're not loosening up. Why have interest rates come down?
A: Falling credit demand. We haven't moved our supply of total reserves, borrowed plus non-borrowed, at all.

EIR: But bank loan demand numbers are up.
A: That's only a part of the picture. The only current data you have is bank loans. You need to look at all the rest of credit demand. If you added up net funds raised in credit markets from the Flow of Funds data, you'd see that other credit demands are way down.

EIR: So the recession has enabled you to let interest rates fall?
A: Yes.

EIR: Albert Sommers of the Conference Board wrote this week that the Fed wants this recession. Is it true?
A: Yes. We need the recession; economic slack may be very painful, it causes agony, but the slack is necessary. It hurts like hell, those are real people out there, but we have to have a period of economic slowdown. We need to cool inflation, and we need to cool off wage demand. The unions will have to cool their demands. But we have to walk a thin line. We have a recession of the right sort.

EIR: The right sort?
A: We can't have 12 percent unemployment like the British—that would cause the Fed political problems. But now, Volcker's in a very strong position, because the economy is not collapsing. Volcker's avoided a British situation with exploding unemployment—that's a real economic collapse. U.S. unemployment will do nothing of the sort, just rise gradually, but we don't want a sharp downturn, just a gradual leveling off. That's not economic collapse, and unless you get a real British-style collapse, with strikes and riots in the streets, Ronald Reagan simply cannot reverse his course on monetary policy overnight, or at all. Volcker has been betting very heavily on what's now happening: the demand for credit slackening off, the recession, and therefore interest rates falling because of the successful recession—and not because we've printed any money at all.

This fall in interest rates will take a lot of pressure off Volcker, that's exactly how he wants it. What we want is a slow fall of the prime rate to 15 percent. That will make a lot of difference in public perception, in world perception, that's very different from 20 percent, from what it was. It is now clear to the world that our money supply targets are all being met, and met without inflating, and yet rates are being successfully brought down.

That's a very big victory for Volcker. It takes the stuffing right out of Ronald Reagan's political sails with respect to the Fed. It makes it virtually impossible for Reagan to attack us.

EIR: But aren't you worried that if interest rates fall, the dollar will collapse?
A: Most of the people predicting that are crazy. The prospects for the dollar are stable for the foreseeable future, at least for six months, it won't move, net.

First of all, rates won't fall much further anyway. But what *will* fall is inflationary expectations.

EIR: Will Volcker continue to demand that Reagan cut the budget, even going into a recession as Hoover did in 1931?
A: Yes. Once the slack continues in the economy, we can have corporate tax cuts of the right kind, the kind that will shift our structural problems [shift U.S. industry from sunset to sunrise—ed.].

© 1981 EIR News Service Inc. All Rights Reserved. Reproduction in whole or in part without permission strictly prohibited.

EIR: But Volcker denounced Reagan's tax cuts last week.
A: Volcker wants the individual tax cuts rescinded or postponed, and all the loopholes closed.

EIR: Aren't you worried that foreign central banks sold $800 million in U.S. Treasury bills last week?
A: They're not dumping, net. The French sold a lot of short-term Treasury bills to support the French franc, which they did in dollars. They sold a lot more than $800 million, that's just the net. They did over $3 to $4 billion in total intervention when the EMS was re-aligned. But they sold a lot of the Treasuries to the Kuwaitis and the Saudis—the Arabs are buying plenty. Short-term U.S. Treasury rates have come down in spite of what the French did, because there is a big capital inflow, net. Kuwaitis are buying up Los Angeles real estate.

Sadat's assassination won't hurt the dollar, it just makes the U.S. and Treasury bills a safe haven from Mideast instability. . . . We can get along without Mideast oil. No matter how destabilized it gets.

There's now been reached an upper limit to energy prices, where demand is fully responsive to price rises. Yamani is right about that. We will just cut our imports more. The U.S. is the best positioned of any industrial economy. This works in favor of the dollar, and the British pound. The U.S. will simply buy less than everyone else, and Europe and the Third World will suffer the most. And Japan.

U.S. Economy

Industrial chain reaction, not 'fine-tuning'

by Richard Freeman

Federal Reserve Board Chairman Paul Volcker's underlings claim that he can finely tune his control over U.S. money supply and interest-rate levels over the next several months so that he can gently ride the U.S. economy down into full recession, but avoid a sharp industrial crash. The latest steel operating-capacity figures disclose that the economy is not going to be so tidily controlled.

This March, steel operating rates were up to 87 percent, as steel was produced at near-capacity levels for rapid auto output. Those cars were soon to sit unsold on auto dealers' lots; once the downturn in auto sales caught up with production schedules, auto companies were forced to cut back production.

As a result, the steel industry produced at only 70.8 percent of capacity for the week ending Oct. 9. The fact that steel operating capacity had fallen 1.6 percentage points from the previous reporting week indicates how fast the industry is unravelling. U.S. Steel announced Oct. 1 that it will close down one of two remaining blast furnaces and two open hearth steel-making furnaces at its Fairless, Pennsylvania works, and will lay off 850 workers.

Developments in other industries show that unemployment—which reached nearly 8 million in September—will continue to increase. The construction industry is indicative. Employment there, which had shown some growth in the later part of 1980 and early months of 1981, fell by 20,000 in September; it has declined by 165,000 since April. The number of construction jobs in September actually tumbled below the July 1980 recession trough level. And the latest report for the month of August, which shows housing construction down to an annualized 937,000 units, 50 percent below normal levels and falling fast, means that construction employment is in for a further big tumble.

Chain-reaction effect

By slashing hard into basic sectors of the economy, Volcker necessarily cuts the props out from other sectors. The fall in the housing and general construction sector has had terrible repercussions for the forestry and lumber industry. Forest company output will be down 10 to 15 percent this year.

The auto industry exemplifies the chain reaction, as indicated above. The Big Three auto producers announced Oct. 1 that the production schedule of cars for the fourth quarter of this year, at 1,544,000, is down 8 percent from last year and will be the lowest level of output since the fourth quarter of 1970, when an autoworkers strike against General Motors, the nation's largest auto producer, wiped out most of GM's production. The cutback in auto production will not only lead to a new wave of layoffs—in an industry with more than 175,000 workers already on indefinite layoff—but will also trigger layoffs in industries that ship a good amount of their output to auto. This is the case in steel, as already documented.

It is also true of aluminum, where orders for the first two weeks of September were down 17 percent from last year's levels. The aluminum industry, of course, also ships to the aerospace and consumer durables sectors, the latter of which is not doing well either. Aluminum