EIR Economics

The Ides of November stalk Bush's 'recovery'

by Steve Parsons

When it comes to economics, George Bush just can't exorcise Herbert Hoover's ghost. For no matter what George thinks he's doing, he's making the same kinds of idiotic economic moves that Hoover did 60 years ago.

Like poor old Hoover, George came into office giddy with the illusory prosperity of a great financial bubble. Then, right on cue, in October of his first year the stock market nosedives, puncturing the junk bond bubble and threatening to take down the banking system. When things temporarily stabilize, George thinks he has escaped; but, alas, in the next year, one bank after another goes under, and the economy goes into a tailspin. Again he thinks he's escaped from Hoover's script when he starts that little war in the Gulf and has the Federal Reserve start dropping interest rates. Surely that would result in a new "confidence" that the recovery is just over the horizon.

Now, months after the war and falling interest rates have failed to staunch the depression, the Ides of November are upon an even more Hooverized and shell-shocked George. When the disaster of Richard Thornburgh's crushing defeat registered on his administration, he could only do what Hoover did: drop interest rates again. And that will help George—and the economy—as much as it did poor Hoover.

Lower rates won't help

The discount rate is now down to 4.5%, the lowest level since 1973, and the prime is at 7.5%, its lowest level since 1970. This is the fifth discount rate cut since last December, and parallels Hoover's rate reductions from 6% to 2% over a 14 month period in 1929-30.

The latest rate cuts on Nov. 6 were a sheer desperation move in reaction to the nation's economic and financial hemorrhaging. Most analysts thought the Federal Reserve would act after the results of the Christmas sales season were in. But the intensifying collapse of everything from car sales to manufacturing, the panic of retailers facing the worst Christmas season since World War II, the growing insolvency of major banks, and now the electoral debacle, all forced the Fed to move now.

As in 1929-30, interest rate cuts will do nothing to stem the collapse. Despite blue-blood Bush's exhortations that low interest rates make "this a good time to buy a home, a good time to buy a car," this is a *depression:* People who are loaded with debt simply can't spend what they don't have and can't borrow, and banks can't lend when their cash flow, deposit base, and loan receipts are dropping like a brick.

Furthermore, prices—especially for big-ticket items like homes and cars—are still far too high, way beyond the reach of an increasing number of people, at *any* interest rate. One couple searching for a house was quoted in the *Washington Post* saying, "What is stopping us from buying is not the mortgage rates, but the fact that prices have not declined," and that they do not have the money for the downpayment.

While a deflation is certainly under way, real estate brokers and government officials have conspired to prevent prices in many markets from collapsing into oblivion. The RTC, for example, is holding the bulk of its hundreds of billions of dollar in real estate off the market to prevent a blowout. Real estate agents in many areas simply won't sell properties if the sale price threatens to drop below a threshold point of roughly 20-30% below supposed "market value." And in other areas, market value has not dropped significantly—

because there are few buyers for any properties!

Until these inflated "values" come tumbling down, the depression will continue to deepen. And, of course, when they do collapse, the chain reaction will blow out the financial sector and the rest of the economy with it.

As the *Post* candidly put it, "the latest reduction is not likely to trigger much more spending or investing. It is not that rates are not low enough, it is that rates are not the issue."

Going from bad to worse

In fact, with interest rates so low and headed even lower, foreign investors not only will boycott U.S. debt sales even more than they have been; they could start to dump U.S. securities and the dollar itself. In recent weeks, the dollar has been dropping against the German deutschemark and other major currencies—including even the British pound, and is now at its lowest point in months against these currencies.

"Foreign exchange managers believe any advance by the dollar will be short-lived," wrote the *Financial Times* of London Nov. 7. One economist at Chemical Bank in London put it quite succinctly: "When the underlying reasons why the Fed cut rates—a weak economy and a growing unwillingness to invest in U.S. securities—sink in, any dollar rally is likely to be temporary."

This poses several huge problems. First, there is little foreign money coming in to buy U.S. debt issues, meaning that almost all funding must come from the domestic economy. That furthers the credit crunch by sucking money out of the banking system which could go for investment and loans to other sectors, including everything from financial markets to manufacturing to mortgages. Second, primary dealers and others have to absorb more and more of these debt issues, and then resell them at a potential loss to customers who simply don't want to invest in such low-yield paper.

And all of this could ultimately lead to interest rates shooting up to prevent a blowout of government paper and the dollar. But that would detonate the financial markets, not to mention whatever is left of the economy.

About the only thing preventing the collapse of the U.S. securities market is the dearth of investment opportunities for domestic capital in the collapsing economy, and the relative perceived "safety" of government debt—a perception that could quickly turn into panic.

Disastrous quarterly refunding auction

As the above-mentioned Chemical trader hinted, alluded to above, another major reason for the Fed's discount rate cut Nov. 6 could have been to bail out the worst quarterly refunding auction in the last 10 years.

The Nov. 5 sale of $14 billion in 3-year notes, the first leg of the $38 billion refunding, was a mess. This was primarily due to the record low yields that would accrue to investors—just 6%—because of the low interest rate offered by the government. That resulted in unusually low demand from dealers in purchasing the notes, and the government had to sell them at reduced prices. There were virtually no Japanese purchases, which had heretofore been a staple of the market.

Only $21.7 billion was bid for the notes, the lowest amount since 1978, only half the amount of recent years. The so-called "bid-to-cover" ratio—the ratio of the amount bid to the amount offered for sale—was only 1.55, the lowest since 3-year notes were first offered in 1974.

With disaster looming over the Nov. 6 and 7 sales of $24 billion of 10-year notes and 30-year bonds, the Fed's discount rate cut aimed to make the Nov. 6 offering of 10-year notes at 7.5% more attractive.

It backfired. That sale, too, was very weak; the notes sold at prices lower than expected, resulting in an extra $250 million in borrowing costs for the government. At best, the drop in the discount rate prevented a disaster, but could not compensate for unattractive rates.

What dropping the discount rate did do for sure was to enormously unsettle the market, because no dealer could be sure what price to bid to ensure he or she could cover costs. "What the hell is the Fed doing, cutting the discount rate in the middle of the refunding!" one trader screamed at the *Wall Street Journal*. "It forced us to have to guess what the cut meant. Investors hate uncertainty more than anything. We are getting lots of it from the Fed." And another: "The whole thing is screwy. . . . It is so unusual a move that it raises more questions than it answers. I have never seen this before."

Although the following day's sale of 30-year notes went relatively well, the handwriting is on the wall.

Essentially all that Bush has left is threats and terror. In its lead editorial Nov. 7, entitled "A Warning for Mr. Bush," the *Financial Times* wrote that Bush could try to stage a replay of the Iraq war: "Unless the U.S. embarks again on *some great international venture comparable to the Gulf war* and brooking no domestic opposition, the overwhelming issues in the presidential campaign will be at home" (emphasis added).

Short of a shooting war, however, but just about as bad, Bush—with his Democratic henchmen in the Congress—is signaling his intention to engage in trade war, in order to blame the U.S. depression on the "protectionism" and "unfair trade practices" of especially Europe and Japan. As the Swiss daily *Neue Zürcher Zeitung* points out, for Bush and Democrats like Richard Gephardt, "Trade is actually a metaphor for the economic decline of the U.S.A.," making, for example, "Tokyo the scapegoat" for the decline of the U.S. auto industry. The London *Guardian* also pointed out the ominous implications of a Nov. 6 speech in which Bush warned his European and Japanese trading partners that "protectionism and trade isolation hastened the worst economic depression in modern history."

That might indeed plunge the world into deep depression and certainly war. But it won't prevent the Ides of November from sweeping away Bush this time next year.