

Domestic Credit by Richard Freeman

Tracking the money supply

Volcker's license for unproductive C&I loans bulges M1-B, a pretext for further rate hikes.

The huge leap of M1-B money supply of \$6.9 billion for the week ending July 8 not only ends a period of very slow M1-B money supply growth of 1.9 percent for the last three months, but raises the possibility of a new interval of burgeoning money supply growth.

As Ben Laden, chief economist of T. Rowe Price Associates, told *EIR*, "If \$3 to \$4 billion of that money supply increases washes out of the banking system during the month of July, then there is no problem. But if it remains, this could spell difficulties." Laden foresees that the money supply could grow even if real business activity weakens, because a large amount of business borrowing in the economy is going to takeovers and mergers, involuntary inventory buildup and debt refinancing. In last week's column I showed that investment in waste, speculation, and overhead expenses increased by at least \$18 to \$20 billion in the second quarter; the amount of credit extended to productive industrial investment, as well as agriculture and transportation, was *negative*.

Eventually, such nonproductive expenditures can swell currency in circulation as well as bank deposits, or M1-B, and will definitely increase checking accounts, which are included in M2-B. In fact, over the recent period, while M1-B was barely moving, M2-B was rising above its target range set by the Volcker Federal Reserve Board of

2.5 to 5.5 percent.

Ultimately, the behavior of M1-B, M2-B, and so forth is an economic consideration of only fifth- or sixth-rate importance. Nonetheless, because Federal Reserve Board Chairman Paul Volcker is attempting to manage the economy by manipulating money supply, the money supply acquires importance.

Volcker told the House Banking Committee in his July 22 mid-year economic review report that he plans to keep interest rates right where they are. This policy has resulted so far in 1981 in bringing the 91 U.S. Treasury bill rate at 14.58 percent, more than 3.5 percentage points above where the Reagan administration estimated it would be. Specifically, Volcker said that he wants the M1-B money supply growth range held to the lower end of the 3.5 to 6.5 percent growth target band for the remainder of 1981, and lowered to 2.5 to 5.5 percent in 1982.

Volcker added that this policy would throw unemployment to 8 percent and beyond in 1982. He then intoned that to break inflation, labor contracts must be broken (a false assumption which opens a yawning pitfall for President Reagan).

Sam Nakagama, chief economist for Kidder, Peabody, told *EIR* July 22, "The high interest rates have created quite a problem for the economy. We had better have an upturn in the economy in the fourth

quarter or we're in trouble. The slowdown in housing has been sharp. If there is not an upturn, after so many months of bad housing figures, there will be big failures in the S&Ls, bigger than some expect. And if auto sales do not pick up by the fourth quarter, one company may not be around and there will be plenty of trouble in Detroit.

"What is highly unusual are the capital spending figures. The machine-tool orders are down," Nakagama continued, referring to the 47 percent drop in machine tool orders in May compared to May of 1980. "This should not be happening in a Republican administration," Nakagama said. "In Republican administrations, capital spending should be up, but interest rates are stopping that."

For the second quarter of this year, GNP in constant dollars was down 1.9 percent; even here, there is more than meets the eye. In the second quarter, final sales rose in current dollars from \$2.848 trillion to \$2.860 trillion, but in constant dollars, actually fell by 4.8 percent. The difference is accounted for by the fact that in current dollars, corporations added over \$20 billion in unwanted inventories in the second quarter. These inventories must come out of third-quarter production and sales levels, foreboding continued negative economic growth.

If M1-B and M2-B continue to grow, Volcker has indicated by his July 22 testimony that he will not move against nonproductive lending for mergers and acquisitions but will pull in the availability of credit. The marginal, purely ideological consideration of money supply will push the economy toward outright disaster.