

The motor of interest rates

Corporate debt financing remains a decisive reason why long-term loans for capital investment are precluded, Richard Freeman reports.

As a harbinger of interest rates levels to come, the 91-day Treasury bill rate should be closely watched, since the bills represent the safest investment there is. When the rate falls, it is reasonably expected that overall interest-rate levels in the United States will follow to lower levels.

Thus, for those oppressed by loan-shark interest-rate policy of Federal Reserve Board Chairman Paul Adolph Volcker, the sharp fall in 91-day T-bill rates for most of the last quarter of 1981 was a welcome development. The rate was at 15.71 percent the week ending Aug. 28, but by Nov. 27, it has plunged to 10.23 percent, a fall of 548 basis points in only two months.

But before anyone could utter "prosperity is just around the corner," the rate took flight, soaring to 12.21 percent by Jan. 11 and still headed upward. The performance of 90-day certificates of deposit of \$100,000 or more at large money-center banks followed the same path, dropping and then pitching upwards by 150 basis points between the last weeks of November and December.

The increase in interest rates has hit the price of bonds, which perform inversely to interest rates. More than half the gain of the bond-market recovery of October 1981 has been wiped out. And the stock market is in a rout, as of Jan. 13, losing more than 40 points in less than two weeks.

The causes

The rise in interest rates is due to two causes. First is the fact that Salomon Brothers' chief economist Henry Kaufman, the alter ego of Fed Chairman Volcker, who has a direct pipeline into Federal Reserve offices, is attempting to destroy all confidence in President Reagan's economic leadership, thus forcing him into deeper austerity measures. A planned panic on the markets during the first and going into the second quarter is what Kaufman, Volcker and others have in store.

The second reason: during the latter part of 1981, despite the worsening depression, corporations were borrowing at very rapid rates. For example, during the period of July 7 through Nov. 11 of last year, after the

economy started heading downward at a steep rate, the business loans by large weekly reporting banks grew at a 12.5 percent rate. In the period Nov. 25 through Dec. 30, business loans grew by an even more rapid 21.4 annualized percent rate.

That growth in bank loans, representing a heavy demand for money, helped push up interest rates beginning in mid-November. During the four-month period July through November 1981, industrial production plunged 5.0 percent; at a 15.0 percent annualized rate, one of the deepest rates of decline since the Great Depression. How is this possible?

The U.S. credit system is perversely out of control. Corporations are spending nearly 60 cents out of each new borrowed dollar to meet interest payments on accrued debt. To prevent themselves from going under, corporations are borrowing hand over fist, even as the economy is being wiped out.

There are other pressures on interest rates. Federal borrowing to pay off a fiscal 1982 budget of over \$100 billion, will mean a large additional demand for funds. State governments, which are losing federal revenue grants because of budget cuts in Washington, will make up some of the loss through heavy borrowing. But, the insatiable corporate need for credit is the greatest factor. Such upward pressure on interest rates is sufficient to lengthen and deepen the depression considerably. Once rates rise again, corporate sales and production fall.

The economy is performing far worse than had been expected, as figures coming in at the end of the 1981 year indicate. For example, the decline in production in the second half of 1981, slashed the use of transportation. As Manufacturers Hanover financial newsletter for Jan. 11 reports, "In December 1981, the number of railroad cars loaded (excluding sharply fluctuating grain and coal shipments) was 18 percent lower than in 1980, following a 14.6 percent reduction in the previous month. Similarly, hauling by trucks has shown intensifying declines in recent months."

Other important industries not making the headlines, such as paperboard and aluminum, turned decidedly downward as the 1981 year drew to a close. During the three months ending in November 1981, aluminum output was running more than 10 percent below the 1980 depressed levels. But new orders for aluminum showed an even worse picture, falling 31 percent below year earlier levels. And in the paperboard industry, despite a 6.5 decline in output in December, compared to the year before, inventories at box plants in November were 26 percent above year earlier levels.

Unemployment

Although final industrial production figures for December are not in as of this writing, the explosion in unemployment for that month indicates that it was dismal indeed. Unemployment shot up to 9.44 million in December, from a level of 9 million. In fact, hidden in the unemployment numbers from the Department of Labor (DOL), is the fact that the size of the labor force on non-agricultural payrolls fell from 98 million to 97.2 million, a drop of 800,000 and far larger than the officially registered increase of 458,000 in unemployment for the month.

The DOL's Bureau of Labor Statistics' attempts to cover itself on this point by reporting that there was a rise of 150,000 unemployed workers in December, who allegedly told the Department of Labor that they were "too discouraged" to look for a job. The DOL, then claimed that those "too discouraged to look for work" were no longer in the labor force.

At the same time, there was a striking 0.8 percent increase in the jobless rate for adult men, to 8.0 percent in December, with the category of blue-collar workers even worse hit with an unemployment rate rising to 12.9 percent in December.

Finally, for the first 10 days of January, domestic auto sales of the Big Three automakers plunged 20.3 percent below last year's bombed-out levels.

Some people are still saying that the worst is over. Many of them foresee a consumer-based recovery, because consumer purchases account for two-thirds of all purchases in the U.S. economy. These pundits should consider that the consumer spending level for December rose a scant 0.2 percent; and for those who think that it will be a capital spending-led recovery, should consider the fact that railroad equipment purchases fell 34 percent in 1981, while the construction of new plant and equipment fell in real terms in 1981, and will not rise with long-term bond rates heading upward again.

Without consumer or capital spending, the economy is left with the prospect that the moment that interest rate goes higher, the economy gets even worse. For the short-term, the rally in the bond market, indicated by the fall in 91-day T-bill rates, is definitely over.

Siberian pipeline: model for growth

by Renée Sigerson

Sometime between 1983 and 1985, a landmark will be reached in world economic events. One day in those years, natural gas from deposits in the Yamal region of western Siberia in the Soviet Union will begin to be pumped along a 3,600-mile pipeline, to factories and power generating stations in 12 nations in Western Europe. In discussions of the project, called the Yamal-Urengoi pipeline, over the years, Soviet officials have proudly noted that the pipeline is "the largest project in recorded history."

The primary importance of the pipeline lies in its ambitious scope, and the way that its construction is drawing upon the industrial-technological capabilities of countries across Europe, as well as Japan. At this juncture of world developments, when the onset of a global economic depression has already triggered mass unemployment in every Western nation, the pipeline provides a model of the kind of economic cooperation and development programs that would reverse the depression.

It is from this standpoint that the opposition of the Reagan administration to the construction of the pipeline needs to be evaluated. President Reagan, with advice from Secretary of State Alexander Haig, has undertaken an aggressive action aimed at postponing construction of the pipeline, if not actually halting it. On Jan. 10, the White House announced it is preventing General Electric Company from exporting a turbine component to firms in West Germany and Italy, which need the component for their building and for export of 41 compressor stations which are to be constructed to pump the gas. Economics Minister Otto von Lamsdorff recently told the German cabinet that Bonn will do nothing to hinder West German companies from sidestepping the effect of U.S. sanctions on the gas deal, so long as secondary suppliers only are involved and not "prime suppliers"—a direct reference to the GE component. It remains to be seen which firm abroad is prepared to produce the compressor part.

The White House explained the move as part of its sanctions policy against the U.S.S.R. in connection with