

Banking by Kathy Burdman

Reserves, not butter

Volcker has the U.S. commercial banks flush with funds, but starving for borrowers.

Over the past six months, the Federal Reserve managed to generate a short-lived consumer boom—at the paradoxical expense of a drastic reduction in American living standards.

As part of his scheme to keep his job and to forestall Latin American debtors from outright default, Paul Volcker injected huge amounts of monetary reserves into the banking system. Volcker has also seen to it that U.S. banks received a major new deposit infusion, at consumption's expense.

The only problem has been, and will be, that the deliberate decimation of consumption has permanently reduced the bank loan market in the U.S. industrial economy—a “reserves, no butter” policy.

In fact, commercial banks, during a period of record deposit growth and record availability of non-borrowed reserves from the Federal Reserve, have actually contracted their rate of business lending. Commercial and industrial loans outstanding at the end of June 1983 are lower than at the end of the third quarter of 1982.

U.S. consumers, too, especially during the third and fourth quarters of 1982, borrowed and spent less than during 1981—in the midst of a supposed consumer-led recovery. During the third and fourth quarters of last year, consumer demand for currency, both borrowed funds and use of their own deposits for spending, was so low, due to unemployment, that the currency part of the monetary base collapsed.

While their consumption and credit demand fell, U.S. households simultaneously provided major amounts of

new liquidity to the banking system, in what amounted to a policy of forced savings of household liquidity. In Hjalmar Schacht's Germany of the 1930s, this was done by means of laws requiring savings deposits. Volcker calls it “deregulation.”

During the first quarter of 1983, U.S. households deposited a net inflow (net of all other withdrawals out of banks) of \$377 billion into U.S. banks and thrift institutions, seasonally adjusted at annual rates. The single largest component of this was a set of newly deregulated accounts including Money Market Deposit Accounts (MMDAs) which constitute “small time deposits.” These rose by an astounding \$403 billion during the first quarter of 1983—four times the rate in 1982.

Households' liquidity was quite clearly deliberately targeted by the Fed's new deregulated accounts, since households are the primary source of bank deposits, to a surprising extent. During 1980, for example, households made two-thirds of all new banking deposits.

“People still can't afford to consume,” one Federal Reserve economist argued. “So they might as well invest, and there is plenty of incentive” in the new accounts.

This rise in household bank deposits occurred despite the depressed state of household income, which continues. In fact, the total of new investible household financial assets only rose during 1983 at the low rates it had shown in 1981 and 1982: \$325 billion, \$333 billion, and \$341 billion, respectively.

The difference was that in the first quarter of 1983, households not only put all their new resources into deregulated accounts, but liquidated other investments to do so. Households drew down \$76 billion from investment bank funds including money market funds, cashed in \$65 billion in U.S. government debt, and sold net \$15 billion in corporate stocks and bonds.

Also, these figures also show that U.S. households have not put a cent into the real U.S. industrial economy, not even by way of the stock market. In fact, the figures show that the entire “Volcker boom” on Wall Street of the period since July 1982 occurred while households were *net sellers* of stocks, \$29 billion in 1982 and \$15 billion in 1983.

The same forced savings occurred in the corporate sector. Under direction from their bank creditors, U.S. corporations shut down their demand for commercial and industrial loans, and instead borrowed on the bond market merely to pay off (actually reduce) their bank loans. A major part of the reduction in interest rates was due to a sharp fall in non-bank demand for funds. Corporations in particular just stopped borrowing, because they had no new plant to build, little to produce, and little to sell.

Not only did corporations reduce loan demand, but they saved so much cash that their deposits to banks soared.

Normally, corporations do not provide much of the deposit base for the banking system. In 1982, for example, they deposited some \$25 billion, only 10 percent of their own new assets, and less than 8 percent of households' new deposits. But because corporations were “saving,” there was a huge rise in corporate financial assets of all types, by \$84 billion in 1983, of which \$54 billion was deployed into bank deposits.