Domestic Market News

Permanent Crisis Ahead

Oct. 17 (IPS) -- The near default by New York City on $453 million of short-term notes today has irreparably shaken confidence in the entire U.S. banking system. The city's near default has pointed up the huge proportion of rotten debt sitting in bank portfolios, of which New York City securities are only one component.

Despite the last minute bailout of the city at 2:30 PM when United Federation of Teachers President Albert Shanker agreed to purchase $150 million of Municipal Assistance Corp. bonds with funds from the Teachers' Retirement System, New York political and financial leaders warned that this was the last time that such fiscal jugglery could avert default by the city. The municipal bond market reacted to Shanker's announcement with "resounding silence" according to a trader at a top investment firm here. Throughout the day, trading on the municipal market came to a virtual standstill, as traders tuned into the radio for the latest developments.

Shanker himself aptly commented that today's bailout was "just prolonging the agony a little bit more." The next time the city faces default is early December when the state rescue package runs out; however the package could fall apart again before then, possibly forcing default as early as Nov. 10.

Today's near default also signals the start of an all-out effort by Rockefeller and his allies to ram a federal bailout of the city through the Congress, despite the objections of President Ford and Treasury Secretary Simon.

Today's events followed a week in which municipal, corporate, and government bonds and notes all rallied in response to easier credit conditions. The collapse of production, combined with modest credit infusion, are temporarily propping up the credit markets. Yesterday the market reaction to the Federal Reserve's announcement that it was reducing reserve requirements was euphoric. Municipal, corporate and government bond and note prices all rose by 1/2 to 1 point.

Fed Eases Refinancing Job

Faced with a massive amount of Government refinancing, the Fed moved yesterday to reduce reserve requirements on time and savings deposits of 4 years or more maturity by an amount that will release roughly $350 million. While the amount itself is not great, it is a symbolic gesture indicating that the Fed has decided to ease up. The chief economist at Irving Trust gave the following interpretation: "The move is designed to push the banks to take on other assets such as Government debt. The Fed wants the banks to increase their footing and at the same time buy the Treasury debt." This economist made it clear that the credit will not be used for commercial and industrial loans, since banks will only take on risk free assets.

In his view the Fed will increase bank reserves; this will drive down the Federal funds rate, which banks will then purchase to buy Treasury bills at higher yields. Yesterday, Federal funds were trading a 5.82 per cent, while the three-month Treasury bill rate was 6.13 per cent, offering a nice spread to the banks doing such arbitage operations.

Illusory Recovery

The August inventory-sales figures released by the Commerce Department on Wednesday show the other side of the picture: the downturn of the real economy. While the rise in inventories in August, for the first time in 7 months, is being viewed by the White House and the New York Times as a sign of strength, the opposite is true. The overall rise in inventories was $1.29 billion, of which fully $1.2 billion reflected an accumulation of unsaleable autos at the dealer level. The breakdown of the inventory figures indicates that the disaccumulation at the manufacturing level reappeared as accumulation at the wholesale and retail levels. At the same time, virtually the entire increase in sales was related to the sale of goods from manufacturers to wholesalers and retailers. In sum, we are seeing a production spurt fueled by an inventory bubble at the retail level which is about to burst.

The 1.9 per cent rise in industrial output in September, the fifth consecutive month of increases according to a Federal Reserve announcement yesterday, was hailed as the largest gain in 11 years. But, far from confirming that the recovery is stronger than expected, the increased output is merely clogging inventories. German bankers were bewildered by the figures, remarking that they must have been doctored!