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Domestic Markets Newsletter

The Nose Dive

Psychology Of Panic Sets In On Bond Markets

NEW YORK, July 24 (NSIPS) — For the first time in many months, two new bonds offered this week carried double-digited rates of return, highlighting the uneasiness in the credit markets over inflation and the direction of the U.S. economy. Continuing where it left off after the release of last week's Federal Reserve Board figures showing large jumps in the money supply, the credit markets opened the new week with dealers dumping unsold inventories of bonds to cut their losses.

The sharp turn in the markets took almost everyone by surprise, and exposed all the concocted press analyses of the "U.S. recovery" to be about as worthless as most bonds. Just last week, the press and most "respected economists," financial letters, etc. were crowing about the new-found stability in the markets. Then these erstwhile bulls decided not to put their money, at least, where their mouths were and bailed out. Even though the market recovered slightly toward the end, the essential point had again been hammered home to all those who had been fooled by the press fantasy world — the so-called U.S. economic recovery is the world's largest confidence game.

Everyone knows it, and the slightest burp from the Federal Reserve Board on some other statistical reporting agency's computer is all that is needed to send the players scrambling to cash in their chips and abandon the premises.

One trader at a government bond house was quoted in the local press as saying, "There I was eight days ago, predicting four to six weeks of harmless trading before having to worry about money tightening. It does not pay to look further ahead than eight hours, I guess." The head trader of the corporate bond department with a large brokerage firm said, "A week ago Wednesday, I was a happy man. On Thursday night, however, my stomach turned into a bunch of knots and I've spent the past six trading days getting rid of inventory." One bond analyst, noting his colleagues' penchant for self-preservation, cynically remarked, "As usual, everyone leaped into the pool at the same time." — Himself included of course.

A leading bank analyst here told our correspondent: "Here's the scenario. This is the beginning of the end — hyperinflation and that falling out bed we've been watching for. Look at the situation. Money is plentiful, right? And mortgages are running 9 per cent... Homes are beyond the reach of the average guy... All the recessions since the war have failed to correct the basic inflationary tendency... this can only be corrected by a depression."

COLLAPSE CONTINUE UNABATED

According to the Labor Department's tampered statistics released this week, the real spendable earnings of U.S. workers have fallen from a year ago, a year of supposed recovery whose main danger, according to the economists, is "overheating" into an inflationary "boom."

Noting the seeming anomaly of income falling during an "upswing," the Wall St. economist says that such a year to year comparison is invalid since income figures last year were boosted by the tax cut, i.e. an inflationary expansion of government debt.

Since income is falling, retail sales are falling. Without retail sales expanding, it is impossible to maintain even current depressed levels of industrial output. And of course, with no real prospects of final sales improving, business is not investing in new plant and equipment, as is undoubtedly the case.

WHY THE PANIC?

The only solution to the crisis is to reverse the present austerity policies which are collapsing living standards and the markets of the industrialists.

The only index that is rising is the one that measures debt. Even though "real" GNP declined by $24.5 billion in 1975, the total of public and private debt soared by $228.5 billion. So, the only sane solution is to rein in the burgeoning debt, and tie credit expansion to productive activity.

The collapse of productive activity has released a mass of funds which have nowhere to go except speculative areas. These debt instruments feed on each other, requiring an ever expanding supply of funds. In monetarist terms, the "multiplier" declines since M1, which as checking accounts generally tends to reflect business activity, loans, etc., doesn't rise as fast as overall funds in the system reflected in the "monetary base (essentially reserves of Federal Reserve banks)." The multiplier has fallen from 2.5 to about 2.4 over the past 12 months, reflecting the bottling-up of free liquidity in the banking system e.g. the rise in savings deposits against checking accounts and the "mysterious" continuing drop in commercial and industrial loans.

Thus there appears to be a mass of "liquidity," as funds slosh around the credit markets. Yet, sooner or later, the markets grow nervous about their inability to realize real profit off their inflated paper holdings. Pretty soon people start bailing out of the market. Before long everybody begins rushing to liquiditate their positions, as the psychology of panic sets on the market. At that point all the previous "liquidity" appears to be tremendous "illiquidity."

This, in mild form, is what happened in the credit markets this week. Everyone knows that any combination of "bad news" could easily produce a panic on the markets.