

U.S. deficit out of control, as hyperinflation looms

by Steve Parsons

While the U.S. government and international media churn out reams of data and forecasts hyping the imminent “recovery,” the U.S. financial system is verging on an uncontrollable hemorrhage of debt and red ink. An unprecedented U.S. budget deficit is now intersecting the insolvency of major financial sectors. From banks and insurance companies to governments at all levels, the enormous demand for financing is threatening to detonate a hyperinflationary explosion as the “alternative” to a deflationary collapse.

First of all, the U.S. government’s budget deficit is out of control. May’s deficit came in at an all-time record \$53.35 billion, even though the Treasury received that month most of the balance of Gulf war tribute money from the “coalition” allies. Thus, the actual deficit was even worse. This boosted the total for the first eight months of the fiscal year to \$175 billion. Although the Bush administration still maintains that this year’s deficit will be under \$300 billion, it is recognized that the U.S. Treasury’s quarterly funding requirements will amount to \$100 billion from now on. That is, the United States is now set to borrow, every three months, an amount approximately equal to Mexico’s total foreign debt.

For the last week of June alone, the Treasury was planning to raise \$55.25 billion in two-year and five-year notes, along with three-month, six-month, and one-year bills, even though a large inventory of short- and intermediate-term notes is sitting unsold on dealers’ shelves. Interest payments alone on the federal government’s present debt are now running at about \$240 billion per year, as much as the Bush administration’s estimate of this year’s deficit, and expenditures are growing almost twice as fast as revenues. These increased funding requirements set the stage for both a dollar devaluation and U.S. interest rate increases in the context of the August quarterly refinancing—thus torpedoing the so-

called attractiveness of U.S. investments for foreign money, not to mention the stock market.

\$300 billion more for the banks

But this is only the tip of the iceberg. Treasury Secretary Nicholas Brady appeared before the House Banking Committee on June 26 to demand another \$180 billion bailout for the bottomless savings and loans pit known as the Resolution Trust Corp.—\$80 billion in direct budget appropriations, and \$100 billion in “working capital” that will be financed through off-budget RTC bonds. This comes on top of the \$80 billion “officially” already provided by Congress, plus \$70 billion in RefCorp bonds already floated. Furthermore, the new \$80 billion on-budget request by Brady understates by approximately \$50 billion what the RTC needs, on two counts: It does not include 208 S&Ls that are insolvent but not yet declared officially dead, and is valued in 1989 dollars, not current dollars. And on top of these shenanigans, Congress is being asked to permit commercial banks to borrow \$70 billion directly from the Federal Reserve.

That puts the total new money requests for the S&Ls and banks at \$300 billion. And no one doubts that this is hardly the end, as the original S&L bailout estimate of \$50 billion now veers up toward \$1 trillion.

Brady not only ignores mention of this stupendous debt run-up, but insists that the so-called on-budget RTC costs add up to just \$132 billion—the latest official cost projection for the S&L bailout. This “new math” project to cover up the catastrophe has not, however, fooled those in the know.

The Swiss-based Bank for International Settlements (BIS) noted, albeit in an exceptionally polite manner, the rigged data coming out of the U.S. government. In its just-released annual report, the central bank of central banks says

that U.S. financial statistics on capital flows are totally contradictory, making it “unclear how the U.S. deficit is financed.” Last year, foreign direct and portfolio investment in the United States plunged more than \$100 billion, to less than \$31 billion, while U.S. investments abroad sharply increased—putting net capital flows roughly in balance. But U.S. current account statistics unaccountably show a surplus—and net inflow of funds—of some \$73 billion.

At the same time, while on-the-books figures from Japan show a sharp decrease in net outflow of securities purchases to only a \$5 billion, Japan’s current account deficit was understated. There was “again a sizable statistical discrepancy—with the opposite sign to that of the United States,” the BIS observed.

What this means, is that a statistical obfuscation is covering up the extent of U.S. deficit financing, and the extent of Japanese subsidy for that financing, for fear of making clear the gaping financial hole in America—and, perhaps even worse, revealing the growing inability to actually finance such enormous deficits. It is this reality that was behind the Group of Seven meeting in London on June 23.

Desperate ploy at G-7 talks

“It is clear from the London G-7 talks that Washington absolutely is determined to prevent large flows of funds from going into the Soviet economy and East Europe,” said City of London economist Stephen Lewis in comments on the recent “pre-talks” prior to the July 15 Western economic summit to which Gorbachov has been invited. “The U.S. is putting behind-the-scenes pressure to redirect capital flows back into the United States. This is also behind the recent spate of articles mentioning the recent BIS report on a global capital shortfall. Washington is trying to ‘orchestrate’ the news to show an ‘upbeat U.S. recovery.’ The problem is that the U.S. stock market is *already* overinflated. At this point, if the markets believe the signs of ‘recovery,’ they will start to pull back, fearing no further interest rate cuts; if there is no more ‘good news’ on the recovery, the markets will fear rising deficits and higher taxes, and will sell as well.”

According to Lewis, Bush has set the stage by permitting Gorbachov to come to the G-7. “Gorbachov will come away from London and the G-7 with nothing. This and the growing catastrophe of the Soviet economy will then dominate press headlines for the coming months. This will benefit Bush, because it will indirectly send the message that Germany is not a secure investment with so many problems in the nearby Soviet economy, hence Washington hopes to reverse capital flows again back into the ‘recovering’ U.S. economy and the dollar.

“The problem for Bush is that, as the recent May deficit showed, the size of the coming U.S. capital funding requirements is so far beyond anything to date, that Bush must attract a very, very large sum of capital, and ultimately that means raising U.S. interest rates to do that. Once this occurs

in a significant degree, it will signal that the game is over for Bush’s economic crisis management.”

A \$500 billion deficit? Or more?

The growing tab for the S&L and commercial bank bailouts are not all that’s hitting Washington. In the wings is the insurance industry, reeling from billions of dollars of losses from crashing real estate, junk bonds, and hefty liability settlements. As of 1989, total real estate and mortgage investments for many insurance companies were up to 10 times greater than capital and surplus. A Townsend & Schupp survey of 61 life insurance companies showed that average real estate investments were more than 400% of capital in 1989. Travelers’ ratio was nearly 900%, Mutual Benefit almost 1,000%, and Aetna’s was 1,100%!

With the failures of First Executive and First Capital showing the utter inadequacy of state guaranty funds, state insurance regulators by year-end are expected to require companies to set aside capital reserves against risky mortgages and real estate investments, similar to the reserve ratios that banks are supposed to maintain to cover potential loan defaults. The greatest hemorrhage of red ink is from the insurance companies with the worst investments, as with the banks, the ones that can least afford to maintain reserves.

That poses the potentiality of an insurance bailout by the federal government, on top of the S&L and imminent bank mess. Some of the largest insurance companies have been discussing with federal officials legislation to have Washington take over regulation of commercial insurers from the states. This would be the prerequisite for creating some form of federal insurance fund, like the Federal Deposit Insurance Corp. (FDIC) for the banks.

And it doesn’t stop there. As the collapse of First Executive shows, the pension benefits of millions with insurance company annuities are in danger. And if there is a bust on the markets—including stocks, mutual funds, and bonds—the institutional pension funds that are the number one source of liquidity for the entire U.S. financial system, are in extreme danger. The call has already gone up for the government’s Pension Benefits Guaranty Corp. to guarantee the pensions for victims of First Executive and other companies, with many mooting that it should insure virtually all pension funds.

Take into account the financing requirements for state and local governments unable to sufficiently cut expenditures or raise taxes to finance some \$200 billion in deficits for fiscal years 1991 and 1992. Then add in unprecedented levels corporate borrowing, and plummeting foreign investment, and you get a horrifying picture of total illiquidity. Government “remedies” of blood-curdling budget cuts and tax hikes, no matter how extensive, simply can’t pay for all this. That leaves simply the printing presses—a Brazilian-style hyperinflation that can only result in a catastrophic deflationary bust.