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Domestic Credit by Lydia Schulman

The snowball effect

The Fed appears to be trying to pump money into the economy to slow the collapse it earlier provoked—but loan demand hasn't revived.

For President Carter to promise the big-city mayors who gathered in Seattle on June 10 that he will do something if unemployment continues to soar is like a hit man offering to send a fruit basket to the widow of his victim. The recession triggered by the March 14 Carter/Volcker credit restraint package is now running out of everyone's control.

The fastest and most deeply collapsing sector has been steel, which operated at only 61.1 percent of capacity in the week ending June 7. Industry sources expect operating rates in their industry to fall to 50 percent of capacity before long, which would make the downturn the worst on record. The immediate cause is the collapse of orders from auto, which has cut back new auto production by more than 30 percent from last year; construction and steel service centers, which are reducing their inventories on the expectation that there will be no rebound in demand. One steel industry source reported to us recently that the murderous cancellation of orders hit the steel industry all at once right after March 14. Until that point, he said, his company had continued to receive orders from customers who were still not convinced that the economy was heading into a prolonged recession.

The Commerce Department's latest survey of business capital spending intentions, taken in late April and May, shows that plant and equipment outlays will rise only about 1 percent this year from last, taking inflation into account, after a 6 percent real increase in 1979. The survey the Commerce Department took in late January and February had indicated that the current level of capital spending would be higher, but that businessmen also expected inflation to be higher. Spending was expected to be as high as 2 percent.

Surprising no one, retail sales dropped 1.5 percent in May before adjustment for inflation, for the fourth consecutive month. The drop was heavily weighted to the auto and buildings materials sectors, which were reported down 22 percent and 13 percent respectively. The overall drop would have been a lot more severe were it not for a 31 percent gain in gasoline sales—entirely a function of price increases. Administration officials are puzzling over the fact that despite the partial lifting of consumer credit controls, American consumers still appear unwilling to resume spending.

From all indications, the Federal Reserve appears to be trying to pump some money into the economy through bringing down borrowing costs in order to arrest the *negative* growth of the basic money supply and patch up the eroding status of the U.S. as an industrial power. This tack is not working any better than the Fed's earlier attempts to bring down the inflation rate by pushing interest rates sky high.

In the nine weeks through May 28, business loans at the large commercial banks plunged by $6 billion to $152.1 billion—at the same time that interest rates tumbled by almost 10 percent. The commercial paper market, which until recently had been picking up some lending business from the banks, has nosedived in recent weeks, falling $2.32 billion in the week ended May 28 and $536 million in the previous week.

Some of this demand for credit has been diverted to the bond market, where the top-rated corporations are converting short-term debt into longer-term maturities. But a lot of the credit demand has simply been crushed by the snowballing economic collapse. Consumer credit outstanding dropped precipitously by $1.99 billion in April, the first decline in more than five years.

Speculation was rife last week that the Fed would be forced to take a more dramatic move to loosen credit and slow down the rate of economic collapse, with some analysts expecting that the Fed might call an emergency session of the Federal Open Market Committee, which determines short-term interest rates, to lower its interest rate targets further. On June 11, the federal funds rate—the key short-term rate—came down to 8 percent and banks began reducing their prime rates to 12 percent. How far the Fed will move to bring interest rates lower is a less interesting question, however, than whether the administration can slow down the uncontrollable collapse it has triggered.

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