

Domestic Credit by David Goldman

The new liquidity crunch

Contrary to the supposed improvement in cash flow, the corporate sector's situation is worsening.

The available measures of U.S. corporate liquidity show a drastic decline during the second quarter of 1983, the most recent for which statistics are available. TRW's Business Payments Index, based on that company's data base of payments information regarding 8 million business locations, shows that past due receivables increased sharply during the second quarter.

TRW reports that receivables 1 to 30 days past due in the economy as a whole jumped from 14.0 percent of the total during the first quarter, the lowest level in three years, to 15.6 percent of the total, the highest level on record. Current accounts receivable (due less than 30 days) fell from 75.9 percent of the total during the first quarter to 74.5 percent during the second quarter.

TRW's data shows that similar declines in this liquidity measure took place in the second quarter of 1981, immediately before the major drop in industrial output during 1981, and again during the second quarter of 1982, before the disastrous third quarter of 1982.

A third measure of corporate illiquidity—after the bankruptcy rate and the late payments rate—is demand for short-term credit. Through the end of August 1983, total bank credit—the sum of loans and investments—appeared to be on a 10 percent or higher trajectory of increase.

Commercial paper plus business loans from all banks, is the most comprehensive measure of growth of bank

credit. According to Merrill Lynch's statistics, in the three months prior to July 22, this measure had actually declined, at an annual rate of -0.2 percent. By the month ended Aug. 24, it had risen to a 13.3 percent annual rate of increase.

The same pattern is evident in the business loan data for all banks.

The other side of the coin is the sharp decrease in banks' rate of purchase of securities (overwhelmingly government securities). During the three months up to July 22, banks increased their securities holdings at a 28.3 percent annual rate; this reflected an annual rate of purchase of government securities of about \$100 billion in absolute terms, unprecedented in peacetime history.

The banking system, in short, financed the public deficit, with the help of the Fed. By the month ending Aug. 24, this had fallen to a negligible rate of increase, and the pattern continued through the first half of September.

The Treasury and Fed financed the uptick in the housing and auto sector, slowing the rate of decline of physical product to about half the 1982 rate of decline, through the "off-budget" agencies of the federal government and the printing press; this occurred to the extent that the federally sponsored agencies supporting the secondary mortgage market doubled their activity to reach a \$100 billion annual rate, while the Fed, through the fastest peacetime rate of credit creation in history as well as sharp reductions in reserve-requirements, enabled the

banking system to finance the Treasury's deficit at a \$100 billion annual rate.

To summarize the events of the first six months of 1982: the federal government undertook a \$100 billion p.a. subsidy to the housing market, a \$30 billion subsidy to the non-financial corporate sector through various tax breaks, a \$20 billion increase in agriculture supports, among other forms of largesse, raising the actual deficit (including the various off-budget operations) to the range of \$350 billion.

During the fourth quarter of 1982 through the present, corporations made a highly dangerous decision to improve their balance sheets, and buy themselves a six-month breathing spell, at the expense of their long-term health and the future prospects of the U.S. economy. Non-financial corporations boosted their liquid assets from \$228.6 billion at the end of the third quarter of 1982, to a level of \$275 billion at the end of the first quarter of 1983, an unprecedented \$50 billion rise in six months, bigger than any increase ever recorded during a 12-month period.

Although data are not yet available for corporate liquid assets in the second quarter, the interest (not counting principal) debt-service that corporations paid, at \$140.8 billion, was equal to 105 percent of pre-tax profits, at \$134.4 billion! The apparent improvement of corporate liquidity through self-cannibalization during the first quarter suffered a drastic reversal during the second quarter, leading to the bankruptcy wave during the end of the third quarter.

It is not surprising under the circumstances that interest rates remain above their May 1983 levels and still threaten to rise. This ensures continued worsening of the bankruptcy rate.