

Domestic Credit by Richard Freeman

Down on your knees

The U.S. economy may be crawling by early next year—just in time for the World Bank, IMF, and GATT meeting.

The U.S. economy may get a new vantage point early next year from which to judge its future: on its knees.

The "Wunderwaffen recovery"—faster than a speeding bullet, able to leap bankruptcy court in a single bound—is coming to an end. The cold winds of collapse blow over it.

The recovery grew on piles of credit, large consumer spending, stock-market and bond-market profits, hypothecated stock issues, and very little real economic activity. The real economy grew the way someone's stomach swells when he contracts worms—there is weight gain, but much of it is related to unwholesome activity.

Helping this process along was the subsidy the United States continues to extract from the rest of the world in the form of manufactured goods imports bought cheaply with a super-strong dollar. The margin of imported manufactured goods, equal to about 7% of U.S. domestic manufactured goods output, fed whatever real economic activity is occurring.

But the import subsidy cannot offset the contraction of credit and the unraveling of the hypothecated profit centers. As credit dries up, while interest rates hold firm, the economy withers. Moreover, the import-subsidy has deflationary implications.

Take housing, for example. Sales of new single family homes fell again in August. A chart showing sales of new home units would start at the level of 755,000 in December of 1983, fall

to 685,000 in January of this year, rise again in February to 705,000 and then continue to fall continuously, down to a level of 569,000 in August. The 8.1% decrease in August was one of the steepest monthly declines.

The decline in the steel industry is even more pronounced. Raw steel production has plunged from over 9 million tons in May to 6.9 million tons in September. Of the six major U.S. steelmakers, four are expected to report an earnings loss in third-quarter orders. There are now various theories to explain why steel operating capacity has plunged from 80% in April to 53% currently.

One theory holds that there was inventorying of steel products in anticipation of an expected long steel strike, and that that cut down on new steel orders and, hence, production. But the strike is on the verge of being settled, with no visible upturn in steel output; nor did the steel output downturn start only at the point of the strike, but many months before that. Noticeable is the fact that steel products prices are falling sharply. Rolled steel, used for flooring of refrigerators, is selling at as little as \$100 per ton, or 20% below list price.

Why are steel prices below list price? Partly, there is the collapse of the steel market, because of the slowdown of housing and other industries. But the super-strong dollar, which has subsidized the economy, is also working a pernicious influence. As the dollar appreciates by 2-3% per month, the

cost of foreign steel products imported into the United States falls by 2-3% per month. U.S. steel producers must respond, in turn, by cutting their prices.

Thus, the strong dollar and lack of sales opportunities is causing a deflationary spiral in steel, as well as in aluminum and other industries. This deflationary spiral has nothing to do with the arid debate among newsletters as to whether there will be a deflation or inflation over the next few months. Rather, the deflation will cause shake-outs in industry.

But there is more. Corporations have contracted massive short-term debts during the recovery. This is unusual for a so-called recovery, when companies usually swap short-term for long-term debt. For the first time in U.S. history, during the first half of 1984, short-term liabilities constitute more than half of all liabilities.

The inability to retire expensive short-term debt means that corporations are now paying more than \$1 out of every \$4 of cash flow for debt service. A deflation in wholesale prices will make this debt all the more difficult to finance, especially as a downturn will shrink profits and cash flow.

Where will this leave the United States? This deflationary price spiral will knock out some of the value of the import subsidy and the downturn in production, concomitant with a credit downturn, will continue.

The first tremors of output downturn, exemplified by the fall in factory orders in September for the second month in a row, will reach earthquake proportions.

Around April of 1984, just at the time that Henry Kissinger's planned super meeting of the IMF, World Bank, and GATT takes place (see *EIR* issue of Oct. 9), the U.S. economy will be on its knees.