

## Domestic Credit by Richard Freeman

### A January breather for the economy?

*Some sectors did very badly indeed, and the overall industrial picture continues to flash danger signals.*

**I**n the first six weeks of the first quarter of 1981, the U.S. economy did not go into the double-dip recession; that is, it showed few overt signs of buckling. But to conclude from this that the economy is "holding its own" is dead wrong.

That assumption was drawn by many leading economists who predicted that "the economic lull is over," and that real growth could reach 3 to 4 percent in 1981. Manufacturer's Hanover Trust wrote less than penetratingly in its January 1981 *Economic Report* "Just as there are some statistics that depict weakness in the economy, there are others that suggest just the opposite."

Interest rates are now at a 19 percent level. If, as economists such as Salomon Brothers' Henry Kaufman predict, there will be a 16 to 19 percent range for the next six months, it would be impossible for the economy to escape collapse. But to fully appreciate why, it is necessary to understand that over the last several weeks the economy got a breather, which won't last for long.

Industrial production rose by 0.6 percent in January accompanied by a 0.9 percent increase in national personal income. In January, there was also an apparent jump in employment of about 300,000. It appears that this overall level of increase was prompted partly by mild weather, which allowed construction to take place in a normally cold month. Second,

many housewives entered the labor force, adding to family income. Further, there was an illusionary factor: because fewer workers were hired in December for the Christmas shopping season, when many stores and industries thought sales would be down, there was less firing afterward. Because figures are seasonally adjusted, those few firings compared with previous Januaries show up. Also, because production figures are based on samples of industries, and employment levels often figure into estimates of production levels, there was most likely an overstatement of the size of the production increase in January, which will be revised downward.

The level of final sales did go up in January, but here some of the internal looting procedures that were applied to keep the economy afloat in January can be seen. While personal income rose by 0.9 percent in January, the consumer price index rose faster by 1.1 percent.

Indeed, the rise in personal income over the last several months has been dwindling, rising by \$30 billion in October, \$25 billion in November, \$21 billion in December, and \$21 billion in January. During this period, consumers drew down their bank accounts to compensate for the steadily dwindling increase in personal income. Thus, the savings rate in October was 5.5 percent, in November it was 5.1 percent, in December 5.2 percent, and in January 4.6 percent. As

personal income dwindled and consumer credit remained flat, consumers dipped into their bank accounts. But this process can only continue so long.

More worrisome is the fact that the economy in January was supported by only a few sectors—the construction of office buildings, which boomed; orders for steel and other products for oil-drilling equipment; and an increase in some of the service industries. Other industries have not recovered, and a structural shift in the U.S. economy continues for the worse. Since last April, 700,000 production and construction jobs have been removed from the economy, while 1.3 million service-sector and white-collar jobs have been added.

Nor is capital spending of any significant dimension occurring. In December, purchase orders for machine tools were down by 25 percent from December 1979. For the second half of 1980, machine-tool orders were down 32 percent. Machine-tool orders are generally a good barometer of capital spending by producers of hard goods.

Finally, there are signs that certain industries like housing, which has barely managed to hold the line at a 1.5 million starts-per-year level, cannot hold out any longer. Building permits fell 9 percent in December, and mortgage commitments, which precede building permits, have fallen even more considerably over the last few months.

While GM and Ford are announcing \$700 to \$1,800 rebates to move their bloated auto inventory and keep up their sales, a rebate policy, too, has a limited life. If Volcker keeps interest rates up and credit tight, then January represented only a breather for the U.S.