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U.S. Industry

First-quarter results confirm EIR forecast

by Richard Freeman

The announcement March 17 that U.S. housing starts fell from a 1,615,000 annualized level in January of this year to a 1,218,000 annualized rate in February signals that the *EIR*'s prediction last autumn of a downturn in the economy in the first quarter of this year is stunningly verified. Housing starts took a staggering drop of 24.6 percent, the biggest one-month drop since March 1970.

In the Nov. 11, 1980 issue of *EIR*, in an article entitled "LaRouche-Riemann Model Projects First-Quarter Downturn for the U.S.," we forecast that the economy would fall out of bed. Most economists claim that GNP rose 4.6 percent in the fourth quarter of last year, so the economy is doing well; but the concept of GNP, which measures hot air, is meaningless.

EIR wrote last November that "a computer-based simulation of the behavior of the American economy . . . conducted Oct. 23 and 24, [showed] that real output will fall steeply during the first quarter of 1981, comparable to, but not as steep as, the second-quarter 1980 downturn."

We said that the key cause of this downturn would be the loan-shark interest rate policy and credit constriction of Federal Reserve Board Chairman Paul Volcker.

"*The bottom line is a prime rate above 16 percent by year end,* and a high interest-rate level even if the economy dips off sharply," *EIR* wrote. During the "recovery period" dating from May to June 1980, "the corporate sector has not been able to improve its balance-sheet liquidity position." Nor did households have the opportunity to restore their income and liquidity positions.

The basis of accuracy

The key to the LaRouche-Riemann approach is that it interprets the consequences of the Volcker interest rate policy as exogenous economic and political assumptions entered into a *thermohydordynamic system* model of the U.S. economy.

This model measures variables of tangible output in the same way that a scientist measures the temperature, volume, and pressure of a diesel engine. Critical to this tangible physical output economic model is the definition of *labor productivity,* which measures the output of surplus of an economy divided by the costs of both the replacement of plant and equipment and the wage bill for feeding and clothing the productive labor force.

Working on this *real* level of the economy, the *EIR* staff estimated that the *labor productivity of the economy,* as measured above, would fall by the first quarter of this year. *EIR* projected that the *net reinvestible surplus* of the economy—the fund of future expansion of the economy—would also fall.

EIR further predicted that the growth rate of the *free energy ratio*—the rate of net investible surplus divided by the real costs of production—would "fall from its best level of about 4 percent at the end of the third quarter of 1980 to a range of *negative* 4 to *negative* 7 percent by the second quarter of 1981."

With these crucial ratios falling and the debt-to-output for manufacturing industry growing, representing the growing illiquidity of the corporate sector, *EIR* concluded that the only factor to abate the collapse would have been significant relief on the interest-rate front from Volcker, allowing firms to rebuild their profoundly unsound financial situations. With this relief denied, *EIR* concluded that the economy would fall through the floor.

Nevertheless, according to a March 15 *New York Times* release, "After months of predicting a significant slowdown in economic activity during the first quarter, the majority of the nation's economic forecasters have changed their tune. According to Blue Chip Economic Indicators, which *polls 40 economic forecasting services,* inflation-adjusted output during the first quarter is now expected to rise 2 percentage points, a much faster rate than expected [emphasis added]."

The Commerce Department reported March 17 that industrial production fell 0.5 percent in February of this year. Industrial production had risen a scant 0.4 percent for January; thus it is down 0.1 percent for the first two months of 1981. It would have to rise 1.9 percent in March for the consensus of the 40 economic houses to be correct. That is not about to happen.

The stunning drop in housing activity—where mortgage loan rates are at a record 15.4 percent—and the news that personal incomes grew by only $14.9 billion in February, indicate that the consumer side of the economy is drying up again. The savings rate of households is only 4.4 percent, a 20-year low. Auto output, while up from January, is only at 5.8 million cars per year, despite a gigantic rebate program.

Business will not only suffer from the loss of consumer purchasing, which is two-thirds of all final purchases in the U.S. economy. According to the Conference Board, capital appropriations by the largest manufacturing firms, excluding petroleum, were off by 22 percent in the final quarter of 1980 from the first quarter peak. If the commercial paper market, which is fueled by the money market funds, drops off, then industry will have no funds even for operating capital.

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