EIR Economics

Collapse verifies EIR's warning of 15-25% decline

by David Goldman

In December 1985, *EIR* forecast a 15% to 25% rate of decline in U.S. output of physical goods during 1986, as a function of the deflationary banking collapse already then on the horizon. The latest news proves us correct.

To be precise, we forecast that, early this year, an impulse-rate of decline in the 15% to 25% range would emerge, depending upon the political resolution of the financial crisis. No precise estimate of this year's downturn can be made as such, given the uncertain outcome of the factional battles surrounding the financial crisis; *EIR* nonetheless identified a 15% to 25% range as the level of physical-production contraction associated with the gravity of the present crisis.

Production and orders data published during the past week makes clear that the turning-point occurred in June, following several months of comparatively slow deterioration. Ignoring the fraudulent Industrial Production Index concocted by four statisticians in a windowless room at the Federal Reserve building in Washington, the following data make clear that the present impulse-rate of decline of the economy ran in the predicted range by no later than June:

The extent of the collapse

1) The Aluminum Association reported on July 30 that aluminum production in the United States fell to an annual rate of 2,883,707 metric tons in June, from 3,349,099 metric tons in May, a 16% drop during the single month. The June level also represents an 18% drop from the June 1985 level.

2) The American Iron and Steel Institute reported on July 31 that production of raw steel fell to 6,729,848 in June from 7,616,215 tons in May, a single-month decline of 13%. The June level represents an 8% decline from June of last year. Since imports of steel declined as well, there is no ambiguity concerning the implication of these data.

3) Factory orders droppped 0.3% in June and 0.5% in May, to $191.54 billion in June from $201.2 billion in December 1985. Manufacturing orders were down 4.8% in the first six months. Transportation equipment orders were down 15.9% in June, and aircraft orders were down 47%, which helps explain why basic metals production collapsed during the same month.

4) The U.S. trade deficit for June was a staggering $14.17 billion, pushing the trade deficit for the first half of 1986 to a record $83.92 billion, a 21.2% rise over last year's first-half deficit and well on the way to surpassing last year's record deficit of $148.5 billion. Given the nearly 40% decline of the dollar since July 1985 against the currencies of other leading industrial nations, the larger deficit represents about 10% less physical imports (U.S. imports from Ibero-America and some other developing-sector nations have not risen in cost, since these nations' undervalued currencies are pegged to the dollar). However, the rising cost is heavily concentrated in industrial components and parts, which raise the cost of domestic output, and encourage cutbacks in production.

5) The price of oil on overseas spot markets remains well below $10 per barrel, while Texas intermediate crude is barely above $11 per barrel. The break-even point for Alaskan oil production, a third of the American total, is $14 per barrel; for less, Alaskan oil cannot be pumped and shipped to refineries in the lower 48 states. At about $10 per barrel, perhaps 40% of domestic oil production will be lost over the next 12 months, as well as virtually all production of oil-field equipment. By itself, the oil price collapse could reduce U.S.

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industrial output by about 7%.

6) The last hope of "consumer-led expansion," the housing market, evaporated along with new home sales during May and June. New homes were sold at a seasonally adjusted annual rate of 703,000 in June, down 9.9% from May, and down more than 20% from April. That was the slowest since October 1985, when 637,000 new homes were sold, and 1% below that of June 1985, when it was 710,000. Federal Reserve chairman Paul Volcker, who was unable to continue reducing interest rates after mid-May, without causing an uncontrolled crash of the U.S. dollar, aborted the hoped-for expansion of housing. The commercial construction sector, burdened with a 25% nationwide vacancy rate in prime urban markets, remains about 20% below last year's levels.

7) The auto industry, the other major consumer sector, continues to deteriorate. U.S. automakers reported combined sales of 177,569 cars in the United States during the July 11-20 period, compared to 216,207 units in the year-ago period. So far in 1986, the firms have sold 4.5 million cars, down 3.7% from the 4.7 million units sold in the comparable 1985 period when calculated on the basis of a daily selling rate.

8) The services sector, the source of all the last six years' employment growth, is in financial trouble. Business failures in services in the first quarter jumped 34.3% to 4,867, from 3,623 in the same period of last year. Overall business failures rose 12.4% during the same period, according to Dun & Bradstreet.

9) The collapse of farm exports, the continued slaughter of dairy herds, the southeastern drought, and the collapse of farm prices across the board, will reduce farm income this year to a negligible level, and reduce physical output of agricultural products by *more* than the 15% to 25% range forecast for the economy as a whole.

In summary, America's agro-industrial base (farming, mining, basic metals) is already contracting at more than a 25% annual rate, while the sectors which showed fleeting signs of life, e.g., home construction, began to drop off during May. The overall rate of economic decline falls within our 15% to 25% range forecast in December.

White House panics

Older listeners to President Reagan's weekly radio address July 26 might have thought they had tuned into a rebroadcast of old Abbott and Costello tapes by mistake, as the President sought to explain the declining economy. He acknowledged that second-quarter growth was lower than expected, but called it only a "temporary" setback caused by decline of the oil, farm, steel, and textile industries. However, the President predicted that "when the tax bill is finalized and businessmen and venture capitalists know the new ground rules, then we can expect business to start moving. . . . Our economy is waiting for tax reform's lower rates. In that sense, this temporary slower growth we're experiencing is a sign of anticipation about the future and better times to come. Don't pay too much attention to those gloom artists. America's economy is strong. Our future bright. With tax reform lighting our heels in the coming years, well, it will give new meaning to the phrase, 'you ain't seen nothin' yet.'"

The President is partly correct to attribute the slowdown to the expected enactment of tax-reform legislation; by destroying the five-year boom in real estate which ended late last year, tax reform will wipe out the last remaining growth sector, and the source of most new service-industry employment since Ronald Reagan took office in 1981. However, as *EIR* documented in February, the result will be to wipe out $250 billion in debt attached to unwanted or unprofitable real-estate ventures, and a blow to the banking system twice as big as (for example) a simultaneous default by all of the Ibero-American debtors.

By July 31, the day on which the Commerce Department was to have released its index of leading indicators, the White House apparently decided that the President's explanation lacked credibility, and decided that plain lying might be more effective. Reporters awaiting release of the indicators were told that the index would not be available, so that the Commerce Department might cross-check data just received—provoking widespread speculation, even in wire-service stories, that the results were so dismal that the administration had decided to re-cook the entire business.

On Friday, Aug. 1, the Commerce Department announced that the index of leading indicators had risen by 0.3%. *EIR* has always dismissed the index as a joke. In this case, much of the increase was attributed to a rise in stock prices. What will the index show after July's 100-point slide in the Dow-Jones average?

A more earnest piece of fakery came from the Department of Labor the same day, which announced that the nation's unemployment rate had fallen from 7.1% to 6.9%. Two weeks after national media explained that the Labor Department underestimated actual unemployment by half, the credibility of these numbers appears strained. Under the circumstances, there is absolutely no reason to believe the Labor Department's claim that non-farm employment rose by 390,000, even taking into account the return of AT&T workers following the telephone strike.

In any case, the administration cannot postpone the political reckoning for long by faking data. The continued collapse of the dollar on the exchange markets, to only DM 2.09 and 154 yen on Aug. 1, shows that a "doomsday machine" has kicked on. America consumes net imports of $170 billion per year, which would cost $300 billion to produce in the United States. These goods represent 18% of the nation's $1.640 trillion of net sales of tangible goods. As the self-feeding spiral of dollar decline and banking insolvency worsens, the physical economy will come apart at an even worse pace, and Washington will have to invent more than a few numbers.