Production Breakdown Sends Stocks In Tailspin

The release of Commerce Department reports Aug. 4 showing that July retail sales have risen 2.4 percent above June levels barely stirred the New York Stock Exchange which stayed at the 18-month low it had hit last week.

Wary traders discounted the possibility that improved retail sales were sufficient to offset the bevy of bleak economic news which has appeared in the financial press for the last three weeks, documenting a crack-up in U.S. production levels and an end to growth in some industries.

BUSINESS OUTLOOK

Reports of this economic news July 27 had sent the Dow Jones industrial average of the New York Stock Exchange shooting down by 20 points. By that week's end, the Dow Jones average had plunged 40 points, wiping out billions of dollars in equity prices. It closed at 888, its lowest level in a year and a half. By Aug. 5, the Dow was still mired in its doldrums, hovering at 888.6 by the conclusion of the week's trading.

The "shell-shocked" stock market, as one analyst described it, for once functioned as a sensitive and accurate economic barometer, detecting the end of what Carter's economists have called the 18-month "industrial recovery."

That so-called recovery was a mirage all along: production levels for most industries are still 5 to 15 percent below 1973 levels, after more than two years of "recovering." But the stock market only registered this fact when the evidence was written so large that even the blind — Treasury Secretary Blumenthal and Charles Schultz for example — could see it.

Heading the list of dismal economic news is poor profit showings in key industrial sectors, the gaping U.S. trade deficit, surging leaps in the money supply, and such critical indicators as declines in manufacturing employment for June.

Concerning the latter development, Lacey Hunt, vice president and economist of the Fidelity Bank, concludes in his July 27 newsletter: "a reduction of the work force by manufacturing firms clearly does not imply confidence about economic conditions."

But the foremost blow to confidence — or rather one might say, the stiffest dose of economic reality — came with the second quarter profits picture, which triggered the most powerful reaction on the stock exchange. The steel industry led the list of losers in corporate earnings. According to steel reports, the steel industry has already reacted to the weak news with knee-jerk production cutbacks, indicating that steel is preparing to lead the rest of U.S. basic industry down the path of deindustrialization (cosmeticized by the euphemism "rationalization.").

Bethlehem Steel Co., the nation's second largest steel producer, announced July 27 that profit margin drops of 38 percent would force a cut in dividends by a half. Lewis Foy, Bethlehem's Chairman, announced at the same time that in addition to the closing of four "smaller, older facilities," cost-cutting was being "intensified" at all its plants.

U.S. Steel, the country's number one steel company, reported July 27 that its earnings had plummeted 87 percent for the first half of 1977. After first blaming "Japanese imports" for the earnings decline, U.S. Steel Chairman Edgar "Albert" Speer did admit that the real problem was "the continuing lag in recovery of demand from the capital goods sector." He announced that in addition to the layoffs and short time now in effect at its Chicago Southworks plant, U.S. Steel may be laying off more workers at its Garyworks. Speer, meanwhile, has directed foremen at the giant Sparrows Point plant in Baltimore to relocate laid-off workers, NERA "boxcar"-style to flood-stricken Johnstown, Pa. to do "volunteer" clean up work for, at best, nominal pay. Later in the week, however, Bethlehem announced it would permanently lay off 4,000 workers at the Johnstown works, and another 3,400 workers "temporarily" — fueling speculation the plant may never reopen.

On the list of steel losers is Lykes, which reported a net loss for the quarter. The company is blaming the loss on its Youngstown Sheet and Tube Division, one of the plants on the Commerce Department's "next to go" list.

The copper industry, slated to be closed down in favor of foreign labor-intensive operations, joined steel to show large second quarter losses, led by Newmont Mining's 57 percent earnings drop. Summing up the state of the copper industry, Kennecott Copper announced last week that it was going to use the $1.2 billion obtained from the sale of its Peabody Coal subsidiary to diversify out of the copper industry altogether!

The Commerce Department too has released its share of bad economic news for the last two weeks. On the capital spending side, domestic orders for machine tools declined 9.7 percent in June, and durable goods orders dropped off 1.1 percent after three straight months of stagnation.

The Commerce Department report of July retail sales gains of 2.4 percent over June was led by a 4.2 percent increase in auto sales, leaving the July net gain over June in other retail sectors a weak 1.9 percent. This increase will not be enough to allay the suspicion and doubt about the retail sector's future that has been engendered by the previous three month's real dollar volume decline in retail sales. Add to that two months of flat business sales and the bankruptcy of the giant Robert Hall clothing outlet, and the news hardly spells that the consumer spending binge is off and running again.

Within the last three months, industrial inventories have been built up to a nearly overstocked level, forcing industries to further slow down their production pace. A big part of the problem — compounding the difficulties stemming from the domestic capital spending lag — is that the capital goods-short Third World cannot make the financial arrangements to become a center for the import of U.S. goods.

The Yawning Trade Deficit

The staggering collapse of the industrial sector is in part explained by the news of another U.S. trade deficit.

On July 28, the government announced a merchandise trade account deficit of $2.8 billion, and a six month deficit of $12.59 billion. When measured by so-called free along side (FAS) accounting which includes insurance and freight costs in the import bill and is a more accurate practice used by almost all OECD nations, the deficit is nearly $17.5 billion or $35 billion annualized.

There is no mystery here: Wall Street debt collection policies have crippled the import capabilities of, notably, the Third World. In June, agricultural exports of a record U.S. harvest were off sharply from May, leading to an overall fall in export levels of 3 percent. Imports to the U.S. rose by 11 percent.

Commerce Department Undersecretary Frank Weill predicted July 27 that "it could take us a decade or more to get back into sustainable equilibrium" in trade — that's assuming that the dollar lasts a few more weeks.

Inflation Around the Corner?

It is perhaps no less significant to the traders on the stock exchange that money supply figures are also shooting through the roof. Although M-1, the amount of currency in circulation plus demand deposits, fell $1.5 billion the week ending Aug. 3 it has skyrocketed at a 19.4 percent annualized rate for the last four weeks. Likewise, M-2 aggregates, which dropped $100 million for the week ending Aug. 3, have gone up at a 17.3 percent annualized rate for the last four weeks.

Federal Reserve chairman Arthur Burns responded by tightening the federal funds rate — the rate at which banks borrow money from each other — by 25 basis points. This pushed up interest rates overall, and began a sharp downturn in municipal and Treasury bond prices.

But the tightening of interest rates will only constrict the supply of credit, accelerating the downward trend in the economy already underway.

This rapid downturn in production has not been lost on Wall Street. For about four weeks now, Wall Street spokesmen such as Jacob Javits, Hubert Humphrey, and Felix Rohatyn, have been plugging their reworked threadbare revisions of Hitler's 1930s economic programs.

Then, on July 28, the New York Times offered its comparison between 1927 — the pre-crash speculative boom in the U.S. — and today. In 1927, central bankers like Benjamin Strong and Sir. Montagu Norman, chiefs of the New York Federal Reserve and the Bank of England respectively, looked to gold to discipline the world economy. Today "as a substitute for gold, there must be political and social discipline," the *Times* concluded.