

Domestic Credit by Richard Freeman

Recovery illusion already over?

Inventory rundowns and corporate buildups of liquid assets are coming to an end as interest rates start to rise.

Major U.S. corporations agreed weeks ago that the supposed economic recovery will evaporate during the fourth quarter. Of course, the recovery was never there in the first place; it consisted of an auto-plus-housing uptick, bloated into a broader-appearing improvement by phony Federal Reserve figures. It now appears that the hoax may already have dissipated.

This much is suggested by the huge drop in August durable-goods sales reported by the Commerce Department, as well as the 13,500 steel layoffs announced the week of Sept. 12 (including the permanent closing of Ford's River Rouge steel plant).

Although auto companies have provisionally scheduled sufficient overtime to maintain output through September, industry and trade-union sources interviewed at the plant level expect a major contraction of auto output during the October-November period.

However, the May-July rise in interest rates may have done more damage than the Federal Reserve expected. Although data are incomplete, it is possible that the recovery bubble popped in August.

A closer look at the unemployment data released for August shows straightforward deterioration of employment conditions.

Contrary to the hoopla surrounding the drop in the official rate from 10 percent in June to 9.5 percent in July, the July rate reflected a shift among formerly employed workers to minimum-wage jobs, simultaneous with an

exclusion of "marginal" sections of employed out of the labor force altogether.

The August rate, unchanged from July, includes an additional 109,000 unemployed, along with the usual Bureau of Labor Statistics tinkering with overall employment figures to prevent the unemployment rate from rising.

Both housing starts and single-family home sales have fallen for the past two months. From the 5 percent drop in lumber production between the end of July and the end of August, it appears that the official August housing-start figure will show equally poor results. Steel production also fell in both June and July.

To make matters worse, the slight improvement in interest rates during late August may be over. The completion of the Treasury's third-quarter borrowing had taken momentary pressure off the credit markets, in the irregular rising pattern which has prevailed since the beginning of 1983. Now that the Treasury must come back to the market for the fourth quarter, rates are beginning to rise again.

The problem is that corporations, who lived by selling their last inventory, squeezing their labor force, and junking much of their capital-goods capacity, are now out of cash, and forced to borrow to keep going. This suggests that interest rates may rise sharply, according to an analysis by Merrill Lynch.

According to the Sept. 8 weekly letter of Merrill's capital markets analyst Peter Canelo, a sharp rise in bank

lending and commercial paper issuance to corporate borrowers during the past two months shows that the "reliquification" of the winter and spring is finished; corporations must now borrow, at exactly the point that the "recovery" bubble is deflating.

During the cannibalistic process of "reliquification," non-financial corporations boosted their liquid assets from \$228.6 billion at the end of the third quarter of 1982 to a level of \$275 billion at the end of the first quarter of 1983. This \$50 billion rise over six months is bigger than any increase ever recorded for a 12-month period.

The decision to sacrifice everything for liquidity was made to prevent the bankruptcy wave from becoming worse than it already is. But corporations' ability to squeeze funds out of already depleted existing operations could not last forever.

In the fourth quarter of 1982, corporations liquidated inventories at a \$45.4 billion annualized level, the highest in U.S. history. In the first quarter of 1983, they liquidated inventories at a \$33.2 billion rate.

Although the inventory data available to the Commerce Department is notoriously inaccurate, the general trend reflected in these data is probably not far from the truth. It also seems clear that the inventory liquidation ended, along with the credit-fed consumer sales bubble, sometime during July. This leaves corporations with heavy borrowing requirements simply to maintain output at present levels at precisely the point that economic activity has begun to drop off, and interest rates have risen.

The official 3.7 percent July drop in durable goods orders suggests that the decision has already been made not to re-accumulate inventories. At this point, the recovery illusion dissolves into thin air.