No Doubt About It: U.S. Economy Collapsed In January

The U.S. economy collapsed in January and now stands on the edge of a new Great Depression unless immediate action is taken by the Carter Administration and the business community. With the economic indicators released by Washington this week no sane economist or businessman can question the seriousness of the present situation. Excuses about the weather and comparisons to last year just no longer hold up.

BUSINESS OUTLOOK

The most startling of the disastrous figures is that the ratio of inventory to sales fell to the *1951 level*. This indicates that after the holiday season no stocks were replenished because merchants expected a collapse. Auto sales, a key economic indicator, have been far below expectations since the introduction of the 1978 models in November.

During January, industrial output fell 0.7 percent, housing starts were off 29 percent, and retail sales fell 3.1 percent. In the week that ended Feb. 11, retail sales plunged another 6.4 percent. Also darkening the picture is the continuous rise in short-term interest rates and the decline of deposit growth and savings at mutual savings banks. Rising interest rates and reduced revenues at savings banks indicate that the housing industry faces a very difficult year in 1978. In New York State alone savings outflows in January totalled $127 million following a $98 million outflow in December. In January 1977 these same banks recorded a net inflow of $246 million.

The overall effects have been to feed the actual U.S. collapse, and just as critical, to promote a crisis of confidence in the Carter Administration. The U.S. business community is petrified that the Administration has no sound policy to pull the economy through. This, combined with some very real economic problems is causing U.S. industry to withhold capital investment plans, creating a self-feeding crisis.

The 1978 Depression

The manipulations against the dollar and the economy by Secretary of the Treasury Blumenthal and Secretary of Energy Schlesinger could not succeed unless major weaknesses existed in the U.S. economy.

The press has cited the harsh winter weather as the cause for the disastrous economic downturn and compared the situation to last year when a similarly harsh winter and poor economic showing was followed by a recovery. But the major difference between today and a year ago is that it is now a year later. Following last winter's downturn, the Fed was able to restart the economy by renewing its pump priming policy through increases in the monetary base. This, and the continued increases in the consumer installment debt bubble, allowed for a paper recovery. This continued the recovery since the 1974 recession based primarily on the creation of a hot air bubble of speculative investment and debt. The U.S. is now finding that this bubble can no longer be supported without destroying the economy entirely.

During the recent period, the Federal Reserve has again been furiously pumping funds into the system. Over the past eight weeks alone the Fed has been increasing the monetary base at a 14.5 percent annual rate.

This increase in the money supply feeds inflation and further weakens the dollar. To keep the market off balance the Fed has been raising short-term interest rates, now at 7 percent, creating a see-saw effect, one day pumping funds into the system, the next, raising interest rates to counter inflation.

According to Lacy Hunt, chief economist at Fidelity Bank in Philadelphia, the consumer debt bubble, another of the major sources of hot air, has passed its peak. The high ratio of installment debt to personal income, combined with the general rise of inflation, he said, is the cause of the fall-off in auto sales not the cold winter. This is borne out by the fact that while sales of U.S. cars were down significantly, sales of lower priced foreign autos were rising. The factors cited by Hunt cause consumers to reduce their purchases of high cost items such as cars.

The effects of this squeeze are being immediately felt by two auto makers, Chrysler and the American Motor Company. Yesterday Chrysler announced an unexpected fourth quarter operating loss of $59.4 million and predicted another loss in the current quarter. Depressed earnings for the next two years are anticipated by the company's management. AMC has all but thrown in the towel and is rumored to be seeking a foreign buyer to take over the company.

Hunt says that for these reasons the current collapse of the auto sector signals that the collapse of the entire economy will hit within a year.

Rising interest rates, resulting from Fed policy, and the huge amounts of government borrowing needed to fund a budget deficit which threatens to reach $130 billion, including off budget requirements, pose a serious threat to the economy. The consumer debt bubble and the housing market are very sensitive to interest rate changes. Rising rates cause money to move out of savings into fixed income securities, causing a shortage of mortgage money and a rise in mortgage interest rates. This will assure that the housing industry does not recover from the January collapse, a collapse felt equally in southern regions unaffected by winter weather. Furthermore the cost of money to all industry will increase, preventing any chance of a resurgence of capital spending, and money will continue to leave the stock market in favor of high yielding "safe" investments such as Treasury notes.

—Joseph Stein