

## Domestic Credit by David Goldman

### The threat of 1930s-style deflation

*Federal Reserve policy notwithstanding, the effort to avoid price falls now means more price falls in the future.*

**T**he USX strike, the Japan-U.S. semiconductor agreement, the Canadian lumber tariff, and a variety of other seemingly disparate actions have a common source: the threat of a deflationary price collapse on the scale of the 1930s. The Federal Reserve's anxiety to avoid a 25-40% collapse in commercial real-estate values has been widely reported, as well as the financial system's inability to sustain real-estate prices much longer.

The problem with all of these measures is that they further reduce the real consumption level of raw and intermediate materials, creating the conditions for even worse deflationary pressures in the immediate future. In fact, the relative stability of prices between July and October may have ended with the fall of international oil prices to below \$15 per barrel, following Saudi Arabia's refusal to adopt additional production cuts Nov. 24.

The prices of all raw and semi-finished materials, were in a tailspin by early summer, when physical production began to fall at an annual rate of 15 to 20% in the United States.

The International Monetary Fund's commodity price index in July stood at only 69.3

in March, a drop of 12% in four months—a 36% annualized rate.

Meanwhile, the international oil price had fallen below \$10 per barrel. The steel industry, oil drillers, farm-

ers, and the financial institutions who lent to them were on the verge of a catastrophe that would have dwarfed the 1929-33 collapse.

The longest-ever strike in the history of the American steel industry has produced no shortage of steel, and not even an uptick in steel imports. On the contrary, it appears that USX, which locked out most of its workforce 117 days ago, forced the strike in order to shut down sufficient steel capacity to avoid a price-collapse in the industry.

According to industry analysts, some of USX's competitors, such as number-two producer Bethlehem Steel, have seen a marginal increase in orders. But most of the reported benefit to USX's competition has been the result of *price increases* in most steel categories.

USX's lockout appears to have been coordinated with the shrinkage of European steelmaking capacity imposed during the summer by the European Commission, under the direction of arch-cartelizer Viscount Davignon. The world steel industry stood on the verge of a deflationary collapse at the beginning of the summer, and responded with a brutal reduction in capacity.

Some of the big Wall Street investment houses warned in mid-July that the steel price collapse then in motion could bring down the entire industry, following the bankruptcy of

LTV Steel, one of the nation's top producers.

Paine Webber, for example, predicted on July 18, "The implication of the LTV bankruptcy is that flat-rolled steel prices, which have already fallen about \$30 a ton in the 'spot' market since June due to the collapse of orders in the second quarter, will fall a further \$30 to \$40 a ton. This would sharply boost the operating losses of all steel companies and raise further bankruptcy threats."

Among the major industrial commodities, the electronics industry stood to suffer most from a price collapse. The end of the computer boom, with hard times for the "sunrise industries" of the early 1980s, reduced demand for semiconductors; during September, semiconductor prices began to collapse at an alarming 44% annual rate.

One brokerage house warned in September, "Japanese integrated-circuit prices are 21% below a year ago and keeping severe pressure on margins. . . . Inventories are 29 days supply as of June. . . . Prices are still worsening, dropping at a 44% annual rate during September. [We] recommend watching chip prices on a weekly basis before purchasing any semiconductor stocks."

At that point, the Reagan administration stepped in with the supposedly "historic" trade-restriction deal with Japan, to reduce Japan's semiconductor shipments to the U.S. market. Domestic semiconductor prices stabilized, at least temporarily.

Similarly, Canada's imposition of an export-tariff on lumber puts a floor under U.S. lumber prices. Temporarily high because of housing demand earlier this year, they stand to fall drastically as housing starts keep falling. The Canadians apparently decided to take preventive action.