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Domestic Credit by Richard Freeman

Aloha, recovery, aloha

The consumer bubble goes pop, while government economists still think there's a recovery.

While a deluded President Reagan may bask in the glow of the announced 8.3% growth in the Gross National Product for the first quarter of this year, he has merely chosen to ignore the monster storm that has come over the horizon.

The so-called recovery is gone, disintegrating in the 27% drop in housing starts recorded in March. Those who explain away the drop by reporting that cold weather dropped housing starts from 2.23 million in February to 1.64 million in March miss the point: rising interest rates. The increase in home mortgage rates was already perceptible in January of this year. Home-buyers went on one last fling in January-February to tie down homes before mortgage rates moved out of their reach. This led to inflated January-February housing sales. March represented reality, as the conventional home mortgage for 30 years reached 13.75% and is still rising.

It must be recalled that the U.S. government bought the housing "recovery" over the last two years, purchasing more than 60% of all housing paper, largely through the secondary market and the Government National Mortgage Association and the Federal National Mortgage Association. Forget the government's protestations about "free enterprise"; it bought itself a housing uptick, "Keynesian style." In most normal years, the government never picks up more than 20 to 25% of the government housing market's paper.

Housing was one of the two "drivers" of the consumer bubble, mislabeled a "recovery." In its train, there were increases in housing-related items: furniture, paper board, gypsum—although not as much as the federal government claimed.

The other "driver" of the consumer uptick was auto. But auto loans are up to 14% and climbing. Even the recent advent of five-year auto loans by some banks, adding one year onto the auto loan maturity and reducing the monthly installment charge to the customer, won't prove attractive enough to bring back auto purchasers at the levels hoped for. Domestic auto sales fell from an 8.5 million annual rate in February to 7.9 million in March.

A secret General Motors memorandum, leaked to the press, states that GM will lay off 80,000 workers. The memo claims that their work will be made up through introduced automation, but that may be a cover story and not compensate for the loss in production.

The fakers in charge of what goes for "economic policy" in the Reagan administration may point with pride to the fact that the operating rate for the nation's mines and factories is up to 80%. But let's be serious. The steel industry has shut down more than 25 million tons of capacity over the last several years. By shutting down capacity, one raises the "operating rate."

There are those who will maintain that an economy can still be "recovering" when interest rates are double-digit. These people are more in need of psychiatric help than economic advice: Most of Wall Street and the Reagan economic staff would be good candidates.

With the U.S. government pumping money into the housing market like there was no tomorrow, it managed to get a short rise in a few consumer-led sectors. It faked the data for the basic industrial sectors it couldn't get to rise any other way.

But never in the history of 20th-century America could a real recovery ever take place with rates above five percent. The fact that in the midst of this so-called marvelous recovery the Public Service Company of New Hampshire, which is constructing the Seabrook II nuclear plant, had to cancel the completion of the plant and may file for bankruptcy is a dead-give-away. The nuclear industry is going down the tubes. A modern nation cannot function without nuclear power. That no one lifted a finger to preserve the basis of any future prosperity—nuclear plants like Seabrook II—in the midst of an alleged recovery, shows that short-term gains in a few selected industries were all the purported recovery could claim to be.

Now the near-sightedness of those who whooped when a few economic numbers moved upward will haunt them. Interest rates are rising and will continue to rise. Look for a 12.5% prime by mid-May. Most of the increase in the prime has nothing to do with domestic U.S. economic matters. The skittishness of the markets over the non-settlement of the Argentina loan package on April 1, has led to higher interbank rates on the Eurodollar market, pushing rates upward. So has the unwillingness of the Europeans and Latin Americans to finance America's Treasury and budget deficits, as well as America's stock market.

There may be one or two good economic numbers trickling in over the next few months, but say goodbye to the "recovery," and wait for the higher interest rates to re-submerge the economy for the fourth time in four years.

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