

Domestic Credit by Richard Freeman

Now capital goods are plummeting

As consumer goods production stagnates at below 1976 levels, production of capital goods is starting to collapse.

The announcement June 3 that new factory orders had fallen by 2.3 percent in April, and that new home sales had fallen by 15.3 percent for the same month, has tended to dampen the enthusiasm of those predicting that the recovery is just around the corner.

Indeed, U.S. industrial output for the first four months of the year points to an ominous trend which, if it continues, will mean another ratchet downward. That trend is the precipitous fall in capital-goods production.

Although capital-goods spending has slackened since Fed Chairman Paul Volcker began raising interest rates in August 1979, this sector had been spared the worst of Volcker's depression. The brunt of the economic downturn for the last two-and-one-half years has been in the consumer-goods sector, led by housing and auto, and in those industrial sectors that feed consumer goods, such as steel and rubber. Now the bottom is falling out of capital goods, which for the first four months of 1982 fell at a 15 percent annualized rate.

The same period shows a strange double-track performance. Consumer-goods production overall has gone from a Federal Reserve Board index of 142.0 in December to 142.5 in April, after dipping in January and February. In other words, consumer goods output has stagnated. It must be remembered that the Federal Reserve's industri-

al production index excludes housing; were housing production included, the index would have fallen for the first four months of the year.

Nonetheless, it is interesting that apart from housing, consumer-goods output did not fall. The reason is that two sectors performed rather well: auto output and the production of home goods, such as furniture and appliances.

Auto output for the first four months of the year has risen at a 33 percent annualized rate. However, this rise is deceptive. First of all, the December level represented only 3.5 million units a year, a third of the 1978 level. Many consumers who had put off buying a car had to finally get a new one, because the average age of a car on the road had risen to seven years, the highest in post-war history, while the average life of a car is three to five years. Secondly, some of this output has gone into unsold inventory.

Home goods rose by a modest 14.4 percent rate since the beginning of the year through April. Here the reason for the increase seems rather straightforward: with the drop in home sales, people were putting the money they would normally spend on homes into fixing up the house they already have.

No one should be under any illusion that consumer-goods production is actually doing well; the overall output index in April was still below the level in 1979. In fact, it is lower than the 1976 level.

What has changed is that as consumer-goods output stagnates, production of capital goods, which had risen generally the last three years, has begun to decline. Business-equipment output has fallen at a 22.3 percent annual rate for the first four months of 1982, led by the collapse of the one go-go area of the economy: the energy sector. In 1979-81, oil, gas, and coal prompted euphoria. The United States was going to have a coal export boom, the rumor was. Synthetic fuels were going to be the next new boondoggle. And oil and gas drilling generated orders for equipment, steel, concrete, and so forth.

The coal export boom, the Commerce Department has been forced to admit, hasn't materialized. Exxon Corporation's cancellation of its \$6 billion Colony Shale Oil Project near Parachute, Colorado signifies the death, for the time being, of synfuels. Oil and gas drilling is plummeting. Thus, during the first four months of 1982, building and mining equipment production has fallen at a 53 percent annualized rate.

Commercial construction contracts have fallen from 981.7 million square feet in the second quarter of 1981 to 750 million in the first quarter of 1982, as the rush to build office buildings and shopping centers has died down.

Perhaps most damaging to capital-goods production is that with capacity utilization of American plants falling during the depression, capital spending is evaporating. The capacity operating rate for all manufacturing was 78.4 percent in 1980. In the first quarter, it was 67.0 percent. And as the economy contracts, the fall in capital goods will deepen.