

Hamburg Institute of International Economics (HWWA) (Ed.)

Article — Digitized Version

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Intereconomics

Suggested Citation: Hamburg Institute of International Economics (HWWA) (Ed.) (1979) : USA: Start of the recession, Intereconomics, ISSN 0020-5346, Verlag Weltarchiv, Hamburg, Vol. 14, Iss. 5, pp. 263-264,
<https://doi.org/10.1007/BF02924572>

This Version is available at:

<https://hdl.handle.net/10419/139639>

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USA: Start of the Recession

In the USA the recessionary influences had evidently gained the upper hand by the middle of 1979. After a slight rise in the first three months of the year the real gross national product declined in the second quarter at a (seasonally adjusted) annual rate of 2½ %. The main factor here was lower private consumption which was pulled down by real-income shortfalls and a tendency to go slow on spending. Lower sales led to involuntary inventory accumulations – especially in the auto trade which suffered more than others. A slight decline was also seen in (price-deflated) investments in fixed assets, possibly as a result of the teamsters' strike and the withdrawal of services by the independent truckers in April/May. On the labour market the recessionary influences have so far had little impact. The numbers in employment have remained virtually unchanged, and the unemployment rate stayed at 6 %.

Rapid Price Increase Continuing

The price rise which had accelerated sharply early in the year proceeded at a fast rate up to mid-1979 although it moderated in the food sector. The rapidly advancing energy prices have now

taken the lead from the food prices the earlier above-average rise of which had been due to special factors. This change shows up most clearly at the producer level of the "inflation structure" where food prices have been going down since April while the price advance of miscellaneous finished goods has gathered speed. The unit costs have been rising at a perceptibly faster rate this year, which is usual at the onset of a cyclical downturn, and this happened although the updrift of wages has if anything slowed down; hourly wages (excl. overtime effects) rose in the first half of 1979 at an annual rate of no more than 7 %. Productivity has fallen because the production has declined while the labour force remained unchanged. In the economy as a whole the unit labour costs were in the first half of the year almost 10 % higher than a year earlier.

Fiscal Policy in Dispute

Little more than a year before the next Presidential elections the economic policy of the USA is more beclouded than ever by conflicting short-term and longer-term considerations. Great importance continues to be attached to the fight against inflation but the worsening employment prospects

are calling forth increasing demands for stimulatory tax cuts. The unexpectedly sharp contraction of the budget deficit in recent months – brought about chiefly by the inflation-related increase of tax receipts – is adduced as an argument for such cuts. In view of the recessive economic trend it must however be expected that the budget deficit will soon mount again. The "built-in stabilizers" such as loss of tax revenue and outlays on unemployment benefits which will soon go up again, will see to that. Whether such discretionary measures as tax cuts will be taken in addition to these is still an open question because of the strength of the price advances.

Failure of Wage and Price Guidelines

A certain amount of uncertainty issued during the summer months from the sphere of monetary policy. The money-supply aggregate M_1 , rose in the second quarter at an annualized rate of 11 %. This was not the least of the factors which put the dollar around the middle of the year under pressure. The gradual rises of the discount rate to 11 % and the appointment of a new Federal Reserve chief who is reputed to guarantee a stability-oriented monetary policy seem to have checked the erosion of confidence. The Administration's wage and price policy on the other hand has so far been a failure, as is also shown by the fact that the originally planned "real-wage

insurance" appears no longer in the latest budget projections of state expenditure in 1980. Whether the changed conditions should be met by keying up the wage guidelines (at present: 7 %) and tightening the price guidelines is currently under discussion.

Outlook: Recession Continuing

A great deal of uncertainty exists at present about the future economic trend as is shown by the discussion on possible tax cuts. Economic forecasts vary widely according to the underlying assumptions, especially for next year. In the latter part of 1979 the recessive tendencies are fairly certain to hold sway. Private consumption is likely to be depressed by receding real incomes and growing propensity to save. In the corporate sector inventories will probably soon be adjusted once more to less favourable sales expectations. Fixed investments, incl. residential building, may well be held for a while at a relatively high level. Overall the real GNP may be expected in the 1979 average still to increase slightly (by about 1½ %), even if economic activity slows as forecast, because there is a relatively large backlog. The

consumer prices are likely to go up by about 11 %.

Inflation Obstructs Rapid Recovery

The excessive increase of inventory and investment outlays which usually occurs in the late phase of a cyclical upswing did not take place this time nor have corporate profits been squeezed. On this side there are thus good auguries for a mild and brief recession. The prospects for a rapid curbing of the updrift of prices on the other hand are not favourable. The inflationary expectations seem to be too firmly imbedded, a fact which also limits the scope of fiscal policy in support of the discussed efforts for stabilization of employment. For if the demanded extensive tax cuts were to be implemented – perhaps with an eye on next year's elections – the initial expansionary impulses would probably be followed by an all the deeper-biting recession.

1980: Stagflation

After years of inurement to inflation the price increases will abate only slowly, even assuming that US economic policy follows a stability-oriented course. Under the

given conditions production and demand may be expected to revive gradually during next year but, taking an overall view, the real GNP in 1980 can scarcely be expected to be higher than in 1979. A considerable increase of unemployment would thus seem likely.

Strengthening of the Dollar?

The stabilization efforts are hampered by the steep rise of OPEC prices for crude oil. Not only has the imported oil become more expensive but the internal oil prices have had to be raised much more than foreseen in order to bring them, as desired, into line with the world market level. The lowering of energy requirements due to the recession will probably help to obviate further OPEC price rises, at least for the time being. In these circumstances the dollar may – with a stabilization-oriented economic policy in force – strengthen in the foreign exchange markets. The current account would also provide appropriate conditions for this insofar as the cyclical trend in the other industrialized countries will probably be less unfavourable than in the USA.

Index Numbers of World Market Prices of Foodstuffs and Industrial Raw Materials

Index and commodity group	1978			1979			
	August	November	February	May	August	September 7	September 21
HWWA-Index*(1952-1956=100) . . .	315.6	333.9	341.8	367.5	408.0	425.0	427.7
Foodstuffs	231.9	251.0	244.2	255.2	288.6	295.2	291.9
Raw materials other than foodstuffs . . .	356.0	373.8	388.8	421.6	465.6	487.6	493.1
Fuels	561.6	565.7	585.4	653.8	751.8	808.8	824.7
Raw materials for consumer goods . .	196.4	210.3	213.8	229.6	240.2	238.0	235.1
Raw materials for capital goods . . .	257.6	291.7	309.9	318.4	330.8	333.9	334.1
Reuter's Index (18. 9. 1931 = 100) . . .	1441.5	1519.9	1532.1	1569.9	1563.2	1577.3	1617.3
Moody's Index (31. 12. 1931 = 100) . .	927.8	980.0	1038.1	1061.7	1073.8	1111.3	1142.2

*Index compiled by the Hamburg Institute for International Economics. On dollar-basis.