

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

Article — Digitized Version

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Intereconomics

Suggested Citation: Hamburg Institute of International Economics (HWWA) (Ed.) (1981) : USA: Expansion slackening off, Intereconomics, ISSN 0020-5346, Verlag Weltarchiv, Hamburg, Vol. 16, Iss. 4, pp. 199-200,
<https://doi.org/10.1007/BF02924771>

This Version is available at:

<https://hdl.handle.net/10419/139757>

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USA: Expansion Slackening Off

The recovery of the American economy following the very brief but sharp recession during the first six months of the past year has been more vigorous than expected. The real gross national product increased at a rate of nearly 5 % — expressed as an annual growth rate — from the second quarter of 1980 to the first quarter of 1981. There are, however, various indications that the expansion of business activity markedly slackened off already during the first quarter of 1981; the growth of industrial production has clearly slowed down since the beginning of the year. Because of a large increase in the size of the labour force the situation in the labour market hardly improved even during the recovery phase. In fact, the unemployment rate in May, standing at 7.6 %, was again at exactly the same level as during the recession a year ago.

Private consumption during the first quarter again showed a marked rise over the preceding quarter and thus appreciably contributed to a vigorous expansion of the real gross national product during that period. While the growth of incomes clearly slowed down, the rate of savings declined to 4.7 % having stood at 5.1 % in the last quarter of 1980 and at over 6 % during the two preceding quarters. There are similarities here with developments at the beginning of 1980, when private households likewise increased their demand at the cost of savings and thereby postponed a decline in production. The expansion in private consumption — when we look at developments within the first quarter of 1981 — slowed down again soon after the turn of the year, following in particular the end of discount campaigns by various car manufacturers: consumers' expenditure in real terms did not rise any further after February and indeed at times showed a decline.

Private fixed investment increased clearly during the first quarter. The increase was 2½ % over the preceding quarter; this was, however, still just under 3 % below the already depressed level of the previous year. The main factor in this vigorous growth was the accelerated rise in private investment, a rise which, however — as indicated by company surveys — has probably not been maintained during the second quarter, no doubt largely because of the high level of

interest. The extreme increase in the cost of mortgage loans is hitting residential investment in particular; this declined again over the year. On the other hand there is some encouragement from investment in stocks, due to the fact that reduction of stocks greatly declined during the first quarter of this year.

New stimuli towards higher prices came chiefly from the abolition of oil price controls at the end of January. In consequence energy prices rose considerably. This more than offset price reductions for other manufactured goods, and the rise in prices at producer level, which had previously been slowed down, once more gathered speed. However, at consumer level the upward movement of prices clearly slackened off during recent months; in May the rate of price increases, compared with the preceding year, was "only" just under 10 %, following a figure of 12½ % at the end of 1980. A major factor in this slowdown was the stabilisation of foodstuff prices; fears that new impulses for price rises would come from this direction have so far proved unfounded. Finally, the rise in the prices of mineral oil products has also again been halted.

The worsening trend of the trade balance continued during the first four months of this year; the deficit increased to US \$ 8½ bn (as basis), having stood at US \$ 5½ bn during the final third of 1980. Admittedly, real exports increased once more in spite of the economic weakness in Western Europe, after a marked decline during the second half of last year. However, as a result of a steady expansion in demand in the USA imports continued to increase vigorously. Moreover, the terms of trade again worsened in spite of the revaluation of the dollar. Its weighted external value once more increased during the short period from December 1980 to May 1981 by roughly 9 %. Apart from the high interest rates in the USA a factor in this was presumably the rise in confidence following the last presidential elections.

Uncertainty about the form in which the proclaimed reorientation of economic policy will eventually be implemented makes it particularly difficult to forecast economic prospects in the USA at present. More

particularly, the date and extent of the proposed tax and depreciation reliefs are still uncertain. Judging by present trends fiscal policy is likely to remain expansionist for the time being. The announced cutbacks in expenditure do not greatly affect the current fiscal year, which runs until the end of September, whereas defence expenditure will probably be greatly increased already during this period. The budget approved by Congress for the 1982 fiscal year envisages an increase of expenditure of nominally 6 %. This means that total expenditure will diminish in real terms but this applies mainly to transfers. Purchases of goods and services on the other hand are likely to increase in real terms in connection with intensified defence efforts. At the same time monetary policy will continue to be focused on the struggle against inflation. The American Central Bank will therefore continue its anti-inflationary efforts even in the event of a renewed slowing down of economic development and oppose any expansion of money supply beyond the target. Temporary deviations, however, continue to be probable, especially in the event of strong movements of interest rates.

It is difficult to predict how, and above all, how fast, investors and consumers will react to the general reorientation of economic policy. There are, however, various indications that there will first of all be a slowing down of growth once more during the summer half of the year. Consumers' demand, having declined already during the first quarter, is likely at first to drop in real terms. Purchases of motor-cars, for instance, are likely to decline for a time following the end of discount

campaigns by various car manufacturers. Available income is not likely to increase in real terms and the rate of savings – recently very low – will if anything increase again. Residential investment, in view of dearer mortgage loans, will clearly decline during the summer months. The continuing under-utilisation of capacity and the exceedingly high interest rates will probably impair private investment as well. Exports will hardly rise in view of the worldwide cyclical downswing especially as the revaluation of the dollar has impaired the competitive strength of American producers. It is even possible that the real gross national product will decline temporarily.

Yet there are signs that this renewed phase of economic weakness will in turn not be of long duration. One reason for this is that monetary tightness will soon slacken at a time of cyclically declining demand for money and of diminishing expectation of inflation and that the interest rates will drop. Moreover, the implementation of the new economic programme will probably stimulate demand; this is true even in the short term if appreciable tax reductions come into effect. In view of generally relatively low stocks an improvement of business expectations will produce rapidly expanding effects in this area. The real gross national product will once again rise in the latter part of this year. However the expected annual average growth of about 2 % mainly reflects the increase already achieved during the first quarter. The rise in consumer prices will probably not continue at the slow pace of the past few months; on an annual average the increase will probably reach approximately 10 %.

HWWA Index of World Market Prices of Raw Materials¹
(1975 = 100)

Raw Materials and Groups of Materials	1980				1981			
	AA ²	June	March	April	May	June	July 3 rd	July 17 th
Total index	226.0	229.5	243.6	242.6	239.4	237.9	237.2	238.1
Total, excl. energy raw materials . .	157.5	156.0	145.7	143.1	135.1	131.4	129.1	131.2
Food, tropical beverages	150.4	150.4	141.0	137.5	123.5	118.6	115.6	120.0
Industrial raw materials	162.9	160.3	149.2	147.4	143.9	141.1	139.4	139.8
Agricultural raw materials	164.3	164.2	156.0	152.6	149.8	148.6	146.2	144.0
Non-ferrous metals	185.5	175.0	160.7	160.8	155.2	152.5	148.6	152.9
Energy raw materials	265.9	272.3	300.8	300.7	300.3	300.1	300.4	300.4

¹On dollar basis. - ²Annual Average. For the new method of computation of the HWWA Index cf. INTERECONOMICS No. 5, 1980, p. 261 ff.