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Continuing Expansion of the US Economy

Since the beginning of 1983 the upswing in the US economy has been very much ahead of that in the other industrialised countries. With an increase in overall production of 6.9 %, economic growth in 1984 reached its highest level since the early fifties. However, the expansion slowed down markedly after the middle of the year, real GNP only increasing at an annual rate of a good 3 %. Stock-cyclical influences played a major part in this development, but there was also a less pronounced increase in final demand. The number of employed persons has increased more slowly and the rate of unemployment has hardly dropped any more. Wage and price increases have continued to be moderate. Consumer prices increased on an annual average by 4.3 %, following a figure of 3.2 % in 1983.

Slower Growth of Industrial Investment

The growth of disposable incomes has levelled off considerably, in particular due to the slower expansion of employment. With an unchanged propensity to save, private consumption only increased at a current annual rate of well over 2 % following a period of one-and-a-half years in which it had expanded almost three times as fast. Industrial investments, which had increased on an annual basis by one-fifth during the first six months of 1984, have risen at a slower pace since summer. The total increase in investments in buildings and equipment in real terms in 1984 amounted to 13 %. Residential building investments, which had helped sustain the upswing right from the start, have fallen slightly in real terms since spring 1984. However, with interest rates beginning to fall, the number of new building projects stabilised during the last few months of 1984.

Despite the continuing appreciation in real terms of the dollar, American exports expanded considerably during the course of 1984. The decisive factors here were the economic improvement in the other industrialised countries and the renewed increase in imports by many developing countries. On an annual average, American exports were about 6 % up on the

1983 figure in real terms. With regard to the domestic market, both the exchange-rate induced improvement of the competitive position of foreign suppliers as well as the economic upswing stimulated imports. During the first six months of 1984 imports were 30 % up on the previous year's level in real terms; afterwards, however, imports responded to the slowdown in overall economic expansion and increased at a markedly slower pace. The balance of trade clearly deteriorated in 1984. Following a figure of US \$ 57 billion in 1983 the import surplus reached US \$ 109 billion (fas values) in 1984.

The central bank noticeably relaxed its monetary course last autumn. After virtually remaining unchanged for about four months the money supply M1 has been clearly increasing since November. Taking the year as a whole the central bank managed to achieve both its M1 and M2 monetary targets. Following the boost to monetary expansion the aggregates slightly overshot the planned ceilings (money supply target 1985: 4 to 7 % for M1, 6 to 9 % for M2). However, the tendency towards falling interest rates, triggered during the summer months by the cyclical tail-off of private borrowing, did not continue at the beginning of 1985. In real terms, long-term interest rates are still very high at well over 7 %; during the seventies they hardly ever exceeded 1 %.

Budget Deficit Reaching a New Peak

Following the election the financial markets yet again fell into the grip of fiscal policy problems. The need to find a convincing approach to consolidation was underlined by the fact that the budgetary deficit reached a new peak during the first quarter of the fiscal year. The draft budget presented at the beginning of February, however, opens up hardly any prospects of solving the consolidation problems. The draft budget shows that the government hopes to gradually reduce deficits via spending cutbacks alone. The latter concentrate on categories such as social welfare expenditure, residential building and agricultural subsidies, whereas

defence spending would continue to increase markedly in real terms. Such a concept, however, has no chance of securing the approval of Congress.

As economic policy impulses begin to ebb and the cyclical stimulating forces die down, the development of the US economy will again be more strongly influenced by the fundamental conditions for growth. Progress in the fight against inflation together with a moderate wage policy have paved the way for a sustained upward economic trend. On the other hand, the government's inability to successfully translate the supply-oriented concept into action is becoming more and more apparent. On the occasion of the economic policy course change at the start of 1981, for example, the government had announced that it would reduce the ratio of federal government spending to GNP. However, even in the "austerity budget" for 1985/86 this ratio still lies at the former level of about 23 %. In this respect, budgetary deficits reflect a fundamental departure from the supply concept, since they significantly reduce the supply of capital to the private sector. Budget proposals for 1985/86 show no signs of giving priority to a deficit reduction. As, in addition, Congress is unlikely to approve of the measures proposed and efforts are at the same time planned to effect far-reaching tax reforms, the fiscal policy setting will be marked by considerable uncertainty for some time to come. All these factors adversely affect further economic development prospects. Monetary policy originally intended making the concretisation of its targets contingent upon the course of consolidation efforts. In view of the strength of the dollar, a monetary expansion in the upper range of the target funnel is now likely despite unresolved fiscal policy problems, particularly since inflationary expectations have tended to diminish. Bearing in mind these economic policy prospects, interest rates are unlikely to drop any further in the near future. A

sustained weakening of the dollar's exchange rate is also improbable.

Now that the steep rise in profits has come to an end the propensity to invest has become a decisive factor for the future course of economic development. Even if the continuing moderation shown in wage settlements supports profit expectations, surveys reveal that a marked slowdown in the increase of business investments is to be expected. Public demand too will not increase as rapidly as in the previous year. At the same time, however, there will be an abatement of the retardant influences currently emanating from the adjustment of inventory investments to the slower pace of economic expansion. There will probably be no further contraction of residential building, since the drop in interest rates here has apparently brought the fall in demand to a standstill. Disposable real incomes and private consumption will increase at a moderate pace, as was already the case in the second half of 1984. Despite the severely impaired competitive strength, exports will rise slightly due to the, albeit restrained, increase in demand in other industrialised countries and the gradual recovery of imports by developing countries. Finally, imports will grow much more slowly than in the preceding year as a result of slower economic expansion. All in all, real GNP in the USA will probably grow by an annual average of about 3½ % in 1985. Unemployment can be expected to fall only slightly. Under the assumption that a pronounced dollar weakness is improbable for the time being, the rate of inflation will not increase to any substantial degree; on an annual average, consumer prices will probably increase by about 4 %.

Compiled by the Department of World Business Trends of the HWWA-Institut für Wirtschaftsforschung-Hamburg.

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

| Raw Materials and Groups of Materials | 1984 | | | | 1985 | | | |
|---|-----------------|---------|----------|----------|---------|----------|-------|-------|
| | AA ² | October | November | December | January | February | 1.3. | 15.3. |
| Total index | 205.0 | 202.8 | 202.6 | 201.1 | 200.7 | 197.7 | 196.9 | 196.5 |
| Total, excl. energy raw materials . . . | 125.1 | 119.5 | 118.6 | 115.0 | 114.1 | 114.1 | 112.5 | 111.5 |
| Food, tropical beverages | 122.7 | 116.2 | 116.0 | 111.9 | 112.6 | 111.4 | 109.5 | 110.9 |
| Industrial raw materials | 126.9 | 122.0 | 120.6 | 117.4 | 115.2 | 116.1 | 114.8 | 111.9 |
| Agricultural raw materials | 128.6 | 125.8 | 119.6 | 115.9 | 111.9 | 112.0 | 111.0 | 105.3 |
| Non-ferrous metals | 135.8 | 125.8 | 131.7 | 127.8 | 129.9 | 131.6 | 129.7 | 129.5 |
| Energy raw materials | 251.7 | 251.5 | 251.6 | 251.4 | 251.3 | 246.6 | 246.1 | 246.1 |

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