

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

Article — Digitized Version

US economy unstable

Intereconomics

Suggested Citation: Hamburg Institute of International Economics (HWWA) (Ed.) (1986) : US economy unstable, Intereconomics, ISSN 0020-5346, Verlag Weltarchiv, Hamburg, Vol. 21, Iss. 5, pp. 259-260, <https://doi.org/10.1007/BF02926981>

This Version is available at:

<https://hdl.handle.net/10419/140046>

Standard-Nutzungsbedingungen:

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

Terms of use:

Documents in EconStor may be saved and copied for your personal and scholarly purposes.

You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.

If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.

US Economy Unstable

The sharp drop in the dollar exchange rate since spring 1985 and the slump in oil prices since the beginning of this year have led to drastic changes in major economic indicators in the USA. This has so far apparently had relatively little effect on the development of the economy. The increase in GNP in real terms during the first six months of 1986 still corresponded to an annual growth rate of a good 2 %. There was a further marked increase in the number of employed persons, an increase which occurred exclusively in the tertiary sector. As the labour supply also increased substantially the rate of unemployment remained at 7 %. Consumer prices, which fell in spring due to the pronounced reduction in the price of oil products, have again increased in recent months; the rate of inflation in July was 1.6 % compared with a year previously.

The expansion of demand primarily emanated from private households. Due to the rapid increase in employment, although there was a further tailing-off of wage increases, there was a considerable increase in disposable incomes. In addition, the purchasing power of incomes increased in the spring as a result of the drop in consumer prices. Private consumption during the first six months of the year rose at an annual rate of 4 to 5 % despite the slightly greater propensity to save. Stimulated by the drop in interest rate levels since mid-1985 there was a much greater expansion in housing investments. In the business sector the restraining effects on the oil industry of the oil price slump initially predominated this year. Fixed investments have already been drastically reduced here, whereas they have probably increased slightly in the remaining sectors of the economy. As regards stock-building, where there was a sharp increase during the winter six months, disappointed sales expectations during recent months have led to more cautious ordering.

The price competitiveness of American businesses has improved substantially as a result of the considerable depreciation in the value of the dollar vis-à-vis the currencies of most competitors. So far, however, this has not noticeably invigorated real

exports. Real imports, which continued increasing markedly until the spring, fell after this period. The import prices of industrial goods would seem to have risen faster than before recently because of the lower valuation of the dollar. Altogether, however, the terms of trade improved markedly during the first six months of 1986 due to the substantial reduction in the price of oil. This encouraged a tendency towards a reduction in the balance of trade deficit; during the first six months of the year, however, the deficit figure of US \$ 75 billion (imports f.o.b.) was still slightly higher than at the end of 1985.

The central bank still fears a production setback more than a resurgence of inflationary expectations. With reference to the average of the fourth quarter in 1985, the money supply M1 expanded up until July at an annual rate of 13 %. The announced target range was between 3 and 8 %. Even though M2 and M3 did not overshoot the mark to such an extent it seems doubtful whether the extreme slowdown in the velocity of circulation of the money supply in its narrower definition can – as is often the case in the USA – be interpreted as a structural phenomenon, thus playing down the expansionary nature of the monetary policy course. The fact that the process of interest rate reduction has been slow to develop despite a further decrease in the discount rate and the restrained economy – the latest yield of 7 % on ten-year government bonds was hardly lower than in April this year – has probably been partly due to the expectation of a renewed higher increase in prices.

Fiscal policy measures were unable to keep the budgetary deficit within the targets, since revenue estimates were based on exaggerated growth projections and defence and agricultural expenditures far exceeded the estimates. The 1985/86 deficit, therefore, will probably be between US \$ 225 billion and US \$ 230 billion (5½ % of GNP), i.e. slightly higher still than the previous year. This would mean that the deficit of US \$ 144 billion estimated for 1986/87, which corresponds to the upper limit laid down in the Gramm-

Rudman law, would be clearly surpassed without new measures. In such an eventuality the law envisages "automatic" spending cutbacks. However, according to the Supreme Court decision, Congress must lay down the probable deficit figure and decide on which cuts are to be made.

Fiscal policy activities during recent weeks have concentrated on shaping tax reform. The draft bill about to be passed envisages a considerable simplification of the taxation system. The number of income tax rates is to be reduced from fifteen to two, the top rate substantially lowered and the tax basis broadened. In the business sector the tax credit for investments is to be dropped, the depreciation period extended and corporation tax reduced. Tax revenue is to remain constant in the medium term, although there will be a noticeable shift in tax payments from households to businesses. The short-term effects on economic activity are uncertain. Above all, it is hardly predictable at this present stage whether the propensity to invest this year and next year will be more strongly influenced by the curtailment of investment benefits or by the improvement of growth conditions hoped for by tax reform efforts.

Allowing for transitional distortions in connection with tax deadlines, it is assumed here that the expansionary and contractive stimuli of the tax reform on overall demand will initially balance out. Probably more significant in the short term is how fiscal policy will take into account the legal commitment to reduce the budgetary deficit. In order to meet the legal target level the deficit would have to be reduced by at least US \$ 80 billion (2% of GNP) during the next fiscal year. This would hardly be possible without a considerable short-term slowdown of the economy and for this reason alone is unlikely. At least, however, an initial move towards consolidation via a limitation of the increase in spending

has become more probable. This would relieve the central bank in its efforts to effect a further reduction in interest rates, even though to begin with a fundamental alteration of the expansionary monetary policy course is unlikely.

Following the fiscal and monetary policy misdevelopments of recent years there is considerable uncertainty regarding the general economic setting. The adjustments required represent a considerable burden to short-term growth prospects. On the other hand, the combined effect of falling interest rates, the depreciation of the dollar and the reduction of oil prices apparently triggers a series of short-term expansionary impulses, which would point towards a further moderate upward trend for the US economy. This is all the more so, since the contraction in the domestic oil industry will probably soon slow down appreciably.

Under these circumstances there will probably on the whole be no further decrease in business investment. Above all, private consumption will continue to provide stimuli for domestic demand. Influenced by the lower valuation of the dollar, the external flows of goods and services will gradually improve. The increase in production will probably accelerate somewhat, a major initial factor being the coming to an end of contractionary stock-building behaviour. All in all, on an annual average in 1986 GNP in real terms will probably be 2½ to 3% higher than during the previous year. The corresponding increase in 1987 is hardly likely to exceed this rate. As the stabilising effects of the decrease in oil prices gradually diminish the increase in prices will become markedly stronger.

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	1985		1986					
	AA ²	August	May	June	July	August	5. 9.	19. 9.
Total index	197.3	196.1	130.6 ^p	129.9 ^p	115.1 ^p	125.1 ^p	135.0 ^p	135.7 ^p
Total, excl. energy raw materials	112.5	110.4	118.6	114.2	111.7	111.8	115.1	116.8
Food, tropical beverages	106.9	99.8	112.4	103.1	100.3	99.0	103.8	105.6
Industrial raw materials	116.8	118.5	123.4	122.6	120.4	121.6	123.7	125.4
Agricultural raw materials	112.4	113.5	131.2	131.6	130.0	131.2	132.9	135.5
Non-ferrous metals	131.5	132.1	125.8	124.8	121.1	120.5	124.6	125.7
Energy raw materials	246.7	246.2	137.6 ^p	137.6 ^p	117.1 ^p	132.8 ^p	146.5 ^p	146.7 ^p

¹ On dollar basis. - ² Annual Average. - ^p Provisional (due to incomplete data on oil prices).