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Continuing Business Upswing in the USA

In the USA the economic upswing is continuing briskly this year, even though the heavy increase in GNP achieved during the first six months was mainly due to – partly unplanned – inventory buildups. Adjusted for inventory fluctuations total demand showed only a slight increase which can be traced exclusively to distinctly rising exports. The number of employed persons increased almost as fast as GNP. Recently the unemployment rate was 6 %, i.e. one percentage point lower than it had been one year earlier. During the first six months consumer prices increased at an annual rate of almost 5 %; in recent months, however, their uptrend has slowed down somewhat due to the steadying of energy prices.

Since during the first half year prices had increased at a much faster pace than previously, the expansion of disposable incomes noticeably levelled off in real terms. Adjusted for seasonal variation private consumption in the first half of 1987 was only slightly higher than in the preceding six months. Housing demand, which in 1986 had still shown a vigorous increase, is declining in 1987. This is probably a consequence mainly of the reduction of tax concessions, but also of the increase in long-term interest rates. Following a marked decline at the beginning of the year business investments, and particularly investments in fixed assets, picked up again. Corporate planning data and orders received by the producers of machinery and equipment suggest that there will be a lasting increase.

Under the influence of the dollar depreciation foreign trade has become a major support of business activity. In volume terms exports have been rising already since early 1986. In the first six months of 1987 they were approximately 8 % higher than a year earlier. Imports, whose vigorous increase had come to a halt at the end of 1986, exceeded the previous year's level by barely 2 % in the first half of 1987; a temporary increase registered in recent months was mainly due to higher imports of oil. The reversal in the trend of real trade flows did not so far lead to any visible improvement in the

– nominal – balance of trade; in the first half of 1987 the seasonally adjusted deficit amounted to \$ 73 billion (imports f.o.b.), i.e. slightly more than in the second half of 1986. A substantial deterioration in the terms of trade resulting from the depreciation-induced increase in import prices as well as from the renewed increase in oil prices has so far offset the real improvement in trade.

As the recent raising of the discount rate has shown, monetary policy is clearly aiming at a reduction of inflationary expectations. At the beginning of 1987 the central bank had already abandoned the expansionary course that it had pursued for more than two years. In 1987 the money supply M1 has so far expanded at an annual rate of merely 4 %, following an increase by 16.5 % in the course of 1986. The more broadly defined aggregates M2 and M3 were also growing at a much slower pace. Due to enhanced inflationary expectations and to the slower monetary expansion a noticeable increase in the level of interest rates was registered as early as the spring. Recently the interest rate level for ten-year government bonds was approximately 9½ %, i.e. almost 2½ percentage points up on the low at the turn of the year and equalling the level prevailing in early 1986. Measured against the inflation rate for private consumption this means that the real interest rate has hardly changed.

Following the \$ 221 billion high reached in fiscal 1985/86, the deficit in the Federal budget was substantially reduced in the fiscal year 1986/87, which ended in September. Calculated on the basis of the first nine months, the annual deficit was \$ 60 billion lower than that of the preceding year. Although expenditure cuts contributed to this development, the main reason was the unexpectedly steep increase in tax revenue. In order to be able to benefit from the low tax rate on realized price gains in force until the tax reform became effective at the beginning of this year, securities were sold on a large scale at the end of 1986. This led to additional tax payments in the following spring. Now the deficit threatens to grow again unless expenditures are cut or

revenues raised. Decisions concerning the further course of fiscal policy, however, have so far not been taken.

On the whole, after a prolonged period of misdevelopments, US economic policy has taken a turn in the direction of stabilisation and consolidation. In the short term this implies some attenuation of domestic demand. However, in view of the simultaneous improvement in foreign trade flows, the prospects for a further increase in economic activity, albeit a moderate one, are nevertheless favourable. On the other hand, there are a number of grave risks. It is still uncertain to what extent the inflationary potential which has accumulated during the more than two years of excessive monetary expansion, will become virulent. In this context the still moderate wage increases suggest that inflationary expectations will continue to keep within bounds. This again seems to indicate that monetary stabilisation policy will not be tightened and that there will be no further sustained increase in interest rates.

There is still great uncertainty as regards further progress in consolidating the budget. In the view of the special influences at work in 1986/87 it could already be regarded as a success if a renewed increase in the deficit could be avoided in the fiscal year 1987/88. The Government and Congress will probably aim at a compromise along these lines. At any rate, the pace of progress achieved by monetary and social policies is less important than the creation of confidence in the durability of such a course. If this succeeds, there will be a fair prospect that the dollar does not continue to weaken to any significant extent even though, for the time being, the deficit on current account will decline only very slowly.

The development of the propensity to invest will be crucial for the further course of economic activity. There are increasing signs that the adjustment of the

exchange rate, together with the continuingly moderate wage settlements, has led to an improvement of profit expectations and that business investment has started to increase gradually. Private consumption will probably grow only slightly; although the expansion of the wages and salaries total will continue to be stimulated by a noticeable increase in employment, real wages are likely to fall further. Due to consolidation efforts, government demand will only grow slowly. Domestic demand as a whole will show only very slight increases in the further course of both the current and next year. As against that, exports will probably continue to grow at a brisk pace while on the domestic market supplies from outside the dollar area will be driven back so that imports will hardly increase.

Due to the petering out of the stimuli emanating from the inventory cycle the expansion of overall demand and production will continue at a clearly slower pace as compared to the beginning of this year. The basic economic trend is indicated by the 2½ % increase in GNP expected on an annual average for 1987. Assuming that the walk along the economic policy tightrope in the USA is successful, a similar increase is to be expected for 1988. For the current year the average increase in consumer prices will amount to 3½ to 4 %; this rate is unlikely to be exceeded significantly in 1988 either. The external consolidation will increasingly be reflected in the current account since as a result of the stabilisation of both the dollar and the oil price the terms of trade will probably not deteriorate further. For the year 1987 as a whole, however, the deficit is expected to be slightly up on the preceding year once more; a reduction will not be achieved before 1988.

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	1986		1987					
	AA ²	August	May	June	July	August	28. 8.	11. 9.
Total index	143.2 ^P	125.1 ^P	148.9 ^P	148.5 ^P	148.5 ^P	148.9 ^P	149.4 ^P	149.8 ^P
Total, excl. energy raw materials	116.1	111.8	122.4	121.5	121.8	122.7	123.7	124.7
Food, tropical beverages	107.1	99.0	93.6	90.2	87.6	86.1	87.1	88.9
Industrial raw materials	122.9	121.6	144.3	145.3	147.9	150.6	151.6	152.0
Agricultural raw materials	131.0	131.2	167.2	168.4	170.6	172.6	174.6	173.5
Non-ferrous metals	124.3	120.5	139.5	142.1	148.5	153.0	151.6	154.2
Energy raw materials	159.1	132.8 ^P	164.4 ^P	164.2 ^P	164.1 ^P	164.2 ^P	164.4 ^P	164.5 ^P

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