

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

Article — Digitized Version

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Intereconomics

Suggested Citation: Hamburg Institute of International Economics (HWWA) (Ed.) (1988) : Continued upswing in the USA, Intereconomics, ISSN 0020-5346, Verlag Weltarchiv, Hamburg, Vol. 23, Iss. 5, pp. 251-252,
<https://doi.org/10.1007/BF02925120>

This Version is available at:

<https://hdl.handle.net/10419/140153>

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Continued Upswing in the USA

In the USA the brisk economic upswing has continued until recently. The growth rate of the real gross national product, which had reached 5% in the course of 1987, corresponded to an annual rate of 3½% in the first two quarters of the current year. Although the increase in domestic demand clearly slowed down, the external stimuli became stronger. This was primarily due to the exchange rate induced improvement in the competitive position of domestic suppliers that resulted from the dollar depreciation up till the end of 1987. The utilisation of capacities continued to increase; in manufacturing industry it was more than two percentage points higher in August than one year earlier. The number of gainfully employed persons has kept rising noticeably, offsetting the increase in the labour force; since last spring the unemployment rate has stagnated, with slight fluctuations, at 5½%.

The improving trend in foreign trade made a greater contribution to the increase in overall production in the first half of the year than the expansion of domestic demand; the latter corresponded to an annual rate of no more than about 1½% in the course of the first six months. However, this did not adequately reflect the basic underlying trend. For one thing, the development in early summer was already impaired by the consequences of harvest shortfalls caused by drought. For another, at the end of 1987 there had been an extraordinary amount of inventory accumulation so that inventory investment was bound to be lower during the following months. Furthermore, government expenditure declined in real terms following a marked increase in the second half of 1987. As against that, final private sector demand showed a considerable expansion.

Investment in fixed assets, above all, continued to rise at a fast pace. Despite the tax reform which tended to shift the tax burden to the detriment of the corporate sector, the earnings situation of enterprises had improved significantly in 1987. This seems to have had a generally positive effect on the propensity to invest. During the first six months of 1988 industrial investment was almost 13% higher than in the previous year. Housing investment, on the other hand, showed another

slight decline, falling below the previous year's level by 4%. The expansion of disposable income has slowed down somewhat. Although, due to the further increase in employment, wages and salaries continued to rise at a hardly reduced pace, the growth rates of other categories of income, especially interest and farm incomes, were clearly levelling off. The propensity to save, that had substantially risen in the wake of the stock exchange crash, showed a slight reduction in the course of the current year; at about 4% of disposable income savings continue to be noticeably lower than during the first half of the eighties. Real private consumption growth corresponded to an annual rate of slightly more than 2%.

The rapid decline in the real import surplus for goods and services was due primarily to the increase in exports. In terms of the definition used in the national accounts, in the first half year real exports were 21% up on the previous year's level; this means that there was an increase by almost one-third within two years. From this it can be seen that the depreciation of the dollar has made an impact; even since the beginning of this year, i.e. after the trend reversal on foreign exchange markets, only a small part of the depreciation has been undone. On the other hand, the exchange rate induced improvement in the competitiveness of American producers has tended to depress imports. Nevertheless, due to the cyclical expansion in demand there was a further increase. In the first half year imports of goods and services were 10% higher than they had been one year earlier. The tendency of foreign trade to improve in real terms was now clearly reflected in the balance of trade, too. If the deficit registered in the first six months of 1988 is extrapolated, the result is an annual deficit that is \$ 30 billion lower than the approx. \$ 170 billion recorded in 1987.

The relatively high degree of capacity utilisation, the labour market situation that has frequently been characterised as full employment as well as the harvest shortfalls due to the drought have led to increasing strain on price expectations. Producer prices for finished goods have been rising markedly since the spring at a current rate that has substantially exceeded the rate of

increase over the corresponding month of the preceding year, which amounted to 2.7 % in August. Up to the end of June consumer prices rose at an only slightly faster pace; the previous year's level was exceeded by 4.1 %. In spite of the sustained improvement of the employment situation the increase in wages has so far accelerated only slightly. In the course of the first six months average hourly wages rose at an annual rate of about 3½ %; this is barely one percentage point more than in the two preceding years. Nevertheless labour costs increased at a considerably higher rate due to the increase in payments for pension and health insurances. All in all, unit labour costs in trade and industry were rising slightly faster than before at an annual rate of 3½ %.

Even though the appreciation of the dollar has dampened the inflationary pressure emanating from imports, concern about a possible revival of inflationary tendencies has been growing. The central bank reacted to the slight acceleration of the uptrend in wages and prices by raising interest rates in order to prevent a reinforcement of inflationary expectations which would make it necessary for stabilisation policy to apply severe restrictions. This policy is favoured by the fact that the announced containment of the budget deficit will probably be more or less achieved this year; the gradual consolidation of public finances is likely to be continued after the elections.

Under these assumptions the dampening influence of economic policy on the expansion of demand will probably extend into the next year. Increased interest rates affect above all residential building, which is likely to undergo a further decline. The propensity to invest will also tend to be impaired. Business investment will therefore rise at a slower pace. For private consumption, too, a certain deceleration is to be expected; in view of the anticipated slow-down in the increase in

employment and the slightly higher inflation rate, disposable income is likely to expand at a somewhat slower pace. Government demand, on the other hand, will probably not decline any further. Allowing for the still decreasing inventory investments, total domestic demand will show a rather moderate increase.

At the same time exports will increase at a lower rate, partly because the re-increase of the dollar exchange rate that started at the beginning of this year has again led to a slight deterioration of US suppliers' international competitiveness. On the other hand, import growth will be slight in view of the slower expansion of overall demand. All in all, although external stimuli to economic activity will lose some of their momentum, they will still make a considerable impact. The current account deficit will decrease only slowly and – assuming that there will be no significant shifts in interest rate differentials – the exchange rate of the dollar is more likely than not to come under pressure again.

Even if the shortfalls in agricultural output that were caused by adverse weather conditions are ignored, real GNP will increase at a reduced rate in the further course of 1988 and in 1989. Due to the high overhang the rate of increase for 1988 will amount to almost 4 %; the corresponding rate for 1989 is estimated at 2½ %. As employment growth is likely to slow down there will probably be no further reduction in unemployment. Prices are expected to rise at a somewhat faster pace; this is partly due to the supply shortfalls caused by the drought. The rate of increase in consumer prices over the preceding year will be 4 to 4½ % for 1988 and 5 to 5½ % for 1989.

Compiled by the Department of World Business Trends of the Hamburg Institute for Economic Research (HWWA).

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

Raw Materials and Groups of Materials	1987		1988					
	AA ²	August	May	June	July	August	2. 9.	16. 9.
Total index ^P	149.2	148.9	149.2	148.8	142.7	140.4	140.5	134.1
Total, excl. energy raw materials	123.8	122.7	149.7	158.2	153.5	149.5	149.6	146.6
Food, tropical beverages	91.2	86.1	103.4	116.4	119.8	112.0	111.6	110.5
Industrial raw materials	148.6	150.6	185.0	189.9	179.1	178.1	178.5	174.2
Agricultural raw materials	167.1	172.6	198.1	198.6	194.3	192.4	189.9	181.4
Non-ferrous metals	150.3	153.0	217.2	234.7	205.6	205.3	209.9	209.2
Energy raw materials ^P	164.0	164.2	148.8	143.3	136.4	135.2	135.2	126.8

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