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USA: Signs of a Slowdown

So far, the American economy has been on the upswing. The pace has slackened since the middle of last year, largely as a result of the shortfalls in farm production due to drought. The 3.8% rise in real GNP for 1988 still topped the previous annual rate. The continuing rapid increase in labour supply was still being absorbed by rapidly expanding employment. Since last autumn however, the decline in unemployment has stopped, the number of jobless persisting at nearly 5½% of the labour force.

Increase in Domestic Demand

Domestic demand rose by 3% in 1988, equalling the 1987 figure and providing the economy with sustained impetus, but at the same time progress on the external adjustment front has flagged. A major factor has been the continued rise in private consumption. Thanks to growing employment in particular, private household incomes have risen appreciably. After its low in 1987, the rate of saving has climbed by 1 percentage point to more than 4%. The favourable trend in incomes has also bolstered demand for residential buildings. Growth in business investment has waned since the middle of last year. The total figure for 1988, however, was 9.5% above that of the previous year. Investment in fixed assets displayed the most robust growth, with investment in commercial and industrial buildings at a standstill. The upsurge in domestic demand, the increasing utilization of capacity and the reviving dollar last year have acted as a spur to imports, while retarding export growth. Nevertheless, mainly attributable to the trend up to the middle of the year, the 18% annual growth in exports of goods and services in 1988 was more than double that of imports. The deficit on current account was US \$ 20 billion lower than in 1987, when it stood at US \$ 154 billion.

The price level rose faster at the beginning of this year, influenced particularly by the more rapid increases in

the cost of energy and foodstuffs. Producer and consumer price rises had already been substantial in 1988, with an annual average of 4.1% respectively and a similar rate throughout the year. Wage increases, though, have remained moderate; in real terms there has even been a further decline in hourly earnings for the economy as a whole, excluding agriculture. The 3% growth in labour costs per unit in 1988 approximates the figure for 1987.

The declared goal of medium-term fiscal planning is still to consolidate the federal budget. According to the most recent government forecasts, however, the deficit for the fiscal year as of October is likely to be considerably in excess of the 1987/88 figure; the anticipated US \$ 170 billion will account for some 3.3% of GNP. Although the public deficit as a whole is expected to turn out to be only about half of this, given the high rate of resource utilization it would still mean a marked "structural" deficit position. The new President's budget proposal for 1989/90 is still based on the optimistic assumptions of his predecessor – sustained vigorous growth, decelerating price rises and substantially diminishing interest rates – and envisages total expenditure going up by a mere 1%. A lowering of the budget deficit to US \$ 95 billion, as estimated on this basis, would seem utterly unrealistic. In view of the altered general conditions alone, Congress put the figure at over 25% higher.

Tight Money Policy

The Federal Reserve's major concern has been to contain the uptrend of costs and prices. Largely via its open-market policy it has worked towards pushing up interest rates on the money market, which at nearly 10% (Federal Funds Rate) at the end of February were more than three percentage points up on the level prevailing a year earlier; long-term interest rates rose far more modestly. The Federal Reserve has succeeded in

ECONOMIC TRENDS

keeping a tight rein on monetary expansion. In the course of the year the increase in the M2 money supply, like that of M3, remained more or less in the middle of the target spread of 4% to 8%. Despite all this it is difficult to assess the latent inflation generated during the phase of exorbitant monetary expansion, particularly in 1985 and 1986.

At the beginning of the seventh upswing year, the utilization of resources in the USA has reached a point where the overall economy is coming under growing strain. The Government and the Federal Reserve obviously do not see eye to eye in gauging the magnitude of inflationary trends, which hampers the harmonization of monetary and fiscal policy. There are many signs to indicate that fiscal policy will continue to steer an unclear course. The Government's draft budget for 1989/90 is likely to be subjected to prolonged deliberation in Congress, ending up with very adulterated consolidation measures. Under these circumstances, the Federal Reserve will no doubt continue to strive to keep a lid on the – in the short term inevitable – upswell in prices, so interest rates will keep going up, too. The stabilizing drive of the Federal Reserve tends to strengthen the exchange rate position of the dollar. It is assumed here that this largely offsets the pressure coming from the unsolved budget problems.

Monetary policy will impede economic development in the course of the year. Increases in interest rates in particular will discourage private households from borrowing. In addition, the likely acceleration of the upward trend in prices will curb growth in real disposable income, thus causing the growth of private consumption to slow down. The recovery in housing construction will under these conditions soon ease off, too. In the

immediate future, businesses will invest more, but in the course of the year, the deteriorating sales and earnings prospects along with higher interest rates will probably act as disincentives. Expansion in government demand will certainly be subdued. Export growth will slow down further, particularly because the impulses emanating from the improvement in competitiveness as of early 1985 are subsiding. The expected slowdown in economic growth will also mean that imports will not rise as rapidly as hitherto. There is unlikely to be any basic change in real net exports in the near future; the current account deficit will probably decline little.

Slower Rise in Employment

The drought aftermath in agriculture having abated, overall production has revived appreciably in the first quarter of this year as against the latter half of 1988, but we can anticipate a marked decline during the remainder. Thanks to the conducive "base" effects of last year's farming shortfalls, real annual GNP looks like exceeding the 1988 performance by 2½% to 3%. This trend will be attended by a noticeably slower rise in employment and, again, slightly more unemployment. With the present continued high utilization of capacity, prices will probably rise somewhat faster, especially since productivity will decelerate and costs will go up more rapidly. Particularly in view of the circumspect monetary policy followed over the last two years though, it does not appear as if destabilizing trends will worsen permanently, which would lead to a sharp tightening of restrictions and deep recession.

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	1988				1989			
	AA ²	February	November	December	January	February	3.3.	17.3.
Total index	143.4	148.3	133.9	145.9	154.5	152.4	155.5	160.5
Total, excl. energy raw materials	150.2	140.6	156.1	160.6	160.4	157.1	160.9	160.2
Food, tropical beverages	108.6	101.7	110.0	113.6	114.6	111.9	112.7	114.7
Industrial raw materials	181.8	170.2	191.1	196.4	195.3	191.5	197.7	194.9
Agricultural raw materials	191.6	185.3	190.7	194.3	192.7	190.1	189.7	192.3
Non-ferrous metals	216.4	187.2	246.8	258.2	258.6	245.3	261.0	248.5
Energy raw materials	139.5	152.7	120.9	137.3	151.1	149.6	152.4	160.7

¹ On dollar basis. -² Annual Average.