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Economic Slowdown in the USA

There has been a marked slowdown in economic growth in the USA. The weaker basic trend was only covered over by the fact that the real gross national product recently was no longer being depressed by farming shortfalls due to drought as up to the end of last year. Excluding agriculture, overall production in the winter six months rose at a seasonally adjusted annual rate of over 2½%, some one percentage point less than in the previous year, its rate of growth clearly slowing down throughout this period. Employment nevertheless increased considerably; the number of jobless fluctuated around over 5%.

The slowdown in the expansion of demand has been due in particular to the restraint shown by private households. Though real incomes rose faster, the propensity to consume subsided tangibly; at an average 5.7%, the rate of saving in the first four months of this year was one and a half percentage points higher than the annual average for 1988. In the first quarter, private consumption increased little. Residential construction stagnated and demand in this sector has been declining slightly since the beginning of the year with mortgage rates on the increase. Business investment on the other hand has expanded appreciably, albeit much more slowly than during the investment boom in the period up to mid-1988. The investment plans of enterprises and the volume of orders for machinery and equipment also indicate that the expansion in the demand for capital goods is slowing down. Exports continued to rise steeply; real imports of goods and services in the first quarter were 11% above the figure of a year ago.

Prices have not continued to rise as fast as at the start of this year, but the upward trend remains strong. In all, the prices for finished products at the producer stage went up in the first five months at an annual rate of

nearly 10%. Consumer price rises were somewhat more restrained at 6½%. Food and energy costs in particular have gone up. Since special factors played a role here, the deterioration in prices has kept within a reasonably narrow margin. Despite a further decline in the number of unemployed, wages rises remained moderate. In the private sector, growth in earnings in the first months of 1989 hardly exceeded that for 1988. With productivity growth slackening only slightly, labour costs thus rose little.

After the statutory period for the evocation of consolidation measures had expired, official estimates put the deficit in the federal budget in the current financial year at 170 billion dollars, far higher than previously estimated. Due to unexpected after-effects of the tax reform of 1986, the figure will probably be well under this mark, though it will certainly not reach as low as the 136 billion dollars stipulated in the Gramm-Rudman Act. In spite of agreement between the President and Congress on basic figures for the 1989/90 budget in line with consolidation targets, future financial policy cannot at present be forecast. The budget deficit has been estimated at 99.4 billion dollars, slightly below the consolidation goal, but no breakdown had been made of the requisite cuts in spending and the discontinued additional revenue. Especially due to the disparate priorities of the President and the majority in Congress, the end result is uncertain. There is also the likely danger that via procedural loopholes the implementation of the budget will diverge greatly from the estimates.

In the first months of this year the Federal Reserve pressed ahead with its stabilization course. In response to the strengthened upsurge of prices, it raised the bank rate in February and via its open-market policy it worked

towards pushing up interest rates on the money market. The Federal Funds Rate in April attained almost 10 %. The expansion of the money supply flattened out further. The announced target spread for the growth of M2 of 3 % to 7 % in this year has not been reached and the M1 supply has even shrunk. The Federal Reserve, however, has recently clearly judged the continuation of its restrictive policy to be too risky. This change of mind is probably due in particular to the indications that expansive forces are beginning to slacken off. The danger of a sustained price uptrend overspilling onto wages is obviously regarded as being less acute than previously. Since the Federal Reserve, against the backdrop of falling interest rates for long-term investments, could bank on the credibility of its anti-inflation course – as underscored by the strength of the dollar on the foreign exchange markets – it relaxed its open-market policy at the beginning of June and the interest rates on the money markets dropped slightly.

All in all, many indications point to greater efforts towards consolidation in financial policy again as the year proceeds, with monetary policy geared to at least avoiding any further constraints on the economy. At first, however, the retarding effects of the monetary stabilization drive pursued so far will continue to dominate economic trends, though only a gradual dampening of the expansive forces is to be expected. Above all, business investment is likely to continue on a moderate upward path, particularly as the enduring wage restraint is conducive to profit expectations and the comparatively early reversal of the interest rate trend will encourage the propensity toward real investment. With a probable slight fall in financing costs, demand for residential buildings is unlikely to flag much, although the increase in real disposable income will slow down,

reflecting the anticipated drop in employment growth and the upsurge in prices. Even assuming then that the propensity to consume will not recede further, a more than restrained rise in private consumption is improbable. Exports will carry on expanding at a rapid pace, with import growth slowing down further. The trend in external trade and payments will thus again contribute slightly to the growth of overall production. The current account deficit will, however, improve little, since a closing of the trade gap will be offset by an increasing deficit on investment income.

Overall, the growth of national output can be expected to decelerate. Assuming that monetary policy is now approximately aligned to potential, its dampening effects will abate next year. Altogether, real gross national product in 1989 will exceed the previous annual figure by 2½ % to 3 % and in 1990 by some 2 %. Unemployment will probably not fall any further and later tend to rise somewhat. With the neutralization of special factors in the further course of the year and as a result of the general economic slowdown, prices will rise more slowly again, although the 1989 annual average price rise for private consumption will exceed that of 1988 appreciably, climbing from 4.1 % to some 5½ %; in 1990 it will probably again slow down a little. Although this economic forecast continues to be beset with considerable risks, particularly considering the momentum of inflationary trends, the chances for averting a stabilization crisis and hence for a "soft landing" for the economy have recently improved.

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	1988		1989					
	AA ²	June	March	April	May	June	30. 6.	14. 7.
Total index ^P	143.4	148.8	161.4	166.9	159.3	155.9	158.8	156.6
Total, excl. energy raw materials	150.2	158.2	159.6	157.5	153.3	148.6	148.9	147.1
Food, tropical beverages	108.6	116.4	113.2	111.5	111.1	108.0	108.2	102.1
Industrial raw materials	181.8	189.9	194.9	192.6	185.4	179.5	179.9	181.3
Agricultural raw materials	191.6	198.6	191.0	192.2	187.8	185.5	186.7	190.8
Non-ferrous metals	216.4	234.7	250.6	240.8	225.0	209.3	207.0	204.4
Energy raw materials ^P	139.5	143.3	162.5	172.4	162.9	160.2	164.5	162.2

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