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Slower Growth in the USA

The USA's real gross national product in 1989 still rose tangibly, at an annual average of 3 %; since autumn the pace of growth – even accounting for exceptional retarding factors such as strikes and natural disasters – has flagged noticeably, however. The utilization of capacity in industry declined by one percentage point in the course of the year. Employment rose little as a whole, although unemployment remained steady at 5¼ % as the increase in labour supply also slowed down markedly. The basic upward trend in prices continued at more or less the same pace; compared with 1988, the rate of price rises for private consumption stayed at 4½ % up to the end of last year, climbing afterwards due to higher prices induced by weather-related factors.

Subdued Investment Activity

At 2.4 %, domestic demand rose in 1989 by nearly one percentage point less than in 1988, slowing down even further recently. In the last quarter, private consumption almost stagnated. The annual rate of 2.8 % is a good half percentage point under the figure for the previous year. This is attributable to a slightly smaller increase in real disposable incomes and a greater propensity to save. After the middle of the year, the expansion of business investment also slowed down tangibly; at a real 3.3 % in all, the 1989 growth rate was only just about half that of 1988. Real investment in housing construction in 1989 was 2.8 % below the previous annual figure.

The foreign trade and payments situation last year was affected by the renewed appreciation of the dollar. Increases in exports of goods and services slowed down considerably in the second half of the year, with real growth only a good half of the 11.1 % achieved on an annual average. Despite declining overall economic growth, however, imports continued on their upward path at more or less the same pace and were in all 6.1 % higher than in the previous year. The deficit on current account declined only gradually to an estimated 120

billion dollars after its 1987 peak of 144 billion; measured against gross national product this amounts to a decline of nearly one percentage point to 2.3 %.

Average annual price rises, 5.1 % for finished products at the producer stage and 4.8 % for the cost of living of private households, noticeably exceeded the rates for the previous year. A major determinant was the rapid increase in the cost of energy. Apart from this, the basic annual trend in consumer prices kept to nearly 4½ %. Foremost as a result of a slower rise in productivity, unit labour costs, including the over-proportionally growing expenditure by employers on social benefits, went up at a faster pace. They increased by 4½ % in 1989, two percentage points more than in the two preceding years.

In the current financial year, there are no signs of any progress in reducing the budget deficit. The cumulative deficit in the first four months since October was only slightly below that of one year previously, so that the latest estimated annual deficit of 124 billion dollars (1988/89: 153 billion dollars) would appear to be too low. In the draft budget for the financial year 1990/91 it is planned to keep just within the legal deficit ceiling of 64 billion dollars. It is, however, premised on very optimistic – and contradictory – assumptions on future trends in the economy. Against this backdrop, and in view of the divergent priorities of the majority in Congress, it can be expected that a consensus will again not be achieved in time and that the automatic statutory cuts will take effect.

The Federal Reserve has been very circumspect in pursuing the policy of more relaxed monetary control which it began in June of last year. The interest rates for Federal Funds, which it largely influences, have hardly fallen since the turn of the year; nevertheless at 8¼ % they were one and a half percentage points lower at the end of February than at the beginning of the policy switch. The Federal Reserve's renewed reticence is probably to be seen not least as a response to the

marked increase in monetary expansion since the middle of last year.

Collision between Targets

The future parameters of economic policy cannot be predicted with any degree of certainty. In financial policy this is particularly because the merely formal adherence to the criteria of the Gramm-Rudman Act continually leads to new divergencies from the principle of "budgetary clarity and truth". In monetary policy, on the other hand, the trend towards short-term monetary fine tuning and the preprogrammed collision between the Federal Reserve's ambitious goal of stability and the comparatively high growth target of the government encumber the prospects of a steady course.

Were it to follow the course charted in the budget for 1989/90 and the draft for 1990/91, financial policy would be more restrictive this year. In fact, everything points to much greater spending and less revenue in the current financial year as compared with the budget estimates and, assuming another unrealistic budget compromise between government and Congress, the present trend will continue in a similar vein. All in all, the overall government deficit is likely to diminish only gradually. The dampening effect on the economy will thus remain weak. The Federal Reserve will be hesitant to take further action to loosen the monetary reins as long as there are no signs of a recession and/or of a clear slackening of the cost and price upswell. This will be underscored by higher interest rates abroad affecting the American finance markets. Lower interest rates in the USA would step up pressure on the dollar exchange rate and thus tend to trigger price rises via more costly imports. It is therefore assumed here that the course of moderate monetary expansion adopted in mid-1989 will be continued with little change for the time being.

The monetary restrictions up to mid-1989 will continue to leave their mark on economic trends in 1990. Under the overall economic policy conditions assumed, however, a recession is unlikely, particularly as the supportive forces unleashed by the monetary relaxation begun nine months ago will gradually take effect. Thus, there are indications that the slowing-down of business investment will remain within narrow limits, though it is hardly likely to expand further in the course of the year. Favoured by the appreciably lower interest rates in the latter half of 1989, housing construction will at least not decline further. On the other hand, with growth in employment on the decline, the expansion of disposable income will slow down and private consumption will increase less rapidly than hitherto. Owing to sustained efforts to contain the budget deficit, government demand will expand little. While domestic demand will therefore lose further momentum, exports will probably continue on their upward trend at a moderate pace.

In all, a very modest growth in real gross national product is to be expected in 1990; the annual figure will amount to some 1.5 %. Under these conditions, employment will expand only slowly and unemployment will probably rise again. Leaving aside the cessation of the recent inflationary impulses resulting from the weather, the cost and price push will slacken only by degrees; particularly due to the avoidance of an economic dip but also because of the renewed decline of the dollar, competition is likely to intensify only gradually. Consumer prices will probably average 4% to 4½ % above the previous year's figure. At the same time, the deficit on current account will tend to diminish.

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	1989				1990			
	AA ²	October	November	December	January	February	2.3.	16.3.
Total index	158.0	159.9	158.6	163.3	168.0	166.1	163.9	162.1
Total, excl. energy raw materials	150.7	145.4	144.4	142.9	144.1	145.5	147.1	150.9
Food, tropical beverages	104.3	95.2	96.3	94.2	95.8	96.3	97.0	98.6
Industrial raw materials	186.0	183.6	181.1	179.9	180.8	183.0	185.2	190.7
Agricultural raw materials	191.3	191.8	195.1	198.2	203.3	206.9	205.4	205.5
Non-ferrous metals	223.5	216.9	201.3	189.7	182.8	182.3	194.0	212.1
Energy raw materials	162.3	168.4	166.8	175.2	181.9	178.0	173.6	168.7

¹ On dollar basis. - ² Annual Average.