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USA: Signs of recovery

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USA: Signs of Recovery

In the first months of this year, the economy in the USA was still in the throes of the recession that started last autumn. Overall production dropped by 1% within six months, reflecting shrinking domestic demand, whereas foreign transactions have recorded a plus since the start of the year. The number of employed has diminished further: unemployment, at 6.9% of the labour force in May, was a good 1 1/2 percentage points higher than a year previously. Consumer prices have risen noticeably more slowly now that the effects of high petroleum costs have worn off.

A contributory factor to the decline in domestic demand has been the pronounced shedding of stocks, but apart from this, demand on the part of business and private households has receded. Not least due to lower employment, the expansion in disposable income has flattened out considerably since last autumn, in fact in real terms it has dropped and private consumption has contracted as a result. In the first quarter it was 0.5% lower than one year previously. Investments in the housing sector have continued to dwindle, falling in the first quarter 19% below the figure for the previous year. Business investment both in buildings and in plant and machinery was reduced at the beginning of the year.

Foreign trade has continued to buoy the economy and mitigate the recession. The marked improvement in competitiveness of American suppliers due to the depreciation of the dollar up to the beginning of this year and the disparity in growth rates between the USA and most of the other industrialized countries boosted exports on the one hand and inhibited imports on the other. The exports of goods and services in the first quarter were 3.2% up on the first quarter of 1990 and imports remained 3.4% under last year's rate, so that net exports have finally recorded a surplus. The deficit in the balance of trade has

gone down further and on top of this the balance on current account has been eased by transfer payments made by the allies to help pay for the costs of the Gulf War.

Thanks to the subsidence of external inflationary impulses, but above all as a result of the economic downswing and the decline in employment, the conditions for slowing down the upsurge in costs and prices have improved. The rise in the cost of living as measured against that of twelve months previously had lessened to 4.9% by May. In production, prices went down substantially under the influence of falling energy prices; but the latest figure is still 3.4% above the level of a year ago. The wage push has already slackened tangibly. Hourly earnings in the private sector, excluding farming, were only 3.3% above the figure one year previously; in real terms, then, they have continued to diminish markedly. Unit labour costs have continued on their steep rise, however, owing to the disproportionate rise in incidental wage costs and the minimal increase in productivity.

Faster Expansion of Money Supply

The policy of the Federal Reserve since last autumn has been primarily addressed to stimulating demand. For the third time in a row, the bank rate was cut in April, this time to 5.5%. At 5 3/4%, the June call money rates on the money markets were some 2 1/2 percentage points down on the rate one year previously; the interest rates for long-term government bonds, in contrast, declined far less. Since the turn of the year, the money supply has also expanded noticeably faster. In the first eight months of the current financial year up to May, the deficit in the Federal Budget grew by US\$ 24 billion on the corresponding previous year's figure. It is thus unlikely that it will increase by

almost US\$ 100 billion to US\$ 318 billion for the entire financial year as forecast by the government. Accountancy factors, however, play a role here. Above all, the expenditure on bailing out the savings and loan banks has only been kept below the estimate by carrying a part of it over to the next financial year. This thus casts doubt on whether the budget deficit for 1991/92 can be confined to US\$ 279 billion, as planned.

Moderate Recovery

The decrease in demand and production in the course of the recession remained within narrow bounds; the contraction forces did not take on a self-sustaining momentum. The forced cuts in interest rates since last autumn and the ensuing accelerating growth in money supply which began at the turn of the year give reason to hope that the recession will soon be over. Now that consumers and investors have regained confidence after the uncertainties of the Middle East crisis, the economic climate has already improved. Under these circumstances, the shedding of stocks will no doubt come to an end soon and this will give impetus to production. The lower interest rates and the optimistic sales and earnings expectations will certainly spur the propensity to invest. Business investment ought therefore to increase again in the latter course of the year. Last but not least, the housing sector is also likely to recover, due to the fall in the costs of borrowing and improving employment and income prospects. When the decline in employment comes to a halt, a major constraint on income expansion will have been removed. Since competition will remain keen at first even after the end of the recession and the rise in consumer prices will thus probably be moderate, private consumption should step up again slightly. Overall, domestic demand can be expected to expand in the course of the summer half-year. Demand from abroad will rise at only a moderate pace, largely due to the slackening growth

rates in many other industrialized countries. The trend shift in imports will make itself more heavily felt as the demand for goods and services from abroad will go up tangibly as the economy recovers. On balance, trends in the flows of foreign transactions will probably now provide only weak stimuli.

When the economic turnabout will take place and how vigorous the recovery will be can only be estimated with a great deal of uncertainty, not least because of the particularly large imponderables with regard to the effects of stock cycles. After the decline of economic activity in the first months of this year, the real gross national product for 1991 as a whole will hardly exceed last year's level. With oil prices unlikely to drop further, the price level will go up slightly more rapidly again than in recent months. The rise in the cost of living will average some 4 1/2% for 1991. Under the influence of the present growth differential between the USA and abroad, the aftermath of the real depreciation of the dollar up to the spring and not least as a result of the allied payments towards the cost of the Gulf War, the deficit on the current account will in all likelihood amount to just about half of that for last year, when it reached US\$ 99 billion. All in all the policy of demand stimulation would appear to be bearing fruit, but the forced reduction in interest rates poses risks to stability, which could quickly prove acute when the economy revives as the recession was evidently too "mild" to have a sustained dampening effect on costs and prices. For this reason, the Federal Reserve will probably again endeavour to check inflationary risks at an early stage. Altogether then, much indicates that after the economic turnaround, the recovery will be relatively moderate. We estimate a growth rate of 2 1/2% for the real gross national product in 1992.

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	1990		1991					
	AA ²	June	March	April	May	June	5.7	19.7.
Total index	185.7	147.5	155.8	157.9	159.2	153.4	155.7	161.5
Total, excl. energy raw materials	150.8	150.0	142.4	138.8	135.4	133.0	131.0	131.6
Food, tropical beverages	94.7	96.5	89.8	89.1	86.6	87.2	85.2	85.6
Industrial raw materials	193.6	190.8	182.4	176.6	172.6	167.9	165.9	166.6
Agricultural raw materials	210.8	207.9	198.9	187.7	186.2	180.2	175.0	174.4
Non-ferrous metals	201.9	198.7	183.2	184.2	173.5	169.0	172.4	169.5
Energy raw materials	206.0	146.0	163.6	169.1	173.1	165.2	170.1	178.9

¹ On dollar basis. ² Annual Average.