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USA: Sluggish Recovery

Economic trends in the USA over recent months have disappointed the hopes of a rapid recovery which were linked above all to the progressive relaxation of monetary policy since autumn 1990. Since the temporary revival of demand and production last summer, due not least to the dwindling of impediments to growth caused by the Gulf War, the prevailing trends have reverted towards stagnation. In all, gross domestic product in 1991 was 0.7% under the figure for 1990. Industrial production even declined again notably during the winter months, with utilization of capacity falling below the low it reached in the spring of 1991. The number of employed in the economy as a whole has changed little altogether for about a year. The rise in unemployment has only remained within narrow bounds because the growth in the labour supply has slowed down substantially. In February 7.3% of the labour force were without work, two percentage points up on the last low in the first half of 1990. This increase is notably below that in previous recession phases.

In the second half of 1991, the upward trend was inhibited by the curtailment of government demand and the continued decline in business investment, particularly in buildings. Stimulated by low interest rates, however, residential building expanded significantly. Largely due to stagnant employment, the incomes of private households rose little and the propensity to consume still did not increase despite lower interest rates. Private consumption has therefore risen little since its low in spring 1991. Altogether, domestic demand in the fourth quarter was 1% higher than its low in the first quarter, largely due to the stock-building cycle. Real exports of goods and services in contrast, have continued to revive markedly despite the economic recession of important trading partners, particularly Canada, and this trend has been accelerating recently. They have evidently still been profiting from the improvement in competitiveness caused by the dollar depreciation up to the beginning of 1991. There was a

strong resurgence in imports in the second half of the year though the economy only improved slightly, but altogether they hardly exceeded the previous year's figure. The trade deficit has thus risen slightly since the middle of last year. The annual figure of US\$ 66.2 billion is, however, a third below that of the previous year. Thanks to the allied transfers to pay for the costs of the Gulf War, the deficit on current account went down even more, from US\$ 92 billion to some US\$ 10 billion.

The persistent weakness of the economy has tangibly narrowed the scope for price rises. The rise in the cost of living as compared with the previous year was a mere 2.6% in January; it has therefore been more than halved in a year – though lower oil prices have been conducive. The core rate, i. e. the rise in prices excluding food and energy, though, amounts to an annual figure of some 4%. At the producer stage, the price level even stabilized under the influence of declining oil prices; here, though, the core rate still amounted to nearly 3%. With the worsening situation on the labour market, the rise in average hourly wages in the economy as a whole (excluding agriculture) has slowed down further: at the turn of the year they were a good 3% up on 1990. With productivity rising again, unit labour costs rose at an annual rate of only 1½% in the course of the latter half of 1991.

Fiscal policy is obviously no closer to its goal of consolidation in the current financial year. The government now estimates a budget deficit of some US\$ 400 billion, 6.8% of gross domestic product. The draft budget for the next financial year beginning in October foresees a rise in revenue of 8.3% and an increase in expenditure of only 2.8% which would mean a deficit of US\$ 352 billion. Based on past experience, though, it is hardly likely that revenue will rise, or spending be curbed, as much as anticipated. The Federal Reserve is keeping to its expansive course. The money supply has grown

substantially faster since the turn of the year. The minimum reserve ratios have recently been lowered to release additional liquidity. Despite the ongoing relaxation in monetary policy, long-term interest rates have risen somewhat. Apprehension has evidently set in on the capital markets – no doubt also in response to the loose fiscal policy – that monetary action has already overstepped the stability threshold and could soon prompt renewed inflation if the economy revives.

The return to a stagnant economy has induced economic policymakers to consider stimulating growth. Fiscal policy, however, can do nothing in view of the inordinate budget deficits. The Federal Reserve has, however, signalled its readiness to further loosen the monetary reins if the economy continues to falter. The renewed reinforcement of monetary expansion in recent months ought, though, to have already established the monetary conditions for the stimulation of demand. At first, the demand for housing, above all, will probably continue on its upward path, but the propensity of businesses to invest also ought to revive with the incipient improvement of the economic climate. Economic stimuli for private household incomes will remain small for the time being, because employment will rise little, as is usually the case in the early phases of economic recovery. Lower interest rates and the trend towards a more favourable economic outlook, however, indicate that the propensity to consume will increase somewhat, so private consumption can be expected to expand a little more rapidly than to date. Altogether, there is much to speak for a modest growth in domestic demand during the course of the present year – also thanks to stock-building. At the same time exports can also be expected to rise, though probably not as rapidly as hitherto, because the effects of the improvement in the USA's international competitiveness caused by favourable exchange rates are no longer making

themselves as strongly felt. Also, the world economy is likely to recover only slowly.

The forces for growth ought in the coming months to regain the upper hand, so that overall economic activity will intensify. The pace of economic expansion will remain quite modest, however: annual gross domestic product for 1992 is likely to be only 1½% to 2% up on 1991. Employment will rise a little, but unemployment will probably also continue to rise at first, particularly as labour supply will expand with the improved employment prospects. In view of the persistently low utilization of capacity, prices will only rise moderately. The annual rise in the cost of living will average about 3½%. With the cessation of transfer payments for the costs of the Gulf War, the deficit on current account will rise greatly in 1992 to between an estimated US\$ 50 billion and US\$ 60 billion.

According to this forecast, the economy will recover later than at first anticipated, but the cause and effect relations assumed do not basically differ from those in earlier cycles. Above all, we do not anticipate that the large rise in household and business debt which occurred during the eighties will prevent an increase in the propensity to consume and invest in response to monetary stimuli. Nevertheless, the costs incidental to these debts will impede the strengthening of the expansionary forces during the upswing. The unsolved problems of consolidating government finances also pose an obstacle to a sustained improvement of the economic climate, not least because they fuel additional uncertainty as to future fiscal and monetary policy. All this would indicate that the increase in economic activity throughout the current year and into the next will not be very strong.

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	1991				1992			
	AA ²	October	November	December	January	February	28. 2.	13. 3.
Total index	161.8	171.6	168.0	153.6	150.7	151.3	149.9	150.0
Total, excl. energy raw materials	136.4	133.7	133.5	133.2	132.8	130.8	131.2	130.6
Food, tropical beverages	89.0	90.1	90.6	92.0	92.3	90.4	89.6	90.5
Industrial raw materials	172.5	167.0	166.2	164.5	163.7	161.6	162.9	161.2
Agricultural raw materials	182.0	170.2	167.5	167.6	167.1	165.0	164.9	163.9
Non-ferrous metals	174.5	170.6	171.7	164.9	163.3	168.5	173.4	170.3
Energy raw materials	176.6	193.8	188.2	165.5	161.2	163.2	160.8	161.4

¹ On dollar basis. ² Annual Average.