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USA: Subdued Recovery

The economic recovery in the USA still lacks momentum. Real gross domestic product grew at an annual rate of some 2% in the first half of 1992, at the end of which it was still under the level attained before the onset of the recession in the early summer of 1990. With only a modest upward trend, utilization of aggregate productive capacity has gone down slightly again. The number of employed, however, has increased once again since the beginning of the year. With improved employment prospects, the labour supply has expanded even more rapidly, so open unemployment has grown at a faster pace, accounting for 7.6% of the labour force in August. Consumer prices, in contrast, have risen more slowly. The cost of living index in July was 3.1% up on last year.

Since the beginning of the year fixed capital formation has once more contributed to the expansion in domestic demand. Most pronounced is the recovery in residential building where investment has continued to surge. The recovery in business has focused on plant and machinery. In commercial and industrial building, with its large surplus of completed projects, though, all that was registered was a halt in the decline. The basic trend in private consumption has been moderate growth. Owing to the weak recovery, the expansion of disposable income has hardly accelerated at all and the savings rate has kept more or less to the level reached at the start of the year. Until the end of the recession foreign trade had stimulated America's economy, but since then the trend has reversed. For one thing, the increase in exports of goods and services has slowed down tangibly this year, largely because of the persistent weakness of economic activity in Japan and Western Europe. For another, imports of goods and services since the end of the recession have already gained considerable momentum, despite the weak revival in overall demand. With only a slight change in export and import prices, the trade deficit rose again during the first six months.

Thanks to the continued relatively low utilization of productive capacity and only moderate growth in demand, prices have been rising less rapidly since the spring. Leaving aside the exceptionally volatile prices for

foodstuffs and energy, the current rate of increase of consumer prices has since the spring remained under 3% on an annual basis. Prices for finished products at the producer level have risen at a similar pace. Accounting for food prices and energy, however, producer prices in August were only 1.5% higher overall than a year ago. Average hourly rates of pay (excluding farming) in July were a mere 2.3% up on those earned twelve months earlier; so in real terms they have continued to decline, despite the moderate rise in prices. Despite a slight increase in employment, productivity has also gone up again. Overall unit labour costs, therefore, have hardly risen. The receding cost upswell has helped corporate profits to recover.

According to revised government estimates, the federal budget deficit for the fiscal year 1991/92 ending in September will reach some US \$ 330 billion, after US \$ 270 billion last year. The increase is to a large extent the result of the lower tax revenue and higher transfer payments due to the weakness of economic activity. The only reason why the deficit is below the US \$ 400 billion originally estimated is that, contrary to the original plans, so far only a small percentage of the costs for government insurance of bank and savings bank deposits has been accounted for in the federal budget. This means that subsequent budgets will be burdened accordingly; therefore the repeated pledges to consolidate state finances still lack credibility. Initial plans for the fiscal year 1992/93 already foresee a further increase in the deficit to US \$ 341 billion.

In spite of this indulgent fiscal policy, the Federal Reserve has again stepped up its efforts to boost the economy. The discount rate was cut again at the beginning of July; now at 3.0%, it has reached the lowest point since 1963. Money market interest rates were pushed down to the same level by the beginning of September by open market interventions, surrendering over five percentage points in two years. Interest on long-term investment has diminished far less, with recent levels at nearly 6 ½% for ten-year and 7¼% for thirty-year government bonds. Presumably, the poor prospects of consolidating government finances and the strengthening of inflationary

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expectations have had an inhibiting effect. The Federal Reserve has obviously first subordinated the further stabilization of prices to the desired stimulation of demand. In its view, the minimal growth since the end of last year in M2 money supply, which it applies as a yardstick, vindicates this policy. The key contributory factor here was that the low interest rates triggered a transfer of term deposits to higher yield investments not recorded as part of the money supply. The more narrowly defined M1 money supply, however, has been expanding extremely strongly for over a year. In August, it expanded at an annual rate of some 13% over the last quarter of 1991.

There is still much uncertainty as to how long the constraints on growth which have been in force until now, and which no doubt have largely stemmed from the higher indebtedness of private households and companies, will tangibly impede the development of forces for recovery in the USA. One reason why consumers and investors remain reluctant is certainly because fiscal policy is offering no realistic hope of a curbing of the enormous government deficit, thus in the medium term also hindering the Federal Reserve in its task of stabilization. This will no doubt remain a significant obstacle to a tangible drop in long-term interest rates. On the other hand, the steep decline in short-term interest rates has sown the seeds for a growing resuscitation of demand; the rapid expansion of the M1 money supply can be construed as a signal.

The reductions in interest rates will provide a further stimulation to residential building in particular but, along with the gradual improvement in sales and earnings prospects, they will also encourage the expansion of business investment. Private consumption will receive a certain boost from the rise in disposable income, which is due mainly to the reviving employment rate, but for the time being the high indebtedness of private households will stand in the way of a sustained increase in the propensity to

spend. Real demand on the part of government for goods and services will hardly increase due to efforts to contain the budget deficit. In view of these developments, the expansion of domestic demand should gradually increase. Inhibited by the prolonged economic torpor in the other industrial countries, demand from abroad will rise only moderately at first, but exports can be expected to expand more vigorously next year thanks to the anticipated world recovery and the improved competitiveness of American producers as a result of the cheaper dollar. The higher exchange rates for the European currencies, on the other hand, will dampen import growth.

Altogether, overall production in the USA will continue to grow at quite a moderate pace for the rest of the year, but growth should accelerate noticeably in 1993. In view, though, of the continued effect of those factors retarding growth, the recovery is not to be expected to be as vigorous as has usually been the case after previous downswings: real gross domestic product will grow only by about 3% in 1993 after some 1 3/4% this year. Since the current pace of growth is an estimated one percentage point higher, the utilization of capacity and employment will pick up again markedly; unemployment will, however, only decline gradually. Under these conditions, price rises will remain moderate at first; consumer prices in 1992 and 1993 ought to be about 3% higher than in the respective previous year. The deficit on current account is likely to continue to rise somewhat owing to the earlier recovery compared with other industrial countries. At an estimated US \$ 50 to 60 billion for 1992 it will be much higher than last year (US\$ 3.7 billion) mainly because the USA received sizable payments in 1991 from the allies for the costs of the Gulf War.

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	August	May	June	July	August	28. 8.	11. 9.
Total index	161.8	159.8	162.6	171.0	168.8	165.9	166.4	168.9
Total, excl. energy raw materials	136.4	130.2	133.8	135.7	137.6	136.4	136.7	135.4
Food, tropical beverages	89.0	87.9	90.5	91.9	88.3	85.2	85.4	86.3
Industrial raw materials	172.5	162.5	166.7	169.2	175.2	175.3	175.8	172.7
Agricultural raw materials	182.0	164.1	173.9	175.5	178.9	178.8	179.3	177.6
Non-ferrous metals	174.5	168.1	172.8	175.8	186.4	186.2	186.5	179.9
Energy raw materials	176.6	177.1	179.4	191.6	187.0	183.1	183.8	188.6

¹ On dollar basis. ² Annual Average.