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Distinct Upswing in the USA

The prime aim of the new American President's economic programme is to boost medium-term growth in the USA. Short-term fiscal policy stimuli have been kept within close bounds, if only because the upswing had already gained considerable momentum prior to the change in administration. Domestic demand in particular has risen rapidly as a result of the sustained strong monetary policy impulses. Seasonally adjusted aggregate production has expanded since the middle of last year at a rate of some 4%; total real gross domestic product in 1992 exceeded the 1991 figure by 2.1%. While the utilization of capacity has again picked up substantially, the number of employed has risen comparatively little. Nevertheless, the unemployment rate, which had risen up until last summer to a seasonally adjusted 7³/₄% of the labour force has already dropped to 7% due to the diminishing labour supply. Prices have continued to rise at a relatively moderate pace; the rise in the cost of living has kept to some 3% on the previous year.

The faster expansion of economic activity since the middle of last year has largely been propelled by an accelerated increase in private consumption. With income having grown hardly any faster so far, this has largely been as a result of a greater propensity to consume; debt repayment, for example, has become less of a priority due to lower interest rates. However, it was the effects of the monetary stimuli to investment that have remained crucial for the upswing dynamic. Following a revival in residential building in the course of the year 1991, business investment also picked up again markedly in 1992. This applies particularly to machinery and equipment; in commercial building the pronounced decline caused by prior speculative excesses has at least come to a halt. Despite the downswing in major partner economies, the export of goods and services has also recently risen, although the pace in the course of last year was much slower than in 1991. Imports have expanded much more, pushing up the deficit in external flows of goods and services.

At an average 3.0% for the year 1992, consumer prices went up substantially less than in the two previous years, in which rates of 5.4 and 4.2% respectively had been recorded. The rate of increase has not, however, continued to diminish in the course of the year. This is all the more remarkable considering that the rise in costs has clearly flattened out; since the middle of last year, unit labour costs in the overall economy have hardly risen at all (1992: 0.8% in all, after 4.6% in 1991). Apart from the continued low

wage push, the main contributory factor has been the accelerated rise in productivity as a result of the upswing. Since the end of the recession, however, this has been no higher than in earlier recovery phases. The "jobless recovery" the government is complaining about is attributable to the slower pace of growth in aggregate output as compared with previous upswing periods.

The Federal Reserve has kept to its course of supporting the revival of economic activity via low interest rates. Money market interest rates have remained at about 3%. Long-term rates have eased further, no doubt also in response to the expectation of measures to curb the budget deficit; ten-year government securities recently had a yield of some 6%. The expansionary monetary policy course has been reflected largely in the narrowly defined money supply: in the fourth quarter of 1992, M1 was a good 14% higher than it had been a year earlier, whereas M2 growth was still slightly below the target range of 2.5 to 6.5%. This prompted the Federal Reserve to lower the margin by half a percentage point for 1993, without intending to signal a tightening of monetary policy. The present expansionary course is likely to be continued. Interest rates on the capital market will be determined largely by fiscal policy anyway, in particular by the credibility of the consolidation measures.

The economic programme the new government has drafted despite the steadily increasing evidence of the consolidation of the expansionary forces, provides for public spending and tax credits for investment totalling 31 billion dollars (0.5% of gross domestic product). The linchpin of the announced fiscal policy, however, is to improve the conditions for growth by means of a medium-term restructuring of government spending and reduction of the budget deficit. For instance, both defence and welfare spending are due for cuts, with more funds to be made available for infrastructure and education. The main contribution to the reduction of the deficit, however, is to be made by tax increases, which will partly revoke the tax reform of 1986. This will entail an increase in the top rate of income tax from 31% to 36%, matching corporate tax to the higher rate, a surtax of 10% for top earners as well as the introduction of a general energy tax.

A reform of the health sector, which is essential to consolidate government finances, is, however, still missing. Nor is it clear how far Congress will go along with the President's ideas. Even assuming, though, that the present fiscal policy strategy is not essentially amended, it

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is difficult to assess its impact on economic growth. The proposed restructuring of government spending will be conducive to growth. The same holds true for the proclaimed curbing of the budget deficit which will at least break the inherent upward trend. At the same time, though, the supply conditions will be worsened by the tax increases, in particular as the heavy burden placed on "higher-income earners" will have an overproportional effect on private saving. So it is doubtful whether cutting the deficit in this way will exert lasting pressure on real interest rates.

In the short term, fiscal policy ought to give a slight stimulus to demand as a result of the economic programme; further stimuli to domestic demand will emerge from the sustained expansionary monetary policy. Above all investment can be expected to show a strong increase. Low interest rates and a lasting improvement in the sales and earnings situation will give a boost to business investment and commercial building ought to bottom out. Private consumption, in contrast, will probably rise less quickly at first than in the second half of 1992, as the propensity to save will presumably not decline any further and the expansion of in-

comes will accelerate only slowly. Exports, too, will probably only increase at a moderate pace, as the weakness of economic activity in major trading partner countries will continue and the competitiveness of American suppliers will be affected by the appreciation of the dollar. Imports, on the other hand, will continue to expand rapidly.

Altogether, overall output will go on growing fast, after an initial slight slowdown. In all, gross domestic product for 1993 is expected to be 3½% up on last year, with a further rise in capacity utilization. The increase in employment is likely to speed up. Nevertheless, for the time being there is little prospect of a further significant reduction of unemployment as the supply of labour will also expand again in response to growing demand. In view of the still comparatively low utilization of capacity competition will remain keen at first, but prices are likely to rise somewhat faster in the latter course of the year. At an annual average of a good 3%, the increase in the cost of living, however, will hardly exceed the figure for last year.

*Compiled by the Department of World Business Trends
of the Hamburg Institute for Economic Research (HWWA).*

Economic Indicators

	1991	1992	1992					1991	1992 ^a	Latest value
			1 st Q.	2 nd Q.	3 rd Q.	4 th Q.				
Real gross domestic product ¹	-1.2	2.1	0.7	0.4	0.8	1.2	Unemployment rate ³	6.8	7.4	7.0 ^b
Domestic consumption	-1.8	2.5	0.7	0.8	1.0	1.1	Hourly rate of pay ^{4,5}	3.2	2.5	2.7 ^c
Private consumption	-0.6	2.2	1.2	-0.0	0.9	1.2	Consumer prices ⁵	4.2	3.0	3.3 ^d
Government consumption	1.2	-0.3	0.4	-0.3	0.9	-0.5	Producer prices ^{5,6}	2.1	1.2	1.6 ^d
Fixed asset investment	-8.5	5.6	1.8	3.6	0.6	3.6	Interest rate short-term ⁷	5.7	3.5	3.0 ^b
Equipment	-4.6	7.5	0.8	5.5	2.3	3.4	Interest rate, long-term ⁸	7.9	7.0	6.2 ^b
Commercial and industrial buildings	-12.0	-6.8	0.7	-0.2	-2.9	-0.3	Money supply, M1 ^{5,9}	8.0	14.2	13.3 ^d
Residential buildings	-12.6	13.2	4.7	3.0	0.1	6.0	Money supply, M2 ^{5,9}	3.1	2.2	1.4 ^d
Net exports ²	0.6	-0.4	0.0	-0.5	-0.2	0.1	External value of the dollar ^{6,10}	-1.7	-2.3	6.6 ^d
Exports	5.8	6.3	0.7	-0.4	2.2	2.4	Terms of trade ⁵	1.0	1.0	1.0 ^e
Imports	-0.1	9.6	0.9	3.5	3.5	1.4	Balance on current account ¹¹	-0.1	-1.0	-

¹ Change over preceding period in %, quarterly values seasonally adjusted. ² Change expressed as % of gross domestic product of preceding period. ³ % of labour force. ⁴ Private sector, excl. agriculture. ⁵ Percentage change over preceding year. ⁶ Finished goods. ⁷ Federal Funds. ⁸ Public sector bonds, maturity 10 years. ⁹ Annual values: 4th Quarter. ¹⁰ For 18 industrial countries. ¹¹ In % of gross domestic product. ^a Partly estimated. ^b February. ^c December. ^d January. ^e 3rd Quarter.

Sources: National statistics, Deutsche Bundesbank, own calculations.

HWWA Index of World Market Prices of Raw Materials¹

(1975 = 100)

Raw Materials and Groups of Materials	1992				1993			
	AA ²	February	November	December	January	February	5. 3.	19. 3.
Total index	160.1	151.3	156.8	151.9	148.1	151.9	157.1	153.0
Total, excl. energy raw materials	132.1	130.8	125.0	124.9	124.2	122.9	122.6	121.8
Food, tropical beverages	88.6	90.4	86.8	88.3	88.2	87.5	88.4	89.9
Industrial raw materials	165.2	161.6	154.1	152.9	151.6	149.9	148.6	146.2
Agricultural raw materials	169.8	165.0	159.4	154.9	151.1	150.2	149.8	142.0
Non-ferrous metals	172.3	168.5	159.8	162.8	163.9	159.2	154.3	159.0
Energy raw materials	176.5	163.2	175.4	167.7	162.1	168.8	177.2	171.3

¹ On dollar basis. ² Annual Average.