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Investment Boom in the USA

For three years now, the US economy has been on the upswing. After a slow start, it has picked up tangibly since the middle of last year. Real gross domestic product rose in the latter half of 1993 at a current annual rate of a good 5% (annual average: 3.0%); after the turn of the year, production shortfalls due to sudden cold spells and earthquakes will have led to a slowdown in growth. Utilization of capacity has risen markedly. Employment has expanded rapidly and unemployment has declined further. According to new statistical definitions, 6.5% of the labour force were without a job in February. The price upswell has abated further; the cost of living was up 2.5% in January compared to a year previously.

In the second half of 1992 the economy underwent a similar surge of growth, but this was soon followed by a pronounced flattening out. This time, though, the large contribution made by fixed asset investment points to a sustained reinforcement of growth forces. Stimulated by low interest rates, higher utilization of capacity and brighter earning prospects, the propensity to invest has revived further. In 1993, real business investment was nearly 12% higher than the previous year with the current growth pace even exceeding this. Growth in machinery and equipment has been particularly robust, although commercial building has also continued to grow. The low interest rates continued to spur residential building though, at just under 9%, growth did not attain the 1992 rate. Buoyed by increased employment, disposable income has expanded swiftly; private consumption averaged an annual growth of 3½%. Government demand, in contrast, was curtailed as part of the consolidation efforts.

Foreign demand grew only a little in 1993, largely as a result of the economic recession in Japan and Western Europe. Not until the end of the year did exports of goods and services increase again noticeably. Imports, in contrast, rose even faster than before as a result of the more rapid rise in domestic demand; annual real growth averaged a good 10%. Altogether, the trend in foreign trade and payments transactions amounted to a "withdrawal effect" of nearly one percentage point of gross domestic product. This reflected in particular the economic trends in the USA as compared with most other industrial countries. Though eased by an improvement in the terms of trade, the deficit on current account rose in 1993 by more than half to

over 100 billion dollars; measured against the gross domestic product this amounts to some 1½%.

The acceleration in the upswing last year was attended by a further decline in price rises. At the beginning of the year producer prices for finished products hardly exceeded the level of a year previously. Though slower, price rises for services had a considerable effect at consumer level. Excluding food and energy, which are often subject to short-term fluctuations, prices in January were 2.8% higher than a year previously. Business benefited from slower cost increases. With wage rises continuing to be low – hourly earnings in industry in 1993 were 2.4% up on the previous year – productivity again rose substantially from the middle of last year. Unit labour costs in the economy as a whole only increased on an annual average by just under 2%.

The development of government finances was marked by a definite trend towards consolidation. The total budget deficit diminished in 1993 in relation to gross domestic product by one percentage point to some 3½%. This trend was helped by a significant curtailment in the growth of public spending; in real terms, public spending went down. In particular cuts in defence spending, less expenditure on guaranteeing deposits in banks and savings banks and savings in debt service thanks to lower interest rates all played a part here. Since government revenue rose faster, the federal budget deficit, which largely amounts to the overall deficit, declined noticeably. This development has been proceeding apace in the current fiscal year since October, when the tax increases as part of the medium-term programme passed in 1993 to lower the deficit take effect. For the next fiscal year the government draft budget foresees more spending cuts in many areas, although these are primarily aimed at financing new programmes, in particular in education and infrastructure. The budget deficit, which is expected to drop to somewhat above 200 billion dollars in the current fiscal year, after 255 billion dollars in the previous one, is projected at 176 billion dollars. It is unclear, however, whether the draft budget will be passed.

The main reason for the stronger growth is monetary stimulus. At 1%, the expansion of M2 money supply used by the Federal Reserve as an indicator has kept at the lower edge of the target band in the course of 1993, but for the M1 money supply and Federal Reserve money the rate

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came to 10%. The Federal Reserve kept the money market rates at a mere 3% throughout the year; yields on the capital market also declined further and reached a low of 5.3% for ten-year Treasury Bills last autumn. In recent months, though, as there were increasing signs of speedier growth, interest rates reversed. At a good 6%, the long-term rates recently attained their level of a year previously. At the same time, with the slight rise in the money market rates under its control, the Federal Reserve has signalled its intention to place more emphasis in future on stability. We can expect a gradual rise in interest rates in the course of this year.

All in all, after several years of trying to stimulate demand in the short term, economic policy will be more geared to establishing the conditions for a more sustained upswing. More important than the dampening effects of fiscal policy on demand is the continued stimulus of low interest rates, even though they have now bottomed out in the present cycle. In view of the evidently favourable sales

and earnings expectations, business investment is certain to go on rising fast, though not at quite the same pace as during the recovery phase. Thanks to the low interest rates and improved income expectations residential building will also continue to expand rapidly. Due to the cyclical stimulus of employment, income will also rise faster but due to the tangible rise in taxes, rates, etc. the growth of private consumption will remain relatively moderate. Real government demand will probably tend to decline. On balance, foreign trade and payments transactions will definitely continue to have a retarding effect; imports will go on rising much faster than exports. In all, gross domestic product in 1994 ought to be 3½% higher than in 1993. With the continuing increase in utilization of capacity and employment, inflation is likely to gain a little momentum.

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

Economic Indicators

	1992	1993	1993				1992	1993 ^a	1994 latest value	
			1 st Q.	2 nd Q.	3 rd Q.	4 th Q.				
Real gross domestic product ¹	2.6	3.0	0.2	0.5	0.7	1.8	Unemployment rate ³	7.4	6.8	6.5 ^b
Domestic demand	2.9	3.9	0.6	0.8	0.9	1.8	Hourly rate of pay ^{4,5}	2.5	2.4	2.8 ^c
Private consumption	2.6	3.3	0.2	0.8	1.1	1.1	Consumer prices ⁵	3.0	3.0	2.5 ^c
Government consumption	-0.1	-0.7	-1.6	1.1	0.1	0.0	Producer prices ^{5,6}	1.2	0.2	0.2 ^c
Fixed asset investment	6.2	10.9	2.6	2.2	2.1	5.6	Interest rate, short-term ⁷	3.5	3.0	3.2 ^b
Equipment	6.8	16.2	4.7	4.6	2.4	5.7	Interest rate, long-term ⁸	7.0	5.8	6.0 ^b
Commercial and industrial buildings	-6.0	0.7	0.1	2.0	0.1	3.4	Money supply, M1 ^{5,9}	14.3	10.4	9.7 ^c
Residential buildings	16.3	8.6	0.4	-2.5	2.9	7.0	Money supply, M2 ^{5,9}	2.0	1.0	2.4 ^c
Net exports ²	-0.3	-0.8	-0.4	-0.3	-0.2	0.0	External value of the dollar ^{5,10}	-2.3	2.6	0.4 ^c
Exports	6.4	3.5	-0.6	0.9	-0.2	4.8	Terms of trade ⁵	-0.7	0.7	1.9 ^d
Imports	8.7	10.3	2.8	3.2	1.5	3.8	Balance on current account ¹¹	-1.1	-1.6	-1.8 ^d

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; new survey method as of January 1994. 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 January. ^d 3rd Quarter 1993.

Sources: National statistics, Deutsche Bundesbank, own calculations.

HWWA Index of World Market Prices of Raw Materials¹ (1975 = 100)

Raw Materials and Groups of Materials	1993				1994			
	AA ²	February	November	December	January	February	4. 3.	18. 3.
Total index	144.3	151.9	135.6	126.9	130.3	130.0	128.7	130.6
Total, excl. energy raw materials	120.0	122.9	118.3	121.8	124.6	126.8	127.0	130.7
Food, tropical beverages	91.4	87.5	96.5	99.7	99.7	99.4	98.6	101.3
Industrial raw materials	141.7	149.9	134.8	138.6	143.4	147.7	148.7	153.0
Agricultural raw materials	140.9	150.2	134.9	138.2	144.8	150.2	151.3	158.4
Non-ferrous metals	145.0	159.2	129.3	136.3	142.7	147.8	148.7	151.5
Energy raw materials	158.5	168.8	145.7	129.9	133.7	131.9	129.6	130.6

¹ On dollar basis. ² Annual Average.