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Powerful Upswing in the USA

Three years after the onset of the upward trend in the United States, which remained sluggish for a long period, the economy is now in the midst of a powerful upswing. An unusually harsh winter in the early months of this year and the earthquake in California have had a detrimental effect on production and demand, but total real gross domestic product rose by an annual rate of some 5% over the winter six months. The utilization of capacity has gone up noticeably and the number of employed has risen at an accelerated rate: in June it was some 3% higher than a year previously. Unemployment has come down further as a result, the latest figure amounting to 6% of the labour force. Despite heavier demands on production capacity, the price upswell has remained relatively weak. The cost of living in June was up 2.7% on June 1993.

The growth in domestic demand has been even faster than that of aggregate demand. A decisive factor here has been the strong stimulus which emanated from the low interest rates of recent years and encouraged in particular the propensity to invest. Real business investment at the beginning of the year was nearly 13% above the previous year's level. Investment in plant and equipment rose above average whereas in commercial building the inhibiting aftermath of the speculative excesses of the eighties has only abated slowly. Low interest rates also stimulated residential building into the current year. The cyclical stimulus to employment and income has brought about a rapid expansion of private consumption, the latest figures exceeding the previous year's level by over 4%.

The basic trend in exports since last autumn has again been pointing clearly upward despite considerable short-term fluctuations. The gradual revival of the world economy is evidently a contributory factor. Nevertheless, American suppliers last year did not benefit fully from expanding demand on their foreign markets, although most of these are on a clear expansion path. It is possible that with increasing utilization of capacity export drives have not been as vigorous as previously. Competitiveness has also declined due to the substantial nominal and real appreciation of the dollar that had occurred since autumn 1992, especially as against European currencies. At the same time, this has spurred imports; real imports have been rising up to the present at an annual rate of some 10%. Altogether, a withdrawal amounting to more than ¼ %

of gross domestic product has been incurred from the external flows of goods and services over the winter six months. The balance on current account has thus swung further into the red.

Despite tangible growth in capacity utilization prices have continued to record moderate growth. Only raw materials have become much more expensive, partly due to lively demand on the world markets. Prices for finished products at producer level have gone up slightly since the beginning of the year, but are still only around the previous year's level. The rise in the cost of living, excluding food and energy which are subject to heavy fluctuations, in June amounted to 3.0%. Restrained wage increases have continued to have a mitigating effect. Hourly earnings have hardly gone up more than the cost of living. Even accounting for the progressive rise in ancillary costs, aggregate unit labour costs have hardly risen since the middle of last year thanks to a marked rise in productivity.

Fiscal policy has continued on its course of consolidation. The national deficit dropped noticeably in the first half of the financial year; the estimated deficit for 1993/94 amounts to US\$ 200 billion (3% of gross domestic product), down a fifth on the previous year. Spending cuts have helped here but the major factor has been an increased rise in revenue. This is in part due to the economic recovery but the tax rises as part of the consolidation programme passed in 1993 have also played a key role. A further cut in the budget deficit is planned to bring it down to US\$ 176 billion for the financial year 1994/95 starting in October. The practical shape of the budget, in particular the direct and indirect impacts of the health reform, cannot be assessed at present. In all, fiscal policy ought to continue to act as a constraint on demand.

The Federal Reserve has tightened the monetary reins a little in recent months. The Federal Funds rate was raised from 3% in January to 4¼ % recently and the discount rate from 3% to 3½ %. This was intended to avert the danger of monetary policy's having an overexpansive effect and inflationary expectations' being kindled, particularly as long-term interest rates had already started to go up again last autumn. By now the latter have exceeded 7% for ten-year Treasury Notes, 2 percentage points above their level last October. In recent months, the expansion of M2 money supply has kept to the lower ends of the 1% to 5% band

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declared by the Federal Reserve as a non-binding target for 1994; the M1 money supply, however, has continued to expand much more rapidly. Monetary policy can be expected to uphold its wait-and-see attitude at first although further interest rate rises are likely with increasing utilization of capacity.

The scope for expansion without causing additional strain has narrowed. The current economic policy framework – characterized by higher interest rates and a restrictive fiscal policy – does not, however, give grounds to expect that the upswing will sustain the same pace into the second half of the year as it has kept up since last autumn. Firstly, the boom in business investment will probably abate somewhat, although it will remain powerful thanks to bright earnings prospects. Secondly, residential building can be expected to expand less rapidly, as higher interest rates will have a more marked effect than the favourable outlook for employment and incomes. Private consumption, however, will go on growing fast. Exports,

too, will expand clearly, thanks in particular to the progressive recovery in Western Europe and the revival in Japan. Declining government demand will continue to have a retarding influence. The robust growth in imports will persist. Altogether, real gross domestic product in 1994 ought to be 3½% to 4% higher than in the previous year; growth for the coming year will probably be a little lower. Employment will continue to rise substantially and unemployment to decline. As always in an advanced upswing phase, an acceleration of inflation is to be expected, but this will keep within comparatively narrow bounds due to the early monetary restraint. The rate of increase in the cost of living in 1994 will average a good 2½%, still a little below that of the previous year; next year it can be expected to increase by about one percentage point. The current account deficit can be expected to increase tangibly in both years.

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

Economic Indicators

	1992	1993	2 nd Q.	1993 3 rd Q.	4 th Q.	1994 1 st Q.		1992	1993 ^a	1994 latest value
Real gross domestic product ¹	2.6	3.0	0.5	0.7	1.7	0.8	Unemployment rate ³	7.4	6.8	6.0 ^a
Domestic demand	2.9	3.8	0.8	0.9	1.6	1.2	Hourly rate of pay ^{4,5}	2.5	2.4	2.4 ^b
Private consumption	2.6	3.3	0.8	1.1	1.1	1.3	Consumer prices ⁵	3.0	3.0	2.7 ^a
Government consumption	-0.1	-0.7	1.1	0.1	0.0	-0.9	Producer prices ^{5,6}	1.2	1.2	0.1 ^a
Fixed asset investment	6.2	11.0	2.2	2.1	5.7	1.9	Interest rate, short-term ⁷	3.5	3.0	4.1 ^a
Equipment	6.8	16.3	4.6	2.4	6.0	4.0	Interest rate, long-term ⁸	7.0	5.8	7.1 ^a
Commercial and industrial buildings	-6.0	0.7	2.0	0.1	2.9	-4.8	Money supply, M1 ^{5,9}	14.3	10.4	6.6 ^a
Residential buildings	16.3	8.7	-2.5	2.9	7.1	2.1	Money supply, M2 ^{5,9}	2.0	1.0	1.5 ^a
Net exports ²	-0.3	-0.8	-0.3	-0.2	0.0	-0.4	External value of the dollar ^{5,10}	-2.3	2.6	0.5 ^a
Exports	6.4	3.5	0.9	-0.2	4.7	-0.7	Terms of trade ⁹	-0.7	0.8	2.0 ^c
Imports	8.7	10.3	3.2	1.5	3.9	2.3	Balance on current account ¹¹	-1.1	-1.6	-1.9 ^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 June. ^b May. ^c 4th Quarter 1993. ^d 1st 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	1993		1994					
	AA ²	June	March	April	May	June	30. 6.	19. 7.
Total index	144.3	147.3	129.3	137.7	146.7	154.0	158.0	159.1
Total, excl. energy raw materials	120.0	117.9	128.9	130.6	137.3	142.3	146.3	151.4
Food, tropical beverages	91.4	87.6	100.3	100.7	108.6	114.8	121.6	128.9
Industrial raw materials	141.7	141.0	150.7	153.5	159.2	163.3	165.1	168.5
Agricultural raw materials	140.9	140.6	155.1	162.2	165.7	167.0	170.5	172.2
Non-ferrous metals	145.0	143.8	148.9	146.9	159.8	172.0	171.7	178.9
Energy raw materials	158.5	164.4	129.5	141.9	152.1	160.7	164.9	163.6

¹ On dollar basis. ² Annual Average.