

Hamburg Institute of International Economics (HWWA) (Ed.)

Article — Digitized Version

USA: Monetary policy dampens upswing

Intereconomics

Suggested Citation: Hamburg Institute of International Economics (HWWA) (Ed.) (1995) : USA: Monetary policy dampens upswing, Intereconomics, ISSN 0020-5346, Nomos Verlagsgesellschaft, Baden-Baden, Vol. 30, Iss. 2, pp. 107-108, <https://doi.org/10.1007/BF02926263>

This Version is available at:

<https://hdl.handle.net/10419/140494>

Standard-Nutzungsbedingungen:

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

Terms of use:

Documents in EconStor may be saved and copied for your personal and scholarly purposes.

You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.

If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.

USA: Monetary Policy Dampens Upswing

The recent turmoil around the dollar has overshadowed the fact that the cyclical upturn in the USA is now entering its fifth year without any notable tensions having emerged. After a long period of moderate growth, production expanded apace throughout 1994. Real gross domestic product was 4.0% up on 1993, at a similar current rate. Aggregate utilization of capacity exceeded the long-term average. The number of employed went up fast with unemployment in early 1995 at 5.7% of the economically active population – one percentage point down on the previous year – despite a marked expansion of the labour force. Even in this advanced phase of the upswing price rises have remained modest; in January the cost of living was up 2.8% on its level one year earlier.

Although the monetary reins have been progressively tightened for a year, domestic demand has been expanding at almost the same pace up to the present, the main contributory factor being investment activity. Thanks to high utilization of capacity and bright earnings prospects, the propensity to invest remained high despite increased interest rates. This has been especially evident in machinery and equipment (1994: +17.5%). Commercial and industrial building, which had stagnated as a late consequence of speculative excesses in the 80s, has now revived. The retarding effects of the increase in interest rates have so far become visible only in residential building; following a surge up to the middle of last year it has since been on the decline. The marked growth in employment has caused a faster increase in disposable income. Despite greater propensity to save, the basic trend in private consumption growth has remained more or less unchanged (1994: +3.5%). Real government demand, in contrast, was curtailed again slightly last year as part of the consolidation drive.

Demand from abroad revived distinctly last year, partly due to the economic recovery in Western Europe. The current rate of increase of exports of goods and services was still noticeably higher than the annual average increase (+9.0%). At the same time the import boom has stepped up (+13.5%); the main contributory factor here has clearly been the increasing rate of utilization of domestic resources. Altogether, the overall

import surplus rose by a similar amount to last year. The current account deficit in 1994 ought to come to some 150 billion dollars (1993: 104 billion dollars); this would correspond to 2.2% of gross domestic product. This figure is thus well below the highest mark in the 80s (1987: 3.7%).

Despite the high utilization of resources the increase in consumer prices averaged 2.6% in 1994, down again slightly on the previous year. Apart from short-term fluctuations, the current rate has evidently hardly risen to date. At the producer level, too, there is so far no sign of lasting price rises in finished products, unlike raw materials. The favourable development of wage costs has played a key role here. Gross hourly wages were a mere 3% up on the previous year and the current wage agreements are keeping to the moderate trend. Accounting for the continuing rise in productivity, unit labour costs in 1994 were only just about 1% above the previous year.

Fiscal policy over the last two years has achieved notable consolidation successes. From a high of 4.3% of gross domestic product in 1992, the overall fiscal deficit looks to have been curbed to less than 2% by 1994. This was partly attributable to a cyclical increase in revenue and drop in spending, but largely to measures to reduce the structural deficit. Aside from tax increases, spending cuts also played a major part. In the current fiscal year that began last October the tendency for the deficits to decline for cyclical reasons has so far persisted; the effects of the consolidation measures, on the other hand, may be expected to have phased out. The draft budget for 1995/96 entails a slight rise in the deficit with substantial spending and tax cuts. Owing to the political shift of power in Congress, however, the outcome of the budget debate is still open.

The Federal Reserve raised the key interest rates again at the beginning of February, doubling the key rate on the money market to some 6% in the space of a year. The aim of the tighter money policy is to slow down growth in demand and production to the estimated rate of capacity growth of 2½% to avoid inflationary tensions. Monetary policy has evidently succeeded in reinforcing stability expectations, as indicated at least by the decline in capital market interest rates; the rate for ten-year government bonds,

ECONOMIC TRENDS

which had reached 8.0% last autumn, dropped again to almost 7½% by early March. The development of money supply was marked by monetary restriction, although M2 has expanded noticeably in recent months after having remained stable during the second half of 1994. In view of the expected easing of cyclical strains and the continued modest price rises, the Federal Reserve is unlikely to raise interest rates again, assuming the recent dollar weakness, which is probably not least due to the Mexican crisis, is temporary.

For over a year now monetary policy has been geared to a soft landing for the economy, where resources are not overstrained and the economy does not relapse into recession. Prospects look bright in particular because in view of the modest rise in wages and prices the Federal Reserve has avoided any abrupt braking action till now and tightened the monetary reins only gradually. The effects on demand will become more apparent in the course of this year. Higher interest rates have so far had a marked impact only on

residential building, but the pace of growth in business investment will also slow down in future. A sharp curb is however unlikely because, with the moderate rise in costs, earnings prospects are still comparatively good. Growth in employment and income will gradually recede. As, in addition, the propensity to save is likely to rise, partly thanks to higher interest rates, the expansion of private consumption will also slow down slightly. Exports, too, ought to increase less rapidly, in particular because the expansion of imports looks like slowing down in the North American partner countries. As a whole, growth in real gross domestic product in the USA in 1995 is likely to slow down to around 3%. At a slightly lower current rate, the rise in aggregate utilization of capacity will flatten out. This improves the prospects of keeping the acceleration of the cost and price upswell typical of the late phase of an upswing within narrow bounds. The rate of inflation will average between 3 and 3½% this year.

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

Economic Indicators

	1993	1994	1994					1993	1994*	1995 latest value
			1 st Q.	2 nd Q.	3 rd Q.	4 th Q.				
Real gross domestic product ¹	3.1	4.0	0.8	1.0	1.0	1.1	Unemployment rate ³	6.7	6.1	5.7*
Domestic demand	3.9	4.7	1.2	1.1	1.1	1.0	Hourly rate of pay ^{4,5}	2.5	2.6	2.7*
Private consumption	3.3	3.5	1.1	0.3	0.8	1.2	Consumer prices ⁶	3.0	2.6	2.8*
Government consumption	-0.8	-0.7	-1.2	0.3	1.6	-1.0	Producer prices ^{6,6}	1.2	0.7	1.8*
Fixed asset investment	11.3	12.2	2.5	2.1	2.1	2.9	Interest rate, short-term ⁷	3.0	4.4	5.8*
Equipment	18.0	17.5	4.4	1.5	4.2	4.3	Interest rate, long-term ⁸	5.9	7.1	7.6*
Commercial and industrial buildings	-1.4	1.9	-3.1	4.8	0.4	2.2	Money supply, M1 ^{9,9}	10.5	2.4	1.1*
Residential buildings	8.2	8.5	2.4	1.7	-1.5	0.2	Money supply, M2 ^{9,9}	1.7	0.7	1.0*
Net exports ²	-0.8	-0.6	-0.4	-0.1	-0.1	0.1	External value of the dollar ^{9,10}	2.6	-2.0	-6.1*
Exports	4.1	9.0	-0.9	3.9	3.5	4.7	Terms of trade ⁵	0.7	0.0*	-
Imports	10.7	13.5	2.3	4.4	3.7	3.1	Balance on current account ¹¹	-1.6	-2.2*	-

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 1993 and 1994: 4th Quarter. ¹⁰ For 18 industrial countries. ¹¹ In % of gross domestic product.

* January. * February. * Estimate.

Sources: National statistics; Deutsche Bundesbank; own calculations.

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

Raw Materials and Groups of Materials	1994				1995			
	AA ²	February	November	December	January	February	3.3.	17.3
Total index	147.8	130.0	159.9	155.9	160.6	163.0	163.7	162.9
Total, excl. energy raw materials	143.2	126.8	158.9	159.2	163.6	163.0	164.9	164.9
Food, tropical beverages	113.5	99.4	121.1	118.2	119.1	118.6	121.2	120.6
Industrial raw materials	165.9	147.7	187.7	190.5	197.5	196.7	198.2	198.7
Agricultural raw materials	171.8	150.2	195.4	196.3	204.7	210.2	214.5	217.2
Non-ferrous metals	171.2	147.8	204.3	212.8	220.2	209.3	206.8	203.3
Energy raw materials	150.4	131.9	160.5	153.9	158.8	163.1	162.9	161.6

¹ On dollar basis. ² Annual Average.