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US Economy Losing Momentum

The US economy distinctly lost momentum last year. With high capacity utilization after a long upswing that started as long as five years ago, this development was largely in line with the monetary policy goal of averting cyclical tensions. The idea of the "soft landing" within the capacity band was to steady economic growth and stabilise employment at a high level. The sustained moderate rise in wages and prices is a significant indicator that the conditions for the success of this policy remain favourable. This appraisal still essentially holds despite alterations in the economic picture due to the recent basic revision of the national accounts (see below). At 2.1 per cent in real terms, the rate of growth of the gross domestic product for 1995 in revised accountancy terms is

probably a good percentage point lower than assumed under the old system. For the whole of the upswing phase since the beginning of 1991 the average annual rate also drops substantially from 3% to 2.4%, but growth in production capacity is also lower by a similar margin at only a comfortable 2%.

Apart from the flatter growth trend, the cyclical slowdown since the beginning of 1995 is also more pronounced after the revision. Decisive here has been the marked dampening of domestic demand; it rose in the course of last year at a rate of about 1.5%, only half as fast as in the course of 1994. A major contributory factor to this slowdown was the turnaround in business stockbuilding. The increase in gross fixed capital formation also slowed down

Revision of the National Accounts

In the revision of the national accounts at the beginning of this year, in contrast to previous practice, the method for calculating real variables has also been fundamentally altered. Until now, this was done with the aid of the prices and price structure of a base year. The longer the timespan from the base year to the present, the more distortions emerge because, for example, the contribution of goods with steep price declines is increasingly exaggerated. So far, the method of attempting to cope with this problem has been to update the base year at long intervals. The new method makes a continuous adjustment by weighting on the basis of the current and previous year's prices. A drawback, however, is that the individual components no longer add up to real gross domestic product (GDP).

Compared with previous calculations, the revision, which combines the correction of data with methodological changes, tends to attribute higher rates of growth to periods in the more distant past but lower ones to more recent periods (see Table). Deviations from the "old" figures in the individual components differ. Especially the rise in investment in machinery and equipment now looks considerably weaker because the figure for data processing equipment has fallen considerably due to the appreciable drop in prices.

The revision of the national accounts has brought about substantial changes in the figures, but the economic picture, which is shaped by the utilization of production capacity and its fluctuations, has not changed to a decisive extent, although the rate of growth of production capacity is now slower than had been thought.

Comparison of National Accounts Figures under the Old and New Systems of Calculation

| | 1992 | | 1993 | | 1994 | | 1995 | | | | | | | |
|--|------|------|------|------|------|------|--------|------|--------|------|--------|------|--------|------|
| | | | | | | | 1st Q. | | 2nd Q. | | 3rd Q. | | 4th Q. | |
| | old | new | old | new | old | new | old | new | old | new | old | new | old | new |
| Real gross domestic product ¹ | 2.3 | 2.7 | 3.1 | 2.2 | 4.1 | 3.5 | 0.7 | 0.2 | 0.3 | 0.1 | 1.0 | 0.9 | 0.2 | 2.1 |
| Domestic demand | 2.5 | 2.8 | 3.9 | 2.9 | 4.7 | 4.0 | 0.9 | 0.3 | 0.5 | 0.2 | 1.0 | 0.6 | 0.1 | 2.1 |
| Private consumption | 2.8 | 2.8 | 3.3 | 2.8 | 3.5 | 3.0 | 0.4 | 0.2 | 0.8 | 0.8 | 0.7 | 0.7 | 0.2 | 2.4 |
| Government demand | -0.7 | 0.5 | -0.8 | -0.3 | -0.8 | 0.0 | -0.2 | -0.3 | 0.1 | 0.2 | 0.8 | -0.2 | -1.0 | 0.1 |
| Fixed asset investment ² | 5.5 | 5.7 | 11.3 | 6.8 | 12.3 | 10.2 | 3.6 | 2.2 | 1.2 | -0.3 | 2.2 | 1.5 | 1.4 | 6.3 |
| Equipment | 6.0 | 6.2 | 18.0 | 10.0 | 17.6 | 13.2 | 5.6 | 4.1 | 2.8 | 0.9 | 2.3 | 1.2 | 1.7 | 10.7 |
| Commercial and industrial buildings | -6.7 | -6.8 | -1.4 | -1.7 | 2.0 | 1.5 | 2.8 | 2.4 | 2.2 | 0.8 | 0.9 | 1.5 | 1.1 | 7.5 |
| Residential buildings | 16.2 | 16.6 | 8.2 | 7.6 | 8.6 | 10.8 | -0.9 | -1.6 | -3.6 | -3.5 | 2.6 | 2.2 | 1.1 | -2.4 |
| Stockbuilding ³ | 0.1 | 0.1 | 0.3 | 0.3 | 0.9 | 0.9 | 0.9 | 0.8 | 0.6 | 0.5 | 0.6 | 0.4 | 0.3 | 0.5 |
| Exports | 6.7 | 6.6 | 4.1 | 3.3 | 9.0 | 8.3 | 1.2 | 0.6 | 1.6 | 1.1 | 2.6 | 2.0 | 2.6 | 8.3 |
| Imports | 8.7 | 7.5 | 10.7 | 9.9 | 13.4 | 12.0 | 2.4 | 2.1 | 2.4 | 1.9 | 2.1 | 0.3 | 0.0 | 7.9 |

¹ Change over preceding period in %, quarterly values seasonally adjusted. ² Excluding government. ³ Change expressed as % of GDP of the preceding period.

Sources: National statistics; own calculations.

considerably. The pace of business investment was thus reduced; nevertheless expansion here remained above average. Residential building revived following a decline up until the middle of last year, the revival evidently due to lower interest rates. With disposable income still expanding noticeably, private consumption increased relatively quickly. Demand from abroad also stayed keen; there was a marked rise in exports in the course of last year, though not as rapid as in 1994. The expansion of imports, in contrast, has slowed down further under the influence of slackening economic growth. The deficit on the current account in 1995 will probably amount to about US\$ 165 billion (2.4% of gross domestic product), and will therefore not be much larger than that of 1994.

Although unemployment declined significantly during the upswing and the rate has remained for quite a long time at a level (just under 6% of the labour force) which is low by American standards, wage rises have remained moderate so far; hourly earnings at the end of last year were about 3% higher than a year previously. However, the statistics after the recalculation of gross domestic product record not only a lower rate of increase in production but also lower growth in productivity; according to the new method, it has been almost one percentage point weaker since 1990 at an annual average of 1.2%. This means that the trend in unit labour costs, which hardly rose at all since mid-1993 according to the old accounting system, does not present quite as favourable a picture. On the other hand, this "fits" better with price trends. At the end of last year, the rate of increase in prices for finished products at the production level was 2.2% higher than a year previously and the cost of living had risen 2.5%. Considering the advanced stage of the upswing, these are comparatively low figures.

After a marked decline in the budget deficit in recent years fiscal policy is currently inert. Govern-

ment and opposition have agreed on a balanced budget in seven years but the basic differences of opinion on the way to achieve this – in particular on tax policy and the apportioning of the unavoidable cuts to social benefits and subsidies – have so far even thwarted the adoption of a budget for the current financial year. The mounting uncertainty about the future course of consolidation is placing a strain on the capital markets after interest rates had again dropped to the level of the last low of autumn 1993 by the turn of the year. Under these conditions, the Federal Reserve is likely to be reticent to continue with its policy of gradual cuts in interest rates – the last was at the end of January – as long as there is no pressing need to take action for cyclical reasons, in particular as the expansion of the M2 money supply is at the upper limit of the 1-5% band.

Economic developments will meanwhile be increasingly underpinned by the impacts of monetary relaxation since the middle of last year and the drop in capital market interest rates since the end of 1994. Above all, the increase in business investment is unlikely to slow down further, now that wage restraint has made a major contribution to avoiding profits shrinking with the downswing. In residential building the interest rate induced recovery will continue, while the expansion of private consumption is likely to slow down somewhat, as the impacts of the slower economy will make themselves more clearly felt on employment and income. With ongoing robust export growth and moderate import expansion, there will be stimuli from foreign trade. Altogether, real gross domestic product ought to increase somewhat more rapidly again: an estimated annual average growth of 2% will approach capacity. The cost of living will go up by a probable 2½% (1995: 2.8%).

Compiled by the Department of World Business Cycles 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 | 1995 | | | | 1996 | | | |
|---------------------------------------|-----------------|----------|----------|----------|---------|----------|-------|-------|
| | AA ² | February | November | December | January | February | 1.3. | 15.3 |
| Total index | 162.7 | 163.0 | 160.7 | 165.4 | 162.6 | 161.1 | 162.8 | 165.4 |
| Total, excl. energy raw materials | 163.3 | 163.0 | 162.7 | 160.6 | 157.2 | 157.0 | 157.0 | 157.0 |
| Food, tropical beverages | 117.4 | 118.6 | 114.4 | 112.5 | 113.1 | 117.4 | 116.9 | 115.5 |
| Industrial raw materials | 198.2 | 196.7 | 199.6 | 197.2 | 190.8 | 187.2 | 187.5 | 188.7 |
| Agricultural raw materials | 213.9 | 210.2 | 216.8 | 214.9 | 209.9 | 203.3 | 203.6 | 203.4 |
| Non-ferrous metals | 209.4 | 209.3 | 210.9 | 207.7 | 192.7 | 190.0 | 190.8 | 192.1 |
| Energy raw materials | 162.3 | 163.1 | 159.5 | 168.2 | 165.7 | 163.4 | 166.3 | 170.3 |

¹ On dollar basis. ² Annual Average.