Nervous wait for interest rate decision

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18 June 1999

A degree of anxiety surrounds US and global financial markets in the lead-up to the next policy meeting of the US Federal Reserve Board scheduled for June 29-30.

The big issue to be determined at that meeting is whether the Fed starts to claw back the interest rate cuts it made last year to head off the global financial crisis that developed following the Russian debt default and the collapse of the US hedge fund, Long Term Capital Management.

The Fed has already indicated that its bias is towards tightening rates. But there are fears that even a small rise—from the present level of 4.75 percent to 5 percent—could prick the stockmarket bubble. This could set in motion a downturn in the US economy, which has been responsible for one-third of the increase in world economic output over the past three years.

In "normal" times a small increase in US interest rates would not have a major effect. But present economic conditions are far from normal.

Over the past three years spending in the US economy has been financed by an unprecedented growth in debt. Savings rates have reached historical lows, and have now turned negative, meaning that spending is higher than income. Corporate debt is also on the rise. Last year US corporations issued $350 billion of new debt, mainly to finance share buybacks and boost their stockmarket value.

The London *Evening Standard* columnist Andrew Smithers underscored the precarious nature of the US boom on Monday. He pointed out that while the International Monetary Fund had acknowledged that it did not predict the Asian financial crisis, IMF deputy director Stanley Fischer has said he will recognise the signs of a crisis in the future.

According to Smithers: "They are an explosion of poor quality debt, a stockmarket bubble and a large and growing trade deficit. The US qualifies on all three counts. Last year's trade figures were bad and 1999's promise to be much worse. The first-quarter figures showed net imports rising at an annual rate equal to 2.5 percent of gross domestic product."

In normal times, Smithers said, the Fed could raise interest rates as a precautionary measure and then cut them again if demand started to falter. But this was now a "high-risk strategy". Experience had shown that if a rate rise caused the stockmarket to crash "cutting rates will not stop the economy from following."

Markets were expecting an indication of the Fed decision to be provided when chairman Alan Greenspan testified before the Joint Economic Committee of the US Congress yesterday on the subject of "Monetary Policy and the Economic Outlook."

In testimony delivered on Monday on the impact of technology, Greenspan indicated that increases in US business productivity resulting from the application of information technology could not go on forever.

Opening his remarks, Greenspan said "something special" had happened to the US economy in recent years. After seeming to have passed its better days, it was now "displaying a remarkable run of economic growth that appears to have its roots in ongoing advances in technology."

The surge in the availability of real time information, he said, had "enabled business management to remove large swaths of inventory safety stocks and worker redundancies, and has armed firms with detailed data to fine-turn product specification to most individual customer needs."

"Moreover, information access in real-time—resulting, for example, from such processes as checkout counter bar code scanning and satellite location of trucks—has fostered marked reductions in delivery lead-times on all sorts of goods, from books to capital equipment. This, in turn, has reduced the relative size of the overall capital structure required to turn out our goods and

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services."

Greenspan told the committee that since 1995 output per labour workhour in the non-farm business sector had grown by an annual rate of about 2 percent. This is double the rate of increase over the previous decade.

As well as shortening investment lead times, new technology had increased the flexibility of capital goods and production processes. New technologies had made "capital investment distinctly more profitable, enabling firms to substitute capital for labour and other inputs far more profitably than they could have a decade ago."

This process, he indicated, was extremely advantageous to US businesses as it enabled "excess capacity previously bottled up in one country to augment worldwide supply and exercise restraint on prices in all countries' markets."

There is no doubt that technological innovations have boosted productivity and profit rates, not least by making possible the continuous downsizing—currently running at around 500,000 jobs per year—in all sections of US industry.

But claims that these productivity increases have created a "new economy" reflected in the spectacular increase in share values do not square with reality. Productivity has increased but nothing like the rise in the stockmarket. Since 1996, when Greenspan issued a warning about "irrational exuberance" the total sharemarket value has risen from around 60 percent of gross domestic product to more than 130 percent—fuelled in large measure by the increase in the money supply and debt.

Even as he was celebrating the state of US business, Greenspan felt the need to offer a word of warning.

"The rate of growth of productivity cannot increase indefinitely. While there appears to be considerable expectation in the business community, and possibly Wall Street, that the productivity acceleration has not yet peaked, experience advises caution. As I have noted in previous testimony, history is strewn with projections of technology that have fallen wide of the mark."

Greenspan, as usual, did not elaborate. Had he done so he might have pointed out that the period of greatest sustained advance in US productivity still remains the 1920s. In that decade the development of assembly-line methods of production and the spread of electrification through all sections of industry produced similar results to the spread of information technology today.

Then too there were claims that the US economy had entered a "new age", moving beyond the business cycle. But as history records, the boom in industrial productivity, the rapid increase in manufacturing capacity and the escalation of stockmarket values ended in the 1929 Wall Street crash and the Great Depression of the 1930s—the biggest breakdown in the history of world capitalism.

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