Sharp slowdown in US growth rate

Nick Beams
31 October 2000

While last Friday's announcement of a slowdown in economic growth produced the biggest rise on Wall Street for five months, there are indications that the US economy may be entering troubled waters in the months ahead.

The 2 percent rise in the Dow Jones Index was prompted by the view that with the annual growth rate running at 2.7 percent in the third quarter—down from the rate of 5.6 percent in the second quarter—the economy is headed for a so-called “soft landing”. That is, the growth rate is high enough to prevent recession but not so high as to increase inflation and bring further interest rate increases by the Federal Reserve Board.

Two figures in the data released by the Commerce Department, however, sparked cause for concern—the fall in investment levels and a drop in the personal savings rate to negative levels not seen since the Depression of the 1930s.

Investment grew by only 6.9 percent for the quarter, less than half its rate of 14.6 percent in the second quarter and only one third of its rate of 21 percent in the first three months of the year. Investment on equipment and software grew by 8.5 percent, down from its rate of 17.9 percent in the second quarter.

Commenting on these results, an editorial in the *Financial Times* noted that while the figures may have to be revised upwards, together with “rising corporate bond yields and a tightening of bank credit standards, they add to fears of a capital spending slowdown. If business investment is falling, then productivity growth—the very source of the US economy's success—could be put at risk.”

The editorial also pointed to the possible effects on the stock market should such a slowdown eventuate. “The financial markets clearly have doubts about how some companies will survive as growth turns from exceptional to just ordinary. Businesses whose earnings are already starting to suffer are being heavily punished by a loss of investor confidence.”

Another area of concern is the unsustainable growth of debt in the US economy, both personal and corporate. At the beginning of the 1990s, the average savings rate in the US was 8 percent. Now it is at -0.2 percent.

Figures produced by the Financial Markets Centre for the second quarter show that borrowing by households rose by 9.6 percent, giving rise to what it called “signs of stress in the household sector”.

“During the second quarter,” the FMC reported, “households enlarged their holdings of mutual fund shares, life insurance reserves and securities issued by government-sponsored enterprises. But, at annual rates, the increase in households' net liabilities ($558.8 billion) far surpassed their net acquisition of financial assets ($409.7 billion).”

This $149.1 billion gap raised “concerns” about the financial position of the household sector. “In 1997, households' net liabilities outdistanced their net accumulation of assets by $67.7 billion. After turning modestly positive ($0.7 billion) in 1998, the sector's net financial investment returned to negative status in 1999 (-$130.6 billion). Now the erosion appears to be gathering steam.”

Another indicator of the vulnerability of households to an economic slowdown, the report said, was the second quarter increase in household debt which “amounted to a daunting 9.1 percent of disposable personal income”.

The danger for the US economy is that the decline in private savings (both personal and corporate) to historically low levels could exacerbate the effects of even a relatively mild recession.

In a comment published on October 17, *Financial Times* columnist Martin Wolf noted that since 1995 a private sector financial surplus of 1.6 percent of GDP had been transformed into an “unprecedented” deficit of 5.1 percent of GDP.

"The stability of the US economy," he continued, "depends on the willingness and ability of the private sector to run this deficit with comfort. But what would happen if the oil price shock disabused people of the belief that recessions are things of the past; if the ongoing profits slowdown punctured optimism about prospects for earnings; if investors who are now confident of the durability of the extraordinary returns of the past 20 years were to change their minds; or if foreigners started to reduce their desired holdings of US assets? The results could be devastating."

Within the US warnings are also being sounded about the possibility of a recession. Delivering the opening address to a major Internet conference in New York last week, former US Treasury Secretary Robert Rubin, now the chairman of the executive committee at Citigroup, said investors had to maintain realism and discipline to keep the US economy going.

The greatest risk, Rubin said, was the "complacent assumption that good times will continue, that disruptions will be mild and brief and fixed by the Federal Reserve Board." He pointed out that the US trade deficit was running at more than 4 percent of GDP, consumer savings were at an all-time low, consumer debt at a record high and the stock market was valued at 200 percent of GDP.

These figures reflected an "excessive reaction" to US strength and such excess inevitably unraveled, he commented. Pouring cold water on the idea that the "new economy" had superseded "old economy" processes, Rubin told his audience they should remember that life-altering technological advances were not new. The telephone, automobile and electricity were viewed as fundamental changes in their time but "none did away with the business cycle," he warned.