US growth figures don’t square with business perceptions

Nick Beams
4 May 2002

Looking at the US growth rate figures for the first quarter of this year brings to mind the old saying about “lies, damn lies and statistics”. According to data released by the Commerce Department last month, the US economy expanded at an annual rate of 5.8 percent for the first three months of the year.

The problem with the figures is that no one thinks they provide a particularly accurate picture of the state of the US economy, much less indicate that it is about to coming roaring back from recession. As one financial commentator cited by the *Australian Financial Review* put it: “The V-shaped recovery camp is now deserted. They’ve all moved into the sluggish-growth 2 to 3 percent growth camp.”

The macro economic figures form a sharp contrast with perceptions in business—that times are hard, margins tight and markets competitive. In the words of one chief executive commenting to the *Philadelphia Inquirer*: “Anyone who thinks we have come out of recession has not been out there trying to sell products and services to major US corporations. Short or shallow recession? I beg to differ.”

A closer examination of the components of the first quarter result, which could be revised over the next month, reveals some of the reasons for the incongruities. The main reason for the sharp increase in GDP was the lower pace of inventory liquidation. Businesses were again building up stock levels after running them down in the last three months of 2001. This item was responsible for more than half of the increase in the growth rate.

But a build-up of inventories is a one-off item. A sustained economic upturn depends on increased business investment. Here the figures tell a different story. Overall business investment fell by 5.7 percent, while the final sale of computers dropped by more than 20 percent. The fall in investment is a result of the fall in profit rates across the economy.

According to a comment published on May 1 by *Washington Post* columnist Robert J. Samuelson, profits constitute the “soft underbelly” of the economic recovery with both government and private estimates of profit levels showing sharp declines.

“The Commerce Department reports that after-tax profits of US companies dropped 16 percent last year to $482.5 billion from $573.9 billion in 2000. The decline began in the last quarter of 2000. Measured from there to the end of 2001—and using quarterly statistics—the decline is 27 percent. But that’s still not as large as the drop in company-reported profits, expressed as earnings per share. In 2000 the reported earnings of firms in the Standard & Poors index of 500 companies were $50 per share for the entire index. In 2001 earnings tumbled 51 percent to $24.69.”

Low profits are not the only reason for the decline in investment. Another important factor is the increase in debt held by US corporations. As an article by *Financial Times* columnist John Plender noted: “The financial condition of US business at the start of the economic recovery was probably worse than at any such juncture since the Second World War, says the veteran Wall Street economist Henry Kaufman. From 1995 to 2001, he adds, the equity of non-financial corporations contracted by $423 billion while net debt increased by $2,300 billion. This was a far greater debt binge than in the notorious leveraged buy-out era of the late 1980s. Meanwhile, economists at Goldman Sachs estimate that corporate cash flow is at its lowest point relative to debt since 1945.”

Nowhere are the consequences of this debt binge more clearly revealed than in the telecommunications industry. In the midst of what has been described as a “meltdown”, telecom stocks are estimated to have lost more than $1 trillion in value since the late 1990s, while banks and investors have written off almost $500 billion, with more to come.

The crisis in telecommunications is an almost textbook example of the anarchy of the capitalist market. At the height of the boom, investment funds poured in to finance the various projects floated by individual companies. Viewed in isolation, these projects seemed to be viable and provide substantial profits. But the problem was that with every other company following the same path, massive overcapacity was created. It is now estimated that less than 10 percent of all fibre-optic capacity is currently being used. Consequently telecom companies have been cutting prices to maintain market share in a desperate struggle to drive their rivals to the wall.

Overcapacity is not confined to the telecommunications industry. It is a significant factor impacting on the US and world economy, revealing its presence through low levels of inflation, or even outright deflation. This places pressure on profits, and consequently new investment, because companies are restricted in the prices they can set.

The first quarter GDP statistics showed that the GDP price index—the broadest measure of inflation—rose at an annual rate of only 0.8 percent, following a 0.1 percent decline in the last quarter of 2001. This means that the US has recorded its lowest aggregate inflation rate since the second half of 1954.

According to Morgan Stanley chief economist Stephen Roach, this is a “worrisome” figure because it shows that the US economy is close to the brink of outright deflation. “With pricing leverage all but absent in the current climate, Corporate America can hardly be expected to step up and take the initiative on hiring and fixed investment, unleashing the forces that typically provide staying power to cyclical recoveries. The risk of deflation has not passed, and until it does, any upturn in the US economy could be on exceedingly shaky ground.”