US growth rate points to global downturn

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Economic growth in the United States has fallen to its lowest rate in two years amid signs that the world economy as a whole is entering a slowdown. Figures released last week show that the US economy expanded at an annual rate of 3.1 percent for the March quarter, well below the predicted rate of 3.5 percent.

The US slowdown is more significant than the overall figure would indicate because the build-up of inventories of unsold goods accounted for 1.2 percentage points, or about 40 percent of the increase. Based on sales alone, the growth rate was 1.9 percent, half the rate experienced in the final quarter of 2004. Consumer spending, which has sustained the economy over the past three years, is starting to fall, with growth declining to 3.5 percent in the first quarter from 4.2 percent.

In a pointer to the future, business investment dropped to a growth rate of 4.7 percent compared to 14.5 percent in the previous quarter. Other data show that orders for durable goods fell in April by 2.8 percent—the worst result in two years—indicating that the slowdown is worsening, with falling orders for cars, computers and aircraft.

Commenting on the wider implications of the figures, the *Economist* noted that for several years the US economy, and particularly American consumer spending, had been powering global growth. Now the locomotive seemed to be losing momentum at a time when inflation was starting to increase. While the situation was by no means as severe as the stagflation of the 1970s, "there are still good reasons to worry".

The article noted that the relatively low US unemployment rate of 5.2 percent was deceptive. The rate had remained low because of a big rise in the number of people who have given up looking for work. "A better measure of the employment picture is payrolls, which only surpassed their February 2001 peak in January of this year. Since the working-age population has grown over those four years, this means the jobs picture is still decidedly troubling."

Another indication of underlying structural problems in the US economy is the fact that while consumer spending has grown to a record 71 percent of gross domestic product (GDP) since 2002, compared to a norm of 67 percent over the period 1975 to 2000, real private sector wage and salary payments have increased by only 5 percent in the first 39 months of the present recovery phase of the business cycle. This compares to an average increase of 15 percent over the previous five cycles.

With job numbers and pay disbursements barely growing, this means that increased consumption spending is being financed entirely out of the growth of debt. As the latest figures showed, the personal savings rate in the US fell to 0.6 percent in the first quarter, the second lowest level ever recorded, after the 0.5 percent rate in the final quarter of 2001.

The day after the US growth data was released, the news from Europe was no better. According to a report issued by the European Commission, economic confidence is falling across the region. The commission said the decline in its "economic sentiment" index to the lowest level since October 2003 indicated "a considerable slowing of output growth in the first half of 2005".

Amelia Torres, the EU spokeswoman for the economy and finance commented that "the situation is not exactly rosy at the moment". Growth-oriented policy changes in countries like Germany, she said, were "taking time to bear fruit". This is a reference to new regulations which bring in severe cuts to unemployment benefits and have helped push unemployment rates to over 5 million.

Ken Wattret, an economist with BNP Paribas in London, told the *International Herald Tribune* that the numbers showed a European economy in trouble. "We thought services would rebound in anticipation of better prospects in industry, and so pessimism really is the order of the day."

The commission said the biggest decreases in its economic sentiment index, which covers industrial, retail, construction, services and consumer confidence, had been in the UK, followed by France. French unemployment has risen to a five-year high of 10.2 percent with a report showing that business confidence in April was at an 18-month low. The business leaders interviewed for the survey were particularly downbeat about the prospects for exports.

While the German unemployment rate declined slightly last month, revised data issued last week show that the economy is in a technical recession, with two consecutive quarters of negative growth in the second half of 2004. The governments of Germany and Italy have both revised downward their estimates of economic growth from 1.6 percent to 1 percent and from 2.1 percent to 1.2 percent respectively.

German business confidence is down to its lowest level since September 2003, after three months of successive declines. Consumer confidence is also reported to be falling.

Despite the continuing boom in the Chinese economy, the overall situation in Asia is little better. Last week, the Bank of Japan acknowledged that the economy, the world's second largest, is still stuck in deflation in spite of three years of stop-start growth. While the fall in prices of 0.2 percent in the year to March was less than the 0.8 percent declines experienced in each of the previous two years, the bank does not expect prices to start rising until 2007.

The latest result means that Japan has experienced eight years of deflation since the collapse of the real estate and share market bubble in the early 1990s. With interest rates at zero and plenty of liquidity there is little financial authorities can do to boost the economy. Increased government spending is also ruled out because previous measures, which failed to provide any long-term revival, have left Japan with a public debt equivalent to 160 percent of gross domestic product.

Japan's domestic economy is virtually stagnant, with real domestic demand only averaging an annual increase of 0.9 percent over the past years. What growth there has been is largely the result of exports, especially to China, which have increased at a rate of 7.4 percent over the same period. But even this source of growth could dry up if China's growth rate begins to fall as a result of a slowdown in the US.

The dependence of the Chinese economy on the US and other foreign markets is reflected in the share of exports as a percentage of GDP: up from 20 percent in 1999 to 35 percent in 2004. Of these exports, one third goes to the US. The picture is the same throughout Asia.

According to calculations by Morgan Stanley economists, over the past five years exports from non-Japan Asia have increased at an annual rate of 15.3 percent; more than triple the 4.9 percent annual increase in domestic consumption spending over the same period.

These figures underscore the growing reliance of China and the rest of Asia on the expansion of the American market and signify that any sustained slowdown in the US economy, not to speak of a recession, will have far-reaching consequences.