Δείγμα γιά τό
διατύπωσου σχολίου γιά
τήν οικονομική πολιτική

DR. A. P. SIMKIN'S PRESENTATION
Tuesday, February 23, 1988

Thank you very much.

Let's first talk about U.S. politics and where they seem to be heading. Americans do not vote. About 47% of Americans who were eligible to vote in 1984, did not vote. You may call the abstainers the economic underclass. Only 53% of eligible voters voted in 1984. Of that total, 59% voted Republican. Several questions arise. Why does not the underclass vote? The answer is: They don't believe their vote for the presidency has any effect on their well being.

There is another side to this. At times in the past -the last time I think was 1932- when the economic underclass did vote, they voted Democratic. After 1932, they kept voting for a whole generation. This generation has now died. From the Republican party's point of view what must be done is try to encourage the underclass to remain passive. The best way of doing that is to maintain the illusion of prosperity. The illusion of prosperity is maintained by jobs. Jobs equals cash flow. Real income has been falling for some time. But, so long as employment is growing individuals' cash flow grows. It gives the Republicans the hope that they can maintain control of the White House. From the Republicans' point of view, with any kind of luck, the rate of abstensions in November will go up to 48-49%. If this happens, the Republicans have a fairly good chance of winning the presidency. Not only that, but the Senate becomes a wide open contest.

This year one third of the Senate -33 seats- is to be elected. Of those 33, 18 are Democratic seats and 15 are Republican. Of those 33, 7 are vacant. Those 7 make it a wide open race. If the Republicans get enough momentum in the presidential voting, in theory, they might regain control of the Senate. Right now, Republican control of the Senate seems unlikely. But if the Republicans do win back the Senate, that would put a different complexion on policy moves over the next couple of years. Should the Democrats retain control of the Senate, and if the Republicans hold onto the presidency, there will be two more years of policy deadlock.

For the moment, it does not appear as if there will be a recession in the United States for the next quarter or two. That suggests unemployment is probably going to remain roughly at its present level of 5.7% for the next few quarters. That's good news for the Republicans.

Let's look now at what has happened at the economic policy recently. Consider the effect on the economy, the balance of payments, interest rates, and so on. First. On the fiscal policy side, the American Congress went through a big charade between the middle of November and the middle of December. It was called budget cutting. If you were in the United States at the time there was not a day when there was not something in the news about cutting the deficit. But they did not do that. What they did was: raise the projection of revenues, and lower the projection of expenditures. Of course, they came up with a smaller deficit. It is what the computer people call garbage in-garbage out. The "deficit cutting" exercise was based on an assumption that in the current financial year (which began the 1st of October) real growth would be about 3%. That was fantasy then. It still is. So, the whole exercise was just so much rubbish. The federal sector's deficit in the last financial year was 148 billion. In the current financial year, the optimists tell you 160 billion, the pessimists will say 170-180 billion. So much for deficit cutting.

To monetary policy. First, have in mind that the governors of the Federal Reserve are all appointees of Mr. Reagan. They know which side the bread is buttered. Look at the numbers. They are very interesting from a political point of view. The series which I follow, is the series which measures the banks' free liquidity. It is called the nonborrowed reserves. The numbers. After October's stock market crash, the Federal Reserve very aggressively added liquidity to the banks. Short term interest rates came down. The dollar fell, but that had to happen in any case. By the middle of November, all the liquidity had been withdrawn which had been pushed into the banks after the crash. By early January, the Fed had reduced the level of bank free liquidity to below where it was before the crash. Then, early in mid-January, statistics began to come out in the United States suggesting that there might bea recession in the offing. The Fed panicked. In the space of roughly a month, they added approximately 10% to the banks' free liquidity. When they realized that there might not be a recession soon, they started to pull it back.

The figures are published. What they tell you is that in a very subtle way the Fed is trying to avoid recession. That's what they are paid to do. They also help their political friends.

I was in the States a couple of weeks ago. The impression I got was that the stock market crash did not have a particularly deadly effect on the consumer spending. The journalists wrote column after column of how this was another 1929. They also wrote a lot about how much money the public lost on October 19th. The consumer is important. Consumer spending accounts for nearly two-thirds of gross national product. Still. Consumer confidence has bounced back. There are two surveys. One is the University of Michigan's and the other is from the Conference Board. The results show that January's level of consumer confidence was roughly just below where it was just before the stock market crashed in October. Yes, it had taken a drop, but it did also back.

Something else is happening. Over the last four or five years, we have seen a succession of sectors going into recession: agriculture, mining, energy, manufacturing.

Today, a broad spectrum of indicators suggest that agriculture and manufacturing are reviving strongly. These tend to concentrate in the Midwest. So what we are seeing is a geographical shift of economic activity: the focus is on the Midwest. Go to Chicago. People there are very pleased about what's going on. Not so on the East Costa, or in parts of the Southeast. Not so in parts of the oil patch. So, what's happening is that there is still consumer spending in the areas which remain in a recession, or which are moving into a recession. But these are offset by job creation and overtime working in the reviving sectors, agriculture and manufacturing.

In the Midwest there's a lot of demand which was backed up during the recession in agriculture and manufacturing. We call it pent-up demand. You see it in housing. Housing starts in U.S. have been falling for the last year or so for America at large. Yet, in the Midwest housing starts are rising. Housing prices are rising. There are millions of people who didn't make that big purchase during the last three or four years. Suddenly, things are looking up. And they are. A large part of this reborn optimism is due to the dollar's undervaluation.

Investment? Despite a very strong demand for American manufactured goods, industry is not investing in new plants. When you ask why, the answer is: it takes two to three years to build a plant and get it going. Managements are not sure that in three years time the dollar would be as undervalued as it is today. Therefore, they don"t build. What are companies doing? They are installing new machinery in order to rationalise. There is another way to look at this. Many American manufacturers are becoming much more efficient at producing the same old stuff. The implication is serious. There is a growing loss of momentum in new product development. this because new plants are not being built.

Other construction is going ahead, especially in the Midwest. It includes office buildings, hospitals, shopping centers, university buildings, stadiums, etc., etc.

America's economic thrust clearly is coming from the dollar. Manufacturing is being driven by exports and import substitution. This leads to another set of questions. How much longer will export growth continue? Many manufacturing sectors are now operating at about 90% of capacity: Chemicals, forest products, plastics, textiles, steel. At such high levels of operating capacity, the strong growth will be easing off soon.

Export growth has been behind the trade deficit's improvement. The improvement may not continue much longer. That is indirectly related to capacity bottlenecks. When you talk to American companies and you ask why they don't get out and export more, they tell you that they are trying to regain their domestic market shares. They want to get closer to their domestic customers. They don't have the capacity service new markets. And for the moment, they aren't going to build it. It tells you that export growth is going to slow down over the next six to nine months. The growth rate is not going to fall. But the thrust to the American economy from exports will lose a lot of its momentum.

What about the balance of payments and inflation? Let me say just a few things about inflation first. More and more manufacturing sectors probably will reach capacity over the next six months. It means more overtime. It means slow productivity growth. It also means that unitlabor cost will syart to rise. Later this year we may well see a bounce back of energy prices. We probably will also see a further food-price increases. Cereal grain prices have been rising now for some time. You can see wage rates for unionized workers are rising. However, it hasn't affected the broad mass of workers yet. This suggests future wage cost pressures. And as more and more companies hit capacity. They will start to raise their prices. Some already have. It's good for profits in the short term. Companies can report to the Wall Street analysts that their earnings went up. And they will for the next three or six or nine months. Inflation probably will accelerate during 1988. If you talk to the optimists in the United States they will tell you that by yearend the cost of living will be 5% higher than a year earlier. My own view is that inflation will be a little higher than that: up probably 6% in the year ending December. Put that in perspective. December 1987's cost of living was 4.4% higher than December 1986's. It does represent some acceleration.

What about the balance of payments? In the last few months, the trade balance has gotten smaller. Those figures are not seasonably adjusted. For the next couple of months, those numbers are likely to get smaller still. That's because they are not seasonally adjusted. March's figures are published in May. They may sho a deficit that isn't getting smaller. Washington is going to start publishing seasonally-adjusted figures again in April, because normally the April seasonal adjustment is a minus.

Let's talk about the dollar yield curve. At present, short term interest rates are in the region of 6 1/2 - 7. The long term U.S. Government bond yielding about 8.4%.

If I'm right, the F will remain very sensitive about the possibility of a 1988 recession. Then, short-term interest rates probably will not move up or down too much. If rates move up, there's an increased recession risk. If rates move down, the dollar could go into a free fall.

And what about long-term bond yields? In my view yields will rise. Inflation will rise. And it won't be long before the bond market realizes this. Perhaps even more important, look at the real return you get on U.S. dollar bonds. U.S. dollar bonds yield as they say 8.4%. The current inflation year to year is 4.4%. You don't like the current inflation? Be optimistic. Take the inflation at the end of this year: 5% You get a 3.4% return in real terms. Compare that with what you get on German bonds. Ten-year German Government bonds now yield about 6.2%. The inflation rate year to year is aoubt 0.7%.

Talk to a very "anstful" German. You'll be told that by the end of this year inflation probably will be 1.5%. That's a very pessimistic German view. But it still gives you a 4.5% real return. Keep in mind that America's current account is in deficit. And that deficit is going to get bigger because the services account has gone into the red. It happened in the third quarter. It means non residents are acquiring more and more dollars. Yet Americans are not paying a risk premium on those dollars. However, sooner or later they will pay. The British are still paying a risk premium on sterling despite nearly nine years of Margaret Thatcher. Britain enjoys a lower inflation rate than America. Britain has a budget surplus. Fine. But look at the premium. Long-term British Government bonds are yielding 9.5%. The inflation rate is 3.3%. Even if you talk to pessimistic British economists they'll tell you that by the end of this year Britain's inflation will be 4.7% Thus, the British are paying a high risk premium.

America is not paying a risk premium. Assume, therefore, that the yields on long-term bonds will rise. Sooner or later, the market will adjust to the "euphoria" that's coming from a very short-term view of the monthly trade numbers.

The dollar will respond as well. Americans are not only living on borrowed money, they are living on borrowed time. It's only a matter of months before what has gone up, i.e., the dollar and bond prices -goes down. When? I honestly don't know whether, it will happen in April, or May. It's out there. It's getting ready to happen.

How far can the dollar fall? Let me say that it could still rise a little bit further. Look at the dollar/DM. Today it is at 1.69-1.70 more or less. It could go to 1.75. It might even get a little stronger than that. "Euphoria!"And the dollar/yen? That's now about 129-130. It's been in that range for a few weeks. It could go to 135. It might even get to 138. Japanese have become very sophisticated players in the forward market. So when the dollar rises, they sell dollars. That could keep the dollar from rising too far.

What does it say? It says that when the "euphoria" runs out, bond prices and the dollar could weaken dramatically. it could all happen very qyickly. It could happen fairly soon. I'm just guessing that the weakness will happen in the next two months. Meanwhile central bankers are patting themselves on the back because of the stability they have created. I think the "stability" won't last. But I'm not sure what would trigger a change: a statistical or political development, probably. Don't be surprised when it happens.

Thank you.

1703M