THE U.S. ECONOMY: LA DONNA È MOBILE

It is unquestionable that, when people have money, they tend to consider spending it.

As equity market values head for higher levels, so the so-called wealth effect kicks in, as investors see the value of their scrip holdings increase in value.

Investors' thrashings on equity markets over the past few years are all but forgotten because memories, by and large, are short – sadly.

In the words of Dante Garbriel Rossetti (1828-1882):

'From perfect grief there need not be
Wisdom or even memory:
One thing then learnt to me, --
The woodspurge has a cup of thee.'

Since the middle of March, the values of key indices on equity markets in the **U**nited **S**tates (US) have risen, on average, by about 20 percent, with technology based equities, having benefitted the most.

It would appear, on the surface, at least, that the US consumer is enjoying somewhat of a fillip, following on from the ill effects of the US-led war on Iraq and from the financial effects, internationally, of the many incidents of cases of **S**evere **A**cute **R**espiratory **S**yndrome (SARS).

Also, there is growing evidence that consumers are minimising – or completely disregarding – the importance of the unmistakable tell-tale signs of the negative aspects of the US economy.

Instead, many US consumers have adopted a dream mentality, which goes along the lines:

1. The worst of the economic recession, or near recession, must be over for the US economy;

2. As the US economy recovers and gathers pace, it will cascade down the line to other economies of the world; and,

3. Get invested while there is still time.

There is little evidence that the dream mentality can be justified by the most-recent statistics, having been spewed out by various departments of the US Government, but, even if such evidence had been forthcoming in great abundance, one has to question such evidence and of its veracity and presentation, which, in some cases, appears to be rose-coloured instead of being impartial and unbiased.

There is the logical fallacy that is, too often, forgotten: Numbers prove.

Last Friday, for instance, The US Secretary for Labour, Ms Elaine L. Chao, commenting on the unemployment figures for the month of May, said:

'The unemployment rate for May rose from 6.0 percent to 6.1 percent and the economy lost 17,000 non-farm payroll jobs.

'The increase in the unemployment rate is disappointing, but it is in line with expectations and the number of jobs lost this month is significantly lower than in previous months. What's important is to look at what is going on behind these numbers: 58,000 new jobs in temporary help services, a leading indicator of economic growth, and the largest increase in these numbers since October 1999. Construction employment is also up and manufacturing work hours increased as well.

'The Jobs and Growth Act of 2003, which was recently passed under the strong leadership of the President, will spur faster economic growth and job creation. The Jobs and Growth Act will put more money back in the pockets of America's working families, seniors and small business owners as soon as next month, stimulating the economy and helping to create new jobs.'

On reading the above statement of Ms Chao, this medium is reminded of the way in which the old **U**nion of **S**oviet **S**ocialist **R**epublics (USSR) used to report on US labour disputes when there was political mileage to be made.

That former Stalinist country used to report along the following lines:

'Labour requested a very reasonable increase in take-home pay of 15 percent per annum; Management offered a miserly increase of 6 percent per annum.'

The operative words here are, *'reasonable'* and *'miserly'*, thus colouring the report, being spewed out by TASS, the former, official news agency of the Government of the USSR.

The statements of Ms Chao smacks of sycophantism, in **TARGET**'s opinion, being more of a political statement, veiled behind a suggestion of the erudition of a would-be statistician.

It was unworthy of this lady.

Numbers prove, Ms Chao?

However, notwithstanding that matter, Ms Chao may, also, be partially correct, for a number of very valid reasons, none of which, probably, occurred to the lady at the time that she was penning her support for her *'Chief of Staff'*.

It is accepted that the US economy contracted in the months of February, March and April, and, in the month of May, it could only have been struggling – at best.

Both industrial production and employment contracted, during these months, with retail sales, being weak to pitiful, and with wages, waning almost monthly.

From this lower base, any upward movement, seen in any set of statistics, could be interpreted as being an improvement in the US economy.

And such a movement would be undeniable.

But whether or not one should jump to the conclusion that consumers are upbeat about the US economy is another matter.

The US Government has passed into law, The Jobs and Growth Tax Relief Reconciliation Act (that is the reference, made by Ms Chao in her 3-paragraph interpretation in respect of unemployment in the US).

This new law is expected, near term, to inject about $US200 million into the economy, with another $US200 million for the year 2004.

The essence of the new law is:

1. About 25 million households, those with children, will receive a child credit of up to $US400 per child; and,

2. About 136 million, US families, which pay income taxes, including 23 million small businesses, which pay taxes at the individual rate, will see their tax load lightened, somewhat.

(For more on this subject, please refer to TARGET Intelligence Report, Volume V, Number 99, published on May 28, 2003: **THE BUSH BUDGET: A BAND-AID; A COMFORTING BALM; OR, A PANACEA ?**)

It is difficult to believe that such a relatively small amount of money as $US200 million will be sufficient to stimulate the entire US economy, very much, if at all.

One wonders:

(a) How much of that $US200 million is, already, earmarked to pay off some of the debts of Mr and Mrs America? and/or,

(b) Whether or not Mr and Mrs America will determine to save all or part of it, rather than go out for a shopping night on the town.

Without denigrating the good intentions of this new law, it would appear to be much too little an amount of money to make much of an impact on the US economy, other than, perhaps, a psychological impression.

One could equate this situation to a man, going down to the seashore, armed with an empty, one-gallon bucket, and expect that his withdrawal of seawater would make any difference to the height of the next tide.

What the US Government is doing is spending more than it is earning.

And that is called, inflation, no matter how one cuts it.

It is, currently, estimated that, over the next decade, the aggregate US Budget Deficit will approach about $US1 trillion.

The Bill Clinton budget surplus has been replaced by the George W. Bush budget deficit.

The Weaker U.S. Dollar And The Snow Job

Japan is terribly concerned about the weakness of the US dollar, vis-à-vis the yen, because it has an immediate and detrimental effect on Japanese exports of goods and services: Japanese exports become less competitive in the marketplace, the US, being Japan's largest single market for its goods and services.

US retailers don't like to see a weaker US dollar, too, because it cuts into profit margins – from which there is no escape.

The US retailer cannot pass on to consumers the added costs of bringing in similar goods at higher costs, due to the relative weakness of the US currency.

Consumers, in the largest single economy of the world, are extremely price-sensitive because, on the one hand, they have less disposable income than they had just a few years ago and, on the other hand, they do not know, from one month to another, whether or not the chief breadwinner of the family will even be employed.

Investments in the Continental US by non-Americans will, without question, be cut back even further as the US dollar continues to weaken on the foreign exchanges of Europe.

The US Government's **B**ureau of **E**conomic **A**nalysis (BEA), just last week, released statistics, relating to foreign, direct investment in the US, during the year 2002.

What it amounted to was that, in 2002, direct investments by foreign investors in the US was at a 9-year low.

The BEA said, among other things:

> *'In 2002, outlays by foreign direct investors to acquire or establish US businesses fell by more than half for the second consecutive year.*
>
> *'Total outlays were $US52.60 billion, down 64 percent from $US147.10 billion in 2001 and 84 percent below the record $US335.60 billion in 2000, which was the final year of a three-year period of exceptionally high outlays.*
>
> *'As a result of these declines, spending for new investments in 2002 was at the lowest level since 1994.*

Outlays for New Investment in the United States by Foreign Direct Investors, 1980-2002

$US billion

p= Preliminary

> *'The decline in outlays in 2002 reflected continuing weakness in the US economy and in many foreign economies and a fall-off in merger and acquisition activity worldwide. 'New investment may also have been dampened by uncertainty about the value of potential targets for acquisition and their future earnings prospects, due to declines and volatility in the US stock market and a few highly publicised cases of questionable accounting practices.*
>
> *'Outlays fell in all major industry sectors, particularly in finance and insurance, manufacturing, and information. 'The decline was especially severe in finance and insurance, which had maintained high levels of outlays in 2001, even as spending declined in other sectors. 'The decline was also widespread across investing countries. In countries, such as Germany, the United Kingdom, the*

Netherlands, and Japan, which historically have been major sources of investment outlays, weak economic conditions slowed the flow of direct investment into the United States. 'Among major source countries, only France had an increase in investment outlays.

Outlays In 2002

'By industry, outlays were largest in manufacturing ($US17.30 billion) and information ($US14.20 billion). 'Within the information sector, outlays increased substantially in motion pictures and sound recording, while outlays in broadcasting and telecommunications declined sharply, from $US15.50 billion in 2001 to $US2.40 billion in 2002 ...

'By country of ultimate beneficial owner, France and the United Kingdom had the largest outlays in 2002, together accounting for over half of the total. 'Outlays by investors from France increased to $US15.60 billion from $US5.80 billion in 2001, while outlays by investors from the United Kingdom fell to $US13.00 billion from $US17.10 billion in 2001 ... '

'In the Asia and Pacific region, Japan ($US3.40 billion) was the largest source of investment outlays, followed by Australia ($US1.70 billion) ...'.

International investors, considering the US as a potential target for their investment dollars, will take into consideration the foreign exchange translation risk, now, because the US dollar has been seen to be depreciating in terms of most other *'hard'* currencies, and the euro, especially.

Further, senior officials of the US Government have applauded the US dollar's de facto depreciation on foreign currency exchange markets, with Secretary of Treasury, Mr John Snow, going on record as saying that it was good for what ails the US economy.

Then, just last Sunday, Secretary of Treasury John Snow, in an interview in Washington, D.C., said that recently enacted tax cuts would lead to a more vibrant economy and an improving employment picture by the fourth quarter of this year.

He said:

'We are going to see the jobless improve. We're going to see people, going back to work.

'We're going to see higher growth rates. We're going to see a more vibrant economy.

'And we're going to see it by the fourth quarter of this year.'

'We're in a recovery, but it's too slow, not robust enough, and it's leaving too many people behind ...'.

Commenting on The Jobs and Growth Tax Relief Reconciliation Act, Mr Snow said that the $US350 billion, 10-year package of tax relief would assist in the recovery of the US economy by putting more disposable income into consumers' pockets.

He, also, said that the new law should boost the stock market:

'Lowering the tax on investments is going to increase the returns in the stock market and (it) *is going to help boost the stock market.*

'In fact, I think we're already seeing some effects of that.'

While the libretto of Mr Snow was somewhat different to that of Ms Chao, there is a similarity in the continuous, unified, and evocative composition of the melodies of both US Government servants.

Talk is one thing; action is another: Unless higher yields can be offered by US manufacturers/businesses in order to attract investment dollars from across the *'pond'*, known as the Atlantic Ocean, they are not going to be successful.

And that will be a difficult task, considering the present state of the US economy and the perception that eurozone has of it, irrespective of waffling statements of Ms Chao and Mr Snow.

<u>Gross Domestic Product</u>

Turning, now, to the first quarter of this year and looking at the Real **G**ross **D**omestic **P**roduct (GDP) – the output of goods and services, produced by labour and property, located in the US – it is seen to have increased at an annual rate of 1.90 percent, according to the BEA.

The major contributors to the increase in real GDP in the first quarter of this year were personal consumption expenditures and residential fixed investment.

The contributions of these components were partly offset by negative contributions from equipment and software and from private inventory investment.

Imports, which are a subtraction in the calculation of GDP, decreased.

The BEA, then, went on to give the following details (**TARGET** has edited this, violently, in order to make it more readable to the non-economists among us):

> *'The small acceleration in real GDP growth in the first quarter primarily reflected a downturn in imports, a smaller decrease in exports, an upturn in non-residential structures, and an acceleration in PCE that were partly offset by a downturn in equipment and software, a deceleration in government spending, and a downturn in private inventory investment…*
>
> *'Real personal consumption expenditures increased 2.00 percent in the first quarter, compared with an increase of 1.70 percent in the fourth.*
>
> *'Real non-residential fixed investment decreased 4.80 percent, in contrast to an increase of 2.30 percent.*
>
> *'Non-residential structures increased 0.40 percent, in contrast to a decrease of 9.90 percent.*
>
> *'Equipment and software decreased 6.30 percent, in contrast to an increase of 6.20 percent.*
>
> *'Real residential fixed investment increased 11.00 percent, compared with an increase of 9.40 percent.*
>
> *'Real exports of goods and services decreased 1.40 percent in the first quarter, compared with a decrease of 5.80 percent in the fourth.*
>
> *'Real imports of goods and services decreased 7.10 percent, in contrast to an increase of 7.40 percent …'.*

<u>Another Indicator</u>

Last week, there was a bit of excitement in respect of the release of **I**nstitute of **S**upply **M**anagement (ISM) Index for the month of May.

This Index had increased by about 8.81 percentile points, from the April 3 figure of 45.40 points to the May 3 figure of 49.40 points.

What seemed to have been forgotten by the release of this Index was that manufacturing in the US is continuing to contract, but at a seemingly slower pace than in the previous few months.

Manufacturing continues to recede: Down is down; down is not up.

The ISM findings mean, in a nutshell, that US manufacturers are continuing to have no trouble in meeting current demands for products, but the problem is: How to beef up demand?

Correlating the US unemployment rate with the ISM Index suggests, not strength for the US economy, but continued weakness.

On a graph, plotting the movement of the ISM Index would suggest that there is the start (and only a start, mind you) of a flattening out of one of the coordinates of the graph.

No firm conclusions may be drawn from the release of the results of this Index, in **TARGET**'s opinion.

So, dream away.

However, with the US dollar, continuing to weaken against other *'hard'* currencies, it is quite likely that many US manufacturers may expect to receive some enquiries from overseas prospects for their goods and services.

Whether or not these enquiries will be translated into cash registers, ringing up orders, remains to be seen.

For More About The U.S. Economy, Please See:

TARGET Intelligence Report, Volume V, Number 104, Published On June 4, 2003

-- E N D --

While TARGET makes every attempt to ensure accuracy of all data published, TARGET cannot be held responsible for any errors and/or omissions.