THE U.S. ECONOMY CONTINUES TO STRUGGLE: <u>LOWER INTEREST RATES MAY NOT HELP</u>

The **U**nited **S**tates (US) faces another crucial test because, while the Federal Reserve Board may set the pace for lower, short-term interest rates, lower that is from the present, 45-year, record-low levels, such a move may well bite the ass of The Fed's Chairman, Dr Alan Greenspan.

Lower interest rates in the US will, most likely, result in international investors, turning to eurozone currencies in order to park their short-term investment cash because interest rates in that part of the world are relatively higher than in the US.

Further, as the flight of investment capital from the US accelerates and the US dollar, on the international marketplace, depreciates against other *'hard'* currencies, such as the euro, so it places stress on any suggested improvement in the economy of the US.

A weak US dollar, vis-à-vis the euro, the Japanese yen, etc, means that US importers will, effectively, have to pay more for their raw materials and energy requirements, thus eroding profit margins.

Such increased costs cannot be passed on to US consumers, who are, already, very cost-conscious, in any event.

A weaker US dollar on the international marketplace will come at a high cost to the economy, in many instances.

At the same time, it will make US-produced goods more acceptable on the international marketplace because of their new price differentials, brought about by further weaknesses of the US dollar.

Weighing up the pros and cons, it may well turn out that there are more cons than pros as the US dollar loses some of its shine, overseas.

However, there is little chance that the US will ever lose its standing as the international currency of choice, the currency by which one may set standards in terms of other *'hard'* currencies.

The Fed has to be concerned about deflation: It faces a dilemma, of sorts, there, also.

If the US economy is said to be on the eve of a recovery (and **TARGET** does not subscribe to this suggestion), further mini-reductions in interest rates will have the effect of broadcasting to investors that, in fact, something must be done in order to keep the economy's momentum moving in the right direction.

If The Fed reduces interest rates too much too quickly, then, it will send entirely the wrong message to investors and, in addition, it hamstrings The Fed because it reduces the number of weapons at its disposal if needs be in the near future.

At the **F**ederal **O**pen **M**arket **C**ommittee Meeting (FOMC) of May 6, it concluded with this statement:

> *'The Federal Open Market Committee decided to keep its target for the federal funds rate unchanged at 1-1/4 percent.*

'Recent readings on production and employment, though mostly reflecting decisions made before the conclusion of hostilities, have proven disappointing.

'However, the ebbing of geopolitical tensions has rolled back oil prices, bolstered consumer confidence, and strengthened debt and equity markets. These developments, along with the accommodative stance of monetary policy and ongoing growth in productivity, should foster an improving economic climate over time.

'Although the timing and extent of that improvement remain uncertain, the Committee perceives that over the next few quarters the upside and downside risks to the attainment of sustainable growth are roughly equal. In contrast, over the same period, the probability of an unwelcome substantial fall in inflation, though minor, exceeds that of a pickup in inflation from its already low level. The Committee believes that, taken together, the balance of risks to achieving its goals is weighted toward weakness over the foreseeable future.'

The Labour Market In The US

The labour market in the US remains in a quite dangerous state, with Initial Claims for Unemployment Insurance, coming in at about 421,000 Claims for the week, ended June 14.

While that figure was an improvement, Week-on-Week, of about 13,000 Claims, the 4-Week Moving Average was, still, running at about 432,000 Claims, which was only about 3,000 Claims less, compared with the 4-Week Moving Average, as calculated as at June 7.

Employers in the US continue to look for methods to reduce recurrent costs rather than considering new hirings or expanding production facilities.

As such, continuing Claims for Unemployment Insurance are being maintained at a 2-decade high.

Further, with the passing of each week, many of the unemployed in The Land of The Free and The Home of The Brave are exhausting their entitlements with regard to Unemployment Insurance benefits, thus presenting a statistical picture, which may distort initial appearances.

In short, a fall in the number of Initial Unemployment Insurance Claims may, in large part, be due to attrition, rather than members of the armies of the unemployed, being able to find jobs.

Employers in the US are continuing to experience weak demand for their products, both domestically and internationally, and, as such, they cannot see their way clear to increase staff levels.

And, as the US dollar weakens against the euro and the Japanese yen, etc, it places further pressure on the economy, in general.

This could well lead to more staff cutbacks by US producers in the near term, thus reversing the direction of the economy, which one saw for the week, ended June 14.

For many US corporations that decided a year or so ago to reduce staff levels, they have learned that, by employing more stringent measures at the workplace, they have become more efficient, with manpower wastage, having been reduced, considerably.

As such, the layoffs of the past year or so may well turn out to be permanent:

'Don't call us, we'll call you.'

As long as the labour market in the US remains moribund, the economy of the world's only superpower is going nowhere – very fast.

Net job creation is the key to a sustained turnabout in the US economy.

And, in the words of any Christian, God-lovin' Texan: *'It ain't thar yet.'*

The US Bureau of Economic Analysis (BEA), last Thursday, announced that *'the surplus on services decreased, net of outflows for unilateral current transfers, and the surplus on income fell'* in the fourth quarter of 2002.

The BEA went on to state:

> *'The deficit on goods and services increased to $*(US)*121.6 billion in the first quarter from $*(US)*116.1 billion in the fourth* (quarter).
>
> *'Goods*
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> *'The deficit on goods increased to $*(US)*136.0 billion in the first quarter from $*(US)*132.2 billion in the fourth* (quarter).
>
> *'Goods exports increased to $*(US)*173.3 billion from $*(US)*170.8 billion. Most of the increase was in industrial supplies and materials.*
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> *'Goods imports increased to $*(US) *309.2 billion from $*(US)*303.1 billion. Petroleum imports accounted for three-quarters of the increase. Within nonpetroleum products, increases in nonpetroleum industrial supplies and materials and in consumer goods more than offset decreases in automotive vehicles, parts, and engines and in capital goods.*
>
> *'Services*
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> *'The surplus on services decreased to $*(US)*14.4 billion in the first quarter* (of the 2003 Fiscal Year) *from $*(US)*16.1 billion in the fourth* (quarter).
>
> *'Services receipts decreased to $*(US)*74.6 billion from $*(US)*75.3 billion. Large declines in travel and passenger fares, reflecting concerns about the war in Iraq and the SARS* (**S**evere **A**cute **R**espiratory **S**yndrome) *virus, were partly offset by increases in "other" private services (such as business, professional, and technical services, insurance services, and financial services) and in royalties and license fees.'*

Turning to US-owned assets abroad, the BEA said that they increased $US75.9 billion in the first quarter of this year, compared with an increase of $US44.9 billion in the fourth quarter of 2002.

The BEA, also, pointed out:

> *'Net U.S. purchases of foreign securities were $*(US)*25.8 billion in the first quarter* (of 2003)*, up from $*(US)*5.4 billion in the fourth quarter* (of 2002*). Net U.S. purchases of foreign stocks were $*(US)*33.1 billion, up from $*(US)*12.9 billion. Net U.S. sales of foreign bonds were $*(US)*7.3 billion, down slightly from $*(US)*7.5 billion …'.*

The BEA's statistics speak for themselves and require no **TARGET** interpretation.

Finally, turning to the housing market of the US, due to the fact that interest rates in the US are at 2-decade lows, the housing market is likely to remain buoyant, with housing starts, hitting new 2003 highs.

But there are dangers, even in this bulwark of the economy, as it has been over the past few years.

The market price of bricks and mortar, of course, is based on returns: It is as simple as that.

As long as banks are paying a pittance in interest rates, people with cash will opt to purchase their own homes since dwellings, purchased on the primary market or the secondary market, have the appearance of being affordable in the present climate.

As long as these people can maintain their present levels of income, and interest rates are maintained at close to today's levels, everything is hunky-dory.

But, in the event that there is a violent shift to higher interest rates or, in the more likely scenario of the chief bread-winners, losing their source of income, due to further cutbacks in the workplace, then, bankruptcies could well swell to new historic highs.

And, this is likely to result in further corporate failures in the fullness of time.

In conclusion, therefore: The situation in respect of the US economy is not clear and The Fed's interim measures may not be the medicine to cure that which ails the US economy of today.

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