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## America's recovery is not what it seems

By Kurt Richebacher

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American economic recovery is the world's great hope. So there was widespread satisfaction when the US Commerce Department last week revised its estimate of annual growth in the second quarter to 3.1 per cent, up from an earlier estimate of 2.4 per cent. A closer look at the numbers, however, tells a somewhat gloomier story.

Much of the growth in gross domestic product is due to a big jump in defence spending, which provided \$40.6bn of the reported GDP growth of \$73.1bn. Yet while the commerce

department and some media reports noted that defence spending had risen by 44 per cent at an annual rate, many commentators failed to mention its role in raising GDP growth. All too often nowadays, new economic data are examined with a single question in mind: are they better than expected? Close analysis with a longer-term perspective is in short supply.

Still, the commerce department report seemed to contain good news on capital investment. "Real non-residential fixed investment increased 6.9 per cent in the second quarter, in contrast to a decrease of 4.4 per cent in the first," it said. "Non-residential structures increased 4.8 per cent, in contrast to a decrease of 2.9 per cent. Equipment and software increased by 7.5 per cent, in contrast to a decrease of 4.8 per cent. Real residential fixed investment increased 6 per cent, compared with an increase of 10.1 per cent." These numbers suggest a vigorous turn in capital spending. However, their strength owes a lot to the singular US habit of annualising many figures. Quarterly data, in other words, are about four times the reality that would be reported in other countries.

So what exactly did happen in the private sector? Consumption increased by \$62.5bn and business fixed investment - vital for a robust, self-sustaining recovery - by \$22.4bn.

A single component of business fixed investment accounted for more than its overall increase. Investment in computers soared by \$38.4bn, or 12 per cent, from \$319.1bn to \$357.5bn.

The trouble is that much of this boom-like increase in computer investment never occurred. The apparent surge is a consequence of the hedonic deflator that US government statisticians use when measuring computer output and investment. The aim is to capture quality improvements by calculating how much it would have cost in 1996 to buy a computer of equivalent power to today's machines.


Measured in current dollars, however, this spending rose a lacklustre \$6.3bn, from \$76.3bn in the previous quarter to \$82.6bn - far below previous peak levels. In other words, hedonic pricing produced \$32.1bn of GDP in real terms, about 43.9 per cent of the reported second-quarter GDP increase of \$73.1bn. In its absence, GDP would have grown a mere \$41bn, implying a growth rate of 1.68 per cent. The important thing about hedonic pricing is that it measures dollars that nobody pays and nobody receives. And it grossly distorts international comparisons.

Recessions and times of slow growth are when businesses and consumers normally

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retrench, correcting boom-time spending excesses. A full-scale recovery, in turn, requires the economy's return to a sustainable pattern of consumption, investment and saving.

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None of these adjustments is happening in the US. Alan Greenspan, the Federal Reserve chairman, has been fighting the consequences of excessive monetary looseness with still more of the same. Inevitably, economic and financial fundamentals, such as profits, national savings, debt levels, balance sheets and the trade deficit, continue to deteriorate across the board.

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Profits, as calculated in the GDP and income accounts, are down again. Total before-tax profits were \$591.5bn in the second quarter, compared with \$621.6bn in the first quarter. Non-financial profits were \$359.2bn, after \$391.3bn in the first quarter. As dividends are rising while profits fall, credit-financed dividends have soared in the non-financial sector to \$102.8bn.

The private sector's strength derived completely from bubble-driven consumer spending. But that bubble has been pricked by the sharp rise in long-term interest rates. Mortgage re-financing activity is falling sharply.

Mr Greenspan has turned bubble creation into a virtue. In days of yore, asset prices were viewed as a by-product of underlying economic conditions. Now, by contrast, the real economy is heavily dependent on asset inflation to fuel borrowing and spending. These conditions are more favourable to recession than to recovery.

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