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UNITED STATES ECONOMIC OUTLOOK

Quarterly Developments

U.S. ECONOMIC OUTLOOK

The U.S. economy is expanding at a significant pace this year, boosted by an increase in inventory investment. Since inventories had been drawn down significantly last year, it was already anticipated that a reduction in the rate of inventory liquidation would induce a rise in industrial output even if final demand did not kick in. However, unless demand strengthens before the effects of inventory replenishment evaporate, the upswing will likely be short-lived.

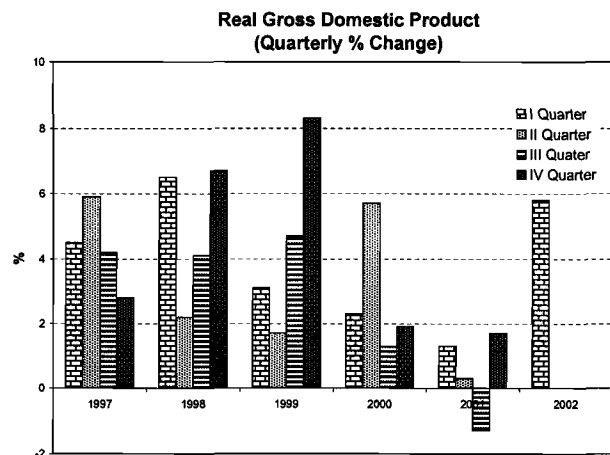
The potential for a significant boost to economic activity relies above all on business spending, which declined considerably in 2001 and remains tame so far this year. The strength of the anticipated recovery of investment remains uncertain and clouded by stock market developments in the wake of corporate scandals and a falling dollar. Stock prices have been falling, hurting both consumer and business confidence, and if the fall in the dollar leads investors from abroad to stop putting their money into stocks and bonds in the United States—as is observed in the latest data—interest rates should rise and stock prices could fall further.

With demand sluggish, job growth meager, no risk of inflation and the stock market in a prolonged gloominess, the Federal Reserve on its last June meeting decided to keep interest rates at their current level of 1.75%

I. CURRENT ASSESSMENT

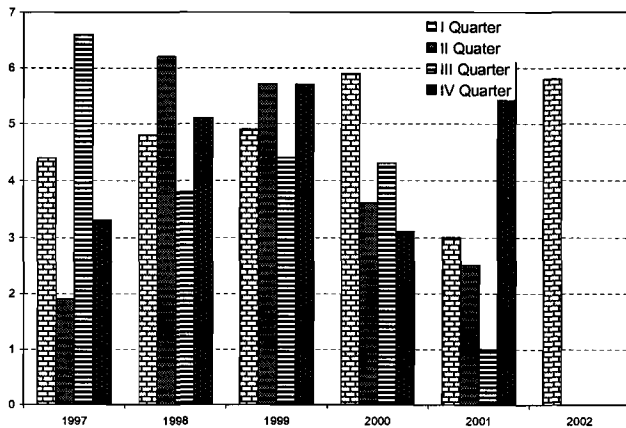
- **GDP growth**

The U.S. economy expanded at an annual rate of 6.1 % in the first quarter of 2002, the fastest pace since the fourth quarter of 1999. The main source was a slowdown in inventory liquidation, which accounted for 3.5% of the 6.1% first quarter increase. Final sales—which exclude inventories—were also strong, signaling greater underlying strength in the economy than expected. Consumer spending continued to drive final



sales, growing at 3.3%. Businesses, on the other hand, continued to cut spending although at a slower pace. Businesses cut spending by 6.2%. Structures investment fell at a 23.8% rate, and equipment and software spending rose but by a meager 0.1%. Government spending rose by 6.7%, mainly due to an increase of 19.6% in defense expenditures.

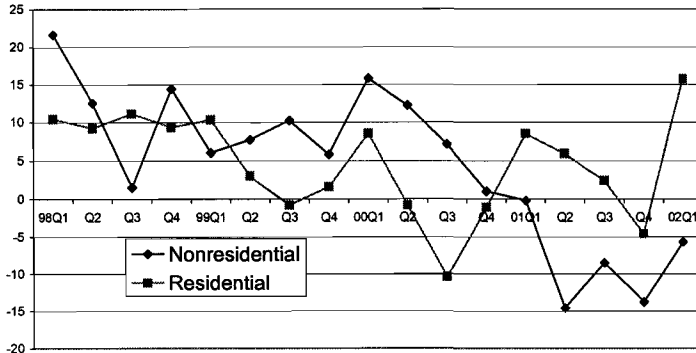
Personal Consumption Expenditures (Quarterly % Change)



Imports grew at a much higher rate than exports, 12.3% 5.3% respectively. Growth in both exports and imports was

the first for five quarters, indicating that both the domestic and the global economy have improved.

**Gross Private Domestic Investment
(Quarterly % Change)**



The long-awaited rebound on business spending could be approaching, according to the business-spending index, compiled by G7 Group Inc.. For this index, any reading less than minus 35 indicates contraction in investment, a reading between zero and minus 35 indicates growth and results greater than zero indicate above-average business investment. The preliminary index in the second quarter of 2002, registered a minus five, a 62-

point increase over the previous quarter. If the index turns out to be accurate, the recovery lead by consumer spending and slow down of inventory liquidation could evolve into a strong and long-lasting rebound.

• **Sectoral Developments**

Industrial production has increased for five consecutive months this year and the industrial component of the economy is on a solid footing after a year and a half of decline. After a contraction of nearly 8% from its peak production level, manufacturing output was up 0.3% in April and 0.2% in May. Fifteen of the twenty industries that make up manufacturing reported an increase in production in May.

Moreover, at 53.9% the “National Association of Purchasing Manager (NAPM)” index of manufacturing activity is well above the 50% level that indicates an expansion. Almost all of the components of the ISM index are now registering expansion.

Meanwhile, inventories continue to fall suggesting that production will continue to increase in the coming months.

Capacity utilization has increased significantly during this year. Although at 75.5% it is still below the rate of utilization of a year ago --in March 2001 capacity use was 78.5%-- it has

Industrial Outlook

2000/2001	Total Industrial Production		Capacity Utilization Rate (%)
	Index 1992=100	Percentage Change From Previous Month	Total Industry
2001			
January	143.9	-0.8	79.3
February	143.5	-0.3	78.9
March	142.9	-0.4	78.5
2001 Q1	143.4		78.9
April	142.0	-0.6	77.8
May	141.6	-0.3	77.5
June	140.3	-0.9	76.7
2001 Q2	141.3		77.3
July	140.4	0.1	76.7
August	140.0	-0.3	76.4
September	138.5	-1.1	75.5
2001 Q3	139.6		76.2
October	137.7	-0.6	75.0
November	137.2	-0.3	74.7
December	136.7	-0.4	74.4
2001 Q4	137.2		74.7
2002			
January	137.4	0.5	74.7
February	137.9	0.3	74.9
March	138.8	0.7	75.4
2002 Q1	138.0		75.0

reached the September 2001 level. This rate of capacity utilization is still low enough to avoid all supply bottlenecks and limited inflationary pressures from the industrial component of the economy.

- **Labor markets**



The expected rebound of the labor market is taking longer than anticipated. While the economy has been in recovery since January, the labor market figures have been disappointing. There has been only one month of job growth this year, new unemployment claims remain high, and the unemployment rate rose to 6% in April, the highest rate since January 1994 though still well below the 7.8% rate observed during the 1990-91 recession. The rise in the unemployment rate was entirely due to a large increase in the labor force participation.

On a positive note, manufacturing losses continue to get smaller. Manufacturing payrolls shrank by just 19,000, down from 38,000 and 54,000 in March and February respectively. In addition, services producing payrolls are rising at an accelerating pace; contributing 134,000 in gains compared to a combined 89,000 in February and March. The gains were virtually all due to retail and private service payrolls rather than government, suggesting strengthening in the private service economy. Also, temporary employment increased by 52,000 in April following a 69,000 gain in March and losses averaging 51,500 monthly during the second half of 2001. Temporary workers tend to be the first fired in a downturn and the first hired in an upswing.

Productivity and costs: Preliminary first-quarter 2002 measures
(Seasonally adjusted annual rates)

Sector	Productivity	Output	Hours	Hourly compensation	Real hourly compensation	Unit labor costs
Percent change from preceding quarter						
Business	8.5	6.5	-1.8	2.8	1.3	-5.3
Nonfarm business	8.6	6.5	-1.9	2.7	1.2	-5.4
Manufacturing	9.7	3.2	-5.9	2.5	1.1	-6.5
Durable	13.3	5.0	-7.3	2.0	0.6	-9.9
Nondurable	5.1	1.2	-3.7	3.9	2.4	-1.1

Productivity of U.S. workers in the non-farm business sector rose at a seasonally adjusted annual rate of 8.4% in the first quarter, the fastest pace in nearly two decades. However, quarterly productivity estimates tend to bounce around sharply from quarter to quarter. Productivity usually soars when the economy is just pulling out of a slump, because payrolls have been cut and companies are sitting with underused factories they can rev up to meet any increase in demand. Hours worked fell by 2.1%.

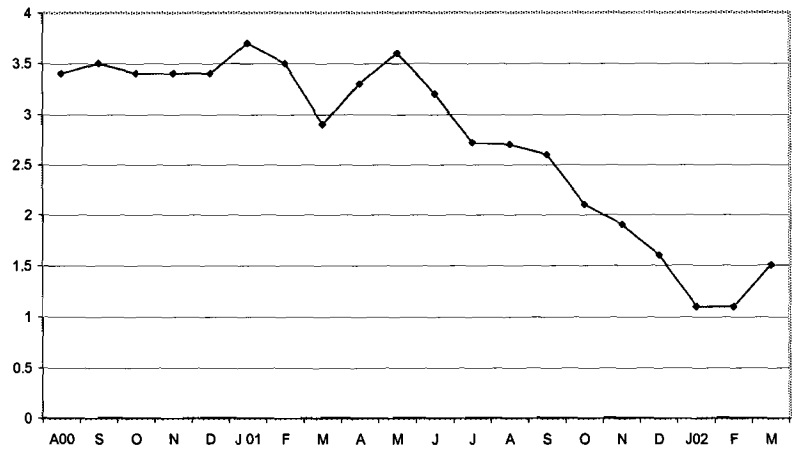
- **Inflation**

The Consumer Price Index (CPI) rose by 1.24% since last December, reversing the three-month falling course observed in the last quarter of 2001. For the twelve months ended in May, consumer prices rose 1.2 %.

Higher gasoline prices explain much of the increase in the CPI. After a four-month consecutive rise, gasoline prices fell in May by 2.8%. Gasoline prices had risen by 2.7% in January and by 0.4% in February, 8.7% in March and 10.6% in April.

Inflation is still low enough for the Federal Reserve to be able to concentrate on a recovery in output and employment without feeling the pressure of an imminent price spike.

Evolution of Domestic Prices
(CPI % Change over 12 months)



- **Monetary policy**

In its June meeting, the Federal Open Market Committee (FOMC) decided to hold monetary policy unchanged, as it had done in its late March and May meetings. The Fed had lowered the fund rate target eleven times during a one-year period to its current level of 1.75% -- the lowest in 40 years. Nonetheless, monetary policy continues to be highly stimulatory; the real federal funds rate is negative and money supply is growing at a much faster pace. M2 and M3 are currently expanding at close to a double-digit year-over-year pace, the strongest growth since the early 1980s.

Fed officials keep citing the importance of job growth to sustain resilient consumer spending and of profit gains to stimulate businesses' spending that has remained dormant since last year. If investment does increase strongly, as the latest indicators are suggesting, the Fed would probably be more confident about the economic outlook and an interest rate hike is more likely. Also, the fact that companies are starting to increase capital spending raises the possibility that they also will become a little more willing to increase employment. If reality does not fulfill the expectations, the Federal Reserve will be in no hurry to change the status quo. A further lowering of the rates, however, seems to be highly unlikely.

• **Financial Markets**

Stock Market

	Dow Jones Industrial Average	S&P 500	Nasdaq
1998	8,625.52	1,085.50	1,794.91
1999	10,464.88	1,327.33	2,728.15
2000	10,734.90	1,427.22	3,783.67
2001	10189.13	1194.18	2035.00
January	10,682.74	1,335.63	2,656.86
February	10,774.57	1,305.75	2,449.57
March	10,081.32	1,185.85	1,986.66
April	10,234.52	1,189.84	1,933.93
May	11,004.96	1,270.37	2,181.13
June	10,767.20	1,238.71	2,112.05
July	10,444.50	1,204.45	2,033.98
August	10,314.68	1,178.51	1,929.71
September	9,042.56	1,044.64	1,573.31
October	9,220.75	1,076.59	1,656.43
November	9,721.82	1,129.68	1,870.06
December	9,979.88	1,144.93	1,977.71
2002			
January	9,923.80	1,140.21	1,976.77
February	9,891.05	1,100.67	1,799.92
March	10,500.95	1,153.79	1,863.05
Week ended:			
2002 Mar	10,538.48	1,156.92	1,885.46
16	10,573.96	1,161.43	1,882.22
23	10,524.42	1,158.00	1,862.20
30	10,366.47	1,140.58	1,827.19
6-Apr	10,267.30	1,131.55	1,802.23

20% since the year began.

Treasuries have maintained an upbeat tone even as the economic news improves, simply because the stock market remains resolutely dull. Treasury market currently trades through the prism of equities and how they react to economic data. In addition, stocks are relatively expensive. The S&P 500's price-to-earnings ratio stands at more than 20, compared with 15 in January 1991 and a historical average in the mid-teens. With the S&P 500 already expensive, price-to-earnings ratio will probably not expand further, so stocks will rise only as quickly as profits. And projected earnings gains are too modest to permit stocks to rise more than 8% or 9% this year, an increase below the historical average.

Investors, worried about the extreme swings that have taken place in recent months in the stock

After the events of September 11, investors bid up stocks anticipating that the stimulus package and monetary policy easing would produce a quick economic recovery. Stocks rose again early in the spring when signs of such recovery started to show in several major economic indicators. But a succession of corporate scandals related to corporate accounting and lack of a forecast of solid sales and profit gains for the second half of this year, have been driving the major stock indexes down since March. Clearly the economic numbers continue to show fairly resilient activity in the economy, but company-specific news does not seem to be significant enough to spur a rally. Of particular significance is the increasing reluctance of foreign investors to purchase US securities. The net foreign purchase of US securities totaled US\$ 93.3 billion in the first quarter, compared to US\$ 156 billion in the first quarter of 2001 and to US\$ 166 billion a quarter ago. The S&P 500 is down 9% so far this year and the Nasdaq composite index, which contains most big technology stocks, is down almost

U.S. Treasury Security Yields

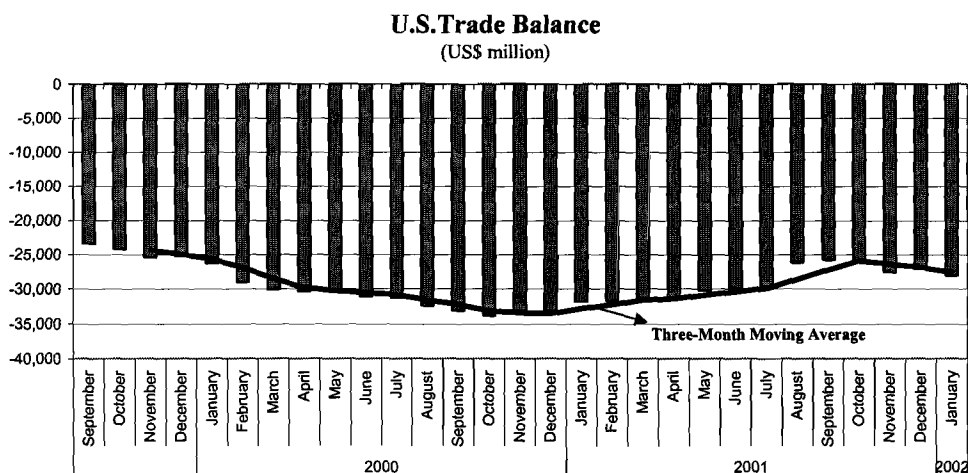
(Percent per annum)

	3-Month Bills (new issues)	Constant maturity 30-year
2001		
January	5.27	5.54
February	4.93	5.45
March	4.5	5.34
April	3.92	5.65
May	3.67	5.78
June	3.48	5.67
July	3.54	5.61
August	3.39	5.48
September	2.87	5.48
October	2.22	5.32
November	1.93	5.12
December	1.72	5.48
2002		
January	1.66	5.45
February	1.73	
March	1.81	
Week ended:		
2002 Mar	1.76	
16	1.83	
23	1.84	
30	1.82	
6-Apr	1.79	

market and the widening of corporate and accounting scandals, are now moving into the more secure bonds and housing markets lowering stock prices even further. Foreign investors who had taken advantage of the higher currency-adjusted rates of return that the U.S. financial markets offered in recent years, are now finding out that U.S. markets are riskier than they thought, selling stocks and consequently driving down the value of the dollar which has gone down by 8% against the yen and 12% against the euro since the beginning of the year.

- **External sector**

The U.S. trade deficit showed a moderate correction in 2001, with the goods and services deficit falling to 3.4% of GDP compared with 3.8% in 2000. While exports contracted for the year as a whole, imports contracted by a faster pace. Services remained in surplus.



As of April 2002, year to date goods and services exports reached \$80.1 billion, a 10.9% decrease from the same period last year. Imports were also down, 7.7% in comparison to previous year and amounting to \$116.0 billion. Agricultural exports totaled \$18.4 billion, while imports reached \$13.8 billion, creating a surplus in Agricultural trade of \$14.0 billion (annual rate).

Trade policy developments

- **Trade Promotion Authority (TPA):** The House of Representatives approved on June 26 a motion to open a conference on the trade package to reconcile the House and Senate trade bills. This conference would include members of the Senate and House to reach a final compromise of the trade bill that includes TPA, the Andean Trade Preference Act and extension of the Generalized System of Preferences (GSP).

- **Andean Trade Preference Act (ATPA):** As part of the TPA package, the Senate approved on May 23rd a five year extension of the ATPA, which has yet to implemented pending the compromise bill between the House and Senate mentioned above. The Andean Trade Preference Act expired in December 2001, and even though the administration had delayed tariff collection until May 16th, 2002, pending a decision on the extension, in the first quarter of 2002, total U.S. imports from ATPA countries decreased 92% from what they amounted to in the first quarter of 2001.

The major differences between the House and Senate version with respect to ATPA are related to market access benefits for apparel, tuna and footwear. Specifically, the House version provides more access for apparel made from regional fabric and provides more flexibility in meeting the criteria to qualify for the regional cap than the Senate version. On tuna and footwear, the House bill would provide unlimited duty-free access while the Senate offers limited market access.

In addition, any new ATPA legislation will likely include language that apparel will qualify for preferences “only if all dyeing, printing and finishing of the fabrics from which the articles are assembled is carried out in the U.S. This is due to the written pledge by the Administration to Congressman De Mint in exchange for his vote in favor of TPA, also included in Caribbean Basin Preference Act (CBTPA).

- **Farm Bill:** On May 13th, 2002, President Bush signed the Farm Security and Rural Investment Act of 2002. This new farm law will add an additional \$51.9 billion over six years to the 1996 Farm Bill baseline. Hence, its total spending reaches \$118.5 billion for the six-year period. According to the White House the subsidies are within WTO limits, which limits U.S. trade distorting spending up to \$19.1 billion a year.

The new farm law alters the farm payment program and introduces counter-cyclical farm income support, expands conservation land retirement programs and emphasizes on-farm environmental practices, relaxes rules to make more borrowers eligible for Federal farm credit assistance, restores food stamp eligibility for legal immigrants, adds various commodities to those requiring country-of-origin labeling and introduces provisions on animal welfare.

According to estimates by the Brazilian Ministry of Agriculture and the Argentine Embassy in Washington, both nations forecast combined losses that will arise from the new law at \$3.9 billion annually, due to a drop in exports caused by the expected price distortions.

Bilateral Trade Negotiations

- **Chile:** On June 13th, U.S. and Chile lead negotiators decided to postpone another round of FTA negotiations, possibly until September. The countries have had high-level technical meetings on sanitary and phytosanitary measures on April 3 – 4 in Washington DC and in

Santiago on April 9 – 12 to discuss market access proposals from both sides, as well as discussions on non-conforming measures related to services and investment.

- **Uruguay:** Presidents Batlle and Bush met in Washington in February 2002 along with USTR Robert Zoellick to discuss the creation of a joint commission on trade and investment. The agreement was signed in April 2002 in Montevideo. Both countries will work toward a bilateral free trade agreement or gradual liberalization toward the Free Trade of the Americas.
- **Central America:** Following President Bush announcement on January 16th, about interest in pursuing a free trade agreement and beginning negotiations, the U.S. and the Central American countries held a series of technical meetings to explore the parameters for an FTA. They are not scheduled to meet again until the fall.

II. LOOKING AHEAD

- While economic activity is expected to moderate from the rapid growth seen in the first quarter, as the initial push from the inventory cycle dissipates, the recovery would be sustained by a rebound of business fixed investment and continued strength in the household sector. Important uncertainties remain, including prospects for corporate profits and investment, the underlying strength of household demand, and the large U.S. current account deficit.
- The latest IMF projections anticipate that the U.S. economy will increase at 2.7% this year.