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US economic outlook for 1973

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end of 1972, and of the consequences of this breakdown of peace negotiations.

Opening of Import Markets

The Eighth Conference of Ministers on Developing South East Asia will take place in Japan in 1973. The invitation to meet in Japan, extended by the Japanese Government, was accepted unanimously. This also means that the Government of Mr Tanaka will have to greet its guests with more generous offers. By his pronouncements about opening the Japanese market for imports and about dismantling the obstacles to trade, Prime Minister Mr Tanaka has underwritten a promissory note which will be presented to him for payment by the governments of South East Asia, though there are doubts whether the Prime Minister will be able to make a breach in the front of Big Business for his new trade policy.

Japan is exporting much to the countries of South East Asia. In 1971, its deliveries to the individual countries of South East Asia reached the following values (in Yen bn): to Indonesia 157.6, to Malaysia 68.1, to Philippines 162.3, to Singapore 177.8, to Thailand 155.5 and to South Vietnam 52.4.

Altogether, South East Asia absorbed Japanese exports equivalent to nearly Yen 775 bn. Relating this overall value to Japanese imports taken by other regions shows the overriding importance of the seven South East Asian countries as outlets for Japanese trade: In 1971, the EEC area absorbed a total value of Yen 570 bn and if the

United Kingdom is added, the result would be about equal to total South East Asian purchases; Latin America took for Yen 553 bn; and Africa for Yen 719 bn, although Liberia's imports must almost wholly be deducted, because they mostly consisted of new ships registered in Liberia but owned by foreign interests. Japan's predominance in South East Asian imports becomes even more striking when the import returns of South East Asian countries are consulted: Japan is far out in front among leading exporters to Singapore, Thailand, Indonesia, Malaysia, the Philippines, but its purchases e.g. from Singapore and Malaysia were only marginal.

Future Outlook

From now on, Japan will be compelled to treat its South East Asian trade outlets with great care, not only in the interest of its exports but also on the import side and in the field of planned investments there. Courting trouble by its political policies and by tactlessness must be avoided by the Japanese Government at all costs, because regionalisation of South East Asia forces Japan to treat this area as the space for its own development, where it must be felt to be an element of cooperation.

Every augury shows that Japan seems to be learning from the errors of its past, including the most recent period, but it has not become obvious, as yet, that Japan's South East Asian partners have accepted the country, without reserve, as their helper and friend.

US Economic Outlook for 1973

by Professor Robert G. Wertheimer, Cambridge, Mass.*

The electorate has spoken — *alea jacta est* — re-electing President Nixon in an old-fashioned landslide for another four years' term. What is to be expected in the internal and external economic sphere during 1973?

The election was won by doubts about the challenger, Senator McGovern, paying tribute to the slow ending of the Vietnam war and the growing speed of the domestic recovery. Popular promises of immediate full employment, rising government spending and a redistribution of income without hurting many sounded too unrealistic. Rising attacks on "favoritism to business" could not sway the impression of inadequacy displayed by the opposing candidate either. In the

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election of the new Congress, however, the Democrats prevailed and while President Nixon will approach this body with a stronger popular mandate than during his first term, most basic domestic and foreign economic decisions will remain in the hands of elected partisan and regional representatives. Looking at the 1972 economic performance now close at hand, a gain in the GNP by \$ 98 bn will be achieved bringing it from the \$ 1,050 bn level in 1971 to \$ 1,148 bn in 1972. Allowing for a price deflator of 3.3 p. c., this total

monetary gain of 9.3 p. c. contains 6 p. c. real gains. At the same time, unemployment remained at the sticky rate of 5.5 p. c., even though employment rose by 2.5 mn during the year.

Unemployment and Inflation

Does the Phillips curve still operate, or has it ever worked claiming the myth of trade-offs between employment and inflation? Actually, opposite trends occurred in 1972; employment in the United States gained 2.5 mn from October 1971 to October 1972, bringing the total to 82.5 mn, while inflation slowed down significantly¹. The fact that the rate of unemployment remained sticky at 5.5 p. c. in 1972 is as much a consequence of the end of the Vietnam War² and demographic causes as the result of the fight against inflation (some economists argue, incidentally, that inflation would have equally declined without any price controls in operation). As to the ability of the economy to create more jobs and to reduce unemployment below the current rate, an addition of at least 1.2 mn workers to the payrolls and a reduction of the average rate of unemployment to 4.8 p. c. in 1973 should be expected (with the low of 4.5 p. c. in autumn).

Price and wage controls, instituted on August 15, 1971, were well received by the consumer, the business community and many labor groups. Surprisingly, they will not be continued in one form or another as Phase III beyond their scheduled expiration *date of April 30, 1973*. Wage increase standards now in operation are built around 5.5 p.c. While labor is bound to press for higher wage gains than the average of 6.3 p.c. received in 1972, arguing that the economy can afford it due to prosperity, larger gains in productivity and rising profits, Chairman Burns of the Federal Reserve System, fearful of the resumption of faster inflation rate, would prefer an average 4 p. c. wage growth rate. In general rising inflation pressures should be expected, reflecting the increasing business tempo, though non-farm unit labor costs which increased by 6 to 7 p.c. annually in recent years have become stabilized recently indicative of larger productivity gains.

Trends in the Monetary Sector

The Federal Reserve Bank of St. Louis, the Friedman stronghold, considers the below 4 p. c. inflation rate of 1972 consistent with, if not the result of, the reasonable growth rate of the money

¹ For 1972, consumer prices are expected to run 3.4 p.c. above 1971; the cost of living by 3.5 p.c. and the deflator by 3.3 p.c.

² The reduction in military employment and war production workers as related to Vietnam accounted for 1.5 mn men seeking work. Above average entries into the labor force reflecting the unusual population boom in the immediate post-war period account for another 700,000 persons looking for work in excess of the long-range averages in the last decade.

supply at 7 p.c. and recommends similar or tighter policies to maintain stabilization. The outlook indeed is for a less liberal monetary policy as the economy swings into higher gear. Despite this, according to general consensus of bankers and Federal Reserve officials "pressures on the credit market next year will not be unusually intense" and long-term interest rates should not differ much from current ones, though they may rise moderately. While ample financing is available for mortgage and consumer credit and business expansion and inventory needs, some doubts were raised at first about the plus \$ 20 bn financing of the Federal fiscal deficit 1973. However, the maintenance of a satisfactory personal savings rate and rising cash flows of corporations together with ample bank credit should furnish sufficient funds for all needs.

So far in 1972, the stock market has shown a restrained performance even though it pierced the magic 1,000 Dow-Jones industrial average. Still, with the low of the year at 889 and the high on December 2, at 1,025, the range of about 15 p. c. is moderate by traditional standards. The fundamentals of the market are sound, based on 63-64 \$ share earnings of the Dow-Jones equivalent to a non-excessive price-earnings ratio of 16.3, a moderate degree of margin speculation and a rising emphasis on peace stocks and cyclicals. The certainty of peace in the near future, the removal of election-related uncertainties with the promise of a continuation of familiar patterns of domestic and foreign policies and the slowing down of inflation triggered the recent market improvement by 100 points. Hence, the usual reaction to the ending of wars in stimulating stock prices to rise promptly has come true.

Stock Market Preview

What of 1973 for the market? Corporate profits after taxes are expected to gain another 13 p. c., reaching about \$ 55 bn, inflation seems to be under control and no money crunch is in the making. These favorable aspects are being reinforced by the determination of the Government to check any new wave of inflation. However, according to monetary econometric models the future of the stock market more than usual will be in the hands of the monetary authority since major changes in monetary policy have a large impact on stock price movements. Hence, in case of a renewed threat of inflation, strong anti-inflationary restrictive monetary policies could hurt the market. As extraneous possibility, an international financial crisis could also bring distress. But even if inflation should simmer down beyond expectations, the market might be affected negatively. In such atmosphere, investors may be en-

couraged to switch from investments in highly-priced low-yielding stocks (dividend yields averaging 3 p.c. of stock market prices) in a bull market reaching maturity to safe bonds yielding 7 to 8 p.c. Finally, a dramatic upward move in the interest rate — for whatever reasons — could be detrimental. Allowing for this variety of factors capable of triggering a downward adjustment, market swings between highs and lows might return to their customary range of say 30 p.c. (the average range being 37 p.c. over time) shifting the market between a high of 1,100 and a low of 820.

Government and International Sector

Federal Government spending proposes a "hold the line" concept, keeping it at \$ 250 bn for 1973. Tax revenues in the same period are expected to run at \$ 228 bn, leaving a not too uncomfortable deficit of another \$ 22 bn (after 1972) which can be financed easily³. While spending for fiscal 1974 is to expand by no more than 6 to 7 p.c. current fiscal spending is expanding at a rate of 8 p.c. down from the 9.5 p.c. of the preceding year. Actually, during the four years of the Nixon Administration, Federal budget spending increased from \$ 185 bn in fiscal 1969 to \$ 250 bn currently, total deficits to the tune of \$ 75 bn occurred and the ratios of defense to welfare spending of one-half to one-third of the budget were reversed⁴. The Administration finally achieved the channelling of 4 p.c. of budget spending into the Revenue Sharing Plan in addition to customary-grants to States and localities (of \$ 40 bn this year), but failed in the plan to consolidate a family assistance program. In view of the visible gains of the private economy, the Federal Government is embarking on a hands-off "economy drive" which, while obviously not economising spending, will curtail Federal job opportunities. State and local spending is expected to increase by another 10 p.c., but for the first time in years a surplus of \$ 10 bn is in the making.

The international sector is expected to show an improved basic balance, even though a reversal of the trade balance deficit responding to the dollar devaluation and upvaluations of other currencies will be slow in coming. The more prosperous American economy, however, will avoid the usual consequences of such cyclical improvement of letting exports grow more slowly and increase its propensity to import. In the financial

³ Corresponding to a deficit of 12 bn on the basis of the so-called "full employment budget" (that is setting the level of actual spending on the basis of tax revenues a fully employed economy would produce).

⁴ For fiscal 1973, defense spending will amount to 37 p.c. of the total budget, but in absolute terms it still will run in the high \$ 70 bn range. Of this, Vietnam spending will account for \$ 5 to 6 bn.

sector of the balance, rising foreign capital inflows for the purchase of U. S. stocks and tangible assets should be expected while capital exports for direct investment in affiliates might be slowing down even without the threat of the Burke-Hartke Bill⁵. In summary, the dollar should be able to keep its stability within the widened par exchange ratios, but any failure of improved international financial cooperation could push the panic button and turn the 75 bn liquid dollar liabilities held abroad into a speculative free-for-all tumble.

Conclusions

The strong economic performance in 1972 achieving a GNP of \$ 1,148 bn, equal to a gain of \$ 98 bn over 1971, a money gain of a total of 9.3 p.c. and real gains of 6 p.c.⁶ allowing for 3.5 p.c. inflation, is expected to be followed by the banner year 1973. Gains of additional \$ 112 bn are expected, raising the 1973 GNP to \$ 1,260 bn with a rate of gain of 9.7 p.c. in money terms and a real gain of 6.2 p.c. allowing for an inflation factor of 3.5 p.c. The current rate of unemployment of 5.5 p.c. is expected to decline moderately below 5 p.c.⁷. Credit flows will remain sufficient but not cheap, though excesses in such costs may find the administration ready to impose restraints on interest rates. Long-term money rates are expected to average below 8 p.c., but short-term rates will move above their present levels of 5 p.c. While the stock market remains "bewitched" by historic precedents of poor markets in the first of reelection years the fundamentals in terms of profits, price-earning ratios and restrained speculation should remain sound. Only massive wage pressures after April 30, 1973 or an international dollar panic could depress the market.

Thus business activity in 1973 will gradually close the gap between actual and potential performance. It can be expected that the economy will move very close to full employment in 1974 (at that stage, the maintainable real growth rate will not exceed 4.5 p.c.), while then facing rising interest rates, inflation pressures and increased taxes.

⁵ While the "what to do about rising imports" argument is heating up, decreasing unemployment or at least gains in employment will keep it under control. There is little chance that the Burke-Hartke Bill might become law at any time. Even though some of its sections bearing upon the financial flows of subsidiaries might be attached as riders to other bills likely of passage. The main thrust would be to tax profits of subsidiaries without credit for taxes paid abroad in the year in which they are earned and to disallow fast write-offs.

⁶ Made possible by a 3.6 p.c. gain in overall productivity, a gain of 2.3 mn in employment, a slightly longer work week and more overtime.

⁷ Under the assumption of a full employment economy, defined at the rate of 4 p.c. unemployment, the present unemployment gap is 1.2 mn. As we register 4.8 mn unemployed, the remaining inactive numbering 3.6 mn consist of frictional unemployment, people changing jobs, some who prefer public support to small income earned by employment, and a large number of unemployables. The Chairman of the Council of Economic Advisors on October 26, 1972, projected a jobless rate of 4.5 p.c. or below by the end of 1973.