

The gloom about America's economy is overdone

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As US growth has slowed, pessimists (once again) have convinced themselves that the oft-predicted demise of the American economy is upon us. Neither recent data nor longer-run trends support this view.

To begin with, in the past decade the resilience of the US economy in the face of repeated shocks has been remarkable. The shocks have included the emerging markets crisis, the meltdown of Long-Term Capital Management, the worst bear market since the Great Depression, one of the worst terrorist attacks in history, corporate scandals, war, hurricanes and record high oil prices. Now, the worst housing recession since the late 1980s does not seem to be dragging down the rest of the economy.

A hard landing of the US economy has been - incorrectly - predicted for more than 20 years. The usual retort by pessimists is that "we ain't seen nothing yet". They point to worsening private and public sector finances as evidence. However, seen in an international context, American finances are unremarkable.

Let us start with the negative US saving rate. The situation is far from unique. Saving rates are more negative in Finland, Denmark and Australia. Since the mid-1980s, rates of saving have fallen even more dramatically in countries such as Italy, Japan, Canada, South Korea and Australia.

What about the indebtedness of much-maligned US consumers? According to data from the Organisation for Economic Co-operation and Development, the ratio of household liabilities to after-tax income is about 130 per cent in the US compared with 155 per cent in the UK, 130 in Japan and Canada and 110 in Germany. US households are in no more trouble than households in many other countries.

So, is US public sector "profligacy" a vulnerability? In 2006 the US budget deficit is expected to have been 1.9 per cent of gross domestic product compared with 2.1 per cent for the eurozone, 3 for the UK and 4.6 for Japan.

Similarly, gross government liabilities as a share of GDP were about 65 per cent compared with 50 per cent for the UK, 63 for Canada, 77 for the eurozone and 175 per cent for Japan. The US fiscal situation is better than the Group of Seven average.

However, there is a problem - the US current account deficit. At about 6.5 per cent of GDP, it is much larger than in any other advanced economy except Spain. While most economists would agree that this deficit is unsustainable at current levels, it too needs to be kept in perspective.

First, a number of smaller countries (such as Australia, New Zealand, Canada and Spain) have run persistent external deficits without running into trouble. Second, at about 20 per cent of GDP, the external debt of the US (usually equal to the accumulation of current account deficits) is not that large and has been remarkably stable for the past four years.

Analysts who continue to believe that private and public sector debt in the US is the ultimate source of today's global imbalances need to explain why Japan runs persistent current account surpluses when levels of household debt there are as high as in the US and levels of public sector debt are much higher.

A better explanation of today's imbalances is the large gap between domestic demand growth in the US and in Europe and Japan - in other words, too much export-led growth outside the US. Consumer spending has been particularly weak in Europe and Japan.

If the growth gap in domestic demand cannot be closed via macro policies and structural reforms, it will be closed via further exchange rate adjustments. Analysts are rightly concerned about the large exchange rate movements needed to bring global imbalances to more sustainable levels. But the focus of their concerns has been off the mark.

The US economy has not suffered much during bouts of dollar weakness since the mid-1980s. Fears of a spike in long bond yields are not supported by the data. The dollar's precipitous decline in the late 1980s was accompanied by a brief rise in long-term rates followed by a decline. Recent episodes of dollar weakness have coincided with

declines in bond yields. The bigger risk is to economies that rely on export-led growth. Without stronger consumer spending, the dollar's fall would hurt them more than it would the US.

While there is no room for complacency, pessimists have consistently overestimated the financial vulnerability of the American economy and underestimated its resilience.

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