Patience and firmness: US economic case and other hopeful ones

There have been some visible shortages of patience as of late. Fiscal, exchange rate, monetary and current account policies plus political tensions have all mixed up under a pessimistic scenario. It need not be the case. The solutions are already in place and their aggregate impact will come sooner or later, but they certainly will. As Milton Friedman would have said when referring to monetary shocks, long and variable lags are part of their essence. And so it happens with other macroeconomic variables.

Some figures and facts are needed to be reminded.

Monetary policy: further quantitative easing seems to be no longer warranted.

After the financial liquidity stress that took place in the second half of 2008 and which was so successfully faced by the Federal Reserve via enabling monetary aggregates such as M1 to grow up to 17% in annual terms at the end of that year – from 2% in June 2008 with respect to June 2007 -, they have progressively fallen back to growth rates around 6%. That is within a reasonable range and patience is due. Basic and essential liquidity was rapidly restored and it does not represent now an inflationary nor deflationary menace. In other words, a monetary policy that is not resulting as expansive as it would seem to be, to the possible surprise of many, and whose return to neutrality is under way. GDP figures are and will respond accordingly.

Fiscal policy: redistribution with no GDP impact, again.

New US Congress after next midterm elections will probably put an end to this out of control expansionary fiscal policy that is only replacing private expenditure and alienating its entrepreneurial spirit. A big pressure to return to a fiscally responsible administration will come into being, going down from a 9% of GDP deficit and a 25% of GDP federal expenditure to a balanced budget under a historic and no bigger than 19% of GDP participation. Tea Party to the rescue, quite surprisingly.

Exchange rate: US$ already devalued.

Do not push for further US dollar devaluation in the short term. As of now, the price adjusted broad dollar index estimated by the Federal Reserve shows that US dollar currency is 10% lower than its average from 1973 until now. It is as devalued as the US dollar in Carter times. That is a big fall, indeed. Under a longer term perspective, however, the emerging world which is catching up with more developed economies such as the US will reflect this convergence via naturally revaluing its currencies – in real terms - against those of them.

Current account deficit: under correction too.

Associated with the US real exchange rate movement, the current account deficit has been slowly moving to a smaller figure. It never was impressively high, reaching 6% in 2006, but now it hovers around 3%. That is fine and will get corrected as required. But there is no necessity to fasten the process. Even China, with a 5% current account surplus, is not terribly out of range either.

Others, such as French pensions, the British budget or the failure of BHP Rio Tinto venture raise hopes even more

Recent news about the French finally recognizing the impossibility of complying with past pension promises, extending working periods, is a good start. Further decisive fiscal tightening by the new British coalition government under a present 10% budget deficit will serve not only its economy but ours, for the example they give. And the failure of a competition threatening merger – disguised this second time – between Rio Tinto and BHP that would have accounted for approximately 20% and 40% of world iron production and world seaborne iron trade, respectively, serve great the economic world, for there is a limit not to trespass message. “You are under our watch” might be a good summary from competitive authorities. That is also going to be true for China, which is trying to coordinate its monopsony power in this commodity market – where it represents near 30% and 60% of both markets, respectively - and others.

In summary, the equilibrium settlement is coming pretty soon in the US economy. Impatience is just not a good guide to policy making. Political and capital markets need to reckon with this fact for otherwise their mistakes can turn into real costs to society as a whole. Let us keep in mind that long term perspectives for the US and the world are really good indeed. Going back to 4% growth rates is no small achievement and quite unique in world economic history.

Manuel Cruzat Valdés

Santiago, Chile

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