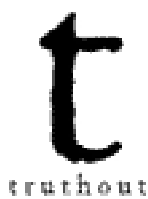

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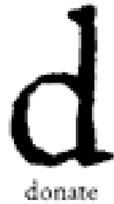

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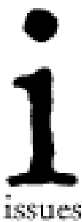
How Much Longer Can the American Economy Live on Credit?
By Eric Leser
Le Monde

Thursday 24 March 2005

Growth of today's global economy rests in large part on American consumption. It represents a little less than 70% of the United States' Gross Domestic Product (GDP) and close to 20% of world economic activity. In counterpart to the Bush administration budgetary negligence, the United States' trade and payment deficits continue to grow - all the more quickly given that Americans devote practically all their income to spending and debt repayment.



The savings rate of American households has fallen to the unprecedentedly low level of 1.5% of available income. This system functions only because the central banks of countries that export to the United States recycle their considerable dollar surpluses. In 2004, China cleared a surplus with the United States of 162 billion dollars (125 billion Euros), with the European Union of 114 billion dollars, with Canada and Mexico of 111 billion, and of 75 billion dollars with Japan.

In the face of such imbalances, the principle adjustment variable is exchange rates. That's why the dollar has not stopped declining the last three years. It's lost close to 38% of its value against the Euro and 23% against the Yen. In theory, that should make American products more competitive. In practice, it has no effect at all. In January, the trade deficit once again attained a record 58 billion dollars. The explanation for this situation is at once the fixed linkage between key countries like China's currency and the dollar, and the incapacity of American industry to substitute for imports.

The increase in demand for manufactured products in a strongly growing economy (4.4% in 2004 and undoubtedly at least 3.5% this

year) is good for the imported auto and steel industries, equipment manufacture, furniture, plastics, chemicals, textiles and toys.

The stagnation of its industry - with the exception of information technologies - and the deterioration of the United States' trade balance are two sides of the same problem. The American economy needs more and more foreign capital to feed its growth. For the moment, central banks (especially in Asia) ceaselessly inflate their dollar reserves and try in this way to avoid a too-brutal decline in the American currency, to preserve both their own growth and their exports to the United States.

Risk of Recession

For most economists, this system is dangerous and cannot persist. Federal Reserve President Alan Greenspan is one of the optimists. "The flexibility of the American economy will allow it to progressively regulate the present difficulties with regard to trade and savings," he declared two weeks ago before the Council on Foreign Relations.

Other experts forecast a painful outcome. When central banks stop buying dollars, the world economy will undergo a wide scale shock. That's the conclusion of a study by Ixis CIB economists. They judge that the imbalances cannot be corrected without a recession in the United States, and afterwards, undoubtedly, the world. "The date of this recession may be belated (2007, 2008 or 2009), since it must wait for the drawbacks of dollar stabilization to exceed the advantages (support for exports) in those countries that make exchange rate interventions," writes Ixis CIB. Without financing from foreign central banks, the United States will be forced to reduce its trade deficit to a fundable level.

Since American industry is incapable of replacing part of United States imports, adjustment can occur only through a reduction in the demand for foreign products. For that to happen, the depreciation of the dollar has to be sufficiently pronounced that the rise in prices of imported products reduces Americans' purchasing power.

They will consume less and save more, sparking a strong reduction in economic activity, calculated by Ixis CIB to be at least 2%. It appears that the shakeup for the rest of the world will be at least as severe. The decline in exports to the United States will be accompanied by a loss of competitiveness on world markets.

*Translation: **t r u t h o u t** French language correspondent Leslie Thatcher.*

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