

MACROECONOMICS AT WORK EXERCISE

THE ECONOMY AND INTEREST RATES IN THE US

REFERENCE: ‘**Flourishing growth pressures US rates**’ (by Sean Aylmer), *The Australian Financial Review*, 27 November, 2003, p. 13.

CHAPTERS RELEVANT TO THIS EXERCISE: Chapters 9, 14, 16.

OVERVIEW

In the September quarter of 2003 the US economy as a whole (as measured by GDP) recorded a growth rate (annualised) of a little over 8 per cent. This was markedly higher than in preceding periods, generally regarded as ones of recession where *real* GDP had been below the *potential* level of GDP. This suggested that a range of stimulatory measures to increase elements of aggregate demand had worked as intended. Among these measures had been progressive cuts in interest rates, implemented by the central bank. At the same time (as one may have expected) the level of inflation had been very low (with the possibility canvassed in some quarters that it could even become negative). In terms of Table 16.1 (p.371) the economy was exhibiting behaviour illustrated in the top two rows, with cuts in interest rates having ‘pushed’ the economy to the right in the table. However, with the increase in aggregate demand resulting in sharp increases in aggregate production (GDP), and the possibility of increased inflation (though without any indications that this was likely to become an immediate problem), the Federal Reserve was, at the end of 2003 (as the article notes) ‘under increasing pressure to review its low interest rate policy’.

QUESTIONS

1. What evidence exists that, prior to the second half of 2003, real GDP in the US had been growing at less than its potential?
2. What measures (of both monetary and fiscal policy) were implemented in the US in recent years?
3. What elements of aggregate demand have been responsive to these measures?
4. Is the revival in company profits a good indicator of increases in demand?
5. To what extent is inflation an issue in the consideration of likely trends in interest rates?
6. What implications do the trends in the US economy have for the Australian economy?