The world's eyes focus on the US jobs market

It has often been said that when the US sneezes the rest of the world catches a cold. The origin of this reflected the USA's pivotal role in the world economy, where strength or weakness would soon spread elsewhere. Although the US is still the major economy it is in the financial markets that its influence has grown.

This has coincided with the globalisation of world markets. This is seen not just in the way in which a rise in US bond and equity prices helps world markets, but also in the way in which governments around the globe now steer economic policies as much to the wishes of international investors as to the aspirations of local electorates.

Gordon Brown, for instance, was in the US during the last few days, attempting to establish credibility with international investors. As the Clinton administration has found, and Labour hopes to discover, endorsing anti-inflationary policies and winning the confidence of the financial markets can have positive economic effects, reducing long-term yields, lowering debt service costs and helping firms raise money more cheaply for investment, boosting growth.

But actions speak louder than words in gaining credibility and thus a difficult task is still ahead for Brown. Yet he may take confidence at the way in which the Clinton administration has performed, helped by a sensible monetary approach by the US central bank, the Federal Reserve.

The steady performance of the US economy in recent years has pleased the financial markets. But the mood of the markets can change, and the current fear is a possibly tightening of monetary policy. If so, this would not just be of concern in the US but around the world. In February 1994 a quarter-point hike in US interest rates send world markets tumbling. Could the same happen again?

Hence this week the attention of world financial markets will be on the chairman of the Federal Reserve, Alan Greenspan, as he explains monetary policy and answers questions in front of the Senate and Congress, in the so-called 'Humphrey Hawkins' testimony. One of Greenspan's qualities is his reluctance to spring surprises. As a result he has continued to outline clearly how he and the Fed are thinking and, in this respect, the Humphrey Hawkins testimony is key. In recent years it has been the best guide to US monetary policy and how the Fed is thinking.

Greenspan's message is likely to be the US economy is in good shape, with steady growth and low inflation, and few imbalances of the type that in the past created problems. This should reassure global financial markets.

Since US interest rates were cut in January last year there has been no need to tighten policy, on account of continued low inflation. However, Greenspan's testimony is likely to be balanced and he will outline the areas he is concerned about and which could force him to raise interest rates. The momentum of the economy, the buoyant Dow Jones index and strong monetary growth could all concern him, but the main worry remains the labour market.

One of the most interesting issues in the US is the extent to which wage pressures remain subdued, despite falling unemployment. US unemployment is 5.4%, below the so-called natural rate at which wage pressures are expected to be appear. This has prompted a view that the Federal Reserve is currently experimenting to see how long it is before low unemployment will trigger higher inflation. During the last week a new study by the San Francisco Federal Reserve concluded that although anxiety about job losses may have helped reduce wages, the impact is likely to be small and temporary. This view is widely shared, but it is likely to be wrong.

Just as in the UK, policy makers have to be quite clear the data is accurately reflecting what is happening. The US unemployment rate may give too good a picture of what is happening in the labour market. Surveys show that four years ago, one in four Americans feared losing their job. Now, despite the recovery, insecurity has risen and nearly one in two fear losing their job. Thus job turnover is low, hardly indicating a buoyant labour market.

In the US there are many discouraged workers who, after being made redundant do not claim unemployment benefit, for whatever reason. An example might be a man in his early fifties who used to work in a plant but now lives off his redundancy money, but if the economy genuinely improves he will get a part-time job. He may not show on the unemployment register but he is available for work. Thus the 'true' unemployment rate may be higher.

Wage gains in the US are concentrated amongst those on high incomes, such as in the financial sector, or where there have recently been skill shortages, such as in computing. But for the bulk of workers, wage increases have been low and companies have been able to cut fringe benefits.

This suggests the US will have low wages and inflation for some time. This combination should prevent the Federal Reserve from raising US rates. Not only should this relieve fears on world financial markets but it may be a good indication of what is to come in the UK.

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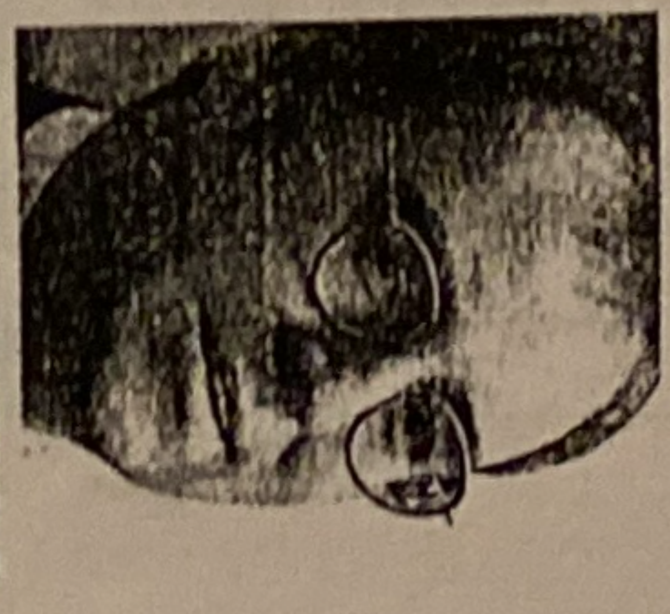

ECONOMICS
WEEK

This week Alan Greenspan will give the best guide to US monetary policy. World markets should listen closely says **Gerard Lyons**