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GLOBAL ECONOMIC INFLUENCES IN THE USA

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Annotation: Businesses obtain long-term external financial capital either by borrowing or by obtaining equity funds. This article describes global economic influences in bond market for businesses in the USA. Also in this article, we'll discuss domestic economic influences in bonds used to identify them.

Key words: global economic influences, domestic global economic influences, stock risk, stock price, firms' profitability

Two main overseas influences will affect firms. The first is the condition of overseas economies. Growth in foreign economies will increase the demand for U.S. exports. Similarly, sluggish foreign demand will harm overseas sales and hurt the financial position of firms doing business overseas. The rate of economic growth overseas can affect the conditions faced by domestic firms, too, as growing demand globally may make it easier to raise prices and sluggish demand overseas may lead to intense competition in the U.S. market. The second influence is the behavior of exchange rates, the price of a currency in terms of another currency. A change in exchange rates over time has two effects on the firm. Changing exchange rates lead to higher or lower U.S. dollar cash flows from overseas sales, more competitively priced import goods, or changing input costs. Thus, changing exchange rates affect profitability by influencing sales, price competition, and expenses. Changing exchange rates also affect the level of domestic interest rates. Expectations of a weaker U.S. dollar can lead to higher U.S. interest rates; to attract capital, U.S. rates will have to rise to compensate foreign investors for expected currency losses because of the weaker dollar. Conversely, a stronger dollar can result in lower U.S. interest rates.

Individuals can spend only what they have (income and savings) or what their future earning capacity will allow them to borrow. Consumption spending (spending by individuals for items such as food, cars, clothes, computers, and so forth) comprises about two-thirds of gross domestic product (GDP) in the United States. Generally, higher disposable incomes (that is, income after taxes) lead to higher levels of consumption spending. Higher levels of spending mean inventories are reduced and companies need to produce more and hire additional workers to meet sales demand. Corporations will spend to obtain supplies and workers based upon expectations of future demand. Similarly, they will invest in additional plant and equipment based upon expected future sales and income. Economic growth results in higher levels of consumer spending and corporate investment, which in turn stimulates job growth and additional demand. Slow or negative growth can lead to layoff s, pessimistic expectations, and reduced consumer and corporate spending. These effects will directly influence company profits and cash flows. Economic conditions affect required returns, too. Investors will be more optimistic in good economic times and more willing to accept lower-risk premiums on bond and stock

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investments. In poor economic times, credit spreads will rise as investors want to place their funds in safer investments. Governments shape the domestic economy by fiscal policy (government spending and taxation decisions) and monetary policy. These decisions may affect consumer disposable income (fiscal policy) and the level of interest rates as well as inflation expectations, (monetary policy) and, therefore, affect the valuation of the bond and stock markets. Some industry sectors are sensitive to changes in consumer spending. Sales by auto manufacturers, computer firms, and other manufacturers of high-priced items will rise and fall by greater amounts over the business cycle than will food or pharmaceutical firms. Changes in interest rates affect some industries more than others, too; banks and the housing industry (and sellers of large household appliances) are sensitive to changes in interest rates more than, say, book and music publishers or restaurants.

A firm’s profits are determined by its sales revenues, expenses, and taxes. We have mentioned taxes and some influences on sales and expenses in our discussion of global and domestic economies, but industry competition and the fi rm’s position within the industry will have a large impact on its ability to generate profits over time. Tight competition means it will be difficult to raise prices to increase sales revenue or profitability. Nonprice forms of competition, such as customer service, product innovation, and the use of technology to the fullest extent in the manufacturing and sales processes may hurt profits by increasing expenses if the features do not generate sufficient sales. Competition may not come only from similar firms; for example, a variety of “entertainment” firms, from music to theater to movies to sports teams, vie for consumers’ dollars. Trucking firms and railroads compete for freight transportation. Cable and satellite firms compete in the home television markets (and for Internet service, along with telephone service providers). Changes in the cost and availability of raw materials, labor, and energy can adversely affect a firm’s competitive place in the market. The influences of competition and supply ultimately affect a firm’s profitability and investors’ perceptions of the firm’s risk. This, in turn, will affect its bond and stock prices. The most attractive firms for investing in will be those with a competitive advantage over their rivals. They may off er a high-quality product, be the low-cost producer, be innovators in the use of technology, or off er the best customer support. Whatever the source of the firm’s advantage is, if it can build and maintain this advantage over time it will reap above-normal profits and be an attractive investment.

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