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## World Economy Out of the Doldrums

by Günter Großer, Günter Weinert, Hamburg\*

**After hopes of an international economic recovery had been repeatedly dashed during a slump period lasting almost three years, 1983 proved to be the long-awaited turnaround year for the world economy. In fact, the upswing came earlier and with greater momentum than had initially been forecast at the beginning of the year. This was particularly the case for the USA and – to a lesser extent – for several other major industrialised countries. Will this upward trend be sustained during 1984?**

Contrary to all expectations, up to now the upswing in the US economy has been every bit as powerful as it was following previous economic recessions. The other industrial centres of the world economy also witnessed a recovery, which was remarkably strong in Japan, but relatively weak in Western Europe, whereby the intensity varied substantially from one country to the next. Britain and the Federal Republic of Germany, in particular, demonstrated a marked increase in demand and production right from the start of 1983, whereas the recession dragged on until the middle of the year in Italy and stagnation continued even longer in France.

The most decisive factor for the changing economic trend was the general easing of monetary restrictions in the second half of 1982 after inflationary expectations had been progressively checked. The USA assumed the role of leader, and central banks in other Western industrialised countries were fast to follow suit and opt for a policy change. The falling interest rates in the USA allowed such a move without subjecting the currencies in other countries to additional pressure against the dollar. The expansion of money supply in the USA and in most other industrialised countries up until mid-1983 exceeded by far a potential-GNP-oriented path, moving well beyond defined monetary targets. The subsequent effects on demand in real terms were all the greater as the slowing-down of wage and price increases – a result of the preceding narrowing of the scope for such increases – still continued. This trend was particularly supported in the spring by the reduction of oil prices, which outweighed the cyclical price increases for other raw materials since the end of 1982.

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The containment of inflation, the relaxation of monetary restrictions and successful lowering of interest rates combined to produce an overall improvement in the economic climate. This was soon reflected in household and business activities. Worthy of note during this period was the marked response of consumers in the USA and in a number of other industrialised countries. Although real disposable incomes continued more or less to stagnate, there was a substantial shift from consumer saving to consumer buying. The extensive tax reductions in the USA were also reflected faster than usual in increased consumption. Catching up on replacement buying postponed during the recession was undoubtedly one of the major motives for this pattern. The same factors, partly in conjunction with fiscal incentives, led in several cases to a pronounced recovery in residential construction, and this despite the still high levels of real interest. As for businesses, the improved economic climate above all enabled a shift to expansive stockbuilding. Despite continuingly low capacity utilisation at the start of the upswing period, the marked increase in plant and equipment investments reveals that there was an early growth in the propensity to invest, in particular in the USA. Tax reliefs may have played a part in this respect. The latter certainly applies to the notable increase in business investments in the Federal Republic of Germany. Japan, on the other hand, exhibits a completely different "structure" when it comes to its economic propellant forces. It was the only major industrialised country to receive most of its expansive impulses from exporting activities, benefitting, in spite of numerous protectionist

hindrances, particularly from the substantial expansion of demand in the USA, its most important export market.

Only in the USA was economic recovery strong enough to bring about a substantial increase in the number of employed persons and a noticeable drop in unemployment during 1983. However, the increase in production in a number of other countries did manage to stop a deterioration in the labour market situation later on in the year.

### **USA Spearheads Recovery**

The decisive impetus for last year's international economic improvement quite clearly came from the USA. While at first it was primarily the monetary relaxation there which exerted a determinant influence on the monetary policies of other countries, later on in the year the expansion of demand in the USA stimulated production and income formation in the rest of the world. Apart from such positive effects, however, the world-wide retardant effects of the extremely high levels of real interest rates cannot be overlooked. In the final analysis, the overstraining of the American capital market via the continued increase in budgetary deficits – even during a marked economic recovery – has implications for the financial markets elsewhere in the world. This slipstream effect prevents all other countries from reducing their interest rates, particularly since despite the expansive fiscal policy in the USA a dollar devaluation at a time of stability-oriented monetary policy is not to be expected. In fact, quite the opposite is true: the attractive interest rates have strengthened the dollar's position even further. Not even a quadrupling of the American deficit on current account to c. \$ 40 billion in 1983 was able to prevent the dollar from surging as it did. This means that even in countries which can claim clear stabilisation and adjustment successes, such as Japan and the Federal Republic of Germany, American interest rates continued to call the tune of the current trend.

High interest rates and the strength of the dollar also caused special problems for developing countries struggling to cope with their debt crises. On the other hand, the cyclically induced increase in demand for raw materials and the accompanying price increases have helped considerably to reduce current account deficits in this group of countries. However, the improving trend was not powerful enough to quell doubts about the ability of important debtor countries to maintain their restrictive recovery course until this has led to success. Refinancing operations, therefore, remained precarious, and the debt crisis continued to simmer, although it could time and again be prevented from reaching boiling point.

Towards the end of last year, almost all industrialised countries at least began to feel the trend towards an improved economic climate. National economic and social dissimilarities and differences in economic policy were apparently offset to a considerable extent by international economic developments. The fact that such a trend was possible after the abatement of income impulses caused by the drop in oil prices and in the face of yet another interruption of the downward trend of interest rates, is an indication of the emergence of expansive cyclical processes. It is difficult to establish the exact contribution of, on the one hand, short-term impulses caused by economic policies and the reduction of oil prices and, on the other, greater confidence in more favourable long-term growth conditions, towards economic recovery. This is also an important factor of uncertainty for the forecast, particularly since the assessment of effects caused by expected economic policy measures depends on this factor.

### **Budget Deficits Push up Interest Rates**

The varying concepts which serve as a guideline for economic policies in the industrialised countries are not reflected in the foreseeable development of public finances. In the USA, for example, despite the basic supply orientation, the share of government spending in the country's gross national product is unlikely to be reduced during President Reagan's final year of office and despite the continuing economic upswing, the budget deficit is hardly likely to decrease. With an eye on potential voters, political parties apparently show little interest in jamming the brakes on dynamic spending or increasing taxes and other fiscal charges. Fiscal policies in the majority of Western European countries and Japan, on the other hand, are still geared towards maintaining a consolidatory trend. Even in the case of governments which, on principle, rather support demand-oriented policies, the rapid increase in budgetary deficits over the past few years has induced them to opt for a more sound and confidence-building fiscal policy, with its relieving effects on capital markets. Although spending cutbacks and the increases in taxes and other fiscal charges initially restrain demand, the emerging improvement in the supply situation also provides a certain degree of stimulating momentum in the short term.

In the middle of 1983, monetary policies in the major industrialised countries again made efforts to adjust the excessive monetary expansion which had preceded this period. This led to fears that economic recovery would yet again be hampered by a restrictive policy course.

## ECONOMIC TRENDS

This clearly shows that an unsteady monetary course such as that practised since mid-1982 causes uncertainty – even if there may be initial stimulation to demand – and thus in the end impedes growth. However, the money supply targets announced in a number of countries provide the necessary scope for a lasting economic upward movement. Even a lax monetary policy in the USA would not be able to cancel out the effect high budget deficits have of boosting interest rates; in fact, the result would probably be increased inflationary expectations, which would run contrary to desired effects.

### Moderate Monetary Expansion

In view of the dominant role played by the USA in the international financial system, the continuing pull effect of the budget deficit and high interest rates there will continue to present a noticeable strain on monetary developments in other economies. In many cases, the (still high) budget deficits in other countries together with the lack of confidence that economic policies will continue to be aimed at stability also add to the external obstacles to a marked reduction in interest rates. As opposed to the USA, where the position of the dollar as a reserve currency and as a currency attracting flight capital has not yet been shaken even by an unsound fiscal policy, the Western European economies are marked by an extremely large degree of external sensitivity. If the moderate monetary expansion announced in the USA is in fact effected, therefore, it is

all the more likely that the central banks in most of the other countries will adopt a similar course of action.

The probable general course of economic policy thus does not indicate that any new short-term stimulation to demand of the kind which could be observed at times last year will emanate from this source. On the other hand, the effects of excessive budget deficits on interest rates are unlikely to become less noticeable. This will definitely hamper the development of cyclical expansive forces in industrialised countries, forces which depend at the advanced stage of economic recovery on an enhanced propensity to invest. This is counterbalanced to a certain extent, particularly in the USA, by a renewed marked increase in profits on account of the continuing restraint shown in wage agreements. Given the substantially improved sales and profits situation, the USA will probably experience a distinct increase in industrial investments despite high interest rates. Residential construction and private consumption, however, will not increase as rapidly, and stock-cyclical impulses will die down. Overall demand in the USA during 1984, therefore, will probably rise at a considerably lower rate than during 1983. Since, assuming that there is little change in the interest-rate differential to other countries, the dollar will probably remain relatively strong, the international competitiveness of the USA will continue to be weakened. Competitors from other countries will thus be able to make up ground during the coming year in the USA and on other markets.

### Economic Indicators

	Real Gross National Product (Year-on-year change in %)				Consumer Prices (Year-on-year change in %)				Exchange Rates <sup>1</sup> (Change over 12 mths in %)		Unemployment Rate <sup>2</sup>	
	1974-81 <sup>a</sup>	1982	1983 <sup>b</sup>	1984 <sup>b</sup>	1974-81 <sup>a</sup>	1982	1983 <sup>b</sup>	1984 <sup>b</sup>	Dec. 1982	Dec. 1983	1982	1983 <sup>c</sup>
USA	2.2	-1.9	3.5	4.5	9.4	6.1	3.0	5.0	10.7	6.4	9.7	8.2
Canada	3.0	-4.4	3.0	4.0	9.7	10.8	6.0	6.0	-1.8	1.1	11.0	11.1
Japan	3.7	3.8	3.0	4.5	9.1	2.7	2.0	2.0	-5.1	8.1	2.4	2.6
Western Europe <sup>3</sup>	1.9	0.5	0.9	1.7	10.8	9.8	7.2	6.3	.	.	8.8	9.8
Austria	2.6	1.1	1.5	1.5	6.4	5.4	3.0	5.0	3.6	-0.3	3.3	4.0
Belgium	1.4	0.7	0.5	1.5	8.2	8.7	7.5	6.0	-9.7	-2.7	11.2	12.5
Denmark	1.4	3.1	2.0	1.5	11.1	10.1	7.0	5.5	-0.4	-4.0	8.8	9.7
Finland	2.7	2.5	2.5	3.5	12.5	9.3	8.5	7.0	-4.5	2.2	6.2	6.3
France	2.5	2.0	0.0	0.0	11.4	11.8	9.5	7.5	-5.6	-7.1	8.9	9.2
FR Germany	2.1	-1.1	1.0	2.5	4.9	5.3	3.0	3.0	7.2	0.6	6.7	8.1
Great Britain	0.5	1.8	3.0	2.5	15.4	8.6	4.5	5.5	-4.1	-0.2	10.9	11.3
Italy	2.4	-0.3	-2.0	1.0	17.3	16.6	14.0	12.0	-2.7	-4.8	9.1	9.3
Netherlands	1.8	-1.7	0.5	1.0	7.1	5.9	2.5	3.0	5.6	-1.1	10.1	14.7
Norway	4.2	-0.6	1.0	1.5	9.6	11.3	8.5	6.0	-4.1	1.8	2.1	3.1
Spain	2.1	1.1	2.0	2.5	17.5	14.4	12.0	10.0	-13.4	-9.9	14.0	16.9
Sweden	1.6	0.6	1.5	2.5	10.5	8.6	8.5	5.5	-14.1	2.9	3.2	3.3
Switzerland	0.5	-1.2	0.5	2.0	4.3	5.6	3.0	2.0	0.4	5.5	0.4	0.8
OECD Countries Total <sup>3</sup>	2.3	-0.1	2.3	3.2	10.0	7.3	4.7	5.1	.	.	8.1	8.0

<sup>1</sup> External value of currencies weighted by share in international trade 1979. <sup>2</sup> In % of total number at or available for work. <sup>3</sup> Total of listed countries weighted by real gross national product or private consumption in 1979 and numbers available for work in 1981 respectively. <sup>a</sup> Average year-on-year change. <sup>b</sup> Estimated or forecast; figures rounded as a rule to nearest 0.5 %. <sup>c</sup> Last available month; adjusted for seasonal variation.

### Western Europe Lags Behind

The demand impulses emanating from the USA will be particularly noticed by Japan, the USA being by far its largest export market. However, despite the easing of monetary policies domestic demand will, with the continuing consolidation of fiscal policy, be slow to increase. Nevertheless, the upward economic trend will be markedly stronger than in Western Europe, where stabilisation and adjustment problems restrain the recovery of demand to a much greater extent than in the USA and Japan. The latter is particularly the case in France and Italy, whereas Britain and the Federal Republic of Germany together with a few of the smaller economies can claim considerable successes in attempts to improve conditions for growth. Intra-European economic links will produce compensatory effects, i.e. stimulating effects for some countries, restraining effects for others. This leaves Western Europe as a whole showing a continuing slight increase in demand and production. Investment activities will probably tend to increase. However, in view of the as yet modest successes in improving supply conditions and the high levels of real interest rates, this process will probably take place at a relatively slow pace.

The foreseeable development of real gross national product will be clearly marked by the cyclical gap in economic performance between the major international economic centres. On average, GNP in Western European economies is likely to be between 1.5 % and 2 % up on last year's figures, whereas the USA, Canada and Japan will experience growth rates of between 4 and 4.5 %. However, the differences during the course of the year will be smaller, since North America carries over a high "overhang" into the figure. The volume of world trade is also likely to increase again by between 4 and 5 % in 1984, especially influenced by the impetus of demand from industrialised countries.

There will also, on the whole, be a slight increase in imports by oil-exporting and other developing countries. For after those countries affected by a debt crisis have drastically cut back imports to adjust to their reduced ability to pay, the countries in which the balance-of-payments situation remained more favourable again determine the trend. In addition, a further cyclical increase in earnings from raw materials exports will also provide relief for the strained balance-of-payments situation.

### Slow Growth Still a Problem

The further increase in demand and production in industrialised countries generally corresponds to the traditional cyclical pattern. However, against the background of the substantial downswing which preceded this cyclical stage, the underlying stimulating forces remain relatively restrained in the majority of industrialised countries. In particular, the recovery of the propensity to invest appears still far too weak to be described as the beginning of the overcoming of slow growth and underemployment. It seems that the progress made up to now in rectifying misdevelopments – which have varied in their extent from country to country – in the distribution of resources between investors and consumers on the one hand, and between the private and public sectors on the other, is not enough to achieve a lasting improvement in conditions for growth. Nevertheless, the international economic recovery helps gain the time needed to effect the unavoidable processes of structural adjustment. However, it would be dangerous if the understanding gained over the past few years\* of the importance of more favourable supply conditions were to disappear all too soon in the wake of economic recovery, particularly since the risks facing a gradual frictionless return to a path of reasonable economic growth are in any case substantial.

**HWWA Index of World Market Prices of Raw Materials<sup>1</sup>**  
(1975=100)

Raw Materials and Groups of Materials	1982		1983				1984	
	AA <sup>2</sup>	December	AA <sup>2</sup>	October	November	December	Jan. 6	Jan. 20
Total index . . . . .	228.6	225.0	209.3	206.5	205.9	205.7	206.6	206.2
Total, excl. energy raw materials . . . . .	117.6	111.8	122.8	128.9	127.7	127.4	129.9	128.9
Food, tropical beverages . . . . .	106.1	103.4	116.8	127.1	127.0	126.7	128.9	128.9
Industrial raw materials . . . . .	126.4	118.2	127.4	130.2	128.3	127.9	130.7	128.8
Agricultural raw materials . . . . .	127.1	114.3	125.5	131.6	131.0	130.0	130.2	130.0
Non-ferrous metals . . . . .	134.9	128.7	145.0	142.9	139.3	139.8	144.7	139.6
Energy raw materials . . . . .	293.4	291.1	259.8	251.8	251.5	251.4	251.4	251.3

<sup>1</sup> On dollar basis. - <sup>2</sup> Annual Average For the method of computation of the HWWA Index cf. INTERECONOMICS No. 5, 1980, p. 261 ff