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Article — Digitized Version

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Intereconomics

Suggested Citation: Großer, Günter (1990) : The world economy in the summer of 1990, Intereconomics, ISSN 0020-5346, Verlag Weltarchiv, Hamburg, Vol. 25, Iss. 4, pp. 211-212, <https://doi.org/10.1007/BF02926173>

This Version is available at:

<https://hdl.handle.net/10419/140255>

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The World Economy in the Summer of 1990

The global economy continues to show an upward trend – albeit at a slower pace – for the eighth year running, although performance differs considerably from country to country. What is the outlook for 1990 as a whole?

In the middle of the year, the world economy presents a mixed picture. While despite the retarding influence of a policy of monetary stabilization, the upward trends clearly prevail in Japan and Western Europe, economic activity in North America is weak and growth in production has lagged noticeably behind potential. Apart from exceptions like Sweden and the United Kingdom, utilization of capacity in Western Europe kept to a high level. Economic tensions have, however, kept within narrow bounds, partly because growth in demand has been somewhat dampened by rising interest rates. The renewed drop in the price of oil has also had a moderating effect on inflation.

Although as a whole growth in real gross national product in the industrialized countries has been slackening for a year, a current rate of some 3% still is a clear indication of the continued upward trend in the global economy for the eighth year running. The sometimes slower pace of the upswing has certainly helped extend its duration. There have also been cyclical fluctuations; in particular the monetary policy of major countries in the eighties generated changing impulses which affected the rate of growth. It is remarkable, though, that stabilization measures by the Federal Reserve over recent years have not yet induced a recession in America and those of the central banks in Japan and Western Europe, adopted somewhat later, have only caused a gradual slowdown. This is undoubtedly partly attributable to the, in the main timely, efforts of monetary policymakers, who have learnt their lesson from the seventies, to contain inflationary expectations. The gain in credibility that accompanied this stabilization course was a condition for the comparatively moderate wage rises in most countries.

In addition, the forces for growth proved to be relatively robust after the fundamental conditions became more conducive to expansion in most countries during the eighties: tax reforms and cuts, deregulation and a lasting easing of conflicts over income shares, partly thanks to the decline in oil prices. An added factor have been the recent impulses for growth emanating from the political and economic reforms in the former socialist countries of Eastern Europe.

The resilience of the forces for growth, however, makes stabilization more difficult when the economy threatens to overheat. This is illustrated particularly clearly by the United Kingdom, where drastic increases in interest rates during the last two years have not succeeded in effectively constraining the vigorous monetary expansion which has been going on for a long time. In most other countries the situation has not become anything like as acute; on the contrary, despite high utilization of capacity, the cost and price spiral has kept within narrow bounds. Compared with last year, the average rise in the cost of living in May in the industrialized countries was a good 4%, slightly below that a year before. The price climate in many countries recently has also tended to calm down. Owing to the global slowdown, the prices on the commodity markets came under pressure as early as the spring of 1989. In the first half of 1990, this has been particularly the case for petroleum. In all, the HWWA Index of World Market Prices of Raw Materials for June, measured in terms of special drawing rights of the International Monetary Fund, was some 10% down on the previous year.

In view of the high capacity utilization, most central banks are still according high priority to containing inflation. This also holds for the USA, where the monetary relaxation which started a year ago has hardly been continued since the beginning of this year. Here,

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no doubt, an effort is being made to avoid a loss of confidence arising from the inability of fiscal policy to cope with the renewed substantial rise in the budget deficit. Probably, Congress will not approve a budget draft until the autumn, which will curb the deficit, also with the help of tax increases. This will then set a process of diminishing interest rates in motion again, supported by the Federal Reserve. With gradually greater success in containing inflation, the monetary reins will presumably continue to be eased next year. With the anticipated high interest rates abroad, the dollar will probably edge down.

The present economic climate in the USA is unstable. The inhibiting effects of the monetary restrictions adhered to until a year ago are now fading but the demand impacts of the ensuing relaxation of monetary policy which has almost come to a standstill will remain within narrow limits. The moderate optimism of private entrepreneurs would indicate that business investment will hardly diminish at all in the course of the year. The adjustment of inventories to the economic slowdown will not constitute a very strong impediment to growth, either, due to the absence of previous overstocking. Owing to the sluggish decline in interest rates, residential construction will not rally in the near future. With slower employment growth, real disposable income and private consumption will only go up moderately. Exports, in contrast, should expand rapidly. In all, demand will only increase modestly in the course of this year. Annual gross national product will be little more than 1.5% higher than last year. For 1991, assuming a renewed monetary relaxation, growth looks like speeding up somewhat.

In most other industrialized countries, the stringent monetary policy has been attended by noticeably improved supply conditions in the course of the eighties. Owing to the sustained strengthening of forces for

growth, higher interest rates are only impeding cyclical expansion of production and demand to a moderate degree. Above all, business investments will expand rapidly. This will be especially the case in Japan, where the depreciation of the yen is promoting exports and curbing imports. Its real gross national product in 1990 will increase by some 4½% and next year by 3½% to 4%. In Western Europe growth will not only receive a boost from the preparation of businesses for the single European market but also from the political and economic reforms in Eastern Europe. In the short term, powerful demand impulses will emanate from the establishment of the German economic and monetary union, which will make themselves felt in other economies via German imports. All in all, growth in Western Europe will continue at more or less the same pace. Only for individual countries such as the United Kingdom and Sweden is a slowdown likely as a result of their efforts to contain overheating. On average, real gross national product in Western Europe for 1990 will increase by some 3% and at almost as high a rate in 1991.

World trade has expanded at a slightly less rapid pace than last year with the slowdown of growth in the world economy. In the remainder of the year, imports by the West European economies in particular will expand vigorously. A stimulating factor here is the German economic and monetary union, since the sudden, large increase of supplies from the Federal Republic to East Germany will mean that more foreign suppliers will be needed. In Japan on the other hand, the increase in imports will be inhibited by the depreciation of the yen and in the USA by the weakness of the growth of demand. The imports of the developing countries will continue to expand appreciably, though at a slower pace than in previous years. As a whole, for 1990 – and probably also for 1991 – real world trade will grow by 6% after a rate of slightly more than 7% last year.

HWWA Index of World Market Prices of Raw Materials¹
(1975=100)

Raw Materials and Groups of Materials	1989		1990					
	AA ²	June	March	April	May	June	29.6.	20.7.
Total index	158.0	155.9	161.7	155.4	155.4	147.5	149.4	162.0
Total, excl. energy raw materials	150.7	148.6	149.5	151.7	152.9	150.0	152.4	150.5
Food, tropical beverages	104.3	108.0	98.3	100.5	100.7	96.5	96.0	92.2
Industrial raw materials	186.0	179.5	188.5	190.7	192.6	190.8	195.4	194.9
Agricultural raw materials	191.3	185.5	205.6	209.2	209.8	207.9	209.7	207.7
Non-ferrous metals	223.5	209.3	204.0	204.7	206.8	198.7	202.2	204.1
Energy raw materials	162.3	160.2	168.8	157.6	156.9	146.0	147.6	168.7

¹ On dollar basis. ² Annual Average.