

Großer, Günter

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World Economic Recovery on the Horizon

Since the middle of last year, west Germany has turned out to be a motor force of the world economy. It has only been able to cope with the heavy demand from the new Lands by massively resorting to supply from abroad. The weakness of economic activity in other industrialized countries, curbing their domestic consumption of resources, has been more a help than a hindrance to the German economy in this situation. Such a detachment from world economic trends can only be a temporary phenomenon, however, simply because of the west German economy's intricate international relationships, and future prospects will again increasingly be influenced by developments abroad.

In all, demand and production in the industrialized countries have hardly risen since autumn; the utilization of capacity in many of them has diminished and the employment situation has deteriorated. This trend has been particularly pronounced in North America, the United Kingdom and Sweden, all of which suffered a recession, while in most of the other countries economic growth has simply been slowing down to a lesser or greater degree. The flagging momentum of the world economy after nearly eight years of sustained upswing, which had increasingly exhausted the potential for expansion, was hardly surprising. Experiences of the past were also confirmed in that the – in all quite successful – efforts of the central banks to counter an inflationary overheating of the economy have retarded the growth of demand and production more than a mere adjustment to capacity limits would have required. The course of this slowdown, however, has been distorted by the effects of the Middle East conflict, and this still makes it difficult today to determine the position the world economy is at.

Without doubt, the substantial rise in oil prices last autumn, the uncertainty amongst consumers and investors as to future price developments and the course of the internal adjustment process was detrimental to the business climate and had a negative effect on demand. This accelerated the incipient downward trend. Conversely, prospects in the first months of this year brightened with the early decline of the oil price and the rapid end to the Gulf War. Like the additional retarding influences at the time, the stimulating impacts emanating from the underpinning of real income by cheaper oil and the disappearance of major uncertainty factors for consumers and investors cannot at present be reliably quantified. Seen in retrospect, though, there is much to argue that the Middle East conflict only played a subordinate role in the course of world economic developments.

Nevertheless, economic policymakers in the industrialized countries were relieved of a burden when the war costs did not escalate as feared and the price climate calmed down. The Federal Reserve in the USA, above all, seized the opportunity to push forward with the expansive policy it had adopted in the autumn. Monetary scope was enlarged by the strengthening of the dollar which began after the successful conclusion of the Gulf War and the improvement of the business outlook. Falling interest rates in the USA and the successful containment of inflationary expectations also facilitated the lowering of interest rates in a number of West European countries, particularly the UK. This was all the more remarkable as the Bundesbank actually raised the central bank discount rate in response to the monetary and fiscal policy risks associated with German unification and the

weakness of the D-mark which resulted in particular from those risks. Japan's central bank – largely due to the growing upward surge of prices – also kept to a strict policy.

Obviously the divergent monetary policies in the major industrialized countries largely corresponded to the different economic situations in these countries. Not least for this reason, the prospects for future world economic trends are marked by a tendency to level out these differences. Above all, the recession in North America, the United Kingdom and Sweden will probably be over in the course of the summer; on the other hand, the expansion in Japan and west Germany will continue at a noticeably more moderate pace. On average, real gross national product in the industrialized countries this year is likely to increase by slightly over 1% and in 1992 by some 2.5%.

Demand impulses will probably be generated in the Middle East, too, with renewed economic activity in this region after the Gulf War and the reconstruction of Kuwait and Iraq. The revenue of the oil exporting countries will be kept down as a result of the return to low world prices, but in view of urgent needs, the propensity to borrow is likely to be greater than hitherto. On the other hand, the inhibiting effects of the current economic slowdown in the industrialized countries on the rest of the world will only subside gradually. Thus, the foreign trade situation of primary producing countries will continue to be affected by low raw materials prices for some time. Though exports from and production in the newly industrializing countries will probably recover in the second half of the year, the increase in demand for imports in developing countries as a whole will remain moderate.

The Eastern European countries are still the scene of the most adverse developments. Their foreign trade is likely to decline to a substantial extent this year. Above all, trade amongst these countries will contract drastically due to the problems entailed in the transition to convertible currencies and the persistent structural crisis in all of them. The efforts to step up exports to the Western economies are still underway, but the shortage of internationally competitive products and trade barriers, especially for farm produce, place narrow constraints on the scope for expansion. Also, oil exports from the Soviet Union are declining owing to worsening production bottlenecks. Under these circumstances the balance of payments of the East European countries will remain under strain thus preventing a tangible recovery in imports, despite vigorous demand. These developments are, however, very disparate, partly because the various nations are at very different stages in the transformation process.

The reconstruction in the Middle East, but above all the structural adjustment and catching up process in Eastern Europe will call for large investments for many years to come. For the most part, these will certainly have to be financed by means of savings in the countries of the region itself. In the initial phase in particular, though, extensive capital imports will be needed in addition. In view of this, an important condition for coping with the problems ahead is increased savings worldwide. An aid to meeting this condition and a way of curbing the trend towards higher real interest rates could be to reduce the use of capital market resources via budget deficits on the part of the industrialized countries, which in many cases is only used to finance consumptive expenditure.

Progress in consolidating government finances in the USA and in Germany, then, would also improve the conditions for world economic growth. It would at the same time tangibly relieve the burden on the central banks in their stabilization endeavours. This would appear all the more important since coordination of monetary policy among the major industrialized countries remains difficult, as the recent discussions in the G7 round showed. The massive pressure exerted by the USA to lower interest rates worldwide and the opposition of other countries may be partly due to differences of opinion as to the probability of a recovery from the present economic weakness in the near future. Above all, however, these disagreements attest again to how differently the potentials and limits of monetary policy are assessed. This in turn means that there will continue to be friction among leading policymakers in the future.

Günter Großer