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World Economic Slowdown

In the course of last year, the economic climate cooled down world-wide; it was placed under additional strain in late summer by the Gulf crisis. In some industrialized countries, especially the USA, recessive trends have recently gained prevalence.

Do indications for 1991 therefore point to a downturn in the world economy?

Annual growth performance for 1990 is by no means unfavourable: the aggregate gross national product of the industrialized countries rose by some 2½%. This increase, however, is the outcome of highly varying developments. On the one hand, growing signs of recession were not confined to the USA; they were also discernible in Canada, Great Britain, Sweden and Finland. On the other, particularly Japan and western Germany recorded robust growth trends. In a number of small West European economies, closely linked to the Federal Republic of Germany, demand and production also rose rapidly, while economic growth in France, Italy and Spain slowed down.

The weakening of growth forces was mainly due to the more stringent monetary policy in response to high capacity utilization adopted in the USA in 1987 and in other industrialized countries in 1988. Central banks thus aimed at curbing the cost and price upswell and forestalling fears of inflation. Evidently thanks to this policy, in 1989 expansion in demand was successfully brought into line with the narrowing scope for increases in production. Therefore even during the upswing the strains on the economy could be kept within relatively limited bounds. During 1990, however, demand was predominantly curbed more strongly, the utilization of capacity ultimately declined in an increasing number of countries, employment grew more slowly or in some cases even declined, as in the USA. The downward trend in unemployment as a whole thus came to a stop; in some cases, such as the USA and Great Britain, unemployment began to increase again.

Even in the final phase of the unusually long eight-year upswing in the world economy the 6% unemployment rate in the industrialized countries as a whole was noticeably higher than in the previous growth phase at the end of the seventies. The rate in Japan, 2%, remained at its previous low level and in the USA it attained by mid-1990 at little more than 5% – a level which is rated in America as full employment – the lowest figure since 1973. The economies of Western Europe, though, averaged 8% unemployment last year, a decline of merely one half of the rise from the end of the seventies to the mid-eighties. High unemployment continued to be attended here by higher wage increases than in the non-European industrialized countries.

The rise in consumer prices has once again been strengthened world-wide with the sudden leap of world prices for oil triggered by the outbreak of the Gulf crisis. In all, though, the central banks of most countries have succeeded in keeping the inevitable acceleration of cost and price increases accompanying an upturn within narrow margins by means of their stabilization policy. At a good 5%, the average rise in the cost of living in the industrialized countries for example was merely some two percentage points higher in 1990 than three years previously. Differentials between countries continued to widen, however.

Differences in Economic Policy

The tighter course of monetary policy was no longer backed by fiscal policy last year as it had been in the past. Budget deficits rose again as a whole. This more adverse development was however partly due to the slowdown in growth, which curbed the increase in tax revenues. The budget deficit in the USA rose again considerably, not only as a result of cyclical factors, but also due to sizable disbursements to bail out savings and loans associations. Finally, in the Federal Republic of Germany, where government suffered substantial losses in revenue due to the tax cuts in effect as of the beginning of the year, public debt expanded rapidly as a result of transfers to eastern Germany.

Differences in monetary policy emerged. The Federal Reserve, which had in fact pursued a restrictive policy up to
mid-1989, was increasingly concerned after that to counter economic weakening by easing the monetary reins, despite unabated price rises. When last autumn it looked as if agreement had been reached on renewed efforts to consolidate government finances, short-term interest rates were tangibly cut in several phases. In Western Europe in contrast, where monetary policy was tightened in the autumn of 1989 with further increases in interest rates, the foremost goal under the guidance of the Bundesbank clearly remained that of stability. Economic policy planners in other countries, too, were intent on convergence with a view to the planned economic and monetary union. A constraint was the high financial burden incurred by the transfer payments to eastern Germany, which prompted further rises in interest rates as the economic, monetary and social union was announced. Given the close international linkages on the financial markets, this had repercussions on all countries, although it was mitigated by a higher risk premium for the Federal Republic of Germany. It reflected growing uncertainty about future monetary and financial policy. In all, the expansion of the money supply in Western Europe evidently slowed down in the course of last year due to the influence of high interest policies.

**Divergent Economic Developments**

A relaxation of monetary policy in the USA on the one hand and a tightening in Western Europe and Japan on the other in conjunction with divergent cyclical trends have brought about substantial changes in international interest differentials. Interest for three-month money on the London Euromarket for dollar deposits was, in the third quarter of 1989, still nearly two percentage points higher than for D-mark deposits; by the end of 1990 this differential was almost completely inverted. The same trend manifested itself in relation to other currencies, in particular the yen. This scissor movement in interest rates was the key cause of a sizable shift in exchange rate patterns: in December the dollar was worth 14% less against the D-mark – and had undergone a similar drop against the other EMS currencies – as compared with one year previously, and as much as 25% compared with mid-1989. It was only during the course of last year that a reversal of the trend against the yen took place, when Japan’s central bank intensified its high interest rate policy by substantially raising the discount rate.

The differences in the timing of monetary stabilisation policy left their mark on trends in domestic demand in the industrialised countries last year. The growth of total domestic demand was curbed considerably in the USA, Canada and Great Britain in particular; in each of these countries it was lower than that of the gross national product. In Japan, on the contrary, domestic demand continued to grow quite strongly and in most continental European countries its expansion was reduced only moderately, although the slow-down became more apparent in the course of the year. In western Germany there was even a marked acceleration in the growth of domestic demand under the influence of the tax reductions and the stimuli emanating from the unification of Germany. The growth of demand in this case was, however, not greater than that of the national product—in contrast to the situation in most other West European countries—because in West Germany’s national accounts supplies to East Germany count as exports.

The high rise in interest rates as part of stabilization policy dampened the sales and earnings expectations of business and made financial investments more attractive thus impeding the expansion of investment in plant and machinery in many countries. This was true in particular in the USA, Canada, Great Britain and Sweden; but also in a number of other countries such as Italy, Spain and Finland the growth of investment in plant and machinery slackened markedly. In Japan, however, the investment boom went on virtually unabated and in western Germany the inhibiting impacts of monetary policy were overcompensated not least by demand impulses from eastern Germany. There were also quite considerable differences in trends in private consumption, if only because employment and the pace of expansion in disposable income were markedly influenced by the respective economic trends. In late summer the expansion of real income and of private consumption slowed down due to the rapid rise in the price of mineral oil products. Unlike the growth in investments in plant and machinery, though, growth in private consumption as a whole was not lower than in the previous year; only in the USA, Canada, great Britain and Spain was there a substantial slow-down.

The divergence in growth rates amongst the leading industrialized countries last year contributed to a further decrease in balances on current account: the deficit in the USA and the surpluses in the Federal Republic of Germany and Japan diminished. In autumn, the rapid rise in petroleum prices on the world market triggered a general shift in balances on current account in favour of the oil-exporting countries.

**Impacts of the Gulf Crisis**

The repercussions of the outbreak of the Gulf crisis in August 1990 on economic developments have kept within bounds largely because of the high elasticity of oil supply outside Iraq and Kuwait which enabled a rapid easing of the market so that oil prices dropped again considerably by