Will There Be a Worldwide Recession?

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In recent weeks, fears of a worldwide economic recession have become widespread because more and more symptoms appear that resemble those at the start of the great depression of 1929. However, wrong conclusions may be drawn from similar symptoms unless basic development trends as well as the differences in overall data and in functional relations are seen at the same time.

The thesis is not new: already about 18 months ago, wide international publicity was given to fears of the dangers of a worldwide — and therefore particularly drastic — economic decline. Such considerations were based on the fact that, in the first half of 1973, all the industrialised countries of the West were going through a boom phase together. For about 20 years, such economic synchronisation had not been seen. Moreover, prices were then rising with extraordinary speed, primarily as an effect of the worldwide boom. Most countries recorded the highest price rises since the Korea crisis.

The Overkill Thesis

Some fears were expressed then that the struggle against the rapid rise of inflation would lead, in various countries, to parallel policies of vigorous reduction of demand. Neglect of the effects of restrictive measures on trade partners, so it was argued, would cause a drop in their exports, leading to developed countries of the West sliding into a vigorous economic decline far superior to what was intended by quenching the feverish boom.

However, during the summer of 1973, warnings against such an “overkill” had to be considered rather a dramatisation of potential developments because it was hardly possible to infer, from the more or less parallel upward move in the trade cycle by most countries, that they would also continue to move at the same speed through its declining phase. Admittedly, in this constellation, developments in different countries tend to reinforce each other, but as movements through trade cycles, over the last 20 years, had been very different in individual industrialised countries of the West, the simultaneous high exploitation of available resources everywhere is more likely to have been accidental.

More realistic, therefore, seems the surmise that business trends in the Western World would again be more differentiated, especially since some of the national economies involved had been using their capacities to their limits already for a much longer period than others. Moreover, the thesis quoted earlier implied that economic policy would not adequately include in its reasonings international economic trends, as is necessary in view of the strong international dependence of most western countries, especially of West European national economies. However, this rather unflattering assessment does not do full justice to most makers of economic policies. Admittedly, international economic cooperation is often less strong than desirable, but measures of economic policy are usually introduced on the basis of a thorough diagnosis and forecast of a given country’s economic development; the hitherto existing as well as the prospective economic trends in the most important partner countries are considered via the analysis of imports and exports.

Oil as a Special Factor

Nevertheless, it is true that worldwide economic contraction proceeded even more quickly than had been feared during the summer of 1973 but this was mainly due to a special factor: the oil crisis, and especially to the explosion of oil prices since the end of 1973. After the cut in crude shipments to the industrialised countries of the West had first led to a temporary reduction in output in some branches, e.g. the chemical industry, and in demand especially for motor cars, the enormous rise in oil prices indirectly caused a lasting slowing down of production. Higher oil prices together with a persistent price boom in the other international commodity markets fed new fuel to the, anyway, powerful rise of prices in western industrialised countries. This worked partly through increases of production costs — where oil imports counted as a first step in the manufacturing process — and partly through higher prices for end products, especially gasoline and fuel oil, entering price indexes. The substantial price rises caused a slowdown of eco-
nomic expansion, or even — notably in the US and Japan — an actual reduction of private house-holders’ real incomes that led to cuts in consumption (adjusted for price).

But a generally steep decline was caused mainly by the economic policy makers in western industrialised countries, who were spurred to action by the powerful rise of crude oil prices. In almost all countries, this intervention had been brought forth by persistent, and now continuing and often accelerated, inflationary trends, but some govern-ments, e.g. that of Italy, were forced to act by their foreign trade position, too. That was because in almost every industrialised country of the West, with a few notable exceptions including the Federal Republic of Germany, suddenly soaring payments for oil imports pushed the balance of payments into big deficits.

Thus, last summer’s economic advances that had been made simultaneously on a broad front were now, indeed, followed by a similarly synchronised retreat into restrictionism — thus the prognosis became reality though under fundamentally changed conditions. At any rate, this is true in so far as the economic downswing has now become worldwide. Only Austria, Norway, Sweden, and for a long time also Belgium and France were able to escape this process. In all other countries, utilisation of productive capacities has visibly dropped.

Yet a true recession — however one defines this — has started, if at all, only in very few countries. If a recession is defined — as is frequently done in North America — as a decline of the Gross National Product (seasonally adjusted) in two subsequent quarters, only the US has experienc-ed one. If recession is interpreted as economic stagnation, also the UK and Japan are now affect-ed by it. In these countries, the GNP in real terms will be somewhat lower in 1974 than in 1973. In most other countries of Western Europe the utili-sation rate of capacity has also gone down but actual supplies of goods and services have still grown. Western Europe’s GNP in real terms in 1974 is likely to be between 2.5 and 3 p.c. higher than in 1973.

Parallels to the Big World Slump

There is not only disagreement over how to de-fine a recession but also on the probable depth of the coming recession expected by many. Warn-ings against a worldwide recession are often as-sociated with memories of the pre-war world slump. In recent weeks, such fears have become more widespread because more and more symp-toms appear that resemble those at the start of the great depression in 1929.

As a particularly striking signal, both of the 1929 depression and of the world slump that is expect-ed now, people point to the — occasionally precip-i-tate — drop of share prices in almost all interna-tional stock exchanges. Was it not the beginning of economic decay when Wall Street crashed in 1929, and do not share prices plummet now too?

However, the effects of this decline are very dif-ferent now. In 1929, speculators who had operat-ed with huge credits had been forced to sell many shares. Today, on the other hand, there are hardly any big portfolios held on a credit basis. Hitherto, even the use of shares as collateral securities for credits, in spite of the deep plunge of their prices which might catch some portfolio holders short, has caused neither selling pressure on the exchanges nor noticeable disruptions in the credit markets.

Different Symptoms

This example — like many other ones, including bank crashes and the downward trend of com-modity prices — demonstrates clearly the danger of drawing the wrong conclusions from similar symptoms unless basic development trends as well as the differences in overall data and in functional relations are seen at the same time. These differences strictly prohibit the habit of in-ferring from the similarity of many symptoms a simple duplicity of developments. On the other hand, it does not do to underrate the braking effect of psychological factors during the present stage of the business cycle, which might be pro-duced by the growing pessimistic belief in a forth-coming crisis. Also the “destruction of capital” caused by falling share prices and by the mount-ing number of bankruptcies will probably reduce the propensity to spend or to invest of many, but it would be wrong to overvalue the sizes of indi-vidual fortunes, or asset structures, as factors determin-ing the movements of demand.

On the whole, “presentiments of a coming de-pression” magnify too much the similarities, whilst neglecting the differences between past and present symptoms. Among decisive differences is, for example, the general price trend. It is true that quotations in international commodity mar-kets, especially in those for industrial raw mate-rials, have gone up during recent months, some-times even steeply — as in 1929. But the general price level in industrialised countries has been soaring exceptionally steeply for more than two years. In the late twenties, on the contrary, gen-eral price levels declined steadily. At first sight, the following statement sounds paradoxical: but it is a fact that the difference in price trends might give more grounds now for believing in a growing risk of economic decay than do the