

THE INTERNATIONAL ECONOMIC OUTLOOK
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To the First National in Palm Beach
March 30, 1988

Good afternoon! It is a pleasure and an honor to have this opportunity to meet with the officers and guests of the First National Bank. When Tom Walker invited me to speak here this afternoon, he asked that I direct a good portion of my remarks to international economic conditions. This is a most welcome topic since we have entered into a period in our history when it will become increasingly difficult to find any business that is not affected by international developments. Not everyone is equally aware of this internationalization, however, and that lack of awareness has some potentially dangerous side effects. Some lack the patience to allow market dynamics to do the work of balancing trade flows. Instead, they demand misguided quick fixes like protectionism, or constraints on foreign investments in this country. Some would also like to return to the days before currencies were allowed to float freely on world markets through unrealistic strategies like fixed exchange rates.

These all too widespread misunderstandings arise from the failure to recognize that times have changed dramatically. Thus I would like to spend most of my time today talking about one of the significant changes that is altering the shape of the global economy today. That is the transition from a consumption-driven economy in the United States to one that is based to a greater extent on exports. I will begin by describing in more detail how this important transition is affecting both the national and the international economic outlook for 1988. I shall then go on to discuss the complexities of international policy coordination in the current situation. While I will not underestimate the challenges we face, I will close by offering some policy initiatives that might be more in line with changing realities.

The National Economic Outlook

To begin, then, let me paint a very broad-brush picture of the economic outlook. Today, when we try to discuss what lies ahead economically, we have to take a global perspective. Because of the sheer size of our domestic economy, our home markets were the sole focus of most American business people until quite recently. Lately, though, Americans have become increasingly conscious of the broadening scope of that marketplace. The dollar's appreciation on foreign exchange markets from 1980 to 1985 hit our manufacturing sector hard. It showed us that there were numerous competitors out there ready to take market share away from us and hold onto it with their high quality products.

Agriculture, too, was hurt as the relatively high value of the dollar made American commodities more costly than those of our competitors. At the same time the fruits of the "green revolution" ripened. Countries like China, which could once be counted upon to import American grain, actually became net exporters. More recently, the stock market crash amply demonstrated the high level of worldwide integration in money and capital markets. Thus, in all aspects of commerce we found that businesses in Tokyo, Hamburg, and Seoul were making major inroads into markets which had been virtual monopolies for American producers.

At the present time, a new development is taking place in this global market. There is a fundamental structural transition underway in most of the world's industrialized economies. In the United States we are in the midst of a shift from an economy driven by consumption to one which will rely upon exports for a great share of its growth. In the economies of our major trading partners, the mirror image of this process is taking place. Their economies are having to rely more on their own domestic demand, whether from consumers, businesses, or government, and less on exports as the main source of growth.

This transition is not entirely new. It really began, at least in the United States, during the last quarter of 1986, when the effect of the falling dollar began to show up in improvements in real net exports. Exports have continued this course nearly uninterrupted through the latest trade figures. This shift is not yet clearly indicated by certain macroeconomic indicators like gross national product, whose growth may remain moderate in spite of increasing exports. What is significant, however, is that the economy continues to find sources of strength as the current expansion moves into its sixth year. In the United States real GNP growth was nearly 3 percent in 1987. This rate of expansion helped lower the unemployment rate to 5.8 percent by December of last year, the lowest it has been in eight years. In February, the latest month for which figures are available, the rate of joblessness was even lower, down to 5.7 percent. Looking to 1988, I see a continuation of expansion, albeit at a slower pace of about 2.5 percent.

The source of strength underlying this encouraging forecast is the greater balance being developed in the U.S. economy. The dollar's substantial decline over the last three years is having very positive effects on those goods that are exported and, to a lesser extent, on products which are sensitive to import competition. As demand for exports strengthens, our manufacturing sector is recovering some of its health. Other sectors that had been lagging can be expected to contribute more as well. Farm prospects look reasonably good—a welcome change from the bleak years of recent memory. Continued stability in oil prices should help the energy sector. This return to greater economic equilibrium should help those areas of the country that have been bypassed by the current expansion. The midwestern farmbelt; the oil patch of Texas, Louisiana, and Oklahoma; and the industrial heartland of the northeast and north-central states should now see much more growth.

International Prospects

Looking beyond the United States, we find that the same dynamics that are affecting our economy are working in the opposite direction in other advanced economies. The price impact generated by the lower dollar will continue to dampen the important export sectors of Europe and Japan. Whereas the worldwide transition is bringing more balance to our economy, however, it is not likely to help the economies of most other industrialized nations. That is because consumption fueled by domestic demand has not been taking up all the slack left by waning exports in these countries; therefore, their growth is likely to decelerate more than in the United States during this transition.

This sluggishness is most apparent in West Germany. Once the dynamo of Europe, Germany seems likely at best to repeat last year's sluggish 1.5 percent GNP growth. Prospects for France are similar. Italy's economy expanded faster in 1987--at about the same rate as in the United States. There too, however, growth will probably slow in 1988.

The strongest growth among European nations next year should come in the United Kingdom, which is not as closely linked with the slow-growing countries on the continent. Last year's 3 and 3/4 percent rise in gross domestic product finally brought unemployment below the 10 percent mark in the last quarter. Such performance is probably unsustainable. Nonetheless, growth in the United Kingdom should remain faster than on the continent and ahead of the U.S.

More rapid growth is also likely across the Pacific in Japan. That country has been more aggressive in making the transition from an export-led economy to one fueled more by demand from domestic consumers, government, and business spending on capital goods and structures. Japan's emergency stimulus package and new tax laws, enacted last year, as well as monetary policy are starting to have a ripple effect and should spur noticeable growth in domestic demand. That increase is likely to lead the economy to

repeat its 1987 growth rate of 3.5 percent, even though reducing its large current account surplus will exert a drag.

Of course, growth rates are not the only measure of economic well-being. Unemployment and inflation must also be weighed. When we do so, the difficulties Europe has been experiencing in making the transition stand out more clearly. Unemployment in much of Europe seems quite high by American standards. Germany's has been edging up to the 9 percent range. Even in faster growing Italy and the United Kingdom, unemployment is still in or near the double digit range.

Fortunately, the dollar's lower value will act as an anti-inflationary force in most other advanced economies. Consumer prices were virtually flat last year in Germany, and inflation is quite low in Japan. However, price pressures are not abating in all countries, despite the dollar's decline and the attendant effects on dollar-denominated imports. In Italy and Great Britain, for example, countries that have been expanding pretty fast, price pressures are intensifying.

Perhaps most importantly, the growth rates projected for most of the world's advanced economies are below their potential. When Americans hear that Japan will likely expand at a pace almost half again as fast as ours in 1988, we tend to regard that as quite high. What we forget is that the structure of Japan's economy is such that it could be growing even faster without generating inflationary bottlenecks. Were they able to do so, the higher income growth that would result could support more purchases of U.S. goods and thus stimulate our expansion.

Even more significant is the fact that faster growth in the industrialized nations would be a decided boon to the world's developing economies, or LDCs. Many are heavily indebted. Still more have had much slower growth in the eighties. With inflation less controlled, living standards in many have deteriorated. The implications of these

seemingly far-away developments for the advanced economies are profound. No one wants to contemplate the reverberations in the banking community of a flare-up in the ongoing LDC debt issue. All of us have lost earlier strong export markets because of the austerity programs launched in much of the Third World in response to this ongoing crisis. Finally, the potential for political upheaval is heightened when the promise of improved living standards is deferred for so long.

Given the fact that growth in many advanced economies and perhaps most of the developing world is below potential, it seems that some form of policy coordination should be undertaken to speed up business activity and ease the pains of transition. Let me turn, therefore, to a consideration of what joint actions we might take to render the structural transition I have been discussing less painful and bring growth up to potential.

Issues and Policy Challenges

When we begin to think about international policy coordination, we naturally tend to focus on specific problems and solutions peculiar to them. Discussions of LDC debt, for instance, often gravitate toward loan restructuring proposals and the like. Such stopgap measures are, of course, necessary for dealing with crises at hand and can sometimes set the stage for more improvement. The recent Mexican debt proposal exemplifies this approach: I find it an innovative and encouraging approach, though it is not a solution for all LDCs.

Similarly, I strongly support economic summits and other regular meetings. When these gatherings result in policy coordination decisions, generally we are all better off. We need only think to the beneficial results of the September 1985 summit on currency realignment. Notwithstanding the success of this meeting in fostering better balance among the world's currencies, I feel that this narrow approach is reaching its limits. The

current focus on targeting particular exchange rates will not be successful, in my view, unless the values for various rates are sustainable in financial markets. Money and capital exchanges are too interconnected, as we saw this past year, to enable governments to maintain artificial exchange rates. The comparative stability of exchange rates for much of the post-World War II period derived from agreement on policy objectives among nations that there was a need for worldwide expansion. In addition, there were no large differentials in inflation rates during that period. When the economic objectives of individual nations began to diverge in the 1970s, the system of pegged exchange rates no longer worked. By the same token, we cannot go back to imposing exchange rate targets or ranges unless we have agreement upon economic objectives.

Unfortunately, consensus is hard to reach when a broader scope of problems is addressed, or when conditions and social values from one country to the next diverge sharply. If their economies are all overly strong, then coordinated policies designed to slow them will be effective. Five years ago when most of the industrialized nations were underperforming as a group--with ample excess capacities--a simple strategy of applying expansionary policies in each country proved beneficial to them all. However, when performance--or social values--vary, coordination may be complex.

This is the crux of our current problem. Differentials in inflation rates tend to move our exchange rates continuously out of line. Clearly, the German public will tolerate more unemployment and less inflation than we will in the United States. Hence, their leaders are reluctant to stimulate more than they already have despite the fact that price pressures are almost nonexistent while joblessness is quite high. Given our different social values and historical experiences, it is difficult to achieve much progress toward coordinated macroeconomic policies.

Aside from the fact that narrow policy agreements are not optimal in a complex

situation and that agreement on broader fundamentals is often difficult to reach, another constraint on international policy coordination inheres in our policy tools. The macroeconomic policies that we have are of only two kinds--the monetary policy of central banks and government fiscal policies. Tax and spending policies in the industrialized nations are very slow, perhaps too slow to change, as all of us are well aware. This places an undue burden on monetary policies, which are often put in the position of trying to attain more goals than they can possibly achieve.

Finally, I must be candid and concede that caution during a period of change is a prudent course. Otherwise, extreme measures can too easily backfire and produce severe dislocations, throwing industry and commerce seriously out of balance.

All this seems very pessimistic, and I do not want to underestimate the complexities and constraints associated with global economic coordination. Still, I believe there is hope. Notwithstanding what I have said about the appropriateness of prudence during a transition and the right of each nation to its own social choices about unemployment, inflation, and economic growth, I personally feel that Germany could afford to do more in the way of domestic stimulus. Its minimal inflation rate and high level of joblessness suggest to me sufficient slack to warrant faster growth. Given that country's pivotal role in the world economy, I would like to see the Germans do more toward expediting growth--for the sake of the world as a whole--and, of course, their own country too.

Another fruitful area for international cooperation is in the realm of trade barriers. The renewal of protectionist sentiment in the last two years or so has captured much attention and prompted several legislative proposals to make it harder for foreigners to sell to Americans. However, all countries have some forms of protectionism. Almost every nation has certain agricultural policies, for example, that work to distort international trade flows. By working to lower trade barriers

everywhere, the nations of the world enhance the advantages of the "global marketplace." I hope that the recent free-trade agreement between Canada and the United States will be a harbinger of similar moves to reduce trade barriers elsewhere. Also, we need more coordination on agreements in the area of technology and creative patents. The recent round of talks in Uruguay were only a small step in this direction. This, then, is a fruitful area for policy coordination that is woefully underexploited.

That is not to say that some attempts to achieve this kind of meaningful coordination are not already underway. Unfortunately, their momentum has slowed because of protectionist pressures in this country and the misplaced focus on exchange rates. The failure of the U.S. trade balance to improve by a substantial amount has brought forth demands from some quarters for more trade barriers. I am hopeful that further improvement in the trade balance will contain these pressures and allow us to meet global policy challenges in a more rational and productive manner.

In addition, under the U.S. political system of checks and balances there are typically offsetting forces when public policy in one arm--or level--of government approaches the shoals of folly. Today, the state and local governments, particularly here in the Southeast, are well aware of the globalization of markets. Policymakers here actively and successfully recruit foreign firms to make direct investments in the region.

In 1985, the latest year for which statistics are available, the Southeast had proportionately more workers employed at foreign-owned businesses than in the U.S. as a whole. Foreign-owned operations are especially prominent in retail trade, real estate, and machinery production. Eighteen percent of downtown office space in Atlanta is foreign-owned. I see no reason why this pattern of foreign direct investments should change. Indeed, the dynamics of the current transition that has been my theme today favors even more such activity, not just in the Southeast but nationwide. The dollar's depreciation may increase the lure of foreign direct investment in the United States.

Many foreign firms are taking advantage of the current situation to increase their holdings here even as their exports to the U.S. decline.

Conclusion

In closing, I would like to end on a note of optimism. Let me remind you that the world's advanced economies should advance this year on average at a rate of 2 percent. That's respectable growth. At the same time, only moderate price pressures prevail generally. Clearly, the American outlook is pretty positive. Furthermore, compared to a worldwide recession, slow growth in the rest of the industrialized world does not look bad even though it is lower than it could be.

It is true that past strategies like currency targeting probably cannot speed up that growth to potential. Moreover, broader-based agreements are harder to reach when domestic values and economic circumstances differ sharply, as they do now. Nonetheless, the investment flows that I just mentioned, through their impact on the community, management styles, technological innovations and the like, foster a more positive orientation toward the importance of international economic linkages. These, in turn, should lend support to the leaders of the world's industrialized nations in working to dismantle the many barriers that impede trade or in reaching some other kind of policy coordination. As this comes to pass, we will move faster toward the one value which we all share--higher living standards for people in every country.