

# THE INTERNATIONAL ECONOMIC OUTLOOK FOR 1991

Remarks by Robert P. Forrestal, President  
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To the German American Chamber of Commerce  
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*at this meeting I discussed  
the SACC, WJC*

Good evening! I am pleased and honored to have the  
opportunity to speak <sup>*at*</sup> ~~to the German-American Chamber~~. <sup>*and World Trade Club*</sup> My  
coming to meet with you at the beginning of each year has  
become something of a tradition. This is the fifth time I have  
given my international outlook here. Of all the times I have  
spoken to you on this subject, though, the present is probably  
<sup>*fairly*</sup> ~~fraught~~ <sup>*difficult*</sup> with the most uncertainty. With a critical deadline  
just one week away, we await with great trepidation the  
outcome of events in the Middle East. <sup>*Remember just how*</sup> ~~Following a year in~~  
<sup>*the we need*</sup> ~~which we celebrated~~ <sup>*is*</sup> a significant reduction in East-West  
<sup>*So*</sup> tensions; it is distressing to begin this one poised on the brink

of violence in another part of the world. Nonetheless, we can look ahead to the other international developments that help renew our hopes of a global order based on commerce rather than armed conflict. Among these, <sup>developments</sup> I count the economic integration of Europe in 1992, and I would like to talk about a few aspects of that link in the expanding global market this evening. First, however, let me give you my outlook for the international economy.

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### **The Oil Price Shock**

Before I begin my survey, I need to qualify my remarks by emphasizing that any forecast of the world's economic prospects depends on the price of oil. Even barring further conflict in the Middle East, the invasion of Kuwait has already brought a significant adverse supply shock to the



international economy, though it will be felt in varying degrees by different countries. Western Europe, and, even ~~more so~~, Japan have made significant investments toward reducing energy consumption in the years since the oil price shock of the early 1970s. Thus, their output will stand to be less severely affected than in this country, since we let our conservation efforts lapse in the 1980s. Still, the present oil price shock ~~has~~ reduced the industrialized countries' ability to produce a given level of output at a given price and ~~should~~ entail <sup>Will result in</sup> a decrease in economic performance in the months ahead. Ultimately, however, I think we should see a further drop in energy prices. The fundamentals, especially greatly increased output from oil producers other than Iraq and Kuwait, suggest that current supply shortages are being met for the most part. Still, oil prices are not likely to return to

**their pre-August 1990 levels for any extended period. For one thing, prices had already been trending up prior to the initiation of hostilities. Moreover, the politics of oil have changed to the extent that oil producers with low reserves seem inclined to support the price even if they disapprove of Hussein's tactics.**

### **International Overview and Outlook for the U.S. Economy**

**With this caution in mind, I believe growth worldwide will moderate on average in the year ahead, although Japan and Western Europe should still make relatively strong showings. I expect further slowing in the U.S. economy for 1991 as a whole over last year's already sluggish activity. Great Britain and Canada are likely to remain in recessions at least through the first part of the year. Overall, economic**



growth should increase about 2 percent in the industrialized economies. Unemployment will probably remain relatively high in Europe, though below the double digit rates of the mid-1980s, and low in Japan--probably just over 2 percent. Price pressures in Japan and most West European countries should peak by spring and then decline moderately, although German inflation could continue to rise throughout the year.

*Rep. to D. B. Reed*

Let me describe my thoughts on the U.S. outlook for 1991 in a bit more detail. <sup>no forecast of</sup> I look for growth in real gross national product in this country to average about 1/2 percent for the year. The contraction we are likely to have seen in the final quarter of 1990 will probably continue for a while and retard overall growth for the year in spite of a pickup later on. For example, expansion could be around 1 1/2

percent on a fourth-quarter 1991 over fourth-quarter 1990 basis. Since employment lags behind GNP, I think joblessness will be slightly above 6 1/2 percent at year's end, and the annual average rate will probably be close to that level as well. I look for inflation to abate, however, and drop back to between 4 1/2 and 5 percent as an annual average.

◀ In the context of continuing pressures from energy prices, I feel that the strongest sectors of the economy will be services consumption and exports. Weaker sectors include construction, business fixed investment, and other consumers' purchases, especially of durable goods. Government will likely be a neutral factor in the next twelve months. Among the strong points for the U.S. economy in the year ahead, the

service sector, which represents half of all personal consumption expenditures, will probably be stronger than manufacturing and construction. Net exports should also remain a source of strength as Japan and several West European trading partners experience relatively <sup>strong</sup> robust expansion. The trade sector should thus contribute to growth in spite of recessions in Canada and the United Kingdom. In addition, business inventories are relatively lean, and adjustments to inventories will therefore not aggravate any downturn by nearly as much as at similar points in past cycles. Underlying this anticipated growth are the Fed's earlier and recent easing moves. These affect the economy with a lag and should make themselves felt over time and provide impetus to growth.



The weak points in the outlook are conditioned to some extent by cyclical forces as well as by longer term trends. The construction industry suffers from the lingering overhang from past overbuilding and hesitancy among many lenders to finance new projects. Again in 1991, as in 1990, the population shift associated with the aging of the baby boom should dampen the demand for first-time home purchases. I feel, however, that the downturn in construction is probably near the bottom and that the industry is not as likely to exert as much of a drag in 1991 as in the year just ended. Consumption of durable and nondurable goods should likewise remain in a cyclical downturn this year. In addition to this slump in demand, many in the business sector are also encountering tighter lending standards at their banks. Thus, it does not look as if business fixed investment will lend



**support to the economy in 1991.**

**The role of fiscal policy in next year's economy appears relatively neutral. Last fall's budget deficit accord carries the promise of greater constraint in government purchases of goods and services. Spending on Operation Desert Shield may temporarily add to purchases, though, and transfer payments tend to go up during times of economic downturn as well. In sum, I look for services and exports to lead U.S. economic growth in 1991 while construction, consumption of durable goods, and investment remain soft.**

### **Outlook for Other Industrialized Countries**

**Moving to other industrialized countries, in Germany the**

financial implications of unification between the eastern and western parts of the country will almost surely continue to dominate the economic picture. Concerns over further government borrowing needed to <sup>to finance unification</sup> achieve a united German state may lead to tighter monetary policy in the early months of 1991. Although growth in western Germany could average as much as 3 1/2 percent for the year, the drag of the eastern economy might bring the country's combined economic performance down to the 2 to 2 1/2 percent range. Unemployment, too, will be unevenly distributed between the two parts of Germany. In the west, <sup>unemployment</sup> joblessness should remain about where it has been, but in eastern Germany, the number of unemployed there should rise significantly. I expect inflation at the consumer level to continue rising toward the 4 percent level.



Growth in Italy and France could hover at or slightly below 2 1/2 percent, somewhat off from their performances last year. Inflation in Italy is likely to be double France's rate of 3 1/2 percent, while unemployment in both countries could remain above EC averages. Both Britain and Canada are entering the new year in recession, and, while Britain could begin recovering in the spring, Canada's downturn may stretch into the third quarter. Whereas a slowing economy should reduce the U.K. inflation rate by nearly half, prices in Canada are likely to rise on average, though mainly as a result of the "goods and sales tax" that goes into effect this month.

After averaging about 5 1/2 percent in 1990, Japan's growth rate should drop back closer to 3 1/2 percent this year--still enviable by international standards. Relatively

slower overseas growth will probably cut into the country's export business, <sup>al</sup> though buoyant domestic demand should compensate for this loss to some extent. <sup>But</sup> Some potential clouds loom on the horizon for Japan, however. Last year's plunge in equity markets has hurt the prospects for business investment there, and Japanese banks, which have experienced losses in capital as a result of the crash, may now face declining real estate values as well. Thus, Japan's longer term outlook may be somewhat less optimistic.

### **Outlook for the Developing Countries**

Elsewhere along the Pacific Rim, the newly industrialized countries of Taiwan, South Korea, Hong Kong, and Singapore could enjoy strong growth in 1991 driven by exports and growing domestic demand. These nations will



continue developing new sources of labor in China, Thailand, Malaysia, Indonesia, and contributing to the oncoming growth in those countries. The outlook for other developing countries is mixed. Internal political instability could continue to plague other Asian countries like Cambodia, Burma, Pakistan, Sri Lanka, and the Kashmir in India. In Africa, the prospects are bleak as well. It is also unlikely that the economies of the Soviet Union and the former communist nations in East Europe will do well this year. These countries need to resolve how they will evolve functioning markets and implement currency convertibility. In addition, their future business leaders have much to learn about doing business in a market, as opposed to a command, economy.

**I am much more optimistic about our neighbors to the South. In fact, Latin America appears more promising to me now than at any point in the past ten years. For one thing, the region's national leaders are now mostly elected in contrast to the military-backed dictators of the recent past. These leaders are also adopting economic readjustment policies that, while painful in the present, hold tremendous promise for the future. Privatization and fiscal reforms are already showing signs of rejuvenating the Mexican economy, which could grow 4 percent in 1991. Other countries appear to be moving in the same direction, and I am hopeful that the "Enterprise for the Americas" concept advanced by the U.S. government last year could provide additional sources of stimulus for expansion in the region.**



In sum, the international outlook is for continued, albeit more moderate growth as relatively strong performance in Western Europe and the Pacific Rim nations balance more sluggish economies in the United States, Great Britain, and Canada. I look for the latter countries to emerge from their doldrums later in the year, however.

### **The Movement toward European Economic Integration in 1992**

As we <sup>look at the</sup> ~~consider~~ <sup>draw a word</sup> the world's economic outlook, international trade stands out as a <sup>major</sup> pivotal factor driving growth in the industrialized countries/ and as the hope for the future in the less developed countries. One important link in the global commercial network is the lowering of trade barriers in Europe in 1992. I would like to spend just a few

minutes on some key aspects of Europe's economic restructuring, namely the end to non-tariff barriers among European countries, the prospects for monetary union, and EC relations with non-European trading partners. The question of non-tariff barriers arose after most tariffs and quotas on goods and services were removed in fairly short order after the 1957 Treaty of Rome. <sup>But</sup> However, in place of these overt forms of protectionism a broad variety of non-tariff barriers arose in the 1970s and early 1980s as loopholes to protect powerful industries in individual countries. These new barriers include differences in product standards across countries, local content and domestic origin rules, and controls and taxes imposed at national borders.

**Amendments to the Treaty of Rome adopted in 1985 deal**



with these non-tariff barriers through the principle of "mutual recognition." Under this principle, by the end of 1992 each nation must freely admit products meeting the legal standards of other member states even if its own standards are different. There have been estimates of a considerable boost in the EC's gross domestic product when such provisions take effect, and, indeed, substantial savings in cost should occur over time. At first, however, the benefits might accrue more to producers of industrial equipment, which tends to have more universal standards already, than to consumer goods. It now appears that regarding the latter, greater conformity in standards will only apply for the most part where required for health and safety purposes. Meanwhile, German factories are likely to continue making household fixtures in sizes compatible with German, but not

necessarily Italian, homes while French electronic firms produce appliances using wiring that German insurance companies have not shown a willingness to insure. Moreover, Europe's rich cultural diversity suggests that strongly segmented markets for foods and other products will persist. This means that although the European market will be more open after 1992, that market will not necessarily be as homogeneous as, say, the U.S. consumer market, and the number of potential purchasers for a large <sup>variety</sup> array of goods may not increase to any great extent. These qualifications aside, however, the mutual recognition agreement and the corresponding abandonment of border check-points constitutes an enormous step in the direction of freer and more open trade in the global trading community.



Monetary union, a second important issue, is probably still a few years off, but prospects began looking brighter at the end of last year. Britain's entry into the EC exchange rate mechanism (ERM) has moved <sup>over UK</sup> that nation somewhat closer to accepting the principle of monetary union. The resignation of Prime Minister Thatcher, a ~~staunch opponent~~ of monetary union, has further raised hopes in Europe that the movement toward a single currency could accelerate. Over time, such a single European currency should become increasingly attractive. Under the present ERM, currencies are allowed to fluctuate within bands of 2 to 6 percent, and swings of this nature still carry considerable uncertainty for those making business decisions. To take the step toward monetary union, though, European nations would have to cede a good deal of their sovereignty. For example, they



would have to bring inflation rates more into line to avoid exacerbating price discrepancies among similar products from different countries. There is an interesting test of the ERM going on at the moment. While the German economy is receiving stimulus from unification of East and West, the economies of many other participants are weakening. The exchange rate mechanism nevertheless implies that all of them should have parallel monetary policies, raising the question of whether revaluation will be necessary at some point rather soon.

✧ However, resolution of the monetary union issue is not essential for achieving the liberalized trading environment we anticipate in 1992. Indeed, it might be accomplished more easily a bit later, as a logical consequence of free trade in

Europe. Later in the 1990s, discussion may well turn to the formation of a European central bank as an element of final monetary union. At that time, the U.S. Federal Reserve System could well serve as a model. The central banks of individual countries would perform the functions of a District Reserve Bank like the Atlanta Fed, while a central governing body coordinates their activities and formulates monetary policy for Europe as a whole.

Another item of unfinished business involves a final decision on how the exports of non-EC countries will be treated. Especially significant at the beginning of this year is the debate over trade in agricultural commodities. Disagreement over this issue brought about the collapse of the Uruguay Round of the General Agreement on Tariffs and

Trade (GATT) last month--one of the most disappointing events of 1990. The United States proposes a much more dramatic elimination of price supports and subsidies to farmers than does the European Community. The GATT's inability to reach a solution to the agricultural question has deferred decisions on intellectual properties and other matters that are of utmost importance to the United States as well as the rest of the world. There is reason to hope that the talks will begin again at some point during 1991. <sup>2 Jan</sup> Indeed, I think a general awareness exists that failure to resume discussions places us in the precarious position of reverting to a world of trade blocs. Europe, the United States, and the rest of the world would be much the poorer--and considerably less secure politically as well--were such a reversal to occur.



On balance, though, I feel that there is already considerable momentum favoring resolution of these and other details involved in the monumental and historic effort to forge a unified European economy. We should not forget how much progress has already been made. At the beginning of the last decade, it appeared the effort had run out of steam as various countries resorted to subtler forms of trade impediments to protect their national industries. Now that sort of bickering has been replaced by an infectious enthusiasm in which we in the United States share. If businesses, government officials, and the people of the European Community can hold to the vision of an integrated Europe, by the start of the twenty-first century, we may be anticipating the beginning of a politically united Europe in the way we now await the events of 1992.

## **Conclusion**

**In conclusion, I look for a relatively good performance from the international economy in 1991 even though the United States is not likely to be one of the driving forces in world growth, at least in the first half of the year. Instead, I expect Western Europe and the Pacific Rim nations to take the lead. Meanwhile, until the crisis in the Persian Gulf is resolved, we must look beyond present uncertainties to an international economic order that should help us avoid such unsettling episodes in the future. European Community market unification in 1992 is one step toward that eventuality. Let us hope that the new year brings not only a peaceful end to the confrontation in the Middle East but also a resumption of talks aimed at salvaging the Uruguay Round of the GATT. Both are essential for keeping us on track**

**toward the continuing expansion of the worldwide market for goods and services in which an economically unified Europe should play a major role.**