THE INTERNATIONAL ECONOMIC OUTLOOK FOR 1993
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It is a special honor to speak to this very knowledgeable and distinguished audience on the subject of international economic conditions. I have been privileged to have had this opportunity for a number of years, but this occasion is especially challenging because of the eventful year that just ended.

Last year at this time, we had a number of hopeful signs about the progress toward greater international coordination, both politically and economically. In contrast, 1992 highlighted the difficulties of forging common ground when national economic performance is disappointing. Two formalized processes for achieving better and more balanced economic performance through a closer integration of economies were diverted, delayed, or recast as a result of unanticipated economic developments. I am referring, of course, to the Uruguay Round of the General Agreement on Tariffs and Trade (GATT) and the Maastricht Treaty, which among other things calls for a central bank for the European Community and a single currency. Fortunately, there were also some prominent successes, most notably the North American Free Trade Agreement (NAFTA). The NAFTA was signed last year by the presidents of the United States and Mexico and the prime minister of Canada. The only step remaining is for the respective national legislatures to grant final approval, although there is opposition.
While the Agreement will prove beneficial to its three participants over time, as a regional agreement it should be viewed as a supplement to the multilateral effort embodied in the GATT and not as a successor. I fervently hope that the Uruguay Round will be successfully and swiftly completed. Although the Maastricht Treaty also represents a regional form of integration, it deserves greater attention because I believe the issue of monetary union is critically important and one that all countries should better understand. I will, therefore, devote some of my remarks today to this issue. Let me begin, however, by reviewing those troublesome economic developments to which I made reference and offering my views on what 1993 holds in store for various regions of the world economy, beginning with the G-7 countries.

International Overview

Overall, growth will continue to be modest during 1993 for the Group-of-Seven industrialized nations. Unlike last year, though, the U.S. rate should be higher than most of the others. The growth rate in gross domestic product (GDP) should average between 2 and 2 1/2 percent for the industrialized nations, including the United States. This rate will be up slightly from the somewhat-less-than 2 percent average growth the industrialized countries probably recorded in 1992. Inflation in most of the G-7 countries seems to be under control and should remain on average near the 1992 rate of about 3 percent.

U.S. Economic Outlook

To give some details to this overview, let me begin with the U.S. economy. U.S. output should expand by a moderate pace of close to 3 percent, after growing 2 percent in 1992. Price
pressures are more moderate than they have been in some time in the United States, and the consumer price index (CPI) should turn out to be 3 percent or a bit higher as an annual average. Since changes in employment lag behind changes in GDP and many businesses are still seeking to improve their productivity, I think the jobless rate will fall only slightly from its 1992 average of nearly 7 1/2 percent. The unemployment rate will probably average 7 percent in 1993 although by the end of the year it should be below that level.

The main sources of strength underlying the U.S. expansion are consumer spending on durable goods, residential construction, and capital spending on equipment by businesses. Clearly, lower interest rates are a factor in each of these areas. First of all, they have enabled households and businesses to restructure their balance sheets. Consumer debt service as a percentage of income, for example, has fallen to levels not seen since 1986. As a result, households are in a better position to purchase goods that are typically financed with credit, and the cost of doing so is much lower than before. Construction of single-family houses has already been rising for more than a year in the wake of lower mortgage interest rates and the gradual absorption of the large inventories of homes built in the 1980s. In turn, housing construction tends to boost demand for furniture, refrigerators, and other durable goods.

Demand for these and other consumer durables like cars is also being heightened by the fact that products simply wore out during the extended period of weak economic performance. To be sure, the much slower population growth the United States has begun to experience will prevent purchases of consumer durables from surging, just as it is retarding the absorption of the
excessive number of apartments and condominiums that were built in the 1980s. Nonetheless, 1993 holds promise for solid gains in demand for consumer durables.

Business investment in capital goods, particularly computers and other equipment, is likewise expected to advance as the pace of growth accelerates. While investment in office and retail space will remain weak due to past overbuilding, nonresidential construction should at least be less of a drag on growth than in the past few years.

Areas of weakness include not only commercial construction but also government spending, especially on defense, and for the first time in many years, international trade. With the new Administration just taking office, it is somewhat risky to forecast government spending, but well-defined plans to reduce defense expenditures are in place and in progress.

More troubling than the likelihood of reduced government spending is the deceleration of export growth. This shift is significant because exports were a main source of strength for U.S. manufacturers during the recent recession and subsequent slow recovery. Also, the improvement in net exports added steady momentum to the U.S. economy until recently. The currently widening deficit in net exports is due not only to a rise in imports as U.S. output expands but also to economic developments in the major trading partners of the United States. So, let me turn to the outlook for other countries.

Outlook for Other Industrialized Countries
The weakness in economic performance that afflicted the United States for the past several years became evident in other G-7 countries during 1992. Forecasts for growth were repeatedly revised downward during the course of the year. The factors driving these revisions varied somewhat from country to country. In Japan and the United Kingdom the forces were similar to those that had undermined U.S. growth—excessive household debt levels, asset price deflation, and dim expectations regarding employment. On the continent high interest rates in Germany dampened growth not only in that country but across Western Europe since exchange rates are formally linked through the Exchange Rate Mechanism. Fortunately, the imbalances that slowed growth in 1992 are being corrected in most of the G-7 countries, and the prospects for 1993 are somewhat more favorable, especially in the second half.

Among the G-7, the outlook for average GDP growth is strongest for Canada. As growth in the United States boosts demand for Canadian exports, that country should come in with more than 3 percent growth in 1993, up from a modest increase of about 1 1/2 percent last year. Prospects are also brighter in the United Kingdom and Japan. The United Kingdom, contrary to earlier expectations, remained in recession throughout 1992. However, lower interest rates should help its economy recover slowly this year and post very modest growth. After decelerating noticeably from 1991 to 1992, Japan will probably see a modest acceleration in its rate of growth from about 2 percent on average in 1992 to about 2 1/2 percent in 1993 as public spending and foreign demand for Japanese products rise.

The weakest performance is likely to occur in Germany. West Germany has increased
taxes to pay for unification with East Germany and maintained comparatively high interest rates. These policy moves, combined with a cyclical downturn in economic activity, should result in slower growth in the near term. The western German economy expanded roughly 1 percent in 1992 and, technically, entered a recession during the middle of the year. In 1993 output will probably advance less than 1/2 percent. The slowdown in Germany will tend to dampen growth in its major trading partners as well. Although the French economy should remain the strongest performer among G-7 countries of Europe, French GDP should slow to around 1 1/2 percent in 1993, compared with 2 percent last year. After hovering just above 1 percent in 1992, the Italian economy should grow just under that rate in 1993.

With business activity growing at a modest pace, it is not surprising that price pressures in the major industrial countries are abating. In France consumer prices should rise between 2 1/2 and 3 percent as they did last year, and Japan's inflation rate should remain below 2 percent. Italian, German and British inflation rates could be above the G-7 average. Italy has not resolved its fiscal imbalances sufficiently to reduce the long-run trend of inflation further. In Britain, the devaluation of the pound and economic recovery should lead to higher prices. The imposition of a value-added tax in Germany will raise prices in the coming months, but price pressures should abate somewhat later in the year. At a more fundamental level, though, the effects of quickly absorbing East Germany and integrating its weaker currency at par are still having an effect on prices in Germany. In 1993 inflation should measure between 3 or 4 percent.

Developing Country Prospects
In contrast to the modest growth anticipated in the G-7 economies, the newly industrializing countries of the Pacific Rim will probably expand by rates of 6 to 7 percent on average. Many of these countries have encouraged growth through foreign trade, and they have done so without shielding domestic firms from international competition. This strategy has proven effective, not only in spurring rapid growth but in fostering an ongoing evolution to higher value added products.

Another rapidly growing region will be Latin America. Over the past several years Latin American economic performance has improved significantly after an extended period when very slow growth and very high inflation reduced per capita living standards. For the region output should expand around 2 percent. Without recent downward revisions to the outlook for Brazil, which is a large share of total Latin American output, this number would be closer to 4 percent. Mexico will probably experience more moderate growth of 2 1/2 to 3 percent, but this performance is largely the result of anti-inflationary policies that have succeeded in reducing inflation to the lowest rate in 20 years. It is true that the reform measures adopted in many Latin American countries--currency stabilization, fiscal discipline, and privatization--have not only catalyzed such positive macroeconomic changes but have also exacted a toll in terms of the transition costs. This price is evidenced in the two attempted coups in Venezuela and the political turmoil in Brazil. However, I strongly believe that the far-sighted leaders of Latin America will not renege on the fundamental changes that have been put in place and that these reforms will, over time, yield more and more benefits to the populations of Central and South America and the Caribbean.
While Latin American countries have experienced some predictable disruptions as their course to market economies gains momentum, the former Communist economies have encountered serious problems just getting started. Russia is hard at work establishing the rudiments of a market economy, including the appropriate government structures such as a framework for establishing a payments system and for issuing debt. However, prices are escalating, and there are few, if any, signs that reform measures have established any momentum. Output in the former Soviet republics could contract over 7 percent this year after falling nearly 20 percent in 1992. Fortunately, some of the smaller economies of Eastern Europe are setting an example of what can be accomplished. Growth in this region should rise for the first time since the iron curtain fell, although only by a modest 2 percent. Poland and Hungary are beginning to see some positive results from reforms that were enacted in the last two years. On the other hand, Czechoslovakia will be delayed in attaining its promising potential because of its recent division into two countries. Political divisions are, as we all know, far worse in the former Yugoslavia.

Africa continues to be the exception to the rule of faster growth or even its prerequisite—a transition to market-based economic systems. Structural problems in the various economies prevent any purposeful movement toward stability. United Nations involvement in Somalia serves as a timely reminder of the complex difficulties facing many African nations.

To sum up the world economic outlook for 1993, the major industrial countries can expect improved performance, on average, relative to last year, albeit modest by the standards
of just a few years ago. Developing countries, especially those in the Pacific Rim and Latin America, can expect rather robust growth. Progress has been slow in the former Communist economies, but, in many respects, these economies have farther to go than did those of Latin America because economic activity was far more centrally controlled and directed. Thus, the adversities witnessed in these economies or in Latin America are an inevitable part of the transition process, both economically and politically, as the focus of activity shifts from the euphoria of the announcement stage to the mundane and often messy realities of implementation.

Integration Face Challenges in 1992

More troubling to me are the challenges to the formal processes of integration that we witnessed in 1991. After having been resuscitated late in 1991, GATT negotiations again faltered in 1992. If the delayed Uruguay Round of GATT negotiations remains blocked, the result could well be to stifle economic recovery throughout the world. This possibility is especially serious in the wake of the disruptions to European integration occasioned by currency crises last year.

The process of economic integration in the European Community did not go very smoothly in 1992. Denmark dealt a severe blow to the Maastricht Treaty when voters there rejected it. As doubts about the implementation of Maastricht spread, the exchange rate mechanism of the European Monetary System—a forerunner to establishing a single European currency—came under severe pressure. Despite massive intervention in foreign exchange markets and major changes in central bank lending rates, the System was jolted by several devaluations
and the exit, at least temporarily, of two of its largest members, Great Britain and Italy. Finally, the Single Market of 1992, although established in name, awaits full implementation of its legislation by EC member states.

Notwithstanding these difficulties, I believe that these delays are likely to be temporary reactions to the economic and political difficulties that Europe faced in 1992. As I have mentioned, economic growth remained weak or recessionary throughout the EC last year. As recovery gains a more solid foundation, many of the problems facing Europe's currency markets could well abate. Danish voters will recast their vote on Maastricht in the spring. Their concerns—and those of many other Europeans—about maintaining national identities and democratic freedoms in the march toward union were addressed by Community leaders at the recent summit in Edinburgh. This effort should help expedite ratification of the treaty. Problems with the adaptation of EC laws into national laws throughout the Community could certainly be the result of the heavy legislative loads placed on most European governments last year, and not the intentional delay of Europe 1992 by member state governments. So, despite the negatives witnessed last year, I am hopeful that Europe will get back on the road to further integration in 1993.

Even if further disruptions to this process occur, we must bear in mind that monetary union has historically been the culmination of economic union. First, trade barriers are eliminated, and then capital and labor flow more freely. As a consequence of this multifaceted liberalization, economic growth accelerates and the stage is set for monetary union. This
sequence has been important because it is easier to deal with the transmission of shocks from one member of an economic union to another in the context of healthy growth.

Conclusion

In conclusion, the year ahead will be a challenging one. Fortunately, the largest economies should turn the corner and are likely to grow somewhat more rapidly than in 1992. This modest improvement in economic conditions should make it a bit easier to address some of the issues that threatened to derail progress toward greater economic integration. Nonetheless, much hard work, an attitude of flexibility, and an unflinching view of the long-term benefits of greater international economic exchange will be required to surmount some of the present obstacles. Despite the current difficulties, let us keep in mind that the end of the Cold War created enormous opportunities for economic progress, which, if seized upon, should raise living standards not only among the former adversaries but throughout the world.