THE INTERNATIONAL ECONOMIC OUTLOOK
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It is a pleasure to be here today to address this group, particularly since it gives me the opportunity to discuss some issues in the international arena. Three policy issues that I believe will continue to have significant consequences for the global economy are free trade, employment (or, I should say, *un*employment), and the need to keep central banks independent from politics. At the end of my remarks this afternoon, I will go into more detail about these issues. First, however, let me provide a run-through of the economic outlook throughout the world, starting with the Group-of-Seven industrialized nations.

International Overview

Looking at the G-7 economies as a whole, growth should pick up moderately, increasing to about 2-1/2 percent as an annual average in 1994 and to between 2-1/2 percent and 3 percent in 1995. These rates would be up from the modest pace of just over 1 percent last year. I am even more encouraged about the pick-up in growth now that the recovery in Germany is fully under way, and there are signs that recovery is beginning in Japan. Those countries leading the G-7 with the strongest growth will be the United States and Canada, followed by Great Britain. Inflation in all of the G-7 countries still appears to be under control, with a projection of between 2 percent and 2-1/2 percent in 1994, and between 2-1/2 percent and 3 percent in 1995. I should mention that these economic forecasts for countries other than the United States are based on numbers provided by Consensus Forecasts, which polls forecasting groups in each country.

The U.S. Economy

Now let me turn to the outlook for the individual G-7 nations and then other industrialized and developing nations. In the United States, the risk in the outlook is not whether the U.S. economy can expand. Rather, it is the possibility that too rapid and thus unsustainable growth will lead to a worsening outlook for inflation. While there have been essentially no signs of inflation up to now, central bankers know that the way to avoid inflation is to act well before it starts to emerge. Once inflation begins to accelerate, much more must be done to get it back down.

Two days ago, the Federal Reserve made a further substantial tightening move to monetary policy. The 75 basis point increase in the Federal Reserve discount rate and a similar rise in money market rates was the largest increase of this type since 1981. (We had actually lowered rates by 100 basis points near the end of 1991, although it always seems easier to move rates down--another aspect of policy that argues for caution.) The Fed decided to tighten monetary policy because the economy was growing at an unsustainable rate, that is, in excess of its long-run potential. The economy was also approaching capacity limitations. This description in economic terms is more or less another way of saying that, if demand grows faster than available supply, producers will start raising prices. We have also seen some evidence of developing labor shortages, which can, of course, lead to wage increases. In addition, although the decline of the dollar vis-a-vis many other currencies contributes to the improving net export situation, it does so by making imports more expensive and less attractive. Also, a weaker dollar can provide the conditions in which domestic producers may be able to raise their prices.

The bottom line is that it is important for the central bank to be ahead of the curve as far as inflation is concerned. This is the tough lesson that I hope this nation learned in the late 1970s and early 1980s. It is far more costly to resist inflation once it has emerged than it is to combat it while the forces that cause it are still in the germination stage. It is also important to note that the Federal Reserve, by resisting inflation, is seeking to maintain sustainable growth and not to impede it.

On the output side, the outlook for the U.S. economy continues to be one of moderate growth sustained by consumer and capital spending. It appears that, as the pent-up demand for durable goods begins to be satiated, the demand for services is picking up. Also, the unemployment rate has been decreasing, and the outlook continues to be good in this area.

Outlook for Other Industrialized Nations

Let me now turn to the prospects for other industrialized nations. As for the G-7 nations in Europe, the European recession has finally bottomed out, and recoveries are under way in most countries. In the case of Germany, economic activity is picking up nicely after a period in which it had been tempered by rising unemployment and, in a larger sense, by the strains of reunification. Overall growth could reach 3 percent this year, with around 2-1/2 percent in western Germany and around 8 percent in the much smaller east. From the U.S. point of view, the strengthening of the economy of this and other important U.S. trading partners should also help U.S. exports to grow more strongly.

France is also recovering from its recession, and improved export markets should also help the French economy begin to grow slowly this year at around 2 percent, compared with a contraction in 1993. Unfortunately, unemployment remains over 12 percent and could remain high for some time. In Italy, where unemployment is also a problem, increased exports generated mainly by the depreciating lira may help the economy to expand by more than 1-1/2 percent also.

The pace of business activity has improved in Great Britain, where the economy continues to recover. Expansion could reach a 3-1/2 percent rate this year, as unemployment declines slightly and consumers spur much of the growth. In other European countries, economic recoveries are under way, with some of the strongest growth being posted in Scandinavia. Denmark and Norway look like they might achieve growth this year of around 3-1/2 percent to 4 percent.

In North America, the moderate recovery in Canada should continue to strengthen this year to around 4 percent. The weaker Canadian dollar is boosting manufacturing activity and exports, and consumer spending has been stronger than expected. Canada also benefits from stronger growth in its dominant trading partner, the United States.

Like other G-7 countries, Japan has been struggling with a much-weakened economy and rising unemployment. It has only recently begun to experience a lethargic recovery. Political turmoil has made it difficult to confront economic weakness in the country. It is not clear what effect this continuing political turmoil will have on the economy. As it stands now, however, average annual growth for 1994 is expected to come in once again under 1 percent, far below the rate that had become customary for Japan. Even as the economy in Japan begins to turn around, the thorny issue of its trade relations with other nations remains.

Outlook for Developing Nations

Turning now to the economic outlook for developing nations in the world, Latin America continues to be a bright spot in the global economy. Chile continues to boom, with growth of nearly 5 percent projected for this year. Growth in Brazil, Argentina, and most other Latin American economies is slowing a bit from 1993, but that appears to be the result of tough anti-inflation factors adopted by these countries. Growth for the region should still exceed 3 percent this year and will probably pick up again in 1995. Despite negative press reports and some market perceptions, I am still positive about prospects for Mexico. NAFTA should be a major help. As a result, growth should pick up this year and next as inflation continues to fall.

Most of Africa still has almost insurmountable problems, but I would like to focus on the promise of a free South Africa. South Africa has the most advanced economy in Africa. If people in that country can at last work together, its economy could begin to form the nucleus of significant economic growth and development among a number of other southern African nations, and perhaps signal a turning point for the continent as a whole. In contrast, the Middle East continues to struggle to achieve sustainable economic growth. Some negative factors are political and social in nature: the violent challenges to governments in Egypt and Algeria by Islamic fundamentalists and the low price of oil. However, peace efforts, should they succeed, will likely yield stronger growth in the future.

Another area of concern is the former U.S.S.R. What many of us may not realize is that the break-up of the former Soviet Union disrupted trade not only among its former satellite countries, but also within the huge nation itself--between Russia and Ukraine, for example. This situation has contributed to problems with output. Concurrently, monetary problems developed as former republics have tried to set up their own monetary systems separate from Russia's, and, more fundamentally, as the central bank of Russia itself allowed inflation to run rampant.

For the long term, it is the economies of China and East Asia that will present the most interesting challenges to the rest of the world because of their tremendous growth and their increasing importance in the global economy. India, too, is also a country that offers substantial new opportunities as a result of its government having loosened certain regulations. Of the most important developing Pacific Rim economies, only the Philippines has projected growth of less than 5 percent this year. Growth in China is expected to average more than 11 percent. As these nations take their places in the global economy, the United States and other countries should have many economic opportunities, if we can become active participants in their markets.

To sum up my outlook then, before I discuss some important policy issues, the strongest rate of output growth in the world is coming from developing Asian economies, as the industrialized nations experience moderate growth. Lower oil prices have helped the industrialized economies in the last two years, but growth in some parts of Europe appears likely to remain too slow to cause a significant downward trend in unemployment.

Policy Issues in the Global Economy

Three policy issues I would like to discuss that have an effect on the global economy are free trade, unemployment, and the need to keep central banks independent. In 1993, we reached promising milestones for the global economy with the successful conclusion of the Uruguay Round of the General Agreement on Tariffs and Trade (GATT) and the approval of the North American Free Trade Agreement (NAFTA). I am very pleased that we achieved the additional steps toward trade liberalization even though the successes were incomplete. Nonetheless, the debate over NAFTA and the difficulty of concluding a GATT agreement show how strong the forces of protectionism are. These episodes also point out the challenges that lie ahead, particularly with ratification of GATT in our own country.

However, another issue that can have an equally large effect on the global economy is unemployment. In Europe, the high level of unemployment, reaching into the double digits, is a plague on the economic houses of many European nations. (Even Japan, which has the lowest unemployment levels of the G-7 nations, is being affected by increasing unemployment--a novel situation.) In Europe, though, as much as the rising levels of unemployment are a problem, the nature of the unemployment is more troubling: rather than people being out of work for short periods of time, unemployment is proving to be long term. Young people in their 20s and 30s are among those most affected. This kind of unemployment has been created in part by regulations that limit flexibility in labor markets; regulations that make it very expensive for companies to hire or fire people; regulations that require, for instance, six weeks or more of vacation. Such regulations dampen the ability of companies to initiate new projects, because they are afraid of being saddled with surplus employees if the project does not work out. Politically, it is always difficult to change rules on which people in a society have come to depend. However, without some recognition that employment cannot be stimulated through regulation, it will be very difficult to ensure balanced economic expansions.

Before I conclude my comments this evening, I would like to discuss one other subject that is close to my heart as the President of the Federal Reserve Bank of Atlanta: the importance of independent central banks. In my view, the key to continued long-term, stable growth throughout the world--in addition to the macroeconomic policies that have already been put in place--depends on having a strong financial system in place in each country. In turn, I believe a strong financial system requires an independent central bank to ensure that the making of monetary policy is separate from fiscal decision-making. Moreover, a strong financial system requires an independent regulatory authority. Personally, I believe that the central bank should perform both roles. However, the main point is that the entity responsible for bank supervision must not be subject to short-term political pressures. Of course, while the central bank and regulatory agency should be independent, they must remain accountable.

Why are such structures so critical to the future of all nations in the world? First, a strong and independent central bank can take steps to reduce and contain inflation. An independent monetary authority would help ensure that the fiscal authority could no longer print money to pay its debts. In turn, the danger of hyperinflation would be greatly reduced.

Second, I would like to emphasize the importance of supervision and regulation in the broader scope of a financial structure. Because the world is driven increasingly by technology that links countries more closely, unsound banking practices pose threats to more than the home country. The collapse of the far-ranging, international bank, BCCI, was an obvious example of unsafe banking practices that have the potential to disrupt global banking. The closing of BCCI raised serious concerns about possible problems that may arise when proper supervisory and regulatory controls are not in place. Generally speaking, the kinds of controls necessary to prevent such situations are enforced by strong, independent banking authorities. In order to ensure the security of the international banking system, it is important that all countries have an independent supervisory authority and that all financial institutions be subject to comprehensive and consolidated supervision.

A third, and perhaps most important, benefit of an independent central bank is that it greatly enhances the credibility of a financial system. In turn, private capital is more readily attracted to banks and other financial intermediaries in a country. As a result, the financial system itself becomes an engine of privatization and growth.

Conclusion

In conclusion, I am excited by the challenges and opportunities presented in our world today. Yes, we have many problems yet to deal with, but I believe we must also take pride in the substantial headway we have made in terms of international trade issues. Many developing nations have begun to exhibit the kind of growth rates that the industrialized nations were accustomed to in the past. Many industrialized nations that had been struggling with constrained circumstances have begun to emerge from their travails. Unemployment and economic reforms present serious challenges for the future. The changes many countries are going through are definitely not easy. Nevertheless, I believe that we all have a future that is much more hopeful for an integrated global economy than it ever has been in the past.