

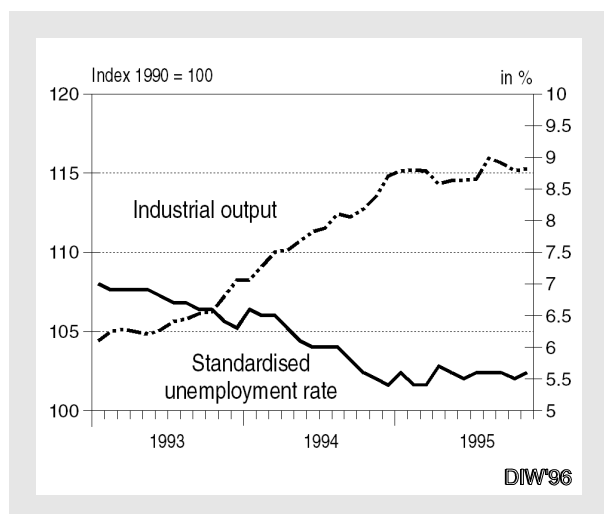
World Economic Trends: Business cycle at the crossroads

The rate of economic growth in western industrialised countries declined perceptibly during the course of 1995. In North America economic expansion weakened, as had been expected following the previous boom. Japan remained locked in economic stagnation. In western Europe a marked slowing of economic growth was inevitable in the wake of the global rise in interest rates. On annual averages real GDP growth in the industrialised countries during 1995 amounted to 2½%, compared with 2¾% the previous year. Average consumer price inflation - 3% in western Europe and under 1.5% in the other industrialised countries - remained very moderate.

The US economy shifted onto a moderate growth path in 1995. The soft landing sought by economic policy makers has thus - initially at least - been successfully accomplished. In the previous year industrial output had in some cases been expanding at two-digit rates; during 1995, on the other hand, trends were uneven. Phases of moderate expansion at the start and in the middle of the year were succeeded by declining output in the spring and autumn.

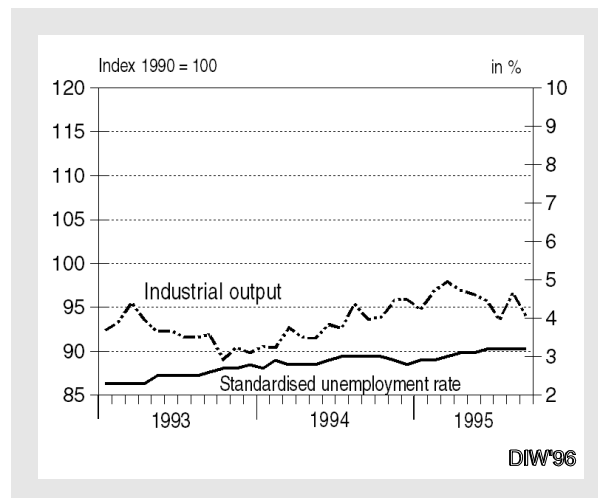
The fact that economic developments in the US have been largely free of tensions over recent years is primarily due to the interaction of an expansionary monetary

Figure 1
Industrial Output and Unemployment Rate
USA



Sources: OECD; DIW calculations.

Figure 2
Industrial Output and Unemployment Rate
Japan



Sources: OECD; DIW calculations.

policy and moderate wage growth. Together, these two trends created the monetary scope for an investment boom which pushed investment as a share of total output to the highest figures since 1970.

Investment is likely to weaken initially at the start of this year, stabilising once more in the course of the year, not least as a result of declining capital market interest rates. No great change is expected in the rate of growth of private consumption in view of the still very favourable employment situation. Because of the economic slowdown in Europe and Canada and the continuing stagnation in Japan, export growth is likely to decline over the course of the year. The dampening of domestic demand will mean, however, that import growth will weaken significantly. Overall GDP will grow by 2% this year, compared with 3.5% in 1995. There will be little change in the level of employment in the course of 1996.

Japan has so far proved incapable of extricating itself from the economic stagnation that has afflicted it for four years now. In the late summer of last year industrial output actually fell below the previous year's level, having grown for the previous twelve months. The decisive factor behind economic trends during the summer of 1995 was the renewed and sharp appreciation of the yen in the spring.

The appreciation of the yen is likely to be partially reversed during this year, opening up the prospect of a return to positive rates of inflation, rather than falling prices. The end of the deflationary phase means that monetary policy can once again make its expansionary effects felt; real interest rates are likely to fall significantly. This, together with improved profitability trends

Table 1

Trends of Gross Domestic Product and of Total Domestic in Western Industrial Countries

Countries	Weight ¹⁾ 1994 in per cent		GDP, real			Total domestic expenditure, real ²⁾			Consumer prices ³⁾		
	GDP	German export	% change on the previous year								
			1994	1995	1996	1994	1995	1996	1994	1995	1996
Germany	10.5		2.9	2.0	1.0	2.8	1.5	1.0	2.8	2.0	2.0
France	6.8	16.0	2.9	2.5	1.5	3.1	2.0	1.5	1.7	2.0	2.0
Italy	5.2	10.1	2.2	3.0	2.0	1.9	1.5	1.5	3.9	5.5	5.0
United Kingdom	5.2	10.7	3.8	2.5	2.0	3.4	2.0	2.0	2.5	3.5	3.0
Spain	2.5	4.2	2.0	3.0	2.0	0.7	3.0	2.5	4.8	4.5	4.0
Netherlands	1.7	10.1	2.5	2.5	2.0	2.5	2.5	2.0	2.7	2.0	2.0
Belgium	1.2	9.0	2.3	2.5	2.0	0.6	2.0	2.0	2.4	2.0	2.0
Sweden	1.0	3.0	2.2	3.5	2.0	1.4	2.5	1.5	2.2	3.0	3.0
Austria	1.0	7.6	2.7	2.5	2.0	4.1	3.0	2.0	3.0	2.0	2.0
Denmark	0.7	2.5	4.5	3.0	2.0	5.8	4.0	2.5	2.0	2.0	2.5
Finland	0.5	1.0	4.1	5.0	4.0	3.5	5.5	5.5	1.1	1.5	2.5
Portugal	0.4	1.1	1.5	2.5	2.5	2.1	3.0	3.0	5.2	4.0	3.5
Greece	0.4	1.1	0.5	1.5	1.5	0.5	2.0	2.0	11.0	9.0	7.0
Ireland	0.3	0.6	6.5	6.0	5.0	4.1	4.5	4.0	2.5	2.5	3.0
EU	37.4		2.8	2.5	1.7	2.6	2.0	1.7	2.9	3.0	2.8
EU excl. Germany	26.9		2.8	2.8	1.9	2.6	2.2	1.9	2.9	3.4	3.1
EU excl. Germany ⁴⁾		77.0	2.8	2.7	1.9	2.6	2.3	1.9	2.8	3.0	2.8
Switzerland	1.3	7.1	1.2	1.0	1.5	3.8	2.5	1.0	0.9	2.0	1.5
Norway	0.6	1.2	5.5	4.0	3.0	4.3	4.0	2.0	1.5	2.5	3.0
European industrial countries	39.3		2.8	2.5	1.7	2.7	2.1	1.6	2.8	2.9	2.8
European industrial countries excl. Germany	28.8		2.8	2.7	1.9	2.7	2.3	1.9	2.8	3.3	3.0
European industrial countries excl. Germany ⁴⁾		85.3	2.7	2.6	1.9	2.7	2.4	1.9	2.6	2.9	2.7
USA	34.4	10.4	4.1	3.5	2.0	4.7	3.5	2.0	2.5	2.5	3.0
Canada	2.8	0.8	4.6	2.5	2.5	3.4	1.5	1.5	0.2	2.5	3.0
Japan	23.5	3.5	0.5	0.5	1.5	0.9	1.5	2.0	0.7	0.0	0.5
Non-European industrial countries	60.7		2.7	2.3	1.8	3.2	2.7	2.0	1.7	1.5	2.0
Non-European industrial countries ⁴⁾		14.7	3.3	2.7	1.9	3.7	2.9	2.0	1.9	1.9	2.4
Total	100.0		2.8	2.4	1.8	3.0	2.4	1.8	2.1	2.1	2.3
Total excl. Germany	89.5		2.8	2.4	1.9	3.0	2.5	1.9	2.1	2.1	2.4
Total excl. Germany ⁴⁾		100.0	2.8	2.6	1.9	2.8	2.4	1.9	2.5	2.7	2.7

1) On dollar basis at 1994 exchange rates (annual average).— 2) Consumption and gross investment by residents.— 3) Germany: price index of private consumption.— 4) Weighted by country's share in German exports 1994.

Sources: National statistics and forecasts by official and private institutions and the DIW. Estimated and forecast rates of change rounded.

and the on-going pressure of rationalisation are likely to generate impulses for a slight rise in private investment.

Private consumption, though, will expand only moderately, as there will be only a slight increase in "mass"

Table 2

Trends in GDP Components in Western Industrial Countries

real % change on the previous year

Countries	Private consumption			Government consumption			Gross fixed investment			Exports			Imports		
	of goods and services														
	1994	1995	1996	1994	1995	1996	1994	1995	1996	1994	1995	1996	1994	1995	1996
Germany	0.9	1.5	2.0	1.2	1.5	1.5	4.3	0.5	0.0	7.5	2.5	1.0	7.1	2.0	2.0
France	1.5	1.5	1.5	1.1	2.0	0.5	1.6	2.0	2.0	5.9	4.5	2.5	6.8	2.5	2.5
Italy	1.6	1.5	1.5	0.0	0.5	0.5	-0.1	6.0	4.0	10.9	12.5	6.5	9.8	8.0	5.5
United Kingdom	3.0	2.5	2.5	2.0	0.0	0.0	3.7	2.0	2.0	8.2	4.0	3.0	6.1	1.5	2.5
Spain	0.9	2.0	2.0	0.2	0.0	0.0	1.0	5.0	3.0	17.7	7.0	4.0	11.0	6.0	5.0
Netherlands	1.7	2.0	2.0	1.0	1.0	2.0	2.7	5.0	1.5	5.1	4.5	2.5	5.3	4.5	2.5
Belgium	1.0	2.0	2.0	1.1	1.0	0.0	1.0	4.0	2.0	6.0	4.0	3.0	4.0	3.5	3.0
Sweden	0.5	0.0	0.0	-1.0	0.0	-0.5	-0.4	12.5	9.5	13.8	9.5	3.5	13.2	7.5	2.0
Austria	2.3	2.0	1.5	2.4	1.5	1.0	5.5	4.0	2.0	4.9	4.5	3.0	7.8	5.5	2.5
Denmark	7.0	4.5	2.0	1.1	2.0	1.5	3.1	6.0	4.0	7.6	4.0	2.5	11.7	7.5	4.5
Finland	1.8	4.5	2.5	-0.6	0.0	0.0	-2.2	12.0	10.0	12.5	6.5	3.0	12.6	9.5	8.0
Portugal	2.0	2.5	2.5	1.0	1.5	2.0	1.0	4.0	2.0	4.5	5.5	2.0	5.0	5.0	2.0
Greece	1.0	1.5	1.5	0.5	0.5	0.0	0.5	7.0	3.0	5.0	3.0	3.0	3.5	3.5	3.0
Ireland	4.3	4.0	3.5	4.0	3.0	2.5	7.0	8.0	5.0	13.0	9.0	6.0	11.0	8.0	5.5
EU ¹⁾	1.6	1.8	1.9	1.0	1.0	0.7	2.6	2.9	1.9	8.2	5.3	2.9	7.4	3.9	3.0
EU excl. Germany ¹⁾	1.9	1.9	1.8	0.9	0.9	0.4	1.8	4.2	2.9	8.5	6.1	3.5	7.5	4.5	3.4
Switzerland	1.0	0.5	0.5	0.8	1.0	0.5	5.9	5.0	2.0	3.3	2.5	2.5	9.0	5.0	1.5
Norway	4.4	3.0	2.0	1.0	1.0	1.5	9.0	12.0	5.0	8.5	3.5	3.5	6.5	4.0	2.0
European industrial countries ¹⁾	1.7	1.8	1.8	1.0	1.0	0.7	2.8	3.1	1.9	8.0	5.1	2.9	7.5	3.9	3.0
European industrial countries excl. Germany ¹⁾	1.9	1.9	1.8	0.9	0.9	0.5	2.2	4.4	2.9	8.2	5.8	3.5	7.6	4.5	3.2
USA	3.5	3.0	2.5	-1.0	0.0	0.0	10.6	8.5	2.0	9.0	11.0	9.5	13.4	11.0	7.5
Canada	3.0	1.5	2.5	-1.7	-0.5	-1.0	7.2	1.5	1.0	14.2	10.5	4.5	10.5	8.5	3.0
Japan	2.2	1.5	1.5	2.8	2.5	0.5	-2.4	0.0	3.0	5.1	5.5	4.0	8.4	11.5	6.0
Non-European industrial countries ¹⁾	3.0	2.4	2.1	0.0	0.7	0.1	3.8	3.9	2.5	8.4	9.1	7.0	11.7	10.8	6.5
Total ¹⁾	2.5	2.2	2.0	0.5	0.9	0.4	3.4	3.6	2.3	8.2	6.7	4.5	9.2	6.7	4.4
Total excl. Germany ¹⁾	2.7	2.2	2.0	0.4	0.8	0.2	3.3	4.0	2.6	8.3	7.3	5.0	9.5	7.4	4.7

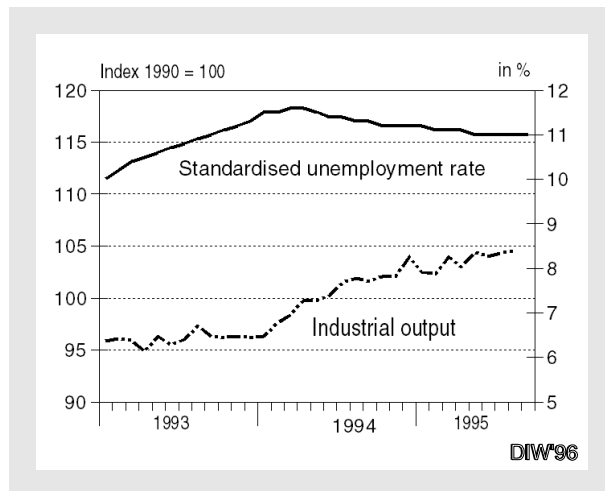
1) 1994 weights on dollar basis at 1994 exchange rates (annual average).

Sources: National statistics and forecasts by official and private institutions and the DIW. Estimated and forecast rates of change rounded.

(wage and transfer) incomes. Import growth is certain to be faster than that of exports. Overall GDP, which stagnated last year, is likely to grow slightly (1.5%).

In western Europe the upturn peaked as early as the autumn of 1994; the expansionary phase was thus extremely short. Just as in 1994 the sharp rise in invest-

Figure 3
 Industrial Output and Unemployment Rate
 EU



Sources: OECD; DIW calculations.

ment demand, reflected by a significant recovery of inner-European trade, was the driving force behind the cyclical upturn, last year's weakening of economic growth was marked by a perceptible decline in investment activity. The hope that the upturn would gradually develop a broader base by virtue of a recovery of private consumption went unfulfilled. Consumer demand remained very restrained.

The western European economy as a whole is increasingly characterised by a weakening of economic growth. Most countries are unable to pursue a fiscal policy that would counter this trend. As regards exchange rate targets, the scope for national monetary policy is also extremely limited. In the absence of fiscal and monetary policies conducive to economic growth, the problems on the labour market are set to worsen. If economic policy makers react inappropriately, there is the real danger of a recession. The economy is currently at the crossroads.

During the course of 1996 it may gradually prove possible to overcome the current economic stagnation and stimulate output. Yet even a slight acceleration of output growth over the course of the year would only generate annual average west European GDP growth of around 2% in 1996, compared with around 2½% in the previous year. Not until 1997 would economic growth once more be in a position to make a contribution towards improving the labour market situation. Consumer price inflation is likely to subside further.

'Arbeitskreis Konjunktur' in the DIW
 (Study Group 'Business Cycle')