Economic Trends 1996/97: Slow Recovery in the Western Industrialised Countries

The western industrialised countries appear to have passed the cyclical nadir. In the United States the economy is expanding more rapidly once more following last year's soft landing, and the Japanese economy, too, has recovered perceptibly following the long period of stagnation. In western Europe, on the other hand, the signs of an economic turnaround are as yet weak. A lasting acceleration of growth there is only possible if fiscal policies abandon the efforts to forcibly consolidate public budgets, and monetary policy adopts an even more expansionary stance. Exchange rate changes will be limited. This is true both of the value of the yen and the D-Mark against the dollar and of parities between the west European currencies, where following the sharp fluctuations of spring 1995, which are partly to be seen as overreactions by the markets, parities have now largely returned to their previous levels.

Marked acceleration of growth in the USA

Following the significant slowdown in the rate of growth of the US economy last year in the wake of the efforts to avoid overheating taken by the monetary authorities, growth has picked up since the start of this year. Despite unfavourable weather conditions and strikes in the automobile industry, industrial output has increased markedly since the start of 1996, and capacity utilisation in manufacturing industry has risen (see figure 1). Strong expansionary impulses are coming particularly from private consumption, although investment, too, is expanding more rapidly than towards the end of last year. Export growth remains strong, although the propensity to import is still high. There has been no decline in the foreign trade deficit.

Employment has expanded extremely rapidly, following the virtual stagnation in the course of last year. The decline in the rate of unemployment was only marginal, however, due to the marked increase in the size of the working population; clearly there has been a fall in non-registered unemployment. This influx of labour is one reason why wage growth has remained moderate, although the rate of growth of hourly wages in the private sector has accelerated slightly, recording an annual rate somewhat in excess of 3% since the middle of last year. Given very low inflation, real wages have increased – slightly – for the first time in many years.

Further progress was made towards a consolidation of government finances. Last year the deficit fell to just over US-$ 160 billion, somewhat in excess of 2% of GDP.[1] As economic growth strengthens once more, the rate at which the deficit is reduced is likely to increase. Until the beginning of this year the monetary authorities relaxed their policy stance further (see figure 1). This led to a fall in short-term interest rates. Since the beginning of the year, however, long-term rates have risen by almost one percentage point, reflecting the improved economic situation in the form of higher earnings and the expectation of a less expansionary monetary policy with higher short-term interest rates. This is likely to have been accompanied by a marginal increase in inflationary expectations. The current strength of the US-dollar on the foreign exchange markets indicates, however, that such expectations are not yet playing a decisive role. Even so, the Federal Reserve is expected to alter its stance in the course of this year and to raise its base rates. Pressure for this change of course comes in the form of the extraordinarily favourable labour market trend. Given the already – for American standards – very low rate of unemployment of around 5½%, more pronounced wage rises are to be expected soon. In order to counter the threat of a lasting rise in inflation – which could occur merely on the basis of expectations to this effect – the central bank is likely to take steps at an early stage.

Even so, a marked increase in investment is expected for the course of this year. Not until next year is the investment dynamic likely to weaken as a reaction to the higher interest rates. Given the favourable employment situation and rising wages, private consumption will generate strong impulses in both the current and coming years. Due to the rise in the external value of the dollar, exports will probably expand rather less markedly than last year. The propensity to import will remain high, so that net exports are likely to slide further into deficit. All in all, GDP growth will be in excess of 2½% in 1997, following a rate of more than 2% this year (cf. table 1).

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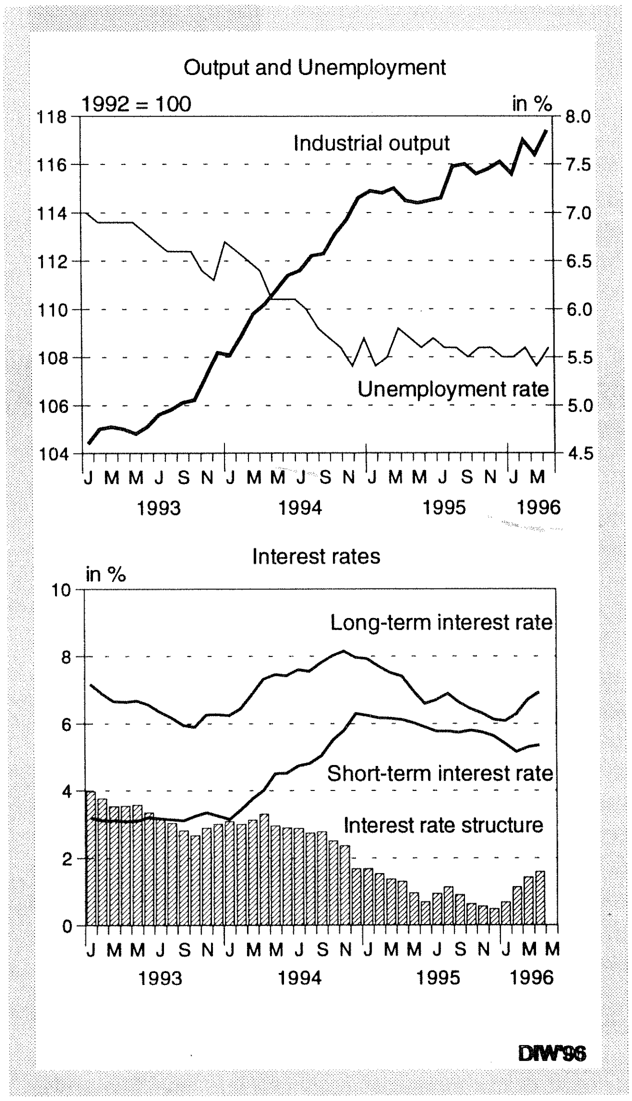
[1] This figure relates to the overall federal budget including the so-called off-budget surpluses. Although this definition differs from that employed in the national accounts, it indicates the extent to which federal government has resorted to the capital markets. At federal state and local government level surpluses were again recorded.

Figure 1
USA



Source: OECD, Main Economic Indicators.

Recovery in Japan

During the first half of 1996 the Japanese economy remained on an expansionary trend. There was a further improvement in business confidence in manufacturing industry. The rise in output remains largely due to the sharp rate at which public demand has grown, although given that the government deficit now accounts for around 5% of GDP, this rapid expansion of public spending cannot be maintained indefinitely. In view of the marked decline in the external value of the yen, the gradual attenuation of government demand impulses is likely to be replaced by stronger export growth. The real effective external value of the yen has fallen by more than one fifth over the past twelve months and has returned to the level of spring 1993. This trend, together with the continued expansion of private consumption, will stimulate private investment.

Stagnation in western Europe gradually coming to an end

Economic trends in western Europe are expected to bottom out during the summer months. The negative net effects emanating since the spring of 1995 from the sharp exchange rate fluctuations in Europe are gradually coming to an end. The monetary policy stance has become more expansionary, with the result that the interest rate structure has become markedly positive. There has been a substantial fall in short-term interest rates. In some cases European central banks have exceeded the pace set by the German Bundesbank without this leading to significant exchange rate tensions. The stringent efforts being made by fiscal policy makers to reduce the scale of budget deficits, on the other hand, must be seen as counterproductive. Although it is often argued that (successful) consolidation has the positive effect of reducing capital market interest rates, there is the very real danger under the prevailing circumstances that such an effect will result merely via a further dampening of economic growth, and that this will put a question mark over the aim of fiscal consolidation itself. There is no sign of an alleviation of the unemployment problem as the rate of economic growth will remain very moderate in 1996/97.

The country whose economic trends are most closely linked to those of Germany is France. The short, sharp upturn in 1993/94 was followed by a marked slowdown in the course of 1995. In the course of this France suffered a perceptible rise in short-term interest rates in the wake of the exchange rate turbulences of spring 1995. Short-term rates subsequently fell, however, and in recent months the French monetary authorities have been able to narrow the interest rate differential vis-à-vis Germany without this leading to exchange rate tensions. Although the now lower interest rates are exerting an expansionary effect on the economy, the policy of fiscal consolidation is being maintained; the reduced fiscal revenue due to the weakness of economic growth will be offset by spending cuts.

Within the field of tension created by this policy constellation, the French economy finds itself in a difficult phase. Although the first quarter of this year saw a sharp rise in private consumption, this consisted very largely of a reaction to the loss of demand during the major strikes during November and December 1995. Incoming orders have stabilised at least, and output prospects have improved. This is due to the generally

Table 1

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

Countries	Weight[1] 1994 in per cent		GDP, real			Total domestic expenditure, real[2]			Consumer prices[3]		
			% change on the previous year								
	GDP	German exports	1995	1996	1997	1995	1996	1997	1995	1996	1997
Germany	10.3		1.9	0.5	1.5	1.7	1.0	1.0	2.0	1.5	1.5
France	6.7	16.0	2.2	1.25	1.75	2.0	1.5	1.5	1.7	2.0	2.0
Italy	5.1	10.1	3.0	1.5	1.5	2.3	2.0	1.5	5.4	4.5	4.0
United Kingdom	5.1	10.7	2.4	1.75	2.5	1.7	1.5	2.5	3.4	3.0	3.0
Spain	2.4	4.2	3.0	2.0	2.5	3.2	2.5	2.5	4.6	3.5	3.5
Netherlands	1.7	10.2	2.4	1.5	2.5	2.4	1.5	2.5	2.0	1.5	2.0
Belgium	1.2	9.0	2.0	1.5	2.0	1.5	1.5	1.0	1.4	2.0	2.0
Sweden	1.0	2.9	3.0	1.0	2.5	1.6	0.5	2.0	2.5	2.0	2.5
Austria	1.0	7.6	1.8	1.0	2.0	2.9	1.0	2.0	2.3	1.5	2.0
Denmark	0.7	2.5	2.6	1.5	2.5	4.6	2.5	3.0	2.0	2.0	2.5
Finland	0.5	1.0	4.2	2.5	2.5	4.5	4.0	3.0	1.0	1.5	2.0
Greece	0.5	1.1	2.0	2.0	2.0	2.0	2.0	2.0	9.3	7.0	6.0
Portugal	0.4	1.1	1.9	2.5	2.5	2.2	2.5	2.5	4.1	2.5	3.0
Ireland	0.3	0.6	7.5	5.0	4.0	6.5	4.0	3.0	2.4	1.0	1.5
EU	36.9		2.4	1.3	1.9	2.1	1.5	1.7	2.9	2.5	2.5
EU excl. Germany	26.6		2.6	1.6	2.1	2.3	1.8	2.0	3.2	2.8	2.8
EU excl. Germany[4]		77.0	2.4	1.5	2.1	2.3	1.6	1.9	2.8	2.5	2.6
Switzerland	1.3	7.1	0.7	0.5	2.0	2.5	1.0	2.0	1.8	1.0	1.5
Norway	0.6	1.2	3.7	3.0	3.0	3.9	2.5	3.0	2.5	1.5	2.0
Europ.indust.countries	38.8		2.4	1.3	1.9	2.2	1.5	1.7	2.9	2.4	2.4
Europ.indust.countries excl. Germany	28.5		2.5	1.6	2.1	2.3	1.7	2.0	3.2	2.7	2.8
Europ.indust countries excl. Germany[4]		85.3	2.3	1.4	2.1	2.3	1.6	2.0	2.7	2.4	2.5
USA	34.8	10.4	2.0	2.0	2.5	2.1	2.5	3.0	2.8	3.0	3.5
Canada	2.8	0.8	2.3	1.5	2.0	1.2	0.5	1.5	2.2	3.0	3.5
Japan	23.6	3.5	0.9	2.0	2.5	1.6	2.5	2.0	−0.1	0.5	1.0
Non–European industrial countries	61.2		1.6	2.0	2.5	1.9	2.4	2.6	1.7	2.0	2.5
Non–European industrial countries[4]		14.7	1.8	2.0	2.5	1.9	2.4	2.7	2.1	2.4	2.9
Total	100.0		1.9	1.7	2.3	2.0	2.1	2.2	2.1	2.2	2.5
Total excl. Germany	89.7		1.9	1.8	2.4	2.0	2.2	2.4	2.1	2.3	2.6
Total excl. Germany[4]		100.0	2.2	1.5	2.2	2.3	1.7	2.1	2.6	2.4	2.6

1) On dollar basis at 1994 exchange rates (annual average).— 2) Consumption and gross investment by residents.— 3) Germany: Deflator 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.

more buoyant state of world trade and the relatively favourable competitive position of French firms. A lasting upturn will not occur, however, due to the growth-inhibiting effects of the fiscal policy stance. Moreover, disposable mass incomes are rising only slowly, leading to only a moderate increase in private consumption. Following economic growth of 1¼% in the current year, a rate of 1½% is expected for 1997. This will be accompanied by a further deterioration in the labour market situation. In both years inflation will remain moderate at around 2%.

The constellation is rather different in Italy. Exports rose again sharply, largely due to the significant depreciation of the lira in the spring of last year, with the result that economic growth was faster than in most other west European countries. Responsible for the economic slowdown during the current year, alongside the general weakness of growth in Europe, is Italian economic policy. For many years now Italian fiscal policy has been attempting to force down the government deficit to below 10% of GDP. This was achieved thanks to the relatively favourable economic growth trend. The attempt to continue the process of consolidation despite far weaker economic growth, however, poses a threat to continued economic expansion, all the more so as the monetary policy stance has become restrictive. Both

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					
	1995	1996	1997	1995	1996	1997	1995	1996	1997	1995	1996	1997	1995	1996	1997
Germany	1.7	1.5	1.0	2.1	1.0	–0.5	1.5	–1.0	1.5	3.8	3.5	5.0	2.7	3.5	3.0
France	1.8	1.5	1.5	0.9	1.0	0.5	2.6	1.0	2.5	6.0	2.5	4.0	5.2	2.5	3.0
Italy	1.7	1.5	1.0	–0.5	–0.5	0.5	5.9	3.5	1.5	11.6	2.5	4.5	9.6	5.5	4.0
Great Britain	2.3	2.5	2.0	0.9	0.5	0.5	–0.7	2.0	3.0	5.7	1.5	2.5	3.1	1.5	2.0
Spain	1.8	2.0	2.0	0.9	0.0	0.0	8.4	4.0	3.5	9.3	4.0	4.0	9.7	5.0	4.5
Netherlands	2.1	2.0	2.0	0.5	2.0	1.5	4.9	2.0	3.0	6.1	2.5	3.5	6.5	2.5	3.5
Belgium	2.0	1.5	1.0	1.0	0.0	0.5	4.0	2.5	1.5	4.0	3.0	4.0	3.5	3.0	3.0
Sweden	0.3	1.0	1.5	–2.2	0.0	0.5	10.6	3.0	4.0	11.4	3.0	4.0	8.7	2.0	3.5
Austria	1.9	1.0	2.0	2.1	1.0	1.0	2.3	2.0	3.0	5.0	3.0	3.5	7.1	2.5	3.0
Denmark	2.3	2.0	2.0	0.2	1.0	1.0	11.0	3.0	4.0	1.0	2.0	3.5	5.4	4.5	4.5
Finland	4.2	2.5	2.0	1.1	0.0	1.0	8.1	5.0	4.0	7.6	3.0	4.5	9.6	7.5	6.0
Greece	1.5	1.5	1.5	1.0	0.0	1.0	8.0	5.0	5.0	4.0	3.0	4.5	3.5	3.0	4.0
Portugal	2.5	2.0	2.0	1.5	2.0	1.5	4.0	3.0	4.0	5.5	2.5	3.5	5.0	2.0	3.5
Ireland	4.0	4.0	3.0	3.0	3.0	2.5	8.0	6.0	5.0	9.0	5.5	5.5	8.0	4.5	4.5
EEC1)	1.9	1.7	1.5	1.0	0.6	0.3	3.3	1.3	2.3	6.2	2.8	4.0	5.3	3.2	3.2
EEC excl. Germany1)	1.9	1.8	1.6	0.5	0.5	0.6	4.1	2.4	2.7	6.9	2.6	3.8	6.1	3.1	3.3
Switzerland	0.2	0.5	1.0	–0.1	0.5	1.0	5.3	1.0	2.0	2.8	1.5	2.5	6.4	2.0	2.5
Norway	2.7	2.0	2.5	0.6	1.5	2.0	5.1	5.0	5.0	3.7	3.5	4.0	4.1	2.0	4.0
European indust. countries1)	1.8	1.7	1.5	0.9	0.7	0.3	3.4	1.4	2.3	6.0	2.8	4.0	5.3	3.1	3.2
Europ. indust. countries excl. Germany1)	1.9	1.8	1.6	0.5	0.5	0.6	4.2	2.4	2.7	6.6	2.6	3.7	6.0	3.0	3.3
USA	2.4	2.5	3.0	–0.3	–0.5	0.5	5.3	4.0	4.5	8.3	7.0	7.5	8.0	7.5	10.0
Canada	1.4	1.0	2.5	–0.7	–2.0	0.0	–0.1	2.5	3.5	12.0	9.5	9.0	8.7	8.0	8.0
Japan	1.6	1.5	2.5	2.0	0.0	–0.5	0.8	4.0	2.5	5.0	5.0	8.0	13.5	11.0	5.5
Non–European industrial countries1)	2.1	2.1	2.8	0.3	–0.5	0.2	2.8	3.9	3.4	7.7	6.7	7.9	9.5	8.5	8.6
Total1)	2.0	1.9	2.3	0.6	0.1	0.3	3.0	3.0	3.0	6.7	4.3	5.5	6.9	5.2	5.3
Total excl. Germany 1)	2.0	2.0	2.4	0.4	–0.1	0.4	3.2	3.5	3.2	7.1	4.4	5.5	7.6	5.5	5.7

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.

Table 3

Trends in Gross Incomes, Unit Profits and Wage Costs per Unit of Output in Western Industrial Countries

% change on the previous year

Countries	Gross income from						Profit per unit of output[1]			Wage cost per uni of output[2]				
	self-employment and property			employment										
	in national currencies												in SDR	
	1995	1996	1997	1995	1996	1997	1995	1996	1997	1995	1996	1997	1995	1996
Germany	8.4	3.0	6.0	3.3	1.5	1.5	6.4	2.0	4.5	1.3	1.0	0.0	8.3	2.1
France	3.6	4.0	5.5	3.8	3.0	3.0	1.3	2.5	3.5	1.5	1.5	1.0	6.5	4.0
Italy	12.6	7.5	7.5	4.4	5.0	4.0	9.3	5.5	5.5	1.4	3.5	2.5	–5.3	11.0
Great Britain	4.0	9.0	11.5	3.7	3.0	3.0	1.6	7.0	8.5	1.2	1.0	0.5	–1.6	1.7
Spain	10.8	7.0	8.0	5.5	5.5	4.5	7.6	4.5	5.5	2.5	3.5	2.0	3.9	8.1
Netherlands	4.6	3.5	6.5	4.0	3.5	3.5	2.2	2.0	4.0	1.6	2.0	1.0	8.7	3.2
Belgium	4.5	3.5	5.0	4.0	3.5	3.5	2.5	2.0	3.0	2.0	2.0	1.5	9.2	3.2
Sweden	19.5	1.5	10.5	4.5	3.5	4.0	16.0	0.5	7.5	1.5	2.5	1.5	3.6	10.0
Austria	9.3	9.0	7.0	3.8	3.5	3.5	7.3	8.0	5.0	1.9	2.5	1.5	9.0	3.7
Denmark	3.3	4.0	6.5	5.1	4.0	4.5	0.6	2.5	3.5	2.4	2.5	2.0	9.7	4.7
Finland	15.9	3.0	3.5	7.6	4.5	5.0	11.2	0.5	1.0	3.3	2.0	2.5	16.6	1.2
Greece	14.5	10.0	9.0	10.5	7.5	7.0	12.0	8.0	6.5	8.5	5.5	5.0	7.3	4.3
Portugal	8.5	5.5	6.5	6.0	5.5	5.0	6.5	3.0	3.5	4.0	3.0	2.5	8.6	4.8
Ireland	14.0	9.5	9.0	6.5	4.5	4.0	6.5	4.5	5.0	–0.5	–0.5	0.0	0.5	1.6
EEC[3]	8.2	5.6	7.3	4.0	3.1	3.0	5.1	3.4	4.9	1.6	1.8	1.0	5.0	4.2
EEC excl. Germany[3]	8.1	6.3	7.6	4.3	3.8	3.6	4.7	3.9	5.0	1.7	2.1	1.4	3.9	4.9
Switzerland	3.5	4.5	4.5	3.5	3.0	3.0	3.0	4.0	2.5	3.0	2.5	1.0	12.4	4.9
Norway	8.0	5.0	6.5	5.0	5.0	5.0	4.0	2.0	3.5	1.0	2.0	2.0	6.2	4.4
European indust. countries[3]	8.0	5.5	7.2	4.0	3.1	3.0	5.0	3.4	4.8	1.6	1.8	1.1	5.3	4.2
Europ. indust. countr. excl. Germany[3]	7.9	6.2	7.5	4.3	3.8	3.6	4.6	3.8	4.9	1.7	2.1	1.4	4.4	4.9
USA	6.9	6.5	4.0	5.0	5.0	6.0	4.8	4.5	1.5	2.9	3.0	3.5	–2.9	6.6
Canada	9.0	3.5	6.0	3.0	4.0	5.0	6.6	2.0	3.5	0.7	2.5	3.0	–5.4	5.8
Japan	3.2	4.0	4.5	1.6	2.0	2.5	2.3	2.0	2.0	0.8	0.0	0.0	3.4	–8.0
Non-European industrial countries[3]	5.6	5.4	4.3	3.6	3.8	4.6	4.2	3.2	2.0	1.8	1.8	2.1	–1.0	1.1
Total[3]	6.6	5.5	5.5	3.8	3.6	4.0	4.7	3.3	3.7	1.7	1.8	1.5	2.9	3.0
Total excl. Germany[3]	6.5	5.7	5.5	3.8	3.8	4.3	4.4	3.5	3.6	1.8	2.0	1.7	2.0	3.2

1) Gross income from self-employment and property per unit of real gross domestic product. — 2) Gross income from employment per unit of real gross domestic product. — 3) Weighted with 1994 shares on dollar basis at 1994 exchange rates (annual average). To 1) and 2): Weighted with export shares on which the calculations of the SDR are based (with the exception of the USA).

Sources: OECD Economic Outlook; EEC Statistical Office; National Accounts; national statistics and DIW forecasts. Estimated and forecast rates of change rounded.

monetary and fiscal policy are now exerting a restrictive effect on the Italian economy. The growth outlook for 1996 and 1997 of around 1½% in each year is modest. At the same time inflation is set to fall to 4% and thus to come a significant step closer to the rates prevailing in the other large European industrialised countries. This should induce the monetary authorities to slacken the reins.

In relative terms the economic situation is most favourable in Great Britain, which in some respects has detached itself from economic policy in continental Europe by the change in economic policy course that followed the country's withdrawal from the exchange rate mechanism of the European Monetary System. The low exchange rate of the pound sterling and rapid interest rate cuts have put the economy on an expansionary path. Also relevant was the fact that the fiscal policy makers opted to accept the – very largely cyclical – increase in the budget deficit, which reached almost 8% in 1993. As the upturn strengthened, the fiscal position was rapidly consolidated: by 1995, i.e. within just two years, the deficit was cut to around 4½% of GDP. This economic policy and the low external value of the pound sterling in real and effective terms on the foreign exchange markets enabled the British economy to weather last year's cyclical weakening in western Europe comparatively well.

If fiscal policy makers continue to refrain from imposing restrictive measures and implement the planned tax cuts, they will, under the current framework of conditions, establish favourable conditions for stimulating the growth process. Economic growth in 1996 is estimated at around 1¾%, whereas in the coming year it will reach 2½% and will thus again be in the front ranks of the large west European economies. Inflation is expected to again decline slightly to around 3%. There will only be a slight improvement in the labour market situation.

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