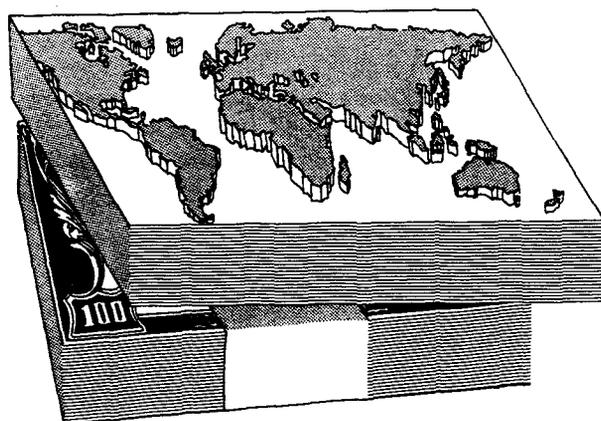


THE WORLD ECONOMY



MACROECONOMIC TRENDS

In the fourth quarter of 1992 quarterly GDP/GNP growth averaged 0.9% in the four major world economies. The world economy remained in the doldrums as growth slowed in the USA and both Japan and Western Europe stagnated. Table 1 sets out growth rates for each country and provides a provisional estimate for the USA and the UK in the first quarter.

Table 1 Growth of GNP/GDP

	92q2	92q3	92q4	93q1
United States	1.6%	2.1%	3.2%	0.9% ^P
Japan	0.0%	-0.6%	0.2%	n/a
Germany	-0.1%	-1.0%	-0.6%	n/a
France	0.3%	0.3%	-0.3%	n/a
Italy	0.3%	-0.7%	-0.6% ^P	n/a
UK	-0.2%	0.2%	0.4%	0.4% ^P

Source: OECD

Industrial production grew strongly in the United States and more visibly than had been expected in the UK (Table 2). Once again, production fell heavily in Japan and Western Europe. The Table also provides clear evidence of the severity of the

recession in Germany.

Table 2 Growth of Industrial Production

	92q2	92q3	92q4	93q1
United States	2.0%	0.9%	2.0%	4.4%
Japan	-6.2%	-6.1%	-7.7%	-5.1%
Germany	-1.0%	-1.3%	-4.6%	-10.4%
France	0.4%	-0.2%	-2.2%	-3.8%
Italy	-0.3%	-0.7%	-2.1%	-4.2%
UK	-0.2%	-0.3%	-0.3%	-2.0%

Source: Financial Times/CSO

Table 3 Consumer Price Inflation (CPI)

	92q2	92q3	92q4	93q1
United States	3.1%	3.1%	3.0%	3.7%
Japan	2.6%	2.0%	0.9%	1.1%
Germany	4.5%	3.5%	3.7%	4.3%
France	3.1%	2.7%	2.2%	2.1%
Italy	5.5%	5.2%	4.8%	4.3%
UK	4.2%	3.6%	3.0%	1.8%

Source: Financial Times

Table 4 OECD Unemployment Rates

	92q2	92q3	92q4	93q1
United States	7.4%	7.4%	7.2%	6.9% ^P
Japan	2.1%	2.2%	2.3%	2.2%
Germany	4.7%	4.8%	5.1%	5.5%
France	10.2%	10.2%	10.4%	10.6%
Italy	10.0%	10.1%	12.3%	n/a
UK	9.7%	10.1%	10.4%	10.6%

Source: OECD

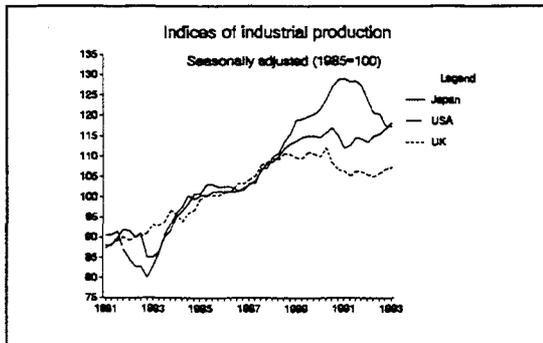
Inflationary forces within the G7 would certainly appear to have been contained by the protracted slowdown in the world economy. Inflationary gains in the UK economy have taken the Consumer Price Index (CPI) (including mortgage interest payments) to its lowest level for decades. The upturn in the German CPI is the product of tax increases.

Revisions to the unemployment figures reveal the

difference between the European economy and its US and Japanese competitors. New official figures for Italy are much worse than had previously been thought.

The United States

After strong growth of 3.2% in the final quarter of 1992 the US economy took a breather and growth fell to an annualized 0.9% in the three months to March. The slowdown reflects a post-Christmas drop in Retail sales and a weakness in the export markets of Japan and the EC.



The US recession may have ended two years ago but growth has failed materialise in the period since the late 1980s credit boom. This apparent risk aversion by consumers which is restraining growth is the result of two factors, namely high debt - income ratios and the absence of job creation. The first factor is a constraint since the FED's loose money policy has reduced personal savings to a fraction of their normal level for this stage of the business cycle. As a result consumers do not have the necessary reserves of cash to rejuvenate their spending plans. Moreover one would expect consumers to run down their savings once recession has ended in the hope of making those purchases which had been postponed during the period of economic uncertainty. In the early days of 1993 this facility is not available and demand therefore remains weak. In addition consumption plans react positively to news of increased income security through renewed job creation. Once recovery is under way one should expect employment growth to provide a stimulus to expenditure. Unfortunately, the expected employment growth is not there and many fear what is currently termed a 'jobless' recession.

Inflation, although creeping up slightly in the first quarter and in April, has failed to make significant

impact on market expectations, at least for the time being. It would seem that the surge to an annual rate of 3.7% from 3.0% was due more to special factors in several sectors such as clothing and transport. Indeed producer prices are currently growing at below 2% per annum, pay settlements are subdued and healthy productivity growth is keeping unit labour costs at a minimum. Overall, the inflationary outlook warrants only routine concern.

The outlook for growth in 1993 suggests growth of around an annualized 3% as investment expenditure has grown strongly in recent months. The proposed government spending cuts and an appreciating dollar will help to keep inflation in check.

Japan

GNP growth of 4.1% in 1991 fell to a mere 1.5% in 1992. Within the components of domestic demand only government spending increased last year. Ultimately this is the result of fiscal front loading undertaken in the two budgets of March and August. The major culprits of decline were business investment and stockbuilding.

It is well known that the Japanese economy suffered heavily for a speculative asset price bubble in the late 1980s. When this burst the housing and financial sectors collapsed and since then have failed to react to any stimulus provided by monetary policy. As a result business confidence has fallen sharply and is considered to be at its lowest level for 17 years.

Prospects for 1993 depend to a large extent on the April Supplementary budget which promises to inject Y13.2bn (2.8% of GNP) although containing roughly the same mix of measures as the August mini-budget. Some analysts feel that the August injection has had a very limited effect and that these new measures are more of a buoyancy aid than a stimulus. Forecasts for 1993 centre on an expected growth rate of 0.5% in GNP, a level previously unimaginable for post-war Japan.

The inflationary outlook is particularly good, given the scale of deflation. Table 3 reveals the major inflationary gains to the economy in the past three quarters. With low producer prices, a rising yen reducing imported input prices and weak domestic demand, it seems unlikely that monetary policy will be tightened in 1993. Certainly the US authorities would like an even stronger Yen but the main curb to the record trade deficit must surely come from

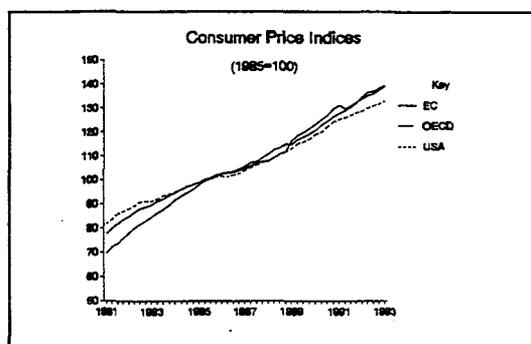
renewed demand within Japan.

THE EUROPEAN ECONOMY

Growth in the EC12 countries fell to only 0.5% in 1992. Forecasters expect a contraction of 0.5% in the current year as deflation increases unemployment and reduces real wage levels.

Germany

Consumption and investment expenditure was very subdued in 1992 and contributed to GDP growth of only 0.3%. The expected boost to consumers expenditure from January's VAT hike has failed to materialise and the manufacturing sector continues to run down stock levels. Now that the unification boom is over we have witnessed gigantic falls in industrial production, down 10.4% in the first quarter of this year.



The Bundesbank dictates monetary policy and favours M3 as its indicator of inflationary trends within Germany. Monetary policy, which is exporting recession of the rest of the EC, is set with an eye to wage settlements and the relationship between M3 and its monitoring range. Recently both have slowed and with the signing of the 'Solidarity Pact' the FRG should experience a fall in the CPI from its recent peak of 4.3% in the first quarter.

The outlook for 1993 is far from rosy. Output is projected to fall by about 1.5%, although declining EC wide interest rates will help the German trade balance. However, consumption expenditure is expected to fall in 1993 in response to rising unemployment and falling real wages.

France

Following the election of the Centre-right worries

of full blown recession appear to have been allayed. In addition, the commitment to the Franc fort monetary policy has been re-affirmed. Since the election interest rates have fallen significantly and France's dogfight for a CPI of only 2.1% seems to have been vindicated, but only at the expense of record business failures and high unemployment.

The rest of Europe

While the Italian and Spanish economies face political and economic turmoil, the most important event this quarter has been the Yes vote in the Danish 'Maastricht' referendum. Now that this is out of the way, and given that fiscal consolidation is taken seriously in member countries, the prospects for successful implementation of the treaty's proposals for price stability are greatly enhanced and should help to reduce pan-European rates through greater exchange rate stability.

EUROPEAN CONVERGENCE

Since April the mechanism has moved ever closer to a two speed system. The inner tier of Germany, France, Denmark and the Benelux countries and have maintained their ECU rates and their anti-inflationary reputation. On balance it is probable that a Monetary Union between these countries, and possibly Austria and Ireland, will happen sooner rather than later since all, with the exceptional case of Ireland who suffered from the UK devaluation, have maintained their ECU parities over the recent period of currency turmoil. It is true, however, that major fiscal consolidation is necessary before any country can pass the Maastricht treaty obligations on fiscal debt. On the other hand, it is obvious that an outer tier is emerging in the guise of Britain, the Iberian peninsula and Italy. Spain devalued again in early May and it is difficult to see how it can have any reputation left after three devaluations in the face of speculative hostilities. Unfortunately for Portugal, its close trading links with Spain means that it assumes the position of an unwilling accomplice to an administration seeking re-election via any means. The Italian political process and the mounting scale of alleged governmental corruption render it unlikely as a player in the fast lane in the immediate future.

WORLD TRADE

With the Clinton administration beginning to show welcome signs of getting its trade policy act together, hopes are being renewed that the Uruguay Round of trade talks may yet be completed by the

end of this year. The US administration is determined to reach a successful conclusion to these trade talks, and is also confident of doing so. In fact the US administration's confidence is so high that there are already talks of a new "Clinton Round" to deal with trade-related environmental issues (already the focus of the side agreements it is pressing to add to the North American Free Trade Agreement (NAFTA), competition policy and technology.(1)

On the other hand, grave concern has been evoked by the possibility of the resurrection of the controversial super-301 legislation which empowers the USA to take unilateral actions against countries which *it* considers to be engaging in unfair trading practices.(2) Should this legislation be accepted by the US congress, aggressive unilateralism will become an integral part of official American trade policy, and the present administration would be putting itself in a position to disregard its commitments to GATT while simultaneously trying to enlarge the sphere of GATT's influence through a settlement of the Uruguay Round of talks.

THE MEDIUM TERM OUTLOOK

Little has changed since the last Commentary. However the clear election result in France, the signing of the (reduced) Solidarity Pact and the Danish referendum have all raised the potential for Intra-EC trade. In 1993 the EC12 economy is expected to contract by about 0.5% but thereafter Scottish export performance should improve as German exports lower interest rates to our main non-US export markets.

NOTES

1. Financial Times, 13 May 1993, p6.
2. Jagdish Bhagwati, "Economic Focus", The Economist, 27 March 1993, p89.