The World Economic Trend and U.S. Economic Outlook

Dr. Allen Sinai

Thank you, Dr. SaKong, for the kind fine introduction. I want to comment briefly on one part of the introduction regarding my frequent consulting of the Clinton administration. Depending on how the administration does, I tend to edit out that part. We have provided information and advice to the administration. However, like all economists, we bear no responsibility for the Clinton and Bush administrations. We tend to be non-partisan in our information provision.

I will get to talking about the Washington policy outlook in a little while. But, first, let me remark on the US and world business expansion which now is synchronous and well entrenched. We are thinking that it is a trend that will last a very long time. In terms of broad business cycle outlines, what we see in the world economy, without any historical precedent, is healthy structural underpinnings in many economies and the prospects of worldwide business expansions which will last for many more years.

In our work at Lehman Brothers, we actually cover 46 countries and many of these countries are names that I never would have dreamed of 5-10 years ago. I never would have dreamed that they would be part of the global economy and the global economic environment, participants and contributors to business activities around the world.

When I first started working, the first newspapers and column I would look at were the Wall Street Journal and interest rates, since my job was to forecast interest rates. The US had two or three interest rates to worry about at that time and now I almost long for those days. Now, the first papers I pick up in the morning are international papers; the Financial Times and news reports on various world economies that might influence the world financial markets. The amount of data we absorb and business activities we observe in the globally intertwined world economy is really extraordinary.

At this time, the expansion of businesses that involves 43 of 46 countries has no historic precedent. Never in the history of the modern world have there been so many countries and businesses trading with one another and so many financial markets tied with one another by fund flows, communications and transaction systems that move in an instant. Business expansions of forty-three nations add up in 1995 to about a 3% economic growth rate.

Two years ago, that growth rate was about 1.3%, which now is more than doubled. Much the same growth is likely in 1996 although perhaps some change in the lineup of global regional growth is strongest and where it might be the weakest. Probably, this trend will extend well into 1997 and 1998.

The US business expansion, now entering its fifth year, was the real motivating force in the world business expansion. The US business expansion has been averaging 3% a year since early 1991. It is the slowest expansion in these terms in all the post-war business expansions. But, because slower growth means fewer excesses building up - the kinds of excesses that ultimately set the stage for the next business cycle downturn - this US business expansion is going to last quite a while.

In 1995, the US economy is likely to grow at a very nice rate of about 3% and that is weaker than 1994 during which growth was 4%. In 1994, because growth was very strong and because the US central bank was following a brand new approach to monetary policy, the rises of interest rates, near doubling of short-term interest rates and some two points or so higher long-term interest rates, are and have begun to slow down the US economy to the pace we think will be about 3%. But, the 3% growth after 4% and in the fifth year of business expansion is quite good. It actually is better than 4% because it is more in-line with the potential supply of the economy and suggests that the usual spiraling of inflation that takes place in the US in a business expansion may not happen this time. Inflation is likely to pick up early in 1995 to 3.5 - 4% and, if it does proceed at a 3% pace of growth, we are thinking that inflation will hold and not spiral higher much as it has done in other business cycles and that it will fade later this year and in 1996. The US economy will continue to grow and move ahead, benefiting many of the world economies tied to the US.

With this brief comment on the broad picture that is expected in the US and business expansion this year, let me take you on a quick trip across other areas of the globe and discuss the prospects for economies around the world. Then, I will come back to the US with some more detail and discuss why this notion of sustained growth without spiraling inflation is going to occur. That is the key business cycle question for the US expansion. Our answer is that sustained growth without spiraling inflation and expansion will persist. By the way, this trip around the world is courtesy of Lehman Brothers.

North America, along with the US, is going to slow down in 1995 and 1996. But it will still expand. Canada, which grew last year at 4%, very booming, because of higher interest rates and the slowing down of the economy, is likely to see its growth move down to a three to four percent range in 1995 and a little less stronger in 1996. South of the border, Mexico, is one of the three countries out of the 46 countries where we expect recession. The recession in Mexico, which is inevitable as the mechanism for reducing its large current account deficit and stabilizing the peso, will fall from anywhere between 2% and 5%. The downturn that is beginning now and that has begun in Mexico is going to be very severe as a result of the outgrowth of the over-valued peso and large current account deficit. The nation will have to go through restriction and austerity in order to satisfy its creditors and re-establish its economic fundamentals on a sound basis. The weakness and recession in Mexico will help to slow down the US economy by reducing US exports to Mexico. In the US context, a number like 8-10 billion dollars in lost exports to Mexico is not very significant. The US economy is almost 7 trillion dollars in nominal terms, but from the point of view of slowing down the economy somewhat, it is significant.

A second country of the three in recession is Venezuela where we will have a decline of about 1%. Argentina and Brazil look to be in the 4% range, but those economies are subject to the risks that have risen as a result of the peso crisis and overvalued currencies. As the year progresses, growth rates in these countries will slow down. North America, Mexico and Latin America will grow more slowly this year, but, by and large, it will still show expansion.

Moving to this part of the world now, let me talk about the non-Japan Asia-Pacific region where the phrase "perpetual prosperity" is still an apt description of the economic activity, trade and production in this part of the world. There appears to be no change to this "perpetual prosperity," where there are strong growth, low unemployment rates, very active trade, finance and business except for one concern. That one concern is inflation, which is high and picking up in some of the countries, although probably not enough to be a source of instability for any country in the non-Japan Asia-Pacific, but enough to raise a flag of precaution looking ahead two or three years. For South Korea, Taiwan, Singapore, Thailand, and Indonesia, growth rates are forecasted around 5-8% and unemployment rates are so low that they are the envy of the world. However, in some of the countries, inflation is high and interest rates have had to rise as a result. It normally takes a long period before rising interest rates feed back and set the stage for a recession in any country. Therefore, from the business side, higher interest rates are not a concern but these are warning signs for potential trouble down the road.

Overlaying the tremendous vitality and prosperity of this region is the China boom, which is now being supplanted by a boom emanating from India with a population of nine hundred million. In China, the expectation is for slower growth and diminishing inflation. However, China is still a very booming economy, subject to boom-bust risks as the political system adjusts to the world following the passing of Deng Xiao Ping. But for now, the Chinese boom and high inflation are lifting the activity levels throughout the Asia-Pacific region. If there is a problem on the economic side stemming from the inability to control inflation made inevitable by the boom-bust that results from runaway inflation, then the damage should not be recession or a bust for the area. Rather, it should be a dent in the growth rate of what is fundamentally the most prosperous global region in all the world.

Australia and New Zealand should have show very strong growth and although interest rates have risen quite sharply in the name of slowing down the pace of growth, we would not expect anything worse than a slowing of activity and solid expansion at least through 1996.

In Europe, recovery just began two or three quarters ago. Economic recovery has been very strong in Germany which is in an export-led recovery. Germany and countries near it are growing now in a 2-3% range and they are just beginning a long upturn. It is an upturn with low inflation and high unemployment, however, with plenty of slack to expand without any danger of inflation in the sense of bringing the business upturn to an end.

The United Kingdom looks very solid. However, it too will slow down this year from a very strong pace of 4% last year as a consequence of hikes in interest rates as part of designs to battle early inflation. But, there is enough vibrancy and no recession is indicated.

Even other areas previously not on the radar screen, such as South Africa, is growing at 3-4%. Israel is growing near 6%

although with a dangerously high inflation rate which is now coming down.

Eastern Europe is growing, also, in the 4% range and eastern Germany is doing surprisingly well. In eastern Germany, inflation is down to the mid-single digits, the unemployment rate is coming down and production rates are quite strong. Combined, Germany leads us to think that 3-4% growth rate will occur this year. The unified German economy is very powerful and warrants the strength of the Deutsche Mark. Scandinavia and southern Europe are expanding, despite the fact that countries like Turkey are expanding with many problems. Greece, I don't know the economy that well, but I would strongly recommend that place as a tourist.

The last country I must mention is Russia - the last of the three countries out of 46 in decline. Russia's economic situation is as dismal as it can get and it amazes me how the current president manages to hang on with the economy doing so badly and that won't likely change for quite some time.

Across the world there is expansion, very active businesses, and the best business opportunities I have seen in decades. The structural characteristics of the economy look better than they have in decades and this is going to be the case for a long time, although with some scary explosions from time to time in financial markets.

Let me now elaborate on the US and talk about its prospects for expansion, particularly the policies and their role in the world economy. And, first I must mention that last year, in an unprecedented manner, the Federal Reserve took action against prospective inflation that no US central bank has ever taken and no central bank in our history would have taken. It was an action that doubled short-term interest rates and was one designed to stabilize future inflation before any obvious inflationary problem became evident. This revolutionary new approach to US policy, at least in the US central bank, has been very controversial and is what we might call the policy of "leading the lags." That is, inflation tends to lag economic activity and then, once in place, price inflation tends to spill into wage inflation. Our central bank throughout history has not begun to counter inflation until one year after it could be seen. By the time the Fed has countered inflation, the inflation, through inflation expectation processes and pricing, has become entrenched. Thus, historically, the initial hikes of interest rates have been unable to stop the inflationary processes. So the central bank, throughout history, fights inflation and, even as the fight of inflation through rising interest rates has continued, the processes of recession have begun. But, because of obvious inflation, the central bank always continued to raise interest rates, the US has some sort of credit crunch crisis, and then a recession. Typically, after the recession is in place, the central bank starts to lower interest rates, but not until after they see the recession. By then it is too late to alter the course which ultimately sets the stage for the next boom due to the fact that monetary policy is pro-cyclical rather than counter-cyclical.

This time around, the US central bank changed its game plan and began to raise interest rates before any of the usual signs of inflation became obvious. It raised interest rates under the notion that with a strongly growing economy, the economy would run out of room and inflation would rise. And, the

Federal Reserve raised interest rates under the notion that it had to act early due to the lags - lags being anywhere from one to two years. It had to act early to start slowing down the economy long before inflation picked up so that when the economy slowed down the usual rise in inflation could be avoided. This approach has never been tried before and no other central bank would have raised the federal funds rate one inch, one basis point from the 3% level with the inflation that has existed. This is a structural break with history and, I believe, it has to and is producing a different pattern for the US expansion. Other countries are using this approach and indeed have been ahead of the US in this - New Zealand, for example, Great Britain, Canada and always the Bundesbank. To the extent other countries follow this approach, I am convinced that inflation rates around the world will be lower than otherwise and this will contribute to sustaining expansion longer than would normally be the case.

In the US, we see a lot of signs of slowing down. It is now about one year since the Federal Reserve began raising rates in this new approach. Historically, after the central bank began to raise interest rates, the economy has slowed down significantly after one or two years. If the central bank keeps raising rates, as it has done, in order to fight inflation, then by the third year we have a recession. We see signs of a slow-down in many areas. Housing activity has slowed down and retail sales, motor vehicle sales, consumer spending generally are weaker. There is a huge capital spending boom in the US, mainly in information processing and communications. That boom is intact, but not as strong as before. Federal government spending, in real terms, continues on a downward track. Businesses are very lean and inventories are lean relative to sales. US exports, which are booming, are going to slow down because of the problems in Latin America. This unmistakable slow-down suggests that the US economy will expand in the first quarter at a little less than 3% and by the second and third quarter will be growing at a 2-2.5% growth rate. For the year, the US economy will slow-down by about a percentage point. The long awaited slowing of the economy is not soon enough to prevent some acceleration of inflation early in the year because of last year's very booming economy. For this reason, we may see some negative inflation statistics. With the processes of a slower economy, less inflation seems to be in prospect a year down the road.

In this context, under this new Federal Reserve approach, the central bank is coming to the end of the hikes of interest rates that had been in place about a year ago. Chairman Greenspan has indicated that it would be consistent with the new approach of the Federal Reserve to reduce the pace of increases of short-term interest rates as it saw a slow-down emerging even before slow-down was well entrenched and well in place. The new approach is consistent in the sense of leading the lags for an inflation down the road and ought to limit any acceleration of inflation we might see early in the year. It is unlikely that the central bank would raise interest rates a lot in 1995 and indeed, a current 6% federal funds rate may be its resting point. Our own forecast is that short-term interest rates may be going up a little bit more, perhaps to 6.5%. In short, we are near the end of the large and frequent hikes of short-term interest rates that went on last year. Those hikes were destabilizing in parts of the world and part of the shockwave and difficulties for financial companies events such as those in Orange County and Mexico. The derivatives and losses last year were not a cause of the Barings problems. Whenever you have rising interest rates in some countries, you have to expect financial shockwaves. It is part and parcel of the process of slowing down the economy. This year, US interest rates should be relatively stable and, in an absolute sense, long-term interest rates in the US will be stable on the basis of a slower economy and an inflation that will not spiral and on a stable Federal Reserve does not have the kind of risk and uncertainty around them as last year. So long-term interest rates will probably trade in the current range plus or minus a half point from where there are now. The Federal Reserve is not likely to reduce short-term interest rates from these levels, unless the US economy is surprisingly weak. By surprisingly weak, I would say 1%, but that is not our expectation. We think short-term interest rates will stay where they are and that long-term interest rates would be fairly stable, on an average.

That back drop stability of US interest rates, is constructive for other US markets, particularly the US equity market. Of course, it is one of the negatives for the dollar because in other countries the momentum on interest rates may well be up. That US interest rates levels may be stable - that is one of the negatives affecting the dollar lately.

It was two weeks ago that Chairman Greenspan made public comments that many participants have come to realize that the Federal Reserve is near the end of its upward course. However, other central banks such as in New Zealand, England, Canada and Germany are not ending their fight against inflation, according to a new central bank ideology. This process, which is very different from the past, will go on. Operationally, this means that short-term interest rates around the world would be higher relative to inflation than during any other time we can remember. In addition, those high short-term interest rates, which are a product of central bank's early moves to prevent inflation, will spill into long-term rates and long-term rates relative to inflation will stay high some time as well. From the point of view of the US business expansion, we can be optimistic that it will last longer because of this approach by central banks. If any spiral of inflation can be nipped in the bud, then that is the key to sustaining US business expansion. The fiscal side of the ledger in the US is also very interesting and a break with history, acting along with the Federal Reserve's early tight monetary policy to prevent rapid growth of the US economy from causing a spiraling inflation. The Budget Acts of 1990 and 1993 have taken hold and produced a declining path and pace of federal government spending. The government purchases of the US have declined 3-5% a year and there is no other time in history where you will find declining federal government spending, in real terms. The US economy is being restrained by the early hikes of interest rates of the Federal Reserve. The US economy is being restrained by continuing cut-backs and purchases at the federal level both monetary and fiscal policies are restrictive, which suggest to me that the pace of growth will indeed slow down and remain anti-inflationary. This is a recipe for preventing business cycle problems that come late in expansion and set the stage for the next recession.

In Washington, failure to pass the Balanced Budget Amendment does not change one iota what is written into the law; a declining pace of federal government spending in real terms. The 1990 and 1993 budget laws guarantee declining federal government spending through 1996 and into 1997. They don't fully guarantee this, because Congress and the President could pass legislation that would reverse what was in the law. However, there is no sense in the "body politic" of the US and no support for this. The Balanced Budget Amendment lost by one vote in the Senate. The latest polls of the US show that two-thirds or more Americans want a Balanced Budget Amendment that would force the budget to be balanced in about 7 years.

Thus, for whatever reasons, the Congress and our "Democratic" president are continuing on the path of fiscal restraint. It is well entrenched in the US and you and I are correct to be skeptical. However, as for now, there is no change in the course. The tightening of monetary policy by the Federal Reserve, the budget restraint in Washington, and a very strong productivity growth record in the US make me optimistic that the US can achieve a balance between the growth of the economy on the demand side and growth on the supply side so as to sustain the expansion without an inflationary spiral. That is our forecast and it is optimistic since this seldom happens in history, but the evidence I see makes this seem the most likely scenario.

However, there are a number of risks that have emerged. One of them has to do with the peso crisis, the Mexican problem and the Latin American risk to US expansion to which I have alluded. The Mexican financial crisis was one of an overvalued currency, overly robust economic growth, and a rising current account deficit because of heavy buying of imports and financing of the current account deficit with short-term hot money as opposed to long-term investment money. It was all complicated by a presidential election year, a year in which had it not been a presidential election year, the right course would have been attempted to increase the rate of depreciation of the peso, which was necessary. Given the political difficulties of the presidential year in Mexico, the central bank apparently pumped funds into the system to shore up the economy, which was the wrong thing to do in terms of reducing the current account deficit and supporting the currency. As we all know, the situation of an overvalued currency under a fixed exchange rate regime cannot last, especially when economic and political factors begin to head in the wrong direction. Not surprisingly, the inevitable attack on the peso in the market on the fixed rate of exchange came and Mexico had to devalue sharply, which set up inflationary and financial shockwaves throughout the US and world economy.

The financial liquidity crisis of Mexico was met by a 51 billion dollar funding program of the IMF and US, also BIS, and for the moment, the liquidity crisis is settled. The Mexican government will not default and will be able to pay and roll over all of its debt, certainly for the next 6-8 months. But, as part of the price of having to correct the result of the overvalued currency, Mexico must go through a very severe austerity program. Very severe cutbacks in government spending, sky-high interest rates which will restrain consumer and investment spending, and cuts in imports in hope of higher exports, and then improvement in the current account deficit will be necessary to allow the peso to stabilize. Probably then, the peso may need something like a currency board.

In the meantime, political stability looks very fragile in Mexico. We have all read the news about the assassinations and arrests. And, between economic austerity and questions about whether the current government can persist in its current form through all of this in Mexico, investment in Mexico remains a high risk proposition. As it stands for the US, the economic effects of the situation are a loss of $10 billion or more in exports and a contribution to the slow-down of the US economy. It is only if the Mexican situation should spill over and be replicated in other countries, that we might worry about expansion. Argentina has characteristics that are not dissimilar to the Mexican situation in 1994. Brazil, with a fixed exchange rate relative to the US, also has some risks as well. For us in our forecasting, we are thinking that the worst would be a distinct slow-down in the pace of growth for all of Latin America that would cause more damage to the rate of growth through exports to the United States and the US economy. The US might grow at 2.5% rather than 3%, but not be dragged down. Nevertheless, markets being what they are, I think the peso problem and the Mexican difficulty are the main catalysts of the recent free-fall of the dollar. The dollar, in the near-term, is a very risky proposition in situations like this.

When you have some unknown forces creating disarray in currency markets and the traversing of new territory that defies previous conventions, almost anything can happen. New fundamentals that perhaps are establishing new boundaries, overshooting, speculative runs and dynamic instability will make any marking of the dollar extremely difficult. The dollar is very weak because of some fundamental factors. Mainly, in the short run, the fundamental factors are such things as the US' pumping a large amount of dollars into the world financial system and into the Mexican government banks to support the peso. More dollars in world financial markets depresses the currency. The recession in Mexico will damage US exports and tend to worsen the current account deficit. The possibility that Mexican problems will be duplicated in countries like Argentina or Brazil and that Latin American economic growth may be weaker is a potential negative for US exports and the US current account deficit. There is no way to be sure that the current economic program in Mexico will actually work. Even worse, we don't know whether the Zedillo government will stand. The exchange stabilization funds of the US have been depleted by 20 billion dollars and market participants are asking whether the US will have the wherewithal to support the dollar if it is necessary to do so. The political and economic ties of Canada and Mexico with the US are greater through NAFTA and troubles of any kind in Mexico are potential troubles for the US. So, for all of these Mexican-related reasons, longer-run fundamentals, continuing current account deficit and budget deficits, I think the dollar is being viewed as a weak currency for now.

Strong currency countries such as Germany, Japan and Switzerland are attracting funds in the face of so many political and financial risks around the world. When you add to this the prospect of stable US short term interest rates, recently indicated by the Federal Reserve, and the speculative push against the dollar, the US currency still appears to be headed for rough sledding. I really cannot mark any floor on the dollar at this point, although downside risks have to be thought of at around 90 yen, perhaps near 1.35 DM, maybe even lower. This is a very risky situation. My own reading of this is that it is very related to the Mexican situation. Not until one can see stabilization in Mexico, or the exhausting of the dollar in finding a fair value, or some change in fundamental policies could we feel comfortable that the near-term instability of the dollar would be over.

In the longer run, we think the US current account deficit will improve, imports will grow by less, exports will grow competitive. Also, we think that the inflation fear on the US will fade by mid-year or a little sooner and that the dollar should rise from whatever levels it falls to.

In the near-term, we have a very dicey situation. I hope that markets will understand that volatility in the currencies, unless accompanied by the changes in the fundamentals that relate to the fixed income markets, do not have to be decisive for how the other markets run. Other than the dollar risk, the interest rate prospect for the US is one of stability and equity market prospects for the US are very positive. We have extraordinary strong earnings growth in the US. But in the near-term, power instability can make some of the market dynamics difficult to predict.

Basically, business around the world is excellent and will remain so for a long time. Without saying it, as an implication, we have seen the lows in interest rates, and that in varying degrees, interest rates will be headed to higher levels. More on the short-end, the central banks will try to fight inflation early. This is a long-run view. Nearer term, we have seen near-the-end in hikes of interest rates and we should have a fairly stable interest rate environment.

In my view, policy trends in the US and monetary and fiscal policy are as positive as they have been in decades, as is the world's near-term economic prospects. In the near-term, we are going through now one of those financial minefield explosions which are bound to happen in strong economies around the world, relating to the Mexican crisis and the problems with the dollar.

Discussions

Q **Mr. Milton Kim** (Senior Managing Director & CEO, Ssangyong Investment Securities)

Dr. Sinai, my name is Milton Kim at Ssangyong Investment Securities. Of the things you mentioned this morning, especially with respect to your tour around the world, I guess it was unintentional that you did not speak too much about Japan. I think most of us here would be interested on your views on Japan and I refer specifically to your predictions that the yen-dollar rate could go as low as 90 yen to a dollar. In your view, what would that do to Japan in the near-term and what implications might that have for Korea? Another in regards to the Barings debacle, is there a need for a regulatory body with respect to OCT derivative transactions?

A **Dr. Allen Sinai**

Let me apologize for not mentioning Japan. That was inadvertent and because I will be spending 4 days in Japan talking extensively about Japan. On the Barings problem and the potential implications for regulation of derivatives in any of the markets, I think the Barings problem was unique to Barings. As I read the newspapers, there seemed to have been a control problem. Even though no firm can be absolutely one hundred percent sure in tracking and monitoring what every individual trader does, this particular episode is aberrant. Therefore, the need to regulate derivatives and regulate the market as a consequence of the Barings' fall does not seem to exist. In Washington, there have been hearings and the central bank's view, which I happen to concur with, and the administration's point is that markets and institutions must not be insured through regulation to prevent these kinds of things from happening. Market participants must police themselves. It is a buyer-beware-situation and the chips will fall where they may. This was reiterated by Chairman Greenspan and the burden of making sure that these kinds of events never occur lies on the participants. And, I would imply that risks are greater through the use of derivatives, but it is for the markets to insist on the right information and truth in selling and lending to keep the risks at a minimum.

The Japanese economy looks to us to be recovering in a halting way. With the Kobe earthquake, there has been significant damage to the early stage of recovery and continuing appreciation of the yen damaging to the path of exports. Nevertheless, recovery of some sort in the order of 1-1.5% this year and 2% next year seems to be in process and the export strength of Japan also seems to be remaining. The Japanese business and workers' adjustment to situations and continued appreciation of the yen is quite extraordinary, although I am sure that I will be told that another 5-6 yen decline would be devastating to Japan. Exports and industry are continuing to improve, but it is less so with continued appreciation of the yen. The yen strength and weakness of dollar is primarily a dollar weakness problem, not a yen strength problem. In the dollar versus DM, it is different. It is a dollar problem, but, for the DM side of it, it is a DM strength problem. In the case of unification, political unification has been achieved and the eastern German performance statistics are quite good and improving. In terms of trade, you see a unified Germany in the middle of eastern and western Europe in a world economy where trade barriers are coming down. This makes Germany look very attractive. Then, of course, there is the Bundesbank which has done a magnificent job, under fire, managing the unification process on the monetary side and acting in ways to bring the inflation rate to 2.3% year - a low inflation rate by world standards. When I said 90, I don't think that is the equilibrium, and something below 90 would not surprise me, but it would surprise me if the dollar-yen relation one year from now is not close to one hundred.

Q **Mr. Sang-Seol Lee** (President, Woljeong International)

My name is Sang-seol Lee and I am an international marketing consultant. How would Korea be affected by the US economy and how should Korea be coping with the inflow of hot money? Should we wave a flag of concern and caution or triumph and optimism?

A **Dr. Allen Sinai**

We are expecting the Korean economy to grow in the 7-7.5 % range in 1995 and 1996 assuming the slow-down of the US economy is of the magnitude I have described. That means that the US as a buyer of Korean exports will be less so but that the strength of other countries in trade flows to Korea and the domestic side of Korean economy will be very vibrant. Last year's growth rate was 8.4%. Inflation in Korea, by western standards, is on the high side- around 6% - but probably not threatening in a sense of the central bank having to raise rates to remove that inflation and it does not look like it is set to accelerate.

In a prescriptive way, from a policy-making point of view, hot money - the kind of investment that doesn't lead to infrastructure investment and productivity enhancement - is less desirable. The kind of money any country would desire is the kind that would eventually raise the supply side, making the economy less inflation prone, which is a plus for the country's currency and less likely to lead to the overvaluing of a currency and other kinds of instability. However, as a business person, I think I could not advise anyone to turn down flows of funds from a business transaction point of view that would help business and financial institutions. Therefore, I could not really argue against that. The risks out here are less domestic and less currency-related for nations that have been called "newly industrializing countries." Instead, they are more political. Also, stemming from the Chinese situation, what the boom-bust Chinese situation might do to surrounding areas and the unknown political ramifications in the aftermath of the Deng era are other possible risks. Actually, we are sanguine about China even though one never knows what the outcome would be when there is a kind of momentous change. The outcome could be very positive with a new guard anxious to do business with the western world in a more traditional Western manner. However, China is a risk because of its high inflation and uncertainty in the aftermath of Deng. Other non-Japan countries in the region had really marvelous performance in 1994, but the trade flows are such that continued trouble in Japan can only dent the activity of Korea and not really do more than that.

Q **Dr. Kihwan Kim** (Senior Advisor, Kim & Chang)

My name is Kihwan Kim. I have a question regarding your prospect for continued global expansion. You indicated that global expansion would last for another several years which amounts to saying that the world is going to enjoy cyclical expansions. My question regards the factors that underlie this expansion. You mentioned "good policy" and "good policy" relates to cyclical development. There must be surely other important factors that sustain this cyclical development. Would you elaborate on what these major forces might be?

A **Dr. Allen Sinai**

It is a very good question. The question is: What are the reasons for this long sustained expansion other than the contribution of good policy. Indeed good policy could well be transitory since in the history of business cycles we rarely see sustained good policy. In fact, I am amazed to even say what I have said here today since it is so rare that monetary and fiscal policy are on the right track. In numerous other countries, fiscal restraint is on track, but, usually, you don't see good policy. I think the most significant reason for long business expansion is what I alluded to as the much greater number of participants in the economy. What we have as a result of the end of the world being on a war-time footing, at least in the major power sense, is something that none of us in our professional life has ever known. This is truly different. The end of the Cold War, the uneasy peace in the mid-East, and truce in Ireland are extraordinary events. If one steps back and thinks of the world economy with trade barriers coming down, country after country turning its attention to economics, with economics the main field of competition, it is very positive. The release of resources into a peacetime footing is part of the supply-side explosion around the world which brings with it enormous demands from all of these new countries. That is the basic thrust that underlies this unusual decade in terms of the world business cycles. If we take China (population of 1.2 billion), India (population of 900 million) and Indonesia (population of 195 million) now in the world community and having to produce for their people, the amount of demand that serves as a source of growth is absolutely mind-boggling. I don' t think most of us can know quite what the current structural change - peace vs. war - is so long as it persists. Historically, these waves last for a decade or more. We cannot know what this structural change really means, but it has to be positive. When you have business companies looking at Sri Lanka and Vietnam, and the Middle East and analyze the kind of liquidity flows, it is an immense wave. Of course, some countries will have recessions, but a world recession will have to come from a US recession or a major power congruent recession. If that does happen, then it would be a great concern.

Q **Dr. Il SaKong** (Chairman & CEO, Institute for Global Economics)

If I may, I would like to pursue further on the issue of "good policy". I recall in the 1960s and 1970s, there was a debate in academia and US policy-making circle on whether fine-tuning is possible. At the time, many people thought it was not possible. But, what you said about the new approach, sounds like fine-tuning to me. Of course, if that is the case, what makes this kind of new approach workable, e.g., Is it good data, good theory, or good economic advice?

A **Dr. Allen Sinai**

There are two elements in the making of a good policy and it's chances for success in sustaining expansion longer than otherwise. From the monetary policy point-of-view, it is leading the lags. That problem of acting on signals of inflation is that those signal flags are raised well beyond the time when the process started. Just starting early alone is a start of a good policy. It is the lags in recognition, the lags in the dynamic processes of the economy and lags in the effectiveness of policy after it is taken in terms of actual impacts on the economy that have made monetary policy procyclical. Second, I would not at all be optimistic about fine-tuning or what some refer to as a soft landing or what I refer to as fly-by — fly-by in the sense of a near full employment without accelerating inflation scenario — if not for fiscal restraints in the US. In the 1980s, there was an attempt for soft-landing which I did not subscribe to. I did not think it would succeed. This was the series of reductions of interest rates by the Federal Reserve in order to cushion the slow- down of the US economy so we would have a soft landing. The efforts did not work because, until the 1990s, the Fed did not get help from the fiscal side. Now, we have Fed policy early in advance of inflation. That slows down the economy and complementary fiscal restraint also slows down the economy. We happen to have in the US strong productivity trends that increase the supply side of the economy. So, in the old days, the space ship, which is US economic activity, hurtled towards the planet, our potential supply, and it used to crash, meaning boom-bust and a recession. That spaceship is now being slowed down by Mr. Greenspan, as his twiddles with the computer in his office and Congress, who put a reverse thrust on the economy by fiscal restraint. At the same time, the spaceship is being slowed down the planet is speeding up a bit. So, it is a synergism of these factors that makes me think we have a better shot at finessing the inflationary spiral that usually arises near the level of full employment.

국문요약

세계경제동향과 미국경제 전망

「리먼 브라더스」社가 지속적으로 수행하고 있는 경기예측작업에 포함되어 있는 총 46개국 중 43개국은 최근들어 역사상 先例가 없을 정도의 景氣擴張을 보이고 있다. 현대 세계사에서 그렇게 많은 국가와 기업이 서로 교역을 하고, 또한 그렇게 많은 金融市場이 순간적으로 이동될 수 있는 資金흐름, 通信 및 去來制度로 서로 연결된 적은 이제까지는 없었다. 그런데 이들 43개국은 경기확장에 힘입어 1995년의 경제성장률이 약 3%에 이를 것으로 전망된다. 이는 성장률이 2년전의 1.3%보다 두 배이상 높아짐을 의미한다. 1996년에도 금년과 비슷한 성장률이 유지되고 이러한 추세는 1997~98년에도 이어질 것으로 예상된다.

<u>北美지역</u>

미국경제는 1995년에 전년의 4% 수준보다 약간 낮은 약 3%의 성장률을 기록할 것으로 전망된다. 작년에는 경제성장률이 너무 높았기 때문에 미국 中央銀行이 새로운 통화정책 接近法을 채택함에 따라 長·短期金利가 상승되었는데, 그러한 금리상승 때문에 금년도 경제성장률은 3% 수준으로 둔화될 것이다. 그러나 전년의 4%에 뒤이은 3% 성장은 경기확장이 5년째 지속됨을 의미하는 것으로서 매우 고무적인 것이다. 이 성장률은 사실상 미국경제의 供給潛在力을 감안할 때 4%성장 보다 오히려 좋다고 보며, 따라서 미국의 경기확장시에 일반적으로 발생하는 인플레이션 압력을 금년에는 피할 수 있게 될 것으로 보인다. 미국 인플레이션率은 1995년 초반에는 3.5~4%까지 상승할 것이나, 경제성장률을 3%선에서 유지하는 한 과거의 경기순환시와는 달리 금년 후반과 1996년에는 해소될 것이다. 미국경제는 성장을 지속함으로써 미국과 관계를

맺고 있는 많은 나라의 경제에 이로운 영향을 줄 것으로 예상된다.

캐나다도 작년에 4% 성장을 이룩했는데 1995년에는 高金利와 그로 인한 경제활동의 둔화로 성장률이 3~4%로 약간 낮아지고, 1996년에는 약간 더 낮아질 것으로 전망된다.

中·南美지역

멕시코는 46개국 중 경기침체가 예상되는 3개국 중의 하나이다. 멕시코의 경기침체는 방대한 經常收支赤字를 줄이고 페소貨의 안정화를 위해 불가피한 것으로서 멕시코 정부는 경제성장률을 2~5%정도 감소시킬 것으로 예상된다. 금년에 경기침체가 예상되는 3개국 중 두번째 국가는 베네주엘라인데, 이 나라는 마이너스 1%정도의 성장률을 나타낼 것이다. 아르헨티나와 브라질은 금년에 4%내외의 성장을 기록할 것으로 전망되나, 이들 경제는 페소貨 危機와 過大評價된 통화로 인해서 발생할 지 모를 어떤 위험(risks)을 감수해야 할 것이다. 따라서 이들 나라의 성장률은 시간이 흐름에 따라 점차 둔화될 것이다.

아세아·太平洋지역

日本을 제외한 아시아·太平洋지역의 경우 '永續的인 번영'이라는 용어가 무역과 생산 등 이 지역의 경제활동을 잘 표현해 준다. 이 지역에는 높은 성장률, 낮은 失業率과 아주 활발한 무역, 금융 및 기업활동이 지속될 것으로 전망되기 때문에 영속적인 번영에는 변화가 없을 것이다. 다만 한가지 관심을 가져야 할 것은 몇몇 나라에서 이미 높은 수준에 있고 또 상승기미를 보이는 인플레이션 문제일 것이다. 이 지역내의 한국, 대만, 싱가포르, 태국과 인도네시아 등의 경제성장률은 5~8%에 이를 것으로 예측되는데 이들 국가의 낮은 실업률은 전세계의 부러움의 대상이다. 그러나 이들 중 인플레이션率이 높은 일부 국가는 金利를 높여야 했다.

이 지역의 活力과 번영을 가능케 하는 中國붐은 현재 9억 人口를 지닌 인도의 붐으로 대체되어 가고 있다. 중국의 경제성장률과 인플레이션률은 모두 낮아질 것으로 기대되나 아직은 好景氣를 나타내고 있다.

다만 鄧小平 死後의 정치체제변화 如何에 따라 好景氣가 不況으로 이어질 위험도 내포하고 있으나 아직은 중국의 好景氣와 높은 인플레이션이 아시아·太平洋지역의 경제활동을 부양시켜 주고 있다.

호주와 뉴질랜드도 높은 성장률을 보일 것으로 예상된다. 이들 나라는 경기과열을 막기 위해서 금리를 크게 높였지만 그들의 성장률은 약간 둔화되는 데 그치고 적어도 1996년까지는 경기확장세가 지속될 것으로 보인다.

유럽지역

독일은 수출주도에 의해서 강력한 경기회복을 경험하고 있으며 따라서 독일과 그 주변국가들은 현재 2~3%의 성장률을 나타내고 있다. 그런데 이러한 성장은 낮은 인플레率과 높은 실업률을 수반한 장기적인 경기상승의 시작을 나타낸다. 英國의 경우는 전년도의 4%라는 高率에서 금년에는 初期 인플레이션에 대한 대책으로서 금리를 높였기 때문에 성장률이 좀 둔화될 것이다. 東유럽 지역국가들도 금년에는 4%정도의 경제성장률을 나타내고 특히 구동독 지역이 놀랄만한 성장을 기록할 것이다. 스칸디나비아 諸國과 南유럽국가들도 경기확장을 보일 것이다. 이 지역의 마지막 나라이자 46개국 중 경기가 下落하는 마지막 나라인 러시아는 금년에도 경제여건의 어떤 好轉을 기대할 수 없을 것이다.

기타 지역

과거에는 관심의 대상이 되지 못했던 南아프리카공화국도 금년에 3~4%의 경제성장을 할 것으로 예상된다. 이스라엘은 조금씩 낮아지고 있기는 하지만 위험스러울 정도의 높은 인플레이션을 경험하고 있으며, 약 6%의 경제성장률을 기록할 것이다.

미국 通貨政策의 새로운 接近法과 예상 효과

끝으로 미국 통화정책의 새로운 접근법과 그것이 미국 및 세계경제에 미칠 효과에 대해서 언급하기로 한다. 미국 聯邦準備委員會는 작년에 예상 인플레이션에 대한 대응조치를 취한 바 있는데 이러한 조치는 과거

미국 중앙은행에서는 취해 본 적이 없었다. 이 조치는 어떤 명백한 인플레이션 문제가 나타나기 전에 장래의 인플레이션을 안정시키기 위해서 단기금리를 두배 이상 인상시킨 것을 의미한다. 이것은 적어도 미국 중앙은행의 경우에는 혁명적인 새로운 접근법이라고 할 수 있는데 '뒤따르는 時差를 先導(leading the lags)'하는 정책이라고 하겠다. 이러한 접근법은 다른 나라에서도 채택하고 있는데 뉴질랜드, 英國, 캐나다와 독일연방은행 등은 이런 면에서 미국보다 앞섰다고 하겠다. 다른 나라들도 이런 접근법을 채택하는 경우 전세계의 인플레이션率은 그런 접근법을 채택치 않는 경우에 비해서 더 낮아지게 될 것이다. 따라서 이 접근법은 보통의 경우보다 경기확장기를 보다 장기간 지속시키는 데 기여할 것으로 확신한다.

미국의 경우 聯準委에 의한 긴축적 통화정책 운영과 聯邦政府의 예산절제, 그리고 생산성의 高度成長 실적 등을 감안할 때 需要측면의 경제성장과 공급측면의 성장간에 균형을 유지함으로써 인플레이션의 가속화 없이 경기확장국면을 지속시킬 수 있을 것이라는 낙관적 전망을 할 수 있다. 그러나 이러한 전망에는 위험요소도 도사리고 있는데 그 하나는 페소貨 위기 또는 멕시코 문제와 관련된 위험요소이며 또 다른 중요한 위험요소는 달라貨 價値의 안정성을 해치는 국제통화시장의 불확실성과 관련된 것이다.