The German Economy

When the Bundesbank cut official interest rates on December 14, other European central banks quickly followed suit. Observers, noting below-target German money growth and low inflation, anticipate further German interest-rate cuts.

The Bundesbank Act requires the German central bank to maintain the “stability of the currency.” The monetary authorities traditionally seem to interpret an inflation rate below 2% as being consistent with this mandate. Germany’s inflation rate, which rose sharply following unification, dropped below 2% early this year and has continued to moderate. In November, consumer prices were up 1.7% over year-ago levels.

Real German GDP growth slowed over the first three quarters of 1995, but remained fairly strong. Many economists, however, fear that real economic activity will stall or possibly contract in 1995:IVQ. Real manufacturing orders fell sharply in October, and industrial production has been weak. December’s disruptions in shipments—stemming from French rail strikes—further darkened the business outlook. Business confidence has ebbed, suggesting that capital spending may slow. A substantial weakening in German economic activity could dampen growth throughout Europe.
The Mexican Economy

A year after Mexico’s disastrous peso depreciation, the worst of the matter may be over. Mexico’s prospects—particularly its access to international capital markets—will depend on the government’s capacity to sustain a stabilization program in the face of weak economic activity and a shaky financial sector. Financial market jitters in October and November (which have since calmed) quickly sent Mexican interest rates higher and the peso lower.

Mexico’s GDP has contracted sharply since 1994:I1Q. More moderate declines in real economic activity since 1995:I1Q, coupled with improvements in the nation’s export industry, offer some hope that the recession has hit bottom. Nevertheless, the prospects for a rapid recovery this year remain few.

The peso’s depreciation and the recession have eliminated Mexico’s current account deficit. In October, imports stood 6.7% below year-ago levels, while exports were 35.7% higher. The current account shifted from a $29 billion (annual rate) deficit in 1994:I1Q to a $2 billion surplus in 1995:I1Q. International reserves, which fell to $6.3 billion by the end of 1994, have since risen to $14.5 billion, although largely from inflows of official funds.

Mexico probably will not sustain a current account surplus once the recent crisis has passed. Countries importing foreign capital for development typically run current account deficits.