Anti-Inflation Fallout

As Interest Rates Go Up, So Do Concerns About Slower Growth in Europe's Economies

BRUSSELS – Rising interest rates and other inflation-fighting steps may further slow economic growth in Europe next year but aren't likely to stop it, European economists say.

The immediate impact of the U.S. Federal Reserve Board's decision Tuesday

This article was prepared by Wall Street Journal staff reporters Terence Roth, Barbara Toman, Linda Bernier and Thomas Kamm and special correspondent Stephen D. Moore.

to force up interest rates has been to heighten pressure on West Germany to do the same. The Belgian central bank quickly raised its discount rate Wednesday, and French economists said the moves are likely to keep France from continuing to cut interest rates. (U.S. banks Thursday raised their prime, or minimum, rates a half-point to 10%. See story on page 9.)

But in a sampling, economists and finance officials in major European capitals say they aren't yet revising downward their forecasts for next year. Slower growth for Europe has been predicted for some time, and many economists had been expecting a round of interest-rate increases. Many experts applaud the moves to nip inflation in the bud as well-timed and prudent.

At the same time, there is growing concern about the outlook, especially in West Germany, Europe's largest economy. The Bundesbank already has been forced to push through a series of interest-rate increases to support the flagging Deutsche mark. In a news conference Thursday, Finance Minister Gerhard Stoltenberg said a further increase in the value of the dollar could lead to higher West German interest rates. (See story on page 11.) That would only add to pressures on the sluggish West German economy, and trouble there could ripple across Europe.

Effects on Europe

"If the Bundesbank continues to move along a restrictive path, the outlook for the economy will begin to look dark," says Prof. Rudiger Pohl, a Hagen University economist who is on a five-member advisory panel to the Bonn government. "This weakness would then spill over into our neighboring countries, whose industries would be getting fewer orders from our importers while also facing increasing competition from our exporters."

Adds Ernst-Moritz Lipp, chief economist of Dresdner Bank AG in Frankfurt: "If interest rates keep rising the way they have been in leading European economies, we are very likely to see a slowdown in European economic activity by the second half of 1989." But he observes that "so far, we see no fundamental weakening in the business cycle."

For West Germany, Mr. Lipp currently expects economic growth to slow to about 2% in 1989 from an expected 3% for this year.

By next year, economists say the combination of higher interest rates and higher consumer taxes could begin eroding consumer demand in West Germany. Auto makers, retailers and their suppliers would be the first to be affected. The capital goods sector also faces a slowdown.

Sweden will be under similar pressure to raise interest rates, economists say, but the politically controlled central bank isn't expected to act until after the national election Sept. 18. The Riksbank boosted its discount rate in April to 8.5%, the highest level in nearly two years. Economists in Stockholm say a further tightening is indicated to counter a recent jump in inflation to 7.1% and a soaring balance-of-payments deficit.

The Swedish economy, like that of the U.S., has been showing signs of overheating. Unemployment is at rock-bottom, plants are running all-out and wages are rising. In addition to raising interest rates, the government is likely to push through fiscal tightening measures after the election, economists say.

Skandinaviska Enskilda Banken, Sweden's biggest bank, already was forecasting a decline in 1989 economic growth to 1.7% from an expected 2.2% for this year. The drop could be even sharper if rising interest rates prompt big companies to trim capital spending plans, says Bengt Rostroem, S-E Banken economist.

More than half of Sweden's industrial output is exported, so an economic slowdown in the U.S. and the rest of Europe could quickly affect Swedish companies, especially AB Volvo and Saab-Scania AB, which sell more cars in the U.S. than in any other market.

In Britain, which has raised interest rates seven times since June, economists

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applaud such measures as necessary to keep a lid on inflation, even though it is likely to slow growth across Europe next year. In Britain, inflation has been running at about 4.6%.

"The cooling is a good thing," says Bill Martin, senior economist at Phillips & Drew, a London stockbrokerage. "The industrial countries are working this one very well. The inflationary risk was such that a rise in interest rates was required. They [the higher rates] don't presage a slide into recession."

He and other British economists haven't revised their growth forecasts following this week's increases in interest rates, which they expected. So economists are sticking with predictions that Britain's gross domestic product will rise just 2% or 3% next year after rising about 4% this year.

Slowing Britain's growth next year will be higher mortgage rates. U.K. building societies recently raised their mortgage rates 1.75 percentage points to an average 11.5%.

"High mortgage rates will start to cut into people's purchasing power," says Gerard Lyons, chief U.K. economist at SBCI Savory Milln, a London investment banking concern. "And indirectly, confidence may be affected." Indeed, Britain's opposition Labour Party argues that higher mortgage rates have more than offset the tax cuts Britons received in March.

Some economists say any slowdown in consumer spending could hit the construction and consumer durables industries particularly hard. But these economists gener-