INTERNATIONAL ECONOMIC SITUATION AND OUTLOOK

INTRODUCTION

The international economic situation continues to be dominated by a persistently high rate of inflation, slow average economic growth in the industrial countries, an uncertain energy market and large external payments imbalances

The overall growth of real gross national product (GNP) in the OECD countries slipped from 3 3 percent in 1979 to an estimated one percent last year A recovery is projected in 1981 but this is expected to be slow and the average growth rate for the area is forecast to be no higher than that of 1980, possibly increasing to around 3 percent by the first half of 1982 The depth of the trough and its likely timing differ across countries The United States has shown some signs of recovery from the short sharp recession which began in early 1980 but there are doubts whether this improvement can be sustained without a renewed upsurge in inflation No turnaround is yet evident in the United Kingdom's steep decline in national output In the other major industrial countries, and also in the smaller ones as a group, aggregate demand, which had remained relatively buoyant through to early 1980, has weakened substantially, leading to sizeable decelerations in the rate of real GNP growth The worsening growth record in the industrial countries is attributable largely to the effects on purchasing power, balance of payments and worldwide inflation of the large oil price rises during the past two years and, more particularly, to the restrictive policy measures taken to counter the inflationary pressure

Reflecting this economic situation, unemployment in the OECD area rose from 5 1 percent in the last quarter of 1979 to approximately 6 5 percent at the end of 1980 and, on the basis of forecast output and productivity, may increase over the next 12-18 months by a further 2 5 million to around 25 5 million, or nearly 7 5 percent of the OECD work force

For the non-oil developing countries, total output increased by about 5 percent in both 1979 and 1980 and as a group is projected to continue to grow at this rate in 1981

Total national output in the oil exporting countries is greatly influenced by their levels of crude oil production Inclusive of oil, real GDP during the period 1979-81 is estimated to grow at an average annual rate of slightly more than 2 percent Output in the non-oil sector is estimated to expand rapidly

Following a period of widespread price acceleration the rate of growth of inflation in the industrial countries moderated in 1980 Inflation in most countries, however, is still high by historical standards and it continues to constitute a serious problem for the authorities Consumer price increases for the seven major industrial countries[1] accelerated from 7-8 percent in 1977/78 to an annual rate of about 15 percent in the first quarter of 1980 This acceleration was due not only to the repercussions of the 1979/80 oil price increases on domestic costs and incomes, but also to the expansionary economic policies operating in many countries prior to the oil price hike Moreover, there are wide differences in the rates of price increase among individual countries, presenting difficulties in the application of monetary and exchange rate policies However tight monetary policies and modest wage responses have resulted in inflation in the OECD countries being reduced to around 11 percent on average by the end of last year Provided there is no substantial increase in the real price of oil, the OECD expects price performance in the area to improve over the coming 18 months but (except for a few countries, notably Italy and the United Kingdom), for any improvement to be small, with the average rate still close to double figures in 1982

The rate of increase in consumer prices for 1980 in the non-oil developing countries as a group is estimated to be around 35 percent Although this figure is affected by extremely high inflation rates in a few countries (notably Argentina, Brazil and Israel), even after allowing for a likely easing of price pressures to an average 25 percent in 1981, inflation will remain a major problem for most of these countries

In the oil exporting group of developing countries prices rose an estimated 14 5 percent in 1980 and are projected to grow 12 5 percent in 1981

The large shift observed since 1978 in the current account balances of the main country groups is projected to partially reverse in 1981 This projection is, however, based on the assumption of an unchanged real price for oil over the forecast period The combined current account for the industrial countries[2] as a whole deteriorated from a $13 billion surplus in 1978 to an estimated deficit of $68 billion in 1980, but is forecast to improve this year to a $34 billion deficit The counterpart of this is expected to be in the falling surplus of the OPEC nations to a projected level of $82 billion in 1981 The current account surplus of these countries rose from $4 billion in 1978 to well over $100 billion for 1980 The non-oil developing countries, however, which have already experienced a doubling in their combined current account deficit over the past two years, are likely to record a further worsening in their external position this year Weak export volume growth and high debt servicing obligations will prevent any improvement in their position in the near future at least

Economic policy since 1979 in most countries has been directed primarily at preventing the increase in the price of oil from spilling over into domestically generated inflation Tight monetary policies have been the principal instrument to date although fiscal policies are likely to be more restrictive this year also There has been, and still is, a general consensus among countries that the seriousness of the existing rate of inflation and of inflationary expectations leaves no alternative to such policies despite the adverse consequences on output and employment in the short-run External considerations in many countries are also acting to constrain any significant easing of economic stance

1 United States, Japan, Federal Republic of Germany, France, United Kingdom, Canada and Italy

2 Includes all OECD member countries with the exception of Turkey, Greece and Portugal

BACKGROUND TO THE FORECASTS

The forecasts referred to in this article are largely those of the Organisation for Economic Co-operation and Development (OECD) and to a lesser extent the International Monetary Fund (IMF) where these have been published. Key assumptions underlying the projections include:

(a) no change in current or announced monetary and fiscal policies;

(b) an unchanged real oil price in the forecast period; and

(c) unchanged exchange rates.

These are standard working assumptions, made for the purpose of preparing statistical projections. The tenuous nature of the assumptions, especially during the current period of uncertainty in world oil markets, must be recognised. Already some modification may be necessary in view of the compromise oil pricing formula agreed by the OPEC nations in December 1980 which permitted price increases averaging slightly under 10 percent. The forecasts were prepared before this meeting, and are based on the assumption that the price of crude oil would rise at the same rate as the industrial countries inflation, about 11 percent in 1981. The impact of larger-than-forecast growth in the price of oil would be to worsen the outlook for the industrial and non-oil developing countries, whilst increasing the oil exporter's external surplus.

The purpose of the forecasts, however, is not to pinpoint numbers, but more importantly (and more realistically), to provide an indication of the direction and pattern of likely changes in the world economy.

In terms of analysis it is useful to aggregate the international economy into three main country groups — the industrial countries containing most of the OECD member countries, the oil exporters, and the non-oil developing countries — deriving totals or averages for each group. Each groups displays different characteristics relative to the others, but within each the countries are comparatively homogeneous. Attention is concentrated on the industrial countries, and more particularly on the major economies of the United States, Japan, the Federal Republic of Germany and the United Kingdom, because of their large weight in the world economy.

In most cases the figures given for 1980 are estimates (actuals not being available at the time of writing), with figures beyond that year, forecasts.

INFLATION

A principal feature of developments during the latest 18 months has been the relatively smooth absorption of the 'second oil price shock'. The oil-induced acceleration of consumer prices peaked in the first quarter of 1980 before dropping at a faster and more pronounced rate than expected in the second half of the year. For the year as a whole, the average rate of increase in inflation in the industrial countries is estimated at 12 percent, up from 9 percent in 1979.

Oil prices, which had declined in real terms in the four years following the 1973/74 price hike, doubled in 1979 and rose a further 25 percent last year, giving a total increase of around 160 percent since the end of 1978. Non-oil commodity prices have generally eased since February 1980, prompted by the slowdown in activity and some destocking. The food commodity price index has recently begun to rise however, and continued supply problems are expected to boost the rate of increase of these commodity prices close to the level for manufactured goods in 1981.

CONSUMER PRICES
(% Change, Annual Rates)

	Average				*12 months to October*
	1961-70	*1971-6*	*1978*	*1979*	*1980*
United States	2.8	6.6	7.7	11.3	12.6
Japan	5.8	11.1	3.8	3.6	7.8
Federal Republic of Germany	2.7	5.9	2.7	4.1	5.1
France	4.0	9.0	9.1	10.8	13.5
United Kingdom	4.1	13.6	8.3	13.4	15.4
Canada	2.7	7.4	9.0	9.1	10.9
Italy[1]	3.9	12.2	12.1	14.8	21.1
Australia	2.5	10.8	7.9	9.1	10.3[2]
New Zealand	3.8	11.3	12.0	13.8	16.1[3]
Total OECD	3.4	8.6	7.7	9.9	12.3

Source: OECD
1. Break in series in 1977
2. 12 months to September 1980
3. 12 months to December 1980

Movement in nominal wages has generally lagged behind that of prices and wage claims in most of the major industrial countries have been moderate; at mid-year being 1.5–2 percent lower over the previous 18 months than would have been expected on the basis of past behaviour. Although some acceleration in wages has been evident in recent months this is expected to slow in response to the projected labour market developments, and restrictive financial policies.

Economic policy in the industrial countries has been aimed primarily at reducing inflation and inflationary expectations. Tighter monetary policy, while having had the effect of containing the rate of price increase, has also led to higher interest rates and a dampening in demand.

There remain wide variations in the inflation rates of different industrial countries, ranging from 4–5 percent for Switzerland and Germany to 20 percent for Italy. Except for those countries currently recording high inflation, any further reduction in the rate of price increase is likely to be small and the average rate is not expected to fall much below 10 percent before 1982.

In North America the rate is projected to be sticky at around 9–10 percent. There are signs in the United States of further pressures on prices in 1981 from food, energy and a catch-up in wages. Germany's inflation rate is forecast to fall to the 1978 level of 3 percent by 1982 while Japan's consumer prices are projected to slow from the current 8 percent growth to around 5 percent by the end of 1981. The deflationary forces in the United Kingdom economy should bring about further falls in that country's inflation rate, reaching single figures by mid-1982. A slight deceleration in consumer price inflation is forecast for the smaller OECD countries as a group to around 11–12 percent in 1981.

The underlying rate in inflation in the industrial world is expected to remain stubbornly at historically high levels despite widespread slack. This prevailing level of inflation, as distinguished from the 1979 acceleration of inflation, is attributable to a variety of factors operative over a period of many years, but notably the application of unduly expansionary fiscal and monetary policies.

OIL

A pervasive factor in the present situation of the international economy is the impact of the oil price rises of 1979 and 1980. The average price of oil rose over 160 percent in this period, from a little under $13 a barrel to around $33 a barrel, compared to the 300 percent rise in 1973/74 from $3 to $12 a barrel.

Staff of the IMF have estimated that the 140 percent increase through to mid-1980 gave rise to an increase of $170 billion in the combined export earnings of the oil exporting countries, and some $20 billion in such earnings of other countries that are net-exporters of oil; implying an addition to oil bills of about $155 billion for the industrial countries as a group and $35 billion for developing countries that are net oil importers. Similarly, the direct impact of the oil price change on prices in the industrial and non-oil developing countries is estimated to have been to raise the annual rate of inflation by 2.25 percent on average. This figure does not include any indirect effects on final-product prices or non-oil energy prices. The direct short-run deflationary impact on aggregate demand is calculated to be around 2 percent of the net oil importers' GNP, the result of the diversion of expenditure away from other goods and services into oil import payments. The actual price and deflationary impact in individual countries, however, depends largely on each country's policy response to the oil price increases.

The recurrence of pressure on energy supplies and the subsequent substantial oil price rises have highlighted again the need for more effective energy policies in oil consuming nations. Conservation efforts and the slowdown in activity led to a reduction in oil consumption by the industrial countries of about 5 percent in 1980 but the supply/demand position remains tenuous. Until the eruption of hostilities between Iraq and Iran, optimistic predictions of low oil price rises this year had been based on the expectation of sluggish demand in world oil markets, slow economic growth, and high inventories (amounting to 100 days supply in September). The prolonged Gulf war however, has eliminated 4.8 million barrels per day of oil production and 4 million barrels per day from world oil supply (about 8 percent of total non-Communist oil trade). Furthermore, the two countries' oil installations appear to be quite severly damaged, and will need a substantial period of restoration before oil production will be able to reach pre-war levels again.

OUTPUT

The average rate of expansion of economic activity in the industrial countries, which since 1976 had remained fairly moderate at around 4 percent, fell in 1979 and again in 1980. The main factor contributing to the marked slowdown in the industrial world's economic growth was the squeeze on real personal incomes as consumer price inflation accelerated in the wake of higher oil prices. Reductions in aggregate spending resulted and subsequently production and investment also fell. It would seem that the world economy is now absorbing the full effects of higher oil prices which shifted the terms of trade substantially and reduced OECD incomes almost immediately by more than 2 percent.

Output fell in the second quarter of 1980 in all the major countries except Japan (where the rate of growth slowed significantly) and subsequent data has confirmed both the severity and international generality of the check to growth. For 1980 as a whole, real GNP in the OECD group is estimated to have risen 1 percent (down from growth of 3.3 percent in 1979) with the United Kingdom, United States and Canada among the major countries recording an absolute fall in aggregate economic activity.

Although the United Kingdom and Italy are projected to record continued output declines this year, the forecast for the next 12 months is one of recovery from the recession but for any improvement to be extremely attenuated. The growth rate in 1981 is projected to remain low at around 1 percent for the OECD area. Monetary and fiscal policies are likely to remain tight, moderating any recovery in pesonal consumption resulting from gains in real income.

Employment growth which had held up until the beginning of 1980, decelerated in 1980 reflecting the weakening activity in the industrial countries as a whole. Unemployment, particularly in the United Kingdom and United States, subsequently rose and despite some recovery in output, is predicted to increase markedly this year as output growth is expected to be more than offset by increases in productivity and the labour force. The unemployment rate for the area is expected to rise to an historically high level of almost 7.5 percent of the workforce in the first half of 1982 (up from 5.1 percent in 1979). This would represent a total of 25.5 million people out of work in the OECD area, compared with about 23 million at the end of 1980.

The United States economy experienced sharp changes in trends and expectations last year which resulted in wide swings in interest rates and in monetary and credit aggregates. After falling steeply in the second quarter of 1980 activity started to recover in the third quarter. The economy however is still subject to deflationary forces and it remains uncertain whether the upturn indicates a lasting recovery of activity. Poor productivity performance, fiscal drag and strong inflationary momentum are likely to produce only weak growth in personal incomes. Restrictive monetary and fiscal policy will help contain inflation, but any deceleration in the increase in prices is likely to be slow, entailing heavy costs in terms of output and unemployment. The unemployment rate is projected to be almost 8 percent by mid-1982 and the average rate of growth in real GNP for 1981 forecast to be 0.8 percent against a decline of 0.7 percent last year.

Economic growth in the United Kingdom is estimated to have fallen 2.3 percent in 1980 and a further 2 percent decline is projected for this year. The Government's policy stance is geared to bring government borrowing, monetary expansion and inflation under control, but despite continued high interest rates, the money supply has persistently expanded beyond the target range set. The high interest rate level, together with a high internal cost structure and an appreciating sterling exchange rate eroding international competitiveness, has resulted in a sharp cutback in investment in fixed assets and stocks with the main impact of the recession being borne by the corporate sector, particularly manufacturing companies. Domestic demand too, is weak. Unemployment has risen sharply to the highest level in forty years and by mid-1982 could reach 11 percent (2.5 million people).

GROWTH OF REAL GNP
(% change)

	Average 1968-1978	*From Previous Year 1978*	*1979*	*1980 (est)*	*1981 (forecast)*
United States	2.9	4.4	2.3	-0.7	0.8
Japan	6.6	6.0	5.9	5.0	3.8
Federal Republic of Germany	3.5	3.5	4.5	1.8	-0.2
France[1]	4.4	3.3	3.3	1.8	1.0
United Kingdom[1]	2.3	3.5	1.5	-2.3	-2.0
Italy[1]	3.4	2.6	5.0	3.8	-1.0
Canada	4.4	3.4	2.8	-0.5	1.3
Australia[1]	3.7	2.9	4.4	2.3	4.0
New Zealand[1]	2.9	-1.9	-0.4	1.3	1.3
Austria	4.4	1.5	5.1	2.5	—
Belgium	4.0	2.5	2.4	1.5	1.0
Denmark[1]	3.2	1.0	3.5	-0.5	1.5
Finland[1]	4.0	1.4	7.2	6.0	2.8
Greece[1]	5.9	6.2	3.8	0.8	1.5
Iceland	5.6	4.2	2.3	1.3	1.0
Ireland[1]	4.3	6.1	1.9	1.5	2.5
Netherlands[1]	3.9	2.4	2.3	0.3	0.3
Norway[1]	4.3	3.0	3.2	3.0	0.8
Portugal[1]	4.8	3.2	4.8	4.0	3.5
Spain[1]	5.0	2.5	0.8	0.5	1.8
Sweden[1]	2.1	2.4	3.8	2.3	1.3
Switzerland	1.7	0.2	2.2	2.5	1.0
Turkey	6.3	3.0	0.6	-0.5	3.3
Total OECD	3.8	3.9	3.3	1.0	1.0

Source: OECD
1. GDP

Economic developments in the coming year will be increasingly affected by the loss of external competitiveness recorded during the past two years. Falling manufactured exports and investment are expected to account for a large proportion of the forecasted decline in activity. Tightening fiscal policy will also dampen demand.

The German economy experienced a sharp slowdown in real GNP growth last year, the growth rate halving to 1.8 percent compared to 4.5 percent the previous year. Some recovery in output from the low levels reached at the end of 1980 is forecast during the course of 1981 and into 1982 but the level of aggregate economic activity for the year is expected to be slightly lower on average in 1981 than in 1980. Restrictive monetary policy resulted in inflationary pressures lessening in 1980, but in spite of the weakening activity and some cautious relaxation in policy mid-year the authorities are constrained by balance of payments considerations. In a move that reaffirms its anti-inflationary policy, and also supports the deutschmark, the Bundesbank has lowered the monetary growth targets for the current year. Aggregate demand is projected to remain weak this year but growth in German export volumes as cost and price competitiveness improves is likely to provide increasing stimulus to activity through the year.

The Japanese economy has adjusted well to the second oil shock, activity remaining buoyant until mid-1980, and inflationary pressures have been kept reasonably under control. The pace of economic expansion however slowed in the past year but, held up by exports and private investment demand, this growth is still considerably higher than that of the other major industrial countries. In common with many European countries, the spreading recessionary trends, slowdown in monetary expansion and evidence of inflation improving would justify a relaxation of restrictive monetary policies but external requirements, in terms of ensuring both the required financing for large current account deficits and defending the external value of currencies to provide support to domestic anti-inflation policies, have limited the scope for any easing. The Japanese authorities have cautiously relaxed their policy stance to one designed to sustain activity. These moves should prevent any marked fall in growth. Aggregate output is forecast to rise almost 4 percent in 1981 against 5.9 percent and 5.0 percent in 1979 and 1980 respectively.

In all, the industrial countries have experienced a marked and widespread slowdown during the past year and although a gradual strengthening is expected during the course of 1981 in most countries average growth rates will remain low for the year as a whole. Except for the United Kingdom, the growth rates projected for individual countries are nearly all positive for 1981, as in 1980, with the few indicated declines being quite small.

INTERNATIONAL TRADE

Following a strong growth in trade volumes during 1979, (with the notable exception of the oil trade), world trade is estimated to grow in volume by only 3 percent per annum in both 1980 and 1981, the slowest advance since the 1974/75 recession. Although oil exporting countries are forecast to absorb higher volumes of imports, slack demand in the industrial countries and financial constraints on expansion of imports by the majority of non-oil developing countries are the main factors contributing to this weak growth.

In terms of the external balances for the main country groups (currently a substantial current account surplus in the OPEC group, mirrored by large deficits in the industrial and non-oil developing countries) the large imbalances are projected to lessen in the coming year. Given no further real increase in oil prices, the oil-exporting countries' surplus is expected to fall to $82 billion this year, down $34 billion, whilst the counterpart will be in the deficit of the industrial countries declining from $68 billion to around $34 billion in the same period (mainly reflecting improvements in the major countries' external balances). Non-oil developing countries, however, are likely to suffer from the slowdown in world trade and a continued deterioration in their terms of trade. Their combined deficit is forecast to widen further in 1981 to $62 billion, over twice that of 1978. In view of the already large size of their external debt and debt servicing obligations, the ability of these countries to finance such deficits, while following appropriate adjustment policies, is of major concern. Its is feared that the commercial institutions will not be able or willing to take as large a part in the financial intermediation process for the developing countries as they have in recent years and that other channels will have to be found. The IMF has made some moves in this direction.

The two ex-surplus countries, Japan and Germany, account for a large share of the OPEC-induced payments deficit in the industrial world, respectively recording current account deficits of $13.2 billion and $17.2 billion in 1980. The surplus balances in the United Kingdom and United States resulted principally from their deeper and earlier recessions relative to the other major economies. Weakness in domestic demand kept imports of manufactured goods low, while industrial destocking and the slowdown in pace led to reduced raw material imports. Positive shifts are forecast for most of the major countries in 1981, in part because of the depressive effects of the cyclical slowdown on the value of their imports from developing countries. Some deterioration in Britain's current account may occur during 1981 as imports increase again following the end of the destocking phase and exports become increasingly effected by the substantial erosion in competitiveness of around 40 percent which has occurred in the last two years as a result of exchange rate movements. However, the United Kingdom is now self-sufficient in oil and a growing surplus from trade in oil will tend to offset any deterioration in the non-oil balance this year.

Among the smaller industrial countries, few are likely to reverse the recent worsening in their current account positions and this group of countries is projected to have a combined current account deficit of $29 billion in 1981. But, unlike the developing countries, they are not expected in general to encounter serious problems financing the shortfall in the near-term given the official reserve holdings of these countries, their creditworthiness and the liquidity of international capital markets. Nevertheless, for a number of these countries, including New Zealand, substantial adjustment will be necessary in the medium term to correct the imbalance.

GLOBAL STRUCTURE OF CURRENT ACCOUNT BALANCE[1]
(Billions of US Dollars)

	1977	*1978*	*1979*	*1980 (est)*	*1981 (forecast)*
Industrial Countries	-19	12	-32	-68	-34
OPEC	29	4.5	68	116	82
Other Developing[2]	-18.5	-25.5	-40	-55	-62
Other Non-OECD	- 8.5	- 9.5	- 3	- 5	- 8
TOTAL[3]	-16	-17.5	- 7	-12	-22

Source: OECD
1. Includes official transfers.
2. Includes Turkey, Greece and Portugal which are OECD members.
3. Reflects statistical errors and asymmetrics.

CURRENT ACCOUNT BALANCES[1]
(Billions of U.S. Dollars)

	1977	*1978*	*1979*	*1980 (est)*	*1981 (forecast)*
United States	-14.1	-14.3	- 0.8	5.5	19.8
Japan	10.9	16.5	- 8.8	-13.2	- 6.7
Federal Republic of Germany	4.2	8.7	- 5.5	-17.2	-10.5
France	- 3.0	3.7	1.2	- 7.7	- 6.2
United Kingdom	- 0.5	1.2	- 3.9	4.5	4.3
Italy	2.5	6.2	5.1	- 5.2	- 2.2
Canada	- 4.0	- 4.4	- 4.4	- 3.5	- 3.0
Australia	- 2.6	- 4.0	- 2.0	- 1.7	- 1.9
New Zealand	- 0.9	- 0.5	- 0.8	- 1.2	- 1.4

Source: OECD
1. Includes official transfers.

DIRECTION OF POLICY

To analyse the effect of different policy moves the IMF recently prepared a number of broad scenarios for the world economy over the next five or so years. By making different general assumptions about the conduct of demand management policies in the industrial countries the analysis indicated that:

(i) continued emphasis on policies to reduce inflation implies some reduction in the growth of nominal demand and increase in economic slack. The outcome of such a stance is likely to be one of a gradual decline in inflation in the industrial world, slow average rates of growth of real GNP and manageable recycling of funds. This should restore by the mid-1980's an environment conducive to sustained long-run growth provided effective supply-side measures are also taken to reduce the energy constraint, and more generally, remove the factors tending to hinder productivity and efficiency.

(ii) an early shift in demand management policies toward expansion would be likely to markedly improve growth rates in the short-run but at the probable cost of increasing oil price and inflationary pressures. A new shift toward severe restraint of demand would most likely then occur, bringing about a fall in the rate of economic growth. Several years would have been lost in the fight against inflation and inflationary expectations would become even more deeply entrenched.

It would therefore seem that, although depressive in the short-term, the implementation of policies designed to combat inflation coupled with appropriate policies on the supply side promises to bring substantial improvement in the international economic environment by 1985 or so, whereas failure to give priority to the control and reduction of inflation would, at the least, waste time in achieving a sustainable growth pattern. Reduction of inflation and inflationary expectations is considered necessary for the restoration of conditions for better investment performance and sustained economic growth.

The former course of action will require maintenance of firm restraint in monetary policy with fiscal policy also in line. In some countries this will mean renewed efforts to control government spending.

CONCLUSIONS AND IMPLICATIONS FOR NEW ZEALAND

The international economy is experiencing a generalised slowdown in economic growth, which, while serving as a brake on inflation, has had adverse effects on employment and trade volumes. In varying degrees most countries are currently recording high inflation, slow growth, substantial under-utilisation of resources and balance of payments difficulties. Real GNP grew only 1 percent in the industrial countries as a whole in 1980 and activity is projected to remain weak into 1981 before picking up later in the year. The picture is one of modest growth at best by the end of the year, featuring a slowly recovering world economy, worsening unemployment, continued high inflation, and a continuation of large external imbalances, albeit at smaller levels than those experienced in 1980.

Despite the current economic situation and outlook, there is a large measure of agreement that top priority must continue to be given to the fight against inflation. Progress in this area is considered necessary for the achievement of sustained economic growth.

As a trading nation New Zealand is not isolated from the effects of such an outlook. The impact will be transmitted through New Zealand's external balance and will feed through to the internal economy influencing the money supply, inflation, demand and production.

Partly reflecting this international outlook, both with respect to projected volume movements and lower terms of trade, recent economic forecasts show a significant deterioration in New Zealand's current account deficit in the June 1981 year and widening further in the following trade year. In spite of relatively favourable export prices, a high rate of increase in import prices (reflecting largely oil price movements and the lagged effects of the 1979 upsurge in inflation in New Zealand's main trading partners), resulted in the country's terms of trade deteriorating markedly through 1980. Continued high import price growth (albeit easing from the peak of around 35 percent) and some slowing of the growth in export prices is projected to keep the terms of trade close to their current low level for the next year at least.

Export volume growth in the past year was aided by above average performance in the agricultural sector but that rate of volume increase is unlikely to be repeated this year and the forecast stagnation in world trade is expected to dampen somewhat the growth of New Zealand's export earning. Import volumes, which are projected to fall slightly in 1980/81 as destocking occurs, are expected to rise again the following year partly in response to the import requirements of the country's large investment in energy and industrial projects.

International inflationary pressures and rising energy prices along with domestic wage increases and the enlarged government deficit will keep inflation high although the increased current account deficit will act to moderate growth in the monetary aggregates. The rate of increase in consumer prices is not expected to improve this year, remaining around 17 percent.

Thus the international recession will be transmitted to New Zealand primarily through adverse terms of trade performance and lower demand for export commodities. The resulting lower real export earning will affect farming income (which is forecast to stagnate for the next two years) and consequently spending, which will have a flow-on effect of this on the economy as a whole. As more of the major investment projects get under way in the next year or two the associated investment will provide a boost to the economy which should help induce a better rate of growth than has been evident in recent years. The ability to sustain higher growth then without generating adverse economic effects will depend significantly, as it will in other countries, on the country's ability to come to grips with the immediate problem of a persistent high rate of inflation.

RESEARCH PAPERS — BULLETIN REPRINTS — BULLETIN SUPPLEMENTS

Readers of the *Bulletin* may be interested to know that the Reserve Bank also publishes on an occasional basis a series of Research Papers, Bulletin Reprints and Supplements. The Research Papers are designed to present to a wider audience the results of the Bank's research endeavours and in most cases are rather more technical than the usual *Bulletin* articles. In addition, the Research Papers have been used to publish material discussing major policy issues, especially where these issues bear on the work of the Bank itself. Although the Bank fully supports the research work of its staff, the views expressed in Research Papers are those of the authors and do not necessarily represent the views of the Bank. Research Papers, Bulletin Reprints and Supplements are available free of charge on request to the Economic Department, Reserve Bank of New Zealand, P.O. Box 2498, Wellington, New Zealand. A mailing list is maintained for those persons or institutions who wish to receive the Research Papers as they are published.

The following is a list of Papers already published.

	BULLETIN REPRINTS
THE CREATION OF FINANCIAL ASSETS	June 1978
MONETARY POLICY INSTRUMENTS AND THEIR RELATIONSHIP TO MONETARY CONDITIONS	March 1978
TRANSMISSION CHANNELS FOR MONETARY POLICY	April 1978
CREATION OF FINANCIAL ASSETS	June 1978
NEW ZEALAND EXCHANGE RATES	August/September 1979
MONEY AND THE NEW ZEALAND ECONOMY	October 1979
THE NEED FOR A CONSTANT VALUE UNIT OF ACCOUNT:	
SAVINGS	November 1979
HOUSING	December 1979
THE USE OF A CONSTANT VALUE UNIT OF ACCOUNT IN BUSINESS ACCOUNTS	May 1980
FUNCTIONS OF THE RESERVE BANK (REVISED)	October 1980

	BULLETIN SUPPLEMENTS
NEW ZEALAND CORPORATE FINANCIAL STATISTICS	August 1978
NEW ZEALAND CORPORATE FINANCIAL STATISTICS	July 1979
NEW ZEALAND CORPORATE FINANCIAL STATISTICS	August 1980
FOREIGN INVESTMENT IN NEW ZEALAND	November 1979

RESEARCH PAPERS

The following is a list of papers already published.

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