# DEVELOPMENTS IN THE INTERNATIONAL ECONOMY[1]

## INTRODUCTION

The present world recession has proved to be the most severe for almost fifty years While early 1983 brought the first signs of a recovery and renewed optimism for prospects later this year and for 1984, the upturn up till now has been rather hesitant, and is relatively weak by historic standards However, economic recovery now seems to be gaining momentum in the US, and the reduction in OPEC oil prices earlier this year is an additional factor which should have beneficial overall effects for the world economy

1982 was a year of particularly depressed economic activity and rising unemployment in almost all industrial and developing countries World demand weakened further from the already low levels reached in 1981, and the volume of world trade fell for the first time since 1975 A combination of weak demand, low commodity prices and high interest rates on international capital markets produced major financing problems for an increasing number of developing countries, although inappropriate domestic economic policies were also an important factor in some cases Major exchange rate developments through most of 1982 were rather difficult to explain in the light of underlying economic and financial developments and in a number of ways these exacerbated the problems of both industrial and developing countries The volatility of exchange rates also continued to be a cause of some concern

From the middle of last year, however, encouraging signs appeared as both inflation and interest rates began to converge in a downward trend Initially, the progress achieved against inflation in the US allowed the Federal Reserve to take steps which seemed to indicate a somewhat easier monetary policy, and the lowering of US nominal interest rates in turn allowed the authorities in other major industrial countries where similar progress against inflation had been made to follow suit

The path which real interest rates now take is seen as the single most critical factor in the recovery With the fall in inflation and in inflationary expectations and more flexibly administered monetary policy in the US, short and medium term interest rates have moved down from the record post-war highs reached in 1981, but long-term rates generally have yet to fall to a corresponding extent. Nominal short-term rates in industrial countries in 1982 were about 2 5 percentage points lower on average than they were in 1981 (the fall over the course of 1982 was larger than this), but real rates fell by only a quarter of a percentage point — 'real' in this context meaning relative to actual inflation rates Real long-term rates in fact rose by an estimated 1 percentage point, apparently reflecting market scepticism about the gains against inflation

Concern about renewed inflation is largely based on the persistence of a large US Federal fiscal deficit Although for most other major industrial countries the fiscal deficit is more 'cyclical' in nature (i e is more the result of various recession-related factors — low tax revenue and higher transfer payments for example), and may be expected to decline proportionately as the economy expands, most analysts do not believe this is the case with the US Present indications are that the US Federal deficit will remain proportionately large even when the economy has moved toward full employment Inflationary expectations have therefore been maintained by the concern that a significant proportion of this imbalance may inevitably be monetised (i e financed by creating money) The US deficit is large relative to the level of domestic saving, and high deficits cannot be financed without direct or indirect upward pressure on US interest rates A country such as Japan by contrast, with a relatively high savings rate (in gross terms around 28 per cent of GNP compared with about 17 per cent for the US) has been able to finance its own relatively large fiscal deficit without incurring significant costs in terms of high inflation and interest rates

Since high US interest rates are also (given the current strength of the dollar) a constraining factor on monetary policy in other industrial countries, the stance of US fiscal policy is presently the focus of much analysis and attention

## INDUSTRIAL COUNTRIES

For the industrial countries as a group, real GNP fell by about 0 3 per cent in 1982, (according to IMF estimates) after rising 1.2 per cent the previous year A mild recovery was previously forecast to begin in mid-late 1982, but failed to materialize due to continued low levels of investment and rapid liquidation of business stocks, and to the weakness of demand for industrial countries' exports by the non-industrial countries Of the seven main industrial nations, only Japan, France and the UK were able to achieve a positive growth rate in 1982 (3 per cent, 1 6 per cent and 0 7 per cent respectively) Although the weakness in activity and demand helped reduce inflation rates in the major industrial countries from an average of 9 9 per cent in 1981 to 7 4 per cent in 1982, it also resulted in further increases in unemployment rates from an average of 6 4 per cent in 1981 to 8 1 per cent in 1982.

Within the industrial country grouping, individual circumstances and policy options vary considerably, and the positions of the four major economies — those which might be expected to 'pull' the rest of the world out of recession — are examined separately below Two general points which can be made are that the sustainability of the recovery will require the maintenance of effective anti-inflationary policies, and that its strength will depend especially on 'structural' fiscal deficits being tackled (see the section on the US below) and on structural distortions which have contributed to low productivity and rising unemployment being addressed Protectionist policies which have been resorted to increasingly by some countries lately also threaten the path of recovery, and it is vital that further protectionist pressures are resisted

1 The forecasts quoted in this article are those prepared by the IMF and presented in their 'World Economic Outlook', IMF Occasional Paper No 21, Washington DC, May 1983

Most of the smaller, relatively 'open' industrial countries face similar sorts of internal problems as well as pressing external adjustment problems Various forms of incomes policies have been implemented in several of these countries in order to try and alleviate the costs (in terms of output and employment lost) of necessary anti-inflationary programmes, but the IMF notes that compatible monetary and fiscal policies will have to be maintained if the approach is to yield longer-term benefits. Also, unemployment increases have not been avoided by the use of prices and incomes policies in preference to 'traditional' macroeconomic policies.

The appearance of 'structural' unemployment in these countries is another issue to contend with Although low levels of demand are a factor in most of these countries, unemployment is also linked to low levels of investment, to poor international competitiveness and to relatively inflexible real wages

For several countries (for example Belgium, Denmark, Ireland and Sweden) large fiscal deficits may have spilled through to higher inflation, interest rates and external current account deficits The current accounts of these countries have been worsened by the downturn in world trade, requiring an additional degree of attention to external financing requirements However, a positive factor which may provide some breathing-space is that a recovery of demand in the major industrial economies together with continued low levels of domestic demand (for imports) should have a favourable impact on the external constraint they face

For the 'minor industrial countries'[2] as a group, real GNP is predicted to rise 0 6 per cent in 1983, after growing 0 2 per cent in 1982 and 0 6 per cent in 1981 Inflation, which averaged 9 7 per cent in 1982 and 10 3 per cent in 1981, is expected to fall to 8 6 per cent in 1983 The aggregate current account deficit of US$14 4 billion for these countries in 1982 is likely to improve significantly in 1983 — to around US$4 5 billion

**Australia**

Policy options for Australia, New Zealand's main trading partner and one of the largest of this group, seem particularly limited The fiscal deficit has expanded rapidly, mainly due to the effects of the recession, and although the Government has indicated that it would like to contain the deficit to between 4 5 and 5 per cent of GDP, its scope for action has been limited by the need to support the already low level of activity in the domestic economy Interest rates have been edging downwards for the most part but are constrained by Australia's relatively high inflation rate and by the need to maintain an adequate inflow of private capital to cover the current account deficit and a part of the Government's financing needs

In 1982, real GDP in Australia rose by around 0 2 per cent (after rising by 4 1 per cent in the previous year) but this figure masks a rapid decline in activity in the second half of 1982 which continued into the first quarter of 1983 The major reasons for this decline were the effects of the long and severe drought on agricultural output and exports, depressed world demand for other major Australian exports and the end of the resource-based investment boom Unemployment increased rapidly in this environment, but appears to have stabilised somewhat during the second quarter of this year at a rate close to 10 5 per cent However, this could be only a temporary respite It has been estimated by some analysts that an average annual growth rate of about 4 per cent could be necessary just to contain unemployment at its present level The OECD forecasts a decline of about 0 8 per cent in real GDP for 1983 in Australia, followed by a return to positive growth of around 4 per cent in 1984 This growth is expected to result from a recovery in agricultural output after the end of the drought, the moderate recovery in world demand and some increase in domestic demand

A major factor behind the recent acceleration in Australia's inflation rate (which increased from around 9 2 per cent in 1980 to 11 per cent in 1982) has been the pattern of wage developments, which in turn is related to labour market pressures resulting from the rapid but temporary growth in employment which started in 1979 and buoyant expectations associated with the 'resource boom' As a result of this, the Government introduced a 'wage pause' late in 1982 and this was absorbed into the prices and incomes policy of the incoming Labour Government in early 1983 This has begun to have appreciable effects on the level of wage settlements, with the rate of increase in award wages recently being less than half that of a year earlier

**United States of America**

Real GNP in the US fell 1 7 per cent in 1982, after rising 1 9 per cent in 1981, and unemployment rose throughout the year, reaching 10 8 per cent by December But as mentioned previously, substantial progress was made against inflation. From an initial 8 5 per cent in January 1982 inflation fell steadily, to 3 9 per cent at the end of the year The upturn in economic activity which began in early 1983 was initially based largely on a recovery in the residential construction sector and on a reduced rate of de-stocking, but recent indications are that output has begun responding across most sectors of the economy, with rising stock levels, increased fixed investment and higher retail sales Growth at a seasonally adjusted annual rate of 2 6 per cent was recorded in the first quarter of 1983, but a considerably faster rate of growth could occur for the second quarter

High interest rates are an important factor constraining recovery in the US — in particular, by retarding the upturn in business investment A further side-effect has been the persistently large current account deficit The dollar's effective exchange rate (as calculated by the IMF) increased 34 per cent between the end of 1980 and the end of 1982, and while unsettled economic and political conditions in other countries have been a factor, real interest rates seem to have been the primary influence on its strength In 1982 the current account moved into an $8 billion deficit (following a $4 5 billion surplus in 1981), largely as a result of the deficit on trade transactions widening from $28 billion in 1981 to $36 billion in 1982

The Federal budget deficit almost doubled to $111 billion in fiscal year 1982 (October 1981 — September 1982), and could increase further to $210 billion, or about 6 5 per cent of GNP in fiscal year 1983 A large element of the deficit is considered to be 'structural', and some projections point to continuing high deficits through to 1988, even when the economy has moved back to high employment levels, unless further budgetary measures are adopted Official estimates suggest that the stock of Federal debt held by the public

2 These are the OECD countries excluding the major seven economies and the three relatively less-industrialised economies (Greece, Portugal and Turkey) — i e Australia, Austria, Belgium, Denmark, Finland, Iceland, Ireland, Luxembourg, Netherlands, New Zealand, Norway, Spain, Sweden and Switzerland

could approximately double from the end of 1982 to the end of 1986, and this inevitably must pre-empt a large proportion of private savings, keeping real interest rates high and investment and productivity growth lower than they might otherwise have been

Some current forecasts suggest that the current account deficit may widen considerably from the US$8 billion in 1982 to US$25 billion (about 1 per cent of GNP) in 1983 and to US$45 billion in 1984 unless the dollar weakens significantly Only a gradual decline in the unemployment rate is likely (unless the recovery proves to be much stronger than expected) but prices are estimated to rise by only about 3 per cent in 1983 The unemployment rate was 10 4 per cent in January and February and 10 3 per cent in March compared to 10 8 per cent in November and December last year The IMF expects real GNP to grow at a rate of about 4 per cent late in 1983, (2 4 per cent for 1983 as a whole), with about half of the increase resulting from a reversal of stock adjustments — from large run-downs in 1982 to moderate accumulation in 1983 During 1984 real growth is expected to slow to around 3 5 per cent as the stock cycle runs its course

**Japan**

In contrast to previous years, external demand contributed little to growth in 1982 The major factor in the 3 per cent growth in output achieved was strong consumer spending Government spending also helped underpin the domestic economy, but the other major components of domestic demand (fixed investment and stock-building) remained depressed throughout 1982 Despite a significant depreciation of the yen, inflation continued to moderate and by the end of 1982 had reached 2 4 per cent The external current account surplus had been expected to widen significantly as a result of falling oil prices, but rose only from US$5 billion in 1981 to US$7 billion in 1982, with exports again depressed by low foreign demand

Domestic economic policy has been constrained by the need to keep under control the large fiscal deficits which emerged in the mid and late 1970s on the one hand, and the need to maintain economic activity on the other, and thus far the Government has steered a relatively stable course with respect to expenditure and the fiscal deficit Monetary policy has been particularly handicapped by sizeable changes in the exchange rate — a cut in the current discount rate (currently 5 5 per cent) has long been expected but has been delayed by the need to avoid any further depreciation of the yen Interest rates have therefore been prevented from following fully the downward trend evident in the other major industrial economies

A slow recovery of business fixed investment and a larger increase in domestically and foreign held stocks is expected in 1983, and consumer price inflation is expected to slow to 2 per cent There is some expectation that the yen should appreciate in the forecast period and real interest rates may thereby have room to decline While domestic demand is expected to be again an important source of growth in 1983, this time all of the increase is expected to come from the private sector The IMF foresees Japanese economic growth of 3 per cent in 1983, and in 1984 this rate of expansion is expected to rise to about 4 per cent as external demand strengthens. A current account surplus of $17 billion is predicted for 1983, and a surplus of $18 billion for 1984 as a result of improvements in the terms of trade and in the volume of exports Inflation may rise marginally (to around 3 per cent in 1984) as the recovery proceeds and commodity prices rise

**West Germany**

Neither domestic demand as a whole nor investment in particular recovered as expected in 1982, while external demand was also weak Real GNP fell 1 per cent, and unemployment rose rapidly, reaching 8 5 per cent of the labour force at the end of 1982, and 9 2 per cent by the first quarter of 1983 However, inflation fell through most of the year, averaging 5 3 per cent in 1982 (compared to 6 per cent in 1981) The external current account surplus of DM 8 billion for 1982 (after a deficit of almost DM 15 billion in 1981) was due to lower oil prices and an improvement in the terms of trade, and also to lower demand for imports

In recent months the outlook for the West German economy has brightened somewhat, with an upturn in both construction and investment expenditure Unlike earlier recoveries, however, this upturn will not be export-led, but will be dependent on domestic factors — and on a strong rise in investment in particular Government policy is now aimed at facilitating the recovery in private sector investment and demand so as to re-establish non-inflationary growth As in Japan, fiscal policy has been aimed at reducing as far as is practicable the government deficit, but present measures imply a deficit of DM 41 5 billion in fiscal year 1983, again at 2 5 per cent of GNP This proportion is expected to be reduced marginally in 1984 — to around 2 per cent

Monetary policy has been somewhat hampered by the deutschmark's weakness against the dollar, but has generally been more relaxed recently Official nominal and real interest rates have declined, but commercial rates have been slow to follow as a result of the cautious attitudes adopted by banks and other financial institutions While monetary policy has therefore been eased somewhat, fiscal policy remains relatively cautious, and in the absence of strong overseas demand real GNP is expected by the IMF to grow only marginally in 1983 — about 0 5 per cent In 1984 the rate of expansion is forecast to pick up to 2 5 per cent, with foreign demand supplying much of the added impetus

These developments however, are not expected to have much effect on the labour market, and the rate of unemployment is likely to rise further — to about 9 per cent in 1983 and 9 5 per cent in 1984 Inflation is expected to continue to decline in 1983 — to around 3 5 per cent, and (notwithstanding rising commodity prices) to be below 3 per cent in 1984 Relatively weak domestic demand (i e demand for imports) and improved terms of trade should see the external current account surplus widen to DM 17 billion in 1983, but these factors are expected to be reversed in 1984 and some deterioration in the balance is likely

**United Kingdom**

Real GDP fell more than 2 per cent in 1981, but is estimated to have risen by 0 5 per cent in 1982, mostly because of an end to the running down of stocks There have been some increases in domestic demand since 1981, but the benefit to domestic industry has been slight as much of the increased spending has been on imports More recently signs of a stronger and more broadly based domestic recovery have appeared, with both retail sales and manufactured output heading upwards

**TABLE 1**
**GROWTH OF REAL GDP**
**(% change from previous year)**

| | *1979* | *1980* | *1981* | *1982* | *Forecast 1983* |
|---|---|---|---|---|---|
| US[1] | 2 8 | −0 4 | 1 9 | −1 7 | 2 4 |
| Japan[1] | 5 2 | 4 8 | 3 8 | 3 0 | 2 8 |
| West Germany[1] | 4 0 | 1 8 | −0 2 | −1 1 | 0 5 |
| UK | 2 0 | −2 1 | −2 2 | 0 7 | 1 5 |
| France | 3 4 | 1 1 | 0 4 | 1 6 | — |
| Canada[1] | 2 9 | 0 5 | 3 1 | −4 8 | 1 9 |
| Italy | 4 9 | 3 9 | 0 1 | −0 3 | −0 1 |
| Other Industrial Countries | 3 0 | 2 1 | 0 6 | 0 2 | 0 6 |
| of which Australia | 4 2 | 1 5 | 4 1 | 0 2 | −0 8 |
| New Zealand | 0 9 | −0 1 | 3 6 | −0 7 | −0 5 |
| All Industrial Countries | 3 4 | 1 3 | 1 2 | −0 3 | 1 6 |
| Oil Exporting Developing Countries | 3 1 | −2 3 | −4 3 | −4 8 | — |
| Non-Oil Developing Countries[2] | 4 6 | 4 3 | 2 4 | 0 9 | 1 9 |

*Source* IMF, except for figures for Australia and New Zealand which are from the OECD
1 GNP
2 Excluding People's Republic of China

**TABLE 2**
**CONSUMER PRICES**
**(% change, average annual rates)**

| | *1979* | *1980* | *1981* | *1982* | *Forecast 1983* |
|---|---|---|---|---|---|
| US | 11 3 | 13 5 | 10 4 | 6 2 | 3 0 |
| Japan | 3 6 | 8 0 | 4 9 | 2 6 | 2 0 |
| West Germany | 4 1 | 5 5 | 6 0 | 5 3 | 3 5 |
| UK | 13 4 | 18 0 | 11 9 | 8 5 | 6 6 |
| France | 10 6 | 13 5 | 13 3 | 11 8 | 10 0 |
| Canada | 9 1 | 10 1 | 12 5 | 10 8 | 7 4 |
| Italy | 14 8 | 21 2 | 18 7 | 16 3 | 14 5 |
| Other Industrial Countries | 7 8 | 10 2 | 10 3 | 9 7 | 8 6 |
| of which Australia | 9 1 | 10 2 | 9 7 | 11 2 | |
| New Zealand | 13 8 | 17 1 | 15 4 | 16 1 | |
| All Industrial Countries | 9 0 | 11 8 | 9 9 | 7 4 | 5 5 |
| Oil Exporting Developing Countries | 10 9 | 12 7 | 12 9 | 9 8 | 12 2 |
| Non-Oil Developing Countries[1] | 28 8 | 36 5 | 36 5 | 38 3 | 39 6 |

*Source* IMF, except for figures for Australia and New Zealand which are from the OECD
1 Excluding People's Republic of China

Considerable progress has been made against inflation, which has fallen to about 4 per cent, from a peak of over 20 per cent in mid-1980 The unemployment rate however continues to edge upwards, and is currently around 13 per cent (12 5 per cent at the end of 1982) Although stronger growth will help to stabilize the labour market there is little prospect of any decline in the unemployment rate, and present indications are that it could continue to increase well into 1984

The external current account has shown large surpluses (due in particular to North Sea oil exports) over the past two years Nevertheless the external position deteriorated markedly in 1982 as the full effects of the losses of competitiveness sustained in 1979 and 1980 made themselves felt on the export sector In early 1983 the level of international competitiveness was still about 35 per cent below the average in 1975–78, despite some depreciation of sterling and a marked rise in labour productivity in 1982

A major goal of fiscal policy has been to reduce the share of the public sector in total output, so as not to 'crowd-out' or stifle private sector investment when the recovery finally is firmly established As in other major industrial countries, however, the government's options have been somewhat restricted by the rise in transfer payments and other recession-related expenditure commitments

Interest rates have followed the general downward trend, but in real terms the movement has been relatively small The current strength of the pound provides the authorities with the option of further reducing real interest rates

Real GDP is forecast by the IMF to rise by 1 5 per cent in 1983, largely as a result of growth in private consumption expenditure The rate of inflation is likely to increase slightly — to around 7 per cent at the end of 1983 as a result of commodity prices strengthening and of the recent depreciation of sterling. The external current account is expected to weaken further, but to still be in surplus Although increased world demand and the improved competitiveness of British products should raise export earnings, a surge in imports seems likely to accompany the rise in domestic output and income

## DEVELOPING COUNTRIES

The developing countries, and the 'non-oil developing countries' (NODCs) in particular, have been severely hit by the world recession. Low demand, deteriorating terms of trade and high debt servicing costs in many cases forced cutbacks in imports and in the level of domestic activity. Output for the NODCs rose 2.5 per cent in 1981 and is estimated to have risen 1.5 per cent in 1982, compared with average NODC growth rate over the late 1960s to the late 1970s of around 5 — 6 per cent. The oil exporting countries were also affected by low demand and weakening terms of trade, and output in these countries is estimated to have fallen 5.4 per cent in 1982, after declining 4.3 per cent the previous year.

The average rate of inflation in NODCs was above 30 per cent in 1982 for the third year running, but some progress is expected later in 1983 as the effects of less accommodating financial policies make themselves felt. For oil exporting countries, the average rate of inflation is estimated to have declined from about 13 per cent in 1980 and 1981 to about 10 per cent in 1982, but tighter supply conditions and exchange rate adjustments may through their effect on the price of imports result in an increase in the average inflation rate in 1983.

For 1983 a small rise in the growth rate of NODCs to 2 or 2.5 per cent is projected, but for oil exporting countries no change in real output is expected. Like the smaller industrial economies, substantial improvements in the growth prospects of developing countries will only follow from a recovery in the larger industrial economies. Nevertheless, the IMF points out that the primary factor which will determine the extent to which they are able to take advantage of the upturn will be the economic policies which they have in place or are going to implement.

## INTERNATIONAL TRADE AND FINANCE

The 2.5 per cent fall in the volume of world trade in 1982 (the first such fall since 1975) was itself an indication of the seriousness of the recession. But taken together with the domestic effects of the recession on output and employment, it was also a factor in renewing protectionist sentiment in several industrial countries, where trade restrictions are sometimes seen as an alternative to structural change. Non-oil developing countries imported (by volume) 7.7 per cent less in 1982, and their import payments rose only 0.8 per cent. Industrial countries' import volumes also fell (by 0.5 per cent), but their exports — partly reflecting weak demand from the hard-pressed NODC group and the oil exporting group — fell 2.5 per cent in volume terms.

The industrial countries in general (and the US in particular) have benefited from the very low levels of commodity prices both in 1981 and in 1982. It is usual during recessionary periods for primary commodity prices to be weaker than those for manufactured goods, but for the NODCs 1982 marked the fifth consecutive year of adverse terms of trade movement. While the 1983 upturn should bring some improvement in commodity prices, the consequent improvement in the terms of trade for the NODCs is not expected to offset more than a minor part of the earlier deterioration. Commodity prices (excluding oil) fell 14.8 per cent in 1981 and 12.1 per cent in 1982, and are expected to rise only 5 per cent in 1983. By contrast, the price of manufactured goods fell only 5.1 per cent and 2 per cent in 1981 and 1982, and the price of oil rose 10.1 per cent and then fell 4.6 per cent over the same two years.

The oil exporting countries' large current account surpluses (US$114 billion in 1980 and US$65 billion in 1981) disappeared in 1982, under the impact of continued low demand for oil and falling prices. These countries moved into an aggregate deficit of US$2 billion in 1982 and are projected to register a US$27 billion deficit in 1983. These developments have had important implications for balance of payments financing by other deficit nations. As the effects of a weakening oil market made themselves felt, some of the oil exporting countries began running down their deposits with the international banks, and from being the major source of funds to the banks in 1980, they became the major net users of funds in 1982.

Although a corollary of the reduction in the oil exporting countries' surplus was that the NODC current account deficit fell, this was also due to a cut-back in imports made necessary as a result of sharply reduced access to international financial markets. As a result of debt servicing difficulties in 1981 and 1982 (see the article on this subject in the May Bulletin), commercial banks became less willing to lend to developing countries in general and for balance of payments financing purposes in particular. With the prevailing high levels of debt servicing costs, the downturn in new bank lending had a significant impact on net financing flows to developing countries. While the aggregate NODC current account deficit fell US$21 billion to US$87 billion in 1982, the IMF estimates that in the same year net bank financial flows to these countries fell by US$26 billion, to around US$25 billion. By contrast, net bank financing expanded $9 billion in 1980 and $2 billion in 1981.

In 1983, the aggregate NODC current account deficit is forecast by the IMF to fall by roughly another US$20 billion (to about US$68 billion). This is due to a return to positive growth in export receipts (a recovery in both volumes and prices) flowing from the moderate upturn in the industrial countries, together with only slow growth in import payments. As for the financing of this deficit, net bank lending to NODCs may decline somewhat further (perhaps to less than US$20 billion) reflecting continuing caution on the part of the banks. But assuming there is no sharp decline in direct investment flows or in official transfers and lending, the overall capital inflow to NODCs should still be sufficient to meet an aggregate current account deficit of the size which appears likely to eventuate.

Exchange rate movements have, of course, been another important cause of developments in trade flows, and some of these movements have already been referred to. But exchange rates have also been rather more volatile than expected by some observers, although the IMF suggests that the restoration of greater stability in monetary conditions in the major industrial countries could lead to a significant reduction in this variability. Even so, the short-term movements which have taken place have caused questions to be raised regarding ways in which the present floating exchange rate system for the major currencies may be improved upon, and have also aggravated trade frictions — in particular between Japan and the other major economies.

This topic and the related issue of protectionism have been discussed by industrial countries in a number of fora over the last year or so, often in the broader context of discussions on improved co-operation and

**TABLE 3**
**CURRENT ACCOUNT BALANCES[1] OF MAJOR INDUSTRIAL COUNTRIES**
**(billions of US dollars)**

| | *1979* | *1980* | *1981* | *1982* | *1983* |
|---|---|---|---|---|---|
| US | -0 5 | 1 5 | 4 5 | -8 1 | -25 0 |
| Japan | -8 8 | -10 7 | 4 8 | 6 9 | 17 0 |
| West Germany | -6 1 | -15 7 | -6 5 | 3 3 | 7 5 |
| UK | -1 8 | 6 7 | 12 4 | 6 9 | 3 0 |
| France | 5 2 | -4 2 | -4 8 | -12 0 | -5 0 |
| Canada | -4 2 | -0 9 | -4 5 | 2 2 | 4 5 |
| Italy | 5 5 | -9 7 | -8 2 | -5 5 | -1 5 |

*Source* IMF
1 Includes official transfers

**TABLE 4**
**WORLD PAYMENTS BALANCES ON CURRENT ACCOUNT**
**(billions of US dollars)**

| | *1979* | *1980* | *1981* | *1982* | *1983* |
|---|---|---|---|---|---|
| Industrial Countries | -6 | -40 | 1 | -1 | 16 |
| Oil Exporting Developing Countries | 69 | 114 | 65 | -2 | -27 |
| Non-oil Developing Countries | -61 | -89 | -108 | -87 | -68 |
| Other Countries | -6 | -5 | -5 | 1 | 2 |
| Total[1] | -4 | -20 | -47 | -89 | -77 |

*Source* IMF
1 Reflects statistical errors and asymmetries which give rise to totals that are significantly different from zero

co-ordination of economic policies amongst these countries Most recently, leaders of the seven major industrial economies met in Williamsburg in the USA in May, where they took up many of the ideas expressed at the earlier OECD Ministerial meeting in Paris The leaders reaffirmed their aim of achieving non-inflationary growth of income and employment, and confirmed that they would seek greater stability of exchange rates "through greater convergence of economic performance" They also stated that they would "pursue a balanced set of policies in order that the recovery may spread to all countries" and renewed their commitment to halt protectionism, to dismantle trade barriers, and to maintain the flow of resources (official development assistance in particular) to poorer countries

## INSTITUTIONAL DEVELOPMENTS

With severe financing and development problems being faced by a number of non-industrial countries, both the World Bank and the IMF have taken steps recently to expand the resources available to members In February, the World Bank introduced a special programme which will supplement other official sources of development finance in helping to restore and sustain investment and growth in developing countries The programme is expected to raise Bank disbursements by around US$2 billion over the next three years, and may be extended further if the international recovery has still not had an appreciable impact on growth in developing countries The programme will expand financial resources available for structural adjustment and investment lending, and will also extend advisory services in these areas The Bank has budgeted loan commitments of US$11.2 billion in fiscal year 1983 (July 1982/June 1983) compared with commitments of US$10 3 in the previous fiscal year, and is authorised to borrow up to US$9 8 billion on capital markets to finance its lending activities (Borrowings were US$8.5 billion in the previous year) In addition to this a further US$3 4 billion is being disbursed on highly subsidised terms by the World Bank's affiliate, the International Development Association (IDA) to the very low income group of developing countries Commitments by IDA in fiscal 1982 were US$2 7 billion The operations of IDA were somewhat hampered in 1982 by a US decision as to the timing of its contributions committed under the present round of fund raising (the 'IDA-6 replenishment'), but the World Bank now hopes that all payments to IDA-6 can be completed in fiscal year 1984, in time for the scheduled start of the next replenishment IDA-6 contributions were originally scheduled to run over fiscal years 1981-83, and a total of US$12 billion was committed In view of the likely increased need for funds (because of the position of many developing countries plus the recent granting of eligibility to China for IDA funds), the World Bank hopes for a much enlarged IDA-7 replenishment

In February of this year, the Interim Committee of the Board of Governors of the IMF agreed that there should be a 47 5 per cent increase in total IMF quotas, raising them from SDR61 billion to SDR 90 billion A recommendation on the Eighth General Review of Quotas had originally been scheduled for adoption by December 1983, but negotiations were accelerated and the timetable brought forward as the participants became more aware of the extent of the debt and adjustment problems being faced by some developing countries Although many Fund members (including New Zealand) had argued for a larger quota increase than that finally agreed to, the increase nevertheless represents a marked change in the position of one or two major Fund members who previously saw little justification for a substantial quota increase The quota increases should be ratified by individual member governments by the end of November this year and the additional resources should be available to the Fund by the end of December (Further detail on the Eighth

Review of Quotas is given in an appendix to the article 'Recent Developments in International Indebtedness' in the May 1983 issue of the Bulletin )

A second development to do with IMF resources relates to the 'General Arrangements to Borrow' (GAB) Under the GAB, members of the G10 (the ten major industrial countries) had previously agreed to lend up to SDR6 4 billion to the Fund to finance drawings by other G10 members Early this year, the G10 agreed to increase GAB resources to SDR17 billion, and to make them available to finance drawings from the Fund by all Fund members The condition for non-G10 countries' drawings to be financed from the enlarged GAB was that the Fund had insufficient resources to meet such drawings otherwise, and that the members involved were facing financing problems of a magnitude which would threaten the stability of the international financial system

In the past, the Fund has borrowed from a variety of official sources to supplement its normal resources and finance its lending activities The Saudi Arabian Monetary Authority has been a major source of borrowed funds, but with the turnaround in the external accounts of the oil exporters there may be rather less scope for the Fund to borrow further from that source While there is a consensus among the membership that the IMF should continue to rely primarily on quota subscriptions as the basic source of finance for its operations, there is as yet insufficient support for an approach to the private capital markets for funds even as a temporary supplement

With a smaller quota increase than many members thought appropriate, the needs of member countries with sizeable payments imbalances likely to persist for several years to come therefore need to be balanced against the requirement that the Fund does not meet too large a proportion of its financing needs through borrowed resources Consequently, Fund lending policy, and specifically the 'enlarged access policy', is currently under review The enlarged access policy sets the maximum amounts which members can borrow from the Fund at 150 per cent of quota in any one year or 450 per cent of quota over three years With the increased quota levels to come into effect, the likely demand for Fund resources could be excessive at those access levels, and some downward revision to the access limits is likely

Another issue under consideration at the Fund is the question of further allocations of special drawing rights SDR allocations were last made on 1 January 1979, 1980 and 1981 and resulted in the total cumulative allocation of SDRs increasing to SDR21 4 billion A number of countries have been pressing for further allocations in order to stimulate world trade, increase world liquidity and restore the earlier relationship between conditional and unconditional Fund resources However, as has been the case for some time, prospects for further allocations remain slim, with a number of major industrial countries opposing further allocations on the grounds that they could provide a stimulus to inflation and inflationary expectations

As at the end of April 1983, all of the Fund's existing standby and extended arrangements (i e 'high conditionality' arrangements) were in support of adjustment programmes in NODCs Although new commitments in 1982 at SDR2 4 billion were well down on 1981 levels, this comparison is a little misleading Negotiations commenced on a number of major arrangements in 1982 which required that the Fund be satisfied that private lenders would continue to play an active role in providing finance for the countries involved This delayed completion of the negotiations in a number of cases Partly as a result of this factor, new commitments in the first three months of 1983 were at the very high level of SDR7 4 billion

**TABLE 5**
**WORLD BANK LENDING ACTIVITIES (US$ BILLION)**
**June years**

| | *1978* | *1979* | *1980* | *1981* | *1982* | *1983*[1] |
|---|---|---|---|---|---|---|
| IBRD Lending Commitments | 6 1 | 7 0 | 7 6 | 8 8 | 10 3 | 11 2 |
| IBRD Lending Disbursements | 2 8 | 3 6 | 4 4 | 5 1 | 6 3 | |
| IDA Lending Commitments | 2 3 | 3 0 | 3 8 | 3 5 | 2 7 | 3 4 |
| IDA Lending Disbursements | 1 1 | 1 2 | 1 4 | 1 9 | 2 1 | |

*Source* World Bank
1 Budgeted commitments

**TABLE 6**
**NEW LOAN COMMITMENTS AND OTHER USES OF IMF RESOURCES**
**(billions of SDRs)**

| | *1978* | *1979* | *1980* | *1981* | *1982* | *Jan-Mar 1983* |
|---|---|---|---|---|---|---|
| New Loan Commitments | 1 0 | −0 8 | 6 6 | 12 1 | 2 4 | 7 4 |
| Industrial Countries | 0 1 | — | — | — | — | — |
| Developing Countries | 0 9 | −0 8 | 6 6 | 12 1 | 2 4 | 7 4 |
| Purchases under low Conditionality Facilities | 0 7 | 0 7 | 1 0 | 1 5 | 3 0 | 2 1 |
| Industrial Countries | 0 1 | — | — | — | 0 1 | — |
| Developing Countries | 0 6 | 0 7 | 1 0 | 1 5 | 2 9 | 2 1 |
| Trust Fund Loans Disbursed (Developing Countries only) | 0 7 | 0 5 | 1 3 | 0 4 | — | — |
| Total | 2 4 | 0 4 | 8 9 | 14 0 | 5 4 | 9 5 |

*Source* IMF

## CONCLUSION

The international economic recovery now seems clearly to be getting underway, but it is likely to spread only slowly from the US and the other large economies to other countries The reasons are that real interest rate levels remain high, that lower rates of investment in recent years and structural changes reducing productivity growth have reduced the rate of increase of productive potential in many countries to levels significantly below these in the 1960s and 1970s, that financial policies in the industrial countries are likely to remain generally fairly restrained, that the erosion of business and consumer confidence resulting from the prolonged period of stagflation will take some time to rebuild, that increased protectionism and other policies and practices which inhibit mobility of resources will reduce growth potential, and that external financing problems are forcing some developing countries to constrain the rate of growth of their imports

The IMF considers that monetary policy must continue to focus on reducing inflation and inflationary expectations, that fiscal deficits must be kept under control and that government financing requirements should not compete unduly with private sector investment needs, and that structural rigidities must be tackled in order to expand employment and production opportunities In addition, continued international co-operation to defuse the threat of spreading protectionism, to monitor and assist in the difficult debt situation faced by some developing countries, and to foster more stability of exchange rates remains an essential adjunct to economic policies and plans The activities of the international institutions will continue to be very important in this context

The implications for New Zealand of the moderate nature of the international recovery stem from the expectation that although some upturn is currently appearing in export receipts, strong growth in these and in farm incomes is unlikely to eventuate in the near future In other words the stimulus to the domestic economy from the international economy is likely to be rather limited in the short-term There has been a marked improvement in New Zealand's current account deficit in recent months, but a major factor in this has been weak demand for imports as a result of the domestic recession. The improvement is thus likely to be reversed by any marked upturn in domestic demand As in many other countries, with large fiscal deficits in prospect, monetary policy will need to remain firm in coming months in order to limit the possibility of such a reversal and in order also to consolidate and build upon the reduced inflation rate which has eventuated under the freeze