DEVELOPMENTS AND PROSPECTS FOR THE INTERNATIONAL ECONOMY[1]

INTRODUCTION AND OVERVIEW

Developments over the latter half of 1983 appear to confirm earlier indications of an upturn in growth in the larger industrial economies. Thus far the United States and Canada have shown the clearest signs of stronger recovery, but demand and output in the other major economies have also strengthened, and growth rates (although relatively low outside North America) have been generally stronger than was earlier thought likely or possible.

Prospects for an eventual world recovery are now brighter than they have been for several years, but optimism has been tempered by two troubling aspects of the upturn. Firstly, the recovery outside North America is likely to remain relatively weak over the coming year. The Japanese recovery, though developing steadily, is not likely to accelerate rapidly over 1984, while for the European economies, the pattern of domestic demand, the stance of fiscal and monetary policy and other economic factors are such as to suggest that there will be little scope for rapid economic expansion in the immediate future. Secondly, the recovery in these countries has been based rather narrowly on household demand and stock building. Until the base of the upturn broadens, it will remain vulnerable to any adverse seasonal movements or any disruption of normal trade and financial flows.

Monetary policies have, in general, ranged from 'cautiously neutral' to 'tight'. Fiscal policies have also been less expansionary, with the main exception being in the US where the strongly expansionary stance of fiscal policy has been an important factor in recent economic developments.

Demand from the developing world has not contributed significantly to the recovery, and this is not likely to change over 1984. Policies of demand restraint and structural adjustment have helped curtail the widening current account deficits of both oil-exporting developing countries and non-oil developing countries, but have also had a significant effect on industrial countries' exports.

The upswing has thus far been primarily underpinned by strong household demand, supported by a return to stockbuilding. Interest-sensitive components in domestic demand, such as housing and stocks, have responded to falling nominal interest rates. Household saving ratios have declined and this, together with rises in real incomes (although only marginal in some countries) and with some real balance and wealth effects following slower inflation, has served to support the rise in consumption expenditure.

Non-housing investment expenditure though has not responded as promptly to the upswing as was hoped. An upturn in productive investment (i.e. business fixed investment) will be essential to maintain the initial impetus and to ensure the longer-term viability of the recovery. Only in the US have favourable trends been established in two important determinants of fixed investment, and some growth in business investment has occurred as a result. Rates of capacity utilisation have steadily climbed over 1983 as the recovery has progressed, while the outlook for profits has shown a marked improvement. In Europe, and to a lesser extent in Japan, the outlook for a stronger rise in business investment is more uncertain.

It therefore appears likely that from a global point of view the current upswing will not spread as quickly nor gather as much momentum as was the case in previous world recoveries. As a consequence, 1984 may continue to present many of the smaller industrial countries with familiar problems — the continued need for structural adjustment, for attention to weak public financial positions and to weak external balances. These factors may limit their scope for expansion over the immediate future, and it will be their policy responses which will determine the extent of their future growth prospects. The outlook for the developing world is similar, if not more uncertain, and the need for adjustment in its various forms is even more pressing.

Looking at various measures of economic performance over the last few years, economic activity in industrial (OECD) countries contracted by 0.3 per cent in real terms in 1982, but made a return to positive economic growth in 1983 with an estimated real growth rate of 2.25 per cent. (These averages mask a wide disparity in economic performances across the group.) Inflation rates have stabilised at relatively low levels — the group average for 1982 was 7.8 per cent, and present indications are that this could fall to around 5.5 per cent for 1983 — a rate which was last achieved in the early 1970s. Relatively wide differentials also exist with regard to inflation rates; these are expected to persist and will be a factor in differing rates of economic expansion over 1984. The group of high inflation smaller OECD countries[2] had an average inflation rate of 14.1 per cent in 1982. This appears to have improved only marginally over 1983, to 13 per cent.

Unemployment rates have risen outside North America, though due to higher than anticipated economic growth rates the increases were more moderate than they might have otherwise been. The OECD group average for 1983 may now settle at around 9 per cent (following 8.4 per cent for 1982) — earlier estimates based on average real economic growth of 2 per cent put the average unemployment rate at 9.25 per cent. The rate for North America appears to have peaked in late 1983, but the outlook for Europe is for a continuation of the present upward trend.

Nominal interest rates have moved to reflect falling inflation rates in the larger OECD countries, but real interest rates have not responded to a similar extent. Although there was a downward trend over 1982, this now appears to have reversed over middle-late 1983. Expected rates of inflation appear to be adjusting only slowly to the lower rates of inflation presently being experienced, which is tending to support real rates of interest. A second and more immediate factor in the US are the implications for interest rates of persistent large

1 The forecasts quoted in this article are those prepared by the OECD and presented in their Economic Outlook, No. 34, December 1983.

2 Australia, Denmark, Finland, Greece, Iceland, Ireland, Luxembourg, Norway, Portugal, Spain, Sweden, Turkey.

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

	1980	1981	1982	1983[3]	1984[4]
US[1]	−0.3	2.6	−1.9	3.5	5.0
Japan[1]	4.8	3.8	3.0	3.0	4.0
West Germany[1]	1.8	−0.2	−1.1	1.3	2.0
UK	−2.1	−2.1	2.0	2.5	2.3
France	1.1	0.2	1.9	0.5	—
Canada[1]	1.0	3.4	−4.4	3.0	5.0
Italy	3.9	0.1	−0.3	−1.5	2.0
Australia	1.5	4.1	—	−1.3	5.3
New Zealand	−0.1	3.6	0.5	−0.5	—
Industrial (OECD) Countries	1.2	1.2	−0.3	2.3	3.5
Oil Exporting Developing Countries	−2.1	−3.9	−4.6	−1.6	4.8
Non-Oil Developing Countries[2]	4.3	2.5	0.8	1.2	3.6

Source: OECD, IMF
[1] GNP
[2] Excluding People's Republic of China
[3] Estimate
[4] Forecast

fiscal deficits clashing with revived private sector credit demand as the recovery progresses.

The latest round of OECD forecasts present a picture of 1984 only marginally different from that seen six months earlier.[3] Underlying conditions over the latter half of 1983 have not changed significantly. The main theme in these projections reflects the earlier concern that the recovery will decelerate over 1984 and into 1985, as sluggish growth in other industrial countries fails to offset the expected moderation in the current North American resurgence. Although industrial (OECD) countries are projected to grow by 3.5 per cent over 1984, little of the impetus will come from outside North America. For instance, OECD Europe is expected to grow by a low 1.5 per cent in 1984, following 1 per cent in 1983 and 0.6 per cent in 1982.

An overall levelling off in the reduction in inflation is likely in the coming year — the 5.5 per cent estimated for the OECD region for 1983 is also projected for 1984. Higher rates though are expected to persist in a group of smaller industrial economies (for example Australia, Ireland, Norway and Sweden). For this group, consumer prices are forecast to increase by 11 per cent over 1984, only slightly down on the 13 per cent recorded in 1983.

The aggregate current account deficit of OECD countries appears to have improved marginally — from US$29.8 million in 1982 to US$24 billion in 1983. The rapidly growing US deficit has been offset by a correspondingly large Japanese surplus and by some overall improvement in the deficits of other countries in the group. A further widening in the total OECD deficit to US$42 billion in 1984 has been predicted with the expanding US current account shortfall again being the major element. Meaningful assessments of current account developments (and of exchange rate imbalances) though are hampered by the presence of a very large statistical discrepancy in world current account figures. It has not proved possible to identify or estimate the elements in the asymmetry, although it is known that the problem is concentrated in the invisibles component. It has been suggested for example, that the true US current account deficit may be much smaller than available figures indicate. If so, this could partially account for the persistent strength of the dollar in the face of a rapidly widening current account deficit.

3 Tables 1 — 4 summarise both forecasts and trends in the main economic indicators in industrial and developing countries. It should be noted that the forecasts have been made assuming no changes from actual or announced policies, and no changes in oil prices or present exchange rates.

MAJOR OECD COUNTRIES

The United States

The US recovery began in late 1982, initially the result of a sharp slowdown in stock liquidation and a marked rise in the interest-sensitive components of domestic demand, but since then the base of the recovery has broadened. The first three quarters of 1983 saw the economy growing at rates of 2.6 per cent, 9.7 per cent and 7.6 per cent respectively, (seasonally adjusted annual rates) and the OECD estimate for the whole of 1983 is for an overall rise in output of 3.5 per cent, compared to an actual fall of 1.9 per cent in the previous year. Unemployment rates reflect these developments — falling from 10.4 per cent at the start of 1983 to under 9 per cent on most recent figures, and inflation has stabilised for the present at around 2.5 — 3 per cent. According to the OECD the year has marked one of the most impressive combinations of strong growth and low inflation in recent decades. The current account deficit though has steadily deteriorated, largely as a result of the presently strong dollar, but also reflecting, in part, the fact that the US is ahead of other countries in its recent economic growth performance.

Initially, the broad approach of US policy mirrored that adopted in the other major economies — tight fiscal and monetary policies to bring down inflation and interest rates and hence provide room for a recovery in private sector demand. More recently, fiscal policy has taken on a pronounced counter-cyclical stance, and the expansionary fiscal deficit has been a particularly strong factor in maintaining the growth of domestic demand. Monetary conditions have eased since mid-1982, as a result of lower inflation, but real interest rates remain high — due mainly to the present mix of expansionary fiscal policy and relatively tight monetary policy.

The size of the fiscal deficit has given cause for concern (both domestically and abroad), because of its influence on interest rates and inflationary expectations. It could possibly remain very high for several years, which would suggest the need for continued high domestic interest rates to generate sufficient domestic savings to finance the deficit. However, these high rates give rise to large capital inflows into the USA, and may tend to reduce the pace of future economic activity, both of which may have unfavourable implications for the world recovery. For the moment the main effect of the fiscal deficit is seen not in 'crowding-out' of private investment (business investment has to date been relatively bouyant) but in the deteriorating position of the export and import-competing sectors of the economy, as the exchange rate has been supported by the capital inflow. On the other hand, the widening current account deficit has helped offset the impact of high US interest rates on the pace of the world recovery, as other countries have experienced correspondingly stronger current account positions.

Recent statistics have indicated that the US recovery has been slowing down as it consolidates. The components in the early stages of the upswing (the stock-cycle, and expenditure on housing and on consumer durables), have settled down, and the pace of economic activity over 1984 is likely to become more moderate. If inflationary pressures also stabilise this may allow a further easing of monetary policy and therefore of (nominal and real) interest rates. This would give greater scope for economic expansion in other industrial economies and would have welcome implications for the balance of payments and growth prospects of developing countries.

The OECD forecasts a US growth rate of 5 per cent for 1984, slowing to an annualised rate of around 3 per cent over the first half of the following year. Unemployment is thought likely to stabilise in 1984 (8 per cent is forecast) and then fall as the recovery progresses (7.75 per cent over the first half of 1985). Inflation is predicted at 5.3 per cent and may increase as the effects of the recovery are felt in prices, and if the exchange rate (assumed constant over the forecast period) does weaken significantly. The current account deficit has been estimated at US$43 billion for 1983, and US$82 billion has been predicted for 1984, but this is also critically dependent on the exchange rate assumption. (Forecasters have been consistently confounded by the strength of the US dollar over the latter half of 1983.)

Japan

The Japanese economy has grown at a steady though slow pace over 1983. The Government has retained its commitment to reducing the relative size of its fiscal deficit, and has also kept a tight rein on monetary conditions to prevent, in particular, further weakening of the yen. Inflation has been reduced and kept at a very low level, but the relatively low rate of growth has not been sufficient to prevent the unemployment rate from increasing slowly (though from a very low base) over the year.

Japan's relatively sluggish growth rate thus far has been the product of low export demand and stagnant domestic demand. Some improvements are apparent as the US recovery in particular proceeds, but greater levels of activity will only follow when domestic demand recovers. Over the past year, despite relatively low export growth the foreign balance has been the major element in the small rise in output achieved. The stock-cycle contributed to some extent but domestic demand was not a significant factor.

Real incomes have grown only marginally thus far, thereby suppressing consumer spending. Fixed investment has been hampered by a large level of unused capacity and by high real interest rates, the latter also being an important factor in the low levels of housing starts. The financing requirements associated with the fiscal deficit and more especially the strong US dollar/high US interest rates combination have been the main factors influencing the structure of domestic interest rates. Domestic inflationary expectations appear to have been a minor determinant and the accumulating surplus in the current account has not had much influence on domestic interest rates (or on the exchange rate), which is due in part to large net capital outflows, to the US in particular.

The Government introduced a package of economic measures late in 1983, designed to stimulate domestic output and employment. These measures involved income-tax reductions, more rapid implementation of some public works programmes, and more importantly a reduction in the Central Bank's discount rate —from 5.5 per cent to 5 per cent. (This rate had remained unchanged since December 1981.) It does not appear that the package will have any significant short-term expansionary effects (indirect taxes may be increased in the next fiscal year for example) and so the outlook for the Japanese economy for 1984 is for growth, unemployment, and inflation rates largely unchanged from those presently being experienced.

The economy grew by 3 per cent in both 1982 and 1983, and over the coming year is projected to expand by 4 per cent — with the foreign balance again the major factor in the upturn. Inflation for 1983 could fall to around 1.5 per cent, and this rate is also forecast for 1984. A similarly stable result is possible for unemployment — 2.75 per cent for both 1983 and 1984, and the current account surplus is likely to continue rising. In 1982 a surplus of US$6.9 billion was achieved; in 1983 US$23 billion appears likely (largely a corollary of the record US deficit), and for 1984 US$31 billion is predicted.

West Germany

While the level of economic activity fell in 1982 (by 1.1 per cent), 1983 saw some improvement with GDP growing by 1.25 per cent. This upturn was fuelled principally by private consumption spending (whereas previous German recoveries have been essentially export-led) and little impetus to growth has come from investment expenditure thus far. Inflation has been contained at very low levels (under 3 per cent on most recent figures), but the unemployment rate, the product of low growth and a rising labour force, continues to edge upwards.

Fiscal and monetary policies have been tight over 1982 and 1983. The authorities have not wavered from their original goals of reducing the size of the fiscal deficit, the public sector and the inflation rate, despite the weakness of the domestic economy. The option of some degree of fiscal stimulus has not been taken despite considerable spare capacity in industry and a consistently low inflation rate. Instead the authorities have been willing to wait for an autonomous recovery in consumption and investment. OECD estimates suggest that the structural (cyclically adjusted) budget surplus will in fact move into a position of substantial surplus in 1984 (1.25 per cent of GNP), and the stance of fiscal policy has evoked some debate both internally and externally. While not advising that the medium-term objective of reducing fiscal deficits to sustainable levels be abandoned, the OECD, for example, has suggested that there is a case for moderating the speed at which the deficit is being reduced, in the light of the continued weakness of the domestic economy. There has been more agreement regarding monetary policy, the scope for relaxation of which has been constrained by the persistent weakness of the deutschmark against the US dollar. Interest rates have not eased much in response to the lowered inflation rate, and as a consequence real interest rates have shown an upward trend on average over most of 1983.

While prospects for 1984 now appear more favourable, the nature of the upswing and in particular the erratic movement of the main elements (consumption expenditure, and to an extent, the foreign balance and stock-building) make predicting the path of the German recovery more difficult than usual. The rate of economic growth over 1984 is forecast at 2 per cent, slightly up on the previous year, but this will not be enough to counter the upward trend in the unemployment rate. Inflation is expected to remain at its present low level — the 1983 rate of around 3 per cent is likely to rise only marginally to 3.25 per cent over 1984, and the current account surplus is projected to stabilise at its present level (US$5 billion) for 1984, possibly rising towards the end of the year and into 1985.

United Kingdom

Prospects for the UK appear rather better than for most other European countries. Firm fiscal and monetary policies have been maintained over the past three years, contributing to the severity of the recession in the short-term but setting the base for sustained non-inflationary growth. The recovery thus far has been relatively mild, but appears to be well established. Inflation (after peaking at around 20 per cent in mid-1980) is now quite low and the unemployment rate has slowed its upward trend.

That the upturn has been quite mild may be attributed to two factors in particular — the fact that the UK recovery has been primarily domestically induced (i.e. has been without the additional impetus from fast-rising export receipts); and the stance of fiscal and monetary policy, which until 1983, had been highly restrictive. The Government's medium-term strategy has not changed — a steady reduction in the fiscal deficit and decelerating growth in monetary aggregates are still primary goals, but there has been more room for expansion in 1983 than in previous years. The budget deficit for the (calendar) year 1983, for example, is estimated to have risen from 2 per cent of GDP in 1982 to 2.5 per cent. With inflation lower, monetary conditions have also eased somewhat (although real interest rates have remained at relatively high levels).

Real GDP grew at an annual rate of around 3 per cent over the first half of 1983. The main element in this has been private consumption — which has responded strongly to low inflation and has risen well in excess of the rise in real incomes. Investment has also shown some response to the rise in activity, and stockbuilding also made a contribution to the upturn in early 1983.

The two areas which are expected to be prominent in the UK recovery over 1984 (the foreign balance and investment) are also those for which prospects are most difficult to gauge. Investment has been on an upward trend but has been highly volatile, and while domestic demand has been bouyant, its growth rate is likely to moderate gradually. Thus far the response of industry to the upswing in consumption and stockbuilding has been limited, with much of the increase in demand being reflected in increased imports and a deteriorating trade balance. Greater impetus from investment and from the foreign balance (i.e. a broader-based recovery) therefore depend partially on an improvement in the United Kingdom's international competitive position.

Real GDP rose 2 per cent in 1982, is estimated to have grown 2.5 per cent over 1983, and growth is forecast to be largely unchanged in 1984 at 2.25 per cent. Inflation (5 per cent on most recent figures) may be held to 6 per cent for 1983 and is projected to remain at this level for 1984. Unemployment meanwhile should gradually stabilise and the 1984 rate should be about the same as the 11.5 per cent achieved in 1983. The current account surplus (US$9.5 billion in 1982) is estimated at US$1.5 billion for 1983, but will improve to around US$2.8 billion in 1984 if events transpire as anticipated.

Australia

The economic situation in Australia has improved over the second half of 1983. Real GDP rose 4.4 per cent (seasonally adjusted) in the September quarter — the highest quarterly rise since the 1960s. This followed seasonally adjusted annual rates of decline of 4.8 per cent in real GDP over the first half of 1983 and 0.7 per cent over the six months ended December 1982.

The recovery in recent months has been largely a result of the restocking now occurring throughout the economy, although there has also been improvement in real consumption expenditure, dwellings construction and export volumes, the latter in line with the international recovery now underway. Agricultural output is now beginning to increase sharply following the end of a prolonged drought. Despite some reduction in nominal interest rates, business fixed investment remains weak and it is not until such investment regains its former strength that it can be said that a more widespread recovery is underway.

In the twelve months ended 30 September 1983, the Consumer Price Index increased by 9.2 per cent as compared with an increase for the year to 31 March 1983 of 11.5 per cent. The depth of the recession and reduced growth in wages as a result of the 'wages pause' introduced in late 1982 were important contributory factors behind this improving trend. Recent unemployment statistics provide further sign of the strengthening recovery with a decrease of 0.3 per cent in the unemployment rate during the month of November to 9.6 per cent which compares with an average rate of 10.3 per cent in both the June and September quarters of 1983. Australia recorded strong export performance in the five months to the end of November 1983, with exports over that period rising by 9 per cent as compared with the same period in the preceding year. While exports have been increasing, imports have been virtually stagnant as a result of the economic downturn and were down 2 per cent on the same period in 1982.

In recent months, the improved balance of payments position and in particular the large net capital inflows have tended to interfere with the conduct of monetary policy and the authorities have not always succeeded in offsetting the impact of these flows on the money supply. Consequently monetary growth rates have tended to exceed the targets set by the authorities. In response to these developments the Australian dollar was revalued quite aggressively over the August-October 1983 period and on 9 December 1983, the Federal Treasurer announced the Australian Government's decision to float the dollar and to abolish a major part of the existing exchange controls. It was hoped that the new exchange rate system would reduce the impact of volatile external transactions on monetary growth rates. Monetary policy is expected to play a pivotal role in ensuring that a sustained reduction in the rate of inflation is achieved so that Australia's rate of inflation is brought more into line with the rates of its main trading partners.

The new Labour Government's economic strategy is centred on an expansionary fiscal policy underpinned by a wage agreement with the trade unions in an effort to promote both a recovery of activity and a gradual deceleration of the rate of inflation. In August, the Budget for the 1983/84 fiscal year (i.e. the year to June 1984) was announced, with the Federal budget deficit estimate for the year at US$7.4 billion, representing 4.7 per cent of estimated GDP, as compared with 2.8 per cent of GDP in 1982/83. The 'wages pause' formally ended in September 1983 with the decision by the National Arbitration Commission to return to a centralized system of wage fixation based on full indexation. Such a system was in place from 1975 to mid-1981 but under the new system, unions must commit themselves not to make wage claims outside the Commission's principles. It has been suggested by some analysts that the return to full indexation at the same time as the commencement of an economic recovery may lead to inflationary pressures, which ultimately may retard the upturn in activity. A sustainable economic recovery will be heavily dependent on the extent of the flow-on effects of expansionary fiscal policies on wage inflation and interest rates.

Nevertheless, the OECD predicts a marked recovery in growth over 1984 — output is expected to rise 5.25 per cent over the year, probably sufficient to first stabilize and then gradually reduce the unemployment rate. The recovery is expected to be underpinned by a resurgence in consumer expenditure, by relatively strong export growth and (to some extent) by restocking. With regard to inflation, the OECD prediction is for a rate of around 7 per cent for 1984 as a whole (although falling below 6 per cent over the second half of the year and early-mid 1985). Imports are likely to rise in line with the rise in domestic demand, but the current account deficit is still expected to improve. After rising to US$8.4 billion in 1982 it appears to have eased to around US$5 billion in 1983. This trend is expected to continue for the coming year — for which a smaller shortfall of US$3.5 billion is predicted.

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

	1980	1981	1982	1983[2]	1984[3]
US	13.5	10.4	6.1	4.0	5.3
Japan	8.0	4.9	2.7	1.5	1.5
West Germany	5.5	5.9	5.3	3.0	3.3
UK	18.0	11.9	8.6	6.0	6.0
France	13.6	13.4	11.8	9.3	7.3
Canada	10.2	12.5	10.8	6.0	5.0
Italy	21.2	19.5	16.6	14.8	12.0
Australia	10.2	9.7	11.2	10.0	7.0
New Zealand	17.1	15.4	16.1	5.0	5.8
Industrial (OECD) Countries	12.8	10.5	7.8	5.5	5.5
Oil Exporting Developing Countries	13.1	13.0	9.8	12.4	10.7
Non-Oil Developing Countries[1]	36.5	36.8	38.6	45.6	28.9

Source: OECD, IMF
[1] Excluding People's Republic of China
[2] Estimate
[3] Forecast

TABLE 3
UNEMPLOYMENT RATES
(national definitions)

	1980	1981	1982	1983[1]	1984[2]
US	7.2	7.6	9.7	9.5	8.0
Japan	2.0	2.2	2.4	2.8	2.8
West Germany	3.4	4.8	6.9	8.5	9.3
UK	7.0	10.6	11.0	11.5	11.5
France	6.3	7.3	8.0	8.3	9.3
Canada	7.5	7.6	11.0	12.0	11.0
Italy	7.6	8.5	9.1	10.0	10.5
Australia	6.1	5.8	7.1	10.3	10.5
New Zealand	3.3	3.7	5.4	6.8	8.3
Industrial (OECD) Countries	6.2	7.1	8.4	9.0	9.0

Source: OECD.
[1] Estimate
[2] Forecast

DEVELOPING COUNTRIES

The oil exporting developing countries have clearly been adversely affected by the world recession. The continued weakness in oil markets since 1980 has brought the need for (in some cases) extensive economic and fiscal re-adjustment and structural change. These developments have been met by moves to cut government expenditure, to reorder government finances and to tighten monetary conditions. More recently, the demand for oil has been rising as the recovery in the industrial countries progresses, and prospects for export earnings over 1984 are now better than was earlier anticipated.

The level of economic activity in this group of countries is estimated to have declined 5 per cent in 1982 and around 2 per cent in 1983, but may rise 5 per cent in the following year. (Annual growth rates over the period 1973–77 averaged 11 per cent). This lowered level of economic activity has been matched by a fall in inflationary pressures and by a continuation in the group's aggregate current account shortfall.

The main element in the present economic position of the non-oil developing countries has been the widespread implementation of balance of payments adjustment programmes in response to the protracted international recession, indebtedness problems in some cases and (latterly) falling levels of private financial inflows for trade and investment. These programmes have reduced current account deficits to more sustainable levels, but have had the immediate effect of depressing achievable growth rates (already low by historical standards). In 1982, output in this group expanded 0.8 per cent; this is estimated to have improved only marginally to 1.2 per cent for 1983, but if the level of capital inflows can be stabilised and the industrial country upturn proceeds as expected the prediction is for growth of around 3.6 per cent for 1984. The average rate of growth for this group over the years 1973–77 was 5.2 per cent.

INTERNATIONAL TRADE BALANCES

The volume of international trade has responded to the revival in the industrial (OECD) countries over 1983. These countries' import volumes have been growing in line with the rising level of consumer demand and higher demand for stockbuilding. Export growth has also been strengthening, though much of this has been intra-group trade — in particular that associated with the widening US trade and current account deficit. The total industrial country trade deficit is estimated to have improved from US$21 billion in 1982 to US$14 billion in 1983. As domestic demand rises though there is likely to be some deterioration in the balance, which for 1984 is projected at US$24.25 billion. A similar pattern is seen for industrial countries' aggregate current account balance. However, as already noted, a large world current account discrepancy makes analysis and interpretation of developments in this area unusually difficult. The discrepancy is apparently due in large part to recording deficiencies in invisibles trade between developing and industrial countries, and (the OECD suggests) may expand — to nearly US$125 billion by mid-1985.

Oil exporting countries appear to have stabilized their balance of payments positions, and little change in their aggregate current account position is in prospect over 1984. Following a surplus of US$52 billion in 1981, the current account moved into deficit — US$16 billion in 1982, an estimated US$31 billion in 1983 and a possible US$32 billion is projected for 1984. The non-oil developing countries' adjustment efforts over the past two years, together with some recovery in export receipts are reflected in a considerably reduced aggregate current account deficit for 1983. Should financial flows be maintained to these countries, this along with the expected rise in export volumes and some improvements in their terms of trade would allow for further expansion in imports and make possible higher rates of economic expansion. Their aggregate current account deficit (US$65 billion in 1982) is expected to fall to around $US45 billion in 1983 and will remain (on present indications) at roughly this level (US$40 billion) over 1984, with import payments rising in line with the growth in exports.

The assumptions made in producing these forecasts (in particular those of constant exchange rates and unchanged oil prices) are of course central to the accuracy of the results. A significant fall in the US exchange rate for example (long expected) could sharply curtail the exports of many industrial and developing economies, and equally far-reaching implications are contained in any marked movement in oil prices over the period of the forecasts.

TABLE 4
CURRENT ACCOUNT BALANCES
(billions of US dollars)

	1980	1981	1982	1983[1]	1984[2]
US	—	5	−11	−43	−82
Japan	−11	5	7	23	31
West Germany	−16	−7	4	5	5
UK	7	13	10	2	3
France	−4	−5	−12	−5	1
Canada	−1	−5	2	3	1
Italy	−10	−8	−6	2	1
Australia	−4	−8	−8	−5	−4
New Zealand	−1	−1	−2	−1	−1
Industrial (OECD) Countries	−70	−28	−30	−24	−42
Oil Exporting Developing Countries	111	52	−16	−31	−32
Non-Oil Developing Countries[2]	−60	−76	−65	−45	−40
Other Countries	−9	−10	3	4	2
Total	−28	−62	−108	−97	−112

Source: OECD
[1] Estimate
[2] Forecast

FOREIGN EXCHANGE AND FINANCIAL MARKETS

As in the previous year, the two main features of foreign exchange markets during 1983 have been the strength of the US dollar on the one hand, and the short-term volatility of major exchange rates around their trend movements on the other. The dollar continues to be supported by relatively high interest rates on dollar-denominated assets and the reduced rate of domestic inflation, together, it would appear, with international political tensions and residual concern about the international financial system. The ongoing strength of the dollar has been greater and has persisted for longer than many analysts were expecting on the basis of interest and inflation rate differentials, especially in the light of the very rapid deterioration in the US current account, which has shown record deficits in recent months.

The often very sharp short term fluctuations in the exchange rates between the US dollar and the major currencies have been the result of a number of factors, but perhaps the single most important cause has been volatility in expectations about the future course of relative interest and inflation rates, and the factors affecting these. For example, the currency markets closely watch the weekly US money supply statistical releases treating them as an indicator of future monetary policy. Similarly, other general economic statistics showing the pace of the current US recovery have also affected expectations about the path of US interest rates.

In line with the continuing improvement in the Japanese current account balance, the yen continued to strengthen through 1983 in terms of its trade weighted index, and was 11 per cent higher in mid-December than at the end of 1982. The yen also strengthened somewhat relative to the US dollar during the course of the year, but the gain occurred almost entirely in September/October, with the yen on a weakening trend relative to the dollar over most of the rest of 1983. Most other major currencies weakened relative to the US dollar over 1983 and, with the exception of the Swiss franc and the Canadian dollar, also declined in trade weighted terms. Sterling's trade-weighted index was around 3.5 per cent lower in mid-December than it was a year earlier, the deutschemark was around 3 per cent lower, and the French franc was almost 11 per cent down.

Activity in the international capital markets has been on a strongly declining trend since around the middle of 1982, the single major factor behind this being the continued caution on the part of international lenders arising from concern about the external financing problems of a number of major sovereign borrowers. As Table 5 shows, total funds raised on international markets in the September quarter of 1983 declined to

TABLE 5
FUNDS RAISED IN INTERNATIONAL MARKETS
(billions of US dollars)

	1981	1982	1983 Q1	1983 Q2	1983 Q3
OECD Countries[1]	136.57	115.80	26.32	29.80	18.76
of which: external bonds	39.23	60.72	18.74	17.61	10.34
bank loans	97.35	55.08	7.58	12.19	8.41
Eastern Europe	1.51	0.70	—	0.20	0.24
of which: external bonds	—	—	—	—	—
bank loans	1.51	0.70	—	0.20	0.24
Opec Countries	6.05	9.36	2.06	2.31	1.73
of which: external bonds	0.31	0.35	0.04	0.05	0.33
bank loans	5.74	9.02	2.03	2.26	1.40
Other Developing Countries	43.95	34.34	11.93	4.56	6.89
of which: external bonds	3.02	2.99	0.14	0.45	0.69
bank loans	40.93	31.35	11.79	4.10	6.19
Other[2]	5.57	9.10	1.92	1.49	2.01
of which: external bonds	5.20	7.59	1.91	1.49	1.73
bank loans	0.37	1.51	0.02	—	0.28
Total	193.66	169.31	42.23	38.36	29.62
of which: external bonds	47.76	71.65	20.82	19.61	13.09
bank loans	145.90	97.66	21.41	18.76	16.53

Source: OECD
[1] Includes International organisations based in Europe.
[2] Includes International development institutions.

under US$30 billion, and for the first three quarters of the year amounted to only US$110 billion compared to US$169 billion for all of 1982 and US$194 billion for 1981.

The sharpest contraction in lending activity has been in medium-term bank credit. New bank lending appears unlikely to exceed US$70 billion for 1983, compared to US$98 billion in 1982 and US$146 billion in 1981. This slow-down has occurred in spite of a large amount of 'non-spontaneous' medium-term lending by commercial banks early in 1983 as part of IMF-backed financing and debt-restructuring packages for a number of countries. In contrast to the downturn in bank lending, activity in external bond markets has remained strong and, in spite of a dip in the third quarter, funds raised for 1983 as a whole will probably be close to US$80 billion.

The decline in lending in 1983 has been spread across all the main country groupings but when the 'non-spontaneous' element is removed, it has been particularly severe for the non-oil developing countries. According to the OECD, in the 10 months to October 1983, the non-oil developing countries were only able to raise US$9 billion on the international capital markets on a purely commercial basis, compared to the US$34 billion raised in 1982. The reluctance of banks to further increase their exposure to developing countries has also been reflected in some shortening of maturities and markedly higher fees and spreads over base lending rates for these countries.

TABLE 6
WORLD BANK LENDING ACTIVITIES
(billions of US dollars, June years)

	1979	1980	1981	1982	1983	1984[1]
IBRD Lending Commitments	7.0	7.6	8.8	10.3	11.2	12.0
IBRD Lending Disbursements	3.6	4.4	5.1	6.3	6.7	8.6
IDA Lending Commitments	3.0	3.8	3.5	2.7	3.4	3.3
IDA Lending Disbursements	1.2	1.4	1.9	2.1	2.6	3.0

Source: World Bank
[1] Budgeted commitments, projected disbursements.

TABLE 7
NEW LOAN COMMITMENTS AND OTHER USES OF IMF RESOURCES
(billions of SDRs)

	1978	1979	1980	1981	1982	Jan-Sept 1983
New Loan Commitments:	1.0	−0.8	6.6	12.1	2.4	10.2
Industrial Countries	0.1	—	—	—	—	—
Developing Countries	0.9	−0.8	6.6	12.1	2.4	10.2
Purchases under low Conditionality Facilities:	0.7	0.7	1.0	1.5	3.0	2.9
Industrial Countries	0.1	—	—	—	0.1	—
Developing Countries	0.6	0.7	1.0	1.5	2.9	2.9
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	13.1

Source: IMF.

INTERNATIONAL INSTITUTIONS: RECENT DEVELOPMENTS

The prolonged international recession has given prominence and greater urgency to the problems of developing country debt and to exchange rate volatility, and has led to difficulties in the international trade and payments systems. These problems were all central to the discussions at the joint IMF/World Bank annual meeting in Washington in September 1983, although the main issue concerned the role that these organisations were to play in the present world economic environment, in the light of the continued problems they faced in arranging financial resources for the needs of the immediate future and over the next few years. Tables 6 and 7 outline World Bank lending activities and budgeted commitments, and IMF disbursements to members over the past five years.

The World Bank[4] in its annual report stated that its lending and investment commitments for fiscal year 1983 (the year ended June 1983) amounted to US$15.3 billion, considerably in excess of the US$13.6 billion recorded for fiscal year 1982. Of the total, US$3.4 billion was accounted for by the World Bank's 'soft-loan' arm, the International Development Association (IDA), but the Bank noted that the magnitude of the economic adjustment problem being faced by many developing countries tended to overshadow even this heightened level of assistance. Its report expressed some concern at the prospects for these countries should a sustained world recovery not eventuate.

The IDA's financial position for the period 1982–85 has been substantially affected by lower than expected commitments under the previous round of fund-raising (IDA – 6), and by protracted negotiations on IDA – 7 (scheduled to come into effect in fiscal year 1984). In January 1984 following a US decision to review the level of its commitment to the IDA, the funding level was set at US$9 billion. Other members may be called upon to participate in a special financing arrangement to enable the Association to maintain its present scale of activities.

Earlier in the year agreement had been reached on an increase in IMF quotas, to enable the organisation to assist more effectively members with balance of payments problems. Unanticipated delays on the part of many members in assenting to the increase put pressure on the liquidity position of the IMF and made necessary a contingency plan to restrict its operations if the additional finance was not forthcoming according to the agreed schedule. In addition it was decided (mainly as a result of the views expressed by the larger member countries) that financing limits under the IMF's 'Enlarged Access Policy' (the main facility under which large-scale balance of payments financing support is granted) would be scaled down from the previous level of 150 per cent of quota to 102 per cent. A number of members had suggested in negotiations that a higher limit would be more appropriate in the light of the widespread need for balance of payments adjustment finance, but uncertainties with regard to the IMF's finances made necessary the more conservative limit.

The eighth quota increase gained the assent of the necessary majority of members (70 per cent) following US Congress ratification of that country's share on 30 November 1983. Prior to this few of the Fund's members had moved to formally implement their quota increases. New Zealand's quota has increased from

4 The International Bank for Reconstruction and Development (IBRD) and its two affiliates, the International Development Association (IDA) and the International Finance Corporation (IFC).

SDR 348 million to SDR 461.6 million. The extended General Arrangements to Borrow (GAB) facility[5] became effective in December 1983, when all participants had agreed to its implementation. Agreement has also been reached on the features of a SDR 3 billion interim financing facility to be made available to the IMF through the Bank for International Settlements (BIS). Nineteen industrial countries, including New Zealand, are involved, and New Zealand's share of the facility is expected to be SDR 25 million. Formal arrangements should be completed in early 1984.

Commonwealth Finance Ministers met in Trinidad in September 1983. Much of the discussion at the meeting centred on the study commissioned on the international monetary, trade and payments system ('Towards a New Bretton Woods: Challenges for the World Financial and Trading System'). It was initiated after several Commonwealth leaders had expressed the view, following the New Zealand Prime Minister's initiative, that a major summit, along the lines of and in the spirit of the original Bretton Woods Conference was needed. A reassessment of the roles and effectiveness of the Bretton Woods institutions — the GATT, the World Bank and especially the IMF was seen as essential. The report, however, acknowledged that before any such economic summit could be arranged, there had to be a consensus on what the more important problems facing the system were as well as on the broad outline of possible solutions. This consensus did not exist at the time, and although Ministers could not agree that formal plans for a new Bretton Woods Conference were needed there was a near-consensus that new initiatives to address problems of imbalances and instability in international trade and finance would be welcome. In the interim, it was concluded that sound and consistent domestic economic policies would go some way toward laying the foundations for a more orderly international trade and payments system. These issues were further examined at the Commonwealth Heads of Government meeting in New Delhi in November 1983, where participants agreed to establish a consultative group to explore further and promote a consensus on the issues under discussion. The group will be composed of representatives of governments from a number of Commonwealth countries (including New Zealand) together with the Commonwealth Secretary General, and will report to the 1984 Finance Ministers' meeting in Toronto, Canada.

5 For details refer to page 287 of the July 1983 Reserve Bank Bulletin.

CONCLUSION

1983 marked the turning point (for most industrial countries) in the most severe world recession since the 1930s. The pattern of the recovery thus-far has confirmed earlier indications of its strength and the speed with which it is being transmitted across countries — and it is now clear that only over the medium-term will the full effects of the downturn on output and employment be effectively countered. For the moment, the task is to consolidate and build upon progress already achieved with regard to inflation rates, public sector finances, structural rigidities, and other impediments to the efficient functioning of markets.

The OECD recently pointed out that the last two decades had left member countries with two major legacies: persistently high unemployment rates; and public finances marked by high deficits and growing debt, high taxation rates and high real interest rates. Growth over the medium term in member countries it suggests, will be primarily motivated by a flexible and efficient private sector, but this will need to be complemented by an adaptable and effective public sector — which will be capable of assisting in the process of economic expansion while also addressing more effectively other areas of its responsibility.

The recovery will still leave many of the more depressed sectors in individual countries in difficulty — overall, unemployment is likely to remain high, and this will be especially true in the structurally weak economies. While the recovery may have positive implications for New Zealand in the form of somewhat higher export volumes and (to a lesser extent perhaps) improvements in the terms of trade, domestic factors suggest that there will be little room for strong growth over 1984. OECD forecasts suggest that output (i.e. real GDP) will not change over 1984 (their forecast may be unduly conservative on this score), while the inflation rate (currently between 3 and 4 per cent) is forecast to rise to around 5.8 per cent. Given the key role of the balance of payments in setting an environment conducive to sustainable recovery, it is very important that inflationary pressures are contained, and that New Zealand's international competitiveness is preserved.