DEVELOPMENTS IN THE INTERNATIONAL ECONOMY[1]

INTRODUCTION

The continued strengthening of the international recovery during the early months of 1984 has assisted in moderating many of the uncertainties and instabilities which beset the early stages of the upturn in late 1982 and during 1983. The marked recovery in North America, together with the more modest upturn in the other major industrial countries and the passage of the most austere phase of adjustment programmes in developing countries, has provided the preconditions for improved economic performance by the less developed nations during 1984 and 1985. Furthermore, the apparent successful handling of the short-term debt crisis of 1982/83 and avoidance of large scale default by debtor countries has also contributed to increased confidence in the outlook for the international economy. Nevertheless, despite this improved confidence some fundamental problems still remain which threaten the sustainability of the recovery in general and also the continued growth and development of the poorer nations.

A significant feature of the international economy in 1983 was the low rate of increase in consumer prices in the major industrial countries. Whereas inflation in these countries had reached a peak of 12.8 per cent in 1980, in 1983 it was down to 5.2 per cent. The reduction in inflation was followed by a recovery in world output. For several years the growth in world output had been falling and in 1982 it was only 0.1 per cent. But in 1983, led by private demand in the industrial nations, world output grew by more than 2 per cent. In its early stages this recovery was generated by an increase in household demand, but over the latter half of 1983 rebuilding of inventories also became an important factor underpinning the expansion.

By the beginning of 1984 it was clear that of all the industrial countries North America was experiencing the strongest recovery. This was most clearly highlighted in unemployment trends. Whereas in the United States strong economic growth had lead to a sizeable reduction in unemployment, for other industrial countries there had been little improvement from the historically high unemployment levels recorded at the time of the economic recession of 1981/82.

Although less rapid than in North America, recovery has taken place in other industrial countries and there appears to be good prospects that further steady growth will be achieved throughout the remainder of 1984. This is reflected in the latest IMF forecasts which are presented in tables 1 to 4.[2] Progress towards a better economic performance in developing countries is likely to remain slow given the economic imbalances that they presently face.

Despite improved prospects for growth and increasing optimism in the outlook for the international economy, some doubt remains as to the sustainability of the world recovery. In particular, a major concern is that the recovery may not spread sufficiently to become firmly established in developing countries, a number of which carry very large debt burdens. The satisfactory resolution of the developing nation's economic difficulties is reliant on these countries being able to trade their way out of their present situation. This process depends on continued growth in industrial countries, together with a further liberalisation of international trade. Debtor countries must be able to export in order to service and repay their debt and to this end must have access to growing markets. The spread of protectionist practices in recent years, coupled with continued high levels of real interest rates stemming from persistent large fiscal deficits in several of the major industrial countries, threatens the foundations of the international recovery currently underway and emphasises the continued precarious nature of the debt situation of developing countries.

INDUSTRIAL COUNTRIES[3]

The present economic recovery, which began in early 1983, has seen real gross domestic product (GDP) of industrial countries as a group grow by 2.4 per cent in 1983 after a fall of 0.3 per cent in 1982 (although experience has varied with Italy, for example, still experiencing negative real growth). Almost all the expansion in demand has been due to increases in private expenditure on consumer goods and on housing. A decline in private savings ratios has allowed increased private consumption while a fall in nominal interest rates has provided a stimulus to spending on consumer durables and residential construction. The increased consumer demand typically led to a run down of wholesale and retail inventories during 1983. For the first few months of 1984 there has been a rebuilding of stocks by firms and this is now providing an important contribution to growth.

An encouraging sign in 1983 was a moderation in consumer price inflation in industrial countries from an average of 7.8 per cent in 1982 to 5.2 per cent in 1983. The unemployment rate for industrial countries as a group, however, rose from 8.4 per cent in 1982 to 8.9 per cent in 1983. Although renewed economic growth is usually accompanied by a decline in unemployment, this has not yet been the case for most countries, though the US is a major exception to this.

Two major policy considerations continue to be generally perceived as important as regards the sustainability of the recovery. First, there remains a need to maintain control of inflation. Not only would this allow the continuation of high levels of domestic demand via real income effects but it may also further lower nominal interest rates as inflation expectations are brought down. Second, a reduction in the size of the fiscal deficits (particularly in the US, Canada and Italy) is required if real interest rates are to decline from current high levels. This in turn should encourage further interest sensitive investment expenditures.

1 The forecasts quoted in this article are those prepared by the International Monetary Fund and presented in their 'World Economic Outlook', IMF Occasional Paper No.27, Washington D.C., April 1984.

2 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.

3 Figures given in this section for Industrial Countries refer to the 24 members of the OECD i.e. Australia, Austria, Belgium, Canada, Denmark, Federal Republic of Germany, Finland, France, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, United Kingdom and United States. The IMF definition of Industrial Countries excludes the three relatively less industrialised economies (Greece, Portugal and Turkey).

Growth rates in the smaller industrial countries[4] have generally been lower than those of the major nations. The IMF estimates that on average the smaller countries grew by only 1.1 per cent in 1983 while over the same period unemployment worsened in all fourteen nations belonging to the group. Furthermore, prospects for 1984 do not appear to be very encouraging. An average growth rate of only 2.2 per cent is forecast with only three countries (Finland, Sweden and Australia) projected to achieve a rate of 3 per cent per annum or higher, while the unemployment rate is expected to be more than 10 per cent on average. Within the group there exist significant differences in inflation rates with Austria, the Netherlands, Switzerland and New Zealand having rather low inflation while other members of the group have much higher rates. It is expected that inflation in these latter countries should moderate over 1984.

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

	1980	1981	1982	1983	1984[3]
US[1]	−0.3	2.6	−1.9	3.3	5.0
Japan[1]	4.8	4.0	3.4	3.1	3.9
West Germany[1]	1.9	−0.3	−1.1	1.3	2.6
UK	−2.5	−1.8	1.9	2.9	2.6
France	1.1	0.3	1.8	0.6	0.6
Canada[1]	1.0	3.4	−4.4	3.0	5.0
Italy	3.9	0.1	−0.3	−1.4	1.9
Australia	1.5	4.1	—	0.2	6.6
New Zealand	−0.1	3.6	0.5	1.7[4]	1.5[4]
Industrial (OECD) Countries[1]	1.2	1.2	−0.3	2.4	4.3
Oil Exporting Developing Countries	−2.0	−4.0	−4.3	−1.1	4.7
Non-Oil Developing Countries[2]	4.8	2.8	1.5	1.6	3.5

Source: IMF, except for figures for total OECD, Australia and New Zealand which are from the OECD.
[1] GNP
[2] Excluding People's Republic of China.
[3] Forecast.
[4] Data are for years commencing 1 April.

United States

The evidence to date continues to point to a strong recovery in the US. After an average annual growth rate of 3.3 per cent in 1983, real gross national product (GNP) grew at a seasonally adjusted annual rate of 9.7 per cent in the first quarter of 1984. Most of this exceptional growth was due to restocking by firms. Growth in 1984 should continue to be underpinned by business fixed investment with a growth rate of 5 per cent expected for the year as a whole. Accompanying the growth in GNP has been a sharp drop in unemployment. By early 1984 the unemployment rate had fallen to 7.8 per cent, its lowest level since September 1981, and it is expected to stabilize at about this level through the rest of the year.

A major concern with the strength of this recovery is that the growth in demand may refuel inflation. Firm monetary policy has helped to reduce the rate of inflation such that consumer prices increased by only 3.2 per cent in 1983 compared with 6.2 per cent in 1982. Inflation is forecast at about 4.5 per cent for 1984 which is in line with experience in the first few months of the year when consumer prices increased at annual rates of less than 5 per cent. Nevertheless, should the recovery continue at anything like its current rate inflationary pressures may intensify. Already capacity utilisation in US industry has reached levels of more than 80 per cent, a range at which price and cost pressures have tended to intensify in the past. The risk of higher inflationary pressures are likely to induce the Federal Reserve to maintain tight control of monetary growth. The Federal Reserve lowered its target rates of increase for monetary aggregates for 1984 from their 1983 levels, and at present the various aggregates are growing at rates near the upper end of these ranges. The pursuit of a firm monetary policy is in turn likely to push up US interest rates and already US bank prime rates have risen from 12 to 12.5 per cent in May 1984 and to 13 per cent in June. However, the stance of monetary policy over the year ahead does have some uncertainty attached to it. Concern about the stability of the US banking system following the liquidity problems of the Continental Illinois National Bank and Trust Company and political pressures in the lead-up to the Presidential Elections may lead the Federal Reserve to ease monetary policy in the short-term.

The major imbalances facing the US are the size of its deficits. The large fiscal deficit stems from tax cuts and spending increases (especially on defence), and is generally regarded as the source of other economic difficulties such as high interest rates. These high interest rates in combination with the relative economic and political stability of the US have helped to attract capital inflows and maintain a strong US dollar. This has served to reduce export competitiveness and widen the US trade deficit. During early 1984 the trade deficit reached record levels (US$12.2 billion for April) reflecting not only the strength of the dollar but also the faster recovery in the US with the consequent larger increase in domestic demand. The fiscal deficit is currently projected to stay at about 5 per cent of GNP for several more years, and this is likely to keep real interest rates high thus constraining interest sensitive expenditures and further aggravating the trade deficit. Any weakening of the dollar in response to the trade deficit would add to inflationary pressures through import prices.

Japan

Although output growth was higher in Japan during the recession of the early 1980s than in any of the other major industrial economies, the subsequent recovery of the Japanese economy has not been rapid. Nevertheless, the generally steady growth and stability of the Japanese economy in recent years has left it as one of the best overall performers of the industrial country group in terms of its main economic indicators. On a year on year basis, Japan's real GNP grew by 3.1 per cent in 1983, as compared with 3.4 per cent in the previous year. Unemployment as a percentage of the workforce stabilised at around 2.5 per cent in 1982 and 1983, a level which is very low by international standards. In addition, with the aid of a firm monetary policy, inflation has been held very low, falling below 2 per cent per annum to 1.8 per cent in 1983, compared with 2.6 per cent in 1982.

As in past years, the external sector provided the main impetus to growth in 1983. However, stronger economic growth was prevented by slow growth in domestic demand, reflecting the impact of stable real incomes on consumption expenditure and high real interest rates on private interest sensitive consumption and investment spending. There was a slight relaxation in fiscal policy in 1983 because of this weakening in domestic demand.

4 Australia, Austria, Belgium, Denmark, Finland, Iceland, Ireland, Luxembourg, Netherlands, New Zealand, Norway, Spain, Sweden, Switzerland.

Generally, though, the Japanese authorities have maintained a tight fiscal policy and the 1984/85 Budget once again moved to restrain government expenditure in the face of increasing internal public debt.

Exchange rate movements, together with inflation, have been a major consideration in determining the course of monetary policy. While there may be scope for some relaxation to assist domestic demand, the authorities still see a need to maintain interest rate levels in order to avoid a weakening of the yen against the US dollar. Such a weakening could further add to the large trade imbalance between the US and Japan.

At the end of April this year Japan announced a package of trade policy measures designed to open its domestic market to a greater quantity of imports. The package included cuts in the tariffs on many products, including some agricultural goods while import quotas on a number of other agricultural products were also to be increased. Furthermore, at the end of May the Japanese Government announced specific measures that would be taken to encourage the creation of a world-wide Euroyen market (similar to the Euro-dollar market), to deregulate its domestic financial markets, and to allow foreign financial institutions greater access to participate in the Japanese financial markets.

The US had been pressing for such a liberalisation of the Japanese financial markets for some time, considering this to be one way to reduce the mounting inequality in trade flows between the two countries. In particular, it is believed that greater use of the Japanese yen as an international currency and the development of a free Euroyen market would increase the demand for the yen and eventually strengthen that currency against the dollar, thereby assisting in reducing the US trade deficit with Japan. Even so, Japan's current account surplus is expected to increase from US$22.3 billion in 1983 to US$29 billion in 1984.

Over 1984 further steady growth in real GNP is anticipated as real incomes begin to rise and domestic demand picks up. Although growth in private consumption remains slow, housing and fixed investment show signs of strengthening. A growth rate for real GNP of 3.9 per cent is forecast for 1984 by the IMF. This growth should be sufficient to keep unemployment at around its current level. Inflationary pressures should continue to be contained and only a small increase in the inflation rate to an annual average rate of 2.1 per cent is expected for 1984.

West Germany

After falling in both 1981 and 1982 West Germany's real GNP rose 1.3 per cent in 1983. This upturn stemmed from increased private consumption expenditure unlike previous expansions which have been mainly export led. Although stronger than in recent years, the rate of economic growth experienced over 1983 has generated insufficient employment growth to absorb the increases in the labour force and as a consequence unemployment has increased to more than 9 per cent. Inflation meanwhile has been contained to an annual rate of about 3 per cent in 1983.

Firm monetary and fiscal policies were maintained over 1983 reflecting a commitment to restrain inflation and to reduce the size of the public sector. The expected favourable effect of this policy on growth through improved confidence and, in turn, an increase in private sector investment has been slow to eventuate, but in the early months of 1984 there has been some evidence that inventory restocking and fixed capital formation have begun to pick-up.

As in Japan, the course of monetary policy in West Germany is complicated by exchange rate considerations. Although the German domestic economy would benefit from increased demand from a relaxation in policies, to do so would mean a weakening of the deutschmark as domestic interest rates would fall. There was some slight relaxation in monetary policy in early 1983 and monetary aggregates grew at a faster rate than targeted but during the second half of the year the rate of growth of Central Bank Money (currency in circulation, excluding banks' holdings of domestic notes and coin, plus required reserves on domestic liabilities) was brought back to within the target range maintained over 1981–83 of 4 to 7 per cent. For 1984 a target range of 4–6 per cent a year has been set and currently this aggregate is growing at the lower end of the range. Based on this policy the IMF has forecast an annual average rate of inflation for 1984 of 2.8 per cent.

Favourable indications of growth in domestic demand, especially investment, plus the expectation that export demand should pick-up as the economic recovery proceeds worldwide and particularly in Germany's European trading partners have led most forecasters to revise upward their growth estimates for West Germany in 1984. The IMF now expects a year on year increase in real GNP of 2.6 per cent. Stronger export demand is anticipated to result in an increase in the current account surplus from US$9 billion in 1983 to US$10 billion in 1984. The unemployment rate for 1984 is forecast to be 8.2 per cent of the labour force, the same as that recorded for 1983.

United Kingdom

The UK economy grew at an average annual rate of 2.9 per cent in 1983, up from the 1.9 per cent registered the year before. This growth was mainly based on private consumption demand, but in addition there was also growth in private capital formation and inventory restocking. The rise in private consumer spending appears to have been financed largely by a reduction in savings, with the drop in inflation from a rate of 8.6 per cent in 1982 to 4.7 per cent and a fall in nominal interest rates helping to lower the savings ratio. Unemployment which remained unaffected by these developments, increased slightly over 1983 to 12.4 per cent of the labour force.

The British Government has maintained its strong commitment to a firm monetary policy and a reduction in the size of the public sector, with a primary aim of reducing the Public Sector Borrowing Requirement (PSBR). Monetary growth rates declined throughout 1983 and by early 1984 monetary aggregates were growing within their target ranges. A generally cautious approach remains with respect to monetary policy reflecting the authorities' continued anti-inflation stance. Continuation of such policies should restrain inflation in 1984 to an average annual rate of 5.2 per cent.

The Budget presented to Parliament in April 1984 introduced a number of taxation measures, including a reduction in company tax, the phasing out of allowances for capital investment and the abolition of the National Insurance surcharge (in effect a tax on labour) which should provide a short-term boost to capital investment while a move to increase basic personal tax free allowances is likely to have a similar effect on private consumption. The phasing out of the capital investment allowances should boost investment in the short run as companies take advantage of the allowances before they are removed. However, in the longer run, in the absence of an allowance firms may be encouraged to use more labour. While this may eventually assist in reducing the prevailing high levels of unemployment, unemployment is not expected to show any marked improvement during the remainder of 1984.

For 1984 the IMF forecasts a growth rate of 2.6 per cent for the UK economy with the main impetus coming from fixed investment. The unemployment rate for 1984 is forecast to remain unchanged at 12.4 per cent of the labour force.

Australia

In Australia, the recovery began around mid-1983 with real GDP rising at a seasonally adjusted annual rate of 11.3 per cent in the six months to December 1983 compared with a 2.2 per cent decline in the first half of the year and a 1.8 per cent drop in the second half of 1982. The acceleration in growth stemmed from a number of factors including the recovery in the rural sector following the end of the prolonged drought, restocking, increased private consumption expenditure, housing demand and an improved trade balance. No contribution to growth came from business fixed investment which has continued to weaken since mid-1982.

Unemployment averaged 9.8 per cent over 1983 compared with 7.1 per cent in 1982 but labour market conditions have steadily improved in early 1984 with the result that the unemployment rate has fallen slightly. Continuing growth in employment has been offset to some extent by a rise in the labour force participation rate.

Inflation has decelerated significantly. Overall the Consumer Price Index (CPI) rose only 5.9 per cent in the twelve months to March 1984 compared with a rise of 8.6 per cent in the year to December 1983. Although the introduction of the Government's Medicare health insurance scheme and the associated fall in private health insurance costs and medical fees artificially reduced the index for the March quarter, the underlying inflation rate, after netting out this distortion, was only 7.6 per cent for the twelve months ended March. Nevertheless, Australia's underlying inflation rate remains more than two percentage points higher than the trade weighted average of its major trading partners, a factor which could affect Australia's international competitiveness and thus constrain future export growth.

Forecasts are for an annual average inflation rate of 6.5 per cent in 1984 which would be an improvement on 1983. However, in September 1983 a return was made to full biannual indexation of wages to the CPI. While this return to full indexation provided the means for an orderly exit from the wages 'pause' which operated prior to September 1983, there is a danger that continuation of indexation into 1985 may result in the institutionalising of an inflation rate which is out of line with international trends. In addition, the return to indexation may prove to be a powerful disincentive to private investment expenditure given that the corporate sector remains wary of the future outlook for wage costs. Any further declines in investment would make it difficult for the economic recovery to be sustained.

Considerable uncertainty remains as to the strength of the current economic recovery in Australia. Although a large increase is expected in the 1984 growth rate to an average annual rate of 6.6 per cent compared with only 0.2 per cent in 1983, the factors currently providing the growth impetus — in particular the rural recovery following the drought and the upturn in the housing sector — are to some extent 'one-off' in nature and may be shortlived. It is yet to be determined whether these influences can be replaced with more sustainable sources of growth, in particular a continued net positive contribution from exports and a pick-up in private investment expenditure.

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

	1980	1981	1982	1983	1984[3]
US	13.5	10.3	6.2	3.2	4.5
Japan	8.0	4.9	2.6	1.8	2.1
West Germany	5.5	5.9	5.3	3.0	2.8
UK	17.9	11.9	8.6	4.7	5.2
France	13.3	13.3	12.0	9.5	7.4
Canada	10.2	12.5	10.8	5.9	5.6
Italy	21.2	17.8	16.5	14.7	12.0
Australia	10.2	9.7	11.1	10.2	6.5
New Zealand	17.1	15.4	16.1	7.4	5.5[1]
Industrial (OECD) Countries	12.8	10.5	7.8	5.2	4.9[2]
Oil Exporting Developing Countries	13.2	13.2	8.1	11.4	10.9
Non-Oil Developing Countries[2]	32.0	31.3	32.9	44.1	34.5

Source: IMF, except for figures for total OECD, Australia and New Zealand which are from the OECD.
[1] Data for year commencing 1 April.
[2] IMF definition of industrial countries.
[3] Forecast.

Table 3
UNEMPLOYMENT RATES
(national definitions)

	1980	1981	1982	1983	1984[2]
US	7.2	7.6	9.7	9.6	7.9
Japan	2.0	2.2	2.4	2.6	2.5
West Germany	3.4	4.9	6.8	8.2	8.2
UK	6.4	10.0	11.7	12.4	12.4
France	6.6	7.7	8.4	9.1	9.9
Canada	7.5	7.6	11.1	11.9	10.6
Italy	7.6	8.4	9.1	9.9	10.1
Australia	6.1	5.8	7.1	9.8	9.4
New Zealand	3.3	3.7	5.4	6.0[1]	7.3[1]
Industrial (OECD) Countries[1]	6.2	7.2	8.4	8.9	8.5

Source: IMF, except for figures for total OECD, Australia and New Zealand which are from the OECD.
[1] Data for year commencing 1 April.
[2] Forecast.

DEVELOPING COUNTRIES

The effects of the recovery have been slow to spread to developing countries, especially the non-oil developing countries (NODCs) whose real GNP grew only 1.6 per cent in 1983 compared with 1.5 per cent in 1982. The major cause of this relatively poor performance was the need for many countries to undertake balance of payments adjustment programmes. Factors such as low export receipts, high interest rates and a decline in the availability of external financing have meant that the bulk of the adjustment fell on the domestic sector resulting in a fall in imports and low output growth. As the effects of the recovery in the industrial nations work through and export demand picks up so to should growth in the NODCs. Growth in real output for these countries of 3.5 per cent is forecast for 1984.

From 1980 to 1983 the major oil exporting countries suffered a 41 per cent decline in their export receipts as the demand for oil fell, accompanied by stable then decreasing oil prices, in the face of the world recession. As a result these countries attempted to control the growth of expenditure which in turn has placed constraints on their growth performance. In 1983, real GNP for these countries fell by 1.1 per cent after it had fallen 4.3 per cent in 1982. The current international recovery should lift the demand for oil and provide the preconditions for a better economic performance. The IMF predicts a growth rate of 4.7 per cent in 1984.

Inflation in NODCs continues at a high rate, averaging 44.1 per cent in 1983, the fourth consecutive year this rate has been in excess of 30 per cent. A moderation is expected in 1984 (to a rate of 34.5 per cent) as a result of the more restrictive policies being implemented in these countries. In oil exporting countries inflation has dropped from 13.2 per cent in both 1980 and 1981 to 11.4 per cent in 1983. A further fall to 10.9 per cent is expected for 1984 mainly as a lasting result of the firm policy stance in the last few years.

INTERNATIONAL TRADE BALANCES

The volume of world trade improved only moderately during 1983, increasing by 2 per cent following a decline of 2.5 per cent in 1982 and sluggish growth in 1980 and 1981. Much of the impetus to trade growth last year stemmed from a rapid increase in the imports of industrial countries, which rose by 11 — 12 per cent from the fourth quarter of 1982 to the fourth quarter of 1983. In contrast, the extent of the adjustment efforts required of the developing countries was a constraining factor behind the growth in world trade volumes. In line with current projections of domestic demand in industrial countries, the growth of imports of these countries is expected to continue but at a more moderate rate. This source of growth is expected to be supplemented by growing import demand in the developing countries as they experience some recovery in economic growth. Overall, the volume of world trade is projected to rise by 5.5 per cent in 1984 on a year-on-year basis.

In 1983 there was again little change in the aggregate current account position of the industrial countries, with a deficit of US$25 billion being recorded. Nevertheless, there were major shifts in the balances of individual members of the group. The US current account deficit increased by US$28 billion in 1983, reflecting the deterioration in US competitiveness vis-a-vis its major trading partners as a result of a further appreciation of the dollar and also reflecting the relatively faster pace of the economic recovery in the US as compared with other industrial countries. Shifts in the current account balances of other industrial nations largely compensated for the deterioration in the US position, with Japan recording a sizeable current account surplus of US$22 billion, compared with US$8 billion in 1982. In 1984 the US deficit is expected to increase to US$68 billion from US$34 billion in 1983, of which only around a third is likely to be offset by compensatory movements within the industrial country group. Hence, a substantial jump in the combined current account deficit of these countries to US$52 billion is expected this year.

One of the most striking developments with respect to international trade in recent years has been the massive reversal in the current account position of the oil exporting developing countries since 1980. Following the sharp increase in the value of oil exports and in the current account surplus of these countries in the late 1970s, the overall current account balance of the oil exporting developing countries has since rapidly deteriorated. It moved into deficit in 1982 but has since stabilised with a deficit of US$16 billion in 1983. In response to a further slide in oil receipts in 1983, restrictive fiscal policy measures were adopted by most countries in the group and, as a result, imports of goods and services declined markedly last year. Some improvement is expected in the combined current account position in 1984, with a deficit of US$8 billion being forecast. This improvement is likely to stem from continuing restraint on imports and the more buoyant outlook for both non-oil and oil exports given the continuing international recovery.

There has been an ongoing improvement in the current account position of the non-oil developing countries over the past two years, which has seen the combined current account deficit of the NODCs decline from US$109 billion in 1981 to US$82 billion in 1982 and US$56 billion in 1983. The constraints faced by the NODCs in obtaining external financing during 1982 and 1983 compelled most of them to take action to reduce their current account deficits. In the face of pronounced weakness in export markets and adverse terms of trade, they were forced to rely heavily on a contraction in imports to achieve this goal. The overall current account deficit of these countries is projected to decline further to around US$50 billion in 1984, based on the assumption of a strong upturn in export earnings being partially offset by renewed growth of imports.

Table 4
CURRENT ACCOUNT BALANCES
(billions of US dollars)

	1980	1981	1982	1983	1984[1]
US	5.1	9.1	− 5.8	− 34.3	− 68.0
Japan	− 9.5	6.2	8.1	22.3	29.0
West Germany	− 8.3	0.1	10.2	9.0	10.0
UK	11.8	16.7	12.7	6.1	5.0
France	− 2.5	− 2.8	− 9.5	− 2.5	1.5
Canada	− 1.2	− 5.1	2.2	0.6	− 2.0
Italy	− 9.5	− 7.5	− 4.9	0.9	1.0
Australia	− 4.0	− 8.3	− 8.4	− 5.2	− 4.0
New Zealand	− 0.9	− 1.2	− 1.6	− 1.2	− 1.0
Industrial (OECD) Countries	− 70.1	− 28.0	− 29.8	− 24.7	− 52.0
Oil Exporting Developing Countries	111.0	53.4	− 12.0	− 16.2	− 8.0
Non-Oil Developing Countries	− 87.7	− 109.1	− 82.2	− 56.4	− 50.0
Total[2]	− 17.1	− 53.8	− 95.6	− 73.8	− 80.5

Source: IMF, except for figures for total OECD, Australia and New Zealand which are from the OECD.
[1] Forecast, figures are rounded to the nearest $0.5 billion.
[2] Reflects statistical errors and asymmetries which give rise to totals that are significantly different from zero.

FOREIGN EXCHANGE AND FINANCIAL MARKETS

As in 1982, the sustained strength of the US dollar was the main feature of foreign exchange markets in 1983 and the same applies to date for 1984. The ongoing strength of the dollar has persisted for longer than many analysts were expecting. Each time the dollar has fluctuated from its trend over the past year, it has been accompanied by the widespread expectation that an ongoing depreciation of the US dollar was underway.

However, the dollar has confounded observers by subsequently regaining its strength against the other major currencies.

There are several strong countervailing forces whose relative strengths have been responsible for the ebb and flow of the US dollar around its trend in recent months. Market concern at the huge US trade deficit and federal budget deficit has consistently provided downward pressure whereas high real US interest rates and the relative safety of US dollar-denominated assets in the face of world political tensions and residual concern about the international financial system, have been almost constant sources of upward pressure. In addition, several forces have vacillated between providing positive and negative pressure. These fluctuating factors include the market's perception of the relative strength of the US economy against the pace of recovery in Europe and Japan, and expectations as to the future course of relative interest rates and inflation rates and the factors affecting these, particularly the actions of the US Federal Reserve with respect to monetary policy.

The value of the deutschmark against the US dollar in terms of its trade weighted index was almost unchanged at the end of May 1984 as compared with the end of December 1983. The deutschmark strengthened against the US dollar during February and March this year reversing the trend of 1983. This was as a result of increasing optimism in foreign exchange markets over economic prospects for West Germany, but over April and May the deutschmark once again weakened against the dollar following industrial unrest in West German engineering and metal working industries. During 1983 the Japanese yen strengthened in trade-weighted terms but at the end of May 1984 its trade-weighted index and value against the US dollar remained broadly unchanged compared with the end of December the previous year. The yen has been supported by favourable economic conditions in Japan, namely the strong external position, low rates of inflation and the overall steady pace of economic recovery. Most other currencies weakened relative to the US dollar over the first few months of 1984, as they had over 1983. Sterling's trade-weighted index was around 4 per cent lower at the end of May than at the end of December last year, the Swiss franc approximately 3 per cent lower and the Canadian dollar some 4 per cent lower.

From around mid – 1982 and throughout 1983, activity in international capital markets remained sluggish. Total new bank lending was only US$81 billion in 1983, compared with US$103 billion in 1982 and US$149 billion in 1981. The single major factor behind this trend was the continued concern on the part of international lenders about the external position of a number of major sovereign borrowers. The market climate improved moderately in the early months of 1984. Total funds raised on international markets during the first quarter of 1984 reached just under US$80 billion, compared with only US$158 billion for the whole of 1983, while medium-term bank credit has exhibited strong growth during the first quarter of this year and new bank lending reached US$52 billion, compared with only US$19 billion in the final quarter of 1983. Similarly, bond market activity in recent months has improved, supported by a heavy flow of new issues by high quality borrowers and renewed interest by investors in bond placements, particularly floating rate and equity-linked issues.

The improvement, though, should be regarded as somewhat fragile in light of developments during the second quarter of 1984 —including Bolivia's temporary suspension of payments on more than US$1 billion of debt to foreign banks and US banking difficulties. In addition, caution is required in the interpretation of the aggregate data on new bank loans, which include commitments for new money entered by commercial banks as part of IMF backed financing and debt rescheduling packages. If this 'non-spontaneous' or 'managed' credit is excluded, 'spontaneous' bank lending during the first quarter of 1984 actually followed the downward trend that has occurred since 1982.

The greater emphasis placed by lenders on creditworthiness in recent times has resulted in significant changes in the market shares of the main groups of borrowers. Of total loans arranged purely on a commercial basis (i.e. excluding 'managed' credits) the share of OECD borrowers rose from 56 per cent in 1982 to 61 per cent in 1983 and to over 80 per cent so far this year, while the share of total borrowing undertaken by developing countries declined over this period. The reluctance of banks to increase their exposure to developing countries in recent years has also been reflected in some shortening of maturities and markedly higher fees and spreads over base lending rates for these countries, but this year there has been a reversal of some of these tendencies. A scarcity of demand for bank loans from prime borrowers, who have preferred to borrow by way of floating rate notes, has allowed some developing country borrowers to negotiate better terms on their loans.

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

	1981	1982	1983	1984 Q1
OECD Countries[1]	136.43	121.81	111.59	66.20
of which: external bonds	42.12	63.63	67.03	24.00
bank loans	94.31	58.18	44.56	42.19
Eastern Europe	1.62	0.70	1.07	0.19
of which: external bonds	0.08	—	—	—
bank loans	1.55	0.70	1.07	0.19
Opec Countries	6.47	9.00	7.94	1.05
of which: external bonds	0.44	0.54	0.42	—
bank loans	6.03	8.46	7.52	1.05
Other Developing Countries	48.70	37.23	27.60	9.17
of which: external bonds	3.82	3.61	2.21	0.64
bank loans	44.88	33.62	25.39	8.52
Other[2]	7.32	10.18	9.62	2.64
of which: external bonds	5.34	7.75	7.49	2.16
bank loans	0.98	2.43	2.13	0.48
Total	200.55	178.93	157.83	79.25
of which: external bonds	51.81	75.53	77.15	26.81
bank loans	148.74	103.40	80.68	52.44

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

INTERNATIONAL INSTITUTIONS: RECENT DEVELOPMENTS

In order to enable the developing countries to take advantage of the recovery now underway, international institutions, in particular the IMF and the World Bank, will continue to require a steady flow of funds to finance their lending programmes. Despite continued problems in arranging financial resources to meet the needs of the next few years, the World Bank[5] has recently negotiated a moderate improvement in its

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

liquidity position. A selective capital increase of US$8.4 billion has increased the Bank's pool of lending resources and the Bank hopes that a framework for a substantial general capital increase can be agreed by mid – 1986. Negotiations on the seventh replenishment (IDA – 7) of the International Development Association, that part of the World Bank which extends long-term, low interest loans to less developed countries, were concluded in January 1984 with a replenishment of US$9 billion being agreed upon. As this represents only half the amount originally hoped for by the IDA, member countries may be called upon to participate in a special financing arrangement to enable the Association to maintain its present scale of activities. New Zealand's share of IDA – 7 at 0.0835 per cent of the total, remains the same as for the previous replenishment, and will involve payment of US$7.5 million.

The IMF's liquidity position which was in doubt prior to the implementation of the quota increases under the Eighth General Review and the Augmentation of the General Arrangements to Borrow (GAB)[6], was further strengthened by the SDR 6 billion borrowing arrangement approved by the Executive Board of the IMF in April 1984. The arrangement comprised four separate agreements with the Saudi Arabian Monetary Authority (SAMA), the Bank for International Settlements (BIS), Japan, and the National Bank of Belgium. Along with other resource replenishment measures this arrangement will enable the Fund to continue to provide resources under its policy of enlarged access to member countries adopting programmes of economic adjustment to correct payments imbalances.

The strengthening of the Fund's liquidity and the apparent successful handling of the short-term debt crisis and avoidance of large scale defaults by debtor countries, together with the recovery of economic activity that is currently underway in the industrial countries at a pace faster than was foreseen, has provided the Fund with an opportunity to give greater attention to the longer term issues relevant to the solution of the debt crisis. The need for such a solution has become more pressing in light of recent developments in the international financial arena. Bolivia's decision to temporarily suspend debt payments to foreign banks, together with concern about the health of the US banking system and a sharp rise in US interest rates in recent weeks, which will further increase the interest rate burden on outstanding international loans to developing countries, are all reasons for continued concern.

Many still see fundamental weaknesses in the international financial system which could lead to major problems with the onset of the next world recession. Because of this there is growing support for a detailed examination of the longer term issues with a view to making changes to the international trade and payments systems.

The fundamental long-term solution to the debt crisis is seen by the Fund and the World Bank as being reliant on the debtor countries' ability to grow and trade their way out of their present difficulties. The achievement of satisfactory growth rates by the developing countries is identified as being particularly reliant on continued growth in the industrial countries, a continued flow of net new funds to the debtor countries (but not at the unsustainable rates that brought about the debt crisis) and a continuation of effective demand-management and appropriate adjustment policies in the developing countries.

The spread of protectionist practices has been identified as potentially jeopardising the international recovery. International trade relations remained very difficult in 1983, and despite the acknowledged need to make use of the international recovery to reverse protectionist trends and dismantle trade restrictions, efforts at liberalisation were limited. Although tariff reductions under the auspices of the General Agreement on Tariffs and Trade (GATT) continued, the adoption by industrial countries of non-tariff barriers further weakened the multilateral trading system. Indicative of recent developments, the Council of the OECD met at ministeral level in Paris on 17 and 18 May this year and agreed to bring forward by one year tariff cuts originally scheduled for 1986 at the last round of talks held under the GATT. The Ministers also called for a new round of negotiations within the framework of the GATT aimed at further rolling back trade barriers.

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	11.1	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	3.3	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)

	1979	1980	1981	1982	1983	Jan-Feb 1984
New Loan Commitments:	–0.8	6.6	12.1	2.4	10.5	–0.9
Industrial Countries	—	—	—	—	—	—
Developing Countries	–0.8	6.6	12.1	2.4	10.5	–0.9
Purchases Under Low Conditional Facilities:	0.7	1.0	1.5	3.0	3.4	—[1]
Industrial Countries	—	—	—	0.1	—	—
Developing Countries	0.7	1.0	1.5	2.9	3.4	—[1]
Trust Fund Loans Disbursed (Developing Countries Only	0.5	1.3	0.4	—	—	—
Total	0.4	8.9	14.0	5.4	13.9	–0.9

Source: IMF.
[2] Less than SDR 50 million.

CONCLUSION

It appears that the recovery in the world economy which began in 1983 and carried over into the early months of 1984 will continue this year and into 1985. The marked recovery in the US and Canada, together with the more moderate improvement in activity in other industrial countries, is now slowly spreading to the developing world. Among the developing nations, progress has been made in correcting unsustainable external positions and this has improved prospects for an eventual resolution of their debt-servicing difficulties and for the resumption of economic growth. Nevertheless, problems still remain which cast uncertainty over the durability of the recovery in the

6 For details refer page 9 of the January/February 1983 Reserve Bank *Bulletin* and page 287 of the July 1983 *Bulletin*.

medium-term. The recovery in the industrial world is still unbalanced, both in its geographical structure and in the pattern of the underlying final demand. In addition, the longer term prospects for economic growth remain blurred by the persistence of rigidities in labour markets and by other structural problems. Real interest rates remain at very high levels, thereby threatening the sustainability of the recovery generally. Finally, the heavy burden of debt in many developing countries constrains their ability to resume the momentum of development.

The implications for New Zealand of developments in the international economy will be determined not only by the strengthening recovery but also by special market conditions which for some of New Zealand's major primary products continue to be either unfavourable or offer scope for only a marginal improvement in prices. The stimulus to the domestic economy from the international recovery has been limited to date. A marked improvement in New Zealand's current account position on an annual basis over the first half of 1983 stemmed more from weak demand for imports reflecting the domestic recession than from the emerging world recovery. Over the latter half of 1983 and into 1984 a deterioration in the current account deficit (on an annual basis) has occurred despite a rise in export receipts. The underlying factor behind this deterioration has been rising import payments as a result of the moderate expansion in domestic demand over the final months of 1983 and early this year.

The smaller industrial nations are dependent to a significant degree on economic conditions and policies in the major countries. To take full advantage of the world recovery, the IMF suggests that the smaller industrial countries should "tackle the fundamental weaknesses that constrain their economic performance". Included in these weaknesses are inflexible relative prices, a rigid industrial structure, structural unemployment, large fiscal deficits and an uncertain climate for investment. The Fund suggests that only by dealing with these problems will these countries be able to sustain a recovery based on export and investment demand.