DEVELOPMENTS IN THE INTERNATIONAL ECONOMY[1]

Introduction

World recovery continues as a further fall in inflation is recorded.

The current international economic recovery which began in 1982 has been sustained in 1984 although indications of a deceleration in growth rates emerged during the latter part of the year. Output growth in the OECD economies was 4.8 per cent in 1984. This increase was the most rapid since 1976. Inflation within the OECD countries has been constrained to an average level of 5 per cent in 1984 and is the lowest experienced in that group since 1972. This is one of the most significant distinguishing features of the current recovery. In previous recoveries, the division between real output and inflation had been less favourable than has been the case in the current recovery.

Another major feature of the current recovery has been the strength of investment in a number of countries and the improvement in labour productivity. Investment growth has been encouraged by a strong improvement in corporate profits while the adoption of new and more productive technologies has also attracted investment especially in the United States and Japan. The corporate sector's operating surplus as a share of GNP has grown quite strongly although it remains somewhat below the average figures of the 1960's and early 1970's. In addition the rate of return on capital has improved. These developments have been facilitated by an improvement in labour productivity and moderation in wage claims. The more vigorous labour productivity growth has probably resulted from the improved use of labour resources which had been under-utilised during the previous recession.

The current international economic expansion has been led by the recovery of the United States' economy where rates of return on investments have been favourable. High relative interest rates together with strong market confidence have motivated a significant capital inflow into the United States since the recovery began. This capital inflow has accommodated an appreciation of the United States' dollar and has helped to increase the competitiveness of other countries' output on the United States' market. As a result, a number of countries have been able to expand their export volumes and this has assisted the spread of the recovery throughout the world.

In addition to developments in the United States' economy, there remain other possible international developments which could impinge upon the world recovery. For example, the unevenness of performances across countries could create future problems if it encourages severe macroeconomic policy responses or imposes pressure on the trade payments system. However, in the main, current account and exchange rate movements have served to accommodate differences in economic objectives. A further potential source of risk is the situation of the heavily indebted developing countries, although their situation has been to some degree aided by the rapid growth in world trade that has been associated with the world recovery.

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

	1981	1982	1983	1984[2]	1985[3]
United States[1]	2.5	−2.1	3.7	6.8	3.0
Japan[1]	4.0	3.3	3.0	5.8	5.0
West Germany[1]	−0.2	−1.1	1.3	2.5	2.8
United Kingdom	−1.5	2.5	3.2	2.0	3.0
France	0.2	2.0	0.7	1.8	2.0
Canada[1]	3.3	−4.4	3.3	4.3	2.8
Italy	0.1	−0.4	−1.2	3.0	2.5
Australia	3.9	0.7	0.6	6.3	2.3
New Zealand	2.7	1.0	3.8	2.5	−0.5
Industrial (OECD) Countries[1]	1.7	−0.3	2.6	4.8	3.0
Oil Exporting Developing Countries	−4.1	−4.2	−0.8	3.8	4.6
Non-Oil Developing Countries	3.1	1.7	1.8	3.7	4.3

Source: OECD, IMF.
1. GNP.
2. Estimate.
3. Forecast.

Major OECD Countries

United States

United States' economy continues on a strong growth path

The United States' economy continued to expand rapidly in the first half of 1984. The expansion was broadly based with capital formation being particularly strong. During the second half of the year there was some evidence of a levelling off in economic activity. Slower growth in private consumption and residential construction contributed to a reduction in the rate of growth of real GNP. On a seasonally adjusted annual basis real GNP grew 1.6 per cent in the third quarter and 3.9 per cent in the fourth quarter of 1984. This strong growth has allowed a significant reduction in unemployment from a peak of 10.7 per cent in late 1982 to 7.2 per cent in late 1984. More than six million jobs have been created since the recovery began in late 1982. Most of these new jobs have been in the service sector.

Despite a historically high real cost of borrowing, investment growth has been buoyant during the current recovery. This strong growth was propelled during 1983 and early 1984 by high corporate profits. However, in the third quarter of 1984 pre-tax corporate profits fell substantially, reflecting the slowdown in real GNP growth.

Residential construction and consumption have weakened, however, apparently in response to higher real interest rates. Housing starts fell from a peak of 2 million (annual rate) in the first quarter of 1984 to 1.7 million in the third quarter. As a result, residential construction ceased to be an expansionary force from mid-1984.

1 The forecasts quoted in this article, except where otherwise noted, are those prepared by the OECD and published in their Economic Outlook, No. 36, December 1984. Tables 1-4 summarise both these forecasts and recent 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 assumed policies, and no changes in oil prices or present exchange rates.

The external sector has had a negative influence on growth. With the recovery stronger in the United States than in the rest of the world, export growth has not kept pace with the demand for imports and the result has been a widening trade deficit. The current account deficit for 1984 is expected to be about US$100 billion compared with only US$41.6 billion in 1983. Usually such a large deficit would have been expected to have led to a weaker United States' dollar but instead it has remained strong. The major reason for this appears to have been a high real interest rate differential favouring the United States which has induced a strong inflow of foreign capital.

A probable explanation for relatively high United States' interest rates is that they result from the operation of a restrictive monetary policy in combination with a large fiscal deficit. In competing for funds to finance its deficit, the Government has helped lift interest rates and also attracted money from overseas which has appreciated the United States' dollar. Increased economic activity has meant tax receipts have risen but these extra receipts have not been sufficient to offset increased expenditures. OECD estimates suggest that the United States' structural deficit will continue to increase over the next 18 months.

Towards the end of 1984 interest rates fell in response to some easing in the Federal Reserve's control of the money supply. This relaxation of monetary conditions was based on the grounds that the inflation rate had fallen and that monetary aggregates were growing towards the lower end of their target ranges.

In spite of fears to the contrary the strength of the recovery has not revived inflationary pressures. Consumer price inflation has remained at an annual rate of less than 5 per cent over 1984 due in part to low world commodity prices and the effect of the strong dollar depressing import prices. Inflation is expected to remain moderate over 1985 but the OECD expects interest rates to follow a slight upward trend given the persistence of high credit demands.

For 1985 as a whole an average annual growth rate of 3 per cent is forecast compared with a rate of 6.8 per cent in 1984. Meanwhile the unemployment rate is expected to stabilise at around 7 per cent in 1985.

Japan

Stronger domestic demand boosts Japan's economic growth

The performance of the Japanese economy during 1984 appears to have been better than in any other period since the first oil crisis, with comparatively strong growth and low inflation rates. As in past years, the external sector provided the main impetus to growth in 1984, although domestic demand has gathered momentum during recent months, despite a restrictive fiscal policy and high real interest rates. The upturn in domestic demand has been led by private fixed investment. The favourable business climate — including not only rising profits, but also increased investment opportunities provided by technological progress — has resulted in a significant surge in business fixed investment. Inventory investment has also risen steadily.

In contrast, private consumption expenditure remains relatively weak due to slow growth in real incomes and government expenditure has declined in line with the official policy objective of reducing the budget deficit over the medium term. Overall, real GNP grew at a seasonally adjusted annual rate of 6.3 per cent in the first half of 1984 and is estimated to have grown at an annual rate of 5.3 per cent in the second half of the year. Despite this strong growth in output, the rate of unemployment as a percentage of the labour force has edged up in recent months, although it still remains very low when compared with the rates achieved by other industrial countries.

The rate of inflation, as measured by the rate of change in the private consumption deflator, has remained low with an annual rate of 2.4 per cent recorded for the first half of 1984 and an estimated annual rate of 2.5 per cent for the second half of the year.

The OECD projects that the recent buoyancy of Japan's economic activity will be sustained over the next eighteen months with growth rates moderating only slightly over the latter part of the forecast horizon. Real GNP is estimated to have grown by 5.8 per cent in 1984, compared with 3 per cent in 1983 and 3.3 per cent in 1982, and is forecast to grow by around 5 per cent in 1985. The main forces behind the expansion are the projected continued strength of export markets, rising capacity utilisation, and the revival of corporate profits. Sustained economic growth is not expected to lead to any significant decline in the unemployment rate. For 1985, the unemployment rate is forecast to decline to 2.5 per cent, from 2.8 per cent in 1984 and 2.6 per cent in 1983. A modest acceleration in the rate of consumer price inflation to 2.8 per cent from 2.3 per cent in 1984 is forecast for 1985, based on the expectation of a modest acceleration in wages. Overall, a current account surplus of US$40 billion is foreseen for 1985, compared with an estimated surplus of US$32 billion in 1984 and a surplus of US$21 billion in 1983.

West Germany

Modest improvement in West German economy fails to reduce unemployment

After achieving a growth rate of 1.3 per cent in 1983 following two years in which real GNP fell, the West German economy was expected to perform better in 1984. However, from May until early July, economic performance was impaired by industrial disputes in the engineering and metal working industries. These disputes had their major impact on industrial production which recorded a drop of more than 9 per cent in June. As a result real GNP fell in the second quarter of the year. The settlement of the disputes has been followed by a return to the upward trend in output and it now appears that real GNP for 1984 will be up 2.5 per cent on its level in 1983. A continuation of this rate of expansion in 1985 is expected by the OECD which forecasts a real growth rate of 2.8 per cent for that year.

A disconcerting feature of the current West German expansion has been the failure to reduce unemployment. During 1983 with employment increasing and the labour force shrinking unemployment fell briefly. But in 1984 this trend was reversed. Overall employment has fallen while the labour force has increased as more people have once again sought work. The result has been a slight increase in the unemployment rate to 8.3 per cent of the labour force in 1984 compared with 8.2 per cent in 1983. With the modest rate of growth forecast for 1985 employment is expected to increase slightly but is likely to be offset by further expansion of the labour force such that no improvement in the unemployment rate is expected.

Inflationary pressures are expected to remain moderate in the coming year and the OECD forecasts an average annual rate of only 2 per cent compared to a rate of 2.5 per cent for 1984 when falling unit labour costs and low commodity prices were responsible for keeping inflation down.

In spite of the large numbers out of work the West German Government has continued to adopt a tight fiscal policy. The 1985 budget aims to limit the increase in public spending to less than 1 per cent and so continue the downward trend in the size of the fiscal deficit. The deficit for 1985 is expected to be a little more than 1 per cent of GNP down from 2 per cent in 1984.

Monetary policy has also remained firm, with the target range for Central Bank Money for 1984 being set at 4 to 6 per cent. Over 1984 the growth in this aggregate has been towards the middle and lower end of the range and for 1985 a range of 3 to 5 per cent has been set. The modest rate of growth in the money supply, together with the restrictive nature of fiscal policy, has kept domestic interest rates low. This has resulted in a sizeable interest differential in favour of the United States and consequently in a weakening of the deutschmark.

However, some benefits have accrued from the weakness of the deutschmark. German manufacturers have found themselves well placed to take advantage of the world recovery, particularly in the United States because of the increase in price competitiveness. As a result of this West Germany is expected to be able to turn in a good export performance during 1985 and its external current account is expected to record a surplus of about US$7.5 billion compared with US$2.3 billion in 1984 and US$4.1 billion in 1983.

United Kingdom

Miners' strike suppresses the United Kingdom's economic growth

The United Kingdom's economy grew 3.2 per cent in 1983 with the growth being based to a large degree on a recovery in private consumption. It was expected that during 1984 real GDP would continue to expand at a moderate rate. However, over the course of the year growth was slower than had been expected largely because of the strike by coal miners which began in March. Personal income growth has been dampened by the loss of earnings by miners and this has depressed private consumption. On a positive note, business fixed investment is showing strong growth while the depreciation of sterling has meant that the competitiveness of British manufacturers should be improved and lead to a positive flow-on impact on exports in the future.

The growth achieved so far has been insufficient to reduce unemployment and there remains more than three million people out of work. Growth in employment has been offset by a substantial increase in the labour force. Many of the new jobs appear to have been filled by workers previously not recorded as seeking work and thus not included in the labour force.

The weakness of sterling has been a further complicating factor for the British Government during 1984. The coal miners' strike has played a part in undermining confidence in the currency while other adverse influences have been the general strength of the United States dollar and the fall in world oil prices given the United Kingdom's dependence on exports of North Sea oil. As the coal strike progressed during 1984, oil was substituted for coal which reduced the surplus on oil trade and resulted in an increased current account deficit.

In July 1984, the weakness of the pound frustrated government attempts to lower domestic interest rates. Instead, rates rose to protect the currency even though domestic monetary conditions did not seem to warrant such a move as monetary aggregates were growing within their target ranges. The Government made it clear that lower domestic interest rates were needed to stimulate growth in output. Once the immediate threat to the pound passed, the Government engineered a fall in rates aided by the subsequent cuts in United States interest rates.

Further falls in the value of the pound would probably be a cause for some concern because of their likely inflationary impact through import prices or through higher mortgage interest rates which would follow a general rise in interest rates designed to defend sterling's value. However, over 1984 inflation was kept to an annual rate of around 5 per cent despite the depreciation of the pound which occurred.

Australia

Australian recovery shows signs of weakening

The Australian recovery, which had begun in mid-1983, continued at a strong pace in the first half of 1984. Quarterly increases in real GDP of 2.4 per cent and 2.2 per cent were recorded for the first two quarters of the year. The expansion was driven by stock building, recovery in the rural sector, increased private consumption, housing demand and a stimulatory Government fiscal policy. However, in the second half of the year the first evidence emerged of some slowing in the rate of growth with third quarter figures showing real GDP falling 0.9 per cent. The figures also showed that private investment growth had not firmed up by the third quarter. Recent business surveys point to a strengthening in capital expenditures in the final quarter of 1984.

Although there have been indications that the rate of growth of real GDP is easing, unemployment has continued to fall. The unemployment rate fell from a peak of more than 10 per cent of the labour force in the middle of 1983 to less than 9 per cent in the latter part of 1984. Meanwhile, aided by the lagged effects of the wages pause and falling import prices, inflation has continued to moderate. The consumer price index (CPI) rose only 3.6 per cent in the year to September 1984 compared with a rise of 9.3 per cent in the year to September 1983. The OECD forecasts a further moderation in inflation in 1985.

With strong growth in domestic demand, imports have increased at a faster rate than exports. This has resulted in an estimated current account deficit for 1984 of US$6.5 billion compared to US$5.4 billion in 1983. Export growth is likely to be further constrained in 1985 both by a loss in competitiveness and a shift to more normal production levels in agriculture. Given this constraint the current account deficit could widen further to as much as US$9 billion in 1985.

Fiscal expansion has been one of the main factors underlying the growth achieved thus far and the fiscal stance remains broadly expansionary for the fiscal year ending June 1985. Increased economic activity has increased tax revenues and the fiscal deficit for 1984/85 should be less than that recorded for 1983/84 (which was equal to 4.5 per cent of GDP) in spite of some income tax cuts introduced in the 1984 Budget.

Considerable uncertainty remains about the future course of the Australian economy. Those factors which initiated the recovery, especially the improvement in the rural sector, have not been sustained and the continuation of the recovery is likely to depend on whether or not private consumption and investment expenditure will expand sufficiently to take over as the driving force behind further growth in real GDP. The OECD expects growth in consumer spending to ease to 2 per cent in 1985 from 2.5 per cent in 1984. Investment growth, which is expected to have strengthened in the latter part of 1984, is also expected to slow in 1985. In addition, a continuing expansion led by government expenditure is unlikely. Nor does it appear that exports will play a significant role in supporting continued growth in real GDP in 1985. Hence, the OECD forecasts real GDP growth to slow in 1985 to an annual rate of 2.3 per cent compared with the 6.3 per cent estimated for 1984. Unemployment is not expected to show any further significant decline.

Table 2
PRIVATE CONSUMPTION DEFLATOR
(% change from previous year)

	1981	1982	1983	1984[2]	1985[3]
United States	8.7	5.9	3.7	3.3	3.5
Japan	4.8	2.7	1.6	2.3	2.8
West Germany	6.1	5.0	2.9	2.5	2.0
United Kingdom	11.2	8.3	5.1	5.0	5.3
France	12.8	11.2	9.4	7.3	6.5
Canada	11.7	10.9	5.8	4.3	4.0
Italy	19.2	17.4	14.9	11.0	8.3
Australia	8.9	10.6	9.7	6.8	4.8
New Zealand[1]	15.4	16.1	7.4	8.0[4]	9.5[4]
Industrial (OECD) Countries	9.3	7.4	5.3	5.0	4.8
Oil Exporting Developing Countries[1]	13.2	8.1	10.0	10.8	10.3
Non-Oil Developing Countries[1]	30.1	30.3	41.4	44.5	27.1

Source: OECD, IMF.
1. Consumer Price Index.
2. Estimate.
3. Forecast.
4. Fiscal year ending March the following year.

Table 3
UNEMPLOYMENT RATES
(national definitions)

	1981	1982	1983	1984[1]	1985[2]
United States	7.6	9.7	9.6	7.5	7.0
Japan	2.2	2.4	2.6	2.8	2.5
West Germany	4.6	6.7	8.2	8.3	8.3
United Kingdom	9.5	11.0	11.5	11.8	11.8
France	7.3	8.0	8.2	9.3	10.5
Canada	7.5	11.1	11.9	11.5	11.5
Italy	8.7	9.1	9.7	10.0	10.5
Australia	5.7	7.1	9.9	9.3	8.8
New Zealand	3.5	4.7	6.4	6.0	7.5
Industrial (OECD) Countries	6.9	8.4	9.0	8.5	8.5

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

Developing Countries[2]

Developing countries benefit from improved export growth

The output growth rates of the non-oil development countries (NODCs) benefited in 1984 from an increase in their exports to the industrial countries. This export growth contributed to an estimated average annual growth rate for the country group of 3.7 per cent in 1984 compared with 1.8 per cent in 1983. A continuation of this upward trend is expected for 1985 with output projected to rise a further 4.3 per cent. Within the NODC grouping those Asian countries which have traditionally been large exporters and whose exports tend to go primarily to Japan and the United States have benefited the most from the recovery in the industrial countries. Latin America, on the other hand, has shown a weak recovery with the stimulus from increased exports being offset in the meantime by domestic policies designed to reduce inflation and improve government finances. African countries in the main have also exhibited a slower increase in output because a large proportion of their exports tends to go to Europe where the recovery has not been as strong. Furthermore, a number of low income countries in Sub-Saharan Africa face serious economic problems because of a combination of reduced exports, high real interest rates on external debt and stagnating flows of foreign aid.

Output in the oil-exporting developing countries has also been stimulated by the recovery in industrial countries. After falling each year since 1980 output in the oil exporting countries is estimated to have risen 3.8 per cent in 1984. In 1985 a rise of 4.6 per cent is forecast given the combination of continuing expansion in the industrial countries and a less restrictive fiscal policy.

The annual rate of consumer price inflation in NODCs is estimated to have averaged 44.5 per cent in 1984 compared with 41.4 per cent in 1983. However, this average is boosted considerably by the experience of Argentina, Bolivia, Brazil, Israel and Peru, all of which have annual inflation rates in triple figures. In other NODCs inflation is slowing and, on average, it fell to 17 per cent from the 21 per cent recorded in 1983. Further moderation in inflation is expected for NODCs in 1985, particularly in those countries with above average inflation where anti-inflationary policies are expected to have a stronger impact. For the NODC group as a whole the forecast is for an annual inflation rate of 27.1 per cent in 1985.

External Balances

Strong growth in world trade generated by the world recovery

The recovery in international trade which began in the first half of 1983 continued at a strong pace in 1984. As a consequence, the current account balances of the developing countries continued to improve as did the financing situation of many of the poorer non-oil developing countries. The main factor influencing the global payments situation has been the rapid rise in industrial country imports as a result of the on-going recovery. Year on year, the volume of imports of industrial countries is estimated to have risen by

2 The forecasts quoted for developing countries in this section are those prepared by the IMF and published in their World Economic Outlook, IMF Occasional Paper No. 32, September 1984. The forecasts have been made on the same basis as those prepared by the OECD (refer footnote 1).

approximately 12 per cent in 1984, compared with only 4 per cent in 1983 and zero growth in 1982. Overall, the volume of world trade is estimated to have grown by approximately 9 per cent in 1984. For 1985, the growth in the volume of world trade is expected to moderate to just over 6 per cent as a result of an expected slowdown in the growth in industrial country import volumes. The decline in the growth of international trade volumes is expected to continue into 1986.

Reflecting the relatively stronger pace of economic activity in the industrial countries, the combined current account balance of those countries moved further into deficit in 1984, to an estimated US$71 billion from US$25 billion in 1983, and is expected to widen again in 1985 to US$86 billion. Although this development is a fairly normal cyclical phenomenon, there is concern about the associated large disequilibria for individual countries, in particular, the United States and Japan. The United States' current account deficit is estimated to have reached US$100 billion in 1984, up from US$42 billion in 1983 and US$9 billion in 1982. The main single counterpart to the deterioration in the United States' current account deficit inside the OECD area may be found in Japan, with an estimated current account surplus of over US$30 billion in 1984, compared with US$21 billion in 1983 and US$7 billion in 1982. Japan's current account surplus is expected to rise to approximately US$40 billion in 1985.

The recovery in industrial countries, together with the adjustment efforts of a number of developing countries, resulted in significant reductions in the aggregate external deficits of the oil-exporting and non-oil developing countries in 1984. The current account position of the oil-exporting countries, taken as a group, recorded a surplus of US$1 billion in 1984 compared with deficits of US$19 billion in 1983 and US$15 billion in 1982. For 1985, some deterioration in the external accounts of the oil producing countries is expected.

Table 4
CURRENT ACCOUNT BALANCES
(billions of US dollars)

	1981	1982	1983	1984[1]	1985[2]
United States	6	– 9	– 42	– 100	– 131
Japan	5	7	21	32	40
West Germany	– 6	4	4	2	8
United Kingdom	15	9	4	– 2	—
France	– 5	– 12	– 4	—	2
Canada	– 5	2	1	1	—
Italy	– 8	– 6	1	– 1	– 2
Australia	– 8	– 8	– 5	– 7	– 9
New Zealand	– 1	– 2	– 1	– 1	– 1
Industrial (OECD) Countries	– 24	– 28	– 25	– 71	– 86
Oil Exporting Developing Countries	50	– 15	– 19	1	– 4
Non-Oil Developing Countries	– 81	– 68	– 41	– 32	– 40
Other Countries	– 10	8	11	11	9
Total[3]	– 69	– 103	– 74	– 90	– 121

Source: OECD.
1. Estimate.
2. Forecast.
3. Reflects statistical errors and asymmetries which give rise to totals that are significantly different from zero.

The combination of continuing import restraint and strong growth in export volumes allowed the non-oil developing countries (NODCs) to continue to improve their aggregate current account position in 1984. The total NODC current account deficit declined to US$32 billion in 1984, from US$41 billion in 1983 and US$68 billion in 1982. The moderation of industrial country growth in 1984 can be expected to be reflected in slower NODC export volume growth which should, in turn, be compounded by the decline in commodity prices which occurred in 1984. These factors are expected to result in a deterioration in the combined current account deficit from US$32 billion to US$40 billion in 1985.

Foreign Exchange

United States' dollar continues to strengthen, assisted by high real interest rates and a strong economy

The dominant feature of foreign exchange markets in 1984 was the continued strength of the United States' dollar. Over the course of 1984 the United States dollar strengthened by about 11 per cent in trade-weighted terms and in the process it reached its highest levels against other currencies since the beginning of the floating exchange rate era in 1973.

The major reason for this continued strength appears to be an interest rate differential in favour of the United States. Even when monetary policy was eased and United States' interest rates declined over the second half of 1984, low inflation in the United States and matching falls in interest rates elsewhere meant that United States' real interest rates remained higher than those in other countries. In more general terms, the strong economic performance of the United States and the perceived political stability of that country have tended to favour the dollar.

Corresponding to the strength of the United States' dollar has been the weakness of other currencies, particularly sterling. Undermined both by industrial disputes and by lower prices for North Sea oil, the pound fell to record low levels against the United States' dollar. Its trade-weighted index fell to all time lows and finished 1984 down almost 12 per cent from its level at the end of 1983. Sterling came under sustained downward pressure on two occasions in 1984. The first was in July when the downward slide was eventually reversed by increases in United Kingdom interest rates. The second major period of weakness was in December when the threat of lower oil prices pushed the pound to even lower levels than it had reached in July, with the movements this time being accentuated by the thinness of the market.

Other currencies also generally weakened against the United States' dollar. Despite the intervention by the Bundesbank, the deutschmark lost more than 12 per cent of its value against the dollar and weakened by around 3 per cent in trade-weighted terms in 1984. The yen, however, maintained its value on a trade-weighted basis. This was mainly because of the better economic performance of Japan in comparison with Europe. The Swiss franc was approximately 7 per cent lower in trade-weighted terms at the end of 1984 than at the end of the previous year, the French franc about 4 per cent lower and the Canadian dollar about 2 per cent lower.

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

	1982	1983	1984 Q1	1984 Q2	1984 Q3
OECD Countries[1]	121.81	111.59	58.76	30.56	44.08
of which: external bonds	63.63	67.03	24.22	20.33	22.61
bank loans	58.18	44.56	34.54	10.23	21.48
Eastern Europe	0.70	1.07	0.16	0.84	1.38
of which: external bonds	—	—	—	—	—
bank loans	0.70	1.07	0.16	0.84	1.38
Opec Countries	9.00	7.94	1.26	0.61	1.39
of which: external bonds	0.54	0.42	0.10	0.14	0.05
bank loans	8.46	7.52	1.16	0.47	1.34
Other Developing Countries	37.23	27.60	9.12	7.57	3.38
of which: external bonds	3.61	2.21	0.66	0.44	0.68
bank loans	33.62	25.39	8.46	7.14	2.70
Other[2]	10.18	9.62	2.56	2.21	2.67
of which: external bonds	7.75	7.49	2.06	1.63	2.17
bank loans	2.43	2.13	0.49	0.58	0.50
Total	178.93	157.83	71.87	41.79	52.91
of which: external bonds	75.53	77.15	27.04	22.54	25.50
bank loans	103.40	80.68	44.82	19.26	27.41

Source: OECD
1. Includes international organisations based in Europe.
2. Includes international development institutions.

Financial Markets

Market activity increases although international debt concerns remain

Activity on international financial markets appears to have recovered during 1984 from the historically low levels reached in 1983. Recent months have witnessed a significant upturn in new borrowing volumes in spite of sharp interest rate fluctuations and unsettled conditions on foreign exchange markets. Although concerns remain about the longer-term prospects for international debt, a more optimistic mood appears to have developed as a result of the progress achieved in debt rescheduling and signs of further improvements in the economic situation of a number of heavily indebted developing nations. As table 5 shows, total funds raised on international markets during the first nine months of 1984 reached US$167 billion, compared with US$158 billion for the whole of 1983 and US$179 billion for 1982. The expansion of international bank credit that was recorded in the latter part of 1983 and in early 1984 continued (although at a slightly slower rate) in the second and third quarters of 1984, with new bank lending during the nine months to September totalling US$91 billion, compared with US$81 billion for the whole of 1983. In addition, fund raising activity on external bond markets improved significantly over 1984.

Overall, the recovery of activity in international financial markets has largely favoured corporate and sovereign borrowers of proven quality and with impeccable debt-servicing records. Furthermore, the acceleration of bank credit growth that occurred in 1984, to a large extent, reflected a pick-up in lending to borrowers in industrialised countries. In contrast, lending to developing countries continued to grow at a decelerating pace in 1984, reflecting both the virtual cessation of non-managed lending (that is, lending which does not form part of IMF backed financing and debt rescheduling packages) to Latin America and a number of other developing countries and lower borrowing requirements of several middle Eastern and Asian countries in response to improved current account balances and strong domestic adjustment measures.

Conclusion

A major feature of the current recovery has been the relatively low rates of inflation that have been experienced throughout its duration. Earlier upturns in economic activity have often been propelled by demand side factors and terminated by increasing inflationary pressures. However, the current recovery has been stimulated largely by supply side factors. In particular, deregulation, (especially within the financial sector) and the establishment of more appropriate macroeconomic policies, have greatly assisted in creating an economic environment which is more conducive to productive activities. In addition, there has been an improvement in the flexibility of markets and the responsiveness of economies. These factors have accommodated an increase in investment. Consequently, productive capacity has been able to expand during the recovery and this has helped reduce inflationary pressures.

The likely path of economic activity over the next year or two is not yet clear and is likely to be significantly influenced by developments in the United States' economy, on which there are two extreme views. The more optimistic view, suggests that the relatively high United States' interest rates and the associated foreign capital inflow into the United States are consistent with underlying developments in the economy and are therefore sustainable. According to this view the United States' economy is unlikely to weaken and thus pose a threat to the world economic recovery. The alternative view is that United States' interest rates are the result of stresses within the financial sector which are associated with the large United States' budget deficit. According to this interpretation, adverse financial market development could occur which would impede the ability of the

United States to maintain its current demand for imports. This development could significantly hamper export growth and therefore may represent a threat to the durability of the recovery.

The implications for New Zealand of these developments will be affected by the significant changes in policy which have occurred recently, as well as by conditions in specific foreign markets. The projected deceleration in growth rates in world economies over the next 18 months is likely to have a restraining influence on the New Zealand economy in 1984/85 and 1985/86. In addition, the OECD expects the recent policy changes to have a further dampening influence on the economy in the short-term. These policy changes have been directed towards a reduction in the degree of state intervention both in the domestic economy and in external trade, and the establishment of greater fiscal and monetary control. The policy changes may be expected to impose some short-term adjustment costs but should ultimately result in a more efficient and flexible economy which will be able to adapt to conditions in world markets. Consequently specific market factors will become less important in terms of their effect on the level of domestic economic activity.