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ECONOMIC TRENDS

The World Economy in Summer 1978

In its quarterly publication "Weltkonjunkturdienst" the Department on Business Cycles and Statistics of HWWA-Institut für Wirtschaftsforschung-Hamburg reports i.a. on the world business trend, economic activity in the most important industrial countries, the external economic relations of the Federal Republic of Germany and the development of world trade. The following contribution represents an excerpt from the findings of the latest issue which was published in mid-July.

During the first half of 1978, in Western industrial countries demand and production have risen distinctly. This applies particularly to the United States, though the upward trend during the first months of the year was distorted by strikes and adverse weather conditions, and to Japan. But in Western Europe, as well, expansionary forces prevailed, albeit here the pattern rather differed between individual countries. Especially in the smaller economies production was very slack. Though economic activity was brisker in industrial countries on the whole, the speed of expansion, apart from the United States, was insufficient for reducing the high rate of unemployment.

Therefore, the solution of the severe employment problems will require accelerated expansion of demand and production in industrial countries. This is nowhere in sight. On the contrary, in some countries expansionary forces are even likely to slacken. In the United States, above all, the accelerated rise in prices has forced monetary and fiscal policy makers to apply more stabilizing measures so that expansion is likely to decelerate noticeably towards the end of the year. In Japan, on the other hand, exports being impeded by the sharp soaring of the Yen and by protectionist measures including "voluntary" restraint are likely to

make themselves felt as a brake on the upswing which can only partly be compensated by internal stimulating measures. In Western Europe the economic situation is unstable since the moderate expansion, in spite of progress being made in stabilization, is still prejudiced by considerable inflationary and balance of payments problems in major countries. Total real gross national product of industrial countries is expected to rise by about 3.5% on the average in 1978, which is as much as in 1977, but with the underlying current rate being slightly higher than last year. Real world trade should expand by about 4%.

National Product and Prices

(Change over preceding year in %)

	Gross National Product (in constant prices)					Consumer Prices				
	1965-74 ^a	1975	1976	1977	1978 ^b	1965-74 ^a	1975	1976	1977	1978 ^b
USA	- 3.1	- 1.3	6.0	4.9	4.0	5.1	9.1	5.8	6.5	7.0
Canada	5.1	1.1	4.9	2.6	3.5	5.0	10.8	7.5	8.0	8.5
Japan	9.1	2.5	6.0	5.1	5.5	8.1	11.8	9.3	8.1	4.0
West Europe ¹	4.4	- 1.5	4.2	2.1	2.5	5.8	12.8	10.5	10.7	8.5
Belgium	4.8	- 2.0	3.0	2.5	2.5	5.2	12.8	9.2	7.1	4.5
Federal Republic	4.0	- 2.5	5.7	2.4	2.5	4.2	6.0	4.5	3.9	3.0
Denmark	3.7	- 1.1	5.3	1.5	1.5	7.6	9.6	9.0	11.2	9.5
Finland	5.1	0.9	0.3	- 0.8	1.5	7.3	17.9	14.4	12.6	11.0
France	5.1	0.1	5.2	3.0	3.0	6.0	11.7	9.6	9.5	9.5
Great Britain	2.5	- 1.7	2.3	0.8	2.5	7.1	24.2	16.5	15.9	10.0
Italy	5.0	- 3.7	5.7	1.7	1.5	6.0	17.0	16.8	18.4	12.5
Netherlands	5.2	- 1.2	4.6	2.5	2.5	6.3	10.2	8.8	6.7	4.5
Norway	4.7	4.2	5.8	3.9	3.5	6.1	11.7	9.1	9.1	8.5
Austria	5.2	- 2.0	5.2	3.5	1.5	4.9	8.4	7.3	5.5	4.0
Sweden	3.4	0.9	1.5	- 2.5	0.5	5.8	9.8	10.3	11.1	11.0
Switzerland	3.6	- 7.7	- 1.3	4.3	2.0	5.4	6.7	1.7	1.3	1.0
Spain	6.6	0.7	2.1	2.4	1.0	7.6	16.9	17.7	24.4	17.0
Total ¹	4.5	- 0.8	5.2	3.6	3.5	5.8	11.0	8.3	8.5	7.0
Total ²	4.6	- 1.5	4.0	2.5	2.5	6.0	12.3	10.0	9.7	7.5

^a Average annual change. — ^b Forecast; rounded to 0.5 percentage points. — ¹ Weighted according to Gross National Product or private consumption, respectively, in 1975; aggregate of all countries specified. — ² Weighted according to shares in German exports in 1975. — Source: OECD, EC, national data, own estimates.

ECONOMIC TRENDS

Thus, about three years after the recovery from the deepest worldwide postwar depression started, a genuine upswing supported by private investment is not yet in sight in industrial countries. On inquiring into the causes one mainly hears the argument of altered economic and social structures in industrial countries. Are, by any chance, external factors to be blamed such as the deterioration of the terms of trade after the oil price explosion of 1973/74? Or do we have to see the reason in the emerging of claims for income shares by social groups which are incompatible with the restoration of economic dynamics? Should the dilemma just have arisen from faults in economic policies? When looking closer at these — and other — influences one must become suspicious of any one-sided explanation. Certainly, the tenacious inflationary and balance of payments problems which have obstructed a general upswing in industrial countries for so long resulted from combined effects of all these reasons. Whatever these reasons, the decisive factor is that confidence in the dynamics of economic growth in the Western world and notably in the effi-

ciency of macro-economic policies has obviously been seriously shaken.

Those again demanding internationally concerted expansionary measures in this situation frequently seem to over-estimate progress achieved in restoring adequate economic prerequisites. It is true that Japan, the Federal Republic of Germany, Austria, the Netherlands, and Switzerland, have managed to bring down their rates of inflation to or even below the level of the sixties. However, in all these countries exports play a crucial part in business trends. Thus, aside from sub-

stantial appreciation in real terms of currencies in some of them, the risks of the remaining inflationary and balance of payments problems in major trading partner countries, notably in the United States, are still preventing sufficient confidence in favourable business conditions from re-emerging. Trying to compensate these inhibitions for the short term by dosing stimulatives to domestic demand the more strongly would certainly amount to staking one's own success in stabilization and, thus, be self-defeating. This also hints once more to the limits of the "convoy" theory.

World Trade Growing Slightly Faster

During the second half of 1977 the tendencies towards a recovery of world trade were apparently much weaker than indicated by the first estimates, but now the data available for the first months of the year 1978 point to slightly faster expansion of international goods exchange. As compared with the preceding year, the foreign trade turnovers of the Western countries increased by about 10% in terms of US dollar; this expansion rate was slightly higher than that of

the preceding quarter. On a dollar basis the average foreign trade values probably continued to be about 7% higher than in the corresponding period of the preceding year. This reflects primarily the depreciation of the dollar, while the average values in terms of the domestic currencies have on the whole grown only slightly. Accordingly during the first three months the world trade should have been about 3% higher in real terms than one year ago.

World Trade ¹

(Change over preceding year in %)

	1975	1976	1977	1976 4. qu.	1977				1978 1. qu. ^a
					1. qu.	2. qu.	3. qu.	4. qu.	
Imports									
World total ²	- 3.8	12.6	2.1	11.7	7.4	4.2	0	- 2.0	3
Industrial countries	- 7.7	14.2	4.4	13.2	9.2	5.8	2.2	0	
North America	- 9.5	16.9	9.0	13.4	14.8	11.6	5.5	5.3	
West Europe	- 4.8	13.3	2.9	14.0	7.6	4.4	1.5	- 2.0	
EC	- 4.8	15.8	2.2	12.9	8.2	2.8	- 0.8	- 2.7	
Japan	- 14.1	11.5	3.1	10.1	9.5	4.4	- 2.1	2.9	
Developing countries ³	10.2	11.3	- 3.6	5.8	- 0.6	- 2.4	- 6.0	- 7.2	
Exports									
World total ²	- 3.6	10.6	4.1	11.3	6.5	4.0	4.2	1.3	3
Industrial countries	- 4.3	11.2	4.7	9.0	7.1	4.6	4.2	3.2	
North America	- 2.2	5.3	2.9	2.8	6.0	2.7	3.0	0.7	
West Europe	- 6.4	11.4	5.4	10.5	7.8	5.4	5.0	3.2	
EC	- 6.3	11.2	5.4	10.3	6.9	6.0	4.2	2.5	
Japan	1.9	22.6	4.7	12.4	5.1	3.1	5.5	5.8	
Developing countries ³	- 4.0	13.2	0.7	22.2	6.5	2.2	3.7	- 7.8	

¹ Foreign trade turnovers adjusted for price and exchange rate variations; basis 1970. — ² Without state trading countries. — ³ Including OPEC. — ^a Partly own estimate. — Source: UN, Monthly Bulletin of Statistics.

The slight increase in international trade is obviously traceable to the more expansionary economic trend in the industrial countries. Their aggregate trade deficit has again grown after the turn of the year. Nevertheless during the first quarter of 1978 it was still substantially lower than one year ago. This reflects the downward trend during the second half of 1977 when the industrial countries' demand was slack and, in addition, the terms of trade underwent marked changes in favour of the industrial countries. Particularly remarkable was the reduction of the minus amounts of the West European deficit countries with the exception of Denmark. As against this, the US trade deficit continued to grow. Similarly problematical, though with plus and minus signs reversed, was the further expansion of the Japanese surplus which is primarily due to the shift of the terms of trade in favour of Japan. Against this, the OPEC countries' surpluses showed a heavy decline. The tendency towards a reduction of the other developing countries' deficits which prevailed in 1977 is unlikely to have continued.

**4 % Increase
Anticipated for 1978**

The present upward movement of demand and production

in the industrialized countries justifies the expectation that the stimulating tendencies in world trade will not be confined to the first months of the year. The OPEC countries' imports should still increase more quickly than those of the industrialized states although the pace will probably slow down noticeably due to the subdued development of the export proceeds for mineral oil. A low rise in imports, if any, of the state trading countries is to be anticipated even after the advanced reduction of the deficits in their current accounts. These countries will certainly endeavour to limitating narrowly their indebtedness to western nations.

Most difficult is a forecast of imports for non-oil-exporting developing countries. The external consolidation course apparently dominating with them last year has been reflected in a reduction of the high current account deficits and a lasting rise in their currency reserves. This success indicates that now more allowance will be made for the still urgent import demand. On the other hand, the terms of trade, also in connection with exchange rate fluctuations, just around the turn of the year have shifted considerably to the disadvantage of raw material producing countries, and a retrograde movement is not in sight. This indicates an only

suspended import increase in developing countries. Altogether it may be a realistic assumption that during 1978 world trade adjusted for price will expand at a current rate of 5 to 6%. On an annual average, however, this implies a growth rate of hardly more than 4% vis-à-vis 1977 (after more than 3% in 1977), since at the beginning of the year the initial level was comparatively low due to the unfavourable development in the preceding year.

**Moderate Expansion
of German Exports**

While economic activity in industrial countries was increasing after the turn of the year, foreign demand for German goods at first slowed down markedly; this seems to be mainly a reaction to the strong rise in late 1977. The decrease of exports in real terms during the first quarter of the year, anyway, was much less accentuated. In the further course of the year exports should rise again. The rate of expansion, though, will be but moderate since the sharp appreciation of the D-mark should gradually make itself felt as a brake to exports. In total, exports in real terms this year will presumably be about 4% higher than in 1977. Real imports should increase by 6% on an annual average.

Index Numbers of World Market Prices of Foodstuffs and Industrial Raw Materials

Index and commodity group	1977			1978			
	June	September	December	March	June	June 30	July 14
HWWA-Index * (1952-1956 = 100)	320.1	306.2	314.9	315.3	314.8	313.1	310.7
Fuels	281.7	246.8	265.3	256.3	249.3	245.1	230.5
Raw materials for consumer goods ..	338.6	334.9	338.8	343.7	346.4	345.9	349.3
Fuels	543.9	549.9	554.1	563.4	557.0	557.2	557.4
Raw materials for consumer goods ..	201.3	179.5	178.6	184.1	187.1	186.7	191.5
Raw materials for capital goods	225.3	224.1	231.1	231.2	242.8	241.4	247.2
Reuter's Index (18. 9. 1931 = 100)	1,601.3	1,499.5	1,443.5	1,400.2	1,503.2	1,471.2	1,443.1
Moody's Index (31. 12. 1931 = 100)	890.7	830.9	874.2	901.7	922.9	916.9	913.7

* Index compiled by HWWA-Institut für Wirtschaftsforschung-Hamburg. On Dollar-basis.