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World Economic Trend Still Weak

by Günter Großer, Günter Weinert, Hamburg*

The world-wide economic recession, which began as a result of the second explosive rise in oil prices in the spring of 1980, lasted throughout the whole of last year. Unemployment in industrialised countries has shot up at an alarming pace, whereas only limited progress was registered in the fight against inflation. Will these problems be further aggravated in 1982, or can we expect a turn for the better?

In 1981 the world economy experienced a year of disappointment. It is true that, contrary to numerous forecasts, the combined gross national product of the industrialised countries for the whole year was in fact slightly up on the figure for 1980; however, the expected transition to an economic uptrend was missing. On the contrary, the USA recently drifted into a proper recession, and Western Europe was still plagued by stagnation; only Japan witnessed a further increase in production, although even here there was a falling off in utilization of productive capacity last year.

Following a substantial increase during the course of the past year, unemployment in a number of countries has reached its highest level for over three decades. The latest unemployment figures reveal that in Belgium already 10 %, and in the United Kingdom more than 11 % of the labour force are out of work; figures for France, Italy, Denmark, the Netherlands and the USA were only slightly lower, ranging from 8-9 %, and in West Germany the 6 % mark will soon be reached.

The continuing weakness of the economy and the decline in employment amongst the industrialised countries were primarily the result of weak domestic demand; exports again expanded, in particular due to the rapid increase in demand from oil-exporting countries. Weak domestic demand was not so much a direct reflection of losses in real income induced by oil price increases, as had been the case in the previous year, but rather more a result of economic policy restrictions. In spite of attempts at consolidation, fiscal policy hardly contributed to this development. Restrictive effects were mainly created by monetary policy, which made efforts to check the considerable upsurge in prices wherever possible.

The monetary course pursued by the USA was of prime importance in this generally restrictive line of action. The slow expansion of money supply, which was even kept below the target funnel, led to a marked increase in interest rates. As, at the same time, the

current account registered a substantial surplus, and the so-called Reagan bonus was making itself felt in the assessment of American economic policy for quite some time, the dollar rate on the international foreign exchange markets rose steeply until late summer last year. Consequently, the central banks of all the other industrialised countries, too, kept a tight rein on money supply, allowing interest rates to reach a level which under domestic aspects alone frequently had to be regarded as excessive.

The external orientation by monetary policy resulted from attempts to keep depreciation against the dollar and the associated rise in import prices within limits, thus protecting the policy of stabilisation, which had been introduced at the beginning of the oil-price upsurge in 1979, against possible set-backs. It was not so much directed at increases in the price of imports from the USA; these imports make up only a relatively small percentage of Western Europe's total imports. The most important factor was that an appreciation of the dollar would have led to a rise in the costs of raw materials imports, especially oil, as these products are invoiced mainly in American currency.

The rise in interest rates in industrialised countries outside the USA only served to make depreciation against the dollar less severe; it could not, however, prevent it altogether, the more so as the strength of the dollar was not only traceable to interest rates. Oil, whose world market prices remained more or less constant during last year following a renewed increase at the start, as well as the other raw materials, whose prices in dollar terms were in fact mostly going down in 1981, have become noticeably more expensive, particularly for Western European countries. This was the main reason why the slowing-down of prices in Western Europe which was expected last year did not, as opposed to the USA and Japan, materialise. The fall of the dollar on the international foreign exchange markets in autumn last year induced a certain degree of "easing off"; the increases in costs, however, experienced by

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firms in conjunction with the previous appreciation of the dollar, could probably so far only be partly passed on.

The external price-increase impulses hampered a slowdown in wage increases, particularly in countries in which wages are formally or in practice linked to price development. However, when compared to the unfavourable development in productivity, these increases also proved too massive in other countries. The rise in unit labour costs, import prices and interest rates, on the one hand, and the limited possibilities for passing on costs, on the other, were reflected in a further marked reduction in profits. Persistent inflation is obviously a sign of unsolved distributional conflicts, which particularly underlines that the readjustment of internal distributive relationships following the boost in oil prices in 1979 and 1980 has as yet not nearly been successfully completed.

Turnabout in Current Accounts

In contrast, the development of the industrialised countries' current accounts seems to indicate considerable progress regarding external readjustment; the combined deficit for 1981, which is estimated at about \$ 35 billion, is almost half the previous year's figure. This, however, is only partly due to the substantial increase in exports to the oil-exporting countries, i. e. due to any real transfer; to a large extent it is due to cyclically-induced reductions of imports in industrialised countries, which also significantly contributed to the heavy drop in the amount of oil imported. In addition, the improving trend is to be found in only a few countries, namely Japan, West Germany, the Netherlands and Switzerland. In a number of other countries, such as Italy and France, the deficits were hardly any lower in 1981 than in 1980, despite the drop in imports.

Undoubtedly the most powerful "swing" was recorded by the Japanese current account; following a deficit of almost \$ 11 billion, last year saw a surplus of about \$ 6 billion. This turnabout was obviously a sign of an extensive process of readjustment. Apparently, Japan had already introduced process and product innovations after the first upsurge in oil prices. This was complemented by a depreciation of the yen, which in spite of intensifying the price increases did not induce an acceleration of wage increases. The latter fact boosted international competitiveness and improved the enterprises' profit situation. The successes achieved via the internal readjustment policies also strengthened the yen's position on the foreign exchange markets in 1980, enabling Japan to largely elude the pull of high interest rates in the USA. Since in 1981 Japan remained

unaffected by any noticeable depreciation-induced deterioration in the terms of trade, since exports surged and imports fell, a vast improvement occurred in its current account. The substantial surpluses in trade with Western Europe and the USA, however, paved the way for increased trade conflicts.

Improved Framework

The fact that the development in the industrialised countries was, at the start of 1982, still overshadowed by the signs of a marked economic recession, which began two years ago, emphasizes the big difference to the cyclical pattern witnessed during the fifties and sixties, and to the course of events following the first upsurge in oil prices in 1973. The initial decline in demand and production was, admittedly, less pronounced this time; this is probably due, amongst other things, to the fact that the shock was not as great this time, and the rise in oil prices was spread out over a longer period. The longer the recession lasts, however, the more the adverse effects upon the development of the utilisation of capacity and upon employment resemble those registered during the mid-seventies, and this with a more unfavourable initial position at the start of the recession. The question must therefore be all the more emphatically raised as to whether the general economic conditions in industrialised countries will soon again be more conducive to growth and whether an economic upturn may be expected.

As regards external factors, it is interesting to note that at the start of the new year no oil-price increases are expected for the immediate future, this being the case for the first time in several years; in fact, during the OPEC conference in December slight nominal reductions were agreed upon. Therefore, everything points towards a real decrease in oil prices during 1982, i. e. they will drop substantially in comparison to the world market prices for industrial products. Continued energy conservation and oil substitution, the increase in oil production outside of the OPEC area, the attempts, especially by Iraq and Iran, to increase oil exports, and the interest shown by Saudi Arabia, by far the most important oil exporter, in a "breather" for the oil-importing countries would all suggest that supplies on the international oil market will remain plentiful in the immediate future. If this proves to be the case, the terms of trade will probably shift again in favour of the industrialised countries, even if, as may be expected, the prices of raw materials other than oil may become moderately more expensive during 1982. The positive impulses to income induced by the trend reversal in the industrialised countries' terms of trade will, however, be

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accompanied by a slowdown in the increase of exports to many of the oil-exporting countries, whose foreign exchange earnings were already heavily decreasing last year due to the steep downward trend in oil sales.

Easing of Monetary Restrictions

Against this external background, an economic recovery depends on stimulating domestic demand in the industrialised countries. An indispensable prerequisite would be that the trend reversal exhibited by interest and exchange rates last autumn mark the beginning of a progressive easing of monetary restrictions. Due to the USA's international significance, events there will once more be decisive. The fall in the dollar is due to a number of reasons, such as the disenchantment regarding the chances of success for President Reagan's economic policies, the deterioration in the American current account prospects, and the fall in interest rates due to a recessionary decline in the demand for credit. In addition, maintaining the planned targets for the money supply would mean boosting monetary expansion, and with increasing under-utilisation of production capacity and diminishing inflationary expectations this would be something the Federal Reserve Board would probably endeavour to achieve.

For the other industrialised countries prospects are looking good for a further reduction in the external influences which necessitated monetary restrictions. The ensuing room to manoeuvre has since last autumn been especially used to revalue against the dollar, so as to combat increased import prices and curb inflation. In some cases there are already signs of success in such attempts. This could speed up a certain relaxation of monetary restrictions in industrialised countries as well as lead to an increased trend towards lowering interest rates.

The monetary relaxation will not increase the scope for fiscal policy measures in industrialised countries. On the contrary, a growing number of governments have come round to the opinion that promising steps towards restraining the increase in government deficits are essential to check inflationary expectations and bring down the level of interest. On the other hand, the lasting economic recession works in favour of further increases in deficits. Therefore, in 1982, governments in industrialised countries will have to walk the tightrope between consolidating government spending as a means of enhancing confidence on the one hand, and the strengthening of recessionary forces by governmental restrictions on demand, on the other. Major stimulatory programmes are not to be expected in

Economic Indicators

	Real Gross National Product (Year-on-year change in %)				Consumer Prices (Year-on-year change in %)				Exchange Rates ¹ (Change over 12 mths in %)		Unemployment Rate ²	
	1971-79 ^a	1980	1981 ^b	1982 ^b	1971-79 ^a	1980	1981 ^c	1982 ^c	Dec. 1980	Dec. 1981	1980	1981 ^d
USA	3.2	-0.2	2.0	0.0	7.2	13.5	10.5	8.5	1.6	8.9	7.1	8.9
Canada	4.4	0.0	3.0	0.0	7.8	10.1	12.5	10.5	-2.2	3.8	7.5	8.2
Japan	5.4	4.2	3.5	4.0	9.1	8.0	5.0	4.0	17.9	1.1	2.0	2.3
Western Europe ³	3.1	1.5	-0.5	1.1	9.3	12.1	11.3	10.0	.	.	5.9	8.2
Austria	3.9	3.1	0.0	1.5	6.3	6.4	7.0	6.0	-1.0	2.2	1.7	2.5
Belgium	3.2	1.9	-0.5	1.0	7.4	6.6	7.6	7.5	-2.7	-2.8	7.9	10.0
Denmark	2.9	-0.2	-0.5	1.0	9.6	12.3	11.5	9.5	-5.8	-3.0	6.2	8.2
Finland	3.3	4.9	1.5	1.0	11.1	11.6	12.0	9.5	2.1	4.4	4.9	5.9
France	3.9	1.4	0.0	2.5	9.2	13.5	13.5	13.5	-2.8	-6.9	6.4	8.1
FR Germany	2.9	1.8	-0.5	1.0	5.1	5.5	5.9	5.0	-4.8	2.4	3.4	5.9
Great Britain	2.2	-2.1	-2.5	1.0	13.2	18.0	12.0	10.0	16.0	-7.1	6.3	10.6
Ireland	3.9	0.9	1.5	2.0	13.2	18.2	20.0	18.0	-11.0	-0.8	8.3	10.9
Italy	3.0	4.0	-1.0	-0.5	13.2	21.2	19.5	17.0	-5.4	-10.5	7.6	8.9
Netherlands	3.1	1.0	-1.0	1.0	7.4	6.5	7.0	6.0	-2.2	1.3	4.8	8.1
Norway	4.4	3.8	1.0	1.0	8.1	10.9	14.0	11.0	-0.1	5.6	1.2	1.5
Spain	4.1	1.7	1.5	2.0	15.2	15.4	14.5	12.5	-9.9	-5.6	10.0	12.5
Sweden	2.0	1.4	-1.0	1.0	8.7	13.7	12.5	11.0	0.8	-8.2	2.0	3.2
Switzerland	0.8	4.0	1.0	0.0	5.1	4.0	6.4	4.5	-2.5	15.3	0.2	0.2
OECD Countries Total ³	3.5	1.3	1.1	1.1	8.4	11.9	10.1	8.6	.	.	5.6	7.4

¹ External value of currencies weighted by share in international trade 1979. ² In % of total number at or available for work

³ Total of listed countries weighted by real gross national product, private consumption and numbers available for work in 1977 respectively.

^a Average year-on-year change. ^b Estimated or forecast; figures rounded to nearest 0.5 %. ^c Partly estimated and rounded to nearest 0.5 %. ^d Last available month; adjusted for seasonal variation.

such a situation, if only because some countries fear the repercussions on the exchange rate. Even France is expected to carry out a less expansionary fiscal policy than in the previous year.

The extent of cuts in interest rates in industrialised countries will depend on how much the hitherto very persistent inflationary expectations can be reduced. The preconditions for moves towards greater stability have now also improved in Western European countries; oil and raw materials imports have even become cheaper since last autumn due to the fall in the dollar rates. There are also certain indications that wage increases are losing momentum, probably not least a result of the strained labour market situation. It is therefore to be expected that stabilising measures will be rewarded by greater success than was previously the case and that the upward trend in costs and prices will be abated for most economies during 1982. A recovery in business profits will be encouraged by the fact that at the same time the tendency towards a shift in the terms of trade in favour of the industrialised countries will somewhat increase the scope for domestic redistribution.

Improvement in the Course of 1982

On the whole, there are many indications that the reversal in interest and exchange rate trends in the late summer of last year marked the beginning of a process of economic relaxation in the industrialised countries which may be expected to continue, though at a slow pace, in 1982. For a while, however, consumer and investor demand will still be dampened by the restrictive factors which have up to now been determining the economic trend; the recession in the USA and the virtual stagnation in Western Europe will therefore continue for the time being. A certain amelioration can be expected during the second half of 1982, with investors reacting to the decline of interest rates and with stockbuilding being

adjusted to the more favourable sales prospects. Overall demand and production, however, will probably be slow to improve since the economic trend will continue to be adversely affected by serious problems of readjustment and stabilisation.

The aggregate gross national product of the industrialised countries will, according to this forecast, increase by only about 1 % for the third year running, expansion speeding up during the course of the year. Unemployment will continue growing in most countries for most of the year; an annual average of about 9 % unemployed is expected in Western Europe and North America. At the same time, the rise in consumer prices will slow down noticeably; nevertheless the rate of price increase in Western Europe during 1982 will still be about 10 % and approx. 8½ % in the industrialised countries as a whole (cf. table). World trade will reflect the sluggish economic trend in the industrialised countries and will at the most achieve a real increase of 3 % compared to the previous year.

Readjustment Problems

Even though world economic prospects are likely to become brighter in the course of 1982, it is still uncertain whether demand and production will reach a level capable of initiating an improvement in the utilisation of capacities and in employment in industrialised countries. It looks as if the "normal cyclical" influences will be superseded by the difficulties involved in the required readjustment of production and distribution structures; this explains also a great deal of the persistence of the inflation problem. Economic policies in industrialised countries are thus faced with a dilemma: the more they yield to the pressures, growing with unemployment, to grant would-be speedy relief, the greater the danger of upsetting medium-term processes of readjustment and thus delaying the setting-up of better growth and employment conditions.

HWWA Index of World Market Prices of Raw Materials¹
(1975 = 100)

Raw Materials and Groups of Materials	1980		1981				1982	
	AA ²	December	AA ²	October	November	December	Jan. 8	Jan. 22
Total index	226.0	236.9	240.7	237.1	242.3	242.1	240.0	239.8
Total, excl. energy raw materials	157.5	152.7	135.6	127.6	126.9	125.9	126.5	126.2
Food, tropical beverages	150.4	150.1	126.1	115.2	115.5	114.1	115.6	115.5
Industrial raw materials	162.9	154.7	142.7	137.0	135.6	134.8	134.9	134.3
Agricultural raw materials	164.3	164.8	146.4	135.5	135.4	134.2	136.1	134.8
Non-ferrous metals	185.5	164.7	156.3	152.5	150.4	151.8	148.5	149.7
Energy raw materials	265.9	286.0	302.1	301.1	309.6	309.9	306.2	306.1

¹On dollar basis. - ²Annual Average. For the method of computation of the HWWA Index cf. INTERECONOMICS No. 5, 1980, p. 261 ff.