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## The world economy in the summer of 1982

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expectations were to enhance the propensity to keep stocks, this impulse would be strengthened.

The slight improvement in the Western European economic framework since autumn last year is likely to support such a tendency. The slowing down of upward price and wage movements in a number of countries indicates that the distributional conflicts are dying down, a development favoured by the slight increase in the terms of trade. This has subdued inflationary expectations and supported a further reduction of interest rates despite the ups and downs of US interest rates. Greater progress is to be expected with regard to fighting inflation, since the effects of stabilisation policies, which most countries have been pursuing for three years, are not likely to be counteracted any more by depreciation effects against the dollar. It is assumed that a budgetary compromise will be pushed through in the USA, which will encourage declining interest rates there, effects spreading to Europe. Countries continuing efforts to combat the depreciation pressures exerted on their currencies by resorting to monetary measures will be left little scope for lowering interest rates. In the case of depreciation, on the other hand, which, considering the need for rectification would appear inevitable in some cases, a lasting success can only be achieved via a consistent stabilisation policy.

Considering the still high level of real interest rates and the delays with which any improvement of the economic framework takes place, a marked stimulation of demand by investors and consumers in Western Europe is not likely to occur during the remaining months of 1982. The declining trend in fixed investments will level off. Private consumption can be expected to continue stagnating. Stimuli to production are expected only from the stock-cyclical impulses. The expected slight increase during the course of the year means that the annual average real GNP in most Western European countries will, if at all, only be marginally up on 1981. At the same time, there are signs of a decline in the inflation rate for private consumption, from 11 % in 1981 to about 9½ % in 1982, levels varying considerably from one country to the next.

Even if production in Western Europe picks up during the second half of the year, unemployment is likely to further increase in most Western European countries. On average, 10 % of gainfully employable persons will probably soon be out of work. How explosive this issue will become depends on whether the general improvement of the economic trend expected for the second half of this year proves to be the start of a gradual recovery or just a transitional stock-cyclical reaction.

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## The World Economy in the Summer of 1982

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**D**uring the first half of 1982 the development of the world economy was persistently weak. The recession in the USA dragged on, and stagnation remained a dominant feature in other industrialised countries. There was a further general drop in capacity utilisation. At the last count, the USA and Western Europe registered an unemployment rate exceeding the 9 % mark. On the other hand, however, a number of major national economies were able to boast progress in curbing inflation. Apparently there was also a further decrease in the aggregate current account deficit of the industrialised countries. The reduction in both the

quantity and price of oil imports played an important part in this respect.

The long duration of the downswing, which began with a world-wide recession in early summer 1980, is a definite sign of the fact that the international economy is not just passing through one of the usual phases of cyclical weakness. We are dealing with a more fundamental crisis of stabilisation and adjustment. Basic misdevelopments had already appeared on the scene by the end of the sixties, as indicated by accelerating inflation in the industrialised countries. The oil price shocks of the seventies aggravated the

situation even more. It was obvious that the social and economic flexibility in the industrialised countries could not, at least not in the short run, cope with the necessary adjustments. The result was a marked weakening of demand and production. Economic policy was faced with the dilemma of, on the one hand, having to blaze a clear stabilisation trail and, on the other, of judging distributional adaptability correctly, so as to avoid additional friction. In case of doubt, monetary institutions in most of the industrialised countries have over the past few years opted for the stability objective. They feared that failing to curb inflation would lead to further delays in the inevitable adjustments and to detrimental effects also on the medium-term chances of growth.

Despite early efforts at stabilisation, the upward drift in prices and wages in the industrialised countries took until the end of the second recessionary year to tail off. One of the several reasons for this development has undoubtedly been the fact that the raising of oil prices dragged on from 1979 until early 1981. There was therefore a steady increase in distributional strains felt by oil-importing countries. Inflationary expectations were constantly refuelled. The development of economic policy in the USA was equally important. The alternating hot and cold monetary baths between spring 1980 and spring 1981 impeded the emergence of expectations of a lasting stabilisation. When economic policy finally adopted a clearly restrictive course oriented towards a quick reduction of inflation, it met upon a fiscal policy which threatened to lead to high government deficits well beyond the recessionary phase itself. The interest-rate-raising effects of such prospects have contributed to keeping the dollar rate at a high level and to impeding a world-wide drop in interest rates.

Against this background it is obvious that the decline in inflationary tendencies during the course of 1982 represents a substantial step in the direction of an improved framework for economic growth. This time it is not just a case of a price trend reversal on the international raw material and oil markets but the increase in wages, the most important internal cost factor, has also slowed down. Although this does not yet apply to the majority of industrialised countries, this has been the case for the USA and a number of other major countries, such as Japan, the Federal Republic of Germany and the United Kingdom. The slowing-down of the upward movement of prices and wages means that the narrow monetary framework has a less restrictive effect. Furthermore, there is a greater probability that the central banks in the USA and in other industrialised

countries will not push the monetary stabilisation course too far. The more clearly the slowing-down of the upward price movement reveals itself to be a reflection of a declining trend in internal cost and price developments, the more not only the nominal but also the – still extremely high – real interest rates will fall.

Although the downward movement of interest rates already began last autumn, starting in the USA, it has so far only progressed gradually, interrupted by set-backs. The high government deficits, reflecting both the cyclical influences and the hesitant adjustment of government expenditure to the bend in the growth path, were important factors in this development. These had an adverse effect on confidence in a continuing stabilisation and the restoration of more favourable conditions for growth. Of course, the situation varies from one country to the next. Due to the international repercussions via the capital and foreign exchange markets, however, the uncertainty in fiscal policy in the USA was of prime importance. Recent developments have improved prospects of a reasonable limitation of the budget deficit. As soon as there are more definite signs that this is the case, there is likely to be a renewed impetus towards bringing down interest rates in the USA. This will make itself felt also in the other industrialised countries.

The extent to which monetary relaxation is possible in individual national economies particularly depends on the respective successes in stabilisation and adjustment. Changes in exchange rates, such as the recent adjustment of central rates in the EMS, do not necessarily decrease existing differences. To begin with, the removal of accumulated disparities means a tendency towards more expensive imports for the devaluing countries and reduced import prices for the revaluing countries. As far as these external effects enter into inflationary expectations, the existing differential initially becomes even larger. The devaluing countries can only neutralize this mechanism if they place greater value on the stability objective – at least in comparison with other industrialised countries. This is a

**Production and World Trade**  
(Year-on-year change in %)

	1980	1981	1982
Real GNP			
Western Europe	1.4	-0.4	0.8
USA	-0.2	2.0	-1.0
Japan	4.2	2.9	2.0
Industrialised Countries, total	1.2	1.1	0.3
Real World Trade	1.5	-1.0	1.5

prerequisite for a real devaluation, which could then support the required adjustments.

Even a continued monetary relaxation in industrialised countries over the coming months will not have any great effect on the development of demand and production during 1982. Nevertheless, the slight improvement in growth conditions which has emerged in the most important national economies since last autumn, will favour demand stabilisation during the year. Supported by cyclical impulses, which result from the gradual running-out of stock reduction, there is even likely to be a slight increase in overall demand in industrialised countries during the second half of the year, even though there will be a drop in exports to oil-exporting countries. The only country likely to register a definite recovery will be the USA, resulting from the effects of a huge mid-year tax decrease. Whether this improvement will turn out to be the start of a lasting upward trend depends on whether continuing progress is made in the fields of stabilisation and adjustment; the chances are there, yet uncertainty still prevails.

Even allowing for the predicted stimulation during the second half of 1982, the real gross national product of the industrialised countries will only be marginally up on last year's figure. World trade will undergo a similar development. The latter is expected to expand during the second half of the year. Demand in industrialised countries will be subject to more stimulative – in particular, stock-cyclical – influences than contractive ones, the latter coming mainly from the oil-exporting countries. The volume of world trade for 1982 as a whole is only likely to be 1 or 2 % greater than last year. The effects of the drop in oil imports will be felt well into the current year; trade in industrial products will probably increase by about 3 % in real terms. The terms of trade are expected to shift further, for the time being, in favour of the industrialised countries. On the one hand, world

market prices for finished and semi-finished goods are likely to increase, though moderately; on the other, largely unchanged crude oil prices and a steady decline in prices for other raw materials are expected. The aggregate current account of the industrialised countries – varying considerably from country to country – will for 1982 as a whole probably cease to record a deficit. The surplus registered by the oil-exporting countries will dwindle substantially.

The reduction of the deficit on current account in the industrialised countries represents a considerable adjustment to the increase in the price of oil, brought about by a boost in exports to the oil-exporting countries and a noticeable reduction in required oil imports. The progress made so far, however, appears larger than it really is, due to the effects of the general weakness in demand. Since the updrift of prices and wages has in most cases just begun to slow down, there is no doubt that the road to a solution of the adjustment and stabilisation problems in the industrialised countries is a long and winding one, particularly in Western Europe. Even if the forecast of an improved trend towards the end of the year holds true, successes in economic policies geared towards improving growth conditions in the medium term, will take a while to materialise. Above all, the high and indeed growing level of unemployment will only start to fall if the economy experiences a lasting recovery. The longer the monetary and fiscal authorities of the major industrialised countries resist the temptation of going for short-term and dubious relief of the serious problems facing them (at the expense of longer-term solutions), the sooner such a situation will come about.

*Compiled by the Department of  
World Business Trends of the  
HWWA-Institut für Wirtschaftsforschung-Hamburg*

**HWWA Index of World Market Prices of Raw Materials<sup>1</sup>**  
(1975 = 100)

Raw Materials and Groups of Materials	1981		1982					
	AA <sup>2</sup>	June	March	April	May	June	June 25	July 9
Total index . . . . .	240.7	237.9	231.9	230.9	229.5	226.0	225.8	226.5
Total, excl. energy raw materials . . .	135.6	131.4	122.0	122.5	122.4	117.5	117.1	115.4
Food, tropical beverages . . . . .	126.1	118.6	111.9	110.0	107.1	104.7	104.2	104.8
Industrial raw materials . . . . .	142.7	141.1	129.7	131.9	134.0	127.2	127.0	123.6
Agricultural raw materials . . . . .	146.4	148.6	133.9	135.0	138.2	134.5	133.7	124.3
Non-ferrous metals . . . . .	156.3	152.5	139.3	137.3	137.8	123.6	125.4	129.2
Energy raw materials . . . . .	302.1	300.1	296.0	294.2	292.0	289.4	289.3	291.3

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