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## The world economy in summer 1986

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## The World Economy in Summer 1986

The drastic reduction in the price of the important production factor oil and the readjustment of distorted exchange rate relationships as a result of the fall in the dollar exchange rate have improved conditions for economic growth in the industrialised countries. Adjustment problems, however, initially led to uncertainty and apparently induced many businesses and private households to delay their decisions. This was particularly the case in Japan and in most Western European economies. During the first six months of 1986 the shift in cyclical stimuli from external to domestic demand was temporarily accompanied by a clear slowdown of the economic upswing. In the USA, too, both demand and output initially increased at no more than a modest pace. Although in many cases there was an – in the USA considerable – increase in the number of employed persons the level of unemployment remained high.

During recent years continuing stabilisation efforts had already managed to contain inflation to a

substantial degree. With the price of oil products falling drastically during recent months the increase in consumer prices even temporarily came to a standstill in many industrialised countries. The most recent year-on-year rise in prices averaged 2%. This varied considerably from one country to the next. Whereas prices in the Federal Republic of Germany were even lower than a year ago and in the Netherlands, Switzerland and Japan were hardly higher, the increase in Italy was over 6%. The imported stability resulting from the sharp fall in oil prices and – in the Western European countries and Japan – from the depreciation of the dollar, therefore, did not cover up the differences in the stability courses pursued by the individual countries' economic policies.

The sluggish economic trend on the one hand, and the successes in containing inflation on the other, encouraged economic policy authorities in the USA to continue the expansionary monetary policy they had been pursuing since the end of 1984. Since mid-1985

### National Product and Prices

(Year-on-Year Change in %)

	Gross National Product (at constant prices)						Consumer Prices					
	1974-82 <sup>a</sup>	1983	1984	1985	1986 <sup>b</sup>	1987 <sup>b</sup>	1974-82 <sup>a</sup>	1983	1984	1985	1986 <sup>b</sup>	1987 <sup>b</sup>
USA	1.6	3.4	6.6	2.2	2.5	3.5	8.1	3.2	4.3	3.5	2.0	4.0
Canada	2.3	3.3	5.0	4.5	3.5	3.0	9.3	5.9	4.3	4.0	3.5	3.5
Japan	3.8	3.2	5.1	4.6	3.0	3.5	8.3	1.9	2.2	2.1	0.5	1.0
Western Europe <sup>1</sup>	1.8	1.5	2.5	2.4	2.5	2.6	10.8	7.4	6.2	5.4	3.1	3.5
Belgium	1.8	0.4	1.3	1.5	2.0	2.0	7.6	7.7	6.3	4.9	1.5	2.0
FR Germany	1.7	1.5	3.0	2.4	2.75	2.75	4.6	3.3	2.4	2.2	0.5	2.0
Denmark	1.5	2.0	3.5	3.1	2.5	2.5	11.0	6.9	6.3	4.7	3.5	2.5
Finland	2.7	2.9	3.0	3.0	2.0	3.0	12.1	8.3	7.1	5.9	4.0	4.0
France	2.4	0.8	1.5	1.1	2.5	2.5	11.0	9.6	7.4	5.8	2.5	3.0
Great Britain	0.8	3.3	2.6	3.3	2.0	2.5	14.7	4.6	5.0	6.1	4.0	4.0
Italy	2.1	-0.2	2.8	2.3	2.5	3.0	17.2	14.6	10.8	9.2	6.0	6.0
Ireland	3.9	0.0	4.4	2.0	3.0	3.0	16.2	10.5	8.6	5.4	3.5	4.0
Netherlands	1.5	0.6	1.7	2.5	1.5	1.0	6.2	2.8	3.3	2.3	0.5	1.5
Norway	3.9	4.5	5.6	4.2	4.0	2.5	9.7	8.4	6.2	5.7	5.5	5.0
Austria	2.4	2.1	2.0	2.9	3.0	2.5	6.3	3.3	5.6	3.2	2.0	2.5
Sweden	1.4	2.2	4.0	2.4	2.5	2.0	10.3	8.9	8.0	7.4	5.0	4.5
Switzerland	0.3	0.7	2.1	4.0	3.0	2.5	3.7	3.0	3.0	3.4	1.0	2.0
Spain	2.0	2.1	2.3	2.1	3.0	3.5	16.8	12.1	11.3	8.8	8.0	6.0
Total <sup>1</sup>	2.0	2.6	4.7	2.7	2.7	3.1	9.2	4.7	4.7	4.1	2.3	3.4
Total <sup>2</sup>	1.8	1.5	2.7	2.4	2.4	2.4	10.1	6.9	6.2	5.2	2.8	3.3

<sup>a</sup> Average year-on-year change. <sup>b</sup> Forecast; figures rounded as a rule to nearest 0.5%.

<sup>1</sup> Total of listed countries weighted by real gross national product or private consumption 1982. <sup>2</sup> Weighted by shares of German exports 1982.

Source: OECD, EC, national statistics, own estimates.

many Western European countries and Japan have tended to pursue a similar course, with interest rate policies being occasionally coordinated between major countries. Worries that this might create a new inflationary potential will probably be pushed into the background for some time to come by the oil-price-induced stabilisation successes. However, later on this year, when the continuing upward price trend outside of the energy sector again becomes more noticeable, greater emphasis will probably be placed in the USA and in other countries on efforts to keep a tighter control on monetary growth.

Although interest rates have fallen considerably since the beginning of the year they are on the whole still relatively high. Long-term interest rates in industrialised countries recently were generally between 4 and 5 % in real terms (in relation to the development of the prices of domestic factors of production). The expansionary monetary policy was obviously also unable to offset the influences driving up interest rates. These include the considerable risks still facing the international financial system as well as, not least important, the continuing misallocation of capital associated with the still high budget deficits in many countries. A number of industrialised countries, among them the Federal Republic of Germany and Japan, have made considerable headway in their efforts to consolidate public finances. However, as a result of the continuingly high US deficit a great deal of capital will continue, beyond the borders of the USA, to be channelled into consumptive uses. It is still not clear whether the latest budgetary decisions mark the long awaited turning-point. On the whole, fiscal policies in the industrialised countries are unlikely to exert any great influence on demand in the near future.

Assuming that there are only slight changes in oil prices and exchange rates, it is to be expected that trends in the industrialised countries during the second

half of 1986 will be determined to an increasing extent by the stimuli to domestic demand which emanate from monetary impulses and the oil-price-induced jump in real incomes. Above all, private consumption will initially increase at an accelerated pace, but lower interest rates and improved sales and profits prospects will in many cases finally also lead to a more rapid increase in private investments in fixed assets. These stimuli will probably be more significant than the contractionary influences associated with the substantial reduction of imports by oil-exporting countries. In Western Europe and Japan, however, the deterioration in the competitive position vis-à-vis suppliers from the dollar area, induced by the development of exchange rates, will also tend to have a retardant effect, whereas this development will gradually provide stimuli for the USA. On the whole, real GNP in the industrialised countries can be expected to increase by between 2½ % and 3 % in 1986 and by a somewhat higher rate in 1987.

With an economic upswing which looks like moving into its fifth year in 1987, and considerable stabilisation successes, there has been a substantial improvement in the economic situation in the industrialised countries following stagnation and inflation at the beginning of the 1980's. There are no signs, however, of a fundamental reduction in unemployment. The obstacles to stronger growth and a more pronounced increase in employment will continue to be substantial as long as the high deficit in the USA makes capital scarce and expensive worldwide, regulations and inflexibilities considerably impair the dynamics of market forces in Western Europe and, finally, many developing countries are unable to effect economic policies which would re-establish their creditworthiness.

*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	1985		1986					
	AA <sup>2</sup>	June	March	April	May	June	27. 6.	18. 7.
Total index . . . . .	197.3	196.8	174.5 <sup>P</sup>	148.6 <sup>P</sup>	130.6 <sup>P</sup>	129.9 <sup>P</sup>	128.2 <sup>P</sup>	112.3 <sup>P</sup>
Total, excl. energy raw materials . . . . .	112.5	111.4	121.3	120.0	118.6	114.2	112.0	111.7
Food, tropical beverages . . . . .	106.9	105.9	119.1	115.7	112.4	103.1	99.3	102.5
Industrial raw materials . . . . .	116.8	115.6	123.0	123.3	123.4	122.6	121.7	118.8
Agricultural raw materials . . . . .	112.4	109.5	127.1	128.3	131.2	131.6	132.1	127.6
Non-ferrous metals . . . . .	131.5	133.0	128.8	128.7	125.8	124.8	120.8	119.9
Energy raw materials . . . . .	246.7	246.6	205.5 <sup>P</sup>	165.2 <sup>P</sup>	137.6 <sup>P</sup>	137.6 <sup>P</sup>	137.7 <sup>P</sup>	112.7 <sup>P</sup>

<sup>1</sup> On dollar basis. - <sup>2</sup> Annual Average. <sup>P</sup> Provisional (due to incomplete data on oil prices).