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Industrialized Countries: Medium-Term Economic Prospects [redacted]

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An Intelligence Assessment

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November 1982

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Industrialized Countries: Medium-Term Economic Prospects [redacted] 25X

An Intelligence Assessment

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Key Judgments

Information available as of 29 October 1982 was used in this report.

All OECD economies have been under serious economic strain in 1982, and although recovery is expected in 1983, it will be substantially weaker than previous postrecession upturns. Declining but still high real interest rates, stemming in large part from the combination of expanding budget deficits and restrictive monetary policies, are expected to remain a major obstacle to vigorous economic growth. The availability of substantial excess capacity will further discourage investment. Moreover, recent surveys indicate that consumers in many countries are not yet ready to increase their purchases of big-ticket items. [redacted] 25X

This year OECD *economic growth* will probably average 0.3 percent, about 1 percentage point less than in 1981; for the non-US OECD, real GNP growth is expected to rise from last year's 0.8 percent to 1.2 percent. For many industrial countries, particularly those in Western Europe, exports should help the recovery—but only moderately; in January-April 1982, the volume of OECD exports rose 1.8 percent from the same period in 1981. An end to the drag of inventory drawdowns is expected to aid the upturn in a number of cases. Final domestic demand probably will continue to be weak, with private and public consumption growing on average by just over 1 percent in the major industrial nations and fixed investment posting a small decline. Falling oil and other raw material prices, however, should help these economies. [redacted] 25X

The brightest spot on the economic scene is the downturn in inflation rates. For the OECD as a whole, consumer prices are expected to rise by 8.2 percent, the smallest annual increase since 1978. The improvement will not be uniform, and in some countries—such as France, Italy, and Spain—large budget deficits and further currency depreciation probably will sustain double-digit rates. [redacted] 25X

In addition, the OECD's *current account* deficit should decline dramatically because of the recent drops in prices of imported raw materials; the overall shortfall may dip below $10 billion—roughly one-third the combined 1981 deficit. Individual performances will vary substantially this year, with Japan and the United Kingdom running hefty surpluses, while the French current account deficit will deteriorate further to $7 billion. [redacted] 25X [redacted] 25X

Mounting *unemployment* is the most serious economic problem. By yearend 1982, total OECD unemployment could reach 29 million—about 15 percent above the 1981 level. In several countries, unemployment rates will remain well above 10 percent; British unemployment stood at 12.7 percent in September, and about 16 percent of the Spanish labor force is idle. [redacted] 25X1

New economic stimulus, however, would intensify already serious *budget* deficits. As matters now stand, *monetary policies* will probably ease only slightly this year as central banks try to contain the inflationary impact of budget deficits. In France, the government deficit will be over 3 percent of GNP this year, after averaging less than 1 percent in 1960-80. Deficits could exceed 10 percent of GNP in several countries, including Italy, Denmark, and Ireland. In most of these countries, high unemployment has boosted the cost of generous social welfare programs, while the recession has held down revenue growth. At the same time, high interest rates have increased debt service burdens. [redacted] 25X1

While *projections for 1983* are more tentative, we expect some improvement in OECD GNP growth, with the annual increase averaging almost 2.5 percent. Even this low rate of economic growth could be stymied for several reasons. Non-OPEC LDC debt problems may curtail import spending, while OPEC countries continue to curb imports due to the accumulated effect of slack oil demand. The outlook for next year assumes that nominal oil prices remain at roughly the 1982 level, that monetary and fiscal policies do not change significantly, and that exchange rate adjustments will be limited. Under this scenario, the OECD *current account* probably will remain in deficit, and *inflation* should slow to less than 8 percent. *Unemployment* would remain a serious problem, particularly in Western Europe. [redacted] 25X1

The strength of the US economy—which we assume will grow by 3 percent in 1983—remains a key to the shape of the economic recovery in the rest of the OECD. We estimate that a 1-percentage-point reduction in US GNP growth would lower GNP growth in the other OECD countries by 0.2 percentage point. If the US recovery is weaker than expected, non-US OECD growth would fall below the 2.1 percent now projected for 1983. [redacted] 25X1

[redacted]

Industrialized Countries: Medium-Term Economic Prospects [redacted]

[redacted]

Economic Conditions in 1981

Last year real GNP growth slowed to just 0.8 percent in the non-US OECD [1] countries, compared to 2.0 percent in 1980 [redacted] Factors in the slowdown included the 1979/80 rise in oil prices—compounded in many cases by a sharp currency depreciation against the US dollar—higher interest rates, and the restrictive fiscal policies of some governments. Three of the Big Six countries and five of the smaller OECD nations reported declines in real GNP. Even Japan—which had experienced a 4.2-percent gain in output in 1980—was affected by the worldwide slump, posting just a 2.9-percent increase in GNP. [redacted]

The United States and Canada bucked the trend with higher growth rates in 1981. The Canadian economy grew by 3 percent after virtually no growth in 1980, while the US economy posted a 2-percent gain following a decline in the preceding year. [redacted]

The growth slowdown resulted in a sharp increase in unemployment last year on top of already high unemployment rates. For the OECD as a whole, the number of unemployed jumped 15 percent in 1981, reaching an estimated 25 million people out of a total labor force of about 360 million. By the end of the year, unemployment had reached 8 percent or more in four of the Big Six countries; only Japan was able to keep unemployment low, holding it to about 2 percent. For some of the smaller OECD nations, jobless ranks swelled to more than 10 percent by yearend; Spain's unemployment rate, for instance, stood at nearly 15 percent. In Western Europe, the unemployment problem was intensified by the growing number of new job seekers. [redacted]

[1] In addition to the United States, the OECD includes 23 other countries: Austria, Belgium, Denmark, Finland, France, Greece, Iceland, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and West Germany in Western Europe; Canada in North America; and Japan, Australia, and New Zealand in the Pacific. The Big Seven countries, which are the seven largest economies in the OECD, are the United States, Japan, West Germany, France, the United Kingdom, Italy, and Canada; the Big Six consist of the Big Seven minus the United States. [redacted]

Last year's economic slowdown, however, did provide some benefits. OECD inflation slowed by more than 2 percentage points, to 10.3 percent [redacted] and the current account deficit narrowed by almost 60 percent to $29.4 billion. Among the Big Six, British inflation improved the most, falling from 18 percent in 1980 to just under 12 percent. For most of the smaller OECD countries, the inflation rate remained unchanged. Turkey, however, slashed its rate by more than one-half to less than 40 percent through tightfisted monetary and fiscal policies. Progress in bringing down the Turkish inflation rate continued to be evident in 1982. [redacted]

Improvements in current account balances varied widely [redacted] Aided by substantial export gains, Japan's current account position improved by $15 billion, to post a $5 billion surplus, and West Germany's deficit decreased by $9 billion. On the other hand, France's current account deficit remained unchanged while Canada's widened. [redacted]

Outlook for Growth in 1982 [2]

We expect some improvement in OECD economic growth in the second half of the year, following little if any growth in the first half. Industrial production continued to register declines in the Big Seven through the first six months of 1982. For all of this year, we project growth for the non-US OECD countries at 1.2 percent, with the smaller OECD economies expanding 0.6 percentage point faster than the average for the Big Six. Continued high interest rates and fiscal austerity measures adopted by some governments will hold back domestic demand. According to recent surveys in the European Community, West European consumers do not yet plan any significant increases in spending for big-ticket items. For the Big Six, the level of fixed investment is expected to decline by 0.6 percent. Growth of public consumption may slow in four of the Big Six. Although the French austerity program is designed to cut the government deficit, increased government consumption still will give a substantial lift to the economy. [redacted]

[2] Our economic projections for 1982 and 1983 are based primarily on judgments by CIA country analysts; we considered numerous private and public econometric forecasts in preparing our projections. CIA's Linked Policy Impact Model was used to assess the economic impact of slower-than-expected US GNP growth and of the French and Italian austerity programs announced in June and July, respectively. [redacted]

[redacted]

Exports will be a modest growth sector for many non-US OECD countries because the strength of the US dollar has greatly improved their competitive positions. The expected modest pickup in the US economy in the second half also should contribute to increased exports by the other OECD countries. Nevertheless, slow economic growth in major markets will keep exports from increasing very rapidly; we expect the volume of Big Six exports to rise 3.5 percent this year. An expected pickup in imports, moreover, will offset much of the improvement. As matters now stand, we estimate that OPEC imports will grow by 8 percent in volume this year, compared to 23 percent in 1981. Imports by nonoil LDCs are expected to register little, if any, growth in volume, and economic problems in the Soviet Bloc should lead to a decline in Communist imports from the West. 25

The Unemployment Problem

Unemployment will remain a serious problem in most OECD countries through this year and beyond (see table 4). The number of jobless in the Big Six countries is expected to average 11 million, about 14 percent higher than in 1981. The United Kingdom will continue to have the most serious unemployment problem; throughout 1982, joblessness will hover around 3 million, 12 percent of the labor force. Adult employment probably will stay roughly stable over the next few months, but unemployment among youth will continue to grow. 25

In France and Italy, the jobless rate should remain around 8 to 9 percent for most of 1982. West German unemployment is expected to average about 1.8 million, more than 6.5 percent of the labor force and by far the highest figure in three decades. Now running at 2.5 percent, the Japanese unemployment rate is the highest since 1968. We expect that Japan will continue holding the jobless rate below 3 percent. 25

Unemployment shows no signs of easing in the smaller OECD countries. For the year, the jobless ranks probably will average about 7.5 million, a 9-percent increase from last year. In Belgium, Ireland, the Netherlands, Spain, and Turkey, joblessness will run well above 10 percent. Swiss unemployment, on the other hand, will remain below 1 percent in large part because unemployed foreign workers are forced to return home. 25

Youth unemployment will remain a particularly serious problem, and we believe that it will get worse 25 before it gets better. Largely as a result of the "baby boomlet" of the late 1950s to mid-1960s, the working-age population of the European Community will grow at an annual average rate of 0.9 percent in 1981-85—increasing the total by 8 million—compared with just 0.5 percent a year in 1971-80. In Italy, three-fourths of the unemployed are between the ages of 14 and 29, and in the United Kingdom, about 40 percent of the

Table 4
Selected Countries: Unemployment

	Level (*million*)	Rate (*percent*)	Latest Month
Big Seven			
United States	10.6	10.1	September
Japan	1.4	2.4	July
West Germany	1.8	7.5	September
France	1.9	8.4	August
United Kingdom [a]	3.0	12.7	September
Italy	2.4	10.4	July
Canada	1.4	11.8	July
Smaller countries			
Australia	0.4	6.6	March
Austria	0.1	2.8	May
Belgium	0.5	14.2	September
Denmark	0.3	7.1	July
Netherlands	0.5	12.6	July
New Zealand	NEGL	2.1	May
Norway	0.1	2.6	June
Spain	2.1	15.8	June
Sweden	0.1	3.0	September

[a] Excluding school leavers.

[redacted]

unemployed are under age 24. In West Germany, however, apprenticeship programs have held youth unemployment slightly below the adult rate. [redacted]

Regional differences in unemployment rates grew markedly in 1979-81 and are widening further this year as traditional heavy industries continue to decline. In Belgium, for example, the difference between the joblessness rate in Brabant Province and Limbourg Province widened from 8 percentage points in 1979 to 12 percentage points in 1981. The unemployment rate in Limbourg, which is dependent on hard-hit coal mining, now stands at more than 20 percent. In the United Kingdom, the difference between unemployment rates in Greater London and the industrial West Midlands—which includes the heavy industrial center of Birmingham—widened sharply from 2 to 6 percentage points. The unemployment rate in the West Midlands now exceeds 14 percent.

On the other hand, the north-south difference in Italy narrowed during 1979-81, mainly because joblessness in the industrialized north began to approach the traditionally high unemployment rate in the less developed south. [redacted] 25X

Massive Budget Deficits

Large budget deficits will continue to be a serious problem this year for a number of OECD countries although most governments are attempting to curb budget growth (see table 5). The recovery in real output is not expected to be vigorous enough to keep unemployment insurance payments from rising or to give a strong push to tax collections. Budget deficits are further aggravated by high borrowing costs. [redacted] 25X

Little improvement in the budget is expected in West Germany, the United Kingdom, or Italy. In West Germany, the federal government expects its deficit to reach about 40 billion deutsche marks—more than last year's 38 billion and well beyond the original 1982 target of 26.5 billion. Continued slack economic growth and rising unemployment have worsened the budget outlook. In the *United Kingdom* the government is projecting public-sector borrowing at 10 billion pounds for this year. The actual deficit could be larger, particularly in light of London's past underestimation of outlays, the shakiness of the modest economic recovery being projected, and the additional spending stemming from the Falklands crisis. In *Italy* the Spadolini government projected a state-sector deficit of 65 trillion lire, equal to 13.8 percent of GNP. That projection probably is optimistic; in recent years, actual deficits have far exceeded projections. Moreover, the budget assumes that the Treasury will be able to enforce the new cash management rules imposed on local authorities and control their borrowing. [redacted] 25X

25X

25X

25X

France, which has been spending heavily to stimulate the economy, will record a substantially larger deficit than in 1981. Despite the spending cuts in the new

Table 5
Selected Countries:
Central Government Budgets

	1979	1980	1981	1982 [a]
Japan [b] *(trillion yen)*				
Revenues	25.7	29.1	34.2 [c]	39.2 [c]
Expenditures	39.7	43.7	50.1 [c]	54.6 [c]
Deficit	14.0	14.6	15.9 [c]	15.4 [c]
Share of GNP *(percent)*	6.4	6.2	6.4 [c]	6.1 [c]
West Germany [d] *(billion marks)*				
Revenues	177.5	188.1	195.8	206.7
Expenditures	203.4	215.7	233.8	246.6
Deficit	25.9	27.6	38.0	39.9
Share of GNP *(percent)*	1.9	1.8	2.4	2.5
France [d] *(billion francs)*				
Revenues	446.9	536.2	555.5	700.0
Expenditures	481.7	572.0	638.9	800.0
Deficit	34.8	35.8	83.4	100.0
Share of GNP *(percent)*	1.4	1.3	2.7	2.9
United Kingdom [d] *(billion pounds)*				
Revenues	56.5	71.8	84.6	95.0
Expenditures	66.9	83.0	94.7	105.0
Deficit	10.4	11.2	10.1	10.0
Share of GNP *(percent)*	5.4	5.0	4.0	3.6
Italy [d] *(trillion lire)*				
Revenues	64.0	99.3	121.2	150.0
Expenditures	94.1	135.3	170.7	215.0
Deficit	30.1	36.0	49.5	65.0
Share of GNP *(percent)*	11.1	10.6	12.4	13.8

	1979	1980	1981	1982 [a]
Canada [d] *(billion Canadian $)*				
Revenues	42.6	49.4	62.6	59.7
Expenditures	51.9	59.6	70.6	76.2
Deficit	9.3	10.2	8.0	16.5
Share of GNP *(percent)*	3.6	3.5	2.4	4.7
Beligum [d] *(billion francs)*				
Revenues	954.7	1,012.4	1,098.0	1,153.5
Expenditures	1,166.5	1,313.1	1,526.0	1,507.7
Deficit	211.8	300.7	428.0	354.2
Share of GNP *(percent)*	6.5	8.7	12.0	9.1
Netherlands [d] *(billion guilders)*				
Revenues	90.7	97.7	104.9	102.8
Expenditures	103.2	113.2	123.5	128.6
Deficit	12.6	15.1	18.6	25.8
Share of GNP *(percent)*	4.0	4.5	5.3	9.8
Spain [d] *(billion pesetas)*				
Revenues	1,715.9	2,400.4	2,548.0	2,750.0
Expenditures	1,894.0	7,507.8	2,765.0	3,100.0
Deficit	178.4	107.6	217.0	350.0
Share of GNP *(percent)*	1.4	0.7	1.2	1.7
Sweden [d] *(billion kronar)*				
Revenues	121.9	140.0	157.3	168.9
Expenditures	159.3	190.4	233.7	251.6
Deficit	37.4	50.4	76.4	82.7
Share of GNP *(percent)*	8.2	9.7	13.4	14.0

[a] Based on national government estimates.
[b] Fiscal year starting 1 April.
[c] CIA estimates.
[d] Calendar year.

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austerity program and the revenue measures announced earlier this year, Paris still expects that the deficit will reach over 100 billion francs, about 20-30 billion francs more than in 1981. With a budget this far into red ink, the government will be hard pressed to meet the 12.5- to 13.5-percent money supply growth target. [redacted] 25X

Budgetary prospects for the smaller West European nations are not much better. In *Denmark* the continuing lack of a parliamentary majority supporting a concerted policy points to further difficulties in containing the budget deficit, which may equal 10 percent of GNP this year. In the *Netherlands,* conflicts over attempts to contain the budget deficit led to the fall of the three-party coalition government this summer. In *Belgium* the center-right Martens coalition has adopted a tight budgetary policy, with ministries supposedly barred from exceeding their allocations for the year. Nevertheless, the government raised its projected 1982 deficit from 200 billion Belgian francs to 350 billion francs. [redacted] 25X

In *Japan* the Suzuki government has publicly stated that its top priorities are reduction of the public-sector deficit and reformation of the government bureaucracy. Japan's government deficit for fiscal year 1981 (which ended in March 1982) was about 6 percent of GNP, and Tokyo expects the shortfall to be slightly smaller this year. Some observers predict, nevertheless, that tax collections this year will fall about 3 trillion yen short of projections. The recently announced $7.7 billion economic relief measures are expected to provide some stimulus to business, especially residential construction. Moreover, Suzuki has ordered that 77 percent of public works funds be spent in the first half of the fiscal year. [redacted] 25X

In *Canada,* Trudeau is unlikely to achieve his aim of lowering government expenditures and the federal deficit because of slower-than-expected economic growth and, to a lesser extent, tax concessions to the oil industry. As a result, this year's federal deficit probably will exceed Ottawa's 16 billion Canadian dollar projection. [redacted] 25X

Monetary Policy Stance

The recent declines in US interest rates will probably set the stage for other governments to ease monetary policies:

- *Bank of Japan* officials hope to trim the discount rate but are holding off for fear of more downward pressure on the yen that in turn would further aggravate trade tensions with other developed countries. The recent drop in US interest rates may well provide Tokyo with the latitude to lower the discount rate. [redacted] 25X
- In *West Germany* the Bundesbank dismantled the special Lombard facility, reintroduced normal Lombard borrowing (borrowing secured by collateral), and lowered the Lombard rate another percentage point. The current rate of 8 percent compares with a peak of 12.5 percent last fall. Bundesbank President Poehl credited West Germany's improving current account position and firming of the deutsche mark for the relaxation. [redacted] 25X
- In *France* the Mitterrand government hopes to limit money supply growth this year to 12.5 to 13.5 percent, but a 12-percent inflation rate and heavy official borrowing probably will push money supply growth beyond this target. The wage-price freeze announced by Prime Minister Mauroy as part of the austerity program should ease pressure on monetary growth. If the government's income policy planned for the postfreeze period does not succeed, catchup wage and price hikes could eliminate the benefits from the freeze. [redacted] 25X
- The *United Kingdom* seems to be loosening its monetary policy in line with improved performance on inflation; it recently let interest rates decline and raised the annual target for money supply growth from a 6- to 10- percent range to 8 to 12 percent. [redacted] 25X

- The *Italian* Government, on the other hand, maintains that it has relatively little scope for easing monetary policy, drawing parallels with 1975 when a premature reversal of policy led to a balance-of-payments crisis. Moreover, Treasury Minister Andreatta views monetary policy as the most effective tool for controlling inflation.

- *Canada,* similarly, is not expected to ease its tight monetary policy very much because its inflation still is in double digits. The Bank of Canada has been trying slowly to reduce money supply growth to rates consistent with stable prices. As a result of its continued tight policy, money supply growth has actually fallen below the 4- to 8-percent target for this year.

Inflation and Current Account Deficits

In our judgment, the OECD's inflation and current account problems should lessen this year. Inflation should slow to 8 percent in 1982, extending the improvement of last year. For the Big Six, inflation will drop to an estimated 8.3 percent, with West Germany and Japan again having the lowest rates. Generally restrictive fiscal policies, continued moderate wage demands—which are averaging 7 percent in Japan and 4 percent in West Germany—and tight monetary policies in West Germany should keep inflation in these two countries at 5 percent or less. At the other end of the spectrum, large budget deficits, wage indexation, and continued currency depreciation against the US dollar will combine to keep inflation in France and Italy around 12 percent and 16.5 percent, respectively.

Inflation will probably ease in most of the smaller OECD countries, probably averaging 11.5 percent for the 17 as a group. Substantial variations in performance will continue this year, with inflation averaging only 4 to 6 percent in Austria, the Netherlands, and Switzerland, but around 28 percent in Greece and Turkey.

We expect current account deficits for most countries to narrow this year as a result of the expected improvement in the OECD's terms of trade and growth in real net foreign demand. For the Big Six, the balance actually should swing into surplus for the first time since 1978. Japan and the United Kingdom will lead the way with surpluses estimated at $9 billion and $7 billion, respectively. The French current account deficit, however, may deteriorate further to $7 billion as a result of the continued rise in imports—the deficit had widened to over $5 billion in the first six months of the year. The aggregate payments position of the smaller OECD countries will improve, with the Netherlands and Switzerland probably recording current account surpluses.

Falling crude oil and nonoil commodity prices account for much of the improvement in the OECD's terms of trade with the rest of the world. In its latest assessment, the OECD Secretariat estimates that the dollar-price index for nonoil commodity prices will fall 5.5 percent this year, following a 7.5-percent decline in 1981. The OECD expects the price of crude petroleum to average about $1 less per barrel this year than in 1981—an estimate similar to our own. As a result of the drop in both oil and nonoil commodity prices, the OECD's terms of trade should improve by about 3.5 percent this year, following a 2-percent deterioration in 1981. For the first six months of this year, the OECD recorded almost a $10 billion dollar improvement in its trade balance with the rest of the world compared to the same period last year.

Prospects for 1983

Although projections for 1983 are still tentative, current trends in commodity prices and government policies suggest some improvement in economic growth next year, but this growth will compare very unfavorably with previous recoveries. On the policy front, we expect a gradual shift toward more relaxed monetary policies that would help reduce real interest rates and provide a stimulus to domestic demand. On the energy price front, we assume only marginal increases in nominal energy prices through yearend 1983, barring some disruption in oil production. For the year as a whole, the official OPEC price should average about $34 a barrel. Although nonoil commodity prices may turn up next year as the pace of the recovery picks up, the increase probably will be fairly moderate. [redacted]

For the non-US OECD, GNP may grow by roughly 2 percent in 1983, with the Big Six advancing slower than the smaller OECD. For the larger OECD countries, we now project the following growth rates:
- Japan—about 3.1 percent.
- West Germany—around 1.5 percent.
- France—around 1.5 percent.
- United Kingdom—about 2.0 percent.
- Italy—2.5 percent.
- Canada—about 2.3 percent. [redacted]

The inflation performance of the non-US OECD countries should also improve in 1983. Single-digit inflation rates are expected in four of the Big Six countries; Japanese and West German inflation rates should be below 4 percent. Many of the smaller OECD countries may also record single-digit inflation. Greece, Iceland, Portugal, and Turkey, however, will still have inflation running at 20 percent or more a year. [redacted]

The OECD current account balance may improve somewhat, in large part because of expected continuing gains in the terms of trade. The Japanese probably will lead the OECD with a current account surplus of about $12 billion, with West Germany, the United Kingdom, the Netherlands, and Switzerland also running sizable current account surpluses. [redacted]

LDC growth prospects in 1983 are a major uncertainty and will affect the OECD outlook. To a large extent, LDC economies will be dependent on external commercial borrowing for import and current account deficit financing of $50-60 billion in 1983. Should prospects for borrowing deteriorate in 1983, then LDC growth and imports will fall. Our findings, based on simulations of our Linked Policy Impact Model of the world economy, indicate that if the LDCs are forced to cut their aggregate growth enough to reduce their current account deficit by $30 billion, non-US OECD GNP growth will fall by 0.5 percentage point, and the aggregate non-US OECD current account deficit will rise by $12 billion. [redacted]

Table 6
OECD: Impact of 1-Percentage-Point Fall in US GNP Growth in 1982

	Change in GNP Growth (*percentage point*)	Change in Current Account Balances (*billion US $*)
OECD [a]	−0.5	2.2
United States	−1.0	6.2
Non-US OECD [a]	−0.2	−4.0
Big Six [a]	−0.2	−3.2
Japan	−0.3	−1.3
West Germany	−0.2	−0.4
France	−0.2	−0.1
United Kingdom	−0.2	−0.5
Italy	−0.2	−0.2
Canada	−0.3	−0.7
Smaller OECD	−0.3	−0.8

[a] Weighted by 1980 GNP.

[redacted]

Importance of the United States in the OECD Outlook

Given its relative size, the US economy is an important factor in our assessment of the 1982-83 OECD outlook. Our pessimistic appraisal of average OECD growth in 1982 largely reflects the slump in the United States. At the same time, the optimistic outlook for next year hinges on a recovery by the US economy. If the US economy fails to rebound, overall OECD real GNP growth will fall short of the 2.8-percent increase that we now expect to see in 1983. [redacted]

To quantify the influence of the United States on overall OECD economic performance, we again used our Linked Policy Impact Model of the world economy. Our findings indicate that a 1-percentage-point drop in the US growth rate would cut overall OECD economic growth by 0.5 percentage point and non-US OECD growth by 0.2 percentage point (see table 6).

Sensitivity Factors in the Current Account Forecast

Forecasting current account balances for the OECD countries is inherently risky even under relatively stable conditions. The present state of the world economy makes our estimates that much more tentative. Declining oil consumption, LDC debt problems, and massive currency fluctuations all are causing major change in international trade and invisibles flows. Because the level of OECD current account inflows and outflows are so large—total trade alone approached $3 trillion in 1981—even minor changes in trading patterns or invisibles flows can generate large shifts in the current account:

- *Each 1-million-b/d change in OECD net oil imports leads to a $12 billion shift in the balance.*
- *Every $1 change in the average price of crude oil results in about a $7 billion adjustment to the current account.*
- *Each 1-percentage-point change in either the volume or price of OECD imports from nonoil LDCs causes a $2 billion shift in the balance.*
- *Each 1-percentage-point change in the volume or price of LDC imports from the OECD alters the current account by about $3 billion.*

[redacted] 25

Japan and Canada experience the greatest declines—0.3 percentage point—primarily because of the larger share of their exports going to the United States. Slower growth of US GNP with resulting slower growth of imports would improve the overall OECD current account balance; $6 billion improvement in the US balance would outweigh a $4 billion deterioration in the non-US balance. Reflecting their reliance on exports to the United States, Japan and Canada—followed by the United Kingdom—would show the largest current account deterioration. [redacted] 25

Appendix A

Country Prospects in 1982

In *Japan* real GNP probably will increase by a remarkably low 2.4 percent, 0.5 percentage point less than last year (see table 7). Household consumption should recover as a result of continued low inflation and wage settlements averaging 7 percent in major industries. Real public consumption, on the other hand, may grow less than 1 percent this year if Tokyo holds to its austerity budget. The drop in real GNP in the fourth quarter of 1981 prompted discussion of a new stimulus package, but none has been approved. As a gesture in this direction, the government has placed 77 percent of public works contracts in the first half of the current fiscal year (1 April–30 September 1982). Even so, fixed investment will remain sluggish because of the substantial slowdown in both domestic and foreign sales. Growth in private capital formation is expected to pick up from less than 1 percent in 1981 to around 2 percent this year. [redacted]

Table 7
Japan: GNP Growth *Percent*

	1981	1982 [a]
GNP	2.9	2.4
Private consumption	0.6	3.1
Government consumption	3.6	1.4
Fixed investment	2.3	0.9
Additions to inventory	−0.6	−0.1
Total domestic demand	0.9	2.3
Exports of goods and services	16.4	5.3
Imports of goods and services	5.7	5.6
Net foreign demand	55.0	4.6

[a] Projected.

[redacted]

For *West Germany* we expect continued economic stagnation until late in the year (see table 8). Domestic demand will decline for the year as a whole, although by a far smaller amount than in 1981. Household consumption will contract again because employment and real wage rates are declining. At the same time, the continued weak profit position of many firms, combined with high, albeit declining, real interest rates, probably will inhibit firms from making substantial outlays on plant and equipment. Construction may decline by as much as 5 percent. We expect no additional support from Bonn beyond the modest job creation program announced in February because of concern over the budget deficit. The newly constituted coalition government headed by Helmut Kohl appears certain not to implement any new spending programs in the remainder of the year and already is calling for spending cuts and tax increases in the proposed 1983 budget. For the year, we expect real public expenditures on goods and services to grow by just 0.5 percent. By the end of the year, both private consumption and fixed investment should begin to pick up. [redacted]

Table 8
West Germany: GNP Growth *Percent*

	1981	1982 [a]
GNP	−0.3	NEGL
Private consumption	−1.1	−0.8
Government consumption	−2.0	0.5
Fixed investment	−3.3	−4.0
Additions to inventory	−1.4	0.2
Total domestic demand	−2.5	−1.0
Exports of goods and services	8.9	5.7
Imports of goods and services	2.1	3.1
Net foreign demand	2.1	0.9

[a] Projected.

[redacted]

Table 9 *Percent*
France: GNP Growth

	1981	1982 [a]
GNP	0.2	1.0
Private consumption	2.2	1.5
Government consumption	2.3	3.0
Fixed investment	−1.9	−2.1
Additions to inventory	−2.2	0.5
Total domestic demand	1.4	1.0
Exports of goods and services	5.1	NEGL
Imports of goods and services	1.0	3.5
Net foreign demand	1.0	−0.6

[a] Projected.

[redacted]

Table 10 *Percent*
United Kingdom: GNP Growth

	1981	1982 [a]
GNP	−1.2 [b]	1.1
Private consumption	NEGL	0.3
Government consumption	0.3	1.0
Fixed investment	−7.6	1.0
Additions to inventory	−1.8	NEGL
Total domestic demand	−1.2	2.4
Exports of goods and services	−1.3 [b]	1.1
Imports of goods and services	−1.9 [b]	5.3
Net foreign demand	−0.6 [b]	−2.0

[a] Projected.
[b] Estimated. No official data are available because of the civil service strike. 25X

[redacted] 25X

Before the imposition of an austerity program in *France,* we expected real GNP growth to amount to 2.5 percent—the highest rate for any major West European country. The new program, however, could pull GNP growth down to 1 percent (see table 9). Mitterrand's package includes a four-month freeze on wages and most prices, a ceiling on the budget deficit at 3 percent of GNP, and a reduction of the deficits of the separately funded social security and unemployment programs. Recent evidence, however, suggests that the economic recovery has stalled. The June INSEE survey of business intentions found production leveling off in the capital equipment industry, falling in the intermediate goods sector, and continuing to grow only in the consumption goods sector. We expect household consumption to grow by 1.5 percent while fixed investment falls by 2.1 percent. On the other hand, public consumption probably will rise by around 3 percent, 0.7 percentage point faster than in 1981. Public-sector spending will contribute to faster import growth. The respected French-based Banque de Paris et des Pays-bas warned that export prospects were diminishing because of continued weak demand in Western Europe and financial problems facing OPEC and a number of East European countries. With imports picking up and exports flat, net foreign demand will decline. [redacted]

In the *United Kingdom* real GNP is expected to grow by 1.1 percent, the first yearly increase since 1979 (see table 10). This extremely modest growth will come from widespread improvement in the components of GNP, but the recovery will still be hesitant. Private consumption will remain almost flat because of continued high unemployment—around 3 million—and prospects for little, if any, increase in real income. A number of observers expect real disposable income to fall for the second consecutive year by about 2 percent. Investment prospects have improved considerably despite continuing high interest rates; fixed investment is expected to rise 1 percent after a nearly 8-percent decline in 1981. Real public consumption may be up slightly this year after remaining flat in 1981. The political threat posed by the Social Democratic/Liberal alliance and mounting pressures from within the Conservative Party to do something about the unemployment problem, however, could well prompt the Thatcher government to raise spending. [redacted] 25X

The *Italian* economy will show a weak recovery, growing by about 1.5 percent (see table 11). The major impetus will come from exports, which are 25X

Table 11 *Percent*
Italy: GNP Growth

	1981	1982 [a]
GNP	−0.2	1.5
Private consumption	0.2	1.3
Government consumption	1.8	1.5
Fixed investment	−0.2	NEGL
Additions to inventory	−3.0	−0.4
Total domestic demand	−2.7	0.6
Exports of goods and services	6.0	6.0
Imports of goods and services	−5.4	3.5
Net foreign demand	2.6	0.5

[a] Projected.

Table 12 *Percent*
Canada: GNP Growth

	1981	1982 [a]
GNP	3.0	−2.9
Private consumption	1.7	−1.6
Government consumption	2.0	2.4
Fixed investment	5.9	−13.8
Additions to inventory	1.1	−1.1
Total domestic demand	3.6	−3.5
Exports of goods and services	1.4	−3.9
Imports of goods and services	3.1	−11.2
Net foreign demand	−0.5	−1.2

[a] Projected. 25X1

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expected to increase by 6 percent in real terms and far outpace the modest 3.5-percent rise in imports. Domestic demand will remain weak throughout most of 1982. The Bank of Italy will likely hold to its tight policies, given the large projected public-sector deficit for 1982 and the sizable current account deficit. Continued high real interest rates, along with high tax rates and uncertainties over employment, will probably hold the growth in household consumption to 1.3 percent. Tight credit will dampen fixed capital formation and stockbuilding; we expect total fixed investment to remain flat this year, and some observers believe capital outlays may drop by more than 5 percent. The growth in public spending on goods and services may slow this year because of severe budgetary problems.

Mirroring the economic situation in the United States, *Canadian* GNP growth will decline this year by 2.9 percent (see table 12). Much of the recent decline in economic activity can be attributed to Ottawa's restrictive monetary and fiscal policies and weak economic conditions in the United States. The federal budget for 1982—designed to reduce the deficit and restructure the tax system—includes tax increases affecting both businesses and households. Meanwhile, monetary policies have remained tight; earlier this year they forced real interest rates to near-record levels. As a result of these restrictive policies and continuing pessimism over short-term economic prospects, fixed investment—particularly residential construction—has plummeted. For the year, fixed investment may be down almost 14 percent. Household consumption is expected to decline slightly as a result of the squeeze on real disposable incomes from government-mandated energy price increases and higher personal taxes. Ottawa's expanding budget deficit, added to the ballooning provincial budgets, will boost government consumption at a faster pace than in 1981. 25

For the 17 *smaller OECD countries,* whose economies did not decline as much as the larger countries, we expect modest improvement in 1982. The decline in oil prices will give most of these countries a significant stimulus. However, in several countries, including Belgium and Portugal, government efforts to control budget deficits through reduced growth in public spending will dampen growth of domestic demand and, in turn, real GNP. Only Iceland is expected to record a decline in real GNP in 1982. 25

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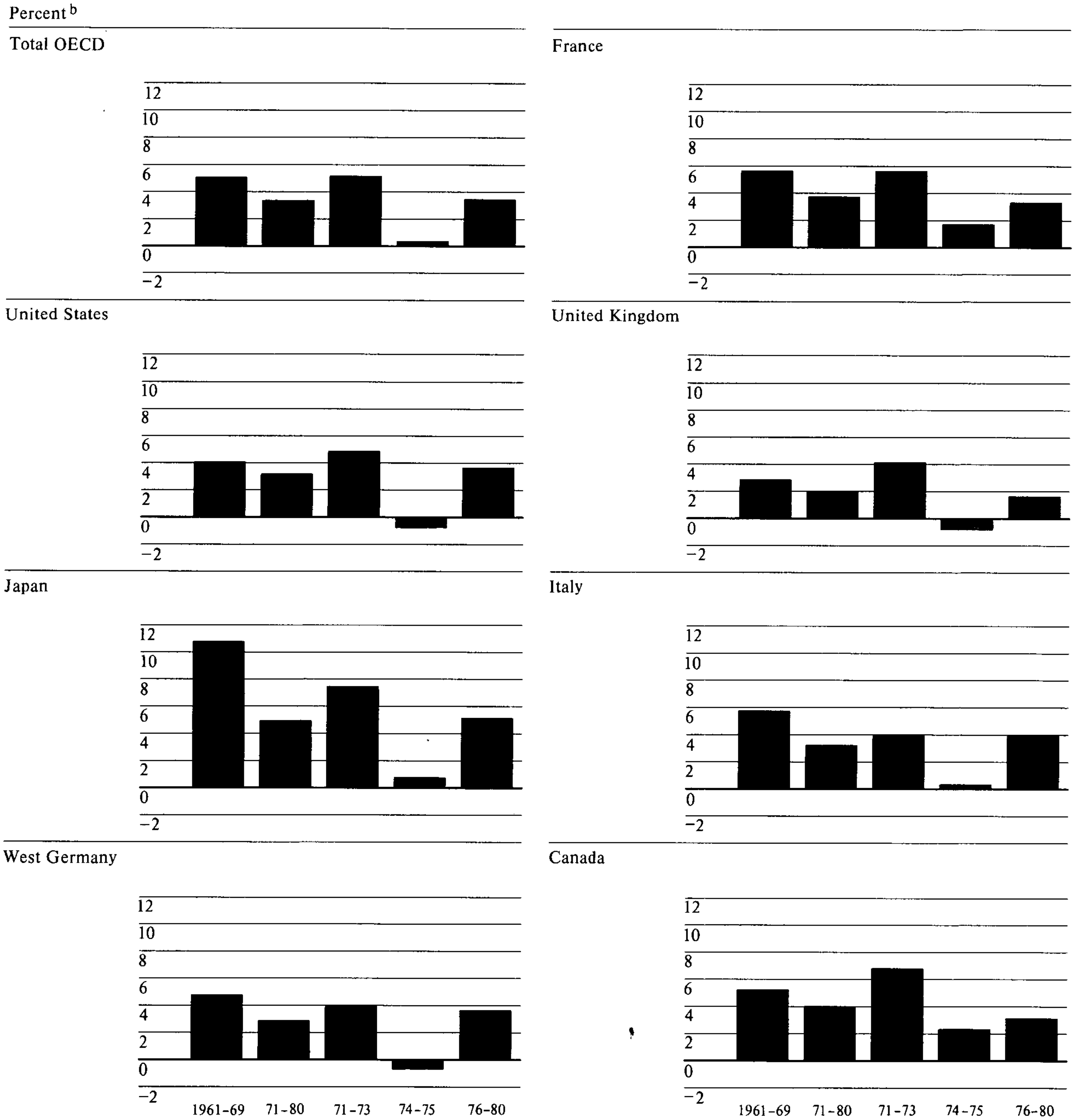
Appendix C

Historical Trends

Figure 1
OECD: Real GNP Growth[a]



[a]Annual data come from OECD Economic Outlook, December 1981.
[b]Average annual.

[redacted]

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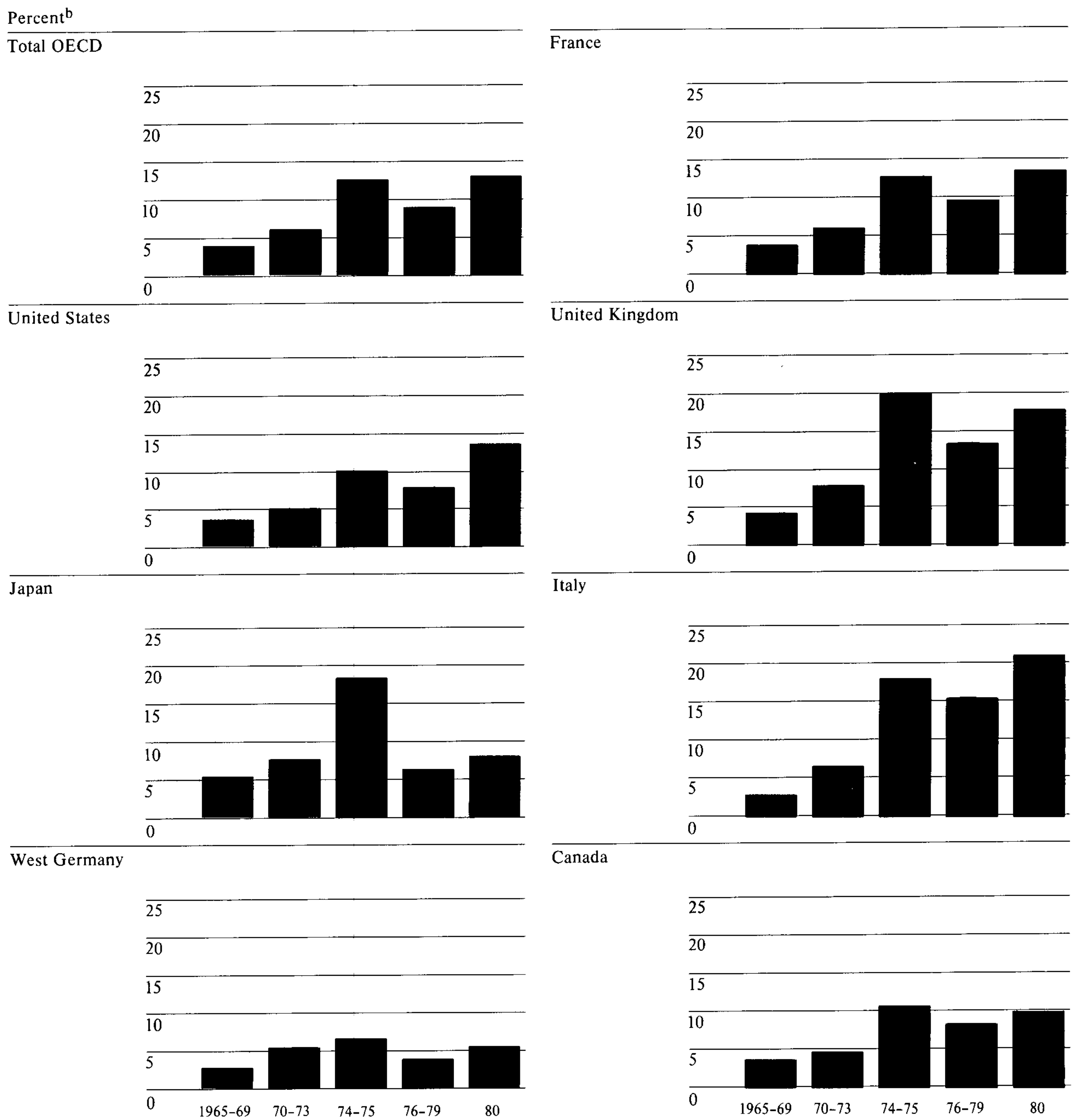
Figure 2
OECD: Inflation Rate[a]



[a] Annual data come from OECD Economic Outlook, December 1981.
[b] Average annual.

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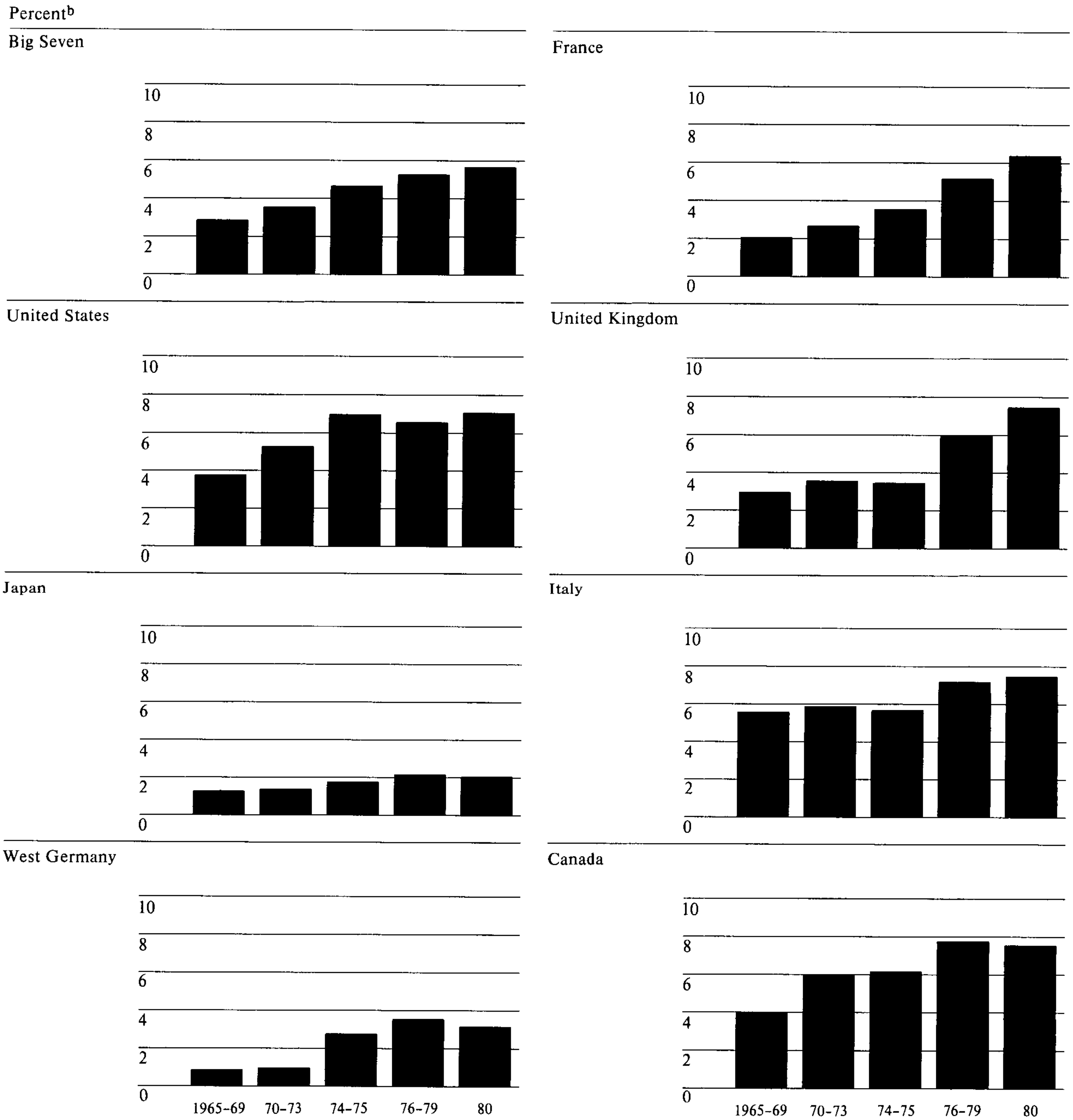
Figure 3
Big Seven: Unemployment Rates[a]



[a] Annual data come from OECD Economic Outlook, December 1981.
[b] Average annual.

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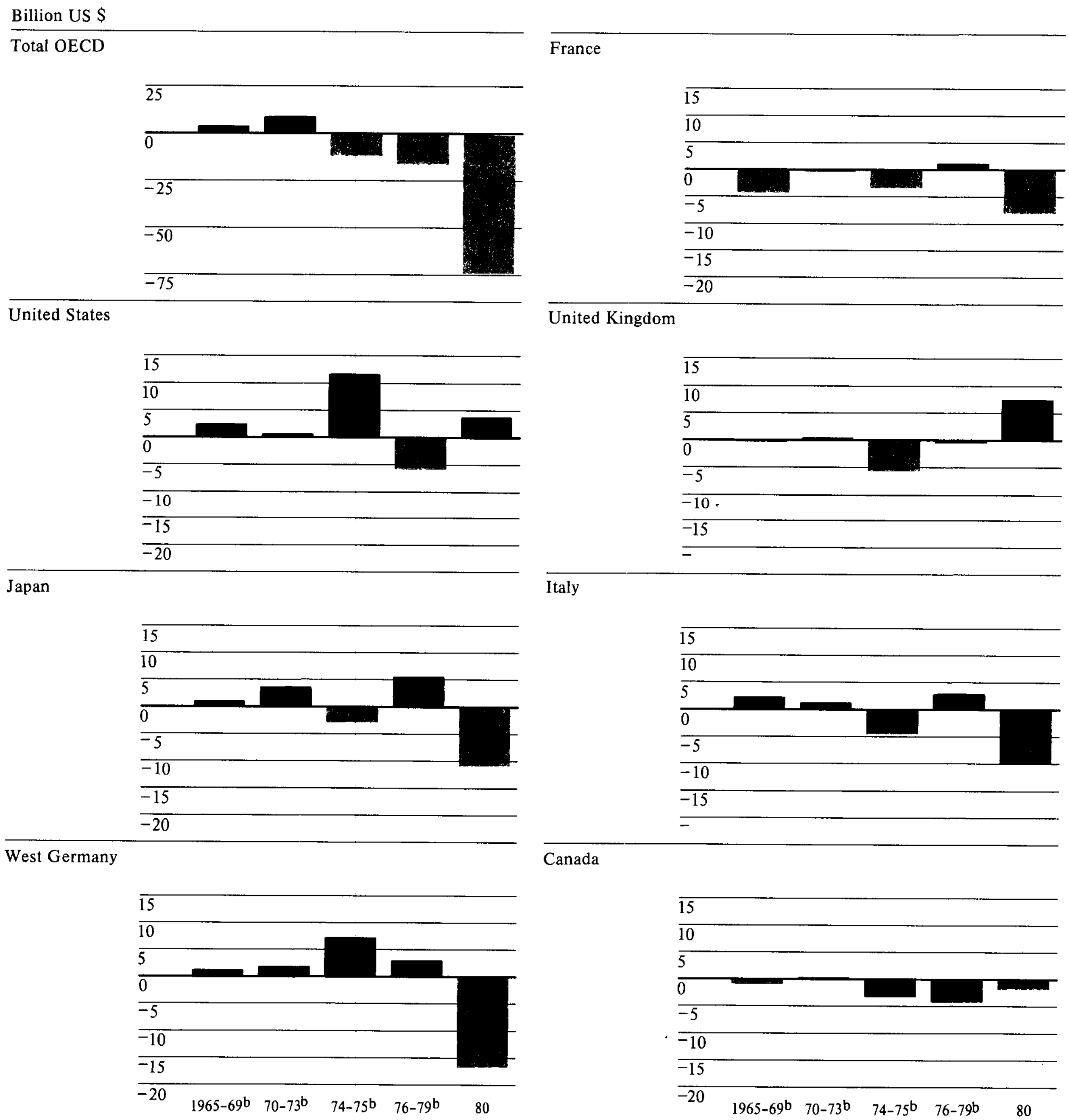
Figure 4
OECD: Current Account Balances[a]



[a]Annual data come from OECD Economic Outlook, December 1981.
[b]Average annual.

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