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Directorate of
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International Economic & Energy Weekly

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29 August 1986

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29 August 1986

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International
Economic & Energy Weekly

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Synopsis

1 **Perspective—Mexico: Dim Prospects for Foreign Investment**

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Mexico's longstanding aversion to foreign investment, in our judgment, is a major constraint on much-needed structural economic reform. Should Mexico City muster the political will to undertake the necessary reforms, foreign direct investment could make an important contribution to Mexico's long-term economic development.

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7 **Mexico: Energy Developments in Baja California**

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17 **West Germany: Progress on Financial Reform**

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23 **India: Domestic Oil Prospects Diminish** 25X1

On the basis of a detailed study of India's oil prospects, we believe India faces a sharp decline in oil output over the next 10 years. Combined with a probable rapid rise in domestic energy consumption and intractable problems in the coal and electric power sectors, India's oil imports would have to rise significantly, exacerbating perennial foreign payments problems. 25X1

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Perspective

Mexico: Dim Prospects for Foreign Investment

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Mexico's longstanding aversion to foreign investment, in our judgment, is a major constraint on much-needed structural economic reform. President de la Madrid has been more receptive to foreign investment than his recent predecessors but has been unable to overcome nationalistic biases, a restrictive legal framework, and a myriad of institutional obstacles. In fact, the Mexican investment climate has, in some ways, deteriorated under de la Madrid. For example, two decrees implemented by the present administration have expanded regulatory requirements in the automotive and pharmaceutical sectors where foreign investment is highly concentrated. Moreover, the deterioration of Mexico's economy has further deterred potential investors and structural reform. 25X1

Despite Mexico City's rhetoric to the contrary, foreign investors have long shied away from what they see as an unfriendly environment. We estimate that net foreign direct investment in Mexico averaged only 2.2 percent of gross fixed investment over the last decade and never accounted for more than 5 percent of the total. The Mexicans instead have shown a strong preference for borrowing, which was roughly 12 times greater than net foreign investment in the period 1976-85. In turn, access to foreign credit from commercial banks has given the Mexican Government little incentive to make the reforms necessary to attract foreign investment. 25X1

In order for Mexico to attract increased foreign direct investment, we believe Mexico City must first dismantle many of the barriers. At the margin, even small changes, such as continuing to reduce the amount of redtape faced by potential foreign investors, would help. A major improvement in Mexico's foreign investment climate, however, will require structural reforms. Although domestic opposition would be strong, Mexico City could encourage foreign investors by phasing out price controls; liquidating nonstrategic state-owned enterprises; improving intellectual property protection; and liberalizing restrictions on majority foreign ownership. 25X1

Should Mexico City muster the political will to undertake the necessary reforms, foreign direct investment could make an important contribution to Mexico's long-term economic development. In our view, the major contribution would not be financial—even a doubling of last year's direct investment inflow would represent only a small fraction of the foreign borrowing expected this year. Instead, we believe the principal benefits of increased foreign investment would arise from the introduction of foreign technology and management practices. Furthermore, Mexican enterprises would be able to form valuable customer and supplier links to foreign firms through their subsidiaries in Mexico. 25X1

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Mexico: Energy Developments in Baja California

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Baja California is becoming increasingly important to Mexico's economic development, particularly with respect to energy resources. The completion this year of the Cerro Prieto geothermal project gives Mexico another source of foreign exchange, which will earn approximately $100 million annually from electricity exports to the United States. There are also new indications of petroleum resources in the Baja region that, if commercially viable, would prove an economic boon to Mexico's northern Pacific states. Other projects being discussed include a thermal power plant that would generate electricity for export to the United States and a tidal energy project. Domestic demand for energy in the Baja region is increasing as a result of population growth and a booming frontier economy. Nevertheless, the export potential of existing and planned projects will undoubtedly be exploited to earn much-needed foreign exchange and lay the groundwork for future regional growth.

Geothermal Energy

Mexico ranks among the top nations in the world in geothermal resources. With proven reserves of 920 megawatts (MW) of generating capacity and possible reserves totaling nearly 12,000 MW, the country possesses a tremendous potential for both domestic use and export. Mexico has made great strides in recent years in developing this resource; it is currently third in the world in the exploitation of geothermal energy, behind the United States and the Philippines.

The most productive site developed to date is at Cerro Prieto, 30 kilometers south of Mexicali and the US-Mexican border. Early in the 1980s the Mexican Federal Electricity Commission (CFE) embarked on an ambitious expansion project to install Japanese turbine generators and more than triple the electricity output at Cerro Prieto. Output, 180 MW in 1982, will reach 620 MW by the end of this year, making the plant the fifth-largest electricity-generating station in Mexico.

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The Baja Frontier

By far the most dynamic area of Baja California is the northern frontier, where urbanization and industrialization are increasing the demand for energy. Tijuana, Mexicali, and Ensenada have all experienced tremendous growth since the 1950s, largely from migration—population of the Baja border region is about 2 million. Although much of the recent population is transient, as campesinos from Mexico's interior flock to the Baja frontier to cross illegally into the United States, many of these migrants settle permanently in the burgeoning slum communities surrounding the cities.

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This region is now becoming one of Mexico's most important industrial zones. Previously associated with the tourist trade, the frontier is now a center for high-technology border assembly operations under Mexico's export-oriented maquiladora *program. Under this program, US and other firms, particularly Japanese, have taken advantage of low labor costs and good transportation connections with the lucrative California market to set up plants assembling products ranging from television components to stereo cabinets. Employment in the Baja* maquiladora *industry increased over 12 percent in 1985.*

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Agriculture is also a major consumer of energy, and the Mexicali Valley is one of Mexico's premier farming areas. It is noted for cotton and vegetable production as well as a large food-processing industry. Water quantity and quality have long been a problem in the valley, dependent on the heavily used Colorado River, but steps have been taken by both the United States and Mexico to ensure an adequate supply of usable water.

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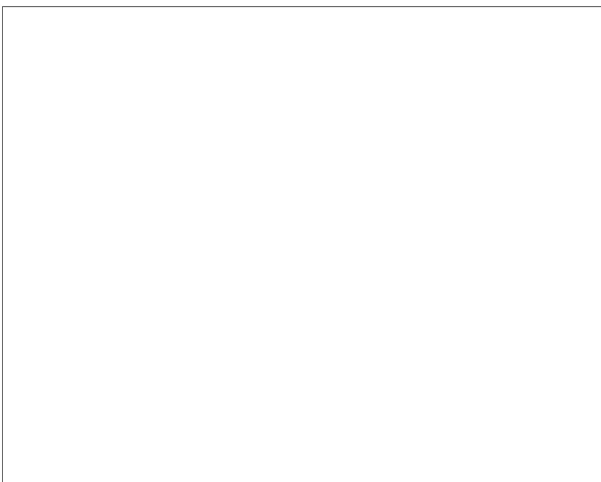
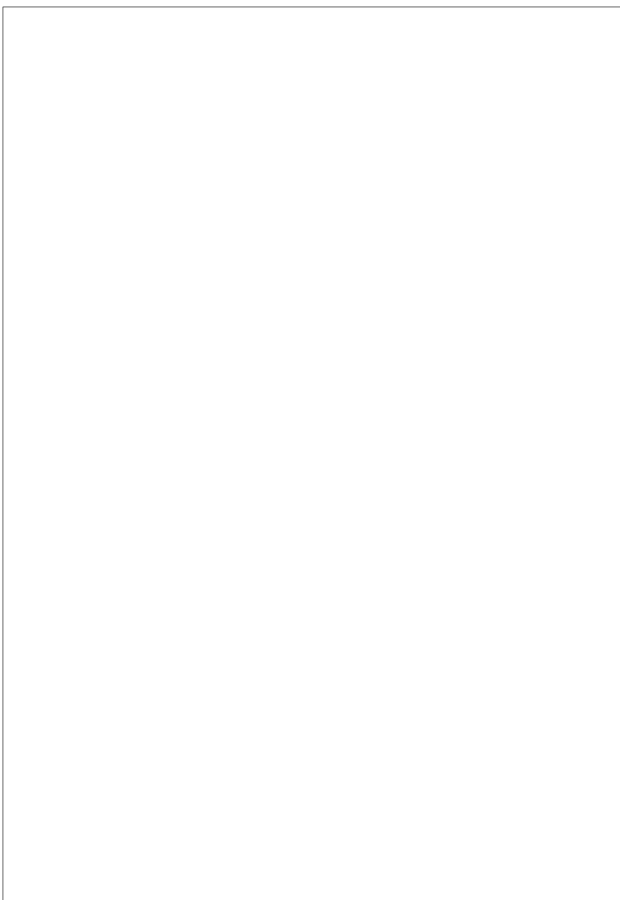
The Cerro Prieto project, however, has suffered many setbacks. It was dealt a serious blow in 1985, when an accident destroyed one of four new power units and disabled another. Total losses from the accident were in excess of $60 million, including purchase and installation of new equipment and lost revenues from the export of electricity. Financial difficulties at the CFE have also slowed progress, and generating capacity that was originally scheduled to be on line last year is only now going into operation.



The Continuing Quest for Oil

Despite generally disappointing exploration efforts in the 1970s, last year PEMEX, the state-owned oil company, again became interested in the petroleum potential of Baja California. Geologic tests in the Gulf of California were promising, particularly in the area off Isla Tiburon.

At some point PEMEX will probably renew its search for oil in the Gulf. The discovery of commercially exploitable oil deposits in the Baja region would stimulate not only the Baja border economy but also all of Mexico's northern Pacific coast. Because of the remoteness of the border area from the oil-producing zones in and around the Gulf of Mexico and the lack of an adequate petroleum distribution network, PEMEX has been forced into costly oil exchange agreements with US companies. Thus, development of the northern Pacific coastal states has been slow, in part because of inadequate or unsure supplies of petroleum.



Export Potential

Although electricity demand in the Baja frontier region is likely to increase, there would still be a

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sizable export surplus for the US market. The completion of the Cerro Prieto complex and the dollars that would be earned through export of electricity will probably spur other energy projects, and further exploration in the northern Baja may find additional exploitable geothermal fields.

Mexico would be well positioned to take advantage of any increase in demand.

Likewise, there would be export potential for any commercially exploitable oil discoveries in the Baja region, particularly if the world oil market improves. California is the second-largest consumer of petroleum products in the United States. Moreover, Baja oil would complement existing Mexican oil supplies by providing better access to potential customers in the nations of the Pacific Rim.

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North Yemen: Economic Challenges Grow

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North Yemen (Yemen Arab Republic) is facing growing economic pressures, but President Salih so far has retained the support of tribal shaykhs and the business community, key supporters of the regime. Remittances from Yemenis working abroad and foreign aid have substantially declined over the past year while an influx of exiles from South Yemen (People's Democratic Republic of Yemen) is increasing the strains on Sanaa's scarce resources. The government has tried various measures to arrest the economy's deterioration, but with little success so far. Sanaa has made progress in developing the 1984 oil find and probably hopes that it can contain the decline until 1988, when oil exports are scheduled to begin. Oil revenues will ease the country's economic situation somewhat in the late 1980s, but will not be the panacea that many North Yemenis probably expect.

Economic Problems Multiply

The recent deterioration of North Yemen's economy stems from a critical shortage of foreign exchange—current reserves are sufficient to cover less than two months of imports—and a growing budget deficit. Foreign aid, primarily grants from Saudi Arabia and the Gulf states, fell to $103 million last year, according to the US Embassy in Sanaa, down more than one-fourth from 1984. In addition, remittances from the estimated 600,000 North Yemeni expatriate workers in Saudi Arabia dropped to $939 million last year from $1.3 billion in 1984. Workers returning home along with reductions in the wages of Yemenis remaining abroad account for much of the decline, but the increasing success of Yemenis in circumventing the banking system also plays a role. Yemenis returning from abroad now more often bring goods rather than cash. Moreover, the frequent devaluations of the riyal over the past year have discouraged many Yemenis from holding cash balances in local currency.

Sanaa's financial support to the approximately 15,000 South Yemeni exiles encamped in the border area have aggravated the economic situation. The cost, estimated at $4.5 million per month, 25X1 25X1 has become a severe financial drain on the government. Sanaa has requested assistance from other Arab countries to help pay for the refugees, but, aside from $5 million recently provided by Libya, none has been forthcoming. 25X1

North Yemen must cope also with declining economic growth, rising unemployment, and worsening inflation. GDP growth, which averaged 2.5 percent last year, probably will reach 1 percent, at best, this year. Many Yemeni workers returning from the Gulf are remaining in Sanaa without jobs, despite government requests that they return to their tribal lands and work in agriculture. Import restrictions also have created shortages of some goods and fueled inflation, which has averaged 18 to 20 percent over the past two years. The conditions have led to a loss of domestic business confidence in the economy and capital flight, 25X1

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Sanaa Seeks Solutions

Sanaa has few financial resources available to deal comprehensively with the mounting economic pressures and, instead, has implemented a potpourri of policies to try to ease them. It has attempted to halt the devaluation of the riyal by tightening controls on foreign exchange. According to the Embassy, the government has eliminated the branch offices of many moneychangers to reduce their numbers and influence. The remaining moneychangers must register with the Central Bank and maintain a large portion of their reserves there. In addition, the government has curtailed exit visas to stem the flow of hard currency out of the country and limited those exiting to the

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North Yemen: Balance of Payments, 1982-86

Million US $

	1982	1983	1984	1985 [a]	1986 [b]
Trade balance	−1,921	−1,761	−1,394	−1,231	−1,290
Exports (f.o.b.)	5	10	9	10	10
Imports (c.i.f)	1,926	1,771	1,403	1,241	1,300
Services balance	875	1,038	1,021	816	815
Remittances (gross)	1,175	1,128	1,059	939	875
Private transfers	23	26	63	73	75
Current account	**−1,023**	**−697**	**−310**	**−342**	**−400**
Government grants	439	160	142	103	150
Government loans (net)	185	197	150	117	150
Direct investment	27	8	6	3	5
Other	−104	−24	−147	72	45
Errors and omissions	69	168	112	24	25
Changes in reserves	−407	−188	−47	−23	−25

[a] Estimated.
[b] Projected.

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equivalent of $50 in Western currencies, 25X1 These efforts probably will meet with only limited success. According to the Embassy, over 85 percent of the remittances coming into North Yemen flow through private channels. 25X1

Sanaa has taken other measures to try to control the economic slide. To ease the foreign exchange crunch, the government last spring declared a temporary moratorium on the issuance of import licenses. It also stepped up enforcement of price controls and further tightened budget expenditures. To increase revenues, Sanaa raised customs duties, licensing charges, taxes on incoming foreign mail, and required expatriate workers to pay a fee of $1,000 per year spent abroad if they wished to return. 25X1

Sanaa has sought aid from various benefactors to tide it over, but the recent commitments have been insufficient to meet North Yemen's needs. Riyadh has given some cash aid—probably previously committed—and has offered Sanaa project aid, fertilizer, and advisers, but has not been forthcoming with much additional cash. The Soviets also offered project aid as well as unspecified amounts of credits and currency support. 25X1 Baghdad sent Sanaa $10 million in July, probably payment for Yemeni troops serving in Iraq. 25X1

North Yemen's debt service burden is relatively low—less than 4 percent of current account receipts—and the government reportedly is considering commercial loans of $200-300 million, even though it is reluctant to resort to borrowing to finance its expenditures. Sanaa had sought a loan from the World Bank but refused to accept the conditions set by the Bank. 25X1

Many North Yemenis for the first time are blaming Salih personally for the country's economic ills. Salih so far has managed to mollify tribal shaykhs, key supporters of the regime, who had been angered that government programs benefiting them had been cut while huge sums were being spent to support the South Yemeni exiles. The business community, which

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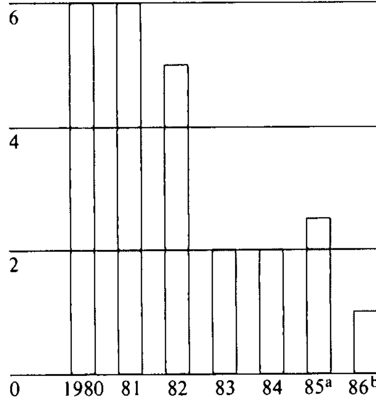
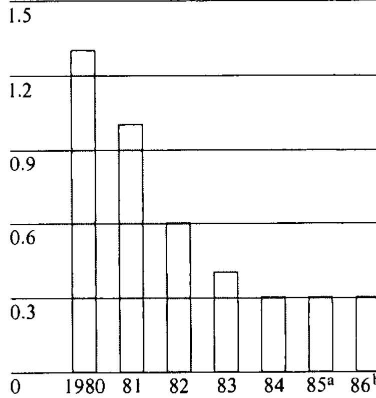
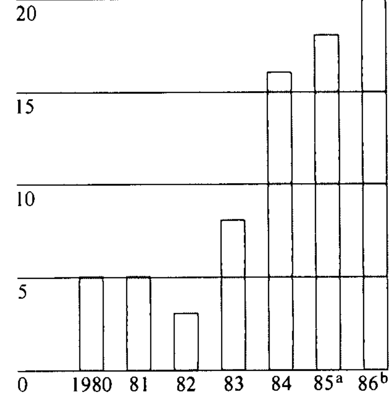
North Yemen: Economic Indicators, 1980-86







[a] Estimated.
[b] Projected.

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traditionally has supported Salih, also has criticized the government's handling of the economy, according to the Embassy. The government has responded by replacing two cabinet ministers said to be blocking Salih's economic policies.

Advances on the Oil Front

Despite these economic troubles, Sanaa has been forging ahead with oil development. Hunt Oil's efforts to delineate the Alif field continue, and the Embassy reports preliminary estimates of proved and probable reserves of 600 million barrels. The government expects to begin production of 135,000 b/d by early 1988, increasing eventually to 200,000 b/d. Exploration has yet to begin on most of the 12 other promising structures in the Hunt concession. Exxon plans to start preliminary seismic exploration of its concession this month, according to the Embassy.

The government reportedly has been careful to underplay the oil find, but Salih opened the Mar'ib refinery last April with great fanfare. The refinery— which will produce diesel oil, gasoline, and fuel oil—will cover about 30 percent of the country's needs. Sanaa is considering plans to build another refinery, but the World Bank believes that importing refined products and exporting crude would be more efficient.

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Sanaa will begin accepting tenders for construction of the underground pipeline from Mar'ib to Salif this month. The pipeline is designed to pump 200,000 b/d but can be modified to pump 400,000 b/d, according to the Embassy. Construction is expected to begin in November and to be completed by the beginning of 1988.

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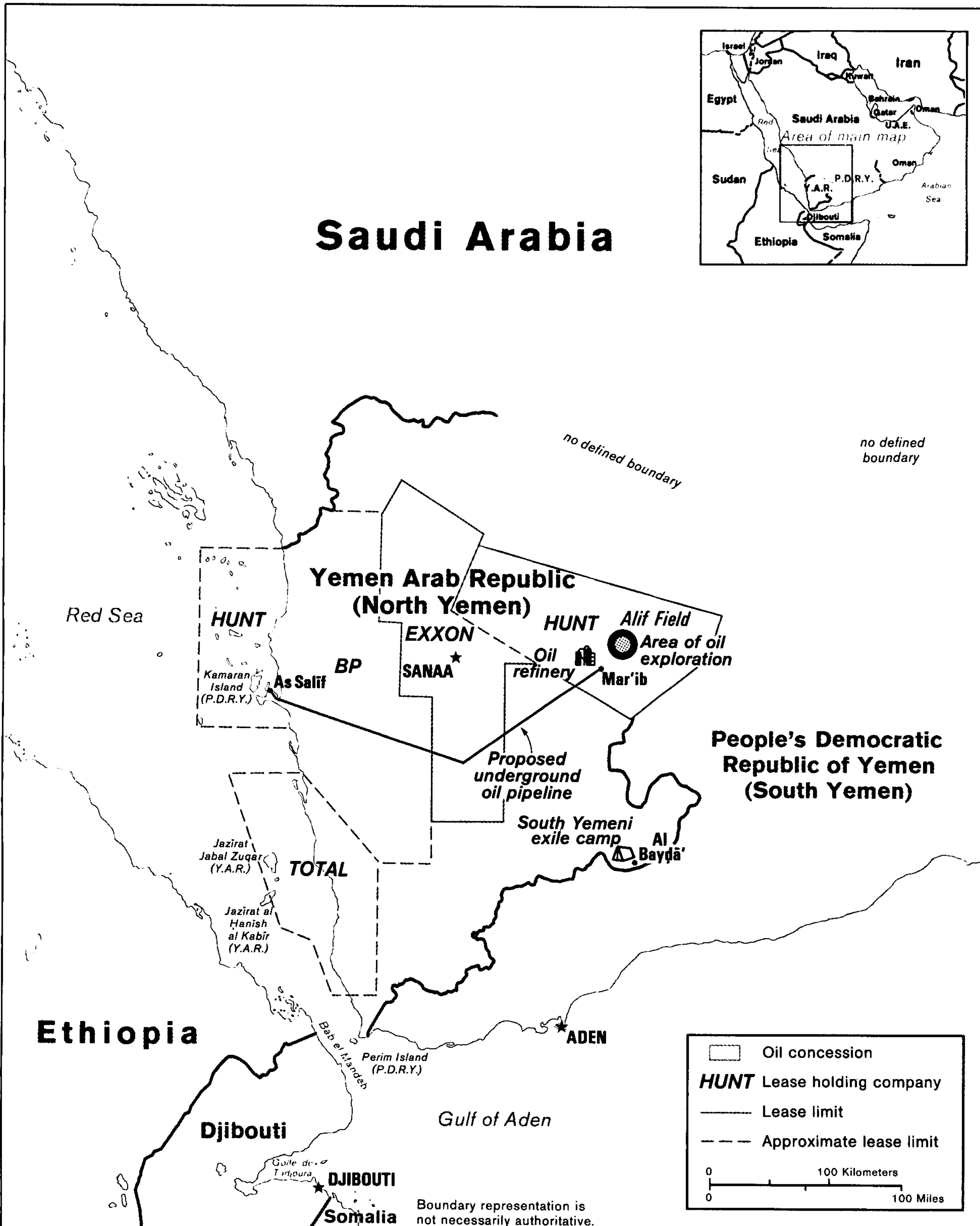

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Outlook

Without sizable additional aid, Sanaa probably will be able to do little to improve the economy over the next few years. Continuing recession in the region will prompt more Yemenis working abroad to return home. Although the government probably will find ways to pare imports and government expenditures, the magnitude of the cuts will not be sufficient to ease the government's financial problems. Nor will revenue measures add substantial additional income. In the past, North Yemenis have chosen to ignore tax increases or increase smuggling through their porous border with Saudi Arabia when faced with higher customs duties.

If North Yemen's economy begins to deteriorate rapidly, Sanaa can turn to outside sources for assistance. Since the oil discovery, Saudi Arabia's fears that its complex client relationship with North Yemen is unraveling has made Riyadh increasingly tightfisted in its aid payments to Sanaa. Riyadh probably would offer large aid infusions, however, if North Yemen's moderate regime appears threatened. Moreover, Sanaa is still considered a good credit risk and could borrow on the international market if necessary.

Sanaa has been careful to limit its announcements about the oil find, but the rising expectations of many Yemenis and hopes that their economic woes will evaporate in 1988 are among the most serious challenges facing the regime. Yemenis have witnessed the rapid development of the Gulf oil-producing states, and most probably expect similarly broad benefits. The planned level of Yemeni production and low oil prices, however, mean that the country's oil revenues will be limited. Foreign aid probably will continue to decline, and Yemenis working abroad probably will return in hopes of finding work and reaping the benefits of oil production. At worst, hard currency earnings from these sources will decline enough to entirely offset the oil revenues.

While continuing economic problems will undoubtedly lead to increased domestic criticism of the regime, Salih probably will retain the support of the military, tribal leaders, and the business community.

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Salih will try to use the oil revenues to stimulate slow and balanced economic growth, but probably will concentrate on using the oil revenues to broaden and consolidate his regime's base of power. Although a widespread conspiracy against the regime is unlikely to develop—even if the economy deteriorates markedly—a disgruntled Yemeni might be able to penetrate Salih's tight personal security network and assassinate him. His successor, however, probably would be selected from Salih's inner circle and would follow policies similar to those of the present regime.

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West Germany: Progress on Financial Reform

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West Germany, over the last two years, has been quietly pursuing a program to liberalize and internationalize its financial markets. The Bundesbank, reversing its traditional hesitance toward innovation, has become the initiator of reform. The West Germans are concerned that, without deregulation, they will lose ground to fast liberalizing markets in Tokyo, London, and Zurich. We believe the recent reforms will improve credit allocation in West Germany, lower corporate borrowing costs, and better equip West German financial institutions to compete overseas, although these benefits will require time to accrue. Foreign corporations and financial institutions, in turn, will enjoy better access to West Germany's broadening capital markets. On the negative side, greater internationalization of the deutsche mark, which will coincide with loosened capital controls in France and Italy, could induce wider swings in West European currency values.

A Rigid System

West German authorities characterize the recent reforms as "residual liberalization" to emphasize their contention that West German capital markets have always been relatively free by international standards. The mark is freely convertible, restrictions on capital flows were generally eased in the 1960s, and West German citizens can purchase any currency. Interest rate regulations for the banking sector were abolished almost two decades ago. Unlike Japan, Canada, and the United States, West Germany does not demarcate its financial institutions by function: West German banks are "universal," and can engage in investment and trust activities as well as commercial banking.

Despite this ostensible liberality, West German capital markets remain relatively primitive. The bond market is dominated by government issues; the stock market is anemic; and the short-term money market consists almost exclusively of interbank dealings. Banks dominate the financial system, both as lenders to corporations and as recipients of private savings.

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The chief factors inhibiting the development of mature capital markets in the past were discriminatory taxes and collusive arrangements between the Bundesbank and banking cartels. These cartels—particularly those involving the "big three" of Deutsche Bank, Dresdner Bank, and Commerzbank—acted to channel funds through the banking system and to discourage foreign participation in the capital markets. The Bundesbank tacitly endorsed this system as a means to tighten domestic monetary control and curb the reserve currency role of the deutsche mark. The government was particularly concerned during the 1970s that heavy capital inflows would inflate the domestic money supply and appreciate the mark, to the detriment of West German export competitiveness.

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Foreign investment in domestic deutsche mark (DM) bonds was discouraged by a 25-percent withholding tax on interest income. A "gentleman's agreement" with the major banks allowed the Bundesbank to tightly regulate the volume of DM bonds issued by foreign borrowers, for which only domestic banks could act as lead managers. The same agreement precluded currency swaps and floating rate issues, and the Bundesbank also prohibited short-term investment instruments—such as certificates of deposit (CDs) and money market funds—that could function as substitutes for bank accounts. The domestic banks, whose securities departments dominate both bond and equity trading, have a strong incentive to limit the number of financial instruments in order to keep both individual savers and corporate borrowers dependent on traditional bank operations.

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West Germany: Financial Liberalization Measures

	Action	Government Agency	Comment
August 1984	Abolished 25-percent withholding tax on interest of domestic bonds owned by foreigners.	Ministry of Finance	Matched similar abolitions by France and the United States.
May 1985	Abolished volume controls on foreign bond issues.	Bundesbank	Prenotification rules—though eased last July—allow continued monitoring by the authorities.
	Permitted resident, foreign-owned banks to lead manage foreign bond issues.	Bundesbank	Reciprocity clause excludes the Japanese.
	Allowed new financial instruments such as swaps, floating-rate, and zero-coupon bonds.	Bundesbank, Ministry of Finance	Applies to both domestic and foreign issues.
May 1986	Allowed certificates of deposit (CDs).	Bundesbank	CDs subject to minimum reserve requirements, which were lowered.
July 1986	Admitted foreign-owned banks into the government bond consortium.	Bundesbank	Domestic banks criticize the foreigners' 20-percent quota as excessive.

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Forces for Change

Despite their predilection for tightly controlled capital markets, the West German authorities have felt increasing pressure in recent years to relax the system. The economic events of the early 1980s—deutsche mark weakness, dollar strength, and the shift in West Germany's capital account balance from surplus to deficit—convinced them of the need to increase the mark's attractiveness to foreign investors. The main motivation for financial reform, however, probably was the growing conviction in Bonn and Frankfurt that, without deregulation and innovation, West Germany would gradually be eclipsed as a world money center. Domestic institutions were already circumventing regulations to some extent by transferring operations abroad—by late 1985, domestic banks were conducting about 12 percent of their business volume overseas. The government and the central bank surmised that liberalized rule at home was preferable to no control over overseas activities.

For a nation somewhat suspicious of change, the speed with which West Germany has pursued deregulation has surprised financial analysts. The few remaining curbs on capital inflows were lifted in 1980-81 and, more important, Bonn abolished the 25-percent withholding tax on the interest earnings of foreigners effective August 1984. Last year, the Bundesbank authorized new capital market instruments, such as swaps and floating rate notes, and allowed foreign-owned banks to lead manage them and traditional bond issues. Minimum reserve requirements were eased this spring to help West German banks compete in Euromarkets, and short-term instruments—including CDs—were permitted. Finally, foreign-owned banks last month were given a share of the lucrative primary market for government bonds.

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Improved Status for Foreigners

As a result of these measures, foreign banks now enjoy effectively equal treatment with domestic institutions. The number of such banks in West Germany

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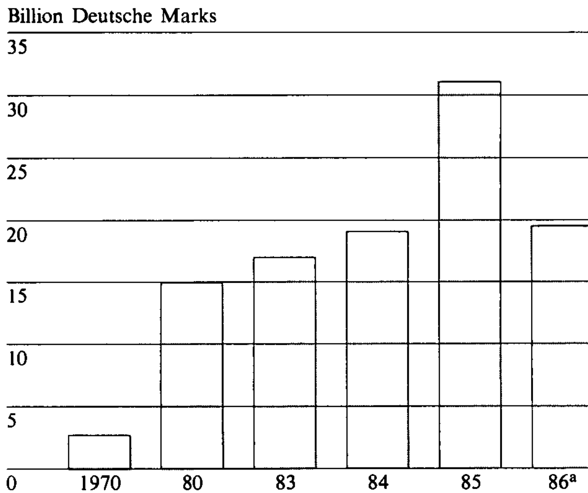
Gross Sales of Deutsche Mark Bonds by Foreigners, 1970-86



[a] January - May only.

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has increased appreciably in recent years—reaching 300 by last December. The newcomers face an uphill struggle against the entrenched domestic banks, however, and few bond issues have thus far been successfully lead managed by non-Germans. The foreign-owned banks also experienced difficulty placing their initial allotments of government bonds.

Foreign corporate borrowers may actually enjoy better-than-national treatment in West Germany because their bonds are not subject to the tough disclosure and collateral requirements applied to domestic companies. Gross sales of foreign DM bonds rose to DM 31 billion last year, 63 percent higher than the 1984 level. Foreign corporations should find their competitive position improved by access to West Germany's low- rate capital markets, although the volume of future borrowing will be sensitive to exchange rate expectations.

The Underdeveloped Stock Market

The West German stock market is small in relation both to the nation's bond market and to stock markets overseas. The recent bull market in West Germany was due almost entirely to foreign buyers, who accounted for about three-fourths of stock purchases last year. Risk-averse West German savers have never shown much enthusiasm for playing the market.

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Most West German companies shun the stock markets as a means of raising capital—debt/equity ratios of West German firms are almost twice those of their counterparts in the United States and the United Kingdom. Only 450 companies are listed on the stock exchanges as of last December, and only about 30 stocks are actively traded. Bonn abolished double taxation of dividends almost a decade ago, which should have spurred development of the stock market. Recourse to equity financing, however, is still discouraged by taxes on the issue and resale of securities, the large fees charged by banks to sponsor equity issues, and the burdensome regulatory environment—including financial disclosure rules and worker participation rights in management—faced by firms that go public. Moreover, the many family-owned firms are reluctant to dilute their control with sale of stock to outsiders.

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Reforms are in train to bolster the stock markets. The eight regional exchanges, led by Frankfurt and Dusseldorf, have formed an association to promote cooperation, common technical standards, and governmental lobbying. The Bundestag is considering bills to give privately held companies indirect access to the stock markets via investment companies or unlisted stock exchanges. The government may also ease regulations on equity purchases by institutional investors. These reforms, at best, will prevent the West German stock exchanges from falling further behind their international competitors.

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Remaining Impediments

While the actions taken thus far will broaden and internationalize West Germany's financial markets, obstacles to free competition and efficiency remain:

- Taxes on financial transactions still inhibit equity markets and short-term capital markets. The levy on securities transactions, for instance, has driven secondary trading of securities away from West Germany to centers such as London.

- The Bundesbank requires that issues of DM bonds and CDs be domestically based. This "anchored in Germany" policy gives the authorities a latent means of control, and it precludes development of a true Eurobond market for deutsche mark securities.

- Bonds issued by domestic companies remain tightly scrutinized and regulated by the Ministry of Finance.

- Financial futures markets are still prohibited and an extensive reform of the nation's stock exchanges is needed.

Finance Minister Stoltenberg recently announced that the security taxes will be repealed if the conservative coalition remains in power after the January 1987 elections. Because the Finance Ministry must decide how to replace the $450 million raised last year by these taxes, however, they may not be abolished until 1988 or 1989. West German banks also continue to complain that the government's minimum reserve requirements, although reduced last spring, still handicap them in competing with London or Luxembourg for Eurocurrency transactions.

Market Developments and Implications

West German financial markets over the last few years have experienced a dramatic rise in the volume and variety of financial transactions, especially those linking the country to the rest of the world. securities transactions with foreigners have increased more than fourfold since the early 1980s. Although large current account surpluses—$30 billion in 1986 by our estimate—destine West Germany to be a net capital exporter over the next several years, financial liberalization will promote a healthy, two-way capital flow. Particularly since the abolition of interest withholding, foreign investors have shown a strong appetite for West German bonds. In 1985, over 40 percent of domestic bonds were purchased by foreign investors. The foreign bond market has been characterized by larger volumes, longer maturities, and more participants, with Japanese, US, and Scandanavian firms tapping the West German market. The CD market has yet to show much life—only one issue by a US bank subsidiary has been undertaken—but this market could also flourish once the securities taxes are lifted.

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Reversing a negative trend in the early 1980s, the importance of the deutsche mark in international transactions is increasing. the mark last year accounted for 14.5 percent of global exchange reserves while DM-denominated assets captured 7 percent of the world securities market. Because of the improved fundamentals of the West German economy and the new types of securities available, we expect the mark to continue to advance as an international financial asset.

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Greater integration of the world and West German financial systems has important implications for exchange rate stability and monetary policy:

- The relative success of the European Monetary System (EMS) in reducing exchange rate fluctuations is, we believe, partly attributable to the limited mobility of capital among the member states. Because financial liberalization in West Germany coincides with major programs in France and Italy to relax exchange controls, the cumulative effect could be a tendency toward wider swings in West European currency values, hampering the operation of the EMS. In the long run, however, capital controls are incompatible with the EMS agreement, and liberalized West European capital markets are essential if the EMS is ever to evolve into a monetary union.

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- We attribute wide fluctuations in the mark's value against the dollar partly to the inelastic supply of mark-denominated international assets relative to highly volatile demand of foreign investors. By increasing the supply of such assets, financial liberalization might help stabilize the mark/dollar exchange rate.

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The West German authorities fear that the accelerating integration of domestic financial markets with those abroad will make the economy more vulnerable to shifts in exchange rate expectations and international interest rate differentials. They have reacted to the possible dilution of traditional monetary policy tools by turning toward more flexible, market-oriented instruments, such as increased open-market operations. We cannot exclude, however, that the West Germans might revert to some form of guidance over capital flows if faced with dramatic exchange or interest rate swings.

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India: Domestic Oil Prospects Diminish

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On the basis of a detailed study of India's oil prospects, we believe India faces a sharp decline in oil output over the next 10 years. Combined with a probable rapid rise in domestic energy consumption and intractable problems in the coal and electric power sectors, India's oil imports would have to rise significantly, exacerbating perennial foreign payments problems. The payments difficulties, which would become particularly acute if world oil prices increase much above current levels, would hinder purchases of Western equipment and technology for the oil sector and other parts of the economy. Meanwhile, the Indian bureaucracy remains ambivalent about Western investment in the oil sector. At the same time, Soviet participation in Indian oil exploration and development is likely to diminish because of Moscow's need for its oil-related resources at home and the relatively low level of technology.

Current Oil Production and Prospects

In the late 1970s prospects for India's future oil and gas production brightened with the development of the offshore Bombay High field, India's largest oilfield, and increased government support for offshore exploration by foreign companies. Some Indian officials publicly speculated that their country had a chance of achieving oil self-sufficiency. Although now less enthusiastic, the government still forecasts some increase in oil production through 1990.

India's crude oil output has increased by an annual average of 13 percent since 1976, slightly exceeding 580,000 b/d in fiscal year (FY) 1985.[2] The Bombay High field accounts for about two-thirds of national production. Most remaining production comes from onshore fields in Assam and Gujarat.

[2] The Indian fiscal year begins on 1 April of the stated year.

The five-year economic development plan (1985-89) calls for production of 690,000 b/d in FY 1989, but a review of public statements by Indian officials suggests many are dubious that this level can be reached. The Indians no longer talk of self-sufficiency, and the US Embassy reports that unofficial estimates of production range from 600,000 b/d to 700,000 b/d.

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We estimate that Indian crude oil production will decline to 490,000 b/d in FY 1989 and to 275,000 b/d in FY 1994. The area of India's undiscovered recoverable oil reserves of 1.4 billion barrels is so vast that there is substantial risk that no new commercially viable reserves may be found. Moreover, any commercial reserves probably would require sophisticated and expensive Western expertise and equipment for exploitation, involving expenditures of scarce hard currency. Even with outside help, significant production increases are not likely in this decade.

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The maximum feasible onshore crude oil production India will attain over the next decade is 200,000 b/d, only a 5,000 b/d increase over current output instead of the 80,000 b/d increase being projected by the Indians. In the most likely case, however, onshore production will decline rapidly after FY 1987 to about 100,000 b/d by FY 1994. Discoveries in new areas can be expected to contribute no more than 25,000 b/d in FY 1987, and decline to about 14,000 b/d by FY 1994. Even this estimate may be optimistic because it assumes that new discoveries will be brought on stream continuously and without delay. If the Indians were to substantially upgrade the efficiency of their operations and produce existing reserves at a faster rate, the decline could be postponed temporarily, but probably only at the expense of a more rapid decline later.

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Offshore production is expected to decline to about 350,000 b/d in FY 1987, stabilize at that level

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Capability of Domestic Oil Industry

India's strategy for increasing oil production over the next few years is based on the assumption that most of the remaining reserves are in small deposits, will require deep drilling, and will be expensive and time consuming to exploit. The current five-year plan calls for intensified exploration in known oil-producing areas and extending exploration to inadequately explored and unexplored areas. The government intends to drill a total of 2.8 billion meters of exploratory wells during the five-year period, nearly triple the drilling in the previous plan period. To carry out this ambitious exploration program, the Petroleum Ministry plans to have over 120 active rigs by 1990—more than double the current amount.

We believe the domestic oil industry will have a difficult time doubling the number of rigs and operating them efficiently enough to triple exploratory drilling. Indigenous drilling capabilities are poor by US standards, and a strong tendency toward centralized "micromanagement" hinders efficient use of India's existing fleet of rigs. The state oil companies missed their onshore drilling targets in FY 1984 by more than 25 percent and offshore targets by about 30 percent. As a result, the government will probably need substantial foreign assistance if it is to even come close to its targets.

The industry also will have a difficult time locating new oil deposits that are likely to be in complex geological formations. Locating these oil deposits will require detailed seismic surveys and a large increase in seismic data processing at a time when India already has a several-year backlog of unprocessed seismic data. The state oil companies have limited data-processing capability and are reluctant to release the data to foreign contractors. Once small geological formations containing oil are found, sophisticated drilling, well servicing, completion, and production techniques—now only available from foreign contractors—will be required to make them profitable.

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through FY 1989, and decline thereafter to about 175,000 b/d by FY 1994. This contrasts with the Indian Government's assessment that it may be able to increase offshore production by 15,000 b/d by FY 1989. Outside of the Bombay High area, the lead-times involved in developing new areas offshore almost guarantee that none will be developed through FY 1989. Even beyond FY 1989, prospects for new areas offshore are not bright. India's most likely remaining offshore potential is less than 1 billion barrels of oil. Considering the large area involved, there is a high risk that no commercial reserves will be found in any given area.

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Implications for India's Economy

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Recent trends point to Indian demand for petroleum products growing by at least 7 percent per year; the government projects 6.4-percent annual growth. The volume of petroleum imports is also almost certain to increase faster than the 8-percent average annual growth projected by the government. Prime Minister Gandhi is pushing for faster industrial growth, liberalization measures are making more automobiles available, many manufacturers are using diesel generators to maintain production when electricity from the public grid fails, and many farmers have turned to diesel pumps for irrigation.

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Increased oil imports will offset major savings resulting from the fall in world oil prices in recent years. By FY 1989 we estimate that the oil import bill will be $2.5-3.9 billion.[3] In contrast, India's oil import bill in FY 1985—with crude at slightly less than $30 per barrel—was about $3.1 billion. As a result, declining oil production would add to India's financial gap in FY 1989 unless oil prices remain near the $10 per barrel level.

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[3] This estimate reflects the projected decline in domestic production, estimated crude oil demand of 1.2 million b/d, and a world oil price of $10 to $15 per barrel.

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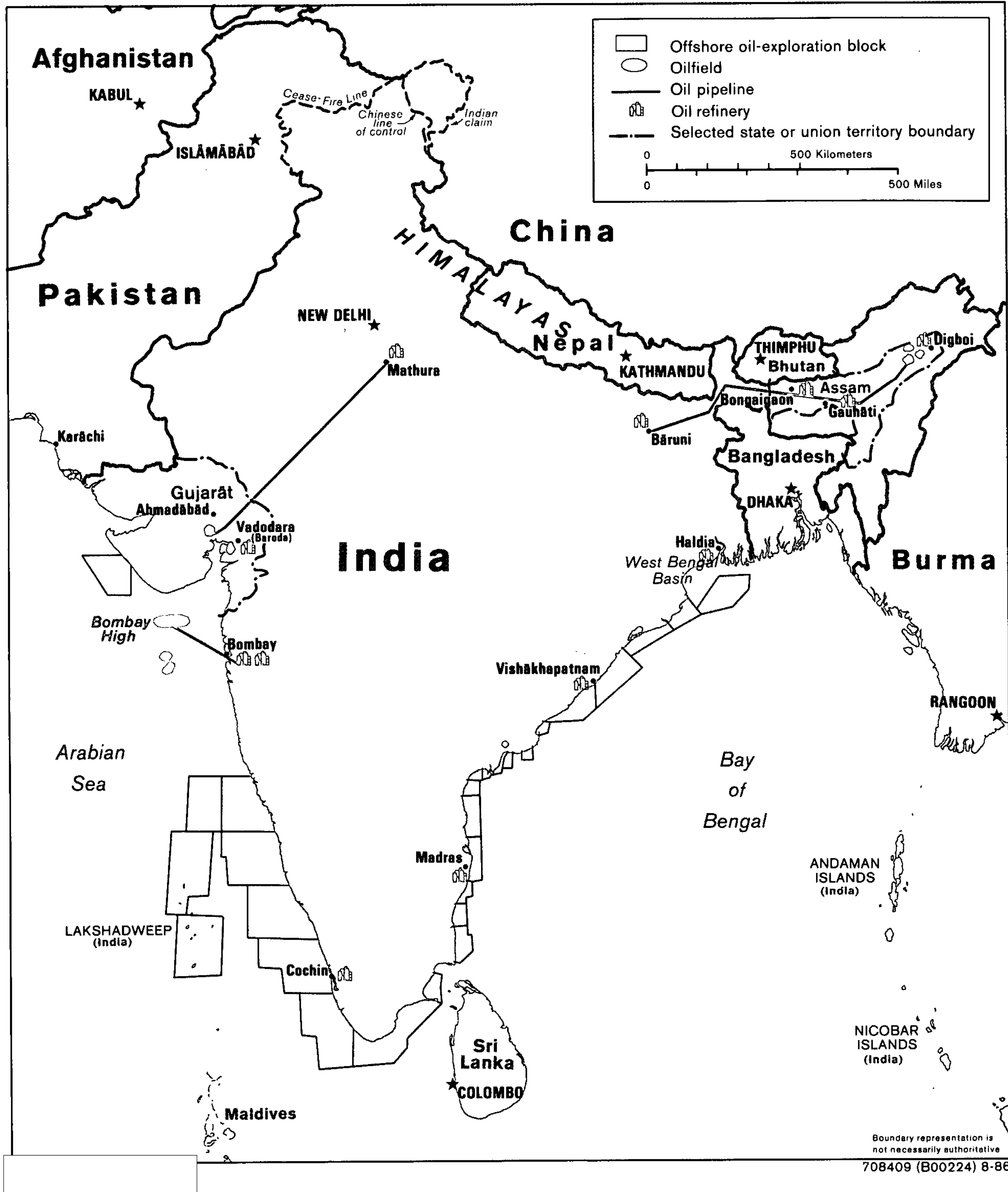
The Petroleum Industry in India



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The Soviet Role

Soviet influence and participation in the Indian petroleum industry is evident at all levels of operation, from India's use of Soviet methodology for estimates of reserves and resources—formulated by Soviet-led teams—to onshore drilling and production operations using Soviet methods. Soviet influence is enhanced because many Indian engineers and managers are Soviet trained, several have married Soviet citizens, and they travel frequently to the Soviet Union.

India is continuing to look to the Soviet Union for inexpensive and basic oil exploration assistance, but we do not believe the Indians expect much Soviet help in high-technology areas. We believe that Moscow will be reluctant to increase dramatically its oil exploration efforts in India when the Soviets have both more critical problems and promising prospects at home. The Soviets have declined an Indian invitation to explore the onshore West Bengal basin or areas in the Himalayan foothills.

Soviet influence and participation in the Indian petroleum sector probably has peaked. The experience of exploiting the offshore Bombay High field has brought Indian managers and key technical personnel into close contact with Western firms having superior equipment, materials, and technology. The Soviets themselves, in contrast, have little experience with offshore petroleum technology. Soviet overseas technical assistance missions use inferior equipment and their least qualified technical personnel. Onshore projects designed and implemented under the auspices of the World Bank have demonstrated to the Indians the technical efficacy of Western state-of-the-art well servicing and recovery techniques. If New Delhi cannot afford the services of Western contractors, it probably will try to copy some of this technology domestically.

Assistance From Western Companies

The Indian Government is looking to foreign oil companies to assist in the stepped-up exploration activity, particularly in new areas where logistic and technical problems are common. India's efforts, however, are being hamstrung by the vacillating policies of the Petroleum Ministry and the relatively poor terms being offered to contractors. Thirty years of reliance on Soviet assistance and equipment also will hamper efforts to incorporate more Western technology and techniques. In addition, the small size and widespread distribution of remaining petroleum resources limit the willingness of contractors to risk their own money to explore for oil in India.

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Nevertheless, India is making a strong effort to attract bids from foreign companies to explore in 27 offshore blocks. New liberalized terms include a greater share of oil production for the foreign operating companies, no royalty payments, and the elimination of minimum spending commitments or bids. Foreign companies have until 30 November 1986 to submit bids.

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Implications for the West

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India's need to use sophisticated techniques in its efforts to find more oil reserves and get maximum recovery from producing fields will present Western countries with a potential market for high-technology goods and services. Offshore exploration, particularly in deep waters, will require expertise and technology that India does not possess and that the Soviets are unable to provide. The onshore search will require highly technical oilfield services, particularly in seismic analysis, to find the small deposits that undoubtedly exist but that are hard to detect. Special enhanced recovery techniques contemplated by India to maximize output from aging fields or complex formations will also require the assistance of outside experts.

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The adverse impact of constant or falling oil production on the balance of payments, however, will make it more difficult for New Delhi to increase purchases of Western oilfield equipment and services along with the other high-technology and capital goods needed to modernize the economy. India probably will seek Western aid and concessional funds to finance oil exploration and development.

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Briefs

Energy

Spot Oil Price Trends

Spot oil prices have firmed over the past three weeks following OPEC's decision to reduce production by 3.5 million b/d in both September and October. Key North Sea and US crudes are selling for $13.75 and $15.35 per barrel, respectively, and the world average price has risen approximately $1.80 the past month to $13.05 per barrel. The market has stayed firm in response to evidence that OPEC producers are taking steps to cut output next month. Saudi Arabia has notified its customers that incentive discounts will not be offered after 1 September; Kuwait is ending spot sales; and Nigeria, Abu Dhabi, and Qatar have informed their customers that they will be reducing liftings. Despite their professed intentions, OPEC countries have pushed production this month to its highest level since January 1982, and the consequent buildup in stocks may dampen demand this winter. In addition, we expect non-OPEC output to rise by as much as 500,000 b/d over the coming months, which will reduce demand for OPEC oil even further. Moreover, the production accord is temporary and tenuous—countries such as Kuwait are prepared to increase production if they observe cheating and there may be a new struggle for market share in November—leaving open the prospect of prices below $10 per barrel. 25X1

International Finance

Cuban Foreign Exchange Shortage

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According to the US Interests Section, Cuban debt payments in August were running about three weeks behind schedule, and [redacted] 25X1 [redacted] the delays stemmed from temporary liquidity problems. [redacted] 25X1 [redacted] in late July that Cuba's hard currency reserves 25X1 were less than $100 million. [redacted] 25X1 [redacted] stricter import criteria had been implemented, and the US Interests 25X1 Section reports that all foreign purchases now have to be approved by the economic commission appointed by President Castro in May. Havana apparently has also tightened banking regulations for foreign exchange transfers and strengthened efforts to acquire US dollars from Western visitors. Castro, however, will have a difficult time extracting new loans from already nervous Western bankers. According to the Interests Section, at least two West European commercial banks have canceled Cuban credit lines recently, and other investors probably will follow suit unless Havana brings arrearages up to date quickly. Moreover, Havana probably will get far less than the $300 million in new credits it requested from commercial creditors as part of debt rescheduling talks scheduled for early September. Consequently, Havana may turn once again to Moscow to bail it out of its hard currency difficulties, but there is no indication that Moscow is willing to increase hard currency assistance to Cuba over 1985 levels. 25X1

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Thai Budget Deficit Threatens IMF Credit

Our calculations indicate a huge shortfall in tax revenues will push the Prem government's 1986 budget deficit to at least $2.3 billion, exceeding by 13 percent the ceiling fixed under its revised IMF standby arrangement. Missing compliance is certain to endanger future Fund disbursements; as it was, the Fund earlier this year delayed a disbursement and tightened up its review of performance criteria when Bangkok failed to meet the original deficit target. The new government's coalition partners are clamoring for increased spending, [ ] as the conservative Finance Ministry tries to hold the line on budget increases and on borrowing. The Ministry is concerned that a cutoff of IMF funds probably would make the country's commercial lenders uneasy and could adversely affect Thailand's good international credit standing. [ ]

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Global and Regional Developments

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Tokyo Pushing Indonesia To Relax Investment Regulations

A recent hard-hitting speech by a Japanese Government official criticizing Indonesia's investment climate is probably part of a stepped-up effort by Tokyo to prod Jakarta to relax foreign investment regulations. The speech was given in Jakarta by the Director of the Japan External Trading Organization (JETRO) in Indonesia and included a list of problems—such as restrictive product pricing regulations and the unavailability of local financing—facing Japanese firms in Indonesia. [ ] 25X1
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investment flows into Indonesia have declined. Tokyo's decision to go public may reflect a belief in Japan that more progress is likely now, given Indonesia's poor economic situation. In addition, Tokyo—which is Jakarta's largest aid donor—may be reacting to pressure from Japanese firms that are struggling in Indonesia. According to the Japanese Government, only 38 percent of Japanese firms in Indonesia are making a profit. Although Jakarta may continue to marginally relax regulations—several were eased in May—it is unlikely that they will move to significantly open the economy to direct investment. Indonesian nationalists remain staunchly opposed to foreign involvement in the economy. [ ] 25X1

China Renews Aid for Tazara Railroad

China has agreed to provide a $3 million credit for the upkeep of the strategic Tazara railway, running between Zambia's copperbelt and the Tanzanian port of Dar es Salaam. [ ] 25X1
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Although the railroad has been plagued with fuel shortages, poor management, lack of spare parts, and equipment failures since its opening in 1976, Zambia currently uses it for about two-thirds of its metal exports, which provide 90 percent of foreign exchange earnings. [ ] 25X1
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National Developments

Developed Countries

South African Preparations to Evade Western Sanctions

According to press reports, the South African Government probably will appoint Fred Bell, an expert on boycott evasion, to coordinate its response to expected Western sanctions. Bell, an aggressive, hardline nationalist, was executive general manager of the Armaments Corporation (ARMSCOR), the government-controlled arms production conglomerate that has prospered since the 1977 UN-sponsored arms boycott against South Africa. ARMSCOR not only has illegally acquired foreign technology but has also independently developed and produced armaments at home. In addition to developing sanctions-busting tactics, we believe Bell will use his ARMSCOR experience to improve South Africa's ability to produce domestic substitutes for imports. [ ] 25X1

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Japanese Pump Priming Measures

In mid-September Prime Minister Nakasone will announce an economic stimulus package—the third this year—in connection with the submission to the Diet of the traditional fall supplemental budget. Although the $19 billion supplemental budget agreed to last week by Nakasone and Finance Minister Miyazawa is being touted as Japan's second largest ever, we believe this package will involve very little new money. The combined budget/stimulus package will probably include housing incentives, additional measures to ease the impact of the strong yen on small exporters, a modest increase in public works spending. It will probably not contain income tax cuts because Tokyo is currently studying a major tax reform for 1987-88. If the economy does not pick up by yearend, however, Nakasone may take the unusual step of proposing an additional supplementary budget in January.

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French Budget Tightening

The French Government's budget for 1987, which will be introduced on 17 September, is being described by Budget Minister Juppe as one more move in the recent series of "near revolutionary changes" in economic policy put in place by the conservative government of Prime Minister Chirac. Juppe told the US Embassy that for the first time in 29 years expenditure growth—at 1.8 percent—will be less than projected inflation. In particular, the new budget envisions sizable cuts in government personnel, in subsidies, and in aid to industry. As a result, the budget deficit will be lowered to $19 billion—4 percent of GDP—despite a $4 billion reduction of the tax burden on businesses and households. Juppe also stated that the government plans to continue its program to decontrol prices, privatize parts of the public sector, and liberalize foreign exchange and capital flows regulations.

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Denmark Resisting Devaluation

Despite the continued worsening of Denmark's current account deficit—$2.4 billion in first half 1986 following a record $3.2 billion for all of 1985—the Conservative-led coalition government opposes a kroner devaluation and has dropped its long-held 1988 target date for balancing the current account. The current account deficit is the government's biggest economic problem, and two minor austerity packages implemented in December and March have failed to stem the red ink. Copenhagen believes it has no further room to tighten fiscal policy because a budget surplus is likely this year and another is expected in the preliminary budget submission for 1987. Prime Minister Schlueter is unwilling to devalue, however, because he took office in 1982 pledging to maintain stable exchange rates. He fears that a devaluation could damage investors' confidence in his government's policies, and thereby jeopardize the strong economic recovery that has pulled unemployment down from 10.5 percent in 1983 to 6.7 currently—among the lowest in the EC.

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Less Developed Countries

Continued Libyan Economic Austerity

Libyan leader Qadhafi is continuing to pursue economic policies that contribute to antiregime sentiment. [redacted] Tripoli has reduced civil service salaries by 5 percent and cut back on government employee housing allowances. In addition, government paychecks are increasingly late and withdrawals from state accounts are restricted. Restrictions on travel allowances are fueling a thriving black market; many Libyans traveling abroad purchase hard currency illegally to supplement the reduced amounts available from banks. These new austerity measures come at a time of unprecedented discontent over Qadhafi's economic policies. Food lines are already long as imports—a primary source of the domestic food supply—are at their lowest levels in seven years. Moreover, Qadhafi has failed to implement low-cost measures such as restocking shelves with a few consumer staples, which could help ease his deteriorating political position. [redacted]

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Moderate Economic Provisions Gain in Draft Philippine Constitution

Leftist delegates threatened this week to delay the commission drafting a new Philippine constitution after losing a bid to protect all domestic businesses from foreign imports. Proponents of trade liberalization prevailed with a draft provision that limits import protection only to cases of "unfair foreign competition." Leftists also failed to win approval of draft language severely restricting foreign investment. The moderates' economic provisions—which now closely track the previous constitution—limit foreign ownership to 40 percent of public utilities and to businesses for which the legislature determines that the national interest is at stake. Although nationalistic economic provisions are being defeated by the moderates, leftists will almost certainly contest ratification of the consitution if they judge that domestic economic interests are not sufficiently protected. In any case, prolonged heated public debate on foreign ownership will probably keep prospective investors on the sidelines until the constitution is ratified later this year. Under these circumstances, the economy's recovery will be weaker than the 6-percent growth in output currently projected by Manila for next year. [redacted]

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Egyptians Enact Customs Reform

Implementation last week of Cairo's long-anticipated customs reform is being hailed by the Egyptian Government as an important step toward revitalizing the economy. The reform measure abolishes most customs exemptions, reduces substantially customs rates as well as the number of customs categories, and increases the valuation of imported items by over 90 percent. Intended to be revenue neutral, the new law is, nevertheless, likely to be used as a tool by the government to quietly raise duties. The ban on the importation of luxury goods and locally produced items, if not accompanied by exchange rate reforms, may, however, lead to encouragement of high-cost domestic production with little economic development impact. Cairo is likely to cite the customs changes as further justification for US support in Egypt's effort to minimize the preconditions of an IMF-endorsed standby program. [redacted]

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South Korea To Produce Electronics-Grade Silicon

In a move that will enhance the vertical integration of the country's microelectronics industry, two of South Korea's electronics firms will soon begin marketing semiconductor materials. Beginning in January 1987, Lucky Advanced Materials—under license from a US firm—will grow electronics-grade silicon ingots that it will slice and polish into finished wafer substrates. Moreover, Korsil—a joint venture between Dongbu and another US firm—by yearend will be importing unfinished substrates for polishing at its local facility. We calculate the combined annual output of these firms, projected [redacted] at some 40 million square inches of electronics-grade silicon, will be enough to supply approximately 85 to 90 percent of local demand for wafer substrates. South Korea currently imports polished wafers largely from the United States and Japan. By acquiring US technology, South Korea is building up its silicon-processing expertise in the same way it developed a world-class semiconductor industry. [redacted]

25X1

25X1

Indonesia Moves To Ease Unemployment

The Soeharto government—expecting flat or negative economic growth this year—is planning to subsidize training and create approved operating zones for the "informal" sector work force—street merchants, food vendors, and pedicab drivers. These moves will be coupled with an end of Jakarta's previous practice of harassing the informal sector to discourage urban migration. Jakarta hopes the new policy will enable the informal sector to absorb one-half to three-quarters of the estimated 2 million new entrants to the labor force each year; we estimate that unemployment currently averages 25 to 30 percent. Although the regime's expectations are probably optimistic, its encouragement of the informal sector would be an important symbolic gesture, and could dampen urban tensions of the kind that contributed to the riots in Jakarta's port district in 1984. [redacted]

25X1

New Moroccan Austerity Measures

Embassy reporting indicates Rabat may hike food prices this week to pave the way for a new IMF accord. The move would come at a time of a series of positive developments—low oil prices, a weaker dollar, falling interest rates, and an end to the drought—that have raised public expectations of an economic recovery, not of new austerity measures. Available foreign reserves total less than two weeks' worth of imports, and Morocco needs an IMF agreement to garner new aid to cover at least a $500 million financial gap this year. Rabat has requested a $250 million bridge loan from the United States to cover payments needs until expected IMF monies are available in October. [redacted]

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[redacted]

25X1

Without a significant infusion of funds, hard currency levels may not be enough to prevent spot shortages of essential consumer goods, which could result in sporadic outbreaks of violence. [redacted]

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Pakistani Islamic Banking Dividends Decline

For the third straight six-month period since coming under Islamic banking statutes, Pakistani and foreign banks declared lower dividends to savers. According to the US Consulate in Karachi, the lower dividends reflect the lack of investment opportunities for banks' excess liquidity rather than weakness in Islamic banking. Despite having ample funds to lend, banks are discouraged from increasing loans by regulations that heavily penalize exceeding state-imposed credit ceilings. The credit ceilings were imposed because of concerns that additional lending may fuel inflation and the state bank's belief that investors should utilize more of their own money rather than depend on funds from the banking sector. Searching for ways to improve dividend performance, foreign banks have asked the state bank governor to float a new security bond that would yield a higher return than mandatory security investments held as reserves.

25X1

Communist

Moscow Reorganizing Foreign Trade

The Politburo has approved a reorganization of the Soviet foreign trade sector—to take effect at the beginning of next year—that will establish a state foreign trade commission similar to the bureau recently created to coordinate the work of machine-building ministries, according to the US Embassy. The decree—to be issued within the next few days—reportedly will allow some enterprises to engage directly in foreign trade, to have greater control over their hard currency earnings, and to have more leeway in negotiating joint ventures. General Secretary Gorbachev's plans for streamlining the bureaucracy are said to have included reorganization of the foreign trade apparatus for at least a year. Moscow hopes the changes will boost exports of machinery and equipment, but their effects will be limited by other shortcomings in the system that inhibit product quality. The potential of the reorganization to improve foreign trade operations will depend on the new commission's authority, the degree to which the Ministry of Foreign Trade's monopoly on trade transactions is reduced, the number of enterprises involved, and the extent of their autonomy.

25X1

More Problems for Key Chinese Hydroproject

Heavy rains have added to construction woes at a key hydroproject in southern China at Tianshengqiao, site of a cofferdam collapse last December that killed 48 workers. China is building the dam with foreign, including some US, equipment and is financing the project with low-cost Japanese loans. In the months since the collapse, heavy rains have caused mudslides and damaged access roads; damage to existing facilities has required repairs that threaten plans for partial operation by 1989.

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Directorate of
Intelligence

Economic & Energy Indicators

29 August 1986

DI EEI 86-018
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Industrial Production

Percent change from previous period seasonally adjusted at an annual rate

	1981	1982	1983	1984	1985	1986			
						1st Qtr	2nd Qtr	May	Jun
United States	2.6	–7.2	5.9	11.6	2.3	0.5	–2.7	–6.5	–3.8
Japan	1.0	0.4	3.5	11.1	4.6	0.7	0.9	4.0	4.0
West Germany	–2.3	–3.2	0.3	2.4	4.8	–0.3		–32.8	
France	–2.6	–1.5	1.1	2.5	0.5	–4.9	5.1	–46.5	31.2
United Kingdom	–3.9	2.1	3.9	1.3	4.7	3.2	–2.7	–19.7	–13.5
Italy	–1.6	–3.1	–3.2	3.3	1.2	11.7	8.9	–43.5	36.7
Canada	0.5	–10.0	5.3	8.8	4.3	–0.9		–21.9	

Gross National Product [a]

Percent change from previous period seasonally adjusted at an annual rate

	1981	1982	1983	1984	1985			1986	
					Year	3rd Qtr	4th Qtr	1st Qtr	2nd Qtr
United States	2.5	–2.1	3.6	6.4	2.7	4.1	2.1	3.8	0.6
Japan	4.1	3.1	3.3	5.0	4.5	2.7	5.8	–2.1	
West Germany	–0.2	–1.0	1.5	3.0	2.4	6.8	–0.2	–6.5	
France	0.2	1.8	0.7	1.5	1.3	3.8	2.1	0.3	
United Kingdom	–1.4	1.9	3.4	2.6	3.3	–1.1	1.8	2.9	
Italy	0.2	–0.5	–0.2	2.8	2.3	1.0	2.3	5.3	
Canada	3.3	–4.4	3.3	5.0	4.5	7.0	5.4		

[a] Constant market prices.

Consumer Prices

Percent change from previous period seasonally adjusted at an annual rate

	1981	1982	1983	1984	1985	1986			
						1st Qtr	2nd Qtr	Jun	Jul
United States	10.3	6.2	3.2	4.3	3.5	1.4	–1.7	5.7	0.4
Japan	4.9	2.6	1.8	2.3	2.0	0	–0.8	0.6	
West Germany	6.0	5.3	3.3	2.4	2.2	–0.9	–1.1	0.4	–2.6
France	13.3	12.0	9.5	7.7	5.8	0.8	1.7	4.5	0.8
United Kingdom	11.9	8.6	4.6	5.0	6.1	4.5	0.4	1.2	0.7
Italy	19.3	16.4	14.9	10.6	8.6	6.2	5.0	6.6	3.8
Canada	12.5	10.8	5.8	4.3	4.0	4.8	3.0	0.3	6.8

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Money Supply, M-1 [a]

Percent change from previous period seasonally adjusted at an annual rate

	1981	1982	1983	1984	1985	1986			
						1st Qtr	2nd Qtr	Jun	Jul
United States [b]	7.1	6.6	11.2	7.0	9.1	7.9	16.8	15.8	18.3
Japan	3.7	7.1	3.7	2.8	5.0	7.7	9.5	7.2	
West Germany	1.1	3.6	10.2	3.3	4.4	9.8	11.3	21.3	
France	12.2	13.9			8.7	20.4	1.9	16.4	
United Kingdom	NA	NA	13.0	14.7	16.7	9.2	33.0	14.7	14.0
Italy	11.2	11.6	15.1	12.3	13.7	8.9			
Canada	3.8	0.7	10.2	3.2	4.1	−13.3	−1.9	28.7	42.3

[a] Based on amounts in national currency units.
[b] Including M1-A and M1-B.

Unemployment Rate [a]

Percent seasonally adjusted

	1981	1982	1983	1984	1985	1986				
						1st Qtr	2nd Qtr	May	Jun	Jul
United States	7.5	9.6	9.4	7.4	7.1	7.0	7.1	7.2	7.0	6.8
Japan	2.2	2.4	2.7	2.7	2.6	2.6	2.8	2.7	2.7	
West Germany	5.6	7.7	9.2	9.1	9.3	10.2	8.6	8.5	8.4	8.6
France	7.6	8.4	8.6	9.6	10.0	9.9	10.0	10.0	10.1	10.2
United Kingdom	10.0	11.6	10.7	11.1	11.3	11.5	11.6	11.6	11.7	11.7
Italy	8.4	9.1	9.9	10.4	10.7	11.5				
Canada	7.5	11.1	11.9	11.3	10.5	9.7	9.6	9.6	9.5	9.9

[a] Unemployment rates for France are estimated.

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Foreign Trade [a]

Billion US $, f.o.b.

	1981	1982	1983	1984	1985	1986				
						1st Qtr	2nd Qtr	Apr	May	Jun
United States [b]										
Exports	233.5	212.3	200.7	217.6	213.3					
Imports	261.0	244.0	258.0	325.7	345.3	92.9	90.8	28.8	30.3	31.8
Balance	–27.5	–31.6	–57.4	–108.1	–132.0					
Japan										
Exports	149.6	138.2	145.4	168.1	173.9	47.8	51.2	16.7	17.6	16.8
Imports	129.5	119.6	114.0	124.1	118.0	30.0	29.0	9.7	9.1	10.2
Balance	20.1	18.6	31.4	44.0	55.9	17.8	22.2	7.0	8.5	6.7
West Germany										
Exports	175.4	176.4	169.5	171.9	184.3	55.1	60.5	21.9	17.5	21.1
Imports [c]	163.4	155.3	152.9	153.1	158.9	45.0	47.4	17.2	14.4	15.9
Balance	11.9	21.1	16.6	18.8	25.3	10.1	13.1	4.7	3.1	5.2
France										
Exports	106.3	96.4	95.1	97.5	101.9	30.4	29.8	9.9	9.7	10.1
Imports	115.6	110.5	101.0	100.3	104.5	30.3	30.9	10.6	10.0	10.3
Balance	–9.3	–14.0	–5.9	–2.8	–2.6	0.1	–1.1	–0.7	–0.3	–0.2
United Kingdom										
Exports	102.5	97.1	92.1	93.6	100.9	26.2	26.8	9.1	8.9	8.8
Imports	94.6	93.1	93.7	99.3	103.5	28.3	29.1	9.5	9.9	9.7
Balance	7.9	4.0	–1.6	–5.7	–2.5	–2.0	–2.4	–0.4	–1.0	–0.9
Italy										
Exports	75.4	73.9	72.8	73.4	78.8	23.3	24.4	8.2	8.1	8.2
Imports	91.2	86.7	80.6	84.4	90.7	26.4	24.0	8.2	7.9	7.9
Balance	–15.9	–12.8	–7.9	–10.9	–11.9	–3.1	0.4	0	0.2	0.3
Canada										
Exports	70.5	68.5	73.7	86.5	88.0	21.7	21.2	7.5	7.1	6.7
Imports	64.4	54.1	59.3	70.6	75.7	19.9	19.6	6.7	6.4	6.5
Balance	6.1	14.4	14.4	15.9	12.3	1.8	1.7	0.8	0.7	0.3

[a] Seasonally adjusted.
[b] Imports are customs values.
[c] Imports are c.i.f.

Current Account Balance [a]

Billion US $

	1981	1982	1983	1984	1985	1986				
						1st Qtr	2nd Qtr	Apr	May	Jun
United States	6.3	–8.1	–46.6	–106.5	–117.7	–33.7				
Japan	4.8	6.9	20.8	35.0	49.2	12.7	23.2	7.9	7.7	7.6
West Germany	–6.8	3.3	4.3	6.7	13.8	6.9	8.1	3.6	2.6	1.9
France	–4.7	–12.1	–4.9	–0.8	0.9	1.0				
United Kingdom	15.3	8.5	4.7	1.9	5.0	0.7	0.8	0.7	0.1	0.1
Italy	–8.6	–5.7	0.6	–2.9						
Canada	–5.0	2.1	2.4	2.6	–0.4	–2.1				

[a] Seasonally adjusted; converted to US dollars at current market rates of exchange.

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Export Prices in US $

Percent change from previous period at an annual rate

	1981	1982	1983	1984	1985	1986			
						1st Qtr	2nd Qtr	May	Jun
United States	9.2	1.5	1.0	1.4	−0.7	−0.5	1.2	3.2	7.1
Japan	5.5	−6.4	−2.4	0.2	−0.6	26.1	24.9	12.9	−3.5
West Germany	−14.9	−2.8	−3.2	−7.1	0	40.7	16.6	20.4	−2.4
France	−12.0	−5.5	−4.8	−2.9	2.5	33.2		15.2	
United Kingdom	NA	NA	−6.2	−5.1	2.3	−2.6	7.2	9.1	−1.7
Italy	−7.8	−3.0	−4.4	−5.2	−0.3	25.9		26.3	
Canada	3.9	−2.0	0.2	−0.4	−3.5	−16.3	5.5	0.9	−0.8

Import Prices in US $

Percent change from previous period at an annual rate

	1981	1982	1983	1984	1985	1986			
						1st Qtr	2nd Qtr	May	Jun
United States	5.3	−2.0	−3.7	1.7	−2.4	−7.1	−10.8	−0.9	−0.4
Japan	3.6	−7.4	−5.0	−2.8	−4.3	−5.3	−49.2	−54.3	−2.2
West Germany	−8.6	−4.7	−5.2	−4.8	−1.5	9.8	−11.6	−7.3	−24.1
France	−7.8	−7.2	−7.0	−3.8	−0.3	10.3		6.6	
United Kingdom	NA	NA	−5.7	−4.5	0.5	−0.5	2.4	3.9	−18.2
Italy	1.0	−5.3	−6.6	−3.7	−1.0	10.7		−19.2	
Canada	8.7	−1.1	0.6	1.0	−2.1	− 8.9	3.6	0.3	−23.0

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Exchange Rate Trends

Percent change from previous period at an annual rate

	1981	1982	1983	1984	1985	1986				
						1st Qtr	2nd Qtr	May	Jun	Jul
Trade-Weighted										
United States	10.5	10.6	5.8	9.1	6.3	–17.8	–11.3	–13.7	21.7	
Japan	9.3	–5.7	10.4	6.2	6.8	26.8	42.4	81.8	18.4	
West Germany	–2.1	7.0	5.8	1.0	1.7	8.5	6.0	11.3	6.5	
France	–5.1	–6.1	–4.7	–2.1	2.7	5.8	–10.4	–3.1	7.4	
United Kingdom	2.5	–2.1	–5.0	–2.5	2.0	–26.0	9.5	11.8	3.7	
Italy	–9.2	–5.1	–1.6	–3.1	–3.8	5.5	5.2	9.3	11.7	
Canada	0.3	0.2	2.3	–2.3	–3.6	–13.1	1.7	6.2	– 7.6	
Dollar Cost of Foreign Currency										
Japan	2.7	–12.9	4.6	0	–0.3	32.2	33.5	42.8	–2.2	48.3
West Germany	–24.6	–7.2	–5.2	–11.5	–3.3	31.3	17.1	19.5	–1.0	35.5
France	–28.7	–20.8	–15.9	–14.7	–2.7	29.7	4.4	15.7	–2.8	27.7
United Kingdom	–13.2	–13.4	–13.3	–11.9	–3.0	1.7	20.8	19.3	–7.7	– 2.0
Italy	–32.8	–18.8	–12.3	–15.6	–8.6	30.1	14.5	18.8	–2.0	35.2
Canada	–2.5	–2.9	0.1	–5.1	–5.4	–6.9	5.7	6.4	–13.1	6.8

Money Market Rates

Percent

	1981	1982	1983	1984	1985	1986				
						1st Qtr	2nd Qtr	Apr	May	Jun
United States 90-day certificates of deposit, secondary market	16.24	12.49	9.23	10.56	8.16	7.68	6.77	6.67	6.75	6.88
Japan loans and discounts (2 months)	7.79	7.23	NA	6.66	6.52	6.38	5.98	6.12	5.98	5.82
West Germany interbank loans (3 months)	12.19	8.82	5.78	5.96	5.40	4.51	4.52	4.47	4.55	4.55
France interbank money market (3 months)	15.47	14.68	12.51	11.74	9.97	8.96	7.41	7.55	7.27	7.41
United Kingdom sterling interbank loans (3 months)	13.85	12.24	10.12	9.91	12.21	12.26	10.09	10.41	10.14	9.72
Italy Milan interbank loans (3 months)	20.13	20.15	18.16	15.91	14.95	16.00	12.71	13.66	12.50	11.97
Canada finance paper (3 months)	18.46	14.48	9.53	11.30	9.71	11.08	9.03	9.52	8.78	8.80
Eurodollars 3-month deposits	16.87	13.25	9.69	10.86	8.41	7.91	7.00	6.95	6.99	7.07

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Agricultural Prices

	1981	1982	1983	1984	1985	1986			
						1st Qtr	2nd Qtr	Jun	Jul
Bananas Fresh imported, (Total world, $ per metric ton)	214.0	217.0	232.0	243.0	110.3	109.8	108.5	109.5	NA
Beef (¢ per pound)									
Australia (Boneless beef, f.o.b. US Ports)	112.4	107.4	111.1	101.0	96.6	97.6	91.3	89.3	90.0
United States (Wholesale steer beef, midwest markets)	100.0	101.4	97.6	100.9	90.7	87.8	84.4	83.9	89.6
Cocoa (¢ per pound)	89.8	74.3	92.1	106.2	98.7	95.7	82.6	81.4	87.6
Coffee ($ per pound)	1.28	1.40	1.32	1.44	1.43	2.01	1.73	1.51	1.50
Corn (US #3 yellow, c.i.f. Rotterdam, $ per metric ton)	150	123	148	150	125	116	116	118	98
Cotton (World Cotton Prices, "A" index, c.i.f. Osaka, US ¢/lb.)	72.69	74.48	85.71	63.91	57.87	53.60	45.51	40.67	36.35
Palm Oil (United Kingdom 5% bulk, c.i.f., $ per metric ton)	571	445	502	730	501	289	241	243	221
Rice ($ per metric ton)									
US (No. 2, milled, 4% c.i.f. Rotterdam)	632	481	514	514	484	453	352	293	288
Thai SWR (100% grade B c.i.f. Rotterdam)	573	362	339	310	249	236	224	226	230
Soybeans (US #2 yellow, c.i.f. Rotterdam, $ per metric ton)	288	244	282	283	225	218	213	210	203
Soybean Oil (Dutch, f.o.b. ex-mill, $ per metric ton)	507	447	527	727	571	407	348	351	336
Soybean Meal (US, c.i.f. Rotterdam $ per metric ton)	252	219	238	197	157	188	184	181	183
Sugar (World raw cane, f.o.b. Caribbean Ports, spot prices ¢ per pound)	16.93	8.42	8.49	5.18	4.04	5.83	7.45	6.36	5.58
Tea Average Auction (London) (¢ per pound)	91.0	89.9	105.2	156.6	90.0	86.4	85.6	79.7	79.8
Wheat (US #2. DNS c.i.f. Rotterdam, $ per metric ton)	210	187	183	182	169	172	158	140	129
Food Index [a] (1980=100)	88	78	86	92	81	95	94	88	83

[a] The food index is compiled by *The Economist* for 14 food commodities which enter international trade. Commodities are weighted by 3-year moving averages of imports into industrialized countries.

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Industrial Materials Prices

	1981	1982	1983	1984	1985	1986			
						1st Qtr	2nd Qtr	Jun	Jul
Aluminum (¢ per pound)									
Major US producer	77.3	76.0	77.7	81.0	81.0	81.0	81.0	81.0	81.0
LME cash	57.4	44.9	65.1	56.8	47.2	51.4	53.1	53.7	50.7
Chrome Ore (South Africa chemical grade, $ per metric ton)	53.0	50.9	50.0	50.0	43.9	40.0	40.0	40.0	40.0
Copper [a] (bar, ¢ per pound)	79.0	67.1	72.0	62.4	64.5	64.5	64.5	64.1	60.6
Gold ($ per troy ounce)	460.0	375.5	424.4	360.0	317.2	342.6	341.6	342.5	348.4
Lead [a] (¢ per pound)	32.9	24.7	19.3	20.0	17.7	16.7	17.6	19.0	17.0
Manganese Ore (48% Mn, $ per long ton)	82.1	79.9	73.3	69.8	68.4	67.2	64.8	64.8	64.8
Nickel ($ per pound)									
Cathode major producer	3.5	3.2	3.2	3.2	3.2	3.2	3.2	3.2	3.2
LME Cash	2.7	2.2	2.1	2.2	2.2	1.8	1.8	1.9	1.8
Platinum ($ per troy ounce)									
Major producer	475.0	475.0	475.0	475.0	475.0	475.0	475.0	475.0	475.0
Metals week, New York dealers' price	446.0	326.7	422.6	358.2	291.0	383.1	420.1	432.3	438.0
Rubber (¢ per pound)									
Synthetic [b]	47.5	45.7	44.0	44.4	44.1	42.8	38.7	37.9	NA
Natural [c]	56.8	45.4	56.2	49.6	42.0	41.7	40.1	41.0	43.0
Silver ($ per troy ounce)	10.5	7.9	11.4	8.1	6.1	5.9	5.2	5.2	5.0
Steel Scrap [d] ($ per long ton)	92.0	63.1	73.2	86.4	74.4	74.0	71.8	70.92	NA
Tin [a] (¢ per pound)	641.4	581.6	590.9	556.6	543.2	357.4	250.5	244.2	244.0
Tungsten Ore (contained metal, $ per metric ton)	18,097	13,426	10,177	10,243	10,656	8,673	7,567	7,474	7,112
US Steel (finished steel, composite, $ per long ton)	543.5	567.3	590.2	611.6	617.8	551.2	554.4	556.6	NA
Zinc [a] (¢ per pound)	38.4	33.7	34.7	41.5	35.4	28.5	33.8	36.5	36.5
Lumber Index [e] (1980=100)	95	84	114	105	103	100	121	112	111
Industrial Materials Index [f] (1980=100)	85	71	82	76	69	68	70	70	70

[a] Approximates world market price frequently used by major world producers and traders, although only small quantities of these metals are actually traded on the LME. As of February 1986 tin prices from the Penang market.
[b] S-type styrene, US export price.
[c] Quoted on New York market.
[d] Average of No. 1 heavy melting steel scrap and No. 2 bundles delivered to consumers at Pittsburgh, Philadelphia, and Chicago.
[e] This index is compiled by using the average of 10 types of lumber whose prices are regarded as bellwethers of US lumber construction costs.
[f] The industrial materials index is compiled by *The Economist* for 18 raw materials which enter international trade. Commodities are weighted by 3-year moving averages of imports into industrialized countries.

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World Crude Oil Production Excluding Natural Gas Liquids

Thousand b/d

	1981	1982	1983	1984	1985 [a]	1986 [a]			
						1st Qtr	May	June	July
World	**55,837**	**53,092**	**52,625**	**53,674**	**52,931**	**54,029**			
Non-Communist countries	**41,602**	**38,810**	**38,228**	**39,257**	**38,692**	**39,758**			
Developed countries	12,886	13,276	13,864	14,302	14,730	15,022			
United States	8,572	8,658	8,680	8,735	8,933	8,898	8,848	8,808	8,800
Canada	1,285	1,270	1,356	1,411	1,457	1,480			
United Kingdom	1,811	2,094	2,299	2,535	2,533	2,711	2,538		
Norway	501	518	614	700	785	856	826		
Other	717	736	915	921	1,022	1,077	927		
Non-OPEC LDCs	6,036	6,633	6,823	7,515	7,845	7,556	7,998		
Mexico	2,321	2,746	2,666	2,746	2,733	2,376	2,527	2,547	2,500
Egypt	598	665	689	827	874	758	845		
Other	3,117	3,222	3,468	3,942	4,238	4,422	4,626		
OPEC	22,680	18,901	17,541	17,440	16,117	17,180	18,000	19,300	20,320
Algeria	803	701	699	638	645	602	600	600	600
Ecuador	211	211	236	253	280	275	300	300	285
Gabon	151	154	157	152	153	160	160	170	170
Indonesia	1,604	1,324	1,385	1,466	1,235	1,223	1,305	1,235	1,250
Iran	1,381	2,282	2,492	2,187	2,258	1,890	2,100	2,200	2,300
Iraq	993	972	922	1,203	1,437	1,732	1,700	1,700	1,900
Kuwait [b]	947	663	881	912	862	1,169	1,400	1,500	1,600
Libya	1,137	1,183	1,076	1,073	1,069	1,000	1,100	1,200	1,150
Neutral Zone [c]	370	317	390	410	355	276	220	300	340
Nigeria	1,445	1,298	1,241	1,393	1,464	1,417	1,550	1,490	1,600
Qatar	405	328	295	399	302	352	360	430	400
Saudi Arabia [b]	9,625	6,327	4,867	4,444	3,290	4,256	4,250	5,100	5,600
UAE	1,500	1,248	1,119	1,097	1,146	1,287	1,405	1,505	1,505
Venezuela	2,108	1,893	1,781	1,813	1,621	1,541	1,550	1,570	1,620
Communist countries	**14,235**	**14,282**	**14,397**	**14,417**	**14,239**	**14,271**			
USSR	11,800	11,830	11,864	11,728	11,350	11,350			
China	2,024	2,042	2,121	2,280	2,496	2,496	2,496		
Other	411	410	412	409	393	425			

[a] Preliminary.
[b] Excluding Neutral Zone production, which is shown separately.
[c] Production is shared equally between Saudi Arabia and Kuwait.

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Big Seven: Inland Oil Consumption

Thousand b/d

	1981	1982	1983	1984	1985	1986						
						Jan	Feb	Mar	Apr	May	June	Jul
United States [a]	16,058	15,296	15,184	15,708	15,726	15,923	16,056	16,188	15,743	15,852	16,150	16,309
Japan	4,444	4,204	4,193	4,349	4,123	4,661	5,002	4,570	3,951	3,576		
West Germany	2,120	2,024	2,009	2,012	2,060	2,096	2,406	2,141	2,640	2,388		
France	1,744	1,632	1,594	1,531	1,493	1,626	2,009	1,525	1,702	1,245	1,284	
United Kingdom	1,325	1,345	1,290	1,624	1,402	1,286	1,483	1,447	1,427	1,330		
Italy [b]	1,705	1,618	1,594	1,513	1,516	1,718	1,855	1,535	1,495	1,345	1,506	
Canada	1,617	1,454	1,354	1,348	1,259	1,261	1,280	1,109	1,239	1,325		

[a] Including bunkers, refinery fuel, and losses.
[b] Principal products only prior to 1981.

Big Seven: Crude Oil Imports

Thousand b/d

	1981	1982	1983	1984	1985	1986						
						Jan	Feb	Mar	Apr	May	June	Jul
United States	4,406	3,488	3,329	3,426	3,201	3,329	2,993	3,000	3,701	3,872	4,508	4,291
Japan	3,919	3,657	3,567	3,664	3,377	3,126	4,273	3,673	3,469			
West Germany	1,591	1,451	1,307	1,335	1,284	1,321	1,258	1,429	1,285	1,340	1,263	
France	1,804	1,596	1,429	1,395	1,476	1,430	1,420	1,380	1,608	1,235		
United Kingdom	736	565	456	482	523	493	445	494				
Italy	1,816	1,710	1,532	1,507	1,462							
Canada	521	334	247	244	283	353	424	260	185			

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Crude Oil Prices

US $ per barrel

	1980	1981	1982	1983	1984	1985	1986			
							1st Qtr	2nd Qtr	May	Jun
OPEC Average [a] (Official Sales Price)	30.87	34.50	33.63	29.31	28.70	28.14	28.09	28.08	28.07	28.11
World Average Price	NA	NA	NA	NA	NA	27.16	20.67	NA	14.06	NA

[a] F.o.b. prices set by the government for direct sales and, in most cases, for the producing company buy-back oil. Weighted by the volume of production.

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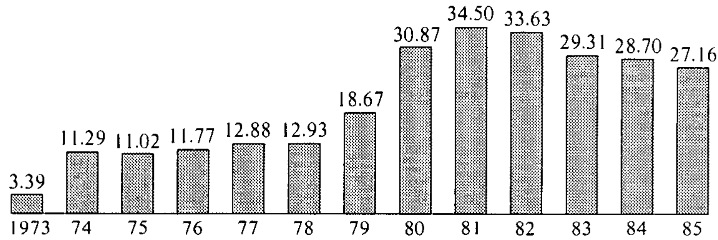
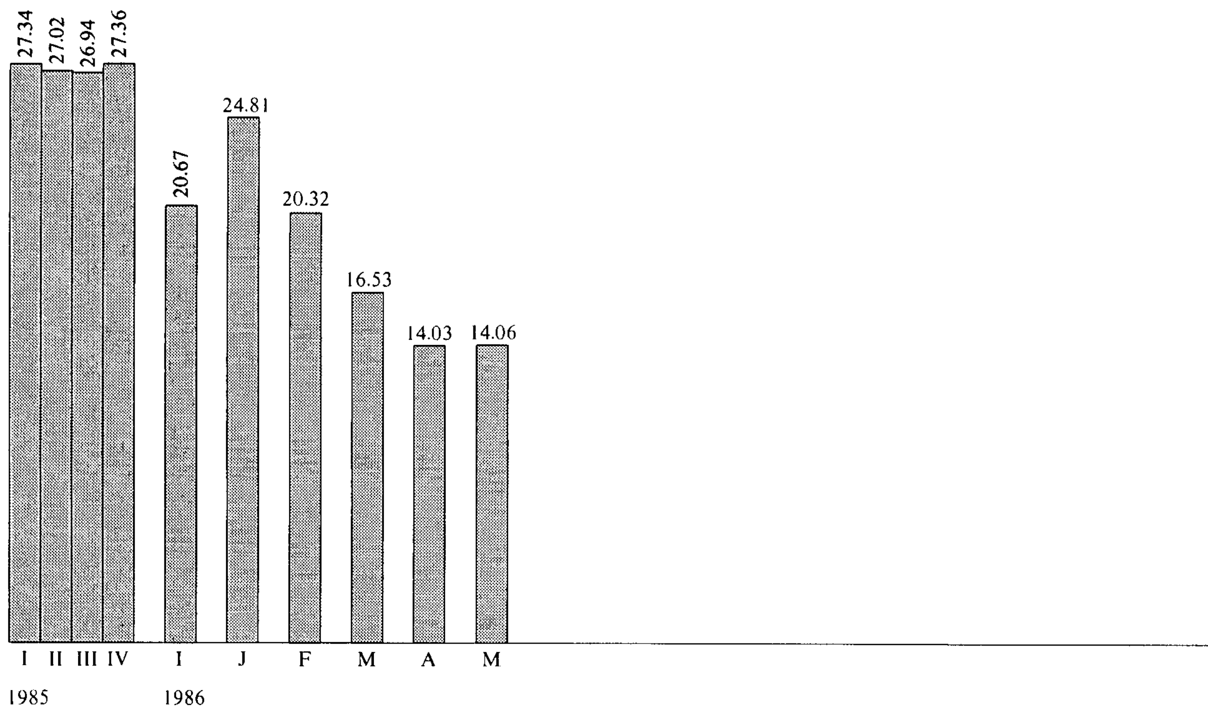
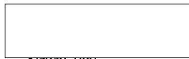
Average Crude Oil Sales Price[a]

US $ per barrel





[a] The 1973 price is derived from posted prices, 1974-84 prices are derived from OPEC official sales prices, and beginning in 1985, prices are a measure of average world sales prices.



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