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International Economic & Energy Weekly

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26 September 1986

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International Economic & Energy Weekly

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26 September 1986

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Synopsis

1 **Perspective—Latin American Concerns Over Possible OECD Recession**

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We believe negotiations to resolve the region's debt problem would become even more arduous in the event of a recession in the industrialized countries as Latin governments reassess debt strategies.

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3 **Big Seven: Prospects for Economic Policy Coordination**

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Despite the commitment by the Big Seven leaders at the May Tokyo Economic Summit to a more formal coordination of economic policies, we believe any future coordinated policy revisions will be restricted to the monetary and exchange rate areas and that politically difficult fiscal adjustments will be driven more by domestic priorities.

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7 **Algeria: Coping With the Energy Price Slump**

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Algeria is facing its most serious financial crisis since independence because of the decline in world energy prices. Algiers has taken some steps to rein in government spending, and we believe additional measures are in the offing.

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11 **The Philippines: Electricity Shortages Looming**

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Electric power shortages on Luzon island—where more than 90 percent of the country's nonagricultural production takes place—are increasingly causing concern among Filipino and US businessmen and will probably constrain any economic recovery.

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17 **Soviet Arctic Petroleum: Moscow's Need for Western Capabilities**

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The Soviet Union has high hopes for the petroleum potential of its Arctic regions, but Soviet reliance on domestic equipment would retard oilfield projects in these areas considerably. If the Soviets discover a substantial oilfield in the offshore Arctic and elect to expedite development, they would need to import large volumes of equipment.

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26 September 1986

Perspective

Latin American Concerns Over Possible OECD Recession

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Industrial-country delegates attending the annual IMF/IBRD meetings that begin 28 September will find Latin American representatives worried about world economic prospects. Slower than expected economic growth in the OECD raises the specter of a recession that would abort the current gradual recovery in Latin America. We believe negotiations to resolve the region's debt problem would become even more arduous in the event of a recession in the industrialized countries as Latin governments reassess debt strategies.

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A flagging world economy would cause Latin American nations' financial needs to rise. According to our Linked Policy Impact Model, each 1-percentage-point decline in OECD growth would worsen Latin American current account balances by at least $1-2 billion in the first year and $2.5-3.0 billion in the second year. Moreover, uncertainty about Latin economic prospects could boost capital flight, widening the financial gap. Although the total impact of an OECD slowdown would depend on its length and severity, the effect of lower Latin export revenues would outweigh relief from lower interest rates.

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The prospect of more austerity to shore up the balance of payments would probably revive fears of political unrest. In the wake of this summer's Mexico-IMF accord that linked new lending to oil prices, the region's debtors—especially Argentina and Brazil—almost certainly would press for further financial concessions to blunt the anticipated political consequences.

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Creditors—who already have taken steps to try to protect themselves from default—would adopt a tougher stance with Latin debtors in the event of an OECD recession. Bankers probably would contend that they have little leeway to ease the need for economic adjustment in the debt-troubled countries. Already reluctant to accommodate IMF pressure for new lending to hard-pressed Latin governments, they would almost certainly become less inclined to grant additional large-scale financing because of deteriorating prospects for repayment. In the event of a severe recession, we believe that individual banks would be tempted to agree to separate deals with debtors.

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Before resorting to the threat of radical debt action, we believe Latin American governments would first look to OECD governments to share more of the burden of adjustment by changing current trade and debt policies. During the recent GATT ministerial meeting at Punta del Este, for example, Argentina and Uruguay called on the United States, the EC, and Japan to dismantle agricultural trade barriers and subsidies and indicated that free trade in farm commodities will be their major goal for a new trade round. We believe financial stringencies caused by an OECD recession might provoke Latin governments to link farm trade concessions to debt. In addition, Latin debtors almost certainly would renew calls

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for preferential trade treatment for their industrial products and more lending by multilateral development banks and the IMF. Moreover, they would probably lobby Western monetary authorities—particularly the US Federal Reserve—for changes in banking regulations that would allow commercial banks to take more innovative approaches to reducing debt service. If Latin debtors perceive industrial-country insensitivity to their plight, we believe this would significantly raise the likelihood of radical action.

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For the time being, the major Latin American debtors apparently remain committed to cooperating with creditors. The strain of a severe recession and the South Americans' belief that Mexico won its concessions by threatening a moratorium may quickly lead to more confrontational stands. Under such conditions, Latin debtors might try to use the threat of collective action under the aegis of the Cartagena Group to intimidate creditors into granting similar concessions.

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Big Seven: Prospects for Economic Policy Coordination

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Despite the commitment by the Big Seven leaders at the May Tokyo Economic Summit to a more formal coordination of economic policies, we believe any future coordinated policy revisions will be restricted to the monetary and exchange rate areas and that politically difficult fiscal adjustments will be driven more by domestic priorities. Actively coordinated macroeconomic policy changes beyond possible discount rate cuts in the near future are unlikely because, barring a major shift in the current economic forecast, there is no strong consensus within the Big Seven that such changes are needed. Moreover, because central bankers want to preserve their independence, we do not foresee the extension of monetary cooperation to encompass coordinated monetary targeting or major reform of the existing exchange rate regime.

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Big Seven Economic Trends

During the past several years, the Big Seven governments have had a mixed record on achieving their economic policy objectives. Inflation rates have fallen dramatically and are forecast to remain low, though a number of the governments are expressing concerns about faster monetary growth. Most fiscal deficits either have been or are being reduced. The major problems facing the group are the growth pauses in the United States and Japan, the US fiscal and current account deficits, and the current account surpluses of Japan and West Germany.

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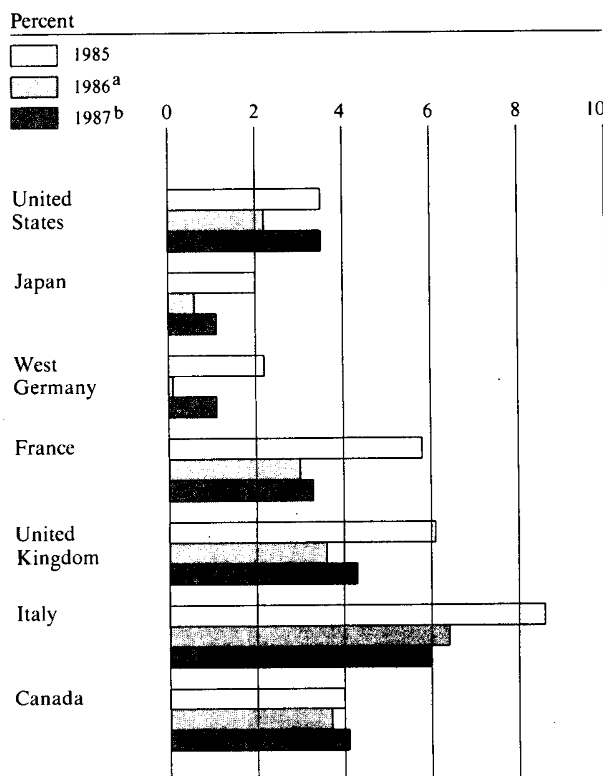
Japan. Because of the extraordinary appreciation of the yen, we expect Japanese real GNP growth will be unusually low this year but will recover modestly in 1987. The current account surplus will probably widen in dollar terms, but volume changes suggest that a long-term reduction in the surplus is already under way. The price and real income effects of the

Big Seven: Consumer Price Inflation, 1985-87



[a] Estimated.
[b] Projected.

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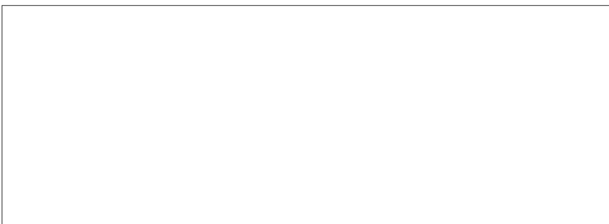
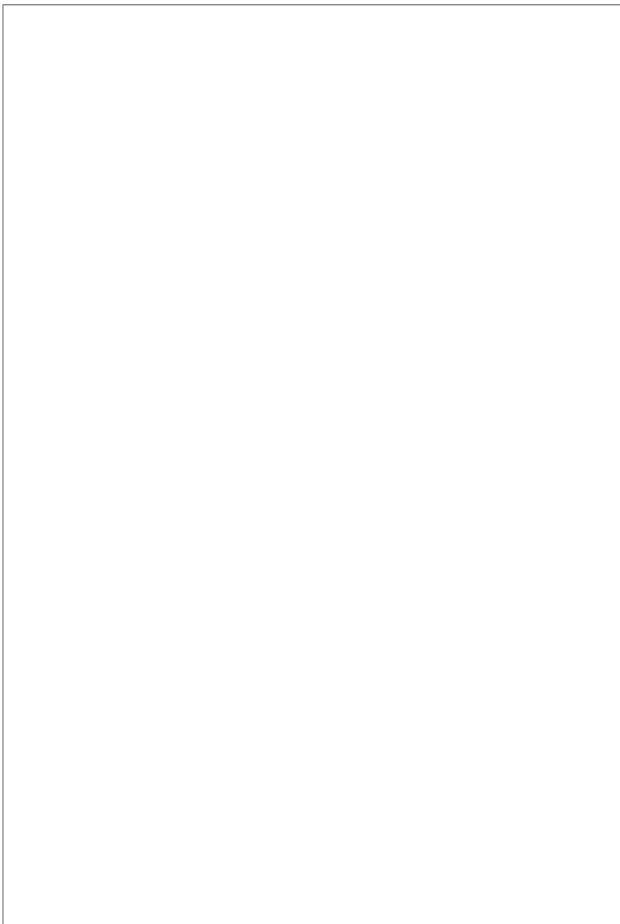
The Framework for Big Seven Policy Coordination

Prior to the Tokyo Economic Summit, macroeconomic cooperation was largely a matter of agreeing on broad economic objectives while leaving the selection of appropriate policies to the individual governments. More extensive economic cooperation involving the coordinated design of policies was agreed to by the heads of state at the Summit. The Big Seven finance ministers were charged with evaluating the compatibility of the individual nations' economic forecasts and objectives. In addition, the heads of state asked their central bankers to meet with the finance ministers to make their best efforts to reach an understanding on appropriate remedial measures whenever necessary.

The finance ministers are to meet periodically to review their economic forecasts collectively with the International Monetary Fund using nine indicators: GNP growth rates, inflation rates, interest rates, unemployment rates, fiscal deficit ratios, current account and trade balances, reserves, and exchange rates.





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yen appreciation will complement the government's recently announced program designed to shift the structure of demand from the foreign sector to domestic sources.

West Germany. Moderate GNP growth for the remainder of 1986 and much of 1987 is now generally forecast for the German economy, despite the weak performance earlier this year. The current account surplus is growing in dollar terms, but rising import and stagnant export volumes indicate a trend toward a more balanced trade account. Domestic demand growth has begun to replace the foreign sector as the primary source of economic growth. To the consternation of the Bundesbank, monetary growth has exceeded its target for several months in succession.

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France. Bouyant consumer demand is expected to continue driving the French economy in 1986 and 1987. The roughly 2.5-percent real GNP average annual growth we expect each of those years, though low by West European standards, represents a major improvement over 1985. Healthy but not excessive

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Big Seven Real GNP Growth 1985-87 [a]

Percent

		CIA		Blue Chip [b]		IMF	
	1985	1986	1987	1986	1987	1986	1987
United States	2.7	NA	NA	2.6	3.1	2.9	3.5
Japan	4.5	2.0	3.0	2.9	3.4	2.7	2.7
West Germany	2.4	2.5	2.5	3.0	3.2	3.0	3.2
France	1.4	2.3	2.5	2.5	2.8	2.2	2.2
United Kingdom	3.3	2.0	2.5	2.4	2.5	2.5	2.4
Italy	2.3	3.2	3.0	2.7	2.9	3.1	2.6
Canada	4.5	2.6	3.0	3.1	3.2	3.3	3.7

[a] Data for 1986-87 are projected.
[b] An average of 43 major private forecasts.

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current account surpluses are also likely. French monetary policy is currently restrained by uncertainty about the new monetary control procedures and the desire to avoid weakening the franc.

United Kingdom. The stimulus to private demand associated with disinflation is being offset by the decline in North Sea oil earnings, leading to gloomy economic forecasts for the United Kingdom. We expect an average annual real growth of 2.3 percent this year and next. If oil prices remain low, the current account, once expected to show a substantial 1986 surplus, will be in modest deficit during 1987.

Italy. The Italian Government faces unusually favorable economic conditions. A consumer-driven surge of domestic demand will probably raise real GNP growth to 3 percent this year and next. Inflation is still high by West European standards but has fallen by more than 2 percentage points in the last year. The current account is expected to move into surplus this year and remain positive in 1987. Italy's major task remains the continued reduction of its fiscal deficit. Higher than anticipated tax revenues have helped reduce the deficit from 16 to about 14 percent of GNP over the past year.

Canada. Real GNP growth is projected at or below 3 percent in 1986 and 1987, down sharply from 1985 due to declining US growth and the effect of falling oil prices on the energy-producing sector. The Canadian current account deficit is expected to widen. In the most recently announced figures, the inflation rate edged slightly upward.

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Future Coordinated Policy Revisions

We believe the most extensive coordination of macroeconomic policy revisions likely in the near future is a cut in central bank discount rates. Even here, however, pockets of resistance in the West German and Japanese central banks are strong. Monetary growth in both economies has recently overshot targets, and strong German domestic demand suggests Bonn will continue to resist calls for further stimulus. Despite its reluctance, Bonn would probably cut its discount rate rather than allow a further appreciation of the deutsch mark following a unilateral reduction in the US discount rate. If the West German, US, and Japanese rates fall, we believe the remaining central banks would rapidly follow suit.

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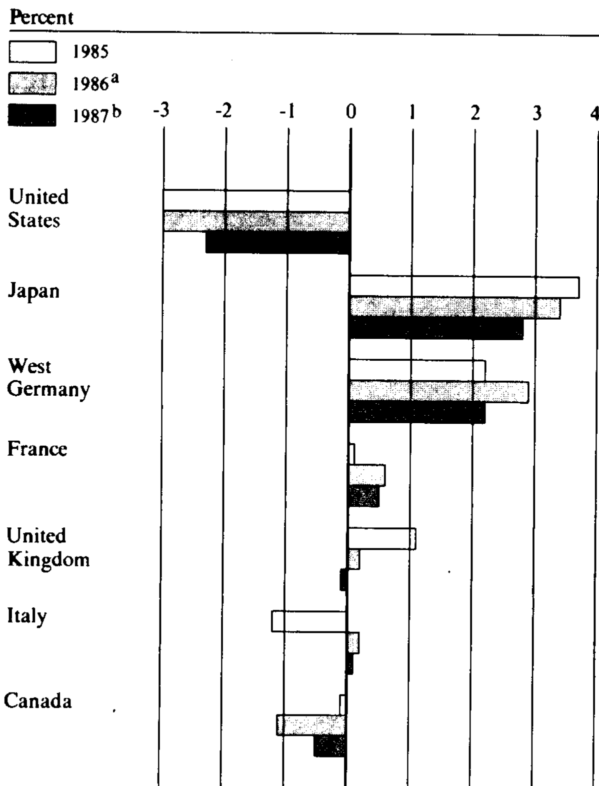
Big Seven: Current Account Balances as a Share of GNP, 1985-87



[a] Estimated.
[b] Projected.

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Beyond discount rate cuts, there is no strong consensus about the nature of, or need for, further coordinated action. To maintain adequate real growth in the Big Seven, we believe that US net exports must rise to offset efforts to narrow the fiscal deficit; at the same time, domestic demand in Europe and Japan must take up the slack for declining net exports. In fact, the needed shifts in the structure of demand are already well under way in West Germany, Italy, France, and to some extent the United Kingdom, and Japanese policy is already focusing on that objective.

The recent movements of the dollar, the yen, and the deutsch mark have already corrected what many observers believed were most serious currency misalignments, paving the way for substantially more balanced trade once the US fiscal deficit is reduced. Further dollar depreciation would reinforce the decline in the trade imbalance, but would probably be strongly resisted by the Japanese and the Germans. Recent press reports suggest the European Community has decided to collectively support the dollar.

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Despite the sentiments expressed at the Tokyo Summit, we believe that, over the longer run, Big Seven–coordinated policy revisions are likely to be confined to occasional and ad hoc monetary agreements. Individual fiscal policies will probably be governed by either short-run domestic political considerations or by the longer run objective of fiscal balance. A precondition for active fiscal coordination—confidence in the parties' ability to "deliver"—is undermined by the inability of heads of state to guarantee the intended outcome of highly politicized budgetary processes. The staunchly defended autonomy of central bankers has allowed them to occasionally act more decisively, but their domestic priorities also preclude the more extensive coordination implied by common monetary rules or fundamental reform of the world exchange rate system.

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Algeria: Coping With the Energy Price Slump

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Algeria is facing its most serious financial crisis since independence because of the decline in world energy prices. We estimate that Algeria will lose some $6 billion in crude oil, condensate, products, and natural gas earnings this year. Algiers has taken some steps to rein in government spending to offset these losses, and we believe additional measures are in the offing. The country is also making a concerted effort to boost earnings by pushing aggressively within OPEC to bolster oil prices while becoming more accommodating in negotiations with its major gas customers to preserve its market share. Current financial problems come at a time when President Bendjedid has focused on the economy as a base for moving away from the Soviet socioeconomic model. Although he has so far been able to sell austerity to the public, he may be forced to step back from some aspects of his austerity program and many of his progressive goals.

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The Current Scene

Hydrocarbons are the mainstay of the Algerian economy, accounting for 98 percent of export receipts, nearly 50 percent of government revenues, and nearly 25 percent of GDP. Algeria has been switching gradually since the early 1980s from mostly crude oil sales to a combination of products. This expansion of its export base allowed Algiers to escape the full impact of falling crude prices until the past year. The collapse in refined product prices as well as increased competition for gas customers has brought the problem of export dependency to Algiers' front door:

- Real incomes are plummeting; GDP per capita is still nominally among the highest in Africa at $2,500, but wage increases have not kept pace with inflation, which is running at about 14 percent—double the 1985 level.
- Unemployment has hit a record 25 percent in many areas and unemployment and underemployment together may exceed 30 percent.
- Joblessness is contributing to growing delinquency and crime among Algerian youth; 65 percent of the populace is under 25 and the population is growing at a rate of 3 percent annually.
- Financial constraints are making foreign aid for liberation groups—including the Polisario—more burdensome.

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Government Actions

The Bendjedid government has announced a variety of measures to stem the country's deteriorating financial position. Algiers has revised the national budget, cutting overall government operating expenses by 11 percent and development expenditure by 26 percent, according to Embassy reporting. Although we have little reporting on the value of specific cuts so far, the government projects these reductions will slash imports by some $2 billion by the end of the year. Algiers, additionally, has suspended the government subsidized c.o.d. postal system, halved foreign exchange allocations for tourist travel, and reduced annual allowances for pilgrimages to Mecca to save scarce foreign exchange.

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Algiers has also taken steps to reduce services imports, which accounted for as much as one-third of total imports of goods and services last year. According to the US Embassy, Algiers is reducing the number of foreign technicians in country by restricting access to work and residence permits. The Italian expatriate community, for example, has dwindled to 700 from 2,000 only 18 months ago. Technical assistance contracts are also being canceled—including construction and possibly some maintenance programs for gas liquefaction plants. These measures could save Algiers an estimated $600-700 million annually.

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Algeria: Current Account, 1985-86

Billion US $

	1985	1986 [a]	1986 [b]
Current account balance	−1.2	−7.1	−3.4
Trade balance	3.6	−2.3	0.7
Exports, f.o.b.	12.6	6.7	6.7
Crude oil	6.3	3.1	3.1
Condensates	3.0	1.5	1.5
Refined products	0.4	0.2	0.2
Natural gas	2.6	1.6	1.6
France	1.0	0.6	0.6
Italy	1.1	0.6	0.6
Belgium	0.3	0.2	0.2
Spain	0.2	0.2	0.2
Other	0.3	0.3	0.3
Imports, c.i.f.	9.0	9.0	6.0
Foodstuffs	1.7	1.7	1.3
Consumer goods	0.5	0.5	0.3
Industrial goods	6.8	6.8	4.4
Net services	−4.7	−4.7	−4.0
Grants	−0.1	−0.1	−0.1

[a] Case 1: Assumes average crude oil price for 1986 is $15 per barrel; condensates' price is $13.42 per barrel; refined products' price is $15.60 per barrel; second-quarter gas prices are average for the year (gas contract renegotiations are inconclusive); production and consumption of all hydrocarbons equals 1985 levels; and no austerity measures are implemented.

[b] Case 2: Assumes all conditions in case 1 hold for the first six months of the year. Assume these same parameters remain constant during the latter half of 1986 except each European gas price equals the French rate of $2.36 per million Btu (the result of successful gas contract renegotiations) and austerity measures slash imports, services, and foreign aid.

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Algeria has also tapped the international financial market. 25X1 after trying unsuccessfully to float a $500 million loan in February—bankers felt Algerian terms were too low—Algiers has managed to win about $900 million in new funds. 25X1 Japanese banks have been especially active in subscribing Algerian loans recently—$650 million so far this year. Middle Eastern banks, too, have been active, possibly to try to calm Algeria's increasingly radical stance within OPEC. 25X1

The Bendjedid government, additionally, has rapidly drawn down reserves while pushing for higher levels of foreign assistance. By the end of July, foreign exchange reserves had fallen from roughly $3 billion at the beginning of the year to about $1.9 billion—the lowest level in nearly two years. New foreign aid has yet to materialize. In addition to problems lining up concessional loans from the United States, Algiers has had difficulties with the French 25X1

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Algiers's efforts to cushion the impact of falling hydrocarbons earnings, however, have not come without cost, according to Embassy reporting. Import cuts

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have resulted in spot shortages of consumer goods and foodstuffs such as coffee. Spare parts shortages are also beginning to affect industrial and agricultural production. State farms are being hit especially hard. Parts shortages are immobilizing heavy machinery, causing planting and harvesting delays. The problem is compounded by the elimination of the c.o.d. postal service through which many replacement parts were previously ordered. Budget cuts are also slicing into social services such as education and housing. Cuts in the country's development program—Embassy reporting indicates only agriculture and import substitution industries are being spared—are increasing pressures on the country's already burgeoning unemployment rate.

The prolonged decline in foreign exchange earnings has had a dramatic impact on Algiers's international debt position. We believe Algerian debt now exceeds $21 billion and the country's debt service ratio could hit 80 percent by yearend if present earnings trends continue—double the ratio just two years ago. Such a high debt-service burden is prompting a more careful monitoring by Algiers's creditors of principal and interest repayments. In addition, the country's favorable international credit rating—long a source of national pride—is being eroded.

Domestic Reactions

The public response to austerity measures so far has been muted. Embassy reporting indicates the government has mounted an impressive nationwide public relations campaign to mobilize popular support to counter the adverse effects of the present international economic situation. Through media blitzes and regional meetings and conferences, the government is urging the people to cut down on imports and eliminate resource waste. Algiers's theme is "self-reliance" in fighting the "economic war that will be almost as difficult to win as the war for independence."

Although President Bendjedid has so far averted a popular backlash from the economic crisis, he is encountering problems within his government. The President is in the midst of trying to turn the cumbersome and inefficient Soviet-style economy toward a Western-oriented system that relies heavily on private enterprise. Bendjedid has had to spend considerable time recently trying to convince detractors that his economic liberalization is not responsible for the country's current financial woes.

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There are already indications that Bendjedid has been forced to allow the hardliners a greater say in foreign policy matters in exchange for their tacit support of his economic agenda. For example, recent Algerian foreign policy activities include rapprochement with Libya, closer ties to radical Palestinians, renewed activity within the "Steadfastness Front," [1] and Algiers's aggressive posture within OPEC.

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Cuts—albeit small—in the military procurement budget are also hurting Bendjedid's standing with the military. Rumors abound in Algiers that Bendjedid's budget cuts are responsible for stalling Soviet-Algerian arms talks.

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Prospects

Algeria's economic outlook for the remainder of 1986 is bleak. Without any improvement in current prices for oil and gas, Algiers could incur a current account deficit as high as $7 billion. Indeed, Algeria's losses could be even greater should OPEC's new production accord collapse or gas negotiations currently in train with major European customers not settle in Algiers's favor.

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A deficit of this magnitude will require further adjustments. Even assuming that Algeria fully implements austerity measures already in place, the financial gap still far exceeds available reserves. We believe the government will try to reduce government spending

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[1] Radical members of the Arab League—Algeria, Libya, South Yemen, and Syria.

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even more by trimming imports, consumer subsidies, and development expenditures. We believe, however, this is not a viable solution because the government cannot make deep enough cuts without jeopardizing the modern economy and risking political backlash from urban workers and the military.

Western bankers believe Algiers will seek to combine moderate new spending cuts with new borrowing of about $900 million this year. Willing lenders, however, could be difficult to find. Recent loan syndications suggest that US and European bankers probably will not participate. Japanese enthusiasm may also wane as Algeria's economic problems deepen. Bankers also expect rising debt pressures will force the Bendjedid government to reschedule some of its debt by next year. Contrary to previous policy, we believe Algeria in the interim may well seek oil and gas barter deals, particularly in exchange for needed food and other essential imports and possibly arms. Algiers may even go so far as to try to convince Libya to resume support to the Polisario, so Algeria can reduce its financial obligations there.

Political Realities

Algiers probably will be able to maintain public order, despite the hardships the new austerity programs are likely to produce. The government has a large and efficient security force and it has not hesitated in the past to move quickly to suppress dissent. To be sure, expectations among the predominantly youthful population are rising. Younger Algerians probably will not be as ready to accept the scarcities that have been a hallmark of the government's emphasis on investment over consumption since independence. There has been an increasing number of demonstrations and riots in recent years attributable to social and economic grievances, and more are likely. Islamic fundamentalists—although a disparate and disorganized group—will attempt to take advantage of the disgruntlement.

Although we do not expect Bendjedid to be toppled from power, we do believe he could be forced to step back from some aspects of his austerity program and many of his progressive goals. Leftist ideologues would attempt to use domestic problems to curtail Bendjedid's economic liberalization program and outreach to Western countries. This leftist challenge, however, would only become serious if it had the support of a large group of military officers.

Bendjedid will almost certainly continue his search for aid from the West to help offset any budding opposition. We believe Algiers will try to use its still decent international credit rating to secure more commercial funds from Western and Arab banking sources. We doubt Algiers would seek large amounts of official lending because many government leaders probably do not want to become overly dependent on foreign governments. Likewise, Bendjedid will also continue to seek military hardware from both the Soviet Union and Western suppliers as a bargaining tool to obtain favorable prices and credit terms but is unlikely to make political concessions to either Moscow or the West to obtain them.

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The Philippines: Electricity Shortages Looming

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Electric power shortages on Luzon island—where more than 90 percent of the country's nonagricultural production takes place—are increasingly causing concern among Filipino and US businessmen and will probably constrain any economic recovery. The Aquino administration's decision to halt the long-postponed completion of the Philippines Nuclear Power Plant (PNPP) has left a gap in planned electrical capacity that will take at least five years to fill, even if plans for other new plants are implemented quickly. Moreover, the government-owned National Power Corporation (NPC) and the Philippine Government, already saddled with more than $1.5 billion in debts from the Bataan plant, will be hard pressed to pay the more than $1.2 billion cost of new plants and renovations. Under these circumstances, Soviet offers of financial and construction assistance will present a strong temptation to the Aquino government. Meanwhile, periodic electricity shortages are likely to worsen—particularly during and immediately following the December-June dry season—until the new and upgraded plants come on line.

25X1

The Luzon Power Grid

The Luzon electrical supply looks good on paper with peak demand—2,300 megawatts (MW)—only 56 percent of installed capacity—4,100 MW. Actual operating capacity, however, is much lower. According to the US Embassy, equipment failures have reduced the capacity of Luzon's 10 oil-fired plants by a total of about 500 MW. Low water levels resulting from the December-June dry season cause a loss of another 500 MW in hydropower. A power industry analyst estimates that weather, maintenance, and other problems altogether cause a drop in the total dependable capacity to 2,350 MW in the dry season and about 3,040 MW in the rainy season. According to the NPC's low GNP growth scenario, demand will increase to more than 2,750 MW by 1990, resulting in a 400 MW dry season electrical shortfall even in the unlikely event—given years of deferred maintenance—that all existing plants will be able to maintain current production levels. Our own estimate—on the basis of our econometric model—suggests a shortfall of about 450 MW.

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Luzon's Electrical Woes

Brownouts and blackouts are once again plaguing the electrical grid on Luzon—the northern Philippine island where 75 percent of the nation's electricity is consumed. Dependable capacity of the Luzon grid during and immediately following the December-June dry season when hydrocapacity is down is barely adequate to cover peak demand. Brownouts—a serious problem in the early 1980s until the economic downturn lowered demand for electricity—began to reappear in mid-June and probably contributed to a blackout on 21 August that affected some 90 percent of the island's residents.

25X1

Although the onset of monsoonal rains is increasing hydropower production and decreasing the frequency of brownouts, the US Embassy reports that businessmen's concern about the power situation ranks just behind their worries over labor problems and the political situation. Many US-owned companies have experienced losses from production shutdowns and equipment damage, and they believe the situation will worsen when the long-expected economic recovery increases the demand for electricity. The business community in Manila cites high power costs—by far the highest in non-Communist East Asia—and looming shortages as among the reasons it is keeping new investments on hold.

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East Asian Electrical Power Cost Comparison, 1986

	Power Cost [a]	
	Cents per Kilowatt Hour	Index: Manila Price per Kilowatt Hour=100
Manila	11.54	100.0
Tokyo	7.33	63.5
Jakarta	6.59	57.1
Hong Kong	6.57	57.0
Singapore	6.46	56.0
South Korea	5.94	51.5
Bangkok	5.78	50.1
Taiwan	5.48	47.5

[a] Nominal cost for large consumers. Data are from Philippine Chamber of Commerce and Industry, July 1986. Cost converted from pesos at the rate of 20.25 pesos to US $1.

The Bataan Nuclear Plant

Much of the projected shortfall in electrical capacity over the next several years can be attributed to the Aquino administration's decision—following months of internal debate and the Chernobyl' disaster—to mothball the nearly completed 620-MW PNPP on the Bataan Peninsula. Reviving the plant would be politically very costly for the Aquino administration given the widespread public opposition to it and President Aquino's campaign promises to halt the project. Moreover, security would be a major problem; 18 of the plant's transmission towers have been toppled by Communist insurgents and by criminal groups—looting the metal for sale as scrap—over the past few years. converting the PNPP from nuclear to coal-fired operation would cost $1.0-1.5 billion and require six to seven years to complete, roughly twice as costly and time consuming as constructing two new 300-MW coal-fired plants.

In addition to delaying expansion of Luzon's electrical capacity, the debt from the nuclear plant constrains NPC's ability to solve the power problem. 25X1

the debt totals more than $1.5 million, mostly from foreign loans—including $644 million from the US Export-Import Bank. The Philippine Government assumed the NPC's foreign obligations on the plant on 13 August, according to the US Embassy. Manila hopes to trim the massive debt servicing costs—currently $114 million per year and scheduled to rise to an average of $240 million annually between 1987 and 1993—through: 25X1

- Legal actions against the plant's contractor, Westinghouse, for alleged overbilling and fraud.
- Suits against former members of the Marcos administration.
- Considering a separate rescheduling of loans for the nuclear plant, according to the US Embassy.

According to late August press reporting, the NPC has suspended payments to Westinghouse and the plant's insurance carriers. 25X1

Officials Overly Optimistic

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Philippine energy officials discount reports that electrical shortages will worsen. According to the US Embassy, the president of the NPC insists that the present system can handle increased demand until new plants come on line and that any shortfalls could be made up by using emergency gas turbines. In August 1986, an energy official announced that the Cabinet has approved NPC's plan to add 400 MW to the Luzon grid by 1992. A 300-MW coal-fired plant will be built near Batangas, south of Manila, and the other 100 MW will come from expanding Luzon's geothermal capacity. In the meantime, the NPC will rehabilitate four oil-fired plants. 25X1

We question the Philippine energy officials' optimism. They do not take into account the likely equipment failures at existing plants. Short-term use of gas turbines to reduce power shortages is technically feasible, but is extremely expensive, according to an industry source. The plans for upgrading the Luzon electrical grid by adding new plants and renovating existing ones will take several years to complete—even if implemented quickly—and we believe such 25X1 25X1

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Luzon Electric Power Developments, 1986

0 150 Kilometers
0 150 Miles

Luzon
Manila
Morong
Mothballed nuclear power plant
Planned new coal-fired power plant
Batangas
Philippines
Samar
Panay
Visayan Islands
Leyte
Palawan
Negros
Mindanao

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plans will require enormous expenditures that the NPC and the government will find difficult to pay. According to the US Embassy:

- All 10 existing oil-fired plants need rehabilitation at a total cost of roughly $1 billion. We believe rehabilitation will require each plant to be taken off line for at least several months, reducing the dependable capacity by an average of 150 MW for each plant.

- The planned coal-fired plant near Batangas will cost at least $250 million, and, as a Philippine official admits, will not be ready until at least the early 1990s.

- Expansion of geothermal capacity is unlikely, according to the US Embassy, until the NPC pays the $85 million it owes UNOCAL, the operator of Luzon's two geothermal fields.

Although the Philippine Government has relieved the NPC of its $300,000 daily interest payment on the PNPP, the NPC corporation faces massive financial problems, largely due to mounting debts of local power cooperatives. According to the US Embassy, NPC accounts receivable totaled about $270 million in 1985—Manila Electric Company (MERALCO) alone owes $175 million. In Manila, the continuation of the Marcos administration's "social pricing" policies for small residential consumers produces a revenue loss that MERALCO cannot make up with its sharply higher rates for large consumers. Additional NPC losses have stemmed from widespread meter tampering and from the tendency of many residents in recently electrified rural areas to ignore electric bills because they believed electricity to be a gift from the government

Outlook

Dry-season brownouts and blackouts on Luzon will probably increase. The long leadtime required to plan and construct any large power plant means that even if financing is found—increasing the government's already large debt burden—it will be at least 1990 before new plants come on line. Renovation of some existing plants and equipment failures are likely to cause additional capacity reductions over the next several years, which would increase shortages even if demand remained constant.

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With the PNPP out of the picture—at least for the present—Manila's alternatives for reducing electric power shortfalls before the early 1990s will be of limited effectiveness:

- Raising rates for small consumers and enforcing payment of electric bills are necessary steps if the NPC is to regain financial solvency, but both would likely arouse political opposition. Moreover, neither measure is likely to forestall electrical shortages in the short term, and both could promote additional meter tampering.

- Publicity campaigns to encourage electricity conservation, especially during dry-season peak hours, are a viable option, but will probably not shrink demand enough to close the gap.

25X1

- Regulating the timing of brownouts and providing sufficient warning would ease the disruptions for many industrial users. MERALCO, however, has had only limited success with its current warning system; US businessmen in Manila report that the warnings are often wrong and that most brownouts occur unexpectedly.

Luzon's electrical problems may lead to increased Philippine ties to Moscow. According to the US Embassy, the Soviets recently offered to construct two 300-MW coal-fired power plants on Luzon, a proposal endorsed by Manila's Ambassador to Moscow as a means of strengthening bilateral economic ties. According to the Philippine press, a senior energy official will travel to the USSR and Austria late this year to discuss the financing and construction of the Batangas plant. A late September 1986 press report claims that a US corporation has offered to finance the plant.

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We believe that Luzon's electrical power problems will act as a brake on Philippine economic recovery as existing industries are unable to operate full-time and

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as local and foreign investors hold off new spending until a stable supply is assured. To the extent that the economy starts expanding next year, as widely predicted, pressure on the government to find solutions to the energy problem could increase dramatically, opening the door to additional Soviet overtures and adding to the political troubles of the Aquino administration.

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Soviet Arctic Petroleum: Moscow's Need for Western Capabilities

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The Soviet Union has high hopes for the petroleum potential of its Arctic regions—in particular the Barents and Kara Seas—but Soviet reliance on inadequate domestic technology and inferior equipment would retard oilfield projects in these areas considerably. If the Soviets discover a substantial oilfield in the offshore Arctic and elect to expedite development, they would need to import large volumes of equipment. Even with Western equipment, any offshore production in the Soviet Arctic is unlikely before 1990. Western companies have mastered onshore petroleum operations in the Arctic and have developed the equipment and techniques needed to work in offshore Arctic conditions. Although Moscow would probably prefer to keep a large Western presence out of their Arctic regions, delays in development and the high risk in Arctic offshore operations could force Moscow to seek Western management and operational expertise.

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Soviet Arctic Development Needs and Options

In the northern reaches of West Siberia, the Soviet Union has primarily focused on developing gas resources, progressively moving farther north to the permafrost zone above the Arctic Circle. In recent years the Soviets have also emphasized exploration and development of Arctic onshore oil resources, but production from Arctic fields is less than 50,000 b/d. The Soviet offshore program is focusing on exploration of the Barents Sea, which we believe has outstanding potential although no commercial deposits have yet been confirmed. In addition, the Soviets have been trying to convince the Japanese to support development of gas reserves found in the subarctic fields off Sakhalin Island, but high development costs and Japan's numerous alternative sources of liquefied natural gas have stalled negotiations.

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The Oil Potential of the Barents Sea

The Barents Sea has the potential to be a major oil bonanza for the USSR. We conservatively estimate that recoverable oil resources in the Soviet portion of the Barents Sea could amount to about 25-30 billion barrels—about the same as North Sea reserves. In fact, the aggregate oil potential of the Barents Sea could match or exceed that of West Siberia. While geochemical indicators point to large potential reserves, we do not have information on the size of the reservoirs that may exist.

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The Barents Sea is a harsh area but presents no insurmountable environmental or technical obstacles to oil development. Because of the influence of the Gulf Stream, conditions in the southern part of the Barents Sea are similar to those in the North Sea. Conditions in the north are similar to those in the Canadian Beaufort Sea, which is currently being explored by Western firms and will be developed when economic conditions permit.

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Indigenous Soviet offshore Arctic petroleum technology is virtually nonexistent. Most of the equipment and technology used by the Soviets has been either purchased from the West or reproduced from technology supplied from Western firms. The Soviets rely heavily on Western drilling equipment in current exploration efforts in the Barents Sea and the area off Sakhalin Island. Soviet officials have indicated that exploration drilling is proceeding slowly, largely because of difficulty in assimilating the advanced technology.

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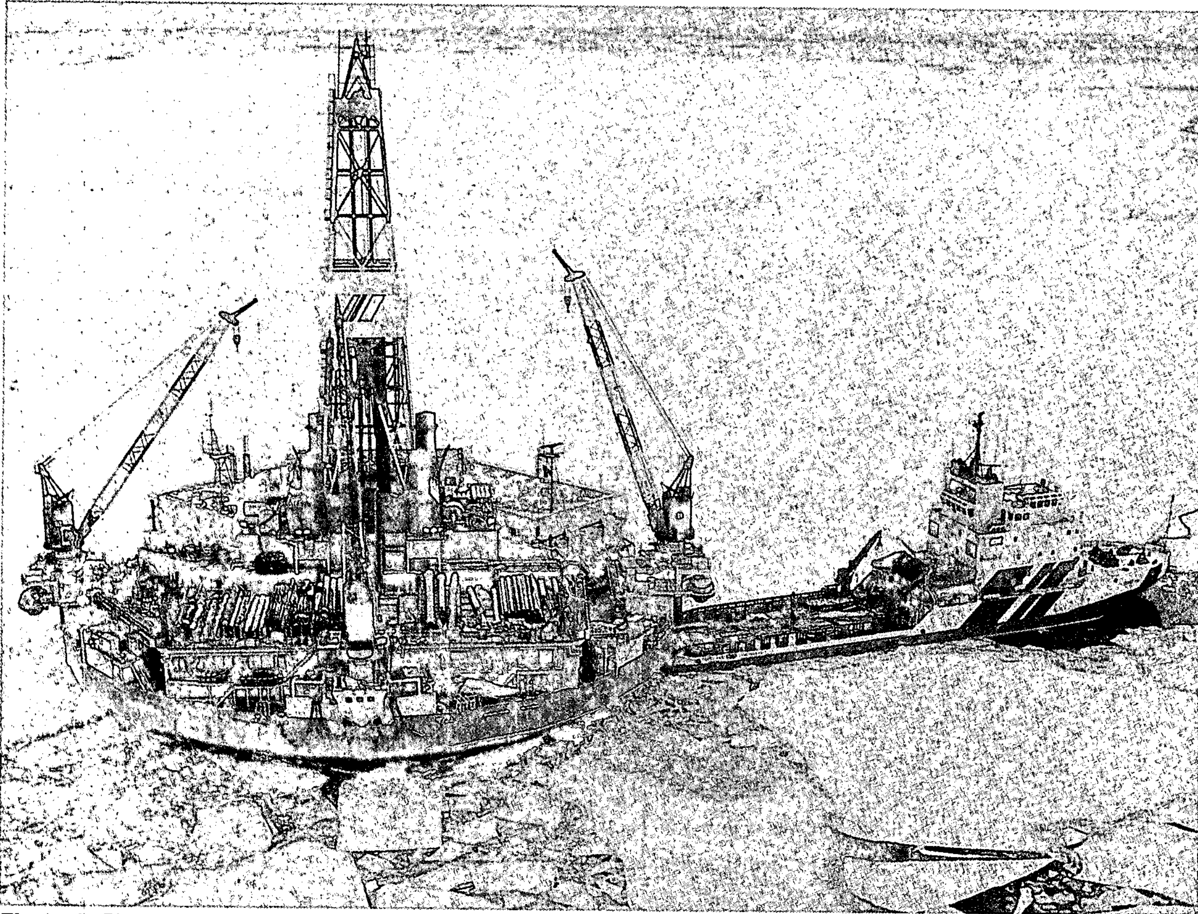

The Arctic Challenge. Development of petroleum resources in the Arctic poses immense challenges. Ice poses the greatest obstacle to Arctic offshore petroleum development. Arctic offshore petroleum structures must be able to withstand a variety of ice forces including the movement of sea ice, the impact of icebergs on surface facilities, and seabottom gouging by pressure-ridge-ice keels. Temperatures as low as −46° C, high winds, and permafrost complicate Arctic onshore operations. Logistic support is hampered by remoteness of projects and lack of infrastructure.

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The USSR probably has enough vessels on hand to sustain a fairly extensive exploration program without foreign assistance; we believe the USSR would encounter serious delays and problems if it pursues single-handed development of any oil discovery. In addition to acquiring the operational expertise to install offshore Arctic platforms, Moscow would have to substantially expand its equipment and platform-fabrication facilities. Because the Soviets would be starting out near the bottom of the learning curve, they would require considerable time to develop the engineering and designs for offshore Arctic equipment. In addition to consuming scarce investment resources, the indigenous manufacture of Arctic offshore equipment would probably impinge on the availability of onshore equipment, the demand for which will grow rapidly during 1986-90. Moreover, the Soviets would need to undertake a major effort to upgrade their capability to make Arctic-grade steels.

Soviet success in developing offshore Arctic petroleum resources will depend heavily on access to Western equipment and technology. In our judgment, the most likely Soviet development strategy would involve huge equipment purchases from the West including everything from fixed production platforms to drill pipe, well casing, and production tubing. Because of Soviet bureaucratic reluctance to relinquish control and military sensitivities to foreign presence in these areas, we judge that the Soviets would prefer to remain the sole developer and operator. Nonetheless, if prospects for oil production slipped drastically, Moscow might turn to the West for management and operating expertise to avoid further delays and to minimize risks.

Because large-scale reliance on Western equipment would require several billion dollars of hard currency, we judge that Moscow would need to discover large and highly productive fields to justify the outlay. At the current low market price for crude oil, such fields would have to have recoverable reserves on the order of 1 billion barrels of oil and be capable of producing approximately 200,000 b/d to warrant Arctic offshore development. Development of offshore projects below this threshold would be less attractive to the Soviets than applying enhanced recovery techniques to existing onshore finds.

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Although Western Arctic equipment is not essential for Soviet onshore oil and gas development, it would greatly improve efficiency. We believe that hard currency constraints will limit the Soviets to selective purchases of some items—drilling rigs, insulated casing, all-terrain vehicles, and modularized gas plant components—with the intent of copying part or all of the embodied technology. Domestically produced equipment, although not as good as the Western equipment, can supplement these imports.

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Technology and Equipment Availability

Exploitation of Arctic resources in the West has occurred primarily on Alaska's North Slope and in US and Canadian offshore areas of the Beaufort Sea. US and Canadian companies have drilled in the Canadian Arctic islands region and in the subarctic regions of eastern Canada. In Western Europe, Norway has sporadically drilled off its northern Arctic coast.

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US and Canadian firms active in developing North America's Arctic onshore and offshore petroleum resources have pioneered the development of the specialized equipment and technology needed to operate in the Arctic environment. West European and Japanese companies also have a major stake in the Arctic petroleum equipment market, especially for offshore operations. Specialized equipment and technology for Arctic conditions include:

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- Onshore
  - — Modular drilling rigs equipped with enclosed work areas.
  - — Downhole drilling and well completion equipment and techniques.
  - — Transportation equipment to cope with permafrost.
  - — Modular construction techniques.

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Relative Strength of Key Countries Engaged in Arctic Petroleum Operations, Equipment Manufacturing and Technology, 1986

Legend: State of the art; Acceptable; Developing capability; Potential capability

Engineering and Equipment Categories	United States	Canada	Finland	France	Japan	Norway	United Kingdom	West Germany
Arctic onshore								
Drilling rigs	State of the art	State of the art	Developing	Potential	Potential	Potential	Potential	Potential
Specialized transport	State of the art	State of the art	Potential	Potential	Potential	Potential	Potential	Potential
Drilling/production	State of the art	State of the art	Potential	Potential	Potential	Potential	Potential	Potential
Construction	State of the art	State of the art	State of the art	Acceptable	Potential	Potential	Potential	Potential
Arctic offshore								
Drilling rigs								
Design	State of the art	State of the art	State of the art	State of the art	Acceptable	State of the art	Acceptable	State of the art
Construction	Acceptable	Acceptable	State of the art	Acceptable	State of the art	Acceptable	Acceptable	Potential
Production platforms								
Design	State of the art	State of the art	Developing	State of the art	Acceptable	State of the art	Acceptable	Developing
Construction	Developing	Developing	Developing	Potential	State of the art	Potential	Potential	Potential
Specialized vessels	Acceptable	State of the art	State of the art	Potential	State of the art	State of the art	Potential	State of the art
Operations	State of the art	State of the art	Developing	Acceptable	Potential	Acceptable	Potential	Potential
Technical support	State of the art	State of the art	Developing	Potential	Acceptable	State of the art	Potential	Potential
Arctic research facilities	Acceptable	State of the art	State of the art	Potential	State of the art	Acceptable	Potential	State of the art
Arctic-grade steel	Acceptable	Acceptable	State of the art	Acceptable	State of the art	Potential	Acceptable	State of the art

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- Offshore
  - Drillships, jack-ups, and semisubmersibles reinforced against ice.
  - Floating and bottom-founded drilling units for severe ice conditions.
  - Artificial gravel islands and stacked caisson-retained islands.
  - Arctic oil production platforms.
  - Transportation equipment and techniques including subsea storage tanks, subsea pipeline installation, and icebreaker tankers.
  - Specialized vessels for Arctic waters including supply ships, accommodation vessels, and heavy lift barges.

Western Business Opportunities

25X1 West European and Asian countries view the USSR as a potential growth market for their petroleum equipment industries—particularly for specialized Arctic equipment. Soviet officials at the high levels have encouraged foreign suppliers with the prospect of large development projects such as Sakhalin Island and the Barents Sea. Western companies are eager to do business with the Soviets, especially because the current oil industry depression has reduced world demand for oilfield equipment.

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Moscow would be able to choose among a number of Western suppliers. Canadian firms are well positioned because of their operational experience in the North American Arctic. Norway, Sweden, and Finland are all trying to gear up to sell Arctic equipment, particularly for offshore development, and the Soviets have responded by raising the possibility of collaborative development of the Barents Sea. Finland has pioneered the sale of Arctic offshore equipment to the Soviets and has built its offshore petroleum equipment industry largely on this business. Japanese companies are expecting large Soviet orders for Arctic-grade pipe and would be eager to fabricate Arctic offshore drilling and production platforms for the Soviets.

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Despite a lack of Arctic expertise, other countries with sophisticated petroleum equipment industries could seek a share of the Soviet Arctic petroleum equipment market—including France, Italy, Netherlands, United Kingdom, and West Germany. In addition, emerging industrial nations such as Brazil and South Korea could be in a position to supply the Soviets with some offshore equipment adaptable for use in the Arctic.

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Outlook for the United States

Although US companies are world leaders in offshore Arctic development—especially in fields such as conceptual engineering for ice-infested waters and project management in harsh environments—adequate Arctic equipment and services are widely available in other countries. The Soviets remain cautious toward large-scale petroleum equipment deals with US firms because of the 1981-82 pipeline equipment embargo and existing petroleum equipment controls. If equipment quality is critical and US equipment is clearly superior to other Western equipment, however, Moscow would probably opt to buy the US equipment. Before any large-scale deal or joint development project could be consummated, Moscow would probably demand delivery guarantees or stiff financial penalties for breach of contract.

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Briefs

Energy

OPEC Reprimands Venezuela

OPEC's marketing committee has sent a sharp reprimand to Venezuela for exceeding its 1.6 million b/d quota in September. During July and August—before the OPEC quota system was reinstituted—Venezuela boosted crude oil output to about 1.9 million b/d, permitting an increase in stocks of about 200,000 b/d, according to the US Embassy. Although Venezuela reduced crude output to 1.6 million b/d on 1 September, inventory drawdowns have allowed Venezuela to continue exports of about 1.5 million b/d and to meet domestic demand of about 325,000 b/d. In its reprimand, the marketing committee asserted that the quota applies to stock drawdowns as well as to current crude production, warning that Caracas's tactic would result in a saturation of the world oil market and a further deterioration of prices, if adopted by other OPEC members. Because of its acute need for foreign exchange earnings, we believe that Venezuela is unlikely to accept a definition of quota that would reduce its petroleum exports, unless OPEC agrees to increase Venezuela's quota.

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Increased Pressure on Iran's Petroleum System

Iran probably will face severe difficulty in providing the petroleum products it needs for domestic use in the coming months. Iraqi air attacks severely damaged five key pipeline pumping stations supplying oil to refineries at Esfahan, Tehran, and Tabriz. These refineries supply about two-thirds of Iran's domestic market for refined oil products. Damage to the pumping stations may have substantially curtailed crude supplies to all three refineries. Unless the pumps can be repaired quickly or emergency pump sets found—neither of which is probable—shortages of gasoline, diesel fuel, and heating oil are likely to become increasingly severe in the coming months. Operating problems, bad weather, and Iraqi attacks continue to disrupt Iran's shuttle system for exports. A shortage of crude oil forced Iran to suspend loading operations at least temporarily at its Larak Island export transshipment point last week. In addition, Tehran has told customers that shipments from Khark Island will be impaired for the rest of the month. Other technical problems may be reducing shipments from Khark, despite a continuing loading capacity of nearly 2 million barrels per day.

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Japanese Gasoline Imports

Japanese gasoline imports have risen sharply following Tokyo's decision early this year to liberalize its oil product import system. During the first seven months of 1986 Japanese gasoline imports averaged 42,000 b/d, or 7 percent of total gasoline requirements. Singapore, South Korea, and the United States have been the major suppliers. The United States accounted for about 5,000 b/d, or 14 percent of total Japanese gasoline imports. Although MITI is reviewing its petroleum product imports system concern for domestic refiners will probably lead MITI to avoid allowing unrestricted product imports.

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International Finance

Bank of France's Views on IMF Meeting

Bank of France Governor Camdessus—whom France has proposed as a replacement for outgoing IMF Director Larosiere—told the US Embassy that he does not expect any significant new initiatives to emerge from the IMF/World Bank annual meetings in Washington this week. Camdessus felt that the primary issue will be the divergence of opinion between the United States and the other major industrialized countries on exchange rates, particularly the appropriate level for the US dollar. He also stated that it may be a good time to nudge West Germany to make at least a symbolic move toward cutting its interest rates. A realistic outcome for the meetings, according to Camdessus, may be the projection of a renewed public spirit of cooperation in international monetary affairs—particulary efforts to dampen exchange market volatility—and reinforcing confidence in the continuing efforts to handle the LDC debt crisis. 25X1

Venezuela Advances Debt Relief Plan

Last week in New York, Venezuelan debt negotiators outlined to international bankers the government's plan to amend the February 1986 agreement that rescheduled $21.2 billion in public-sector debt. 25X1 the Venezuelans requested reschedulings of $1.0 billion in principal due in 1987 and $1.9 billion of the $3.6 billion due over the 1988-90 period, linkage of principal repayments to oil revenues and interest rate levels, and reduction in the 1.125-percentage-point spread over LIBOR specified in the February agreement. Although not part of the request, Venezuela indicated it would seek $600 million in new money through a voluntary loan syndication deal with commercial bankers. Although the proposal contains no major surprises, it was not well received by the bank advisory committee, 25X1 Before bankers agree to amend the February agreement, they are likely to demand that Venezuela resolve the uncertainty over the repayment of the private-sector debt and pay banks the $750 million promised in February as a downpayment on the public-sector debt deal. Bankers also are likely to question the need for interest rate relief and new money when Venezuela has more than $15 billion in international reserves. 25X1

Nigeria Maneuvering on IMF Agreement

Lagos has signed a letter of intent with the IMF to undertake economic reforms that could pave the way for a full IMF standby agreement. 25X1

the US Embassy reports that the government is continuing preparations for its proposed two-tier foreign exchange system and is seeking a $400 million bridge loan from official creditors to fund its operation. Babangida probably still hopes to avoid signing or drawing from an IMF standby agreement, but creditors will continue pressing him to sign. He is likely to gauge political reaction to the two-tier currency system before deciding whether he can override opposition to the IMF agreement in the Ruling Council. 25X1

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Tunisia-IMF Reach Agreement

Tunis has signed a letter of intent with the IMF obligating the government to a series of stiff economic reforms over the next 15 months. The letter removes the final obstacle to Fund approval of $250 million in new financing, according to the US Embassy. The new funds are critical to government efforts to stem the drawdown of foreign exchange reserves—which cover less than a few days' worth of imports—and to offset the effects of the drought this spring. Nevertheless, to meet IMF-supported targets the government will have to curtail domestic consumption, keep the lid on wages, and trim the budget to the bone. As a result, Prime Minister Sfar almost certainly will have difficulty maintaining the domestic calm while adhering to the IMF program. Missed targets or popular unrest, however, will greatly hinder government efforts to raise additional commercial lending to cover the still large projected financing gap next year.

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International Trade

Thai Concessions to the United States on GSP

The Thai Cabinet approved Ministry of Foreign Affairs' recommendations concerning the US Generalized System of Preferences (GSP). The Cabinet approved in principle revisions of the copyright law to extend protection to more US products, replacement of the existing import licensing system for soybeans and products with a tariff system within one year, and presentation of a new trademark bill within six months that would increase infringement penalties and extend coverage for services trademarks. The Thai Government hopes that making concessions on these major bilateral trade issues will improve their chances of retaining US GSP benefits. However, opposition from members of parliament over alleged US protectionism could delay or block implementation of the changes.

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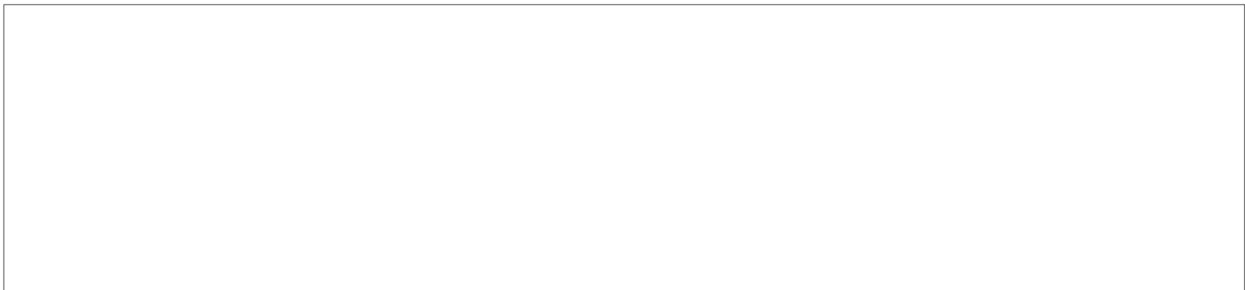

25X6

Global and Regional Developments

Venezuela Offers Aid to Haiti

Venezuela has offered to sell oil to Haiti on concessionary terms in response to US requests. According to US Embassy sources, Caracas has also formed a coordinating committee to provide other emergency assistance. Venezuela apparently believes that helping President Namphy's government will advance its regional interests. The shipment of oil and the promise of more aid are calculated to induce Port-au-Prince to maintain its commitment to democracy and to expand on

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informal political organizational efforts in Haiti by Venezuela's two major parties. The price of the oil—to be supplied under the San Jose accords, by which Mexico and Venezuela provide oil on concessionary terms to countries in the Caribbean basin—may not offer significant savings compared with current spot market prices, but Venezuela's support could improve Haiti's standing with other foreign investors.

25X1

25X1

Soviet-Afghan Trade Relations

Afghan merchants are facing growing pressure to trade with the Soviet Union, according to the US Embassy. The merchants complain that this barter trade is less profitable than their hard currency trade and they have no choice but to accept poor-quality Soviet products in payment. According to a Kabul businessman, the Soviets are also delaying the passage of Western-bound goods shipped through the Soviet Union in an attempt to disrupt Afghanistan's trade with Western firms. Furthermore, an increasing share of Afghanistan's exports are being used to finance the regime's mounting debt to the Soviet Union, according to press reports. A Soviet diplomat recently stated that about 85 percent of Soviet aid to the regime is now in loans that will eventually have to be repaid. The diversion of resources—such as natural gas and cement—from domestic use to the Soviet Union as debt repayment may constrain Kabul's development efforts.

25X1

National Developments

Developed Countries

Miyazawa Taking Charge of Japan's Economic Policy

Tokyo's expanded package of economic pump-priming measures, announced last week, marks the growing influence of Finance Minister Miyazaa on economic policy. At the center of the $23.2 billion package are an expansion in public works spending and additional government loans for housing. The package is more than $3 billion larger than the Finance Ministry had originally planned, and it includes a 5-percent subsidy for large private projects as well as low interest loans to bail out small firms hurt by the strong yen.

25X1

Miyazawa—leader of the second-largest faction in the ruling Liberal Democratic

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Party—requested the increase in the pump-priming package. He wants to use government bonds—as opposed to existing revenues—to finance the package in order to increase the stimulative effect on the economy, according to press reports. Miyazawa is also recommending abolition of a reserve fund to redeem government bonds [redacted] The real test of Miyazawa's influence will come next month when the government decides how to finance its package. The lackluster economy will make his bond option more attractive. Although the use of bonds could raise growth this fiscal year, which ends in March, by one-half percentage point over current estimates, it would still be difficult to reach Tokyo's 4 percent growth target. [redacted]

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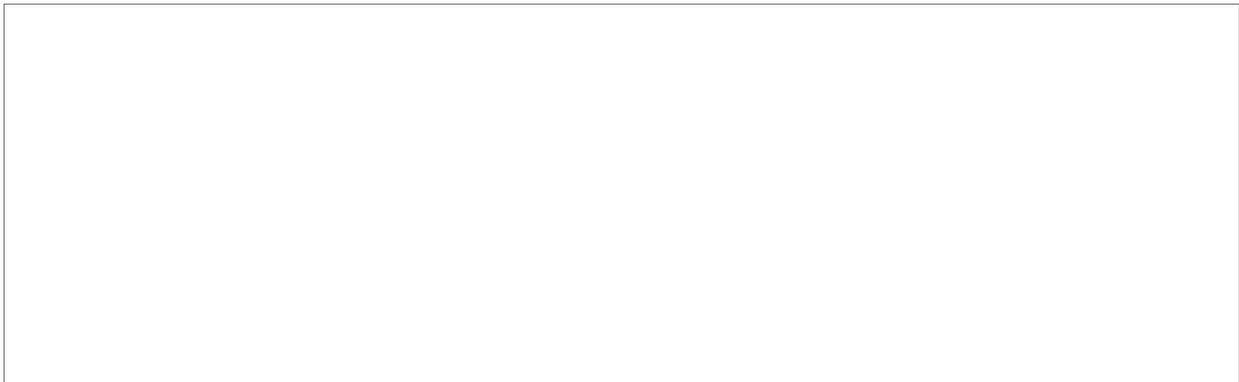

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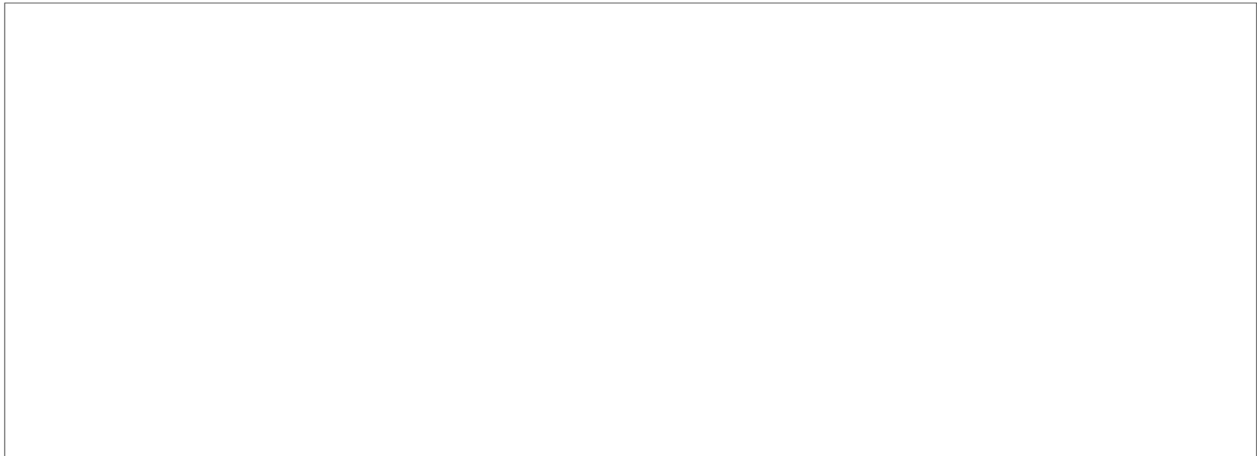

25X6

French Government Outlines Electronics Policy

Prime Minister Chirac and other Cabinet members last week detailed significant changes in electronics policy that are likely to improve opportunities for foreign suppliers trying to break into the French market. These changes should also make French electronics firms—many of which are scheduled to be denationalized—more attractive to foreign investors. True to their campaign promises, the

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conservatives are stressing competition in electronics and trying to limit government influence in the market. The government rejects central planning for the entire industry and will no longer insist on an independent French capability in all aspects of electronics. In particular, France will abandon the practice of designating "national champion" companies, which in the past have been used as channels for all government investment in a given product. Furthermore, a number of government-sponsored electronics agencies—notably several dealing with computers and software development—are to be abolished. Despite these changes, government aid to the electronics industry is slated to grow from about $370 million this year to about $390 million in 1987, while becoming increasingly project-oriented. This continued financial support indicates that, in spite of its free market rhetoric, Paris does not intend to let key electronics sectors languish.

25X1

Lisbon Introduces Investment Incentives

The Portuguese Government has introduced two tax incentive measures as part of its continuing effort to stimulate industrial investment. One allows firms a tax credit equal to 10 percent of new investment this year, with the rate declining to 4 percent by 1989. The other measure permits retained earnings and reinvested profits to be deducted from taxable income in the three years following the completion of the investment. Despite the new incentives, we believe real investment this year will fall several percentage points short of Lisbon's ambitious 9-percent target because firms have had little time to take advantage of the August decree law. The new measures' effectiveness also is questionable because corporate taxes have not traditionally played an important role in investment decisions. Moreover, business lacks confidence in the staying power of the minority Cavaco Silva government, and even now there is speculation about a possible Cabinet crisis and a new election after the budget debate this fall.

25X1

New Greek Austerity Plans

Athens will apparently announce in November a new set of belt-tightening measures designed to boost productivity. In his major annual economic address, Prime Minister Papandreou described the need for new reforms, stating that wages must be linked to productivity and that unprofitable firms would no longer be subsidized. The government has already announced the upcoming liquidation of 20 firms that were nationalized under the "ailing enterprises" law, and plans to privatize the remaining 23 unless they are considered strategically important. The new measures may also include a 20-percent devaluation and eased rules for the dismissal of workers. Papandreou is under pressure to substantially reduce inflation and the public-sector borrowing requirement in order to receive the second part of an EC balance-of-payments loan. He hopes that these measures will bring Greece into line with these terms, or at least send the right signals to the EC. While the new policies probably will boost unemployment from 8.5 to 10 percent, Papandreou appears determined to stick with austerity despite political costs, including possible losses in the October municipal elections.

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Swedish Wage Proposal Rejected

Most Swedish public-sector unions and firms last week rejected the final 1986-87 wage proposal of the state-appointed mediating commission despite a discount rate cut timed to appease labor. The unions want a larger raise for lower paid workers, while management—backed by the Carlsson government—regards the proposal as inflationary. With both sides firm in their positions, increased labor unrest in both the public and private sectors is likely to result. Workers believe that the increased business profits and tighter fiscal policy of recent years have come at the expense of higher wage increases. The government, however, believes that giving in to the public-sector unions would cause the private-sector unions to boost their own wage demands in renegotiations that may occur in early 1987. Because additional wage increases in either the public or the private sector would hinder government efforts to boost Sweden's sagging competitiveness by containing labor costs and reducing inflation—which is over twice the rate of Sweden's main competitor countries—the government side was willing to risk potential strikes to demonstrate its commitment to these objectives. The discount rate cut may, however, add to Stockholm's problems. Following the already strong growth in credit and private consumption of recent months, it probably will prevent inflation from falling much below the current 3.6-percent rate. This could further boost wages because the agreements with private-sector unions earlier this year enable them to hold the new talks if inflation exceeds 3.2 percent. 25X1

Less Developed Countries

Mexico Makes Token Foreign Investment Reform

The de la Madrid administration recently allowed several foreign-owned firms to establish 100-percent ownership of their Mexican operations 25X1 25X1 Although this circumvents foreign investment laws requiring majority Mexican ownership, it probably does not signal a permanent shift in Mexican foreign investment practices. In our view, Mexican officials probably believe this would demonstrate to the IMF and commercial creditors their willingness to liberalize foreign investment. The administration in 1984 made similar moves to attract foreign investment, none of which resulted in significant improvements. Like those actions, the current initiative does not involve modifications to investment laws and is unlikely to encourage potential investors. In addition, high inflation, this year's recession, and uncertainty over next year's economic performance will continue to make the Mexican investment climate unattractive. 25X1

Brazil's Reaction to US Economic Stance

President Sarney was irritated by remarks of senior US officials during his visit urging Brazil to accept increased imports and surprised by the "hardness" of US economic positions As a result, he took a harder public line on these issues than he had planned. Nevertheless, Sarney still wants to resolve the dispute with the United States over protection of Brazil's computer industry 25X1 25X1 Although Sarney wants to settle the dispute before Brazil's congressional election in November, he will be reluctant to

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make further major concessions, fearing a voter backlash. To avoid being labeled a weak president, he might react to any new US trade sanctions by taking a harder line with creditors, restricting US agricultural imports, or finding new suppliers for imported computer components. These actions would ease the political repercussions, but they would also strengthen hardline protectionists in the long run.

25X1

25X1

Jordan's Arab Aid Cutback

Reduced Arab aid will seriously strain Amman's ability to meet its foreign exchange obligations. The US Embassy in Amman reports that payments under the Baghdad Pact and other assistance are likely to reach only $436 million in 1986—a 35-percent drop from last year's level. So far, only Saudi Arabia, which is honoring its Baghdad commitments, and Oman are providing aid. Riyadh, however, has turned down Jordan's requests for additional financial assistance for military purchases and West Bank development projects. Arab aid accounts for about three-fourths of Jordan's foreign assistance and is Amman's most important source of foreign exchange after worker remittances. Jordan will have to cut imports and further draw down its foreign exchange reserves, which at about $376 million are now the equivalent of only two months' imports. Declining oil revenues have forced the other major Arab donors—Kuwait, Qatar, and United Arab Emirates—to curtail assistance to Jordan.

25X1

Kenya's Banking Crisis

President Moi recently placed two Kenyan-owned banks under receivership. To prevent a run on the financial system, however, and possibly to avoid escalating tensions with the economically dominant Kikuyu tribe, he has apparently decided not to close additional banks—at least for now. Several Kenyan banks, protected from Central Bank oversight by their politically influential owners, have been in trouble since 1984 because of management incompetence, corruption, and undercapitalization. The US Embassy reports that a number of financial institutions would be closed if Kenya's banking laws were rigidly enforced. Moi has appointed a special committee to recover depositors' money and has ordered the Central Bank to accelerate implementation of last year's Banking Act amendments. Nonetheless, government assistance will probably be needed to keep some banks open. Despite the President's intervention, worried customers are shifting funds to

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more conservative and better managed banks, some owned by foreigners. These developments probably will set back Moi's efforts to increase local participation in the country's economy. 25X1

Malaysian Economy Shrank in 1985

The Malaysian Central Bank has quietly let it be known that real GDP actually fell by 1 percent last year—the first full-year decline—instead of growing nearly 3 percent as it had announced in March. Although the economy has been in a slump for over a year because of depressed prices for its commodity exports, the timing of the release will probably produce widespread criticism that Prime Minister Mahathir withheld the bad news until after the August national election. The unexpected revision in the growth rate will almost certainly force Kuala Lumpur to revise its revenue estimates downward, and we expect that the budget to be announced in October will probably contain larger spending cuts than those anticipated by domestic observers. The Bank's revised growth figures, in our judgment, will also bolster speculation about possible currency devaluation to boost exports and investment and to spur economic growth—which the Bank forecasts at only 1 percent this year. 25X1

Communist

Soviet Industrial Growth Good, but Short of Plan

Soviet industry performed respectably for the first eight months of 1986, but growth for the year is likely to fall a little short of plan. Industrial production through August—as estimated from Soviet statistics—increased by roughly 4.5 percent over the same period in1985. Production of machinery—important to General Secretary Gorbachev's modernization program—grew at approximately the same rate. In August, for the first time since 1980, oil liftings met a monthly target. Industrial growth continues to slow gradually. Output in the first four months of this year was about 6 percent higher than the unusually poor performance registered in the same period of 1985, but the rate of increase in the next four months was roughly 3 percent. Production of machinery so far this year falls well short of Gorbachev's ambitious plans. Producers of machine tools and chemical equipment, in particular, are under heavy pressure to deliver on schedule. The manufacture of equipment for the oil industry and agriculture has increased rapidly, however, helping those sectors raise current production. 25X1

Yugoslav Premier Delays Economic Program

Premier Mikulic has postponed new economic reforms scheduled to be implemented this month because he was not able to achieve a consensus among Yugoslavia's regions, according to a source of the US Embassy. Mikulic had warned that some measures—raising interest rates and closing chronically unprofitable firms—would be unpopular and provoke interregional debate. According to the source, the proposals, which the government still hopes to implement by yearend, may require significant changes in Yugoslavia's system of worker self-management and possibly the Constitution itself. The government's failure to build a consensus among the regions has already weakened the initial phases of its economic adjustment program. Chances for major reforms now appear slim. The regions almost certainly will block meaningful changes to the Constitution and obstruct modifications to the self-management system. Public disputes over the new measures will increase as their contents become known. 25X1

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Financing China's Modernization Program

China is increasing its gold sales and commercial borrowing in an attempt to offset its trade imbalance and finance its economic modernization program. China has already sold more than $1 billion worth of gold in international markets this year—10 times its sales for all of 1985. The Bank of China reportedly has decided to export gold bullion to help pay for the capital imports China needs for its modernization program and to partially compensate for the revenue lost because of lower world oil prices. Chinese press reports indicate that Beijing also is increasing its commercial borrowing and has signed loan agreements for $2.5 billion during the first half of the year—twice the amount borrowed during the same period in 1985.

25X1

China also is trying to improve its trade balance by increasing exports and reducing imports of automobiles, consumer goods, and some raw materials. Nonetheless, Chinese customs statistics through August indicate the trade deficit this year will probably approach $9 billion. Even if oil prices recover, trade imbalances will persist because Western quotas are limiting export growth in other important sectors—such as textiles—and because China's demand for imported capital goods remains strong. Although China may continue to sell large quantities of gold over the next few months, Beijing will probably need to increase gold mining efforts to avoid drawing down its gold reserves much more. The press reported those reserves were about $4 billion in December 1985. Increased borrowing abroad may lead Beijing to restructure its external debt, now heavily weighted toward short-term commercial credits.

25X1

25X1

China Pushing Agricultural Chemical Use

Chinese officials, alarmed at a continuing slowdown in applications of agricultural chemicals, are engaging in a low-key publicity campaign to encourage use of fertilizers, insecticides, and herbicides. According to *People's Daily,* weeds alone have cost China 17 million metric tons yearly in lost grain production.

25X1
25X1

China's imports of insecticides and herbicides—which we estimate peaked at $240 million in 1983—slipped to $230 million in 1984 and plummeted to only $30 million in 1985. Reform measures that have made farmers responsible for their own profitability underlies the decline in usage of agricultural chemicals; they are simply reluctant to spend the money. If government efforts convince farmers of the benefits of using such chemicals, however, rising consumption would stimulate imports and reopen a market for US and other Western products.

25X1

Vietnam Fails To Halt Currecny Slide

25X1

Vietnam's economy is not responding to the price, wage, and management reforms introduced over the past year. Despite a nationwide self-criticism program aimed at correcting deficiencies in implementing the reforms, continuing shortages of goods and soaring inflation reflect a loss of public confidence in the leadership. Symptomatic of the loss of confidence, the black-market rate for Vietnam's currency has slumped to 325 dong per dollar since the regime pegged the official rate at 15 dong in September 1985. Rumors that a ship had unloaded a cargo of newly printed currency have sparked expectations of another devaluation and further inflationary pressure.

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Directorate of
Intelligence

Economic & Energy Indicators

26 September 1986

DI EEI 86-020
26 September 1986

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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	Jun	Jul
United States	2.6	–7.2	5.9	11.2	2.0	1.2	–2.1	0	3.9
Japan	1.0	0.4	3.5	11.1	4.6	0.7	0.9	4.0	–3.8
West Germany	–2.3	–3.2	0.3	2.4	4.8	–0.3	11.8	41.0	
France	–2.6	–1.5	1.1	2.5	0.5	–4.9	5.1	31.2	
United Kingdom	–3.9	2.1	3.9	1.3	4.7	3.1	–3.0	–14.5	48.9
Italy	–1.6	–3.1	–3.2	3.3	1.2	11.7	7.1	89.8	
Canada	0.5	–10.0	5.3	8.8	4.3	–0.9			

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	3.6
West Germany	–0.2	–1.0	1.8	3.0	2.5	6.9	–2.7	–4.2	14.3
France	0.2	1.8	0.7	1.5	1.4	3.6	2.3	0	4.0
United Kingdom	–1.4	1.9	3.4	2.6	3.8	–0.4	0.7	4.4	0.7
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	Jul	Aug
United States	10.3	6.2	3.2	4.3	3.5	1.4	–1.7	0.4	
Japan	4.9	2.6	1.8	2.3	2.0	0	–0.8		
West Germany	6.0	5.3	3.3	2.4	2.2	–0.9	–1.1	–2.6	0.7
France	13.3	12.0	9.5	7.7	5.8	0.9	1.6	1.1	2.7
United Kingdom	11.9	8.6	4.6	5.0	6.1	4.4	0.6	1.0	2.4
Italy	19.3	16.4	14.9	10.6	8.6	6.2	5.0	3.6	7.6
Canada	12.5	10.8	5.8	4.3	4.0	4.7	3.0	7.9	5.4

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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	Aug
United States [b]	7.1	6.6	11.2	7.0	9.1	7.9	16.8	15.8	18.1	22.9
Japan	3.7	7.1	3.7	2.8	5.0	7.7	9.4	7.5	6.5	13.0
West Germany	1.1	3.6	10.2	3.3	4.4	9.8	11.3	21.3	-0.4	
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	27.3
Italy	11.2	11.6	15.1	12.3	13.7	8.6				
Canada	3.8	0.7	10.2	3.2	4.1	−13.4	−1.9	28.7	41.6	−3.3

[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	Jun	Jul	Aug
United States	7.5	9.6	9.4	7.4	7.1	7.0	7.1	7.0	6.8	6.7
Japan	2.2	2.4	2.7	2.7	2.6	2.6	2.8	2.7	2.9	
West Germany	5.6	7.7	9.2	9.1	9.3	10.2	8.6	8.4	8.6	8.5
France	7.6	8.4	8.6	9.7	10.0	9.8	10.1	10.2	10.2	10.3
United Kingdom	10.0	11.6	10.7	11.1	11.3	11.5	11.6	11.7	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	9.5	9.9	9.7

[a] Prior to May 1986, unemployment rates for France were estimated.

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Foreign Trade [a]

Billion US $, f.o.b.

	1981	1982	1983	1984	1985	1986				
						1st Qtr	2nd Qtr	May	Jun	Jul
United States [b]										
Exports	233.5	212.3	200.7	217.6	213.3	92.9	90.8	30.3	31.8	34.1
Imports	261.0	244.0	258.0	325.7	345.3					
Balance	-27.5	-31.6	-57.4	-108.1	-132.0					
Japan										
Exports	149.6	138.2	145.4	168.1	173.9	47.7	51.3	17.6	16.9	17.7
Imports	129.5	119.6	114.0	124.1	118.0	29.9	29.0	9.2	10.1	9.8
Balance	20.1	18.6	31.4	44.0	55.9	17.8	22.3	8.4	6.9	7.9
West Germany										
Exports	175.4	176.4	169.5	171.9	184.2	55.1	60.9	17.6	21.4	21.2
Imports [c]	163.4	155.3	152.9	153.1	158.9	45.0	47.6	14.4	16.0	16.0
Balance	11.9	21.1	16.6	18.8	25.3	10.1	13.3	3.2	5.4	5.3
France										
Exports	106.3	96.4	95.1	97.5	101.9	30.4	29.8	9.7	10.1	10.8
Imports	115.6	110.5	101.0	100.3	104.5	30.3	30.9	10.0	10.3	10.6
Balance	-9.3	-14.0	-5.9	-2.8	-2.6	0.1	-1.1	-0.3	-0.2	0.2
United Kingdom										
Exports	102.5	97.1	92.0	93.7	100.9	26.2	26.8	8.9	8.8	9.0
Imports	94.6	93.1	93.3	99.4	103.5	28.4	29.2	10.0	9.7	9.9
Balance	7.9	4.0	-1.3	-5.7	-2.6	-2.1	-2.4	-1.1	-0.9	-0.9
Italy										
Exports	75.4	73.9	72.8	73.4	78.8	23.3	24.5	8.1	8.2	8.6
Imports	91.2	86.7	80.6	84.4	90.8	26.3	24.3	8.0	8.1	9.0
Balance	-15.9	-12.8	-7.9	-10.9	-12.0	-2.9	0.2	0.1	0.1	-0.4
Canada										
Exports	70.5	68.5	73.7	86.5	88.0	21.9	21.3	7.2	6.7	7.0
Imports	64.4	54.1	59.3	70.6	75.7	20.3	19.2	6.4	6.4	7.2
Balance	6.1	14.4	14.4	15.9	12.3	1.6	2.1	0.7	0.3	-0.2

[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	May	Jun	Jul
United States	6.3	-8.1	-46.6	-106.5	-117.7	-34.0	-34.7			
Japan	4.8	6.9	20.8	35.0	49.2	12.7	23.2	7.7	7.6	8.0
West Germany	-6.8	3.3	4.3	6.7	13.8	6.9	8.3	2.7	1.9	2.7
France	-4.7	-12.1	-4.9	-0.8	0.4	1.1	0.3			
United Kingdom	15.3	8.5	4.7	1.7	4.8	0.8	0.7	0	0.1	0
Italy	-8.6	-5.7	0.6	-2.9						
Canada	-5.0	2.1	2.4	2.6	-0.4	-2.0	-1.3			

[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	Jun	Jul
United States	9.2	1.5	1.0	1.4	-0.7	-0.5	1.5	9.2	7.8
Japan	5.5	-6.4	-2.4	0.2	-0.6	26.1	24.9	-3.5	43.8
West Germany	-14.9	-2.8	-3.2	-7.1	0	40.7	16.6	-2.4	48.8
France	-12.0	-5.5	-4.8	-2.9	2.5	33.2			
United Kingdom	NA	NA	-6.2	-5.1	2.3	-2.6	7.2	-1.7	-15.8
Italy	-7.8	-3.0	-4.4	-5.2	-0.3	26.1	6.4	-14.9	
Canada	3.9	-2.0	0.2	-0.4	-3.5	-16.3	6.0	11.1	-30.7

Import Prices in US $

Percent change from previous period at an annual rate

	1981	1982	1983	1984	1985	1986			
						1st Qtr	2nd Qtr	Jun	Jul
United States	5.3	-2.0	-3.7	1.7	-2.4	-7.2	-10.4	0	8.7
Japan	3.6	-7.4	-5.0	-2.8	-4.3	-5.3	-49.2	-2.2	39.0
West Germany	-8.6	-4.7	-5.2	-4.8	-1.5	9.8	-11.6	-24.1	6.7
France	-7.8	-7.2	-7.0	-3.8	-0.3	10.3			
United Kingdom	NA	NA	-5.7	-4.5	0.5	-0.5	2.4	-18.2	-8.2
Italy	1.0	-5.3	-6.6	-3.7	-1.0	10.9	-20.6	-11.6	
Canada	8.7	-1.1	0.6	1.0	-2.1	- 9.1	3.8	-21.3	14.4

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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	Aug
Trade-Weighted											
United States	10.5	10.6	5.8	9.1	6.3	-17.8	-11.3	-13.7	21.7	-17.2	
Japan	9.3	-5.7	10.4	6.2	6.8	26.8	42.4	81.8	18.4	113.6	
West Germany	-2.1	7.0	5.8	1.0	1.7	8.5	6.0	11.3	6.5	17.0	
France	-5.1	-6.1	-4.7	-2.1	2.7	5.8	-10.4	-3.1	7.4	2.2	
United Kingdom	2.5	-2.1	-5.0	-2.5	2.0	-26.0	9.5	11.8	3.7	-21.5	
Italy	-9.2	-5.1	-1.6	-3.1	-3.8	5.5	5.2	9.3	11.7	15.1	
Canada	0.3	0.2	2.3	-2.3	-3.6	-13.1	1.7	6.2	- 7.6	2.9	
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	27.5
West Germany	-24.6	-7.2	-5.2	-11.5	-3.3	31.3	17.1	19.5	-1.0	35.5	40.0
France	-28.7	-20.8	-15.9	-14.7	-2.7	29.7	4.4	15.7	-2.8	27.7	28.1
United Kingdom	-13.2	-13.4	-13.3	-11.9	-3.0	1.7	20.8	19.3	-7.7	-2.0	-16.7
Italy	-32.8	-18.8	-12.3	-15.6	-8.6	30.1	14.5	18.8	-2.0	35.2	37.9
Canada	-2.5	-2.9	0.1	-5.1	-5.4	-6.9	5.7	6.4	-13.1	6.8	-0.9

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	Jul	Aug
Bananas Fresh imported, (Total world, $ per metric ton)	214.0	217.0	232.0	243.0	110.3	109.8	108.5	108.9	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	90.0	91.5
United States (Wholesale steer beef, midwest markets)	100.0	101.4	97.6	100.9	90.7	87.8	84.4	89.6	90.3
Cocoa (¢ per pound)	89.8	74.3	92.1	106.2	98.7	95.7	82.6	87.6	89.1
Coffee ($ per pound)	1.28	1.40	1.32	1.44	1.43	2.01	1.73	1.49	1.47
Corn (US #3 yellow, c.i.f. Rotterdam, $ per metric ton)	150	123	148	150	125	116	116	98	87
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	36.35	37.03
Palm Oil (United Kingdom 5% bulk, c.i.f., $ per metric ton)	571	445	502	730	501	289	241	221	195
Rice ($ per metric ton)									
US (No. 2, milled, 4% c.i.f. Rotterdam)	632	481	514	514	484	453	352	288	NA
Thai SWR (100% grade B c.i.f. Rotterdam)	573	362	339	310	249	236	224	230	NA
Soybeans (US #2 yellow, c.i.f. Rotterdam, $ per metric ton)	288	244	282	283	225	218	213	203	198
Soybean Oil (Dutch, f.o.b. ex-mill, $ per metric ton)	507	447	527	727	571	407	348	336	273
Soybean Meal (US, c.i.f. Rotterdam $ per metric ton)	252	219	238	197	157	188	184	183	185
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	5.58	5.50
Tea Average Auction (London) (¢ per pound)	91.0	89.9	105.2	156.6	90.0	86.4	85.6	79.8	86.5
Wheat (US #2. DNS c.i.f. Rotterdam, $ per metric ton)	210	187	183	182	169	172	158	129	124
Food Index [a] (1980=100)	88	78	86	92	81	95	94	83	81

[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	Jul	Aug
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	50.7	51.0
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	60.6	59.1
Gold ($ per troy ounce)	460.0	375.5	424.4	360.0	317.2	342.6	341.6	348.4	365.4
Lead [a] (¢ per pound)	32.9	24.7	19.3	20.0	17.7	16.7	17.6	17.0	17.5
Manganese Ore (48% Mn, $ per long ton)	82.1	79.9	73.3	69.8	68.4	67.2	64.8	64.8	65.6
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	1.8	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	438.0	495.7
Rubber (¢ per pound)									
Synthetic [b]	47.5	45.7	44.0	44.4	44.1	42.8	38.7	38.3	NA
Natural [c]	56.8	45.4	56.2	49.6	42.0	41.7	40.1	43.6	43.5
Silver ($ per troy ounce)	10.5	7.9	11.4	8.1	6.1	5.9	5.2	5.0	5.1
Steel Scrap [d] ($ per long ton)	92.0	63.1	73.2	86.4	74.4	74.0	71.8	71.8	75.0
Tin [a] (¢ per pound)	641.4	581.6	590.9	556.6	543.2	357.4	250.5	244.0	245.5
Tungsten Ore (contained metal, $ per metric ton)	18,097	13,426	10,177	10,243	10,656	8,673	7,567	7,112	6,360
US Steel NA (finished steel, composite, $ per long ton)	543.5	567.3	590.2	611.6	617.8	551.2	554.4	556.6	556.6
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	111	NA
Industrial Materials Index [f] (1980=100)	85	71	82	76	69	69	70	67	67

[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**	**54,039**			
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	2,196	
Norway	501	518	614	700	785	856	826	848	
Other	717	736	915	921	1,022	1,077	927	915	
Non-OPEC LDCs	6,036	6,633	6,823	7,515	7,845	7,556	7,998	7,964	
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	753	
Other	3,117	3,222	3,468	3,942	4,238	4,422	4,626	4,664	
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**	**14,281**			
USSR	11,800	11,830	11,864	11,728	11,350	11,350			
China	2,024	2,042	2,121	2,280	2,496	2,506	2,557	2,557	
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	15,998	16,309
Japan	4,444	4,204	4,193	4,349	4,123	4,661	5,002	4,547	3,924	3,568	3,577	
West Germany	2,120	2,024	2,009	2,012	2,060	2,096	2,406	2,141	2,640	2,388	2,473	
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	4,675	4,291
Japan	3,919	3,657	3,567	3,664	3,377	3,126	4,273	3,673	3,469	2,756	2,798	
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	1,454	
United Kingdom	736	565	456	482	523	493	445	494	610	767	442	
Italy	1,816	1,710	1,532	1,507	1,462							
Canada	521	334	247	244	283	353	424	260	185	276		

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Crude Oil Prices

US $ per barrel

	1980	1981	1982	1983	1984	1985	1986			
							1st Qtr	2nd Qtr	July	Aug
OPEC Average [a] (Official Sales Price)	30.87	34.50	33.63	29.31	28.70	28.14				
World Average Price	NA	NA	NA	NA	NA	27.16	20.55	13.65	11.42	12.33

[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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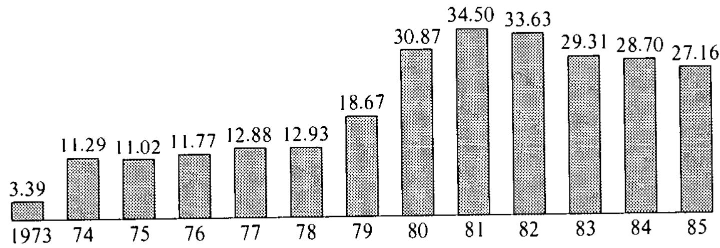
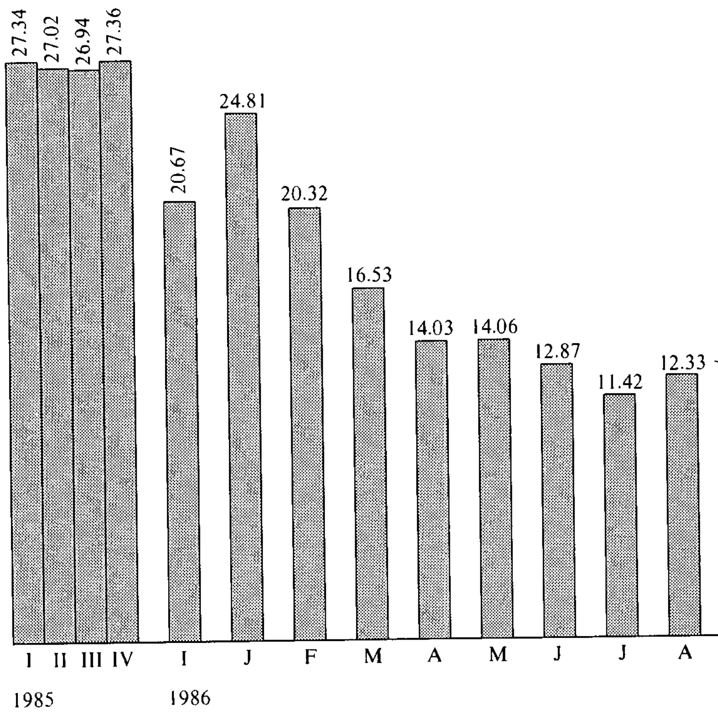
Average Crude Oil Sales Price[a]

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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