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21

World Economic Outlook

A Survey by the Staff of the International Monetary Fund

International Monetary Fund
Washington, D.C.
1983

Occasional Paper No. 21

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Preface

This is the fourth in a series of annual *World Economic Outlook* reports that have been prepared by the staff of the International Monetary Fund. The present study is published by the Fund as Number 21 in the Occasional Paper series.

This report is similar in character to the ones issued in 1980–82. It is directed comprehensively toward three related tasks: to provide a statistical record of past and prospective developments in the world economy, building up the estimates for various groups of industrial and developing countries on a country-by-country basis; to analyze the significance of these developments and the problems they pose; and to discuss the main issues of policy confronting member countries and the international community. These tasks, of course, are inherently difficult, requiring continuous attention and effort. In the present report, two specific areas of attempted further progress are (a) expansion of policy-oriented research on key developments and issues (in the form of supplementary notes in Appendix A), and (b) extension and improvement of the estimates of external indebtedness and capital flows for the non-oil developing countries (as embodied in the statistical tables in Appendix B).

The World Economic Outlook is a large-scale project in the Fund, incorporating the specialized contributions of staff members from the five Area Departments and from several functional departments, particularly the Exchange and Trade Relations Department, the Fiscal Affairs Department, and the Research Department. The work is coordinated in the Research Department, and has been supervised by Charles F. Schwartz, Director of Adjustment Studies. He has been assisted in the current project by many colleagues throughout the Fund, among whom special mention may be made of Andrew D. Crockett, Carl P. Blackwell, Jacques R. Artus, Michael C. Deppler, and Stig von Post.

This report is being issued in the name of the staff and does not necessarily represent the views of the Executive Board. Further, the description of developments and policies, as well as the projections for individual countries, should not be attributed to either Executive Directors or their national authorities.

In their evolution over the period since the early 1970s, staff studies on the World Economic Outlook have become an integral part of the work of the Fund. This latest study is a particularly timely one, at the present juncture of incipient economic recovery from prolonged conditions of high inflation and unsatisfactory growth. On behalf of our institution, I am pleased to present another World Economic Outlook study to the public, with the hope that it may contribute to knowledge and understanding over the wide range of important and difficult issues with which it deals.

/s/
J. de Larosière
Chairman of the Executive Board
and
Managing Director
International Monetary Fund

May 1983

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The following symbols have been used throughout this report:

- . . . to indicate that data are not available;
- — to indicate that the figure is zero or less than half the final digit shown, or that the item does not exist;
- – between years or months (e.g., 1980–82 or January–June) to indicate the years or months covered, including the beginning and ending years or months;
- / between years (e.g., 1981/82) to indicate a crop or fiscal (financial) year.

"Billion" means a thousand million.

Minor discrepancies between constituent figures and totals are due to rounding.

I Introduction

The present report on the World Economic Outlook—like the corresponding reports published in 1980–82 [1]—is the outgrowth of a comprehensive staff project involving a number of departments in the Fund. This introductory chapter briefly describes the World Economic Outlook project, outlines the contents of the report, and points out features of the statistical projections.

Scope and nature of the project.—Staff work for this report has entailed mainly a forecasting exercise covering 1983 in depth and 1984 on a preliminary basis. The 1984 projections are not presented in tabular form but are incorporated at various points in the text to amplify the analysis. The projections are accompanied by historical estimates extending back over a number of years.

Both the estimates and the short-term projections have been prepared on the basis of a detailed procedure involving an individual country approach. Derivation of figures for individual countries permits them to be shown separately (as in the case of the seven major industrial countries) or to be combined into meaningful subgroups (as in the case, notably, of the large and heterogeneous group of some 115 non-oil developing countries, for which economic totals or averages require disaggregation for purposes of analysis).

The time horizon of the statistical and analytical work for this report has been extended through the preparation of medium-term projections. These have taken the form of "scenarios" of how the world economy could evolve over the period through 1986 under alternative assumptions regarding policies and developments.

This report has had the benefit of consultations recently conducted by the Fund staff with a number of member countries—either in the course of its regular work or as part of the special consultations, primarily with the larger industrial countries, that are held in connection with exercises on the World Economic Outlook. These recent consultations, as usual, have proved valuable and have influenced both the statistical work and the analysis in many places, even though explicit references to them may not be made.

Content of the report.—This report contains five chapters and two appendices. Chapter II, which provides a general survey, consists of three main sections: a summary of the international economic situation and outlook; a discussion of the key issues of policy confronting various groups of member countries; and a brief account of the role being played by the Fund in its endeavors to assist member countries in the adjustment and financing of external imbalances and to underpin the functioning of the international system. Chapters III–V cover, respectively, the industrial countries, the oil exporting countries, and the non-oil developing countries. The treatment in each case is comprehensive, with discussions of both domestic and external developments and of the current stance of economic policies. Separate coverage of these main groups of countries, as in previous reports, is warranted because they continue to be in diverse and changing positions, with the positions of countries within the three groups varying widely.

Appendix A provides 11 supplementary notes on varied aspects of the current project. Particular attention may be called to the extensive note on Country and Regional Surveys; this serves, in effect, to supplement Chapters II, III, and V by reviewing in greater depth and detail the economic situation, prospects, and policies of the industrial countries and of the non-oil developing countries, and it includes a special section on Eastern Europe and the U.S.S.R. The next three supplementary notes deal, respectively, with fiscal, monetary, and exchange rate developments in the major industrial countries. Then follow three notes that incorporate the results of some special policy-oriented research on the non-oil developing countries. The eighth supplementary note covers various aspects of the world oil situation, including an analysis of the economic

[1] *World Economic Outlook: A Survey by the Staff of the International Monetary Fund* (Washington, May 1980); the June 1981 report, with the same title, was published as Occasional Paper No. 4 in the IMF Occasional Paper series; the April 1982 report, also with the same title, was published as Occasional Paper No. 9. (Hereinafter, these reports are referred to as *World Economic Outlook*, with the appropriate date.)

impact of declining oil prices. The next two notes deal with developments in commodity prices and in the important field of trade policy, and the final note focuses on the very difficult problem of the large statistical asymmetry that has arisen in the estimation of global current account balances.

Appendix B contains a set of some 75 tables that have emerged from the present statistical work and that provide quantitative frames of reference for much of the textual comment. The estimates and projections, it may be noted, have been extended and improved in certain respects. For the non-oil developing countries, in particular, an intensive effort has gone into the preparation of figures on capital flows and on outstanding external arrears and short-term debt.

An important aspect of this report concerns its geographical coverage as this relates both to the definition of the "world" and to the classification of the individual countries among the industrial, oil exporting, and non-oil developing groups of countries. This matter is treated in the introduction to Appendix B.

Features of statistical projections.—The projections in this report for 1983 and 1984 are based on the assumption of "present policies"; for a few countries, this has been interpreted to encompass certain policy adaptations or changes that seem likely to occur even though they have not been announced by the authorities. It was also assumed, as a working hypothesis, that the average exchange rates of a recent period (March 22–31, 1983) will prevail throughout the rest of 1983 and during 1984. Another working hypothesis for present purposes is that the average price of oil will remain essentially constant in nominal (U.S. dollar) terms from April 1983 through the end of 1984.

The Fund staff projections for 1983 and 1984, particularly the latter, are subject to various caveats or limitations, which are similar to those pointed out in previous *World Economic Outlook* reports. For one thing, the character of the projections is substantially affected by the working assumptions regarding present policies, exchange rates, and oil prices (which are the standard types of assumption used by the Fund and other international agencies for the purpose of economic statistical projections). It will be readily evident that these assumptions are tenuous, and that they tend to become increasingly so with the lengthening of the projection period. At the same time, foresight becomes dimmer and the projections inevitably take on a "normative" character. More generally, it should also be borne in mind that the projections have been made at a time of great uncertainty and of unusual problems, with past relationships furnishing only a limited guide to probable future developments, so that the margins of error in this type of exercise are at present undoubtedly larger than customary.

Because of the range of uncertainties now prevalent, one needs to avoid attaching precision to the staff projections. This is intended as a general caution, but it is clearly applicable to the projections of balances on the external current account, which are derived statistically as a small residual between very large flows of exports and imports and are subject to considerable error. The presence of error in the current account balances is directly evident in two respects: (1) the sharply higher "statistical asymmetry," as discussed in Appendix A-11, that has emerged in the global results of estimating current account balances on an individual country basis; and (2) the sizable statistical revisions that have occurred in these balances in the course of the past year, as well as on some other occasions.

These caveats or limitations, as well as others that could be cited, emphasize the need for caution in use of the staff projections. Nevertheless, if the numbers are not taken too literally, and if the main attention is given to the directions and patterns of indicated changes, the present type of forecasting exercise can be helpful in depicting the global economic situation and in providing a basis for analyzing and deciding on the policies required to deal with both domestic and external problems.

II General Survey

The present chapter—by summarizing recent and prospective developments in the world economy, discussing key issues of policy, and describing principal activities of the Fund—is intended to provide a general survey of the wide-ranging subject matter covered in this report.

Current Situation and Prospects

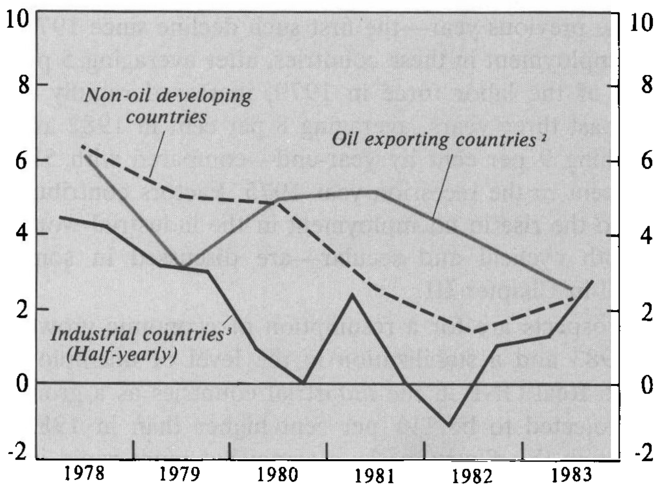
The following profile of the world economic situation and outlook focuses on output and employment, inflation and interest rates, trade and protectionism, developments on external current account, external debt of non-oil developing countries, and exchange market developments; it then concludes with a brief "overview" of the world economic scene. In the interest of brevity, this section deals summarily with a whole range of matters that, for the most part, are treated in more detail in subsequent parts of the report.

Several major developments can be singled out as having primarily determined the international economic setting in the recent period. Of fundamental importance was the adoption of increasingly restrictive financial policies by the authorities of the major industrial countries during 1979 and 1980 in order to counter mounting inflationary pressures attributable to the second round of oil price increases and other developments, at a time when various forces of "stagflation" were operative after having been built up over a long period. Basically, the anti-inflation stance of policies was continued in 1981 and 1982 without essential modification, despite the weakening of output growth to which it contributed. Monetary policy generally received insufficient support from other policies and had to bear by far the greater share of the burden of restraint; an important result of this unbalanced policy approach was unprecedentedly high interest rates, in real as well as nominal terms, in almost all of the industrial countries. On the external side, the international distribution of current account balances was dramatically affected during 1979 and 1980 by the increase in oil prices. But, in 1981 and 1982, this distribution was substantially changed by two partly related developments: the progressive softening of the previously tight conditions in the world oil market, and the prolongation of recession in the industrial world.

Output and Employment

Real gross national product (GNP) in the *industrial countries* as a group, after increasing by only a little over 1 per cent in 1980 and in 1981, actually declined slightly in 1982. (See Chart 1 and Appendix B, Table 1.)

Chart 1. Growth of Total Output,[1] 1978–83
(Changes, in per cent)

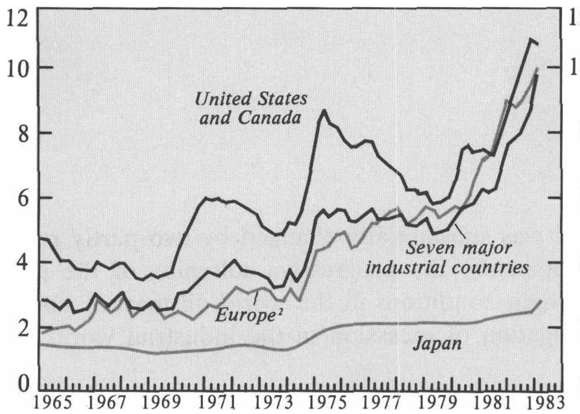


[1] Real GDP or GNP.
[2] Non-oil sector.
[3] Seasonally adjusted annual rates.

The moderate recovery that had been expected to take hold in the second half of 1982 was delayed by unexpected weakness in investment activity, by a continued rapid liquidation of business inventories, and by weakness of import demand in the nonindustrial world. All the major industrial countries shared in the sluggish performance of 1980–82, with only Japan recording an average annual growth rate (4 per cent) significantly above 1 per cent.

Chart 2. Major Industrial Countries: Unemployment, 1965–First Quarter 1983 [1]

(In per cent of labor force)



[1] National unemployment rates weighted by labor force in the respective countries.
[2] France, the Federal Republic of Germany, Italy, and the United Kingdom.

Weakness in economic activity has been reflected in a continuing rapid increase in unemployment. (See Chart 2.) The number of persons actually employed in the seven major industrial countries is estimated to have been about 1 per cent lower, on average, in 1982 than in the previous year—the first such decline since 1975. Unemployment in these countries, after averaging 5 per cent of the labor force in 1979, increased rapidly in the past three years, averaging 8 per cent in 1982 and reaching 9 per cent by year-end—compared with 5½ per cent in the recession year 1975. Factors contributing to the rise in unemployment in the industrial world—both cyclical and secular—are discussed in some detail in Chapter III.

Prospects are for a resumption of economic growth in 1983 and a stabilization in the level of unemployment. Real GNP in the industrial countries as a group is projected to be 1½ per cent higher than in 1982, although this figure masks a somewhat more rapid increase in the course of the year. Beginning in the first half of 1983, the factors that retarded economic activity during 1982 seem likely to operate less strongly; and this circumstance, in conjunction with a modest strengthening in other elements of demand, is expected to result in output growth of 3 per cent at an annual rate from the first to the second half of 1983 in the major industrial countries. (See Chapter III, Table III-1.) A similar pace of expansion is tentatively projected for 1984. Within the group of industrial countries, the United States and Canada, which had the weakest economic performance in 1982, are expected to experience an earlier and faster recovery. In Europe, the combined effects of lower oil prices, moderating interest rates, and stronger activity in North America are projected to lead to a modest pickup in growth toward the end of 1983, and this should become more firmly grounded in 1984. Japan, having weathered the recession better than the other industrial countries, is expected to have the same growth rate (about 3 per cent) in 1983 as in 1982.

In the United States, according to the staff projections, real GNP would grow by 4 per cent during 1983, with nearly one half of the increase resulting from a turnaround in inventories (from a large liquidation in the last quarter of 1982 to a moderate accumulation in the latter part of 1983). During 1984, growth of real GNP would slow somewhat (to 3½ per cent) as the inventory cycle ran its course. While the staff thus envisages a recovery of U.S. economic activity in 1983–84, there are questions about the outlook for growth beyond the short run. In the absence of additional fiscal action, the prospect of large federal budget deficits even after the economy emerges from the current recession does not augur well for an enduring expansion of economic activity. Such deficits and the attendant increase in government debt would tend to pre-empt savings and keep real interest rates high, with adverse effects on capital formation and productivity growth, and could generate uncertainty about the Government's commitment to anti-inflation policies. (See the discussion of the U.S. outlook in Appendix A-1; see also the discussion of fiscal balances in relation to national saving in Appendix A-2.)

It may be noted that Appendix A-8 discusses the effects that lower oil prices might be expected to have on output and inflation in the industrial countries generally. With the further reduction in underlying inflation rates that now seems likely, existing monetary targets in the larger industrial countries should be sufficient to accommodate growth at the projected pace. Appendix A-3 reviews monetary developments and prospects in those countries, including some of the factors influencing changes in the demand for money.

The *non-oil developing countries* have been hit particularly hard by the international recession. Sluggish markets in the industrial world, deteriorating terms of trade, and sharply higher debt servicing costs forced a further retrenchment of import demand in 1982, and this inevitably was associated with a decline in the achievable growth rate. Total output in this group of countries, after growing by 2½ per cent in 1981, is estimated to have increased by only about 1½ per cent in 1982. For 1983, a modest rise in the growth rate, to 2–2½ per cent, is projected. (See Appendix B, Table 2.) Looking further ahead, the staff has attempted to assess the output and balance of payments prospects for the non-oil developing countries on the basis of alternative scenarios for growth and inflation in the industrial world. The "central" scenario suggests that the external current account and debt positions of the non-oil developing countries—on the assumption of appropriate adjustment policies—should be sufficiently strengthened to permit growth of about 4½ per cent during the period 1984–86 (Appendix B, Table 38).

The growth rates of these countries in 1981–83 represent a dramatic slowdown from the rates of around 6 per cent achieved in the late 1960s and early 1970s and of 5 per cent in the late 1970s and in 1980. Even so, they do not give a full picture of the strains being experienced by this group of countries. First, the deterioration in their terms of trade and the need to curtail the size of their external deficits have meant that domestic absorption has had to be restricted to a much lower rate of growth than gross domestic product (GDP). Second, since the non-oil developing countries have a high rate of population growth, the recorded increases in output, even in the absence of adverse external factors, would leave virtually no room for increases in per capita income. Third, the average growth rate for this large and disparate group of countries conceals a diversity of experience, so that growth performance in a considerable number of countries has been significantly below the average (with output in the Western Hemisphere region, for example, having actually declined in both 1981 and 1982 and being projected to decline further in 1983). Last, and most obviously, since the income level of many developing countries is very low, their capacity to meet and adapt to a significant deceleration in their growth rate is correspondingly less.

As discussed in Chapter V, any substantial improvement in the growth prospects of non-oil developing countries will depend on recovery in the industrial world. At the same time, economic policies in these countries themselves will be very important in determining how far they are able to take advantage of such an upturn. In this connection, structural measures to improve resource allocation and strengthen productive efficiency have an important role to play, in addition to continued attention to demand management. Appendices A-5 and A-6 analyze the impact of financial policies on economic performance in the non-oil developing countries and provide some evidence that effective domestic stabilization and realistic exchange rates are associated with improvement in the balance of payments and a higher level of output. Appendix A-7 addresses a number of other economic policy issues that are important for these countries.

In their domestic economies, the *oil exporting countries* as a group are currently faced with the need for a fundamental reappraisal of existing policies, so as to bring financial commitments into conformity with the shrinking availability of financial resources—a matter discussed in the section on "Key Issues of Policy," below. The export earnings of these countries had increased by two thirds in real terms (i.e., deflated by import prices) from 1978 to 1980, but fell sharply during the following two years because of the substantial weakening of international oil demand (as described in Appendix A-8). With a further drop in prospect for 1983, reflecting mainly the recent oil price decline, the earlier gain in real export earnings is expected to be eliminated. Primarily because of the pursuit of increasingly restrictive financial policies, and the consequent scaling back of development programs, the rate of growth of total non-oil output in the oil exporting countries is estimated to have declined from 5 per cent per annum in 1980 and 1981 to about 3½ per cent in 1982, and a further slowdown, to about 2½ per cent, is foreseen in 1983. (See Appendix B, Table 2.)

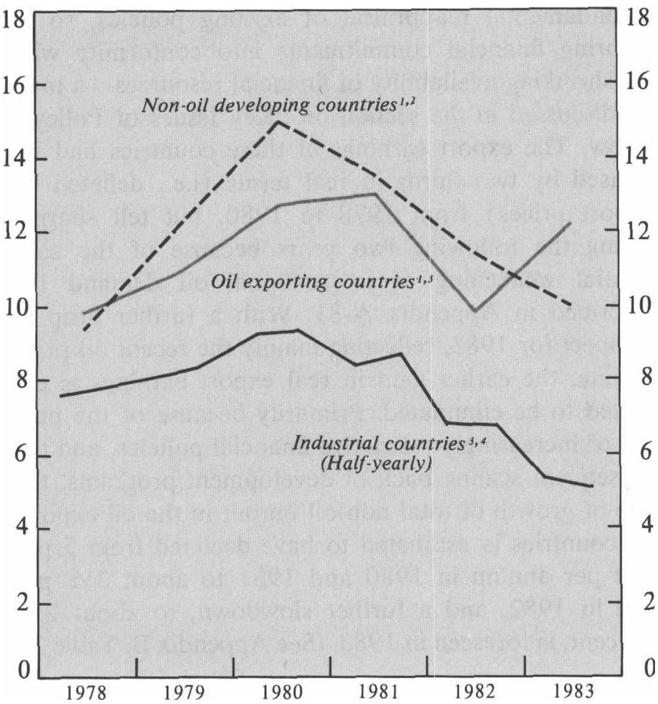
Inflation and Interest Rates

A distinctly encouraging development in the past year was the progress made in reducing inflation in *industrial countries* (see Chart 3 and Appendix B, Table 1) —progress that reflects the severity of the recession, the effectiveness of official policies, and declines in oil and other commodity prices. As measured by the increase in the GNP deflator, inflation in the major industrial countries as a group was reduced to less than 7 per cent in 1982 (the smallest increase in ten years); inflation according to this measure is projected to decline to 5 per cent in 1983 and 1984. Most of the drop in inflation from 1981 to 1982 is attributable to the noteworthy progress made by the United States and the United Kingdom; however, there are now encouraging signs that inflation has begun to recede in Canada and, though more hesitantly, in France and Italy as well. With Japan and the Federal Republic of Germany continuing to maintain relatively low levels of price increase, 1983 may therefore see a significant degree of convergence of price trends among the major industrial countries. Among the smaller industrial countries, prospects are more mixed, with the average inflation rate in 1983 projected to decline only moderately, to 8½ per cent.

An important consequence of the declining rates of inflation in the industrial world has been a fall in interest rates. (See Chart 4.) Since high nominal and

Chart 3. Inflation, 1978–83

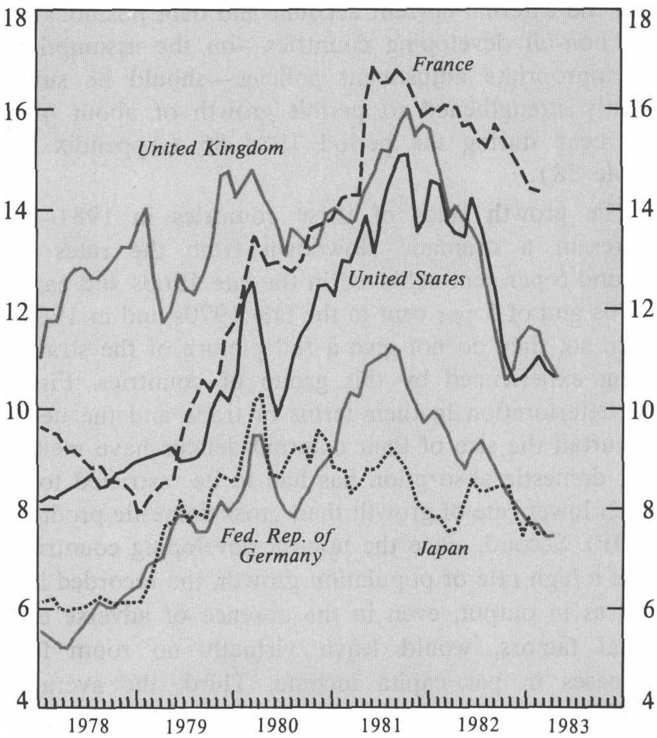
(Per cent per annum)



[1] Change in consumer price index.
[2] Median estimates. For estimates on a weighted-average basis, see Appendix B, Table 3.
[3] Weighted-average basis.
[4] Change in GNP (or GDP) deflators. Seasonally adjusted annual rates.

Chart 4. Five Major Industrial Countries: Long-Term Interest Rates, 1978–April 1983 [1]

(In per cent per annum)



[1] Monthly averages of daily or weekly yields on government bonds, with maturities ranging from 7 years for Japan to 20 years for the United States and the United Kingdom.

real interest rates have been a major factor in prolonging the recession, the success of economic policy in establishing conditions in which interest rates can be brought down and held down is central to the progress of recovery. In the United States, by early 1983 short-term rates had fallen by about 10 percentage points from their 1981 peaks, while long-term rates had fallen by 3–4 percentage points; in other countries, the declines were somewhat less so that interest rate differentials had narrowed. The smaller response in the longer maturities may reflect the persistence of inflationary expectations, as well as the fear that large fiscal deficits will compete with private demands for credit as recovery proceeds, thus keeping real interest rates high. Long-term interest rates in early 1983 were still some 6–7 percentage points above the current inflation rate—considerably higher than usual in the initial stages of economic recovery.

In the *non-oil developing countries*, inflationary pressures have remained strong in recent years because of accommodating financial policies, as well as the higher cost of oil and other imported goods. The weighted-average rate of consumer price inflation in these countries continued above 30 per cent in 1982 for the third successive year (Appendix B, Table 3), complicating the task of encouraging investment and posing difficult problems in the area of exchange rate management.

The fact that the non-oil developing countries have not made more progress in reducing inflation must be considered disappointing. It seems to result from the difficulties often encountered in designing fiscal and monetary policies that come to grips with the combination of adverse circumstances faced in recent years. As a result, fiscal deficits in the non-oil developing countries have tended to become larger, and monetary expansion has remained high. However, some progress has been made recently in the adoption of policies aimed at combating inflation. This is reflected in the decline of observed price increases as measured by the median rate of inflation for non-oil developing countries (shown in Chart 3); a further modest decline in the median rate is projected for 1983. (The median rate—representing the "middle" country in the sense that half the countries have a higher rate and half a lower rate—is more indicative of the rate of increase in consumer prices in the "typical" or "representative" country of the group than is the weighted average, which has been significantly affected by exceptionally high rates of inflation in a small number of the largest countries and, as shown in Appendix B, Table 3, is at a higher level.)

Among the *oil exporting countries,* the weighted-average inflation rate is estimated to have declined from close to 13 per cent in 1980 and 1981 to about 10 per cent in 1982. This development reflects the impact of the more restrained demand management policies being pursued since late 1981 and the effects of moderating or declining import prices. In 1983, however, rising prices of imported goods in some of these countries, caused in part by tighter supply conditions or exchange rate adjustments, are expected to lead to an increase in the average inflation rate of the oil exporting group.

Trade and Protectionism

Prolongation of the recession has resulted in continued weakness in world trade, a further adverse shift in the terms of trade of primary producers, and an intensification of protectionist pressures in many countries. After stagnating in 1981, the volume of world trade actually declined (by about 2½ per cent) in 1982, bringing it to approximately the 1979 level. (See Appendix B, Table 8.) Non-oil developing countries, faced by severe financial pressures, curtailed the volume of their imports by almost 8 per cent in 1982, while imports by the industrial countries were about unchanged. The imports of oil exporting countries grew somewhat, but at a much slower pace than in the previous two years.

In 1983, a small upturn in the volume of world trade is expected to accompany the recovery being projected for the industrial countries. This upturn would gather pace during the year, although the growth of trade for 1983 as a whole (over 1982) would amount to only 1 per cent. With a continuation of the projected economic upswing into 1984, a considerably more rapid increase in world trade would be likely for that year.

Price developments in international trade have by and large accentuated the effects of the volume shifts. The rate of increase of world trade prices expressed in SDRs slowed dramatically in each of the past two years; reflecting the strength of the U.S. dollar on foreign exchange markets, prices actually declined in U.S. dollar terms from 1981 to 1982. As is usual during recession periods, primary commodity prices have been weaker than those for manufactured goods, so that the terms of trade again moved against the non-oil developing countries. Indeed, 1982 was the fifth consecutive year of adverse terms of trade movement for these countries; for the great majority of countries within the group that are net importers of oil, the cumulative deterioration amounted to nearly 20 per cent. (See Appendix B, Table 9.)

The economic upturn in the industrial world should bring about a modest improvement in primary commodity prices and, together with lower energy prices, is expected to arrest the deterioration in the terms of trade of non-oil developing countries. Nevertheless, primary commodity prices are projected to rise by only 5 per cent from 1982 to 1983, and the consequent improvement in these countries' terms of trade would not offset more than a small part of the earlier deterioration.

The weakness of world trade and the rising levels of unemployment in many countries have been reflected in renewed pressure for protectionist measures. (See Appendix A-10.) This has been most evident in the industrial countries, where the necessity for structural change, at a time of generally weak aggregate demand, has caused acute difficulties for sectors of the economy that are economically and politically important. All major governments have reaffirmed their commitment to liberal trading principles, but in a number of cases governments have taken the view that bilateral or "voluntary" arrangements are necessary to defuse the pressure for overt action to protect domestic producers. The danger of such informal arrangements, of course, is that they tend to become accepted and entrenched and do not receive the same degree of critical scrutiny from the international community as measures subject to the rules developed by the General Agreement on Tariffs and Trade. It cannot be stressed too emphatically that the pressures of protectionism are severe and that yielding to them could have very serious consequences for the growth of world trade.

Current Account Developments

Analysis of external current account developments among the major groups of countries is complicated by the existence of a large statistical asymmetry. This is analyzed in Appendix A-11, where it is indicated that the bulk of the discrepancy is probably accounted for by an underrecording of current receipts (or an overrecording of payments) among the industrial countries and the oil exporting countries. The large size of the asymmetry naturally suggests caution in the interpretation of the global pattern of payments balances on current account shown in Appendix B, Table 15; however, it is not believed to invalidate the broad trends described in the following paragraphs.

A noteworthy feature of current account developments in the past two years was the shift in the position of the *oil exporting countries*. Their combined surplus, which reached $114 billion in 1980, was virtually halved in 1981 and disappeared altogether in 1982. This change occurred despite a sharp deceleration in the growth of their import payments. It resulted mainly from the large drop in oil export volume, as well as from some downward movement in oil prices. Export earnings of the oil exporting countries are likely to drop further in 1983, with average prices projected to be almost 14 per cent lower than in 1982, and export volume some 6 per cent lower. The staff is projecting a combined deficit of $27 billion for these countries, despite severe restraints on import demand in many of them. Some of the oil exporting countries are now faced with major financing problems, which it is expected will have to be addressed primarily by further adjustment measures, in some cases of a structural nature.

The current account position of the *industrial countries* as a group, excluding official transfers, is estimated to have been in rough balance in 1981 and 1982 and, with lower oil prices, should move into moderate surplus in 1983. (See Appendix B, Table 15; balances including official transfers are shown in Appendix B, Table 16.) Among individual countries, there has been a notable weakening in the current account position of the United States, together with a strengthening in the positions of Japan and the Federal Republic of Germany—divergent movements that are projected to persist or intensify in 1983 and 1984. Most other industrial countries are expected to have a stable or strengthening position, although in France, Italy, and some of the smaller industrial countries, the external position will continue to be a constraint on domestic policy.

With respect to the external position of the *non-oil developing countries,* their aggregate current account deficit is estimated to have declined from a peak of $108 billion in 1981 to $87 billion in 1982. A further improvement, to some $67–68 billion, is in prospect for 1983 and 1984, making the deficit actually smaller, in relation to exports of goods and services, than the average for the period 1976–78. The present situation differs from that period, however, in that it represents a response to extreme financial pressures, rather than a more comfortable balance between underlying payments and receipts. In 1982, aggregate net inflows of capital to the non-oil developing countries actually declined by about $35 billion, chiefly because of the reduction in borrowing from international commercial banks (Appendix B, Table 25); and it was only through substantial use of reserves and reserve-related credit that the need for an even greater compression of the current account deficit was avoided. Reliance on these sources of financing, while temporarily softening the cutback in flows of imported resources, tended to impair external liquidity positions and thus to make necessary the further reduction in current account deficits projected for 1983.

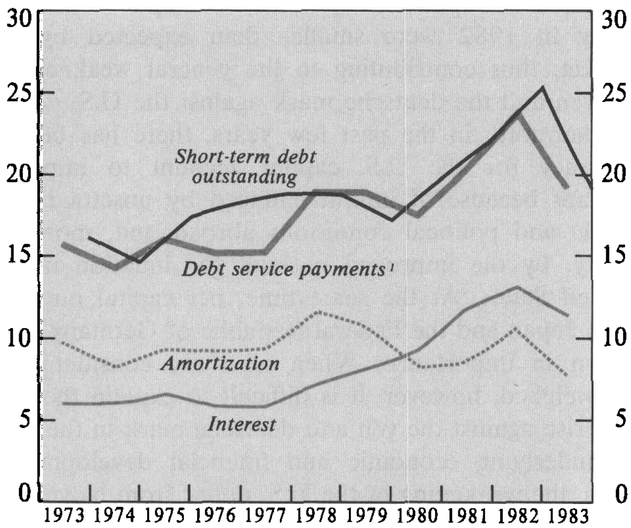
Substantial as it is, the decline that has taken place in the aggregate current account deficit of the non-oil developing countries understates the real adjustment in their external position, because it has occurred against the background of a strong adverse trend in their terms of trade, growing weakness in their principal export markets, and a very high interest burden on their external debt. The improvement in the current account has been achieved, therefore, at the cost of a severe compression of imports, and consequent low growth of output. While the volume of exports from non-oil developing countries increased by an estimated 17 per cent from 1979 to 1982, the volume of imports was the same in both years (Appendix B, Table 8). For 1983, the projected recovery in output and demand in the industrial world should bring some moderate acceleration of export volume growth, together with a partial reversal of the 1982 decline in primary commodity prices. This would result in an upswing—estimated at $21 billion—in the non-oil developing countries' earnings from merchandise exports.

External Debt of Non-Oil Developing Countries

The current account developments and financing patterns discussed above have brought important changes in the level, composition, and rate of growth of the external debt of the non-oil developing countries (see Chart 5 and Appendix B, Tables 32–34). Scaled in relation to exports of goods and services, the outstanding total of such debt (including that of the People's Republic of China) rose from 120 per cent at the end of 1981 to 136 per cent at the past year-end. The further debt expansion projected for 1983, however, is expected to be broadly matched by export growth, so that the corresponding ratio for the current year would increase only marginally, to 137 per cent.

A significant feature of the external debt situation is the extent to which this debt is concentrated among a few large and relatively developed countries of Europe, the Western Hemisphere, and the Far East. Of the 115 non-oil developing countries, 20 relatively advanced countries with good access to international capital markets account for 73 per cent of total external debt outstanding and 84 per cent (or $350 billion) of debt owed to private creditors—the component that is the source of greatest concern. By comparison, these same countries account for only 56 per cent of the combined GDP of non-oil developing countries, and 50 per cent

Chart 5. Non-Oil Developing Countries: Short-Term Debt and Debt Service Ratios, 1973–83
(In per cent of exports of goods and services)



[1] Debt service payments shown here comprise interest payments on both short-term and long-term debt, together with amortization payments on long-term debt.

of their export earnings. Further to be noted, 10 of the non-oil developing countries account for 53 per cent of the group's total external debt and 68 per cent ($285 billion) of the debt owed to private creditors, but only 39 per cent of GDP and 33 per cent of exports. In the treatment of the external debt problem, this concentration of debt among a relatively small number of countries underscores the fundamental importance of adjustment programs tailored to the particular situation of each country.

The rate of growth of total external debt of the non-oil developing countries in 1982 was about 10 per cent, considerably more than the growth of exports, which were seriously affected by the global recession. Nevertheless, the rate of increase in debt was only about half as rapid as in the years 1975–81 on average. The slowdown was concentrated mainly in lending by international banks. Such lending is estimated to have fallen from more than $50 billion in 1981 to some $25 billion in 1982 (Appendix B, Table 25). The staff's projections for 1983 indicate that net bank lending may recede somewhat further, to $15–20 billion; with reserves already severely depleted (Appendix B, Table 30), there will therefore continue to be strong pressure to curb current account deficits—pressures that will be only slightly moderated by an expected substantial increase in the use of Fund credit.

Despite the slower growth of debt in 1982 than in other recent years, debt service payments continued to rise sharply as a proportion of export earnings—reaching 24 per cent, compared with 20 per cent in 1981 and 15 per cent in 1976–77. (See Appendix B, Table 35.) This increase reflected the downturn in export earnings, as well as the enlargement of outstanding debt and some further shortening of its average maturity, only partially offset by a small decline in average interest rates and some impact of debt rescheduling. Geographically, by far the highest average debt service ratios and the steepest increases of the past two years were those of the Western Hemisphere region, reflecting its heavy reliance on borrowing in private markets during a period of very high interest rates.

In 1983, the impact of debt rescheduling on debt service payments will be significantly larger. Agreements reached until now involve the rescheduling of some $20 billion of long-term debt falling due in 1983; without this, the debt service ratio for non-oil developing countries as a group would be 4 percentage points higher than the ratio shown in Appendix B, Table 35. So far, the principal beneficiaries of rescheduling have been Western Hemisphere countries, whose debt service ratio is projected to fall by almost one third in 1983, and may fall further as a result of negotiations currently under way. Beyond the impact of rescheduling on calculated debt service ratios, the external financial position of countries undertaking such agreements is being eased by the refinancing of large amounts of short-term debt (the amortization of which is not included in debt service ratios) at longer maturities.

Of course, rescheduling or refinancing agreements will represent merely a postponement of debt service problems to future years unless developments and policies in the intervening period bring about an improvement in the balance of payments performance of the countries concerned. In this context, it is of particular importance to consider the implications of world economic prospects over the medium term for the external positions of non-oil developing countries. In its "central" scenario, the staff has made estimates of possible developments in the balance of payments and external debt of these countries for the period 1984–86, on the principal assumptions of moderate growth in world output and trade and of appropriate adjustment policies on the part of the debtor countries themselves. These calculations suggest that the aggregate current account deficit of the non-oil developing countries could be expected—in association with a growth rate for these countries averaging 4½ per cent—to settle in the neighborhood of 14 per cent of their exports of goods and services. This is a considerably lower ratio than in 1981–82 and similar to the average for the latter part of the 1970s. A deficit of this size should not pose serious financing problems or unmanageable debt burdens in the aggregate, despite the difficulties that may be encountered by individual countries.

A markedly less satisfactory course of the world economy, however, would lead to a different outcome. Lower growth in the industrial countries would have serious consequences for the trade and growth performance of the non-oil developing countries, as would a further cutback in lending to these countries by private banks or a further intensification of protectionist pressures.

Exchange Market Developments

For most of 1982, the most striking feature of exchange market developments was the continuing effective appreciation of the U.S. dollar. (See Chart 9 in Chapter III.) This trend was interrupted in November 1982, and, for a while, the other major currencies strengthened noticeably. By April 1983, however, only a relatively small part of the earlier trend of the U.S. dollar had been reversed.

The developments in the first ten months or so of 1982 are all the more difficult to explain in light of (1) the persistent, though declining, adverse inflation differential between the United States, on the one hand, and Japan and the Federal Republic of Germany, on the other; (2) the fact that the effective exchange rate for the U.S. dollar had already risen strongly during most of 1981 (at the end of October 1982 it was some 37 per cent above the low point reached in late 1980); and (3) the fact that Japan and the Federal Republic of Germany were in surplus on their current accounts while the U.S. position was showing clear signs of erosion. The large exchange rate movements that have taken place have tended to exacerbate trade frictions in a number of cases and have complicated the task of resisting protectionist pressures.

While the short-term movements in exchange rates that took place during 1981 and the first half of 1982 appeared to reflect in part the evolution of short-term real interest rate differentials among the major countries, subsequent developments were less consistent with such a pattern. In the third quarter of 1982, the short-term real interest rate differential in favor of assets denominated in U.S. dollars tended to decline markedly while the U.S. dollar was moving to new high levels against the deutsche mark and the yen. However, long-term interest rate differentials favorable to assets denominated in U.S. dollars—and the expectation that these differentials would persist—may have contributed to the strength of the dollar during that period. In any event, movements in interest rate differentials cannot explain the extent of the appreciation of the U.S. dollar during the past two years or so.

Exchange rates are affected also by trends in current and capital account positions and by market perceptions of how such positions are likely to shift in the future. (This subject is discussed in Appendix A-4.) It may be that the improvements in the current account positions of Japan and the Federal Republic of Germany in 1982 were smaller than expected by the market, thus contributing to the general weakness of the yen and the deutsche mark against the U.S. dollar. Furthermore, in the past few years, there has been a tendency for the U.S. capital account to improve, perhaps because of inflows induced by unsettled economic and political conditions abroad and, more recently, by the improved outlook for inflation in the United States. At the same time, net capital outflows from Japan and the Federal Republic of Germany have grown in importance. When all these considerations are weighed, however, it is difficult to explain the dollar's rise against the yen and deutsche mark in the light of underlying economic and financial developments. Thus, the weakening of the U.S. dollar from November 1982 to April 1983, though modest, could be viewed as being in the direction of restoring a more sustainable pattern of exchange rates.

The large changes in exchange rates for major currencies that have occurred in recent years, together with their apparent lack of correspondence to underlying economic and financial conditions, have raised questions about the functioning of the international currency system. In part, these questions concern possible improvements in the role of monetary policy and of exchange market intervention (the subject of a special study, released at the end of April 1983, by officials of the seven major industrial countries) for the purpose of achieving a greater measure of exchange rate stability. More generally, difficult and controversial issues are posed concerning the assessment of balance of payments and exchange rate developments in the context of national economic policies, both for the individual members and in a multilateral setting. This range of problems is currently under study within the Fund as part of its continuing and evolving responsibility for surveillance over members' exchange rate policies.

Appendix A-5 covers a number of issues related to exchange rate management in non-oil developing countries. Such countries, as well as those in the oil exporting group, have faced difficult decisions in this area in recent years as a result of the continuance of generally high domestic inflation rates and the growing need for external adjustment. The analysis in the appendix note suggests that those countries that have brought about adequate and timely adjustment of their exchange rates have, in general, fared rather better than those that have allowed their external competitiveness to be eroded.