

# WORLD ECONOMIC OUTLOOK

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A Survey by the Staff of the  
International Monetary Fund



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## Assumptions and Conventions

A number of assumptions have been adopted for the projections presented in this report. It has been assumed that average real effective exchange rates will remain constant at their March 1993 levels except for the bilateral rates among the exchange rate mechanism (ERM) currencies, which are assumed to remain constant in nominal terms; that “present” policies of national authorities will be maintained; that the average price of oil will be \$17.67 a barrel in 1993, \$18.13 a barrel in 1994, and remain unchanged in real terms over the medium term; and that the six-month U.S. dollar London interbank offered rate (LIBOR) will average 3<sup>3</sup>/<sub>4</sub> percent in 1993 and 5<sup>1</sup>/<sub>4</sub> percent in 1994. These are, of course, working hypotheses rather than forecasts, and the uncertainties surrounding them add to the margin of error that would in any event be involved in the projections. The estimates and projections themselves are based on statistical information available on April 14, 1993.

The following conventions have been used throughout the report:

- . . . to indicate that data are not available or not applicable;
- to indicate that the figure is zero or less than half the final digit shown;
- between years or months (for example, 1991–92 or January–June) to indicate the years or months covered, including the beginning and ending years or months;
- / between years or months (for example, 1991/92) to indicate a fiscal or financial year.

“Billion” means a thousand million; “trillion” means a thousand billion.

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

\* \* \*

As used in this report, the term “country” does not in all cases refer to a territorial entity that is a state as understood by international law and practice. As used here, the term also covers some territorial entities that are not states but for which statistical data are maintained on a separate and independent basis.





## Preface

The projections and analysis contained in the *World Economic Outlook* are an integral element of the IMF's ongoing surveillance of economic developments and policies in its member countries and of the global economic system. The IMF has published the *World Economic Outlook* annually from 1980 through 1983 and biannually since 1984. An *Interim Assessment* of the *World Economic Outlook* was published in January 1993, evaluating prospects and policies following the unexpected weakening of activity in many key economies and a period of considerable turmoil in foreign exchange markets.

The survey of prospects and policies is the product of a comprehensive interdepartmental review of world economic developments, which draws primarily on the information the IMF staff gathers through its consultations with member countries. These consultations are carried out in particular by the IMF's area departments together with the Policy Development and Review and Fiscal Affairs Departments.

The country projections are prepared by the IMF's area departments on the basis of internationally consistent assumptions about world activity, exchange rates, and conditions in international financial and commodity markets. For approximately 50 of the largest economies—accounting for 90 percent of world output—the projections are updated for each *World Economic Outlook* exercise. For smaller countries, the estimates are based on the projections prepared at the time of the IMF's regular Article IV consultations with member countries or in connection with the use of IMF resources; for these countries, the estimates used in the *World Economic Outlook* are updated incrementally to reflect changes in global economic conditions.

The analysis in the *World Economic Outlook* draws extensively on the ongoing work of the IMF's area and specialized departments, and is coordinated in the Research Department under the general direction of Michael Mussa, Economic Counsellor and Director of Research. The *World Economic Outlook* project is directed by Flemming Larsen, Assistant Director in the Research Department, together with David T. Coe, Chief of the World Economic Studies Division.

Other contributors to the current issue include Staffan Gorne, Garry J. Schinasi, Robert P. Ford, Manmohan S. Kumar, Johan Baras, Monica Hargraves, Robert A. Feldman, Alexander Hoffmaister, Hossein Samiei, Vivek Arora, Tamim Bayoumi, Tessa van der Willigen, and Tom Enger. Steven Symansky and Sheila Bassett generated the alternative scenarios supporting the analysis. The authors of the annexes are indicated in each case. The Fiscal Analysis Division of the Fiscal Affairs Department computed the fiscal impulse measures. Anthony G. Turner, Sungcha Hong Cha, and Toh Kuan provided research assistance. Cathy Wright, Allen Cobler, Nicholas Dopuch, Gretchen Gallik, Steven Parker, Prem Pillai, and Celia Winkler processed the data and managed the computer systems. Susan Duff, Margarita Lorenz-Santin, and Nora Mori-Whitehouse were responsible for word processing. James McEuen of the External Relations Department edited the manuscript and coordinated production of the publication.

The analysis has benefited from comments and suggestions by staff from other IMF departments, as well as by Executive Directors following their discussion of the *World Economic Outlook* on April 12 and 14, 1993. However, both projections and policy considerations are those of the IMF staff and should not be attributed to Executive Directors or to their national authorities.

# Cooperation for Sustained Global Expansion

The following "Declaration on Cooperation for Sustained Global Expansion" was adopted at the conclusion of the fortieth meeting of the *Latin American Committee of the Board of Governors of the IMF*, April 30, 1993.

1. With economic stagnation or decline in most of Europe, only tentative indications of an upturn in Japan, and quite gradual recovery in the United States, 1993 will be the third straight year of generally poor growth for the industrial countries. While the overall performance of the developing countries has been encouraging, a number of them still suffer from declining per capita incomes, and the process of transition to market economies is proving complex and requiring considerable perseverance and support. Nevertheless, there are now a number of positive developments which, if sustained in a coordinated and cooperative manner, have the potential of strengthening global economic performance in both the near and medium term. We are consequently of the view that it is timely to join forces in a *global cooperative effort* to bolster confidence and strengthen prospects for a durable, noninflationary world expansion. Member countries and the multilateral institutions are invited to strengthen their efforts in carrying out and supporting mutually reinforcing policies along the following lines.

2. From our common global perspective there is an immediate and urgent need for successfully *concluding the Uruguay Round*. This is crucial for increasing world prosperity. Persistent failure to complete the Round would not be a standstill, but could reverse the trend of trade liberalization which has been an important contributor to growth. Every effort will thus be made by all countries concerned to speed up negotiations to reach an agreement very soon. In the meantime, all member countries commit themselves to resist inward-looking policies.

3. The recent strong performance of many *developing countries* and their growing openness to international trade have positively contributed to alleviating the effects of global slack. It is essential that developing countries continue to carry forward with intensified adjustment and reform programs, thereby allowing them to reap the benefits of sound policies in terms of stronger growth, to devote more resources to human investment and poverty alleviation, and to contribute further to the global recovery. These efforts must be supported by the international community with financial and technical assistance, including debt relief as appropriate.

4. Continuing, decisive progress in the transformation of the *formerly centrally planned economies* is a key element of our cooperative growth effort. To this end, enhanced assistance, both financial and technical, is crucial for all countries in transition that strengthen their policymaking process, create the appropriate mechanisms for mutual economic cooperation, and implement the macroeconomic and reform programs needed for the establishment of market-based systems. Improved access to foreign markets will also be essential.

5. The central responsibility for strengthening growth prospects rests with the *industrial countries*. Cooperative actions being undertaken are strengthening confidence and will insure against downside risks. We welcome the programs of fiscal consolidation announced in North America and in other industrial countries, which will improve national savings and investment and facilitate a reduction in interest rates; the additional economic package announced by the Japanese government which will strengthen domestic demand and contribute to re-

ducing the large external imbalance; as well as the European growth initiative and the reduction of interest rates in Europe which will constitute an important element of economic recovery. Conditions which should allow for a progressive further reduction of interest rates, without raising concerns of renewed inflation, are expected to continue to improve in the period ahead.

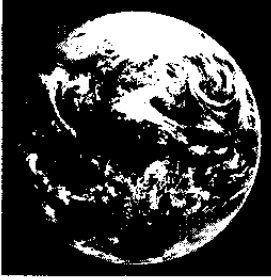
6. A broad-based sustainable recovery will provide room to pursue the fiscal consolidation required to increase domestic savings in those industrial countries facing large structural deficits. To that effect, these countries intend to firmly adhere to a *medium-term strategy of deficit reduction* which will have a major favorable impact on interest rates, private investment and job creation, as well as on the supply of savings needed for growth in the developing countries. *Structural measures* to improve the allocation of resources and the functioning of markets are equally important for achieving faster output growth. We recognize in particular that, in order to achieve a substantial and lasting reduction in the unacceptably high levels of unemployment, especially in Europe, bold measures will need to be taken to make labor markets more flexible.

7. Notwithstanding the improved performance of developing countries as a group, many low-income countries, particularly in Africa, still face difficult economic situations and a lengthy process of adjustment. The Fund is encouraged to continue with its efforts in helping to implement growth-oriented adjustment strategies and catalyze external financing through its *concessional facility for low-income members*. We thus invite the Executive Board to complete its work on a successor to the enhanced structural adjustment facility by end-November 1993. We encourage the Board urgently to consider all the options for financing the successor facility.

8. We welcome the Fund's prompt response to the extraordinary circumstances being faced by a number of its members as a result of the widespread transition to market-based economic systems. The new *systemic transformation facility* will enable the Fund to play its essential role in promoting this historic transformation. We are confident that a number of members will qualify early for support, thereby paving the way for further support through the Fund's customary facilities.

9. We had an exchange of views on the question of an *allocation of SDRs* in present circumstances, and request the Executive Board to assess the long-term global need for a supplement to existing reserve assets, the potential economic and monetary effects of an allocation, and the future of the SDR as a reserve asset. We request that a report on this work be submitted to the Committee at its next meeting.

10. We all stand ready to play our individual part in the global cooperative effort for economic growth outlined in this declaration and will monitor the situation carefully to ensure a consolidation of the recovery. In this context, we will also strengthen our *collaboration with the Fund* as the central international monetary institution. To help us face the challenges of an ever more integrated global economy, the Fund's effective *surveillance over members' exchange rate and macroeconomic policies* becomes even more important. We support the steps agreed by the Executive Board to strengthen this surveillance, including regional developments, with a view to identifying and addressing in a timely manner problems that may give rise to tensions in the world economy and undesirable volatility in exchange rates.



# I

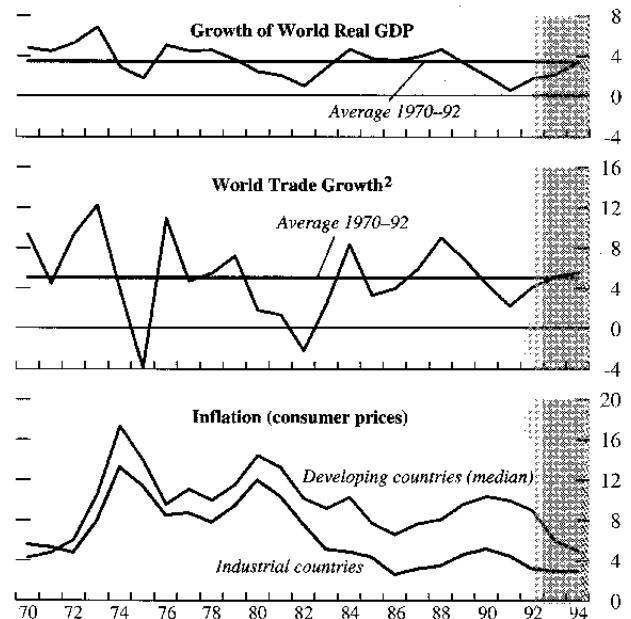
## Overview

The recovery of global economic activity after the 1991 downturn remains hesitant and uneven. Although some industrial countries have emerged from recession, growth has declined sharply in many other countries because of extensive balance sheet restructuring, persistently high short-term real interest rates, considerable financial tensions, and depressed levels of consumer and business confidence. As a result, the growth of world output picked up only modestly, from  $\frac{1}{2}$  of 1 percent in 1991 to  $1\frac{3}{4}$  percent in 1992, which was the third consecutive year of below-trend performance (Chart 1). World output is projected to grow by  $2\frac{1}{4}$  percent in 1993 and then to strengthen by  $3\frac{1}{2}$  percent in 1994, but the outlook remains unusually uncertain. On the positive side, inflation has continued to abate in most industrial and developing countries.

Encouraging signs of stronger growth in North America contrast with the recent marked deterioration in economic performance in Japan and especially in Europe, where recessionary tendencies are expected to persist through much of 1993. For Japan, growth in 1993 has been revised down to  $1\frac{1}{4}$  percent, from  $2\frac{1}{2}$  percent in the January 1993 *Interim Assessment* and  $3\frac{3}{4}$  percent in the October 1992 *World Economic Outlook*. These revisions are due partly to the effects of balance sheet adjustments by households, corporations, and financial institutions after the recent correction of inflated asset prices. The sharp slowing of growth in Europe—to a revised projection that suggests stagnation in 1993 compared with 1 percent growth in the *Interim Assessment* and  $2\frac{1}{4}$  percent in the October *World Economic Outlook*—reflects a range of adverse factors, including tight monetary conditions, inadequate progress toward inflation convergence and budgetary consolidation in many countries, and the attendant weakness of consumer and business confidence. More generally, the turbulence in foreign exchange markets since the middle of 1992 and an escalation of tensions over trade have contributed to increased uncertainty in many countries.

Many developing countries have continued to show resilience to the weakness of activity in industrial countries. Low interest rates on dollar-denominated external liabilities, and considerable

**Chart 1. World Indicators<sup>1</sup>**  
(In percent)



<sup>1</sup>Blue shaded areas indicate IMF staff projections.

<sup>2</sup>Excluding trade among states of the former U.S.S.R.

capital inflows in some cases, have helped to offset the effects of declining terms of trade for commodity exporters and of generally weak demand in the industrial countries. But the most important reason for the comparatively strong performance of a growing number of developing countries has been the beneficial effects of sustained stabilization and reform efforts in the context of outward-oriented economic strategies. For many other developing countries, however, economic performance has remained unsatisfactory, and living standards are continuing to decline in many of the poorest countries.

The economic situation also remains difficult for the countries in transition from central planning, following what has already been a sizable decline in output. The contraction now appears to be bottoming out in parts of central Europe, where some countries are projected to register positive growth in 1993 and 1994. But key aspects of the reform and stabilization efforts have not yet been fully implemented, and there remain risks of policy slippages. In the Russian Federation and most other countries of the former Soviet Union, economic conditions are of particular concern because of inadequate attention to macro-economic stabilization and because of political unrest and armed conflicts in many regions.

Notwithstanding the continued economic difficulties in many countries, recent positive developments offer hope for a cooperative growth strategy in the near term, which could also permit a strengthening of global economic performance over the medium term (see the IMF Interim Committee's declaration, facing the opening of this chapter). Many developing countries are reaping the fruits of sustained reform and stabilization efforts. There are now early signs of recovery in some of the economies in transition. Efforts to enhance assistance to countries affected by the transition to market-based trading systems occurring in central Europe and the former Soviet Union, and to low-income countries to support strengthened stabilization and restructuring efforts, are moving forward. In Europe, exchange market tensions have eased, and interest rates have been falling and should continue to do so as evidence accumulates of the waning of inflationary pressures. The near-term fiscal stimulus announced by the Japanese government should help to restore confidence and promote economic recovery. Other industrial countries have announced programs of budget deficit reduction that have been favorably received in financial markets. Implementation and further strengthening of these deficit-reduction plans would lay the foundation for sustainable increases in growth and living standards over the medium term. To be successful, it is vital that these efforts are supported by an immediate conclusion of the Uruguay Round: a failure to complete the Round would deprive the world of the benefits of further liberalization and

would risk aggravating protectionist pressures, which would seriously harm all countries.

## Industrial Countries

The present difficulties in the industrial world owe much to the failure to implement key elements of the medium-term strategy that was adopted in the early 1980s as the appropriate guide for economic policy. In particular, inadequate budgetary consolidation and structural rigidities have left countries in a weak position to cope with the recent—and continuing—sluggishness of global economic activity. Large budget deficits have contributed to high real long-term interest rates and have also been an important factor in the recent turbulence in European currency markets. And labor market policies have been unsuccessful in addressing persistently high unemployment, especially in Europe.

Despite success in reducing inflation in most countries, important challenges still confront monetary policy. The speculative excesses in asset markets in the late 1980s were at least partly a result of excessive credit expansion and risk taking by financial institutions. The eventual tightening of monetary policy did succeed in puncturing the speculative bubbles, but the tightening occurred too late to prevent the unwarranted run-up and subsequent abrupt correction of asset prices. Although important lessons have been learned about the need to strengthen prudential oversight and to pay greater attention to asset markets in the conduct of monetary policy, many countries continue to suffer the consequences of asset deflation.

In the United States, monetary conditions were eased substantially between 1990 and the end of 1992 in response to the recession and to the weakness of the recovery (Chart 2). This has helped to stimulate demand and has also promoted balance sheet adjustment by lowering debt-service costs. Monetary conditions have also been eased significantly over the past two years in Japan as evidence of financial strain and slowing activity has accumulated. The cuts in the official discount rate together with recent fiscal measures should help to support activity, but the experience of other countries that are going through similar balance sheet difficulties suggests that the weakness of private demand may persist for some time. In Europe, by comparison, the level of real short-term interest rates has remained very high, which has delayed balance sheet adjustment and weakened activity.

Looking ahead, the industrial countries now need to take effective action to strengthen growth and to diminish exchange and financial market tensions while preserving progress in reducing inflation. In the United States, the first steps toward meaningful medium-term fiscal consolidation are being taken.

Japan has recently announced a new package of stimulatory measures. At the same time, conditions are improving for significant reductions of official interest rates in Europe, which should help to contain recessionary forces and ensure that recovery takes hold by 1994. There is also an urgent need for positive steps to resist protectionist pressures, especially by bringing the multilateral trade negotiations under the Uruguay Round of the General Agreement on Trade and Tariffs (GATT) to a successful conclusion. Determined action to alleviate short-term difficulties and to achieve key medium-term objectives would unquestionably strengthen consumer and business confidence.

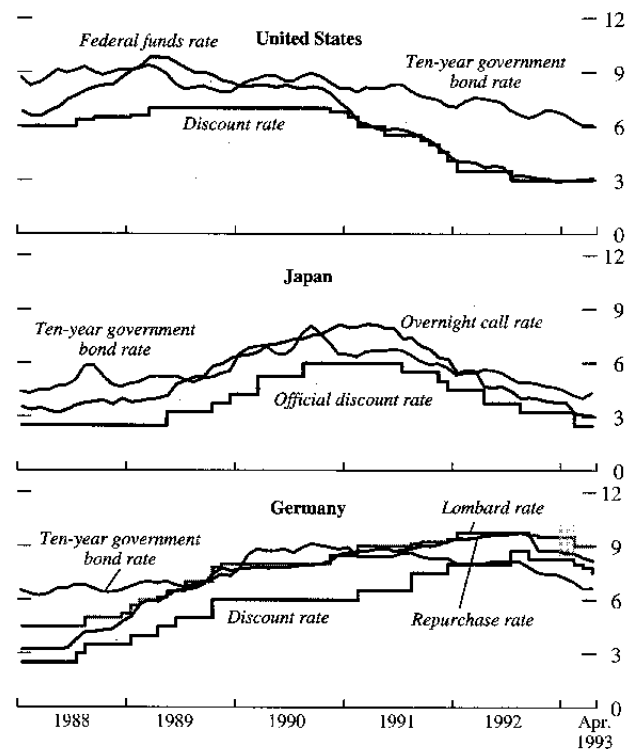
For the *United States*, as recognized by the administration, the most pressing priority of economic policy is the need to reduce the large federal budget deficit and to strengthen saving and investment. The economic plan presented in mid-February represents a considerable effort, but its full enactment and implementation could still leave the structural federal fiscal deficit in FY 1998 at about 3 percent of GDP (more than 4 percent if the social security surplus is excluded)—that is, at the same level as in the late 1980s. Thus, further action is needed to ensure an adequate degree of fiscal consolidation over the medium term. Recent economic developments suggest that the natural forces of recovery, aided by earlier monetary stimulus, are taking hold and that significant short-term fiscal stimulus is now less necessary than might have appeared earlier. As the recovery gathers momentum and economic slack is reduced, the authorities may need to allow monetary conditions to tighten in order to avoid any resurgence of inflationary pressures.

In *Canada*, where recovery is not yet as firmly established as in the United States, interest rates have been coming down after a sharp rise associated with exchange market developments in the fall of 1992. In light of the cyclical situation, there should be room for a further easing of interest rates without jeopardizing the progress made toward price stability. Continued perseverance in reducing the structural budget deficit also is required.

In *Japan*, the authorities announced a large package of stimulative fiscal measures in August 1992, and the official discount rate was reduced further in the face of a sharp weakening of activity. While there are recent signs of a bottoming out of the recession, uncertainties remain with respect to the timing and strength of the upswing. To give recovery the desired momentum, substantial additional measures, supplementing the FY 1993 budget, have recently been announced. Given Japan's efforts at fiscal consolidation in the past, these measures do not jeopardize the credibility of the authorities' medium-term budgetary objectives. The low inflation rate and the recent strength of the yen suggest

**Chart 2. Three Major Industrial Countries: Policy-Related Interest Rates and Ten-Year Government Bond Rates<sup>1</sup>**

(In percent a year)



<sup>1</sup>End of month except for the federal funds rate, which is the average of daily observations, and the repurchase rate, which is the average of weekly data.

that there also remains some room for interest rate reduction should economic weakness persist.

In Europe, although conditions differ among countries, an essential contribution to stronger growth would come from a further reduction of interest rates in *Germany* as the inflationary consequences of unification fade. Recent small reductions in official German interest rates have helped to reduce the tensions in the European Monetary System (EMS), but monetary conditions remain unduly tight in most countries. Substantial interest rate differentials relative to Germany, associated with the recent exchange market turbulence, have exacerbated this situation. Large budget deficits in most of Europe generally preclude short-term fiscal stimulus, since this would only delay the critically needed decline in both short- and long-term interest rates, further complicate the achievement of medium-term fiscal objectives, and jeopardize policy credibility.

Conditions for a further reduction of short-term interest rates in Germany are improving, however. Although increases in prices have remained high in recent months, the pronounced weakening of the economy, early indications of a slowdown in money growth, and favorable developments on the wage front suggest that inflation should soon begin to moderate. Progress toward fiscal consolidation, which would need to go beyond the recent solidarity pact, would also contribute to the reduction of macroeconomic imbalances. These developments should ensure a durable reduction of inflation in Germany and would allow a marked easing of monetary conditions that would be fully consistent with both domestic objectives and the broader interests of the world economy.

For *France*, persistent pressure on the exchange rate since September 1992 had necessitated the maintenance of a very large short-term interest rate differential relative to Germany, despite lower inflation than in Germany, but these pressures seem now largely to have subsided. The differential has recently narrowed substantially, following the new government's reaffirmation of the strong commitment to the current exchange rate mechanism (ERM) parity and the announcement of plans to give more autonomy to the Banque de France. The reduction of exchange market tensions should permit a further narrowing of the interest differential. While fiscal policy is allowing the automatic stabilizers to cushion activity during 1993, it will be important to reduce the budget deficit as activity recovers in 1994 and beyond.

For the *United Kingdom*, the lowering of interest rates and the sharp depreciation of the exchange rate following the suspension of the pound sterling from the ERM have improved prospects for recovery. The sustainability of the recovery, however,

will depend on the authorities' ability to safeguard the credibility of their anti-inflationary commitment, especially in light of the potential inflationary consequences of sterling's decline. This, in turn, depends critically on the adoption of further measures, in the 1994 budget or even before, to secure a faster reduction of the large budget deficit. A general decline of interest rates throughout Europe would help to alleviate the downward pressure on the exchange rate, but any further easing of monetary policy in the United Kingdom should be resisted unless there is good reason to believe that a further cut in interest rates would not endanger the goal of containing inflation.

The need for a substantial reduction of the fiscal deficit is particularly critical in *Italy*. The large depreciation of the lira has improved the competitive position considerably, but a sizable interest rate premium relative to Germany persists, particularly on long-term interest rates. Important measures have been taken to contain the budget deficit, but, as the government recognizes, further action is required to strengthen the credibility of the fiscal consolidation efforts and permit a decline in interest rates. Additional measures will be needed both to achieve the 1993 budget objective and to meet the government's medium-term target of bringing the overall deficit below 5 percent of GDP by 1995. Substantial financial assistance has been granted by the European Community (EC) to help to establish the conditions under which the lira could rejoin the ERM. An adequate degree of fiscal consolidation will be crucial to permit such a move.

The recent crisis in the EMS witnessed the suspension from the ERM of two major currencies, four realignments imposed by market pressures in just five months, and the floating of three Nordic currencies that had been pegged to the European currency unit (ECU). In all cases, the direction of the exchange rate adjustments that have taken place appears to have been in accordance with the fundamentals, including differences in policies associated with divergent cyclical positions. For some currencies, however, the large depreciations appear to have overshot, which is adding to strains in economic relations within Europe. Although the pressures on the system have abated since early February, economic policy cooperation within the EMS will need to be strengthened to reduce the risk of a recurrence of turbulence and to promote further progress toward economic and monetary union (EMU). A key requirement remains the need to ensure greater economic convergence. Because some countries may achieve a sufficient degree of convergence only in the medium term, small adjustments of parities within the ERM band on a timely basis could help to avoid new tensions without undermining the character of the system.

More fundamentally, recent experience has demonstrated the crucial importance of strengthening monetary policy cooperation across Europe. It is necessary to recognize that economic and financial integration is rapidly eroding the distinction between resident and nonresident enterprises and financial institutions and appears to be blurring the distinction between national monetary indicators. To ensure that monetary conditions are compatible with sustained noninflationary growth in Europe as a whole, it will therefore be necessary to consider whether—and how—national indicators of monetary conditions, activity, and inflation might be complemented with ERM-wide indicators. While the scope for independent monetary policies has largely disappeared with the close economic and financial integration of the European economies and the commitment to stable exchange rates, monetary policy continues to have a comparative advantage in ensuring price stability across the ERM countries as a group. Increasingly, however, the task of dealing with the consequences of economic disturbances that affect inflation and economic activity in specific countries or regions now falls primarily on fiscal and structural policies rather than on monetary policy.

Especially in the present period of economic difficulty, the ongoing policy responses of the industrial countries need to be complementary if more satisfactory growth is to be achieved during 1993 and beyond. The confidence of markets in the longer-run orientation of U.S. monetary policy toward the objective of low inflation facilitated a significant monetary policy response to the recession of 1990-91 and to the subsequent sluggish recovery, without raising concerns about longer-term inflation that would have been adversely reflected in long-term interest rates. The responsiveness of monetary policy also helped to avoid fiscal stimulus that would have enlarged an already excessive federal deficit. The fruits of this policy can be seen in the relatively rapid pace of economic expansion now under way in the United States, the benefits of which will gradually spread to other countries. Conversely, economic recovery in Europe and Japan, provided that it begins this year and gains momentum by 1994, should help to offset any short-term dampening effect of deficit-reduction measures that the U.S. administration plans to implement during 1994.

More generally, sustained expansion in each of the major industrial countries benefits from, and to an important extent requires, sustained expansion in its partner countries. Within Europe, where economic linkages are particularly strong and getting stronger, economic recovery in one country cannot get very far unless the whole of the continent is also recovering. Mutually reinforcing growth for

Europe as a whole would, in turn, help to support economic expansion beyond Europe. Similarly, the monetary and fiscal policy measures already undertaken in Japan, and the additional measures recently announced for FY 1993, will be important in spurring recovery of the Japanese economy and will also contribute to strengthening activity worldwide.

A broadly based recovery would provide better opportunity for governments to pursue determined medium-term programs of fiscal consolidation. Favorable effects on confidence, and on longer-term interest rates, from the announcement of credible programs of consolidation would help to offset any short-term dampening effects from reductions in public expenditure or from tax increases. Moreover, it would be highly desirable if any tendency for overheating during the coming expansion were offset by a tightening of fiscal policy, which in any case is required in most countries to achieve adequate medium-term fiscal consolidation. This would not relieve monetary policy of its primary responsibility for assuring reasonable price stability, but it would make the fulfillment of this goal consistent with a lower path for interest rates. An appropriate fiscal and monetary policy mix would also promote greater calm in foreign exchange and other financial markets, thereby facilitating a general recovery of consumer and business confidence. In addition, improving saving-investment balances through fiscal consolidation in key deficit countries would help to address the most important cause of large, persistent international payments imbalances and thereby reduce the associated tensions over trade and permit increased resource transfers to developing countries and to economies in transition.

The implications of complementary and mutually consistent macroeconomic measures for trade policies deserve particular emphasis. As the experience of the 1930s so dramatically demonstrated, the apparent loss of jobs to foreign competition can easily give rise to calls for protectionist policies during a period of pervasive economic weakness and rising unemployment. Firm adherence to the established rules of the open international trading system—and the reconfirmation of countries' commitments to these rules through early completion of the Uruguay Round—are obviously the first line of defense against self-defeating protectionist policies. But pressures for protection must not be allowed to become too great. Properly attuned and cooperative macroeconomic policies must guard against persistent economic weakness and high unemployment and must seek to limit the extent and duration of cyclical divergences among countries, their impact on international payments imbalances, and the repercussions on financial and foreign exchange markets.

## Developing Countries

Output in the developing countries is projected to expand by 5 percent in 1993 and 1994, only slightly less than in 1992, which had the highest growth in more than a decade. Even excluding special factors such as the reconstruction in the Middle East, which boosted growth in that region to 10 percent in 1992, this is an impressive result, especially given the weakness of activity in the industrial countries. Divergences in growth among developing countries have tended to widen in recent years, however, as many countries have failed to register any meaningful improvement in economic conditions. In some of these countries, per capita real incomes remain below the levels experienced ten or even twenty years ago.

The stronger performers among the developing countries share a number of essential characteristics. Compared with the slow-growing countries, the successful countries have markedly higher saving rates; higher investment rates (also in human capital); and higher efficiency of investment and higher overall productivity growth. They also typically finance a larger proportion of investment from domestic saving, and when they have recourse to external saving, it is often in the form of foreign direct investment and equity capital rather than debt-creating capital inflows. Finally, these countries are generally more outward-oriented than the low-growth countries, both with respect to trade links with the industrial countries and in terms of their economic ties with other developing countries. Many developing country exporters have weathered the current sluggishness of growth in the industrial world by expanding their trade with other developing countries.

Government policies explain an important part of the divergences in economic structure and performance across the developing countries. The stronger performers have maintained or restored sustainable fiscal balances, low and predictable inflation, positive but low real interest rates, viable external positions, and competitive and stable exchange rates. In addition to macroeconomic stability, the successful countries have relied on market forces to allocate resources efficiently, through reduced government intervention, through trade liberalization and currency convertibility, and through financial market reform. The impressive growth record of many Asian countries illustrates the longer-term benefits from sustained stabilization and reform efforts, and the recent experience of many Latin American countries demonstrates that economic growth can recover when the necessary policies are put in place.

In some of the successful developing countries, the recent strength of economic performance has

been accompanied by substantial capital inflows in the form of both direct and portfolio investment. This has contributed to excess demand pressures and, in several cases, to growing signs of overheating. There is also a risk of speculative excesses in asset markets like those experienced in many industrial countries in the 1980s. In countries where demand pressures are strong, a tightening of fiscal policy may be necessary to make room for higher investment. Allowing some appreciation of the currency may also be appropriate. It may finally be possible to speed up privatization, which would help to retire both domestic and external debt. In China, strong demand pressures generated an increase in output in 1992 of close to 13 percent in the context of accelerated reform efforts; to sustain the momentum of the reforms and to avoid overheating, a cautious stance of stabilization policies will be essential during the period ahead.

In most African countries, major reform efforts are quite recent, and the resulting higher growth rates are only beginning to show up. However, at their relatively early stage of development these countries remain highly vulnerable to adverse terms of trade and other shocks, such as drought, which held back growth in 1992 in most of southern Africa. An important issue is the difficulty of coherent implementation of economic policies during the (often lengthy) transition to democracy. For many countries, it is clear that decisive progress will not materialize in the absence of considerable improvements in governance supported by adequate levels of financial and technical development assistance. Where the required policy changes are implemented, the international community must stand ready to provide strong support—for example, through appropriate debt relief and through the IMF's concessional enhanced structural adjustment facility (ESAF), a successor to which is currently under consideration. As the economic outlook improves in other parts of the world, there should be scope for increased efforts to assist the poorest countries.

## Countries in Transition

The early experience of the former centrally planned economies has already demonstrated the crucially important link between structural reforms, macroeconomic stabilization, and successful economic transformation. Among the central European countries, the Czech Republic, Hungary, and Poland have made the greatest progress in structural reform; inflationary pressures there have abated following price liberalization, and output has begun to recover. These achievements will be difficult to sustain, however, in the absence of strong efforts to contain the large fiscal deficits that have accom-



panied the considerable losses of output and tax revenue since the start of the reform process.

In the Baltic countries there are encouraging signs that reforms are taking hold and are being supported by strong stabilization efforts. In most other countries of the former Soviet Union, in contrast, inadequate stabilization efforts now threaten to lead to hyperinflation, which could derail the reform process. Inflation, which had abated following the immediate impact of price liberalization in early 1992, surged to extremely high levels in late 1992 and early 1993. The main reason for this development has been excessive credit expansion to the government and to state enterprises. The transformation process is being seriously hampered by the widespread subsidization of inefficient enterprises and the resulting misallocation of resources. The lack of effective economic and monetary cooperation among the countries of the former Soviet Union exacerbates other problems by severely constraining trade flows and impeding inflation control. Partly as a result of these difficulties, some countries have decided that the introduction of separate currencies offers the best scope for avoiding hyperinflation and for improving economic conditions. This development can facilitate the implementation of stronger stabilization programs, but it is not a substitute for fiscal and monetary discipline and vigorous structural reform.

The international community must continue to provide support for strong stabilization policies and reforms in the countries of the former Soviet Union as they struggle to overcome the legacies of the past. To ensure the success of the transformation process, it is vital that the rest of the world open its markets to the exports of the reforming countries. Cooperative efforts on trade and payments issues are also crucial to these countries' common task of economic restructuring. Considerable emphasis should be placed on technical assistance and on policy advice in all areas. There is also scope for increasing financial support for specific programs of industrial restructuring, including conversion of defense industries. Financial assistance has a critical role to play, and a new IMF facility has been created to help meet the special needs of countries affected by the transition to market-based trading systems. However, the effectiveness of such assistance will be seriously impeded so long as macroeconomic conditions remain highly unstable.

## Trade Policies

The experience of the past forty years offers strong evidence of close linkage between liberal trade and exchange regimes and economic prosperity. The liberalization of trade in manufactured goods among the industrial countries was one of the

principal reasons for the rapid growth of world output in the 1950s and 1960s. Many developing countries also have increasingly moved to make their currencies convertible, to promote competition, and to liberalize foreign trade, and this has helped them to overcome the debt crisis of the 1980s and to sustain growth even in the face of weak activity in the industrial countries since 1990. Most recently, central planning has been abandoned as a viable model for economic progress, giving way to market-based economic reforms that will allow a large number of countries to share in, and contribute to, continued gains in global economic performance.

Yet the significant benefits from free trade now seem threatened. The failure to conclude the Uruguay Round is adding to trade tensions and is depriving the world of potentially large gains from further liberalization of tariff and nontariff barriers; from the extension of multilateral rules to new sectors; from a strengthening of rules and disciplines on antidumping, subsidies, and safeguards; and from a strengthening of the dispute settlement mechanism and of trade policy surveillance. The industrial countries are increasingly seeking recourse to countervailing and antidumping duties and to nontariff barriers. Excessive focus on bilateral or even sectoral trade imbalances has led to a dangerous proliferation of managed trade agreements. And there is a risk that regional trading arrangements could become inward looking, rather than serving primarily to promote regional integration in the context of multilateral free trade.

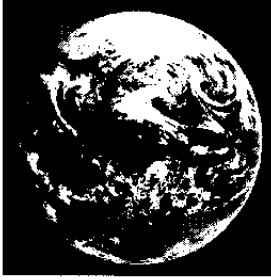
Efforts to bring the Uruguay Round to an early and successful conclusion and reverse the rise in protectionist barriers must be a central element of any cooperative effort to strengthen growth worldwide. Given constraints on financial resources, market-opening measures by industrial countries are crucial to support the efforts of developing countries and economies in transition to implement outward-oriented reform strategies successfully. Such positive steps are also important in view of the likelihood that current account imbalances among the major industrial countries will widen further as cyclical positions are reversed, which threatens to fuel protectionist sentiment. Not only would trade restrictions do little to affect underlying external positions, they would run the risk of triggering a spiral of retaliation and counterretaliation, severely harming business confidence and prospects for recovery. To reduce the large structural components of the external imbalances, it is necessary to tackle their root cause: the inadequacy of national saving relative to domestic investment opportunities, particularly in the United States, but also in several other countries. In these cases, fiscal consolidation is essential to restore external viability. At the same

time, surplus countries have a responsibility to maintain adequate growth of domestic demand and to step up market-opening efforts.

\* \* \*

This issue of the *World Economic Outlook* introduces a new set of weights for aggregation of output across countries based on estimates of purchasing power parities (PPPs). An important difference compared with the previous weights, which were

based on market exchange rates, is that the developing countries' share of world output increases significantly. Because of this change, world and regional aggregates reported in this *World Economic Outlook* are not directly comparable with those shown in earlier issues. The rationale for and implications of introducing PPP-based weights are discussed in Annex IV. In addition, in this issue the Statistical Appendix has been extended to include historical data on growth and inflation in individual countries.



## II

# World Economic Situation and Short-Term Prospects

Following two years of slow economic growth, the recovery for the world economy in 1993 is projected to be sluggish (Table 1). A protracted slowdown in Europe and an unexpectedly sharp weakening of activity in Japan have contributed to significant downward revisions to the output projections for many countries for 1993.<sup>1</sup> Against this background of recent setbacks there are, however, some encouraging developments: strengthening recoveries in North America; continuing progress and resilience in many developing countries; indications in some central European economies that reforms are starting to bear fruit; and significant reductions in inflation in a number of countries. There is also scope for improving economic prospects in 1994 and beyond through a cooperative growth strategy.

This chapter presents baseline projections. The uncertainties in the outlook are illustrated by alternative scenarios discussed in Chapter III for the industrial countries and in Chapter IV for the developing countries.

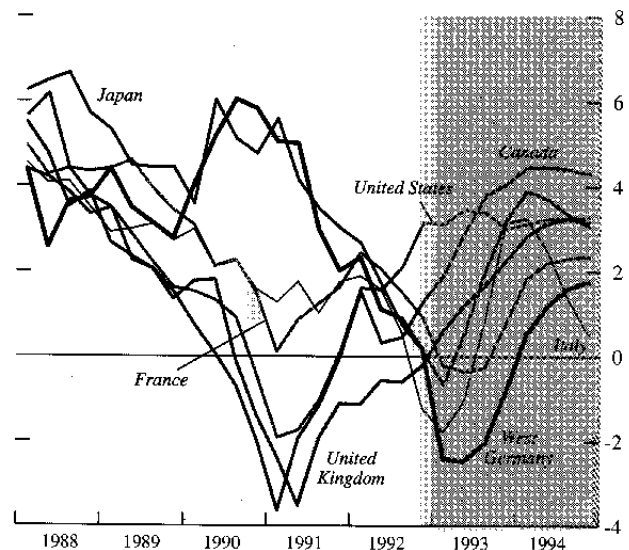
### Activity and Employment

In the *industrial countries*, economic growth increased modestly to an average of 1½ percent in 1992 following stagnation in 1991. Growth is expected to remain below potential in 1993 before strengthening to 3 percent in 1994 (see Table 1). Beneath the hesitant aggregate performance lie significant differences in cyclical positions among individual countries. The United States, the United Kingdom, and Canada were the first among the major industrial countries to move into recession in 1990 (Chart 3). Activity remained weak in the United Kingdom and Canada in 1992, but in the United States the recovery, which had begun early in 1991, strengthened markedly in the second half of the year.

The initial sluggishness of the recovery in the *United States* was largely due to restrained demand

<sup>1</sup>The revisions reported in Table 1 are relative to projections in the October 1992 *World Economic Outlook*, recalculated using PPP weights. Relative to projections in the January 1993 *Interim Assessment of the World Economic Outlook*, the largest downward revisions among the industrial countries have been for Germany, Japan, and France.

Chart 3. Major Industrial Countries: Real GDP<sup>1</sup>  
(Percent change from four quarters earlier)



<sup>1</sup>Blue shaded area indicates staff projections; data for Italy in the fourth quarter of 1992 are also projected.

**Table 1. Overview of the Baseline Projections<sup>1</sup>**  
(Annual percent change unless otherwise noted)

	1991	1992	Current Projections		Differences from October 1992 Projections	
			1993	1994	1992	1993
<b>World output</b>	<b>0.6</b>	<b>1.8</b>	<b>2.2</b>	<b>3.4</b>	<b>-0.2</b>	<b>-1.4</b>
Industrial countries	0.2	1.5	1.7	2.9	-0.2	-1.2
United States	-1.2	2.1	3.2	3.2	0.2	0.1
Japan	4.0	1.3	1.3	3.5	-0.7	-2.5
Germany	1.0	2.0	-1.3	1.7	0.2	-3.9
France	1.1	1.8	—	2.3	-0.4	-2.7
Italy	1.3	0.9	0.3	1.9	-0.4	-1.3
United Kingdom	-2.2	-0.6	1.4	3.1	0.2	-0.7
Canada	-1.7	0.9	3.2	4.4	-1.2	-1.2
Seven countries above	0.2	1.6	1.9	3.0	-0.1	-1.1
Other industrial countries	0.6	0.8	0.6	2.1	-0.9	-1.7
<i>Memorandum</i>						
European Community	0.7	1.1	0.1	2.2	-0.3	-2.1
West Germany	3.7	1.5	-2.0	1.2	-0.3	-3.9
Developing countries	4.2	6.1	5.1	5.1	—	-1.0
Africa	1.5	0.9	2.7	3.9	-1.1	-1.0
Asia	5.8	7.9	6.7	6.6	0.4	—
Middle East and Europe	2.1	9.9	5.0	3.5	0.1	-4.2
Western Hemisphere	3.1	2.3	2.3	2.6	-0.6	-1.6
<i>Memorandum: Developing countries excluding Middle East and Europe</i>	4.5	5.6	5.1	5.3	—	-0.5
Countries in transition	-10.1	-15.5	-8.8	-1.6	-1.0	-5.0
Central Europe <sup>2</sup>	-13.5	-7.5	-1.5	2.6	-2.8	-4.5
Former U.S.S.R.	-9.0	-18.5	-11.8	-3.5	-0.2	-5.3
<b>World trade volume</b>	<b>2.3</b>	<b>4.2</b>	<b>5.2</b>	<b>5.6</b>	<b>-0.3</b>	<b>-1.4</b>
Industrial country import volume	2.4	4.0	3.9	4.7	-0.1	-1.2
Developing country import volume	9.1	10.2	8.6	8.3	1.7	-1.0
<b>Commodity prices</b>						
Oil <sup>3</sup>	-17.0	-0.5	-3.0	2.6	-0.5	-2.5
In U.S. dollars a barrel	18.30	18.22	17.67	18.13	-0.10	-0.55
Nonfuel <sup>4</sup>	-4.5	-0.1	1.3	3.1	-1.6	-1.6
<b>Consumer prices</b>						
Industrial countries	4.5	3.2	3.0	3.0	-0.2	-0.3
Developing countries	35.7	38.7	33.6	20.0	3.5	10.8
Countries in transition	100.5	776.2	416.2	49.8	-56.8	318.0
Central Europe <sup>2</sup>	119.4	196.6	144.2	17.7	-15.9	113.3
Former U.S.S.R.	94.7	1,201.8	599.3	66.4	-94.4	464.8
<b>Six-month LIBOR (in percent)<sup>5</sup></b>						
On U.S. dollar deposits	6.1	3.9	3.8	5.3	—	-0.4
On Japanese yen deposits	7.2	4.3	3.1	3.9	-0.2	-1.8
On deutsche mark deposits	9.4	9.4	7.0	5.9	-0.3	-2.2

Note: Real effective exchange rates are assumed to remain constant at the levels prevailing during March 1993, except for the bilateral rates among ERM currencies, which are assumed to remain constant in nominal terms. These assumptions imply an effective appreciation of the U.S. dollar by about 10 percent relative to the assumption underlying the October 1992 *World Economic Outlook*.

<sup>1</sup>Country group composites for output and inflation are now based on individual country estimates weighted by purchasing power parity (PPP) values of their respective GDPs; the differences shown in the last two columns of the table are based on a comparison with the October 1992 *World Economic Outlook* projections, reaggregated using the new PPP weights.

<sup>2</sup>The countries in central Europe comprise Albania, Bulgaria, the Czech Republic, Hungary, Poland, Romania, the Slovak Republic, as well as Croatia, Slovenia, and the other republics of the former Socialist Federal Republic of Yugoslavia.

<sup>3</sup>Simple average of the U.S. dollar spot prices of U.K. Brent, Dubai, and Alaska North Slope crude oil; assumptions for 1993 and 1994.

<sup>4</sup>In U.S. dollars; based on world export weights.

<sup>5</sup>London interbank offered rate.

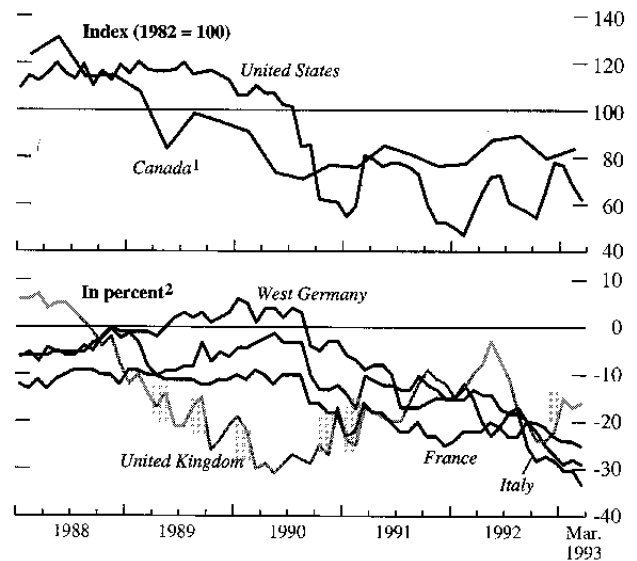
as households and businesses sought to lower debt burdens accumulated in the late 1980s. The associated weakness in housing and commercial property markets played an important role by depressing private sector net worth. Rising unemployment up to early 1992 has also contributed to significant caution on the part of consumers (Chart 4). By mid-1992 the lowering of interest rates had eased debt burdens significantly, supporting progressively stronger growth in the third and fourth quarters. Productivity gains were particularly significant in 1992, reflecting the benefits of considerable restructuring in many sectors. As the recovery gathers momentum, growth in 1993 and 1994 is projected to average 3¼ percent, in part on the basis of strength in residential construction and equipment investment.

The U.S. recovery will have positive effects on the Canadian economy, which registered only 1 percent growth in 1992. As in the United States, Canada's growth in 1992 was much weaker than in previous recoveries. In part this is attributable to the interdependence of the U.S. and Canadian economies, along with balance sheet adjustment problems, as experienced elsewhere, and ongoing restructuring and cost cutting by businesses. Employment in Canada declined in 1992, and the unemployment rate rose by 1 percentage point over the year to over 11 percent (Chart 5). Supported by lower interest rates and stronger growth in the United States, there are recent signs of recovery, and the Canadian economy is expected to expand by 3¼ percent in 1993 and by 4½ percent in 1994.

In contrast to recent developments in North America, recovery in the United Kingdom has remained elusive. Economic activity declined in 1992 by ½ of 1 percent, and unemployment rose to 10½ percent by the end of the year. In contrast to previous recessions, employment losses have been distributed more evenly across regions and across sectors of the economy. Balance sheet problems have been particularly severe and have only recently begun to ease in response to the reduction in interest rates since September. Recent indications of increased manufacturing output, stronger domestic demand, continued easing of debt burdens with lower interest rates, and the effects of the pound's depreciation on the export sector point to improved prospects for 1993. Output growth for the year is projected at 1½ percent, and the recovery is expected to be firmly established by 1994, with growth projected at 3 percent. There are considerable uncertainties in the outlook, however, both for growth and for inflation.

Economic conditions have weakened considerably in Japan since the October 1992 *World Economic Outlook*. The boom in Japan's equity and property markets during the expansion of the late

**Chart 4. Six Major Industrial Countries: Indicators of Consumer Confidence**

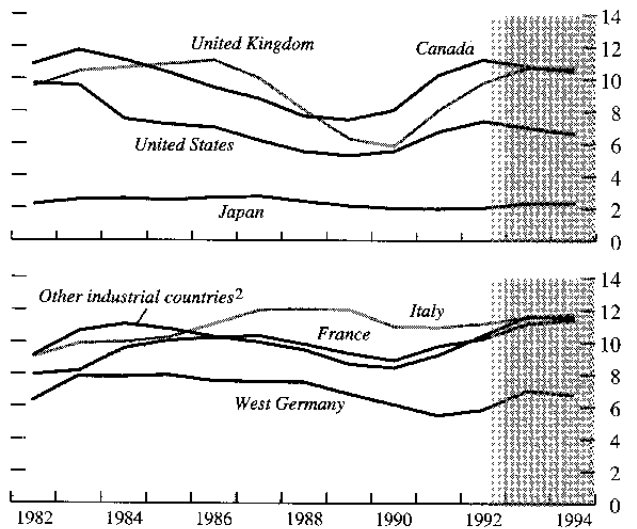


Sources: For the United States, the Conference Board; for Canada, the Conference Board of Canada; and for the lower panel, European Community.

<sup>1</sup>Quarterly observations.

<sup>2</sup>Percent of respondents expecting an improvement in their situation minus percent expecting a deterioration.

**Chart 5. Industrial Countries: Unemployment Rates<sup>1</sup>**  
(In percent of labor force)



<sup>1</sup>Blue shaded areas indicate staff projections.

<sup>2</sup>Aggregation based on labor force weights.

1980s supported high rates of investment and consumer spending on durable goods, but both of these components of demand have now retreated sharply following the decline in asset prices. Profits have fallen sharply, the previously tight labor market conditions have eased considerably, and consumer confidence is low. The banking sector has experienced a sharp rise in nonperforming loans, and strains in the financial system are likely to continue. The decline in interest rates and the two large fiscal stimulus packages should help to contain the recessionary forces, but substantial uncertainties remain. The 1992 stimulus package implies continued fiscal stimulus in early 1993, and the recently announced new fiscal package should result in an additional injection of stimulus in FY 1993. These measures are expected to sustain growth of 1 $\frac{1}{4}$  percent in 1993, despite the recent appreciation of the yen. Growth is expected to recover to 3 $\frac{1}{2}$  percent in 1994.

Developments in *Germany* in 1992 were dominated by increased strains from the expansionary fiscal policy following unification and the tight monetary policies required to contain inflation. Domestic demand has been restrained by high interest rates, which, along with cost pressures, also have weakened the export-oriented manufacturing sector and have contributed to a loss of competitiveness. Continuing strength in the construction and service sectors supported activity in eastern Germany, but the recovery of industrial output has been much weaker than expected, in part because of the pressures on costs resulting from rapid growth in wages relative to productivity. Activity in west Germany weakened sharply in the course of the year and in early 1993; as a result, real GDP in west Germany is projected to fall by 2 percent in 1993. Likely reductions in official interest rates during the period ahead are expected to ease the recession as the year proceeds, allowing the German economy to recover in 1994.

Other European countries have also been adversely affected by tight monetary conditions and by a general deterioration in the economic climate, although the downturn has not been as sharp as in Germany. Economic growth in *France* was 1 $\frac{3}{4}$  percent for 1992 as a whole, somewhat better than in 1991 but still weaker than expected.<sup>2</sup> High real interest rates have discouraged real fixed investment, which declined by 2 percent during the year. Echoes of the property market problems and associated

weaknesses in the financial sector experienced elsewhere have also contributed to domestic concerns. Although the export sector showed improvement early in the year, indicators of consumer confidence remained weak in 1992, and unemployment rose to historically high levels by the end of the year. Continued weakness is expected in 1993; unemployment is projected to exceed 11 percent, and output is expected to remain unchanged. The outlook for 1994 indicates a pickup in growth to 2 $\frac{1}{4}$  percent, as monetary conditions ease and activity strengthens in other industrial countries.

Increasing unemployment and declining consumer confidence have been features of recent developments in *Italy* as well. Uncertainty regarding the prospects for fiscal reform and the political situation has contributed to the decline in confidence. Domestic demand weakened in 1992, although this was offset somewhat by improved competitiveness of the export sector in the second part of the year as a result of an incomes policy eliminating wage indexation and following the lira's withdrawal from the ERM. Industrial production remained weak, however, and overall output growth for 1992 was only 1 percent. High interest rates and the need for fiscal retrenchment limit prospects for improvement in the near term, and growth for 1993 is projected at just  $\frac{1}{4}$  of 1 percent. Provided that recent gains in competitiveness are not eroded by inflation, a moderate recovery should be possible in 1994.

In the *smaller industrial countries*, average growth has been below 1 percent since 1990 and is unlikely to improve in 1993, although somewhat stronger prospects are emerging for 1994 (Table 2). Faltering demand in Germany and in most of Europe has weakened key export markets for a number of countries. Budgetary imbalances and other domestic difficulties have played an important role as well. Special problems related to financial sector developments and balance sheet difficulties contributed to output declines in 1992 in Sweden and Finland. The decisions to float their respective currencies have eased the financial tensions somewhat, although growth is expected to remain negative in both countries in 1993. Australia's recovery is projected to continue in 1993, but the recession in Japan poses a risk to Australia's exports and overall economic performance.

Growth in the *developing countries* strengthened in 1992 to 6 percent, led in part by strong recovery in the Middle East, and is expected to moderate to a still satisfactory rate of 5 percent in 1993-94. For 1993, the downward revision by 1 percentage point relative to the October 1992 *World Economic Outlook* is due primarily to a slower pace of reconstruction in the Middle East and the adverse effects of policy slippages in Brazil (see Tables 1 and 3). The strong growth performance in the *Middle East* in

<sup>2</sup>After the *World Economic Outlook* projections were completed, the French national statistics office revised down by about  $\frac{1}{2}$  of 1 percentage point GDP growth in both 1991 and 1992. Since growth in the fourth quarter of 1992 was only marginally revised, the revisions to the historical data would not necessarily have a major impact on the projection for 1993.

**Table 2. Industrial Countries: Real GDP and Consumer Prices***(Annual percent change)*

	Real GDP				Consumer Prices			
	1991	1992	1993	1994	1991	1992	1993	1994
<b>All industrial countries</b>	<b>0.2</b>	<b>1.5</b>	<b>1.7</b>	<b>2.9</b>	<b>4.5</b>	<b>3.2</b>	<b>3.0</b>	<b>3.0</b>
Major industrial countries	0.2	1.6	1.9	3.0	4.4	3.1	2.8	2.9
United States	-1.2	2.1	3.2	3.2	4.2	3.0	3.0	3.1
Japan	4.0	1.3	1.3	3.5	3.3	1.7	1.0	1.5
Germany	1.0	2.0	-1.3	1.7	4.8	4.5	4.4	2.5
France	1.1	1.8	—	2.3	3.1	2.8	2.0	2.5
Italy	1.3	0.9	0.3	1.9	6.3	5.5	5.7	5.2
United Kingdom <sup>1</sup>	-2.2	-0.6	1.4	3.1	6.8	4.7	3.9	4.0
Canada	-1.7	0.9	3.2	4.4	5.6	1.5	2.3	2.0
Other industrial countries	0.6	0.8	0.6	2.1	5.5	4.1	3.9	3.4
Spain	2.3	1.0	0.1	2.1	5.9	5.9	4.5	3.6
Netherlands	2.2	1.5	0.5	1.8	3.9	3.7	2.0	2.8
Belgium	1.4	0.8	—	1.9	3.2	2.4	2.6	2.7
Denmark	1.2	1.1	1.1	2.3	2.4	2.0	1.7	2.0
Greece	1.8	1.5	1.4	1.8	19.5	15.9	13.3	9.8
Portugal	2.2	1.4	1.1	2.0	11.4	8.9	6.9	6.2
Ireland	2.5	2.6	1.7	2.4	3.2	3.0	3.2	3.4
Sweden	-1.7	-1.7	-1.5	1.2	9.3	2.3	6.5	4.0
Switzerland	-0.4	-0.6	0.2	1.6	5.8	4.1	3.3	2.4
Austria	3.0	1.5	-0.7	1.8	3.3	4.1	3.6	2.3
Finland	-6.4	-3.5	-1.0	2.5	4.2	2.6	3.4	4.5
Norway	-2.5	3.0	1.0	2.6	3.4	2.3	2.7	2.5
Australia	-1.1	1.5	2.6	3.0	3.2	1.1	2.6	3.1
New Zealand	-1.3	2.6	3.0	2.9	1.7	1.3	1.3	1.3
<i>Memorandum</i>								
European Community	0.7	1.1	0.1	2.2	5.2	4.4	3.7	3.6
West Germany	3.7	1.5	-2.0	1.2	3.5	4.0	3.8	2.1

<sup>1</sup>Retail price index excluding mortgage interest.

1992 was primarily due to recoveries following the 1990-91 regional crisis. Growth in Saudi Arabia, which had been at very high levels during the crisis as oil production adjusted, slowed markedly in 1992. In the Islamic Republic of Iran, structural reforms and liberalization in trade and exchange systems resulted in continued strong growth in 1992. The rate of expansion in Turkey recovered from 1 percent in 1991 to a robust 5½ percent, in part because of reforms to increase investment. For the region as a whole, rates of expansion are expected to average 5 percent in 1993 but then to slow to 3½ percent in 1994 as growth approaches the long-run trend for the region.

In *Asia*, a dramatic rise in China's growth rate in 1992, owing to strong increases in fixed investment, contributed to a substantial increase in regional trade and growth. Sound financial policies and ongoing structural reforms in Bangladesh, India, and Pakistan also contributed to the robust performance of the region. Economic conditions remain buoyant in the fastest-growing economies, but concerns about capacity constraints and overheating may require policies of financial restraint in

several countries. Rates of expansion in 1993-94 are projected to average 6¾ percent.

In the developing countries of the *Western Hemisphere*, overall output growth slowed in 1992, mainly due to a significant and unexpected decline in output in Brazil associated with difficulties in defining an appropriate macroeconomic policy. Excluding Brazil, regional growth averaged 4 percent, with Argentina, Chile, Uruguay, Venezuela, and a number of smaller countries growing by 7 percent or more. In these countries, significant improvements in economic performance in recent years have reflected sound financial policies and sustained structural reform efforts. In view of the considerable uncertainty regarding the outlook for Brazil, growth in the region as a whole is expected to average only 2½ percent in 1993-94, roughly the same as in 1992.

In *Africa*, output growth slowed to just 1 percent in 1992. Adverse movements in terms of trade (particularly for exporters of minerals and tropical beverages), the ongoing effects of the drought in southern Africa, and disruptions from conflicts in a number of countries restrained economic activity.

**Table 3. Selected Developing Countries and Countries in Transition: Real GDP and Consumer Prices**  
(Annual percent change)

	Real GDP			Consumer Prices		
	1991	1992	1993	1991	1992	1993
<b>All developing countries</b>	<b>4.2</b>	<b>6.1</b>	<b>5.1</b>	<b>35.7</b>	<b>38.7</b>	<b>33.6</b>
<b>Africa</b>	1.5	0.9	2.7	32.2	40.2	16.8
Algeria	0.2	3.0	-2.5	22.8	32.0	15.2
Cameroon	-6.0	-5.6	-3.5	-0.6	2.0	-4.5
Côte d'Ivoire	-0.8	-1.8	-0.4	1.6	1.9	0.8
Kenya	2.4	2.0	4.5	14.8	7.0	5.0
Morocco	5.1	-3.0	6.4	8.2	4.9	5.0
Nigeria	4.5	4.6	4.5	13.0	45.2	23.0
South Africa	-0.4	-2.0	0.5	15.3	14.5	9.5
Sudan	6.0	10.6	4.8	123.6	114.5	50.0
Tunisia	4.0	8.6	3.8	7.8	5.5	4.3
<b>Asia</b>	5.8	7.9	6.7	8.5	7.4	7.4
China	7.8	12.8	8.5	2.7	5.3	7.0
India	0.9	4.0	4.6	13.4	10.0	7.1
Indonesia	6.6	6.0	6.0	9.3	7.5	6.4
Korea, Republic of	8.4	4.7	6.0	9.5	6.0	4.5
Pakistan	6.7	5.8	4.9	12.3	10.1	9.3
Philippines	-1.0	-0.3	3.1	13.1	8.1	6.0
Taiwan Province of China	7.3	6.4	6.9	3.6	5.1	4.6
Thailand	8.2	7.5	7.8	5.7	4.1	4.3
<b>Middle East and Europe</b>	2.1	9.9	5.0	23.8	20.6	25.0
Egypt	1.2	0.7	1.3	18.1	15.0	9.5
Iran, Islamic Republic of	8.1	6.5	4.0	19.6	9.0	30.0
Israel	5.9	6.4	4.3	19.0	12.0	10.0
Saudi Arabia	9.7	3.0	1.1	4.5	-0.4	3.0
Turkey	1.0	5.4	4.7	66.0	70.1	65.0
<b>Western Hemisphere</b>	3.1	2.3	2.3	135.8	169.9	150.9
Argentina	5.0	7.0	3.5	171.7	25.0	9.3
Brazil	1.0	-0.9	—	413.3	1,037.5	1,004.3
Chile	6.0	10.4	6.0	21.8	15.4	11.9
Mexico	3.6	2.7	3.0	22.7	15.3	8.0
Venezuela	10.4	7.3	4.0	34.2	31.9	32.9
<b>Countries in transition</b>	<b>-10.1</b>	<b>-15.5</b>	<b>-8.8</b>	<b>100.5</b>	<b>776.2</b>	<b>416.2</b>
Former Czech and Slovak Federal Republic	-15.9	-8.5	—	57.7	10.8	—
Poland	-7.2	1.0	2.0	70.3	43.0	40.0
Former U.S.S.R.	-9.0	-18.5	-11.8	94.7	1,201.8	599.3

Growth in countries that had arrangements in 1992 under the IMF's structural adjustment facility (SAF) or enhanced structural adjustment facility (ESAF) was somewhat above the average growth rate for the region. Continued reforms and cautious financial policies in countries with these arrangements during 1993-94 are expected to support average growth of 4<sup>3</sup>/<sub>4</sub> percent. For the region as a whole, growth is expected to strengthen somewhat in 1993-94, on the assumptions of some improvements in the terms of trade and a return to normal rainfall in southern Africa. Continuation of conflicts in countries currently suffering severe disruptions is a major risk in the outlook.

Economic conditions appear to have improved for some of the *transition economies of central Europe* during the past year. Following three successive years of output declines, there are preliminary indications of a turnaround in the former Czech and

Slovak Federal Republic, Hungary, and Poland; growth in private sector activity and strong exports, especially to western Europe, now appear to have contained the fall in output. Economic activity continued to decline in Bulgaria and Romania in 1992, but the rate of decline slowed toward the end of the year. Economic performance in both countries has been adversely affected by disruptions caused by the civil war in the former Yugoslavia. Most central European countries in transition, however, are expected to achieve positive real growth in 1993-94 as market reforms deepen. The strength of the projected output gains will depend crucially on the ability of the reforming countries to contain fiscal deficits and inflation and on their continued access to, and success in, export markets.

Economic conditions in the *former Soviet Union* have continued to deteriorate. Real GDP in Russia is estimated to have fallen 19 percent in 1992, after



a 9 percent decline in 1991. In many other countries of the region, output losses have been even larger. These declines reflect the adjustment difficulties during the early stages of the transition, high rates of inflation, the compression of imports, disruption in trade among the countries of the former Soviet Union, and uncertainties about the reform process itself. Large-scale subsidies are delaying industrial restructuring and are exacerbating the fiscal situation. A reversal of these adverse factors is not anticipated in the near term, and output is expected to decline further in 1993 in most of these countries.

## Inflation and Commodity Prices

Improved inflation performance in a number of countries is a bright spot in the short-term outlook. The inflation projections for a number of the *industrial countries* have been revised downward since the October 1992 projections, with several countries now experiencing the lowest inflation rates in thirty years. Among the major countries, Italy had the highest inflation in 1992. Although inflation in Germany (including the eastern Länder) declined only slightly from 1991, to 4½ percent, price pressures are likely to abate significantly during 1993. In the United States, despite some improvement, inflation remains at 3 percent. Canada and Japan were close to price stability for 1992 as a whole, with measured inflation below 2 percent. In France and the United Kingdom respectively, late 1992 and early 1993 figures on inflation represented the lowest rates of price increase observed in decades. A number of the smaller industrial countries also attained significant reductions in inflation in 1992 (see Table 2). Although cyclical weakness has contributed to these gains, structural reforms facilitating price flexibility and the credibility of countries' commitment to inflation reduction have played an important part. For most countries, progress in reducing inflation is expected to continue in 1993.

Average inflation in the *developing countries* in 1992 rose slightly above its 1991 level but is expected to decline again in 1993 (see Table 3). The median inflation rate, which is not distorted by the very high inflation rates prevailing in a few countries, presents a more favorable picture, showing a decline from 10 percent in 1991 to 9 percent in 1992, with a projected further decline to 6 percent in 1993. Inflation rates in most Asian countries declined in 1992 relative to the previous year, in part because of cautious financial policies. In China, however, signs of overheating point to the risk of higher inflation during the period ahead. In the Western Hemisphere, inflation fell in 1992 in many countries; the notable exception was Brazil, where a widening fiscal imbalance led to a tenfold rise in the price level. In Africa, the average inflation rate

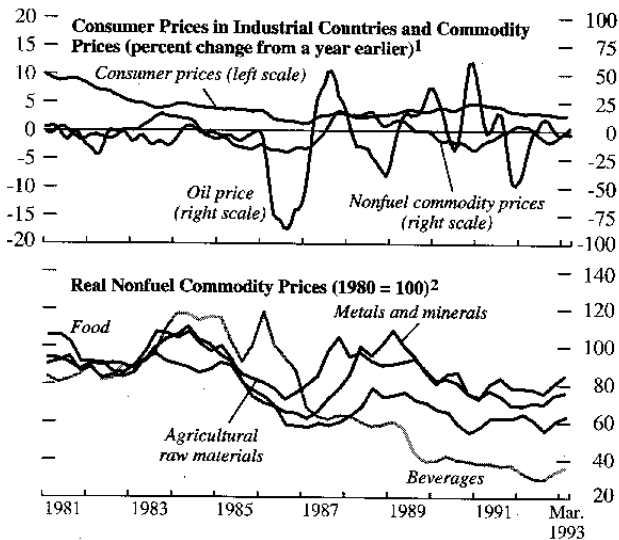
increased in 1992, in part because of the drought in southern Africa, although price performance improved in a number of individual countries. The countries of the Communauté Financière Africaine (CFA) are expected to register an average inflation rate of 1 percent in 1993-94, the lowest in the region.

In *central European economies in transition*, there were marked divergences in countries' inflation performance in 1992. Following successive rounds of price liberalizations during 1991 and 1992, inflation has been brought under control in the former Czechoslovakia and has fallen substantially in Hungary and Poland. Inflation remained high in Romania and in Bulgaria, despite significant improvement in the latter, and hyperinflationary conditions prevail in much of the former Yugoslavia. The threat of hyperinflation also looms large in the *former Soviet Union*, which registered a twelvefold rise in prices in 1992. In Russia, price liberalization led to a jump in the price level in early 1992, after which inflation moderated until August. Lax fiscal and monetary policies, however, led to a sharp acceleration of inflation in the last quarter of 1992 and in early 1993. Inflation has surged in other countries of the region as well, with the exception of a marked deceleration of inflation in Latvia and in Estonia, following the introduction of the Estonian kroon, which is pegged to the deutsche mark.

As regards *commodity prices*, prices of crude petroleum fell from \$18.94 a barrel in the fourth quarter of 1991 to \$18.27 a barrel in the fourth quarter of 1992 (Chart 6). The decline was due to a combination of high levels of production, weak economic conditions, and unseasonably warm weather in Europe and North America. The decision by OPEC in February to restrain oil output in the second quarter of 1993 raised price expectations and market prices and may help to stabilize real prices during the period ahead, although dollar prices are likely to reflect the recent effective appreciation of the dollar. Increased future allocations for Kuwait may put further downward pressure on oil prices during the period ahead.

Average nonfuel commodity prices remained at relatively low levels in 1992 because higher prices in dollar terms for agricultural raw materials were offset by significant price declines for beverages, metals, and minerals (see the Statistical Appendix, Table A25). Weak demand, high rates of production, and, in the case of metals, large exports by the former Soviet Union were the central factors. In the first quarter of 1993, prices of beverages and of metals fell further in dollar terms. Over the year as a whole, nonfuel primary commodity prices are expected to increase slightly in dollar terms, permitting a terms of trade gain for many commodity

Chart 6. Consumer Prices and Commodity Prices



<sup>1</sup>Three-month centered moving average of twelve-month inflation rates. Consumer prices are measured in local currencies and are averaged using GDP weights. The nonfuel commodity price index is an export-weighted average of 36 prices denominated in SDRs, including gold. The oil price is a simple average of the U.S. dollar spot prices of U.K. Brent, Dubai, and Alaska North Slope crude oil, equally weighted.

<sup>2</sup>Nonfuel commodity prices deflated by the export price of manufactures of industrial countries.

exporters. However, metals prices are expected to remain quite weak because of sluggish growth in industrial country demand, high inventories, and continued exports from the former Soviet Union.

### Foreign Exchange and Financial Markets

Since conclusion of the last regular *World Economic Outlook* exercise, the ERM has experienced considerable turmoil, leading to a series of realignments and to the suspension of the lira and the pound sterling from the mechanism. Linked to these developments, three Nordic countries opted to float their currencies, which had been pegged to the ECU. These events were discussed in detail in the January 1993 *Interim Assessment of the World Economic Outlook* and are reviewed only briefly below. So far in 1993, foreign exchange markets have been characterized by several broad developments. Ongoing strains within the ERM were significant for part of the period, followed after early February by a marked reduction in visible tensions. The yen continued to appreciate against the European currencies and rose sharply in value against the dollar, reaching a record high in mid-April. The dollar continued to appreciate against the European currencies into March and remained well above the level reached at end-August 1992, despite some downward movement toward the end of the period.

The period of intense pressures within the ERM followed a buildup of strains in the weeks leading up to the referendum in France on the Maastricht Treaty. Since the withdrawal of the pound sterling and Italian lira from the ERM in September, the two currencies have depreciated in nominal effective terms by 14 percent and 23 percent, respectively (end-August 1992 through mid-April). Realignments involved depreciations of the Spanish peseta, the Portuguese escudo, and the Irish pound. Outside the ERM, significant depreciations followed the decisions to float the Finnish markka (on September 8) and the Swedish krona (on November 19); the Norwegian krone depreciated to a lesser extent following its floating on December 10.<sup>3</sup> Financial markets in Canada experienced their own episode of turbulence, owing in part to the uncertainties in the run-up to the constitutional referendum in October.

Accompanying these developments, both the dollar and the yen appreciated markedly—by 10 percent and 17 percent, respectively—from end-August 1992 through mid-April (Chart 7). During

<sup>3</sup>As of the end of 1992, these currencies had depreciated against the U.S. dollar by 26 percent, 15 percent, and 7 percent, respectively.

this period, projections for economic growth (by both official and private forecasters) were being scaled back for many European countries, while the economic recovery was looking increasingly robust in the United States. These developments justified expectations that interest differentials would narrow in favor of dollar-denominated assets. More recently, these expectations were reinforced by small reductions in official German interest rates in early January, early February, and again in March and early April; base rates were reduced in the United Kingdom in late January. The strength of the yen can be attributed in part to implications of the growing Japanese external current account surplus. In addition, expectations of reduced interest rate differentials in favor of assets denominated in European currencies, reinforced by the anticipation and eventual announcement of an additional fiscal stimulus package in Japan as mid-April approached, also played a role.

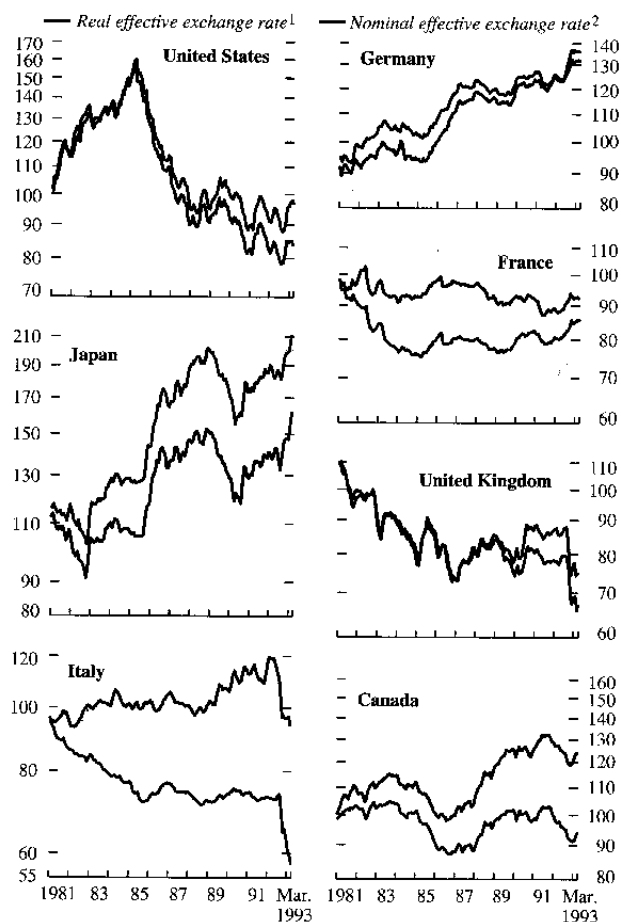
Within the ERM, the Irish pound, the Danish krone, and the French franc continued to experience bouts of intense selling pressure early in 1993, with market participants seemingly focusing on the difficulties of sustaining high interest rates in the face of deteriorating domestic economic conditions and high unemployment. The Irish pound was seen by the markets to be vulnerable in the wake of the significant depreciation of the pound sterling after the September crisis, while the Danish krone was vulnerable as a result of the depreciation of other Scandinavian currencies.

In early January, the Irish authorities raised official interest rates as high as 100 percent to support the Irish pound; further support came from intervention by other central banks. The Banque de France intervened to support its currency and raised official interest rates, notably by introducing on January 5 a new facility for banks to borrow overnight at 12 percent; the Bundesbank reportedly also intervened in support of the French franc. Pressures in the ERM receded temporarily when the Bundesbank announced on January 7 that it would reduce its securities repurchase rate by about 15 basis points.

The period of relative calm was short-lived. Renewed pressures emerged near the end of January, starting with heavy selling pressure on the Irish pound after base rates in the United Kingdom were reduced by 1 percentage point on January 26 and the pound sterling fell to record lows against the deutsche mark. This selling pressure overwhelmed increased official and market interest rates in Ireland, as well as intervention by other central banks in support of the Irish currency. After a devaluation of the Irish pound within the ERM by 10 percent on January 30, the pressure again shifted to the Danish krone, pushing it to its ERM floor notwithstanding

**Chart 7. Major Industrial Countries:  
Nominal and Real Effective Exchange Rates<sup>1</sup>**

(Indices, 1980 = 100; logarithmic scale)



<sup>1</sup>Defined in terms of relative normalized unit labor costs in manufacturing and constructed using trade weights based on 1980 trade data; monthly averages of daily data. Data for October 1991 through March 1993 are estimated on the basis of preliminary information on normalized unit labor costs.

<sup>2</sup>Constructed using same weights as real effective exchange rate indices.

**Box 1. Equity Markets in Southeast Asia**

Equity markets in many Southeast Asian economies have developed rapidly over the past decade and are among the most mature in the developing countries, although they are still quite regulated by comparison with those in industrial countries. Foreign ownership is restricted in many cases; in Korea and Taiwan Province of China, for example, even limited direct foreign investment was allowed only in 1990. The remarkable increase in turnover in these markets has reflected the increased importance of equities in raising capital, and the privatization of public enterprises during the process of financial liberalization (see table). The largest and most volatile stock market in the region is in Taiwan Province of China. The stock markets in Hong Kong and Singapore are the most integrated into international capital markets, in part because both economies are important regional financial centers, with Hong Kong serving as an important link to China. Equity markets in Indonesia, Malaysia, Thailand, and elsewhere in Southeast Asia are becoming more open, and international investment is growing rapidly.<sup>1</sup>

The intensity of activity, as measured by the ratio of turnover to total capitalization, has risen during 1986-91 in all of these markets except for the Philippines. This contrasts with both the U.S. and Japanese

stock markets, where intensity of activity fell during this period. Because the Asian markets are still relatively small, they are vulnerable to external events, scandals, and individual trades, which have contributed to high price volatility compared with stock markets in industrial countries. Further expansion and internationalization of these markets may reduce volatility.

Although many Southeast Asian stock markets are only gradually becoming integrated into the world capital market, their equity prices have been strongly influenced by developments in the world's major stock markets and by the economic prospects of industrial country trading partners. For example, the sharp decline in equity prices in October 1987, the previous rise in stock prices in the United States and elsewhere, and the steep fall in equity prices in the United States during the second half of 1990 were all reflected in similar movements in Asian stock markets (see chart).

Developments in China have had an important influence on equity markets in Southeast Asia, particularly those in Hong Kong and Taiwan Province of China. The steep rise in Hong Kong stock prices between mid-1989 and late 1992 was related in part to market-oriented reform and robust economic growth in China. The increasing integration between Hong Kong and southern China has also removed some of the uncertainty surrounding the state of Sino-British relations and the transfer of sovereignty in 1997, contributing to the robust stock market performance. Stock market developments in Taiwan Province of China also increasingly reflect Chinese economic prospects, as ties between the two economies have strengthened.

<sup>1</sup>See *Pacific Basin Capital Markets Research*, Vols. 1, 2, and 3, edited by S. Ghon Ree and Rosita P. Chang (Amsterdam and New York: North-Holland, 1990, 1991, 1992); and David Lynch and Bill Norton, "Asian Financial Markets" (North Ryde, N.S.W., Australia: Centre for Studies in Money, Banking, and Finance, Macquarie University, 1992).

**Selected Economies: Stock Market Activity**

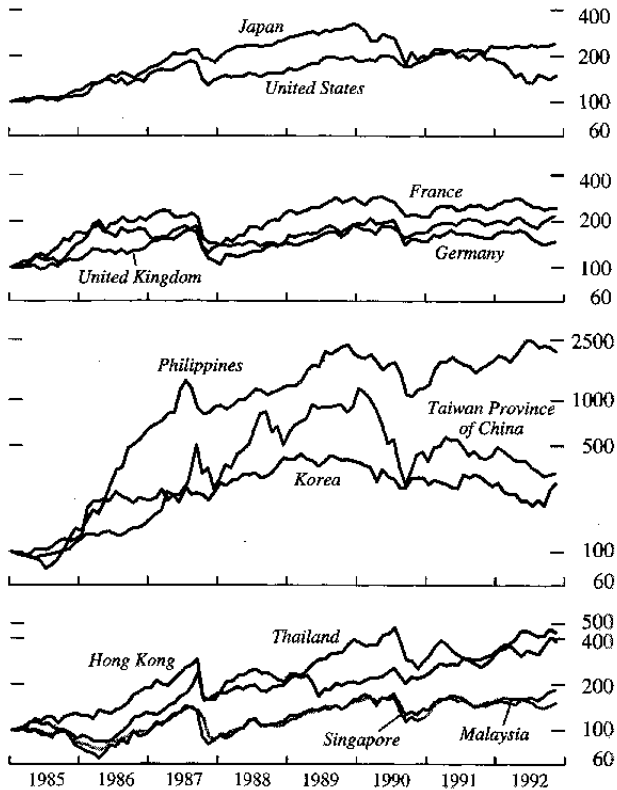
	Turnover						Volatility <sup>1</sup>
	In billions of U.S. dollars		As percent of GDP		As percent of total capitalization		
	1986	1991	1986	1991	1986	1991	
Hong Kong	15.3	43.0	40	53	28	35	0.086
Korea	10.9	85.5	10	30	78	88	0.086
Malaysia	1.3	10.6	5	22	9	18	0.079
Philippines	0.4	1.5	1	03	20	15	0.109
Singapore	2.7	18.1	15	47	16	38	0.063
Taiwan Province of China	18.1	365.2	24	201	117	290	0.151
Thailand	1.1	30.1	3	32	40	84	0.089
France	51.5	118.2	7	10	34	32	0.068
Germany	135.7	818.6	15	49	53	208	0.067
Japan	1,145.6	995.9	58	30	62	32	0.066
United Kingdom	132.9	317.9	24	31	30	32	0.058
United States	1,795.9	2,254.9	40	42	68	54	0.049

Sources: International Finance Corporation, *Emerging Stock Markets: Factbook* (Washington, 1992) and Emerging Stock Markets data base; World Economic Outlook data base.

<sup>1</sup>Standard deviation of monthly rate of change in stock prices from January 1985 to November 1992.

### Selected Economies: Stock Market Indices

(In local currencies; logarithmic scale, January 1985 = 100)



sharp increases in domestic interest rates and sizable foreign exchange market intervention. The pressure against the Danish currency eventually subsided after the February 4 reduction in official German interest rates—the Lombard rate by 50 basis points and the discount rate by 25 basis points.<sup>4</sup> This action also relieved some of the pressure on the French franc, whose parity with the deutsche mark might well have been tested if the Danish krone had been devalued.

Visible tensions have since subsided markedly, despite several factors that might have been expected to exert significant pressure on the ERM. These included parliamentary elections in France, a strengthening of the deutsche mark against the dollar since early February, reports of unfulfilled market expectations of further official interest rate cuts in Germany, budget difficulties in Belgium, and growing signs of recession and rising unemployment in many countries. Market uncertainty nevertheless remained evident in the persistence for some time of large interest rate differentials in a number of countries vis-à-vis interest rates in Germany. These premiums have recently narrowed significantly in many cases.

More generally, changes in short-term market interest rates in many European countries since August 1992 largely reflected exchange market developments as a number of authorities raised official interest rates in support of their currencies, but then allowed them to decline as exchange rate pressure eased. In countries that devalued within the ERM (Spain, Portugal, and Ireland) or floated their currencies (Italy, the United Kingdom, and the Nordic countries), short-term interest rates subsequently moved lower, led by reductions in official rates.<sup>5</sup> Abstracting from the effects of the EMS crisis, it is clear that both short- and long-term interest rates have tended to decline in most of the industrial countries (Charts 8 and 9). Weak growth, declining inflation, and growing expectations of fiscal deficit reduction in several countries have been the principal factors supporting this trend. Short-term interest rates are expected to decline significantly during 1993 in Europe and Canada, to remain close to current rates in Japan, and to begin to firm in the United States as the recovery continues.

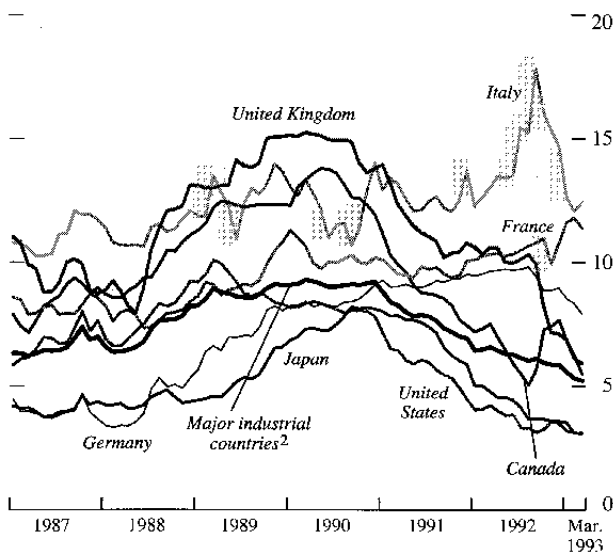
In equity markets, the largest price increases were recorded in Italy and the United Kingdom,

<sup>4</sup>In addition to lowering official interest rates, the Bundesbank announced it would reduce reserve requirements on time liabilities and savings deposits from an average of 4.5 percent to 2 percent. Other types of deposits were not affected. It was indicated that the liquidity effect of this action would be neutralized by the introduction of new short-term investment instruments.

<sup>5</sup>Recently, pressures on the Spanish peseta and Portuguese escudo have been countered with higher interest rates.

**Chart 8. Major Industrial Countries:  
Short-Term Interest Rates<sup>1</sup>**

(In percent a year)

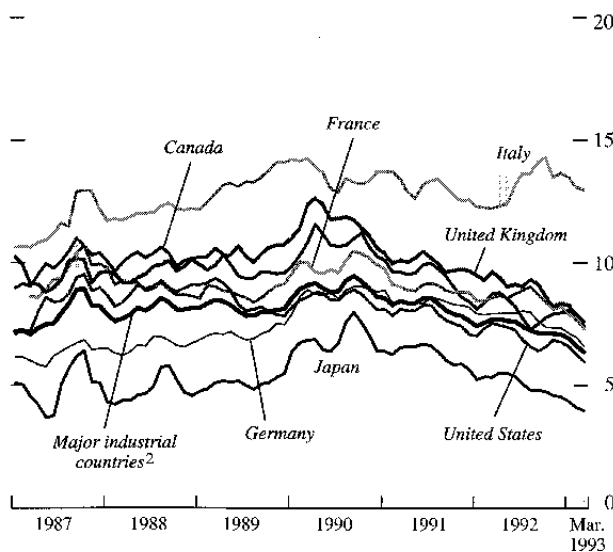


<sup>1</sup>For the United States and Japan, three-month certificate of deposit rates; for Italy, three-month treasury bill rate; for Canada, rate on three-month prime corporate paper; and for other countries, three-month interbank deposit rates. Monthly averages of daily observations are plotted for all countries other than Italy and Canada. For Italy, monthly averages of results of fortnightly treasury bill auctions are shown. For Canada, monthly averages of weekly observations are plotted.

<sup>2</sup>1987 GDP weights.

**Chart 9. Major Industrial Countries:  
Long-Term Interest Rates<sup>1</sup>**

(In percent a year)



<sup>1</sup>Yields on government bonds with residual maturities of ten years or nearest. Monthly averages of daily data.

<sup>2</sup>1987 GDP weights.

where prices in local currency have risen by 31 and 23 percent, respectively, since end-August 1992. Elsewhere, equity prices have risen 16 percent in France, 10 percent in Germany, and 6 percent in the United States. Over the period as a whole, equity prices in Japan have risen by 14 percent. The recent sharp increase of 20 percent since early March reflects both the anticipation and eventual announcement of additional fiscal stimulus measures. Expanding equity markets in Southeast Asian economies have mirrored some of the movements in stock prices in the major industrial countries, although other factors account for the greater volatility in these markets (Box 1).

### External Payments, Financing, and Debt

The growth of world trade recovered in 1992 to 4¼ percent from 2¼ percent in 1991, spurred by the continued expansion of intraregional trade, particularly in Asia, and by somewhat higher import growth in the industrial countries. A further pickup in the growth of trade is expected for 1993–94 as industrial country activity continues to strengthen and as developing country output and trade links expand.

The current account balance of the United States again moved into a large deficit during 1992 as cyclical factors and war-related transfers that had contributed to the decline in the deficit in 1991 were being reversed or were no longer at work. Japan's current account surplus increased steadily in 1992, reaching a record level in absolute terms (although not relative to GNP). Factors underlying this rise included sharp reductions in domestic demand during 1992; lower world commodity prices; and the appreciation of the yen in 1991–92, which raised the dollar value of exports. France also recorded a current account surplus for 1992 because of strong exports early in the year and slow domestic demand. Improved competitiveness in the United Kingdom associated with the depreciation of sterling should help to contain the large external deficit as recovery gets under way. The U.S. current account deficit is projected to widen further in 1993 and 1994; Japan's surplus is expected to increase in 1993 and then decline somewhat in 1994 (Chart 10). A slight deterioration is expected for 1993 in Germany's current account position, which moved into deficit in 1991. Some reduction in deficits is anticipated for Canada and Italy and for other industrial countries.

The aggregate current account deficit of the developing countries narrowed slightly, to \$78 billion in 1992, primarily because of the substantial reduction of the current account deficit in the Middle East as the impact of the 1990–91 regional conflict subsided. In the same period there was a sharp increase

in net financing flows to the Middle East region, which moved from a net outflow position in 1991 to an inflow of \$22 billion in 1992 (Chart 11). Asset flows in 1992 returned to a more normal level, relative to the unusually large drawdown of foreign assets used to finance the 1990-91 conflict.

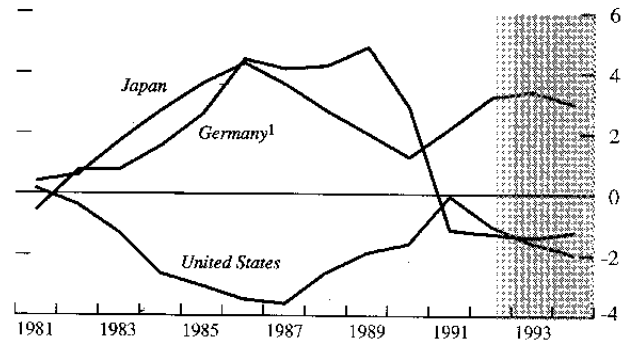
Other developing country regions saw their current account deficits widen as a result of relatively strong growth. In the Western Hemisphere region, reserve holdings grew despite the increase in the current account deficit, reflecting a sharp rise in portfolio investment inflows. Developing countries in Africa faced adverse terms of trade movements and the ongoing consequences of the drought, which expanded the regional current account deficit to almost \$8 billion. Reserve accumulation slowed considerably during the year, and net external financing to the region remained essentially unchanged. Strong import demand led to an increase in the aggregate current account deficit of Asian developing countries in 1992, primarily owing to a reduced current account surplus in China and to a shift into external deficit in Taiwan Province of China. External financing flows declined from their high in 1991, and the average rate of reserve accumulation slowed as continued rapid increases in some countries were more than offset by much slower rates of increase in China and Taiwan Province of China. Net external financing to the developing countries overall is expected to decline to \$106 billion in 1993 and then rise to \$119 billion in 1994.

For countries in transition, the aggregate current account balance moved further into deficit, although experiences within the region differed considerably. The aggregate current account deficit in the countries of central Europe declined significantly during 1992 to only \$0.5 billion, primarily because of increased exports to western Europe. A decline in exports by the countries of the former Soviet Union, particularly of oil, led to a widening of the aggregate current account deficit in 1992. Net external financing flows to central European countries in transition rose to \$3½ billion in 1992 and are expected to reach \$7½ billion this year, mainly because of continued long-term borrowing from official creditors; for most countries, direct investment flows and commercial bank lending are expected to remain subdued. For 1993, the aggregate current account deficit in central Europe is projected to widen because improving domestic conditions and continued capital inflows should generate higher import growth.<sup>6</sup>

<sup>6</sup>Owing to uncertainties about the underlying numbers, current account estimates for the former Soviet Union for 1992 and beyond are not reported.

**Chart 10. Three Major Industrial Countries: Current Account Imbalances**

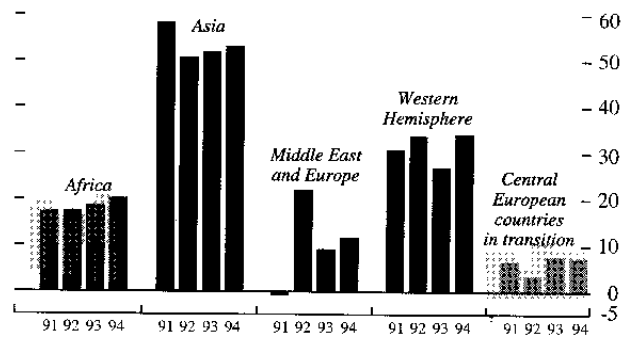
(In percent of GDP)



<sup>1</sup>Before July 1990, the current account balance of west Germany excluding the bilateral balance with east Germany; from July 1990, the current account balance of unified Germany. Blue shaded area indicates staff projections.

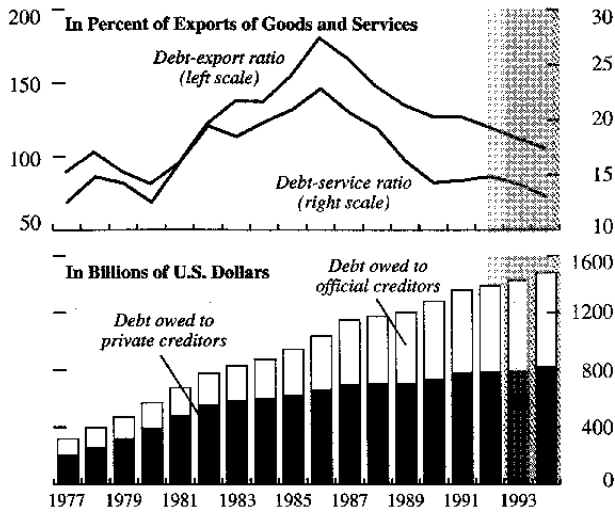
**Chart 11. Developing Countries and Countries in Transition: Net External Financing Flows<sup>1</sup>**

(In billions of U.S. dollars)



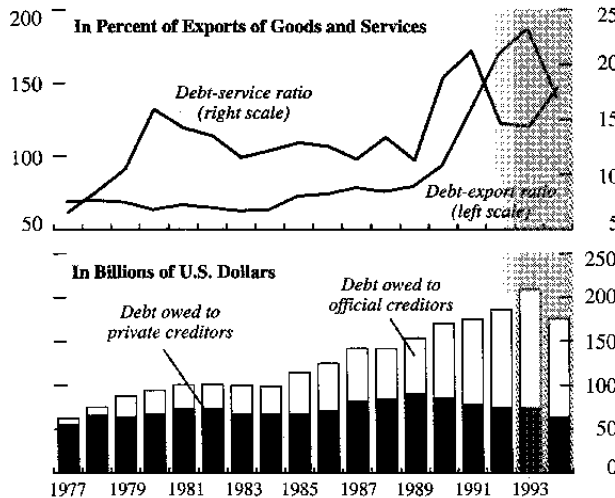
<sup>1</sup>The sum (with opposite sign) of balance on current account, excluding official transfers, change in reserves, asset transactions, and errors and omissions, net. See the Statistical Appendix, Table A32.

**Chart 12. Developing Countries:  
External Debt and Debt Service<sup>1</sup>**



<sup>1</sup>Debt service refers to actual payments of interest on total debt plus actual amortization payments on long-term debt. The projections (blue shaded areas) incorporate the impact of exceptional financing items.

**Chart 13. Countries in Transition:  
External Debt and Debt Service<sup>1</sup>**



<sup>1</sup>Debt service refers to actual payments of interest on total debt plus actual amortization payments on long-term debt. The projections (blue shaded areas) incorporate the impact of exceptional financing items.

Total debt in dollar terms (excluding IMF credit) of the developing countries as a percent of export earnings fell some 7 percentage points, to 120 percent, in 1992 (Chart 12). A further drop of 15 percentage points is expected by 1994, when the aggregate debt-export ratio is projected to have fallen to the level prevailing in 1982. The recent progress is encouraging, although many individual countries continue to face difficult debt problems. Aggregate debt of the countries in the Western Hemisphere rose only slightly in 1992, owing mainly to the impact of a number of debt-reduction operations. The debt-export ratio in the region fell 8 percentage points, to 250 percent. The improvement in debt-export ratios was also significant in Asian developing countries, where continued strong economic performance was combined with modest borrowing. Africa's debt-export ratio fell only slightly, to 229 percent, mainly because of continued official lending to sub-Saharan countries. Total debt of the countries in transition increased to \$186 billion and is expected to increase further in 1993, to some \$209 billion (Chart 13).

Significant debt-restructuring agreements were completed in 1992. They involved restructuring of commercial bank debt totaling \$35 billion and a net reduction of arrears of \$15 billion, a substantial amount of which was concentrated in the Western Hemisphere. Major agreements included a debt-restructuring package with the Philippines and an agreement to restructure Argentina's foreign debt. These agreements are financed in part by the allocation of about \$1 billion from the IMF in support of debt-reduction packages. Brazil reached an agreement on a term sheet for a comprehensive bank debt package, which was recently presented to creditors. Among low-income countries, Bolivia, Guyana, and Uganda have progressed significantly toward debt workouts.

In addition, progress has been made with official creditors offering debt relief under enhanced Toronto terms for several low-income developing countries, and several agreements have been concluded in the context of the Paris Club. Agreement has also been reached between Bulgaria and its official creditors to provide cash relief on debt-service obligations. Negotiations are under way between Paris Club creditors and the Russian Federation on the rescheduling of part of the debt of the former Soviet Union.