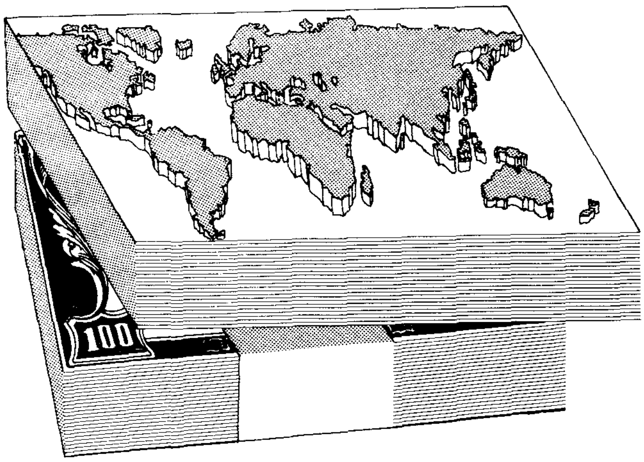
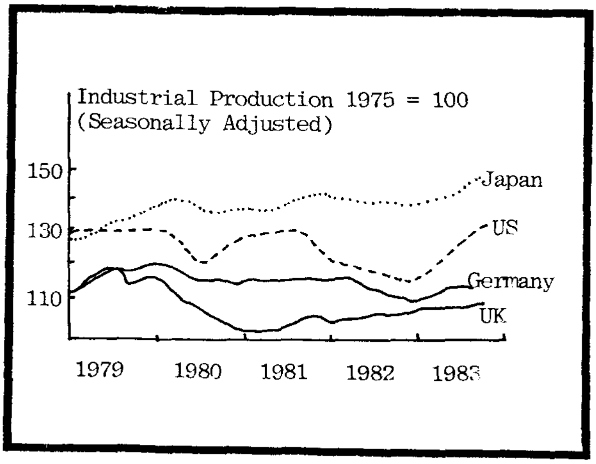
The World Economy



The world economy is now dominated by three different events: the massive budget deficit in the USA, the agricultural crisis in the African continent, and the debt problems of some of the developing countries. The US administration's budget for the coming fiscal year contains only token measures to reduce spending in spite of increasing reservations by the Federal Reserve and the Council of Economic Advisers about the medium term implications of structural deficits. Failure to tackle the problem has ensured that real interest rates remain high, with no downward trend apparent as 1983 drew to its close. The dollar remains strong, underpinned by the surplus on the capital account of the US balance of payments.

OUTPUT



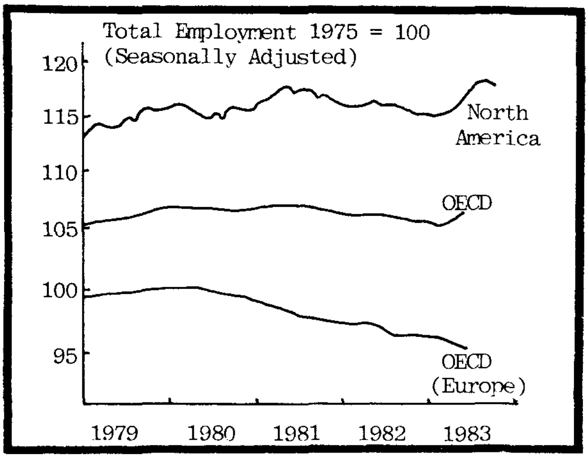
Industrial production increased sharply in the US, Canada and Japan during 1983, but remained broadly flat in Europe where the strongest performance was recorded by the UK. Not all European countries have yet emerged from recession. Industrial production in France in the final quarter of 1983 was below the level of a year previously, while French GDP ended the year lower than in the final quarter of 1982. In France, West Germany and Canada, retail sales turned down at the close of 1983, marking a possible break in the consumer spending spiral in industrialised countries. While Germany's growth was retarded by a slow rate of growth of exports during the first half of 1983, France's recovery depends on continuing to curb both its current account deficit and comparatively high rate of inflation.

Economic growth in the OECD area is expected to be of the order of 3% during the current year, compared to 1.7% in the first half of 1983 and about 0.5%

in the second half of 1982. Within the OECD, considerable variation in 1984 growth rates is expected, ranging from 4.5% in the US, through 2.5% (on the output measure) in the UK, down to 1-2% for most of the other European economies. World trade, which grew by less than 1% during 1983, is forecast to grow by more than 4% annually over the coming two years. UK export markets, which contracted by 1.5% in 1982-3, are set to grow at 4% per annum. Markets for UK manufactures, which fell by almost 2% in 1982, with a further marginal fall last year, are forecast to expand at an annual rate of 3%.

Growth at forecast rates in the rich countries will not be sufficient by itself to generate adequate living standards in many developing countries. According to the **World Bank's Annual Report**, if the rich countries do not solve their structural problems of high unemployment and inflation and the developing countries achieve only low growth, Hit is easy to envisage a downward global economic spiral emerging with catastrophic consequences for the developing countries.H Although Asian and oil-producing countries have not done badly in the last year, many African countries have been badly affected by drought while the typical Latin American experience remains one of mounting debt, extremely high inflation and little economic growth. A determined effort to resume the liberalisation of trade, prudent but dynamic international lending policies and more generous aid need not await the resumption of fast global economic growth; on the contrary they may be necessary to bring it about.

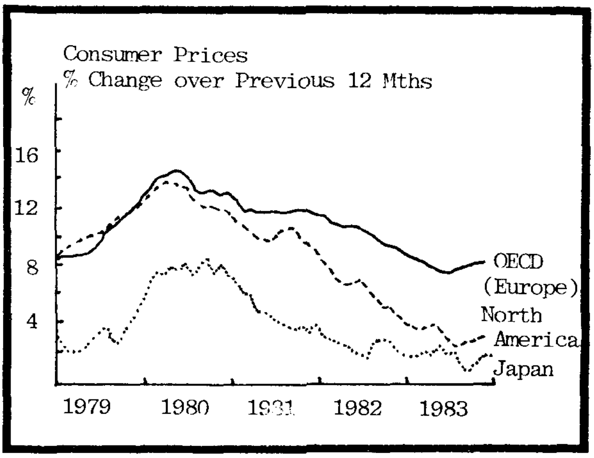
LABOUR MARKETS

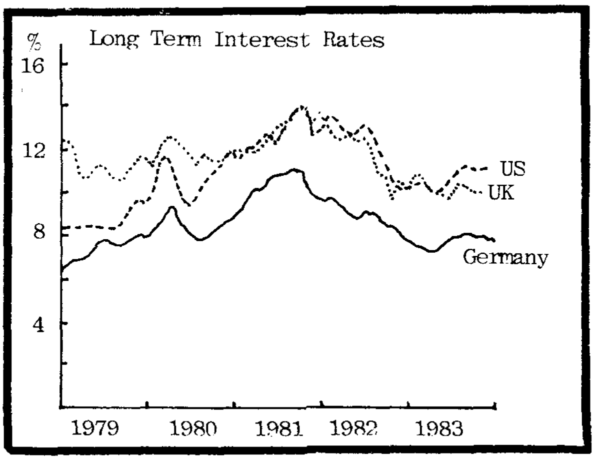


The general experience of labour markets in 1983 was of a levelling off in unemployment but with a downward trend apparent only in the US, Canada, Germany and perhaps the UK. Employment continued to fall in OECD Europe. Only in the US and Canada does employment show a sustained upward trend, and then only since the Spring of last year. Approximately 50% of additional employment generated in the US during the first six months of 1983 occurred in the service sector, a quarter in manufacturing, and a further sixth in construction.

INFLATION

Though the trough of inflation was passed in mid-1983, there has been no marked revival in inflationary pressures or expectations. The upturn is not closely synchronised amongst the major countries, unlike the upswing of 1971-72. Pressure on raw material prices has accordingly not been particularly marked. Indeed, in the case of oil, present levels of excess supply, combined with record exploration and development in non-OPEC countries and the apparent desire of some OPEC members to boost output, may drive prices lower in the short run, even though overall oil demand may rise in 1984 - the first annual rise since 1973. Hourly earnings have





accelerated somewhat in recent months, but this appears to reflect increasing use of overtime as much as any inflation in basic rates. Earnings continue to increase more rapidly than consumer prices, thereby increasing disposable income for those in work and fuelling the consumption boom.

PROGNOSIS

As a result of structural shifts in the pattern of borrowing and lending, and in the financial framework generally,authorities in many countries have taken a more flexible view of the growth rate of particular monetary aggregates. As a result money stock in the seven major industrial countries has been allowed to grow at a faster rate than in the immediate past. The rise and fall of inflation and interest rates in recent years, compounded by rapid financial innovation, has led to increased mobility of funds between accounts with varying degrees of liquidity. Monetary authorities have accordingly adopted a more pragmatic approach to monetary targets, which has led to a comfortable supply of reserves to the banking system. Relatively higher rates of monetary growth have not however brought about any significant reductions in interest rates.

There is a close link between lower interest rates and the consequent reduction of debt burdens in the developing world. The servicing of debt has not been facilitated by the protectionist measures undertaken by developed countries. Continued access to world markets by the debtor countries is essential if they are to be in a position to service their external debts and maintain an adequate level of imports.

Significant falls in the worldwide level of interest rates seem unlikely during the coming year. Measures to reduce the US deficit are currently perceived by the Administration as harmful to the President's re-election prospects. This view might change if the dollar weakened significantly. However, while a concerted effort to reduce the deficit should in the long run herald a trend to lower real interest rates worldwide, the short term repurcussions of such an about-turn in American policy on world financial markets are unpredictable. In the absence of Administration action, the dollar seems likely to weaken somewhat of its own accord. Preliminary estimates of fourth quarter profits in the US showed a substantial fall on previous quarters. If last quarter's experience is repeated, the capital inflow to the US currently sustaining the dollar may slacken and the long overdue adjustment process may be set in train.