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HER MAJESTY'S TREASURY

WORKING PARTY ON
WORLD ECONOMIC PROSPECTS

I attach a report on the Autumn update of the WEP exercise. Detailed background tables can be obtained from Mr Hennebry - on (233 3829).

Stephen Matthews

STEPHEN MATTHEWS

WORLD ECONOMIC PROSPECTS : AUTUMN 1985

INTRODUCTION AND SUMMARY

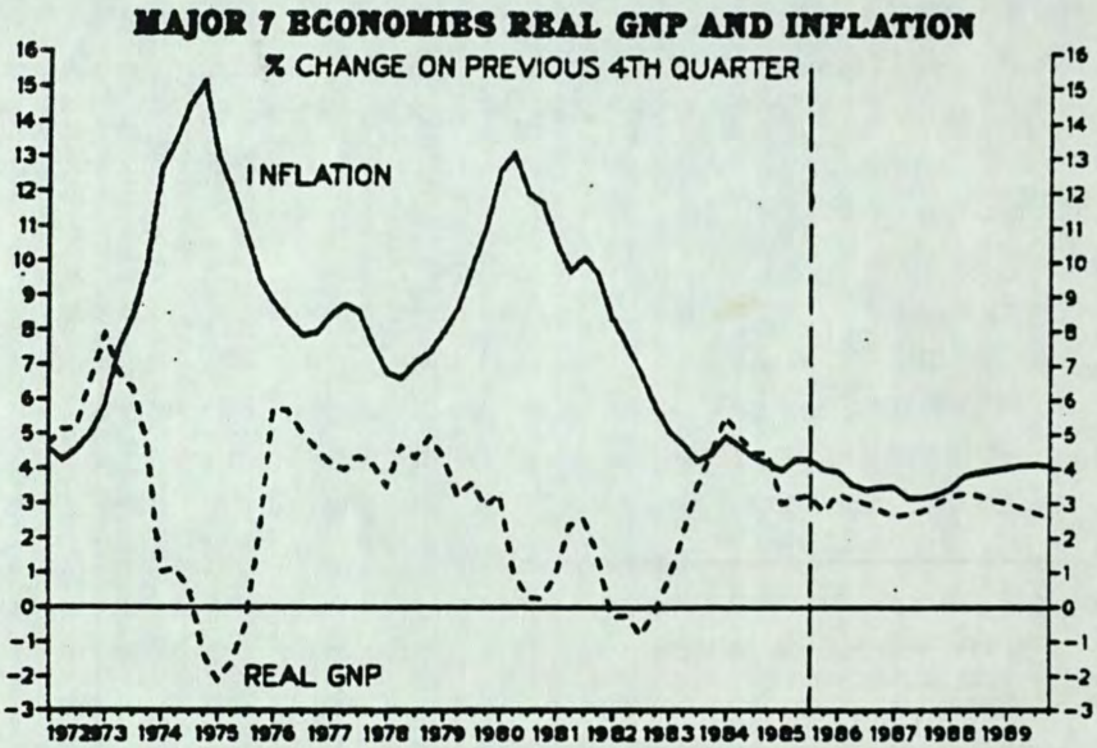
This report describes a favourable prospect for the world economy; it shows output and trade growing steadily at 3 per cent and 4-5 per cent respectively each year, plus some slight slowdown in the rate of inflation assisted by persistent weakness in commodity prices. With the continuing success of firm fiscal and monetary policies in the industrialised countries in bringing down the rate of price inflation, the conditions could perhaps be as favourable for growth over the next few years as they were in the 1960s, especially once the expectations of market operators have fully adjusted to low inflation. As in previous forecasts, the oil producing countries (especially Saudi Arabia) are squeezed by weak oil demand and low prices, and the prospects for non-oil developing countries are difficult but debt problems appear in aggregate to be manageable.

2. However there are clearly risks to such an outlook. The forecast makes no allowance, for instance, for any major spread of protectionism consequent upon the squeeze on US manufacturers; it does not allow for the default of a major country debtor with all its implications for the world's financial system; neither does it allow for any sharp dislocations to the pattern of world trade brought about by either a sudden fall in oil prices or a dramatic realignment in exchange rates leaving the dollar much lower and the yen and Deutschemark much higher than shown here. We do not feel that these events are the most likely - it is against the best interests of too many people for protectionism or default to be allowed to come about except in the last resort - but nevertheless the probability of one or more of them occurring is not negligible and the world economy could take a vastly different path as a result.

Table 1 : Output, Inflation and Trade

% change on previous year	1983	1984	1985	1986	1987	1988	1989
Major 7 real GNP	3	5	3	3	2½	3	3
Major 7 consumer prices (CED)	5	4	4	3½	3½	3	3½
World trade in manufactures (UK weights)	1½	10½	7	5½	3½	4	5

Chart 1:



3. Policy stance in the developed countries could also be significantly different from that assumed; with or without a sharp depreciation in the dollar, governments in Europe and Japan may reduce the current account imbalances by easing fiscal and monetary policies in order to raise their own domestic demand growth relative to that of the US. The forecast assumes that Japan will make a considerable adjustment in its policies (eg liberalisation of its capital markets to assist the yen to rise; lower interest

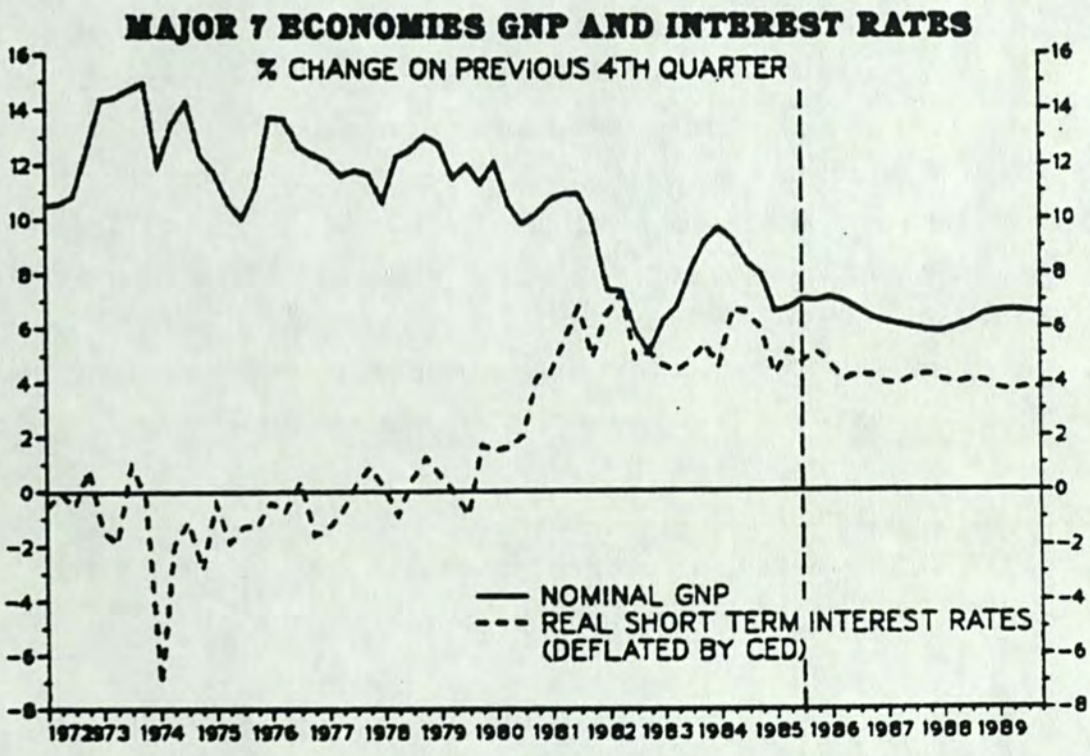
rates and encouragement of domestic consumption and investment; much less reliance on export growth) as a major contribution to the resolution of the world imbalances. However, even with the threat of major protectionist measures against them, the Japanese may be reluctant to undertake all of this adjustment.

4. These issues are discussed more fully elsewhere in this paper.

POLICY

5. In brief we have again assumed that the medium-term policy stance of the industrialised countries will remain slightly restrictive, as evidenced by the slowdown in money GDP growth shown below.

Chart 2:



Firm monetary policies are expected to continue. With government deficits being reduced only slowly as a proportion of GNP, this leads to real interest rates remaining high throughout the forecast period. This may constrain real GNP growth to rates broadly in line with the rough estimates of productive potential expansion shown in table 2.

Table 2: Average growth rates in output and productive potential

	1964-73	1973-79	1979-84		1984-89	
	Growth	Growth	Growth	Potential	Growth	Potential
US	4	2¾	2	2¼	2½	2½
Japan	9¼	3¾	4¼	4¼	4¼	4¼
Germany	4½	2½	1	2½	3	2¾
France	5¼	3¼	1	3	2½	2¾
Italy	5	2½	1	3	2½	2½
Canada	5¾	3¼	1¾	2½	2¾	2¾
Major 7	5	2¾	2	2¾	3	3

6. With their exchange rates strengthening against the dollar, Japan and Europe may allow domestic monetary aggregates to grow a little faster without fearing renewed inflationary pressures, especially since commodity markets look like remaining weak. In the US, the Fed are assumed to attribute much of the overruns in monetary growth this year to a shift in the demand for narrow money; with inflationary pressures receiving less attention, the Fed give greater consideration than hitherto to a range of factors, such as real activity rates, the exchange rate and the problems of financial institutions, when setting monetary policy. The recent G5 agreement on concerted intervention to reduce the dollar's value on foreign exchange markets will leave little room for higher US interest rates in the next few months. Thereafter, there need be no great movement in interest rates; we assume a little upward pressure in the next few quarters and in the longer term real US three-month interest rates should remain at or near 5 per cent.

7. We assume that some limited progress is made in reducing the US Federal budget deficit, but not by the full amounts agreed in the recent Congressional Budget Resolution. On our growth assumptions, this leaves deficits of $150-200 billion in each year, albeit falling in relation to nominal GNP. Some slippage is also likely in Canadian attempts to reduce their budget deficit. Fiscal policy is initially fairly tight in Japan and Europe, but

unemployment remains high in the latter, and the resulting electoral pressures may lead to some fiscal relaxation. In particular, we have explicitly assumed that the German government introduces tax cuts worth DM10-12 billion in each of 1986, 1987 and 1988, which stabilises their deficit to GNP ratio at about 1 per cent. In France, tax reductions next year and general slippage on their fiscal targets are together assumed to lead to no reductions in their deficit in relation to GNP.

Table 3: Average Real interest Rates*

	US	Japan	Germany	Italy
1969-73	2	-½	2¼	-1½
1974-79	¼	-1	1	-4½
1980-84	6¼	4¼	4¼	2½
1985-89	4	3½	2¼	5½

*Average of annual nominal three-month interest rates less quarterly increase in CED at an annual rate.

Chart 3:

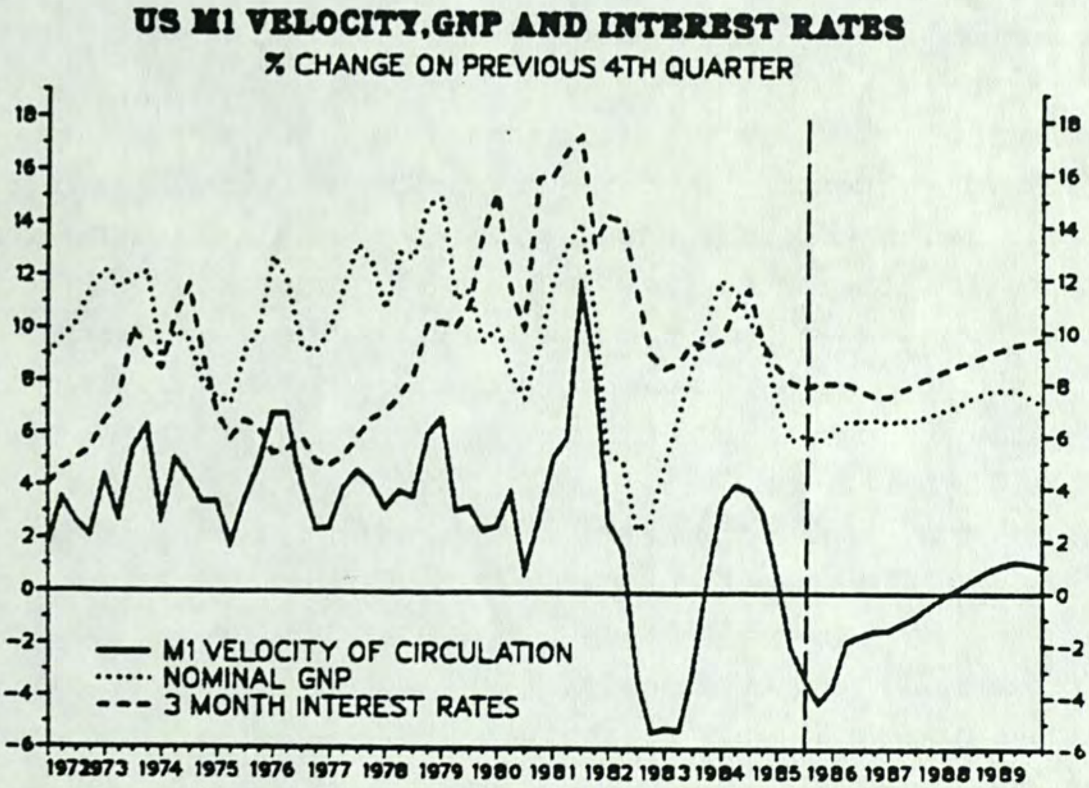


Table 4: General Government Deficits

General government financial balances as % of GNP	US	Japan	Germany	France	Major 7
1969-73	- ½	0	¼	½	½
1974-79	-1¼	-3½	-3	-1	-2½
1980-84	-2½	-3½	-3	-2¼	-3½
1985-89	-3	- ½	-1¼	-3¾	-3¼

ACTIVITY

8. Real GNP in the United States grew by only 1.9 per cent (seasonally adjusted annual rate) in the first half of 1985. Domestic demand grew strongly by 3 per cent, with consumer's expenditure rising by 5 per cent over this period (all figures seasonally adjusted at an annual rate), but much of the expansion in demand leaked into the external sector - export volumes fell for the first time since late 1982 while imports continued to rise steadily. The 'flash' estimate of GNP growth in the third quarter was only slightly better at 2.8 per cent (annual rate). The recovery is now ten quarters old and is at the point where there is considerable uncertainty as to whether it will continue or whether it will turn into recession. Fears that the economy will turn down centre on the continuing erosion of manufacturing competitiveness, the relatively modest expectations from investment surveys, the moderately low levels of capacity utilisation and the mounting burden of household indebtedness as consumers have been spending on cheap imports. On the positive side, the effects of lower interest rates and continuing good inflation performance should still feed through to residential investment and consumption, stocks are not high by historical standards for the stage of the cycle, and the assumed depreciation of the dollar should start to improve the external contribution to GNP growth from now on. Furthermore although households have taken on a lot of consumer debt, they have built up (financial) assets as well as liabilities and the comparatively comfortable net debt position should minimise the risk of an abrupt halt in consumer spending.

9. The outcome shown in the forecast is therefore for a mild cyclical decline in domestic activity partially offset by a recovery in net trade. Real GNP grows by 2½ per cent this year and 2½-3 per cent in each of the next three years, with the foreign trade sector contributing positively towards growth after 1987. The risks to such a "soft-landing" are clear - the dollar remaining high, interest rates rising sharply, domestic activity falling sharply - but we feel that a sharp US recession is not the most likely outcome.

Table 5 : Real GNP growth in Major 7 Countries

% change on previous year	1983	1984	1985	1986	1987	1988
US	3½	7	2½	3	2½	2½
Canada	3½	5	4	2½	2	2½
Japan	3½	5½	5	4	3½	4
Germany	1½	2½	2½	3½	3	3
France	½	1½	1	2	2½	3
Italy	-½	2½	2½	3	2	2½
Major 7	3	5	3	3	2½	3

10. In Japan, industrial production, business investment and exports bounced back strongly in the second quarter of 1985, although retail sales and investment intentions data have been less encouraging. We expect the economy to grow by 5% between 1984 and 1985 with domestic demand growing steadily but not sufficiently to offset the smaller contribution from external trade. Over the forecast period as a whole net exports worsen as the yen rises strongly against most currencies and growth of export markets slows. Domestic demand growth is assumed to strengthen, reflecting falling interest rates and a gradual decline

in the savings ratio, and this counters in part the negati[ve] external contribution to GNP growth. We therefore expect activity to grow at an average rate of about 4 per cent over the rest of the decade, close to estimates of Japan's productive potential growth.

11. <u>German</u> output in the second quarter of 1985 recovered from the poor performance in the previous quarter, which can mainly be attributed to the effects of the severe winter weather. Nevertheless, the sluggish performance in the first half of the year means that growth of only 2¼ per cent seems likely this year. In 1985, as in 1984, German growth is expected to rely heavily on its strong export performance. However the assumed appreciation of the Deutschemark from 1986 onwards is expected to lead to some loss of competitiveness and hence to a deterioration in the contribution of the external sector to growth. Domestic demand is expected to compensate; rising real earnings, together with reductions in the tax burden, lead to appreciably faster growth in private consumption. As a result we are forecasting growth of about 3 per cent through 1986; this translates to year-on-year growth of 3½ per cent due to the low base in the first half of 1985.

12. 1985 seems likely to be another year of slow growth in <u>France</u>, with output expected to be just over 1 per cent higher than in 1984. Consumers' expenditure is the main contributor to growth, with the high level of the first half of 1985 maintained for the rest of the year. Little or no growth is expected in investment as the residential sector continues to be weak. We should see rather faster growth from 1986 onwards. Further increases in real wages, together with some easing of the tax burden, are likely to boost consumption and investment is also expected to pick up. In spite of the assumed depreciation of the Franc external trade makes a negative contribution to growth.

13. <u>Italy</u> looks likely to continue the revival of growth which started in 1984 and growth of 2½ per cent this year should be sustained in later years. This growth is based on domestic demand. Rising real wages and a decline in the savings ratio combine to

produce reasonably strong growth in private consumption. Government consumption is assumed to grow steadily in the absence of convincing action to contain the government deficit. Investment and stockbuilding are also fairly buoyant.

14. As the stimulus fades from trade with the US, Canada relies on a recovery of fixed investment and strong, if slowing, consumption for most of its growth this year and next. Activity remains steady rather than strong for most of the forecast period, picking up a little towards the end of the decade.

15. This picture of steady growth in the major industrialised countries is considerably better than the performance in the 1979-1983 period. Nevertheless, table 2 above showed that growth was unlikely to be greater than our crude estimates of growth in productive potential, constructed on the basis of projections of labour supply and trend productivity growth, in most countries. This is reflected in our forecasts of unemployment shown in table 6. Only in Germany, where output is expected to grow very slightly faster than potential, is there any fall in the unemployment rate and then only a small fall. Growth rates significantly above potential would be needed to make substantial inroads into unemployment, and the associated risk of inflation might be that much greater.

Table 6: Unemployment

%	1974-83 Average	1983	1984	1985	1988
US	7½	9½	7½	7¼	7½
Japan	2	2½	2¾	2½	2¾
Germany	5	9¼	9	9¼	8¼
France	6¼	9	10¼	10¾	11
Italy	7½	10	10½	10¼	11¼

INFLATION

16. We still expect no change in the rate of inflation over the forecast period - some further reductions in European price

inflation are broadly offset by a slight pick-up in the US as the dollar falls. Generally firm fiscal and monetary policies and continuing high unemployment provide a favourable background for low inflationary pressures, enhanced by weakness in commodity markets, especially oil.

Table 7 : Consumer price inflation in Major 7 countries

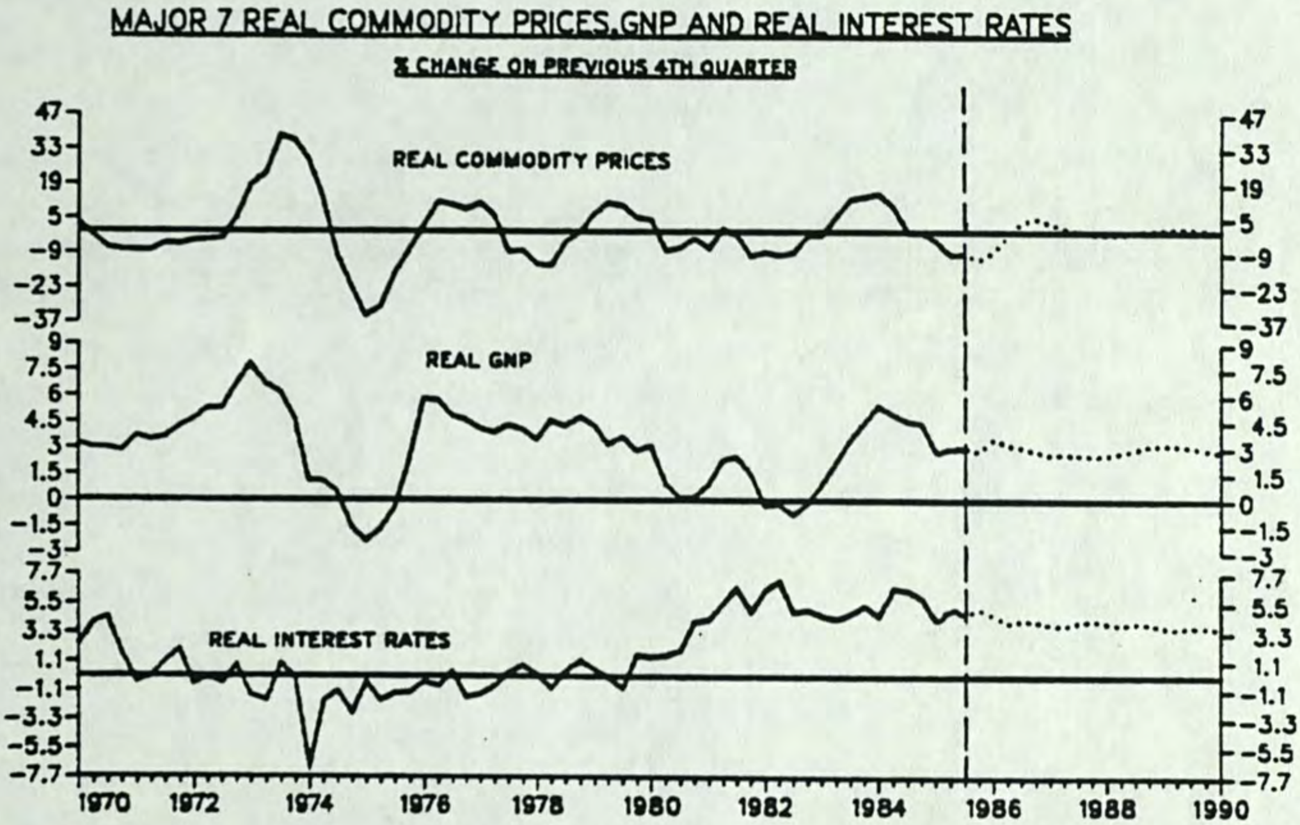
% change in the consumers' expenditure deflator on a year earlier	1983	1984	1985	1986	1987	1988
US	3½	3	3	3½	4	4½
Canada	6	4	4	4	3½	3½
Japan	1½	2	2½	2	1	1
Germany	3	2½	2½	1	½	0
France	9½	7½	6	5½	4½	3
Italy	16	11½	9½	7½	6½	6½
Major 7	5	4	4	3½	3½	3

17. Over the summer months, <u>food</u> commodity prices have weakened almost without exception on world markets. Harvest prospects for 1985 look good with probable record levels of world production of cereals, oilseeds, major tropical products and sugar. Improvements in agricultural technology have raised yields significantly and supply should exceed demand for some time although ultimately low prices should lead to lower production. Food markets are likely to remain depressed for the next year or two, although cuts in US Federal spending on the farm support budget could apply some upward pressure on prices.

18. Agricultural non-food production has also been high and prices correspondingly weak this summer. As a result the prices of <u>industrial materials</u> have been slightly weaker than expected despite some strength in prices of metals and ores. With production high and new capacity ready to be brought on stream at short notice, commodity markets look set to remain weak as long as there is no major upturn in world activity. The <u>oil</u> price has stayed

surprisingly firm through most of the summer, although dollar weakness in July and September has resulted in some fall in the real oil price. We expect a fall in the real oil price of some 30 per cent by 1990, much of this being achieved through dollar depreciation.

Chart 4:



WORLD TRADE

19. We have assumed that the relationship between trade and activity over the forecast period remains much the same as that over the last ten years. Table 8 thus shows a forecast of world import volumes growing by about 5 per cent each year from 1984 to 1989, while real GNP in the major 7 industrialised nations grows by about 3 per cent. We have not allowed for any major increase in protectionism in the forecast; we assume that the free-trade commitment of the US Administration and governments in the other leading developed economies is sufficiently strong to hold back the pressure for trade restrictions by moves such as the recent G5 agreement on concerted intervention to push down the value of the dollar and measures to open up Japanese markets to imported goods. It is against the interests of too many of

the world's trading partners for protectionism to be introduced lightly. If it were, however, this could be expected to show up in slower world trade (and indirectly output) growth and higher trade and domestic prices. The exact impact on growth and inflation would depend on the precise form of trade restrictions (import controls, tariffs, etc) and their geographical impact (whether global or directed against specific countries).

20. After a year of rapid growth in 1984 (world import volumes rose by 8½ per cent over the 1983 level), the picture of world trade is a little obscure in the first quarter of 1985 - import volumes are estimated to have risen by nearly 10 per cent at an annual rate (with North American and German imports being especially strong) while exports remained fairly flat in real terms. Growth in US imports is likely to be slower this year as the dollar has fallen somewhat from its earlier peak values; worsening European competitiveness should conversely attract more imports. The relative strength of European imports, and the declining share of UK exports going to the weak OPEC markets, suggest that UK-weighted measures of world trade, while still slower than unweighted trade growth, will be less unfavourable than in recent years.

Table 8 : World Trade

Average annual % change	1966-73	1973-84	1984-89	1984 weights (%) World exports	UK exports	UK manuf exports
Major 7 Real GNP	5	2½	3			
Imports volumes						
US	11	6½	5	19	14	14
Japan	16	2	9	7	1	2
Germany	9½	4	7	8	11	10
Major 7	11	3½	6	49*	42*	39*
Other OECD	9	4½	4½	23	33	29
Other Developed	5½	3	2	3	4	5
OPEC	10½	10	-4	7	8	10
NODCs	8	5	6	15	11	14
Total world imports	10	4	5	100		
World imports (UK-weighted)	8½	3½	4½		100	
World trade in manufactures (UK-weighted)	10	4½	5			100

*Major 6 (ie excluding UK)

CURRENT BALANCES AND EXCHANGE RATES

21. The figures in the table below show the world current account imbalances becoming even more severe this year and next, both in absolute terms and in relation to nominal GNP. We have, as in previous forecasts, assumed that the dollar weakens in response to the continued current account deficits and the emergence of the US as a major debtor country; but that confidence in the general

strength of the US economy (and expectations of continuing high Federal deficits and consequently strong long-term real interest rates) will prevent any dramatic dollar collapse, notwithstanding the sharp fall in the dollar's value in September. The Yen and the Deutschemark are both forecast to appreciate by some 30 per cent relative to the dollar over the next three years.

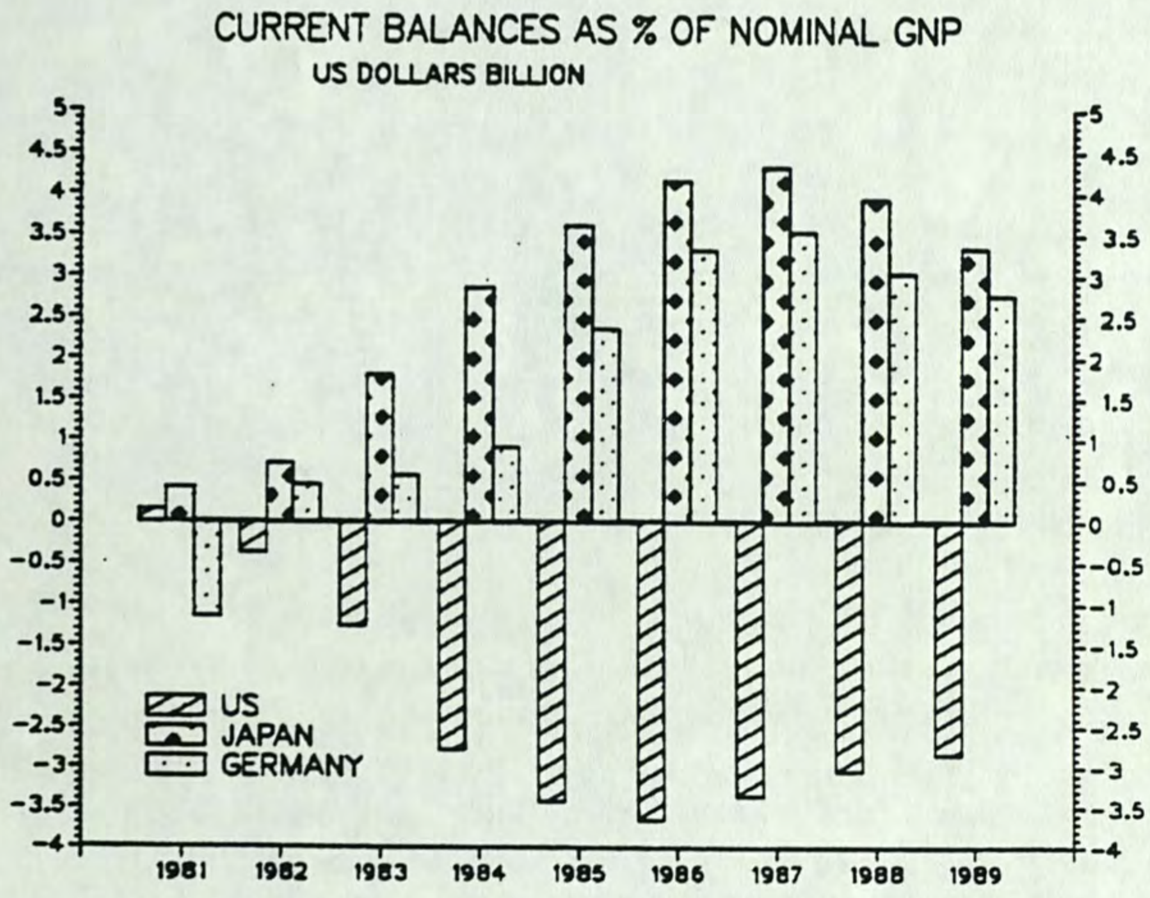
Table 9: Current Balances

$billion	1982	1983	1984	1985	1986	1987	1988
US	- 11	-42	-102	-133	-152	-148	-144
Japan	8	21	35	47	71	89	92
Germany	3	4	6	15	26	33	32
NODCs	- 63	-37	- 26	- 28	- 30	- 33	- 34
OPEC	- 16	-18	1	- 11	- 29	- 35	- 30
World Imbalance	-114	-61	- 85	-111	-102	- 89	- 87
as % of GNP							
US	-½	-1½	-3	-3½	-3½	-3½	-3
Japan	½	2	3	3½	4	4½	4
Germany	½	½	1	2½	3½	3½	3

22. The impact of large exchange rate movements when the initial current account positions are so out of balance is outside our normal experience and it is unlikely that models can contribute much to our projections. There are a number of reasons why the US current account should respond only slowly to the depreciation of the dollar - the large initial deficit (the trade deficit in 1984 is equal to over half the value total US merchandise exports); successive J-curve effects; exporters to the US squeezing their profit margins which they had built up during the dollar's rise, and vice versa for US exporters; and the existence of large deficits with Canada (the Canadian dollar is not expected to appreciate significantly against the US dollar) and other countries who tie their currencies to the dollar.

23. Similar reasoning applies in reverse to the Japanese current account. Here, however, the picture is exacerbated by the weakness in commodity markets and, in particular, oil. Manufactured goods make up only a small proportion of Japanese imports, whereas oil accounts for about a third. The large falls in oil prices in the forecast, with no significant short-run effects on oil consumption, ensure a considerable reduction in the Japanese import bill over the next few years. Hence the Japanese current account moves into bigger surplus because of the favourable terms of trade patterns, even though the trade surplus in constant prices starts to fall after this year.

Chart 5:



24. To what extent are these deficits sustainable? Previous reports have discussed the implications for world savings portfolios and debt servicing burdens and concluded that US deficits of 3-4 per cent of GNP can be supported for some years. The Japanese too seem to be quite willing to export capital to the tune of some 3 per cent of their own GNP, but it is not clear that they would wish to go much higher. Sharper exchange rate movements seem unlikely on their own to be sufficient to bring down the Japanese surplus. Policy actions to raise Japanese and European domestic activity relative to that in the US may be more effective; or the more damaging route of protectionism and trade restrictions may be undertaken. The free-trade commitment of President Reagan may not be enough to quash totally the calls for protectionist measures now being heard on Capitol Hill. However the forecast does not make any explicit allowance for the introduction of major trade restrictions, but the possibility should be borne in mind.

25. In the European Monetary System, we have assumed some realignment immediately after the French elections early in 1986. The French and Belgian Francs are both assumed to depreciate against the Deutschemark, the former by about 7 per cent, with some further moves in the same direction later in the same year. The Deutschemark remains strong within the EMS throughout the forecast period.

OPEC AND THE OIL MARKET

26. The world oil price has been surprisingly strong throughout the summer months, buoyed up by worries about Soviet oil production shortfalls and by very low Saudi Arabian output (only just 2 million barrels a day at one point). However demand for oil has been rather weaker than anticipated, and this pattern is expected to persist. World oil demand is likely to show virtually no increase this year or next, and even at the end of the decade is projected to be only about 5 per cent higher than in 1984. With some increase in non-OPEC production, OPEC oil output is likely to be constrained to roughly its present level for the rest of the decade.

Table 10: The oil market

Millions of barrels per day	1983	1984	1985	1986	1987	1988	1989
Demand[1]	44½	45½	45	45½	46	47	47½
Production							
Non-OPEC	26	27	28	29	29	29½	29½
OPEC	18½	18½	17	16½	17	17½	18
Oil Price							
$ per barrel	29.0	28.1	26.9	24.9	23.4	23.5	24.8
Real (1980=100) (relative to world manufactured export prices)	108¼	109	104	84	71¼	66¾	66½

[1]Consumption plus stockbuilding in OECD, OPEC and developing countries.

27. We still think that OPEC will recognise the importance to themselves of holding the cartel together, even if there are periods when squabbles over quotas lead to some temporary loss of control and consequent price slippage. With signs that Saudi Arabia is now pricing its oil on the open market (rather below its contract price) and raising its production, the price is likely to fall over the winter and more especially next Spring - we are projecting a fall of $3 per barrel over the next year. With some rise in oil demand in the later years of the decade, the downward pressure on oil prices should ease and we are projecting no further falls in the real dollar price after mid-1988. Together with the assumed depreciation of the dollar, this gives a fall in the real oil price of some 30 per cent by 1990. If the OPEC cartel were to collapse the fall in oil prices could be much greater; on the other hand we think that it would take much faster growth in world activity or a major cut in oil supply for present prices to be maintained in real terms.

28. Some indication of the sensitivity of the forecast to different oil price assumptions is given in a Treasury Working Paper (no.34, "The Economic Effects of Lower Oil Prices" by Stephen Powell and Geoff Horton, April 1985). This analyses the effects of a 10 per cent reduction in the dollar oil price on both the world and the UK economies with the help of simulations on the Treasury's WEP and UK macroeconomic models. On the assumptions (a) that governments in the major 7 countries keep monetary growth unchanged by adjusting interest rates, (b) that countries with historically high budget deficits (US, France, Italy and Canada) take the opportunity given by the operation of automatic stabilisers to reduce their deficits as a proportion of GNP, but (c) that Japan, Germany and the UK leave their deficits unchanged, the paper estimates that a 10 per cent fall in the price of oil could raise real GNP in the major 7 countries by 0.5 per cent after two years and world import volumes by 0.7 per cent. Major 7 inflation could fall by over half a per cent after two years before the higher world activity pushed inflation back to the base level after four years. Broadly speaking these effects would be reversed if the world oil price were to remain higher than shown in our forecast. However, there are assymmetries involved in this process - the OPEC countries might react more slowly in adjusting their spending (particularly on imports) upwards in response to the gain in income from a higher oil price than vice versa. The reduction in output arising from a 10 per cent higher oil price might therefore be rather smaller than the increase in output for the reverse case. The UK will perhaps do better from higher oil prices than most countries because of the greater share of OPEC countries in our export markets.

29. In the forecast, we assume that Saudi Arabia's budgetary problems will ensure that they produce nearer to their quota by the end of the forecast period, at the expense of OPEC members with better financial positions. Demand for imports by oil producers is likely to remain severely constrained, especially for Saudi Arabia, for some time to come; nevertheless, they continue to run current account deficits and the position appears to be only just sustainable.

NON-OIL DEVELOPING COUNTRIES

30. The proposals for non-oil developing countries (NODCs) balance of payments are summarised in Table 11. The outturn for the current account in 1984 now appears to have been worse than we were assuming at the time of the last WEP, with the balance on invisibles substantially worse. As a result of rapid US import growth and the NODCs substantial gains in market share, the trade balance moved into surplus in 1984. It appears to have returned to deficit in the first two quarters of 1985; and although it is difficult to disentangle the separate effects of prices and volumes at this stage, this is probably a result of weak commodity prices and a consequent deterioration in the NODCs terms of trade.

Table 11 : NODCs Current Account

	1983	1984	1985	1986	1987	1988
Export Volume growth (%)	6½	13½	6	8	4½	6½
Export Market growth (%)	2	9½	5	7	5	5
Import Volume growth (%)	0	8	6½	7	5	5
Current Account ($bn)	-37	-26	-28	-30	-33	-34
of which:						
trade[1]	-15	4	- 2	0	1	5
invisibles	-22	-29	-26	-30	-34	-39
Change in Reserves	2	14	4	11	10	13
Memo items						
Reserve/Import Ratio[2]	23	28½	27	27	27	27½
Terms of Trade (% change)	1½	3.0	- 1½	0	½	- ½
Capital Account ($bn)	41	41	33	41	43	47

[1]fob/fob

[2]end-year

31. The slowdown in US import growth means that NODCs markets will not grow as fast as they did in 1984; but with world trade expected to be fairly buoyant, if there is no significant increase in protectionism, growth in NODCs markets may be around 5 per cent a year. While they are unlikely to repeat the spectacular gains in market share of the past two years, it seems possible that export volumes will still grow slightly faster than markets. Given the assumptions about capital flows, discussed below, the NODCs may be able to increase their imports by 5 per cent a year. With the terms of trade roughly unchanged after the fall earlier this year, this produces a return to small trade surpluses from 1986.

32. With dollar interest rates some 2¼ per cent lower than in 1984, reduced debt servicing costs produce an improvement in the invisible balance in 1985, but it is not sufficient to outweigh the deterioration in the trade balance. Thereafter, growth in the nominal stock of debt and sharply rising cif payments combine to produce a steady deterioration in the current balance.

33. Net capital inflows in the first quarter of 1985 appear to have been far lower than previously forecast, with net bank borrowing actually negative. As a result, NODCs reserves fell. There are some indications that these figures will prove to be atypical and, while this forecast must be treated with considerable caution until the picture becomes clearer, we have assumed that capital flows will pick up over the remainder of the year. Nevertheless only a small increase in reserves over the year looks possible and the reserve/imports ratio is likely to fall. In later years we have assumed a steady increase in concessional lending as the World Bank, in particular, increases its activities. We assume that commercial banks increase their exposure by some 2-3 per cent a year, with new lending concentrated on those countries who have so far avoided debt difficulties. The NODCs as a whole are expected to start making net repayments to the IMF. After the small increase this year, larger reserve increases should be possible over the rest of the forecast period and a constant reserve/imports ratio is maintained.

Table 12 : NODC Debt Indicators

	1977-82 average	1983	1984	1985	1986	1987	1988
Growth in the Stock of debt: nominal	20	6	5½	6	6¾	6¼	6¾
real	10½	10	9¼	5½	-6½	-4	-1
Gross debt/export ratio	1.4	1.8	1.7	1.8	1.5	1.5	1.5
Net debt/export ratio	1.0	1.3	1.2	1.3	1.2	1.0	1.1
Gross interest service ratio	0.1	0.19	0.17	0.16	0.14	0.13	0.13
Net Interest service ratio	0.17	0.13	0.11	0.10	0.09	0.09	0.09

34. The NODC debt indicators shown in Table 12 move favourably over the forecast period and suggest that developments in the world economy, particularly the expected depreciation in the dollar and lower US interest rates permit some easing of debt problems. Even so some countries will still need to reschedule their debt, and in many cases the process of agreeing IMF programs and negotiating these reschedulings could well prove difficult, although we assume no outright debt repudiation.