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IMF: WORLD ECONOMIC OUTLOOK

Summary

A rather gloomy review. Directors noted the apparent slowdown in growth in the industrial countries so far this year and the very difficult position continuing to face the ldcs not least because of the weakness of commodity prices. On the positive side however most Directors from the industrialised countries noted that the prospects for a "bounce back" in growth remained good as a result of recent falls in interest and inflation rates together with the beneficial effects of the oil price feeding through. The ldcs were more sceptical.

2. On policies in the major countries, Directors noted the continuing uncertainty hanging over prospects for the US economy. They underlined therefore the importance of early and firm action to reduce the budget deficit. Most Directors felt that Germany and a fortiori Japan should also take measures to slow their pace of fiscal retrenchment.

Detail

3. On 12 September the Board concluded its discussion of the staff's latest forecasts for the world economy.

4. Directors noted the slowdown in growth in the industrialised countries so far in 1986. This partly reflected the negative results of the oil price fall feeding through before the positive effects were apparent. Most Directors from the industrialised countries supported the staff's view that this "growth pause" would prove temporary and that growth was likely to recover in the second half of the year and through 1987. The ldcs were more sceptical however and underlined the damaging effects that slower growth in the industrialised countries was having upon them.

5. Directors recognised that the position facing the ldcs remained very difficult. Ldc Directors expressed particular concern about the recurrent weakness of commodity prices. They welcomed therefore the staff's discussion of this problem and they expressed interest in further study.

6. Directors continued to support the broad stance of policies followed by industrial countries in recent years. Nonetheless they expressed concern about the size of the current account imbalances expected in the largest countries over the medium run. The substantial realignment of the major currencies was welcome but Directors doubted whether this alone would be sufficient to bring about sustainable current account positions. They emphasised therefore the need for appropriate fiscal and monetary policies. Directors stressed the need for the US authorities to press firmly ahead with their fiscal adjustment effort. In addition, most Directors thought that Japan and Germany should moderate the pace of fiscal adjustment in order to support domestic demand.

7. In response to these views Grosche (Germany) noted that, in contrast to the position in Japan, current exchange rates were already expected to lead to a substantial reduction in the current account surplus relative to GDP over the years ahead. The authorities would implement their fiscal policies flexibly. Indeed the draft 1987 budget showed a rise in net borrowing. In any case, growth in Germany both this year and next was expected to be robust. Fujino (Japan) was more vehement. He questioned the staff's forecasts for Japan and suggested various drafting changes before the WEO should be published, including deleting section IV of the paper (which contains the material on economic indicators). The Japanese current account surplus would fall and anyway it was misleading to express the surplus in dollars. Japanese growth would pick up. The rapidly rising debt burden made fiscal action difficult although the authorities would announce a fiscal package soon.

8. Dallara (US) expressed concern about the prospects for the US current account deficit which was likely to remain high despite the fall in the dollar. The administration remained committed to fiscal adjustment. Even so, other countries would also need to adopt appropriate policies if US adjustment was not to lead to an excessive slowdown in growth. In

particular, he was concerned about the slow growth through next year shown in the staff's forecasts for Germany and Japan. In this light, while he supported the authorities' overall fiscal objectives, he thought that both Germany and Japan had some room for flexibility in the short-term.

9. Turning to policies in the developing countries, Directors emphasied the very difficult situation which would require the maintenance of policies to reduce the reliance of the economy upon imports and foreign savings. The weakness of commodity markets underlined the importance of continued export diversification. While Directors recognised that import substitution might have a role to play in some developing countries, they said that these should be used in the light of comparative advantage and without reliance upon excessive protectionist barriers. On the other hand, Sengupta (India etc.) - the strongest, and quite often the only advocate in the Board of development through administrative controls - argued that tariffs and export subsidies could be economically efficient.

10. Several Directors referred to the forthcoming GATT discussions. The ldc Directors underlined the importance of the industralised countries giving ldc exports unrestricted access to their markets. Rye (Australia etc.) continued his campaign against agricultural protection which he argued was an important factor behind the weakness of agricultural prices.

11. Directors welcomed the material on economic indicators for the major countries included in the staff's report. Only a few Directors took the opportunity to make specific suggestions on the way in which this exercise might be extended. Both Wijnholds (Netherlands etc.) and de Groote (Belgium) felt that the exercise should be made more specific in its policy content. Wijnholds thought that the staff should work towards the setting of policy norms which could be used to trigger policy discussions if policy went off track.

UK Intervention

12. Foot spoke to your telnos 202 - 204.

13. He noted that there appeared to have been a slowdown in growth so far this year. Nonetheless he suggested that it was probably too early to read

very much into this. In part it seemed to reflect the fact that those who had lost from the oil price fall had adjusted their behaviour before those who had gained. In any case, he was confident that the recovery had not ended and that, subject to one key uncertainty, the conditions for continued growth appeared to be good. In support of this view, Foot noted that both inflation and interest rates had been significantly reduced during the course of this year. Indeed he questioned whether the staff had not been too pessimistic not only on the outlook for inflation in the UK but also more generally. A significant realignment of exchange rates had also taken place. Foot also wondered whether the staff had not been too pessimistic concerning recent trends in commodity prices. The ffgures in the staff report seemed to imply that commodity prices in the second quarter of this year had been rather weaker than would be implied by the Economist index or estimates of the UN index.

14. The main uncertainty that Foot identified was the outlook for the US economy. The prospects for continued large current account deficits was a source of concern. This emphasised the need to take resolute measures to reduce the fiscal deficit. Such action was particularly important as the financial markets seemed to have already discounted some fiscal action and there was a danger that interest rates might rise if the expected fiscal adjustment were not put in place.

15. Turning to the policies in the industrial countries, Foot said that he continued to support the strategy followed over recent years which had allowed recovery to be combined with a good inflation performance. Where inflation was low, there might be a case for bringing forward tax adjustments.

16. Continuing, Foot noted that the staff seemed to have some doubts that the private sector would take up the resources freed by the planned reduction in fiscal deficits in the major countries in the years ahead. It was important not to see this question out of perspective. One reason for the poor performance of the world economy in recent years might well be the crowding out of private sector activity by the public sector. In this light, the planned reduction in the demands of the public sector should help to contribute to the strengthening of the growth performance.

17. The situation facing the ldcs remained difficult Foot said. Additional borrowing should only be undertaken cautiously. It was important for the ldcs to reduce their reliance upon imported goods and capital in stimulating faster growth.

18. Foot welcomed the staff's material on economic indicators. He suggested that its usefulness could be increased if it included scenarios investigating the effects of different policy options.

19. Finally, on the GATT round, Foot noted the importance of resisting protectionist pressures. This would require the flexible attitude of all participants in the talks.

## Staff Replies and Other Points

20. Hood (Director, Research Department), in personal remarks in his last WEO discussion before his retirement, underlined the uncertainties in the present situation and in particular the growing signs of disatisfaction with the operation of the international monetary system as evidenced by "economic warfare" on the trade front. Nonetheless there were positive signs and he stressed that the Fund had potentially a vital role.

21. Crockett (Deputy Director, Research Department) noted that there had been some positive developments since the forecast was completed and these would be taken into account in the update that the staff were currently preparing. The revision to the US Q2 GNP figures was not a major source of concern because final domestic demand was still growing strongly. The update would incorporate a $15 oil price for this year - the same as that used in the Spring exercise but higher than that in the papers for this meeting. The main effect of this change would be to improve the UK's balance of payments in the short term. The position of the OPEC countries would also improve somewhat.

22. Concerning the point Foot had raised on the recent developments in the commodity markets, Crockett accepted that the price index used by the staff had diverged significantly recently from the Economist index. The staff had been surprised by this but thought that this difference was unlikely to

make any significant difference to the forecasts as these were done for all the individual commodities and then aggregated.

23. There was a brief discussion of the arrangements for publishing the WEO. It was agreed that, as in previous years, it should be published in final form after the Annual Meetings. A shortened version would be given to the press at the time of the Interim Committee.

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