OECD

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

ECONOMIC OUTLOOK

ORGANISATION DE COOPÉRATION ET DE DÉVELOPPEMENT ÉCONOMIQUES

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OECD ECONOMIC OUTLOOK

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ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

TABLE OF CONTENTS

v. THE ECONOMIC OUTLOOK FOR 1979

1. DOMESTIC DEVELOPMENTS

1. Demand, Output and Employment
17. Fiscal and Monetary Policies
25. *Special Section:* Sectoral Financial Positions
31. Wages, Costs and Prices

44. INTERNATIONAL DEVELOPMENTS

44. Foreign Trade and Current Balances
59. International Monetary Developments

69. DEVELOPMENTS IN INDIVIDUAL COUNTRIES

69. United States
75. Japan
80. Germany
85. France
91. United Kingdom
96. Canada
100. Italy
105. Other OECD Countries

113. TECHNICAL ANNEX

113. Detailed Supporting Tables
121. Background Detail on OPEC and Non-Oil Developing Countries
126. Historical Statistics
136. Sources and Methods

Included in the associated issue of Occasional Studies:[1]

The OECD international linkage model
Demand for money in major OECD countries

1. To be published in mid-January.

CONVENTIONAL SIGNS

$	US dollar	—	Irrelevant	( )	Figures based on incomplete data
c	US cent	.	Decimal point	‖	Break in series
£	Pound sterling	I, II	Calendar half-years	*In charts:*	
..	Data not available	Q1, Q4	Calendar quarters	S	Strike
0	Nil or negligible	Billion	Thousand million	B	Break in series

LIST OF TABLES AND CHARTS[1]

TABLES

Page	Table	
1	1.	Growth of real GNP in the OECD area
3	2.	Growth of real GDP in other OECD countries
3	3.	Development of total domestic demand in OECD area countries
8	4.	Contributions to changes in real GNP/GDP
10	5.	Factors affecting real private consumption in seven major countries, 1977-1979
11	6.	Manufacturing capacity utilisation rates
12	7.	Unemployment rates in selected OECD countries: national definitions
13	8.	Adjusted unemployment rates in selected OECD countries: national definitions
14	9.	Employment and productivity
17	10.	Simulation of recent expansionary packages in Japan and Germany
18	11.	General movement net lending on a S.N.A. basis
19	12.	Primary impact of budgetary changes in selected OECD countries 1975-1979
22	13.	Summary of principal domestic monetary measures in OECD countries, June-December 1978
23	14.	Monetary aggregates. Recent trends and targets
25	15.	Financial balances by sectors
26	16.	Indicators of households' financial behaviour
28	17.	Selected balance sheet ratios for non-financial corporations
29	18.	Public sector borrowing
30	19.	Sectoral contributions to total monetary expansion
32	20.	Index of non-oil commodity prices
34	21.	Hourly earnings in manufacturing
35	22.	Unit labour costs in manufacturing
37	23.	Consumer prices
39	24.	Private consumption deflators in seven major countries
39	25.	GNP deflators in seven major countries
42	26.	Real wage adjustments
44	27.	Industrial output, foreign trade and current balance in the seven largest OECD countries
45	28.	Output and foreign trade of the OECD area
47	29.	Domestic and foreign trade prices of the OECD area
52	30.	Components of OECD trade balance changes
53	31.	Current balances of major OECD countries and country groups
53	32.	Current balances of other OECD countries
55	33.	World current account
57	34.	Adjustment of current balances in seven largest OECD countries
59	35.	Recent exchange rate variations
62	36.	Balance of payments summary
66	37.	International official liquidity: changes

Page	Table	
		TECHNICAL ANNEX
113	38.	Appropriation account for households: United States
113	39.	Appropriation account for households: Japan
113	40.	Appropriation account for households: Germany
113	41.	Appropriation account for households: France
113	42.	Appropriation account for households: United Kingdom
113	43.	Appropriation account for households: Canada
113	44.	Appropriation account for households: Italy
114	45.	Comparison of consumer prices and GNP/GDP deflators
114	46.	Exchange rates of OECD countries
115	47.	Effective exchange rate changes of OECD countries
115	48.	Volume of imports of major OECD countries and country groups
115	49.	Volume of exports of major OECD countries and country groups
115	50.	Foreign trade volumes of selected other OECD countries
116	51.	Export market growth and relative export performance of selected OECD countries
117	52.	Foreign trade prices (average values) of major OECD countries and country groups
117	53.	Foreign trade prices (average values) of selected other OECD countries
117	54.	Trade balances of major OECD countries and country groups
117	55.	Trade balances of other OECD countries
118	56.	Current invisible transactions of major OECD countries and country groups
118	57.	Net imports of oil of major OECD countries and country groups
118	58.	OECD countries' exports to OPEC
119	59.	OECD countries exports to Eastern Europe, the Soviet Union, China and selected other Asian countries
119	60.	Spot prices of non-oil primary commodities
119	61.	OPEC's current balance
120	62.	Balance of payments of non-oil developing countries
		Historical Series
126		Growth of real GDP at market prices in the OECD area
126		Growth of real GNP/GDP – Seven major OECD countries
127		Consumer prices (annual figures)
127		Consumer prices (half-yearly figures)
128		Current balances (annual figures)
128		Current balances (half-yearly figures)
129		Nominal exchanges rates, national currencies against the United States $

CHARTS

Page	Chart	
2	A.	Industrial production in seven major countries
4	B.	Selected indicators of orders
5	C.	Selected indicators of stocks of manufactures
6	D.	Retail sales
9	E.	Household savings ratios
20	F.	Monetary management and interest rate trends
27	G.	Indicators of corporate financial positions
31	H.	Index of non-oil commodity prices in $ terms
33	I.	OECD industrial production and spot commodity prices
36	J.	Cost and price indicators
38	K.	Change in consumer prices
40	L.	The real wage gap
46	M.	Volume of trade of the seven major OECD countries
48	N.	Measures of relative competitive position

Page	Chart	
54	O.	Current balances of selected OECD countries
60	P.	Effective exchange rates of major currencies: recent developments
63	Q.	U.S.-Germany: interest rate differential and bilateral exchange rates
64	R.	Evolution of selected European currencies vis-à-vis the DM
67	S.	International official liquidity
		TECHNICAL ANNEXES
130	T.	Effective exchange rates
133	U.	Exchange rates of major currencies against the dollar
134	V.	Uncovered interest rate differentials
135	W.	Germany, Japan and Switzerland: relative exchange rate evolutions, current account positions and changes in net official reserves

1. Tables and charts included in country notes are not listed.

The cut-off date for information used in the compilation of the forecasts was 23rd November 1978.

THE ECONOMIC OUTLOOK FOR 1979

The prospects for 1979 have changed considerably since last July's Economic Outlook, *and in many respects for the better. Present policies should result in brisk expenditure growth in Japan and Germany, and a slowing-down in the United States, and this combination, backed by the effective appreciation of the yen and depreciation of the dollar, is likely to produce a more balanced international pattern of payments positions. With the help of an unexpectedly large terms of trade gain, price increases have been reduced and the OECD area's current account deficit brought virtually into balance. A particularly encouraging sign is the number of countries where, in accordance with the OECD's concerted action programme, firm stabilisation policies have been rewarded by greatly reduced inflation and external deficits. With these developments capped by the recent international financial arrangements to help defend the dollar — arrangements which are much more appropriate in present circumstances than they would have been a few months ago — many factors seem to be running in favour of less turbulent conditions in exchange markets and better business confidence.*

But unemployment is likely to remain high for some time to come. After a surprisingly rapid fall, it could show some increase in the United States in 1979. And it may change little in Europe. Until an important further indentation has been made on the remaining problem of inflation, the prospects for reducing unemployment further may not be very bright. Indeed, despite the very real progress made in many countries, the rate at which costs and prices are still rising suggests that economic prospects in general have to be viewed with somewhat mitigated optimism. Inflation risks being faster in the United States in 1979 than in some other major trading countries, and until this gap has begun clearly to be reduced, the recent calmer conditions on exchange markets cannot be assumed to be durable. In most countries inflation still represents a serious constraint on the scope for expansionary action and — the ultimate test in market economies — on the willingness of business to invest: success or failure here will materially affect the prospects for the important new efforts now being made to reduce fluctuations between European currencies.

In a different but not unrelated field, insufficient progress has been made by most countries in reducing dependence upon imports of oil from traditional suppliers, and this could constitute an additional discouragement to business initiative and sustainable expansion. More generally there is some danger that, faced with problems of high unemployment, countries are entering into a protectionist movement which, at best, can alleviate surplus manpower problems in only the very short term, at the expense of exacerbating them later on. Unless the trend towards protectionism is reversed, and the adjustment of industrial structure to changing patterns of demand stepped up, the world could risk slipping back half a century to conditions in which non-inflationary growth is increasingly difficult to achieve and constructive relationships between the increasingly interdependent countries of the North and South are replaced by the more destructive forms of dialogue. These are not counsels of despair, but indications of the challenges which OECD governments have to face if they are to build on the better foundations which they have laid in recent months.

Differential Demand Trends

In the present exceptional circumstances, the appropriate focus for discussion of developments in the OECD area is not global GNP growth so much as the newly-evolving pattern, as between countries, of domestic demand. In 1979 there seems little likelihood that GNP growth in the area as a whole will be any greater than in 1978. But this is an aggregation which masks a potentially encouraging development. The encouraging factor is what may be described as a scissors movement of domestic demand growth between the United States, where it is shrinking, and the other largest countries, where it is speeding up. Conversely, net exports are already strengthening in America and weakening in Germany and Japan. As a result of preconcerted divergencies between demand-management policies, significant changes in relative cyclical positions are expected. During the two years 1976-77 the annual growth of domestic demand in the United States exceeded that of the other major countries by nearly 3 percentage points. In 1979 the United States' rate is likely to be nearly 3 percentage points *below* that of its major partners.

The divergent demand management attitudes required by the OECD concerted action programme of last June were implemented by Japan, Germany and the United States in the following months. The policy packages are complex, particularly in the case of Japan and Germany, and the size and the time profile of their overall effects are necessarily somewhat uncertain[1]. In Japan the 7½-7¾ per cent rate of growth of domestic demand achieved throughout 1978 is likely to continue in the first half of 1979, but could fall back to around a 5 per cent rate in the second half of the year, when the direct effects of the special measures wear off, if no further support is provided. In Germany, some slight further acceleration of domestic demand growth seems likely from the 5 per cent rate achieved in the second half of 1978. After the projected mid-1979 increase in value-added tax rates this growth could slow down unless the autonomous forces which underlie private sector expenditure turn out to be more buoyant than expected: the rate is forecast to decline to around the 3½ per cent mark in the second half of the year. Domestic demand growth in the United States will be affected to an important extent by the course of monetary policy; a continuation of relatively tight monetary policy through 1979 could temporarily reduce the growth of domestic expenditure to around 1 per cent.

The substantial changes in exchange rates since the forecasts in the July *Economic Outlook* were made – an effective revaluation of 15 per cent for the yen and devaluations of around 9 per cent for the United States and slightly more for Canada – should serve to stimulate net exports in volume terms from the North American countries, with the opposite development in Japan. Exchange rate changes and relative domestic demand movements should therefore have mutually-reinforcing favourable effects on foreign balances in real terms. Because exchange rates have changed so sharply, to all-time high or low values, quantification of their effects is more than usually uncertain. But the change in Japan's real foreign balance (goods and services) could be considerable. Conversely, in the United States, the change in the foreign balance could contribute perhaps a quarter of a percentage point to GNP growth in the first half of 1979 and twice as much in the second; in Canada too, a substantial

1. A simulation of the likely effects of the measures, considered by themselves, is given in Table 10 and discussed in the accompanying text. A description of the basic model used to perform the simulation exercise will be contained in an *Occasional Study* accompanying the present issue which will be made available in January 1979 ("The OECD International Linkage Model", OECD, *Occasional Studies*, January 1979).

Summary of demand and output forecasts
Per cent changes, annual rates

	Total domestic demand						
	From previous year			From previous half-year			
	1977	1978	1979	1978		1979	
				I	II	I	II
Total OECD	3½	3½	3¼	3½	4¼	3	2¼
of which:							
United States	5½	3¾	1½	3	3½	1	½
Japan	4	6½	7	7¾	7¾	7¾	5¼
Germany	2½	3¼	4¾	2¾	5	5¼	3½
Total OECD *less* the United States	2	3¼	4¼	3¾	4½	4½	3½
	Real GNP						
Total OECD	3¾	3½	3	3½	3¾	2¾	2½
of which:							
United States	5	3¾	2	2¾	4½	1¼	1
Japan	5¼	5¾	4¾	7¾	4	5¼	4¼
Germany	2½	3	4	2¾	4	4¼	3¼

positive contribution is expected. Major countries' GNP growth rates should therefore be distinctly less divergent than the trends of domestic demand. GNP could grow by 2 per cent in the United States in 1979, 4 per cent in Germany, and 4½ to 5 per cent in Japan.

There should ensue, over time, a much less uneven pattern of current payments balances. In the short run, the favourable movements of real exports and imports may be obscured, in the value figures, by terms of trade movements: the "J-curve" effects push up Japan's export prices and the United States' import prices in dollar terms. Even so, if there are no further important changes in effective exchange rates (and this as usual is assumed in the present forecasts) the United States current account deficit and the Japanese surplus might both be roughly halved in dollar terms in 1979 and the German surplus could be substantially reduced. France, Italy and the United Kingdom could well remain in surplus. The combined balance of smaller OECD countries, stubbornly high for several years, has probably already shrunk in 1978 by

Current balances[a]
$ billion

	1974	1975	1976	1977	1978	1979
Total OECD	–27½	0	–19	–27½	–½	–1½
of which:						
United States	1.7	18.4	4.3	–15.3	–18	–8
Japan	–4.7	–0.7	3.7	10.9	20	12
Germany	9.8	4.0	3.8	3.7	6	2½
Other major European countries	–22.6	–4.9	–11.0	–0.5	7	8½
Benelux-Switzerland	2¾	4¾	6	2.9	3	4
OPEC	59	27	37	31½	11	7½
Non-oil developing countries	–24½	–38½	–26	–24	–34	–38

a) Including official transfers.

over $10 billion, largely as a result of measures to limit domestic demand and inflation, with particularly big swings in Sweden, Norway, Austria, Spain and Turkey. The situation of this group is expected to be consolidated in 1979.

There are, thus, grounds for cautious optimism about the outlook for the international pattern of demand, at least through to mid-1979, in the three largest OECD countries. At the same time, a disturbing feature of the outlook is the recent deterioration in the United States price performance and the risk of a continued widening of inflation differentials vis-à-vis other major countries; hence the importance to be attached to achievement of the aims of the Administration's anti-inflation programme. Given the need to consolidate the recent strengthening of the dollar, a temporary period of slow growth of the United States economy is probably both inevitable and, given the reduction of unemployment already achieved, to be welcomed. The measures to support demand growth in both Germany and Japan, together with such steps as the other three stronger-currency countries – Belgium, the Netherlands and Switzerland – may be able to take to this end, should help to moderate the impact on other economies of the United States' slowdown.

Unemployment rates, estimates and forecasts
Per cent of civilian labour force, seasonally adjusted

	1978	1979	1978 I	1978 II	1979 I	1979 II
Total OECD[a]	5¼	5½	5¼	5¼	5½	5½
of which:						
United States	6	6½	6	6	6¼	6¾
Japan	2¼	2½	2¼	2¼	2½	2½
Germany[b]	4½	4½	4½	4½	4½	4½
Total OECD Europe[c]	5½	5¾	5½	5½	5½	5¾

a) Representing over 90 per cent of the OECD labour force. A rate of 5 per cent represents approximately 15 million unemployed excluding Portugal and Turkey; including these countries could add 2½ million to the number unemployed.
b) As a percent of dependent labour force.
c) Excluding Portugal and Turkey.

Scope for Further Action

The OECD programme also envisages that a number of "convalescent" economies so far operating under inflation and balance-of-payments constraints might, when lower inflation permits, take advantage of the elbow-room imparted to their external positions by growth in the strong-currency countries and expand, somewhat, their own domestic demand. Such elbow-room has already begun to emerge, and in some cases may even increase. But for most of the convalescent countries the problem of inflation, if less acute than earlier, is still a difficult one. Present stabilisation policies in many of the smaller countries should bring price increases more in line with the average of the larger countries in 1979, after a gap in performance which amounted to over 3 percentage points in 1977 and 2 points in 1978. And many countries, both large and small, are benefitting from the effect of depressed primary product markets on consumer prices. But a further large fall in the prices of primary products relative to manufactures would seem unlikely in 1979; and the expected behaviour of the domestically-generated components of inflation, as broadly indicated by movements of the GNP deflator, can hardly be considered as being satisfactory, yet, from the point of view of future sustained growth.

Summary of price forecasts
Per cent changes, annual rates

	Consumer prices[a]						
	From previous year			From previous half-year			
	1977	1978	1979	1978 I	1978 II	1979 I	1979 II
Total OECD	7¾	6¾	6½	6¾	6¾	6½	6½
of which:							
United States	5¾	7	7	7¾	7	7¼	7
Japan	6½	4	4	3½	3½	4	5
Germany	3¾	2¾	2¾	2½	2¼	2¾	3¼
Total OECD Europe	10	7½	6¾	7	7	6½	6½

a) Or private consumption deflators.

The convalescent countries have therefore still to guard against any demand-management action which would exacerbate inflation. In each of the four large countries in this category, there are particular reasons why the timing of any further measures would need to be subject to extreme care. In France, the economy is in the process of adjusting to the lifting of price controls. In the United Kingdom, the Phase IV wage round is at a critical stage. In Italy, measures envisaged in the Government's three-year plan still have to be adopted and the outcome of important wage negotiations is uncertain. In Canada, the transition from a period of wage and price controls has to be completed. And in a number of smaller countries there is continuing need for caution, lest the gains achieved by dint of courageous reductions of real income be dissipated by untimely reflationary action.

Although there is further to go, the parts of the OECD's concerted action programme which applied to domestic demand and stabilisation aims could fairly be said to be in course of implementation in most countries. One precautionary note which may have to be struck arises from the possibility, illustrated by the forecasts presented in the current issue, of some new weakening of domestic demand growth in the latter part of 1979 in both Japan and Germany. Capacity utilisation levels expected in the early parts of the year, and relatively depressed export prospects, may not be sufficient to spark off the investment boom needed if autonomous private sector demand is to take over the running from policy-induced boosts. This forecast could prove pessimistic. Turbulence in the foreign exchange market over the last year has almost certainly depressed confidence. If calmer conditions prevail through 1979, private sector expenditure could be more buoyant than presently suggested. Nonetheless, it will be appropriate for governments to be alert to forward-looking indicators as the moment approaches for the mid-year VAT increase in Germany and for the exhaustion of the present stimulus from public expenditure in Japan. It is certainly not yet clear that, after mid-1979, private sector demand will be imparting the desired stimulus in either country.

Flanking Policies

When governments of the countries still experiencing inflationary constraints eventually feel able, cautiously, to avail themselves of their external elbow-room to undertake internal expansionary measures, it is highly desirable that they select policies which can actually help reduce the risk of inflation. It would make more sense in many

countries to stimulate demand by cutting taxes, with a beneficial effect on the general price level, than to make substantial increases in government expenditure. More generally, however, the problem of how to consolidate – or further reduce – rates of inflation under conditions of moderate but steady expansion of demand is one that is exercising virtually all governments. Firm demand-management policies are a prerequisite. But because of the *momentum* of inflation inherited from the past, a return to earlier low wage and price trends solely *via* the demand-management route may, for many countries, be far more costly than in the past, and perhaps in some countries seem socially and politically unacceptable in terms of lost output and employment. Hence, the renewed interest in policies aimed more directly at breaking the wage-price spiral. In recent years, a number of countries have tried various forms of price and incomes policies to this end. These include voluntary wage guidelines (with norms that allow nominal wages to rise in step with consumer prices or which limit the rise in real wages to that of productivity), mandatory wage and price controls and temporary wage and price freezes. Some countries have also resorted to conditional income tax reductions in an attempt to curb nominal wage claims. The use of tax-based incomes policies (TIP) to reward wage and price restraint and/or penalise excessive increases has also attracted growing attention in policy discussions: the latest United States stabilisation programme includes a proposal along these lines.

Experience with incomes policies differs between countries: so does interpretation of the results. Some consider that prices and incomes policies can be useful in breaking, shortly and sharply, the spiral of inflationary expectations, but that in the longer run they are at best unhelpful, and may actually make matters worse by introducing or exacerbating distortions in the economy. Others hold that only if a price and incomes policy is kept in place for some time, perhaps a number of years, can the chain of inflationary expectations be firmly and demonstrably broken. A third view is that such policies, whether applied for a short period or for a run of years, are at best useless and at worst harmful. These views are not necessarily inconsistent, for policies which work in one country may well not work in another. And policies found to be appropriate in one period can subsequently be found to be less useful. What is clear is that price and incomes policies may complement – but certainly cannot be a substitute for – appropriate macroeconomic policy, and can succeed only if backed by a broad social consensus.

Success in returning, on a sustainable basis, to a more acceptable rate of growth will depend, in the slightly longer run, not only upon policies aimed directly at the further reduction of inflation, but on the other associated policies which were thrown into relief when the concerted action programme was adopted last June. These include the maintenance of an open multilateral trading system and the successful conclusion of the Tokyo round of trade negotiations, which have an obvious bearing on price stability and business confidence in the future. They also include action to reduce dependence upon imported energy and to adjust industrial structures to changing patterns of demand. Progress in some of these areas has so far been very limited, and the difficulty of implementing appropriate policies is understandable. The incentive to persevere with politically-unpopular energy policies has been weakened by the fact that softer oil prices, in conjunction with Alaskan production, have, for the time being, substantially reduced the area's oil-related deficit. The pressure to take defensive measures of various types to prop up weak sectors and firms has grown in countries where unemployment has been high, external demand weak and competition from imports

strong. These are classic examples of the danger which short-term policies entail for prosperity over the longer-term. If, as intended, economic activity picks up, the absence of satisfactory energy policies would substantially strengthen the demand for and the price of oil with serious consequences both for the external balance and inflation. Every 10 per cent rise in the price of oil adds, given associated increases in the price of other forms of energy, nearly one half of a percentage point to the area's inflation rate and $ 12-14 billion to the area's oil import bill: the present forecasts are based on the technical assumption of an oil price-rise of about 5 per cent. Similarly, more rapid growth could lead to bottlenecks if countries adopt defensive industrial and employment policies. These will leave their economies with outdated industrial structures and render them ill-equipped to take advantage of stronger demand conditions.

These are not new dangers. The better conditions into which OECD's economies should be moving in 1979 as the result of recent national and international efforts can help governments to cope with them and head off the growing tendencies towards inflexibility of structures and public resistance to change. If the international pattern of demand develops as forecast over the coming few months, apparent structural problems may be found less forbidding than currently supposed. But a primary condition for economic progress may lie in a further important reduction in the general rate of inflation and in the disparities between individual inflation rates. This will require, in most OECD countries, that governments and electorates persevere in the counter-inflationary efforts on which they are embarked.

5th December 1978.

DOMESTIC DEVELOPMENTS

DEMAND, OUTPUT AND EMPLOYMENT

TRENDS AND PROSPECTS

In the first half of 1978, the quarterly pattern of activity was heavily influenced by weather conditions and other short-term irregularities. The growth of the OECD area's GNP and total domestic demand, of about 3½ per cent at an annual rate, remained broadly unchanged from the previous half-year. In the major seven countries, where the average GNP growth rate was 4 per cent, there was some recovery in private investment and a swing in the contribution from stockbuilding, partially offset by slower growth in public expenditure and a smaller contribution from the change in the foreign balance.

Inflation in the first half of the year speeded up in a number of OECD countries. This was most pronounced in North America, largely because of increases in food prices. Although some improvement has occurred in the past few months as the rise in food prices has abated, the rise in labour costs and the slow growth of productivity in a number of countries suggests that there has been little fundamental improvement in the inflation situation for the area as a whole. Employment growth continues to be surprisingly strong, and productivity growth sluggish. This has led in turn to a slight fall in unemployment rates in a number of countries. On the external side, the initial terms of trade effects following the exchange rate changes of the previous half-year led to an increase in the Japanese and German current account surpluses and an enlarged U.S. deficit. In Italy, the current surplus increased further. There was also an improvement in the situation in France, where the current account moved significantly into surplus, and in many smaller European countries, where deficits declined sharply.

Total domestic demand growth in the OECD area as a whole probably strengthened in the second half of 1978, to an annual growth rate of around 4¼ per cent (Table 3). The growth of public sector demand is likely to have been particularly important in the seven major countries considered as a group, with the considerable improvement in the OECD area's terms of trade also having been an additional contributing factor (Table 4). The growth of domestic demand may have been strongest in Japan, at an annual rate of about 7¾ per cent, partly on the assumption that some of the effects of the substantial supplementary measures announced by the Japanese authorities during the summer will have been felt towards the end of the year. Demand is expected to have strengthened

Table 1
Growth of real GNP in the OECD area

Percentage changes seasonally adjusted at annual rates

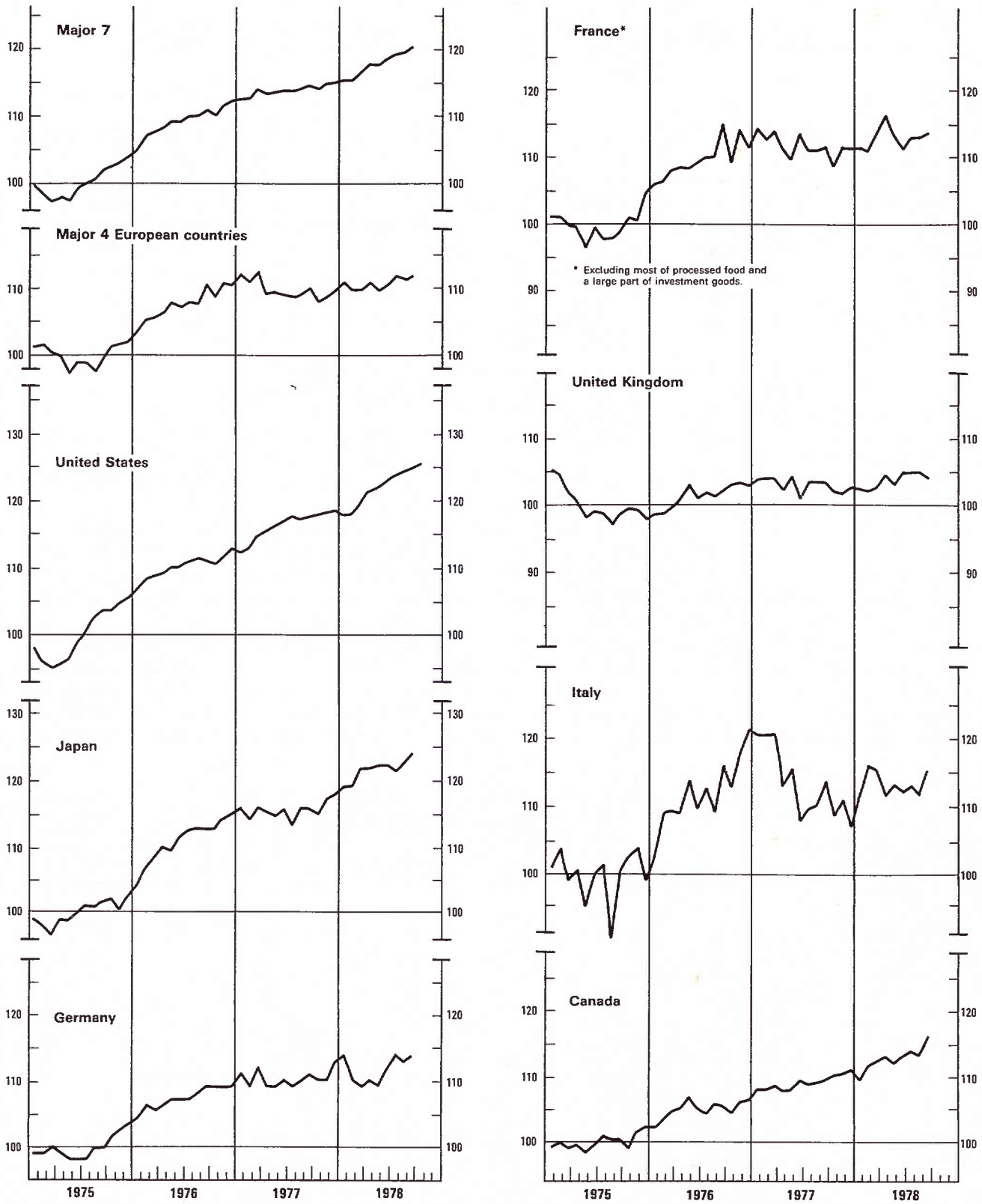
	Weights in total[a]	Average 1965-66 to 1975-76	From previous year			From previous half-year				
						1977	1978		1979	
			1977	1978	1979	II	I	II	I	II
United States	38.9	2.7	4.9	3¾	2	5.1	2.8	4½	1¼	1
Japan	14.1	8.2	5.2	5¾	4¾	3.7	7.8	4	5¼	4¼
Germany	10.6	3.3	2.6	3	4	2.1	2.8	4	4¼	3¼
France[b]	7.9	4.7	3.0	3	3½	2.7	3.4	2¾	3¾	3½
United Kingdom[b]	5.1	2.1	1.6	3	2¼	3.0	3.1	2½	2¼	1½
Canada	4.1	4.7	2.7	3½	4	2.5	4.1	3¾	4	4¼
Italy[b]	4.0	4.1	1.7	2	3½	-3.6	4.2	3¼	3½	4
Total of above countries	84.7	4.0	4.0	3¾	3	3.6	3.9	4	2¾	2½
Other OECD countries[c]	15.3	4.4	1.8	2¼	3	2.2	2.0	3¼	2¾	2¾
Total OECD	100.0	4.1	3.7	3½	3	3.4	3.6	3¾	2¾	2½
Memorandum items										
Four major European countries	27.6	3.6	2.4	2¾	3½	1.6	3.2	3¼	3½	3¼
Industrial production:										
Seven major countries[a]	—	4.0	4.1	4¼	3¾	2.0	4.6	6¼	3¼	2¼
Total OECD[a]	—	4.2	3.7	4	3¾	1.5	4.2	6	3¼	2¼

a) 1977 GNP/GDP weights and exchange rates.
b) GDP.
c) For details, see Table 2.

CHART A

INDUSTRIAL PRODUCTION
in seven major countries

Monthly index s.a. 1975 = 100



in the United States, reflecting carry-over from the strong second quarter surge. Higher private investment and buoyant stockbuilding are expected to have given a fillip to growth in Germany, and some pick-up of domestic demand growth is expected in Italy. Although information on the profile of half-yearly developments is limited for the smaller countries as a group, domestic demand in a number of them should have recovered from the extremely low levels of the first half of the year. In the remaining larger countries, the rate of domestic demand growth is expected to have decreased.

GNP growth for the area at a rate of 3¾ per cent may have been somewhat slower than domestic demand growth, reflecting a negative swing in the contribution of the foreign balance of ¼ of a percentage point (Table 1). But the position is likely to have varied, to an important degree, among countries. In Japan, the successive appreciations of the yen may have sharply curtailed real export growth while markedly increasing import volumes, resulting in a negative contribution of the change in the real foreign balance of a full 3 per cent of GNP. Higher imports and less buoyancy in exports in Germany should, similarly, have lead to a negative contribution by the foreign balance, perhaps of ¾ of a per cent. In contrast, the United States is likely to have experienced an acceleration in export demand and a deceleration in import growth: GNP may therefore have risen at a 4½ per cent rate, approximately 1 per cent faster than domestic demand.

Table 2
Growth of real GDP in other OECD countries
Percentage changes

	Weights in total OECD[a]	Average 1965-66 to 1975-76	From previous year 1977	1978	1979
Australia	2.0	4.6	2.1	2½	2¾
New Zealand	0.3	3.2	–1.8	¾	2¼
Austria[b]	1.0	4.5	3.5	1½	2¾
Belgium[b]	1.6	4.1	1.2	2¼	3¼
Denmark	0.9	3.3	1.8	1	2½
Finland	0.6	4.6	0.5	3	3½
Greece	0.5	6.2	3.7	5½	3½
Ireland	0.2	4.0	5.5	6½	4
Netherlands	2.2	4.7	2.3	2	3
Norway	0.7	4.6	4.1	3¾	2½
Spain	2.4	6.3	2.4	3	3½
Sweden	1.6	3.1	–2.5	2¼	3½
Switzerland[b]	1.3	2.2	2.7	1	½
Total smaller European countries	13.0	4.4	1.8	2¼	3
Total of above countries	15.3	4.4	1.8	2¼	3
Memorandum items					
OECD Europe	40.6	3.9	2.2	2¾	3¼
EEC	32.5	3.7	2.3	2¾	3¼

a) 1977 GNP/GDP weights and exchange rates.
b) GNP.

The outlook for 1979

The forecasts for the two half years of 1979 are based on the customary assumptions of unchanged policies and exchange rates. The configuration of the present forecasts suggests, for the area as a whole, some deceleration of domestic demand growth in the course of 1979, broadly reflecting a weakening in the United States economy and, in the second half of the year, the technical assumption that policies in both Japan and Germany become less expansionary. *In the first half*

Table 3
Development of total domestic demand in OECD area
Percentage changes, volume seasonally adjusted at annual rates

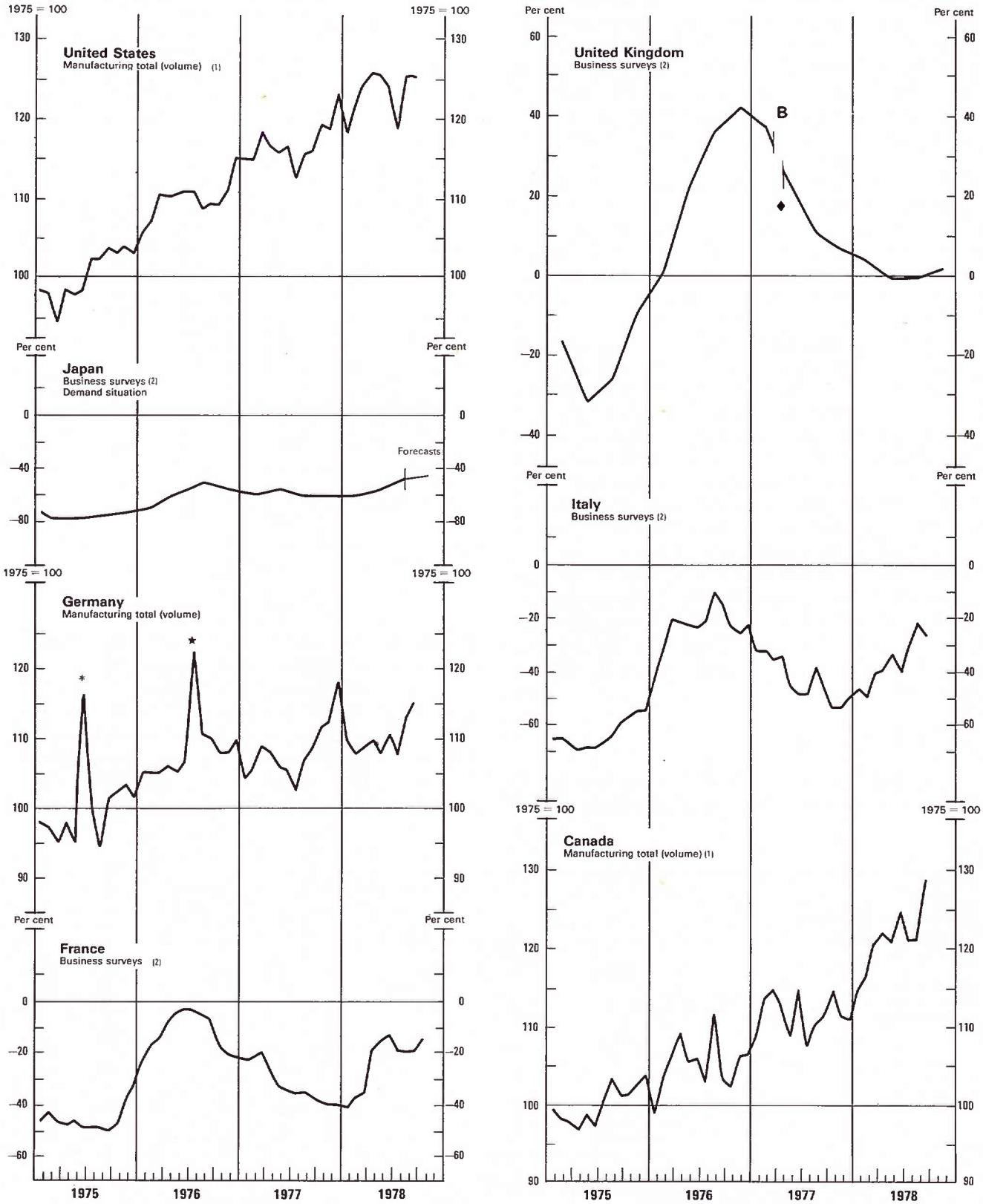
	From previous year 1977	1978	1979	From previous half-year 1977 II	1978 I	1978 II	1979 I	1979 II
United States	5.4	3¾	1½	5.7	3.0	3½	1	½
Japan	4.0	6½	7	3.5	7.7	7¾	5¼	5¼
Germany	2.6	3¼	4¾	3.1	2.7	5	5¼	3½
France	2.0	2¾	3½	1.8	3.3	2¾	4	3¾
United Kingdom	–0.1	4	2	–1.3	7.3	3	2¼	1¼
Canada	1.3	2¾	3½	0.5	3.5	3½	3¼	4¼
Italy	0.1	1¼	4	–6.0	3.4	4½	3¼	4½
Total of above countries[a]	3.7	4	3¼	3.4	4.1	4¼	3¼	2¼
Other OECD countries[a]	1.5	1	2¾	..	..	..	..	..
Total OECD[a]	3.4	3½	3¼	3.0	3.5	4¼	3	2¼
Memorandum item								
Four major European countries[a]	1.6	3	3¾	0.6	3.8	3¾	4	3¼

a) 1977 GNP/GDP weights and exchange rates.

CHART B

SELECTED INDICATORS OF ORDERS

monthly, seasonally adjusted



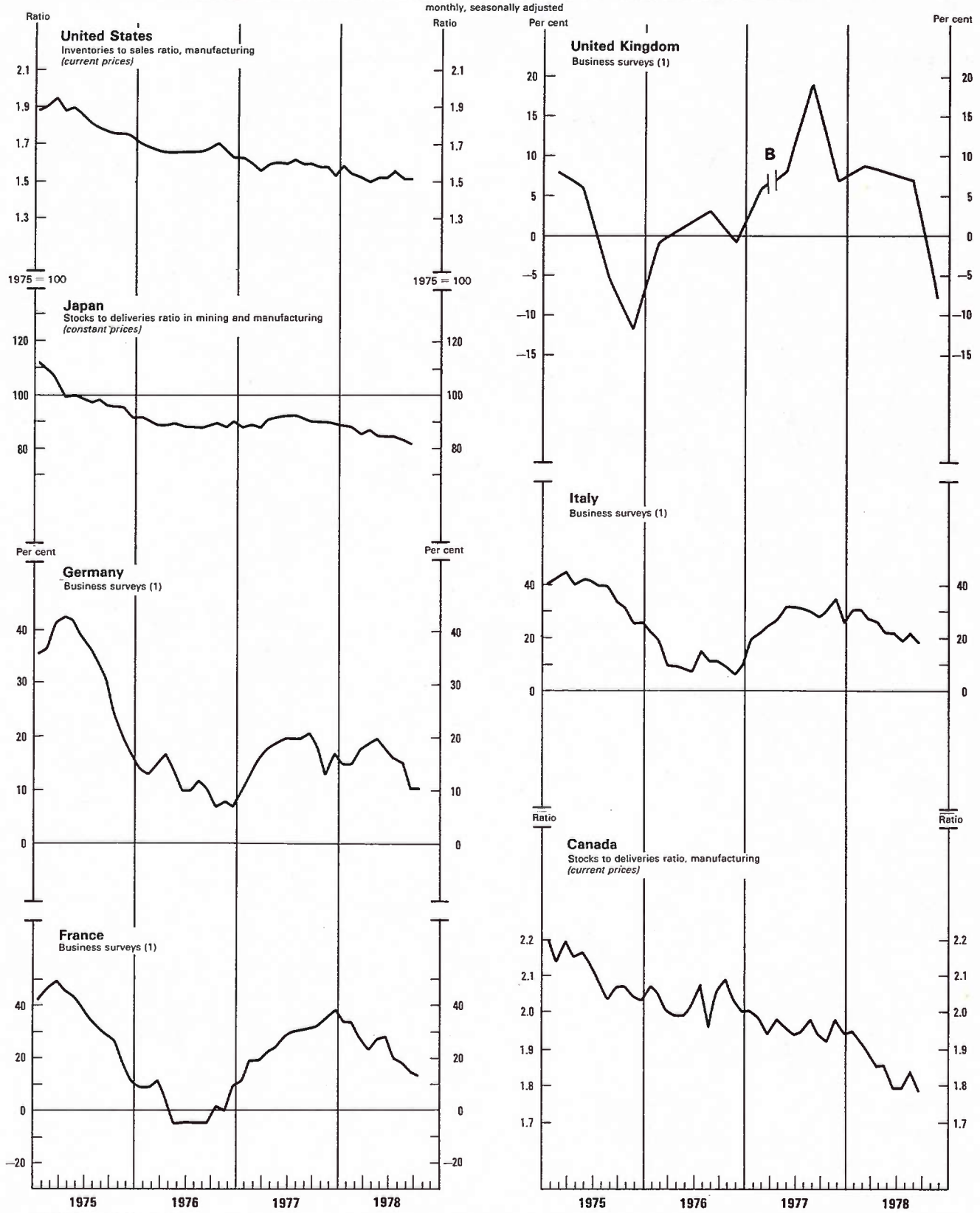
1. Deflated by the OECD. 2. % balance of positive over negative replies.
◆ From April 1977 in volume terms. In value terms previously.

* Affected by order deadline for 7 1/2 per cent investment subsidy in June 1975.
★ Affected by orders for large-scale projects.

CHART C

SELECTED INDICATORS OF STOCKS OF MANUFACTURES

monthly, seasonally adjusted

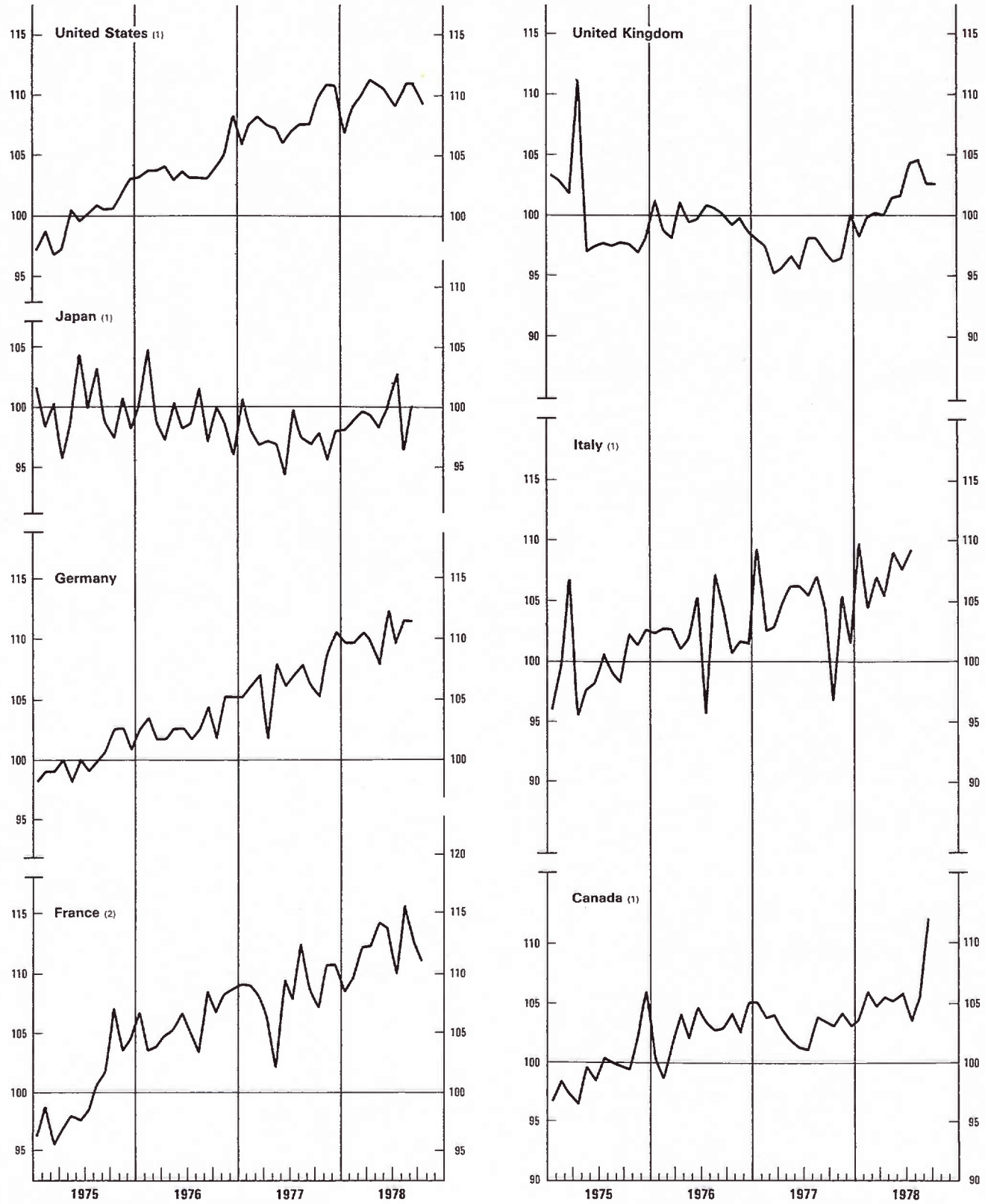


1. % balance of positive over negative replies.
◆ From April 1977 in volume terms. In value terms previously.

CHART D

RETAIL SALES

Monthly index, s.a., 1975 = 100, volume



1. Deflated by the OECD. 2. Consumption of industrial goods.

of 1979, total domestic demand for the area as a whole is now expected to grow at a rate of 3 per cent, about 1 per cent less than in the second half of 1978 (Table 3). But under present circumstances, OECD totals are probably less important than the way they are broken down between countries: the total conceals very important differences, particularly between Japan and Germany on the one hand, and the United States on the other. Thus, it is expected that by early 1979, the rate of domestic demand growth in the United States will be considerably below that of Europe, the first time that this has happened since the latter part of 1975. The continuation of expansionary policies in Japan (in the form of higher public expenditure and aid to housing in the first quarter) and measures to boost consumption in Germany at the beginning of 1979 should maintain high rates of growth of domestic demand in these countries. There may also be some modest pick-up in France, with consumption recovering somewhat but other demand components remaining depressed. In the United States, on the other hand, higher social security taxes and the recent further tightening of monetary policy are likely to reduce total domestic growth to around 1 per cent: all domestic demand components, and in particular housing expenditure, are expected to weaken. In the United Kingdom, the forecast slowdown in real wage increases, on the assumption that the proposed government guidelines are largely met and no tax relief occurs in 1979, could lead to a sharp decline in the growth of consumption, but weaker final domestic demand may be partly offset by a smaller negative contribution from stockbuilding.

For the area as a whole, the negative contribution from the change in the foreign balance of ¼ of a per cent of GNP is expected to be smaller than in the previous half-year, and the GNP growth rate of 2¾ per cent should be only slightly below that of domestic demand. However, a substantial variation among countries in the contribution of the change in the foreign balance is again likely. In Japan, a continued decline in export growth and a further rapid increase of imports is forecast, so that GNP growth—despite the strength of domestic demand—may be limited to about 5¼ per cent. Similar developments are forecast for Germany; imports seem likely to continue to rise strongly, and the negative contribution of the foreign balance change may keep the GNP growth rate down to about 4¼ per cent. The counterpart to this would be a positive contribution from the foreign balance in the remaining larger countries except France. A forecast slowdown in imports underlies the ¾ of a percentage point contribution to growth in Canada. In the United States, the positive contribution from the foreign balance may be around ¼ of a percentage point, implying GNP growth of around 1¼ per cent. The rapid growth of German imports is expected to benefit a number of smaller European countries, which should experience a significant improvement in their foreign balances.

The forecasts for total domestic demand *in the second half of 1979* reflect in large part the policy assumptions for the largest OECD countries. It has, as is customary in the forecasting procedure, been assumed that no supplementary expansionary measures will be undertaken in Japan[1]. For Germany the announced increase in VAT rates (net of increased transfers to households) in the middle of the year would partly reverse the effects of the stimulatory measures taken in the earlier part of the year, and reduce demand growth by about ¾ percentage point at an annual rate. For the United States, it is assumed that monetary policy will remain tight. Given these assumptions, total domestic demand growth for the area as a whole is forecast to decelerate by about ¾ of a percentage point between the two half years to a rate of approximately 2¼ per cent. A deceleration in domestic demand growth is forecast for both the United States, reflecting more sluggish stockbuilding and a decline in non-residential investment, and the United Kingdom, where growth of consumption is likely to be slow. In contrast, some acceleration in demand growth may occur in Canada, where consumption may recover with rising wages, and in Italy, as a result of the stepping up of the public investment, a recovery in private non-residential investment, and a fall in savings ratios.

The change in the foreign balance may be very small for the area as a whole in the second half of 1979. Given the deceleration in domestic demand growth forecast for Japan and Germany, the negative impact of the change in the foreign balance could be less important than in the previous two half-years. In Italy, an acceleration in domestic demand growth could lead to faster import growth and a negative contribution from the change in the foreign balance. On the other hand, a continued rapid rate of growth of exports relative to imports for the United States would mean that the foreign balance remained a positive element in GNP growth, while in the United Kingdom increasing North Sea oil production could make a substantial positive contribution.

1. Government expenditure in FY 1979 is taken to grow at about the rates suggested in the FY 1978 budget.

Table 4
Contributions to changes in real GNP/GDP
As a per cent of GNP/GDP in the previous period
seasonally adjusted annual rates

	1977	1978	1979	1977 II	1978 I	1978 II	1979 I	1979 II
Seven Major Countries[a]								
Private consumption	2.2	2¼	1⅜	2.2	2.2	2¾	1⅜	1¾
Public expenditure[b c]	0.5	⅜	1	1.0	0.4	1¼	1	¾
Private residential construction[b c]	0.3	¼	0	0.2	0.2	0	−¼	0
Private non-residential investment[b]	0.6	½	½	0.3	0.7	½	½	¼
Stockbuilding	0	0	0	−0.4	0.3	0	0	−½
Foreign balance	0.4	0	−¼	0.2	0	−¼	−¼	¼
GNP/GDP	4.0	3⅜	3	3.6	3.9	4	2¾	2½
United States								
Private consumption	3.0	2¾	1¼	2.9	1.9	2½	1	1
Public expenditure	0.5	½	½	1.2	−0.2	1	½	½
Private residential construction	0.8	¼	−½	0.6	0	0	−½	−½
Private non-residential investment	0.9	¾	¼	0.6	0.8	½	¼	−¼
Stockbuilding	0.2	¼	−¼	0.3	0.4	−½	0	−½
Foreign balance	−0.5	0	½	−0.5	−0.1	1	¾	½
GNP	4.9	3¾	2	5.1	2.8	4½	1¼	1
Japan								
Private consumption	2.1	2½	2½	1.2	3.1	2¾	2½	2¼
Public expenditure	1.2	2¼	2¾	2.2	1.7	3	3¼	1¼
Private residential construction	0.1	⅜	⅜	−0.1	1.5	¼	½	½
Private non-residential investment	0.2	⅜	1	0.3	0.9	1	¾	¾
Stockbuilding	0.2	−¼	0	−0.3	−0.3	0	0	0
Foreign balance	1.5	−¼	−2	0.5	0.7	−3	−2	−¾
GNP	5.2	5¾	4¾	3.7	7.8	4	5¼	4¼
Germany								
Private consumption	1.7	1¾	2½	2.7	1.6	1½	3	2
Public expenditure	0	¾	½	0.5	0.9	¼	¾	½
Private residential construction	0.2	¼	¼	0.1	0.1	½	¼	¼
Private non-residential investment	0.8	½	¾	0.5	0.5	¾	1	¾
Stockbuilding	−0.3	0	½	−0.9	−0.5	1¾	0	−¼
Foreign balance	0	−¼	−½	−0.9	0.2	−¾	−¾	−¼
GNP	2.6	3	4	2.1	2.8	4	4¼	3¼
France								
Private consumption	1.5	2	2	1.7	2.3	1¾	2¼	2
Public expenditure[c]	0.7	¾	¾	0.8	0.9	¾	¾	¾
Residential construction[c]	−0.2	−¼	−¼	−0.3	−0.2	−¼	−¼	0
Private non-residential investment	−0.1	0	½	−0.3	0.1	¼	½	½
Stockbuilding	0.1	0	½	−0.1	0.2	0	½	½
Foreign balance	1.0	¼	0	0.8	0	0	0	0
GDP	3.0	3	3½	2.7	3.4	2¾	3¾	3½
United Kingdom								
Private consumption	−0.6	3¼	1¾	1.9	4.1	3	1½	½
Public expenditure	−1.2	0	¾	−0.1	−0.6	¾	½	¾
Private residential construction	−0.3	0	0	0.3	−0.2	0	−¼	0
Private non-residential investment	0.7	1	0	0.5	1.9	−¼	¼	−¼
Stockbuilding	0.7	0	−½	−2.1	1.7	−1¼	−¼	¼
Foreign balance	1.8	−1	¼	4.3	−3.9	−¼	¼	½
Compromise adjustment	0.5	−¼	¼	−1.7	0.1	½	¼	0
GDP	1.6	3	2¼	3.0	3.1	2½	2¼	1½
Canada								
Private consumption	1.8	2	2¼	0.9	2.7	2	2	2¾
Public expenditure	0.5	½	¾	−0.2	0.8	½	½	½
Private residential construction	−0.3	−¼	0	−0.3	−0.3	0	0	¼
Private non-residential investment	0.2	¼	½	−0.2	0.4	½	½	½
Stockbuilding	−0.8	¼	¼	0.3	−0.1	¾	0	¼
Foreign balance	1.0	1¼	½	1.3	1.6	0	¾	0
Error of estimate	0.3	−½	0	0.6	−1.2	0	0	0
GNP	2.7	3½	4	2.5	4.1	3¾	4	4¼
Italy								
Private consumption	1.4	1¼	2¼	0	1.6	2	2¼	2½
Public consumption	0.3	¼	¼	0.4	0.3	¼	¼	¼
Residential construction	−0.1	0	0	−0.3	0	0	0	¼
Non-residential investment	0.1	−¼	½	−1.5	0.1	¼	½	¾
Stockbuilding	−1.6	0	½	−4.4	1.1	1¾	0	¼
Foreign balance	1.6	¾	−¼	2.3	1.0	−1	¼	−¼
GDP	1.7	2	3½	−3.6	4.2	3¼	3½	4

a) 1977 GNP/GDP weights and exchange rates.
b) Government fixed asset formation for Italy is included in private investment.
c) Public expenditure on housing in France is included under "Residential construction".

Risks and uncertainties

There are more uncertainties surrounding the preparation of these forecasts than is normally the case. The principal issues would appear to be:

a) *The quantification of the demand effects of policy measures.* Both the German and the Japanese measures are complex packages, involving goods and services expenditures, transfer payments and tax changes. The calculation of the fiscal impact, details of which are given below in the Fiscal and Monetary Policies section, are necessarily somewhat uncertain. In the United States, the effects of the assumed tighter monetary policy can only be approximated, as recent changes in the rules governing financial markets make it more difficult to foresee the impact of recent measures. Further, monetary policy, unlike a once-and-for-all budget, is an instrument which can be, and often is, varied frequently—for example, in response to higher inflation rates or unsettled conditions on exchange markets. The course of monetary policy over the period can therefore be forecast only imperfectly.

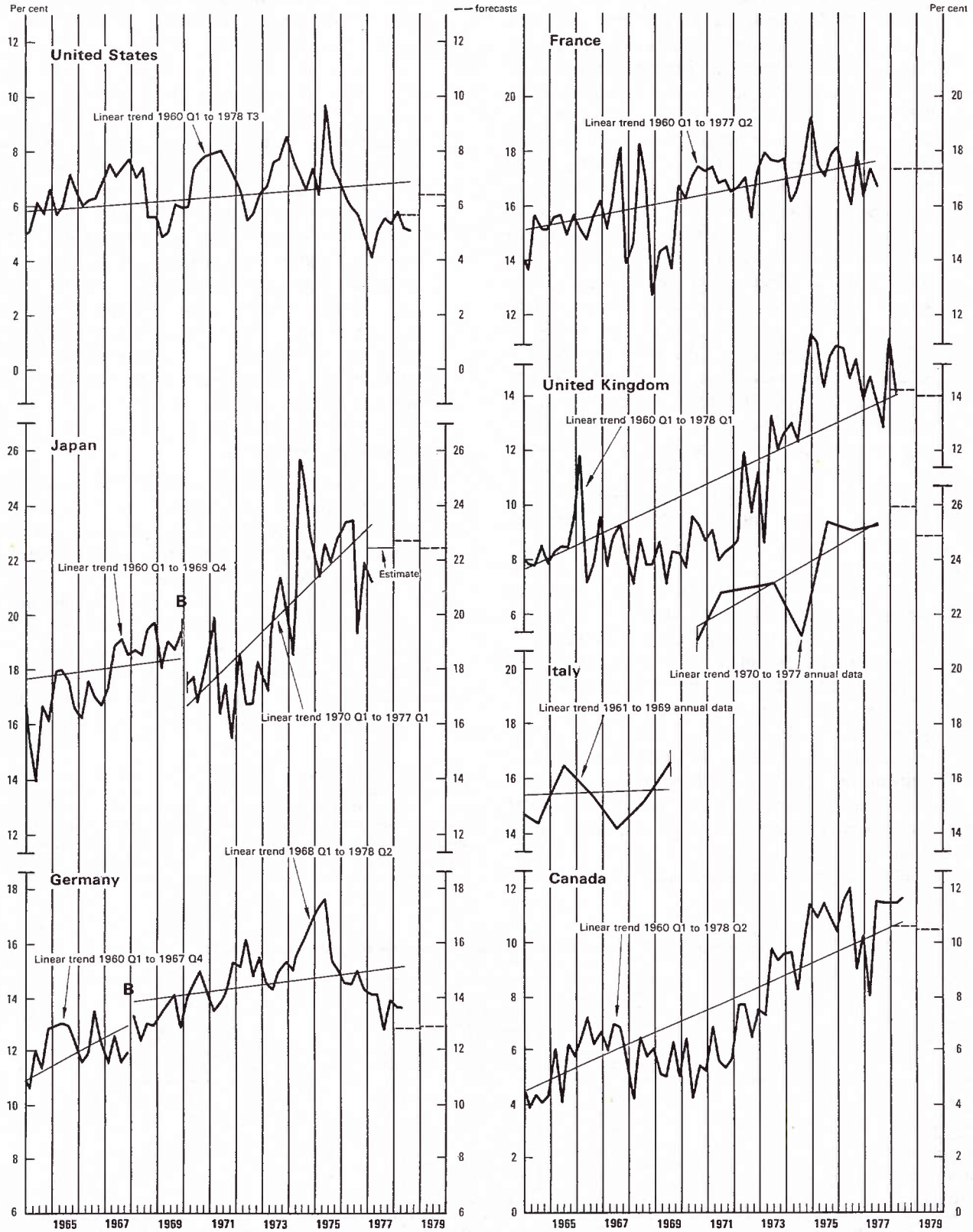
b) *The implementation and timing of the policy measures.* Given the substantial size of the Japanese public expenditure programme, the demands effects could appear later than is presently forecast, depending upon the interval between announcement and implementation. For Germany, the forecasts foresee a fairly rapid expenditure response to the measures in the first half of 1979. Slower growth might occur in Italy if the authorities failed to implement the public investment programme planned for the latter part of 1979.

c) *The impact and timing of exchange rate effects.* The movement of exchange rates outside their normal range of variation inevitably places doubt on the applicability of existing estimates of price elasticities for working out the volume effects on exports and imports. The present forecasts predict a large and rapid fall in the volume of Japanese exports, largely as a result of the assumption that a threshold has been reached at which Japanese exporters can no longer substantially offset the effects of revaluation by squeezing profit margins or by further reducing production costs. However, there will be some offset in the cost-price structure, particularly in the basic materials industries, arising from the substantial terms

CHART E

HOUSEHOLD SAVINGS RATIOS (1)

Quarterly, seasonally adjusted



1. Net savings as per cent of disposable income. In the case of the United States, Canada and particularly France, the forecast levels are not totally consistent with the savings ratios presented in the detailed tables in the Technical Annex, due to slightly different concepts of disposable income and savings. For Germany, savings exclude retained earnings of unincorporated businesses; in addition the savings ratios are slightly higher than those in the country forecasts because private transfers to pension funds are included in savings.

For Italy, the definition of the savings ratio has changed from net savings to gross savings in 1970, with the change in the system of national accounts.
For Japan, series have been seasonnaly adjusted by the OECD from 1970 Q1.

of trade gain. There is a possibility that adjustment lags may be longer than expected in the forecasts, which would reduce the strong forecast negative effect on output of the change in the foreign balance in the second half of 1978 and in 1979. Further, even if the export forecasts are borne out, it is extremely difficult to assess which other producing countries will fill the gap left by the exporters in the appreciating countries. Where domestic producers in the depreciating countries prove competitive in supplying their home markets, an important effect might lie in reduced imports. Elsewhere, traditional export competitors might be expected to pick up additional sales, but in quantifying the possible effects it is difficult to be sure that the standard method of allocating marginal changes in exports on the basis of market shares—even after adjusting for changes in competitive positions—will be correct if threshold effects are present. While this is unlikely to affect area demand, it could mean that the GNP of individual countries is forecast incorrectly as a result.

d) Terms of trade effects. For the area as a whole, there is a possibility that the improved terms of trade with the non-OECD area—which, in 1978, may have amounted to approximately ¼-½ of a per cent of GNP—will have greater stimulatory effects on demand than forecast. Past errors in forecasting OECD growth have, on occasions, been quite closely associated with terms of trade changes from outside the area. To the extent that the present forecasts underestimate this impact, GNP growth would turn out to be somewhat higher than expected, especially in the first half of 1979. In addition, substantial effects on the terms of trade of individual countries can result from changes in exchange rates. This phenomenon is likely to be particularly important in Japan, which as a result of a 15 per cent effective exchange rate change since *Economic Outlook,* No. 23, is likely to experience a terms of trade gain equivalent to about 1¼ per cent of GNP. It is assumed that slightly less than half of this gain accrues to the corporate sector in the form of higher profits, with the balance accruing to the consumer as higher real income. The effects on demand will depend upon the proportion of the gain which is spent: the assumption in the forecast is that about three quarters will be spent by the end of 1979, contributing perhaps half a percentage point to domestic demand (direct impact) in 1979.

Components of demand

With the growth of nominal wage rates and consumer prices slowing down in most major countries and with employment growing rapidly, real *private consumption* growth has generally been rapid in 1978[2]. The pattern of wage and price growth seems likely to be similar during 1979, but employment growth may be less in most countries, particularly in the United States. Real income growth is expected to slow down in 1979 for the United States and Japan but to accelerate somewhat in the major European countries (Table 5). Despite tax

2. Although real consumption for the seven largest countries increased in the first half of 1978 at a 3¾ per cent rate, around that recorded in the second half of 1977, the average was held down by the adverse weather and strikes in the United States and Germany; in the five remaining large countries, consumer outlays advanced at a 5 per cent rate compared with 2 per cent in the second half of 1977.

Table 5
Factors affecting real private consumption in seven major countries, 1977-1979
Percentage changes over previous year

	Real income of households before net taxes[a] (1)			Effect[b] of net taxes on real disposable income[a] (2) = (3) − (1)			Real disposable income (3)			Impact of changes in savings ratio on real private consumption (4) = (5) − (3)			Real private consumption (5)		
	1977	1978	1979	1977	1978	1979	1977	1978	1979	1977	1978	1979	1977	1978	1979
United States	5.2	5.2	3.4	−1.4	−1.1	−0.5	3.8	4.1	2.9	0.9	−0.5	−0.8	4.7	3.6	2.1
Japan	4.1	4.9	4.4	0	0.3	−0.2	4.1	5.2	4.2	−0.3	−0.4	0.5	3.8	4.8	4.7
Germany	2.8	2.6	3.7	−0.8	0.8	0.7	2.1	3.4	4.4	1.0	−0.2	−0.1	3.1	3.2	4.3
France	3.3	3.3	3.5	−0.3	0.4	0	3.1	3.7	3.5	−0.6	−0.4	−0.1	2.5	3.3	3.4
United Kingdom	−3.1	4.0	2.4	1.8	1.8	0.2	−1.3	5.8	2.6	0.4	−0.1	0.3	−0.9	5.7	2.8
Canada	2.0	1.8	3.1	1.0	1.1	0.6	3.0	2.9	3.7	−0.2	0.4	−0.1	2.8	3.3	3.6
Italy	1.3	1.5	3.4	0.1	1.0	−1.2	1.4	2.5	2.2	0.7	−0.5	1.2	2.1	2.0	3.5
Major seven countries	3.7	4.2	3.5	−0.6	−0.1	−0.2	3.1	4.1	3.3	0.5	−0.4	−0.2	3.6	3.8	3.1
Four major European countries	1.7	2.9	3.4	0	0.9	0.1	1.6	3.8	3.5	0.4	−0.3	0.1	2.0	3.5	3.6

a) Net taxes are taken to mean direct taxes (including social security contributions) *minus* transfers received. In the case of Germany, transfers paid are also included.
b) A positive (negative) value implies that net taxes as a proportion of before tax income has fallen (risen).

Table 6
Manufacturing capacity utilisation rates
Seasonally adjusted, per cent

	Average 1964-1973	1977 Q3	1977 Q4	1978 Q1	1978 Q2	1978 Q3	1978 Q4
United States Federal Reserve Board	85.4	83.0	82.9	82.1	84.0	84.9	
Japan MITI Index[a]	92.6	82.8	83.3	85.7	85.8	86.0	
Germany Ifo[b]	..	80.2	80.8	81.3	80.4	80.2	
France INSEE[c]	84.8	..	83.1	83.3	84.0	..	83.8
United Kingdom CBI[b d]	45.3	32	30	33	33	35	38
Canada Satistics Canada	88.1	83.6	84.3	84.3	86.4		
Italy ISCO[e]	78.5	71.6	71.5	72.1	72.7	72.8	

a) 1973 average = 100.
b) First month in period.
c) March, June and November; total industry.
d) Percentage of firms at full capacity.
e) Last month in period; average covers 1969-1973; total industry.

cuts in the United States and Germany, net taxes for the seven largest countries considered as a group may exert a negative effect of perhaps ¼ of a percentage point on real disposable income in 1979, primarily through fiscal drag[3]. For the four largest European countries as a group, virtually no impact from net taxes is foreseen; but since net taxes increased the growth of real disposable incomes by about 1 percentage point in 1978, a slowdown of real disposable income is expected in these economies taken together. Savings ratios for the major seven countries as a group seem likely to rise slightly and real consumption is now forecast to grow by around 3 per cent in 1979, compared with the 3¾ per cent expected in 1978. But the impact of higher savings ratios is likely to be most pronounced in the United States, where inflation may accelerate and consumer debt is high. In Europe, savings ratios should be broadly unchanged.

Public consumption is expected to grow about in line with past trends over the forecast period. With growth rising slightly in the United States in 1979, and a broadly unchanged trend in the remaining countries, public current expenditure in the major seven countries as a group may rise by about 3 per cent in 1979. *Public investment* is likely to be more buoyant and is expected to provide considerable support to aggregate demand up to the middle of 1979. In Japan, public investment will probably rise by nearly 30 per cent at an annual rate in the two half years ending in mid-1979, but there remain some doubts whether so large a programme can be implemented as planned. A rebound is probably taking place in the United Kingdom following the expenditure cuts in the first half, and public investment should rise by about 7 per cent over the same period. In France, public investment growth seems likely to be sustained throughout the forecast period at a rate of about 5 per cent, while in Italy, the projected public investment programme could well boost investment spending in the latter part of 1979.

Non-residential fixed investment picked up somewhat in the first half of 1978. The turnaround was more pronounced in Europe, where outlays in the four largest countries grew around 4¾ per cent, compared with virtual stagnation in 1977 second half. Recent indicators of orders and businesses' investment intentions point to continued, albeit moderate, strength for the remainder of 1978. In addition, capacity utilisation rates, which have been increasing since late 1977, are likely to rise further in the next few quarters as industrial production is forecast to grow faster than capacity in the majority of major countries. The financial position of firms is also more conducive to investment: the recent terms of trade gains experienced by most Member countries appear to have accrued more to profits than to wages. Business confidence has strengthened, especially in Germany where the

3. In addition, real disposable income will be depressed by the assumed suspension of income tax reductions in Japan and the return to a normal calendar of tax payments in Italy. Even in the United States and Germany, where household tax rates will be reduced in 1979, this positive influence on consumption will be to some extent offset by increases in other taxes: United States employer and employee social security contributions are to be raised on 1st January and German VAT on 1st July.

IFO business climate indicator for October recorded the highest level since 1973. In addition, several smaller countries have recently introduced selective measures to stimulate investment. These factors should contribute to a continued moderate growth of outlays for plant and equipment in 1979. However, in the United States, a slowdown is forecast to occur within 1979, on the assumption that the present high level of interest rates is maintained. Overall, business investment is forecast to grow by about 5½ per cent in 1978; while investment forecasts are always uncertain, it is questionable whether private non-residential investment in 1979 will be generally buoyant enough to take over from tax cuts and public expenditure increases as the main source of continued growth of demand.

Residential construction. The major seven countries as a group are expected to give virtually no support to aggregate demand growth over the forecast period. Although the level of residential building reached high levels during the first half of 1978 in the United States, Germany and Japan, it remains weak in the remaining countries. In the second half of 1978, declines or only modest growth in activity are expected in all countries except Germany, where the increase of permits in the first half of the year was particularly strong. During 1979, the effects of tighter monetary policy in the United States are expected to lead to considerable declines in residential construction, although this weakening may well be less than would be expected on the basis of past experience: changes in financial markets should make mortgage money easier to obtain than in comparable past periods of monetary stringency, and the underlying demand still appears strong. Additional government loans for housing in Japan in the second half of 1978 should lead to an increase in demand in the first half of 1979, moderating slightly in the course of the year as these measures wear off. In the remaining major countries, growth may remain modest at best. In Germany, this partly reflects supply constraints in the construction industry. In France and the United Kingdom, the high cost of mortgage funds and, in the latter, the squeeze on real incomes and a marked rise in house prices, may lead to a decline through the year.

In the first half of 1978, *stockbuilding* contributed a positive boost of ¼ of a point to GNP

Table 7
Unemployment rates in selected OECD countries
National definitions[a]
Per cent of civilian labour force, seasonally adjusted

	Peak 1955-73	1976	1977	1977 Q3	1977 Q4	1978 Q1	1978 Q2	1978 Q3	Average of latest three months	Latest rate
United States	7.5 July 58	7.7	7.0	6.9	6.6	6.2	5.9	6.0	5.9	5.8 Oct.
Japan	1.9 Oct. 55	2.0	2.0	2.1	2.0	2.1	2.2	2.3	2.3	2.3 Sept.
Germany[b c]	4.9 Mar. 55	4.7	4.6	4.7	4.5	4.5	4.4	4.4	4.3	4.3 Oct.
France[b]	2.4 Sep. 72	4.2	4.8	5.1	4.8	4.7	5.1	5.6	5.5	5.4 Oct.
United Kingdom[b e]	3.9 Apr. 72	5.4	5.7	5.8	5.9	5.8	5.6	5.6	5.6	5.6 Oct.
Canada	7.9 June 58	7.1	8.1	8.2	8.4	8.4	8.6	8.5	8.4	8.2 Oct.
Italy[d]	5.5 Apr. 59[h]	6.7[i]	7.2	7.7	7.4	7.1	6.8	7.5	7.5	7.5 July
Austria	..	2.0	1.8	1.7	1.9	2.0	2.0	2.1	2.1	2.1 Oct.
Australia[d]	2.6 Aug. 72[f]	4.4	5.6	5.6	5.5	7.0	6.2	6.0	6.0	6.0 Sept.
Belgium[b]	4.0 Feb. 59	5.8	6.6	7.0	7.0	6.9	7.1	7.2	7.2	7.1 Sept.
Denmark[g j]	..	6.1	7.7	7.7	7.9	8.6	8.5	8.6	8.7	8.7 Oct.
Finland	5.0 Jan. 68	4.0	6.1	6.2	6.8	8.0	7.3	7.4	7.4	7.4 Sept.
Ireland[k]	..	12.3	11.9	11.5	11.2	11.8	10.9	..	10.9	10.3 June
Netherlands[g]	2.8 Nov. 72	5.1	4.9	5.1	4.9	4.7	5.0	5.2	5.2	5.0 Oct.
Norway[b]	2.1 Dec. 58	1.1	0.9	0.9	0.8	0.9	1.0	1.2	1.2	1.3 Sept.
Spain[d l]	..	4.9	5.7	5.9	6.3	7.0	7.1	..	7.1	7.1 June
Sweden[d]	2.9 Nov. 73	1.6	1.8	1.9	1.9	2.4	2.0	2.5	2.5	2.5 Sept.

a) These rates are not comparable between countries.
b) Registered unemployed. (For France, end of month rates.)
c) As per cent of dependent labour force.
d) Not seasonally adjusted.
e) Great-Britain, as per cent of total employees (unemployed + employed).
f) Peak in period 1964-73.
g) Registered unemployed as per cent of dependent labour force.
h) Peak in period 1959-1973.
i) Estimate based on the definition of the new survey.
j) As from January 1977, insured unemployed persons searching for part-time works are included.
k) Insured unemployed as a per cent of insured labour force.
l) A break in the series occured during 1976.

Table 8
Adjusted unemployment rates in selected OECD countries[a]
Per cent of total labour force, seasonally adjusted

	1976	1977	1977 Q1	1977 Q2	1977 Q3	1977 Q4	1978 Q1	1978 Q2	1978 Q3
United States	7.5	6.9	7.3	6.9	6.8	6.5	6.1	5.8	5.9
Japan	(2.1)	(2.1)	(2.0)	(2.1)	(2.2)	(2.1)	(2.2)	(2.4)	(2.5)
Germany	(3.6)	(3.6)	(3.6)	(3.6)	(3.7)	(3.6)	(3.5)	(3.5)	(3.7)
France	(4.6)	(5.2)	(4.9)	(5.2)	(5.6)	(5.2)	(4.9)	(5.3)	(5.8)
United Kingdom	(6.3)	(6.8)	(6.6)	(6.6)	(7.0)	(7.1)	(7.0)	(6.8)	(6.8)
Canada	7.1	8.1	7.8	8.0	8.2	8.3	8.3	8.5	8.4
Italy	6.6	7.1	6.8	6.6	7.7	7.3	7.0	6.7	7.4
Australia	4.7	5.6	5.2	5.7	5.9	5.5	6.8	6.3	6.4
Finland	4.0	6.1	4.8	5.9	6.5	7.1	8.2	7.2	7.8
Norway	1.8	1.5	1.5	1.8	1.2	1.3	1.9	1.5	2.1
Spain	5.1	5.7	5.4	5.2	5.9	6.3	7.0	7.1	(7.6)[b]
Sweden	1.6	1.8	1.7	1.6	1.9	1.9	2.2	2.3	2.6
Total[c]	(5.4)	(5.4)	(5.4)	(5.4)	(5.5)	(5.4)	(5.3)	(5.2)	(5.4)

a) Figures in brackets have been adjusted to international definitions by the OECD. A description of the method used is included in *Economic Outlook*, No. 19, July 1976.
b) Two months.
c) Representing about 90 per cent of total OECD.

growth for the major countries considered as a group, after making a negative contribution of ½ a point in the preceding half-year. Reflecting a cautious attitude of business towards inventory accumulation, inventory/sales ratios have fallen during 1978 in most major countries to low levels. Recent surveys indicate that business generally now considers stocks to be near desired levels, given expected production. The main exception is Japan, where stocks of raw materials may still be too high. Given the cautious stockbuilding attitude that marked the recent past, inventory accumulation is not expected to fluctuate strongly in 1979, even if there is some slowdown in the course of the year in domestic demand growth.

As is usually the case when growth is proceeding at a moderate pace, the change in the area's *foreign balance* in 1978 was probably small and had little impact on GNP growth. However, its distribution among Member countries was highly uneven, primarily reflecting differences in domestic growth rates. In the seven largest countries, where total domestic demand grew at a 4 per cent rate, it contributed virtually nothing to growth. In the smaller countries, where total domestic demand was nearly stagnant, the foreign balance change contributed about 1¼ percentage points to growth. In 1979, real trade flows are again likely to help adjust balance of payments disequilibria: among the seven largest countries, the United States may have a very large positive contribution of about a half a percentage point, while Japan and Germany may have negative contributions of about 2 percentage points and ½ of a point respectively. With total domestic demand picking up in the smaller countries as a group, no significant contribution to GDP growth from a change in the foreign balance is expected.

LABOUR MARKETS

Summary

Employment growth in the first half of 1978 was surprisingly strong, given the weak expansion of demand and output, but this rapid growth is expected to decelerate over the forecast period. The counterpart to buoyant employment growth has been an extremely weak productivity performance, which is expected to rebound somewhat, albeit to a rate below its long-term trend. Although the rise in participation rates in the first half of this year seems likely to slow down, this will probably be insufficient to prevent the civilian labour force from growing faster than employment. Consequently, given the forecast growth of output, unemployment in the OECD area appears likely to rise from its present rate of around 5¼ per cent to perhaps 5½ per cent in the latter half of 1979.

Employment and productivity

Since the beginning of 1978, the OECD area has been undergoing a period of rapid growth in total employment, led by very sharp rises in North America and above-trend growth in Japan, accompanied by a stabilisation of employment levels in several European countries. The gains in employment have typically been concentrated in the non-manufacturing sectors; in most countries employment growth in manufacturing has remained weak, or continued to decline, as employers appear to have continued to adjust their work-forces to levels consistent with levels of production. Since there has been only a modest increase in output for the economy as a whole, the rate of productivity growth in the first half of 1978 was the lowest since 1974/1975, which itself represented the lowest rate of

Table 9
Employment and productivity

Total economy, percentage changes, seasonally adjusted at annual rates

	Average		From previous year			From previous half-year				
	1964-73	1974-78[a]	1977	1978	1979	1977 II	1978 I	1978 II	1979 I	1979 II
United States										
Employment	2.2	2.2	3.5	4	1¼	4.0	4.9	2½	1¼	0
GNP/employment	1.8	0.1	1.3	–¼	¾	1.1	–2.0	2	0	1
Japan										
Employment	1.4	0.6	1.3	1½	1	0.9	2.0	¾	1	¾
GNP/employment	8.9	3.4	3.9	4¼	3¾	2.8	5.7	3¼	4¼	3½
Germany										
Employment	0	–1.4	–0.3	–¼	¼	–0.3	0	–¼	½	0
GNP/employment	4.7	3.2	2.9	3	3½	2.4	2.8	4¼	3½	3
France										
Employment	0.9	–0.1	0.1	0	¼	0.2	0	–¾	¾	¼
GDP/employment	4.5	3.0	3.0	3¼	3¼	2.5	3.4	3½	3	3½
United Kingdom										
Employment[b]	–0.1	0	0.4	½	0	0	0.4	½	0	–¼
GDP/employment[c]	3.2	0.8	0.3	2	1½	2.5	2.2	1	1¾	1
Canada										
Employment	3.3	2.7	1.9	3	2½	2.4	3.4	3	2½	2¼
GNP/employment	2.4	0.6	0.7	½	1½	0.1	0.7	¾	1½	2
Italy										
Employment	–0.6	0.9	1.0	0	½	–0.4	–0.4	1¼	¼	½
GDP/employment	5.4	1.1	0.6	2	3	–3.2	4.6	2	3¼	3½

a) Forecast values for 1978.
b) Great Britain, employees only.
c) Based on GDP growth, excluding the contribution from North Sea oil.

increase for more than a decade. To the extent that employers have been adjusting average hours worked per employee rather than the number of employees, there is a statistical problem in that the measure of labour productivity shown in Table 9 may overstate the true slowdown in productivity growth. Possible reasons for the observed slowdown in productivity growth since 1973 are discussed below.

A comparison with past trend rates would suggest that the post-1973 productivity slowdown has been quite dramatic (see Table 9). However, this would almost certainly overstate the extent of the deceleration, for productivity growth, which typically is procyclical, could on that account alone have been expected to have been moderated by the slower than average growth of output over the last five years. The extent to which productivity growth is procyclical depends upon the reaction of employment to changes in output. Typically, in the six major economies other than Japan, employment fluctuations are correlated with fluctuations in output, but have a smaller amplitude. In Japan, employment tends to fluctuate little about its trend, so that deviations of output relative to trend result in approximately proportionate fluctuations in productivity.

The reason for this procyclical productivity behaviour seems fairly clear. Once firms foresee that a downturn is no longer likely to be temporary, and the costs of holding labour become greater than the expected costs of laying-off workers and rehiring later, some shedding of labour occurs. But the proportionate decrease in employment will generally be less than the fall in output, first, because the productivity of workers still employed typically falls, in part because of a less effective use of the existing capital stock; second, because there are limits to the possible reductions of that part of the labour force which constitutes overhead labour, so that average productivity of the remaining workers declines; and third, because hours worked per employee tend to fall during a downswing.

The extent to which these phenomena take place varies between countries. Estimates of the short-run elasticity of employment with respect to output (the "Okun coefficient") for each country depend typically upon the period of estimation, the specification of the presumed short-run employment function, and the frequency of data used. But on the basis of a number of employment functions recently estimated by the Secretariat, using peak-to-peak data until 1973/1974, it would seem that reasonable values might be about 0.6 for each of the four major European economies, 0.4 for the United States, 0.8 for Canada and perhaps 0.05 for Japan, where lifetime employment policies result in little

cyclical fluctuation in overall employment growth. Applying these coefficients to the deviations from trend output implicit in the GNP forecasts gives the extent to which, on the basis of past relationships, productivity could be expected to be below trend in 1978. Expressing these figures as annual average rates of change yields the following results (see Table below)[1].

Productivity shortfall 1974-1978
Annual average; percentage points

	Total shortfall	*Of which:* Due to cyclical factors	Due to non-cyclical factors
United States	2	1	1
Japan	5¼	4½	¾
Germany	1½	1	½
France	1	¾	¼
United Kingdom[a]	2¾	¾	2
Canada	1¼	½	¾
Italy	4	1½	2½

a) Excluding contribution of North Sea oil to GDP growth.

These calculations suggest that cyclical effects on productivity could be quite large[2]. However, at the same time it is clear that, for a number of countries, cyclical factors, assessed on the basis of past relationships, cannot explain the entire slowdown in productivity growth since 1973/1974. Thus, while more than two thirds of the observed slowdown in productivity growth could perhaps be accounted for by cyclical factors in Japan, Germany and France, only half of the observed slowdown could be explained in the United States, and around a third in the United Kingdom, Canada and Italy.

It seems likely that a number of factors are responsible for the slowdown in productivity growth, some of which will have affected the underlying trend, while others may have affected the cyclical relationship between output and employment. It is possible, for example, that a number of countries experienced a once-and-for-all downward level shift in potential GNP after the oil price rise in 1973/1974. Further, a sectoral shift of employment towards the service sector has been taking place in most OECD countries; it may well be the case that both productivity levels and the rate of productivity growth are below those in manufacturing, so that this structural shift may have reduced the underlying trend rate of growth of potential GNP, as may the allocation of an increasing proportion of investment towards replacement or satisfying new environmental or safety regulations. In addition, a number of factors could well have influenced the cyclical response of employment to output. Employment-supporting measures, ranging from government support schemes such as job subsidies, training programmes and temporary public sector employment, to private sector employment support measures written into collective bargaining agreements, have been important in a number of countries. Employee protection legislation has increased the costs of laying-off workers, compared with the situation in earlier periods of cyclical slowdown, in a number of countries (the United States being a notable exception); this is likely to result in fewer workers being laid off in the downswing—and probably fewer additional workers being hired in the upswing. And in several countries worksharing arrangements, particularly with a rising share of part-time workers, have become increasingly important.

For many of the OECD countries, these substantial and possibly fundamental changes in the relationship between output and employment make it difficult to explain recent developments, and even more so to forecast employment with any degree of certainty. In the construction of the employment forecasts given in Table 9, it has been assumed that a more normal productivity development will prevail over the forecast period. Thus, with the forecast slowdown in total output growth during 1979, it is suggested that employment growth will also decelerate; it is also assumed that employment-supporting policies will give less support in the period immediately ahead[3]. During 1979, the employment growth rate in the seven major OECD countries may

1. For this table, the peak-to-peak output growth rate, taken as a proxy for the growth rate of potential output, was calculated for a period to 1973/1974. This same period was used to determine the Okun coefficients. These periods were: 1960-1973 (United States), 1961-1973 (Japan), 1966-1973 (Germany), 1962-1974 (France), 1964-1973 (United Kingdom), 1963-1974 (Italy), 1960-1974 (Canada). The total shortfall is calculated as the difference between the trend growth rate of productivity extrapolated through 1978, and actual productivity growth rate over the period from 1973/1974 to 1978. Using the extent to which 1978 GNP is below its extrapolated trend, together with the Okun coefficients, the cyclical shortfall of productivity was calculated. The non-cyclical component is the residual shortfall.

2. Inevitably, the estimates are subject to margins of uncertainty. To the extent that the trend growth rate of potential output is overstated, for example because of a failure to allow for the importance of structural shifts in the composition of output, the cyclical corrections to productivity reported above will also be overstated, although by proportionately less than the estimated output shortfall.

3. In particular, it is assumed that there will be no expansion in the coverage of employment-support schemes in the United Kingdom, and that the various schemes will terminate as at present announced. In France, it is assumed that, in smaller firms, 50 per cent of social security contributions for new young workers aged between 18 and 25 will be paid for by the State, for one year. Prior to 1st July 1978, the State paid the full amount for a period of 18 months and to a wider range of firms.

slow down from 2 per cent in 1978 to below half a per cent by the second half of 1979. This forecast is dominated by expected developments outside Europe. For both the largest four European countries, and the smaller countries as a group, total employment may grow by one-third of one per cent in 1979, following stagnation in 1978.

Labour force and unemployment

The expansion of the labour force in recent months has matched that of employment, so that total unemployment in the area, excluding Turkey and Portugal, was over 15¾ million in the third quarter of 1978, about the same as at the beginning of the year. Part of this recent labour force growth is due to increasing participation rates in many countries, especially amongst women, and in some countries, especially in North America, the downward trend in adult male participation rates appears to have bottomed out.

It is not infrequently claimed that rising participation rates are one of the factors underlying present high unemployment rates. In four of the major seven countries (the United States, Canada, the United Kingdom and Italy), rising participation rates during the last 4-5 years have exerted, in an accounting sense at least, a considerable upward influence on unemployment rates. On the other hand, both Germany and France have had declining participation rates since 1973, so that in these countries the present unemployment rate would probably have been higher had it not been for this development. There is little evidence that recent cyclical influences on the participation rate have been markedly out of line with past experience, but overall participation rates have been affected to an important extent in a number of countries by changes in the age distribution of the population.

It is often suggested that the departure of foreign workers from certain European countries has moderated the growth of the labour force and, hence, the growth of measured unemployment. It appears, however, that these effects can be exaggerated; if there had been no net migration[4] since the 1973/1974 peak in economic activity, it is unlikely that the major European countries' labour forces would have been drastically different from what they are in fact. On the assumption of no net migration since 1973/1974, it appears that the labour force would differ from the presently-forecast labour forces of Germany and France by only ¼ of a per cent, although this mechanically-derived figure may disguise large inflows offsetting the outflow of foreign workers, and does not take account of the fact that prior to 1973/1974 net inflows of labour had been quite substantial. In contrast, traditional labour-importing countries, particularly the North American economies, have had much stronger cumulative effects from net inflows since 1973/1974 than the corresponding effect in OECD countries with net outflows. Amongst the larger OECD countries, the most extreme case is Canada, where migration flows and rising participation rates have had an equal impact on the labour force; for the remaining six countries, on the other hand, movements in participation rates appear to have been far the greater influence on changes in labour supply.

Assuming that the recent rises in participation rates decelerate over the forecast period, and that the recent stabilisation of the net outflow of foreign workers in certain European countries continues, it seems likely that growth in the total labour force will slow down, although not by as much as the deceleration of total employment growth. Hence, total unemployment in the OECD area seems likely to begin creeping up again during 1979, and by the latter half of the year the area's unemployment rate could be 5½ per cent of the labour force, compared with around 5¼ per cent currently. Because the forecast weakening of the rate of growth of total output is more pronounced in the United States, the associated rise in unemployment could also be more marked. For the major European countries, little further upward movement in the unemployment rate from the present 5½ per cent is expected, although for many of the smaller OECD countries slight rises seem likely.

4. Of people of working age.

FISCAL AND MONETARY POLICIES

Summary

Differential adjustments in demand management policies since last summer and the budgetary and monetary outlook in the OECD area for the next twelve to eighteen months indicate growing recognition of the limited scope for independent national policy action. The most important developments have been the announcement of expansionary fiscal measures in Japan and Germany, a significant tightening of money and credit market conditions and a more contractionary Federal budget stance in the United States, and continuing acceptance by the stronger surplus countries of easier monetary conditions than planned. Domestic inflation and exchange rate considerations, which tend to be interrelated rather closely due to the extreme sensitivity of financial markets, have continued to require cautious economic management in the United Kingdom, Italy, France and Canada although external current account positions in the first three of these countries have strengthened.

Reflecting uneven exchange rate pressures among participants in the European joint float, monetary conditions have tightened in the Benelux countries; but official lending rates have been brought down or kept stable in the Scandinavian countries and Austria since last summer. In Southern European countries, which have sharply reduced their combined current account deficit, the scope for employment-supporting action remains rather limited because inflation in most of them is still comparatively high.

The short-run monetary and budgetary outlook for the area appears consistent, in its broad pattern, with the programme of internationally concerted action agreed on at the OECD Ministerial meeting in June. Implementation of policy changes has not been easy and, at least to some extent, reflects governments' responses to unsustainable conditions in exchange markets. Following the exceptional disturbances of the past twelve to eighteen months, it is difficult to predict the extent to which the changing pattern of national policy positions may exert a lasting stabilising influence on currency portfolio behaviour in world financial markets and on exchange rate expectations.

In many countries, the handling of fiscal and, in particular, monetary policy instruments may continue to be geared towards moderating the speed or size of exchange rate adjustments. A particularly

Table 10
Simulation of Recent Expansionary Packages in Japan and Germany
Annual rates; including multiplier effects and international trade repercussions

JAPAN									GERMANY					
	1978	1979	1980	1978 II	1979 I	1979 II	1980 I	1980 II		1979	1980	1979 I	1979 II	1980[c] I	1980[c] II
Size of shock (Yen trillion)									*Size of shock* (DM billion)						
Government investment	0.64	1.53	0	1.28	2.56	0.5	0	0	Net direct household taxes and transfers[b]	–13.62	–15.75	–12.75	–14.50	–15.50	–16.00
Land purchases (= transfers)	0.025	0.045	0	0.05	0.09	0	0	0	Net business taxes[b]	0	–1.50	0	0	–1.50	–1.50
Total cost of package, gross[a]	0.665	1.575	0	1.33	2.65	0.5	0	0	Indirect taxes[b]	3.25	6.88	0	6.50	6.75	7.00
									Government investment	2.75	2.75	2.75	2.75	2.75	2.75
									Total cost of package, gross	13.12	13.12	15.50	10.75	13.00	13.25
Domestic impact									*Domestic impact*						
% increment to real GNP level	0.4	1.0	0.5	0.7	1.4	0.6	0.5	0.5	% increment to real GNP level	1.1	1.4	1.0	1.1	1.4	1.5
% increment to annual rates of growth of real GNP	0.4	0.8	–0.5	1.8	1.5	–1.7	–0.2	0	% increment to annual rates of growth of real GNP	1.1	0.4	2.2	0.2	0.5	0.2
% increment to annual rates of growth of exports (volume)	0.1	0.1	–0.1	0.2	0.3	–0.2	0	0	% increment to annual rates of growth of exports (volume)	0.5	0.4	0.8	0.4	0.4	0.3
Net increase in borrowing requirement (Yen trillion)	0.5	1.0	–0.3	1.0	1.9	0.2	–0.3	–0.3	Net increase in borrowing requirement (DM billion)	6.7	4.2	9.5	3.9	4.4	4.0
International impact									*International impact*						
% increment to annual rates of growth of real GNP									% increment to annual rates of growth of real GNP						
OECD Europe	0	0	0	0	0.1	0	0	0	OECD Europe	0.5	0.2	0.8	0.2	0.3	0.2
OECD Total	0.1	0.2	–0.1	0.3	0.3	–0.3	0	0	OECD Total	0.2	0.1	0.4	0.1	0.2	0.1

a) The total amount of the package is Yen 2.5 trillion and includes public enterprise investment and loans for private housing. However, since Yen 0.26 trillion substitutes for private financing of housebuilding, the cumulative value of the simulated package only amounts to Yen 2.24 trillion.
b) Minus sign suggests stimulus.
c) The German authorities have indicated that new measures may be announced for 1980. For purely illustrative reasons, the Secretariat has included a business tax cut of DM 1.50 billion and another investment programme amounting to DM 2.75 billion. The direct and indirect tax changes in 1979 have been considered as permanent and the corresponding revenue effects will roughly increase in step with nominal incomes.

Table 11
General government net lending on an SNA basis, 1975-1979

		Government net lending					Change in government net lending[a]				
		1975	1976	1977	1978*	1979*	1975	1976	1977	1978*	1979*
Percentage of nominal GNP/GDP	United States	–4.2	–2.1	–1.1	–0.2	–1.1	–4.3	1.9	0.9	0.8	–1.0
	Japan	–2.7	–3.7	–4.8	–6.1	–7.3	–3.4	–1.4	–1.7	–1.9	–1.8
	Germany	–5.7	–3.6	–2.5	–3.0	–3.5	–4.7	1.8	0.9	–0.7	–0.7
	France[b]	–2.2	–0.4	–1.3	–1.9	–1.6	–1.9	1.8	–1.0	–0.9	0.2
	United Kingdom	–4.8	–5.0	–3.2	–4.0	–4.1	–2.0	–1.1	1.3	–1.4	–0.6
	Canada	–3.0	–2.3	–3.1	–4.3	–4.2	–5.2	0.3	–1.0	–1.6	–0.5
	Italy[c]	–14.6	–9.9	–9.8	–12.6	–13.0	–10.6	2.2	–2.1	–4.5	–2.6
	Total of above countries[d]	–4.4	–2.9	–2.5	–2.6	–3.3	–4.2	1.1	0.1	–0.5	–1

a) In per cent of previous year's nominal GNP/GDP. Minus sign suggests expansionary nominal fiscal impulse.
b) Gross lending.
c) Including consolidation of mutual benefit agencies' debts to hospitals.
d) 1976 GNP/GDP weighted.
* OECD estimates.

important element—bearing on both external conditions and domestic demand expectations in the area—could be the prospect, for a time, of continued tight monetary conditions in the United States. Implementation of a European Monetary System in early 1978 could significantly affect the short-run policy outlook; however, the consequences for exchange rate and domestic economic management in participating Member countries and the rest of the OECD area cannot, at this stage, be assessed with confidence. On present budget plans and monetary trends and targets, the overall policy position in Member countries may now embody a modest expansionary thrust. In addition, the pattern of individual countries' policy stances now emerging could begin to remove some important obstacles to a more satisfactory growth and inflation performance in the area, with external imbalances and disturbances being progressively reduced.

Fiscal policy

Thus far, the most important results in the budgetary field flowing from the concerted action strategy have been the expansionary measures announced in Japan and Germany. The impact on domestic and international activity of the two packages, the main components of which are described in the detailed country notes, has been simulated tentatively with the use of the Secretariat's International Linkage Model (Table 10)[1]. In Japan, where very speedy implementation of the package could meet with difficulties, the expansionary impact resulting from the new measures may be distributed rather evenly over the period from the last quarter of 1978 through the second quarter of 1979, with a small residual effect spilling over into the second half. The various tax and transfer measures announced in Germany could be assumed to be made permanent; the resulting impact on the spending power of the private sector should accordingly increase gradually through 1980 in line with rising nominal incomes. On these assumptions, the level of real GNP could be raised through the recent action, by about one per cent in both Japan and Germany next year. In Japan, economic activity should already be supported significantly by the end of 1978, while the discretionary budget impact in Germany is likely to build up over the first three quarters of 1979.

The simplifying assumptions underlying these illustrative policy simulations limit the extent to which precise predictions or assessments can be drawn. Nevertheless, the estimates shown in Table 10—which need to be interpreted with care—incorporate some quantitative features which may be particularly relevant in the context of concerted policy action:

— Due to the nature of the measures and their expected timing, the Japanese package augments the real GNP level in 1980 only by ½ per cent; the German measures, if made permanent, may raise output in 1980 by almost one and a half per cent above what it would have been otherwise.
— The policy packages adopted in the two countries generate significant international trade repercussions. The openness of the German economy and its geographical trade pattern imply that expansionary domestic action may boost economic activity in Germany's European trading partners by about

1. "The OECD International Linkage Model" in the *Occasional Studies* associated with this *Economic Outlook*.

¼ per cent in 1979 and, in turn, German exports by, perhaps, ½ percentage point in both 1979 and 1980.

— The stimulative impact of the Japanese and German measures on economic activity at home could be expected to generate additional government revenues offsetting around half of the initial budget cost of the two packages by 1980.

The overall budgetary posture in the seven major countries, which represent 85 per cent of the area's GNP, may be expansionary in both 1978 and 1979. Preliminary estimates of their *combined budget deficit* (Table 11) suggest an expansionary swing in general government net lending in 1978 roughly equivalent to ½ per cent of nominal GNP. All major countries outside the United States are forecast to record rising deficits. For 1979, the budget assumptions, which are set out in individual country notes, point to a slightly bigger rise in the aggregate budget deficit of the order of 1 per cent of GNP. Reflecting the prevailing degree of fiscal caution, increases in general government budget deficits by one per cent of GNP or more, are forecast only for the United States, Japan and Italy, with the budget outlook in the United Kingdom rather uncertain. Secretariat fiscal policy assumptions for Japan suggest a slightly lower budget stimulus in calendar 1979 than in 1978; nevertheless, the increase in the 1979 deficit is higher than implied by the recent reflationary package. The predicted rise in the 1979 German budget deficit can almost totally be attributed to the measures announced after the Bonn Summit.

Although the Federal high employment deficit in the United States may contract sharply in FY 1979 (beginning 1st October 1978), the expected substantial declines in State and local sector surpluses are likely to lead to some deterioration in the overall financial position of the public sector in the calendar year. The anticipated widening of the 1979 budget deficit in the United Kingdom by, perhaps, some ½ per cent of GNP assumes the continuation of a cautiously reflationary policy stance. The overall budget deficit in Italy will probably increase marginally next year as efforts to raise additional revenue may be more or less offset by higher transfer payments to the private sector and increased government investment outlays. In spite of present efforts to cut Federal expenditure on goods and services, the size of the Canadian deficit could remain broadly unchanged due to sluggish growth of revenue and increases in public transfers.

Secretariat estimates of changes in *real standardised budget balances,* in which specific "first

Table 12
Primary impact of budgetary changes in selected OECD countries
Changes in real weighted standardised budget balances
Per cent of previous year GDP at constant prices

	1975	1976	1977	1978	1979
UNITED STATES					
Total net	3.50	–1.78	–0.87	–0.64	0.50
Expenditures	0.53	0.26	0.60	0.47	0.59
Taxes	2.97	–2.04	–1.47	–1.11	–0.09
GERMANY					
Total net	2.74	–0.88	–0.56	0.51	0.57
Expenditures	0.43	0.57	0.19	0.79	0.72
Taxes	2.31	–1.45	–0.75	–0.28	–0.15
UNITED KINGDOM					
Total net	0.91	0.36	–1.06	0.54	0.42
Expenditures	1.97	–0.59	–1.00	0.27	0.28
Taxes	–1.06	0.95	–0.06	0.27	0.14
ITALY					
Total net	3.04	–1.20	0.09	0.60	–0.53
Expenditures	0.17	0.17	0.40	0.48	0.39
Taxes[a]	2.87	–1.37	–0.31	0.12	–0.92
JAPAN					
Total net	2.58	0.97	0.27	2.34	1.48
Expenditures	1.21	0.44	0.93	1.56	1.72
Taxes	1.37	0.53	–0.66	0.78	–0.24
FRANCE					
Total net	2.07	–0.67	0.75	0.67	–0.02
Expenditures	1.12	0.85	0.54	0.60	0.56
Taxes	0.95	–1.52	0.21	0.07	–0.58
CANADA					
Total net	3.91	–0.29	0.68	1.18	0.58
Expenditures	2.25	0.92	0.72	0.54	0.66
Taxes	1.66	–1.21	–0.04	0.64	–0.08
TOTAL SEVEN					
Total net[b]	3.00	–0.90	–0.40	0.30	0.54
Expenditures	0.84	0.37	0.48	0.67	0.73
Taxes	2.16	–1.27	–0.88	–0.37	–0.19

a) Excluding changes in capital transfers.
b) Impact aggregation excludes trade effects and is based on 1976 GNP/GDP weights.
Note: Total fiscal impacts measure changes in the weighted real budget balance of general government (S.N.A. definition) and are expressed as a percentage of the previous year's real GNP/GDP. The weighting scheme applied reflects only « first round » multiplier effects of the budget. For a detailed description of methodology see "Budget Indicators", *OECD, Economic Outlook—Occasional Studies*, July 1978.

CHART F

MONETARY MANAGEMENT AND INTEREST RATE TRENDS

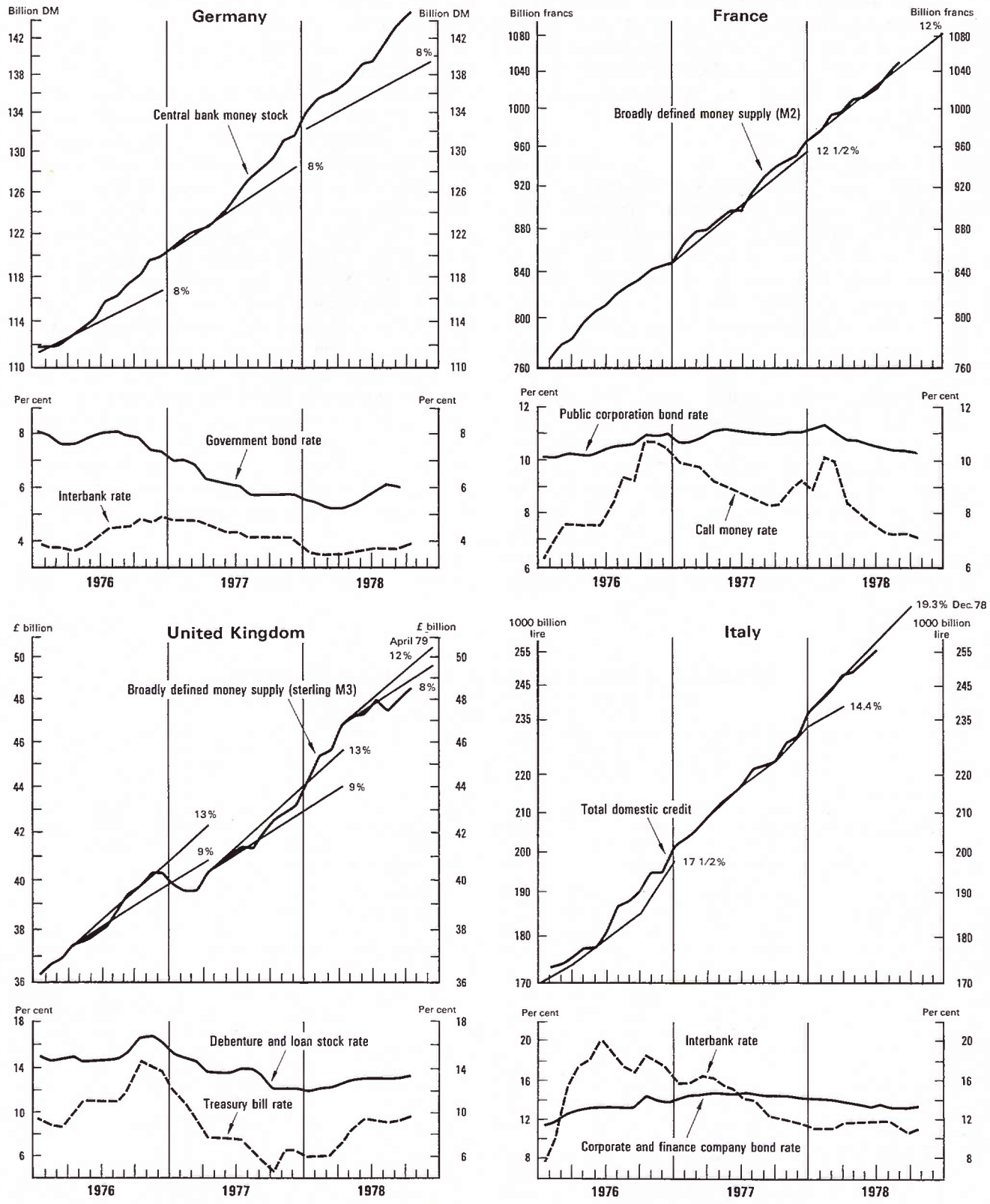
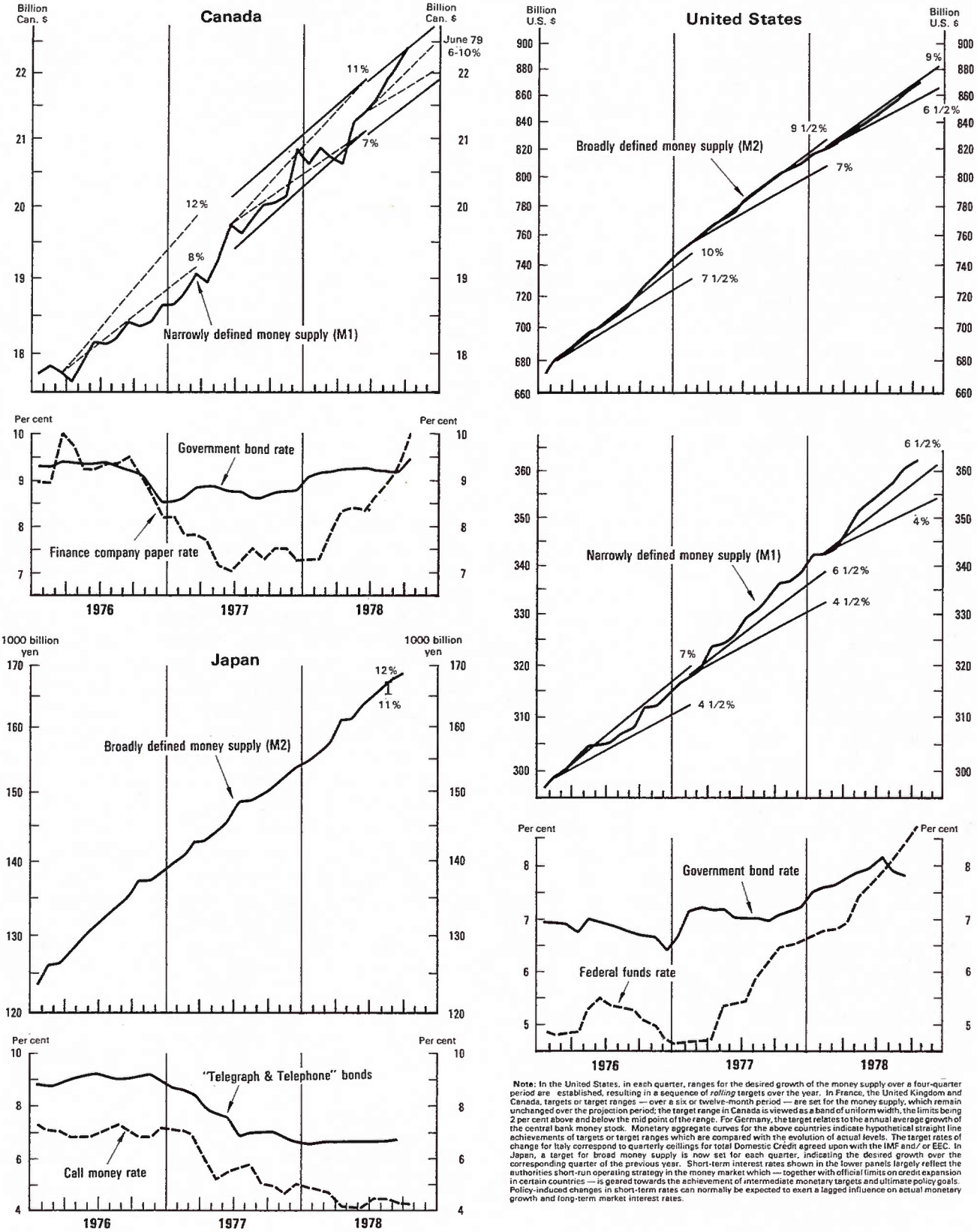


CHART F (cont.)

MONETARY MANAGEMENT AND INTEREST RATE TRENDS



Note: In the United States, in each quarter, ranges for the desired growth of the money supply over a four-quarter period are established, resulting in a sequence of *rolling* targets over the year. In France, the United Kingdom and Canada, targets or target ranges — over a six or twelve-month period — are set for the money supply, which remain unchanged over the projection period; the target range in Canada is viewed as a band of uniform width, the limits being 2 per cent above and below the mid point of the range. For Germany, the target relates to the annual average growth of the central bank money stock. Monetary aggregate curves for the above countries indicate hypothetical straight line achievements of targets or target ranges which are compared with the evolution of actual levels. The target rates of change for Italy correspond to quarterly ceilings for total Domestic Crédit agreed upon with the IMF and/or EEC. In Japan, a target for broad money supply is now set for each quarter, indicating the desired growth over the corresponding quarter of the previous year. Short-term interest rates shown in the lower panels largely reflect the authorities short-run operating strategy in the money market which — together with official limits on credit expansion in certain countries — is geared towards the achievement of intermediate monetary targets and ultimate policy goals. Policy-induced changes in short-term rates can normally be expected to exert a lagged influence on actual monetary growth and long-term market interest rates.

round" weights are attached to broadly homogeneous government transactions (Table 12), confirm the impression of a moderately stimulatory budget stance in major economies. The aggregate "primary impact" on activity for the seven largest countries adds up to GNP equivalents of 0.3 and 0.5 per cent respectively in 1978 and 1979. These calculations tend to confirm the impression given by the nominal variations in net lending (Table 11) of a somewhat higher budgetary stimulus in 1979 than in 1978.

Present budget estimates suggest that next year's budgetary stimulus may be generated largely through relatively rapid growth of government consumption and capital outlays, while net changes in taxes and transfers, on the whole, could turn out more contractionary in 1979 than during 1978. Except for the United States and Germany, total net tax changes are likely to support economic activity this year, while realisation of present budget proposals would imply a restrictive overall tax impact in the seven major countries during the coming calendar year, despite the tax measures envisaged in Germany.

Table 13
Summary of principal domestic monetary measures in OECD countries, June-December 1978

	Central bank lending rates [a]		Expansionary (+) or Contractionary (—) Measures affecting	
	June 1978	Early December 1978	Bank liquidity	Bank Credit Ceilings
United States	7	9½	—	
Japan	3½	3½		
Germany	3	3	+ + —	
France	9½	9½		—
United Kingdom	9	12½		
Canada	8½	10¾		
Italy	11½	10½		—
Australia	..	..	+	
Austria	5½	4½		
Belgium	5½	6		
Denmark	9	8		+
Finland	7¼	7¼	—	
Netherlands	4	6½		—
Norway	7	7	+	
Sweden	7	6½	— — —	

a) Discount rate except in the case of the United Kingdom (Minimum Lending Rate).

Monetary policy

The most significant monetary development since the summer has been the continued marked firming of North American credit market conditions. Following the rise of the official discount rate to a historic peak of 9½ per cent on 1st November, policy-controlled short-term interest rates in the United States exceeded their early May level by about 2 percentage points. (Table 13 and Chart F). At the same time, the Canadian Bank rate has been raised in four steps since late July to a record 10¾ per cent. Since monetary conditions in the stronger surplus countries have remained easy since the spring, key gross interest rate differentials in favour of the United States dollar have climbed to exceptionally high levels.

Before the 1st November package, the widening of nominal interest arbitrage incentives in favour of the U.S. dollar was accompanied by persisting dollar depreciation expectations[2]. With the upward shift of the current inflation rate in the United States coinciding with lower inflation levels in appreciating-currency countries, anticipated comparative net yields on dollar assets and money market investments in strong currencies apparently remained unfavourable until the recent sharp upward adjustment of U.S. interest rates. Moreover, private domestic credit demand and the supply of credit market funds in the United States had shown little visible response to the continued rise in nominal interest rates.

The future course of monetary conditions in the United States will be influenced by four interrelated principal factors: the firmness of control of monetary aggregates aimed at by the Federal Reserve, pressures for interest rate moderation from the domestic public, domestic inflation trends, and the state of the dollar. Since the spring surge in monetary growth, when annual rates of growth of M1 averaged 11-12 per cent, this aggregate has continued to advance at rates well above the current 4-6½ per cent four-quarter tolerance range (Table 14) and its volatility has increased (Chart F). Although M2 growth has been moderate, it has also moved close to the upper end of its 6½-9 per cent range. Present inflation trends make unlikely any significant moderation of monetary growth over the near term. The authorities may therefore have to keep the Federal funds rate in its 9½-10 per cent range at least until next spring in order to consolidate control over the expansion of money and credit aggregates[3].

Reflecting the underlying strength of the real economy, the state of inflationary expectations, and a relatively slow pace of bank disintermediation,

2. See Section on International Monetary Developments.
3. Furthermore, the behaviour of the aggregates will carry new uncertainties in coming months as a result of recent innovations that have made it much easier for essentially chequeable deposits to earn interest. As a result, the M1 target has been re-specified and a new aggregate, "M1 Plus", introduced.

the rise in market interest rates over the first three quarters of 1978 affected the United States economy less severely than might have been expected on the basis of past behavioural relationships. However, the incipient cyclical deterioration in corporate and private household financial positions[4] may begin to reinforce the contractionary impact of the recent significantly tighter monetary conditions. Public demand for lower interest rates could therefore intensify before domestic inflation and monetary growth have returned to more acceptable levels. But policy will, no doubt, continue to be framed in the light of the extreme sensitivity of international currency holders to perceived monetary and inflation trends, since a further significant decline of the dollar would inevitably worsen the domestic inflation outlook.

Expected domestic monetary trends in other major economies should help to consolidate the present pattern of relative international monetary conditions, though a further narrowing of the differences seems unlikely. The scope for further monetary relaxation in stronger surplus countries may be very limited. Growth of the broad money stock in Japan, for which the authorities have begun to publish forecasts on a quarterly basis, has accelerated somewhat since last spring (Table 14), reflecting a temporary bulge in intervention activity in the exchange market, heavy public sector borrowing and faster expansion of housing loans. The existing ceiling on city bank lending should facilitate a steady and moderate rate of monetary expansion during the winter, broadly consistent with official projections. While short-term bank lending rates continued to decline following the earlier reductions in the official discount rate, long-term bond rates have firmed since last spring as portfolio holders showed some preference for investments in short-dated securities[4].

Recent monetary trends in Germany point to continued buoyant growth of credit and monetary aggregates, and the central bank money stock is expected to exceed its 1978 target level quite substantially. The Bundesbank has essentially aimed at keeping banks' short-run liquidity positions and refinancing costs broadly unchanged[5] and cushioned temporary upward pressures on long-term bond rates through open market purchases. The authorities' accommodative posture in the money market may, for the time being, be continued for both domestic and external reasons. The strong cyclical revival of private credit demand and the substantial borrowing requirements of the public sector are therefore unlikely to induce an early significant firming of market interest rates. In Switzerland, to counteract a further appreciation of the currency, the monetary authorities have actively encouraged a decline of market interest rates. As long as appreciation pressures persist, the supply of bank reserves is likely to be kept ample, and the Swiss central bank seems to be prepared to tolerate a growth rate for the narrowly

4. See Special Section on "Sectoral Financial Positions".
5. The increase in banks' compulsory reserves by about DM 4 billion with effect from 1st November, decided upon in late October, has left the general orientation of bank liquidity management unchanged.

Table 14
Monetary aggregates[a]
Recent trends and targets
Percentage changes, seasonally adjusted at annual rates

		Last 12 months	Last 6 months	Last 3 months	Last observation	Official or semi-official target[b]	Previous target
United States	M1	8.0	9.2	8.6	Oct.	4–6½[c]	4½–6½[c]
	M2	8.3	9.2	10.1	Oct.	6½–9[c]	7–9½[c]
Japan	M1	11.7	15.5	16.4	Sept.	..	..
	M2	12.0	14.4	12.7	Sept.	11–12[d]	..
Germany	M1	13.2	10.0	13.2	Oct.	..	..
	M3	11.0	13.0	17.1	Oct.	8	8
France	M1	10.7	9.4	9.8	Aug.	..	..
	M2	13.6	12.2	12.7	Aug.	12	12½
UnitedKingdom	M1	18.0	11.1	12.0	Oct.	..	..
	M3	14.4	9.0	4.1	Oct.	8–12	9–13
Canada	M1	11.0	14.5	14.8	Oct.	6–10	7–11
	M2	10.6	12.1	12.4	Oct.	..	..
Italy	M1	24.3	30.3	21.9	July	..	..
	M2	22.8	23.2	17.7	July	..	18–19[e]

a) M1 is the narrowly defined money supply. M2 (for the United Kingdom Sterling M3 and Germany M3) is the broadly defined money supply. The German target rate has been set for the central bank money stock which broadly reflects developments of M3. The growth rates of monetary aggregates are the seasonally adjusted annual rates of change of the most recent 3 month period ending with the latest observation, over the three month average for 12, 6 and 3 months before.
b) Target for 1978 or current twelve months period, as shown on graph.
c) Targets for 1978 Q2 to 1979 Q2 and 1977 Q2 to 1978 Q2.
d) Official forecast for July-September 1978 (rate of change against previous year).
e) Rate consistent with IMF ceiling for total domestic credit expansion.

defined money stock very substantially in excess of the 5 per cent target rate announced for the current year.

External and domestic concerns limit the extent to which easier monetary conditions could be expected in other major economies. Mirroring the rise in short-term rates in the United States, and in view of the continued threat which depreciation implied for domestic inflation, the Canadian authorities have continued to tighten domestic money market conditions since mid-1978. Moreover, the official target for the growth of M1 was reduced from 7-11 per cent to a range of 6-10 per cent. Prospects for a lowering of interest rates may largely depend on clear evidence that the long slide of the Canadian dollar has bottomed out. In the United Kingdom, continued operation of the "corset" and modest demands for banking funds have facilitated a moderate pace of monetary expansion in the United Kingdom in recent months. The sharp upward adjustment of Minimum Lending Rate, to 12½ per cent, in early November should help keep monetary growth within the updated target range—8-12 per cent for sterling M3 for the 12 months to end-October 1979. But despite some possible crowding out of private sector spending, it may in the near term be difficult to initiate a return to the lower levels of short and long-term rates. The sharp increase in North American interest rates and uncertainties surrounding the outcome of the new wage round could adversely influence sentiment regarding sterling, and require the maintenance of comparatively tight monetary conditions for some time to come.

Monetary conditions in France have eased somewhat in recent months as the franc's appreciation against the dollar facilitated a progressive decline of money market rates. In order to counteract persistent inflation fears and consolidate the franc's longer-term position in the European context, the authorities have announced an 11 per cent target growth rate for the broadly defined money stock for 1979, compared with a projected 12.9 per cent rise in nominal GNP and the 12 per cent monetary objective adopted for 1978. While this year's money supply target may be achieved without much difficulty, adherence to the narrower 1979 monetary limit may imply some tightening of credit market conditions. In Italy, growth of money and credit aggregates has tended to accelerate since last spring. At the same time, interest rates have been permitted to decline and monetary restrictions relaxed as the external outlook improved. The present 14 per cent limit on bank credit expansion, over the twelve month period ending March 1979, may not impose severe restraints on the growth of real private demand provided the Treasury's borrowing requirements can be kept within reasonable bounds.

Special Section

SECTORAL FINANCIAL POSITIONS

This section discusses recent trends in selected flow of funds indicators in the United States, Japan, Germany and the United Kingdom[1]. Significant cyclical swings have occurred in financial positions of the main non-financial sectors in these countries over the past two years. Special attention is paid to financial developments in the United States because the advanced stage of economic recovery and uncertainties surrounding the impact of tighter monetary policy make the information provided by flow-of-funds data particularly relevant for that country.

Sectoral financial balances

The uneven speed of output growth, divergent orientations of monetary and fiscal policies, and the resulting external imbalances among the economies considered are reflected clearly in the contrasting pattern of countries' sectoral financial balances (Table 15). In the United States, the strong revival of household expenditure on consumption and housing, which was accompanied by a steep decline in saving rates, and the speeding up of corporate investment have led to a significant worsening of the financial positions of private domestic sectors. Relative to nominal GNP the financial surplus of households has tended to decline, while the financial deficit of the corporate sector has been increasing. With the public sector deficit steadily shrinking during the recovery, the foreign sector has become an important net lender following the widening of the deficit of U.S. balance of payments on current account. Judging from the preliminary estimates for the first half of 1978, these financial trends have continued and strengthened this year.

In Germany, the vigorous upturn in spending by households and the moderate expansion in corporate investment have implied a slight net worsening in

1. The methodology applied in this section is similar to that presented in *Economic Outlook*, No. 20, December 1976. It has been described in detail in a paper by H. Dudler and J.C. Chouraqui, "Flow of Funds Analysis in a Short-term Context", Banque de France, *Cahiers économiques et monétaires*, No. 7, Paris 1978, pp. 113-140.

Table 15
Financial balances by sectors[a]
Surplus (+) or deficit (−) as percentage of nominal GNP/GDP

	1973	1974	1975	1976	1977	1978
United States						I[b]
Personal sector	4.0	4.2	5.0	3.1	2.0	1.4
Corporate business sector	−3.0	−4.2	0.5	−1.0	−1.5	−2.8
Public sector	−0.2	−0.7	−5.1	−2.8	−1.9	−0.7
Foreign sector	0.1	0.2	−0.8	0.1	1.1	1.5
Japan						Q1[b]
Personal sector	8.8	10.3	10.5	11.4	11.1	9.0
Corporate business sector	−7.6	−8.5	−4.1	−3.9	−2.6	−0.8
Public sector	−2.9	−3.7	−7.3	−7.4	−7.3	−7.7
Foreign sector	0.1	1.0	0.1	−0.7	−1.5	−2.4
Germany						I
Personal sector	7.9	8.6	9.4	7.8	7.2	6.8
Corporate business sector	−8.3	−5.5	−3.4	−4.0	−4.8	−3.6
Public sector	1.2	−1.4	−5.8	−3.6	−2.6	−2.6
Foreign sector	−1.3	−2.6	−1.0	−0.8	−0.6	−1.1
United Kingdom						Q1[b]
Personal sector	4.5	7.0	8.2	7.5	7.2	6.7
Corporate business sector	−1.5	−5.8	−0.6	−0.9	−1.4	−1.5
Public sector	−4.1	−6.7	−8.5	−7.7	−4.7	−5.1
Foreign sector	1.5	4.9	1.7	1.0	0.1	0.9

a) Financial balances shown for public sector are not necessarily identical with figures for general government net lending shown in Table 12 due to differences in concept and recording practices. For sources and definitions see Technical Annex.
b) Seasonally adjusted.

Table 16
Indicators of households' financial behaviour[a]
Flows as percentage of disposable income

	1973	1974	1975	1976	1977	1978
						I[b]
United States						
Net financial investment	7.1	7.5	9.4	6.8	5.3	3.7
Acquisition of financial assets	15.7	12.5	14.1	15.0	16.4	14.2
Of which: Liquid assets	12.3	9.3	9.9	10.9	11.6	11.6
Indebtedness	8.6	5.0	4.7	8.2	11.1	10.5
Of which: Consumer debt	2.6	1.0	0.9	2.0	2.7	3.2
Mortgages	5.3	3.7	3.6	5.3	7.2	6.5
Japan						
Net financial investment	13.2	14.7	14.2	15.4	15.0	..
Acquisition of financial assets	27.7	21.2	23.8	24.0	22.2	..
Of which: Liquid assets	20.7	15.4	16.1	15.5	14.5	..
Indebtedness	14.5	6.5	9.6	8.6	7.2	..
Germany						I
Net financial investment	12.7	13.6	14.1	12.0	11.2	10.7
Acquisition of financial assets	13.6	13.7	15.2	14.0	13.2	12.7
Of which: Liquid assets	6.8	7.9	9.6	7.0	7.2	5.5
Indebtedness	0.9	0.1	1.1	2.0	1.9	2.0
Of which: Consumer debt	0.7	0.1	1.0	1.9	1.8	2.0
United Kingdom						Q1[b]
Net financial investment	8.1	10.9	9.8	8.6	9.0	7.7
Acquisition of financial assets	16.5	14.8	14.2	14.2	14.6	15.9
Of which: Liquid assets	11.8	8.8	8.3	6.6	8.9	11.6
Indebtedness	8.4	3.9	4.4	5.6	5.6	8.2
Of which: Consumer debt	2.2	0.1	–0.5	0.8	1.4	0.9
Mortgages	5.5	3.8	4.8	4.4	4.0	5.3

a) For sources and definitions see Technical Annex.
b) Seasonally adjusted.

the relative financial positions of private domestic sectors since 1976. This development has been offset by the reduction in the financial deficit of the public sector to the equivalent of around 2½ per cent of GNP and, to a lesser degree, by a smaller foreign sector financial deficit (i.e., a reduced current account surplus). While the public sector deficit in Japan has remained at a virtually unchanged level of around 7½ per cent of GNP since 1975, the combined financial surplus of the private domestic sectors has increased steadily, leaving as a counterpart the significant rise in the foreign sector's deficit. In the case of the United Kingdom, the most striking features have been the sharp decline in the public sector deficit by around 3 per cent of GNP since 1976 and the elimination of the foreign sector's surplus (reflecting the improvement in the United Kingdom's current balance). However, these trends may have been reversed slightly during 1978.

Households' financial behaviour

The rapid growth of private consumption and house-building activity in the United States is clearly reflected in households' financial transactions during recent years. As shown in Table 16, household indebtedness, including both consumer debt and mortgages, rose steeply to levels of more than 10 per cent of disposable income in 1977 and 1978. By borrowing more heavily for current consumption purposes and investment in durables, households in the United States may have been seeking to make advance purchases of real assets as a hedge against accelerating inflation. Consumers have apparently been willing to accept rising debt amortisation burdens as, in the prevailing inflationary climate, they may have been counting on more rapid increases in their nominal incomes. This has been a major factor in the upward pressures on market interest rates.

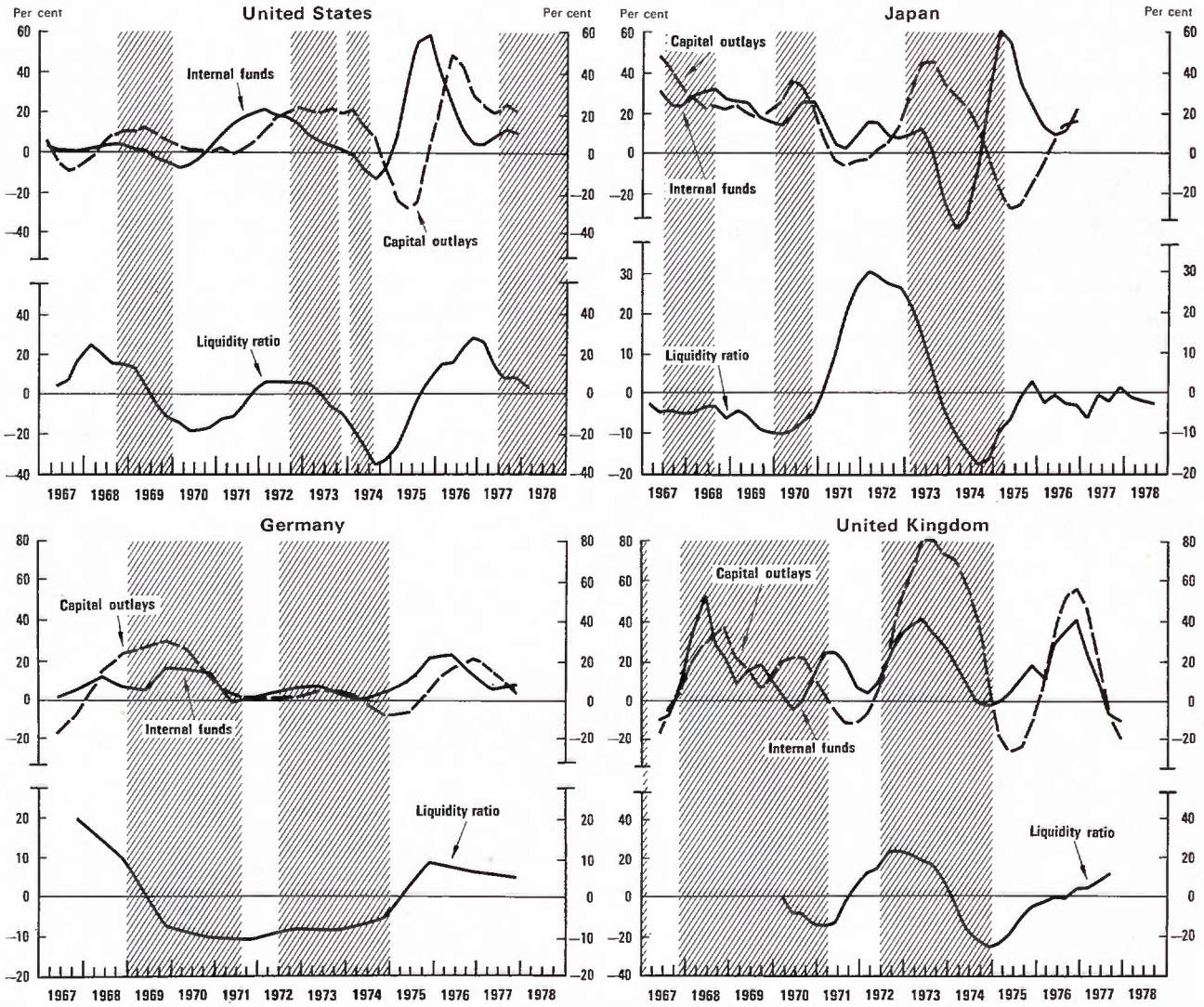
The fall in the savings rate in Germany—which has greatly helped the recovery of private consumption—has been accompanied by a moderate increase in households' indebtedness relative to disposable income. It must, however, be stressed that German data on financial flows do not provide an adequate measure of the rising personal indebtedness for housing investment; the partial indicators available suggest that mortgage debt incurred by households expanded quite considerably in 1977 and 1978. In Japan, households' propensity to borrow has remained at a low level. Since, at the same time, the private savings rate has increased,

financial data reflect a very cautious attitude on the part of individuals regarding both consumption and investment spending. In the United Kingdom, where households' relative debt burden has remained fairly stable, the fall in interest rates until the spring of 1978 acted as a stimulus to personal borrowing to finance purchases of consumers durables, and the demand for mortgages has remained strong, against the background of sharply rising house prices.

In all four countries, financial investment by households—as a percentage of disposable income—has increased or remained steady over the last two years (Table 16). In the United States and Germany, the ratio of financial investment to disposable income has been close to the historically high level recorded in 1973. The rapid accumulation of financial savings has however been less concentrated on liquid assets, except for the United Kingdom. This seems to indicate a tendency towards greater diversification by households of their financial portfolios which, until recently, may have been facilitated by subsiding longer-term inflation fears and greater stability of bond prices.

CHART G

INDICATORS OF CORPORATE FINANCIAL POSITIONS [1]



1. The indicators cover private non financial corporations. They are based on quarterly data (seasonally adjusted) except for Germany for which half yearly data (not seasonally adjusted) have been used. Capital outlays and internal funds are expressed as percentage changes of 3-period moving averages over a year earlier. Liquidity ratios are expressed as deviations from long term trends. Shaded areas indicate periods of restrictive monetary policy. For further definitions see Technical Annex.

Corporate finance

Financial positions of private corporations have deteriorated significantly in the United States in 1977-1978. The growth of capital spending by the business sector has been faster than the flow of internally generated funds in the form of undistributed profits and depreciation allowances (see Chart G). With external financing needs increasing, non-financial corporations relied much more heavily on credit market funds. A growing share of business credit requirements was met through short-term borrowing at banks. At the same time, U.S. corporations have reduced bond and equity financing substantially compared with the record volumes of debentures and shares issued in the earlier stages of the cyclical recovery. This reduction in long-term debt financing was concentrated in bond issues by large, highly-rated firms which had improved their debt structure in previous years. Moreover, the recent rise in bond yields and the lower level of share prices may have discouraged non-financial corporations from issuing long-term debt, while expectations were growing that the cyclical peak in market interest rates might not be far off.

Recent trends in corporate financing contrast with the pattern observed in 1975-1976, a period during which U.S. companies aimed at restructuring their balance sheets. This is clearly evident from Table 17 in which three main features stand out:

- a reduction in corporate self-financing (decline in the internal funds/capital outlays ratio) and, as counterpart, an increase in corporate indebtedness to credit markets (rise in debt/equity ratio);
- a marked reversal of the earlier trend towards lengthening the maturity structure of corporate debt; this is reflected in the rise of the short-term debt/total debt ratio to a level approaching the peak recorded at the end of 1974;
- a deterioration of corporate liquidity as measured by the ratio of liquid assets to current liabilities; this means that firms increased their holdings of liquid assets only moderately compared to the rise in short-term indebtedness.

In contrast to the developments observed in the United States, the improvement in corporate sector financial positions has been consolidated in Japan and Germany (see Chart G and Table 17). This mirrors the moderate expansion of productive investment in those two countries, but may also reflect more cautious financing habits of corporations following the financial strains experienced around the mid-1970s. In Japan, businesses have aimed at reducing the burden of their interest payments. They have slowed down investments in liquid assets, effected net repayments on past loans, and restrained from new borrowings. Together with downward adjustments in plant and equipment invest-

Table 17
Selected balance sheet ratios for non-financial corporations[a]

	1973	1974	1975	1976	1977	1978
United States						I[b]
Internal funds/capital outlays	0.68	0.56	1.07	0.88	0.82	0.70
Short-term debt/total debt	0.24	0.26	0.24	0.24	0.25	0.26
Liquid assets/current liabilities	0.25	0.27	0.32	0.34	0.30	0.29
Total debt/equity	0.58	0.99	0.78	0.68	0.81	..
Japan						Q1
Internal funds/capital outlays	0.61	0.41	0.83	0.85	0.89	..
Short-term debt/total debt	0.75	0.76	0.74	0.74	0.73	0.73
Liquid assets/current liabilities	0.29	0.28	0.29	0.29	0.30	0.30
Total debt/equity	9.85	10.30	10.57	11.08	11.31	11.31
Germany						I
Internal funds/capital outlays	0.71	0.75	0.89	0.87	0.85	0.97
Short-term debt/total debt	0.35	0.36	0.33	0.33	0.32	0.32
Liquid assets/current liabilities	0.88	0.78	0.87	0.89	0.96	0.96
Total debt/equity	5.81	5.95	5.55	5.74	5.80	5.77
United Kingdom						Q1[b]
Internal funds/capital outlays	0.89	0.65	0.93	0.92	0.87	0.84
Liquid assets/current liabilities	0.70	0.55	0.67	0.66	0.69	..

a) Figures for internal funds and capital outlays represent flows. Those for short-term debt, total debt, liquid assets, current liabilities and equity represent outstanding amounts at the end of period. For sources and definitions see Technical Annex.
b) Seasonally adjusted.

Table 18
Public sector borrowing[a]

	1973	1974	1975	1976	1977	1978
United States						I[b]
Public sector borrowing requirement (as percentage of nominal GNP)	1.9	2.3	6.9	5.9	4.9	4.0
Of which: Central government	0.8	1.1	6.0	4.7	3.4	2.7
Public sector share in credit market funds raised by non financial sectors (per cent)	10.5	14.5	47.4	32.4	24.3	21.3
Japan						Q1[b]
Public sector borrowing requirement (as percentage of nominal GNP)	5.1	6.6	9.4	10.4	10.4	12.7
Of which: Central government	0.8	2.1	4.5	5.9	6.6	5.1
Public sector share in credit market funds raised by non financial sectors (per cent)	18.6	28.8	36.9	40.4	47.3	71.8
Germany						I
Public sector borrowing requirement (as percentage of nominal GNP)	1.7	2.4	6.3	4.2	3.1	3.1
Public sector share in credit market funds raised by non financial sectors (per cent)	16.1	21.9	42.8	30.6	26.5	31.8
United Kingdom						Q1[b]
Public sector borrowing requirement (as percentage of nominal GDP)	6.6	8.7	11.3	8.4	4.8	5.0
Of which: Central government	3.7	4.7	9.0	6.2	3.6	4.4
Public sector share in credit market funds raised by non financial sectors (per cent)	17.8	40.5	61.1	32.2	49.6	..

a) For sources and definitions see Technical Annex.
b) Seasonally adjusted.

ment, this objective of curtailing financial cost has been one of the main causes of the weak demand for credit market funds by Japanese firms in the recent period. Similarly in Germany, firms have tended to reduce investment risks by increasing the proportion of internal resources in overall financing. In the first half of this year, when business capital spending showed first signs of a sustained pick-up, internal funds accounted for 97 per cent of corporate gross investment, about the highest self-financing ratio recorded in the post-war period. The fact that the number of bankruptcies of industrial enterprises has considerably increased since the 1974/1975 recession may well explain this cautious attitude.

Despite a slight deterioration in self-financing conditions, the overall financial situation of business companies in the United Kingdom has hardly changed during the past eighteen months. Companies' liquidity positions have tended to improve somewhat, mainly reflecting a reduction in current liabilities[2].

Public sector borrowing

The public sector borrowing requirement declined in all the countries except Japan in 1977-1978[3] to levels well below those recorded in 1975-1976 (Table 18). This common trend mainly reflects a reduction in central government deficits due, in the United States and Germany, to a cyclical increase in tax revenues and, in the United Kingdom, to action by the authorities to cut public spending in the context of stabilisation programmes. The share of funds raised by the public sector on credit markets has accordingly tended to decline. In the United States, where the demand for credit by firms and households rose steeply, competition in financial markets between the public sector and the private sector became stronger. With the Federal Reserve not fully accommodating the resulting pressure on financial markets, supply of and demand for credit could be equilibrated only at rising interest rates.

Reflecting mainly the widening of the central

2. The improvement is more marked with regard to corporations' net liquidity, because of exchange rate influences. Since the amount of borrowing in foreign currencies by U.K. companies exceeded their foreign exchange deposits, the rise in the pound until early 1978 reduced their net liabilities in sterling terms.

3. For previous trends see "Public Sector Indebtedness and Government Financing", *OECD Economic Outlook*, No. 22, December 1977.

Table 19
Sectoral contributions to total monetary expansion[a]

	1973	1974	1975	1976	1977	1978 I
United States						
Total monetary expansion[b]	13.7	8.6	4.9	8.5	10.4	10.9
Of which: Contribution from[c]:						
Private domestic sectors	84.4	85.7	–15.5	50.5	80.0	85.6
Government sector	16.8	24.4	98.2	40.6	16.3	12.8
Foreign sector	–1.1	–10.2	17.4	8.9	3.6	1.7
Japan						
Total monetary expansion[b]	13.1	12.8	15.9	14.3	11.9	12.7
Of which: Contribution from[c]:						
Private domestic sectors	127.2	96.7	72.7	72.4	69.8	63.3
Government sector	–3.6	17.9	31.5	23.8	18.6	25.3
Foreign sector	–23.6	–14.6	–4.2	3.7	11.5	11.4
Germany						
Total monetary expansion[b]	12.0	7.5	12.4	9.8	8.7	9.1
Of which: Contribution from[c]:						
Private domestic sectors	70.9	66.2	32.0	64.9	72.8	71.4
Government sector	5.8	29.3	49.3	33.9	25.2	29.1
Foreign sector	23.3	4.6	18.8	1.1	2.0	–0.5
United Kingdom						
Total monetary expansion[b]	26.3	13.2	8.9	12.2	9.6	13.3
Of which: Contribution from[c]:						
Private domestic sectors	88.3	94.0	–2.1	79.2	77.9	67.8
Government sector	23.7	55.9	108.0	53.1	–5.4	–12.2
Foreign sector	–12.0	–49.8	–5.9	–32.5	27.5	44.4

a) For sources and definitions see Technical Annex.
b) Percentage growth from previous year.
c) Percentage of total.

government deficit since the 1974/1975 recession, the public sector borrowing requirement has continued to increase steeply in Japan. In 1977, it corresponded to about 10½ per cent of GNP (6½ per cent on account of the central government), or about twice the levels observed in the other three countries. An increasing proportion of the funds raised by the non-financial sectors on the domestic credit market thus went to the public sector. While the demand for credit by the private sector has continued to be weak, large-scale bond-financing of the government deficit has, nevertheless, created some difficulty this year. As investors shifted their portofolios towards shorter-term securities, whose yields fluctuate more freely following the recent move towards liberalisation of the money market, long-term bond prices came under downward pressure. To counteract this tendency, the authorities have shortened the original maturity of newly issued government bonds and widened the scope for open market operations in bonds.

Sectoral contributions to domestic monetary expansion

Recent trends in financial positions of the various economic sectors have influenced the sources of total monetary expansion (Table 19). In the United States, increased borrowing by households and non-financial corporations from banks in 1977 and the first half of 1978 resulted in larger relative contributions of these two sectors to monetary expansion. A roughly similar situation, although less accentuated, has emerged in Germany. In Japan domestically induced money creation was initiated more heavily through the central government whose borrowing from banks increased in line with the rise in its borrowing requirement. The strengthening of Japan's external position also contributed to monetary expansion. In the United Kingdom, where the current account deficit was corrected, externally generated monetary growth has tended to advance more rapidly than that caused by domestic sectors.

WAGES, COSTS AND PRICES

Introduction

Weak labour market conditions in nearly all countries, and incomes policies in a few, have contributed to a substantial moderation of nominal wage increases in 1978. As consumer prices have decelerated less, real wage gains have declined—in line with or even below productivity increases—in a number of countries. Moreover, with the area experiencing favourable terms-of-trade developments, 1978 witnessed a considerable narrowing of the "real wage gap", discussed below. The United States was the main exception to this latter trend: due to an exceptionally weak productivity performance and despite unfavourable terms-of-trade changes and food price developments, real wage gains exceeded the rise in national income, implying a rather large shift to labour income.

Near-term price prospects for the OECD area have improved somewhat, largely as a result of a better situation in respect of food prices in North America and lagged effects of the terms-of-trade improvement. However, the underlying trend may have changed only little and present output forecasts imply little easing in unit cost pressures arising from better productivity performance. Thus, the area's inflation rate over the next 12-15 months may fall only slightly from the 7 per cent trend which has persisted since late 1977. Moreover—and in contrast to the forecast convergence of real growth and balance-of-payments positions—inflation differentials between the United States and other major OECD countries may widen further next year.

Another feature of the outlook is that the favourable development in the area's import prices, which contributed importantly to a moderation of domestic prices in 1978, is unlikely to be repeated in 1979. Indeed, a lagged adjustment of commodity prices to recent exchange-rate changes is underway and the future course of oil prices is uncertain. Consequently, any further narrowing of the "real wage gap" will mainly depend on real wage and productivity developments. On present trends, a moderation of real wage expectations is likely to continue in most countries, but a pattern of divergence, similar to that observed in 1978, is forecast for 1979.

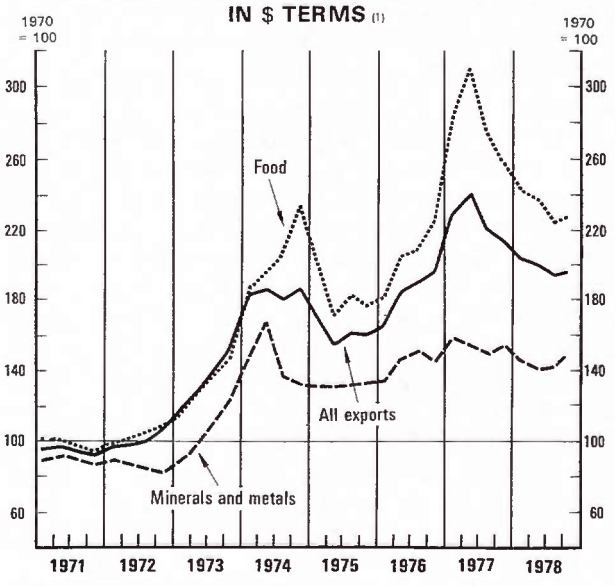
Recent commodity price developments and prospects

Commodity price developments since the summer have been dominated by two events: better world crop prospects and the fall in the U.S. dollar. Although a catch-up for dollar devaluation is underway, lags in the adjustment of dollar quoted commodity prices temporarily reduced non-oil commodity prices to below their previously forecast 1978 second-half level[1]. Including oil, primary commodity import unit values may have fallen by 4-5 per cent (in SDR terms) in the second half of 1978 (Table 20 and Chart H).

The better food price outlook is largely supply-related. Tropical beverage prices stabilised with the subsiding of fears related to the effects of frost in Brazil on the coffee crop and with improved cocoa supplies. World grain prospects (especially in the USSR and a number of large developing countries) are now for a record crop. Consequently, carry-over stocks held by major exporting countries may

CHART H

INDEX OF NON-OIL COMMODITY PRICES IN $ TERMS (1)



Source: *National Institute Economic Review, NIESR.*
1. Indices corrected for changes in the United States effective exchange rate.

1. Measured in U.S. dollars, spot non-oil commodity prices are marginally below their previously forecast 1978 second-half level. However, the fall in the dollar against a total commodity-import weighted basket of currencies would indicate a 1978 second-half level roughly 6 per cent lower than forecast in *Economic Outlook*, No. 23.

Table 20
Index of non-oil commodity prices
In terms of US $, 1977 = 100

	1974 Peak	1975 Trough	1977 April	1977 Dec.	1978 Oct.
All non-oil commodities	86.7 (Q2)	71.4 (Q4)	110.4	94.6	101.9
Food	86.2 (Q4)	63.1 (Q4)	116.2	91.0	94.5
Agricultural raw materials	107.8 (Q1)	77.9 (Q3)	103.5	96.7	111.8
Metals and minerals	113.4 (Q2)	86.8 (Q3)	100.9	102.9	112.6

Source: National Institute for Economic and Social Research, London.
Note: Bracketed figures give peak and through quarters.

be at their highest levels since the 1960s. An improved feedgrain situation may also contribute to higher white-meat supplies, helping to alleviate the continuing tight beef supply situation.

Spot market prices for industrial materials were temporarily depressed by the devaluation of the dollar, but an adjustment took place in the autumn. The observation that a fall in the numéraire affects spot commodity prices is somewhat puzzling. So far as can be judged, overall demand and supply conditions were close to earlier predictions (Chart I)[2]. Moreover, given the market-clearing nature of spot price behaviour[3] and the fact that contract lags are virtually non-existent, an automatic compensatory rise in world prices for the devaluation of the dollar would normally be expected[4]. The 2-3 month lag observed between the decline in the dollar and an adjustment in spot industrial materials prices also introduces a degree of uncertainty into the outlook. First, it implies that commodity markets may have a higher degree of imperfection than previously assumed. Second, it makes a distinction between transient factors and underlying trends more difficult.

On the basis of present forecasts for final demand, spot non-oil commodity prices are likely to rise relatively moderately (in dollar terms) over the next 12 months. Allowing for a complete catch-up in fall 1978, and a subsequent resumption of trend, prices might be only 7 per cent higher than a year earlier by the second half of 1979. Food prices are likely to remain comparatively stable, reflecting better crops and ample stocks. On the other hand, agricultural raw materials and minerals and metal prices might rise 8-10 per cent, reflecting a changing demand/supply balance and catch-up effects (Table 60). Future oil prices, in particular, are difficult to forecast[5]. The technical forecasting assumption is for no change in "real" oil prices after 1st January, 1979[6]. This implies an oil price increase of roughly 5 per cent (in dollar terms) at the beginning of 1979 and a somewhat larger rise between the calendar years 1978 and 1979.

Given the lags between spot and transactions prices, non-oil import unit values (in dollar terms) might be only 1-2 per cent higher in 1979 than a year earlier, even allowing for a relatively strong recovery throughout the next 12-15 months. This would imply a considerable deterioration in primary producers' terms of trade in 1978 and a slow reversal through 1979. For the OECD area as a whole, the terms of trade are therefore likely to improve only marginally in 1979, but could still contribute to dampening cost inflation and redressing the gap between real wages and productivity discussed below.

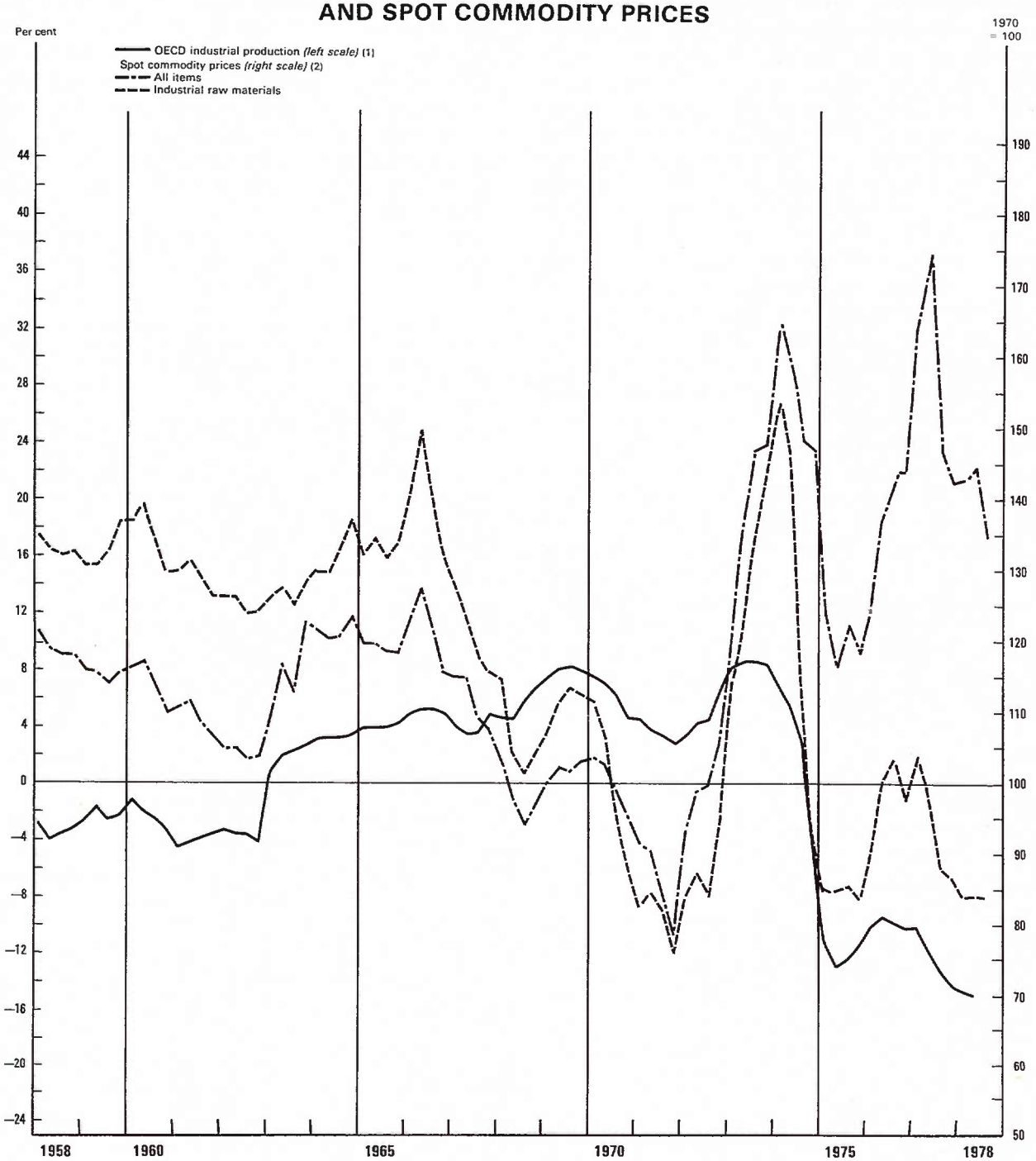
Current wage developments and prospects

Whereas nominal wages have an obvious bearing on the general development of inflation, they should also be considered in the wider context of real wage/productivity relationships and adjustments to changes in the terms of trade[7]. Preliminary estimates for 1978 indicate that, for the OECD area, the increase of nominal wages decelerated by about 1¼ per cent to 9 per cent. Real wage costs, with output prices rising on average by 7¼ per cent, increased broadly in line with productivity gains; and with an improvement in the area's terms of trade there was a slight closing in the area's real wage gap and a small shift to non-wage incomes. The pattern, however, differed widely between countries. While

2. Industrial output in the seven largest countries expanded slightly faster than forecast in the first six months of 1978. The anticipated reduction of surplus producers' inventories appears to have been in line with expectations, partly reinforced by supply difficulties (civil war in Zaire and scattered strikes in the pulp and paper and mining industries).
3. This argument is particularly relevant for homogeneous products. This is not to say that commodities are perfectly homogeneous. Rather that commodity trade is carried out with clearly defined quality and grade differentials which are maintained through highly efficient arbitrage and terminal facilities.
4. However, the extent of the adjustment is not completely clear. The usual practice of weighting exchange-rate changes by commodity imports would tend to overstate the compensatory rise because the United States is both the world's largest producer and consumer of industrial materials.
5. The oil market, which had been characterised by excess supply, began to tighten in late summer, partly in anticipation of a price increase at end-year. However, supply disruptions in Iran have recently resulted in a sharp tightening in market conditions, particularly for light grade crudes.
6. "Real" oil prices are measured against OECD manufactured export prices in U.S. dollar terms.
7. See *Economic Outlook*, No. 21, pp. 61-64.

CHART I

OECD INDUSTRIAL PRODUCTION AND SPOT COMMODITY PRICES



1. Percentage deviations from trend 1958-77.
2. The Economist dollar index for commodities, adjusted for changes in the US $ effective exchange rate and deflated by the GNP price index for the seven largest OECD countries.

the United States experienced a significant deterioration in productivity performance and a shift to labour income, the real wage gap narrowed considerably in the other larger countries. Small countries, as a group, suffered a terms-of-trade loss in 1978, but nevertheless most of them also recorded some reduction in the gap.

In most countries, negotiations for the 1979 wage

round are just beginning. The indicators generally point to continued moderation in nominal wages in many European countries and Japan. This would largely reflect the somewhat better trend in consumer prices (partly related to lower import prices) and weak labour market prospects. The outlook for North America is less favourable; on current trends, wage increases could be significantly higher in 1979.

The likelihood of a significant improvement in productivity gains is relatively small, as present demand and output forecasts indicate little rise in capacity utilisation rates. In the United States, some improvement from the abnormally depressed 1978 productivity performance is expected; but further cyclical gains are unlikely. In Europe, with a faster growth of output, productivity performance could improve slightly[8]. As a result, total unit labour costs, for the area as a whole, may remain close to their current 7 per cent trend, but with a continuing large dispersion between countries[9].

In the United States, compensation per employee increased by 8½ per cent in 1978, the same rate as the previous year. However, productivity performance deteriorated unexpectedly and unit labour costs rose very sharply. A number of factors could suggest stronger wage inflation in 1979. First, 1979 is a heavy bargaining year and major settlements concluded in the year 1978 would point to an acceleration. Second, if labour market conditions are now close to the zone of accelerating inflation, additional pressures could arise from catch-up by non-union workers. Third, higher minimum wages and social security payments serve to increase pressure on nominal wage increases and total compensation (Table 21). Much may depend on the degree of success attending the voluntary wage/price guidelines. But even allowing for some dampening effect from the anti-inflation programme[10], unit labour costs could rise by close to 8 per cent, unless there is a strong recovery in productivity gains (Table 22).

In Japan, nominal wage increases decelerated in 1978; but because of the marked improvement in

8. In Europe, a trend towards negotiating a shorter working week and job security may also moderate nominal wage behaviour. It is, however, uncertain how productivity and unit labour costs will be affected by shorter working time.

9. The trend in manufacturing could be ½-¾ percentage point lower because of higher productivity gains than in the service sectors.

10. A more detailed assessment of the anti-inflation programme is difficult given the voluntary nature of the guidelines, and exemptions permitted (low-paid, previous contracts, emulation clauses, etc.). In addition, details of the real wage insurance plan have not yet been finalised, and will ultimately have to be passed by the Congress. The present proposal would provide a real wage guarantee for workers adhering to the 7 per cent wage standard. Individual groups of workers would receive a tax rebate in the event that the rise in the CPI exceeded 7 per cent over the relevant 12-month period. It should be noted that no penalty is attached to wage increases in excess of the pay standard.

Table 21
Hourly earnings in manufacturing
Percentage changes

	Average 1966 to 1976	From previous year					Latest month
		1977	1978	1979	1978 Q1	1978 Q2	
United States	6.7	8.5	8½	9	8.9	8.4	8.8 Oct.
Japan[a]	16.4	9.5	7¾	8	9.0	7.0	6.9 Sept.
Germany	8.6	7.5	5½	6¼	5.1	5.0	..
France[b]	12.8	12.7	13¼	13	12.0	12.0	..
United Kingdom[c]	12.8	10.3	14½	12¼	11.8	15.5	16.1 July
Canada	9.9	10.8	7½	9¼	8.5	6.8	6.7 July
Italy[b]	15.3	27.9	14	13¼	19.7	16.1	14.7 Aug.
Austria[a]	10.5	8.6	7½	6	8.0	2.7	0.9 June
Belgium	12.5	9.2	7½	6½	8.8	6.9	..
Denmark	14.2	10.1	9½	7	11.8	10.0	9.5 July
Finland	14.4	8.9	6¾	10	9.3	..	..
Greece	14.6	20.8	20	10	21.2	22.4	..
Ireland	16.0	15.6	17	13	13.1	..	..
Netherlands[b]	11.2	7.3	8	6½	7.2	6.4	3.9 Aug.
Norway	12.2	10.8	8½	4	9.7	6.9	..
Spain	17.4	22.3	22	15½	26.1	25.2	29.2 July
Sweden	..	6.7	8	7¼	9.4	10.3	8.9 Aug.
Switzerland[a]	7.0	1.7	2½	2½	3.0	3.0	..
Australia[b]	11.6	11.1	7	6½	9.7	6.2	4.3 Aug.
Total OECD[d]	10.4	10.2	9	9	9.8	9.0	..
OECD Europe[d]	11.9	12.0	10¼	9½	11.0	10.7	..

a) Monthly earnings.
b) Hourly rates for actual data.
c) Weekly earnings.
d) 1977 GNP/GDP weights and exchange rates.

Table 22
Unit labour costs in manufacturing
Percentage changes

	Average 1966 to 1976	From previous year					
		1977	1978	1979	1978 Q1	1978 Q2	Latest month
United States	4.1	6.6	7½	8	8.3	7.3	5.8 Sept.
Japan	7.3	3.9	1	2	1.4	–2.0	–2.9 Sept.
Germany[a]	4.9	3.6	2	1½	3.5	4.6	2.1 July
France[b]	6.9	9.5	9½	8	9.8	6.8	..
United Kingdom	10.3	11.1	13¼	9½	13.8	..	13.2 May
Canada	5.7	5.5	3½	4	5.2	3.2	–0.3 July
Italy[c]	11.3	17.4	12	10¾	..	..	..
Total[d]	5.8	6.8	6¼	6¼	7.1	..	..

a) Mining and manufacturing.
b) Industry.
c) The 1977 data (based on compensation) is lowered by cut in employers' social security charges.
d) 1977 GNP/GDP weights and exchange rates.

the terms of trade, real wage incomes rose as rapidly as in 1977. For 1979, spring-round increases in basic wages of 6 per cent are assumed, as in 1978, partly due to the improved profit positions accruing from lower import prices. The trend in unit labour costs in manufacturing might accelerate marginally to 2 per cent. In Germany, real wage increases declined only slightly in the face of a relatively moderate growth of nominal wages, for similar external reasons. For 1979, Germany's improved profit situation and stronger labour market conditions are assumed to lead to some acceleration in basic wage increases, perhaps to some 6 per cent in the next wage round. Hourly earnings might rise slightly faster, with the re-emergence of modest wage drift. However, a better productivity performance could leave unit labour cost increases in manufacturing still below 2 per cent.

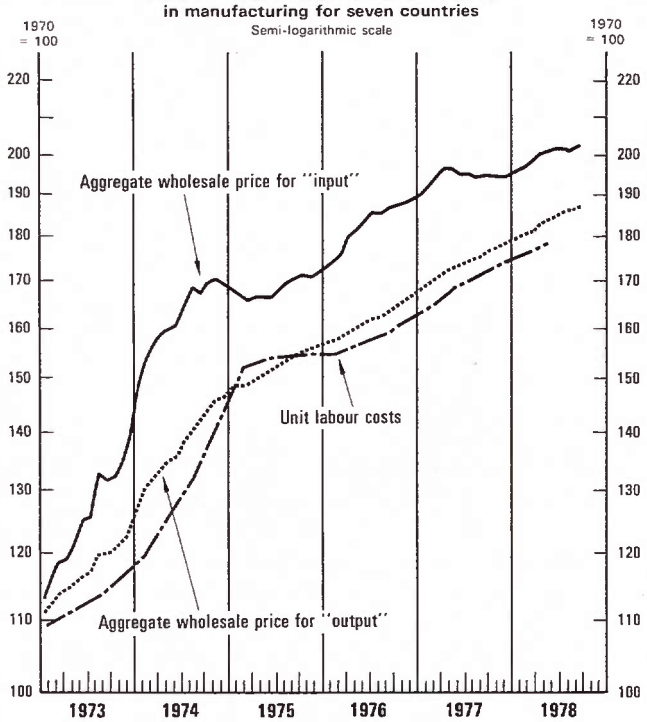
In France, nominal wages continued to rise strongly in 1978, partly influenced by higher pay for the lowest paid. With consumer prices accelerating during the year, the growth of real wages slowed to about 3¼ per cent, so that the improvement in terms of trade largely accrued to non-wage incomes. For 1979, little change in nominal wage or productivity trends is forecast and unit labour cost rises are likely to remain relatively high. In the United Kingdom, an overshooting of the Phase III pay norm, together with the moderating influence of falling import prices on the Consumer Price Index, led to real pre-tax wage increases of almost 4 per cent in 1978. A major uncertainty for 1979 is the degree to which the Phase IV norm (5 per cent increase in basic pay) will be met. Notwithstanding large post-tax real wage gains in 1978 and relatively weak labour market prospects, current settlements suggest that nominal wage increases may considerably exceed the official norm in 1979[11]. This would permit little easing of pressures on nominal wages and unit labour costs, which became stronger in 1978. In Italy, nominal wages decelerated markedly in 1978, mainly reflecting the ending of a special compensation arrangement within the indexation system. Real pre-tax wages nonetheless increased 1½ per cent, partly due to an improvement in the terms of trade. Renegotiations of major collective agreements have begun this autumn and will not be completed before the early months of 1979. The forecast assumes small increases in real wages. However, unit labour cost rises, of perhaps 11 per cent, might decline only marginally from 1978. In Canada, nominal wage increases decelerated substantially in 1978, leading to a marked fall in real wages which was compounded by a large deterioration in terms of trade. For 1979, a certain acceleration in nominal wages and labour costs is assumed, reflecting some catch-up following the phasing-out of wage/price controls. However, wage and unit labour cost increases would still be below the OECD average.

The moderation of nominal wage increases in other OECD countries as a group was quite substantial in 1978. By 1979, they should be in line with the area average. In a number of countries, balance-of-payments constraints, considerations of international competitiveness, links to the EEC "snake" or a "hard currency" option have strengthened attempts to dampen wage inflation. In some, these attempts have been strongly influenced by the need to match the trend in German unit labour costs, which is below the "snake" average and even further below the area average. In Austria, basic wage rate rises were only slightly above those in Germany in 1978, but a shift in employers'

11. Hourly compensation will increase somewhat more because of the 1½ per cent rise in employers' national insurance charges, beginning in October 1978.

CHART J

COST AND PRICE INDICATORS
in manufacturing for seven countries
Semi-logarithmic scale



financing of family allowances led to a larger rise in total labour costs. Further nominal wage moderation is forecast for 1979, in line with weaker labour market prospects and the deceleration in consumer price increases. In Switzerland, nominal wages were virtually stable in 1978, but a slight acceleration is possible for 1979. In Belgium, a deceleration in the rate of wage gains was supported by stable import prices. However, part of this was offset by an end to the freeze on indexation payments for the highly paid; in 1979, existing indexation arrangements and continued stability of Belgium's import prices could lead to further moderation in nominal wage increases, a trend that may also be influenced by negotiations for a shorter working week. In the Netherlands, wage drift led to an acceleration in nominal wages to above the "zero real wage" norm in 1978. For 1979, emphasis on shorter working time and job security in wage negotiations may result in further modest nominal wage moderation[12].

In Denmark, nominal wage gains have declined somewhat, although wage drift has continued to lead to overshooting of the 6 per cent wage norm. Higher indirect taxes and public charges produced a relatively sharp fall in real wages in 1978, but further deceleration in nominal wages and wage-costs will depend on the outcome of the forthcoming negotiations. In Sweden, the two-year agreement signed in 1978 should result in further wage moderation in 1979. An easing in wage drift should also support this trend. In Norway, real wages continued to rise in 1978, albeit marginally; in order to contain the external deficit, the Government has adopted a wage/price freeze until the end of 1979 and suspended the 1979 wage negotiations. In Finland, part of the centrally negotiated wage increase was postponed to 1979; real wages therefore fell slightly in 1978, but should rebound somewhat in 1979. In Australia, nominal wages decelerated sharply in 1978, reflecting the application of less-than-full indexation, and there was a marginal fall in real wages; a further modest deceleration in nominal wages is forecast for 1979. In Ireland, nominal wages accelerated in 1978, due mainly to tight labour market conditions. In Spain and Greece, nominal wage gains remained very high in 1978, but some moderation is hoped for in 1979.

Some impression of recent profit developments and their implications for price prospects can be obtained by examining the various components of current costs (Chart J). It appears that the slowing-down and subsequent decline in summer 1978 of input prices was initially reflected in an improvement in profit margins in most countries other than the United States. Moreover, the moderation in nominal and real wage gains has, in some countries, allowed a further increase in profit margins and the share of non-wage incomes. The price forecasts for 1979 presented below are broadly consistent with no further change in profit margins for the area as a whole. But there are likely to be important divergences between countries, partly reflecting recent shifts in exchange rates and lagged terms-of-trade effects.

Price developments and prospects

The rise in OECD consumer prices eased a bit in the summer months, with the annual rate of increase (not seasonally adjusted) dropping back to 8 per cent. This reversed the sharp acceleration in the first four months of the year (Table 23). The broadest indicator of inflation, the OECD GNP price deflator, has remained on a relatively stable 7 per cent path since late 1977. Price prospects have improved modestly in most countries, largely as a result of an improvement in the terms of trade. A small deceleration in the OECD GNP deflator and

12. As mentioned earlier it is uncertain how productivity and unit labour costs will be affected by shorter working time.

a somewhat more pronounced moderation in consumer price trends is forecast for 1979. On present exchange-rate assumptions, a narrowing in the dispersion of inflation rates can be expected, but with the important exception that the spread between consumer price increases in the United States and in other major OECD countries is likely to widen over the near term.

The profile during 1978 of a sharp winter acceleration followed by a summer slowdown largely reflected the swing in food prices, particularly in North America[13]. Retail food prices should develop more favourably over the next 12-15 months. As noted earlier, temperate-zone supply prices are unlikely to rise much and the fall in tropical beverage prices should also promote a more moderate food price trend. In North America, despite tight beef supplies, ample harvests point to some deceleration in the rate of food price increases. In Europe and Japan, favourable harvests and lower tropical beverage prices should make for a continuing moderate food price trend in the near term. In the longer run this will be further influenced, in Community countries, by likely modest adjustments in EEC agricultural support prices (Chart K).

Prospects are for little change in the trend in non-food, non-energy prices. This reflects the offsetting

13. **Changes in food price component of CPI**
Percentage changes at annual rates

	1975 to 1976	1976 to 1977	12 months to Sept. 1978	6 months to Sept. 1978
North America	3.0	6.5	11.2	11.8
Europe	12.3	13.3	7.6	8.1
Japan	9.0	7.0	3.5	6.2
Total OECD	7.9	9.6	8.7	9.6

Table 23
Consumer prices
Percentage changes from previous period, not seasonally adjusted

	At annual rate[a]						At monthly rate			
	Average 1961-70	Average 1971-75	1976	1977	12 months to October 1978	6 months to October 1978	July	August	Sept.	October
United States	2.8	6.7	5.8	6.5	8.9	10.1	0.7	0.6	0.8	0.8
Japan	5.8	11.5	9.3	8.1	3.3	3.8	0.4	0.1	1.2	0.2
Germany	2.7	6.1	4.5	3.9	2.1	–0.1	0.0	–0.3	–0.3	0
France	4.0	8.8	9.6	9.8	9.3	10.7	1.2	0.6	0.6	0.9
United Kingdom	4.1	13.0	16.5	15.9	7.8	6.8	0.5	0.7	0.4	0.4
Canada	2.7	7.3	7.5	8.0	8.7	9.7	1.5	0.1	–0.2	1.0
Italy[b]	3.9	11.3	16.8	17.0	12.0[c]	11.5[c]	0.6	0.5	1.6	..
Austria	3.6	7.3	7.3	5.5	3.1	2.4	0.2	0.6	–0.4	0.2
Belgium	3.0	8.4	9.2	7.1	3.9	3.7	0.6	0.5	0.4	0.2
Denmark	5.9	9.3	9.0	11.1	7.4	9.0	0.3	0.4	0.7	1.9
Finland	5.0	11.7	14.4	12.6	6.1	7.0	0.2	0.4	0.8	0.5
Greece	2.1	12.3	13.3	12.1	12.0[c]	7.1[c]	–1.4	–1.6	2.8	..
Iceland	11.8	24.6	33.0	29.9	51.7[d]	54.1[d]	←	3.6[e]	→	←
Ireland	4.8	13.3	18.0	13.6	8.2[d]	10.0[d]	←	1.0[e]	→	←
Luxembourg	2.6	7.2	9.8	6.7	3.3	3.0	0.2	0.1	0.2	0.6
Netherlands	4.0	8.6	8.8	6.4	4.2	4.7	0.8	0.5	0.7	0.2
Norway	4.5	8.4	9.1	9.1	8.0	7.3	1.0	0.3	1.3	0.1
Portugal[b] [f]	3.9	15.4	19.3	27.1	25.6	20.7	1.6	1.8	1.5	3.4
Spain[b]	6.0	12.1	17.7	24.5	16.1	15.9	2.0	1.7	0.8	0.8
Sweden	4.0	8.0	10.3	11.4	7.8	4.5	0.4	–0.1	0.7	0.5
Switzerland	3.3	7.7	1.7	1.3	0.4	–0.2	0	0.1	–0.3	–0.2
Turkey	5.9	18.6	17.4	26.0	67.2[c]	57.6[c]	3.8	2.6	4.5	..
Australia	2.5	10.2	13.5	12.3	7.9[d]	8.2[d]	←	0.6[e]	→	←
New Zealand	3.8	10.2	16.9	14.3	11.2[d]	10.7[d]	←	0.8[e]	→	←
Total OECD[g]	3.4	8.6	8.6	8.9	8.2	8.5	0.7	0.5	0.7	0.7
OECD Europe[g]	3.8	9.6	10.8	11.2	8.8	8.2	0.7	0.5	0.6	0.7
EEC[g]	3.6	9.1	10.3	9.9	6.7	6.4	0.6	0.3	0.5	0.6

a) The data shown in the first four columns refer to averages for calendar years.
b) Break in series: 1977.
c) To latest month available.
d) Since consumer prices are only available on a quarterly basis, the figures shown for the rates of change over 12 and 6 months are calculated as the rates of change over 4 and 2 quarters respectively, to the latest quarter available.
e) The monthly rate is calculated as the change between the two most recent quarterly indices, expressed at a monthly rate and centered at the mid-month of the quarter.
f) Excluding rent.
g) From 1975, weighted by 1975 private consumption and exchange rates.

CHART K

CHANGE IN CONSUMER PRICES

Percentage changes, at annual rates, seasonally adjusted

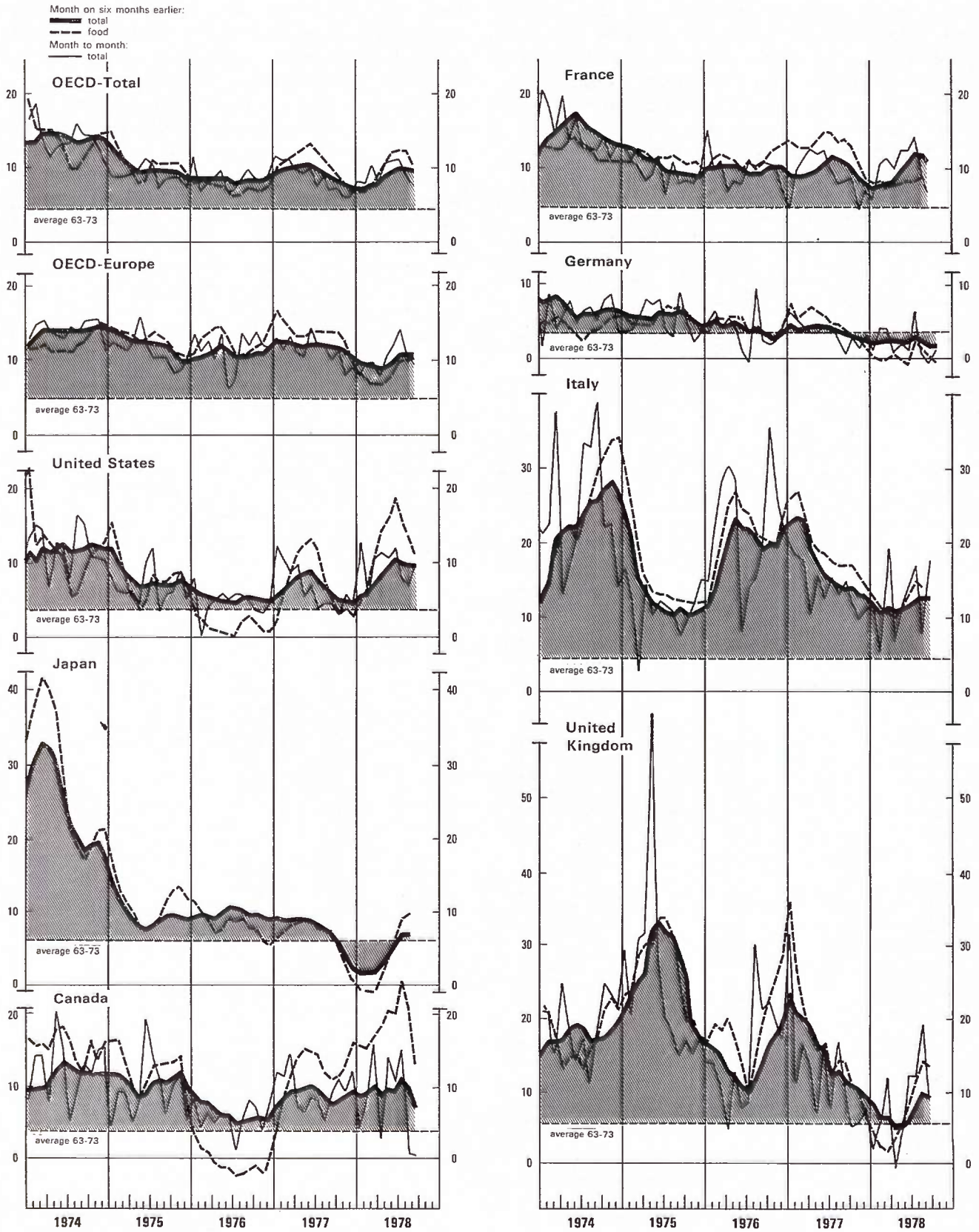


Table 24
Private consumption deflators in seven major countries

Percentage changes seasonally adjusted at annual rates

	Average 1965-66 to 1975-76	From previous year			From previous half-year				
		1977	1978	1979	1977 II	1978 I	1978 II	1979 I	1979 II
United States	5.2	5.7	7	7	5.1	7.7	7	7¼	7
Japan	8.2	6.4	4	4	5.0	3.5	3½	4	5
Germany	4.4	3.8	2¾	2¾	3.4	2.5	2¼	2¾	3¼
France[a]	6.9	9.5	9½	9¼	10.1	8.1	11¾	8¾	8
United Kingdom	9.1	14.7	8	8¾	11.3	6.4	8½	9	8½
Canada	5.5	7.5	8	7¼	8.0	7.6	8½	6½	7¼
Italy[a]	8.5	17.0	12	10¾	12.8	12.1	11	10¾	10¼
Total of above countries[b]	6.2	7.1	6½	6½	6.2	6.5	6¾	6½	6½
Memorandum item									
Four major European countries[b]	6.6	9.4	7	7	8.1	6.2	7½	6¾	6½

a) Consumer price index not seasonally adjusted.
b) 1977 GNP/GDP weights and exchange rates.

effects of continuing pressures emanating from the service sector and moderation in other goods prices. In most countries, service prices are advancing more rapidly than goods prices, partly as a result of a catch-up of government-regulated prices and public charges. Moreover, lower measured productivity levels and a shift in the composition of demand and output towards services tend to raise the overall deflator. A relatively moderate rise in non-food goods prices over the year 1979 is expected, given the forecast movement of basic materials, energy[14] and unit labour costs in manufacturing.

On balance, the outlook is for some further reduction of inflation in most OECD countries, given recent shifts to non-wage incomes, continuing nominal wage moderation and modest improvements in the terms of trade. Japan and Germany might consolidate their price performance, which is already a favourable one in historical terms (Tables 24 and 25). In addition, the average for the smaller OECD countries, which has been consistently above the rate of the seven largest countries, is forecast to decelerate to the OECD average in 1979 (Table 45).

Real wage adjustment

In order to set inflation trends in a wider perspective and analyse the extent to which wage and price

14. The technical assumption of a 5½ per cent rise in oil import prices in 1979 would mechanically add one-tenth of a percentage point to the OECD general price rise. By comparison, the virtual freeze on the dollar price of oil, since mid-1977, resulted in a dampening effect of four-tenths of a percentage point in 1978. These calculations consider only direct effects. The total effects (including indirect pass-on and inflationary expectations) could be substantially greater in the case of a large oil price increase.

Table 25
GNP deflators in seven major countries

Percentage changes seasonally adjusted at annual rates

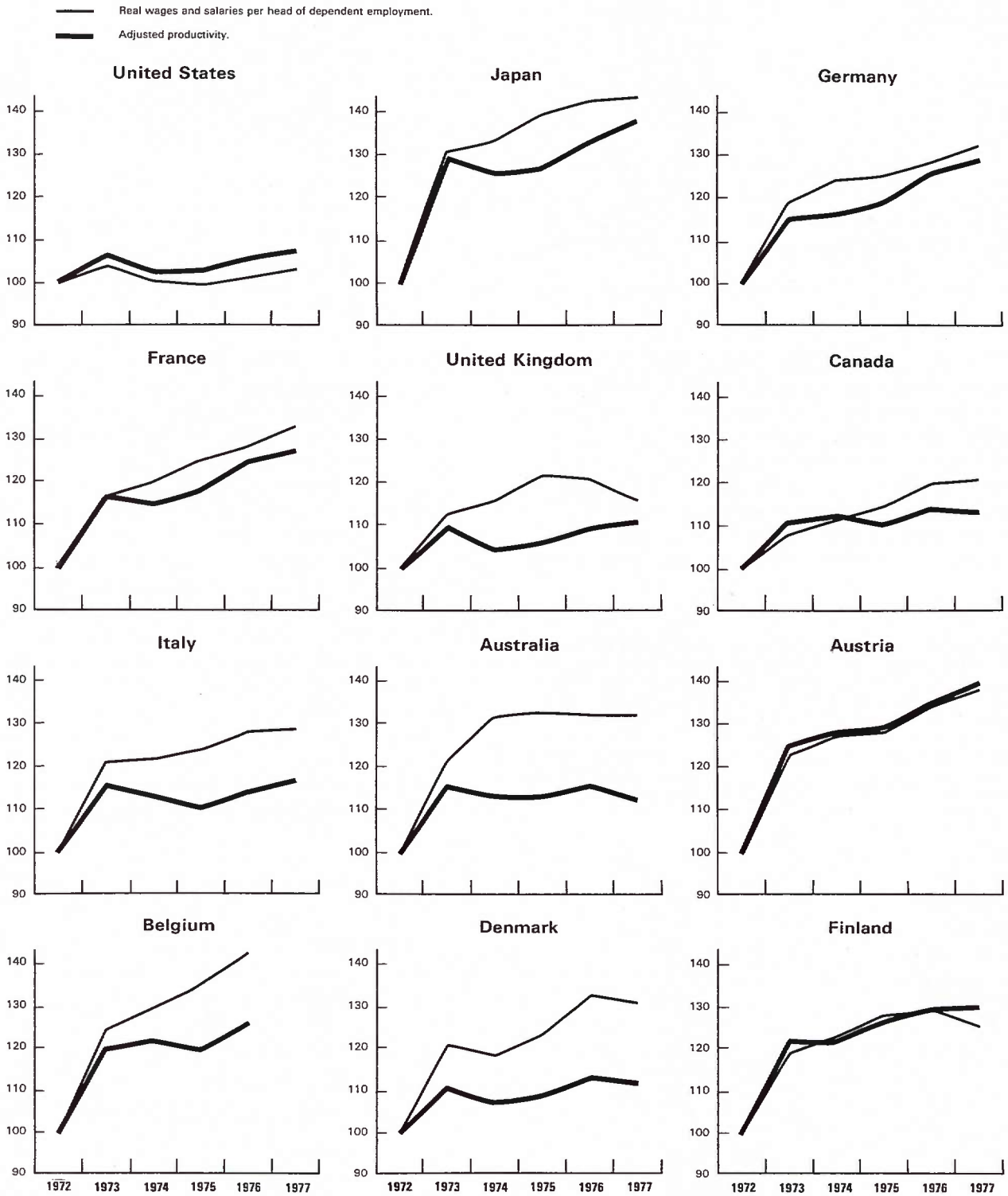
	Average 1965-66 to 1975-76	From previous year			From previous half-year				
		1977	1978	1979	1977 II	1978 I	1978 II	1979 I	1979 II
United States	5.6	5.9	7½	7¼	5.9	7.7	8	7	7
Japan	7.4	5.5	4	4½	5.7	3.2	3¾	4½	5
Germany	5.1	3.6	3¾	3½	4.7	3.0	4	3	3¾
France[a]	6.8	8.7	9¾	9½	8.8	8.4	13	8½	7¾
United Kingdom[a]	9.5	13.3	11¼	10	12.0	10.3	12	9¾	8½
Canada	6.6	6.9	6¾	7	6.9	6.6	6½	7	7½
Italy[a]	8.4	18.3	13½	12¾	14.1	13.6	13	12¾	12½
Total of above countries[b]	6.4	6.9	7	7	6.8	6.9	7¾	6¾	6¾
Memorandum item									
Four major European countries[b]	6.9	9.0	8¼	7¾	8.6	7.5	9½	7¼	7

a) GDP deflator.
b) 1977 GNP/GDP weights and exchange rates.

CHART L

THE REAL WAGE GAP

(1967-72 = 100)

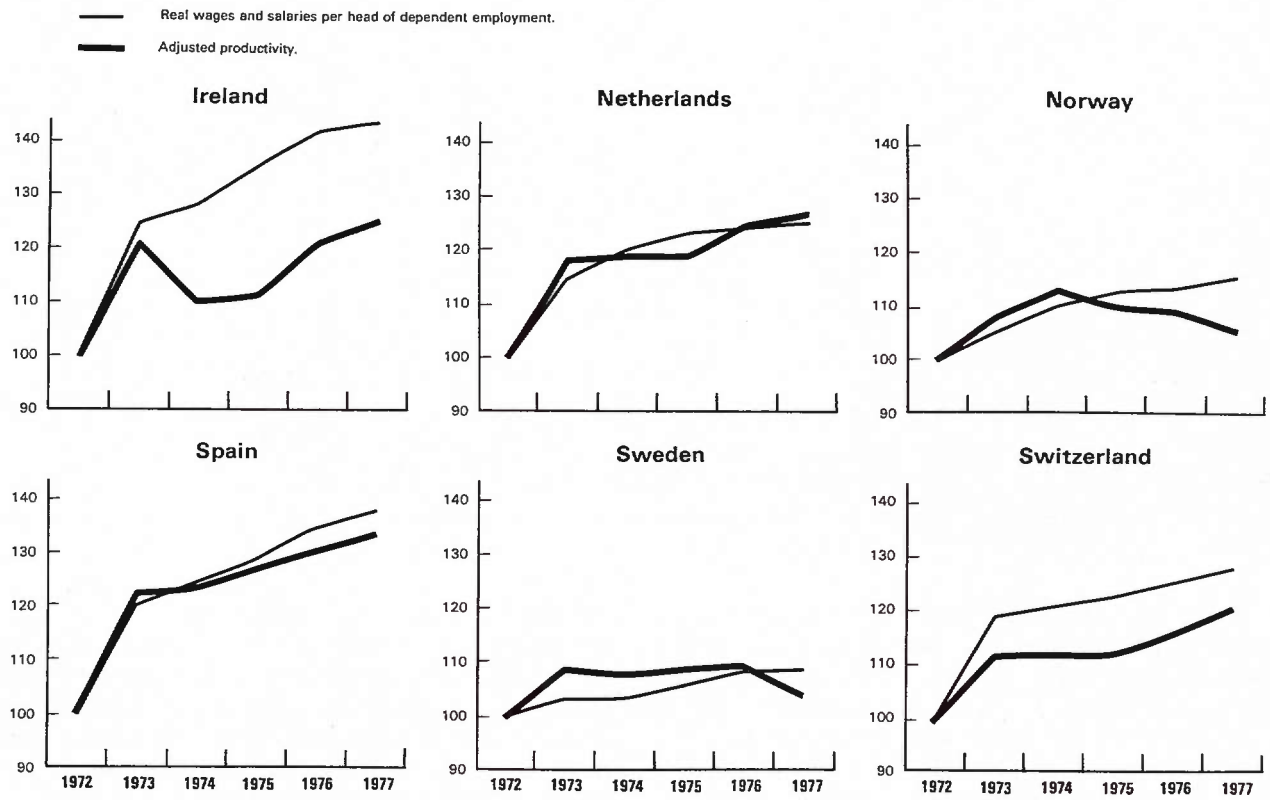


Note: Wages and salaries are corrected by the private consumption deflator. Adjusted productivity equals real GDP per employed person, corrected for changes in the terms of trade.

CHART L (cont.)

THE REAL WAGE GAP

(1967-72 = 100)



Note: Wages and salaries are corrected by the private consumption deflator. Adjusted productivity equals real GDP per employed person, corrected for changes in the terms of trade.

developments facilitate balance-of-payments adjustments and faster output growth, recent Secretariat work has stressed the relationship between real wage and productivity developments. To this end, Chart L illustrates the evolution of real wages and the rate of growth of real national income (GDP per employed person, corrected for changes in the terms of trade), for 18 countries over the period 1972-1977[15]. The implication is that if real wages rise faster than domestic absorption possibilities, neither an adjustment of the balance of payments, nor a faster recovery in private fixed investment is likely to be achieved[16].

Salient features for the period 1972-1977 included:

- a sharp (2.6 per cent) fall in real national income relative to real GDP in 1973-1974, largely related to the oil price increase[17];
- the uneven incidence of the external shock;
- the widely differing success by 1977 in adjusting real wages to the external shock and lower productivity growth following the 1975 recession[18].

15. The data are normalized by using the 1967-1972 period as 100. Details of the calculations are given in the Technical Annex.

16. The absence of a real wage gap is not, of course, a sufficient condition for an improvement in the foreign balance, nor is the gap measure necessarily an indicator of a country's inflation performance. It should also be noted that it is difficult to distinguish between longer-run changes in the gap—probably related to structural features—and variations due to recent cyclical developments. However, experiments with different base periods suggest that the figures presented in Table 26 are quite heavily influenced by factors other than cyclical developments in Belgium, Denmark, Finland, Ireland, Italy, Australia and New Zealand.

17. For the OECD area as a whole, the estimated subsequent *improvement* in the terms of trade between 1974 and 1979 amounts to ¼ per cent of GDP.

18. By 1977, only four countries (the United States, Finland, Austria and the Netherlands) had brought real wages into line with real national income. The United States was the only country where real wages increased less rapidly than national income throughout 1972-1977, as real wages, particularly in the non-union sector, displayed a high degree of flexibility.

Table 26
Real wage adjustments

	Real wage gap[a]		Terms of trade loss[c] (1972-74)	Deceleration of productivity growth[d]	Deceleration of real wage rise[e]
	1977[b]	1978[b]			
	(1)	(2)	(3)	(4)	(5)
United States	–4	–2¼	–1.3	1.2	1.8
Japan	7	4	–3.8	5.4	2.6
Germany	3	2	–2.0	1.0	2.1
France	4½	3½	–2.7	1.6	0.6
United Kingdom	4	3½	–5.0	1.8	1.9
Canada	8	5	3.1	1.7	0.1
Italy	13	12¼	–5.0	3.5	3.9
Austria	–1¾	1¾	0.1	2.3	2.9
Belgium	17¾	19¼	–0.8	1.4	0.6
Denmark	17¼	13½	–4.0	1.7	1.7
Finland	–6½	–8½	–0.4	2.4	3.0
Ireland	19½	27	–4.5	1.6	1.3
Netherlands	–3½	–2¼	–2.7	1.2	2.8
Norway	10¼	8	–1.9	0.8	0
Spain	1¾	¾	–2.5	2.2	1.7
Sweden	3¼	½	–2.1	3.1	2.0
Switzerland	9	6¾	–2.0	1.6	2.5
Australia	15	11¾	2.4	1.4	–0.3
New Zealand	16	19	–5.7	1.1	2.2

a) Excess of real wages and salaries over adjusted national income, 1967-72 = 100 (excluding changes in terms of trade in 1967-72).
b) Preliminary estimates.
c) Income effect of total change in the terms of trade from 1972 to 1974 (in per cent of GDP); for Japan and Norway the change in the terms of trade relates to 1972-75.
d) Rise in productivity (1962-72, annual rate) minus rise in productivity (1972-77 annual rate).
e) Rise in real wages (1962-72, annual rate) minus rise in real wages (1972-77 annual rate).

Table 26 summarises some of the key points noted above and presents preliminary estimates of the real wage gap for 1978. Two other features are also to be noted. In most countries the rise in real wages between 1972 and 1977 fell below the 1962-1972 trend (column 5). While this can be viewed as an adjustment of real wage expectations, the difficulty is that in most countries the lowering of real wage expectations has been achieved within the context of lower output growth and poor productivity performance (column 4). These last two factors, along with terms-of-trade developments, had a major influence on the real wage gaps recorded in 1977.

1978 saw a marked change in a number of countries, as real wage increases were below productivity gains and favourable terms-of-trade developments raised national income relative to GDP. The United States was the only country, among the seven largest, experiencing a swing to wage incomes in 1978[19]. Real compensation per employee in this country rose 1½ per cent (though much less if deflated by the CPI). Productivity fell in absolute terms and, combined with a deterioration in the terms of trade, this produced a small fall in real national income. The "reverse" real wage gap which has persisted throughout the past ten years was reduced by perhaps 1½ percentage points. For 1979, forecasts of nominal wages, productivity and prices imply a further shift to wage incomes in the United States.

In Japan, the relatively large real wage gap was reduced by almost 5 percentage points in 1978, as real wages rose slightly less than productivity and the marked improvement in the terms of trade resulted in a substantially faster rise (perhaps 1¾ per cent) in real income than GNP. A further but small closing of the real wage gap is forecast for 1979, partly supported by continued terms-of-trade gains. In Germany, real wages in 1978 also rose less than productivity. Terms-of-trade effects raised national income by roughly 1 per cent relative to GNP, bringing real wages largely into line with domestic absorption possibilities. Next year, the remaining very small gap is expected to change only little.

Real wages grew broadly in line with productivity in France, but an improvement in the terms of trade lowered the real wage gap slightly. For 1979, any further reduction will probably depend on terms-of-trade developments as little change in real wage or productivity trends is forecast. In the United Kingdom, real wage increases of almost 4 per cent in 1978 exceeded the growth of productivity by close to 1 per cent. However, a marked improvement in the terms of trade almost eliminated the wage gap. Here again, any further reduction will depend largely on future terms-of-trade gains, as real wage increases are forecast to exceed productivity gains in 1979. In Italy, pre-tax real wages rose

19. Belgium, Ireland and New Zealand were among the few smaller OECD countries experiencing a widening gap in 1978.

1½ per cent in 1978, slightly less than the rise in productivity. The small reduction in the relatively large gap was supported by a ½ per cent boost to domestic absorption possibilities arising from favourable terms-of-trade developments. A similar development is tentatively projected for 1979. By contrast, in Canada real wages fell almost 3 per cent in 1978. Thus, despite a relatively poor productivity performance and a substantial deterioration in the terms of trade (equal to almost ½ per cent of national income), the real wage gap closed by roughly 2½ per cent. For 1979 little further change in the relatively large gap is foreseen, as a small shift to non-wage incomes in GNP may be offset by further terms-of-trade losses.

The adjustment of real wage positions in other OECD countries has reached widely different stages. In a first group of countries (Austria, Finland and the Netherlands) a relatively high degree of real wage flexibility permitted the elimination of the gap by 1977. In Austria and the Netherlands, there was a small swing back to wage incomes, reflecting shifts in employers' financing of family allowances and a small terms-of-trade loss in the former and wage drift in the latter. The situation is forecast to stabilise or be reversed slightly for 1979. By contrast, Finland experienced a further substantial shift (2-2½ per cent) to non-wage incomes in 1978, largely as a result of a favourable productivity trend and a small fall in real wages. With a likely recovery in real wages, some shift to wage incomes is forecast for 1979.

In a second group of countries, the relatively small gap was further reduced in 1978. In Switzerland, small real wage increases matched productivity gains, but there was a major improvement in the terms of trade (perhaps equal to 3 per cent of national income), reflecting initial revaluation effects. For 1979, little change in real wage and productivity trends is forecast, but lagged effects of the terms-of-trade changes could further reduce the gap. In Spain, real wages grew slightly faster than productivity in 1978, but a large terms-of-trade gain reduced the wage gap by more than 2 percentage points. For 1979, nominal and real wage increases are at present forecast to slow down sharply, and with an improved productivity performance the gap may narrow further.

In a last group of countries, real wage rigidity has resulted in a persistently large real wage gap over the period 1973-1977, though some adjustment seems to have taken place in 1978. In Denmark, real wages fell, reflecting limitations on indexation payments and indirect tax increases in 1978. A 2 per cent rise in productivity and a large improvement in the terms of trade resulted in a reduction of the wage gap of almost 5 percentage points, with a further modest adjustment forecast for the year 1979. In Australia, real wages fell somewhat in 1978 and the wage gap was reduced by close to 2½ percentage points, as large productivity gains were only partly offset by deteriorating terms of trade. The gap may be reduced further in 1979 with a small rise in real wages coinciding with a recovery in terms of trade. In 1978 and 1979 Norway should also experience a closing in the wage gap, with small rises in real wages and a 2-2½ per cent increase in productivity. (The productivity gain shown is largely concentrated in the oil sector.) On the other hand, real wage increases in Ireland exceeded productivity gains by a large margin in 1978 and a similar evolution is forecast for 1979. In Belgium, real wages rose perhaps ½ per cent above productivity gains in 1978; no improvement is forecast in 1979 in the light of existing indexation agreements. In New Zealand, real wage increases appear to have exceeded productivity gains by about 2½ percentage points in 1978 (partly related to the return to free collective bargaining) and the gap may continue to widen next year.

INTERNATIONAL DEVELOPMENTS

FOREIGN TRADE AND CURRENT BALANCES[1]

Trade volumes

Since mid-1976, real GNP of the OECD area has grown at a steady 3 per cent[2] or slightly more per annum. Over the same period, the volume of OECD trade has expanded at around a 5 per cent annual rate, albeit with large quarter to quarter variations in import growth. The assessment of domestic prospects outlined above suggests a slowdown in the rate of growth of demand for the area as a whole during 1979. The real growth of OECD trade, especially that of imports, is therefore expected to fall below 5 per cent by the end of 1979 (Table 28).

Within this broad overview, there could be strikingly different movements as between the major OECD regions. Developments in the United States may lead to a substantial slowdown in the growth of imports. On the other hand, the underlying prospects for demand and imports in Europe, importantly affected by stimulatory measures in Germany, now appear somewhat stronger than before the summer. Indeed, the sources of external demand may be more widespread in 1979 than in 1978. In 1978, import volumes of the seven major countries may have expanded by 6 per cent[3] while smaller OECD economies, many of whom have significantly restricted demand for balance of payments reasons, appear to have held import volumes down to 1977 levels. In 1979, the differences in import growth between larger

1. Supporting tables 46-62 in the Technical Annex give details by country and area groupings of total trade volumes and prices, commodity prices, oil imports, exchange rates, market growth and export performance, and trade, invisibles and current balances.
2. Weighted by each country's share in total OECD imports.
3. See Table 27 for detail on recent output and trade trends in the seven major countries.

Table 27

Industrial output, foreign trade, and current balance in the seven largest OECD countries

Based on seasonally adjusted data

		Indices, 1977 = 100				$ billion, annual rates		
		Industrial production[a]	Volume of imports	Volume of exports	Terms of trade	Trade balance	Balance on invisibles account	Current balance
1976	Q1	94.2	92.7	90.3	102.2	12.0	–7.5	4.5
	Q2	96.2	92.3	94.9	100.7	11.0	–4.5	6.5
	Q3	97.5	97.4	96.1	100.5	–1.0	–8.5	–9.5
	Q4	98.5	99.1	96.7	100.6	–7.0	–6.0	–13.0
1977	Q1	100.1	100.5	98.5	100.3	–5.7	–6.7	–12.4
	Q2	99.6	99.3	99.5	99.4	3.7	–7.5	–3.8
	Q3	100.0	99.1	101.0	99.5	8.4	–9.6	–1.2
	Q4	100.2	101.1	101.1	100.9	5.6	–8.5	–2.9
1978	Q1	101.5	102.7	101.8	101.4	10.1	–8.5	1.6
	Q2	103.0	105.2	105.4	102.9	29.3	–6.6	22.7
	Q3[b]	104.4	107.5	106.7	103.9	26.1	–10.1	16.0
	July	104.0	107.8	102.9	103.2	..	..	..
	August	104.1	104.8	105.3	103.9	..	..	..
	September[b]	104.9	109.8	111.7	104.7	..	..	..
	October[b]	..	108.6	109.4	103.5	..	..	..
Forecast								
1978	II	105¼	108¼	106¾	102¼	20½	–11	9½
1979	I	107¼	110½	109	102½	21	–11¼	9¾
	II	108¾	112½	111½	102¾	22½	–12¼	10¼

a) Import weighted.
b) Partly estimated.

Table 28
Output and foreign trade of the OECD area

Percentage changes at annual rates, seasonally adjusted

	Change from previous year			Change from previous half-year					
	1977	1978	1979	1977 I	1977 II	1978 I	1978 II	1979 I	1979 II
Output									
Real GNP	3¾	3½	3	4	3½	3½	3¾	2¾	2½
Real GNP (import weighted)	3	3¼	3	3¼	2¾	3¼	3½	3	2¾
Industrial production (import weighted)	2¾	3	4	3	¼	3½	5¼	3¾	3
Volume of trade									
Total exports	5	5¼	5	4½	4¼	5½	5½	5	4¾
Total imports	4½	4¼	5	2¼	½	4¾	7¼	4½	3¾
Intra-OECD trade[a]	4½–4	5–5¾	5¼	4¼–1½	1½–3	6–7	6¼–5¾	5¼	4½
Exports to non-OECD	6	6¼	4½	3½	11	5¼	4	4½	5¼
Imports from non-OECD	5½	1¾	4¼	4¼	–4¼	½	10½	2½	2¼
Memorandum items									
Exports to:									
OPEC	14	5	5	12	11½	2	5	5	5
Non-oil developing countries	6	8¼	6	2½	12	8	5½	6	6
Other	–4	3½	¾	–4	8	3½	–½	0	3½
Imports from:									
OPEC	3½	–3¼	3	½	–8	–9½	16	–1½	0
Non-oil developing countries	9	6½	6	11	–5	13	6½	6½	4½
Other	3½	2½	4¼	–1	10	–1½	4	5	3½

a) In periods of fluctuations in growth of intra-OECD trade, percentage changes calculated from data on intra-OECD exports tend to differ significantly from corresponding changes based on intra-OECD imports because of time lags in the recording of trade flows. The fact that intra-imports are recorded c.i.f. while exports are recorded f.o.b. is another reason for such discrepancies. The growth rates indicated to the left in the columns are calculated on the basis of intra-exports, while intra-imports are shown to the right.

and smaller OECD economies (considered as groups) is expected to be much narrower.

The area's balance with non-OECD countries is likely to be virtually unchanged in real terms in 1979; a number of unrelated factors may combine to generate similar growth rates of extra-area imports and exports for the year as a whole[4], with both slightly below that of trade among OECD countries. Imports from non-OECD countries in aggregate are foreseen to grow rather slowly during 1979, largely because of the erratic behaviour of oil imports from OPEC countries (Table 28). Oil imports fell during 1977, and again declined substantially in the first half of 1978 due to the combined effects of increases in indigenous energy production and de-stocking. However, a major rebound in net oil imports may have occurred in the second half of 1978 (in anticipation of price increases early in 1979 and as stocks were built up in the United States and Japan) leading to a large carryover into 1979. The technical reaction to the anticipatory stockbuilding of 1978 could therefore result in very sluggish oil import volumes during 1979. Import volumes from non-oil developing countries are expected to grow at rates somewhat above those of total OECD trade, largely reflecting imports of manufactures from newly industrializing countries, but to be less buoyant than in the recent past. Exports to non-oil developing countries may expand at above average rates: despite experiencing substantial adverse terms of trade movements in 1978, these countries, as a group, still appear to be in a satisfactory external financial position. In the course of 1979, they should start to experience more favourable terms of trade. Gauging the likely strength of OECD exports to OPEC countries is, as usual, difficult. After a prolonged period of growth rates well into double digits, the real expansion of exports to OPEC countries fell abruptly in the first half of 1978. Several of the "high absorbers" are now registering relatively large current account deficits. However, some recovery is likely in OECD exports to OPEC[5]; the forecasts here assume that they will expand at 5 per cent in 1979.

Following the large changes in effective exchange rates over the spring and summer months of 1978, Japanese export volumes may fall between 1978 and 1979, while the growth of United States' exports could accelerate. Among other OECD countries, the smaller economies (as a group) may continue to enjoy a more rapid expansion of export volumes than major countries. Given the stagnation of import volumes and relatively buoyant export volumes of smaller countries during

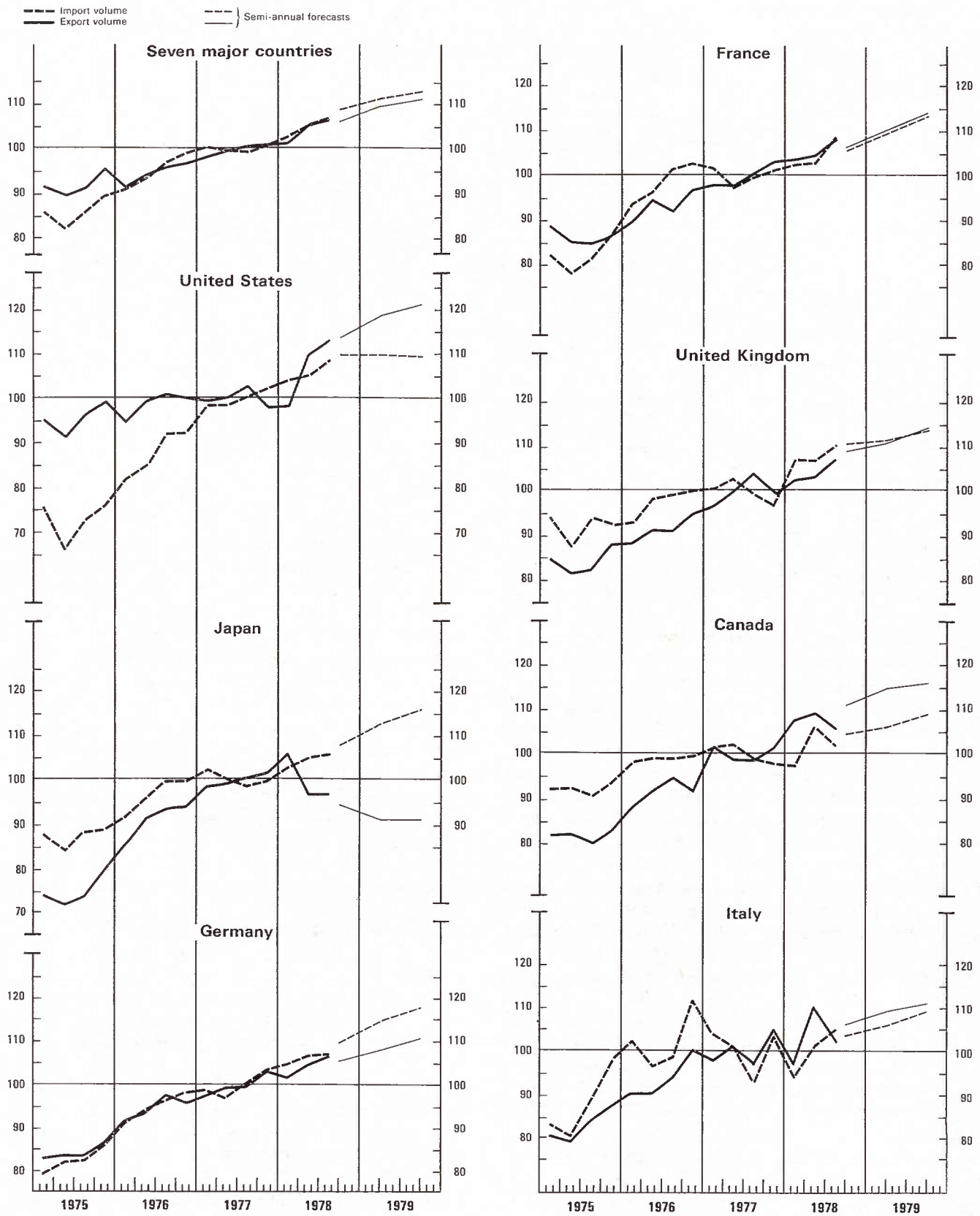
4. For more detail on trade with the non-OECD, see Technical Annex.

5. Detail on OECD exports to OPEC is given in the Technical Annex.

CHART M

VOLUME OF TRADE OF THE SEVEN MAJOR OECD COUNTRIES

(Indices 1977 = 100, seasonally adjusted)



1978, a number of those previously in balance of payments difficulties have already made a substantial real adjustment. In most cases this is expected to continue or at least be consolidated in 1979.

Trade prices

The most striking feature of recent foreign trade price trends is that prices of industrial raw materials—in dollar terms—remained surprisingly weak up to the late summer of 1978, and abundant harvests worldwide are exerting a dampening influence on food prices. Dollar prices of raw materials have generally recovered sharply during the last few months of 1978: but measured in terms of an average OECD exchange rate (which has appreciated against the dollar) this recovery was barely sufficient to return commodity prices to the levels of early 1978. Consequently, trade prices (in local currency terms) in the second half of 1978 and into 1979, appear to be increasing markedly more slowly than the 5 per cent forecast six months ago in *Economic Outlook* No. 23; even in the second half of 1979, their annual rate of increase may still be below 5 per cent (Table 29).

6. For more detail on the prospects for commodity prices see Wages, Costs and Prices.

This outlook implies some acceleration over the next year as prices of raw materials recover from their depressed mid-1978 levels[6]. The usual technical assumption has been made that the price of imported oil will rise at the same rate as prices of manufactured goods during 1979, i.e. by 5 per cent. The weakness of commodity prices during 1978 is expected to have resulted in a terms of trade gain for the area as a whole more than twice as great as the loss experienced in 1977, with some carryover into 1979. No significant change in the terms of trade is expected during 1979.

The large terms of trade gains for the OECD area in 1978 were not shared equally by all countries (Table 30). Certain OECD countries whose exports contain an important share of primary commodities benefited less—if at all—from the favourable terms of trade swing to manufactured goods. In addition, the large movements in exchange rates that occurred in 1978 were a further source of terms of trade movements among OECD countries, generating substantial "J-curve" effects on trade, with revaluing countries benefiting at the expense of devaluing countries. Detailed forecasts of trade prices are given in Tables 52 and 53 of the Technical Annex. Comparing import and export prices for each country, it can be seen that,

Table 29
Domestic and foreign trade prices of the OECD area
Percentage changes at annual rates

	Change from previous year			Change from previous half-year					
	1977	1978	1979	1977 I	1977 II	1978 I	1978 II	1979 I	1979 II
GNP deflator	7½	7¼	7	7½	7¼	7¼	7¾	6¾	6¾
GNP deflator (export weighted)	8	7¼	6¾	8	7½	7	7¾	6½	6½
Consumer prices (export weighted)	8¼	6¾	6¼	8¾	7¼	6½	6¾	6	6¼
Trade prices[a] in terms of national currencies									
Total exports	6½	3½	4¼	7¼	2¾	3¾	3¾	4¼	4½
Total imports	8	2¼	4	9½	3¾	1½	2½	4¼	4½
Trade prices[a] expressed in US$ terms									
Total exports	8¼	13¾	8¼	9	7½	15	17¼	6¼	4½
Total imports	9¼	11¼	7¾	10¾	7¼	11¼	14½	6¼	4½
Exports of manufactures	9	14½	9	8	9½	14½	19	7	4½
Imports of oil	8	1½	5	12	5½	–½	1½	7	4½
Memorandum items									
Average value of non-oil commodities exported by developing countries	16	5	7	..	..	..	..	..	..
Spot prices of non-oil commodities exported by primary producing countries:									
Total	22½	–2½	8½	46	–11	–3	9½	8	7½
Food	37	–8½	5½	83½	–16½	–9	2	6½	6½
Non-food agricultural raw materials	7	6	11	10	–9½	8	19½	9	7
Metals and minerals	7	1½	11	10½	–2	–2	13½	9½	9

a) Average values.

CHART N

MEASURES OF RELATIVE COMPETITIVE POSITION

Indices in US $ terms, 1970 = 100

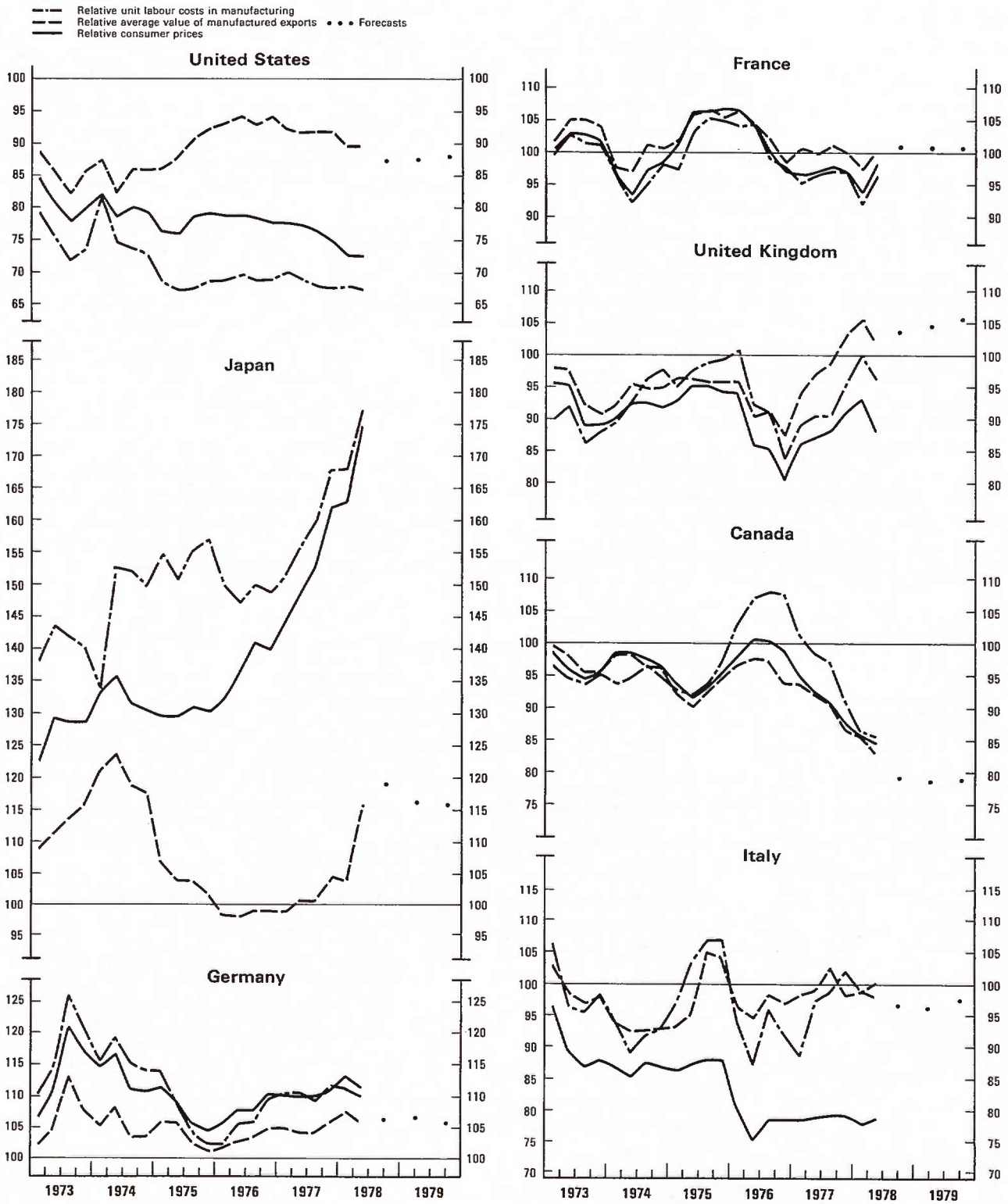
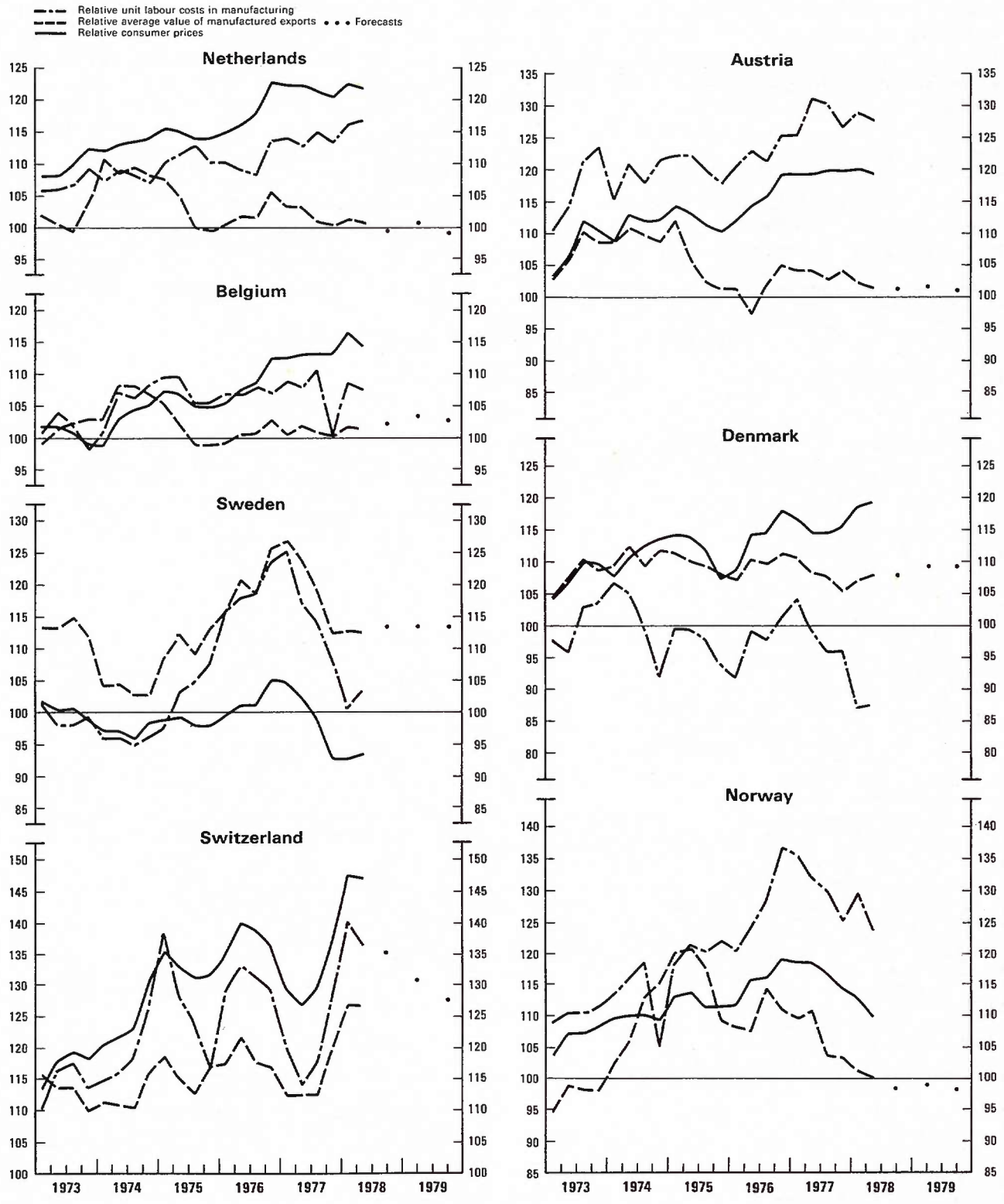


CHART N (cont.)

MEASURES OF RELATIVE COMPETITIVE POSITION

Indices in US $ terms, 1970 = 100



during the course of 1979, on average, a deterioration is forecast in the terms of trade of countries with below-average inflation, and vice versa. It should be noted, however, that these forecasts are influenced by the usual technical assumption of unchanged nominal exchange rates during the forecast period. A detailed discussion of the effects of this assumption on the forecast can be found in the box below.

Trade and invisibles balances

In the first half of 1978, the substantial terms of trade improvement outlined above, supplemented by a drop in oil imports, put the OECD aggregate trade balance into surplus after a deficit of $23 billion the previous year—a swing equivalent to as much as half a percent of OECD GNP. Although oil imports may have risen sharply in the second half, a continued favourable terms of trade effect may have sufficed to maintain this trade surplus. During 1979, the expected flattening out of oil imports could more than offset the forecast cessation of favourable terms of trade effects; the area's trade surplus could be running at $5-10 billion (annual rate) by the second half of next year.

Within this overall movement into trade surplus, several broad factors are at work, affecting individual countries in different ways and with different timing:

THE OECD's TECHNICAL ASSUMPTION ON EXCHANGE RATES

Forecasts in the *Economic Outlook* have always been made on the technical assumption of unchanged nominal exchange rates from the time at which the forecasts are finalised. In view of the recent behaviour of exchange markets, it is of interest to review the problems stemming from this assumption and to determine whether alternative technical assumptions would have been closer to the actual outcome.

An exchange rate change will, to some extent, affect trade prices[1], hence terms of trade, domestic inflation, and competitive positions. Terms of trade changes will, in turn, affect real income and, hence, real expenditure; competitive position changes will, with some lag, affect real net exports. Thus, in dealing with a country for which there is a reasonable likelihood of a change in the effective exchange rate during the forecast period, the ramifications of forecasting on the basis of a technical assumption of unchanged exchange rates could be felt throughout the forecast.

In the case of a country for which there is a likelihood of effective appreciation, forecasting on the basis of unchanged exchange rates is likely, in the first instance, to over-estimate import prices in local currency terms. Domestic inflation will thus be over-estimated. If the forecast error on import prices is sufficiently large, the growth of real income (and hence real expenditure) in the wake of the exchange rate change will be under-estimated due to failure to take appropriate account of the income effects of terms of trade changes[2]. Indeed, terms of trade movements may not only be wrongly estimated but have the wrong sign when the likelihood of an exchange rate appreciation is based on the forecast that the rate of domestic inflation in the country in question will be significantly below the OECD average. With unchanged exchange rates, the translation of relative inflation rates into trade prices makes export prices increase less fast in the country in question than in other countries (whence the import prices of the country in question are derived). In other words, the country will be forecast to experience a terms of trade loss rather than the gain which would accompany the expected exchange rate appreciation. In this case, apart from the implications for domestic demand, the current balance position would also be underestimated.

In such a case, exclusion from the forecast of the likelihood of appreciation means that a deterioration of competitive position is not taken into account, and as a result real net exports will be overestimated. Given enough time, this should more than offset the under-estimation of the terms of trade effect on demand. However, it is generally held that the lags between changes in competitive position and full effects on real net exports are relatively long. Therefore, it could be argued that failure to take account of an effective exchange rate appreciation *during* the period of a short-term forecast is most likely to result, on balance, in an under-estimation of the strength of demand over the forecasting period.

The case of unchanged-exchange-rate forecasts for a country where there is a reasonable likelihood of effective exchange rate depreciation is, of course, exactly the opposite:

- underestimated import price (in local currency);
- overestimated domestic income/expenditure;
- possible error of forecasting a positive rather than a negative terms of trade effect;
- overestimated current balance position;
- but a possible partial offset, increasingly important over the forecasting period, from underestimated real net exports.

These problems stemming from the present technical assumption on exchange rates during the forecasting period give rise, from time to time, to suggestions that alternative technical assumptions be considered. The most frequently suggested alternative is unchanged "real" exchange rates over the forecasting period, i.e. nominal exchange rates changing exactly to offset differences in inflation rates among countries. However, this suggestion runs into a number of problems. In the first place, there might well be some difficulty in agreeing

1. Some part (and, in some cases, a substantial part) of exchange rate changes will be taken on profit margins. The effects from this on the real economy may not be felt within the time span of a short-term forecast.
2. The extent of error here will also depend on the size of the foreign sector in relation to GNP.

— the favourable swing in the terms of trade to exports of manufactured goods, particularly benefiting larger OECD countries;
— recent exchange rate changes, which have augmented the terms of trade gains in Japan and Switzerland, while adversely affecting the United States, Canada and some smaller OECD countries;
— the response of trade volumes to recent changes in competitive positions. This may, in particular, lower Japanese exports and have positive effects on the net exports of the United States and Canada;
— stabilization measures, partly for balance of payments reasons, which appear to have substantially reduced the deficit of smaller OECD countries in 1978;
— the expansionary measures in Japan and Germany and the slowdown of demand foreseen in the United States, which should contribute significantly to balance of payments adjustment (see below).

The net effects of these factors are tentatively quantified in Table 30. For the United States, adverse volume and terms of trade effects may have worsened the trade balance by $5 billion in 1978. Japan may have recorded terms of trade gains of some $15 billion in 1978, only partially offset by a weakening volume balance; however,

Comparison of alternate « technical » assumptions on exchange rates

Difference between assumed and actual effective exchange rates changes[a]

	1975			1976			1977		
	A	B	C	A	B	C	A	B	C
United States	–1.2	–2.5	–2.1	1.3	0.1	–0.6	0	–2.1	–0.7
Japan	0.4	2.7	2.2	3.7	1.3	–0.4	10.3	9.5	9.8
Germany	0.6	–4.3	–3.4	5.5	1.6	3.5	2.8	–0.6	–0.1
France	6.5	7.3	6.1	–6.5	–4.3	–6.5	–0.6	1.1	1.3
United Kingdom	–7.5	–1.3	–2.1	–11.2	–4.4	–4.1	6.7	11.1	14.5
Italy	–1.2	4.5	3.2	–17.4	–13.9	–15.3	–3.9	7.0	1.8
Canada	–3.7	–3.7	–6.3	4.4	5.6	5.9	–9.7	–9.7	–10.3
Belgium	–0.5	–1.8	–2.3	3.1	6.9	4.1	1.6	3.0	0.6
Netherlands	0.5	–0.8	0.5	1.7	2.2	2.7	0.4	–0.5	–1.0
Sweden	2.5	2.1	0.3	2.5	2.5	2.0	–6.4	–5.1	–6.4
Switzerland	6.3	1.8	2.5	9.0	5.5	4.9	0.2	–4.9	–2.6
Austria	1.2	0.2	–1.1	3.2	2.3	2.3	2.2	1.2	0.7
Denmark	0.8	3.5	0.8	1.4	0.4	2.3	–2.5	–2.5	–2.0
Finland	0.3	1.7	–1.0	2.1	7.8	0.7	–5.4	–3.2	–5.4
Ireland	–4.9	–1.5	–5.3	–7.1	–0.3	–0.6	4.3	9.7	7.3
Norway	2.7	3.2	2.7	3.5	4.9	2.1	–1.5	0.4	–1.9
Greece	–8.9	..	..	–2.4	–0.6	..	–0.9	6.9	..
Spain	–2.7	–2.2	1.2	–9.4	–3.6	–7.3	–10.5	–4.7	–7.5
Australia	–0.5	6.6	6.2	–2.2	1.4	–0.4	–13.2	–11.8	–13.6
New Zealand	–7.2	–7.6	–7.2	–1.9	7.1	4.9	–1.6	5.8	–0.6
Memorandum items[b]:									
Better		5	4		13	12		6	6
Worse		9	8		6	5		9	7
Same		5	7		1	2		5	6

a) Cases considered are:
A: unchanged nominal exchange rates;
B: unchanged relative GNP deflators;
C: unchanged relative export prices of manufactures.
For each year, the calculations are based on the previous December's *Economic Outlook*, i. e. unchanged nominal exchange rates from about mid-November of previous year (Case A) or exchange rates adjusting to take account of forecast differences in GNP deflators (Case B) or export prices (Case C).

b) This bank of figures compares Cases B and C with Case A, indicating, for each year, the number of countries for which technical assumptions B and/or C would have been Better (closer to what actually happened), Worse, or about the Same (errors within 20 per cent of each other).

on a precise definition of "real" exchange rates[3]. Furthermore, this alternative is something more than a purely technical (mechanical) assumption, for it begins to take a view on the process of exchange rate determination —a view implicitly assuming purchasing power parity, which most observers would agree has limited validity in the short-term. Hence, the alternative might be regarded as an unhappy compromise between a mechanical assumption and an incomplete attempt to forecast exchange rates.

After examination of the evidence, it transpires that, in any event, had OECD forecasts been based in recent years on unchanged "real" exchange rates, the rates embodied in the forecasts *would not on average have been closer to the actual outcome* that those stemming from the technical assumption actually used. This conclusion may come as a surprise to the casual observer, though not to those who have difficulty with a purchasing power parity view of short-term exchange rate determination. The inset table gives details of a comparison, for 1975, 1976 and 1977, of actual changes in effective exchange rates with three alternative technical assumptions: the assumption that effective exchange rates would be unchanged from those at the time the previous December's *Economic Outlook* was finalised (Case A— the present assumption) and the assumptions that effective exchange rates would change over the year in line with differences forecast in the previous December's *Outlook* in countries' GNP deflators (Case B) or export prices (Case C) in local currency terms[4]. Differences for each country and for each year between the assumed rate in each case and actual outcome are given in the table. A summary of a comparison of the results for Cases B and C with those of Case A is given in the table's bottom bank of figures, which indicate the number of countries for which the alternative technical assumptions would have been closer to the actual outcome (Better), further from it (Worse) and broadly the same (Same). Summed over the three years, the results are:

	Better	*Worse*	*Same*
Case B	24	24	11
Case C	22	20	15

Hence, adopting a technical assumption of unchanged "real" rates would not have produced a better exchange rate basis for the forecasts.

3. For example, "real" exchange rates are sometimes losely assimilated to competitive position, a concept for which there is clearly no single definition (see discussion in "The International Competitiveness of Selected OECD Countries", *OECD Economic Outlook, Occasional Studies*, July 1978, for more detail on this point).

4. These assumptions were applied mechanically. Feedback from implied exchange rate changes to domestic inflation, etc. was not taken into account. However, this would not necessarily bias the comparison here. To the extent that the initial implications for the change in the real exchange rate were wrong, the feedback would be wrongly calculated (hence pushing the exchange rate assumption further from the actual outcome).

Table 30
Components of OECD trade balance changes[a]
$ billion

	1975 to 1976			1976 to 1977			1977 to 1978			1978 to 1979		
	Total	Volume	Terms of trade	Total	Volume	Terms of trade	Total	Volume	Terms of trade	Total	Volume	Terms of trade
United States	–18½	–18¾	¼	–21¾	–16	–5¾	–4¾	–1	–3¾	8¾	10	–1¼
Canada	2½	1¾	¾	1¼	3	–1¾	½	3	–2½	0	1	–1
Japan	4¾	7½	–2¾	7½	4½	3	10¼	–5	15¼	–7	–11	4
France	–6¼	–6	–¼	2	3	–1	4	1	3	–¼	–½	¼
Germany	–1	0	–1	2¾	1	1¾	4	–2	6	–1	–2½	1½
Italy	–3	–1¼	–1¾	4½	3½	1	3	2	1	–¾	–1	¼
United Kingdom	¾	1¾	–1	3½	3	½	0	–2	2	2	1½	½
Other OECD	–2	–1¾	–¼	–5½	1	–6½	10	12	–2	¼	3	–2¾
Total OECD	–22¾	–16¾	–6	–5¾	3	–8¾	27	6½	20½	2	½	1½
OECD trade with:												
OPEC	–8½	–4½	–4	½	5½	–5	13	6	7	½	½	0
Non-oil developing countries	–8½	–7	–1½	–4	–½	–3½	10	1	9	2	1	1
Other non-OECD countries	–6	–5½	–½	–2½	–2	–½	4	–½	4½	–½	–1	½

Note: Detail may not add due to rounding.
a) Rough estimates. When either prices or volumes are increasing rapidly the breakdown into volume and price effects is necessarily approximate due to the presence of substantial second order terms, usually negligible, which are neither clearly volume nor clearly price effects.

in 1979 the reduction of the real trade balance could outweigh further terms of trade gains in Japan by $5-10 billion. Smaller OECD countries, which as a group may have registered a small terms of trade loss in 1978, appear likely to record a $10-15 billion swing on their volume balance, largely attributable to the weakness of their domestic demand. Major European countries are all likely to record marked terms of trade gains over the period 1978-1979. In Germany these may be more than offset in 1979 by the effects of demand on trade volumes.

Somewhat unexpectedly, the OECD area's deficit on invisible transactions fell by about $3 billion (annual rate) in the first half of 1978. The improvement was largely concentrated in the United States (where the investment income balance recovered) and France (partly explained by temporary factors). Official transfers from Common Market countries to the European Community climbed steeply[7]. Continued increases in official transfers in 1979, reflecting development assistance and cancellation of debts of poorer developing countries, may more than counterbalance net earnings from services and private transfers, and result in a net invisibles deficit of the order or $7-9 billion (annual rate) for the area as a whole by the second half of 1979.

The adjustment of current balances

The above assessment implies that the overall OECD current account position, in deficit by $27½ billion[8] in 1977, may be broadly in balance in 1978 and through 1979. This would be the first time since 1973 that for a sustained period the area was not in substantial deficit: the balanced position reached in the recession year of 1975 was quickly reversed when demand began to recover. From what has been said above, it is evident that weak commodity prices—especially oil prices—are the main factor behind the reduction of the deficit. It is equally clear that a sharp increase in these prices relative to export prices of OECD countries could push the area back into substantial deficit. In this connection, the forecast that non-oil commodity prices will recover—but no more—in 1979 might be thought consistent with the expected moderate growth of OECD demand in 1979. The forecasts here embody the usual OECD technical assumption that oil prices over the period of the forecast will rise at rates similar to those of manufactured goods, some 5 per cent year on year[9].

7. These official transfers are one of the many asymmetries (without counterparts elsewhere in the current balance accounts) in the recording of invisibles.

8. The figure given in *Economic Outlook*, No 23 was $32½ billion. Changes in United States accounting practices regarding the treatment of reinvested earnings by foreign subsidiaries have had the effect of reducing the United States current deficit by $5 billion without offsetting changes elsewhere.

9. Should petroleum prices be raised by 10 per cent in dollar terms at the beginning of 1979, the estimated OECD current balance for that year might be reduced by some $3-4 billion, a figure which allows for an increased volume of imports by "high absorber" OPEC countries.

Table 31
Current balances of major OECD countries and country groups
$ billion; seasonally adjusted at annual rates

	1977	1978	1979	1977 I	1977 II	1978 I	1978 II	1979 I	1979 II
United States[a]	–15.3	–18¼	–8	–10.8	–19.7	–20.2	–16	–11	–5
Canada	–3.9	–4	–4½	–3.9	–3.9	–3.3	–4½	–4¼	–4½
Japan	10.9	20	12	9.2	12.6	21.4	18¾	14¼	9½
France	–3.3	2	2	–3.9	–2.7	2.1	2	2	2
Germany	3.7	6	2¼	3.6	3.8	6.5	5¼	2¾	1¾
Italy	2.3	5½	4¾	0.5	4.0	6.1	4¾	5	4½
United Kingdom	0.5	–½	1½	–2.8	3.8	–0.5	–¼	1	2
Belgium-Luxembourg	–0.7	–¼	0	–0.7	–0.8	–0.1	–¼	0	0
Netherlands[b]	0.2	–1½	–1¼	–0.2	0.7	–1.8	–1¼	–1½	–1
Other EEC	–1.9	–1½	–1½	–1.9	–1.8	–1.1	–2	–1½	–1½
Other North Europe	–8.1	¼	–¼	–6.7	–9.5	0.2	½	0	–½
Other OECD	–12.1	–8½	–8¼	–12.6	–11.5	–8.2	–8¾	–8½	–8
Total OECD	–27.6	–¾	–1¼	–30.2	–25.0	1.2	–2½	–2	–¾

Note: Detail may not add, due to rounding.
a) For technical reasons, the forecasts do not include an allowance for the increase in official gold sales that was announced in November 1978. An additional $ 3 billion improvement in the 1979 current account may result from these gold sales.
b) The data normally used by the Dutch authorities are on a national accounts basis which exclude certain transfers. On that basis, the figures corresponding to those given in this table are –1.2 billion in 1978 and –0.9 billion in 1979.

During 1979, the volume of net oil imports may be rather sluggish in view of weakening domestic demand in the United States, and generally high levels of oil stocks in OECD countries. Hence market conditions might point to relatively modest oil price increases in 1979. However, market conditions have recently been relatively buoyant due to stockbuilding and the curtailing of supply by the strike of oil workers in Iran early in November. There may also be pressure for price increases from certain OPEC countries which may be finding that the desired growth of imports is running into financial constraints—even taking into account their relatively good prospects for borrowing on international capital markets.

Assuming the forecast improvement of the overall OECD position is realized, it is likely to embody substantial intra-OECD adjustment (Tables 31 and 32). Inside Europe, considerable adjustment has taken place already, and progress here should be consolidated in 1979. By firmly restricting demand, a number of countries have achieved significant improvements in their current accounts. Among these are Italy, Sweden, Finland, Spain, Norway and, to a lesser extent, Austria and Denmark. Given the forecast impact of Germany's

Table 32
Current balances of other OECD countries
$ million

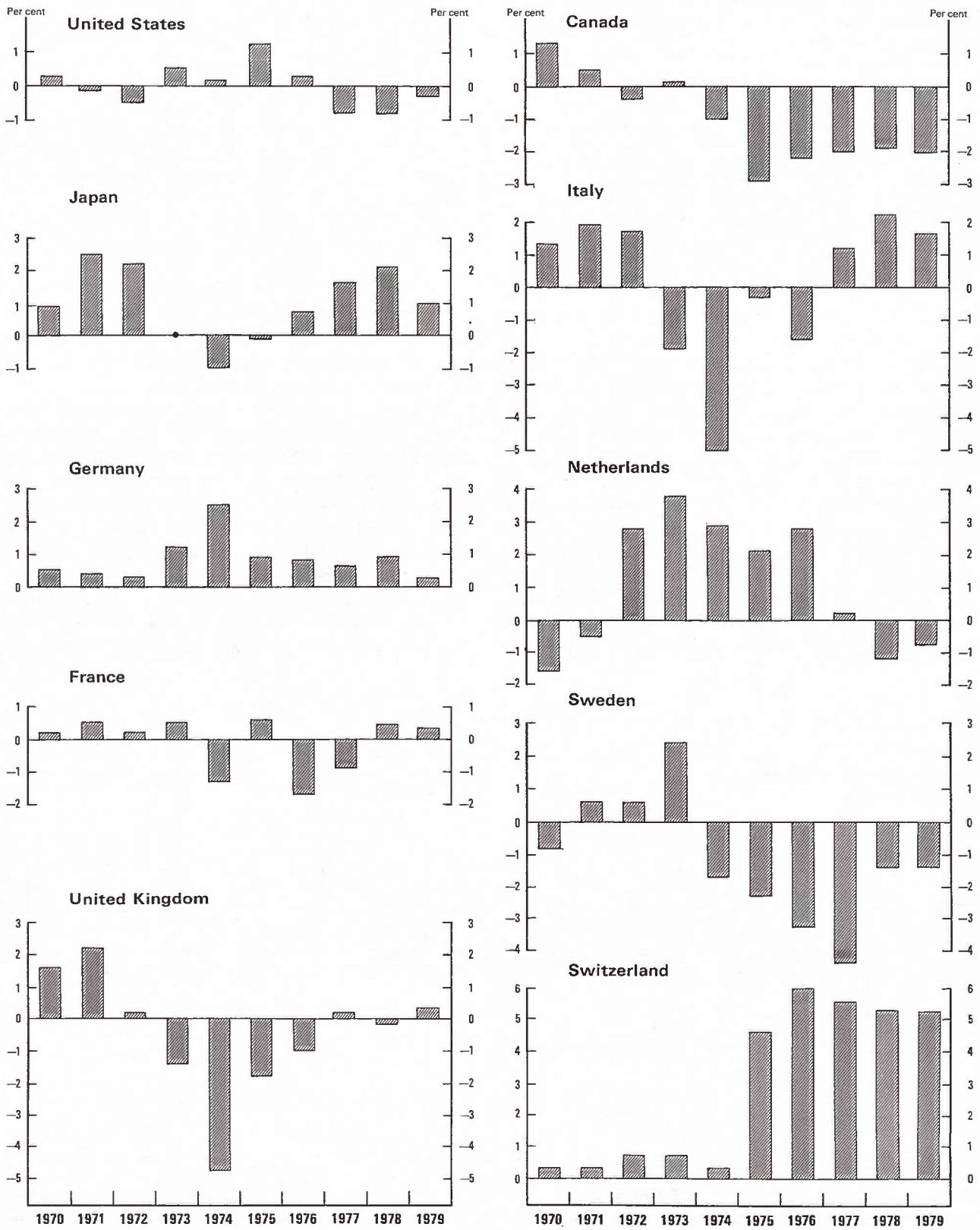
	Annual average 1970-73	1974	1975	1976	1977	1978[a]	1979[a]
Ireland	–188	–671	–24	–248	–210	–¼	–½
Denmark	–373	–910	–513	–1915	–1646	–1¼	–1
Norway	–292	–1103	–2408	–3771	–4983	–2	–2¼
Sweden	358	–950	–1614	–2407	–3385	–1¼	–1½
Finland	–270	–1212	–2173	–1169	–159	¼	¼
Iceland	–18	–155	–144	–24	–49	0	0
Austria	–159	–471	–322	–1470	–2978	–1½	–2
Switzerland	162	171	2587	3497	3441	4½	5
Spain	516	–3245	–3488	–4294	–2512	½	1
Portugal	248	–829	–819	–1246	–1496	..	..
Greece	–591	–1233	–1065	–1084	–1278	–1½	–1¾
Turkey	107	–634	–1832	–2166	–3323	..	..
Australia	–149	–2612	–619	–1415	–2558	–3¾	–4
New Zealand	104	–1128	–1400	–751	–626	–¾	–1¼
Total[a]	–½	–15	–13¾	–18½	–21¾	–9¾	–10½
Memorandum item							
Total OECD[a]	4½	27½	¼	–18¾	–27½	–¾	–1¼

a) $ billion.

CHART O

CURRENT BALANCES OF SELECTED OECD COUNTRIES

(Percentage of GNP/GDP)



expansionary measures on other European countries, these improved current positions may well persist in 1979. In addition, France and the United Kingdom experienced large terms of trade gains in 1978. For a number of European countries, therefore, external constraints as such may be considerably less binding than was the case six months or a year ago.

In the first three quarters of 1978, the Japanese surplus was running at about $20 billion at an annual rate and the United States deficit at $15-20 billion (annual rate). This may represent the peak of current balance disequilibrium for each country; the forecasts outlined above imply that, with relative domestic demand movements reinforcing the recent exchange rate changes, there should be significant adjustment over the next twelve months; by the second half of 1979 the United States deficit may be reduced to perhaps $5 billion[10], while Japan's surplus may fall to some $10 billion (both at annual rates). But Switzerland's surplus could widen from $4½ billion in 1977 to some $5 billion in 1979. Among other OECD countries, Canada's current deficit to the end of 1979 may continue to widen from the $4 billion recorded in 1977; over the coming months, gains on the real trade balance are likely to be offset by terms of trade losses and increasing net invisibles payments. A persistent weakness of non-energy exports may leave the Netherlands current balance

10. Excluding increased net exports resulting from sales of official gold, which could be worth some $4 billion.

Table 33
World current account[a]
$ billion

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979
Trade balance										
OECD	8¾	10¼	9¼	8½	–26¼	5½	–17¼	–23¼	3¾	5¾
OPEC	6½	9	10	21½	77	49½	65	61½	42½	41
Non-oil developing countries	–6	–9½	–6½	–7½	–23½	–38½	–25	–23½	–34	–40
Other	–2¾	–3	–2¾	–4¼	–10¾	–18¾	–12¾	–9	–9¼	–7¾
Total[b]	6½	6¾	10	18	16½	–2¼	10	5¾	3	–1
Services and private transfers, net										
OECD	3¼	5¾	6	9¾	9¼	7¼	11¼	10¼	15	16¼
OPEC	–6¾	–8¼	–7¾	–12	–15¼	–19½	–25½	–28	–30	–32
Non-oil developing countries	–5½	–5	–4½	–5½	–9	–10	–10	–10	–10½	–11
Other	0	0	¾	1	1	¼	0	–1	–1½	–2
Total[b]	–9	–7½	–5½	–6¾	–14	–21¾	–24¼	–28¾	–27	–28¾
Balance on goods, services and private transfers										
OECD	12	15¾	15¼	17¾	–16¾	13	–6	–13	18¾	22
OPEC	¼	¾	2¼	9½	61¾	30¼	39½	33½	12½	9
Non-oil developing countries	–11½	–14½	–11	–13	–32½	–48½	–35	–33½	–44½	–51
Other	–2¾	–3	–2	–3¼	–9¾	–18½	–12¾	–10	–10¾	–9¾
Total[b]	–2	–1	4½	11	2¾	–23¾	–14¼	–23	–24	–29¾
Official transfers, net										
OECD	–5¼	–6	–7¼	–8¼	–10¾	–12¾	–12¾	–14¾	–19½	–23¼
OPEC	–¼	–¼	–½	–1½	–2½	–3	–2½	–2	–1½	–1½
Non-oil developing countries	3½	4	5	6	8	10	9	9½	10½	12
Other	0	0	0	0	0	0	0	0	0	0
Total[b]	–2	–2¼	–2¾	–3¾	–5¼	–5¾	–6¼	–7¼	–10½	–12¾
Current balance										
OECD	6¾	10	7¾	9½	–27½	¼	–18¾	–27½	–¾	–1¼
OPEC	–½	½	1¾	8	59¼	27¼	37	31½	11	7½
Non-oil developing countries	–8	–10½	–6	–7	–24½	–38½	–26	–24	–34	–38
Other	–2¾	–3	–2	–3¼	–9¾	–18½	–12¾	–10	–10¾	–9¾
Total[b]	–4½	–3	1½	7¼	–2½	–29½	–20½	–30	–34½	–41½
Memorandum item										
USSR and Eastern Europe	–1¼	–1	–2¼	–4	–7	–15	–11¼	–9	–9½	–8½

a) Historical data for the OECD area are aggregates of reported balance of payments data by each individual country. For non-OECD groupings the data are estimated; in particular for the derivation of trade balances of these country groups use is being made of trade statistics reported by OECD countries, one important advantage being that such data are reported with much shorter time lag than non-OECD countries' own trade statistics. Because of various statistical problems as well as a large number of non-reporters among non-OECD countries, trade and current balances estimated on the basis of these countries' own balance of payments records may differ from corresponding estimates shown in this table.

b) Reflects statistical errors and asymmetries. Given the very large gross flows of world balance of payments transactions, statistical errors and asymmetries easily give rise to world totals (balances) that are significantly different from zero.

in deficit by over $1 billion again in 1979; Belgium's could move from a deficit in 1977 to about balance in 1979.

World current account

Estimates of the counterpart of the $25-30 billion improvement of the OECD's overall current position in 1978 are given in the bottom set of figures in Table 33. About half of this improvement appears to have been with OPEC (evenly split between changes on volume balance and terms of trade gains) while $10 billion of it appears due to terms of trade gains vis-à-vis non-oil developing countries. Largely because of these developments OPEC's current surplus may have fallen by some $20 billion from 1977 to just over $10 billion in 1978; the current deficit of non-oil developing countries could have increased by $10 billion to just under $35 billion.

In 1979, with the OECD's demand for net imports of oil relatively moderate and given the technical assumption on oil prices outlined above, the OPEC surplus could fall to $5-10 billion. "High absorbers" appear to have already moved into a large current deficit which, during 1979, could be running at $10-15 billion. The financial position and real export prospects of non-oil developing countries are likely to be sufficiently good, during 1979, for demand from these countries for OECD goods and services to continue to expand at rates above those of OECD trade (as in 1978). Hence, their current deficit could widen slightly to $35-40 billion in 1979.

The combined current deficit of USSR and Eastern Europe has been adjusted substantially, shrinking from $15 billion in 1975 to below $10 billion in 1977. It appears to have remained at that level in 1978. Policies in several countries in this group aim at increasingly substituting trade within the group for trade with the OECD. However, the main effect of these policies may be felt in the longer term; the overall current deficit of this group may change little in 1979.

These forecasts for major world zones suggest that the world discrepancy ("total" line in Table 33) may increase from $35 billion in 1978 to above $40 billion in 1979. The reasons for this discrepancy were discussed briefly in last July's *Economic Outlook,* No. 23, pp. 42-43. It should prove possible to comment more fully on them in the next *Economic Outlook.*

Adjustment in major countries

To provide more detail on recent and forecast workings of the adjustment process in the seven largest OECD countries, changes in their current balances have been broken down into some of their more important components in Table 34. One distinction the table attempts to draw is between terms of trade effects due to overall changes in relative prices of primary commodities and manufactured goods, and those associated with exchange rates. Both factors markedly affected trade balances in 1978, offsetting each other in depreciating countries while reinforcing each other in appreciating countries. This is shown in columns 5 and 6 of Table 34, column 5 contains estimates of total terms of trade effects while column 6 gives the part reflecting the shift in relative prices of manufactured goods and primary commodities. Thus, between the second halves of 1977 and 1978, the total United States terms of trade deterioration, which appears to have been kept to $1-2 billion, would have been some $4 billion bigger without the swing in the "commodity" terms of trade. This latter factor accounted for half of Japan's favourable terms of trade movement, over the same period, of almost $20 billion, the major part of Germany's $7 billion terms of trade gain, and $2 billion of France's $4 billion estimated terms of trade improvement. Without the favourable manufactures/commodities price swing, both the United Kingdom and Italy might have recorded terms of trade losses of $2 billion each instead of registering small gains. On the other hand, more than half of Canada's $2-3 billion terms of trade loss can be attributed to this factor.

Table 34 also provides estimates of changes in the volume trade balance of each country (column 7), distinguishing, in broad terms, between changes due to oil (column 8), differential demand growth among countries (column 9) and other factors (column 10). The change in the oil balance reflects, in general, the evolution of industrial production, stock movements and increases in indigenous production in the United Kingdom and United States[11].

In column 9 an attempt is made to identify "cyclical"[12] movements in the real trade balance, i.e. changes resulting from the fact that demand is growing relatively more (less) rapidly in a given

11. Indigenous production in 1977 II, 1978 II and 1979 II may be 0.8, 1.3 and 1.7 mbd in the United Kingdom, 10.0, 10.5 and 10.5 mbd in the United States.

12. Until recently "cyclical" movements in trade balances referred to temporary changes reflecting a leading or lagging cyclical position of the country in question and which would be reversed when cyclical positions turned around. Recently, however, certain developments which are "cyclical" when they occur, i.e. which reflect above or below average demand growth, may not necessarily be reversed as, in certain cases, it is uncertain whether differences in demand growth will be fully made up.

Table 34
Adjustment of current balances in seven largest OECD countries[a]

Estimates and forecasts

Change from same period of previous year, $ billion seasonally adjusted annual rates

		Level of current balance	Change in current balance: Total	of which: Invisibles	Trade	of which: Price	of which: Manufact./ Commodities	Volume	of which due to: Oil	Demand (non-oil)	Other factors	Memorandum item: Calculated effect of changes in competitive position: A	B
		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
United States	1977 II	–19½	–20½	1¾	–22¼	–7½	0	–14½	–2½	–6	–6	..	..
	1978 II	–16	3½	2½	1½	–1½	4¼	3	–3	–½	5½	5	9
	1979 II	–5	11	2	9	–2	–¾	11	–1	4	8	13½	16½
Japan	1977 II	12½	10½	½	10	4	½	6	–¼	4¼	2	..	..
	1978 II	18½	6	–2	8	19	8½	–11	–1	4	–14	–4½	–9
	1979 II	9½	–9	–1	–8	½	½	–8½	–½	2	–10	–16	–16½
Germany	1977 II	4	½	–3	3½	2½	¼	1	½	0	½	..	..
	1978 II	5	1½	–1½	3	7	5	–4	–¼	–½	–3¼	–3½	–5
	1979 II	1½	–3½	–3	–1	1	¼	–2	–¼	½	–2¼	–4	–2½
France	1977 II	–2½	7	½	6½	0	0	6½	0	0	6½	..	..
	1978 II	2	4½	1	3½	4	2	–½	–¼	½	–¾	0	–2
	1979 II	2	0	½	–½	–½	0	0	0	¾	–¾	–3	–5½
United Kingdom	1977 II	4	6½	–¾	7¼	1½	¼	5½	2½	0	3	..	..
	1978 II	–½	–4½	–1½	–3	½	2½	–3½	1½	–½	–4½	–7	–8½
	1979 II	2	2½	0	2½	1	¼	1½	1¾	¾	–1	–5	–5
Canada	1977 II	–4	–½	–1¼	¾	–2½	–¼	3½	–¾	1¼	3	..	..
	1978 II	–4½	–½	–½	0	–2½	–1½	2½	–¾	¾	2½	3½	6
	1979 II	–4½	0	–½	½	–¼	–¼	¾	–¼	–2½	3½	6½	7
Italy	1977 II	4	6½	¾	5¾	1	¼	4½	1	2	1½	..	..
	1978 II	5	1	0	1	1	3	0	–¼	0	¼	–½	½
	1979 II	4½	–½	0	–1	–½	¼	–½	0	½	–1	1	½

a) The method of calculating the figures presented in this table are as follows: Columns 1-4 are straight-forward: level of current balance for 1977 II (actual), 1978 II (estimate) and 1979 II (forecast) in column 1; change from the same period of the previous year in each case (column 2), broken down into changes in net invisibles (column 3) and change in trade balance (column 4). This last is further decomposed into changes due to « price » (column 5) and changes due to volume developments (column 7). Column 7 is calculated directly by applying changes in the volume of imports and exports to the level of each in the base period. Column 5 is calculated as a residual and hence includes « pure » terms of trade effects, second order terms which cannot be uniquely attributed to either volume or to price and, in some cases, the inflation of an initial imbalance. (When imports and exports are not equal in the base period, the same percentage change in the price of each will produce different absolute changes. A change in exchange rate vis-à-vis the numéraire currency will have the same effect.)

Column 6 attempts, in very broad terms, to estimate terms of trade changes resulting from different relative price movements, at the *total OECD level*, of manufactured goods, oil and non-oil primary commodities. The point of this calculation is to provide some orders of magnitude on the two forces which independently have had substantial effects on terms of trade in 1978: the sharp fall in the relative prices of commodities and the "J-curve" effects (intra-OECD) of exchange rate changes. The figures given in column 6 were calculated by applying the average (trade-weighted) OECD dollar prices of manufactured goods, oil and non-oil primary commodities to the country's trade balance in each category. (As it was felt that "inflation" effects should be excluded from a calculation of the effects of *relative* changes in prices, in these calculations trade balances in each category were normalised i. e. total imports and exports were adjusted proportionally, to produce a "normalised" overall trade balance of zero.)

Column 8 is calculated as the change in the volume of net oil imports valued at base period prices. Column 9 attempts to isolate the direct effects of demand alone on trade by calculating what the change in the non-oil trade balance would have been if, on the import side, only the elasticity of import volumes with respect to GNP and GNP growth were operative and, on the export side, only the normal elasticity of exports with respect to markets and market growth were operative. This column can be thought of as representing the estimated effect, on trade volumes, of differential growth rates of GNP among OECD countries.

Column 10 is derived as a residual. It might be seen as largely reflecting the effects of changes in competitive position. (Although it also reflects any special factors, the "noise" usually encountered in the type of time series under consideration here and indirect effects of demand such as the effects of changes in pressure of demand on incentives to export.) Column 10 can be compared with effects of changes in competitive position calculated directly (columns 11, Case A; column 12, Case B) on the basis of substitution (price) elasticities of 1¼ (Case A) and 1½ (Case B) for exports of manufactured goods, ¾ (Case A) and 1¼ (Case B) for imports of manufactures calculated on the basis of the following lag structures (per cent of total effect on volumes realised during the half-year following the change in competitive position):

	Half years 0	1	2	3
Case A (column 11)				
Exports	0	20	50	100
Imports	10	30	60	100
Case B (column 12)				
Exports	10	40	75	100
Imports	15	45	80	100

country than in its trading partners. In general, the calculated effects of this factor in the period covered are fairly small, suggesting roughly average growth in most cases. The most noteworthy feature of this set of figures is the negative effect of some $6 billion on the United States trade balance in the year to the second half of 1977, expected to turn around to a positive contribution over the coming year as the United States grows at below-average rates.

The most important element in "other factors" (column 10) is the effect of changes in competitive

positions on trade balances. These effects have also been calculated directly under two sets of assumptions in columns 11 and 12. In general there appears to be a rough correspondence between the direct and indirect estimates of these effects which reinforces the confidence attaching to these two methods of calculation. In this connection, it might be noted that the quantification of the effects on trade of changes in competitive positions has always raised difficulties given the problems of defining such positions[13] and of determining the size and lag structure of the relevant substitution (price) elasticities. Recently, the value of econometric evidence here has been somewhat reduced as most measures of competitive position have changed by amounts outside the range of variations seen in the past. Hence, in attempting to quantify the effects of changes in competitive position on trade flows, the Secretariat has applied different assumptions to a broad interpretation of the evolution of competitive position based on an examination of the different indicators given in Chart N.

13. See "The International Competitiveness of Selected OECD Countries", *OECD Economic Outlook, Occasional Studies,* July 1978, for a full discussion of the problems of measuring competitive position.

INTERNATIONAL MONETARY DEVELOPMENTS

Exchange rates, capital flows and official intervention

The salient feature of the recent period has been the sharp decline of the dollar in October and its strong rebound after the introduction by the United States authorities of a substantial programme for its defence. Mirroring this evolution the Deutschemark, the yen and other strong currencies reached new historical peaks in October, but fell back markedly in November. Official market intervention, which had been somewhat more restrained over the summer, was stepped-up again in October, both within the framework of the EEC joint float and in support of the dollar, and continued in November. As a result, international payments imbalances, as measured by net transactions of monetary authorities, widened considerably in October and November and creation of international official liquidity accelerated.

The *United States dollar,* after declining by 4½ per cent in effective terms in the third quarter, fell by more than 6 per cent in October. Following the announcement of new support measures it rebounded sharply in early November, practically erasing in a few days all its losses of October. It subsequently gained some further ground (Table 35 and Chart P). As a result, the cumulative effective depreciation of the dollar since end-September 1977 —the beginning of its recent slide—fell from a peak of 18½ per cent at end-October to around 12 per cent in late November. This was still roughly equivalent to the depreciations of mid-1971 to mid-1972, and of the first seven months of 1973[1]. But the earlier depreciations had taken place at a time when the United States' relative cost/price performance[2] was considerably more favourable than during the last 14 months. Even if the present depreciation of the dollar were to be maintained, its effects on the United States' competitive position —though not inconsiderable—could be significantly smaller than in the two previous episodes of sustained depreciation.

The acceleration of selling pressures on the dollar in October was accompanied by stepped-up official intervention by Switzerland, Germany and, to a smaller extent, the Federal Reserve Bank itself. The combined purchase of dollars by the official institutions of all Group of Ten countries may have been of the order of $6 billion in October, compared with a little over $5 billion for the third quarter as a whole. Heavy support continued in early November but was then gradually reduced. During this period, the Federal Reserve presumably relied

1. Over these two periods the dollar recorded an effective depreciation of 8 per cent and 12½ per cent, respectively.
2. For example, in terms of unit labour cost.

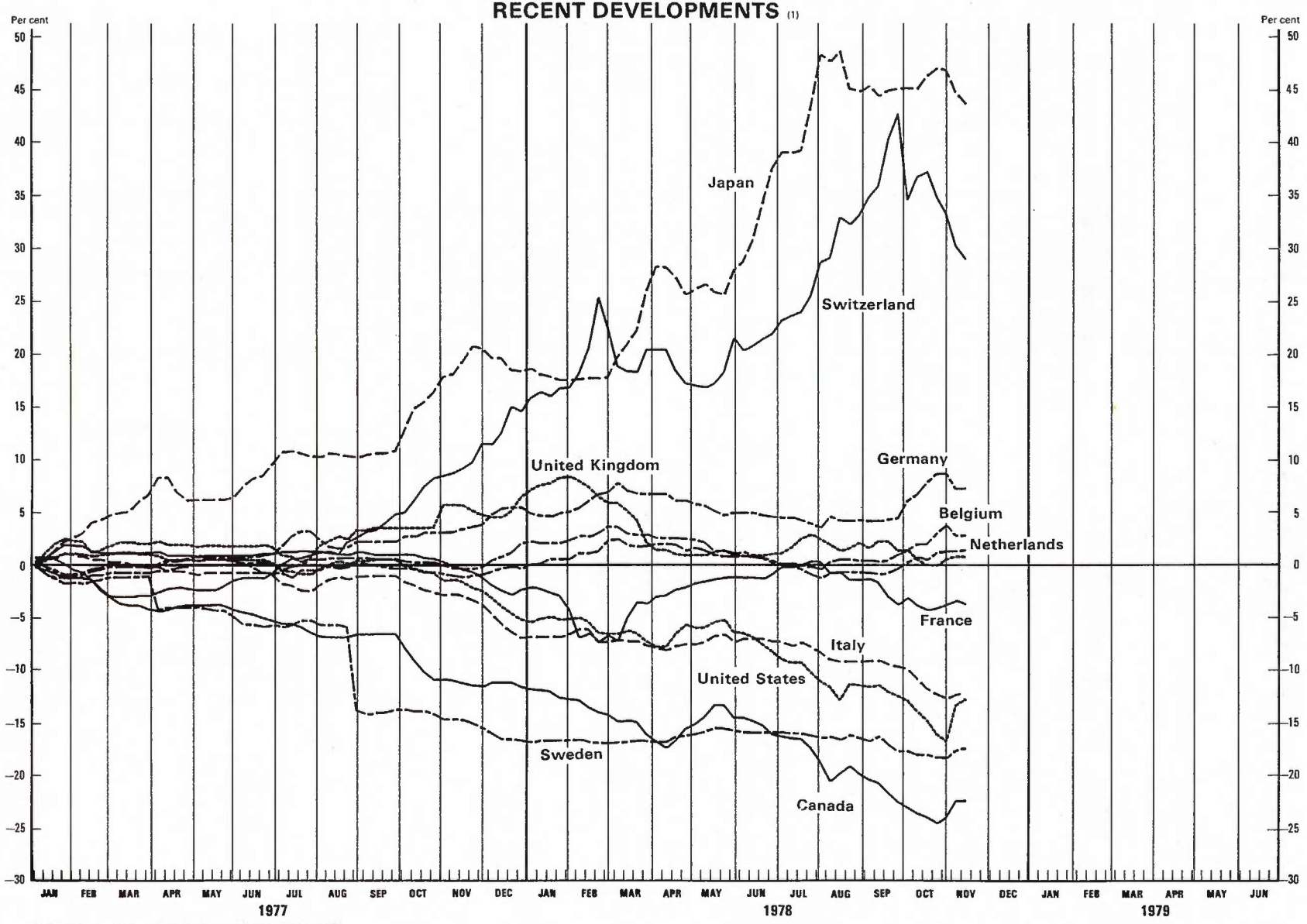
Table 35
Recent exchange rate variations
Percentages

	Net changes over period						*Memorandum items* Net changes from end-Sptember 1977[c]			
	Q3 1978[a]		October 1978[b]		31 Oct.-22 Nov. 1978		To 31 October 1978		To 22 November 1978	
	Effective	Vis-à-vis $	Effective	Vis-à-vis $	Effective	Vis-à-vis $	Effective	Vis-à-vis $	Effective	Vis-à-vis $
United States	–4½	—	–6½	—	8¼	—	–18½	—	–12	—
Japan	5½	9	–2½	7¼	–4¾	–7½	34¼	51¼	27¾	37½
Switzerland	17	23	–6	2	–6¾	–12½	28¼	58¾	19¾	36¾
Germany	0	6¾	5	12¼	–1½	–9	7½	34¼	5½	20¾
Belgium	¾	6¾	3½	12½	–2¼	–9¼	4	31¾	1¾	18¼
Netherlands	–½	6	¼	10	½	–9	½	28¾	1	18½
United Kingdom	¼	6	–1¼	5½	1½	–6	–3½	19	–2	11¾
France	–3	4	–¼	8¼	–¼	–8¾	–5	22	–5	11¾
Sweden	–2¼	3¾	–¾	7½	1¾	–6¼	–5¼	17¾	–3½	9½
Italy	–2½	4	–3½	4¼	1½	–6½	–12¼	11¾	–10¾	4¼
Canada	–7½	–4½	–2½	1¼	3¾	–½	–19¼	–7¾	–16¼	–8½

Note: Weekly figures are averages of daily figures.
a) From the last week of June to the last week of September.
b) From the last week of September to 31st October.
c) Last week of September.

CHART P

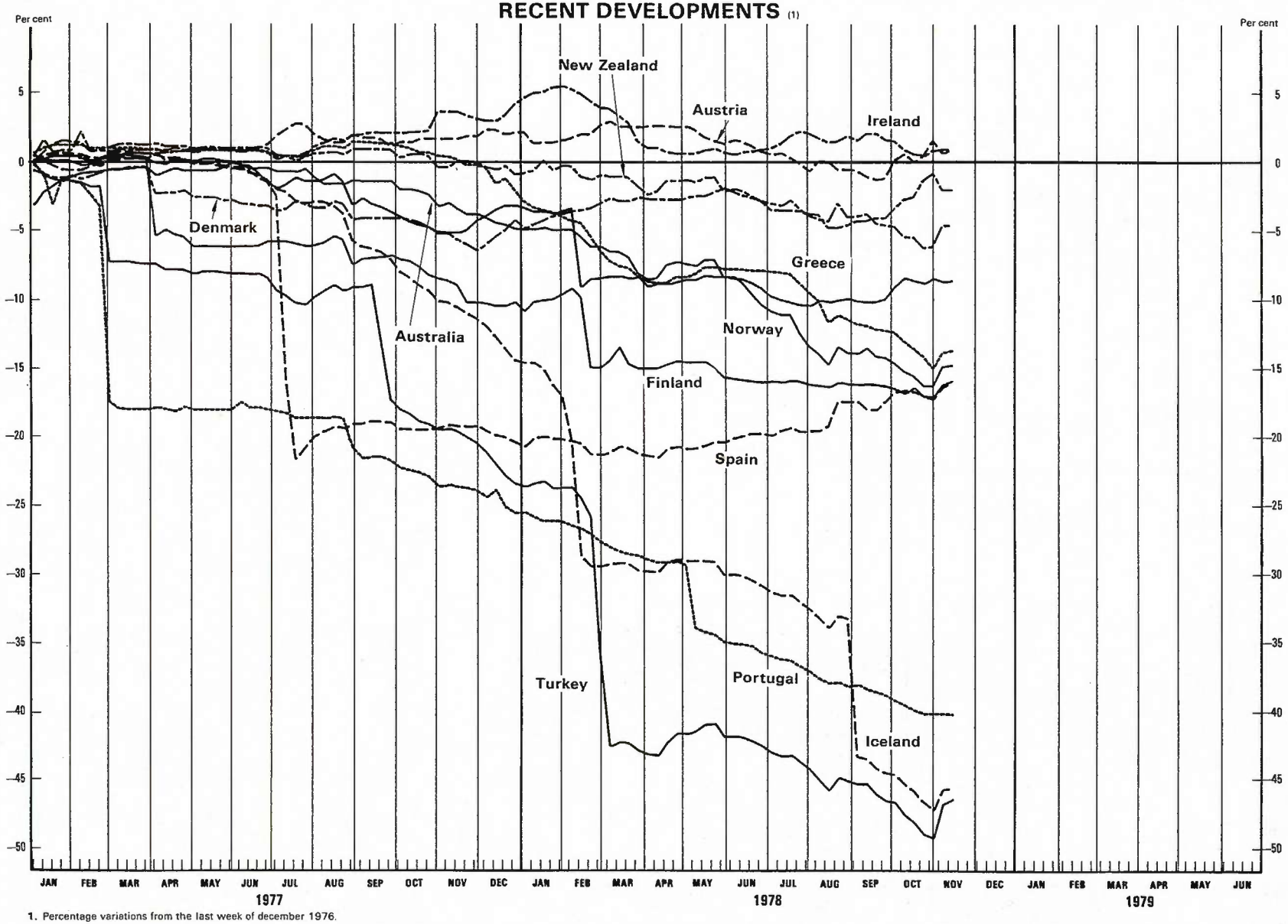
EFFECTIVE EXCHANGE RATES OF MAJOR CURRENCIES: RECENT DEVELOPMENTS (1)



1. Percentage variations from the last week of december 1976.

CHART P (cont.)

EFFECTIVE EXCHANGE RATES OF OTHER CURRENCIES: RECENT DEVELOPMENTS (1)



1. Percentage variations from the last week of december 1976.

Table 36
Balance of payments summary
$ billion, not seasonally adjusted

	1978 Q1			1978 Q2			1978 Q3[a]		
	Current account	Capital account	Net transactions of monetary authorities	Current account	Capital account	Net transactions of monetary authorities	Current account	Capital account	Net transactions of monetary authorities
United States	–6.5	–8.4	–14.8	–2.8	7.4	4.6	–5	0	–5
Japan	4.0	2.7	6.7	4.6	–6.5	–1.9	5	–3¾	1¼
Germany	1.6	0.6	2.2	2.0	–4.0	–2.0	¼	2½	2¾
Switzerland	1.0	–0.1	0.9[b]	0.7	–1.6	–0.9[b]	1	–1	0[b]
Italy	0.3	0	0.3	1.7	1.2	2.9	2	¾	2¾
Netherlands	–0.3	0.5	0.2	–0.3	0.2	–0.1	–½	–¼	–¾
Sweden	–0.5	0.7	0.2	–0.3	0.8	0.5	–½	½	0
Belgium	0.2	0.6	0.8	–0.2	0.2	0	–¼	–¾	–1
United Kingdom[c]	–0.8	1.1	0.3	0.6	–3.3	–2.7	–½	¾	¼
France	–0.3	0	–0.3	1.6	–0.5	1.1	½	½	1¼
Canada	–1.3	0.2	–1.1[d]	–1.4	1.9	0.5[d]	–½	–1¾	–2¼[d]

Note: Detail may not add due to rounding.
a) Partly estimated.
b) Excluding foreign exchange taken by the Swiss National Bank from commercial banks under swaps.
c) Changes in official sterling balances are recorded as capital flows while Euro-currency borrowing by Her Majesty's Government and public sector borrowing under the foreign exchange cover scheme are recorded as transactions of monetary authorities.
d) Including drawings under the Government's stand-by facility with Canadian chartered banks, US and other foreign banks.

strongly on its swap lines with the Bundesbank, the Bank of Japan and the Swiss National Bank (which, after the recent increase, amount in aggregate to $15 billion). The United States authorities also drew $2 billion from the reserve tranche in the International Monetary Fund and sold the equivalent of $0.8 billion of SDRs to Germany and $0.6 billion to Japan[3].

Upward pressure on the *Deutschemark* within the EEC joint float was already evident during the summer. Significant intervention, mainly in favour of the Belgian franc in August and the Dutch guilder in September, was needed to keep snake currencies within the allowed ±2¼ per cent band. These interventions, in aggregate, amounted to some $1¾ billion over the third quarter, and largely accounted for the $2.8 billion increase in net official reserves —the remainder essentially representing interventions in support of the dollar. After recording sizeable capital outflows and a deficit in net transactions of monetary authorities in the second quarter, Germany moved back into a large surplus in June-September as a result of a swing in capital account of some $6½ billion (Table 36). The inflows of funds accelerated in early October and, after further massive intervention by the Bundesbank in support of the other snake currencies (some $3½ billion), the Deutschemark was revalued at mid-month by 2 per cent vis-à-vis the Belgian franc and the Dutch guilder, and by 4 per cent vis-à-vis the Norwegian krone and the Danish krone.

As a result the Deutschemark, which in the third quarter had remained level, in effective terms, rose to a new historical high, both in effective terms and vis-à-vis the dollar, representing an appreciation over the month of 5 and 12 per cent, respectively. No further intervention was required within the joint float arrangement in the second half of October. The rebound of the dollar after the steps announced by the American authorities at the beginning of November was especially strong against the Deutschemark, which fell to the bottom of the snake. Since April 1972, when the snake was first introduced, all currencies which at one time or another have been included in this arrangement have depreciated vis-à-vis the Deutschemark. This depreciation has ranged from a minimum of less than 10 per cent for the Dutch guilder to a maximum of over 20 per cent for the Danish and Norwegian krones for current members, and from 30 per cent for the French franc to nearly 60 per cent for the Italian lira, for former members (Chart R).

The *yen* resumed its upward trend vis-à-vis the

3. Details are not yet available on the sources and composition of private United States capital flows during this period. In the third quarter, despite considerable pressure on the dollar, the overall United States capital account was practically in equilibrium (i.e. intended capital outflows were allowed to drive down the exchange rate to levels which, on balance, prevented net outflows) following overall net inflows in the second quarter. Since the positive swing of the United States capital account in the second quarter had largely been accounted for by banking funds and the errors and omissions item, it seems likely that the deterioration in the third quarter and in the more recent period, was also primarily accounted for by these two categories of transactions which typically have been the most volatile in periods of international monetary turbulence.

CHART Q

US-GERMANY: INTEREST RATE DIFFERENTIAL AND BILATERAL EXCHANGE RATES

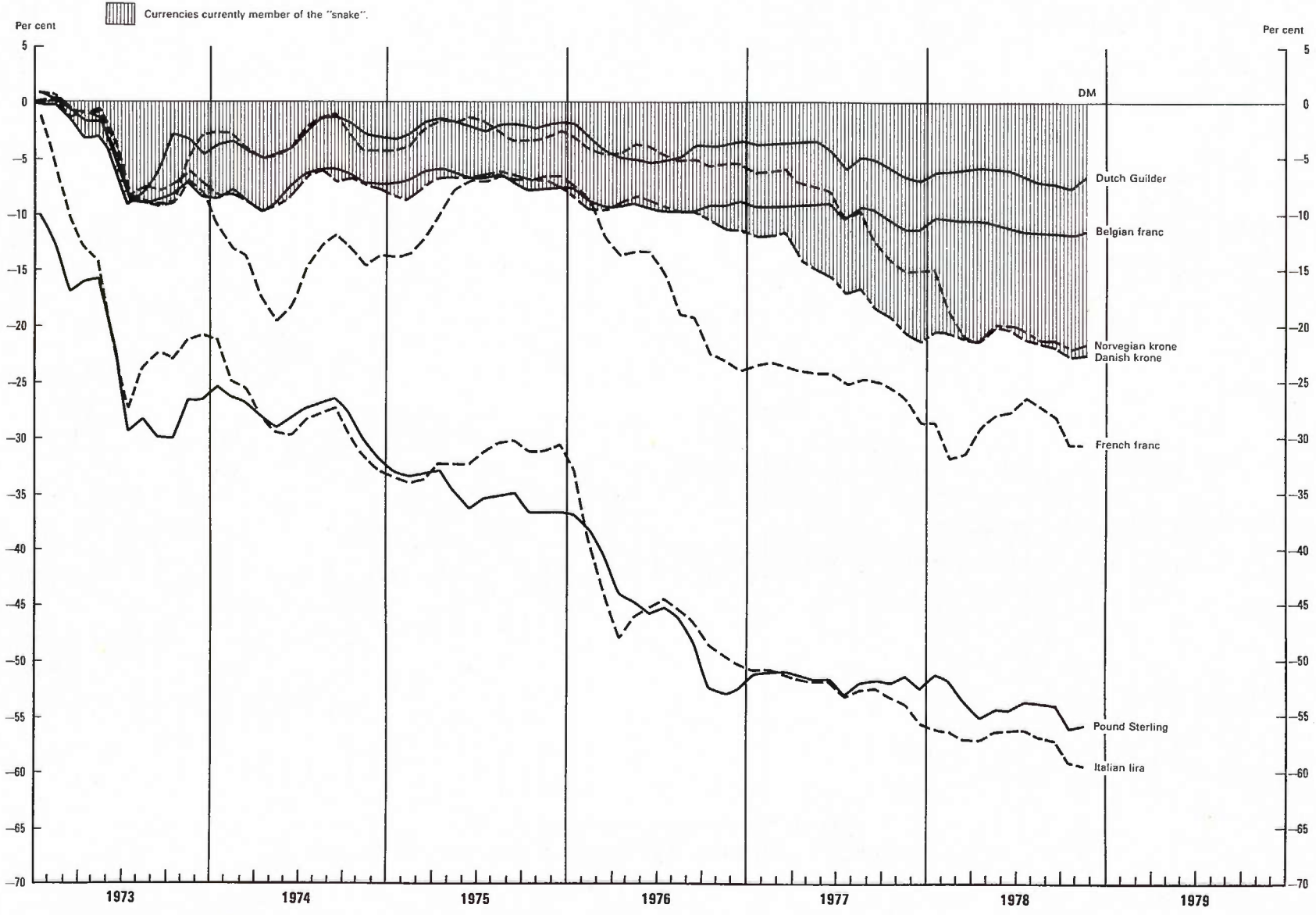


* First week of March 1974 = 100.

CHART R

EVOLUTION OF SELECTED EUROPEAN CURRENCIES VIS-A-VIS THE DM

Percentage variations from bilateral rates (in Frankfurt) of April 1972 (introduction of the EEC "snake")
Monthly averages of daily figures



dollar in October, reaching a new record level at the end of the month. As a result of the evolution of several other currencies, however, in effective terms it remained somewhat below its July peak. Despite stepped-up intervention in November by the Bank of Japan the dollar recovered less against the yen than against the strong European currencies (Chart U).

Following an unprecedented effective appreciation of the *Swiss franc* of some 17 per cent over the third quarter, Switzerland announced a policy of more active intervention in early October. This may have resulted in the acquisition by the Swiss National Bank of some $3 billion over the month. While vis-à-vis the dollar, at end-October, the Swiss franc was practically back to the record level of late September, in effective terms it was nearly 10 per cent below the previous peak. The dollar rebounded sharply against the Swiss franc in November, and recent intervention by the Swiss National Bank seems to have been on a considerably smaller scale.

The *pound sterling* and the *Italian lira* did not appreciate against the dollar as much as other strong currencies in October and, as a result, fell somewhat in effective terms. The *French franc* and the *Swedish krona* stayed roughly unchanged in effective terms, but the Canadian dollar, showing little movement vis-à-vis its United States counterpart, continued its two-year slide, reaching a cumulative effective depreciation since late 1976 of nearly 25 per cent. During October, the United Kingdom repaid, ahead of schedule, nearly $1 billion to the International Monetary Funds; its market intervention in favour of the dollar was very modest (some $0.1 billion).

Factors affecting the dollar

During the second half of 1977 and most of 1978 (April and May being a brief exception) sizeable United States capital outflows and/or a declining dollar coincided with large and widening *interest rate differentials* in favour of the dollar, especially compared to DM-denominated assets (Charts Q and V). But interest rate differentials seemed insufficient to offset depreciation expectations. Persistent pressure on the dollar in October suggested that, despite an effective depreciation approaching 20 per cent, exchange rate expectations still largely outweighed interest rate considerations, and that investors, as a group, expected a further depreciation well in excess of the interest differentials in its favour (amounting to 10 per cent in respect of Switzerland[4]).

This rather pessimistic view of the dollar may have seemed largely unwarranted by certain fundamental economic considerations, notably the substantial improvement in the United States current account expected as a result of exchange rate variations which had already taken place and a convergence of growth rates among the major economies. But there were other, more negative, considerations in the United States, including rising inflationary trends and expectations; continuously strong expansion of monetary aggregates which might have cast doubt on the actual stance or effectiveness of monetary policy; disappointment with the final form of the energy bill and the Administration's anti-inflation policy; and persisting (albeit declining) trade and current account deficits. None of these factors, alone, could reasonably have justified the position of the dollar at end-October; together they may provide a rough indication why—without external help—a further decline of the dollar may have been required to convince enough investors to move into dollar assets, thereby providing the necessary financing for the continuing current account deficit, some structural capital outflows, and possibly some diversification of official reserves from dollars into other currencies (see below).

One result of the *dollar support measures* announced by the United States authorities in November may be to provide this financing—or bridging operation—until the current account position fully reflects past exchange rate changes and the slowdown of economic activity in the United States relative to the rest of the industrialised world. The eventual issue of up to $10 billion of Treasury securities in foreign currencies (Deutschemark, yen and Swiss francs) would provide foreign exchange to be fed into the market in a pre-arranged, systematic way—rather than as a reaction to crisis—somewhat along the line other countries have followed for their compensatory foreign borrowing. Ideally, this financing would largely have been provided by private investors ("stabilising speculation"). And it is of course possible that the United States stabilization programme may reduce uncertainty sufficiently to encourage private investors to play this financing role, obviating the need for substantial further intervention and enabling interest rate differentials to work more normally.

When there is protracted weakness of the dollar, such as in recent months, *diversification of official*

4. Moreover, for investors unwilling to take exchange rate risks, the weakness of the dollar on the forward market had generally offset the attractiveness of United States money market rates.

reserves (mainly by OPEC and other developing countries) and its effect on exchange markets becomes a matter for discussion. Lack of data, and long reporting lags where information is available, preclude more than an impressionistic discussion of recent trends. Nonetheless, there is some limited evidence that the investment strategy of OPEC countries has been gradually shifting. A switch (of a little over $1 billion) out of dollar assets into those denominated in other currencies reportedly took place in the Eurocurrency market in the first quarter of the year, though at the same time OPEC countries added $1.4 billion to their financial investment in the United States[5]. In the second quarter, identified OPEC financial investment in the United States fell by $2¼ billion—the first quarterly decline since the increase in oil prices in late 1973. Since, during this quarter, published official reserves of OPEC countries, in aggregate, declined by an unprecedented $3½ billion[6], the liquidation of OPEC financial investment in the United States may to a significant extent have reflected the current sharp reduction in the combined investible surplus of the oil producers and the severe cash squeeze affecting several of them.

Non-oil developing countries may also have carried out some diversification of their reserves, at least as regards the composition of reserve increases. These countries' official holdings in the United States increased by less than $1 billion in the first six months of 1978, compared with an increase in their published foreign exchange reserves of some $6 billion.

International official liquidity

After its extremely rapid increase in late 1977, international official liquidity grew at a much slower pace in the first three months of 1978 and remained practically unchanged in the second quarter (Table 37). As a result, its rate of growth over the first half (at an annual rate) was less than 8 per cent in dollar terms, compared to over 20 per cent in 1977 (Chart S). In absolute terms, official reserve assets increased by some $12 billion to $331 billion at the end of June. "Controlled creation", that is, stemming from bilateral or multilateral official decisions, resulted in a $3½ billion destruction of liquidity, essentially reflecting repayments of support operations (by Italy and members of the EEC joint float) as well as net repayments of IMF drawings.

All the net increase in international official liquidity in the first half was in the form of foreign

5. During this period, OPEC investment in sterling balances (in the United Kingdom) were practically unchanged, despite a decline in their combined official reserves ($1.8 billion).

6. During this period, OPEC investment in sterling balances declined by some $0.4 billion.

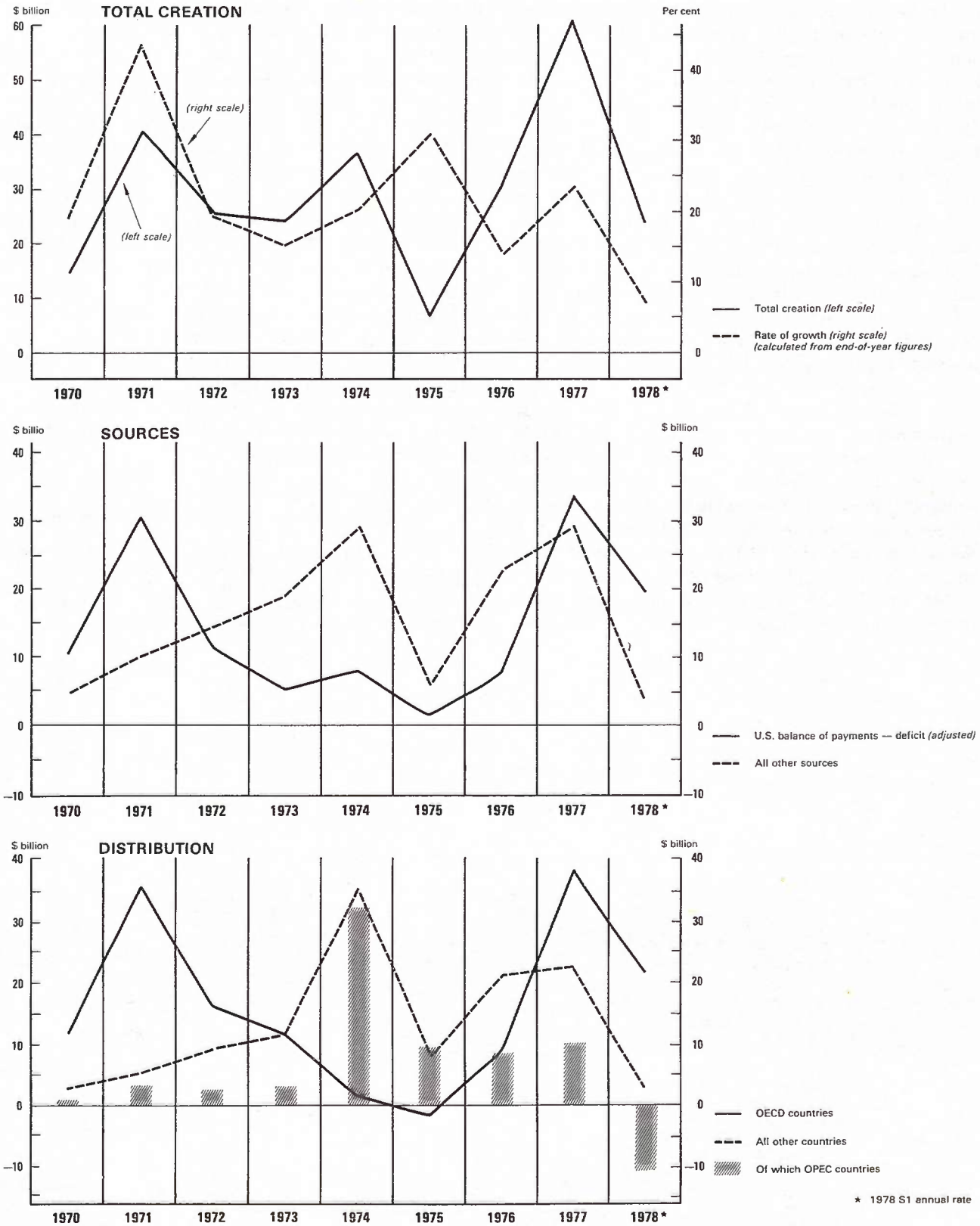
Table 37
International official liquidity : changes
$ billion, not seasonally adjusted, actual rates

	1977 Q3	1977 Q4	1978 Q1	1978 Q2	1977 I	1977 II	1978 I	1977 Year
TOTAL[a]	11.2	29.2	12.0	0	20.4	40.4	12.0	60.8
Percentage changes (at annual rate)	(17.1)	(46.8)	(15.9)	(0)	(16.4)	(31.1)	(7.7)	(23.5)
COMPOSITION								
Currency reserve assets	12.6	26.4	11.6	0.5	18.6	39.0	12.1	57.6
Others	–1.4	2.8	0.4	–0.5	1.8	1.4	–0.1	3.2
SOURCE								
US deficit in net transactions of monetary authorities[b]	7.3	14.6	14.7	–5.0	10.6	21.9	9.7	32.5
All others	3.9	14.6	–2.7	5.0	9.8	18.5	2.3	28.3
DISTRIBUTION								
OECD countries	7.8	20.7	9.9	0.8	9.9	28.5	10.7	38.4
All other countries	3.4	8.5	2.1	–0.8	10.5	11.9	1.3	22.4
of which :								
Oil exporting countries	0.7	3.8	–1.8	–3.5	5.8	4.5	–5.3	10.3
Memorandum item :								
"Controlled" creation[c]	–1.3	0.2	–2.1	–1.3	1.6	–1.1	–3.4	0.5

a) As published in *International Financial Statistics*.
b) Net transactions of monetary authorities (+ = deficit) adjusted for financing through reserve assets, special transactions, and foreign official investment in United States corporate bonds.
c) Non-currency reserve assets (excluding valuation adjustments), Fund sales of dollars and support operations.

CHART S

INTERNATIONAL OFFICIAL LIQUIDITY



★ 1978 S1 annual rate

exchange. Other reserve assets (monetary gold, SDRs and reserve positions in the Fund) in aggregate, showed practically no change, as the increase in the dollar value of these assets stemming from the depreciation of the dollar was offset by an actual decline in reserve positions in the IMF (as a result of the net reduction in the use of IMF credit noted above). By far the major source of the increase in currency reserve assets was the United States balance of payments deficit[7] which played a much larger proportional role that in 1977. The mirror image of this seems to have been a substantially smaller role of the Eurocurrency market as a source of international official liquidity. After a record creation of over $20 billion of identified official Eurodeposits in 1977 (of which the equivalent of $6 billion was in currencies other than the dollar), increases in official liquidity originating from this source may have been rather small in the first half of 1978 (perhaps a few billion dollars). The salient feature of the distribution of new reserve assets over this period was the decline of over $5 billion in combined reserves of oil exporting countries. While for some of these countries published figures may be of questionable value, this decline—the first on a half-yearly basis since the oil crisis—would seem sufficiently large (and sufficiently broadly distributed within this block) to underline the recent international payments situation of the oil exporters. Non-oil developing countries, as a group, continued to increase their gross reserves but nearly all the net creation of international official liquidity was absorbed by OECD countries, which increased their aggregate reserves by nearly $11 billion.

The change of direction of official intervention in dollars, from net sales in the second quarter to net purchases in the third combined with support operations within the EEC joint float, seems certain to have resulted in a new significant increase of official international liquidity since mid-1978. There was probably an acceleration of this creation in October and November, but a significant proportion of this is likely to have been of a very short-term nature, since support extended within the snake arrangement is usually repaid during the following month. Moreover, a sustained improvement in the position of the dollar would be followed by a marked reduction in official intervention in its support—perhaps even net official sales of dollars, as in the second quarter—and, consequently, a slowdown in the growth of official international liquidity[8].

7. Adjusted to reflect its actual impact on official reserve assets.

8. Also, unlike official support operations, compensatory foreign borrowing does not affect official international liquidity since, in the case of the United States, the United States Treasury would increase its liabilities vis-à-vis foreign private investors, rather than foreign official institutions.

DEVELOPMENTS IN INDIVIDUAL COUNTRIES

UNITED STATES

Recent trends

Preliminary data for the first three quarters suggest that the growth rate of demand and output in 1978 will have been close to 3½ per cent. Following the second quarter rebound from cold weather and strikes, GNP rose by 3¼ per cent (s.a.a.r.) in the third quarter. Private consumption continued to provide much of the impetus in the upswing. Continuing weak productivity increases led to an unexpectedly large growth of employment up to mid-year; thereafter employment and the length of the working week remained relatively stable. The unemployment rate averaged just under 6 per cent during the six months to October, down from the 7 per cent average for 1977. Buoyant real income growth in the second half of 1978 has come mainly from accelerating hourly rates of pay—particularly among white collar and non-unionised workers—helped by a deceleration of the growth of food prices over the summer. A historically low personal savings ratio and further substantial extentions of new consumer credit have also bolstered private consumption demand; in the third quarter, the ratio of households' financial assets to liabilities was about 2.0, a fraction higher than in the second quarter, but well down from the peak of 2.4 in mid-1976. Federal government expenditure on goods and services fell sharply in the first half of the year, almost entirely because higher farm prices led to reduced purchases under price-support programmes. With the growth of food prices decelerating in the third quarter, a return to more normal expenditure levels brought a recovery in real Federal government expenditure. Non-residential fixed investment in the third quarter was 7.3 per cent up on a year earlier and business fixed investment may have advanced moderately through to the end of the year. Private residential investment has remained buoyant, although the number of starts turned down slightly during the summer. Net exports of goods and services (in real terms) made a strong positive contribution to output growth during 1978, estimated at the equivalent of ¾ per cent of GNP in the year to the fourth quarter.

It had been expected that the surge in prices during the first half of 1978 would moderate later in the year, when the effects of higher social security charges and minimum wages had worked through and the growth of food prices had moderated. There was indeed some deceleration in July and August, primarily in food prices, but it neither lasted as long, nor went as far, as had been hoped. Wholesale prices and producer prices of crude materials rose at annual rates of 10 per cent and 14 per cent respectively over the three months to October. Hence, the 7¾ per cent annual rate of growth in the private consumption deflator

Trends in prices, costs and unemployment
Percentage changes, seasonally adjusted, annual rates

	Dec. 1976 / Dec. 1975	Dec. 1977 / Dec. 1976	Oct. 1978 / Dec. 1977
Consumer price index	4.8	6.7	9.6
Food	0.5	8.1	12.7
Non-food commodities	6.2	6.3	8.9
Of which:			
Fuel and utilities	9.2	8.0	8.4
Services	7.4	7.9	10.4
Wholesale price index	4.6	5.9	10.1
Farm products, processed foods and feeds	–1.1	3.0	15.9
Industrial commodities	6.3	6.7	8.6
Of which:			
Fuels and related products and power[a]	8.1	11.8	6.6
Average hourly earnings index (production workers, private non-farm)	7.5	7.4	8.4
Unemployment rate (final month of period)	7.8	6.4	5.8

	1977 Q3	1977 Q4	1978 Q1	1978 Q2	1978 Q3
Private non-farm economy[b]					
Output per man-hour	3.5	0.7	–3.1	1.4	3.9
Compensation per man-hour	8.2	7.6	12.2	8.2	8.8
Real compensation per man-hour	3.1	2.9	3.3	–0.5	2.3
Unit labour costs	4.3	7.0	15.8	6.4	5.0

a) Not seasonally adjusted.
b) Changes from previous quarter.

Demand, output and prices
UNITED STATES
Percentage changes
Volume (1972 prices)
Seasonally adjusted at annual rates

	1977 current prices billion $	From previous year			From previous half-year				
		1977	1978	1979	1977 II	1978 I	1978 II	1979 I	1979 II
Private consumption	1206.5	4.7	3½	2	4.6	2.9	3¾	1½	1¾
Government expenditure	393.9	2.4	2¼	2¾	5.9	–0.8	4¾	2	2¼
Private fixed investment	282.3	12.4	6	–¾	8.3	6.0	4	–1¼	–4
Residential	91.9	20.5	3¼	–9	14.1	0.5	–¾	–12½	–10¼
Non-residential	190.4	9.1	7¼	2¾	5.9	8.5	6	3½	–1¾
Final domestic demand	1882.7	5.2	3½	1¾	5.4	2.6	4	1	1
*plus change in stockbuilding	15.6[a]	0.2	¼	–¼	0.3	0.4	–½	0	–½
*plus change in foreign balance	–11.1[a]	–0.5	0	½	–0.5	–0.1	1	¼	½
GNP at market prices	1887.2	4.9	3¾	2	5.1	2.8	4½	1¼	1
GNP implicit price deflator	..	5.9	7½	7¼	5.9	7.7	8	7	7
Memorandum items									
Industrial production	..	5.6	5½	2¼	5.3	4.2	7¾	1	0
Consumer prices[b]	..	5.7	7	7	5.1	7.7	7	7¼	7
Stockbuilding (actual rate, 1972 prices, billion $)	..	8.9	11.2	7.0	4.9	6.3	4.9	4.5	2.5

* As a percentage of GNP in the previous period.
a) Actual rate of stockbuilding and foreign balance.
b) National accounts implicit private consumption deflator.

in the first half of 1978 (from the previous half-year) may have fallen back to only about 7½ per cent in the second half. The "underlying" rate of inflation, measured by excluding the price of energy and such volatile items as food and housing rose to 7½ per cent, compared with 6 per cent in the previous two years. The pick-up of wage and salary earnings, and of both import and import-competing prices as the exchange rate of the dollar declined, were the major factors behind this acceleration.

Between May and September, the dollar depreciated by 17 per cent against the yen and 5 per cent against the Deutschemark. The effective rate fell by about 6 per cent over the same period, bringing the year-on-year depreciation to 10 per cent. Nonetheless, the terms of trade actually rose over the year to the third quarter, reflecting the substantial increase in world prices of manufactured goods relative to primary commodities. Strong domestic inflation and some expansion of exporters' profit margins led to a 10 per cent increase in average export values. The average import value increase was only 8 per cent, being held down by the denomination of oil and many other commodity prices in dollars and, possibly, by some reduction in the profit margins of suppliers of manufactured goods. As a result, there was little apparent adverse terms of trade effect (J curve) on the trade balance over the first three quarters of 1978, which was also helped by buoyant agricultural exports and some improvement in the volume of manufactured exports. With a small increase in invisible earnings, the current external deficit of $28 billion (annual rate) in the six months to March gave way to one of $13 billion in the six months to September.

Policies

While output was expanding briskly through mid-1978, accompanied by a much more rapid reduction in unemployment that had been generally expected, inflation accelerated and the exchange rate of the dollar fell repeatedly. In response, demand management became somewhat less expansionary and a more comprehensive counter-inflation policy was introduced in October. Congress passed an energy bill, although in a much modified form from the original proposals. These policy moves did not, however, prevent a further sharp depreciation of the dollar exchange rate, and a series of measures designed to bring more stable exchange market developments and to reduce inflationary pressures was introduced in November. Monetary policy was tightened to give further backing to the dollar and to counteract the buoyancy of the monetary aggregates during the summer months.

a) Fiscal policy

The July federal budget review led to a scaling down of expenditure estimates for the fiscal year 1978 (ending in September 1978) and FY 1979, mainly reflecting continuing expenditure shortfalls. Revisions to receipts reflected changes from the

Administration's original tax reduction and reform proposals for FY 1979. The Administration's revised and more modest proposals for tax reductions in FY 1979 were again reshaped during their passage through Congress. The suggested reforms largely disappeared, and capital gains concessions were added, weighting the proposals more in favour of middle and upper incomes[1]. The final FY 1979 estimates reflect a further shift in fiscal posture with expenditure reductions again the principal change. The following table compares budget proposals at various stages (unified budget basis, $ billion):

	FY 1978			FY 1979			FY 1980
	Jan.[a]	July[b]	Actual	Jan.[a]	July[b]	Sept.[c]	Oct. 78[d]
Receipts	401.3	401.2	402.0	440.5	448.2	448.7	..
Outlays	463.1	452.3	450.7	501.0	496.6	487.5	..
Deficit (-)	- 61.8	- 51.1	- 48.7	- 60.5	- 48.5	- 38.8	- 30

a) January 1978 Budget estimates.
b) July 1978 mid-session review estimates.
c) Final version as settled by Senate and House Conferees.
d) Aim contained in the counter-inflation programme.

b) Counter-inflation programme

The main elements of the October package were:

i) A pledge by the Federal government to limit spending and to reduce the Federal deficit. The share of GNP accounted for by Federal spending is to be reduced from 23 per cent in FY 1976 to 21 per cent in FY 1980, a year ahead of the previous schedule. The FY 1980 Federal deficit proposal will be about $30 billion, compared with an estimated $40 billion in FY 1979.

ii) A voluntary standard of 7 per cent for annual increases in wages and private benefits was set. Existing wage contracts, wage increases which maintain a close historical relationship with other wage levels agreed before the programme, and wage rates of less than $4 per hour are exempt from the wage standard; the ceiling is raised to 8 per cent for the first year of a multi-year contract, and demonstrable productivity improvements will be acceptable justification for increases above the standard.

iii) The price standard for firms for their next accounting year was set at a half percentage point below the 1976-1977 average annual rate of price increase, subject to a 9.5 per cent ceiling. Greater deceleration will be required if wage rates decelerate by more than a half percentage point. Any very important acceleration of other costs is allowed to lead to price rises over the standard provided that profit margins do not exceed the average for the best two of the last three fiscal years.

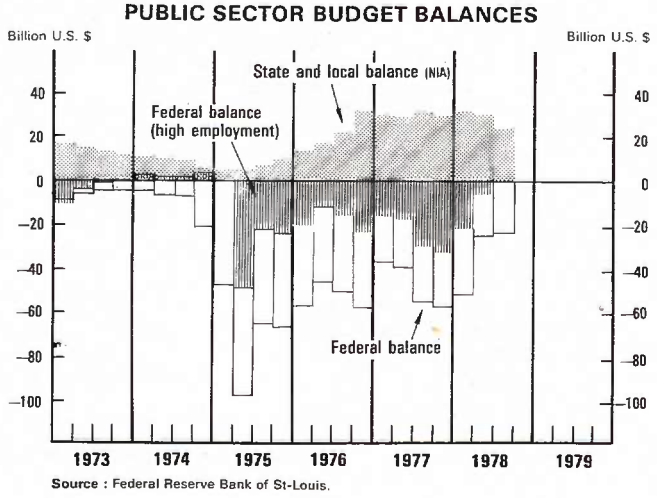
iv) Government action such as changes in regulatory and procurement policies will be used to encourage compliance.

v) A programme of real wage insurance will be recommended to Congress. Groups of workers meeting the pay standard would receive a tax rebate if the rate of inflation over the next year were to exceed 7 per cent.

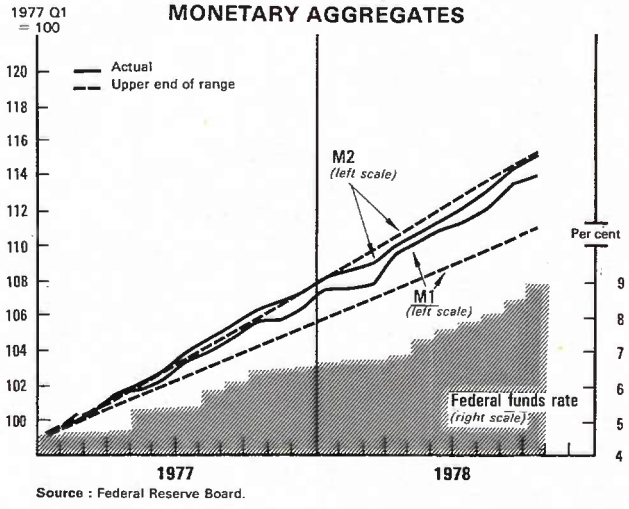
1. **Comparison of tax packages**
($ billion, FY 1979)

	Administration proposal (Jan.)	Final legislation
Personal	-16.9	- 12.7
Corporate profits	- 5.7	- 3.7
Capital gains	+0.1	- 2.2
Miscellaneous	- 2.1	
Total	- 24.5*	- 18.7

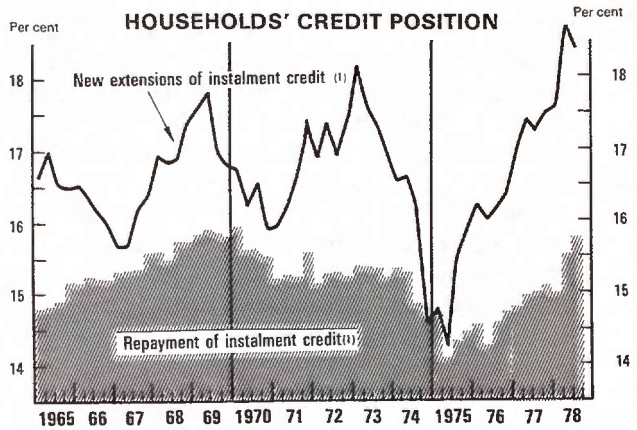
* Revised down to -19.4, July 1978.



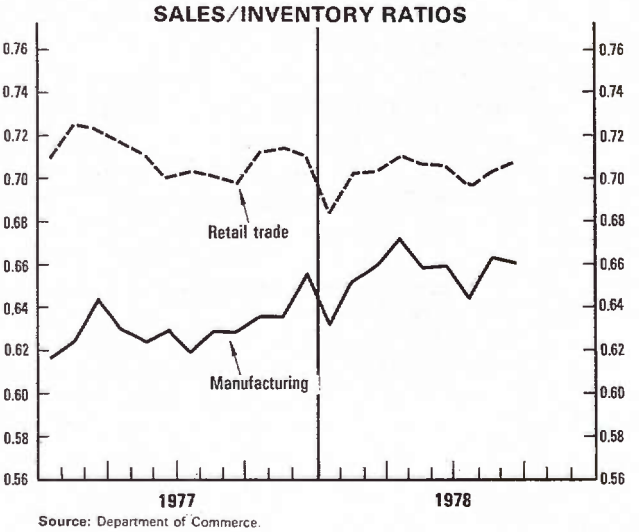
Source : Federal Reserve Bank of St-Louis.



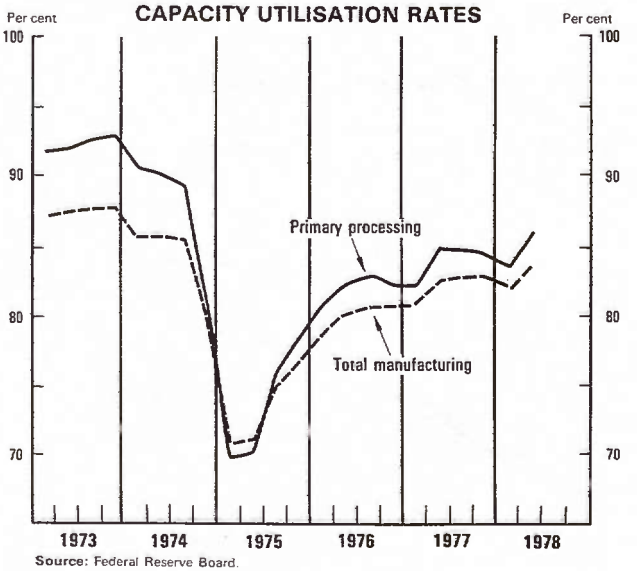
Source : Federal Reserve Board.



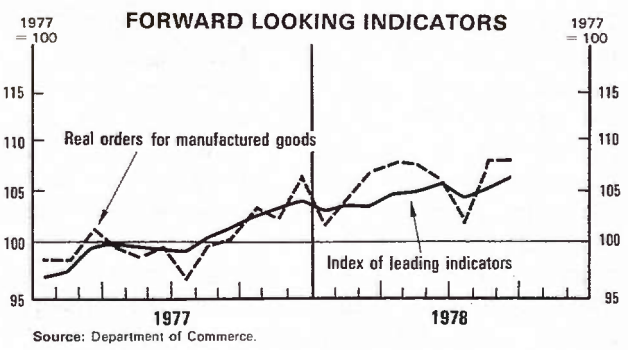
Source : Federal Reserve Board.
1. As a percentage of disposable income.



Source: Department of Commerce.



Source: Federal Reserve Board.



Source: Department of Commerce.

Allowing for other influences on prices, it is officially estimated that widespread compliance with these norms would lead to an overall 6-6½ per cent inflation rate in 1979[2].

(c) The November measures

The following measures were announced on 1st November 1978:

i) An increase in the discount rate from 8½ to 9½ per cent.

ii) A 2 per cent reserve requirement, in addition to existing reserve requirements (currently running from 1 per cent to 6 per cent), on time deposits of $100,000 or more.

iii) A series of measures to mobilise $30 billion for use in exchange market intervention to support the dollar[3]. This intervention would

2. The figures underlying the programme are as follows:

Standard pay	7 per cent
Legislated cost increases to come	½ per cent
Productivity	1¾ per cent
Unit labour costs	5¾ per cent
Non-food prices	5¾ per cent

3. These measures were:

	$ billion
i) Actions in the International Monetary Fund:	
1. Drawings of U.S. reserves tranche (Drawings of DM and yen totalling the equivalent of $2 billion, plus $1 billion equivalent drawing following GAB activation.)	3.0
2. Sale of SDRs	2.0
ii) Actions increasing Federal Reserve swap lines:	
1. Increase in swap lines with Bundesbank to	6.0
2. Increase in swap line with Bank of Japan to	5.0
3. Increase in swap line with Swiss National Bank to	4.0
iii) Issuance of foreign currency denominated securities up to	10.0
Total	30.0

(Of this total, approximately $1.8 billion had been utilised in earlier operations under Federal swap lines, but the total excludes Treasury swap facility with the Bundesbank.)

be supported by and coordinated with the Central Banks of Germany, Japan and Switzerland.

iv) An increase in gold sales by the U.S. Treasury, to at least 1½ million ounces monthly, beginning in December.

(d) Energy

The Energy Bill, which had been before Congress for eighteen months, was passed in October. The final version is officially expected to bring 1985 oil consumption down by 2-2½ million barrels per day below the levels previously expected. This would be roughly equivalent to a $9-12 billion saving in the 1985 oil import bill (at present oil prices) and about a half of the 4.5 million barrels per day savings envisaged in the original Administration proposals. Conservation measures broadly in line with the Administration's proposals were adopted, although a phased deregulation of natural gas prices was substituted for the original proposal to continue price controls at higher levels, and two oil taxes (a well-head tax and an industrial users' tax) were rejected. These latter modifications left the energy programme some way short of the commitments made at the Bonn summit meeting and one of the Administration's objectives is still to raise domestic oil prices to world market levels. This could be achieved through discretionary powers[4] or by further legislation.

These changes have led to a much tighter demand management posture for 1979 than was envisaged six months ago. Firstly, the scaling-down of the tax cut and reduced expenditure projections, somewhat offset by developments in the State and local sectors[5], have resulted in a less expansionary fiscal stance. Secondly, monetary policy has also taken a more restrictive turn. In the first ten months of 1978, short-term interest rates rose substantially, the Federal Funds rate rose from 6¾ per cent to 9 per cent, and the prime rate from 7¾ to 10 per cent between January and October. However, these changes were accompanied by a growth of the monetary aggregates at or beyond the upper end of target ranges so that the higher interest rates over this period reflected both buoyant credit demand and more restrictive monetary policy. There were, however, further jumps in short-term rates following the counter-inflation and dollar stabilisation measures—by end-November the Federal Funds rate was around 10 per cent and the prime rate at 11½ per cent—representing a more definite tightening of monetary policy and conditions. The annual target ranges for M2 and M3 were maintained, suggesting the possibility that the policy tightening would prove temporary, but public statements by the Authorities have made it clear that any easing would have to await clear signs of reduced exchange rate and inflationary pressures[6].

Prospects

The immediate effect of the latest policy announcements, particularly the tightening of monetary conditions, will possibly be to exert a significant contractionary influence on demand and output in 1979. While nominal interest rates are now well above levels which previously have provoked recession, the economy may be less vulnerable to severe recessionary tendencies at this stage of the conjuncture than it was at a similar point in previous cycles. No excess of inventories has developed; and statutory changes have increased mortgage companies' ability to attract funds on financial markets when interest rates are high, so that both inventory and residential investment seem less prone to sharp reversal than in previous upswings. Furthermore, corporate balance sheets are strong and could support the moderate growth in business fixed investment next year suggested by intentions surveys. And more buoyant demand prospects outside the United States and the recent decline in the dollar should result in some positive contribution to demand from the change in the foreign balance.

A detailed assessment of prospects for 1979 necessarily depends upon assumptions concerning the success of the new programmes and the backing they may require from continuing tight monetary policy. The official forecast of about 3 per cent growth for 1979 is based essentially on the

4. The Administration has the authority to impose import duties on crude oil. Furthermore, current price controls on domestic oil expire next spring, and could be allowed to lapse.

5. State and local surpluses are expected to decline sharply in FY 1979: expenditure growth is likely to remain rapid because many projects were held up by financial constraints during the recession, while the "tax revolt" in California and tax limitation initiatives in other States will hold back revenue growth. Overall, the total public sector deficit may increase by about $20 billion in calendar year 1979.

6. In mid-November, the annual target range for M1 was reduced from 4½-6½ to 2-6 per cent, and a 5-7½ per cent target set for a new aggregate M1+. M1+ is defined as M1+NOW accounts (checkable savings accounts)+credit union drafts+savings deposits at commercial banks. These changes were made in anticipation of increased use of savings accounts as the Federal Reserve Board approved facilities for the automatic transfer of funds from savings accounts to current accounts beginning 1st November 1978.

Balance of payments UNITED STATES

Value, $ million

	1977	1978	1979	1977 II	1978 I	1978 II	1979 I	1979 II
SEASONALLY ADJUSTED								
Exports	120 555	141 250	165 800	60 446	65 731	75 550	80 650	85 150
Imports	151 658	177 100	192 800	77 904	84 734	92 400	95 250	97 550
Trade balance	–31 103	–35 850	–27 000	–17 458	–19 003	–16 850	–14 600	–12 400
Services and private transfers, net	19 586	22 000	23 700	9 497	10 989	11 000	11 400	12 300
Official transfers, net	–3 749	–4 300	–4 700	–1 879	–2 105	–2 200	–2 300	–2 400
Current balance	–15 265	–18 150	–8 000	–9 840	–10 119	–8 050	–5 500	–2 500
UNADJUSTED								
Current balance	–15 265			–10 429	–9 193			
Long-term capital	–10 567			–4 216	..			
Short-term capital and unrecorded	–3 734			–3 391	..			
Balance on non-monetary transactions	–29 566			–18 036	..			
Net transactions of monetary authorities[a]	–33 896			–22 546	–10 256			
Memorandum items (seasonally adjusted)								
Per cent change in volume[b]								
Exports	1.2	8¾	10½	1.1	7.3	19½	8½	5½
Imports	13.6	7¼	2½	6.3	6.3	10	0	–½

Note: Detail may not add, due to rounding.

a) Previously "Balance on official settlements".

b) Over previous period at annual rates, customs basis.

assumption of a fairly rapid response of inflationary expectations to the new programme. The Secretariat forecast assumes that it will take somewhat longer for success of the counter-inflation programme to become fully apparent. On the basis of fiscal policies as outlined, observance of the target growth rates for the monetary aggregates, the customary assumption of no change in exchange rates, and a reasonable degree of success for the counter-inflation programme, a GNP growth rate of about 2 per cent seems likely in 1979.

Although detailed proposals for the real wage insurance scheme and the other new policies may reduce inflationary expectations, the acceleration of the underlying rate of inflation and the decline of the dollar during 1978, together with higher social security and minimum wage costs in early 1979, suggest that a markedly improved price performance is unlikely to occur before mid-1979. Further, 1979 will see the start of a new three-year cycle of pay negotiations, so that success in ensuring a series of settlements in line with the counter-inflation programme could possibly not be demonstrated before mid-year. These considerations, together with the present relatively buoyant growth of demand and prices, suggest that short-term interest rates could possibly increase further, and stay at their higher levels at least through to mid-year. Thereafter, a degree of success with the counter-inflation programme and lower inflationary expectations might allow for some fall in interest rates. Such a reduction would be consistent with the assumed adherence to the current targets for the growth of monetary aggregates, considered in conjunction with the projected behaviour of real output and prices.

The forecast assumes a 9½ per cent increase in compensation per employee in 1979, compared with 8 per cent in 1978. The legislated increase in compensation due at the beginning of the year, heightened inflationary expectations and a tight labour market continuing through much of the early part of 1979 underline this forecast acceleration. During the second half of 1979, there may be good prospects that the growth rate of employee compensation will come down towards the norms of the counter-inflation programme. During the pause in output growth, employers are unlikely to make a full adjustment of their labour force: a further year of weak productivity growth may therefore seem likely, and there could be some erosion of profit margins. Unit labour costs and the GNP deflator are forecast to grow by 8¾ and 7¼ per cent respectively in 1979; a deceleration through the year seems likely, with the GNP deflator growing at perhaps a little under 7 per cent in the second half of the year.

Residential investment may be cut back sharply given the prospective levels of interest rates, in part because of the higher cost of financing, and also because of the rise in nominal rates relative to inflationary expectations over the forecast period. The fall will probably be cushioned by demographic factors and the limited extent of disintermediation;

nevertheless, a decline of about 10 per cent is forecast. Recent surveys and data on orders suggest that non-residential investment will be relatively buoyant through the first half of 1979, but some squeeze on profit margins and high financing costs may bring a weakening in the second half of the year. After some involuntary accumulation early in the year, a mild stockbuilding correction is expected so that, for the year as a whole, a positive contribution of stockbuilding to demand is estimated of the order of only ¼ per cent of GNP. The household sector's extended debt position may make consumer demand, particularly for durables, vulnerable to the tighter monetary conditions forecast, so that an increase in the personal savings ratio is expected over the year. While the pay and price forecasts outlined above, taken together with the income tax cut due at the beginning of the year, may result in an increase of nearly 3 per cent in real disposable income in 1979, the forecast increase in the savings ratio suggests a growth of consumers' real expenditure of only a little over 2 per cent. Despite a continuing, positive contribution from net exports and public expenditure[7], GNP is forecast to rise by under 1½ per cent between the fourth quarters of 1978 and 1979, which translates into a 2 per cent increase year-on-year.

The improved competitive position of United States exporters is expected to increase their share of foreign markets in 1979. Export volumes of manufactures, on a customs basis, could grow by some 10 per cent, compared with market growth of only around 5 per cent. The weak development of total domestic demand is likely to hold down the overall growth of import volumes to perhaps 2¼ per cent for 1979. With little change expected in the terms of trade and a slight increase in invisible earnings, the current account deficit may improve considerably, falling from $18 billion in 1978 to perhaps $8 billion in 1979. By the second half of 1979, the current external deficit could fall to an annual rate of $5 billion.

7. Real Federal government expenditure is expected to grow by less than 2 per cent in 1979, real State and local expenditures to grow at 3¼-3½ per cent. Thus, aggregate government expenditure is expected to increase by roughly 2¾ per cent in 1979, making a relatively strong contribution to aggregate demand—something it has not done in the expansion to date.

JAPAN

Recent trends

Contrary to developments during most of 1976 and 1977, domestic demand growth has recently constituted a major source of strength, accelerating from an annual rate of 7.2 per cent in the first quarter of this year to 9.4 per cent in the second. Massive increases in public investment played a leading role together with publicly financed housebuilding, but other components of final domestic demand also rallied significantly. The volume of imports—especially of manufactured goods—has been expanding steadily since the beginning of the year; the volume of exports, after rising sharply in the first quarter, has been falling[1], no doubt affected by the cumulative impact of the appreciation of the yen over the past eighteen months[2]. It was because of this marked swing in the external balance that the growth of real GDP decelerated from an annual rate of 10.4 per cent in the first quarter to 4.4 per cent in the second. Industrial production remained virtually flat, at least in the five months to August.

Reflecting the irregular pattern of recovery, and the cautious attitude of enterprises, employment has remained depressed, with regular employment decreasing steadily and the unemployment ratio hovering since the spring in the historically high range of 2.3-2.4 per cent. The business profit situation seems to have improved significantly, and bankruptcies have been decreasing since the beginning of the year. This may be explained partly

1. As in some earlier periods, the two measures of foreign trade volume developments diverge considerably for the first half of 1978. The foreign trade volume indices (calculated by deflating customs figures by unit values and rebased on 1975) suggest a much smaller increase of exports and a much larger increase of imports than shown by the national accounts (revised to conform to the new international standardised system but still based on 1970 prices). It should be noted that the price deflators used in the national accounts differ from the unit values.

2. From the end of 1976, when the phase of rapid appreciation began, until early November, the Yen has appreciated by some 55 per cent against the dollar and 45 per cent in effective terms.

Demand, output and prices
JAPAN

Percentage changes
Volume (1970 prices)
Seasonally adjusted
at annual rates

	1977 current prices trillion yen	From previous year			From previous half-year				
		1977	1978	1979	1977 II	1978 I	1978 II	1979 I	1979 II
Private consumption	107.2	3.8	4¾	4¾	2.3	6.0	5¼	4¾	4¼
Government consumption	18.4	4.3	5¾	4¾	5.3	6.5	4½	4¾	4¾
Fixed investment	55.5	3.7	11	11½	6.3	12.1	12¾	13¼	6¾
Public[a]	16.9	10.4	20½	23¼	21.9	14.3	31¼	27¾	9
Private residential	13.0	1.3	12	6¾	–1.9	24.9	3¼	9¼	5½
Private non-residential	25.7	1.2	5	5¾	1.8	5.9	6½	5½	5½
Final domestic demand	181.1	3.8	7	7	3.9	8.1	7¾	7¾	5¼
*plus change in stockbuilding	1.4[b]	0.2	–¼	0	–0.3	–0.3	0	0	0
*plus change in foreign balance	2.9[b]	1.5	–¼	–2	0.5	0.7	–3	–2	–¾
GNP at market prices	185.4	5.2	5¾	4¾	3.7	7.8	4	5¼	4¼
GNP implicit price deflator	..	5.5	4	4½	5.7	3.2	3¾	4½	5
Memorandum items									
Industrial production[c]	..	4.2	6	4¾	1.0	9.3	4½	5	4
Consumer prices[d]	..	6.4	4	4	5.0	3.5	3½	4	5
Stockbuilding (actual rate, 1970 prices, trillion yen)	..	0.97	0.74	0.82	0.44	0.37	0.38	0.40	0.42

* As a percentage of GNP in the previous period.
a) Including nationalised industries and public corporations.
b) Actual rate of stockbuilding and foreign balance.
c) Mining and manufacturing.
d) National accounts implicit private consumption deflator.

by successful efforts by enterprises to reduce their fixed costs, by modest wage rises and reduced interest rates, but also by the impact of the appreciation of the yen on imported material prices. Inflation has slowed down considerably; wholesale prices have continued to decline in line with the currency appreciation, and the year-to-year rise in consumer prices has remained around 4 per cent throughout the first nine months of the year. As a result of last spring's negotiations, basic wages rose by only 5.9 per cent, compared with 8.8 per cent in the spring of 1977. In spite of the recent fall in export volumes and the recovery of imports, the current surplus, because of the marked improvement in the terms of trade, has remained very large. Nevertheless, it declined gradually, from a seasonally adjusted annual rate of nearly $23 billion in the first quarter of 1978 to $20 billion in the second and $18½ billion in the third. Partly as a result of emergency imports in October, officially estimated to be worth $1.2 billion, this trend continued, the surplus falling to $130 million.

Policy

Following the front-loaded execution of sizeable public works under the initial Fiscal Year 1978 budget, a new reflationary package was announced in early September. These latest measures amount to yen 2.5 trillion[3] (or roughly 1.3 per cent of GNP) comprising 1.7 trillion for additional public investment and 0.8 trillion for housing. After relevant adjustments[4], the direct impact of these measures (excluding multiplier effects) is officially expected to raise real GNP by approximately 1 per cent in Fiscal Year 1978. The Fiscal Year 1979 budget will be formulated in December. The present Secretariat forecast is based on the assumption that the growth of nominal public expenditure will be about the same as initially budgeted for Fiscal Year 1978, with special emphasis continuing to be put on public works, but no changes in tax rates.

Monetary policy has remained very accommodating. The official discount rate was lowered to 3.5 per cent in March, virtually its lowest level in the post-war period. Bank lending rates have continued to decline as a lagged response to earlier reductions in both the discount rate and deposit

3. This includes expenditure by local governments, public enterprises and induced expenditure by the private sector. Additional appropriations amount to yen 0.5 trillion under the Central government general account budget and 0.6 trillion under the FILP. Furthermore, some of the additional expenditure will be financed by savings on government consumption resulting from the fact that price and wage increases have been lower than forecast in the initial Fiscal Year 1978 budget. Thus, the net increase of the general account budget, i.e. the size of the supplementary budget, is only yen 145 billion. (The bond financing ratio is now estimated to reach 32.8 per cent, compared with 32 per cent in the initial budget. Excluding about Yen 2 trillion of transferred tax receipts from the next fiscal year, the deficit-to-expenditure ratio is raised to 37.6 per cent.)

4. The adjustments include deductions of land purchases and projects to be financed under the Fiscal Year 1979 budget, and an allowance for some substitution in housebuilding from private to public financing.

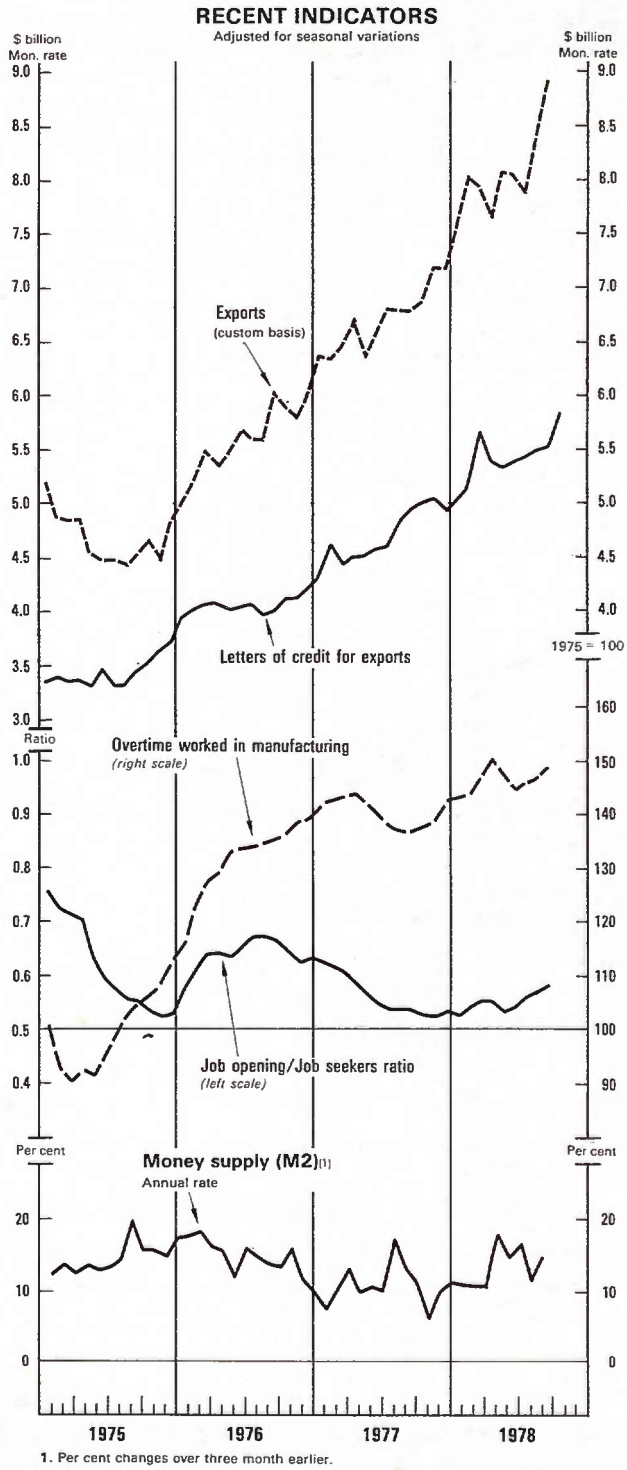
rates. The growth of money supply (M2), has shown some acceleration since last spring to a seasonally adjusted annual rate of about 14 per cent. The year-on-year increase has remained around 12 per cent as the considerable rise in foreign assets and claims on the public sector has been more or less offset by weak credit expansion for the private business sector. It is assumed that the current posture of monetary policy will be maintained over the forecast period.

Policies

The main feature of the present forecast is the continuing switch in the pattern of demand from net exports towards domestic expenditure. Given the marked deterioration of external price competitiveness resulting from the sharp appreciation of the yen since the end of 1976, and the reduced scope for Japanese exporters to absorb the effects through a profit squeeze and/or cost reduction, the impact on export volume should normally be more significant in coming months. The predicted slowdown in some important export markets, notably the United States, should also help to dampen exports. On the other hand, the marked improvement in the terms-of-trade, resulting from the appreciation of the currency and the expected moderate rise in world commodity prices, will continue to boost domestic real income (and eventually domestic demand) through higher corporate profits and/or lower inflation. The recent reflationary package and the assumed expansionary stance of fiscal policy in Fiscal Year 1979 should also contribute markedly to demand. Domestic demand is therefore projected to expand at an annual rate close to 7¾ per cent through the first half of 1979. But because of the expected strong negative contribution from the change in the foreign balance, the growth of real GNP may be much more moderate (of the order of 4 to 5 per cent).

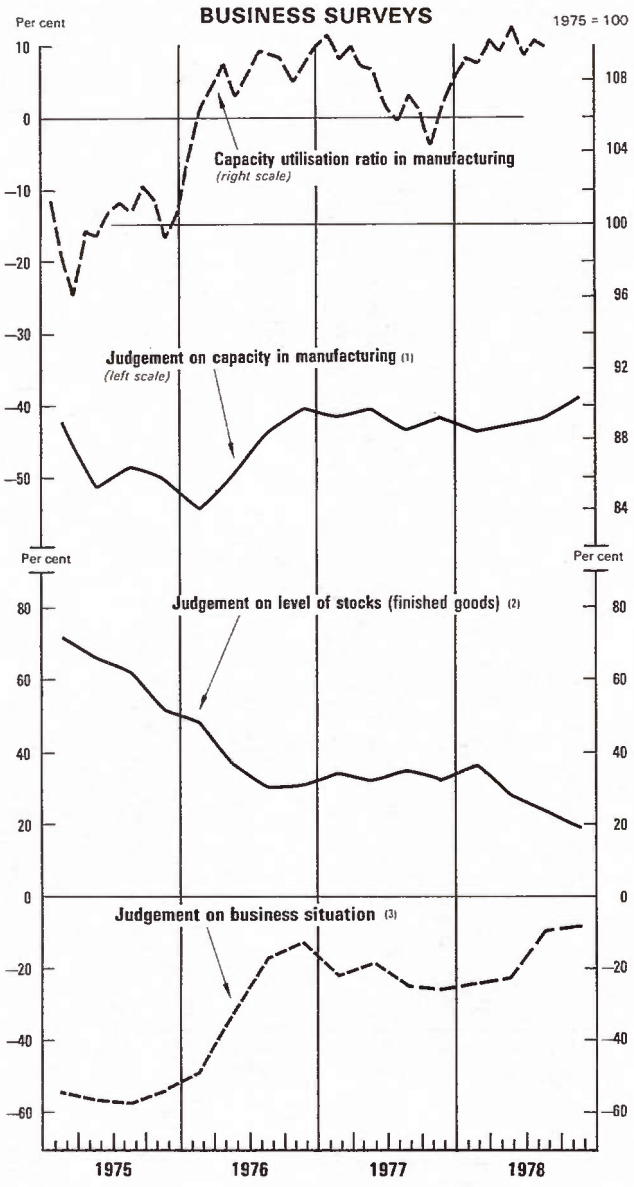
As the direct effect of the recent reflationary measures progressively wears off, total domestic demand growth could weaken in the latter part of 1979. This may depend largely on the course of private non-residential investment; unless the margin of slack is taken up more rapidly than suggested by the Secretariat forecast, or business confidence returns particularly sharply, a significant recovery of business fixed investment or a more buoyant stockbuilding at present seems unlikely.

Real private consumption rallied sharply in the first half of this year, mainly reflecting the marked moderation of inflation. However, slower growth



1. Per cent changes over three month earlier.

in household real disposable income may bring its growth rate down gradually over the forecast period. Largely reflecting the outcome of the spring wage negotiations, households' nominal income has probably grown less rapidly in the second half of the calendar year. The inflation rate is unlikely



1. % of firms with insufficient capacity *minus* % of firms with excessive capacity.
2. % of replies "too high" *minus* % of replies "too low".
3. % of replies "good" *minus* % of replies "bad".

Sources: Bank of Japan, *Short-Term Economic Survey of Principal Enterprises in Japan*. M.I.T.I., *Industrial Statistics Monthly*, EPA *Japanese Economic Indicators*.

★ Forecasts — values referring to the expected situation are attributed to the end of the 4-month period.

to continue to fall significantly. Based upon predicted trends in inflation, the labour market and business profits, basic wages are expected to rise in the 1979 spring settlement by around 6 per cent, as in the last round, implying a slight slowdown year-on-year. Overtime work is not expected to increase significantly in 1979. Increases in bonus payments may accelerate somewhat in the winter and next summer, but may weaken slightly at the end of 1979. Assuming a rise of 1.2 per cent in dependent employment (year-on-year), compensation of employees may expand by 8.9 per cent in 1979, compared with 9.3 per cent in 1978. The overall trend in non-wage income is unlikely to change much in 1979, with a slight improvement in individual businesses on the one hand, and a weakening in agricultural income[5] on the other. Given some increase in the tax burden, in line with the assumption of no income tax cut in the coming fiscal year, nominal disposable income would decelerate further in 1979. The slight reacceleration predicted for consumer price growth during 1979 would accentuate such a slowdown in real terms, particularly in the latter part of next year. All in all, assuming a marginal decline in the savings ratio linked to the relatively good price experience, private consumption in 1979 is forecast to grow by 4¾ per cent in real terms.

Following its unexpected weakness in 1977, residential construction expanded very sharply in the first half of 1978 (at an annual rate of 25 per cent in real terms) due largely to the sizeable extension of low-interest public loans in the early months of the year. Particularly favourable conditions with regard to interest rates, credit availability, land prices and construction costs were also important factors behind this buoyancy of housebuilding. Markedly slower growth, from the high level achieved, seems likely in the second half of the year. But the desire for better accommodation remains strong in Japan; and given the extension of large public loans in the autumn, residential construction may again expand significantly in the first half of 1979.

Reflecting the additional appropriations under the recent reflationary package, and assuming a front-loaded execution of an expansionary Fiscal Year 1979 budget, public investment may remain a major source of strength. Even if a significant slowdown were to occur in the latter half of 1979, real public investment could expand by around 23 per cent between 1978 and 1979, compared with 20 per cent in the previous year. There may be some risk that such sizeable increases over two consecutive years will create bottlenecks of a physical or administrative nature. This will depend particularly upon the split between public works proper and investment by public enterprises.

Following virtual stagnation in 1976 and 1977, real business fixed investment picked up somewhat in the first half of 1978. Recent business surveys point to some improvement in the investment climate. This may be linked to the recovery of

5. The government allowed a very limited increase in producers' prices of rice for 1979.

Balance of payments JAPAN

Value, $ million

	1977	1978	1979	1977 II	1978 I	1978 II	1979 I	1979 II
SEASONALLY ADJUSTED								
Exports	79 333	96 450	99 200	40 853	46 624	49 850	49 250	49 950
Imports	62 022	68 900	78 650	31 567	32 415	36 450	37 950	40 700
Trade balance	17 311	27 550	20 550	9 286	14 209	13 400	11 300	9 250
Services and private transfers, net	–6 199	–7 150	–8 100	–2 906	–3 371	–3 800	–3 900	–4 200
Official transfers, net	–194	–300	–500	–60	–124	–200	–250	–250
Current balance	10 918	20 100	11 950	6 320	10 714	9 400	7 150	4 800
UNADJUSTED								
Current balance	10 918			7 842	8 795			
Long-term capital	–3 184			–2 253	–3 232			
Short-term capital and unrecorded	9			164	73			
Balance on non-monetary transactions	7 743			5 753	5 636			
Net transactions of monetary authorities[a]	6 059			5 152	4 851			
Memorandum items (seasonally adjusted)								
Per cent change in volume[b]								
Exports	9.6	–2¼	–6	4.2	0.1	–12½	–5½	0
Imports	3.2	6	7¾	–4	10.5	7½	8½	6½

Note: Detail may not add, due to rounding.
a) Previously "Balance on official settlements".
b) Over previous period at annual rates, customs basis.

business profits since early 1978, as well as to the impact of the rise in public investment. Since the increasing profit squeeze in exporting industries may be offset by a further improvement of the cost-price structure, notably in basic material industries, the overall profit situation may not change significantly throughout 1979 from its present level. Manufacturing investment is, nevertheless, forecast to decline further over the period: the considerable degree of unused capacity will probably be reduced only slowly, and the predicted decline of exports may affect business expectations adversely. However, replacement and rationalisation investment, postponed because of unfavourable balance-sheet positions, may now be carried out and provide an offsetting element. And a more sustained trend may be expected to continue in the non-manufacturing sector, led notably by capacity expansion of the power-generation industry. All in all, the annual growth of real private non-residential investment is forecast to remain around 5½ per cent throughout 1979.

Virtually no contribution from stockbuilding to the growth of real GNP is forecast over the period. As a result of efforts by many enterprises to run down excessive inventories, the ratio of stocks to total demand seems to have been reduced rather significantly, and business surveys suggest that the downward inventory adjustment at producers level should be completed by the end of this year. Nevertheless, no strong accumulation is at present foreseen in 1979, given the moderate prospects for the growth of total final demand and repeated experience of involuntary accumulation in the last two years. Stocks of raw materials are not expected to increase significantly, their ratio to consumption currently being substantially higher than trend values, partly because of long-term import contracts. On the other hand, in line with the rather buoyant domestic picture, stocks should rise moderately at wholesale and retail levels, where the inventory situation currently is normal.

In spite of the forecast modest expansion of industrial production, and the present high stock levels of imported raw materials, import volumes may continue to expand briskly following the rebound in the first half of 1978. A marked rise in imports of manufactured goods, induced by the change in relative prices in the wake of the appreciation of the Yen, should raise the elasticity of imports to overall activity. As this impact tapers off progressively, and if total demand growth slows down, import volume growth could lose momentum towards the end of next year, although amounting to some 8 per cent between 1978 and 1979. Given the projected substantial decline of export volumes—11.5 per cent at annual rate in the second half of 1978 and around 6 per cent in 1979—the change in the real foreign balance should exert a sizeable negative effect on GNP growth through late 1979. Based on the customary assumption of unchanged exchange rates (at the

level of early November 1978) the trade surplus on a balance of payments basis may be reduced to around $20 billion in 1979, from $28 billion this year, in spite of the improvement in the terms of trade. And if the terms-of-trade gains decrease in the course of next year, the current account surplus may come down to around $10 billion (annual rate) in the second half of 1979.

Particularly large uncertainties have to be attached to these foreign trade forecasts. Given the unprecedented variation in exchange rates, it is hardly possible to assess, with any reasonable degree of confidence, the price elasticity of demand for Japanese exports and the speed with which the change in relative prices will affect the volume of exports. Similar problems arise with regard to imports of processed goods. In addition, it is extremely difficult to judge the effects of "voluntary" export restrictions, which should normally be deducted from the estimated impact on the volume of exports of demand and exchange rate developments. There are also considerable uncertainties about the magnitude and timing of exceptional imports planned by the authorities.

Labour market conditions are expected to remain depressed throughout the forecast period. Employers are likely to maintain a cautious attitude and to persist in their efforts to reduce the rigidity of their cost structure, particularly if business confidence is affected by declining exports. Even assuming an increase in the elasticity of employment to activity from its abnormally low level in early 1978, the growth of dependent employment is not expected to accelerate significantly. In view of a probable stagnation in self-employment, and assuming a slight reduction in participation rates, the unemployment rate could edge up to around 2½ per cent of the labour force in 1979.

The declining trend of wholesale prices, which has prevailed since mid-1977 is expected to continue in the current half-year, as the significant drop in import prices works itself through. However, given the forecast slight acceleration of the rise in unit labour costs to around 4 per cent in 1979, and the improved inventory situation, wholesale prices could resume a moderate upward trend in the course of next year, when, given the unchanged exchange rate assumption, the favourable impact from import prices will peter out. Following virtual stabilisation until mid-1979, the rise in consumer prices may also speed up gradually towards the end of the forecast period, reflecting the lagged impact of wholesale price increases. However, in view of the modest wage advance expected next spring, and the relatively small increase foreseen in public charges, the inflation rate for 1979 as a whole may still be limited to around 4 per cent.

GERMANY

Recent trends[1]

Following the strong acceleration of GNP growth in the fourth quarter of 1977, the rate of expansion fell below capacity growth again during the first two quarters of 1978. The slowdown can be explained in part by special factors: bad weather in the first quarter depressed construction activity, and in the second a prolonged strike in the metal industry curtailed the growth of manufacturing output. Activity seems to have picked up after mid-year. The monthly index of industrial production (excluding construction) increased significantly, though erratically, from the low point reached in May, and the volume of industrial orders has shown a similar movement; excluding special large project orders from abroad, this improvement has been concentrated on domestic orders, foreign orders having remained flat since early 1977. By late summer the volume index of construction output exceeded the previous year's level by about 10 per cent. The Ifo business climate indicator for manufacturing increased steadily from April, and by October had reached a higher level than that recorded in the autumn of 1973. The rapid increase in the volume of construction orders since

1. Discrepancies between the actual and normal number of working days are particularly pronounced between 1978Q1 and 1979Q4. Because the procedures used to seasonally-adjust quarterly GNP and its components offset only normal fluctuations in working days, actual data during the 1978/1979 period are distorted by the extreme workday fluctuations. The data presented in the accompanying tables and interpreted in the text are workday adjusted (in addition to the routine seasonal adjustment) to show the underlying development of the economy. The methods used in the workday adjustment are explained in the "Sources and Methods" section.

Demand, output and prices
GERMANY

Percentage changes
Volume (1970 prices)
Seasonally adjusted
at annual rates

	1977 current prices billion DM	From previous year			From previous half-year				
		1977	1978	1979	1977 II	1978 I	1978 II	1979 I	1979 II
Private consumption	668.6	3.1	3¼	4½	4.9	2.8	2½	5½	3¾
Government consumption	240.1	1.0	2½	2¾	2.2	3.3	1	3¼	3¼
Fixed investment	250.2	4.1	4½	5½	3.4	4.4	6½	5¾	4¼
Public[a]	40.2	–3.8	6¾	2	4.3	10.2	2¼	2¾	½
Private residential	70.9	3.5	3¾	5	1.0	1.9	10	3½	3½
Private non-residential	139.1	6.9	4½	6¾	4.2	3.9	6	7½	5½
Final domestic demand	1158.9	2.9	3½	4¼	4.1	3.2	3	5	3¾
*plus change in stockbuilding	11.2[b]	–0.3	0	½	–0.9	–0.5	1¾	0	–¼
*plus change in foreign balance	28.6[b]	0	–¼	–½	–0.9	0.2	–¾	–¾	–¼
GNP at market prices	1198.7	2.6	3	4	2.1	2.8	4	4½	3¼
GNP implicit price deflator	..	3.6	3¾	3½	4.7	3.0	4	3	3¾
Memorandum items									
Industrial production	..	2.6	2½	5¾	0.9	0.9	7	6½	3
Consumer prices[c]	..	3.8	2¾	2¾	3.4	2.5	2¼	2¾	3¼
Stockbuilding (actual rate, 1970 prices, billion DM)	..	7.5	7.2	10.6	2.9	1.9	5.3	5.6	5.0

* As a percentage of GNP in the previous period.
a) Excluding nationalised industries and public corporations.
b) Actual rate of stockbuilding and foreign balance.
c) National accounts implicit private consumption deflator.

early 1977 shows some signs of levelling off, although at a relatively high level.

Merchandise exports (volume) have been volatile in recent months, and have exhibited no significant trend increase from the level reached in the second half of 1977, whereas import volumes have increased steadily for over a year. Nevertheless, the current external surplus rose substantially in the first three quarters of 1978 because of better terms of trade and a large improvement in the services balance. Prices have generally remained stable, helped by the continuing decline in import prices which partly reflected the effective appreciation of the Deutschemark in the first part of 1978. By September the industrial producer price index exceeded its previous year's level by only 1.2 per cent, and the agricultural producer price index was 6.4 per cent lower than a year earlier. Despite the increase in VAT rates last January[2], year-on-year increases of the consumer price index have gradually fallen, to reach 2.2 per cent by October.

Policies

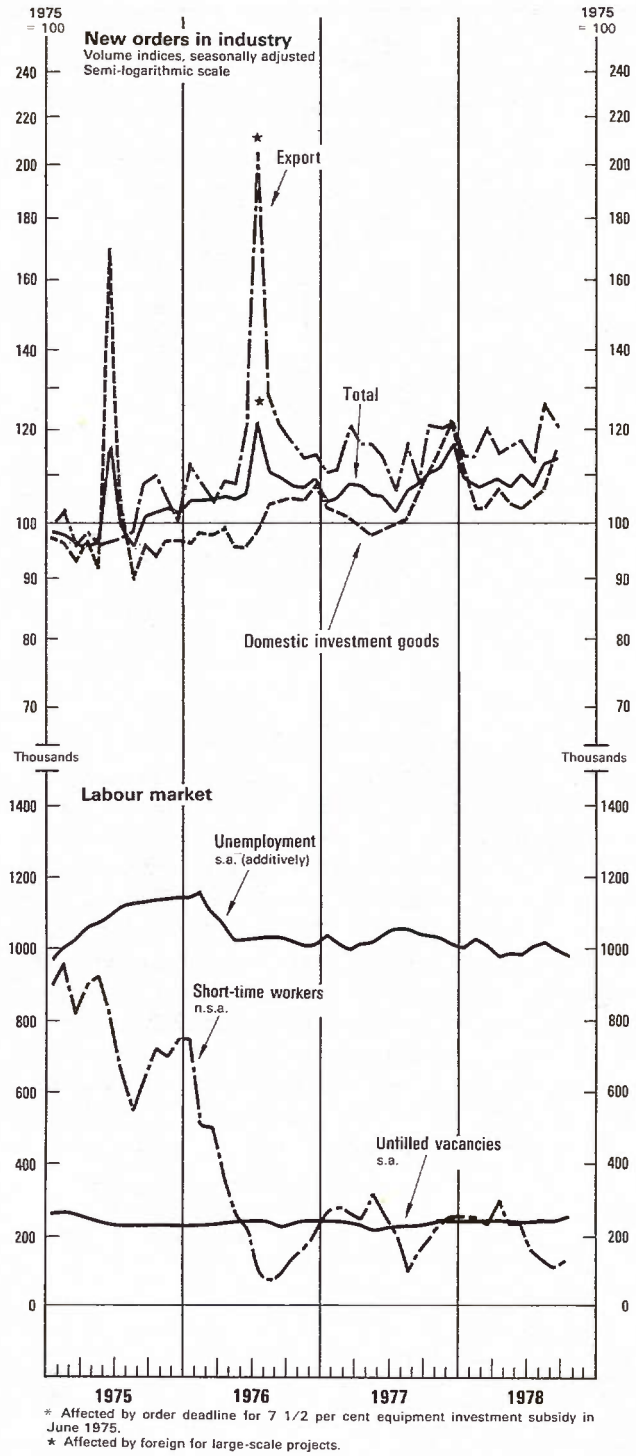
A large and unexpected increase in revenues from indirect and self-assessed income taxes is likely to result in an increase in the public sector net borrowing requirement of less than DM 10 billion (¾ per cent of GNP) to DM 39 billion, rather than the DM 20 billion increase (1¾ per cent of GNP) envisaged in early 1977. Fiscal policy would therefore seem to have been less expansionary than expected earlier, which may well have been a factor behind the weakness of demand in early 1978. After the OECD Ministerial meeting and the Bonn Summit, the Federal Government announced a fiscal programme in July to strengthen demand and improve economic growth in 1979. With minor modifications the programme was adopted by Parliament in mid-November. The following measures, to become effective in 1979, are included in the final version of the programme:

Measure[a]	Amount[b] DM billion (annual rate)	Effective Date
Change in income tax schedules, reducing direct tax on household factor income	11	1/1/79
Increase in children's allowances and early retirement option	1¾	1/1/79
Additional Federal expenditure	1	1/7/79
Increase in maternity benefits	2¾	1/1/79
Increase in VAT rates	¾	1/7/79
	- 6½	1/7/79

a) Additional measures are planned for 1980 and 1981, mainly aiming at a reduction in business taxes (other than profits tax).
b) On an accruals basis; a negative sign indicates a contractionary effect.

Thus, the expansionary measures scheduled to take effect at the beginning of 1979 amount to DM 15½ billion, or more than 1 per cent of GNP. The direct expansionary impact would subsequently

2. VAT rates were raised from 11 to 12 and 5½ to 6 per cent respectively, mechanically entailing a ¾ per cent increase in the consumer price index.



* Affected by order deadline for 7 1/2 per cent equipment investment subsidy in June 1975.
★ Affected by foreign for large-scale projects.

be partly offset by the proposed increase in VAT on 1st July, despite the simultaneous increase in transfer payments by DM 1¾ billion (annual rate).

In addition, public pensions (unchanged over the last 18 months) will be raised by 4½ per cent on 1st January 1979. Public consumption expenditure is scheduled to increase by 6¾ per cent in 1979 (slightly faster than in 1978), but the growth of public investment is expected to decelerate from 13 to 7½ per cent between 1978 and 1979 as a result of an expected peak in medium-term investment expenditure in early 1979. These various measures and changes are expected to increase the public sector's net borrowing requirement by about DM 9 billion (¾ per cent of GNP) to approximately DM 48 billion (almost 4 per cent of GNP).

The adjusted Central Bank money stock (CBM) has risen faster than the official 8 per cent target for 1978 (average, year-on-year)[3]. Nevertheless, the Bundesbank took steps to ease the upward pressure on short and long-term interest rates which developed between March and August: commercial banks were allowed to include their cash holdings in legally-required reserves, discount quotas were increased, and large net purchases of foreign exchange and (to a lesser degree) public bonds by the Central Bank prevented a significant decline in the banks' liquidity position, despite a rapidly expanding volume of bank credit. Large foreign exchange purchases by the Bundesbank, mainly in support of other snake currencies, led to a rapid increase in banks' free liquid reserves after mid-1978. To absorb part of this excess liquidity, the Bundesbank raised minimum reserve requirements on 19th October by 9 per cent, neutralising DM 4 billion of banks' increased reserves. The Bundesbank has so far not made an official announcement concerning its conduct of monetary policy in 1979, but in constructing its forecasts the Secretariat has assumed that it will not permit a significant and prolonged tightening of interest rates so long as a sustained upswing in activity has not been firmly established, and inflation rates do not show signs of renewed acceleration. Interest rates are therefore expected to change little over the forecast period.

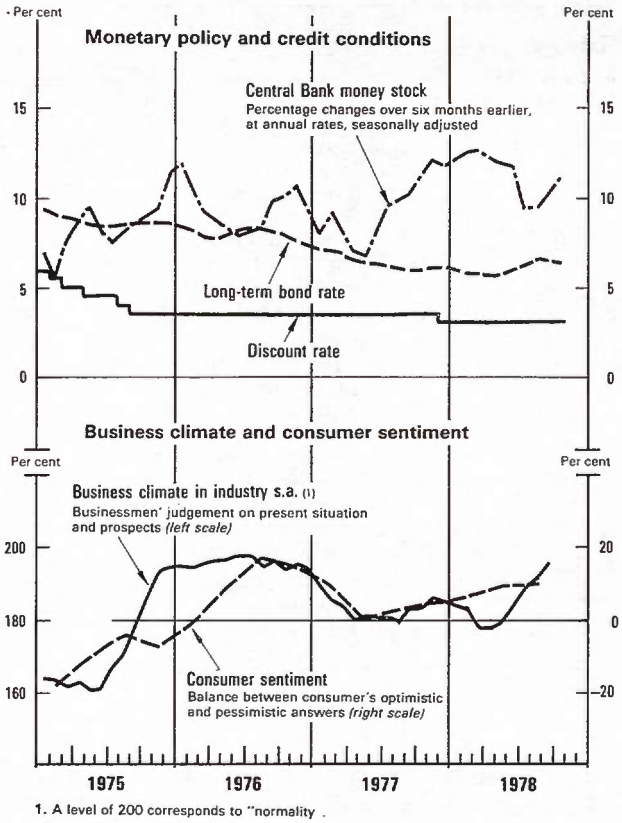
Prospects

German exports markets are expected to grow at an annual rate of 5 per cent during the three half-years of the forecast period. The volume of new export orders has fallen short of merchandise exports (volume) for some time, probably reflecting the appreciation of the Deutschemark in the second half of 1977 and in early 1978. Some slowdown

3. The strong expansion of CBM in the first quarter of 1978 can be traced to a large increase in currency in circulation, probably related to speculation in foreign exchange markets during that period.

in real export growth is therefore expected in the course of the second half of 1978. Export volumes are expected, on the basis of the technical assumption of no further change in exchange rates, to increase slightly less in 1979 than export markets. Public expenditure in volume terms is forecast to increase less rapidly than total output: as noted, expenditure under the medium-term public investment programme is expected to peak, while public consumption is expected to grow steadily at a rate of around 3 per cent.

The 1977/1978 wage bargaining round resulted in average wage increases (hourly basis) of slightly below 5½ per cent. The outcome of the forthcoming round is difficult to predict because trade unions seem to be shifting the emphasis of their demands towards a reduction in working hours. However, taking account of improved prospects for after-tax business profits, some acceleration in wage rate growth is expected. Moreover, with a probable pick-up in employment, possibly accompanied by some positive wagedrift, the gross wage and salary bill will probably increase somewhat faster than in 1978[4]. Because of rate reductions in January 1979, wage taxes are likely to increase less than proportionally with wages, while social security contributions should rise more or less proportionately; on these assumptions net wages and salaries would increase by 7¼ per cent in 1979. Public transfers may increase by rather less (6½ per cent), while net profit withdrawals are expected to be buoyant (8 per cent). All in all, total personal disposable income may increase by approximately 7¼ per cent, about 1 percentage point faster than in 1978. Assuming little change in either the savings ratio[5] or the rise in the consumption deflator, private consumption should increase by over 4 per cent between 1978 and 1979; the advance should



1. A level of 200 corresponds to "normality".

be even stronger in the first half of the year, given the proposed tax cuts, but higher VAT rates could entail a deceleration in the second.

The most recent Ifo investment tests for 1978 indicated volume increases of 7 per cent in industry and 20 per cent in construction, and the August/September survey[6] envisages only slightly lower rates in 1979. Since then, the Ifo Business Climate Indicators for all sectors of the economy have improved further, reflecting a more optimistic assessment of both the present situation and the outlook for the next 6 months. The improved business climate may lead to some upward revisions of investment plans, although this may partly depend on the movement of the Deutschemark exchange rate. Except for the construction and automobile sectors, capacity utilisation rates are still relatively low, and it is assumed that rationalisation will remain the dominating investment motive. The present forecast assumes a stabilisation of business fixed investment growth in the course of 1979, at a rate well above the medium-term average, and slightly above presently-known investment intentions in industry. But no acceleration in the course of 1979 is assumed because, so far as can be judged on the basis of existing indicators, capacity utilisation in most industrial

4. On a year-on-year basis the major assumptions underlying the estimate of the gross wage and salary sum are as follows:

	Average annual growth rates		
	1977	1978	1979
Dependent employment	0.1	0	½
Contractual wages (monthly basis)	6.8	5½	6
Wagedrift	0.1	- ¼	½
Gross wage and salary sum	7.0	5¼	6¾

5. While broadly unchanged for the year as a whole, the savings ratio is expected to be higher in the first half of 1979 than in the second half, reflecting the gradual adjustment of expenditure to the increase in disposable income due to tax reduction.

6. Ifo Schnelldienst, 1978: 30, pp. 5-11.

Balance of payments GERMANY

Value, $ million

	1977	1978	1979	1977	1978		1979	
				II	I	II	I	II
SEASONALLY ADJUSTED								
Exports	113 729	137 000	155 550	59 216	65 089	71 900	76 200	79 350
Imports	94 399	113 650	133 300	48 940	53 463	60 200	65 300	68 000
Trade balance	19 330	23 350	22 250	10 276	11 626	11 700	10 900	11 350
Services and private transfers, net	–11 384	–11 350	–13 100	–6 082	–5 413	–5 950	–6 150	–6 950
Official transfers, net	–4 249	–6 100	–6 900	–2 318	–2 956	–3 150	–3 350	–3 550
Current balance	3 697	5 900	2 250	1 876	3 257	2 600	1 400	850
UNADJUSTED								
Current balance	3 697			1 701	3 529			
Long-term capital	–5 545			–2 132	–901			
Short-term capital and unrecorded	2 536			1 735	–1 066			
Balance on non-monetary transactions	688			1 304	1 562			
Net transactions of monetary authorities[a]	4 501			4 959	206			
Memorandum items (seasonally adjusted)								
Per cent change in volume[b]								
Exports	5.0	4¼	5	6.4	2.6	5	4¾	5¼
Imports	4.9	7½	8	8.8	6.4	8	9¼	5¼

Note: Detail may not add, due to rounding.

a) Previously "Balance on official settlements".

b) Over previous period at annual rates, customs basis.

sectors remains low, while the growth of other types of demand may slow down in the course of 1979, and export growth is likely to remain relatively modest. Stockbuilding has been declining since the middle of 1977, and stock/output ratios have fallen below the long-term average. It is assumed that over the forecast peroid stocks will rise faster than final demand and output, imparting a significant positive contribution to total demand growth in the second half of 1978 and a smaller contribution in 1979. The stock/industrial production ratio, though assumed to increase, may remain slightly below its long-term trend. Though the present investment forecast is already cautiously optimistic, significant further improvement in business confidence, which might result from calmer foreign exchange markets, could lead to a somewhat more buoyant investment picture.

Housebuilding has recovered from the low level caused by the severe winter, to reach a level which is the highest since early 1974 and which corresponds approximately to the estimated medium-term "equilibrium output level" of 425,000 units annually. Given buoyant demand indicators and past shortfalls, housing is expected to exceed these medium-term requirements over the forecast period. However, the order inflows—though remaining above the present level of output—have shown a tendency to level off since early 1978, and a slowdown of the rise in housebuilding seems probable; increasing bottlenecks in the building trades point in the same direction. The recovery in housing has affected mainly owner-occupied dwellings, although the construction of rental units has also turned up for the first time since 1973.

Given the forecast strengthening of aggregate demand (domestic demand plus exports), import volumes are expected to pick up strongly. Because the growth of export volumes is likely to remain modest, the real foreign surplus seems likely to decline, imparting a negative contribution to GNP growth of perhaps 0.6 percentage points in 1979. A substantial improvement in the terms of trade has probably more than offset the deterioration in the real balance experienced in 1978, leading to an increase in the current surplus. For 1979, on the exchange rate assumption adopted, a slight deterioration in the terms of trade is forecast, and on this basis the current account surplus would decline significantly.

Germany's recent record of relatively slow inflation seems likely to be maintained. Unit labour costs may rise by 2¾ per cent between 1978 and 1979, slightly faster than earlier. With the VAT increase becoming effective on 1st July 1979 and, possibly, a moderate further improvement in profit margins, the GNP deflator may increase by 3½ per cent, slightly less than in 1978, when the VAT increase became effective at the beginning of the year and when profit margins improved. On the other hand, the dampening effect of declining import unit values on consumer prices is not

expected to continue into 1979. The net effect on the consumption deflator growth would seem likely to be small, with most of the acceleration concentrated in the second half of 1979 when the VAT increase is scheduled to become effective. With continuing demand pressure in the building sector, the construction deflator is expected to increase significantly faster than the GNP deflator both in 1978 and 1979.

Stronger expansion will probably be accompanied by an increase in the demand for labour. Part of the increase may be satisfied by a reduction in short-time work, but the number of employed is expected to increase from the fourth quarter of 1979 onward. The number of self-employed workers is expected to continue to fall, but dependent employment may increase by ½ per cent between 1978 and 1979. The above-average rate of expansion in the labour-intensive construction sector is likely to contribute significantly to the envisaged employment growth. Whether the increased demand for labour will result in a decline in unemployment is uncertain: the domestic population of working age is increasing rapidly, and the net outflow of foreign workers seems to have slowed down. Participation rates—especially for women and young people—have been cyclically depressed in recent years. Given these circumstances it has been assumed that the unemployment rate will remain roughly unchanged over the forecast period.

FRANCE

Recent trends

GDP growth accelerated slightly to 3.5 per cent (annual rate) during the first half of 1978, due mainly to a marked recovery in private consumption in the second quarter[1]. Gross fixed asset formation, which had fallen in the second half of 1977 (1.5 per cent in annual terms) also recovered slightly, mainly because of a rise in private non-residential investment. Public investment maintained a rate of growth of the order of 5 per cent at an annual rate, but residential construction continued to decline at an annual rate of 3 per cent. Some second-quarter rebuilding of stocks in the basic materials and consumer goods industries probably exerted a slightly positive effect on demand. The volume contribution to growth of the change in the foreign balance, still high in the second half of 1977, virtually disappeared in the first half of 1978, and for the whole year will probably be no more than some 0.2 per cent. After falling by 3.4 per cent in the second half of 1977, industrial production as measured by the monthly index rose by 4.3 per cent (annual rate) during the first six months of 1978, and stabilised in the third quarter at the same level as in the first half. The rate of unemployment[2], seasonally adjusted, which had fallen in the autumn of 1977, remained steady during the first quarter and subsequently worsened, reaching 5.4 per cent in October, compared with the 4.7 per cent average for the first quarter. Dependent unemployment[3] declined by 0.9 per cent between July 1977 and July 1978.

There has been a very sharp reversal in the trend of prices and wages since the beginning of 1978. While the annual rate of consumer price increase had been brought down from 10.3 per cent to 7.7 per cent between the first and second halves of 1977, the first nine months of 1978 saw a rate of 10.3 per cent again. This acceleration affected all categories of consumer prices. The adjustment of the parity for the "green franc", the imbalance in the meat market, the rise in oilseed prices, and the freeing of the price of bread all affected food prices. Prices of services have been influenced by the adjustments made to agreements with the administration concerning private services

1. The recovery was mainly in industrial consumer goods, as is shown by the trend of the indicator of consumption of industrial products by households:
Per cent rate of growth on preceding quarter (s.a.)

	Q1	Q2	Q3	Q4
1977	0.7	- 2.6	3.4	-0.1
1978	0.7	2.9	- 0.8	

2. As measured by the ratio of job seekers (at the end of the month) to the labour force.

3. i.e. numbers employed in all activities except agriculture and government.

Demand, output and prices
FRANCE

Percentage changes
Volume (1977 prices)
Seasonally adjusted
at annual rates

	1977 current prices billion francs	From previous year			From previous half-year				
		1977	1978	1979	1977 II	1978 I	1978 II	1979 I	1979 II
Private consumption	1157.1	2.5	3¼	3½	2.8	3.7	3	3½	3½
Government consumption	283.2	3.8	3¾	3	3.9	4.0	2¾	3¼	2¾
Fixed investment	422.1	–0.6	½	2½	–1.5	0.9	2	2¼	2¾
Public[a]	101.4	2.5	5	5	4.5	5.1	5¼	5	4½
Residential[b]	139.9	–2.0	–2¾	–2	–3.3	–3.0	–2	–2	–1½
Private non-residential	180.8	–1.1	¾	4	–3.3	1.5	3½	4	4¾
Final domestic demand	1862.4	2.0	2¾	3	2.0	3.1	2¾	3¼	3
*plus change in stockbuilding	17.6[c]	0.1	0	½	–0.1	0.2	0	½	½
*plus change in foreign balance	–9.7[c]	1.0	¼	0	0.8	0	0	0	0
GDP at market prices	1870.3	3.0	3	3½	2.7	3.4	2¾	3¾	3½
GDP implicit price deflator	..	8.7	9¾	9½	8.8	8.4	13	8½	7¾
Memorandum items									
Industrial production[d]	..	1.2	2½	5	–3.1	4.8	4	5½	5¼
Consumer prices[e]	..	9.5	9½	9¼	10.1	8.1	11¾	8¾	8
Stockbuilding (actual rate, 1977 prices, billion francs)	..	17.6	19.7	28.9	8.6	9.7	10.0	13.1	15.8

* As a percentage of GDP in the previous period.
a) General government and public enterprises excluding residential construction.
b) Including public housing.
c) Actual rate of stockbuilding and foreign balance.
d) Quarterly index.
e) Consumer price index, not seasonally adjusted.

and the increase of public utility charges[4] last Spring. The rise in prices of manufactures accelerated after the first quarter as a result of the increase in public utility charges and the freeing of industrial prices: during the first nine months of the year, the increase was at an annual rate of 10.3 per cent, compared with 7.6 per cent in the second half of 1977. Industrial prices at the production stage also tended to rise faster, despite moderation in the rates of import price growth. The increase in hourly wage rates also accelerated sharply, from 2.2 per cent in the first quarter of the year to 4.2 per cent in the second (an annual rate of nearly 18 per cent). This development, which seems to have affected wages and salaries throughout the private sector, was probably due largely to some catching-up after the low rate of increase in the first quarter[5], but may also have reflected a temporary change in the expectations of firms. There was some easing in the third quarter when the increase in hourly wage rates fell to 2.7 per cent.

Customs-basis export volumes have steadied since the beginning of the year, but because of the large increase towards the end of 1977 the rise in the first half of 1978 over the previous half-year was at a seasonally adjusted annual rate of nearly 4.5 per cent. The expansion of the volume of imports was also comparatively moderate in the first half of 1978 (4¼ per cent in annual terms on the preceding half-year), broadly reflecting the lack of buoyancy of domestic demand. The rise in the exchange rate of the franc in relation to the dollar, and the moderate development of world raw material prices, prolonged the substantial improvement in the terms of trade which began in the second half of 1977[6]. Hence, the trade deficit recorded throughout 1977 gave way to a surplus during the first ten months of 1978. Allowing for the very favourable trend of invisible transactions, the current balance showed a surplus to October estimated at $2.1 billion (seasonally adjusted) compared with a deficit of $2.9 billion in the corresponding period in 1977.

Policies

Recent measures follow the general lines of policy laid down last Spring, aiming at an improvement in the competitiveness and financial position of

4. Public utility charges have increased as follows since 1976 (per cent, annual rates):

1976		1977		1978
I	II	I	II	I
13.5	16.9	8.4	2.3	16.0

5. The fact that the average increase in hourly wage rates in the first half of 1978 (13.4 per cent in annual terms) was greater than in the first and second halves of 1977 (11.6 per cent and 12.5 per cent respectively) suggests that the acceleration in the second quarter was more than a mere catching-up phenomenon.

6. Trend of average import and export values (percentage increases on preceding period (s.a.a.r.).

	1976 II	1977 I	1977 II	1978 I
Average values of imports	23.2	12.4	1.6	2.2
Average values of exports	18.3	8.6	5.6	5.8

firms and the stimulation of a recovery in productive investment, while maintaining the objective of fighting inflation. The freeing of factory prices of industrial products was completed in mid-August. The controls on retail trading margins and prices of services lapse at the end of 1978. Monetary policy will be tightened in 1979, in order to encourage firms to resist an overall rise in wages. A number of measures taken in 1977 to increase employment of young people are being prolonged into the second half of 1978 and 1979 in a partially modified form[7]. As part of the policy of restructuring industry, an industrial adjustment fund (fonds spécial d'adaptation industrielle) has been created to help, by grants and loans, to create new activities and convert industries in areas affected by the unfavourable trends in certain branches such as steel and shipbuilding[8]. And the Government has taken over control of part of the steel industry in order to be able to participate, by means of a Treasury capital grant of Frs. 10 billion over five years, in the structural reforms needed to improve competitiveness.

The outturn of the central Government budget (on an administrative basis) will probably be a deficit of the order of Frs. 30 billion in 1978[9], compared with Frs. 8.9 billion forecast in the initial budget, with the bulk of the deficit being incurred during the first half-year. On the revenue side, this results from delays in collecting local taxes which obliged the central Government to advance money to the local authorities, the weakness of VAT receipts during the first quarter, and the poor yield of company tax on 1977 profits. But the deficit is due mainly to rising expenditure, particularly increased transfers to the social security fund, payments to finance employment policy measures and, to a lesser extent, increased capital expenditures. Nearly 40 per cent of the deficit was covered by the creation of new money. Allowing for the foreseeable rise in tax revenue (from an increase in the petrol tax in July, and increased VAT receipts following the recovery in consumption during the second quarter), budget income and expenditure might be in approximate balance

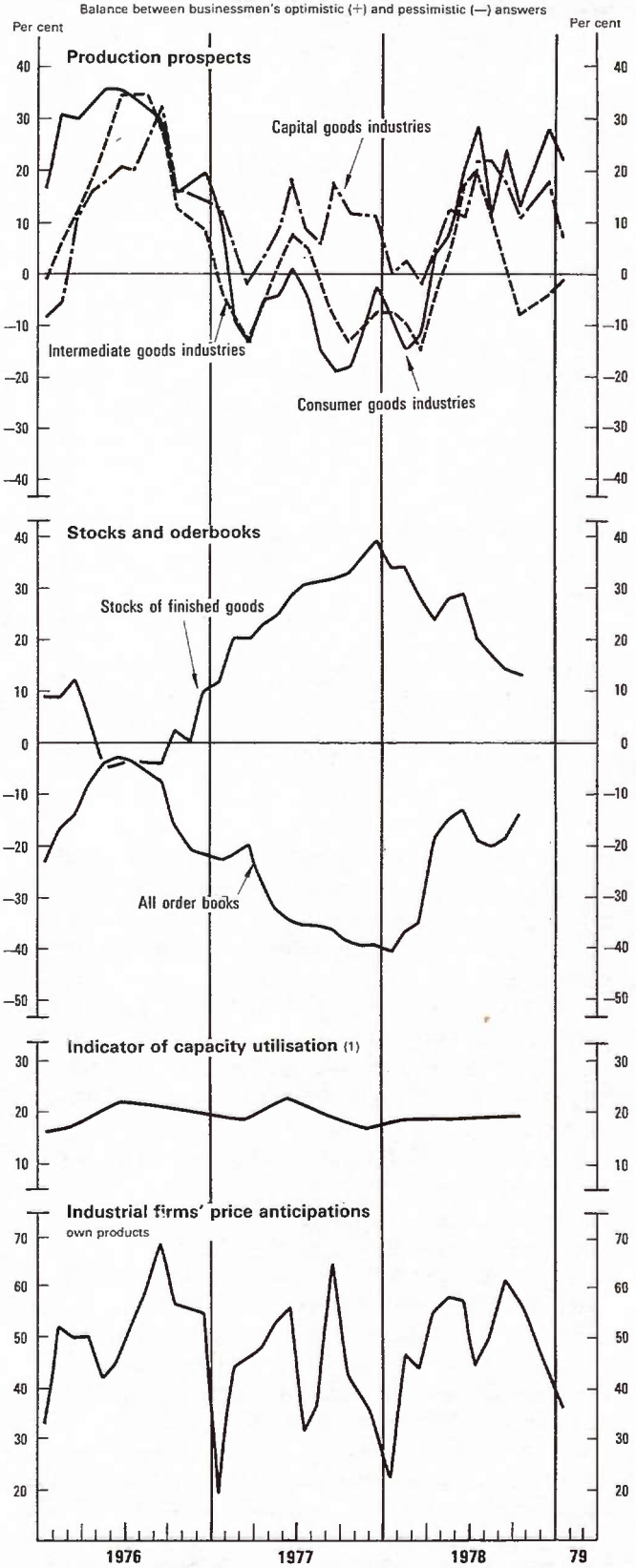
7. Payment by the State, for a period of one year, of employers' social security contributions in respect of employees aged 18 to 25 hired between 1st July 1978 and 31st December 1978 will be limited to 50 per cent, and will apply only to small and medium-sized firms and craftsmen.

8. This fund will have at its disposal Frs. 3 billion, one-third of which is expected to be available by the end of 1978.

9. According to the third amended budget, the budget deficit of central government should amount to Frs. 29.8 billion in 1978.

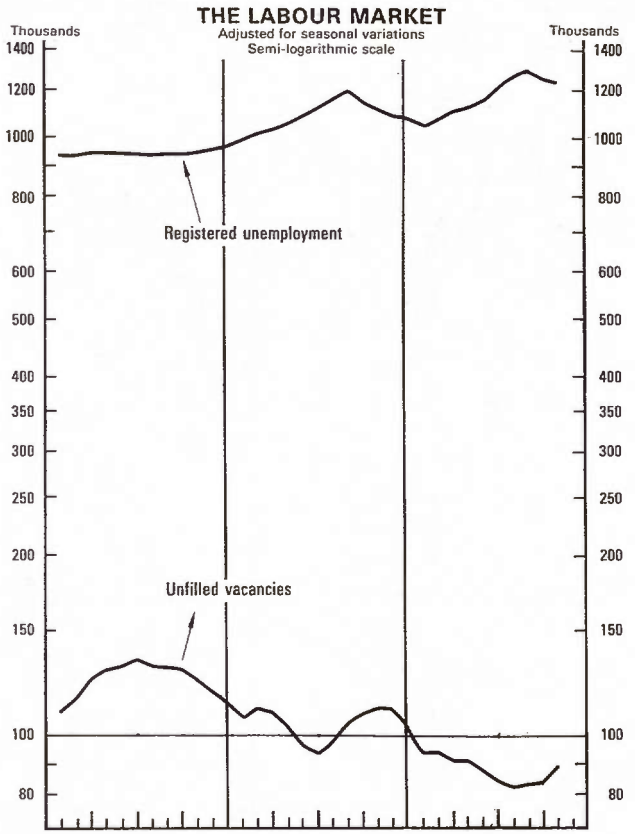
BUSINESS SURVEYS IN INDUSTRY

Balance between businessmen's optimistic (+) and pessimistic (—) answers



1. This series gives the percentage of firms currently unable to increase production for various reasons (shortage of materials, insufficient equipment or shortage of labour).

Sources: I.N.S.E.E., *Tendances de la conjoncture.*



during the second half of 1978. In terms of national accounts concepts, the general government borrowing requirement might be nearly Frs. 45 billion (2 per cent of GDP) in 1978, or practically twice what it was in 1977. In addition to the increase in the budget deficit, there will probably be a big reduction in the surplus on the social security fund connected with the sharp rise in benefits. The borrowing requirement of local authorities, however, is likely to remain at its 1977 level.

The draft 1979 Budget provides for increases of 15.2 per cent in expenditure and 14.4 per cent in income over the initial 1978 Budget, which would result in a deficit of Frs. 15 billion. However, the considerable gap between the initial forecasts and the final results for 1978 indicate the difficulty of analysing the economic impact of fiscal policy in 1979. The official estimates and forecasts of national accounts aggregates presented at the same time as the draft 1979 Budget provide more comparable sets of figures. According to these estimates, the borrowing requirement on the consolidated general government account is likely to be slightly lower in 1979 than in 1978 (Frs. 41.6 billion compared with 44.2). The central Government deficit should decrease considerably, but this should be partly offset by a deterioration of the order of Frs. 5 to 6 billion on the social security account because of the continuing tendency for the increase in benefits to outrun that of contributions[10]. Taking into account the foreseeable trend of prices, both public consumption and investment (including that of the nationalised enterprises) might continue to rise in 1979 in volume terms at about their 1978 rates, 3 and 5 per cent respectively. But in view of the expected faster rise of revenue than of expenditure, the overall demand impact of general Government transactions is likely to be less expansionary in 1979.

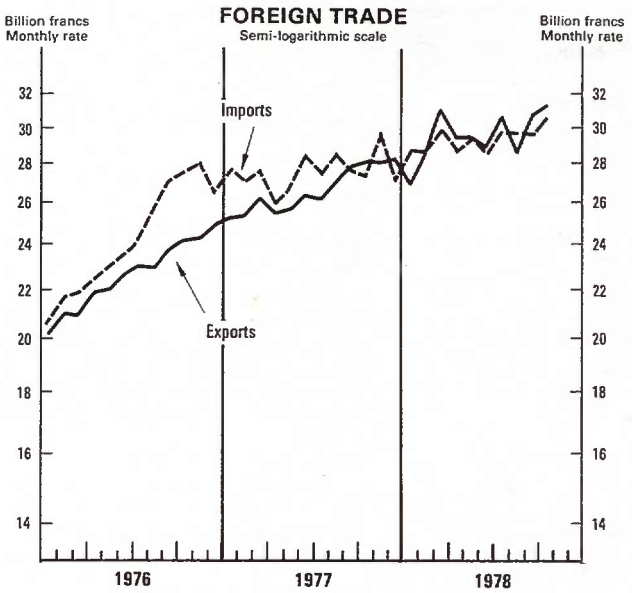
Monetary policy does not seem to have had any significant restrictive effect on demand growth. During the first half of 1978 the money supply (M2) increased at a seasonally adjusted annual rate of 12.2 per cent, not significantly different from the official target set for 1978. It has on the whole been possible to keep to the credit control norms[11] because of weak investment demand for funds by firms, whose financial situation improved during the first half of 1978. The large budget deficit together with the balance of payments surplus was the main cause of the creation of new money since the beginning of the year. The decline of short-term interest rates, which began in March, continued till mid-October, when the rate for call money was 7 per cent. The 1979 money supply target (M2 growth, December to December) has been fixed at 11 per cent, as against the official 12.9 per cent forecast for the growth of nominal GDP. The main instrument for controlling the rise in the money supply will continue to be control over the expansion of credit. The norms established for the expansion of bank credit until 30th June 1979 imply, in the case of the major banks, no increase in the amounts outstanding from the levels of 30th June 1978. Moreover, the obligatory reserves have been raised from 2 per cent

10. Net lending (+) or borrowing (—) requirement of general government, official estimates and forecasts in billion francs:

	1977	1978	1979
Central government *(of which* State)	- 16.9 (- 17.8)	- 30.5 (- 32.1)	- 20.4 (- 21.9)
Local administration	- 15.1	- 15.5	- 16.9
Social Security	+ 8.6	+ 1.8	- 4.3
General Government	- 23.4	- 44.2	- 41.6

11. Because of changes in the presentation of monetary statistics introduced last January, there are no longer any seasonally adjusted series of bank credit, which makes it difficult to interpret recent trends.

to 4 per cent of deposits. These measures clearly amount to a restrictive shift of credit policy, but certain types of bank credit (mainly for exports) remain outside the quantitative ceilings[12]. Credit to the private sector by financial intermediaries other than the commercial banks is also important; however, there are no recent data or official estimates for the near future. The overall tightness of the credit market over the next few months must, therefore, be uncertain. The fiscal incentives recently granted for the purchase of stocks should help to improve the financial situation of enterprises, so that if the improved profit situation of enterprises is maintained as foreseen (given the assumptions for wages and prices) financing a moderate increase in investment should not prove difficult.



Prospects

After a slowdown in the second half of 1978, concentrated mainly in real private consumption, GDP growth is expected to accelerate slightly in the first half of 1979 to an annual rate of 3¾ per cent. An appreciable recovery in export growth is expected, due partly to world trade growth but especially to strongly rising German imports; positive effects on domestic demand, particularly private non-residential investment, are expected. The moderate recovery of productive investment last spring may therefore be confirmed in 1979, given the recent improvement in the financial situation of enterprises and the support measures to be taken with the help of the industrial adjustment fund. Allowing, however, for the large amount of unused capacity, especially in the more capital-intensive sectors (steel, petrochemicals, building materials), the rate of growth of private productive investment may be relatively low, of the order of 4 per cent in 1979. Despite the slowdown of some of the public investment programmes, these should maintain an annual growth rate close to 5 per cent in 1979. The negative trend of recent years in residential construction, however, seems unlikely to be reversed, given the low level of building permits and starts. In all, gross fixed asset formation might gradually increase to the end of 1979, but because of the negative influence of housebuilding, overall growth in volume terms is unlikely to exceed 2.5 per cent between 1978 and 1979. Assuming that a policy of moderation of the purchasing power of wages is maintained, the rate of growth in volume of private consumption will probably be almost the same in 1979 as in 1978 (3½ per cent). The level of stocks, especially of raw materials and goods in process of manufacture, might rise slightly in 1979 from the comparatively low 1978 level, so that in 1979 the contribution of stockbuilding to GDP growth might be about 0.5 percentage points.

Given the forecast growth rate of exports, a GDP growth of 3.5 per cent could be envisaged for 1979. Industrial production, which might be stimulated markedly by the expansion of exports and non-residential investment, will probably grow more rapidly during the first half-year, and for the year as a whole the figure might be of the order of 5 per cent. But any resulting increase of employment is likely to be limited (approximately 0.3 per cent) because of continued industrial restructuring and reorganisation. Given the likely growth of the labour force, and allowing for the special measures[13] taken to encourage employment of young people and early retirement of workers in various industries, the unemployment rate could stabilise at its end-1978 level, but the number of unemployed could increase by 100,000 (yearly average) between 1978 and 1979.

The effects of freeing the factory prices of industrial products during the summer cannot yet be assessed. Beyond the immediate price increases at the production stage, it is difficult to foresee the repercussions at subsequent stages of distribution,

12. These categories ("crédits désencadrés") represent about one quarter of total bank credit, and have been expanding much faster than credit subject to ceilings.

13. According to official estimates, the special measures announced in July may reduce the number of job applicants by 50,000 during the fourth quarter of 1978.

Balance of payments FRANCE[a]

Value, $ million

	1977	1978	1979	1977 II	1978 I	1978 II	1979 I	1979 II
SEASONALLY ADJUSTED								
Exports	62 065	75 950	88 150	32 225	35 580	40 350	42 950	45 200
Imports	64 817	74 650	87 100	33 334	34 975	39 650	42 350	44 750
Trade balance	–2 752	1 300	1 050	–1 109	605	700	600	450
Services and private transfers, net	840	2 350	3 000	340	1 335	1 000	1 300	1 700
Official transfers, net	–1 420	–1 600	–2 000	–590	–870	–750	–900	–1 100
Current balance	–3 332	2 050	2 050	–1 359	1 070	950	1 000	1 050
UNADJUSTED								
Current balance	–3 332			–1 207	1 326			
Long-term capital	593			461	–1 298			
Short-term capital and unrecorded	5 039			2 984	1 947			
Balance on non-monetary transactions	2 299			2 238	1 975			
Net transactions of monetary authorities[b]	647			527	770			
Memorandum items (seasonally adjusted)								
Per cent change in volume[c]								
Exports	7.0	5½	6	9.0	4.4	4¾	6½	6
Imports	1.3	4½	6½	3.0	4.6	6	7	6½

Note: Detail may not add, due to rounding.
a) Balance with all countries on a transactions basis.
b) Previously "Balance on official settlements".
c) Over previous period at annual rates, customs basis.

or the effects on expectations and the behaviour of enterprises and households. Recent business surveys show that the proportion of firms intending to raise prices, although high, has not risen since the summer. The impact should be limited by the expected moderate trend in import prices and relatively hesitant demand conditions in many sectors. Some continuing pressure on consumer food prices is to be expected following the Community agreements of last spring, while prices of services in the private sector are also likely to be affected by recent wage developments.

In view of the foreseeable moderation of the rise in wage costs, inflation might gradually slow down to an annual rate of 7¾ per cent in the second half of 1979. Wages may rise at a lower rate both during the second half of 1978 and in 1979; but any substantial deceleration seems unlikely, given the policy of raising the wages of the lowest paid, a climate of a slight recovery of activity, and the likely stabilisation of the unemployment rate. Hence, the year-on-year growth of hourly wage rates might be reduced to approximately 13 per cent (compared with 13.5 per cent in 1978) and the increase during the year to approximately 12 per cent. Because of the expected small increase in employment, the total wage bill would increase slightly more rapidly.

Exports of goods and services should be stimulated by the expected expansion of world trade and in particular by a more rapid increase of German imports. In national accounting terms, the year-on-year volume increase might be of the order of 6¼ per cent in 1979 (compared with 5.5 per cent in 1978). This acceleration is expected to take place mainly in the first half-year, and to be sustained by a continuing recovery in exports of agricultural and food products. Imports are also likely to rise faster because of stronger final demand, the rate of expansion (in volume terms) being perhaps 6½ per cent for the year as a whole. On the customary technical hypothesis of unchanged exchange rates, any improvement in the terms of trade is likely to be appreciably less marked than in 1978. The trade balance, which improved considerably in 1978, might remain in surplus in 1979, and the current account could show a surplus of the order of $2 billion.

UNITED KINGDOM

Recent trends

Led by consumer demand, the recovery of activity which started in the second half of 1977 has continued. Private consumption rose at an annual rate of more than 7 per cent in the first half of 1978 reflecting the marked increase in real earnings (6 per cent) under Phase III of the pay policy together with substantial income tax relief. Private investment remained relatively buoyant, largely in North Sea oil and manufacturing; private residential investment which rose sharply in the second half of 1977, has turned down partly because of the substantial increase in house prices. Public sector investment continued its steep decline for the fourth half-year running. Fairly weak up to early 1978, manufacturing production and construction activity turned up appreciably in the second quarter but showed no further change in the third. Consumers' expenditure on the other hand again rose substantially in real terms in the third quarter. Reflecting both the growth of demand and output and the effects of employment-creating schemes, the unemployment rate declined steadily during the nine months to June 1978. Since then it has been relatively stable and stood at 5.6 per cent at the end of October.

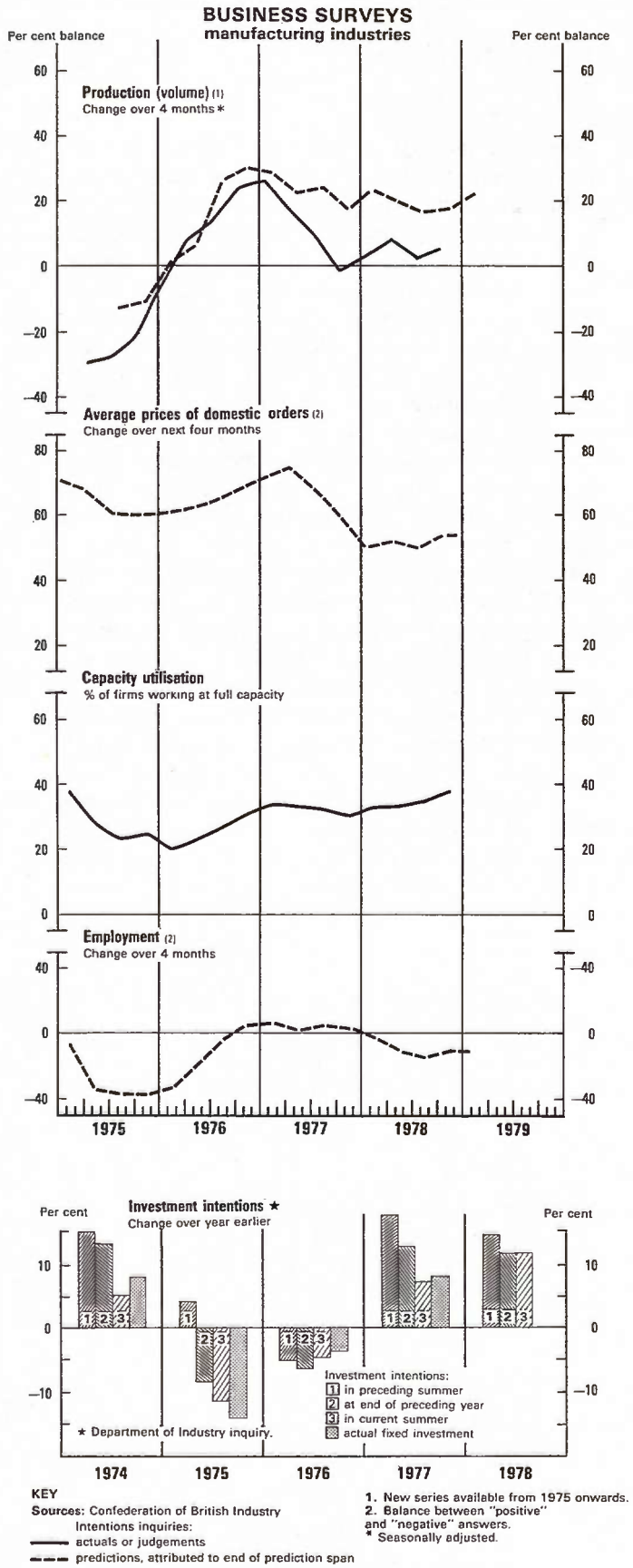
During Phase III of the pay policy (over the twelve months to July 1978) average earnings rose by 14¼ per cent, compared with 8 per cent during the previous twelve months. In September the rise over a year earlier was 15 per cent. Despite sharply accelerating labour costs, the growth in retail prices continued to slow down in early 1978, and has since stayed at about 8 per cent year-on-year. The lagged effects of the stability of import prices in the nine months to the first quarter of 1978 are partly responsible for this relatively low inflation rate. Between March and October, import prices were actually rising at an annual rate of about 8 per cent, but this was broadly offset by favourable seasonal factors.

After the large surplus recorded in the second half of 1977 (the first for six years) the current account of the balance of payments turned back into deficit in the first half of 1978. Reflecting buoyant domestic demand, there was a strong upturn in the volume of imports, while exports stayed rather flat. Since July, however, an upsurge in exports has more than offset the growth of imports, leading to an improvement in the real foreign balance. This was reinforced by continuing improvement in the terms of trade (4 per cent in the year to October 1978) giving a small current account surplus ($¼ billion,

Demand, output and prices
UNITED KINGDOM
Percentage changes
Volume (1975 prices)
Seasonally adjusted
at annual rates

	1977 current prices billion £	From previous year			From previous half-year				
		1977	1978	1979	1977 II	1978 I	1978 II	1979 I	1979 II
Private consumption	83.5	–0.9	5¾	2¾	3.3	7.2	5¼	2½	1
Government consumption	29.1	–0.4	2½	1¾	1.6	3.0	2	1¾	2
Fixed investment	25.4	–3.7	2	1	2.1	2.4	¾	2¼	–½
Public[a]	9.5	–13.9	–8¾	4	–5.6	–17.1	7	2¼	4½
Private residential	2.3	–13.2	–1¼	–4¾	17.1	–11.4	3½	–8½	–4½
Private non-residential	13.7	7.5	10	¼	5.4	20.0	–3¼	4	–3
Final domestic demand	138.1	–1.3	4¼	2¼	2.7	5.4	3¾	2¼	1
*plus change in stockbuilding	1.3[b]	0.7	0	–½	–2.1	1.7	–1¼	–¼	¼
*plus compromise adjustment[c]	..	0.5	–¼	¼	–1.7	0.1	½	¼	0
*plus change in foreign balance	1.1[b]	1.8	–1	¼	4.3	–3.9	–¼	¼	½
of which: North Sea oil[d]		0.9	½	¾	0.5	0.5	1	½	¾
GDP at market prices[c]	140.5	1.6	3	2¼	3.0	3.1	2½	2¼	1½
GDP implicit price deflator	..	13.3	11¼	10	12.0	10.3	12	9¾	8½
Memorandum items									
Manufacturing production	..	1.7	1	2½	–1.6	1.2	4	2½	1½
Consumer prices[e]	..	14.7	8	8¾	11.3	6.4	8½	9	8½
Stockbuilding (actual rate, 1975 prices, million £)	..	1051	1090	660	240	710	380	300	360

* As a percentage of GDP in the previous period.
a) Including nationalised industries and public corporations.
b) Actual rate of stockbuilding and foreign balance.
c) Data for GDP in the past are based on a compromise estimate which is a weighted average of the expenditure, output and income estimates of GDP. The compromise adjustment is the difference between compromise GDP and the expenditure estimate of GDP.
d) Contribution of the increase in North Sea oil production at 1975 prices.
e) National accounts implicit private consumption deflator.



annual rate) in the four months to October. Partly because of growing government transfers abroad and the increase in invisible payments associated with North Sea oil, the shrinkage of the invisible surplus, which began towards the end of 1976, has continued. Despite some official debt repayment, official reserves fell only moderately during the six months to end-October, when their level was $16 billion, some $5 billion down from the peak in January 1978. The effective exchange rate of sterling has been broadly stable since April.

Policies

The 1978/1979 budget represented a relaxation of fiscal policy from the tight posture of the previous year. The present Secretariat forecast assumes that the budget[1] estimates will be broadly realised. Largely because of income tax relief the PSBR was running ahead of the budget estimates in the first half of the present financial year. But with a more normal level of fiscal revenue in the second half of the financial year, which should more than offset a forecast upturn in public sector investment, the PSBR is expected to be close to the budget target of £8½ billion (5½ per cent of GDP) in 1978/1979. It is assumed that in the next budget personal income tax allowances will be indexed to the rise in the cost of living over the previous twelve months; but with no change in tax band rates some fiscal drag will occur, making for a somewhat more restrictive fiscal stance in the 1979/1980 financial year.

A number of measures were taken in May-June[2]

1. Some amendments to the budget were made during the passage through Parliament of the Finance Bill. The standard rate was reduced to 33 per cent (instead of the budget proposal of 34 per cent) but in order to offset this the authorities proposed a 2½ per cent national insurance surcharge on employers, subsequently reduced to 1½ per cent. This is expected to yield some £300 million in 1978/1979 and £900 million in a full year, i.e. some £150 million less than the revenue loss in 1978/1979 resulting from the parliamentary amendments to reduce the personal tax burden.

2. These measures were:
   - *i)* the market-related system for determining the Minimum Lending Rate (MLR) was abandoned and the old system of fixing by administrative decision was reimposed on May 25;
   - *ii)* the MLR was raised from 7½ per cent to 9 per cent on May 26 and to 10 per cent on June 8; and
   - *iii)* the supplementary special deposit scheme, "the corset", was reintroduced.

Under this scheme banks are obliged to deposit with the Bank of England non-interest bearing deposits if the growth in their interest-bearing eligible liabilities exceeds a certain limit, fixed at 4 per cent between the average of the make-up days in the six months, November 1977—April 1978 and August—October 1978. Progressively higher penalties are imposed as the excess gets greater. On August 17, the corset was further extended to mid-June 1979, allowing for a penalty-free rate of growth of eligible liabilities of 1 per cent per month.

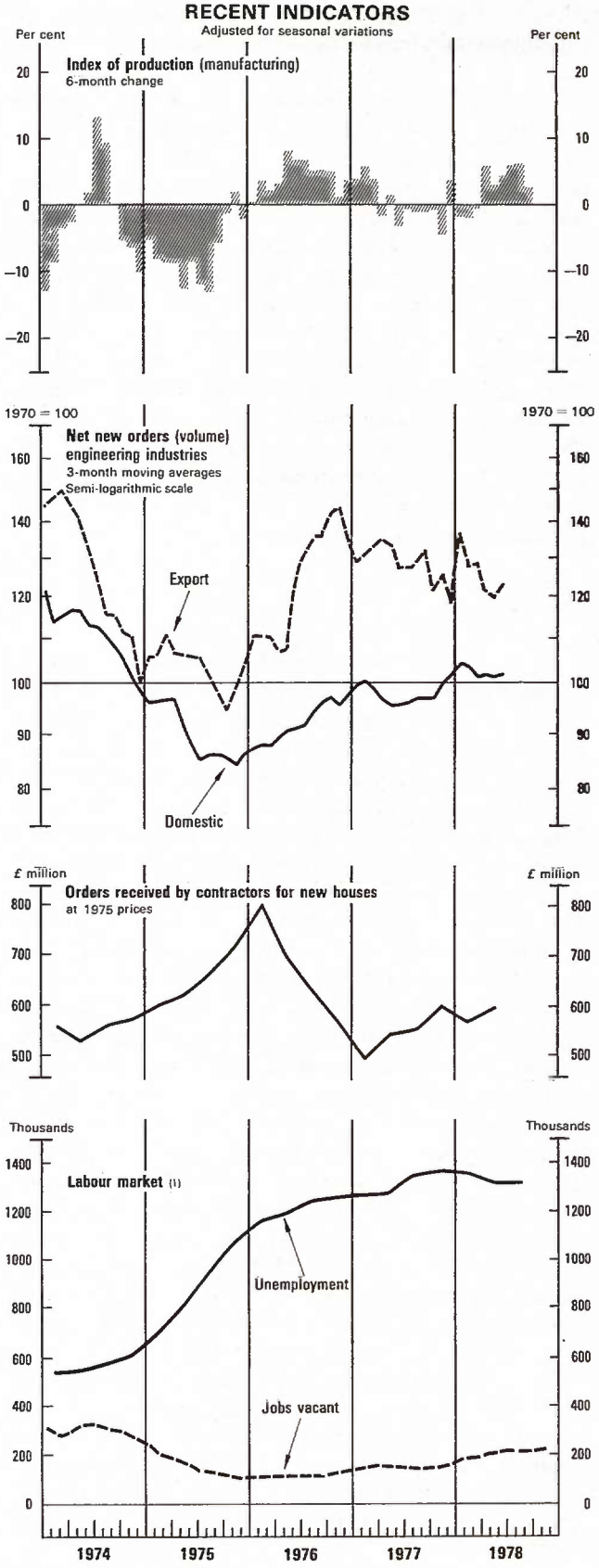
to help keep the growth of sterling M3 and domestic credit expansion (DCE) within the target range of 8-12 per cent and £6 billion respectively during the financial year 1978/1979. Following the sharp increases in these aggregates towards the end of the 1977/1978 financial year, the six months to October saw a marked slowdown: sterling M3 rose at an annual rate of some 7½ per cent, although its rate of growth has accelerated to near the 12 per cent upper limit again in recent months. DCE, at an annual rate of only £5 billion over the same period, was also considerably below target. Large sales of gilt-edged stocks to the non-bank public in the weeks following the June measures also helped to squeeze bank credit. Indeed, the Bank temporarily had to release special deposits to relieve the upward pressure on interest rates and avoid excessive fluctuations. Nonetheless, short-term money market rates exceeded 10¼ per cent during most of June and July, but by the beginning of October had fallen to around 9½ per cent. To keep the growth of monetary aggregates within the limits, but also to ward off speculative pressures against sterling, the Minimum Lending Rate was raised by 2½ percentage points to 12½ per cent on November 10th. Moreover, the present growth target of 8-12 per cent for M3 was extended to October 1979, implying some tightening given the low starting base in October 1978. Mortgage rates were also raised by 2 percentage points, to 11¾ per cent. Other short-term interest rates have been raised but to a smaller extent. The forecast assumes that there will be an acceleration in the growth of sterling M3 and DCE during the rest of the 1978-1979 financial year, but that the targets will be broadly observed, and that the authorities will maintain their tight control over the monetary aggregates up to the end of the forecast period.

The White Paper on pay guidelines[3] for Phase IV of the pay policy, beginning on August 1, 1978, would permit:

i) a maximum increase in average earnings of 5 per cent for each group, with higher percentage increases for those earning less than £44.50 per week;
ii) self-financing productivity increases above the 5 per cent guideline;
iii) provisions for a small number of specific groups where higher pay increases would be in order, and
iv) the maintenance of the twelve-month rule interval between pay settlements.

3. *Winning the Battle Against Inflation,* Cmnd, 7293, HMSO, July 1978.

RECENT INDICATORS



1. Great Britain only.

As under Phase III, the authorities announced that they would impose sanctions on companies which breached the guidelines. The impact of the self-financing productivity deals, together with the special exemptions, might add about 2 percentage points to the rise in average earnings. In addition, as in the previous wage round, there would probably be some wagedrift. But with strong trade union opposition to the 5 per cent guideline there is much uncertainty as to the final outcome. On the basis that wage-drift will be about the same as under Phase III, the present forecast incorporates the *technical assumption* that the rise in average earnings will be 10 per cent. However, it may well be that earnings will rise faster than assumed by the Secretariat. For illustrative purposes a simulation was undertaken to examine the possible effects of an assumed 12 per cent increase in average earnings; the results of this simulation are discussed below.

Prospects

Even under the assumed increase in average earnings of 10 per cent[4], the deceleration in total labour costs is expected to be gradual. Because of the 1½ per cent national insurance surcharge and the fact that many pay settlements during the rest of 1978 will still be made under the terms of Phase III, the annual rate of growth of unit labour costs may remain in two digits until early 1979, thus keeping upward pressure on inflation over the next few months. Thereafter, the assumed slower rise in average pay could bring the increase in consumer prices down to an annual rate of about 8 per cent towards the end of 1979; this would assume an increase in import prices of 6 per cent during 1979.

The steep deceleration in the wage and salary bill would entail a much smaller rate of increase of real earnings than under Phase III. Other income[5] in real terms is also expected to grow considerably less than in 1978. Furthermore, it is assumed that apart from the indexation of income tax allowances, the 1979/1980 budget will not grant tax reliefs. Consequently the tax burden on personal income would increase from the low level reached in the three half-years to the end of 1978. The annual rate of growth of real disposable income might slow down from about 6 per cent in the first half of 1978 to somewhat less than one-half of one percentage point in the second half of 1979. But assuming a small reduction of the personal savings ratio in the second half of 1979, the deceleration in the growth of consumers' expenditure would be rather less.

The forecast increase of government consumption is of the same order (2 per cent) as planned in the 1978/1979 Budget. Public sector investment, after falling sharply during the two years to mid-1978, is expected to rise at a fairly rapid pace in the second half of 1978 to make good some of the earlier shortfall, but then to slow down to a more moderate rate of growth, broadly in line with the medium-term Government Expenditure Plans[6]. The recovery in demand and output since the middle of 1977, improved profitability, lower inflation and the need to replace obsolete equipment after seven years of sluggish investment, have all played a role in the strong growth of manufacturing investment in the year to mid-1978. This is expected to continue, but more slowly up to the end of 1979, broadly in line with recent investment surveys. In the second half of 1979 manufacturing investment may be almost 30 per cent higher than the low point in the first half of 1976, and for the first time exceed the earlier peak reached in 1970. After a small decline in the first half of 1978, investment in distribution and services should resume its moderate rise. The squeeze on real disposal income, high mortgage rates and the tight liquidity position of building societies may contribute to a slight fall in private residential investment during the forecast period. Moreover, the expected decline in North Sea oil investment from its recent peak will also depress total private investment. With stock/output ratios in the first half of 1978 at around their longer-run levels, and with the profit situation remaining relatively weak and the expansion of activity slowing down, little inventory accumulation seems likely.

Total domestic demand growth may therefore slow down quite sharply over the forecast period. Export market growth may not change significantly but the deterioration of competitiveness since the end of 1977 may entail some loss in market shares so that the rise in non-oil commodity exports may remain moderate (3½ per cent during 1979). Moreover, after the sharp increase in North Sea oil production in the first three quarters of 1978, the rate of increase of oil exports is likely to slow down somewhat. Total commodity exports may rise in real terms by 4½ per cent during 1979[7]. The increase in the volume of exports of services, in

4. It is, moreover, assumed that the 10 per cent increase in earnings will continue between July 1979 (the end of the present wage round) and December 1979.

5. Mainly self-employment income, rent, dividend and interest receipts.

6. The Government Expenditure Plans, 1978/1979 to 1981/1982 (Cmnd. 7049-I and II), January 1978.

7. These estimates are on a balance of payments basis and are not strictly comparable with those on a customs basis shown in Table 49.

Balance of payments UNITED KINGDOM

Value, $ million

	1977	1978	1979	1977 II	1978 I	1978 II	1979 I	1979 II
SEASONALLY ADJUSTED								
Exports	56 144	68 650	79 800	29 665	32 300	36 350	38 800	41 000
Imports	59 126	71 600	80 800	29 647	33 729	37 900	39 600	41 200
Trade balance	–2 982	–2 950	–1 000	18	–1 429	–1 550	–800	–200
Services and private transfers, net	5 452	5 650	6 700	2 931	2 760	2 900	3 250	3 450
Official transfers, net	–1 966	–3 250	–4 300	–1 060	–1 579	–1 700	–2 050	–2 250
Current balance	504	–550	1 400	1 889	–248	–350	400	1 000
UNADJUSTED								
Current balance	504			1 955	–164			
Long-term capital	6 528			2 426	492			
Short-term capital and unrecorded	5 240			1 834	–507			
Balance on non-monetary transactions	12 272			6 215	–179			
Net transactions of monetary authorities[a]	15 284			8 940	–2 759			
Memorandum items (seasonally adjusted)								
Per cent change in volume[b]								
Exports	8.6	6	6	7.7	3.4	9¼	4¾	5½
Imports	2.1	8½	3½	–6.2	17.1	7¼	2	3

Note: Detail may not add, due to rounding.

a) Previously "Balance on official settlements". Changes in official sterling balances are included in the capital account while foreign borrowing by the public sector is included below the line as a financing item.

b) Over previous period at annual rates, customs basis.

line with recent trends, is expected to be fairly small, so that exports of goods and services may rise by just over 3½ per cent over the same period.

Despite erratic movements in the volume of imports in recent years, it has been estimated that the elasticity of non-oil commodity imports with respect to final expenditure (excluding oil) is a little over 2, in which case they might rise a little more than non-oil commodity exports during the forecast period. A small deterioration of the real trade balance excluding oil is thus expected, together with some decline in the services surplus. However, there should be a bigger improvement in the oil balance in volume terms resulting from higher North Sea oil production[8]. The real foreign balance of goods and services could, therefore, make a small positive contribution to GDP growth through the forecast period. On the technical assumption of an unchanged effective exchange rate of sterling as from 8 November, the annual rate of growth of import prices may be some 6 per cent during 1979, while the rate of export prices may be about 6½ per cent, implying a small improvement in the terms of trade. This would reinforce the positive developments in the real foreign balance. On the other hand, because of payments associated with North Sea oil and the rising contribution to the EEC, the deficit on factor income and government transfers is forecast to increase. In total, a current balance of payments surplus of almost $2 billion is forecast in 1979, compared with a deficit of less than $½ billion in 1978.

The rise in GDP, probably about 2¾ per cent during 1978, may slow down to about 2 per cent in the course of 1979. The contribution of North Sea oil to GDP growth is estimated at about ¾ per cent both in 1978 and 1979. Despite the relatively rapid rise in manufacturing output over the last twelve months, the level of activity is still relatively low. Some further growth is forecast, so that in the second half of 1979 output levels should, for the first time since the downturn, be close to those reached at the 1973 peak.

The relatively strong recovery between mid-1977 and the end of 1978 is expected to have pulled the annual rate of growth of productivity[9] up to about 2 per cent, compared with one of a little over ½ per cent between the peak of the boom in 1973 and mid-1977, and with the approximate 3¼ per cent rate in 1966-1973. It may remain relatively high during 1979 (about 1½ per cent) despite the slower increase

8. It is assumed that
   i) one-third of the increase in North Sea oil production is exported and two-thirds replaces imports;
   ii) North Sea oil production increased from 38 million tons in 1977 to 58 million tons in 1978 and to 80 million tons in 1979.

9. Because of the distorting effect of North Sea Oil, productivity has been estimated by dividing GDP excluding the increase in North Sea oil production by the number of employed. The implicit assumption is that employment in North Sea oil (a sector with extremely high productivity) will remain broadly stable.

of output. The forecast assumes that the labour force will increase by almost ½ per cent, and that the coverage of the employment-creating schemes will not change during the forecast period. Under these assumptions employment should increase a little up to early 1979 and then fall slightly. Consequently, unemployment could increase gradually and reach about 6 per cent of the total number of employees by the end of 1979, ¼ of one percentage point more than in 1977.

If, for illustrative purposes, it is assumed that average earnings under the terms of the present wage round were to rise by 12 per cent instead of the technically-assumed 10 per cent rate incorporated in the basic forecast, the effect on the real side would be negligible, but the impact on inflation would be relatively important. Higher labour costs, which might also put some downward pressure on sterling (with implications, therefore, for import prices) would raise the rate of growth of consumer prices to perhaps a little over 10 per cent during 1979, instead of the 8¾ per cent under the 10 per cent assumption. This, combined with heavier fiscal drag, would limit the rise in real disposable income to 1¼ per cent, annual rate, about ¼ percentage point more than under the 10 per cent assumption. Moreover, because of stronger inflation, the personal savings ratio might rise a little. Taking import leakages into account, the addition to GDP growth resulting from the higher earnings assumption could be less than ¼ of one percentage point. Such a calculation excludes any negative effects on business and foreign confidence resulting from a higher inflation rate, which could depress growth more than under the 10 per cent assumption and, therefore, lead to a higher rise in unemployment than presently forecast.

CANADA

Recent trends

Despite some pick-up during the first half of 1978, output growth has remained below potential[1]. The acceleration was attributable mainly to a policy-induced boost to private consumption, very buoyant exports, and a strong recovery in the volume of government expenditure. Retail sales figures suggest continued buoyancy of private consumption through the third quarter, but housing starts have fallen to the lowest level for three years. On the other hand, the recent inflow of orders for machinery and equipment would suggest that some revival in non-residential investment may now be taking place. Employment growth remained strong through the first half of 1978 (3½ per cent s.a.a.r.), though more recently there has been some slowdown, with most new recruits being absorbed into the service sectors. The unemployment rate has remained around the 8¼ per cent mark for over half a year, although it fell back to 8.2 per cent in October.

Total domestic demand growth accelerated to some 3½ per cent (s.a.a.r.) during the first half of 1978. The contribution from the change in the foreign balance also increased though only marginally. Export volumes were surprisingly strong, although below the exceptionally high figure experienced during the final months of 1977. Exports subsequently suffered from protracted strikes in the iron ore mining industry. Import volumes, reflecting the sluggishness of domestic demand, have either stagnated or shown a tendency to decline, although in the second quarter bunching of investment goods deliveries led to a marked upsurge.

External factors continued to be the main driving force behind the unfavourable price performance during the first half of 1978. During the twelve months to July food prices—mainly influenced by developments in the United States—rose by some 20 per cent, and the overall consumer price index by 9.8 per cent, well above the OECD average of 8.2 per cent. Excluding food, consumer price growth decelerated during this period. In August and September, food costs actually fell, but while the overall consumer price index stabilised on a seasonally adjusted basis in August, it rose through October to give a year-on-year increase of 8.7 per cent. The growth of labour costs has continued to moderate. Settlements under major collective agreements fell from 6.6 per cent (average over life of contracts) during the first quarter of 1978 to 6.4 per cent in the second. During the first half of the year the growth of average hourly earnings in manu-

1. Provisional estimates may be subject to considerable revision. An indication of the scope for such revision is the size of the residual error of estimate; during the first half of 1978, this item amounted to 1¼ per cent of GNP.

Demand, output and prices
CANADA

Percentage changes
Volume (1971 prices)
Seasonally adjusted
at annual rates

	1977 current prices billion Can. $	From previous year			From previous half-year				
		1977	1978	1979	1977 II	1978 I	1978 II	1979 I	1979 II
Private consumption	122.3	2.8	3¼	3½	1.4	4.4	3	3½	4½
Government consumption	43.4	2.0	2½	3	–2.0	4.8	3	3	2½
Fixed investment	48.4	0.3	½	2¾	–1.5	0.4	2	3	3½
Public[a]	7.0	2.6	1	1	6.2	–0.5	–1½	1	3
Private residential	12.7	–4.6	–4	2¼	–6.2	–5.3	1	2½	3
Private non-residential	28.7	1.7	1¾	3½	–1.4	2.7	3¼	3½	3¾
Final domestic demand	214.1	2.1	2½	3¼	0.2	3.6	2¾	3¼	4
*plus change in stockbuilding	0.1[b]	–0.8	¼	¼	0.3	–0.1	¾	0	¼
*plus change in foreign balance	–4.5[b]	1.0	1¼	½	1.3	1.6	0	¾	0
*plus error of estimate	0.4[b]	0.3	–½	0	0.6	–1.2	0	0	0
GNP at market prices	210.1	2.7	3½	4	2.5	4.1	3¾	4	4¼
GNP implicit price deflator	..	6.9	6¾	7	6.9	6.6	6½	7	7½
Memorandum items									
Industrial production	..	4.0	4¼	5½	3.0	4.0	6	5½	5½
Consumer prices[c]	..	7.5	8	7¼	8.0	7.6	8½	6½	7¼
Stockbuilding (actual rate, 1971 prices, million Can. $)	..	–23	276	645	39	21	255	280	365

* As a percentage of GNP in the previous period.
a) Excluding nationalised industries and public corporations.
b) Actual rate of stockbuilding, foreign balance and error of estimate.
c) National accounts implicit private consumption deflator.

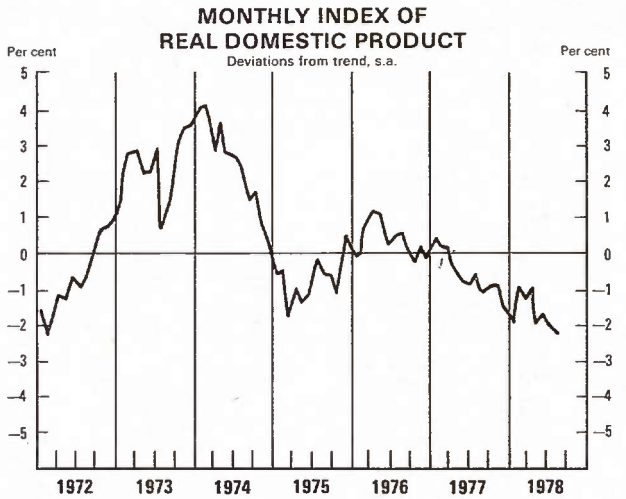
facturing fell to only 5¼ per cent (annual rate) from 9½ per cent in the preceding half year, while the increase in overall average earnings according to the national accounts estimates amounted to only 4½ per cent. Although this implied a decline of about 3¼ per cent in purchasing power[2], household real disposable income rose by a full 4½ per cent, being buttressed by fiscal measures (see below) and by the rapid growth of employment. There appears to have been some reacceleration of manufacturing earnings growth in the third quarter.

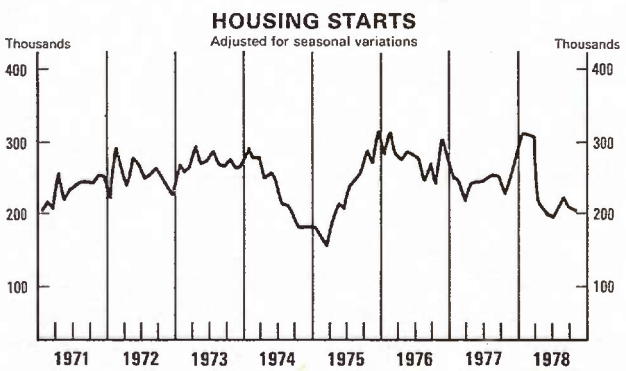
The change in the real foreign balance contributed positively to the GNP growth rate during the first half of 1978. However, a continuing deterioration in the terms of trade (at a 4 per cent annual rate) limited the improvement in the trade balance to a surplus of US $4 billion (annual rate), compared with US $ 3 1/3 billion in the second half of 1977. Although the movements of total merchandise exports have been irregular in recent months, due partly to strikes, exports of finished products have fared well, suggesting that Canadian manufacturers may have begun to benefit from the improvement in their competitiveness. During the third quarter the trade surplus eased back to the earlier US $3 1/3 billion rate. The net services deficit during the first half of 1978 recorded only a small increase on the preceding half-year's figure and indeed, in seasonally-adjusted terms, the second quarter showed an improvement over the first as the travel account strengthened. During this period, the overall current account deficit declined by US $½ billion (s.a.a.r.) to US $3.3 billion, the equivalent of some 1.6 per cent of GNP. In the third quarter the invisibles deficit remained steady, resulting in an overall current account deficit of some US $4 billion (annual rate). Increased borrowing by the federal government was largely responsible for the pick-up in the net inflow of long-term capital to around the rate recorded in 1976. A net outflow of short-term capital continued, however. Canada's foreign exchange reserves, after recovering from a sharp fall at the beginning of this year, subsequently declined around mid-year before recovering again to US $5.1 billion at end-October, some US $0.5 billion above the end-1977 figure. The Canadian dollar has continued to decline irregularly, with its effective exchange rate falling by some 14¾ per cent during the ten months to end-October.

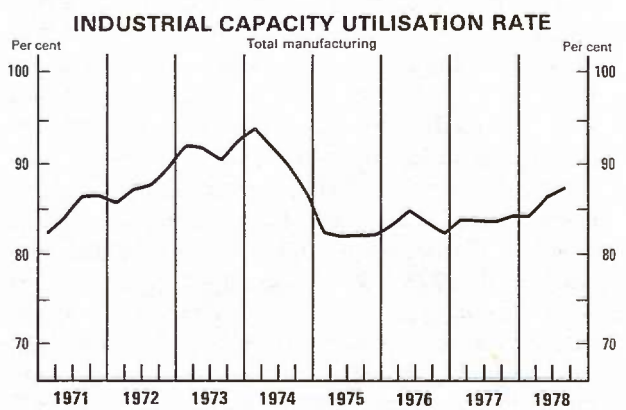
Policy

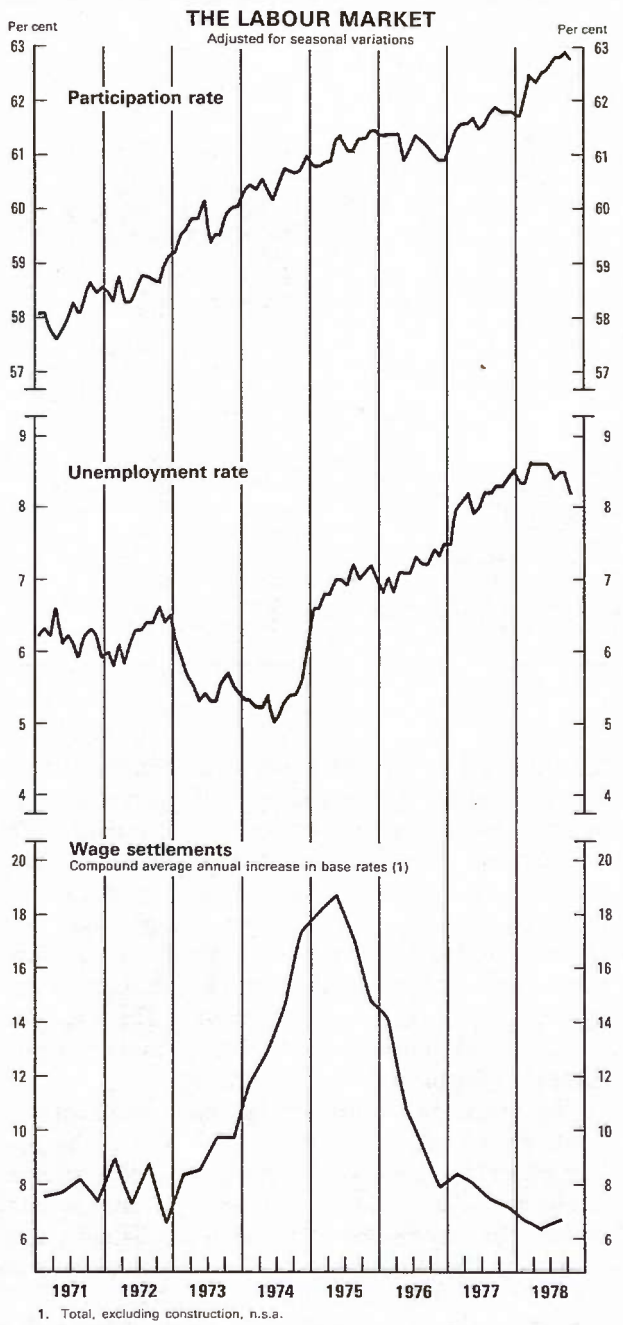
Economic policy has continued to be directed towards reducing the inflation rate and, in conjunction with this goal, to restraining the growth of public expenditure. But slower growth of private

2. Applying the national accounts implicit deflator for private consumption. The difference between this deflator (which amounted to 7.6 per cent) and the rise in consumer prices (8.6 per cent) was larger than usual in the first half of 1978.









1. Total, excluding construction, n.s.a.

sector incomes, together with various fiscal concessions (notably indexation of tax rates and an increase in the minimum tax credit[3]) have held back the growth of government revenues. These factors, together with the uneven timing of government expenditures and rising transfer commitments (including debt interest payments), led to an increase in the general government deficit during the first half of 1978 to the equivalent of 4.4 per cent of GNP (compared with 3.4 per cent in the preceding half-year). More recent data relating to federal government finances point to continued weakening; during the first six months of the current fiscal year (that is, to end-September) the budget deficit was substantially higher than in the corresponding period of fiscal 1977/1978. In August, a series of measures was announced, which entailed both a reallocation as

3. Present Canadian legislation allows for a "tax credit" equal to 9 per cent of federal personal income tax otherwise payable, subject to specified maximum and minimum limits. The amount of minimum deduction was raised temporarily for 1978 from $200 to $300.

well as an overall reduction in federal government expenditure, mainly affecting fiscal 1979/1980[4]. On November 16 a new mildly stimulatory budget was introduced, the main provision of which was a reduction in manufacturers' federal sales tax. The overall impact of measures announced is estimated to reduce revenue by some $1.4 billion (or about ½ per cent of GNP) in fiscal 1979/1980.

Monetary policy has continued to operate through controlling the growth of the narrowly-defined money supply. At the same time, the rising trend of interest rates in the United States, coupled with the continuing weakness of the Canadian dollar, has led to four increases in the Bank rate since late July to the present record level of 10¾ per cent. While the structure of domestic short-term interest rates has, as usual, adjusted rapidly to this action, the rise in long-term rates has been much less marked. Money supply growth, relatively steady during the early months of the year, fell below the lower target range in April, but subsequently picked up to around the middle of the range, and recently has been growing at a rate clearly above the target, which was lowered by 1 percentage point in September to 6-10 per cent. The Canadian authorities have intervened in the foreign exchange markets in order to steady the movement of the dollar.

4. Based on expenditure levels as presented in the fiscal 1978/1979 budget, the cuts amount to $0.9 billion, of which $0.2 billion applies to the current fiscal year and the balance to 1979/1980.

With the phasing-out of the system of compulsory prices and incomes control, a Centre for the Study of Inflation and Productivity has been set up within the Economic Council of Canada. The Centre's task consists mainly of the surveillance and reporting of inflationary developments, and the establishment of an early-warning system of inflationary pressures. The Centre lacks the mandatory powers previously vested in the Anti-Inflation Board.

Prospects

The present outlook would suggest that the growth of Canada's foreign markets is likely to slow down over the forecast period. But the improved competitive position should ensure some gain in shares of both the export and the domestic markets. After a slowdown during the second half of 1978, domestic demand will probably strengthen during 1979, with a revival in private consumption as household real disposable income growth picks up. The foreign balance is likely to continue to make a positive contribution to the growth of total GNP, though considerably less than has been the case over the past year.

The growth of wages is expected to accelerate during the forecast period, as demands for compensation for earlier consumer price increases harden; moreover, some strengthening in the demand for labour could develop. With the recent fiscal concessions no longer applying, and, indeed, with the

Balance of payments CANADA

Value, U.S. $ million

	1977	1978	1979	1977 II	1978 I	1978 II	1979 I	1979 II
SEASONALLY ADJUSTED								
Exports	43 293	47 500	51 600	21 740	23 340	24 150	25 250	26 350
Imports	40 225	43 900	47 900	20 069	21 352	22 550	23 400	24 450
Trade balance	3 068	3 600	3 700	1 671	1 988	1 600	1 850	1 900
Services and private transfers, net	–6 464	–6 950	–7 500	–3 361	–3 360	–3 600	–3 700	–3 800
Official transfers, net	–507	–600	–700	–246	–285	–300	–300	–400
Current balance	–3 903	–3 950	–4 500	–1 936	–1 657	–2 300	–2 150	–2 300
UNADJUSTED								
Current balance	–3 903			–1 259	–2 380			
Long-term capital	4 087			1 995	2 707			
Short-term capital and unrecorded	–3 123			–1 623	–1 603			
Balance on non-monetary transactions	–2 939			–887	–1 276			
Net transactions of monetary authorities[a]	–1 342			–542	–905			
Memorandum items (seasonally adjusted)								
Per cent change in volume[b]								
Exports	9.2	9¾	5½	–0.2	16.9	6	6½	3
Imports	1.1	3¼	4	–7.1	7.4	6	3½	3½

Note: Detail may not add, due to rounding.

a) Previously "Balance on official settlements".

b) Over previous period at annual rates, customs basis.

partial reversal of the temporary reduction of provincial sales taxes which may only be partly countered by the reduction in manufacturers' sales tax rates, household real disposable income is expected to decline during the second half of 1978. A recovery may take place during 1979, particularly during the early part of the year, with the indexation of personal income tax scales (by a factor of 9 per cent). Provided that food prices remain reasonably stable following their recent fall, the development of consumer prices should be more favourable than during the earlier part of 1978. Furthermore, earlier movements in industrial sales and wholesale prices suggest that further increases in retail prices are still to come.

The rise in capacity utilisation rates in manufacturing, and the recovery in profits, together with the recent consolidation of corporate balance sheets and financial positions, should help to stimulate business investment. While the comprehensive survey of investment intentions issued by Statistics Canada suggests that the volume of fixed capital formation will remain depressed in 1978, the Conference Board's latest Survey of Business Attitudes suggests that expenditure plans may now be revised upwards. The earlier boom in housing starts has helped to sustain the level of residential construction activity until recently, though the current lower level of starts seems unlikely to revive until the present backlog of unsold dwellings is reduced. The announced cuts in Federal Government expenditure will probably have relatively little effect on public sector final outlays over the forecast period.

The improvement in Canadian manufacturers' competitiveness is expected to show in sales in both domestic and foreign markets. The inflow of orders has recovered recently, and the inventory/sales ratio in manufacturing is now approaching the low 1973 level. Although a revival of industrial activity would strengthen the demand for labour, an acceleration of wage rate growth would operate in the opposite direction. At the same time, the growth of the labour force seems likely to decelerate as the growth of the participation rate slackens[5]. But little movement is expected in the unemployment rate, even if total output growth accelerates to around 4½ per cent by the end of the forecast period.

The real foreign balance is expected to remain favourable in the second half of 1978, but the terms of trade are forecast to continue to deteriorate. The travel account should benefit further from recent exchange rate movements. For 1978 as a whole the balance of payments on current account is expected to show about the same deficit as last year, or some US $3.9 billion, just under 2 per cent of GNP. The less favourable development of real trade flows, together with some further deterioration in the terms of trade, can be expected to push the current account deficit back up to the US $4½ billion mark in 1979.

5. Among the fiscal measures announced in August is a tightening of conditions for entitlement to unemployment benefits, which seems likely to affect participation rates, the movement of which has been particularly influenced by young people and women.

ITALY

Recent trends

The recovery in activity, which appeared at the beginning of 1978 after nine months of recession, has proved to be comparatively slow-moving. After steady progress throughout the first quarter, industrial production in September was only 1 per cent above the level of a year earlier. Order books have remained thin, the level of stocks high, and the rise in capacity utilisation limited. Nonetheless, the latest surveys show a marked improvement in orders, and production prospects for the closing months of the year have increased sharply. For the first half-year, GDP probably rose at an annual rate of about 4 per cent, helped mainly by a sharp increase in the real foreign balance, a recovery in household consumption, and the ending of the investment slowdown. The labour market has remained depressed, the unemployment rate being 7.5 per cent in July, slightly below the level of a year earlier. In the first half of 1978, employment in large firms in the industrial sector has stagnated while short-time working increased markedly to attain the level of the same period of 1975.

Despite the very marked slowdown in the growth of import prices, comparatively little progress has

Demand, output and prices
ITALY
Percentage changes
Volume (1970 prices)
Seasonally adjusted
at annual rates

	1977 current prices billion lire	From previous year 1977	1978	1979	From previous half-year 1977 II	1978 I	1978 II	1979 I	1979 II
Private consumption	113 269	2.1	2	3½	0	2.5	3	3½	4
Government consumption	24 270	2.3	2½	2½	2.9	2.2	2¼	2½	2¾
Fixed investment	34 193	0.1	–2	3¼	–10.3	0.7	1½	2¾	6
Public[a]	9 483	–7.2	–5	2¼	..	..	..	..	..
Private residential	8 618	–2.1	–2	1	–7.4	–0.5	¾	1	1½
Private non-residential	16 092	6.2	–¼	5	..	..	..	..	..
Final domestic demand	171 732	1.8	1¼	3¼	–1.5	2.1	2½	3¼	4¼
*plus change in stockbuilding	2 390[b]	–1.6	0	½	–4.4	1.1	1¾	0	¼
*plus change in foreign balance	–1 134[b]	1.6	¾	–¼	2.3	1.0	–1	¼	–¼
GDP at market prices	172 988	1.7	2	3½	–3.6	4.2	3¼	3½	4
GDP implicit price deflator	..	18.3	13½	12¾	14.1	13.6	13	12¾	12½
Memorandum items									
Industrial production		1.1	1	4	–10.4	5.8	4¼	3½	5
Consumer prices[c]	..	17.0	12	10¾	12.8	12.1	11	10¾	10¼
Investment in machinery and equipment	14 647	1.3	–4	5	–18.1	1.0	2	4½	8½
Stockbuilding (actual rate, 1970 prices, billion lire)	..	548	475	880	–119	80	395	420	460

* As a percentage of GDP in the previous period.
a) Including nationalised industries and public corporations.
b) Actual rate of stockbuilding and foreign balance.
c) Consumer price index, not seasonally adjusted.

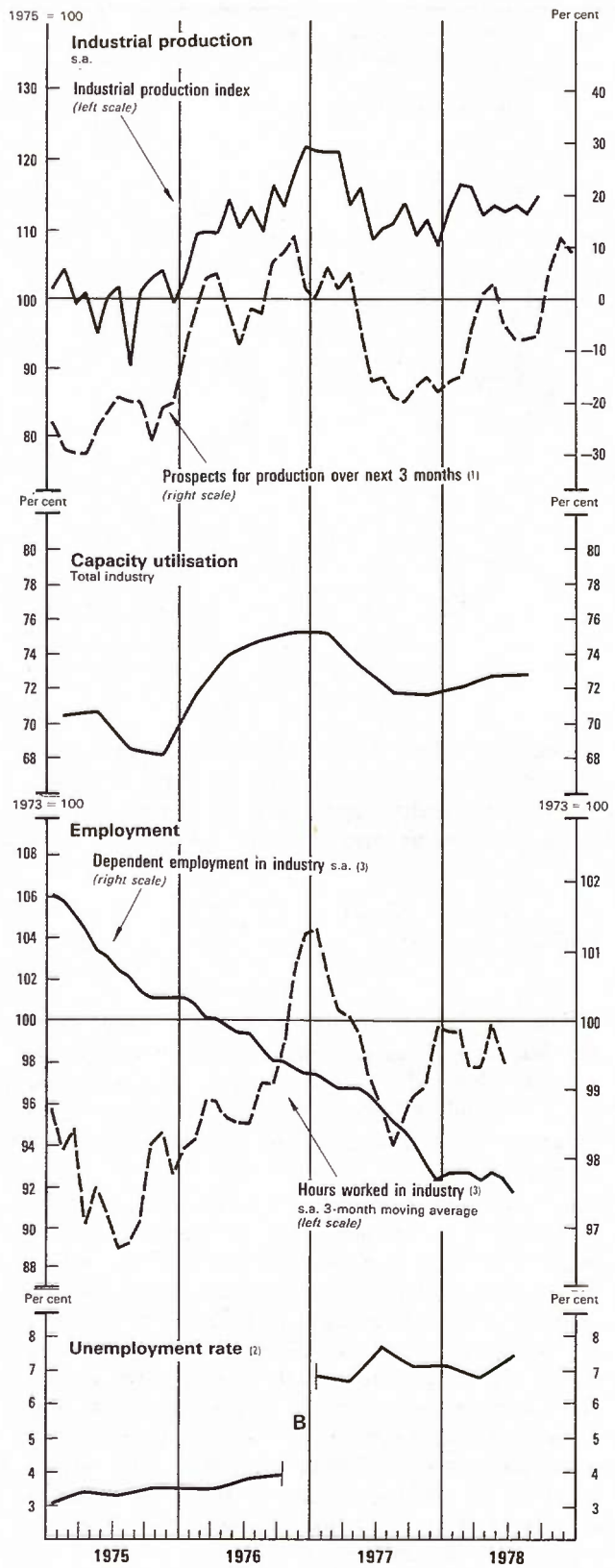
been made in reducing the rate of inflation: wholesale prices rose at an annual rate of close to 9 per cent during the first nine months of the year, and since the middle of 1977 the monthly rise in the cost-of-living index has averaged 1 per cent, the fluctuations in the third quarter of 1978 being largely seasonal. The rise in wage rates in industry over the first three quarters of 1978 also stabilised, at an annual rate of 14 to 15 per cent.

Although changes in the quarterly trade figures have been erratic, largely because of statistical problems[1], it would appear that merchandise import volumes, for the first nine months of 1978, were practically stationary at the level of a year earlier, while exports rose by 5 per cent and the terms of trade improved. The trade balance accordingly improved considerably, showing a surplus (fob-fob) of about $2 billion for the period January-September, compared with a slight deficit a year earlier. The surplus on invisibles also increased, and in all the current balance yielded a surplus of nearly $4 billion. Capital movements were also in surplus, and the Italian authorities were able to accelerate the repayment of foreign debts while increasing the level of reserves. The effective rate of exchange of the lira continued to decline slightly (12½ per cent from end-1976 to early November 1978), but the lira appreciated by some 4 per cent against the dollar over the same period.

1. Various strikes prevented the normal recording of customs figures in the first half of the year. This factor appears to have been corrected, at least in part, in July, but a quarter-by-quarter analysis would be meaningless. A further correction for under-recording might be made, as usual, at the end of the year.

Policies

The very rapid expansion of government transfers has played an appreciable role in maintaining domestic demand. This acceleration affected households through a substantial rise in pensions, but especially firms, whose transfer receipts are expected to rise by over 70 per cent in 1978. There was also more rapid settlement of outstanding public sector debts to suppliers. In all, payments made by the "enlarged" public sector to firms, net of direct taxes and including financial operations, are expected to increase by 6.5 trillion lire in 1978, according to official estimates. At the same time, public sector revenue growth slowed down because of changes in the timetable for collection of direct taxes and the extension of the budgetisation of social security contributions; this was only partially offset by the raising of certain taxes, in particular on the interest on bank accounts, and the prepayment of tax on non-wage income. For the first nine months of the year, the central government budget was in deficit by 20 trillion lire, and for the whole year the authorities expect the total cash



1. Balance between "positive" and "negative" answers.
2. Including first job seekers, as a percentage of present active population.
3. In large enterprises.

deficit of the "enlarged" public sector[2] to be lire 33 trillion, or 16.5 per cent of GDP. Financial operations would, however, appear to account for a large part of this deficit, for in national accounting terms, the general government borrowing requirement is likely to be of the order of 12 per cent of GDP.

In its main outlines, the draft Budget for 1979 conforms to the policy objectives contained in the three-year programme presented to Parliament at the beginning of September. This provided for the stabilisation of the government deficit as a percentage of GDP, and for a restructuring of public expenditure in favour of investment. According to the Italian authorities the programme should make it possible, provided that per capita real wage incomes remain stable, to raise the growth of GDP to 4 per cent annually over the period 1979-1981, and to reduce the growth of the GDP implicit price deflator from 14 per cent in 1979 to 8 per cent in 1981. In 1979, additional public investment, mainly in public works and in the electricity sector, should total lire 2,200 billions[3],

2. Four definitions of the public sector deficit are currently used by the Italian authorities:

a) The general government borrowing requirement on a national accounts basis (central government, social security, local authorities). These accounts are on a cash basis.

b) The cash deficit of the "enlarged" public sector, excluding financial operations (disavanzo). The "enlarged" public sector includes general government plus the "autonomous agencies" (mainly the railways, the monetary agency and the postal service), the hospital authorities, the National Electricity Corporation (ENEL) and the municipal enterprises.

c) The cash deficit of the "enlarged" public sector, —including the traditional financial operations (fabbisogno), i.e. grants to the specialised credit institutions and to enterprises in which the State participates, and the indebtedness of local authorities to the banking system.

d) The total cash deficit of the "enlarged" public sector (fabbisogno complessivo), which also includes the settlement of outstanding debts to suppliers.

According to these various definitions, the official estimates of the deficit as a percentage of GDP for 1978 and 1979 are as follows:

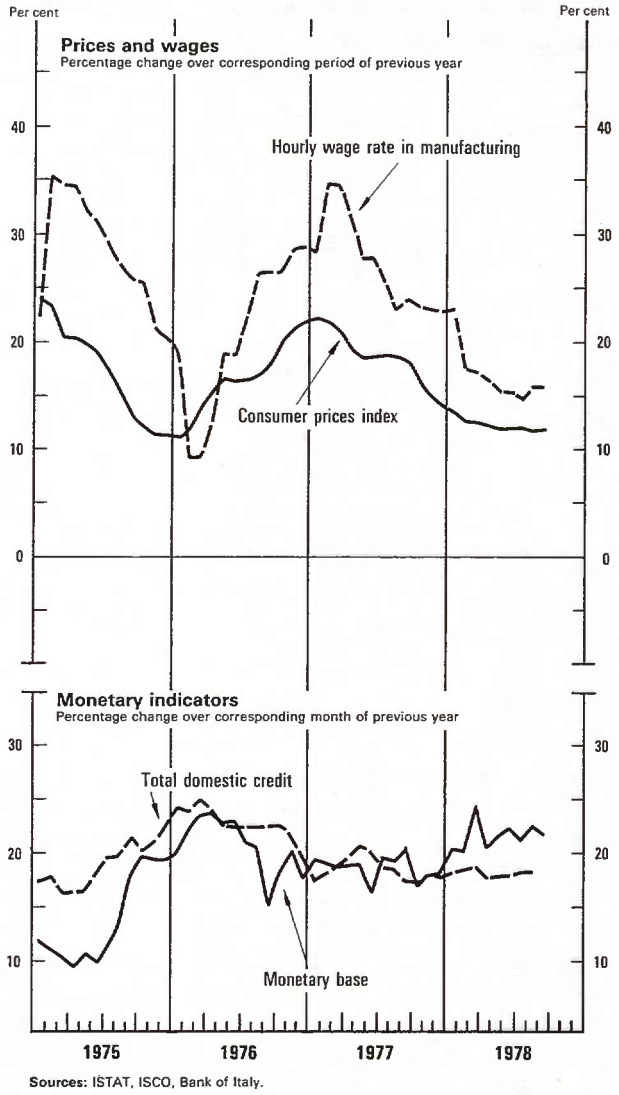
	General Government national accounts basis	"Enlarged" public sector in cash terms		
		Disavanzo	Fabbisogno	Fabbisogno complessivo
1978	11.9	14.1	15.8	16.5
1979 "trend"	14.0	16.7	17.7	18.2
1979 "target"	12.2	14.8	15.8	15.7

3. Of this, lire 650 billion is to be invested under the industrial conversion law, but has not been allocated in detail.

nearly 6 per cent of total investment in 1978. As a counterpart, the increase in transfers is to be checked, by setting a ceiling on pensions and changing their system of indexation[4], and by moderating the growth of expenditure on health services. Measures to prevent tax evasion are to be strengthened, and certain taxes are to be raised. The general government borrowing requirement on a national accounts basis should be reduced to 12.2 per cent of GDP; without any change in policy, the figure would, according to official estimates, have been 14 per cent. The overall deficit of the "enlarged" public sector would be 15.7 per cent of GDP, compared with more than 18 per cent on a continuation of present trends.

Monetary policy has gradually become easier. Money supply (M2) grew somewhat faster during the first half of 1978, and in June was 23 per cent above the level of a year earlier. The main sources of monetary expansion were the large Treasury deficit and an overall surplus on balance of payments account. In September, it was decided to lower the discount rate from 11.5 to 10.5 per cent, a change which repercussed throughout the interest rate structure, and the ratio of banks' investment in securities (including securities of the specialised credit institutions) to new deposits was brought down from 30 per cent to 6.5 per cent. The change of relative interest rates in favour of medium- and long-term rates has led to an increase in the demand for bonds. The arrangements for credit control were continued, with a ceiling of 6 per cent over March 1978 levels until September, and 14 per cent until March 1979. The rise in bank credits remained well within the ceiling until June 1978, as a result of weak investment and stockbuilding and the very rapid expansion in government transfers to enterprises. However, credit to small firms increased more rapidly and in July and August bank credits, as a whole, seem to have recovered appreciably. Lastly, the favourable trend of the balance of payments led the authorities to abolish the regulations governing payment for exports in foreign currency, and to extend the payment period for imports. The objectives of monetary policy for 1979 have not yet been laid down, but in the construction of these forecasts an accommodating policy has been assumed.

4. The estimated net saving is lire 2,400 billion, of which lire 600 to 700 billion will come from higher social security contributions by the self-employed and lire 500 billion from more rapid collection of income.



Sources: ISTAT, ISCO, Bank of Italy.

Prospects

The main uncertainty for 1979 is the outcome of the collective bargaining over the next few months for the renewal of contracts covering approximately two thirds of all wage-earners. If the negotiations do not give rise to important social disturbances, and result in only limited wage increases, the recovery in production and demand, and especially investment, should continue and, indeed, gain momentum in the course of next year. For 1979 as a whole, the rise in GDP may be of the order of 3½ per cent, based largely on the growth of domestic demand. Exports of goods and services are expected to provide a stimulus, but the acceleration of domestic demand growth could lead to a sharp increase in imports and

Balance of payments ITALY

Value, $ million

	1977	1978	1979	1977 II	1978 I	1978 II	1979 I	1979 II
SEASONALLY ADJUSTED								
Exports	44 529	51 750	58 050	22 990	24 751	27 000	28 300	29 750
Imports	44 390	48 750	55 850	22 154	22 895	25 850	27 050	28 850
Trade balance	139	3 000	2 200	836	1 856	1 150	1 250	900
Services and private transfers, net	2 740	3 350	3 800	1 480	1 600	1 750	1 850	1 950
Official transfers, net	–595	–900	–1 200	–300	–400	–500	–550	–650
Current balance	2 284	5 450	4 800	2 016	3 056	2 400	2 550	2 200
UNADJUSTED								
Current balance	2 284			2 972	2 040			
Long-term capital	1 033			..	..			
Short-term capital and unrecorded	–903			..	..			
Balance on non-monetary transactions	2 413			4 421	1 600			
Net transactions of monetary authorities[a]	5 920			3 631	1 500			
Memorandum items (seasonally adjusted)								
Per cent change in volume[b]								
Exports	6.4	5	5	3.4	5.4	5½	5	4½
Imports	–2.4	½	7½	–8.1	–1.1	13	5	7

Note: Detail may not add, due to rounding.
a) Previously "Balance on official settlements".
b) Over previous period at annual rates, customs basis.

hence to no contribution from the change in the foreign balance, in contrast to the large positive contributions in 1977 and 1978. Given the inertia of labour market reactions to cyclical fluctuations in activity, and the importance of short-time working, total employment is likely to increase by no more than 0.5 per cent. Despite the continuing upward trend in the population of working age, the unemployment rate might remain practically unchanged, the adjustment being made through participation rates. On the assumption of moderate wage increases and a comparatively slow rise in import prices, prices as a whole might rise more slowly in 1979. The slowdown is likely to be only moderate, however, because enterpreneurs will probably seek to restore their profit margins in the more favourable business climate. No information is available about the decisions to be taken on public utility charges, but these are likely to increase at least as rapidly as costs, given the policy of reforming public sector finance.

The contractual wage increase to be granted in the collective wage agreements, combined with the increases resulting from the indexation mechanism for all wages, will have to remain limited if the authorities' objective of stability in real wages is to be achieved.[5] The Secretariat has assumed that the rise in hourly wage rates is likely to be some 13½ per cent, so that with some increase in the number of hours worked, the total wage bill is expected to rise by 15 per cent. Given the orientation of budgetary policy and the proposed changes in the indexation of pensions, there should be a marked slowdown in the growth of public transfers, and the most dynamic element in incomes of households is likely to be earnings from property and entrepreneurship. A distinct slowdown in the growth of direct tax payments is likely in 1979 as a result of the anticipated payments made in 1978. This should be roughly offset by an acceleration in the growth of social security contributions, which were affected in 1978 by the budgetisation measures. In all, the rise in households' real disposable income may be slightly slower than in 1978, but this should be more than offset by a fall in the savings ratio due partly to the lower rate of increase of pensions. Further helped by moderating inflation, private consumption could accelerate sharply. It has been assumed that the increase in public consumption, about which almost no information is available, will continue along the lines of recent years.

A pronounced recovery of investment seems likely. The pick-up may be cautious in the first half of 1979, while collective wage agreements are being negotiated, but become faster in the second half-year. The share of investment (at 1970 prices) in GDP, however, may still be some 3.5 percentage points below what it was in 1974. Allow-

5. Approximately 10,000 lire per month and per employee, around 2½ per cent of the average monthly wage in 1978.

ing for administrative delays, it is likely that, as in the past, implementation of the public investment programmes will be below target, at least in the first part of the year. Public investment should, nonetheless, exert a significantly stimulatory effect, after depressing demand over the last two years. The expected improvement in profits and demand prospects should lead to some recovery of productive investment in the private sector. Purchases of machinery and equipment, which have fluctuated widely in the past, might recover rapidly. The movement will probably be slower in construction, in view of the time-lags in this sector and the poor prospects for private residential construction. Stockbuilding is expected to make a positive, though moderate, contribution to growth. The trend of the past 18 months seems to indicate that with the abatement of inflationary expectations, stocks are being managed much more prudently, and qualitative information suggests that the desired stock/output ratio has fallen appreciably.

The effective devaluation of the lira has maintained the competitiveness of Italian exports, despite the rapid rise in domestic prices. But rising domestic demand could lead to some reduction in the growth of exports. It has therefore been assumed that the volume of exports will continue to expand during the forecast period at about the same rate as Italy's export markets. The forecast recovery of investment in machinery and equipment and the rise in stockbuilding (both items with a high import content) should result in a significant rise in imports, both absolutely and in relation to GDP. Allowing for the present prospects for prices on world markets and on the customary technical assumption of unchanged exchange rates, the trend of the terms of trade should remain favourable. The trade balance surplus should narrow in 1979 to about $2¼ billion. Assuming that Italy retains its share of the tourism market, the surplus on current account might be close to $4½ billion.

OTHER OECD COUNTRIES

Summary

In the past few years, most smaller countries have adopted a relatively tight policy stance in order to reduce inflation and correct current account imbalances. By mid-1978, considerable progress had been made in achieving these objectives, although initially with a cost in terms of sluggish domestic demand growth and rising unemployment. A positive stimulus to domestic demand emanating from the external side may bring about some recovery in the forecast period. However, to the extent that there is some pick-up from the extremely poor productivity performance of recent years—which has sometimes been encouraged by employment-supporting policy measures—the forecast expansion is likely to be achieved without much change in employment. Continued weakness in labour markets may further contribute to a slowing down of wage growth. The growth of unit labour costs (and hence of the general price level) is forecast to ease off substantially, to about the same rate as in the seven largest countries. On the external side, the current account deficits of many smaller countries have been reduced substantially in 1978, but no further improvement is forecast for the group in 1979.

Recent trends

The progressive shift of demand from the domestic to the external sector—one of the primary policy objectives of most smaller countries in the past few years—began in early 1977 and continued in the first half of 1978. The composition of demand in the two half-years to mid-1978 was approximately the same, with total domestic demand growing at a mere ½ per cent annual rate, the contribution from the change in the foreign balance amounting to around 1½ percentage points, and GDP increasing at an annual rate of about 2 per cent[1]. As total domestic demand in the seven largest countries grew at only a moderate 3¾ per cent pace during the year to mid-1978, the shift in the real foreign balance of the smaller countries was not the result of strong export growth but predominantly due to a historically rare fall in real import volumes in response to both relative and

1. Comparison of these growth rates with those of 1976, when restrictive policies were first put in place in most smaller countries, highlights the magnitude of this shift: real GDP increased by 3 per cent in 1976, with total domestic demand growing by 3¼ per cent and the foreign balance making a negative contribution of ¼ a percentage point.

OTHER OECD COUNTRIES[a]
Demand, output and prices

	Percentage changes in volume terms		
	1977 / 1976	1978 / 1977	1979 / 1978
Private consumption	2.0	1½	2¼
Government consumption	3.5	3¼	3
Gross fixed investment	1.6	0	2½
Final domestic demand	2.1	1½	2½
*plus change in stockbuilding	–0.6	–¼	½
Total domestic demand	1.5	1	2¾
*plus change in foreign balance	0.3	1¼	0
GDP at constant prices	1.8	2¼	3
GDP price deflator	10.1	9	6¾
Memorandum item			
Consumer prices	11.3	8¾	6¼
Industrial production[b]	1.1	1½	3¾

* As a percentage of GDP in the previous period.
a) Australia, New Zealand, Austria, Belgium, Denmark, Finland, Greece, Ireland, Netherlands, Norway, Spain, Sweden and Switzerland. 1977 GNP/GDP weights and exchange rates.
b) Excluding Denmark and New Zealand.

OTHER OECD COUNTRIES
Current balances
$ billion

	1977	1978	1979
Total other OECD countries	–22.5	–11½	–11¼
Excluding: Benelux and Switzerland	–25.4	–14¼	–15
Memorandum items			
Belgium-Luxembourg	–0.7	–¼	0
Netherlands	0.2	–1½	–1¼
Switzerland	3.4	4½	5
Total OECD	–27.6	–¾	–1¼

Current balances
As per cent of GDP/GNP

	1977	1978	1979
Iceland	0.0	..	..
Finland	–0.7	1	¾
Ireland	–2.1	–2½	–2¾
Spain	–2.2	¾	½
Australia	–2.7	–3½	–3½
Denmark	–3.5	–2¼	–1½
Sweden	–4.3	–1½	–1½
Greece	–5.2	–5½	–5
Austria	–6.3	–2½	–3¼
New Zealand	–6.5	–4¾	–6¼
Turkey	–7.4	..	..
Portugal	–8.8	..	..
Norway	–14.0	–5	–5
Average of above[a]	–4.9	–2½	–2¾
Switzerland	5.4	5¼	5
Netherlands	0.2	–1¼	–¾
Belgium-Luxembourg	–0.9	–¼	0
Average of above[a]	1.6	1¼	1½

a) Detail may not add due to rounding.

absolute weakness of demand[2]. Of the 13 smaller countries for which the Secretariat prepares forecasts, all but three experienced a growth of total domestic demand in the first half of 1978 below the average of the seven largest countries[3], and seven smaller countries experienced a growth of domestic demand of 1 per cent or less.

Demand in the smaller countries probably picked up somewhat in the second half of 1978, because of multiplier effects from the exogenous export stimulus and the generally more favourable outlook resulting from the recent measures in major countries. However, the generally restrictive policy stance has apparently exerted a dampening influence on activity. For the year as a whole, the growth of all major components of domestic demand appears to have decelerated: growth of public and private consumption in 1978 may turn out to have been ¼ and ½ per cent slower, respectively, than in 1977, and fixed investment, influenced by tight monetary policy and the weak prospects for demand both at home and abroad, stagnated, compared with the 1½ per cent rise in the previous year. Inventories in 1978 were generally in line with sales, so that changes in stockbuilding seem likely to have had only a slight influence—of perhaps - ¼ percentage point—on domestic demand growth[4].

In contrast to the sluggishness of domestic demand growth, developments in the external sector were extremely favourable. On a national accounts basis, real imports of goods and services by the smaller countries rose by only 1½ per cent in 1978, whereas exports grew by nearly 6 per cent[5]. The contribution of the change in the foreign balance to GDP growth was about 1¼ percentage points, slightly more than half the growth rate of GDP. Three factors were responsible for this outcome. First, the differential in the growth rate of domestic demand between the larger and smaller countries was exceptionally wide. Second, reflecting this, the import elasticity of the larger countries was significantly higher than that of the smaller[6]. Third, restrictive fiscal policies have often been aimed at curbing import-intensive components of private consumption. In additional, several smaller countries have used incomes policies to regain cost/

2. Total merchandise imports in real terms fell in each of the three half-years from the beginning of 1977. The only other period of falling import volumes since 1960 was in the two half-years of 1975.

3. The three exceptions were Australia, Ireland and Greece. In the latter two countries, maintenance of an expansionary policy stance in recent years has resulted in the fastest growth of domestic demand among OECD countries.

4. The exceptions were New Zealand, Ireland, Sweden and Norway, where the negative contribution from stockbuilding ranged from ¼ to 1¼ percentage points.

5. Note, however, that import volume growth picked up to 4-4½ per cent in the second half of 1978, whereas export volume growth slowed down to much the same rate.

6. The seven largest countries' import elasticity with respect to total domestic demand in 1978 was about 1¾, compared with 1¼ for the smaller countries: typical values in the past have been around 1¾-2 and 1½-1¾ for the two country groups respectively.

Forecast adjustment of current balances in 1978
Changes from 1977 to 1978, $ billion

	Change in current balance					*Memorandum item:* Percentage change 1977 to 1978 Effective exchange rate[a]
	Total	*of which:*				
		Trade	*of which* due to		Invisibles	
			Volume	Price		
Australia	–1	–½	0	–½	–½	–9½
New Zealand	0	¼	¼	0	–¼	–3½
Austria	1½	1	¾	¼	¾	–¼
Denmark	½	½	¼	¼	0	0
Finland	½	½	¾	–¼	0	–10½
Ireland	0	–¼	0	–¼	0	–¼
Norway	3	3½	3¾	–¼	–½	–6¾
Sweden	2¼	2½	3¼	–¾	–½	–10¼
Greece	–¼	–½	–½	–¼	¼	–9¾
Portugal	¼	0	0	0	¼	–21
Spain	3	2	2	0	1	–11
Turkey	1½	1½	1½	0	¼	–34¼
Total of above countries	11	10	12	–2	1	..
Belgium-Luxembourg	½	½	½	0	0	1¾
Netherlands	–1¾	–1¼	–1¼	0	–½	1
Switzerland	1¼	½	–½	1	½	23
Seven Major Countries	16	17	–4	21	–1	..
Total OECD	27	27	6½	20½	0	..

Note: Detail may not add due to rounding.
a) Assuming unchanged nominal exchange rates from 6th-8th November.

price competitiveness, and in some countries, past devaluations have favourably affected real trade flows.

The low 2¼ per cent growth of GDP in the smaller countries in 1978, coming at a time of already extensive underutilisation of existing employees, resulted in a further weakening of labour markets. Employment in about half of the smaller countries stagnated or fell and unemployment rose in virtually all countries, in some cases reaching record high rates (Table 7)[7]. Total unemployment in the smaller countries, excluding Turkey and Portugal, was over 2½ million (5½ per cent of the labour force) in mid-1978 compared with less than 2¼ million a year earlier.

Substantial progress has been made in bringing nominal wage increases in the smaller countries down towards the average of the larger countries. This moderation in wage increases, in combination with improvements in the terms of trade of a few of them—particularly Switzerland and countries attached to the EEC snake—was a key factor explaining a shift towards non-wage income.

7. The exceptions were Switzerland, where net emigration has prevented a rise in recorded unemployment, and Ireland where growth has been very rapid. The absence of comprehensive labour market statistics in Greece makes it impossible to establish whether the strong growth of internal demand was sufficient to absorb the return of Greek workers from Northern Europe.

AUSTRALIA
Demand, output and prices
Percentage changes, volume (1974-75 prices)

	1977 current prices million Aus. $	1977	1978	1979
Private consumption	50 749	1.9	3¼	2¾
Government consumption	14 109	3.6	6¾	2½
Gross fixed capital formation	20 720	–0.8	2	1½
Final domestic demand	85 578	1.5	3½	2½
*plus change in stockbuilding	591[a]	–0.5	–¼	¾
*plus change in foreign balance	–389[a]	0.1	–¾	–¼
GDP at market prices[b]	85 780	2.1	2½	2¾
GDP implicit price deflator	—	9.1	7¾	6½
Memorandum items				
Consumer prices[c]	—	12.3	7½	5¾
Industrial production	—	–1.7	1½	2½
Stockbuilding (actual rate, 1974-75 prices, million Aus. $)	—	260	157	600

* As a percentage of GDP in the previous period.
a) Actual rate of stockbuilding and foreign balance.
b) Includes statistical discrepancy not included in the components. For forecasting purposes, the statistical discrepancy is assumed to remain at its 1977 value throughout the forecasting period.
c) Consumer price index.

NEW ZEALAND
Demand, output and prices
Percentage changes, volume (1977 prices)

	1977[a] current prices million NZ $	1977	1978	1979
Private consumption	8 180	–5.7	1½	4½
Government consumption	2 645	3.0	5	2
Gross fixed capital formation	3 283	–6.0	–2½	¾
Final domestic demand	14 108	–4.2	1¼	3¼
*plus change in stockbuilding	497[b]	1.0	–½	1
*plus change in foreign balance	–497[b]	1.5	¼	–2
GDP at market prices	14 108	–1.8	¾	2¼
GDP implicit price deflator	—	13.5	13	10½
Memorandum items				
Consumer prices[c]	—	14.4	11½	10
Industrial production	—	..	..	..
Stockbuilding (actual rate, 1977 prices, million NZ $)	—	497	430	540

* As a percentage of GDP in the previous period.
a) The values shown in current prices for 1977 refer to the 1977/78 financial year. The growth rates are for calendar years.
b) Actual rate of stockbuilding and foreign balance.
c) Consumer price index.

AUSTRIA
Demand, output and prices
Percentage changes, volume (1964 prices)

	1977 current prices billion schillings	1977	1978	1979
Private consumption	461.9	6.9	−1¾	3½
Government consumption	127.8	2.0	2	2
Gross fixed capital formation	213.8	8.2	−1	4½
Final domestic demand	803.5	6.7	−1	3½
*plus change in stockbuilding	13.6[a]	−1.6	−½	0
*plus change in foreign balance	−26.6[a]	−1.5	3¼	−1
GNP at market prices	790.5	3.5	1½	2¾
GNP implicit price deflator	—	4.9	5	4
Memorandum items				
Consumer prices[b]	—	5.5	4¼	3
Industrial production	—	3.6	2½	4¼
Stockbuilding (actual rate, 1964 prices, billion sch.)	—	7.3	5.0	5.3

* As a percentage of GNP in the previous period.
a) Actual rate of stockbuilding and foreign balance.
b) National accounts implicit private consumption deflator.

FINLAND
Demand, output and prices
Percentage changes, volume (1975 prices)

	1977 current prices billion Mk	1977	1978	1979
Private consumption	62.1	−2.2	1	2
Government consumption	24.7	4.8	4½	3½
Gross fixed capital formation	32.5	−4.7	−2½	2¾
Final domestic demand	119.3	−1.5	¾	2½
*plus change in stockbuilding[a]	0.5[b]	−2.6	−¼	½
*plus change in foreign balance	1.7[b]	4.6	2½	½
GDP at market prices	121.5	0.5	3	3½
GDP implicit price deflator	—	10.0	6¼	7
Memorandum items				
Consumer prices[c]	—	12.6	7¾	7¾
Industrial production	—	1.0	3	5
Stockbuilding (actual rate, 1975 prices, billion Mk)[a]	—	1.4	1.1	1.6

* As a percentage of GDP in the previous period.
a) Including statistical discrepancy.
b) Actual rate of stockbuilding (including statistical discrepancy) and foreign balance.
c) Consumer price index.

BELGIUM
Demand, output and prices
Percentage changes, volume (1970 prices)

	1977 current prices billion BF	1977	1978	1979
Private consumption	1 760.9	2.1	2	2½
Government consumption	490.5	3.4	3¾	4
Gross fixed capital formation	602.8	−0.7	2	2
Final domestic demand	2 854.2	1.7	2¼	2½
*plus change in stockbuilding	7.6[a]	−0.1	0	0
*plus change in foreign balance	15.2[a]	−0.4	0	½
GNP at market prices	2 877.0	1.2	2¼	3½
GNP implicit price deflator	—	6.8	4¾	4½
Memorandum items				
Consumer prices[b]	—	7.1	4½	4
Industrial production	—	0.3	1½	4
Stockbuilding (actual rate, 1970 prices, billion BF)	—	7.1	7.1	9.0

* As a percentage of GNP in the previous period.
a) Actual rate of stockbuilding and foreign balance.
b) Consumer price index.

DENMARK
Demand, output and prices
Percentage changes, volume (1970 prices)

	1977 current prices billion D. Kr.	1977	1978	1979
Private consumption	155.2	0.9	−1	1½
Government consumption	66.4	2.8	2	2¾
Gross fixed capital formation	64.4	−1.8	1¼	2½
Final domestic demand	286.1	0.7	¼	2
*plus change in stockbuilding	0.5[a]	−0.4	0	0
*plus change in foreign balance	−10.3[a]	1.5	¾	½
GDP at market prices	276.2	1.8	1	2½
GDP implicit price deflator	—	9.0	8½	6
Memorandum items				
Consumer prices[b]	—	11.1	9¾	5¾
Industrial production	—	..	..	..
Stockbuilding (actual rate, 1970 prices, billion D. Kr.)	—	0.2	0.2	0.4

* As a percentage of GDP in the previous period.
a) Actual rate of stockbuilding and foreign balance.
b) Consumer price index, including indirect taxes and subsidies.

Reduced cost pressures enabled firms to raise profit margins while at the same time moderating the rate of output price increase. From 1977 to 1978, the growth of the deflators for GDP and private consumption decelerated by about 1 and 3 percentage points respectively. However, both were still rising about 2 points faster than in the seven largest countries (Table 45).

With inflation rates falling towards those of the larger countries, and with significant differentials between growth rates, considerable progress was made in 1978 in reducing the large current account deficits of most smaller countries. Excluding Switzerland and the Benelux countries, the smaller countries' deficit in 1978 was about $14 billion, slightly more than half that of 1977. This favourable outcome was entirely due to the volume flows —imports stagnated while exports grew moderately. Indeed, for some of these countries, there was a further deterioration in the terms of trade, which, by itself, would have accentuated their current account deficit positions. This contrasts vividly with the current account improvement in the larger countries, where the bulk of the gain was through the favourable impact of terms of trade gains in appreciating countries. Current account deficits, as a percentage of GDP, were reduced substantially in most smaller countries; the combined current account swing of Austria, Finland, Norway, Spain and Sweden may have amounted to $10 billion, around 40 per cent of the swing for the OECD area as a whole. The only deficit countries that did not participate in the general improvement were Ireland and Greece, where domestic demand was very buoyant, and the Netherlands and Australia, where an unfavourable commodity composition of

GREECE
Demand, output and prices
Percentage changes, volume (1970 prices)

	1977 current prices billion Dr.	1977	1978	1979
Private consumption	645.7	4.8	4¾	3¼
Government consumption	152.0	5.5	2½	2½
Gross fixed capital formation[a]	223.0	8.2	6	5½
Final domestic demand	1 020.7	5.5	4¾	3½
*plus change in stockbuilding	18.7[b]	–0.2	¼	0
*plus change in foreign balance	–117.0[b]	–1.2	–¼	–¼
*plus error of estimate	0[b]	–0.6	¼	0
GDP at market prices[a]	922.4	3.7	5¼	3½
GDP at factor cost	832.8	3.2	5¼	3¼
GDP implicit price deflator	—	12.9	13¼	11
Memorandum items				
Consumer prices[c]	—	12.1	12½	11
Manufacturing production	—	2.0	5	3½
Stockbuilding (actual rate, 1970 prices, billion Dr.)	—	8.8	10.8	11.2

* As a percentage of GDP in the previous period.
a) Excluding ships operating overseas.
b) Actual rate of stockbuilding, foreign balance and error of estimate.
c) Consumer price index.

IRELAND
Demand, output and prices
Percentage changes, volume (1977 prices)

	1977 current prices million £	1977	1978	1979
Private consumption	3 493	5.4	8	3
Government consumption	988	1.7	5	2½
Gross fixed capital formation	1 327	8.3	11	7
Final domestic demand	5 808	5.4	8¼	3¾
*plus change in stockbuilding	42[a]	1.1	–¾	¾
*plus change in foreign balance	–470[a]	–1.4	–1½	–1
GDP at market prices	5 380	5.5	6½	4
GDP implicit price deflator	—	13.5	9¾	10½
Memorandum items				
Consumer prices[b]	—	13.6	8	9
Industrial production	—	8.2	9	7
Stockbuilding (actual rate, 1977 prices, million £)	—	42.0	5.0	50.0

* As a percentage of GDP in the previous period.
a) Actual rate of stockbuilding and foreign balance.
b) Consumer price index.

exports (and falling gas exports in the case of the Netherlands) pushed up deficits.

Policies and prospects

To consolidate recent gains on the inflation and balance of payments fronts, virtually all smaller countries in 1979 are expected to maintain, and in some cases to reinforce, their restrictive policy stance[8]. Even Ireland and Greece, countries that had pursued expansionary policies in the past few years, have announced shifts towards a less stimulatory stance, reflecting concern over the size of public sector deficits in the former country and inflationary pressures in the latter. Within the context of a tight fiscal policy, a number of countries (Austria, the Netherlands, Finland and Spain) have taken selective measures to increase the profitability of private investment essentially because, given existing excess capacity and the moderate growth of demand, special incentives are required to achieve a recovery of investment and to shift the requisite resources from consumption. In addition to the restrictive policy stance, several countries are attempting to lower the rate of inflation by instituting or reinforcing incomes policies.

As the severest part of the adjustment from domestic to external demand appears to have taken place in most smaller countries, and as indicators of activity improved during the second half of 1978,

8. Only New Zealand, which has experienced the sharpest decline in domestic demand in the OECD area (final domestic demand in 1978 was about 3 per cent lower than in 1976) and to a lesser extent Sweden and Finland, have shifted policy to an expansionary stance.

NETHERLANDS
Demand, output and prices
Percentage changes, volume (1975 prices)

	1977 current prices billion glds	1977	1978	1979
Private consumption	152.4	4.3	3¾	2¼
Government consumption	47.8	3.6	1	3
Gross fixed capital formation	56.4	10.8	3¾	2
Final domestic demand	256.6	5.5	3¼	2¼
*plus change in stockbuilding	3.9[a]	0.1	–½	0
*plus change in foreign balance	1.9[a]	–3.0	–1	¾
GDP at market prices	262.4	2.3	2	3
GDP implicit price deflator	—	7.2	5¼	4¼
Memorandum items				
Consumer prices[b]	—	6.8	4¼	4
Industrial production	—	–0.1	¾	4
Stockbuilding (actual rate, 1975 prices, billion glds)	—	3.7	2.7	2.8

* As a percentage of GDP in the previous period.
a) Actual rate of stockbuilding and foreign balance.
b) National accounts implicit private consumption deflator.

NORWAY
Demand, output and prices
Percentage changes, volume (1977 prices)

	1977 current prices billion N. Kr.	1977	1978	1979
Private consumption	106.4	4.6	–1½	¾
Government consumption	35.5	10.2	4½	1¾
Gross fixed capital formation	69.3	1.3	–13¼	–6
Final domestic demand	211.1	4.4	–4½	–1¼
*plus change in stockbuilding	–1.5[a]	–2.4	–2	1½
*plus change in foreign balance	–20.2[a]	1.7	10½	2½
GDP at market prices[b]	189.5	4.1	3¾	2½
GDP implicit price deflator	—	7.4	7	4
Memorandum items				
Consumer prices[c]	—	9.1	8	4
Industrial production[d]	—	0	–1¾	–1
Stockbuilding (actual rate, 1977 prices, billion N. Kr.)	—	–1.5	–5.0	–2.0

* As a percentage of GDP in the previous period.
a) Actual rate of stockbuilding and foreign balance.
b) GDP excluding oil and shipping: 1977: 3.5; 1978: 1; 1979: 1¼.
c) Consumer price index.
d) Excluding oil sector.

SPAIN
Demand, output and prices
Percentage changes, volume (1970 prices)

	1977 current prices billion pesetas	1977	1978	1979
Private consumption	6 063	0	1½	2¼
Government consumption	906	4.5	4	4
Gross fixed capital formation	1 885	–1.0	–3½	4
Final domestic demand	8 853	0.2	½	2¾
*plus change in stockbuilding	115[a]	–0.2	–¼	¼
*plus change in foreign balance	–185[a]	2.4	2½	½
GDP at market prices	8 783	2.4	3	3½
GDP implicit price deflator	—	22.5	20½	13½
Memorandum items				
Consumer prices[b]	—	24.5	19¾	13
Industrial production	—	4.0	2½	5
Stockbuilding (actual rate, 1970 prices, billion pesetas)	—	43	34	45

* As a percentage of GDP in the previous period.
a) Actual rate of stockbuilding and foreign balance.
b) Consumer price index.

SWEDEN
Demand, output and prices
Percentage changes, volume (1975 prices)

	1977 current prices billion S. Kr.	1977	1978	1979
Private consumption	189.3	–0.9	–1¼	2
Government consumption	100.9	2.7	2¾	3¼
Gross fixed capital formation	71.4	–3.4	–2½	3¼
Final domestic demand	361.6	–0.5	–½	2½
*plus change in stockbuilding	–1.3[a]	–3.1	–1	¾
*plus change in foreign balance	–8.8[a]	1.1	3½	0
GDP at market prices	351.5	–2.5	2¼	3½
GDP implicit price deflator	—	11.5	8½	7¼
Memorandum items				
Consumer prices[b]	—	11.4	10¼	6
Industrial production	—	–3.0	–¾	6
Stockbuilding (actual rate, 1975 prices, billion S. Kr.)	—	–1.4	–3.8	–1.4

* As a percentage of GDP in the previous period.
a) Actual rate of stockbuilding and foreign balance.
b) Consumer price index.

SWITZERLAND
Demand, output and prices
Percentage changes, volume (1970 prices)

	1977 current prices billion SF	1977	1978	1979
Private consumption	92.5	2.8	2	1¾
Government consumption	19.0	–0.2	1½	1
Gross fixed capital formation	30.2	1.5	1	1¾
Final domestic demand	141.7	2.2	1¾	1½
*plus change in stockbuilding	0.1[a]	–0.1	½	0
*plus change in foreign balance	9.9[a]	0.7	–1	–1
GNP at market prices	151.7	2.7	1	½
GNP implicit price deflator	—	0.5	3½	2
Memorandum items				
Consumer prices[b]	—	1.3	1¼	1½
Industrial production	—	5.7	1½	1
Stockbuilding (actual rate, 1970 prices, billion SF)	—	0.1	0.6	0.7

* As a percentage of GNP in the previous period.
a) Actual rate of stockbuilding and foreign balance.
b) Consumer price index.

growth of total domestic demand may be somewhat faster in 1979; however, given the restrictive policy stance, the rate is still likely to be quite modest. Private and public consumption may grow by around 2¼ and 3 per cent respectively; the former component may accelerate slightly from the 1978 rate as activity picks up and employment stabilises, but the growth of the latter component may slow down a little as governments move towards a more restrictive policy stance, in part through cutbacks in public expenditures. Investment growth, stimulated by special measures and a recovery of foreign and domestic demand, may pick up to a 2½ per cent rate instead of the zero figure of 1978. All in all, final domestic demand may grow by 2½ per cent in 1979 compared with 1½ per cent in 1978. With a not very buoyant development in sight, firms would seem likely to maintain cautious inventory policies. Consequently, the contribution from stockbuilding may generally be small. However, in the four countries with sizeable negative contributions this year, some rebuilding of inventories (or reduced destocking in the case of Norway and Sweden) may result in significant positive contributions[9]. Total domestic demand may therefore rise by 2¾ per cent, 1¾ percentage points faster than in 1978.

Real GDP of the smaller countries combined may grow at about a 3 per cent rate in 1979, ¾ of a point faster than in 1978, with most countries experiencing an acceleration. While the recovery of activity may be sufficient to arrest the trend of declining employment, it is unlikely to prevent a further rise in unemployment. In the second half of 1979, unemployment in the smaller countries for which forecasts are prepared, may be around 2¾ million, compared with 2½ million in mid-1978.

The outlook points to some further reduction in inflation. Helped by rising unemployment, the rate of nominal wage gains is forecast to fall in all smaller countries except Switzerland (where inflation is virtually non-existent). And the growth of unit labour costs should be slowed by a further deceleration in nominal wage increases. Aided by incomes policies in some countries, consumption and GDP deflators may, for the first time since the oil crisis, grow at about the same rate as in the seven largest countries, 6½ to 7 per cent respectively[10].

9. Sweden, Ireland and New Zealand may have positive contributions of about ¾-1 percentage points; Norway is forecast to have a 1½ percentage point contribution from stockbuilding.

10. However, for a number of smaller countries with close trading links with Germany and Japan, further substantial progress is required to reduce inflation differentials with their most important trading partners.

The trade balance of the smaller deficit countries is likely to remain at about the same level in 1979 as in 1978, even though export volume growth (around 6 per cent), is forecast again to exceed that of imports (4½ per cent) and terms of trade effects are expected to be broadly neutral. The marginal deterioration in the current account balance reflects the size of the initial excess of imports over exports, and an expected $¾ billion deterioration of the invisibles account[11]. For most smaller countries, the current balance as a percentage of GDP is likely to be close to that recorded in 1978. The main exception is New Zealand, where pursuit of expansionary policies in 1979 may result in some deterioration of the current balance.

11. With neutral terms of trade effects, and a forecast $¾ billion deterioration in invisibles, export volumes of merchandise trade in 1979 would need to grow about 3 percentage points faster than imports to achieve a $1 billion improvement on current account.

TECHNICAL ANNEX

Detailed Supporting Tables

DEMAND AND OUTPUT

Table 38. **UNITED STATES**
Appropriation account for households

	1977 billion $	Percentage changes over previous year 1978	1979
Compensation of employees	1 153.4	12¾	11
Income from property and others	307.2	11	10
Current transfers received	208.8	8½	11
Less: interest on consumer debt	28.6	17½	23
Total income	1 640.8	12	10½
Less: direct taxes	366.4	14	11¾
Current transfers paid	1.0	—	—
Disposable income	1 273.4	11¼	10¼
Consumers' expenditure	1 206.5	10¾	9½
Savings ratio (as per cent of disposable income)	5.3	5¾	6½

Table 39. **JAPAN**
Appropriation account for households

	1977 trillion yen	Percentage changes over previous year 1978	1979
Compensation of employees	100.87	9¼	9
Income from property and others	42.28	8	8¼
Current transfers received	28.30	16	13
Total income	171.44	10	9½
Less: direct taxes	9.19	10	13
Current transfers paid	25.56	14½	13
Disposable income	136.69	9¼	8½
Consumers' expenditure	106.05	9	9
Savings ratio (as per cent of disposable income)	22.4	22¾	22½

Table 40. **GERMANY**
Appropriation account for households

	1977 billion DM	Percentage changes over previous year 1978	1979
Compensation of employees	670.9	5¼	6¾
Income from property and others[a]	250.4	5½	6
Current transfers received[b]	210.3	6	6½
Less: interest on consumer debt	7.7	9¾	6
Total income	1 123.8	5½	6½
Less: direct taxes	329.4	3¾	4¾
Current transfers paid[c]	30.1	5	5¾
Disposable income	764.3	6¼	7¼
Consumers' expenditure	668.6	6	7
Savings ratio (as per cent of disposable income)	12.5	12¾	13

a) Excluding retained earnings of unincorporated business.
b) Public and private.
c) Mainly transfers of foreign workers to the rest of the world and insurance premiums paid.

Table 41. **FRANCE**
Appropriation account for households

	1977 billion francs	Percentage changes over previous year 1978	1979
Compensation of employees	1 018.6	13	13½
Income from property and others	517.0	13	12½
Current transfers received	416.3	17½	16½
Total income	1 951.9	14	14
Less: direct taxes	475.5	15	15½
Current transfers paid	83.5	16	16½
Disposable income	1 392.9	13½	13
Consumers' expenditure	1 154.9	13¼	13
Savings ratio (as per cent of disposable income)	17.1	17¼	17¼

Table 42. **UNITED KINGDOM**
Appropriation account for households

	1977 billion £	Percentage changes over previous year 1978	1979
Compensation of employees	85.8	12¾	11¼
Income from property and others	24.2	11½	10¾
Current transfers received	15.1	18¼	17
Total income	125.1	13¼	12
Less: direct taxes	27.7	8½	14
Current transfers paid	0.1	—	—
Disposable income	97.3	14½	11½
Consumers' expenditure	83.5	14¼	11¾
Savings ratio (as per cent of disposable income)	14.2	14¼	14

Table 43. **CANADA**
Appropriation account for households

	1977 billion Can. $	Percentage changes over previous year 1978	1979
Compensation of employees	121.6	9	10¼
Income from property and others	27.5	13¾	11½
Transfers received	23.2	13¼	12
Total income	172.4	10¼	10¾
Less: direct taxes	31.3	6½	9¼
Other transfers paid	3.8	13½	7¾
Disposable income	137.2	11	11
Consumers' expenditure	122.3	11½	11
Savings ratio (as per cent of disposable income)	10.9	10½	10½

Table 44. **ITALY**
Appropriation account for households

	1977 billion lire	Percentage changes over previous year 1978	1979
Compensation of employees	98 575	14½	15
Income from property and others	54 730	16	16½
Current transfers received	36 770	21	11¾
Total income	190 075	16	14¾
Less: direct taxes	42 840	16½	16¾
Current transfers paid	—	—	—
Disposable income	147 235	16	14½
Consumers' expenditure	109 967	15	15½
Savings ratio (as per cent of disposable income	25.3	26	25

COSTS AND PRICES

Table 45
Comparison of consumer prices and GNP/GDP deflators[a]
Percentage changes.

	Average 1965-66 to 1975-76		From previous year: 1977		1978		1979	
	Consumer price index	GNP/GDP deflator	Consumer price index	GNP/GDP deflator	Consumer price index	GNP/GDP deflator	Consumer price index	GNP/GDP deflator
United States[b]	5.2	5.6	5.7	5.9	7	7½	7	7¼
Japan[b]	8.2	7.4	6.4	5.5	4	4	4	4¼
Germany[b]	4.4	5.1	3.8	3.6	2¾	3¾	2¾	3½
France	6.9	6.8	9.5	8.7	9½	9¾	9¼	9½
United Kingdom[b]	9.1	9.5	14.7	13.3	8	11½	8¾	10
Canada[b]	5.5	6.6	7.5	6.9	8	6¾	7¼	7
Italy	8.5	8.4	17.0	18.3	12	13½	10¾	12¾
Seven major countries	6.2	6.4	7.1	6.9	6½	7	6½	7
Austria[b]	5.2	5.6	5.5	4.9	4¼	5	3	4
Belgium	5.8	6.3	7.1	6.8	4½	4¾	4	4½
Denmark	7.3	8.0	11.1	9.0	9¾	8½	5¾	6
Finland	8.3	9.4	12.6	10.0	7¾	6¼	7¾	7
Greece	7.5	7.9	12.1	12.9	12½	13¾	11	11
Ireland	10.1	10.6	13.6	13.5	8	9¾	9	10½
Netherlands[b]	6.9	7.2	6.8	7.2	4¼	5¼	4	4½
Norway	6.8	6.8	9.1	7.4	8	7	4	4
Spain	8.6	8.4	24.5	22.5	19¾	20½	13	13½
Sweden	6.2	6.6	11.4	11.5	10¼	8½	6	7¼
Switzerland	5.7	5.9	1.3	0.5	1¼	3½	1½	2
Total smaller european countries	6.9	7.2	11.0	10.2	8¾	9	6¼	6¾
Australia	7.8	8.5	12.3	9.1	7½	7¾	5¾	6½
New Zealand	8.5	8.4	14.4	13.5	11½	13	10	10½
Total other OECD countries	7.0	7.4	11.3	10.1	8¾	9	6¼	6¾
Total OECD	6.3	6.5	7.7	7.4	6¾	7¼	6½	7
OECD Europe	6.7	7.0	9.9	9.4	7½	8½	6¾	7½
EEC	6.6	6.9	9.2	8.8	6¾	8	6½	7¼

a) 1977 GNP/GDP weights and exchange rates.
b) National accounts implicit private consumption deflator instead of consumer price index.

FOREIGN TRADE

Table 46
Exchange rates of OECD countries
Spot rates in terms of units of national currency per US $

	1977	1978	1979[a]	1977 I	1977 II	1978 I	1978[a] II	1979[a] I	Average exchange rate 6-8 November 1978
United States	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000
Canada	1.0634	1.1397	1.1701	1.0411	1.0856	1.1199	1.1594	1.1701	1.1701
Japan	268.4762	209.6460	188.9700	280.3194	256.6331	229.2176	190.0745	188.9700	188.9700
France	4.9135	4.5052	4.3017	4.9646	4.8624	4.6809	4.3294	4.3017	4.3017
Germany	2.3222	2.0087	1.8924	2.3788	2.2657	2.0760	1.9413	1.8924	1.8924
Italy	892.3507	848.0948	839.5333	884.3447	880.3567	862.1685	834.0211	839.5333	839.5333
United Kingdom	0.5732	0.5213	0.5064	0.5826	0.5639	0.5316	0.5109	0.5064	0.5064
Belgium-Luxembourg	35.8426	31.4582	29.6541	36.4672	35.2181	32.3632	30.5532	29.6541	29.6541
Netherlands	2.4547	2.1631	2.0433	2.4859	2.4236	2.2235	2.1028	2.0433	2.0433
Ireland	0.5732	0.5213	0.5064	0.5826	0.5639	0.5316	0.5109	0.5064	0.5064
Denmark	6.0011	5.5069	5.2253	5.9496	6.0526	5.6636	5.3503	5.2253	5.2253
Norway	5.3216	5.2321	5.0215	5.2742	5.3690	5.3258	5.1384	5.0215	5.0215
Sweden	4.4806	4.5103	4.3388	4.2965	5.6648	4.6273	4.3933	4.3388	4.3388
Finland	4.0206	4.1019	3.9782	3.9349	4.1063	4.1611	4.0428	3.9782	3.9782
Iceland	198.7874	270.2153	312.7800	192.0252	205.5497	247.3670	293.0635	312.7800	312.7800
Austria	16.5239	14.5327	13.8700	16.9057	16.1422	14.9482	14.1172	13.8700	13.8700
Switzerland	2.4036	1.7817	1.6352	2.5158	2.2914	1.9227	1.6406	1.6352	1.6352
Spain	76.0116	76.7020	71.1216	68.9310	83.0922	80.3637	73.0403	71.1216	71.1216
Portugal	38.2331	43.8446	45.9500	36.5917	39.8745	42.2240	45.4652	45.9500	45.9500
Greece	36.8325	36.5498	35.6300	37.2457	36.4193	36.8258	36.2738	35.6300	35.6300
Turkey	17.8279	24.0416	25.0000	17.1749	18.4810	23.0832	24.9999	25.0000	25.0000
Australia	0.9003	0.8710	0.8628	0.9079	0.8927	0.8780	0.8639	0.8628	0.8628
New Zealand	1.0252	0.9590	0.9354	1.0367	1.0138	0.9762	0.9419	0.9354	0.9354

a) On the technical assumption of no further change in rates after the 6-8 November 1978.

Table 47
Effective exchange rate changes of OECD countries[a]

Percentage changes from 1st quarter 1970

	1977 I	1977 II	1978 I	1978 II	1979[b] I	Average 6-8 November 1978
United States	-12.20	-13.78	-18.26	-23.64	-24.33	-24.33
Canada	-2.31	-7.98	-13.92	-20.59	-21.81	-21.81
Japan	19.09	29.05	40.12	63.60	63.19	63.19
France	-8.61	-9.43	-12.57	-11.68	-12.57	-12.57
Germany	34.45	38.44	41.99	42.05	43.87	43.87
Italy	-43.32	-44.73	-47.28	-49.12	-50.23	-50.23
United Kingdom	-39.15	-38.20	-37.94	-39.39	-39.59	-39.59
Belgium[c]	9.23	10.12	12.12	11.29	12.65	12.65
Netherlands	18.02	17.49	19.52	18.39	19.67	19.67
Ireland	-25.81	-25.02	-24.71	-26.62	-28.83	-28.83
Denmark	10.66	7.73	9.21	9.02	10.04	10.04
Norway	20.48	17.48	12.25	9.78	10.64	10.64
Sweden	3.92	-5.56	-10.54	-11.21	-11.49	-11.49
Finland	-6.79	-11.58	-17.31	-19.92	-19.83	19.83
Iceland	-58.46	-61.62	-69.57	-75.61	-77.57	-77.57
Austria	25.50	27.33	27.48	24.97	25.44	25.44
Switzerland	48.21	59.95	80.12	99.07	96.53	96.53
Spain	-10.80	-27.62	-29.34	-26.67	-25.66	-25.66
Portugal	-28.55	-35.87	-42.75	-50.10	-51.22	-51.22
Greece	-32.73	-33.06	-37.86	-40.85	-40.66	-40.66
Turkey[d]	-28.84	-36.03	-51.86	-59.37	-59.92	-59.92
Australia	-11.54	-13.57	-17.73	-24.12	-24.62	-24.62
New Zealand	-15.82	-16.34	-17.70	-20.22	-20.34	-20.34

a) Using 1972 trade weights with allowance for third market effects along the lines of the IMF Multilateral Exchange Rate Model.
b) On the technical assumption of no further change in rates after 6-8 November 1978.
c) Commercial rate.
d) Measured from August 1970 official parity.

Table 48
Volume of imports of major OECD countries and country groups

Customs basis; percentage changes at annual rates, seasonally adjusted[a]

	From previous year 1977	1978	1979	From previous half-year 1977 I	1977 II	1978 I	1978 II	1979 I	1979 II
United States	13.6	7¼	2¼	13.9	6.3	6.3	10	0	-½
Canada	1.1	3¼	4	5.7	-7.1	7.4	6	3½	3½
Japan	3.2	6	7⅜	2.5	-4.0	10.5	7½	8½	6½
France	1.3	4½	6½	-6.2	3.0	4.6	6	7	6½
Germany	4.9	7½	8	-0.1	8.8	6.4	8	9¼	5¼
Italy	-2.4	½	7½	-5.7	-8.1	-1.1	13	5	7
United Kingdom	2.1	8½	3½	3.4	-6.2	17.1	7¼	2	3
Belgium-Luxembourg	3.4	2	4⅜	8.0	-6.1	5.3	4½	4⅜	5
Netherlands	2.0	4¼	4¼	-1.6	0.8	6.0	4½	4½	3⅜
Other EEC	1.2	4⅜	5⅜	-0.8	-4.9	8.9	7	5	5
Other North Europe	2.6	-2¼	4⅜	-5.6	4.8	-7.5	3	5⅜	4½
Other OECD	0.3	-3	3⅜	-3.5	-6.7	-5.2	5¼	3	3⅜
Total OECD	4.3	4¼	5	2.3	0.5	4.8	7¼	4½	3⅜
Memorandum items									
Seven major countries	5.3	6	5	3.9	1.2	7.2	8½	4½	3½
Non oil imports									
United States	10.9	13½	3	6.5	-6.0	7.5	6½	4	4
United Kingdom	6.5	10¼	6½	9.5	-4.7	20.6	6½	7	5⅜

a) Seasonally adjusted data are used for calculating semiannual as well as annual changes. The latter may therefore differ from changes based on unadjusted or annual data.

Table 49
Volume of exports of major OECD countries and country groups

Customs basis; percentage changes at annual rates, seasonally adjusted[a]

	From previous year 1977	1978	1979	From previous half-year 1977 I	1977 II	1978 I	1978 II	1979 I	1979 II
United States	1.2	8⅜	10¼	-1.6	1.1	7.3	19½	8½	5½
Canada	9.2	9⅜	5½	16.0	-0.2	16.9	6	6½	3
Japan	9.6	-2¼	-6	10.8	4.2	0.1	-12½	-5½	0
France	7.0	5½	6	7.0	9.0	4.4	4⅜	6½	6
Germany	5.0	4¼	5	3.8	6.4	2.6	5	4⅜	5½
Italy	6.4	5	5	4.2	3.4	5.4	5½	5	4½
United Kingdom	8.6	6	6	11.3	7.7	3.4	9¼	4⅜	5¼
Belgium-Luxembourg	4.6	3¼	5⅜	5.4	-2.0	5.0	5	6	6
Netherlands	-2.0	1½	5½	-8.6	2.2	-0.2	4	6½	5½
Other EEC	7.5	8¼	6	6.6	11.3	9.0	4	7	6½
Other North Europe	2.9	7⅜	5½	1.3	3.5	11.2	4⅜	5½	5
Other OECD	4.6	8	5⅜	0.6	8.3	10.5	2½	7	6¼
Total OECD	5.0	5¼	5	4.4	4.2	5.6	5½	5	4⅜
Memorandum items									
Seven major countries	5.8	5	5	5.9	4.4	5.0	6	4½	4½
Non oil exports									
United Kingdom	7.9	4	4⅜	8.9	8.1	0.6	7	5½	4

a) Seasonally adjusted data used for calculating semiannual as well as annual changes. The latter may therefore differ from changes based on unadjusted or annual data.

Table 50
Foreign trade volumes of selected other OECD countries

Customs basis; percentage changes

	Exports 1977	1978	1979	Imports 1977	1978	1979
Ireland	18.2	15	8¼	12.3	13	8¼
Denmark[a]	3.4	5¼	5	-2.5	1½	4¼
Norway[b]	-4.0	12	12½	6.4	-11	0
Sweden	-2.6	7	5¼	-6.7	-9	6½
Finland	9.8	7	4⅜	-6.7	-1½	4½
Austria	3.2	9⅜	5	10.2	-1½	6½
Switzerland	10.1	5½	2	10.1	9¼	5
Spain	13.2	13	7⅜	-5.4	-4½	4⅜
Australia	1.7	2⅜	3⅜	1.8	2½	5
New Zealand	2.6	3½	3	-4.2	-5½	7⅜

a) Excluding ships and airplanes.
b) Excluding ships and drilling platforms.

Table 51
Export market growth and relative export performance of selected OECD countries

	Share of commodity groupings in total 1977 exports			Growth of export markets[a]									
				Percentage changes from previous period at annual rate; seasonally adjusted									
	Manufactures	Food	Other non-oil commodities	1977	1978	1979	1976 II	1977 I	1977 II	1978 I	1978 II	1979 I	1979 II
United States	71	13½	14½	3⅜	5	5¼	4¼	4¼	2½	6	5¾	5	5¼
Canada*	55½	10½	29½	8⅜	9½	3½	8¼	9⅜	7½	13	4¾	3⅜	1⅜
Japan	97½	1	1½	7¼	7½	4½	7⅜	7½	7	9	4⅜	4¼	4
France	78½	14	5	5	4¾	5½	9	3⅜	4	4¼	6¼	5	5
Germany	90½	4½	4	4	3½	5	8¼	2	4¼	2	5½	4½	5
Italy	85	7½	2	5¾	5¼	5¼	9½	3⅜	6⅜	4¼	5½	5¼	5
United Kingdom	84	7	3	5½	4½	5¼	9	4⅜	3⅜	4½	5½	5	5
Belgium-Luxembourg	82	9	4	4¾	5½	6	9⅜	2½	5	5¼	6½	6	5½
Netherlands*	55	20½	12½	4⅜	5¼	6¼	7⅜	4	3½	5½	6⅜	6¼	5½
Ireland*	55½	39½	4½	5⅜	8	6	8½	8	–1	13½	6⅜	5⅜	5
Denmark*	57½	32½	7½	3½	3	5¾	7½	3¼	½	3	5½	5⅜	5½
Norway	64½	10	7	3	4	5¾	8½	2½	–1½	5½	6¼	5¾	5½
Sweden	82	2	14½	3⅜	3¼	5	8	2⅜	2¼	3½	4¼	5	5
Finland	77½	4	16½	1½	2	4⅜	2½	1½	½	1½	4½	4½	5
Austria	86	3½	10	3¼	4½	5¼	4⅜	1⅜	5	3½	5¼	5	5
Switzerland	94	4	1½	4½	4¼	5½	8½	2¼	5	2⅜	6½	5¼	5¼
Spain	72	19	5½	5½	5½	5¼	9½	4	5½	5½	5⅜	5	4⅜
Portugal	70½	15	12½	4⅜	5	5½	10	4	1⅜	6	6	5½	5¼
Greece*	54½	32	8½	5¼	5	5½	9	3½	5	4¼	6½	5¼	5

RELATIVE EXPORT PERFORMANCE[b]

	Annual averages			1973	1974	1975	1976	1977	1978	1979	1973 II to 1979 II
	1964-68	1969-73	1974-78								
United States	–1½	–3	½	1	2¼	2½	–3¾	–2½	3½	4¾	2
Canada*	6	–2½	¼	–½	–5½	6½	–¾	½	0	2	2
Japan	7½	3	2	–11¼	½	3¼	12½	2¼	–9	–10	–6½
France	–1	2	¾	–3¼	3	–2⅜	¼	2	¾	½	1
Germany	2½	–1½	0	–1½	2½	–7⅜	3¼	1	½	0	0
Italy	6	–3	½	–12½	–2	3	1½	½	–¼	–¼	–¼
United Kingdom	–3½	–3	–¾	–2¼	–7⅜	4¼	–1½	2¼	–½	–½	–¼
Belgium-Luxembourg	2	¾	–1¾	¾	–5	–6½	2	–¼	–2¼	–¼	¼
Netherlands*	2½	1½	–2½	–3	–¼	–4	4¼	–6½	–3⅜	–½	0
Ireland*	..	..	..	..	..	..	..	11⅜	6⅜	2	3¼
Denmark*	3½	0	–½	–4	–6½	3	–1	0	2¼	–½	0
Norway	2	–2¼	–2½	–7½	–7⅜	7¼	–3½	–8¼	0	½	0
Sweden	0	–1½	–2⅜	–3	–2½	–5½	–4¼	–6	3¾	¼	1½
Finland	..	..	..	..	..	..	..	8¼	5	0	½
Austria	2	–¾	2	–6	3½	–5	6	0	5	–¼	¾
Switzerland	0	–2½	–1¾	–5¼	–10⅜	–5	1	5½	1	–3½	–3½
Spain	..	..	..	..	..	..	..	7½	7½	2½	2½
Portugal	..	..	..	..	..	..	..	2½	..	..	..
Greece*	..	..	..	..	..	..	..	–7	1¾	0	..

* Indicates countries whose commodity composition of exports differs from that of the typical OECD country to such an extent that market growth (as defined in footnote *a*) may be an indicator of rather dubious value for appraising the growth of foreign demand facing these countries' total exports.

a) The calculation of market growth through 1976 is based on growth of total import volume of manufactures in each exporting country's markets, the latter being the 24 OECD countries plus 8 groups of non-OECD countries. Total OECD export volume growth to each of the 8 non-OECD groupings is taken as a proxy for the latter's imports of manufactures. For the calculation of each OECD country's market growth the growth (as defined above) in each market is weighted by its share in the country's total exports of manufactures. The calculation of market growth for 1977 and subsequent periods is based on each market's growth of non-oil imports (adjusted for any significant growth difference between total OECD's imports of non-oil from OECD and from non-oil developing countries) rather than its imports of manufactures. The growth rates given for those periods should therefore be viewed only as broad indications of foreign demand for OECD countries' exports of manufactures. Furthermore, the specific commodity composition of several OECD countries' exports (particularly those countries marked in the table by an *, even within the manufacturing sector, varies to such a degree that market growth calculation on the basis of geographic distribution of trade only, may in many instances be a relatively unreliable measure of foreign import demand.

b) Through 1976 this is the percentage by which a country's actual volume growth of manufactured exports exceeds (falls short of) the growth of its markets. From 1976 onwards the export performance is defined as the percentage by which an OECD country's non-oil export growth exceeds (falls short of) its market growth. It should be noted that since market growth is measured on the basis of imports there are inconsistencies in annual or semiannual calculations of export performance due to the time lag that exists between the recording of imports and exports.

Table 52
Foreign trade prices (average values) of major OECD countries and country groups
Annual percentage changes; national currency terms

	Exports			Imports		
	1977	1978	1979	1977	1978	1979
United States	4.3	8	6½	8.0	9¼	6½
Canada	6.3	7½	6	11.1	12½	8
Japan	–0.5	–2½	–¾	–3.5	–18¼	–5½
France	10.4	5½	4¾	11.8	1½	3½
Germany	1.6	–1	2¼	1.9	–3½	2½
Italy	19.8	6½	6	17.0	4¾	5
United Kingdom	14.5	6	6¾	13.0	2¼	5
Belgium-Luxembourg	1.4	1	2¾	1.8	1	2
Netherlands	3.0	–2	2½	3.5	–2	3
Other EEC	8.9	4½	5	11.2	1½	3¾
Other North Europe	6.6	2¼	3	8.5	2½	2½
Other OECD	14.1	10¼	7½	18.6	13¼	6½
Total OECD	6.0	3½	4¼	7.7	2¼	4
Memorandum item						
Seven major countries	6.0	3¾	4¼	7.2	1¾	4

Table 53
Foreign trade prices (average values) of selected other OECD countries
Annual percentage changes; national currency terms

	Exports			Imports		
	1977	1978	1979	1977	1978	1979
Ireland	15.4	5	7¼	18.5	5	5¾
Denmark[a]	6.2	4¼	4	8.9	¼	3
Norway[b]	6.5	2½	3¾	7.6	5	4
Sweden	7.9	7	4¾	13.0	11½	4¾
Finland	16.6	6½	5½	16.2	10¼	5½
Austria	3.2	–¼	2¾	3.6	¼	2¾
Switzerland	3.5	–4	–1	6.2	–10	–4
Spain	17.4	17¼	7½	22.0	12¾	5
Australia	9.8	2½	7	18.8	5½	4½
New Zealand	14.1	4½	8	10.6	3½	7¼

a) Excluding ships and airplanes.
b) Excluding ships and drilling platforms.

Table 54
Trade balances of major OECD countries and country groups
Seasonally adjusted, $ billion

	1977	1978	1979	1977		1978		1979	
				I	II	I	II	I	II
United States	–31.1	–35¾	–27	–13.6	–17.5	–19.0	–16¾	–14½	–12½
Canada	3.1	3½	3¾	1.4	1.6	2.0	1½	1¾	2
Japan	17.3	27½	20½	8.0	9.3	14.2	13½	11¼	9¼
France	–2.8	1¼	1	–1.6	–1.1	0.6	¾	½	½
Germany	19.3	23¼	22¼	9.1	10.3	11.6	11¾	11	11¼
Italy	0.1	3	2¼	–0.7	0.8	1.9	1¼	1¼	1
United Kingdom	–3.0	–3	–1	–3.0	0	–1.4	–1½	–¾	–¼
Belgium-Luxembourg	–1.4	–1	–¾	–0.7	–0.7	–0.5	–½	–½	–¼
Netherlands	–0.2	–1½	–1½	–0.3	0.1	–0.6	–1	–1	–½
Other EEC	–3.3	–3	–3¼	–1.8	–1.5	–1.4	–1¾	–1½	–1½
Other North Europe	–7.0	1	1	–3.0	–4.0	0.4	½	½	½
Other OECD	–14.4	–11¾	–11½	–7.3	–7.0	–5.7	–6	–6	–5¾
Total OECD	–23.2	3¾	5¾	–13.7	–9.6	2.1	1½	2¼	3½

Note: Detail may not add, due to rounding.

Table 55
Trade balances of other OECD countries
$ billion

	1977	1978	1979
Ireland	–0.6	–¾	–1
Denmark	–2.7	–2¼	–2¼
Norway	–4.1	–½	–¼
Sweden	0.3	2¾	3
Finland	0.5	1	1
Iceland	–0.1	0	0
Austria	–3.9	–3	–4
Switzerland	0.3	¾	1
Spain	–6.1	–4	–4
Portugal	–2.5	..	..
Greece	–3.3	–3¾	–4¼
Turkey	–3.4	..	..
Australia	0.9	¼	¾
New Zealand	0	¼	¼

Table 56
Current invisible transactions of major OECD countries and country groups[a]
$ billion

	Annual average 1970-1973	1973	1974	1975	1976	1977	1978	1979
United States	1.8	6.0	7.0	9.4	13.7	15.8	17¾	19
Canada	–2.5	–2.9	–3.5	–4.3	–5.6	–7.0	–7½	–8¼
Japan	–2.5	–3.8	–6.1	–5.7	–6.2	–6.4	–7½	–8½
France	–0.8	–1.4	–2.1	–1.5	–1.3	–0.6	¾	1
Germany	–7.3	–10.9	–12.5	–13.8	–13.3	–15.6	–17½	–20
Italy	1.7	1.3	0.5	0.4	1.2	2.1	2½	2¾
United Kingdom	2.3	3.8	4.1	3.4	3.9	3.5	2½	2¾
Belgium-Luxembourg	0	–0.1	0	0.2	0.6	0.6	¾	½
Netherlands	0.8	1.4	1.5	0.7	0.9	0.5	0	¼
Other EEC	0.6	0.9	1.2	1.1	1.1	1.4	1½	1¾
Other North Europe	2.3	2.9	2.2	0.8	0.2	–1.1	–¾	–1½
Other OECD	3.1	4.8	4.1	4.0	1.9	2.3	3¼	3½
Total OECD	–½	–2	–3½	–5¼	–3	–4½	–4½	–7

a) Balance on services (including factor incomes) and total transfers (both private and official).

Table 57
Net imports of oil of major OECD countries and country groups[a]
Million barrels per day

	1973	1974	1975	1976	1977	1978	1979
United States	6.25	6.15	6.07	7.30	8.71	8.27	8.79
Canada	–0.44	–0.19	–0.01	0.12	0.22	0.26	0.34
Japan	4.95	4.84	4.35	4.67	4.86	4.91	5.08
France	2.55	2.47	2.02	2.32	2.16	2.20	2.20
Germany	2.85	2.61	2.42	2.69	2.65	2.71	2.77
Italy	1.90	1.96	1.72	1.80	1.73	1.66	1.72
United Kingdom	2.22	2.17	1.71	1.59	1.04	0.75	0.37
Belgium-Luxembourg	0.56	0.53	0.46	0.47	0.50	0.50	0.51
Netherlands	0.52	0.50	0.40	0.50	0.47	0.49	0.50
Other EEC	0.49	0.45	0.42	0.44	0.47	0.46	0.49
Other North Europe	1.66	1.44	1.24	1.26	1.24	1.12	1.10
of which: Norway	0.14	0.13	–0.05	–0.11	–0.09	–0.23	–0.30
Other OECD	1.55	1.53	1.44	1.71	1.75	1.74	1.79
Total OECD	25.06	24.46	22.24	24.87	25.78	25.04	25.64

a) Including oil products.

Table 58
OECD countries' exports to OPEC[a]
Data based on $ values of exports

	Value in $ billion		Percentage change			Exports to OPEC as a percentage of total exports				Share of OPEC market[b]					
	Annual average 1972-73	1977	At annual rates 1973-75	At annual rates 1975-77	1977I to 1978I	Annual averages 1972-73	Annual averages 1974-75	Annual averages 1976-77	1978I	Annual average 1972-73	1974	1975	1976	1977	1978I
United States	3.2	14.2	72.0	15.4	17.0	5.3	8.8	10.9	12.2	22.8	23.4	23.0	23.5	21.1	21.5
Canada	0.3	1.2	75.8	20.0	–1.9	1.2	2.2	2.7	2.1	1.9	2.0	1.7	1.7	1.8	1.2
Japan	2.3	12.0	86.7	19.1	28.0	7.1	13.1	14.5	15.1	16.4	19.0	18.0	17.2	17.9	18.4
France	1.5	5.6	62.5	10.1	16.0	4.7	7.8	8.6	8.4	10.3	9.8	9.8	8.7	8.8	8.4
Germany	1.9	10.8	72.9	26.1	16.1	3.3	6.4	8.7	8.6	13.3	14.0	14.4	15.3	16.0	15.5
Italy	1.1	5.8	75.4	25.2	–8.0	5.4	9.5	12.3	10.4	7.7	7.8	7.9	7.8	8.7	6.8
United Kingdom	1.6	7.0	60.5	22.1	31.8	6.0	9.3	11.8	12.6	11.6	9.1	9.9	9.7	10.4	11.6
Belgium-Luxembourg	0.4	1.9	56.1	27.3	18.9	2.0	3.4	4.5	5.0	2.7	2.4	2.4	2.4	2.7	2.8
Netherlands	0.5	2.0	53.4	22.6	17.4	2.4	3.4	4.6	4.7	3.5	2.9	2.9	3.2	3.0	3.1
Ireland	0	0.2	145.0	52.8	10.0	0.1	1.9	3.7	3.8	0.1	0.1	0.2	0.2	0.3	0.3
Denmark	0.1	0.5	73.2	15.5	18.1	2.1	3.5	4.6	4.5	0.8	0.7	0.8	0.7	0.7	0.7
Norway	0	0.2	62.8	14.8	7.1	1.2	1.6	2.0	1.7	0.3	0.2	0.3	0.3	0.3	0.2
Sweden	0.2	1.0	82.1	14.8	3.1	1.8	3.7	5.4	4.7	1.4	1.3	1.6	1.9	1.5	1.3
Finland	0	0.3	48.3	52.6	48.8	1.4	2.3	3.5	4.6	0.3	0.4	0.3	0.4	0.4	0.5
Iceland	0	0	0	0	0	0	0	1.1	2.0	0	0	0	0	0	0
Austria	0.1	0.6	76.1	23.2	7.4	2.4	4.3	6.4	5.4	0.8	0.8	0.8	1.1	0.8	0.8
Switzerland	0.3	1.5	53.9	33.7	43.9	3.8	5.8	8.3	8.8	2.2	1.9	1.8	2.1	2.3	2.6
Spain	0.3	1.2	59.9	21.0	36.5	6.2	9.4	11.0	12.9	2.0	1.7	1.8	1.5	1.8	2.2
Portugal	0	0	73.2	22.5	–40.0	0.8	1.5	2.4	1.3	0.1	0	0.1	0.1	0.2	0.1
Greece	0	0.4	145.0	16.3	9.7	4.1	11.0	14.0	14.4	0.3	0.6	0.6	0.6	0.6	0.5
Turkey	0	0.1	91.5	4.5	–22.2	4.3	7.5	7.3	6.6	0.3	0.2	0.3	0.2	0.2	0.2
Australia	0.3	0.8	53.6	6.0	30.8	3.1	5.2	5.5	6.6	1.8	1.6	1.5	1.3	1.1	1.2
Total OECD[c]	14.1	67.1	69.3	19.4	18.5	4.1	7.2	9.0	9.2	100	100	100	100	100	100
Memorandum item Seven major countries	11.8	56.5	70.6	19.1	17.9	4.7	8.3	10.3	10.5	83.8	85.1	84.8	83.9	84.2	83.4

a) See Table 52 in *Economic Outlook*, No. 23, for historical data year by year 1973-1977.
b) Percentage of total OECD exports to OPEC.
c) Excluding exports of New Zealand for which figures are not available.

Table 59
OECD countries' exports to Eastern Europe, the Soviet Union, China and selected other Asian countries
Data based on value in US $

	Value in 1977 ($ million)		USSR and Eastern Europe						China and selected other Asian countries					
	USSR and Eastern Europe	China and sel. other Asian countries	Exports as a percentage of total exports			Share of market[a]			Exports as a percentage of total exports			Share of market[a]		
			1976	1977	1978 I	1976	1977	1978 I	1976	1977	1978 I	1976	1977	1978 I
United States	2 544	173	3.0	2.1	3.4	12.6	9.1	14.6	0.1	0.1	0.3	3.2	3.6	5.8
Canada	549	355	2.0	1.3	1.2	2.8	2.0	1.7	0.5	0.9	1.0	4.8	7.4	6.6
Japan	2 705	2 222	6.5	3.4	3.4	10.2	9.7	9.7	2.8	2.8	3.1	44.6	46.5	42.4
France	2 799	134	4.9	4.4	3.6	9.9	10.1	8.6	0.7	0.2	0.3	9.1	2.8	3.8
Germany	6 662	562	6.1	5.6	5.5	22.5	24.0	23.4	0.7	0.5	0.8	15.7	11.8	15.3
Italy	2 317	105	5.4	5.1	4.2	7.1	8.3	6.5	0.4	0.2	0.4	3.2	2.2	3.0
United Kingdom	1 460	118	2.6	2.5	2.8	4.3	5.3	6.0	0.3	0.2	0.2	3.0	2.5	2.4
Belgium-Luxembourg	763	54	2.4	2.0	1.9	2.9	2.7	2.6	0.1	0.1	0.5	1.2	1.1	2.9
Netherlands	823	75	2.0	1.9	1.8	2.8	3.0	2.8	0.1	0.2	0.2	1.3	1.6	1.6
Ireland	29	1	0.3	0.7	0.8	0.1	0.1	0.1	0	0	0	0	0	0
Denmark	290	33	3.1	2.9	2.6	1.0	1.0	0.9	0.1	0.3	0.3	0.3	0.7	0.5
Norway	277	101	3.5	3.2	2.2	1.0	1.0	0.7	0.3	1.2	0.8	0.5	2.1	1.2
Sweden	957	75	5.7	5.0	4.7	3.8	3.5	3.1	0.4	0.4	0.4	1.7	1.6	1.3
Finland	1 712	25	23.7	22.3	20.5	5.4	6.2	5.1	0.4	0.3	0.3	0.6	0.5	0.4
Iceland	62	11	10.3	12.1	8.5	0.2	0.2	0.1	0	2.1	4.0	0	0.2	0.3
Austria	1 417	32	15.2	14.5	13.8	4.7	5.1	5.0	0.3	0.3	0.5	0.6	0.7	0.8
Switzerland	882	67	5.4	5.0	4.6	2.9	3.2	3.2	0.4	0.4	0.5	1.5	1.4	1.5
Spain	284	23	3.5	2.8	2.8	1.1	1.0	1.1	0.2	0.2	0.4	0.4	0.5	0.8
Portugal	81	1	4.6	4.0	3.0	0.3	0.3	0.2	0.1	0	0	0	0	0
Greece	340	13	11.4	12.5	13.5	1.0	1.2	1.2	0.1	0.5	0.2	0.1	0.3	0.1
Turkey	172	6	8.5	9.9	15.8	0.6	0.6	1.0	0.1	0.3	0.7	0	0.1	0.2
Australia	493	534	4.8	3.7	3.8	2.3	1.8	1.7	2.5	4.0	4.2	7.6	11.2	8.7
New Zealand	157	60	4.9	4.9	3.6	0.5	0.6	0.4	0.9	1.9	0.5	0.6	1.2	0.3
Total OECD	27 775	4 780	4.4	3.9	3.8	100	100	100	0.7	0.7	0.8	100	100	100
Memorandum items														
Seven major OECD countries	19 036	3 669	4.2	3.6	3.7	69.4	68.5	70.5	0.8	0.7	0.9	33.6	76.8	79.3
OECD Europe	21 327	1 436	5.0	4.6	4.3	71.6	76.9	71.6	0.4	0.3	0.5	39.2	30.0	36.1
EEC	15 143	1 082	4.3	4.0	3.7	50.0	54.5	50.9	0.4	0.3	0.5	33.8	22.6	29.5

a) Percentage of total OECD exports to indicated country group.

Table 60
Spot prices of non-oil primary commodities[a]
Indices, 1977 = 100; $ terms

	1977	1978	1979	1977 I	1977 II	1978 I	1978 II	1979 I	1979 II
Food	100	91½	96½	104½	95½	91	92	95	98
Non-food agricultural raw materials	100	106	118	102½	97½	101½	111	116	120
Metals and minerals	100	101½	112½	100½	99½	98½	105	110	115
Total, non-oil primary commodities	100	97½	106	103	97	95½	100	104	108

a) Indices through 1978 I based on data compiled by the National Institute of Economic and Social Research (London).

Table 61
OPEC's current balance
$ billion

		1975	1976	1977	1978	1979
OPEC	Exports	107½	132½	145¼	142½	153
	Imports	58	67¾	83¾	100	112
	Trade balance	49½	65	61½	42½	41
	Services and private transfers, net	−19¼	−25½	−28	−30	−32
	Official transfers, net	−3	−2½	−2	−1½	−1½
	Current balance	27¼	37	31½	11	7½
"Low absorbers"[a]	Exports	52	67¼	73¼	70½	75
	Imports	16½	24¼	31¼	37½	43½
	Trade balance	35½	43	42	33	31½
	Services and private transfers, net	−7	−7½	−8	−8½	−9
	Official transfers, net	−2½	−2	−1¾	−1½	−1½
	Current balance	26	33½	32¼	23	21
"High absorbers"[b]	Exports	55½	65½	72	72	78
	Imports	41½	43½	52½	62½	68½
	Trade balance	14	22	19½	9½	9½
	Services and private transfers, net	−12¼	−18	−20	−21½	−23
	Official transfers, net	−½	−½	−¼	0	0
	Current balance	1¼	3½	−¾	−12	−13½
Memorandum items						
Percentage changes in volume of OPEC trade						
Exports		−9	13	3	−3½	3
Imports		36	15	14	4¼	5
of which "Low absorbers"		44	45	19	4¾	8
"High absorbers"		34	3	11	4	3

a) The oil-exporting countries included under the heading comprise: Bahrain, Kuwait, Libyan Arab Jamahiriya, Oman, Qatar, Saudia Arabia and the United Arab Emirates.
b) The oil-exporting countries included under the heading comprise: Algeria, Ecuador, Gabon, Indonesia, Iran, Iraq, Nigeria and Venezuela.

Table 62
Balance of payments of non-oil developing countries[a][b]
$ billion

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979
Exports, fob	38	39½	47	67½	98	92	115	135½	151	168
Imports, fob	44	49	53½	75	121½	130½	140	159	185	208
TRADE BALANCE	–6	–9½	–6½	–7½	–23½	–38½	–25	–23½	–34	–40
Services and private transfers, net	–5½	–5	–4½	–5½	–9	–10	–10	–10	–10½	–11
Balance on above	–11½	–14½	–11	–13	–32½	–48½	–35	–33½	–44½	–51
Official transfers, net (ODA)	3½	4	5	6	8	10	9	9½	10½	12
CURRENT BALANCE	–8	–10½	–6	–7	–24½	–38½	–26	–24	–34	–38
CAPITAL BALANCE	10	11½	11	14½	26	35½	35½	36½	45½	47
Direct investment	1½	1¼	1½	3	3½	3¼	3¼	4	4¼	4½
Aid (ODA)	2¾	3	3½	4	5¼	7¼	7	6¾	7¼	8
Other official flows (OOF)	1¼	1½	1¾	2½	3¼	4½	4½	4½	4¾	5¼
Portfolio investment	½	¾	1½	3	3½	3½	5	6½	7½	8½
Official export credits	1½	1¼	1	½	1¼	2	3¼	4¼	5½	6½
Other capital, including errors and omissions[c]	2½	3¾	1¾	1½	9¼	15	12½	10¾	16½	14¼
Net transactions of monetary authorities	2.1	0.9	4.8	7.5	1.5	–2.9	9.6	12.4	11½	9
Other official financing	0.3	0.7	1.0	0.1	1.3	1.8	2.0	–0.4	–1½	–1
Changes in international reserves	2.4	1.6	5.8	7.6	2.8	–1.1	11.6	12.0	10	8
Memorandum items										
Gross medium term Euroborrowing	⅛	½	1¼	4½	7¼	8½	11	11½	20	16
Percentage changes in trade										
Volume										
Exports						–10	26	6	6	4½
of which: Exports to OECD						–12	26	7¾	7¾	6
Imports						–3	5½	4	6	5½
of which: Imports from OECD						–2½	2½	6	8	6
Price[d]										
Exports						5	–½	11	5	6
Imports						11	1	9½	10	7

a) OECD estimates and forecasts. For coverage of countries in this group, see Technical Annex.
b) During work on the world current account, two inconsistencies in the recording of non-oil developing countries' balance of payments were discovered. Estimates in the present table have been adjusted so as to exclude the so-called "dependent territories", and services and private transfers have been adjusted so as to avoid possible double-counting of technical assistance.
c) Includes Euroborrowing.
d) Average values in $ terms.

Background Detail on OPEC and Non-Developing Countries

This section provides the detailed technical background to the broad conclusions, presented in the section on International Developments, that:

— the financial position and real exports prospects of non-oil developing countries are sufficient to ensure demand from these countries for OECD goods and services to expand at rates above those of intra-OECD trade both in 1978 and 1979, despite significant terms of trade losses;
— given increased indigenous OECD energy production and moderate demand growth, total OECD net oil imports in 1979 may be running no higher than their level in 1977—despite exceptional stockpiling by United States and Japan;
— reflecting falling demand for oil and adverse terms of trade movements the OPEC surplus could decrease significantly to $5-10 billion in 1979. Recently "high absorbers" appear to have moved into a large current deficit (of some $10-15 billion).

Non-oil developing countries

After falling substantially in 1977 II, exports of primary commodities by non-oil developing countries rose sharply in 1978, reflecting the pick-up of industrial activity and some build-up of stocks in OECD countries. Exports of manufactured goods, in particular from the "newly industrialising countries" in South East Asia, recently have been growing steadily—at rates slightly faster than OECD intra-trade in manufactures.

The resumption of industrial activity in the OECD area in 1978 was generally too weak markedly to affect dollar prices of primary commodities, which remained depressed. With prices of manufactured goods in dollar terms rising well above a double digit annual rate, the terms of trade loss for the non-oil developing countries may have been some 5 percentage points in 1978, about the same as in 1975. However, developments of import volumes (growing some 5 per cent in 1978 I—only very marginally below historical trends) suggest that non-oil developing countries as a group now have the financing capacity to absorb such terms of trade losses without the need for real adjustment[1]. Within the non-oil developing country group, South East Asian countries experienced a markedly faster rise in economic activity and imports than did the other non-oil developing countries.

During the second half of 1978, trends seen earlier in the year seem to have persisted (except that exports of primary commodities may be expanding at more normal rates). On this basis, the trade deficit of the non-oil developing countries may widen by some $10 billion for the year as a whole to close to $35 billion (Table 62). This increase in the deficit largely occurred in the second half of 1977; the estimated 1978 trade deficit is not much higher than the deficit realised in 1977 II. The deficit on current account may show a similar increase, a rise in the deficit on services and private transfers being broadly offset by increased official transfers.

As in 1976 and 1977, the current deficit appears to have been more than covered by capital in-flows in 1978, reserves increasing by some $10 billion. The most conspicuous feature of recent financing flows has been increased borrowing in international financial markets: gross Euro-borrowing was running at an annual rate of $20 billion in the first three quarters of 1978, 75 per cent above the 1977 level[2]. As before, the borrowing was heavily concentrated in a handful of countries—Brazil and Mexico alone taking more than 40 per cent of the total. The bulk of non-oil developing countries have been relying on longer-term private and official capital flows to finance their current deficits. While direct investment appears to have increased only modestly in 1978, aid flows (ODA), other official flows and official export credits may have increased more rapidly. In a number of countries, official export credits seem to be increasingly used to secure, for domestic industry, export contracts to the non-oil developing countries' market.

The volume of OECD imports from non-oil developing countries may grow 5-6 per cent in 1979. The growth expected during the year is somewhat more rapid than indicated by a historical relationship between these imports and OECD industrial activity, largely reflecting increased competitiveness of the newly industrialising countries relative to OECD and, in particular, to Japanese exporters. In 1979, the expected strengthening of non-oil commodity spot prices will be translated, with a certain lag, into a recovery of export unit values. At the same time, increases facing non-oil developing countries in the dollar prices of manufactured goods should slow down substantially. Taking into account the technical oil price assumption (see below), terms of trade of the non-oil LDCs should develop less unfavourably than over the last twelve months. As in 1978, terms of trade developments could be more favourable in the South East Asian countries than, on average, in other non-oil developing countries.

The forecasts above imply an increase in non-oil developing countries export revenues of some $15-20 billion in 1979. In addition, ODA, other official flows, official export credits and portfolio investment are expected to show some real increase (or increase $3-4 billion in nominal terms). Direct investment, on the other hand, may hardly change in 1979. The extent of dependence on international financial markets is uncertain. It is likely that a small group of non-oil developing countries will continue to borrow heavily and, in the forecast here, gross Euro-borrowing has been put at $16 billion in 1979. The decline from 1978 is based on an assumption of smaller refinancing activity. However, Euro-borrowing could be substantially larger (which would most likely be reflected in reserves rising more rapidly than forecast here).

These forecast increases in the funds available for non-oil developing countries will allow a comfortable financing margin[3] for import volumes to increase at historical rates close to 6 per cent (or $20-25 billion in nominal terms). OECD exports to this group of countries could be growing slightly more strongly, in line with historical trends. The South East Asian countries may see the strongest increase in imports reflecting their buoyant exports, but some of the larger countries in Latin America may also see import growth above the average.

The sum of the details outlined above amounts to a current deficit for non-oil developing countries as a group of $35-40 billion in 1979, some $5 billion bigger than in 1978. In current prices, this is about the size of the 1975 record deficit. Taking account of price increases and the economic growth since then (as well as increased financing possibilities), the forecast deficit is, of course, very much below the 1975 peak.

1. Reserves of non-oil developing countries increased at an annual rate of more than $10 billion in the first half of 1978.
2. This did, to a large extent, reflect refinancing because of interest considerations, but there seemed also to be a number of important new investment projects being financed this way.
3. i.e. leaving room as well for continued increases in reserves. In the forecasts here, the ratio of reserves to imports is held broadly constant (at 35 per cent) throughout the forecast period, implying an increase of $38 billion in 1979.

Net oil imports

The main factors on which the forecast of OECD net oil imports depend are:

— elasticity of energy consumption with respect to GNP growth of 0.8[4];
— non-oil energy consumption accounting for slightly more than half of the increase in total energy requirement over the next year;
— increases in indigenous production of oil amounting to close to half of the increase in total energy requirement in 1978 and about a third in 1979;
— the ebb and flow of stockbuilding depressing oil imports on average in 1978 but increasing them in 1979.

In the first half of 1978, OECD net imports of oil fell significantly despite a sizeable increase in oil consumption. This reflected a modest increase in the area's oil production and, more importantly, a large run-down of stocks. However, in the second half of the year, substantial oil stocking may have occurred as the normal year-end seasonal increase in stocks (and possibly stockbuilding in anticipation of an oil price increase) combined with exceptional stockpiling in the United States and Japan[5]. In all, the sharp rundown of oil stocks in the first half of 1978 may have been completely offset by an equal amount of stockbuilding in the remainder of the year. Since oil stocking added some ¾ mbd to net oil imports in 1977, unchanged stocks in 1978 as a whole will have a dampening effect on the 1978 growth rate. As it is likely that the expected increase of the area's indigenous oil production in 1978—just over 1 mbd—will roughly offset increased oil consumption, OECD net oil imports may have declined by the amount of the negative swing of stocks between 1977 and 1978, ¾ mbd.

Among major OECD countries in 1978, United States net oil imorts may decline more markedly than the OECD average (Table 57). United Kingdom production increases in the North Sea (especially in the second half of the year), appear to have cut net imports of oil by as much as one quarter. In Italy, very slow growth of energy consumption coupled with a small rundown of stocks appears to have resulted in a fall of net imports of oil. For other major OECD countries, increases in net imports of oil appeared to be very modest because of very sluggish growth of energy consumption (for Japan), slow increase of oil consumption due to somewhat higher growth of non-oil energy (for Canada) and a negative stock swing (for France and Germany).

In 1979, the OECD's indigenous oil production is likely to increase but by less than in 1978, now that Alaska's North Slope production has reached a temporary peak level of 1.2 mbd. The United States' stockpiling plan will continue through 1979 and could add 0.35 mbd or more to net oil imports[6]. Assuming more stockbuilding in other OECD countries, the area's increased oil production in 1979 may only be sufficient to cover the stock increases. Hence, OECD net imports of oil are likely to increase in 1979 by the amount of the likely increase in the OECD area's oil consumption, some ¾ mbd. United Kingdom net imports of oil may be halved in 1979 in view of a continuing production increase in the North Sea. For the United States, however, with indigenous production levelling off from the first half of 1979 and substantial stockbuilding, net oil imports could increase 6 per cent despite an increase in oil consumption of below 1 per cent.

OPEC current balance

In the first half of 1978, the OPEC current surplus fell to some $10 billion (annual rate) from $30-35 billion in 1977 and from $25-30 billion (annual rate) in the second half of 1977. While low absorbers as a group (the countries in the Arabian Peninsula and Libya) were still running a surplus of some $20 billion at an annual rate, the high absorbers' (Algeria, Equador, Gabon, Indonesia, Iran, Iraq, Nigeria and Venezuela) combined current position appears to have moved into a large deficit of more than $10 billion (compared to a position roughly in balance in 1977). This abrupt deterioration of the OPEC current balance results both from real and nominal factors. The sharp decline of the value of the United States dollar (implying an increase of some 15 per cent in the dollar price of manufactured goods) in the first half of 1978 at a time when the oil price remained frozen, produced a terms of trade loss of some $10 billion among OPEC countries. And, although these countries may have reduced the growth rate of real imports very sharply in the first half of 1978 in an effort to brake the deterioration of their current position, this has been more than offset by the decline in net imports of oil by the OECD (noted above)[7].

In the second half of 1978 real demand for OPEC oil appears to have picked up due to stockpiling by OECD countries. A larger part of the production gain in the second half of the year is likely to accrue to high absorber countries whose revenue positions have been quite severely squeezed in recent months[8]. As a consequence, there may be some strengthening of high absorbers' imports towards the end of 1978, and possibly through the course of 1979 to an annual increase of 3-4 per cent. For low absorbers, a buoyant growth of import volumes is likely from the second half of 1978, although at a pace somewhat below post-oil-price-increase trends. However, it seems that during the second half of the year, OPEC import volumes grew sufficiently modestly that, despite a likely further large terms of trade loss ($10 billion at an annual rate), OPEC's overall current surplus hardy changed from the $10 billion (annual rate) recorded in the first half (Table 61). In 1978, the reduction of the OPEC surplus by some $20 billion may have had some $15 billion of its counterpart in trade with the OECD; in dollar terms, OECD exports to OPEC countries appear to have increased by close to 20 per cent while OECD imports from OPEC fell by 2-3 per cent.

On the technical assumption that the oil price rises at the same rate as that of exports of manufactured goods in 1979, and with a prospect of some increase in OECD demand for OPEC oil, production may rise ½ to 1 mbd and exports earnings of the OPEC countries may increase by some $10 billion. The effect of restored growth of export revenues is likely to differ substantially between low and high absorbers. For low absorbers, with a collective current surplus of $20 billion, import growth is still associated with domestic economic conditions rather than export earnings. In the present forecast the expansion of low absorber

4. This is the average elasticity now used in medium-term energy projections; it takes account of energy savings/conservation measures taken in the light of increased energy prices (and compared to an elasticity of slightly above 1 in the period 1960-1972). In the short-term, it is somewhat volatile, largely due to variations in winter temperatures.

5. The United States strategic petroleum reserve totalled 29 million barrels at the end of June, and is scheduled to increase to 125 million barrels by end-1978 (adding 0.5 mbd net oil imports). Japanese emergency stockpiling which began in September, may add 0.1 to 0.2 mbd to OECD net oil imports in the second half of 1978.

6. The figure of 0.35 mbd is based on a stockpiling aim of 125 million barrels. The United States administration was originally aiming at stockpiling which would reach 250 million barrels by the end of 1978 and 500 million barrels by 1980. However, the target level of 1978 was halved to 125 million barrels.

7. It should be noted that the decline of OPEC oil production has been more marked than suggested by the OECD net import figures because there has been a rapid increase in OECD oil imports from "non-oil" developing countries and Sino-Soviet countries.

8. Saudi Arabia's yearly oil production ceiling for 1978 was set in May at 8.5 mbd, well below the average production of the last year (9.5 mbd). In addition, in February the Saudi Arabia government set the ratio of light crude liftings at 65 per cent. More heavy crude produced would mean lower overall sales volumes as customers turn to other sources of light crudes, whose refinery costs are cheaper than those of heavy crudes. It is noted, however, that the 2 week long strike of Iranian oil workers in early November and a subsequent slow recovery of oil production to its prestrike level could have changed the OPEC oil production measurably in favour of low absorbers in the last quarter of 1978.

import volumes has been put at 7-8 per cent, somewhat below recent performance[9].

On the other hand, export earnings are clearly one of the factors affecting the volume of high absorbers' imports. In light of their external revenue situation in 1978, import restrictions have been imposed by some of these countries (Nigeria, Venezuela). However, their effect could be marginal because of the countries' important requirements for machinery and equipment for their development plans. In view of the pressure on imports likely to result from economic growth envisaged or planned for the current years among major high absorbers (for example, between 6-8 per cent for Venezuela, Algeria, Indonesia) and the prospect of a continuing increase of overseas borrowing, the current deficit of high absorbers is likely to widen somewhat in 1979 such that import volumes should grow moderately.

Overall, OPEC import volumes may grow 5-6 per cent in 1979, with export volumes expanding only 2-3 per cent. However, as exports of goods are some $40 billion larger than imports, the trade surplus may decline only marginally from its level in 1978. At the same time, a slight widening of the invisibles deficit is likely, largely falling on the group of high absorbers. Hence, the overall OPEC current surplus could fall to below $10 billion in 1979 with the deficit of high absorbers approaching $15 billion (Table 61).

9. Of primary importance is the position of Saudia Arabia whose imports are the largest among the OPEC countries and close to 50 per cent of the total of the low absorbers. The inflation outlook in Saudia Arabia looks better. Although the coming fiscal years' budget was reduced at the last minute by some $4.3 billion, possibly reflecting the cautious attitude of the government about the economy's capacity to absorb a large amount of expenditure, the size of the budget is still planned to increase sizeably from $32.2 billion in 1977 to $37.7 billion.

COMMODITY AND COUNTRY CLASSIFICATION

OECD TRADE BY COMMODITY GROUPS

	SITC
Oil (and products)	33
Manufactured goods	5-9
Food	0,1
Other	2, 3 excl. 33, 4

GEOGRAPHIC DISAGGREGATION

WORLD

OECD
Non-OECD

OECD

The seven largest OECD countries	Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States
Other OECD countries	
Benelux	Belgium-Luxembourg and the Netherlands
Other EEC	Denmark and Ireland
Other North Europe	Austria, Finland, Iceland, Norway, Sweden and Switzerland
Other OECD	Greece, Portugal, Spain, Turkey, Australia and New Zealand

NON-OECD

OPEC	
Less absorptive OPEC countries	Bahrein, Kuwait, the Libyan Arab Jamahiriya, Oman, Qatar, Saudi Arabia, and the United Arab Emirates
More absorptive OPEC countries	Algeria, Ecuador, Gabon, Indonesia, Iran, Iraq, Nigeria and Venezuela
Non-oil developing countries	
In the Western Hemisphere (Latin America)	All countries and territories in the Western Hemisphere excluding Canada, the United States, and Venezuela
In South-East Asia	China (Taiwan), Hong Kong, Macao, Malaysia, the Philippines, Singapore, South Korea, Thailand, and Timor
Other	All non-oil developing countries and territories not included in the Western Hemisphere or the South-East Asian groups
Other non-OECD countries	
USSR and Eastern European countries	Albania, Bulgaria, Czechoslovakia, Germany (Dem. Rep.), Hungary, Poland, Rumania, and the Union of Soviet Socialist Republics
China and selected other Asian countries	China, Dem. Kampuchea, Lao People's Dem. Rep., Mongolia, North Korea, and the Socialist Republic of Vietnam
Other	Gibraltar, Malta, South Africa and Yugoslavia (also includes trade not specified in terms of origin or destination)

Historical Statistics

Growth of real GDP at market prices in the OECD area

Percentage changes

	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976
United States	2.3	5.6	4.1	5.1	6.0	6.0	2.7	4.5	2.6	–0.1	2.9	5.8	5.4	–1.3	–1.0	5.8
Japan	14.6	7.1	10.5	13.2	5.1	9.8	12.9	13.5	10.7	10.9	7.3	8.9	9.8	–1.0	2.4	6.0
Germany	5.1	4.4	3.0	6.7	5.6	2.5	–0.2	6.3	7.8	6.0	3.2	3.7	4.9	0.5	–2.6	5.6
France	5.5	6.7	5.3	6.3	4.8	5.2	4.7	4.3	7.0	5.7	5.4	5.9	5.4	2.6	–0.1	5.6
United Kingdom	3.3	0.8	4.0	5.6	2.3	1.9	2.6	3.4	1.4	2.5	2.8	2.4	6.6	–0.6	–1.6	2.6
Canada	3.1	6.8	5.5	6.4	6.8	7.0	3.4	5.6	5.2	2.6	7.0	5.8	7.5	3.5	1.2	5.8
Italy	8.2	6.2	5.6	2.6	3.2	5.8	7.0	6.3	5.7	5.0	1.6	3.1	6.9	3.9	–3.5	5.6
Total of above countries[b]	4.1	5.4	4.6	5.9	5.4	5.7	3.8	5.5	4.4	2.5	3.9	5.6	6.2	–0.1	–0.7	5.6
Australia	–0.2	6.3	6.1	6.5	5.3	2.4	6.8	5.7	7.0	5.0	5.5	3.4	6.1	2.4	1.9	3.8
New Zealand	3.3	3.1	6.1	6.2	6.0	3.8	–0.9	2.2	5.0	3.7	2.5	4.4	7.2	4.0	1.5	0.3
Austria	5.6	2.6	4.2	6.2	3.4	5.0	2.4	4.4	5.9	7.8	5.3	6.4	5.8	4.1	–2.0	5.2
Belgium	5.1	5.3	4.4	7.0	3.7	3.0	4.0	4.3	6.6	6.3	4.1	5.8	6.5	4.7	–2.1	5.7
Denmark	6.4	5.7	0.6	9.3	4.6	2.7	4.2	3.8	8.6	2.7	3.6	4.3	2.8	0.2	–1.1	5.3
Finland	8.1	4.3	2.5	6.6	5.1	2.4	2.6	2.4	10.4	8.3	2.4	7.0	6.5	4.3	0.9	0.3
Greece	11.1	1.5	10.1	8.3	9.4	6.1	5.5	6.7	9.9	8.0	7.1	8.9	7.3	–3.6	6.1	5.9
Iceland	0.7	7.5	9.4	8.5	6.6	8.5	–1.7	–5.7	3.1	7.5	11.7	6.7	6.0	3.9	–0.6	3.4
Ireland	4.7	3.6	4.8	4.2	2.0	1.3	5.2	8.1	6.1	3.2	4.0	5.4	4.4	1.4	0.3	3.2
Luxembourg	3.4	1.6	2.2	7.3	1.8	1.7	0.2	4.1	8.3	2.3	2.5	4.4	7.1	3.4	–7.7	2.9
Netherlands	2.9	4.3	3.3	8.6	5.3	2.8	5.3	6.7	6.8	6.9	4.4	3.9	5.9	4.2	–1.2	4.6
Norway	5.1	4.7	5.4	5.4	5.2	4.5	5.8	3.5	5.1	4.2	4.6	5.1	4.1	5.3	3.5	6.0
Portugal	5.5	6.7	5.9	6.6	7.5	4.1	7.5	8.9	2.1	9.1	6.6	8.0	11.2	1.1	–4.3	6.2
Spain	11.8	9.3	8.8	6.2	7.2	8.3	4.3	5.7	7.8	6.0	4.8	8.5	8.4	5.3	0.7	2.1
Sweden	5.7	4.3	5.2	6.8	4.2	2.4	3.4	4.0	5.1	5.0	0.7	2.6	3.5	4.0	0.9	1.5
Switzerland	8.1	4.8	4.9	5.3	3.2	2.5	3.1	3.6	5.6	6.4	4.1	3.2	3.0	1.5	–7.3	–1.4
Turkey	1.7	6.1	9.4	4.1	2.6	11.7	4.5	6.7	5.3	4.9	9.1	6.6	4.4	8.5	8.8	8.5
Total (excluding major 7)[b]	5.5	5.3	5.4	6.6	4.9	4.2	4.4	5.0	6.6	5.8	4.4	5.2	5.7	3.6	0	3.5
Total OECD[b]	4.2	5.3	4.7	6.0	5.3	5.5	3.9	5.5	4.7	2.9	4.0	5.5	6.1	0.4	–0.6	5.2
Memorandum item:																
Total OECD Europe[b]	5.6	4.6	4.6	6.0	4.3	3.9	3.4	5.0	6.0	5.2	3.7	4.4	5.7	2.1	–1.4	4.5
Total EEC[b]	5.1	4.4	4.1	5.9	4.1	3.5	3.2	5.1	5.8	5.0	3.5	4.0	5.7	1.7	–1.8	5.0

a) Excluding Saar and West Berlin.
b) For the periods 1961-65, 1966-70 and 1971-75 the weights are the average of the weights calculated for each year of the period. The weights used for 1976 are those of the period 1971-75.

Growth of real GNP/GDP—Seven major OECD countries

Percentage changes from previous half year, seasonally adjusted at. annual rates

	1961		1962		1963		1964		1965		1966		1967		1968		1969		1970		1971		1972		1973		1974		1975		1976		1977
	I	II	I	II	I	II	I	II	I	II	I	II	I	II	I	II	I	II	I	II	I	II	I	II	I	II	I	II	I	II	I
United States	2.5	6.8	6.7	3.0	3.4	6.0	5.7	3.6	6.3	7.3	6.6	3.3	1.8	4.0	4.5	4.4	2.6	0.6	–1.2	0.5	4.2	3.0	6.6	6.7	6.9	1.5	–1.9	–3.1	–4.5	7.5	6.3	3.0	5.7
Japan	17.1	11.4	6.1	4.8	10.6	15.3	15.0	7.7	3.3	6.8	10.0	12.4	12.8	13.7	12.9	14.0	10.0	9.4	12.9	9.2	6.5	7.5	8.4	11.6	12.9	2.2	–2.2	7.0	–2.0	6.7	7.3	4.0	6.5
Germany	3.9	1.8	6.1	3.7	–1.8	12.4	4.5	5.2	6.7	3.6	4.6	–2.4	–0.8	3.6	6.3	9.6	6.3	9.3	4.4	5.6	3.0	1.9	4.5	3.7	7.6	1.1	1.6	–2.7	–5.8	4.9	7.4	3.0	2.7
France	4.5	5.3	8.6	6.4	2.8	11.2	8.5	2.9	4.9	8.0	5.8	3.8	6.1	5.3	–1.2	15.7	5.0	4.8	7.6	5.8	4.2	7.6	5.2	4.8	6.8	5.0	6.3	–1.9	–7.0	2.8	9.6	2.6	4.6
United Kingdom	5.6	–0.7	1.6	1.1	3.6	7.8	6.0	3.6	0.8	3.1	1.5	1.9	4.0	–0.4	5.7	2.8	–0.8	4.2	1.6	2.7	0.7	7.0	–0.5	3.2	13.3	–2.7	–2.2	4.7	–4.8	–3.8	7.0	2.4	–1.6
Canada	0.5	8.2	7.0	5.2	4.0	7.3	7.3	5.1	7.4	6.7	9.3	2.6	4.2	2.4	6.3	8.4	4.4	4.3	1.9	2.0	8.2	9.2	4.9	5.7	9.8	5.0	5.0	–0.6	1.1	3.7	8.9	0.8	3.7
Italy	9.8	8.8	6.1	3.9	4.9	8.5	2.2	–1.9	4.5	5.7	5.2	7.0	6.8	7.5	4.4	9.0	7.0	–0.1	9.1	2.1	0.8	2.5	3.1	3.8	6.1	11.8	5.4	–4.8	–4.9	1.0	9.1	4.1	3.2
Total[a]	4.3	6.0	6.3	3.4	3.5	8.0	6.4	3.8	5.5	6.5	6.4	3.7	3.5	4.8	5.2	7.0	3.9	3.0	2.2	2.5	4.2	4.4	5.7	6.4	8.3	2.3	–0.1	–1.0	–4.3	5.4	7.2	3.0	4.6

a) See footnote *b*) of above table. For 1977 I, 1971-75 weights.

Notes and sources:
United States: Gross National Product at market prices. *Source: Survey of Current Business*, Department of Commerce, Washington, D.C.
Japan: Gross National Product at market prices. *Source: Economic Statistics Monthly*, Bank of Japan, Tokyo.
Germany: Gross National Product at market prices. *Source: Statistical Supplements to the Monthly Reports of the Deutsche Bundesbank*, Frankfurt.
France: Gross Domestic Production at market prices. This aggregate excludes value-added by general government, financial institutions, and domestic servants among others. *Source:* Institut National de la Statistique et des Études Économiques (INSEE), Paris.
United Kingdom: Gross Domestic Product at market prices. *Source: Monthly Digest of Statistics*, Central Statistical Office, London.
Canada: Gross National Product at market prices. *Source: National Income and Expenditure Accounts*, Statistics Canada, Ottawa.
Italy: Gross Domestic Product at market prices. *Source:* Istituto Nazionale per lo Studio della Congiuntura (ISCO), Rome.

Consumer prices

Percentage changes from previous year

	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976
United States	1.6	1.1	1.2	1.2	1.3	1.7	2.9	2.8	4.2	5.4	5.9	4.3	3.3	6.2	11.0	9.1	5.8
Japan	3.6	5.3	6.8	8.5	3.9	6.6	5.1	4.0	5.3	5.2	7.7	6.1	4.5	11.7	24.5	11.8	9.3
Germany	1.4	2.3	3.0	3.0	2.3	3.4	3.5	1.4	2.6	1.9	3.4	5.3	5.5	6.9	7.0	6.0	4.5
France	3.6	3.3	4.8	4.8	3.4	2.5	2.7	2.7	4.5	6.4	5.2	5.3	6.1	7.3	13.7	11.7	9.6
United Kingdom	1.0	3.4	4.3	2.0	3.3	4.8	3.9	2.5	4.7	5.4	6.4	9.4	7.1	9.2	16.0	24.2	16.5
Canada	1.0	0.5	1.2	1.8	1.8	2.4	3.7	3.5	4.1	4.5	3.3	2.9	4.8	7.6	10.8	10.8	7.5
Italy	2.3	2.1	4.7	7.5	5.9	4.6	2.3	3.2	1.4	2.6	5.0	4.8	5.7	10.8	19.1	17.0	16.8
Total of above countries[a]	1.7	1.6	2.1	2.3	2.0	2.6	3.2	2.8	4.0	4.9	5.6	5.0	4.4	7.7	13.4	11.4	8.3
Australia	3.8	2.5	–0.3	0.6	2.3	4.0	2.9	3.2	2.7	2.9	3.9	6.1	5.8	9.5	15.1	15.1	13.5
New Zealand	..	1.8	2.6	2.0	3.5	3.4	2.8	6.0	4.3	4.9	6.5	10.4	6.9	8.2	11.1	14.7	16.9
Austria	1.9	3.6	4.4	2.7	3.8	5.0	2.2	4.0	2.8	3.1	4.4	4.7	6.3	7.6	9.5	8.4	7.3
Belgium	0.3	1.0	1.4	2.1	4.2	4.1	4.2	2.9	2.7	3.8	3.9	4.3	5.5	7.0	12.7	12.8	9.2
Denmark	1.2	4.2	7.5	5.3	3.6	6.5	6.7	6.9	8.6	4.2	5.8	5.8	6.6	9.3	15.3	9.6	9.0
Finland	2.9	1.9	4.5	5.2	9.9	5.3	3.6	5.5	9.5	2.2	2.8	6.5	7.1	10.7	16.9	17.9	14.4
Greece	1.6	1.8	–0.3	3.0	0.8	3.0	5.0	1.7	0.3	2.4	3.0	3.0	4.3	15.5	27.0	13.4	13.3
Iceland	2.0	4.9	10.2	13.4	19.3	6.8	11.0	3.1	15.1	21.9	13.3	6.6	9.7	20.6	42.9	49.1	33.0
Ireland	0.4	2.7	4.2	2.5	6.7	5.0	3.0	3.2	4.7	7.4	8.2	8.9	8.7	11.4	17.0	20.9	18.0
Luxembourg	0.5	0.5	0.9	2.9	3.1	3.3	3.3	2.2	2.6	2.3	4.6	4.7	5.2	6.1	9.5	10.7	9.8
Netherlands	5.0	1.0	1.9	3.8	5.5	4.0	5.8	3.5	3.7	7.5	3.6	7.5	7.8	8.0	9.6	10.2	8.8
Norway	0.3	2.6	5.2	2.6	5.7	4.3	3.3	4.4	3.5	3.1	10.6	6.2	7.2	7.5	9.4	11.7	9.1
Portugal	3.1	–0.8	2.5	2.0	4.3	3.4	5.7	3.8	4.6	7.0	6.3	8.3	8.9	11.5	29.2	20.4	19.3
Spain	1.5	0.9	5.7	8.8	7.0	13.2	6.2	6.4	4.9	2.2	5.7	8.3	8.3	11.4	15.7	16.9	17.7
Sweden	4.1	2.2	4.8	2.9	3.4	5.0	6.4	4.3	1.9	2.7	7.0	7.4	6.0	6.7	9.9	9.8	10.3
Switzerland	1.4	1.9	4.3	3.4	3.1	3.4	4.7	4.0	2.4	2.5	3.6	6.6	6.7	8.7	9.8	6.7	1.7
Turkey	6.0	3.1	3.8	6.5	0.8	4.6	8.7	14.0	5.3	4.8	7.9	19.0	15.4	14.0	23.9	21.2	17.4
Total OECD[a]	1.8	1.6	2.2	2.4	2.3	2.9	3.4	3.0	4.0	4.8	5.6	5.3	4.9	8.0	13.6	12.2	9.0

a) 1960 private consumption weights and exchange rates for 1960-1972; 1973 weights and exchange rates for 1973-1974 and 1975 weights and exchange rates for 1975-1976.

Consumer prices

Percentage changes over previous period, annual rates, not seasonally adjusted

	1960		1961		1962		1963		1964		1965		1966		1967		1968		1969		1970		1971		1972		1973		1974		1975		1976		1977
	I	II	I	II	I	II	I	II	I	II	I	II	I	II	I	II	I	II	I	II	I	II	I	II	I	II	I	II	I	II	I	II	I
United States	1.1	1.7	0.7	1.2	1.0	1.6	0.8	2.0	1.0	1.3	1.5	2.0	3.1	3.7	1.8	3.7	4.1	4.9	5.3	6.1	6.1	5.3	4.0	3.7	3.0	3.6	6.0	9.2	11.2	12.4	8.3	7.6	4.8	5.7	7.0
Japan	3.9	3.0	4.8	8.8	7.4	4.0	13.5	3.6	3.1	5.4	8.7	3.9	6.9	2.4	4.8	4.0	6.8	3.7	4.8	7.7	9.3	4.4	7.6	5.0	4.0	5.1	12.7	16.7	32.2	17.6	11.5	7.3	11.0	8.1	10.0
Germany	1.1	0.8	3.0	2.4	4.1	1.4	5.3	0.1	3.8	1.7	3.9	4.0	4.4	1.2	2.4	–0.3	5.3	0.3	3.3	0.7	5.4	2.2	7.5	3.9	6.3	5.5	8.3	5.9	8.6	4.9	7.2	4.4	5.9	2.2	5.7
France	5.3	2.8	1.2	4.4	6.4	3.7	5.6	5.1	2.7	2.4	3.2	2.0	2.9	2.5	2.7	3.1	4.9	5.1	6.9	5.2	6.1	4.5	5.6	5.9	5.4	7.6	6.0	9.9	15.0	14.5	11.6	9.3	9.7	9.8	9.0
United Kingdom	1.4	2.0	3.4	5.0	5.4	1.2	3.5	–0.1	4.5	4.4	5.3	4.1	4.1	3.4	2.8	1.0	6.6	4.6	7.0	3.3	7.7	6.9	11.6	7.7	6.4	7.8	9.5	10.0	19.0	16.3	28.7	23.2	15.1	13.5	20.5
Canada	0.8	0.8	0.5	0.4	1.1	2.2	1.2	2.3	1.5	1.9	2.4	3.0	4.3	3.5	2.8	5.0	3.7	4.1	4.4	5.0	3.5	1.7	2.3	5.1	4.0	6.0	7.1	10.1	10.3	12.6	9.6	11.5	6.4	6.0	8.4
Italy	3.1	1.4	2.2	2.4	5.5	5.3	10.0	4.6	6.5	6.0	4.5	3.2	2.3	1.6	4.4	2.5	1.2	0.3	3.0	4.4	5.5	4.5	5.1	4.4	5.4	7.8	12.1	11.2	19.9	25.5	16.8	9.8	18.8	19.5	21.0
Total, above countries[a]	1.6	1.7	1.3	2.0	2.3	1.9	2.7	2.0	2.0	2.1	2.8	2.6	3.6	3.2	2.4	3.1	4.5	4.1	5.2	5.3	6.3	4.7	5.3	4.5	4.1	5.1	7.8	10.1	15.1	13.5	11.7	8.9	8.2	7.7	9.8
Australia	4.3	4.7	2.7	0	–0.7	0.5	0.5	0.7	2.1	4.4	3.6	4.2	2.6	2.5	3.1	4.1	2.0	2.7	3.1	2.8	4.1	4.6	5.9	7.9	5.4	4.9	9.1	14.6	13.6	18.8	15.0	11.6	14.3	13.7	13.4
New Zealand	..	2.7	0.5	3.8	2.2	2.4	1.4	2.8	2.8	5.4	2.5	3.3	2.7	2.5	8.1	5.2	3.5	5.2	5.4	3.8	6.2	9.8	11.6	8.6	7.2	4.9	8.8	10.1	10.3	13.7	14.4	16.3	18.3	14.3	13.6
Austria	2.2	0.4	4.8	4.3	6.8	–0.1	5.1	0.9	6.0	2.7	5.9	5.2	1.0	1.8	5.5	3.1	2.2	3.5	2.7	3.4	4.6	4.9	3.9	6.2	5.6	8.0	7.6	6.9	11.6	8.2	9.7	6.3	8.7	5.6	6.5
Belgium	–0.5	0	1.2	1.5	1.8	0.6	2.5	3.0	4.4	5.0	3.6	4.1	5.4	1.8	3.2	3.4	2.4	2.6	4.2	3.9	4.5	2.8	4.7	5.3	4.9	6.6	7.5	6.2	13.9	16.7	12.1	10.5	9.3	7.6	7.5
Denmark	0.8	1.2	3.8	7.0	6.9	9.2	6.6	0	4.5	4.8	6.2	8.5	7.0	4.9	4.7	16.5	6.1	3.9	2.5	5.0	6.1	8.8	4.0	6.7	6.1	7.4	8.7	12.3	16.3	16.1	8.9	5.1	9.8	11.4	9.6
Finland	3.8	2.8	1.5	0.9	5.2	6.3	4.0	5.7	15.2	5.4	5.0	4.4	3.1	4.9	5.7	6.0	13.5	4.0	1.5	1.9	3.3	2.4	7.1	9.3	5.4	8.3	9.0	16.6	16.6	18.0	18.6	16.2	14.7	11.9	13.3
Greece	0.4	3.6	3.0	–2.2	–0.6	2.1	5.1	–0.5	1.9	0.2	3.5	4.7	6.0	3.4	3.6	–3.4	1.8	1.3	3.7	1.2	4.6	1.5	5.1	0.6	6.7	3.3	15.0	29.4	35.8	9.6	16.5	11.1	17.3	8.0	15.0
Iceland	4.8	0.9	2.4	13.2	10.0	11.2	11.9	16.9	26.3	7.9	6.7	8.3	12.1	9.9	–0.1	5.1	20.7	11.7	29.3	17.2	10.6	16.3	5.2	1.4	11.4	15.1	19.7	29.2	47.3	46.4	54.2	40.9	28.7	35.0	27.8
Ireland	1.5	2.5	3.2	2.3	6.4	1.9	2.4	3.0	8.3	7.5	5.0	2.5	2.2	5.1	2.4	2.8	6.1	4.1	9.6	6.0	8.5	10.0	8.5	9.0	8.4	8.9	12.7	11.4	18.6	19.6	27.8	9.2	24.0	15.0	15.9
Luxembourg	–1.0	1.6	–0.6	1.5	0.3	1.5	2.7	4.7	2.1	3.6	2.7	4.4	4.2	0.5	2.1	3.8	2.5	1.8	2.7	2.0	6.7	3.3	5.5	4.4	4.9	6.8	6.3	5.0	11.8	9.7	11.4	10.4	10.8	7.4	8.1
Netherlands	4.0	0.6	2.6	0.7	4.6	0	7.1	–0.9	10.7	3.2	3.7	4.9	8.2	1.8	4.0	4.0	3.8	3.4	12.5	1.8	3.8	5.2	8.9	6.9	8.9	6.6	9.2	7.0	10.6	10.2	10.7	9.3	9.3	7.4	6.7
Norway	0	0.2	2.4	5.3	5.2	5.3	2.8	–0.3	8.4	6.2	4.4	2.0	3.1	5.1	3.7	5.2	2.9	3.0	2.9	3.5	15.7	7.9	6.0	5.3	7.9	7.7	7.5	6.9	10.9	8.9	13.8	10.3	9.5	7.5	10.3
Portugal	4.4	0.2	–3.9	4.8	1.3	2.7	2.8	–0.2	7.1	3.3	3.2	3.9	8.0	2.6	3.3	6.2	4.5	3.4	9.3	5.9	6.7	5.5	8.7	10.7	10.4	4.0	13.0	16.4	34.7	31.0	20.6	11.0	22.4	21.5	34.7
Spain	1.0	1.8	0.7	0.3	7.0	8.6	11.3	3.9	4.1	16.1	15.5	6.3	6.8	5.0	7.4	5.8	6.7	0.8	2.4	3.1	5.3	9.3	7.9	7.8	7.9	9.4	9.6	16.9	13.9	18.1	17.8	14.3	18.9	18.3	25.1
Sweden	7.2	0.9	3.0	1.7	7.2	3.1	2.9	2.5	3.4	4.2	3.8	8.1	7.1	3.5	5.5	2.8	1.8	1.5	2.9	3.6	9.2	6.2	9.3	4.8	6.9	5.5	7.2	7.0	11.6	9.4	9.3	11.1	11.0	7.9	12.2
Switzerland	1.3	2.5	0.3	4.2	4.7	3.6	3.2	3.7	3.1	2.4	2.9	5.5	5.0	3.6	4.1	4.2	1.9	1.8	3.2	1.8	3.4	5.7	7.3	5.9	7.1	6.5	9.4	9.6	10.2	9.1	7.3	3.2	1.4	1.0	1.4
Turkey	5.1	–5.1	7.4	3.6	5.1	1.8	11.7	0.8	1.9	–0.1	6.6	5.3	14.3	0.6	25.9	5.8	4.7	6.1	4.7	4.2	9.6	8.3	18.6	30.6	9.3	14.5	9.5	22.4	24.7	23.8	25.9	10.6	22.5	14.5	20.4
Total OECD[a]	1.7	1.7	1.4	2.0	2.5	2.0	2.9	2.0	2.3	2.5	3.1	2.9	3.8	3.2	2.9	3.3	4.4	3.9	5.1	5.0	6.2	4.9	5.6	4.9	4.6	5.4	8.1	10.4	15.1	13.8	12.9	9.3	9.2	8.5	10.7

a) 1960 private consumption weights and exchange rates for 1960-1972; 1973 weights and exchange rates for 1973-1974 and 1975 weights and exchange rates for 1975-1977.

Current balances[a]

$ million

	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976
United States	2 824	3 821	3 388	4 414	6 822	5 435	3 034	2 587	621	406	2 360	–1 407	–5 979	6 885	4 457[b]	18 445	4 339
Japan	140	–982	–48	–780	–480	932	1 254	–190	1 048	2 119	1 970	5 797	6 624	–136	–4 693	–682	3 680
Germany	1 139	798	–395	248	131	–1 556	122	2 502	2 964	1 913	870	885	768	4 307	9 807	3 982	3 847
France	146	187	–84	–344	–760	353	–255	205	–855	–1 475	68	525	284	–675	–5 980	–66	–6 097
United Kingdom	–685	61	358	367	–996	–72	291	–805	–687	112	1 754	2 653	338	–2 592	–8 575	–4 106	–2 043
Canada	–1 272	–916	–776	–483	–394	–1 050	–1 079	–463	–91	–850	1 059	427	–389	108	–1 493	–4 677	–3 790
Italy	283	474	236	–746	620	2 209	2 117	1 599	2 627	2 340	1 133	1 902	2 043	–2 662	–8 017	–751	–2 816
Australia	–887	–221	–361	–157	–474	–1 139	–681	–936	–1 304	–901	–826	–799	551	485	–2 612	–619	–1 415
New Zealand[c]	–66	–146	7	–28	2	–134	–120	–116	4	37	–142	–66	55	147	–1 590	–1 342	–989
Austria	–91	–38	77	11	45	–39	–190	–115	–96	89	–21	–109	–194	–359	–471	–322	–1 470
Belgium-Luxembourg[d]	89	22	130	33	11	399	62	300	396	427	669	656	1 424	1 262	–157	–106	–41
Denmark	–58	–110	–240	24	–198	–189	–210	–294	–216	–410	–546	–422	–58	–467	–910	–513	–1 915
Finland	–43	–68	–92	–21	–176	–188	–198	–142	64	21	–239	–338	–117	–387	–1 212	–2 173	–1 169
Greece	–59	–62	–80	–50	–200	–268	–236	–186	–234	–352	–414	–341	–374	–1 189	–1 233	–1 065	–1 084
Iceland	–10	7	11	–4	–8	5	–9	–54	–48	3	8	–45	–20	–13	–155	–144	–24
Ireland	–11	–13	–69	–96	–111	–127	–73	26	–57	–195	–191	–190	–136	–235	–671	–24	–248
Netherlands	347	181	141	121	–154	48	–214	–80	65	31	–519	–170	1 278	2 353	2 060	1 986	2 668
Norway	–107	–183	–175	–180	–73	–133	–195	–243	93	128	–242	–516	–58	–349	–1 103	–2 408	–3 771
Portugal	–45	–198	–31	–26	–	6	51	165	78	202	117	174	350	351	–829	–819	–1 246
Spain	393	221	51	–186	33	–485	–564	–456	–242	–394	79	856	571	557	–3 245	–3 488	–4 294
Sweden	–78	79	63	52	71	–171	–167	–36	–108	–196	–264	210	264	1 221	–950	–1 614	–2 407
Switzerland	93	–211	–338	–360	–411	–69	123	240	544	526	70	83	220	281	171	2 587	3 497
Turkey	–26	–24	–130	–180	–66	–9	–82	–58	–158	–133	–70	24	124	615	–634	–1 832	–2 166
Total OECD	2 016	2 678	1 642	1 629	3 234	3 758	2 781	3 449	4 408	4 448	6 683	9 789	7 569	9 508	–28 035	249	–18 954

a) Goods, services and all transfer payments.
b) Excluding cancellation of Indian debt (–1993) and extraordinary grants (–746).
c) Data for the period 1960-66 are on a settlements basis.
d) Trade data for the period 1960-75 are OECD estimates.

Current balances[a]

$ million

	1970		1971		1972		1973		1974		1975		1976		1977
	I	II	I	II	I	II	I	II	I	II	I	II	I	II	I
United States	1 368	987	188	–1 596	–3 386	–2 595	626	6 257	3 736	719	8 447	9 996	3 844	495	–5 425
Japan	927	1 043	2 308	3 489	2 977	3 642	1 189	–1 325	–4 085	–608	516	–1 198	2 671	1 012	4 602
Germany	390	480	867	18	120[b]	648[b]	1 686[b]	2 621[b]	4 922	4 885	2 491	1 492	2 213	1 634	1 821
France	30[c]	40[c]	386	138	121	165	112	–788	–3 416	–2 564	622	–688	–1 223	–4 874	–1 975
United Kingdom	955[b]	799[b]	1 065[b]	1 589[b]	606[b]	–268[b]	–720[b]	–1 870[b]	–4 100[b]	–4 475[b]	–2 240[b]	–1 870[b]	–742	–1 302	–1 385
Canada	330[b]	730[b]	530[b]	–110[b]	–200[b]	–190[b]	260[b]	–150[b]	–360[b]	–1 140[b]	–2 410[b]	–2 270[b]	–2 208	–1 582	–1 967
Italy	488	645	446	1 454	1 314	731	–1 356	–1 309	–4 639[c]	–3 378[c]	2[c]	–753[c]	–1 471[c]	–1 345[c]	268

a) Goods, services and all transfer payments; actual data, seasonally adjusted.
b) Adjusted to revised annual data by OECD.
c) OECD estimates.

Nominal exchange rates, national currencies against the United States $

Average of daily rates

	Monetary Unit	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977
United States	Dollar	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Japan	Yen	360	361	361	361	362	361	362	362	361	358	358	349	308	271	282	297	297	268
Germany	Deutschemark	4.17	4.02	4.00	3.99	3.98	4.00	4.00	3.99	4.00	3.93	3.65	3.48	3.19	2.67	2.59	2.46	2.52	2.32
France	Franc	4.90	4.91	4.90	4.90	4.90	4.90	4.91	4.92	4.95	5.20	5.53	5.51	4.04	4.45	4.81	4.29	4.78	4.91
United Kingdom	Pound	0.36	0.46	0.36	0.36	0.36	0.36	0.36	0.36	0.42	0.41	0.42	0.41	0.40	0.41	0.43	0.45	0.56	0.57
Canada	Dollar	0.97	1.01	1.07	1.08	1.08	1.08	1.08	1.08	1.08	1.08	1.04	1.01	1.00	1.00	0.98	1.02	0.99	1.06
Italy	Lira	621	621	621	622	624	625	624	624	623	627	627	618	583	582	650	653	832	882
Australia	Dollar	0.89	0.90	0.67	0.67	0.67	0.67	0.88	0.90	0.90	0.90	0.90	0.88	0.84	0.70	0.69	0.76	0.82	0.90
New Zealand	Dollar	0.72	0.72	0.72	0.72	0.72	0.72	0.72	0.74	0.90	0.90	0.90	0.88	0.84	0.73	0.70	0.83	1.00	1.03
Austria	Schilling	26.00	25.99	25.85	25.85	25.84	25.84	25.85	25.85	25.86	25.87	25.87	24.91	23.12	19.59	18.69	17.42	17.94	16.52
Belgium-Luxembourg	Franc	49.87	49.87	49.77	49.87	49.75	49.64	49.83	49.69	49.94	50.14	49.66	48.59	44.01	38.96	38.96	36.79	38.61	35.84
Denmark	Krone	6.90	6.91	6.90	6.90	6.91	6.92	6.91	6.99	7.48	7.52	7.50	7.41	6.98	6.03	6.09	5.74	6.04	6.00
Finland	Markka	3.12	3.12	3.12	3.22	3.22	3.22	3.22	3.43	4.21	4.21	4.21	4.21	4.16	3.82	3.76	3.67	3.86	4.02
Greece	Drachma	30.00	30.00	30.00	30.00	30.00	30.00	30.00	30.00	30.00	30.00	30.00	30.00	30.00	29.64	30.00	32.02	36.52	36.83
Iceland	Krona	36.27	40.16	43.05	43.05	43.05	43.05	43.05	44.22	60.94	88.09	88.09	87.85	87.72	92.39	99.23	153.33	181.92	198.79
Ireland	Pound	0.36	0.36	0.36	0.36	0.36	0.36	0.36	0.36	0.42	0.41	0.42	0.41	0.40	0.41	0.43	0.45	0.56	0.57
Netherlands	Guilder	3.77	3.63	3.60	3.60	3.61	3.60	3.62	3.60	3.62	3.62	3.62	3.50	3.21	2.79	2.69	2.53	2.64	2.45
Norway	Krone	7.13	7.14	7.14	7.15	7.16	7.15	7.15	7.15	7.14	7.14	7.15	7.04	6.59	5.74	5.52	5.22	5.46	5.32
Portugal	Escudo	28.62	28.65	28.58	28.67	28.74	28.71	28.72	28.75	28.69	28.56	28.59	28.21	27.01	24.37	25.24	25.48	30.15	38.23
Spain	Peseta	60.11	60.08	60.04	60.01	60.01	60.03	60.06	61.21	70.07	70.10	70.03	69.53	64.29	58.16	57.64	57.40	66.93	76.01
Sweden	Krona	5.17	5.17	5.16	5.19	5.15	5.16	5.19	5.16	5.17	5.17	5.19	5.11	4.76	4.35	4.43	4.15	4.36	4.48
Switzerland	Franc	4.32	4.32	4.32	4.32	4.32	4.33	4.33	4.33	4.32	4.31	4.31	4.12	3.82	3.17	2.98	2.58	2.50	2.40
Turkey	Lira	9.01	9.02	9.02	9.02	9.04	9.04	9.04	9.04	9.04	9.04	11.49	14.86	14.15	14.00	14.00	14.30	15.78	17.83

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EFFECTIVE EXCHANGE RATES

Percentage changes from 1st quarter 1970
Weekly averages of daily figures

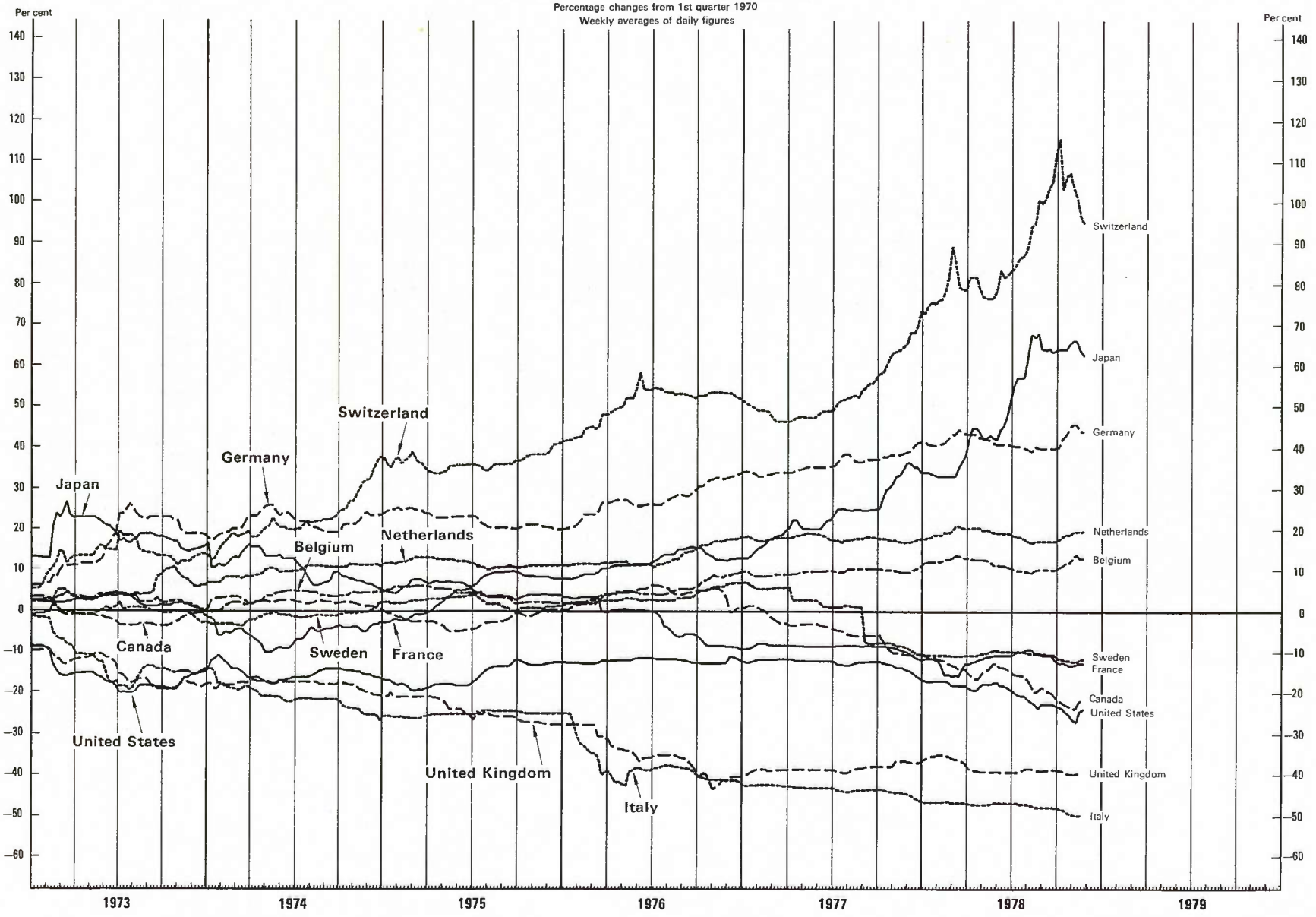


CHART T (cont.)

EFFECTIVE EXCHANGE RATES

Percentage changes from 1st quarter 1970
Weekly averages of daily figures

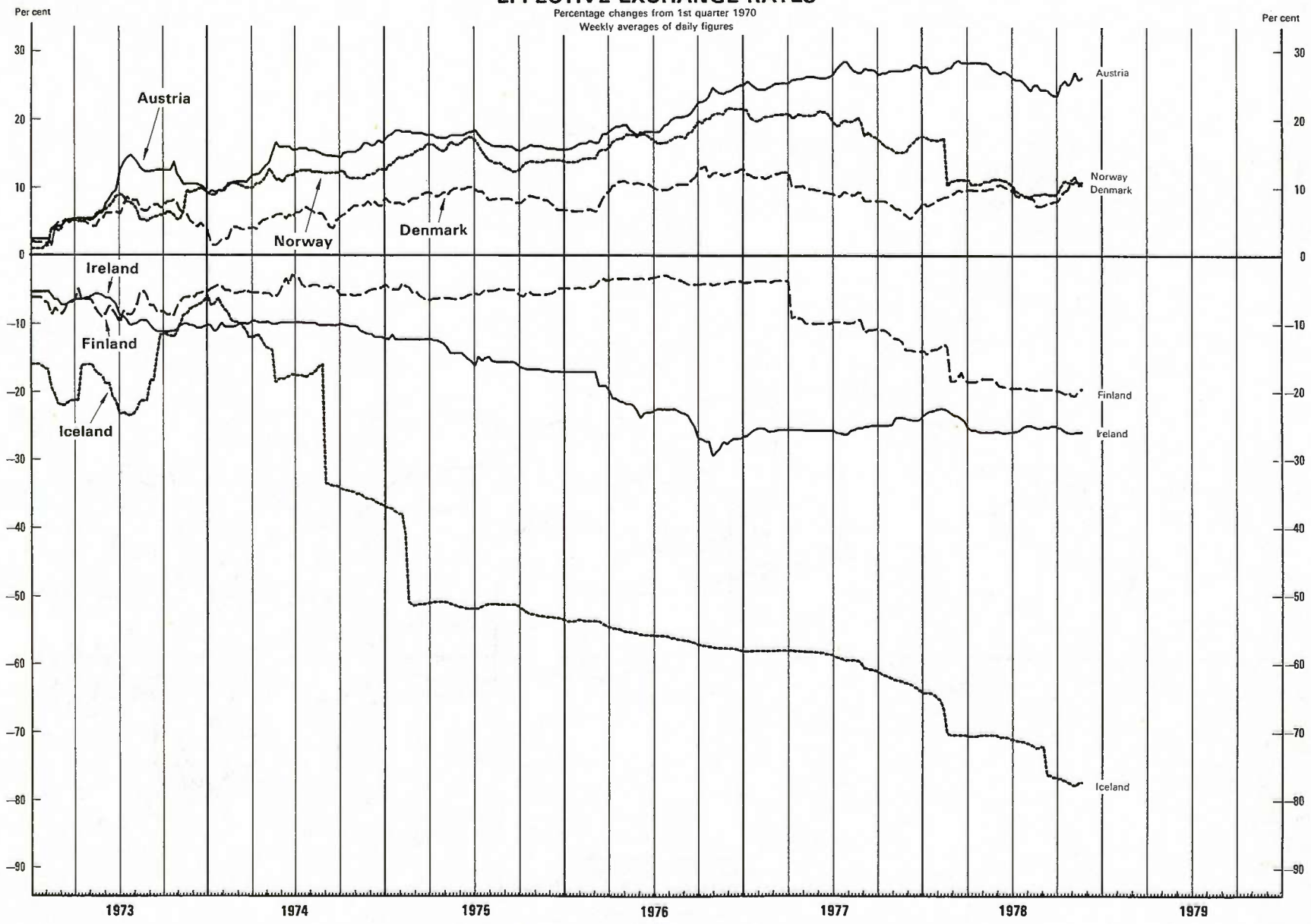


CHART T (cont.)

EFFECTIVE EXCHANGE RATES

Percentage changes from 1st quarter 1970
Weekly averages of daily figures

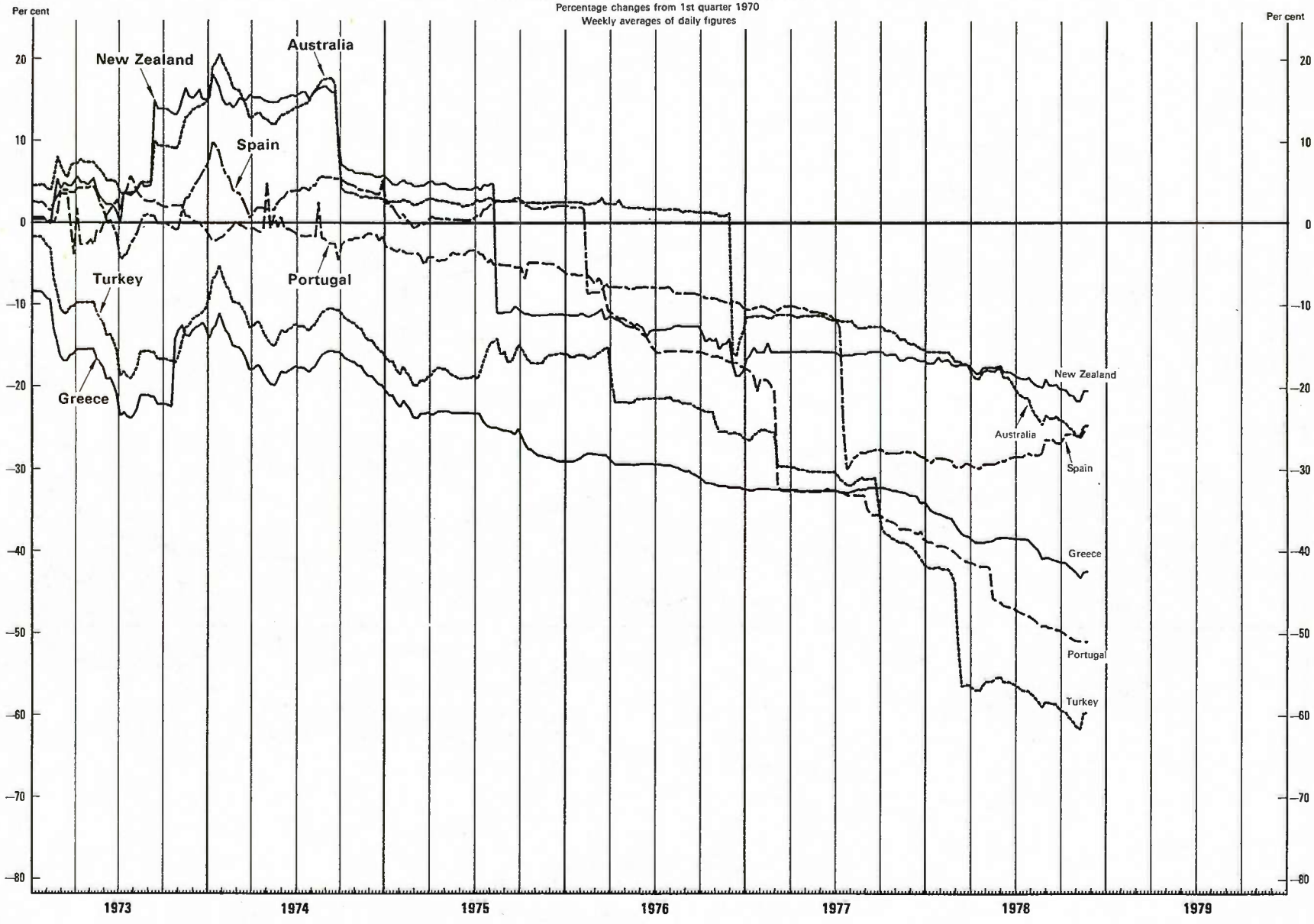


CHART U

EXCHANGE RATES OF MAJOR CURRENCIES AGAINST THE DOLLAR

Percentage deviations with respect to dollar parities of October 1967

end of month figures *

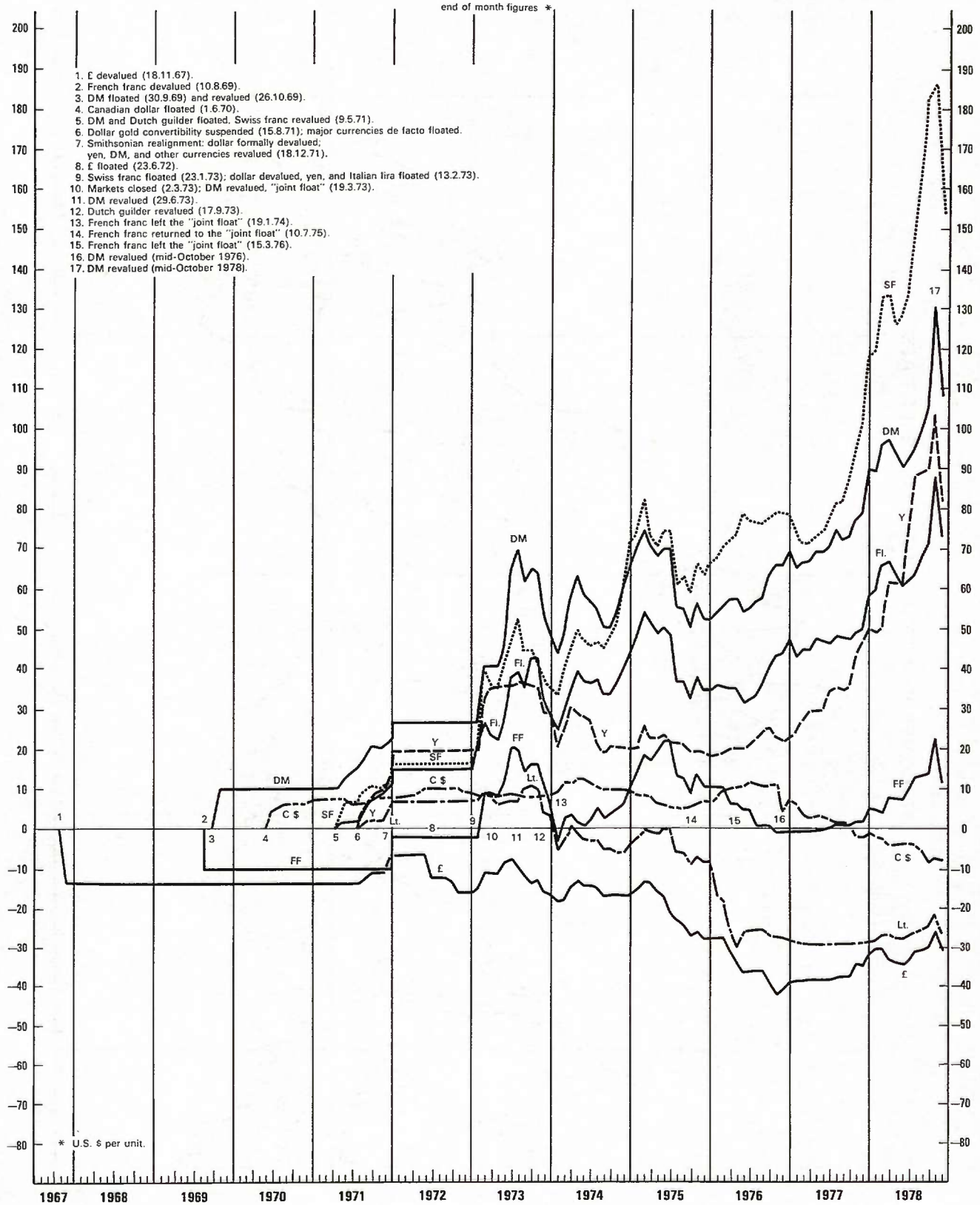


CHART V

UNCOVERED INTEREST RATE DIFFERENTIALS

Domestic rates *minus* Euro-dollar rates, wednesday figures

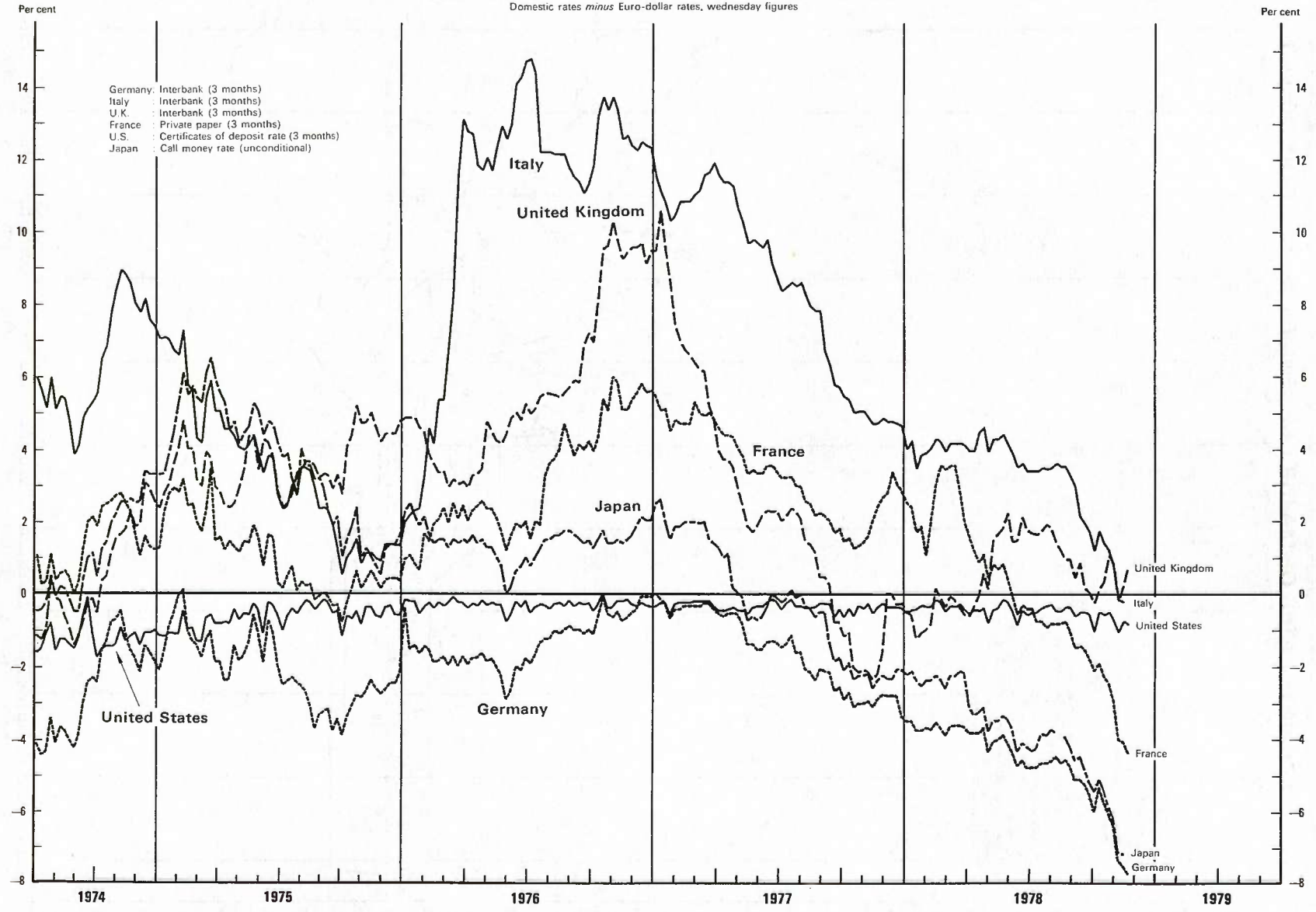
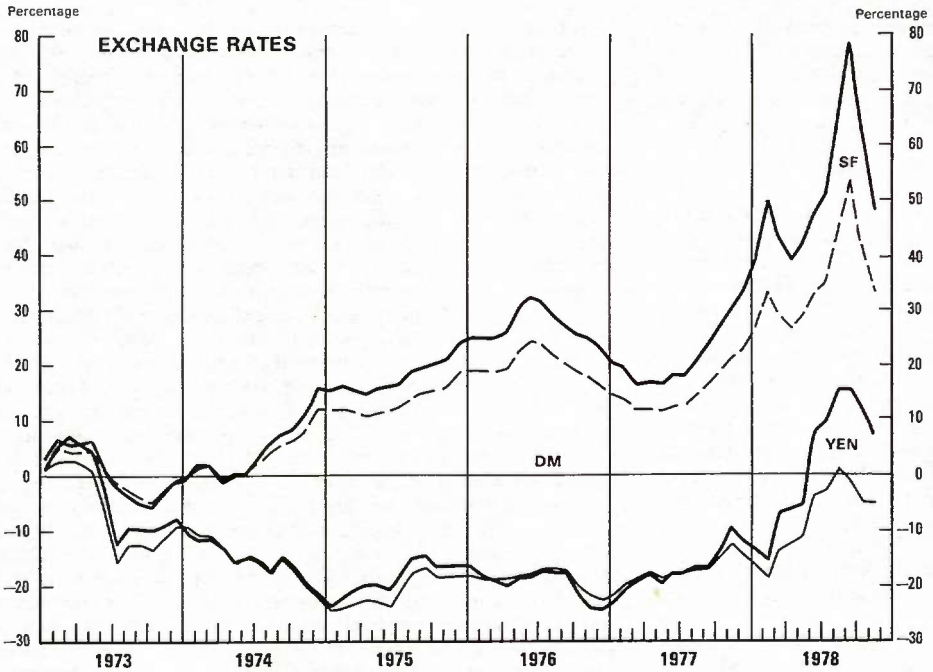


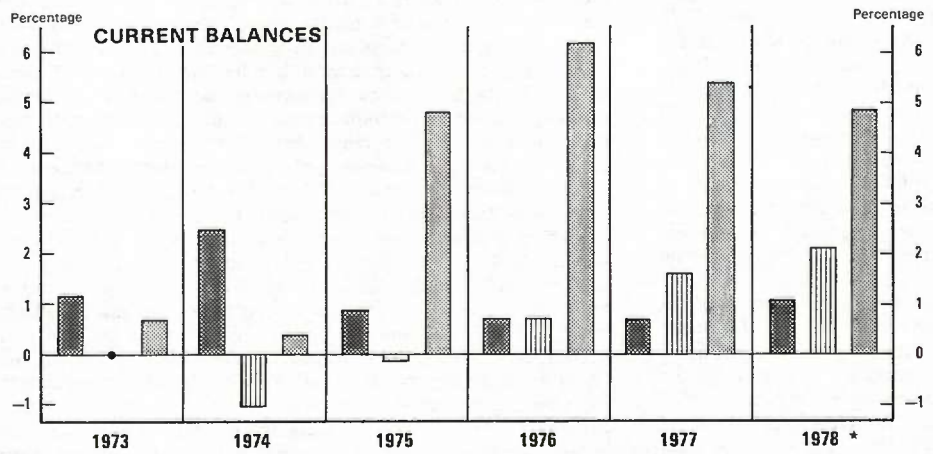
CHART W

GERMANY, JAPAN AND SWITZERLAND: RELATIVE EXCHANGE RATE EVOLUTIONS, CURRENT ACCOUNT POSITIONS AND CHANGES IN NET OFFICIAL RESERVES



Yen { effective rates (a)
S.F. \ *(left scale)*
Yen { against the D.M. (b)
S.F. \ *(right scale)*

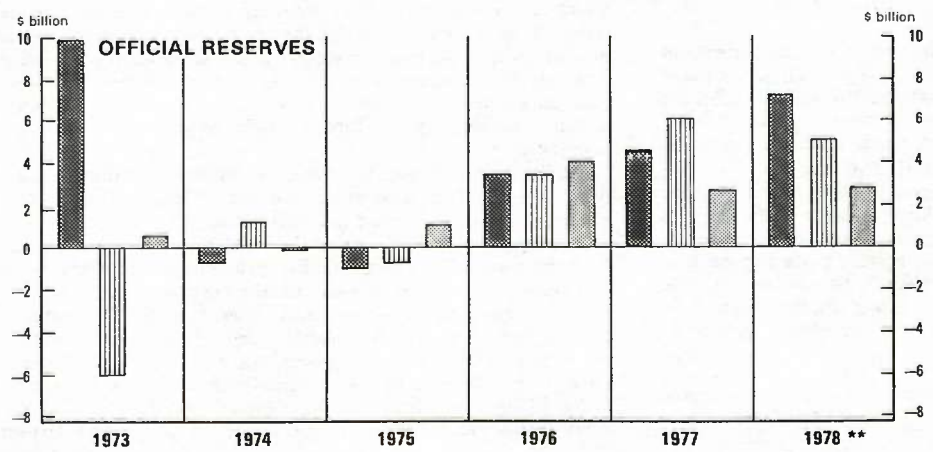
a. Percentage variations of the Yen and the Swiss franc *less* percentage variations of the Deutschemark.
b. In Frankfurt.



Current account positions (in $) as a percentage of GNP (in $)

Germany
Japan
Switzerland

* Partly forecasts



Changes in net official reserves (in $)

Germany
Japan
Switzerland

** January-October

Sources and Methods

The OECD *Economic Outlook* draws heavily on the statistical work of the Department of Economics and Statistics. The following notes describe briefly the statistical concepts and methods applied as well as the forecasting techniques used. Special emphasis is given to deviations from national or other international practices.

FORECASTING TECHNIQUES

A key feature of the OECD semi-annual forecasting cycle is that it produces a set of forecasts for the Member countries which is consistent externally as well as internally.[1] Hence, considerable emphasis is placed on international trade influences. The forecasting period is normally the half-year within which the forecast is carried out and the two subsequent half-years. Forecasts of national accounting aggregates are made for each country using the techniques and the procedures described below. Basically, the forecasting "round" involves a set of successive iterations between domestic and external projections. The purpose is to take into account as fully and consistently as possible, for each country, both domestic impulses and the export demand generated by the import needs of the other countries. The country tables for demand and output, and the trade and balance of payments tables are the final result of this process. While account is taken of forecasts prepared in countries concerned, both official and unofficial, the forecasts given here are entirely the responsibility of the OECD Department of Economics and Statistics.

Relatively detailed forecasts are prepared for the seven largest OECD countries (the United States, Japan, Germany, France, the United Kingdom, Canada and Italy) which account for 72 per cent of total OECD trade and 85 per cent of total OECD GNP (1977 weights and exchange rates). Within this group, the forecasts are prepared on a quarterly basis for the United States, Japan, Germany, and the United Kingdom, although the *Economic Outlook* presents only half-yearly and yearly forecasts. For the other OECD countries, available data permit only somewhat less detailed forecasts. In some cases, however, where only yearly data are available from national sources, the OECD Secretariat prepares its own half-yearly estimates on the basis of short-term economic indicators. All half-yearly demand and output figures shown are seasonally adjusted and percentage changes are presented at annual rates.

Some of the basic forecasting methods employed, particularly in the major countries, have been described in the OECD report, *Techniques of Economic Forecasting*, Paris 1965. In addition, use is made of the results of econometric models, developed by the Secretariat as well as other organizations, for individual countries and for trade flows among Member countries. Although there are some variations in procedures, depending *inter alia* on data availability, the country forecasts are generally developed in a similar fashion.

The forecasting "round" begins with preliminary assessments of the level of demand for the individual countries which permit initial estimates of import and export demand to be derived on a consistent basis. Forecasts are then prepared in volume terms for the other broadly exogenous components of demand: public consumption and gross fixed investment. Fiscal and monetary policy assumptions are generally based upon existing stated policies, although these are occasionally modified in cases where there is strong likelikood of particular measures being enacted (the individual country notes discuss the assumptions made in particular cases). For public consumption and public investment, as much use as possible is made of budgetary statements, although their availability and usefulness vary from country to country. Private investment components are separately forecast, the minimum disaggregation for the major countries being the distinction between residential and non-residential investment. Foreign exchange rates are assumed to remain unchanged over the forecast period.

The forecasts for the exogenous elements of demand plus any information that may be obtained regarding stock changes and an initial estimate of the possible growth in private consumption, provide a first revision of the preliminary estimate of the level of demand. This information, in conjunction with estimates of the possible growth of "potential" supply, are used to calculate required data for forecasting the household appropriation account and subsequently private consumption. In order to get some indication of the possible growth of supply, use is made of a number of relationships describing the "potential" growth rate of the economy and the differences between this and the level of demand give some measure of the pressure of demand. However, since the definition of potential growth may, at times, pose difficult problems, various indicators of demand pressure are actually used. The forecast change in the level of demand leads to forecasts for employment. The pressure of demand, information on the pattern of wage settlements and a strong element of judgement regarding cyclical labour productivity change give an estimate of the probable development of labour incomes and property and profit incomes accruing to households. The resulting forecasts of incomes are then adjusted to take account of taxes and transfers to derive personal disposable income. Real consumption is forecast from consumption functions; as a check, the implied savings ratio is compared with its past behaviour. The forecast of demand and foreign trade prices (see below) as well as an assessment of supply potential, provide a basis for an evaluation of the possible development of domestic prices. The expected evolution of wages, employment and productivity growth give the contribution of unit labour costs to changes in non-food prices. Special factors which may affect food prices are taken into account and an estimate is finally reached for the implicit price deflator for private consumption. Denlators for the other demand components are usually separately estimated in order to obtain the deflator for total output and an estimate of nominal GNP. Finally, the various components of demand, particularly investment, are reviewed in the light of the overall level of aggregate demand and adjustments made to allow for feedbacks where the level of consumer expenditure was markedly different from the level implicitly or explicitly assumed in the initial stages of the forecasting exercise or for indirect effects which may appear from the nominal side. On the basis of past cyclical relationships between demand (domestic and foreign) and imports and the import content of different demand components, an estimate is also made of the likely volume of import demand. Forecasts for merchandise imports and for imports of services are usually made in terms of customs and balance of payments statistics (see below) and then transposed into national accounting terms. Thus, a first forecast of the change in real expenditures is obtained, with links between volume and price developments taken explicitly into account. The subsequent stages of the forecasting procedure consist of iterations, with a view to ensuring the international consistency of foreign trade forecasts of individual countries.

OECD trade forecasts in volume are based on the projected import demand of individual countries described above. Alongside the estimates of import demand in OECD countries, forecasts are generated for demand from outside the OECD area. These are made for eight non-OECD groups: OPEC high and low absorbers, Latin America, South-East Asia, other developing countries, Soviet-bloc countries, Sino-bloc countries and other non-OECD countries. Having forecast import volumes for each OECD country and for the eight non-OECD country groupings, it is possible to calculate the growth of demand facing the exporters of each OECD country. Calculations are made for growth of export markets and of relative export performance. These concepts are defined in Table 51. Export

1. Further details on how the OECD's INTERLINK model is used for checking the international consistency of forecasts are available in the *Occasional Studies* associated with this copy of the *Economic Outlook*.

performance is affected, *inter alia*, by movements in competitive position[2] and by relative demand pressure among countries.

Separate forecasts are made for trade prices (average values) in each OECD country:

i) Export prices of manufactures are based on estimates of the evolution of unit labour costs, prices of raw materials, and possible profit margin adjustments.

ii) Prices of industrial commodities are related to the overall growth of industrial demand in the OECD area. Food prices are projected on the basis of expected crops and the situation of stocks.

iii) Prices of imports and re-exports of oil, as well as other energy products are not forecast but are assumed to remain unchanged relative to prices of manufactures.

Given the above, it is possible to obtain forecasts for total export prices for each individual country. Having forecast export prices of manufactures, the implicit import price of manufactures is obtained for each country by weighting its suppliers' export prices – in U.S. dollars – by the share of suppliers' manufactured exports in the country's imports. An estimate of total import prices can be derived for each OECD country given the import prices of manufactures, commodities and energy. From these forecasts for prices and volumes for each country, total trade flows in value are calculated.

A similar but much simpler process is employed in arriving at forecasts of invisible transactions. For each main category of invisibles – travel, transportation, investment income, workers' earnings and migrants' remittances, government services, other miscellaneous services, private and official transfers – forecasts are prepared for each country's imports (debits) and for the OECD's transactions with the rest of the world. The resulting total OECD exports (or credits) are then allocated to individual OECD countries and to the non-OECD area.

The foreign trade and invisible transactions forecasts often change the country demand and output forecasts themselves since these were initially prepared without a cross-country consistency check. The revised forecasts are then used to produce a new foreign trade forecast. Successive iterations of this procedure increase the consistency of trade and output forecasts.[3]

NATIONAL ACCOUNTS

The figures shown in the country tables on Demand and Output follow, in general, the *OECD Standardized System*[4] definitions, which need not be summarised here. One important deviation from the *Standardized System* is the line public investment which includes, whenever possible, fixed capital formation by both general government and government owned and controlled enterprises. The latter's definition and coverage may vary as between countries.

a) *United States*

Official quarterly national accounts, published in the *Survey of Current Business* of the Office of Business Economics of the U.S. Department of Commerce, are available through the third quarter of 1978. The Appropriation Account for households is on OECD definitions and differs slightly from official U.S. figures. Briefly, OECD disposable income equals U.S. disposable income minus consumer interest payments and OECD personal taxes equals U.S. personal taxes plus social insurance contributions. OECD estimates of the saving rate may thus differ by one to two tenths of a percentage point from estimates based on the official U.S. definition. Government fixed investment expenditures (including those of government enterprises) are included in "government expenditure" and no allowance is made for depreciation of government fixed capital. The investment figures, therefore, refer to the private sector only.

b) *Japan*

Quarterly national accounts are published in the *Annual Reports on National Income Statistics* and *National Accounts Statistics Quarterly* of the Economic Planning Agency. Partial national accounts data are also published by the Economic Planning Agency in *Japanese Economic Indicators*. Figures for the second quarter of 1977 through to the second quarter of 1978 are preliminary estimates published by the Research Institute of the Economic Planning Agency.

c) *Germany*

The German official national accounts follow the *Standardized System* and are published on a half-yearly, not seasonally adjusted basis by the Statistiches Bundesamt in *Wirtschaft und Statistik* and on a quarterly basis, seasonally adjusted, by the Deutsche Bundesbank in *Statistiches Beiheft zu den Monatsberichten,* Reihe 4. Data are available up to and including the second quarter of 1978. Seasonal adjustments to quarterly unadjusted sub-aggregates of gross fixed construction investment are made by the OECD.

Working day adjustment: The fluctuation of working days per quarter around the "normal" pattern (i.e. the pattern which the applied seasonal adjustment routine assumes to exist) is very pronounced during the time period covered by the present forecasting round:

	1978				1979			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Difference between actual and "normal" change in working days per quarter (percentage points)	−1	+2	−3.5	0	+3	−2	−1	0

Such deviations from "normal" quarterly working day patterns occur due to movable holidays, coincidence of holidays with weekends, and the existence of leap years. To what extent deviations of working days per quarter from "normal" patterns are reflected in seasonally adjusted output and demand figures will depend on:

- the type of working day irregularity (e.g. an additional working day due to a leap year has a different effect from that due to coincidence of two holidays);
- the demand component under consideration (e.g. private consumption will hardly be affected[5] while public consumption (volume), a large part of which is measured by hours worked by public employees, will be greatly affected);
- the production process under consideration (e.g. continuous process activities will be less affected than other types of activities).

It is obvious that a cyclical interpretation of variation in growth rates due to workday effects (whatever they may be) is undesirable and dangerous. The Ministry of Economics assumes that about 50 per cent of the irregular working day fluctuations are on average reflected in GNP growth[6], but no attempt is made to distribute the effect among the various demand components. The Bundesbank, whose historical quarterly GNP figures are used in this document, does not make any working day adjustment, but takes account of the effect (to varying degrees) in the verbal interpretation of the published numbers. In the light of the size of the workday effects during the current forecast period, a workday adjustment starting with the first quarter of 1978 was considered necessary. The following procedure has been applied: half the deviation of quarterly working days from the "normal" pattern is assumed to be reflected in quarterly GNP figures. The overall effect on output has been distributed among the various demand components according to the following rules:

2. The exchange rates used to derive competitive position measures and, more generally, balance of payments projections, are those prevailing at the time the forecasts are finalised. For a more detailed discussion on the measurement of competitive position, see "The International Competitiveness of Selected OECD Countries", OECD, *Economic Outlook – Occasional Studies,* July 1978.

3. The process of arriving at a mutually consistent set of trade and domestic demand forecasts is facilitated by the use of an econometric model of world trade. See Lee Samuelson, "A New Model of World Trade", OECD, *Economic Outlook – Occasional Studies,* December 1973.

4. United Nations, *A System of National Accounts* (New York, 1968).

5. If it is argued that typical households consume more on a holiday than on a workday, a reduced number of workdays should lead to higher consumption.

6. This explains a large number of particularly violent historical fluctuations in German quarterly GNP growth rates.

i) Private consumption: no effect (assuming equal consumption on working days and holidays).
ii) Public consumption: 50 per cent of working day deviation assumed to be reflected in demand since about half of public consumption (volume) is measured by hours worked.
iii) Construction: proportional effect on output due to the simultaneity of output and demand measurement, i.e. no stocks.
iv) Exports and imports: proportional effect on demand due to work patterns in transportation;
v) Residual output effect to fall on stockbuilding.

d) *France*

In October 1976, INSEE published a new system of national accounts. The old French national accounts has been replaced by the *Enlarged System of National Accounts* (ESNA), a modified version of the system of accounts employed by the European Economic Community. For a description of this system, see *Système Élargi de Comptabilité Nationale,* collection of INSEE, May 1976. Annual data based on this system are available for 1970-1977. Quarterly national accounts based on ESNA are being prepared. At present, quarterly accounts are only available on the old French national accounts basis and cover the period until the fourth quarter of 1976. Because of differences in concepts and definitions between the French national accounting system and the standardized accounting system, the half-yearly developments, as estimated by OECD, differ somewhat from the quarterly national accounts.

e) *United Kingdom*

The forecast is based upon national accounts through the second quarter of 1978 and balance of payments data up to the third quarter of 1978 published in *Economic Trends*, CSO, 1978. The three official estimates of GDP were weighted giving 40 per cent to both output and expenditure and 20 per cent to income to yield a "compromise" GDP estimate. The compromise adjustment is assumed to remain constant from the fourth quarter of 1978 onwards. The forecast assumes that one third of the total oil output from the North Sea will be exported and two thirds will be used domestically as import substitutes. Figures are given in the forecast table for the contribution of North Sea oil to GDP during the forecast period.

f) *Canada*

Official quarterly national accounts through the second quarter of 1978 are from *National Income and Expenditure Accounts* of Statistics, Canada. The Canadian national accounting convention includes a separate entry for the "residual error of estimate". This item is included in the OECD figures for GNP, which are therefore not the sum of the expenditure components. Over the forecast period, the residual error has been assumed to remain unchanged from the level of the first half in 1978.

g) *Italy*

The definitions used are those of the *European System of Accounts* (ESA). The line public investment includes investment by General Government, public enterprises and "autonomous bodies" (e.g. railways). The annual aggregates for 1975 and 1976 are drawn from the data published in *Relazione Generale* 1977. Past half-yearly developments, up to mid-1978, are partly based on quarterly national accounts estimated by *Istituto Centrale di Statistica* (ISTAT) and *Istituto Nazionale per lo Studio della Congiuntura* (ISCO). From 1976 onwards, the ISTAT has not published an appropriation account for households and it has been estimated by the OECD.

FISCAL AND MONETARY POLICIES

a) *Fiscal impacts* (Table 11 and Table 12)

The fiscal impact measure is derived from changes in the real weighted budget balance for a sample of seven major OECD countries. The measure takes into account the fact that different categories of revenues and expenditures impart different impacts to activity. Changes in deflated budget items are thus multiplied by different "weights" which are computed on the basis of a simple macro-model of income determination. Import propensities and household and business sector spending propensities constitue the key parameters in the model.[7] The measures do not incorporate "secondary" or "general multiplier" effects. Calculations cover current revenues (net of transfers) and expenditures on goods and services of the general government as defined in the OECD *Standardized Systems* (SNA). Changes in the aggregated budget deficit are based on general government net lending for seven countries (SNA basis). Figures for 1978 and 1979 are forecasted by the Secretariat.

b) *Monetary aggregates* (Chart F and Table 14)

i) The money supply narrowly defined (M1) consists of currency in circulation with the public and demand deposits; the money supply broadly defined (M2) is M1 plus time deposits. For the United Kingdom, the money supply broadly defined is M3 consisting of currency in circulation with the public, together with all deposits (public and private) denominated in sterling. For Germany, M3 consists of M2 as defined above plus standard savings deposits; the central bank money stock includes currency in circulation and compulsory reserves on deposits held by residents at constant (January 1974) reserve ratios. Domestic credit shown for Italy corresponds to bank loans, loans of special credit institutions, bonds issued by local authorities, public corporations and business companies plus net indebtedness of the state sector.
ii) The growth rates of monetary aggregates shown in Table 14 are the seasonally adjusted annual rates of change of the most recent 3 month period ending with the latest observation, over the three month average for 12, 6, and 3 months before. Three month averages are used to eliminate the influence of erratic monthly movements in money stocks.
iii) All data are seasonally adjusted and are taken from various national sources.

c) *Interest rates* (Chart F)

The interest rates or yields shown are generally those at or near ends of periods. For the countries indicated, the sources are the following:

United States: Federal Funds and Government bonds – *Federal Reserve Bulletin.*

Germany: Interbank Money – *Monthly Report of the Deutsche Bundesbank;* Government bonds – OECD, *Main Economic Indicators.*

France: Call Money – OECD, *Main Economic Indicators;* public corporation bonds – *Conseil National du Crédit.*

United Kingdom: Treasury bills – OECD, *Main Economic Indicators;* debentures – *Financial Statistics.*

Canada: Finance Company Paper and Government Bonds – *Bank of Canada Review.*

Italy: Interbank money – Banca d'Italia, *Bollettino;* Bonds of corporations and financial institutions – *Mediobanca.*

d) Sectoral financial positions (Special Section)

i) *Sector Definitions*

The sectoring adopted in Tables 15 to 19 corresponds to national flow of funds definitions except for the public sector in the United States, which has been defined as Federal government and state and local governments, while the latter are treated as part of the non-financial private sector in U.S. flows of funds statistics.

ii) *Financial Surpluses and Deficits* (Table 15)

Financial balances of domestic sectors (households, corporate businesses and public sector) indicate the differences between total funds available for investment

7. For a detailed description of the model used and data definitions, see "Budget Indicators". OECD *Economic Outlook – Occasional Studies,* July 1978.

(gross saving plus net capital transfers received), and capital expenditures (gross fixed investment plus stockbuilding). A surplus represents the amount a sector has available for adding to financial assets or reducing liabilities, while a deficit measures the amount it has to raise by borrowing or by reducing financial assets. The financial balance of the foreign sector corresponds to the current account surplus or deficit of the balance of payments with the opposite sign.

iii) *Households' Financial Transactions* (Table 16)

Net financial investment is equal to the net acquisition of financial assets less the net increase in liabilities. Discrepancies between the net financial investment and the financial surplus of households in Table 15 result from unidentified financial transactions.

Liquid assets are defined as follows:

United States: currency, demand and time deposits, U.S. government securities, state and local obligations, open market paper and money market fund shares.

Japan and Germany: currency, demand deposits, savings and time deposits.

United Kingdom: notes and coins, national savings deposits, bank deposits, deposits with other financial institutions (building societies and finance houses), temporary local authority debt and tax reserve certificates.

Indebtedness corresponds to the following items in national flow of funds:

United States: home and other mortgages, consumer credit, loans, security credit, trade debt.

Japan: loans (by private and public financial institutions), trade credit, other liabilities.

Germany: consumer credit, personal loans (excluding identified mortgages).

United Kingdom: bank loans, hire purchase debt, loans for house purchase, other liabilities.

iv) *Balance Sheet Ratios for Non Financial Corporations* (Table 17)

The variables used for the calculation of the ratios are defined as follows:

Internal funds: retained profits (less inventory valuation adjustment), depreciation and net capital transfers received.

Capital outlays: stockbuilding (excluding valuation adjustment) and gross fixed investment (estimates for Germany explicitly include net purchases of land).

Short-term debt: United States: approximately 60 per cent of bank loans, commercial paper, finance company and U.S. government loans. Japan: approximately 85 per cent of loans by private financial institutions. Germany: short-term bank loans plus sale of money market paper. United Kingdom: bank borrowing.

Total debt: short-term debt, as defined above, plus other credit market borrowing (i.e. mainly bond issues and long-term loans).

Liquid assets: same definitions as for the household sector under iii).

Current liabilities: short-term borrowing plus trade credit and miscellaneous liabilities.

Equity: stock issues.

v) *Corporate Financial Positions* (Chart G)

Internal funds and capital outlays: above definitions under *iv*).

Liquidity ratios: United States and Germany: liquid assets over current liabilities as defined above under *iv*). United Kingdom: holdings of current assets over holdings of current liabilities, derived from company surveys (see CSO, *Economic Trends*, November 1974 and May 1977). Japan: cash and deposits at end-quarter over average sales, derived from short-term economic survey of enterprises.

vi) *Public Sector Borrowing* (Table 18)

The *public sector borrowing requirement* corresponds to the increase (+) in liabilities in the flow of funds account of the public sector. It can also be defined as the sum of financial surplus (-) or deficit (+) and financial asset formation (+) by the public sector (i.e. all transactions which require financing through net borrowing).

Credit market funds raised by non-financial sectors are funds borrowed by households, corporate business, public and foreign sectors, which correspond to the following categories of liabilities in flow of funds accounts:

United States: Treasury issues, corporate equities, bonds, mortgages, consumer credit, bank loans, U.S. Government loans, open market paper, other debt instruments.

Japan: securities (bonds and stocks), loans by private and public financial institutions.

Germany: money market paper, bonds, shares, bank loans, loans by building and loans associations and by insurance companies.

United Kingdom: bank lending, hire purchase and other instalment debt, loans for house purchase, U.K. Government loans, other loans, marketable government debt, other local authority debt, capital issues by U.K. companies.

vii) *Contributions to Total Monetary Expansion* (Table 19)

Ratios of absolute annual changes in net claims of the consolidated banking system (including central bank) on private domestic sectors, the government and the foreign sector to the corresponding change in the sum of money stock, quasi money, and other bank liabilities. The latter sum equals the total of domestic bank credit and net foreign assets held by the banking system.

viii) *Sources*

Tables 15 to 18 and Chart G: United States: Federal Reserve publications of flow of funds accounts. Japan: Bank of Japan, *Economic Statistics Annual and Monthly*. Germany: Tables and methodological notes on the capital finance account, (Special Prints No 4), and *Monthly Report of the Deutsche Bundesbank*. United Kingdom: Bank of England *Quarterly Bulletin*, *Financial Statistics and Economic Trends* (CSO).

Table 19: IMF, *International Financial Statistics*.

COST AND PRICE DATA

In order to facilitate the interpretation of current cost and price trends, the OECD Secretariat has compiled indicators on wage costs, and consumer and producer prices from various sources. In spite of the efforts made to derive reasonably comparable series, there are considerable divergences in definitions and statistical methods and intercountry comparisons can only be made with great caution.

Prices indices

The coverage and calculation methods of *consumer price indices* vary greatly from country to country.[8] In some countries, the weights used to calculate the index are revised fairly frequently on the basis of family expenditure surveys using large samples, and in such cases, the index moves about in line with the deflator for private consumption. In some countries, however, the weighting system relates only to low income groups, and/or, is seriously out of date. In such cases, the weight of food is generally higher and that given to services lower, compared with the pattern of expenditure for private consumption as a whole and the consumer price index can diverge substantially from the consumption deflator.

The lack of uniformity is even more marked for *wholesale price indices*. Differences are particularly important with regard to the

8. For a detailed survey see C. Vannereau, "Comparability of Consumer Price Indices in OECD Countries", OECD, *Economic Outlook – Occasional Studies*, No. 17, July 1975.

degree of coverage for finished goods, raw materials and semi-finished products. The number of items included varies from a few hundred to several thousand.

The following price series[9] have been used for *"input"* prices in compiling the figures for Chart K.

Canada: Raw and partly manufactured goods (W).

United States: Crude materials for further processing and intermediate materials and supplies (W).

Japan: Raw materials and semi-finished goods (W).

France: matières premières industrielles et produits industriels semi-transformés (W).

Germany: Grundstoffe und Produktiongüter (P).

Italy: Materie prime e prodotti intermedi (W).

United Kingdom: Basic materials and fuels used in manufacturing industries (W).

The price series indicated below have been used for *"output"* prices.

Canada: Fully and chiefly manufactured goods (W).

United States: Finished goods (W).

Japan: Investment goods and consumer goods (W).

France: Produits manufacturés (prix à la consommation).

Germany: Erzeugniss für Investitiongüterindustrien (P). Erzeugnisse für Verbrauchsgüterindustrien (P).

Italy: Prodotti finiti (W).

United Kingdom: Output of manufacturing industries (W).

The composite indices shown on the chart have been calculated by applying 1977 GNP weights.

Wages

Wage indices are not comparable between countries, not only because of the variety of sources and methods of calculations, but also because of important differences in definitions (e.g. hourly rates, hourly earnings, monthly earnings, inclusion or exclusion of fringe benefits, etc.).

The different series used in Table 21 and their sources for the largest countries are:

United States: Gross hourly earnings per production worker: *MEI* (i.e. OECD *Main Economic Indicators).*

Canada: Hourly earnings: in firms employing 20 workers and over, last payroll of month: *MEI.*

Japan: Monthly earnings: cash payments including bonuses earned by regular workers in firms employing 30 or over: *MEI.*

France: Hourly rates: wage earners excluding under-18's and piece work: *MEI.*

Germany: Hourly earnings: all production workers, all regular payments including efficiency and social premiums and bonuses, and overtime: *MEI.*

Italy: Hourly rates per production worker, excluding family allowances: *MEI.*

United Kingdom: Average weekly earnings: all employees (G.B.): *MEI.*

Unit labour costs in manufacturing (Table 22)

In principle, unit labour costs are derived from total labour costs per worker to the employer (including fringe benefits and social charges) divided by indices of output per man-hour. The data shown are by and large unit wage costs, except for the United States, where fringe benefits and employers' social security contributions are included. There are also differences in definitions and coverage in all the component series (earnings, employment, hours worked and output).

For Canada, the data are taken from the *Canadian Statistical Review*. This series is calculated as the ratio of wages and salaries divided by real domestic product in manufacturing. The United States series is from the monthly *Business Conditions Digest* and measures the ratio of labour costs in manufacturing to industrial production. The comparable Japanese data are taken from the *Japanese Economic Indicators*. German data are taken from the *Statistiche Beihefte zu den Monatsberichten der Deutschen Bundesbank,* while data for the United Kingdom come from the *Monthly Digest of Statistics*. For the countries above, the series are currently reproduced in the MEI. Data for France are supplied by INSEE. For Italy, the data are taken from the *Relazione Annuale* (Banca d'Italia).

The real wage gap (Chart L)

Estimates of the real wage gap are based on standard national accounts data and OECD forecasts. "Real wages" are defined as wages and salaries per dependent employee deflated by the private consumption deflator. "Adjusted productivity" is defined as productivity in the broadest sense, i.e. real GDP per employed person, adjusted for the effect of changes in the terms of trade on total income.

There is, at present, no single method generally accepted as the best for measuring the effects of changes in the terms of trade on real national income (y). The following formula was used:

$$y_t = \left[\frac{X_t}{\dot{P}_i} - \frac{X_t}{\dot{P}_x}\right] + \left[\frac{M_t}{\dot{P}_m} - \frac{M_t}{\dot{P}_i}\right]$$

where: $\dot{P}_x$ and $\dot{P}_m$ = changes in the deflators for exports and imports of goods and services from the previous year; X_t and M_t = current year export and import values; and $\dot{P}_i = \frac{\dot{P}_x + \dot{P}_m}{2}$. The terms of trade effect on total income has been expressed as a percentage of the previous year's GDP.

BALANCE OF PAYMENTS DATA

a) *Sources*

Annual balance of payments statistics in *Economic Outlook* are derived from OECD countries annual submissions to the Organisation, on the basis of a reporting system common to OECD and the IMF. The concepts and definitions underlying this system are, with few exceptions, those described in the IMF *Balance of Payments Manual* (third edition, July 1961).

Up-to-date information and figures for periods of less than one year are normally derived from national sources and adjusted by the Department of Economics and Statistics to internationally comparable definitions. Seasonally adjusted series are taken from national sources for Canada, Germany, the United Kingdom, the United States, Australia, the Netherlands, Finland, and, for some data, Japan, and estimated by the Department of Economics and Statistics for other countries.

b) *Presentation*

For analytical purposes, the *Economic Outlook* makes use of a uniform presentation of the balance of payments data for all OECD countries. The analytical groupings adopted are the following:[10]

A) *Trade balance.* This is defined as merchandise exports less imports fob frontier. It is recorded on a transactions basis, i.e. derived from customs records of merchandise trade, with valuation and coverage adjustments required:

i) To put the figures on to a fob frontier basis.

ii) To ensure that the data reflect as closely as possible the net transfer of ownership of goods to and from abroad by the residents of a country.

B) *Current balance.* This is the sum of the trade balance, net services and private and official transfers.

C) *Balance on non-monetary transactions.* This covers all current and long-term capital transactions, as well as the short-term capital transactions of the non-monetary sector of the economy (including the balance of unrecorded transactions). It excludes, however, official transactions undertaken for specific balance of payments reasons; such "special transactions" relate, in particular, to the anticipation or postponement of public debt servicing, and

9. W: wholesale prices; P: producer prices.

10. For details, see E. Veil, "Surpluses and Deficits in the Balance of Payments: Definition and Significance of Alternative Concepts", OECD, *Economic Outlook – Occasional Studies,* No. 17, July 1975.

changes in official long-term assets and liabilities, such as the extension of special credits to international lending institutions.

D) *Net transactions of monetary authorities* (formerly balance on official settlements). This is the sum of the following transactions:

i) Changes in official holdings of gold and currency assets.
ii) Changes in holdings of SDRs, whether resulting from allocations or transfers.
iii) A counterpart item for the allocation of SDRs.
iv) Changes in the net IMF position.
v) Changes in official liabilities to foreign official monetary institutions, and in official short-term assets other than gold and currency. (For the United States, changes in private liabilities to foreign monetary institutions are also included.)
vi) Special transactions, as described above.

c) *Relation to national concepts*

In a number of cases, the uniform concepts and definitions used by the Department of Economics and Statistics to ensure intercountry comparability differ from those most commonly found in national presentations of balance of payments statistics. The main deviations are listed below:

A) *Trade balance.* While the trade balance concept appears in all national publications, its definition may differ from that adopted in *Economic Outlook.*

i) In Canada, the trade balance as usually defined excludes inland freight on both imports and exports.
ii) In Belgium, trade as well as other components of the balance of payments are recorded on a settlements basis, i.e., based on foreign exchange rather than customs statistics. Recently, trade data designed to reflect transactions, have been produced on an experimental basis. France and Italy publish data on both transactions and settlements bases.
iii) In Germany, the trade balance concept which appears most frequently in public discussion is based on the customs figures. It includes, therefore, all freight on imports and excludes the coverage adjustments of customs data to a balance of payments basis.

B) *Current balance.* Aggregates corresponding to the current balance concept appear in all national presentations under various denominations. They are identical with the data appearing in *Economic Outlook,* subject to the remarks made above about France, Italy and Belgium.

C) *Overall balance.* Most national presentations emphasize some form of overall balance which either takes the form of a balance of monetary movements (akin to the balance on non-monetary transactions) or a balance on official reserve transactions (akin to net transactions of monetary authorities). The concepts used in major OECD countries are related to those shown in *Economic Outlook* as follows:

i) The overall balance as defined under various denominations in France, Italy and Japan corresponds fairly closely to the balance on "non-monetary transactions", except insofar as special transactions are generally not shown below the line.
ii) The United States "official reserve transactions balance", which was dropped by the U.S. authorities in 1976, corresponds to net transactions of monetary authorities with non-scheduled repayment of U.S. Government assets (including sales of foreign obligations to foreigners) and the allocations of Special Drawing Rights recorded above the line;
iii) The overall balance as defined in the United Kingdom, Canada and Germany approximates the concept of "net transactions of monetary authorities" except insofar as special transactions are included above the line.

d) *Inconsistencies in balance of payments recording*

A uniform accounting framework does not by itself ensure consistent recording of each transaction by the two participating countries. In fact, transactions of the same type among OECD countries do not sum to zero as theoretically they should. The sum of any particular balance for all OECD countries should therefore not be taken to be the balance of the OECD area with the rest of the world, and developments in this type of aggregate should be interpreted with due regard to the possibility that the net effect of inconsistent recording may vary over time.

Some important sources of inconsistency in OECD countries' balance of payments recording are:

A) On current account, inconsistencies arise in connection with the classification, coverage and timing of transactions. In particular, the border-line between merchandise and service transactions tends to be blurred in the case of government purchases, while the distinction between services and transfers may be interpreted differently by the two partner countries in the case of workers' remittances: a cross-classification problem also arises from official indemnification payments to private recipients. Discrepancies occur in the estimation of freight on imports (which tends to exceed the corresponding receipts) and in the recording of foreign travel (where receipts tend to exceed payments). Further discrepancies result from the inclusion in some countries' data of re-invested earnings of foreign subsidiaries, which are not covered in most countries' statistics and the existence of flags of convenience (transportation receipts of ships sailing under such flags are normally omitted). The expansion of services such as engineering and construction, which are difficult to identify statistically, has added considerably to the world discrepancy of recorded invisibles. Timing discrepancies are due to the fact that the recording of countries' imports (particularly of goods but also of services) by receiving countries occurs much later than the recording of corresponding exports by the supplying countries. Some, but by no means all, of these inconsistencies cancel out at the current balance level. For a more detailed discussion of the various problems arising out of the inconsistent recording of invisible transactions, see the Technical Notes at the end article "OECD Invisibles in 1960's", *Economic Outlook — Occasional Studies,* July 1970.

B) On capital account, asymmetries result in the first place from the inconsistent recording of current transactions (the net effect of which produces an offsetting entry under unrecorded transactions). Further asymmetries result from the principle of allocating changes in assets and liabilities according to the domestic sector involved, which implies that international transactions between two different sectors (e.g. banks on one side and non-banks on the other) will be reported under different headings by the two partner countries. Inconsistent recording of official settlements will also be reflected in the capital account.

C) On net transactions of monetary authorities, the sum of all OECD countries' balances will not reflect the change in the area's net official positions *vis-à-vis* the rest of the world, due to:

i) Changes in total official gold holdings resulting from the incorporation of newly mined gold or sales to private users.
ii) The inclusion in official reserve assets of the dollar holdings in the Eurodollar market or of claims in currencies the counterpart of which is not reported as a liability to monetary authorities.

USE OF CURRENT NATIONAL STATISTICS

Unless otherwise stated, all the national statistics quoted in the *Economic Outlook* are taken from the *Main Economic Indicators* published monthly by the OECD (*MEI*). Starting in September 1967, supplements to *MEI* have been published describing in detail the sources and methods of these statistics. The following notes are therefore confined to some methodological points of special importance for the understanding of the text.

Unemployment Statistics (Table 7)

The figures are generally taken from the OECD *Main Economic Indicators* which reproduces the most usually quoted national series. The series are usually seasonably adjusted by the national authorities, and they vary considerably from one country to another insofar as methods of collection, coverage and definition are concerned.

The unemployment series for Canada, the United States, Japan, Finland and Sweden are based on monthly sample surveys, whereas the Italian, Spanish and historical Australian figures are based on sample surveys carried out each quarter. The figures for France, Germany, the United Kingdom, Austria, Belgium, Denmark, the Netherlands and Norway relate to *registered unemployed* and those for Ireland relate to *insured unemployed* as a percent of the insured labour force. For Germany, the Secretariat seasonally adjusts unemployment by an additive method and it is expressed as a percentage of the dependent labour force. For the United Kingdom it should be noted that the figures cover people registered as wholly unemployed in Great Britain as a percentage of the dependent labour force. In Italy, the new survey from 1977 incorporates an enlarged definition of unemployment. As from February 1978 the sample survey in Australia became monthly, though no seasonally adjusted data are yet available. In Denmark, the series used includes part-time insured unemployed persons as from January 1977.

In a number of countries, including Germany and France, sample surveys of employment are carried out at yearly or less frequent intervals and their results are of some use for the correction and interpretation of the monthly unemployment figures.

Index of industrial production (Country tables and charts)

The figures shown include, as far as possible, mining, manufacturing and public utilities (electricity, gas and water), but exclude construction. The exact coverage, the weighting system and the methods of calculation vary from country to country but the divergences are less important than in the case of the price and wage indices.[11] With the exception of certain smaller countries, the indices are seasonally adjusted by national statistical offices using different methods usually derived from the U.S. Bureau of the Census Method II.

Merchandise trade

As a general rule, data on merchandise exports and imports are taken from OECD foreign trade statistics as published in MEI and the OECD *Statistics of Foreign Trade* bulletins.[12] Except where indicated in the country notes to these publications, exports are recorded fob frontier and imports cif frontier. United States import and export data are fas and relate to general trade; exports exclude Department of Defense shipments.

Seasonally adjusted data are calculated by the Department of Economics and Statistics, except for the United States, Japan, Germany, France, the United Kingdom and Canada, where national estimates are used.[13]

Data for total OECD trade by areas differ from the aggregates published in *Statistics of foreign trade,* Series A on account of adjustments for inconsistent recording of intra-OECD trade from the import and export sides respectively, arising from differences in timing, coverage and valuations, and inconsistencies in the seasonal adjustment of individual series. These adjustments could only be applied to major aggregates of OECD trade: where relevant, they are signalled by a footnote.

Seasonal adjustment

As noted above, some of the series used have been seasonally adjusted by the Department of Economics and Statistics, notably in the area of foreign trade but also in some cases for industrial production, unemployment, and consumer prices. The method used is the X-11 variant of the U.S. Bureau of the Census Method II as programmed for computer use by that Agency. (Further details may be found in Technical Paper No. 15 of the Bureau of the Census and OECD, *Sources and Methods,* No. 15, Dec. 1972.) Where appropriate, series are also corrected for calendar variations.

11. A quarterly supplement to *Main Economic Indicators* provides an internationally comparable selection of industrial output indices for branches and a number of categories.

12. The OECD publishes three sets of foreign trade bulletins. *Series A — Monthly bulletin of foreign trade; Series B* — trade by commodities (in values only), analysis by main trading areas and individual OECD Member countries; and *Series C* — trade by commodities (in quantities and values), detailed analysis in the form of trade matrices.

13. For the United States, Germany, France and Germany, data seasonally adjusted by the Department of Economics and Statistics are published in *Statistics of foreign trade.*

OECD

Department of Economics and Statistics

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