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## The World Economy in 1977

The initial expectations concerning the cyclical recovery in the Western industrialised countries have been surpassed by the more than 5 p.c. average increase of real GNP in 1976. Nevertheless, it is obvious that currently there prevails a certain worldwide disappointment at the cyclical development. In the first particularly expansive stage of the upturn the widely held misgivings regarding inflation, balance of payments difficulties and structural problems had apparently been relegated to the background. With the slackening of the impulses emanating from the stimulating economic measures, however, their significance became more obvious again. For, due to the lasting cautiousness of entrepreneurial action the transition into a self-accelerating expansive process was long in coming everywhere. A number of countries — among them particularly Italy, France, and Great Britain — was already under the necessity of taking extensive stabilising measures again. It seems as if in this unstable international economic situation expectations deteriorated more heavily than justified by the cyclical data.

The further development, however, is subject to considerable uncertainties regarding the future framework conditions set by economic policy. This applies, on the one hand, to those countries, particularly the USA and Japan, in which measures for stimulating economic activity are under discussion. On the other hand, there are still uncertainties with regard to the strength of the restrictive course in the aforementioned problem countries. In any case there are in-

dications of a new differentiation of cyclical trends after the largely parallel recovery. The forecast, however, is afflicted with further uncertainties resulting from the difficulties in anticipating the investors' and consumers' attitudes. Is the widely held assumption really justified that, as a result of inflation and recession, a more pessimistic basic attitude will prevail in the foreseeable future? In most cases the objective conditions have already improved with the significant increases in capacity utilisation and profits. Therefore in a number of countries there is a real chance for a stimulation of the propensity to invest as soon as the present scepticism regarding the world business trend turns out to be exaggerated. In this respect a reification of the expected stimulating measures in the USA could serve as a signal. Another essential precondition, however, would be visible progress with the reduction of the European problem countries' difficulties. In this context a key element would be the achievement of a certain consensus relating to distribution policy. Initial steps in this direction have become visible.

### **Stimulating Forces Dominating Further**

If allowing for the measures of economic policy which are to be expected, the stimulating forces will, on the whole, certainly further be predominating. Especially in the leading national economies — USA, Japan, Federal Republic of Germany — they should be strong enough for a moderate upswing. With that the process of mutual economic stimulation in the world econ-

omy will be kept going. This will make it easier to keep the slackening of business activity in those countries, which were forced to introduce stabilisation programmes, within certain limits. The growth rate of the industrialised countries' real GNP could reach about 4.5 p.c. in 1977, i.e. a little less than last year. In world trade the slowing down of the expansion will probably be more obvious. Owing partly to a smaller carry-over the price-adjusted growth rate may fall from 11 p.c. to an estimated 8 p.c.

With the anticipated cyclical trend, the high unemployment in the industrial countries will generally show no significant decline. On the one hand, the increase in productivity will be relatively high, on the other hand, the labour force will continue to grow. All the more the upward tendency of wages may be expected to slacken further. With that there are also prospects that the price increase will slow down once more. However, on an average the increase in private cost of living will probably still reach about 7 p.c., though with considerable differences between the individual countries. With that it would have fallen by almost 50 p.c. within three years, but the present signs point only to a slow improvement in spite of the general underemployment. This emphasizes the importance of a consensus relating to distribution policy.

### **Western Europe: Cooling of the Economic Temperature**

In Western Europe the economic temperature has been cooling during the last months. The hopes that the surprisingly strong recovery after the recession would immediately turn into an upswing according to the traditional pattern, were not fulfilled: in the second half year

the expansion of demand and output was slowing down significantly. In spite of the recovery the utilisation of the productive capacities and particularly of the labour force was still relatively low so that a more pessimistic attitude gained ground again. This pessimism was supported by the fact that Italy, France, and Great Britain were faced with the necessity to adopt stabilising measures with deflationary effects. Apparently the aggravation of balance of payments problems was the decisive cause once again, the more so as international emergency loans to countries with a high external indebtedness are only granted if these countries adopt promising measures for curbing inflation. The upward tendency of prices, however, had clearly accelerated again, in Italy and Great Britain largely as a consequence of more expansive monetary policies and the resulting devaluation of the lira and the pound. In order to achieve now progress in stabilisation while keeping the restrictive effects on demand and output as small as possible, the efforts for checking the uptrend

of wages were intensified at the same time.

The risks inherent in the problem countries' development are certainly to be judged only with difficulty at present. On the other hand, the chances of a continuation of a moderate upswing in the other countries seem to be frequently assessed too unfavourably. After all the capacity utilisation has remarkably drawn away from the trough of recession in the course of recovery and the distribution ratios have moved again towards higher profits. In particular for these reasons a somewhat stronger increase of investment activities than in 1976 is still to be expected for Western Europe in 1977. The anticipated average growth rate of about 3 p.c. in real terms is, however, extraordinarily low for an upswing. Private consumption adjusted for price will probably at an annual average increase even somewhat more weakly than investments. This reflects above all its slowing down in those countries that had to undertake stabilisation measures. As against this ex-

ports to non-European countries should expand somewhat more strongly in real terms. In the aggregate an increase of the West European GNP in real terms by 3.5 p.c. seems to be not unrealistic in 1977 (1976: 4 p.c.) – though with considerable differences between countries. A slight decline in the speed of inflation to an average of 9 p.c. in consumer prices is to be reckoned with.

### Trends in the USA and Japan

In the USA the stimulating cyclical forces have also weakened noticeably in the course of 1976. Apart from the cessation of impulses originating from expansive stock keeping the increase in private consumption and housebuilding slowed down noticeably. For the whole of 1976 there will be – mainly due to the considerable rise in spring – nevertheless a growth rate of real GNP of about 6 p.c. After a temporary decline during the first half-year the unemployment ratio approached again the previous year's level. Recently the rise in prices still slowed down only because of

### Gross National Product

(comparison with a year earlier)

	at constant prices				at current prices				Deflator of GNP			
	1964-74 <sup>1</sup>	1975	1976 <sup>2</sup>	1977 <sup>3</sup>	1964-74 <sup>1</sup>	1975	1976 <sup>2</sup>	1977 <sup>3</sup>	1964-74 <sup>1</sup>	1975	1976 <sup>2</sup>	1977 <sup>3</sup>
USA	3.6	~ 1.8	6.0	5.5	8.3	7.3	11.5	11.0	4.5	9.3	5.0	5.0
Canada	5.2	0.6	4.5	4.0	10.8	11.4	15.0	11.5	5.3	10.7	10.0	7.0
Japan	8.7	2.1	6.0	6.0	16.4	9.4	13.0	12.5	7.1	7.1	8.5	6.0
Western Europe <sup>4</sup>	4.4	~ 2.0	4.0	3.5	10.4	11.9	14.0	12.0	5.8	14.2	9.5	8.5
Belgium	4.8	~ 2.0	3.5	3.5	10.5	10.2	14.0	12.0	5.4	12.2	10.0	8.0
Germany	4.1	~ 3.2	5.8	5.0	9.0	4.7	9.3	9.0	4.7	8.1	3.4	4.0
Denmark	3.8	~ 1.3	4.5	2.5	11.5	9.8	14.5	10.5	7.4	11.3	9.0	8.0
Finland	5.1	0.1	0.5	4.0	13.4	16.5	12.5	13.0	7.9	16.4	11.5	8.5
France	5.3	~ 1.2	5.5	4.0	11.2	12.6	16.0	12.5	5.6	14.0	10.0	8.0
Great Britain	2.5	~ 1.3	1.0	2.0	9.4	26.0	16.0	14.0	6.7	28.4	15.0	12.0
Italy	4.7	~ 3.7	4.5	1.0	11.1	13.2	23.5	19.0	6.1	17.5	18.0	18.0
Netherlands	5.0	~ 1.1	4.0	4.5	11.9	9.6	13.5	12.0	6.6	10.8	9.0	7.0
Norway	4.6	3.3	5.5	7.0	11.1	14.7	16.0	16.5	6.2	11.0	10.0	9.0
Austria	5.1	~ 2.0	4.0	4.5	10.6	8.7	11.5	11.0	5.2	8.9	7.0	6.0
Sweden	3.5	0.6	1.0	2.0	9.3	16.1	16.0	13.5	5.6	15.4	15.0	10.0
Switzerland	3.4	~ 7.6	1.0	3.0	9.5	~ 1.5	3.0	5.0	5.9	6.6	2.0	2.0
Spain	6.5	0.8	3.0	3.0	14.5	17.4	15.5	13.5	7.5	16.5	12.0	10.0
OECD-countries, total <sup>4</sup>	4.7	~ 1.3	5.0	4.5	10.4	9.6	13.0	11.5	5.4	11.1	7.5	6.5
OECD-countries, total <sup>5</sup>	4.6	~ 1.8	4.0	3.5	10.8	11.2	14.5	12.5	5.9	13.3	10.0	8.5

<sup>1</sup> Annual average change. <sup>2</sup> Estimate, rounded to half percentage points. <sup>3</sup> Forecast. <sup>4</sup> Weighted by GNPs and exchange rates 1974; total of OECD-countries; without Australia and New Zealand. <sup>5</sup> Without Federal Republic of Germany; weighted by shares in German exports 1974.

Source: OECD, National Accounts of OECD-countries 1974, Vol. 1, and current publications; EC: national data; own estimates.

declining agricultural prices. The balance of trade which in 1975 still registered a surplus of \$ 11 bn, should in 1976, not least of all because of higher mineral oil imports, wind up with a deficit of more than \$ 5 bn.

For the period after the turn of the year only a slightly rising expansion of the stimulating forces is to be calculated on. Therefore it is generally assumed that the new Administration will turn towards a more expansive financial policy already in the first half of the year and – possibly in connexion with an increase in expenditure – carry through a tax reduction to the tune of \$ 10 to 15 bn. A tax reduction of this size would mean a primary income effect of roughly 1 p.c. of GNP. Depending on the volume and form of these measures an increase of GNP in real terms of between 5 and 6 p.c. could be expected in 1977. Unemployment would again decline together with this growth rate. On the other hand, the upward trend in prices should not yet reincrease in this case. Under such conditions no obstacles from monetary policy quarters would have to be anticipated. As regards the balance of trade a further increase of the deficit is indicated in view of the accelerated expansion of domestic demand.

Japan's vigorous cyclical stimulation at the beginning of

the year was followed by a pronounced flattening-out of the increase in production while the rise in consumer prices continued almost as before. The Government demonstrated its determination not to permit a discontinuance of the upswing by its programme for supporting economic activity as initiated already in November and further planned measures aiming at the same direction. Together with similar prospects for the USA, Japan's most important sales outlet, this should restabilise the entrepreneurs' expectations and improve the chances of a growing propensity to invest. In view of the anticipated increase in exports, public demand, housebuilding and business investments, impulses for private consumption will not fail to come about. The speed of expansion will, however, remain moderate. In 1977 the rise of GNP in real terms should reach nearly 6 p.c. als already in 1976.

#### Reliable Stabilisation Policy Required

The assumption that also in the future protectionist interference with the international exchange of goods is renounced is a major prerequisite to the moderately optimistic forecast of the world economy's development. At any rate the balance of payments position of the deficit countries would already improve noticeably in view of the

role played by anticipating capital transactions as soon as a certain success of the stabilisation programmes is indicated – all the more so since then the surplus countries' preparedness for interim credits would be all the less questionable. The burdens of the recent mineral price increase which are aggravating the rehabilitation process in the field of foreign trade in the deficit countries could also be better overcome. In the aggregate, however, progress towards a lasting reduction of disequilibria will come only in sight if the present efforts for stabilisation reflect more than an unavoidable compulsion caused by pressing balance of payments requirements. Decisive would be that actually the role inflation plays in high unemployment would not only be recognised but that corresponding action would be taken. A credible stabilisation policy is – as becomes constantly clearer – an indispensable prerequisite to a return to full employment also in a system of flexible exchange rates. After years of false developments this process will, however, take some time and it will hardly succeed without setbacks.

*Compiled by the Department on Business Cycles and Statistics of HWWA-Institut für Wirtschaftsforschung-Hamburg.*

Index Numbers of World Market Prices of Foodstuffs and Industrial Raw Materials

Index and commodity group	1975	1976				1977	
	Dec.	March	June	Sept.	Dec.	Jan. 7	Jan. 21
HWWA-Index * (1952–1956 = 100) .....	286.9	277.0	291.7	282.7	297.8	303.9	307.7
Foodstuffs .....	197.3	207.9	227.0	207.9	236.8	243.2	253.2
Raw materials other than foodstuffs ...	300.5	310.4	322.9	289.2	327.2	333.1	334.0
Fuels .....	491.0	495.8	492.4	485.2	503.1	518.2	521.0
Raw materials for consumer goods ..	179.0	183.5	210.4	189.0	220.7	214.3	208.0
Raw materials for capital goods .....	191.4	210.1	228.9	193.8	222.8	227.7	231.6
Reuters Index (18. 9. 1931 = 100) .....	1,158.5	1,277.7	1,514.4	1,477.3	1,547.7	1,547.7	1,606.9
Moody's Index (31. 12. 1931 = 100) .....	748.3	784.2	866.3	828.4	846.4	863.3	879.9

\* Index compiled by HWWA-Institut für Wirtschaftsforschung-Hamburg. On Dollar-basis.