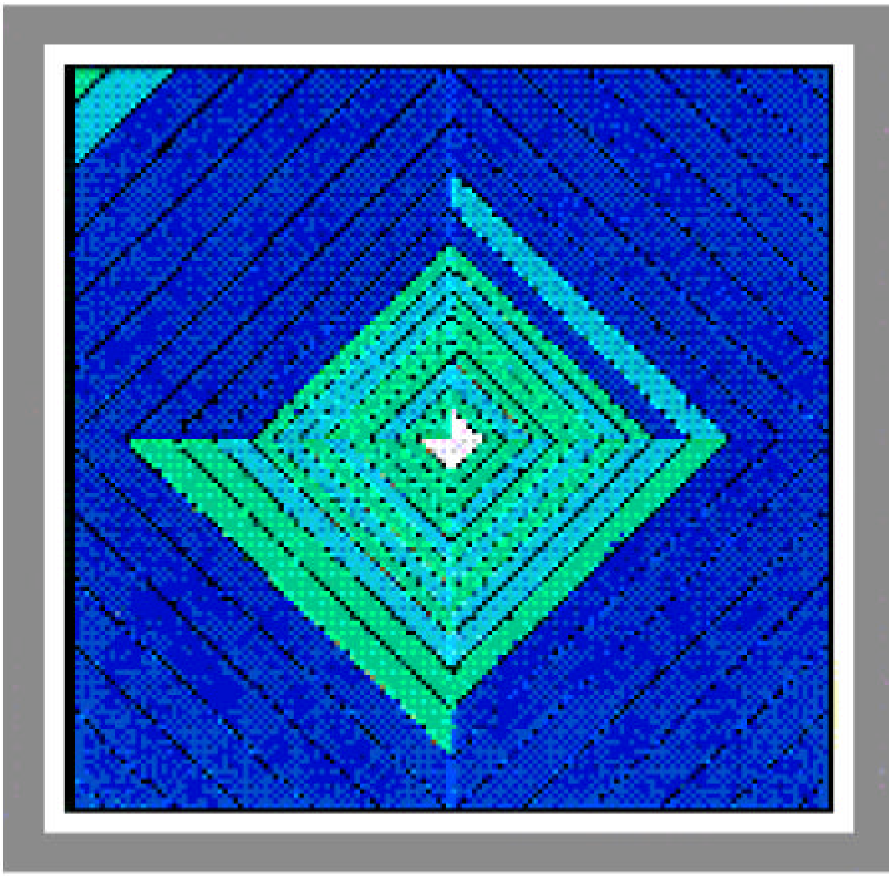
GLOBAL TRENDS



Chapter I

THE WORLD ECONOMY: PERFORMANCE AND PROSPECTS

A. Overall trends

1. World output

The economic recovery that began in 1993 continued throughout 1996, when world output grew by 2.8 per cent (table 1). However, as foreseen in *TDR 1996*, growth has again failed, for the third consecutive year, to fulfil expectations that the world economy would embark on a new era of sustained growth in excess of 3 per cent, which would allow unemployment in the North to be lowered and average per capita income in the South to rise. Current short-term prospects are for neither faster growth nor reduced unemployment.

Growth in the developed market economies as a whole has continued to remain below the rates of the 1980s. At 2.3 per cent in 1996, the growth rate was slightly above the previous year but slower than had earlier been expected. Expansion in the United States has been more persistent than most forecasts had predicted, and Japan has finally reaped the benefits of its fiscal packages and attained a recovery faster than expected. But the widely expected recovery in continental Western Europe, where unemployment has reached record levels, has not yet materialized. Policy in the European Union has continued to focus on the requirements of introducing a single currency in 1999, rather than on employment and growth.

Developing countries (including China) grew twice as fast as developed countries in 1996, as in the previous year. However, growth in the developing world was uneven and fragile. Latin America has recovered from the depressed conditions of the post-Mexican crisis, but its growth remained at a modest 3.3 per cent. East Asia continued to be the brightest spot in the world economy, but even there growth slowed down with the weakening of exports, and policies in some countries have been reoriented towards curbing rising external deficits and price levels and, in some cases, towards coping with difficulties in the financial sector. Growth in both regions continues to depend, to an important degree, on capital inflows to finance increasing current account deficits.

Economic recovery in Africa, which began in 1994, gathered further momentum in 1996 as the growth of regional output accelerated to 3.9 per cent from 2.8 per cent in the previous year, exceeding population growth and reversing the decline in real per capita income that had persisted for almost a decade. Furthermore, the expansion in output was widespread among all subregions and countries. Favourable commodity prices, much improved weather, diminished civil strife in several instances, and greater domestic policy efforts have played an important role in the recovery. However, many of these factors are of a one-off

Table 1

WORLD OUTPUT, 1993-1997

(Percentage change)

Country/region	*1993*	*1994*	*1995*	*1996*[a]	*1997*[b]
World	1.4	2.8	2.4	2.8	3.0
Developed market-economy countries	1.0	2.9	2.0	2.3	2.3
of which:					
United States	3.4	4.1	2.0	2.5	2.9
Japan	-0.2	0.5	0.8	3.5	1.9
European Union	-0.6	2.8	2.4	1.5	2.0
of which:					
Germany	-1.2	2.9	1.9	1.4	2.2
France	-1.5	2.7	2.2	1.3	1.9
Italy	-1.2	2.2	3.0	0.7	1.2
United Kingdom	2.2	3.8	2.4	2.0	2.5
Central and Eastern Europe	-8.1	-10.3	-2.7	-2.8	0.7
Developing countries[c]	5.0	4.8	4.8	5.6	5.6
of which:					
Latin America	3.9	4.5	0.5	3.3	4.0
Africa	-0.6	1.4	2.8	3.9	3.9
Asia[c]	6.7	5.6	7.3	6.9	6.7
of which:					
China	14.0	11.8	10.2	9.7	9.0
Other countries	5.0	3.9	6.5	6.1	6.0
Memo item:					
Developing countries excluding China	3.9	3.7	4.0	4.9	5.1

Source: UNCTAD secretariat calculations, based on data in 1990 dollars.
a Estimate.
b Forecast.
c Including China.

character and cannot be expected to lift output indefinitely. Commodity prices are already levelling off, weather is changeable, and there is a limit to gains from a peace dividend. Sustained growth in Africa, as in poor countries elsewhere, ultimately depends on combining policy efforts with adequate external financing.

In 1996, output in the transition economies of Central and Eastern Europe as a whole declined by 2.8 per cent, as in the preceding year. However, divergence in economic performance has continued to widen. A number of countries in Central Europe have sustained strong growth, whereas in many other countries there were further economic setbacks, leading to further falls in output and even to social and political chaos.

2. World trade

Growth in the volume of world merchandise exports slowed down sharply in 1996, reaching only 4.6 per cent, against 10.0 per cent in the preceding two years (table 2), and falling more than had been expected at the beginning of the year. Since output continued to grow more or less at a constant pace, the divergence between trade and output growth, which has been increasing since 1990, was greatly reduced. Only a modest acceleration of growth in world trade is expected in 1997.

An important factor in the slowdown of world trade was a sharp deceleration of import growth in developed economies, which together account for about two thirds of world import demand, from 11.0 per cent in 1994 to only 5.2 per cent in 1996 (table 2). Particularly drastic was the drop in both the United States and Japan. In Western Europe imports remained sluggish because of slower GDP growth, whereas other factors were at play in the United States and Japan. In those two countries the income elasticity of imports (i.e. the ratio of the percentage change in import volume to that of GDP from 1995 to 1996) dropped respectively from 4.0 to 2.6 and from 15.6 to 1.0, whereas it increased from 2.8 to 3.1 in Western Europe. In Japan, slower import growth coincided with a depreciation of the yen, after a surge during 1991-1995 associated with a substantial appreciation of the currency. In the United States the rise in imports of capital goods, especially computers and related equipment, which had loomed large in earlier years, slowed dramatically in 1996.

In East Asia export growth declined significantly, falling below the growth of output for the first time in many years. A major factor was a drastic fall in the prices of certain electronic and information equipment, particularly semiconductors, largely on account of market saturation. In China a reduction in export tax rebates in late 1995 had prompted enterprises to rush their exports as much as possible, including those planned for 1996. By contrast, in Latin America, particularly among the members of MERCOSUR, the rate of acceleration of exports achieved in 1995 was maintained or even slightly exceeded in 1996.

Table 2

EXPORTS AND IMPORTS BY MAJOR REGIONS AND ECONOMIC GROUPINGS, 1994-1996

(Percentage change in volume over previous year)

	1994	*1995*	*1996[a]*
Exports			
World	10.4	10.0	4.6
Developed market-economy countries	9.6	7.4	4.2
of which:			
Japan	1.7	3.3	0.8
North America	10.0	9.4	5.7
Western Europe	11.3	7.4	4.0
Developing countries	13.5	16.2	6.1
of which:			
Africa	4.3	8.3	8.1
Latin America	9.2	9.9	9.3
South and East Asia	14.8	18.0	5.8
West Asia	7.1	16.9	7.3
China	31.0	20.7	0.7
Imports			
Developed market-economy countries	11.0	7.6	5.2
of which:			
Japan	13.6	12.5	3.5
United States	12.0	8.0	6.4
Western Europe	9.1	6.7	5.3

Source: *World Economic and Social Survey 1997* (United Nations publication, Sales No. E.97.II.C.1), table A.19 and (for the United States) *OECD Economic Outlook*, June 1997, p. 43.

a Preliminary.

In value terms the slowdown in world exports in 1996 was even sharper than in volume, growing by only 4.1 per cent as compared to 19.6 per cent in 1995. The average dollar prices of globally traded goods stabilized in 1996 after having increased by 10 per cent in the previous year, due partly to the appreciation of the dollar vis-à-vis the currencies of several major trading countries, particularly France, Germany, Japan and the Republic of Korea.

The picture is similar for the value of world exports of commercial services, with growth decelerating to 5 per cent in 1996 from 14 per cent in the preceding year. The slowdown in this trade (for both exports and imports) was particularly pronounced in Western Europe and Asia, whereas North America maintained the pace of expansion of the previous year. Financial and insurance services, royalties and licence fees, construction services and other business services continued to be more dynamic than transportation or travel. By and large, the slowdown in growth in the value of world trade in commercial services can be attributed to the appreciation of the dollar against a number of major currencies and to the stagnation of trade in continental Western Europe, which alone accounts for one half of world trade in commercial services.

3. Commodity prices

After two consecutive years of substantial increases, non-oil primary commodity prices started to decline in 1996 and for the year as a whole were over 4 per cent lower than in the previous year. This decline affected all major commodity groups except temperate foodstuffs. Slow growth in industrial countries, as well as oversupply and turmoil in metals markets, contributed to the downward pressure on prices during the year. Thus, after a more or less stable first quarter, prices started to weaken steadily for major non-oil commodity groups of export interest to developing countries. On an annual basis, prices of tropical beverages fell by over 15 per cent, and those of minerals and agricultural raw materials by more than 12 per cent (table 3). Most commodities were affected in the latter two groups whereas the average for tropical beverages reflected mainly the steep decline in coffee prices during the year.

Expectations of a large coffee crop in Brazil weakened prices during the year in spite of a tight supply situation. *Coffee* prices declined on average by some 26 per cent in 1996, but on the whole prices proved less volatile than expected thanks to low stocks, especially in consuming countries, and also to the export ceiling adopted by the Association of Coffee Producing Countries (ACPC). There was a sharp recovery in the early months of 1997 because first estimates of the Brazilian crop were well below last year's level of output and also because of labour unrest in Colombia. With stocks at very low levels and a tight supply-demand situation, the expectation is for fluctuations around a rising trend in coffee prices in 1997. Concern over continued low earnings has encouraged a number of producers to explore more thoroughly the gourmet market, which has grown quite noticeably, especially in the United States.

Prices of other tropical beverages held up much better during 1996. *Cocoa* prices, in particular, remained firm during the year, in view of concerns about a possible tightening of supplies, even though crops in Côte d'Ivoire and Ghana turned out to be quite large. *Tea* prices recovered somewhat from the declines recorded in 1995, thanks mainly to increases in global demand, especially in Eastern Europe, and despite plentiful supplies from plantations in northern India and Kenya. *Banana* prices were on average 7.5 per cent higher than in 1995; after a sharp rise early in the year they dropped significantly thereafter. *Sugar* prices fell by 10 per cent from the 1995 level. By contrast, despite a drop in the latter part of 1996, *wheat* prices averaged a 13.7 per cent increase and *maize* prices one of 25 per cent. Since stocks are still relatively low, the risk of some rebound in grain prices, due to unforeseen increases in import demand or an unfavourable crop outlook, still exists. The *rice* market seems to be more or less well balanced, with price fluctuations much weaker than for other commodities.

Among agricultural raw materials, *rubber* and *cotton* prices weakened considerably in 1996, as did those of minerals. *Copper* prices were particularly volatile in 1996, sometimes plunging abruptly in a matter of hours. The uncertainties surrounding the losses by a major Japanese company due to unauthorized trading compounded the already weak market trends caused by oversupply and moderate demand growth. Expectations of large stock disposals added pressures to the prevailing sluggish market trends. Despite some recovery towards the end of the year, on account of improved consumption and lower stocks, prices were on average almost 22 per cent lower than in 1995 and could well fall further in the coming months. *Aluminium* prices also fared badly and lost much of the gains recorded in 1995; consumption growth was particularly sluggish in both North America and Japan, and consumption may even

Table 3

WORLD PRIMARY COMMODITY PRICES, 1994-1997

(Percentage change over previous year)

Commodity group	*1994*	*1995*	*1996*	*Feb. 1997*[a]
All commodities[b]	**17.6**	**10.5**	**-4.2**	**5.8**
Food and beverages	**19.4**	**4.6**	**2.3**	**9.6**
Tropical beverages	74.4	0.7	-15.7	29.3
Coffee	118.2	2.9	-26.3	35.4
Cocoa	24.8	2.7	1.6	-6.9
Tea	-4.4	-10.3	8.8	-1.4
Food	10.1	5.7	6.9	5.6
Sugar	19.6	10.8	-10.0	0.7
Beef	-10.9	-18.3	-6.4	2.8
Maize	1.4	23.5	25.1	-6.7
Wheat	4.8	30.4	13.7	8.8
Rice	33.6	-10.2	5.2	10.5
Bananas	-0.5	0.1	7.5	32.1
Vegetable oilseeds and oils	**25.5**	**10.2**	**-4.5**	**3.0**
Agricultural raw materials	**14.6**	**16.9**	**-12.2**	**-3.3**
Hides and skins	30.3	4.1	-23.7	1.6
Cotton	28.0	15.4	-7.9	0.0
Tobacco	10.4	-11.1	15.6	0.0
Rubber	39.3	38.6	-11.9	-2.5
Tropical logs	2.9	5.4	-20.1	-7.3
Minerals, ores and metals	**13.5**	**20.6**	**-12.3**	**4.2**
Aluminium	29.6	22.3	-16.6	5.3
Phosphate rock	0.0	6.1	8.6	7.9
Iron ore	-9.5	5.8	6.0	1.1
Tin	5.9	13.7	-0.8	0.8
Copper	20.6	27.2	-21.8	6.1
Nickel	19.8	29.8	-8.8	17.5
Tungsten ore	24.1	49.6	-17.9	3.1
Crude petroleum	**-4.1**	**9.3**	**20.7**	**-13.5**
Memo item:				
Manufactures[c]	**2.6**	**7.0**	**1.2**	**1.4**

***Source**:* UNCTAD, *Monthly Commodity Price Bulletin*, various issues; United Nations, *Monthly Bulletin of Statistics*, various issues.

a Change from December 1996.

b Excluding crude petroleum.

c Unit value index of exports of manufactures from developed market-economy countries.

have declined in both Western Europe and the countries members of CIS.

The major exception to this bleak picture was *petroleum* prices, which rose steadily throughout the year and by December were almost $6 per barrel higher than 12 months earlier. While low stocks and robust demand growth due to a long cold winter contributed to the buoyancy of oil markets, the steady rise in oil prices also reflected continued production restraint by OPEC members and shortfalls in supply from other exporters due to technical problems. The much-delayed resumption of oil exports from Iraq (under Security Council resolution 986) also led to speculative purchases and higher prices. Prices can be expected to weaken in the near future on account of oversupply (total OPEC production exceeded the quota in the last quarter of 1996). However, there is much uncertainty concerning non-OPEC members on account of continued possible technical constraints.

B. The world economy: growth and imbalances

Global imbalances reminiscent of the 1980s have recently started to emerge in the world economy, due in large part to disparities in demand growth in the major industrial countries. While growth of domestic demand in the United States has continued, and even accelerated, most other industrial countries have relied essentially on exports for growth in their economies. As in earlier periods of demand imbalance, these conditions have been accompanied by increased exchange rate variability. Since 1995 the yen has moved within a range of around 80 to 125 yen to the dollar and the corresponding variation in major European currencies has been around 30 per cent.

These disparities in demand growth, together with the appreciation of the dollar, have been the main factors behind a growing trade deficit in the United States and growing surpluses in Western Europe and Japan. However, unlike the 1980s, expansion in the United States has been associated with falling, rather than rising, fiscal deficits. A return to a more sustainable pattern of global demand and trade balances thus requires expansionary policies in the surplus countries, rather than a contraction in the United States. However, policy continues to be restrictive in most EU countries, especially those aspiring to be initial participants in the monetary union, since economic performance in 1997 will be the basis for determining eligibility. In Japan the current expansion is not based on permanent factors. The growth stimulus of the emergency budget packages is now largely exhausted, and current plans are to act aggressively to reduce the budget deficit through higher taxes. Thus, there is little prospect of a contribution by Europe and Japan to a more balanced pattern of global demand.

The effect of the tightening of monetary policy in the United States may not be limited to widening the global deflationary gap. Together with continued upward pressure on the dollar, its likely effect will be to widen, rather than to narrow, the trade imbalances. It could also lead to a generalized increase in interest rates, given the increasing integration of world financial markets.

Such developments can have serious consequences for the global economy in general and developing countries in particular. A combination of slow growth, rising unemployment and increased trade imbalances could make it more difficult to resist protectionist pressures in the developed world and to avoid trade frictions. Moreover, a generalized rise in interest rates and the appreciation of the dollar could compromise the ability of developing countries to continue as a major source of global demand expansion, since these countries are extremely susceptible to reversals of capital flows. In addition, many of the larger developing countries, which are the most dependent on world trade, tie their exchange rates to the dollar. Consequently, any sharp appreciation of the dollar could also lead to an appreciation of their currencies against third countries, worsening their trade balances and necessitating restrictive domestic monetary policies. Such an outcome would not only compress domestic demand, but also threaten the financial stability of those countries that are in the process of trying to restructure their banking systems.

1. Developed market-economy countries

(a) United States

The United States is now in its sixth year of continuous expansion since the recession of 1990-1991. Rather than declining, as might be expected in this relatively late stage in the cycle, growth has accelerated to 2.5 per cent, a rate which is marginally above the official estimate of long-term sustainable growth.[1] The most visible impact of this sustained growth has been the simultaneous decline in unemployment to levels below 5 per cent and inflation to rates below 3 per cent, the lowest levels since 1973 and approaching Golden Age averages. This decline in the unemployment rate has occurred despite an accelerated growth of the labour force due to higher participation rates. There has also been a rapid decline in the government deficit, to around 1.5 per cent of GDP, and a primary surplus (i.e. in the budget balance net of interest payments on government debt) since 1994. A decline in the deficit is appropriate during sustained expansion and should normally lead to a balanced budget as the economy achieves full employment. The elimination of the deficit and the reduction in interest payments as a major component of government expenditure should free fiscal policy to play a more active role and take off some of the pressure from monetary policy.

There is, however, still a debate on the level of employment and the rate of growth compatible with price stability. While a number of estimates put the non-accelerating inflation rate of unemployment (NAIRU) at above 6 per cent, unemployment has been below that rate continuously for over three years, and in early 1997 fell to 4.8 per cent, without any significant wage or inflationary price pressures. Indeed, most measures of inflation have continued to decline during this period. This lends support to the proposal made in *TDR 1995* that, in order to solve the unemployment problem central banks must be willing to allow their economies to test the validity of assumed potential growth rates. The Federal Reserve appears to be showing such a willingness, since it has responded much more slowly with a tightening of policy than in 1994.

This benign behaviour of prices and wages is in part due to the recovery in productivity growth, which has been strong in manufacturing. Inflation in the service sector has been subdued despite increasing employment, suggesting that there has been an increase in productivity in these sectors also. Since 1992, 12 million jobs have been created in services, while all other sectors produced only 1 million new jobs, almost all in construction. Low-paying, low-productivity jobs (which were analysed in *TDR 1995* as "disguised unemployment") fell as workers shifted into higher-skilled positions in the service sector. There has also been a marked decline in long-term unemployment.

Despite lower inflation and improved employment conditions, there has been little movement in money wages, with the result that average gross weekly earnings in real terms have fallen in almost every year of the recovery. Average hourly real earnings in the private non-agricultural sector declined from $7.73 in 1987 to $7.45 in 1991 and failed to recover subsequently, remaining at $7.43 in 1996. As a result, consumption has contributed little to domestic demand expansion, which has been driven primarily by investment accompanied by improving exports, although imports have remained high. The continued rise in productivity, particularly in manufacturing, has meant that profits have improved considerably. Profits as a share of non-financial corporate business GDP rose by around 3.5 percentage points from 1992 to 1996, in part because of the reduction in net interest costs as firms replaced debt at lower rates or tapped the stock market for funding. As a share of national income, profits have returned to levels not seen since the beginning of the 1970s. Wage earnings, however, started to rise during 1996. Most recent figures point to a rise of around 2.0 per cent on an annual basis in 1997, suggesting that private consumption will also make a contribution to sustaining expansion.

(b) Japan

The Japanese economy has finally emerged from a prolonged period of stagnation, in which the economy grew by a little over 2.6 per cent in all from 1992 to 1995. As explained in past *TDRs*, this was primarily the result of overinvestment in the previous boom, when capital spending rose by around 8 per cent per annum. As a result of the collapse of the financial bubble and the global recession, capital spending fell by 23 per cent from

1991 to 1994, forcing industry to rationalize and restructure. Further, the yen appreciated sharply from 1991 to 1995. To offset this adverse impact of falling investment and exports, from August 1992 to September 1995 six separate stimulus packages were implemented, primarily for public works, as a consequence of which the construction sector was the main area of expansion in the economy; employment in the sector rose by 32 per cent from 1991 to 1995, against 9 per cent for the rest of industry.

Investment recovered in 1995; together with rising exports due to yen depreciation and the cumulative impact of the fiscal packages, it brought about an output expansion of 3.5 per cent in 1996. Exports expanded by 10 per cent in the second half of FY 1996, while imports declined. Private consumption remained low until the end of the calendar year, when it began to recover. The recovery continued into the first quarter of 1997 as consumers attempted to bring forward expenditures in view of the increase in consumption taxes that was to take place in April.

To the extent that the recovery in investment and exports has been due to the recent depreciation of the yen, growth in Japan may simply revive the trade frictions which dominated its relations with the United States in the 1980s. The largest Japanese producers have hedged themselves against problems of market access and a reversal of exchange rate movements by expanding their existing production facilities in the United States, Mexico and Asia; in 1995 Japanese automobile producers built more cars abroad than they exported from Japan. To the extent that Japanese profits and growth remain centred on exports, and thus on the behaviour of the exchange rate, they will continue to be erratic.

As a result of rationalization and downsizing, unemployment has remained above 3 per cent. In the restructuring that took place in 1990-1995 many industries, including textiles, steel, and electrical machinery, not only sought wage reductions but also reduced their permanent employment levels by up to 5 per cent. This continued success of Japanese industry in restructuring to offset the impact of a constantly appreciating currency has been one cause of the delay in the introduction of structural and regulatory measures to reduce the country's dependence on exports. Despite several attempts to introduce supply-side policies to reduce domestic costs and liberalize the economy, economic performance remains dependent on exports, and investment both at home and abroad continues to be undertaken with an eye to international competitiveness.

(c) European Union

The level of activity in continental Western Europe declined towards the end of 1996 and some of the major economies, such as Germany and Italy, touched recession. In the United Kingdom, by contrast, expansion has been sustained and lasted longer even than in the United States. Indeed, there was an acceleration towards the end of the year, resulting in a growth rate of 2.0 per cent for the year as a whole. Spain and a number of smaller EU economies also achieved growth above 2 per cent.

The continued weak performance of the continental EU economies is due in large part to the continued application of restrictive fiscal policies aimed at reducing government deficits to the 3 per cent of GDP reference value set out in the Maastricht Treaty. Pressure on fiscal policy has become particularly acute, given that the decision on qualification for entry into the third phase of EMU will be determined by national economic performance in 1997. This concentration of public expenditure reductions and tax increases in 1996 and 1997 has more than offset the relaxation of monetary policy during 1995-1996. Indeed, given the continued abatement of inflation, to around 2 per cent for members of the European Exchange Rate Mechanism (ERM), monetary policy has become somewhat more restrictive in some countries.

As discussed in last year's *Report*, budget deficits increase due to cyclical factors, so that when growth is slow, rising deficits act as an automatic stabilizer of demand. Raising taxes or reducing expenditures to meet a budget deficit target in such conditions eliminates the normal stabilization properties of deficits, depresses growth and simply serves to raise deficits further, necessitating additional budget retrenchment. The consequence is increasing pressure on social safety nets and living standards, leading eventually to popular resistance against such policies. The insistence of some governments that qualification for entry into the third phase of EMU depends on meeting the precise numerical reference values in the face of mounting evidence that none of the major economies will be able to do so creates conditions conducive to greater volatility in financial and foreign exchange markets at the very time when expectations should be converging on uniform interest rates and irrevocably fixed exchange rates.

As a consequence of these restrictive policies, the performance of the major European economies has depended on export growth. Increasing global competition has put greater pressure on costs, leading to labour shedding and holding down wages, thereby compressing domestic consumption demand. Exports have been stimulated by the depreciation of most continental EU currencies relative to those of stronger economies, namely the dollar and sterling. A large proportion of Western European exports is now directed towards developing countries, in particular in Asia, and transition economies in Central Europe. Since growth in the former countries is less rapid than in the past, and in the latter is highly erratic, Western European exports and hence growth have been highly variable.

Political developments in EU suggest that it will be difficult to sacrifice growth and employment for the sake of meeting the reference values of EMU. However, postponing the date of entry of the third phase of monetary union is not a real option. Further budgetary restrictions may not bring about any improvement in deficits, whereas they risk creating financial and labour market instability. By most measures of nominal and real economic variables, convergence of the EU economies has already taken place. With the exception of Ireland, the prospects for 1997 are that no country will grow at a rate which is more than 1 percentage point away from the EU average. Likewise no country (with the exception of Greece) has an inflation rate which is more than 1 point higher, and long-term interest rates and public sector deficits are, with a few exceptions, also within this range. Fiscal balances in most countries in 1997 will be within half a percentage point of each other, at an average slightly above 3 per cent of GDP. Finally, unemployment rates are also converging, albeit at levels as high as 11 per cent. Since these averages for inflation and interest rates are in the ranges which are considered acceptable for monetary stability and also appear to be sustainable, whereas the unemployment rates are converging around a rate which appears stable but politically unacceptable, it seems reasonable to move to a single currency as rapidly as possible. Delay may cause fiscal deficits to diverge even further from the reference values, making it even more difficult to comply with the Maastricht targets. It should be recalled that the reference values were drawn up to provide a broadly similar economic environment in all countries that would allow uniform monetary policy and low and stable inflation, objectives which have now been achieved. The issue of fiscal balance compatible with stability may need to be redefined subsequently, and the required adjustment be carried out under better cyclical conditions.

2. Latin America

In Latin America the recovery of output in 1996 was chiefly due to an upturn in Argentina and Mexico and, to a lesser extent, Uruguay, together with robust growth in some other countries (table 4). The contrasting recent experiences of Argentina and Mexico, in particular, highlight the kind of policy dilemmas faced by many Latin American countries. In those two countries, which together account for over 40 per cent of regional GDP, output contracted sharply in 1995 as a consequence of a reversal of capital flows. In Argentina the burden of adjustment fell entirely on domestic absorption as the nominal exchange rate was kept constant. While inflation was thus kept at international levels, unemployment soared. In Mexico, by contrast, the sharp decline in the exchange rate, combined with tight monetary policy, gave a strong boost to exports, offsetting partly the adverse effects of external adjustment on employment, but inflation soared, exceeding 50 per cent.

The recovery of both Argentina and Mexico in 1996 was significant, albeit modest. In both cases growth was export-led. In Mexico, devaluation played a key role whereas in Argentina the rapid expansion of exports largely resulted from a sharp rise of the real exchange rate in Brazil. In both Brazil and Argentina the expansion assisted recovery in Uruguay.

In Brazil, consumption played a leading role in the recovery that followed from the success of the *Plano Real* in stopping hyperinflation. After a spurt in 1994, growth slowed down as monetary policy was tightened in order to check domestic demand in the face of a sharp deterioration in the trade balance associated with trade liberalization and currency appreciation. High interest rates encouraged portfolio inflows, allowing monetary authorities to rely on the exchange rate as an in-

Table 4

LATIN AMERICA: OUTPUT, AND EXPORT AND IMPORT VOLUMES, 1994-1996

(Percentage change over previous year)

	Output[a]			Exports			Imports		
	1994	1995	1996[b]	1994	1995	1996[b]	1994	1995	1996[b]
All countries	4.5	0.5	3.3	9.2	9.9	9.3	14.8	4.9	9.5
of which:									
Argentina	6.7	-4.6	3.5	18.5	20.3	7.1	25.4	-14.4	18.3
Bolivia	4.8	3.7	4.0	20.1	5.2	9.9	0.7	13.2	24.5
Brazil	5.7	3.9	3.0	4.5	-2.3	2.2	27.2	31.4	4.7
Chile	4.1	8.2	6.5	12.0	11.5	10.5	3.2	23.1	10.1
Colombia	6.3	5.7	3.5	2.4	2.2	5.5	20.9	6.8	1.0
Costa Rica	4.4	2.3	0.5	4.3	8.7	4.1	2.4	-2.9	1.8
Ecuador	4.7	2.7	2.0	10.6	7.1	4.2	25.1	14.5	-13.3
El Salvador	6.0	6.1	3.5	32.0	15.3	10.6	16.3	21.6	0.3
Guatemala	4.1	5.0	3.0	5.3	19.4	-1.8	8.0	10.7	0.6
Mexico	4.6	-6.6	4.5	11.8	24.4	19.4	15.7	-13.8	21.8
Paraguay	2.9	4.5	2.0	14.8	19.7	-6.5	31.3	20.2	-14.0
Peru	13.9	7.7	2.0	17.9	8.2	5.1	24.5	27.5	-0.1
Uruguay	6.9	-2.8	5.0	2.9	-0.7	14.5	21.5	-5.3	12.8
Venezuela	-2.5	2.3	-1.5	7.3	6.0	8.9	-26.5	24.9	-8.0

Source: Table 1 (for regional output totals), table 2 (for regional export totals) and ECLAC, *Preliminary Overview of the Economy of Latin America and the Caribbean 1996*, Santiago, Chile, 1996 (United Nations publication, Sales No. E.96.II.G.13), tables A.1, A.9 and A.10.

a Based on values at 1990 prices.

b Preliminary.

strument for price stability. However, the resulting currency appreciation added further to trade deficits. Measures initiated in 1995 to restrict financial capital inflows have been eased in recent months (see chapter II). A combination of relatively high budget deficits and monetary policy has continued to attract financial capital at the expense of investment and exports. Consequently, growth faltered further in 1996.

Peru has gone through similar phases of rapid expansion and slowdown. Growth was rapid after the success in taming hyperinflation in 1992, but concerns for the external balance led the authorities to adopt restrictive fiscal and monetary policies, which cut growth drastically after 1994.

In Chile, exports continued to grow faster than output. In spite of a 30 per cent reserve requirement on all foreign financial investments, strong capital inflows have continued, resulting in a sizeable real appreciation of the currency. Partly for that reason, real wages have risen, bringing about increases in consumption and so in aggregate demand that have necessitated restrictive monetary and fiscal policies.

In the external sector, with the exception of Argentina, which benefited from a rise in prices of temperate zone foodstuffs, gains in the terms of trade in 1996 were achieved only by oil exporters. Even so, domestic conditions and policies in the major oil-exporting countries of the region hindered them from capitalizing fully on favourable oil prices. In Mexico, a major exporter of manufactures, the terms of trade were unchanged, as they were also in Brazil, Costa Rica, Paraguay and Peru. In other countries, the terms of trade fell, in some cases substantially (for example, in Chile due to the drastic fall in copper prices noted above).

While exports continued as the main source of growth for most countries, for the region as a whole they increased in value by only 10.2 per cent in 1996, against nearly 21 per cent in the previous year. The deceleration was region-wide (with the exception of Venezuela, and to a lesser extent Bolivia and Uruguay) and was the result of stagnant or declining export prices, following an upsurge in 1995. Trade among countries of the region has grown rapidly, on account of both unilateral trade liberalization and the strengthening of trade groups, such as MERCOSUR,[2] the Andean Group, the Latin American Integration Association (LAIA), the Central American Common Market (CACM), and the Caribbean Community (CARICOM). During 1994-1996, intra-MERCOSUR exports grew on average by about 17 per cent per annum, compared to 9 per cent for exports of the member countries to the world. While exports to developed countries are heavily concentrated on raw materials and natural-resource-intensive goods, intra-regional trade has a much larger component of manufactures; in 1995, manufactures constituted 37 per cent of the region's exports to the world but 46 per cent of intra-regional trade. The strengthening of regional trade links and the opening up of broader economic spaces among the countries in the region has not only provided a means of diversifying exports, but also encouraged intra-regional investment flows; Argentine firms have been investing in Brazil and Brazilian firms in Argentina, while Chilean firms have made large investments in Argentina, particularly in agro-industrial sectors.

The growth of import volume for the region in 1996 was almost twice that of the previous year, primarily because of economic recovery in Mexico and Argentina, which together account for nearly half of the value of regional imports, and also because of a similar recovery in Uruguay. Among the countries where import volume growth was weaker than in 1995 special mention should be made of Brazil and Chile. Ecuador, Paraguay and Venezuela were prominent among countries where imports actually declined in volume.

The region continued to be dependent on substantial capital inflows. In 1996, they amounted to \$50 billion, against \$26 billion in 1995, with a larger proportion consisting of FDI and investment in long-term bonds. The existing structure of most of the economies in the region makes for low rates of growth, as they still rely on raw materials for their export earnings. Trade liberalization and the dismantling of import substitution regimes have not, by themselves, induced export diversification and a more dynamic integration of most Latin American countries into the international economy. Slow output growth has translated into growing unemployment and falling or stagnant real wages. A worsening of the labour situation, which was already evident in 1995 in a number of countries, such as Argentina, Mexico, Uruguay and Venezuela, continued in 1996. Only in Chile, Nicaragua and Peru was the unemployment rate lower than in 1995. At the same time, it is not at all certain that a new era of low inflation has been inaugurated. Real exchange rates continue to be very volatile, discouraging productive investment and reducing growth below its potential.

3. Developing Asia

An outstanding feature of events in developing Asia in 1996 was a significantly slower growth of output in a number of economies, which was accompanied by a sharp slowdown in exports (table 5) that was particularly pronounced for the first-tier NIEs (Hong Kong, Republic of Korea, Singapore and Taiwan Province of China), as well as in Malaysia, Thailand and China. The slowdown in exports obliged a number of countries to take measures to restore external balance by restricting aggregate demand.

The decline in export growth has given rise to a debate on the sustainability of rapid economic expansion in Asia, although it is now evident that the performance of the fast-growing economies of the region is not attributable to any single factor. The links between capital accumulation, technological progress and economic growth in the first-tier NIEs, and the interdependence of exports and investment and its role in accelerating structural change and industrial growth, were analysed in detail in *TDR 1996*. To remain competitive over the years, both governments and private entrepreneurs have managed to overcome such constraints as shortages of skills and expertise, rising labour costs and structural and infrastructure bottlenecks which had emerged as a result of rapid growth. With respect to what happened to exports in 1996,

Table 5

DEVELOPING ASIA: OUTPUT, AND EXPORT AND IMPORT VALUES, IN SELECTED SUBREGIONS AND COUNTRIES, 1994-1996

(Percentage change over previous year)

	Output[a]			*Exports*			*Imports*		
	1994	*1995*	*1996*	*1994*	*1995*	*1996*	*1994*	*1995*	*1996*
Newly industrializing economies	7.6	7.5	6.3	15.0	21.0	4.8	17.4	22.9	5.6
of which:									
Hong Kong	5.4	4.7	4.7	11.9	14.8	4.0	16.7	19.1	3.0
Republic of Korea	8.6	9.0	7.0	15.7	31.5	4.1	22.4	32.1	12.2
Singapore	10.5	8.8	7.0	25.8	21.5	6.7	19.8	21.6	6.0
Taiwan Province of China	6.5	6.0	5.7	9.4	20.0	8.2	10.3	21.0	2.0
South-East Asia	7.8	8.2	7.4	19.2	22.8	5.6	21.9	28.4	8.2
of which:									
Indonesia	7.5	8.2	7.8	9.9	13.1	8.8	13.9	23.0	11.8
Malaysia	9.1	10.1	8.8	23.1	25.9	4.0	28.1	29.4	1.3
Philippines	4.4	4.8	5.5	18.5	29.4	17.5	21.2	23.7	25.0
Thailand	8.9	8.7	6.7	22.2	24.7	0.1	18.5	31.6	4.1
South Asia	6.6	6.4	6.5	13.2	20.6	11.7	14.7	26.7	10.2
of which:									
Bangladesh	4.2	4.4	4.7	6.3	37.1	11.8	3.2	39.4	17.9
India	7.2	7.1	6.8	18.4	20.9	13.0	27.0	30.0	8.1
Nepal	7.9	2.9	6.1	-2.7	-9.6	2.0	14.6	21.9	9.3
Pakistan	4.5	4.4	6.1	-1.4	16.1	7.0	-13.6	18.5	16.2
Sri Lanka	5.7	5.6	3.8	15.2	18.4	12.0	21.7	9.0	8.0
China	11.8	10.2	9.7	35.6	24.9	1.5	10.4	15.5	5.1

Source: *Asian Development Outlook 1997 and 1998* (Hong Kong: Oxford University Press for the Asian Development Bank, 1997), tables A1, A11 and A13.

a Based on data in constant prices.

the key question is whether the outcome was due to temporary factors or reflected underlying forces of a longer-term nature.

To begin with, it should be recalled that both 1994 and 1995 were years of exceptional export growth because of the unusual coincidence of a number of factors, including the appreciation of the yen, a strengthening of efforts by Japanese corporations to relocate production overseas, and the large demand for electronic products. On the other hand, factors responsible for the decline in the value of exports in 1996 include a dramatic fall in the prices of some electronic and information equipment, particularly semiconductors, which had dire consequences for a number of countries in the region; in December 1996, the unit price of semiconductors had fallen by nearly 70 per cent from its level a year earlier. As a share of total exports, electronic products currently account for nearly 50 per cent in Singapore, almost 25 per cent in Malaysia and the Republic of Korea, and 10-15 per cent in Taiwan Province of China, Thailand and the Philippines. Furthermore, with the depreciation of the yen vis-à-vis the dollar by some 53 per cent between April 1995 and February 1997, a number of currencies linked to the dollar appreciated strongly. Finally, some countries lost competitiveness in a number of labour-intensive products. While some of these factors may be reversed over time, they nevertheless pose serious problems of adjustment.

China succeeded in 1996 in bringing down inflation to a single-digit rate and taking some heat off the economy, which nevertheless grew at an impressive rate of almost 10 per cent. On 1 December 1996, it formally gained the status of an IMF Article 8 country, which made the yuan convertible for the purposes of current account transactions. Improving the agricultural infrastructure and accelerating the reform of state-owed enterprises are objectives that continue to be given top priority in economic reform.

Unlike both the first-tier NIEs and South-East Asia, the growth momentum was maintained in South Asia (table 5), while in West Asia growth accelerated. Among the first-tier NIEs, growth fell significantly in the Republic of Korea in 1996 as the economy experienced both internal and external imbalances; the current account deficit was almost triple that of 1995. Hong Kong was directly affected by weaker export demand from China on account of the latter's own slower export growth, but nevertheless maintained the previous year's growth rate. In Taiwan Province of China, tensions with the mainland affected consumer and business confidence in the second half of 1995 and early 1996. Because of its relatively diversified export base, it was less affected than other economies by the slump in demand for electronics, so that the rate of GDP growth declined only marginally. In contrast, there was significantly slower growth in Singapore, due to a sharp deceleration in investment in machinery and equipment as a result of weaker exports and adjustments to bloated inventories.

In South-East Asia, output growth in 1996 slowed moderately in both Indonesia and Malaysia, exports slowed down and monetary and fiscal stance was tightened to counter inflationary pressure. In both countries, high interest rates triggered inflows of foreign funds, which in turn offset the impact of stringent monetary policy. Eventually, to reduce their current account deficits, the authorities had to resort to raising deposit reserve ratios. In Thailand, the 2-percentage point fall in the growth rate was the result of currency appreciation and rising real wages which eroded competitiveness in labour-intensive sectors. In addition, financial markets were disturbed by the sharp increase in non-performing assets of banks (see chapter II). By contrast, growth in the Philippines accelerated in 1996, while its balance of payments stayed at sustainable levels for the third consecutive year.

For South Asia as a whole the growth momentum has been unabated, but there was considerable variation among countries. Economic reforms in India implemented so far have enhanced its integration into the world economy, but stronger growth in 1996 was constrained by high domestic real interest rates and supply bottlenecks. In Pakistan, although growth accelerated significantly, the chronic budget deficit persisted and continues to threaten internal and external stability. Good weather played a key part in economic recovery in Nepal, whereas civil war and drought were responsible for the slowdown in Sri Lanka. In Bangladesh, the implementation of a comprehensive programme of structural reforms since the early 1990s has been associated with only a slight acceleration of the growth rate.

Economic performance in West Asia is dominated by developments in the oil sector and by political conditions in the subregion. The continued recovery in output in 1996, following a mild recession in 1994, was due largely to the rise in oil prices, which provided the oil-exporting countries of the subregion with much-needed revenues to ease fiscal and external imbalances as well as the means to repay some of the arrears to contractors and suppliers (Saudi Arabia) or reduce their external debt (Islamic Republic of Iran). For member countries of the Gulf Cooperation Council[3] as a whole, despite more than two decades of export diversification, the oil sector still accounts for 35-40 per cent of GDP, 80 per cent of government revenues, and 85 per cent of exports.

4. *Africa*

The economic recovery in Africa that set in in 1994 continued in 1996; moreover, it was broadly based. In all the subregions, with the

Table 6

AFRICA: OUTPUT GROWTH BY SUBREGION, 1990-1996

(Percentage change over previous year)[a]

	1990 -1995	*1994*	*1995*	*1996*
Central Africa	-2.5	-1.3	5.0	4.4
of which:				
Cameroon	-0.4	-1.5	6.0	4.0
Central African Republic	-0.1	5.7	1.1	1.3
Equatorial Guinea	7.5	0.6	11.0	16.2
Gabon	2.7	1.7	3.4	2.9
East Africa	2.9	4.5	4.9	4.3
of which:				
Ethiopia	2.5	2.2	3.2	3.6
Kenya	2.6	2.5	6.3	3.9
Madagascar	0.0	2.2	2.0	3.5
Somalia	-0.1	-21.0	2.3	3.9
Uganda	6.0	7.2	8.5	6.0
United Republic of Tanzania	3.0	2.9	3.5	4.6
North Africa	1.5	1.8	1.8	4.4
of which:				
Algeria	1.2	0.7	4.0	5.5
Egypt	1.9	2.7	2.6	3.2
Morocco	1.8	7.2	-5.0	5.9
Sudan	3.7	1.7	3.5	4.0
Tunisia	5.0	6.5	2.5	6.6
Southern Africa	0.9	2.5	2.5	3.0
of which:				
Botswana	4.4	2.5	3.1	4.9
South Africa	0.7	5.1	2.9	2.5
Zambia	-1.1	1.0	-4.9	4.9
Zimbabwe	0.2	4.6	-3.4	6.6
West Africa	2.4	2.5	3.4	4.2
of which:				
Côte d'Ivoire	-0.2	0.8	5.4	5.2
Ghana	4.5	8.0	4.5	5.0
Niger	0.6	2.9	3.8	2.6
Nigeria	3.3	2.1	2.3	3.8
Senegal	1.6	1.3	4.6	4.6

Source: ECA, "Report on the Economic and Social Situation in Africa, 1995" (E/ECA/CM.21/3), Addis Ababa, March 1995, statistical table 2; *ibid., 1997* (E/ECA/CM.23/3), Addis Ababa, March 1997, table I.5 and statistical table 2.

a Based on values at 1990 prices.

exception of East and Central Africa, growth was faster than in 1995 (table 6). In 11 countries it reached or surpassed the 6 per cent target set by the United Nations New Agenda for the Development of Africa in the 1990s (UN-NADAF), in 28 it ranged from 3 per cent to 6 per cent, in 12 it was still positive but below 3 per cent, and in only 2 did output decline abruptly.[4] The major factors behind this improved performance of Africa in 1996 were greater policy effort, favourable weather in most subregions, significantly higher export earnings (particularly by oil-exporting countries), and improved terms of trade.

The rise in agricultural output by 5.2 per cent in 1996, in contrast to no growth in the previous year, was the highest since the beginning of the decade and was the major factor behind the strong economic recovery in the region as a whole. At the same time, upturns in the prices of bananas, groundnuts, tea and tobacco, as well as crude oil, lead, iron ore and phosphates, more than compensated for the fall in the prices of beverages, metals and non-oil minerals and agricultural raw materials, so that there was an improvement of 4.6 per cent in the terms of trade and of 8.8 per cent in the purchasing power of exports. The value of exports increased by 8.7 per cent, on account of a 4.0 per cent rise in volume and a 4.7 per cent increase in prices. On the other hand, the value of imports grew more rapidly (9.3 per cent), almost entirely because of an increase in volume.

The North African economies rebounded strongly in 1996 following four years of modest to lacklustre growth. The major factors responsible for the surge in output included much better weather, spirited industrial growth, a rise in oil prices and recovery in the tourist trade. Most remarkable was the sharp swing in output in Morocco, which suffered from a severe drought in 1995 but enjoyed a record harvest in 1996 together with a recovery in the prices of potash. Agriculture also contributed much to the faster growth of output in Egypt and Sudan. In contrast, Tunisia was hit by drought for the second year running, resulting in severe output losses. Nevertheless, growth accelerated, largely thanks to industry. Despite the upturn in agriculture and vigorous industrial expansion by 8 per cent, North Africa continues to be overwhelmingly dependent on minerals, and on hydrocarbons in particular.

The growth momentum which began in West Africa in 1994 was sustained in 1996. Aided by high oil prices and improvements in the agricultural sector, the Nigerian economy grew by nearly 4 per cent, compared to 2 per cent or so in the previous two years. However, consumer spending remained weak because of the prevailing high unemployment and the inadequacy of public utility services. Indeed, many sectors other than oil and agriculture continued to suffer from severe recession. Countries of the franc zone (CFA) continued to reap the benefits of the economic reforms initiated since 1994. In Côte d'Ivoire, the largest of those economies, there was a recovery in agriculture, and also in the water, power and construction sectors, as well as a revival in manufacturing and services. Senegal maintained the improved growth rate of 1995; an expansion in construction, tourism and other service sectors, as well as in export-oriented industrial activities, more than compensated for the relatively poor performance in agriculture. Output growth in Niger, on the other hand, declined in 1996, on account of unfavourable weather and unprecedented declines in uranium prices. In Ghana, the 1995 growth rate was surpassed. Production and exports of cocoa, its major export earner, increased and in addition gold has become a major source of export revenue.

Average GDP growth in Central Africa in 1996 was slightly below the 5 per cent reached in the previous year, but performance varied considerably among countries. In the CFA countries growth was faster (at 4.8 per cent) than in 1995 (3.1 per cent). The best result was achieved by Equatorial Guinea, where GDP rose by more than 16 per cent as a result of a strong revival in mineral and oil output. Gabon continued on the path of recovery embarked on in the previous year. Performance in other countries of the subregion was affected in varying degrees by continuing social tension, civil and political instability and the associated burden of coping with very large numbers of refugees and displaced persons. GDP in Burundi declined by close to 6 per cent in 1996, due largely to economic sanctions by neighbouring countries, as a result of which huge stocks of unsold coffee and tea were accumulated. In Cameroon, the most important of the CFA countries in the subregion, growth slowed in 1996, after the strong upturn in 1995, due to reduced oil production and greater political instability.

Although the average growth rate in East Africa in 1996 exceeded that of the African region as a whole, it was slightly lower than in 1995, in spite of a significant improvement in industrial output. It was largely Kenya, the largest economy in the subregion, that pulled down the average, due to a weak performance in agriculture and tourism. In Uganda also growth slowed down, whereas in the United Republic of Tanzania it accelerated. Both countries benefited from an increased inflow of FDI. While agricultural output rose by almost 50 per cent in Somalia in 1996, harvests were generally a third below the levels prevailing before hostilities broke out, and consequently the rise does not seem to have had a significant impact on the overall food situation. Ethiopia more than maintained its relatively high growth rate of 1995, owing to a combination of good weather and a revival in manufacturing.

Although output in Southern Africa grew on average in 1996 less than in Africa as a whole, the increase constituted a further improvement over the rates of the previous years. The primary cause was the return of favourable weather and higher export receipts. Economic recovery has also been aided by greater political stability and improved commodity prices. Outstanding was the turnaround in Zimbabwe, due to an improved performance in agriculture, manufacturing and mining, and also in Zambia, as a result of a significant recovery in copper production as well as in both agriculture and manufacturing. However, the Zambian economy is still beset with problems of declining export revenues and a resurgence of inflation. Economic performance was disappointing in South Africa, the most developed country in the subregion and which accounts for more than a quarter of Africa's total output. Growth slowed somewhat in 1996, having decelerated more markedly in the previous year, as the economy suffered from relatively high rates of inflation and unemployment.

While the African countries are highly dependent on foreign trade, export-led growth remains seriously constrained by the persistence of anachronistic production structures and heavy reliance on a narrow range of primary exports. Investment is considerably below the levels needed to attain and sustain a rate of growth that would have any appreciable or significant impact on the economies of the region. The need for greater mobilization of domestic resources and their efficient utilization is further dictated by declining inflows of ODA and the serious difficulties experienced in attracting FDI. The debt burden in many countries has become intolerable. Despite the many reschedulings and arrangements to reduce debt-service obligations to a more manageable level, the debt overhang has grown large enough to prejudice the success of the very reform efforts aimed at the restoration of economic and socio-political viability in many African countries. Accumulated arrears at the end of 1994 amounted to $54.9 billion, or 20 per cent of the total debt stock. Given that, of the 41 countries which have been identified as eligible under the HIPC Initiative, 33 are in Africa, the future performance of the region depends, *inter alia*, on how the initiative is implemented (see chapter II below).

5. Central and Eastern Europe

The European (and Central Asian) economies in transition continued to show a marked divergence between those which continued in 1996 to enjoy further growth and those which were still struggling to achieve economic stability and balance. All three Baltic States achieved faster growth than in the previous year (when it had been negative in Lithuania) and growth was positive in the majority of the CIS members.

For Central and Eastern Europe as a whole, growth in 1996 was significantly slower than in the previous year (table 7).[5] The general slowdown of growth in this subregion is attributable to internal and external imbalances, which called for more restrictive macroeconomic policies, as well as to major market failures in some countries.

With growth of 6.0 per cent in 1996, Poland became the first of the transition countries to reach a level of output exceeding that of 1989 (to the extent of over 4 per cent). Turkmenistan was virtually at the pre-transition level, while Slovenia had recovered to 7 per cent short of it, and in a number of other countries the shortfall was 10-20 per cent. Slovakia continued to maintain rapid growth in both 1995 and 1996. However, recovery so far has depended primarily on the expansion of non-manufacturing activity and government expenditures on infrastructure. The sustainability of growth in the Czech Republic, which is undergoing financial difficulties (see chapter II) is also open to question. Although GDP grew relatively fast in both 1995 and 1996, its industry is becoming increasingly uncompetitive.

Major macroeconomic adjustments were undertaken in Hungary following the implementation of a stabilization programme in May 1995. Fiscal and current account deficits declined substantially in 1996, inflation slowed down and manufactured exports rose. The economy is now apparently poised for a much faster rate of growth. There was a marked recovery for the first time in Croatia in 1996. In Slovenia, large investment projects in infrastructure and services kept the growth rate above 3 per cent. Both economies benefited from the lifting of United Nations sanctions and the resumption of economic relations with the former Yugoslav republics.

In a number of other Central and Eastern European countries economic conditions worsened. Growth in Romania decelerated sharply in 1996 in the face of worsening macroeconomic imbalances, leading to radical policy changes by a new government. The social and political crisis in Bulgaria was the first case of a major upset in the transition process following a gradual recovery and disinflation; the drop in output of some 10 per cent in 1996 after modest growth in 1994-1995 was of much the same magnitude as in 1990, the year following the break-up of the USSR. In Albania, the collapse of large-scale fraudulent investment schemes brought political and social chaos. As in Bulgaria, major market failures led to a rapid and more general deterioration of the economic situation and to a serious political crisis.

Growth in the Baltic States accelerated in 1996. For the first time since their independence, there was positive growth in all three countries. Both Lithuania and Latvia seem to have largely recovered from the banking crisis of 1995. Indeed, in all three countries, there was improved macroeconomic stability, but it was accompanied by a widening of trade and current account deficits.

Growth in the CIS continued to be uneven. For the Commonwealth as a whole, output continued to fall, but there was positive growth in seven countries, compared to only two in 1995. The recovery was particularly marked in Belarus, Kyrgyzstan and Uzbekistan. In Azerbaijan, Kazakstan and Turkmenistan, the fall in output appears to have already bottomed out, while Armenia and Georgia continued the upturn of 1995. In contrast, output was further depressed in the Republic of Moldova and Tajikistan. The Moldovan economy, which is heavily dependent on agriculture, was badly affected by poor weather in 1996.

Contrary to earlier expectations, output in Ukraine and the Russian Federation continued to

Table 7

EUROPEAN ECONOMIES IN TRANSITION[a]: SELECTED ECONOMIC INDICATORS, 1994-1996

	GDP			Consumer prices			Current account balance		
	Change over previous year[b] (*Per cent*)						(*$ million*)		
Country/region	*1994*	*1995*	*1996*	*1994*	*1995*	*1996*	*1994*	*1995*	*1996[c]*
Central and Eastern Europe[d]	3.9	5.6	4.0	..	..	..	..	-1389	-12935
of which:									
Bulgaria	1.8	2.1	-10.0	122.0	33.0	311.1	-25	-26	-34
Croatia	0.6	1.7	4.4	-3.0	3.7	3.5	103	-1711	-1129
Czech Republic	2.6	4.8	4.4	10.3	8.0	8.7	-50	-1362	-4476
Hungary	2.9	1.5	0.5	21.3	28.5	19.9	-3911	-2480	-1678
Poland	5.2	7.0	6.0	29.4	22.0	18.7	..	5455	-1352
Romania	3.9	7.1	4.1	61.9	27.7	56.8	-428	-1639	-2336
Slovakia	4.9	6.8	6.9	11.8	7.4	5.5	712	646	-1401
Slovenia	5.3	3.9	3.5	18.3	8.6	8.9	540	-36	47
Baltic States	-0.2	1.4	3.4	..	..	..	-67	-827	-908
of which:									
Estonia	-2.7	2.9	3.5	41.8	28.8	14.9	-178	-185	-223
Latvia	0.6	-1.6	2.5	26.1	23.3	13.2	201	-27	-273
Lithuania	1.0	3.0	4.0	45.0	35.5	13.1	-90	-614	-412
CIS	-14.5	-5.7	-5.3	..	..	..	9629[e]	7471[e]	8804[e]
of which:									
Belarus	-12.6	-10.0	3.0	1957.3	244.2	39.1	-506	-567	-752
Rep. of Moldova	-31.2	-3.0	-8.0	104.6	23.8	15.1	-82	-115	-134
Russian Federation	-12.7	-4.2	-6.0	214.8	131.4	21.8	11378	9305	10243
Ukraine	-22.9	-11.8	-10.0	401.1	181.7	39.7	-1161	-1152	-553

Source: ECE, *Economic Survey of Europe in 1996-1997* (United Nations publication, Sales No. E.97.II.E.1), table 3.1.1 and appendix table B.15.

a Including also the economies of Central Asian countries members of CIS.
b For consumer prices change from December to December.
c January-September except for Slovakia (Jan.-Nov.) and Croatia, Czech Republic, Hungary, Poland, Romania, Slovenia and The former Yugoslav Republic of Macedonia (Jan.-Dec.).
d Incorporating revision of Poland's balance of payments data.
e Total for the four States listed.

decline, affecting all sectors in the latter country, where domestic demand was severely depressed by continued pursuit of monetary and fiscal austerity as part of the stabilization programme of February 1996. In Ukraine, where substantial progress was made in macroeconomic stabilization, output continued to fall.

One of the most encouraging developments in the region in 1996 has been the slowing down of inflation. By the end of the year consumer prices were 20 per cent or less than 12 months earlier in 15 out of 25 countries, with the notable exceptions of Bulgaria and Romania. By contrast, the balance of payments of most European transition economies worsened despite a reduction in debt burdens, as imports of goods and services increased more than exports. Exceptionally, however, the Russian Federation continued throughout 1994-1996 to achieve a substantial current account surplus.

In Central and Eastern Europe, and in Estonia and Latvia, the current account deficit widened, as a result of stronger output expansion, a rising real exchange rate due to an upsurge in capital flows, tariff reductions, and a slowing of exports to Western Europe. In several cases the deterioration proved much greater than had initially been expected. In most countries the current account has been in deficit since the beginning of the decade, but the imbalance in 1996 is the largest so far.

C. Short-term outlook and uncertainties

Since the tightening of monetary policy during 1994, the quarterly performance of the United States economy has been highly erratic. However, the accelerated expansion that started in the second half of 1996 continued in the first quarter of 1997. The very strong increase in consumer expenditure since the beginning of 1997 suggests that some of the productivity gains which have led to increased profits and investment during the current cycle are starting to translate into higher real personal incomes and generate greater consumer confidence. It is also possible that the impact on household wealth of the sustained increases in stock prices has produced some increase in discretionary expenditures. Because of faster demand growth than in its major trading partners and the recent appreciation of the dollar, the trade balance of the United States is unlikely to contribute to growth in the coming year, while the agreement recently reached on the budget suggests that fiscal policy will be neutral or at best provide only a slight stimulus. With unemployment below 5 per cent, fears of inflationary pressure are increasing. Yet, there has been no evidence of either rising wages or rising prices. The Federal Reserve has already taken measures with a view to forestalling such pressure; its intervention rate and long-term rates have again moved up to around 7 per cent. Interest rates are widely expected to increase during the year. The outcome for 1997 will thus depend on the behaviour of consumers, on the extent of monetary tightening, and movements of the exchange rate.

In Japan, performance in 1997 will also depend on consumer behaviour and the exchange rate, as well as on fiscal policy. The impact of the series of fiscal packages has now been absorbed, and the Government has announced its intention to introduce measures to reduce some of the accumulated outstanding debt created. Higher consumption taxes that came into force in April 1997 are expected to depress consumption in subsequent quarters. On the other hand, and barring any sharp reversal of the depreciation of the yen, both exports and investment should continue to expand. However, if the current recovery is judged to be a continuing one, interest rates may well be increased. Although the risk of financial instability seems to have lessened, any substantial increase in interest rates may put an end to the highly profitable financial operations whereby borrowed yen are swapped into dollars for investment in United States long-term Treasury bonds. Since such operations have been instrumental in bringing about yen depreciation, any rise in interest rates would lead to a sharp reversal of the movement. Growth during 1997 is likely to be uneven.

Prospects for EU countries are dominated by the fact that performance in 1997 is to be used as a yardstick for judging eligibility for membership of the EMU. Fiscal policies are thus expected to remain restrictive and monetary policies unchanged. Consumption is likely to stagnate, except in countries that have either chosen to delay entry or have not yet taken a final decision, while investment will be influenced primarily by exports and hence exchange rates. Most countries have benefited from the continued appreciation of the dollar, but exchange rates will also be influenced by the Maastricht process as markets attempt to gauge the relative position of the dollar against the future euro and the latter's initial currency basket.

In Germany, despite strong exports, growth in 1977 is unlikely to be much greater than 2 per cent. Given the extent of corporate restructuring under way, this will not be sufficient to reduce unemployment. France faces similar conditions, but without any investment response to increasing export sales. Unless these trends are reversed by a new economic package, growth is likely to be lower than in Germany. In Italy, fiscal retrenchment introduced in a last-minute-attempt to reach stage three of EMU will depress demand at the same time as the reentry of the lira has reduced the possibility of achieving greater competitiveness of exports, which remain the sole impetus in the economy. The growth rate in 1996 was below even the most pessimistic expectations, and 1997 is unlikely to be much better. The United Kingdom stands apart, with low and stable inflation, falling unemployment and a surprisingly stable current account, despite an appreciation of sterling and booming consumer demand. In the absence of any new fiscal measures, further increases in interest rates are likely, even though their impact may be felt little in the current year.

Recent trends are also expected broadly to continue in developing countries. For Latin America output growth is expected to further accelerate in 1997. In particular, activity may pick up moderately in Argentina, Brazil, and Colombia and more sharply in Peru. With resumed substantial inflows of foreign capital, most of the countries in the region will not face an external constraint to growth. However, vulnerability to swings in capital flows remains high in a number of countries with large external deficits. Moreover, in most countries the basic conditions for sustained rates of growth of 5 per cent or more have not yet been fulfilled. Questions also arise as to whether the export surge can be sustained. In Mexico, where much of the recent surge in exports was a one-off response to exchange rate alignment, a policy of taking the restoration of capital inflows as an opportunity to lower the rate of inflation by using the exchange rate as a nominal anchor can have serious adverse effects not only on exports but also on investment, and hence more generally on growth. In Brazil, where a combination of trade liberalization and currency appreciation in the context of an exchange-based stabilization programme has resulted in a substantial worsening of the current account, there is very little room for domestic expansion or export growth without an exchange rate adjustment. For that country the challenge is how to move to more realistic and flexible exchange rates without triggering a financial crisis or inflation. Indeed, attaining exchange rate stability and sustainable payments positions while growing vigorously remains the most important challenge to most countries in the region.

For developing Asia, prospects for 1997 are for growth at a pace similar to, but in the first-tier NIEs below, that of 1996. Most countries in South-East Asia are expected to fare better in 1997, but large current account deficits and financial instability may render it difficult for some to accelerate or even maintain growth. Although no longer benefiting from a strong yen, exports are expected to continue to be an important source of growth in East Asia. More generally, the outlook for developing Asian countries will depend to a significant extent on developments in China and in the industrialized world, particularly Japan and Western Europe. Having been guided successfully to a soft landing in 1996 after a three-year austerity programme, the Chinese economy appears poised to enter a period of relative stability with mild inflationary pressure and sustained high rates of growth. Among the factors that may influence policies and economic performance in China is the forthcoming quinquennial party congress scheduled for the autumn of 1997, the first in the post-Deng era, as well as the resumption on 1 July 1997 of Chinese sovereignty over Hong Kong. In South Asia, growth is expected to further accelerate in 1997, while in West Asia it is likely to be more moderate because of a fall in oil prices.

Although the economies of most African countries remain fragile, the region can be expected to maintain its current growth trend in 1997. Non-oil commodity prices are expected to increase modestly on account of favourable movements in food and agricultural raw material prices on world markets. Oil prices, on the other hand, are likely to decline, to the advantage or disadvantage of different countries, depending on their net export positions. Central Africa is expected to continue the strong recovery of 1996 through improved performance in the mining sector and - it is hoped - greater political stability in Rwanda and Burundi. Prospects for East and Southern Africa are promising, in as much as weather conditions have been favourable in the first quarter of 1997 and the prices of minerals, particularly copper, gold and

Table 8

GDP GROWTH IN SELECTED OECD COUNTRIES IN 1996: COMPARISON OF ACTUAL GROWTH WITH FORECASTS BY VARIOUS INSTITUTIONS

(Percentage)

Country	*LINK* (May 96)	*ECE* (June 96)	*OECD* (Dec. 95)	*EU* (Dec. 95)	*IMF* (April 96)	*NIESR* (May 96)	*NRI* (May 96)	*UNCTAD* (June 96)	***Actual***
United States	2.0	2.0	2.7	2.3	1.8	2.2	2.0	2.2	2.5
Japan	2.0	2.0	2.0	2.3	2.7	2.4	1.5	2.1	3.5
Germany	2.0	1.0	2.4	2.4	1.0	1.0	0.8	0.5	1.4
France	0.9	1.5	2.2	2.4	1.3	1.6	1.2	0.9	1.3
Italy	2.2	2.0	2.5	3.0	2.4	1.4	2.1	1.5	0.7
United Kingdom	2.2	2.0	2.7	2.7	2.2	2.4	2.0	2.2	2.0

Source: Table 1 for actual growth rates; *TDR 1996*, table 5.

diamonds, have turned upwards. In addition, the revamping of the former East African Community, whose permanent Tripartite Commission was inaugurated in March 1996, is expected to exert a positive influence in the subregion through greater currency convertibility, increased demand, and better synchronization of standards for industrial goods. In West Africa, the expectation is for better prices of cocoa, coffee and gold, as well as an increase in industrial investment and capacity utilization. For North Africa, weather conditions are important, but much will also depend on prices of oil and potash as well as the extent of economic recovery in EU countries. Consequently, growth in the subregion may well be lower than in 1996.

Expectations for the transition economies in Central and Eastern Europe (and Central Asia) as a whole are for faster growth, but with much variation among countries. The fragility of the banking sector may be a crucial factor in a number of countries. In some of the more advanced economies, particularly the Czech Republic, Poland and Slovakia, slightly slower growth is expected, while in others (Croatia, Slovenia and the three Baltic States) growth is likely to accelerate. Hungary is expected to continue its recovery following the severe macroeconomic restructuring which began in early 1995. On the other hand, output is expected to decline significantly in Bulgaria and Romania as a consequence of the ongoing strong macroeconomic adjustment and restructuring programmes. For CIS members, prospects are for continued expansion in Armenia, Azerbaijan, Georgia, Kazakstan and Kyrgyzstan. Progress in Belarus and Moldova, respectively, will depend largely on whether energy imports from the Russian Federation continue and on how the weather treats the agricultural sector. Neither the Russian Federation nor Ukraine shows signs of emerging in 1997 from extended periods of declining GDP.

A caveat nevertheless needs to be entered in respect of short-term forecasts. As pointed out in previous issues of this Report, they are subject to varying degrees of uncertainty associated with a variety of factors, such as the evolution of economic policies, which can be subject to unexpected shifts as a result of political developments, and external influences that are transmitted through international trade, finance and investment. Trade policy has become particularly important, in the light of globalization of the world economy and the way in which multilateral Agreements reached in the Uruguay Round are implemented. (For trade disputes that have arisen regarding "national treatment" see the annex to Part One.)

The degree of uncertainty and hazards associated with short-term forecasting can be seen from table 8, which compares GDP forecasts for 1996 by various international organizations and research

Table 9

ALTERNATIVE FORECASTS OF GDP GROWTH IN 1997 FOR SELECTED OECD COUNTRIES

(Percentage)

Country	*LINK*	*ECE*	*OECD*	*EU*	*IMF*	*NIESR*	*NRI*	*UNCTAD*
United States	2.6	2.5	3.6	2.3	3.0	2.8	2.6	2.9
Japan	1.5	1.6	2.3	1.8	2.2	2.0	1.1	1.9
Germany	2.5	2.0	2.2	2.2	2.3	2.5	1.8	2.2
France	2.5	2.2	2.5	2.1	2.4	2.6	1.8	1.9
Italy	1.1	1.2	1.0	1.4	1.0	1.1	0.6	1.2
United Kingdom	3.2	3.0	3.0	3.0	3.3	3.0	2.7	2.5
Memo item:								
European Union	2.5	..	2.3	2.3	2.4	2.4	1.7[a]	2.0

***Source*:** United Nations, University of Pennsylvania and University of Toronto, "Project Link World Outlook" (mimeo), post-LINK meeting forecast (May 1997); ECE, *Economic Survey of Europe in 1996-1997* (United Nations publication, Sales No. E.97.II.E.1); OECD, *Economic Outlook* (June 1997); Commission of the European Communities, *European Economy, Supplement A* (December 1996); IMF, *World Economic Outlook* (May 1997); National Institute of Economic and Social Research (London), *National Institute Economic Review* (April 1997); Nomura Research Institute (NRI), *Quarterly Economic Review* (May 1997); and table 1.

a Total OECD.

institutions for selected OECD countries with the actual outcome. All forecasters failed dismally to allow for the acceleration of recovery in Japan and all were overoptimistic for Italy, and to a lesser extent also the United Kingdom.

Forecasts for 1997 by the same institutions, on the other hand, appear to converge better than those made for 1996 (table 9). With the notable exception of Japan, all forecasts agree that growth in the selected OECD countries will be faster than in 1996. As regards individual countries, the spread in percentage points among the alternative forecasts is highest for the United States and Japan (1.3 and 1.2, respectively) whereas for the European countries it is only around 0.7-0.8.

Perhaps a major source of uncertainty surrounding short-term prospects is the possible evolution of politics and policies in the EU. Predicting how the EU will move in the fiscal and monetary fields in the second half of 1997 has been made particularly difficult as a result of the general elections held in May/June in the United Kingdom and France. In view of the importance of the EU in the world economy, any sudden shifts in policy can have serious repercussions for the rest of the world, including other major industrial countries and developing countries.

A second source of uncertainty relates to currency and financial markets. The persistence of trade imbalances may lead to large swings in exchange rates which, in turn, serve to redistribute overall demand and growth impulses, rather than eliminate disparities in demand generation. Deepening of imbalances and increased exchange rate instability could in turn lead to financial instability, with unfavourable consequences for global growth due to the depressing effect on expenditure and recourse in some countries to more restrictive macroeconomic policies.

Finally, there is uncertainty regarding the economic implications of the return of Hong Kong to China. It is not clear what the effects of resumed Chinese sovereignty will be either on the trade and investment links within the "Chinese Economic Area", consisting of China, Hong Kong and Taiwan Province of China, or on broader patterns of economic interdependence in East and South-East Asia. ■

Notes

1 The Council of Economic Advisers, in *Economic Report of the President, 1997*, table 2.3 (p. 86), estimated the long-term growth rate of the United States economy for the period 1996-2003 at 2.3 per cent.

2 In January 1995, the Common External Tariff, which covers about 85 per cent of the value of trade among member countries, went into effect. Chile became an associate member in October 1996 and Bolivia reached a similar agreement with the Group in December.

3 The members are Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and United Arab Emirates.

4 For country detail see the 1997 source cited for table 6.

5 For purposes of this chapter this group of countries corresponds to "Eastern Europe" as defined by the ECE secretariat in the source to table 7, i.e. Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Hungary, Poland, Romania, Slovakia, Slovenia, The former Yugoslav Republic of Macedonia, and Yugoslavia.