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1988 WORLD TRADE OUTSHINES EXPECTATIONS

PROSPECTS FOR THIS YEAR ALSO ENCOURAGING

The growth of world merchandise trade volume in 1988 is estimated to have reached 8½ per cent, far outstripping the 5½ per cent of the previous year and equalling the 1984 record for the 1980s. This performance marked four consecutive years of accelerating trade growth, and six consecutive years in which world trade grew more rapidly than world production.

World merchandise trade value is estimated at $2,840 billion, a 14 per cent increase reflecting, for the most part, increased trade volume as well as a contribution from inflation and from a further moderate depreciation of the US dollar.

This "dynamism" in world trade is welcomed in a report, published today, giving the GATT Secretariat's first assessment of developments in 1988.*

Looking to 1989, GATT's economists suggest that if governments meet two immediate policy challenges - control of the recent pick-up in inflation, and keeping world markets open - the volume of world merchandise trade is likely to record another year of growth well above the average thus far in the 1980s.

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*Figures for 1988 are preliminary estimates based on data available as of mid-February. Later in 1989, when more complete information is available, major trade developments and trends will be analyzed in greater detail in Volumes I and II of GATT's annual report International Trade 1988/89.

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MORE

The 1988 trade performance - which brought the volume of world merchandise trade to a level nearly 40 per cent higher than at the time of the 1982 recession - is one of three favourable factors currently benefiting world economic activity. Apart from trade growth, GATT's economists point to moderate inflation in the industrial countries and to strong investment last year as the other two healthy elements.

The report stresses the broad-based nature of the present trade expansion. Thus, while trade in manufactured goods grew most quickly (10 per cent), both mining products, including petroleum (7 per cent) and agricultural products (4 per cent) also experienced significant volume growth.

More importantly, the trade expansion was experienced by a relatively wide range of countries, in particular, the industrial countries and the leading developing economy traders. For developing economies as a group, the volume of exports increased by 9½ per cent (against 8 per cent for developed countries), while their imports were up 10 per cent (9 per cent). The results were even more marked for non-OPEC developing economies. Imports into the members of OPEC fell by an estimated 1½ per cent.

These results reflect a quite different situation from the 1984 trade boom which was largely triggered by the import demand of just one country, the United States. In 1988, the 6½ per cent gain in US imports was well below the world average and its export volume increased by 21½ per cent.

For the fifteen heavily indebted countries whose trade performance the GATT has charted for a number of years, 1988 marked the second successive year of export and import growth and brought their aggregate trade surplus to nearly $28 billion. But this trade performance needs to be seen against the background of rising interest charges and continued lack of fresh capital inflows.

There are also interesting trends in the dollar value of inter-regional and intra-regional trade. Here, statistics indicate that trade within the West Pacific region and Transpacific trade is the most dynamic while Transatlantic trade and trade within Western Europe have been among the slowest growing.

A table of the world's leading exporters shows the Federal Republic of Germany and the United States in a virtual tie at the top of the league followed by Japan, France and the United Kingdom. The United States is still, by far, the world's biggest importer (15½ per cent share of world imports) followed by the Federal Republic of Germany, the United Kingdom, Japan and France.

* * * * *

RECENT DEVELOPMENTS IN WORLD MERCHANDISE TRADE

Two outstanding features characterized world merchandise trade in 1988. One was its dynamism, which exceeded even the most optimistic forecasts. The other was the broadly based nature of the trade expansion. Strong business investment, particularly in the industrial countries, was a driving force behind the acceleration of output and trade growth last year.

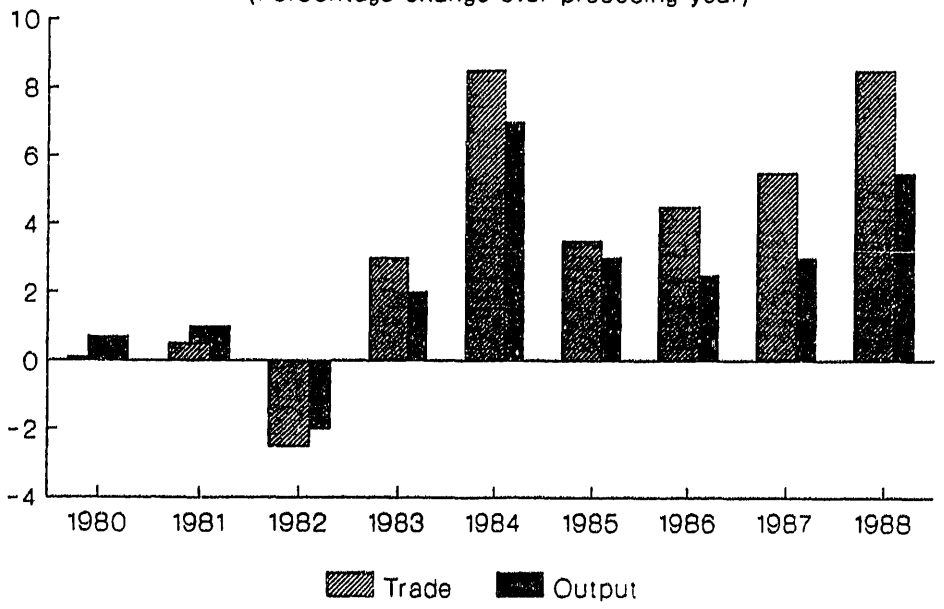
TRADE VOLUME

The volume of world merchandise trade increased by an estimated 8½ per cent in 1988, marking the fourth consecutive year of accelerating trade growth (Chart 1). Last year's impressive trade performance equalled that of the 1984 post-recession boom, and came at a time when the economic expansion was widely considered to have passed its peak.

World merchandise trade growth in 1988 again exceeded the increase in world output, which also accelerated. The substantial margin of trade over output growth indicates that economic linkages between countries continue to grow unabated. And once again trade-related investment and production were leading sources of growth in the world economy.

CHART 1 - VOLUME OF WORLD MERCHANDISE TRADE AND OUTPUT, 1980-88

(Percentage change over preceding year)



Expansion Exceeds Recovery from 1975 Recession

By now, the current expansionary phase in the world economy has become more vigorous than the previous one. The volume of world merchandise trade is up nearly 40 per cent, and world output up 25 per cent, from their 1982 recession levels. In the six years following the 1975 recession, the volume of world merchandise trade and output increased by 30 and 22 per cent, respectively. Moreover, while the sixth year (1981) of the earlier recovery marked the end of world trade and output expansion and the beginning of a major recession, few analysts foresee a similar development any time soon.

Since the middle of 1987, the world economy has benefited from a productive conjunction of three favourable factors. One is that the inflation that has accompanied the continued growth in world output has remained moderate. Another is the central rôle played by business investment in the strong growth, with its promise of increased production capacities. The third is the breadth of the trade expansion.

At present, inflation is a serious problem for a number of developing economies, including some of the most heavily indebted countries. However, the current expansion lacks the symptoms of widespread over-heating that, in 1979-80, showed up in a return to double digit inflation in the developed countries. For the OECD area as a whole the 1988 rate of inflation in consumer prices is estimated to have been 3 3/4 per cent, up from the 3 1/4 per cent increase recorded in the preceding year.

It is true that inflation has continued to pick-up in a number of developed countries, including the United States, the United Kingdom, France, and, most recently, the Federal Republic of Germany. As a result, predictions for 1989 anticipate a modest acceleration of inflation in consumer prices in the OECD area to 4 per cent, with some risks on the up-side. But while this situation has led to a tightening of monetary policy with consequent increases in nominal interest rates, there is no expectation of the kind of drastic anti-inflation policies that triggered the 1982 recession.

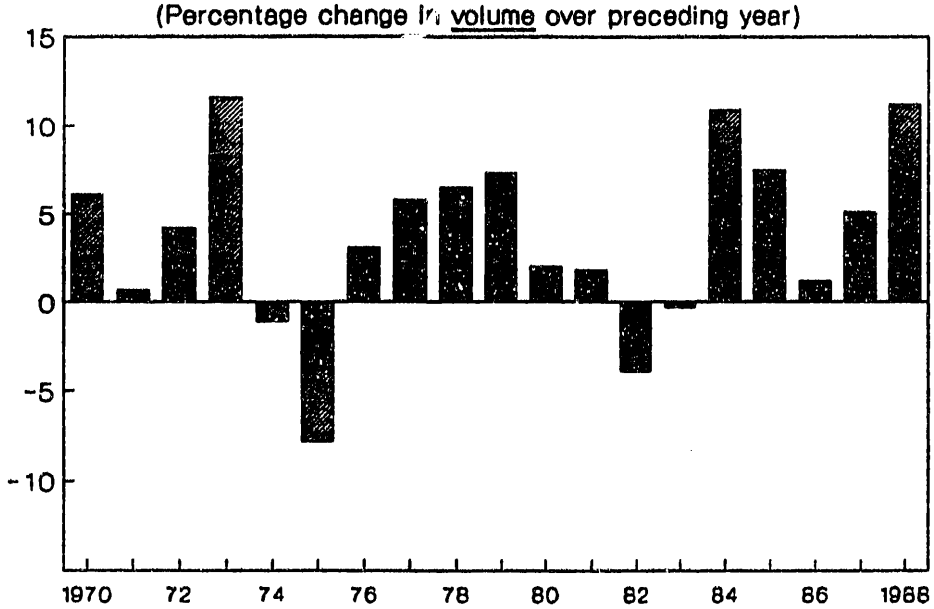
MORE

A second positive factor in the present situation is the recent strength of business investment. In the OECD area, the volume of private non-residential investment increased by an estimated 11 per cent in 1988, a rate of growth that has been matched only twice since the beginning of the 1970s (Chart 2). Furthermore, as compared to the 1984 investment boom, last year's investment was more broadly based among the industrial countries. Preliminary information suggests that a number of developing economies, especially in Asia, also participated in last year's investment growth. This widespread investment activity was reflected in the composition of merchandise trade last year, with large gains being recorded for trade in capital goods.

An economic expansion in which investment plays a key role is likely to be more sustainable than one based primarily on consumption because it increases productive capacity as it goes along. In particular, it promotes structural adjustment and reduces the risk that inflationary bottlenecks will choke off the expansion.

CHART 2 - GROSS PRIVATE NON-RESIDENTIAL FIXED CAPITAL FORMATION IN THE OECD AREA, 1970-88

(Percentage change in volume over preceding year)



Source: OECD Economic Outlook, December 1988.

The third encouraging characteristic of the current expansion is that the growth of world trade is relatively broadly based across products and, even more importantly, across countries.

In 1988, as in 1984, the 8½ per cent increase in the volume of world trade was led by rapidly growing exports of manufactures. In both years, export volumes of agricultural and mining products expanded more slowly than total trade, but above their averages for the 1980s.[1] However, the range in trade growth rates among the three broad product groups was less pronounced last year than in 1984 (Table 1).

Table 1 - Growth in the Volume of World Merchandise Exports and Output by Major Product Group, 1970-1988

(Average annual percentage change)

	1970-80	1980-88	1984	1987	1988
Exports					
Agriculture	4½	2	3	6	4
Mining	1½	½	4	2	7
Manufacturing	7	5	11	6½	10½
All merchandise	5	4	8½	5½	8½
Production					
Agriculture	2	2	5½	0	-2
Mining	2½	-½	1	1	6½
Manufacturing	4½	3½	8	4½	7
All merchandise	4	2½	7	3	5½

[1] One feature which distinguishes 1988 from 1984 is that the estimated 4 per cent increase in world trade volume of agricultural products last year coincided with a decline of world output in agricultural products. In 1984, in contrast, world output of agricultural commodities grew more rapidly than the volume of world trade in those commodities.

An even stronger element in the current expansion is the more balanced pattern of world trade growth among countries relative to 1984. As is evident from Table 2, preliminary estimates suggest that the range between the fastest and slowest growing country groups narrowed from 8½ to 3 percentage points in the case of import volume, and from 4½ to 2½ percentage points for export volume.

Table 2 - Growth in the Volume of World Merchandise Trade by Major Country Group, 1984, 1987 and 1988

(Percentage change over preceding year)

	Imports			Exports		
	1984	1987	1988	1984	1987	1988
Developed countries	11½	6½	9	10	5½	8
Developing economies	3	3	10	7	7	9½
Eastern trading area*	5	0	7	5½	2½	7
World	9	5½	9	8½	5½	8½

*East European countries, USSR, China and other centrally planned economies in Asia.

Note: The volume estimates for 1988 in Table 2 are highly provisional due to the unusually small number of reporting countries in the major country groups.

On a more disaggregated level, it is apparent that the 1984 trade boom was largely triggered by the import demand of just one country, notably the United States. Last year, that country's 6½ per cent increase in import volume was well below the overall increase in world trade. The 1988 expansion in world merchandise trade was boosted by accelerated import demand in a relatively broad cross section of other countries, including both developed and developing ones (Table 3).

Table 3 - Growth in the Volume of World Merchandise Trade by Selected Countries and Groups of Countries, 1984, 1987 and 1988

(Percentage change over preceding year)

	Imports			Exports		
	1984	1987	1988	1984	1987	1988
United States	24	6½	6½	7½	15	21½
Germany, Fed. Rep.	5	5½	6½	9	3	7½
Japan	10½	9½	16½	15½	½	4
Other developed countries	6½	6½	9	9½	5½	8
OPEC	-6	-13½	-1½	½	-2	8½
Other developing economies	6½	8	12	11	10½	10
World merchandise trade	9	5½	9	8½	5½	8½

Recovery of Non-Fuel Commodity Prices Helps Many Developing Economies

OPEC's export volume recovered from its modest decline in 1987 and expanded at the same rate as the volume of total world merchandise trade. However, supply developments caused crude petroleum spot prices to soften from close to $18 per barrel on average in 1987 to around $14 per barrel on average in 1988. Given the reduced foreign exchange earnings, plus the nearly 6 per cent increase in export unit values for manufactures, it is not surprising that the members of OPEC were the only group in Table 3 to report a decline in import volume last year.[2]

Developing economies outside the OPEC group, in contrast, experienced another year of above average export growth in 1988, with the 10 per cent increase in their export volume almost matching the 1987 performance. What distinguishes the two years is the different pattern of trade expansion within the group.

[2] Nevertheless, import developments of OPEC contributed to the year-over-year acceleration of the growth of world merchandise trade volume, in the sense that the decline in import volume in 1988 was very much less than in the year before.

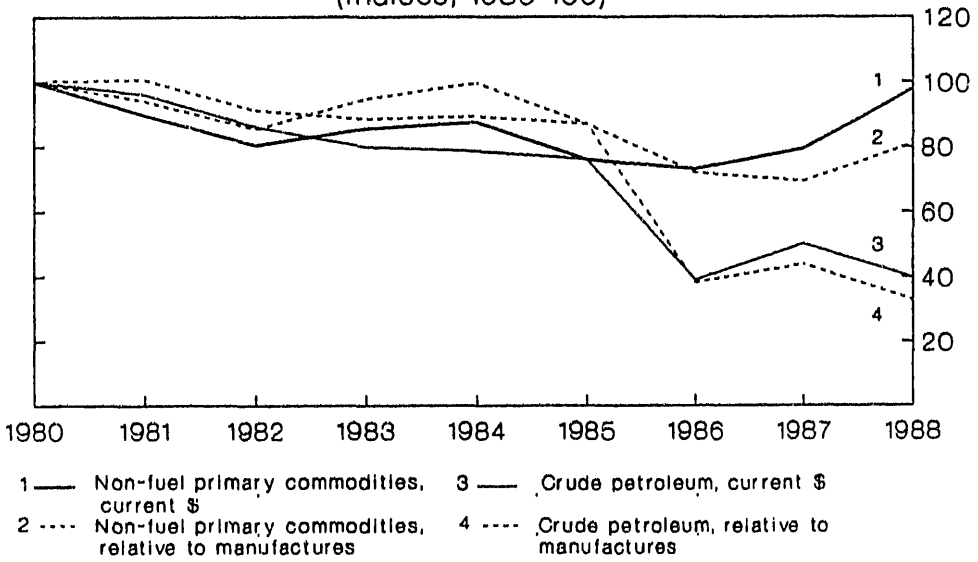
While leading exporters of manufactures among the developing economies in Asia once again recorded particularly strong export growth, in most cases the increase in the volume of exports was below the gain recorded in 1987. Meanwhile, their import volume is estimated to have expanded last year at about the same rapid rate as in 1987. A comparison of the 1988 figures shows import volume increasing at a faster rate than export volume.

As a group, those developing economies which are neither members of OPEC nor among the leading Asian exporters of manufactures, experienced an acceleration in the growth in the volume of their combined exports in 1988. Coupled with a substantial recovery of non-fuel primary commodity prices, this stimulated their foreign exchange earnings, helping to finance higher growth in their import volume.[3]

Dollar prices of non-fuel primary commodities, on a declining trend for most of the period 1980-86, increased by about 25 per cent last year according to IMF estimates. Setting this figure against the estimated 6 per cent increase in the dollar unit value of world exports of manufactures, it is apparent that non-fuel primary commodity prices recovered in real as well as nominal terms (Chart 3).

CHART 3 - PRICE DEVELOPMENTS FOR CRUDE PETROLEUM AND NON-FUEL PRIMARY COMMODITIES, 1980-88

(Indices, 1980=100)



[3] The average performance for a group of countries nearly always masks differences in individual performances. A more precise assessment of developments in individual developing economies will be available later this year - in International Trade 1988/89 - when additional data on developing economies are available.

The extent to which individual countries benefited from this overall recovery in prices depended, of course, on the particular commodity mix of their exports. Among non-fuel primary commodities, the dollar prices for ores, minerals and non-ferrous metals recorded the strongest gains in 1988, on average close to 50 per cent according to IMF estimates. Agricultural raw materials showed the smallest price gains in 1988 (about 10 per cent), ranging from sharp increases for wool and rubber to a decline for cotton. World market dollar prices for food increased 20 per cent, with the drought in the United States having been a major factor, particularly for grains. Not all food items participated in the price increase, of course. For example, a large increase in output resulted in a sharp drop in the dollar price of cocoa, and the dollar prices for robusta coffee, pepper and cassava also declined.

TRADE VALUE

An estimated 14 per cent increase over the preceding year brought the value of world merchandise exports to a new record high of $2,840 billion in 1988 (Table 4). The most important factor behind the increase was the estimated 8½ per cent growth in world merchandise trade volume noted above. Inflation also contributed to the value increase, as did the "automatic" increase in trade value due to the valuation effects of a further moderate depreciation of the dollar.[4]

Table 4 - Value of World Merchandise Trade by Major Country Group, 1987 and 1988

(Billion dollars)

	Imports (f.o.b.)		Exports (f.o.b.)	
	1987	1988	1987	1988
Developed countries	1 776	2 021	1 742	2 014
Developing economies	477	555	490	544
Eastern trading area	237	264	258	282
World	2 490	2 840	2 490	2 840

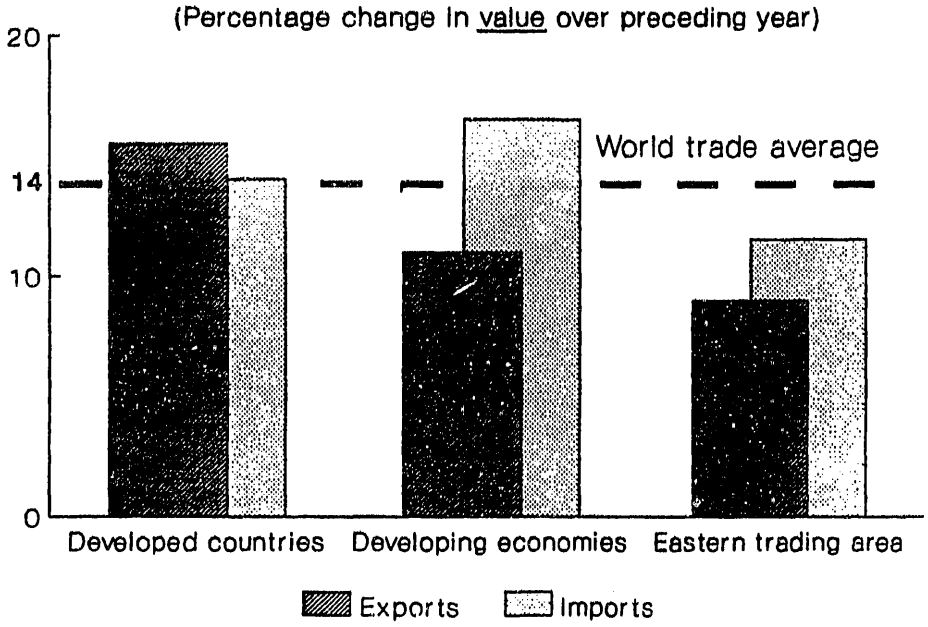
[4] According to IMF estimates, the average value of the dollar's (trade-weighted) nominal effective exchange rate in 1988 was 6 per cent below the average level in 1987; the corresponding figure for the change between 1986 and 1987 shows a decline of 12½ per cent.

Imports into Developing Economies Show Fastest Growth

While each of the three major groups of countries participated in the expansion of the dollar value of world merchandise imports and exports in 1988, the strongest demand side stimulus came from the developing economies (Chart 4).[5] The supply side of the world market saw the developed countries in the lead, a fact that is due more to price and valuation effects than to increases in export volume.

CHART 4 - GROWTH OF MERCHANDISE TRADE BY MAJOR COUNTRY GROUP IN 1988

(Percentage change in value over preceding year)



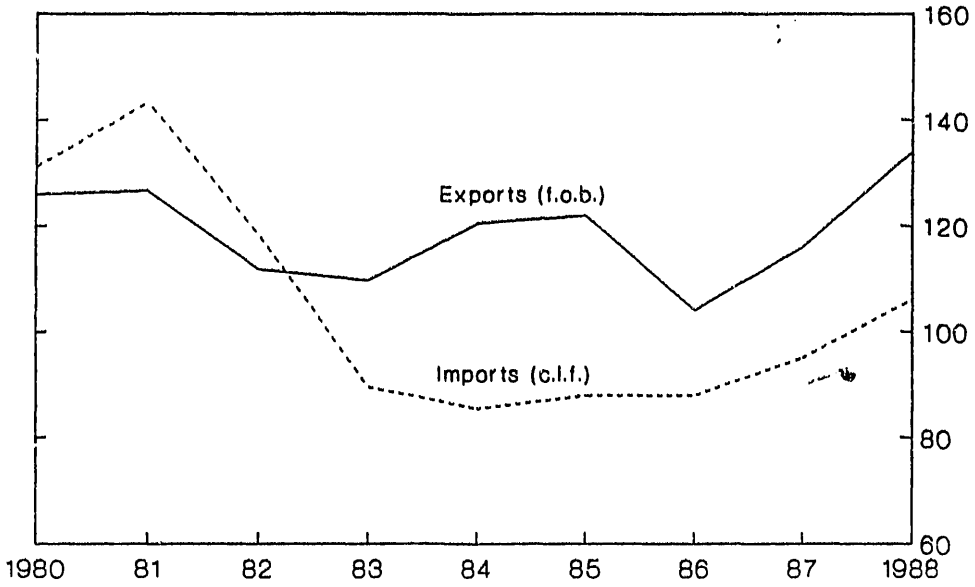
As was noted above, last year's export performance of the developing economies as a group was adversely affected by lower earnings from exports of crude petroleum. This is also evident from the fact that the non-OPEC developing economies expanded their export earnings by an estimated 18 per cent last year, outperforming the developed countries.

[5] There is as yet no estimate to what extent this picture is affected by valuation effects of recent exchange rate changes. However, the fact that the developing economies were also the strongest force in the growth of world merchandise trade volume supports the view that the developing economies made an above-average contribution to the acceleration in the growth of merchandise trade last year.

Export Acceleration in the Heavily Indebted Countries

Last year marked the second consecutive year of export and import growth in fifteen heavily indebted developing countries as a group (Chart 5).[6] Once again, the increase in the value of exports exceeded the increase in imports, pushing the group's aggregate merchandise trade surplus to nearly $28 billion. Export growth was strong enough to raise the dollar value of exports above the 1981 peak for the first time since the onset of the third world debt service problem.[7]

CHART 5 - MERCHANDISE TRADE OF FIFTEEN HEAVILY INDEBTED DEVELOPING COUNTRIES, 1980-88
(Billion dollars)



[6]The fifteen countries are Argentina, Bolivia, Brazil, Chile, Colombia, Côte d'Ivoire, Ecuador, Mexico, Morocco, Nigeria, Peru, Philippines, Uruguay, Venezuela and Yugoslavia.

[7]Because of the intervening inflation in world market prices (export unit values for manufactured goods, for example, increased by 28 per cent between 1981 and 1988), the purchasing power of last year's exports measured in constant dollars is still below the 1981 level. As far as debt servicing is concerned, however, it is the current value of export earnings that matters (the currency or currencies in which the foreign debt is denominated is also important in this regard).

According to preliminary estimates, ten of the fifteen countries increased their export earnings last year, led by Brazil in absolute value (the increase of nearly $8 billion brought total merchandise exports to almost $34 billion) and by Argentina and Chile in terms of percentage increase (each around 35 per cent). Part of this disparity in export performance is explained by the divergent commodity price developments described above. On the import side, seven of the fifteen countries reported increased expenditures on imports, with Mexico taking top spot in both absolute value ($9 billion) and percentage increase (50 per cent).

For many of the heavily indebted developing countries these trade developments occurred at a time when their overall economic situation was worsening. Preliminary estimates suggest that per capita income growth slowed or was negative in several countries. The reduced income reflects, among other things, the pressures created by rising interest rates on the debt and the lack of fresh capital inflows.

West Pacific Leads in Trade Dynamics

Table 5 gives data on major intra-regional and inter-regional merchandise trade flows in 1988. It is evident that the levels of the individual trade flows differ widely, with intra-Western Europe trade ranked at the top and intra-North American trade at the bottom of the list.

Table 5 - Selected Regional Merchandise Trade Flows, 1987 and 1988

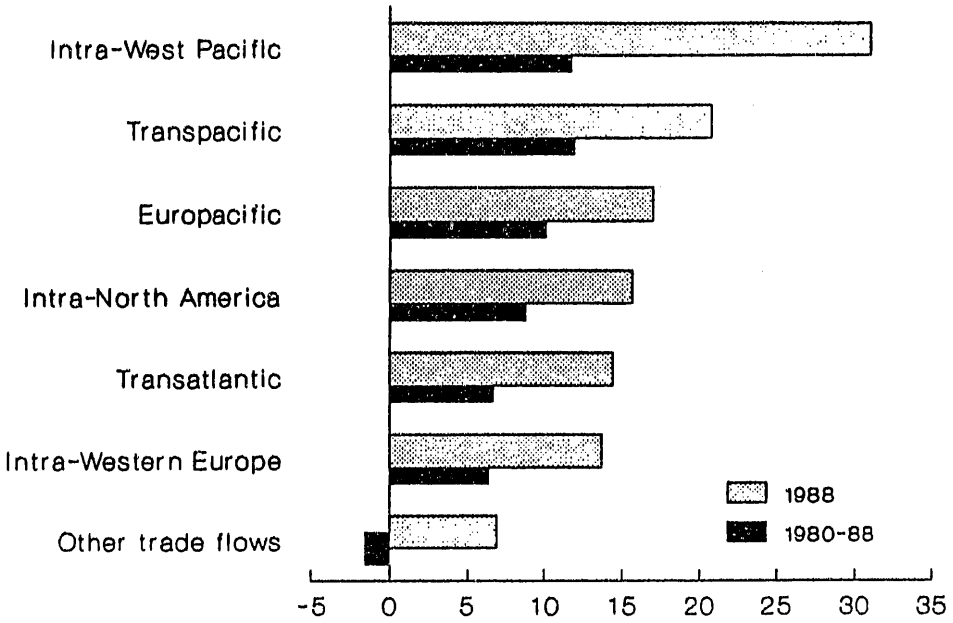
(Billion dollars and percentage shares)

Trade flow	Value	Shares	
	1987	1987	1988
Intra-Western Europe	787	31½	31½
Transpacific	252	10	11
Intra-West Pacific	195	8	9
Transatlantic	185	7½	7½
Europacific	164	6½	6½
Intra-North America	131	5½	5½
Other trade	776	31	29
World merchandise trade	2 490	100	100

The picture changes dramatically once the dynamics of trade flows come into focus. While all of the trade flows shown in Table 5 increased more rapidly last year than on average thus far in the 1980s, the spread in growth rates was substantial (Chart 6). The most dynamic growth was recorded for trade within the West Pacific region, followed by trade between North America and the West Pacific region (Transpacific trade) and trade between Western Europe and the West Pacific region (Europacific trade).[8] This pattern of trade expansion is not just a short-term phenomenon, but also characterizes developments over the period 1980-88.[9]

CHART 6 - INTER-REGIONAL AND INTRA-REGIONAL MERCHANDISE TRADE, 1980-88

(Average annual percentage change in value)



[8]The West Pacific region includes Australia, China, Hong Kong, Indonesia, Japan, Rep. of Korea, Malaysia, New Zealand, Philippines, Singapore, Taiwan and Thailand. Intra-Western Europe trade includes trade flows among all countries in Western Europe. Transatlantic trade refers to the sum of exports in both directions between Western Europe and North America. Transpacific trade refers to the sum of exports in both directions between North America and the West Pacific region. Europacific trade refers to the sum of exports in both directions between the West Pacific region and Western Europe. The category "other trade" includes all world merchandise trade not elsewhere specified.

[9]Between 1980 and 1988, two changes in ranking of the trade flows occurred. First, intra-Western Europe trade replaced the unspecified "other trade flows" as the largest trade flow. A major factor behind this development was the sharp decline of the dollar value of trade in crude petroleum, which is an important component of the residual trade flow shown in Table 5. Second, trade within the West Pacific region surpassed Transatlantic trade in dollar value.

Mixed Progress in Reducing the Major External Imbalances

Last year witnessed the first reduction in the United States merchandise trade deficit (from $170 billion to $137 billion) in this decade. Japan's merchandise trade surplus recorded a modest decline, from $80 billion to $78 billion. The merchandise trade surplus of the Federal Republic of Germany, in contrast, continued to increase, reaching $72 billion (Table 6). To a large degree, these developments reflected underlying volume developments in 1988 (Table 7).

The progress in reducing the United States merchandise trade deficit coincided with an investment boom. While government consumption and private consumption are estimated to have increased by 1/4 and 2 3/4 per cent in real terms, respectively, the volume of private non-residential investment is estimated to have increased 9½ per cent last year. The investment boom was reflected in trade developments. For example, in the first three quarters of 1988, the volume of exports of capital goods (excluding automobiles) from the United States rose 36 per cent while the volume of imports of those goods increased by 27 per cent.

A steady slowdown in the growth of import volume beginning in the second quarter helped to carry the adjustment of the United States merchandise trade deficit throughout 1988, as the growth of export volume also lost momentum in the course of the year. In part, the slowdown of export growth appears to have been related to increasing capacity constraints. Another factor was the United States drought in mid-1988 which, while stimulating prices, led to a decline in the export volume of the affected products.

Table 6 - Leading Exporters and Importers in World Merchandise Trade in 1987 and 1988

(Billion dollars and percentage shares)

Exports (f.o.b)				Imports (c.i.f.)			
	Value		Share in		Value		Share in
	1987	1988	1988		1987	1988	1988
World	2 490	2 840	100.0		2 580	2 950	100.0
Germany, Fed. Rep.	294	323	11.4	United States	424	459	15.6
United States	254	322	11.3	Germany, Fed. Rep.	228	251	8.4
Japan	231	265	9.3	United Kingdom	154	190	6.4
France	148	168	5.9	Japan	151	187	6.3
United Kingdom	131	144	5.1	France	158	173	5.9
Italy	116	129	4.5	Italy	125	139	4.7
Canada	98	115	4.0	Canada	93	112	3.8
USSR	108	112	3.9	USSR[a]	96	106	3.6
Netherlands	92	103	3.6	Netherlands	91	99	3.4
Belgium-Luxembourg	84	93	3.3	Belgium-Luxembourg	83	94	3.2
Hong Kong[b]	48	63	2.2	Spain	49	61	2.1
Taiwan	54	61	2.1	Hong Kong[b]	48	58	2.0
Korea, Rep. of	47	60	2.1	Switzerland	51	56	1.9
Switzerland	46	51	1.8	China	43	54	1.8
Sweden	45	50	1.8	Korea, Rep. of	41	53	1.8
China	40	48	1.7	Taiwan	35	50	1.7
Spain	34	41	1.4	Sweden	41	45	1.5
Singapore[b]	29	39	1.4	Austria	33	36	1.2
Brazil	26	34	1.2	Singapore[b]	33	35	1.2
Australia	27	33	1.2	Australia	29	34	1.1
Total of above	1 952	2 254	79.4		2 006	2 292	77.7

[a] Imports f.o.b.

[b] Includes substantial re-exports and imports for re-exports.

Table 7 - Merchandise Trade Volume in the United States, Japan and the Federal Republic of Germany, 1985-1988

(Percentage change over corresponding period of previous year)

		United States		Japan		Germany, Fed. Rep.	
		Exports	Imports	Exports	Imports	Exports	Imports
1985		2.1	5.3	4.6	0.4	5.9	4.2
1986		5.8	13.5	-0.6	9.5	1.3	6.1
1987		14.9	6.5	0.3	9.3	2.9	5.4
1988		21.5	6.5	4.0	16.5	7.4	6.7
1988	Q1	29.1	10.2	2.6	21.4	2.5	4.8
	Q2	25.9	7.9	2.5	19.6	8.3	3.6
	Q3	18.6	4.8	6.7	15.3	8.7	6.8
	Q4	14.0	4.0	6.5	11.0	10.0	10.0

Note: The quarterly figures for the United States and the Federal Republic of Germany are seasonally adjusted. The figures for the United States are derived from values and unit values on a national accounts basis. Figures for 1988 are preliminary estimates.

In Japan, merchandise import volume has increased rapidly over the past three years, both absolutely and relative to domestic demand. However, given the size of the merchandise trade surplus and the sharp improvement in Japan's terms of trade (up 40 per cent between 1985 and 1988), future reductions in the merchandise trade surplus will be difficult to achieve if trends in export and import volumes evident in the second half of 1988 continue. With capital equipment now accounting for more than half of Japan's exports, last year's export performance benefited from the investment boom.

In the Federal Republic of Germany, a further increase of the merchandise trade surplus was the major factor behind the continuing growth in its current account surplus. Volume trends worked against a reduction in the trade surplus, with export volume expanding more rapidly than imports for the first time since 1985. The recent export performance is all the more noteworthy because the growth of domestic investment in the Federal Republic of Germany also picked up.

Higher demand for machinery and equipment - stimulated by healthy profits, a backlog of investment accumulated in the early 1980s and the European Community's plans for a unified market - boosted Germany's exports to major European trading partners. In addition to France, for many years Germany's most important export market, the United Kingdom, Italy and the Netherlands individually imported more merchandise from the Federal Republic of Germany last year than did the United States.

As is evident from Table 6, a number of other economies among the top twenty traders reported sizeable changes in their merchandise trade balances. Among the more dramatic changes was the doubling of the United Kingdom's trade deficit to an estimated $46 billion.

Finally, for some purposes it is useful to take a broader view of the external imbalance issue - first by considering the full current account rather than merchandise trade account balance, and second by relating the imbalance to gross domestic product (GDP). On this basis, the adjustments in 1988 were pronounced for both the United States and Japan. The ratio is estimated to have declined from 3.4 in 1987 to 2.7 per cent in the case of the United States current account deficit, and from 3.6 to 2.8 per cent for Japan's surplus (adjusted for GDP, the United States current account deficit is now smaller than that of the United Kingdom, where the ratio increased steeply in 1988). For the Federal Republic of Germany, the ratio fell marginally from 4 per cent in 1987 to 3.9 per cent in 1988.

Few Changes in Ranking of the Top Traders

A list of the world's leading exporters shows that the United States has caught up with the Federal Republic of Germany and is now in a virtual tie for first place. Japan, France and the United Kingdom continued to round out the top five (Table 6). The United States is still, by far, the world's biggest importer (15½ per cent share of world merchandise imports) followed by the Federal Republic of Germany, the United Kingdom, Japan and France.

CONCLUSION

The performance of world output and trade during the last eighteen months raises two challenging questions. First, what were the sources of the unexpectedly strong expansion, and second, what can we expect from the world economy in 1989?

As was noted above, the conjunction of three key factors - relatively moderate inflation in the industrial countries, investment-led expenditure growth and the broadly based nature of the trade expansion - seems to explain much of the strength of the recent expansion. But it is evident that these factors are themselves the result of more fundamental forces. In particular, it appears that the world has been benefiting from a productive interaction of rapidly expanding growth opportunities and a cumulation of favourable changes in the policy sphere.

Expanding Growth Opportunities

Statistics for the 1980s indicate that the markets for three important inputs into the production of goods and services - labour services, energy and non-fuel primary commodities - have become less tight relative to the 1970s. For example, annual increases in unit labour costs in manufacturing in the OECD area since 1980 have averaged about one-half the rate of increase of the 1970s. From its peak in 1981, the real price of fuels (that is, the nominal price deflated by the export unit value for manufactures) has fallen by more than one-half. Meanwhile, despite last year's increase, the real price of non-fuel primary commodities remains about 20 per cent below its 1979 level.

The short-to-medium-term growth prospects of those developing countries which are net exporters of primary commodities have not been helped by the decline in the real prices of those commodities. At the same time, these price developments suggest that supply constraints which slowed economic growth in the industrial countries in the 1970s have become less binding for these countries in the course of the 1980s.[10]

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[10] There are, of course, exceptions to this generalization among individual countries. For example, at the present time there appears to be relatively little slack in the labour markets in the United States, Japan and Switzerland.

It is also apparent that technological advances are multiplying opportunities for specialization, innovation and product diversification in world markets for manufactured goods and services. Enterprises in a broad cross-section of countries have responded to the new opportunities by increasing their foreign sourcing for equipment and other inputs, and by intensifying firm-to-firm co-operation, including agreements for joint production and marketing, technology sharing and mergers. The common thread linking these developments is that the world is becoming a more cosmopolitan place to do business.

The creation of new opportunities for growth is only part of the story, however. Another key part concerns changes in the policy environment which have helped to translate the new opportunities into sustained economic growth.

Policy Developments

The ability of and incentives for firms to take advantage of the expanding growth opportunities has been substantially enhanced by changes ranging from an improvement in the general political climate in the world to progress in dealing with specific economic policy problems. The latter includes continuing efforts to make individual economies more competitive, more flexible and more responsive to pressures for structural change. The planned elimination of barriers to regional trade among some of the world's leading traders and, more importantly, the commitment of more than one hundred governments to a major round of multilateral trade negotiations are also having a positive effect on the business environment.[11] A third important factor is the increased confidence in the ability of central banks to deliver on their promise to control inflation, evident in the fact that inflation has remained relatively low in the industrial countries after six years of an economic expansion that actually picked-up steam in the last eighteen months.

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[11] Although not strictly speaking a policy reform, mention should be made of the willingness of individual governments to resist pressures in recent years for large-scale increases in trade barriers. The broadly based nature of the output growth and trade expansion last year suggests that relatively open markets for most products made it possible for part of the increase in expenditure to be satisfied with increased imports, rather than being bottled-up inside the economy. In other words, the stronger demand was "spread around", allowing more countries to share in the growth and helping to keep a lid on price increases.

It is true that the sizeable reductions in the surpluses of Japan and the Federal Republic of Germany, which many analysts had hoped to see last year, did not materialize. But it is also true that - contrary to many predictions - the United States was able to achieve a sizeable reduction in its current account deficit last year without at the same time depressing world output and trade. What this demonstrated was the commonsense point that in the context of a strong expansion of world output and trade, the relative magnitudes of the needed adjustments is reduced and can be accommodated - without excessive difficulty.

In all of these areas more progress is needed. But the evolution of policies has been encouraging and there is reason to believe that in many countries this has greatly strengthened consumers' and investors' confidence in the medium-term economic outlook, thus improving the investment climate in the world economy.

Keeping the Expansion Going

The figures underlying Charts 1 and 2 make it clear that trade and investment can be volatile and that a strong performance in one year does not guarantee trade and investment led growth in the following year. This is particularly true when the world is still searching for solutions to long-standing problems relating to third world indebtedness, large trade imbalances, and high rates of unemployment in many countries, as well as to the failure of many developing countries to share in recent economic growth. Persistent efforts to tackle these problems are essential.

For the immediate future, two major policy challenges are evident. One is the control of the recent pick up of inflation in major countries. The other is to ensure a trading environment in which markets can be kept open and business confidence about the future strengthened. If governments succeed in meeting these two policy challenges there is little reason to believe that the current expansion in the world economy should come to an abrupt end any time soon. The volume of world merchandise trade could thus be expected to record another year of growth well above the average thus far in the 1980s.

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