Economic Survey 2/91

Economic Trends in Norway

AIECE – General Report

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The present issue of Economic Survey contains a review of current economic trends in Norway and an outlook for 1991. The main source of information is the quarterly national account system, which is based on less detailed information than the annual national accounts. The cut-off date for information used in this publication was 5 June 1991.

The AIECE General Report, spring 1991 was prepared to the AIECE meeting 1991 in Essen, Germany, 6-7 May.

Both Economic Trends in Norway and the AIECE General Report have been prepared by the Research Departement in the Central Bureau of Statistics. Inquiries should be directed to Knut Moum or Øystein Olsen.

ECONOMIC TRENDS

SUMMARY

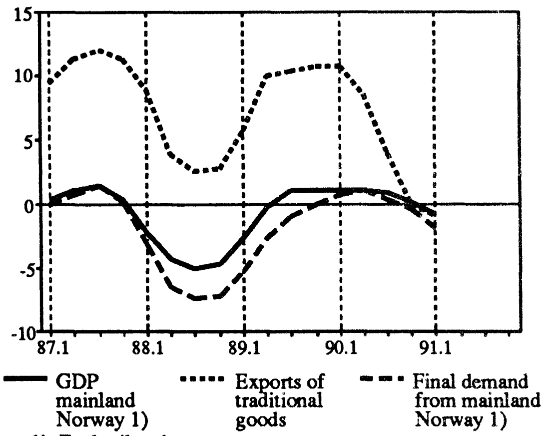
Provisional figures from the quarterly national accounts show a decline in demand from mainland Norway in the first quarter of this year. The weak trend was in evidence for both private consumption and gross fixed investment. The fall-off in demand was influenced by the greater uncertainty which arose following the outbreak of war in the Persian Gulf. Both consumption and investment demand can therefore be expected to pick up later in 1991. In spite of some growth in traditional merchandise exports, mainland GDP fell in the first quarter. Employment also showed a decline through the winter months.

With the exception of Germany, where an expansionary economic policy has contributed to continued high growth, most of Norway's main trading partners are now experiencing a cyclical downturn. An economic recovery in the US in the second half of this year, however, is expected to lead to a moderate expansion in the international economy.

The rise in prices and wages in Norway remains moderate. Price inflation, measured by the Consumer Price Index, is noticeably lower than for our trading partners, and the inflation differential is now about 2 percentage points. Now that most wage settlements have been concluded it appears likely that wage increases in 1991 will be slightly lower than in 1990. Due to continued low inflation, however, average real wages will probably rise.

The economic situation seems somewhat less encouraging now than when the Economic Survey for 1990 was presented. Projections based on the Central Bureau of Statistics' macroeconomic model KVARTS indicate, however, that the growth in demand in mainland Norway will pick up slightly through 1991. Combined with a rising growth in the markets for Norwegian exports through the year, this may result in a slightly higher growth in mainland GDP in 1991 than in 1990. As a whole, the economic outlook has not changed dramatically since the beginning of February. Continued growth in productivity is contributing to a lower rise in prices, but may also result in a weaker development in the labour market than previously estimated.

CYCLICAL DEVELOPMENT
(Per cent growth from previous quarter.
Seasonally adjusted and smoothed. Annual rates.)



1) Excl. oil and ocean transport.

International economy: On the verge of a recovery?

The growth in the international economy slowed through 1990 after the protracted cyclical upturn in the OECD area culminated in 1989. The crisis in the Persian Gulf and increase in oil prices which followed in the wake of Iraq's invasion of Kuwait contributed to amplifying the downturn and resul-

MAIN TRENDS IN ECONOMIC DEVELOPMENTS
Underlying tendency (from previous quarter). Annual rate. Per cent 1)

	90.2	90.3	90.4	91.1
DEMAND AND OUTPUT VOLUME INDICATORS				
Final domestic use of goods and services	-1	-2	-1	-3
- Demand from mainland Norway	1	0	0	-2
- Private consumption	3	2	0	-1
- Government consumption	3	2	1	-2
- Gross fixed capital formation, mainland Norway	-8	-7	-4	-5
Eksport	8	6	4	0
- Traditional goods	8	3	0	-1
Imports	0	-4	-4	-8
- Traditional goods	8	3	0	-5
GDP	2	2	2	1
- Mainland Norway	1	1	0	-1
LABOUR MARKET				
Man-hours worked	0	-1	-2	-3
Employed persons	0	0	-1	-2
Unemployment rate 2)	5,3	5,3	4,9	5,3
PRICES				
Consumer Price Index	4,0	3,8	4,5	3,8
INCOME				
Current balance, NOK bn 3)	-2,3	9,4	13,1	5,5

1) See "Technical comment".
2) Seasonally adjusted levels in per cent.
3) Unadjusted levels in NOK bn.

ted in considerable uncertainty concerning the economic outlook.

After the war between the Allied forces and Iraq ended the general view among forecasters has been that the world economy will begin to recover as early as this year. The United States is expected to lead this development with an economic upswing in the second half of 1991. US exports have exhibited a positive trend for some time, but there are still (end-May) no visible signs that domestic demand has strengthened in the US. Following a projected GDP growth of nearly zero this year, however, DRI forecasts that GDP will expand by 2 1/2 per cent in 1992. Economic growth in Japan has fallen considerably but is still well above GDP growth in the rest of the OECD area.

In Germany, the economic situation is heavily influenced by the economic adjustment problems in connection with the reunification of the two German states. An expansionary fiscal policy has spurred strong growth in the western part, while the change in regime and the start of privatization in the east have so far resulted in a sharp decline in output and a rise in unemployment. To finance the sizeable government budget expenditures a substantial increase in taxes from 1 July this year has been approved. Developments in Germany can have both positive and negative effects for other European countries. The high level of activity may stimulate exports. There are already signs that this has taken place in neighbouring countries Austria and Belgium. The rise in the German interest rate level, which traditionally has dictated interest rate movements in other countries, may have opposing effects.

Due to the deterioration in both government budgets and the balance of payments in Germany, however, the position of the D-mark has weakened in foreign exchange markets. This has contributed to loosen the link between the German interest rate level and other European rates. Money market interest rates have dropped, and several central banks have lowered their official discount rates. In the longer term this may stimulate investment demand which was a major factor contributing to the recent cyclical downturn in Europe.

Economic growth in the UK has been negative since last summer, and the forecasts for 1991 point to an average annual GDP decline of about 2 per cent. The interest rate level, however, has fallen considerably in recent months, and the rate of inflation is also easing. As a result of this and a projected world economic recovery, the British economy is expected to improve towards the end of the year.

Sweden is experiencing a deep recession, and GDP is expected to fall in both 1991 and 1992. Due, among other things, to tax changes, price inflation in 1991 will be high, about 9 per cent, but the rate of inflation is thereafter expected to taper off rapidly. One of the aims of the Swedish link-up with the ECU as from 17 May was to halt speculation about a devaluation of the Swedish krona.

The rate of price inflation internationally is on a declining trend, partly because oil prices have temporarily stabilized at a relatively moderate level. The price of oil is nevertheless a significant factor of uncertainty, both for future price developments and for growth prospects internationally. The forecasts of a moderate economic recovery in the OECD area towards the end of 1991 and in 1992 are generally based on an assumption that oil prices will be approximately or slightly higher than USD 20 a barrel. Developments in the crude oil market thus far this year and estimates for oil consumption and production for 1991 may indicate continued downward pressures on crude oil prices this year.

The weak price trend for other raw materials of special importance to Norwegian exports has persisted thus far in 1991. Aluminium prices fell further through the first quarter of this year, but are expected to pick up towards the end of 1991.

Marked deterioration in exports, but growth towards the end of the year

In 1990 the international cyclical downturn was also noticeable for Norwegian exports. The underlying growth rate for traditional merchandise exports slowed throughout last year, and the decline persisted in 1991. Export performance has been particularly weak for import-competing goods which on a seasonally-adjusted basis fell by 2.5 per cent from the fourth quarter of 1990 to the first quarter of 1991. Exports of goods from export-oriented industries showed signs of decline in the second half of 1990, but picked up slightly from the fourth quarter of last year to the first quarter of 1991. Service exports also showed a slower rate of growth through 1990, and the volume of exports fell markedly from the fourth quarter of last year to the first quarter of 1991. Exports of crude oil and natural gas (seasonally adjusted) posted only marginal increase from the fourth quarter of 1990 to the first quarter of 1991. For total exports the provisional figures show a noticeable decline in volume in this period. A higher growth internationally in the second half of this year will help to boost traditional merchandise exports towards the end of the year.

Fall in domestic demand, but resumed growth in second half of the year?

Demand from mainland Norway fell from the fourth quarter of 1990 to the first quarter of 1991 following a slowdown in the underlying growth rate through 1990. Private consumption declined by 0.2 per cent on a seasonally-adjusted basis after dropping 0.7 per cent in the fourth quarter of last year. The decline in consumption can particularly be ascribed to reduced purchases of consumer durables and direct purchases abroad by resident households, while consumption of other services has made a positive contribution. It is reasonable to view the sharp decline in direct purchases abroad by resident households in connection with the uncertainty following the outbreak of war in the Persian Gulf. Other components of consumption may also have been negatively influenced by these events. Along with a continued growth in household real disposable income, this indicates that consumption will pick up again later in 1991.

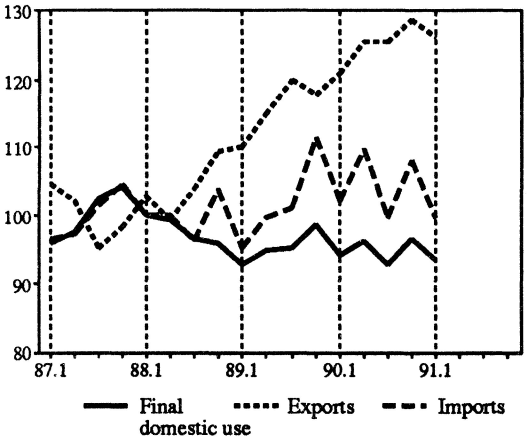
Total public consumption in the first quarter of this year was 1.8 per cent higher than in the same period one year earlier. Based on the proposals for changes in fiscal policy in the Revised National Budget for 1991, it now appears that public consumption will rise by about 2.9 per cent from 1990 to 1991.

Through 1990 there were clear indications that the fall in gross investments in mainland Norway - which has persisted since the second quarter of 1988 - was in the process of coming to a halt. Following an increase in the fourth quarter of 1990, however, investment (sesonally adjusted) fell again in the first quarter of 1991, and is now two thirds of the level recorded in the peak year 1987. There was nevertheless a growth in manufacturing investment through 1990 and in 1991, but the Central Bureau of Statistics' investment data for the first quarter of 1991 do not provide a basis for determining whether this development will continue throughout the year. Housing investment continues to decline even though there are signs of some levelling off. Nor does it appear that investment in other private services has bottomed out. A growth is expected, however, in public sector investment from 1990 to 1991 which, combined with a sharp rise in investment in oil and gas activities, will contribute to a growth in total fixed investments from 1990 to 1991.

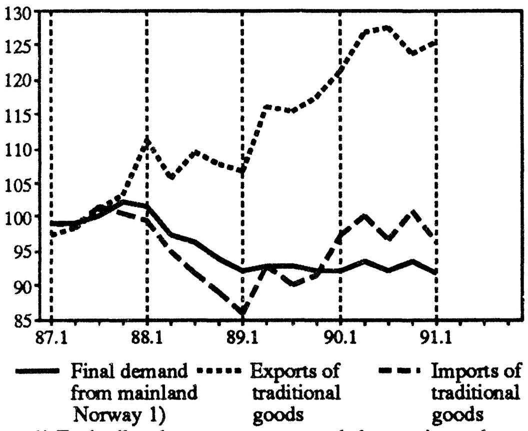
Import growth is levelling off

Both total imports and traditional merchandise imports showed a slower underlying growth through 1990 and the beginning of 1991. As a result of a sharp fall in imports of aircraft and cars, etc., traditional merchandise imports declined by 4.8 per cent from the fourth quarter of 1990 to the first quarter of 1991. If imports of such transport equipments are excluded, imports of traditional goods remained

TOTAL EXPORTS, IMPORTS AND FINAL DOMESTIC USE
1987 = 100. Seasonally adjusted

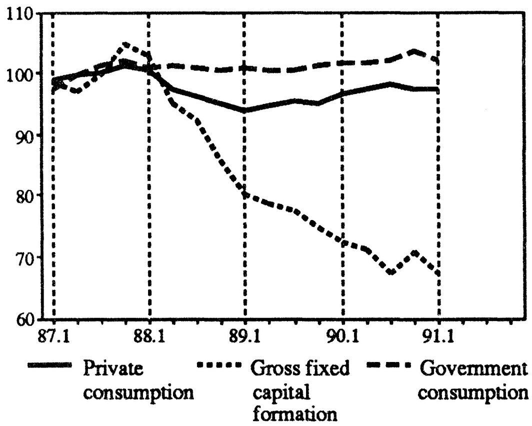


EXPORTS, IMPORTS AND DOMESTIC DEMAND, MAINLAND NORWAY
1987 = 100. Seasonally adjusted



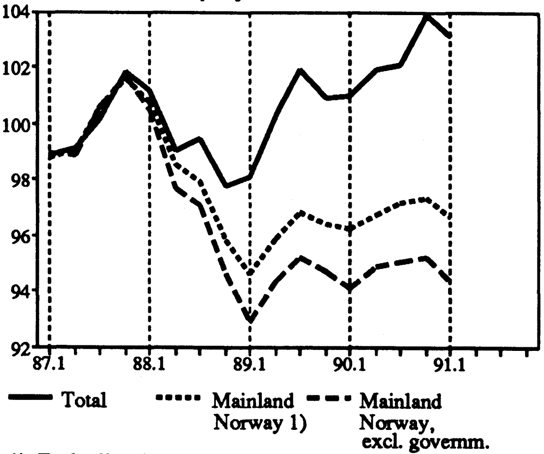
1) Excl. oil and ocean transport, and changes in stocks.

CONSUMPTION AND FIXED CAPITAL FORMATION, MAINLAND NORWAY 1)
1987 = 100. Seasonally adjusted



1) Excl. oil and ocean transport, and changes in stock.

GROSS DOMESTIC PRODUCT
1987 = 100. Seasonally adjusted



1) Excl. oil and ocean transport.

rather constant through the past year. The same is true for service imports. A decline in imports of ships and oil platforms, etc. has contributed to a fall in total imports. A moderately rising growth in the Norwegian economy through 1991 will contribute to a rise in imports through the present year.

Temporary fall in production

The noticeable decline in domestic demand and slower rate of growth in traditional merchandise exports resulted in a decline of 0.7 per cent in mainland GDP from the fourth quarter of last year to the first quarter of 1991, following slower growth rates through the last two quarters of 1990. The gross product for manufacturing industry and other commodity-producing industries fell by 2.4 and 1.9 per cent respectively, seasonally adjusted, while private service industries recorded zero growth. The output decline was particularly strong for import-competing manufacturing, where developments on both the export and domestic market contributed to lower activity. Building and construction also registered a decline in gross product in the first quarter of this year after showing some increase in the level of activity towards the end of 1990. The figures for the last few quarters and short-term indicators for building activity may indicate that the strong output decline in the building and construction sector is in the process of levelling off. In the oil and shipping sectors, gross product fell slightly from the fourth quarter of last year to the first quarter of 1991, and on a seasonally-adjusted basis total GDP fell by 0.7 per cent in this period. A growth in domestic demand, particularly in public and private consumption, but also a growth in investment in petroleum activities, entail that the growth in mainland GDP may nevertheless be slightly higher in 1991 than in 1990.

Decline in employment, but stabilization later in the year?

The production decline contributed to a reduction in the total number of man-hours worked of 1.5 per cent from the fourth quarter of 1990 to the first quarter of 1991. The fall in employment was slightly lower, about 1 per cent, indicating a greater use of part-time work and a continued decline in the use of overtime. Because the labour force declined almost as much as employment, seasonally adjusted unemployment rose only moderately according to the Central Bureau of Statistics' labour market survey. Seasonally-adjusted figures for the total number of registered unemployed and people employed on labour market measures (excluding rehabilitation) increased through the first quarter of 1991 but showed little change later in the spring. There are few indications that there will be any significant growth in employment or reduction in unemployment in 1991.

Continued moderate rise in wages and prices

According to revised national accounts figures, average wages per man-hour in mainland Norway increased by 5.3 per cent from 1989 to 1990. Important wage settlements for this year have now been concluded. All total, the annual growth in wages in 1991 seems to be nearly 4 1/2 per cent, i.e. lower than in the previous year.

For the period January-April 1990 to January-April 1991 the Consumer Price Index increased by 3.8 per cent. Measured in this way, the rise in prices was 0.5 percentage points lower than in the same period one year earlier. Higher wage inflation in 1990 compared with 1989 was offset by high productivity gains in commercial trade and other private services. The rise in import prices remains at the same level as a year ago in spite of an increase in price inflation for Norway's main trading partners. In the first quarter of 1991 price inflation for Norway's trading partners was about 2 percentage points higher than in Norway. International price inflation is expected to ease through 1991, indicating that the rise in import prices will remain low.

With a crude oil price of about USD 20 a barrel and an unchanged dollar exchange rate through the year, the rise in consumer prices in Norway from 1990 to 1991 can be estimated at some 3 1/2 per cent.

Lower oil prices reduced current account surplus

The current account showed a surplus of NOK 5.5 billion in the first quarter of this year. This is NOK 3.2 billion higher than in the same period last year, but NOK 7.5 billion lower than in the fourth quarter of 1990. The reduced surplus compared with the fourth quarter of last year is primarily due to lower crude oil prices and a deterioration in the balance of interest and transfers as a result of higher payments of share dividends, particularly from oil companies. Norway's real disposable income increased by 3.6 per cent from 1989 to 1990. In the first quarter of 1991 real disposable income was 0.3 per cent higher than in the same period last year.

Lower interest rate level internationally is pushing down Norwegian interest rates

The three-month (theoretical) ECU-rate in May was about 0.9 percentage points lower than at the end of the year. Through the same period the three-month Euro-krone rate fell about 1.5 percentage points, entailing that the interest rate differential in May had on average been reduced to 0.1 percentage point, in the krone rate's disfavour. There is reason to believe that the krone interest rate will follow the ECU rate in the period ahead, entailing that the projected interest rate decline internationally will induce similar movements in the Norwegian credit market.

DEVELOPMENT TRENDS IN SELECTED MACROECONOMIC VARIABLES

Percentage change in volume in 1989 prices [1)]

	NOK billion	Growth from same period previous year				Underlying tendency Annual rate (measured from previous quarter)[5)]			
	1990	90.2	90.3	90.4	91.1	90.2	90.3	90.4	91.1
Private consumption	320.2	2.2	2.7	2.4	0.3	3	2	0	-1
Goods	201.6	1.8	3.1	2.3	0.0	3	2	-1	-2
Services	107.9	2.4	1.5	2.8	2.3	3	3	4	4
Norwegian consumption abroad	20.4	3.4	1.1	0.1	-18.7	*	*	*	*
- Non-residents' consumption	9.8	1.8	-4.7	-0.9	-17.7	*	*	*	*
Government consumption	134.2	3.0	1.6	3.7	1.8	*	*	*	*
Central government	53.8	5.5	1.6	5.6	3.5	*	*	*	*
Civilian	32.8	7.1	0.7	5.4	3.0	*	*	*	*
Military	21.0	3.1	3.3	5.8	4.6	*	*	*	*
Local government	80.4	1.3	1.5	2.2	0.8	*	*	*	*
Gross fixed capital formation	122.3	-36.8	-32.8	-29.5	-6.9	*	*	*	*
Oil and shipping	25.9	-67.6	-66.5	-61.0	8.7	*	*	*	*
Mainland Norway	96.3	-11.0	-12.8	-6.9	-10.6	-8	-7	-4	-5
Manufacturing and mining	13.4	-10.5	-7.7	14.6	6.6	6	13	18	14
Production of other goods	13.3	-13.9	-13.4	-14.9	-3.7	-12	-8	1	9
Other services	69.6	-10.4	-13.7	-9.3	-14.3	-10	-10	-9	-11
Stocks (contribution to GDP growth)	16.2	(9.9)	(5.3)	(4.1)	(-1.1)	*	*	*	*
Ships and oil platforms in progress (contribution to GDP growth)	11.7	(7.1)	(3.2)	(2.1)	(-0.4)	*	*	*	*
Other stocks (contribution to GDP growth)[3)]	4.4	(2.8)	(2.0)	(2.0)	(-0.7)	*	*	*	*
Final domestic use of goods and services	592.8	-0.1	-1.9	-2.8	-2.0	-1	-2	-1	-3
- gross capital formation in oil and shipping (incl. stocks)[2)]	37.7	-29.8	-38.5	-47.5	-1.6	*	*	*	*
- demand from mainland Norway	550.7	-0.2	-0.6	0.9	-1.3	1	0	0	-2
Exports	281.8	7.4	4.8	8.6	3.1	8	6	4	0
Traditional goods	119.6	5.8	10.8	4.1	-0.0	8	3	0	-1
Crude oil and natural gas	74.8	-1.2	-4.7	11.9	15.4	5	13	17	13
Ships and oil platforms	10.8	165.0	11.2	69.2	-20.5	*	*	*	*
Services	76.7	7.0	5.1	7.3	-1.3	6	4	1	-5
Total use of goods and services	874.6	2.3	0.2	0.6	-0.4	2	1	0	-2
Imports	240.7	7.7	-1.9	-3.4	-4.1	0	-4	-4	-8
Traditional goods	150.1	5.3	7.0	9.3	-3.7	8	4	0	-5
Crude oil	1.4	109.3	15.5	129.3	-34.8	*	*	*	*
Ships and oil platforms	18.7	24.4	-55.7	-51.9	-20.1	*	*	*	*
Services	70.5	6.4	1.2	1.6	-0.9	3	-1	-2	-4
Gross domestic product (GDP)	633.9	0.2	0.9	2.2	1.0	2	2	2	1
- Mainland Norway	533.6	-0.8	1.1	0.1	-0.9	1	1	0	-1
Oil activities and shipping	100.3	5.9	-0.1	14.1	11.1	8	10	12	8
Mainland industry	493.5	-1.2	1.0	-0.2	-	1	1	0	-1
Manufacturing and mining	92.4	-3.3	1.7	-0.3	-3.0	2	1	-1	-2
Production of other goods	71.3	-5.0	1.0	-7.1	-2.7	-4	-5	-5	-2
Other services	329.8	0.2	0.7	1.5	-	2	2	1	0
Correction items (contribution to GDP growth)[4)]	40.1	(0.2)	(0.2)	(0.2)	-	*	*	*	*

[1)] Notes, see "Technical comment".

PRICE INDICES FOR SELECTED MACROECONOMIC VARIABLES

	Percentage change from the same period the year before				Underlying tendency annual rate (measured from previous quarter)			
	90.2	90.3	90.4	91.1	90.2	90.3	90.4	91.1
Private consumption	4.0	4.3	4.7	4.3	5	5	5	3
Government consumption	2.4	3.6	4.7	5.0	2	8	8	2
Gross fixed captial formation	1.7	3.0	2.3	1.4	0	9	3	-3
- mainland Norway	0.6	1.7	2.0	0.6	-1	8	2	-7
Final domestic use of goods and services	2.9	3.5	4.4	4.0	3	7	5	1
- demand from mainland Norway	3.0	3.7	4.2	3.9	3	6	5	1
Exports	-5.7	1.7	14.2	0.3	-17	27	64	-42
- traditional merchandise exports	-7.4	-5.7	2.8	1.2	-10	1	32	-14
Total use of goods and services	0.1	2.9	7.6	2.8	-4	13	22	-16
Imports	1.4	0.4	0.2	-2.2	0	-1	3	-9
- traditional merchandise imports	0.9	-0.5	-0.4	-3.8	-1	1	-1	-12
Gross domestic product (GDP)	-0.5	3.8	10.4	4.5	-5	18	29	-18
- mainland Norway	1.2	1.8	3.9	5.6	3	3	10	7

TECHNICAL COMMENT ON THE QUARTERLY ACCOUNTS FIGURES

Footnotes: 2) Including ships, oil platforms and platform modules in progress. 3) Excluding ships, oil platforms and platform modules in progress. Contributions to GDP growth are calculated as the difference between investments in stocks in the quarter and the same quarter the previous year, calculated as a percentage of GDP the same quarter the previous year. 4) Corrected for free bank services and certain excises. The contributions to GDP growth are calcualted as the increase in the item from the same quarter the previous year, measured as a percentage of GDP the same quarter the previous year. 5) Growth from previous quarter in smoothed, seasonally adjusted series, converted to an annual rate. 6) Estimates partly based on projections. *) Percentage changes are meaningless.

Quarterly calculations: The calculations are made on a less detailed level than the calculations for the annual national accounts, and are based on more simplified procedures. The quarterly national accounts figures for the years up to and including 1989 have been reconciled against the most recently published annual accounts figures.

Gross fixed capital formation: Total gross fixed capital formation is heavily influenced by significant fluctuations in investment in oil activities. These fluctuations are inter alia due to the fact that platforms that have been under construction for several years are counted as investment in the quarter and with the capital value they have at the time they are towed out to the field.

Seasonally-adjusted figures: The quarterly national accounts are not seasonally-adjusted, as these accounts are attempts to register the actual transactions that have taken place in each quarter. Many of the statistical series thus show clear seasonal variations. These are therefore seasonally adjusted on the detailed accounts level and then added together with the other statistical series to obtain the figures presented in the tables and charts of this volume. Seasonal adjustments for the public sector's purchase of goods and services are based on estimates, as there is not enough information available yet to map out the seasonal pattern.

Underlying trend: The Norwegian economy is so small that random or single important occurrences can give wide variations in the figures. The seasonally adjusted figures are therefore smoothed so that it is possible to find the underlying trend for each series. Smoothing is an attempt to distinguish between random and systematic variations in the series.

REVISIONS OF UNDERLYING TREND

Per cent growth from previous quarter. Seasonally adjusted and smoothed. Annual rates

Publ.	87.2	87.3	87.4	88.1	88.2	88.3	88.4	89.1	89.2	89.3	89.4	90.1	90.2	90.3	90.4	91.1
							GDP mainland Norway									
Jan. - 88	1	2	2													
June -88	0	1	0	-2												
Sept.-88	0	0	0	-1	-1											
Dec.- 88	0	1	1	0	-1	-2										
Feb.- 89	0	1	1	0	-1	-1	-2									
June -89	2	2	2	0	-2	-3	-4	-3								
Sept.-89	2	2	2	-1	-2	-4	-4	-2	1							
Dec.- 89	2	2	2	0	-2	-4	-4	-2	1	3						
Feb.- 90	2	2	2	0	-2	-3	-3	-1	2	3	2					
June -90	1	1	-1	-3	-4	-4	-3	-1	1	1	0	-2				
Sept.-90	1	1	-1	-3	-4	-4	-3	-2	1	1	1	1	3			
Dec.- 90	1	1	-1	-3	-4	-4	-3	-2	1	1	1	2	3	3		
Feb.- 91	1	1	-1	-3	-4	-4	-3	-1	1	2	1	1	2	2	2	
June -91	1	1	-1	-2	-4	-5	-5	-3	0	1	1	1	1	1	0	-1
							Final demand from mainland Norway									
Jan. - 88	-1	0	1													
June -88	0	1	1	-2												
Sept.-88	0	0	0	-2	-4											
Dec.- 88	0	0	0	-2	-4	-4										
Feb.- 89	0	0	0	-3	-5	-4	-3									
June -89	1	1	0	-3	-5	-5	-4	-3								
Sept.-89	1	1	0	-3	-6	-7	-6	-4	0							
Dec.- 89	1	1	0	-3	-5	-6	-6	-5	-2	0						
Feb.- 90	1	1	0	-3	-5	-6	-6	-4	-2	0	1					
June -90	1	1	0	-3	-6	-7	-7	-4	-2	-1	-1	-1				
Sept.-90	1	1	0	-3	-6	-7	-7	-5	-2	0	1	2	3			
Dec.- 90	1	1	0	-3	-6	-7	-7	-5	-2	-1	0	1	2	2		
Feb.- 91	1	1	0	-3	-6	-7	-7	-5	-2	0	1	1	2	2	2	
June -91	1	1	0	-3	-6	-8	-7	-5	-3	-1	0	1	1	0	0	-2

COMMENTS ON THE REVISIONS

Revisions can either be due to new/revised quarterly figures for the current year, new/revised annual national accounts figures for previous years, or a change to a new base year for prices. Because the growth rates following the change-over to an annual rate are rounded off to the nearest whole per cent, a 1 percentage point change in the growth rate can be due to different rounding.

Published:	Price basis:	New annual accounts:	Other comments:
Jan. - 88	1986		
June -88	"	1985-87	New seasonal adjustment programme used
Sept.-88	"		
Dec.- 88	"		
Feb.- 89	"		
June -89	1987	1986-87	
Sept.-89	"		Revised seasonal adjustment programme
Dec.- 89	"		
Feb.- 90	"		
June -90	1988	1987-88	
Sept.-90	"		
Dec.- 90	"		
Feb.- 91	"		
June -91	1989	1988-89	

OUTLOOK FOR 1991

In this section estimates for macroeconomic developments in Norway for 1991 are presented. The calculations have been made by running the Central Bureau of Statistics' macroeconomic quarterly model, KVARTS. The aim of these calculations is to illustrate probable cyclical developments in the Norwegian economy in the period ahead. The main results from the calculations are presented in the table below, which also includes projections from other institutions. For some key variables the results from the KVARTS calculations are also shown in diagrams as seasonally adjusted and smoothed growth from the previous quarter.

In the calculations, output growth in mainland Norway is estimated at some 1 per cent in 1991, slightly higher than in 1990. A growth in domestic demand, especially public and private consumption, in addition to a brisk growth in investment in oil and gas activities, will make a positive contribution to growth in the Norwegian economy. The growth projections for production and domestic demand are somewhat lower than corresponding estimates presented in the Economic Survey for 1990 (1/91). One of the main reasons for the moderate downward revision in GDP is a weaker trend in traditional merchandise exports. In addition, the growth in private consumption has been revised downwards compared to earlier projections. The calculations still indicate, however, a moderate upturn in output and demand in the mainland economy. The projections for market growth and price inflation for our trading partners as well as for the rise in domestic prices and wages have also been revised downwards. Like the projections presented in the Economic Survey for 1990, we expect a weaker upturn in the Norwegian economy than many other institutions which have presented corresponding forecasts (see table).

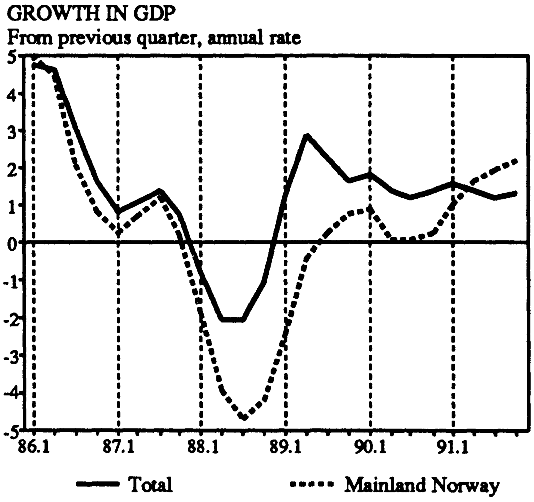
Weak international growth

The projections are based on assumptions entailing a sluggish trend in Norwegian export markets through the first three quarters of 1991, but with market

THE DEVELOPMENT OF MAIN ECONOMIC INDICATORS
Percentage change in volume from pervious year unless otherwise noted[1)]

	1990	1991			
	Accounts	CBS	MoF	NHO	DnB
Private consumption	2.6	1.6	2.4	2.9	2.0
Public consumption	2.3	2.9	2.9	2.0	3.2
Gross fixed capital formation	-28.5	3.4	5.3	7.9	5.9
- mainland Norway	-9.8	-1.2	0.5	4.3	0.8
Exports	7.8	2.7	3.9	2.7	2.7
- traditional exports	8.7	1.1	2.0	3.0	3.7
Imports	2.6	2.2	1.2	-0.5	3.7
- traditional imports	9.5	2.3	3.5	5.1	4.3
Gross Domestic Product (GDP)	1.8	1.5	2.9	2.3	1.9
- mainland Norway	0.7	1.1	1.8	1.9	1.5
Man-hours worked, employees	-0.5	-0.4	..	..	0.2
Unemployment rate (level)	5.2	5.3	..	4.8	5.0
Rise in wages per man-hour	5.0	4.6	4.0	..	4.7
Consumer Price Index	4.1	3.6	3.8	3.7	3.6
Current account (level, bill. NOK)	22.6	18.9	20.0	26.8	17.5

1) MoF: Ministry of Finance. Forecast according to Revised National Budget 1991.
CBS: Forecast according to Central Bureau of Statistics.
NHO: Forecast according to Confederation of Norwegian Business and Industry.
DnB: Forecast according to Den norske Bank, Economic Secretariat.



growth picking up towards the end of the year. This results in an average growth for Norwegian export markets of about 2 per cent from 1990 to 1991. For the price of oil, the calculations are based on an annual average of slightly less than USD 20 a barrel and a dollar exchange rate at about USD 6.50. The rise in prices for traditional merchandise imports is projected to be even lower in 1991 than in 1990.

Slightly more expansionary fiscal policy

The calculations for public sector employment, intermediate consumption, investment and interest rate developments in state banks are based on the Government's programme as presented in the Revised National Budget for 1991. The interest rate level in private credit institutions is projected to fall slightly later in 1991.

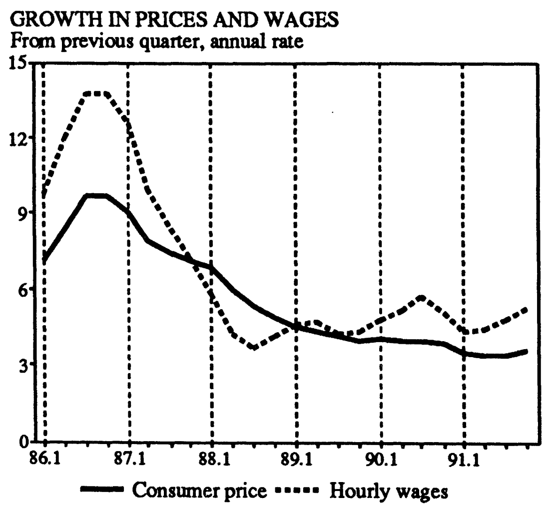
Slower rise in prices and wages

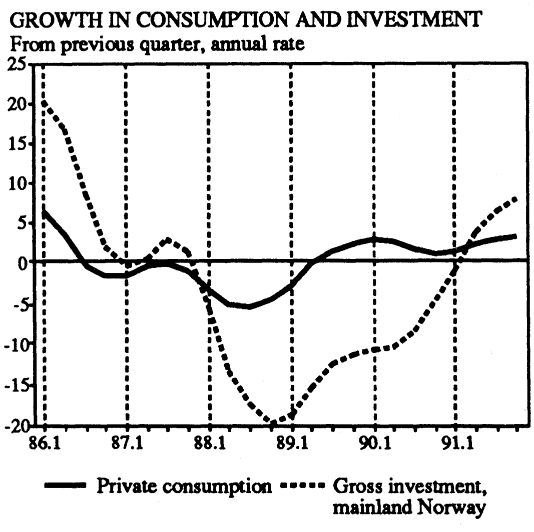
The relatively high growth in wages through 1990 is, in the calculations, projected to decline in 1991: the average growth in hourly wages is estimated to be reduced from 5 per cent in 1990 to about 4 1/2 per cent this year. A relatively low rise in prices and a continued high level of unemployment are the main contributing factors.

A moderate growth in wages, a low rise in import prices and continued growth in productivity are the most important factors underlying lower consumer price inflation in 1991. The decline in oil prices (in USD terms) following the temporary surge in the fourth quarter of last year is pushing down the annual rise in the Consumer Price Index in spite of an increase in the dollar exchange rate through the winter months of this year. Lower interest rates in both state owned and private banks in 1991 may also have a dampening effect on inflation. The reduction of subsidies on cheese and milk from 1 July 1991 may entail that inflation will pick up slightly in the third quarter.

Moderate growth in consumption, turnaround in investment?

Private consumption started to expand at the beginning of 1989 after having declined for two and a half years. The growth through the first three quarters of 1990 was relatively substantial, but this trend was halted by decline in the last quarter of last year. The decline persisted into 1991. The development in consumption in the first quarter of this year can partly be attributed to the crisis in the Persian Gulf which led to a marked fall in direct purchases abroad by resident households. The sharp rise in the growth rate for consumption in the second quarter of this year is related to a gradual normalization of these direct purchases abroad. The increase in household real disposable income, as a result of higher real wages and some tax relief, also contributes to the growth in private consumption. The growth in income, along with a continued high real interest rate, will contribute to a rise in the household savings ratio in 1991 for the fourth consecutive year.





Investments in mainland Norway have been tapering off since the beginning of 1988. The projections indicate that the decline will come to a halt in 1991, and a resumed growth in investment, albeit weak, can now be expected in the second half of the present year. Due to the decline through 1990 the annual growth will probably still be negative in 1991. A noticeable rise in public sector investments, some increase in manufacturing investments as well as a levelling off in the decline in housing investments are important factors in this picture.

As a result of a sharp growth in investments in oil and gas activities, total gross fixed capital formation is projected to rise by 3.7 per cent in 1991.

Higher export growth towards the end of the year?

Following a prolonged period of strong growth in traditional merchandise exports, a marked reduction in growth is now likely in 1991. A higher growth in export markets in the fourth quarter of 1991 will stimulate growth in traditional merchandise exports which, according to the calculations, will pick up slightly towards the end of the year.

Prices for traditional merchandise exports from Norway are projected to rise at a slightly faster rate from 1990 to 1991 than the average rise in prices for imported goods. This, along with a slightly weaker growth in the volume of traditional exports compared with imports will result in an approximately unchanged balance of trade for traditional goods.

The growth in crude oil exports will continue in 1991. Gas exports will be slightly reduced, but as a result of higher gas prices in 1991 the value of gas exports will still rise in 1991. The value of gross freight earnings is expected to rise slightly in 1991, primarily because rates will remain at a higher level than last year. Exports of second-hand ships are projected to fall from 1990 to 1991. All total, imports are estimated to increase by about 2 per cent from 1990 to 1991. The decline in direct purchases abroad by resident households in the first quarter has the effect of reducing the growth in imports. The sizeable component of import-intensive investment in the oil and gas sector, such as the construction of gas pipelines, has the opposite effect. While the projections for 1991 point to approximately similar growth rates in volume for total exports and imports, the surplus on the balance of trade will, according to the calculations, be reduced in relation to 1990 as a result of a deterioration in the terms of trade. Norway's net foreign debt has been reduced during the last couple of years. In isolation this will contribute to a reduction in Norway's net interest expenses in 1991, but this may be offset by a continued high dollar exchange rate. Sizeable payments of share dividends (net) to foreign owners from oil companies nevertheless entail that the deficit on the balance of interest and transfers in 1991 is projected to remain approximately unchanged from 1990. The current account surplus in 1991 is thus estimated to be slightly lower than in 1990.

GROWTH IN TRADITIONAL MERCHANDISE EXPORTS AND IMPORTS
From previous quarter, annual rate

Few bright spots on the labour market

The output growth through 1991 does not appear to be strong enough to increase employment to any great extent; the calculations estimate a weak decline in the number of man-hours worked. With an approximately unchanged labour force unemployment will thereby remain at a high level in 1991.

In addition to the estimates for exports, the development on the labour market represent the most visible shift compared to the projections presented in the Economic Survey for 1990. While earlier calculations indicated an increase of 0.5 per cent in man-hours worked from 1990 to 1991, a reduction in man-hours of the same magnitude is now expected. The background for this downward revision is information of a weaker trend on the labour market in the last quarter of 1990 and in the first quarter of 1991 than previously envisaged. The decline in employment in this period may point to a continued high growth in productivity in 1991. Downward revisions in GDP growth in Norway in 1988 and 1989 which, in isolation, reduce productivity in these years may be indications of the same.

AIECE GENERAL REPORT
Spring 1991

SHORT-TERM PROSPECTS FOR THE EUROPEAN ECONOMIES

1. Introduction

The growth in the world economy declined through 1990, after a long period of strong increases in demand and activity levels in most industrialized countries. Until early August 1990, indicators pointed at a "soft landing"; there was little concern of increased inflationary pressure and there seemed to be few clouds shadowing the medium term economic growth prospects. However, dark clouds entered the international scene after the Iraqi invasion of Kuwait. During the last months of 1990 economic forecasts were revised downwards, and the world prepared for a new period of high oil prices.

However, even before the ending of the war in the Persian Gulf, oil prices had come down to more moderate levels. In the forecasts provided by the AIECE institutes for this report, oil prices are assumed to remain at or slightly above 20 US$ per barrel both this year and the next. In addition to the dependence on oil prices, the forecasts for the European countries all seem to be conditioned on a cyclical upturn in the US. Consistent with these assumptions, most western European countries expect economic performance to improve at the end of 1991 and in 1992.

Within Europe there are in particular two issues that require specific focus in an overall evaluation of economic development. Many eastern European countries face severe economic problems as they are transforming their economies from centralized economic planning systems to market economies. There now seems to be a growing recognition that the establishment of properly functioning markets in these countries, including necessary institutional frameworks, may be more difficult and take longer time than previously anticipated.

In Germany the economic situation is highly influenced by the unification process. Due to increased transfers to the eastern Länder, fiscal policy has become quite expansionary and the surplus on the current account has been reduced rapidly. From a general European point of view, the buoyant German demand may be good news, and some countries already seem to have benefited from this in terms of increased exports to Germany. On the other hand, the need for a continuing tight monetary policy have pushed German interest rates upwards, and this may contribute to maintain high interest rates in other European countries. An interesting question, however, is to what extent the role of DM among international currencies will be affected by the recent economic development.

Various uncertainties exist regarding the international economic perspectives. Some of the specific factors mentioned above, such as the oil price expectations and growth impulses from Germany, suggest that the downturn of the world economy will be relatively short and moderate. In addition, it is generally believed that structural changes in many countries during the last years together with increased coordination of economic policy, as for instance within the EC, serve to prevent a severe cyclical downturn. On the negative side, the problematic situation in East Europe may have dampened optimism somewhat. Within the EC, the process towards an economic and monetary union will perhaps involve more difficulties than one thought just a short time ago. And internationally, the expected economic upturn in the US is still to materialize.

2. The International Economic Environment

2.1 The crude oil market - heading for lower prices?

The impact of the latest Gulf crisis on oil prices has again demonstrated how dependent the oil consuming world are on political and economic stability in the Middle East. In the early stages of the crisis, the effects of the Iraqi invasion of Kuwait had some similarities with the oil price hikes in the 1970s. Until the summer 1990, world demand for crude oil had been increasing steadily. Moreover, the general view was that the prevailing capacity in OPEC was under some pressure. So, even before the crisis in the Persian Gulf and the subsequent trade embargo there was a climate in the oil market for increasing prices.

The immediate effect of the crisis, and later of the war, did however not meet initial expectations regarding the oil prices. Most analysts expected oil prices to skyrocket in case of war. This was mirrored in the spot markets. Shortly after the outbreak of the crisis, the price on UK Brent reached its peak at 40 US$ per barrel. After reaching the 1976 prices in nominal terms, the oil price plummeted, and at the start of the war they fell further from 30 US$ per barrel to 20 US$ per barrel and are now hovering around this level.

Even though the dust has yet to settle, some facts governing the oil market in the near future are visible. On the *supply side* the recent oil crisis provided a useful demonstration of the flexibility in the production capacity of some major OPEC producers, and in particular Saudi Arabia. During the fall last year this country alone increased its running production with close to 3 million barrels per day (mbd), compensating alone 75 per cent of the drop in the deliveries from Iraq and Kuwait. By the end of 1990 total OPEC production had reached about the same level as before the invasion (see table 2.1).

Regarding the future market balance and price movements, the central questions are of course

- How fast will exports from Iraq and Kuwait come on stream?
- What will be the reaction from Saudi Arabia on a reopening of these production capacities?

In the first quarter of 1991, OPEC production showed little change, remaining slightly above 23 mbd according to recent estimates from IEA. Much of the production and transport capacity in Kuwait and Iraq is destroyed. Some Kuwait production is expected on stream from the third quarter this year, but full restoration of the 2.2 million barrels per day might take two to three years. Iraq's ports and export pipeline to the Red Sea are destroyed. But as soon as the civil war is over, export capacity at 1.5 million barrels per day through Turkey will be on stream. Saudi Arabia will then have to reduce its output in order to avoid oversupply and diving prices. Seasonal factors may increase the pressure in the short run.

Table 2.1. Oil Supply and demand. Million barrels per day

	90Q1	90Q2	90Q3	90Q4	1990	91Q1	91Q2	1991
DEMAND	67.2	64.5	65.5	65.6	65.7	67.5	64.1	65.9
OECD-Europe	12.9	12.4	12.7	12.6	12.6	13.2	12.3	12.9
Rest-OECD	25.4	24.2	25.1	24.9	24.9	25.2	23.9	24.6
Non-OECD	28.9	28.0	27.7	28.2	28.2	29.1	28.0	28.4
SUPPLY	67.9	67.2	64.8	66.7	66.6	66.8		
OPEC	23.7	23.6	21.9	23.1	23.1	23.1		
Non-OPEC	42.3	41.7	41.1	41.8	41.7	41.9	41.1	41.3
STOCK CHANGE	0.7	2.7	-0.7	1.1	0.9	-0.7		

Source: Oil Market Report (IEA). April 1991

The oil supply outside OPEC will only be slightly reduced according to IEA. *Oil stocks* were already abundant when the crisis broke out, and were built up further during the crisis and the military actions. During the first months of 1991 minor reductions of stocks have been registered, and total stocks in the OECD area are now (March) at the same level as a year ago.

The *demand* side in the oil market is also likely to have been affected by the Gulf crisis. The events have served as a reminder of the risks of dramatic price shocks and severe cuts in deliveries of crude oil. This repeated lesson for consuming countries may vitalize efforts of energy conservation and substitution away from the "risky card".

Total world oil demand stagnated in 1990. For industrialized countries this was due to slower economic growth, a tendency observed before the Iraqi invasion. The price hikes last fall further dampened world oil demand, in particular in developing countries. For 1991, IEA expects world demand to increase by 0.5 mbd.

Confronted with the assumed development of the supply side of the oil market, the demand scenarios point at downward pressure on prices.

The demand for OPEC oil may of course be stronger than predicted by IEA. If a cyclical upturn internationally takes place in the near future, increases in world oil demand may resume its pace from the second half of 1980s (1.5 mbd annually). On the supply side, the net exports from Soviet Union constitute a major uncertainty. In 1990, these deliveries were reduced by about 0.2 mbd. Economic and political problems in Soviet Union may lead to further decline in production, but most analysts foresee that further cuts in exports will be avoided due to the desperate need for hard currency incomes. In a longer time perspective, a revival of the economies in both Soviet and eastern Europe may contribute to a growing demand for crude oil. Another uncertainty for the the medium term crude oil balance and price movements is related to the possibility of establishing an international climate convention (see appendix A in this report). If coordinated measures are taken in a number of countries to restrict all consumption of fossil fuels, this will put downward pressure on producer prices. Furthermore, one may point at the possibility that national climate policies will discriminate against the use of oil, since national or regional markets with strong elements of domestic protection exist for other energy resources such as coal and natural gas.

On the background of the brief discussion above, we attempt the following conclusion: The Gulf crisis has revealed that key OPEC producers may have more than sufficient capacity to meet demand. In *the short to medium term*, a brief survey of the energy balance between supply and demand in the oil market indicate that unless world demand for OPEC crude increase by 1.5-2 million barrels per day anually in the following two years, there will be a downward pressure on prices from the present level (20 US$).

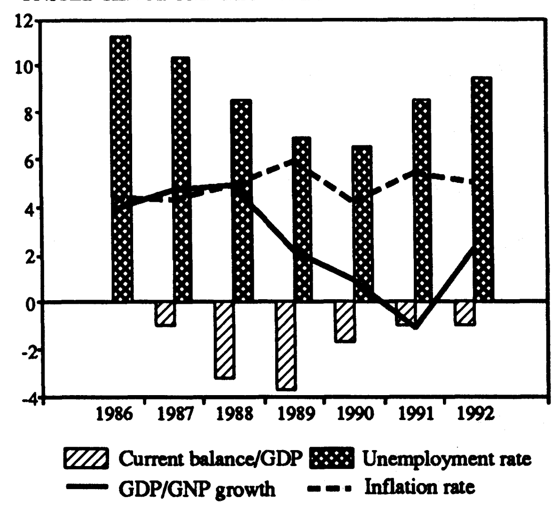
A reasonable expectation is thus that OPEC will have surplus capacity in the medium term, and stable prices in real terms will be hard to manage even for a well cooperating cartel. But the possibility of a better working cartel cannot be ruled out. After the war, the Saudi Arabia dominance within OPEC has increased. The crisis has revealed that Saudi Arabia has sufficient surplus capacity to follow punishment strategies. Saudi Arabia might be willing to restrict production sufficiently to reach the OPEC target of 21 US$ per barrel and stabilize prices in real terms if other key producers are willing to cooperate, i.e. restrict their production by a similar percentage. The unwillingness to return to a role as swing producer was, however, quite outspoken at the last OPEC meeting. A failure by Iraq to settle the internal war and finance the restoration of its 3.5 million barrels per day capacity, will of course also contribute to higher prices in the medium term.

2.2 The United States

During 1990 the US economy weakened significantly and headed into a recession. In the fourth quarter GNP was reduced by 1.6 per cent (seasonally adjusted annual rate), and from 1989 to 1990 GNP grew by merely 1 per cent. The weakest demand component was residential construction, which declined by more than 5 per cent. Other parts of domestic demand were also weak: Private consumption increased by 0.9 per cent, while the growth in non-residential fixed investments was 1.8 per cent. Export was again the strongest demand component, even if the growth rate of 6.4 per cent was only half the growth rate seen in 1989.

The US economy showed signs of weakness already in 1989, but it was believed by many analysts

UNITED KINGDOM. MACROECONOMIC INDICATORS



that the monetary finetuning through most of 1989 and 1990 would take the economy in for a "soft landing". The impression now is that a recession started in the third quarter of 1990, after several quarters with declining growth rates. The consumer confidence was badly affected by the Gulf crisis; the Conference Board's index fell from 101.7 in June 1990 to 54 in January. The dramatic fall in consumer confidence, together with a drop in real disposable income, led to a substantial fall in consumer spending and residential construction in the fourth quarter.

Recent statistics tell a mixed story:

- The purchasing managers index, which had been falling since May last year, rose in February and March but is still as low as 40, i.e. indicating a contracting economy.
- The stock market is having a mini-boom since the middle of January.
- The consumer confidence index rose markedly in March from 59.4 to 81.
- Housing starts picked up in February, offsetting the rather steep decline in January.
- Industrial output fell by 0.8 per cent in February, the fifth successive monthly decline, and is now 4.5 per cent below the peak reached last September.
- Car sales are extremely low, and the value of retail sales was 0.7 per cent lower in March than a year ago.
- Unemployment rose to 6.8 per cent in March and contributed to slow growth in personal incomes.

Most analysts regard these statistics as consistent with a recession of average or slightly less than average strenght. The drop in GNP in this cycle is expected to be about 2 per cent from peak to trough. A recovery in the early summer would imply a duration of 9 to 12 months. The average post war recession has lasted 11 months and involved a fall in GNP of about 2.5 per cent.

The consumer price index rose by 5.4 per cent in 1990, compared to 4.8 per cent in 1989. Excluding the volatile components food and energy, the core inflation rates were 5.0 per cent in 1990 and 4.5 per cent in 1989. The decline in the crude oil price since the middle of January has brought about a reduction in the overall inflation rate, but the core inflation rate ran as high as 0.7 - 0.8 per cent on a monthly basis in the first two months of the year. Rises in indirect taxes are included in these figures. In March the inflation rates improved significantly, and the consumer price index declined for the first time in several years, by 0.1 per cent. The inflation rates should continue to improve over the next months, helped by the rising unemployment and the appreciation of the dollar. The consumer price inflation will probably be around 4 per cent this year, and below 3.5 per cent in 1992.

Well into the recession the Federal Reserve Board maintained a tight monetary policy. However, when the credit crunch threatened to reduce the money supply growth to unacceptably low rates, the Federal Funds rate was reduced more rapidly. The Fed Funds rate is now (the middle of April) as low as 6.0 per cent, compared to 8.0 per cent last July. The short term interest rates are thus lower in the US than in Germany and Japan. The recent sharp appreciation of the dollar has created scope for further lowering of the US rates. The mean forecast of 33 US institutes (published in Economic Forecasts, North Holland in March) indicates that the short term interest rates will ease down some 25 base points through the second and third quarter. Most analysts then expect a tightening of monetary policy to be initiated in the late summer. According to the mean forecast mentioned above, the Fed Funds rate will be around 6.3 per cent on average in 1991, rising to 6.7 per cent in 1992.

Government spending was brisk in the first quarter this year, partly due to the war in the Persian Gulf. The seasonally adjusted annual growth reached 24 per cent. The Federal deficit will probably reach a peak in 1991, due to costs concerning the Gulf war and the Savings and Loans bailout. In 1992 the budget proposal points at a slightly negative growth rate in real government non-defense spending. The budget proposal suggests cuts in real spending over the next 5 years.

The forecasts for 1991 and 1992 differ considerably. Still, the consensus view is that the recovery will be modest, and that positive GNP growth rates will be seen either in the second or the third quarter of 1991. The mean forecast of the 33 US institutes indicates a growth rate of around 2 1/2 per cent in the second half of 1991, giving a zero annual growth rate. In 1992 the GNP growth rate will remain at about 2 1/2 per cent. DRI (Data Resources Inc.) is more optimistic, expecting the growth rates to be around 1 percentage point higher. According to the forecasts private investments will stagnate in 1991, but will pick up again in 1992 along with private consumption. Exports will continue to show strong growth from the second half of 1991.

The trade deficit improved further in 1990. The deficit of 108.7 billion US$ is the lowest in 7 years, down from 115 billion US$ in 1989. In 1991, the fall in crude oil prices and an expected negative growth in imports will probably bring the deficit down to around 70 - 75 billion US$. The current account deficit improved from 110 to 99 billion US$ from 1989 to 1990, representing 2.1 and 1.7 per cent of GNP respectively. The deficit in 1991 will be distorted by the surge in transfers to the US in connection with the financing of the Gulf war. The current account deficit could run as low as 35-40 billion US$. The transfers are then estimated to around 35 billion US$ this year. In 1992, the trade deficit is expected to increase slightly, while the current account deficit probably will increase to 60 - 70 billion US$. However, excluding the transfers the current account deficit is expected to improve slightly.

2.3 Japan

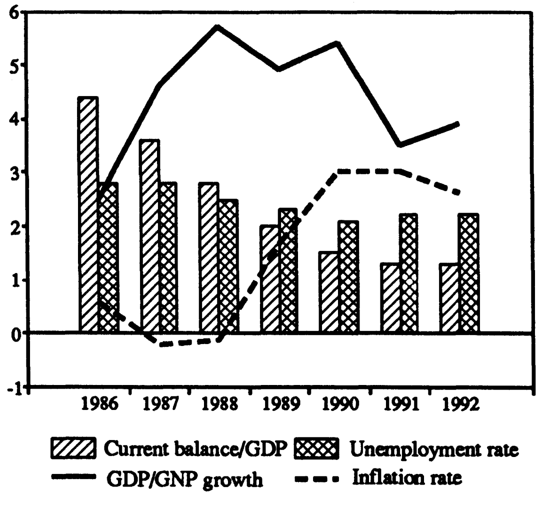
The Japanese economy is still relatively strong compared to the rest of the OECD-area, but economic growth decelerated through 1990. GNP grew by 5.6 per cent in 1990, but the growth rate was only 2.1 per cent in the fourth quarter (seasonally adjusted annual rate). Sluggish domestic demand growth was the major reason for the slowdown in the fourth quarter; private consumption and residential investment fell at annual rates of 1.1 per cent and 6.3 per cent respectively. On the other hand, business investments and exports kept the pace at about 12 per cent.

Recent statistics confirm the tendency to slower growth:

- Industrial production is stagnating and there are tendencies to inventory buildups.
- Car sales are down.
- New orders are declining.
- The Leading Indicator of the Economic Planning Agency is showing a weakening tendency.
- Housing starts are weak.
- Business failures are increasing and profits are declining.

The Bank of Japan is still more worried about inflation than recession. Consumer inflation in 1990 ran at about 3 per cent, 0.5 percentage point more than in 1989. The inflation rate was increasing through 1990: In the first half of the year a depreciating yen played a part, while the hike in crude oil prices fueled inflation rates in the second half. In January this year the consumer price index rose by 4.5 per cent from a year ago, the highest figure since 1981. In February and March inflation declined, but were still as high as 3.8 per cent. Even with a stronger yen and lower crude oil prices, the tight labour market - with the ratio of job offers to applicants at 1.46 in January - still represents a potential inflationary pressure. The ongoing wage negotiations are believed by analysts to be decisive for the inflation prospects. In addition to the development in wages, the uncertainties in the forecasts stem from different assumptions about monetary policy and exchange rate developments. The consencus view is that consumer inflation will run between 2.5 and 3 per cent in both 1991 and 1992.

JAPAN. MACROECONOMIC INDICATORS



The monetary policy is expected to remain tight in the forecast period. From May 1989 to August 1990, the discount rate increased from 2.5 per cent to 6 per cent. So far, this policy has led to a substantial decline in the money supply. The broad M2 measure was growing at merely 5.4 per cent in February (from a year ago), the lowest growth rate since the start of the series in 1968. In May last year growth peaked at 13.2 per cent. Analysts believe that the Bank of Japan will ease policies somewhat if the wage increases settled in April are not much higher than 6 per cent. However, there will not be a return to the low interest rate policy of the last part of the 1980s. The discount rate is expected to remain above 5 per cent in the next couple of years.

The 11 billion US$ (total so far in 1990 and 1991) contribution to the US to cover part of the Gulf war costs will probably result in some tightening of the fiscal policy. The transfer is expected to be partly funded by increases in oil products, corporate and cigarette taxes. Hence, the fiscal policy will tighten somewhat in the coming years, compared to the accommodating stance taken in the last years.

Forecasts for Japan indicate a growth of GNP at 3 to 3.5 per cent in 1991, increasing to about 4 per cent in 1992. Exports growth in 1991 will be weak, possibly around 3 per cent. Some analysts predict even lower growth. The bearish outlook for exports depend partly upon a stronger exchange rate and partly upon the weak growth internationally, particularly in the US.

Business investment growth will decline due to high financing costs, but will be held up somewhat by investments in labour saving technology. Two investment planning surveys conducted before the cease-fire in the Persian Gulf indicate a mere 1 per cent growth in fiscal 1991 (starting April 1st). However, in the last years investment planning surveys have turned out to be far too pessimistic. But high interest rates, the decline in property prices and the reduced value of equities and profits give some support to the pessimistic surveys. On the other hand, the cease-fire and increasing belief in a turnaround in the US this summer could lead to upward revisions of investment plans. Residential investments is expected to decline in the next few years, due to high financing costs.

Private consumption is expected to grow at lower rates in 1991 and 1992 than in 1990. Consumers are, at the moment, more pessimistic and cautious, and some indirect taxes will probably be raised.

The current account surplus was reduced by 37 per cent from 1989 to 1990, to 35.8 billion US$. Several factors contributed to the reduction. In 1988 and 1989 strong growth in import volumes was the main factor behind the decrease in the trade balance. In contrast, in 1990 the rise in import prices contributed more than growth in volumes to the 17 per cent decrease in the trade surplus to 63.9 billion US$. Another important factor in 1990 was the service deficit, which increased by 42 per cent to 22.6 billion US$, due to increased tourism.

The trade figures for the first months this year show a strong growth in the merchandise trade surplus, compared to a year ago. Even if the export growth is expected to be relatively weak (compared to 1989) the next few years and the positive effect of the stronger exchange rate since August last year will wear off, most analysts expect some improvement in the trade surplus in 1991 and 1992. The current account surplus will probably improve to a lesser degree, due to the increasing deficit in the service balance.

3. The Economic Development in the AIECE Area

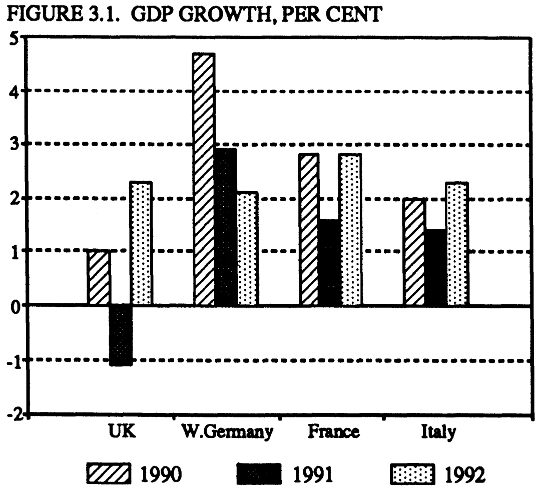
3.1 Overall economic development

After strong economic performance in 1988 and 1989, most European countries faced declining GDP growth in 1990. The sharp rise in oil prices in the third quarter contributed to the slowdown, but the peak had been reached by most countries well ahead of the conflict in the Gulf-area. Cyclical differences between countries also became apparent during 1990. In the UK, Sweden and Finland the economic downturn became evident already in 1989 and economic growth decelerated further last year. The decline in economic activity has been more modest in France, Italy and Spain, but the oil price hike affected business and consumer confidence negatively also in these countries. In western Germany, economic growth in 1990 was boosted by the unification process, and increased German import demand contributed positively to the export performance in countries closely linked to Germany. For the east European countries it is clear that the road towards more market oriented economies will be long and difficult. The economic liberalization has led to dramatic increases in prices, falling production and accelerating unemployment. Economic development and problems in these countries are discussed in section 3.2.

The outlook for 1991 and 1992 still points towards a European slowdown rather than recession. The four major western European economies will however all face declining growth this year (see figure 3.1).

The UK will according to these estimates experience negative growth in GDP and a significant rise in unemployment in 1991. However, both the UK, France and Italy expect improved GDP growth rates in 1992, conditional on oil prices staying at or below present levels (20 US$ per barrel) and that a cyclical upturn occurs in the United States in the near future. In Germany, the expansionary policy and buoyant growth in domestic demand help keeping GDP growth at a relatively high rate also this year. Among the smaller countries, negative growth is projected for Sweden and Finland, while Austria and Belgium still experience relatively strong and stable GDP growth.

FIGURE 3.1. GDP GROWTH, PER CENT



Most forecasting institutes expect a cyclical trough in Europe sometime during the second half of 1991. These forecasts are based on moderate oil prices and stronger growth in the rest of the OECD-area, but renewed growth in domestic demand is also expected to contribute. However, the figures indicate a relatively modest upswing. For the western AIECE area, the estimated GDP growth rates are 1.8 per cent and 2.4 per cent for 1991 and 1992 respectively, down from 3.0 per cent in 1990.

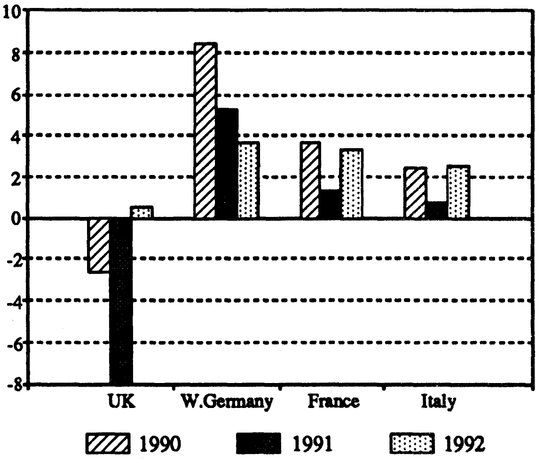
A later or weaker recovery than expected in the US will affect the prospects for Europe, but not necessarily dramatically. It is argued that Europe is less dependent on the economic development in the US today compared to earlier economic cycles. Furthermore, structural changes undertaken by many European countries during the eighties have improved overall economic flexibility.

Domestic demand

Fear of inflationary pressure and cyclical imbalances between countries induced governments of many European countries to pursue a tight monetary policy in 1989 and 1990. The resulting increase in interest rates is considered a major factor in triggering the cyclical downturn, led by a weaker development in investment demand. Investment activity in many countries was restricted both by the high interest rates and by the previous expansion of productive capacity (a traditional accelerator effect). High interest rates seem in particular to have dampened residential investments in many countries.

The decline in investment growth occurred after a long period with strong economic growth and increases in the investment ratio in most countries in western Europe. The tendencies to increased integration in Europe and in particular the preparation of the economies to the EC internal market have

FIGURE 3.2. INVESTMENT GROWTH. PER CENT



probably stimulated investments. These positive elements for business confidence may now have levelled off, and to some extent the decline in investments may be regarded as a natural process to bring the investment ratio back to a more normal level. The high interest rates that have been established in many countries may be regarded as the dual to this necessary adjustment of investments.

Looking at the forecasts for 1991 and 1992, with only few exceptions, growth rates for real capital formation are assumed to be reduced this year. Among the four largest countries the UK will have negative investment growth. On the positive side, the reconstruction of the eastern Länder contributes to maintain a high rate of growth in capital accumulation in Germany.

Private consumption growth is assumed to be reduced in 1991 in most countries, but lower inflation and reduced interest rates are likely to stimulate consumer demand at the end of the year, and the growth figures are somewhat stronger in 1992. It remains to be seen, however, to what extent the decline in consumer confidence during the last months of 1990 and early in 1991 was due to the ongoing crisis and war actions in the Persian Gulf.

External balances

The export performance in 1990 showed some variations between the various countries. As mentioned above, some countries like Austria, Belgium and the Netherlands benefited from the high activity level in Germany, which contributed positively to their export performance. Norwegian exports have also shown strong growth, partly as a result of a continuing significant growth in oil exports. However, in most countries the recent developments with lower international growth and losses in competitiveness vis-a-vis US goods have served to dampen exports, and further reductions in export growth are forecasted this year. The recent increase in the dollar exchange rate versus European currencies may help European producers regain some of their competitiveness. Combined with the expected upswing in growth in both the US and in most European countries, this should stimulate European exports in 1992.

The current account imbalances in major countries were reduced last year; the deficit in the US and the UK, and the surpluses in Germany and Japan diminished. The imbalances have been on a declining trend since 1987/88 in both Japan and the US, and the unification process is likely to contribute to significant reductions of current account surpluses for Germany in the years to come. This is confirmed by the average estimate from the German institutes, pointing at a deficit on the current account for a unified Germany in 1992. In France and Italy deficits of the same magnitude as in 1990 are assumed, while some improvements will be achieved in the UK and Spain due to a slowdown in domestic demand.

Overall world trade is assumed to grow by about 4 1/2 and 5 1/2 per cent in 1991 and 1992 respectively, according to the average of the AIECE member institutes' forecasts. In that case, international trade in 1992 will resume the same pace as in 1990. In the longer run, trade prospects are dependent on the ongoing Uruguay Round for trade negotiations. The agreement should have been completed by the end of 1990, but the discussions have so far faced severe difficulties. A total breakdown of the negotiations and failure to establish a new treaty may lead to increased protectionism internationally. In such a case, the tendency towards regional trading blocks and bilateral agreements may be reinforced. Smaller countries will probably be the main loosers in such a scenario, but in general business confidence may be negatively affected and hamper the growth prospects for European countries, even in a short term perspective.

FIGURE 3.3. CURRENT ACCOUNT IN PER CENT OF GDP

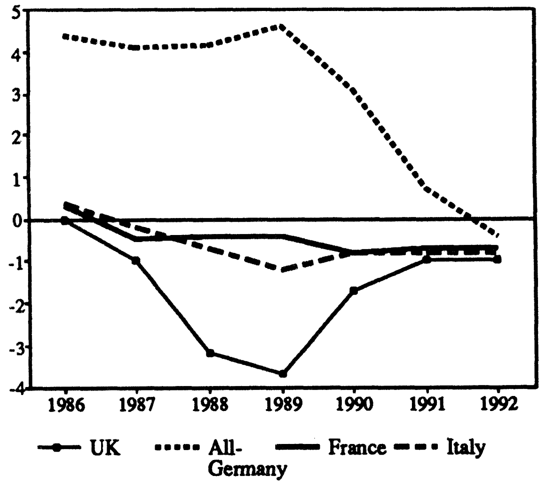
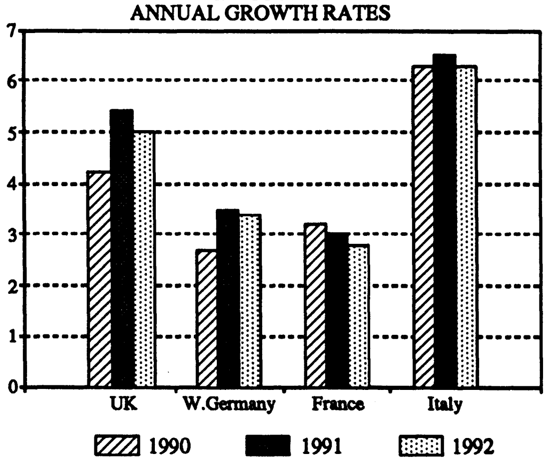


FIGURE 3.4. CONSUMER PRICES. ANNUAL GROWTH RATES



Oil prices and inflation

The AIECE institutes' forecasts for the development in crude oil prices are broadly in line with the view discussed in chapter 2, i.e. that oil prices will remain low over the projection period. According to the average estimates, oil prices are assumed to decline gradually to 20 US$ per barrel in 1991 and increase moderately to 21 US$ in 1992. The spread of the estimates are also rather narrow; 71 per cent of the point estimates lie within a 10 per cent interval of the average for 1992. There are only two institutes assuming the crude oil price to exceed 23 US$ per barrel in 1992.

Higher oil prices boosted inflation in European countries last year, although the impact on domestic import prices was counteracted by a declining US dollar. However, inflation is expected to resume a declining trend in most countries, due to reduced oil prices and a general slack in economic development. An important exception from this picture is Germany, where expansionary fiscal policy and high capacity utilization are expected to push growth in consumer prices upwards during the current year, but inflation is expected to stabilize in 1992. The forecasts indicate higher annual rates of inflation this year also in Italy, Austria, the Netherlands and Denmark. However, growth in consumer prices in the latter two countries are still relatively low compared to other European economies. In Italy, a significant reduction in the growth of consumer prices is not expected until 1992. Despite an expected reduction in the inflation rate in Greece by nearly 7 percentage points, two-digit inflation figures will still persist over the projection period. The very high inflation rate in Sweden is assumed to continue in 1991, but will come down to 3-4 per cent already in 1992 according to the forecasts.

To some extent, the limited focus in the forecasts on the danger for a prolonged period of increased inflation in the western European area reflects that moderate inflation still is a main priority in economic policy of most countries.

Economic policy

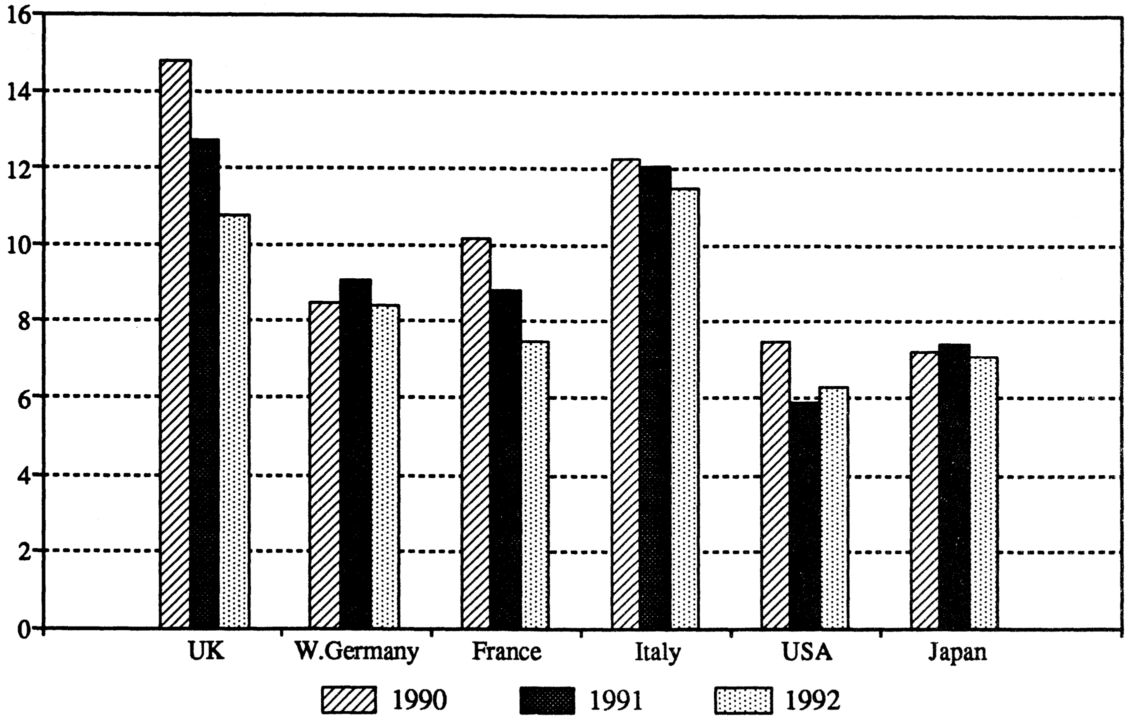
Along with the increasing economic and political integration in Europe, economic policy has become more coordinated. This is particularly true with respect to monetary policy, due to deregulations and the opening of international capital markets, in particular the pegging of currencies to ECU. As a result, changes in interest rates in leading economies are transferred to other countries. Nominal interest rates still vary, however, due to different expectations of currency adjustments in the various countries. The steps towards an economic and monetary union (EMU) will further strengthen the dependency between interest rates and other nominal variables. The EMU process is further discussed in section 3.3.

Interest rate differentials have been reduced during the last months. In the UK, interest rates came somewhat down at the end of 1990, although from high levels. France also managed to reduce its interest rate differential against DM in 1990. Recently, primary rates have been reduced in the UK, Spain and in Italy. Low inflation rates, reduced economic activity and high and rising unemployment should generally create a climate for further reductions in interest rates in 1991 and 1992. An important uncertainty is again Germany, where interest rates have been increasing since mid-year 1990. On the background of the weakening of the current account and the prospects of continuing expansionary policy in Germany, the position of DM within the European Monetary System may not be as dominant as previously. In that case, German interest rates may cease to constitute a strict bottom-line for the downward movements in interest rates in other European countries.

A tight fiscal policy to curb public deficits and keep down inflation is still a main target of most European governments. However, the economic slowdown in many countries have reduced tax revenues and increased outlays to unemployed, and these events made it difficult to improve budget balances in 1990. In most countries, with Germany and the UK as the most important exceptions, the forecasts point towards some improvements in public deficits this year, calculated as a percentage of GDP. Some of these estimates, however, basically reflect the goals of the authorities and are likely to be revised during the year.

The concerns of the authorities in many countries with respect to the persistent high public debts and borrowing requirements and their efforts to reduce these burdens are strongly emphasized by many forecasters. In part, this may reflect that the real costs of financing deficits have become quite high

FIGURE 3.5. SHORT TERM INTEREST RATES 1)



1) AIECE forecasts, Economic Forecasts (USA) and CBS (Japan).

in most countries. Inflation rates are generally at modest levels, well below nominal interest rate figures. With moderate real growth in aggregate output a severe debt situation is not sustainable without increasing taxes. Figure 3.7 indicates how the relation between real borrowing costs and GDP growth has changed over the last 15 years.

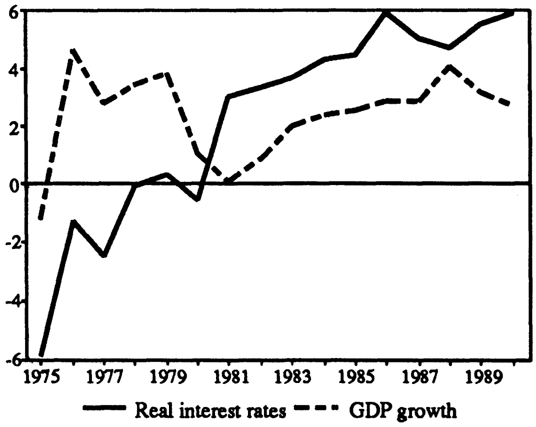
In Germany a significant deterioration of the budget balance took place from 1989 to 1990, due to tax cuts at the beginning of 1990 and the unification process which gave a significant boost to government spending. Public sector deficit is expected to remain relatively high over the forecast period due to transfers to the eastern Länder. In fact, the unification and the remarkably fast political integration of the former two states may have implied a shift of regime in German economic policy, which in turn will affect the overall economic development in other countries. The commitments to the eastern part can hardly be reversed, and unless significant burdens are placed on the shoulders of people in the western part, a continuation of high and possibly growing public expenses seem difficult to avoid.

Germany's new role and the expansionary policy that is likely to be pursued in a medium term perspective, may have conflicting impacts on the economic development in the AIECE area. We have already noticed that there are clear signs of positive feedbacks from the high activity level in Germany to other countries exports. The opening towards the eastern European countries may also stimulate economic development in these countries, as soon as they manage to undertake the necessary structural changes in their economies. The negative effect created by the development in Germany is that too heavy burdens may be placed on monetary policy. This may lead to interest rate increases that may curtail the push in investment demand that is expected to be a driving force in a new cyclical upturn in Europe.

Preparations to meet requirements and challenges of EC's internal market have also affected economic policy in many countries the last couple of years, and more countries are likely to follow in this process. Both in countries inside and outside the EC area, tax reforms have been implemented to harmonize national measures with EC standards. The economic and monetary union, and particularly membership in ERM (Exchange Rate Mechanism), have also increased the necessity of coordinating monetary and fiscal policy to that of Germany, due to the key function of the DM in the EMS.

Finally, an interesting question is whether the increased focus on environmental problems in recent years will affect policy and economic development in the European countries. The most pressing of these environmental issues is probably the greenhouse effect. Some aspects regarding this problem and its relation to economic performance are discussed in appendix A in this report. Negotiations

FIGURE 3.6. REAL INTEREST RATES AND GDP GROWTH 1975-1990. Per cent[1)]



1) Averages for major 4 European countries.

towards an international climate convention has now started with the aim of completion in 1992. A number of studies indicate that if signature states agree upon strong policy measures to combat the greenhouse problem, the impacts on economic development may be significant. In particular, it is an open question whether increased taxes on petroleum products and other fossil fuels are compatible with a development with increased transport activities and exchange of goods and services that are assumed to follow the increased European integration from 1992 and onwards. On the other hand, in addition to the positive effects on the environment, the revenues from a CO_2 tax may be highly appreciated by governments given their difficult deficit situation as discussed above. In particular, if crude oil prices remain rather low, increases in energy taxes may stand out as an attractive alternative in economic policy. Steps in this direction have already been taken by some countries.

3.2 Trends and challenges in eastern Europe

All the eastern European countries are in some stage of reforming from centrally planned to market economies. The process has so far led to a deep recession: Output fell by 3 - 5 1/2 per cent in Czechoslovakia, Hungary and the Soviet Union and by more than 10 per cent in Bulgaria, Poland and Romania. Some countries - Hungary, Poland and to a certain extent Czechoslovakia - have made considerable progress in the reform process. In the other countries, only few measures towards stabilization and structural reforms are implemented, and no agreements about coherent transformation programmes are yet reached. In the Soviet Union and Yugoslavia the political struggle and tensions between the central government and the republics have created serious problems.

The central areas of policy and institutional changes that need to be addressed in the transformation process include:

a) Creation of a system of economic legislation. This includes property laws, accounting rules, banking, payment and exchange rules.
b) Change of ownership rules to create motivation for efficient economic decisions.
c) Creation of market institutions: A system of financial intermediaries, a government budgeting system and exchange market organizations.
d) Creation of a competitive environment.

The speed of change in the transformation process is to a large extent determined by the current level of institutional and human resources of the individual countries. Progress in the areas listed above, especially ownership rules and property laws, are essential. Claims from former owners of confiscated property may slow down the privatization process, and in particular hamper foreign investment necessary to speed up the reconstruction process. In Hungary, a bill giving expropriated owners first options to buy their property back will be voted on in late April. In Czechoslovakia the legislation concerning privatization was recently passed. The "small privatization" - auctions of small businesses - is in full operation. The "big privatization", involving sales of shares by a coupon system, will take place in 1992. In Poland, thousands of small private businesses are in operation in the retail trade, but the privatization of the industrial firms has only just begun. Both in Hungary and Poland stock market exchange institutions have been opened.

It is generally agreed that the institutional changes a) to c) should take place as quickly as possible. When it comes to the task of creating a competitive market, however, the opinions and strategies differ. The creation of a competitive environment involve free flow of goods, services, labour and capital, without financial or administrative discrimination. This task includes the elimination of administrative constraints, tax and price reforms and a halt to the accommodating bail-out practise. The widespread existence of large monopolies has made liberalization of imports especially important in order to create competitive markets.

Basically two different strategies for creating competitive markets have been adopted. In Poland a shock treatment was instituted. All prices, with a few exceptions, were completely liberalized together with stabilization measures and the currency was sharply devaluated. Underlying this strategy was a wish to avoid further speculations and to minimize uncertainties. It turned out that inflation was much higher and lasted longer than anticipated, and the fall in domestic demand and production was deeper than expected. This resulted in serious social unrest, and a period of relaxation of the strict programme of reform in the last part of 1990. However, according to recent forecasts, Poland will experience positive growth in the next years. If so, it may be argued that the shock treatment has been working reasonably well. But inflation will continue to run high, and it will probably take several years for GDP to reach the levels of the late 1980s. Unemployment may reach double digit figures this year and the next.

In Hungary and Czechoslovakia a more gradual approach was adopted. In Hungary, gradual changes started already in 1987. This strategy has led to less severe reductions in economic activity, and inflation has been more moderate. But distortions continue to exist, giving "wrong" signals and motivating market participants to take full advantage of the distortions. One example is that a gradual removal of consumer subsidies will result in higher growth in consumer prices than in producer prices. In Hungary, this is expected to continue to be the case throughout the forecasting period. Thus, the households will face a lower real rate of interest than firms demanding funds for investments. There is a risk of a protracted period of stagflation, with low levels of capital formation. Unemployment is rising substantially, but, according to the forecasts, will not be as severe as in Poland.

The exchange rate reform of January 1st this year replacing transferable roubles with hard currency for trading in eastern Europe and with the Soviet Union was a major reason for the 20 per cent drop in trade volumes in this area last year. This reform was agreed upon last summer, and since it was unclear how outstanding claims and liabilities would be settled, trade was depressed in order to minimize outstanding balances. The reform coincided also with a new legislation in the Soviet Union, requiring Soviet enterprises to surrender most of their hard currency earnings to the central bank. The hard currency was needed to repay the Soviet Union's foreign debt and to finance centralized spending for key imports, like food. This resulted in an unexpected drop in exports to the Soviet Union, since Soviet enterprises were unable to finance part of their planned imports. A significant part of the loss of exports from eastern Europe to the Soviet Union are goods "tailor-made" for the Soviet market, and thus cannot easily be redirected to other countries.

The reduction in energy supply from the Soviet Union was another major factor behind the recession last year. A continued shortfall of energy supply will exacerbate the fall in production in eastern Europe this year.

A major task for eastern European countries in the short term is to prevent that trade within eastern Europe and with the Soviet Union collapses. Some kind of barter will probably be negotiated in a transition period.

In April this year, the European Bank for Reconstruction and Development (EBRD) was inaugurated. One of the major goals of EBRD will be to give technical assistance to help establish the creation of financial intermediaries, stock markets, accounting systems and to train managers in eastern Europe. There are 39 members of the bank: nearly all European countries and others, including the US, Canada, Japan and the Soviet Union. The bank has two main divisions: A development bank and a merchant bank, which will be "slightly bolder" than private banks.

3.3 The development towards an Economic and Monetary Union in the European Community.

The inter-governmental conference on the economic and monetary union (EMU) started in December last year. A treaty is intended to be agreed upon this fall, and ratified in 1992. The treaty will contain the goals and scope of EMU and the institutional structure. The framework for a common central bank system will also be set out.

Parallel to the EMU discussions is the inter-governmental conference on the political union. Here general political and institutional questions are addressed. One of the most important issues is the question of the Commission's authority in both foreign and domestic politics. The outcome of these talks will influence the decisions in the EMU-process.

The Delors-report mentions three conditions for a monetary union; completely and irrevocably convertible currencies, no currency regulations and fixed exchange rates. Monetary policy will then be decided at the community level, by a common central bank. A common currency is regarded as strengthening the union, but not as a necessary condition.

The conditions for an economic union are free flow of labour, capital, goods and services, a strengthening of the common regional and structural policy and increased coordination of fiscal policy. The Delors-report advocates a firmer coordination of fiscal policies, as well as rules to prevent persisting imbalances in the economies. However, only decisions concerning issues of strictly common interests will be transferred to the EC bodies.

The Delors-report sets out the development towards the EMU in three stages: In the first stage, that started July 1st last year, the goal is a more uniform development in the member countries concerning inflation, growth and public finances. All currency control will be abolished, and a system of coordination and multilateral surveillance of economic policy will be established. January 1st 1994 is the suggested date for the introduction of the second stage. The process of reducing major differences in the member countries' economies will continue, while the ERM bands will be narrowed. A common European central bank system is suggested to be operative in this stage. In the third and final stage, the exchange rates will be irrevocably fixed, and the European central bank will be fully responsible for a common monetary policy. Moreover, central EC bodies will evaluate the budget policies of the member states with the power to intervene with binding measures, thus preventing the national governments to step out of line with the community. The third stage may lead to a common currency. The timing of the introduction of the third and final stage of the EMU process will be decided soon after 1997, after an evaluation of the development and the progress made in the first two stages.

There is a general political recognition among the member countries that EMU calls for a strengthening of the community institutions. The need for more coordination of economic policy and a medium term basis for the fiscal policy are also generally recognized.

When it comes to the actual implementation, some differences of opinion appear. Especially the UK is reluctant to give up national sovereignty over monetary policy. However, the ERM is already constraining monetary policy, and the difference between the ERM-system operative today and a future common monetary policy may therefore not be very significant.

Germany has recently proposed new and stricter conditions concerning the gradual development towards EMU: Before entering stage two a substantial improvement regarding price stability must be evident in the various countries and budget deficits on national levels must be under control. All members must have started working on legislation giving national central banks the independence that is required within the common European central bank system. Furthermore, Germany wants to maintain national control over monetary policy through the second stage, to ensure that a common monetary policy will not be put in force until all conditions are fully met. In the third stage, Germany wants very strict rules for the allowed size of budget deficits. Germany's proposals of stricter conditions are probably based on the experience from the unification. Chancellor Helmut Kohl's view is that he "will not replace the D-mark with the ECU in German pockets until and unless he gets a more democratic and solid European roof to put over the newly-enlarged German house" (Financial Times April 8th).

Another German proposal is that some countries may postpone the entry to stages two and/or three. France suggests that all member countries enter stage two at the same time, but will allow for different times of entry into the third stage.

There is also disagreement concerning the goal of a common currency. The UK has proposed that the so called "hard ECU" will play the role as a common currency. In principle this is the existing ECU, but with possible future changes in parities the hard ECU shall always follow the strongest currency. The other members favour the abolishment of national currencies altogether. According to the Commission, this may lead to more efficient trade and more integrated capital markets.

Another important question to be addressed at the EMU-conference is to what extent political control should be transferred to community institutions like the European central bank. For example when it comes to deciding on external exchange rate policy, should this be left to the central bank or to the national governments?

The inter-governmental conference on political union has been concerned about the Gulf war's consequences for the political union. Topics of discussion are common foreign and security policies, extension of Community activities, and more efficient decision-making. These talks have to some extent shifted the focus away from the EMU discussions. It would seem that further progress in the EMU negotiations will not be reached until some progress is made in the discussions on a political union. A key question is Germany's wish for more power to reside in the European Parliament, and the prospects for increased German representation due to Germany's increased population.

4. AIECE Country Reports [1)]

FRANCE

After a rapid expansion from spring 1987 to mid-1989, *real GDP* growth has been slowing down. The average growth rate declined from nearly 4 per cent in 1989 to 2.8 per cent in 1990, and preliminary figures indicate negative economic growth in the 4th quarter. France was already entering a traditional cyclical downturn with investments having peaked and consumer spending decelerating when expectations and economic conditions shifted further downwards as a consequence of the Gulf crisis. The oil price increases last fall caused *inflation* to accelerate somewhat, but due to the subsequent normalization of oil prices and moderate increases in production costs inflation is assumed to remain moderate in the period 1991-92.

The forecasts do not foresee any immediate upturn in economic activity; the estimates for 1991 GDP growth are close to 1 1/2 per cent. Investment demand is assumed to decline further as a result of the reduced output-growth, high interest rates and a squeeze of company profits. Industrial production may show negative growth in 1991 and contribute to an increase in unemployment. However, if oil prices stabilize at the present level and interest rates start to decline, GDP growth may pick up again at the end of this year and in 1992.

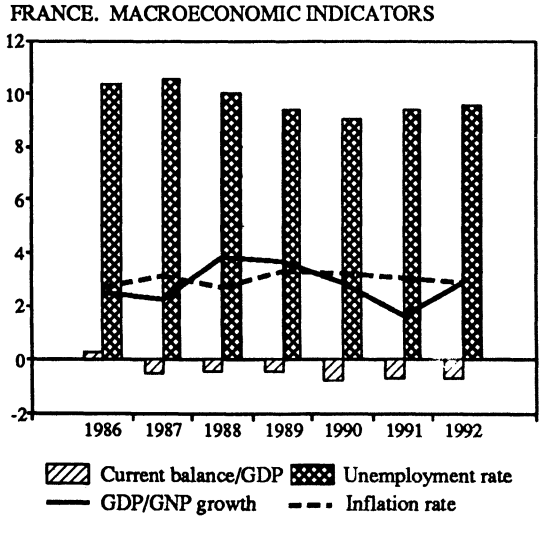
Economic policy is quite restrictive. Monetary policy has aimed at pegging the franc to DM, resulting in a reduction of interest rate spread between Germany and France in 1990. Fiscal policy has also been tightened; recently the Government decided to cut public expenditures by 12 billions francs in the 1991 budget. Wage costs and the defence are excluded from the cut, implying that the reductions in other areas have to be larger.

GERMANY

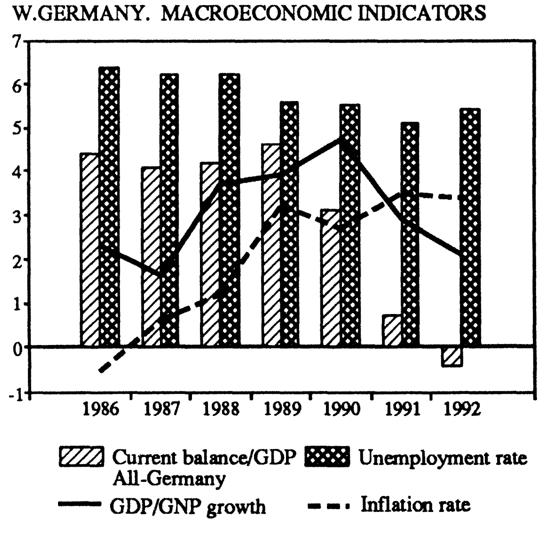
The economic development in the united Germany is characterized by strongly divergent trends with a boom in the western Länder and deep structural crisis in the eastern. The forecasts show declining *growth in GDP* in the western Länder over the next two years, due to reduced growth in both domestic demand and exports. Still, projected GDP growth for 1991 is high when compared with other countries. Domestic demand is restricted by high interest rates as well as tax increases. The unemployment rate in the western Länder is expected to decline further this year, despite a continuing migration from east.

The collapse in production in the eastern Länder after the introduction of the monetary, economic and social union last summer resulted in a dramatic rise in unemployment and the number of short-time workers. Whether the eastern Länder will reach a turning point and economic stabilization already this year is uncertain. At present, east German

FRANCE. MACROECONOMIC INDICATORS



W.GERMANY. MACROECONOMIC INDICATORS



1) The figures presented in the diagrams in this chapter for the years 1990-92 are average estimates made by the AIECE institutes. The historical data are from OECD - and the World Bank.The unemplyment rates are standarized for most countries.

products are neither competitive at home nor on the world market. Furthermore, exports to east European countries have been cut back severely, partly due to their lack of foreign currency. East German firms are also suffering from very high wage increases and a poor performance in productivity growth.

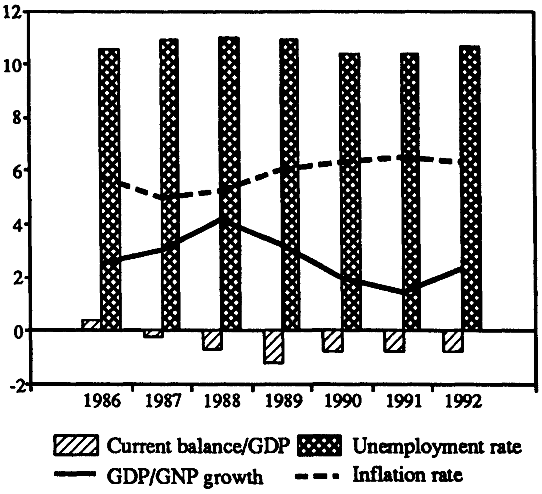
Although the expansion in the West so far has been achieved with almost stable prices, the forecasts indicate a rising trend in prices this year, but a stabilization in inflation already in 1992. A new upswing in economic growth in West Germany is expected during the second half of 1992.

Economic policy: Priority is given to domestic growth, especially the reconstruction of the eastern Länder, but also inflation is of major importance. Fiscal policy will stimulate economic activity in the first half of 1991, but for the second half of this year and in 1992 fiscal policy is likely to have dampening effects on economic activity. Monetary policy is assumed to remain tight, and the short term interest rate is expected to increase from 1990 to 1991, but to decline from 1991 to 1992. It is assumed that a wage-price spiral can be avoided, although recent wage settlements have resulted in relatively high wage increases.

ITALY

After several years of high growth, the Italian economy experienced a rapid downturn in 1990. The slowdown was evident already before the Gulf crisis, but was accelerated by the events in the Persian Gulf and the accompanying increases in oil prices. According to preliminary figures, the growth rate for *real GDP* averaged 2 per cent in 1990. Industrial production has pointed downwards since last summer. For 1990 as a whole there was a slight reduction in industrial output, and the weak development seems to have continued in the early part of the present year. The forecasts point in the direction of a further deceleration of domestic demand and activity, led by a continuing decrease in the growth rate for private investments. In 1991 the GDP growth rate will hardly exceed 1 per cent. As for many other countries, the prospects for 1992 are viewed to be somewhat brighter following a recovery in the international business cycle.

ITALY. MACROECONOMIC INDICATORS



The *inflation rate* has increased somewhat in the recent past, fueled by increases in taxes and administered prices. At the end of 1990 consumer prices increased at a rate of 6 1/2 per cent. Significant increases in wholesale prices so far in 1991 indicate that inflation will remain higher than the European average. Consumer price inflation is expected to decline slightly in 1992.

The large public deficit constitutes a major concern for *economic policy*. Fiscal policy now aims at eliminating the deficit net of interest payments, but so far this goal has not been achieved. A large part of the expenses are tied up in the social security system and as salaries to public employees. Further expenditure cuts are therefore likely to affect public investments and transfers to firms. The lack of public expenditure control has contributed to the recent crisis in the Italian political system. Frequent changes of governments probably contribute negatively to the overall economic climate, and may thus in turn increase the difficulties of solving the financial problems in the public sector.

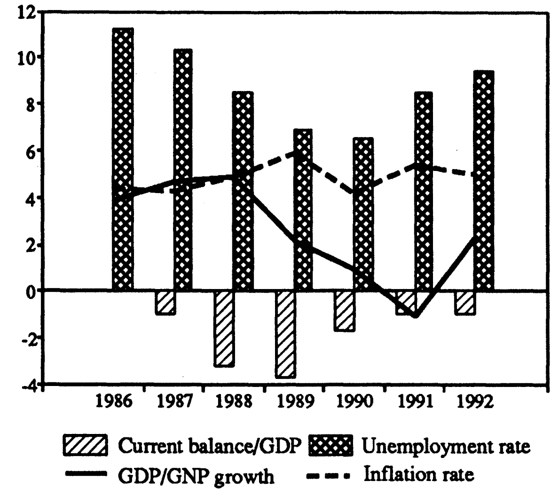
With significant deficits both in the public sector and on the current balance, interest rates have been kept high in order to master inflation and defend a stable exchange rate. So far, the interest rate differential against DM has apparantly been sufficient to stimulate capital inflow and positive market responses on the issuing of foreign currency bonds.

UNITED KINGDOM

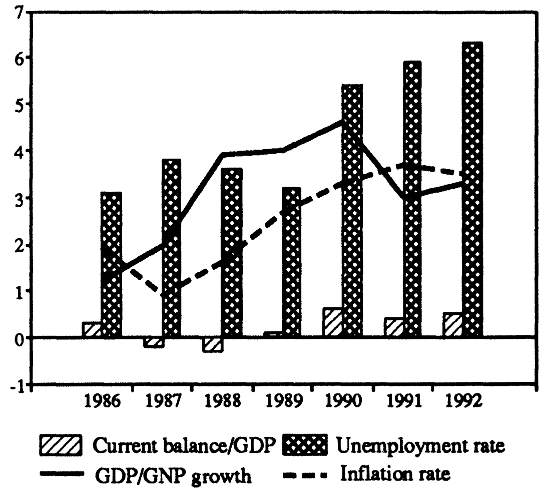
GDP decreased sharply during the second half of 1990, and the recession is expected to continue in the first half of this year. It is already announced that the present forecasts, which give a GDP growth rate around -1 per cent this year, will be revised downwards. This is partly due to downwards revisions in the growth figures for the second half of 1990, which give an annual GDP-growth in 1990 of only 1/2 per cent. Unemployment is increasing rapidly. The leading force behind the slowdown was high interest rates due to a tight monetary policy. According to NIESR, a major factor in triggering the recession was the financial situation of the company sector, with a shortage of liquidity leading to reductions in company spending.

Domestic demand is expected to fall this year, due to an accelerated decline in investments together with reduced growth in both private and government consumption. Export growth will decrease because of the slowdown in international trade. It is not expected much further loss of relative price

UNITED KINGDOM. MACROECONOMIC INDICATORS



AUSTRIA. MACROECONOMIC INDICATORS



competitiveness this year. Large increases in wage rates and a relatively poor productivity performance are assumed offset by cuts in exporters margins. Import growth will also come down significantly, due to the decline in domestic demand.

The trough is expected to be reached in the second half of 1991, as inflation and interest rates come down and international growth picks up. The recovery will be driven by an increase in personal spending and renewed growth in housing investment. Both these elements are vulnerable to continued high interest rates.

Growth in retail prices is still very high, but is assumed to come down to about 4 per cent by the end of this year from an annual rate of 10 per cent in the 4th quarter of 1990. The growth in retail prices at the end of 1990 and early 1991 was affected by the development of domestic interest rates and the introduction of the community charge. These items are not included in the inflation rate reported in the diagram.

Economic policy: Concern about inflation has dampened in recent months, though it remains the main macroeconomic priority. Monetary policy is assumed to be loosened over the next two years and the interest rates gradually reduced. But the decline in interest rates is restricted by the position of sterling within the exchange-rate mechanism. The Bank base rate have been cut by 3 per cent to 12 per cent since sterling entered the ERM. The public sector surplus is eroded as economic growth decelerates and unemployment increases.

AUSTRIA

GDP growth was 4.6 per cent in 1990, and is expected to be around 3 per cent both this and next year, but somewhat higher in 1992 than in 1991. Last peak was in the first quarter of 1990, and the slowdown started with declining growth in domestic demand. This process was cushioned by the export boom to Germany after the unification. Export growth is however expected to decline significantly this year and only recover slightly in 1992, fueled by an expected upturn in the US and also in the EC area.

Due to a large immigration wave from East Europe last year, unemployment increased significantly.

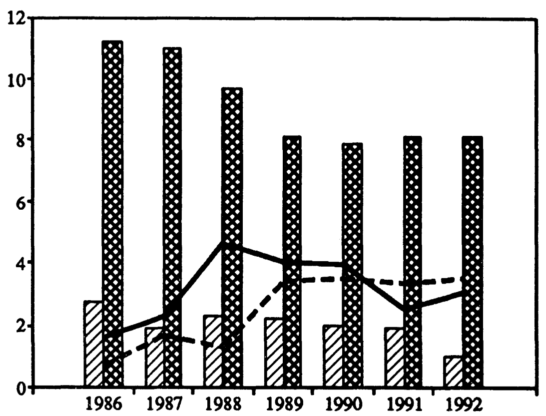
Inflation is assumed to increase slightly this year, remaining above inflation in West Germany. Wage growth recovered strongly last year, and the forecast shows only a modest decline this year.

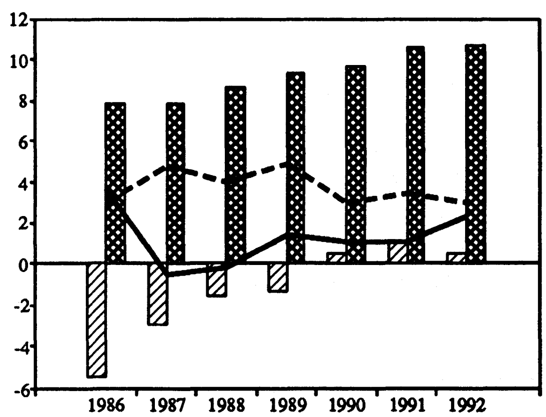
Economic policy: Fiscal policy is aimed at reducing the federal deficit from 3 1/2 per cent of GDP in 1990 to 2 1/2 per cent in 1994. A tax reform is envisaged in 1992 to harmonize taxes according to EC measures. Monetary policy is assumed to accommodate interest rate movements in Germany, in order to maintain the close link between the Schilling and the DM.

BELGIUM

While most other European countries experienced a marked slowdown in economic activity in 1990, relatively high growth in demand and production persisted in Belgium. *Real GDP* increased by close to 4 per cent from 1989 to 1990, more or less the same growth rate as in the preceeding year. While the contributions to growth from public expenditures have been rather modest in recent years, both private domestic demand and exports have have been buoyant. Economic indicators show however that a peak in the business cycle was reached in the first quarter of 1990. The Gulf crisis contributed to a further slackening of domestic demand, while exports were stimulated by increasing sales to Germany.

The forecasts for 1991 and 1992 point at somewhat slower economic growth than in the past years, but there are few signs of a severe economic downturn. GDP growth estimates for 1991 are in





the neighbourhood of 2 1/2 per cent. Investment demand is likely to level off, while private consumption will continue to grow at rates around 3 per cent anually. Inflation, having accelerated somewhat during the last two years from a very low level, is expected to remain lower (around 4 per cent) than in many countries.

The priority target for *economic policy* the last 2-3 years has been to reduce the public deficit and to improve competitiveness of the tradeable sector. This policy may be said to have succeeded well, since presently neither inflation nor the current account restrain economic development. The public sector borrowing requirement was reduced from close to 9 per cent of GDP in 1985 to less than 6 per cent in 1990. Fiscal policy is assumed to remain tight, but the prospects of obtaining a further reduction of the deficit may be hampered by increasing interest rates. Monetary policy will continue to be devoted to maintaining the value of the Belgian franc as close as possible to the DM.

DENMARK

The recession that started in the second half of 1986 is still marking the Danish economy, with high rates of unemployment and low *GDP growth.* Still, 1990 turned out better than what was expected and Denmark experienced the first current account surplus since 1963. Several years of tight fiscal and monetary policy have restricted domestic demand and thereby imports. The reduction in the Krone's effective exchange rate until 1990 has also had a strong impact on Danish export growth.

Danish consumer prices rose only by 2.6 per cent in 1990.

Strong export growth has not been able to balance the impact of slow growth in domestic demand on the rate of unemployment. Unemployment has been growing steadily since 1987 and reached almost 10 per cent of the working force in 1990.

Domestic demand growth is expected to remain low in 1991. Combined with a prolonged tight fiscal policy and a slightly decreasing export growth this may lead to a further increase in unemployment in 1991. In 1992 a slight decrease in interest rates is expected to have a positive effect on the growth rates of consumption and private investments. An upturn in world trade may lead to higher export growth this year. The rate of unemployment is however expected to remain around 10.5 per cent in 1992.

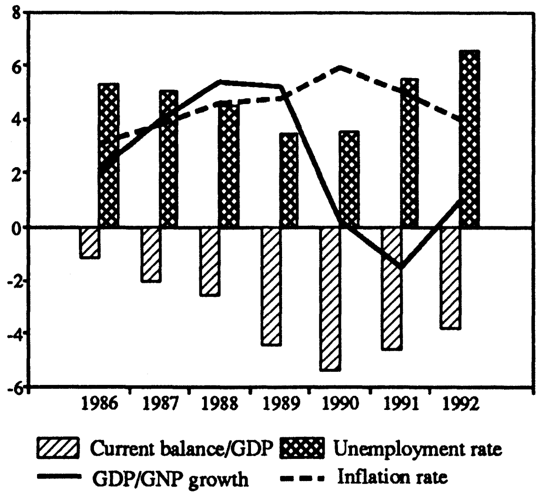
Wage settlements for 1991 and 1992 are almost concluded, and the preliminary figures suggest an annual growth in wages of 3-3.5 per cent for these years. Combined with a moderate rise in oil prices, this is expected to keep inflation down to around 3 per cent also in 1991 and 1992.

In order to preserve the recent positive trend in the current account, the economic policy will probably remain restrictive in the coming years. One of Denmark's biggest challenges will be to reduce the massive foreign debt which amounted to 34 per cent of GDP in 1990. The foreign debt resulted in net interest payment of 34 billion danish kroner in 1990 (more than 4 per cent of GDP).

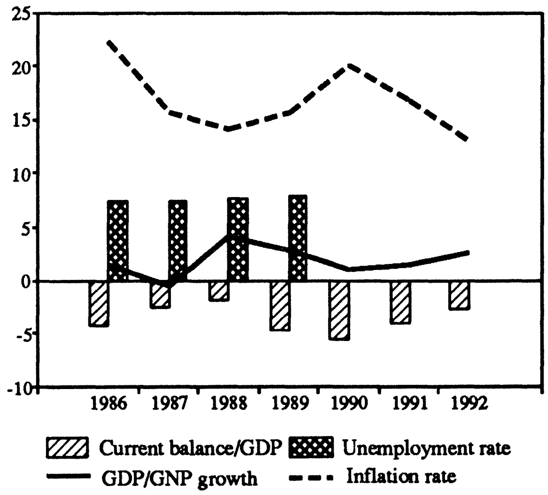
FINLAND

Finland experienced a strong downturn in the economy in 1990 after the boom in 1988-89. *Real GDP* growth dropped from 5.2 per cent in 1989 to 0.3 per cent in 1990. The recession was primarily due to reduced growth in domestic demand, both in investments and private consumption. High interest rates as a consequence of large deficits on the current account, have had a depressing effect on the willingness to invest i new projects, and has stimulated private savings. Private fixed investments declined by 3.2 per cent in 1990 compared to 1989. In 1991, a further decline in domestic demand is expected. This, together with a drop in exports to the Soviet

FINLAND. MACROECONOMIC INDICATORS



GREECE. MACROECONOMIC INDICATORS



Union of about 50 per cent this year, is expected to increase unemployment considerably. Lower interest rates and increased market shares in the western markets are expected to lead to a slight improvement of the Finnish economy in 1992.

The central government budget for 1991 must be characterized as very expansive. Government expenditure is rising by 7.5 per cent in real terms this year, partly as a consequence of rising unemployment. The net financing requirement of the state will rise to FIM 12.5 billion in 1991. This amounts to 2.3 per cent of GDP. For 1992 the fiscal policy is expected to be tightened compared to 1991.

GREECE

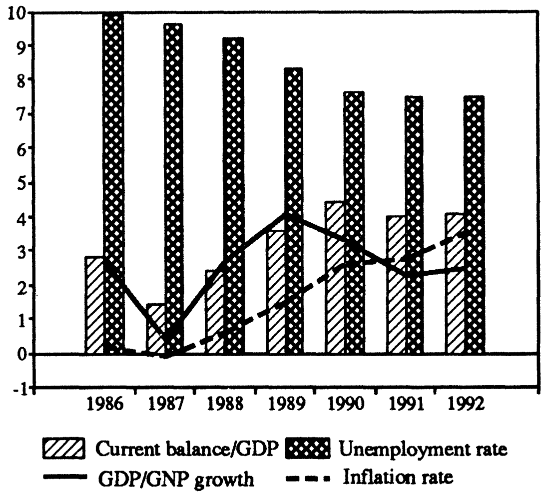
Severe macroeconomic imbalances have for several years characterized the Greek economy, with high inflation rates and significant financial deficits both in the public sector and in the current account. *Real GDP* growth peaked (close to 4 per cent) early in 1989, and on a yearly basis the growth rate was reduced to 1 per cent in 1990. Real government expenditures actually fell from 1989 to 1990, and weaker growth in private consumption also contributed to the decline in the overall activity level. The structural problems in the economy are expected to further restrain economic growth in 1991, while an ongoing stabilization program may stimulate investments and exports and lead to an economic upturn in 1992.

After the election of a new government in April 1990 the main targets for *economic policy* are to reduce the huge public sector deficit, thereby dampen the inflation pressure and to retain confidence in the currency. A three years fiscal programme aims at reducing public sector borrowing requirements from the 1990-figure of 16.5 per cent of GDP to about 6 per cent i 1992. Central government debt as a percentage of GDP may in the same period go down from 76 to 71 per cent. Observers, like OECD, tend to regard these targets as optimistic due partly to sizeable expenditure commitments and continuing high interest rates. However, similar conditions have recently become part of the terms of a loan of 2.2 billions ECU from the EC to Greece.

THE NETHERLANDS

Real GDP growth has been rather strong during the last three years. However, there was a turnaround in economic growth somewhere in the middle of 1990. The growth rate for this year is estimated to 3 1/4 per cent, a marked decline from the 4 per cent peak in 1989. The leading force behind the slowdown in Dutch economic growth was investment, in particular residential construction. Consumer spending, stimulated by the income-tax reform increased by close to 4 per cent in volume terms in 1990. Very moderate inflation rates during the past years have stimulated exports, and the external balance improved further in 1990. According to the forecasts of the CPB, the economic slowdown will continue the coming two years, with real GDP growth rates slightly exceeding 2 per cent.

NETHERLANDS. MACROECONOMIC INDICATORS



The *economic policy* pursued by the present coalition aims at decreasing the government deficit. On the monetary side, the development is dominated by the close relationship between Dutch and German interest rates. Short term interest rates thus increased by 1.3 percentage point from 1989 to 1990, and they are expected to remain high during the present year.

The situation in the labour market has improved during the last couple of years, but the unemployment rate is still at a high level. Strong increases in the labour force in the coming years will tend to keep unemployment high.

NORWAY

The decline in domestic use of goods and services came to a halt in 1990 after having lasted for two years. Along with a continued rapid growth in exports during most of 1990, *GDP* increased by nearly 2 per cent. GDP exclusive oil and shipping grew by 1 per cent after having fallen the previous two years. Unemployment increased rapidly during 1988 and 1989 but has been stable around 5 per cent for nearly two years. The inflation rate was 4 per cent in 1990 and there was a surplus on the current account of nearly 4 billion US dollars or 4 per cent of nominal GDP. High oil prices due to the Gulf conflict accounted for roughly half the surplus.

An expected turnaround in investments during 1991 and continued but moderate growth in public and private consumption will result in moderate growth in GDP in 1991.

The growth rate is expected to increase to 3 per cent in 1992 as exports will again increase due to higher growth in world trade. Total GDP is expected to increase faster than mainland GDP due to further increases in petroleum production (presently above 2 million barrels per day). Unemployment is expected to change very little in 1991 and 1992. Inflation was down to 3.5 per cent in March and is not expected to change much. The surplus on the current account is highly dependent upon the crude oil price. With prices around 20 dollars per barrel and the current dollar exchange rate there will be a current account surplus of 3 per cent of GDP in 1991 and 1 per cent in 1992. Moderate wage increases continue to improve competitiveness.

Fiscal policy is now quite expansionary and is expected to remain so due to high unemployment which according to the government is given main priority. Uncertainties regarding the capital tax reform effective from January 1992 may delay the expected increase in investment and harm housing prices further. The exchange rate has been pegged to the ECU since October 1990.

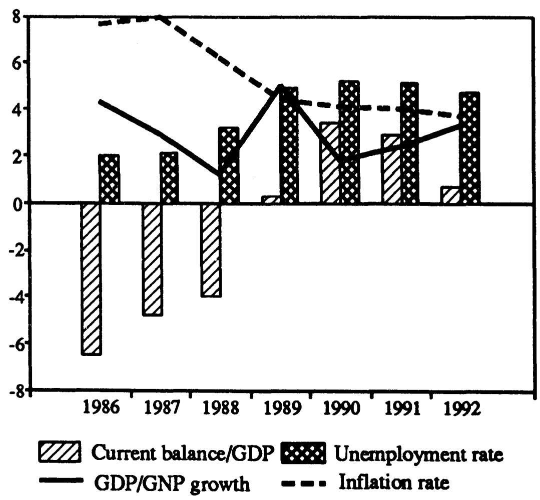
SPAIN

After having expanded rapidly in the period 1987-89, the Spanish economy cooled off in 1990. *Real GDP* increased with 3 1/2 per cent, down from 5 per cent the year before. Economic forecasts point at a further weakening of economic growth; in the present year GDP growth is estimated to about 2 1/2 per cent by most institutes. However, recently the Spanish government presented a somewhat more optimistic forecast, with GDP growth around 3 per cent for the current year. Parallel to the slowdown of economic growth inflation has been reduced, but still Spain experiences an inflation gap compared to other EC countries.

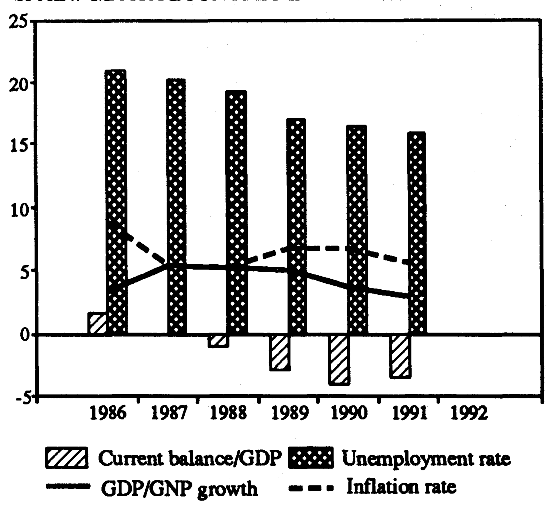
The price increase on crude oil following the crisis in the Persian Gulf contributed to a further worsening of the current account in 1990, reaching 3.1 per cent of GDP. The perspectives for the external balance seem somewhat better for 1991 and 1992, as imports will follow domestic demand downwards, and exports may be stimulated by a brighter international economic picture.

Interest rates in Spain have for quite some time

NORWAY. MACROECONOMIC INDICATORS



SPAIN. MACROECONOMIC INDICATORS



been very high compared to other European countries. As a result, the country has experienced considerable capital inflow and a strong peseta.

Economic policy has the last couple of years supported the high interest rate level. In the summer 1989, strict credit ceilings were imposed on financial institutions. Developments after lifting these ceilings early in 1991 indicate that there are still demand pressures in the credit markets. However, following signals of reduced inflation rates in February and March, Bank of Spain decided to cut its money market intervention rates with a percentage point to 13.5 per cent. Through the coming years fiscal policy will have to take a larger part of the burden of dampening domestic demand. On the background of the significant public deficit, the growth in public expenditures will have to be moderate.

SWEDEN

After a peak in the first half of 1989, the Swedish economy went into a recession. A slowdown in domestic demand, partly due to weak business confidence as a result of the Gulf-war, led to a fall in *real GDP* in the third and fourth quarter of 1990. The growth in private consumption is expected to be low in 1991. Combined with a decline in gross investments and exports, this is expected to result in a fall in real GDP of approximately 1 per cent in 1991. Unemployment is expected to increase from 1.5 per cent in 1990 to around 4.0 per cent in 1991.

Inflation has increased rapidly since 1988. In 1989 the consumer prices increased by 6.4 per cent and in 1990 by 10.4 per cent. Due to the new Swedish tax reform, high growth in consumer prices is expected also for 1991.

The wage agreements for 1991 and 1992 tend to give an average wage growth for industry around 6 per cent in 1991. It is expected that the rapidly growing rate of unemployment will result in a lower wage drift this year and that the wage growth in 1992 will end somewhere around 3.5 per cent.

A weak upturn in economic activity is expected in 1992 as a consequence of a recovery of the international business cycle and a slightly increasing domestic demand due to reduced interest rates. The inflation rate is expected to fall to 3.5 per cent in 1992. Reduced investments and exports, and a tight fiscal policy also in 1992 may lead to a further increase in the unemployment rate, reaching around 6 per cent.

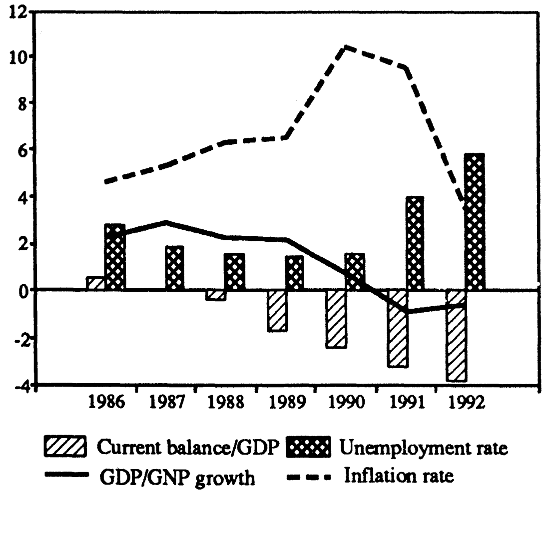
Reducing inflation is regarded as the main goal for *economic policy* in the years to come. The Swedish government budget for 1991 is rather tight. However, the latest reports suggest that the budget may be exceeded, since the rapidly increasing unemployment is inducing increased outlays and resulting in reduced tax revenues

SWITZERLAND

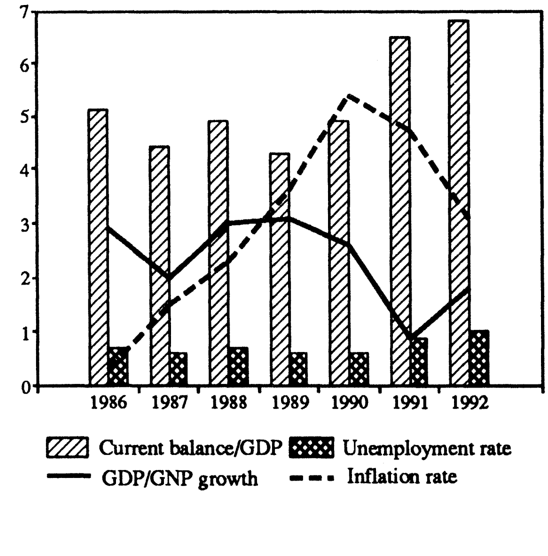
The Swiss economy peaked in the 4th quarter of 1989. The following slowdown was mainly due to increasing interest rates spurred by a restrictive monetary policy. The forecast indicates a relatively sharp slowdown in *real GDP growth* from 2.6 per cent in 1990 to less than 1 per cent in 1991. A further appreciation of the Swiss franc as well as a relatively large increase in unit labour costs are likely to harm competitiveness on both domestic and foreign markets. High interest rates are assumed to help bring inflation down, but will also contribute to the expected fall in investments this year. Exports are assumed to recover in 1992, and this together with higher growth in domestic demand bring GDP growth up to almost 2 per cent.

Economic policy: The Swiss National Bank announced a new policy rule in December 1990, implying a significant shift in monetary policy. Interest rates will only be increased if the evolution of the exchange rate, especially Swiss franc against

SWEDEN. MACROECONOMIC INDICATORS



SWITZERLAND. MACROECONOMIC INDICATORS



DM, threatens price stability. The increase in German rates on the 1st of February was not followed by the central bank. Fiscal policy is intended to curb expenditures further, as revenues are expected to increase less than in the past.

CZECHOSLOVAKIA

A restrictive monetary and fiscal policy, coupled with uncertainties associated with the reformation process, brought about a decline in *GDP* by about 3.5 per cent in 1990. The decline was mainly due to reduced production in construction, coal-mining and transport. The development was heavily influenced by reduced deliveries of oil from the USSR.

The price-liberalization was put into effect at the beginning of 1991. *Inflation* appeared to fall off in March, but is still expected to reach 40 - 50 per cent on average this year. The restructuring of the economy, together with the collapsing trade within central and eastern Europe, will lead to further decline in GDP this year. The privatization programme is advancing slowly, leading to uncertainties concerning decisions for the future. For 1992 the forecasts indicate some improvement in the economy. A stabilization of the economic situation towards the end of 1992 is expected to result in a moderate rate of inflation, the decline in industrial production and GDP will come to a halt, and private consumption will increase somewhat.

There are considerable risks to the forecasts. For one thing, Czechoslovakia is heavily dependent on continued deliveries of oil and gas from the USSR. Should destabilization occur in the USSR, this might endanger the deliveries. There also seems to be a growing problem of separatism in the Slovak republic. Most of Czechoslovakia's military industry is located there, probably resulting in a more severe slowdown in this part of the country.

HUNGARY

Since 1987 Hungary has been following a gradual strategy of transition to a market economy. So far, this has led to declining growth, increasing inflation and an external debt as high as 60-65 per cent of GDP. In the next few years the economic performance will continue to be poor: Firstly, the problems of the transition of the economy will be in full force. Secondly, similar problems in the rest of eastern and central Europe and the exchange rate reforms have brought about a severe reduction of trade in this area. Increased exports to countries paying in hard currency h[illegible] some extent dampened the effect of this reduction, but the overall effect on the economy is rather small. However, this may be an indication that structural reforms are starting to work.

In 1990, the recession became deeper. *GDP* was reduced by 4 per cent. All categories of demand declined, but investments and exports were hardest hit. The reduction of industrial production was 5 per cent, and unemployment rose sharply from 1.8 per cent in 1989 to 4.5 per cent in 1990. The recession is expected to continue in the next two years. Both GDP and domestic demand will decline by nearly 5 per cent in 1991. In 1992 the situation is expected to improve somewhat, with a 2 per cent reduction in GDP.

Inflation ran at 29 per cent in 1990, while average earnings in industry increased by 20 per cent. In 1991 the consumer prices are expected to grow by 40 per cent. Inflation will be high in 1992 as well, but lower than in 1991.

After several years with a *current account* deficit, Hungary managed a turnaround to a small surplus (0.3 billion US$) in 1990. However, due to the collapse in the eastern Europe trade in general and especially the reduced demand from the USSR and East Germany, there will probably be a current account deficit of 1 billion US$ in 1991.

The main priority of the *economic policy* is to reduce Hungary's foreign debt. The monetary policy was tight in 1990, and radical cut-backs in state subsidies and tax reliefs reduced the public sector deficit to less than 1 per cent of GDP. In the next two years the monetary and fiscal policy is assumed to loosen somewhat.

POLAND

Poland has adopted a cold turkey approach to the transformation to a market economy. From the beginning of 1990 all prices except for energy and housing were liberalized, and tight control over wages and incomes was imposed together with a restrictive monetary and fiscal policy. The costs, in terms of inflation, lost output and social unrest, were severe in 1990: *GDP* declined by 12 per cent and unemployment rose to 6.2 per cent.

The new government that took office last summer relaxed the fiscal and monetary policy for the rest of the year, leading to a small positive economic growth in the third quarter. However, the *inflation rate* also picked up. For the whole year, the inflation ran at 600 per cent.

In the next two years the domestic demand will be the main economic driving force. After being reduced by more than 10 per cent in 1990, it is expected that real personal income will remain unchanged or increase slightly, and the saving ratio will be reduced. According to the forecasts, the inflation rate will improve to 75 per cent in 1991 and 50 per cent in 1992.

Like the other central and East European countries, Poland will also be negatively affected by the transition from transfer rouble to US dollar in foreign trade transactions. An additional negative impact will be a continuing overvaluation of the exchange rate: The zloty is only expected to depreciate by about 5 per cent this year compared to US dollar. This will affect Poland's competitiveness. On the bright side, the recently negotiated debt relief with the Paris Club will reduce the expected current account deficit.

YUGOSLAVIA

Since 1985 Yugoslavia has experienced a marked deceleration in economic activity. The main factor behind the slowdown has been restrictions on domestic demand in order to curb the very high inflation (488 per cent last year). Recent data give evidence of a deep recession in 1990, when *GDP* declined by 8 per cent. The industrial production decreased by 11 per cent last year, and the unemployment rate was as high as 19 per cent.

In the next two years, declining employment and reduced output is expected to continue due to shrinking eastern European markets, economic disarray and political instability. The political struggle has prevented the implementation of coherent programmes of economic reform and has also blocked the adoption of effective measures to deal with the stabilization problems.

The outlook is, therefore, highly uncertain.

Appendix A: The Greenhouse Effect and Economic Development

The greenhouse effect - a global problem

Global warming has become one of the most pressing environmental problems. Emissions of carbon dioxide (CO_2) caused by the burning of fossil fuels are responsible for about 50 per cent of the manmade warming effect. Since emissions from burning of fossil fuels cannot be curbed by adding end-of-pipeline technologies, the remedy will have to involve both energy conservation and inter-fuel substitution. Severe limitations on the use of fossil fuels are most likely to have a negative impact on economic growth.

Excessive CO_2 emissions is a global problem calling for internationally coordinated actions. A number of countries have set out goals and declared their intention to undertake reductions in their future emissions of greenhouse gases to the atmosphere. Moreover, a process towards an international climate convention has been going on since the mid-1980s, involving a number of conferences and meetings both between experts and scientists and on a political level. In november 1990 the United Nations Intergovernmental Panel on Climate Change (IPCC) delivered its interim report, which is likely to form part of the basis for an international climate convention. Through the IPCC process agreement has been obtained on a number of important issues, such as

- to immediately undertake so-called "no regret policies", i.e. measures that undoubtedly are beneficial, as they may also correct other externalities in the economy or the environment. These include policies for energy conservation, restrictions on the utilization of ozone gases and efforts to curb deforestation.
- transfers of financial and technological aid to developing countries
- to sign an international climate convention by the end of 1992.

The time schedule of the negotiating process may seem very ambitious in light of the severe problems that are still unsolved and the different positions that are held by different groups of countries. The major difficulty in reaching an international agreement on limiting CO_2 emissions is the problem of equity. Countries are affected differently by global warming and abatement costs vary considerably. Moreover, in the present situation a group of nations - the rich industrialized countries - are responsible for a major part of the global emissions of CO_2. Developing countries and other low income areas with substantially lower emissions per capita will therefore probably require significant compensations in terms of income transfers in order to join a climate convention.

Another major preoccupation so far in the discussions towards a climate convention has been the aspect of *cost effectiveness*, i.e. the intuitively attractive property that CO_2-emissions should be reduced at the lowest possible costs, at a global as well as national levels. Given some idealized assumptions, economic policy instruments, such as the use of emission taxes or tradeable permits, will secure cost effectiveness. Traditional agreements based on pro rata reductions in emissions are on the other hand usually not cost efficient, since they do not take into account the fact that the costs of reducing emissions vary between different countries. An important part of a cost effective strategy is to undertake price reforms and introduce other economic incentives in areas where different kinds of regulations and protection of domestic energy sources have led to excessive use and low efficiency in energy markets. Both in developing countries and in several European countries there are probably huge potentials for energy conservation because end users are not faced with the real costs of providing energy. In addition, the costs of limiting CO_2-emissions depend on the overall flexibility in the various economies, i.e. the possibilities of substitution both on the supply and on the demand side. Here, a basic hypothesis is that the costs of CO_2 abatement are relatively high in developing countries, due to limited flexibility (low price elasticities) and unmature economies with respect to energy consumption (high income elasticities).

Strategies of regional CO_2-stabilization

Altogether, if economic development shall continue in developing countries it is hard to see how increases in energy use and CO_2 emissions in these regions can be avoided. To reach a climate convention that does include restrictions on energy use in developing countries, means in effect that severe problems of income distribution between countries have to be solved simultaneously.

As an alternative to a global climate convention, a strategy based on regional stabilization of CO_2-emissions has been proposed as a more realistic alternative. Nitze (1990) argues for a stepwise procedure where countries first establish *national strategies* and goals of limiting future emissions. Within these borders, market based policy instruments such as CO_2-taxes should be used. In addition, socalled "bubbles" with common CO_2-limits and coordinated policies for a group of countries should be established where possible. The European Community (EC) is here a good example. Within these borders, market based policy instruments such as CO_2-taxes should be used in order to achieve the emission targets. Nitze also stresses that a climate convention should be considered as a continuing process, with regular contacts between the signature states, the establishment of control measures and frequent evaluation of targets and policies.

Within the Nitze framework it may be useful to review the positions that various countries have taken with respect to the climate problem and their targets for future emissions. Based on a number of (unofficial) sources, the ambitions of various countries are listed in table A.1. Obviously, declarations and intentions on climate policies are difficult to compare, and the formulations in the table should at best be regarded as brief characterizations of present positions.

Many *Western European countries* have signali-

Table A.1. The positions taken by different countries regarding climate policies

Country	*Share of global emissions*	*Ambition towards future CO_2-emissions*
USA	*22.0*	*No declaration of reduction*
Canada	*2.0*	*Stabilization at 1990 level within 2000*
Japan	*4.4*	*Stabilization per capita emissions at 1990 level within 2000*
New Zealand	*0.1*	*20 % reduction within 2000*
Soviet Union	*18.3*	*No declaration of reduction*
Germany	*4.7*	*25 % reduction of 1987 level within 2000*
UK	*2.8*	*Stabilization at 1990 level within 2005*
France	*1.7*	*Recommends 20 % reduction within 2005*
Italy	*1.8*	*20 % reduction within 2005*
Austria	*0.3*	*20 % reduction within 2005*
The Netherlands	*0.7*	*Stabilization within 1995, 2-3 % reduction within 2000*
Belgium	*0.5*	*Stabilization at 1988 level within 2000*
Switzerland	*0.2*	*Stabilization within 2000, proposal of 20 % reduction*
Ireland	*0.1*	*Stabilization on present level*
Sweden	*0.3*	*Stabilization at 1988 level within 2000*
Denmark	*0.3*	*20 % reduction within 2005*
Norway	*0.2*	*Stabilization at 1989 level within 2000*
Finland	*0.3*	*Stabilization at 1990 level within 2005*

zed ambitions of stabilizing or reducing their emissions of CO_2. Some differences in attitude may however be noted. The Nordic countries, together with the Netherlands and Germany have presented the most binding plans limiting CO_2 emissions. The Netherlands intend to stabilize emissions from 1995. On the other hand, some of the southern European countries, such as Spain, Portugal and Greece hold out that their present (lower) income levels prevent them from sticking to a too radical climate policy. France and Italy have announced ambitious goals, but at the same time they have made their own policies conditional on other countries actually undertaking similar emission reductions.

For all countries the declarations regarding climate measures should be evaluated against the background of their economic situation in general and the energy structure in particular. Germany's position should for instance be seen in light of the reunion of the previous two German states, and the large energy conservation potential that is likely to exist in the eastern part. France has its large nuclear program, and by selecting a reasonable base year, the reductions of CO_2 emission need not be very difficult to achieve. Sweden, on the other hand, has in addition to its CO_2 target decided to gradually close down the country's nuclear plants. There is now a growing perception in Sweden that one of these targets will have to yield.

Soviet Union and the eastern European countries have in general very energy intensive industrial structures, based to a large extent on coal, the most carbon rich energy carrier. The future development may be characterized by two conflicting tendencies. One the one hand, the economic and political reforms will stimulate modernization of the countries' industries and thus tend to reduce energy intensities and carbon emissions. On the other hand, economic growth and investments in infrastructure may induce increasing energy consumption in particular in the transport sector.

Among other (non-AIECE) countries, the *United States* has so far been reluctant with respect to setting specific targets for limiting CO_2-emissions. Partly, this is due to the central role of fossil fuels in US energy consumption. Increasing electricity demand is expected to give a push for further growth in the fossil energy use, in particular since production will be based partly on coal.

Japan has also been hesitant in making declarations of emission reductions. However, recently the Japanese government expressed their intention to stabilize per capita emissions of CO_2 within 2000.

Economic impacts of stabilizing CO_2-emissions

A policy directed towards restricting the future growth of CO_2 emissions and energy use may adversely affect the overall economic development. For a specific country the effects will depend on the general flexibility of the economy. Assume that an emission target is implemented by imposing a si-

Table A.2. Macroeconomic costs of CO_2 restrictions

STUDY	*REGION*	*CO_2 RED., PER CENT*	*GDP RED., PER CENT*
Reilly et al (1987)	*OECD*	*10*	*1.5*
DRI (1990)	*Western Europe*	*18*	*1.5*
Montgomery (1990)	*USA*	*35*	*6*
IEA (1990)	*OECD*	*12*	*3*
Bergman (1990)	*Sweden*	*28*	*4.5*
KLØKT (1991)	*Norway*	*18*	*1*

Sources: Bergman, L. (1990): General Equilibrium Effects of Environmental Policy: A CGE-Modelling Approach. Working Paper, Stockholm School of Economics.
DRI (1990): Green Europe: Economic Implications and Business Opportunities. DRI/McGraw-Hill.
KLØKT (1991): Climate, Economy and Policy Measures. Report from a Norwegian Government appointed committee on climate issues. Central Bureau of Statistics, Oslo.
Montgomery, D.W. (1990): Effects on Energy Markets and the US Economy of Measures to Reduce CO_2 Emissions from Fossil Fuels. Paper presented at "Energy and the Environment in the 21st Century". MIT, Cambridge MA.
Reilly, J., J. Edmonds, R.H. Gardner and A.L. Brenker (1987): Uncertainty Analysis of the IEA/ORAU CO_2 Emissions Model. The Energy Journal, Vol. 8(3).
IEA (1990) (Kouvaritakis, N): Policy Measures and their Impacts on CO_2 Emissions and Accumulations.

zeable carbon tax on all use of fossil energy. End users will then seek to substitute away from CO_2 intensive products. Producers will tend to increase energy efficiency in production and to substitute away from the most CO_2 intensive energy carriers, such as coal. With little structural flexibility, i.e. limited ability to undertake the kind of adjustments mentioned, a CO_2 limit may have to be obtained partly by reducing the activity level and economic growth.

A number of studies have analyzed macroeconomic effects of limiting emissions of CO_2. When undertaking this kind of analysis, the reference scenario is typically assumed to be a development without specific actions taken to curb CO_2 emissions. By carrying out model simulations, the effects of introducing a CO_2 tax is then analyzed. For several studies the purpose has been to calculate the "necessary" CO_2 tax for obtaining a stabilization of emissions in the specific region. It should be readily mentioned that since an emission target typically refers to the level of a specific year, the overall economic development in the reference scenario is decisive for the calculated magnitude and time paths of the "necessary" CO_2 taxes.

In table A.2, main results from some of these empirical studies are listed. The second column shows the region in focus. Furthermore, the table indicates the reductions in CO_2 emissions compared to the reference scenario and the percentage change in the GDP. All numbers refer to calculated impacts in year 2000.

The different studies do not present any clear picture with respect to macroeconomic costs of CO_2 reductions. This is hardly surprising, and is due to a number of factors (in addition to regional differences in the overall flexibility). Firstly, the analysis utilize highly different model frameworks. A main distinction exists between those using a general equilibrium approach and models more directed to calculate short and medium term effects. Both the study of Reilly et al (1987) and Lars Bergmans study of effects of CO_2 restrictions on the Swedish economy may be characterized as general equilibrium type of analysis. These studies trace long run effects on the economy of imposing CO_2 restrictions, and the estimated GDP losses are caused mainly by reallocation losses in the overall economy due to rising energy costs. Both these long term studies yield CO_2/GDP elasticities (percentage impact on GDP by reducing emissions of CO_2 by 1 per cent) of the magnitude 0.15. The DRI study, the recent Norwegian KLØKT study and Montgomery on the other hand apply model frameworks directed more towards analyzing short and medium term effects of changes in economic policy. Montgomery focuses particularly on the differences between short term and long term effects. The "short term" effects reported in table A.2 are produced by model runs on DRI's annual model of the US economy. This model involves a description of the dynamic features of the economic structure, and as a result the economy is "vulnerable" to short term "shocks", as for instance a sizeable CO_2 tax. In order to calculate long term effects Montgomery utilizes a general equilibrium model constructed by Dale Jorgenson. The GDP loss related to the CO_2 reduction in year 2000 is then reduced from 6 to 1 per cent.

Another important factor when evaluating macroeconomic effects of adapting to lower emissions of CO_2 is the economic policy that is assumed to accompany the introduction of climate measures. As mentioned previously, some reduction in the use of fossil fuels may be consistent with "rational energy policy", e.g. resulting from a seize in the protection of domestic energy industries. Moreover, even without such potential benefits, there is the question of how to utilize the tax revenues that emerge from a CO_2 tax. An interesting answer is that this provides the opportunity to reduce other taxes in the economy, e.g. on labour or capital income. This may counteract the abatement costs caused by a CO_2-ceiling. In the Norwegian KLØKT study, it is assumed that the incomes from the CO_2 tax is redistributed to private households and firms as reliefs in other taxes, so that the overall activity level is maintained. This contributes to the explanation of the rather moderate macroeconomic costs of restricting Norwegian CO_2 emissions in this study.

Finally, the economic costs of restricting the emissions of CO_2 in a country or a region will depend on whether the reduction is unilateral or part of a broader international effort. In both cases, the countries involved must bear the costs associated with a reduction in energy use, and the accompanying restructuring of production and consumption. If several countries participate in the efforts, world market prices are likely to change, and terms-of-trade effects will add favourably or unfavourably to the reallocation effects. For example, as a net exporter of oil Norway may be hit hard by an international agreement to reduce emissions of CO_2, while as a producer of hydro based electricity Norway will probably gain on climate measures being taken internationally.

APPENDIX B: Forecasts of the AIECE institutes

	GDP 1)			Private consumption			Gross investments		
	1990	1991	1992	1990	1991	1992	1990	1991	1992
AUSTRIA, WIFO	4.6	3.0	3.3	4.1	3.2	3.0	6.9	4.7	5.2
BELGIUM									
DULBEA	4.0	2.5	3.0	3.8	3.0	3.3	9.0	1.0	3.0
IRES	3.8	2.5		3.7	2.9		8.7	1.9	
DENMARK, DEC	1.0	1.0	2.3	0.7	0.8	2.0	-0.8	-1.1	4.6
FINLAND, ETLA	0.3	-1.5	1.0	0.4	0.0	1.0	-1.9	-12.0	-6.0
FRANCE									
BIPE	2.8	1.7	2.6	3.1	1.8	2.3	3.7	2.0	2.8
COE	2.8	2.1	2.8	3.1	2.5	2.9	3.7	2.5	3.3
INSEE 2)	2.8	1.5		3.0	2.4		3.7	1.0	
OFCE	2.8	1.3	3.1	3.1	2.2	3.0	3.7	1.6	3.5
REXECODE-IPECODE	2.8	1.7	2.7	3.2	2.0	2.7	3.7	0.5	3.8
GERMANY									
IFW	4.7	3.0	2.0	4.4	2.5	1.5	8.2	4.5	3.0
IFO	4.7	3.0	2.0	4.0	2.5	1.8			
DIW	4.5	3.0		4.0	3.0		8.7	6.0	
RWI	4.7	3.0	2.5	4.0	2.5	2.0	8.7	5.0	4.0
HWWA		2.5	2.0		2.5	2.0		5.5	4.0
GREECE, KEPE	1.0	1.5	2.5	2.1	2.2	3.0	3.0	6.3	7.6
HUNGARY									
KOPINT-DATORG	-4.0	-5.0	-2.0	-4.0	-5.0	-1.0	-8.0	-5.0	1.0
ITALY									
PROMETEIA	1.9	1.0	2.8	2.7	2.3	3.4	1.9	-0.1	3.2
ISCO	2.0	2.0		2.7	2.7		2.4	0.8	
IRS	2.0	1.2	2.5	2.8	2.1	2.9	1.9	0.1	2.3
CONFINDUSTRIA	2.1	1.4	1.7	2.5	2.4	2.6	3.4	2.0	2.3
NETHERLANDS, CPI	3.3	2.3	2.5	3.7	2.8	1.8	4.2	1.3	0.8
NORWAY, CBS	1.8	2.4	3.3	3.1	2.5	2.8	-26.5	7.3	17.7
POLAND, FTRI	-12.0	3.0	6.0	-18.0	4.0	4.0	-9.0	2.0	10.0
SPAIN, DGPC	3.7	3.0		3.7	2.7		6.7	5.8	
SWEDEN, FSI	0.7	-0.9	-0.6	-0.4	0.5	0.5	0.0	-3.5	-1.5
SWITZ., KOF/ETH	2.6	0.9	1.8	2.0	1.5	2.2	2.2	-2.0	0.0
CHECH., CSFR	-3.5	-1.2	0.3	0.0	-4.8	1.3	-5.2	4.1	-3.6
UNITED KINGDOM									
NIESR	1.0	-1.4	2.1	1.8	0.1	1.1	-2.8	-11.1	-0.7
LBS	0.9	-0.8	2.4	1.9	0.3	2.0	-2.5	-4.8	1.6
YUGOSLAVIA, MRI	-8.0			-5.0			-9.0		

1) GNP for HWWA, IFW, DIW (Germany) and KEPE (Greece)

2) 1991-figures are 1991 I, annual rates, except for GDP

APPENDIX B: Forecasts of the AIECE institutes

	Consumer prices			Unemployment rate 3)			Interst rates 4)		
	1990	1991	1992	1990	1991	1992	1990	1991	1992
AUSTRIA, WIFO	3.3	3.7	3.5	5.4	5.9	6.3	8.5	9.0	9.0
BELGIUM									
DULBEA	3.5	3.3	3.5	9.7	10.0	10.0	9.6	9.5	9.3
IRES	3.4	3.3		8.1	8.2		9.7	8.8	
DENMARK, DEC	2.9	3.4	3.0	9.7	10.6	10.7	14.0	13.2	13.2
FINLAND, ETLA	5.9	5.0	4.0	3.5	5.5	6.5	14.0	13.0	11.0
FRANCE									
BIPE	3.4	3.0	3.1	8.9	9.5	9.9	10.3	9.5	8.7
COE	3.4	3.1	3.0	9.0	9.2	9.1	10.0	9.3	8.6
INSEE 2)	3.0	3.1		9.0	9.1		10.3		
OFCE	3.4	2.8	2.0	9.0	9.6	9.5	10.3	8.3	6.8
REXECODE-IPECODE	3.0	3.1	3.2	9.0	9.2	9.3	10.0	8.6	7.0
GERMANY									
IFW	2.7	3.5	3.0	6.2	5.5	6.0	8.5	9.3	8.8
IFO	2.7	3.5	3.5	6.4	5.9	6.1	8.6	8.7	8.0
DIW	2.7	3.5		6.2	5.7		8.5	8.9	
RWI	2.7	3.5	3.5	6.2	6.0	6.5	8.6	9.3	8.4
HWWA		3.5	3.5	6.4	5.8	6.0			
GREECE, KEPE	20.0	16.7	12.9	3.4	4.2	3.4	24.5	18.4	15.9
HUNGARY									
KOPINT-DATORG	29.0	40.0	28.0	4.5	7.1	8.2	39.0	32.0	30.0
ITALY									
PROMETEIA	6.5	6.5	6.5	10.9	11.1	11.0	12.3	12.6	11.3
ISCO	6.5	6.4	0.0	11.0					
IRS	6.1	6.5	5.8	11.0	11.5	11.5	12.2	11.0	10.5
CONFINDUSTRIA	6.2	6.5	6.6	11.9	12.2	12.6	12.3	12.8	12.8
NETHERLANDS, CPI	2.6	2.8	3.5	7.6	7.5	7.5	8.6	8.5	7.5
NORWAY, CBS	4.1	4.0	3.7	5.2	5.1	4.7	11.3	12.1	10.1
POLAND, FTRI	585.0	70.0	45.0	6.2	11.2	13.5			
SPAIN, DGPC	6.7	5.6		16.3	15.8		15.2	13.5	
SWEDEN, FSI	10.4	9.5	3.5	1.5	4.0	5.8	13.7	12.2	8.0
SWITZ., KOF/ETH	5.4	4.7	3.1	0.6	0.9	1.0	6.8	7.6	6.7
CHECH., CSFR	10.0	40.0	5.0	1.0	4.0	7.0	7.0	15.0	15.0
UNITED KINGDOM									
NIESR	4.3	3.6	4.8	5.9	7.9	9.1	14.8	12.8	10.8
LBS	4.1	7.1	5.2	5.7	7.2	7.8	14.8	13.3	12.0
YUGOSLAVIA, MRI	488.0			19.0	21.0	20.0	-9.0		

2) 1991-figures are 1991 I, annual rates

3) KEPE (Greece): Non-agriculture. HWWA (Germany): Civilian labour force

4) WIFO (Austria): Day to day. DEC (Denmark) and LBS (UK): Base rates

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