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THE WORLD ECONOMY IN 1993

Forecasts from the MIMOSA model

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PREFACE

The forecasts presented in this document have been produced by a joint team from the CEPII[1] and the OFCE[2], with the help of the MIMOSA macroeconomic model of the world economy, which these two organisations have developed together. The results of their work were presented for the first time in May 1989 to a meeting at the French Sénat organised by the Délégation pour la Planification.

Following the kind invitation of Senator Bernard Barbier, Chairman of the delegation, this meeting was attended by members of the Working Group on Macroeconomic Research of the European Centre for Parliamentary Research and Documentation (ECPRD). Fourteen parliamentary assemblies were represented at the meeting and, as a service to Members of these assemblies, the ECPRD has decided to publish a summary of the MIMOSA forecast. We should like to express our appreciation to the CEPII and OFCE for making this possible.

The summary, which has been prepared by the Statistical Service of the European Parliament, does not purport to represent the views of the European Parliament; its intention is to contribute to the debate on this important topic.

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THE WORLD ECONOMY IN 1993

Forecasts from the MIMOSA model

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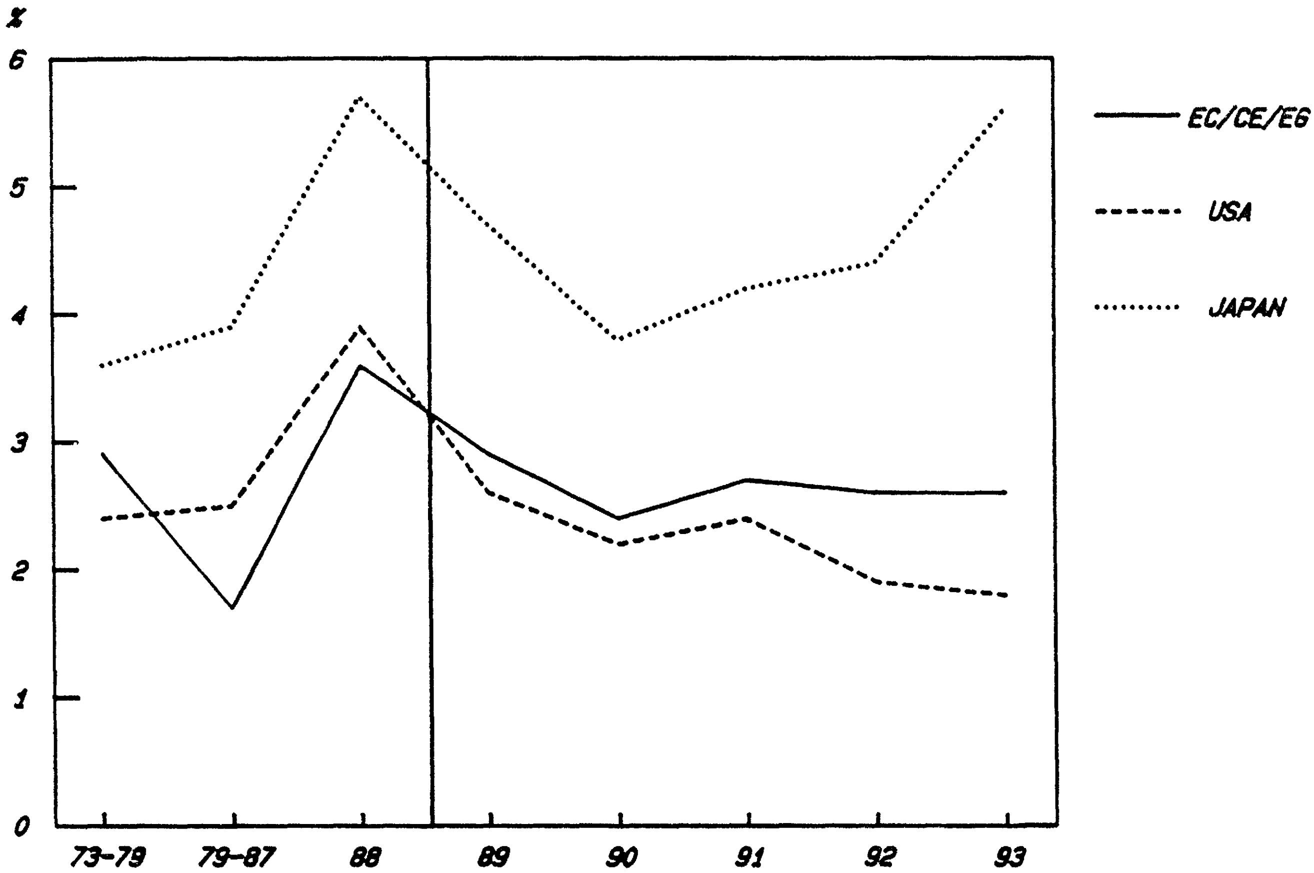
1. THE FORECAST SUMMARIZED IN THREE TABLES

Table 1

World growth

Growth in GDP (average rate in %)	73-79	79-87	88	89	90	91	92	93	Average 88-93
Germany	2.3	1.4	3.5	3.1	2.5	1.9	2.3	2.3	2.5
France	2.8	1.7	3.4	2.6	2.1	2.8	2.5	2.0	2.4
Italy	2.6	2.2	3.8	3.6	2.9	3.7	2.9	3.1	3.3
United Kingdom	1.6	1.8	4.2	2.5	2.1	2.7	2.7	2.5	2.5
Rest of EC	2.5	1.6	3.3	2.6	2.5	2.7	2.9	3.2	2.8
EC total	2.9	1.7	3.6	2.9	2.4	2.7	2.6	2.6	2.7
Rest of Europe	1.9	2.2	2.7	2.2	2.3	2.8	3.1	3.6	2.8
United States	2.4	2.5	3.9	2.6	2.2	2.4	1.9	1.8	2.2
Japan	3.6	3.9	5.7	4.7	3.8	4.2	4.4	5.6	4.5
Rest of OECD	3.6	2.9	3.8	2.9	3.0	3.0	2.9	3.0	3.0
OECD total	3.1	2.5	4.1	3.0	2.6	2.9	2.8	3.0	2.9
Latin America	4.9	1.8	0.7	2.0	3.5	4.0	5.0	6.0	4.1
Middle East/Maghreb	5.7	0.7	1.5	6.0	5.0	10.0	9.7	11.2	8.3
African LDCs	3.0	0.4	3.0	4.0	5.0	5.0	5.0	5.0	4.8
4 Asian NICs	9.1	7.4	9.4	7.5	6.1	6.2	7.3	8.1	6.6
Rest of Asia, Oceania	5.3	7.0	9.2	5.8	5.0	5.0	6.0	7.0	5.8
USSR, Eastern bloc	2.9	1.5	1.1	1.3	1.5	1.7	1.9	2.2	1.7
World	3.6	2.5	4.2	3.2	3.1	3.5	3.6	3.9	3.5

Growth in GDP   Croissance du PIB   Wachstum des BIP



Unemployment Rate   Taux de chômage   Arbeitslosenquoten

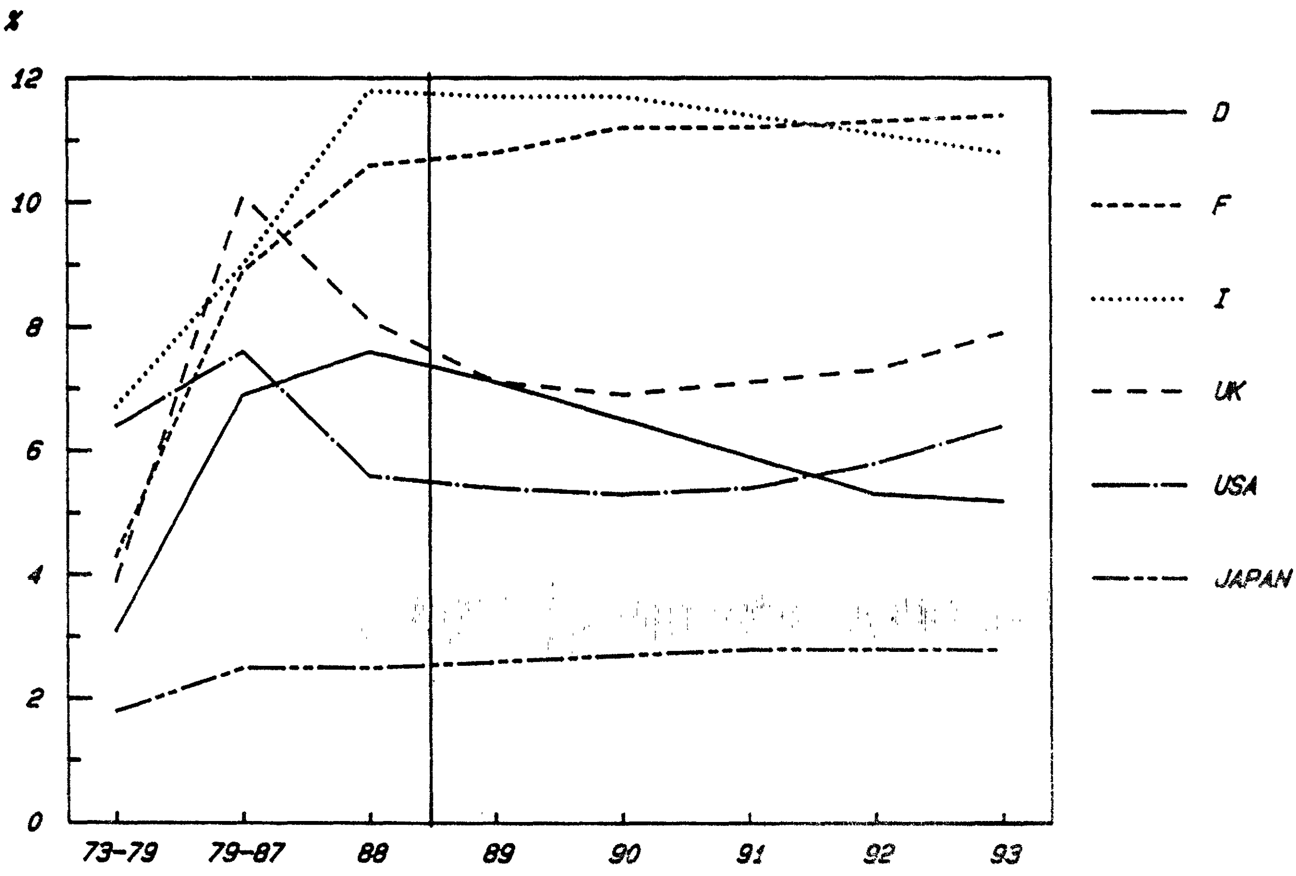


Table 2

Major industrialized countries: most significant results

Rate of inflation (consumer prices)	73-79	79-87	88	89	90	91	92	93	Average 88-93
Germany	4.6	3.0	1.7	2.7	1.6	1.2	1.0	1.1	1.5
France	11.0	8.3	2.8	3.9	3.0	3.1	3.0	2.6	3.1
Italy	17.1	13.0	5.5	6.6	5.8	6.1	6.6	7.1	6.4
United Kingdom	15.7	7.4	5.2	6.5	6.4	5.7	4.2	2.8	5.1
United States	7.8	5.4	4.1	4.7	4.9	5.2	5.4	5.4	5.1
Japan	9.4	2.6	1.1	1.9	2.1	1.9	2.0	1.5	1.9
Employment (variation in %)	**73-79**	**79-87**	**88**	**89**	**90**	**91**	**92**	**93**	**Average 88-93**
Germany	- 0.4	- 0	0.5	0.9	0.8	0.5	0.5	0.4	0.6
France	0.5	- 0.2	0.8	0.7	0.5	0.6	0.6	0.5	0.6
Italy	0.8	0.2	0.8	0.5	0.5	0.6	0.6	0.6	0.6
United Kingdom	0.5	- 0.2	2.4	1.7	0.8	0.3	0	- 0.4	0.5
United States	2.5	1.6	3.3	1.9	1.4	1.1	0.6	0.3	1.1
Japan	0.8	0.9	1.8	1.1	1	0.7	0.8	0.9	0.7
Unemployment rate (%)	**73-79**	**80-87**	**88**	**89**	**90**	**91**	**92**	**93**	**Average 88-93**
Germany	3.1	6.9	7.6	7.1	6.5	5.9	5.3	5.2	6.3
France	4.3	8.9	10.6	10.8	11.2	11.2	11.3	11.4	11.1
Italy	6.7	9.0	11.8	11.7	11.7	11.4	11.1	10.8	11.4
United Kingdom	3.9	10.1	8.1	7.1	6.9	7.1	7.3	7.9	7.5
United States	6.4	7.6	5.6	5.4	5.3	5.4	5.8	6.4	5.7
Japan	1.8	2.5	2.5	2.6	2.7	2.8	2.8	2.8	2.7
General government balances (% of GDP)	**73-79**	**80-87**	**88**	**89**	**90**	**91**	**92**	**93**	**Average 88-93**
Germany	- 2.4	- 2.2	- 2.0	- 0.8	- 2.0	- 2.2	- 2.2	- 2.1	-
France	- 0.9	- 2.3	- 1.5	- 1.4	- 1.7	- 1.5	- 1.2	- 1.0	-
Italy	- 9.0	-12.0	-10.8	-10.7	-10.3	- 9.9	-10.0	-10.2	-
United Kingdom	- 3.9	- 2.8	0.7	1.4	1.6	0.5	- 0.6	- 0.9	-
United States	- 0.9	- 2.8	- 1.8	- 2.0	- 1.5	- 1.0	- 0.5	- 0.5	-
Japan	- 3.2	- 2.2	0.8	0.6	1.0	1.3	1.9	2.7	-
External balance (% of GDP)	**73-79**	**80-87**	**88**	**89**	**90**	**91**	**92**	**93**	**Average 88-93**
Germany	0.9	1.4	3.9	4.0	4.2	4.2	3.9	3.7	-
France	0.2	- 0.5	- 0.5	- 0.5	- 0.4	- 0.5	- 0.3	- 0.4	-
Italy	0.2	- 1.2	- 0.5	- 0.5	- 0.4	0	0.2	0.3	-
United Kingdom	- 0.8	0.7	- 2.3	- 2.2	- 1.6	- 1.5	- 1.9	- 2.3	-
United States	0.2	- 1.9	- 2.9	- 2.4	- 2.5	- 3.0	- 3.0	- 3.2	-
Japan	0.3	2.2	2.8	2.5	2.5	2.8	2.6	2.6	-

Table 3

Monetary variables and basic commodities

Exchange rates	73-79	80-87	88	89	90	91	92	93	Average 88-93
Dollar/mark	2.34	2.69	1.76	1.85	1.75	1.60	1.55	1.50	-
Dollar/100 yen	2.65	2.46	1.28	1.30	1.20	1.05	1.00	0.95	-
Mark/franc	1.98	3.30	3.39	3.39	3.39	3.65	3.65	3.65	-
Mark/100 lira	3.31	6.95	7.39	7.51	7.49	8.01	8.01	8.01	-
Mark/pound	0.21	0.30	0.31	0.32	0.34	0.37	0.37	0.37	-
Short-term interest rates	**73-79**	**80-87**	**88**	**89**	**90**	**91**	**92**	**93**	**Average 88-93**
Germany	-	-	4.0	5.8	5.5	5.0	4.5	4.0	-
France	-	-	7.5	8.5	8.0	7.0	6.0	6.0	-
Italy	-	-	11.3	12.0	11.5	10.5	10.0	10.0	-
United Kingdom	-	-	10.3	12.8	11.0	9.5	9.5	9.0	-
United States	-	-	7.6	9.9	9.5	8.5	8.5	8.5	-
Japan	-	-	3.6	4.3	4.0	3.5	3.5	3.5	-
Price of basic commodities	**73-79**	**79-87**	**88**	**89**	**90**	**91**	**92**	**93**	**Average 88-93**
Oil (Brent) $/barrel	11.0	26.6	15.0	17.5	17.5	19.0	22.0	25.0	16.4
real growth rate*	22.8	- 3.6	-25.3	9.0	- 3.5	4.6	9.7	8.7	5.6
Industrial raw materials in $:									
nominal growth rate	8.6	0	26.4	6.3	-11.6	- 2.2	11.9	-	0.6
real growth rate*	- 3.0	- 3.0	20.5	5.4	-17.2	- 8.5	2.0	- 4.4	-4.9
Agri-foodstuffs:									
nominal growth rate	4.9	- 3.8	22.9	27.1	10.0	-	- 0.8	-	6.8
real growth rate*	- 6.3	- 6.6	17.2	26.0	3.0	- 6.4	- 6.0	- 4.4	1.8

* Price in dollars deflated by the price of manufactured products exported by the OECD.

2. THE FORECAST IN BRIEF

1988 was a particularly successful year throughout the industrialized world: growth was substantial, inflation rose only slightly and current payment imbalances were reduced. Is the improvement only temporary or does it mark the beginning of a new period of growth? This question is central to any forecast of the medium-term development of the world economy.

Before the surprising and welcome changes of last year, it in fact seemed certain that world growth would continue along the path embarked upon during the years following the oil price shocks, and this mediocre performance indeed seemed threatened in its turn by the exceptionally large balance of payment imbalances between the industrialized countries. The developments over the last few quarters call for a re-examination of the medium-term prospects. They have shown that expansion is possible, and can occur without warning, and suggest that we should undertake a review of the possible factors standing in its way. This projection is based on such an approach.

The results may seen surprisingly pessimistic: after slowing down during 1989-90, the rate of growth in the OECD countries will rise to approximately 3% per year by 1993, which is significantly lower than the 1988 performance (4.1%). Growth will be unevenly distributed among the United States (2.2% per annum during 1988-93), the EC (2.7%) and Japan (4.5%). The trend will, however, be less disappointing for the developing countries in Latin America and Africa, which will gradually get back on the road to growth, while Asia as a whole will experience particularly buoyant growth. Inflation rates will vary greatly: low in Japan, Germany and France (1.5%, 1.1% and 2.6% respectively at the end of the forecast period) but appreciably higher in the United States (5.4%). Despite a nominal depreciation in the dollar and the slowdown in American growth, the imbalances will persist; the United States current payment deficit will reach 3.2% of GDP by the end of the period, while Japan and Germany will maintain their surpluses. The differences within Europe will become more accentuated as unemployment continues to increase in France, remains stable in Italy, falls steadily to 5.2% by the end of the period in Germany and remains well below the 1987 level in the United Kingdom.

This gloomy outlook is not the result of an initially pessimistic assessment of growth factors nor of some inevitable progression which will not permit continued expansion. It is rather imposed by the various constraints, whether objective or chosen, which limit the free scope of the major industrialized countries and by the imbalances carried over from the beginning of the 1980s.

3. GROWTH AND INFLATION IN THE WORLD ECONOMY

3.1. Introduction

The determination of the economic authorities to curb inflation is, in the short term, the principal obstacle to continued growth. While the average rise in the rate of price increases was slight in 1988, the first months of 1989 have seen renewed pressure on prices in almost all countries. This general acceleration is the result of both universal factors and factors specific to certain countries. The most important among the former is growing pressure on the markets in goods; rates of utilization of industrial production capacity everywhere are reaching their highest levels ever. The combined effects of an explosion in agricultural prices, a rise in the price of industrial raw materials and an increase in oil prices are fuelling inflation on the commodities market. The factors of the second type fall into two very different categories, one structural and the other conditioned by short-term economic trends: firstly, renewed pressure on the labour market in the United States and the United Kingdom and, secondly, the increase in indirect taxation in Germany and Japan.

Monetary policies reacted promptly to this pressure in the summer of 1988 with increases in short-term interest rates. The desired slowdown is already well under way in the United Kingdom and should make itself felt in the United States over the next few months. In continental Europe, where the restraining measures have been less severe, it is likely to be more gradual. It should nevertheless occur, and the projection shows a general decline in the growth rate in the industrialized countries in 1989 and 1990 (Table 1).

Will this slowdown be enough to curb the inflationary pressure? There is reason to believe that it will have the desired effect on the prices of industrial raw materials, which tend to mirror the trend in demand. The price of oil, which has recently undergone an increase primarily because of short-term economic factors (exceptional consumption and reduced supply in the OECD countries), should also stabilize in real terms before progressing slightly at the beginning of the next decade. On the other hand, at the beginning of the period in question there will still be inflationary pressure on prices of agricultural products, particularly those produced in temperate zones, because of two poor harvests in succession. Overall, however, it would seem that between now and the middle of the next decade it will be possible to eliminate any risk of serious pressure on the commodities markets and, in particular, the risk of a third oil crisis.

3.2. United States

The outlook is less certain as regards the domestic causes of inflation in the major industrialized countries. In the United States, the level of unemployment in 1988 was 5.4%, which was close to the level generally regarded as representing full employment. Continued expansion at the same rate as in the last few years would undoubtedly lead to renewed wage inflation, while the rate of price inflation is already 5% per annum. The Federal Reserve has thus been obliged to impose a rise in interest rates in order to curb growth. However, one consequence of this restrictive monetary policy is the rise in the value of the dollar, which jeopardizes the external adjustment. This is why some budgetary correction has long been expected. It is assumed that the limited provisions already approved or adopted for 1990 and subsequent years will be supplemented, during the 1991 and 1992 financial years, by new measures which will reduce the entire public sector deficit from 1.8% of GDP in 1988 to 0.5% in 1993. The curbing of domestic demand will be sufficient to bring unemployment above 6%, despite a relaxation of monetary policy made possible by the knock-on effect of successive budgets.

Adjustment of the American budget is likely to be accompanied by depreciation in the dollar for two reasons. Firstly, it would allow the American monetary authorities to give higher priority to reducing the external deficit without having to fear that growth in foreign demand and rising import prices will lead to inflationary overheating. Secondly, the consequent fall in short and long-term interest rates would favour downward adjustment of the dollar on exchange markets. After remaining strong in 1989, the dollar could thus resume a downward trend in 1990, falling still further in 1991. Despite the easing of the situation on the market in goods and the labour market, the fall in the exchange rate and the rise in oil prices would then cause American inflation to level off at around 5.4% per year in 1992 - 1993.

3.3. Japan

Japan is not faced with the same dilemmas as the United States. Although the level of unemployment is still low by comparison with the other industrialized countries, it is not likely to provoke an inflationary surge. The most likely outlook for the medium-term is that the Japanese economy will maintain the commendable control of prices and salaries which has been in operation since the end of the 1970s. The main question concerns the impact of the measures set in motion in recent years to open up the Japanese market and make domestic demand the target for growth, both avowed objectives of medium-term economic policy. The prediction is that the opening up of the Japanese market to imports will continue during the years 1988-1993, although at a slower rate than during the period 1985-1988. Despite this major transformation, which will bring about a profound change in the structure of imports, it is by no means certain that the retargeting of growth towards domestic demand will continue. Firstly, there is likely to be a high level of demand for Japanese exports from the countries of Asia and, secondly, Japanese companies, which had quickly adjusted to the rise in the yen and which enjoy favourable production costs, should be in a position to maintain, or even extend slightly, their share of the market. Instead of growth centred on domestic demand, the likely scenario is therefore a situation of balanced expansion in which the contribution of the foreign balance will be almost zero.

3.4. The European Community

Without the lead given by America and with ever greater competition from Japan and the Asian NICs on foreign markets, Europe will have to look to its own devices to achieve expansion. But while it is not subject as a whole to any balance of payments constraints or, with the exception of the United Kingdom, any serious threat of inflation, the interplay of constraints on individual European countries may stand in the way of continued growth. Germany, which exerts crucial influence on European market conditions in its role as collective guarantor of price stability, no longer needs rapid growth in order to make its way towards full employment in the medium term. It could thus get by with an annual growth rate of around 2.5% during the period 1989-1993. After several years of expansion, the United Kingdom is again faced with its macro-economic dilemma of the 1970s, and after combating inflation at the expense of the foreign balance, the government is likely to have to combat the external deficit at the expense of growth. France's objectives are to maintain the foreign balance, reduce the public sector deficit and bring inflation into line with the best European performance, and it has little room for manoeuvre all the time the foreign trade results are not strong. Italy will not be able to achieve a higher rate of growth than its partners unless it is prepared to accept an above-average level of inflation and a particularly high public sector debt. In all, there is little reason to suppose that economic policies will provide any motivation for European growth in the medium-term and it is more likely that the spontaneous effects of interdependence will result in a level of performance similar to that at the beginning of the 1980s.

3.5. The developing countries and the East European countries

While the above analyses indicate continuity in relation to trends prior to 1988, the same is not true for regions outside the OECD. There are a number of reasons for supposing that the developing countries will experience faster growth in the coming years than in the first half of the decade. In Asia, the rate of increase of GDP should remain high after a temporary slowdown. The NICs are able to take advantage of the fall in the dollar to increase their share of the market, and the continued appreciation of the Korean won and the Taiwanese dollar against the US dollar do not seem likely to threaten the export performances of the 'four dragons'. The other countries in the region, particularly China and India, should also experience rapid growth, with a cyclical low point of around 5% per year. Asia as a whole will thus be caught up in a dynamic process of growth and interlinked trade. One new development is that Latin America and Africa may also see an increase in real income as a result of improvement in their terms of trade and measures to reduce the foreign debt burden. Lastly, the performance of the economies of Eastern Europe and the Soviet Union will remain mediocre on average. Perestroika is not expected to produce immediate results.

4. THE FUTURE OF INTERNATIONAL PAYMENT IMBALANCES

The current account imbalances between the major industrialized countries are generally regarded as a threat to world growth. Without any severe restraint imposing foreign balance equilibrium on all countries, it would seem dangerous to accept for the medium-term the maintenance of surpluses or deficits which would lead to the continuing growth, as a proportion of GDP, of excessively positive or excessively negative net foreign positions.

This forecast takes account of the two factors which might be expected to reduce the imbalances - a fall in the dollar and a slowdown in American growth. The surpluses/deficits will, however, persist. At the end of the forecast period, the United States has a deficit of 220 000 million dollars, Japan a surplus of 168 000 million and Germany a surplus of 56 000 million (Table 4). As a proportion of each country's GDP, the surplus or deficit will remain near the 1988 level in the case of the United States and Japan and fall slightly in the case of Germany.

Table 4
Current account balances
(thousand million dollars)

	1982	1987	1988	1993
United States	- 8.9	-154.4	-135.5	-218.5
Japan	7.0	87.9	79.2	167.6
Germany	5.1	45.2	48.6	56.4
All OECD	- 32.8	- 46.1	- 55.7	-117.6
4 Asian NICs	- 2.8	29.9	30.2	108.0
Middle East/Maghreb	8.7	- 0.5	- 27.2	- 8.7
Latin America	- 42.6	- 14.5	- 9.5	- 27.5
World	- 62.0	- 38.1	- 77.6	- 96.5

There are two reasons for this stability. The first is the burden of the United States' foreign debt and, conversely, the investment income accruing from the accumulation of foreign assets by Japan and Germany.
The United States' capital balance, which was still in surplus in 1988 is thus likely to deteriorate by 1 percentage point of GDP during the period covered by this forecast.

The second reason relates to the limited effects of movements in nominal exchange rates in the context of pronounced inflation differentials. Between 1988 and 1993, the yen will appreciate by 35% in relation to the dollar, its exchange rate falling from 128 to 95 yen per dollar. Over the same period, however, the inflation differential measured by the GDP price index will reach 20%. Taking account of the high productivity gains in the Japanese manufacturing industry and the efforts made by producers with regard to profit margins in order to retain their share of the market, the export prices in dollars of Japanese industrial products will increase at a slower rate than American prices. The depreciation of the dollar, which permitted a spectacular recovery in American exports in 1987-88, has ceased to be effective as a weapon. If applied suddenly it would allow for a recovery in foreign trade, but the combined effects of an increase in exports and a rise, however small, in import prices would be enough to bring the American inflation rate up to a level which undermines the credibility of the anti-inflation policy. There is therefore little chance of this happening during the period under review. A progressive slide in the dollar, on the other hand, will simply offset the effects of price increases, assist Japanese disinflation and fuel American inflation.

It is thus clear that the substantial movements in nominal exchange rates forecast by this projection will not be sufficient to bring about any major shift in balance. The United States' share of export markets in manufactured products (measured by the ratio of exports to export demand) will continue to grow in volume in 1989 but will decline thereafter, while Japan will regain some of the ground lost since 1984 and the four Asian NICs will continue to progress. The value of their surplus will increase constantly, reaching half the level of the Japanese surplus by the end of the period.

5. THE SEARCH FOR CONVERGENCE IN EUROPE

The construction of the single European market and the often expressed desire to implement a common macroeconomic policy in Europe, either through the coordination of budgetary policies or via the slow path towards a common currency, mean that particular attention must be given to the convergence of macroeconomic performances in this region. As far as Europe is concerned, this period will probably be influenced by the prospect of 1992, both because of the economic harmonization measures which it will require and on account of the changes which it may produce in the behaviour of economic actors. We have been fairly cautious here; apart from tax measures which have already been announced or are certainly to be expected, we have taken the view that the uncertainties regarding tax harmonization are too great to be included here.

In establishing our working hypothesis, we have taken account of views expressed in the FRG, according to which the current exchange rate policy is too free of constraints and is partly responsible for the present serge in inflation. We have thus assumed that, when the dollar falls sharply at the beginning of 1991, the German mark and associated currencies will appreciate by 7% against the franc and the lira. Coinciding with the fall in the dollar, this shift in parity will have little impact on inflation in these countries. Because of the British foreign debt, the pound sterling, which is currently supported by high interest rates, is likely to fall sharply during the period under consideration. We have estimated that this will occur at the end of 1990, after which, having levelled off at 2.8 marks, it will prepare to enter the EMS.

In the short term, interest rates will remain high, directed towards combating inflation in the United Kingdom and the FRG and constrained in France and Italy by the need to maintain the parity against the mark. After 1991, however, the realignment and subsequent convergence of monetary policies will allow real interest rates to be more closely harmonized at a relatively low level: 2.9% in the FRG as compared with 3.3% at present, 3.4% in France, as compared with 4.6%, 5.3% in the UK as compared with 7% and 2.8% in Italy as compared with 5.4%.

There is little evidence of convergence when it comes to the public sector deficits. While France will achieve its goal of progressive reduction of the deficit, the FRG will retain a deficit of around 2% of GDP as a result of the tax reform and low growth. The United Kingdom will retain a surplus for a long time to come, while Italy will have a high deficit of over 10% of GDP (in 1970 lire). In the European countries as a whole, policy will be aimed primarily at curbing public spending, with, where possible, tax reduction programmes, particularly in the United Kingdom, France and the FRG. Budgetary policy is thus not likely to support growth.

The inflationary surge of 1989 is not likely to last. Europe will benefit after 1990 from the fall in the dollar, which will partly offset the effects of the rise in oil prices, and will become a region of low inflation. At the end of the period under consideration, inflation rates will range from 1.1% in the FRG to 2.8% in the United Kingdom, with France, at 2.6%, approaching the German model. Italy will, however, retain a higher rate (7% in 1993).

But Europe will also be a region of moderate growth, the average figures for the period as a whole being 2.5% for the FRG, France and the United Kingdom and 3.3% for Italy. In the EC as a whole growth will fall off between 1988 (3.6%) and 1990 (2.4%) as a result of various national anti-inflation policies and the slowdown in the world economy, before settling at a plateau of 2.6% between 1991 and 1993. Domestic demand will undoubtedly grow more quickly (3% in the FRG for example), but the external balance will make a negative contribution to growth; exports will rise more rapidly than GDP but less rapidly than imports. European countries will tend to lose some of their share of export markets and suffer from excessive import penetration. This is the result of competition from Japan and the 'four dragons'.

The rate of increase in per capita productivity will remain fairly high in Italy (2.7%) but will be more mediocre in the other three major countries (approximately 1.7% per year). By comparison, real wages will increase only slightly in France (1%) and the FRG (1.7%) and more in Italy (2.6%) and the United Kingdom (3.7%). There is thus an inverse imbalance between France, where the situation of industry is continuing to improve, and the United Kingdom, where it is deteriorating.

Employment is progressing at a fairly uniform rate, around 0.6% per annum, but, because of pronounced differences in the growth of the labour force (0.1% in the FRG, 0.4% in Italy, 0.6% in the United Kingdom and 0.7% in France), there are marked disparities in the development of unemployment rates. The FRG, which is also pursuing an active policy of reducing hours of work, will bring its unemployment rate down to 5% at the end of the period, which represents almost full employment. In the United Kingdom, the present high rate of growth will initially bring unemployment below 7% but the curbing of growth will bring it up again at the end of the period. In Italy there will be a continuous but slow reduction in the initially high level of unemployment, and in France it will start to rise slowly. Unemployment will thus become a Franco-Italian problem. On the other hand, the pressure on production capacity, which is particularly acute at the moment, will ease off in all the European countries as a result of the current investment efforts and the slowdown of industrial growth.

While Italy and France will see little change in their foreign deficit, the United Kingdom will lose its energy surplus and its situation will deteriorate while the FRG will maintain a relatively stable surplus in relation to its GDP.

This feeble growth in Europe might lead one to suppose that global re-expansion would be welcome. However, such re-expansion is not wanted in the FRG, which has an external surplus and prefers to deal with unemployment by reducing hours of work; it is scarcely possible in France, which is hampered by the external constraint and does not wish to devaluate, or to produce adverse effects on its public sector balance, or to lose any competitive advantage by allowing wage increases; it is already underway in the United Kingdom, thanks to a sharp fall in the exchange rate and the drop in the savings ratio, but it is on the point of reverting because of the unacceptable effects on inflation and the foreign deficit; and, lastly, it is limited in Italy by the constraints of the public sector and foreign balances.

Examination of each country in turn reveals the difficulties standing in the way of the necessary coordination of economic policies. There is in all cases a severe constraint which limits growth. Europe does not (yet?) enjoy the advantages of synergy brought about by transfers of capital and labour.

6. THE UNCERTAINTIES OF TOMORROW

The scenario described in this forecast is consistent within itself. However, some mention must be made of possible dangers and of possible hopes for a more encouraging future.

Attention has been drawn in various places to the possible risks of loss of control. The main dangers are those of an inflationary surge in the United States and continuing current account imbalances. If the American economy were to go off course in the short or medium term, there would probably be a reaction from the Federal Reserve, as pointed out above, and a recession could result. This is a recognized problem and no further explanation is necessary. However, less is known about the dangers represented by a continuing situation of international imbalances. No one can define the upper limit for the US foreign debt - recent experience has shown that limits which were previously considered absolute have been transgressed without any consequent damage. Our projection does not lead up, at the end of the five year period, to any stabilization of foreign assets/liabilities as a proportion of each country's GDP. Reactions to a continuing foreign deficit may come from both the debtor and the creditor and there are reasons to fear that failure to reduce the United States trade deficit may ultimately push trade disagreements too far.

There is also the possibility that favourable surprises may occur, particularly for Europe. The approach adopted here concentrates on macro-economic chains of events and the interplay of the policies of the different countries. We do not consider that there will be any major changes in this area between now and 1993. Monetary union is still a relatively distant prospect and its institutional make-up is uncertain. Similarly, there is as yet no indication as to whether greater coordination of macro-economic policies in Europe is likely to mean expansion or restraint. During the coming years, the prospect of greater competition within the Single Market could certainly stimulate investment and rationalization and this new boost to supply could result in better European performance on foreign markets. However, given the information available at present, these are mere hopes rather than objective data which may be included in a forecast.

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