Approved For Release 2008/06/20 : CIA-RDP85-01156R000100010026-8

THE DIRECTOR OF CENTRAL INTELLIGENCE

WASHINGTON, D.C. 20505

DDI #184-82
11 January 1982

National Intelligence Council

MEMORANDUM FOR: Director of Central Intelligence

VIA: Chairman, National Intelligence Council

FROM: Maurice C. Ernst
National Intelligence Officer for Economics

SUBJECT: Perspectives for 1982: The Global Economy

1. The year 1982 will see the trough of and early recovery from the current economic recession in the US and Western Europe. Inflation will slow markedly, especially in the United States, but unemployment will remain very high. The major trade and payments problems will involve a growing US deficit, a massive Japanese surplus, and severe balance of payments constraints in many less developed countries. Commodity markets will be generally weak, and oil prices should fall, at least in real terms.

2. The timing of the trough of the US recession and the speed of the subsequent recovery is a major uncertainty in the world economic picture. Experts differ widely on these questions: I am an optimist. US economic performance is unusually important to the world economy this year, because there is little most other countries can do to expand their purchases. Specifically, most LDCs and Communist countries face weak markets for their primary exports and a rising debt service burden while the decline in demand for oil will force many oil exporters to slow the growth of their imports.

3. Another major uncertainty concerns the price of oil. The chances are that the present nominal price of crude oil will be held stable throughout the year, and therefore will decline in real terms. But should Iran and Iraq manage to end their war and then substantially increase their oil production, Saudi Arabia, even with some cooperation from other OPEC countries, would be hard put to cut production enough to balance the market. Should the nominal price of oil decline, many oil exporting countries would soon be in serious financial trouble.

4. 1982 will be a difficult year for Western Europe. Most experts predict very slow economic growth, but in any case a further increase in unemployment is likely. The European unemployment problem is already

All portions of this document are classified SECRET

SECRET

Deriv Cl By Signer
Revw on 11 Jan 88

Approved For Release 2008/06/20 : CIA-RDP85-01156R000100010026-8

Approved For Release 2008/06/20 : CIA-RDP85-01156R000100010026-8

severe; political and institutional, as well as economic factors make it almost intractible. Western Europe is having great difficulty adjusting to rapid changes in the structure of costs and demand and to mushrooming competition from Japan and the newly industrializing LDCs in a period of reduced economic growth possibilities. Rising labor costs and inflexibility in labor markets are discouraging business from adding to employment and are causing investment to be directed to saving labor rather than to building new capacity. Tax disincentives, income-maintenance at high levels, and in many countries pervasive government controls are important sources of inflexibility.

5. Dissatisfaction with slow growth and high unemployment is taking divergent political forms: A right-wing reaction seeks a solution through reduced government controls and generally enhanced economic flexibility; a left-wing reaction, such as in France, seeks increased economic growth through greater government involvement. This growing bifurcation of political trends will create increasing strains within the European Community and with the United States. At the same time, both right-wing and left-wing forces in Europe will look to expanded exports outside the community to help relieve their economic problems while becoming more inclined toward protectionist policies.

6. Japan is certain to run a massive trade and hard currency surplus in 1982. This will be so even though export growth slows substantially and domestic economic expansion continues at a fairly high rate based on rising domestic demand. The Japanese surplus will create severe political reactions in the US and especially Western Europe. Neither the politically feasible measures Japan may take in response to these pressures, nor the likely appreciation of the yen, will have much effect on the trade surplus for 1982, although they could in 1983.

7. Many less developed countries will experience serious economic trouble in 1982. In Central America the disruptive impact of insurgencies and the depressive effect of weak commodity markets will continue or will worsen in 1982. In much of Africa, declines in earnings from primary exports, due partly to low prices, have uncovered a legacy of decades of economic mismanagement. A growing number of countries in both areas will have to reschedule their foreign debt obligations, but most countries will meet their obligations by cutting the imports which have supported the small but politically crucial urban populations. Among the large, newly industrializing LDCs, Brazil will have to keep the brakes on the economy to handle its enormous debt service burden, Mexico will have to greatly slow its economic growth to adapt to lower real oil prices and pay for past policy errors, and South Korea will have difficulty sustaining its renewed dynamism in the face of weak foreign markets and protectionism.

8. These economic difficulties abroad will complicate achievement of US policy objectives. Many foreign nations believe they have been paying a price for US policies, especially the resulting high interest rates,

Approved For Release 2008/06/20 : CIA-RDP85-01156R000100010026-8

Approved For Release 2008/06/20 : CIA-RDP85-01156R000100010026-8

designed to achieve economic renewal in the United States. Whether or not this will continue to be a major issue, and how foreign nations will react will depend in part on US economic performance, especially in the second half of the year.

9. In any event, protectionist forces in Europe are bound to become even stronger, because of high unemployment, the increased competition from Japan and newly industrializing LDCs, and attempts by some countries, notably France, to expand their economy through pump-priming and greater government controls. European protectionism will be particularly directed at the Far Eastern countries; in general it will make a successful initiation of the Multilateral Trade Negotiations exceedingly difficult. Protectionism will take the form mainly of ad hoc import quotas and increasingly elaborate informal government controls on trade and investment.

10. Pursuance of the US objective of encouraging private investment in LDCs is unlikely to get very far in a year of weak commodity markets, protectionist reactions to LDC exports of manufactures and severe balance of payments problems. Although banks will continue to lend on a large scale to LDCs, if only in some cases to protect their exposure, they are unlikely to expand their lending to make up for any reduction in other sources of funds or to cover any increase in current account deficits.

Maurice C. Ernst

Approved For Release 2008/06/20 : CIA-RDP85-01156R000100010026-8

Approved For Release 2008/06/20 : CIA-RDP85-01156R000100010026-8

DDI #184-82
11 January 1982

SUBJECT: Perspectives for 1982: The Global Economy

DCI/NIC/NIO/Econ:MErnst:bha(11 Jan 82) 25X1

Distribution:
Orig - Addressee
1 - DDCI
1 - O/DCI/ExDir
1 - ER
1 - C/NIC
1 - VC/NIC
1 - AC/NIC
1 - Each NIO
2 - NIO/Econ
1 - DI Registry

SECRET

Approved For Release 2008/06/20 : CIA-RDP85-01156R000100010026-8