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ROOM NO.	BUILDING		
3A930	Pentagon		

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World Financial Markets

Morgan Guaranty Trust Company of New York

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Lower oil prices and world recovery

Last month's agreement by OPEC — lowering its benchmark price by \$5 per barrel — was a delayed, but inevitable accommodation to long-gathering market forces. Following Britain's proposal for a North Sea selling price compatible with Nigeria's, it appears, as of the beginning of April, that the OPEC accord has a better-than-even chance of holding prices in the \$25-\$30 range.

For the world economy, the prospect of reasonably stable oil prices, and at a lower level than in 1981-82, is good news: first, inflation will be reduced, by as much as 1% in the industrial countries this year; second, the odds of a moderate economic recovery are enhanced, provided governments do not reinforce deflationary monetary policies as measured inflation lessens. The winter months brought encouraging signs of recovery and improved confidence in the United States, Canada, Germany, and the United Kingdom. Nonetheless, sizable risks remain, not the least that U.S. interest rates may fail to fall, or could rise further in real terms, jeopardizing the longer-term revival of investment so necessary for sustained recovery in the United States and the

world at large.

Resumed OECD growth and this year's lower interest rates come none too soon for the economic and financial well-being of developing countries. Oil-importing LDCs will receive the multiple benefits of lower oil import bills, reduced interest payments, and stronger export markets. Nonetheless, few can afford any easing-off in present adjustment efforts. Oil-exporting countries, facing reduced earnings, will experience intensified financial pressures for adjustment. OPEC and other oil-exporting LDCs are headed for a collective current account deficit this year exceeding \$50 billion, requiring correspondingly large "reverse recycling."

Oil prices

The fall in oil prices — from an effective OPEC average of just under \$33 per barrel in January to \$28.50 in late March — was the inevitable result of dramatic shifts in world oil demand and supply generated by the large price increases of 1979-80 and continuing adjustment to the first oil shock. Oil consumption dropped 6.5 million bpd, or over 12%, from 1979 through 1982. Oil inventories, built up rapidly in 1979-80, have been drawn down steadily

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since mid-1981 (see Chart 1). Together, the consumption decline and inventory shift reduced demand on the producing nations by 9.5 million bpd between 1979 and 1982, a drop that was absorbed entirely by OPEC (see Tables 1 and 2).

Key features of the recent OPEC agreement are national production quotas and an overall OPEC production ceiling of 17.5 million bpd for the rest of this year. The 13 nations are to maintain quality and location price differentials established last year. It is their ability to adhere to these decisions, as well as the non-OPEC producers' willingness to avoid conflicting actions and the oil buyers' expectations about the oil exporters' resolve, that will determine to a large extent the course of oil prices.

The next few months are crucial because there is still room for further inventory reduction — particularly if oil companies believe the chances of the OPEC agreement holding are low. More fundamentally, oil consumption will be undergoing its normal seasonal fall at a time when weak economic activity in the industrial countries will be adding

further downward pressure. In the short term, oil consumption will respond little to the recent oil price declines.

Indeed, for the whole of 1983 world oil consumption is likely to fall 1%-2%. The pace of decline will be greatest in the first half, slow progressively during the latter part of the year, and may eventually turn into an increase, especially in 1984, given the expected pickup in world economic growth. But the modest dimensions of price declines so far are unlikely to restore the extravagant oil consumption of the past.

In real terms, oil prices remain high by the standards of the 1960s. Investments made during the 1970s in more efficient energy use and in oil substitution are not likely to be dismantled. In some cases, they may increase in step with other investment. Further improvements in energy efficiency are on the way in the United States, through legislated gasoline consumption standards for new automobiles. Moreover, the fall in oil prices provides a case for increasing taxes on oil consumption in many industrial countries and LDCs.

In the face of mounting financial pressures and weak oil demand, especially in the near term, several OPEC members could be tempted to offer hidden discounts. Non-OPEC members may formally cut prices further in order to boost sales. Unsettled price differentials could become the incentive, or pretext, for price shading. These actions, if widespread, could even precipitate a new round of declines in oil prices.

Opposing these forces is the OPEC accord reached after protracted negotiations in London last month. Even though the agreement is vulnerable to continuing inventory withdrawals in the near term, the greater unity among the members marks a significant change from the disarray of the past nine months.

Oil demand, supply, and inventories
quarterly data in millions of barrels per day

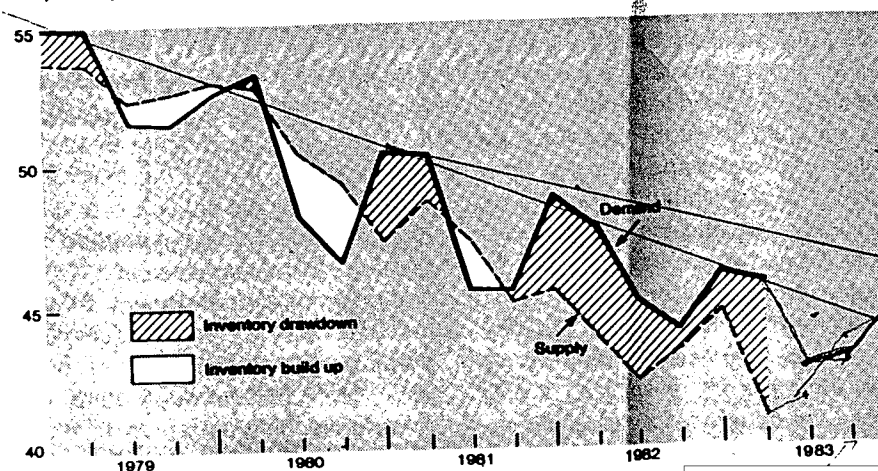


Table 1
World oil demand and supply¹
millions of barrels per day

	Change between 1979 & 1982		
	1982	1982	1983
Demand²	-9.4	43.8	43.8
<i>Oil consumption</i>	-6.5	45.7	44.8
<i>Industrial countries</i>	-7.2	34.5	33.8
<i>Developing countries³</i>	0.7	11.3	11.0
<i>Stock changes</i>	-2.8	-1.9	-1.0
Non-OPEC supplies	2.7	24.4	25.1
<i>Non-Communist production</i>	2.5	23.1	23.6
<i>Communist net exports</i>	0.2	1.3	1.5
OPEC production	-12.1	19.4	18.7
<i>Of which: crude oil</i>	-12.2	18.5	17.8

¹Including natural gas liquids.

²Excluding Communist countries.

³Including OPEC.

Table 2
Distribution of OPEC crude oil
production
production in millions of bpd
shares in percent

	Jan 1981	Jan 1982	Jan 1983
Total OPEC	24.6	20.8	16.7
<i>Saudi Arabia</i>	10.3	8.7	4.6
<i>% share</i>	42	42	27
<i>Other Gulf producers¹</i>	3.9	2.7	2.0
<i>% share</i>	16	13	13
<i>Rest of OPEC</i>	10.4	9.4	10.1
<i>% share</i>	42	45	60
Of which:			
<i>Nigeria</i>	9	9	5
<i>Venezuela</i>	9	10	13
<i>Libya</i>	7	4	7
<i>Iran</i>	5	5	16
<i>Iraq</i>	2	6	5
<i>Others²</i>	11	12	14

¹Kuwait, Qatar, and the UAE.

²Algeria, Ecuador, Gabon, and Indonesia.

OPEC also appears to have won the tacit cooperation of Mexico, the largest non-OPEC exporter, on both oil production and prices. Further, the new OPEC agreement on quotas is more substantive than last year's. By designating Saudi Arabia as the swing producer without a formal quota, and by allocating to Iraq and Kuwait quotas they are not likely to reach, the accord has a built-in downward flexibility of around 3 million bpd. That is, it effectively accommodates OPEC production as low as 14.5 million bpd — about the same as recent actual levels — even if all the other members were to reach their quota limits. Both the overall and individual production limits have been set as quarterly ceilings, with no carry-over allowed for any unused portion of the quotas. In addition, the OPEC committee appointed to monitor compliance with the agreement has been given somewhat greater powers. Finally, there is the prospect that by the fourth quarter of 1983 demand for OPEC oil may exceed the 17.5 million bpd ceiling. These factors, and the probability of an upturn in oil consumption in 1984, could well strengthen the members' resolve to adhere to the accord in the near term.

Given the uncertainties about the behavior of inventories and of OPEC members, no price projection can be asserted with confidence. In what follows, OPEC oil prices are assumed to average \$28 per barrel for 1983 as a whole. This level is more than \$1 below the annual average that would result if the present price structure were to survive intact and, thus, allows for price shading but no price collapse. An average price of \$28 represents a drop of more than 15% from the 1982 annual OPEC average of just over \$33. Allowing for inflation and a modestly weaker dollar, it implies a decline of 20% in real terms.

Industrial countries: policy response and economic outlook

Lower oil prices will shift about \$40 billion from oil-exporting to oil-importing countries, not counting trade volume adjustments. The reduction in income will be felt principally by OPEC, while most of the benefit — over \$30 billion — will accrue to the industrial countries and will be equivalent to about 0.4% of OECD GNP.

The reduction in oil prices has much the same effect on oil-importing countries as an excise tax cut. The first result is lower import costs. These should pass directly to a reduction of OECD inflation by up to 1% this year, allowing for related price adjustments on other energy supplies. The lower inflation, in turn, will provide a one-time boost in real incomes.

How far this gain will translate into a sustained increase in spending and real output hinges critically on the policy response of the industrial countries. Their role today is even more important than when oil prices were rising sharply. At that time oil exporters could be relied on to respond a significant part of their higher income; indeed, their absorptive capacity turned out substantially greater than expected. Today, by contrast, most oil exporters have been obliged to cut spending. Considerable weakening already is evident in industrial-country exports to OPEC and Mexico (see Table 3). OPEC import volume this year may be down some 10% from 1982. Moreover, given severe balance of payments constraints, oil-importing LDCs cannot boost spending and imports significantly.

Accordingly, the industrial countries must resist any temptation to tighten monetary policies. To do so would risk delaying world economic recovery and could impair international financial stability. In this con-

Table 3

**Industrial countries:¹
merchandise exports to OPEC
and Mexico**

	Value of exports, \$ billions, seasonally adjusted annual rates		Exports to OPEC & Mexico % change year ago
	To OPEC	To Mexico	
1980	94	21	33
1981	110	24	17
1982	106	17	-9
1981 QIV	115	25	17
1982 QI	117	20	9
QII	111	19	-6
QIII	99	16	-15
QIV	99	10	-22
1983 Jan-Feb (est)	95	8	-25

¹United States, Canada, Japan, Germany, France, United Kingdom, Italy, Belgium, Netherlands, Spain, Sweden, and Switzerland. These 12 countries supply three-quarters of OPEC and Mexico's total merchandise imports.

nection, any new upward surge of the dollar in exchange markets would be disruptive. Fear of renewed depreciation of their currencies limits the scope of foreign monetary authorities to reduce their own domestic interest rates, but without lower domestic interest rates, economic recovery abroad may not be sustained.

Wise response to the lower oil prices should not impede their stimulative effects nor hamper efforts to achieve a reduction of real interest rates. Lower oil prices do not, in themselves, warrant adjustment of targets for money supply growth in nominal terms. With unchanged targets, a given growth in nominal income implies higher growth of real output if general inflation lessens. As shown in Table 4, current monetary targets allow room for moderate economic recovery in the United States, Germany, and Japan, provided the authorities aim for the upper ends of their target ranges. This assumes, of course, that velocity does not fall as much as last year. That expectation will have to be monitored closely, lest present monetary targets prove ill-chosen.

The reduction of inflation and inflationary expectations should permit a reduction of nominal interest rates, contrary to the recent upward drift in U.S. rates. Whether interest

rates also fall in real terms rests in part on the outlook for government financing and on financial-market perceptions of prospective budget deficits. Since a portion of the income transfer to the industrial countries from the oil exporters will be saved, a given budget deficit can be financed at a lower interest rate. Increased taxes on energy consumption could contribute, at least marginally, to a narrowing of budget deficits where they are a genuine obstacle to reduction of interest rates.

Of course, the real income benefits of lower international oil prices should not be taxed away. The fundamental justification for higher energy consumption taxes is to sustain long-term conservation. Where budgetary considerations are not overriding, increased revenues from energy levies will allow reductions in other taxes. Further, to foster energy production and development, the United States and Canada need to review taxation of their energy industries, as Britain has done for North Sea producers in the March budget.

Given present policies in the major industrial countries, which have generated some reduction over the past year in nominal interest rates, the new stimulus imparted by oil price declines should promote a moderate economic recovery. The signs of economic revival among the seven major industrial economies are most evident in the United States, Germany, the United Kingdom, and Canada. The rebound is expected to be less strong than the typical experience following previous recessions in the postwar period: after declining 0.5% in 1982, overall real GNP in the seven major industrial countries is expected to advance about 2% in 1983 (see Table 5). Given productivity increases normally achieved during economic recovery, this output growth will not

Table 4

Monetary targets and income growth in 1983

% change per annum

	Target aggregate	Target rate of monetary growth ¹	Projected % change			Implied change in velocity	
			Real GNP	GNP deflator	Nominal GNP	1983	1982
United States	M1	8.8	2.6	4.4	7.0	-1.8	-2.4
	M2	9.0	2.6	4.4	7.0	-2.0	-3.4
Japan	M2+CD	7.5	3.2	1.6	4.9	-2.6	-4.1
Germany	Cent'l. Bank Money	6.5	0.9	3.6	4.5	-2.0	-1.6
France	M2	9.0	0.0	10.2	10.2	1.0	-0.3
United Kingdom	£M3	9.2	2.5	6.5	9.2	0.0	-3.8

¹Computed at upper end of target range: standardized to yield approximate calendar-year average growth rates.

Table 5
Real GNP/GDP
% changes

	1981	1982	1983
United States	1.9	-1.8	2.6
Canada	3.1	-4.8	1.0
Japan	3.8	3.0	3.2
France	0.3	1.5	0
Germany	-0.2	-1.2	0.9
United Kingdom	-2.4	1.2	2.5
Italy	-0.2	-0.3	0
weighted average (1981 GNP weights)	1.5	-0.5	2.0

dramatically reduce the high levels of unemployment in these economies. Nor is there any chance that recovery will be investment-led, as had been hoped two years ago prior to the long slide in capacity utilization. Pickup in business investment will, at best, be delayed till the second half of 1983 and is even then contingent on robust expansion of consumer demand.

In the United States, the upswing in economic activity in early 1983 can be traced mainly to a slowing of the sharp inventory decumulation that took place late last year and to the remarkable rebound in residential construction. Real GNP is expected to grow 2.5% or more in 1983 on a full-year comparison, which translates into a little more than 4% growth from the end of 1982 through the end of 1983. On the whole, recent statistics point to continued recovery: industrial production has been rising since December, while housing starts attained a 1.75 million annual rate in February, more than twice their 0.84-million low in November 1981. The index of leading indicators jumped 3.5% in January and climbed a further 1.4% in February. But if the economic rebound is to bring enduring advance, consumer demand must strengthen. In volume terms, retail sales held flat during this past winter and the latest reading on factory orders showed a decline in February. More promising for the future, however, is the recent stability of unemployment and prospective gains in real disposable incomes.

Economic growth in the United States is a prerequisite for sustained economic advance in Canada. Currently, the Canadian economy is showing distinct signs of turnaround. Industrial production rose 5% in January, following little change in the previous two months. Housing starts in early 1983 were

more than 50% above the low levels reached last summer. Significant also is an apparent slowdown in inventory destocking. Increased exports to the United States and, in time, less inhibited consumer spending are further important forces that should underwrite overall expansion: the fall in real consumer spending accounted for 1.5 percentage points of the 5.7% drop in real GNP over the last four quarters.

Few European countries can hope for speedy recovery. Germany may be one exception. German factory orders rose 6.7% in January after increasing 4% in December and 6.4% in November. Industrial production rose 1% in January. For the year, 1% growth in real GNP looks achievable, or 4% from the fourth quarter of 1982 to the fourth quarter of 1983. Rising consumption and investment spending are the essential engines of growth. The main stimulus to consumption will come from higher real incomes and from lower saving rates as consumer confidence is restored. Real consumer spending fell 2.5% from the end of 1981 to the end of 1982, outpacing the 2% decline in real GNP. However, the saving rate fell from 15.6% in the first quarter of 1982 to 14% in the last quarter, leaving it little above the 13.5% rate of the expansion years in the late seventies. Further decline or stability of the saving rate will speed the economic recovery.

A second key to German economic recovery is an upturn in investment promoted by lower interest rates and a revival of consumer spending. An important step is the recent one-percentage-point cut in German official rates, which will help spur construction activity. While construction orders began to increase in real terms during 1982, year-end orders were still below the levels of early 1981.

Real GDP of the United Kingdom

Table 6

Consumer prices
% changes, December-December

	1981	1982	1983
United States	8.9	3.9	3.5
Canada	12.1	9.3	5.5
Japan	4.4	2.4	2.0
France	14.0	9.7	8.5
Germany	6.3	4.6	2.0
United Kingdom	12.0	5.4	7.5
Italy	19.0	16.3	15.0
weighted average (1981 GNP weights)	9.3	5.4	4.5

could be up 2.5% in 1983. Already in 1982, and against the tide, Britain scored a 1.2% gain in real GDP — but with still-rising unemployment and sagging industrial activity during the second half. The main growth impetus comes from consumer spending, which rose sharply beginning last summer. For some time that advance was met by massive stock drawdowns. Only in December and January did manufacturing output finally pick up. Business confidence now has clearly improved, with wide-ranging increases being reported in new orders. Lower nominal interest rates are encouraging construction and consumer borrowing. Consumer spending is further underwritten by the recent budget's personal income tax reductions. In time, moreover, the major gain in competitiveness of domestic producers, provided by sterling's exchange market slide since November, should yield gains in overall economic activity commensurate with rising domestic demand.

France has little hope of GDP growth this year. The economy is constrained by the austerity measures undertaken in conjunction with the EMS realignment. Those measures impose forced savings on high income groups and increase taxes on alcohol, tobacco, and energy. Also, social security taxes will be raised by 1% of taxable income. Consumer spending was the driving force behind French real growth over the past two years and will have to be restrained to correct the current account deficit. The austerity measures are intended to cut consumer purchasing power by 2%. To help reduce the current account deficit, French tourists now are limited to 2000 francs annual spending abroad.

Neither is the Italian economy expected to grow in 1983. Economic policy aims to reduce the large public-sector deficit, over 15% of GDP

in 1982, through spending cuts and tax increases, and to curb the high rate of inflation. At 16%, Italian inflation is far above inflation in other major countries. This year's renegotiation of the wage indexation machinery lowers the automatic degree of wage indexation by 15%, which should facilitate reduction of inflation.

In Japan, there is no immediate sign of a growth upturn. Industrial production, declining three months in a row, dipped 0.9% in February. Both consumption and investment, the twin sources of growth in 1982, are expected to grow more slowly this year. Real consumption is braked by lower wage increases. Investment will be held back by high real interest rates and by excess capacity, especially in export-related industries. Nonetheless, as stockbuilding and residential construction pick up, real GNP will grow by 3.2%, scarcely more than in 1982.

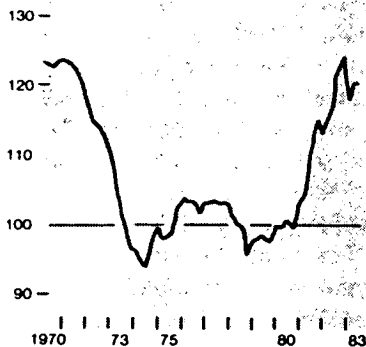
The decline in oil prices will further cool OECD inflation, which has been receding for more than two years as a result of the long recession. By the end of 1983, consumer price increases should decline to an average 4.5% for the seven major industrial countries, following 5.4% in 1982 and 9.3% in 1981 (see Table 6). Maintaining or bettering the surprisingly good outcome of last year, consumer prices are likely to increase by 3.5% or less in the United States, Germany, and Japan in 1983. In the United Kingdom, by contrast, consumer prices will accelerate in the months ahead as sterling's steep depreciation feeds through the domestic price structure. Italy and France will once again suffer much higher inflation rates than the other major countries, in part because exchange rate depreciation will reduce the anti-inflation bonus from the decline in dollar oil prices.

Table 7

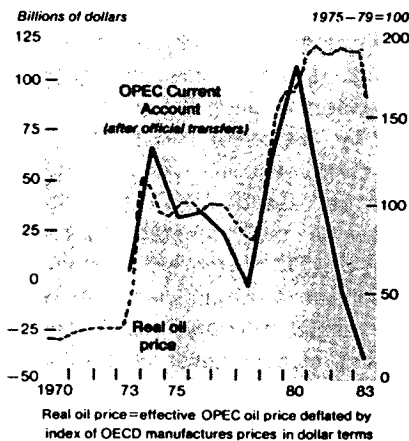
Current account balances
billions of dollars

	1981	1982	1983
United States	5	-8	-25
Canada	-5	2	3
Japan	5	7	15
France	-5	-12	-6
Germany	-7	3	9
Italy	-9	-6	-2
United Kingdom	12	7	-2
Total	-4	-7	-8

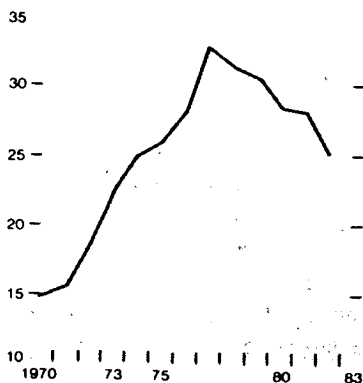
Real effective dollar exchange rate index, 1975-79=100



Oil prices and the OPEC current account



U.S. net oil imports as percent of total industrial countries' net oil imports



For the seven largest industrial countries as a group, the oil import savings from lower prices may approximately offset the adverse current account impact of higher economic growth and increased imports. Their combined current account deficit could show little change in 1983 (see Table 7). The distribution of their joint deficit should, however, shift significantly. The appreciation of the dollar over the past two years and the recovery of the U.S. economy would be the main factors behind this shift. The U.S. deficit may increase by \$17 billion, from \$8 billion in 1982 to \$25 billion this year. The combined current account surpluses of Japan and Germany could increase by \$14 billion, from \$10 billion to \$24 billion. At the same time, increased exports to growing economies, lower oil prices, and minimal domestic growth should shrink the combined deficits of Italy and France from \$18 billion last year to \$8 billion in 1983. Falling oil prices and economic recovery may push Britain's current account into balance or small deficit this year, after a \$7 billion surplus in 1982.

Although many analysts believe that the current account shift between the United States and other industrial countries will yield a significant weakening of the dollar, such an outcome is far from assured. Over the past few years, exchange rate changes have been influenced to a much greater extent by capital flows than by current account developments. The dollar will continue to benefit from a favorable interest rate differential, in real and nominal terms, and from international economic and political uncertainty. While the OPEC current account deficit undoubtedly will lead to sales of dollar assets by member countries, these will only have an exchange rate impact insofar as the asset preferences of the new hold-

ers differ significantly from those of OPEC. As Chart 2 illustrates, the dollar has fluctuated in the same general direction as real oil prices over the past decade, but its surge in 1981-82 occurred while the OPEC current account surplus was disappearing. Movements of the dollar were more heavily influenced by changes in U.S. oil-import dependence and U.S. anti-inflation policies — particularly high real interest rates — than by oil price movements or the OPEC surplus. By contrast, there is a closer relation between oil price changes and fluctuations of sterling and the yen, with sterling weakening and the yen normally strengthening in periods of falling oil prices. Yen strength now would be a highly welcome development in view of its sizable undervaluation and mounting trade frictions.

Prospects for the major non-oil LDCs

For the 12 oil-importing LDCs who are also major borrowers in the international financial markets, net oil import bills in 1982 were \$32 billion. Lower oil prices in 1983 should reduce those costs by \$4-\$5 billion, a significant fraction of the group's \$33 billion current account deficit in 1982. Measured against outlays for imports of other goods and services, excluding interest payments, Table 8 shows that the direct benefit of lower oil prices is especially important for Brazil, Turkey, and Thailand, and also provides substantial relief for the Philippines and Korea.

In addition, the 12 oil importers should achieve a \$300 million reduction in oil import bills through volume savings. Their domestic oil production is set to rise 10% this year and will furnish 31% of their consumption needs, up from 23%

Table 8

**Oil-importing LDCs:
implications of a \$28 per barrel
oil price for 12 major borrowers**

	Decrease in net oil imports in 1983		
	\$ billions ¹	% of 1982 imports ²	% of 1982 GNP
Argentina	0.0	0.0	0.0
Brazil	1.4	8.0	0.5
Chile	0.1	1.6	0.3
Colombia	0.1	1.1	0.1
Korea	1.0	4.7	1.5
Philippines	0.3	4.1	0.8
Taiwan	0.6	3.1	1.2
Thailand	0.4	6.1	1.1
Ivory Coast	0.1	3.3	1.0
Morocco	0.2	4.0	1.1
Israel	0.3	2.3	1.2
Turkey	0.5	8.4	0.9

¹Reduction of 15% in 1982 net oil imports value, before volume adjustment.

²Goods and services excluding oil and interest.

Table 9

**Oil-importing countries: external
position of 12 major borrowers¹**

	1981	1982	1983
Non-oil export volume, % change	11.8	-0.5	5.0
Non-oil import volume, % change	3.9	-9.5	4.0
Net oil imports, mm bpd	2.7	2.5	2.3
Terms of trade, 1977-79=100	80	81	82
\$ billions			
Merchandise exports	111	106	115
Merchandise imports	-127	-112	-115
Trade balance	-16	-6	0
Oil trade balance	-36	-32	-27
Net interest payments	-22	-26	-23
Other services and transfers, net	-1	-1	0
Current account	-39	-33	-23
as % of exports of goods and services	26	23	14
Total external debt, year-end	267	294	318

¹Argentina, Brazil, Chile, Colombia, Korea, Philippines, Taiwan, Thailand, Ivory Coast, Morocco, Israel, Turkey.

as recently as 1979. Moreover, from 1979 through 1982, the group's consumption appears to have diminished 7%, against a 4% rise in their GNP — a quite unexpected conservation achievement.

A second plus for the borrowing countries this year is the decline in international interest rates. Total external debt of the 12 major non-oil LDCs rose just over 10% in 1982, standing close to \$300 billion by year-end. At 1982 interest rate levels, the rise in outstandings would have swollen the group's net interest payments by over \$3 billion in 1983. Instead, lower interest rates mean that they should see net interest payments lessened by \$3 billion. Thus, even with allowance for rising loan-rate spreads and reduced earnings on external assets, lower world interest rates confer a \$6 billion net benefit on these LDCs — with Brazil, Argentina, and Korea the main beneficiaries.

The financial and economic prospects of the oil-importing LDCs in 1983 depend most of all on the projected economic recovery in their industrial-country export markets. In 1982, when there was an overall reduction in world trade volume of some 2%, the exports of the 12 major non-oil LDCs slipped by less than 1%. This was a respectable showing in the global context, but a disastrous outcome when set against the 12% average annual export volume gains they had achieved over the 1975-81 period. Moreover, while the terms of trade of these LDCs did not deteriorate further last year — softer oil and import costs in dollar terms offset, on average, continued erosion of export prices — those terms of trade remained 20% less favorable than in the more benign conditions of 1977-78.

Nonetheless, scarcity of foreign exchange in 1982 obliged the group to cut back import volume by 9.5%, leaving little room for GNP growth.

Indeed, Argentina and Chile suffered major declines in overall economic activity of 4% and 14%, respectively. Most Asian countries achieved GNP gains well below their normal expectations.

Latest forecasts for LDCs still are marking down hopes for 1983, in light of the disappointing outcome for 1982 and the extreme weakness of world trade during the past winter. Gloom can be exaggerated. The current trend in industrial-country forecasts is to upgrade cautiously the expected scale of aggregate demand recovery. Upturn in the inventory cycle should quickly generate revival of demand for LDC exports, although some will be frustrated by protectionism.

For the 12 major non-oil LDCs the current account projections in Table 9 assume a 5% average gain in export volume this year — modest in historical perspective, but perhaps realistic when viewed from the depressed position of today. Likewise, the projected 5% rise in non-oil LDC export prices would be feeble for a normal period of world economic recovery, but in fact assumes sizable advance, relative to present levels, through the balance of 1983.

Since external financial conditions remain difficult, the non-oil LDCs cannot look forward to fast GNP growth this year. For the twelve major borrowers, average GNP growth may be little more than 1%, which would hold total imports to a rise of less than 3% in volume terms. On these assumptions, their joint current account deficit should shrink by \$10 billion or more from last year's \$33 billion outcome. The \$10 billion improvement would represent \$5 billion in net oil import savings, a \$3 billion reduction in net interest payments, and a \$2 billion improvement in net trade in other goods and services.

The new money required to fi-

Table 10

OPEC current account
billions of dollars

	1980	1982	1983
Total OPEC			
Oil revenues	274	193	154
Other exports of goods and services ¹	28	29	28
Imports of goods and services ¹	-200	-235	-224
Investment income, net ²	13	16	8
Current account	116	2	-34
Official transfers, net	-9	-8	-6
Current account after transfers	107	-6	-40
Four Gulf producers³			
Oil revenues	142	103	73
Other exports of goods and services ¹	9	12	11
Imports of goods and services ¹	-83	-106	-108
Investment income, net ²	12	20	14
Current account	80	29	-10
Official transfers, net	-8	-8	-5
Current account after transfers	72	21	-15

¹Excludes investment income but includes private transfers.

²Excludes oil sector investment income which is included in the calculation of oil revenues.

³Saudi Arabia, Kuwait, Qatar, and the UAE.

nance their remaining \$23 billion current account deficit will not be easily obtained, nor will the maturing portion of their \$300 billion outstanding debt be readily refinanced. Lenders and borrowers, however, can take some tentative encouragement from the gradual improvement in the external environment facing non-oil LDCs. No relaxation of adjustment efforts is warranted, however, since a more helpful global environment was always an underlying assumption in adjustment programs.

Outlook for the oil-exporting LDCs

The immediate implications of lower oil prices for the oil-exporting LDCs are negative. Economic recovery in the world at large will ultimately be helpful to oil exporters. In the near term, however, the pluses — lower interest rates and strengthening demand for non-oil exports — are likely to be offset by the sharp decline in these countries' oil and gas earnings. Oil comprises the great bulk of their total exports of goods and services — over 80% for OPEC members and about 50% for Mexico.

The 13 OPEC members will be the hardest hit by lower prices and demand. An average price of \$28 per barrel for 1983 implies a near-\$40 billion decline in OPEC oil revenues to \$154 billion, the lowest since 1978. Exports of natural gas also will be adversely affected by lower oil prices. OPEC's other non-oil exports are small. The result will be import cutbacks and a larger current account deficit.

OPEC members have the ability to reduce imports substantially. Indeed, they have already done so. OPEC's total imports of goods and services rose over 20% by volume in 1981, but less than 5% in 1982. The full-year gain in 1982, however, masked cutbacks as the year pro-

ceeded, as is confirmed by industrial countries' export data (see Table 3). In 1983 OPEC imports of goods and services could well contract by almost 10% in volume. Even with this decline, the OPEC current account will shift into deficit of about \$40 billion in 1983, from near balance in 1982 (see Table 10).

Most of the deterioration in the aggregate OPEC current account is likely to be absorbed by Saudi Arabia and the other three oil exporters of the lower Gulf—Kuwait, Qatar, and the UAE. These countries not only are experiencing the largest drop in oil production, but also in prices. Having adhered most closely to OPEC's previous benchmark price of \$34, they face a greater decline in their export prices than those OPEC members that offered discounts in 1982. Thus, even though the Gulf producers also are likely to cut imports of goods and services, perhaps by 3% in volume, their aggregate current account is projected to shift from a surplus of over \$20 billion in 1982 to a deficit of around \$15 billion in 1983.

This deterioration need not place severe strains on the Gulf economies. The four together had estimated official foreign asset holdings of over \$250 billion at end-1982. Nor should the use of external assets by these four countries cause liquidity problems in financial markets, since use of these assets merely implies their shift to other hands.

For those oil-exporting LDCs that are major borrowers the challenge will be much more serious. Their 1983 current account and external financing needs are shown in Table 11. The group consists of nine countries, members and nonmembers of OPEC. Their \$75 billion net oil and gas exports in 1982 represented almost 60% of their total foreign exchange earnings. Between 1980 and 1982 the combined current account of these countries swung from a

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Table 11

Oil-exporting countries: external position of nine major borrowers¹

	1980	1982	1983
Oil sector			
Oil production, mm bpd	10.2	9.8	9.7
Net oil exports, mm bpd	7.1	6.1	6.0
Average export price, \$/barrel	32.0	31.8	28.0
\$ billions			
Net oil & gas exports	85	75	66
Non-oil & gas trade balance	-58	-66	-61
Exports	29	23	25
Imports	-87	-89	-86
Net interest payments	-7	-16	-16
Other services and transfers, net	-17	-19	-18
Current account as % of exports of goods and services	3	-26	-29
	2	22	24
Total external debt, year-end	151	208	230
Official foreign assets, year-end	48	25	18

¹Algeria, Ecuador, Egypt, Indonesia, Malaysia, Mexico, Nigeria, Peru, and Venezuela.

Table 12

Oil-exporting countries: implications of a \$28 per barrel oil price for nine major borrowers

	Change in net oil exports in 1983		
	\$ billions ¹	% of imports ²	% of 1982 GNP
Indonesia*	-2.3	10.7	2.5
Venezuela*	-2.2	12.7	3.1
Nigeria*	-1.7	10.0	2.5
Mexico	-1.5	6.5	0.9
Algeria*	-1.3	9.6	3.2
Ecuador*	-0.3	13.1	2.4
Malaysia	-0.2	1.3	0.8
Peru	-0.2	5.0	1.2
Egypt	-0.1	1.0	0.3

*Member of OPEC.

¹After adjustment for price differentials and export volume changes.

²Goods and services, excluding oil and interest, before adjustment to lower oil earnings.

modest surplus to a deficit of \$26 billion. Their imports climbed rapidly until 1981, while a steady drop in oil and non-oil export volumes was compounded in 1982 by a \$2.50 drop in their average oil export price. Thus, in just two years, their total external debt grew nearly 40% and exceeded \$200 billion by end-1982, of which two-thirds is owed to banks. Of the total, \$76 billion or 36% falls due this year.

The projected decline in oil prices to an average of \$28 per barrel in 1983 will reduce these countries' net earnings from oil and gas exports by about \$9 billion, or 12%. The impact will range from a high of over \$2 billion for Indonesia (over 2.5% of GNP) to a low of \$100 million for Egypt (0.3% of GNP, see Table 12). With the notable exception of Nigeria, most of these countries' excess oil production capacity is small. To raise oil production would, in any event, jeopardize price stability.

Lower world interest rates will help these nine countries by reducing their gross interest payments on floating rate debt. Their total net interest payments, however, may change little because of rising debt outstandings, stiffer terms on new borrowings, and lower earnings on declining external assets.

More significant is the expected rise in these countries' other exports of goods and services. Most

of the improvement will be realized in late 1983 and in 1984, as industrial country growth picks up. In 1983, such earnings (excluding interest receipts) could rise \$2-\$3 billion for the nine countries, with Malaysia, Indonesia, and Mexico being the main beneficiaries.

Lack of foreign exchange will compel another round of import cutbacks this year by most of these countries. Several will suffer outright declines in overall economic activity. In the aggregate, their imports of goods and services (excluding oil, gas, and interest) may be down by nearly 8% in volume. This would help contain their 1983 current account deficit to just under \$30 billion, \$3 billion higher than in 1982.

The increased current account deficit of these oil-exporting countries, together with the refinancing of their maturing debt, poses a major challenge for international finance in 1983. The projected current account deficit presumes resolute adjustment by the borrowing countries. In view of the new oil export shortfall, external lenders — notably the IMF and the commercial banks — must be prepared to see an increase in their exposure to oil exporters somewhat exceeding earlier objectives. For a time, the great recycling of funds from oil producers to consumers must, of necessity, be reversed.