Stephan Schulmeister

Recovery in Industrialised Countries, Strong Acceleration of Growth in the Other Groups of Countries

Medium-term Projection for the World Economy until 2008

The present forecast builds on the following assumptions with respect to global economic framework conditions: the exchange rate of the euro to the dollar will fall to 1,08 $ by 2008, the oil price will remain roughly stable; and after presidential elections in the current year, monetary and fiscal policy in the USA will follow a less expansionary course than since 2000. Under these assumptions economic growth in the USA will reach 2.9 percent p.a. between 2003 and 2008. GDP of the enlarged European Union is set to increase by slightly less (+2.3 percent). The growth rate in the new EU member states should be noticeably higher, their catching-up process being facilitated by improved prospects and by the structural adjustments necessary for EU accession. According to the forecast, the German economy will continue to grow at the slowest rate within the EU (+1.8 percent), with restrictive fiscal policy as a major brake on the upswing. Japan is expected to attain a medium-term expansion rate of 1.9 percent p.a., a marked improvement with respect to the 1990s.

Stefan Schulmeister is an economist at WIFO. **The author would like to thank Heinz Handler and Ewald Walterskirchen for their valuable advice and suggestions. The data were processed and analysed with the support of Eva Sokoll** **• E-mail addresses: Stephan.Schulmeister@wifo.ac.at, Eva.Sokoll@wifo.ac.at**

The present outlook constitutes a basis for the forecasting model of the Austrian economy until 2008 included in this issue (*Baumgartner – Kaniovski – Walterskirchen,* 2004)[1].

Outlook for the US economy

During 2004 economic policy in the USA is set to continue on a strong expansionary course. The Federal Reserve Bank has repeatedly announced that it will keep the key interest rate at the extraordinary low level of 1 percent. At least three explanations can account for this stance: firstly, the business cycle upturn is not yet self-supporting (so far, unemployment has hardly been abated and business investment-demand remains hesitant). Secondly, the Fed usually avoids interest rate raises during a presidential election year (November 2004). And finally, both the government and the central bank are expected to favour a low exchange rate of the dollar, and therefore a negative interest rate differential with respect to the euro.

Fiscal policy will stimulate the business cycle chiefly through the tax cut decided in 2003:

- The lowest income tax bracket (10 percent) will be expanded by 2,000 $.
- The rates of the higher tax brackets will be slashed by approximately 2 percentage points.
- Child tax credits will be increased from 400 $ to 1,000 $.

[1] The outlook for the world economy for 2004 and 2005 corresponds to the WIFO cyclical forecast of December 2003 (*Marterbauer,* 2004). For the period 2006 to 2008, the November 2003 medium-term forecast by Oxford Economic Forecasting and the October 2003 forecast by the National Institute of Economic Research (*NIER,* 2003) have been used.

- Investment will be stimulated through more generous depreciation write-off regulations (no general tax relief for firms, but incentives for additional investment).
- Taxes on capital gains will be reduced by 5 percentage points; revenue from dividends will not be taxed at ordinary income rates, but only at 5 percent. Both measures will stimulate the stock market and thus indirectly private consumption (*Schulmeister*, 2004).

On the expenditure side, fiscal policy will strengthen the economic recovery through continuing high military spending, as well as through additional social transfers (prescription drug benefit – a partial refund of drug costs to retired people).

US exports are set to benefit from the strongly undervalued exchange rate of the dollar. Under these conditions, the economic upturn in the USA will consolidate: the projection assumes that in 2004 GDP will expand by 3.8 percent (Table 2). The strong growth acceleration and the economic policy determinants that drive this upswing are, however, expected to aggravate existing imbalances in the US economy:

- According to recent projections by the OECD, the general government budget deficit will surge to 5.1 percent of GDP in 2004.
- In 2004 the current account deficit is set to expand to 575.8 billion $, i.e., 5.0 percent of GDP: the boost to imports caused by the cyclical upswing should be greater than any increase in exports due to an undervalued dollar.
- The increase in housing prices, which has been strong relative to the weak economic growth, has heightened the risk that this speculative bubble will burst.

Table 1: Global economic framework conditions

	Exchange rates		Interest rates				Oil price (OECD import-price)	Real interest rate on foreign dollar debt
			Dollar interest rates		Euro interest rates			
			Short term	Medium term	Short term	Medium term		
	Yen to $	$ to € or ECU	In percent				In $	In percent
1966-1973	340.7	.	7.2	6.1	.	.	2.4	1.4
1974-1979	263.9	1.32	8.6	8.1	.	.	14.2	– 7.5
1980-1985	235.0	0.99	12.3	12.1	.	.	31.6	11.3
1986-1991	189.1	1.07	9.9	10.2	.	.	24.7	7.7
1992-1997	120.2	1.22	5.8	7.1	.	7.5	18.5	5.5
1998-2003	119.3	1.01	4.0	5.1	3.5	4.8	22.4	4.0
2003	116.0	1.13	1.1	4.1	2.3	4.1	29.0	– 9.2
2004	110.0	1.16	1.3	5.0	2.0	4.0	27.0	– 0.3
2005	113.0	1.14	3.0	5.0	3.0	4.5	27.0	2.1
2006	115.0	1.12	2.5	4.8	2.5	4.3	27.0	2.3
2007	118.0	1.10	3.0	5.0	2.5	4.3	28.0	1.7
2008	120.0	1.08	3.0	5.0	3.0	4.5	28.0	1.0
2004-2008	115.2	1.12	2.6	5.0	2.6	4.3	27.4	1.4

	Exchange rates			World trade prices				
	MERM	4 reserve currencies to $	$ to €	Total	Fuels	Food	Raw materials	Manufactured goods
	Average year-to-year percentage change							
1966-1973	– 2.1	– 2.7	.	+ 5.5	+ 6.3	+ 7.0	+ 5.3	+ 5.5
1974-1979	– 1.1	– 2.3	.	+ 15.2	+ 32.3	+ 10.0	+ 12.1	+ 11.4
1980-1985	+ 5.7	+ 8.7	– 9.3	+ 0.6	+ 7.0	– 2.2	– 1.7	– 0.8
1986-1991	– 6.8	– 7.4	+ 8.5	+ 3.2	– 9.7	+ 3.2	+ 1.8	+ 6.2
1992-1997	+ 1.0	+ 0.6	– 1.5	+ 0.1	– 0.4	+ 4.4	– 0.7	– 0.8
1998-2003	– 0.1	– 0.0	– 0.1	– 0.1	+ 5.2	– 6.1	– 1.9	– 0.1
2003		– 12.8	+ 19.4	+ 10.4	+ 11.5	+ 10.7	+ 14.2	+ 11.4
2004		– 2.9	+ 2.8	+ 1.6	– 5.0	+ 2.0	+ 3.0	+ 2.0
2005		+ 1.8	– 1.7	+ 0.9	+ 0.1	– 2.0	– 2.9	+ 1.0
2006		+ 1.7	– 1.8	+ 0.2	+ 0.1	– 1.5	– 1.9	+ 0.0
2007		+ 1.8	– 1.8	+ 1.3	+ 2.1	– 0.0	+ 0.0	+ 1.0
2008		+ 1.8	– 1.8	+ 2.0	+ 3.1	+ 2.0	+ 1.1	+ 1.5
2004-2008		+ 0.8	– 0.9	+ 1.2	+ 0.0	+ 0.1	– 0.1	+ 1.1

Source: OECD, IMF, WIFO.

For these reasons, the forecast assumes that after the election year 2004 fiscal and monetary policy in the USA will take a slightly restrictive stance. The key interest rate is expected to climb to 3.0 percent in 2005, while at the same time budgetary consolidation measures will dampen the business cycle. Under these assumptions, economic expansion is projected to slow down to 2.3 percent until 2006, and to resume at full speed in the following years (2008 +3.0 percent). Accordingly, the medium-term growth rate between 2003 and 2008 would average 2.9 percent p.a., and therefore be equal to the rate in the period 1997-2003 (Table 2).

Great uncertainty over exchange rate developments

Hardly any other variable is as important for the development of the world economy as the exchange rate of the dollar – particularly vis-à-vis the euro and the yen. This is a consequence of the double role of the dollar as anchor currency of the global economy and as domestic currency of the USA.

The nature of the dollar as "key currency" is evidenced by the fact that almost all raw materials are traded in dollars, and that international financial assets and liabilities (especially those of developing countries) are kept in dollars. For this reason a pronounced shift in the dollar exchange rate has repercussions, ceteris paribus, on the world-wide income distribution, affecting net-exporters and importers of raw materials on the one hand, and dollar debtors and creditors on the other (see *Schulmeister,* 2000). For instance, a strong depreciation of the dollar worsens the terms-of-trade of oil-exporting countries, while it benefits oil importers. Oil-producing countries will react to this change by trying to mark up the price (in dollars) of oil (Figure 1 highlights the inverse relationship between the exchange rate of the dollar and the prices of raw materials). At the same time, a fall in exchange and interest rates of the dollar favours international debtor countries at the expense of their creditors.

The role of the dollar as domestic currency implies that marked fluctuations in its exchange rate influence the terms-of-trade, the share in world exports and the current account balance of the USA. Thus, US policymakers are interested in a depreciation or appreciation of the dollar depending on whether they perceive high unemployment, or high inflation as more problematic. They use monetary policy and other measures to influence the exchange rate to that effect (*Schulmeister,* 2004).

The strong depreciation of the dollar since spring 2002 represents a good case in point:

- The low-interest rate policy of the Federal Reserve Bank and the "talking the dollar down" strategy of US economic policymakers have triggered off and reinforced the depreciation process. As a result, the USA has gained shares in the export markets, mainly at the expense of the euro area (Figure 7 in *Schulmeister,* 2004).
- The size of the US current account deficit and foreign debt exerts structural downward pressure on the exchange rate of the dollar. The double role of the dollar makes it possible for the USA to be the only country to contract debt almost exclusively in its domestic currency.
- The devaluation of the dollar as key currency contributed on the one side to the recent improvement of the financial situation of big debtor countries like Brazil, and on the other side to relatively high oil prices in spite of the cyclical weakness in industrialised countries.

To sum up, the exchange rate of the dollar touches the most diverse interests. This, coupled with the fact that the dollar is the key currency on the foreign exchange markets, results in particularly high uncertainty about its medium-run development. Two regularities have been observed on the basis of empirical analysis (*Sarno – Taylor,* 2002): the further an exchange rate moves away from its fundamental equilibrium, the higher is the likelihood of a shift in the opposite direction; the speed at which this adjustment to fundamental equilibrium occurs is relatively low.

If we take purchasing power parity based on manufactured goods as the benchmark for fundamental equilibrium, and if we consider that according to this yardstick at the beginning of 2004 the dollar was undervalued by roughly 30 percent (with respect to a weighted average of the other most important currencies), it is plausible to assume that the US currency will appreciate in the medium run, if only at a very slow pace. The exchange rate of the dollar to the yen is expected to rise to 110.0 Yen (2004) and 120.0 Yen (2008). The exchange rate of the euro vis-à-vis the dollar is projected to fall to 1.16 $ in 2004, and to undergo a steady, if modest, depreciation to 1.08 $ until 2008 (Table 1).

Recovery in Japan

In 2003 the Japanese economy has expanded markedly for the first time since the year 2000 (+2.3 percent). However, the problems that caused the stagnation since the early 1990s have not yet been completely overcome. This is particularly true of the persistent deflation and the consequences that derive from it: under – even if only slight – deflationary conditions, the real interest rate level cannot be pushed below the growth rate of the economy. The expectations of a further decline in the price level exert a restraining effect on consumption. At the same time, deflation makes it extremely difficult for the banking sector to dispose of non-performing loans, and for the authorities to consolidate public finances.

For these reasons – as well as because of the recent appreciation of the yen – almost all projections for Japan (OECD, IMF, European Commission) envisage a renewed growth slowdown in 2004. The present forecast assumes an expansion of Japanese GDP by 1.5 percent for 2004. In the following years growth should accelerate slightly, reaching an annual rate of 2.0 percent between 2006 and 2008 (Table 2). The Japanese output should therefore increase at a medium-term rate of 1.9 percent per year between 2003 and 2008, and thus perform noticeably better than in the previous five years (+0.8 percent).

Growth in Germany continues to be weaker than in the euro area

The growth perspectives of the German economy continue to be unfavourable. This situation is determined mainly by the following problems: high unemployment and the reduction in social welfare payments dampen households' prospects and propensity to consume; at the same time – and also in light of the strong appreciation of the euro – the firms' propensity to invest remains weak.

During the past year in Germany the number of wage and salary earners fell by 1.8 percent; this represented the sharpest drop since 1992, and the unemployment rate soared to almost 9 percent. As a result, the pessimistic outlook of private households has been reinforced. Arguably this pessimism has also been fuelled by the perception that various labour market reforms might worsen the situation. As of April 2003, the income limit for precarious employment has been raised from 325 € to 400 €, in an effort to create new job opportunities for the unemployed. In fact, the number of these "mini-jobs" increased by approximately 1 million since introduction of the measure. However, because of the concomitant exemption from social insurance contributions, these jobs have been taken almost exclusively by people that were already economically active (second or third jobs). Hence, labour market access for the (long-term) unemployed has become even more difficult.

The boost given to precarious employment coupled with the recently decided easing of dismissal protection legislation could result in an additional reduction in the number of jobs covered by social insurance (through substitution; *DIW,* 2004); this would increase the inequality of income distribution, reduce purchasing power and consumption, and weaken the financial basis of social insurance institutions.

In December 2003 the government decided to reduce the unemployment benefits for those who have been unemployed for longer than 12 months (18 months for those aged 55 and over) to the level of social assistance (roughly 350 €). This measure affects approximately 1.5 million unemployed and will slash their purchasing power. A similar effect can be expected from the cuts in health care and pension benefit insurance scheme payments, and increases in contributions, that became effective as of 2004.

Against the backdrop of these pessimistic household prospects, the tax cut (reduced to a magnitude of 0.4 percent of GDP) that has been decided for 2004 will not stimulate private consumption by any appreciable amount (47 percent of households have expressed the view that they will "rather save" additional income accruing from the tax reduction).

Business investment will therefore depend on the firms' assessment of the German export dynamic: the latter has improved thanks to the cyclical upturn in the USA and the strong economic expansion in East Asia, but the prolonged euro appreciation is damping prospects markedly.

For these reasons the German economy is expected to have a weaker recovery in 2004-05 as well as a slower growth rate in the medium run than the euro area (Table 2). With respect to the development of the business cycle, the forecast makes the following assumptions: mainly as a consequence of the strong performance of the US economy in 2003-04 and of the sustained growth dynamic in East Asia, economic growth in the EU 15 and in Germany is likely to accelerate to 2.5 percent and 2.2 percent, respectively, until the year 2005. Economic growth in the EU 15 will then fall back to annual growth rates of 2.0 percent until 2007, in concomitance with the cyclical slowdown in the USA, and accelerate again in 2008. The German growth rate lag is projected to diminish noticeably towards the end of the forecast period (Table 2).

Under these conditions the medium-term growth rate in the EU 15 between 2003 and 2008 will average 2.2 percent p.a. (euro area +2.1 percent, Germany +1.8 percent). It should therefore be marginally higher than between 1997 and 2003, and continue to be almost 1 percentage point below the US growth rate (Table 2).

Table 2: World production and world trade

	1965-1973	1973-1979	1979-1985	1985-1991	1991-1997	1997-2003	2003	2004	2005	2006	2007	2008	2003-2008
					Average year-to-year percentage change								
World GDP, real	+ 5.9	+ 3.7	+ 2.5	+ 3.2	+ 3.2	+ 3.4	+ 3.3	+ 4.3	+ 4.1	+ 3.8	+ 3.7	+ 4.2	+ 4.0
Industrialised countries	+ 5.2	+ 2.8	+ 2.3	+ 3.1	+ 2.6	+ 2.4	+ 1.9	+ 2.7	+ 2.4	+ 2.3	+ 2.4	+ 2.6	+ 2.5
Oil-exporting countries	+ 9.0	+ 5.4	+ 0.9	+ 2.5	+ 3.2	+ 3.2	+ 3.1	+ 5.0	+ 4.0	+ 3.0	+ 3.5	+ 4.0	+ 3.9
Other developing countries	+ 5.3	+ 5.1	+ 4.2	+ 5.3	+ 6.7	+ 4.6	+ 5.1	+ 5.7	+ 6.0	+ 5.5	+ 5.0	+ 6.0	+ 5.6
Transition countries	+ 7.1	+ 3.5	+ 2.0	+ 0.1	− 5.3	+ 4.1	+ 4.9	+ 4.6	+ 4.7	+ 4.7	+ 4.6	+ 4.5	+ 4.6
CEEC 8	.	.	.	.	+ 3.5	+ 3.0	+ 2.9	+ 3.5	+ 4.0	+ 3.5	+ 3.0	+ 3.3	+ 3.5
Russia	.	.	.	.	− 7.2	+ 4.3	+ 6.0	+ 4.9	+ 5.0	+ 4.8	+ 4.6	+ 4.4	+ 4.7
USA	+ 3.9	+ 3.0	+ 2.6	+ 2.6	+ 3.4	+ 2.9	+ 2.8	+ 3.8	+ 2.5	+ 2.3	+ 2.8	+ 3.0	+ 2.9
Japan	+ 9.5	+ 3.5	+ 3.3	+ 4.5	+ 1.6	+ 0.8	+ 2.3	+ 1.5	+ 1.8	+ 2.0	+ 2.0	+ 2.0	+ 1.9
EU 25	.	.	.	.	.	.	+ 0.9	+ 2.1	+ 2.6	+ 2.3	+ 2.0	+ 2.3	+ 2.3
EU 15	+ 4.5	+ 2.4	+ 1.6	+ 2.8	+ 1.7	+ 2.1	+ 0.8	+ 2.0	+ 2.5	+ 2.3	+ 2.0	+ 2.3	+ 2.2
Euro area	+ 4.6	+ 2.5	+ 1.5	+ 2.8	+ 1.5	+ 2.0	+ 0.4	+ 1.8	+ 2.5	+ 2.1	+ 1.8	+ 2.1	+ 2.1
Germany	+ 4.0	+ 2.4	+ 1.4	+ 2.9	+ 1.2	+ 1.3	+ 0.0	+ 1.3	+ 2.2	+ 1.9	+ 1.7	+ 2.0	+ 1.8
EU accession countries	.	.	.	.	.	.	+ 2.8	+ 3.5	+ 4.0	+ 3.5	+ 3.0	+ 3.3	+ 3.5
Total world trade, real	+ 9.2	+ 3.3	+ 2.0	+ 6.6	+ 8.0	+ 4.9	+ 3.1	+ 6.4	+ 6.2	+ 5.6	+ 5.7	+ 6.5	+ 6.1
Fuels	+10.0	− 0.6	− 5.0	+ 8.7	+ 5.3	+ 4.7	+21.2	+ 2.9	+ 3.4	+ 3.3	+ 3.2	+ 3.7	+ 3.3
Food	+ 5.2	+ 3.5	+ 2.7	+ 6.7	+ 0.5	+10.0	+ 1.5	+ 5.4	+ 4.4	+ 3.8	+ 4.4	+ 5.2	+ 4.6
Raw materials	+ 5.9	+ 1.0	+ 0.8	+ 5.1	+ 5.9	+ 3.0	− 1.1	+ 4.6	+ 3.6	+ 2.5	+ 2.6	+ 4.2	+ 3.5
Manufactured goods	+10.3	+ 5.9	+ 4.6	+ 6.1	+ 9.8	+ 4.5	+ 0.1	+ 7.5	+ 7.2	+ 6.5	+ 6.6	+ 7.4	+ 7.0
Industrialised countries													
Exports	+ 9.3	+ 3.9	+ 3.5	+ 6.8	+ 7.3	+ 4.1	+ 1.7	+ 5.4	+ 5.5	+ 4.9	+ 5.0	+ 5.8	+ 5.3
Imports	+ 9.7	+ 2.6	+ 1.2	+ 8.3	+ 7.1	+ 4.9	+ 2.4	+ 6.0	+ 5.5	+ 5.0	+ 5.5	+ 6.0	+ 5.6
Oil-exporting countries													
Exports	+12.0	+ 1.1	− 8.9	+ 7.9	+ 5.2	+ 1.9	+ 4.1	+10.4	+ 4.3	+ 4.1	+ 4.1	+ 4.6	+ 5.5
Imports	+ 9.5	+14.3	+ 2.1	− 1.1	+ 5.9	+ 5.4	− 0.0	+ 9.0	+ 7.5	+ 6.0	+ 7.0	+ 8.0	+ 7.5
Other developing countries													
Exports	+ 7.0	+ 4.9	+ 4.7	+10.5	+12.2	+ 7.7	+ 5.9	+ 7.4	+ 7.9	+ 7.3	+ 7.5	+ 8.3	+ 7.7
Imports	+ 7.6	+ 4.6	+ 4.6	+ 8.0	+11.6	+ 4.9	+ 5.5	+ 7.0	+ 7.5	+ 7.0	+ 6.0	+ 7.5	+ 7.0
Transition countries													
Exports	+ 6.5	+ 1.9	+ 3.5	− 8.4	+ 0.9	+ 4.4	+ 6.6	+ 9.7	+ 7.5	+ 7.1	+ 7.2	+ 8.0	+ 7.9
Imports	+ 7.7	+ 1.6	+ 2.9	−12.8	+ 4.3	+ 3.3	+ 7.7	+ 9.0	+10.0	+ 9.0	+ 8.0	+10.0	+ 9.2

Source: OECD, IMF, WIFO.

Slow catching-up process of the EU accession countries

Since the beginning of the 1990s the catching-up process of the 8 Central and Eastern European countries (CEEC 8) that will join the EU in 2004 together with Malta and Cyprus has slowed down. Between 1991 and 1997 the expansion rate of these economies had been 1.8 percentage points above the EU 15 average; this growth rate gap has shrunk to +0.9 percentage point between 1997 and 2003 (Table 2). The most relevant constraint on medium-term growth prospects of the CEEC 8 is represented by their high current account deficits. This imbalance points to two underlying problems:

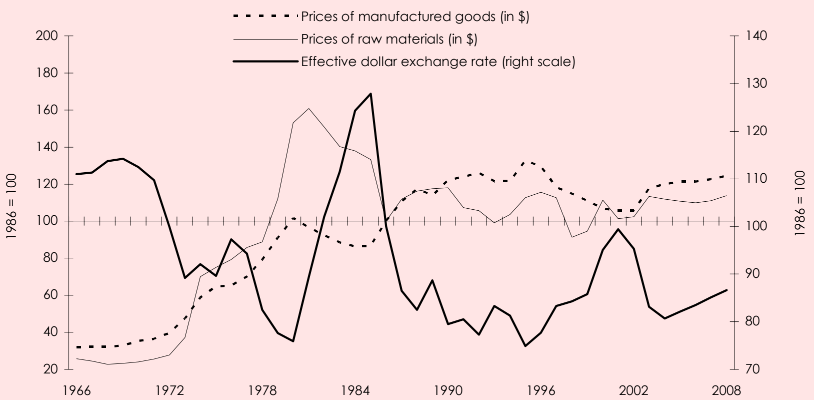
- When one region experiences faster economic expansion than another, its current account deficit relative to GDP can be sustained only if the faster growing region gains in competitiveness and is thus able to stimulate its exports and to curb its imports.
- This goal can hardly been achieved if the two regions are at different stages of economic development. In fact, in the course of market opening and the related economic integration, the catching-up process in the less developed region is faster with respect to private consumption than with respect to investment and production technology.

The resulting structurally high current account deficits of the EU accession countries have undergone a further deterioration because of the real appreciation of their currencies since the mid-1990s. This revaluation has resulted mainly from high capital inflow, which consisted not only of foreign direct investment, but also of (short-term) portfolio investment (higher interest rates, sharp price fluctuations on the particularly volatile stock markets of Eastern Europe).

The accession countries have reacted to this sharp deterioration of their current account balances (mostly coupled with a marked increase in budget deficits) with contractionary monetary and fiscal policies that have in turn dampened the business cycle. These difficulties could have been overcome with a policy-induced stimulation of aggregate demand, and therefore of imports, in the EU. Another option would have been a comprehensive financing programme to improve production and export conditions, the infrastructure in particular, in the accession countries. However, the EU policymakers – constrained by the rules governing monetary and fiscal policy in the euro area – chose not to pursue any of these strategies (a detailed analysis of the situation in Central and Eastern European countries can be found in *Pöschl,* 2003).

Figure 1: Dollar exchange rate and world trade prices

1986 = 100

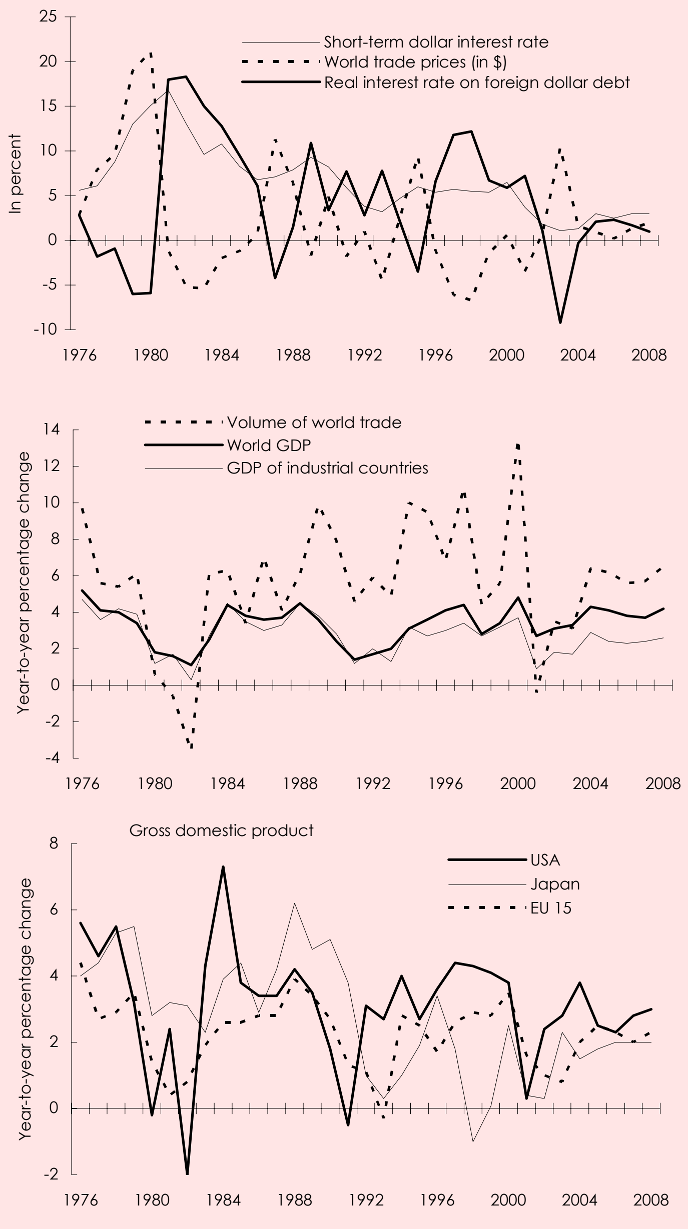


Source: OECD, WIFO.

The forecast assumes that the output of the Central and Eastern European accession countries will increase by 3.5 percent in 2004 and by 4.0 percent in 2005. This upswing will be carried by improved expectations on the part of firms and households in the wake of EU membership, as well as by the cyclical upturn in the EU 15 (the real exchange rates of the accession countries are projected to remain roughly stable). In the following years the growth rate is expected to fall slightly, resulting in an average of 3.5 percent p.a. for the years between 2003 and 2005. Thus medium-term economic expansion in the accession countries should be 1.3 percentage points faster than in the EU 15, and result in a larger growth rate gap than during the period

1997-2003. Particularly the structural improvements following EU accession will contribute to this result. Given the small relative weight of the accession countries' GDP (at purchasing power parity), the medium-term growth rate in the enlarged EU (+2.3 percent p.a.) should be only marginally higher than in the EU 15 (Table 2).

Figure 2: Trends of the world economy



Source: OECD, IMF, WIFO.

Growth of world trade accelerates

Figure 1 shows the inverse relationship between the effective exchange rate of the dollar and world trade prices expressed in dollars. In 2003, the strong depreciation of the dollar was in fact the main driving force behind the price hike of manufactured goods (+11.4 percent) and raw materials (+10.9 percent) that took place in spite of sluggish economic growth. Under the assumption of a medium-term rebound of the dollar, raw material prices can be expected to remain largely unchanged until 2008, while the dollar prices of manufactured goods should increase only by 1.1 percent per year. A further assumption of this scenario is that, by steering the oil production of its member states and cooperating with other oil-producing countries, OPEC will continue to be able to stabilise the oil price around 28 $ per barrel.

Under these conditions, the terms-of-trade of the oil-exporting countries and of the transition countries[2] are set to worsen slightly, while those of the remaining developing countries and of the industrialised countries improve marginally. With the nominal interest rate of the dollar kept at a low level, the real interest rate on foreign debt in dollars should average merely 1.4 percent until 2008 and thus be clearly lower than during the 1980s and 1990s (Figure 2, Table 1). This should make it easier for developing countries to service their foreign debt, and indirectly stimulate their imports.

Between 2003 and 2008 the industrialised countries' imports of goods should increase by slightly more than during the previous five-year period (+5.6 percent p.a. against +4.9 percent p.a.). In line with the business cycle forecast, the growth rate of imports should slow down marginally in 2005 and 2006 (to +5.0 percent) and accelerate again to +6.0 percent in the following years (Table 2). Thanks to high trade surpluses, the transition countries[3] and the oil-exporting countries will be able to increase their imports until 2008 by an average of 9.2 percent and 7.5 percent, respectively. Imports in the remaining developing countries will benefit from low real interest rates on foreign debt, and expand only slightly less (+7.0 percent). Under these assumptions the medium-term growth rate of total world trade jumps from 4.9 percent (1997-2003) to 6.1 percent (2003-2008, Table 2).

The exports of industrialised countries are projected to expand by 5.3 percent on a yearly basis until 2008, and hence grow less than total world trade (the industrialised countries will continue to lose market shares at a rate similar to that of the 1990s). The strongest increment in exports will be achieved by the former communist countries and the remaining developing countries (+7.9 percent and +7.7 percent p.a., respectively; Table 2).

Higher economic growth in developing countries and former planned economies

The strong increase in imports (particularly of capital goods) should boost the economies of the oil-exporting countries and help to push their growth rate from 3.2 percent (1997-2003) to 3.9 percent p.a. (2003-2008). In the non-oil developing countries economic expansion is expected to accelerate even more (from +4.6 percent to +5.6 percent). The gains in export market shares – which have been driven also by the relocation of production units to these countries – will contribute to this dynamism.

The growth dynamic in the former planned economies (including Russia and the other members of the Commonwealth of the Independent States) will depend largely on developments in the EU accession countries (CEEC 8) and in Russia.

Since the end of the financial crisis of 1998 the Russian economy has had a vigorous performance, with GDP growing at a yearly average of 6.2 percent between 1998 and 2003. This upturn has been fuelled by the strong growth in imports of consumer and producer goods that has been financed with increased revenues from oil exports. The forecast assumes that the Russian economy, which will be favoured by persistently high oil prices, will expand at a rate of 4.7 percent per year between 2003 and 2008 (+0.4 percentage points with respect to 1997-2003). Hence the medium-term growth rate of the transition countries as a group is set to increase from 4.1 percent to 4.6 percent (Table 2).

In line with the business cycle forecast, the growth rate in the industrialised countries should rise to 2.7 percent in the current year, fall to 2.3 percent until 2006, and rebound to 2.6 percent in 2008. Thus, their medium-term growth rate in 2003-2008 (+2.5 percent) should be only marginally higher than during the previous five years (Table 2). Driven by the strong upswing in other groups of countries, total world GDP is expected to increase by 4.0 percent p.a. over the forecast period – noticeably faster than between 1997 and 2003 (+3.4 percent).

[2] The definition "transition countries" includes the former planned economies of Central and Eastern Europe, as well as Russia and the other members of the Commonwealth of the Independent States.

[3] The current account surplus of Russia outweighs the deficits of the CEEC 8.

References

Baumgartner, J., Kaniovski, S., Walterskirchen, E., "Economic Activity Moving Closer to its Potential in the Medium Term. Projections for the Austrian Economy until 2008", Austrian Economic Quarterly, 2004, 9(1), pp. 24-33, http://publikationen.wifo.ac.at/pls/wifosite/wifosite.wifo_search.get_abstract_type?p_language=1&pubid=25023&pub_language=-1&p_type=1

Deutsches Institut für Wirtschaftsforschung (DIW), "Grundlinien der Wirtschaftsentwicklung 2004/2005", DIW-Wochenberichte, 2004, (1-2), http://www.diw.de/deutsch/produkte/publikationen/wochenberichte/docs/04-01-1.html.

European Bank for Reconstruction and Development, Transition Report 2003, London, 2003.

European Commission, Economic Forecasts. Autumn 2003, Brussels, October 2003.

International Monetary Fund (IMF), World Economic Outlook, Washington, D.C., September 2003.

Marterbauer, M., "Business Cycle Recovery Gaining Shape. Economic Outlook for 2004 and 2005", Austrian Economic Quarterly, 2004, 9(1), http://publikationen.wifo.ac.at/pls/wifosite/wifosite.wifo_search.get_abstract_type?p_language=1&pubid=24811&pub_language=-1&p_type=0.

National Institute of Economic Research (NIER), "The World Economy", National Institute Economic Review, 2003, (186).

OECD, Economic Outlook, Paris, December 2003.

Pöschl, J., "Internationale Konjunkturflaute stellt Wirtschaft der MOEL auf die Probe", WIFO-Monatsberichte, 2003, 76(5), pp. 349-369, http://publikationen.wifo.ac.at/pls/wifosite/wifosite.wifo_search.get_abstract_type?p_language=1&pubid=23992.

Sarno, L., Taylor, M.P., "Purchasing Power Parity and the Real Exchange Rate", IMF Staff Papers, 2002, 49(1).

Schulmeister, S., "Globalization Without Global Money: The Double Role of the Dollar as National Currency and as World Currency", Journal of Post Keynesian Economics, 2000, 22(3).

Schulmeister, S., "Zur unterschiedlichen Wachstumsdynamik in den USA, in Deutschland und im übrigen Euro-Raum", WIFO-Monatsberichte, 2004, 77(2), pp. 119-137, http://publikationen.wifo.ac.at/pls/wifosite/wifosite.wifo_search.get_abstract_type?p_language=1&pubid=24855&pub_language=-1&p_type=1.

Recovery in Industrialised Countries, Strong Acceleration of Growth in the Other Groups of Countries

Medium-term Projection for the World Economy until 2008 – Summary

With interest rates kept at low level and taxes strongly reduced, monetary and fiscal policies in the USA are expected to remain on an expansive course in 2004. This will strengthen the economic upswing but will also accentuate the disequilibria in the US economy: in 2004, both the budget deficit and the current account deficit are envisaged to increase to at least 5 percent of GDP. For this reason, the USA will pursue a slightly restrictive course after the 2004 election year. Interest rates will probably be raised to 3.0 percent in 2005, and measures to consolidate the budget should dampen final demand, reducing the rate of growth to 2.3 percent by 2006. In the following years, the economy should take an upturn again, and expand by 3.0 percent in 2008. In the medium run, the USA will thus manage an economic growth of 2.9 percent p.a. for the period of 2003-2008.

The main predicaments confronting the Japanese economy – a declining price level, a huge amount of non-performing loans in the financial sector and growing unemployment – have improved noticeably in recent times. This forecast assumes that this trend will continue and permit an annual growth rate of 1.9 percent over the medium run.

In Germany, the economic outlook continues to be unfavourable: high unemployment and cuts in social welfare benefits weaken consumer demand while business remains hesitant about investments, not least due to the strong euro. For these reasons, the German economy is expected to grow by just 1.3 percent and 2.2 percent, respectively, in 2004 and 2005, which means a slower recovery than in the EU 15 in general (+2.0 percent and +2.5 percent). In the wake of retarded growth in the USA, growth up to 2007 should decelerate to 2.0 percent in the EU 15 and to 1.7 percent in Germany, before picking up again in 2008.

Subject to these conditions, between 2003 and 2008 the EU 15 will enjoy a medium-term growth rate of 2.2 percent annually (euro zone +2.1 percent, Germany +1.8 percent), thus achieving a slightly higher rate than in 1997-2003, but continuing to remain almost 1 percentage point below the USA.

Among the EU accession countries in Eastern Europe, economic growth is set to expand to 3.5 percent and 4.0 percent in 2004 and 2005, before decelerating again, to achieve 3.5 percent p.a. as an average for 2003-2008.

Vigorous expansion of imports (especially of capital goods) should enable oil-exporting countries to push up their medium-term economic growth rate from 3.2 percent (1997-2003) to 3.9 percent (2003-2008). The other developing countries will experience even stronger growth (from 4.6 percent to 5.6 percent), with a further boost coming from gains in shares in the export markets. The former centrally planned economies should improve their growth rates from 4.1 percent (1997-2003) to 4.6 percent (2003-2008), due not least to the sustained dynamic of the Russian economy.