World payment trends in 1990

This article, the second in an annual series, examines the factors shaping developments in trade, current and capital account flows in 1990 and early 1991. The Gulf crisis and the subsequent rise in oil prices in the second half of 1990 exacerbated recessionary tendencies in several industrial economies which in turn slowed trade growth. Domestic demand developments in the G3 worked to reduce current imbalances, while exchange rate movements improved the competitiveness of the United States and Japan at the expense of Europe.

Current account imbalances were largely matched by private sector capital flows with only modest official intervention occurring. There was however some turbulence in financial markets, particularly in the Japanese bond and equity markets, and the activities of international banks underwent changes as a result of pressures on banks' capital and widespread credit downgrading. These developments caused volatility in capital flows during the course of 1990, particularly in Japan and the United States.

Some highlights were:

- *The US current account deficit fell again in 1990, reaching 1.7% of GNP against 2.0% in 1989, as US domestic demand growth slowed further.*
- *The Japanese surplus showed another sharp decline in 1990 to 1.2% of GNP against 2.0% in 1989 as the pace of domestic demand growth quickened slightly.*
- *German political and monetary union buoyed German domestic demand which in turn contributed to a reduction in the German current account surplus to 3.2% of GNP, compared with 4.8% in 1989.*
- *In 1990 the deutschemark strengthened and the dollar weakened on the international exchanges, reversing the pattern of the previous year. The yen continued to fall both against the dollar and on an effective basis.*
- *Activity in the international capital markets was broadly unchanged in 1990. International bank lending fell back while gross international direct investment flows continued to increase.*

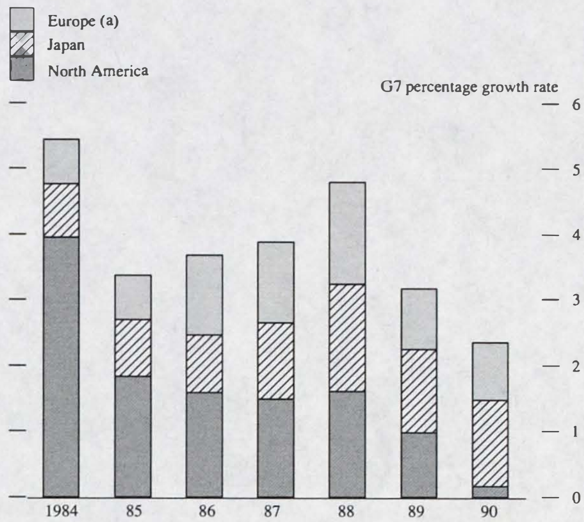
Trade and current account developments

A significant slowing in the growth of activity in the industrialised world in 1990 contributed to a slowing in the growth of the volume of world trade to 5.0% from 7.1% in 1989. The slowdown in trade volume growth was particularly pronounced in the second half of the year when it fell to an annual rate of 3.6% from 5.4% in the first half, as the crisis in the Middle East overshadowed other political and economic events. The Gulf crisis had a substantial direct effect on Middle East trade volumes both as a result of the UN embargo against Iraq and occupied Kuwait and because of the wider dislocation it caused. In addition to its direct effects, the Gulf crisis generally damaged confidence, so depressing activity and trade both during the second half of 1990 and into the first half of 1991.

The loss of Iraqi and Kuwaiti oil supplies from the world market from the summer of last year caused an initial jump in prices, but was soon largely balanced by increased production by other OPEC members. The relative weakness of oil import volumes on the part of the industrial economies somewhat mitigated any effect that high prices had on their trade balances. Nevertheless, the trade account of most oil importing nations was adversely affected during the second half of 1990. Continued declines in non-oil commodity prices, by some 9% in dollar terms in 1990 over 1989, aggravated the effect of higher oil import prices on the non-oil-exporting less developed countries (LDCs). Declines in beverage prices were particularly large over the year, most seriously affecting non-oil African LDCs.

Domestic demand developments once again explained much of the movement in trade and current accounts in the G3 in 1990. Faster growth of domestic demand in Japan and Germany contrasted with a sharp slowing of demand growth in the United States to only 0.5%. This widened the divergence of domestic demand growth between Japan and Germany on the one hand and the United States on the other that began to open up in 1987–88. In Germany, a surge in import volumes was coupled with little growth in export volumes as output was redirected to the expanding domestic market as a consequence of unification. As Chart 1 shows,

Chart 1
G7 domestic demand growth - geographical distribution



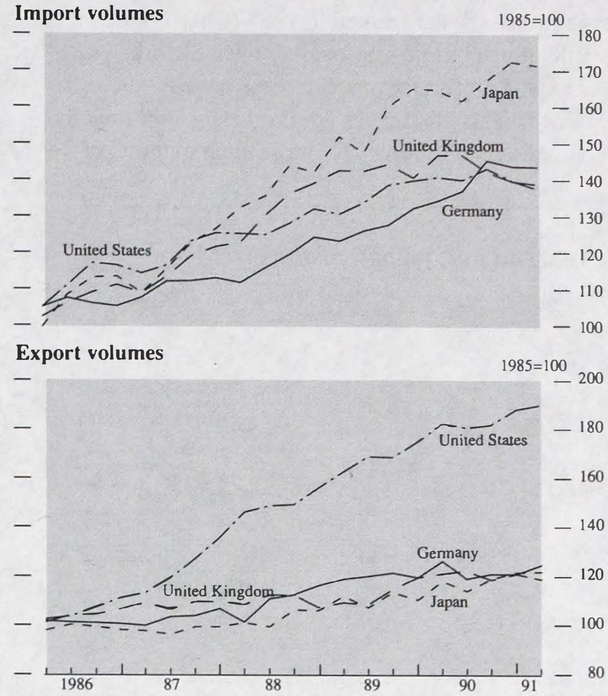
(a) Germany, France, Italy and United Kingdom.

North America provided a smaller contribution to aggregate domestic demand growth in the G7 economies in 1990, the lowest since 1982. Although the European members of the G7 (Germany, France, the United Kingdom and Italy) contributed a higher proportion of G7 growth than in the previous year, buoyed particularly by western Germany, their aggregate demand growth nevertheless slowed from the previous year.

In Europe outside Germany, the strength of the German market provided some support to otherwise flagging export volumes, with Germany's traditional northern European suppliers such as Belgium and the Netherlands benefiting most. Given that intra-European trade now makes up between 60% and 70% of total trade for most European countries, the slowdown in demand growth in Europe outside Germany contributed strongly to a slowdown in both import and export volumes for most European economies.

Largely as a result of higher EC domestic demand relative to other OECD economies, the EC's modest aggregate current account surplus declined to $2 billion in 1990 from $7 billion in 1989 and moved into deficit in the early part of 1991. The United States in particular benefited, with its

Chart 2
Import and export volumes



bilateral trade balance with western Europe moving into surplus in 1990 for the first time since 1982.

The strength of exchange rate mechanism (ERM) currencies in 1990 boosted the terms of trade of the ERM 'bloc' (which now comprises all EC countries except Greece and Portugal), while the associated competitiveness loss may have begun to affect export volumes adversely in the second half of the year, contributing to the decline in the current account surplus.

The world current account discrepancy, calculated by summing national current account balances, showed an aggregate deficit of $140 billion in 1990 against the previous year's figure of $101 billion. The discrepancy has been on a rising trend since 1987, when it stood at $43 billion, and inevitably suggests caution in the interpretation of published current account data.

Movements in relative prices produced competitiveness gains for the United States, Japan and the newly industrialised economies (NIEs)[1] in 1990, mostly at the expense of Europe. Exchange rate movements are usually the most important determinant of relative price movements in the short run, and in the case of Japan an 8% fall in the effective exchange rate in 1990 compared to 1989 accounted for almost all of the decline in relative export prices during the year. A fall in the dollar effective rate of 3% in the same period, coupled with only a modest increase in the dollar price of US exports, boosted US export competitiveness.

Competitiveness measured using relative costs provides a somewhat different picture from that given by relative price

(1) South Korea, Taiwan, Hong Kong and Singapore.

measures. Trend unit labour costs have declined significantly in the United States relative to its main trading partners since the dollar peaked in 1985 (Chart 3). Up to the end of 1988 much of this improvement was absorbed in widened export profit margins, but these have fallen back slightly since. This still leaves US producers significantly more competitive in relative cost terms than in terms of

Chart 3
Relative trend unit labour costs [(a)]

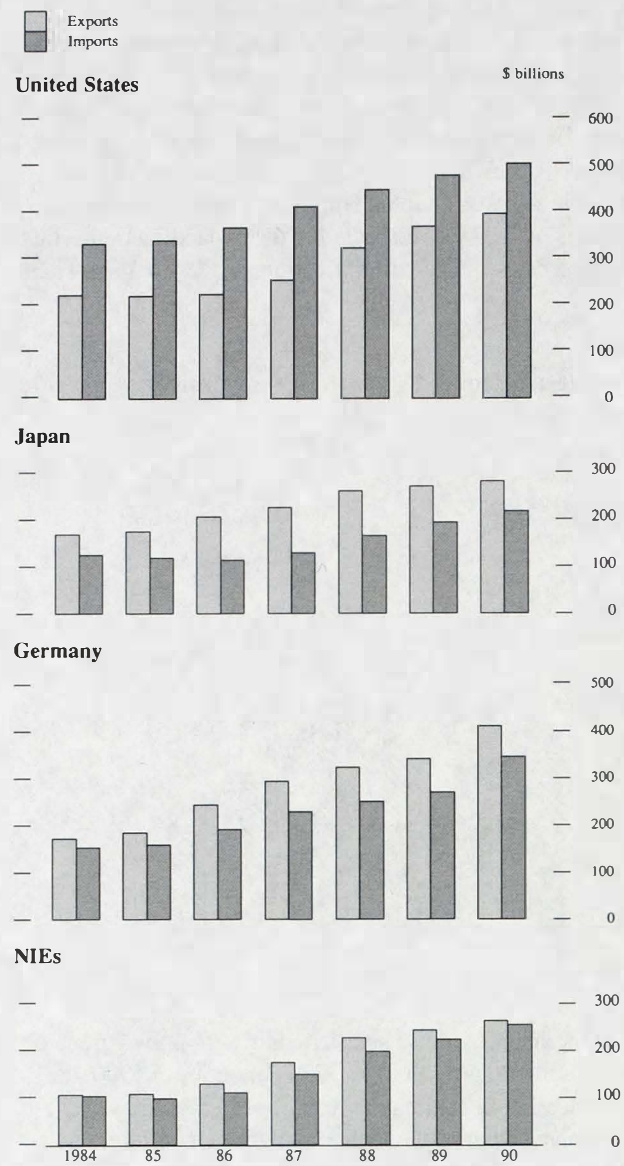
(a) Manufacturing, in a common currency.

price, compared with their position in 1985. The sharp rise in inward direct investment in the United States over the 1985–89 period may owe something to this relative lowering of costs in the United States compared with other industrial nations, while net outflows from Japan were in part an attempt by Japanese corporations to move production away from increasingly high relative costs in Japan.

The response of exporters to changing relative costs again varied between economies in 1990. The Japanese responded to the falling yen by increasing the yen price of exports by over 4%, far faster than other G7 producers increased their domestic currency export prices. This may have been an attempt to 'price-to-market'—absorbing changes in cost competitiveness in export margins to stabilise foreign currency prices in export markets. European producers, faced with strengthening currencies, mostly contracted margins but US exporters also reduced margins despite the dollar's weakness.

Chart 4 shows developments in the dollar value of imports and exports in the G3 and the Asian NIEs over the last few years. Although exchange rate movements complicate the interpretation of year-to-year movements in such figures, some longer-term trends are discernible. For instance, Germany recaptured the position of the largest exporter from the United States in 1990 but this was mainly the result of the strength of the deutschemark. In a longer perspective, the take-off of US exports and also Japanese imports since 1986 is evident. Equally striking is the increase in the value of NIE trade since 1985, with the NIEs' aggregate import values now exceeded only by that of Germany and the United States.

Chart 4
Exports and imports of goods



Capital account developments

Financing current account deficits

In 1990 current account deficits in some of the industrial economies were matched mostly by private sector flows, with only limited changes in official reserves. Despite a partial withdrawal of Japanese investors from the United States and falling US short-term interest rates, the $92 billion US current account deficit was financed by private sector flows without putting much downward pressure on the dollar. The recession in the United States in combination with the easing of monetary policy and consequent movement of interest differentials against dollar assets contributed to a reduction in recorded net foreign direct and portfolio investment in the United States. However, net private sector banking inflows doubled in 1990; moreover, an unusually large statistical discrepancy of $64 billion may relate in part to unrecorded capital inflows, making exact interpretation of the recorded data difficult.

Table A
External financing of the G7 economies
$ billions (inflow+/outflow-)

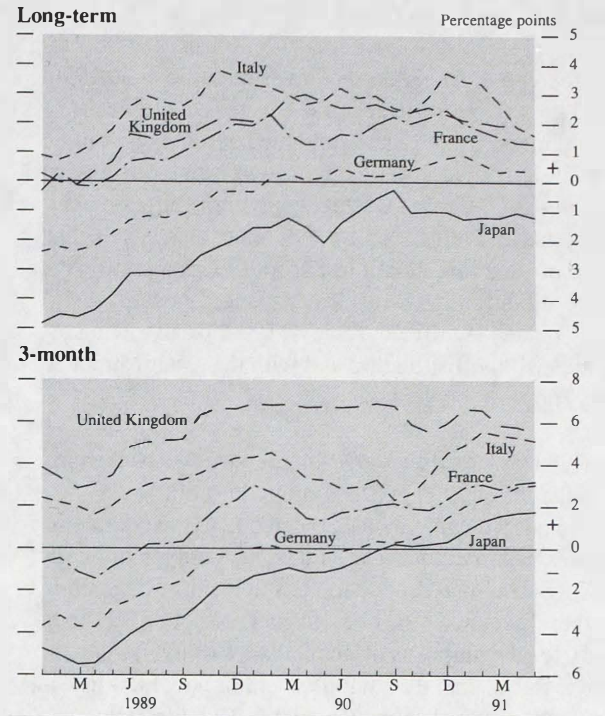
	1987	1988	1989	1990
United States				
Identified current account	-160	-126	-106	-92
Financed by:				
Direct investment	27	42	37	4
Portfolio investment	29	39	46	-26
Banking sector	47	14	12	15
Other(a)	48	35	36	101
Official financing balance(b)	9	-4	-25	-2
Japan				
Identified current account	87	80	57	36
Financed by:				
Direct investment	-18	-35	-45	-46
Portfolio investment	-97	-65	-31	-11
Banking sector	80	47	42	46
Other(a)	-12	-11	-35	-32
Official financing balance(b)	-39	-16	13	8
Germany				
Identified current account	46	51	57	47
Financed by:				
Direct investment	-7	-10	-7	-21
Portfolio investment	5	-37	-3	-4
Banking sector	-5	-5	-23	-12
Other(a)	-22	-17	-35	-7
Official financing balance(b)	-18	19	12	-4
France				
Identified current account	-5	-5	-5	-8
Financed by:				
Direct investment	-4	-6	-9	-18
Portfolio investment	5	8	23	28
Banking sector	-4	2	4	29
Other(a)	5	-4	-14	-32
Official financing balance(b)	3	5	1	1
United Kingdom				
Identified current account	-8	-27	-32	-24
Financed by:				
Direct investment	-17	-19	-7	13
Portfolio investment	34	9	-40	-16
Banking sector	4	25	26	15
Other(a)	6	17	45	13
Official financing balance(b)	-20	-5	9	—
Italy				
Identified current account	-1	-6	-11	-14
Financed by:				
Direct investment	2	1	—	-1
Portfolio investment	-7	—	4	—
Banking sector	8	13	23	41
Other(a)	4	—	-5	-12
Official financing balance(b)	-5	-8	-11	-13
Canada				
Identified current account	-9	-11	-17	-19
Financed by:				
Direct investment	-4	-2	-1	4
Portfolio investment	9	10	16	9
Banking sector	2	2	-2	2
Other(a)	5	9	4	5
Official financing balance(b)	-3	-8	—	-1

(a) Includes balancing item reflecting unidentified net flows which may be associated with either the current or the capital account.
(b) - = increase in reserves.

In France and Italy non-official capital inflows were sufficient to finance current account deficits and in the latter case official reserves increased. The rise in Italian reserves occurred as foreign exchange intervention was used to limit the appreciation of the lira after the removal of exchange controls. High interest rates coupled with an expectation of greater exchange rate stability attracted non-resident deposits into the lira after the remaining controls were lifted. In the United Kingdom, net short-term banking inflows, which had played a major role in financing the current account deficit in 1988 and 1989, declined sharply in 1990. This was offset by lower gross direct and portfolio outflows, partly related to lower overseas acquisition activity by UK companies and reduced interest in overseas equities on the part of UK pension funds.

Balance of payments data for most countries include a substantial balancing item, which represents unrecorded

Chart 5
Interest rate differentials against the United States

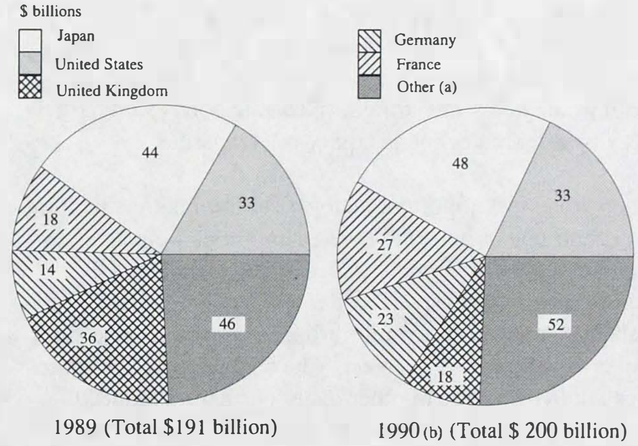


current or capital account flows. The size of such statistical discrepancies suggests that a degree of caution is required when interpreting published balance of payments data. Moreover, data relating to capital account movements are particularly tentative, given the difficulty of measuring capital flows with accuracy.

Foreign direct investment (FDI)

Aggregate gross direct investment outflows from the thirteen largest industrial countries increased from $191 billion in 1989 to $200 billion in 1990, with large increases recorded from France and Germany (Chart 6). However, statistics on foreign direct investment in 1990 are particularly difficult to interpret because reported aggregate outflows from these countries rose by $13 billion while aggregate inflows fell by

Chart 6
International direct investment - gross outflows



(a) Other G10 countries plus Australia and Spain.
(b) Partly estimated.

about $40 billion. Increased recorded net inflows into all other countries account for some of this imbalance but this is not sufficient to account fully for the discrepancy.

The destination of foreign direct investment flows in 1990 reflected growth performance in the major economies. Recession in the United States and the United Kingdom limited foreign direct investment inflows into these countries while continental Europe was a recipient to a larger extent than in the past. Preparation for 1992 may also have been a factor supporting investment in Europe. German unification did not result in foreign direct investment in eastern Germany on any significant scale in 1990, partly owing to difficulties with infrastructure and with the establishment of property rights.

Japanese net foreign direct investment outflows peaked in the first quarter of 1990 at $13 billion. Part of the subsequent slowdown may have been due to the completion of factories begun in the wake of the yen's appreciation in 1985–87. Substantial production has now come on stream and further direct investment looks increasingly likely to be primarily for the purposes of maintenance of overseas operations rather than the establishment of new facilities and therefore on a somewhat smaller scale. The difficulty of raising capital cheaply in the euromarket through warrants or convertible bonds following the decline in Japanese equity prices may have contributed to the slowdown in Japanese outward direct investment. Gross US direct investment abroad increased last year, but by much less than in 1989. Continental European FDI outflows again grew strongly, much of it being intra-European. France and Germany together invested approximately as much abroad as Japan last year; German net direct investment increased threefold over 1989's figure, while French direct investment doubled.

Portfolio investment

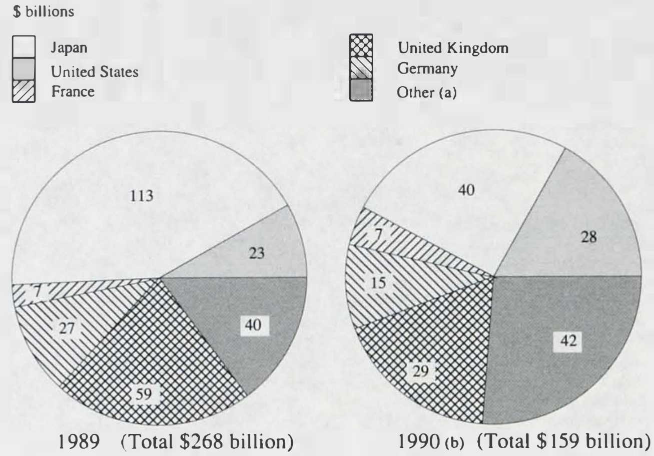
Aggregate portfolio outflows from the thirteen largest industrial countries fell steeply in 1990 to $159 billion, from $268 billion in 1989. The reduction was concentrated in Japan, but falls were also recorded by the United Kingdom and Germany (Chart 7).

In international bond markets total new issues, at $260 billion, were little changed from 1989 but there was a substantial shift in instrument composition. Increases in floating-rate notes and straight fixed-rate bonds were largely offset by a sharp decline in equity-related issues.

Among the most important factors determining the direction and magnitude of portfolio investment flows were changes in interest rate differentials (especially between the G3 economies), changes in credit ratings, the removal of exchange controls in several European economies and stock market developments in Japan. The decline in dollar interest rates relative to those of other major currencies reduced foreign demand for US bonds: Japanese investors were net sellers of US paper last year. Short-term yen rates rose above dollar rates and the long-term premium on dollar assets narrowed. German and UK portfolio outflows both declined last year. Long-term deutschemark interest rates rose and accordingly German investors tended to invest more domestically and most foreign bonds purchased by German residents were denominated in deutschemarks. In the United Kingdom confidence in sterling increased and non-bank financial institutions invested less in overseas shares and more domestically.

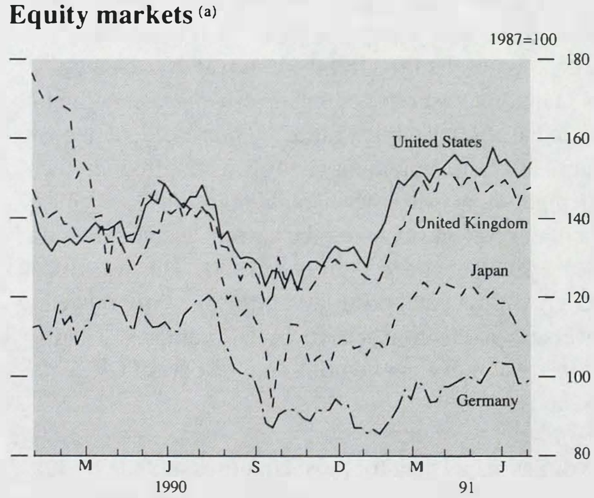
French and Italian markets (in particular the straight bond market) were boosted by the liberalisation of capital movements, while some Japanese institutional investors showed signs of having completed desired diversification into foreign securities in the wake of the deregulation of the 1980s. However, US pension funds began to buy foreign paper on a much larger scale than previously. Issuance of equity-related bonds, the major source of growth in international bond markets in 1989, fell sharply in 1990. This reflected less activity by Japanese corporate borrowers, as a consequence of the persistent weakness of the Japanese equity market throughout 1990 (Chart 8).

Chart 7
International portfolio investment - gross outflows



(a) Other G10 countries plus Australia and Spain.
(b) Partly estimated.

Chart 8
Equity markets (a)



(a) Stock market index FT (weekly).

The Gulf crisis and German unification both created uncertainties, the former causing investment in securities to decline as investors sought more liquid and less risky assets, and the latter increasing uncertainty over the course of German interest rates. Among deutschemark-denominated issues, floating-rate note issues were particularly popular because of the uncertainty surrounding future German interest rate movements.

Japanese borrowers continued to be the single most important nationality group in the international bond markets in 1990, although the net volume of funds raised was less than half the amount in 1989 and the share of total financing of Japanese companies accounted for by international bonds contracted from 13% in 1989 to 5% in the first nine months of 1990. Net recourse to the international bond markets by US residents remained modest, whereas French and Italian issuers gained importance as they adjusted to a more liberalised regulatory environment. Supranational bodies were also active in the market.

International bank lending

The gross level of new international bank lending was $589 billion in 1990, well below 1989's figure of $807 billion. The level of cross-border interbank lending fell to 50% of this total in 1990 against 65% the previous year. Two major factors behind the decline in international lending, and in particular in interbank business, were the contraction of Japanese banks' international operations and, more generally, increased concern about profit margins and counterparty risk. In the international syndicated credits market new lending rose 9% to $165 billion despite banks' increased caution about the quality of loans and a rise in banks' margins. Syndicated lending for mergers and acquisitions fell sharply because of such quality concerns and reduced demand from North America and the United Kingdom, but overall corporate borrowing remained broadly unchanged. Among sovereign borrowers, the better rated Asian borrowers secured loans while banks remained highly cautious in their attitude to eastern Europe.

Japanese banks, which had expanded their international lending activities aggressively during the mid-1980s, have more recently been affected by the constraint imposed by BIS capital requirements and difficulties in raising new capital due to the decline in the Japanese equity market since late 1989, partly compensated for by the issue of subordinated debt by the banks. Although some concerns were expressed about the damaging effect that the contraction of Japanese finance might have on world capital markets, these concerns have proved too pessimistic and markets appear to have adjusted smoothly to the differing mix of borrowers and lenders. A related concern about a possible world shortage of savings has similarly proved to be less serious than many commentators forecast, partly because the reduced supply of savings from Japan and Germany has been met by reduced demand from the English speaking economies.

Concerns were also expressed about fragility in the financial system, particularly in the United States where the onset of recession caused an increasing proportion of loans, especially to the property sector, to become non-performing. Such concerns led to a downgrading of bank credit ratings, increasing the relative cost of intermediation. Although this provoked worries about an overall shortage of new funds available to borrowers, it appears that its effect was not to reduce aggregate available savings so much as to increase risk premia, widen bank margins and slightly alter the channels of intermediation as concerns about counterparty risk affected the interbank market. The Gulf crisis provided further uncertainties, with Japanese banks in particular moving rapidly to reduce exposure in the Middle East.

Total new long-term bank credit commitments to LDCs fell slightly (by $0.4 billion) between 1989 and 1990. Although within this total the spontaneous element rose slightly, 75% of new syndicated loans to LDCs went to a small number of more creditworthy developing countries in Asia. However, there was a modest resumption in bank lending to certain highly indebted LDCs in Latin America that were pursuing adjustment programmes. External debt of the non-oil LDCs (excluding the NIEs) held by commercial banks rose by $9 billion over 1990 to $304 billion.

Detailed country/regional analysis

United States

The steady decline of the US current account deficit since its peak of $160 billion in 1987 continued in 1990, when it totalled $92 billion or 1.7% of GNP, less than half the proportion recorded in 1987. While data for the first quarter of 1991 show a $10 billion current account surplus, this was affected by receipt of burden-sharing payments relating to the Gulf war. Nevertheless, even excluding those receipts, the underlying trend in the deficit was still down. Services and interest, profits and dividends (IPD) both produced increased surpluses in 1990.

Although export volumes grew faster than import volumes in the United States in 1990 there was little improvement in the US trade deficit because the depreciation of the dollar over the year reduced the average price of US exports relative to imports. This reversed the pattern of the previous year when the effect of buoyant export volumes was compounded by terms of trade gains associated with a strengthening of the dollar in 1989. Because of the relatively long lags in the response of US trade volumes to competitiveness changes, the weakening of the dollar in 1990, which was concentrated in the second half of the year, will not have affected trade volumes during 1990 to any significant extent. Although the dollar's strength in 1989 may have begun to affect trade volumes in 1990, movements in the dollar over the past three years or so are modest by comparison with the large depreciation of 1985–87 and it appears that export volumes are still benefiting from the competitiveness gains of that period. The price of US exports relative to those of its foreign competitors was 33% lower in 1990 than in 1985, representing a very significant and sustained gain in competitiveness.

The contraction of the US current account deficit over recent years has reduced concern about its financing and the dependence on foreign investors. In 1990 reduced dependence on private sector capital inflows was illustrated by a fall in identified gross inflows to only $54 billion against $208 billion in 1989, which occurred without causing serious dollar weakness. The decline was spread across all categories of capital flow, the biggest fall being in gross banking inflows, which fell to $10 billion from $63 billion. At the same time, gross US portfolio and direct investment outflows both increased but this was more than offset by US banks' claims abroad which fell by $5 billion against an increase of $51 billion the previous year. These data on banking flows indicate a sizable contraction of international activity by US banks while concerns about the health of US banks reduced foreign deposit inflows.

Japan

The Japanese current account surplus fell to $36 billion in 1990 against $57 billion the previous year and a peak of $87 billion in 1987. As a proportion of GNP, at 1.2%, the 1990 figure was the lowest since 1982 and one third of that of 1987. The net IPD balance in 1990 was little changed from the previous year's while the net services deficit increased by some $7 billion.

Although Japanese domestic demand growth was faster relative to its main trading partners in 1990 than in 1989, the decline in the trade surplus to $52 billion on a customs cleared basis arose mainly from a sharp fall in the terms of trade, associated with an 8% fall in the effective exchange rate. Japanese trade volumes appear to have begun to respond to the gain in competitiveness, with export volume growth in 1990 outstripping that of import volumes for the first time since 1985, despite the weakness of export markets. However, improved trade volumes only partly offset the effect of the shift in the terms of trade.

It is clear from trade and current account data for the early months of 1991 that the competitiveness gain provided by a weaker yen is now being translated into significantly higher surpluses as trade volumes continue to respond to improved competitiveness. The seasonally-adjusted current account surplus in the first quarter of 1991 was $18 billion, almost treble its rate in the fourth quarter of 1990. 1990 is thus likely to represent a trough for the trade and current account surpluses. Moreover, the extremely high rate of business investment over the last few years should have enabled Japan to raise factor productivity and improve innovation, which should further strengthen its export performance.

The geographic spread of the Japanese trade balance has been shifting quite significantly in recent years. The trade surplus with the United States has fallen from $52 billion in 1987 to $38 billion last year on a customs cleared basis while the trade surplus with western Europe has fallen slightly over the same period. These changes reflect a substantial build-up of Japanese production in Europe and more particularly in North America, as well as efforts on the part of the Japanese to reduce structural impediments towards imports. Over the same period Japan has seen its trade surplus with south-east and east Asia double to $28 billion, reflecting improved Japanese competitiveness particularly against Taiwan and South Korea and substantial domestic demand growth throughout south-east Asia.

During 1990 Japanese equity and bond markets reacted to a tightening of monetary policy, and the rising financial asset prices of the previous few years were sharply reversed. However, higher short-term interest rates did not provide much support for the yen, which was 5% lower on average against the dollar in 1990 than the previous year. Portfolio outflows were affected significantly by the turbulence in domestic financial markets, with net portfolio outflows falling to $11 billion in 1990 against a figure of $31 billion in 1989, as many Japanese investment funds sought to cover losses on their domestic portfolios by selling and repatriating funds previously held in foreign securities.

Germany

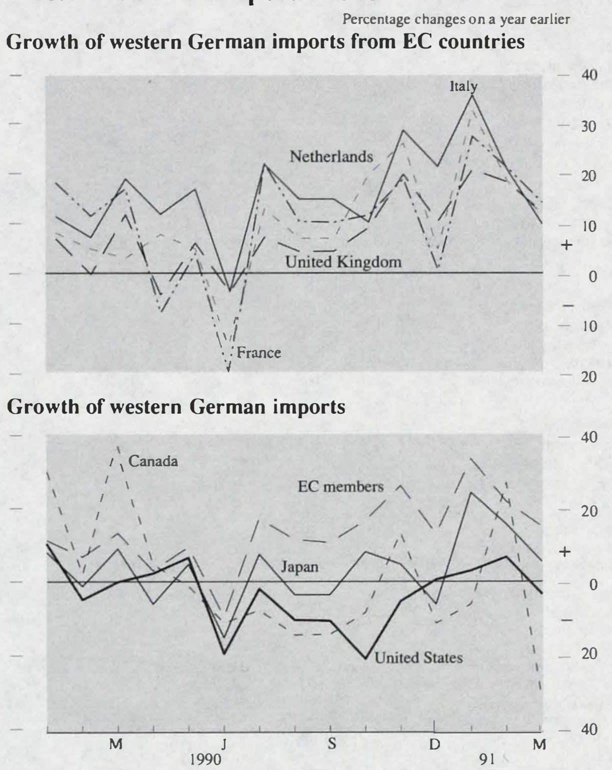
The German current account surplus fell to $47 billion in 1990 from a record $57 billion the previous year. A lower net services deficit and higher net IPD inflow helped to counterbalance a rapid deterioration in the trade account. Unified German trade figures, available only for the second half of 1990, show a higher surplus than those relating to western Germany alone because while eastern German exports held up well initially, helped by government subsidies, imports from former Council for Mutual Economic Assistance (CMEA) countries collapsed following monetary union and the conversion to hard currency trade within the CMEA bloc. Additionally, trade with eastern Germany is not included in western German trade data, so the surge in western German 'exports' to the east is not recorded.

Economic and monetary union had a particularly significant effect on Germany's external account as the pressure of rapidly expanding domestic demand raised import volumes and diverted some western German output from export to home markets. The trade and current account surpluses would have fallen even more substantially in 1990 were it not for terms of trade gains resulting from an appreciation of the deutschemark, which averaged 5% above its 1989 level on an effective basis. However, the deutschemark's rise, most of which occurred in late 1989, may also have contributed somewhat to Germany's poor export volume figures in 1990.

The unified German current account moved into deficit in the early part of 1991, as demand for western products in eastern Germany surged following the introduction of the deutschemark coupled with the loss of traditional export markets in eastern Europe, following the breakdown of the CMEA trading system and the loss of German government subsidies. Gulf war payments also affected the current account position in the first quarter of 1991, contributing to a deficit of $7 billion.

The surge in the value of German imports in 1990 was very unevenly spread across its trading partners, with other EC countries benefiting most. A seemingly weak performance by the United States is partly explained by the valuation effects of a strong deutschemark relative to the dollar during 1990, although the Japanese fared better despite an even weaker yen. Nevertheless the figures do illustrate the sizable impulse given to the exports of Germany's European trading partners following unification (Chart 9). For instance, increased Italian exports to Germany accounted for 1 percentage point of Italian GDP growth in 1990.

Chart 9
Western German import values



Increased net private sector capital inflows into Germany and higher official short-term interest rates buoyed the deutschemark during 1990. A large increase in inward direct investment occurred, stimulated by expansion on the part of European firms ahead of the completion of the single market and capital liberalisation across Europe. Unification also contributed to foreign interest in German assets, but in 1990 this was not translated into foreign direct investment in eastern Germany to any significant extent despite the attempt of the Treuhand to sell a large number of businesses.

France

France's current account deficit nearly doubled in dollar terms in 1990 to $8 billion, but as a proportion of GDP it remained less than 1%. An improvement in the services balance was more than offset by a swing into deficit on the IPD account.

French export volume growth was adversely affected by the slowdown in most of the rest of Europe in 1990 and a loss of competitiveness against its non-European trading partners due to the strengthening of the franc since early 1989. However, the higher value of the franc was offset by other relative price changes, leaving the French terms of trade unchanged on 1989. The value of exports to Germany rose 8%, fairly modest compared with most other EC countries. Import volume growth fell back in 1990, and a slowing economy has caused a further decline in the early part of 1991.

United Kingdom

1990 saw a significant reduction in the United Kingdom's current account deficit to $24 billion or 2.4% of GDP against $32 billion in 1989, indicating an easing of the demand pressures that had been associated with a rising current account deficit in 1988 and 1989. The surpluses on the services and IPD accounts increased although visible trade provided most of the overall current account improvement.

The easing of demand in the United Kingdom has not only caused a rapid deceleration of import volumes since 1988, but also appears to have contributed to higher export volume growth as producers have targeted export markets in the face of depressed demand at home. Some industries that have experienced the sharpest slowdown in domestic sales, such as cars, have simultaneously experienced the most marked improvement in export performance.

Italy

The Italian current account deficit increased to $14 billion in 1990 against $11 billion in 1989. The dollar-denominated deficit was the largest on record, and as a percentage of Italian GDP at 1.3% it was the highest since 1982. Lower net services receipts, partly as a result of the decline in tourism in the second half of the year, together with higher net IPD outflows were responsible for the worsening current account position despite the trade account moving into surplus for the first time since 1986.

Canada

A sharp slowing of the Canadian economy in 1990 helped to contain the current account deficit despite a further deterioration in the net IPD position. The current account deficit rose marginally to US$19 billion or 3.3% of GDP.

Export volumes grew largely in line with the growth of Canada's export markets at 4½%, while import volumes grew only ½% as domestic demand registered a decline from the previous year. A decline in the terms of trade did not prevent a rise in the trade surplus to $9 billion from $6 billion the previous year. The replacement of a federal sales tax with the goods and services tax in January 1991 raised the price of some imports (such as capital goods) relative to domestic goods and is therefore expected to contribute to lower import volume growth and lower current account deficits in the medium term.

Smaller OECD economies

The aggregate current account deficit of the smaller OECD countries was little changed at $18 billion in 1990. Lower domestic demand helped to trim Australia's current account deficit to $14 billion (4.8% of GDP) while Spain's deficit continued to grow, reaching $16 billion (3.3% of GDP) as domestic demand advanced strongly for the fifth consecutive year.

In Sweden, a deteriorating IPD position and a worsening of the terms of trade in 1990 pushed the current account deficit up to $6 billion despite the weakness of domestic demand. In contrast, the Netherlands recorded a current account surplus rising to nearly 4% of GDP in 1990 despite growth in the domestic economy of 3½%.

Asian newly industrialised economies (NIEs)

The NIEs' collective current account surplus declined sharply in 1990 to $11 billion from $20 billion in 1989 and a peak of $28 billion in 1987. During 1990 the NIEs continued to experience structural adjustment—a shift away from traditionally important industries reliant on cheap labour. Higher domestic costs, particularly wages, have eroded the low cost base which had facilitated the period of exceptionally fast export-led economic growth in the second half of the 1980s. Weakening demand growth in 1989 and 1990 in the United States, which still takes a third of NIE exports, served to depress export volumes. Weaker overseas demand was compounded by exchange rate appreciation in all of the NIEs in 1989. However, during 1990 much of the previous year's currency appreciation was reversed in Taiwan and South Korea, permitting a modest increase in export volumes for these economies.

Structural adjustment has coincided with rapid domestic demand growth in the NIEs since 1987 and demand remained buoyant in 1990, except in Taiwan where the domestic economy cooled somewhat. Import volume growth was therefore strong in South Korea, Hong Kong and Singapore while falling back in Taiwan. The rapid growth of import volumes in South Korea in recent years has contributed to a pronounced turn-round in its current account, which moved from a surplus of $14 billion in 1988 to $5 billion in 1989 and a deficit of $2 billion in 1990. A weak recovery in South Korean export volumes in 1990 was offset by the terms of trade loss associated with a weaker won, also contributing to the move into deficit.

OPEC nations

The sharp rise in oil prices that followed Iraq's invasion of Kuwait and the UN embargo that followed produced a revenue windfall for other oil exporters in the second half of 1990, with the average oil price rising to $26 per barrel from $16 per barrel in the first half of the year. Higher crude oil production on the part of a number of OPEC states, most notably Saudi Arabia, compensated for the loss of Iraqi and Kuwaiti supplies. The value of OPEC exports thus rose strongly, the total for 1990 reaching an estimated $184 billion, a 26% increase on the previous year. While the estimated value of OPEC imports was little changed from 1989's figure, a sharp rise in the invisibles deficit is likely to have prevented any substantial improvement in the aggregate current account. Identified movements in the external assets of the oil-exporting countries were predominantly into eurocurrency and US bank deposits in the latter half of the year.

Table B
Identified deployment of oil exporters' funds [(a)]
$ billions

	Dec. 1989 levels	1990 Q1	Q2	Q3	Q4	Dec. 1990 levels
Industrial countries						
United Kingdom:						
Sterling bank deposits	10.8	0.1	-0.2	0.3	0.7	13.7
Eurocurrency bank deposits	44.9	0.8	0.4	6.0	4.5	57.3
Government paper	4.3	—	0.1	0.3	-0.8	4.6
Other investments	15.7	0.1	—	0.2	—	12.1
	75.6	1.0	0.3	6.7	4.3	87.8
Other EC:						
Domestic currency bank deposits	7.2	—	0.4	-0.3	0.5	8.8
Eurocurrency bank deposits	23.0	0.4	-1.0	0.2	3.5	26.9
Other investments	114.2	0.1	0.2	-0.1	-1.4	98.7
	144.4	0.5	-0.4	-0.2	2.7	134.4
United States:						
Bank deposits	19.0	0.5	-0.4	1.1	2.9	23.1
Government paper	50.0	2.8	0.5	-2.0	-0.5	55.3
Other investments	53.5	-0.2	-0.4	-0.5	-1.2	47.4
	122.6	3.1	-0.3	-1.4	1.2	125.7
Other:						
Domestic currency bank deposits	5.7	-1.2	0.4	—	1.8	6.9
Eurocurrency bank deposits	36.3	-1.2	—	-2.5	7.5	40.2
Other investments	92.7	-0.2	0.8	—	4.8	103.3
	134.7	-2.6	1.2	-2.5	14.1	150.4
Offshore centres:						
Bank deposits	56.4	-0.3	0.3	-10.7	6.7	52.4
Placements with ldcs	73.2	—	0.1	0.5	1.0	74.9
OEC credit to non-banks	13.0	—	—	—	—	12.9
IMF and IBRD (b)	33.2	-2.3	-1.5	1.6	1.8	27.7
Total identified additions (+)/reductions (-) in deployed assets	**653.0**	**-0.7**	**-0.4**	**-6.0**	**28.1**	**666.3**
Net movements in external borrowing etc		*-2.7*	*1.7*	*-10.8*	*2.5*	

(a) The oil exporting countries covered are defined in the notes and definitions to Table 16 of the statistical annex in the February 1991 *Bulletin*.

(b) Includes holdings of gold.

Non-oil less developed countries (LDCs)

In 1990 non-oil LDCs (excluding the NIEs) incurred a current account deficit of approximately $51 billion, representing a sharp deterioration from the $37 billion deficit recorded in 1989. Over the same period the trade deficit for these economies deteriorated to $31 billion. These figures reflect a worsening of the terms of trade in 1990 of around 3% for the oil importing LDCs following the rise in oil prices and a continued decline in non-fuel commodity prices. Furthermore, export volume growth was half of that achieved in 1989. In the non-oil-exporting African economies the current account deficit increased to $9 billion as prices of tropical beverages fell to their lowest level since 1980 and oil import costs rose. Similarly in Latin America, the aggregate current account deficit rose, with a particularly rapid deterioration in Brazil.

In terms of financing, 1990 witnessed a substantial increase in total net external borrowing, from $32 billion to

$46 billion. This largely reflected increased borrowing by creditworthy countries in Asia and exceptional financing (including the accumulation of arrears) in Latin America. A large proportion of lending to other non-oil LDCs in 1990 was provided by official creditors. Over the same period net foreign direct investment to all developing countries fell by $3 billion. The increase in net financial flows allowed non-oil LDCs to boost official reserves by around $4½ billion in 1990.

Soviet Union and eastern Europe

In the Soviet Union, the trade deficit widened in the first half of 1990, trade arrears increased and the Soviet Union's credit rating fell. A combination of measures to restrict imports and the lack of finance led to a significant degree of import compression in the second half of 1990. Although continuation of this compression resulted in a small trade surplus in the first quarter of 1991, the external position remained serious, not least because of the decline in oil exports reflecting a further fall in oil production. In addition, the near collapse of trade with former CMEA members significantly reduced the terms of trade gain which had been expected following the change in intra-CMEA trading arrangements. The loss of Soviet markets has also caused serious dislocation of trade for the emerging eastern European democracies, compounding the burden of higher market oil prices in the second half of 1990.