

# World Economic Trend, Spring 2006, No. 9

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(summary)

## Key Points of Chapter 1

### 1. Global price stability: Global economy continues to show price stability and recovery despite oil price spike

- Prices have been stable globally. Global price hikes have slowed to 4% from some 30% in the early 1990s, while real global economic growth has accelerated to around 4% from less than 3% in the early 1990s. Since 2000, the world economy has achieved better growth and price stabilization performance than in the past. (Table 1-1)

Table 1-1 World Consumer Price Rises and Real GDP Growth Rates

#### (1) Consumer Price Rises

(% change from previous year)	1970s	80-84	85-89	90-94	95-99	00-04	2003	2004	2005	Variance			
										1970s	1980s	1990s	2000s
World	10.1	14.6	16.2	29.5	7.9	3.8	3.7	3.7	3.9	10.6	14.3	151.9	0.1
Industrial countries	-	8.8	3.9	3.8	2.0	1.9	1.8	2.0	2.2	-	10.8	1.6	0.1
U.S.	-	7.5	3.6	3.6	2.3	2.6	2.3	2.7	3.1	-	12.8	1.2	0.4
Eurozone	-	-	-	3.2	1.7	2.2	2.1	2.1	2.1	-	-	0.9	0.0
Germany	-	4.5	1.3	3.7	1.1	1.5	1.0	1.8	1.7	-	4.8	2.4	0.1
Japan	-	3.9	1.1	2.0	0.4	-0.6	-0.2	0.0	-0.4	-	5.2	1.5	0.2
Developing countries	-	24.6	37.6	80.6	17.1	6.3	6.0	5.8	5.9	-	150.1	1383.2	0.4
Asia	-	9.2	11.2	10.3	7.3	2.7	2.6	4.2	4.2	-	6.0	14.0	0.8
Middle East	-	11.5	14.1	14.6	11.5	6.7	7.1	8.4	10.0	-	15.9	15.2	1.4
Latin America	-	89.1	212.1	263.5	17.0	7.9	10.6	6.5	6.3	-	13595.7	30071.4	3.4
Africa	-	4.5	1.3	3.7	1.1	1.5	1.0	1.8	1.7	-	3.2	186.2	4.4

#### (2) Real GDP Growth

(% change from previous year)	1970s	80-84	85-89	90-94	95-99	00-04	2003	2004	2005	Variance			
										1970s	1980s	1990s	2000s
World	4.4	2.7	4.0	2.6	3.7	3.8	4.0	5.1	4.3	1.9	1.4	0.7	1.3
Industrial countries	-	2.2	3.8	2.3	3.1	2.4	1.9	3.3	2.5	-	2.3	0.6	1.4
U.S.	-	2.4	3.7	2.3	3.9	2.6	2.7	4.2	3.5	-	6.4	2.1	2.0
Eurozone	-	-	-	1.1	2.4	1.8	0.7	2.0	1.2	-	-	1.9	1.5
Germany	-	1.0	2.6	3.0	1.7	1.2	-0.2	1.6	0.8	-	2.1	3.5	1.7
Japan	-	2.7	4.8	2.2	1.2	1.3	1.4	2.7	2.0	-	2.4	3.6	1.7
Developing countries	-	3.5	4.2	3.0	4.5	5.7	6.5	7.3	6.4	-	0.7	1.6	1.6
Asia	-	6.5	7.2	7.8	6.8	7.0	8.1	8.2	7.8	-	1.3	3.4	1.2
Middle East	-	1.8	1.6	4.1	3.8	5.0	6.5	5.5	5.4	-	6.2	3.4	1.2
Latin America	-	1.6	2.6	3.4	2.6	2.4	2.2	5.6	4.1	-	6.8	3.2	5.5
Africa	-	1.0	2.6	3.0	1.7	1.2	-0.2	1.6	0.8	-	1.1	3.4	0.6

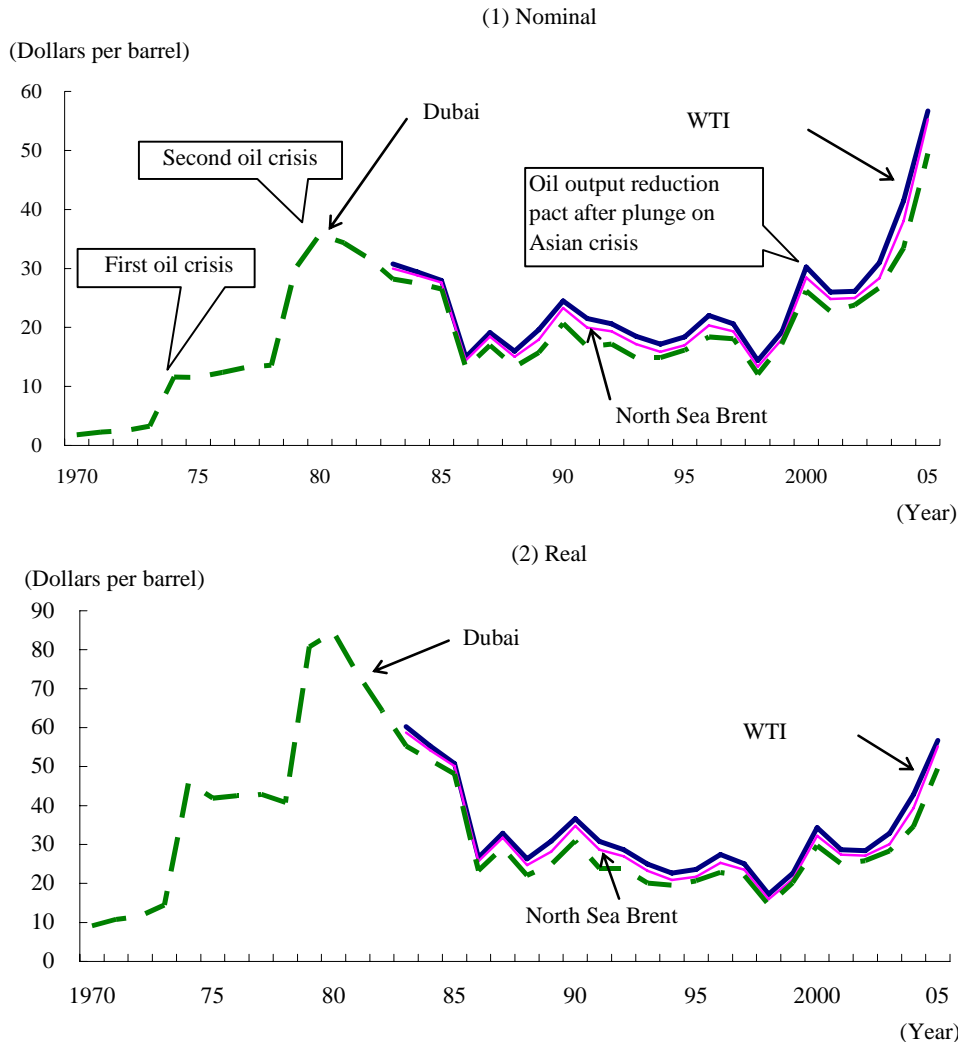
Source: IMF, *World Economic Outlook Database*

Notes: 1. Data for the eurozone have been available since 1992.

2. Variance figures are based on calendar-year data. For regions, relevant regional data are adopted.

- Since the autumn of 2003, oil prices have continued their rapid rise (Figure 1-2).

Figure 1-2 Trends in Crude Oil Prices



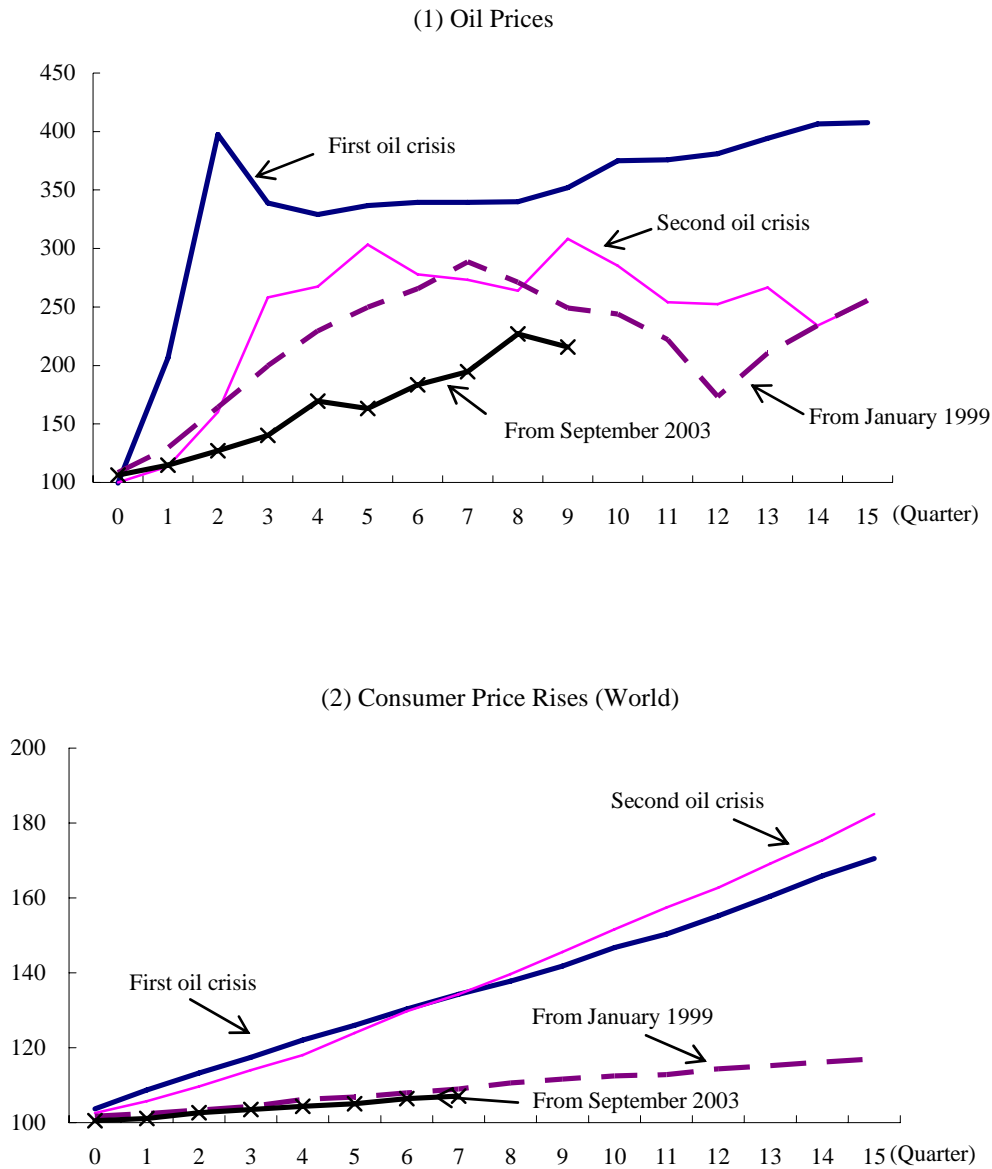
Sources: BP Statistics (for 1970-1982), Bloomberg (since 1983)

- Notes:
1. WTI prices are the WTI spot price for 1983-1986 and the key WTI futures price for years from 1987.
  2. North Sea Brent prices (on the International Petroleum Exchange, or IPE) are the spot price for 1983-1988 and the key IPE futures price for the period from 1989.
  3. The Dubai crude price is defined as follows:
    - Until 1974: Saudi Arabian Light 34 degrees API, posted price, ex Ras Tanura
    - 1975-1994: Middle East Light 34 degrees API, spot
    - From 1995: Medium, Fatch 32 degrees API, spot, f.o.b., Dubai
  4. Real prices are based on the U.S. consumer price index with 2005 set as the base year.

**Primary product (commodity) prices have also been climbing. The CRB (Commodity Research Bureau) commodity futures index hit a record high in 2005. Unlike past oil price spikes, the current hike has resulted from medium to long-term demand/supply factors rather than supply shocks.**

**But the current hike has been relatively more moderate than past ones, allowing consumer price rises to remain at low levels (Figure 1-3).**

Figure 1-3 Past Oil Price Spikes and Consumer Price Rise



Sources: IMF, *International Financial Statistics* ; Bloomberg  
 Notes: 1. Oil prices are the Dubai price for the years to 1983, the WTI spot price for 1984 and 1985, and the WTI futures (one month) price for the period from 1986.  
 2. Prices are for a four-year period (16 quarters), based on 100 for the quarter before each of the following  
 oil price hikes:  
 First oil crisis: October 1973-August 1974  
 Second oil crisis: October 1978-April 1982  
 Recent oil price rises: From January 1999, from September 2003

## 2. Factors behind global price stability even given the oil price spike: The Great Moderation?

• The first factor behind stable consumer prices even given the oil price spike is a decline in the effect of oil price volatility on domestic prices. Since the 1990s, primary product price rises have had a certain impact on import prices in major countries. But import price rises have lost any impact on domestic core consumer prices. One reason for this situation is a decline in dependence on oil (Table 1-4).

Table 1-4 Declining Impact of Oil and Other Primary Product Prices on Consumer Prices

(Year)	Impact of oil and other primary product prices on import prices		Impact of import prices on core consumer prices	
	1970~89	90~05	70~89	90~05
U.S.	0.36 **	0.20 **	0.33 **	-0.09
Japan	0.48 **	0.29 **	0.23 **	0.04
Germany	0.12 *	0.08 *	0.17 **	-0.11
U.K.	0.16 *	0.17 **	0.29 *	0.01
South Korea	0.33 **	0.37 **	0.51 **	0.12

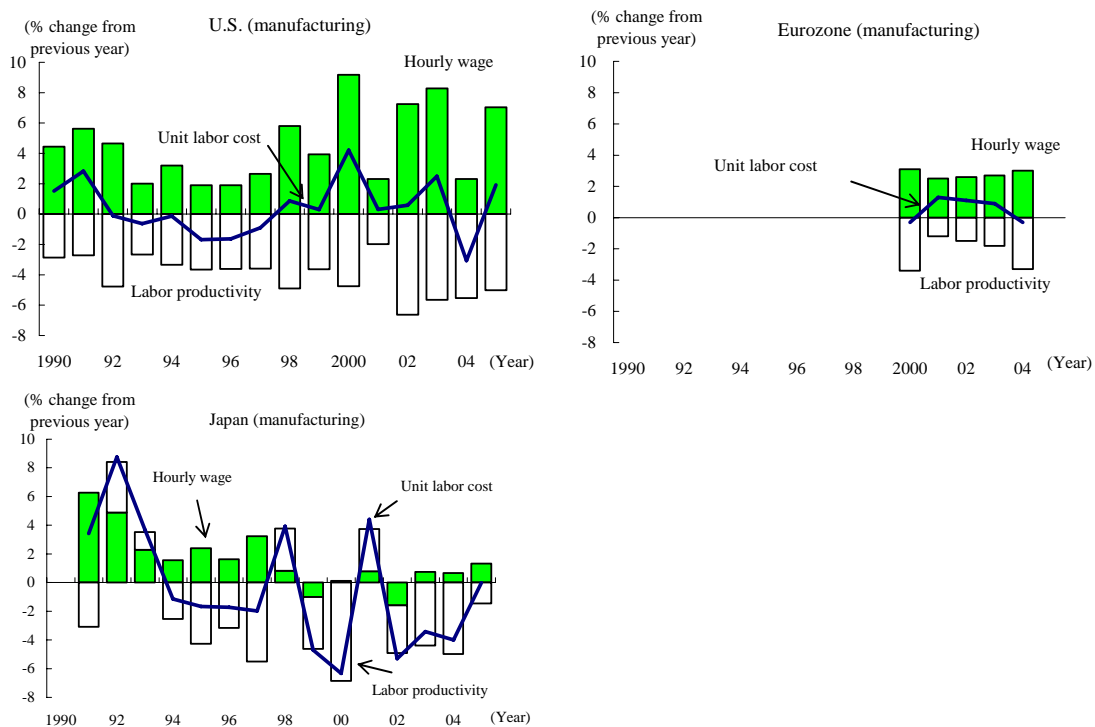
Notes: 1. Data for the United States are for the period from 1976. Data for South Korea are for the period from 1975.

2. Based on BIS (2005) Table II. 2. \*\* denotes the impact at the 1% significance level.

\* denotes the impact at the 5% significance level.

• **Second, the economic structure has changed along with companies' pricing behavior. Specifically, price hikes' impact on wages has declined. Growing global competition has made it difficult for companies to pass cost increases on to product prices. Communications and transportation sectors have also been liberalized and deregulated (Figures 1-5 and 1-6).**

Figure 1-5 Unit Labor Cost Stabilizing in Manufacturing Industries



Sources: U.S.: Depart of Labor

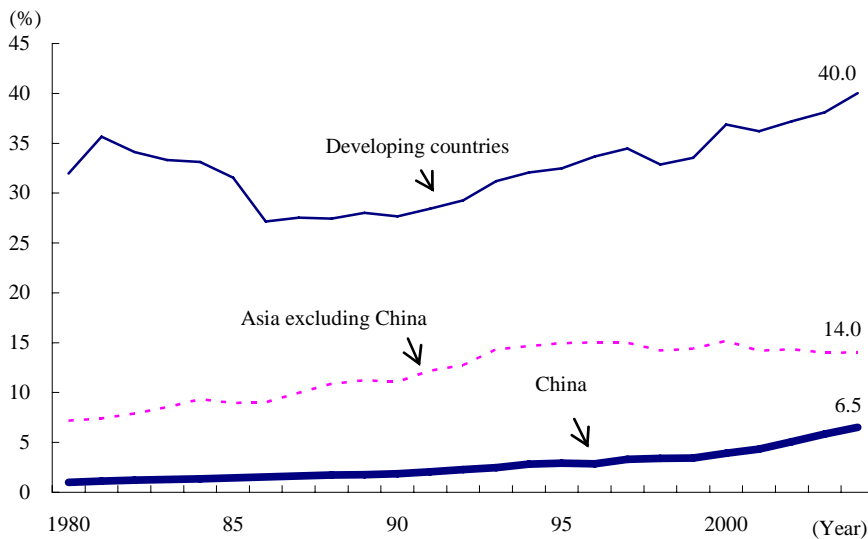
Eurozone: European Central Bank

Japan: Ministry of Economy, Trade and Industry, *Industrial Production Index*, *Tertiary Industry Activity Index*, *All-industry Activity Index*;

Ministry of Health, Labor and Welfare, *Monthly Labor Statistics Survey*; Cabinet Office, *National Accounts*.

Labor productivity is on a man-hour basis.

Figure 1-6 World Export Shares for China, Asia and Developing Countries

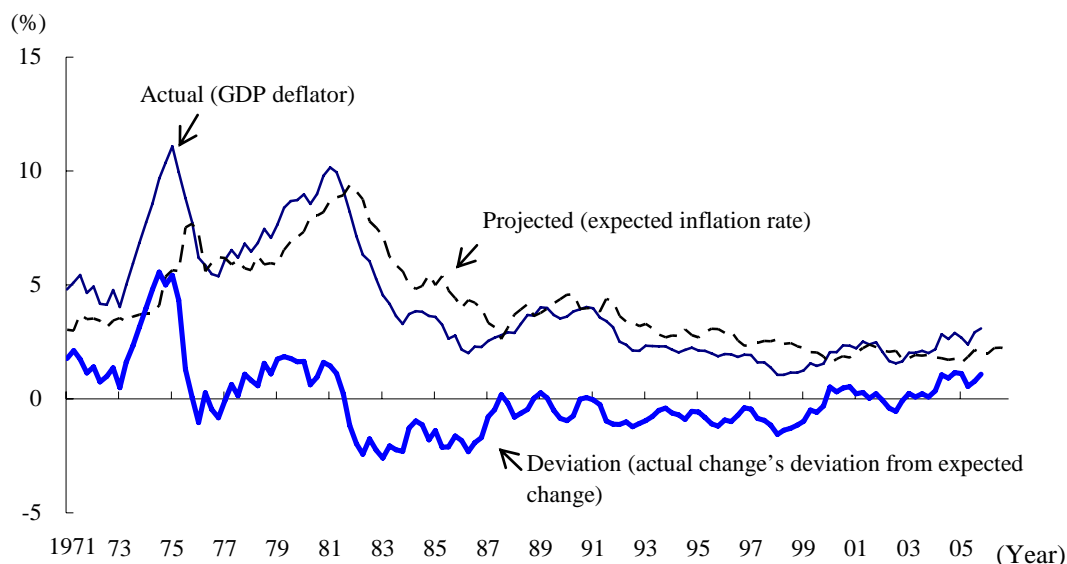


Sources: IMF, *International Financial Statistics*, *World Economic Outlook*, *Direction of Trade Statistics*; Taiwan Executive Branch

Note: Regarding developing countries, Asia excluding China covers South Korea, Taiwan, Hong Kong, Singapore, Indonesia, Thailand, Malaysia, the Philippines and India.

- **Third, macroeconomic policies have changed. Governments have reduced budget deficits through austere budgets in the 1990s and central banks have emphasized inflationary expectations in monetary policy in a bid to stabilize prices. These changes have contributed to the present price stability (Figures 1-7 ,Table 1-8).**

Figure 1-7 Decline in Expected U.S. Inflation Rate



Sources: Projections are by the Federal Reserve Bank of Philadelphia, *Survey of Professional Forecasters*. Others are by the Federal Reserve Board and Bloomberg.

Table 1-8 Improvement in General Government Budget Balance in Major Regions

	(% of GDP)			
	Primary budget balance		Budget balance	
	1970-89	1990-02	1970-89	1990-02
Industrial countries	-0.11	2.76	-2.50	-2.13 (*)
Developing countries				
Asia	-1.29	-1.20	-3.91	-3.56
Middle East	2.53	-0.96	-7.57	-4.48
Latin America	-0.13	1.25	-4.58	-2.70
Africa	-3.58	-1.63	-6.45	-4.99

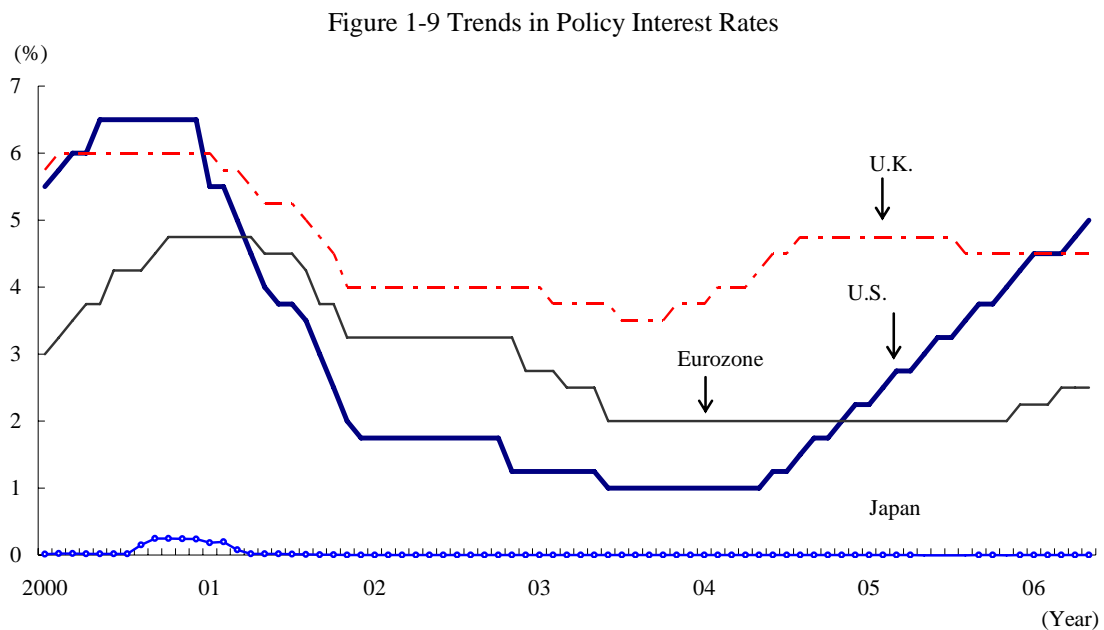
Sources: Rogoff (2003); IMF, *World Economic Outlook Database, September 2005*

Notes: 1. (\*) indicates the 1990-1994 budget balance for the industrial countries.

2. The industrial countries are Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Britain and the United States.

### 3. Monetary policy under price stability

• After an accommodative monetary policy to cope with a global business slump following the bursting of the information technology bubble, major countries are shifting to a more neutral monetary policy in response to inflationary pressures emerging from a U.S.-led economic recovery and rising oil prices. The U.S. policy interest rate has been raised from an accommodative level to a neutral one. Interest rate hikes have also started in the eurozone. (Figure 1-9)



Sources: U.S.: Federal Reserve Board, Eurozone: European Central Bank, U.K.: Bank of England, Japan: Bank of Japan

Notes: 1. The eurozone policy interest rate is the ECB policy interest rate.

2. Japan's policy interest rate is the uncollateralized overnight call loan rate.

• While the importance of price stability has been appreciated, central banks in major countries have grown more independent since the mid-1990s. On the other hand, central banks have been required to improve their accountability and transparency. They have thus given priority to communication with markets through disclosure of policy decisions and minutes of their meetings. (Table 1-10)

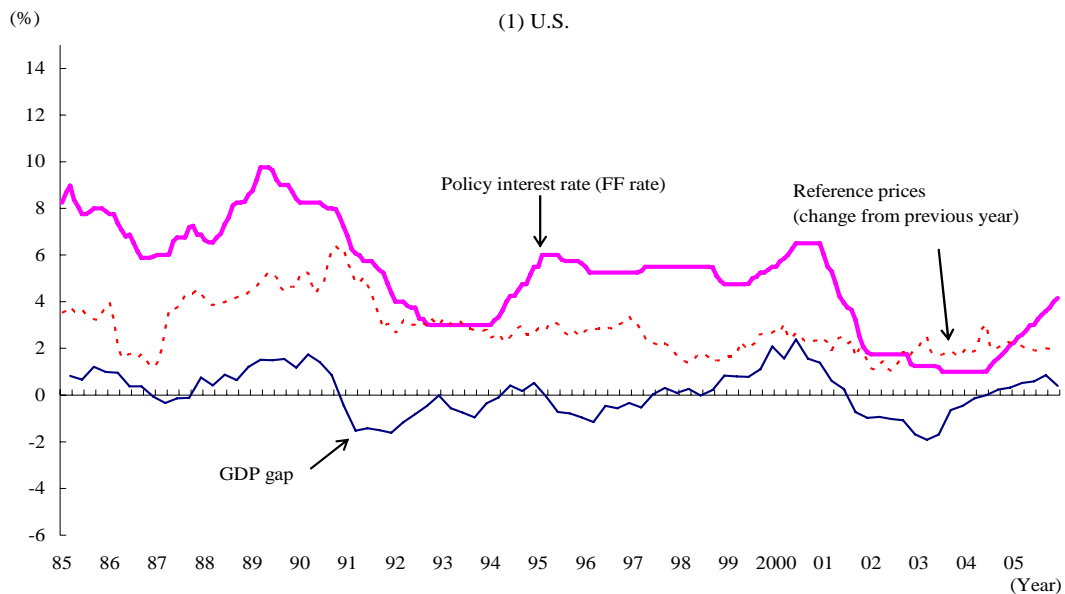
Table 1-10 FOMC Measures for Improvement in Transparency and Communication with Markets

Month/year	Major decisions
February 1994:	Any policy change at an FOMC meeting will be published through a written statement.
February 1995:	Of the minutes from 1979, those five years old and older will be disclosed. A FOMC statement will specify a target for the federal funds rate.
December 1998:	A statement will be published, if necessary, when the FOMC substantially changes its view about the risk balance or the monetary policy bias.
February 2000:	The FOMC will issue a statement after every meeting. The FOMC statements will drop comments on the policy bias and specify the view about the risk balance.
March 2002:	FOMC statements will specify each committee member's vote.
May 2003:	FOMC statements will describe the view about the inflation rate.
August 2003:	FOMC statements will describe the forward-looking policy direction.
December 2004:	FOMC summary minutes will be released sooner, three weeks after each meeting (before the next meeting).

Sources: Federal Reserve Board, Woodford (2005), Yellen (2006), Pakko (1995)

- Central banks have also begun to emphasize forward-looking monetary policy including creation of expectations. Through their commitment to present and future monetary policy paths under forward-looking policies, central banks can exert their influence not only on short-term interest rates that they directly control, but also on long-term rates and other key economic variables that have greater real economic effects. (Figure 1-11)**

Figure 1-11 GDP Gaps, Consumer Prices and Policy Interest Rates

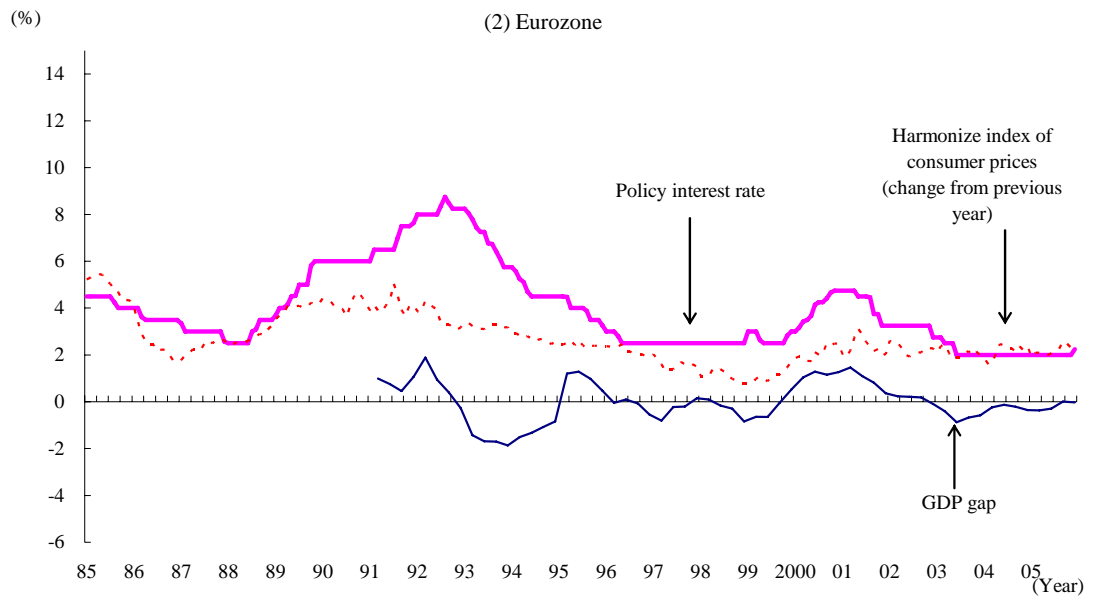


Sources: U.S. Department of Commerce, Department of Labor, Federal Reserve Board

Notes: 1. Reference prices refer to the CPI for January 2000, the PCE (personal consumption expenditure) price index between February 2000 and June 2004, and the core PCE index from July 2004.

2. The GDP gap was estimated using the Hodrick-Prescott filter for the period between the first quarter of 1970 and the fourth quarter of 2005.

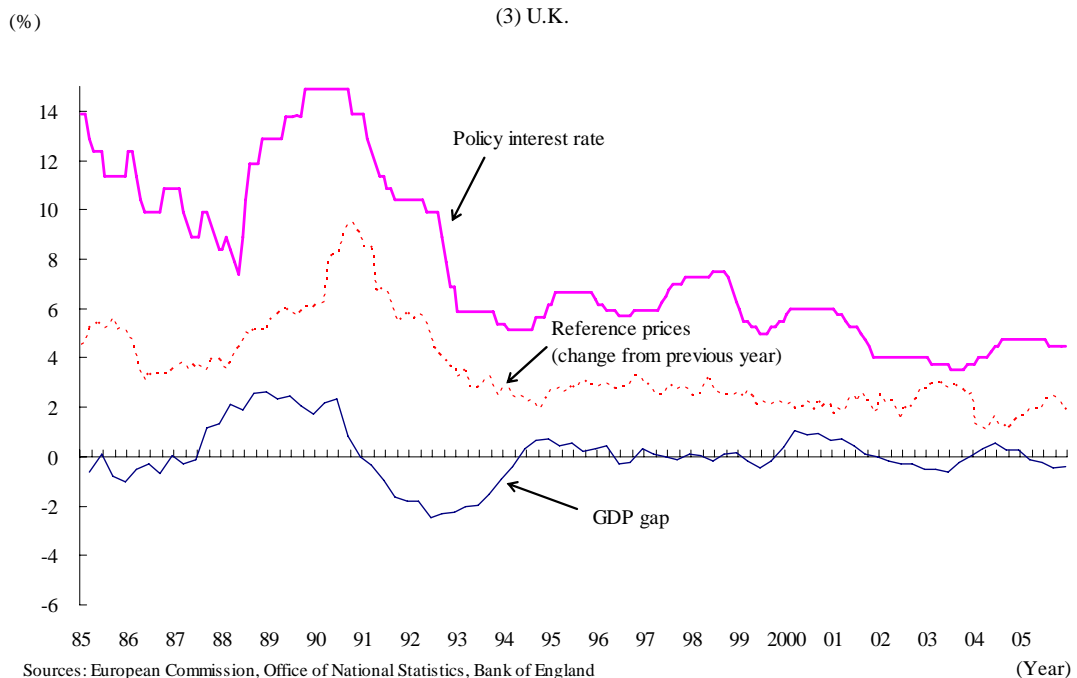




Sources: European Commission, ECB

Notes: 1. The policy interest rate refers to the German official discount rate for the years to 1998 and the ECB policy interest rate for the period from 1999.

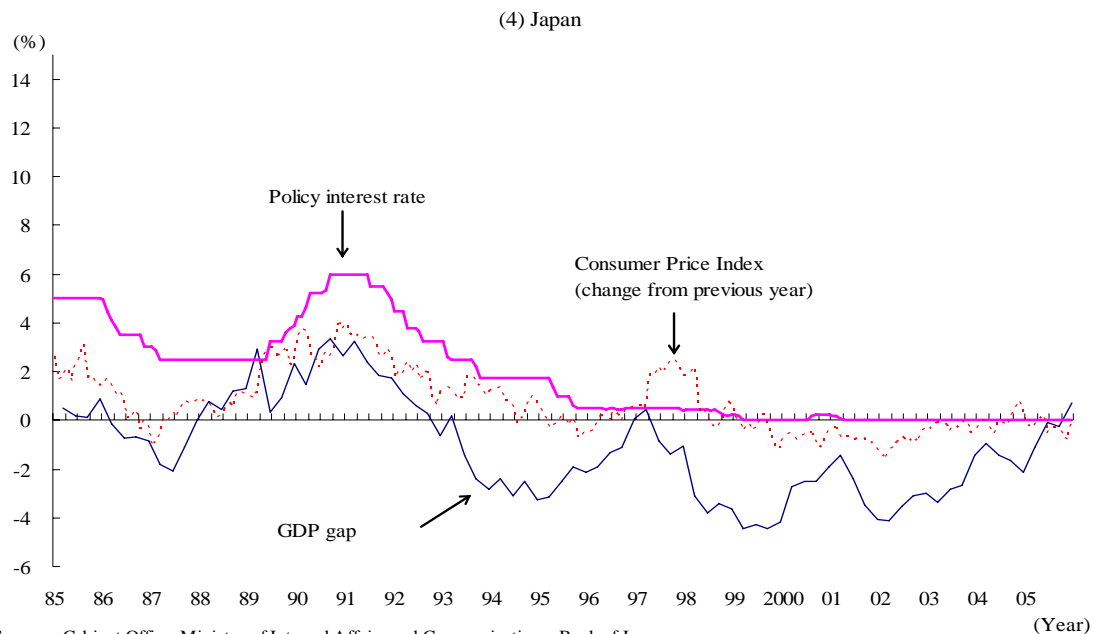
2. The GDP gap was estimated using the Hodrick-Prescott filter for the period between the first quarter of 1991 and the fourth quarter of 2005.



Sources: European Commission, Office of National Statistics, Bank of England

Notes: 1. Reference prices refer to the RPIX for the years to 2003, and the HICP for the period from 2004.

2. The GDP gap was estimated using the Hodrick-Prescott filter for the period between the first quarter of 1970 and the fourth quarter of 2005.



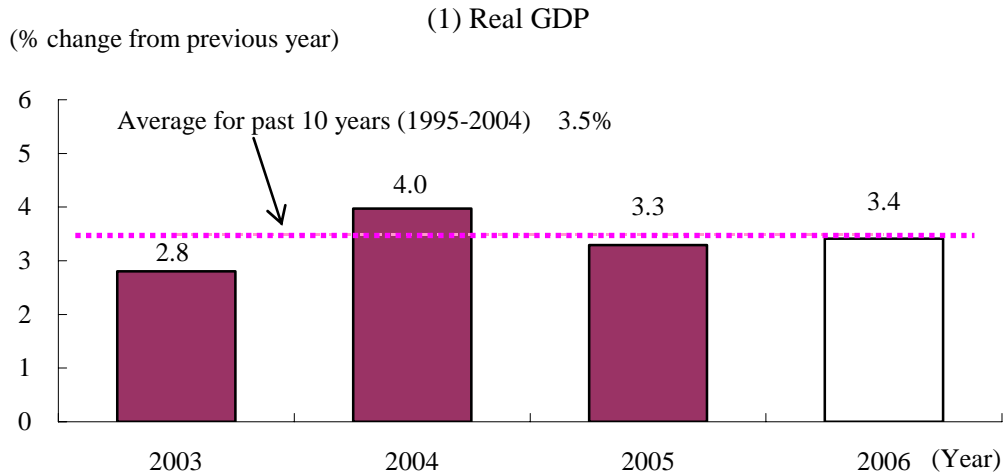
- The recently controversial inflation-targeting approach is a useful monetary policy tool from the viewpoints of both transparency and expectation creation. However, when deciding on the necessity of such an approach, a central bank should consider its effectiveness within the overall monetary policy framework.

## Key Points of Chapter 2

### World economy expected to maintain 2005 growth pace in 2006

- The world economy (based on 22 countries and regions with a close relationship with Japan) has been recovering steadily. The United States still serves as the locomotive of the world economy, although its gap with Japan and Europe has narrowed. The 22 economies' growth was 3.3% in 2005.
- The world economy (the 22 countries and regions) is expected to grow some 3.4% in 2006 as the U.S. economy remains firm and recovery grows clearer in the eurozone. (Figure 2-1)

**Figure 2-1 Forecast for the World Economy (22 countries/regions)**



**1. U.S. economy expected to score slightly faster growth than potential in 2006, though slowing down growth pace somewhat from April-June**

- The U.S. economy grew smoothly in 2005 despite an oil price rise that has continued since 2003, although October-December growth slowed to 1.7%. In reaction to the slowdown, the U.S. economy saw a high growth rate of 5.3% in the January-March quarter of 2006. Later in the year, however, growth is expected to decelerate somewhat. For the whole of 2006, the U.S. economy is projected to post a growth rate around 3.5%, close to the 2005 level.
- Amid the economic expansion, the Federal Reserve has raised its policy interest rate at a measured pace since mid-2004. Oil prices have rewritten their all-time highs, leading to a fear that prices could rise generally to affect the economy. But consumer prices excluding energy prices have remained stable. Oil price rises' downward pressure on the economy has been limited.

## **2. Asia to continue high growth led by China**

- China, which has been serving as a locomotive of the Asian economy, saw a high growth rate of 9.9% in 2005 while its government continued its careful policy management to achieve the economy's soft landing through macroeconomic control. Its 11th five-year plan, beginning in 2006, has shifted the emphasis from investment-led growth to more sustainable growth. Growth is expected to remain high.

## **3. Eurozone to continue moderate recovery based on foreign demand**

- Toward late 2005, the eurozone, though seeing somewhat decelerating economic growth due to oil price rises, continued its moderate recovery based on foreign demand as exports remained buoyant on a global recovery and the euro depreciated against other major currencies. Eurozone companies' business confidence has improved remarkably on expectations of expanding exports. While energy prices have risen, other prices have so far remained stable. In and after 2006, however, energy price rises are expected to have spillover effects on other prices. Eurozone economic growth is predicted to accelerate to 1.9% in 2006 after decelerating to 1.3% in 2005 from 2.0% in 2004. (Table 2-2)

**Table 2-2 Region-by-Region Economic Forecast by Private Institutions**

Real GDP

(% change from previous year)

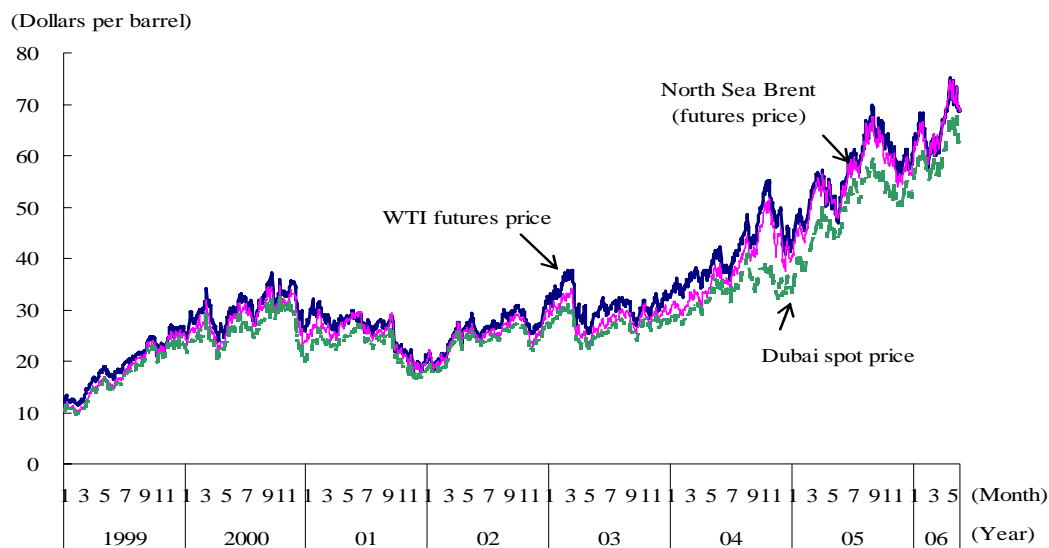
Country/region		2004	2005	2006	2007
		(Results)	(Results)	(Forecast)	(Forecast)
U.S.		4.2	3.5	3.4	3.0
Asia	NE Asia	8.4	7.9	7.4	6.9
	ASESAN	6.2	5.4	5.1	5.2
Europe 4		1.9	1.1	1.8	1.7
(Ref.) Eurozone		2.0	1.3	1.9	1.8
(Ref.) Japan		1.7	3.0	2.6	2.1

- Notes: 1. Results are from statistics of each country, forecasts are averages of forecasts made by private institutions.  
 2. NE Asia: China, South Korea, Taiwan and Hong Kong.  
 ASEAN: Singapore, Indonesia, Thailand, Malaysia, and the Philippines  
 Europe 4: Germany, France, Italy and the U.K.  
 3. The GDP growth rates of NE Asia, ASEAN, and Europe 4 are weighted averages of nominal GDP for 2004.  
 4. Forecasts published by private institutions in March-April 2005  
 Private institutions: BLUE CHIP (54 companies in 2006, 51 companies in 2007), CREDIT SUISSE, EIU, OEF, JP Morgan, Morgan Stanley, Morgan Stanley, Bank of Tokyo-Mitsubishi UFJ, Nomura Securities, Mitsubishi Research Institute, Mizuho Research Institute, Japan Center for International Finance  
 5. As for Japan, 2004 and 2005 figures are estimates by the Department of National Accounts, Cabinet Office, and 2006 and 2007 figures are estimates published in EPS Forecast (Economic Planning Association) in May.

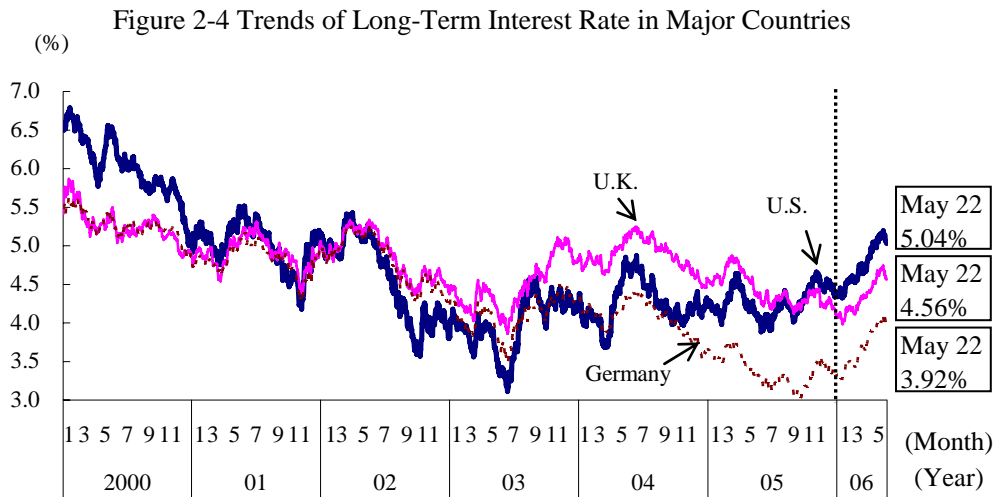
## 4. Risks facing world economy in 2006

- **Future downside risks facing the world economy include (1) growing price-boosting pressures amid oil price rises (Figure 2-3),**

Figure 2-3 Trends of Crude Oil Prices



(2) a U.S. economic slowdown on a fast housing market slump, and (3) rapid exchange rate realignments and long-term interest rate rises emerging from doubts about sustainability of the U.S. twin deficits (Figure 2-4).



Source: Bloomberg

Note: Data are interest rates on 10-year government bonds