ARTICLE IV CONSULTATIONS

Under Article IV of the Articles of Agreement, the Fund holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepare a report, which forms the basis for discussion by the Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of the Directors, and this summary is transmitted to the country's authorities. Table 4 lists the 143 Article IV consultations concluded by the Fund in 1995/96.

In this section, the main features of the Board discussions on Article IV consultations with a number of countries are described. In addition, overviews summarizing policy trends in three groups of countries—the smaller industrial countries, developing countries, and countries in transition—are presented. The individual countries selected have been chosen because of their importance in the global or regional economy, with some smaller countries included on a rotating basis. For each country, a summary of the conclusion of the Board discussion is featured, with a brief description of salient macroeconomic and structural developments and a table of data available to the Board at the time of the consultation. Except in a few cases, subsequent revisions to the data have not been taken into account.

Industrial Countries

United States

Directors met in August 1995 to discuss the Fund's Article IV consultation with the United States. The U.S. economic expansion that started in the second quarter of 1991 gained momentum during 1994 before decelerating in the first quarter of 1995, partly because of the tightening of monetary policy that began in early 1994. After rising at an average annual rate of 3.1 percent in 1993, real GDP increased by 4.1 percent in 1994 as domestic demand continued to drive growth while real net exports declined (see Table 5).

By the second quarter of 1995 the capacity utilization rate in manufacturing, particularly in the durables sector, was well above long-term average levels. The unemployment rate fell by about 1 percentage point from the first quarter of 1994 to the first quarter of 1995, when it stood at 5.5 percent. It subsequently rose to 5.7 percent in the second quarter.

Inflation was relatively steady during 1994, but some evidence of a temporary pickup in underlying inflation (excluding the effects of food and energy prices) emerged early in 1995. The federal funds rate, which had remained at 3 percent since September 1992, began to rise in February 1994 and reached 6 percent in February 1995. In July 1995 the Federal Reserve moved to cut the federal funds rate by 25 basis points.

The external current account deficit rose sharply in 1993 and 1994. The merchandise trade deficit widened further as the cyclical position of the United States improved relative to that of its trading partners. The current account deficit continued to grow during the first quarter of 1995, mainly because of a swing to deficit in the U.S. trade account with Mexico and a pronounced rise in merchandise imports.

In their discussion, Directors noted that in many respects the economic situation of the United States was very favorable, largely owing to the adoption of good policies; in particular, skillful management of monetary policy had helped to maintain unemployment and inflation at relatively low levels. The authorities' success in achieving a substantial reduction in the structural budget deficit of the Federal Government had also been an important factor.

Directors observed that measures still were needed to strengthen national saving and reduce the federal debt as a share of GDP, as well as to further reduce inflation. Tangible progress in these areas would help

Table 4
ARTICLE IV CONSULTATIONS CONCLUDED IN FINANCIAL YEAR 1996

Country	Date	Country	Date	Country	Date
Albania	May 26, 1995	Grenada	May 12, 1995	Panama	May 12, 1995
Algeria	May 22, 1995	Guatemala	May 22, 1995	Papua New Guinea	July 14, 1995
Angola	Oct. 18, 1995	Guinea	Dec. 20, 1995	Paraguay	July 12, 1995
Antigua and Barbuda	May 1, 1995	Guinea-Bissau	Oct. 18, 1995	Peru	Dec. 1, 1995
Argentina	Sept. 27, 1995	Guyana	June 16, 1995	Philippines	Sept. 29, 1995
Armenia	Sept. 29, 1995	Hong Kong[2]	Mar. 8, 1996	Poland	Jan. 17, 1996
Aruba[1]	July 28, 1995	Iceland	May 3, 1995	Portugal	Oct. 20, 1995
Australia	Mar. 22, 1996	Iceland	Jan. 19, 1996	Romania	Dec. 21, 1995
Austria	May 31, 1995	India	July 10, 1995	Russia	Sept. 14, 1995
Azerbaijan	Nov. 17, 1995	Indonesia	July 24, 1995	Rwanda	Sept. 18, 1995
Bahamas, The	July 31, 1995	Iran, I. R. of	Oct. 2, 1995	São Tomé and Príncipe	June 7, 1995
Bahrain	Feb. 26, 1996	Ireland	June 30, 1995	Saudi Arabia	Oct. 2, 1995
Belarus	Sept. 12, 1995	Israel	Sept. 15, 1995	Senegal	June 9, 1995
Belgium	Feb. 21, 1996	Italy	Mar. 15, 1996	Seychelles	Apr. 17, 1996
Belize	Apr. 26, 1996	Japan	July 21, 1995	Sierra Leone	Dec. 18, 1995
Benin	May 22, 1995	Jordan	Sept. 6, 1995	Singapore	Oct. 27, 1995
Bhutan	Oct. 25, 1995	Kazakstan	Jan. 5, 1996	Slovak Republic	Sept. 1, 1995
Bolivia	Mar. 25, 1996	Kenya	Nov. 10, 1995	Slovenia	Sept. 1, 1995
Botswana	Feb. 12, 1996	Kiribati	Nov. 15, 1995	Sri Lanka	May 17, 1995
Brazil	Dec. 15, 1995	Korea	Oct. 23, 1995	St. Kitts and Nevis	May 19, 1995
Bulgaria	Dec. 21, 1995	Kuwait	Aug. 28, 1995	St. Vincent	Oct. 20, 1995
Burkina Faso	Dec. 22, 1995	Latvia	Oct. 20, 1995	Sudan	Feb. 13, 1996
Burundi	Apr. 1, 1996	Lesotho	July 31, 1995	Suriname	Mar. 13, 1996
Central African Republic	June 26, 1995	Lithuania	July 14, 1995	Swaziland	Dec. 1, 1995
Cambodia	Sept. 15, 1995	Luxembourg	Apr. 26, 1996	Switzerland	Feb. 26, 1996
Canada	May 3, 1995	Macedonia, F.Y.R.	May 5, 1995	Syrian Arab Rep.	Mar. 6, 1996
Canada	Apr. 1, 1996	Madagascar	June 9, 1995	Tanzania	Nov. 27, 1995
Chile	Sept. 8, 1995	Malawi	May 10, 1995	Thailand	June 23, 1995
China	Apr. 1, 1996	Malaysia	Oct. 2, 1995	Togo	Dec. 20, 1995
Colombia	Jan. 19, 1996	Maldives	June 26, 1995	Tonga	June 16, 1995
Côte d'Ivoire	Dec. 11, 1995	Mali	Oct. 23, 1995	Trinidad and Tobago	Apr. 26, 1996
Croatia	Nov. 1, 1995	Marshall Islands	July 27, 1995	Tunisia	Feb. 23, 1996
Cyprus	Jan. 24, 1996	Mauritania	Apr. 17, 1996	Turkmenistan	Feb. 23, 1996
Czech Republic	July 28, 1995	Mauritius	Nov. 20, 1995	United Arab Emirates	June 14, 1995
Djibouti	Apr. 15, 1996	Mexico	June 30, 1995	Ukraine	Jan. 19, 1996
Dominica	June 16, 1995	Micronesia	July 27, 1995	United Kingdom	Oct. 30, 1995
Dominican Republic	June 16, 1995	Moldova	June 21, 1995	United States	Aug. 4, 1995
Ecuador	Aug. 3, 1995	Mongolia	Feb. 14, 1996	Uruguay	June 23, 1995
Egypt	Sept. 22, 1995	Morocco	Oct. 23, 1995	Vietnam	Aug. 3, 1995
El Salvador	Apr. 5, 1996	Mozambique	June 9, 1995	Western Samoa	Nov. 15, 1995
Equatorial Guinea	Oct. 25, 1995	Myanmar	Oct. 20, 1995	Yemen, Republic of	May 10, 1995
Fiji	Nov. 15, 1995	Namibia	July 31, 1995	Zaïre	Mar. 1, 1996
Finland	Sept. 1, 1995	Nepal	May 24, 1995	Zimbabwe	Feb. 28, 1996
France	Oct. 25, 1995	Netherlands	May 1, 1995		
Gabon	Nov. 8, 1995	New Zealand	Nov. 20, 1995		
Gambia, The	Oct. 18, 1995	Nicaragua	July 10, 1995		
Georgia	Sept. 29, 1995	Nigeria	Nov. 1, 1995		
Germany	Aug. 30, 1995	Norway	Feb. 7, 1996		
Ghana	June 30, 1995	Oman	Oct. 18, 1995		
Greece	Aug. 4, 1995	Pakistan	Dec. 13, 1995		

[1]Consultation discussions with Aruba are held in the context of the consultation with the Kingdom of the Netherlands.
[2]Consultation discussions with Hong Kong are held in the context of the consultation with the United Kingdom.

Table 5

UNITED STATES: SELECTED ECONOMIC INDICATORS

(Data as of Board discussion in August 1995; annual percent change unless otherwise noted)

	1992	1993	1994	1995[1]
Domestic economy				
Real GDP	2.3	3.1	4.1	2.8
Unemployment rate (in percent of labor force)[2]	7.4	6.8	6.1	5.7
Consumer price index	3.0	3.0	2.6	3.0
External economy				
Exports, f.o.b. (in billions of U.S. dollars)	440.4	456.8	502.5	552.2[3]
Imports, c.i.f. (in billions of U.S. dollars)	536.5	589.4	668.6	732.4[3]
Current account balance (in percent of GDP)	–1.1	–1.6	–2.2	–2.5
Direct investment (in billions of U.S. dollars)	–31.1	–31.5	0.1	–34.5[3]
Securities, net (in billions of U.S. dollars)	21.6	–37.9	42.6	158.2[3]
Capital (official and private, in billions of U.S. dollars)	85.0	63.9	165.5	84.5
Real effective exchange rate	–1.9	4.0	0.8	. . .
Gross international reserves (in billions of SDRs)	51.9	53.4	50.9	. . .
Financial variables				
General government balance[4]	–4.3	–3.4	–2.0	–1.9
Federal[5]	–4.8	–4.1	–3.1	–2.5
Personal saving (in percent of GDP)	4.1	3.0	3.0	. . .
Gross private investment (in percent of GDP)	13.1	13.9	15.3	. . .
Growth rate of M2[6]	2.1	1.3	1.9	. . .
Three-month treasury bill interest rate[2]	3.4	3.0	4.2	5.8
Ten-year government bond interest rate[2]	7.0	5.9	7.1	6.6

[1]Projected.
[2]Yearly average.
[3]First quarter 1995 data on an annual basis.
[4]On a national accounts basis and in percent of GDP.
[5]On a unified budget, fiscal year basis and in percent of GDP.
[6]Year over year, in percent.

to ensure that national saving would be sufficient to support satisfactory rates of investment and growth without an excessive reliance on foreign borrowing, and it would also reduce the risk of disruptions in world financial markets. Further progress in this area would appear appropriate from both domestic and international perspectives. They welcomed the authorities' commitment to a balanced federal budget, which they considered an important signal. Some Directors observed that a more ambitious target would be preferable, in view of the need to bolster national saving and avoid placing an undue tax burden on future generations, although the practical difficulties in achieving a more ambitious target were recognized.

Directors expressed concern that the budget plans presented by the Administration and the Congress would involve front-loading of tax cuts and back-loading of expenditure cuts, which would delay much of the deficit reduction until the end of a seven- or ten-year period. In addition, the budget-reduction plans relied heavily on the assumption that interest rates would drop substantially in response to deficit reduction. Such an outcome was possible, but could not be taken for granted. Moreover, the likelihood of a substantial drop in interest rates would be increased by a front-loaded program that bolstered the credibility of the adjustment effort and reduced its vulnerability to shifts in the economic and political environment. In this context, Directors felt it would be desirable to defer the introduction of any tax cuts until visible progress had been made toward balancing the budget.

Directors commended the Federal Reserve for its conduct of monetary policy during the 12-month period prior to the discussion, and, in particular, for having tightened monetary conditions in 1994 ahead of an actual increase in price pressures. These steps had improved the prospects for sustaining a noninflationary economic expansion and had greatly enhanced the credibility of the Federal Reserve's commitment to price stability. Most Directors thought that the adoption of an explicit inflation target would not necessarily help in further enhancing such credibility. Moreover, Directors agreed that economic policies should not be aimed at specific targets for the dollar's exchange rate.

While commending the U.S. authorities for their strong support of multilateral and regional trade liberalization, Directors regretted that frequent recourse by the United States to unilateral trade actions risked undermining these cooperative efforts. They encouraged the authorities to make more active use of existing multilateral procedures, and hoped that any future trade disputes could be resolved without threats of trade sanctions.

Directors noted with disappointment the decline in U.S. contributions to official development assistance as a share of GDP, but noted that such a decline was not a policy of the authorities.

Since the date of the consultation, the pace of economic activity appeared to strengthen. Sluggish performance of the economy in the second half of 1995

prompted the Federal Reserve to act to lower short-term interest rates to 5¼ percent from 5¾ percent in two steps in December 1995 and January 1996. Real GDP growth picked up to 2¾ percent (annual rate) in the first quarter of 1996, despite the adverse effects of severe winter weather and labor unrest. With strong employment growth, the unemployment rate fell to 5.4 percent in April. Although there has been upward pressure on energy and food prices, the underlying trend in price inflation has, for the most part, remained well contained, with core prices up at a 3 percent annual rate in the first third of the year, roughly the same pace as during 1995. Longer-term rates rose sharply in early 1996 owing in large part to a strengthening of economic activity, a renewed focus on energy and food price movements, and reduced prospects for enactment of a balanced budget plan.

Table 6

JAPAN: SELECTED ECONOMIC INDICATORS

(Data as of Board discussion in July 1995; annual percent change unless otherwise noted)

	1992	1993	1994	1995[1]
Domestic economy				
Real GDP	1.1	–0.2	0.5	0.4
Unemployment rate (in percent)	2.2	2.5	2.9	3.2
Consumer price index	1.7	1.3	0.7	–0.2
External economy				
Exports, f.o.b. (in billions of U.S. dollars)	339.7	360.9	395.6	442.9
Imports, c.i.f. (in billions of U.S. dollars)	233.0	240.7	274.7	336.1
Current account balance (in billions of U.S. dollars)[2]	117.6	131.4	129.1	127.3
Current account balance (in percent of GDP)	3.2	3.1	2.8	2.4
Net direct investment (in billions of U.S. dollars)	–14.5	–13.6	–17.0	. . .
Net securities (in billions of U.S. dollars)	–26.2	–62.7	–48.9	. . .
Overall balance (in billions of U.S. dollars)	–1.4	23.5	–2.3	. . .
Real effective exchange rate (relative normalized unit cost; 1990 = 100)	109.9	128.9	138.0	. . .
Total international reserves minus gold (in billions of U.S. dollars)	71.6	98.5	125.9	. . .
Financial variables				
General government balance (in percent of GDP)	1.5	–1.4	–3.1	–3.7
General government balance excluding social security (in percent of GDP)	–2.0	–4.9	–6.5	–7.0
Gross national saving (in percent of GDP)	34.3	33.1	31.7	31.1
Gross domestic investment (in percent of GDP)	31.1	29.9	28.8	28.8
Broad money (M2 plus CDs, period average)	0.6	1.1	2.1	. . .
Three-month CD rate (average)	4.3	2.8	2.1	. . .
Official discount rate (end of period)	3.2	1.8	1.8	. . .

[1]Projected.

[2]Data for current account balance are on the basis of the 1995 edition of the *Balance of Payments Statistics of Japan.*

Japan

Directors met in July 1995 to discuss the Fund's Article IV consultation with Japan against a background of a weak recovery from the recession that bottomed out in the fourth quarter of 1993 (Table 6). Output grew at an average annual rate of only ¾ of 1 percent from the fourth quarter of 1993 through the first quarter of 1995, compared with average growth of 5½ percent in past recoveries. The main factor underlying the modest turnaround in activity was a reduced pace of decline in private fixed investment. Growth in private consumption rose only marginally despite income tax cuts implemented in mid-1994. While private spending picked up, the stimulus provided by higher government spending moderated, as public investment plateaued at a high level in mid-1994 before dropping sharply in the first quarter of 1995.

The unemployment rate rose in late 1994 to the previous peak of 3 percent reached briefly in 1987, marking a large swing at the 2 percent level in early 1992. Unemployment subsequently increased to slightly over 3 percent in April and May 1995. Simultaneous declines in the ratio of job offers to seekers and in total hours worked provided additional signs of weakness in labor markets.

Following its sharp appreciation from mid-1992 to mid-1993, the yen was broadly stable in effective terms through early 1995, as a further mild rise against the dollar was accompanied by a fall against European currencies. From mid-February through mid-April 1995, however, the yen rose by another 15 percent in effective terms. The cumulative increase of about 50 percent since mid-1992 had taken the yen well above historical trends.

Reflecting large margins of excess capacity and the effects of yen appreciation, the consumer price index rose by only ¾ of 1 percent in 1994. Disinflation continued, and slight deflationary pressure appeared subsequently, as the level of the consumer price index at the end of the first quarter of 1995 stood ¼ of 1 percent below the previous year's level. At the end of the first quarter of 1995, citing downside risks to the recovery,

the Bank of Japan eased monetary policy through a reduction in the overnight call rate. On the basis of the overall judgment of economic and financial developments, including a further rise in the yen and a drop in equity prices, the Bank of Japan decided to ease monetary conditions further in April, by cutting the official discount rate to 1 percent, a new low, and encourage a further reduction in the short-term money market rate.

The current account surplus, which had risen to over 3 percent of GDP in 1992 and 1993, declined to 2.8 percent in 1994 and then to 2.4 percent in the first four months of 1995. While the pickup in domestic demand was modest, effects of structural changes in industry and trade patterns and the lagged effects of earlier yen appreciation boosted import volume growth to an annual rate of over 15 percent during late 1994 and early 1995. The fiscal position deteriorated substantially between 1991 and 1994 as the overall balance shifted from a surplus of 3 percent of GDP to a deficit of an equivalent size. Excluding social security, the deficit rose to almost 7 percent of GDP in 1994, approaching the historical peaks reached in the late 1970s.

In their review, Directors noted that the appreciation of the yen, the drop in equity prices, and strains in the financial system had clouded the prospects for a revival of activity in Japan. They welcomed the fiscal and monetary measures introduced over the previous few years to support activity, including the first supplementary budget of 1995 and the reduction in short-term interest rates. Nevertheless, most Directors believed that, despite the limited scope for action, the emergence of new risks to the outlook justified further measures to support activity until the recovery was firmly established.

Directors observed that, notwithstanding the low level of nominal interest rates, monetary conditions had effectively tightened, owing to the large appreciation of the yen, which had become clearly overvalued in terms of fundamentals. Accordingly, a number of Directors advocated further reductions in short-term interest rates—including a cut in the official discount rate. In addition, some Directors called for providing additional liquidity to the banking system and unsterilized intervention in exchange markets to counteract upward pressures on the yen. Other Directors, however, doubted whether a further easing of monetary policy would be effective in stimulating demand, given the already low level of interest rates and strains in the financial system. Many Directors agreed that action by Japan should be complemented by appropriate policies in its economic partners.

Board members broadly agreed that the past deterioration in the structural fiscal balance called for a resumption of fiscal consolidation once the recovery was well established. Many Directors emphasized that macroeconomic stimulus should be combined with comprehensive structural reforms, stressing that it was in Japan's national interest to push forward ambitiously the agenda for structural reform and deregulation.

Directors noted that Japan's current account surplus was primarily a macroeconomic phenomenon, and emphasized that it was in Japan's interest to enhance market access through measures to reduce barriers to trade. They also urged that measures to address the strains of the financial system be implemented without delay.

Directors commended Japan's role as the world's largest provider of financial assistance to developing countries, and also paid tribute to Japan as a key contributor to the Fund's enhanced structural adjustment facility (ESAF).

Germany

The Board concluded the 1995 Article IV consultation with Germany in August 1995, when the economy was in its third year of recovery and output had recovered to well above its pre-recession peak. The recession bottomed out in the first half of 1993, and GDP grew by an unexpectedly high 3 percent in 1994. Industrial surveys suggested that growth continued in 1995, albeit at a slightly slower pace than during 1994. (See Table 7.)

As in past cycles, exports led the way out of the recession. They were boosted initially by growth in the United States, the United Kingdom, and some developing countries, and later by the recovery in the rest of continental Europe. Export growth was also underpinned by important restructuring efforts in industry, which yielded large productivity gains. Domestic demand had also begun to revive, with investment becoming the second engine of growth. By contrast, private consumption, weighed down by tax increases and restrained growth in wages, remained sluggish. Public consumption was held back by fiscal consolidation.

Owing to industrial restructuring, unemployment continued to rise well into the economy's recovery phase and then declined slowly as the recovery progressed. In western Germany, unemployment reached a peak of 8.3 percent in May 1994, and job losses continued as employment fell 1.3 percent in 1994 before finally appearing to stabilize in April 1995. After falling by 12.8 percent in 1992 and by a further 3 percent in 1993, employment appeared to reach its trough around the end of 1993 in eastern Germany, and unemployment fell noticeably between the first half of 1994 and the first half of 1995.

Consumer price inflation, which had proved stubborn during the recession, eased gradually to an annualized rate of about 2 percent by the last quarter of 1994. Consumer price inflation in eastern Germany,

which was for years well above the western German inflation rate, continued to approach that of the west. In the first half of 1995, eastern German consumer price inflation ran at levels comparable to, or below, those of western Germany.

Further progress was made in 1994 toward correcting the fiscal policy imbalances induced by unification. Through a combination of tax measures, expenditure savings, and higher-than-expected growth, the general government deficit was cut to 2½ percent of GDP in 1994, almost 1 percent of GDP below the level initially planned. However, in 1995 the deficit increased to 3.5 percent of GDP.

In their discussion, Directors commended the financial consolidation implemented by the German authorities. Directors noted that the financial imbalances that had initially arisen after unification had been greatly reduced, as had inflationary pressures. Considerable progress had been made in reducing fiscal deficits. Nevertheless, they considered that important challenges remained, most notably in the form of persistent structural problems.

Directors supported the authorities' broad objectives for fiscal policy in the medium term, comprising both a further reduction in the fiscal deficit and a lowering of Germany's heavy tax burden. They believed it was important to be ambitious on both those counts, particularly in view of the fiscal pressures that were likely to ensue from the prospective aging of the German population. A further reduction in the deficit would also relieve the burden on monetary policy as the recovery matured, and increase the availability of capital, both at home and abroad.

Directors commended the efforts made in the draft budget to limit the increase in the federal deficit and to set the stage for a further reduction in the general government deficit.

Directors welcomed the substantial, albeit gradual, relaxation of monetary conditions that had taken place between 1992 and 1994, and that had been made possible in large part by the continued progress in fiscal consolidation. They observed that the sharp appreciation of the deutsche mark in early 1995 had compounded the difficulties of policymaking.

Directors welcomed the progress made in addressing important structural problems, including through deregulation, privatization, and reform of the financial system, but stressed that much remained to be done. They expressed special concern that there had been little progress on structural unemployment, which had become Germany's most pressing problem. They considered that, ultimately, Germany would have to tackle the difficult problems of the relationship between gen-

Table 7

GERMANY: SELECTED ECONOMIC INDICATORS

(Data as of Board discussion in August 1995; annual percent change unless otherwise noted)

	1992	1993	1994	1995[1]
Domestic economy (western Germany)				
GDP (percent change at 1991 prices)	1.8	–1.7	2.3	2.5
Unemployment rate (in percent of labor force)	5.8	7.3	8.3	8.2
Consumer price index	4.0	4.1	3.0	2.2
Domestic economy (eastern Germany)				
Real GDP	7.8	5.8	9.2	9.0
Unemployment rate (in percent of labor force)	14.7	14.8	14.6	12.9
Consumer price index	11.1	8.9	3.3	2.6
External economy				
Exports, f.o.b. (in billions of deutsche mark)	671.6	632.6	690.2	. . .
Imports, f.o.b. (in billions of deutsche mark)	630.2	566.9	607.8	. . .
Current account balance (in billions of deutsche mark)	–33.7	–25.8	–33.4	–26.6
Direct investment, net (in billions of deutsche mark)	–26.8	–23.7	–28.7	. . .
Securities transactions, net (in billions of deutsche mark)	45.3	177.3	–44.6	. . .
Capital account balance (in billions of deutsche mark)	90.3	6.1	57.1	. . .
Real effective exchange rate	4.0	8.8	–0.2	. . .
Foreign exchange reserves (in billions of deutsche mark)	141.4	120.1	113.6	. . .
Financial variables				
General government balance (in percent of GDP)	–2.9	–3.3	–2.5	–2.5
Gross national saving	. . .	. . .	. . .	. . .
Gross national investment	. . .	. . .	. . .	. . .
Money and quasi-money (M3; percent change in annual average)	8.5	8.2	8.5	–0.6[2]
Three-month money market rate (period average, in percent)	9.5	7.2	5.3	4.8[3]
Yield on government bonds (period average, in percent)	8.0	6.3	6.7	7.0[4]

[1]Projected.
[2]Average January–June.
[3]Average January–May 1995 compared with average January–May 1994.
[4]Average January–May.

erous social protection and low wage differentiation on the one hand, and high structural unemployment on the other.

Several Directors commended the authorities for their large-scale assistance to economies in transition, and hoped that they would reverse the decline in official development assistance observed in the preceding few years.

France

The Board considered the 1995 Article IV consultation with France in October 1995, as recovery from the deep recession of 1993 slowed from the pace set in 1994. (See Table 8.) Real GDP increased by an average of 3 percent in 1994, but the rate of growth declined to an annualized rate of 2¼ percent in the first half of 1995. The recovery was triggered mainly by an upturn in partner country demand, which led to a resurgence of export growth. After rapid growth in late 1994 and early 1995, exports slowed sharply in the second quarter in line with the weakening of growth in European partner countries.

Nonfarm employment began to rise in the course of 1994, and grew by 2.2 percent in the 15 months to June 1995. Unemployment, however, continued to increase even after the turning point in output and employment had been passed, because of increased labor force participation. The unemployment rate held steady near its record rate of 12½ percent for most of 1994 but subsequently declined to 11.4 percent by July 1995.

Consumer price inflation, which was relatively low even at the peak of the previous cycle, fell further during the recession and the early stages of the recovery. Although the increase in the tax on petroleum products at the beginning of 1995 and the higher value-added tax rate that went into effect during the summer pushed up the price level, the effect was temporary. The low rate of underlying inflation reflected mainly the slow growth of wages and the persistence of a substantial output gap.

The external current account remained in surplus at about ¾ of 1 percent of GDP in 1994, as an expansion in foreign demand for French exports outpaced the increase in domestic demand for imports. The current account continued in surplus in early 1995, accompanied by further net outflows of long-term capital, which had also been substantial in 1994. In 1994 and early 1995, external competitiveness was broadly unchanged; the nominal and real effective exchange rates showed only a small appreciation.

France's general government deficit reached unprecedented levels in peaking at 6.1 percent of GDP in 1993 and staying at 6 percent in 1994. The new Government formed after the May 1995 presidential elections reaffirmed its commitment to fiscal consolidation. As a first step, the Government prepared a supplementary budget for 1995 aimed at correcting slippages in the central government deficit from its initial budget target; on this basis, the authorities expected the general

Table 8
FRANCE: SELECTED ECONOMIC INDICATORS
(Data as of Board discussion in October 1995; annual percent change unless otherwise noted)

	1992	1993	1994	1995[1]
Domestic economy				
Real GDP	1.3	–1.5	2.9	2.9
Unemployment rate (in percent of total labor force)	10.3	11.6	12.4	11.7
Consumer price index	2.4	2.1	1.7	2.1
External economy				
Export volume	4.9	–0.4	5.8	6.9
Import volume	1.1	–3.4	6.8	5.7
Current account balance (in billions of francs)	20.4	59.5	54.1	62.0
Net direct investment (in billions of francs)	–16.8	–0.1	0.3	. . .
Net portfolio investment (in billions of francs)	187.1	16.9	–308.2	. . .
Capital balance (in billions of francs)[2]	–132.5	–79.7	50.2	. . .
Effective exchange rate (MERM)[3]	3.7	0.5	0.7	4.2[4]
Net change in official reserves (in billions of francs; – = increase)	5.3	30.9	–13.9	. . .
Financial variables				
General government balance (in percent of GDP)	–4.0	–6.1	–6.0	–5.2
Gross national saving (in percent of GDP)	19.9	18.1	18.9	. . .
Gross national investment (in percent of GDP; stockbuilding included)	19.8	17.2	18.4	. . .
Broad money (M3)	5.3	–3.2	2.0	4.6[5]
Three-month interbank money rate	10.4	8.4	5.8	6.8[5]
Government bond yield	8.6	6.8	7.2	7.7[5]

[1]Projected.
[2]Equals long-term capital plus short-term nonofficial capital, including errors and omissions.
[3]Based on the Fund's multilateral exchange rate model; a positive figure indicates an appreciation.
[4]Average to September 15, 1995; percent changes calculated relative to the average for the previous year.
[5]Second quarter of 1995 over the same period in 1994.

government deficit to decline to about 5 percent of GDP in 1995.

In their review, Directors noted the continued economic recovery in France and the decline in unemployment from the record level reached in 1994. They also commended France on the progress made during the past decade toward establishing low inflation. However, Directors observed that the French authorities had, unfortunately, not made the best use of these favorable circumstances to correct two stubborn problems. These were the fiscal deficit and high unemployment, whose main underlying causes were the generosity and insufficient targeting of the welfare system, and labor market rigidities.

Directors noted with concern that in recent years the general government deficit had risen sharply and could still remain above 5 percent of GDP in 1995. They stressed that early announcement and implementation of a credible program of fiscal consolidation was essential to secure a lasting reduction in interest rates, to boost domestic and foreign confidence in the authorities' overall strategy, and to promote durable financial stability and sustained economic expansion. Although the draft 1996 budget for the central Government presented in September was a step in the right direction, much more had to be done. Directors therefore urged France to announce urgently measures to reduce the general government deficit to below 3 percent of GDP in 1997.

In the structural area, several Directors recommended more vigorous privatization and deregulation policies to promote domestic competition and public enterprise reform. Directors emphasized that labor market policy would need to address squarely the basic causes of high unemployment among the unskilled—namely, a high minimum wage with attendant high nonwage labor costs, which together price many untrained workers out of the market, and generous minimum social benefits, which reduce work incentives.

Directors commended the Bank of France for its skillful conduct of monetary policy. However, they observed that the central bank's room for maneuver in the interest rate area remained limited. Rapid progress on the fiscal front was urgently required if the credibility of the exchange rate anchor was to be safeguarded and if interest rates were to be lowered to a level more compatible with the domestic priority of job creation.

Directors commended France on its generous official development assistance, which at 0.65 percent of GDP was higher than in most other industrial countries. They hoped that these flows would be maintained even as France attempted to come to terms with its public sector deficit.

At the end of October, following the consultation, the French authorities announced that the achievement of convergence in accordance with the treaty on European Monetary Union would henceforth be the principal objective of macroeconomic policy. To this end, the Government indicated that a comprehensive deficit-reduction program would be adopted, with the aim of reducing the general government deficit to 4 percent of GDP in 1996 and 3 percent in 1997. As a first step, the Government in November presented a substantial reform of social security, with an emphasis on restraining the growth of health care expenditure.

United Kingdom

The Article IV consultation with the United Kingdom was concluded by Directors in October 1995, as the pace of U.K. economic activity moderated and the recovery entered a more mature phase. From an annual rate of 4 percent in the first half of 1994, real GDP growth slowed to just over 2 percent in the first half of 1995, owing to both policy tightening and an easing in overseas growth. Job growth and the decline in unemployment also slowed, with the latter falling to about 8 percent from a peak of 10.5 percent in 1992. (See Table 9.)

Between 1993 and 1994, the underlying source of growth shifted from private consumption to exports. Mainly because of a tightening of fiscal policy, a sustained real exchange rate depreciation, and buoyant world export markets, a recovery initially supported by consumption became an expansion increasingly driven by export and investment demand in late 1994 and early 1995. Higher interest rates, a subdued housing market, and a squeeze on disposable income restrained consumption expenditures from the second half of 1994.

Fiscal policy was conducted in the context of the Government's Medium-Term Financial Strategy. The November 1994 budget sought to reduce the public sector borrowing requirement from 6 percent (excluding privatization revenues) in 1994/95 to 3.4 percent in 1995/96, aiming at balance by 1998. As an integral part of the Medium-Term Financial Strategy, monetary policy has since late 1992 been oriented to a quantified target for underlying inflation—the lower half of a 1 to 4 percent range by the second quarter of 1997 at the latest and beyond that to continue to achieve 2½ percent or less. Short-term interest rates were raised by 150 basis points in three equal steps between September 1994 and February 1995. Underlying inflation reached its trough in late 1994 at an annual rate of 2 percent, but then rose in response to import cost increases; commodity prices rose sharply during 1994, and the impact of their decline in early 1995 was partly offset by the depreciation of sterling.

The external current account moved close to balance in 1994, supported by strong exports and buoyant investment income. The pickup in world trade in

Table 9
UNITED KINGDOM: SELECTED ECONOMIC INDICATORS
(Data as of Board discussion in October 1995; annual percent change unless otherwise noted)

	1992	1993	1994	1995[1]
Domestic economy				
Real GDP	–0.5	2.2	3.8	2.7
Average unemployment rate (in percent of labor force)	9.7	10.3	9.3	8.3
Retail price index[2]	4.7	3.0	2.4	2.9
External economy (in billions of pounds)				
Exports	107.3	121.4	134.5	148.1
Imports	120.4	134.8	145.1	158.7
Current account balance	–9.8	–11.0	–1.7	–7.4
Net direct investment	–1.7	–7.5	–9.7	–8.7
Net portfolio investment	–3.8	–37.7	50.4	–10.6
Basic balance	–15.3	–56.2	39.0	–28.3
Nominal effective exchange rate (period average, 1990 = 100)	96.99	88.98	89.25	85.33[3]
Official reserves (end of period)	27.5	29.0	28.1	29.3
Financial variables				
General government receipts[4] (in billions of pounds)	223.0	231.0	250.8	278.2
General government expenditure[4] (in billions of pounds)	267.0	281.3	296.1	305.6
Gross national saving	. . .	. . .	. . .	. . .
Gross national investment	. . .	. . .	. . .	. . .
M0	2.4	4.9	6.4	6.2[5]
M4	3.1	5.0	4.2	6.1[5]
Three-month interbank interest rate	9.6	5.9	5.5	6.7[6]
Ten-year government bond yield	9.1	7.5	8.2	7.9[6]

[1]Projected.
[2]Excluding mortgage interest.
[3]January–September average.
[4]Outturn figures from Central Statistical Office for fiscal years 1992/93, 1993/94, and 1994/95, and from proposed budget in Financial Statement and Budget Report for fiscal year 1995/96.
[5]January–August average.
[6]September.

1994 was partly responsible for the strength in exports, but export market share also improved. Export growth leveled off in early 1995 in response to softer demand in some key markets. After a period of relative stability in most of 1993 and 1994, the nominal effective exchange rate for sterling depreciated by 6 percent in the first half of 1995 before stabilizing.

In their review, Directors noted that the United Kingdom's economic upswing had continued, with growth moderating to a sustainable pace, and domestic cost pressures had remained subdued despite the further decline in unemployment. Directors viewed the conduct of U.K. policies in the past year as clearly adhering to the principles underlying the Madrid Declaration, pointing to the authorities' medium-term policy framework as a key ingredient in the favorable performance. Directors recommended that, to achieve lasting success, the authorities maintain the established medium-term course and resist any pre-election pressures for policy easing. Directors emphasized that the November 1995 budget would need to play a crucial role in demonstrating firm adherence to the medium-term strategy.

Directors also highlighted the significance of fiscal policy for longer-term economic performance, and several speakers advocated a clearer economic articulation of medium-term fiscal policy. Some Directors noted that, as U.K. rates of saving, investment, and potential output growth still appeared low relative to some other industrial countries, implementation of announced plans for medium-term fiscal consolidation was critical to raising the rate of national saving and improving growth performance.

Directors considered that inflation targeting, which had triggered a pre-emptive tightening of monetary policy, had served the economy well. They believed, however, that the authorities' presentation of the target could have been more direct, and advised that inflation targeting be kept simple. Directors welcomed the transparency of the monetary policy framework, observing that the publication of minutes had enhanced accountability and improved policy formation. Some Directors recommended further progress toward independence of the Bank of England, in particular by transferring to it responsibility for interest rate policy. Given the comfortable external and competitive positions, Directors felt that an appreciation of the pound sterling's effective exchange rate toward early 1995 levels would be welcome.

Several Directors commended the authorities for overcoming structural impediments in the economy. They noted that labor market reforms were succeeding in terms of both employment and wage behavior; although unemployment was high and long-term unemployment remained a particular concern, it did begin to fall in 1995. The authorities were encouraged to expand initiatives to enhance the labor market

prospects of the long-term unemployed.

Italy

Directors met in March 1996 to conclude the Article IV consultation with Italy, against the background of a strong but unbalanced recovery in which export growth was the driving force. (See Table 10.) Real GDP growth accelerated from 2.2 percent in 1994 to about 3 percent in 1995, as the weakness of the lira and the further decline in unit labor costs sustained further gains in export market shares and boosted the current account surplus to 2½ percent of GDP. Fiscal cutbacks restrained public consumption, and private consumption remained sluggish as wage moderation and the contraction in dependent employment slowed total compensation growth. Employment and income uncertainty, along with rising inflation, also depressed consumer confidence and supported precautionary saving. Domestic demand was thus subdued even though activity was buoyant.

Table 10
ITALY: SELECTED ECONOMIC INDICATORS
(Data as of Board discussion in March 1996; annual percent change unless otherwise noted)

	1992	1993	1994	1995[1]
Domestic economy				
Real GDP	0.7	–1.2	2.2	3.2
Unemployment rate (in percent of total labor force)[2]	10.7	10.2	11.2	12.0
Consumer price index	5.2	4.5	4.0	5.4
External economy[3]				
Export volume	3.8	8.9	10.7	13.6
Import volume	3.4	–10.2	11.4	12.9
Current account balance (in percent of GDP)	–2.3	1.1	1.5	2.5
Net direct investment (in billions of lire)	–3,373	–5,469	–4,632	1,589
Net portfolio investment (in billions of lire)	1,288	113,485	–8,264	44,531
Capital account balance (in billions of lire)	10,317	14,799	–22,157	. . .
Real effective exchange rate	–2.9	–14.9	–6.2	–8.3
Total gross official reserves (in millions of U.S. dollars, end of period)	50,818	51,138	58,607	60,475
Financial variables				
General government balance (in percent of GDP)[4]	–9.5	–9.6	–9.0	–7.1
Broad money[5]	5.9	8.2	1.9	2.1
Six-month treasury bill rate[6]	14.4	10.5	9.1	10.9
Ten-year treasury bond rate[6]	13.3	11.2	10.6	11.6

[1]Projected.
[2]Excluding workers in Wage Supplementation Fund.
[3]Volumes are customs basis; current account is balance of payments basis.
[4]Includes interest accruing on zero-coupon bonds.
[5]Growth rate used for target monitoring; that is, moving average of last three months.
[6]In percent, gross.

The combination of a weak lira and the gathering recovery reinforced other factors, such as higher world commodity prices and indirect tax increases, to boost inflation from a 25-year low of 3.8 percent in mid-1994 to an average of 5.4 percent in 1995. Underlying inflation, as measured by consumer prices adjusted for increases in indirect taxes and terms of trade changes, remained relatively contained at about 4 percent. This owed much to the restraint exerted by the July 1993 agreement on wage bargaining, which continued to limit increases in minimum contractual wages to the official inflation objective of 2½ percent. The agreement thus implied a more stringent wage policy than expected, so that, with real wages declining and productivity increasing, unit labor costs fell for the second consecutive year in 1995.

The overall deficit of the state sector narrowed to 7.3 percent of GDP in 1995 from 9½ percent of GDP in 1994, compared with an initial budget target of 8 percent of GDP. With the primary surplus widening to 3.4 percent of GDP, the rise of the ratio of public debt to GDP was halted. The improvement in recent years stemmed fully from a decline in primary spending amounting to 4 percentage points of GDP between 1993 and 1995. The level of primary spending is currently some 3½ percentage points of GDP below the European Union average, while the revenue-to-GDP ratio is broadly in line with that observed in the rest of the European Union.

Monetary policy remained cautiously restrictive. Beginning in mid-1994, the Bank of Italy raised official interest rates in three steps, by a cumulative 200–250 basis points, to quell inflationary tendencies, and pushed up money market interest rates in reaction to recurrent exchange market tensions. M2 expanded by 2.1 percent on a three-month moving average to December 1995.

In their review, Directors commended Italy's progress in fiscal consolidation, which had been achieved under difficult political circumstances. The correction in the public finances in 1995 had been better than targeted, and had begun to reverse the previously inexorable rise in the debt ratio. Directors considered pension reform to be another concrete and

important achievement in 1995, and urged the authorities to build on these gains.

Directors noted that the lira's weakness had led to an unbalanced recovery that exacerbated existing structural imbalances between regions. They considered that a strengthening of the lira, following fiscal consolidation, would likely be accompanied by a decline in interest rates that would offset the normal contractionary effects of fiscal consolidation and of the exchange rate appreciation. Against that background, Directors called for a quickening of the pace and structural content of fiscal consolidation, agreeing that it was crucial that the commitment to consolidation be credible to the markets. Most Directors were of the view that Italy should strive to meet the Maastricht criteria even in 1997, a year earlier than had been anticipated at the end of 1994. To this end, they urged the authorities to adopt a set of front-loaded measures to achieve the general government deficit criterion of 3 percent of GDP by 1997. They agreed that, as in the authorities' plans, as much of the fiscal adjustment as possible should take the form of durable measures on the expenditure side.

Directors noted that a credible acceleration of fiscal adjustment would create a more favorable setting for the conduct of monetary policy and would likely result in a further appreciation of the lira. They observed that, in the absence of a renewed fiscal effort, monetary policy would have to bear a heavy burden to attain the desired reduction in inflation. Under those circumstances, policy would need to remain tight, and the Bank of Italy would need to stand ready to act if fiscal policy slippages threatened to undermine the inflation objective.

Directors believed that a new impetus was needed in structural reform. They stressed the need for reform of the budgetary process to bring macroeconomic constraints fully to bear on spending, increase accountability, and enhance transparency in budgetary documents. They noted that passage of the law on regulatory authorities had set the stage for the privatization of public utilities, which should now proceed at an even quicker pace, and also advised that a high priority be given to privatization of the banks owned by public foundations. They were concerned about the persistence of unemployment, the duality between north and south, and the high youth and long-term rates of unemployment and stressed the need, inter alia, for greater regional and industrial wage differentiation.

Canada

The Board considered the staff report for the 1996 Article IV consultation with Canada in April 1996. The strong economic expansion during 1993 and 1994 slowed in 1995. (See Table 11.) By the time of the 1995 consultation, the slowdown in real GDP growth in 1995 was considerably greater than had been anticipated earlier. The shortfall in growth was mainly due to the larger-than-expected effects of the rise in interest rates that began in late 1994, weak consumer and business confidence, and the sharpness of the slowdown in the United States during the first half of 1995, which limited export growth.

Real GDP growth was near zero during the first half of 1995, owing to steep declines in net exports and construction, as well as to a slowdown in personal consumption expenditure. The economy recovered in the third quarter as net exports grew strongly, but slowed again in the fourth quarter because of weakness in consumption, inventory accumulation, and residential investment. Employment growth fell from 3 percent in 1994 to 0.8 percent during 1995 as private sector employment growth slowed and public sector employment contracted. The participation rate continued to decline, so that the unemployment rate fell from a cyclical peak of 11.9 percent at the end of 1992 to 9.6 percent at the end of 1994 and remained little changed through 1995 and into 1996.

The rate of core consumer price inflation rose modestly from 1.6 percent during 1994 to 1.9 percent during 1995, owing to the lagged effects of the depreciation of the Canadian dollar and a sharp increase in commodity prices in the first half of 1995. The external current account deficit narrowed from 3 percent of GDP in 1994 to 1.7 percent of GDP in 1995 as the value of exports grew strongly, a trend related to higher commodity export prices, earlier depreciation of the Canadian dollar, declining unit labor costs for manufactures, and stronger import demand in the United States as the year progressed.

During much of 1995 and early 1996, an appreciating Canadian dollar, weaker-than-expected economic activity, and moderating inflationary pressures allowed the Bank of Canada to ease monetary conditions. From early May 1995 to end of March 1996, the Bank of Canada lowered its target range for the overnight rate by 300 basis points.

The 1996/97 budget presented to Parliament in March 1996 confirmed government targets for the federal budget deficit equivalent to 3 percent of GDP in 1996/97 and 2 percent of GDP in 1997/98, and restated the authorities' longer-term commitment to a balanced budget. The budget's measures focused mainly on spending cuts designed to reduce the nominal level of noninterest spending by an average annual rate of 2.5 percent during the next three years. To achieve this objective, the budget introduced further cuts in defense, international assistance, social and cultural programs, as well as cuts in agricultural and transport subsidies and in government operating costs.

In their review, Directors commended the authorities for the progress made in implementing their strategy since the last Article IV consultation in May 1995. Inflation had been contained and was projected to remain low, the federal fiscal deficit had continued to decline, the external current account deficit had narrowed, and progress had been made in reforming a number of key social programs. Nevertheless, Directors considered that it remained important to sustain the momentum of adjustment to put the high debt-to-GDP ratio on a clear downward path, as the high level of government indebtedness left the economy vulnerable to shifts in market confidence and to domestic and external shocks.

Directors noted that, in the March 1996 budget, the Government had reaffirmed its commitment to fiscal deficit reduction and was likely to meet its targets for a reduction of the federal deficit, but they stressed the importance of sustaining fiscal consolidation over the medium term. Although the federal debt-to-GDP ratio is expected to decline in 1997/98, it is still high by international standards and leaves the economy vulnerable to adverse interest rate developments. Most Directors agreed that the focus of fiscal consolidation should remain on expenditure cuts in areas that would also support structural reform. The Board welcomed the improvements in the budgetary process to target spending cuts across a broad range of programs and services.

Table 11

CANADA: SELECTED ECONOMIC INDICATORS

(Data as of Board discussion in April 1996; annual percent change unless otherwise noted)

	1993	1994	1995	1996[1]
Domestic economy				
Real GDP	2.2	4.6	2.2	1.9
Unemployment rate (in percent of labor force)	11.2	10.4	9.5	9.6
Consumer price index (annual average)	1.8	0.2	2.1	1.3
External economy				
Export volume	11.2	14.7	12.3	6.6
Import volume	11.1	13.6	9.8	3.8
Current account balance (in billions of Canadian dollars)	–28.8	–22.3	–13.1	–5.3
Net direct investment (in billions of Canadian dollars)	–1.1	1.7	8.8	. . .
Net portfolio investment (in billions of Canadian dollars)	27.1	12.5	20.2	. . .
Real effective exchange rate (based on unit labor costs)	–8.5	–5.5	–6.6	. . .
Gross official international reserves (in billions of U.S. dollars)	12.8	12.5	15.2	. . .
Financial variables				
General government balance (in percent of GDP)	–7.3	–5.3	–4.2	–2.4
Gross domestic saving (private, in percent of GDP)	17.8	18.0	18.4	16.5
Gross domestic investment (private, in percent of GDP)	15.8	16.3	15.4	16.3
M2 (money and quasi-money, end of period)	3.1	2.7	4.0	. . .
Three-month treasury bill rate (in percent)	4.8	5.5	7.0	5.1
Ten-year government bond rate (in percent)	7.2	8.4	8.1	7.7

[1]Projected.

Directors endorsed the authorities' efforts to reform the Unemployment Insurance system, although some Directors noted that deeper cuts in benefits could help to reduce structural unemployment in Canada. Steps taken to address the long-term sustainability of the system of government benefits to the elderly were welcomed by Directors. It was noted, however, that the measures would not begin to yield fiscal saving for many years. Directors also expressed concern about the large and growing unfunded liability of the Canada Pension Plan, which would require substantial increases in contribution rates, or considerable reductions in benefits, or both. Changes in the Plan are presently under discussion.

Directors commended the authorities for their continued success in maintaining inflation at a low level and for the steps that had been taken to improve the transparency of the monetary policy process. They generally agreed that the easing of monetary conditions since early 1995 had been appropriate in light of favorable price developments and the considerable slack prevailing in the economy.

Directors considered that Canada's consistent support for free trade was commendable and welcomed, in particular, the recent actions to reduce agricultural subsidies, accelerate Uruguay Round tariff cuts, and make the tariff system simpler and more transparent. The liberalization of internal trade was also welcomed. The authorities were commended for the high quality of their official assistance to developing countries, and were encouraged to meet their commitment to the 0.7 percent of GDP target for official development assistance.