

PART A

Chapter 2: THE INTERNATIONAL ECONOMIC SYSTEM

General economic policy

The world economic picture was characterized in 1981 by continuing high inflation rates in many countries and a marked slow-down of growth in most industrialized economies. The results were high unemployment and a drop in the expansion of world trade. Very high interest rates were a particular source of uncertainty and concern. Some industrialized countries experienced extremely large and unusually volatile external imbalances on current account, while sharply increased deficits on current account generated financing problems for many developing countries. One important and positive trend during 1981 was a moderation in crude oil prices.

Domestically too, Canada was unable to isolate itself from the world-wide contagion of severe inflation, extremely high interest rates and high unemployment. While the economy grew at a rate faster than expected in the first half of 1981, it experienced a pronounced slow-down in the second half of the year as the growth in the economies of our major trading partners, particularly the USA, began to cool significantly. Over the year however, real gross national product (GNP) increased 3 per cent in 1981, after remaining stagnant in 1980. Canada's inflation rate, as measured by the change in the consumer price index, averaged 12.5 per cent in 1981, up significantly from 10.25 per cent in 1980. While Canada's merchandise trade surplus was \$7 billion in 1981, the current account deficit increased sharply to \$6.5 billion in 1981 from \$2 billion in 1980. This was a result of a marked deterioration in the terms of trade, and a significant increase in net interest payments abroad. A contributing factor was the large outflow of direct investment as a result of take-overs of foreign businesses, which was financed by net new issues of Canadian securities sold abroad and by short-term foreign borrowing.

The US prime rate was close to 20 per cent for most of the year, reflecting the American Administration's pursuit of a tight money policy. This became an important factor in world financial markets because high US rates affected interest rates and hence the value of the currencies of the other major industrialized countries, including Canada. The Bank of Canada responded to the consequent pressures on the Canada-United States exchange rate by raising interest rates in Canada.

During the year, Canada took an active part in a variety of international economic meetings. These included the Organization for Economic Co-operation and Development (OECD) ministerial meeting in June; the Ottawa Economic Summit in July; the Cancun North-South Summit in October; the joint meeting of the Board of Governors of the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (World Bank) in September; two sessions of the Trade and Development Board of the United Nations Conference on Trade and Development (UNCTAD) and the annual session of the General Agreement on Tariffs and Trade (GATT) contracting parties.