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WORLD ECONOMIC SETTING

The Issue and Its Setting

Economic growth among the industrial countries is expected to moderate this year and next, running at just over 3 per cent. Growth among developing countries is forecast to be only slightly better (in the 3.5 per cent to 4 per cent range). One of the major accomplishments of the past few years has been the decline in inflation among the industrial countries. This trend is particularly noteworthy, as it has been accompanied by sustained economic growth. However, inflation rates in developing countries have not yet declined, and may have accelerated slightly in 1985.

Developments in the global economy have been encouraging, particularly the reduction of inflation in developed countries and the sustained growth in both industrial and developing countries. However, persistently large budget deficits and the associated increase in public sector indebtedness are putting pressure on financial markets, and risk reducing the flexibility of fiscal policy over the coming years. Despite last year's reductions in nominal interest rates, real rates remain very high by historical standards, limiting potential growth prospects. Unemployment in many countries remains unacceptably high. There is continued concern about the variability of exchange rates. Finally, rigidities in many economies remain a problem, limiting capacity to adapt to new economic and technological developments.

The financial position of developing countries has improved somewhat. If world economic growth continues as projected, and developing countries are able to continue their adjustment strategies and export expansion, further easing of the international debt situation should be possible. However, recent months have seen a growing