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1. Letter	A.K. Rawlinson to William E. Simon re oil facility in the IMF (1 p.)	9/17/74	A
2. Proposal	"Development of the IMF Oil Facility" (6 pp.)	Undated (ca. 9/17/74)	A

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DEPARTMENT OF THE TREASURY

INTERNATIONAL ECONOMIC ISSUES

BRIEFING BOOK

OFFICE OF ASSISTANT SECRETARY FOR INTERNATIONAL AFFAIRS

and

Office of the Assistant Secretary for Trade, Energy and Financial Resources Policy Coordination

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CLASSIFIED BY F. Lisle Widman
SUBJECT TO GENERAL DECLASSIFICATION SCHEDULE OF EXECUTIVE ORDER 11652 AUTOMATICALLY DOWNGRADED AT TWO YEAR INTERVALS AND DECLASSIFIED ON DEC. 31 1980

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LAW OF THE SEA CONFERENCE

STATEMENT OF ISSUE

The U.S. met with nearly 150 other nations on key issues of resource jurisdiction and ocean law at the U.N. Law of the Sea (LOS) Conference in Caracas. The next session will convene in March in Geneva, with a possibility of another summer session in Vienna and a later meeting in Caracas. It is essential that valuable U.S. interests in the mineral resources of the continental margin and deep seabed are protected and that any specific economic concessions (e.g., international revenue sharing) be fully analyzed and justified.

BACKGROUND

The objectives of the U.N. Law of the Sea Conference are to 1) create a new international order for the recovery of deep seabed minerals; 2) determine the nature and extent of coastal state offshore jurisdiction (including control over seabed and living resource as well as vessel navigation); 3) agree on international standard for pollution from vessels, land based sources and outer continental shelf operations; 4) create a system for the peaceful settlement of ocean disputes; 5) agree on a system to conserve and effectively manage the living resources of the oceans both within and outside the boundaries of national jurisdiction.

The Treasury seeks the formulation of an economically sound policy which will permit the effective development of deep sea minerals and continental margin hydrocarbon reserves, and efficient utilization of the sorely needed protein resources of the ocean.

Little progress was made this summer at Caracas. The rules of procedure were finalized in early July followed by some substantive discussions. There appear to be too many important issues yet to be resolved on which there is little basis for agreement and it therefore seems unlikely that there will be a law of the sea settlement this year.

There is concern that economic issues of great interest to this Nation have not been given adequate review and may be conceded in order to reach some sort of treaty settlement.

Despite the growing scarcity of raw materials causing constantly increasing higher prices for these resources, there are indications that the U.S. position on seabeds, rather than becoming more conservative, is being pushed toward a more discretionary, more powerful and potentially harmful international authority.

In light of the dim prospects for a treaty settlement, there has been a movement in Congress to enact legislation to stop depletion of fish off our coasts by foreign fleets and to enable us to begin to tap the hard mineral resources. S.1988 which establishes national jurisdiction over the living resources of the ocean 200 miles offshore, was reported out of the Senate Commerce Committee, but then was referred to Foreign Relations Committee. It was reported out unfavorably by a narrow margin and is now under consideration by the Armed Services Committee, who must take action shortly after the Senate reconvenes.

The Deep Seabed Mining Bill (S.1134) creates an interim legal mechanism permitting commercial recovery of the minerals on the deep seabed beyond the limits of national jurisdiction. It was reported out of the Senate Committee on Interior and Insular Affairs, but is now considered buried in the Foreign Relations Committee. Treasury is concerned that the noneconomic interests as they pertain to these issues have been overemphasized, and that the substantive arguments for the legislation have not been fully weighed. Nevertheless, Treasury has taken no official position on these bills.

CURRENT STATUS

Treasury continues to provide economic assessments and suggestions to the Interagency Task Force on the Oceans Policy and continues to be concerned by the effect of U.S. positions on domestic and worldwide economic developments especially with respect to the possibility of the economic issues becoming concessions in the negotiations.

October 15, 1974

MONETARY AND INVESTMENT

A

STATUS OF IMF ACTION ON C-20 RECOMMENDATIONS AND OTHER ISSUES

STATEMENT OF ISSUE

The new Interim Committee of the IMF and the Executive Directors are faced with an active work program during the next few months, dealing with C-20 recommendations and several other key issues. The work program covers: examination of the possible need for supplementary "recycling" arrangements; consideration of various amendments to the IMF Articles of Agreement; completion of the current review of IMF quotas; and implementation of a number of the C-20's recommendations for immediate action.

BACKGROUND

At its inaugural meeting October 3, the Interim Committee requested the Executive Directors to consider, as a matter of urgency, the adequacy of existing private and official financing arrangements as they relate to recycling, to report on the possible need for additional arrangements, including enlarged financing arrangements through the Fund, and to make proposals for dealing with the problem.

The C-20 requested the Executive Directors to prepare for consideration by the Interim Committee draft amendments on several subjects: establishing a permanent Governors' Council; legalizing floating; giving permanent force to the IMF trade declaration; authorizing a substitution account; gold; an SDR-aid link; and improving the operations of the IMF General Account and the SDR. (With the exception of the Governors' Council, none of these possible amendments is yet agreed in principle.) These draft amendments are to be considered by the Interim Committee in parallel with the current review of IMF quotas, now scheduled for completion by February 1975.

Also, the Interim Committee and the Executive Board must implement and/or oversee the operations of a number of C-20 recommendations concerning the agreed guidelines for floating; the IMF trade declaration; new procedures for surveillance of the adjustment process and of developments in global liquidity; interim valuation of the SDR; the oil facility; and study of future arrangements for gold.

CURRENT STATUS

The Executive Directors are expected to report on their work on recycling in time for the next meeting of the Interim Committee, January 15-16, 1975. Draft amendments to the

Articles have been prepared by the Fund staff, and will also be considered on a priority basis by the Interim Committee, together with the closely related issue of Fund quotas. (If quotas are to be increased, an amendment will be necessary to remove the present requirement that 25 percent of quotas be paid in gold; the U.S. considers the quota increase, this related amendment and other possible amendments as a single comprehensive package that must be viewed and discussed as a whole.)

Executive Board decisions have already been taken on several of the immediate steps recommended by the C-20: interim SDR valuation; guidelines for floating; and the oil facility. The IMF Managing Director has invited members to subscribe to the trade pledge and we expect it to take effect shortly. The IMF Governors acted to create the Interim Committee during the week of the annual meetings, pursuant to the C-20's recommendation.

OUTLOOK AND ACTION REQUIRED

The U.S. will participate through its Executive Director and through the Interim Committee in this extensive IMF work program, much of which results from U.S. initiatives in the C-20. The U.S. is also committed to a reconsideration of its position in opposition to the SDR-aid link, and we can anticipate continued pressure from the LDC's for acceptance of the link -- they may view a favorable decision on the link as the quid pro quo for their support of a general package of IMF amendments as favored by the U.S.

B

THE FINANCIAL AND ECONOMIC CONSEQUENCES OF THE QUADRUPLING OF THE PRICE OF OIL

The Magnitudes of Current Money Flows

The OPEC countries will probably receive about $80 billion in 1974 in payment for petroleum operations -- over five times what they received in 1972. Current prices (including increases announced in mid September) and production rates will actually generate payments at an annual rate of $105 billion per year, but the time lags are such that total OPEC receipts for the calendar year are likely to be some $20 billion lower. They will receive perhaps $5 billion from exports of other commodities and services in 1974. Of these $85 billion of receipts, the OPEC countries will probably spend about $30 billion on imports of goods and services, leaving some $55 billion to invest outside their borders.

If prices and production rates remained unchanged through 1975 the surplus could reach the $65 billion figure even with a generous allowance for increased import payments. See Table 1.

Economic Effects

Most directly, the oil price increase has been a major contributor to worldwide inflation. Measurement of the inflationary impact of the oil price increase is of course a complex task, but some preliminary estimates are available. The impact of increased oil prices as a percentage of GNP are themselves sizeable, on the order of 1 to 3 percent for the major industrial countries, but even these considerably understate the full inflationary impact of the oil price increases. More comprehensive estimates suggest that the quadrupling of oil prices over the past year, when its effects are fully felt, will have contributed in the range of 5 to 8 percentage points to the increase in our wholesale price index. This is on the order of almost half the increase in the U.S. wholesale price index from mid-year 1973 to mid-year 1974 of roughly 14 percent. For many other oil importing nations the contribution of the oil price increases to inflation will be even greater.

At the same time the increase has a deflationary effect as well. It shifts purchasing power from consumers in oil importing countries to OPEC countries who do not use it to purchase goods and services but add it to savings. This deflationary impact is not easy to measure; it is certainly far less than the magnitude of the OPEC surplus since to a considerable extent consumers in the importing countries will reduce their savings rather than their consumptions and the drive for alternative sources of energy will expand the demand for investment funds. Furthermore, the action came at a time when excess demand was generally prevalent.

Table 1

Estimated Payments
Position of OPEC Countries
(billions of dollars)

	1974	1975 (If oil prices and production rates were to stay at mid-September 1974 levels)
Oil receipts	80	105
Other export receipts including investment income	5	10
Import payments	-30	-50
Current account balance	55	65

Sectoral balances in national economies have been altered. Sectors in which petroleum represents a high input face relatively higher costs and weaker demand than others. These sudden shifts cause the loss of output and create unemployment even when some sectors of the economy are still at full capacity.

High oil prices also affect the performance of the world economy through their impact on the international financial system. With the OPEC countries running large surpluses in their goods and services balance, the oil importing countries as a group cannot avoid equivalent deficits. This is a drastic change for the industrial nations of the world which, collectively, have been accustomed to surpluses in their goods and services account and to being net lenders on the international scene. The developing countries, which have been borrowing to finance their economic development, now find they must borrow to finance essential current consumption as well, unless they are prepared to cut back on their development programs or depress the living standards of their people. It is not clear that the oil importing countries are all prepared to accept the vast amount of borrowing implied by these changes, at least at current levels of output and real income.

Placement of OPEC Funds

We estimate that the OPEC countries may have had a surplus of somewhere approximately $28 billion between January 1 and August 31, 1974. Of that $28 billion, about $7 billion appears to have been invested in the U.S. Over $4 billion of this - perhaps $5 billion - was invested in Treasury bills and other marketable U.S. government securities, including some so-called "agency" securities. Most of the remainder was placed with commercial banks in the United States, although a few hundred million dollars may have gone into corporate securities and real estate.

We suspect -- although we have no firm supporting evidence -- that $2 billion or more was invested in Europe through direct placement loans to official or quasi-official agencies, plus direct purchases of private securities and real estate. At least $3 billion may have been invested in the U.K. in sterling, some of which probably involved purchases of British government securities.

We have received reports of more than $15 billion in commitments by OPEC countries to developing countries and multilateral lending institutions and over $3 billion in commitments to industrial countries. Some of these reports appear to reflect firm commitments and some reflect tentative agreements or statements of intent which have not yet been translated into firm programs for action. Some call for outright grants. Some involve soft loans and some loans on near commercial terms. Some call for immediate disbursement but most imply that the funds will be disbursed over a considerable number of years. We think it reasonable to conclude that as much as $3 billion was disbursed in the first eight months of 1974, however.

Our assumption is that most of the remaining $13 billion (of the $28 billion surplus) is currently being held in Euro-dollar and other Euro-currency deposits in banks outside the U.S., largely in London.

In the past few months a larger share of the funds appears to have gone into long-term, direct placement loans and into the securities of major governments than appeared to have been the case in the earlier months of the year. This very logical development may have come about in part because the OPEC governments have had more time to plan the investment of their funds, whereas initially they were merely left on deposit with commercial banks. In part, it may have come about because banks have, in some cases, reduced their offers for large scale short-term deposits, thus creating a financial incentive for the investing governments to look for other outlets for their money. Banks are increasingly serving as brokers in arranging the direct placement of OPEC funds with longer-term borrowers and OPEC countries have increasingly gone into national capital markets - to buy government securities. One $500 million credit effectively made to the government of an industrial country has been reported in September.

Current Recycling Problems

The sudden appearance of large OPEC surpluses has created strains on the banking system. But these strains have induced the banks and other financial institutions to devise new methods and new techniques which enable them to cope with most of the problems. The system is in no real danger. Regulatory and supervisory authorities in the various countries have been alerted to guard against mismanagement and speculative excesses by banking institutions. Some countries are strengthening their banking laws. Procedures for assuring the liquidity of our financial systems are being tightened.

There are no indications that the banks cannot handle the intermediation problem. As their financial assets grow, many of the oil producing countries are coming to realize that they will not be able to use their money for goods and services in the near future and that they would be well advised to place these funds in longer term maturities. We have already seen some indications that a significant portion of the funds being placed with the banks is going into medium-term time deposits and certificates of deposit.

The fact that the financial system remains sound does not mean that all the needs of all countries will be met. If the OPEC surpluses continue an increasing number of countries will find that they are not prepared to borrow on the scale and the terms on which funds would be available. The private markets will -- as they should -- place limits on their lending to countries whose creditworthiness becomes questionable.

Just as there are limits to private market lending, so there will be limits to lending by other oil importing countries and by international institutions. Thus, except to the extent they can -- and wish to -- borrow directly from oil producing states an increasing number of countries will choose to reduce their borrowing. If their actions are not to aggravate the problems of other oil importing countries, the reductions will have to come through reducing either the price or the quantity of oil imported from the OPEC countries.

U.S. Treasury
OASIA
10/15/74

Table 2
ESTIMATED OPEC INVESTMENTS
MADE BETWEEN JANUARY 1 AND AUGUST 31, 1974

(billions of dollars)

<u>In the United States</u>	7
(Of which over $4 billion, perhaps $5 billion in U.S. Treasury bills and other marketable government securities)	
<u>In the United Kingdom</u>	3
(British government securities and other sterling assets)	
<u>In other European Countries and Japan</u>	
(Largely direct placement loans to official or quasi-official agencies, some real estate and private securities)	2
International institution bonds	.5
LDC's	2.5
Euro-currency markets	13
Total	28

C

~~CONFIDENTIAL~~

Reserve Gains of OPEC Countries, First Eight Months of 1974
(in $ million)

Country	1st Qtr.	Apr.	May	June	July	Aug.*	TOTAL Jan.-Aug.
Algeria	267	178	201	85	28*	80	839
Ecuador	87	24	49	43	-46	-44	113
Indonesia	125	348	-17	123	441	-144	876
Iran	887	37	1609	1669	642	222	5066
Iraq	679	421	77	148	152	111	1588
Kuwait a/	155	22	306	-25	-19	-2	437 a/
Libyan A.R.	351	74	284	160	358	(n.a.)	(1227) b/
Nigeria	526	346	542	141	912	(n.a.)	(2467) b/
Qatar	(n.a.)						
Saudi Arabia	988	648	714	861	1255*	971	5437
U.A. Emirates	(n.a.)						
Venezuela	389	1339	-477	938	-256	365	2298
TOTAL	4454	3437	3288	4143	3467*	(1559) b/	(20,348) b/

Source: IMF International Financial Statistics

* Note all August data plus July data for Algeria and Saudi Arabia are Confidential until published in IFS.

a/ Central bank only; excludes Government assets.
b/ Excluding August changes for Libyan A.R. and Nigeria

n.a. - not available

Treasury:OASIA
10/15/74

~~CONFIDENTIAL~~

D

October 15, 1974

Use of the Oil Facility as of October 16, 1974

(Million SDR)

			Amount
A. Purchases Effected			
1. Industrial Countries		262.50	
Italy	262.50		
2. Other Developed Countries		76.22	
Greece	36.22		
Yugoslavia	40.00		
3. Developing Countries		233.75	572.47
Bangladesh	40.39		
Cameroon	4.62		
Central African Republic	0.63		
Chad	1.11		
Chile	41.47		
Costa Rica	5.36		
El Salvador	4.40		
Fiji	0.34		
Haiti	1.15		
Ivory Coast	11.17		
Kenya	9.21		
Korea	21.00		
Malagasy Republic	3.45		
Nicaragua	3.31		
Pakistan	30.61		
Panama	7.37		
Sri Lanka	11.00		
Sudan	9.41		
Tanzania	6.32		
Uganda	4.98		

B. Purchases Pending (intention to request purchase approved)			
1. Industrial Countries		--	
2. Other Developed Countries		--	
3. Developing Countries		275.24	275.24
Guinea	3.51		
India	200.00		
*Pakistan	67.41		
Sierra Leone	4.32		
C. Intention to request purchase (subject to Executive Board approval)			
1. Industrial Countries		--	
2. Other Developed Countries		--	
3. Developing Countries		5.58	5.58
Liberia		5.58	
Total			853.29

*Second purchase

Countries Lending to the Oil Facility

Country	Amount Pledged	Amount Still Available 2/
Abu Dhabi	SDR 100 mil.	
Canada	SDR 257.3 mil. 1/	
Iran	SDR 580 mil.	
Kuwait	SDR 400 mil.	
Oman	SDR 20 mil.	
Saudi Arabia	SDR 1,000 mil.	
Venezuela	SDR 450 mil.	
Total	SDR 2,807.3 mil.	SDR 1,959.59

1/ Canadian $ 300 mil. converted into SDR's as of September 6, 1974.

2/ After purchase requests approved as of October 16, 1974.

10/16/74

E

U.S. REACTIONS TO PROPOSALS FOR NEW OR EXPANDED MECHANISMS FOR RECYCLING

Various proposals have been made for creation of new or expanded mechanisms for recycling oil funds. U.K. Chancellor of the Exchequer Healey has proposed a greatly expanded IMF facility (see attached). OECD Secretary-General van Lennep has promised to prepare a paper shortly on an alternative proposal, and other alternatives have been mentioned. The U.S. agreed with a request by the new IMF Interim Committee that the Executive Directors consider as a matter of urgency the adequacy of existing private and official financing arrangements, to report on the possible need for additional arrangements, including enlarged financing arrangements through the Fund, and to make proposals for dealing with the problem.

Our general position, as expressed at the recent IMF/IBRD meetings, is as follows:

-- So far, the existing complex of financial mechanisms, private and intergovernmental, has proved adequate to the task of recycling the large volumes of oil monies already moving in the system. We believe they will continue to do so, be we recognize that this situation could change. If it becomes clear that there is a need for additional international lending mechanisms, the United States will support their establishment.

-- Current proposals seek to meet a wide-range of potential future problems, many of which will never come to pass. The present need, therefore, is for careful study of present arrangements and of the alternatives, rather than a rush to create new mechanisms which might be inadequately formulated and which might encourage either oil producers or oil consuming countries to believe that there is an easy out.

U.S. concerns with proposals for new facilities such as the Healey proposal have centered on the following:

- Timing. OPEC countries have a greater need to lend than most of us have to borrow. Most industrial countries can postpone borrowing by using reserves. OPEC countries can't really postpone lending. This is not a time to take the OPEC countries off the hook by offering them a market rate asset with a governmental guarantee.

- Creation of a big new facility would reduce the likelihood that we can get the oil price down. Takes some of the urgency off conservation and development of alternative sources of energy. Lets the OPEC countries get credit for rescuing the world from a disaster that they have caused.

- Financing arrangements do not solve the basic problem, which is the capacity of the importing countries to service debt. Number of countries which can not afford to borrow at market rates to meet increased oil bills is going to increase if the oil price is not brought down. Will include some of the larger industrial countries. Private banks already calling a halt to their lending to a number of important countries. Even governments of countries which are themselves victims of the oil price increase cannot extend very much long-term official credit to other victims.

-- IMF or a new institution could not lend the sums which would be necessary without imperiling its own solvency and risking call on ultimate guarantors - the governments of the member states. Twenty-three percent of IMF guarantee is provided by the United States.

-- Many countries will not be prepared to borrow indefinitely. Others who may be willing to borrow may find no lenders unless the OPEC countries themselves will take the risk. Beggar-thy-neighbor policies designed to divert the deficits elsewhere will be unacceptable to the rest of the world.

-- We need to exercise caution about the rate at which we expand world liquidity. The oil price increase exerts certain deflationary effects on the world but we need to recognize its inflationary impact as well.

10/15/74

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This form marks the file location of item number 1-2 as listed on the pink form (GSA form 7122, Withdrawal Sheet) at the front of the folder.

F

Problems Faced by Banks

Banks in the Euromarket and in some national markets have come under strain and there is considerable nervousness in banking circles. This situation has been aggravated by the several well-publicized recent cases of individual bank failure or difficulty, such as the Herstatt bank collapse (and the closing of several small private banks) in Germany and the losses suffered by the Franklin National Bank in the U.S. Questions are being raised about the soundness of the banking system, the adequacy of official arrangements for regulating and providing liquidity for banks, and the banking system's ability to recycle a major portion of OPEC oil funds. More specifically, these questions involve problems such as:

-- the segmentation of the market between "first-tier" and second or "lower-tier" institutions as depositors and other lenders to banks become more selective;

-- intermediation strains as lenders show a perference for short-term placements and the needs of borrowers are for ever-lengthening terms;

-- constraints on the recycling ability of banks as borrowing countries reach threshholds of credit-worthiness; and

-- doubts whether national supervisory authorities and lenders of last resort (central banks) have the will to act and cooperate so as to assure the liquidity and solvency of the system as a whole.

It is clear that the private financial markets are facing strains and potential difficulties. The fact that individual insitutions can get into trouble through mismanagement or imprudence does not, however, indicate that the financial system as a whole is failing.

We also believe that the markets are demonstrating a capacity for adaptation and flexible response to the requirements of the current situation:

-- Banks are becoming more selective and prudent in their policies.

-- They are paying lower rates for short-term deposits and are more frequently adopting the role of a broker in arranging direct placements.

-- Lenders are also adapting by looking for other places to put their money, including government securities, advance import payments, direct loans to governments, and placements with corporate borrowers.

Governments have also acted to assist the process:

-- The IMF oil facility is beginning its operations.

-- G-10 countries have agreed that gold could be used as collateral for loans and the first example of such a loan is about to be made.

-- Instances of direct loans by OPEC countries to their oil customers are increasing.

-- Oil producers are beginning to transfer funds to various international and regional lending institutions.

<u>Confidence Questions</u>

Of the broad categories of problems cited above, clearly those most apt to affect confidence in the financial system are the most important. This suggests that governments may want to focus particular attention on:

-- the consequences of the flight from the smaller and weaker banks

-- The adoption of reassuring attitudes regarding official action as a lender of last resort.

The first focus suggests in turn that prompt attention be given to assuring depositors in smaller institutions some security with respect to their funds. In Germany, for example, the plight of the small banks is made more difficult because there is no deposit insurance scheme (and the assurances being given by the German banking association have some times proved unreliable and at other times have come too late). While the best procedures for giving such assurances will vary from country to country, they would seem clearly to be a priority area for attention. It is important to emphasize publicly the fact that failures of small banks in one country are not an indication of trouble for banks in other countries -- or even for the large banks in the same country.

Such measures would also ease lender of last resort questions. The basic dilemma is to give reassurance to the system without underwriting the solvency of individual banks or undermining anti-inflationary policies. The BIS announcement early in the month left many questions unanswered in the public mind. The impression is now prevalent that major countries are willing to take responsibility for their banks in their own country and for their branches abroad. The situation with respect to subsidiaries abroad and consortium banks remains unclear. A Bank of England letter to consortium banks in London is attached.

It is a time also when bank supervisory authorities should exercise special vigilance and examine whether their own practices are adapting to the changed circumstances. Individual governments will be incurring increasingly large debts and guarantee commitments to non-resident banks. Individual banks may find their exposure to particular countries tending to exceed traditional limits in terms of the bank's capital. The balance of payments prospects of the borrowing countries and the size of the external debt will pose increasingly serious questions for the bank supervisory authorities, raising the possibility that the flow of private capital to weak countries may be brought to a halt through the procedures of the bank supervisory authorities in the interest of assuring the solvency of individual banks.

German authorities have moved quickly to head off a widespread withdrawal of deposits from smaller banks. With respect to foreign exchange transactions, particularly forward transactions, they have established detailed reporting procedures and have placed a limit on banks' open positions relative to their capitalization. They have established a "liquidity bank" which will enjoy Bundesbank support in providing assistance to banks which have solvency problems). They will shortly submit legislation designed to strengthen banking regulations.

The press has recently carried somewhat garbled reports of actions by the U.S. Comptroller of the Currency which have resulted in medium and long-term credits by U.S. banks to Italy and Argentina being put in a kind of "early warning" category. These actions and the associated publicity may result in a reduction of exposure in these countries by U.S. banks and may even raise questions with banks in other areas. The U.S. procedures will probably need to be explained and European authorities may question whether the Comptroller's actions (as publicly reported) are consistent with U.S. Government promises to assist Italy in solving its financial problems. A description of the procedures is attached.

It appears that a good deal of attention has already been given to the question of adequacy of capital. Banks are understandably reluctant to seek new capital at a time when price-earnings ratio make new equity money excessively expensive and there is a question as to whether traditional capital ratios limitations are important.

It also appears desirable to encourage more careful supervision of foreign exchange positions, given the several cases of unreasonable speculative activities by banks (Franklin, Herstatt). Statements concerning supervisory practices in the major countries might also be considered as a confidence-building step.

There is also a widespread feeling that agreements among governments and central banks to maintain very close, very frequent consultations and to improve the exchange of information would be helpful. Consultation procedures already exist-from the Monthly Basle meetings to OECD's Working Party 3, and the new IMF Interim Committee to the frequent bilateral, EC and small-group sessions. Furthermore, a rapport has been established which permits frequent use of the telephone. The extent of consultation could be publicly highlighted.

Actions might also be taken to improve the exchange of information. Special attention could be given to shortening the time lags in collecting and transmitting pertinent data. Thought might also be given to a general request to Swiss National Bank authorities for the gradual broadening of their data collection and for reducing the time lag in its dissemination. Much more data could be supplied without compromising banking confidence.

Flow of Funds to Oil Importing Countries

The confidence questions should be clearly distinguished from those questions concerning the ability of the system to re-cycle a sizable portion of OPEC monies. If the system is lacking in this respect, it will not ncessarily result in a general financial crisis. It will simply mean that too much money goes to some countries and not enough -- through private channels -- to others. Thus it will pose questions for governments as to the degree to which they are prepared to lend officially to borrowers who are unable to borrow from private sources. While a few strong countries might try to keep unneeded funds out, it is highly unlikely that the OPEC countries will have such difficulties in finding placements for their monies that they would cut back oil production for this reason. Nor is it likely that rejection of capital by the strong can force direct OPEC lending to the weak.

IMF Proposals

The IMF staff is also undertaking work on the Euro-currency market and its problems. They will be examining questions concerning the responsibility for support of institutions in the market and a possible Fund role in improving data on international banking. They are considering the idea of having governments work out guidelines for banks regarding the acceptance of short-term monies, appropriate maturity balances and capital ratios.

10/15/74

G

Problems Arising from Private Gold Price

Statement of Issue

The rise in the private gold price to well above the monetary price has stimulated speculation that a large increase in the monetary price could yet take place. A very large divergence in price tends to place strain on the two-price system and underscores the issue of whether gold's monetary role will in fact be diminished.

Background

The rise in the market price of gold is in part due to self-serving rumors on the part of the gold lobby, a virtual monopoly on handling the supply by a few Swiss banks, and reduced production as low-grade ores are mined. Moreover, gold in the private markets is perhaps more subject to speculative activity than other commodities. The market is relatively small and a few million dollars of increased demand or reduced supply can result in a rather sharp price variance.

Current Status

Given the wide discrepancy in price, monetary authorities do not trade in gold at the monetary price. The increased oil bill has also given those countries which are large gold holders an incentive to raise the price. In light of this, the two-tier system was terminated and monetary authorities are free to sell official gold to the market if they wish. (Buying from the market remains restricted by the IMF Articles, a number of which are under review.) In June, the Group of Ten Finance Ministers visualized the possibility that official gold could be used as collateral for international borrowing. One such borrowing has occurred, a $2 billion loan to Italy by Germany.

Outlook and Action Required

Gold may be overvalued at the present market price in terms solely of industrial demand (including jewelry use), but a reduction in price close to the monetary price is unlikely. Also the increase in the gold price is not out of line with that for a number of other commodities. As announced publicly, our twin objectives are to phase gold out of a central role in the monetary system and at the same time permit it to be mobilized when needed by countries in balance of payments difficulties. There is agreement that this matter will continue to be discussed in the IMF.

October 15, 1974

H

Holding of Gold by Private U. S. Citizens

Statement of Issue

Legislation that lifts existing restrictions on holding gold by American citizens after December 31, 1974 has generated interest in what the policy of the Treasury will be on gold sales from official stocks.

Background

There has been considerable activity by banks, commodity exchanges and metal dealers in preparing to sell gold in various forms to the public. American citizens have been free to hold almost unlimited quantities of gold coins since restrictions were eased in December 1973, but freedom to hold and deal in bullion has been restricted since 1933. Expectations vary widely on the extent to which public demand will increase and the world market price will be affected.

Current Status

The President has the authority to remove the existing restrictions prior to December 31, 1974, if he finds that international monetary reform has proceeded to a point where this action would not adversely affect the U. S. international monetary position. There is no legal requirement that official U. S. gold should be sold in the market when the remaining restrictions are lifted. Official U. S. gold sales would be tangible evidence of our policy to demonetize gold and remove it from the center of the international monetary system. Under Secretary Bennett recently indicated that official gold might be sold after the restrictions are lifted, although no decision had yet been taken on whether, when or how such sales would be made. The effect of private purchases on U. S. imports would be one consideration.

Outlook and Action Required

There will be increasing pressure for clarification of the Treasury position on gold sales to the public. This will come both from gold dealers as well as foreign governments.

October 15, 1974

I

Foreign Exchange Developments and Market Intervention Policy

Statement of Issue

The sharp rise in the price of oil, and the fact that most payments for oil are made in dollars, has substantially increased the demand for dollars. While some of this demand does not directly enter the foreign exchange market, it is evident that -- as the effects of the oil price increase became increasingly felt -- during the summer months the dollar tended to appreciate in the foreign exchange market, despite the deterioration in the U.S. trade position. Most recently, some diversification of oil country receipts and reserve holdings into other currencies has tended to depreciate the dollar in terms of some of the stronger European currencies. This situation tends to pose the issue of the appropriate level of the dollar in light of U.S. policies and objectives on trade, balance of payments and domestic inflation.

Background

Modest intervention in the foreign exchange market by the U.S. authorities, from time to time, has been a signal to the market that U.S. authorities intend to intervene to maintain orderly conditions in the market and may resist unusually sharp changes in exchange rates. In the Group of Ten Communique of March 16, 1973, the major industrial countries indicated that intervention "may be useful at appropriate times to facilitate the maintenance of orderly conditions, keeping in mind also the desirability of encouraging reflows of speculative movements of funds". Subsequently, at the recent Annual Meeting in Washington, the IMF approved specific "Guidelines for Management of Floating Exchange Rates", essentially to (a) smooth out very short-run fluctuations; (b) offer a measure of resistance to market tendencies in the slightly longer run, particularly when they are leading to unduly rapid movements in the rate; and (c) resist movements that appear to be deviating substantially from a reasonable estimate of the medium-term norm, to the extent such an estimate can be formed.

Current Status

As our public statements indicate, and consistent with international understandings, the U.S. has recently intervened in the exchange market primarily to assure orderly conditions and to moderate unduly wide swings during particular days.

Outlook and Action Required

In contrast with previous periods, there is at present no discernable pressure in the exchange market based on expectations that one or another major foreign currency will significantly increase in value in terms of the dollar. However, the potential volatility of very large funds in the financing of various kinds of payments related to oil will continue to have a major effect on the market and on exchange rates. No particular new action appears to be called for except to continue to coordinate operations closely on a bilateral basis and to pursue through the IMF the discussions on managing the interim floating rate system.

October 15, 1974

J

WORLD PAYMENTS PROSPECTS

SUGGESTED TALKING POINTS

--Acknowledge that overall situation cannot be tolerated indefinitely.

-oil consuming countries facing need to borrow $55 billion in 1974 and perhaps $65 billion in 1975 if oil prices don't come down and imports of oil are not reduced.

--Stress the real economic impact of this situation on oil consuming countries.

--Note that among major industrial countries only Germany is running large current account surplus. All others are sharing in the borrowing--by running current account deficits.

--Report on U.S. balance of payments position and outlook.

-Trade deficit $1.1 billion in August ($.8 billion in July). Likely total $4-1/2 to $5 billion for last half of 1974 ($9 to $10 billion annual rate) and $10 to $12 billion in 1975 (import figures f.o.b.) despite relatively slow domestic growth.

-Fuel import bill could be $26 billion in 1974 and $30 billion in 1975.

-Current account deficit likely be over $4 billion in second half 1974 and $10 billion or so in 1975.

-Although we have had short-term inflows of $7 billion from OPEC countries directly and $10 billion from other areas -- our banks lent about $15 billion leaving a net inflow of short-term capital of $2 billion or so to balance the current account deficit, our aid expenditures and long-term capital outflows.

-Our reserve assets have risen about $1.1 billion, but over $900 million of this increase resulted from IMF drawings by other nations.

-Exchange rate movements balance the flows. Tendency toward inflow of funds exceeding current deficit pushes dollar rate up and restores balance. If OPEC countries were to place too high a proportion of funds in the U.S., it seems almost inevitable that rate would rise as necessary to evoke compensatory outflow or increase in current account deficit unless foreign central banks intervened to prevent it.

-Thus we would feel we were doing our part in promoting recycling.

--Ask whether Japanese announced determination to eliminate current account deficit is likely to place undue burden on other countries. Does GOJ plan to tailor its policies to achieve this objective or is this merely an estimate of positions which would develop in absence of government intervention? Does GOJ actively intervene on foreign exchange market or give guidance on foreign borrowing by banks toward fulfillment of this objective?

--Ask whether British are confident that their policies will keep the current deficit within limits which can be easily financed without raising questions of credit worthiness.

OASIA/IMA
9/28/74

WORLD ECONOMIC OUTLOOK

SUGGESTED TALKING POINTS

--Review current situation and prospects in the U.S.

--Acknowledge growing fear of world recession and in particular fear that in its determination to stop inflation U.S. may engage in "overkill."

--Recognize that slow growth is a clear possibility although note OECD is estimating that first half 1975 will show GNP rising (annual rates first half 1975 over second half 1974) 7-1/4% in Japan, 5-1/4% in Canada, and 4-1/4% in Germany and France.

--Inflationary threat is so serious that world may need to take more risk of downturn than would be warranted when curbing inflation rates of 4 to 5%

--Nevertheless U.S. will watch situation carefully in order to avoid overkill.

--Report on economic summit and describe plan for reaching policy decisions.

OASIA/IMA
9/26/74

Short-Term Economic Outlook for Major OECD Countries

General Overview

The last comprehensive analysis of the short-term outlook for the economies of OECD member countries available to policy officials was the Economic Outlook prepared by the OECD staff in July 1974. This analysis was based upon individual country work performed in late May and discussed at the early June EPC meetings. Substantial changes have occurred in the economic scene since that time. Disappointing first and second quarter economic data, and hard evidence that anti-inflationary policies take a considerable time period to become fully effective necessitate a substantial revision of the July forecast.

Recent private and public statements give credence to a growing pessimism over the short-term economic outlook. A speech by Chancellor Healey and a press interview by Chancellor Schmidt are the most prominent examples. Given the rather gloomy outlook for real GNP growth for the remainder of 1974 -- and for the year as a whole -- and the expectation of continuing double digit inflation, this pessimistic view of the world economy should certainly be considered to be one possible scenario. Although we would disagree with the degree of pessimism expressed by some, we would not rule out the possibility of such a scenario. (The possibility may increase proportionately to the number of policy officials expounding such a view.)

In terms of real growth and inflation, preliminary first half statistics suggest that the current economic malady is even more deep-seated than had earlier been thought. As a result anti-inflationary policies will result in a correction that comes about more slowly and more painfully than had earlier been expected. Given the potentially disastrous effect on the world economy that run-away inflation psychosis could have, we still believe that concerted anti-inflationary policies are not only appropriate but are mandatory.

The detailed analysis which follows will describe the current and short-term economic outlook for the following: real growth -- government demand management policies (monetary and fiscal); price performance -- GNP deflator and wholesale or consumer prices; and the foreign sector -- trade and current accounts.

The subsections will present both a composite outlook for the major six countries and some country specific detail. The forecasts are summarized in the following tables:

Table 1

REAL GNP GROWTH

(percent change)

Country	1972	1973	Estimated 1974 Treas.	Estimated 1974 OECD
U.S.	6.1	5.9		.05
Canada	5.8	7.1		5.0
Japan	9.4	10.3	1.0	-1.5
Germany	3.0	5.2	1.5	1.75
France	5.5	6.1	4.8	4.75
U.K.	3.5	5.4	0.5	-2
Italy	3.4	5.4	5.4	3.5
Total Seven	5.8	6.5	n.a.	0.5
OECD Total	5.7	6.3		1

1975 First Half -- Estimated

	Treas	OECD
U.S.		3.0
Canada	n.a.	5.25
Japan	n.a.	7.25
Germany	2.7 (yr)	4.25
France	4.5 (yr)	4.25
U.K.	1.75(yr)	1.25
Italy	1.8	1.5
Total		3.75

(1) Treasury Estimates
(2) OECD July 1974

Table 2

CONSUMER PRICE MOVEMENTS

(Percent Change over the Year)

Country	1972	1973	Estimated 1974 Treasury	Estimated 1974 OECD Jul 74	Estimated 1975 Treas
U.S.	2.6	5.3		10	
Canada	3.5	5.6		10	
Japan	4.9	11.8	23.5	24 3/4	12.5
Germany	5.6	7.2	7.5	8 1/2	7
France	6.2	7.3	15-16	14	7.5
U.K.	6.7	8.6	18-20	15	12-17
Italy	5.7	10.8	19	19	15
Total Seven	4.1	7.2		13	

CONFI AL

Estimated Trade and Current Account Balances

($ Billions)

Country	Trade Balances 1973	Trade Balances 1974 Treas.	Trade Balances 1974 OECD 7/74	Trade Balances 1975 (1st half) Treas.	Trade Balances 1975 (1st half) OECD 7/74	Current Account Balances 1973	Current Account Balances 1974 Treas.	Current Account Balances 1974 OECD 9/74	Current Account Balances 1975 (1st half) Treas.	Current Account Balances 1975 (1st half) OECD 7/74
U.S.	0.5	-6.3	-2.7	-4.8	-2.7	0.7	-3.7	0	-4.6	
Canada	2.4		1.7		0.7	-0.3	n.a.	-1 1/2	n.a.	-2.5
Japan	3.7	+2.1	-2.3	11.8 1/	0.2	-0.3	-4.3	-6.5	4.8 1/	-2.8
Germany	15.4	20.0	20.0	18.0 1/	8.5	4.5	8.1	7.5	5.0 1/	0.8
France	1.5	-4.8	-4.1	-3.5 1/	-1.5	-0.8	-6.5	-6.2	5.5 1/	-2.7
U.K.	-5.8		-12.2		-5.2	-3.3	-9.5	-9.8	-7.0 1/	-4.2
Italy	-4.0	-9.0	-10.1	-5.0 1/	-3.4	-2.5	-9.1	-7.5	-5.6 1/	-2.8
Total Seven	13.7	-8.5 2/	-8.5 2/	-9.7		-2	-26.5 3/	-24	-20.5 1/	-15.1
Other OECD							-28.5	-12	-50.5	-4.9
LCD's non-oil								-24		
OPEC							55 4/	60	70 4/	

1/ Year

2/ Assures OECD estimate for Canada and U.K.

3/ Assures OECD estimates for Canada.

4/ Assuming current prices and production levels.

~~CONFIDENTIAL~~

Real GNP Growth

General

Preliminary data for the first half of 1974 indicate a slump in real growth of significant proportions for the major OECD countries. Lags between anti-inflation policies and concrete results imply that recovery from the current recessionary pressures will be slow. Real growth for the remainder of 1974 is likely to be relatively flat with the beginnings of a recovery showing in early 1975. This reduced growth in real output is a necessary side effect of the anti-inflationary measures being pursued in the major industrial countries. In most countries it is expected that restrictive monetary and fiscal policies will be continued until the potentially more damaging inflationary psychosis is brought under control.

Some countries such as Italy and France can be expected to show continued growth of real GNP although at an unspectacular rate during the second half of 1974 and on into 1975. Real growth rates for 1974 as a whole should range from slightly more than 5% for Italy to roughly zero for the U.S. During 1975, the range generally moves upwards with the slowest real growth rate of between 1 1/2-2% likely to occur in Italy and the U.K. The French may experience slightly less growth than during 1974. In general, these forecasts fall in the mid-range of the various forecasts by other analysts. The CIA is clearly more pessimistic in its real growth outlook while Project Link and Chase Econmetrics are more optimistic. Although the July OECD Economic Outlook was more bullish the OECD staff would most likely revise its outlook downward on the basis of recent data.

Specific Country Detail

JAPAN is in the midst of the most perverse elements of economic stagflation. Real GNP declined 8.1% during the first half of 1974, while inflation rates rose to record heights. By mid-year Japan's recession may have bottomed out, although some Japanese analysts remained pessimistic. A September report appearing in the respected NIHON KEIZAI Journal expressed deep concern that "stagflation will become further intensified in the future." The article noted that the only positive elements during the second quarter were the trade sector and private investment. The private investment strength may in fact be "unintended" inventory build-ups that do not represent a real growth stimulus -- they may actually indicate further recessionary pressures as business firms adjust output to the high inventory levels during late 1974-early 1975. It is generally accepted that if current tight monetary and fiscal policies are maintained then recovery will be relatively slow in coming. Monetary policy is quite restrictive for the Japanese economy with the money stock (M 1) growing on the order of 12% rather than the "normal" mid-20% growth rate.

At summer's end, the FRENCH economy remained in the grip of strong, persistent inflationary forces. As governmental stabilization policies continue to be felt, the rate of real growth will probably moderate to slightly under 5% during 1974. Growth prospects for 1975 are even less favorable with real growth being perhaps on the order of 4.2%. In particular business outlays for plant and equipment--the mainstay of past economic expansions--will be depressed under the combined influence of newly increased tax burdens and tight monetary policy. The stringent budget position will likewise dampen government consumption and investment. While France might hope to benefit some from economic recovery in Germany, the gains are likely to be largely offset by trends elsewhere--particularly in Italian markets.

Though the indicators are not totally clear, the general outlook for the BRITISH economy is poor. Stagflation presents the same frustrations for policy makers in Britain as it does in the other major industrial countries. We doubt that GNP will show any real growth during 1974. With the exception of the export sector, the basic elements in domestic demand appear to be weak. Recent surveys of private investment plans indicate that manufacturing investment in plant and equipment will grow by somewhat less than 5% in real terms. Personal consumption expenditures have declined as real disposal income fell during the first quarter. Consumption is expected to remain flat throughout the remainder of 1974. The recent posture of monetary policy has been quite restrictive. The broadly defined money supply (M 3) has grown only 4% in nominal terms -- a very negative growth rate in real terms. The British case is particularly representative of wide swings in policy. During 1973 the broadly defined money supply grew over 25%.

The ITALIAN economic outlook presents one of the more perplexing problems of the major industrial countries. As a result, various forecasters view the real growth prospects quite differently. Our own view is basically that the impetus of a rather high rate of growth in the first part of 1974 will be difficult if not impossible to reverse during the second half of 1974 and hence it will be early 1975 before the economy responds to governmental policies of restraint. As a result of this underlying trend growth, we believe that real growth will be on the order of 5.4% during 1974. As the austerity policies begin to become effective, real growth will probably be reduced to roughly 1.8% in 1975.

The swing originally forecast for the second half of 1974 in GERMANY has not yet occured and does not seem likely to take place during the remainder of the year. As a result, real growth may be only 1.5% during 1974 -- a substantial drop from the 5.2% real GNP growth of 1973. Private consumption expenditures are expected to show no real growth and investment should continue at a rather stagnant rate. As in the British case, only public consumption and the foreign trade sector are providing any stimulus to growth. Since the trade sector is significantly affected by the growth outlook in other EC countries (especially Italy), even this particular element of strength may weaken in the near term.

Price Performance

Inflation continues to be rampant throughout the industrial world. A signficant part of the current inflation can be traced to the direct and indirect effects of the recent four-fold price increase for crude oil. The world-wide shortages of agricultural products and primary commodities during the last few years underly another major segment of current inflation rates. Even after taking into account these diverse influences on inflation rates, a sizeable element remains. If one assumes that roughly half of the double digit price increases of late are directly accounted for, there is still an underlying inflationary trend that is generally unacceptable.

Continuation of this inflation if left unchallanged could result in inflationary expectations that would seriously disrupt both the social and political structure of major nations.

The outlook for cost of living increases in the major countries during 1974 is quite pessimistic. With the notable exception of Germany, (where we forecast a CPI increase of "only" 7-8%) the major countries will face inflation rates of 15 to 20 percent during the year. This degree of inflation --unless curtailed--will lead to excessive wage demands that could fuel still another round of inflationary pressures during the early part of 1975. For most countries wholesale prices will increase even more rapidly during 1974.

<u>Specific Country Detail</u>

<u>JAPAN</u>, for example, is expected to experience wholesale price increases of greater than 30% during this year--even though highly restrictive governmental fiscal and monetary policies have been in effect since late 1973. The rate of wholesale price increase should be reduced towards 10% during 1975. Consumer prices are expected to register 24% increases in 1974, followed by roughly 13% in 1975. These projections assume a continued policy stance of restraint.

During the first seven months of 1974 the <u>FRENCH</u> consumer price index advanced at a seasonally adjusted annual rate of nearly 17 percent. Hourly wage rates increased more than 6% in the first quarter alone (24% annual rate). It seems inevitable that these very large wage boots will continue to exert heavy upward pressure on costs and prices throughout the remainder of the year. The Government's stabilization program should produce some price improvement in 1975 and the forecast rate of price increase is roughly 7-1/2%.

Retail prices in the <u>U.K.</u> have risen at an annual rate about 20% during the past few months, and are expected to produce a rate of nearly 20% for the year as a whole. Wage demands--and the basic political situation--may result in an inflation rate of nearly 15% during 1975. Although the British reduced the value added tax by 2 percentage points in July, a "tough" policy stance will be needed to keep the inflation rates at currently forecast levels.

In ITALY the G.N.P. deflator is predicted to rise by some 20% during 1974--probably the largest deflator increase among the industrial countries. Suprisingly even this forecast is based on rather optimistic assumptions regarding agricultural and commodity prices. The outlook for 1975 is hardly better, with the GNP deflator forecast to rise by 15% and the cost of living index to also increase roughly 15%.

The price outlook for GERMANY is considerably better than that of other countries. Consumer price increases on the order of 7.5% for 1974 and roughly 7 percent for 1975 are forecast. Clearly the German policies of restraint have been more successful than other countries' approaches.

TRADE AND CURRENT ACCOUNT BALANCES

General Outlook

The oil importing countries are experiencing a dramatic swing in their trade and current account balances during 1974--from an aggregate surplus to a deficit on both accounts. For the major seven countries the aggregate trade account will swing more than $20 billion--from a surplus of roughly $14 billion in 1973 to a deficit of some $7-10 billion during 1974. This substantial turnaround in the balances had been projected immediately following the second round oil price increases of January 1974, and became evident in the statistics late in the first quarter of the year.

Somewhat more disturbing, however, is the extreme unevennous of the distribution of the deficits among the oil importing countries. A rough indication of the maldistribution of the deficits can be seen in the trade account forecasts for Germany and Italy. Germany is expected to experience an increase in its trade surplus of some $5 billion -- to an unprecedented figure of $20 billion, while Italy's trade deficit is likely to rise some $5 billion further in 1974 to approximately $9-10 billion. Implicit in such a maldistribution of deficits, is a danger that countries will resort to self-defeating and chaotic attempts at unilateral account balancing.

As a result of decreased real growth rates in the developed countries, growth in the volume of world imports during 1974 is likely to decrease substantially from recent trend rates of growth. Partly as a by-product of OPEC increased oil revenues, the growth in the volume of OECD exports is not expected to suffer a similiar decline.

Specific country detail

The outlook for JAPAN's trade and current account shows substantial improvement from forecasts made immediately following the oil price increase. The increased price of oil is expected to add some $20 billion to Japan's import bill, which by itself would drive the trade account into a fairly large deficit. This potential deterioration in the trade account has been largely offset however by a dramatic increase in Japan's surplus on non-oil trade. Current predictions indicate an improvement of approximately $20 billion in the non-oil trade surplus, resulting in a forecast of near balance for the 1974 over all trade account. Another factor behind the improve outlook is that reduced real growth in the domestic economy more directly affects the volume of imports in Japan than in most other countries. Import volumes have remained virtually flat so far during 1974. The trade account has steadily improved throughout 1974 and is estimated to be running in surplus during the third quarter. The outlook is for continued improveement during the remainder of the year and on into early 1975, reaching a surplus of somewhere near $5 billion for the year 1975. Similiarly the current acount outlook is for continuing improvement and although it is likely to be in deficit--some $4-5 billion--for the year as a whole, it moved toward near balance in the third qurter, and is expected to continue its surplus trend well into 1975. The publically expressed goal of current account balance in 1975 should be easily attainable.

We forecast the FRENCH trade deficit this year to be about $4.8 billion and a current account deficit of $6.5 billion. The 1975 outlook is rather muddy. Given the forecast of continued real growth in the domestic economy, the volume of French imports should continue to increase, hence possible trade account improvement rets on the prospect of increasing exports. Although sizeable plans are underway for expanded exports to the Soviet Union and the oil producing countries, firm export commitments and therefore shipments are not likely to take place during 1975. Hence the main potential thrust for increased exports during 1975 rests with traditional trading partners--Germany (20% of French exports), Italy and the other countries of Western Europe. The state of demand for imports in these countries is critical to French exports. The trade and current account for 1975 are forecast to be in deficit by $3.5 billion and $5.5 billion respectively.

ITALY's trade and current account deficits this year should both be about $9 billion and next year between $5-6 billion in deficit. While this represents a substantial improvement in the situation, it still leaves a very large deficit to be financed. The forecast improvement is critically dependent upon the forecast slowdown in the rate of domestic economic growth.

While the U.K. has been hard hit by increased oil prices, it has been--so far--able to improve the non-oil trade balance. A recent improvement in the terms of trade is also favorable to continued improvement. Thus the general outlook for the current account is one of slow improvement. The near term outlook, however, is dependent upon domestic price movements and the general growth of world trade. We presently forecast a current account deficit of roughly $9.5 billion in 1974, which may be reduced to some $7 billion during 1975.

The GERMAN trade account outlook remains bullish in the near term. The trade surplus is forecast to improve roughly $5 billion during 1974, reaching $20 billion for the year. If economic activity abroad slows down during late 1974 and early 1975, the trade surplus will probably suffer a moderate decline but a 1975 surplus of approximately $17-18 billion is not impossible.

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