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CLASS II FOMC

TO: Federal Open Market Committee

FROM: Arthur L. Broida ALB

Attached for your information is a copy of a report by Mr. Solomon on recent meetings of Working Party 3 and the Economic Policy Committee of OECD.

Attachment

Robert Solomon
March 13, 1975

Report on Meetings of OECD's Working Party 3 and Economic Policy Committee, March 5-7, 1975

The WP-3 discussions focussed on a) the overall current account deficits of the OECD area with the rest of the world, b) the distribution of these deficits among member countries and c) the position of the U.S. dollar in foreign exchange markets.

a) There was general agreement that the OECD area's current account deficit realized in 1974 and projected for 1975 was considerably less than earlier estimated. The 1974 deficit was put at about $34 billion and the 1975 deficit at $28 billion. Most of the improvement was related to the general cyclical weakness, which had a depressing effect on both volumes and prices of imports from non-member countries, including oil imports. Exports to OPEC countries have been increasing rapidly. The better OECD position for 1975 was likely to be reflected in balance of payments difficulties for non-oil developing countries.

b) The distribution of the projected deficits among OECD countries implied only little progress, if any, towards a diminution of the large imbalances that currently exist. Some improvement was seen for Italy and Denmark. But improvement was also projected for countries whose external positions were already relatively favorable, e.g., Netherlands, Belgium, and Japan. The OECD Secretariat also foresaw a further increase in the surplus position of Germany (to a current account surplus of $12 billion) but the German representative argued strongly that a small reduction in the surplus was more likely (and the Federal Reserve staff is inclined to agree with this judgment). The United States is likely to have a current account deficit of $5 to $7 billion, a not excessive share of the total OECD deficit. On the whole, financing of the prospective deficits in 1975 was viewed with equanimity, except for some doubts regarding the U.K. and the Danish positions.

c) During the discussion of the foreign exchange position of the U.S. dollar, the Swiss representative outlined the severe difficulties that the Swiss export and tourist industries were confronting at the present exchange rate, though he failed to note that some of these difficulties may be a reflection of world recession rather than of an overvalued exchange rate. The U.S. representatives reviewed recent developments and, according to Chairman Emminger's sum-up, "reassured" other members of the working party that the U.S. attitude was not one of benign neglect. U.S. monetary policy was not criticized for being insufficiently stimulative. Instead two or three representatives expressed a concern that U.S. short-term rates ought to be regarded as an instrument of foreign exchange management. But others stressed that recent exchange rate movements have a number of causes, only one of which is interest rate differentials. Finally, there was widespread agreement with the proposition that this is not the time to return to exchange rate targets or zones.

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The discussions in the EPC focussed largely on the economic position and policy stance of the United States, Germany and Japan. In all three of these countries activity had declined rather more than expected, price performance had been better than expected, and the external position was relatively strong.

Alan Greenspan presented a relatively favorable picture of the prospects for an upturn in the U.S. economy and expressed his well-known concerns about future financial strains. The reactions around the table were mixed: some doubts were expressed about the timing and sustainability of the U.S. upturn and about Greenspan's concern over the future effects of financing deficits. The German delegate observed that the present uncertainty as to the timing and extent of U.S. policy was unsettling.

The discussion of Germany acknowledged that the Government had adopted significant fiscal action--involving a fiscal stimulus estimated to be about 2-1/2 percent of GNP--as well as an easier monetary policy. While foreign orders for German products had fallen, domestic orders may have turned up again. Germany has less of an inventory overhang than other countries and the major question was not whether activity would turn up but whether the domestic expansion would be sufficiently strong and sustained to restore prosperity in Germany and permit some of its trade partners to improve their balance of payments positions.

Economic activity in Japan has fallen sharply--industrial production has dropped more than in any other major country--and the rate of price advance has moderated strikingly. The Government has adopted a number of selective and unannounced measures of a stimulative nature but its general stance is to hold off on major policy actions until the spring wage negotiations (beginning mid-April) are completed. The Japanese representatives stressed the persistence of inflation expections, despite the recent price performance. They also believe that Japan's future growth potential will be less than in the past, perhaps 5-7 percent instead of 10 percent.

The meeting was summed up by its chairman with the statement that there was a diversity around the table in the degree of concern over the economic prospects and policies of the three major countries, but that most representatives tended to give present policies the benefit of the doubt without being fully convinced.