Authorized for public release by the FOMC Secretariat on 2/3/2021

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D.C. 20551

July 27, 1976

CONFIDENTIAL (FR)
CLASS II FOMC

TO: Federal Open Market Committee

FROM: Arthur L. Broida

Attached for your information is a report by Mr. Truman, dated July 23, 1976, on the meeting of Working Party Three held in Paris on July 19-20.

Attachment

Authorized for public release by the FOMC Secretariat on 2/3/2021

RESTRICTED

E.M. Truman
July 23, 1976

Report of Meeting of Working Party Three*/
(Paris, July 19-20, 1976)

The meeting consisted primarily of a tour de table concentrating on (1) the outlook for real growth, (2) the outlook for domestic inflation rates, and (3) the outlook for current account balances. The general conclusions of the discussions were:

(1) Some deceleration of the rate of economic expansion is expected, but the Working Party generally felt that this prospect represented an approximate normalization.

(2) No further substantial lessening in inflationary pressures is now expected, except in the United Kingdom and, perhaps, Italy where some moderation in the rate of inflation is anticipated. The Working Party expressed a generally relaxed attitude about the possible price effects of the European drought.

(3) In part because of somewhat stronger growth than had earlier been expected and in part because of the drought in France, somewhat larger current account deficits are now being forecast for France and Italy in 1976. Some of the smaller OECD countries -- for example, Portugal, Spain and Turkey -- are also now expected to register substantial deficits this year.

---

*/ The intended confidential nature of WP-3 discussions was emphasized at this meeting by a decision to discontinue the practice of having the Chairman, Mr. Emminger, give a brief report to the press on the topics discussed. This Report should be treated accordingly.

Authorized for public release by the FOMC Secretariat on 2/3/2021

It was generally agreed that those countries without severe balance-of-payments problems were appropriately following cautiously expansionary monetary policies. Mr. Emminger drew particular attention to the fact that the DM-dollar exchange rate had been stable for many months without substantial intervention while other countries had experienced considerable instability in their currencies' exchange rates and had intervened heavily.

Review of Countries with Major Economic Problems

A. Italy

The Italian representatives offered a somewhat disjointed presentation of the Italian economic situation. Italy has recently been experiencing a strong spurt of economic expansion led by private consumption and stockbuilding. In part as a result of this growth and in part as a result of inflation, the EEC-limit on overall credit expansion has been exceeded. Real growth is expected to slow to zero or less in the second half of 1976, as the effects of monetary measures that were adopted early in 1976, including the deposit scheme, are felt. The Working Party was cautioned against exaggerated optimism based on recent accumulations of reserves. The Italian current account deficit is expected to increase to $3-1/2 billion in the second half of 1976, and no additional restrictive effect on domestic liquidity from the deposit scheme will be felt after early August. The scheme has been extended until November 5 to

Authorized for public release by the FOMC Secretariat on 2/3/2021

give a new government the chance to develop a program, but after that date the scheme will lead ceteris paribus to an expansion of domestic liquidity.

The Italian representatives were unable to present the outlines of the new economic program, but it should involve the following elements, at least in the view of the Working Party: (1) new monetary measures and a realistic ceiling on domestic credit expansion, (2) reduction of the budget deficit -- the Italians spoke of eliminating the current account deficit of the budget in three years -- and the adoption of stronger procedures of budgetary control, (3) an "understanding" with labor on wage increases and indexation, and (4) additional measures to stimulate domestic investment.

B. The United Kingdom

The British representatives said that their recent expansion had been largely export-led, although the expansion in exports had recently slowed down. It is hoped that the expansion in 1977 will be led by investment. Unemployment is not expected to peak until late 1976 -- the discussion was held before the announcement of the rise in unemployment in July -- and this poses policy problems. Because of the depreciation of sterling, achievement of the interim target of less than two-digit inflation is not now expected until early 1977. The Working Party was told to expect an announcement of cuts in public expenditures in a week or so; the announcement came two days later.

Authorized for public release by the FOMC Secretariat on 2/3/2021

The British representatives acknowledged that they faced potential problems in controlling the rate of growth of the monetary aggregates. They expressed the hope that they would be able to maintain the five-plus per cent short-term interest rate differential with the United States without the need to raise U.K. rates further.

C. France

France is experiencing a fairly rapid expansion, but the authorities are concerned about restoring profit margins without adding to inflation and are also concerned about the low level of investment. On the inflation front, it is doubtful that the rate will decline by more than two percentage points over the next year from the current 11 per cent rate. The Working Party expressed concern about the rate of wage increase, which is now at about 17 per cent at an annual rate. The French authorities hinted that a new incomes policy may be implemented. The drought in France is expected to add 3-5 billion French francs to the current account deficit in 1976-77 -- a bit more than half in agriculture and the rest in energy -- bringing the projected deficit in 1976 to almost $5 billion, without taking account of any adverse effects of the depreciation of the franc.

The French representatives argued that the recent depreciation of the franc had been triggered by psychological factors based on newspaper reports of the drought and the French foreign debt. They said

Authorized for public release by the FOMC Secretariat on 2/3/2021

they were calm about the recent developments because of the low foreign holdings of francs, the existence of exchange regulations governing transactions by residents, and the fact that they were following a tight monetary policy that was directed at limiting the drift of the franc. (The recent tightening of short-term interest rates occurred largely after the WP-3 meeting.)

D. The Smaller OECD Countries

The OECD Secretariat presented a report on the balance-of-payments problems of the smaller OECD countries. The situation for Denmark, Finland, Greece, and New Zealand is regarded as difficult but not severe. Portugal faces larger problems, and the current account deficits of Spain and Turkey could reach a danger zone this year. The representative of the International Monetary Fund commented that the potential access of these countries to the conditional resources of the Fund would finance only a tiny portion of their current account deficits.