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CONFIDENTIAL (FR)
CLASS II FOMC

TO: Federal Open Market Committee

FROM: Arthur L. Broida

Attached for your information is a report by Mr. Truman on recent meetings of the OECD.

Attachment

CONFIDENTIAL (FR)
CLASS II -- FOMC

Edwin M. Truman
December 14, 1977

Report on Meetings of the OECD's Economic Policy Committee and Working Party Three (November 21-23, 1977)

The focus of discussion at the meeting of the Economic Policy Committee (EPC) was on an examination of national targets for 1978. The average target rate of growth for real GNP in 1978 for the OECD countries as a group is about 4-1/2 per cent, compared with an indicated growth rate averaging about 3-3/4 per cent in 1977 and a general agreement at the June OECD Ministerial that 5 per cent real growth in 1978 would be desirable. The OECD Secretariat's forecast for 1978, on the basis of no further changes in members' economic policies, is about 3-1/2 per cent real growth with slower growth expected in the second half of the year than in the first half of the year.

Against this background, the EPC concentrated on two questions. First, should the stronger countries (Germany and Japan) take further policy actions to ensure that they will reach their 1978 growth targets and lay the foundation for faster growth in 1979? Most of the representatives from the other countries answered this question affirmatively. The German representatives said that they would be unwilling to consider additional policy actions before the middle of 1978, when the effects of their recent policy changes would be more certain. The Japanese representatives -- stressing their already large budget deficit -- were only marginally more encouraging to those who pressed them to adopt more forceful policy steps now. Chairman Schultze reported that the Administration would propose a tax cut in 1978 to help the United States achieve its objective of real growth close to 5 per cent. The United States was not urged to seek a higher (or lower) target.

The second question was whether the weaker countries could afford to try to reach their growth objectives in 1978 if the Secretariat's forecast that the stronger countries are unlikely to reach their objectives is accurate. The consensus was that the weaker countries would have to scale back their aspirations, since achieving them could well exacerbate their balance-of-payments problems.

On inflation rates, there was little disagreement and little discussion. The average rate of increase in GNP deflators in the OECD countries is expected by the Secretariat to decline only marginally, from about 7-1/2 per cent in 1977 to about 7 per cent in 1978.

On the external side, the Secretariat is forecasting a combined current-account deficit for the OECD countries of about $25 billion in 1978, essentially unchanged from 1977. The Secretariat expects the U.S. deficit to rise from $18 billion in 1977 to $21 billion in 1978.

The U.S. deficit was the main focus of discussion in Working Party Three (WP-3). The U.S. representatives argued that (1) our deficit is due to two factors -- the rise in the U.S. oil bill and differences in real growth here and abroad -- and not to a deterioration in the U.S. competitive position; (2) no further change in the dollar's average exchange rate is expected or necessary; and (3) the best way to deal with our deficit is through an effective energy program in the United States, control over the domestic inflation rate, and a reduction in other countries' surpluses through an acceleration in the expansion of domestic demand abroad.

Most of the participants in WP-3 endorsed the U.S. arguments. However, the representatives of Germany, Belgium, the Netherlands, and Switzerland did suggest mildly that U.S. interest rates might be raised in order to attract capital inflows and relieve exchange-rate pressures. However, none of the participants implied that the United States should try to slow down the growth of the economy, by monetary policy actions or other means, in order to reduce its current-account deficit.