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

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CONFIDENTIAL (FR)

TO: Federal Open Market Committee

FROM: Arthur L. Broida

Attached for your information is a copy of a report by Mr. Solomon on the November meetings of WP-3 and The Group of Ten Deputies.

Attachment

Robert Solomon
December 11, 1974

<u>Report on November Meetings of Working Party 3
and The Group of Ten Deputies</u>

The Working Party examined the balance of payments prospects of OECD countries for 1975. For the OECD as a whole, the current account deficit in 1975 is expected to be roughly the same as in 1974, close to $40 billion, assuming the price of oil stays where it is. Rapidly rising OECD exports to OPEC countries will be offset by increasing OPEC interest earnings. In the latter part of 1975, however, the OECD current deficit is expected to begin to decline.

The distribution of the deficit among OECD countries raises problems. A disproportionate share of it ($15 billion) is projected to lie with the smaller OECD countries: Spain, Australia, New Zealand, the Scandinavian countries, Austria, Portugal, Greece and Turkey. Among the larger countries, Germany is expected to continue to have a substantial ($5 billion) current account <u>surplus</u>, though smaller than in 1974. The United States and Canada are expected to have larger current account deficits in 1975 while the positions of Japan, Italy and the United Kingdom improve. Although these changes for the larger countries are regarded as being in the right direction, they still leave an unsatisfactory distribution of the total OECD deficit.

The hope was expressed that more expansionary policies in the countries with relatively strong balance of payments positions, while those with weaker positions experienced a resultant increase in exports to the stronger countries, would improve the distribution of current account positions while also contributing to resumption of economic expansion in the OECD area as a whole. The possibility of some change in relative exchange rates was not ruled out.

As to the financing of current account deficits, the most vulnerable countries appeared to be reasonably confident about the next 6 months or so (this was before the Saudi Arabian decision not to accept sterling in payment for oil exports). They all have lines of credit that have not yet been drawn and the U.K. was receiving a substantial amount of OPEC funds. It was agreed that countries borrowing directly from OPEC countries should not provide indexed loans nor denominate their borrowings in the currencies of OPEC countries.

The decline in short term interest rates in the United States was cited as one explanation for the movement of the DM-dollar exchange rate, but no complaints were voiced about U.S. monetary policy.

The Deputies of the Group of Ten focused mainly on the Kissinger-Simon-van Lennep proposals for a backstop financing facility among the OECD countries to complement market channels and the IMF. The U.S. proposal was well received by the Deputies of most countries, with some hesitation by the German and Japanese representatives.

Most of the discussion concerned details of the plan. Among the issues are: 1) Should the facility be based on government to government lending through the BIS or on government guarantees that would permit the BIS to borrow in markets and lend to countries in need, or both? 2) How should quotas--for both borrowing and lending--be established and should borrowing rights and lending obligations be equal for each country? What conditions should be attached to use of the facility and how would its use be related to drawings on the Fund?

The Deputies established a working group to examine the technical aspects of the proposals. A report is expected in time for the January Ministerial Meetings of the Group of Ten and the IMF Interim Committee.