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

March 1, 1979

CONFIDENTIAL (FR)
CLASS II - FOMC

TO: Federal Open Market Committee

FROM: Murray Altmann M.A.

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

Attachment

CONFIDENTIAL (F.R.)
CLASS II FOMC

February 28, 1979

TO: FEDERAL OPEN MARKET COMMITTEE

FROM: Edwin M. Truman EMT

REPORT ON MEETING OF THE OECD'S WORKING PARTY THREE
(Paris, February 22-23, 1979)

The meeting discussed two main topics: (I) the outlook for external developments in 1979 and (II) the medium-term outlook.

I. The Outlook for 1979

Considerable attention was focussed on likely economic developments for the United States. The group welcomed the determination of the U.S. authorities to give priority attention to the fight against inflation even if real growth in 1979 should fall short of current expectations. With respect to U.S. monetary policy, some participants suggested that monetary conditions had not been tightened early enough or were not yet sufficiently tight. In this connection, the participant from the Bundesbank (Mr. Rieke) suggested that the differential in long-term interest rates on dollar-denominated and mark-denominated assets, which is considerably less than the differential in short-term interest rates, should be wider. Finally, a few participants questioned the Treasury representative's (Fred Bergsten) statement that U.S. policy was not to place a "cap" on the dollar's exchange rate. These participants--from the OECD (Mr. Marris) and the United Kingdom (Mr. Couzens)--felt that the United States might usefully arrest the dollar's rise and fortify its amunition for intervention in the future. We also learned that the Bank of France believes that the dollar should not be prevented from rising.

With respect to Germany, the group accepted the official German outlook for real growth at a rate of at least 4 per cent in 1979 (year over year) led by strong private investment demand. The group was somewhat less convinced that the German current account surplus would decline from $8.3 billion in 1978 to around $5 billion in 1979, which is the German forecast. (The OECD forecast is for a surplus of $7 billion.) Subsequent discussion revealed that the German 1979 trade surplus valued in Deutschemarks was expected to be little changed from the surplus in 1978, implying--at the current exchange rate--a small increase in the trade surplus valued in U.S. dollars. Any reduction in the German current account surplus in 1979, consequently, is expected to come from a larger net deficit on other current account items.

Concerning Japan, the group heard the now familiar Japanese forecast of a $7½ billion surplus for FY 1980, starting April 1. As usual, the Japanese emphasized that their large public sector deficits were not sustainable and were placing upward pressure on interest rates on government bonds.

II. The Medium-Term Outlook

This topic was discussed in the context of an OECD paper on sustainable capital flows through 1985. The point of departure for the paper was two scenarios for real economic growth in OECD countries through 1985. One would involve average growth for the OECD countries

(1979-85) of 4½ per cent; the other would involve average real growth of about one per cent per year lower, i.e., at rates recently experienced. Both scenarios show the United States with a current account deficit of $3 billion in 1981, which was the year the group focussed upon.

Fred Bergsten made two major comments. First, he said that this outlook for the U.S. current account did not show enough progress; the United States would expect to have a current account surplus in 1981. In general, this remark was not interpreted I think, as the announcement of a U.S. current account objective; rather it was viewed as an indication of what the United States thought was desirable from the standpoint of general international financial stability. Second, Mr. Bergsten emphasized the need for structural adjustment in the United States, e.g., involving energy and export policies, and other countries starting in 1979 when trends were likely to be in the right direction. Few participants picked up on this theme.

Some participants, especially the OECD Secretariat (Mr. Marris) and the Japanese, stressed the possible role in the future of so-called compensatory financing, i.e., borrowing from private lenders in international capital markets by governments or state-owned firms. (Not surprisingly, U.S. securities denominated in foreign currencies were cited as a particularly appropriate manifestation of this phenomenon.) However, this theme did not receive a great deal of support. In particular, the Swedish participant (Mr. Wohlin) and the U.K. participant (Mr. Couzens) noted that willing lenders were not always matched by willing borrowers--private or public.