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Economic Intelligence Weekly

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Note: Comments and queries regarding this publication are welcomed. [redacted]

ECONOMIC INTELLIGENCE WEEKLY

Articles

USSR: HARD CURRENCY SURPLUS IN STORE

Unprecedented hard currency surpluses in prospect for 1974-75 will greatly strengthen the Soviet position in international economic negotiations. Barring major shifts in trade policy or bad harvests, the USSR is expected to earn annual surpluses of at least one billion dollars in its hard currency balance of payments, following more than a decade of deficits. Rising prices for Soviet oil, minerals, and other raw materials, combined with a sharp fall in grain purchases after last fall's record harvest, account for the turnaround.

Soviet Hard Currency Balance of Payments

Million US $

	1972		**1973**		**Projected 1974**	
	Credit	**Debit**	**Credit**	**Debit**	**Credit**	**Debit**
Current account	....	1,420	....	1,876	506	....
Merchandise trade	2,815	4,171	4,817	6,566	6,200	5,600
Transportation (net)	....	....	....	50	35	....
Travel	120	25	147	28	162	32
Interest repayments	....	124	....	157	....	220
Dividends	10	....	10	....	15	....
Transfer payments	....	45	....	49	....	54
Capital account	580	....	1,021	....	540	....
Medium-term and long-term credits	1,030	438	1,690	657	1,410	858
Compensation payments	....	12	....	12	....	12
Gold sales	300	....	950	....	N.A.	....
Change in hard currency assets[1]	540	....	....	95	....	1,045

1. Includes errors and omissions, short-term capital movements, and hard currency repayments from less developed countries on Soviet credits.

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Using its monopoly control of trade, Moscow might consider speeding up imports from the West as a result of its improved cash position. But a large upsurge in imports is unlikely in the next year or two because of the difficulties in adjusting plans and the long leadtimes needed for major investment projects. The leadership has more immediate ways to take advantage of its position; it:

- will not have to accept unsubsidized loans at high interest and will bargain hard on all contract terms;
- will pay cash for more of its current purchases;
- may postpone exports of some commodities – diamonds, for example – for which world demand is growing steadily; and
- will have the option of reducing or even halting gold sales.

Even with any plausible combination of measures to increase imports and limit exports, Soviet authorities almost certainly will have to deal with a sizable surplus in the hard currency balance of payments in 1974, and probably in 1975 as well. Historically, they have not held large hard currency reserves, fearing devaluations. Rapid inflation in the West probably has increased this reluctance. Nonetheless, the only reasonable option available to the Soviet foreign trade managers is to place these surpluses in their own banks in the West or in other Western banks. More important, the new-found liquidity should encourage Soviet planners to count more heavily on Western machinery in framing the capital construction programs in the 1976-80 Plan. [redacted] 25X1

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INDIA: ANOTHER CRITICAL MONSOON AT HAND

India enters the June-September monsoon period with its grain situation as tight as in 1973, when supplies were stretched thin until the November harvest. Government stocks -- used for subsidized sales, largely in urban and industrial areas -- are at best no higher than the exceptionally low stocks of a year ago. Domestic grain procurement between now and the fall harvest probably will fall below the 1973 rate. Grain imports, however, are expected to reach 5 million tons, compared with 4 million in 1973.

Early stages of the monsoon have arrived on schedule in the southwestern and northeastern corners of India, but meaningful assessments of the fall harvest will not be possible until late summer. The summer monsoon normally provides three-fourths of annual rainfall; a similar proportion of agricultural output – including two-thirds of all foodgrains -- is grown during this period. Fertilizer supplies, far less important than weather in determining production, again are expected to grow slightly, still falling short of demand. A normal monsoon would enable India to avoid boosting grain imports in 1975. But a monsoon failure would prompt New Delhi to seek sizable grain imports on concessional terms.
[redacted] 25X1

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GISCARD ADOPTS DEFLATIONARY POLICIES

The deflationary economic program announced by Paris last week aims to cut the inflation rate to 6% by mid-1975 and to eliminate the trade deficit by yearend 1975. At the same time, the government is promising to maintain growth and full employment. We expect the French to fall short of all these goals.

Fiscal and Monetary Measures

Tighter fiscal policy will play a key role in reducing the rise in consumer prices, now running at an annual rate of 18% to 20%. During the second half of this year, an 18% tax surcharge on corporate profits and reduced depreciation allowances will draw an additional $1.2 billion into the Treasury. Individual incomes will be subject to varying surcharges up to 15% for an additional yield of $500 million. Giscard also promised expenditure cuts totaling $200 million. All told, the government will siphon about $2 billion out of the economy, equal to 2% of GNP for the six-month period. Only part of the additional tax revenue will be used to finance new social measures, to be announced this week.

On the monetary side, the existing limit on credit expansion – 13% for any 12-month period – is to be more strictly enforced. To encourage savings, interest rates will be boosted by two percentage points; an increase in lending rates also is expected. The existing price control program is to be tightened, with a special tax threatened for firms that raise prices "excessively." Business will be pressured more than ever to hold down wage increases. Together with high-income groups, business will bear the brunt of new austerity measures.

By so dampening domestic demand, Paris hopes to force French industry to divert production to filling export orders. Many producers are operating at peak capacity, and the number reporting severe labor shortages has hit a post-war high. In a direct move to improve the trade balance, the Giscard government also intends to cut oil imports by 10% by raising product prices about 5%, rationing heating oil, and instituting other conservation measures.

Giscard's previous inclination toward deflationary measures undoubtedly was reinforced by his recent meeting with Chancellor Schmidt and by the increase in the trade deficit in May. German officials have been advocating stricter coordination of policy in the EC, which to them means adoption of tighter fiscal and monetary policies by other members. They have made it clear that such policies are a prerequisite for German financial assistance. Aid from Bonn is not now an important consideration to Paris but could become so if the trade picture continues to deteriorate. The French had been expecting trade deficits of about $300 million monthly during 1974 because of higher oil prices. Rapidly growing imports of manufactured items – particularly capital goods – pushed the deficit to $400 million in April and well over $600 million in May.

Prospects

The anti-inflation and trade goals set by Giscard will be difficult if not impossible to achieve. Cutting inflation to a third of its current rate within one year is unlikely even if prices of imported raw materials drop substantially. Wages will be the principal problem, as the unions – already anti-Giscard – continue to press for record-breaking increases.

Restoring foreign payments equilibrium by the end of 1975 may prove to be even more elusive. The OECD recently projected a trade deficit of $4.4 billion and a current account deficit of $6.5 billion for France in 1974. The higher corporate taxes should reduce domestic demand for capital goods, thereby cutting imports of capital goods while freeing some for export. New conservation measures should also reduce oil imports, although probably not to the extent hoped for by Paris. On the other hand, imports of industrial raw materials and consumer goods are likely to increase moderately. Moreover, France's ability to boost export earnings substantially will depend on demand by major foreign customers, several of which face industrial slowdowns and severe trade deficits.

As for the goal of maintaining full employment, export industries will hardly be able to pick up the expected slack elsewhere in the economy. Domestic demand will be doubly hit as the new cutbacks in government and private expenditures will be added to cutbacks arising from higher oil costs. 25X1

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MONETARY DISCUSSIONS CLOSE WITHOUT MAJOR AGREEMENT

No major agreements on international monetary reform or on the recycling of oil funds were reached at last week's financial meetings. These included sessions of the IMF Committee of Twenty (C-20), the Group of Ten (major financial powers, G-10), and the Bank for International Settlements (BIS). Participants again pledged not to pursue beggar-thy-neighbor policies in dealing with the impact of higher oil prices. They failed, however, to develop arrangements that would allow each consuming country to finance its higher oil import bill for a sufficient period to permit smooth current account adjustment.

As expected, the C-20 failed to develop an outline for basic international monetary reform. Uncertainties arising from sharply increased oil prices precluded agreement, despite nearly two years of negotiations. The C-20 merely adopted a number of interim reform measures that will not substantially alter existing practices.

- New guidelines for the management of floating exchange rates are so general that members will continue to be free to pursue their own currency intervention goals.

- A new IMF lending facility does not command sufficient funds to bail out countries with oil-related payments problems.

The G-10 agreed to allow gold to be used as collateral at negotiated prices in official borrowings. This measure offers only partial and temporary relief to developed countries in major payments difficulties and does nothing for LDCs.

Central bankers at the monthly BIS meeting in Basel discussed a number of pressing problems: the recycling of oil funds to consuming countries, central bank use of monetary gold reserves, and Italy's financial plight. They were unable to reach any consensus. They again discussed plans to aid Eurocurrency banks in the event of a financial crisis but did not come up with any operational proposals. Italy's government crisis and the premature departure of Italian Central Bank Governor Carli prevented the bankers from arriving at concrete plans to help Rome finance its payments deficit. The mood of the meeting was very somber. [redacted] 25X1

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ECONOMIC IMPLICATIONS OF INDIAN NUCLEAR PROGRAM

The economic burden of India's nuclear program has been minor. The explosion on 18 May was the culmination of a reported five-year program that cost $216 million. In this same period, India also spent more than $400 million on other nuclear programs, predominantly power research and facilities. India has two nuclear power stations in operation and is building a third. The entire nuclear program represented only 2.8% of the $22.4 billion public sector development expenditure during the last five years.

[redacted] 25X6

[redacted] 25X6

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SYRIA: ECONOMIC ASSESSMENT OF RETURNED TERRITORY

As a result of the recent disengagement, Syrian refugees apparently will be permitted to resettle a thin strip of the Golan area including the city of Al Qunaytirah. Although politically valuable to Damascus, this territory is an economic liability.

The city of Al Qunaytirah formerly served as the main marketing center for the province that embraced all of the Golan Heights. Prior to the June 1967 war, this province, which accounted for 1% of the land area, produced 17% of Syria's millet, 12% of its fodder crops, 6% of its fruit, and 3% of its vegetables. Nearly all of the productive agricultural area remains in Israeli hands under the present disengagement.

Rebuilding the city not only will be a costly project but also will entail subsidies for the inhabitants, who may approximate the 1966 total of 25,000. Expenditure on housing alone could cost $20 million, or about one-fifth of the amount mentioned as possible US assistance to Syria. Supporting facilities, such as water treatment and electric powerplants, shops, and administrative buildings, conceivably could cost twice the housing outlay. Although reconstruction activities will employ some local labor, thousands will remain jobless. The city, in essence, would become a huge refugee camp requiring continued support from Damascus.

The bleak economic outlook for the recovered Golan segment reinforces the Syrian view that disengagement must be treated as only a first step toward eventual return of all the Golan Heights. [redacted] 25X6

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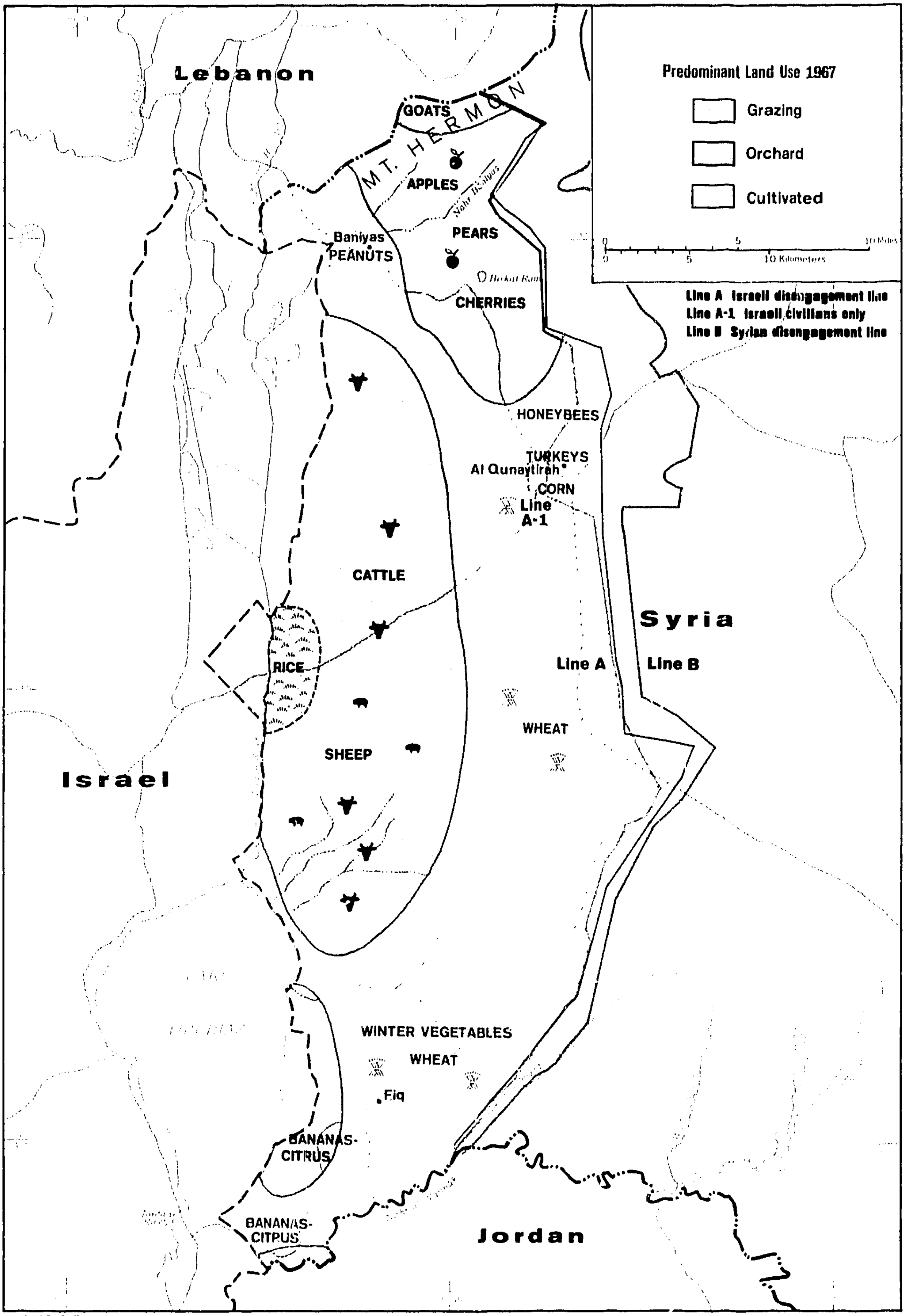
The Israeli-Syrian Disengagement Lines



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OECD: SOMBER ECONOMIC PROSPECTS

Depressed growth, soaring inflation, and mounting current account deficits will dominate the economic outlook for the developed countries over the next 12 months. New OECD forecasts – which continue to point to a mild economic recovery in the second half of 1974 accelerating somewhat in the first half of 1975 – appear overly optimistic as long as countries continue to pursue restrictive economic policies to deal with inflation.

The OECD projections, presented by the Secretariat at a 10-11 June meeting, envision more rapid growth and less inflation in most countries than indicated in the forecasts prepared in January and May. The Secretariat expects economic performance in OECD countries in the first half of 1974 to be a little better than previously forecast. Only Italy's growth rate has been revised substantially downward – from 3.6% to 2.0%. Real GNP is still expected to decline in the United States, Japan, and the United Kingdom in the first half of 1974 and increase only moderately in all other major developed countries.

Developed Countries: Economic Projections

	1973	Total 1974[1]			1st Half 1974[1]			2d Half 1974[1]		
		Jan	May[2]	Jun	Jan	May[2]	Jun	Jan	May[2]	Jun
	Real GNP Growth (Percent Change from Previous Period)									
United States	5.9	0	4.7	-0.5	-1.8	-2.7	-2.9	1.5	1.4	3.0
Canada	7.1	4.3	4.7	4.7	4.0	4.8	4.7	5.0	4.3	4.5
Japan	10.6	1.8	1.1	1.5	-0.5	-2.3	-2.0	5.5	5.5	5.5
France	6.1	4.3	4.5	4.5	4.0	4.4	4.5	3.3	3.8	3.7
West Germany	5.3	0.8	2.1	2.5	1.0	2.5	3.3	2.3	3.1	3.5
Italy	5.4	5.0	4.8	4.0	3.0	3.6	2.0	4.0	2.6	3.0
United Kingdom	5.4	-2.5	-2.5	-1.5	-11.0	-8.7	-6.1	12.5	8.3	6.0

1. OECD estimates.

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Stronger overall economic performance is expected by OECD in the second half of 1974. Real GNP growth forecasts have been raised for Canada, West Germany, and Italy. Current projected real GNP growth for the United States is now twice as high as the original January estimates. Only Britain's economic growth is expected to fall well below May's estimates.

Developed Countries: Economic Projections

	1973	Total 1974[1]		1st Half 1974[1]		2d Half 1974[1]	
		Jan	Jun	Jan	Jun	Jan	Jun
		Current Account Balance (Billion US $)					
United States	3.0	-4.0	-1.0	-2.5	0.4	-1.5	-1.4
Canada	-0.3	0	-0.7	0	-0.2	0	-0.5
Japan	-0.1	-7.5	-7.5	-4.0	-4.1	-3.5	-3.4
France	-0.2	-3.5	-6.5	-2.0	-3.3	-1.5	-3.2
West Germany	4.7	-1.0	5.5	0	4.0	-1.0	1.5
Italy	-2.5	-5.5	-7.5	-3.0	-4.3	-2.5	-3.3
United Kingdom	-3.7	-8.0	-11.0	-4.5	-5.6	-3.5	-5.4
		GNP Deflator (Percent Change from Previous Period)					
United States	5.4	7.8	9.0				
Canada	7.1	8.0	9.0				
Japan	12.1	16.5	22.5				
France	7.0	12.0	11.0				
West Germany	6.0	7.0	7.3				
Italy	10.5	11.0	14.3				
United Kingdom	9.0	10.5	8.0				

1. OECD estimates.

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The new OECD forecasts assume that expansionary economic policies will be introduced this summer in France, West Germany, and Japan as inflationary pressures begin to ease and domestic unemployment rises. It is far from certain, however, that current restrictive economic policies will soon be abandoned. The governments generally face unacceptable rates of inflation and worrisome trade deficits. Moreover, unemployment rates remain comparatively low in most instances.

The Japanese OECD delegation stressed that Tokyo would neither relax its monetary policy nor increase government investment in the near future. The delegation estimated that real GNP would consequently decline by 1.5% this year rather than increase as the Secretariat had projected. Italian and French representatives also argued that the OECD assumptions were overly optimistic.

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Notes

[redacted] 25X1

CEMA Grapples with Raw Material Problems

Soviet raw material prices and deliveries in 1976-80 are expected to be the major topic of discussion at the 28th CEMA Session, which opened yesterday in Sofia. The East Europeans are worried about the consequences of paying more and getting less than desired from their principal supplier. If Eastern Europe is forced to buy a larger share of its industrial raw materials in the West, imports of Western machinery will suffer. The session will also take up revision of intra-CEMA currency exchange rates, the status of plan coordination, and multilateral projects such as a natural gas pipeline and an electric power line connecting the USSR with Eastern Europe. [redacted] 25X1

[redacted] 25X1

Joint Copper-Bauxite Action?

At the upcoming meeting of the Intergovernmental Council of Copper Exporting Countries (CIPEC) in Lusaka, Peru probably will propose that copper exporting nations coordinate their actions with those of the Intergovernmental Bauxite Association. Because aluminum is a substitute for copper, joint action would make it easier to establish and maintain a minimum price for copper. We doubt that the copper producers will agree to fix a minimum price at this time or that the bauxite producers would take concerted action with CIPEC. In the past, for example, CIPEC has failed to establish a minimum price because of the unwillingness of members to sacrifice immediate foreign exchange earnings by withholding copper from the market. [redacted] 25X1

Publications of Interest

China: Modernization of International Telecommunications
(ER IR 74-14, June 1974, [redacted] 25X1

China is pressing a vigorous program for the modernization of its international telecommunications. Since 1972, three standard Intelsat ground stations have been placed in operation, construction of a high-capacity cable route linking Canton and Hong Kong has been completed, and work is starting on a submarine cable connection between China and Japan. In addition, major improvements are being made in the quality of existing radio telephone circuits and international switching capability. The modernization program has provided an exponential increase in international high-grade telephone and telegraph channels which will enable China to handle the sharp growth in traffic anticipated in the remainder of the decade.

Petroleum Developments in Sub-Saharan Africa
(ER RP 74-12, June 1974, [redacted] 25X1

This publication surveys exploration, production, and export of oil in sub-Saharan Africa. Recent price hikes and interruptions in supply have reinvigorated the search for oil in the region. Almost every sub-Saharan country has let exploration concessions to international oil companies, which are attracted by the high quality of the oil and the proximity to North American and West European markets. The potential producing countries have noted Nigeria's sizable earnings from oil exports. Even small amounts of oil could relieve the balance-of-payments drain caused by expensive oil imports.

Western Investment in Eastern Europe: Reluctance on Both Sides
(ER IM 74-8, June 1974, [redacted] 25X1

Large-scale Western investment in Eastern Europe appears unlikely. Only Yugoslavia and Romania are actively seeking foreign investments. Bulgaria, Czechoslovakia, and East Germany prohibit equity ventures while Poland continues to equivocate on the issue. Hungary, although permitting equity ventures for the past four years, granted tentative approval to its first project only this month. Even in the countries that permit equity ventures, Western investors are often deterred by the frustrating negotiating process, the limited profit possibilities, and the requirement that much of the product be exported.

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INTERNAL ECONOMIC INDICATORS

GNP*
Constant Market Prices

	Latest Quarter	Percent Change from Previous Quarter	Average Annual Growth Rate Since 1970	1 Year Earlier	Previous Quarter
United States	74 I	-1.8	3.9	0.2	-8.3
Japan	74 I	-5.0	8.2	-2.4	-18.6
West Germany	73 IV	-0.1	3.1	3.4	-0.3
France	73 IV	1.8	5.8	5.7	7.3
United Kingdom	73 IV	-0.4	3.1	3.9	-1.4
Italy	73 I	0.8	3.1	5.2	3.4
Canada	74 I	1.7	5.4	3.0	7.0

WHOLESALE PRICES
Industrial

	Latest Month	Percent Change from Previous Month	Average Annual Growth Rate Since 1970	1 Year Earlier	3 Months Earlier
United States	May 74	2.7	8.4	20.1	40.6
Japan	May 74	0.7	11.1	35.3	8.4
West Germany	Mar 74	1.6	6.8	13.1	30.3
France	Apr 74	2.4	12.8	34.0	45.3
United Kingdom	Apr 74	2.1	11.2	25.8	54.5
Italy	Jan 74	7.1	11.8	33.9	68.3
Canada	Mar 74	2.8	10.4	20.7	39.1

INDUSTRIAL PRODUCTION*

	Latest Month	Percent Change from Previous Month	Average Annual Growth Rate Since 1970	1 Year Earlier	3 Months Earlier**
United States	May 74	0.4	4.6	0.4	-0.5
Japan	Apr 74	-1.7	6.9	2.7	-9.9
West Germany	Apr 74	0	3.2	1.1	-2.9
France	Apr 74	0.8	6.5	8.7	2.1
United Kingdom	Apr 74	3.4	2.5	0.5	2.4
Italy	Apr 74	3.0	4.8	14.0	-10.2
Canada	Apr 74	0.4	6.6	5.0	7.9

CONSUMER PRICES

	Latest Month	Percent Change from Previous Month	Average Annual Growth Rate Since 1970	1 Year Earlier	3 Months Earlier
United States	Apr 74	0.8	5.8	10.3	12.9
Japan	Apr 74	2.7	11.4	24.9	30.8
West Germany	Apr 74	0.6	6.3	7.1	7.3
France	Apr 74	1.6	7.7	13.2	17.7
United Kingdom	Apr 74	3.4	10.3	15.2	27.0
Italy	Apr 74	1.2	9.2	16.3	26.6
Canada	Apr 74	0.7	6.0	9.9	11.4

RETAIL SALES*
Current Prices

	Latest Month	Percent Change from Previous Month	Average Annual Growth Rate Since 1970	1 Year Earlier	3 Months Earlier**
United States	May 74	1.0	10.3	6.8	13.9
Japan	Feb 74	-2.2	13.2	17.6	8.8
West Germany	Feb 74	0.9	8.7	0.9	11.4
France	Feb 74	0.8	7.0	12.9	29.0
United Kingdom	Mar 74	1.3	12.0	9.4	6.5
Italy	Nov 73	-3.3	18.4	34.1	100.2
Canada	Mar 74	-1.0	11.4	11.8	23.1

MONEY SUPPLY*

	Latest Month	Percent Change from Previous Month	Average Annual Growth Rate Since 1970	1 Year Earlier	3 Months Earlier**
United States	May 74	1.6	7.0	7.0	10.0
Japan	Mar 74	2.6	18.0	15.4	15.7
West Germany	Mar 74	2.0	9.2	-0.8	9.0
France	Feb 74	-0.3	11.9	9.0	14.9
United Kingdom	Apr 74	2.7	9.3	3.0	1.0
Italy	Dec 73	2.6	21.2	17.9	22.1
Canada	Apr 74	4.2	13.8	14.4	18.5

MONEY-MARKET RATES

	Representative Rates	Latest Date	Percent Rate of Interest	1 Year Earlier	3 Months Earlier	1 Month Earlier
United States	Prime finance paper	Jun 12	9.00	7.50	7.50	9.25
Japan	Call money	Jun 7	12.00	6.63	12.00	12.00
West Germany	Interbank loans (3 Months)	Jun 5	9.50	12.63	11.00	9.13
France	Call money	Jun 12	9.26	7.62	12.38	12.88
United Kingdom	Local authority deposits	Jun 12	12.38	7.36	15.75	13.63
Canada	Finance paper	Jun 12	11.05	6.88	8.38	11.50
Euro-Dollars	Three-month deposits	Jun 12	11.74	8.75	8.69	11.75

*Seasonally adjusted.
**Average for latest 3 months compared with average for previous 3 months.

19 June 1974
Office of Economic Research/CIA

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EXTERNAL ECONOMIC INDICATORS

EXPORTS*
f.o.b.

	Latest Month		Cumulative		
		Million US $	Million US $ 1974	1973	Percent Change
United States	Apr 74	8,230	30,824	20,908	46.6
Japan	May 74	4,070	19,963	13,814	44.5
West Germany	Apr 74	7,734	28,070	19,070	47.2
France	May 74	3,832	18,151	13,800	31.5
United Kingdom	Apr 74	3,052	10,754	8,801	22.2
Italy	Apr 74	2,502	8,827	5,768	53.0
Canada	Apr 74	2,429	10,010	7,978	25.5

IMPORTS*
f.o.b.

	Latest Month		Cumulative		
		Million US $	Million US $ 1974	1973	Percent Change
United States	Apr 74	8,138	29,843	21,545	38.5
Japan	May 74	4,907	21,542	11,398	89.0
West Germany	Apr 74	5,423	19,720	14,994	31.5
France	May 74	4,467	19,845	13,281	49.4
United Kingdom	Apr 74	4,201	14,790	9,796	51.0
Italy	Apr 74	3,368	11,580	6,406	80.8
Canada	Apr 74	2,306	9,560	7,290	31.1

TRADE BALANCE*
f.o.b./f.o.b.

	Latest Month		Cumulative (Million US $)		
		Million US $	1974	1973	Change
United States	Apr 74	92	781	-637	1,418
Japan	May 74	-237	-1,579	2,416	-3,995
West Germany	Apr 74	2,310	8,355	4,075	4,280
France	May 74	-635	-1,694	519	-2,213
United Kingdom	Apr 74	-1,149	-4,036	-995	-3,041
Italy	Apr 74	-866	-2,753	-638	-2,115
Canada	Apr 74	123	449	688	-238

BASIC BALANCE**
Current and Long-Term-Capital Transactions

	Latest Period		Cumulative (Million US $)		
		Million US $	1973	1972	Change
United States*	73 IV	214	1,209	-9,838	11,047
Japan	May 74	-5	-5,893	-3,594	-2,299
West Germany	Apr 74	860	3,271	917	2,354
France	73 IV	-352	-2,391	-369	-2,022
United Kingdom	73 IV	-1,394	-3,164	-1,989	-1,175
Italy	72 IV	800	N.A.	2,983	N.A.
Canada	73 IV	27	376	1,155	-779

OFFICIAL RESERVES

	Latest Month		Billion US $		
	End of	Billion US $	Jun 1970	1 Year Earlier	3 Months Earlier
United States	Apr 74	14.7	16.3	14.0	14.6
Japan	May 74	13.2	4.1	15.9	11.9
West Germany	Mar 74	32.9	8.8	32.3	33.1
France	May 74	8.1	4.4	11.6	8.1
United Kingdom	May 74	6.9	2.8	6.7	6.6
Italy	Mar 74	6.7	4.7	6.3	6.4
Canada	May 74	6.2	4.3	6.1	6.2

*Seasonally adjusted.
**Converted into US dollars at current market rates of exchange.

EXPORT PRICES
US $

	Latest Month	Percent Change from Previous Month	Average Annual Growth Rate Since 1970	1 Year Earlier	3 Months Earlier
United States	Apr 74	0.8	11.5	30.3	23.5
Japan	Jan 74	0.1	13.4	31.4	8.0
West Germany	Mar 74	6.9	13.9	21.9	37.5
France	Jan 74	-5.9	11.1	18.9	-35.2
United Kingdom	Dec 73	0.1	8.7	17.4	12.0
Italy	Nov 73	-2.4	10.5	21.3	12.4
Canada	Feb 74	4.1	12.4	34.3	65.6

EXPORT PRICES
National Currency

	Latest Month	Percent Change from Previous Month	Average Annual Growth Rate Since 1970	1 Year Earlier	3 Months Earlier
United States	Apr 74	0.6	11.5	30.3	23.5
Japan	Jan 74	6.8	7.6	27.3	71.3
West Germany	Mar 74	2.3	4.1	13.0	30.6
France	Jan 74	3.2	8.0	17.6	31.3
United Kingdom	Dec 73	3.1	9.8	18.8	33.0
Italy	Nov 73	2.0	8.7	22.8	22.9
Canada	Feb 74	2.7	10.3	31.8	51.5

IMPORT PRICES
National Currency

	Latest Month	Percent Change from Previous Month	Average Annual Growth Rate Since 1970	1 Year Earlier	3 Months Earlier
United States	Apr 74	6.3	19.0	48.6	98.2
Japan	Jan 74	13.1	10.8	43.1	170.0
West Germany	Mar 74	1.6	6.2	25.7	56.1
France	Jan 74	14.9	11.3	33.0	127.4
United Kingdom	Dec 73	4.5	16.3	42.6	50.6
Italy	Nov 73	3.5	14.8	42.3	30.8
Canada	Feb 74	3.6	7.9	21.3	42.4

EXCHANGE RATES Spot Rate
As of 14 June 74

	US $ Per Unit	Percent Change from Dec 66	18 Dec 1971	19 Mar 1973	7 Jun 1974
Japan (Yen)	0.0035	28.20	8.93	-6.99	-0.08
West Germany (Deutsche Mark)	0.3976	58.15	28.13	12.28	-1.24
France (Franc)	0.2036	0.84	3.40	-7.62	-0.54
United Kingdom (Pound Sterling)	2.3925	-14.27	-8.18	-2.78	-0.46
Italy (Lira)	0.0015	-4.18	-10.81	-13.33	-1.35
Canada (Dollar)	1.0370	12.42	3.93	3.94	-0.12

TRADE-WEIGHTED EXCHANGE RATES***
As of 14 June 74

	Percent Change from Dec 66	18 Dec 1971	19 Mar 1973	7 Jun 1974
United States	-17.16	-7.77	-1.13	0.39
Japan	16.82	3.06	-0.85	0.10
West Germany	33.69	16.55	11.49	-0.59
France	-22.53	-8.96	-11.41	0.34
United Kingdom	-34.09	-19.88	-5.50	-0.02
Italy	-26.38	-24.99	-18.06	-0.63
Canada	9.08	2.47	4.11	0

***Weighting is based on each listed country's trade with 16 other industrialized countries to reflect the competitive impact of exchange-rate variations among the major currencies.

19 June 1974

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Confidential

Annex to

Economic Intelligence Weekly

Canada: Inflation Overshadows Good Growth Record

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CIA No. 8130/74/A
19 June 1974

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CANADA: INFLATION OVERSHADOWS GOOD GROWTH RECORD

1. Canada's economic boom, which carried through the first quarter of 1974, is giving way to merely moderate growth. Weakened demand probably will hold the rise in real GNP for the full year to about 4-1/2%, compared with the 1965-73 average of 5-1/2%. No other major developed country has much chance of matching this performance in 1974.

2. Canada has been able to do well despite economic stagnation in most other major industrial nations. The economy has benefited from an investment boom in residential construction and in manufacturing facilities designed to serve the domestic and export markets. Unaffected by the world oil crisis, consumer demand for automobiles and other durable consumer goods has remained strong. Although real demand for exports has slipped, soaring world prices for Canada's raw material exports have provided an ample inflow of foreign exchange. Ottawa thus has been able to continue a moderately expansionary economic policy without worrying about the balance of payments.

3. With the fading of the oil crisis and the acceleration of price increases to an annual rate of 13% in recent months, inflation has become the public's overriding concern. Disagreement on how to deal with price rises percipitated the fall of the Trudeau coalition government in May. The inflation issue likewise is dominating the campaign preceding the 8 July election.

4. Since early polls suggest that voters will not make a clearcut choice between Trudeau's Liberals and the opposition Conservatives, Canada seems headed for another coalition government including the New Democrats as minor partner. Whichever party heads the government, economic policy probably will remain moderately expansionary because the party, in seeking to bolster its position with the voters, will wish to avoid action that would risk jobs. Prospects thus are for only moderate relief from inflationary pressures in the second half. Even the expected 4% growth rate in the second half will not prevent an appreciable rise in the unemployment rate, possibly to a politically damaging 6-1/2% by yearend.

5. In spite of improved terms of trade, we expect Canada's trade surplus (imports f.o.b.) to drop in 1974 to about $1.4 billion – two-thirds that of last year. Export volume probably will dip slightly, since prospects are for reduced deliveries of wheat, crude oil, motor vehicles, and automotive parts. The balance on service transactions should also worsen, but the resulting current account deficit will probably be partly offset by an increased inflow of long-term capital.

The Economy on the Eve of the Election

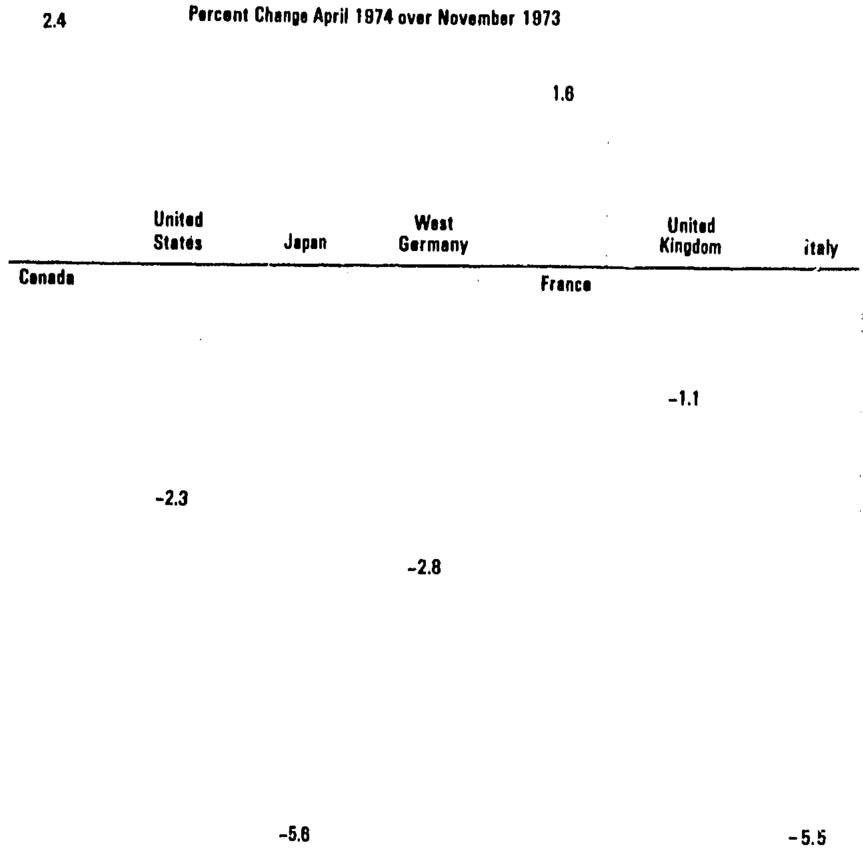
6. Real GNP advanced at a rate of 6% in January-March over the corresponding period of 1973, as a result of increased private investment outlays -- particularly for manufacturing plants and housing – and buoyant consumer

demand. Small losses in real wages were offset by increased welfare payments, by an income-tax indexing scheme designed to maintain real disposable income in spite of rapid inflation, and by strong employment gains. In March the number of employed workers reached 9.1 million, a gain of 150,000 since December.

7. In the current quarter, Canadian economic growth apparently has slowed to about a 4% annual rate because of a slower increase in demand. Through April, only Canada and France – among the major developed countries – had avoided a decline in industrial output (seasonally adjusted) from the November level.

INDUSTRIAL PRODUCTION

Percent Change April 1974 over November 1973



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8. The value of Canadian trade is growing much faster than we foresaw a few months ago because prices have risen more than anticipated. The 25% gain in export earnings in January-March from a year earlier was made up of a 30% rise in prices and a 3-1/2% drop in volume. At the same, the continued domestic boom and soaring foreign prices boosted imports by 30%. The first-quarter trade surplus consequently slipped to $320 million from $515 million a year earlier. A strike by St. Lawrence River pilots brought a 10% decline in the value of trade in April, without further damage to the surplus. The huge increase in world oil

prices has had little effect on the trade balance, since the rising cost of oil imports for eastern Canada has been largely offset by price hikes on sales of west Canadian crude to the United States.

9. Heavy inflows of short-term capital from the United States have kept the Canadian dollar strong in spite of a deteriorating basic balance. These inflows have eased since March, when US interest rates turned up again. Although Ottawa has increased its foreign reserve holdings by $400 million since last December to $6.2 billion, the value of the Canadian dollar has climbed from parity with the US dollar to $1.04.

Inflation Woes

10. The good growth record has brought small comfort to the inflation-harassed consumer. The rise in the cost of living hit an annual rate of 11% in the first four months, reflecting mainly higher world commodity prices and wage settlements averaging 11%. Strong domestic demand, fueled by a 14% growth in the money supply through April, contributed to inflationary pressures. In May, higher food and petroleum prices pushed inflation up to an annual rate of 22%, to the dismay of the rank-and-file citizen.

11. The fact that inflation is less severe in Canada than in most industrial nations has done little to temper the issue. In May, rising prices led to increasing friction between Trudeau's Liberals and the New Democratic Party (NDP), their informal coalition partner. The government was toppled when the New Democrats joined the Conservative opposition in voting against Trudeau's proposed budget for fiscal 1975 because it lacked anti-inflation measures. Trudeau already had dismissed NDP demands to hold domestic prices of basic commodities below world market levels and had rebuffed a Tory proposal for sweeping price and wage controls. Instead, he proposed a moderately expansionary budget stressing output and jobs.

Harsh Anti-Inflation Policy Unlikely

12. The new government will confront substantial -- though somewhat reduced -- inflationary pressures. While food prices should now begin leveling off, rising prices of other raw materials are pushing up other prices. Steel producers, for example, increased prices 12% in May to cover higher raw material costs. Equally important, union militancy is rising as workers attempt to keep pace with inflation. Expected wage settlements yielding 10%-11% increases for the next 12 months will add substantially to unit labor costs.

13. Whether headed by Liberals or Conservatives, the next government will be under considerable popular pressure to do something about prices. But if its hold on the reins of government is precarious, as seems likely, the dominant party will want to avoid a clash on the size of wage settlements as well as responsibility for idling workers through fiscal and monetary constraints. If Trudeau returns to

power, he may opt for selective price controls on a few key consumer goods. The Tories, on the other hand, probably would introduce a 60-90-day wage-price freeze to be followed by a period of flexible controls. At best, only a small reduction in the inflation rate, to 10%-11%, is in prospect for the second half.

Slowing Output Growth and Rising Unemployment

14. Even without restrictive government action, demand pressures are likely to be substantially lower in the second half. Consumer spending clearly is weakening, and private investment outlays show signs of being stretched out. Increased provincial mining taxes last spring are delaying large mining projects, and investors' confidence has been shaken further by the prospect of stiffer federal taxes on mining and petroleum companies. We believe the advance in real GNP will be held to about 4% in the second half, compared with 5% in the first half. Even with this moderate slowing of growth, the jobless rate could climb by one percentage point, to 6-1/2%.

A Small Basic-Balance Deficit

15. The trade surplus for the full year can be expected to show a substantial decline from last year. The drop probably will not be as sharp as in the first quarter, since slowing Canadian output growth will reduce the gain in import volume for the year to perhaps two-thirds of the 1973 rate. We project the increase in the value of exports for the full year at 23% over 1973. The expected small decline in export volume mainly reflects prospects that shipments of crude oil, wheat, and motor vehicles and parts will be appreciably smaller this year than last. Crude oil shipments will continue to be held back by increased domestic requirements, while wheat export sales probably will be depressed by the bad crop weather in May and early June. Automobile sales volume is expected to continue to be hampered by reduced US demand. We believe these declines, together with expected slow growth of sales volumes and easing of prices for metals and minerals, will help to cut the trade surplus to $1.4 billion, $700 million below 1973.

16. Despite a large probable gain in long-term capital inflows compared with 1973, we believe that reduction of the trade surplus will cause a small basic-balance deficit. Our projection is as follows:

	Million US $	
	1973	1974
Trade balance	2,131	1,400
Net services	-2,466	-2,700
Current account balance	-335	-1,300
Net long-term capital	667	1,000
Basic balance	332	-300

Canada: Projected 1974 Trade

	Value in 1973 (Billion US $)	Projected Increase in 1974 (Percent)			Projected Value in 1974 (Billion US $)
		Volume	Price	Value	
Exports (f.o.b.)	25.2	-2	26	23	31.0
Agricultural and fisheries products	3.3	-7	66	55	5.1
Of which:					
Wheat and wheat flour	1.3	-20	150	100	2.6
Metals and minerals	5.1	3	7	10	5.7
Crude oil	1.5	-35	230	150	3.7
Motor vehicles and parts	5.4	-15	10	-6	5.1
Other manufactures and miscellaneous	9.9	8	7	15	11.4
Imports (f.o.b.)	23.3	8	18	28	29.8
Crude oil	0.9	-4	250	235	3.1
Industrial and construction materials	5.5	7	12	20	6.6
Motor vehicles and parts	6.3	5	10	16	7.3
Capital equipment	5.6	14	7	22	6.8
Consumer goods and miscellaneous	5.0	8	12	21	6.0
Trade balance, customs basis	1.9	....	....	....	1.2
Adjustment for balance-of-payments purposes	0.2	....	....	....	0.2
Trade balance, adjusted	2.1	....	....	....	1.4

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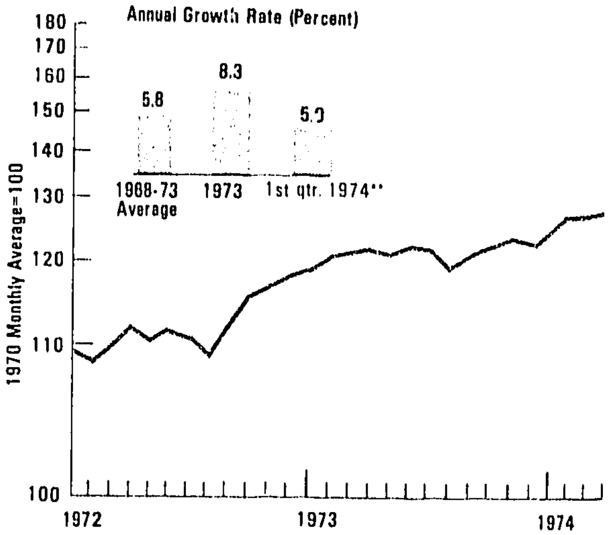
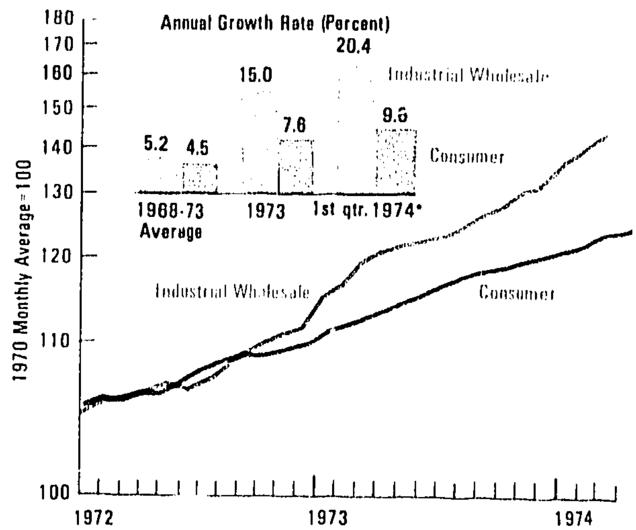
CANADA: INTERNAL ECONOMIC INDICATORS

INDUSTRIAL PRODUCTION*



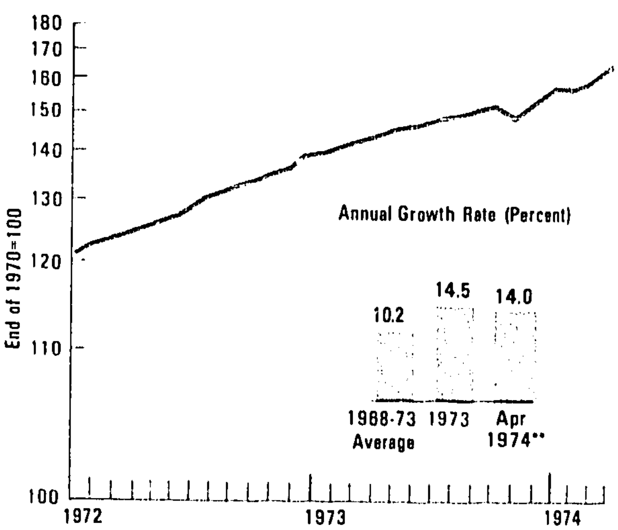
*Seasonally Adjusted.
**Increase over comparable period of 1973.

PRICES



*Increase over comparable period of 1973.

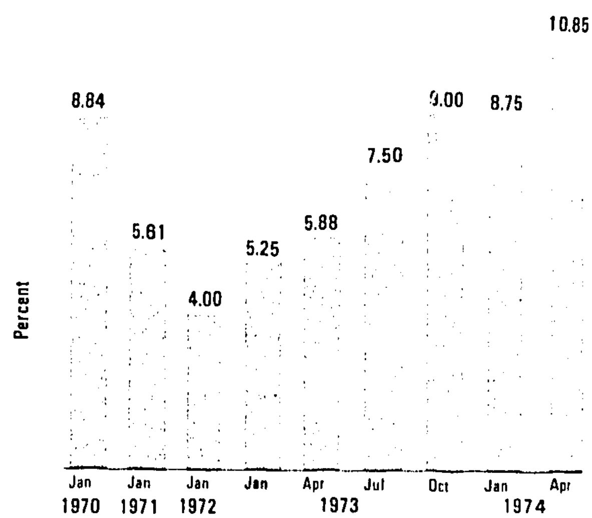
MONEY SUPPLY*



*Seasonally Adjusted.
**Increase over comparable period of 1973.

MONEY MARKET RATES

Interest Rate for Finance Paper



Note: End of period.

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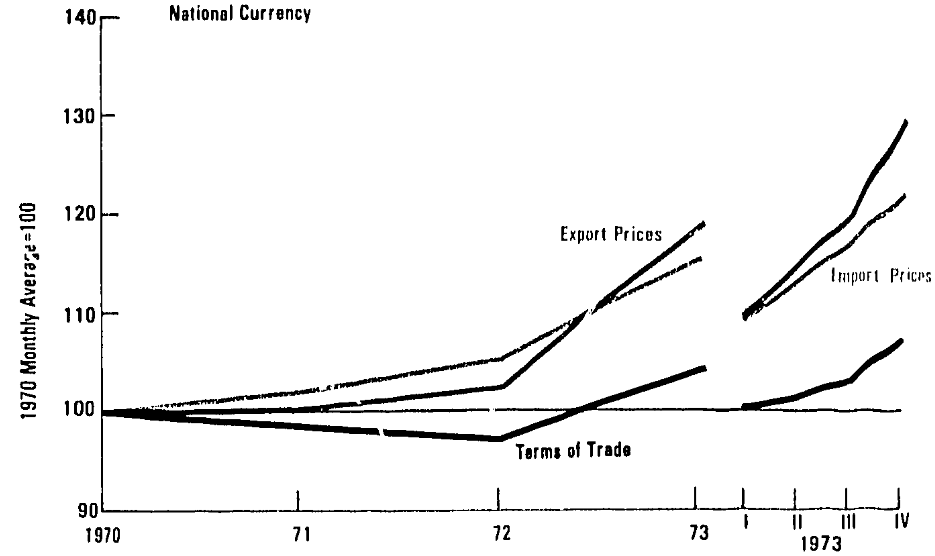
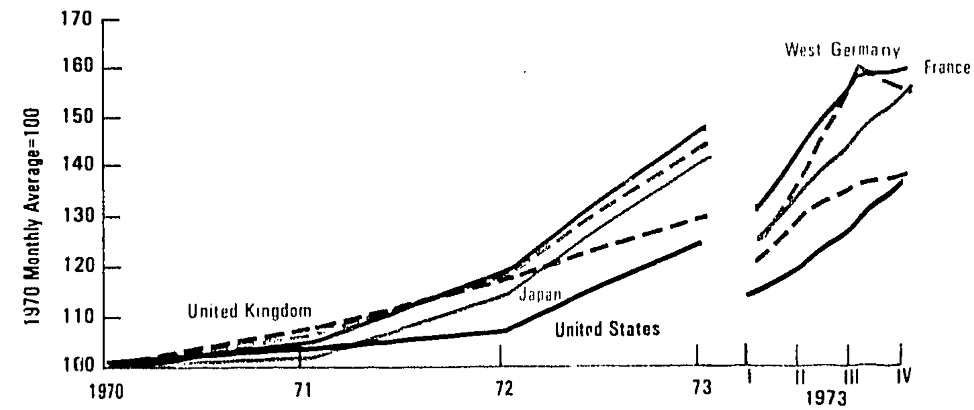
CANADA: EXTERNAL ECONOMIC INDICATORS

TERMS OF TRADE

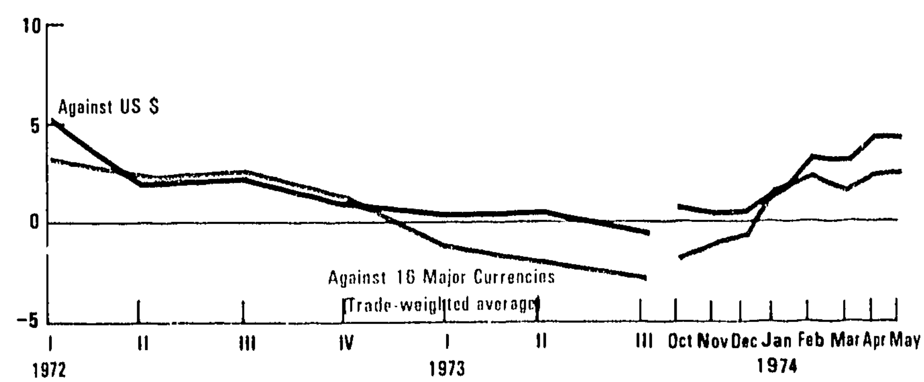


EXPORT PRICES IN US $



EXCHANGE RATES FOR THE CANADIAN DOLLAR

Percent Change from 18 Dec 71



Note: End of Period.

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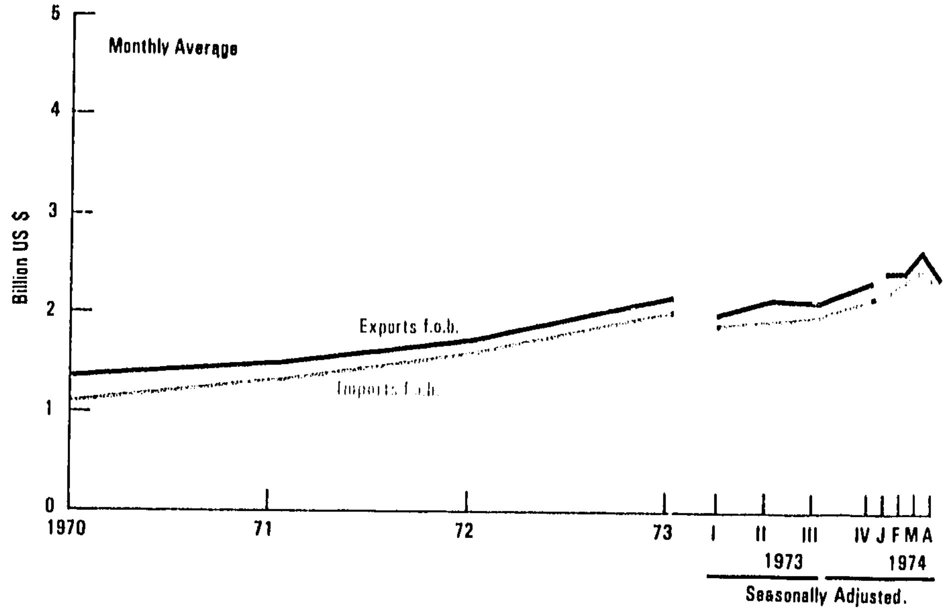
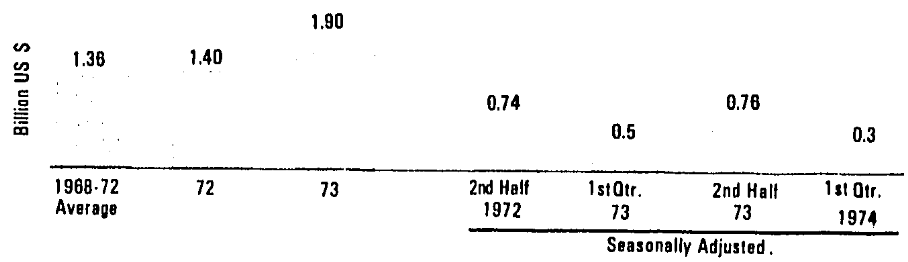
CANADA: EXTERNAL ECONOMIC INDICATORS

VALUE OF TRADE

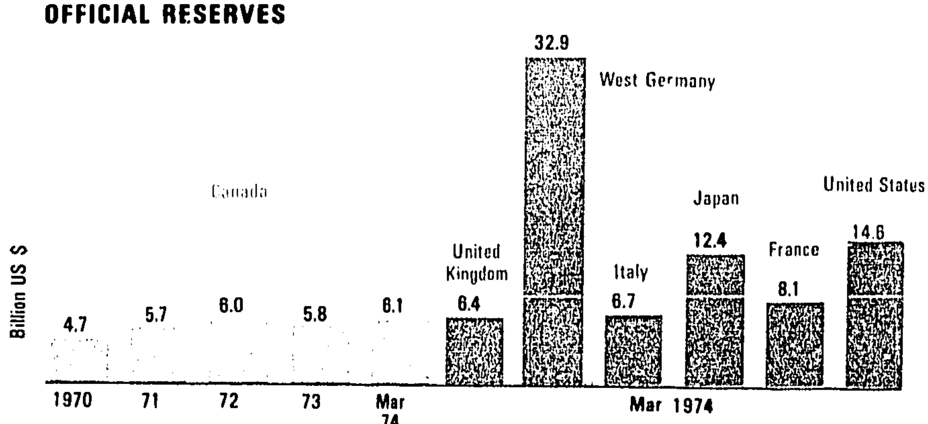


TRADE BALANCE

f.o.b./f.o.b.



OFFICIAL RESERVES



Note: End of Period.

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