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STAT



Annex to
Economic Intelligence Weekly

*Developed Countries: Short-Term
Economic Prospects*

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DEVELOPED COUNTRIES: SHORT-TERM ECONOMIC PROSPECTS

Recent Trends

1. The world's major developed countries¹ have just gone through one of the sharpest upswings and subsequent decelerations in growth ever experienced. The boom, which began at the end of 1971 as policies generally became more expansionary, was unprecedented in strength and in temporal coincidence of upturns in the various countries. In 1972 the six major foreign economies grew at a real annual rate of almost 6%. In the first half of 1973, the rate accelerated to 9%. Each country except Italy achieved a rate of 8% or more in the first half of 1973.

2. The intensity and synchronization of the upswings resulted in commodity shortages and strained capacity in basic industries. In the first half of 1973, prices (measured by the GNP deflator) increased in the six foreign economies at an average annual rate of 9.1%. In response, most of the governments shifted to more restrictive policies by mid-1973 -- considerably sooner than in earlier cycles. The main burden fell on monetary policy. In general, the rate of economic expansion -- and, to a lesser extent, the rate of inflation -- decelerated in the third quarter of 1973 to what observers hoped would be a "soft landing" near the long-term growth rate.

3. Growth decelerated much more sharply than expected. Real output of the major foreign economies grew at an annual rate of only 3.4% in the second half of 1973 and fell 0.9% in the first half of 1974. Growth of output slowed considerably in the second half of 1973 in all the countries except Italy. The small decline in aggregate output in the first half of 1974 resulted mainly from drops in Japanese and British GNP and a sharp decline in the Italian growth rate. Rather than a "soft landing," the major industrial countries slipped into the most widespread recession since World War II. Meanwhile, inflation accelerated to an annual rate of 15.3% in the first half of 1974.

4. The sharp deceleration in growth is a consequence of several interrelated factors. In part, it is a direct result of the shift to more restrictive policies. In West Germany, in particular, demand-management policies had become extremely

1. Defined, for the purposes of this report, as Canada, France, Italy, Japan, the United Kingdom, and West Germany, together with the United States.

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tight and a sharp slowdown was anticipated. In most of the economies, housing investment fell substantially because of high interest rates and scarce mortgage money. Overall demand in some countries also weakened because downturns abroad hurt export volume. A pronounced cyclical downturn probably would have occurred even if there had been no additional deflationary disturbances.

5. The oil crisis that began in October 1973 reinforced contractionary pressures. Initially, concern about the adequacy of oil supplies eroded business confidence and depressed investment. Energy conservation measures had a direct impact on demand, especially on automobile purchases. These measures also affected other elements of private consumption in a number of countries, as well as investment in Japan and elsewhere. Actual supply limitations had a major impact only in the United Kingdom, where the oil embargo aggravated energy shortages caused by the coal strike.

6. Sharp increases in oil prices in January added to the problem. By shifting the terms of trade – the ratio of export to import prices – against consumers in industrial countries, the price hikes reduced domestic purchasing power in a manner analogous to an increase in indirect taxes. Domestic purchases of goods and services other than oil had to be cut. This contractionary impact was not offset by a shift to more expansionary policies. By stimulating inflationary expectations, increased oil prices contributed to a further rise in prices of most other commodities.

Government Policies

7. Governments in the major developed countries generally cannot reconcile their present growth, price, and balance-of-payments objectives. This was often true in the past, but the difficulty is particularly acute now. Most governments are having difficulty achieving any of their major aims in full measure. With few exceptions, the first-half downturn in output or economic growth was accompanied by record increases in prices and unprecedented trade and current account deficits.

8. Most of the governments have made the fight against inflation their number one economic priority, although reducing the payments deficit is still an important objective of Tokyo, Rome, and London. This is a marked shift in attitude from the 1960s, when policy focused on rapid growth and full employment. Only in Canada and France, where inflation is viewed more as an international than a domestic problem, is rapid growth the primary objective.

9. Demand-management policies -- particularly monetary policy -- consequently have remained generally restrictive despite the first-half slump. Indeed, rather than compensating for the contractionary impact of the oil price rise, several countries have tightened policies considerably. Some countries now have the most restrictive policies in years.

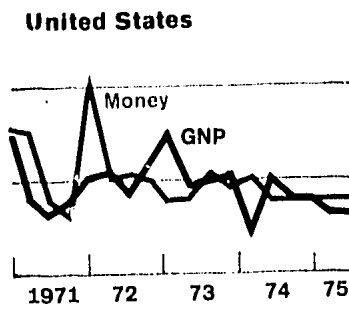
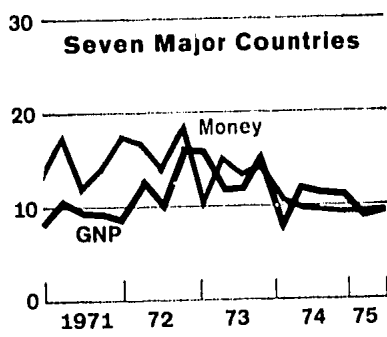
10. Popular pressure for a shift to more expansionary policies is not strong, so far. The fight against inflation in most countries is generally endorsed by economic interest groups. Labor's interest in fighting inflation has been stimulated by the fact that rising prices rather than declining employment have been the major factor eroding income. Although working hours are down sharply in some industries, unemployment has grown little despite the output slump. Business tends to blame rising costs rather than sluggish economic growth for the squeeze on profits.

11. Policies are likely to remain restrictive in most of the countries even though pressures for relaxation will build. Continuing sluggish growth will increase unemployment, particularly if wages begin to rise faster than prices, as expected. The profit squeeze and liquidity problems arising from restrictive monetary policies will generate business pressures for expansionary policies. We nevertheless believe that most governments will pursue current policies until inflation decelerates noticeably. This will probably not occur before the end of 1974. More time will be needed for the economies to respond to the shifts that eventually will take place. Thus, for the remainder of this year and the first half of 1975, we think the effect of policies in most countries will be basically restrictive.

12. The present policy mix differs somewhat among countries. Most are continuing to pursue a tight monetary policy as the key element in their anti-inflation program. Since mid-1973 the money supply (broadly defined) in most of the countries has been growing less rapidly relative to nominal income than has historically been the case, and the ratio recently has been declining further (see Figure 1). The reduction in the ratio is particularly great in Japan, West Germany, Italy, and the United Kingdom. As a result, credit is tight throughout the industrial world and interest rates are at record levels.

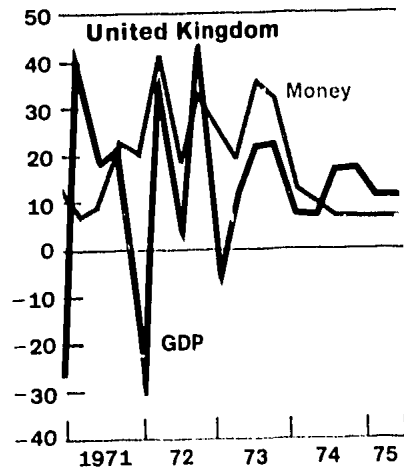
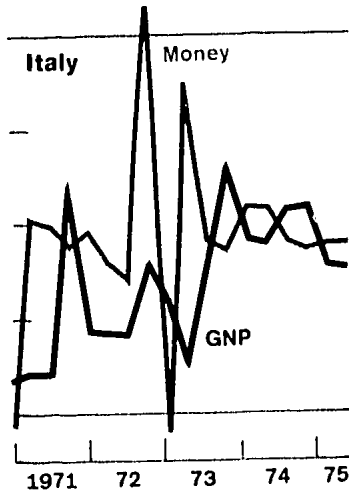
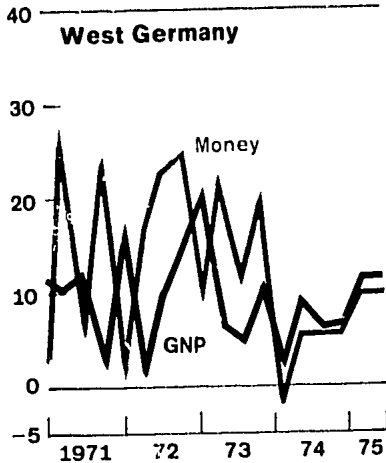
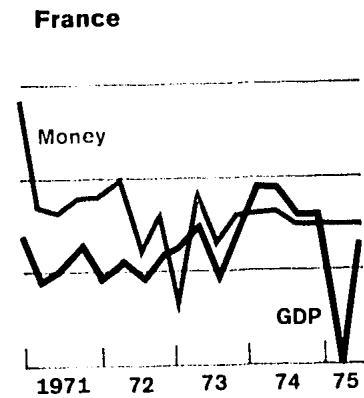
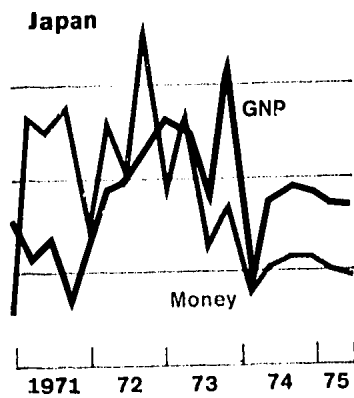
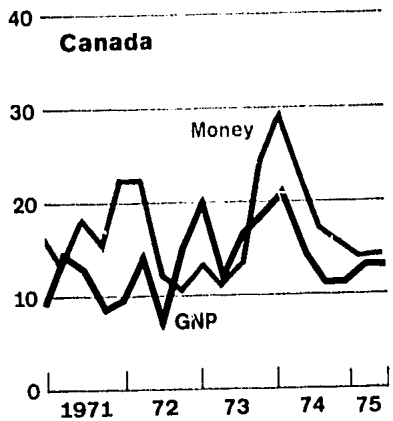
13. Fiscal policies vary more but have become more restrictive in most countries. This trend is partly due to fiscal drag. As prices and incomes rise, taxes have increased more than proportionally because of progressive tax structures. The government deficit is being reduced substantially in Italy and appreciably in Japan. In France, the budget has moved from traditional balance into small surplus. Fiscal policy in the United Kingdom has swung around since the beginning of the year and is now mildly expansionary. In Canada, budget policy remains moderately expansionary.

figure 1



Developed Countries: Growth of Nominal Output and Money Supply

Quarterly changes (in national currency, seasonally adjusted) at annual percentage rates



Note: 1st and 2d quarters 1974 estimated, 3d and 4th quarters 1974 and 1st and 2d quarters 1975 projected.

Growth Prospects

14. The major foreign economies will begin to recover in the second half of 1974, unless policy becomes more contractionary. The recovery probably will be weak. Real GNP is projected to increase at an annual rate of only 1.5% in the second half of 1974 and 3.2% in the first half of 1975 (see Table 1). Growth is expected to be most rapid in France, Canada, and Japan. If US output expands

Table 1
Developed Countries: Projected Growth in Real GNP

	Percent Change ¹				
	Estimated		Projected		
	First Half 1973	Second Half 1973	First Half 1974	Second Half 1974	First Half 1975
Canada	9.1	4.5	4.8	2.2	4.0
France ²	8.1	5.7	5.2	3.3	3.9
Italy	4.2	9.7	1.8	0.4	0.6
Japan	12.8	3.0	-8.1	2.4	3.9
United Kingdom ²	8.6	1.1	-4.3	2.2	0.6
West Germany	8.3	0.3	1.3	1.0	3.9
Six major foreign economies ³	9.1	3.4	-0.9	1.5	3.2
United States	7.3	2.0	-3.2	1.5 ⁴	3.0 ⁴
Seven major developed countries ³	8.2	2.7	-2.1	1.5	3.1
Other OECD countries	5.1	5.8	2.0	1.4	1.6
All OECD countries ³	7.8	3.1	-1.5	1.5	2.9

1. Change from preceding half year, at annual rate. All data are seasonally adjusted.

2. GDP.

3. Weighted by 1972 GNP and exchange rates.

4. OECD projections.

as fast as the OECD estimates – which now seems optimistic – real GNP in developed countries as a group probably will grow at annual rates of only 1.5% in the second half of 1974 and 2.9% in the first half of 1975.

15. The projected recovery for the six major foreign countries rests almost entirely on an anticipated pickup in domestic demand. After declining in the first half of 1974, domestic demand in major foreign economies will grow at estimated rates of 1.2% in the current half year and 3.0% in the following half (see Table 2). The foreign sector, which cushioned the recent downturn, is likely to provide less net stimulus through mid-1975.

Table 2

Six Major Foreign Countries:¹ Economic Trends

	Percent Change ²				
	Estimated		Projected		
	First Half 1973	Second Half 1973	First Half 1974	Second Half 1974	First Half 1975
Private consumption	7.1	2.8	-1.1	2.3	3.1
Government consumption	4.8	5.1	0.6	2.8	3.0
Gross fixed capital formation and inventory accumulation					
Of which:					
Housing	12.5	2.0	-9.8	-0.4	0.9
Plant and equipment	10.5	13.1	0.3	2.6	3.4
Total domestic demand	9.5	3.8	-1.4	1.2	3.0
Exports	13.1	9.5	13.5	4.4	5.5
Imports	19.1	11.5	1.8	1.1	4.6
GNP	9.1	3.4	-0.9	1.5	3.2
GNP deflator	9.1	10.4	15.3	12.9	10.6

1. Japan, Canada, France, West Germany, Italy, and United Kingdom.

2. Change from preceding half year, at annual rate. All data are seasonally adjusted. Weighted by 1972 GNP and exchange rates.

16. Our forecast of only a sluggish recovery in the current half rests in large part on an expected continuing decline in investment. Record interest rates and tight credit – accompanied in Japan and France by direct controls or special taxes designed to discourage investment – have depressed private outlays everywhere. Fiscal belt-tightening has slowed the growth of government investment.

17. As expected, housing investment has been hit particularly hard. Housing starts are down as much as 20%-25% in several countries. An upturn is likely in most countries by mid-1975, but housing starts probably will remain below the 1973 level except in France.

18. Investment in plant and equipment has also fallen in most countries, although much less sharply than housing. Machinery purchases are less sensitive to interest rates. Moreover, high levels of capacity utilization and shortages in some industries have encouraged firms to expand. At the same time, the economic slowdown has eroded confidence, causing some companies to stretch out or cancel investments scheduled during the 1973 boom. The threat of nationalization has

further inhibited investment in the United Kingdom, material shortages have slowed outlays in Canada, and government controls have retarded investment in Japan.

19. Private and government consumption probably will expand moderately rapidly through mid-1975. Private expenditures are projected to increase 2.3% in the current half -- somewhat faster than GNP -- and 3.1% in the following half. Private consumption is likely to grow more rapidly than income in the second half of 1974 because of a slight shift in income distribution favoring low-income groups and a small decline in the savings ratio. Government consumption will expand at estimated rates of 2.8% in the current half and 3.0% in the next half.

20. Catch-up wage increases of more than 20% are now common in most of the economies. Real wages are increasing at an annual rate averaging about 7%. The gain in earnings is being tempered, however, by reduced working hours and growing unemployment. Workers' real earnings nonetheless are projected to rise nearly 3% in the second half of 1974 and somewhat more than 3% in the first half of 1975.

21. The ratio of household savings to disposable income is expected to increase slightly during the first half of next year, following a slight decline in the current half. For the 12 months ending in June, the ratio should be essentially unchanged from recent years. The desire to maintain living standards and to buy now in anticipation of further price rises will tend to depress the ratio in Japan and West Germany in the current half and in a few countries, particularly the United Kingdom, throughout the period. On the other hand, the ratio will tend to be raised by consumers' concern over growing unemployment and shorter working hours, a desire to maintain real savings, and inclination to put off purchases of automobiles and homes.

22. The foreign sector had a strong negative impact on OECD growth in the first half of 1974 due to a sharp deterioration in the terms of trade, which more than offset a growing OECD surplus in volume terms. The continued favorable volume trend in the second half of the year will again be more than offset by price movements as the increased price of oil is fully reflected in trade. The foreign sector will provide a small net stimulus to growth during the first half of 1975 due to continued favorable volume trends and an expected slight improvement in the OECD terms of trade, assuming no change in oil prices (see Table 3).

Table 3

OECD: Foreign Trade Trends

	Percent ¹				
	Estimated		Projected		
	First Half 1973	Second Half 1973	First Half 1974	Second Half 1974	First Half 1975
OECD					
Exports					
Volume	16.0	12.2	10.7	5.2	5.6
Price	29.1	23.8	19.0	10.8	9.6
Value	49.7	38.9	31.7	16.6	15.8
Imports					
Volume	15.9	7.0	3.3	3.7	4.0
Price	31.8	33.8	47.0	13.7	8.9
Value	52.7	43.2	51.9	17.9	13.3
OECD Excluding the United States					
Exports					
Volume	12.4	11.9	9.9	5.0	5.1
Price	32.1	22.9	17.2	12.4	11.2
Value	48.5	37.5	28.8	18.0	16.9
Imports					
Volume	16.4	10.6	2.9	3.4	3.7
Price	35.1	34.3	44.0	13.6	9.5
Value	57.3	48.5	48.2	17.5	13.6

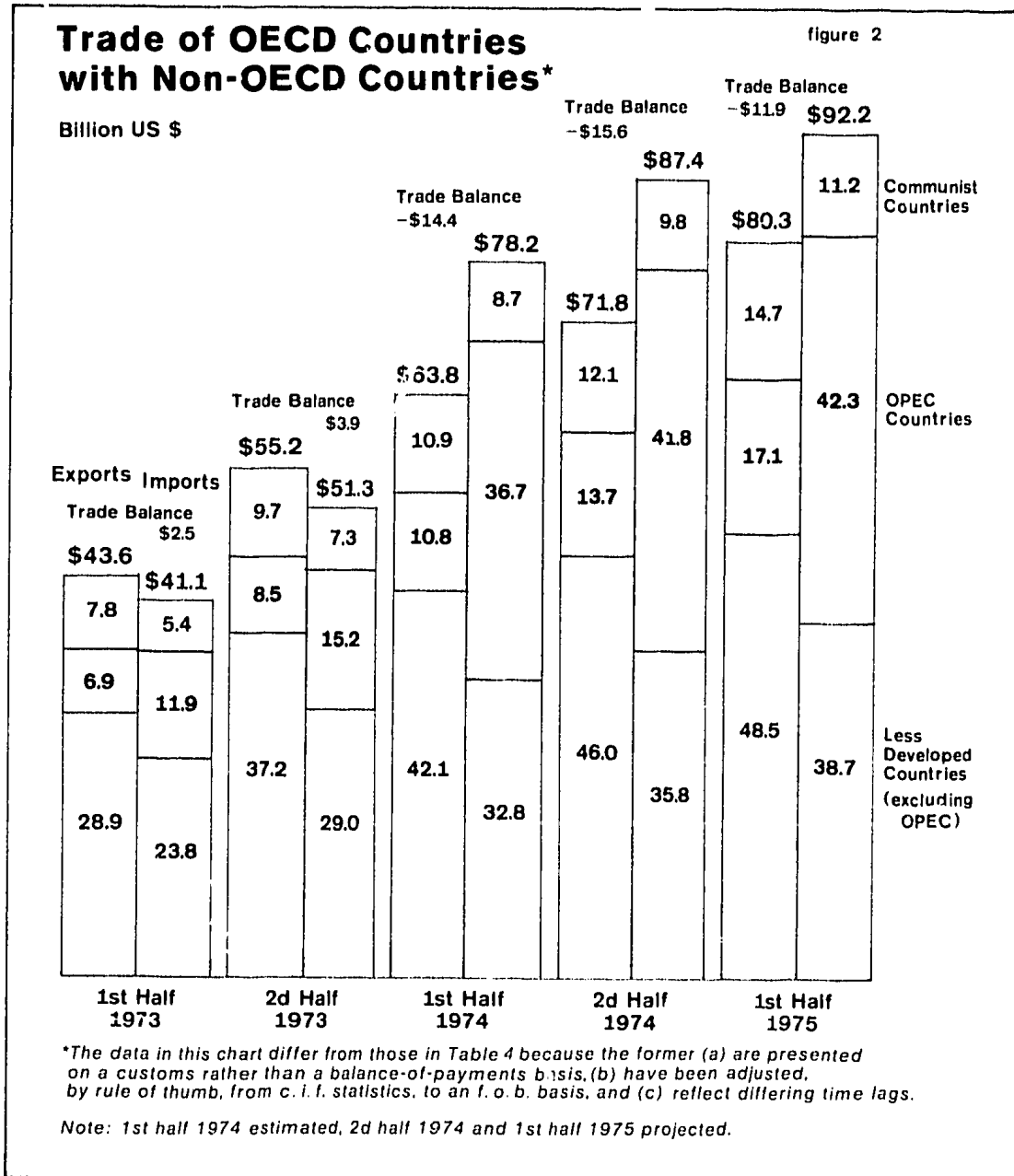
1. Change from preceding half year, at annual rate. All data are seasonally adjusted.

Outlook for Trade Balances²

23. Projected increases in the value of exports and imports point to a \$1 billion rise in the developed countries' trade deficit in the current half year, to \$15.6 billion. A drop to about \$12 billion is indicated for the first half of 1975.

2. This section, prepared before the OPEC price announcement of 13 September, is based on the assumption of unchanging oil prices during the period under consideration. The OPEC countries have increased prices by about 5% for the fourth quarter of 1974. Taking time lags into account, this measure will have little effect on the trade balance projected for OECD countries in the second half. The oil producers are planning a price indexing arrangement that threatens further increases in the cost of oil, amounting to \$1 billion annually for each 1% rise in price. Even the price hike already announced for the next quarter will largely wipe out the improvement projected for the developed countries' trade deficit for the first half of 1975.

24. In the second half of 1974, oil will continue to be the most influential factor in the trade accounts. The developed countries' projected increase of \$1 billion in the trade surplus with the non-OPEC LDCs and the Communist states is expected to be more than offset by a \$2 billion jump in the deficit with OPEC countries (see Figure 2). Sales to OPEC countries will surge by an estimated



\$3 billion, while oil imports should rise by \$5 billion. The oil bill will rise because of a small increase in volume and higher average prices than in the first half, when some oil was imported at 1973 prices and some under agreements that yielded a lower average price than now prevails.

25. The deficit with OPEC countries is projected to drop nearly \$3 billion in the first half of 1975 as a result of a continuing surge in their imports. Under the stimulus of ambitious development programs in countries such as Iran and Venezuela, these imports are expected to reach \$17 billion, up from \$11 billion a year earlier. About half of the gain in exports to OPEC countries will be offset by increases in OPEC investment earnings in the developed countries.

26. The developed countries' trade surplus with Communist countries in the second half of 1974 is forecast at \$2.3 billion -- about the same level as in three preceding half years. Rapid growth of exports of manufactured goods to the Communist states is expected to offset the reduction in Soviet grain purchases and higher prices paid for Communist oil this year. A further large increase in developed countries' sales probably will raise the surplus by \$1 billion or so in the first half of 1975.

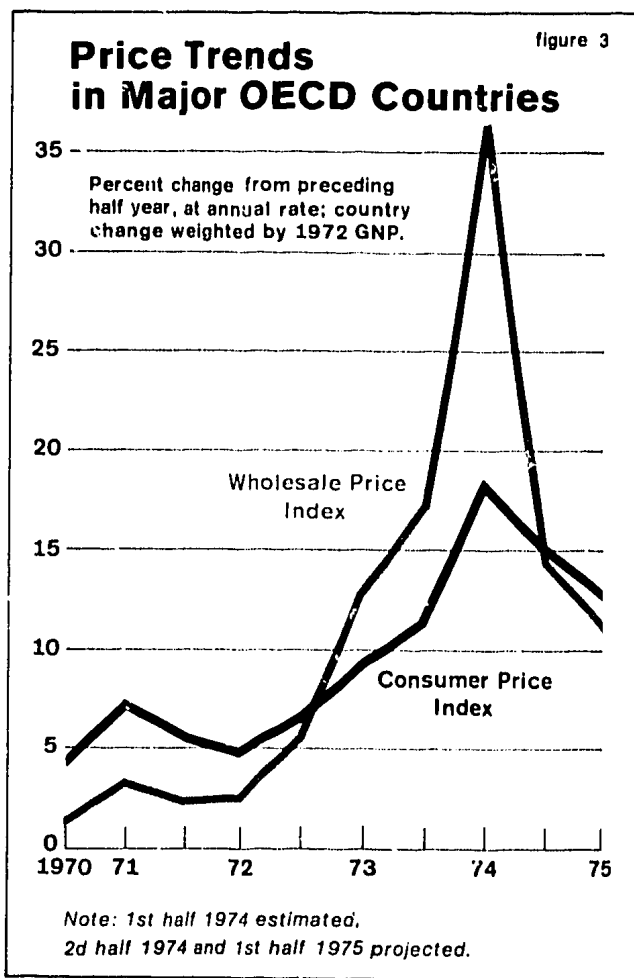
27. We estimate that the trade surplus with non-OPEC LDCs will hit about \$10 billion in both the current half year and the next one. The surplus was only half that large as recently as the first half of 1973. Growing populations, lagging agricultural production, and relatively high economic growth rates are sustaining rapid growth of LDC imports from the developed countries. Meanwhile, demand for LDC goods is stagnating because of the economic slump in developed countries. The LDC's present large deficits with developed countries cannot continue very long without a sharp increase in aid.

28. The distribution of the OECD's overall trade deficit among the individual countries will probably not improve much through mid-1975. We estimate that the United States, Japan, and France will increase their exports more rapidly than the average growth of the developed countries' markets. Exports of Italy, Britain, Germany, Canada, and the smaller OECD countries accordingly will probably increase less rapidly than average. As a result, the German surplus and the British deficit will remain about as large as in the first half of 1974. Italy, which is sharply restricting its economic growth to improve the balance of payments, can be expected to reduce its trade deficit only moderately.

29. Viewed in the aggregate, developed countries should not have a problem financing their trade deficit. The surplus revenues of the OPEC countries, estimated to exceed the developed countries' current account deficit by nearly \$30 billion in the period under consideration, will be reinvested largely in the developed countries. The problem arises from the fact that some countries' receipts of OPEC investment funds will diverge considerably from their needs. For the purposes of this study, we have assumed that individual OECD countries will be able to finance the deficits which we estimate will result from their present growth and trade and exchange policies. The trade balances shown in Table 4 for individual OECD countries thus are indicative of the estimated magnitude of recycling problems.

Inflation

30. Inflation remains a serious problem in all the countries. Despite the shift to more restrictive policies, prices rose at an unprecedented rate in the first half of 1974. Consumer prices increased at an 18% rate and wholesale prices even faster (see Figure 3). For the year ending in June, consumer prices are projected to increase about 15%—still four times the long-term average. The increase in wholesale prices probably will drop more dramatically but remain well above the historical norm. Prices are expected to rise the most in Italy, the United Kingdom, and Japan (see Table 5). West Germany's inflation almost certainly will be the most moderate for the year as a whole.



31. A marked change is developing in the primary causes of inflation. By and large, recent inflation has resulted mainly from excess demand and soaring prices for commodities, especially oil. Higher oil costs accounted for more than half of the inflation in the major developed countries during the first half of 1974; higher

Table 4
Trade Accounts of OECD Members¹

	Billion US \$				
			Estimated	Projected	
	First Half 1973	Second Half 1973	First Half 1974	Second Half 1974	First Half 1975
Canada					
Exports	12.2	13.3	14.6	15.9	18.2
Imports (f.o.b.)	11.0	12.3	13.7	15.1	17.3
Trade balance	1.2	1.0	-0.9	0.8	0.9
France					
Exports	16.9	19.7	22.2	24.5	26.9
Imports (f.o.b.)	16.1	19.1	24.0	26.9	29.3
Trade balance	0.8	0.6	-1.8	-2.4	-2.4
Italy					
Exports	9.6	12.6	13.6	15.3	16.6
Imports (f.o.b.)	11.2	14.8	17.6	18.3	19.2
Trade balance	-1.7	-2.3	-4.0	-3.0	-2.6
Japan					
Exports	16.9	19.2	24.8	28.4	30.7
Imports (f.o.b.)	14.2	18.3	26.4	27.8	29.6
Trade balance	2.7	1.0	-1.6	0.5	1.1
United Kingdom					
Exports	13.4	14.6	16.9	18.6	19.8
Imports (f.o.b.)	15.3	18.5	23.2	24.8	25.8
Trade balance	-1.9	-3.9	-6.2	-6.2	-5.9
United States					
Exports	31.9	38.4	46.3	48.9	51.5
Imports (f.o.b.)	33.2	36.7	47.9	51.2	54.2
Trade balance	-1.3	1.6	-1.6	-2.3	-2.7
West Germany					
Exports	29.8	37.8	42.8	44.9	47.2
Imports (f.o.b.)	23.3	28.3	30.5	32.8	35.0
Trade balance	6.5	9.5	12.3	12.1	12.2
Other OECD					
Exports	52.2	59.2	65.8	70.2	75.9
Imports (f.o.b.)	52.1	63.3	77.4	84.7	88.5
Trade balance	0.1	-4.1	-11.6	-14.5	-12.6
Total OECD					
Exports	182.9	214.7	247.1	266.4	286.5
Imports	176.4	211.3	260.7	281.0	297.6
Trade balance	6.6	3.3	-13.6	-14.6	-11.1
Net services	-0.4	-0.5	-1.9	-5.1	-5.7
Current account balance	6.2	2.8	-16.2	-20.9	-18.0

1. See the footnote on Figure 2 for an explanation of differences in data.

Table 5
Developed Countries: Price Trends

	Percent Change ¹				
			Estimated	Projected	
	First Half 1973	Second Half 1973	First Half 1974	Second Half 1974	First Half 1975
Canada					
Consumer prices	7.2	10.0	10.4	9.0	8.1
Wholesale prices	18.7	15.5	23.6	19.9	18.2
GNP deflator	6.9	10.7	9.3	8.8	8.5
France					
Consumer prices	6.1	9.9	15.0	15.5	13.0
Wholesale prices	15.5	20.2	48.9	10.0	8.0
GDP deflator	6.2	8.6	13.0	13.5	11.0
Italy					
Consumer prices	12.1	11.1	19.9	25.0	19.0
Wholesale prices	14.6	26.6	51.0	25.0	20.0
GNP deflator	11.9	10.3	15.5	21.0	15.0
Japan					
Consumer prices	13.0	17.0	32.0	18.0	14.0
Wholesale prices	17.0	24.0	47.0	14.0	11.0
GNP deflator	11.0	19.0	30.0	16.0	12.0
West Germany					
Consumer prices	6.6	7.5	7.1	8.5	8.5
Wholesale prices	7.8	7.3	18.2	10.0	8.0
GNP deflator	6.3	6.3	6.0	7.0	8.0
United Kingdom					
Consumer prices	9.4	10.0	19.0	16.0	15.0
Wholesale prices	5.2	11.8	28.7	15.0	10.0
GDP deflator	12.6	1.3	12.0	14.0	10.0
United States²					
Consumer prices	6.0	9.0	11.0	9.0	8.0
Wholesale prices	17.0	9.0	26.0	N.A.	N.A.
GNP deflator	6.0	8.0	10.0	8.0	6.0

1. Change from preceding half year, at annual rate. All data are seasonally adjusted.

2. OECD estimates and projections.

prices for other commodities were responsible for most of the remainder. The oil price rise alone boosted wholesale prices by 10%-15%. Given the exogenous nature of the rise in commodity prices, governments could do little to prevent accelerated inflation.

32. The current pressure on prices stems chiefly from internal factors. Both business and labor are attempting to restore their real income, part of which has recently been diverted to the world's raw materials producers. The response from labor has been substantially increased wage demands. In most countries, wage settlements recently have been running about 50% above last year's level. With few exceptions, hourly wage rates are likely to increase at least 20% in the year ending in June. Since the expected slow growth in output will not permit sizable productivity gains, unit labor costs will rise dramatically. In Japan, rising unit labor costs are expected to boost wholesale prices about 10%. A 5%-10% increase is likely in most West European countries.

33. Given the current momentum of wage increases, restrictive fiscal and monetary policies will not reduce European and Japanese inflation to acceptable levels by mid-1975. Over the longer term, curbs on aggregate demand may be helpful to the extent that they encourage business to resist extreme wage demands and force it to absorb part of any increase in labor costs. Profit margins in various industries already have been squeezed by the recent fall-off in demand. Faced with added labor costs that are difficult to pass on, many firms will be more inclined to reduce output than prices and profits. Relaxation of government policies would ease cost pressures in the short term by permitting increased production and productivity. If carried very far, however, such an easing would soon create production bottlenecks, especially in basic industry.

Comparison with OECD Forecasts

34. Our growth estimates are substantially more pessimistic than those presented by the OECD Secretariat in its midyear *Economic Outlook*.³ The estimates do agree on the likelihood of a modest recovery in the second half of 1974 and somewhat more rapid growth in the first half of 1975. The OECD expects the six major foreign economies to grow at an annual rate of 3.7% in the current half and 4.5% in the following half. We are projecting rates of 1.5% and 3.2% (see Table 6).

35. The differences between the two forecasts are most pronounced for West Germany and the United Kingdom in the current half year and for Japan throughout the period. The differences reflect our assessment that Bonn and Tokyo will continue to pursue restrictive policies for some months and that British output fell less in the first half than the OECD estimates.

3. OECD *Economic Outlook*, 15 July 1974.

Table 6

**Developed Countries: Comparison of CIA and OECD Estimates and Projections
of Real Growth in GNP**

	Percent Change ¹							
			Estimated		Projected			
	First	Second	First	Second	First		First	
	Half	Half	Half	Half	Half	Half	Half	Half
	1973	1973	1974	1974	1975	1975	1975	1975
			CIA	OECD	CIA	OECD	CIA	OECD
Canada	9.1	4.5	4.8	6.0	2.2	3.5	4.0	5.2
France ²	8.1	5.7	5.2	4.8	3.3	4.5	3.9	4.2
Italy	4.2	9.7	1.8	2.5	0.4	0.6	1.5
Japan	12.8	3.0	-8.1	-6.5	2.4	4.5	3.9	7.5
United Kingdom ²	8.6	1.1	-4.3	-6.0	2.2	4.6	0.6	1.2
West Germany	8.3	0.3	1.3	2.0	-1.0	3.5	3.9	4.2
Six major foreign economies ³	9.1	3.4	-0.9	-0.4	1.5	3.7	3.2	4.5
United States ⁴	7.3	2.0	-3.2	-2.8	1.5	1.5	3.0	3.0
Seven major developed countries ³	8.2	2.7	-2.1	-1.6	1.5	2.6	3.1	3.7

1. Percent change from previous half year at annual rate. All data are seasonally adjusted.

2. GDP.

3. Weighted by 1972 GNP and exchange rates.

4. OECD projections.

36. We believe that domestic demand in most of the economies will grow less rapidly in the 12 months than the OECD forecasts. Private investment probably will decline in the second half rather than recover, as the OECD expects. Our more pessimistic assessment is based on recent data showing continuing severe limitations on the growth of the money supply in most of the economies. Since we do not expect savings ratios to fall as much as the OECD indicates, we are forecasting less rapid growth of private consumption. The two assessments of the foreign sector's contribution to growth are similar.

37. Our estimates for the OECD's trade performance over the next year are slightly more pessimistic than those of the OECD Secretariat. Both estimates indicate a modest reduction in the OECD's trade deficit, but we see a smaller improvement than the OECD and, in fact, feel that there is a substantial chance for the anticipated improvement to be eliminated by further oil price increases. Paradoxically, we are forecasting a better volume performance over the next 12 months than the OECD Secretariat anticipates. We feel that the OECD's imports,

measured in real terms, will grow by only 4% over the period while the OECD is forecasting a rise of more than 6%. The variance in these estimates stems from the Secretariat's more optimistic appraisal of the OECD's GNP growth prospects for the next year. In contrast to the improved real performance, however, we see a further deterioration in the terms of trade offsetting most of the real improvement, leaving only a slight reduction in the OECD's trade deficit. The OECD Secretariat, on the other hand, is forecasting some improvement in the terms of trade compared with the first half of 1974. The difference apparently stems from our assessment that, despite gradual improvement, the terms of trade will remain worse than they were in the first half when higher oil prices were not fully reflected in the statistics.

Uncertainties

38. The economic outlook for developed countries is particularly uncertain at this juncture. They have not suffered such a pervasive slump since the Second World War and have never before experienced such rapid inflation. No clear indications of an imminent return to acceptable rates of economic growth and inflation have yet emerged. In several countries, political weakness adds to the economic uncertainty. Leadership has changed recently in West Germany and France and could change soon in Britain. The governments in Italy and Japan are sufficiently shaky to be cautious in changing policy. Specific estimates for economic growth, inflation, and the balance of payments in the next 12 months should be viewed only as expressions of general notions about the likely course of events.

39. Although our growth estimates are considerably lower than OECD's, we see little chance -- perhaps 25% -- that time will show our forecasts to be too low. We see nothing on the horizon likely to give much impetus to growth. The Japanese government is principally concerned with inflation and the external balance; unlike the OECD, we think it unlikely that Tokyo will relax economic policy appreciably before yearend. In West Germany, inflation also is the major concern, and we judge that policy adjustments will merely offset a decline in stimulus from the foreign sector.

40. We believe chances are substantially greater that our growth estimates will err on the high side. While our estimates for the first half of 1974 and our projections for the current half probably are reasonably accurate, the forecasts for the next half are less firm. The 3% growth rate predicted for the six major foreign economies in the first half of 1975 is not a result of any expected external

stimulus. Rather, it is the result of anticipated marginal improvements in all components of aggregate demand. Some of these may not be realized, and the acceleration forecast for the first half of next year, therefore, may simply not take place.

41. Our doubts do not extend to fears of a real depression. The situation has substantial elements of stability. Nominal wages will be increasing fairly rapidly, investment is strong in energy-related industries, and the impact of last winter's drastic increase in oil prices will diminish with time. More importantly, we believe that if the economic picture becomes decidedly darker, governments would rapidly alter priorities from fighting inflation to maintaining employment.

42. While we see little on the horizon that is likely to produce higher growth rates than we project, events have already occurred that may well result in lower growth rates than we have forecast for the first half of 1975. In particular, our assumptions about constant oil prices and US economic growth now seem optimistic. The recent OPEC decision on prices for the last quarter of 1974 will raise the cost of oil to OECD countries by \$5 billion per year. The oil producers apparently plan increases of similar size in the following quarters. The OECD estimates of US growth that we have used in our projections are now viewed as unrealistically high by most private forecasters.

43. Other contingencies that could further depress growth below our forecast are:

- A reduction in the share of disposable income spent on consumption.
- Inability of countries to finance their projected deficits.

44. Our estimates are based on the assumption that consumers will try to maintain living standards in spite of inflation and that there will be a tendency to buy early to avoid even higher prices later. If consumers become more concerned about future employment and real incomes, savings could rise and consumption could become a depressant in economic growth.

45. We have assumed that private financial markets, with some assistance from the IMF special lending facility and bilateral government loans, will be sufficient to deal with the recycling problem during the period under consideration. If this is not the case, countries with extremely large projected deficits, such as

Italy and the United Kingdom, may be forced to curtail net imports. This could be done either directly, through changes in trade and exchange rate policies, or indirectly, through more restrictive demand management policies. Either set of policy changes would bode ill for growth prospects in developed countries.