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ECONOMIC INTELLIGENCE WEEKLY

25 June 1975

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Overview

The Firming Trend of Industrial Output Continued in April-May in Most of the Major Economies. Production rose for the second consecutive month in Japan in April, and a sharp jump in Italian output pushed its index above the October 1974 level. In most other countries, output was steady or slipped only slightly. In West Germany, however, tentative data suggest a 2% drop in April, a major factor in recent downward revisions in the German economic outlook.

While the decline in output may be bottoming out, the six major foreign economies can expect little economic recovery in the second half, even if the United States grows at the 5% annual rate predicted by the OECD. Such an increase would probably add 0.6% at most to Big Six exports, boosting their aggregate demand by a mere 0.1%. Only Canadian exports and final demand would be materially affected.

Although major foreign governments are beginning to recognize that recovery will be long drawn out in the absence of additional stimulative measures, they remain reluctant to act. Price and payments problems are still restraining expansionary action in France, Canada, the United Kingdom, and Italy. Bonn will not take additional measures early enough to have much effect in 1975. [redacted] 25X6

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The Recession in Industrial Countries Is Cutting Heavily into Exports of Non-Oil LDCs. Sales of raw materials -- the mainstay of their exports -- and of light manufactures such as textiles and electronics have plummeted because of weak demand, particularly in the United States and Japan. South Korea and Singapore reported 15% declines in first-quarter export volume from the previous quarter while Taiwan's exports were off 6%. Non-oil LDC imports fell in early 1975, although less rapidly than exports. The trade deficit -- totaling $20 billion last year -- has been widening rapidly.

Producer and Consumer Members of the International Tin Council Reached a Compromise Last Week on Financing Buffer Stocks for the Next Five Years. The new agreement, effective 1 July 1976, sets compulsory buffer stock contributions by producer countries at 20,000 tons (10% of annual world consumption), the same as the present five-year agreement. If slack conditions require further stockpiling, consumer members will be asked to finance an additional 20,000 tons. In the past, only France and the Netherlands have made voluntary contributions to the buffer stocks. (Confidential)

Articles

DEVELOPED COUNTRIES: SHORT-TERM GROWTH PROSPECTS

The six major foreign economies can expect little economic recovery through the end of 1975. Even if the US economy grows at an annual rate of 5% (real terms) in the second half, as predicted by the OECD Secretariat, the resulting rise in US imports will not be enough to spark an upturn abroad. Inflation and payments problems are still inhibiting government expansionary action in France, Canada, the United Kingdom, and Italy. Bonn and Tokyo also are moving cautiously despite foreign and domestic pressures to reflate.

Weak Turnaround in the Second Half

We believe that economic activity in the Big Six will rise at an average annual rate of 1-1/2% in the second half of 1975, after declining at a 2-1/2% rate in the first half. Japan and France should lead the group, with rates estimated at

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Industrial output plunged in the early months of the year, while domestic demand appears to have been flat. As a result, the excess inventories built up last year probably were cut substantially. The production decline showed signs of leveling out in the second quarter, suggesting that the worst of the inventory adjustment process had ended. If so, the inching up in final demand forecast for the second half of 1975 would be reflected in a mild upturn in production.

Private Consumption

Consumer spending during the remainder of the year is unlikely to grow any faster than the 2% annual rate estimated for the first half. Although real household incomes are rising as higher wage rates and unemployment compensation more than offset inflation and growing unemployment, consumers are holding down their spending because of uncertain job prospects. Savings rates at the margin appear to be running at about 35% in Japan and 40% in West Germany -- the two largest foreign economies.

Consumer confidence probably will not improve much until unemployment begins to decline. The jobless rate is now about two-thirds higher than a year ago. The rise in employment expected in the second half probably will be insufficient even to absorb all new entrants into the labor force.

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Government Purchases

Government spending, source of one-fifth of aggregate demand in the Big Six, also should continue to increase at about the same rate in the second half of 1975 as in the first. Some governments, [redacted] have quietly boosted purchases in recent months. Others have made small budgetary adjustments that will add to purchases later this year. If government spending rises at the expected rate of 5%, it almost certainly will be the most dynamic component of demand. 25X6

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Private Investment

Private capital spending, which fell at a 6-1/2% annual rate in the first half, probably will decline again in the second half. Because capacity utilization rates are extremely low, government efforts to stimulate private investment by lowering interest rates and providing tax incentives are having little effect. The decline in business spending on plant and equipment could even [redacted]

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The Foreign Component

We expect a slight deterioration in net foreign demand in the second half. Imports, after plunging 12-1/2% in the first half, probably will show little change in the months ahead. Export volume, down 10% in January-June, is expected to show a further small decline.

A 5% growth rate in the United States would in itself have little effect on exports and economic growth in other major developed countries. Experience during the 1971 recovery indicates that US import volume would increase at a 19% annual rate in the second half. Even this increase – which is unlikely because of changed competitive relationships in the US market and other factors – would add only about 0.6% to exports of the Big Six, boosting their aggregate demand by a mere 0.1%. Only Canadian exports and final demand would be affected appreciably.

Although the Europeans and Japanese tend to exaggerate the direct effect of US economic recovery on their domestic prospects, tentative signs of a break in the US recession are doing little to improve their confidence. Foreign businessmen are skeptical that a strong pickup in US demand is in the offing. Their willingness to spend and invest will not get a lift until the US recovery clearly is well under way.

Current Policy Positions

Despite increasing evidence that recovery will be painfully slow without additional stimulative measures, major foreign governments remain reluctant to act. Inflation is still viewed as a major threat in most countries. Payments problems pose additional constraints, [redacted] These considerations still outweigh political pressures stemming from high unemployment rates.

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Realistically or not, most governments appear to be waiting for others -- particularly the United States -- to initiate expansionary measures that will prod their recovery. The reaction to a rise in foreign demand, once perceived, would vary. [redacted] 25X6

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France: Waiting To Be Led

Paris views the present French slump as the unavoidable result of the worldwide recession. Thus far, Giscard has concentrated on cushioning those effects

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of the downturn -- particularly unemployment among the young -- that might cause social unrest. Because Paris is waiting to be led out of the slump by recovery in West Germany and the United States, a major policy shift is unlikely; further palliatives may be introduced this fall.[2]

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The other three members of the Big Six -- which together account for only 30% of output -- have little latitude in stimulating domestic recovery on their own. Serious inflation and payments constraints compel them to let their dominant partners take the lead in reflation.

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Although Italy's financial problems have eased since last year, the government views stimulative policies as risky because of the massive foreign debt. The newly regained trade surplus could vanish quickly; capital flight has become a renewed threat since the communist and socialist parties gained substantially in regional elections earlier this month. The Left's increased strength ultimately will force a relaxation in Rome's conservative stance, yet few economic policy changes are likely until the Moro government rearranges political alliances to accommodate the new balance of power.

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2. For an analysis of France's most recent policy actions, see ER EIW 75-23, 11 June 1975.

Later Recovery Trends

Even if growth accelerates in the first half of 1976, as seems likely, we believe that recovery will be slower than from previous post-World War II recessions. Underutilization of capacity and low profits will remain an extraordinary drag on investment.

The foreign sector also is unlikely to lead these countries out of the recession. The sharp upturn in government purchases or private consumer spending needed to spark a swift recovery is unlikely to occur.

Governments will still be balancing conflicting price and employment goals in deciding on additional stimulative action late this year and early next. Although price rises should continue to moderate in the months ahead, most governments fear that strong measures could result in a resurgence in inflation, particularly since firms will try to improve profit margins once given the chance. Disappointing growth in the second half of 1975 probably will tip the scales in favor of cautious additions to government spending this winter.

A strong pickup in private consumer spending would depend heavily on a reversal in psychology. [redacted] 25X6

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Comparisons with Other Forecasts

Our current view of economic prospects for the second half of 1975 is slightly gloomier than the projection made in April. Although inventory cuts early this year apparently were sharper than expected – thus worsening first-half results and reaffirming our estimate of a mild upturn later this year – we now foresee a continuing decline in investment instead of a constant level. [redacted] 25X6

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USSR: PROGRESS IN SATELLITE COMMUNICATIONS

The development of Soviet satellite communications – both domestic and international -- is picking up speed after a cautious beginning.

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Domestic Communications

The Orbita network, the first domestic network in the world, now reaches 58 Soviet cities, with 5-10 new stations being added each year. Orbita stations receive television programs directly from Moscow via Molniya-2 satellites and distribute the programs locally 16 hours each day. Moscow is pushing hard to reach every Soviet citizen with educational, political, and entertainment programs.

International Communications

In the international arena, Intersputnik – the Communist counterpart to the US-sponsored INTELSAT -- is now in limited operation, relaying communications and television signals among Cuba, Czechoslovakia, and the USSR. But with only nine members (the others are Bulgaria, East Germany, Hungary, Poland, Romania, and Mongolia), Intersputnik is merely a regional system in contrast to the 90-member worldwide INTELSAT organization. Indeed, the USSR and Romania are building stations that will link up with the INTELSAT network for commercial communications with the West.

The USSR also is building two earth stations for use in the planned satellite HOTLINE link. When activated late this year or early next year, the new link will improve communications between Moscow and Washington during crisis situations.

Cost Considerations

We estimate that the USSR has spent at least $2 billion on its major domestic and international Comsat programs since 1965. These ambitious programs have outrun Soviet technology. Soviet satellites typically have much shorter operational lifetimes and substantially smaller relay capacities than INTELSAT satellites. Moreover, Soviet earth stations incorporate noisier receivers, still depend on vacuum tubes, and are not so highly automated as INTELSAT stations.

The USSR nonetheless passed a major technological milestone when it launched a communications satellite into geostationary orbit in July 1974. In the next few years, geostationary satellites are likely to replace some satellites now operating in elliptical or highly eccentric orbits. Increasing use of geostationary satellites should substantially reduce the costs of maintaining and expanding Soviet Comsat facilities because fewer are needed to provide the same coverage and they tend to last longer. (Confidential)

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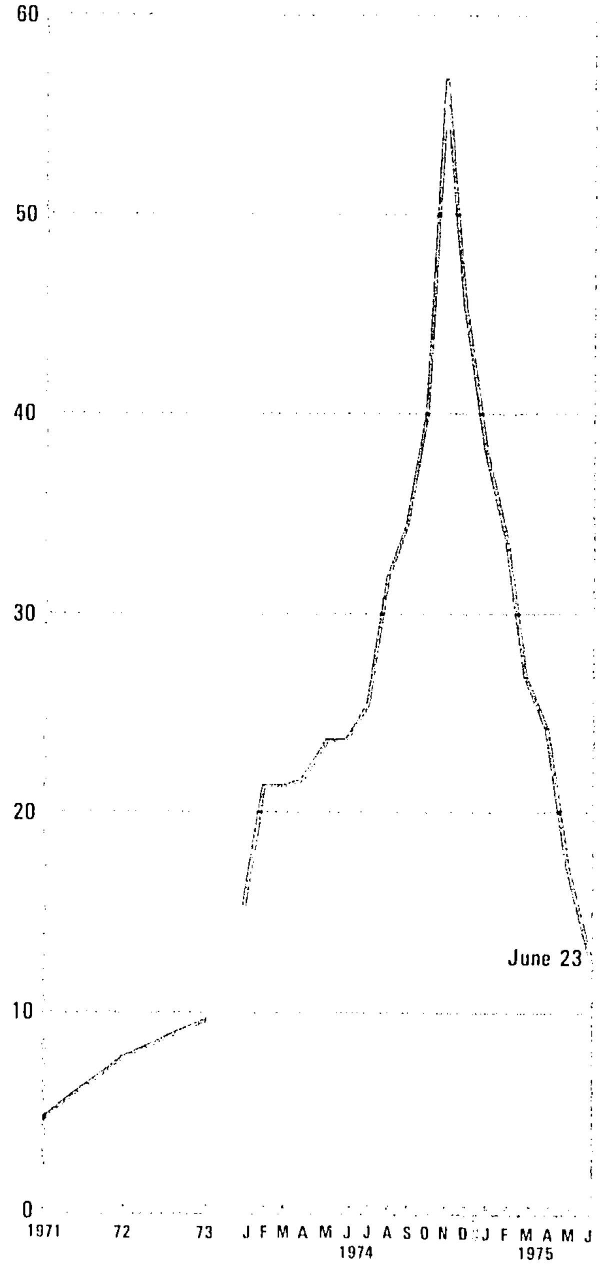
Note

World Sugar Market Softens

Depressed demand and prospects for a record harvest in the crop year beginning 1 September have cut world sugar prices to 13 cents a pound f.o.b. Caribbean ports--80% below the record high of last November and the lowest level since December 1973. Consumer resistance to high sugar prices, as well as the global recession, has turned an expected world market shortage into a surplus; the Philippines and certain other exporting countries that withheld sugar in hope of a price rebound are now stuck with excess stocks. Expanded acreage and return of normal weather in most major producing countries are expected to boost world sugar production in the 1975/76 crop year to 81.5 million tons. Because of lagging consumption, world stocks will increase substantially for the first time since 1971, probably keeping world market prices at about 10 cents for the remainder of 1975. The recent price dive and rising production costs have rekindled interest among exporting countries in cooperative measures to stabilize prices. (Unclassified)

World Market Sugar Price[1]



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1. US cents per pound, Caribbean ports.

Publications of Interest

The Structure and Function of Multilateral Aid Institutions
(ER RP 75-17, June 1975, For Official Use Only)

This publication serves as a research reference on the structure of multilateral aid agencies, the types of aid provided, and the amount of aid given less developed countries in 1974.

USSR: Prospects for Grain Production and Trade at Mid-June
(ER IB 75-4, June 1975, Confidential)

Weather during late April and May favored crop developments in the western and eastern portions of the Soviet Union while reducing yields in the central portion. We now estimate the 1975 grain crop at 215 million tons, 5 million tons less than our April forecast. This publication uses weather data through May and collateral data available in mid-June to describe crop developments in the spring and to discuss the likelihood of Soviet grain imports.

* Copies of these publications may be ordered by calling [redacted] Code 143, Extension 7234. 25X1A

ECONOMIC INDICATORS

Prepared by

The Office of Economic Research

June 25, 1975

Foreword

The *Economic Indicators* provide up-to-date information on changes in the domestic and external economic activities of the major non-Communist developed countries. To the extent possible, the *Economic Indicators* are updated from press ticker and Embassy reporting, so that the results are made available to the reader weeks - or sometimes months - before receipt of official statistical publications.

Comments and queries regarding the *Economic Indicators* are welcomed. They may be directed to [redacted] the Office of Economic Research, Code 143, Extension 7402 or 351-7402. 25X1A

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