



The President's Daily Brief

August 20, 1974

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FOR THE PRESIDENT ONLY
THE PRESIDENT'S DAILY BRIEF

August 20, 1974

PRINCIPAL DEVELOPMENTS

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Stepped-up communist attacks north and west of Saigon appear to indicate the start of a limited military campaign. Despite some recent tactical setbacks and disruption of rural pacification efforts, the government retains firm control over the country's population centers and major highways. (Page 2)

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Zairian President Mobutu reportedly will meet with Portuguese President Spínola later this week to discuss the future of Angola. Portugal probably regards Mobutu as its best hope for ending an impasse between the two leading rebel groups in Angola. (Page 4)

West German Chancellor Schmidt is considering traveling to Peking sometime after his visit to Moscow this autumn. (Page 5)

At Annex we discuss the outlook for the international economy with special attention to new circumstances caused by the abrupt and massive increase in the price of oil.

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GREECE-CYPRUS

The Karamanlis government yesterday put distance between itself and its discredited predecessors with a major purge of military officers. The purge focused on officers identified in the public mind with the last regime's Cyprus policy.

--Ousted were armed forces chief General Bonanos and army chief General Galatsanos, as well as several other senior military officers.

--The new armed forces chief is General Dionysios Arbouzis, who commanded the Greek army contingent in Korea. He has been retired since shortly after the first military coup in 1967.

--Lieutenant General Davos, a critic of the last junta who is believed to have been instrumental in the recall of Karamanlis, was named army chief.

--Lieutenant General Gratzios, also a Karamanlis man, was named commander of the key army corps in Thrace on the Turkish border.

The appointments appear designed to consolidate Karamanlis' hold and ease the fears of those who viewed the continued presence of key junta leaders as evidence that the civilian government was not in full control.

Defense Minister Averoff told the US ambassador in Athens that leadership of the navy and air force, not as closely associated with the previous military regimes, will not be affected by the shakeup.

Averoff said that strongman Brigadier General Ioannidis, who is on six months leave but is frequently seen in army headquarters, has "not yet" been affected by the changes.

* * *

The military situation in Cyprus remained quiet early this morning.

The situation is reportedly under control in Nicosia, following a day of violent demonstrations that led to the death of US Ambassador Davies. President Clerides has banned public meetings and the US embassy is being guarded by contingents of the Cypriot national guard, Cypriot armed police, and a small UN force.

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SOUTH VIETNAM

Stepped-up communist attacks north and west of Saigon appear to indicate the start of a limited military campaign in Tay Ninh, Binh Duong, and Bien Hoa provinces. The Viet Cong, according to captured documents [redacted] hope to eliminate Saigon's presence in some of the more remote areas of these provinces to get closer to population centers and food-producing areas.

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The upsurge in fighting together with government setbacks in the northern provinces, where a second district capital has been lost in less than two weeks, is causing the South Vietnamese high command some nervousness. Contingency plans already have been drawn to protect the capital region if the communist campaign proves too much for government forces already in the area.

South Vietnamese forces, however, appear capable of handling the stepped-up fighting. Despite some tactical setbacks and disruption of rural pacification efforts, the government retains firm control over the country's population centers and major highways.

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IRAN-IRAQ

The Shah appears determined that any Iraqi operations against the Kurds that spill over into Iran will be met with force.

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Two squadrons of F-4 Phantom fighters are at the base and presumably will be used to defend Iranian airspace against any violations by Iraqi aircraft attacking Kurdish targets near the border.

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ZAIRE-PORTUGAL-ANGOLA

Zairian President Mobutu reportedly will meet with Portuguese President Spinoia later this week to discuss the future of Angola. Mobutu has been a principal supporter of the liberation cause in Angola. He is, however, determined to ensure that the government of an independent Angola is headed by someone responsive to himself.

Portuguese negotiations with Angolan insurgents have been precluded by the rivalry between the two leading rebel groups. Lisbon probably regards Mobutu as its best hope for ending the impasse. Mobutu has been anxious for a meeting with Portuguese leaders, primarily to determine Lisbon's attitude toward the Zairian-based National Front for the Liberation of Angola and toward the future of Cabinda, an exclave of Angola that has oil deposits important to Zaire. Mobutu has been working behind the scenes to boost National Front leader Holden Roberto as the leader of future nationalist negotiations with Lisbon.

WEST GERMANY

Chancellor Helmut Schmidt indicated during a newspaper interview on August 14 that he would consider traveling to Peking sometime after his visit to the Soviet Union this autumn. An article by the newspaper's Peking correspondent on August 15 indicated that the visit, which has been under discussion for some time between West German and Chinese authorities, could come at the end of this year.

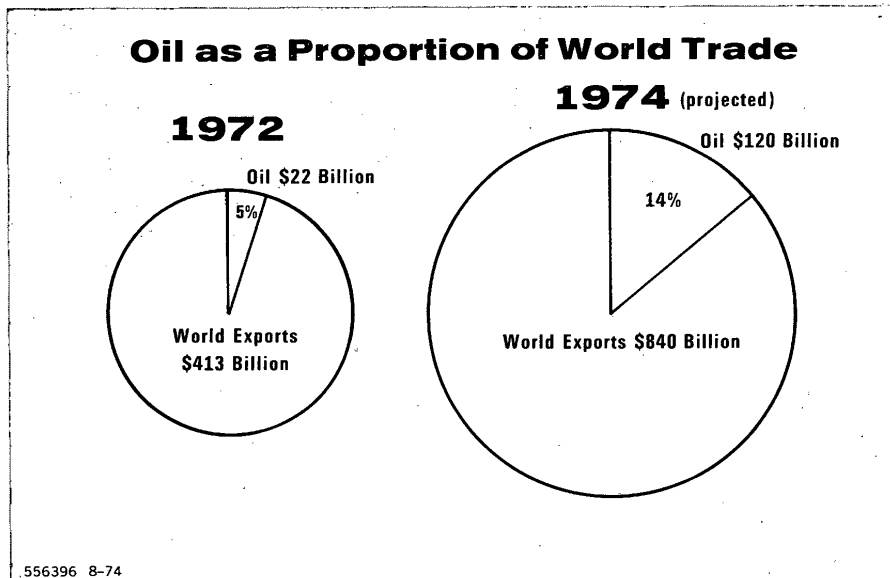
The Chinese have been disappointed with what they regard as Bonn's overriding interest in its relations with the USSR. On a number of occasions the Chinese have expressed the hope that high-ranking Bonn officials would visit China.

The Chinese have also invited the leaders of West German conservative opposition parties to visit China, and Christian Democratic Union Chairman Helmut Kohl will leave for Peking on September 2 for a ten-day stay.

Schmidt's intention to visit China will not sit well with Soviet leaders, who remain wary of Bonn's contacts with the Chinese. The Soviets are concerned that Schmidt may give less emphasis to detente than former chancellor Brandt did.

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THE INTERNATIONAL ECONOMIC OUTLOOK

The abrupt and massive increase in the price of oil has caused a shift in the world pattern of trade surpluses and deficits unprecedented in magnitude and rapidity. How to adjust to these new circumstances is the major international economic policy problem for the oil-importing countries. Without a high level of international cooperation, high oil prices threaten:

- to encourage excessively deflationary policies,
- to increase trade restrictions,
- to disrupt the world financial system, and
- as a combined result, to decrease economic growth and intensify some of the forces of inflation in the oil-importing countries.

Higher oil prices have already caused large increases in the prices of fertilizer and shortfalls in the production of fertilizer, thus aggravating yet another major international economic problem--high grain prices and uncertainty about the adequacy of food supplies in some countries.

Oil Prices, Production, and Consumption

From mid-1973 to mid-1974 the price of internationally traded oil increased approximately four-fold. This staggering rise has reduced the quantity of oil consumption worldwide. Since the production of members of the Organization of Petroleum Exporting Countries (OPEC) has recovered to approximately the pre-embargo level, world production now exceeds world consumption by some 2 million barrels per day (roughly 6 percent of total OPEC production). There is little unused storage capacity. Hence, there will be downward pressure on oil prices in the near future unless exporting countries reduce production.

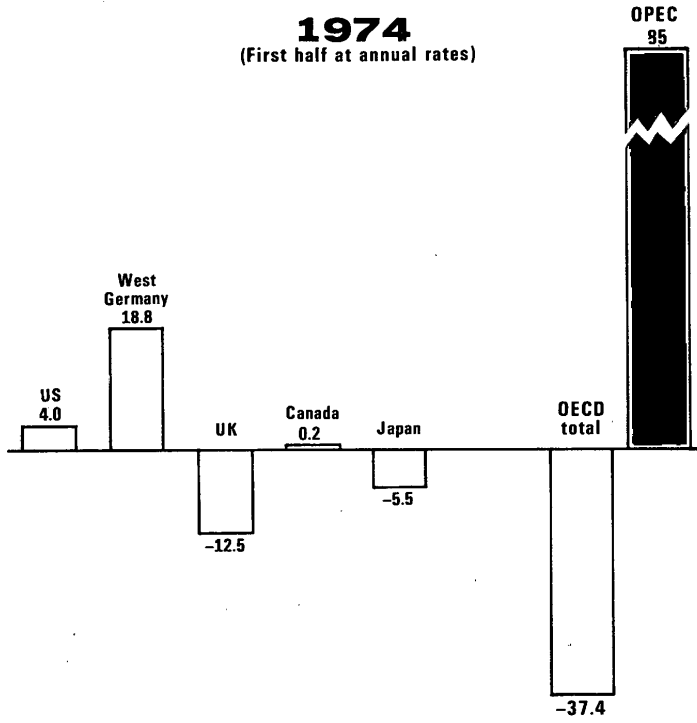
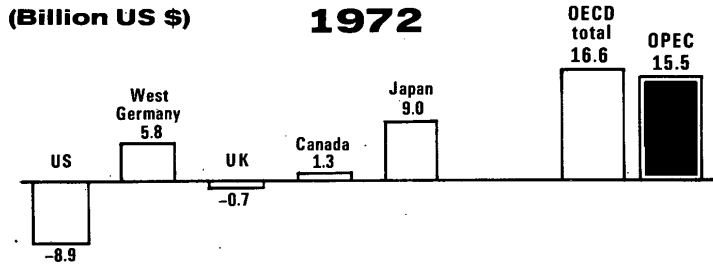
- A major reduction of oil prices over the short term would require a decision by Saudi Arabia to expand production significantly, but this step seems unlikely at the moment.

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Trade Balance of OPEC and Selected Industrial Countries



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--The possibility that the Saudis might consider such a move derives from the perception of key individuals, including King Faysal, that the current price of oil threatens the economic and political stability of the non-communist world. But the Saudis are reluctant to take such action, primarily because they want to avoid steps that would be opposed strongly by other Arab countries and other oil exporters.

Shifts in Trade Deficits and Surpluses

In 1972 the members of OPEC generated surplus revenues of about \$3 billion. The 1974 surplus is expected to be over \$65 billion. A large imbalance between the foreign revenues of the OPEC countries and their physical capability to absorb imports will continue until the end of this decade, if the current ratio between the prices of oil and of industrial imports does not change appreciably.

The major oil-importing countries have not been able to agree on how the total deficit should be distributed. A wide range of domestic and international economic factors affect this distribution, and it is difficult to forecast the net effects of these various factors on the international payment positions of individual countries.

During the first half of 1974 the balance-of-payments positions of the US, Germany, and Japan remained more favorable than would have been predicted on the basis of increased cost of oil imports alone. The balance-of-payments positions of the United Kingdom and Italy worsened by an amount greater than would have been expected on that basis.

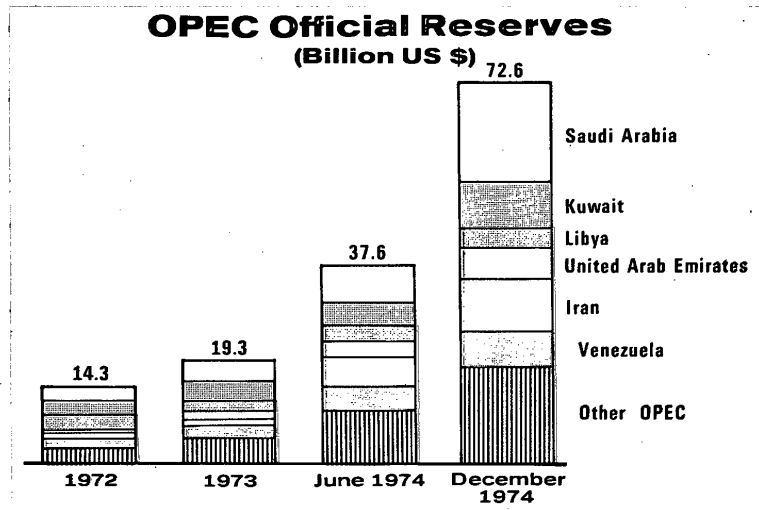
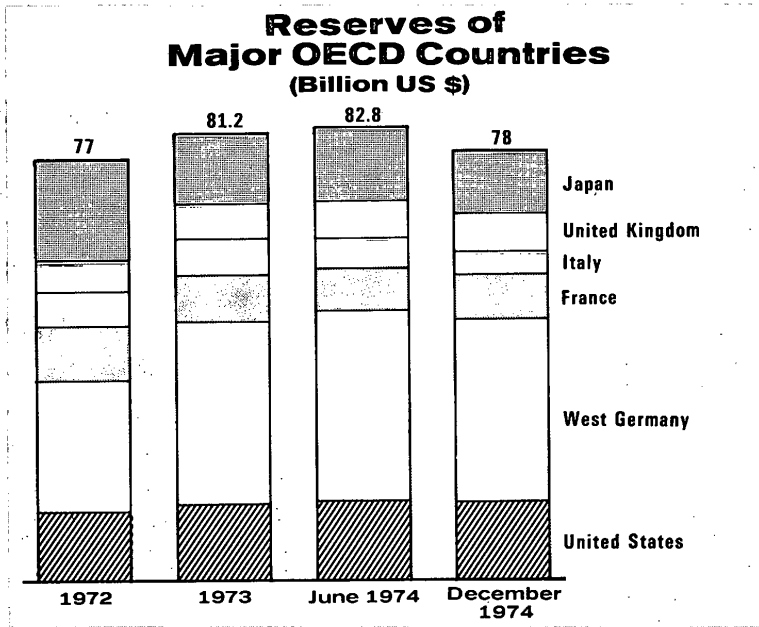
Financing Trade Deficits

The ultimate sources for financing the trade deficits of the oil-importing nations are the trade surpluses of the OPEC members, but the pattern of direct capital exports from OPEC states will not match the pattern of trade deficits of oil-importing countries. In the first half of 1974 the bulk of the surplus revenues of the oil-exporting countries were invested in short-term liabilities of banks operating in the Eurocurrency market.

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The flow of funds directly to the US was relatively small, though it is expected to increase dramatically in the second half of 1974. Most developed countries, with the notable exception of Italy, have readily been able to obtain sufficient private credit to finance their deficits. Italy and many less developed countries have had to go to public institutions such as the International Monetary Fund to supplement private credit.

There are several reasons to believe that the present "recycling" mechanism for oil exporters' surpluses will not be adequate in the future.

--The flow of funds to be recycled will increase markedly in the second half of 1974.

--There are doubts as to the stability of the Eurocurrency system itself. This concern has been intensified, for example, by the failure of Germany's Herstatt bank. That failure has concentrated the burden of recycling even more in the largest banking institutions.

--The pattern of trade deficits is unlikely to be matched by credit flows based on conventional standards of credit-worthiness. This mismatch may come from a government's short-run difficulties in achieving a domestic political consensus behind economic policies consistent with its balance-of-payments position (as in Italy). It may also come from longer run difficulties--for example, pessimistic expectations of economic growth and high debt-service burdens (as in India, Pakistan, and Bangladesh).

Rapid Inflation, Low Rates of Growth

The oil embargo and increase in oil prices have played a key role in accelerating rates of inflation worldwide. Although the cost of certain raw materials has now begun to fall, consumer prices in the major industrial nations are expected to continue to increase rapidly (roughly 10 to 20 percent annually) through at least the first half of 1975. Given the political difficulty of checking the substantial rises in wages that workers feel are needed to catch up with inflation, any future reduction in rates of inflation will be gradual.

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There is currently an anti-inflationary focus to domestic policy in most of the major developed countries. Recent predictions that the average growth rate of major countries would rise to 2.8 percent in the second half of 1974 and to 3.7 percent in the first half of 1975 thus appear to be highly optimistic.

World Supply of Grain

The low level of world stocks of grain and the effects of bad weather on the US harvest create uncertainty as to the near-term course of food prices. Soviet grain production in 1974 will be less than last year, but we expect the USSR to be able to satisfy domestic needs and export commitments without major purchases in the world market.

Grain imports by the Peoples Republic of China will probably increase, however, and bad weather will reduce the grain crop in India. Although a general shortage of grain (with the exception of corn) cannot be predicted at this time, world grain output in 1974 is not expected to be enough to build up stocks. Major problems of food supply continue in areas like Sahelian Africa (along the southern Sahara) and Bangladesh.

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