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| 243547 | PAPER | GLOBAL ECONOMIC PROPECTS, P.2 ONLY, PARTIAL | 1 | 6/18/1981 | B1 | B3 |
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Bullet Papers

# MACROECONOMICS

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  - -- To reassure Summit colleagues that the U.S. is sensitive to international implications of U.S. policy.
  - -- To develop understanding of U.S. economic objectives: vigorous growth, low inflation, minimal goverment interference.
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BULLET PAPER ON NORTH-SOUTH

-- We must recognize the serious problems faced by the developing countries and the importance of their development to our economic, humanitarian, political and security interests.

-- The restoration of growth, containment of inflation, and maintenance of open markets in our own countries are among the most important contributions we can make to developing countries.

-- We remain committed to supporting the development efforts of the LDCs and intend to honor our international aid commitments.

-- Our aid policies should support efforts to overcome the key development problems of food production, population growth and energy.

-- The developing countries need to make a greater effort to adopt rational economic policies and provide a favorable investment climate.

-- The US has doubts about the utility of global negotiations. We would like to hear the views of other Summit countries. We prefer to postpone any decision on global negotiations until after the Cancun Summit which should provide additional perspectives on the issue.

-- We need to work closely with the Ottawa Summit countries to assure the Cancun meeting is a constructive dialogue, but that is does not result in new commitments.



CONFIDENTIAL

GDS 6/19/87

BULLET PAPER ON ENERGY

-- The U.S. is concerned that increased European dependence on Soviet energy resources could offer the Soviets political leverage and weaken western security. European countries should at a minimum not take any decision hastily and should develop a safety net that will reduce their vulnerability to a Soviet cut-off.

-- The U.S. will work in the International Energy Agency to increase readiness to deal with oil supply interruptions. Summit countries should maintain large emergency oil reserves.

-- Faster development of their indigenous energy resources could make developing countries less politically and economically dependent on OPEC. The World Bank has proposed an expansion of its energy lending program, including a separate affiliate. The U.S. has officially indicated that it cannot support an affiliate but still has under study the more general question of expanded energy lending.

-- The U.S. will be a reliable supplier of coal. Port congestion is a short term problem which is being resolved by the private sector. The responsibility for increasing production and trade must be shared by the producing and importing countries. Foreign investment in the coal industry and related infrastructure is welcomed.

-- The U.S. wishes to enhance public confidence in nuclear power, restore our image as a reliable nuclear supplier and find realistic approaches to minimizing proliferation risks.



~~CONFIDENTIAL~~
(GDS 6/24/81)

BULLET PAPER ON TRADE

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BULLET PAPER ON TERRORISM

-- We have an opportunity in Ottawa to build upon the work of previous Summits.

-- The Bonn Anti-Hijacking Declaration in 1978, its reaffirmation at Tokyo in 1979 and the 1980 Venice condemnation of hostage taking and embassy seizures with agreement on mutual assistance were very important steps.

-- We must demonstrate our common commitment to combat terrorism and our willingness to cooperate and consult.

-- We should therefore take the opportunity to announce the suspension of air service with Afghanistan for its failure to bring the PIA hijackers to justice.



CONFIDENTIAL
6/19/87 (Quainton, Anthony C.E.)

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BULLET PAPER ON REFUGEES

--Refugees and displaced persons number 12-16 million, primarily in depressed and underdeveloped countries. Pakistan supports almost 2 million Afghan refugees.

--The Summit partners share a global interest in lessening the political tensions created by the mass migration of people, and supporting international relief efforts as an instrument of maintaining stability.

--The US supports the efforts of Canada and the FRG to examine the human rights and political causes of refugee flows, and seeks a common ground between the two initiatives.

--It is the obligation of those countries opposed to Soviet intervention in Afghanistan to aid Pakistan shelter Afghan refugees.

--The EEC and Japan should be encouraged to bear a greater share of the Pakistani relief effort, but without cost to the Indochinese relief effort.

--The willingness of ASEAN countries to provide first asylum to Indochinese refugees remains contingent upon tangible evidence from developed countries of continued commitment to provide relief and resettlement alternatives.

CONFIDENTIAL

GDS, 1/19/87

BULLET PAPER ON UN BUDGETS

-- UN assessed budgets are rising out of control (to $1.3 billion in 1980), and the Summit Governments pay 60% of the bills.

-- At a time when Governments are controlling their spending by cutting programs, international organizations are continuing low priority and/or obsolete programs while adding new programs sometimes of dubious value.

-- The failure of UN system organizations to recognize that they, too, are affected by economic realities and to act accordingly undermines their credibility and threatens the confidence the major donors have placed in them.

-- The United States is supportive of the important work performed by the UN system. But, since the resources are limited, they must be managed more wisely.

-- By eliminating the unnecessary, by terminating obsolete programs, and by adhering to a strict schedule of priorities and objectives, the UN system could actually improve its performance while maintaining the same level of required resources.

-- We believe the major donors must work together for a pause in the growth of UN system assessed budgets.

BULLET PAPER ON FUTURE SUMMIT

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Schedule/Agenda

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Communiques

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ECONOMIC BOOK

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# MACROECONOMICS

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-- Other Summit participants (France, Germany, Italy, uncertain about Canada) do not fully understand the program and are highly critical of the level and volatility of U.S. interest rates. They are alarmed by recent depreciation of their currencies and the resulting inflationary pressures, and the high level of interest rates, all of which hamper their desire to reduce unemployment.

-- Two specific proposals may be made to the U.S.:
- -- Reduce or defer the tax cuts, and go a year-at-a-time, thus lowering the forecast budget deficits.
- -- In coordination with Europe and Japan, intervene in foreign exchange markets.

-- Both are unacceptable.

# MACROECONOMICS -- TALKING POINTS

-- OUR PEOPLE ARE TIRED OF ECONOMIC POLICIES WHICH FAIL, OR WHICH SIMPLY REPLACE ONE ECONOMIC ILL WITH ANOTHER EQUALLY DISTASTEFUL MALADY. WE MUST EXERCISE LEADERSHIP -- BUT THAT LEADERSHIP, FOR THE UNITED STATES, DOES NOT MEAN AN EVER LARGER ROLE FOR THE GOVERNMENT.

-- THE OBJECTIVE OF MY ECONOMIC RECOVERY PROGRAM IS TO PUT THE U.S. ECONOMY BACK ON THE ROAD TO VIGOROUS, SUSTAINED AND NONINFLATIONARY GROWTH BY PROVIDING A STABLE AND UNFETTERED ENVIRONMENT IN WHICH INDIVIDUALS -- WORKERS, BUSINESSMEN, CONSUMERS, SAVERS, AND INVESTORS -- CAN CONFIDENTLY PLAN AND MAKE DECISIONS.

-- THE EMPHASIS IS ON LONG-RUN STABILITY, NOT "QUICK FIXES" OR FINE TUNING; ON THE PRIVATE SECTOR AND THE INDIVIDUAL, NOT GOVERNMENT; VIGOROUS GROWTH, NOT STAGNATION; AND ON LOW INFLATIONARY PRESSURES.

-- THE 4 COMPONENTS OF MY PROGRAM ARE EACH CRUCIAL, SINCE THEY MUST WORK TOGETHER TO ACHIEVE THE DESIRED RESULTS. EVEN SO, OUR ECONOMIC ILLS WILL NOT BE CURED QUICKLY -- THEY ARE CHRONIC, THE RESULT OF YEARS OF INAPPROPRIATE, SHORT-RUN POLICIES. WHAT IS NEEDED, HOWEVER, IS A COMBINATION OF BUDGETARY DISCIPLINE, INCENTIVE-PROMOTING TAX CUTS AND REGULATORY REFORM IN AN ENVIRONMENT OF STEADILY DECLINING GROWTH OF THE MONEY SUPPLY.

-- EVERY ELEMENT OF THE PROGRAM IS ANTI-INFLATIONARY AND, AT THE SAME TIME, EACH COMPONENT IS DESIGNED TO ESTABLISH CONDITIONS FOR VIGOROUS GROWTH IN THE PRIVATE SECTOR.

-- I KNOW YOU ARE CONCERNED BY THE HIGH LEVEL OF INTEREST RATES IN THE UNITED STATES -- SO AM I. AND I AM DOING EVERYTHING IN MY POWER TO ELIMINATE THE MAJOR FACTORS DRIVING RATES UP -- INFLATION, INFLATIONARY EXPECTATIONS AND A WIDESPREAD DOUBT THAT THE GOVERNMENT AND THE MONETARY AUTHORITIES CAN STICK IT OUT AND BEAT INFLATION.

-- AS YOU MAY KNOW, OUR HIGH LEVEL OF INTEREST RATES IS HURTING SOME KEY SECTORS OF OUR ECONOMY -- HOUSING, SAVINGS INSTITUTIONS, AND OUR AUTOMOBILE INDUSTRY.

-- I HAVE HEARD A GREAT DEAL OF REACTION FROM YOU, INDIVIDUALLY, AND IN THE PRESS, TO THE PROGRAM I HAVE PROPOSED. LET ME ASSURE YOU THAT WE DEVELOPED THIS PROGRAM BEARING IN MIND THE EFFECT WE HAVE ON YOUR ECONOMIES. I WELCOME EVERY OPPORTUNITY TO DISCUSS OUR PROGRAM WITH YOU -- AND HAVE ASKED MY ECONOMIC ADVISERS TO DO THE SAME.

-- IF WE ARE TO PROVIDE LEADERSHIP TO OUR CITIZENS AND TO OTHER NATIONS OF THE WORLD, WE MUST STRIVE TO SUPPORT EACH OTHER AND DEVELOP CONFIDENCE IN OUR ECONOMIC POLICY.

-- I BELIEVE THAT WE CAN ALL AGREE THAT CONCLUSIVE RESOLUTION OF THESE SUBSTANTIVE ECONOMIC ISSUES IS UNLIKELY. BUT BETTER UNDERSTANDING AND COMMUNICATION CAN HELP US TO DO OUR WORK.

CONTINGENCY POINTS

(The following is intended for use in addressing specific issues which may arise in the course of formal and informal discussions. The European Council (Heads of Government) will meet prior to the Ottawa Summit to try to agree on a common line. These talking points for responding to other countries' assertions may need to be revised in light of that meeting.)

1. Excessive reliance on control of money growth is causing unnecessarily high U.S. interest rates and downward pressures on foreign currencies, forcing others to adopt unduly restrictive domestic policies.

-- HIGH AND FLUCTUATING INTEREST RATES IN THE UNITED STATES ARE, OF COURSE, ONE FACTOR IN EXCHANGE MARKET DEVELOPMENTS AND CURRENT DOLLAR STRENGTH, BUT THEY ARE BY NO MEANS THE ONLY ONE. POLITICAL AND ECONOMIC DEVELOPMENTS IN EUROPE AND OTHER AREAS ARE AS IMPORTANT, IF NOT MORE SO.

-- I CAN ASSURE YOU, WE DO NOT WANT HIGH INTEREST RATES. WE ARE NOT USING INTEREST RATES AS A POLICY TOOL. HIGH INTEREST RATES ARE HARMFUL TO OUR ECONOMY, AS THEY ARE TO OTHERS BUT THEY ARE ONE OF THE SIDE-EFFECTS OF A LONG PERIOD OF INFLATION.

-- OUR AIM IS LOW INTEREST RATES AND INCREASED REAL SAVING. THE RECORD IN THE U.S. IS CLEAR: SLOWER MONEY GROWTH BRINGS LOWER INTEREST RATES, ESPECIALLY OVER THE LONGER RUN.

-- I BELIEVE THAT I UNDERSTAND THE POLITICAL PROBLEMS MANY OF YOU FACE FROM RECORD HIGH UNEMPLOYMENT. I AM STRUGGLING WITH SOME OF THE SAME PROBLEMS -- ESPECIALLY IN A FEW DEPRESSED INDUSTRIES AND REGIONS. BUT IF WE HAVE LEARNED ANYTHING FROM THE 1970s IT IS THAT WE MUST LICK INFLATION IF WE ARE TO RESTORE VIGOROUS

GROWTH. THAT TASK WILL TAKE TIME, COURAGE AND PERSISTENCE.

2. Tighten fiscal policy (e.g., defer the tax cuts) to ease the burden on monetary policy.

-- THE TAX CUTS ARE AN ESSENTIAL PART OF OUR EFFORT TO ENCOURAGE WORK, SAVING AND CAPITAL FORMATION -- THE UNDERPINNINGS OF ECONOMIC GROWTH.

-- THE TAX PACKAGE I HAVE PROPOSED WILL NOT ONLY INCREASE REAL PRODUCTION, HELPING TO REDUCE INFLATION, BUT IT WILL ALSO INCREASE THE POOL OF SAVINGS, TENDING TO PUSH DOWN INTEREST RATES. IN PARTICULAR, THE ACROSS-THE-BOARD CUTS IN PERSONAL TAX RATES WILL HAVE VERY DIFFERENT EFFECTS ON SPENDING AND SAVING DECISIONS THAN TRADITIONAL TAX CUTS FOCUSED ON LOWER INCOME GROUPS.

-- WE ARE COMMITTED TO ELIMINATING THE DEFICIT BY 1984. MEANWHILE, WE ARE REDUCING THE DEFICIT BUT CANNOT OVERCOME A LEGACY OF PAST BUDGET MISMANAGEMENT -- DISTORTIONS AND DISINCENTIVES IN A TAX STRUCTURE THAT DISCOURAGES ENTERPRISE, AND EXCESSIVE GROWTH IN GOVERNMENT SPENDING.

-- DELAYING ACTION ON THESE LARGER ISSUES FOR THE SAKE OF BALANCING THE BUDGET A YEAR OR TWO EARLIER WOULD BE SHORT-SIGHTED.

-- A SMALL GROUP OF MY SENIOR ADVISERS IS CAREFULLY MONITORING THE DEFICIT AS EXPENDITURE AND REVENUE TRENDS DEVELOP. ANY TENDENCY FOR THE DEFICIT TO RISE ABOVE OUR GUIDELINES IS IMMEDIATELY COUNTERED

BY NEW PROPOSALS TO CUT SPENDING. OUR RESOLVE TO CUT THE DEFICIT IS STRONG.

3. Intervene in the exchange markets to hold down the dollar and insulate foreign economies from the effects of high U.S. interest rates.

-- OUR APPROACH TOWARD THE EXCHANGE MARKETS IS TO ALLOW MARKETS TO OPERATE FREELY AND EFFICIENTLY, IN AN ENVIRONMENT OF STABLE DOMESTIC PRICES AND VIGOROUS ECONOMIC GROWTH. OUR PROGRAM IS DESIGNED TO PROVIDE A LASTING BASIS FOR A STRONG AND STABLE DOLLAR.

-- THE EXCHANGE MARKETS FOR MAJOR CURRENCIES ARE BROAD AND EFFICIENT. GOVERNMENT INTERVENTION CANNOT FUNDAMENTALLY AFFECT THEM; ATTEMPTS TO RESIST FUNDAMENTAL TRENDS ARE CERTAIN TO BE COUNTERPRODUCTIVE.

-- WE QUESTION WHETHER INTERVENTION IS NECESSARILY STABILIZING, EVEN IN THE SHORT RUN. ATTEMPTS TO HOLD RATES AGAINST MARKET FORCES COMBINED WITH UNCERTAINTY ABOUT GOVERNMENT INTERVENTION, MAY WELL INDUCE --RATHER THAN PREVENT -- DESTABILIZING SPECULATION.

-- U.S. INTERVENTION TO HOLD THE DOLLAR DOWN -- INJECTING DOLLARS INTO THE MARKET -- WOULD CONFLICT WITH OUR EFFORT TO REDUCE MONEY GROWTH.

-- MORE FUNDAMENTALLY, WE DO NOT BELIEVE INTERVENTION CAN EFFECTIVELY SHIELD ECONOMIES AND POLICYMAKERS FROM THE NEED IN THE LONG RUN TO TAKE APPROPRIATE DOMESTIC ECONOMIC MEASURES.

-- WE RECOGNIZE THAT EXCHANGE RATE BEHAVIOR IS A PROPER SUBJECT FOR INTERNATIONAL CONCERN AND DISCUSSION. IN THIS SPIRIT, WE REMAIN PREPARED TO INTERVENE IF CONDITIONS OF SERIOUS MARKET DISORDER ARISE. WE ARE NOT, HOWEVER, PREPARED TO ENGAGE IN REGULAR INTERVENTION OR TO TRY TO MANAGE EXCHANGE RATES.

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MACROECONOMIC BRIEFER

## Background

As has been the case for the past four Summits, the Chairman of the U. S. Council of Economic Advisers has prepared the basic assessment document for the macroeconomic discussions. The paper, generally supported by others in the preparatory discussions, concluded that countries need a more medium-term orientation of policies, less "fine-tuning," and greater emphasis on free markets. All agreed that strong anti-inflation policies must be maintained. More recently, however, the French have argued that reducing employment should be a co-equal policy objective -- and led the fight on this issue at the June OECD Ministerial.

## U. S. Objectives

The size and traditional role of the U. S. in the world economic system ensures that the U. S. economy is a top priority concern of the other Summit participants. It is essential to establish confidence in U. S. economic management. To this end, the U. S. objectives are:

-- To present and explain the Economic Recovery Program: its objectives and the interrelated nature of its four components -- reductions in the growth of government spending, tax relief, regulatory reform and monetary restraint.

-- To demonstrate that the international implications of the Program have been taken into account, and that the Administration is sensitive to the problems that adjustment in the U. S. causes others.

-- To achieve understanding among the seven leaders that the U. S. program will also generate substantial international benefits. The emphasis on less government and more reliance on the private sector, it might be suggested, could be followed propitiously by other Summit countries.

-- To underscore the importance of fighting inflation as the number one common priority, and to strengthen the understanding that lower rates of inflation are a precondition for sustained growth in employment and productivity.

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## Issues

Other Summit leaders have become increasingly critical of U. S. macroeconomic policy, since they view their economies to be hostage to our policies. There is one overriding issue -- U. S. interest rates -- yet a proper understanding of the Administration's Economic Recovery Program may be the underlying question.

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ORIGINAL CL BY James. Burnham
☒ DECL ☐ REVW ON 6/19/87
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REASON

The Europeans and the Japanese see the Economic Recovery Program as a combination of tight money and easy fiscal policy. Thus, they expect U. S. interest rates to be high and volatile for an extended period.

-- They attribute the strength of the dollar to our high interest rates, and complain that imported inflation and the lost purchasing power of their currencies are delaying their own economic recovery, making unemployment painfully high.

-- The most pessimistic foreigners evoke the specter of high U. S. interest rates driving the rest o the world into a prolonged recession.

The basic foreign criticism is that the Economic Recovery Program is placing the entire burden of fighting inflation on monetary policy.

-- Tax relief is judged to be inflationary (they take a Keynesian view of the tax cuts).

-- The operating procedures of the Fed are considered by many to be unnecessarily destabilizing in terms of interest rates, and thus in foreign exchange markets.

-- U. S. inflationary momentum is expected to take a a long time to dissipate, causing a collision between rising demand for money and more slowly growing supply.

Other Leaders' Objectives and Views

The other Summit participants will applaud the objectives of our Program but will strongly challenge specifics and international side effects.

-- In Germany, U. S. policies are a convenient target to deflect criticism of Schmidt's policies. Schmidt faces growing pressure from the left to adopt expansionary policies to reduce unemployment. The Bundesbank, however wants to reduce inflation. There are strong indications that it supports U.S. monetary restraint.

-- The French are concerned because a strong dollar and U. S. anti-inflation policies conflict with Mitterand's desire to increase social transfers, raise the minimum wage, and nationalize key industries.

-- The British publicly support our policies, partly since they resemble Mrs. Thatcher's efforts. But they fear their recovery will be thwarted by slow European growth and high interest rates.

-- The Italians complain that their exchange rate depreciation is worsening their already large external deficits and high inflation. But they are unlikely to likely ease domestic policies in any event.

-- The Canadian dollar has remained stable. Only recently have the Canadians begun to criticize U. S. interest rates focusing on the effects on LDC borrowing costs.

-- The Japanese have reduced interest rates as ours rose. Recently, they too have stated that a falling yen will worsen their inflation performance.

Our partners' concerns about interest rates and the dollar's strength are understandable. However, the strength of the dollar has also been influenced by a strong U. S. balance of payments, growing market confidence in the U. S. commitment to anti-inflation policies (and skepticism about European commitments), and worry over political unrest in Europe.

Two basic recommendations have emerged from other Summit participants:

-- Tighten U. S. fiscal policy (postpone the tax cuts) to reduce financial market pressures and thus lower interest rates; or,

-- Cooperative foreign exchange market intervention to prevent unwanted depreciation of European currencies (a recommendation spear-headed by the French).

None of the other Summit countries want the U. S. to abandon its anti-inflation effort. They all want the U. S. to succeed, and recognize the importance of a strong dollar. But they would especially like closer cooperation on exchange rate policies. They may say that we are following an anti-intervention policy that exposes their currencies to disorderly exchange markets and sizeable rate movements.

-- The other Summit nations do not fully appreciate the severe pains we are feeling in key domestic industries affected by high interest rates -- automobiles, homebuilding, and the thrifts.

-- The Economic Recovery Program is designed to do exactly what they want, to lower U. S. inflation and interest rates while promoting a strong domestic economy.

-- The differences arise primarily from varying estimates of the chances that the program will work, and how soon.

-- Conclusive resolution of these macro issues is unlikely, but better understanding and communication can calm the rhetoric.

MACROECONOMICS

Drafted - CEA: MCasse/JBurnham

Clearances -

Treasury: B. Sprinkel
Commerce: J. Thompson
State/EB: R. Gold

6/19/81

## The Economic Recovery Program

The objective of the Economic Recovery Program is to put the U. S. economy back on the road to vigorous, sustained, noninflationary growth by providing a stable and unfettered environment in which individuals can confidently plan and make their own decisions. The Program consists of four interdependent, mutually supporting parts:

### Slowing the Growth in Government Spending

A central feature of the President's proposals is a dramatic slowing in the growth of Federal budget outlays.

-- By 1984, Federal budget outlays, as a percent of GNP, are expected to decline by 3 percentage points.

-- Budget priorities are shifted substantially. While maintaining the Federal government's support for "safety net" programs, increased importance is being given to national defense.

### Tax Relief

The tax proposals are designed to: (1) limit tax revenue as a percent of GNP to 20 percent; (2) provide incentives for increased production in the private sector; (3) stimulate greater saving and investment; and (4) promote innovation and productivity growth.

The proposals for tax reduction include an across-the-board cut in marginal tax rates for individuals of 5 percent on October 1, 1981, followed by additional 10 percent cuts on July 1, 1982 and July 1, 1982.

For businesses, the Administration has proposed its Accelerated Cost Recovery System which will accelerate write-offs for depreciation of machinery, equipment,and structures.

### Monetary Restraint

The Administration's economic scenario assumes a steady reduction in the growth of the monetary aggregates such that monetary growth rates would be reduced by half between 1980 and 1986. This assumption is consistent with Federal Reserve policies.

### Regulatory Reform

The Administration's on-going regulatory relief effort involves review of all major existing and proposed regulations, especially those that impose large costs on the economy. To date, the burden of complying with federal regulation has been reduced by $18 billion.

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## Global Economic Prospects

Global economic prospects appear much brighter than just a few months ago because of the current "mini-glut" of oil and the consequent softening of oil prices. As always, US economic performance will play a key role in determining the overall outlook. Other industrial countries are still concerned about high US interest rates. To hold down capital outflows they feel compelled to keep their own rates higher, impeding their economic recoveries. Also the recent appreciation of the dollar has raised the price they pay for oil imports.

Growth in the industrial countries as a group should turn up during the second half of this year and gain further momentum in 1982; the OECD'S 1981 GNP growth rate of about 1.5 percent should double next year. Among the major countries, Japan has the best outlook for 1981, combining good growth and relatively low inflation with a sharp improvement in the balance of payments.

Progress against inflation also will become more evident due to the recent softening of oil prices and the growing impact of restrictive monetary and fiscal policies. This is particularly true in the UK where inflation will fall by more than one-third this year, to 11 percent. For the OECD, inflation should almost drop out of the double-digit range, and further slowing is likely next year. The Big Seven also will be the major beneficiaries of the substantial reduction in the OPEC current account surplus this year. Japan and the United States will probably see the biggest improvement.

Unemployment now appears an increasingly intractable problem and is likely to draw more attention in coming years. In many West European countries the number of jobless has doubled or tripled since 1973 and is still rising; unemployment rates in France, Italy and the UK equal or exceed that in the US. Nor is there much hope of rapid improvement because (1) economic growth is likely to remain sluggish by 1960s standards; and (2) in most countries relatively few people are reaching retirement age, while unusually large numbers of youth are reaching working age.

Prospects for the developing countries are unfortunately less bright -- particularly on the balance-of-payments front. Because of soaring interest rates and high oil prices, the non-OPEC LDCs will see their already large current account deficit widen in 1981 by $5-10 billion, with little improvement expected next year. The number of countries seeking debt relief and/or going into arrears surely will rise. Growing payments problems also will constrain economic growth in many countries, making 1981 another lackluster year for the non-OPEC LDCs as a group. They will, however, make some progress against inflation.

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## ECONOMIC OUTLOOK IN OTHER SUMMIT COUNTRIES

As our Summit partners come to Ottawa, the current economic slump will probably be bottoming out. Recovery in their economies will likely be slower than in 1975-76; stockbuilding and investment did not drop as much and, therefore, will not provide as much of an impetus to recovery. However, the recent decline in oil prices has improved the outlook.

Japan should outpace the other Summit nations, growing over 4 percent again this year. Japanese exports will continue to provide a major lift to the economy, albeit much less than in 1980. Lower interest rates and inflation, however, should boost private domestic demand, especially in second-half 1981.

West Germany's recession may have bottomed out early this year, much to the relief of Chancellor Schmidt who has been under strong domestic pressure, in part, because of the economic slowdown. Much of the strength will come from exports; orders are already up sharply. High interest rates, however, will continue to constrain domestic demand until 1982.

For France, recovery is likely in second-half 1981. Consumption and exports have revived but investment remains weak. Mitterrand's decision to raise the minimum wage, pensions, and other transfer payments will boost consumption and inflation.

Britain's economic outlook remains bleak; real GNP will decline for a second straight year while rising unemployment will become an increasingly serious political problem. Recent indicators suggest a turning point is at hand. Nonetheless, consumption will remain weak through yearend, and an investment upturn is unlikely before 1982.

In Italy, recent monetary tightness will probably limit economic gains this year. Investment -- a major factor behind the rapid growth of the past two years -- is unlikely to rise in 1981. However, exports should provide a lift in the second half because of the lira's depreciation against the dollar.

Canada is expected to grow around 3 percent this year after basically no increase in 1980. Although growth probably slowed in the second quarter, recovery has likely resumed with a pickup in net exports, stockbuilding, and housing providing much of the impetus.

Big Six inflation and current account balances are expected to improve this year. The deficit will narrow by about $20 billion with much of the improvement in Japan. Inflation will be lower in all the Summit countries except Canada and possibly West Germany. Japan and West Germany will have the lowest inflation -- around 6 percent -- as a result of generally restrictive macroeconomic policies and moderate wage demands.





19 June 1981

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## International Monetary Developments
## Background

Major foreign countries generally have announced restrictive monetary policies. But some appear to be less successful this year than they were in 1980, in holding to their monetary growth targets. Short-term interest rates have risen considerably in Canada and continental Europe since the beginning of the year, mostly parallelling higher U.S. rates; interest rates have eased in Japan and the U.K. The U.S. dollar has been very strong in foreign exchange markets.

Monetary Policies. Major foreign countries were generally successful in slowing the growth rate of their targeted money supplies during 1980, with the notable exception of the U.K. Targets for monetary aggregates in 1981 are generally more restrictive than last year. Canada, France, Germany and the U.K. set explicit target growth rates for monetary aggregates, but they place different degrees of emphasis on hitting targets. Japan publishes a "projected" growth rate one quarter ahead, which by virtue of its publicity, serves as a quasi-target. Italy does not target monetary aggregates, relying instead on quantitative credit controls. In France and the UK monetary growth is considerably faster than desired so far this year; Japan's growth is above target, German growth is right on target, and Canadian money supply is growing considerably slower than desired.

Interest Rates. Short-term interest rates eased during the second half of 1980 in most major foreign countries, partly reflecting soft domestic loan demand, declining inflation rates and some easing of inflation expectations. However, this easing trend reversed during the first quarter of 1981 in Germany, France and Italy. By mid-June interest rates had risen significantly in Canada, France, and Italy; in the UK, Germany and Japan they held firm at first quarter levels.

Over the past year differences between U.S. and foreign interest rates have changed dramatically. In June 1980, U.S. interest rates were the lowest among Summit participants. This June U.S. interest rates were among the highest. This switch has been a major factor increasing the relative attractiveness of U.S. assets (thus strengthening the dollar).

Exchange rates. The U.S. dollar has been very strong in foreign exchange markets during 1981. On a trade weighted basis, against other industrial countries, the dollar has risen by 9 percent. Against individual summit participants the dollar has appreciated: 26 percent against the Italian lira; 13 percent against the French franc; 20 percent against the German mark; 19 percent against the UK pound; 11 percent against the Japanese yen; and 1 percent against the Canadian dollar.

Over time these exchange rate movements will tend to reduce the large balance of payments deficits of European countries as their exports become more attractive and imports more expensive. The reduced imbalances will tend to ease exchange market pressures on their currencies.

# International Monetary Developments

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## Macroeconomics



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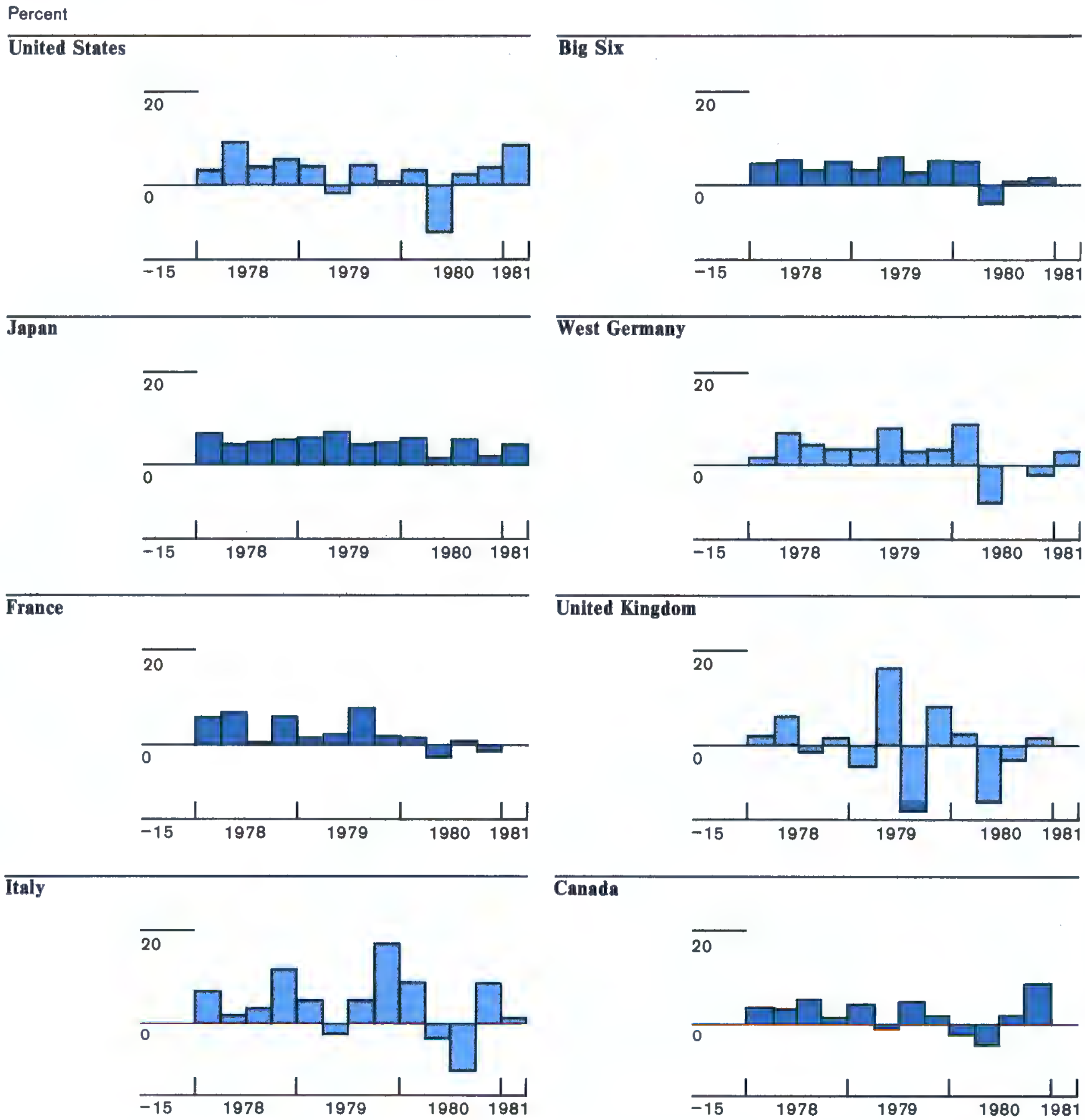
## Big Seven: Real Gross National Product[a]




[a]Percent change from previous quarter, seasonally adjusted at an annual rate.

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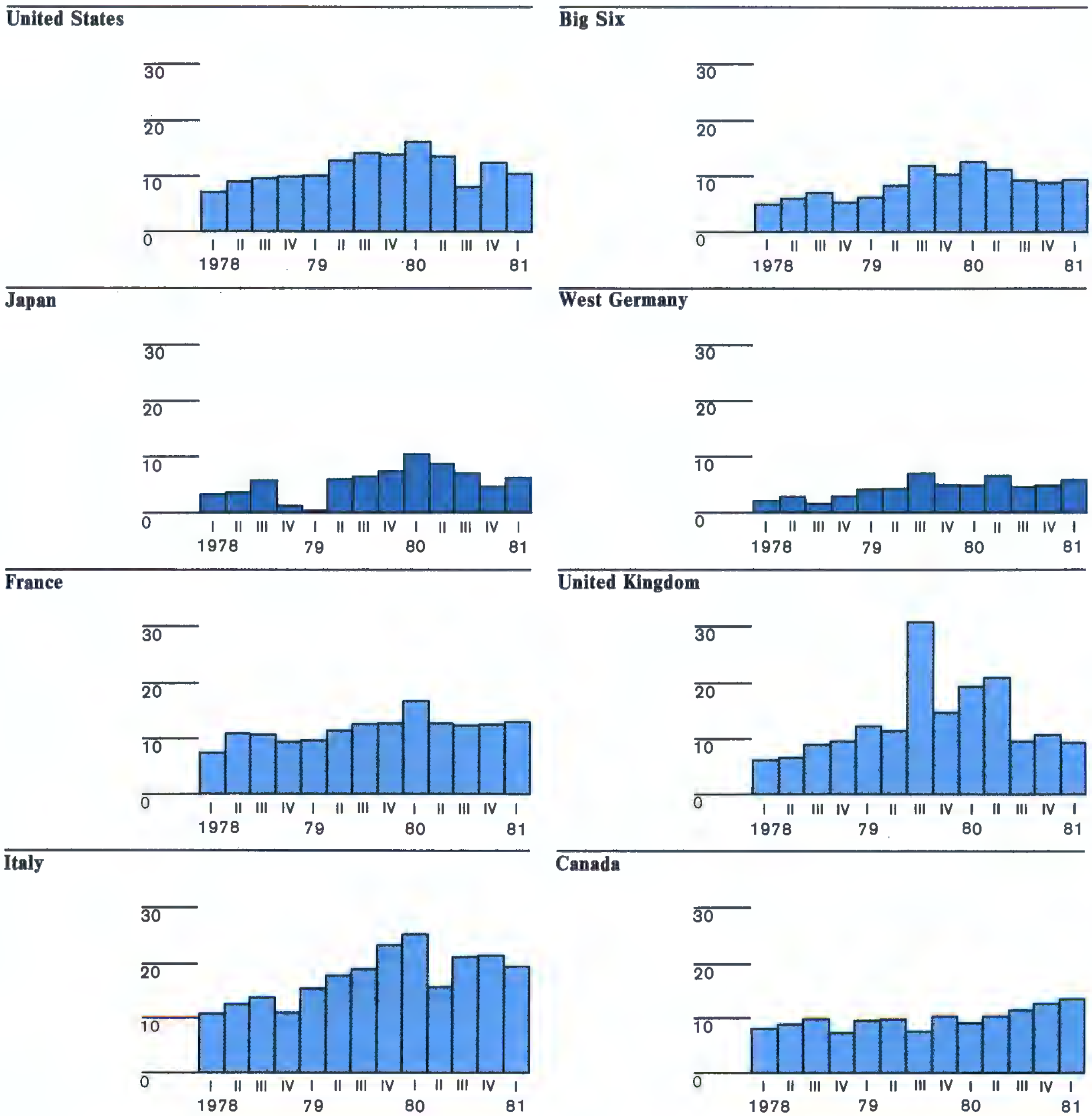
## Big Seven: Inflation[a]




[a]Quarterly consumer price data, seasonally adjusted at annual rates.

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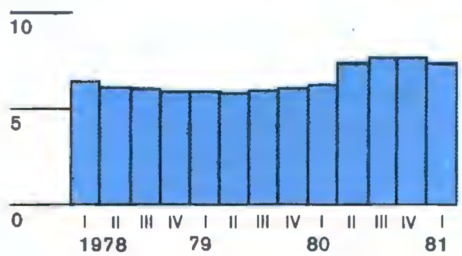
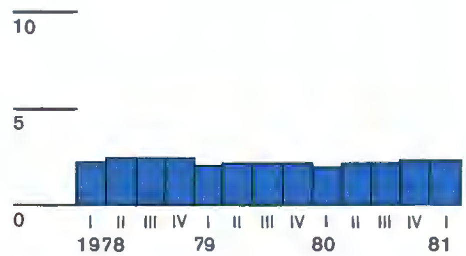
## Big Seven: Unemployment[a]

Percent

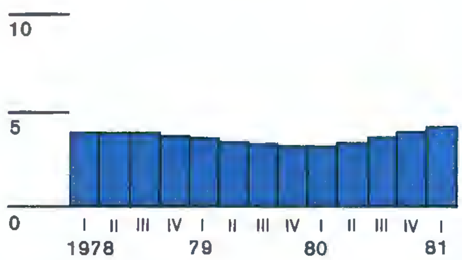
**United States**



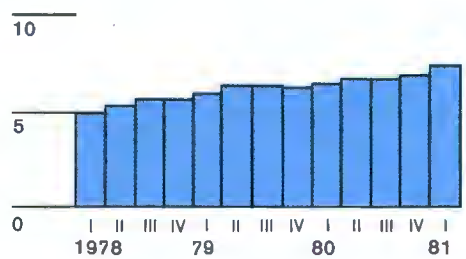

**Japan**



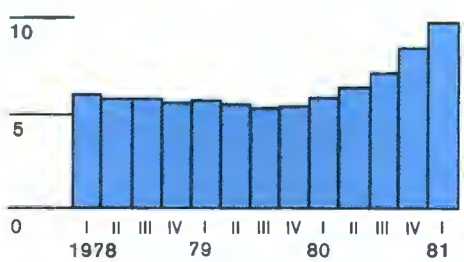

**West Germany**



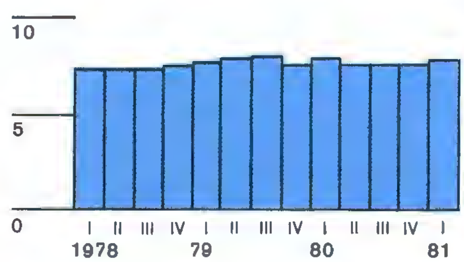

**France**



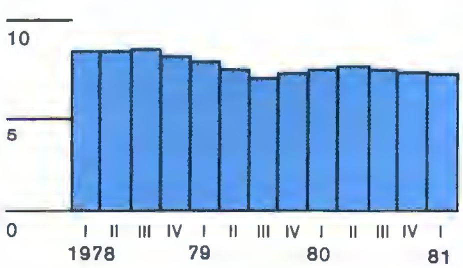

**United Kingdom**




**Italy**




**Canada**




[a] Seasonally adjusted.

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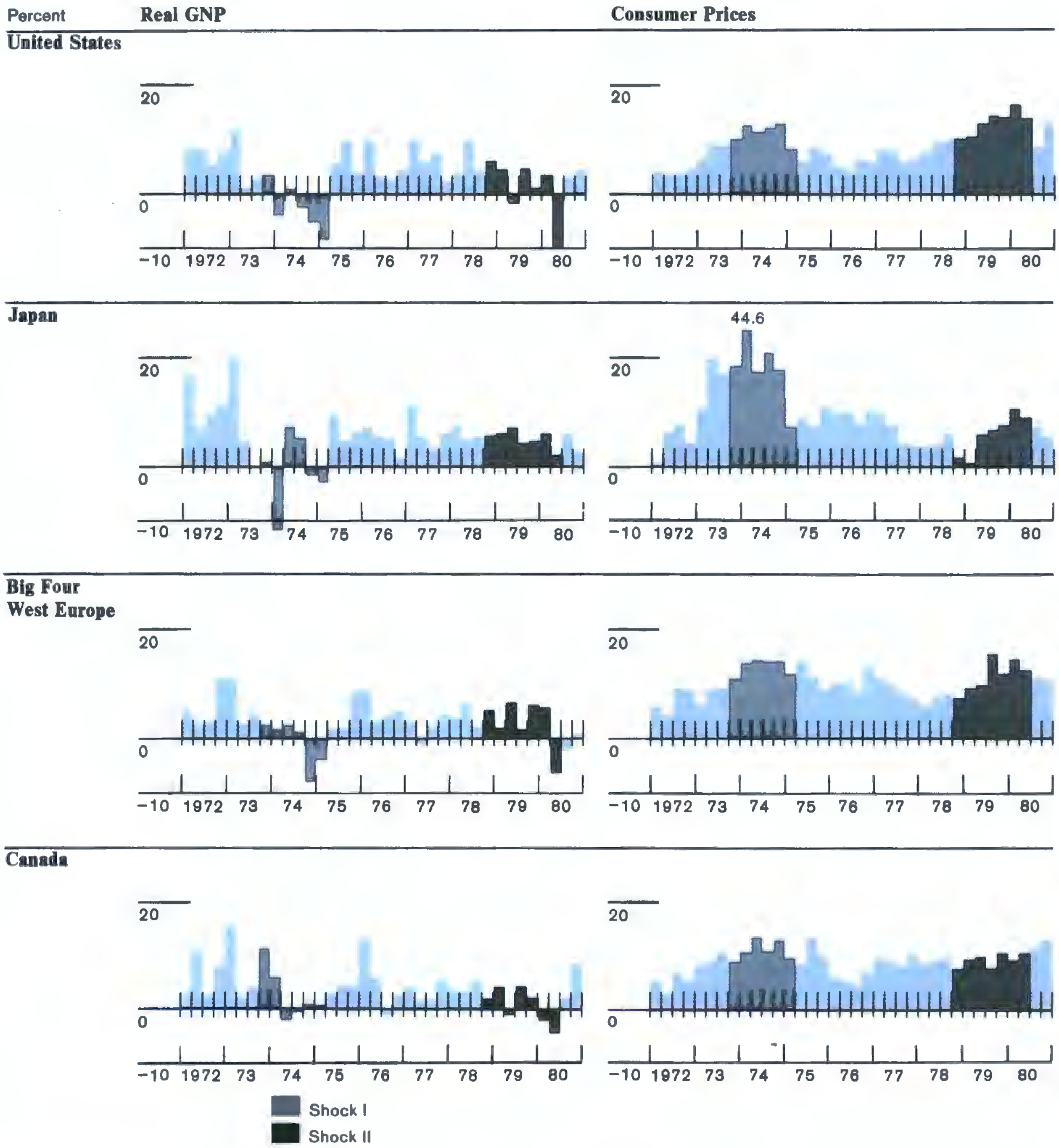
## Big Seven: Comparative Real GNP and Consumer Price Trends During Oil Shocks I and II[a]




[a]Percent change from previous quarter, seasonally adjusted at an annual rate.

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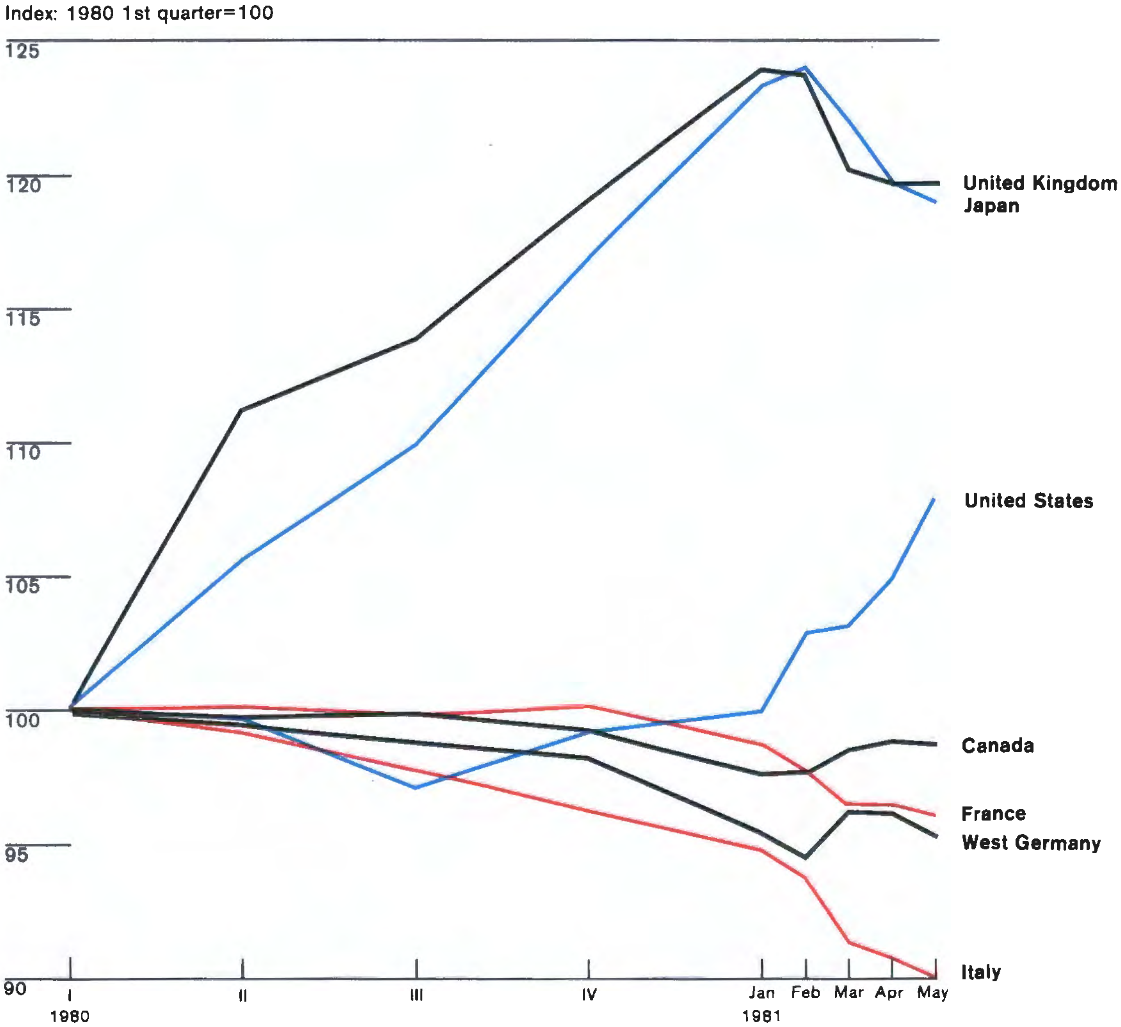
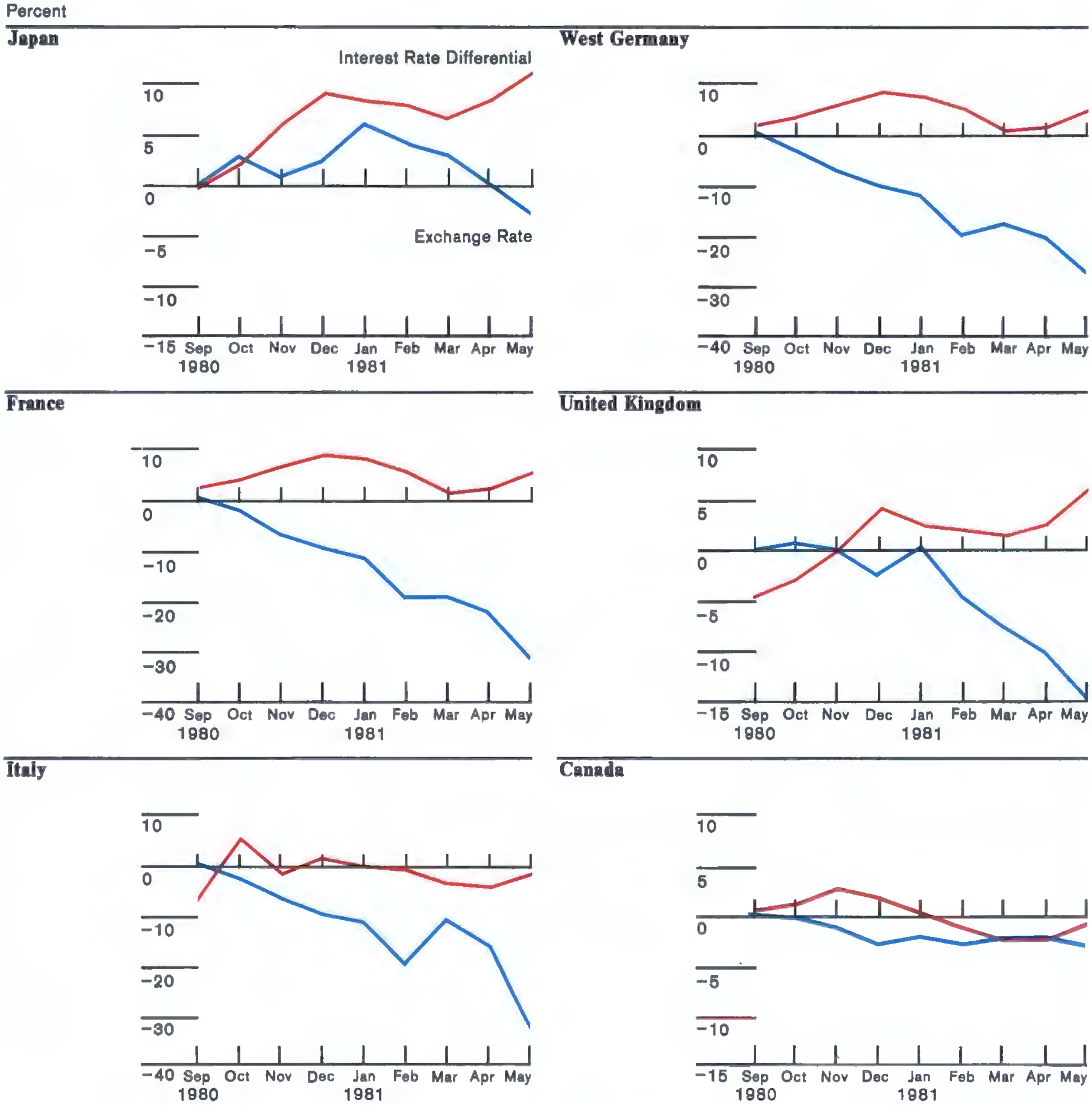
## Big Seven: Trade-Weighted Exchange Rates




[a]Each line represents a currency's trade-weighted average appreciation or depreciation against other major currencies.

Unclassified

## United States-Big Six: Comparative Interest- and Exchange-Rate Performance[a]




[a]These exchange rate movements below the origin reflect a depreciation of these currencies against the dollar.
Note change in scale.

**Unclassified**