PO-CH/NL/0093 PT B

Part. B:

SECRET

(Circulate under cover and notify REGISTRY of movement)

Begins: 22/9/87.
Ends: 28/9/87.

PO -CH /NL/0093

PART B

Chancellor's (Lawson) Papers:

GROUP OF FIVE SEVEN AND TEN MEETINGS WASHINGTON SEPTEMBER 1987

Disposal Directions: 25 Years

1/8/95.

PO -CH /NL/0093
PART B

Tables & Charts.

ds22

FROM: D SAVAGE
DATE: 22 September 1987

CHANCELLOR

cc: Sir T Burns
Mr Culpin
Mr Matthews

IMF MEETINGS

I attach a package of tables and charts similar to those provided for the IMF meetings in April.

DS.

D SAVAGE

TABLES AND CHARTS

1. The tables show for each of the Group-of-Seven countries:

A. Nominal income growth
B. Real GNP/GDP growth
C. Inflation GNP/GDP deflator
D. Current account balances
E. General government financial balances
F. Budget deficits - projections by national governments
G. Interest rates
H. Exchange rate movements since February 1985 (dollar peak)
I. Effective exchange rates
J. Dollar exchange rates
K. Sterling exchange rates
L. Trade and exchange rates of Asian NICs.

Tables A to E show the IMF's World Economic Outlook forecasts.

2. The charts illustrate movements over the last ten years in:

M. Effective exchange rate indices
N. Dollar exchange rates
O. Sterling exchange rates
P. Yen-D-mark exchange rate and real effective dollar.

3/006

A

NOMINAL GDP

NOMINAL INCOME GROWTH (in per cent)

	1985	1986	1987	1988	1989	1990
<u>IMF forecasts</u>						
US	6½	5	5½	6½	6½	6½
Japan	6	4½	4	5	5	5
Germany	5	5½	4	4½	4½	5
France	7½	7½	5	5	5	5
UK	9½	6½	8	7	6½	6½
Italy	11½	10½	8	7½	7½	7
Canada	7½	6½	7	6½	6½	6½
G7	6½	6	5½	6	6	6
<u>UK forecast</u>						
UK - MTFS (published FY figures in brackets)			7 (7½)	6½ (6½)		

Notes:

1. World Economic Outlook forecasts.
2. Money GDP at market prices.

B

REAL GNP/GDP GROWTH (in per cent)

	1985	1986	1987	1988	1989	1990
<u>IMF forecasts</u>						
US	3.0	2.9	2.4	2.7	2.9	2.9
Japan	4.7	2.5	3.2	3.4	3.5	3.5
Germany	2.5	2.4	1.5	2.3	2.1	2.6
France	1.7	2.1	1.5	1.8	2.7	2.7
UK	3.4	3.0	3.3	2.2	2.3	2.3
Italy	2.7	2.7	2.5	2.4	2.5	2.5
Canada	4.3	3.3	2.8	2.9	3.0	3.0
G7	3.2	2.8	2.5	2.7	2.9	2.9
<u>UK forecast</u>						
UK - FSBR			3.0	2½		

Notes:

1. World Economic Outlook forecasts.
2. Fund figures for UK are average measure of GDP at market prices.

Real GDP

C

INFLATION

	1985	1986	1987	1988	1989	1990
IMF forecasts						
US	3.2	2.6	3.3	3.8	3.6	3.4
Japan	1.5	1.8	0.6	1.7	1.5	1.5
Germany	2.2	3.1	2.4	2.2	2.5	2.5
France	5.7	4.7	3.4	3.0	2.5	2.5
UK	6.0	3.5	4.5	4.8	4.2	4.0
Italy	8.8	8.0	5.3	5.3	5.0	4.5
Canada	3.2	3.0	4.2	3.5	3.3	3.3
G7	3.5	3.0	2.9	3.3	3.1	2.9
UK forecast						
UK - FSBR			4	4		

GDP DEFLATORS

Notes:

1. World Economic Outlook forecasts.
2. GNP/GDP deflators.

D

CURRENT ACCOUNT ($ billion) % of GDP in brackets

	1986	1987	1988	1989	1990
<u>IMF forecasts</u>					
US	-141(-3½)	-148(-3½)	-139(-3)	-142(-3)	-146(-2½)
Japan	86 (4½)	85 (3½)	83 (3)	86 (3)	86 (3)
Germany	35 (4)	37 (3½)	27 (2½)	30 (2½)	28 (2)
France	3 (½)	2 (½)	- (-)	- -	1 (-)
UK	- -	- -	-2 (-½)	- 3 (-½)	-3 (-½)
Italy	4 (1)	- 1 (-)	-3 (-½)	-4 (-½)	-6 (-½)
Canada	-7 (-2)	-8 (-2)	-9 (-2)	-8 (-2)	-8 (-1½)
G7	-20 (-½)	-31 (-½)	-41 (-½)	-41 (-½)	-49 (-½)
<u>UK forecasts</u>					
UK - FSBR				-4 (-½)	

Note:

1. World Economic Outlook forecast.

CURRENT ACCOUNTS

E

GENERAL GOVERNMENT FINANCIAL BALANCES

IMF forecasts

	1985	1986	1987	1988	1989	1990
US	-3.3	-3.5	-2.3	-2.4	-2.2	-2.0
Japan	-0.8	-0.6	-1.2	-1.6	-1.6	-1.5
Germany	-1.1	-1.2	-1.5	-2.0	n.a	n.a.
France	-2.9	-2.9	-2.6	-2.1	-2.1	-2.0
UK	-2.6	-2.8	-2.6	-2.5	-2.4	-2.2
Italy	-12.2	-11.2	-10.3	-9.8	-9.2	-8.7
Canada	-7.0	-5.5	-4.6	-4.2	-3.8	-3.4
G7	-3.3	-3.3	-2.6	-2.7	-2.7	-2.6

UK forecasts

UK - latest HMT view

GOVT DEFICI

Notes:

1. World Economic Outlook forecasts
2. Percentages of GDP/GNP.

F

PROJECTIONS OF BUDGET DEFICITS*

		Central Government deficit/ borrowing**			General Government Fiscal Deficit***	
		Latest Government Estimates		IMF Estimates	Government Estimates	IMF Estimates
		National Currencies	% of GDP/GNP			
United States	1987	$158 bn	3.6	3.7	2.6	2.3
	1988	$123 bn	2.6	3.7	1.7	2.4
Japan	1987	Y11½ bn	3.4	4.1	n.a	1.2
	1988	n.a	n.a	4.6	n.a	1.6
Germany	1987	DM29 bn	1.4	1.3	2.4	2.4
	1988	DM29 bn	1.4	1.5	2.6	2.9
France	1987	FFr129 bn	2.5	2.5	2.8	2.6
	1988	FFr115 bn	2.1	2.1	2.3	2.1
UK	1987	n.a	n.a	n.a	1.0	n.a
	1988	n.a	n.a	n.a	1.0	n.a

Notes

* Except for Germany and France, figures are for financial years (Oct. to Sept. for US, and Apr. to Mar. for Japan and the UK).

** Definitions vary considerably. Figures for Germany and France exclude social security funds. Japanese figures include the surplus of the social security system and net lending to public corporations.

*** German figures are for territorial authorities. UK figures are for the PSBR. Figures for other countries are on a national accounts basis.

NB.

G

INTEREST RATES IN THE G7

18 Sept. 1987

	Three Month money	Discount rate*	10 year government** bond yield
United States	7.5	6.0	9.3
Japan	3.8	2.5	5.3
Germany	4.0	3.0	6.6
France	7.9	7.5	10.1
United Kingdom	10.0	9.9	10.3
Italy	12.8	12.0	11.3
Canada	9.3	9.5	10.6

23 February 1987

	Three Month money	Discount rate*	10 year government bond yield
United States	6.1	5.5	7.2
Japan	4.0	2.5	4.7
Germany	4.0	3.0	6.2
France	8.4	8.0	8.9
United Kingdom	10.7	10.9	9.7
Italy	11.4	12.0	9.8
Canada	7.4	7.6	8.7

INTEREST RATES

* Official lending rate to market. Discount rate in the US, Japan, Germany and Italy; rate at which 1st category paper is purchased by authorities in France; rate at which bills are purchased by authorities in the UK; and bank rate in Canada.

** Rates as at 14 September.

Nominal exchange rate movements to date

	Latest	Dollar Peak		Plaza Agreement		Louvre Agreement	
	18.9.87	26.2.85	% change to date	20.9.85	% change to date	20.2.87	% change to date
Effective rates (1975 = 100)							
United States	100.5	157.2	-36	139.6	-28	104.0	-3½
Japan	222.4	157.1	+41½	156.6	+42	209.1	+6½
Germany	146.7	117.2	+25	125.5	+17	148.3	-1
France	71.6	62.0	+15½	67.2	+6½	72.2	-1
United Kingdom	73.3	70.2	+4½	82.0	-10½	69.1	+6
Italy	47.3	45.1	+5	44.0	+7½	48.6	-2½
Canada	76.6	88.5	-13½	85.6	-10½	78.6	-2½
Bilateral rates							
Yen/$	142.7	261	-45½	240	-40½	154	-7½
DM/$	1.81	3.43	-47	2.84	-36½	1.83	-1
FF/$	6.02	10.50	-42½	8.68	-30½	6.09	-1
£/$	.60	.95	-37	.73	-18	.65	-7½
Lira/$	1303	2166	-40	1922	-32	1299	+3
C$/$	1.31	1.41	-7	1.38	-5	1.33	-1½
$/£	1.66	1.05		1.37		1.53	

Note: Changes in bilateral rates show appreciation of currency against dollar

EXCH RATE TABLES

7/018

I

EFFECTIVE EXCHANGE RATES (IMF MEASURE, 1980 = 100)

		US	Japan	Germany	France	UK	Italy	Canada
1985	Jan	155.9	122.1	93.2	67.8	74.5	69.4	107.7
	Feb	161.3	121.6	92.3	67.2	74.4	68.6	106.9
	Mar	162.7	122.9	92.3	67.3	76.4	66.9	104.9
	Apr	155.9	122.5	94.5	69.2	81.2	67.3	104.5
	May	156.5	122.9	94.0	69.1	82.0	67.2	103.8
	Jun	154.8	123.3	94.0	69.3	83.3	67.5	104.0
	Jul	149.2	124.1	94.4	70.7	86.8	66.4	103.5
	Aug	146.0	124.5	96.0	71.9	85.1	66.1	102.1
	Sep	147.7	125.8	98.0	71.6	84.6	65.7	101.6
	Oct	139.6	134.7	97.3	73.0	83.8	66.3	99.5
	Nov	137.1	141.0	99.1	73.4	83.3	66.4	98.1
	Dec	135.6	140.2	100.8	74.2	82.5	66.7	96.2
1986	Jan	133.7	140.7	102.1	74.9	79.9	65.6	94.7
	Feb	128.5	149.8	103.3	75.8	77.3	68.4	93.4
	Mar	125.7	152.5	104.1	76.2	77.6	68.9	92.7
	Apr	125.3	155.8	104.0	73.7	79.3	68.5	93.5
	May	122.7	162.8	104.5	73.4	79.4	68.6	93.7
	Jun	123.7	162.4	104.5	73.5	79.0	68.8	93.0
	Jul	120.6	169.9	105.8	73.7	77.1	69.4	92.8
	Aug	118.2	172.8	107.9	74.2	74.3	70.5	91.5
	Sep	117.8	171.4	108.8	74.3	73.3	70.8	91.5
	Oct	117.2	169.2	110.0	75.3	70.5	71.4	91.1
	Nov	118.9	163.0	110.2	75.3	71.3	71.5	91.8
	Dec	117.8	162.2	111.2	75.5	71.3	71.9	91.8
1987	Jan	112.6	165.9	114.2	76.5	71.6	72.2	91.4
	Feb	110.0.	165.6	114.9	77.0	71.9	72.2	92.8
	Mar	110.2	167.4	114.0	76.5	74.8	71.5	93.6
	Apr	107.8	176.2	113.6	76.3	75.4	71.2	92.8
	May	107.0	178.3	114.5	76.4	76.4	70.4	90.8
	Jun	108.6	174.8	113.8	76.2	75.7	70.2	91.6
	Jul	110.2	169.1	113.6	76.2	75.8	70.0	93.1
	Aug	110.2	172.7	112.7	75.7	75.3	69.7	93.1
	Sept 18	107.2	176.0	113.7	76.2	76.3	70.3	90.7

DOLLAR EXCHANGE RATES

		Yen	D-mark	Franc	Sterling	Lira	C.dollar
1985	Jan	254	3.17	9.70	.88	1950	1.32
	Feb	260	3.30	10.12	.91	2040	1.25
	Mar	258	3.30	10.09	.90	2080	1.37
	Apr	251	3.08	9.41	.80	1970	1.36
	May	252	3.11	9.47	.80	1980	1.38
	Jun	249	3.06	9.34	.78	1950	1.37
	Jul	241	2.91	8.87	.73	1900	1.35
	Aug	237	2.79	8.54	.72	1880	1.36
	Sep	237	2.84	8.66	.73	1900	1.37
	Oct	215	2.64	8.06	.70	1780	1.37
	Nov	204	2.59	7.90	.69	1750	1.38
	Dec	203	2.51	7.68	.69	1710	1.40
1986	Jan	200	2.44	7.49	.70	1660	1.41
	Feb	185	2.33	7.16	.70	1590	1.40
	Mar	179	2.27	6.97	.68	1540	1.40
	Apr	175	2.27	7.20	.67	1560	1.39
	May	167	2.23	7.11	.66	1530	1.38
	Jun	168	2.23	7.12	.66	1530	1.39
	Jul	159	2.15	6.93	.66	1480	1.38
	Aug	154	2.06	6.72	.67	1420	1.39
	Sep	155	2.04	6.68	.68	1410	1.39
	Oct	156	2.00	6.56	.70	1390	1.39
	Nov	163	2.02	6.62	.70	1400	1.39
	Dec	162	1.99	6.53	.69	1380	1.38
1987	Jan	155	1.86	6.19	.66	1320	1.36
	Feb	153	1.82	6.08	.65	1300	1.33
	Mar	158	1.84	6.11	.63	1300	1.32
	Apr	143	1.81	6.03	.61	1290	1.32
	May	141	1.79	5.98	.60	1290	1.34
	Jun	144	1.82	6.07	.61	1320	1.34
	Jul	150	1.85	6.20	.62	1340	1.33
	Aug	148	1.86	6.20	.62	1350	1.33
	Sept 18	143	1.81	6.02	.60	1300	1.31

7/018

K

STERLING EXCHANGE RATES

		Dollar	Yen	D-mark	Franc	Lira	C.dollar
1985	Jan	1.13	287	3.58	10.9	2200	1.49
	Feb	1.09	285	3.61	11.0	2230	1.48
	Mar	1.12	290	3.70	11.3	2340	1.55
	Apr	1.24	312	3.83	11.7	2450	1.69
	May	1.25	315	3.88	11.8	2480	1.72
	Jun	1.28	319	3.92	12.0	2500	1.75
	Jul	1.38	333	4.02	12.2	2620	1.86
	Aug	1.38	328	3.87	11.8	2590	1.88
	Sep	1.37	323	3.87	11.8	2600	1.87
	Oct	1.42	305	3.76	11.5	2540	1.94
	Nov	1.44	294	3.73	11.4	2520	1.98
	Dec	1.45	293	3.63	11.1	2480	2.02
1986	Jan	1.42	285	3.47	10.7	2370	2.00
	Feb	1.43	264	3.34	10.2	2270	2.01
	Mar	1.47	262	3.33	10.2	2260	2.06
	Apr	1.50	262	3.40	10.8	2330	2.08
	May	1.52	254	3.39	10.8	2320	2.09
	Jun	1.51	253	3.37	10.7	2310	2.10
	Jul	1.51	239	3.25	10.5	2230	2.08
	Aug	1.49	229	3.07	10.0	2110	2.06
	Sep	1.47	228	3.00	9.8	2070	2.04
	Oct	1.43	223	2.86	9.4	1980	1.98
	Nov	1.43	232	2.88	9.4	2000	1.97
	Dec	1.44	233	2.86	9.4	1980	1.98
1987	Jan	1.51	233	2.80	9.3	1980	2.05
	Feb	1.53	234	2.79	9.3	1980	2.04
	Mar	1.59	241	2.92	9.7	2080	2.10
	Apr	1.63	233	2.95	9.8	2110	2.14
	May	1.67	234	2.98	9.9	2150	2.23
	Jun	1.63	235	2.96	9.9	2140	2.18
	Jul	1.61	242	2.97	9.9	2150	2.13
	Aug	1.60	236	2.97	9.9	2150	2.12
	Sep 18	1.66	236	2.99	9.9	2160	2.18

L

TRADE AND EXCHANGE RATES OF ASIAN NICS

Current Accounts

	1986		1987 (to date at annual rate	
	$ bn	% of GNP	$bn	% of GNP
Taiwan	16.2	23	18.4	26 (Q1)
Korea	4.6	4½	7.8	8 (Q1)
Singapore	0.5	3	n.a	n.a
Hong Kong	1.7	7	n.a	n.a

Exchange Rates

	National currency/ $	Nominal effective rate *	Real rate**
Taiwan			
1984	39.60	104.0	97.1
1985	39.85	96.1	94.6
1986	37.84	101.0	88.7
1987 Q1	34.77	101.8	88.8
Q2	32.83	111.8	92.6
Latest	30.11 (11 Sept)	114.5 (11 Sept)	98.6 (July)
Korea			
1984	806.0	82.8	96.5
1985	870.0	70.2	89.2
1986	881.5	67.1	75.8
1987 Q1	855.7	65.9	73.9
Q2	827.8	68.3	74.5
Latest	806.3 (11 Sept)	67.9 (11 Sept)	77.7 (July)
Singapore			
1984	2.133	123.1	102.4
1985	2.200	119.8	95.7
1986	2.177	114.0	80.3
1987 Q1	2.145	112.4	75.2
Q2	2.124	112.5	73.5
Latest	2.088 (11 Sept)	113.0 (11 Sept)	76.0 (July)

ASIAN NICS

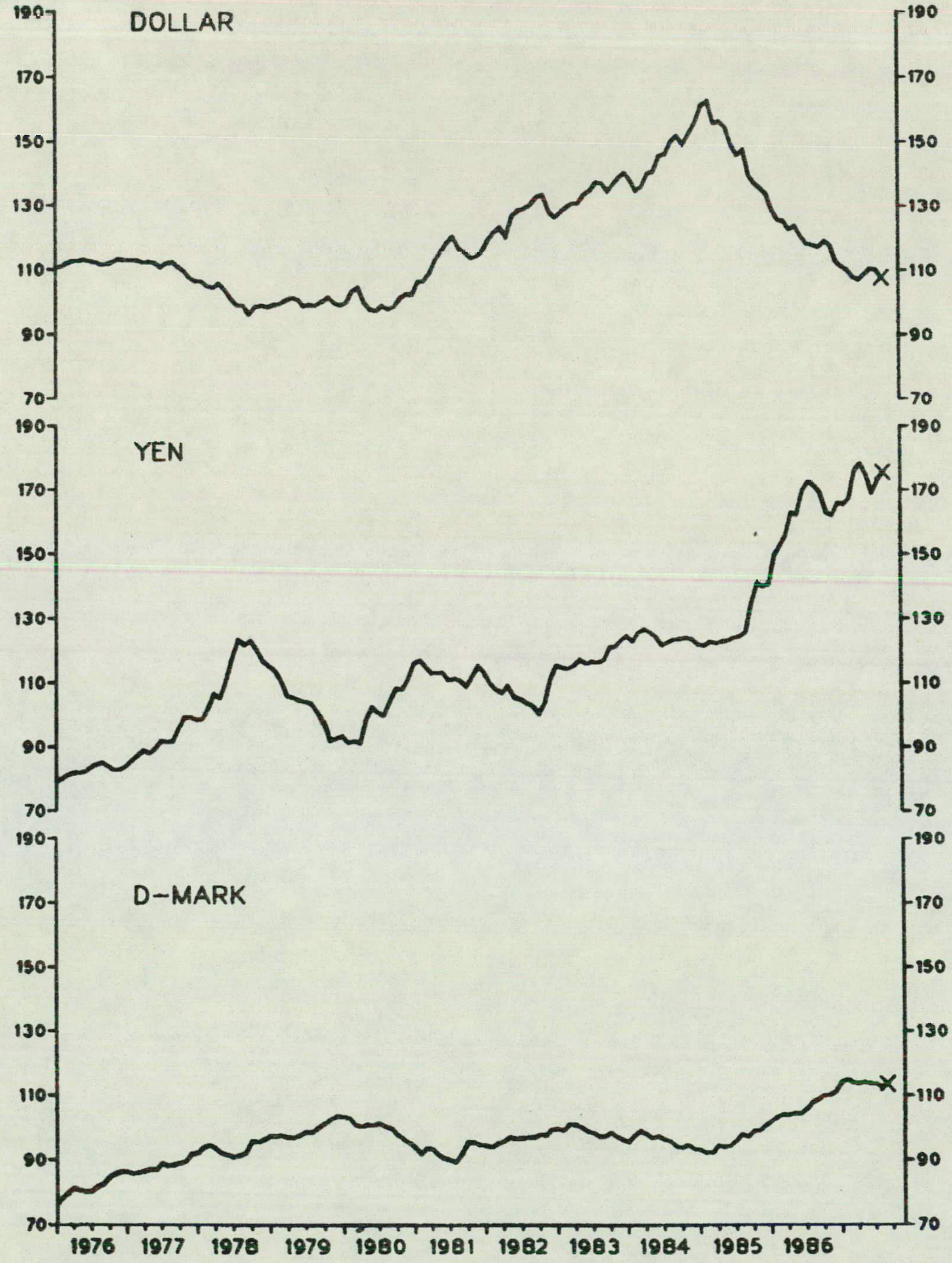
	National currency/ $	Nominal effective rate *	Real rate**
Hong Kong			
1984	7.82	71.9	100.2
1985	7.79	65.3	104.2
1986	7.80	60.7	94.9
1987 Q1	7.79	58.2	91.1
Q2	7.80	57.4	91.4
Latest	7.81 (18 Sept)	56.8 (11 Sept)	92.0 (July)

* As calculated by Phillips and Drew (end of period, 1980=100).

** As calculated by Morgan Guaranty in terms of relative consumer prices (1980=100).

M

NOMINAL EFFECTIVE EXCHANGE RATES
(IMF , 1980=100)

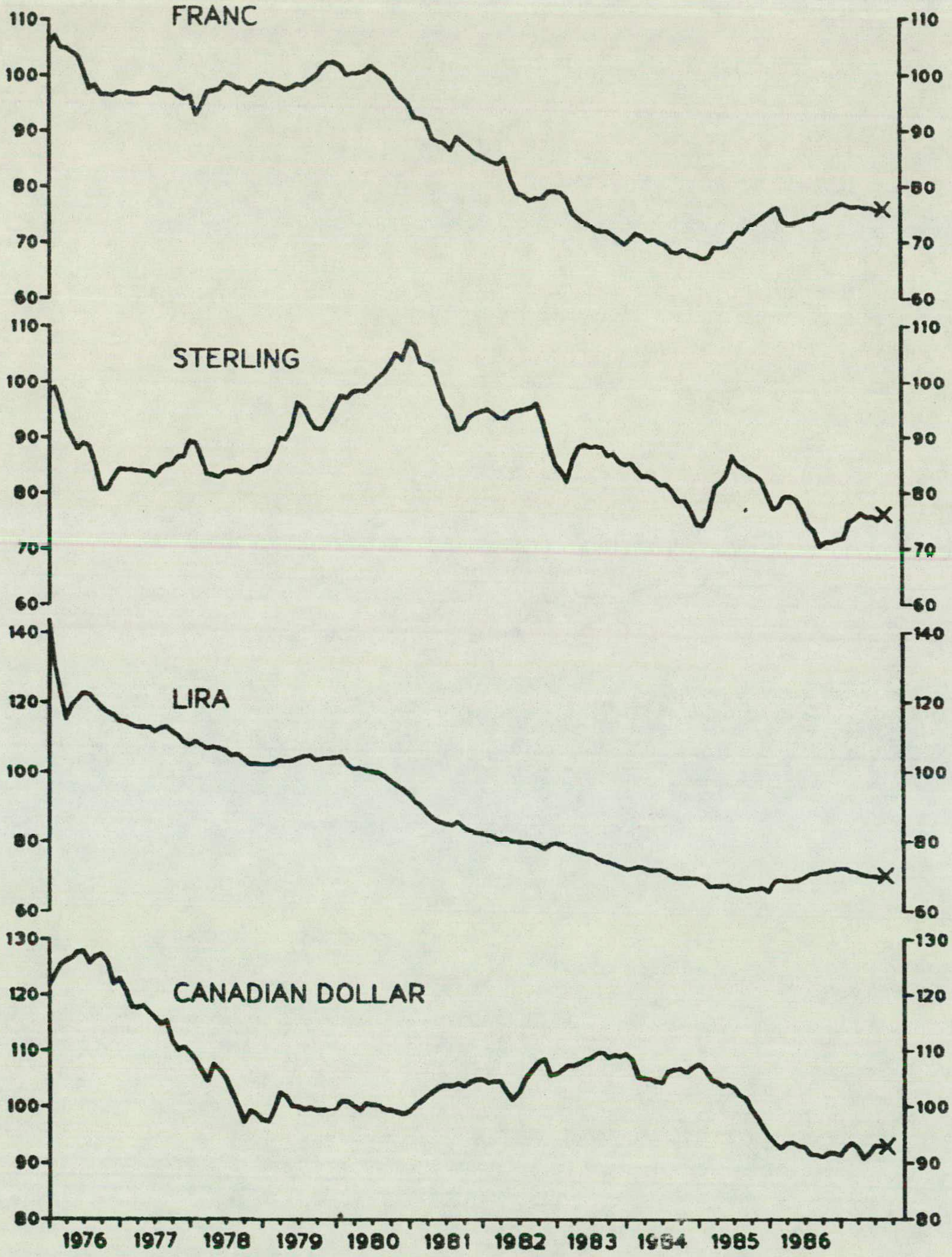


X = 17 September

EXCH. RATE CHARTS

M

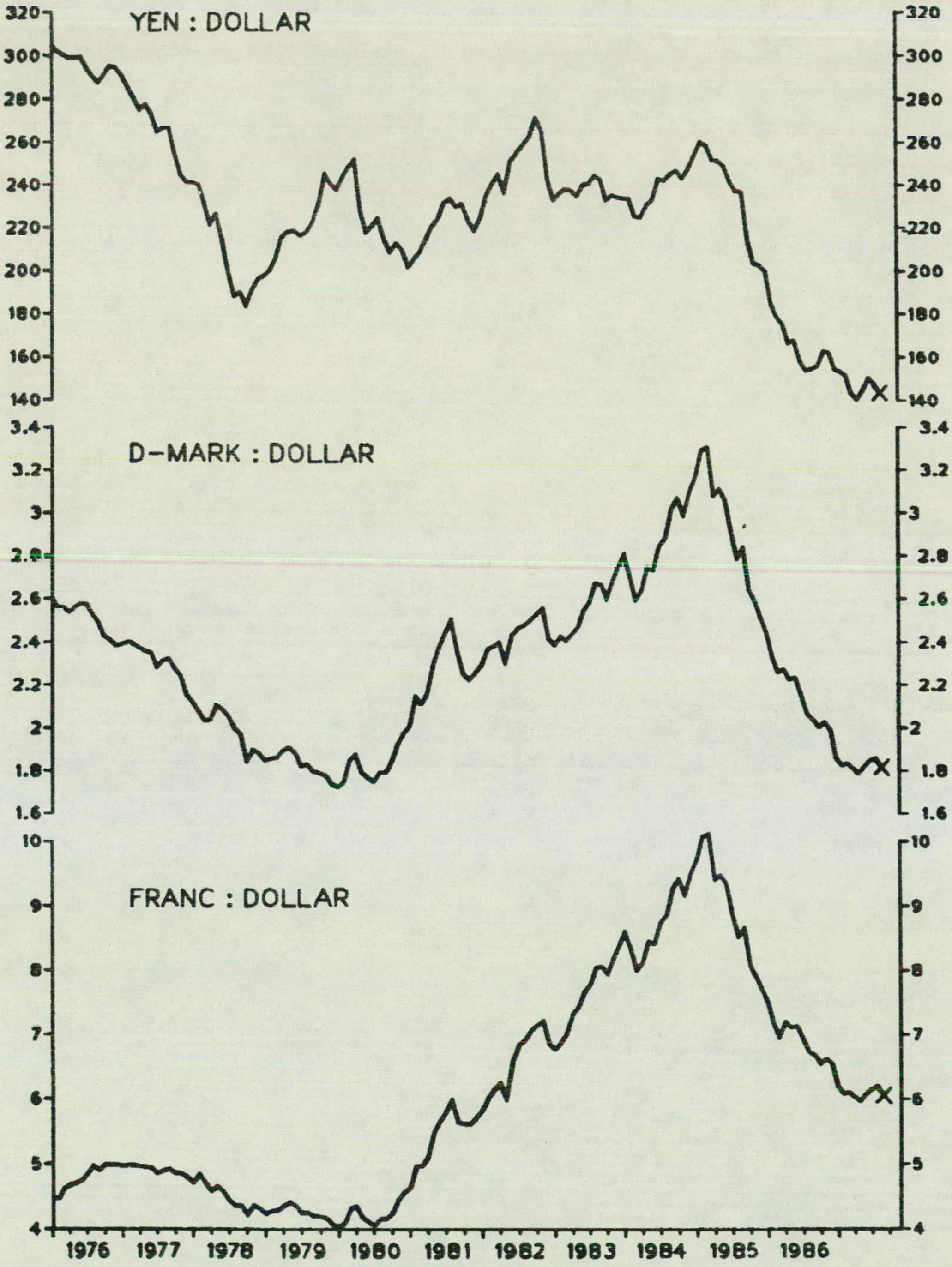
NOMINAL EFFECTIVE EXCHANGE RATES
(IMF , 1980=100)



X = 17 September

N

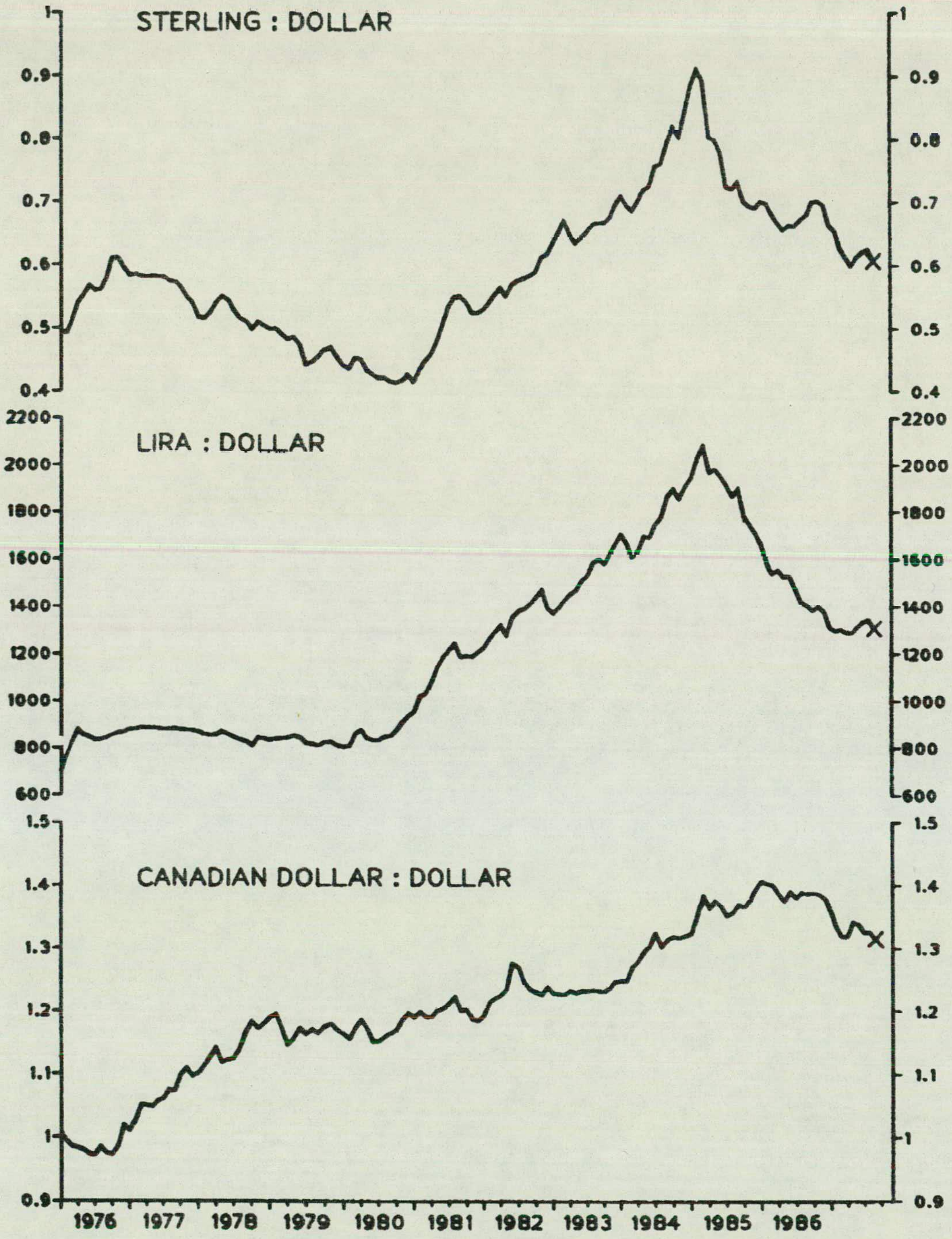
DOLLAR EXCHANGE RATES
(MONTHLY AVERAGES)



X = 17 September

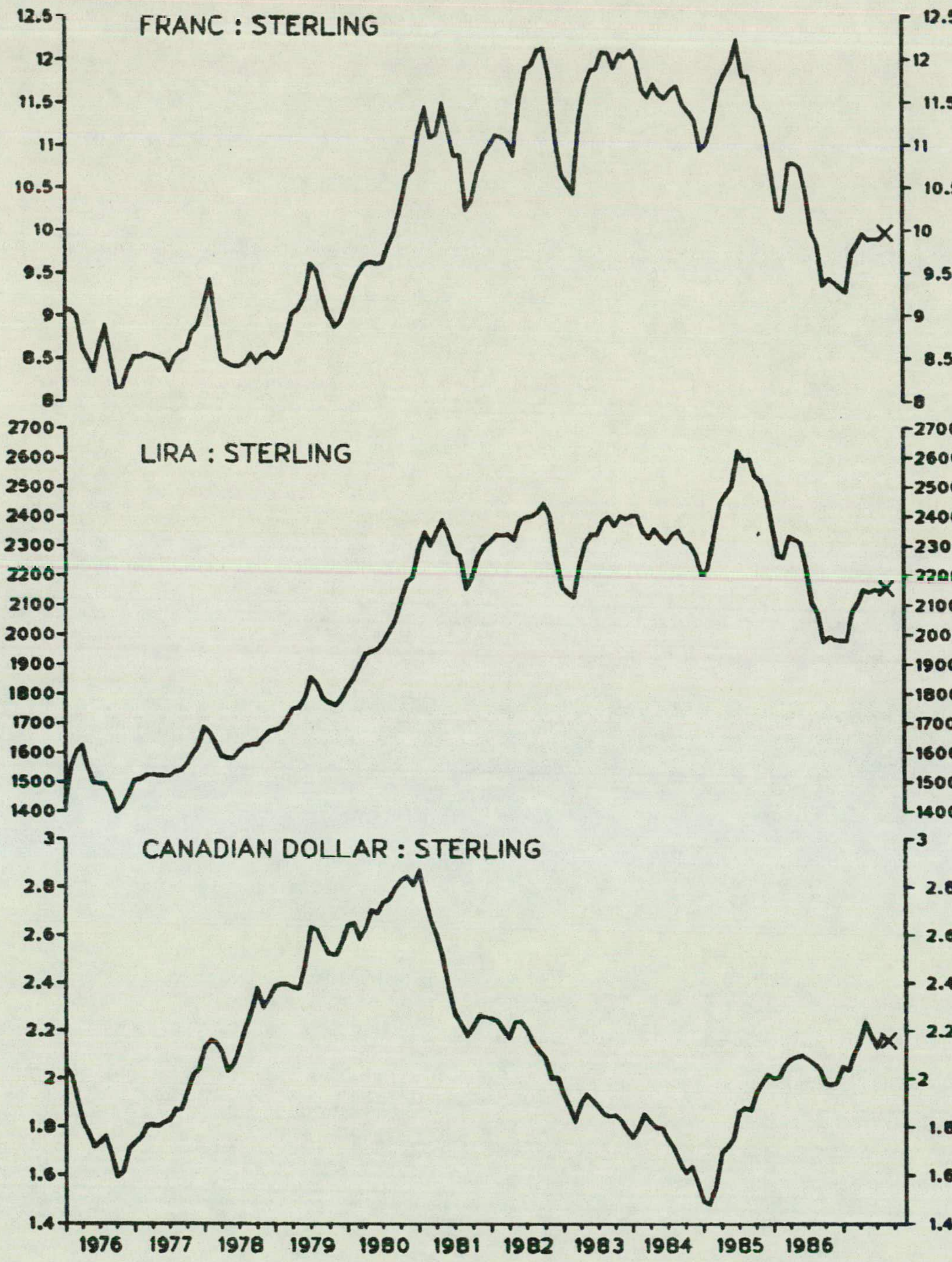
N

DOLLAR EXCHANGE RATES
(MONTHLY AVERAGES)



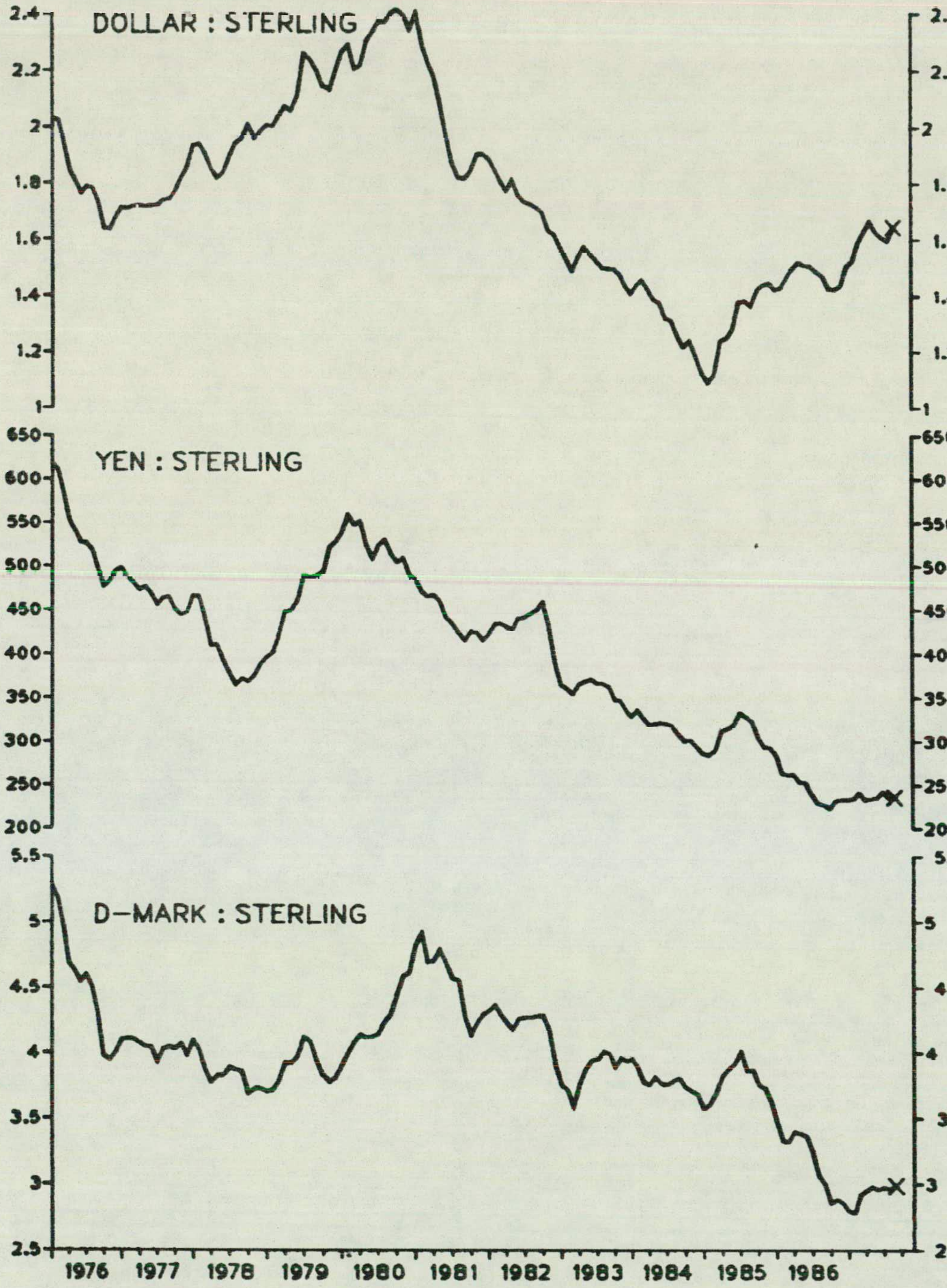
X = 17 September

STERLING EXCHANGE RATES
(MONTHLY AVERAGES)



x = 17 September

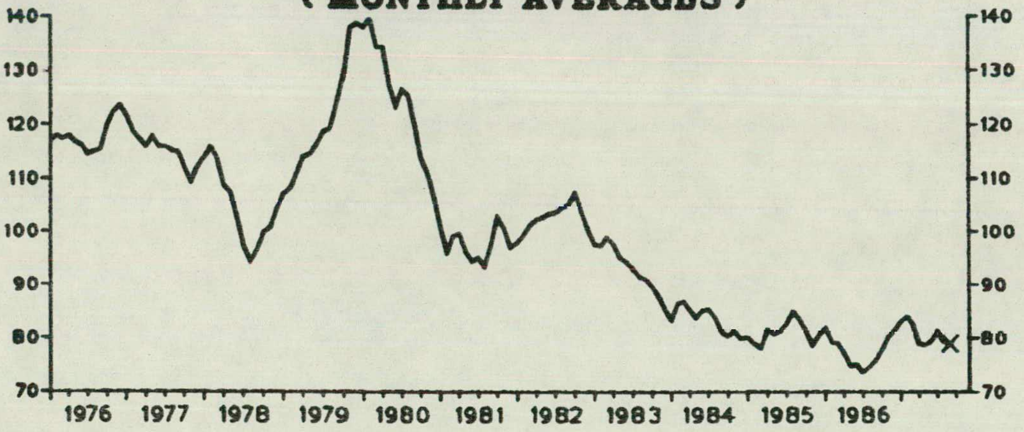
STERLING EXCHANGE RATES
(MONTHLY AVERAGES)



X = 17 SEPT

P

YEN : D-MARK EXCHANGE RATE
(MONTHLY AVERAGES)



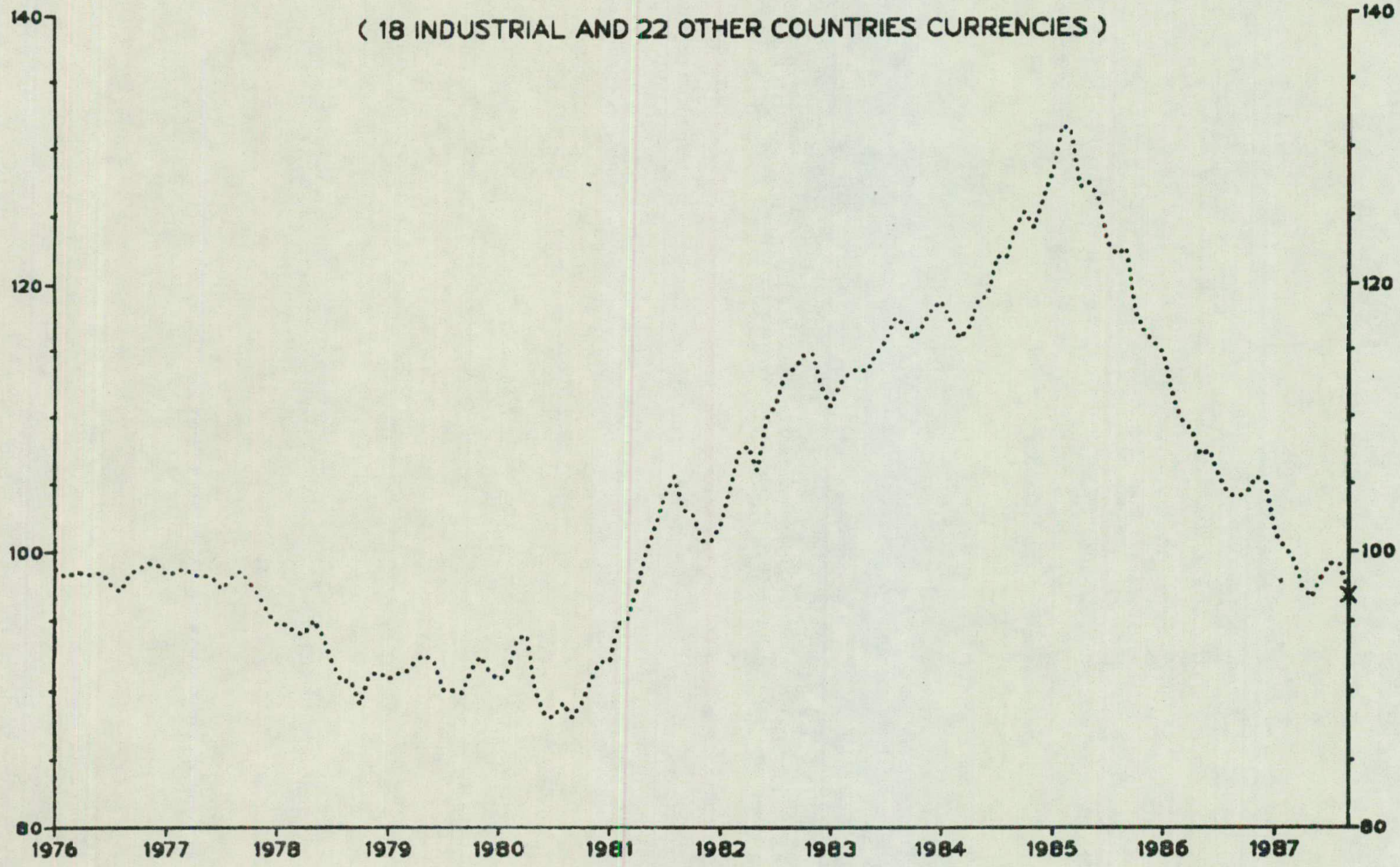
X = 17 September

a

REAL DOLLAR EXCHANGE RATE

(MORGAN GUARANTY, 1980-82=100, MONTHLY AVERAGES)

BROAD

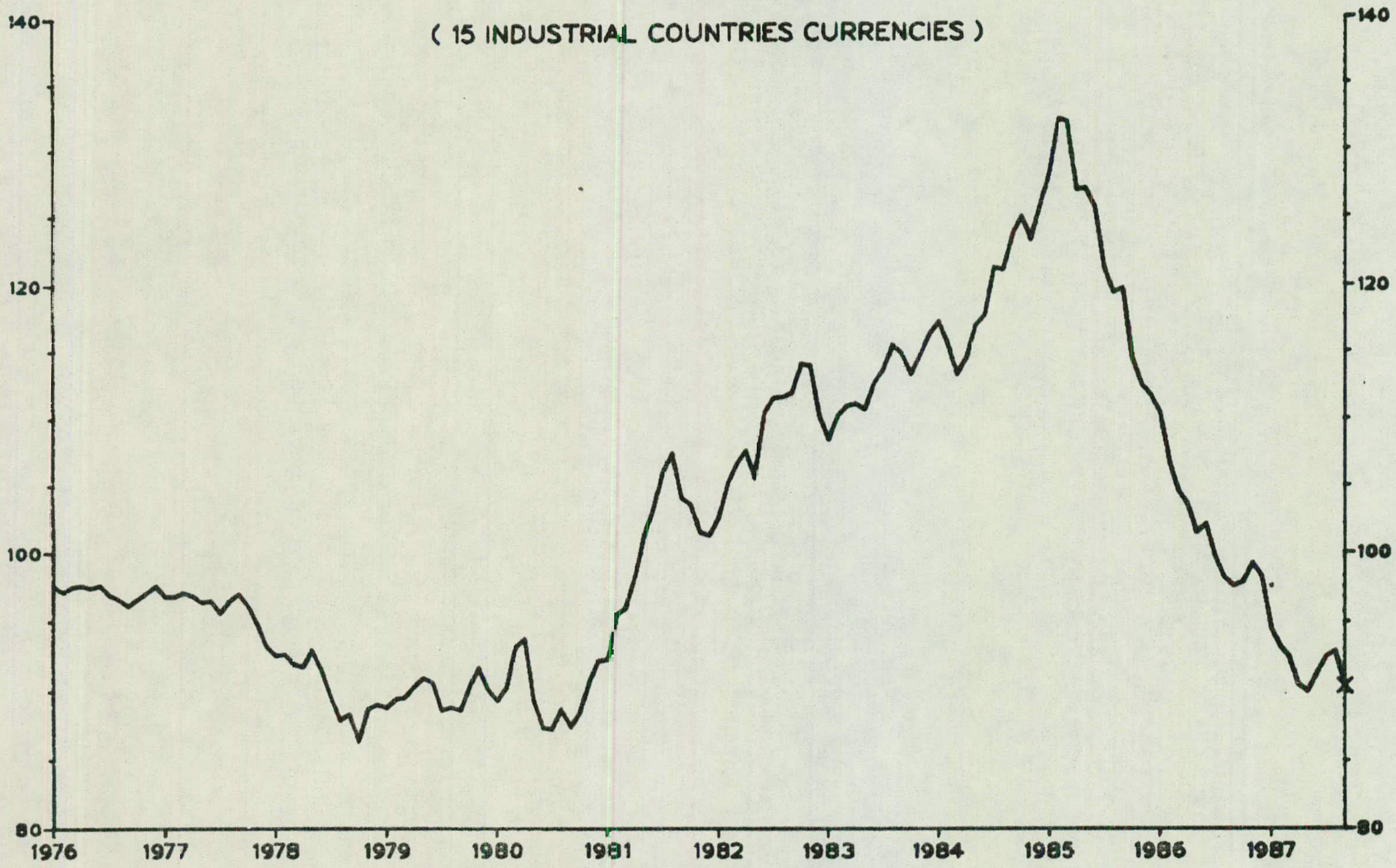


X = 18th SEPTEMBER

REAL DOLLAR EXCHANGE RATE

(MORGAN GUARANTY, 1980-82=100, MONTHLY AVERAGES)

NORMAL



X = 18th SEPTEMBER

INTERVENTION

3319.76

SECRET

FROM: H C GOODMAN

DATE: 22 September 1987

SIR T BURNS

cc: PPS
Sir G Littler
Mr Peretz
Mr Kelly

INTERVENTION

You asked how the figures in the article in todays FT (attached) were reconciled wih those in the table attached to my minute of yesterday.

2. The reason for the apparent discrepancies is that they cover different periods and countries:-

	Period	Amount	Coverage
Poehl's estimate	end Dec 86-May 87	\$70bn	G10
Bank estimate	"	\$75bn	G10
FT estimate	Jan 87-Aug 87	\$70bn +	G10
Bank estimate	"	(\$67.5bn	G 5
		(\$3bn	E.C.
Treasury estimate	23 Feb-18 Sept 87 (\$)	\$60.5bn	G5 + EC
	(non \$)	\$1.6bn	G5 + EC

3. The Bank say they cannot comment on the 'whole world figure' of \$90bn, because only EC, Switzerland, Norway, Sweden, US, Japan, Canada, Austria and Finland report their intervention.

H C Goodman.

H C GOODMAN

SECRET

Extract from Financial Times, Tuesday 22 September 1987

Central banks' intervention over $70bn so far this year

BY STEWART FLEMING, US EDITOR IN WASHINGTON

FOREIGN EXCHANGE intervention by central banks of the Group of Ten leading industrial countries and other European nations rose to well over $70bn (£42.25bn) in the first eight months of this year.

The heaviest intervention was by Japan, the UK and Spain, official figures suggest. About 30 per cent was accounted for by Japan, 20 per cent by Britain and 15 per cent by Spain.

Between 5 per cent and 10 per cent of the total intervention was conducted by the Bank of France and the US Federal Reserve Board, while the West German Bundesbank, which is concerned about domestic monetary implications, accounted for less than 5 per cent of the intervention.

The Group of Ten consists of the US, the UK, Japan, West Germany, France, Belgium, the Netherlands, Italy, Sweden and Canada. Switzerland is an honorary member.

The overall intervention estimate is in line with figures disclosed in August by Mr Karl Otto Poehl, the president of the Bundesbank.

In an interview with the West German magazine Der Spiegel, he said that between the end of 1986 and about the middle of 1987 "central banks in the whole world had bought between $60bn-70bn." The figures for the Group of Ten and the European central banks do not include intervention by, in particular, Asian countries, such as Taiwan, which have also been buying dollars, in part to prevent too rapid an appreciation of their own currencies.

One analyst with access to the figures said yesterday that in view of the renewed weakness in the dollar in August and September, worldwide intervention has probably reached around $90bn.

The motivations for the intervention will have varied among the central banks. One official suggested yesterday, for example, that UK intervention will partly have been aimed at stabilising the sterling-Deutschmark rate.

However, much of it will have been designed to stabilise the dollar and the figures to support the contention by private economists that most of the US current account deficit this year is being financed by official sources.

The massive intervention, coupled with the sharp rise in US interest rates, has helped keep the dollar within the broad ranges agreed by the seven leading industrial countries in February.

IMF/World Bank talks, Page 24

SECRET

FROM: SIR T BURNS
DATE: 22 SEPTEMBER 1987

CHANCELLOR

cc Sir G Littler
Mr Evans
Mr Peretz
Mr C W Kelly
Mr S Matthews
Mr Hudson
Ms Goodman

BRIEFING FOR G5/G7 MEETING

I attach a briefing note for the G5/G7 Meeting. There should be time for some further editing tomorrow. If necessary I will bring a further version with me to Washington.

T B

T BURNS

ENC

Ch
Bit of duplication with the tables below, but probably useful to have them all
AA

BRIEFING FOR G5/G7 MEETING

BRIEFING NOTE

Review of operation of Louvre Agreement

1. **Exchange rates have moved within a narrow band**

	DM/$	Yen/$
- Louvre Central rates	1.825	153.5
		146.0 (Washington)

- High-Low since Louvre

	DM/$	Yen/$
6/5 (Low)	1.77	139
11/8 (high)	1.90	152
22/9	1.82	144

- Charts of $/Yen and $/DM rates since September 1985 show that there has been much greater stability post-Louvre. (Charts 1 to 3 attached).

- Sterling has also been very stable - particularly against against DM.

	DM/£	$/£
20/2 Louvre	2.79	1.53
17/3 Budget	2.93	1.60
31/3	2.90	1.60
8/5	3.00	1.67
22/9	2.99	1.65

2. **Large-scale intervention has been deployed when necessary**

$ billion	US	Japan	W Germany	France	UK	Other EC	Total
23/2/87 to date	4.6	17.9	1.6	5.2	16.9	14.4	60.5

3. **Monetary Policy has been adjusted to help to sustain the agreement**

- US 3 month interest rates are up by almost 1½ per cent; German interest rates are unchanged; and Japanese rates are marginally lower.

	US	Germany	Japan
23 February	6.1	4.0	4.0
18 September	7.5	4.0	3.8

Very little

- Monetary targets are being exceeded in Germany and Japan; and undershoot in US

	Target	Recent Growth
US M3	5.5-8.5	4.8 (July)
Japan M2 + CDS	10	10.3 (July)
Germany CBM	3-6	7.3 (July)

4. **So far not much change to fiscal policies**

United States:

- Louvre: said it would reduce Federal Deficit from estimated 3.9 per cent ($170 billion) in fiscal 1987 to 2.3 per cent ($108 billion) (G-R-H target) in fiscal 1988.

- This year expected to be around $160 billion - one-off receipts from tax reform, asset sales etc.

- Next year range of forecasts from small reduction (Administration) to $183 billion (CBO current legislation baseline).

Japan:

- Louvre: undertook to 'follow monetary and fiscal policies which will help to expand domestic demand and thereby contribute to reducing external surplus'.

- Action: Y6 trillion package, first announced in April but not presented in detail until 29 May. IMF tentatively estimate will raise Japanese GNP by ½ per cent this year and by 1-1½ per cent in 1988.

Germany:

- Louvre: proposed 'to increase the size of the tax reduction already enacted for 1988'.

- Action: income tax cuts of DM 5.2 billion or 0.3 per cent of GNP (part of the larger tax reform originally scheduled for 1990) to be brought forward to next January.

Forecasts

- Latest forecasts and estimates of fiscal impulse shown below indicate some move in right direction (see table A16 of IMF World Economic Outlook). Fiscal impulse figures are not to be taken too seriously!

General Government (figures % of GDP)

Fiscal balance	**85**	**86**	**87**	**88**
US	-3.3	-3.5	-2.3	-2.4
Japan	-0.8	-0.6	-1.2	-1.6
Germany	-1.1	-1.2	-1.5	-2.0
UK	-2.6	-2.8	-2.6 No!	-2.5
G7	-3.3	-3.3	-2.6	-2.7
Fiscal impulse				
US	0.7	0.3	-1.3	0.1
Japan	-1.0	-0.7	0.4	0.3
Germany	-0.6	0.3	-	0.6
UK	-0.7	0.4	0.3	-
G7	0.2	-	-0.7	0.1

5. There are few signs of improvement in Current Account Imbalances

- **US:** Since end of 1986 relative volumes have improved: but terms of trade have deteriorated.

	Export Volume as Percentage of Import Volume	Terms of Trade	Current Account $bn
85 Q1	67	115	-26
Q2	62	116	-29
Q3	61	114	-29
Q4	59	113	-34
86 Q1	58	116	-33
Q2	58	120	-34
Q3	56	121	-37
Q4	56	118	-38
87 Q1	58	116	-37
Q2(Estimate)	60	113	-41

18 mth = Q2 1988

- **Japan:** A large turn-round in relative volumes of imports and exports. But large improvement of terms of trade.

	Export Volume as Percentage of Import Volume	Terms of Trade	Current Account $bn
85 Q1	128	108	9
Q2	130	111	12
Q3	131	112	12
Q4	130	124	16
86 Q1	123	132	16
Q2	111	161	22
Q3	111	173	24
Q4	108	174	24
87 Q1	114	167	25
Q2(Estimate)	103	166	21

is 18 mth lag

- **Germany:** Again a large turn-round in relative volumes of imports and exports. But improvement in terms of trade.

	Export Volume as Percentage of Import Volume	Terms of Trade	Current Account $bn
85 Q1	116	95	2
Q2	118	96	3
Q3	114	99	4
Q4	115	100	4
86 Q1	112	107	8
Q2	110	112	8
Q3	111	115	11
Q4	109	115	9
87 Q1	108	117	11
Q2	107	116	11

NEXT STEPS

1. Need a firm reaffirmation of Louvre and agreement to maintain exchange rate. A mistake to think that simply devalue until current account improves:

- the exchange rate changes that have occurred will take time to have effect: J-curve;

- exchange rate changes can only play a part. Even large exchange rate changes only have small effect when begin from heavy imbalance;

- the inflation effects on US can be serious;

- and for Japan and Germany further $ depreciation would cause more problems for export markets which could lead to further dislocation of their economies;

- credibility in the new approach requires a sustained period of stability.

2. Well articulated intervention agreement:

- US and Germany both need to do more;

- develop a swap agreement;

- visibility of intervention will help to improve credibility;

- possible to make a profit if careful with timing.

(figures to follow on profitability of intervention)

3. Need a clear agreement of approach to monetary policy:

- countries undertake to make monetary policy adjustments if exchange rate moves away from agreed levels;

- in process keep eye on average level of interest rates for G7. Important that interest rate changes to deliver exchange rate objectives do not lead to unintended drift in average rates;

- at present no need for aggregate change; inflation under control; commodity prices showing only modest recovery in SDR terms.

- suggests that if there is a need for interest rate adjustments they should be shared.

4. Important that US, Germany and Japan continue to direct policy at achieving improvement of current account imbalances. For US means domestic demand growth below GDP growth. And for Germany and Japan domestic demand growth above growth of GDP. Latest IMF figures -

% growth	**1983**	**'84**	**'85**	**'86**	**'87**	**'88**
US: GDP	3.6	6.8	3.0	2.9	2.4	2.7
DD	5.1	8.7	3.6	3.9	1.7	1.9
Japan: GDP	3.2	5.1	4.7	2.5	3.2	3.4
DD	1.8	3.8	3.8	4.0	4.1	4.4
Germany: GDP	1.8	3.0	2.5	2.4	1.5	2.3
DD	2.3	1.9	1.5	3.7	2.9	2.9

exrat1

EXCHANGE RATE MOVEMENTS

Exchange Rates

	£ ERI	$/£	DM/£	Yen/$	DM/$	$ ERI
Plaza (20 Sept '85)	82.0	1.374	3.903	238.5	2.840	139.6
Louvre (20 Feb '87)	69.1	1.528	2.791	153.5	1.826	104.0
Washington (8 Apr '87)	72.4	1.613	2.965	146.6	1.839	102.2
21 September 1987	73.3	1.651	2.993	143.4	1.813	100.9
% change since Plaza	-10.6	20.2	-23.3	66.4	56.7	-27.7
% change since Louvre	6.1	8.0	7.2	7.1	0.7	-3.0
% change since Washington	1.2	2.4	0.9	2.2	1.4	-1.3

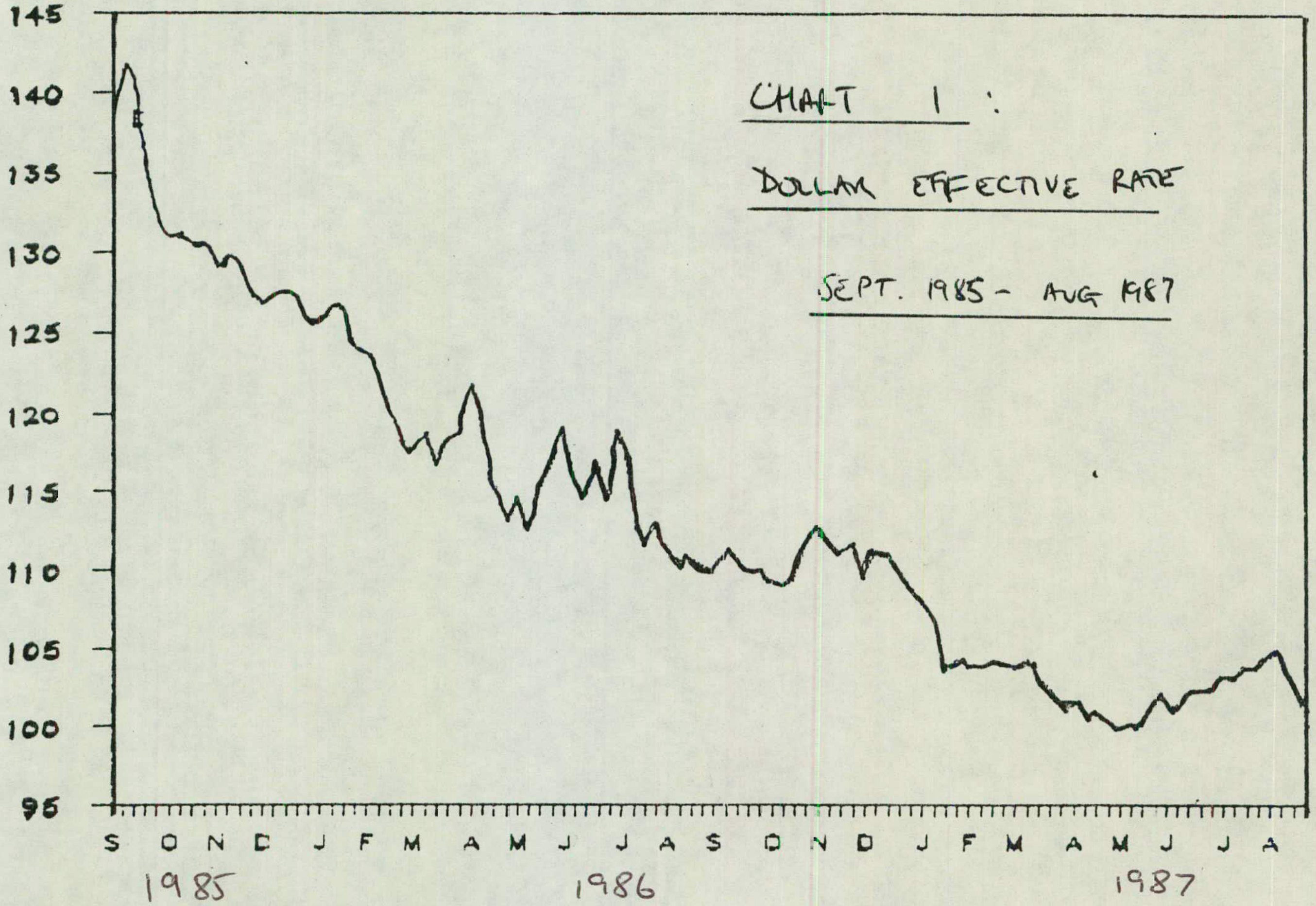


CHART 1 :
DOLLAR EFFECTIVE RATE
SEPT. 1985 - AUG 1987
145
140
135
130
125
120
115
110
105
100
95
S O N D J F M A M J J A S O N D J F M A M J J A
1985
1986
1987

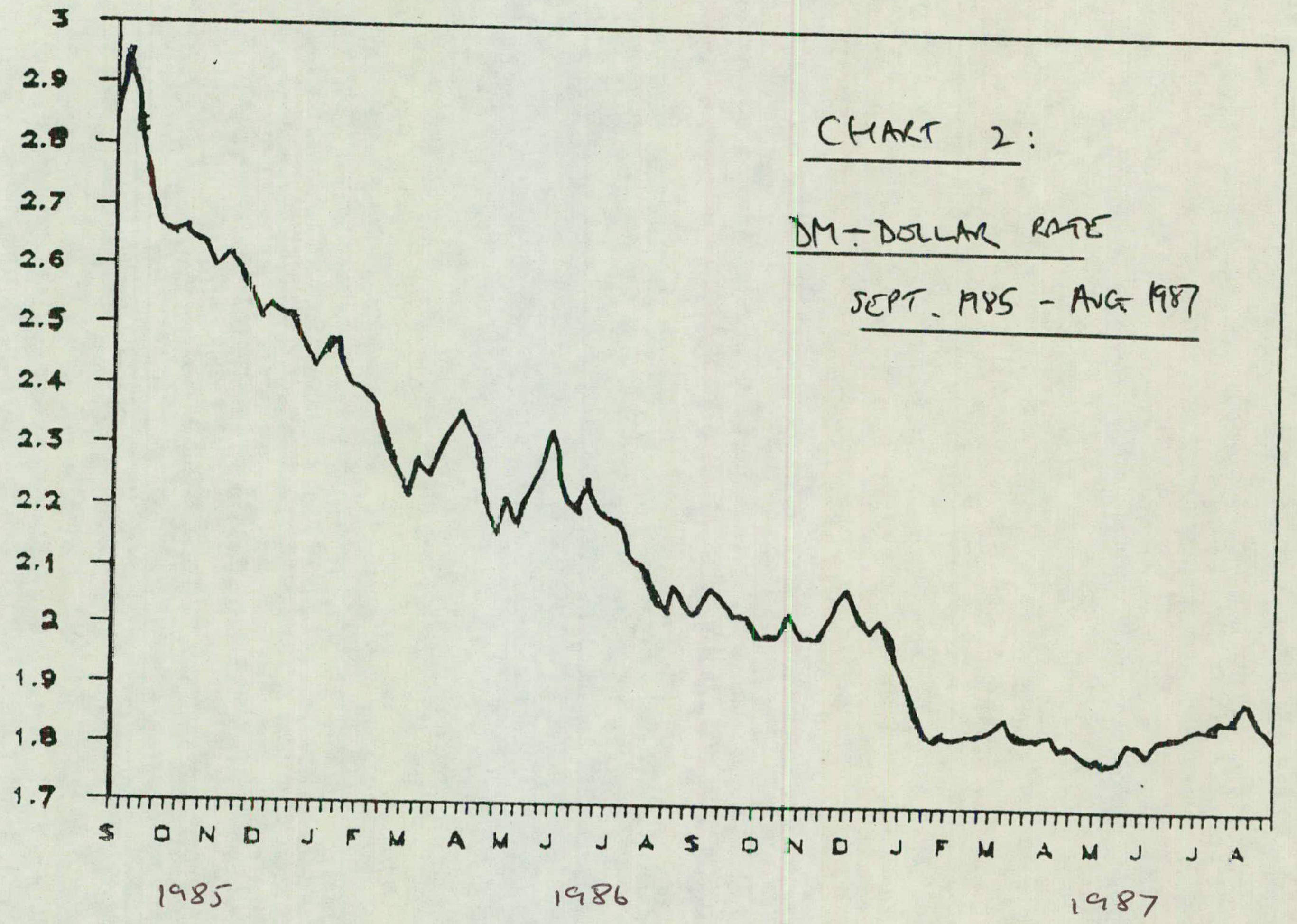


CHART 2:
DM-DOLLAR RATE
SEPT. 1985 - AUG 1987
3
2.9
2.8
2.7
2.6
2.5
2.4
2.3
2.2
2.1
2
1.9
1.8
1.7
S O N D J F M A M J J A S O N D J F M A M J J A
1985
1986
1987

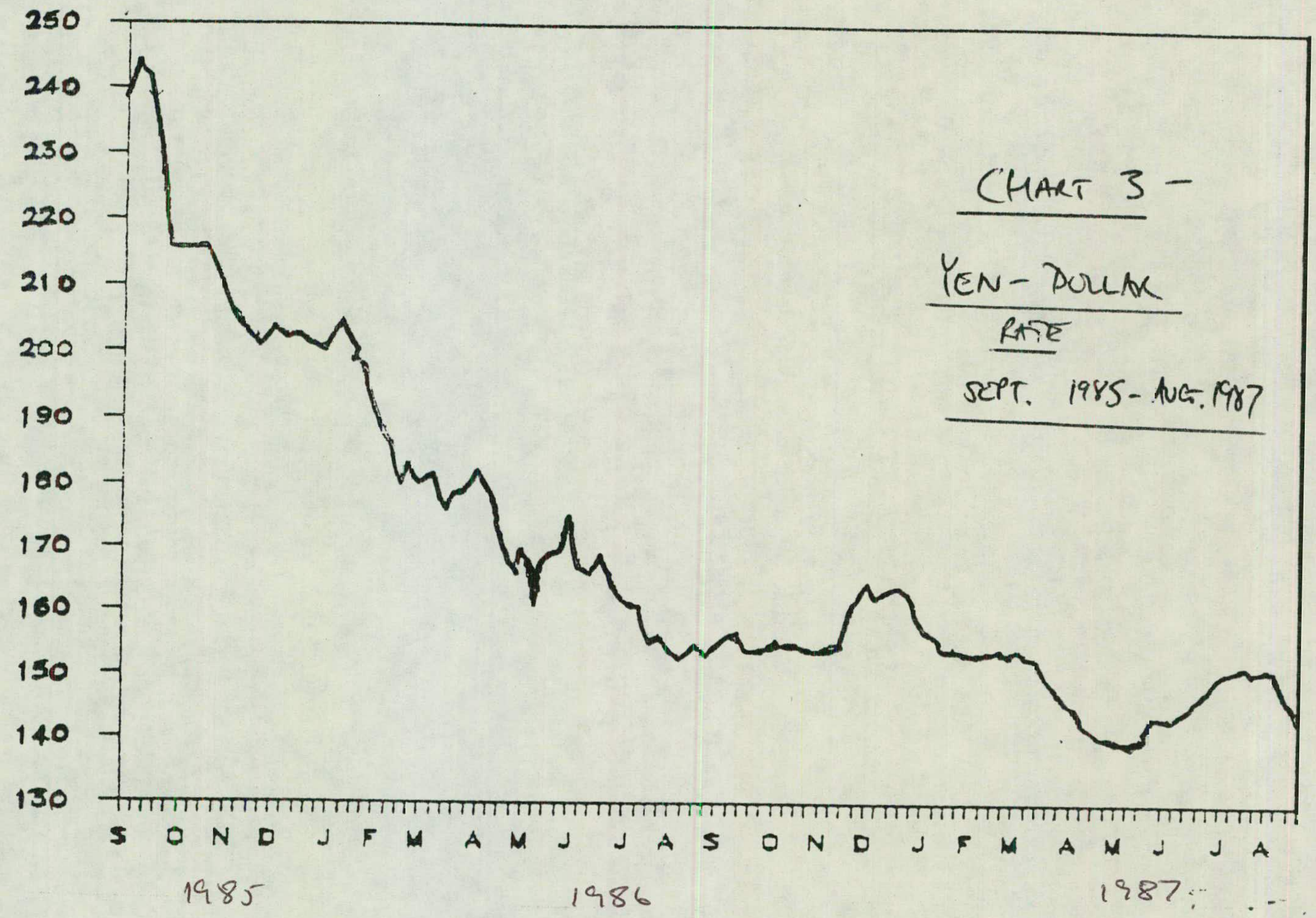
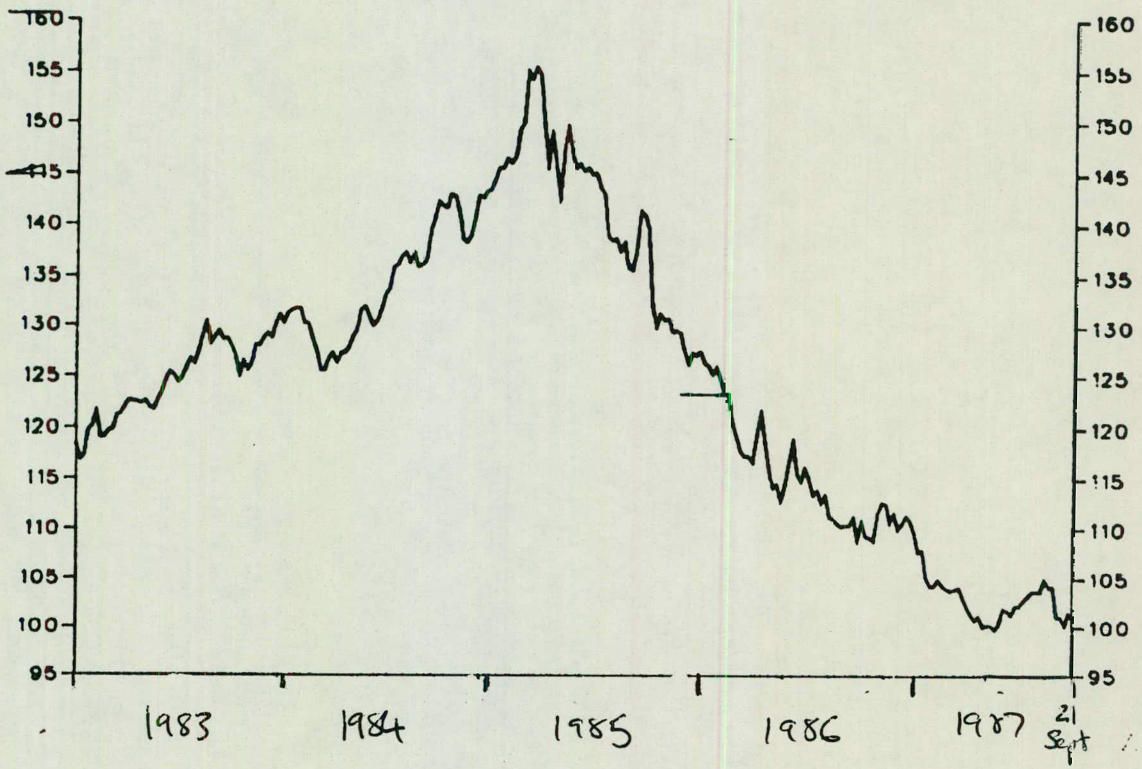


CHART 3 -
YEN - DOLLAR RATE
SEPT. 1985 - AUG. 1987
250
240
230
220
210
200
190
180
170
160
150
140
130
S O N D J F M A M J J A S O N D J F M A M J J A
1985
1986
1987

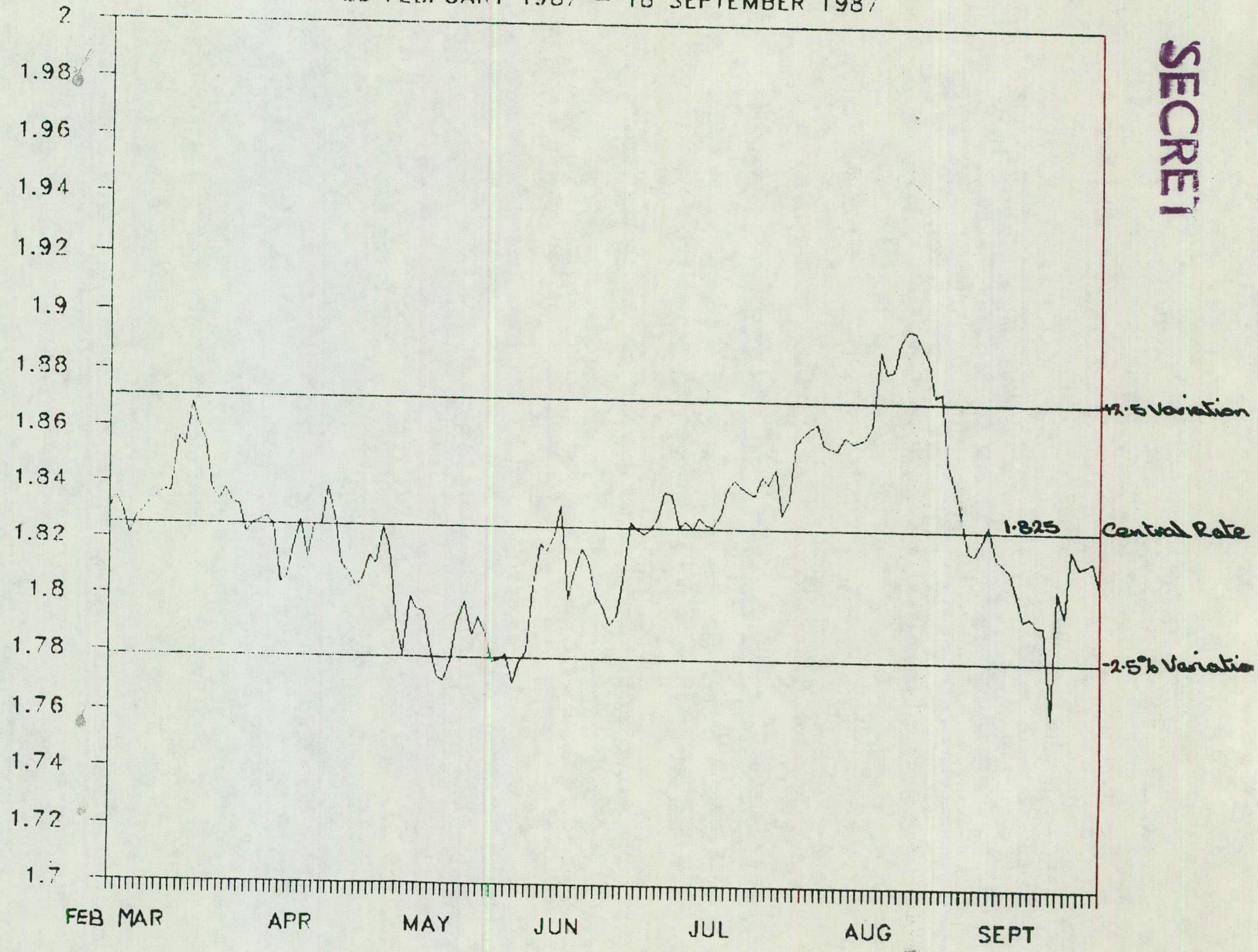
@>

DOLLAR EFFECTIVE RATE



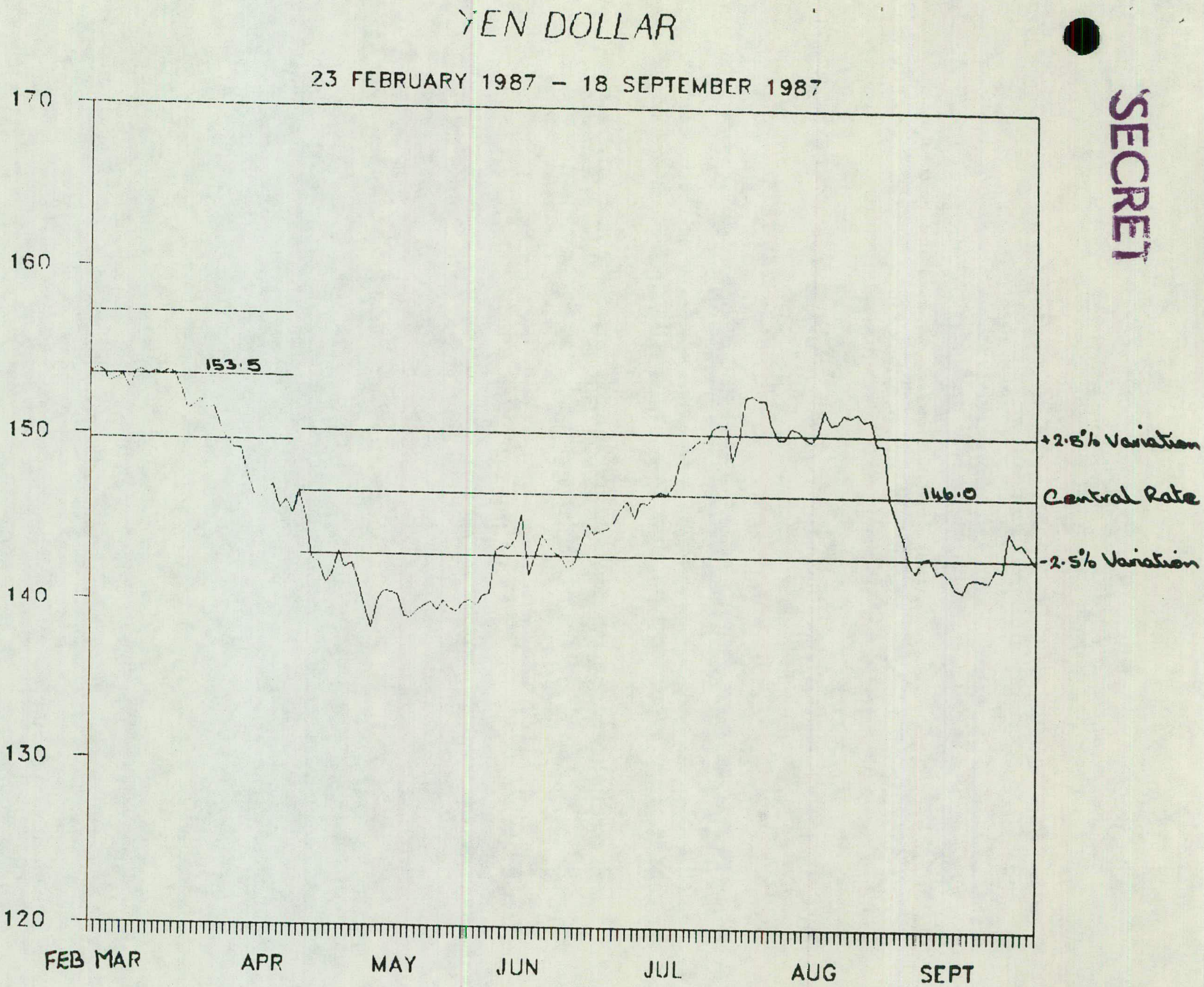
DEUTSCHEMARK DOLLAR

23 FEBRUARY 1987 – 18 SEPTEMBER 1987



SECRET

SECRET

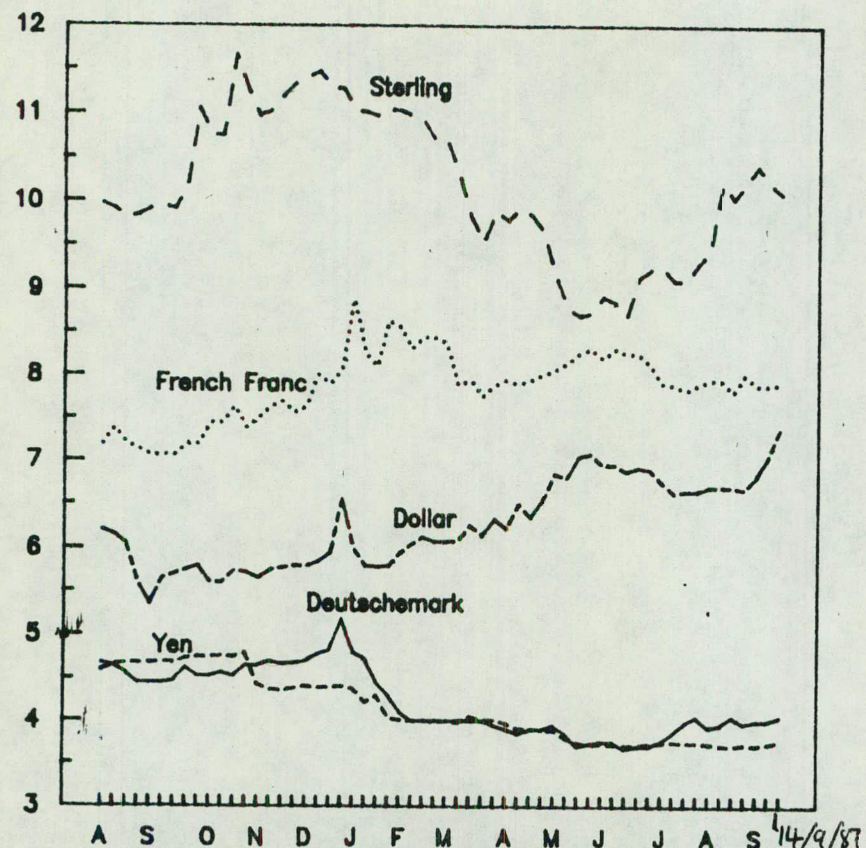

YEN DOLLAR
23 FEBRUARY 1987 – 18 SEPTEMBER 1987
170
160
150
140
130
120
153·5
146·0
+2·5% Variation
Central Rate
-2·5% Variation
FEB
MAR
APR
MAY
JUN
JUL
AUG
SEPT

INTEREST RATES

SOURCE: BANK OF ENGLAND

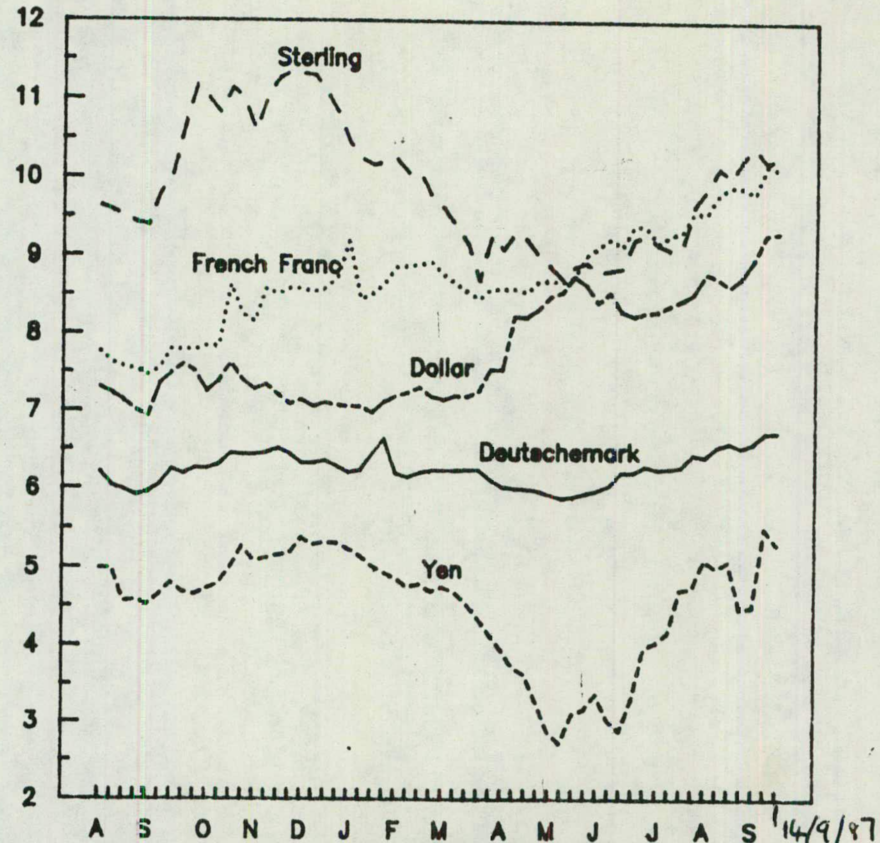
DOMESTIC 3-MONTH MONEY MARKET 1986/87

Per cent per annum

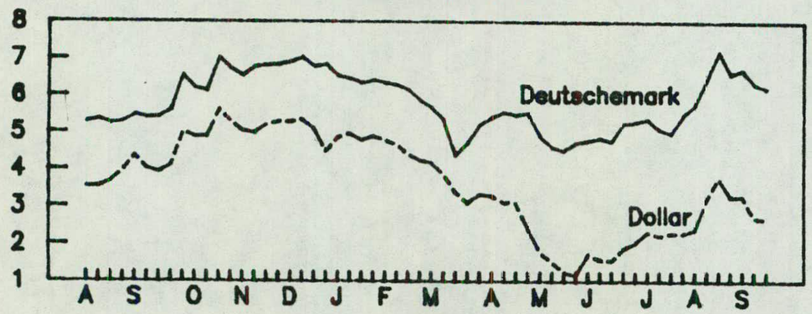


DOMESTIC LONG-TERM G'MENT BOND YIELDS 1986/87

Per cent per annum

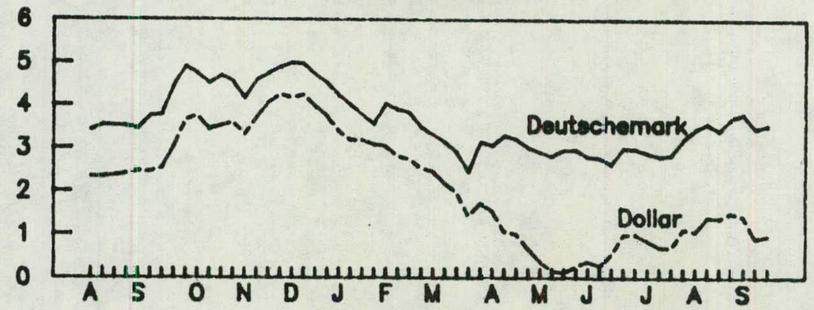


DOMESTIC STG - EURO $ DEPOSIT/EURO DM DEPOSIT DIFFERENTIAL



1986/87

STG - DOLLAR BOND YIELDS/DM BOND YIELDS DIFFERENTIAL



1986/87

TABLE 4 - THREE MONTH INTEREST RATES

		1 UK	2 USA	3 USA-CD	4 GERMANY	5 JAPAN	6 FRANCE	7 ITALY	8 UK-WORLD BASKET	9 UK-USA	10 UK-GERMANY	11 UK-USA CD
									---- UNCOVERED DIFFERENTIALS ----			
1973		11.47	9.42	6.87	12.14	13.60	9.13	6.92	1.06	2.05	-0.67	4.60
1974		13.43	11.26	7.78	9.90	14.80	13.02	14.57	1.21	2.17	3.53	5.65
1975		10.67	6.96	5.85	4.96	9.80	7.84	10.64	3.04	3.71	5.71	4.82
1976		11.39	5.64	5.03	4.25	7.60	8.69	15.68	4.12	5.75	7.14	6.36
1977		8.12	6.16	5.58	4.37	6.06	9.22	14.04	1.06	1.96	3.75	2.54
1978		9.25	8.85	8.25	3.70	4.86	8.16	11.50	2.01	0.40	5.55	1.00
1979		13.67	12.09	11.26	6.69	8.13	9.48	11.68	3.82	1.58	6.98	2.41
1980		16.59	14.19	13.16	9.54	9.90	12.20	17.64	4.10	2.40	7.05	3.43
1981		13.93	16.78	15.86	12.11	6.75	15.26	20.18	-0.35	-2.85	1.82	-1.93
1982		12.25	13.16	12.25	8.88	6.96	14.73	20.26	0.26	-0.91	3.37	0.00
1983		10.11	9.03	9.06	5.77	6.45	12.63	18.25	0.60	1.08	4.34	1.05
1984		9.93	10.81	10.41	5.99	6.33	11.74	17.37	2.54	-0.88	3.94	-0.48
1985		12.26	8.35	8.08	5.46	6.49	9.72	15.28	3.88	3.91	6.80	4.18
1986		10.95	6.81	6.57	4.62	5.02	7.77	12.91	4.11	4.14	6.34	4.38
1985	Q1	13.05	8.98	8.67	6.16	6.29	10.59	16.24	4.14	4.07	6.89	4.38
	Q2	12.65	8.29	8.39	5.89	6.27	10.35	15.40	4.17	4.36	6.76	4.26
	Q3	11.72	8.07	7.97	4.97	6.33	9.85	14.55	3.66	3.65	6.75	3.75
	Q4	11.64	8.09	8.01	4.87	7.09	9.11	14.63	3.55	3.55	6.77	3.63
1986	JAN	12.42	8.12	7.88	4.75	6.84	9.04	15.06	4.33	4.30	7.67	4.54
	FEB	12.95	8.03	7.77	4.56	6.22	8.97	15.88	4.95	4.92	8.39	5.18
	MAR	11.76	7.56	7.25	4.54	5.45	8.35	15.89	4.16	4.20	7.22	4.51
	APR	10.44	6.87	6.56	4.42	4.78	7.67	13.61	3.58	3.57	6.02	3.88
	MAY	10.30	6.93	6.72	4.59	4.58	7.28	12.88	3.66	3.37	5.71	3.58
	JUN	9.79	6.94	6.74	4.63	4.64	7.30	12.08	3.21	2.85	5.16	3.05
	JUL	9.99	6.59	6.37	4.64	4.61	7.19	12.03	3.56	3.40	5.35	3.62
	AUG	9.88	6.20	5.98	4.59	4.67	7.22	11.41	3.64	3.68	5.29	3.90
	SEP	10.20	5.92	5.74	4.51	4.71	7.11	11.10	4.10	4.27	5.69	4.46
	OCT	11.11	5.95	5.73	4.57	4.76	7.47	11.18	4.94	5.16	6.54	5.38
	NOV	11.13	6.00	5.75	4.67	4.36	7.59	11.38	4.97	5.14	6.46	5.38
	DEC	11.32	6.37	6.06	4.90	4.40	8.02	11.43	4.93	4.95	6.42	5.26
1987	JAN	11.02	6.16	5.84	4.57	4.23	8.46	11.75	4.71	4.86	6.45	5.18
	FEB	10.89	6.37	6.10	4.02	3.99	8.44	11.57	4.69	4.52	6.87	4.79
	MAR	10.04	6.45	6.17	3.99	4.01	7.97	11.18	3.93	3.59	6.05	3.87
	APR	9.80	6.78	6.52	3.89	3.92	7.94	10.41	3.67	3.02	5.91	3.28
	MAY	8.84	7.26	7.03	3.81	3.79	8.19	10.44	2.52	1.58	5.03	1.81
	JUN	8.96	7.14	6.96	3.71	3.72	8.23	10.99	2.62	1.82	5.24	2.00
	JUL	9.18	6.90	6.73	3.90	3.74	7.87	11.13	2.93	2.27	5.27	2.45
	AUG	10.06	7.02	6.81	3.98	3.71	7.91	12.25	3.65	3.04	6.08	3.25
	SEP											
	OCT											
	NOV											
	DEC											

NOTE: Column 1 3 Month Interbank
2 3 Month Eurodollar
3 3 Month Certificate of Deposit in NY
4 3 Month Interbank
5 3 Month Gensaki rate
6 3 Month Interbank
7 3 Month Interbank
8 World basket consists of weighted average of above countries and Canada

Column 9 Column 1 - Cloumn 2
Column 10 Column 1 - Column 4
Column 11 Column 1 - Column 3

REAL INTEREST RATES IN THE G7

	Nominal Short Rate (1)	Inflation Rate (2)	Real Rate (3)
UK	10.0	4.4	5.4
US	? 7.5	3.9	3.5
Japan	3.8	-0.4	4.2
Germany	4.0	0.8	3.2
France	7.9	3.4	4.4
Italy	12.8	4.7	7.7
Canada	9.3	4.7	4.4
Crude average			G7 4.7
			G5 4.1

(1) Three month money market rates, 17.9.87 source: Reuters

(2) Latest change on 12 months earlier for July (except for Germany)

(3) Latest short nominal rates deflated by inflation rate.

[illegible] US [illegible]
[illegible] 26th [illegible]

3606/8

Table 1: Real Interest Rates for the G7*

	1981	1982	1983	1984	1985	1986	Now
Nominal Rate (1)	14.1	11.8	9.2	9.6	8.5	7.0	
Inflation Rate (2)	9.9	7.1	4.6	4.5	3.9	1.9	
Real Interest Rate (3)	3.8	4.4	4.4	4.9	4.4	5.0	4.7

*Weighted by 1980 GDP at 1980 exchange rates

(1) Three month money market rates

(2) Change in consumer price index from year earlier (RPI for UK)

(3) Nominal rate deflated by inflation rate

NB Real rate better 4 & 5

Table 17: Broad money growth (percentage change in seasonally adjusted measure on a year earlier)

(Recent growth over target base, at annual rate, in brackets)

		US M3	Japan M2+CDs	Germany M2	France M3	UK M3	G5	Germany CBM*
1980		9.2	9.2	8.9	11.2	15.0	9.9	4.8
1981		11.9	8.9	9.9	12.0	19.7	11.7	4.4
1982		10.9	9.2	6.5	11.5	21.2	10.8	4.9
1983		9.8	7.4	2.7	10.2	12.2	8.6	7.3
1984		10.1	7.8	3.3	9.8	9.3	8.6	4.8
1985		9.0	8.4	4.1	8.6	12.2	8.4	4.6
1986		8.1	8.6	4.0	5.1	18.1	8.1	6.4
1987	Jan	8.9	8.6	6.8	5.2	18.4	8.9	7.5
	Feb	8.5	8.8	6.8	4.8	19.8	8.8	7.7
	Mar	7.9	9.0	6.7	4.8	19.3	8.5	7.9
	Apr	7.5	9.8	7.7	6.9	20.3	8.9	7.7
	May	7.2 (5.4)	10.2	8.5	6.6 (9.2)	19.1	8.8	8.4 (7.9)
	Jun	7.0 (5.4)	10.8	7.4	7.7 (12.3)	19.2	8.7(est)	8.8 (8.1)
	Jul	6.1 (4.8)	10.3	7.1	-	20.8	-	8.4 (7.3)
Target		5.5-8.5	10** (Q3)		3-5			3-6

* Comprises 100 per cent of currency in circulation, 16.6 per cent of sight deposits, 12.4 per cent of time deposits and 8.1 per cent of savings deposits.

** Target set in first month of quarter for growth from four quarters earlier

BROAD MONEY GROWTH

sw39

TRADE FIGS.

(iv)

JAPAN

Merchandise trade, 1980=100

		ERI (1975=100)	Export volume	Ratio of X to M	Import volume	Export prices	Import prices	Terms of trade	Current account: $bn	%GNP
1984	Q1	157.2	128.4	121	105.2	99.2	92.9	108.8	7.2	2.3
	Q2	158.7	132.9	121	110.0	99.3	91.1	110.5	9.4	2.9
	Q3	155.0	135.3	121	112.0	97.7	96.2	109.2	7.4	2.4
	Q4	156.5	141.2	132	106.8	95.0	94.0	109.8	11.2	3.6
1985	Q1	154.4	138.2	128	107.6	91.9	96.7	108.1	9.4	3.1
	Q2	155.3	141.7	130	109.4	94.5	94.1	111.3	12.2	3.9
	Q3	157.7	141.3	131	107.9	95.4	89.8	111.8	12.1	3.6
	Q4	175.0	143.8	130	110.3	104.4	77.3	123.5	15.7	4.0
1986	Q1	186.7	138.6	123	112.7	108.6	68.5	131.5	15.9	3.7
	Q2	202.8	140.4	111	126.9	115.3	53.7	161.1	21.6	4.4
	Q3	214.8	141.5	111	127.9	120.0	47.8	172.7	23.8	4.4
	Q4	207.9	136.6	108	126.4	121.2	49.4	174.0	24.3	4.6
1987	Q1	210.1	138.6	114	122.0	123.4	50.6	167.3	24.9	4.6
	Q2	222.9	134.9*	103	131.4*	130.8*	49.7	165.8*	20.9	3.5*

% change over year earlier

		ERI	Export volume	Import volume	Export prices	Import prices	Terms of trade
1985	Q1	-1.8	7.6	1.3	-7.4	4.1	-0.7
	Q2	-2.1	6.6	-0.5	-4.8	3.2	0.7
	Q3	1.7	4.4	-3.7	-2.4	-6.6	2.4
	Q4	11.8	1.8	3.3	9.9	-17.7	12.5
1986	Q1	20.9	0.3	4.7	18.2	-29.2	21.7
	Q2	30.6	-0.9	16.0	21.9	-42.9	44.8
	Q3	36.6	0.1	18.5	25.9	-46.7	54.5
	Q4	18.8	-5.0	14.6	16.1	-36.2	40.9
1987	Q1	12.5	0.0	8.3	13.6	-26.2	27.2
	Q2	9.9	-3.9*	3.6*	13.4*	-7.5	2.9*

* 'WEP Overview' forecast, September 1987

(iv)

UNITED STATES

Merchandise trade, 1980=100

		ERI (1975=100)	Export volume	Rates $ X & M	Import volume	Export prices	Import prices	Terms of trade	Current account: $bn	%GNP
1984	Q1	128.9	83.9	.66	126.7	114.0	100.4	113.5	-18.1	-2.0
	Q2	130.2	85.0	.64	132.1	114.5	101.5	112.9	-28.5	-3.0
	Q3	137.9	87.7	.66	132.8	113.2	101.5	111.6	-29.0	-3.0
	Q4	141.7	88.9	.66	134.8	112.4	101.2	111.1	-31.8	-3.3
1985	Q1	150.0	86.4	.67	129.6	113.6	98.8	114.9	-26.1	-2.7
	Q2	145.8	84.7	.62	136.9	113.8	98.3	115.8	-29.4	-3.0
	Q3	138.4	84.8	.61	138.1	112.2	98.1	114.4	-28.5	-2.8
	Q4	128.8	85.5	.59	145.9	111.6	98.3	113.3	-33.7	-3.3
1986	Q1	121.2	85.3	.58	146.6	112.7	97.1	116.0	-33.0	-3.2
	Q2	116.0	89.9	.58	154.1	112.9	94.1	120.0	-33.8	-3.2
	Q3	111.4	88.8	.56	159.6	113.6	93.9	120.9	-36.6	-3.4
	Q4	110.5	89.5	.56	158.8	113.6	96.4	117.8	-38.0	-3.5
1987	Q1	104.2	91.4	.58	158.0	113.6	97.8	116.1	-36.8	-3.4
	Q2	101.0	97.7*	.60	162.0*	115.5*	102.7*	112.5*	-41.1	-3.7
% change over year earlier										
1985	Q1	16.4	3.0		2.2	-0.3	-1.5	1.2		
	Q2	12.0	-0.3		3.6	-0.7	-3.2	2.6		
	Q3	0.4	-3.3		4.0	-0.9	-3.4	2.5		
	Q4	-9.1	-3.9		8.2	-0.7	-2.8	2.2		
1986	Q1	-19.2	-1.3		13.1	-0.8	-1.8	0.9		
	Q2	-20.4	6.1		12.6	-0.7	-4.2	3.7		
	Q3	-19.5	4.6		15.6	1.2	-4.2	5.7		
	Q4	-14.2	4.8		8.8	1.8	-1.9	3.8		
1987	Q1	-14.0	7.1		7.8	0.8	0.8	0.1		
	Q2	-12.9	8.7*		5.1*	2.3*	9.1*	-6.3*		

* 'WEP Overview' forecast, September 1987

(iv)

GERMANY

Merchandise trade, 1980=100

	ERI (1975=100)	Export volume	Ratio of X to M	Import volume	Export prices	Import prices	Terms of trade	Current account: $bn	%GNP
1984 Q1	125.6	117.1	112	104.2	77.0	118.3	96.8	1.6	1.0
Q2	125.8	114.1	110	104.0	76.8	119.5	95.8	0.2	0.1
Q3	123.2	122.2	114	107.1	73.0	121.7	96.3	1.6	1.0
Q4	121.3	126.1	119	105.3	70.7	123.8	96.0	3.2	2.2
1985 Q1	119.5	126.3	116	109.0	67.3	127.2	94.9	2.0	1.4
Q2	121.7	126.9	118	107.6	71.7	126.7	96.1	3.1	2.1
Q3	125.2	128.6	114	112.5	77.4	122.2	99.4	4.3	2.6
Q4	128.7	128.3	115	111.7	84.3	119.6	100.2	4.4	2.4
1986 Q1	133.1	129.2	112	114.9	91.9	111.3	106.6	7.9	3.8
Q2	134.7	129.4	110	117.7	94.8	104.3	112.3	8.1	3.6
Q3	138.6	129.2	111	116.4	101.3	100.7	115.4	11.3	4.8
Q4	142.6	128.3	109	118.0	104.8	100.2	115.4	9.3	3.8
1987 Q1	147.7	127.1	108	117.7	112.9	97.8	116.8	11.0	4.1
Q2	146.9	131.9	107	122.8	113.9	97.4	116.2	10.7	3.8

% change over year earlier

	ERI	Export volume	Import volume	Export prices	Import prices	Terms of trade
1985 Q1	-4.8	7.8	4.6	-7.4	7.5	-2.0
Q2	-3.2	11.2	3.4	-4.8	6.0	0.2
Q3	1.6	5.3	5.1	-2.4	0.4	3.2
Q4	6.1	1.7	5.1	9.9	-3.4	4.3
1986 Q1	11.4	2.3	5.4	18.2	-12.5	12.4
Q2	10.7	1.9	9.4	21.9	-17.7	16.9
Q3	10.7	0.4	3.5	25.9	-17.6	16.2
Q4	10.8	0.2	5.6	16.1	-16.2	15.2
1987 Q1	11.0	-1.7	2.4	13.6	-12.1	9.5
Q2	9.0	1.9	4.3	13.4	-6.6	3.5

(vi)

Output: Industrial Countries

Table A2. Industrial Countries: Real GNP and Total Domestic Demand, 1969–88[1]
(Annual changes, in percent)

	Average 1969–78[2]	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	Fourth Quarter[3] 1986	1987	1988
Real GNP														
Canada[4]	4.8	3.9	1.5	3.7	–3.2	3.2	6.3	4.3	3.3	2.8	2.9	1.8	3.5	3.1
United States	2.8	2.5	–0.2	1.9	–2.5	3.6	6.8	3.0	2.9	2.4	2.7	2.2	2.7	3.0
Japan	5.8	5.3	4.3	3.7	3.1	3.2	5.1	4.7	2.5	3.2	3.4	2.0	3.3	3.4
France[4]	4.4	3.2	1.6	1.2	2.5	0.7	1.4	1.7	2.1	1.5	1.8	2.0	1.1	2.5
Germany, Fed. Rep. of	3.5	3.9	1.5	—	–1.0	1.8	3.0	2.5	2.4	1.5	2.3	2.4	1.7	1.8
Italy[4]	3.4	4.9	3.9	1.1	0.2	0.5	3.5	2.7	2.7	2.5	2.4	2.6	2.5	2.3
United Kingdom[5]	2.2	2.7	–2.5	–1.4	1.5	3.3	3.0	3.4	3.0	3.3	2.2	3.8	3.0	1.9
Other industrial countries	3.6	3.1	2.3	0.5	0.4	1.7	3.3	2.9	2.3	2.0	1.8	2.1	2.0	2.0
All industrial countries	**3.4**	**3.4**	**1.3**	**1.5**	**–0.3**	**2.7**	**4.9**	**3.2**	**2.7**	**2.4**	**2.6**	**2.2**	**2.6**	**2.7**
Of which,														
Seven major countries above	3.4	3.4	1.2	1.7	–0.5	2.8	5.2	3.2	2.8	2.5	2.7	2.3	2.7	2.8
European countries	3.5	3.4	1.6	0.2	0.7	1.6	2.7	2.6	2.5	2.1	2.0	2.6	2.0	2.0
Real total domestic demand														
Canada	4.9	5.1	1.9	4.7	–6.6	4.1	4.9	4.9	3.9	2.8	2.9	2.1	3.7	2.7
United States	2.8	1.5	–1.8	2.2	–1.9	5.1	8.7	3.6	3.9	1.7	1.9	2.7	1.4	2.5
Japan	5.6	6.5	0.8	2.1	2.8	1.8	3.8	3.8	4.0	4.1	4.4	3.8	4.3	4.2
France	4.1	3.8	1.6	–0.1	3.5	–0.7	0.5	2.2	3.7	2.3	2.1	3.9	1.2	2.7
Germany, Fed. Rep. of	3.6	5.5	1.1	–2.7	–2.0	2.3	1.9	1.5	3.7	2.9	2.9	4.1	2.5	2.3
Italy	3.1	5.7	7.0	–1.2	0.3	–0.4	4.4	3.1	3.2	3.8	2.9	3.4	3.8	2.6
United Kingdom	1.8	3.8	–3.0	–1.5	2.0	4.6	2.8	2.8	3.5	3.7	2.9	4.2	4.1	2.0
Other industrial countries	3.4	3.4	2.0	–1.3	0.3	0.5	2.5	3.0	3.5	2.2	1.8	3.4	2.0	2.1
All industrial countries	**3.3**	**3.6**	**0.2**	**0.6**	**–0.3**	**2.9**	**5.2**	**3.3**	**3.8**	**2.5**	**2.6**	**3.2**	**2.4**	**2.8**
Of which,														
Seven major countries above	3.3	3.6	–0.1	1.0	–0.3	3.3	5.7	3.3	3.8	2.6	2.7	3.2	2.5	2.8
European countries	3.3	4.4	1.6	–1.8	0.7	1.3	2.1	2.5	3.8	3.0	2.4	4.0	2.6	2.3

[1] Composites for the country groups are averages of percentage changes for individual countries weighted by the average U.S. dollar value of their respective GNPs over the preceding three years.
[2] Compound annual rates of change.
[3] From fourth quarter of preceding year.
[4] GDP at market prices.
[5] Average of expenditure, income, and output estimates of GDP at market prices.

REAL GDP GROWTH

UK	[illegible] 7	[illegible] 5
1979	6	5
80	7	5
81	7	5
82	3	3
83	2	2
84	5	3
85	3	2
86	2	1
87	1	1

(V)

Table A17. Major Industrial Countries: General Government Fiscal Balances and Impulses, 1979–88[1]
(In percent of GNP)[2]

	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988
Fiscal balance										
(+ *surplus,* − *deficit)*										
Canada	–2.0	–2.8	–1.5	–5.8	–6.9	–6.4	–7.0	–5.5	–4.6	–4.2
United States	0.5	–1.3	–1.0	–3.5	–3.8	–2.8	–3.3	–3.5	–2.3	–2.4
Japan	–4.7	–4.4	–3.5	–3.6	–3.7	–2.1	–0.8	–0.6	–1.2	–1.6
France	–0.8	—	–1.9	–2.8	–3.2	–2.7	–2.9	–2.9	–2.6	–2.1
Germany, Fed. Rep. of	–2.6	–2.9	–3.7	–3.3	–2.5	–1.9	–1.1	–1.2	–1.5	–2.0
Italy[3]	–9.5	–8.5	–11.5	–11.3	–10.7	–11.5	–12.2	–11.2	–10.3	–9.8
United Kingdom	–3.2	–3.5	–2.8	–2.3	–3.6	–3.8	–2.6	–2.8	–2.6	–2.5
Seven major countries above	**–1.8**	**–2.5**	**–2.7**	**–3.9**	**–4.1**	**–3.4**	**–3.3**	**–3.3**	**–2.6**	**–2.7**
Seven major countries except the United States	–3.7	–3.5	–3.9	–4.3	–4.4	–3.9	–3.3	–3.0	–2.9	–3.0
Fiscal impulse										
(+ *expansionary,* − *contractionary)*										
Canada	–0.2	0.5	–0.8	1.3	1.2	1.3	1.6	–1.0	–0.6	–0.1
United States	–0.5	0.7	–0.5	0.5	0.6	0.6	0.7	0.3	–1.3	0.1
Japan	–0.5	–0.4	–1.2	–0.1	–0.2	–1.2	–1.0	–0.7	0.4	0.3
France	–0.9	–1.4	1.4	0.7	–0.2	–0.8	–0.1	—	–0.7	–0.6
Germany, Fed. Rep. of	0.8	–0.2	–0.5	–1.9	–0.5	0.4	–0.6	0.3	—	0.6
Italy[3]	0.4	1.3	1.9	–1.4	–1.7	0.8	0.9	–0.9	–0.8	–0.5
United Kingdom	–0.9	–2.0	–2.7	–1.1	1.6	0.5	–0.7	0.4	0.3	—
Seven major countries above	**–0.4**	**—**	**–0.4**	**–0.1**	**0.2**	**0.2**	**0.2**	**—**	**–0.7**	**0.1**
Seven major countries except the United States	–0.2	–0.5	–0.4	–0.5	–0.1	–0.2	–0.3	–0.3	–0.1	0.1
Memorandum										
Fiscal balance, territorial authorities[4] Germany, Fed. Rep. of	–3.3	–3.9	–4.9	–4.4	–3.3	–2.6	–2.1	–2.2	–2.4	–2.9

[1] Data are on a national income accounts basis. Composites for the country groups are weighted averages of the individual national ratios for each year, with weights proportionate to the U.S. dollar value of the respective GNPs in the preceding three years.
[2] Canada, France, Italy, and the United Kingdom: in percent of GDP.
[3] Data from 1980 are not comparable with those for 1979 because they are based on a recent revision of the national income accounts. The fiscal impulse estimate of the April 1987 WEO is shown for the transitional year 1980.
[4] General government, on an administrative basis, excluding social security transactions.

GOVT DEFICITS

(vi)

Table A3. Industrial Countries: Components of Real GNP, 1969–88[1]
(Annual changes, in percent)

	Average 1969–78[2]	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988
Consumer expenditure											
Canada	5.2	2.9	2.2	2.3	–2.6	3.4	4.3	5.2	3.9	3.3	2.9
United States	3.4	2.2	–0.2	1.2	1.3	4.7	4.8	4.6	4.2	1.8	2.1
Japan	5.8	6.4	1.4	1.3	4.1	3.2	2.7	2.6	2.7	3.7	3.7
France	4.8	3.0	1.2	2.1	3.5	0.9	1.0	2.4	3.4	1.8	1.7
Germany, Fed. Rep. of	4.4	3.6	1.3	–0.5	–1.3	1.7	1.5	1.7	4.2	3.2	2.7
Italy	3.6	5.3	4.3	1.5	1.1	0.4	2.2	2.7	3.2	3.9	3.0
United Kingdom	2.1	4.5	–0.2	—	0.8	3.9	2.1	3.6	5.1	4.1	3.3
Other industrial countries	3.7	2.7	1.1	–0.1	0.9	1.0	1.1	2.9	3.0	2.2	1.9
All industrial countries	**3.8**	**3.4**	**0.8**	**0.9**	**1.4**	**3.0**	**3.1**	**3.6**	**3.8**	**2.6**	**2.5**
Of which,											
Seven major countries above	3.8	3.5	0.8	1.1	1.5	3.4	3.4	3.7	3.9	2.6	2.6
European countries	3.8	3.5	1.3	0.3	0.8	1.5	1.4	2.6	3.9	3.0	2.4
Public consumption											
Canada	4.6	0.6	2.8	2.5	2.4	1.4	1.5	2.7	1.0	1.6	1.9
United States	0.1	0.8	1.9	1.5	1.9	1.1	4.4	7.3	3.8	2.2	3.2
Japan	5.1	4.4	2.8	4.8	1.9	2.9	2.8	2.0	6.6	1.0	3.3
France	3.6	3.0	2.5	3.1	3.7	2.1	1.1	3.2	2.7	1.5	1.5
Germany, Fed. Rep. of	3.8	3.4	2.6	1.8	–0.8	0.2	2.5	2.2	2.5	2.6	2.2
Italy	3.2	1.7	2.1	2.7	2.9	2.8	2.0	3.5	3.0	2.4	2.0
United Kingdom	2.0	2.3	1.5	0.4	1.0	1.9	0.6	0.4	0.8	1.9	1.2
Other industrial countries	4.4	2.9	2.8	2.3	1.9	3.0	1.5	2.9	2.6	1.6	1.3
All industrial countries	**2.2**	**2.2**	**2.3**	**2.3**	**1.8**	**1.8**	**2.9**	**4.5**	**3.6**	**1.9**	**2.6**
Of which,											
Seven major countries above	1.9	2.1	2.2	2.3	1.8	1.6	3.1	4.7	3.7	2.0	2.8
European countries	3.5	3.0	2.4	2.1	1.7	1.8	1.5	2.3	2.3	2.0	1.6
Gross fixed investment											
Canada	4.9	8.3	10.0	11.7	–11.0	–0.7	1.6	8.1	5.1	5.1	2.5
United States	3.8	3.7	–7.9	1.1	–9.6	8.2	16.8	5.5	1.8	–1.4	1.9
Japan	6.4	5.3	—	3.1	0.8	–0.3	4.9	5.6	6.5	6.6	5.4
France	3.6	3.1	2.6	–1.9	–1.4	–3.6	–2.3	1.1	3.0	3.9	4.0
Germany, Fed. Rep. of	2.4	7.3	2.8	–4.8	–5.3	3.2	0.8	–0.4	3.3	2.7	4.4
Italy	0.7	5.8	9.4	–2.3	–5.7	–1.6	4.4	3.3	1.2	2.8	2.9
United Kingdom	0.9	2.6	–4.8	–9.5	4.1	5.9	9.0	1.9	1.2	4.8	2.8
Other industrial countries	2.5	0.4	2.2	–2.0	–2.4	–0.9	3.0	3.8	5.3	3.5	2.4
All industrial countries	**3.4**	**4.0**	**–1.5**	**–0.4**	**–4.9**	**3.3**	**8.8**	**4.3**	**3.2**	**1.9**	**3.1**
Of which,											
Seven major countries above	3.5	4.6	–2.2	–0.2	–5.3	4.0	9.6	4.4	2.9	1.7	3.2
European countries	2.2	3.5	2.3	–4.4	–2.3	0.9	2.6	1.8	3.9	3.7	3.3

Comp-onents of GDP

(vii)

Table A9. Industrial Countries: GNP Deflators and Consumer Prices, 1969–88[1]
(Annual changes, in percent)

	Average 1969–78[2]	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	Fourth Quarter[3] 1986	1987	1988
GNP deflator														
Canada[4]	7.2	10.0	10.6	10.8	8.7	5.0	3.3	3.2	3.0	4.2	3.5	3.2	4.0	3.4
United States	6.7	8.8	9.1	9.6	6.4	3.8	3.7	3.2	2.6	3.3	3.8	2.2	3.9	3.7
Japan	8.2	3.0	3.8	3.2	1.9	0.8	1.2	1.5	1.8	0.6	1.7	1.3	1.2	1.6
France[4]	8.5	10.1	11.4	11.4	11.7	9.7	7.5	5.7	4.7	3.4	3.0	3.5	3.4	2.9
Germany, Fed. Rep. of	5.6	4.0	4.8	4.0	4.4	3.2	2.0	2.2	3.1	2.4	2.2	3.0	2.0	2.4
Italy[4]	12.1	15.9	20.7	18.5	16.2	15.2	10.2	8.8	8.0	5.3	5.3	7.1	5.4	5.1
United Kingdom[4]	11.8	14.5	19.9	11.5	7.6	5.1	4.1	6.0	3.5	4.5	4.8	2.1	4.7	5.0
Other industrial countries	9.0	7.7	9.1	9.4	9.7	7.6	6.7	5.6	5.7	3.9	3.6	5.3	3.5	3.6
All industrial countries	**7.8**	**8.1**	**9.3**	**8.8**	**7.2**	**5.1**	**4.2**	**3.8**	**3.3**	**3.1**	**3.3**	**2.8**	**3.3**	**3.3**
Of which,														
Seven major countries above	7.6	8.2	9.3	8.7	6.7	4.7	3.8	3.5	3.0	2.9	3.3	2.5	3.3	3.2
European countries	8.8	9.0	11.1	9.8	9.2	7.6	5.8	5.3	4.7	3.6	3.5	4.0	3.4	3.5
Consumer prices														
Canada	6.9	9.2	10.2	12.5	10.8	5.8	4.3	4.0	4.2	4.3	3.7	4.3	4.2	3.5
United States	6.5	11.3	13.5	10.4	6.1	3.2	4.3	3.6	1.9	3.7	4.1	1.3	4.6	4.0
Japan	9.1	3.7	7.7	4.9	2.7	1.9	2.3	2.0	0.6	0.3	1.6	–0.2	1.3	1.3
France	8.4	10.8	13.3	13.4	11.8	9.6	7.4	5.8	2.7	3.3	3.0	2.3	3.2	3.0
Germany, Fed. Rep. of	4.6	4.1	5.4	6.3	5.3	3.3	2.4	2.2	–0.2	0.7	2.6	–1.1	2.1	2.6
Italy	11.1	14.8	21.3	19.5	16.5	14.7	10.8	9.2	5.8	4.5	4.9	4.4	4.8	4.8
United Kingdom	11.7	13.4	18.0	11.9	8.6	4.6	4.9	6.1	3.4	4.2	4.5	3.4	4.0	4.8
Other industrial countries	8.6	7.9	10.1	10.3	9.9	7.8	6.3	5.8	4.8	4.0	3.7	4.5	3.8	4.2
All industrial countries	**7.6**	**9.1**	**11.8**	**10.0**	**7.5**	**5.0**	**4.7**	**4.1**	**2.3**	**3.0**	**3.4**	**1.7**	**3.6**	**3.5**
Of which,														
Seven major countries above	7.4	9.3	12.1	10.0	7.1	4.5	4.5	3.9	2.0	2.9	3.4	1.3	3.6	3.4
European countries	8.4	8.9	11.9	11.3	9.7	7.4	6.2	5.4	2.9	2.9	3.4	2.3	3.2	3.7

[1] Composites for the country groups are averages of percentage changes for individual countries weighted by the average U.S. dollar value of their respective GNPs over the preceding three years.
[2] Compound annual rates of change.
[3] From fourth quarter of preceding year.
[4] GDP at market prices.

INFLATION

KARL OTTO PÖHL
PRÄSIDENT DER DEUTSCHEN BUNDESBANK

6 FRANKFURT AM MAIN
WILHELM-EPSTEIN-STRASSE 14
TELEFON 1581

September 23, 1987

The Rt. Hon. Nigel Lawson
Chancellor of the Exchequer
Parliament Street

London SW1P 3AG
England

cc Sir G Littler
Governor
Mr Loehnis
Mr Lankester

Dear Chancellor:

In my capacity as Chairman of the Group of Ten central bank governors, I should like to draw your attention to certain aspects of a possible enlargement of the number of members of the Group of Ten which are causing me some concern. Meetings of the Central Bank Governors of the Group of Ten, unlike meetings of the Council of Ministers, have been taking place practically every month since 1964 as part of the meetings held at the BIS, and have developed into possibly the most important forum of international cooperation among the central banks. The intensity of this cooperation can be seen, among other things, from the fact that over the years we have set up a great number of committees which have carried out important practical work. I need only recall the present deliberations in the context of the Committee on Banking Regulations and Supervisory Practices, known as the "Cooke Committee". There are the following committees as well:

Committee of Experts on Gold and Foreign Exchange
Group of Computer Experts
Euro-currency Standing Committee
Group of Experts on Monetary and Economic Data Bank Questions
Group of Experts on Payment Systems

In addition to the routine work done by these committees, the G-10 Central Bank Governors have taken some exceptionally important decisions in recent decades; I need only remind you of the stand-by credits for the pound sterling in the 1960s and 1970s, the bridging loans for problem debtor countries in the 1980s and the two BIS credits to the International Monetary Fund which were guaranteed by the central banks of the Group of Ten.

It is of great importance to us all to have an opportunity of conversing at monthly intervals on terms of strict confidentiality on the subject of monetary policy, conditions in the foreign exchange markets and the like. In my opinion, this style of cooperation would be gravely impaired if the Group of Ten were enlarged to include other countries. I can understand the political rationale of any such move, but I feel it is incumbent upon me to draw your attention to the implications which it may have for cooperation among central bank governors, which has so far functioned so effectively and so unobtrusively.

Yours sincerely

Karl Otto Pöhl

Rt. Hon. Nigel Lawson

G R O U P   O F   T E N

(Note by the Chairman)

ENLARGEMENT OF MEMBERSHIP

At a previous meeting concern was expressed whether there could be any way of drawing a line on the admission of members.

As a basis for discussion I offer the following possible guide-lines for strictly limited enlargement of membership:

1. Group of Ten and GAB membership must be identical.

2. The Group consists of willing industrial countries with the most substantial economies.

3. Economic substance for this purpose can appropriately be measured by gross domestic product and IMF quota shares.

4. Membership should continue to be restricted: new members should not be admitted unless their economies are more substantial than those of the smallest existing members; to qualify they should outrank one or more existing members in both GDP and IMF quota shares.

5. GAB quotas for new members should be settled on the basis of IMF quota shares in relation to those of other members of similar size.

The Annex to this note gives relevant figures.

(Signed) Nigel Lawson

G.D.P., FUND QUOTAS AND G.A.B. MEMBERS' SHARES

	GDP 1986	Fund Quota		GAB Share	
	$ bn	SDR bn	%	SDR mn	%
G.A.B. Members:					
United States	4167	17.9	(20.1)	4250	(25.0)
Germany	890	5.4	(6.1)	2380	(14.0)
Japan	1959	4.2	(4.7)	2125	(12.5)
France	706	4.5	(5.0)	1700	(10.0)
United Kingdom	545	6.2	(6.9)	1700	(10.0)
Italy	504	2.9	(3.3)	1105	(6.5)
Switzerland	134	–	–	1020	(6.0)
Canada	359	2.9	(3.3)	892.5	(5.25)
Netherlands	171	2.3	(2.5)	850	(5.0)
Belgium	111	2.1	(2.3)	595	(3.5)
Sweden	132	1.1	(1.2)	382.5	(2.25)
Total				17000	(100)
Applicants:					
Australia	161	1.6	(1.8)		
Spain	227	1.3	(1.4)		
Austria	94	0.78	(0.87)		
Other OECD Members:					
Denmark	80	0.71	(0.80)		
Norway	69	0.70	(0.78)		
Finland	70	0.57	(0.64)		
New Zealand	26	0.46	(0.52)		
Turkey	59	0.43	(0.48)		
Greece	39	0.40	(0.45)		
Portugal	29	0.38	(0.42)		
Ireland	25	0.34	(0.38)		
Luxembourg	5	0.08	(0.09)		
Iceland	4	0.06	(0.07)		
Other:					
South Africa	62	0.91	(1.03)		

INTERNATIONAL MONETARY FUND

cc: Sir G. Littler
[illegible] Evans
Mr. Lankester

Re G10 Meeting, agenda item 2

Possible Enlargement of G-10 Membership September 24, 1987

Memorandum for the Ministers and Governors of the G-10 from the Ministers and Governors of the Netherlands and Sweden

---

At the meeting of Ministers and Governors of the Group of Ten on 27th September 1986, it was decided that the issue of a possible enlargement of G-10 membership would be taken up again before the end of 1987. Consequently, the Group will now consider the applications for membership by various countries.

As was pointed out last year, our main concern should be the homogeneity of interests of the participating countries and the importance of this factor for the functioning of the Group. The issue is not whether or not we are opposed to one or more of the individual applicants. The issue at stake is whether an extension of the G-10's membership per se might detract from its role and effectiveness.

The Group of Ten has laid the basis for an effective network of more specialised groups in which the G-10 members participate. Among these are the Central Bank Governors, the G-10 Deputies, Working Party 3 of the OECD, the Eurocurrency Standing Committee, the so-called Cooke-committee coordinating banking supervision and the Gold and Foreign Exchange Committee. In their present homogeneous and limited composition these are groups of proven value and effectiveness. When we consider the possible consequences of admitting new members, our prime concern should be to what extent an enlargement of the G-10 might impinge on the current functioning of these groups. We are convinced that their homogeneity would run grave risks of being undermined by an extended membership.

Last year, a number of delegations expressed fear that any agreement to the admission of Spain and Australia might encourage requests for membership by other countries. Indeed, we now have already before us one more such request lodged by the Government of Austria. This seems to justify the hesitation expressed by several delegations against the creation of precedents concerning the admission of new members, which would compromise the Group's character.

Consequently, it seems to us that the Group of Ten should be preserved in its present form and size.

Il Direttore Generale della Banca d'Italia

Sir G. Littler
Mr. Lechris
Mr. Lankester
Mr. Evans

Group of Ten
Chairman of the Deputies

Rome, September 25, 1987

To the Deputies of
the Group of Ten

Please find enclosed the text of the report to the Ministers and Governors on the Deputies' meeting of September 9, 1987.

In view of the brevity of the scheduled meeting of the G-10 on September 27, it is my intention to make at that meeting only a brief oral presentation of this report, the full text of which will be available to the Ministers and Governors and will be placed on the record.

Dini

Report to the Ministers and Governors of the G-10
from the Chairman of the Deputies on the
Meeting of 9 September 1987 in Paris

In preparation for today's meeting your Deputies met on 9 September to exchange views on issues to be discussed in the Interim and Development Committees. Three broad issues were examined: the international adjustment process and multilateral surveillance; the debt situation of the developing countries; and IMF policies. The Deputies also discussed some questions relating to the GAB.

1. ADJUSTMENT PROCESS AND MULTILATERAL SURVEILLANCE

The discussion opened with broadly similar presentations by IMF and OECD staff of the world economic outlook. Recent evidence suggests that the economic situation in the industrialized economies has shown signs of improvement since the spring. Growth has picked up after a poor first quarter and seems set to continue at a moderate pace next year.

In this regard the Deputies noted that the industrial countries are now into the fifth year of uninterrupted economic growth. Since this has been achieved in the face of important structural adaptations, which are still under way, it is understandable that growth has been slower than during previous periods of economic expansion. Policies to remove impediments to the efficient working of markets have been paying off in terms of increased structural flexibility. Moreover, growth appears set to continue in the foreseeable future; there have been no signs so far of the kind of inflationary tensions that brought preceding recoveries to a halt. There is thus good reason for governments to continue with the medium-term approach, which highlights the need for sustainable macroeconomic policies as well as structural reform.

Turning to external adjustment, the Deputies noted that growth in countries with large external surpluses has recently picked up: while the shift in relative growth rates has not been large enough to reduce international imbalances substantially, there is a definite tendency in the right direction. In this regard the Deputies stressed the importance of looking beyond nominal changes, which have been much affected by the valuation effects of currency movements, to developments in trade and services flows in volume terms, where a significant adjustment is taking place. These positive developments reflect an improvement in the underlying economic fundamentals. In particular, there has been improved coordination of economic policies following the Louvre Accord, which was seen as the main reason for the orderly conditions in exchange markets. An important aspect has been the reduction of the budget deficit in the United States achieved in 1987; the expansionary fiscal measures announced in countries with strong current account positions have likewise been of help. The Deputies therefore reaffirmed their strong belief in the continuing validity of the Accord on ground that a further depreciation of the US dollar could prove counterproductive, and stressed the importance of reducing policy inconsistencies in order to accelerate external adjustment. Some Deputies argued that a satisfactory resolution of the imbalances problem requires stronger growth in the surplus countries, especially in view of the modest outlook for growth in the world economy that is in prospect. Improved levels of activity would have the additional benefits of reducing unemployment rates -- a crucial consideration for Europe -- and of easing the severe difficulties of the developing countries. The Deputies pointed out that the problem of adjustment is not confined to the major industrial countries: some newly industrialized countries must take action to reduce their unsustainably large trade surpluses.

Another requirement for satisfactory world economic performance is the maintenance of free trade; the Deputies expressed concern about rising protectionist tendencies in some countries, which pose a threat to economic growth and efficiency world-wide and particularly to conditions in the developing countries.

On the issue of indicators, the Deputies thought that the work of Fund staff has provided useful inputs to multilateral surveillance. Indicators not only have helped to improve understanding of how economies interact but have also heightened awareness of the political realities and constraints in national decision-making processes. The Deputies emphasized in this respect that no automatic policy responses can be attached to movements in indicator variables. In view of the useful start that has been made, the Deputies also recommended that the Fund continue to develop its use of indicators in surveillance exercises; some Deputies considered that the exercise could be extended to a wider group of countries.

II. DEBT SITUATION

The Deputies unanimously reiterated their support for the current case-by-case, growth-oriented strategy on developing countries' debts, relying on the active cooperation of governments, commercial banks and international institutions. In view of the duration of the debt difficulties and the recent acute problems with some of the major debtors, the Deputies discussed some aspects where the strategy might need strengthening.

It seemed clear, in the first place, that the banks have not been playing the role envisaged for them, nor are the prospects for the future good, as the banks are increasingly reluctant to put up "new money" for balance-of-payments financing to countries whose liabilities are already trading at heavy discounts in secondary markets. The Deputies stressed the importance of increased participation by the banks and approved of innovations in the "menu" of instruments that might induce banks to maintain their involvement, such as debt-equity or debt-commodity swaps. However, they noted that these techniques could not in practice be expected to result in very large increases in lending. At the same time, the Deputies were firmly against the public sector taking over any part of the burden that properly belongs to the banks: schemes for officially financed general debt relief were thus considered to be out of the question. In this context, the Deputies warned that secondary market valuations of sovereign debt must not be used as a basis for loan forgiveness. Beyond this, however, there was no clear consensus on the best way to deal with any shortfalls in bank loans.

Some Deputies noted that certain underlying conditions have become less favourable than had been anticipated at the inception of the strategy: for example, growth in the industrialized countries has not maintained the three per cent pace thought necessary for adequate growth in developing country exports; and real interest rates have remained high. These Deputies were led to conclude that it might be necessary to explore, at least as a contingency measure, the possibility of new official initiatives to promote financing to the developing countries, on a case-by-case basis. This, it was stressed, would provide no official help to the banks with respect to their existing exposure and would be confined to debtor countries that implement strong adjustment programmes.

Other Deputies placed more emphasis on the positive aspects of the situation. First, some large debtor countries have recognized more clearly that there is no substitute for sustained reforms, the example of the developing countries in Asia that have avoided serious debt problems being instructive in this regard. Second, there has been some movement towards increased reliance on the private sector. Third, more realistic views have been emerging of how external financing might contribute to development. These Deputies considered that any additional public sector financing must be fairly limited and should be seen primarily as a catalyst for increasing private sector flows.

In any event, your Deputies agreed that it was of critical importance that debtor countries implement and sustain growth-oriented adjustment programmes, and stressed the central role of IMF conditionality. They thought it important to dispel any illusion that different ways are available to any government that chooses not to follow an IMF programme, and to isolate countries that tried unilaterally to evade their international responsibilities.

The Deputies reiterated that a clear distinction should be drawn between middle-income countries predominantly indebted to the banks and very poor countries whose debts are largely to official lenders. The Deputies recognized that in many cases the latter countries simply do not have the resource base to service their external debt and favoured generous treatment of them. They noted that indeed there have already been positive developments in this regard, notably the significant concessions granted on interest rates and repayment periods through Paris Club reschedulings. The Deputies thought that such initiatives might desirably be taken further.

ours done

A number of Deputies thought it appropriate at this stage to set clear priorities for action by the industrialized countries on the debt problem. They included: (i) full implementation of the IDA VIII replenishment; (ii) enhancement of the IMF Structural Adjustment Facility; (iii) early agreement on a general capital increase of the World Bank; and, with lower priority, (iv) the 9th IMF quota review.

III. IMF POLICIES

The Deputies agreed that the enlarged access policy should be continued for another year. On whether access limits should be left unchanged or should be lowered, the Fund staff pointed out that since actual IMF lending has remained below the existing limits, any decision on this issue would depend on what signal the authorities wished to send out, rather than on immediate effects on financing flows. Most Deputies recommended that existing limits be retained for a further year. They saw this as a useful signal of encouragement to the developing countries and also to the banks. One Deputy argued, however, that a small cut in access limits, and specifically in the cumulative limit, would be an appropriate reminder that enlarged access was indeed meant to be temporary.

All Deputies supported the proposed enhancement of the Structural Adjustment Facility, but opinions differed somewhat on how best to accomplish this. A majority concurred with the IMF staff that a trust fund arrangement would be preferable to direct lending to the IMF's general resource account (GRA). The IMF staff explained that the trust arrangement would present several advantages: it would better protect the revolving nature of Fund resources; it would allow assistance to be confined to the countries most in need; and it would avoid conflicts with the policy on access to the GRA or the need for precedent-setting special arrangements.

A number of Deputies, however, preferred direct lending to the Fund's GRA, arguing that the trust approach, which will require members' contributions to come out of government budgets, would make it more difficult to raise the targeted amounts and result in unwanted delays. The trust fund concept also raises legal problems for particular countries. In addition, there were other questions to be settled, notably how to ensure (i) the liquidity of placements in a trust fund; and (ii) the security of trust fund assets against the risk of non-repayment of loans. Most Deputies considered the proposals made by the Fund staff on these two points as useful but felt they required further scrutiny.

The Deputies discussed how the burden of SAF financing should be shared and stressed the need for a clear understanding on the size of potential contributions. Some, while taking into account reservations expressed by the IMF, saw a balance of advantage in favor of sales of Fund gold as one source of finance, but others were more inclined to the IMF view. A number of Deputies stressed the importance of participation by all the major countries, while others argued that the countries with current account surpluses should shoulder most of the burden. The Deputies urged that the required technical work proceed rapidly, keeping in mind the time framework indicated in the Venice Communiqué, but recognized that the associated negotiations, given the complexity of the issues, might take some time.

IV. GAB RENEWAL AND RELATED ISSUES

The Deputies were briefed by the Treasurer of the Fund on the procedures for the renewal of the General Arrangements to Borrow for a further five-year period. Under Paragraph 19 of the GAB the Fund is to adopt a decision on renewal at least one year prior to the expiry of the Arrangements -- in the present case the decision needs to be taken no later than December 24,

1987. In considering renewal, the Fund and the participants are to review the functioning of the Arrangements, including the provisions on the use of the credit arrangements for non-participants.

There has been no activation of the GAB since the 1983 revision and enlargement, and thus no experience with the functioning of the existing GAB decision. The IMF staff has nonetheless reviewed the provisions of the GAB decision and does not consider that any changes are necessary: it therefore proposes that the Arrangements be renewed for a further five-year period without amendments. The Deputies were in agreement with this recommendation.

On this basis, provided that the G-10 Ministers and Governors indicate their agreement, the Fund staff will submit a paper on renewal to the Executive Board (around mid-November); individual GAB participants need not concur formally in the renewal; participants will be deemed to continue to adhere to the decision unless notice of intention to withdraw from the Arrangements is received by the Fund no later than June 25, 1988. The Fund will consult with Saudi Arabia regarding the renewal of the Associated Agreement for another five years.

The Treasurer of the Fund also reported briefly on the procedure to be followed in the event that the GAB members wish to admit new participants to the Arrangements. Paragraph 3(b) of the GAB decision requires that, after giving notice of its desire to adhere to the GAB decision, the prospective new participant consult with the Fund, that the Fund agree, and that no participant object. It also requires that the amount of the credit arrangement of any new member shall be no less than the smallest existing arrangement.

A decision to admit new participants is legally distinct from the decision on renewal. Therefore, any new participants could become participants prior to renewal, upon renewal or after renewal of the Arrangements.

The Deputies had a brief exchange of views on the merits of this issue, but no consensus on the admission of new participants emerged.

Ch

(!)

prop

AA

Note for G10 - WASHINGTON

The EC Commission will be represented in the G10 meeting by Mr Matutes, the Spanish Commissioner.

He has indicated to the Secretariat that he would like to make a statement (under the heading of preparation for the annual meetings) in support of 'indicators'!

I have told the Secretariat that I have taken note and will inform the Chairman.

(Geoffrey Littler)

c.c. PPS
Mr Huw Evans

SIR GEOFFREY LITTLER   cc: Mr. Foot

CALCULATED QUOTAS

You asked for some arguments against the proposition that calculated quotas should be used in discussion of G10 membership.

2. Calculated quotas are used only as one of a number of inputs in the review of quotas. Even here, there are other important considerations. The various formulae for calculated quotas are at best an approximation to relative economic strengths - though we are not pressing for a revision to the formulae in the current review, because of the potential work and uncertainty over the outcome for the UK. Were the calculated quotas to be used more widely, or if the outcome would be likely to be very different for the UK, then we could easily point to some difficulties in the formulae at present used.

3. Actual quotas are and always have been what matter.

H.P.E.

Huw Evans
26 September, 1987

SIR GEOFFREY LITTLER

cc PPS

G10

I gave Van Houtven the one-page note from the Chancellor with attached table, for distribution to members (not observers) in the course of today and for having on the table at the meeting.

2. On the draft communique, we agreed that the words "no major change" could be omitted, since they left open the possibility of minor changes.

3. On agenda item 4, Admission of New Members, it was agreed that this should be in Executive Session i.e. members only. On the position of the Managing Director for this item, it would be best if the Chancellor invited him to remain for the discussion.

HPE

Huw Evans
26 September, 1987

26/9/87.

pup

NOTE FOR THE RECORD

cc: J. Caines
T. Lankester
H. Evans
T. Richardson
R. Ware
G. Leader
J. Gibb
I. Buist)
K. Frost) ODA

Chancellor should see X

R

MEETING OF G6 DEPUTIES ON MULTILATERAL DEVELOPMENT BANKS

Ken Frost and I attended the G6 Working Dinner hosted by Jim Conrow and Frank Vukmanic (US Treasury). The main representatives from the other countries were: Kashiwaya (Japan), Eberhard Kurth (Germany), Lajeunesse (France) and John Coleman (Canada). This note covers the World Bank issues. Mr. Frost will be recording the discussion on the RDBs and IFAD.

!! 2. All agreed that Italy, which applied for membership, should be admitted to the group. Mr. Frost suggested the retention of the title G6, to distinguish from the existing G7 Deputies Group.

GCI

3. Conrow introduced the Meeting by referring to the newly announced US position on the GCI. The US was ready to negotiate immediately with the object of having a GCI effective within a year. They had yet to take a position on size. On paid-in, Conrow argued that the US had a limited pot of funds for all MDB's, and more for the World Bank meant less for other uses. The World Bank was financially strong, and he saw no financial need for a paid-in element. In subsequent discussion most representatives stressed the importance of market perceptions, which argued for at least a token paid-in element. Several countries, particularly Japan, Germany and France favoured substantial figures (5% or more). Japan argued for more than 7½%.

4. Coleman enquired whether there might be a role for a Deputies Group in negotiating the GCI. Kurth argued that this had always been handled by the Executive Board, and while not excluding an ad hoc meeting if there were difficult policy issues to be solved, believed that the GCI should remain basically the Board's responsibility. This view was generally supported.

Other World Bank Issues

5. Conrow wondered whether there should be some sort of cross default clause between the IMF and the World Bank on the one hand, and the World Bank and the RDB's on the other. Others argued that a pragmatic approach was needed, likening the IMF and World Bank to the bad cop and good cop act.

6. The reorganisation was discussed. There was general agreement with the UK view that there had been serious flaws in implementation, but the Bank should now be encouraged to put this episode behind it and get back to work.

MIGA

7. It was noted that the IDA8 advance contribution scheme had just taken effect with a substantial Japanese contribution. Conrow said that there was still much work to be done in getting IDA 8 through Congress. The expectation was that an omnibus Continuing Resolution would be passed around the end of November. The Administration were optimistic that they would obtain authorisation for IDA 8, and first year appropriations in the $800 million plus range.

Japanese Initiatives

8. There was an exchange on MIGA. The US Treasury was pressing for authorisation and full appropriation ($44 million), but the outcome was still unclear. Japan had already ratified, Germany expected to ratify shortly and Canada in October/November. The UK and France expected to ratify early in the new year, due to their legislative programs.

9. The Japanese announced they would be proposing two intiatives:

(a) A capital fund managed by IFC designed to promote debt/equity conversions;

(b) A facility to provide guarantees against commercial risks for lending by commercial banks - perhaps in the form of a MIGA Phase II, after MIGA had established its initial investment guarantee business.

Both were ideas for further study, rather than detailed and defined proposals. The US and Canada both expressed strong reservations about the guarantee proposal. The bank's must assume responsibility for their own commercial risk assessment; Governments and tax payers should not step in to bail them out. Coleman suggested that the program of World Bank cofinancing with commercial banks should be re-examined by the Executive Directors. It did not seem to have made much progress.

Sub-Saharan Africa

X 10. I introduced the subject of Sub-Saharan African debt, and called for support for the Chancellor's Initiative. Hard line statements were made by the US, West Germany, Canada and Japan stressing budgetary difficulties and the risk of "contagion". The US had concluded that the financial impact would be small, and not critical in most countries, and the risk of contagion and of domestic implications (farm credit) made it not worthwhile.

11. The French response was sympathetic in tone, but contained little support in substance. France placed more emphasis on the

enlargement of the SAF. On concessional interest rates, they saw no early prospect of concensus, but agreed that " we should move in that direction". Initial moves might be:

(i) Concessional interest on rescheduled aid loans;

(ii) low or zero margins on moratorium interest rates.

In conclusion, France would join a concensus on concessional interest rates in the Paris Club, but had considerable hesitations over contagen: Egypt and Cote d'Ivoire would be early candidates for joining the list.

12. On the SAF, Japan advocated sale of IMF gold to finance half the cost. Canada was concerned about the lack of response to the SAF proposal, and felt there was a danger of losing momentum.

13. Coleman said there was a strong feeling in Canada that the country had already done enough, and others had not matched it. Canada had extended RTA beyond the lldcs, and enquired about others' position. Germany and France had carried out RTA for the least developed countries. The US had not. (Conrow remarked with satisfaction that he had blocked it while a Congressional aide). RTA now would be at the expense of other aid flows.

J A L FAINT
26 September, 1987

September 26, 1987

Statement of the Group of Seven

1. The Finance Ministers and Central Bank Governors of seven major industrial countries met today. The Managing Director of the IMF also participated in the meeting. This continues the economic policy coordination process agreed by their Heads of State or Government at the 1986 Tokyo Summit and strengthened at the 1987 Venice Summit meetings. The Ministers and Governors are convinced that this process, including the use of economic indicators, provides an important and effective means of promoting a healthy and prosperous world economy and stable monetary system.

2. The Ministers and Governors reviewed together the events, policy developments, and evolution of foreign exchange markets since the Louvre Agreement and the April G-7 meeting in Washington. They were pleased with the exchange rate stability which has been achieved and which has benefitted their policies and performance.

3. In the Louvre Agreement the Ministers and Governors set out the policies which they intended individually to pursue, and undertook to monitor them together and as necessary intensify or adapt them. They note that some important decisions have been taken in individual countries which were envisaged in the February statement, and that generally the evolution of policies has been along the lines intended.

4. Some important favorable results are beginning to be seen. The substantial reduction in fiscal 1987 in the United States federal budget deficit is a very positive step, as is the continued determination in resisting protectionist pressures, and they particularly welcomed the announcement today by the President of the United States of his decision to sign legislation which will reinforce progress in reducing the budget deficit. The major program of additional expenditures and income tax cuts in Japan is being rapidly implemented. In Germany the reductions in income taxes from January 1988 will be greater than previously planned and the legislation for them has already been enacted. There have been reductions in external imbalances in real terms, although they remain high. Growth in domestic demand in surplus countries is picking up, but it is important that it improves further in some countries.

5. The Ministers and Governors note that the large trade surpluses of some newly industrialized economies continue to be an important factor contributing to external imbalances. They repeat their view expressed on earlier occasions that these economies should reflect their growing importance and responsibilities by reducing trade barriers and pursuing policies that allow their currencies to reflect more fully underlying economic fundamentals.

6. The Ministers and Governors commit themselves to take further appropriate actions as necessary to achieve the agreed goals set forth in the Louvre Agreement. They will particularly intensify their efforts to liberalize markets, implement tax reforms and pursue other structural changes to strengthen the vitality of their economies, to foster a high rate of sustained non-inflationary growth and to reduce external imbalances. They reaffirmed their determination to fight protectionism, and to promote an open world trading system.

7. The Ministers and Governors reaffirmed their intentions to carry forward their economic policy coordination efforts. During the coming year the developments of their economies will be monitored closely under the strengthened surveillance arrangements outlined in the Venice Summit. In light of the progress achieved to date in laying the basis for a reduction of imbalances, and the prospects for further progress, Ministers and Governors reaffirmed that currencies are within ranges broadly consistent with underlying economic fundamentals. They recommitted themselves to continue to cooperate closely to foster the stability of exchange rates around current levels.

JOINT MINISTERIAL COMMITTEE
OF THE
BOARDS OF GOVERNORS OF THE BANK AND THE FUND
ON THE
TRANSFER OF REAL RESOURCES TO DEVELOPING COUNTRIES

(Development Committee)

DC/87-19

September 26, 1987

INFORMATION DOCUMENT

The attached communique of the 37th meeting of the Ministers of the Intergovernmental Group of Twenty-Four and Statement on Immediate Action are circulated for the information of the Committee at the request of the Chairman of the Group.

Attachments

INTERGOVERNMENTAL GROUP OF TWENTY-FOUR

ON INTERNATIONAL MONETARY AFFAIRS

September 26, 1987

Dear Mr. Chairman:

I am instructed by the Ministers of the Intergovernmental Group of Twenty-Four to forward to you the attached communiqué, and Statement on Immediate Action, with the request that you will be good enough to have it made available to the Members of the Development Committee.

Sincerely yours,

S. Rikanovic

Svetozar Rikanovic
Chairman
Intergovernmental Group
of Twenty-Four

Chairman, Joint Ministerial Committee
of the Boards of Governors of the Bank
and the Fund on the Transfer of Real
Resources to Developing Countries
Washington, D.C. 20431
U.S.A.

STATEMENT OF THE MINISTERS OF THE GROUP OF 24 ON IMMEDIATE ACTION

(Adopted in their 37th meeting held on September 26, 1987 in Washington, DC)

After reviewing the current world economic trends and problems the Ministers:

-- Stress that despite the strenuous efforts made in recent years by low-income countries, especially those in Sub-Saharan Africa, the problems of these countries continue to be serious.

-- Express grave concern over declining transfer of resources to developing countries and deplore the dismal prospects of ODA flows to low-income countries;

-- Underline that restricting access of developing countries' exports to the markets of industrial countries is especially detrimental to the growth prospects and restructuring efforts of both developing and industrial countries.

-- Strongly emphasize that the present debt strategy is not viable under current economic conditions. Despite strong efforts by developing countries, it has not achieved adjustment with growth. The high and rising levels of interest rates, the lack of voluntary lending by commercial banks, the continuing negative resource flows to the developing countries, and the deterioration of their trade situation have resulted in an increasing number of developing countries finding it difficult to maintain their debt service payments. There is a growing consensus that the debt strategy must be recast in order to reduce debt service payments in support of adjustment with growth, sharing equitably adjustment benefits and costs between debtors and creditors.

-- Consider that conditions exist for a long-term solution to the debt problem. Some creditor countries have acknowledged the need to write down the official and concessional debt of a number of low-income countries. The market judgment is that the existing debt of a significant number of indebted countries, both middle and low-income, is far below its nominal value. This new market reality opens the way for a long-term solution of the debt problem through the adoption of new innovative mechanisms which may bring about a change in approach from mere debt reschedulings to debt reconstruction taking into account, among other factors, the market value of the debt as well as the need to reduce both debt stock and debt service.

Therefore the Ministers:

(a) Reiterate that there is an urgent need to increase the ODA in compliance with the 0.7 percent target and with the recommendations of the Task Force on Concessional Flows; call for urgent steps to make IDA VIII effective; urge prompt support be given to the initiatives in the Fund and in the Bank for the enhancement of SAF and the Special Assistance Program for Low-Income Countries, bearing in mind the need for ensuring genuine additionality in concessional flows; call for prompt steps for a General Capital Increase of the World Bank during this fiscal year, for an early conclusion of the Ninth General Review of Quotas in the Fund and a substantial allocation of SDRs, with a view to at least doubling the resources of both institutions.

(b) Urge the industrial countries to remove their protectionist barriers, improve the access of developing countries' exports to their markets, and recycle their huge surpluses and terms of trade gains.

(c) Reiterate the call for creation of a representative Committee of Ministers to examine proposals for reform and improvement of the international monetary system.

(d) Urge that an expanded dialogue between industrial and developing countries should take place on the debt problem. This dialogue is urgently needed since a concerted effort is required to avoid the prospect of a deadlock and to pave the way for a cooperative solution to the issue. To that end, consultations should take place, preferably before the next Spring meeting.

INTERGOVERNMENTAL GROUP OF TWENTY-FOUR
ON INTERNATIONAL MONETARY AFFAIRS

Thirty-Seventh Meeting of Ministers

COMMUNIQUE

1. Ministers of the Group of Twenty-Four on International Monetary Affairs held their Thirty-Seventh Meeting in Washington, D.C. on September 26, 1987. Mr. Svetozar Rikanovic, Federal Secretary for Finance, Yugoslavia, was in the Chair, with Mr. L. C. Bresser Pereira, Minister of Finance, Brazil, and Mr. Jean-Pierre Lemboumba-Lepandou, Minister of Finance, Gabon, as Vice-Chairmen. The Meeting was attended by Mr. M. Camdessus, Managing Director, International Monetary Fund, Mr. B. B. Conable, President, The World Bank, Mr. Bernard T. G. Chidzero, Chairman, Development Committee, Mr. Rafeeuddin Ahmed, Under Secretary General, United Nations, K. K. S. Dadzie, Secretary General, UNCTAD, Mr. Sidney Dell, Project Director, UNDP/UNCTAD, Mr. Olivier Castro, Excutive Secretary, Central American Monetary Council, Mr. Y. Seyyid Abdulai, Director General, OPEC, Mr. Isaac Cohen, Director, Economic Commission for Latin America and the Caribbean, Mr. Subhi Frankool, Deputy Governor, Central Bank, Iraq, Mr. Mohamed Berrada, Minister of Finance, Morocco, Mr. A. N. Hersi, Islamic Development Bank, Mr. Osama J. Faquih, Deputy Minister for International Economic Cooperation, Saudi Arabia. Ms. Qiu Qing, Deputy Governor, People's Bank of China, attended as an invitee.

2. The meeting of Ministers was preceded on September 24 and 25 by the Fiftieth Meeting of Deputies of the Group of Twenty-Four with Ambassador Gavra Popovic, Yugoslavia, as Chairman, and Mr. Carlos Alberto Amorim, Jr., Brazil, and Mr. Jean-Paul Leyimangoye, Gabon, as Vice-Chairmen.

World Economic Outlook

3. Ministers noted that the prevailing world economic trends are characterized by slowing growth of output and international trade, high and increasing interest rates and uncertainties regarding exchange rate movements, further declines in the total financial flows to developing countries and intensified protectionist pressures. Ministers expressed their deep concern over the adverse consequences of these developments for the growth prospects of the world economy in general and of the developing countries in particular.

4. Ministers pointed out that the resource outflows as a result of high debt service and deteriorating terms of trade have contributed to a prolonged decline in income in many developing countries. The 1980s have experienced the most severe setback to the development process in the last three decades; indeed, to the developing countries it is fast becoming a 'lost decade.'

5. Ministers noted at this critical juncture for the world economy some indication of better international understanding as evidenced by the final act of the UNCTAD VII as well as by positive signs given by some of the industrial countries, mainly regarding the debt of low-income countries. Nevertheless, Ministers recalled the responsibilities of industrial countries to ensure a more promising environment for the growth and exports of developing countries, which together with these countries' strengthened national economic policies and measures for raising savings and investment and for diversifying their production--if supported by adequate external financing and access to markets--should constitute a basis for cooperative actions by all governments in revitalizing the world economy and international trade.

6. Ministers emphasized that any optimism regarding growth projections in the period ahead can be justified only if all parties concerned assume their responsibilities for the attainment of adjustment with growth; Ministers underlined that resumption of economic growth in the developing countries will in turn enhance their capacity to service external debt and also to increase their imports from industrial countries; Ministers stressed that adjustment with growth is possible only if net flows of external resources to developing countries are increased and trade barriers against their exports are removed, and they reaffirmed that more effective international policy coordination could help sustain growth of output and employment both in industrial and developing countries.

7. Ministers welcomed the introduction of more realistic alternative medium-term scenarios in the latest Fund world economic outlook exercise, in view of the past tendency of such exercises to contain overly optimistic projections, and they hoped that these scenarios, as possible future outcomes, would be given more prominence in future exercises.

8. Ministers suggested that the Fund's alternative medium-term scenarios should provide for a needed higher per capita output growth rate in the developing countries. For the attainment of such a rate it is necessary to establish corresponding policy settings as well as foreign capital requirements and to take effective measures for recycling surpluses for the purpose of satisfying these requirements.

<u>Use of Indicators in Fund Surveillance</u>

9. Ministers underlined that policy coordination and remedial domestic policy actions by industrial countries are far from adequate, with continued adverse impact on the world economy, and they noted with concern that such policy coordination efforts have so far been limited to attempts at removing the immediate, most pressing tensions, while true efforts in moving the world economy toward the desired path of sustained global growth with increased stability are as remote as ever. In this context, Ministers reaffirmed that stronger remedial action, rules and practices aimed at strengthening the Fund's surveillance on the major industrial countries are essential, in order to bring about more symmetry in the international adjustment process.

10. Ministers welcomed the introduction of indicators in medium-term scenarios in the World Economic Outlook but noted that their use could be improved to the advantage of the entire Fund membership only if the alternative policy settings--on which such scenarios are based and which should help identify the needed policy corrections in the major industrial countries--are clearly set out and take into account fully the needs and requirements of the developing countries.

Debt Situation and Strategy: Developments and Prospects

11. Ministers expressed deep concern with the evolution of the debt crisis. Low-income countries, as well as middle-income debtor countries, are facing exceptional social, economic, and political difficulties. The adoption of austere and painful adjustment programs has brought a significant reduction in current account deficits, but such an adjustment has not brought about a solution to the problem. Debt indicators of both groups of countries have further deteriorated and remain at historically high levels, while net resource flows have continued to decline; private banks have increased capital and allocated funds for losses and reduced their exposure to the developing world. But they have no more assurance today of being paid in full than they had in 1982. Indeed, there is a growing sentiment in the market that part of the debt is uncollectable.

12. Ministers pointed out that the three building blocks of the present strategy show serious inconsistencies. Notwithstanding the fact that debtor countries have through serious adjustment efforts achieved important improvements in their non-factor payments current account balance, they have not been able to reconcile debt service with growth. Also, the international economic environment, which should have supported the adjustment effort by debtor countries, has not developed in a favorable manner, while prospects for voluntary lending to debtor countries are poor and are not improving.

13. Ministers acknowledged that under the present circumstances, and if no changes are introduced to the debt strategy, the prospect may well be that of a further overall worsening of the debt situation. In view of the dismal outlook for both world economic growth and international trade, adverse terms of trade and rising interest rates as well as added debt service burden arising from changes in the currency composition of debt, an increasing number of debtor countries may find themselves in a situation in which they may be forced to limit or suspend debt payments, a situation which is already taking place. Such a scenario does not seem to be in the interest of any of the parties involved in the debt issue.

14. Ministers pointed out the need for, and the feasiblity of, new approaches to the debt problem. The market judgment is that a part of the existing debt is far below its nominal value. The new market reality, inter alia, opens the way for a long-term solution to the debt problem through the adoption of new, innovative mechanisms which may bring about a change in approach from mere debt reschedulings to debt reconstruction, which may encompass: reduction of the debt overhang, by taking into account, among

other factors, the market value of the present stock of debt through such procedures as negotiations among parties involved, a new debt management facility, securitization of parts of the debt, and buy-back mechanisms; reduction in interest rates to normal historical levels; and protection of adjustment efforts from the impact of negative external shocks.

15. Ministers considered that a new approach on the part of the multilateral financial institutions is also required as they have to play a major role in supporting, with adequate finance, growth-oriented programs designed by debtor nations. They should play a key role in "debt reconstruction" in different ways, including a more flexible approach in dealing with financial obligations to these institutions.

16. Ministers welcomed the recent extension of maturity and grace periods in rescheduling the debt of low-income countries by Paris Club creditors, expressed concern about the reluctance by some creditors to reduce interest rates on existing debt and called on all official creditors from industrial countries to convert the remaining ODA loans to grants and reduce interest rates on existing debt of these countries.

17. Ministers emphasized the need for exploration and development of new mechanisms to ensure future financing for growth, taking into account, in particular, the recycling of resources from surplus countries.

18. Ministers underlined that an effective solution to the debt problem transcends the financial sphere itself and can be found only through increased concerted action by, and cooperation among, the parties involved. The Group of 24 has already insisted on the need for an expanded dialogue among industrial and developing countries and has proposed different sorts of initiatives. This dialogue is needed now more than ever. A real concerted effort is required to remove the prospect of a deadlock and to pave the way for a cooperative solution to the debt problem. To this end, consultations should take place between now and, preferably, the next Spring meeting of the Group of 24 to find a suitable way to undertake this dialogue.

Enhancement of the Structural Adjustment Facility (SAF)

19. Ministers recalled the understanding at the time of the establishment of SAF regarding additional resources to be catalyzed from other non-Fund sources to supplement the Trust Fund reflows, and they deplored suggestions regarding further tightening of conditionality in the event the proposed enhancement of SAF resources materializes.

20. Ministers stressed that SAF resources should be substantially enlarged in volume if the facility is to make a genuine contribution to adjustment and development of the low-income countries. In this context, Ministers welcomed the Fund Managing Director's proposal for tripling the resources of the SAF but expressed concern about the slow response of donors and creditors in securing the resources needed, and urged that an agreement on this proposal be reached as soon as possible to make the enhanced SAF operative by January 1, 1988 and that the increase be in a manner that ensures genuine additionality in concessional flows to low-income countries.

21. Ministers highlighted the urgency of increased use and quick disbursements of SAF resources by applying minimal conditionality.

22. Ministers emphasized that SAF-eligible countries should continue to have access to the Fund's general resources and that the SAF should not become a substitute for other Fund facilities; and they urged that the cost of using the Fund's general resources for low-income countries be reduced through the establishment of an interest subsidy facility.

Access Limits to Fund Resources

23. Ministers noted with grave concern that the present access limits and, even more so, the actual Fund practice to keep effective access well below formal limits, prevent the Fund from discharging its role in fostering adjustment with growth as well as from playing a greater role in solving the deepening debt crisis.

24. Ministers emphasized that the Fund, by enlarging financial support and by increasing access limits to its resources, will at the same time be performing its role in supporting growth-oriented adjustment.

25. Ministers reiterated the need for restoring larger access to the Fund's resources under special facilities, the compensatory financing facility in particular.

Ninth General Review of Quotas

26. Ministers requested that the work on the Ninth General Review of Quotas be concluded as soon as possible, thus creating a strong positive signal of international cooperative efforts that would truly support the Fund's readiness and ability to effectively deal with the already evident and possible future challenges, consistent with the Fund's central responsibilities for orderly functioning of the international monetary system.

27. Ministers urged that the share of developing countries in Fund quotas be increased.

The Question of Allocation of SDRs

28. Ministers deplored the fact that the opposition by a few major industrial countries has prevented new SDR allocations since the last basic period, thereby hindering the Fund from playing its role with regard to international liquidity, despite overwhelming evidence that the conditions of the Articles of Agreement are fully satisfied.

29. Ministers noted with grave concern that the lack of a new SDR allocation has seriously undermined efforts aimed at the revival of the global economy and, in particular, has constrained the liquidity of a large number of developing countries.

30. Ministers called for a substantial new SDR allocation, its magnitude to be consistent with keeping the growth of international reserves in line with the projected growth of imports.

Proposals for Action for Low-income Countries Facing Exceptional Difficulties, Especially the Seriously Indebted Countries in Sub-Saharan Africa

31. Ministers recognized the bold and intensive measures undertaken by the governments of low-income countries, particularly those in Sub-Saharan Africa, for reforming their economies with a view to achieving sustained growth; they emphasized that such efforts cannot be sustained unless supported by additional resources and, in this connection, they reiterated that the development crisis facing low-income countries--particularly those in Sub-Saharan Africa--and the social, economic and political costs of adjustment necessarily require that the highest priority be given to their problems through the allocation of substantial additional net resources.

32. Ministers strongly supported the proposals and initiatives from the World Bank and the Fund that are geared to the resumption of growth in the low-income countries facing exceptional difficulties, and they called upon donors to immediately consider their early implementation, bearing in mind the urgent need for additionality.

33. Ministers commended those industrial countries which have taken actions--such as the conversion of existing loans to those with more concessional terms or to outright grants--to ease the debt burden of some developing countries.

34. Ministers strongly supported the proposal that all industrial countries convert all remaining outstanding ODA loans to grants or grant concessions in interest rates on existing debt by adjusting retroactively the terms of ODA loans.

35. Ministers requested commercial banks to implement innovative solutions that would ease terms of existing loans to low-income countries where the debt they owe to commercial banks is significant.

36. Ministers expressed concern at the declining trend in lending by the World Bank for agriculture and rural development and, in view of the importance of this sector, they urgently called for a reversal of this trend and for an increase in lending to this sector.

37. Ministers urged that a thorough review of the design and implementation of structural adjustment programs be undertaken and that, where country circumstances render implementation of a full structural adjustment program inappropriate, the approach of undertaking a series of investment projects and sector adjustment programs be adopted.

38. Ministers noted that the share of non-project lending in the World Bank has increased substantially since 1981, and they urged that, in view of the need for additional investments with long term positive benefits in low-income countries, a more realistic balance in favor of project lending be reached, which in some cases would require a more flexible approach by the Fund as far as its conditionality is concerned.

Review of Growth-oriented Programs in the Heavily Indebted Middle-Income Countries

39. Ministers strongly emphasized that the time has come to recognize that the present debt strategy is not viable under current economic conditions nor is it compatible with adjustment with growth. There is a clear inconsistency between what is recognized as necessary by the current debt strategy and the actions taken by industrialized countries and commercial banks. Major economic imbalances persist in industrialized countries, preventing an adequate expansion of the world economy. Voluntary net lending by commercial banks neither exists nor is in prospect. In view of this, the debt strategy must be recast to reduce debt service payments in support of adjustment with growth. Ministers drew attention to the fact that, if the economic situation of the debtor countries worsens, all parties involved, both debtors and creditors, as well as the international financial system, would suffer serious adverse consequences.

40. Ministers indicated that the burden of adjustment is supported disproportionately by the indebted countries, resulting in substantial negative net transfer of resources from debtor countries as well as heavy economic, social and political costs associated with declines in output, employment, and per capita income; therefore, Ministers highlighted the urgency of reducing debt-related transfers and of generating substantial new net financial flows from private, official and multilateral sources to the heavily indebted middle-income countries under terms that should be consistent with growth targets and a higher level of investment and technology, as well as an acceptable debt service burden.

41. Ministers emphasized that growth-oriented adjustment programs should be targeted to mitigate social costs as well as deterioration in capital structure.

42. Ministers underlined that since the inception of the debt crisis, the implementation of the existing debt strategy in countries undertaking adjustment without adequate financing has led to either inflationary growth or recession, both of which are no longer socially or politically tenable.

43. Ministers pointed out that faster complementary adjustment in industrial countries, with freer access to their markets for the developing countries, will be beneficial to both developing and industrial countries, given the nature of the large and unsustainable imbalances in the world economy, most visible in the patterns of current account disequilibria among key industrial economies and in the massive net overall transfer of resources from developing to industrial countries. Ministers emphasized that an

orderly unwinding of these two sets of related disequilibria requires concerted policy actions by the industrial countries and a far higher degree of international cooperation, with a bold medium-term perspective.

44. Ministers reiterated the proposal put forward in previous Group of 24 communiques requesting the creation of a Task Force of the Development Committee consisting of members representing developing and industrial countries to report shortly on the necessary guidelines for the solutions to the debt problem.

The Capital Requirements of the World Bank Associated with its Expanded Lending and Catalytic Role

45. Ministers reiterated that the primary role of the World Bank should continue to be investment-related lending for development, growth and poverty alleviation as determined in its Articles of Agreement.

46. Ministers expressed concern that in an overall environment of declining financial flows to developing countries, the World Bank has lowered its lending projections. In this context Ministers called upon the World Bank to exert redoubled efforts to expand its lending by liberalizing its approach to conditionality and loan pricing.

47. Ministers expressed concern at the declining net transfers from the World Bank to the developing countries, and Ministers emphasized that the Bank should strive to achieve a lending and disbursement program which would provide for reasonable net transfers to developing countries.

48. Ministers emphasized that the increased needs of many developing countries for accelerated disbursements should be met by designing fast disbursing loans without burdening the borrowers with undue conditionality or cross conditionality so that any adverse impact on their social and economic development is minimized.

49. Ministers expressed concern that the Bank's lending program is being constrained by the inadequacy of capital and they urged that prompt steps be taken for completing negotiations for a substantial General Capital Increase within the current fiscal year as a matter of urgency, allowing at least a doubling of its current capital and covering growth in lending for at least six years and also providing for liberalization in repayment terms by reverting to the pre-1976 annuity type pattern, particularly for low-income countries.

50. Ministers underlined that all developing countries should benefit in an adequate and equitable manner from the Bank's catalytic role in mobilizing resources, including its advisory services and technical assistance.

The Status and Adequacy of Resource Transfers to the Developing Countries

51. Ministers regretted that the report on adequacy of resource transfers to all developing countries as requested by the Development Committee at its last two meetings has not so far been completed, and Ministers called upon the World Bank to urgently complete the work and present its reports for consideration by the Development Committee at its next meeting.

52. Ministers expressed serious concern at the stagnation in and dismal prospects for ODA flows at a time when low-income countries are struggling to deal with problems of poverty alleviation and development, and they stressed the need for a substantial increase in the transfer of concessional resources to these countries. In this connection, Ministers deplored the fact that growth of ODA has not kept pace with growth in donor countries and they called upon the donor countries to take urgent steps to achieve the internationally agreed target of 0.7 percent of GNP and, in particular, within the overall target of 0.7 percent, to allocate 0.15 percent of their GNP to least developed countries, and to put ODA on an assured, continuous, and predictable basis.

53. Ministers urged that early steps be taken for implementing the recommendations of the Task Force on Concessional Flows which called for redoubled efforts to expand the flow of ODA as a matter of urgency.

54. Ministers expressed grave concern over the continuing negative transfer of resources to developing countries and they called for urgent steps to arrest and reverse this trend. To that end, Ministers emphasized the crucial role of expanded official flows and multilateral lending at a time when the needs of developing countries have increased and financial flows from other sources are declining, and they urged that given the reverse financial flows to the Fund and declining net flows from the World Bank, immediate steps for augmenting the resources available to these institutions be taken to enable them to make an adequate and effective contribution to adjustment and development in developing countries.

55. Ministers emphasized that implementation of growth-oriented programs in many developing countries will continue to be strongly jeopardized by insufficient supporting finance and that resolution of the debt problem will require considerable augmentation in net financial flows from official and commercial sources.

56. Ministers reiterated that regional development banks have an important role to play and they deplored proposals of some industrial countries to link capital replenishments to changes in the basic agreements under which these institutions have been created and to try to impose higher and new types of conditionalities.

The impact of Industrial Policies of Developed Countries on the Developing Countries

57. Ministers strongly deplored the protectionist policies of industrial countries, which instead of immediately applying the stand-still and roll-back commitments to which they subscribed in the Declaration of Punta del Este, continue to introduce new or additional export subsidies and to strengthen the existing and introduce new trade barriers to imports of industrial products from developing countries; and Ministers expressed deep concern that adjustment efforts and growth prospects of developing countries have been drastically hindered and jeopardized by protectionist practices of some industrial countries, practices that are totally in conflict with the proclaimed policies of the global adjustment process.

58. In this context, Ministers called upon the industrial countries to undertake effective adjustment on both the macroeconomic and structural fronts with a view to improving their economic performance.

59. Ministers urged the Fund to actively pursue this very important problem with its industrial country members, in view of their larger impact on world trade, during bilateral consultations with them.

60. Ministers called upon the Fund and the Bank to prepare the report which should provide an in-depth study on the impact of industrial policies of industrial countries on developing countries requested in the 1987 Spring communique of the Development Committee. This study should cover the international resource allocation aspects of the industrial countries' protectionism and subsidy policies and their effect on the growth prospects of developing countries so that definite recommendations can be put to the Development Committee.

61. Ministers welcomed the encouraging prospects that have arisen regarding stabilization of commodity prices following the support by several industrial countries for setting up a common fund for primary products and urged all the industrial countries to join the fund.

62. Ministers also called upon the industrial countries to improve the access to their markets of the developing countries' exports, including commodities and manufactured and semi-manufactured goods. In this connection, Ministers welcomed the efforts of the Managing Director of the Fund and the President of the Bank to encourage industrial countries to move in this direction. Further, Ministers urged that UNCTAD be requested to present a special report to the Development Committee on the progress achieved in this regard.

63. Ministers emphasized the detrimental effects on the developmental and adjustment efforts of developing countries of so-called 'voluntary export restraint' practices implemented especially but not solely in footwear, chemicals and textiles. A number of other industrial products of developing countries for household consumption have also been hard hit in a similar way. Additionally Ministers pointed out that the frequency of countervailing actions against developing countries' products is rapidly increasing, while the frequency of anti-dumping cases has reached alarming proportions.

64. Ministers called upon the industrial countries to improve the coordination of their policies also by relying on indicators that would point out the negative consequences of their protectionist policies for the imports from developing countries as well as the cost resulting from the associated misallocation of resources in industrial countries themselves.

Review of the World Bank's Graduation Policy

65. Ministers re-emphasized the call on the IBRD to implement the 'Statement on Graduation' unanimously adopted by the Executive Directors on September 11, 1984, according to which graduation can only take place with the agreement of the country concerned and is subject to review if warranted by changed circumstances; and Ministers expressed grave concern at the fact that recent Bank practice seems to contravene the 'Statement on Graduation.'

Review of Discussions on the Role of the Fund in Adjustment with Growth

66. Ministers strongly urged that the Interim Committee undertake the discussion of the role of the Fund--based on the proposals contained in the Reports of the Group of 10 and the Group of 24--in its next Spring meeting. To that end Ministers suggested that the comprehensive evaluation of the proposals in the Reports be made without delay by the Fund's staff, but Ministers pointed out that this is possible only through an integrated approach, by examining all the proposals together, keeping in view their inter-relationship.

Reform of the International Monetary and Financial System

67. Ministers reiterated the call for the creation of a representative Committee of Ministers from developing and industrial countries to examine the proposals of the Group of 10 and the Group of 24 relating to the reform and improvement of the international monetary system, so that necessary follow up actions are pursued; this Committee could perhaps take the form of a joint subcommittee of both Interim and Development Committees and should conduct its business on the basis of consensus.

68. Ministers reiterated that an effective reform of the international monetary and financial system requires the convening of an international conference, and expressed the view that the proposed representative Committee of Ministers mentioned in the preceding paragraph will be an effective step in preparing for such a conference.

Program of Research and Studies and Relations with UNCTAD/UNDP

69. Ministers very much regretted that consultations with UNDP have not yet resulted in an agreement on the continuation of its technical support to the Group of Twenty-Four. Ministers attached great importance to this matter. UNDP's support for the Group's research and studies has been highly productive, and Ministers expressed their deep appreciation to the UNDP and to UNCTAD for the efficiency with which they have

responded to the Group's needs over the past several years. This is not the time for changes in the modalities of the technical underpinning of the Group's work. Too much is at stake. It is vital for the international dialogue on these matters to be maintained. Ministers, therefore, urged the UNDP to assure the fruitful continuation of its support by including this project within its current program cycle, and restoring the volume of funding to adequate levels. Ministers recommended to the Chairman and the Bureau of the Group to continue consultations with a view to securing an extension of UNDP cooperation. The stage has been reached at which new and innovative departures will be needed in achieving adjustment with growth. Several studies would have to be made, including, as an immediate priority, a study of the role of the World Bank in adjustment with growth, as well as studies in regard to surveillance and the debt crisis.

122043
MDLIAN 8191

CONFIDENTIAL
FROM UKDEL IMF/IBRD, WASHINGTON
TO ROUTINE FCO
TELNO 245
OF 272000Z SEPTEMBER 87
INFO ROUTINE VIENNA, CANBERRA, BONN, PARIS, MADRID, TOKYO,
INFO ROUTINE UKDEL OECD, UKMIS GENEVA

PMP

MEETING OF G10 MINISTERS

1 MINISTERS AND GOVERNORS OF THE G10 MET ON SUNDAY, 27 SEPTEMBER. THE MEETING WAS LOW-KEY, NOTING SOME POSITIVE DEVELOPMENTS IN THE WORLD ECONOMY AND WELCOMING THE G7'S AFFIRMATION OF CONTINUING SUPPORT FOR THE LOUVRE AGREEMENT ON EXCHANGE RATES AND POLICY MEASURES.

2 THE ONLY SUBSTANTIVE AGENDA ITEM CONCERNED THE EXTENSION AND POSSIBLE ENLARGEMENT OF THE GAB. EXTENSION OF THE ARRANGEMENTS WAS AGREED FOR A FURTHER FIVE YEARS WITH CURRENT TERMS AND AMOUNTS UNCHANGED.

3 IT PROVED IMPOSSIBLE TO AGREE ON POSSIBLE ENLARGEMENT TO INCLUDE SPAIN AND AUSTRALIA. THE UK EXPRESSED ITSELF AS STRONGLY IN FAVOUR OF ADMITTING THESE TWO COUNTRIES BUT THE NETHERLANDS, SWEDEN AND SWITZERLAND SPOKE EQUALLY STRONGLY AGAINST, AS THEY SAW THIS AS DETRIMENTAL NOT ONLY TO THE WORKINGS OF THE G10 BUT ALSO RELATED COMMITTEES IN BASLE AND THE OECD. SINCE UNANIMITY IS REQUIRED FOR ADDITIONS TO MEMBERSHIP, THERE WILL THEREFORE BE NO CHANGE. THERE SEEMS NO PROSPECT OF RETURNING TO THE SUBJECT IN THE SHORT TERM.

4 FCO PLEASE ADVANCE TO PS/SIR P MIDDLETON AND LAVELLE (HMT), PS/GOVERNOR (BANK OF ENGLAND), PS/CAINES (ODA) AND DRUMMOND (ERD).

LANKESTER

YYYY

122043
MDLIAN [illegible]91

DISTRIBUTION 152

MAIN 147

MONETARY

ADDITIONAL 5

MR DRUMMOND ERD FCO
PS/SIR P MIDDLETON (HMT)
LAVELLE (HMT)
PS/GOVERNOR (BOE)
PS/CAINES (ODA) [A HARNEY]

NNNN

122042
MDLIAN 8189

pmp

CONFIDENTIAL
FROM UKDEL IMF/IBRD, WASHINGTON
TO ROUTINE FCO
TELNO 246
OF 272000Z SEPTEMBER 87
INFO ROUTINE VIENNA, CANBERRA, BONN, MADRID, PARIS, TOKYO,
INFO ROUTINE UKDEL OECD, UKMIS GENEVA

GROUP OF TEN MEETING - SEPTEMBER 27, 1987

THE FOLLOWING IS THE COMMUNIQUE OF THE GROUP OF TEN MEETING HELD IN WASHINGTON ON SEPTEMBER 27, 1987:

BEGINS

1 THE MINISTERS AND CENTRAL BANK GOVERNORS OF THE COUNTRIES PARTICIPATING IN THE GENERAL ARRANGEMENTS TO BORROW MET IN WASHINGTON ON SEPTEMBER 27, 1987. THE MEETING WAS CHAIRED BY THE RT. HON. NIGEL LAWSON, CHANCELLOR OF THE EXCHEQUER OF UNITED KINGDOM. THE MANAGING DIRECTOR OF THE INTERNATIONAL MONETARY FUND, MR MICHEL CAMDESSUS, TOOK PART IN THE MEETING, WHICH WAS ALSO ATTENDED BY MR J.-C. PAYE, SECRETARY-GENERAL OF THE ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, SIR GEOFFREY LITTLER, CHAIRMAN OF THE WORKING PARTY NO. 3 OF THE ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, MR A LAMFALUSSY, GENERAL MANAGER OF THE BANK FOR INTERNATIONAL SETTLEMENTS, AND MR A MATUTES, MEMBER OF THE COMMISSION OF THE EUROPEAN COMMUNITIES.

2 THE MINISTERS AND GOVERNORS REVIEWED THE PROVISIONS OF THE GENERAL ARRANGEMENTS TO BORROW AND ENDORSED THE RENEWAL OF THE ARRANGEMENTS FOR A FURTHER FIVE-YEAR PERIOD ON DECEMBER 24, 1988.

3 THE MINISTERS AND GOVERNORS HAD A PRELIMINARY EXCHANGE OF VIEWS ON MATTERS TO BE DISCUSSED IN THE FORTHCOMING MEETINGS OF THE INTERIM COMMITTEE AND DEVELOPMENT COMMITTEE. THE MINISTERS AND GOVERNORS EXPRESSED THEIR SATISFACTION WITH THE STRENGTHENED CO-OPERATION RESULTING FROM THE LOUVRE AGREEMENT, IN PARTICULAR THE EXCHANGE RATE STABILITY THAT HAS BEEN ACHIEVED. THEY WARMLY WELCOMED THE DECISION TO CONTINUE THE LOUVRE AGREEMENT.

4 MR KJELL-OLOF FELDT, MINISTER OF FINANCE OF SWEDEN, WAS ELECTED CHAIRMAN OF THE GROUP OF TEN FOR THE COMING YEAR.

5 FCO PLEASE ADVANCE TO PS/SIR P MIDDLETON AND LAVELLE (HMT), PS/GOVERNOR (BANK OF ENGLAND), PS/CAINES (ODA) AND DRUMMOND (ERD).

12 .2
MDLIAN 89

LANKESTER

YYYY

DISTRIBUTION 157

MAIN 152

MONETARY WIAD

ADDITIONAL 5

MR DRUMMOND ERD FCO
PS/SIR P MIDDLETON (HMT)
LAVELLE (HMT)
PS/GOVERNOR (B O E)
PS/CAINES (ODA)

NNNN

27/9/87.

SECRET

NOTE FOR THE RECORD

MEETING OF GROUP OF FIVE

A meeting of the Group of Five was held in the United States Treasury on Saturday, 26 September from 9.50am until just after mid-day. Those present were the customary trio (Finance Minister, Central Bank Governor, Senior Official) from each country, plus two interpreters (one for the French Minister and one for the Japanese Governor).

Exchange Rates

2. Baker (United States), opening the meeting as Chairman, said that he wanted the Louvre Agreement to continue. Comparing exchange rates now with what they had been at the time of the last G5 meeting in April, there had been very little change, and the variations in between the two dates had been within an acceptable range. This was a pretty good record of stability, although he noted that it had been achieved only with some large-scale intervention and some tightening of US interest rates - measures on which it would be difficult to rely in facing any future pressure. He must warn that, if the United States faced a choice between exchange rate stability and economic growth, they would choose to keep steady growth and avoid recession. He was not satisfied that all countries had done all that was necessary in their own policies. Publicly, he would like at this stage a general recommitment to the Louvre Agreement. Privately, he felt that all colleagues should reflect seriously on what additional action they could take and be ready, not later than the beginning of the new year, to declare and implement policy measures.

3. On the United States position, he claimed good progress in meeting undertakings given in the Louvre Agreement. The extent of the reduction of the fiscal deficit in the current year had been much greater than originally hoped: in April he had himself spoken of a reduction from \$220 billion to \$180 billion - it now seemed likely that the result would be \$155 billion. This was the largest reduction of a deficit in a single year, in terms of proportion of GDP, to be found in the experience of any major country in recent years. He acknowledged that he had benefitted from a once-for-all boost of revenue as a result of capital gains tax reforms, but said this had made only a modest contribution.

4. As far as the coming year was concerned, the proposed revision of Gramm-Rudman - which he very much hoped the President would now endorse - would point to a deficit in fiscal 88 of around \$150 - \$155 billion, maintaining momentum and giving a further reduction in the deficit as a proportion of GDP.

5. The economy was growing reasonably well. At the beginning of the year he had forecast a rise in the rate of inflation to 5 per cent, following the exceptional low figure of just over 1 per cent last year. Latest estimates suggested that they would stay safely within 5 per cent. Two months from now they would pass the record for the longest ever peace-time expansion of the economy.

6. The resistance by the Administration to protectionist pressure in Congress and elsewhere was continuing. The President had exercised his veto on proposed measures in the textile field. The Omnibus Trade Bill now under consideration was going through an enormously complicated committee procedure in Congress. The Administration were trying to secure improvements: some elements of the present proposals were in themselves very welcome. But at the end of the day, he thought the balance of the Bill would be unacceptable and there would be a good chance of the President exercising and sustaining his veto again.

7. Miyazawa (Japan) said that, consistently with undertakings in the Louvre Agreement, Japan had announced on 29 May some income tax reductions and massive increases in expenditure; the supplementary budget had been passed on 24 July for immediate implementation, and the tax changes on 19 September would result in $11 billion equivalent of tax cuts in the current year and a further $5 billion of cuts in local taxes next year, as well as the elimination of tax concessions on smaller savings.

8. The sharp appreciation of the yen in 1986 had slowed down total growth, with a 4 per cent rise in domestic demand being offset by a 1.6 per cent fall in external demand. Currently the economy seemed to be rebounding, with domestic demand remaining buoyant: retail sales were up more than 5 per cent on one year ago and new housing starts were over 20 per cent higher. Corporate profits were rising again, particularly during the most recent quarter.

9. The structure of the Japanese economy was changing, away from dependence on exports and towards satisfaction of higher domestic demand, with substantial relocation overseas by some Japanese manufacturers. There could already be seen a sharp reduction in the Japanese trade surplus in dollar terms and he was expecting this to continue.

10. Looking ahead on the fiscal front, he expected continuation of a stance which would encourage a high level of domestic demand. It appeared - although the exposition was confused - that future budgets might aim to start from the basis of the current year total of main and supplementary budgets, instead of going back each time to the main budget. He claimed to have achieved a useful commitment to future expenditure in the "infrastructure fund", explaining that the government could expect to receive over the next three years some 14 trillion yen from sales of NTT shares: 9 trillion yen would go towards reduction of the outstanding national debt, but 5 trillion would go to the new fund for expenditure.

11. On the money market, the Bank of Japan had been resisting some pressure from the market to react to what they saw as an excessive previous fall in rates. Overall he hoped that Japan could now resume non-inflationary growth and reduce its external imbalances, but he felt that continued exchange rate stability was an important condition for this, and he therefore strongly endorsed the continuation of the Louvre Agreement.

12. Baker asked whether the Japanese budget for 1988 would be as good as that for 1987 and Miyazawa assured him that it would, since it would carry forward expansionary measures of expenditure and tax cuts. There was then a series of complicated exchanges as Sumita (Governor of the Bank of Japan) was questioned about Japanese interest rates and policy towards them. What appeared to emerge was that stories of a recent rise of one half per cent in Japanese interest rates were incorrect. There had been no movement in official rates and only a very small increase in some market rates. On the other hand the Bank of Japan had given very strong guidance to deter what they saw as excessive lending for property which had contributed to a rapid rise in land prices. On the direct challenge by Larosiere and others that quantitative control would surely tend to tighten the market and raise interest rates, it appeared that the Japanese authorities expected their market to be more obedient, particularly because there had been widespread public criticism of property speculators. Sumita appeared to give an assurance that the authorities would seek to avoid any increase in interest rates (his interventions were peculiarly difficult throughout: his Japanese interpreter seemed to have only modest command of both the subject and the English language! - in marked contrast to the French interpreter).

13. Before concluding the discussion on Japan, Baker took the opportunity of suggesting that a favourable impact on land prices could be helped if local rice fields ceased to be protected. The Chancellor, paying tribute to the measures taken by the Japanese authorities and to the resilience of Japanese industry, said that he had shared the concern of others over press reports of increases in Japanese interest rates. What had just been said was a very helpful clarification. He hoped that this clarification could be given wider publicity.

14. On the UK economy, the Chancellor said that growth was currently at a faster rate than in any of the other countries represented at this meeting. He thought the outturn for 1987 compared with 1986 could well be a 4 per cent real increase. This was in spite of a decline in activity in the oil sector and, incidentally, in spite of the United Kingdom having the highest interest rates of any country represented here. Healthy growth should continue, although he could not expect the present high pace to last through 1988. The inflation rate was likely to be in the 4 - 5 per cent range over the coming year, but he hoped it would come down thereafter. The target for the PSBR this year was 1 per cent of GDP after allowing for asset sales. In fact it was likely to turn out well below that level. A current account deficit for the current year of around one half per cent of GDP could readily be financed.

15. He strongly supported the continuation of the Louvre Agreement, which should be reaffirmed in clear terms. It had been far more successful than markets, press, and even some participants had expected at the outset.

16. One remark by Baker had caused him some concern: the reference to choice between exchange rate stability and economic growth. He thought this was dangerous talk. There was no sign of the United States plunging into recession. If there was a danger, it was rather that inflation in the US might rise a little more than was comfortable. He very much hoped that Japan and Germany would not raise interest rates, but it was surely wrong to rule out any further rise in US interest rates if the need was demonstrated in the event. If we were serious about maintaining the Louvre Agreement, the operation of monetary policies must be consistent with that Agreement.

17. Baker commented that he did not disagree with what the Chancellor had said, but measures taken and results achieved in the United States had been bigger than those of other countries since our last meeting. If other countries took unilateral decisions on interest rates or other matters they could not expect the United States to take it calmly. Greenspan added that he felt that the interest rate structure in the US was a potential threat to the vigour of the economy, which meant that there was not a great deal of room for increases in rates without doing damage. He was disappointed that the differential between the US and Japan in long-term rates had narrowed by as much as 100 basis points in recent weeks.

18. Stoltenberg (Germany) said that his assessment of the Louvre Agreement was entirely positive. It should be reaffirmed with a strong public message.

19. As far as Germany was concerned, a major process of adjustment to the new exchange rate structure was still taking place, and this largely explained the period of weakness in growth in Germany, to some extent shared in other parts of Europe. Without the exchange rate stability since the Louvre Agreement, this could have been very much worse. However, after the setback around the turn of the year, some recovery was now being seen and he expected this to gain strength as we moved into 1988. He was satisfied that correction of trade balances was taking place in real terms and beginning to be seen in nominal terms.

20. On German commitments under the Louvre Agreement, he noted that increased tax reductions for 1988 had now been legislated, in spite of some domestic argument. He was moving towards decisions on changes thereafter. Overall, the cumulative scale of tax reduction would be very large, amounting to nearly 2.5 per cent of GNP, and that would exhaust room for manoeuvre on the fiscal front. In passing, he noted that the budget deficit was currently increasing, from 2.5 per cent in 1986 to 3 per cent or more in the current year, largely as a reflection of the period of slower growth.

21. He thought it might be useful to review policies some time early in 1988. It would certainly be his hope to continue the Louvre Agreement. Without exchange rate stability, he frankly could not see a coherent strategy to maintain growth. It would be right in a few months to discuss again possibilities of action and the various factors affecting future prospects. But the burden of maintaining growth could not rest simply on fiscal policy.

22. In brief exchanges mainly between Baker, Stoltenberg and the Chancellor, there was a general sense that a further meeting early in 1988 could be helpful but that it was important to give no hint of such a meeting now.

23. Balladur (France) said that he had secured a substantial reduction of the budget deficit, down to 2 per cent of GDP. Inflation was down to only a little over 3 per cent this year, and he hoped 2 per cent next year. The rate of growth was inadequate, but he saw no room for fostering an increase through fiscal relaxation. Investment seemed to be picking up and indeed on OECD figures France would have the highest investment rate among OECD countries for the 3-year period 1986-1988. A massive program of privatisation was going well: 140 billion francs by the end of this year and another 40 billion francs early in 1988. The proceeds were effectively being used to pay off debt.

24. He was very pleased with the success of the Louvre Agreement, although not satisfied that all the commitments made in it had yet been fully carried out. On the problem of conflict between economic growth and exchange rate stability, he shared the Chancellor's worries, because he believed that instability in exchange rates itself undermined growth prospects.

25. He liked the idea of a meeting early in 1988, to be kept secret now, and suggested we might plan now two or three particular subjects to be considered. His own suggestions would be: interest rate policies and the possibility of avoiding increases; new engagements to promote stronger growth; increased cooperation among central banks, perhaps reactivating swap facilities. The Chancellor partly agreed: he thought there might also be something on intervention and its visibility which was important; but he counselled against seeking stability of interest rates, in the sense suggested by Balladur, because one might positively need changes to help maintain stable exchange rates. However, he did think it was possible and would be desirable to attempt an assessment of the overall level of interest rates among the major countries, to determine whether there was a case for the general level to rise or not. The value of this could, for example, be that if the judgement were that no general rise of rates should take place, that would imply that any attempt to widen differentials should involve symmetrical movement. Balladur commented that he was certainly not seeking rigidity of interest rates, but in his view real rates were too high and should not in general be allowed to rise further.

26. Poehl (Bundesbank) cautioned that there were real market pressures tending to edge interest rates up, and in the last resort it was wrong to fight such pressures. Any public statement about holding interest rates steady could have a bad effect on markets. Balladur repeated that we could never achieve satisfactory growth rates with the present high level of real interest rates. What we therefore had to do was to convince markets that we would fight inflation and, on the back of better expectations, seek to get interest rates down.

27. The Chancellor said that we must be vigilant over any risk of renewed inflation, but needed to keep that in perspective. The rise in inflation rates during the present year had been fully foreseen and had a perfectly good explanation in the year following the exceptionally low rates recorded in 1986.

28. Greenspan pointed to the unusual phenomenon that there really was no evidence of accelerating inflation in the major countries, and yet interest rates were reflecting growing market pessimism on future inflation. The fact was that markets were expecting events for which there was absolutely no evidence. It was probably a case of delayed understanding. He very much agreed with the analysis the Chancellor had made: we must try to communicate a better understanding and hope that the markets would soon catch up with the real prospects.

29. Larosiere, agreeing with the remarks just made, thought that one troublesome element was the continuing market suspicion and uncertainty over the future dollar exchange rate. It would be helpful in this respect to show that we were serious in reaffirming the Louvre Agreement. He also suggested that, when markets were tending to move long-term rates up as had happened recently, it was necessary for the authorities to be very careful not to validate market anxieties by allowing short-term rates to rise.

30. In brief concluding exchanges on this part of the agenda, it was agreed that the idea of a meeting early in 1988 would not be canvessed in the wider G7 meeting. As far as others were concerned, let there be an assumption that the next meeting would in the normal way be next April.

Debt Questions

31. At about 11.40am Baker introduced a brief discussion of debt strategy, mainly in relation to middle-income debtors. Everybody agreed that the case-by-case strategy must continue, resting on the broad principles which had been followed hitherto. It was in particular agreed that adjustment of economic and financial policies by debtor countries remained crucial and that standards of conditionality should not be allowed to slip.

32. As regards debts to commercial banks, there was general support for the "menu" approach in the context of voluntary negotiations between commercial banks and debtor governments.

33. Miyazawa wondered whether there could be a role for some international agency to help ease marginal banks out of their involvement and thus simplify negotiations. Challenged by Baker as to who would pay, he said that he was simply thinking of an agency such as the IFC which could assist with information and coordination, and did not have in mind any official financing.

34. Baker referred briefly to his own talks with the Brazilian Finance Minister and the current position of Brazil. Trichet (France) confirmed the conditions recently agreed by the Paris Club. There followed some suggestions, particularly from Baker, that commercial banks should be pursuaded to defer any agreement with Brazil in respect of 1988 maturities until an IMF agreement had been reached. There was some sympathy with the idea that such a move by commercial banks could add to the pressure on Brazil to reach such an agreement, although the point was also made that what the banks would be asked to do by Brazil was no more than re-financing interest payments immediately due. However, the Chancellor insisted that, just as governments should not incur moral hazard by persuading banks to lend, so they should also not fall into the trap of persuading them not to lend. The decision was one for judgement by the commercial banks themselves. This proposition was widely accepted.

35. Finally, on Argentina, Baker reported that notwithstanding the shift of power in recent elections, his belief was that Argentina would not try for an outright confrontation, but would try to maintain relations with the IMF and negotiate for the best terms possible.

Envoi

36. As the meeting broke up shortly after mid-day, Baker announced that President Reagan had just agreed to sign the legislation which effectively sets a new Gramm-Rudman target and this was unanimously welcomed as an important and helpful contribution towards reassuring markets.

Geoffrey Littler
27 September, 1987

JOINT MINISTERIAL COMMITTEE
OF THE
BOARDS OF GOVERNORS OF THE BANK AND THE FUND
ON THE
TRANSFER OF REAL RESOURCES TO DEVELOPING COUNTRIES

(Development Committee)

September 27, 1987

To : Members and Associates of the Development Committee

From : Fritz Fischer, Executive Secretary F.F.

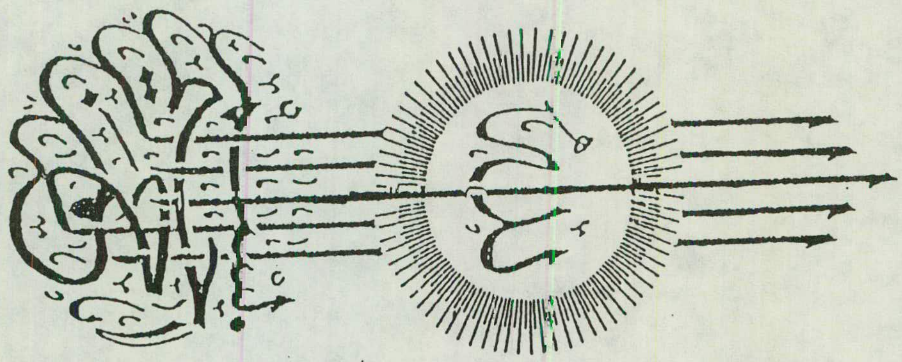
Subject : Statement by the President of the Islamic Development Bank

At the request of Mr. Ahmad Mohamed Ali, President of the Islamic Development Bank, the attached statement is made available for the meeting of the Development Committee on September 28, 1987.

Attachment

STATEMENT OF THE PRESIDENT
OF THE
ISLAMIC DEVELOPMENT BANK
TO THE
32ND MEETING OF THE
DEVELOPMENT COMMITTEE
Washington, D.C.
(September 28,1987)

ISLAMIC DEVELOPMENT BANK
P. O. BOX 5925
JEDDAH 21432, SAUDI ARABIA
Muharram 23,1408H
September 16,1987



STATEMENT BY DR. AHMAD MOHAMED ALI
PRESIDENT
OF THE ISLAMIC DEVELOPMENT BANK
AT THE 32ND MEETING OF THE DEVELOPMENT COMMITTEE
WASHINGTON, D.C., SEPTEMBER 28, 1987

Mr. Chairman,

I would like first of all to thank you and the Development Committee for the kind invitation that you extended to the Islamic Development Bank for participation in this meeting. This is one of the most important fora for the exchange of ideas on current economic issues of international concern. The IsDB closely follows your discussions and it is with the greatest appreciation that the IsDB seizes each of these opportunities to share its views on various international issues that concern its member countries.

I note that this current session of the Development Committee will discuss various topics including proposals for action in relation to low-income countries facing exceptional difficulties, especially the seriously indebted countries in Sub-Saharan Africa; review of growth-oriented programs in the heavily indebted middle-income countries; the capital requirements of the World Bank associated with its expanded lending and catalytic role; the status and adequacy of resource transfers to the developing countries; and the impact of the industrial policies of the developed countries on the developing countries. Therefore, my observations would be confined to these topics which deal with the most critical issues facing the member countries of the IsDB and, indeed, the entire group of developing countries.

During the past twelve months, the economic performance of the members of the IsDB has continued to be depressed. For the entire group, the rate of growth has continued to be almost zero, with the majority experiencing negative growth rates. As the World Bank's preliminary estimates for 1986 indicate, there has been a decline of about 0.6 percent in the GDP growth rate for developing countries. The corresponding declines are 1.7 percent for Sub-Saharan Africa, 2.6 percent for low-income countries, 0.6 percent for the highly indebted countries and a very modest improvement of 0.4 percent for middle-income countries.

A major critical feature of the contemporary international economy is that of mounting external indebtedness of developing countries, while their implementation of structural adjustment programs have yet to produce the anticipated economic growth. With regard to the problem of external indebtedness, estimates for the period 1980-86 by the World Bank show that the ratio of these debts to exports rose from 90 percent to 144.5 percent for all the developing countries as a group. However, for Sub-Saharan African countries, most of which are members of the IsDB, this ratio stood at 221.3 percent as of 1986. Mr. Chairman, this serious problem requires concerted action by the entire international community.

The achievement of real economic growth, at the level of the respective countries as well as at the global level, is the key to resolving a majority of critical contemporary problems, including that of increasing the volume of international trade and maintaining external indebtedness within tolerable limits. There is no doubt that all of these issues: growth, trade and indebtedness are interrelated. However, it is when the volume of international trade can be increased significantly and sustained at reasonably high levels that the right catalyst would have been injected that would produce relief for the indebted and the creditor countries as well.

In relation to international trade, the industrialized countries enjoyed an increase of 15.3 percent in the average unit price of exports during 1986. Simultaneously, there was an improvement of 8.3 percent in their terms of trade. Furthermore, these countries, as a group, had a current account balance of US$21.6 billion during the same period. Unfortunately, the developing countries continued to experience declines in the average unit price for their exports, as well as further declines in their terms of trade. For the majority of these developing countries, export earnings are the most important source for the financing of their economic growth, as well as meeting their debt-service obligations. Therefore, under these prevailing conditions of international trade, the developing countries, including the member countries of the IsDB, continue to be subjected to extreme economic hardship.

Mr. Chairman, there is no doubt in my mind that positive economic developments in the developing countries would enhance the economic performance of the industrialized countries and vice versa. However, given the nature of the relative degrees of economic sophistication, the industrialized market economies have a larger role to play in restoring and sustaining a more healthy international economic environment. This is why the IsDB shares the view that the economically more developed countries should pursue deliberate policies oriented toward growth in their respective domestic economies as well as growth in international trade.

As regards the developing countries, most of them, with a view to achieving real growth, have been implementing various structural adjustment programs, in concert with relevant international development financing organizations. The complement to these programs have always been estimated net inflows of multilateral, bilateral and private capital. In relation to the structural adjustment programs which the member countries of the IsDB have pursued, these inflows of much needed financial and other resources as well as their future projections continue to be very discouraging. In most cases, such as in Sub-Saharan Africa, the level of poverty has been worsened further.

Of course, members of the IsDB along with all the other developing countries do not expect instant positive results from their respective structural adjustment programs. The mobilization of domestic human and non-human resources is time consuming, complex and costly, in both direct and indirect terms. However, if growth-oriented programs are to be pursued vigorously, the credibility of structural adjustment programs needs to be bolstered by adequate inflows of the estimated financial resources, so that the projected positive effects of these programs would be more evident than has been the case thus far.

Mr. Chairman, as I mentioned earlier, an indispensable element of the equation of growth of the member countries of the IsDB is how they fare, along with other developing countries, in international trade. All the members of the IsDB depend on exports of primary products for their main earnings of foreign exchange. However, through a combination of tariff and non-tariff barriers, policies that deliberately subsidize domestic producers and other measures pursued by the industrialized market economies, both export prices and the terms of trade have continued to move against the interests of the developing countries and to hamper international trade as a whole. For the developing countries, the multiplier effects of these policies further depress their respective net economic growth and welfare, while worsening their external indebtedness.

Mr. Chairman, the problematic contemporary economic issues that I have discussed thus far only go to emphasize the need for increased inflows of financial and other resources into the developing countries. These countries must be assisted to become economically viable components of the international community. In this connection, the development financing institutions have a crucial supportive role. In many instances, they are catalysts that prepare the economic environment so that it can stimulte the inflow and productivity of private and other types of financial resources. In most cases, these multilateral financing institutions are the primary sources of financial resources for countries that, for various obvious reasons, are unable directly to tap existing capital markets, including the resources of foreign commercial banks. This role needs to be sustained and made more effective, especially since net financial inflows from public and private sources have either reduced to a trickle or dried out, while most developing countries have ironically become net exporters of capital.

The positive role that has been played by the World Bank needs to be supported through increases in its capital resources. For the same reasons, the regional development financing institutions need to be encouraged through the augmentation of their capital resources. Particularly for the enormous efforts needed in Sub-Saharan Africa, the IsDB would like to urge generous donations to the African Development Fund. Under current conditions of worsening economic conditions for the developing countries, the recommendations of the Task Force on Concessional Flows that was presented during the October 1985 meeting in Seoul continue to require serious, urgent and coordinated international action.

The 44 members of the Islamic Development Bank are all developing countries, with a substantial number, 21, falling under the category of Least Developed Countries (LDCs). Particular attention is paid to the requirements of its least developed member countries, through grants for the financing of programs that embrace technical assistance and technical cooperation. Interest-free loans are made available to these least developed member countries for financing infrastructural developmental projects.

One other mode of financing that has been of enormous assistance to the member countries of the IsDB has been its foreign trade operations which has tended to emphasize imports of inputs of developmental impact for the member countries. It has also brought some relief from stress in the balance of payments, since countries have up to 18 months or slightly longer within which to repay the cost of these imports. Between 1977 and the end of August 1987, the total operations for this mode of financing have reached about US$5 billion. In order to promote exports of its member countries, the Islamic Development Bank has launched a new scheme to finance their non-traditional exports for those countries that participate in the scheme. The period of financing of this facility will vary between 18 months and 5 years.

Mr. Chairman, in order to augment the modest volume of financial resources available to the IsDB, various measures are being explored that would mobilize additional financial resources from the private sector. The most recent of these is the Islamic Banks' Portfolio (IBS), a pooling arrangement involving other Islamic banks. Through these additional resources, more assistance would be made available to the member countries on short- and medium-term financing.

To conclude my remarks, I would like to thank you, Mr. Chairman and the members of the Development Committee for the invitation to share with you some ideas and thoughts concerning issues of crucial importance to the member countries of the IsDB. The developmental tasks facing these member countries are enormous and beyond the capacity of any single development financing institution. Therefore, the IsDB has cooperated with other sister institutions that share the same objectives. Through this strategy, there can be the appropriate pooling of human, non-human and other resources to properly address the common concerns that the august members of your Committee and all of us share. In this connection, I bring the best wishes for success in your deliberations and in implementing the resulting policy prescriptions.

Chanceller 12/2

EUROPEAN DEALERS VOICE DISAPPOINTMENT AT G-7 TALKS ECSI
LONDON, SEPT 28 - CURRENCY DEALERS IN EUROPE EXPRESSED DISAPPOINTMENT WITH THE GROUP OF SEVEN'S TALKS OVER THE WEEKEND, SAYING THEY SHED LITTLE LIGHT ON THE DOLLAR'S NEAR TREND. BUT ALL SAW IT FALLING IN THE LONGER TERM.

"NOTHING NEW CAME OUT OF IT AND ALL THE OLD PROBLEMS ARE STILL THERE," SAID GEOFFREY DENNIS, INTERNATIONAL ECONOMIST WITH STOCKBROKERS JAMES CAPEL AND CO IN LONDON.

THE GROUP'S REAFFIRMATION OF FEBRUARY'S CURRENCY STABILITY PACT HAD BEEN WIDELY EXPECTED, BUT THE DECISION TO COOPERATE TO KEEP EXCHANGE RATES AROUND CURRENT LEVELS WAS SEEN AS GIVING SHORT-TERM SUPPORT AND BOOSTED THE DOLLAR IN TRADING TODAY.

28-SEP-1318 MONO22 MOND ETPJ COAT CSAG CMAI CGAD SHNG BONJ
MORE

P

EQUITIES 2000-IDNA 1537

EUROPEAN DEALERS =2 LONDON ECSJ
"THIS AGREEMENT MEANS A CONTINUED PERIOD OF RELATIVELY LITTLE EXCHANGE RATE MOVEMENT," SAID ANDERS HEDENSTROM, CURRENCY ANALYST WITH S-E BANKEN IN STOCKHOLM.

IN THE NEAR TERM, MOST ANALYSTS SAW THE DOLLAR HOLDING TO ITS CURRENT LEVEL IN A 1.80 TO 1.85 MARK RANGE, BUT SAW IT HITTING 1.75 MARKS BEFORE THE END OF THE YEAR.

"THE MARKET FEELS SECURE HOLDING DOLLARS AT THE MOMENT...BUT SOONER OR LATER THE DOLLAR'S FUNDAMENTAL WEAKNESS WILL PREVAIL," SAID CHRIS ZWERMANN, CURRENCY ANALYST AT SWISS BANK CORP'S FRANKFURT OFFICE.

28-SEP-1326 MONO31
MORE

P

EQUITIES 2000-IDNA 1537

EUROPEAN DEALERS =3 LONDON ECSK
IN PARIS, A DEALER WITH A MAJOR U.S.-BASED BANK SAID U.S. TREASURY SECRETARY JAMES BAKER'S REPETITION OF EARLIER COMMENTS THAT OTHER NATIONS SHOULD KEEP UP EFFORTS TO BOOST GROWTH AROUSED CONCERN THAT THE DOLLAR MAY ONCE AGAIN BE TALKED LOWER.

BUT OTHER FRENCH DEALERS FOCUSED MORE ON AN EXPECTED HARD LINE ON INFLATION EXEPCTED FROM NEW FED CHAIRMAN ALAN GREENSPAN, AND GAVE LESS WEIGHT TO BAKER'S REMARKS THAN EARLIER THIS YEAR.

MOST ANALYSTS EXPECTED THE CURRENCY TO DECLINE GENTLY, WITH ANY EXCESS IN SELLING FERVOUR BEING DAMPENED BY CONCERTED CENTRAL BANK INTERVENTION IN THE OPEN MARKET AND BY A FURTHER WIDENING OF WORLD INTEREST RATE DIFFERENTIALS.

28-SEP-1334 MONO43
MORE

P

EQUITIES 2000-IDNA 1537

EUROPEAN DEALERS =4 LONDON ECSL
BUT WEST GERMAN ANALYSTS SAW PARTICIPATION BY THE BUNDESBANK IN ANY SUCH ACTION AS BEING LIMITED.

FEAR OF SWELLING THE ALREADY BLOATED SUPPLY OF MARKS IN THE DOMESTIC BANKING SYSTEM WOULD PREVENT IT FROM SELLING MARKS TOO AGGRESSIVELY. AND ANY REDUCTION IN INTEREST RATES MIGHT FUEL INFLATION CONCERNS, THEY SAID.

THEY NOTED JAPAN WAS IS ALSO IN NO POSITION TO LOWER INTEREST RATES. THERE, RISING PRICES ARE PROMPTING FEARS OF INFLATION, SUGGESTING THAT HIGHER, RATHER THAN LOWER, INTEREST RATES MAY BE NECESSARY.

28-SEP-1337 MONO49
MORE

EQUITIES 2000-IDNA 1537

EUROPEAN DEALERS =5 LONDON ECSM

HOWEVER, BANK OF JAPAN GOVERNOR SATOSHI SUMITA SAID IN WASHINGTON ON SATURDAY THAT JAPAN HAD NO INTENTION OF RAISING ITS DISCOUNT RATE FOR THE MOMENT.

ANALYSTS SAID THE UNITED STATES IS LIKELY TO HAVE TO TAKE MOST OF THE STRAIN OF ANY DOLLAR WEAKNESS, BY RAISING ITS DISCOUNT RATE ONCE MORE.

"THE U.S. DISCOUNT RATE WILL PROBABLY HAVE TO RISE AGAIN AND THE 30-YEAR (TREASURY BOND) YIELD WILL GO TO 10 OR 10-1/4 PCT," SAID ERNST PULLMAN, SENIOR CURRENCY TRADER AT DEUTSCHE GIROZENTRALE-DEUTSCHE KOMMUNALBANK.

THE RATE WAS RAISED TO SIX PCT FROM 5.50 PCT ON SEPTEMBER 4.

28-SEP-1338 MON054

MORE

P

EQUITIES 2000-IDNA 1537

EUROPEAN DEALERS =6 LONDON ECSN

U.K. ANALYSTS AND DEALERS NOTED THAT LOW UNEMPLOYMENT LEVELS IN THE UNITED STATES AND GROWING EVIDENCE OF FACTORY CAPACITY RESTRAINT MADE A RISE IN U.S. INTEREST RATES MORE LIKELY.

"THEY'RE REACHING THE POINT WHERE A FALLING DOLLAR WILL FUEL INFLATION FASTER THAN NORMAL," SAID IAN AMSTAD OF CHASE MANHTTAN SECURITIES IN LONDON.

THE U.S. TRADE FIGURES FOR AUGUST, DUE OCTOBER 14, ARE SEEN AS THE NEXT TEST FOR THE DOLLAR, FOLLOWING JULY'S RECORD 16.47 BILLION DLR DEFICIT. THIRD QUARTER GNP DATA DUE A WEEK LATER COULD UNDERLINE THE DETERIORATION OF NET EXPORTS IN REAL TERMS, JAMES CAPEL'S DENNIS SAID.

28-SEP-1340 MON057

MORE

P

EQUITIES 2000-IDNA 1537

EUROPEAN DEALERS =7 LONDON ECSO

ELSEWHERE, DEALERS NOTED BRITISH CHANCELLOR OF THE EXCHEQUER NIGEL LAWSON'S STATEMENT THAT THE DOLLAR TARGET RANGES WERE UNCHANGED, BUT WERE MIXED OVER HOW LONG THIS WOULD CUSHION THE DOLLAR'S FALL.

IN SWITZERLAND, ALOIS BISCHOFSBERGER, CHIEF ECONOMIST AT CREDIT SUISSE SAID HE THOUGHT THE DOLLAR WOULD REMAIN RELATIVELY STABLE IN THE NEXT THREE TO SIX MONTHS.

CITING A WIDENING INTEREST RATE DIFFERENTIAL IN FAVOUR OF THE DOLLAR AND IMPROVED GROWTH PROSPECTS FOR THE U.S ECONOMY AS MAIN SUPPORT FACTORS, HE SAW THE DOLLAR HOVERING AROUND 1.50 SWISS FRANCS, WITH OCCASIONAL SWINGS TO 1.45 OR 1.55 FRANCS.

28-SEP-1354 MON082

MORE

P

EQUITIES 2000-IDNA 1537

EUROPEAN DEALERS =8 LONDON ECSP

BUT BISCHOFSBERGER SAW DOLLAR PRESSURE PICKING UP IN 1988 DUE TO RISING U.S. INFLATION, A POOR U.S. BALANCE OF PAYMENTS AND POLITICAL UNCERTAINTIES CAUSED BY THE PRESIDENTIAL ELECTION.

HE SAID IT COULD DIP TO HISTORIC LOWS OF AROUND 1.35 FRANCS DURING 1988. ITS PREVIOUS LOW OF 1.4445 WAS SET ON MAY 5, 1987.

IN THE NETHERLANDS, A SENIOR FOREIGN EXCHANGE DEALER AT RABO BANK SAW THE DOLLAR RISING IN THE NEXT FEW DAYS, ONLY TO DROP BACK TO AROUND 1.80 MARKS THEREAFTER.

BUT DUTCH ANALYSTS SAID THE MAIN ISSUE AT THE WASHINGTON MEETINGS WAS THIRD WORLD DEBT. IF THE WEST COULD NOT DEVISE A NEW APPROACH, GROWTH IN DEBTOR NATIONS WOULD SLOW DOWN, THEY SAID.

28-SEP-1358 MON093

REUTER

 28/9/87.

NOTE FOR THE RECORD

MEETING OF GROUP OF SEVEN

A meeting of the Group of Seven was held in the United States Treasury on Saturday 26 September, beginning with an informal lunch without collective discussion and then running at the meeting-table from about 1.45pm until 4.30pm. Those present were the customary trio (Finance Minister, Central Bank Governor, Senior Official) from each country, plus two interpreters (one for the French Minister and one for the Japanese Governor). The Canadian senior official was Stanley Hartt, not Dr. Wendy Dobson who acts normally as Deputy. The IMF Managing Director, Michel Camdessus, attended for the first part of the meeting only.

Surveillance

2. Camdessus was invited to open the discussion. He said he would not go in detail through the paper and figures he had circulated, but would simply highlight some of the achievements on the one hand and the uncertainties and problems on the other, which struck him as being important.

3. Under the heading of achievements, he pointed first to the scissors effect of the changing relationships between domestic demand growth and growth in total GNP, which were now shifting in the right directions. The reduction in the US fiscal deficit this year was turning out much larger than had been generally expected. There had been important advances in structural policies, including Canadian liberalisation of financial markets, French privatisation, French and Italian reductions of exchange controls.

4. Particularly important were the remarkable results achieved in foreign exchange markets, in terms of the degree of stability which had been maintained since the spring. There had indeed been a cost in intervention, and also in the need to adjust interest rates, but the management of the market had been conducted very well. In passing he wanted to convey the appreciation which had been expressed at the Executive Board by the whole IMF membership.

5. Under uncertainties and problems he began with the three main external imbalances which remained at an unsustainably high level. Even after allowing for J-curve effects, he doubted whether enough had been done. Prospects for the US fiscal deficit were still worrying (Baker interposed the news that the President had just signed the Debt Ceiling Bill, which Camdessus had not known and warmly welcomed). Activity in Germany and Japan was not strong enough to help with the scale of changes needed in the US external imbalance. The burden of adjustment could not be left to the US alone, and indeed needed cooperation and adjustment by many surplus countries.

6. He noted that there had been some slightly better figures from Germany recently, but he could not yet be confident, especially given the tendency in recent years for Germany to suffer a sluggish first half of each calendar year. The substantial measures taken by Japan seemed to be having effect, but it would be extremely important that the effects carry through and grow into 1988.

7. There were renewed worries in the markets about inflation, particularly in the United States and Japan. We must not risk loose monetary policies, but overriding importance should be given to keeping exchange rate stability.

8. He then suggested that there might usefully be discussion of the particular questions posed in his circulated paper.

9. Focussing on questions about the US, Baker said that, in signing the new legislation, the President was acutely conscious that he was putting himself at risk of having to cut the defence budget more than he wanted or accept tax increases. The determination of the US to preserve the momentum of deficit reduction should be clear. He thought it was also clear that they remained firm in resisting protectionism. On monetary policies, he agreed that we must not through imprudence lose important ground which had been gained, but he saw no evidence to justify the fears of renewed inflation to which the Managing Director had referred.

10. Miyazawa spoke of the Japanese intention to keep up the momentum of domestic demand in the coming years. He said there had been a change in attitudes in the new era since the Louvre agreement. Sumita spoke of the importance of maintaining price stability, but appeared to endorse a suggestion from the Managing Director that, while interest rates could perhaps not be reduced, it would be wrong to raise them.

11. The Chancellor took up the question on structural policies. He noted that the UK had during the last eight years introduced three pieces of legislation successively improving labour markets, mainly by giving the unions back to their members; and further measures were in preparation. The United Kingdom had taken a lead in pressing for agricultural reform - he only wished he could find more support from Germany and other colleagues present. And the UK record on privatisation was outstanding.

12. He did not share the apparent worries of the Managing Director about immediate inflationary pressures, especially as regards Japan. Inflation rates in Japan were consistently very low. Asset prices had indeed shown remarkable increases, but that was a rather special problem and not a major threat to price stability in general.

13. On interest rates, he noted that the UK had the second highest short-term rates of those around the table. This reflected the determination of the authorities to keep firm pressure against inflation. Interest rates must be handled flexibly if they were to be used - as they should be - both to help support exchange rate stability and to combat inflation. He thought the group should look at the general level of interest rates across the countries represented in the group as a whole. On that basis, his judgement would be that there was no need for a rise in the general level: world inflation was higher this year than last, but for special reasons, and looking at other potential warning signs, such as unit labour costs or commodity prices, he really saw no evidence of a significant resurgence of inflation in prospect. This being the case, it seemed to him that changes in interest rates within the group should be broadly symmetrical. Where there were market worries based on false expectations of renewed inflation, the authorities should try to educate and shape market sentiment.

14. He also picked up the reference by the Managing Director to the unsustainability of present levels of current account imbalances. He said that the argument must not be taken too far. There was no chance of the United States and Japan eliminating their imbalances in three or four years, as the Managing Director had said, but this was not necessarily a problem. The position of Japan as a major net saver in the world implied a current account surplus, and he recalled the history of the United Kingdom position a hundred years ago.

15. Finally, he drew attention to the interesting lag in reactions of volume and value of trade in Germany and Japan after the Plaza agreement and, he thought, in the United States in rather slower time. Greenspan endorsed this comment. He said that one reason for the slow reaction in the United States trade position since early 1985 was that huge profit margins had been built into trade at the currency levels then prevailing, so that the first phase of exchange rate correction did not significantly affect trade volumes. Effects were now being seen, and following what the Chancellor had said he would look for changes in nominal dollar values around the turn of this year.

16. Stoltenberg said that a key factor in the temporary slow-down of growth in Germany had been the impact of the exchange rate adjustment - which was still continuing. Against this background, the Louvre agreement had been of vital importance. He spoke of difficulties facing Germany, with a rising public sector deficit at the present time, troublesome moves by trade unions to reduce working time, and the continuing problems of adjustment to the higher value of the currency. He argued that the marginal changes in figures in Germany did not constitute a serious recession, that recent experience had been more promising, and that he was determined to pursue his programme of tax reductions.

17. Wilson said that Canada was pursuing a strategy of reducing the overall fiscal deficit, although he had problems in the inability to control provincial deficits. He aimed at a deficit of no more than 2½ per cent of GNP by 1990. Privatisation was continuing, along with further liberalisation of markets, and a substantial programme of reduction of subsidies. Such subsidies as remained - and there were strong political pressures to keep them - were in several areas of regional development and in relation to some grains and oil seeds. The process of change would inevitably slow down as the next elections approached, but the direction would remain consistent (Camdessus asked whether the strength of Canadian growth currently did not give opportunity for a renewed attack on the deficit: Wilson answered that it might do so in an academic sense, but not in the real world of politics).

18. He shared some of the concern of Camdessus over current account imbalances stretching out into the future. We could not carry too far the reliance on "unnatural" measures such as interventions and interest rate movements, and in any case recourse to high interest rates was damaging to the world economy.

19. Amato observed that Italy was emerging from a period of several months of a caretaker government, which had allowed some problems to fester. Domestic demand growth had risen rather faster than was prudent. The recovery of oil prices had not helped. When an effective government was restored in August, there were pressures which had to be resisted. Initial measures had been taken to reduce domestic demand - widely criticised as being too late, although he thought that a mere 15 days after the installation of the government was not too bad a record.

20. For 1988 he foresaw a continuation of higher growth than the IMF were forecasting, but basically with the same shading off during the year. Inflation should remain under control, but a bit above what had previously been expected - perhaps 4.8 per cent in 1987 and 4.5 per cent by the end of 1988.

21. The public sector deficit would probably remain at the same nominal amount (109000 billion lira) in 1988 as in 1987, but representing a fall in proportion of GDP from 11.2 per cent to 10.4 per cent. Interest payments on borrowing were a very heavy burden. He had in mind a kind of Italian Gramm-Rudman with the objective of reducing the deficit by 1991 to zero, excluding interest payments. He mentioned in passing that he had been able to use a popular switch from direct to indirect taxation in order to raise revenue.

22. The Italian government was pursuing liberalisation. He thought that an important psychological switch had been achieved. Whereas formerly people were able to do only what was specifically permitted, they were moving towards being able to do everything except what was specifically forbidden (although many people said that still too much was forbidden!).

23. He closed with a brief reference to agriculture and the community budget, saying that there was a growing realisation in the community that the existing system was unbearable, and that survival of the community as an effective institution required change.

24. Balladur outlined French policies over the two-year period between the last legislative elections and the forthcoming presidential elections. He had reduced the budget deficit by cutting expenditure by some 110 billion francs, using only 70 billion francs for tax reduction, partly to reduce personal taxes and partly to lower VAT towards what was likely to be an ultimate community scale. Over the next three years he would pursue a similar strategy, aiming for further 90 billion franc reduction in expenditure, half of which would be used to reduce the deficit and the other half to secure other reductions in VAT.

25. The record on inflation was very successful, with a total increase of only 8 per cent over the three-year period 1986-1988 - which put France third in the league after the two champions (Japan and Germany).

26. Progress was being made in reducing labour rigidities, although much remained to be done, particularly on the social security and local government budgets. Subsidies were being produced as a means of cutting expenditure. He agreed that something needed to be done in agriculture, but insisted that it must be comprehensive and take into account the fact that a common market in agriculture remained a primary goal of community policy.

27. He believed interest rates were too high - partly as a result of lack of conviction in markets about the inflation prospects, partly because of world increases, especially in the United States. He welcomed the assurances Sumita had given about Japanese interest rates.

28. Baker concluded this part of the discussion by suggesting that the process of surveillance could be very helpful if we persisted in improving it, while recognising the political difficulties. He hoped that all would cooperate, and that those who were slow or deficient in providing numbers would come into line. He expected Deputies to report progress by early 1988. At this point, Baker thanked Camdessus, who left the meeting.

World Bank: General Capital Increase

29. Baker confirmed that the US position was now that a GCI was appropriate, that negotiations should be concluded speedily, that they should not be disrupted by quarrels over shares. He would need to consult Congress before settling the US position, in respect of the total amount of the increase (for which he thought the staff proposals of $40 - 80 billion were the right ball-park) and the paid-up proportion.

IMF Structural Adjustment Facility

30. Baker said that this was a useful idea for recycling surpluses, but the United States could not contribute to everything which was proposed while continuing to cut its public sector deficit.

31. Stoltenberg said that Germany had a positive reaction to the proposal, although he felt that doubling rather than tripling should be the aim. They had not yet settled how their contribution could be made. Subsidies in particular presented difficulties. But they looked forward to continuing discussion. He thought that, as regards the sharing of burdens, the criterion of surplus or deficit was irrelevant. If it was not the case that all members would participate, then the arrangements would have to be voluntary, and that could be difficult to settle quickly.

32. Balladur noted that France was not a surplus country, but was nevertheless ready to accept a tripling of the facility and, in the sense of doing its duty, to offer a substantial contribution, as he had already publicly indicated. He recalled that the group had received a mandate from the Venice Summit to settle this matter by the end of the year. It was important to give a sense of direction at the present meetings.

33. The Chancellor noted that the United Kingdom was not a surplus country either. He recalled that there had been two proposals on which the Venice Summit had sought progress by the end of the year - the tripling of the Structural Adjustment Facility and his own proposals for the very poorest and heavily indebted countries, mainly in Sub-Saharan Africa. He thought that the Managing Director shared his own view that these two proposals should be seen in parallel. There was no question that the countries we were discussing here could return to creditworthiness on commercial markets within any foreseeable future. Indeed they would not be able to service their bilateral debts, so that creditors would sooner or later face a budget burden anyway. Creditors should take on that burden now and take the opportunity of linking a concession on interest rates with proper adjustment policies.

34. As regards the structural adjustment facility, he expressed a positive United Kingdom reaction, saying that the UK would certainly pay a fair share of grant for subsidy and could be ready to contribute capital in principle, although there were problems about the modalities of this. He awaited more precise proposals from the Managing Director.

35. Baker again made it clear that the United States would not be prepared to contribute at this stage, and added that it would be extremely counter-productive if pressure for a contribution were added to the lists of demands on Congress before the end of the year. Miyazawa said that Japan would happily join in, if the framework were satisfactory. He suggested that, given the large scale of the proposed expansion, sales of IMF gold should be considered as a means of financing, say, half the proposed expansion.

36. Wilson noted that none of the countries present had surpluses on domestic budgets, but one way or another support must be given to these poorest countries. Canada would do its share. Use of the proposed facility could be a valuable way of avoiding the necessity of rescheduling World Bank lending. (Baker quickly made a plea against what he saw as yet another initiative at this juncture).

37. Amato said that Italy was in much the same position as France in offering support in principle, but they preferred to wait for clarification of detailed proposals before giving specific answers on an Italian contribution. Baker accepted that all creditor countries should make an effort - including the United States but it was important not to let surplus countries off the hook. They had huge amounts of funds to recycle. If France was offering $500 million, how much would and should Japan offer?

38. After some desultory exchanges, it was agreed that the Managing Director should be encouraged to develop his proposals in further detail.

IMF Quotas

39. With no discussion it was quickly agreed that there was no urgency in pursuing the increase in IMF quotas. On the other hand, enlarged access should continue without any change. (No word was mentioned by United States or others about possible token reductions in cumulative limits, etc.).

Communique

40. Baker then tabled the communique which had been prepared by Deputies the previous evening. The Chancellor offered the suggestion of a much shorter communique, the text of which was also circulated, but after a pause for reading a consensus emerged in favour of the longer version. The meeting then considered the communique paragraph by paragraph, making a few amendments, and reaching unanimous agreement.

41. The agreed text of the communique, as published, is attached.

Geoffrey Littler
28 September, 1987

SECRET

pup

From: Sir Geoffrey Littler
Date: September 28, 1987

MR. ALLEN

cc: Governor
Mr. A. Loehnis
Sir P. Middleton
Sir T. Burns
Mr. D. Peretz
Mr. H. Evans
Mr. C.W. Kelly

MEETINGS OF G5 AND G7

I attach fairly detailed records of the two meetings at Ministerial level held in Washington on Saturday 26 September, together with the communique eventually issued from the G7.

2. Following various bilateral contacts among Ministers, as well as the meeting of Deputies the night before, it was tacitly agreed that no new cooperative action or measures should be announced, but the Louvre agreement should simply be declared to continue. There was therefore no discussion in detail of intervention arrangements, or of other modalities of cooperation.

3. On the main issue of the Louvre agreement, the meeting was in fact very harmonious throughout.

Geoffrey Littler

Attachments

JOINT MINISTERIAL COMMITTEE
OF THE
BOARDS OF GOVERNORS OF THE BANK AND THE FUND
ON THE
TRANSFER OF REAL RESOURCES TO DEVELOPING COUNTRIES
(Development Committee)

September 28, 1987

To : Members and Associates of the Development Committee

From : Fritz Fischer, Executive Secretary F.F.

Subject : Statement of the President of the African Development Bank

At the request of Mr. Babacar N'Diaye, President of the African Development Bank, the attached statement is made available for the meeting of the Development Committee on September 28, 1987.

Attachment

STATEMENT OF BABACAR N'DIAYE

PRESIDENT OF THE AFRICAN DEVELOPMENT BANK

AT THE 32ND MEETING OF THE DEVELOPMENT COMMITTEE

WASHINGTON , D.C., 28 SEPTEMBER 1987

Mr. Chairman,

Ladies and Gentlemen,

1. Economic conditions in Africa continue to be difficult. The decline in per capita income generally experienced since the beginning of the 1980s continued through 1986, and the forecasts for 1987 suggest no real improvement. The estimated growth of 1.2 per cent in the combined regional gross domestic product for 1986 and the projected figure of 2.5 per cent for 1987, are both below the rate of population growth. A major factor depressing GDP performance in 1986 was the collapse in oil prices, which led to a decline in GDP in the African oil-exporting countries. However, economic performance varied considerably between the sub-groups and sub-regions of Africa. For instance, the non-oil exporting countries experienced an estimated growth of 4 per cent in 1986. This improvement was largely due to a satisfactory domestic situation. Improved incentive systems and favourable weather resulted in a rise of 3 per cent in gross agricultural output for the continent as a whole, with cereal production estimated to have increased by close to 6 per cent. But this encouraging performance in agriculture is not expected to continue in 1987 as is indicated by recent developments in parts of Eastern and Southern Africa. Non-oil commodity prices have continued to decline substantially in 1987 leading to a very large current-account deficit.

2. The unfavourable developments in the external sector - especially through their consequences on reducing import capacity and the servicing of external debt - curtail investment and rehabilitation programmes and thereby diminish prospects for growth. For now that so many African countries are taking conscious measures to rectify domestic policy shortcomings, economic growth depends, possibly more than before, on the extent to which the international environment -notably aspects relating to export earnings and resource flows - is supportive of growth. Since Africa's primary commodity exports are expected to continue with their depressed price trends, significant improvements in export earnings cannot be expected in the near future. Augmenting external resource flows for investment and rehabilitation, therefore, assumes special significance in pursuing growth under these circumstances.

3. It is now well appreciated that there is in Africa a widespread commitment to the pursuit of policies that are conducive to growth and development. It is stated in the World Development Report 1987, for instance, that some twenty-five countries in Sub-Saharan Africa, which account for a large proportion of Africa's population and output, are implementing major programs of structural reforms or are about to do so. For example, the growing emphasis on agriculture as the leading sector in Africa has been reflected in the orientations of government policies in the recent past. In line with the recommendations of Africa's Priority Programme for Economic Recovery, 1986-1990, many governments have stepped up measures to provide high producer prices and other incentive packages to farmers. Budgetary resource allocations to agriculture have been increased and institutional reforms undertaken. But while African countries are doing much

.../3

to adjust and diversify their economies, these measures in themselves will not be adequate to place economies on the path of sustained growth and development. To reinforce a point raised earlier, adjustment measures must be supported by external resource flows to be effective. Two additional reasons stand out. The first is that substantial proportions of the external resources that are provided in support of adjustment measures have to be recycled to meet debt-service obligations. And second, the continued slump in the prices of commodity exports undermines the capacities of individual African countries to raise their own domestic resources and to generate foreign exchange in support of adjustment programmes. Substantially increased resource flows to Africa, including debt relief, are therefore necessary to sustain adjustment measures. In this regard, we look forward with keen interest to concrete suggestions resulting from the deliberations of this Committee on its agenda item devoted to the discussion of proposals for action (to enhance growth) for low-income countries facing exceptional difficulties, especially the seriously indebted countries in Sub-Saharan Africa. But this issue obviously goes beyond the work of this Committee. In particular, the question of Africa's debt calls for deliberations and actions at wider fora of the international community.

4. Growth prospects in Africa - even under favourable expectations - leave much to be desired. In the scenarios formulated for the 1986-1995 period in the 1987 World Development Report, economic performance in Sub-Saharan Africa is expected to trail behind all other country groupings. In the High case, output would be expected to grow at 4 per cent and per capita income at 0.7 per cent per year. In the Low case - predicated on assumptions that cannot be designated pessimistic when viewed against recent

records - output would grow at 3.2 per cent and per capita income would not grow at all. Considering the social and economic conditions prevailing in so much of the continent, it surely behoves African governments and the international community to work together against such (or even grimmer) eventuality.

5. For our part in the African Development Bank, we have been putting considerable efforts in directly or indirectly addressing issues relating to resource flows to Africa. We have also continued to work actively with other continental organizations and with regional member countries in analysing important issues in African economic development. More directly, we proposed and secured the approval of our shareholders to triple the capital base of AfDB so as to increase very substantially non-concessional lending during the 1987-1991 period. Planned commitment over that period will, in nominal terms, exceed cumulative commitments since the start of Bank operations. We are also at an advanced stage in consultations with our State Participants for a fifth general replenishment of the resources of the African Development Fund. Our augmented resources, even if still only a small fraction of the continent's requirements, will nontheless enable us to orient both the nature and magnitude of our operations to better respond to the needs of our members. In line with the priorities set in Africa's Priority Programme for Economic Recovery, agriculture and agriculture-related activities will continue to constitute a major focus for resource allocation. We also intend to introduce new directions in operations by giving special support to activities in the spheres of the environment, population, women in development, co-financing, trade-financing and the private sector. We are also significantly expanding on policy-based operations - sector adjustment and structural adjustment

.../5

loans - which will be undertaken in close collaboration with other multilateral institutions. We shall keep the Committee informed on these and other initiatives aimed at responding to the difficult economic situation in Africa.