

International: a road to recovery

The deepest recession of the postwar period, experienced by virtually all countries around the world in 1974 and 1975, abated during 1976. The recovery began in late 1975 and continued throughout 1976. However, the momentum of the recovery, which appeared strong in the first part of the year, slowed considerably in the latter part. Economic growth, as measured by the expansion in the gross national product (GNP) and corrected for changes in prices in the world's 24 major industrial countries comprising the membership of the Organization for Economic Cooperation and Development (OECD), slowed from around a 6 percent annual rate during the first six months to about 3 percent during the balance of 1976. The slower rate of growth in the latter part of the year seriously impeded these countries' efforts to reduce unemployment, which in most countries had been hovering around postwar peaks. At the same time, however, the rapid rate of inflation that plagued the world economy in the past several years moderated considerably during 1976, as the rate of increase in the consumer prices slowed from well over 13 percent, experienced in the 24 major industrial countries during 1974, to just below 8 percent in 1976.

Patterns of growth

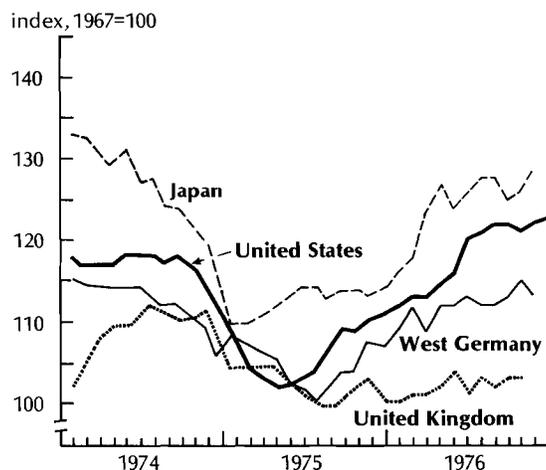
The ever-growing volume of world trade has led to the development of economic interdependence among nations. This interdependence has caused the cyclical movements in the economies of individual countries to become highly synchronized. Indeed, the severity of the 1974-75 worldwide recession was in large part attributable to the mutually reinforcing, coinciding adverse trends in major countries. Declining demand for goods and services in one country had an impact not only on the industrial and commercial activities in that country, but also on activities in countries that were important

suppliers of raw materials and finished products in the markets of that country—and vice versa. Similarly, the countercyclical measures taken by individual countries in an effort to deal with declining domestic production and rising unemployment provided a self-enforcing impetus to recovery for all the countries in late 1975 and early 1976.

The vigorous rate of economic expansion that the United States, Japan, and Germany experienced in early 1976 was of particular importance as a stimulus to recovery in other countries. However, by midyear the rate of expansion of these three major countries slowed considerably in the wake of cautious economic policies followed by the governments in their effort to moderate domestic inflation. The rate of growth of the real GNP in the United States slowed from a 6½ percent annual rate in the first half of 1976 to 4 percent in the second half, in Japan from 8½ percent to 3¼ percent, and in Germany from 7 percent to 3¼ percent.

These slowdowns accentuated the problems of other major countries where the

Industrial production in major industrial countries slows down in late 1976



process of the recovery was already being hampered by high rates of inflation, balance-of-payments difficulties—and by closely connected foreign exchange market pressures against their currencies. In the United Kingdom, with inflation running in excess of 15 percent, with foreign trade experiencing a large deficit, and with the British pound depreciating sharply on the foreign exchange market, the authorities pursued restrictive policies throughout the year. As a result, the real Gross Domestic Product increased by only 1 percent in 1976. In Italy the rampant inflation and the recurring pressures against the country's currency triggered by massive capital outflows, forced the government to adopt measures that dampened the country's economic growth during the year. In France large balance-of-payments deficits forced the authorities to withdraw the French franc from the European Community's "joint float" arrangements early in the year and to tighten its economic policies.

The combined impact of these developments in the major industrial countries resulted in a marked slowdown in the growth of the world economy in the second half of 1976. But despite the slowdown the overall performance of the world economy in 1976, as a whole, was considerably better than during the previous year. The economy was on a firm road to recovery.

Problems of developing countries

The resumption of economic growth in industrial countries in late 1975 and early 1976 was accompanied by increased demand for raw materials. The rising demand and the resulting firming of prices provided some relief for many of the less-developed countries for whom exports of these commodities provide a major source of income. But it was only partial relief. Deep-rooted economic problems, combined with rapidly rising aspirations of their peoples, continued to plague the economic conditions of these countries during 1976. Drought, crop failures, the past sharp increase in the price of oil, and the low demand for their products due to

slow economic growth abroad have caused large current account deficits for the developing countries. The already large indebtedness of these countries (estimated at \$151 billion at the end of 1974) increased further during 1975 and 1976 as a result. Increasing militancy of many of these nations in demanding assistance for solution of their problems became a distinct feature on the world economic scene during 1976.

The U.S. balance of payments

The renewal of economic growth in the United States and in countries abroad during 1976 was reflected in the substantial shifts in the U.S. balance of payments. The U.S. merchandise trade account shifted abruptly from a record surplus during 1975 to an annual rate deficit of about \$8 billion during the first 10 months of 1976. The cause of the shift has been the divergence in the rate of economic recovery between here and abroad. Following the U.S. economy's upward turn in the latter part of 1975, imports began to rise. The rise accelerated sharply during the first half of 1976 as imports rose 16 percent above the last half of 1975. The level of imports stabilized during the latter part of 1976 as the momentum of the economic expansion in the United States moderated. But in spite of this leveling off, U.S. imports during the second half of last year were about 12 percent above first-half levels. The most rapid increases took place in imports from Japan and the OPEC countries as demands for energy increased with the pickup of economic activity.

U.S. exports continued to expand throughout the year but at a rate considerably lower than imports. This reflected a slower rate of economic recovery abroad than was experienced in the United States. U.S. exports to industrial countries rose 7 to 8 percent above 1975 levels through the first three quarters of the year. However, over the same period exports to OPEC countries were up only 13 percent in 1976, compared with a 76 percent increase in 1975. This expected slowdown in the rate at which OPEC countries imported U.S. goods was largely because of the

limited absorption capacity of these relatively underdeveloped economies. U.S. exports to the non-OPEC less-developed countries (LDCs) were down 2 percent from 1975 during the first three quarters of 1976. This reflected the continuing economic difficulties of the LDCs in sustaining economic expansion; the higher costs of their oil imports diverted their demands from capital goods and food imports typically supplied by the United States.

International capital markets responded to the generally improved U.S. economy and to the resulting strengthening of the U.S. dollar vis-a-vis major foreign currencies in 1976. Particularly notable was the renewed

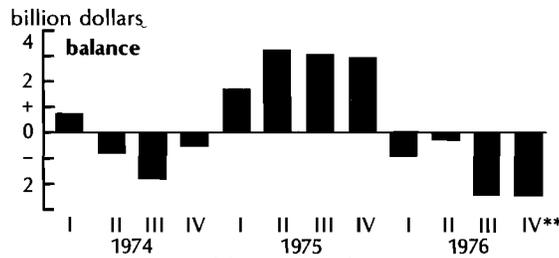
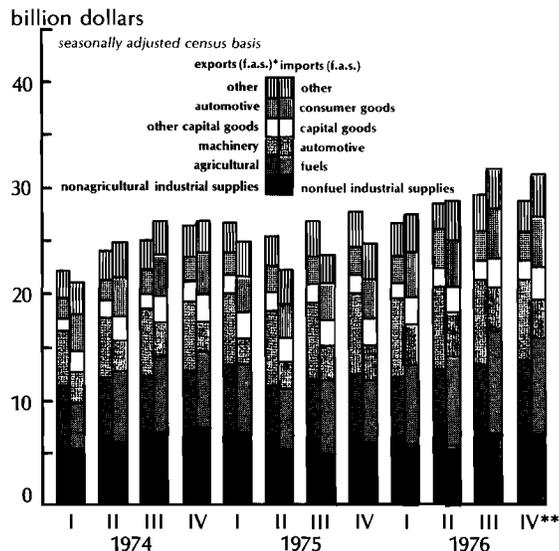
placement of substantial funds in U.S. capital markets in 1976 by OPEC countries. Capital outflows from the United States also increased. The U.S. banks were major contributors to this outflow as the weak domestic loan demand made it attractive for U.S. banks to deploy funds abroad.

International activities in the district

Last year witnessed a further broadening of international activities in the Seventh Federal Reserve District. While current data on the volume of exports originating in the district are not available, it is generally believed that the Illinois, Indiana, Iowa, Michigan, and Wisconsin manufacturers and farmers significantly increased their share of total U.S. exports—up from about the 25 percent share historically experienced. This was particularly true for exports of agricultural commodities. As the world's increased demand for food sharply boosted U.S. agricultural exports, the district's share of these exports rose from 23.7 percent in fiscal 1975 to 26.9 percent in fiscal 1976.

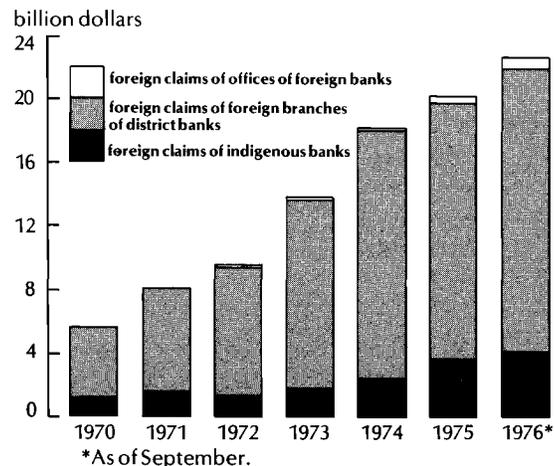
International financial and banking activities in the district also continued to expand during 1976, following the trend that began in the early 1960s. At the beginning of 1960 the

The U.S. trade balance turns sharply into deficit

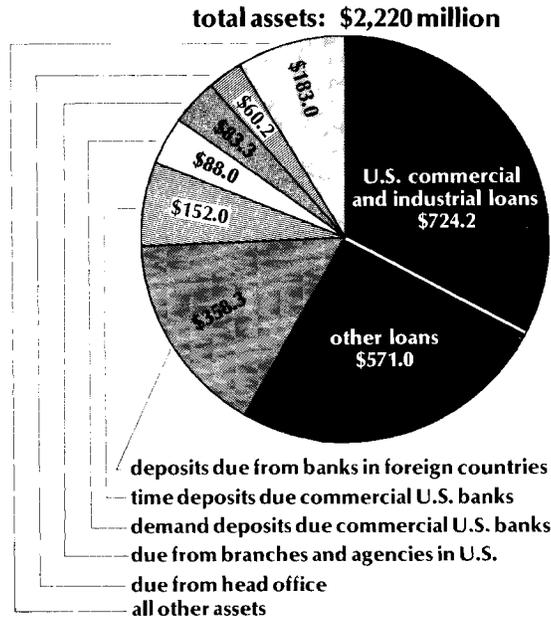


^aDomestic and foreign merchandise excluding military grant-aid shipments.
^{**}Fourth quarter figures based on October-November data.

Foreign claims of the district banks continue to rise



Assets of the district's foreign banks double in 1976



district banks' total claims on foreigners amounted to \$100 million; by September of 1976 the total stood at \$22.6 billion. There have been three major channels through which this growth took place: (1) head office lending; (2) expansion of activities of the foreign branches of the district banks; and (3) establishment and growth of branches and subsidiaries of foreign banks in the district.

Until 1974 the expansion of direct international lending by the district bank was hampered by the Voluntary Foreign Credit Restraint (VFCR) program instituted by the government in 1965 to shore up the country's balance-of-payments position. After the termination of the program in 1974, foreign lending expanded rapidly. By the end of 1975 the district banks' claims on foreigners rose to \$3.7 billion, and toward the end of 1976 the total amounted to \$4.1 billion.

Far more important, however, has been the usage of overseas facilities as on-the-location lending outlets. While in 1960 no Seventh District bank maintained foreign facilities, by 1970 district banks had 33 branches abroad, with assets amounting to \$4.4 billion. By 1976 district banks had 77 branches abroad with total assets of \$17.8 billion.

The most recent developments in the district's international banking has been the emergence of the presence of foreign banks in Chicago. The influx was made possible by the legislative action of the Illinois General Assembly in 1973. By 1976 there were 22 branches of foreign banks and two fully owned foreign subsidiaries operating in Chicago. Their total assets at the end of September 1976 amounted to \$2.2 billion. Most of these were commercial and industrial loans to U.S. residents. This attested to the full integration of foreign banks into the banking environment in the Seventh Federal Reserve District.

Prospects

Progress toward recovery from the deepest recession of the world's economy since the 1930s was perhaps slower than was desirable. But the progress was marked by determination of national governments to deal in cooperative spirit with the economic adversities besetting them. Individual national policies aimed at dealing with specific problems confronting their domestic economies have been, by and large, developed in a way so as not to impinge on the goals and economic objectives of other nations. This cooperative spirit bodes well for the future. As individual nations, including the United States, are in the process of reassessing their economic policies to determine whether further stimulus is needed, the past record holds a promise for the future that their combined actions will result in a mutually reinforcing impetus to economic growth.