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To: Members of the Executive Board

From: The Secretary

Subject: Statement of the Group of Seven

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December 22, 1987

STATEMENT OF THE GROUP OF SEVEN

1. The Finance Ministers and Central Bank Governors of seven major industrial countries have conducted close consultations in recent weeks on their economic policies and prospects in light of developments in financial markets. They reaffirmed their conviction that the basic objectives and economic policy directions agreed in the Louvre Accord remain valid and provide for a positive development of the world economy. They will continue to carry forward their economic policy coordination efforts in 1988 under the arrangements endorsed at the Venice Summit.

2. The Ministers and Governors reemphasized their view that the major external imbalances in the world economy must be corrected. The policies which have been implemented this year are gradually showing the intended effects. In particular, the balance between domestic demand and output in the United States and in Japan and the Federal Republic of Germany has shifted in a direction which promotes external adjustment and in volume terms their trade imbalances are diminishing. The greater stability of exchange rates achieved for much of the past year, following the earlier substantial exchange rate changes, contributed to this adjustment. The marked exchange rate changes over the past few weeks, however, stress the need to strengthen underlying economic fundamentals and to continue policy cooperation.

3. Developments in stock markets since mid October may have some adverse effect on prospects for economic growth for the industrialized countries as a group. The Ministers and Governors believe, however, that with sound economic policies and effective coordination the rate of growth should be substantial. To this end they agreed that appropriate policies for strengthening non-inflationary growth in their countries are necessary.

4. Accordingly, the Ministers and Governors agreed to intensify their economic policy coordination efforts. Their common efforts are directed towards reducing external imbalances. In particular, the United States has secured Congressional action to implement the agreement between the President and the bipartisan Congressional Leadership on a two-year package of additional budget savings that will reinforce progress in reducing the budget deficit. Japan has implemented a major stimulus program to strengthen domestic demand and will see to it that in the FY 1988 budget the expenditure for general public works will not be less than that for the FY 1987 budget including the July supplemental. The Federal Republic of

Germany is supplementing the previously announced increase in tax reductions in 1988 with new measures to increase investment and will not seek to offset the budget revenue losses arising from recent developments. There have also been coordinated reductions in interest rates in Europe which should contribute to the expansion of domestic demand and reduce trade imbalances. The specific policy intentions and undertakings by each country are set forth in the annex to this statement.

5. The Ministers and Governors are of the view that the recent monetary policy decisions and the reduction of interest rates in some countries were appropriate and will contribute to a restoration of stability to financial markets. They agreed that monetary policies should continue to be directed towards providing adequate monetary conditions to achieve strong economic growth in the context of price stability as well as to foster financial market stability.

6. The Ministers and Governors strongly rejected protectionist measures as a means of dealing with present imbalances. Protectionism constitutes a direct and serious danger to world prosperity and equilibrium and would have harmful consequences for those countries which resort to it. They reaffirmed their determination to fight protectionism and to promote an open world trading system.

7. The Ministers and Governors believe that the reduction of world trading imbalances requires cooperative action by other countries, particularly those with surpluses. They expressed particularly serious concern that some newly industrialized economies have failed to take adequate action to deal with large and growing trade surpluses which are exacerbating global imbalances and fostering protectionist pressures. They urged the newly industrialized economies to implement without delay trade and exchange rate policies that will facilitate the reduction of excessive trade surpluses and allow their currencies to fully reflect the strong competitive position of their economies.

8. The Ministers and Governors agreed that either excessive fluctuation of exchange rates, a further decline of the dollar, or a rise in the dollar to an extent that becomes destabilizing to the adjustment process, could be counter-productive by damaging growth prospects in the world economy. They reemphasized their common interest in more stable exchange rates among their currencies and agreed to continue to cooperate closely in monitoring and implementing policies to strengthen underlying economic fundamentals to foster stability of exchange rates. In addition, they agreed to cooperate closely on exchange markets. The Ministers and Governors stressed the need for consistent and mutually supportive policies and believe that the measures being taken

will accelerate progress towards the increased, more balanced economic growth, and sustainable external positions necessary for greater exchange rate stability.

Annex

Policy Intentions and Undertakings

The Government of Canada's fiscal strategy has succeeded in achieving a drop in the rate of growth of its spending and substantial, on-going declines in the budget deficit. Marked progress has been made in slowing the growth of debt, and towards the medium-term objective of stabilizing the debt-to-GDP ratio. Fiscal restraint has been accompanied by impressive growth of domestic demand, output and employment. Major structural initiatives directed at enhancing competitiveness and the underlying potential of the economy have been undertaken, particularly tax reform and the negotiation of a free trade agreement with the United States. Monetary policy remains geared to non-inflationary growth in a climate of orderly exchange markets.

The Government of France has fully met its commitment to reduce its fiscal deficit and tax burden. The fiscal deficit will be reduced by 0.8% of GNP from 1986 to 1988. Over the same period of time, tax cuts will amount to 1.3% of GNP. A further reduction of 45 billion french francs in the fiscal deficit and an additional 45 billion french francs in tax cuts are scheduled in a 1989-1991 three year program which constitutes the long term strategy of the government and will be implemented in the yearly budgets. The privatization program decided upon in early 1987 is being carried out, and its initial objectives have even been surpassed. The full implementation of the program will be resumed as soon as market conditions permit.

The French Government will continue to pursue its adjustment and liberalization policies. New measures to sustain household savings, develop financial markets and improve the competitiveness of firms have been taken. Additional steps will be taken in the same direction in 1988.

The Government of the Federal Republic of Germany has increased the amount of the tax reductions for 1988 and beyond to about 14 billion DM, and will not seek to offset the budget revenue losses arising from recent developments. In addition, the necessary decisions have been taken for the structural tax reform with a further net tax reduction of 20 billion DM from 1990 onward.

In order to strengthen private and public investment, the Federal Government will provide special loans for the next 3 years of about 21 billion DM under preferential conditions. Moreover, it will accelerate investment in telecommunication infrastructure and take initiatives for further deregulation of markets.

The Bundesbank has reduced short-term interest rates substantially during the last few weeks. Monetary policy will continue to maintain appropriate conditions for sustained non-inflationary growth.

The Government of Italy, in the context of continuous significant growth, has taken temporary measures to halt the deterioration of the balance of payments due to a higher rate of domestic demand in Italy than in other industrialized countries. For 1988 the objective embodied in the Finance Bill is to maintain a relatively high level of growth and to reduce inflation, while making progress in correcting the public sector imbalance.

In the medium-term, to alleviate unemployment the Italian authorities intend to achieve satisfactory rates of growth while maintaining the balance of payments current account in substantial equilibrium, to stabilize the debt/GDP ratio, and to devote more resources to the financing of productive as well as infra-structural investments, thus improving the quality of public services.

The Government of Japan noted that the Japanese economy is in a vigorous expansionary phase, led by domestic demand growth. The Government will steadfastly continue implementing the 6 trillion-yen-plus package decided on last May, and will see to it that in the FY 1988 budget the expenditure for general public works will not be less than that for the FY 1987 budget including the July supplemental.

The Bank of Japan will follow appropriate and flexible monetary policy supportive of non-inflationary growth and exchange rate stability.

The United Kingdom Government, in the context of the British economy's continued vigorous growth of output and domestic demand, coupled with sound public finances, will continue to strive to reduce inflation by pursuing a prudent monetary policy, while increasing its capacity for non-inflationary growth by further measures designed to free the operation of markets and increase the efficient use of resources, including tax reduction and tax reform. Public expenditure will continue to increase less rapidly than the growth of the economy as a whole, and the government will continue to work for the dismantling of barriers to trade both within the European Community and in the context of the Uruguay round of the GATT.

The United States Government has secured Congressional action to implement the agreement between the President and the bipartisan Leadership of the Congress on a two-year package of budget savings to reduce the U.S. budget deficit. This agreement provides for total budget savings, through a combination of spending restraint and increased taxes, in fiscal 1988 and 1989 of approximately $76 billion.

The budget agreement is part of an ongoing process of deficit reduction provided for under the revised Gramm-Rudman-Hollings legislation. It will reinforce the progress already achieved in reducing the deficit (including a fiscal 1987 cut of $73 billion or 1.9 percent of GNP) that has brought the deficit down to 3.4 percent of GNP from a peak of 6.3 percent.

The Administration will also continue to oppose steadfastly protectionist trade measures, while working for legislation authorizing negotiations to foster a more open and fair system for the international exchange of goods, services and investment.