

Unfavoured to
Cheques

and
seen by
TL AM
tl.

CONFIDENTIAL



Prime Minister,
The Chancellor would like
to speak with you about this
tomorrow.

Treasury Chambers, Parliament Street, SWIP 3AG
01-233 3000

Duty Clerk.
13 Oct.

PRIME MINISTER

ECONOMIC PROSPECTS

I have received a preliminary summary from officials of the results of their autumn forecasting exercise and I thought that you would find it helpful to have a brief indication of this and of the further work that is in hand.

2. The general picture is, I fear, a gloomy one and more pessimistic than the forecast we published at the time of the Budget and those of most outside commentators. GDP, after modest growth this year, is expected to fall substantially next year and the rate of price inflation to decelerate more slowly next year than had previously been expected. The inflation prospect for next year has worsened mainly because of higher prices for oil and other imported materials and because earnings in the year ending last July were higher than expected.

3. With price inflation worse but with the rise in earnings moderating because of our tight monetary policy and some prospective rise in unemployment, consumer spending is likely to be lower. Moreover the higher levels of the exchange rate and earnings this year has led to worsening competitiveness which, together with the unfavourable performance so far this year in trade volumes, makes the prospect for trade worse than in the budget forecast. These factors, together with a smaller

/ increase in

CONFIDENTIAL



increase in world demand for our exports, explain the more pessimistic view on output. Despite lower activity in general, poor trading performance and the virtual disappearance of the usual invisibles surplus lead to substantial current account deficits this year and next.

4. The PSBR prospect for both this financial year and 1980-81 is, however, broadly in line with the previous forecast, remaining at around a constant $4\frac{1}{2}$ per cent of market price GDP. This is, of course, subject to major uncertainties, but I see no case at present for any further policy changes on this account, and I was interested to note that in the seminar I held here with a number of outside economists last Friday on medium term financial plans there was general agreement that it was right to view the PSBR in real terms.

5. I think that the preliminary results of the forecast are a plausible guide to the general direction of the main economic developments in the short-term. But they are, of course, subject to very large margins of error and critically dependant on a number of key judgements. I am not satisfied that these are entirely plausible or acceptable, and I have therefore asked officials to do further work on a number of variants and I hope to have the results of this available within the next few days.

6. We shall need to consider in the light of the further work the form in which we publish the forecast under the requirements of the Industry Act. Although I had previously envisaged that it would be convenient to combine this at the end of this month with the first Public Expenditure White Paper

/ containing our

CONFIDENTIAL



containing our plans for 1980-81, I now think that the best course would be to separate them and publish the Industry Act forecast later. This could be delayed until the end of November without our statutory obligations under the Industry Act becoming a serious embarrassment, and would give us more time in which to get the presentation right.

7. Subject to your own views, therefore, I think we should go ahead with publication of the 1980-81 White Paper on its own at the end of this month as previously decided, and I have instructed my officials to plan to this effect.

A handwritten signature in dark ink, appearing to be 'G.H.' with a flourish.

(G.H.)

12th October, 1979

CONFIDENTIAL