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FM WASHINGTON 312340Z

TO IMMEDIATE FCO

TELEGRAM NUMBER 1730 OF 31 MAY 1984

SECRETARY OF STATE'S VISIT: BREAKFAST WITH VOLCKER

1. AT BREAKFAST TODAY, DISCUSSION BETWEEN THE SECRETARY OF STATE AND CHAIRMAN VOLCKER FOCUSED ON INTERNATIONAL DEBT AND PROSPECTS FOR THE US ECONOMY.

2. ON DEBT, VOLCKER SAID THAT HE HOPED THE LONDON SUMMIT WOULD ENDORSE MULTI-YEAR RESCHEDULINGS. HE WAS ESPECIALLY ANXIOUS TO MAKE SUCH AN ARRANGEMENT FOR MEXICO, TO SPAN THE NEXT FOUR OR FIVE YEARS, AND HE WOULD BE PROMOTING THE IDEA AT THE PHILADELPHIA BANKING CONFERENCE. (MEXICO WOULD NOT, HE THOUGHT, NEED NEW MONEY IN 1985.) MORE GENERALLY, VOLCKER SAID HE WAS CONCERNED ABOUT THE PROPOSED BOGOTA MEETING OF LATIN AMERICAN DEBTORS, FOR WHICH ARGENTINA SEEMED TO HAVE BEEN A MOVING SPIRIT. ARGENTINA WAS ALSO A WORRY IN ITSELF: HE DID NOT RULE OUT THAT THEY MIGHT REFUSE TO AGREE AN IMF PROGRAMME. HIS BROAD STRATEGY WAS TO TRY TO ISOLATE ARGENTINA, BY CONSOLIDATING THE PROGRESS WHICH HAD BEEN MADE IN MEXICO AND BRAZIL AND IF POSSIBLE BY PERSUADING VENEZUELA TO CO-OPERATE WITH THE IMF. AT THE SAME TIME, EVERY EFFORT SHOULD BE MADE TO KEEP ARGENTINA IN PLAY THROUGH CONTINUING NEGOTIATIONS WITH THE FUND AND THE COMMERCIAL BANKS. THIS STRATEGY DID, HOWEVER, INVOLVE CONSIDERABLE DIFFICULTIES OF TIMING. AGREEMENT OF A MULTI-YEAR RESCHEDULING FOR MEXICO WOULD TAKE SOME WEEKS. MEANWHILE, THE END OF JUNE WOULD BE A CRITICAL DATE FOR ARGENTINA. THE US BANKS WERE LESS WELL PLACED NOW TO WITHSTAND THE CONSEQUENCES OF LOAN QUALIFICATION THAN THEY HAD BEEN AT THE END OF MARCH. IN RESPONSE TO A COMMENT BY THE SECRETARY OF STATE ON RISING INTEREST RATES, VOLCKER ACCEPTED THAT RECENT INCREASES HAD PROVIDED AMMUNITION TO THE LATIN AMERICANS: THERE WAS QUOTE AN ETERNITY UNQUOTE BEFORE THE PRESIDENTIAL ELECTION. VOLCKER INDICATED THAT HE WAS ATTRACTED BY THE IDEA OF INTEREST RATE CAPPING BUT STRESSED THAT ANY COSTS WOULD HAVE TO BE BORNE BY THE BANKS. FINALLY, VOLCKER SAID HE DID NOT THINK DEVELOPMENTS IN THE GULF WOULD SERIOUSLY AFFECT MANAGEMENT OF INTERNATIONAL DEBT PROBLEMS: ON SOME READINGS, THEY MIGHT BENEFIT THE OIL DEBTORS WITHOUT HURTING THE NON-OIL DEBTORS.

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3. ON THE US ECONOMY, VOLCKER THOUGHT THAT IT WAS IN SOME WAYS DOING TOO WELL. BUT THERE WAS SOMETHING RATHER PERVERSE ABOUT THE WAY GOOD NEWS ON GROWTH LED TO FALLS IN THE FINANCIAL MARKETS. HE WAS CONCERNED ABOUT THE TRADE DEFICIT AND SURPRISED THAT IT HAD PROVED SUSTAINABLE FOR SO LONG. ON FISCAL POLICY, VOLCKER THOUGHT THAT THE FINANCIAL MARKETS HAD ALREADY DISCOUNTED THE EFFECTS OF THE QUOTE DOWN PAYMENT UNQUOTE PACKAGE. FOR THE FUTURE, HE DID NOT WHOLLY SHARE THE GENERAL EXPECTATION THAT THE ADMINISTRATION WOULD MAKE A SERIOUS ASSAULT ON THE DEFICIT SOON AFTER THE ELECTION. THEY MIGHT BE SIDETRACKED, IN PARTICULAR BY REFORM OF THE TAX CODE. ON INTEREST RATES, VOLCKER SAID THAT THE RECENT RISE HAD NOT, FORMALLY, RESULTED FROM ACTION BY THE AUTHORITIES. IT HAD BEEN A MARKET RESPONSE TO OVERALL CREDIT DEMAND AND RISING INFLATIONARY EXPECTATIONS.

4. FCO PLEASE ADVANCE TO PS/CHANCELLOR, LITTLER, LAVELLE (FOR WICKS) (HMT), PS/GOVERNOR, LOEHNIS (BANK) AND TAIT (ERD)

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(ADVANCED AS REQUESTED)

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