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TELEGRAM NUMBER 968 OF 5 MARCH

US ECONOMIC PROBLEMS

1. OUR SAVINGRAM 11 OF 29 FEBRUARY REPORTED THE MARKED DETERIORATION IN THE CLIMATE OF ECONOMIC OPINION HERE AND INDICATED THAT THE ADMINISTRATION ARE CONDUCTING A WIDE-RANGING ECONOMIC POLICY REVIEW.

2. TWO FURTHER DEVELOPMENTS THIS WEEK HAVE INTENSIFIED THE PRESSURE ON THE ADMINISTRATION'S ECONOMIC POLICIES.

(I) INTEREST RATES HAVE RISEN EVEN HIGHER WITH MOST MAJOR BANKS RESETTING THEIR PRIME RATES AT 17 AND A QUARTER PERCENT ON 4 MARCH AND THE TREASURY PAYING RECORD YIELDS ON NEW BILLS.

(II) THE BUDGET DEFICIT FOR CURRENT YEAR (FY80), ORIGINALLY SET AT DOLLARS 29.9 BN. IN THE SECOND BUDGET RESOLUTION LAST OCTOBER AND RAISED TO DOLLARS 40 BN BY PRESIDENT CARTER IN HIS CONGRESSIONAL BUDGET MESSAGE ON 28 JANUARY, IS NOW GENERALLY EXPECTED TO TURN OUT EVEN HIGHER.

3. THE MAIN POLICY OPTIONS UNDER CONSIDERATION ARE REPORTED TO INCLUDE THE FOLLOWING.

(I) A TIGHTENING OF FISCAL POLICY INVOLVING A REDUCTION IN FEDERAL EXPENDITURE DESIGNED TO BALANCE THE BUDGET FOR THE FISCAL YEAR BEGINNING IN OCTOBER (FY81). AT PRESENT THE BUDGET PROPOSALS CALL FOR A DEFICIT OF DOLLARS 15.8 BN, ALTHOUGH MANY COMMENTATORS BELIEVE IT WOULD TURN OUT HIGHER. ALL GOVERNMENT DEPARTMENTS EXCEPT DEFENCE HAVE BEEN ASKED TO PROVIDE OPTIONS FOR REDUCING EXPENDITURE. MEASURES UNDER CONSIDERATION REPORTEDLY INCLUDE DE-INDEXING SOCIAL SECURITY PAYMENTS AND CURTAILMENT OF JOB CREATION PROGRAMMES. SMALLER REDUCTIONS IN FY80 EXPENDITURE ARE ALSO UNDER CONSIDERATION. THESE ARE LIKELY TO BE DIRECTED AT OFFSETTING RECENT INCREASES IN THE EXPENDITURE ESTIMATES OF SOME PROGRAMMES, SO THAT THE PRESIDENT CAN STILL ACHIEVE THE BUDGET DEFICIT OF DOLLARS 40 BILLION HE PROJECTED IN HIS CONGRESSIONAL BUDGET MESSAGE.

(II) A SECOND AREA OF POSSIBLE ACTION IS ON MONETARY POLICY. THERE IS MUCH TALK OF THE ADMINISTRATION PROPOSING CREDIT CONTROLS. THE FED, WHO WOULD BE RESPONSIBLE FOR OPERATING ANY CONTROLS, HAVE IN THE

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PAST MADE CLEAR THEIR <sup>BE A</sup>DISLIKE OF ANY GENERAL SYSTEM OF CONTROLS NOT LEAST BECAUSE THEY WOULD NIGHTMARE TO ADMINISTER. IT WOULD NOT BE SURPRISING, HOWEVER, IF THEY WERE LOOKING FOR MORE SELECTIVE WAYS TO RESTRAIN CREDIT, FOR EXAMPLE IN THE AREAS OF CONSUMER OR BUSINESS LOANS, OR TO RESTRICT THE MARKETS IN THOSE INSTRUMENTS WHICH HAVE HELPED TO FINANCE THE CONTINUING CREDIT EXPANSION BUT WHICH ARE NOT INCLUDED IN THE MAIN MONETARY AGGREGATES. WE HAVE HEARD, INTER ALIA, THAT THE FED HAVE INCREASED THEIR SURVEILLANCE OF THE COMMERCIAL PAPER MARKET LEADING AT LEAST ONE BANKER TO INFER THAT SOME DEVICE MAY BE UNDER CONSIDERATION WITH THE OBJECT OF CONSTRAINING SUCH SOURCES OF FINANCE. OTHER OPTIONS REPORTEDLY BEING DISCUSSED INCLUDE INCREASED MINIMUM PAYMENTS ON CREDIT CARD BALANCES OUTSTANDING AND LIMITING BANK LOANS FOR CORPORATE TAKEOVERS, THOUGH MOST RECENT REPORTS SUGGEST THESE ARE NOT FAVOURED BY THE ADMINISTRATION. A FURTHER POSSIBILITY WOULD BE FOR THE FED TO AGREE TO ANOTHER INCREASE IN THE DISCOUNT RATE.

(III) ACTION IS ALSO UNDER CONSIDERATION ON THE ENERGY FRONT. THE MOST COMMONLY MENTIONED OPTIONS ARE TO RAISE OIL IMPORT DUTIES AND TO INCREASE GASOLINE TAXES. NEITHER OF THESE IS LIKELY TO BE POLITICALLY APPEALING TO THE PRESIDENT AT THIS TIME.

(IV) INTEREST IN MANDATORY WAGE AND PRICE CONTROLS HAS RECENTLY REVIVED. HOWEVER, ANY MOVE IN THIS DIRECTION SEEMS LIKELY TO RELEASE A SURGE OF ANTICIPATORY PRICE INCREASES WHILE CONGRESS WAS CONSIDERING WHETHER TO GRANT THESE POWERS. FOR THIS AND OTHER REASONS THE ADMINISTRATION HAVE REPEATEDLY RULED OUT CONTROLS, FOR EXAMPLE AT THE TIME SENATOR KENNEDY PROPOSED THESE ON 7 FEBRUARY, AND MOST RECENTLY LAST WEEKEND IN A TELEGRAM ON INFLATION FROM THE PRESIDENT'S INFLATION ADVISER, KAHN, AND TREASURY SECRETARY MILLER TO THE 500 LARGEST CORPORATIONS IN THE US. THE PRESIDENT COULD NONETHELESS SEEK TO STRENGTHEN THE REPORTING REQUIREMENTS UNDER THE EXISTING VOLUNTARY WAGE AND PRICE GUIDELINES.

4. THE PRESIDENT'S RECENT STATEMENT THAT INFLATION HAS REACHED A QUOTE CRISIS STAGE UNQUOTE AND THE SIEDLY REPORTED POLICY REVIEW HAVE NOW BUILT UP EXPECTATIONS TO SUCH AN EXTENT THAT ONLY SUBSTANTIAL PACKAGE IN THE NEAR FUTURE WILL BE SEEN AS ADEQUATE. THE RESULTS OF THE NEW HAMPSHIRE PRIMARY ALSO SUGGEST THAT SENATOR KENNEDY HAS MADE SOME HEADWAY ON ECONOMIC ISSUES AND THAT INFLATION HAS AGAIN RETURNED TO CENTRE STAGE AS A POLITICAL ISSUE. IN THESE CIRCUMSTANCES, THE PRESIDENT IS LIKELY TO FEEL OBLIGED TO TAKE THE LEAD, RATHER THAN LEAVING THE FED TO MAKE THE RUNNING AS HITHERTO.

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OF THE VARIOUS MEASURES DISCUSSED ABOVE, THE MOST LIKELY OUTCOME SEEMS TO BE A PACKAGE OF EXPENDITURE CUTS, BUT THIS ALONE MAY NOT BE ENOUGH TO QUELL INFLATIONARY EXPECTATIONS. SELECTIVE ACTION ON THE MONETARY FRONT IS COMMONLY QUOTED AS THE NEXT MOST LIKELY COMPONENT OF ANY PACKAGE.

5. THERE HAS BEEN LITTLE OFFICIAL INDICATION OF HOW SOON ANY PROPOSALS MIGHT BE ANNOUNCED. CLEARLY, THE CURRENT INTEREST IN THE REVIEW AND THE PROXIMITY OF THE IMPORTANT ILLINOIS PRIMARY (MARCH 18) POINT TO SOME TIME FAIRLY SOON. A CONTACT AT THE OFFICE OF MANAGEMENT AND BUDGET HOWEVER HAS INFORMED US THAT THE GENERAL INTENTIONS IS FOR A NUMBER OF DETAILED OPTIONS FOR BUDGET CHANGES TO BE PUT TO THE PRESIDENT LATER THIS WEEK, ENABLING HIM TO ANNOUNCE GENERAL PROPOSALS AROUND THE END OF NEXT WEEK - THE TIME OF YEAR BUDGET REVISIONS ARE CUSTOMARILY SENT TO CONGRESS.

6. FCO PLEASE PASS TOTURNBULL (TREASURY) AND HAYWARD (BANK OF ENGLAND) AND ALSO TO COUZENS (TREASURY) REF. TELECON ANZON/COUZENS OF 4 MARCH.

FRETWELL

[THIS TELEGRAM WAS NOT ADVANCED]

FINANCIAL DISTN  
NAD  
SIR A. ACLAND  
LORD N. G. LENNOX

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