

BY BAG

FM WASHINGTON

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TO FCO TEL NO. 42

SAVING OF 7 AUGUST 1980

Prime Minister

To glance

MAD 11/8

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UNITED STATES MONTHLY ECONOMIC REPORT FOR JULY 1980

SUMMARY

1. The decline in US economic activity is continuing, but at a slower pace than during the second quarter. The unemployment rate, now 7.8%, failed to show the further increase expected in July, but this pause is probably only temporary. The rise in consumer prices, although less rapid than in the first quarter, still continues close to the underlying rate of inflation at about 10% a year.

2. The full extent of the steep fall in economic activity in the second quarter is now known. GNP fell by 2.2%, mostly due to lower sales of US cars and to a lesser extent housing. The reduction in demand was caused by a squeeze on real incomes and by the failure of the US car industry to produce sufficient small cars, as well as high interest rates and credit controls. The initial impact of the latter is now recognised to have been much more substantial than originally envisaged.

3. President Carter sent to Congress on 21 July his mid-session review, including a new official economic forecast and revised budget estimates for FY 1981. The forecast accepts that the economy is experiencing a deeper recession than thought likely earlier this year. It expects the economic recovery to begin around the end of the year, but to proceed slowly in 1981, with unemployment remaining at 8.5% in the absence of policy changes. The rate of inflation is forecast to be only slightly lower in 1981 than 1980 (though for technical reasons the consumer price index may show a temporary improvement later this year).

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4. No new tax or expenditure initiatives are proposed in the revised budget estimates. On that basis, the budget is projected to be in deficit in 1981-82 by \$28.9 bn, instead of the surplus of \$16.5 bn estimated in March. The balance of risk is that the deficit could be higher than this.

5. President Carter continues to be criticised by Governor Reagan and others for his failure to table a tax cut at this stage, but these views are not universally held. He has responded by stressing the importance of following through in the fight against inflation and the need to address long term economic objectives, both of which point to deciding the amount and form of a tax cut nearer the time. Although it seems almost certain that Congress will eventually enact a tax cut to come into effect in early 1981, it is not clear that this will be done before the November elections.

6. The Federal Reserve Board, in their mid-year policy report to Congress, have re-emphasised the importance of curbing inflation. Mr Volcker, in subsequent testimony, came out against a general tax cut in 1981, although he did not rule out a cut targeted to encouraging business investment. The Board have also published provisional target ranges for growth of the main monetary aggregates in 1981, consistent with a modest further tightening of monetary policy.

(See MIFT for full REPORT)

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US MONTHLY ECONOMIC SITUATION
REPORT

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PRINCIPAL INDICATORSQuarterly Data (1980 - Q2)

	<u>% change on</u>	
	<u>Previous Quarter</u>	<u>Year earlier</u>
GNP	-2.2	-0.8
Exports of Goods & Services	-2.3	10.9
Imports of Goods & Services	-6.8	-3.4

Actual Level

	<u>Latest Quarter</u>	<u>Previous Quarter</u>
Balance of Payments Current Account (Q1)	-2.6	-1.8

Monthly Data

	<u>% change on</u>	
	<u>Previous Month</u>	<u>Year earlier</u>
Consumer Price Index (Jun)	1.0	14.3
Money Stock M1B (Jun)	1.2	4.4
M2 (New) (Jun)	1.4	8.2
Dollar Effective Exchange Rate (Jly)	-0.6	-1.3

Actual Level

	<u>Latest Month</u>	<u>Year earlier</u>
Banks Prime Rate % (Jly)	11.25	11.5
Unemployment Rate % (Jly)	7.8	5.7