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TELNO 3848 QF 17 DECEMBER 1981,

INFO PARIS, BONN, TOKYO, ROME, OTTAWA, UKDEL OECD, UKREP BRUSSELS.

THE US RECESSION AND PRESIDENT REAGAN'S ECONOMIC RECOVERY PROGRAMME.

1. THE US ECONOMY IS NOW RECOGNISED TO BE IN RECESSION. IN NOVEMBER INDUSTRIAL PRODUCTION DECLINED BY 2.1%, THE FOURTH SUCCESSIVE MONTHLY DROP. THE RECESSION IS UNDOUBTEDLY AFFECTING THE CREDIBILITY OF PRESIDENT REAGAN'S MEASURES TO STRENGTHEN THE ECONOMY BY REDUCING THE ROLE OF THE FEDERAL GOVERNMENT. WHATEVER THE LONG-TERM MERITS OF THE ADMINISTRATION'S POLICIES, IT BECAME INCREASINGLY EVIDENT DURING THE LAST WEEKS OF THE 1981 CONGRESSIONAL SESSION THAT EXPENDITURE CUTS ARE BECOMING PROGRESSIVELY MORE DIFFICULT FOR THE CONGRESS TO SWALLOW. THE MAIN FACTOR IS THE PRESENT LEVEL OF UNEMPLOYMENT OF 8.4%, WHICH IS SPREAD UNEVENLY BETWEEN LOCALITIES AND RACIAL GROUPS. WHEN THE OFFICIAL FORECASTS OF PROSPECTIVE BUDGET DEFICITS RANGING FROM DOLLARS 100 BILLION TO DOLLARS 163 BILLION FOR FY82-FY84 WERE LEAKED, UPWARD PRESSURE ON US INTEREST RATES WAS AGAIN EVIDENT, REVERSING THE DECLINE THAT BEGAN IN THE SUMMER. THIS COMBINED WITH EVENTS IN POLAND, HAS ALSO INCREASED THE EXTERNAL VALUE OF THE DOLLAR. THE UNDERLYING RATE OF INFLATION IS DECLINING AND IS EXPECTED TO CONTINUE TO DECLINE NEXT YEAR, BUT THE LATEST PUBLISHED LEVEL OF THE CONSUMER PRICE INDEX (10.2% IN OCTOBER OVER OCTOBER OF LAST YEAR) IS STILL HIGH ENOUGH BY HISTORICAL US STANDARDS TO KEEP IT IN THE PUBLIC CONSCIOUSNESS.
2. THE RECESSION STARTED IN THE CAR AND HOUSING INDUSTRIES AND HAS SPREAD FROM THOSE AREAS TO THE REST OF THE ECONOMY. CAR PRODUCTION IS AT A VERY LOW LEVEL, WITH NOVEMBER SALES ABOUT 18% BELOW EVEN THE DEPRESSED LEVEL OF NOVEMBER 1980. CAR IMPORTS ARE NOW REGULARLY CAPTURING ABOUT 25 TO 30 PERCENT OF THE DOMESTIC MARKET. HOUSING STARTS IN 1981 WILL PROBABLY BE AT THE LOWEST LEVEL SINCE 1959 WHEN STATISTICS BEGAN TO BE RECORDED. WHILE INTEREST RATES HAVE COME DOWN, THEY HAVE NOT DONE SO SUFFICIENTLY TO MAKE MORTGAGES (NOW TYPICALLY AT 16%) ATTRACTIVE TO HOME BUYERS OR TO ALLEVIATE THE VERY SERIOUS SOLVENCY PROBLEMS OF THE SAVINGS AND LOAN ASSOCIATIONS.
3. THE REACTION OF THE ADMINISTRATION TO THESE RECENT UNFAVOURABLE ECONOMIC DEVELOPMENTS HAS BEEN TO CLAIM THAT THEY DID NOT FORESEE THE SEVERITY OF THE PRESENT RECESSION OF THE DEGREE TO WHICH HIGH INTEREST RATES HAVE BECOME ENTRENCHED BECAUSE OF THE POLICIES OF THE PREVIOUS ADMINISTRATION. AT HIS PRESS CONFERENCE ON 17 DECEMBER, PRESIDENT REAGAN DECLARED HIMSELF OPPOSED TO TAX INCREASES

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AND EVEN TO "IRRESPONSIBLE" EXPENDITURE REDUCTIONS, AND DID NOT COMMIT HIMSELF TO BALANCING THE FEDERAL BUDGET BY ANY SPECIFIC DATE. THERE IS THEREFORE LITTLE HOPE THAT THE COUNTER-INFLATIONARY BURDEN OF MONETARY POLICY WILL BE TRANSFERRED IN ANY SIGNIFICANT DEGREE TO FISCAL POLICY. IF THE US ECONOMY EXPANDS AGAIN AS EXPECTED IN THE SECOND HALF OF 1982, THERE IS THE OBVIOUS RISK THAT EXTREMELY HIGH INTEREST RATES WILL RE-EMERGE.

4. PROSPECTS FOR GROWTH IN 1982 ARE FOR A RISE IN REAL GNP OF 1% OR LESS. THE REPUBLICAN PARTY IS EVIDENTLY RELYING ON THE PROSPECT OF SHARPLY INCREASED GROWTH AFTER MID-1982 TO RETRIEVE THE SITUATION AND THEY ALSO DOUBTLESS HOPE FOR A CONTINUING DECLINE IN THE RATE OF INFLATION AND INTEREST RATES. BUT IF THE ADMINISTRATION CONTINUE THEIR PLANS FOR NO INCREASES IN TAXATION, HIGH DEFENCE EXPENDITURE, AND ONLY MODERATE REDUCTIONS IN EXPENDITURE ON CIVIL PROGRAMMES, THEIR STRATEGY IS CLEARLY A RISKY ONE. IT APPEARS TO BE BASED ON THE ASSUMPTION THAT HIGH INTEREST RATES WILL NOT RE-EMERGE IN TIME FOR THE RECOVERY TO BE CHOKED OFF, AN ASSUMPTION WHICH IS BY NO MEANS SELF-EVIDENT.

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