

SECRET

19 January 1983

ALAN WALTERS

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PRIME MINISTER

THE BUDGET - FIRST THOUGHTS

In a week or so the Treasury will be producing its first forecasts for next year, as the background to the Budget discussions. I believe that little credence should be put on any of the particular forecasts; they tend to extrapolate historical relationships, whereas we know that such relationships have changed considerably.

But I do not think that the forecast should have any substantial influence on the main target variables in the March Budget, in particular the PSBR. The outcome of the PSBR this year (1982/83) may be as much as £1½bn-£2bn less than the target, giving a realised borrowing requirement of about £7½bn.

I believe there is a consensus emerging in the Treasury that we should aim for about £8bn for 1983/1984. On present guesses this would mean that, in addition to one Rooker-Wise, there would be around £2bn, perhaps even £2½bn, for additional tax cuts etc.

However, I think it would be wise to aim for a figure of about £7bn. One of the main reasons for a lower figure is that the savings rate of households has been falling quite dramatically in recent months. From highs in the region of 13%-17% over the last decade, it has fallen to about 9%. This compares with the long run average, before 1972, of about 8%. We seem to be getting back to a "normal" savings ratio.

A second argument for the £7bn is that it would provide a useful pointer to the markets that, as we run towards the election, there will be no vestige of an inflationary package. We should actually show that we are making room in the market for corporate borrowers. (There are other good technical reasons, which I will not burden you with, but will develop on request, for heading for a low PSBR when inflation is lowered.)

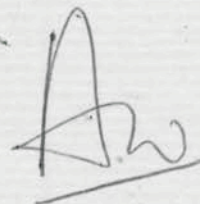
I suspect that if we suggest a PSBR of £7bn we shall be urged to raise it to at least £7½bn as a compromise between the Treasury view and ours. I regard £7½bn as a little on the high side, but one that is not inconsistent with the basic strategy. May I suggest then that in your discussions with the Chancellor you might suggest £7bn as the appropriate target?

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If we adopted a £7½bn target then the present very tentative indications are that we could make tax reductions of round about £1½bn-£2bn. This would enable us to raise the thresholds to their 1979 real values and leave round about £½bn or a little more over for other tax reductions.



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10 DOWNING STREET

Prime Minister

The Budget

Do you want the same tight security within no 10 which we had last year? That is, only Robin or I and Alan, and no-one else whatever apart from Alan's secretary, would see any of the papers?

MLS 19/1

Yes
no