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US ECONOMY

1. A GRADUAL US ECONOMIC RECOVERY APPEARS NOW TO BE UNDER WAY. MOST ANALYSTS BELIEVE THAT GROWTH COULD BE 2-2.5 PERCENT BETWEEN 1982 AND 1983, AND THEREFORE THAT THE ADMINISTRATION FORECAST OF 1.4 PERCENT IS TOO CAUTIOUS. INDUSTRIAL PRODUCTION ROSE BY NEARLY 1 PER CENT IN JANUARY, THE INCREASE BEING WELL SPREAD AMONGST CONSUMER GOODS AND DEFENCE INDUSTRIES. HOUSING STARTS ROSE SHARPLY TO AN ESTIMATED 1.7 MILLION UNITS (ANNUAL RATE) IN JANUARY, ALSO BENEFITING ANCILLARY INDUSTRIES SUCH AS FURNITURE AND APPLIANCES. THE DECLINE IN INVENTORIES SLOWED IN DECEMBER AND IT IS EXPECTED THAT STOCKBUILDING WILL CONTRIBUTE TO MUCH OF THE GROWTH IN THE FIRST QUARTER.
2. DURING 1982, INFLATION (THE CONSUMER PRICE INDEX) ROSE BY LESS THAN 4 PER CENT, THE SMALLEST ANNUAL INCREASE SINCE 1972. THE OUTLOOK ON INFLATION CONTINUES TO BE FAVOURABLE AND IT COULD BE BELOW THE ADMINISTRATION'S FORECAST OF 5 PERCENT IN 1983. THE CONTINUATION OF LOW RATES OF INFLATION WILL DEPEND ON FURTHER PRODUCTIVITY IMPROVEMENTS WHICH, COMBINED WITH WAGE MODERATION, SHOULD RESULT IN RELATIVELY LOW INCREASES IN UNIT LABOUR COSTS. THE PROSPECT FOR LOWER ENERGY PRICES IS ALSO FAVOURABLE.
3. THE FIRMNESS OF INTEREST RATES SINCE EARLY JANUARY IS THE MAIN REASON FOR DOUBT ABOUT THE STRENGTH OF THE RECOVERY, ALTHOUGH MANY BANKS' PRIME RATES WERE REDUCED TO 10 AND HALF PERCENT ON 25 FEBRUARY. THIS FIRMNESS REFLECTS LARGER THAN EXPECTED US TREASURY BORROWING, UNCERTAINTIES OVER THE GROWTH RATE OF MONEY SUPPLY AND THE CONCERN OVER THE SIZE OF THE STRUCTURAL BUDGET DEFICITS AFTER 1984. REAL INTEREST RATES REMAIN HIGH. THUS CAPITAL SPENDING MAY REMAIN WEAK, ESPECIALLY AS CAPACITY UTILISATION IS LOW (ONLY 67.8 PERCENT IN JANUARY). MOST ANALYSTS FORECAST ONLY A SLIGHT DECLINE IN UNEMPLOYMENT FROM THE JANUARY LEVEL OF 10.4 PERCENT DURING THE YEAR.
4. FEDERAL RESERVE BOARD CHAIRMAN VOLCKER HAS INDICATED THAT MONETARY POLICY WILL CONTINUE TO BE FLEXIBLE ENOUGH TO ACCOMMODATE RECOVERY WITHOUT BEING INFLATIONARY. VOLCKER HAS FREQUENTLY STRESSED THE DIFFICULTY OF PURSUING A FLEXIBLE MONETARY POLICY ULTIMATELY TO LOWER INTEREST RATES WHEN LARGE BUDGET DEFICITS ARE TENDING TO PUSH UP MARKET RATES. ACTION TO LOWER THE BUDGET DEFICIT IS LIKELY TO BE ESSENTIAL IF INTEREST RATES ARE TO FALL.

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5. IN COMMENTING YESTERDAY ON THE SHORT-TERM PROSPECTS FOR INTEREST RATES, SENIOR MEMBERS OF THE ADMINISTRATION AND FEDERAL RESERVE CHAIRMAN VOLCKER ALL EXPECTED A FURTHER DECLINE IN AT LEAST SOME INTEREST RATES IN LINE WITH THE DECLINE IN INFLATION. THIS DECLINE WAS, THEY POINTED OUT, BEING GIVEN FURTHER IMPETUS BY THE DECLINE IN OIL PRICES. SECRETARY REGAN WENT SO FAR AS TO SUGGEST THAT THE PRIME RATE CHARGED BY THE BANKS COULD FALL TO THE RANGE 6-9 PER CENT.

6. THE ADMINISTRATION'S INCREASED CONFIDENCE ABOUT PROSPECTS FOR US ECONOMIC RECOVERY, AND THEIR AGREEMENT TO A JOBS BILL PACKAGE WORTH DOLLARS 4.6 BILLION (TOGETHER WITH OTHER MEASURES TO ALLEVIATE UNEMPLOYMENT), HAS FOR THE TIME BEING IMPROVED RELATIONS WITH CONGRESS. THE FISCAL YEAR 1984 BUDGET PROCEDURE IS STILL AT AN EARLY STAGE, AND THERE ARE GOING TO BE SUBSTANTIAL DIFFERENCES BETWEEN THE ADMINISTRATION AND CONGRESS ON WHAT AMENDMENTS ARE ACCEPTABLE TO THE ORIGINAL ADMINISTRATION PROPOSALS. THE DEMOCRATS ARE LIKELY TO OPPOSE THE PROPOSED SPENDING FREEZE (IN REAL TERMS) IN FY84 SINCE IT IN FACT CONSISTS OF A STRONG INCREASE IN REAL DEFENCE EXPENDITURE AND A DECLINE IN REAL NON-DEFENCE EXPENDITURE. THE ADMINISTRATION IS ASKING FOR A FURTHER SEVEN PER CENT REAL INCREASE IN DEFENCE SPENDING; CONGRESS WILL BE TRYING TO HOLD THIS DOWN TO BETWEEN THREE AND FIVE PER CENT. THE CONGRESS IS ALSO UNLIKELY TO ACCEPT THE ADMINISTRATION'S CONTINGENCY TAX PROPOSAL. UNLESS AN ALTERNATIVE TO THIS CAN BE FORMULATED, THERE WOULD BE THE UNACCEPTABLE PROSPECT OF CONTINUING BUDGET DEFICITS OF ABOUT DOLLARS 200 BILLION BEYOND FISCAL YEAR 1985. THERE IS THEREFORE PLENTY OF SCOPE FOR SHARP DIFFERENCES BETWEEN THE ADMINISTRATION AND CONGRESS TO RE-EMERGE ON BUDGET ISSUES DURING THE SPRING AND SUMMER.

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