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PRIME MINISTER

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UNITED STATES ECONOMIC POLICY

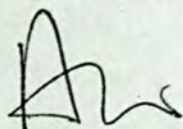
There is some evidence that the Fed is reducing the very rapid rate of monetary growth that began in July 1982. Over the past five weeks the rate of growth appears to have slowed down somewhat. This has been reflected in quite sharp increases in short term interest rates and very modest increases at the long end.

The main hope, and I am afraid it is only hope, is that the Fed will continue gradually to rein in the outrageous monetary growth of the last nine months. Their record in this respect has been quite dismal since the policy changes of October 1979. For example, after the massive expansion at an annual rate of 22% from February to April 1981, they then dramatically reduced the rate to $-8\frac{1}{2}\%$ for the next ten weeks. If this performance is repeated then we are likely to have a replay of mid-1981.

Fortunately, there is a good chance that an erratic monetary policy may be bailed out by a fall in the price of oil or a resuscitation of European growth. Similarly, there is a chance that the temporary decline in velocity will be reversed, and so any sharp monetary contraction may be offset by a rise in velocity.

There is, however, a real possibility of a renewal of recession in the United States in 1984. If that results in a Democratic victory in the Presidential elections, there is every reason to believe the inflation will take off once more.

I am sorry that I cannot be more precise about potential outcomes. But I thought you ought to know where the analysis and evidence lead - for there are important implications for us.



ALAN WALTERS
14 April 1983