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INFO PARIS, BONN, TOKYO, UKREP BRUSSELS, UKDEL OECD

**US ECONOMY: RECENT DEVELOPMENTS**

1. THERE IS NOW CONFIRMATION THAT A US ECONOMIC RECOVERY IS UNDER WAY. PRELIMINARY ESTIMATES INDICATE THAT REAL GNP GREW AT A 3.1 PER CENT ANNUAL RATE IN THE FIRST QUARTER OF 1983, FOLLOWING A 1.7% DECLINE IN 1982. THIS FIRST QUARTER RISE WAS SOMEWHAT LESS THAN THE 4 PER CENT EXPECTED EARLIER, AND SOME ADMINISTRATION OFFICIALS DO NOT EXPECT INCREASED MOMENTUM TO GATHER UNTIL THE SECOND HALF OF THE YEAR. THE FIRST QUARTER RECOVERY WAS NARROWLY-BASED AND DOMINATED BY INCREASES IN HOUSING CONSTRUCTION AND A DECLARATION IN THE DRAWDOWN OF INVENTORIES. A SUBSTANTIAL RECOVERY WILL DEPEND UPON A REVIVAL IN CONSUMER SPENDING, WHICH IS NOT YET FIRMLY ESTABLISHED, ALTHOUGH CONSUMER CONFIDENCE IMPROVED SHARPLY IN MARCH. CAR SALES WERE ESPECIALLY DISAPPOINTING IN THE FIRST QUARTER.

2. INFLATION (CONSUMER PRICE INDEX) IN MARCH WAS ONLY ABOUT 3.5 PER CENT ABOVE A YEAR AGO. THE YIELD ON A 3-MONTH TREASURY BILL IS CURRENTLY ABOUT 8 PER CENT AND, ON A LONG-TERM GOVERNMENT BOND, 10.5 PER CENT. ADJUSTED FOR INFLATION, THEREFORE, INTEREST RATES REMAIN HISTORICALLY HIGH ESPECIALLY FOR THE EARLY STAGE OF A RECOVERY. THE FEDERAL RESERVE CLEARLY WANTS A FURTHER DECLINE, NOT AN INCREASE, IN INTEREST RATES TO SUPPORT THE RECOVERY AND HIGHLY RESTRICTIVE ACTION TO BRING THE MONETARY AGGREGATES BACK WITHIN THE TARGET RANGES SEEMS UNLIKELY AT THIS POINT.

3. THE ADMINISTRATION IS NOT CURRENTLY ENJOYING A HIGH SUCCESS RATE ON DOMESTIC ECONOMIC ISSUES IN THE CONGRESS. THE FY 84 FEDERAL BUDGET PROCESS IS IN A CONFUSED STATE, WITH THE DEMOCRATS SO FAR EXHIBITING BETTER PARTY DISCIPLINE THAN THE REPUBLICANS. ON 23 MARCH THE HOUSE OF REPRESENTATIVES PASSED A DEMOCRATIC BUDGET RESOLUTION WHICH PROVIDED FOR A DEFICIT OF DLRS 175 BILLION, INCLUDING AN INCREASE IN REAL DEFENCE EXPENDITURE OF LESS THAN 5 PER CENT AND THE CANCELLATION OF THE 10 PER CENT CUT IN INCOME TAX RATES SCHEDULED FOR JULY. THIS RESOLUTION WAS UNACCEPTABLE TO PRESIDENT REAGAN. THE SENATE HAS YET TO VOTE ON A BUDGET RESOLUTION, BUT THE SENATE BUDGET COMMITTEE YESTERDAY APPROVED A DEMOCRATIC RESOLUTION SIMILAR TO THE ONE PASSED IN THE HOUSE INCLUDING A PROVISION FOR THE CANCELLATION OF THE JULY TAX CUT. REPUBLICANS ON THE COMMITTEE WERE SPLIT BETWEEN THOSE WHO DID NOT WANT EVEN THE LIMITED FY 84 TAX REVENUE INCREASES PROPOSED BY THE PRESIDENT AND THOSE WHO WERE IN FAVOUR OF SUBSTANTIAL INCREASES, SO THAT THE VOTE IN FAVOUR OF THE RESOLUTION WAS 13 TO 4. THIS UNDOUBTEDLY CAME AS A DISAPPOINTMENT TO THE PRESIDENT, WHO HAD EARLIER AUTHORISED SENIOR WHITE HOUSE OFFICIALS TO TRY TO NEGOTIATE A COMPROMISE ACCEPTABLE TO HIM.

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4. THE VOTE IN THE SENATE BUDGET COMMITTEE DEMONSTRATES HOW LITTLE CONTROL THE ADMINISTRATION NOW HAS OVER THE CONGRESSIONAL BUDGET PROCESS. THE PRESIDENT'S PREROGATIVE, THE VETOING OF LEGISLATION, DOES NOT APPLY TO BUDGET RESOLUTIONS SINCE THESE DO NOT COME TO HIM FOR APPROVAL. IN ORDER TO AVOID A BUDGET RESOLUTION IMPLYING THE CANCELLATION OF THE SCHEDULED JULY TAX REDUCTION, THE PRESIDENT NOW HAS TO GAIN A VICTORY IN THE VOTE ON THE SENATE FLOOR. THE DEBATE WILL PROBABLY BEGIN AT THE END OF NEXT WEEK AND THE VOTE ON TAXATION COULD WELL BE CLOSE. THE PRESIDENT COULD HOWEVER VETO ANY ATTEMPT TO ENACT THE CANCELLATION OF THE TAX REDUCTION IF HE LOSES THE VOTE IN THE SENATE AND THE DEMOCRATS DO NOT APPEAR TO HAVE ENOUGH VOTES TO OVERTURN THIS. AT THIS STAGE IT APPEARS THAT IF A CONGRESSIONAL COMPROMISE WERE REACHED ON THE FY 84 BUDGET, IT WOULD RESULT IN A SOMEWHAT LOWER DEFICIT THAN THAT PROPOSED BY THE PRESIDENT (DLRS 190 BILLION), BUT WITH (PERHAPS) SOMEWHAT HIGHER TAXATION AND (ALMOST CERTAINLY) HIGHER SOCIAL EXPENDITURE AND LOWER DEFENCE EXPENDITURE THAN THE PRESIDENT WOULD LIKE. BUDGET DIRECTOR STOCKMAN, IN A LEAKED MEMORANDUM, HAS INDICATED THAT HE FEARS THAT THE FY84 BUDGET PROCESS WILL NOT SUCCESSFULLY BE COMPLETED SO THAT DLRS 200 BILLION DEFICITS WOULD EXTEND INTO THE FUTURE. SO FAR, HOWEVER, THE PRESIDENT HAS NOT GIVEN UP HOPE OF REACHING AN ACCEPTABLE FY 84 BUDGET COMPROMISE IN THE CONGRESS.

5. THE ADMINISTRATION SUFFERED A MINOR DEFEAT YESTERDAY WHEN THE SENATE APPROVED A MEASURE THAT WOULD DELAY FOR FOUR YEARS THE INTRODUCTION OF A WITHHOLDING TAX ON DIVIDEND AND INTEREST INCOME DUE TO TAKE EFFECT FROM 1 JULY. RELIANCE IS INSTEAD PROPOSED TO BE PLACED ON BETTER COLLECTION AND ENFORCEMENT OF THIS TAX. THE HOUSE MAY ALSO SUPPORT THIS MOVE AND IT LOOKS AS IF THE PRESIDENT COULD NOT SUSTAIN A VETO. THE LOBBYISTS FOR THE BANKS THUS SEEM TO HAVE ACHIEVED A MAJOR VICTORY IN HAVING A SIMPLE ANTI-EVASION MEASURE POSTPONED. THE LOSS OF REVENUE IS ESTIMATED AT ABOUT DLRS 5 BILLION A YEAR.

6. THERE IS A CONTINUING WAVE OF SPECULATION ABOUT THE POSSIBLE SUCCESSOR TO FEDERAL RESERVE CHAIRMAN VOLCKER. IT WAS REPORTED EARLIER THIS WEEK THAT SENIOR WHITE HOUSE ADVISERS HAD RECOMMENDED TO THE PRESIDENT THAT HE SHOULD NOT RE-APPOINT VOLCKER WHEN THE LATTER'S TERM OF OFFICE ENDS IN AUGUST. BUT AT THE END OF THE MEETING OF REAGAN'S ECONOMIC POLICY ADVISORY PANEL, ON 20 APRIL, REAGAN TOOK VOLCKER ASIDE AND TOLD HIM THAT HE HAD NOT YET ADDRESSED THIS ISSUE. IT IS GENERALLY BELIEVED THAT, IF ASKED, VOLCKER WOULD STAY FOR ANOTHER TERM. HIS RE-APPOINTMENT IS SUPPORTED NOTABLY BY FELDSTEIN (CHAIRMAN OF THE COUNCIL OF ECONOMIC ADVISERS) AND GREENSPAN (ONE OF THE CHIEF OUTSIDE CANDIDATES). RECENT EDITORIALS IN THE WASHINGTON POST AND THE WALL ST JOURNAL HAVE ALSO SUPPORTED HIS RE-APPOINTMENT. THE PRESIDENT IS HOWEVER KEEPING HIS OPTIONS OPEN FOR THE TIME BEING.

7. FCO PLEASE PASS TO PS/CHANCELLOR, PS/LITTLER, BOTTRILL (TREASURY) AND WATSON (BANK OF ENGLAND). **THIS TELEGRAM**

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