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CONFIDENTIAL

PRIME MINISTER / AT 9/11

US ECONOMY AND INFLATION IN 1984

My prognosis for the US economy is the same as I reported in my minute of 24 June. I am fairly certain that by the end of 1984 the inflation rate will reach 6% and might even be as high as 9%.

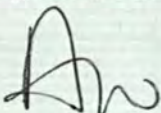
In the 12 months from July 1982 to July 1983 the monetary growth (M1) has been 13½%. The rise in the two years ending July 1983 was larger than any earlier two year period. I cannot see how this substantial monetary expansion cannot be reflected in the rate of inflation in 1984. That expansion has already produced a rapid "recovery" of the American economy over the past three quarters. It has had its effect on quantities; the consequences on prices must follow.

Since July 1983, however, there has been a sharp decline in the monetary growth rate. From July to October 1983 it has run at an annual rate of about 2½%. (This slow down was forecast as a likely outcome in the June memorandum.) It is likely that this will cause a marked decline in the rate of growth of the American economy probably beginning early next year.

I suspect as soon as this happens, Paul Volcker will come under pressure to expand. The taps will be open once again. We shall see again the familiar policy of switching between feast and famine.

We cannot entirely dismiss the possibility that there will be some return to wages and price controls. Nixon introduced them under similar circumstances in 1981. If the democrats win the presidency, then wages/price regulations are a virtual certainty. But even with a Reagan victory I would judge that there is a 50-50 chance of controls being introduced.

All these thoughts, together with the seemingly permanent large (\$200bn) federal deficit, suggest that 1984/85 will be quite a rough ride for the world economy. The best policy for Britain is to continue to pursue our programme of sound finance. This will ensure that we are as robust as we can be in all the turbulence around us.



ALAN WALTERS
9 November 1983

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