PRIME MINISTER 29 March 1985

CURRENCIES AND ECONOMIES

The Dollar

The dollar's turn last month is important. Speculators who were short of pounds are reversing their positions quickly. Those with large dollar investments are now thinking about hedging their dollar positions, and in the last couple of days - with sterling rising above $1.24 - an important chart break point has been reached which may trigger a new wave of sellers of dollars who base their investment decisions on charts rather than fundamentals. These movements are usually self-feeding.

The US Economy

In the US, industrial production in February was nearly 1% below the peak reached in August last year, while the factory operating rate, at 80.7%, was 2 points down on its July peak. Foreign competitors are now making substantial inroads into the American marketplace at the expense of American industry.

The number of banks on the Federal Deposit Insurance Corporation's problem list has reached a record 901 at the end of February, whilst the Controller of the Currency has

33 banks listed as "in danger of failure", up from 21 a year ago. The energy, farming and construction sectors have been badly hit by high interest rates and the strong dollar, and some of their lending is now at risk.

The US has slender foreign exchange reserves, and is now building up foreign indebtedness at a rapid rate. The US authorities face an agonising dilemma. If they do not allow interest rates to rise, their money growth will remain quite sloppy, and it will be increasingly difficult to attract the funds from around the world to pay for their deficits. If they do allow rates to rise to attract the necessary money from overseas, their real economy and banking system will be put under even greater pressure. Recent indications from the Fed imply that they are going to preserve a fairly neutral stance for the next few weeks in the hope that the Ohio problem will pass.

The Far Eastern economies

The Asian Pacific region has kept up a cracking pace of growth over recent years. In each of these countries, government consumption accounts for a much smaller share of their total national product than in a typical industrialised economy. But in some, like Singapore, the government has played a rôle in achieving the extraordinarily high rate of gross investment; whereas in Hong Kong, it has been the private sector that has provided the driving force. The table beneath sets out the high levels of investment, low levels of government consumption, and high levels of growth achieved over the last 15 years:

Country	Average Annual Real GDP Growth 1970-83	Real GNP per Head 1982 as a multiple of 1970 level	Gross Investment as a % of GDP	Govt. Consumption as a % of GDP
Hong Kong	8.7	2.2	27.2	8.1
S. Korea	8.3	2.0	27.2	11.2
Singapore	9.2	2.3	45.1	11.3
Japan	5.1	1.5	30.4	10.1
Ave. all indust. countries	2.7	1.3	19.8	18.0

All these economies depend on export growth, particularly to the US market. They have therefore been enjoying great success in the last couple of years as the American economy has been wide open to import penetration; but will be concerned about the falling dollar and any moves towards protectionism in the US.

The UK Budget Stance

The timing of the Budget was magnificent: the dollar turned just before, but we can claim some credit for the performance of sterling as a result of a cautious Budget.

The City has been reassured to some extent by the Budget arithmetic, although most in the City feel that public expenditure is not under control, and that the reserve will be used up. As every 1% fall in the sterling price of oil costs nearly £150 million in lost oil revenue, the City is also expecting some shortfall here. The most recent 10% + move has already cost us £1.5 billion, compared with Budget day levels.

Although a few in the City have taken the view that the high Contingency Reserve shows reasonable caution, the more the analysts probe the figures, the more they see that there is still considerable drift; and there are dangers if public spending is not kept under control as promised. The table beneath sets out some adjustments to the Public Sector Borrowing Requirement:

Year	Actual PSBR £bn	% of GDP	Special Asset Sales & other Financial Payments £bn	Net Sales of Land & Bldgs. £bn	Adj. PSBR	% of GDP
1981/2	8.6	3.3	-2.0	1.7	8.3	3.2
1982/3	8.9	3.1	0	2.3	11.2	3.9
1983/4	9.7	3.2	1.9	2.1	13.7	4.5
1984/5	10.5	3.3	3.4	2.0	13.1	4.1
1985/6	7.1	2.0	2.7	2.1	11.9	3.4

As this table reveals, the PSBR in relation to GDP is being controlled, compared with Election year; but in 1985/6, if public expenditure and revenues can be held to Budget forecasts, it will still be slightly higher in relation to GDP than it was in 1981/2. Since this Government took over, oil revenues have risen by a little more than £10,000 million per annum, and government is particularly vulnerable both to reductions in the sterling oil price and - because it is a heavy net borrower - to increases in interest rates.

In summary, sterling against the dollar is now giving us some respite, and may enable us to bring interest rates down, lowering the government interest rate charge and limiting the damage being done to our recovery. This will only be sustainable, however, if credibility in our prudence is maintained; and this means, given the vulnerability of the sterling oil revenues, retaining a strong control over public expenditure.

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Sources:

US and Far Eastern Statistics - IMF and N M Rothschild

UK - Philips & Drew (adjusted)