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PARIS SUMMIT: UNITED STATES ECONOMIC PERSPECTIVE

SUMMARY

1. US SUMMIT REPRESENTATIVES LIKELY TO BE BULLISH ABOUT G7 ECONOMIC SITUATION AND, IN PARTICULAR, DEVELOPMENTS IN US ECONOMY. US OFFICIALS MAY PROVE MORE PRICKLY ON QUESTION OF RECENT RISE IN EUROPEAN INTEREST RATES. US MAY ALSO PRESSURE G7 PARTNERS TO INTERVENE WITH MEMBER BANKS IF MEXICAN DEBT DEAL NO FURTHER FORWARD AT TIME OF SUMMIT.

DETAIL

2. US OFFICIALS ARE LIKELY TO PROVE UPBEAT ABOUT WORLD ECONOMIC PROSPECTS AT THE PARIS SUMMIT. SPEAKING AT A 6 JULY PRESS CONFERENCE, TREASURY SECRETARY BRADY REFERRED TO CURRENT ECONOMIC CONDITIONS AROUND THE WORLD AS QUOTE VERY, VERY GOOD UNQUOTE. HE EXPECTED THE ECONOMIC UPSWING TO CONTINUE QUOTE AT A SUSTAINABLE PACE AT LEAST THROUGH 1990 UNQUOTE. FURTHERMORE, INFLATION FOR MOST G7 COUNTRIES WAS EXPECTED TO QUOTE REMAIN MODEST AND CONTAINED UNQUOTE.

3. US OFFICIALS ARE LIKELY TO BE SANGUINE, IN PARTICULAR, ABOUT US DEVELOPMENTS. MARKETS HAD BEEN CONCERNED AS TO WHETHER THE FED COULD PUT A SUFFICIENT BRAKE ON US INFLATIONARY PRESSURES WITHOUT THROWING THE ECONOMY INTO RECESSION. LATEST INDICATORS (SEE MY TELNO 1832) SUGGEST THAT THIS BALANCING ACT HAS WORKED SO FAR: GROWTH HAS SLOWED TO A (STILL RESPECTABLE) 2 PER CENT RATE AND THE FED HAS FELT SUFFICIENTLY CONFIDENT ABOUT INFLATION AS TO BEGIN UNWINDING SOME OF ITS PREVIOUS MONETARY TIGHTENING.

4. DESPITE THIS OPTIMISM, HOWEVER, THE US ARE LIKELY TO CONTINUE TO WANT TO PRESS FOR MORE ACTION ON TRADE IMBALANCES. MANY ANALYSTS IN THE US HAVE POINTED OUT THAT THE UNDERLYING IMPROVEMENT IN THE TRADE DEFICIT HAS STALLED SINCE THE EARLY PART OF 1988, WITH MORE RECENT FIGURES RESULTING MORE FROM THE REDUCED COST OF US IMPORTS AS THE DOLLAR HAS RISEN. THERE IS LITTLE CONVINCING EVIDENCE THAT A REAL DOWNWARD TREND IS EMERGING. THE US WILL THEREFORE BE KEEN TO SEE COMMITMENTS TO STRUCTURAL REFORM THAT THEY CAN POINT TO AS AN ALTERNATIVE INDICATION OF PROGRESS GIVEN THE LACK OF GENUINE

IMPROVEMENTS IN THE TRADE DEFICIT NUMBERS.

5. THE US ARE ALSO LIKELY TO FEND OFF CRITICISM OF THEIR OWN STRUCTURAL WEAKNESSES BY POINTING TO THE REDUCTION IN THE BUDGET DEFICIT SINCE 1986 (WHEN IT REACHES DOLLARS 220 BILLION) AND THE RECENT BUDGET AGREEMENT. HOWEVER, THE DEFICIT HAS STUCK AT AROUND DOLLARS 150 BILLION SINCE 1987 AND IS, IF ANYTHING, DRIFTING UPWARDS. THE BUDGET AGREEMENT REMAIN LITTLE MORE THAN GOOD INTENTIONS WHICH, EVEN IF IMPLEMENTED WOULD PROBABLY LEAVE THE FY1990 OUTTURN UNCHANGED AT AROUND DOLLARS 150 BILLION (AFTER ALLOWANCE FOR EXPENDITURE ON THE THRIFT INDUSTRY CRISIS). FOR THE MEDIUM TERM THERE REMAINS LITTLE EVIDENCE OF EITHER THE ADMINISTRATION OR CONGRESS MAKING SERIOUS ATTEMPTS TO TACKLE THE DEFICIT, EVEN THOUGH, AS IS OFTEN THE CASE, THE PLAYERS ARE TALKING TOUGH ABOUT WHAT THEY WILL DO NEXT YEAR.

6. IN REGARD TO EXTERNAL ECONOMIC DEVELOPMENTS, THE US ADMINISTRATION ARE UNLIKELY TO HAVE WELCOMED THE 29 JUNE ROUND OF INTEREST RATE INCREASES IN EUROPE, FEARING ADVERSE CONSEQUENCES FOR EUROPEAN GROWTH, US EXPORTS AND THE US TRADE DEFICIT. NEVERTHELESS, GIVEN THE APPARENT STRENGTH OF ACTIVITY IN EUROPE, US CRITICISM OF THE RATE RISES MAY BE MUTED. INDEED, BRADY APPEARS TO HOPE FOR AN UNCONTENTIOUS SUMMIT WITH REGARD TO MACRO ECONOMIC COOPERATION AND COORDINATION. QUERIED AT HIS PRESS CONFERENCE ABOUT AREAS OF CONTENTION, BRADY NOTED THE FAVOURABLE WORLD ECONOMIC CONDITIONS AND SUGGESTED IT WAS NOT THE TIME QUOTE TO FIDDLE WITH THE CONTROLS TOO MUCH WHEN YOU'VE GOT THAT KIND OF A BACKDROP UNQUOTE.

7. THE ADMINISTRATION'S COMMITMENT TO PROGRESS ON THE BRADY DEBT PLAN IS MORE LIKELY TO BE A SOURCE OF DISAGREEMENT, PARTICULARLY IF NO FURTHER PROGRESS HAS BEEN MADE ON THE NEGOTIATIONS BETWEEN MEXICO AND THE BANKS OVER DEBT REDUCTION. THE US AUTHORITIES (INCLUDING THE FED AND THE TREASURY) HAVE LEANED HARD ON US BANKS IN AN ATTEMPT TO GET AN AGREED PACKAGE. THE FED SUSPECT THAT MORE COULD BE DONE TO THIS END IN EUROPE (SEE MY TELNO 1819). THIS COULD FLARE UP IF NO DEAL HAS BEEN REACHED BY THE TIME OF THE SUMMIT (OR AT LEAST THE CLEAR PROSPECT OF A DEAL ON PREDICTABLE TERMS) AND IF EUROPEAN BANKS ARE PERCEIVED TO BE DRAGGING THEIR FEET.

8. FCO COPY TO PS/CHANCELLOR, SIR TERENCE BURNS, EVANS, SEDGWICK AND MELLISS (TREASURY), RICHARDSON AND BROADBENT (FCO) AND GREEN (BANK).

FALL