

SECRET



10 DOWNING STREET

LONDON SW1A 2AA

30 July 1986

From the Private Secretary

Dear Alex,

THE CURRENT ACCOUNT

The Prime Minister has several times recently referred to her concern that there could be a current account deficit next year. The Prime Minister has not explained her concerns in detail, but I suspect they are of two kinds.

One relates to the economic effects of a current account deficit (including the need to finance it and the possible effects on the exchange rate) and what it suggests about weaknesses in the British economy. This concern in turn leads to arguments which imply the use of a foreign exchange premium in taking decisions which affect trade flows. Secondly, there are more political and presentational concerns. A current account deficit next year would be the first year of deficit since 1979. It could be used to suggest that other industries are not and will not grow, as the Government has suggested, to replace the contribution of oil, that the last seven years have seen fatal damage to manufacturing industry from which it will not recover, and that arguments that investments overseas would help to replace declining oil revenues are false and that therefore the bonus of North Sea oil has been wasted.

It would I think be helpful to the Prime Minister to have a note which would discuss the past and prospective performance of the current account, giving perspective to these concerns and setting out the arguments which will be used to defend the Government's position as a current account deficit emerges, if it does.

*Yours,
David*

DAVID NORGROVE

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