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FM WASHINGTON 102314Z DEC 79  
TO IMMEDIATE F.C.O.  
TELEGRAM NUMBER 4134 OF 10 DECEMBER.  
[CULL]

*Prime Minister*

*ans, 11.12.*

FOR TURNBULL HMT FROM DADD  
BEGINS:

SUMMARY OF MONTHLY ECONOMIC REPORT FOR THE U.S.

1. RECENT STATISTICS HAVE CONFIRMED THAT THERE WAS A CONSIDERABLE RECOVERY IN THE THIRD QUARTER, GROWTH NOW BEING ESTIMATED AT A 3.5 PERCENT ANNUAL RATE. THE RESILIENCE OF THE U.S. ECONOMY IN THE THIRD QUARTER APPEARS TO HAVE BEEN DUE TO THREE MAIN FACTORS. THESE ARE THAT U.S. CONSUMERS WERE OFFSETTING THE FALL IN REAL INCOMES BY SAVING LESS; THAT U.S. BUSINESS DID NOT REDUCE INVENTORIES BY AS MUCH AS MIGHT HAVE BEEN EXPECTED AND HOUSE BUILDING HELD UP WELL COMPARED WITH PREVIOUS CYCLES. THERE MAY ALSO HAVE BEEN SOME POSTPONEMENT OF CONSUMER EXPENDITURE FROM THE SECOND QUARTER DUE TO THE EFFECTS OF THE PETROL SHORTAGE.

2. HOWEVER, THE LATEST ECONOMIC AND FINANCIAL INDICATORS ARE AGAIN BEGINNING TO POINT MORE STRONGLY TO THE POSSIBILITY OF A RECESSION. FOR CARS AND HOUSING, TRADITIONALLY THOSE SECTORS MOST AFFECTED BY AN ECONOMIC RECESSION, SALES AND HOUSING STARTS WERE WELL DOWN IN OCTOBER. FOR CARS, SEASONALLY ADJUSTED SALES WERE 17 PERCENT DOWN AND SEASONALLY ADJUSTED HOUSING STARTS WERE 8 PERCENT DOWN COMPARED WITH SEPTEMBER. CAR SALES WERE ALSO LOW DURING THE FIRST HALF OF NOVEMBER. RETAIL SALES ALSO DECLINED 1 1/2 PERCENT IN OCTOBER THOUGH THE UNEMPLOYMENT RATE IMPROVED marginally TO 5.8 PERCENT. THE GROWTH IN MONEY SUPPLY HAS SLOWED SHARPLY OVER THE PAST 2 MONTHS, PARTIALLY DUE TO THE FED'S MEASURES, AND IS NOW WITHIN THE TARGETS. BUSINESS LOAN DEMAND WHICH HAD BEEN RISING VERY FAST IN THE THIRD QUARTER IS NOW DECLINING. AND INTEREST RATES HAVE DECLINED SOMEWHAT FROM THE PEAKS REACHED IMMEDIATELY AFTER THE ANNOUNCEMENT OF THE FED PACKAGE.

3. THE MERCHANDISE TRADE DEFICIT NARROWED TO DOLLARS 2.02 BN SEASONALLY ADJUSTED IN OCTOBER. THE IMPROVEMENT HAS BEEN DUE MAINLY TO HIGHER AGRICULTURAL AND MANUFACTURED GOODS EXPORTS. THE VALUE OF OIL IMPORTS ROSE 7.8 PERCENT TO DOLLARS 6.8 BN. THE U.S. DOLLAR HAS FALLEN BACK SOMEWHAT ON FOREIGN EXCHANGE MARKETS OVER THE LAST MONTH.

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4. THE CONSUMER PRICE INDEX ROSE BY ANOTHER 1.0 PERCENT IN OCTOBER, HOUSING SHOWING THE HIGHEST RATE OF INCREASE. AS THE EFFECTS OF THE INCREASE IN MORTGAGE RATES COME THROUGH, THE CPI WILL RISE MORE SHARPLY SINCE THE INDEX ASSUMES THAT ALL HOUSEHOLDERS REMORTGAGE THEIR PROPERTY EACH MONTH. THE CPI HAS INCREASED AT ABOUT A 13 PERCENT ANNUAL RATE SO FAR THIS YEAR, COMPARED WITH AN INCREASE IN THE IMPLICIT GNP DEFLATOR AT A 8.0 PERCENT RATE IN THE THIRD QUARTER.

5. SOME BANKS HAVE REDUCED THEIR PRIME RATES FROM THE HIGH LEVELS REACHED A FEW WEEKS AGO. THESE NOW STAND AT BETWEEN 15 1/4 - 15 3/4 PERCENT. SHARP DROPS HAVE ALSO OCCURRED IN THE RATES ON FEDERAL FUNDS AND BANK CERTIFICATES OF DEPOSIT. MANY ANALYSTS NOW BELIEVE THAT INTEREST RATES HAVE PEAKED, ALTHOUGH THERE IS NO CONSENSUS OF HOW QUICKLY THESE WILL FALL.

6. THE ECONOMIC IMPLICATIONS OF THE IRANIAN CRISIS ARE WIDELY DEBATED ALTHOUGH THERE REMAIN MORE QUESTIONS THAN ANSWERS. OF CONCERN ARE THE POSSIBLE EFFECTS OF HIGHER OIL PRICES ON INFLATION AND THE IMPLICATIONS FOR THE DOLLAR OF THE BLOCKING OF IRANIAN ASSETS (WHICH WAS WIDELY SUPPORTED IN THE U.S.) AND POSSIBLE CHANGES IN THE METHOD OF PAYMENT FOR OIL. RELATIVELY LITTLE PUBLIC ATTENTION TO DATE HAS BEEN GIVEN TO ASSESSING THE EFFECTS OF POSSIBLE OIL SHORTAGES ON ECONOMIC ACTIVITY AND WHAT POLICY MEASURES MIGHT BE APPROPRIATE. THE ADMINISTRATION ARE HOWEVER WORKING ON CONTINGENCY PLANS TO REDUCE CONSUMPTION.

7. ECONOMIC FORECASTERS ARE UNUSUALLY RELUCTANT TO COMMIT THEMSELVES ON THE COURSE OF U.S. ECONOMY OVER THE NEXT 2 TO 3 QUARTERS IN THE ABSENCE OF A CLEAR UNDERSTANDING OF WHETHER OR NOT THE ECONOMY HAS PASSED A CYCLICAL TURNING POINT. THOSE FACTORS CAUSING PARTICULAR DIFFICULTY INCLUDE THE NEW MONETARY CONDITIONS, THE OIL PRICE AND SUPPLY SITUATION IN THE LIGHT OF THE IRANIAN CRISIS, AND THE SAVING AND BORROWING PATTERNS OF CONSUMERS IN FACE OF CONTINUING INFLATION. HOWEVER THE CONSENSUS VIEW IS FOR A SOMEWHAT MORE PRONOUNCED RECESSION THAN PREVIOUSLY ANTICIPATED IN THE FIRST HALF OF 1980, THOUGH STILL CONSIDERABLY LESS SEVERE THAN THAT EXPERIENCED IN 1974/75. THE RATE OF INFLATION IS NOT EXPECTED TO MODERATE BEFORE THE LATTER PART OF 1980.

8. FULL REPORT WILL FOLLOW BY WEDNESDAY BAG.

HENDERSON

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US MONTHLY ECONOMIC  
SITUATION REPORT