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NOTE OF A DISCUSSION BETWEEN THE PRIME MINISTER AND AMBASSADOR
BURNS AT THE RESIDENCE ON THURSDAY 28 OCTOBER, 10.30 PM

1. The Prime Minister started by asking Ambassador Burns what was happening in American economic policy.
2. Ambassador Burns said that there had been a real change in the direction of American monetary policy. The FED had been trying out the market since July and had found that they had more room for manoeuvre in reducing interest rates than they had expected. There had been recent disappointment because the FED had not made a further reduction in the discount rate, but Ambassador Burns believed that this was because the FED did not want to appear to be acting politically in advance of an election. He was in no doubt that there had been a real change of policy in the interests of stimulating the real economy.
3. On the prospects for the US economy, Ambassador Burns said that it had bottomed out and there would be some slight growth in the coming year. House building had already begun to turn up, but business investment was still declining. The real surprise was that consumer expenditure had not so far risen more: this appeared to be because high unemployment levels were causing people to hold back from spending, and this was reflected in an increase in the savings ratio.
4. Turning to the pipeline, Ambassador Burns said that the President very much wanted to remove the sanctions. He disliked regulations of this sort, but had been obliged to take action because of his political constituency. America had been subsequently rethinking its foreign policy and had reflected that it had not been logical, when the West was spending vast sums on defence, to make available to Russia foreign exchange which bolstered the Russian defence effort.
5. Turning to the banking system, Ambassador Burns said that the commercial banks had over-lent since the mid-1970s and were now feeling the effects of having been more concerned with quantity than with quality. In some ways, they had acted as

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- 2 -

imprudently as investment banks in the United States in the 1920s. But Britain, Germany and the United States had good mechanisms for supporting their banking systems, and he was optimistic that there would not be a major collapse. However, as the banks drew in their horns, it would have a depressing effect on the world trade system, which in his opinion was likely to produce a sluggish period of international trading activity for the next two years.