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INFO SAVING PARIS, BONN, UKREP BRUSSELS, UKDEL NATO, UKDEL OECD

US ECONOMY: BACKGROUND BRIEFING ON THE BUDGET AND THE ECONOMIC REPORT OF THE PRESIDENT

1. FELDSTEIN (CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS) BRIEFED OECD EMBASSIES TODAY ON THE ECONOMIC BACKGROUND TO THE FY84 BUDGET AND THE ANNUAL CEA REPORT.

2. IN OPENING THE SESSION, FELDSTEIN EMPHASISED THE INTERNATIONAL CONTEXT OF THE ECONOMIC MEASURES PROPOSED BY THE ADMINISTRATION. FELDSTEIN NOTED THAT HE WOULD BE ACCOMPANYING VICE PRESIDENT BUSH ON HIS TRIP TO EUROPE AND SAID THAT THIS WAS AN INDICATION OF THE AWARENESS WITHIN THE ADMINISTRATION OF THE INTERDEPENDENCE OF THE OECD ECONOMIES. ONE OF THE ASSUMPTIONS UNDERLYING THE ADMINISTRATION'S LATEST FORECASTS WAS THAT THE OECD COUNTRIES WOULD HAVE A GRADUAL RECOVERY AND THAT THERE WOULD BE NO MAJOR DEFAULTS OF HIGH-DEBT COUNTRIES.

3. FELDSTEIN SAID THAT THE ADMINISTRATION'S SHORT-TERM FORECAST WAS INTENDED TO BE REALISTIC AND WAS NOT SIMPLY A GOAL. HE THOUGHT THAT IT WAS TREMENDOUSLY IMPORTANT THAT THE FORECAST SHOULD BE CREDIBLE WITHIN THE FINANCIAL COMMUNITY. GROWTH IN REAL GNP FROM THE FOURTH QUARTER OF 1982 TO THE FOURTH QUARTER OF 1983 WAS EXPECTED TO BE 3.1 PERCENT. THIS FIGURE REPRESENTED A BALANCE OF PROBABILITIES. IF THE RECOVERY HAD BEGUN IN JANUARY HE WOULD HAVE FORECAST SOMETHING MORE LIKE 5 PERCENT INSTEAD OF 3.1 PERCENT. BUT THE STARTING POINT FOR THE RECOVERY WAS STILL UNKNOWN: WHILE THE LEADING INDICATORS POINTED TO A RECOVERY IN THE MONTHS AHEAD, THE LATEST COINCIDENT-INDICATORS (FOR DECEMBER), SUCH AS INDUSTRIAL PRODUCTION, SHOWED THAT IT HAD NOT YET BEGUN. IF RECOVERY DID NOT BEGIN UNTIL MAY HE THOUGHT THAT THE GROWTH BETWEEN THE FOURTH QUARTER OF 1982 AND THE FOURTH QUARTER OF 1983 COULD BE AS LOW AS 2 PERCENT.

4. FOR THE LONGER TERM, FELDSTEIN EMPHASISED THAT THE ADMINISTRATION'S OBJECTIVE WAS SUSTAINABLE GROWTH. THIS WAS FORECAST AT A STEADY 4 PERCENT FROM THE SECOND HALF OF 1983. THE OBJECTIVE WAS NOT TO ALLOW THE RECOVERY TO ADD SIGNIFICANTLY TO INFLATION, AND THE ADMINISTRATION WERE NOT TRYING TO DRIVE UNEMPLOYMENT DOWN TO THE LOW TARGET LEVELS OF THE EARLY 1970S. FOR INSTANCE, THE SO-CALLED HIGH EMPLOYMENT DEFICIT ESTIMATES IN THE BUDGET DOCUMENTS HAD BEEN MADE ON THE BASIS OF 6 1/2 PERCENT UNEMPLOYMENT. WHILE THE GROWTH IN THE GNP DEFLATOR WAS PUT AT 5.4 PERCENT IN 1983 COMPARED TO 4.6 PERCENT 1982, THIS INCREASE WAS LARGELY RELATED TO THE FALL IN AGRICULTURAL PRICES IN 1982 WHICH WOULD NOT NECESSARILY BE REPEATED.

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5. IN ANSWER TO A QUESTION ABOUT MONETARY POLICY, FELDSTEIN SAID THAT THE FORECAST OF NOMINAL GNP GROWTH DURING 1983 OF 3.8 PERCENT WAS INTENDED TO BE CONSISTENT WITH A GROWTH OF THE MONETARY AGGREGATE M2 WITHIN THE UPPER PART OF THE FEDERAL RESERVE BOARD'S PRESENT TARGET RANGE OF 6-9 PERCENT. HE GAVE A WARNING HOWEVER THAT THE ACTUAL FIGURES FOR M2 IN THE FIRST FEW MONTHS OF 1983 COULD BE CONSIDERABLY ABOVE THE TARGET RANGE BECAUSE OF INSTITUTIONAL FACTORS, PARTICULARLY RE-INTERMEDIATION FOLLOWING THE INTRODUCTION OF MONEY MARKET INTEREST RATES ON SOME BANK ACCOUNTS. HE MENTIONED POSSIBLE MONTHLY FIGURES WHICH COULD BE TRANSLATED INTO ANNUAL M2 GROWTH RATES OF AS HIGH AS 15-20 PERCENT. THE LARGEST PART OF THIS HE SAID WOULD REPRESENT AN UPWARD SHIFT IN M2, NOT EXCESSIVE GROWTH. THE BUDGET DOCUMENTS CONTAINED A FORECAST OF DECLINING SHORT-TERM MARKET INTEREST RATES AND HE ACKNOWLEDGED THAT THIS WAS AGAINST THE LATEST MARKET MOVEMENTS. BUT ONCE MARKETS CAME TO REALISE THAT SOMETHING WAS GOING TO BE DONE ABOUT FUTURE BUDGET DEFICITS, HE THOUGHT THAT THE DOWNWARD TREND IN THESE RATES SINCE MID-1982 WOULD CONTINUE.

6. ON THE FUTURE EXTERNAL VALUE OF THE DOLLAR, FELDSTEIN DID NOT GIVE ANY FORECASTS BUT MENTIONED TWO OPPOSING FORCES. HE THOUGHT THERE WOULD BE A HIGH MERCHANDISE TRADE DEFICIT IN 1983 (AMOUNTING TO 2 PERCENT OR MORE OF GNP) AND ALSO A LARGE CURRENT ACCOUNT DEFICIT. THIS WOULD TEND TO DRIVE THE DOLLAR DOWN. BUT HE SAW A CONTINUATION OF HIGH LONG-TERM REAL INTEREST RATES, WHICH WOULD TEND TO HOLD THE DOLLAR UP. THE AVERAGE NOMINAL RATE OF INTEREST ON A 10-YEAR TREASURY NOTE WAS FORECAST AT 10.2 PERCENT IN 1983, WHICH WAS ABOUT 5 PERCENT ABOVE THE RATE OF INFLATION.

7. COPIES OF THE BUDGET DOCUMENTS AND THE ECONOMIC REPORT OF THE PRESIDENT (WHEN THE LATTER BECOMES AVAILABLE) FOLLOW BY BAG TO BOTTRILL (TREASURY), BROADBENT (FCO) AND WATSON (BANK OF ENGLAND).

FCO PASS SAVING PARIS, BONN, UKREP BRUSSELS, UKDEL NATO AND UKDEL OECD.

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