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for Regan folder,
(6.15 pm, 8/12)

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FM WASHINGTON 052254Z DEC 83

TO PRIORITY F C O

TELEGRAM NUMBER 3660 OF 5 DECEMBER.

U.S. ECONOMY: LATEST DEVELOPMENTS

1. THE LATEST INDICATORS CONTINUE TO SHOW THAT THE U.S. ECONOMY IS UNDERGOING A RAPID EXPANSION. REAL GNP ROSE AT AN ANNUAL RATE OF 7.7 PERCENT IN THE THIRD QUARTER, MAINLY AS A RESULT OF AN INCREASE IN FIXED INVESTMENT AND IN STOCK BUILDING. INDUSTRIAL PRODUCTION CONTINUES TO RISE, AND UNEMPLOYMENT FELL TO 8.4 PERCENT IN NOVEMBER, ALMOST A FULL 1 PERCENT BELOW THE 9.3 PERCENT SEPTEMBER LEVEL. RETAIL SALES ARE RISING, MAINLY REFLECTING THE STRONG RISE IN CAR SALES WHICH IN OCTOBER WERE 22 PERCENT ABOVE THE LEVEL OF A YEAR AGO.

2. THERE IS NO SIGN OF AN INFLATIONARY SURGE. THE CONSUMER PRICE INDEX IN OCTOBER WAS 2.9 PERCENT HIGHER THAN IN OCTOBER 1982 AND PRODUCER PRICES HAVE BEEN RISING ONLY MODERATELY. UNIT LABOUR COSTS HAVE RECENTLY BEEN RISING ONLY MODERATELY - AT AN ANNUAL RATE OF 1.3 PERCENT IN THE THIRD QUARTER SO THAT THEY ARE ONLY 0.3 PERCENT ABOVE A YEAR AGO. AT THIS STAGE THERE ARE NO SIGNS THAT PAY SETTLEMENTS ARE MOVING TOWARDS A MORE INFLATIONARY PHASE.

3. IN RECENT MONTHS THE GROWTH OF THE MONEY SUPPLY HAS SLOWED DOWN AND IN OCTOBER ALL THE MONETARY AGGREGATES WERE WITHIN THEIR TARGET OR MONITORING RANGES. M1 HAS BEEN INCREASING AT AN ANNUAL RATE OF ONLY ABOUT 1.7 PERCENT SINCE JULY, WHICH HAS GIVEN RISE TO SOME APPREHENSION WITHIN THE ADMINISTRATION THAT MONETARY GROWTH IS NOW TOO SLOW. FED CHAIRMAN VOLCKER HAS HOWEVER CLAIMED THAT THE STANCE OF MONETARY POLICY IS APPROPRIATE IN ORDER TO REDUCE THE CHANCES OF REKINDLING INFLATION AS THE ECONOMY CONTINUES TO GROW. IT IS WIDELY EXPECTED THAT FEDERAL RESERVE POLICY, WHICH IS NOW HIGHLY JUDGEMENTAL RATHER THAN MECHANISTIC, MAY RESPOND IF THERE IS ANY SIGNIFICANT SLOWING DOWN OF THE ECONOMY IN THE FOURTH QUARTER. INTEREST RATES, ESPECIALLY ALLOWING FOR INFLATION, REMAIN VERY HIGH AND THE NOMINAL RATE ON A THREE-MONTH TREASURY BILL IS NOW ABOUT 9 PERCENT AND, ON A TWENTY-YEAR GOVERNMENT BOND, ABOUT 12 PERCENT.

4. THERE WAS A RECORD DOLLARS 9 BILLION TRADE DEFICIT IN OCTOBER, AND CUMULATIVE TRADE DEFICITS FOR THE FIRST TEN MONTHS OF THIS YEAR AMOUNT TO DOLLARS 56 BILLION. IT IS WIDELY EXPECTED THAT THE TRADE DEFICIT MAY AMOUNT TO DOLLARS 65-70 BILLION FOR 1983 AS A WHOLE, RISING TO CLOSE TO DOLLARS 100 BILLION IN 1984. HIGH U.S. INTEREST RATES CONTINUE TO KEEP THE DOLLAR EXCHANGE RATE STRONG.

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5. THE PROSPECTS ARE ENCOURAGING AND THE BLUE CHIP CONSENSUS OF PRIVATE FORECASTS PREDICTS REAL GNP TO GROW BY 5.3 PERCENT IN 1984, FOR INFLATION TO INCREASE AT A RATE OF 5 PERCENT, AND FOR UNEMPLOYMENT TO AVERAGE 8.5 PERCENT FOR THE YEAR AS A WHOLE. THERE IS VIRTUAL UNANIMITY AMONGST COMMENTATORS THAT THE RECOVERY WILL CONTINUE AT LEAST UP UNTIL THE NOVEMBER 1984 PRESIDENTIAL ELECTIONS. WHILE HOUSING STARTS ARE DECLINING, MOST OTHER LEADING INDICATORS ARE RISING AND THE INDEX OF LEADING INDICATORS HAS RISEN IN EVERY MONTH SINCE SEPTEMBER 1982.

6. EFFORTS IN THE CONGRESS TOWARDS THE END OF THE LAST SESSION TO MAKE PROGRESS IN REDUCING THE U.S. BUDGET DEFICIT DID NOT SUCCEED, MAINLY BECAUSE THE PRESIDENT THREATENED TO VETO TAX LEGISLATION. CHAIRMAN OF THE COUNCIL OF ECONOMIC ADVISERS FELDSTEIN HAS RECENTLY MADE PUBLIC COMMENTS INCONSISTENT WITH THE PRESIDENT'S VIEW OF THE CAUSES OF THE DEFICIT AND OF THE APPROPRIATE MEANS OF DEALING WITH IT. FELDSTEIN HAS FOCUSED ON HIGH DEFENCE EXPENDITURE AND THE NEED FOR TAX INCREASES, HARKING BACK TO THE PROPOSAL IN THIS JANUARY'S FY 84 BUDGET FOR A CONTINGENCY TAX INCREASE IN FY 86. THIS HAS EMBARRASSED THE ADMINISTRATION (WHO PROBABLY INTEND TO DROP THE PROPOSAL IN THE FY 85 BUDGET) AND HAS ENDANGERED FELDSTEIN'S PERSONAL POSITION AS CHAIRMAN OF THE COUNCIL OF ECONOMIC ADVISERS.

7. THE ADMINISTRATION WOULD CLEARLY LIKE TO REDUCE PUBLIC EXPENDITURE BUT THEY HAVE NOT MADE DETAILED PROPOSALS FOR SO DOING, IN AN ATTEMPT TO STEER THE DIFFICULT DEFICIT ISSUE BEYOND THE 1984 NOVEMBER ELECTIONS. THEY WILL HAVE TO PRESENT THE FY 85 BUDGET TO CONGRESS IN EARLY 1984, BUT THEY MAY HOPE THAT ATTENTION WILL FOCUS ON THE UNADJUSTED BUDGET DEFICIT RATHER THAN THE STRUCTURAL BUDGET DEFICIT IMPLIED BY THE FIGURES.

8. ON THE LAST DAY OF THE CONGRESSIONAL SESSION, A BILL WAS PASSED ENABLING THE U.S. TO CONTRIBUTE DOLLARS 8.4 BILLION TO THE I.M.F. QUOTA INCREASE AND INCORPORATING BOTH AUTHORISATION AND APPROPRIATION LEGISLATION. CONGRESS ALSO HAS APPROVED AN INCREASE IN THE PUBLIC DEBT CEILING FROM DOLLARS 1.389 TRILLION TO DOLLARS 1.49 TRILLION. IT IS ESTIMATED THAT THE NEW CEILING WILL ENABLE THE GOVERNMENT TO CONTINUE FUNDING ITS PROGRAMMES UNTIL APRIL 1984.

9. LATEST DATA ARE GIVEN BELOW:-

SUMMARY: ECONOMIC INDICATORS

(ALL FIGURES ARE SEASONALLY ADJUSTED UNLESS OTHERWISE NOTED)

QUARTERLY DATA (1972 PRICES) (1983 - Q3)	PERCENT CHANGE ON	
	PREVIOUS QUARTER	1 YEAR EARLIER
GNP	1.9	4.6
PERSONAL CONSUMPTION	3.7	4.8
EXPORTS OF GOODS AND SERVICES	3.2	-4.0
IMPORTS OF GOODS AND SERVICES	5.1	6.4

ACTUAL LEVEL

²RESTRICTED CURRENT

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		LATEST QUARTER	PREVIOUS QUARTER
CURRENT ACCOUNT (1983 - Q2) DOLLARS BN		-9.7	-3.6
MONTHLY DATA		PERCENT CHANGE ON	
		PREVIOUS MONTH	1 YEAR EARLIER
RETAIL SALES	OCT	1.1	13.2
INDUSTRIAL PRODUCTION	OCT	3.8	14.1
CONSUMER PRICE INDEX	OCT	0.4	2.9
M1	OCT	3.1	10.4
M2	OCT	3.7	12.0
DOLLAR EFFECTIVE EXCHANGE RATE NSA	NOV	1.5	2.4
		ACTUAL LEVEL	
		LATEST MONTH	1 YEAR EARLIER
UNEMPLOYMENT RATE	NOV	8.4	10.7
3 MONTH TREASURY BILL NSA	NOV	8.7	8.1.

10. F C O PLEASE PASS TO LITTLER (FOR WICKS) AND BOTTRILL (TREASURY), GREEN (BANK) AND BROADBENT (ESID).

WRIGHT

FINANCIAL D
ESID
NAD

COPIES TO
MR LITTLER }
MR BOTTRILL } TREASURY

MR GREEN
BANK OF ENGLAND