RECORD OF A DISCUSSION ON THE JUNE FORECAST IN THE TREASURY AT 11 A.M. ON 13TH JULY

Present:-

Chancellor	Mr. Burns	Mr. Cassell
Chief Secretary	Sir Kenneth Couzens	Mr. Kemp
Financial Secretary	Sir William Ryrie	Mr. Ridley
Economic Secretary	Mr. Middleton	Mr. Kerr
Minister of State (R)	Mr. Quinlan	Mr. Riley

Papers

1. The meeting considered the forecast report of 30 June, together with Mr. Burns' minutes of 30 June and 12 July; together with comments from the Financial Secretary, the Economic Secretary, the Minister of State (C), Mr. Ridley, and Professor Walters' letter of 5 July to Mr. Burns.

International Background

2. The Chancellor referred to the discussion of the international situation at his meeting with the Governor on 8 July. The US position remained threatening; but he and the Governor had concluded that our best course lay in continuing to do what we could, in consultation with our European partners, and particularly the Germans, to insulate ourselves from the effect of continuing high US interest rates. He had some sympathy for Mr. Ridley's argument (minute of 12 July) that the forecast might be rather bullish about the future price of oil. It was pointed out that the North Sea price might hold even if there were a fall of $1 or even $2 in the world price; and that the dollar's strength boosted our revenue take. But it was nevertheless agreed that OPEC's disarray strengthened the downside risks to future revenue though not by so much as to lead us to wish to take fiscal action, invoking the contingent threat in the Budget speech.

<u>Are monetary and fiscal policies too tight?</u>

3. <u>The Chancellor</u> referred to the Financial Secretary's view that some mild relaxation of the fiscal stance might be worth considering; to Professor Walters' concern that monetary policy might be too tight; and to Sam Brittan's article in the Financial Times on 8 July suggesting that money GDP was growing at a rate lower than would be consistent with the MTFS, and that a fiscal stimulus would be appropriate. Representations to him and to the Prime Minister from industry - and perhaps shortly from the Secretary of State for Industry - suggested that we were still bumping along the bottom of the recession, and that action to stimulate output was becoming urgent. <u>Mr. Burns</u>, however, pointed out that the adverse changes between the Budget and June forecasts were not particularly significant; and that post-Budget developments in the real economy had not out-dated the Budget judgements. To change course now would mean accepting that these judgements had been wrong. <u>The Financial Secretary</u>, while accepting that the June forecast reduced the expected increase in total output in 1982 and 1983 by only ½ per cent in each year, thought that the very fact of a deterioration in economic prospects, widely diagnosed outside, was politically and psychologically damaging. He would not wish to propose a "package" as such, but he thought that it might make sense to take whatever opportunities arose for modest measures of fiscal relaxation in particular areas.

4. <u>Mr. Burns</u> and <u>the Chief Secretary</u> were however reluctant to envisage early fiscal action. The revisions to the forecast did not amount to a case for such action, and fiscal policy was expected to be easier this year than last. Moreover, action now might create difficulties later in the year, when it might be politically necessary to act to make the 2 per cent NIS rate permanent, and a bad outcome from the Public Expenditure Survey could create a requirement for fiscal action in the opposite direction. <u>Sir William Ryrie</u> agreed that fiscal changes now were to be avoided: if mid-year action had to be taken, it should be in the autumn.

5. On Sam Brittan's argument about money GDP, Mr. Burns pointed out that the June forecast revised downward the 1982 growth of money GDP by only 1 per cent; and Mr. Middleton recalled that in the pre-Budget discussions about monetary targets, it had been decided that money GDP was not appropriate to prescriptive planning, since neither the pay nor the output levers were in the Government's grasp. The Chief Secretary pointed out, however, that the presentation of policy in the past had sometimes implied a very direct trade-off between inflation and output, and might thus have created an expectation of a fiscal adjustment to encourage increased output in a situation where both inflation and growth in money GDP were declining.

6. The Chancellor thought that fluctuations in output, inflation, and hence GDP forecasts were inevitable. He still did not regard money GDP as a measure appropriate to prescriptive targeting. What struck him most was the comparison (Mr. Burns' minute of 12 July) between the first half of this year and the same period in 1981. Domestic demand was almost 4 per cent higher, but exports had risen by only 1 per cent, while imports had gone up by 11 per cent. Clearly the drive for greater competitiveness must be maintained. Mr. Cassell, agreeing, pointed out that the June forecast was for a steeper increase in average earnings in 1982, and a markedly steeper increase in 1984, than had been suggested in the Budget forecast.

7. The Chancellor concluded that the case for a substantial fiscal stimulus, as made out by Sam Brittan, was not sustained. For the present, the main assistance we could give to industry lay in bringing interest rates down as far and as fast as was prudently possible. The Financial Secretary was concerned that much of the benefit of interest rate reductions went not to industry but e.g. to those with mortgages: he would favour targeted assistance to industry, through assistance on loan finance. The consensus however was that reductions in interest rates were of general benefit, and were entirely appropriate given the monetary figures.

8. <u>The Chancellor</u>, summing up the discussion, thought that the balance of fiscal policy had not been proved wrong. It would be right to examine the case for a concession on NIS, and perhaps on electricity prices, in the autumn; to continue the search, suggested by the Minister of State (C) (minute of 9 July) for further cost-effective measures to reduce unemployment; and to look again, as the Financial Secretary proposed, at the question of a small business loan finance package. But the current overall direction of policy, and emphasis on stimulus to output through reductions in interest rates, should be maintained.

JOK

J.O. KERR
14 July 1982

Distribution:-

Those present
Minister of State (C)
Sir Douglas Wass
Sir Anthony Rawlinson
Mr. Byatt
Mr. Evans
Mr. Moore
Mr. Dixon
Mr. Hall
Mr. French
Mr. Harris