PO-CH/NL/0174

PART A

Part A

SECRET

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PART A

PO -CH /NL/0174
PART A

Chancellor's (Lawson) Papers:

INTEREST RATES

Disposal Directions: 25 Years

[signature]

6/9/95.

pwl

Ch

For all purposes, [illegible]

RC 7/1

FROM: R P CULPIN
7 January 1986

CHANCELLOR

cc Economic Secretary
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Peretz
Mr H Davies

INTEREST RATES: NEDC SPEAKING NOTE

Draft attached, agreed with Sir Peter Middleton - short and factual to use for all purposes.

The answer to many supplementaries would be that, while monetary conditions are reasonably satisfactory, taking account of all the evidence, we think it right to err on the side of caution.

RC

R P CULPIN

CHANCELLOR'S SPEAKING NOTE FOR NEDC, WEDNESDAY 8 JANUARY

Over the last few days, market interest rates have risen to levels more consistent with 12 per cent than 11½ per cent base rates, following some reduction in the sterling exchange rate. The clearing banks decided this morning to bring their base rates into line with the market. The Bank of England acted immediately to endorse the new level of interest rates.

I said in my Budget speech that "there can be no doubt about the Government's commitment to maintain monetary conditions that will continue to bring down inflation. Short-term interest rates will be held at the level needed to achieve this". Today's action shows that this Government remains determined to take no risks with inflation.

SECRET

FROM: H J DAVIES
DATE: 23 JANUARY 1986

CHANCELLOR

cc CST
EST
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Cassell
Mr Culpin
Mr Walsh

Governor (Bank of England)
Mr George
Mr Loehnis

Ch/ The old brief below may also be useful. RL 23/1

INTEREST RATE PNQ

It remains unclear whether or not we shall need a PNQ response tomorrow morning. But in case we do a revised version of my draft of yesterday is attached. Sir Peter Middleton chaired a high level drafting group this afternoon which also included Sir Geoffrey Littler, Sir Terence Burns, Mr Culpin and Mrs Lomax. (very briefly!)

2. The short-form response is incorporated in paragraphs 1-4 of the draft. This would be more in line with the way in which you responded to interest rate PNQs last year - in fact even this short version is longer than anything you volunteered in 1985.

3. But there is clearly a case for a longer version. The square bracketed passages, mainly taken from yesterday's draft, would fill it out, and produce a far more considered statement, which might well allow you to seize the parliamentary initiative. (For convenience, I attach the short version also on one sheet of paper).

4. You will no doubt wish to discuss the tactics for handling this tomorrow morning if, indeed, we conclude that an interest rate move is needed.

HJD

H J DAVIES

INTEREST RATE PNQ: DRAFT RESPONSE

[In recent days the financial markets - in London and around the world - have been dominated by the impact of events in the oil market. Not all the market reactions - or indeed all the commentary on them - have been justified by the reality of the changes.]

1. Since I presented my Autumn Statement to the House in November last year, the world oil price has fallen by a third. It is now at its lowest level since 1979. North Sea oil prices have fallen in line with the rest of the market. The sterling exchange rate has fallen by 7 per cent over the same period. Market short term interest rates have risen to nearly 14 per cent. This morning the Bank of England raised its dealing rates, and bank base rates...

[1a. It is important to keep the significance of oil to the UK economy in perspective. Oil production and exploration currently represents around 5-6 per cent of GDP. The proportion of government revenues derived from the North Sea is around 8 per cent - and net oil exports account for a similar percentage of our total exports of goods and services.

In aggregate oil is certainly an important contributor to our economic well being; but its importance is

How much has it fallen this week?
[get sterling figs for oil price & XR]

Why did we not move earlier?

Effect on mortgage rates, & RPI

often overstated. It has contributed only ½ per cent a year to the annual growth of around 3 per cent during the last five years. We are far from being an oil-based economy. Nor will the government's finances be put into disarray by a fall in the contribution from oil taxation.]

2. Lower oil prices in themselves are helpful to inflation. But a lower exchange rate works in the opposite direction.

Say expressly that some adjustment in ER to lower oil prices was appropriate? Need to put decision in context of what is consistent with maintaining appropriate monetary conditions

3. The speed and magnitude of the fall in the exchange rate in recent days suggests that the markets are taking an exaggerated view of the importance of North Sea oil to the British economy. This was beginning to pose a threat to our objectives for inflation. A rise in short term interest rates was therefore appropriate.

[3a. The government cannot, of course, be indifferent to the level of the exchange rate, if it is to maintain downward pressure on inflation. Its primary responsibility is to keep our healthy, growing economy on course. That means firm control of financial conditions, and an unshakeable commitment to lower inflation. And that, in turn, means keeping interest rates at whatever level is appropriate to keep inflation coming down.

There is one further point which the House should bear in mind. Turbulence in the oil markets cause problems, but a lower oil price is by no means a disaster for the UK. Tax revenues may be lower, but petrol prices are lower too.]

restate

4. Lower oil prices benefit world trade, world output, and world inflation. At home, consumers and industry will also benefit directly. Inflation will continue to fall and the prospects for growth and exports have, if anything, improved.

[4a. Over the past two years the UK economy has faced two huge challenges. First was the long and debilitating coal strike of 1984-85. Now the dramatic fall in oil prices. It is a tribute to the resilience of the recovery and the soundness of the policies sustaining it that the economy has remained — and will remain — on course and the prosperity of our people has continued to grow.]

DRAFT

In recent days the financial markets - in London and around the world - have been dominated by the impact of events in the oil market. Not all the market reactions - or indeed all the commentary on them - have been justified by the reality of the changes. // Since I presented my Autumn Statement to the House in November last year, the world oil price has fallen by a third. It is now at its lowest level since 1979. North Sea oil prices have fallen in line with the rest of the market. The sterling exchange rate has fallen by 7 per cent over the same period. Market short term interest rates have risen to nearly 14 per cent. And this morning the Bank of England raised its dealing rates, and bank base rates .....

2. Lower oil prices in themselves are helpful to inflation. But a lower exchange rate works in the opposite direction.

3. The speed and magnitude of the fall in the exchange rate in recent days suggests that the markets are taking an exaggerated view of the importance of North Sea oil to the British economy. This was beginning to pose a threat to our objectives for inflation. A rise in short term interest rates was therefore appropriate.

4. Lower oil prices benefit world trade, world output, and world inflation. At home, consumers and industry will also benefit directly. Inflation will continue to fall and the prospects for growth and exports have, if anything, improved.

Why not move earlier?

Mortgage rate — ← RPI

SECRET

27 MAR 1986

From: SIR PETER MIDDLETON

Date: 6 March 1986

002665

1. ECONOMIC SECRETARY ES See note at end.

2. CHANCELLOR

cc Sir T Burns
Mr Cassell
Mr Peretz
Mr Walsh
Mr H Davies

RP

INTEREST RATE DILEMMA: HAROLD ROSE

I agree with Mr Cassell's conclusions. The present arrangements give us as much control over the level and structure of interest rates at the short end of the market as we are ever likely to have. We can respond in different ways according to circumstances. Sometimes we may wish to be moved by the market which provides us with some information - and say that this is the case. Sometimes we may wish to apply a touch of the brakes of differing degrees of visibility. At other times we may wish to give a very strong signal to the market by using MLR and discount window lending.

2. I can see very few advantages in always using MLR. I thought at the time that the Healey/Richardson move back to an administered system was a mistake. And I still think so. It is all very well to think that Government policy is paramount and the authorities should be clear about what they want and resolute about imposing it. But the practice is different. Interest rate changes do become more political, they do tend to be slower, and they take on the appearance of a continuous contest with the market which can have unhelpful market effects and which the Government certainly does not always win.

3. As Mr Cassell says, the change which Harold Rose suggests is not a big one looked at as a technical proposition. But it would seem to be much bigger than it is. The 1981 arrangements were sold as a move to more flexible interest rates - as an integral part of a strategy based primarily on the monetary aggregates. To

move away from these arrangements back to MLR/lender of "first" resort might be thought to be burying that strategy before it is dead.

bill mountain

4. There is no doubt that the arrangements are not working as originally intended. But that is the result, partly of overfunding but mainly because policy is more discretionary and complex. I doubt whether you can give the markets more certainty in these circumstances by changes in interest rate techniques. We need to join the EMS to do that. We could then provide a more certain policy framework. But I think we would still want to leave open the option of a graduated response on interest rates. For though the direction in which interest rates change would then be clearer, we should still, on occasions, wish to feel our way as to the size of the response needed; and tactically there could still be occasions where we would be better off not showing our hand too clearly as well as occasions when it would be helpful to do so.

PEM

P E MIDDLETON

I agree with Mr Cassell (esp. paras 14 & 16) & Sir Peter (esp para 2). Rose (on behalf of consumers) would prefer a product which he could assess more easily. But there would be a corresponding loss of flexibility to the authorities, & I don't think there is a case for transferring advantage from the authorities to the market. The idea that interest rates wd thereby on average be lower seems to me to be quite unprovable, but personally I don't believe it. LS

If there is any sign of optimism in the market's t-morrow (FRI), then go ahead with 2.30 lending. If there isn't, don't. NL

FROM: F CASSELL
5 June 1986

Any views?

(2:30 would be a signal that we doubt that the money figures would be consistent with a fall in interest rates: i.e. a desirable message. The single message — rotten money figures would be conveyed by other means. I doubt whether it would be sensible to reduce interest rates now or even anyhow, so I don't greatly care)

CHANCELLOR

cc Economic Secretary
Sir P Middleton
Sir G Littler
Sir T Burns
Mr Peretz
Mr Culpin
Mr Walsh
Mr Ross Goobey

INTEREST RATES

Though money market rates have been steady today and sterling has softened a little, expectations of a further cut in base rates still appear to be quite strong in the City, based partly on the belief that the money supply figures to be published next Tuesday will be good. We could, if we wished, discourage misplaced optimism on that score by 2.30 lending tomorrow (when there is a large shortage in prospect).

The Bank (or at least Eddie George) are not pressing for such action, but on balance think it just worth taking. They can cope with the technical problems of tomorrow's shortage by lending to the discount houses at 2.45, and they believe that markets are likely to react badly to the figures whatever we do beforehand. But they see some tactical advantage in giving a warning ahead of the money figures, and hope that this might moderate any sharp set-back on Tuesday.

The arguments, either way, are hardly compelling. Lending at 2.30 tomorrow, however, might get the market adjustment to the money figures over more quickly, which could be helpful.

I should be grateful to know your view.

F CASSELL

SECRET

FROM: F CASSELL
5 December 1986

CHANCELLOR

cc Economic Secretary
Sir P Middleton
Sir T Burns
Mr Peretz

INTEREST RATES

You asked for a draft paper that you could put to the Prime Minister setting out the case for a 1 per cent rise in interest rates. I attach a draft. ~~(without the chart that will show 3, 6 and 12-month growth of MO)~~. This draws on the discussion at Sir Peter Middleton's Treasury/Bank meeting earlier this week.

You thought this should be a joint Treasury/Bank paper. I have not in the time available been able to discuss the draft with Eddie George, but I am copying this submission to him.

F CASSELL

Treasury &
BoE
3 pages

296/58

SECRET

INTEREST RATES

Note by Treasury and Bank of England

We have been considering our stance on interest rates in the light of the latest monetary indicators, with an eye also on the pressures that have beset us in the past two Januaries.

2. [~~For much of this year the monetary indicators were giving conflicting signals.~~] Until the summer ~~even though broad money was growing fast,~~ the general picture was that broad money and some asset prices (notably houses and equities) were ~~indicating~~ suggesting fairly loose monetary conditions, whereas ~~MO,~~ the generally more reliable indicators, MO, the exchange rate (when allowance was made for the fall in the oil price), ~~and real interest rates~~ were indicating that policy was if anything rather tight. ~~This~~ Real interest rates were at their highest level ever. ~~[check].~~ ~~made the assessment of monetary conditions difficult, but over the spring and early summer,~~] With inflation coming down well and signs that the economy was sluggish, we [~~gave most weight to sterling and narrow money and~~] accordingly brought our interest rates down. ~~- by rather more than those in the other major countries.~~

[As drafted, it is open to the counter that X R & MO provided unreliable guides earlier this year]

3. In recent months, however, [~~the indicators began to tell much more of a consistent story.~~] while Broad money has gone on expanding at a rapid rate, [~~but~~] the exchange rate has been weak and MO growth has accelerated sharply, (see attached chart), ~~Thus all the main monetary indicators have been signalling~~ signalling that monetary conditions ~~are~~ have been getting easier. This has coincided with evidence that activity in the economy is picking up sharply and with an increase in inflationary expectations in the markets.

4. Despite the rise in nominal interest rates in October, this increase in inflationary expectations may ~~even~~ mean that our real interest rates have actually fallen slightly recently. If real rates are calculated by taking the differential between nominal rates and current retail price inflation then of course our rates remain well above those in most other countries. ~~when measured against retail prices.~~ The picture, however, is far less clear when real interest rates are measured by movements in producers' prices.

~~or labour costs.~~ On these comparisons our real rates are lower than those in the United States, Germany or Japan (see table attached).

5. There were ~~of course beginning to be~~ Some signs in September that monetary conditions were loosening, particularly the pick-up in MO growth and the fall in the exchange rate. ~~at a time when oil prices were rising.~~ It was this evidence that led us to wish in early October to raise interest rates. But ~~in the light of the evidence available we judged then that a 1 per cent increase was all that was required to get monetary conditions back to the degree of tightness envisaged at Budget time.~~ Having made this judgement, it was necessary to act firmly and decisively in order to make it stick, and in this we were successful. ~~It was nevertheless a difficult judgement to make, and in deciding on 1 per cent~~ We recognised, however, that we would need to keep the monetary situation under especially close review as more evidence became available. ~~We also had an eye to the tactical situation~~ looking forward over the autumn and beyond, with ~~in particular~~ the Autumn Statement ahead of us, there was considerable tactical ~~advantage at that time~~ in limiting the rise to 1 per cent.

merit
merit and medium-term advantage

6. ~~All~~ The monetary evidence that has come to hand since then ~~has tended to confirm~~ indicates shows that monetary conditions ~~have become looser.~~ are still too lax. MO growth has continued to accelerate; the growth of broad money has shown no signs of slowing; the exchange rate has remained close to the low level it reached at the beginning of October; and financial markets generally have remained fragile, with the gilts market now having fallen substantially since the October rise in base rates, raising long-term rates above 11 per cent. ~~At the same time, the evidence from the economic statistics suggests that~~ And the sluggishness of the economy that was apparent in the summer ~~has~~ appears to have given way to fairly brisk growth.

7. We have concluded, therefore, that if we are to avoid taking risks with inflation, we ought to raise our rates very shortly by a further 1 per cent. The market at the moment is not expecting us to make a further ~~early~~ move before the New Year – precedent of ~~last year~~ in both 1985 and 1986 interest rates rose in the first half of January – and we therefore need to consider the timing carefully. We ~~want~~ need to move in circumstances that would inspire confidence rather than diminish it – for example ~~and we shall therefore need to judge carefully the circumstances in which we acted. We want to act at a time when the move will be~~

~~When to act.~~

by ~~engender~~ engendering fears that we know something the market doesn't.

SECRET

~~We want to make sure that our reasons are fully~~ ~~understood,~~ so as ~~to~~ avoid unsettling the markets ~~by fears that~~ we ~~knew something that they don't.~~

8. There is, however, considerable advantage in moving well before our hand is forced by the market. ~~As was seen in~~ January last ~~last~~ the fact that we were prepared to ~~take early action meant that we could avoid~~ raise interest rates promptly by 1 per cent enabled us to avoid the sort of drastic action we had had to take in July 1984 and January 1985. An early move would help to re-establish the credibility of our policies, which is under question in the markets following the increases in public expenditure plans and the approach of the General Election. It would give us the best chance of keeping the rise in interest rates over the months ahead to the minimum necessary, and the best hope that we could look forward to the next move being downwards. The consequent improvement in market sentiment should also enable us to replenish the reserves.

Conclusion

9. ~~The Treasury and the Bank are agreed that it is highly desirable that we should not leave the initiative in raising interest rates to the markets.~~ We will need to consider carefully the precise tactics and timing of making the move. ~~Possibly~~ The next set of money numbers, to be published on 18 December, would provide a suitable opportunity. ~~But we~~ are agreed that in the light of the latest evidence a further 1 per cent rise in interest rates is needed to ensure that our strategy against inflation is not undermined.

although we would need to be prepared to move sooner than that should financial confidence start to deteriorate.

SECRET

PPSCH ?

FROM: P D P BARNES
DATE: 8 December 1986

PPS

cc Sir P Middleton
Sir T Burns
Mr Cassell
Mr Peretz

INTEREST RATES

The Economic Secretary has seen Mr Cassell's submission to the Chancellor of 5 December.

2. The Economic Secretary was not totally convinced by this.

PB

P D P BARNES
Private Secretary

Ch
Frank is getting comments from Bank & will feed them in tonight.

AA

PS ask EST to expand on this — reasons etc.

N

3885B/009

CONFIDENTIAL

prep.

FROM: C W KELLY

DATE: 24 July 1987

ECONOMIC SECRETARY

cc: Chancellor
Sir P Middleton
Sir G Littler
Mr Cassell
Mr Peretz
Mr Culpin
Mr Grice
Mr Rich - o/r
Mr Cropper
Mr Patterson - DNS

GENERAL EXTENSION RATE (GER)

We need to take your mind on whether it is now time to make a further reduction in the General Extension Rate (GER), the tax-free variable rate of interest paid on matured fixed interest national savings certificates.

Background

2. Total holdings on GER are currently around £6.5 billion and expected to grow. The present DNS forecast is that the stock could rise to £7.4 billion by next April. Around £1 billion of the 24th Issue is due to mature in September and October. The interest bill on the current stock is around £455 million a year.

3. Recent changes in the level of the GER have been as follows:

	%
June 1986	8.01
November 1986	8.70
April 1987	7.50
May 1987	7.02

4. The main factors relevant to setting GER are the terms of competition from building societies and other financial institutions (taking account of the tax-free nature of GER), relativities with other national savings products and progress towards the current funding objective.

5. We also have to take into account the rather low quality of funding it represents. GER money is repayable on about eight days notice. It is thus in theory very liquid. In practice this liquidity is tempered in two ways:

i. Interest is credited quarterly, so holders have an incentive to time their repayments to avoid losing up to three months interest.

ii. Previous experience has been that, once the point of maturity has passed, holders are very slow to respond to GER changes. It is quite likely that many of them do not even know what GER is, or what level it stands at.

It has to be said, however, that we have no experience with a GER perceived to be very uncompetitive.

6. Just after this year's Budget, we announced general reductions in the terms of all national savings products except the indexed-link ones. This was partly in response to the general fall in lending rates, and expectations of similar falls in retail deposit rates. But it was also because we expected a much lower funding requirement this year as a result of the lower PSBR. Ministers decided that the assumed national savings contribution to funding should be set at £2 billion (compared with a net inflow of £3.3 billion in 1986-87). One consequence was that there appeared to be more room to experiment.

7. The two reductions in GER of 1.2 per cent on 1 April and a further ½ per cent on 1 May were part of this. The intention was to stimulate some outflow from the GER stock, thus improving the average quality of the total stock of DNS funding, and to

reduce the cost of what remained. We also hoped (though without much expectation of success) that it might be possible to encourage the switching of some modest amount of GER funds into the current fixed interest saving certificate. For this reason we introduced a new facility whereby GER holders switching into the current certificate are now allowed an additional holding of up to £5,000 on top of the (new) holdings limit of £1,000 which applies to everyone else.

8. In practice, there has been very little movement since then out of GER at all, even less into the certificate.

The competition

9. The main competition for GER is probably building society 90-day accounts, currently paying between 7¾ per cent to 8¼ per cent, more for the top tier.

10. A comparison of GER with this and with other national savings products at different tax rates is shown below. Broadly speaking, GER is less competitive than building society 90-day accounts for basic rate taxpayers, more competitive for higher rate taxpayers.

	nil tax	**27% tax**	**45% tax**	**60% tax**
GER	7.0	7.0	7.0	7.0
Fixed interest certificate	7.0	7.0	7.0	7.0
Investment account	10.0	7.3	5.5	4.0
Income bonds	10.5	8.0	6.1	4.4
Building society 90-day accounts (net of CRT)	7.7-8.3	7.7-8.3	5.8-6.2	4.2-4.5

11. If anything, building society deposit rates have recently been edging up. But some at least are expected to bring down their lending rates for all borrowers by ½ per cent net on 1 August following a reduction already announced by the banks in their mortgage lending. If they do not lose their nerve in the face of the recent firming of interbank rates, it would be surprising if deposit rates did not follow - though there could be a lag.

Funding position

12. The contribution to funding from national savings in the first 3 months of 1987-88 (£605 million) would, if continued at the same rate, be more than sufficient to provide a £2 billion contribution over the year as a whole. Even at current interest rates, however, DNS are expecting lower net flows later in the year, partly because of heavy outflows from indexed-linked certificates after this year's supplement is paid in August. Their current forecast of their funding contribution for the year as a whole is currently £1.75 billion.

13. We have, however, made considerable progress on funding elsewhere; and, even though we now have additional intervention to fund, the forecast of the PSBR has also fallen. There is no reason to think that a DNS contribution to funding of less than £2 billion would cause us any great difficulty.

The DNS view

14. DNS accept the case for encouraging more shake-out from GER. Indeed they share our view that it is the best way of adopting national savings to the lower PSBR and funding levels. But they are opposed to a further immediate reduction. In particular they fear that an announcement now, to take effect on 1 August, when building society rates have been edging up, could raise damaging press speculation about the future of national savings, and revive doubts about the general competitiveness of national savings. They believe that a figure

much lower than 7 per cent would reinforce comments that the GER was now being set at a level designed only for high rate taxpayers. They point out that the GER has already gone down 1.7 per cent in two stages since March, compared with just 1 per cent by the building societies.

15. They are also concerned that a reduction on 1 August would coincide with the traditional surge of repayments from indexed-linked certificates earning the 4 per cent supplement on that day. This supplement adds £130 million to the funding total in August. But, if 1985 and 1986 provide a valid guide, repayments might be around £175 million in August, £100 million in September. DNS would prefer to have the bulk of this outflow behind them before a further reduction in the GER is announced.

16. Their preference would therefore be that a decision in principle should be taken now to reduce the GER by a further ½ per cent to 6.5 per cent, but not to announce it until mid-September to take effect on 1 October. They point out that this timing would give ample opportunity to encourage shake-out over the period when the maturities of the 24th Issue are particularly heavy (£200 million in September, £800 million in October).

The MG view

17. We do not, of course, discount these views. I am sure that Mr Patterson is right to attach importance to avoiding press articles about lack of competitiveness which could rub off on to other national savings products. We ought particularly to hesitate before making a reduction at a time when short-term rates generally have been firming and when, although there appears to be no serious pressure for an immediate rise in base rates, the general sentiment appears to be that the next move is more likely to be up than down.

18. But, we remain worried about the size of the GER mountain, the prospect of it growing still further, and the poor quality of the funding it represents. Moreover, if it were to turn out that the next reduction in GER was the one that triggered a substantial outflow as holders woke up to what we were doing (which I personally doubt), the sooner we know about it the better so that we can take account of it in other funding decisions. Nor do we think that the background of competitors rates is likely to provide a more favourable contest for a reduction in GER in the autumn. If anything, the reverse seems more likely.

19. On balance, therefore, we favour a ½ per cent reduction from 1 August. I so recommend.

20. The announcement would be made in a low-key way. We do not think that it is likely to be regarded as having any signalling implications for our view on interest rates generally.

? Reconsider in light of Friday's decision X

CWK

C W KELLY

3760/008

CONFIDENTIAL

1. Alex - to see
2. RJA

FROM: P D P BARNES
DATE: 27 July 1987

MR KELLY

cc PS/Chancellor
Sir P Middleton
Sir G Littler
Mr Cassell
Mr Peretz
Mr Culpin
Mr Grice
Mr Rich - o/r
Mr Cropper

Mr Patterson - DNS

GENERAL EXTENTION RATE (GER)

The Economic Secretary was grateful for your submission of 24 July.

2. The Economic Secretary wondered whether GER funds shaken out would not go into building society deposits and so boost mortgage lending, or whether this would be no different from the result that would obtain if GER funds were retained and less was borrowed from the gilts market.

3. The Economic Secretary thinks there is some force in Mr Patterson's argument that we should wait to see what happens to index linked repayments in August before making a move on this.

4. The Economic Secretary also thinks that it might appear perverse to reduce this rate when the general desire must be to tighten up rates.

5. On balance therefore, the Economic Secretary thinks that we should wait until 1 October before making a move.

PB

P D P BARNES
Private Secretary

From : D L C Peretz
Date : 4 August 1987

CHANCELLOR

Thanks.

cc Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Cassell
Mr C W Kelly

PJ

INTEREST RATES : MONEY FIGURES

You should this evening get a first sight of the full June trade figures. You asked to see alongside those the best guess we and the Bank could give, at present, of the likely money figures for July.

2. As you know, the "first guess" for the money figures will not be available until 11 August. Even that figure, which the Bank compile by grossing up returns from the weekly reporting banks, has proved pretty unreliable in the past : and the counterparts breakdown has proved particularly unreliable.

3. At this stage during the month what the Bank do for their internal purposes is produce a projection for the likely outcome for the month. We do not normally see this, but on this occasion I have negotiated for us to have it. It is based on figures from the weekly reporting banks up to 22 July, together with a projection for the last nine days of the month based on full knowledge of the central Government's own operations over that period, and partial knowledge of the operations of the rest of the public sector. This projection for the last part of the month is notoriously unreliable, and the Bank themselves put little weight on it. This month the actual outcome will also have been affected by BAA, which will certainly have distorted the end-month figures (the Bank's projected figures, given below, make no allowance for any BAA distortion; nor for any special effects from Stock Exchange settlement problems).

4. Subject to all these health warnings, the Bank's projections for July are as follows :-

- 2.1% (seasonally adjusted) increase in M3 in July

- 20.6% 12 month growth rate in M3 to end-July

- £4 billion increase in bank lending in July.

5. In addition to these figures, of course, we are already pretty sure that M0 will show a 12 month growth rate to July of 5.4% (or 5.3% not seasonally adjusted). (See Mr Pike's minute of 30 July). This compares with 4.2% to June, but is distorted upwards by an unusually low figure for bankers' balances in July 1986.

6. I hope I have said enough to indicate that the estimates given above for broad money and credit growth in July should be treated with extreme caution. Even so, it looks to me as if one could say with reasonable confidence that there is unlikely to be anything in the final figures for broad money and credit growth, or indeed in the figure for MO, in July that would lead us to regret a decision to raise short-term interest rates, were such a decision to be taken in the next few days.

Gilt-Edged Market

7. I might also take this opportunity to report that the Bank have sensed over the last two days, for the first time for some time, some sign that the fall in the gilt market may be coming to an end. Gilt-edged market makers report some retail demand over the last couple of days, and today the gilt market rose a little (more than half a point at the long end), while US bonds fell. In these circumstances it might well be sensible to consider cutting the price of the tap, so that we can begin to make some sales. But the Bank would not want to do this until after a rise in short-term interest rates, if there is to be one. A cut in the tap price could then usefully consolidate and build on the move.

Possible Market Reaction to Trade Figures

8. Finally, you might be interested to know the Government broker's assessment of the likely market reaction to next week's trade figures, given without knowledge of what the figures are likely to be. This is :-

- trade deficit of more than £1 billion : even a 1% rise in base rates would not hold.

- trade deficit of less than £½ billion (ie current account surplus) : should be able to hold current structure of short-term rates.

- trade deficit of between £½ billion and £1 billion : 1% rise in base rates should hold.

9. Of course this is only one person's assessment, and an assessment that might easily change if market circumstances change over the next few days. But I report it for what it is worth.

DLP

D L C PERETZ

SECRET

Pmp

From : D L C Peretz
Date : 5 August 1987

CHANCELLOR

Thanks.

cc Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Cassell
Mr C W Kelly

INTEREST RATES : MORTGAGE RATES AND THE RPI

Mr Allan said you would like a note before the meeting tomorrow with the Prime Minister about the implications of any rise in base rates for mortgage rates, and for the RPI - particularly for the September RPI figure, which affects the social security uprating.

2. It is not an easy question to answer, not least because the current situation on mortgage rates is fairly complicated.

Mortgage Rates

3. I attach a table showing how mortgage rates have moved during this year in relation to base rates. Broadly speaking, since the turn of the year :

- base rates have fallen by 2%
- building society mortgage rates (for existing borrowers) have fallen by 1%
- Lloyds and National Westminster mortgage rates (for existing borrowers) have fallen by 1½% and 1¾% respectively.

4. This is not necessarily a stable situation. Abbey National has now announced a 0.75% cut in its rate to existing borrowers from 1 September; and today the Halifax announced a 0.45% cut in its rate for existing borrowers, also with effect from 1 September. In both cases this brings rates charged to existing borrowers into line with those charged to new borrowers. If base

rates remain unchanged this might in due course - but not necessarily by September - become a general ½% fall in building society lending rates to existing borrowers.

5. If base rates were to rise by ½% this would be less likely. And in due course presumably Lloyds and Nat West would be expected to raise their present rates by ½% or so, and the Halifax and Abbey National raise their rates back to 11¼% again.

6. If base rates were to rise by 1%, the two clearers might be expected to move more quickly. But it is perhaps unlikely that in the short-term, at least, they would want to move their rates above the general (present) 11¼% building society rate. In these circumstances any general building society reaction might also be delayed for some considerable time. But the Halifax and Abbey National might decide to reverse the reductions they have announced for September.

Impact on the RPI

7. The mortgage interest rate in the RPI is the average of building society rates. So movements in bank lending rates have no direct effect on the RPI. Changes in building society rates that are confined to new borrowers only are also neither here nor there from the point of view of the RPI.

8. A ½% change in the average building society mortgage rate shifts the RPI by 0.2 (and 0.2%), with the effect coming through more or less immediately.

9. The conclusion of the above discussion would seem to be that the most likely impact on the RPI of an early rise in base rates would not so much be a rise in the RPI, but more to prevent a possible fall that might otherwise have taken place. Here there are two possibilities :-

a) The reduction by Abbey National and Halifax might not be followed by other societies at least in the short-term. Together these two societies account for 37% of building society mortgages, so that this move by itself would bring about a fall of just under 0.1 in the RPI.

b) The move might be followed, but perhaps in rather slower time, by other societies reducing their rates, say to $10^3/_4$%. That would bring about a total reduction in the RPI of 0.2.

10. The most likely scenario, in the absence of an early rise in base rates, is one of continued upward market pressure on interest rates over the weeks ahead. In those circumstances it seems less likely that building societies generally will be in a hurry to move their rates down.

Conclusion

11. So all in all the conclusion is probably that a rise of up to 1% in base rates is unlikely to increase the RPI at least by September; but that it could (if it leads to a quick change of mind by the Halifax and Abbey) prevent a fall of just under 0.1 that is now in the pipeline.

DLCP

D L C PERETZ

BASE RATES AND MORTGAGE RATES IN 1987

	Base Rates	Bank Mortgage Rates	Building Society Mortgage Rates
1st Jan	11%	Lloyds 12.3 Midland 12.5 Others 12.25	12.375 Abbey 12.25 Others
10 March	10½%	During March Lloyds 11.3)for	During March
19 March	10%	Midland 11.5)new Others 11.5)mortgages	11.25 for new mortgages
29 April	9½%	1st May As above, for existing mortgages	1st May As above for existing mortgages
11 May	9%		
June		Lloyds 10.8 for new mortgages	17 June Abbey 10.5)for new Halifax 10.8)mortgages
July		21 July Natwest 10.5 for new mortgages	
August		1 August Natwest and Lloyds : as above for existing mortgages	
September			Abbey and Halifax : as above for existing mortgages, with effect from 1st September.

PH1/61

RESTRICTED

preg

FROM: A C S ALLAN

DATE: 6 AUGUST 1987

Mr PERETZ

cc PS/Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Cassell
Mr C W Kelly

INTEREST RATES: MORTGAGE RATES AND THE RPI

The Chancellor was grateful for your minute of 5 August.

ACSA

A C S ALLAN

Ch/PPS PWP
Mr Flitton
Mr Brown

CHANCELLOR - INTERVIEW ON INTEREST RATE RISE

Transcript from: LBC Radio, 5-6PM News, 6 August 1987

PRESENTER: Now we turn to another of today's stories in the City, already jittery today when it was taken completely by surprise by the Bank of England's signal that it wanted interest rates to go up. Fears that next week's trade figures will be even worse than those for May published only a week ago because of delays caused by civil service industrial action and the worsening situation in the Gulf had already wiped billions off share values. Well, this evening the 30 share FT index is down 45.2 at 1751.4. The broader 100 share index sunk 56 to 2261.4. The estimated value wiped off shares is around 2 1/2%, that's a record one day drop. A bolt from the blue was how one dealer described the news at the 100 share index fall 37 points in half an hour. What the Bank of England did was to raise by a full 1% the rate at which it lends to the wholesale money markets. It means that the High St banks will have to pass the increase cost onto you and me the customers. Indeed Barclays, Midland and the Nat West already have, putting their base rates a full 1% from 9 to 10%. And it throws the building societies into confusion. Only yesterday the Halifax cut its lending rate for existing borrowers. For some time now the Bank of England has been warning that the economy was overheating. Well by that they mean that it's growing too fast and industry can't keep up with the demand for goods and that means a rise in imports and bad trade figures. Cynics in the City beleive that the Chancellor Nigel Lawson has finally accepted the Bank's argument because he's seen next week's trade figures already and he wants to pave the way for bad news and stop a run on the £. Mr Lawson says no that isn't true. He says the moves has been taken to keep inflation down.

CHANCELLOR: We've had a tremendous success in bringing inflation down and keeping it down. And we've achieved that through making sure that financial conditions are always sufficiently tight to get on top of inflation.

INTERVIEWER: (MARIE KINSEY) In other words, you're worried about the amount of lending and spending on credit cards?

CHANCELLOR: No, credit cards are only a small part , tiny part, of total lending anyway. And lending itself is again only a part of the overall picuture. It's a matter of taking the overall, an overall judgement, of how the economy is and deciding what it's necessary to do. We've done it many times in the past, I've done it myself on a number of occasions during my time as Chancellor, sometimes interest rates have to go up, sometimes they can come down. But that way we keep on track. And as a result of this policy we now have got the fastest growing economy of all the major nations of the world and the inflation low and I want to keep it that way.

INTERVIEWER: Last month's trade figures were very worrying because of the big rise in the amount of imports that are coming into the country. The next lot are due out next week. Can we believe from today's move that they may be even worse?

CHANCELLOR: No I don't think that you should make any judgements about next week's trade figures from today's move, there's no way you can. Today's move was because I judged that taking the temperature of the economy it was right for me to keep on track, a track which has been extremely successful, and it was right to put interest rates up very slightly.

INTERVIEWER: Looking at the point of view of inflation, it is possible now that the banks and building societies are going to push up their mortgage rates which is not going to do very much good for the rate of inflation in the coming month. Isn't that going to throw your forecasts for the rest of the year out of joint a little?

CHANCELLOR: No, you'll see inflation ending the year I think as I forecast at or below 4%. What of course the banks and the building societies is a matter for them and they will have to make up their own minds. But you know we wouldn't have got inflation down dramatically as we have done since we first took office if we'd not been prepared to put interest rates up from time to time when it was necessary to do so. It's never an agreeable thing to do but when it's necessary we've done it.

INTERVIEWER: Is it possible then that today's move is a precaution against a possible run on the £ should next week's trade figures turn out to be worse than many thought?

CHANCELLOR: It is wrong to be fixed on the trade figures. As far as the trade figures are concerned I forecast at the time of the Budget that we would be lucky to have a current account balance of payments deficit of about £2 1/2 billion, which is very small in relation to the economy as a whole. And all the outside forecasts based on the year so far are that in fact the deficit will be less than that. So there's no need to draw alarmist conclusions from last month's trade figures.

INTERVIEWER: There's been a lot of talk about worries about the economy overheating in lots of fairly different ways. Does this mean that you perhaps may agree that there is the beginning of a tendency for the economy to overrun itself?

CHANCELLOR: I think it was necessary in order to keep the economy on track, to keep the economy healthy and to keep inflation coming down to have a slight increase in interest rates now and that was why I took the decision I did.

PWP

CHANCELLOR - INTERVIEW ON INTEREST RATE RISE

Transcript from: ITN, News at Ten, 6 August 1987

REPORTER: .... , so why was today's interest rate rise necessary?

CHANCELLOR: Because looking at the economy as a whole it seemed necessary and sensible to do so to keep monetary conditions, financial conditions, on track. We've had a tremendous success in getting inflation down under this Government and in keeping it down. And that has been done by having financial conditions right and that's what I wanted to maintain.

JOHN SMITH Our industry is not doing as effectively as it should in the export markets. And the underlying reality of the British economy, which is the importance of our manufacturing industry, has been neglected for too long by this Government. In effect I think we've got a candy floss economy and I'm afraid it looks as if we're going back to all the stop go things that the Government told us were never going to happen again.

CHANCELLOR - INTERVIEW ON INTEREST RATE RISE

PWP

Transcript from: ITN Channel 4, 7-8PM News, 6 August 1987

INTERVIEWER: (Nicholas Owen) Mr Lawson was in very cheerful form on the way to his last Budget speech. It looked then as though interest rates could only be on the way down as the Chancellor beamed upon a booming economy. But that boom, reflected in very heavy business in the shops accompanied by huge increases in credit card transactions has led to an enormous rise in personal borrowing and a lot of buying of imported goods. The City has been warning for a couple of months that the economy could overheat with inflation in danger of taking off. Whatever the Government's confidence dealers here are not at all sure the future's set fair. And the trouble for individuals is that official concern to cool the economy comes just as some mortgage charges have started coming down. Only yesterday the Halifax, the biggest society, announced a cut. This afternoon the Halifax said we hope to maintain our position, any further increases or strong market reaction will be bound to make us reconsider. This afternoon the Chancellor defended his decision.

CHANCELLOR: The important thing with the interest rate change is that the only way in which you do maintain a healthy economy and get inflation coming down is to have financial conditions right. And that means sometimes taking a decision to put interest rates up - we've done it in the past and it has worked and we shall continue to do so when it is necessary to do so.

INTERVIEWER: Might your critics not say that the 1% rise in rates won't do anything to discourage personal borrowing but it could easily discourage industrial investment and therefore affect jobs?

CHANCELLOR: I would expect there to be a tremendous upsurge in investment. All the indications are that there's going to be a tremendous upsurge in investment over the next 12 months. Business and industry is extremely confident. I believe it will remain confident. You only have to look at the most recent CBI surveys. And as for unemployment I would expect that to continue to come down.

INTERVIEWER: The Chancellor says he's sure the 1 point rise in base rates is enough, most economic commentators are inclined to agree with him. But they will be watching like hawks a series of indicators throughout next week that will show just what is happening inside the British economy. First at the end of the week the detail on inflation. The rate for June was running at 4.2%. The City predicts 4 and a half % for July, at the top end of the Government's own assumptions for the level of inflation in the coming months. Also due are figures covering the increases to manufacturers of raw materials which rose in June at a 12 month rate of 4%. Some experts think this figure could rise to nearer 7% which will have an impact on the prices we all pay for goods eventually. Then the most worried about set of figures, those showing the deficit on visible trade, trade in goods rather than services. The May deficit, the excess of import over exports, was over £1.1 billion. There are some forecasters who reckon there could be another £1 billion deficit in the June figures, though there are experts who are much more optimistic. It was thought you might hold off until next week when the trade figures came out, are you one of those who believe that the last set of trade figures that we saw - those for May - were a bit of a freak?

CHANCELLOR: Well certainly they did look pretty freakish. But the trade figures are only a part of the picture and not the main part of the picture. Indeed, the balance of payments so far this year is running better than I forecast it would in the Budget.

INTERVIEWER: Does that mean that next week we can look for figures which will be reasonably comfortable?

CHANCELLOR: I don't know what the figures will show and you'll have to see them when they come out. But it was a matter of taking all the economic indicators as a whole and forming a judgement that there needed to be a slight tightening of financial conditions in order to keep the economy healthy and on track.

INTERVIEWER: One of the Chancellor's aims is to defend sterling. Tonight its rate against the $ was still down a little on the day but its index showing how it's doing against a range of important currencies was steady. However the stock market took real fright at the consequences of higher borrowing and the FT 30 index closed down 42 and a half and the wider 100 index tumbled 56 having been 70 points lower at one stage. The market's been falling heavily and steadily for a couple of weeks now. Recently privatised popular stock hasn't done too badly in the circumstances, British Airways a fortnight ago, 23 July, were 158 pence - this afternoon they were 141: Telecom are down from 287 to 274 pence and British Gas, 182 two weeks ago are now quoted at 172. Those with longish memories see today's move as rather like an old fashioned credit squeeze. Once upon a time Chancellors could do that relatively easily. Now with credit cards and economies across the world so closely linked it's much harder. The Government must balance the benefits of strong economic growth, the best in the western world Ministers claim, with the perils of letting inflation out of its cage again.

-----

chancellor

NP 12/2

RC
NT
GS
Chancel

DEARER MONEY RIGHT, SAYS LAWSON

SIR DAVID NICKSON, PRESIDENT OF THE CONFEDERATION OF BRITISH INDUSTRY SAID TODAY'S ONE PER CENT RISE IN INTEREST RATES WOULD ADD £250 MILLION A YEAR TO BUSINESS COSTS AS BRITISH FIRMS WERE FIGHTING TO INCREASE THEIR SHARE OF HIGHLY COMPETITIVE WORLD MARKETS.

''WE HOPE THE INCREASE WILL BE ONLY TEMPORARY. WHAT MUST CONCERN US IS THE POSSIBILITY THAT A RISE OF ONE PERCENTAGE POINT MAY AFFECT BOTH ORDERS AND JOBS AND LEAD TO SLOWER GROWTH,'' SAID SIR DAVID.

THE RISE WOULD BE UNDERSTOOD IF IT HELPED MAINTAIN A STABLE POUND, WHICH CBI MEMBERS REGARDED AS EXTREMELY IMPORTANT.

EXPLAINING THE INCREASE, CHANCELLOR NIGEL LAWSON SAID ON BBC RADIO FOUR: ''THE ECONOMY IS DOING WELL.

''INFLATION IS LOW AND I WANT TO KEEP IT THAT WAY. MY JUDGMENT WAS, LOOKING AT INDICATIONS AS A WHOLE, IT WAS RIGHT TO TIGHTEN MONETARY CONTROLS A LITTLE BY PUTTING INTEREST RATES UP A POINT.''

--

NJF verbatim but seems OK

061530 AUG 87

Confederation of British Industry
Centre Point
103 New Oxford Street
London WC1A 1DU
Telephone 01-379 7400
Telex 21332
Facsimile 01-240 1578

From
Sir David Nickson KBE DL
President

PS

CBI

C/ The PA transcript, below, exhibits unfortunate, if predictable, selectivity.
JF
9/8

August 6 1987

Dear Nigel,

I attach for information a copy of the C.B.I. press release on Interest rates. I trust this causes you no problems

Yours ever

David.

Confederation of British Industry
Centre Point
103 New Oxford Street
London
WC1A 1DU
Telephone: 01-379 7400

NEWS RELEASE

CBI

P.166.87

RISE IN INTEREST RATES: CBI REACTION

Sir David Nickson, President of the Confederation of British Industry, commenting on today's increase in interest rates, said, "CBI members regard the stability of sterling as extremely important and if this increase in interest rates helps to maintain a stable pound it will be understood. Nevertheless, it will add £250 million a year to business costs at a time when British firms are fighting to increase their share of highly competitive world markets and we hope that the increase will be only temporary. What must concern us is the possiblity that a rise of one percentage point may affect both orders and jobs and lead to slower growth".

The Rt. Hon. Alick Buchanan-Smith, M.P.

HOUSE OF COMMONS
LONDON SW1A 0AA

RP

12th August, 1987.

612

INTR
HM TREASURY – MCU
RECD. 14 AUG 1987
ACTION MGT
CC APS/CHX
CHX
23545/8

The Rt. Hon. Nigel Lawson, M.P.,
Chancellor of the Exchequer,
The Treasury,
Parliament Street,
London, S.W.1.

Dear Nigel.

During the Election Campaign and subsequently, I have been approached by a number of people, mostly connected with small businesses, who are concerned about the relatively high level of interest rates in the United Kingdom compared with some of our industrial and trading competitors overseas. Particularly since the increase in Minimum Lending Rate last week, I have had a considerable number of other representations.

I understand that the increase last week was because of concern of the economy 'over heating' and, in particular, the credit boom which appears to be taking place.

However, this does not explain the longer term relatively higher level of interest rates. It is, of course, appreciated that, having London as a main worldwide financial centre, there are influences on interest rates which are not felt to the same extent in some other European countries. The question is, nonetheless, put to me whether it is worth while having London as such a centre if it means higher interest rates for the rest of the economy. The question is also put whether it might be better for us in these circumstances to be members of the EMS. Finally, I am asked whether perhaps the Pound is over-valued and therefore there ought to be some form of de-valuation either now or before going into the EMS.

All these points are of a fairly general nature but they are put to me with increasing regularity. I would very much appreciate your comments on them.

Yours ever

Alick

3761/044

PMP

FROM: P D P BARNES
DATE: 12 August 1987

MISS BARLOW - IR

cc PS/Chancellor 2
Mr Painter - IR
Miss Rhodes - IR

BASE RATE INCREASE : EFFECT ON RATE OF INTEREST ON UNPAID AND OVERPAID TAX AND ON OFFICIAL RATE OF INTEREST ON CHEAP LOANS

The Economic Secretary was grateful for your submission of 10 August.

2. The Economic Secretary is content that you should issue the press release as recommended.

Guy Westhead

PP P D P BARNES
Private Secretary

817.36

Woodod PWP
(W/ton)

CONFIDENTIAL

FROM: IAN RICH

DATE: 18 September 1987

1. MR KELLY

2. ECONOMIC SECRETARY

cc: Chancellor
Sir P Middleton
Sir G Littler
Mr Cassell
Mr Peretz
Mr Grice
Mr Pickford
Mr Cropper
Mr Call

Mr Patterson) DNS
Mr Ward)

At the time we first proposed this, we thought that building society rates might be coming down. Even though this has not happened because of the base rate rise, we still believe that a 1/2 per cent reduction is justified by the other considerations mentioned in this minute.

18.9.

GENERAL EXTENSION RATE (GER)

1. Mr Kelly's submission of 24 July recommended a reduction of ½% in this tax free interest rate, paid to holders of matured fixed interest savings certificates. This move was to be part of the continuing experiment to shake out some part of this form of funding. GER has been 7.02% since May 1987 - the same as the guaranteed return on current fixed interest certificates held to maturity. The pattern of change recently has been:

	%
June 1986	8.01
November 1986	8.70
April 1987	7.50
May 1987	7.02

2. You decided in July that no reduction should be made until 1 October. You did not wish to move GER down when market rates were moving up. Also, DNS argued for delay until 1 October, fearing large outflows from index-linked certificates might jeopardise the expected total contribution to funding. They preferred to leave the option of a GER reduction open until the size of these outflows were known. You saw force in this.

CONFIDENTIAL

3. We and the DNS have now taken stock of the position. The arguments against a reduction have weakened. Outside interest rates seem to have settled down since the 1% rise in base lending rates in the summer. Some retail deposit rates have edged up slightly since July - particularly building society 90 day rates which are generally in the range 8%-8.75% according to size of deposit. A few small societies pay 9%. Building society instant access "gold" accounts (7.5%-7.75%) and bank high interest cheque accounts (7%) are generally unchanged.

4. The arguments for a reduction are strong:

(a) The outflow from index linked certificates is about half the level experienced last year. Figures are:

	1986 £m	1987 £m
August	175	95
September (first 2 weeks).	61	25 (first estimate)

(b) A further £1 billion will be added to the GER stock when the main bulk of 24th issued fixed certificates mature over the next six weeks. DNS expect outflow from cashing in at maturity to be small - 10% of the issue or £110 million.

(c) Without a change, DNS now expect their total funding contribution for the year to be a little above £2 billion, at a time when the total funding requirement appears to be moving down sharply.

5. Were it not for the increase in base rates, there would now be a case for a reduction of 1% (equivalent to 1.37% gross for basic rate taxpayers) in the GER. But DNS would strongly oppose a reduction of this size because GER would then be so far out of line with the market. As it is, we and DNS recommend a reduction of ½% to 6½% (6.51%, since the amount has to be divisible

by 3) from 1 October. For administrative reasons, changes in GER need to be made from the 1st of the month.

6. We seek your agreement accordingly. Presentation of a reduction in the GER given the scenario in paragraph 3 and no expectation of a fall in rates, could be awkward. We propose to play this as low key as possible. An announcement will have to be made. But it will be the minimum necessary. DNS would like it to mention that the Government is keen to encourage further re-investment into the current (33rd) issue of savings certificates. We will submit separately a draft DNS press release and advice on the line to take in briefing.

7. This submission has been agreed with the DNS.

Ian Rich

IAN RICH

3764/074

CONFIDENTIAL

FROM: P D P BARNES
DATE: 21 September 1987

MR RICH

cc PS/Chancellor
Sir P Middleton
Sir G Littler
Mr Cassell
Mr Peretz
Mr Brett
Mr Grice
Mr Pickering
Mr Cropper
Mr Call
Mr Patterson - DNS
Mr Ward - DNS

GENERAL EXTENSION RATE

The Economic Secretary is grateful for your submission of 18 September. We spoke.

2. The Economic Secretary would like to defer a decision on this until after this week's gilt auction. You said this will present no difficulties.

PB

P D P BARNES
Private Secretary

3886/002

CONFIDENTIAL

FROM: C W KELLY

DATE: 5 November 1987

CHANCELLOR

Tony D.

cc: Chief Secretary
Financial Secretary
Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Cassell
Mr Peretz
Mr Grice
Mr Richardson
Mr Murphy
Mr Hurst
Mr Cropper

BANK AND BUILDING SOCIETY INTEREST RATES

You may be interested in a brief note on the repercussions of the last two interest rate cuts.

2. All the major clearing banks reduced their base rates to 9 per cent yesterday afternoon.

3. The Halifax very quickly announced that their mortgage rate would be cut to 10.3 per cent from 11.25 per cent, with effect from Monday for new borrowers, from 1 December for existing borrowers. The Abbey National followed with an announcement that they too would be cutting rates from 1 December, but had yet to decide what the new rate would be.

4. Other building societies are expected - by the Building Societies Association, inter alia - to reduce mortgage rates quickly as well: probably to around 10¼ per cent from 1 December. The overall position of societies is healthier than for some time as a result of buoyant retail inflows (benefitting from lack of competition from unit trusts) and the possible easing of wholesale funding restrictions. Societies will therefore

be reluctant to accept any medium-term loss of competitiveness in the mortgage markets. The society to watch for signs of this wider downward movement should be Nationwide Anglia, who led the resistance in the summer (and are quoted in today's FT as "sitting tight till the murk clears slightly").

4. Banks can be expected to bring their mortgage rates into line. Mortgage corporations' rates usually reflect LIBOR; the Mortgage Corporation reduced its rate to 10.5 per cent on Monday, and a further cut could follow.

5. Deposit rates have not yet changed, but will probably come down parallel with mortgage rates.

6. When the dust settles, we shall need to weigh the implications of the new situation for national savings. In the meantime, there seems little risk that the 7 per cent rate offered by the 33rd Issue certificate will be left stranded above the competition; and in case, DNS are reasonable confident that the £1,000 maximum holding limit would help prevent the sort of excessive inflows that have occasionally occurred in the past.

C W KELLY

CONFIDENTIAL

FROM: A A DIGHT

DATE: 6 November 1987

MR C W KELLY

BANK AND BUILDING SOCIETY INTEREST RATES

The Chancellor has seen and was grateful for your minute of 5 November.

A A Dight

A A DIGHT

pvp

CONFIDENTIAL

From: Sir G.Littler
Date: 11 November 1987

MR PERETZ

c.c. Mr Alex Allan
Sir P.Middleton
Sir T.Burns
Mr Cassell
Mr C W Kelly

EUROPEAN INTEREST RATES LAST WEEK

It has occurred to me that, in the rush of discussions last week, I never recorded the quite interesting European dimension of our decision last week.

2. At and around the meeting of the EC Monetary Committee in Madrid on Friday 30 October, there was a good deal of pressure on German colleagues for a cut in German interest rates in the hope of easing tensions which had become very strong between the DM and other currencies, especially the French franc, at the end of that week. Tietmeyer and Gleske both showed privately much sympathy, but told us that the balance of opinion in the Bundesbank was very hostile. We were all conscious that the Bundesbank would have a Council meeting on Thursday 5 November which could be an occasion for reconsideration.

3. The Netherlands Central Bank made a small downward move on Tuesday or Wednesday (as far as I know this was not prompted by or designed to encourage others). The UK decision at lunch-time on Wednesday 4 November (one-half per cent cut) was suggested by market pressure and timing in relation to the Mansion House speech, but in discussing it we had some exchanges about the German position and about whether our move and its timing might be influential, which would of course be welcome. It was agreed that at least we should try to exert influence.

CONFIDENTIAL

4. Accordingly I telephoned to Tietmeyer almost simultaneously with our announcement, representing to him that, while we were of course in part responding to market pressure, we had timed our move and I was now speaking to him in the hope that it might offer useful argument in encouraging the Bundesbank to see the value of a similar move themselves in easing current tensions all round. Tietmeyer was very grateful to know of this. I think that the Chancellor spoke along the same lines later to Stoltenberg.

5. I then telephoned Trichet at the French Tresor, giving him the same message and explaining that I had pressed Tietmeyer. He was particularly pleased because the French and Germans were locked in negotiations on the subject of interest rates at that very moment.

6. The following day, 5 November, agreement was reached by the Bundesbank and Banque de France - publicly welcomed in a joint statement by the two Finance Ministers - on reductions in German short-term rates and increases in French. Just before they were announced, Tietmeyer and Trichet in succession telephoned me to give me the news and couple it with thanks for our move which, Tietmeyer said explicitly, had provided Stoltenberg with a valuable extra argument in the Bundesbank Council that morning.

7. Not exactly 'concertation' but a good example of European cooperation - and so far with a good calming effect in the ERM, which deserves recognition at ECOFIN and Monetary Committee!

8. I am copying this to Anthony Loehnis (B/E).

(Geoffrey Littler)

Inland Revenue

Policy Division
Somerset House

CONFIDENTIAL

FROM : J R STREETER
17 November 1987

1. Mr O'Connor 17/11
2. Mr Johns 17/11
3. Mr Painter 18-11
4. Financial Secretary

DETERMINATION OF COMPOSITE RATE FOR 1988/89

1. This note seeks your approval

   a. to a determination of the 1988/89 composite rate for building societies, banks and local authorities at 23.25% (a drop of 1.5% from the current rate), and

   b. for laying a Treasury Order to that effect (with accompanying Press Release) in the near future.

Background

2. Under the composite rate scheme, the rate for building societies, banks and local authorities is to be statutorily determined each year. It is determined on the basis of data for the preceding rather than the current year. Section 26 Finance Act 1984 provides for the rate to be determined by Treasury Order before, at latest, 31 December preceding the relevant tax year starting the following 6 April.

---

cc. Chancellor
Financial Secretary
Chief Secretary
Economic Secretary
Sir P Middleton
Mr Scholar
Mr Culpin
Mr Peretz
Mr Riley
Miss Sinclair
Mr Cropper

Mr Painter
Mr Johns
Mr Corlett
Mr Beighton
Mr Bousher
Mr O'Connor
Mr Munro
Mr Whitear
Mr Dearman
Mr McNicol
Mr McCarney
Mr Graham
Mr Streeter
PS/IR

Thus the rate for 1988/89 has to be determined before 31 December 1987. The rate has to be, as nearly as may be, revenue neutral.

Parliamentary Procedure

3. The Order falls to be made by statutory instrument which is subject to the negative resolution procedure. It remains subject to this procedure for forty sitting days and under a House practice rule statutory instruments should, where practicable, not come into force before 21 calendar days after they have been laid.

Recommendation on 1988/89 rate

4. Under Section 26 Finance Act 1984, in fixing the composite rate up to and inclusive of 1988-89, the aim of revenue neutrality may be directed to amounts payable by building societies alone, allowing time to obtain data from a full survey of bank depositors and other deposit-takers. This survey has commenced in respect of 1986/87, but until it is completed in 1988, there is not expected to be any reliable evidence about the tax liability (in the absence of composite rate) of interest other than that on deposits with building societies, which was obtained in the last survey relating to 1982-83. The Board's Statistics Division has examined the evidence on building society interest and estimates of movements in components of personal incomes between 1982-83 and 1987-88 (1987-88 is the year relevant to the rate for 1988-89, because of its previous year basis since the extension to banks). The Division has concluded that the evidence supports a rate of 23.25% for 1988-89 (a drop of 1.5% from the 1987-88 rate). The reasons leading to this conclusion are set out in Annex A. The main reason the reduction in the composite rate is proportionately less than the 2% reduction in basic rate is that incomes have risen faster than tax allowances which increases the proportion of interest that would be liable to tax.

CONFIDENTIAL

Timing of Order

5. The end of the calendar year is the latest statutory date for determination, but the normal practice is to lay the Order earlier. Last year the Order was laid on 9 December and it is desirable to work to a similar timetable this year.

Court action by The Woolwich Equitable Building Society

6. Last year we warned you that the Order determining the rate for 1987/88 might be challenged in the Courts on the grounds that it would lead to excessive taxation of building societies. Such a challenge was threatened by the Woolwich Equitable Building Society at a time when they thought that they might be prevented from challenging on similar grounds the Regulations which govern composite rate tax paid by building societies.

7. In the event, the 1987/88 rate-fixing Order was not challenged. And the Woolwich's action against the composite rate tax Regulations proceeded and was successful, although this decision is subject to appeal by the Revenue, which has now been lodged.

8. In the present circumstances, we feel that the possibility of a challenge against this year's Order is remote.

Summary

9. We seek your approval for:

a. the determination of composite rate for 1988/89 at 23.25% (paragraph 4 and Annex A);

b. the laying of a Treasury Order as soon as possible (paragraphs 3 and 5);

c. the issue of the draft Press Notice.

J R STREETER

CONFIDENTIAL

ANNEX A

Evidence on a revenue neutral rate for building society interest, and assessment of uncertainties

1. In this Annex, the evidence is presented in terms of the year preceding the one to whose composite rate it is relevant. This is because under Section 26 Finance Act 1984 the composite rate fixed to apply in any tax year must be based only on information that relates to periods before the end of the year of assessment in which the rate for that year is determined.

2. The available evidence for 1987-88 has been translated into a "calculated" composite rate. This is the product both of the evidence itself and the application of a number of assumptions made to deal with areas of uncertainty.

3. Though these assumptions (together with the statistical error associated with any information that is based on a sample) inject considerable uncertainty into what constitutes a revenue-neutral rate, for purposes of comparison the calculated rate is presented to 2 decimal places. For 1987-88 the calculated rate is 23.50 per cent.

4. The assumptions made to deal with areas of uncertainty reflect well established conventions agreed with the building societies during the long period, which ended in May 1984, when a composite rate was negotiated with them. The most important of these assumptions concern the treatment of interest received by investors in the statistical sample for whom it has not been possible to trace an Inland Revenue record.

5. In the negotiations, acknowledgement of the uncertainties in estimating a revenue-neutral rate invariably resulted in a rate below the calculated rate, typically by between 1/4 and 1/2 percentage points. During the period in which composite rate has

been determined rather than negotiated, it has been felt to be sufficient acknowledgement of the uncertainties for an adjustment at the lower end of the 1/4 to 1/2 percentage point range to be made, with the answer rounded to the nearest 1/4 percentage point. There is no new evidence on this occasion justifying a departure from this practice, which produces a revenue neutral rate for 1987-88 (for application in 1988-89) of 23.25 per cent.

6. Since the rate currently applicable was determined at 24.75 per cent changes to the calculated rate can be summarised as follows:

1. Calculated revenue neutral rate for 1986-87.	24.93	
2. Revision in the light of more recent information.		-0.01
3. Growth in taxable incomes between 1986-87 and 1987-88.		+0.59
4. Raising of personal allowances.		-0.24
5. Reduction in basic rate from 29% to 27%.		-1.74
6. Effect of introducing higher level of age allowance for over 80s.		-0.03
7. Total change.	-1.43	
8. Calculated revenue neutral rate for 1987-88.	23.50	

. The total change in the calculated rate, in line 7, of a reduction of 1.43 percentage points, compares with a reduction of 1.5 percentage points between the currently applicable rate and that provided for applicability in 1988-89 by the method explained in paragraph 5 of this Annex. The small difference reflects a slightly larger degree of rounding down the calculated rate this year than last year.

8. To the nearest quarter percentage point, a composite rate of 23.25 per cent is that most likely to have achieved revenue neutrality for 1987-88.

STATISTICS DIVISION
INLAND REVENUE
November 1987

INLAND REVENUE

Press Release

INLAND REVENUE PRESS OFFICE, SOMERSET HOUSE, STRAND, LONDON WC2R 1LB
PHONE: 01-438 6692 OR 6706

[3x]

COMPOSITE RATE FOR BUILDING SOCIETIES, BANKS AND LOCAL AUTHORITIES ETC FOR 1988-89

A Statutory Instrument was laid before the House of Commons today fixing at 23.25% the rate at which building societies, banks, local authorities and other deposit-takers will account for tax on interest paid in 1988-89 to individuals resident in the United Kingdom.

The Statutory Instrument, which has the title "The Income Tax (Reduced and Composite Rate) Order 1987" will be published on

Copies will be obtainable from HMSO.

Note for Editors

The general aim of the composite rate, is to set a rate (on the basis of a periodic statistical survey of depositors) which will achieve revenue neutrality - that is a rate which will result in the same amounts of tax in total becoming payable as would be payable if there was no composite rate. Pending a wider statistical survey covering banks and local authorities as well as building societies, the composite rate for 1988-89 is to be determined by reference to data relating to building society depositors only.

The 23.25% rate now determined for 1988-89 is a reduction of 1.5% from that for 1987-88.

STATUTORY INSTRUMENTS

1987 No.

INCOME TAX

The Income Tax (Reduced and Composite Rate) Order 1987

Made .... ________________

Laid before the House of Commons ________________

Coming into force .... 6th April 1988

The Treasury, in exercise of the powers conferred on them by section 26 of the Finance Act 1984(**a**), hereby make the following Order:

1. This Order may be cited as the Income Tax (Reduced and Composite Rate) Order 1987 and shall come into force on 6th April 1988.

2. The Treasury hereby determine that the rate which, under the provisions of the said section 26, shall for the year 1988-89 be the reduced rate (for building societies) and the composite rate (for deposit-takers) shall be 23.25 per cent.

1987 Two of the Lords Commissioners of Her Majesty's Treasury

(a) 1984 c.43.

EXPLANATORY NOTE

(This Note is not part of the Order)

In respect of payments of dividends and interest made to investors in the year 1986-87 and subsequent years of assessment, a building society is required to pay to the Inland Revenue in accordance with regulations (S.I.1986/482) made under subsection (1A) of section 343 of the Income and Corporation Taxes Act 1970 (c.10) (which was inserted by section 40(3) of the Finance Act 1985 (c.54)) an amount representing income tax on certain sums calculated in part at the basic rate and in part at "the reduced rate".

Under the provisions of section 27 of the Finance Act 1984 a deposit-taker on making payments of interest in respect of a relevant deposit is liable to account for and pay an amount representing income tax on such payments. The amount is calculated by applying "the composite rate" determined in accordance with section 26 of that Act.

Section 26 provides that the Treasury shall by order made by statutory instrument determine a rate in each year of assessment which for the following year of assessment shall be the reduced rate (for building societies) and the composite rate (for deposit-takers). This Order determines the rate at 23.25 per cent. for the year 1988-89. The rate for the years 1985-86 and 1986-87 was 25.25 per cent. (S.I. 1984/1674 and S.I. 1985/1836) and for 1987-88 was 24.75 per cent. (S.I.1986/2147).

42/2 4368/13 vj

FINANCIAL SECRETARY TO THE TREASURY

FROM: MISS S J FEEST
DATE: 24 NOVEMBER 1987

MR J R STREETER - IR

cc
Chancellor
Chief Secretary
Economic Secretary
Sir P Middleton
Mr Scholar
Mr Culpin
Mr Peretz
Mr Riley
Miss Sinclair
Mr Cropper

PS/IR

DETERMINATION OF COMPOSITE RATE FOR 1988/89

The Financial Secretary was grateful for your minute of 17 November 1987 and approves the action suggested therein.

Susan Feest

SUSAN FEEST
ASSISTANT PRIVATE SECRETARY

3977/2

Pup

PERSONAL - SECRET

FROM: P J CROPPER
DATE: 30 November 1987

CHANCELLOR

MORTGAGE MEETING 30 NOVEMBER 1987

CST Preference for Residence basis, marginally favouring the 40. Did not think Individual basis 50/25 would be saleable: it would have to be 60/30 if we took that route. Worried about effect on house prices.

FST Preference for Residence basis. Sharers were a de minimis problem: complexity would be limited if improvement loans were disallowed. Would have chosen Individual basis with 30/15 if that had been available but it was not.

EST Would like to see the economic impact and losers papers before reaching a decision. Slightly concerned about cardboard partitions and other fiddles, but inclined to favour Residence basis with 35 plus abolish home improvement relief.

PJC Reiterated case made in paper of 23 November for Individual basis at 60/30: theoretical superiority of individual basis, affinity with independent taxation. Don't overlook impact on housing market if removing top IT rates. Second preference Individual basis at 50/25.

AGT Still in favour of Individual basis 60/30, or 50/25 if PM would allow it. We could be following the Manifesto and ending the penalty on marriage. Presentation easier than with a switch to Residence. Stock market crash has taken the froth off the housing market already.

MC Favoured Residence basis with lowest limit we can achieve. The Individual basis 60/30 would pass through into house prices.

PMG For reasons of Conservatism and purity of argument, and because it removes the penalty on marriage, would go for Individual basis 50/25, with 60/30 as second choice. Did not think PM would accept 40/20. In favour of getting rid of home improvement loan relief.

P J CROPPER

NB C/Ex asked FST to find out what had been the consultative response to the Residence basis proposal in the Green Paper.

149/51

FROM: R I G ALLEN
DATE: 3 DECEMBER 1987

AAP

SIR GEOFFREY LITTLER

cc Mr A C S Allan
Mr Cassell
Mr Pickford

INTEREST RATES

If rates are cut at 12.00 pm today, following German action, I have agreed with the Chancellor that he will appear on BBC Radio 4's "The World at One" to explain what has been done: we are not planning any other media appearances.

2. We shall, however, need a holding line to put on the Reuters/PA screens. I discussed this briefly with the Chancellor, and suggest something very simple along the following lines:

> "This is part of a concerted action with Germany [and France], taken in the light of current financial circumstances."

3. We shall also tell Reuters/PA that the Chancellor will be expanding on the reasons for the move on radio.

4. If you agree with the above line, we should tell the Bank what we propose to say.

G. MacDowell

pp R I G ALLEN

INTEREST RATES

Factual

Bank of England dealing rates cut by ½ per cent at noon. All four major clearing banks have now responded by cutting base rates to 8½ per cent. Base rates were last at this level in March 1984 (briefly, and some banks then remained at 8¾ per cent), and before that in May 1978.

2. The Bundesbank have announced a cut of ½ per cent in their discount rate, to 2½ per cent. The Bank of France have cut their interest rates by ¼ per cent to 7¾ per cent.

Line to take

3. The moves on interest rates follow intensive discussions between the authorities in the United Kingdom, Germany and France over the past few days. All agreed to move today in the light of current financial conditions. This demonstrates effective international co-operation.

4. UK interest rates are now at the lowest level they have been for nearly 10 years.

RA3.85 *final version, sent to Norgrove 2.45*

pnr

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RA3.85

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[illegible]

Ch

OK?

AA

OK small change

pmp

INTEREST RATE REDUCTION: 3 DECEMBER

Factual

(i) West Germany cut its discount rate today by 1/2 per cent to 2 1/2 per cent.

(ii) In the noon dealing round, the Bank of England accepted offers of bills 1/2 per cent below previous dealing rates.

(iii) Bank of France has reduced its intervention rate by 1/4 per cent.

Positive

(i) **International cooperation**: cuts further evidence of international cooperation. Will also be welcomed by industry.

Defensive

(i) **Why only 1/4 per cent cut from the French ?**

Very much a matter for them. But the reduction is a welcome move.

(ii) **Loosening of monetary conditions ?**

No. - stock market fall had tightened monetary conditions;

- exchange rate index up 1 1/2 per cent since the start of November;
- stable and firm exchange rate against DM scarcely suggests resurgence of inflation.

(iii) **What about fast growth in money supply ?**

- little sign of acceleration in growth of monetary aggregates;
- MO annual growth of 5.5 per cent still within target range;
- October's growth in broad money (22.2 per cent annual growth for M3, 15.7 per cent M4) distorted by increase in reserves, to be sterilised over time, and build-up of liquidity for BP sale.
- stock market fall may have raised volume of liquidity willingly held. No threat to inflation.

(iv) **Further cuts on the way ?** Wait and see. Unhelpful to speculate.

(v) **Half per cent cut too small ?**

- Third cut in rates since fall in stock market;
- Government remains fully committed to keeping downward pressure on inflation

(vi) **Cut inconsistent with what Chancellor said in Commons last Thursday?**

Not at all: Chancellor said that he was keeping the possibility of interest rate cuts in mind and balancing the possible recessionary influences from the stock market collapse against need to keep inflation under control.

(vii) **Implications for mortgage rates ?** A matter for the building societies

(viii) **Prospects for G7 ?**

Still hopeful meeting will take place. But as this move demonstrates, finance ministers/ central banks in constant touch by telephone.

CHANCELLOR 12/2

pl ~~send~~ cc to PS/CST

PMP

MPW.

CHANCELLOR - INTERVIEW ON INTEREST RATE CUT

Transcript from: BBC Radio 4, PM, 3 December 1987

INTERVIEWER: (FRANCIS COVEDALE) It came as quite a surprise when the Bank of England announced a 1/2% cut in interest rates this morning, bringing the cost of borrowing down to 8 1/2%. All the indications from the Chancellor, Nigel Lawson, had been that there wouldn't be a further fall. Shortly after came the expected news that the West German Bundesbank was cutting its rate by 1/2%, then that France, Austria and Holland were cutting their key rates too. So has this been a concerted move to halt the slide of the $? The Chancellor of the Exchequer is at this moment in our radio car outside No 11 Downing St. Mr Lawson, first why have you cut interest rates today?

CHANCELLOR: This has, as you said, been a concerted move among a number of countries. We've been in very closetouch and I've personally been in very close touch with my opposite numbers in Germany and France in particular over the past few days and indeed weeks. And it is.. something that we considered appropriate in the light of the current financial conditions.

INTERVIEWER: Who's going to benefit from the cut then?

CHANCELLOR: The whole economy will benefit from these reductions which do bring in this country interest rates down to as low a figure as they've been at any time in almost the last 10 years.

INTERVIEWER: British exporters particularly?

CHANCELLOR: I think that the whole British economy will benefit from this. Interest rates sometimes have to go up, sometimes they have to go down, inorder to keep the economy on an even keel. And this move down, in concert with moves by other countries, is something which will help to deal with the rather troubled conditions there are in financial markets at the present time and provide a securer future for the economy.

INTERVIEWER: You certainly took the City by surprise didn't you?

CHANCELLOR: Well I've no idea whether I did or not. If they were taken by surprise I'm a little bit puzzled. I doubt whether the more perceptive people in the City were taken by surprise because all along I made clear that I'm working for greater international co-operation. And I think this has been a very welcome sign of the high degree of economic co-operation that there is between the major countries.

INTERVIEWER: It does sound as though you've had a sort of mini G7 meeting over the phone; when will there be a propermeeting of the Group of 7?

CHANCELLOR: Well as I said last week when I was talking to the American Chamber of Commerce in London the key thing now, because we've had the measures on the fiscal front, on the budget front, both in the United States - although they've still got to get through the Congress- and now the Germans yesterday announced their measures and I believe the Japanese will come forward in due course - we've also had now reductions in interst rates among most of the major countries - not from the United States where it wouldn't be appropriate, the key thing that remains is whether there will be an agreement on everybody's part to contribute to the stabilisation of the $. That is the critical element. If there cannot be that commitment on everybody's part, and that means particularly the United States, then as I said last week I see little point in holding a G7 meeting at all. If there can be that commitment then I think we could have an early G7 meeting. It dependson that.

INTERVIEWER: On the home front, do you expect this cut to stop a slump in our economicgrowth?

CHANCELLOR: I see no sign whatever of a slump inour economic growth. We've been growing at a very rapid rate and I think the rate of growth next year, although lower than this year, will be far higher than we had say in the 70's. It'll be a very resepctable rate of growth. And indeed there is no sign of any serious slow down, although there may be some slight slow down, but there's no sign of any serious slow down in world economicgrowth. I think a lot of this doom and gloom stuff - is not only been overdone - bears no relation to the actual power of evidence.

INTERVIEWER: Mr Lawson can I ask you a last question, won't this possibly lead to higher inflation?

CHANCELLOR: No it won't. Indeed I would expect inflation to be edging down over the next few months. And I certainly wouldn't have redcued interest rates if I'd thought it would lead to higher inflation. But what you've got to do is to take into account not merely theinterst rate butalso the exchange rate. And the exchange rate has been rising and it's against that background that we were able to join in, sensibly, to join in this concerted reduction in interest rates.

-----

mjd 3/22m

KEEP CAREFULLY

CW/ The table you asked for.

~~SHORT-TERM~~ REAL INTEREST RATES

mpw 4/12

4/12/87. pup

	THREE MONTH (1) NOMINAL INTEREST RATE	CONSUMER (2) PRICE INFLATION	THREE MONTH (3) REAL INTEREST RATE
United States	7.6	4.5	3.0
Japan	3.9	0.6	3.3
Germany	3.6	0.9	2.7
France	8.6	3.2	5.2
UK	8.6	4.5	3.9
Italy	11.6	5.3	6.0
Canada	8.9	4.3	4.4
Avge	7.5	3.3	4.1
Jap/Germany	3.75	0.75	3.0
~~[illegible]~~ US/France/UK [illegible]	9.1	4.4	4.5
~~[illegible]~~	~~10.25~~	~~4.8~~	5.2

(1) 4 December

(2) Latest available figures (October)

(3) Three month nominal interest rates deflated by change in consumer price index on year earlier.