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PRIME MINISTER

I am afraid there is more bad news (to place alongside the trade figures ) to show that our inheritance was much worse than we had appreciated.

2. The money supply figures for banking May show a growth of 1.2 per cent (an annual rate of 13.1 per cent since last October). For banking June the figures will be higher, possibly 2 per cent if we take no action. And the CGBR (£730 million in banking May) is expected to be £1,300 million in the next month, even after seasonal adjustment. The figure for bank lending to the private sector (banking May) is up to £870 million - nearly twice the average monthly rate forecast.

3. These figures were considered by Treasury and Bank officials. And I met Gordon Richardson this morning (together with John Biffen and Nigel Lawson) to discuss the position.

4. Gordon's view was clear - and he emphasised that he would have had to give the same advice to the last Government, Budget or no Budget - to the effect that MLR would have to go up tomorrow by 2 per cent to 14 per cent. This is, of course, bound to raise mortgage rates - not necessarily immediately, but probably to 13 per cent.

/5. None

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5. None of us has any doubt that the rate would have to go up. And anything less than 2 per cent would simply arouse expectations of more. For it is the only possible response to money supply figures moving, as they are, right outside even Denis Healey's target range. That case is, of course, even stronger for us, since we are working to a target of 7-11 per cent at an annual rate from mid June 1979 to mid April 1980. And our commitment to monetary discipline is well known, although it has yet to be shown in practice.

6. The only question was over the timing of the necessary response. Nobody argued for it to be announced on Budget Day (Denis Healey made that mistake last year). After the Budget, at any time and in any stages, it would look like a vote of no confidence in the Budget. Yet all our advisers are agreed that the Budget should, in itself, be well received and have a good effect on confidence.

Friday

7. We are left then with tomorrow. Even then, there is some risk that the announcement could diminish the impact of the Budget. But this is not thought likely. For the decision to raise MLR would be seen as a more or less inevitable response to the deteriorating monetary situation. And that judgment would be seen as justified in retrospect by Friday's trade figures.

8. This was a most disagreeable problem to have to face. But given the choice between rising interest rates and declining confidence after the Budget, and a firm display of our determination to reassert monetary discipline, in face of an obvious need, before the Budget, I am as confident as anyone can be in such cases that we have made the right decision.

9. I am copying this minute to Gordon Richardson.

*Am Baccini*

*Principal Private Secretary*

Approved by the Chancellor of the Exchequer and signed in his absence 6<sup>th</sup> June, 1979 (G.H.)