

PRIME MINISTER

Econ
Psl

Meeting with the Chancellor - Thursday 8 November at 9 a.m.

I understand that the Chancellor and the Governor decided this evening not to propose an increase in MLR tomorrow. They decided, instead, to put off the increase, which they regard as inevitable, until next week. The disadvantage of postponing is that we will lose another week before gilt sales start moving again. On the other hand, there are substantial advantages of waiting. These are that the increase - and I do not think a figure has yet been decided - would be accompanied by the announcement of the new six month, monetary target and possibly the ending of the "corset". We are committed to announcing a new target very soon; moreover, as you know, the "corset" has been ineffective for some time in controlling the money supply broadly defined and is less effective still now that exchange controls have been abolished. The drawback of getting rid of the "corset" is that it will bring into M3 money which is currently not recorded as part of it; and this will give a once and for all boost to M3. On the other hand, we are interested in controlling the money supply properly measured, and most commentators are now well aware that M3 - while the "corset" continues - does not provide an adequate measure.

The Chancellor will be sending over a note later tonight. Subject to whatever that says, you might ask him:-

- i) How big an increase in MLR he envisages next week? And what effect will the increase have on sterling? (sterling was very strong today).

- ii) What are the real causes for the surge in the money supply in October? The Treasury tell me that VAT receipts were probably postponed because of industry's worsening financial position - in turn, partly due to the engineering strike, partly to the PAYE refunds. These latter factors no doubt go to explain the very high level of bank lending to the private sector. High bank lending does not necessary imply that the recession is being postponed: it could be that firms are borrowing to finance stocks they cannot