

Evan Pt.

PRIME MINISTER

Meeting with Mr. Gordon Richardson: 1630,
Friday, 13 July

You are seeing the Governor tomorrow to have a general chat. You will not want to anticipate too much the Monetary Seminar next Wednesday which of course the Governor will be attending. The Seminar will be considering methods of controlling the monetary aggregates, and in particular the "monetary base" method suggested by Gordon Pepper; and methods of funding the borrowing requirement, particularly the operation of the gilts market. The Bank have recently published articles on the monetary base, and on the gilts market. These are at Flag A; they will be on the agenda for next Wednesday, along with Gordon Pepper's own paper, and papers by the Treasury.

You might like to raise the following issues:-

- (i) Interest rates. Gordon Pepper is expecting that interest rates will fall substantially next year. The Treasury, on the other hand, supported I believe by the Governor, are not so hopeful: the post-budget forecast, which assumes expenditure cuts on the scale the Chancellor is looking for, shows interest rates continuing at Present levels, and even possibly rising a little. The Treasury arguments for this are that high rates will be needed if the Authorities are to sell enough gilts, and in order to persuade people to hold smaller monetary balances against a background of GDP in money terms growing roughly twice as fast as the money supply.

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- (ii) EMS. The Governor will of course be aware that we are reviewing our position on the exchange rate regime. He is likely to favour our joining, whereas the Chancellor has very considerable doubts because of the straightjacket which it would put us in.
- (iii) The overall economic strategy. I am sure the Governor fully supports the Chancellor's efforts to get expenditure back to 1978/79 levels in 1980/81 - though he will probably not be aware of the precise amount that the Chancellor is looking for. You might ask what will be the consequences of not achieving substantial cuts. Is it possible, as even Mr. Nott has argued, that - because sterling is now a "petro-currency" - we could live with a slightly higher PSBR, and still achieve our monetary and other objectives?
- (iv) Asset disposals. How will the Markets react if we sell up, say, £600 m of BP shares in the autumn?
- (v) The effectiveness of the "corset". Gordon Pepper argues that it is both ineffective in holding back Bank lending to the private sector, and that it also distorts the financial system.

One point which the Governor may raise with you is the Stock Exchange's request for exemption from the Restrictive Trade Practices Legislation. This was refused by the Labour Administration, and the Director General of Fair Trading has referred the Stock Exchange Agreement to the Restrictive Practices Court.

/ Mr. Goodison

Mr. Goodison has now applied again to be exempted; and I believe he has the Governor's support. Mr. Nott has so far taken the view - which you have endorsed - that it would be hard to justify not having the Stock Exchange investigated by the Court. The Chancellor, however, has argued that it would be better if there were to be an Inquiry by some other body.

The Chancellor and Mr. Nott are due to discuss the matter shortly. If the Governor does raise it, I suggest it would be best for you to be non-committal.

As background to the meeting, you may wish to glance at my record of your two meetings with Gordon Pepper since the Election (Flag B).

RL
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12 July, 1979.