

1. MR MIDDLETON
2. CHANCELLOR

cc Financial Secretary
Sir D Wass
Sir K Couzens
Mr Burns
Mr Britton
Mr Lavelle
Mr Turnbull

MLR REDUCTION

You asked for reactions to the possibility of a reduction in MLR in the period before the Budget. A reduction would of course be helpful to the company sector and also, marginally, restrain the tendency of the exchange rate to rise.

2. A possible time would be soon after the provisional monetary figures for banking January are published on Tuesday, 10 February.

3. However, a reduction in MLR then does not seem either desirable or likely to be well understood and received by the market. If the January $\pounds 3$ figure is of the order of 1%, the annual growth rate of adjusted $\pounds 3$ over the target period would be about 19% over the last 11 months, 16% over the last 6 months and 15% over the last 3 months. There has been some deceleration, though it has not been as fast as the Treasury's September statement or your statement of 24 November were taken to suggest. Even in the latest 3 months we have not got the growth rate down to the mid-point of the current target or of the target likely to be set for 1981/82.

4. The November reduction of 2% in MLR was not well received by the gilts market. But even on the assumption that a reduction in MLR would now have a favourable effect, a reduction in order to sell debt in banking February does not at present seem necessary. Nearly half the convertible short was applied for on Wednesday; prices rose on Thursday and again today and $\pounds 150$ million more of it has been sold. In addition $\pounds 70$ million of the low coupon stock has been sold today. The Bank are reasonably confident that they will be able to make sales of the long tap during the rest of the banking month.

S E C R E T

5. Finally, the market might be puzzled by a further reduction in MLR, and hence relaxation in the monetary stance, before the Budget has established that the 1981/82 PSBR will be substantially lower than this year's. Without that there is not much prospect of keeping within a respectable monetary target with lower interest rates. Effective fiscal measures and slower monetary growth both seem desirable before a further reduction in MLR is made. It would also be greatly preferable to have reached a decision on monetary control and on the new monetary target before making such a move.



N MONCK

30 January 1981