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Treasury Chambers, Parliament Street, SW1P 3AG
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PRIME MINISTER

MONETARY SITUATION

I mentioned to you last week that we might be faced with the choice of letting the Banks raise their base rates, or intervening to ease pressure on their liquidity. Two of the clearing banks have told the Bank that, in the absence of such intervention, they will have to raise their base rates to-morrow by 2 per cent: we would then have little option but to follow with MLR on Thursday.

2. I have discussed this with the Governor and we are agreed that the right thing is to intervene in order to avoid the rise in bank rates. This will involve entering into purchase and resale agreements with the clearing banks for some £500 million of the gilts held by them. It will need to be made public - so that it can affect money market rates before noon to-morrow. This will be done in as low key as possible. The inference which we will want to be drawn is that the authorities consider that interest rates should not change before the Budget.

3. One clear implication of this action will be to put a greater onus on the Government to take fiscal action in the Budget which will help with the control of the money supply. But I think that it is right to accept that.

/4. There are also

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CHANCELLOR OF THE EXCHEQUER

4. There are also risks involved - there may well be criticism that we are backing away from allowing our policies to be carried through to the point at which they take effect. The advocates of monetary base control, and other means of giving the market a greater say in interest rates, will claim this is another example of the authorities mis-using the discretion they have under the present system. This criticism will be heightened if other events in the next six weeks mean that we cannot hold interest rates - we cannot be certain that we shall succeed either over the February make-up day or later.

5. I consider that we should take these risks and answer the criticism, if it arises, by saying explicitly, if necessary, that monetary control depends on a combination of fiscal policy and interest rates, and that at this stage and close before the Budget, it is right to decide on the two together, rather than to pre-judge now the balance to be struck between them. Moreover, we can point out that now, in contrast to earlier, the other monetary aggregates appear to be growing less quickly than Sterling M3.

6. Perhaps we can have a word before 9 a.m. to-morrow if you have any points to raise.

7. I am sending a copy of this minute to the Governor.

Approved by the Prime Minister.
13/2/1980.
T.G.

(G.H.)
12th February 1980

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