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PRIME MINISTER

THE GILT MARKET

Gordon Pepper and other men in the City have urged me to say that the fall in gilt edged securities is a vote of confidence, not no confidence, in you and your policies. It reflects a fear that you may lose control of the Government. This would be regarded as a major disaster in the City.

6 April 1982


ALAN WALTERS

SECRET

Prime Minister

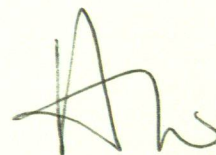
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PRIME MINISTER

11/15 6/4

MONETARY POLICY AND THE FALKLANDS

1. The Falklands incident has the inevitable effects on the exchange rate and the price of securities. Markets reflect these uncertainties, and primarily uncertainties of a political nature. Once it is again clear that you have tight control on government, then the markets are likely to come back.
2. It is of the utmost importance that we do not react to these politically-inspired moves of the exchange rate and security prices. In particular, we should not increase our interest rates sharply in an attempt to "defend sterling". Increased interest rates would not ease political anxieties, indeed they would exacerbate them by creating economic and political strains in that environment. However, holding our monetary aggregates, we should allow the interest rates to reflect the natural pressures on the yield curve generated by the market. This is the way the "new arrangements" should work - and in practice they have worked quite well in the past strains. The initiative should be with the market and not the Authorities.
3. All the other monetary signals are propitious. The inflation rate is coming down quite quickly. The monetary aggregates, and in particular the monetary base and M1, are well under control. No doubt when the March figures are published they will be a steadying effect on the market.
4. I have spoken to Peter Middleton and he agrees that this is the best approach. Both of us are rather afraid that pressure from the Bank and other parts of the Treasury may induce an over-reaction. I thought therefore I should warn you in advance.
5. I shall be away from London for about two weeks. But if you need me I can be back with 48 hours notice.



ALAN WALTERS

6 April 1982

SECRET