CONFIDENTIAL

Addressed to the Governor's Private Secretary

Copies to the Deputy Governor
Mr Fforde
Mr Dow
Mr George
Mr Coleby
Mr Goodhart
Mr Walker
Mr Quinn

JB

10 DOWNING STREET

From the Private Secretary

3 July 1980

Dear Tim,

As you know, the Chancellor and the Governor called on the Prime Minister at 0900 hours this morning and they decided that MLR should be reduced today by 1%. This is simply to record the basis of their decision.

The Governor said that, since the meeting with the Prime Minister on Monday, new information had emerged on the banking figures for June which was less favourable than he had then indicated. Instead of M3 increasing 0.5%, it now seemed likely that it would have increased by 0.7%. Bank lending was estimated at £410 million rather than £270 million, though the bill leak was somewhat lower than had earlier been estimated. Given these figures, M3 since February would show an increase of 11.2% at an annual rate, which was just outside the target range. This made him more doubtful about the wisdom of reducing MLR at all. Indeed, the money supply figures on their own would scarcely justify a reduction and the new Bank forecasts due the following week could well reinforce his doubts. Bank lending did appear to be moving down as the recession deepened. But the case for a reduction now, rather than waiting for some further improvement in the money supply figures, was that the pressure on the corporate sector caused by high interest rates and the high exchange rate had become too great and needed to be moderated. (If there was to be an early move, it ought to be today: a reduction next week might appear to be in response to the Cabinet discussion on strategy.) A further factor in favour of a reduction was that Barclay's were considering the possibility of reducing their Base Rate. If this happened, and all the more so if the other clearers followed, the authorities would look very stubborn if MLR were held at 17%. Provided he could be sure that Government expenditure was not going to get out of control, it might still be worth taking the risk of reducing MLR by 1%. If it were decided to move, it was essential that the presentation should be got right: the Government must rebut any criticism that it was backing away from the strategy and emphasise that MLR was being reduced by a modest amount because it believed that monetary growth was coming back within the target range.

The Prime Minister and the Chancellor said that on balance they believed it was right to go for the 1% reduction proposed, in spite of the risks involved.

There was a short discussion of a draft press statement - which was subsequently amended in discussion between yourself, myself and the Bank, with the Chancellor's approval.

JB a.m. 7/7.

I am sending a copy of this letter to John Beverly (Bank of England).

Yours ever
Tim Lankester.

A.J. Wiggins, Esq.,
H.M. Treasury.

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