cc Mr. Whitmore

cc Econ Pol, Disposal of Assets
Euro Pol, EMS
Master

NOTE OF A MEETING BETWEEN THE PRIME MINISTER AND THE GOVERNOR OF THE BANK OF ENGLAND ON FRIDAY 13 JULY 1979 AT 1630 HOURS

The following are the main points which came up when the Governor called on the Prime Minister:

I. EMS

The Prime Minister commented that, had the UK joined the Exchange Rate Regime, we would have been forced to change sterling parity in relation to the grid. The Governor said that this was not necessarily the case. There would certainly have been upward pressure against sterling's maximum limit; on the other hand, this pressure might have been limited to some extent by the fact that market operators would have thought it unlikely that sterling's parity would have moved so soon. On the other hand he thought that against the current background of turbulence in the exchange markets, which was likely to continue for a while, it was best that the UK had not joined the Regime.

II. June Banking Figures

The Prime Minister commented that the June figures were even worse than the Governor had predicted at the meeting on the mortgage rate the previous week. The Governor said that this was so - including the "acceptance leak", lending to the private sector had been £1,250 million against £1,200 million which he had forecast. The high figure seemed to be due primarily to the June spending spree, which was now reflected in the provisional retail figures. The Prime Minister said that she continued to be concerned about the stock relief provisions, which tended to exaggerate the need for working capital since there was an incentive for businesses to build up their industries; she was also concerned about the tax provisions on leasing which also stimulated bank lending. The Governor replied that the leasing provisions did encourage investment; however, he understood that the Inland Revenue were looking at them.

III. Interest Rates

The Prime Minister said that she was worried at the prospect of interest rates having to stay high, though she fully accepted that - while the banking figures continued bad - there was no alternative. The Governor commented that the future level of

/ interest rates

interest rates depended very much on what happened to wages. If wage inflation accelerated, interest rates would inevitably stay high. In addition, interest rates in other countries were moving up. The Germans had just announced a 1% increase in their discount rate, even though Dr. Emminger had been implored - at the recent Central Bankers meeting in Basle - to avoid this. The Dutch and the Belgians had been obliged to follow. The Germans were clearly trying to fight inflation by keeping the DM up.

IV. The U.S.

The Governor said that the US economy was almost bound to go into recession after four years of rapid growth and with inflation slowing the economy down. Inflation over the last six months was running at an annual rate of 14% - this was partly due to the oil price increase, but food prices were also rising rapidly partly because of fears about the Russian harvest. It was uncertain what the Administration would do. With the election coming up, they would be under pressure to reflate and relax interest rates. But if they did, the dollar would certainly slide.

V. Gilts

The Governor said that the authorities had sold sufficient gilts to cover the Government's financing needs up to the end of August; but it would be important to make further substantial sales so as to bring in funds in September. A new short tap was being issue that day; it would be for decision the following week whether a new long tap should be issued.

VI. Sale of BP Shares

The Prime Minister said that she had stopped the sale of the BP shares in July. The alternative options needed to be considered more carefully, and in any case a sale later in the year might well produce larger proceeds. She had also been concerned that the Treasury were pressing to sell in New York and Frankfurt as well as in London. For political reasons, even though foreigners might buy in the secondary market, it was important to limit the sale to London. One further consideration was that the Lords' decision on Burmah might go against the Government. (The Governor commented that a final decision on Burmah could not be expected until October 1980.) One alternative to selling off BP shares was for

BNOC's assets to be sold virtually in their entirety. This was being considered. Asked whether the sale of BP shares to the institutions would be additional to their purchase of gilts, the Governor replied that there would be some substitution, but on the whole, purchases should be additional.

R.

16 July 1979