10 DOWNING STREET

*From the Private Secretary*

10 March 1980

Copies to the Deputy Governor
Mr Fforde
Mr Dow
Mr Loehnis
Mr George
Mr Goodhart
Mr Cairncross
Mr Walker

Dear John.

As you know, the Prime Minister held a meeting on Friday evening to discuss the proposed medium-term financial strategy. The following were present: the Chancellor, the Governor, Sir Douglas Wass and Sir Robert Armstrong. They had before them a revised version of the draft which the Chancellor had sent under cover of his minute of 20 February.

The Governor said that he and his staff had had valuable discussions with the Treasury over the past 10 days, and as a result the draft had been softened and the targets made less rigid. But he still had serious misgivings about the whole exercise. He appreciated the object of the strategy - namely, the desire to show a path through the difficulties ahead and to demonstrate that the Government is committed to the policies necessary to overcome them. Yet the case presented in the latest draft was still less than persuasive. The assumption of 1 per cent per annum of growth would disappoint those who were hoping for a more dynamic economy from the Government's policies; and although the assumption might be no more than realistic, by publishing it in this way the Government would be seen as taking responsibility for continued slow growth. This was, admittedly, to a large extent, a political point. On the other hand, the Chancellor's proposals did affect his own task. Monetary policy had to be defensible. It was hard enough to set a monetary target for one year ahead: it was much harder for a four year period. Even with a target range, there was still in his view too much rigidity in the figures. He was concerned at the prospect that wages might not accommodate to the declining monetary path; and that if they did not, the pressure on interest rates and activity might well be intolerable. The Government was finding it hard enough to stay within the existing one year target. It would be better for Ministers not to commit themselves to targets for the later years until they had a clearer idea of how wages were going to respond. The Government had already made clear its strong commitment to getting the rate of monetary expansion down: to publish medium-term targets would add little to this commitment.

/In a brief

In a brief discussion, the following points were made:

(i) whether or not the Treasury published medium-term monetary targets, it would almost certainly be obliged to reveal its assumptions about real growth in the context of the public expenditure White Paper. It was better to be cautious than repeat the unfounded optimism of the previous government;

(ii) there were risks in publishing a medium-term strategy. On the other hand, if it were not published, the Government would be seen as lacking confidence in its own basic approach. There was in any case no real alternative to pursuing the path of monetary deceleration shown in the draft. At the same time, the target figures would be reviewed annually;

(iii) the publication of medium-term targets and plans, including the figures for fiscal adjustment in later years, would greatly help the presentation of this year's Budget.

Summing up, the Prime Minister said that she understood the Governor's misgivings. But she and the Chancellor were convinced that it would be right to publish medium-term targets on the lines of the draft; she hoped that the Governor would be able to live with this. The draft itself ought to be looked at again - particularly paragraph 9 - before being finalised.

The Prime Minister confirmed that she would like the Chancellor's proposals to be endorsed by Cabinet, and asked him to circulate a paper in time for Cabinet this week. Contrary to my earlier advice, she does not want there to be an accompanying presentation by Sir Kenneth Berrill and Mr. Terry Burns.

I am sending a copy of this letter to David Wright (Cabinet Office), and to John Barratt (Bank of England).

Yours ever.

Tim Lankester.

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