



10 DOWNING STREET

From the Private Secretary

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SIR D. WASS
SIR L. AIREY
SIR K. COUZENS
MR LITTLER
8 November 1979
MR BRIDGEMAN
MR MIDDLETON
MR UNWIN
MR RIDLEY

Dear Tom,

When they met this morning, the Prime Minister and the Chancellor of the Exchequer discussed latest monetary developments. They had before them the Chancellor's minute of 7 November.

The Prime Minister said that she was not convinced that a further increase in MLR next week would bring the money supply under control. It would also, of course, create political problems. It seemed to her that existing policy levers were no longer working; in particular, an increase in interest rates of even several percentage points was unlikely to choke off lending to the private sector. Her own impression was that the demand for credit was continuing at a very high level, and that the banks were all too willing to provide it. There was the further difficulty that any increase in interest rates would tend to put upward pressure on the exchange rate; and with its worsening liquidity position, this could cause problems for industry.

The Prime Minister went on to say that alternative ways of bringing credit creation to the private sector under control should be examined with the utmost urgency. She understood that the work on monetary base control was still proceeding; this should be speeded up. Other possibilities, such as putting direct pressure on the banks, tightening their reserve asset ratios and even imposing higher taxes on their profits, should be examined. It was essential, in her view, to devise new measures of control - preferably as a substitute for a further rise in interest rates.

The Chancellor said that he too was most unhappy at the prospect of having to raise MLR. But he did not think there was any alternative. On the other hand, he shared the Prime Minister's concern about the inadequacy of the existing policy levers, and had asked that alternatives should be examined. If there were to be any changes on the existing set up, it was important that decisions should be reached in a considered manner; otherwise, there was the risk that we would move in the wrong direction. Logically, there was a case for abolishing the "corset" forthwith since it was now largely ineffective; but there were practical and political arguments for keeping it in place until an alternative system had been devised. The Chancellor went on to say that the major priority must be to make sure that next month's figures were much improved, and he agreed therefore that urgency was of the essence.

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Turning to the borrowing requirement for this year, the Prime Minister said that renewed efforts must be made to reduce it. She agreed with the Chancellor that a new fiscal package should be ruled out; but there was a case for going harder on sales of assets, and also for reducing the borrowing of the nationalised industries. As regards the latter, she wondered whether new steps could not be taken to recover some of the lost revenue caused by the telephone billing dispute: could not subscribers be given a small discount on their bills if they paid early? The Chancellor commented that on practical grounds, he did not think assets sales could be pursued much further during the current financial year; and in any case, any further sales would not be all that helpful for the money supply because they would be - to some extent - substitutes for sales of gilts.

In conclusion, the Prime Minister re-emphasised that alternative options to a further increase in MLR should be examined very urgently. She would meet the Chancellor, the Chief Secretary, the Financial Secretary, the Secretary of State for Trade, the Governor and senior officials tomorrow to discuss the position further.

I am sending a copy of this letter to John Beverly (Bank of England). I will also be giving a copy of this letter personally to the Secretary of State for Trade.

Law *en.*

The Labour.

A.M.W. Battishill, Esq.,
H.M. Treasury.

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