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SECRET AND PERSONAL

CHANCELLOR

c Mr Unwin

BRIEFING FOR 15 NOVEMBER STATEMENT

1. I attach as much of the briefing as we have been able to get typed this evening. The material is still subject to final revision as it has had to be drafted without a final version of the statement being ready. You may nevertheless find it useful to have to clear your mind for tomorrow.

2. A final full set of briefs will be submitted to you, and copied to your Treasury colleagues and No. 10, early tomorrow morning. A list of the briefing is attached as an annex to this note.

3. We shall be submitting separately in the morning a briefing note on points to make in response to the kind of suggestions put forward by Mr Healey in his "World at One" interview on 12 November. (Mr Hall's note of today refers.)

M J Folger CU
14.11.79

CODE 18-77

SECRET AND PERSONAL

- ANNEX

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Brief		Subject
A	1.	Recent monetary developments
	2.	Monetary target
	3.	Interest rates (including implications for Building Societies)
	4.	SSD scheme and monetary control techniques
B		National Savings
C		Advancing collections of PRT
D		PSBR for 1979-80
E		PSBR and public expenditure for 1980-81
F		Effects on industry, GDP and employment
G		Prospects for tax cuts
H		Public Expenditure White Paper on the later years
J		Medium term financial plan
K		Exchange control and the monetary position

A1 RECENT MONETARY DEVELOPMENTS

factual

1. £M3 grew by 2% in banking October (figures published 2.30 pm today). Bank lending was main expansionary factor (increased by £1¼ billion).

2. In four months since mid-June, £M3 grown at annual rate of just over 14% (14.2%), ie above 7-11% target range. If allowance made for take-up of acceptancesoutside banking sector, underlying growth somewhat higher.

3. Details of recent developments in Annex.

positive

1. Latest figures suggest taking longer than hoped to bring down money supply growth from rate inherited but Government determined to bring back within target range.

2. Excess growth largely due to sustained rapid growth of bank lending and high PSBR in first half of year.

3. Can expect some slowing in £M3 growth. Budget measures reducing the PSBR will take effect in second half of the year. Further reduction from bringing forward PRT due date. Bank lending growth should moderate with lower activity, and interest rate increases.

defensive

1. Banking October:

(i) Banking October figures swollen by a number of distortions to normal financial flows.

(ii) CGBR in banking October affected by timing of receipts from higher rate of VAT; expected low £M3 growth meant no receipts from part paid gilts were planned.

(iii) High demand for credit in banking October following small rise in banking September. Special factors operating

other way and tending to increase lending in October, eg ending of engineering strike; also impact of tax rebates on companies' cash flow.

(iv) Outflows from non-bank private sector, as in other recent months. Probably associated with exchange control relaxations.

(v) M1 growth substantial (3.4%) but rise in interest bearing sight deposits accounted for much of it; possibly associated with funds awaiting longer term investment.

2. Government borrowing: Has been running at high level; impact on receipts of Budget tax rebates in large part taken effect. But in second half of year expect asset sales, receipts from higher rate of VAT, partial recovery by Post Office of arrears, and benefit of bringing forward PRT due date.

3. Bank lending: Remained strong since beginning of year (increased about £700 million in last 3 months). Affected in some months by special factors, but expect increases to moderate not least as a result of higher interest rates and lower activity. But timing difficult to predict.

4. Acceptances: Recognise underlying growth in bank-type credit understated by published figures. Substantial take-up of acceptances outside banking sector (£1.1bn in last 5 months). A side effect of SSD scheme (see separate brief). Action to prevent leakage would be counterproductive - force credit into more damaging and hidden channels.

5. Debt sales: Substantial sales until recent weeks. Sales affected by market uncertainties but also lack of part payments in anticipation of low £M3 growth and substantial redemptions and buying in of next maturities.

6. Exchange control abolition: Net effect on monetary growth difficult to assess but likely to be small this year (see separate brief).

RECENT MONETARY DEVELOPMENTS

I. Monetary Growth

	Banking October	£bn seasonally adjusted Banking July - Banking October (4 months)
CGBR	0.94	3.65
Purchases of central government debt by non bank private sector (increase:-)	+0.04	-2.02
Other public sector	-0.62	-0.18
Sterling bank lending to: private sector	1.24	2.48
overseas	-0.03	0.05
DCE	1.57	3.98
External and foreign currency finance adjustment	-0.40	-1.28
Net non deposit liabilities etc.	-0.09	-0.31
£M3	1.08	2.39
%	2.0	4.5

II. Cumulative £M3 growth (at an annual rate in target period)

banking months %

Target	August	September	October
7-11% (annual rate)	11.6	10.3	14.2

III. Bank lending and acceptances

£bn

	July	August	September	October
Bank lending	0.4	0.7	0.2	1.2
Acceptances	0.1	0.3	0.2	0.2
Total	0.5	1.0	0.4	1.4

	last 6 months	last 3 months
Average bank lending to private sector, adjusted for bill leak	£900m	£920m

A2 MONETARY TARGET

Factual

1. Objective remains to keep firm monetary control with progressive reduction of target range.

2. Present target period extended: £M3 target now 7-11% (at annual rate) to apply from mid June 1979 to mid October 1980 (16 months).

3. Growth of 7-11% for whole period implies substantial deceleration over next 12 months.

4. Target to be rolled forward again in Spring.

Positive

1. Keeping £M3 growth within target vital to improving inflation and prospect for revitalisation of industry.

2. Keeping same base avoids building-in recent excess growth (ie avoids 'base drift': to rebase on October 1979 would be less restrictive since £M3 growth to mid October above target range).

3. Target allows us to offset recent rapid growth over reasonable period. Growth at middle of range (9%) over whole 16 months implies 7.4% mid October 1979 - mid October 1980.

4. Provided private sector exercises restraint in pay bargaining, expect room within target for necessary finance for industry.

Defensive

1. Lower target: To reduce target now would be unnecessarily restrictive; new target implies sharp deceleration. Still intend to reduce target in longer term.

2. Higher target: To be less restrictive would be contrary to commitment to progressive deceleration of monetary growth. An increase in inflation would be much more damaging to investment and growth.

3. Turnaround excessive: Much sharper switch achieved in 1976-77 /£M3 growth in 6 months to mid November 1976 was 15% at an annual rate; in following 6 months just 1%/.

4. Medium term targets: Chancellor considering whether to formulate more precisely longer term objectives (see separate brief on medium term financial plans).

5. Too complicated: No, simply applies to longer period. Necessary to avoid base drift.

6. Other aggregates: We monitor and take account of movements in other measures of money supply and liquidity. Additional targets would overconstrain the system. £M3 has a number of advantages as a target and is well understood by markets.

7. Exchange control makes £M3 less relevant: Not necessarily, but will monitor developments and reconsider appropriate definitions if and when necessary.

A3 INTEREST RATES (including implications for building societies)

factual

1. Bank announced at 12.30 today increase in MLR by 3% to 17% from today.

2. Bank statement also gave details of roll forward of SSD scheme and foreshadowed statement this afternoon (see separate briefs).

3. Recent interest rates developments in Annex.

positive

1. Increase confirms rises in market rates that have already taken place (in response to domestic monetary situation and rise in rates overseas), and shows Government's determination to bring money supply under control.

2. High nominal rates of interest essential, given present rate of inflation, to slow demand for credit.

3. Increase will help bring down recent rapid growth in bank lending. Reflects Government's determination to meet monetary objectives.

4. Future interest rates crucially dependent on future inflation and earnings growth. If progress in reducing inflation is slower than expected then would not hesitate to take further fiscal or monetary action required.

defensive

1. Building societies: Recent rises in market rates will inevitably put some strain on societies. If high interest rates continue, they will have to increase rates for both borrowers and savers if flow of funds for housing is to be sustained. (Money market rates now some 3% above societies' grossed up share rate of 12½%.) See separate brief for impact of national savings measures.

2. Future mortgage rates: Matter for the societies. The decisions will doubtless depend on how long higher interest rates

last, which in turn depends on progress in restraining £M3 growth and reducing inflation.

3. Lower rates: As factors boosting monetary growth fall away, should be possible to see lower interest rates. Timing of fall will depend on external and internal developments, and we will want to be sure monetary growth is under control.

4. Still higher rates: MLR rise is sufficient to meet present situation.

5. Exchange rate: Increase in interest rates needed on internal grounds. Overseas interest rates also risen, therefore may be little net impact on exchange rates. But unchecked expansion of domestic credit would have put pressure on exchange rate in longer term.

6. Industry and investment: Higher interest rates may have some impact on activity, and will add to companies' costs. But surge in rate of inflation would be more damaging to output and employment (see separate brief).

7. High interest rates inflationary: No, high rates restrain demand for credit and reduce monetary growth. This helps to reduce inflation. [For reference: increase of 1% in mortgage rate adds ¼% to RPI.]

8. U-turn: No, Government remains determined to bring money supply under control. In time, as inflation comes down and public expenditure is restrained, this should be possible with lower interest rates. 'Consistency and continuity' about policy.

INTEREST RATES: RECENT DEVELOPMENTS

1. Sterling Rates

1979	MLR	Clearing Banks' Base Rate	3 month Interbank	Gilt Yields* 5 years	10 years	20 years
25 May	12	12	11 13/16	11.4	11.9	12.2
29 June	14	14	14 1/16	12.3	12.8	12.9
27 July	14	14	14	12.4	12.3	12.3
31 Aug	14	14	14 5/16	12.1	12.3	12.4
28 Sept	14	14	14 1/8	12.2	12.3	12.6
19 Oct	14	14	14	12.6	12.9	13.0
26 Oct	14	14	14 3/4	13.5	13.6	13.5
2 Nov	14	14	14 3/4	13.3	13.5	13.4
9 Nov	14	14	15 5/8	14.8	14.5	14.3
14 Nov	14	14 +	16 1/16			

*on nearest convenient date (for 14 November, on that day)
+ except for Nat West, at 15½%

2. U.S. Rates

	3 month Eurodollar	3 month Interbank	Covered* differential
28 Sept	12 7/8	14 1/8	-
19 Oct	14 7/8	14	-7/16
26 Oct	15 13/16	14 3/4	-5/16
2 Nov	15 11/16	14 3/4	-1/4
9 Nov	15 11/16	15 5/8	+1/8
14 Nov	15	16 1/16	+ 1/16

* - indicates differential against sterling

A4 SSD SCHEME AND MONETARY CONTROL TECHNIQUES

Factual

1. SSD scheme (the 'corset') to be phased out in due course.

2. Current guideline extended to mid June 1980; allows for further growth of 1% per month in banks' interest bearing eligible liabilities (IBELs). Details announced in Bank press release at 12.30 pm.

3. Bank and Treasury to undertake consultations with those most concerned on monetary base schemes.

Positive

1. Whatever the control system, main methods of control must be policies on PSBR and interest rates. Monetary base control no substitute for this.

2. Recognise that SSD scheme has nearly outlived its usefulness, therefore to be phased out. Inappropriate in present circumstances to dismantle completely.

3. Consultations on monetary base control to assess whether it could help smooth monetary growth or bring about more readily necessary interest rate changes.

4. Directional guidance remains in force: asks banks to give priority to finance for industry and exports and, in order to ensure they can meet priority requirements, to exercise strict restraint on lending to persons, property companies, and for purely financial requirements.

Defensive

1. Distortions: Recognise SSD scheme and other direct controls encourage development of alternative channels of liquidity and credit - SSD scheme particularly encouraged take-up of acceptances outside bank sector. Also has damaging structural impact on financial sector. Hence decision to phase out scheme.

2. Adjust figures: Can only estimate total impact of distortions; preferable to remove cause.

3. Other controls distort: Depends on form of control and how they are used. No substitute for getting PSBR and interest rates right.

4. Monetary base now: Highly technical subject with wide ranging institutional implications. Hence need for consultations. Not sensible to introduce before new system fully understood and widely accepted.

5. Exchange control: Transactions abroad potentially a further loophole of SSD scheme. But high sterling interest rates bite on demand for sterling credit whatever its source. Ability to get the fundamentals right not significantly affected by abolition of exchange controls (see separate brief).

6. Guideline still too tight: Relationship between IBELs and £M3 very complex. Tightness depends, inter alia, on money market developments. But guideline growth somewhat greater than targeted £M3 growth rate. Would hope that bank lending moderates sufficiently to allow some reversal of distortions.

7. Industry squeezed: Availability of finance to industry depends on pay bargains agreed. Providing these are reasonable, room within guidelines for necessary finance to industry.

8. Restrict personal lending: Directional guidance remains in force. More direct controls would only increase distortions. Lending to persons relatively small part of total.

9. Increase HP controls: HP controls have a discriminatory impact between industries; and the net effect on credit growth would be small.

C ADVANCING COLLECTIONS OF PRT

i) factual

At present PRT is normally paid four months after the end of the 6-monthly chargeable periods. The proposal is to require, by legislation, that companies should make their payment with the return they already submit two months after the end of each chargeable period. These payments would be received at the beginning of March and September. Assessed tax is, and continues to be, due at the beginning of May and November.

ii) defensive

The proposal will bring the payments arrangements for PRT into line with those which already operate for the collection of royalties by the Department of Energy.

The proposal does not conflict with the assurances about stability of the North Sea fiscal regime. There is no change in the rate of tax, only in the arrangements for collection.

The problem on the PSBR has arisen in large part from late payment of telephone bills or of tax. It is appropriate to correct this by a measure that brings forward the timing of tax collections.

[If questioned on IMPLICATIONS FOR RECENT BP SHARE SALE: This is a general measure affecting all oil companies paying PRT. It has no special implications for BP.]

iii) positive

The effect of the change, which will be permanent, will be to increase the PRT receipts in 1979-80 by £700 million and to raise receipts for 1980-81 by £300 million. The beneficial effects will continue so long as taxable profits from the North Sea are on a rising trend.

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D PSBR for 1979-80

i) factual

The Budget forecast for the PSBR was £8¼ billion. The first estimate for the first half of the financial year will be published on 22 November. The material is not yet complete but the main component - the central government borrowing requirement has already been published. It was about £6 billion, after allowing for seasonal factors (the actual figure was about £6½ billion). The total PSBR in the half year was probably close to £6½ billion (seasonally adjusted) with an actual total near £7 billion. It was always to be expected that the bulk of the year's PSBR would lie in the first six months. But the latest evaluation is for a PSBR for the year of about £9 billion before allowing for the acceleration of PRT collection. This means about £8¼ billion after taking PRT into account.

IMPORTANT NOTE THESE FIGURES ARE NOT PRECISE AND THE SEASONAL ADJUSTMENT IS SUBJECT TO CORRECTION BEFORE 22 NOVEMBER

Factors pointing to an excess if some action were not taken included the Post Office telephone billing excess. Though bills are now going out again, recovery will not be completed in this financial year: a net excess of about £400 million is now expected this year. Secondly, local authorities have been borrowing more than was expected in June; and this is now expected to continue.

ii) defensive

The wide margins of error in any forecast of the PSBR are well known, but it would have been unsafe not to heed the evidence so far. We seemed to be heading for a figure of about £9 billion.

The acceleration of PRT collection will improve the prospective public sector cash flow by about £700 million and so lessen the borrowing needed in the remainder of this year.

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The PSBR for the current year is now estimated at about £8¼ billion.

The improvements to the terms of National Savings will help to finance the PSBR in a non-inflationary way.

iii) positive

The extra receipts from the change in the PRT collection arrangements will help to ensure that the PSBR for the year as a whole is in line with the Budget forecast of £8¼ billion. We have demonstrated therefore our determination to take steps to keep borrowing under control.

E PSBR AND PUBLIC EXPENDITURE FOR 1980-81

i) factual

Government expenditure plans for 1980-81 were given in Cmnd 7746 on 1 November. They provide for stabilisation of the volume of public expenditure at the 1979-80 level.

Treasury Ministers will not wish to say anything which rules out categorically a possible further review of 1980-81 spending plans, in time for the Budget say.

It is intended to publish a forecast figure for the 1980-81 PSBR in the Industry Act forecast to be published in the next ten days or so.

The proposal to accelerate collection of PRT will itself benefit the PSBR to the tune of some £300 million next year.

ii) defensive

As indicated by the statement today the Government will be ready to adjust the fiscal balance as necessary to help secure observance of the monetary targets. We will be considering the PSBR for 1980-81 on this basis.

Apart from relatively minor adjustments, such as further savings as a consequence of the Lord President's exercise on Civil Service staff costs, there are no plans at present for further reductions in planned public spending.

A final view on the PSBR and fiscal plans for 1980-81 will be taken in next spring's Budget.

iii) positive

The 1980 Budget will be framed in the light of the monetary targets, which are of paramount importance.

As the Prime Minister has said, the Government is embarking on a sustained programme of trying to get public expenditure

down as a proportion of national income. We cannot go on spending money which the nation does not earn.

A forecast figure for the 1980-81 PSBR will be given in the Industry Act forecast to be published shortly. [IF PRESSED ON TIMING OF PUBLICATION: I must ask the House to be patient - the forecast will be published soon.]

But decisions on the PSBR and the fiscal balance will be taken later.

The proposal to accelerate collection of PRT will itself ease the PSBR position for 1980-81 by about £300 million.

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F EFFECTS ON INDUSTRY, GDP AND EMPLOYMENT

i) factual

1. Impossible to give reliable figures for impact on GDP of recent upward trend in interest rates.

2. Interest rates not necessarily the most important determinant of investment; prospect for economy generally much more important.

3. The Industry Act forecast will probably be published in the next day or so but not by 20 November, which on one interpretation is the deadline implied by the Act. It will take account of the monetary package, and will contain a figure for the 1980-81 PSBR. A garbled story about the alleged content of the draft forecast appeared in the Financial Times on 14 November. It stressed the alleged pessimism on the outlook, especially for the path of GDP.

ii) positive

1. Reduction in monetary growth and hence inflation crucial to give the right conditions for investment and revitalisation of industry.

2. The acceleration of PRT collections will benefit public sector cash flow and hence reduce need for public sector borrowing.

3. As inflation and money supply brought under control it should be possible to meet objectives with lower interest rates.

4. Financial prospects for industry depend crucially on moderation in pay negotiations. Interest rate rises should help by confirming government's unwavering commitment to reduce monetary growth.

iii) defensive

1. The Industry Act forecast will be published shortly. Meanwhile it would not be right to give a detailed account of the economic outlook. However, nearly all forecasters are expecting some fall in GDP next year. This is a cost that we must be ready to bear if inflation is to be brought under control. [IF PRESSED

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ON THE PUBLICATION DATE: I must ask the House to be patient - the forecast will be published soon.]

2. Higher interest rates damaging to Investment, Output and Jobs: Higher inflation would be much more damaging to investment, output and employment over the longer term.

3. Monetary target too tight: Provided private sector exercises restraint in pay bargaining, expect room within target for necessary finance for industry. (See brief A2 on new target.)

4. Impact on liquidity: Recognise that higher interest rates will add to burden on many companies, and liquidity already depleted following strikes, bad weather last winter, and recent cost pressures. But Government no intention of financing inflationary wage increases; companies will benefit in longer term from reduction in inflation.

5. Two Tier Interest Rates: There are objections of practice and principle to such schemes. Financial system too sophisticated; and protective for one sector would require greater restraint on others.

G PROSPECTS FOR TAX CUTS

i) factual

i. Main tax points in Chancellor's speech to Tax Reform Conference

- chances of economic and industrial recovery will certainly be improved by further pruning and re-shaping of the damaging tax structure that was inherited; but even that important task cannot be allowed to blunt the determination to keep borrowing down and the money supply under control

- certainly hope to be able in the years ahead to make further cuts in the basic rate of income tax

- also want to bring further relief to those at the bottom of the income tax scale, by raising the thresholds

- and to make improvements in company taxation

- but must have regard to the constraints imposed by the combination of low growth and in-built public spending.

ii. Chancellor's intentions for the next (and subsequent) Budgets

We recommend against being drawn into any discussion of prospects for tax adjustments in 1980 and the medium term, or of timing and form of specific tax changes that might be introduced. Budget fiscal policy will have to be consistent with the overriding need to contain monetary growth.

iii. Tax reductions expensive - for example:
- 1p off basic rate: over £500m (full year)
- £100 on basic personal allowances: over £700m (full year)

ii) positive

i. Much already achieved.

3p off basic rate. Allowances increased by double the amount needed to keep up with inflation. Substantial cuts in higher rates - threshold up from £8,000 to £10,000, 60% maximum on earned income. Aim has been to improve incentives, reward hard work, responsibility and success. Direc tax reduced by £4,300m in full year.

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ii. Long-term objectives unchanged

Budget cuts in income tax only a first step. Objective remains 25% basic rate and to raise thresholds as high as possible. Need for a simpler and less oppressive system of capital taxation.

iii) defensive

i. Burden of tax to be increased in next Budget?

Determined to cut burden of income tax further. Too early to be specific about scope for action. Tax Reform speech said: "No Chancellor at this time could encourage over-generous expectations."

ii. Thresholds?

As outlined in Tax Reform speech, there is a strong case for raising thresholds - best way of widening gap between those in and those out of work and improving incentive to work.

iii. 1977 Finance Act indexation?

Action on thresholds will naturally be a major priority. [Recommend - avoid specific commitment to raise thresholds in line with 1979 price inflation (ie 17% plus).]

iv. Specific duties

To be considered in usual way in framing Budget.

v. VAT

No intention of going back on commitment not to raise 15% rate ceiling.

vi. Why consider cuts in capital taxes, when no more being done on income tax?

Income tax was given priority this year - bulk of the benefit went to helping those liable at basic or reduced rate. Right to review capital taxes as the second stage.

vii. Reliefs/exemptions/mortgage interest relief ceilings etc

Will all be considered in usual way in framing Budget judgement. No question of withdrawing mortgage interest relief.

H PUBLIC EXPENDITURE WHITE PAPER ON THE LATER YEARS

i) factual

(a) Date of publication

It has been the general practice recently to publish a White Paper in January giving details of public expenditure plans for a five year period. In the Press Conference held on publication of Cmnd 7746 on 1 November Treasury Ministers said that a White Paper on the years to 1983-84 would be published at around "the turn of the year". In his statement to the House the Chief Secretary said simply that plans for later years would appear in a "subsequent" White Paper. The intention to publish in January, or indeed whether to publish at all, is being reviewed by Treasury Ministers. Therefore for the moment as little as possible should be said publicly about the publication date: neither to give a stronger commitment on January nor to give rise to speculation about delay or cancellation.

(b) Economic content

Treasury Ministers warned at the Press Conference on 1 November that the White Paper on the later years might not contain all the detailed "futurology" that was in recent White Papers. Treasury Ministers are reviewing the economic content of the next White Paper. Therefore little should be said, neither to imply that there will be a detailed forecast of revenue etc nor to suggest that decisions on expenditure are proving difficult for Cabinet to reach.

ii) defensive

By presenting Cmnd 7746 on public expenditure for 1980-81 the Government has already provided a basis for planning for next year. Plans for later years will be announced later. [IF PRESSED ON PRECISE PUBLICATION DATE: There is nothing to add at this stage to what the Chief Secretary said in his statement to the House on Cmnd 7746.] [IF PRESSED ON ECONOMIC CONTENT: We shall be considering the details of the next White Paper in due course.]

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iii) positive

Spending plans for the years after 1980-81 will be announced later. Public expenditure in the years ahead will be consistent with the observance of monetary targets. As the Prime Minister has said, we must try to get public expenditure down as a proportion of national income. We cannot go on spending money which the nation does not earn.

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MEDIUM TERM FINANCIAL PLAN

i) factual

The Chancellor has said in the House that he is considering whether there would be advantage in adopting and publishing a medium term financial plan. Such a plan would contain specific medium term commitments on the progressive reduction of the rate of growth of the money supply. It could also contain supporting data, such as revenue and expenditure projections.

ii) defensive

A medium term financial plan could be helpful in further demonstrating that the government is absolutely determined to control inflation. But, as the Chancellor said in the House on 8 November, this is not the only argument to be taken into account. It would not be right to rush a decision on this important matter.

iii) positive

The government has already given a firm commitment to reduction of the rate of growth of the money supply. The announcement of a tight monetary target for next year and the measures adopted to help meet it are further moves in discharging that commitment. The Government will remain ready to adopt whatever measures prove necessary to secure observance of the monetary target.

K EXCHANGE CONTROL AND THE MONETARY POSITION

i) <u>factual/positive</u>

1. Abolition of controls removed an artificial distortion of capital markets which discriminated against private investment overseas.

2. Domestic monetary implications complex, and have been somewhat overplayed. An outflow from the UK private sector would put <u>downward</u> pressure on money supply whereas our present problem is <u>excessive</u> monetary growth.

3. Net effect likely to be spread over months or even years. Net effect this year likely to be small, and could go either way.

ii) <u>defensive</u>

1. <u>Detailed effects</u>: Contractionary impact as private sector seeks investment opportunities abroad. But offset if bank borrowing increased to finance overseas investment or repayment of foreign currency debt; and foreign assets may be purchased at expense of gilts. Net impact will also depend on size and nature of offsetting inflows.

2. <u>Domestic economy exposed</u>: Abolition does mean we are more sensitive to developments overseas. But recent increases in overseas interest rates, especially in US, have been so dramatic that a UK response would have been necessary regardless.

3. <u>Domestic Monetary Control</u>: Abolition weakens SSD scheme (see separate brief). But as always the key things are an appropriate fiscal policy and the right level of interest rates. We remain determined to get these fundamentals right and our ability to do so not significantly affected by abolition. Higher sterling interest rates bite on demand for sterling credit whatever its source.