Prime Minister

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PRIME MINISTER

Cecil Parkinson recently attended a meeting of the British Overseas Trade Board at which there was a discussion on the effect of the exchange rate, domestic inflation and interest rates on price competitiveness and exports. Subsequently the BOTB Chairman sent the Minister the attached written note of the main points.

The Board includes a good cross section of leading industrialists, covering a wide range of business interests. Their reservations and comments were made against a background of support for the Government but they were concerned for the future of their own businesses. It was noticeable that the two "city" representatives, Sir Francis Sandilands (Commercial Union and Chairman of the Committee on Invisible Exports) and Guy Huntrods of Lloyds Bank International were a good deal less critical of our financial policies that were those representing the manufacturing sector.

Needless to say Cecil Parkinson defended our policies vigorously. His arguments were noted and he elicited a general - if grudging - support of those policies.

At the request of Lord Limerick, the Chairman of the BOTB, I am bringing their thoughts to your attention since this Board exists to advise the Government on our trade policies.

I am sending a copy of this minute to E Committee colleagues and Sir Robert Armstrong.

J N

Department of Trade
1 Victoria Street
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30 June 1980

MINISTER FOR TRADE

THE EFFECT OF THE EXCHANGE RATE, DOMESTIC INFLATION AND INTEREST RATES ON PRICE COMPETITIVENESS

The discussion at Tuesday's well-attended BOTB meeting seemed to me to be of such importance and to reveal such unanimity that I should let you have a short note right away of the main points which emerged.

2 First, Board members pointed out the improved May trade figures did not reflect the very serious underlying position facing exporters of manufactured goods. They felt that this problem had significantly deteriorated over the past few weeks and would show up in the trade figures later this year and early next year. The combination of high interest rates, high domestic inflation, and a strong currency, has undermined the price competitiveness of our exports and many exporters have managed to maintain export volume and market shares only by absorbing increased costs to the extent that much current export business is no longer profitable - and some of it is loss-making. This means that too many companies are simply not generating sufficient cash-flow to enable them to maintain current levels of activity, still less to keep up r and d and product development programmes. We must, therefore, expect to see a decline in export volumes in the near future, with more serious long term implications.

3 Second, Board members are now finding that the continuing and vital task of reducing costs at the required speed can be achieved only by negative means, such as plant closures and redundancies. Further steps along the positive route of improved working practices and greater investment as a means of raising productivity could not take effect quickly enough, or over a large enough area, to deal with the scale of the present problem and the speed at which the situation is deteriorating. Present interest rates are so high as to inhibit future investment so that firms are not re-equipping for the market conditions in the next decade. In the shorter term, Board members are worried that the volume of redundancies which manufacturers are being forced to plan will have serious social and political implications, perhaps beyond what any Government can tolerate.

4 Third, it was recognised that wage elements are a key to the inflationary spiral. Board members therefore felt let down by excessive wage settlements in many nationalised industries, often unrelated to productivity, which undermined the efforts of private employers to achieve real wage settlements

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below the rate of inflation. The public sector - particularly the nationalised industries - had to be seen to be subject to the same harsh medicine as the private sector.

5 Fourth, there was general belief that the exchange rate is intimately linked to interest rates, so that needed relief from lowering the latter would very quickly bring a more competitive exchange rate. It was felt likely that a substantial and increasing element of bank lending is now financing unsaleable stocks and trading losses.

6 However, the position was not entirely one of gloom. The assessment of the representatives of the invisible sector was that the combination of a strong exchange rate, high inflation and high interest rates was not having so bad an effect on our total invisible exports as it was on visible exports. Even so, there are pockets within the invisible sector where this combination is similarly adverse, for example, tourism, and on the ability of our consultants to win overseas business.

7 I realise that my Board members were outspoken on Tuesday, but I think this only emphasised that they were speaking with sincerity about pressing problems. They are men of standing and experience in their different fields and with good contacts across industry and commerce. I would sum up their position in this way. They feel themselves representative of business and commercial thinking which continues to support the Government's broad approach to grappling with deep-seated problems, notably bringing down inflation in the short term and changing attitudes in the medium term. Their concern to see the Government's policy succeed was apparent.

8 Board members do however foresee that to continue with interest rates at or approaching current levels will badly damage substantial sectors of British manufacturing industry, and consequently they believe that this particular policy is now doing more harm than good. Against a bleak outlook for world trade, much of the resultant job loss could well be permanent. The discussion brought out the urgent hope that an opportunity for easing interest rates will shortly arise with the anticipated turndown in the published rate of inflation. Such action could have an important psychological impact in maintaining the support and confidence of businessmen as well as providing a modest easing of the formidable problems they face.

for LIMERICK
19 June 1980

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