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Subject



bc Walters  
Wolfson  
Sir R. Armstrong

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From the Private Secretary

19 February 1981

The Prime Minister held a meeting yesterday evening with the Chancellor of the Exchequer and the Governor to discuss short term interest rates. Mr. Middleton and Mr. Walters were also present. They had before them the paper which you circulated with your letter of 17 February.

It was agreed that it would be a mistake to reduce MLR today. If there was to be a reduction, it should now not take place until the Budget. In reaching this conclusion, it was argued firstly that it would be difficult to rationalise in advance of the monetary and fiscal decisions to be announced in the Budget. In particular, it would be easier to justify a reduction when the Chancellor had made his substantial revenue raising proposals. Also, more time was needed to construct a convincing rationale. Second, the PSBR for the first three quarters of 1981/82 would be announced today (Thursday) at a figure of over £13 billion, and this was likely to be badly received by the market. Third, the exchange rate had not appreciated as much as might have been feared after the publication of the trade figures.

It was generally agreed that some reduction in MLR on Budget Day would be desirable, although a final decision could not be taken until nearer the time. The Prime Minister expressed the view that a 1 per cent reduction - though no more than that - should be feasible. It was also agreed that, as the Governor had argued at the meeting on 11 February, any reduction would have to be justified by a number of factors - including the state of the real economy, the exchange rate and the real level of interest rates. It would not be possible to justify a reduction purely in terms of the prospects for the monetary aggregates however defined. It was going to be difficult enough to stay within the monetary target over the coming months: to reduce MLR would probably increase the risk of overshoot.

I am sending a copy of this letter to Tim Allen (Bank of England).

J. P. LANKESTER

John Wiggins, Esq.,  
HM Treasury.

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