

CHANCELLOR OF THE EXCHEQUER

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You got this the same time as  
the others - they received the usual  
mistake of leaving off originator.

cc Chief Secretary  
Financial Secretary  
Mr Burns  
Sir K Couzens  
Mr Ryrie  
Mr Monck  
Mr Britton  
Mr Riley  
Mr Turnbull  
Mrs Lomax  
Mr Unwin

## MLR IN THE BUDGET

I find the question of the right amount of the move of MLR in the Budget a very difficult one on which to advise you, certainly while the exchange <sup>rate</sup> is behaving as volatily as it is.

If the Budget were not as tough as it now is and if we were doing a little more for industry, I would want strongly to advise you to err on the side of caution and contemplate at most a 1% reduction in interest rates. The case for considering 2% now is in my view largely political. As Mr Ryrie argues, without a significant move on MLR the Budget will be greeted with dismay by the industrial lobby; indeed many of your own supporters will be pretty upset too.

But if you abstract the politics from this issue, I am not at all sure that a reduction of 2% is right or sensible. It may be the case as Mr Middleton argues that the forecasters tell us that EM3 may grow at the middle of the new target range consistently with MLR two points below its present level. But monetary forecasts like this are notoriously inexact and unreliable, and I think you would be very unwise to suppose that you could go down two percentage points without exposing yourself to the risk that you would have to reverse it at least in part during the course of the year. The recent behaviour of the monetary aggregates does not suggest to the unbiased observer that our monetary objectives are consistent with MLR at 12%, and the purists will want to know why you are so confident that you can move to that level now. The Budget speech, as drafted, is singularly unconvincing on this point

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and indeed suggests that interest rate determination now is a pretty pragmatic thing.

Then again there is the question whether an immediate reduction of 2% in MLR is conducive to the selling of gilt-edged. If the market were to conclude that this is the limit of what you can do, much of the impetus to buy gilt-edged in the wake of the Budget would disappear. Per contra a reduction of only 1%, coupled with the prospect of a further reduction if events develop favourably, could be helpful.

Finally there is the question of the exchange rate. If sterling continues to weaken in the next 7 days you may find that a 2% reduction, which would be a move ahead of the market, would generate a further slide. I am not at all sure that you would want to see this, given what has happened in the last week or two.

On balance, despite the lack of convincing intellectual reasoning, I am inclined to be on the side of those who want a 2% reduction. But my reasons are to help to secure acceptance of the Budget rather than because I think such a fall would be helpful to your monetary objectives. But if you do move by 2% we shall need to look at the presentation very carefully indeed. I have had a meeting with Mr Burns, Mr Ryrie, Mr Middleton, Mr Unwin and Mr Monck this afternoon and we are all agreed that the paragraph on MLR needs substantially to be redrafted. I would like it to be firmly linked to your monetary objectives and for some general principles to be stated about the determination of short-term interest rates in the future. Without some such framework the defence of an interest rate cut could look particularly weak under cross-examination from for instance the Select Committee and even more from some of our monetarist critics.



DOUGLAS WASS  
2 March 1981

P.S. You will see from the attached letter to me from Alan Walters that he would not go beyond a 1% reduction.



## 10 DOWNING STREET

26 February 1981

*Dear Douglas,*BUDGET

I believe the clock has now stopped on the 1981 Budget. There is nothing more to be done.

I thought you ought to know, however, that essentially I have not changed my views. I have seen neither evidence nor arguments to suggest that the present proposals are not very much a case of too little and the wrong kind. The consequences are likely to appear in crisis measures after a few months.

I suppose, however, there is still room for some decisions about MLR. As you know, with this Budget I would think it desirable not to move MLR at all, except for the fact that the markets are expecting three or even four points reduction. If, therefore, it is to be reduced at all then I think the maximum of one point reduction is in order. I think three or four would be quite disastrous.

*Yours  
Alan*

Sir Douglas Wass, GCB,  
HM Treasury.