

SUBJECT

cc Hasler

SECRET

17 <sup>cc on</sup> <sup>me</sup> <sup>vs</sup>

Copy to  
Domestic Monetary  
Board  
19/9



cc Mr. Walters

cc Euro Pol: EMS: June 79

10 DOWNING STREET

From the Private Secretary

14 September 1981

*Handwritten initials*

Dear Tim.

As you know, the Chancellor and the Governor called on the Prime Minister late this morning to discuss interest rates and the exchange rate. They were accompanied by Sir Kenneth Couzens.

The Chancellor said that towards the end of the previous week he had become increasingly concerned about the fall in the exchange rate. It had continued to fall this morning; and at noon the effective rate was 86.6, which was below its level at the time of the General Election, and the DM rate was just over 4.21. These rates compared with 98.6 and 4.66 respectively on Budget Day. He and the Governor now believed it would be appropriate to raise the undisclosed interest rate band - probably by 1½% - with a view to bringing about a 2% rise in base rates. This was partly with a view to arresting the fall in the exchange rate; but it was also justified to some extent by the domestic monetary situation. The latest money supply figures and their medium prospects, and in particular the strength of bank lending to the personal sector, were a cause for concern.

The Governor explained that sterling had been weakening for several months, but the fall against the DM had accelerated over the last few days. One reason for the decline was the widening of the interest rate differential between sterling and the dollar; another was the weakening of oil prices, which particularly favoured the DM. He supported the Chancellor's view that, on both exchange rate and domestic monetary grounds, a 2% rise in base rates was required.

The Prime Minister said that, if interest rates were to be raised at all, the increase should be sufficient to achieve a steadying of the exchange rate. She therefore agreed with the proposal that the undisclosed band should be raised so as to bring about an increase in base rates of 2%; anything less would be likely to be insufficient. The Prime Minister went on to say that recent developments on the exchange rate front raised the question once again of whether the UK should join the EMS. She hoped that the Chancellor would reconsider the options. The Chancellor said that he was already looking at this question, and he hoped to be in a position to advise the Prime Minister further before he went away later in the week.

*Annexed*

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

*Handwritten initials and signature*

John Kerr, Esq.,  
H.M. Treasury

SECRET