

Michael - I spoke to Alan
on Sunday.

Prime Minister

3 8

SECRET

PRIME MINISTER

LETTER FROM GORDON PEPPER

I have told Alan about
the seminar we are fixing for early
January; and that the Treasury will be

I think we shall have to
take action
with the Treasury Bank on

1. Gordon Pepper points out that we are in danger of repeating the writing
extraordinarily tight monetary squeeze that we imposed, albeit next week.
inadvertently, in 1979/80.

Monday. mt

MCS 4/12

2. He argues that the narrow indicators are much more reliable than
M3 as indicators of monetary stringency. He also shows that
among the wider aggregates PSL2, the most reliable of them, exhibits
some stringency, (5% annual growth in recent months).

3. Gordon Pepper's view is entirely consistent with the view I put
in my memo of 30 November, which urged you to allow the interest
rate to fall. I understand that yesterday a meeting of Treasury
Ministers and the Bank decided that a reduction in the band was not
appropriate at the present time, primarily because of the expansion
of bank lending. The statistics suggest, however, that much of this
lending is simply banks substituting for non-banking institutions.

Alan was not
invited - but
neither were
several Treasury
Ministers: the

Chancellor
wished to
keep it
small.

MCS 4/12

I believe there is an underlying reason for the Governor's
reluctance to let interest rates follow the market. I think it
arises from his opposition to the possible issue of non-restricted
indexed gilts. During September, when there was great difficulty
in selling ordinary gilt-edged, there was considerable pressure on
the part of the Treasury to issue a non-restricted gilt. I believe
that such is the Governor's opposition to such an issue, that he
would wish to keep interest rates high in order to be absolutely
certain that there would be no excuse for issuing non-restricted
indexed gilts.

5. All this suggests that the quicker we move to some form of monetary
base control the better.

Home copy of Stephens to PM
White to ch/Er

AW

4 December 1981

ALAN WALTERS

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