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PRIME MINISTER

In our Budget discussion on 22 February I undertook to let you know my eventual proposal on the 1984-85 PSBR.

2. At that time I had in mind publishing a figure in the range £7-7½ billion, consistent with a revenue-neutral Budget. I have now concluded that it would be possible to publish a figure towards the bottom of that range, probably £7.2 billion, (which will be rounded down, in the summary tables in the Red Book, to £7 billion), while keeping a margin in hand, as we both think sensible.

3. £7.2 billion will be £1 billion below the target for this year, and a more substantial reduction of this year's expected outturn, which we are still putting at around £10 billion. As a proportion of GDP the PSBR would fall from 3¼ per cent to 2¼ per cent. This should have favourable market consequences.

4. For the years further ahead I still plan to chart a more gently declining path, with the PSBR ratio falling to about 1¼ per cent by 1988-89. This would, on the expenditure totals and GDP growth rate of 2¼ per cent assumed, imply substantial room for tax cuts in subsequent budgets.

5. I should mention one further change to the presentation of the MTFs. Our initial plan, as you know, was to include M2 and PSL2 as monetary targets, subsidiary to the main targets, MO and £M3. However, M2 has recently been affected by some substantial data revisions because of changes in the terms of building society deposits. This makes its future behaviour more uncertain, and I have concluded that it would be best to confine the target ranges to MO and £M3. M2 and PSL2 will still be mentioned in the text, as aggregates to which we shall pay particular attention in interpreting the performance of the targetted aggregates, but their significance will clearly be lower than if they were target



aggregates. I myself preferred from the outset the idea of only 2 target aggregates - one broad and one narrow: I was prepared to settle for the previous formulation because it seemed likely to ensure the co-operation of the Bank. The Bank now share our increased concern about M2, and the Governor has confirmed that he is entirely content with the new formulation. I shed no tears over the change.

A handwritten signature in black ink, appearing to be 'N.L.' with a small flourish at the end.

N.L.

6 March 1984