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14 September 1982
ALAN WALTERS

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PRIME MINISTER

INTEREST RATES AND MONETARY POLICY

At today's meeting of the Bank and Treasury, there was an unprecedented degree of unanimity on the appropriate policy over the next few months. The main issue was whether there was any further room for reducing rates over the next month or so. The conclusion was that there probably was some room, but the urgency for getting interest rates down was not nearly so great as it had been over the past eight or nine months. All the monetary aggregates had increased their growth rates after the very sluggish or negative performance during the first part of the year. But in the case of the narrow aggregates they had still some way to go to get back on to the acceptable trend values. Sterling M3 was around about the middle of the target range. At the other end of the spectrum, the monetary base had been fairly flat and had yet to show convincing signs of any growth. And the exchange rate remains on the high side.

All this suggests that monetary conditions are still a little on the tight side, but we have eased considerably from the excessive stringency of the first half of the year. Real interest rates, however, are still round about 4 per cent and this also suggests that monetary conditions are by no means easy. As the inflation continues to fall, we must avoid any inadvertent increase in real interest rates.

We should, therefore, look for some reductions in interest rates when the opportunity offers. I realise it would be politically attractive if we could secure a reduction in base rates of ½ per cent or so, perhaps even into the symbolic single digit region, before the Party Conference. Even if everything goes well, however, I doubt if we should have base rates less than 9 per cent by the end of the year. (Incidentally, it may just be possible that early next year our inflation rate will drop below that of West Germany!)

The funding problem, in spite of the large amount of maturing debt late in the year, is easily manageable. And there is likely to be an increasing number of issues of industrial debentures. This will enable a much needed reconstruction of balance sheets and a removal of some of the credit from the banking system.

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It may be tempting fate to say so, but I believe our monetary policy is going along quite satisfactorily.

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