Pt 10

SECRET

Prime Minister ②

(Written before the events of late morning.)

MCS 10/2

PRIME MINISTER

MONETARY POLICY AND INTEREST RATES

Market conditions are developing much as was envisaged in my memorandum of 31 January, namely:

a. reductions in interbank rates into the low elevens and high tens, and

b. a pronounced negative slope to the interbank yield curve.

The market is clearly expecting some reduction in interest rates in the weeks ahead.

This has not been engineered by the Bank. Indeed the report of yesterday suggested that the Bank had under-supplied the market, (although this I believe is somewhat misleading). The pressure is from the market and arises from both the belief that sterling is not "vulnerable" and has absorbed the expected oil price decrease, and the wide expectation that interest rates have not ceased their fall in the United States. [I fear however that the U.S. M2 figures may offset that expectation]

I agreed with the Treasury that we should shade the yield on the national income bond in order to follow the markets rather than resist. If the market conditions persist into next week, that is after the oil price changes on Friday, then we can follow the market with lower dealing rates. One would expect them to have at least ½% off base rates before the Budget.

ALAN WALTERS
10 February 1983

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