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ALAN WALTERS

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Seen by PM
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PRIME MINISTER

INTEREST RATES

In the light of the appreciation of sterling and the persistent downward slope of the yield curve in the money markets, there is developing some pressure in the market for a reduction of interest rates. This needs to be handled carefully.

There is a powerful case politically for taking another half off base rates. This would virtually ensure that the building societies would not move on their present 10%. One would expect that it would increase the in-flow into the building societies coffers, and would go some way to restoring the imbalance between incoming money and mortgage loan operations.

But on the other hand there is no convincing monetary argument for reducing interest rates, even by another half a percentage point. Gordon Pepper's view, though ill-argued, does represent the general market sentiment. But even he would agree that a combination of somewhat lower world interest rates and rapidly appreciating sterling do create an appropriate case.

The best policy for us to follow is to be rather, but not too, reluctant to acquiesce in market pressure. Then we cannot be accused of pre-election expansions. We are simply succumbing to the pressure of the market. Above all we must make it clear that we are not pushing for lower interest rates at this stage.

There is always a risk that we shall have to tighten up later in the year. But that is not an argument for trying to hold out against market forces now.

(Tactically the Bank may wish to build up the pressure to ensure a good market for its new convertible IG - but that will be only a matter of a few days.)

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