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Prime Minister²

ALAN WALTERS

6 May 1983

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PRIME MINISTER

MONEY, INTEREST RATES AND FUNDING

The monetary aggregates for April should^{be}/interpreted as a warning signal rather than as a basis for any active policy change. The main worry is clearly the increase in the central government borrowing requirement.

While most of the unexpected increase occurred in the last week of the 1982/83 financial year, I understand that the CGBR has not slumped back again to its expected value. There are many possible explanations; tax receipts may be delayed because of the change in building society arrangements, and expenditure items may be continuing to exceed estimates. But it is much too early to say that the CGBR has become set on a more expansionary course. We must watch it carefully and analyse the components in the weeks ahead.

Another feature of the month was the expansionary effect of external items - including predominantly switches from foreign currency into sterling. These tend to be very transitory items which are usually reversed in next month's figures. They cause a lot of "noise" but give very little of a signal. It is best to play down one's interpretation of that element.

The evidence that the monetary stance is not expansionary is first the monetary base is still very well contained, and even in the month of April non interest bearing M1 showed quite a modest increase. Secondly, there is no evidence of monetary laxity to be adduced from the behaviour of the exchange rate; that if anything has been rather on the strong side. The exchange rate is consistent with the monetary base; both indicate a fairly firm monetary policy.

However, there are good reasons for not acquiescing in interest rate reductions under only moderate market pressure. And there is no indication of any substantial pressure in the money markets. I believe that the various straws in the wind, the expansionary CGBR, etc have reduced market expectations of any near term reduction in interest rates.

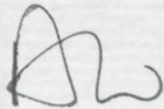
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The stepped-up funding programme for banking May is proceeding quite well. The new IG-convertible sold £400 million on tender and Eddie George thinks it is very likely that the other £600 million will go quite quickly. We managed to do this without disturbing either the IG or the conventional market. We shall probably sell about £1½ billion in banking May - that is to say £½ billion more than the original target.



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