E.R.

25 February 1985

PRIME MINISTER ②

AT 25/2

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THE DOLLAR

The dollar still shows no signs of falling, and the response to the President's statement demonstrates just how foreign exchange speculators wish to push the dollar higher. With dollar real interest rates as high as they are, with the balance of trade in the States not deteriorating for a few months, and with the US economy still strong, it's not surprising.

Our monetary policy is now tight, having been loose for too long. Whilst it would take some months to bring the money numbers back into shape, with short-term interest rates at these levels and with the funding programme and type of yield curve we have, we have done all the tightening we need do. It would be masochism to go to the defence of the pound against the dollar with yet another hike in interest rates.

Presentational effort should now be placed on stressing:

a. the Government has shown its commitment to a strong anti-inflationary policy by its monetary action;

b. money policy is now tight, and the Government means to get its expenditure and funding under control;

c. all currencies are falling against the dollar - it is not sterling weakness, but dollar strength;

d. international action to make the speculators lose money is still a possibility, but we cannot tell people when we're going to do it, as that would remove the major element of surprise;

e. we are still concentrating on our domestic economic and monetary policy, and do not have some hidden sterling exchange rate target.

John Redwood

JOHN REDWOOD

Domestic Monetary Policy