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cc Mr Wells
Professor Griffiths.

PRIME MINISTER

DINNER ON SUNDAY

You are giving dinner on Sunday to the Chancellor, the Chief Secretary, Peter Middleton and Terry Burns. Brian, Nigel and I will also be present.

The three of us will arrive at 6.30pm to allow half an hour or so to discuss the agenda. The others will arrive at 7pm. I suggest we start in the study and move into dinner at about 8pm. I attach a possible seating plan.

The dinner is intended to allow a debate about the economy and economic policy in which people can speak relatively freely. It should also help to ease tensions about discussion of economic policy which there may be after the ERM meetings.

For this reason, I suggest the following:

- (i) you should start the evening by saying that nothing will be taken down and used in evidence;
- (ii) I will not take a record;
- (iii) we should not discuss either the ERM or figures for the size of the PSBR next year.

The Chancellor himself has not thought in detail about the fiscal stance and he would be very sensitive about detailed discussion. I suggest this aspect should be kept very general.

Brian Griffiths' note attached sets out an agenda. (I also attach a note by Alan Walters.) This falls essentially into three parts:

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- the world and domestic economic background.
- objectives
- the policy stance: monetary and fiscal policy.

I have warned Terry Burns that you may ask him to introduce the discussion of the first part, and to give for 5-10 minutes a description of how he sees the economic position and prospects.

I am told that the Chief Secretary is not yet familiar with discussions of macro-economic policy and is likely to be out of his depth when a discussion gets among the Ms. But it will be right at some stage to invite him to talk about the position and prospects for public expenditure.

DN

DAVID NORGROVE
13 December 1985

JALAGA

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DINNER WITH THE CHANCELLOR

A. SCENE-SETTING

International Scene-Setting

Prospects

What are the prospects for world growth?

Risks

How risky is the international scene, given the uncertainties on:

International Debt?

The Oil Price?

The Dollar?

Domestic Scene-Setting

Performance. Where is the economy now?

Policy. What is the stance of fiscal policy and monetary policy at the present?

Prospects. What are the prospects for inflation, growth, and unemployment on current policies?

B. OUR GENERAL POLICY STANCE

Objectives

Is the overriding objective of policy to reduce inflation and keep it at lower levels? (This does not mean you are insensitive to unemployment.)

The Mix of Monetary and Fiscal Policy

Why are interest rates so high? What should the mix of policy be?

Monetary Policy

Is present monetary policy consistent with our inflation objectives?

How should we express monetary policy (target ranges, aggregates, exchange rates, other factors)?

- Without moving to Monetary Base Control, should we increase the importance given to M_0 ? If so, how?
- Should a target range for $\text{£}M_3$ be given for the full 3 years of the MTFs as usual? Is $\text{£}M_3$ now so uncertain that we should only look one year ahead?
- Can we use a different target which is less distorted?

The PSBR

According to the last Budget, next year's PSBR should be $\text{£}7\frac{1}{2}$ bn or 2% of GDP. The increase in forecast asset sales that year from $\text{£}2.25$ bn to $\text{£}4.75$ bn is an argument for reducing the PSBR. The fall in oil revenues - if we believe it to be temporary - is an argument for increasing it.

Tax Policy

How much money is there to spend on tax reductions? Should it go on thresholds or rates?

Will the Chancellor be publishing his Green Paper on fully transferable tax allowances along with the Budget?

Does the Chancellor have plans to change the tax treatment of pension funds in the light of their enormous surpluses?

Does he have any other groups in mind for special attention?

C. WAGES

Unit labour costs are holding up unemployment. Do we have any extra measures to influence them?

Bh.

BRIAN GRIFFITHS

INFLATION

Increase in average Q4 RPI compared with average in Q4 of
previous year.

<u>Calendar Year</u>	<u>Change in Previous Year Q4</u>
1980	15.3
1981	11.9
1982	6.2
1983	5.0
1984	4.8
1985	5.5
1986	3.7*

* Autumn Statement forecast

YEAR ON YEAR GROWTH OF GDP AT FACTOR COST

<u>Calendar Year</u>	<u>Change on Previous Year</u>
1980	-2.4
1981	-1.6
1982	+2.0
1983	+3.3
1984	+2.4
1985	+3.7*
1986	+2.9*

* Autumn Statement forecast

MONETARY GROWTH

Sterling M3

<u>Financial Year</u>	<u>Target Range</u>	<u>Outturn</u>
1979-80	7-11	16.2
1980-81	7-11	19.4
1981-82	6-10	12.8
1982-83	8-12	11.2
1983-84	7-11	9.7
1984-85	6-10	11.9
1985-86	5-9 (now suspended)	14.4*
1986-87	4-8	
1987-88	3-7	
1988-89	2-6	

M0

<u>Financial Year</u>	<u>Target Range</u>	<u>Outturn</u>
1984-85	4-8	5.7
1985-86	3-7	3.2*
1986-87	2-6	
1987-88	1-5	
1988-89	0-4	

* Last 12 months

THE PSBR

<u>Financial</u> <u>Year</u>	<u>PSBR</u>	<u>PSBR as %</u> <u>of GDP</u>	<u>Asset</u> <u>Sales</u>	<u>PSBR excl.</u> <u>Asset sales</u> <u>% of GDP</u>
1971-72	1.0	1.6		
1975-76	10.3	9.3		
1979-80	10.0	4.8	0.4	5.3
1980-81	12.7	5.4	0.4	5.5
1981-82	8.6	3.3	0.5	3.3
1982-83	8.9	3.1	0.5	3.3
1983-84	9.7	3.2	1.1	3.6
1984-85	10.2	3.1	2.1	3.8
1985-86	8.0*	2.2*	2.5*	2.9
1986-87	7.7+	2.0+	4.75*	3.3
1987-88	7.0+	1.75+	4.75*	2.9
1988-89	7.5+	1.75+	4.75*	2.9

*

Autumn Statement forecast

+

1985 Budget forecast

UNIT LABOUR COSTS

Calendar Year

Rise in Unit Labour Costs
(Manufacturing)

1980	22.2
1981	9.3
1982	4.9
1983	1.3
1984	3.4
1985 Q1	5.4
Q2	6.0
Q3	6.9