

PRIME MINISTER

INTEREST RATES AND YOUR MEETING WITH BRIAN GRIFFITHS AND
ALAN WALTERS

You are meeting Brian Griffiths and Alan Walters for three-quarters of an hour at 0915 tomorrow morning. The Chancellor is holding a meeting to discuss the market position which will start at 0830 and he may come round to see you at about 0945. I understand that he does not feel strongly if Brian Griffiths and Alan Walters were to stay when he arrived.

The Chancellor, I understand, is inclined to think it would now be too risky not to bring about a 1½ percent increase in base rates. (I am not clear whether the clearing banks have asked for an increase of this size.) The Chancellor fears that to continue to put it off could risk a further serious and sudden move in the exchange rate. Others feel that it would be better to wait to see how the oil markets move and also to allow the political controversy to die down. The Chancellor may yet be persuaded by those who favour delay.

You will want to explore with Alan Walters and Brian Griffiths what their views are. I suspect that Alan at least will favour delay: he is likely to argue that if the markets take the exchange rate down too far they will come back again to a realistic level later.

For what it is worth, my own feeling would be in favour of delay, allowing the exchange rate to continue to take the strain. The risk is that if rates rise tomorrow and there is further political upheaval to come over the weekend or in the early part of next week, the markets will react and we may risk facing an increase in interest rates from 14 percent rather than 12½ percent.

It is also entirely reasonable to expect and to allow the exchange rate to depreciate when oil prices have fallen by a quarter or more in the space of a few weeks.

You will no doubt want to test the Chancellor's arguments carefully if he does in fact conclude that an increase in base rates is justified. But if he remains convinced that an increase is necessary, his judgment will have been based on an assessment that the risks are simply too great to be borne. There clearly is a risk that failure to act, against the present political background, would be taken as a symptom of failure of will rather than a decision resulting from a careful assessment of the economic position.

Martin Sawyer (Duty Clerk)

pp. DAVID NORGROVE
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