

.MR PAGE

FROM: D L WILLETTS
15 March 1983

cc Principal Private Secretary
Chief Secretary
Financial Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir Douglas Wass
Mr Littler
Mr Middleton
Mr Kemp
Mr Monck
Mr Peretz
Mr Turnbull
Mr Hall
Mr R Allen
Mr Bailey
Mr Ridley
Mr Harris

Mr Scholaw

You may wish
to see this Treasury
note on Base rate
cuts prepared this p.m.

[Signature]
15/III/83

THE CUT IN BASE RATES

At 10.30 this morning Lloyds reduced its base rate to $10\frac{1}{2}$ per cent from 11 per cent effective today. Midland Bank followed at noon. (We have no news yet of any reductions by the other major clearers.) This cut in rates reverses in part the 11 January increase in base rates to 11 per cent from 10 per cent (from $10\frac{1}{4}$ per cent in the case of Midland).

2. At 12.30 today the Bank dealt with the discount houses at the rates set out below (the figures in brackets are the previous dealing rates).

Band 1	10 9/16	(11)	
Band 2	$10\frac{1}{2}$	(11)	
Band 3	10 7/16	(11)	
Band 4	$10\frac{3}{8}$	(11)	- (the Bank have not dealt in Band 4 since 23 February)

The cut in base rates follows a downward trend in interbank rates over the past weeks. A fortnight ago on Tuesday 1 March, 3 month interbank rates stood at $11\frac{3}{8}\%$ (having been as high as $11\frac{5}{8}\%$ at the

beginning of the month) whereas this morning before the cut in base rates it stood at $10\frac{7}{8}$ per cent. Inter-bank rates represent the marginal cost of funds for the clearers and therefore the fall in base rates can be directly related to inter-bank rate movements, just as the increase in rates in November and January were both responses to upward movements in inter-bank rates. The wider factors that were relevant to this downward move include the OPEC agreement and optimism about the Budget.

3. Although the exchange rate strengthened overnight on the OPEC news, it has eased this morning partly on fears that the OPEC agreement would not hold and partly on expectations of the cut in base rates.

4. The table below shows how interest rates now compare with their level a year ago and at the time of last year's Budget.

	<u>3 month interbank</u>	<u>Base rate</u>
9 March 1982	$13\frac{1}{4}$	$13\frac{1}{2}$
15 March 1982	13 $\frac{5}{16}$	13
15 March 1983	10 $\frac{11}{16}$	$10\frac{1}{2}$

Base rates fell immediately after the Budget, in response to it, rather than anticipating it as has happened this year. The fairest comparison is therefore with rates a year ago: on this basis they are $2\frac{1}{2}$ per cent lower.

5. Question and Answer briefing is attached.

D L Willetts

D L WILLETTS

BRIEFING ON THE CUT IN BASE RATE

Did it fall or was it pushed? Was it fixed to coincide with the Budget?

Base rate responds to market forces: it is not controlled by the Government. Today's reduction in rates is clearly related to the downward movement in inter-bank rates over the past weeks, just as the increase in base rates in January was a response to upward movements in inter-bank rates.

Is the reduction in dealing rates meant to nudge interest rates down further?

No. It is purely a response to the adjustment in market rates which has already occurred.

Does the fall in interest rates mean that monetary conditions are becoming more lax?

No. Ministers have always made clear that any falls in interest rates are a consequence of sound monetary conditions and low inflation. Monetary growth is comfortably within the target range. Inflation is well into single figures. The Chief Secretary made it clear in the House on 19 January after the last rise in rates that sticking to the fundamentals would make it possible to begin reversing recent rise in rates, as happened after the rise in the Autumn of 1981.

Implications for the Exchange Rate

Sterling's fall in recent weeks has not been a reflection of lax monetary conditions in the UK; on the contrary the evidence of domestic indicators suggested that a modest relaxation in interest rates would be appropriate. The pound's fall seems to have largely reflected the weakening in international oil markets. While the future course of the exchange rate will no doubt continue to reflect international factors such as the oil markets, there should be no doubt about the Government's continued pursuit of sound monetary and fiscal policies.