

PRIME MINISTER

BILATERAL WITH THE CHANCELLOR

The main item for discussion will be the indirect tax proposals, set out in the Chancellor's minute. *(which we expect to receive in the morning)*

There are three other possible items.

First, employment measures. The Chief Secretary has been discussing employment measures for the Budget with Lord Young, and the Chancellor may want to touch base with you.

Secondly, interest rates. As you know, inter-bank rates have fallen  $\frac{3}{8}$  per cent or so during the last few days and the yield curve at the shorter end is now downward sloping, which would suggest that the market is looking for a move down. The three-month rate is at  $12\frac{1}{4}$  per cent. Sterling is very firm even though oil prices for April and May are at \$15 or below. Sterling's strength is, to a large extent, a reflection of the dollar's weakness: the dollar has fallen by 8 pfennigs in the last few days and is not far off its all time low against the yen (the Japanese response has been to start to put together large loans at subsidised interest rates for their exporters!).

The market pressures for lower interest rates are as yet not strong and the Bank would have to give a signal to secure a reduction in base rates. This is, however, largely a reflection of the fact that the markets expect the Government to want to see a fall in interest rates alongside the Budget.

Caution must be the watchword here, as elsewhere. But there would be no harm in opening this up with the Chancellor.

Thirdly, the Green Paper on Personal Taxation. You might discuss with the Chancellor the handling of Cabinet. Do you want to arrange for one or two members of the group to speak after the Chancellor, eg. Mr. Tebbit and Lord Young? I understand that Mr. Fowler may want to circulate a minute for Cabinet on Thursday. (I have mentioned this to the Chief Whip.)

DWS

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