

PRIME MINISTER

BILATERAL WITH THE CHANCELLOR

You have half-an-hour for the bilateral.

You might raise the money numbers. Sterling M3 has risen by 18½-19 per cent over the past year, by more than 20 per cent over the last six months at an annual rate, and by 35-38 per cent over the past three months at an annual rate. It is wrong of course to rely too heavily on figures which cover only a short period, extrapolating these to an annual rate. But with the Chancellor's convictions about the EMS he may be relying too much on the firmness of the exchange rate. Is he taking the money numbers seriously enough? It would be right to push him hard. This is a worrying growth in a highly liquid potential spending power. The only action we could take to constrain it - or try to - would be to raise short-term interest rates, in a highly undesirable way. But the Treasury and Bank should be making ever effort to try to work out what is going on.

The Chancellor wants to discuss Mr. Baker with you. Mr. Baker has told the Chief Secretary about his Friday meeting with you, and the Chancellor will no doubt want to urge that Mr. Baker should be away empty handed. (The pressures for higher spending on education are very considerable. But I wonder whether in fact it might be better - if money has to be given - to give it directly rather than by changing the capital controls, which would have knock-on effects. These might be avoided if extra spending could be tied to short-term widely perceived needs, e.g., more money for GCSE, which Mr. Tebbit supports among others. This would also probably give a less damaging signal to local authorities than a change in the capital control regime.)

The Chancellor also wants to discuss Victor Paige's successor. I suspect he simply wants to know what is going on.

DW

DAVID NORRGROVE

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