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PRIME MINISTER

BILATERAL WITH THE CHANCELLOR: 13 JULY

There are three items on the agenda. Papers are in the dividers as follows:

1. Markets — no separate papers.

Today has been another quiet day for sterling. You may want to have a word with the Chancellor about the next move on interest rates. I assume for the reasons discussed previously you would not want to see a further move this week. But you might want to put the case for another move early next week. You should bear in mind that next Monday, 18 July, you will be having a seminar with the Chancellor, Sir Peter Middleton and Sir Terry Burns about the latest Treasury economic forecast and the policy implications that arise from it. Papers for that meeting will be available for the weekend.

2. Cabinet discussion on public expenditure

There are six papers in the dividers:

Flag A: the Chancellor's Cabinet paper on the economic prospects. He has taken on board your comments on the earlier draft.

Flag B: the Chief Secretary's paper on public expenditure. Again this reflects your comments.

Flag C: a suggested speaking note for you drafted by the Treasury. You will want to consider how far to go in emphasising difficulties arising from the external deficit; the Chancellor is likely to advocate a cautious approach and advise against your giving any 'crisis' signals.

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Flag D: the Treasury's suggested line for Bernard to take with the Lobby once the Cabinet discussion is over, together with defensive Q and A briefing. The proposed line reflects the approach you have already discussed with the Chancellor and Bernard is quite content with it.

One point to note in the Q and A material is ^{the} ~~a~~ suggestion on Q(xi) that Mr. Parkinson's appointment as Star Chamber chairman should be confirmed. Given the publicity this has already had, Bernard and I see no point other than to confirm it. If you agree you will presumably want to make this point to Cabinet under the last of the conclusions in the Chief Secretary's paper.

Flag E: the Chief Secretary's background paper for Cabinet detailing all the departmental additional bids. This is for reference only, although if there is discussion in Cabinet of particular programmes you may find it useful to refer to it.

Flag F: again by way of background you may like to glance at the Morgan Guaranty Trust article about the implications of rising US social security demands for the conduct of fiscal policy. There is an interesting read across from this to the position we face in the UK; and the main moral I draw is the need as we look ahead to be planning for substantial budget surpluses.

3. Bank of England Directors

The Chancellor may mention to you the proposal to appoint Mr. John Flemming as a director of the Bank. His Who's Who entry is in the divider.

The vacancy arises because one of the non-executive directors, Mr. van der Weyer, is having to resign in the early autumn because of ill health. This follows on from the change earlier this year when David Walker, on assuming the chairmanship of the SIB, moved from being an executive to a non-executive director; so producing a position where there

are currently only three executives (in addition to the Governor and Deputy Governor) rather than the normal four.

The Governor and Chancellor now apparently propose to replace the non-executive van der Weyer with a new executive director, bringing the strength back up to four. John Flemming is the proposed appointment.

I have discussed this privately with Brian Griffiths. His view is that it would be a worthy but uninspired appointment, which would bring no life to the Court. But Brian Griffiths' view is that there are no other internal Bank candidates who have any stronger claim. So the only issue would be whether to bring in an outsider as an executive director - as has happened in the past, for example with Christopher Dow, Anthony Loehnis, etc.

You will obviously want to consider whether to raise any of these doubts and you will certainly not want to attribute them to Brian Griffiths.

PGG.

PAUL GRAY

12 July 1988

SLHAYP

FLEMMING, John Stanton; Economic Adviser to the Governor, Bank of England, since 1984; b 6 Feb. 1941; s of Sir Gilbert Nicolson Fleming, KCB, and of Virginia Coit; m 1963, Jean Elizabeth (née Briggs); three s one d. *Educ.*: Rugby Sch.; Trinity and Nuffield Colls. Oxon. BA Oxon 1962, MA 1966. Lecturer and Fellow, Oriel Coll., Oxford, 1963-65; Official Fellow in Economics, 1965-80, Emeritus Fellow, 1980, and Bursar, 1970-79, Nuffield Coll., Oxford. Chief Adviser, Bank of England, 1980-84. Member: Nat. Freight Corp., 1978-80; Council, Royal Economic Soc., 1980-; Adv. Bd on Research Councils, 1986-; Chm., Economic Affairs Cttee, SSRC, 1981-84. Associate Editor: *Oxford Economic Papers*, 1970-73, *Review of Economic Studies*, 1973-76; Editor, *Economic J*, 1976-80. *Publications*: *Inflation*, 1976; contrib. economic jls. *Address*: Bank of England, Threadneedle Street, EC2. T: 01-601 4963.

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PRIME MINISTER

BILATERAL WITH THE CHANCELLOR, 14 JULY

We have re-arranged the bilateral, cancelled today, for tomorrow. It should not take long. The main item envisaged for today, handling of the Cabinet discussion on public expenditure, will be overtaken by tomorrow afternoon. That just leaves items 1 and 3 on my original note below - markets and Bank of England Directors.

On markets, today has been another very quiet day. My impression is that the Chancellor has no wish to make any move at the end of this week; the question remains what to have in mind for next week.

PRG.

PAUL GRAY

13 July 1988