



10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

22 August 1988

Dear Alex

TRADE FIGURES: MARKET RESPONSE

This records the main points which came up when the Chancellor came in this evening to see the Prime Minister.

The Chancellor said that it was the import side of the equation which was the seriously bad news; exports were up quite satisfactorily. The problem was it showed that the economy was growing faster than had hitherto been thought. Rises in interest rates were still working their way through the system. Market expectations were for a July deficit of £1 billion. Given the signs of the July deficit, it was necessary to have a full one per cent rise in interest rates announced on Thursday 25 August at the usual time, i.e. after the trade figures themselves were to be announced. The Chancellor said that he planned to go on radio to explain the rise and to provide reassurance to the markets and the public about the generally strong state of the economy.

The Prime Minister endorsed the Chancellor's decision to go for a one per cent rise. She felt that the Chancellor should defend the decision with a television appearance, both at lunchtime and, if necessary, in the late evening slot on the news. The Prime Minister fully accepted the Chancellor's view that the poor trade figures were a symptom of underlying inflationary pressures and that action needed to be directed against those inflationary pressures. Trade figures were, and had been for a very long time, a political touch-stone and their importance in the public mind could not be overstated, hence her suggestion to the Chancellor of television appearance. The Chancellor endorsed that approach.

The Chancellor said that we should be braced for a further set of bad figures while the interest rate rises work their way through. August was traditionally a bad month for trade figures. For the medium term, the Prime Minister and Chancellor agreed that a mini-Budget in the autumn was not the right approach and would send out the wrong signals. The Chancellor agreed to consider the appropriate rates for health

contributions and national insurance contributions generally in the autumn statement and to look at wider measures in the 1989 Budget, notably a substantial rise in alcohol duties, although the Chancellor felt that the political difficulties with a substantial rise in the tax on spirits should not be understated.

Lynn

Andy

PP DOMINIC MORRIS

Alex Allan, Esq.,
H.M. Treasury.