PRIME MINISTER

INTERVIEW WITH DAILY EXPRESS

You are to give an interview to Nick Lloyd, editor of the Daily Express on Wednesday morning.

His main question areas will be:

The economy when he will want to talk to you about

- balance of payments
- possible credit restrictions
- interest rates; were the right remedies taken after the Stock Market crash
- mortgages and the high interest rates first time buyers are now facing
- was the last Budget such a good idea
- will we see changes to income tax in an effort to stop people spending.

Northern Ireland

I have told Nick Lloyd that you will not give any details about the proposals the Government has for tackling the IRA and improving security in Northern Ireland.

The Health Service Review

Mortgage Tax Relief

- what plans you may have for ending tax relief on mortgage interest payments as this would help flatten out house prices.

Public Expenditure

- Is this going to be even more tightly controlled now and do you expect the Star Chamber to have to meet.

Other areas he will want to talk to you about if there is time are:

- The motions on law and order which have been put down for debate at the Party Conference.
- Are we going to see a re-kindling of private share-ownership.
- Your objectives for the new Parliamentary year.

Briefing for the interview will be available Tuesday evening.

Content for photographs to be taken at the end of the interview?

Yes mr

T.J.P.

TERRY J PERKS
Deputy Press Secretary

26 August 1988

PRIME MINISTER

INTERVIEW WITH DAILY EXPRESS

You are to be interviewed tomorrow morning by Nick Lloyd, editor of the Daily Express. He hopes to carry the interview before the end of the week.

At **Annex A** are the question areas. At **Annex B** is the briefing prepared by Paul on the economy and at **Annex C** the note by Brian Griffiths which you saw over the weekend.

Paul and I will be available to brief you further tomorrow morning before the interview.

T. J. P.

TERRY J PERKS
Deputy Press Secretary

30 August 1988

INTERVIEW WITH DAILY EXPRESS: TUESDAY 31 AUGUST 1988

BALANCE OF PAYMENTS

No denying that the latest monthly figures were disappointing. But it is important to set them in context. The British economy is now in very good health; manufacturing productivity is rising by 7 per cent, manufacturing investment is up by 14 per cent, unemployment is at its lowest for five years, and corporate profitability is high.

The second key point is that the Government's own finances continue to be under firm control. Public expenditure's share in national income is falling, and we have a healthy budget surplus. That is not true of the position in the United States; and it was certainly not true of the last Labour Government in this country.

Rather, what we now have is a balance of payments current account deficit reflecting very strong demand by the private sector. British industry is continuing to improve its export performance - exports of manufactures (excluding erratic items) were 8½ per cent higher in volume terms in the last three months than a year earlier. But the strength of demand means that the increase in imports has been even greater. In large part this reflects higher investment by British industry, which will further strengthen our performance in the future - for example, imports of capital goods were 25 per cent higher in the last three months than a year earlier.

But higher imports have also reflected strong demand for consumer goods - not least motorcars, where recent demand has been boosted by the new registration letter. Consumer demand in recent months has been higher than we were expecting earlier in the year - probably a reflection of very high levels of confidence by consumers following the strengthening of the economy over the last few years. People have been saving at much lower rates than in the past, and been more willing to increase their borrowing.

So it has been necessary to take steps to reduce demand. This is not a crisis reaction, because there is no crisis. But it is right to restrain recent levels of demand; and higher interest rates are the appropriate way of doing this. They will ensure that the growth of money supply is restrained. And they demonstrate our determination not to take any risks with inflation. Over time the action we have taken will also improve the balance of payments position, as demand for imports is restrained.

Higher interest rates are also of course good news for savers. Most of the publicity whenever interest rates change is directed to the effect on borrowers, particularly house-buyers. Of course that is an important aspect, and higher mortgage rates may be uncomfortable for some who have borrowed large multiples of their incomes. But all borrowers must remember that interest rates go up and down over time; and the action the Government has taken will help new house-buyers by slowing the rate of growth of house prices. But overall those borrowing to finance house purchase number substantially less than those who are savers. For example, at the end of 1987 there were 7.2 million borrowers from building societies, and a total of 45 million shareholders and depositors. Many old folk, for instance, who have worked hard to build up a nest egg would, I am sure, be very pleased that they will now be getting a higher level of reward.

POSSIBLE CREDIT CONTROLS

These would not be appropriate. Direct controls of one sort or another have been used on various occasions in the past, and the results have always been blunt and ultimately ineffective. In today's complex world of competitive international financial markets, direct controls would be impossible to enforce. For example, unless we were to re-impose exchange controls - which I am very glad to say we abolished early in the life of this Government - direct controls on borrowing would simply shift it overseas or to domestic lenders who were not covered by the controls.

The right answer is to tighten monetary conditions by working with market forces not by trying to curtail them. That is what we have done by raising interest rates.

REACTIONS TO THE STOCK MARKET CRASH

With the benefit of hindsight we can now see that world economic activity was stronger in the second half of last year than people generally realised at the time; and that the world economy was therefore better able to absorb the effects of the stock market crash. But that is not the same as saying that the wrong action was taken at the time temporarily to reduce interest rates around the world. Confidence last autumn was distinctly fragile, and we could easily have faced a far worse position if the authorities in the main countries had not taken the action they did at the time. Now that that phase has passed, and it is clear that the world economy is growing strongly - perhaps too strongly - it is right substantially to tighten conditions again.

1988 BUDGET/MINI BUDGETS

The 1988 Budget was an excellent one. It was not concerned with short-term adjustments to the level of demand in the economy. That is not the proper role for tax policy. It was concerned with furthering the development of the enterprise economy and ensuring that in the future the economy will be much more flexible and adaptable - what the economists call "improving supply performance". Reducing tax rates was essential to provide the right incentives for everyone - families and companies - to work, invest and be enterprising, and tax rates must continue to be set on the basis of medium term objectives, not on the latest set of economic statistics.

An autumn mini-budget would be totally inappropriate. We saw in the mid-70s, when Denis Healey was Chancellor, what happens when you have umpteen budgets a year. We have a prudent budgetary policy which Nigel Lawson set out in March, and which we shall stick to. In the shorter term, it is right for necessary adjustments to be made by using interest rates.

PUBLIC EXPENDITURE

We have consistently kept tight control of public expenditure - it has fallen substantially as a share of national income over the last six years. That is the policy we will continue with. It is much too soon to be talking about exactly how this year's negotiations will proceed - the Chief Secretary is only just embarking on his annual round of discussions with Ministerial colleagues. But the Cabinet is at one on the need for a prudent overall approach, for securing improved value for money, and for targetting resources on key priority areas.

30 August 1988

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PRIME MINISTER

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26 August 1988

For interview with L[illegible] Express

THE ECONOMY AND THE BALANCE OF PAYMENTS

Below are some suggested responses to questions on the economy and the balance of payments, which are supportive of the Chancellor.

1. "The size of the deficit is surely evidence of mismanagement".

The Government has not mismanaged its own finances. Public expenditure is under control and the PSBR is in surplus.

In the last budget the Treasury forecast that the balance of payments would move into deficit in 1988 because of the huge increase taking place in investment.

Like all outside forecasting bodies we did not anticipate the strength of consumer borrowing and spending earlier this year.

But recognising the problem, we have now taken appropriate action and raised interest rates.

This is not evidence of mismanagement.

2. "The British economy is in an old-fashioned sterling crisis".

It is not - this is not a sterling crisis:

- the public finances are in excellent shape: in the sterling crises of the past public expenditure and public borrowing were invariably out of control: there is no evidence of mismanagement of spending or borrowing.

- the British economy itself is in good health: manufacturing productivity is rising by 7%, manufacturing investment is up by 14% unemployment is at its lowest for 5 years, corporate profitability is high.

- foreign investors have confidence both in the economy and the Government.

These are not typical of a sterling crisis.

The present external deficit is the result of an expected surge in private spending financed through borrowing. We have taken the necessary steps to deal with the problem.

3. **"It makes no sense to allow monetary policy to take all the strain of slowing the economy".**

The root of the problem is a surge in spending caused by unexpectedly high demand for borrowing. It is right in these circumstances, namely when demand has risen, to allow interest rates - the price of credit - to rise. Higher interest rates affect expenditure on a very broad front. All the alternatives which have been recommended would target specific sectors and would be both inefficient and unfair.

Interest rates have also been rising in all other major countries - Europe and the US - in response to the same problems.

4. "**But why not introduce direct controls on credit**".

Direct controls on credit would be impossible to enforce in the complex world of competitive, international financial markets in which we now live. Direct controls would

(a) place existing British financial institutions in a straitjacket.

(b) require the re-imposition of detailed exchange controls - contrary to the whole thrust of EEC policy.

(c) create incentives for new financial institutions and new markets to be created which would circumvent the controls.

Direct controls have been used on various occasions in the past in the UK. The results have always shown them to be blunt and ultimately ineffective.

- they create distortions and black markets in borrowing and lending.

- they lead to new institutions and new markets being set up.

- the controls are always circumvented and in the end have to be dismantled because their side effects are too perverse.

Direct controls are not the answer to our temporary deficit.

5. "**Why not introduce a mini-budget**".

This Government has managed the public finances well because it has done so in a medium-term context. Tax rates have been set to provide incentives for families and companies to work, invest and be enterprising. This year's budget was just a part of a whole strategy.

It has been crucial for the re-birth of enterprise and the continued growth of the UK economy. We will not be blown off course in providing the framework for greater prosperity in this country.

Tax rates will continue to be set on the basis of medium term trends.

6. "**When will current measures have an effect?**".

(a) First one would expect the increase in interest rates to affect spending intentions and asset prices. Already there is evidence that the housing market has peaked: the weekly commitments (new lending) of the 14 leading building societies (making up 85% of the market) which were running for many months at £1bn - £1.1bn, have since the end of July, been £800m, £700m and £800m respectively.

While part of this may be related to the deadline for the elimination of multiple mortgage tax relief on single properties, there was no sharp increase in the figures in the run-up to July: hence one suspects there has been a developing softness in the housing market for a few months. One expects that the growth of home prices will come to a halt.

Housing is also a leading indicator of consumer expenditure and indeed a good deal of consumer expenditure is housing related (furniture, carpets, kitchens etc). Hence this evidence is important:

(b) by September/October money supply growth (MO) should start coming down and be back within target by the end of the year

(c) retail sales and production should also noticably be affected by the year end, and

(d) then by next year I would expect to see some impact on the balance of payments: this will naturally take longest and will work via imports, which is the area with the greatest lag between a policy change and its ultimate effect.

Brian Griffiths

BRIAN GRIFFITHS