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PRIME MINISTERBILATERAL WITH THE CHANCELLOR

The following subjects are likely to come up:

i. Securities Regulation. ^{Flag A} The Governor has written to you outlining his proposals for a group of senior City figures to suggest ways in which the Gower framework of self-regulation could be made to work. You indicated that you would like to talk to the Chancellor and Mr. Tebbit about this before replying to the Governor. In Mr. Tebbit's absence in the US, the Chancellor has set up a meeting tomorrow morning with the Governor and Mr. Fletcher. He will report on the outcome and advise on how you might reply to the Governor. You might like to look at the Policy Unit note on investor protection which is attached. ^{Flag B}

ii. World financial markets. You have received a blood curdling account of the dangers facing the world financial system from Sir Robert Muldoon. He mentioned the problems of Continental Illinois but he will not have known that it will shortly be announced that the rescue package from other banks has failed to restore confidence and stem the outflows, and that the bank will be declared insolvent. Responsibility for coping with the problem falls to the Federal Deposit Insurance Corporation and the Fed itself. It has been argued that a key difference from the 1920s and 1930s is that there are now lenders of last resort to prevent a cumulative collapse. Continental Illinois will be a major test of this and if a cumulative collapse is

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prevented some good may have been done. Interestingly it appears to have been unsound domestic lending rather than an international default which has brought Continental Illinois down.

The Chancellor will have seen Sir Robert Muldoon at the meeting of the Commonwealth Consultative Group in the morning and he will report on the discussion. On Thursday he goes to the OECD for a meeting of the G10 which will undoubtedly discuss these issues. Following the sharp rise in US interest rates, the Chancellor may want to discuss how far it is right to keep criticism of the US deficit off the Summit agenda.

iii. You could ask the Chancellor to report on domestic markets. Fears of a further rise in the bank rate have ceased somewhat but there are still clouds on the horizon. Banking May ended today and gilt sales totalled £540 million against the target of £1250 million, some £700 million short. The figure for the PSBR in April is due to be published on Friday, and the Chancellor may have the advance figures.

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iv. Sleipner Gas. The Chancellor and Mr. Tebbit have both written to Mr. Walker urging that acceptance of the Sleipner deal be made conditional on allowing exports of UK gas. It may be helpful to discuss, not substantive issues, but the best way to handle this decision. You may wish to hold a meeting with the Chancellor, Mr. Tebbit and the Foreign Secretary.

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15 May 1984

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