

PRIME MINISTER

BILATERAL WITH THE CHANCELLOR

Following last week's bilateral, you asked for a further note to go over the current economic scene at greater leisure. There are a number of features to be considered, several of which are worrying:

(i) Interest Rates

3 month inter-bank rate rose today to $9\frac{15}{16}$ per cent threatening the $9/9\frac{1}{4}$ per cent structure of base rates. Should the Government resist a further rise in base rates on the grounds that it is the product of market nerves, rather than being justified by underlying conditions; or should it acquiesce? Much depends on just how hard resistance turns out to be. It is not helpful for the authorities to be seen to be desperate to hold down interest rates. The money supply figures to come out on Tuesday are likely to be reasonable, and certainly better than market expectations.

(ii) Equity and Gilts Markets

Following a switch-back day, the FT Index closed 6.5 points down. The gilts market, by contrast, recovered.

(iii) US Markets

Where the 3 month rate is now $11\frac{11}{16}$ per cent and bond rates nearly 14 per cent. - See attached note by John Redwood

(iv) Foreign Exchange Markets

So far, conflicting influences have held sterling steady.

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(v) Public Expenditure

Where around £1 billion has to be allowed for the cost of the coal dispute.

(vi) Inflation

What are the prospects for getting to 4½ per cent by the autumn, as promised in the Budget?

(vii) The Pay Round

Although railways have been settled, there are still problems, particularly with the Post Office and teachers.

(viii) Trade Figures

How does the Chancellor assess market interpretation of the outcome?

At 5.30 p.m. the Governor will join the meeting to discuss international debt and the problems of banking. You might like to look at the latest debt report. The Governor will come prepared to update the position. He will also be prepared to discuss the proposition that tax relief for bad debts inhibits proper provisioning. A note by John Redwood argues that this is not a serious problem.

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COMMISSIONER