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From the Private Secretary

13 October 1986

THE MARKETS

The Chancellor yesterday evening discussed the markets with the Prime Minister.

The Chancellor said that the PSBR figures to be published on Thursday at present showed borrowing at £2<sup>1</sup>/<sub>4</sub> billion. The half year total would be £6.1 billion and on this basis the fiscal position seemed to be broadly on track. However, there was some tendency to looseness in the monetary position. Sterling M3 was difficult to interpret. The present rate of growth would not be alarming if taken on its own. But M0 was now edging up and of course the exchange rate was very weak. He had reached a preliminary conclusion that it would be right to raise base rates by 1%, probably on Tuesday this week. Some critics would no doubt argue that the Government had held off the increase simply in order to avoid it coinciding with the Party Conference. The answer to that would be that the delay had enabled the increase to be confined to 1% as against the 2% which markets and commentators had been pointing towards. There would probably be some questioning about whether a 1% increase would be enough. The figures for borrowing to be published on Thursday should, however, help to cement the increase.

The Prime Minister agreed with the Chancellor's proposed way of proceeding. However, she noted that base rates might have to be increased today, Monday, if sterling came under severe pressure. Any intervention today should be very small.

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SECRET