

PRIME MINISTER

BILATERAL WITH THE CHANCELLOR: 29 SEPTEMBER

I have agreed with the Chancellor's office the following agenda:

1) Debrief on Berlin

The Chancellor returned from Berlin this afternoon, and you will want to ask him how things went. I enclose at Flag A a copy of his speech there today (which we did not see in draft). You may feel that it sounds rather complacent about the current account deficit.

(Incidentally I gather that the Governor of the Bank was taken ill in Berlin and has been in bed most of today; nothing very serious by all accounts but a very bad cold that is threatening to turn into pneumonia.)

2) Markets

Today's Evening Report is at Flag B

Both sterling and the equity market have continued strong today.

Against that background I do not think there is any need for major operational decisions tomorrow. You may want to tell the Chancellor that further interest rate increases should not be ruled out; but there is no need to press him to go further at this stage, particularly as there are increasing signs that the heat has been taken out of the housing market.

I think it is probably too soon for you to open up discussions with the Chancellor on the possible shape of next year's budget. But I am discussing with the Treasury

the possibility of setting up another seminar with the Chancellor, Peter Middleton and Terry Burns during the autumn.

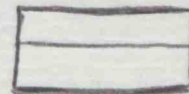
3) Public Expenditure

I have arranged a separate meeting next Monday, 3 October, with the Chancellor, Chief Secretary, Cecil Parkinson, Robin Butler and Richard Wilson to discuss the state of play in the PES discussions and the arrangements for the Star Chamber. So there is probably no need for much to be said about this tomorrow.

My understanding is that the bilaterals are proceeding much as expected. The most difficult problem areas seem to be defence, Scotland, Wales and social security; and not far behind in degree of difficulty come health, employment, transport and education. Peter Walker is, true to form, proving difficult, and there are mutterings (e.g. to Mark Lennox-Boyd) that he will want to come and see you. I would strongly advise against this, certainly in advance of next Monday's meeting.

I will let you have a fuller note on public expenditure for the weekend.

*Recd.*



Paul Gray

28 September 1988