

CCB/JP

26(a-d)

PRIME MINISTER

WEEKLY BILATERAL WITH THE CHANCELLOR: 28 JUNE

You are seeing the Chancellor for your regular weekly bilateral tomorrow afternoon. Following discussion with the Chancellor's office I suggest the following agenda:

(i) Madrid

You will presumably want to have some discussion of today's outcome at the European Council. You might want to take up with him why he thought that putting a date to ERM entry was so crucial given that the other Members made no effort to press you beyond your initial statement - see Andrew's separate note (Flag A).

(ii) Markets

The market reports for yesterday and today are at Flag B.

Yesterday things were rather rocky. Sterling steadily depreciated during the day, to close with an effective rate under 90 and the DM rate under 3.02, notwithstanding intervention of some \$½ billion.

Things steadied overnight and sterling traded somewhat above yesterday's levels pending the 11.30 am announcement of the trade figures and the news from Madrid. The markets had been expecting the trade figures to be substantially worse, and once they were published sterling picked up. This trend was reinforced as news from Madrid came through, and sterling has ended the day at over DM 3.05 and with the effective rate nearly back up to 91. A much happier position!

So any question of an interest rate change has now receded.

(iii) Legal reforms

You saw the attached progress report (Flag C) from Caroline Sinclair over the weekend, and decided to talk this through with the Chancellor before taking any further action. The Chancellor has himself had a talk with the Lord Chancellor today, and I understand that the Lord Chancellor put to him very much the same package as you have already heard. The Chancellor reacted to it rather coolly, although saying that the judgement was obviously one for the Lord Chancellor to take.

You will also want to glance at the further short up-dated note from Caroline at Flag D. The immediate issue is whether you or the Chancellor now want to give any further steer or reactions to the Lord Chancellor before he brings a draft white paper to the forthcoming meeting of E(CP).

We have also had reports back from the Chief Whip that the judges and the Bar are dissatisfied with the Lord Chancellor's proposals. (The Chief Whip, though loyally sticking to the Government line, does have strong reservations about the original proposals and the way the consultation process has been handled). The judges are jibbing at being put in the spotlight, having to exercise their concurrence in public and in the face of views from the Advisory Council. The Heads of Division have suggested broadening the group to the Judge Council which includes four other senior judges and are seeking a less public role.

The Lord Chancellor has heard their arguments but proposes to write back urging them to accept his

revised package. The position of the Attorney is unknown (he is in Canada) but the Chief Whip claims he is reluctant to impose anything on the judges. For him to change sides would be outrageous when

(i) the judges sought a right of concurrence and have been given it

(ii) he told the Lord Chancellor he was content.

(iv) Future business

I have now arranged that at next week's bilateral with the Chancellor (on Tuesday) he will be joined by the Chief Secretary for a discussion of the handling of the public expenditure Cabinet on 12 July. The Chief Secretary will be sending in a further note about this before the weekend. I also hope to have for you on the same timescale the Treasury's latest economic forecast, which is just being completed.

In the wake of the Madrid outcome and the calmer position in the markets following the trade figures, you will also want to consider whether now is a good time to convene a meeting with the Chancellor, Peter Middleton and Terry Burns. The purposes of such a talk might be:

- to discuss the Treasury paper of two or three weeks ago on "What went wrong with inflation".
- to review the economic prospects and the stance of policy in the light of the latest forecast.
- to establish an agreed approach to monetary policy and exchange rate management post-Madrid.

If you would like to have such a meeting there is time available in the diary next Wednesday. One drawback of that

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date is that, on present plans, Alan Walters will still be in the United States: but if you wanted him to be there I could see whether Alan could accelerate his return for his pre-summer visit by a couple of days.

I have not mentioned the possibility of such a meeting to the Chancellor's office. But is this something you would like to propose to the Chancellor tomorrow?

And, if so, would you like me to see if Alan could make an early return in order to attend?

PLCG

PAUL GRAY

27 June 1989

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