

SIR ALAN WALTERS

cc Mr. Turnbull

22(a-e)^a

ECONOMIC PERFORMANCE AND PROSPECTS

You will want to see the attached record of the meeting the Prime Minister had with the Chancellor and Treasury officials on Wednesday.

There is one aspect on which I think it would be helpful if you could prepare an explanatory note for the Prime Minister. It relates to the issues raised in (vi) of my record. The Prime Minister said she found it hard to believe that the \$25 billion intervention undertaken in 1987-88 had been genuinely sterilised and funded; the Treasury insisted that it had. At a later point in the discussion (not recorded) the Prime Minister made welcoming noises about the recent intervention in support of sterling, and urged the Treasury not to sterilise it; otherwise she said the beneficial tightening on monetary conditions would be lost. The Treasury response was that this would be inconsistent with the policy of level funding.

Could you therefore do a note which:

- sets out the facts as you see them on whether or not the 1987-88 intervention was sterilised and funded;
- relates to the process of sterilisation/funding to the concept of level funding;
- offers your view on whether the more damaging development in 1987-88 was the intervention or the constraining of interest rates to meet exchange rate objectives.

Perhaps you could let Andrew and me have a sight of your note before we put it in to the Prime Minister.

PAUL GRAY

6 July 1989

DASAWP