

PRIME MINISTERBILATERAL WITH THE CHANCELLOR: 25 OCTOBER

You are seeing the Chancellor tomorrow afternoon, initially for a bilateral and then for a discussion which John Major and Nick Ridley will join on the proposed UK paper on EMU. The papers in this folder are for the bilateral only; there is a separate folder for the EMU meeting.

There are two main agenda items: the markets and public expenditure.

Markets

Reaction in the markets to today's trade figures has been muted. The exchange rate has held up extremely well, although equities took a knock following several days in which they have been slowly recovering from last week's mini-crash. Wall Street also fell with renewed worries about the United Airlines deal, but had recovered by the close. The reaction of UK equities probably also owes something to the Quarterly CBI Industrial Trends Survey, which was also published this morning. A summary of it is at Flag A; today's market report is at Flag B.

Against this relatively quiet background, there are no immediate operational decisions to be taken. At your last talk with the Chancellor, you had a good run-over the position on ERM, which I recorded as at Flag C. There is probably no need for much further discussion on this tomorrow. But you may want to reiterate your view about not defending a particular rate and doing no more than "smoothing" intervention.

Public Expenditure

As I reported before the weekend, the Chief Secretary has been making good progress. Only minor tidying-up is now outstanding. The Chief Secretary has today sent you the minute at Flag D which summarises the outcome, both for the overall totals and

individual programmes. The paper attached to his minute is the one he will be circulating tomorrow morning at a meeting of the Star Chamber. This is the first, and probably only, meeting of the that Committee, which will be very much a re-run of the position in both 1987-1988 when the Star Chamber met simply to note the outcome of the Chief Secretary's discussions.

You will see from the Chief Secretary's covering minute that he now expects the GGE ratio in 1990-91 to be held to no more than 39 per cent. This will be above the expected outcome for 1989-90, but will be in line with the 1990-91 figure in last year's Autumn Statement. So presentation should not be too difficult. For the later years he hopes to be able to show a return to some downward trend.

Given the progress achieved, things are on track for the Chancellor to make his Autumn Statement on the afternoon of 9 November, following Cabinet endorsement that morning. Unless you have any points in the details of the individual settlements set out in the Chief Secretary's paper, all you need do at tomorrow's bilateral is to confirm with the Chancellor the plan to go for 9 November.

Alan Walters

The Chancellor may also raise the question of Alan Walters' now infamous article for the American Economist. Andrew has been keeping you briefed on developments on that. But to give you some feel of the extent of media interest this has stirred up, you may like to be aware of the wadge of press cuttings at Flag E. This evening's news bulletins have again been full of the story following today's economic debate. The Chancellor has repeatedly faced the question in interviews "shouldn't Alan Walters be sacked?"

*Recd.*

PAUL GRAY

24 October 1989

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