

PRIME MINISTER

BILATERAL WITH THE CHANCELLOR: 22 NOVEMBER

36(a-c)

You have your weekly bilateral with the Chancellor at 1430, following your return from the morning trip.

There is a reasonably full agenda. You need to cover the first three items below, although the 4th and 5th are optional if time runs out.

1. Markets

As you know, sterling has been unsettled in the last few days. On both Friday and Monday the Bank carried out intervention of around £150 million. Today's market report is at flag A and you will see there was further intervention of over £200 million. Nonetheless, sterling did this afternoon drop below DM2.85, although we have strengthened during the day against the dollar and stand now (1900) at \$1.57. The effective rate is now at its lowest point of the year.

The Chancellor has been taking a fairly cautious attitude towards intervention, and has authorised less than some in the Treasury and Bank would have wished in recent days (please do not reveal). My impression is that he shares your view that some depreciation of our cross rate against the DM is not unwelcome; but wants to avoid too much overall sterling weakness. That is particularly so this week during the run-up to the trade figures on Thursday, given that the markets are making an over-pessimistic forecast.

It would I think be worth your talking market management policy through with the Chancellor to make sure that you understand each other's views. But I assume you will want to avoid placing rigid limits on his freedom of action.

2. Bank of England appointments

You agreed with Nigel Lawson before his resignation that Eddie George should be the next Deputy Governor. But the

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formal procedures for the appointments have not yet been put into effect. And before they are, a decision is needed on who should replace Eddie as an Executive Director.

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3. Local authority rents

When you saw Nigel Lawson on the day before he resigned, he raised with you the question of what to assume in the public expenditure arithmetic for the increases next year in local authority rents. During the negotiations, Norman Lamont and Chris Patten had agreed it should be 5 per cent real. But Nigel Lawson suggested that, by revising this to zero per cent real, this could take up to 0.1 per cent off the RPI next April. You agreed with him this might be a better course. So I minuted out accordingly, informing DOE. It was agreed at that time that the necessary adjustments to the precise public expenditure numbers would be made after the Autumn Statement.

part of a letter. bilateral with
Chancellor 21/11/89.

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Both DOE and the Scottish Office have now protested at the proposed change from 5 per cent real. Their letters, together with my earlier note, are at flag B.

I gather the new Chancellor would like to take your mind on this point again. Like Nigel Lawson, he can see there are two sides to the argument. My impression is that he would be prepared to accept either 0 per cent or 5 per cent.

The arguments DOE put certainly have significance force. You will want to consider whether you find them more persuasive than the attractions of up to 0.1 per cent off the RPI. You will see that, if you are minded to stick with 0 per cent real on rents, both Chris Patten and Malcolm Rifkind want to have the opportunity to talk it through with you.

4. Morgan Grenfell

I gather the Chancellor may have some further information to give you, responding to the points raised in Charles' letter to the Treasury of 31 October (flag C).

5. Review Bodies

You saw the note from Sir Robin Butler (flag D) over the weekend. I gather the Chancellor has not yet seen Sir David Nickson; and I am not clear whether he has yet been briefed by Sir Peter Middleton on the likely level of recommendations from the TSRB and AFPRB. I have warned the Chancellor's office you may want to raise this issue, though not necessarily tomorrow.

Sara Howe P.S. 6. National Income Fund

RP.

PAUL GRAY

21 November 1989

The Chancellor also wishes to discuss the N.I.F. You saw a note at the weekend proposing abolition of the NITS allocation, and said you wanted to discuss with colleagues. I have put it on the agenda for (FA) tomorrow, but the Chancellor wants an advance word about it today. His latest minute just received is at Flag E.

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Rec'd 2/11