

PRIME MINISTER

BILATERAL WITH THE CHANCELLOR

Your weekly bilateral with the Chancellor is set for 0930 tomorrow morning. The Chancellor has suggested three items for the agenda.

- (i) The RPI
- (ii) The Community Charge
- (iii) The ERM and Spain.

(As advised in my separate note, you may also want to talk about the pay of electricity supply industry manuals.)

On (i), the Chancellor has now responded again on the RPI (Flag A). His line is as follows.

- (a) It is too late to change the Retail Prices Index in prospect for April. (We do not yet know what the Index will show, but the inclusion of capped community charges will be marginally helpful.)
- (b) The Chancellor does not think that a public statement from Sir Jack Hibbert dissociating himself from the RPIAC advice is desirable, for reasons of propriety and likely hostile political response.
- (c) Instead he proposes action on a longer-term scale:
 - To get rid of the RPIAC
 - To replace it with a Committee comprising mainly professional statisticians and economists

- To set a remit for the new Committee to produce an Index more consistent with EC practices; and

- To undertake the above on a time-scale such that the benefits of unwinding the Community Charge and mortgage rates effects now pushing up the Index would be reflected in annual rates of increase in the RPI below the underlying inflation rate in a year or so's time. *— as now?*

In essence, you and the Chancellor agree on the need to change the construction of the RPI and to replace the RPIAC.

I suspect that, following Sir Jack Hibbert's unwillingness to re-open the earlier decision that the Community Charge should be included within the RPI, it is now too late to change whatever figure for April is going to emerge.

However unsatisfactory the recent history may be, there are attractions in the course the Chancellor now proposes. But it will need to be accompanied by intensive and careful briefing when the April RPI is published on 11 May. The Chancellor is right to suggest emphasis on the underlying rate next month. But it will be a difficult trick to emphasise the underlying rate now, and then the headline rate in a year's time when that is more favourable.

On (ii) - the Community Charge - you already have extensive briefing for the main discussion.

On (iii), the note at Flag B describes the Spanish experience following entry to the ERM in June last year. The main points are as follows:

- (a) The exchange rate has remained above its central rate against the DM.

- (b) Market interest rates are at much the same level as before entry.

- (c) The rate of monetary growth appears to have slowed down (but there may be an element of statistical illusion in this).

(d) The rate of inflation is broadly unchanged since joining the ERM though perhaps slightly down in the first three months of this year.

BHP

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25 April 1990

jd c:chancellor