

PRIME MINISTER

BILATERAL WITH THE CHANCELLOR

The Chancellor would like to discuss two issues at the bilateral on Monday:

- economic situation;
- the community charge.

You may also wish to discuss the deregulation work of E(CP) - see separate note from the Policy Unit.

Economic Situation

The main points for the discussion might include the following

- (i) Inflation: will the headline RPI figure drift up over the next few months? Or will it remain below 10 per cent? Are there indications that the underlying rate may be slackening?
- (ii) Money Supply: There seem to be no indications of deceleration in either narrow or broad money growth. But some City economists (eg. Congdon) are expecting a sudden fall. What is the Treasury prediction?
- (iii) Wage settlements: They seem to show no response as yet to slackening labour market conditions (with underlying unemployment beginning to rise).
- (iv) Corporate Sector: Despite the pressures of high interest rates on the large financial deficits, industry does not seem to have responded by cutting back wage settlements: but is there any evidence that they are beginning to cut profit margins and hence keep down prices?

- (v) Output: The CBI evidence suggests some slowdown in order books; output remains flat: but is consumer demand still too high?
- (vi) Balance of Payments: Are there any indications on the balance of trade figures due out the week after next?
- (vii) Exchange Rate: This remains weak despite the advantage of better than expected local elections results and RPI figures.

The key short term policy issue is whether a rise in interest rates can be avoided. The timing of joining the ERM is also critical.

By the end of the month the Chancellor should be able to provide the papers on the review of monetary policy and the practicalities of joining the ERM. You may wish to suggest a further economic seminar with Sir Terence Burns, Michael Scholar and Sir Peter Middleton.

Community Charge

There are separate notes on the community charge in your Box. The Chancellor's line is likely to be:

- that only when there is some reasonably firm limit on local authority spending can he discuss with Mr. Patten the amount of extra grant to keep down community charges next year; but on any realistic figures, a large injection of Exchequer grant (over £2 billion) will be necessary: the difficulty is finding offsetting savings to stay within public spending plans;
- that, while he has misgivings, he would be prepared to accept the cash limit approach if it can be combined with referenda to make it politically acceptable; but
- that it may not be possible to draft the necessary legislation in time or get it through the House easily.

I understand the Chancellor is, however, not attracted to the idea of an extra community charge, set at the national level, for those on high incomes. He will argue that extra money is better concentrated on improving transitional relief. The Chief Secretary has argued the latter point strongly in recent meetings.

But the extra money was to provide for extra transitional relief.
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BHP

BARRY H. POTTER

11 May 1990

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