NOTE FOR THE RECORD

LUNCH WITH IAN HARWOOD - CHIEF ECONOMIST, S.G. WARBURG & CO.

The main points which emerged from my lunch with Ian Harwood were as follows.

(i) Although there was increasing evidence of a slow down in the UK economy, it was too soon to decide whether a cut in interest rates was justified. The picture was simply not yet clear enough.

(ii) The impact of any cut in interest rates on the exchange rate would also depend upon the course of interest rates abroad. This was particulary unpredictable given the Gulf situation. In time US interest rates would go down, although the Fed might resist any quick reduction given the impact of oil prices on the dollar. But German interest rates could well go up to help finance the borrowing necessary to transform the East German economy. Any rise in German interest rates might be delayed until after the December general election.

(iii) Whether or not the UK joined the ERM, international competitiveness pressures, combined with a slower growth in world trade, would restrain inflation in traded goods and services within the UK over the next year. The problems lay more in the local service sector: all developed economies were discovering that, without pressure to generate competition locally, price inflation in local services tended to reflect cost increases.

(iv) It was too early to assess the impact of the oil price increases on the world economy. But the general expectation was that oil prices might settle down somewhere within the $22-$25 range - <u>assuming</u> no damage to the Saudi Arabian oilfields. But the tendency to play down the impact of the oil price increase should be resisted. Oil prices at the $22-$25 range clearly would not have the serious shock experienced in 1974-75 and again in 1979-80. But, the short golden era in the mid-1980s, when rapid growth had been accompanied by low inflation rates in the developed countries' economies could, with hindsight, be seen to have taken place against the background of falling real energy prices. Rising real energy prices would give a short term stimulus to inflation and hold back the growth in output.

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