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From the Private Secretary

15 November 1990

BILATERAL WITH THE CHANCELLOR

The Prime Minister had a short bilateral discussion with the Chancellor yesterday evening. The discussion focused on the latest economic indicators and the prospects for the months ahead.

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The following were the main points which emerged in the discussion.

i. Despite the current relative weakness of sterling, the Chancellor thought it might still be both appropriate and possible to reduce interest rates by a half or one per cent before Christmas. If, as expected, the headline RPI inflation figure was seen to fall below 10 per cent in the middle of December, given the underlying buoyancy of sterling, the level of the exchange rate should not restrict the Government's ability to cut interest rates. It would of course be necessary to ensure that the monetary indicators continue to show sufficient deceleration.

ii. The slow-down in the economy could be both sharper and shorter than the Autumn Statement projections indicated. Recent output and retail sales figures had shown larger falls than expected. The key factor was the large corporate sector deficit: how far would industry continue to finance such a large deficit, particularly at the high interest rates; and how far would they try to reduce the deficit by cutting activity, for example by de-stocking and reducing investment plans? There was room for a considerable difference in views about the response from industry and commerce. But the outcome could well be a sharper slow-down than projected in the Autumn Statement. If so, it would mean a more prolonged upswing from a lower level of activity. Secondly, it could mean that core inflation was reduced further because of the severity of the down-turn.

Finally, the Chancellor also indicated that, while the central forecast was for a small public sector surplus of £3 billion in this financial year, a small deficit at out-turn was well within the margins of error.

BARRY H POTTER

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