The Governor

cc. The Deputy Governor*
Mr. Fforde*
Mr. Loehnis*
Mr. Dow
Mr. Coleby*
Mr. George
Mr. Goodhart
GPS

* Already have copies,

Addressed to the C.P.S.

SUMMARY RECORD OF A DISCUSSION BETWEEN THE CHANCELLOR AND THE GOVERNOR AT 9 A.M. ON 8 JANUARY 1982, AT NO.11 DOWNING STREET

Present:-

Chancellor of the Exchequer	Governor
Economic Secretary	Deputy Governor
Sir Douglas Wass	Mr. Fforde
Sir Kenneth Couzens	Mr. Loehnis
Mr. Ryrie	Mr. Coleby
Mr. Burns	
Mr. Middleton	
Professor Walters	

The Chancellor referred to a conversation with the Governor over luncheon at the Bank on 5 January, during which it had been agreed that the undisclosed band should be lowered, and there had been discussion of the prospect of a half per cent fall in base rates. The Governor's subsequent letter of 6 January had implied that a precondition for such a fall might be a further rise in sterling taking the effective rate above 92: he himself saw no particular magic in the figure of 92. The Governor agreed: 92 was in no sense seen as a trigger point. The reference in his letter should be read only as indicating that the maintenance of the current generally upward movement of sterling could bring about conditions in which short-term interest rates could appropriately fall. The Bank had in recent weeks successfully resisted a potential rise in interest rates. This had involved massive money market assistance; and more cash would be injected into the market over the next two weeks. But a cut in rates must appear market-led, rather than officially engineered: for it would fly in the face of the evidence of excess growth in the monetary aggregates. The December money supply figures had been better than expected, but the over-run over the year would still be substantial, and the sterling M3 figure in January would be very high. The strength of sterling, if sustained, might however be seen as justifiying a cut in rates.

2. Professor Walters thought that a cut was overdue: if none took place soon, the markets would conclude that there was an unpublished exchange rate target, not yet reached. The Economic Secretary disagreed: the markets must be aware that the intention was to bring rates down.

3. Sir Douglas Wass queried the need for a full and detailed public justification of small moves in interest rates. The system should be flexible, and sufficient evidence to justify a small cut now existed, particularly on the exchange rate front. The justification would not satisfy the most severe critics, but if the Government were to wait until all the indicators pointed in the same direction, the essential flexibility would be lost. The Chancellor agreed: the current strength of sterling, and the December money supply figures, created an opportunity which he would be reluctant to miss. Professor Walters suggested that it was already being missed: the system seemed to have got stuck. The Governor however pointed out that the recent stability in interest rates had resulted from the success of the Bank's fight against an upward movement in rates. He could not accept Professor Walters' view that the markets thought we were trying to get sterling up, and were therefore holding interest rates up. His own position was that he wanted rates to come down, and thought that the conditions for a reduction were close to being achieved. He was however clear that a reduction should be market-led, and not the result of sudden and dramatic action, against the markets' expectation, by the authorities. A reduction by the latter route might be very short-lived.

4. The Chancellor said that this point was well taken. The essential question was whether more could be done to create the necessary conditions for a "natural" fall. Mr. Ryrie pointed to the fact that sterling was only drifting up: a more staccato and dramatic rise might more readily create the right market environment for an interest rate cut. Sir Douglas Wass suggested that a fairly small increase in assistance to the markets might

perhaps do the trick, but Mr. Fforde and Mr. Coleby thought that this would not necessarily affect rates at the longer end. Sir Douglas Wass and Sir Kenneth Couzens thought that it was clear that a "natural" cut of about a half per cent would be in order, provided that all concerned were prepared if necessary to reverse it: the essence should be flexibility in both directions.

5. The Chancellor agreed. The question was whether we could achieve the cut quickly and without heavy-handed action in the money markets. The Economic Secretary stressed the importance of avoiding heavy-handed action. The Governor agreed that it would be right to aim at creating the conditions which would permit a half per cent fall in base rates within the next week or two. The means by which this end could be achieved were the Bank's business. There could be no guarantee of success, but the market circumstances should be helpful in a technical sense over the next two weeks.

6. The Chancellor said that all were agreed as to the objective: a reduction in Bank base rates soon. All were also agreed that a reduction of more than about half a per cent would not be feasible in the near future. While the risk of an unforeseen obstacle - e.g. a rise in US rates - was understood, the hope was that an apparently market-led "natural" cut could be effected within the next fortnight.

7. The meeting ended at 10.20 a.m.

Jill Rutter

PP J. ~~O. KERR~~
11 January 1982

Distribution: Those present
PS/ Chief Secretary
PS/Financial Secretary
Mr. Monck
Mr. Kemp
Mr. Ridley
Mr. Turnbull