

5411

SECRET

Re Governor Request:

- DG
- ADL
- OSAG/ALC
- JLR
- JSF
- WPC/BQ
- MTB
- JSR
- CRG
- DM
- GPS

Re Governor
 There is an obvious error
 in para 5. OSAG has
 suggested a redraft, as
 marked. A 28/4



For Record
Corrections in
para 4, 5 & 8
passed to Chancellor's
Office on 30/9
[Signature] 30/9

RECORD OF A DISCUSSION BETWEEN THE CHANCELLOR AND THE GOVERNOR AT
10.30 A.M. ON FRIDAY, 24TH SEPTEMBER 1982 AT NO.11 DOWNING STREET

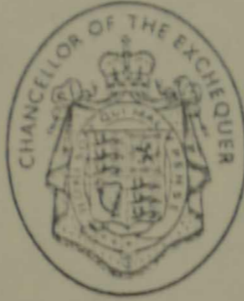
62-28/9

Present:-

Chancellor	Mr. Littler	Governor
Sir Douglas Wass	Mr. Middleton	Deputy Governor
Mr. Burns	Mr. Monck	Mr. George

Domestic developments

The Governor said that, while the Bank of course entirely shared the Chancellor's wish for conditions conducive to a further fall in interest rates, their efforts had in recent weeks been directed to validating the present rates. The markets had been under considerable strain, and the clearing banks had tended to argue that the last ½% fall had come too quickly: it had been a struggle to hold the rates down. However from 22 September sentiment had changed: funding had been good, and the rates had started to ease. It should now become possible to press, without cutting across the grain, for a further half percentage point. The Chancellor drew attention to the steadily improving inflation prospect, and to the upward pressure on sterling, which was again close to an effective rate of 92. The Governor agreed: the Chancellor's 6½ per cent inflation forecast had been well received in the gilts market, and there was some inflow of foreign funds. But the growth of the monetary aggregates had accelerated, no doubt partly due to lower interest rates. Further falls would further fuel monetary growth. The M1 target was already beginning to look a lost cause, and the other aggregates were getting near the top of their target zones. New preliminary figures for the latest period would be available today, and would be higher than previously thought. Bank lending was still strong. However, the monetary performance was not yet such as to preclude the immediate interest rate action which was envisaged.



2. The Chancellor concluded that the aim should be to seek an early base rate reduction of another $\frac{1}{2}$ percentage point. The Governor agreed. The Bank were ready, and indeed eager, to encourage a move as soon as conditions were right. The timing might be partly dependent on new US figures.

3. On funding, it was agreed that the plan to announce a £1 billion (nominal) 1988 stock for tender on 29 September should stand.

International developments

4. The Governor said that the world-wide recession was deepening. The atmosphere in the markets was, on the surface, less frenetic than at the time of the Toronto meetings, but the actual situation had not improved. And the tension remained high: considerable upheaval that morning had resulted from reports that the Singapore branch of a Japanese bank had sustained heavy losses in foreign *dealings* exchange futures. The yen was now at a 5-year low.

5. On Mexico, the situation remained confused. It was remarkable that [no] drawings [had yet been made] ^{had been as small as they had been} on the BIS facility. The threat of defaults in the inter-bank market was still very real: such defaults would be extremely damaging.

6. The Argentine would be seeking \$1.5 b. support to get through to 1 January, by which time a deal with the IMF was envisaged. The banks had however indicated that the bid for \$1.5 b. was unrealistically large. The Anglo-Argentine deal negotiated in Toronto was sticking rather well, except for the continuing presence of supervisors in UK banks and other businesses. The Chancellor said he had raised this with Secretary Regan, and Mr. MacNamar had in turn taken it up with the Argentine authorities.

7. The Governor said that Larosière and Whittome were giving encouraging accounts of the IMF's negotiation with Hungary, and seemed to suggest that agreement might have been reached on the substance of a programme. This would need close examination. Meanwhile the Hungarians were seeking an immediate additional

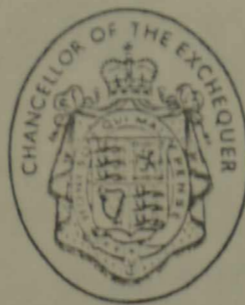


\$300 million standby. This created a difficult situation for us and for others (not least the Germans). Yet there would be substantial damage to confidence if Hungary were seen to be turned down. It might be right to provide, presentationally, for a new \$300 million standby, but in practice to hold the new component to \$90 million, by rolling over the outstanding tranches of \$100 million and \$110 million which were due to mature on 7 October and 17 November respectively. But it was not clear how the discussion would go at the forthcoming meetings in Basle. The Chancellor said that the question of a Treasury guarantee for a UK contribution to a further tranche for Hungary created major difficulties. And the Bank's one-seventh share of the existing two tranches seemed disproportionately large. The Governor agreed that it was disproportionate to our share of Hungary's trade with the West: it did however reflect the position of London as a major financial centre. It would however be right to straighten out the basis of participation in such arrangements: the make-up of the Mexican facility was very curious.

8. The Governor added that the question of support for Yugoslavia might arise very quickly: the position would however be rather different from that of Hungary since the State Department would, he understood, be keen that the Fed should participate in the operation.

9. As for the difficulties in London over Treasury guarantees, the Governor wondered whether it would be sensible to envisage taking a general statutory power, rather than being obliged to report seriatim to Parliament. The Chancellor agreed that this question would have to be considered: the Mexican case had highlighted the unsatisfactory nature of the present position. Sir Douglas Wass said that the Mexican case did in fact cause him some concern, and Mr. Littler added that he would be discussing the general issue with Mr. Loehnis. He was not worried about what had been done in the Mexican case, but was very chary of repeating it for Hungary. It was agreed that the issues of propriety and procedure would be further explored.

S E C R E T



10. The meeting ended at 11.30 a.m.

A handwritten signature in dark ink, appearing to be "J.O. Kerr".

J.O. KERR

27 September 1982

Distribution:-

Those present

PS/Chief Secretary

PS/Economic Secretary

Sir Kenneth Couzens (o/r)

Mr. Carey

Mr. Lavelle

Mr. Turnbull

Mr. Peretz

Mr. Ridley (o/r)