

UR 12/1

MEETING WITH THE CHANCELLOR

1 We need to address ourselves to how we go on if the exchange rate remains very weak in the period ahead.

2 That possible weakness is now likely to be predominantly caused by political uncertainty and Shore's alternative policies. But there is little doubt now - see today's Press and yesterday's - that the Government posture of unconcern about exchange rate per se is likely to aggravate weakness stemming from this primary cause. Policy will be more difficult unless a more positive attitude is adopted. This would comprise positive attempts to persuade Press and markets that the Government felt the fall in the exchange rate had gone quite far enough, eg compared with the dollar ie we do not need further depreciation which would have damaging consequences for the economy.

3 This posture would not be the same as declaring a rate which we committed ourselves to defend - given the nature of the uncertainty there can be no confidence that we could choose a rate of that sort. But it would provide market reassurance that we were not looking to see the rate lower, and in this sense it is very different from the posture of "looking at monetary conditions as a whole".

4 We may none the less continue to slide. In that case our money market policy would have to be to seek to contain for as long as we could the upward pressure on interest rates but to act decisively ourselves to raise rates when it became clear that the upward pressure could no longer be withstood. This would be in the nature of damage limitation.

5 This posture in the money markets would need to be supported from time to time by exchange market intervention designed to help consolidate short-term interest rates, eg just after the rise in interest rates if that was necessary or where there were particular reasons for hoping that the exchange market, and associated money market, pressure was likely to prove temporary.

G.R.

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