

SECRET

Re Governor

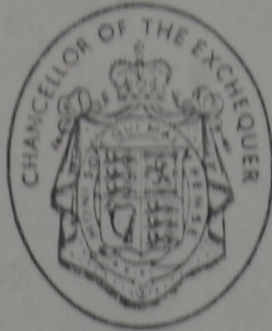
1. Copies have gone
direct to G6, SOI
88056. I have
not given any further
circ. here.

R

6/5

2. At 88056's request
I have left a message for
John Ken to correct
the figures in para 2, line 4 for PSL 2
- i.e. $1\frac{3}{4}\%$, not $2\frac{3}{4}\%$. R 6/5

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FROM: J O KERR

DATE: 5 May 1983

RECORD OF A DISCUSSION BETWEEN THE CHANCELLOR AND THE GOVERNOR
AT 8.45AM ON 5 MAY AT NO 11

*A branch attempt by
Kerr to
at some*

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Present:

Chancellor
Economic Secretary
Mr Middleton
Mr Burns
Mr Cassell
Mr Monck
Mr Lavelle

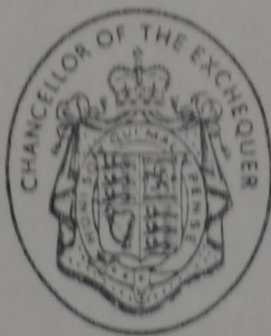
Governor
Deputy Governor
Mr Loehnis
Mr George

The meeting reviewed the current prospects for interest rates, picking up recent developments on the issues covered in the Chancellor's reply (of 26 April) to the Governor's letter (of 19 April) about the monetary situation.

2. The Governor drew attention to the money supply figures which would be published on 10 May, and would be unexpectedly bad. It appeared that the monthly increase in EM3 would be as high as 2 per cent, with M1 at about $1\frac{1}{2}$ per cent, and PSL2 at about $1\frac{3}{4}$ per cent. Even the more pessimistic outside commentators had not suggested figures as bad as these. Government borrowing too was well above forecast. Sterling had risen since the meeting at No 11 on 22 April: the main factors behind the rise had probably been the prospect of oil price stability, improved monetary prospects in the United States, and talk of an early election. If there were to be no early election, sterling could suffer; and overnight selling in the United States had in fact brought sterling down from its closing (effective rate) level of 85.1 on 4 May to an opening level of 84.6 on 5 May.

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3. The Governor could see no case, and no market pressure, for a reduction in interest rates. Indeed the monetary figures - together with electoral uncertainties - created a powerful case against any reduction. He also noted that the results of the IG sale were not yet known, and that the 5 May local authority elections created a further uncertainty.

4. The Chancellor noted that, despite the overnight fall, sterling had risen substantially and sharply in recent weeks. It was also noted that the rise in sterling reduced Government revenues and so exerted upward pressure on the CGBR, which might be one of the causes of higher monetary figures. The dilemma for policy lay in the fact that the monetary aggregates and the exchange rate pointed in opposite directions. But it was also noted that the threat of an increase in building society rates, which would be very real in June if there were no election, and would remain real for subsequent months even if there were a June election, presented a serious political difficulty; and that if such a rise were deemed politically unacceptable, preventative action ought to be taken fairly quickly.

5. It was agreed that, given the Governor's disturbing news of the monetary aggregates, it would be wrong to act this week in such a way as to bring about a fall in base rates. However, the situation should be reviewed within a week, taking full account of any further movement in sterling.

A handwritten signature in dark ink, appearing to read 'J O Kerr'.

J O KERR

Distribution:

Those present
Chief Secretary
Financial Secretary
Mr Littler
Mr Kemp
Mrs Lomax
Mr Peretz