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RECORD OF A DISCUSSION BETWEEN THE CHANCELLOR AND THE GOVERNOR
AT NO 11 AT 9.45AM ON 1 JUNE 1983

Present:

Chancellor
Economic Secretary
Mr Middleton
Mr Littler
Mr Lavelle
Mr Monck

Governor
Deputy Governor
Mr George
Mr Loehnis

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copies*

The Chancellor said that he had thought a discussion of interest rates and the exchange rate timely, principally because sterling's recent rapid climb must be creating new problems for exporters. A further reduction in base rates would presumably slow the ascent; and would of course be useful in the context of building society problems. He had noted that the "first guess" at the May money supply figures, to be published on 7 June, showed no growth of £M3: even allowing for the recently demonstrated unreliability of "first guesses", the May figures were clearly going to be much better than April's, and would probably be seen as very good: they certainly did not amount to a case against a fall in base rates. But his understanding was that sterling had in fact weakened since the London market closed on 31 May.

2. Mr Loehnis confirmed this. After closing in London at an effective rate of 87.8, sterling had fallen in New York, and again more sharply early on 1 June. The effective rate at 9.15am had been 87.2. The main cause of the fall was a very strong dollar; a contributory factor in the sharp fall early on 1 June might be new public opinion polls suggesting that the gap between the Parties had narrowed. Mr George added that, while the "first guess" May £M3 figure had indeed shown no growth, the final figure might show growth of some 0.5 per cent.

3. Mr Middleton said that he favoured lower interest rates. But sterling's recent strength had had no impact on the domestic money

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markets; and, with no pressure for downward movement, the authorities would, in order to produce one, have to make a very public signal. This would be unusual, and a little dangerous, late in an election campaign.

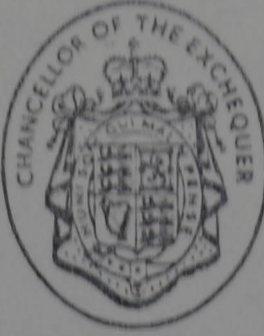
4. The Governor thought it important to analyse the reasons for sterling's recent strength. He suspected that it contained a large electoral element, for the dollar too was very strong, with US interest rates rising, and no real hope of early action on the US deficit.

But the electoral element might not outlive the Election: he thought it conceivable, and some in the Bank were fairly confident, that, even given a Conservative victory, attention post-9 June would switch to the underlying issues, and sterling would fall. While it had been worrying in recent weeks to watch sterling rise above the level which had brought relief to industry (at the cost of some increase in future inflation) and back towards levels which industry had previously found excruciating, the level even of last November had not in fact yet been regained.

5. As for the domestic markets, there was no pressure for reductions in interest rates. The money supply figures on 7 June should provide some reassurance to the market, but the monetary situation remained worrying, with doubts about the 1982-1983 PSBR outturn, and its significance, still unresolved.

6. Mr Middleton thought it important to take account of the exchange rate whenever one considered monetary conditions. We had done so when sterling had been falling: we should also do so when it rose. This, together with the fact that real interest rates were rather high, suggested that the monetary position was fairly tight. On the other hand, an overt move on interest rates before the Election would be very dangerous. Following the Economic Summit, and the absence of any grounds for hope of effective US action on their deficit, the

SECRET



expectation must be that US interest rates would remain high. UK rates might start to fall following the publication of the May money figures: but to try to accelerate that fall would be unwise. The Economic Secretary agreed, and the Chancellor noted that there was no dissent from the view that we should not, in the absence of any spontaneous market movement, try to bring rates down immediately.

7. In subsequent discussion:-

- (a) The Governor noted that there might be a case for a major study, after the Election, of how much weight should be given to exchange rate considerations if furthering industrial recovery were to be the major aim;
- (b) Mr Littler thought that it might be worth comparing UK and German interest rates in recent months. His impression was that they had been closely in line, but that ours had risen in the last couple of months, and were now closer to US rates; and
- (c) It was suggested that intervention policy in the short term ought to remain approximately the same as in recent weeks, though there might be a need for a further review if more than £0.5B were taken in, or sterling rose above an effective rate of 90, before the Election.

real interest rates

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