The Governor

a/ *The Deputy Governor

*Mr. George

*Mr. Loehnis

Mr. Plenderleith

Mr. Dow

Mr. Flemming

Mr. Coleby

Mr. Goodhart

GPS

Cw

22/6

* Already have copies.

17.6.83

Rec'd 20/6 14.10

RECORD OF A DISCUSSION BETWEEN THE CHANCELLOR AND THE GOVERNOR AT 4.15PM ON 15 JUNE IN HM TREASURY

Present:	Chancellor	Sir T Burns	Governor
	Economic Secretary	Mr Littler	Deputy Governor
	Mr Middleton	Mr Cassell	Mr George
			Mr Loehnis

The Chancellor said that he had found the paper on "the operation of monetary policy", sent by the Deputy Governor on 13 June, impressive and useful. He would welcome a discussion, in due course, of the issues which it raised; but be had suggested the present meeting in order to discuss the present situation.

2. The Governor said that while the exchange rate had fallen, and monetary growth remained within the target zone, in the last months of 1982-83, the converse had since obtained. Even assuming that the sharp acceleration in the growth of the broad aggregates in banking April was exceptional, and that the contrast with the picture at the turn of the year might be less sharp than it appeared (because the PSBR in the winter months might have been below trend), there could be no doubt that underlying monetary growth had accelerated, and to a degree which gave cause for concern. But real interest rates had hardened in recent months, and the inflation prospect remained good: these factors suggested that policy remained reasonably tight. The markets however believed that the authorities wished to see the exchange rate fall; and reductions in interest rates were perceived as inconsistent with previous policy, given the clear evidence of rapid monetary growth. The markets also noted that, with no progress on the US budget deficit, US interest rates had drifted up post-Williamsburg.

3. The Chancellor said that the cause of recent monetary growth which gave him most concern was the PSBR. He hoped that an

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analysis of the implications of the surge at the end of 1982-83 would soon be available.

4. Mr Middleton agreed with the Governor's description of the current situation. As for the PSBR, studies were in hand, and the picture would become clearer when the forecast was available in a fortnight's time. The 1983-84 PSBR was undoubtedly running above profile, though supply expenditure was not. Major improvements to the system for monitoring the PSBR were undoubtedly required, for on supply the current system had produced erroneous information in February/March, and arrangements in respect of local authorities and nationalised industries had never been more than rudimentary.

5. The Chancellor said that it seemed clear to him that we should press ahead with a heavy funding programme. Mr George confirmed that a full and appropriate range of instruments was available, and that sales of some £600m for the month ahead, and £300m for the following month, were already tied up. Gross sales over the last three months had run at an annual rate of over £16B.

6. The Chancellor said that he was puzzled by the press treatment of sterling's relatively minor recent falls, and by the press suggestions that the Government had encouraged them, and might encourage more. The fact was that sterling's effective rate was now precisely the same as it had been on the day the election was announced: lower against the strong dollar, but higher against all the European currencies. Between 9 May and 9 June the markets had clearly anticipated the election result: some profit-taking now need not cause alarm, and he saw no reason to depart from the normal ground-rules on intervention, and exceed the guideline of roughly $50m a day. In contacts with the Press, Treasury and Bank spokesmen should however make it clear that policy towards the exchange rate had not changed, and that suggestions that the authorities wished to see sterling fall were misconceived.

/7. In subsequent

7. In subsequent discussion, it was suggested that such reports were not surprising when the authorities encouraged a fall in the general level of interest rates which could not be justified by current money supply developments, and when US rates were rising. But it was also noted that monetary growth had not been such as to justify the sharp interest rate rises of winter 82-83. On the other hand, it was suggested that sterling's fall in and after November 82 had been fed by rumours that the authorities wished to see a fall: given that two thirds of the fall had been wiped out by election day, the markets might reasonably assume that the authorities wanted another. Yet the markets, and the Press, should recall that the authorities had in 1980 consciously decided not to tighten conditions despite very rapid monetary growth: so policy had been applied flexibly before. It was also noted that the market would watch closely to see what the authorities did about the threatened rise in building society rates: action, or inaction, would undoubtedly affect the exchange rate.

8. The Chancellor's conclusion was that further efforts should be made to persuade the markets that their perception of policy was misconceived: there had been no major change. The analysis of the PSBR position, and the possible need for corrective fiscal action, should be given high priority. The funding programme should be pressed ahead. And the more fundamental issues addressed in the paper submitted by the Deputy Governor would be addressed in due course.

JOK.

J O KERR
17 June 1983

Distribution:

Those present

Chief Secretary	Mr Monck	Mr Ridley
Financial Secretary	Mr Lavell	Mr Hall
Minister of State	Mr Lankester	Mrs Lomax
		Mr Peretz