

MEETING WITH CHANCELLOR 2 AUGUST

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SECRET

NOTES FOR MEETING WITH CHANCELLOR: 2 AUGUST

A Experience suggests that an active campaign by the Bank to lead interest rates down would be very dangerous.

- (i) Important to be confident that any reduction does not need to be quickly reversed. Unfortunate precedents in 1982 and 1983 (separate briefing).
- (ii) Many factors outside our control (for example, US interest rates - where there is a general expectation of a further rise - and oil prices).
- (iii) Despite Chancellor's comments about the primacy of monetary targets, we cannot let the exchange rate go into a 'flat spin'.

B In any case, we cannot bring down market rates by our own operations without reducing our dealing rates - which would be a very 'heavy' signal.

C Must first see market reaction to money supply figures. In present irrational mood, no guarantee that market will turn bullish.

D But we are not trying to keep rates unnecessarily high. We do want them lower, when conditions are right.

E We should press the case for maintaining satisfactory progress on funding. This will be important for sentiment, and the mood should be greatly helped if we can issue an orthodox partly-paid stock this Friday. We are not keeping rates high simply to ease funding - but successful funding is important in encouraging a move to lower rates.

F Intervention in support of sterling may not be a long-term panacea, but it can have short-term uses, eg in buying time ahead of expected good news. In any case, intervention is less of a major decision than to flood the money market.

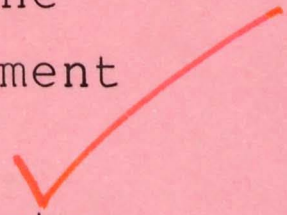
G Important to concentrate on the credibility of monetary policy over the next few months.

Chui
Pl awang — *done* *MS*

THE GOVERNOR

4.30

We have now heard that the meeting with the Chancellor to discuss money market management will be on Thursday 2 August at 4.15³⁰ pm.



The Chancellor will be supported by Middleton, Cassell and Stewart.

Who would you like in your team, please? Perhaps the Deputy Governor, Messrs Loehnis and Coleby?

Yes

26/7 *Chris*

£ mn

SPEAKING NOTES

1 The preliminary money figures for July are now confirmed by the provisional figures covering all reporting institutions. Sterling M3 is shown as falling by 1% on the month to produce an annualised rate of growth over the first five months of the current target period of 9.1%. M0 rises by 0.2% which brings down the annualised rate to 5.7%. PSL2 also falls slightly to produce an annualised rate of 15.6%.

2 The forecast for the current banking month is for a growth in sterling M3 of 0.5%. That was based on projected gross gilt sales of 1250, but also on a forecast of the CGBR which currently looks like being overshoot by some 350. Gross gilt sales to date are ~~1120~~ 1140.

3 The domestic markets have in the past 24 hours become distinctly more cheerful. The origins lie in changing sentiment in the United States, which has seen a sharp improvement in bond prices and an evaporation of fears of higher interest rates though, as yet, no significant decline. Our own money market rates have not declined at all far and the three month inter-bank rate remains at 12 3/16%.

*not monetary laxity
- City. not quite same view
- risk of interpretation
of X rate
oil price
markets short circuit*

The present situation.

1 para 2 in dossier

2. This follows a week in which the market improved last Thurs/Fri after Volker but fell back on Mon with 3m @ 12 - seeming nervousness still there until to-day.

3. Our q. is posed in the letter to me

a) how prepared to further upward pressure, shd. it develop.

b) how actively to seek to promote

or how ii) actively to seek

b first + i) first. how active - we shd. be?
"initially fairly cautious" my phrase - solely to ensure reasonable sureness

(see my letter 23rd July)
£ reasonable degree of firmness in mkt's.
fisk funding re-established. - good chance.

b ii) should we actively induce - experience of Oct/Nov '82
June '83.

only acceptable if we are anticipating a market move
prodding us already there

If so, why not be patient - chances of improvement
thro' Aug. & Sept.

a) how to respond to upward pressure, should it develop.

A. - upward flow from fall in £x (combined with ^{doches} minus U.S. _{hit})
federal as well as \$

- mkt. convinced interest rates wd. go up sooner or later, given no intervention policy.

- once nervousness reached certain level, response of market felt it.

Coleby

AT SOME POINT authorities must be concerned (anti-inflationary policy)

paras

4

- the more strongly we rule out intervention }
the greater the pressure on interest rates }

1

? undermine the present certainty. Greater freedom.

10

CHANGE - nature, presentation, timing careful but otherwise vulnerable.

B. i. avoid technical state of market creating upward pressure

ii contain adverse expectations from being self-reinforcing.

Coleby paras 8-9.