

SECRET

PRIME MINISTER

The Budget, etc.

1. When we are buffeted around by massive shifts in the target variables as we saw in this morning's (Tuesday's) meeting, the strategic planning of the budget is extremely difficult. The most important elements, the PSBR, with the fM_3 equation and interest rates, emerge with lurches of frightening magnitude. It is very difficult to create stable conditions in such an environment. We cannot make nice adjustments in any meaningful way. But we ought to plan on the basis of our past experience.
2. The trend of the forecasts of PSBR is upwards - and, by the nature of the extrapolative forecasts, they are unlikely to undershoot unless there is a marked turn around in the economy. True there will be attempts to cut spending, but it would be unwise to be sanguine about the result of such attempts. We are likely therefore to budget for too low a reduction in PSBR (as we did in 1980/81).
3. This will lead either to an additional late summer or autumn budget (which is to be avoided) or to putting great strains on funding. This last resort may lead to a funding crisis, but it will certainly lead to high interest rates, retaining high exchange rates and yet another squeeze on the private sector. This outcome must be avoided - it would be a quite impossible scenario for the approach to an election.
4. Painful decisions now, properly packaged as being due to the costs of last wage round and NI Losses, and put forward as an employment budget, might get things right in time for an election. But there is little time even to make the decisions, let alone package and sell them to Colleagues who must be persuaded that we have got it right.
5. I have discussed this with David Wolfson and John Hoskyns.

10 February, 1981

SECRET

