128

1. Mr Ryrie
2. Chancellor of the Exchequer

cc Financial Secretary
Sir Douglas Wass
Sir Kenneth Couzens
Mr Burns
Mr Britton
Mr Lavelle
Mr Monck
Mr Turnbull

MINIMUM LENDING RATE

1. I agree with Mr Monck's comments below. The case for reducing MLR is based on opportunism. The combination of a small reduction in MLR plus agressive selling of stock could enable us to sell a lot of stock for banking February and March. It would help mop up some of the liquidity in the system whcih is shown by the increase in £M3 and the other wider aggregates.

2. But of course what is needed for this is the expectation of lower interest rates. There is no doubt that such an expectation is already about - market rates are below MLR and a reduction in MLR is widely forecast by the commentators. The convertible unlocked the demand for stock which had been building up in the institutions. I agree with Mr Monck that the Bank's confidence in its ability to sell stock in these conditions should be well placed. An actual reduction is not needed for funding purposes.

3. If we are talking about a 1% change in MLR which is all I think we could be contemplating - it is doubtful whether there would be much noticable effect on the exchange rate. Much larger changes seem to have had no effect at all. It would be more of a gesture than anything. And though one can see the importance of this, and the expectations raised by the Prime Minister's appearance on Weekend World, it has to be weighed against the difficulties it would cause.

4. These mainly concern the future of monetary policy. The January £M3 figure at 1% is not a good one. We cannot keep reducing interest rates while the monetary aggregate we are targeting is rising way outside the target range without creating a confusion in explaining policy which goes beyond the markets. In the budget - in 6 weeks time - you will be trying to set the

129

strategy back on track including deciding the general stance of policy, and how short term interest rates are to be determined, and whether we adopt new funding techniques. It is of crucial importance that these should appear credible to a wide selection of opinion. You may decide on a combination of policies, taking account of the exchange rate, which would be consistent with a fall in MLR. But it is equally likely that you would find that a 1% reduction before the Budget makes your post Budget position a good deal more difficult to sustain or explain.

5. It is for this reason, together with what Mr Monck says about fiscal policy, that I think it would be very risky to go for immediate reduction in MLR. As a minimum we need to have a pretty clear idea of the future stance and implementation of monetary policy, the discussions on which are only just beginning.

P E MIDDLETON
2 February 1981

Encs