



26.7.79

see 27.7.79

CHANCELLOR

Financial Secretary

c

Sir F Atkinson  
Sir Douglas Wass  
Sir Kenneth Couzens  
Sir Lawrence Airey  
Sir Anthony Rawlinson

THE COMPANY SECTOR IN 1980

1. The position into which the finances of the company sector could be forced by 1980 has always been one of the key issues underlying the viability of present policies. I believe that the time has now come for it to be examined rather carefully. Memories of what happened in 1970/71 and 1973/74 should be sufficient to remind us of what can happen if the real money supply is fiercely reined back while the profit margins of the company sector are squeezed to the limit at the same time.
2. The issue arises in a most direct way over the projections of the flows of funds for next year and, in particular over the degree of deterioration projected for the non-oil part of the company sector. Here the position is worryingly obscure. The basic arithmetic is, admittedly, open to very wide margins of error. Even so, it seems quite possible that the outcome could exceed the margin of the acceptable. The only proper way to deal with that anxiety is to investigate the various projections and assessments currently available, the position they imply, and to consider what conclusions one might draw for policy - in this case principally the monetary target, the exchange rate or, bearing 1974 in mind, corporate taxation.
3. The Treasury post-Budget Financial Forecast [Table 1. "The rest of the forecast"] suggests a substantial company sector deficit of around £3½ bn in each of the three financial years 1978/79 to 1980/81. One might consider this a not unacceptably large deficit which is not deteriorating significantly. The only important qualification to this judgment is that the projection covers the



entire company sector including oil companies. So it may conceal within a stable total a sharp improvement due to OPEC and North Sea developments matched by an equally sharp deterioration on the part of the rest of the company sector.

4. The LBS [June/July "Economic Outlook" Table II, p10] project a much larger deficit of over £5½ bn for calendar 1979, and a marginally smaller one in 1980. Unfortunately I have been advised that there is a mistake in the calculations. The corrected figures are not yet known, but probably will reveal a considerably larger deficit in 1980 than in 1979. Such a deterioration from so high a level would be distinctly worrying.

5. Phillips and Drew show a picture which is, in its way, as disturbing as the LBS one seems likely to be when corrected. Though they only estimate the 1979 deficit to be about £4 bn, they project a further deterioration to about £5½ bn in 1980. They also go on to project what companies might in consequence have to borrow from the Banks. The path of yearly borrowing rises sharply from about £3 bn in 1978 to nearly £5½ bn in 1980, implying that the company sector's share of the total increase in Bank lending to all sectors rises from under 25% to well over 60% over those three years. All that is on the assumption that the weighted exchange rate lies between 66 and 67 both this year and next!

6. The differences between these three sets of estimates arise, as always, for several reasons. Assumptions about public spending, tax revenue and inflation are clearly different for example, any of which can have a decisive influence on the figures. So it might be worthwhile to ask the economists to look carefully at these three sets of projections - and any other reputable ones such as Wood Mackenzie's - in order to establish just how difficult the company



sector's position might realistically be expected to become. The fact that the exchange rate is now far higher than was thought likely a little while ago complicates the issue a bit. But if on fairly comparable exchange rate assumptions the "downside risk" is shown to be far greater than the post Budget Financial Forecast suggested, we shall in my view be threatened with dangerously difficult times in the next 12-18 months which could put some of your policies at risk.

*AR*

A N RIDLEY  
26 July 1979

H.W. 100

CONFIDENTIAL

See 26.7.79

30.7.79



away.

- cc Chief Secretary
- Financial Secretary
- Minister of State (C)
- Minister of State (L)
- Sir Douglas Wass
- Sir Fred Atkinson
- Sir Kenneth Couzens
- Sir Lawrence Airey
- Sir Anthony Rawlinson
- PS/Governor

Mr Dixon  
Mr Butt

MR. RIDLEY

THE COMPANY SECTOR IN 1980

The Chancellor was grateful for your minute of 26 July, which I have copied at his request to other Treasury Ministers and to the Bank of England.

2. I am also taking the liberty of copying it to Mr. Dixon and to Mr. Butt, since the Chancellor has commented that it is important that this subject be studied carefully, and they seem best placed to co-ordinate work.

*M.A.H.*

M. A. HALL

27 July 1979

Copies to the Deputy Governor

Mr. Friswell

Mr. Morrison

Mr. Dow

Mr. Bundred

The Chief Cashier

Mr. Dick. Mansel

Mr. Walker

Sir Henry Benson

Lord Cosham.