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(Copied to Bkg. Sept. 10R)

SECRET AND PERSONAL



Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

17th May, 1979

The Governor has
now agreed

Copies to Mr. Ffrench
Mr. Mellor
Mr. Dow

Len 18/5

Dear John,

JRB
24/5 ONLY

The Governor had a talk with the Chancellor yesterday about current developments at which Sir Douglas Wass was also present.

The Governor gave an account of the situation in the domestic and overseas markets. The markets had responded positively to the Queen's Speech. The money markets were in surplus again after a period of sustained tightness and short and long interest rates had eased a little. A reasonably comfortable make up day was indicated. Publication of the money supply figures today would show a rise of $6\frac{1}{4}$ per cent since October, an annual rate of $12\frac{3}{4}$ per cent, outside the present target range. The annualised growth in M1 was even higher at 15 per cent. The central government borrowing requirement, though distorted by the Civil Service strike, was high. The rise in bank lending at £520 million had come down a little from recent levels, but the Governor said he remained sceptical about attributing the strength of bank lending to the effects of earlier industrial dislocation. He thought the lags were generally longer than that. Sir Douglas Wass added that if the high figures reflected increased stock holding this would show up when the trade figures were published.

In the foreign exchange markets the Governor reported that the pound had been firm over the last two or three days. There had been some profit taking and the market had hesitated a little when the earnings figures were published. But the Bank had not needed to support the pound and indeed had taken a little money in.

The Chancellor then raised the subject of exchange control relaxation on which Bank and Treasury advice was very close. He wondered if there might be tactical advantage in announcing changes ahead of the Budget against market expectations.

/In reply,

J. Beverly, Esq.,
Private Secretary,
Bank of England

SECRET AND PERSONAL

X I have made it
clear to Britnell
accept that I



made no statement
entirely correctly this is he is concluding
on

In reply, the Governor explained that even if the Chancellor were in a position to finalise decisions in a few days the necessary preparations could not be completed until a week before Budget Day. Presentation apart, he felt that decisions on exchange control should be taken and announced in the context of the Government's overall economic and financial policy. Both he and Sir Douglas Wass felt that this pointed to announcement in the Budget statement.

Turning to the size of the PSBR the Chancellor confirmed his commitment to a figure of about £8 billion this year though he would not be disturbed by a margin of £100 or £200 million, given the fragility of the PSBR forecasts. Both Sir Douglas Wass and the Governor thought that the Budget was shaping up to a package which would be well received by the markets, so long as it had a substantial public expenditure element which did not rely excessively on sales of assets. The Chancellor said he had in mind not more than £1 billion from disposals of which not more than half should come from the sale of BP shares. The Financial Secretary had suggested about 16 per cent: he thought this was about right. The Governor confirmed the Bank's judgement that, with appropriate preparation, the market should be able to absorb a figure of £1 billion over a year. Careful thought would need to be given both as to timing and arrangements for handling disposals: there was an important co-ordinating role for the Bank. Otherwise, departments would be badgered by merchant bankers. Sir Douglas Wass said that was already happening. Concluding, the Governor said the Bank stood ready to advise Ministers on this issue.

X
So. the
basis not for
such a judgement
The Governor
certainly made
his point that
asset sales would
not count in
same way as
expenditure cuts

The Bank would also like to provide the Chancellor with an assessment of the likely financial effects of the Budget if he could be kept in touch with developments. The Chancellor welcomed this.

There was also a short discussion, in the context of BP, about the present state of the Burmah action. As advised, the Government's position seemed reasonably secure. Nevertheless, the Governor suggested it might be prudent to give some consideration to the possible need for a settlement at some future stage. It was agreed that the Bank should send the Chancellor a short paper on the Burmah issue including the settlement aspect.

The discussion then turned to EMS. The Chancellor expressed the view that political imperatives could inexorably drive the Government to participate in the exchange rate mechanism - as an earnest of its commitment to Europe and the means of making progress on the problem of our net contribution.

/It was



It was not too early to be considering how best to handle this situation tactically and how to prepare ourselves for eventual full membership. Realistically we should be devoting energy to the question when we joined, rather than whether - though he was not suggesting that this latter question should be taken as settled. The Prime Minister was likely to be tackled about EMS at the European Council: while she could say it was a matter for the middle distance, her tone of voice would be important. Deposit of reserves for ECUs, though largely a technical matter, had a symbolic significance: decisions should be taken in the context of an overall tactical plan.

The Governor asked about dividend controls. The Chancellor said he would announce in the Budget that the present controls would not be renewed in July.

There was a brief exchange about the likelihood of a meeting between the Chancellor and Mr. Blumenthal in the margins of the OECD Ministerial meeting in June. The Governor thought that talks with Mr. Blumenthal might well be affected by his own recent exchanges with Mr. William Miller about the Euro-markets. He would let the Chancellor have a note.

*Overstated.
The point is only
that the Chancellor
should be forewarned
about the exchanges
with Miller.*

The meeting concluded with a brief discussion about the reference of the Stock Exchange to the Restrictive Practices Court. The Chancellor told the Governor that he thought that he had excluded the Stock Exchange from exposure in the Fair Trading Bill. Arguably the Stock Exchange had only themselves to blame for their present difficulties. Even so, he felt that they ought to be removed from the Order and made subject to some other scrutiny more appropriate to professional practices. The Chancellor welcomed the Governor's offer to consider possibilities and provide advice for the Secretary of State and himself on how best to proceed. The Governor suggested that Mr. Edmund Dell would have useful experience to contribute to an alternative enquiry if not incompatible with his previous office. The Chancellor agreed.

I am copying this letter to Nick Sallnow-Smith in Sir Douglas Wass's office.

Yours ever,

A.M.W. Battishill

(A.M.W. BATTISHILL)