

CHANCELLOR OF THE EXCHEQUER

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

## MINIMUM LENDING RATE

You asked us to consider the case for a reduction in MLR before the Budget. I assume we are talking about a 1% cut which might be announced on 12th February.

2. In the minutes below, both Mr Monck and Mr Middleton advise on balance against doing this.
3. The strongest argument against is that the £M3 figures provide no justification at all and £M3 is still our target variable: although we may be about to change to a system in which we give more emphasis to narrower aggregates we have not yet done so. It is also possible that a move of this kind now would limit your room for manoeuvre by strengthening expectations that the Budget will tighten fiscal policy.
4. On the other hand, it is right in making judgments about interest rates to have some regard for what is happening to the narrower aggregates and the exchange rate. Very preliminary indications are that M1 was flat in banking January but of course we should look at this trend over a longer period. And the exchange rate remains very high. I think one should be influenced by that privately whatever one says publicly. That is not to say that 1% would have any significant effect on the exchange rate but it could only help. It is also right, as the Prime Minister said on the television on Sunday, to pay attention to what is happening to inflation and the real economy. All these factors make a general case for a further downward movement of short-term interest rates, although they do not necessarily indicate that this is the moment.

157/2

327/81

5. The state of the gilt market is also a factor but I think a neutral one at this point. We may benefit from a further 10 days or so of expectations of a cut in MLR but by then it may well be that there would be nothing to lose by making the reduction.

6. This suggests strongly to me that no decision should be made until about the beginning of next week by when we shall have had some time to consider the arguments and shall have better information about the movement of both £M3 and M1.

W.S.R.

W S RYRIE

2nd February 1981