



10 DOWNING STREET

THE PRIME MINISTER

8 April 1980

Mr Brandon.

You wrote to me on 21 March about the sterling rate of exchange and its effect on industry. I am grateful for what you said about our economic policy.

I recognise that the recent high exchange rate has caused widespread concern, and has posed problems for exporters. But I cannot agree that these difficulties could be overcome by a policy of devaluing sterling. It is very doubtful whether, in a world of freely floating exchange rates, the Bank of England could engineer a major, but controlled, reduction in the exchange rate. Even if the Bank could do this, it would involve intervention in the foreign exchange markets on a scale which would jeopardise our monetary targets and hence the fight against inflation, which has to be our first priority. As the Chancellor said in his budget speech, it is an illusion to suppose that we have any real choice between defeating inflation and some other course.

It is true that a high exchange rate is an important channel through which a firm monetary policy is transmitted into a lower rate of inflation. But I must emphasise that there is no question of our keeping the exchange rate artificially high in order to combat inflation. Our policy is that the rate should be set by market forces. *Those forces can never be resisted for long.*

We do, of course, attach the greatest importance to providing a favourable climate for manufacturing industry by removing unnecessary restrictions and increasing the rewards for extra effort. Last week the Chancellor announced a further

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series of measures designed to encourage economic change and improve incentives in the enterprise sector of the economy. But there are limits to what the Government can do. In the longer term, industry can only improve its competitiveness through higher productivity and through pay settlements which companies can afford. There is no easy other way.

*Y
Lousen*

Alfred

Sir Brandon Rhys Williams, Bt., M.P.