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Copies to The Governor
M. Fforde

6.5.80

INTEREST RATES AND THE MONETARY PROSPECT

Note of a meeting in the Financial Secretary's room at 10.15 am on Friday 2 May 1980

Those present: Financial Secretary
Mr Middleton
Mr Riley
Mr Wiggins

~~Deputy~~ Governor
Mr George
Mr Coleby

The meeting had been called to discuss the line the Governor might take at a meeting with the discount market later the same morning.

no such mtg was ever planned. vide JSB 22/5.

The Financial Secretary noted officials' advice that steps should be taken to calm market expectations of a fall in short-term interest rates when the provisional sterling M3 figure for banking April became known the following week. His own view was that it might seem strange if the discount market were called in and asked not to allow money market rates to fall too rapidly, only to have this message apparently contradicted a few days later by measures designed to keep interest rates down by relieving money market shortages. He took Mr George's point that the impact of technical shortages would be felt at the short end of the market, whereas it was three-month rates that were most likely to be influenced by a change in expectations; but at the same time he thought that there was bound to be some link between the two.

In a short discussion, following main points were made:

i. If technical money market shortages were not relieved by continued sale and repurchase and/or special deposit operations, there was a likelihood that Bank base rates would rise. This would probably give rise to greater criticism of the Government than would an attempt to moderate the fall at present in prospect.

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ii. The central difficulty with the present position was that market expectations of a fall in interest rates were running ahead of the prospects for a reduction in bank lending. There was a tension between these two forces which could eventually lead to serious problems on the funding front if allowed to proceed unchecked. The discussions with the discount market now proposed would help to reduce the likelihood of such dislocation.

iii. There would be no suggestion that the authorities wanted to see interest rates remain at their current level: some fall was clearly in prospect, and it was simply a matter of moderating this.

iv. Continued action to relieve money market shortages was likely to be necessary for some time to come, given that the Government were in effect over-financing the public sector in order to allow the companies sector to be helped by the bank system, whilst remaining within the monetary target.

In the light of these points, the Financial Secretary accepted that the Bank should seek to moderate market expectations of a fall in interest rates as they proposed. In this context, however, it should be clearly understood that it was the monetary prospect in general, and the level of bank lending in particular, that gave rise to the need for caution - and not the rate of inflation *per se*. The Financial Secretary was still concerned about the likely tenor of press comment, and hoped that the Bank would do their best to handle developments in as low key a manner as possible. He added that, so far as future trends in bank lending were concerned, it should not be felt that the Government would have to wait for several months'figures after the ending of the Supplementary Special Deposits Scheme before sanctioning a fall in interest rates: he wanted to see a re-assessment of the position as soon as there was some improvement in the figures.

## Tap Stock

Before closing the meeting, the Financial Secretary confirmed that he was content with the proposal in Mr Riley's minute of

1 May for the announcement of a new part-paid medium /stock on the afternoon of 2 May.

SAJL

S A J LOCKE

2 May 1980

Distribution: Principal Private Secretary
PS/Chief Secretary
Sir D Wass
Mr Burns
Mr Bridgeman OR
Mr Britton
Mr Ridley
Mr Cardona

Those present