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PRIME MINISTER

## INTEREST RATES

I had a further discussion this morning with the Governor and officials from the Treasury and the Bank.

2. The action which the Bank have, with my agreement, been taking in recent weeks has successfully prevented a rise in interest rates. This has entailed assistance to the markets amounting to some £2 billion in Banking November, and £½ billion in Banking December: a further £1½ billion was already foreseen for Banking January.

3. There was general agreement today on the objective of trying to secure an early further reduction in bank base rates of about ½ per cent. Such a move would, it is true, not be consistent with the growth of the wider monetary aggregates in relation to the £M3 target, nor with concern over the continuing strength of bank lending to the personal sector. But it could be justified by the recent relative strength of the exchange rate, the more favourable position with regard to the narrow aggregates, and the relatively good figure for £M3 in December - though January promises to be another bad month for £M3.

4. There would however be considerable risk in forcing a cut in base rates by heavy-handed action in the money markets. The markets would be taken by surprise, and could be worried as to what our action signified, particularly for monetary policy.

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We could dislodge the exchange rate, so that it began to move down rapidly. And there would be a risk that we might have to put interest rates back up.

5. This means that it would be unwise for the Bank to attempt to give a dramatic signal of lower interest rates - of the sort which might be given if the market were forced to borrow at lower interest rates through the discount window. We want to use the present strength of sterling to bring interest rates down a little, rather than take measures which might make the markets think we wanted to bring the exchange rate down a lot.

6. The Governor therefore undertook to do what he could to bring about the desired fall in interest rates by appropriate day-to-day action in the markets. This will have to depend on the circumstances prevailing in the market - but these should be helpful in a technical sense over the next two weeks. Therefore, although there is always a risk of unfavourable developments overseas, or indeed at home, I am reasonably confident that we shall be able to meet the agreed objective in the near future.

7. I am sending copies of this minute to the Governor and to Sir Robert Armstrong.

(G.H.)

8 January 1982