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PRIME MINISTER

MEDIUM TERM FINANCIAL STRATEGY

The key to sustained recovery remains keeping inflation down, which in turn means further firm control of money supply growth, and of borrowing. So I plan to emphasise on 13 March the continuity of our economic policies, and to restate the Medium Term Financial Strategy, which, as Cabinet agreed on 9 February, will be extended to cover the next five years.

2. I shall of course be announcing monetary ranges for 1984-85. As you know, I have reviewed the formulation of monetary policy, and the results were foreshadowed in my Mansion House speech in October. I am sure that it is right now to have separate targets, consistent with a continuing reduction in inflation, for broad and narrow money, and the MTFS will therefore show ranges for £M3 and MO. There is no reason to change the range of 6-10 per cent for £M3 shown for 1984/85 in the 1983 MTFS. For MO (mainly notes and coin in the hands of the public) a range of 4-8 per cent would be appropriate. I envisage a subordinate role for PSL2 and M2 as cross checks on growth of broad and narrow money respectively. These changes were discussed with Alan Walters when he was last over; he was very much in favour of the new range for narrow money. For later years the MTFS will include illustrative ranges showing a downward path for both money measures, and making clear our determination to achieve a substantial reduction in monetary growth, taking us towards the ultimate objective of stable prices.

3. The monetary targets need of course to be supported by a consistent policy for public borrowing. The 1983 MTFS suggested a PSBR for 1984-85 of 2½ per cent of GDP, or £8 billion. As you know, I believe it would be right, for three reasons, to aim a little below this:-

(a) First, interest rates are still high both in nominal and in real terms. Lower public borrowing will ease the domestic sources of pressure on our interest rates, and insulate us to some extent against possible disturbances arising from uncertainties about the outcome of United States policies.

(b) Secondly, special sales of assets may bring in some £2 billion next year, or nearly £½ billion more than was assumed at the time of the 1983 Budget. The monetary benefit from this form of reducing expenditure is smaller than from other forms, and we must allow for this in settling the size of the PSBR.

(c) Thirdly, 1984-85 may be the peak year for North Sea revenue, and therefore ought to be a year in which to make a substantial reduction in borrowing: thereafter the PSBR would need to decline only very gradually.

I have of course taken full account of the views expressed in Cabinet on 9 February, and I shall not take a final decision until the latest revisions to the forecasts are available. But my present intention is to publish a figure of 2¼ per cent of GDP, or some £7-7½ billion. The reduction on the 1983 Red Book figure would demonstrate that we had taken account of the three factors mentioned above. Publishing £7-7½ billion would put borrowing firmly back on track after the likely PSBR overshoot this year. And the latest forecast suggests that it would be consistent with the neutral Budget I envisage, and would still leave us a safety margin in hand, which we both think important.

4. The MTFS would show an illustrative path for the PSBR declining further to 1¾ per cent of GDP in 1988-89, with room for cutting taxation next year and over the remainder of the life of this Parliament - provided of course that firm control is on public spending is retained. The path shown in the MTFS will of course be consistent with the assumptions to be used in the Green Paper on expenditure and revenue in the longer term.

If any of the numbers mentioned above cause you any concern, I should of course be happy to discuss them.

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N.L.

20 February 1984