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Prime Minister

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PRIME MINISTER

INTEREST RATES

1. At the meeting of Treasury and Bank officials today, it was agreed that there was a good case for bringing down interest rates with the objective of reducing base rates by another $\frac{1}{2}$ %. This is consistent with the view expressed by the same committee a month ago. We thought then that interest rates should come down $\frac{1}{2}$ %, to be followed by another $\frac{1}{2}$ % if conditions remain propitious.
2. The basis for the reduction was the very slow rate of growth of the narrow aggregates, and indeed the fall in the monetary base. In addition there was convincing evidence of monetary stringency in the high real interest rates, especially as measured against the wholesale price index, and the robustness of the effective exchange rate. Even sterling M3, together with PSL2, appear to be within the target band, although there is some fear that £M3 might be a little above it towards the end of the target period. (But our forecasts have been so far rather too high for £M3 so it may well be that the fear of overshoot is exaggerated.)
3. Although the Treasury were keen on the interest rate reduction, the Bank were rather reluctant. But finally the Bank officials could not discredit the cumulative evidence of monetary stringency.
4. There is, as always, the question of timing. That we decided to leave, as is proper, to the operational people to decide. When we moved interest rates two weeks ago, it was done rather well. The market carried it down nicely. I hope we will be able to repeat the same performance on this occasion.
5. I believe that further reductions in interest rates will be desirable, probably over the next two or three months. The monetary conditions are suitable for us to move to a base rate of about 11%. But I believe it is best if we allow the market to take us down gradually. This is the broad plan that I have agreed with Peter Middleton.

ALAN WALTERS

15 June 1982

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