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10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

30 September 1986

THE MARKETS

My letter recording the meeting held by the Prime Minister this morning to discuss the markets omitted one important conclusion, namely the Prime Minister's view that it would not be helpful to make public the existence of the swop agreement with the Bundesbank.

I am copying this letter to John Footman (Bank of England).

(David Norgrove)

Tony Kuczys, Esq.,
H.M. Treasury.

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10 DOWNING STREET

LONDON SW1A 2AA

30 September 1986

From the Private Secretary

Dear Tony,

THE MARKETS

The Prime Minister this morning held a further meeting to discuss the markets. Present were the Economic Secretary, Sir Peter Middleton (HM Treasury), Mr. Frank Cassell (HM Treasury), the Deputy Governor of the Bank of England and Mr. Eddie George (Bank of England). Professor Brian Griffiths was also present.

The Deputy Governor reported that sterling had opened somewhat firmer and there had been no deterioration in money market rates. A swap had been agreed with the Bundesbank with a limit of £1 billion, for 3 months renewable three times. It would be at the discretion of the Government whether and when the existence of this swap might be made public.

The meeting continued the discussion reported in my letter of yesterday about whether the fundamental economic position warranted an increase in interest rates. It was suggested that a depreciation of the size which had occurred would itself justify some increase in interest rates if the full benefits of the depreciation were to be gained. It was also recognised that there tended to be a ratchet effect on interest rates: the markets often seemed to look for particular increases in interest rates regardless of the starting point. This argued for trying to reduce rates at every opportunity where this could be done without unsettling the markets.

As regards the shorter term position it was agreed that the Bank of England should continue to intervene today. Some intervention in London would be a counter-part to intervention to be undertaken by the Bundesbank on the Bank's behalf. Total intervention for today should be kept within a limit of $200 million but within this limit intervention should be kept to an absolute minimum. Intervention on this scale was justified in order to try to guide the markets through to a calmer period. An increase in interest rates still seemed on balance more probable than not, but a postponement might allow a smaller increase.

I am copying this letter to John Footman at the Bank of England.

Yours,

David

DAVID NORGROVE

A. Kuczys, Esq.,
H. M. Treasury