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Treasury Chambers, Parliament Street, SW1P 3AG
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12 December 1986

Note.

Dear David

The Chancellor decided that this
should be discussed at a bilateral
meeting.

AMS
15/12

INTEREST RATES

(pa)

The Chancellor has seen your letter to me of 10 December recording the meeting the Prime Minister held on interest rates; he felt it gave a wholly accurate account of the discussions.

However, in the light of the Prime Minister's comment that the cause of the present problems was clearly a PSBR that had been set too high in the 1986 Budget, he feels that the Prime Minister should be aware:

- (a) that our current forecast for this year's PSBR, even adding back privatisation proceeds, is smaller as a percentage of GDP than any previous year since the Government took office, with the exception of 1985-86, despite the loss of £6½ billion of oil revenues; furthermore, the latest monthly figures for the PSBR show it running below the profile we expected when the forecast was made; and
- (b) that while the level of short-term interest rates during the seventies was fairly well correlated with the size of the PSBR, during the 1980s other factors have come to predominate: in 1985-86, for example, when we had the lowest PSBR of all, interest rates were at their highest levels since 1981-82.

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

Yours
Alex

A C S ALLAN

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