

16.9.82

5411
THE DEPUTY GOVERNOR

Cwm

BRIEFING FOR THE GOVERNOR

I thought it might be useful to give the Governor a background brief for use in talking to the Chancellor.

It seemed to me that the most helpful approach might be to set down a series of points which the Governor might think of making, as far as possible in words he might use. The attached is a hurried shot at such a list. As background, notes could be added giving evidence, or explaining these points.

If the Governor felt able to make some of these points, we could then consider giving a paler version in the Mansion House speech.

If you liked the idea, I would make a more considered version and enlist ED's help in adding notes.

JCRD

16th September 1982

J C R Dow

- Squeezing inflation out is the right aim but obviously has costs. World is in a pretty pass. Need to ask ourselves whether cost is not proving too great.
- Overhasty action unproductive. May make system less flexible, eliminate capacity that is really needed, hamper redeployment/retraining. Long-term process
 - must leave producers with some hope.
- Recession has gone on too long - world-wide and in UK.
- We would all welcome an upturn - if it happened naturally eg exports.
- This means that we don't welcome increasing unemployment. To stop it there must be enough demand of some dimension to support an upturn. This would obviously be compatible with maintaining a good deal of slack in the economy and maintaining downward pressure on domestic costs.
- Unemployment can be said to be due to resistance of unions to disinflationary policies. In a sense they cause the unemployment. But attitude of unions only changes gradually. Question is do we want to increase pressure on them, or let things work themselves out more slowly and temper the wind a bit.
- It has to be recognised that things are not coming right, spontaneous force of expansion in private economy is not likely to produce an upturn. Should be realistic about this. Prices have come down, but that in itself is not going to prove enough.
- We do therefore need to look at the thrust of policies. No-one would claim that fiscal policy has no effects on the economy - we ought therefore to think carefully what the effects are - not just follow predetermined formula (ie reducing money PSBR year by year).

- It is very widely (though not universally) agreed that impact of FP is two-fold.
 - (a) Government spending is part of total demand. A cut reduces activity. Taxes affect personal spending; a cut would increase spending. A change in the balance between spending and revenue (roughly the PSBR) therefore affects spending - a cut in PSBR reduces it.
 - (b) Interest rate effects from changes in PSBR may at least partly offset the first effect (see later).
- Difficult to estimate first effect, but in the broad it seems clear it has been restrictive. This was indeed intended as part of counter inflationary thrust. But impact on economy has probably been quite large. Could account for our recession being worse than other countries.
- There are theoretical arguments for thinking smaller PSBR will reduce interest rates. But in fact the association between them has not been close or very evident. This may be because interest rates are affected by other things as well.
 - (a) Fall in inflation will help to get rates down.
 - (b) Interest rates abroad - uncertain. But something depends on how closely the market thinks we want to follow US rates.
 - (c) Monetary policy. Has not been very tight. But aggregates have grown less rapidly than money GNP. Must have helped to keep interest rates up.

Should think of all this.

- Not ready to suggest ^{concrete} concoct new steps. But suggest should search for ways of mitigating policy impact with a view to strengthening upturn and stopping unemployment rising next year.

- As central banker, naturally worried about banks - hence their customers. Hate to see good firms broken up, enterprise stifled.
- Situation getting worse - banks ^{cannot} can lend against indefinite profit/less recession. Could easily find ourselves giving public support to firms, or public guarantees of bank debt - wasteful use of public resources, attack only symptoms.
- Something similar true of lending to ldc's. A lot are not very creditworthy if recession continues. Should give official finance (IMF). But this too a wasteful use of public resources. Better to create more demand.
- UK on its own can't create world-wide increase in demand. Helpful if other developed countries were thinking on similar lines - casting about for remedies. So far no international discussion. Summits have just optimistically hoped things would come right. We should think of taking a lead.
- But this will at best be slow. Without it what we could do to help ourselves bound to be limited. But this is perhaps all we should aim for anyhow.
- None of this would be incompatible with continuing to give emphasis to getting inflation down (for reasons explained above).
- This would nevertheless be a modification of present policy approach. A further problem would be to present this in such a way that it seemed a natural extension of policy.
- Within these limits, suggest we do now need to "cast about for remedies", look at what we could do.

Re Governor

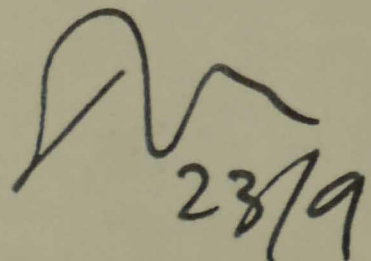
9 + dinner

10:30 G/E

John Ken rang at 12.55 he went ^{24/9}
 to say that he had suggested & the
 G/E had agreed that a discussion would be
 desirable tomorrow morning, covering the
 "current big issues" - i.e. "Further progress
 on interest rate reduction", Funding
 and the M's letter re the Bond. And, if
 you wish, Hungary.

22.9.82 / CofE - in MP 2055

He had in mind that Wars, Middleton
 & (for Hungary) Hitler should be there too.
 He could clear any time between 9.00
 & 11.30 (when the Chancellor must leave for
 his constituency). This evening would be
 and the possibility, say 5.30 or 6.00 - but
 he would prefer tomorrow morning.



23/9