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PART D

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PART D

SECRET

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PART D

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CHANCELLOR'S PAPERS ON
THE MONEY MARKETS

Begins: 4/7/89

Ends: 2/9/89

DD: 25 years

[Signature]

26/9/85

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PO

PART D

FROM: N MONCK
DATE: 4 JULY 1989
EXTN. 4399

CHANCELLOR

cc Sir P Middleton
Mr Anson
Mr Odling-Smee

3i

Pen Kent at the Bank of England rang me today to let us know that tomorrow's press might well include reports that the shareholders of 3i are considering a flotation. As you know, the shareholders are the clearing banks and the Bank of England (which has nearly 15%). Discussions have been going on for some time but this story has apparently broken earlier than expected, probably because a meeting on the subject is being held on Thursday.

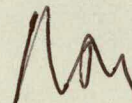
2. Midland and Lloyds want to sell their shares. NatWest would like to own the whole thing but Barclays do not want this to happen. The Bank expect that NatWest and Barclays will both remain shareholders while Midland and Lloyds will hold a public sale of their holdings. But this partial flotation has not yet been formally decided upon and nothing has been settled about method of sale etc.

3. The line for the press from the shareholders today, and probably after the meeting on Thursday, will be that the shareholders are discussing their holdings and that there is nothing to add beyond this holding statement.

4. It is envisaged that the character of 3i will not be changed and that steps will be taken to make sure of this for some defined period. The Bank argue, however, that the character of 3i's activities are not very different from that of the venture capital industry which has developed so strongly since 3i was originally set up. Like other venture capital concerns, its activities are very far from being confined to start-ups and it has been a leading player in management buyouts particularly

5. I gather that the clearers which want to sell their holdings are influenced by a feeling that there is a conflict of interest between participation in 3i and their own venture capital activities and also that they may not be making the best use of their available capital.

6. The Bank has not taken a final decision about its own shareholding. But it has told the clearers that it does not see itself as a long term holder. The Bank would be relaxed about the timing of the sale and would want it to help the whole operation to go smoothly.



N MONCK



FROM: A C S ALLAN

DATE: 5 July 1989

M

MR MONCK

cc Sir P Middleton
Mr Anson
Mr Odling-Smee

3i

The Chancellor was grateful for your minute of 4 July.

ACSA

A C S ALLAN

CONFIDENTIAL

FROM: N J ILETT (FIM2)
 DATE: 25 July 1989
 EXT: 5549

1. MR MONCK
 2. CHANCELLOR

AM 25/7
Charles
X is fair
On/Tiresome. Will ask for report on outcome of SISCOT meeting on 24 August.
yr pbr

cc PS/Financial Secretary
 PS/Economic Secretary
 Sir P Middleton
 Mr Anson
 Mr Wicks
 Mr Scholar
 Mr Walsh
 Mr Bent
 Mr Ilett
 Mr Kelly
 Mr Woodfield
 Miss M Hill, IR

TIMETABLE FOR TAURUS & PAPERLESS TRADING IN EQUITIES

This submission reports further delays in the Stock Exchange's timetable for the full implementation of the TAURUS system for the settlement of share transactions. This news emerged at Mr Monck's latest meeting with the Stock Exchange which followed a meeting of SISCOT. No immediate action on the part of Ministers is necessary at present, but the situation is most unsatisfactory and it could become desirable for the Government to bring further pressure on the Exchange and the securities industry to get its house in order.

Sources of delay

2. The first piece of bad news is that the Exchange has put back the target date for the implementation of TAURUS 3/8 from May 1990 to May 1991, though it is keeping open a late 1990 date for partial implementation to be achieved through contracting out some of the work. (TAURUS 3/8 is the version of the system which the Exchange agreed in April this year; ie involves the extensive use of nominee systems.) The explanation for the extra 12 months is that the first target date was based on "intuition", whereas the new date is based on detailed work schedules.

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3. Potentially more serious, however, are indications that the TAURUS 3/8 system, which was thought to command a consensus in the market, may no longer do so. These indications are not new, but it looks as though they are more substantial than the Exchange thought. The problem is that company registrars are still not convinced that they will have timely and confidential access to the details of the beneficial owners of their shares under TAURUS 3/8, because they will have to approach the nominee companies who will be the only people with this information. TAURUS 3/8 contains arrangements for companies to get at this information (the "Listed Companies Access Service" or LCAS), but company registrars argue that this will be expensive and unnecessarily complicated. If the Exchange cannot convince the registrars otherwise, it may have to scrap TAURUS 3/8 and go back to the basic question of design which was in hand at the beginning of this year. We should know whether this threat is a real one after the SISCOT meeting on 24 August when a full technical analysis of the LCAS will be considered. If TAURUS 3/8 is dropped at this stage, there could be further long delays. We told the Stock Exchange that Ministers would be very disappointed by such delays.

Privatisation

4. The immediate implication for the privatisation programme is for the third call for water, currently provisionally scheduled for July 1991, ie 2 months after the new target date for TAURUS 3/8. Our hope had been to introduce dematerialised trading for water shares at that stage and to notify investors accordingly in the prospectus. This may well now be unrealistic. So a lasting cheap dealing system for small investors (and indeed all investors) may be further away. But the Stock Exchange say that the existing TALISMAN paper-based system will be able to cope with water, and indeed other privatisation issues, so that should be no threat to the logistics of the initial issues.

5. TALISMAN was used for the Abbey National issue, and appeared to work well. But its capacity to handle really large volumes, as may be necessary for water, has not been tested because so many investors failed to get their certificates in time for early trading and because there was less selling than expected by those that did get their certificates on time.

CONFIDENTIALTax

6. The slippage in the timetable does not affect the Revenue's proposals for stamp duty reserve tax as they relate to TAURUS. Assuming that detailed specifications for TAURUS 3/8 are available in December, the Revenue will have 3 months to work out provisions for the 1990 Finance Bill.

Comment

X | 7. This is depressing, though consistent with the ISE's track record. The objections of the registrars to TAURUS 3/8 may be due to disarray within the clearers' groups. Mr Monck has spoken to the Bank about this and the Governor will be briefed to stress the need for the Chairman of the clearers to sort this out at his regular meeting with them tomorrow. Pen Kent will take a similar line at the meeting of Mr Hugh Smith's "Group of 15" set up to follow up the G30 report on Thursday. He will let us know after the meeting how it has gone.

pp R. Jackson
N J ILETT



FROM: D I SPARKES
DATE: 26 July 1989

MR ILETT (FIM2)

cc PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Mr Anson
Mr Wicks
Mr Monck
Mr Scholar
Mr Walsh
Mr Bent
Mr C W Kelly
Mr Woodfield

BF 25/8

Miss M Hill - IR

TIMETABLE FOR TAURUS AND PAPERLESS TRADING IN EQUITIES

The Chancellor was grateful for your minute of 25 July concerning the further delays that have emerged in implementing TAURUS. He thought fair your assessment that the latest depressing turn of events is entirely consistent with the ISE's track record to date. Please would you report on the outcome of the SISCOT meeting on 24 August.

A handwritten signature in dark ink, appearing to read 'D. Sparkes'.

DUNCAN SPARKES

CONFIDENTIAL

FROM: N MONCK
DATE: 28 July 1989
EXT: 4399

CHANCELLOR OF THE EXCHEQUER

cc PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Mr Anson
Mr Wicks
Mr Scholar
Mr Walsh
Mr Bent
Mr Ilett
Mr S Kelly
Mr Woodfield

Handwritten initials in red ink, possibly "N.M." and "S.K."

Miss M Hill, IR

TIMETABLE FOR TAURUS ON PAPERLESS TRADING AND EQUITIES

I understand that the meetings of the Governor with the Chairmen of the clearers and of Mr Hugh Smith's UK Steering Group on the G30 report have been useful so far as TAURUS is concerned. The main developments are as follows:

- (a) a new executive group, chaired by Mitford Slade, will steer the practical work on developing TAURUS. A new project leader will be hired from 1 September;
- (b) there was a general welcome for the idea of a new steering house company in which the Stock Exchange would have a less than controlling interest. A heavyweight shadow board and a chief executive will be chosen. The majority will not be Stock Exchange members and the chairman too will probably come from outside the Stock Exchange;
- (c) at least initially TAURUS and Talisman will provide services to the clearing house, though eventually the hardware and employees may be transferred to the clearing house;
- (d) the general view seems to be that the design of the system will be TAURUS 3/8, ie the nominee system. But the registrars' wish to reopen this cannot yet be regarded as stopped in its tracks.

I understand most of it is still confidential, apart from the idea of the jointly owned clearing house.

2. So far as it goes this news is encouraging. The Bank are certainly very pleased.



N MONCK



FROM: D I SPARKES
DATE: 7 August 1989

MR N MONCK

mp

cc PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Mr Anson
Mr Wicks
Mr Scholar
Mr Walsh
Mr Bent
Mr Ilett
Mr S Kelly
Mr Woodfield

Miss M Hill - IR

TIMETABLE FOR TAURUS ON PAPERLESS TRADING AND EQUITIES

The Chancellor was grateful for your minute of 28 July concerning the recent, encouraging developments with TAURUS.

D.I.S.
DUNCAN SPARKES

FROM: N J ILETT (FIM2)

DATE: 31 August 1989

EXT: 5549

CHANCELLOR

*Thanks.
N.J.
MS.*

*Ch/Tiresome but not
really surprising.*

011

cc: Financial Secretary
Economic Secretary
Sir P Middleton
Mr Anson
Mr Wicks
Mr Scholar
Mr Monck
Mr Moore
Mr Walsh
Mr Bent
Mr Kelly PE
Mr Woodfield o/r

Miss M Hill IR

TIMETABLE FOR TAURUS : PAPERLESS TRADING IN EQUITIES

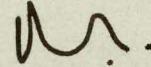
This is a follow-up report to my submission of 25 July (attached). You asked for a report of the SISCOT meeting on 24 August, which was billed as the occasion on which the Stock Exchange would take key decisions on the TAURUS 3/8 nominee-based system.

2. As it happened, the 24 August meeting was inconclusive. Its main task was to assess whether the "Listed Company Access Service" described in paragraph 3 of my note of 25 July was up to scratch, on the basis of a full technical analysis. It appears that this technical analysis addressed, in part, the wrong question. It is now being done again. Once it has been completed, later in September, it will go out for consultation in the market.

3. There continue to be pressures for TAURUS 3/8 to be dropped, and for a return to one of the numerous other versions abandoned in the past. For the moment, the Exchange is successfully resisting these. Any change would, of course, imply months of delay.

4. The Exchange has put back the implementation of a partial electronic link between institutional shareholders and the central market from October 1989 to 26 January 1990.

5. We will continue to report developments.

A handwritten signature in black ink, consisting of a stylized, cursive 'N' followed by a 'J' and a period.

N J ILETT

S E C R E T

From : D L C Peretz (MG)
 Date : 1 September 1989
 x 4460

CHANCELLOR

Thanks.

cc PS/CST
 PS/PMG
 PS/EST
 Sir P Middleton o/r
 Mr Anson
 Sir T Burns o/r
 Mr Wicks o/r
 Mr Evans
 Mr Scholar o/r
 Mr O'Donnell
 Mrs Ryding
 Mr N Williams
 Mrs Chaplin
 Mr Tyrrie

*See Market report
 behind, Poo.*

ois

MARKETS

Given the general return to work next week, you and others might like a note about the state of the financial markets.

2. Things have been remarkably quiet since the publication of the July trade figures, on 23 August. There has been more movement in the \$ than in sterling. Sterling has in fact strengthened a little against the DM. Sterling interest rates, both short and long, have also risen a little as any remaining expectation of an early cut in interest rates has disappeared (the latest weekly figures for the note issue, from which MO can be estimated, seem to have had some effect here).

3. We supported sterling with \$250m of fairly public intervention when the trade figures were published on 23 August, and a further \$70m or so of quiet support was given later in the day. Since then, no support has been needed.

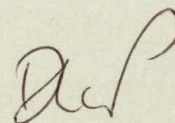
4. The \$ fell below DM 1.94 on 30 August, but has since strengthened despite significant intervention by the Fed and Bank of Japan.

S E C R E T

	<u>close 22/8</u>	<u>close 23/8</u>	<u>close 1/9</u>
ERI	91.6	91.2	91.4
\$/£	1.5790	1.5713	1.5627
DM/£	3.0825	3.0687	3.0840
DM/\$	1.952	1.953	1.973
3 month interbank	13 ⁷ / ₈	13 ²⁹ / ₃₂	14
Yield on long gilt (11 ³ / ₄ 03/07)	9.59	9.68	9.75

5. Looking to the future, it is normal to have exchange market excitement at this time of year, as dealers and investors return from holiday. Sterling however looks reasonably solid for the present. Monday's clutch of figures (August reserves, and July final retail sales and credit figures) should not worry anyone. The next significant statistical event is probably the provisional August retail sales figures, on 11 September. There is an outside chance of a rise in German official interest rates at the Bundesbank Council meeting next week*: there is certainly a view in the market that German rates will go up sometime this autumn, and German market (3 month rates) have risen to 7¹/₄% from 7% two weeks ago. We should pick up a better feel for how likely this is, and when it might happen, at the meeting of the Monetary Committee on Wednesday.

*Thursday



D L C PERETZ



FROM: D I SPARKES
DATE: 4 SEPTEMBER 1989

MR ILETT (FIM2)

imp

TIMETABLE FOR TAURUS: PAPERLESS TRADING IN EQUITIES

The Chancellor has seen and was grateful for your minute of 31 August concerning the outcome of the SISCOT meeting on 24 August.

D.I.

DUNCAN SPARKES



FROM: D I SPARKES

DATE: 4 September 1989

MR PERETZ - MG

mp

MARKETS

The Chancellor has seen and was grateful for your minute of 1 September.

D.I.

DUNCAN SPARKES

S E C R E T

imp

From : D L C Peretz (MG)
Date : 20 September 1989
x 4460

CHANCELLOR

*Burns
Burns*

cc Sir P Middleton
Sir T Burns
Mr Wicks
Mr Scholar
Mr O'Donnell
Mrs Chaplin

MARKETS MEETING : 21 SEPTEMBER

You and copy recipients might like to have the attached up to date summary sheet of monetary conditions, as background for tomorrow's meeting.

→ attach per - Post →

DLCP

D L C PERETZ

SECRET

Monetary developments since last month's report

Latest outturns available at time of:

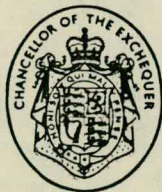
	June Report	July Report	August Report	Latest
Monetary aggregates (12 month % growth)	(May)	(June)	(July)	(August)
M0 (sa)	6.2	5.9	5.3	6.0
M4	18.1	18.5	16.5	17.3
M5	17.5	18.0	16.1	16.9
Bank & building society lending	23.2	22.4	21.6	22.0
Interest rates (%)	6 July	1 August	7 Sept	19 Sept
3 month interbank	14.0	13.8	14.0	13.9
20 year gilt-edged (par yield)	9.7	9.3	9.6	9.6
Yield gap	4.4	4.5	4.4	4.3
UK real 3 month interbank	6.4	6.8	7.0	6.9
Equity dividend yield (all share)	4.3	4.0	3.9	4.0
IG yield (2001) assuming 5% inflation	3.7	3.5	3.5	3.5
3 month UK interest differential with				
Germany	7.0	6.9	6.9	6.7
US	4.9	5.5	5.1	5.1
World basket	5.6	5.6	5.6	5.4 (est)
Exchange rate				
\$/£	1.62	1.65	1.54	1.57
Yen/£	226	226	227	229
DM/£	3.06	3.09	3.07	3.07
ERI	91.9	92.7	90.9	91.3
Oil adjusted ERI**	98.7	101.0	98.5	99.0
Asset prices				
FT-A Index (% pa)	15.2	21.1	35.2	30.4
FT-A Level (July 1987 peak: 1239)	1110	1170	1222	1198
Halifax house index (% pa)***	26.9	23.1	18.1	14.2

** The oil adjusted ERI shows whether the joint effect of oil price and exchange rate changes has been counter-inflationary or otherwise, relative to the base period Jan 1983-Nov 1985, on the assumption that the inflationary effect of a 4 per cent rise in oil prices is exactly offset by a 1 per cent rise in the exchange rate.

*** 12 month growth rates shown are for May, June, July and August.

1.58
3.07
91.6

cc Sir P Middleton
Sir T Burns
Mr Wicks
Mr Scholar
Mr Peretz



Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

21 September 1989

Paul Gray Esq
PS/Prime Minister
10 Downing Street
LONDON
SW1

Dev. P.1

MARKETS

The Chancellor has asked me to write to you to let you know the conclusions reached at a discussion he held this morning with the Governor, together with Treasury and Bank officials, to consider how best to handle the markets following publication of the August trade figures on 26 September.

... I am attaching a note by Treasury officials analysing the trade figures in greater detail.

The trade figures will, clearly, be a disappointment to the markets, which suspended judgement on the poor July figures and on the August money figures which were published this week. There must be a risk that we will face substantial downward pressure on sterling after the trade figures are published on Tuesday 26 September. The Chancellor believes nevertheless that it may be possible to contain that pressure by determined intervention, and he has authorised the Bank to act accordingly on the lines that were agreed on a contingency basis last month.

If, however, intervention proves insufficient to resist a significant fall in the exchange rate, the Chancellor believes that it will be necessary to raise interest rates, in order to support the exchange rate and maintain the credibility of the



Government's anti-inflationary stance, at a time when MO growth remains stubbornly above the top of its target range. He hopes that this will not arise. I will in any case telephone you from Washington should events take an unpleasant turn.

Yours sincerely

Jst. Gieve

JOHN GIEVE

The August Trade Figures

1. The August trade figures, to be published on Tuesday 26 September, will show a current account deficit of £2.0 billion which compares with last month's deficit of £2.2 billion. This will not be well received: the markets are predicting a deficit of around £1.7 billion, the monthly average for the year to date. It brings the total deficit for the year to date to £13.9 billion. It is clear therefore that the deficit for the year as a whole will be significantly above the Budget forecast of £14½ billion.

Table 1: Current Account

	£ billion								
	<u>1988</u>	<u>1988</u>	<u>1988</u>	<u>1988</u>	<u>1989</u>	<u>1989</u>	<u>1989</u>	<u>1989</u>	<u>1989</u>
		Q2	Q3	Q4	Q1	Q2	June	July	August
Non-oil visibles	-23.6	-5.5	-6.4	-6.9	-6.2	-6.2	-2.1	-2.5	-2.4
Oil	2.8	1.0	0.6	0.4	0.2	0.3	0.2	0.1	0.1
Total visibles	-20.8	-4.5	-5.7	-6.5	-6.0	-5.8	-1.9	-2.5	-2.3
Invisibles	6.2	1.7	2.3	1.1	1.2	1.0	0.3*	0.3*	0.3*
Current balance	-14.6	-2.8	-3.4	-5.4	-4.8	-4.9	-1.6	-2.2	-2.0
Memo Items:									
Balancing Item	12.3	3.7	2.9	5.2	1.2	6.6	-	-	-
Non-oil deficit as per cent of GDP	5.1	4.8	5.4	5.7	5.0	4.9	4.8	5.9	5.5

* CSO projections

2. As far as we can ascertain there are no special factors that have distorted the August figure. The dock strike may have had some impact on the figures but the effects are unlikely to have been large.

3. The current account figures are only estimates and are frequently revised substantially. In the past the quarterly

invisibles surplus has tended to be revised upwards. The monthly invisibles figures are only projections as most of the data are only available quarterly or annually (and in some cases at even less frequent intervals). The balancing items - which represent an unknown combination of unidentified capital inflows and unrecorded net exports - have been particularly large in the last few years, and notably in the second quarter of this year. Any errors in the net export figures are likely to be mainly in the invisibles statistics. The visible data are thought to be relatively reliable.

Composition of the Deficit

4. Over the past six month the deficit in consumer goods appears to have deteriorated by slightly less than the deficit in other industrial groups (see table A1). Capital goods imports continue to grow very rapidly reflecting the high level of investment in the economy as a whole and capacity constraints in UK capital goods industries. There is a particular shortage of skilled labour in this sector. Capacity constraints have eased in other industries but remain at historically high levels (see chart 2). Around half of the deterioration in the visible deficit over the past year as a whole is due to increased deficits on fuel and cars, (see table A2). The oil balance has been badly affected by the various accidents in the North Sea and should improve as output comes back on stream. The rest of the deterioration in the deficit was spread fairly evenly across a number of industries.

5. Non-oil imports are now around a third higher than non-oil exports in value terms. Therefore with imports growing by 12 per cent in the latest 3 months compared to the same period a year ago, exports would have had to grow by 15½ per cent simply to prevent the deficit getting bigger. In fact export growth, at 14 per cent, is now in excess of import growth but the gap is clearly not yet sufficient to improve the deficit.

Assessment

6. Import growth should in due course decline in response to slower demand growth and as new capacity comes on line after the recent investment boom. But this process is taking longer than expected.

Chart 1: Non-oil Visible balance

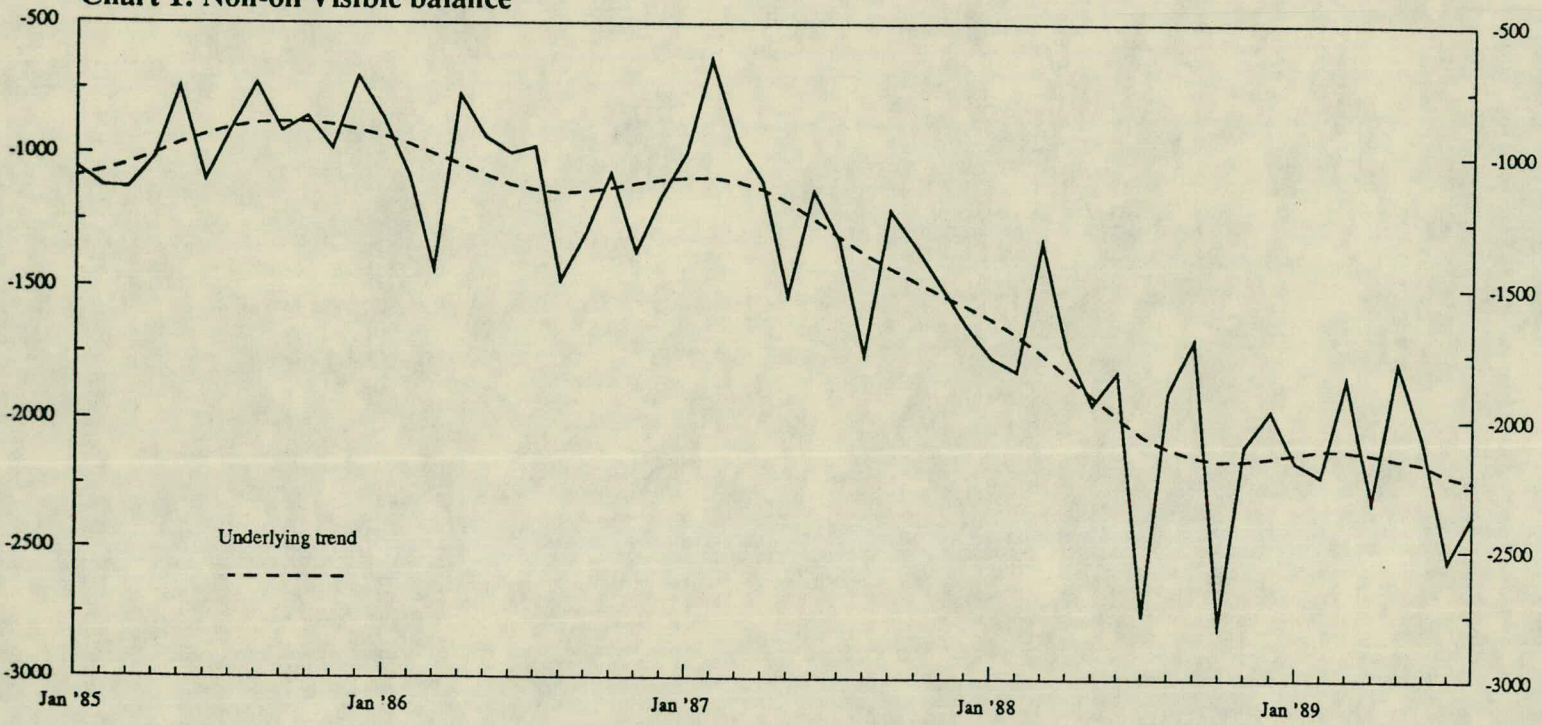
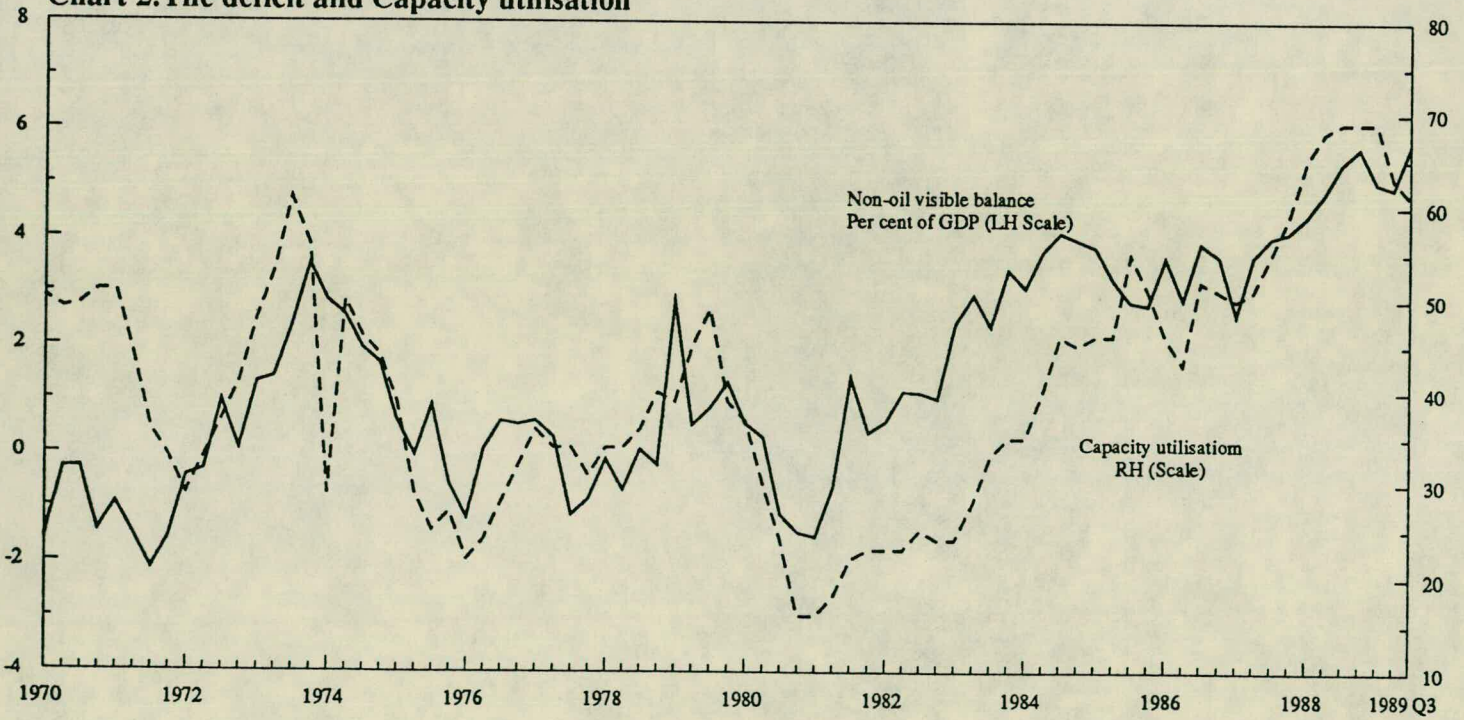


Chart 2: The deficit and Capacity utilisation



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Table A1: Trade performance by category of manufactured goods
(OTS, excl erratics)

	Latest 12 months on previous 12 months			Change in trade balance between latest two 6 mth periods (fbn)
	Export growth (%)	Import growth (%)	Change in trade balance (fbn)	
Consumer goods	12½	19½	- 2.4	- 0.1
Capital goods	18½	18½	- 0.3	- 0.3
Intermediate and semi-manufactured goods	10	16	- 3.2	- 0.2

Table A2: Trade performance at industry level (OTS basis)

	Latest 12 months on previous 12 months			Change in trade balance between latest two 6 mth periods (fbn)
	Export growth (%)	Import growth (%)	Change in trade balance (fbn)	
Fuels	-25½	5½	- 2.1	- 0.3
Road vehicles	15½	24	- 1.7	0
Electrical engineering	14½	17½	- 1.0	- 0.2
Clothing and footwear	- 2½	12½	- 0.5	- 0.2
Basic materials	12	12	- 0.5	0 (-)
Mechanical engineering	13½	18	- 0.3	0 (+)
Metals	21	24	- 0.3	- 0.1
Chemicals	9	13½	- 0.2	0 (+)
Scientific and photographic app.	8	15	- 0.2	- 0.1
Metal manufacture	11	16	- 0.2	0 (-)
Food, drink and tobacco	10½	5	- 0.1	0 (+)
Textiles	9	2	+ 0.1	0 (+)
Total	9	15	- 7.8	- 0.4

CONFIDENTIAL

SECRET AND PERSONAL

FROM M C SCHOLAR
DATE 21 SEPTEMBER 1989
EXTN 4389

~~CHANCELLOR~~ —

*for comment. The main
question is what to
say about the possibility of
raising rates. Michael's draft
keeps this head on.*

cc Sir Peter Middleton
Mr Wicks
Mr Peretz

MARKETS: MINUTE TO NO 10

JC

[Red handwritten marks]

As requested, I attach a draft minute which Mr Gieve could send Mr Gray recording this morning's conclusions and covering a note on the trade figures.

MCS

M C SCHOLAR

SECRET AND PERSONAL

DRAFT LETTER

FROM : JOHN GIEVE

TO : Mr Gray,
No.10

MARKETS

The Chancellor has asked me to write to you to let you know the conclusions ~~he has~~ reached ^{at} ~~following~~ a discussion he held this morning with the Governor, together with Treasury and Bank officials, to ~~take stock of the monetary situation,~~ and consider how best to handle the markets following publication of the August trade figures on 26 September.

2. I am attaching a note by Treasury officials analysing the trade figures in greater detail.

3. The Chancellor believes that many of the recent indicators - retail sales, house prices and turnover, surveys of consumer and business confidence and various measures of inflation - are consistent with broadly satisfactory progress in reducing the excessive growth of demand. But monetary growth in recent months has been disappointingly rapid - Mo moved further away from its target range in August - and import growth remains stubbornly high. // While it is possible to identify special factors that have affected some of these statistics, the Chancellor considers that, in these

(although it has shown some signs of falling back again in recent weeks)

SECRET AND PERSONAL

circumstances, any loosening of policy, such as would be brought about by a fall in the exchange rate, would be wholly inappropriate. If anything, some tightening of policy may be desirable in order to ensure that inflation continues to fall over the months ahead.

4. The trade figures will, clearly, be a disappointment to the markets, which suspended judgement on the poor July figures and on the August money figures which were published this week. There must be a risk that we will face substantial downward pressure on sterling after the trade figures are published on Tuesday 26 September. The Chancellor believes nevertheless that it may be possible to contain that pressure by determined intervention, and he has authorised the Bank to act accordingly. *(on the lines that were agreed on a contingency basis last month).*

5. There are several international developments which may complicate the picture. It may be that the dollar will fall following the weekend G7 meeting in Washington. That would probably be helpful to us. But the indications are that the Bundesbank will decide to raise German interest rates before long, and perhaps when its Council meets on 5 October. That will put us under further pressure on the exchanges.

If, however, intervention proves insufficient
 6. ~~The Chancellor believes that either at that time, or earlier in the wake of the trade figures, it may not prove possible to resist a substantial fall in the~~ *exchange rate*

SECRET AND PERSONAL

exchange rate, *the Chancellor* ~~is~~ *believes* ~~by intervention alone.~~ In that ~~circumstance he thinks~~ that it would be necessary to raise interest rates, in order to ^{support} ~~prevent a fall in~~ the exchange rate and maintain the credibility of the Government's anti-inflationary stance, *at a time when the Mo growth remains stubbornly above the top of its target range. He hopes that this will not arise, and would in any case telephone you from Basel for should ~~the~~ events take an unexpected turn.*