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FROM: P N SEDGWICK  
DATE: 7 January 1983

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Professor A Walters - No. 10

INTERPRETATION OF MONETARY CONDITIONS : JANUARY

... I attach a copy of the note for this month.

P.N.J.  
P N SEDGWICK

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INTERPRETATION OF MONETARY CONDITIONS

INTRODUCTION AND SUMMARY

1. While the twelve month growth rates of the nominal narrow monetary aggregates continue to rise there are signs that the six month growth rates may have ceased to rise, although they remain at a high level. The indications are that the lagged effects of the fall in nominal interest rates through 1982 will keep growth of the narrow aggregates at a high level in the immediate future.

2. There are indications that the six month growth rates of the real narrow aggregates as well may have ceased rising, although the growth both real M1 and real non-interest bearing M1 were in December at very high levels and much higher - by 15-20 percentage points - than at the beginning of 1982.

3. Other indicators continue to present conflicting evidence on the tightness of monetary conditions. While nominal interest rates have risen slightly from their low point in November real short term interest rates in December (and in early January) have been approximately at the same level as they were at the beginning of 1982. Other indicators, however, suggest less tight conditions. The effective exchange rate is now below even the December average. It may be the case that money GDP and prices have ceased to decelerate.

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(1) THE GROWTH OF THE MONETARY AGGREGATES

4. Table 1 and Charts I to IV summarise the most recent information on the nominal monetary and financial aggregates as well as data for previous financial years. (NB the figures for October 1982 in all the tables and charts in this note are central estimates, agreed by the Bank and the Treasury, of what would have happened in the absence of the STC distortion).

TABLE 1 : % GROWTH RATES IN THE NOMINAL AND FINANCIAL AGGREGATES  $\phi$

	Composite monetary indicator	M0	Non- interest bearing M1	M1	£M3	M3	PSL2
<u>(a) financial years</u>							
1979-80*	6.2	9.6	4.2	3.2	11.0	12.4	11.3
1980-81*	10.2	7.4	7.9	11.3	19.8	21.5	14.0
1981-82*	6.2	1.1	0.3	4.3	12.4	15.7	11.1
<u>(b) changes on same period in previous year*</u>							
1981 (1)	8.1	7.5	4.2	7.4	18.3	19.4	12.8
(2)	10.4	5.8	8.9	12.1	18.7	21.3	13.4
(3)	12.1	5.0	9.4	10.6	15.3	21.1	13.8
(4)	8.6	4.2	4.8	7.7	13.1	18.8	11.6
1982 (1)	8.5	2.7	4.0	8.4	13.9	16.1	12.0
(2)	6.7	2.2	1.5	6.4	12.6	13.5	10.5
(3)	7.1	2.0	4.4	7.6	10.5	10.4	8.4
(4)	9.1	4.1	9.1	11.2	10.4	11.8	9.1
<u>(c) changes on same period in previous year</u>							
1982 Jan	10.6	6.8	7.4	11.1	14.3	17.8	12.3
Feb	8.8	3.3	4.2	9.0	13.9	16.8	12.4
March	8.5	2.7	4.0	8.4	13.9	16.1	12.0
April	6.2	1.1	0.3	4.3	12.4	15.7	11.1
May	5.7	0.7	0.0	4.0	11.9	14.1	10.4
June	6.7	2.2	1.4	6.4	12.6	13.5	10.4
July	5.7	2.3	1.1	4.7	11.1	12.5	9.0
Aug	7.0	-0.2	3.1	8.3	11.6	12.3	9.1
Sept	7.1	2.0	4.4	7.6	10.5	10.4	8.5
Oct ++	8.4	3.3	6.6	9.1	9.9	9.3	8.4
Nov	0.3	3.4	8.1	10.5	10.4	10.8	9.2
Dec	9.1	4.1	9.1	11.2	10.4	11.8	9.1
<u>(d) changes (at an annual rate) in 6 months to</u>							
1982 Jan	5.2	7.2	-2.4	3.8	13.9	12.7	10.6
Feb	5.8	3.2	-1.1	8.3	12.1	10.6	9.9
March	3.1	-1.2	-3.5	2.9	8.9	7.5	7.9
April	5.0	0.2	-0.5	4.9	7.0	6.4	8.6
May	6.2	-0.5	1.4	4.1	8.7	8.6	9.7
June	7.5	2.1	4.8	7.5	9.2	9.1	9.6
July	6.1	-2.4	4.8	5.5	8.4	12.3	7.3
Aug	8.2	-3.4	7.5	8.4	11.2	14.0	8.2
Sept	11.3	5.2	12.9	12.7	12.2	13.5	9.2
Oct	11.8	6.4	14.2	13.8	12.9	12.3	8.3
Nov	12.5	7.5	15.2	17.4	12.2	13.0	8.6
Dec	10.6	6.1	13.7	15.1	11.7	14.6	8.5

(see page 3 for footnotes)

Annualised  
percentage change

CHART I: GROWTH RATES IN M0

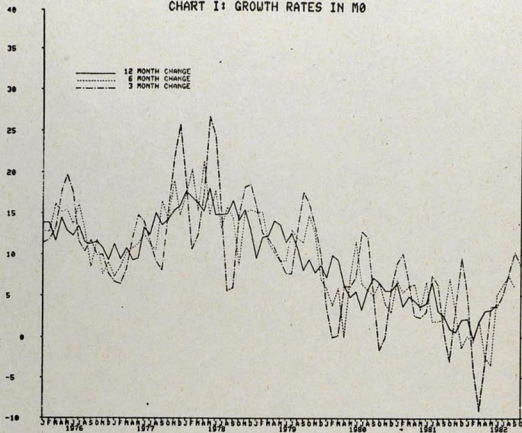
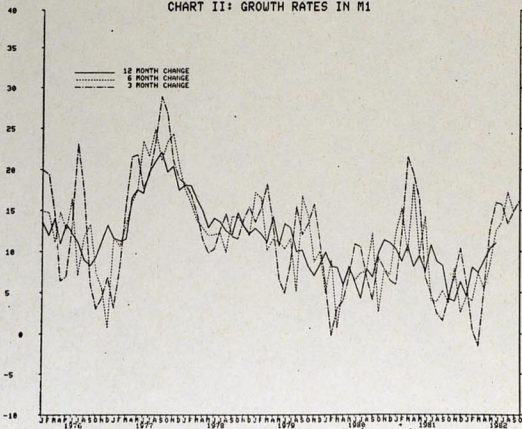


CHART II: GROWTH RATES IN M1



Note: The growth rates are shown as the mid-point of the period over which they are measured. Thus the growth from September 1981 to September 1982 is shown as March 1982 and the six month annualised growth rate from March 1982 to September 1982 is shown as June 1982.



5. The December figures show a continuation of the rise in the twelve month growth rates of the narrow monetary aggregates - M0, non-interest-bearing M1, and M1 - though the composite monetary indicator showed a slight fall. The six month growth rates, however, suggest some levelling off at the high growth rates that have prevailed in the last three to four months. The available econometric work on the demand for M1 suggests that a significant proportion of the effect on M1 from the reduction in nominal interest rates during 1982 is still to occur. The prospect for the immediate future is therefore for sustained growth of the narrow aggregates at a fairly high rate.

6. The twelve month growth rate of £M3 has been fairly steady in the range of 10-11½ per cent since the middle of 1982. Its six month growth rate rose between July and October, but has since declined slightly. The sixth month growth rate of M3 - which includes residents' foreign currency deposits - rose during 1982 from a low of 6½ per cent in April to 14½ per cent in December.

7. Table 2 and Charts V and VI show the six and twelve month growth rates of the RPI and the real monetary aggregates. The figures for December show a continuation of the increase in the twelve month growth rates as inflation continues to fall and the growth of the nominal aggregates to rise. The six month growth rates of the real aggregates show signs - as with the nominal aggregates - that the growth rates have begun to level off, though at very high growth rates for M1 and non-interest bearing M1 in particular. The turnaround during 1982 in the six month growth rates of the real narrow aggregates - from large falls in the early months of the year to large increases in the closing months of the year - is striking. The coincidence of a sharp fall in nominal interest rates - with the inevitably large effect on the growth of the nominal narrow aggregates - and of a large fall in the inflation rate - itself in part the result of high interest rates in the preceding period - explain this dramatic change in the growth of the real narrow money supply.

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Footnotes to Table 1

- \* through the financial year (mid-April on mid-April).
- Ø the growth rates for all monetary aggregates, except non-interest bearing M1, are adjusted for recent changes in definition.
- + quarterly figures are for the final banking month of the quarter.
- ++ the October 1982 figures have been greatly distorted by the over-subscription of the STC share issue. Changes shown here are the Bank of England/Treasury best estimates of what would have happened in the absence of the distortion. These estimates lie towards the lower end of the published ranges.

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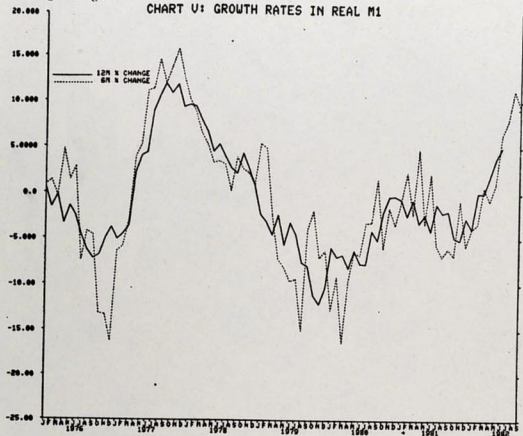
TABLE 2 : CHANGES IN THE REAL MONEY SUPPLY (%)

	<u>RPI*</u>	<u>Composite monetary indicator</u>	<u>M0</u>	<u>Non Interest Bearing M1</u>	<u>M1</u>	<u>£M3</u>	<u>FSL2</u>
(a) Change in 12 months to							
1982 Jan	12.0	-1.3	-4.6	-4.1	-0.8	2.0	0.3
Feb	11.0	-2.0	-7.0	-6.2	-1.8	2.6	1.2
March	10.4	-1.7	-6.9	-5.8	-1.8	3.2	1.5
April	9.4	-2.9	-7.6	-8.3	-4.7	2.7	1.5
May	9.5	-3.4	-8.0	-8.6	-5.0	2.2	0.9
June	9.2	-2.3	-6.4	-7.1	-2.5	3.1	1.1
July	8.7	-2.8	-5.9	-7.0	-3.7	2.2	0.3
Aug	8.0	-0.9	-7.6	-4.5	0.3	3.4	1.0
Sept	7.3	-0.1	-4.9	-2.7	0.3	3.0	1.1
Oct	6.8	1.5	-3.3	-0.2	2.3	2.9	1.5
Nov	6.3	-2.7	-2.8	1.6	3.8	3.8	2.7
Dec	(5.6)	3.3	-1.4	3.3	5.3	4.5	3.3
(b) Change (at an annual rate) 6 months to							
1982 Jan	11.3	-5.5	-3.7	-12.3	-6.7	2.4	-0.6
Feb	8.7	-2.7	-5.1	-9.0	-0.4	3.1	1.1
March	8.8	-5.2	-9.2	-11.3	-5.4	0.1	-0.8
April	8.6	-3.4	-7.8	-8.4	-3.4	-1.5	0.0
May	7.5	-1.1	-7.4	-5.6	-3.1	1.2	2.1
June	6.6	0.9	-4.2	-1.7	0.9	2.4	2.8
July	6.3	0.0	-8.0	-1.3	-0.6	2.1	0.9
Aug	7.1	1.0	-9.8	0.4	1.2	3.8	1.0
Sept	5.7	5.4	-0.4	6.9	6.7	6.2	3.3
Oct	5.0	6.3	1.2	8.6	8.2	7.4	3.0
Nov	5.3	6.5	1.8	9.0	11.1	6.3	2.8
Dec	(4.8)	5.5	1.2	7.7	10.5	6.6	3.9

\*The simple method of seasonal adjustment for the RPI for use in calculation of the six monthly growth rates was described in the February 1982 Interpretation of Monetary Conditions.

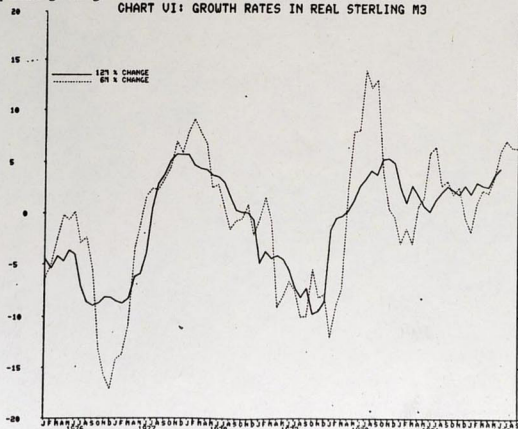
Annualised  
percentage change

CHART U1: GROWTH RATES IN REAL M1



Annualised  
percentage change

CHART U1: GROWTH RATES IN REAL STERLING M3

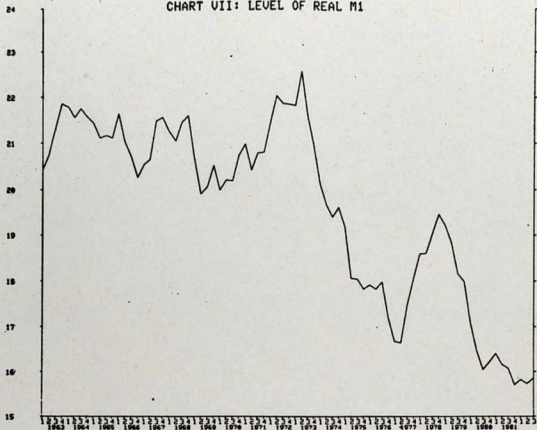


Note: The growth rates are shown as the mid-point of the period over which they are measured. Thus the growth from September 1981 to September 1982 is shown as March 1982 and the six month annualised growth rate from March 1982 to September 1982 is shown as June 1982.



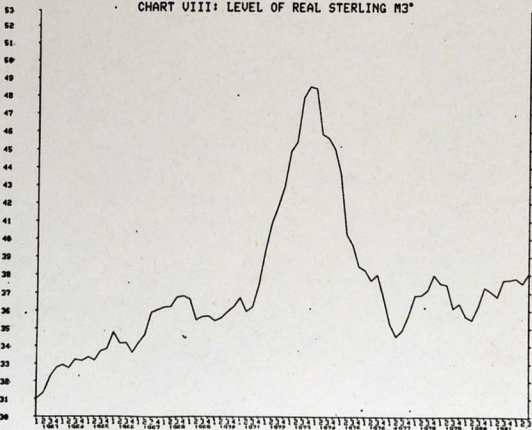
1975 prices

CHART VII: LEVEL OF REAL M1



£m  
1975 prices

CHART VIII: LEVEL OF REAL STERLING M3\*



\*Note: These charts use the quarterly monetary data, which in the most recent past produce lower increases in the monetary aggregates than the monthly data.

£bn  
1975 prices

CHART IX: LEVEL OF REAL PSL2

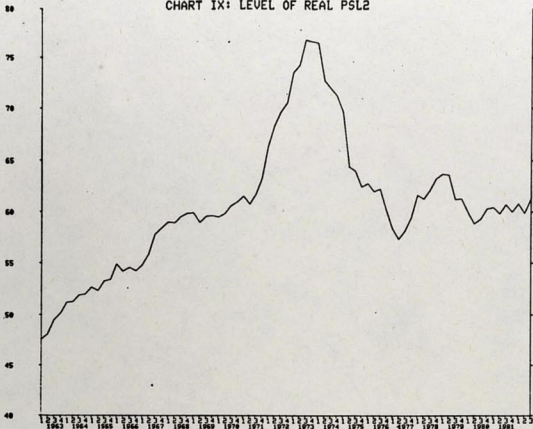
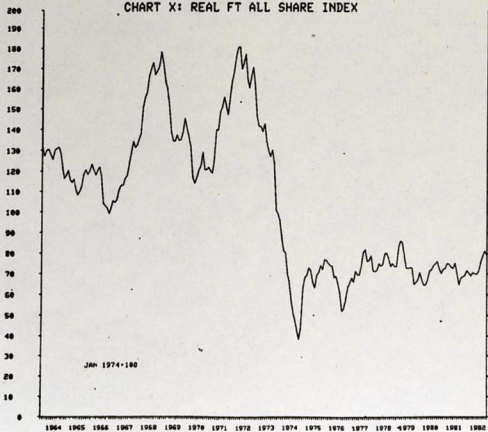


CHART X: REAL FT ALL SHARE INDEX



8. Table 3 shows that the six and twelve month growth rates of the stock of bank lending, which rose very sharply in the final months of 1981 and stayed at high levels during the first half of 1982, have shown definite signs of falling. Both growth rates are significantly higher than the equivalent growth rates of any of the monetary aggregates.

TABLE 3 : BANK LENDING  
(monetary sector, banking months,  
seasonally adjusted)

	<u>Percentage change in stock of lending over</u>	
	<u>12 months</u>	<u>6 months (at annual rate)</u>
1981 September	14.6	12.9
October	14.0	13.9
November	17.9	23.1
December	19.3	27.9
1982 January	19.9	31.1
February	21.8	31.9
March	23.4	34.8
April	26.0	39.3
May	27.5	32.1
June	29.3	30.6
July	30.9	30.7
August	29.8	27.5
September	30.3	25.9
October	30.3	22.7
November	28.2	25.0
December	26.5	23.2

9. One element in the deceleration in bank lending in recent months has been the fall in the growth rate of bank lending for house purchase. Table 4 shows data (for calendar months) for lending

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TABLE 4 : NET LENDING FOR HOUSE PURCHASE

	<u>Percentage change in stock of lending</u> (calendar months, seasonally adjusted at annual rates)					
	<u>Building Societies</u>		<u>Banks (excl. TSBs) Estimated</u>		<u>Total Banks and Building Societies</u>	
	12 months	6 months	12 months	6 months	12 months	6 months
1983						
June	12.8	13.4	101.9	102.3	19.5	21.0
July	13.0	14.4	102.3	107.4	19.8	22.6
August	13.0	15.4	103.1	108.2	20.4	24.0
September	13.4	16.0	100.9	100.9	20.9	24.4
October	14.2	17.0	96.0	93.6	21.6	24.9
November	15.0	17.5	89.2	84.5	22.1	24.9

by both banks and building societies. Table 4 shows clearly that there has as yet been no deceleration in total lending for house purchase because the decline in lending by banks has been more than offset by an increase in lending by building societies.

(2) OTHER INDICATORS OF MONETARY CONDITIONS

10. Table 5 shows that the twelve month growth of money GDP fell through 1982. The six month growth rate appears to have fallen during the first three quarters of 1982, but the CSO's latest short term projection suggests that this growth rate could have levelled off or even risen slightly in the fourth quarter.

TABLE 5 : GROSS DOMESTIC PRODUCT AT CURRENT PRICES

	<u>GDP at</u> <u>market prices</u> (expenditure based)		<u>GDP at</u> <u>market prices</u> (CSO's average estimate)	
	% change on a year earlier	% change over six months (annual rate)	% change on a year earlier	% change over six months (annual rate)
1981 Q1	12.6	10.7	10.9	9.6
Q2	10.1	7.9	9.3	8.7
Q3	8.2	5.7	9.4	9.2
Q4	8.5	9.0	9.0	9.3
1982 Q1	8.9	11.9	9.3	9.0
Q2	8.9	9.6	8.6	8.0
Q3	8.7	5.5	7.8	6.6
Q4	(8.6)	(7.6)	(7.6)	(7.3)

11. Table 6 shows that the annual rates of retail and wholesale output price inflation fell throughout 1982, with retail price inflation falling from a higher to a lower level than wholesale output price inflation. There was a rise in both the twelve and six month growth rates of wholesale input prices in November. This in part reflects the effects of the fall in the exchange rate, particularly on oil prices which for this particular price index are adjusted as soon as the exchange rate changes.

TABLE 6 : RETAIL AND WHOLESALE PRICES  
(% change on same period a year before)

	Retail prices		Wholesale output prices (home sales)	Wholesale input prices
	Recorded	Under-lying $\Delta$		
1981 Q1	12.7	12.2	10.9	8.5 (12.1)*
Q2	11.7	11.2	10.3	12.2 (23.4)*
Q3	11.3	12.3	10.1	16.8 (21.7)*
Q4	11.9	12.7	11.2	16.7 (10.4)*
1982 Jan	12.0	11.5	11.0	13.9 ( 5.1)Ø
Feb	11.0	10.0	10.6	12.1 ( 2.6)Ø
March	10.4	9.0	9.7	8.0 (-2.2)Ø
April	9.4	8.0	8.8	7.7 ( 0.4)Ø
May	9.5	9.0	8.7	4.8 ( 0.5)Ø
June	9.2	9.0	8.2	5.6 ( 5.6)Ø
July	8.7	8.5	8.5	5.2 ( 6.8)Ø
Aug	8.0	8.0	7.9	3.0 ( 3.4)Ø
Sept	7.3	7.5	7.5	3.3 ( 9.1)Ø
Oct	6.8	7.5	7.6	3.4 ( 6.6)Ø
Nov	6.3	7.5	7.4	6.2 (12.2)Ø
Dec	(5.6)			

$\Delta$  The underlying rate of inflation is based on recent movements in the RPI which have been purged of influences which make difficult the assessment of the trend. More precisely, increases in rents, rates, Nationalised Industry prices and seasonal food are computed on a twelve month basis whilst changes in the remaining items that comprise retail prices are calculated in a fashion that gives more weight to (annualised) one month changes than to twelve month changes.

\* Increase over two quarters before at an annual rate.

Ø Increase over past six months at an annual rate.

12. Table 7 shows that domestic short term interest rates were in December on average just over a percentage point above the average for November, the low point for 1982, even though US rates were slightly lower. Because the yield on indexed gilts changed by very little (see table 7) the increase in UK long rates in December, albeit by a slightly smaller amount than for short rates, suggests that an upward revision to inflation expectations took place during the closing weeks of 1982.

TABLE 7 : NOMINAL INTEREST RATES (period averages)

	<u>Three month Interbank</u>	<u>Three month Eur-dollar</u>	<u>Base Rate</u>	<u>Long Rate (20 year gilts)</u>	<u>Yield gap</u>
1981 Q1	13.3	16.5	13.6	13.8	0.5
Q2	12.5	17.7	12.0	14.2	1.7
Q3	14.2	18.4	12.3	15.2	1.0
Q4	15.6	14.3	15.1	15.7	0.1
1982 Jan	15.0	14.5	14.4	15.6	0.6
Feb	14.4	15.8	13.9	14.7	0.3
March	13.5	15.0	13.9	13.8	0.3
April	13.8	15.3	13.0	13.9	0.1
May	13.4	14.3	13.0	13.7	0.4
June	13.0	15.7	12.5	13.6	0.6
July	12.4	14.2	12.3	13.2	0.8
Aug	11.2	11.7	11.3	12.1	1.9
Sept	11.0	12.0	10.5	11.4	0.4
Cct	9.8	10.4	9.8	10.5	0.7
Nov	9.4	9.8	9.2	10.6	1.2
Dec	10.5	9.5	10.1	11.4	0.9
1983 Jan 6	10.5	8.9	10.1	11.2	0.7

13. Table 8 shows estimates of real interest rates. There

TABLE 8 : REAL INTEREST RATES (period averages)

	Expected inflation over <u>12 months*</u>	Real 3 month Interbank <u>Rate</u>	Yield on 1996 indexed <u>gilts</u>
1981 Q1	10.7	2.6	2.1
Q2	10.0	2.5	2.4
Q3	10.3	3.9	3.1
Q4	10.1	5.5	3.2
1982 Jan	10.5	4.5	3.2
Feb	10.4	4.0	3.2
March	10.1	3.5	2.8
April	9.3	4.4	2.9
May	9.3	4.0	3.0
June	9.0	4.0	3.1
July	8.2	4.2	3.2
Aug	8.1	2.9	2.9
Sept	7.7	3.0	2.9
Cct	7.5	2.3	2.7
Nov	5.4	3.9	2.7
Dec	5.9	4.6	2.8
1983 Jan 6	6.0	4.5	2.6

\*Unweighted average of forecasts by Phillips & Drew, National Institute and the London Business School, calculated over the six months forward and six months back.

are severe conceptual and practical problems involved in measuring real rates of interest. The estimate in the second column of Table 8 adjusts the nominal three month interbank rate by an estimate of expected inflation over the immediate future based on three outside forecasts. In spite of a small rise in December in this measure of expected inflation the real three month interbank rate rose to just over 4½ per cent, the same value as in January 1982. The yield on 1996 indexed gilts fell in March 1982 after derestriction, but has shown remarkably little change since the summer and at the end of 1982 was close to its value immediately after derestriction. In the light of the, admittedly far from conclusive, evidence on both short and long real interest rates it is difficult to resist the conclusion that real rates did not fall significantly - if at all - during 1982.



14. Table 9 records the sharp fall in the effective and £/\$ exchange rates which has continued in the recent past with the effective exchange rate for January 4 significantly below the December average. The recent rise in sterling interest rates

TABLE 9 : EXCHANGE RATES (period averaged)

	Effective rate	£/\$ rate	uncovered differential*	
			£/\$	£/DM
1981 Q1	101.8	2.31	-3.1	1.0
Q2	97.8	2.08	-5.0	-0.7
Q3	90.6	1.84	-4.2	1.6
Q4	89.7	1.88	1.3	4.4
1982 Jan	91.1	1.88	0.5	4.8
Feb	91.5	1.85	-1.4	4.3
March	90.8	1.81	-1.5	3.7
April	90.1	1.78	-1.4	4.5
May	89.9	1.81	-1.0	4.3
June	91.0	1.76	-2.7	3.8
July	91.2	1.72	-1.8	3.0
Aug	91.3	1.72	-0.5	2.4
Sept	91.7	1.72	-1.0	2.9
Oct	92.5	1.70	-0.6	2.6
Nov	89.3	1.63	-0.4	2.3
Dec	85.4	1.62	1.0	4.2
1983 Jan 6	82.9	1.61	1.6	4.9

\* Between 3-month UK Interbank rate and 3-month Eurdollar rate and the 3-month Euro DM rate.

has contributed to a significant improvement in the uncovered differential between sterling and both the dollar and the Dm.