

~~0JR~~
@ AW

covering CONFIDENTIAL

FROM: P N SEDGWICK
DATE: 11 NOVEMBER 1983

SIR TERRY BURNS

- cc Mr Middleton
- Mr Littler
- Mr Cassell
- Mr Unwin
- Mr Evans
- Mr Lankester
- Mr Lavelle
- Mr Monck
- Mr Odling-Smee
- Mr Folger
- Mr Hall
- Mrs Lomax
- Mr Mowl
- Mr Peretz
- Mr Pirie
- Mr Riley
- Mr Shields
- Mr Bell
- Mr Bennett
- Mr Hood
- Mr Johnston
- Mr Lewis
- Mr Matthews
- Mr O'Donnell
- Mr Vernon
- Mr Willetts
- Mr Milne
- Mr Timmins
- Mr A Ridley

Sir J Boreham - CSO

- Deputy Governor)
- Mr George)
- Mr Coleby) Bank
- Mr Fforde) of
- Mr Goodhart) England
- Mr Plenderleith)
- Mr Allen)
- Mr Foot)

Professor A Walters No. 10

INTERPRETATION OF MONETARY CONDITIONS : NOVEMBER

... I attach the note for this month which reflects the discussion at your meeting yesterday.

P.N.S

P N SEDGWICK

INTERPRETATION OF MONETARY CONDITIONS

(1) INTRODUCTION AND SUMMARY

The latest information on the nominal broad monetary aggregates confirms the fall in recent months in their six month growth rates, which are now significantly lower than in June and July. Within the nominal broad aggregates those that include building society deposits, such as PSL2, have since February had higher six month growth rates than £M3.

2. The six month growth rates of most of the narrow aggregates - M1, NIBM1, NIB sight and M2 (which is not adequately adjusted for seasonal factors) - and the composite monetary indicator have fallen since June and July, and now have growth rates close to those of £M3. The six month growth rate of the wide monetary base, MO, has risen slightly, but this is not the case with its principal constituent, notes and coin, which has a lower growth rate than earlier in the year.

3. The six and twelve month growth rates of all the real monetary aggregates have fallen in recent months. The fall in the six month real growth rates has been substantial for all the aggregates.

4. The information on monetary conditions given by other indicators is more or less consistent with that given by the nominal and real monetary aggregates. The rate of retail and producer price inflation is in the range of 5-5½ per cent. While growth in real output has risen this has not involved a rise in the growth of money GDP. Both short and long term nominal interest rates have fallen, broadly in line, since the beginning of the year. While estimated real short term interest rates are lower than at the beginning of the year the yields on indexed gilts are still higher than they were then (though lower than in July and August). It had looked as if the rate of house price inflation had been edging up. The most recent information - for September - makes this look less likely, though the inflation rates of the various measures of house prices continue to be significantly higher than those both of other asset prices and of measures of the general price level.

CONFIDENTIAL

(2) THE BEHAVIOUR 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.

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

	Composite monetary indicator	M0	Non- interest bearing M1	M2 ⁶		£M3	M3	PSL2	
				narrow defin- ition (mone- tary sector)	broad defin- ition				
(a) financial years									
1980-81*	11.1	6.4	7.8	11.2		19.9	21.6	14.4	
1981-82*	5.4	2.4	-0.3	3.9		12.0	15.3	10.8	
1982-83*	10.9	5.7	11.3	14.9		11.5	12.8	11.4	
(b) changes on same period in previous year+									
1981(1)	8.8	7.3	4.6	7.7		18.7	20.9	13.5	
(2)	11.6	5.6	8.6	11.8		18.6	22.5	13.9	
(3)	12.2	5.2	9.2	11.4		16.1	22.4	13.6	
(4)	8.2	5.2	4.9	7.8		13.0	18.6	11.1	
1982(1)	7.7	3.1	3.5	8.0		13.2	15.5	11.7	
(2)	6.0	2.7	1.3	6.4		12.0	13.1	10.3	
(3)	6.3	2.0	3.9	8.8		10.3	10.3	8.5	
(4)	8.9	4.3	8.8	11.5	6.4	4.3	10.4	12.0	8.8
1983(1)	10.5	5.7	10.9	13.3	8.1	6.5	10.2	13.3	10.2
(2)	11.3	7.3	10.5	15.9	8.9	8.0	11.7	13.1	11.7
(3)	10.4	6.0	9.1	12.4	8.0	7.8	9.6	11.2	11.8
(c) changes on same period in previous year									
1982 Nov	8.5	3.9	7.5	10.5	4.9	3.4	10.1	10.7	8.9
Dec	8.8	4.3	8.8	11.5	6.4	4.3	10.4	12.0	8.8
1983 Jan	7.5	2.0	6.0	10.7	4.3	3.5	9.9	12.4	8.6
Feb	9.1	3.8	8.9	11.8	6.3	5.1	10.2	13.1	9.4
March	10.5	5.7	10.9	13.3	8.0	6.5	10.2	13.3	10.1
April	11.3	5.7	11.3	14.9	8.5	7.3	11.5	12.8	11.3
May	11.5	6.2	11.5	16.0	9.1	8.1	11.0	12.2	11.3
June	11.2	7.3	10.5	15.9	8.9	8.2	11.7	13.1	11.6
July	12.0	6.0	10.7	15.0	8.4	7.9	12.4	13.1	12.9
Aug	11.5	6.4	10.3	13.9	8.5	8.0	11.4	12.3	12.9
Sept	10.4	6.0	9.1	12.4	7.8	7.9	9.6	11.2	11.8
Oct	10.9	6.3	9.4	13.7	7.7	7.9	10.6	11.9	11.9
(d) changes (at an annual rate) in 6 months to									
1982 Nov	11.2	7.1	15.4	18.3	8.9	6.5	10.7	12.0	7.6
Dec	9.5	6.6	13.2	15.1	6.3	5.5	9.7	13.0	6.8
1983 Jan	9.1	5.4	8.4	16.2	3.6	4.6	11.3	12.2	9.2
Feb	10.6	6.0	10.1	13.6	6.4	7.1	10.5	13.3	10.9
March	11.4	5.8	9.9	13.9	8.4	8.8	9.9	14.7	12.1
April	13.0	5.2	10.1	15.8	9.7	9.9	12.5	14.8	14.5
May	11.7	5.3	7.7	13.8	9.3	9.8	11.2	12.4	15.1
June	13.0	8.0	8.0	16.8	11.6	10.9	13.7	13.2	16.7
July	14.9	6.5	13.2	13.8	13.5	11.4	13.6	14.0	16.7
Aug	12.5	6.8	10.5	14.3	10.6	9.0	12.4	11.3	15.0
Sept	9.5	6.3	8.3	11.0	7.3	6.9	9.2	7.8	11.6
Oct	8.8	7.4	8.6	11.8	5.7	5.9	8.7	9.0	9.4

(See page 3 for footnotes)

Footnotes to Table 1

- * Through the financial year (mid-April on mid-April)
- ∅ The growth rates for all monetary aggregates, except non-interest bearing M1, are adjusted for changes to the new monetary sector. The October 1982 figures were greatly distorted by the over-subscription of the STC share issue. The figures shown here are the Bank of England/Treasury best estimates of what would have happened in the absence of the distortion.
- + The quarterly figures are for the final banking month of the quarter.
- ∅∅ M2 is "seasonally adjusted" by using a seasonally adjusted series for the NIEM1 component and unadjusted series for the other components. When proper seasonal adjustment of M2 is eventually possible its within year movements will be different.

CONFIDENTIAL

5. The fall in the six month growth rates of the broad aggregates - £M3, M3, and PSL2 - since the peak growth rates experienced in June and July lies in the range of 4-7 percentage points. Table 1A shows the recent behaviour of the main components of £M3.

- There has been a fairly steady fall in the six month growth rate of total interest bearing deposits (with a more erratic path for the component included in M1).
- The six month growth rate of non-interest bearing sight deposits rose fairly sharply in July, but has fallen back since then. The lagged effects of the fall in interest rates during this year are unlikely on their own to produce a significant rise in the growth rate of non-interest bearing sight deposits in the near future.
- The six month growth rate of notes and coin rose during the second half of 1982 and early 1983, but is now lower than the rate of 8-9 per cent rate that prevailed earlier in the year.

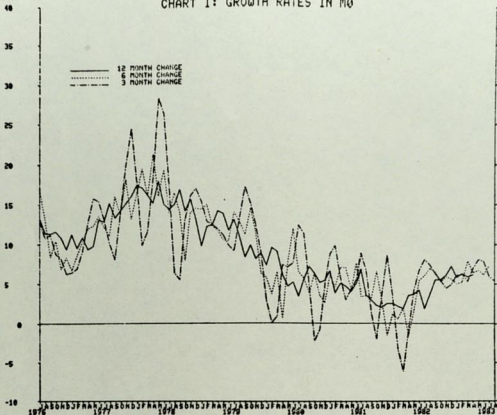
CONFIDENTIAL

TABLE 1A : GROWTH RATES OF COMPONENTS OF FM3 (%)

	Notes/Coin		Non-interest bearing sight deposits		All private sector interest bearing deposits		Interest bearing sight deposits (included in M1)	
	12 months	6 months (annual rate)	12 months	6 months (annual rate)	12 months	6 months (annual rate)	12 months	6 months (annual rate)
981 Q1	6.3	5.1	-	11.7	-	17.7	33.7	13.7
Q2	5.8	6.8	12.5	15.9	26.6	12.6	33.7	6.8
Q3	5.5	6.4	12.5	13.6	20.4	20.6	23.9	23.8
Q4	5.3	3.7	4.7	-5.4	17.3	22.0	25.7	47.8
982 Q1	4.7	3.1	2.5	-7.5	18.0	15.4	32.8	42.5
Q2	3.5	3.1	-0.1	5.6	17.5	13.1	33.5	20.5
Q3	4.8	3.9	4.2	17.2	12.8	10.3	28.4	15.7
Q4	4.8	6.6	11.4	17.5	10.0	7.0	20.9	21.2
383 Q1	6.3	8.8	13.8	10.6	9.7	9.1	21.3	27.2
Q2	7.7	8.8	12.3	7.4	11.6	16.9	33.2	46.3
Q3	7.2	5.7	10.3	10.0	11.0	10.9	23.2	9.3
982 Nov	4.4	6.2	9.5	17.5	10.8	8.6	21.9	28.1
Dec	4.8	6.6	11.4	17.5	10.0	7.0	20.9	21.2
383 Jan	3.9	7.7	7.3	8.8	10.6	10.7	26.7	44.1
Feb	5.8	8.8	10.9	10.9	10.1	9.5	21.5	24.7
March	6.3	8.8	13.8	10.6	9.7	9.1	21.3	27.2
April	7.2	9.1	14.0	10.8	11.2	14.4	26.9	34.8
May	7.5	8.4	14.2	7.3	11.2	13.9	31.1	34.1
June	7.7	8.8	12.3	7.4	11.6	16.3	33.2	46.3
July	7.3	6.9	12.9	17.2	12.2	13.7	28.5	15.3
August	6.3	3.9	12.8	14.7	11.6	13.8	25.2	25.6
Sept	7.2	5.7	10.3	10.0	11.0	10.9	25.3	19.3
Oct	7.5	6.0	10.5	10.3	11.7	9.0	27.9	21.3

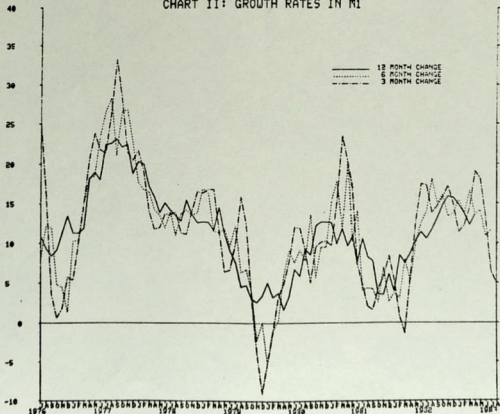
Annualised
percentage change

CHART I: GROWTH RATES IN M0



Annualised
percentage change

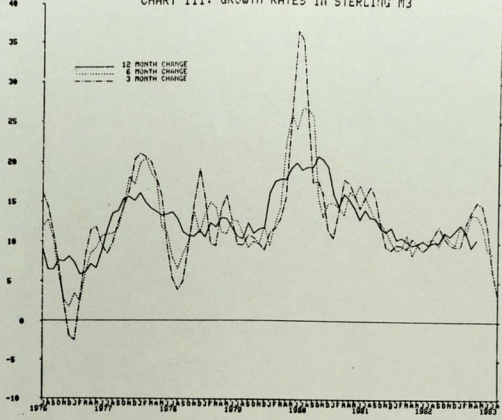
CHART II: GROWTH RATES IN M1



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.

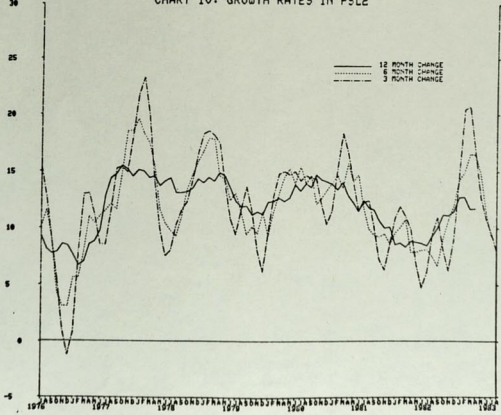
Annualised
percentage change

CHART III: GROWTH RATES IN STERLING M3



Annualised
percentage change

CHART IV: GROWTH RATES IN PSL2



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.

6. Table 2 and Charts V and VI show the latest data on the growth of real money.

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

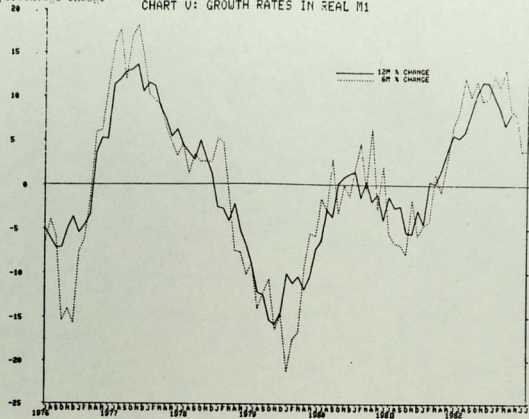
	RPI+	Composite monetary indicator	MO	Non interest bearing M1	M1	£M3	PSL2
(a) Financial years*							
1980-81	12.0	-0.9	-5.0	-2.7	0.3	7.9	2.5
1981-82	9.4	-3.6	-6.4	-8.9	-5.2	2.3	1.3
1982-83	4.1	6.6		7.0	9.9	7.3	6.4
(b) Changes in same period in previous years							
1981(1)	12.6	-3.3	-4.7	-6.1	-3.5	6.1	1.0
(2)	11.3	0.3	-5.2	-1.5	1.4	7.4	2.7
(3)	11.4	0.7	-5.6	-1.4	0.5	4.3	2.5
(4)	12.0	-3.4	-6.1	-6.3	-3.9	0.9	-0.3
1982(1)	10.3	-2.4	-6.6	-6.2	-2.3	2.6	1.2
(2)	9.2	-2.9	-6.0	-7.2	1.4	2.6	1.0
(3)	7.3	-0.9	-4.9	-3.0	5.8	2.8	1.1
(4)	5.4	3.4	-1.0	3.4	5.8	4.7	3.3
1983(1)	4.6	5.6	1.0	6.0	8.3	5.3	4.9
(2)	3.7	7.4	3.5	6.6	11.8	7.7	8.0
(3)	5.1	5.0	0.8	3.8	6.9	4.2	6.4
(c) Changes in 12 months to							
1982 Oct	6.8	0.4	-2.9	-1.2	1.9	2.8	2.0
Nov	6.3	2.2	-2.2	1.2	4.1	3.6	2.5
Dec	5.4	3.3	-1.0	3.3	5.8	4.7	3.2
1983 Jan	4.9	2.5	-2.8	1.0	5.5	4.8	3.5
Feb	5.3	3.6	-1.5	3.4	6.2	4.6	3.9
Mar	4.6	5.7	1.0	6.0	8.3	5.3	5.3
April	4.0	7.1	1.6	7.1	10.5	7.2	7.0
May	3.7	7.5	2.4	7.5	11.9	7.0	7.3
June	3.7	7.3	3.5	6.6	11.8	7.7	7.7
July	4.2	7.5	1.7	6.3	10.3	7.9	8.3
Aug	4.6	6.6	1.7	5.4	8.9	6.5	7.9
Sept	5.1	5.0	0.8	3.8	6.9	4.2	6.4
Oct	5.0	5.6	1.2	4.2	8.3	5.3	6.6
(d) Change in 6 months to							
1982 Oct	5.0	4.3	0.9	7.0	8.5	5.0	2.9
Nov	5.3	5.7	1.7	9.6	12.4	5.2	2.2
Dec	4.4	4.9	2.1	8.4	10.2	5.1	2.3
1983 Jan	3.8	5.2	1.6	4.4	12.0	7.2	5.2
Feb	3.5	6.8	2.4	6.4	9.7	6.7	7.1
Mar	3.5	7.6	2.2	6.2	10.0	6.2	8.3
April	2.8	9.9	2.3	7.1	12.6	9.4	11.4
May	2.2	9.3	3.0	5.3	11.3	8.7	12.6
June	3.0	9.6	4.8	4.8	13.3	10.4	13.3
July	4.7	9.8	1.8	8.2	8.7	8.5	11.5
Aug	5.6	6.5	1.1	4.6	8.2	6.4	8.8
Sept	6.7	2.6	-0.4	1.5	4.1	2.3	4.6
Oct	7.2	1.5	0.2	1.4	4.3	1.5	2.1

+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.

*Through the financial year (mid-April on mid-April)

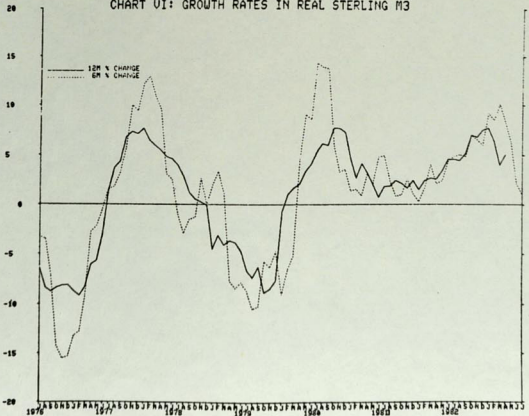
Annualised
percentage change

CHART U: GROWTH RATES IN REAL M1



Annualised
percentage change

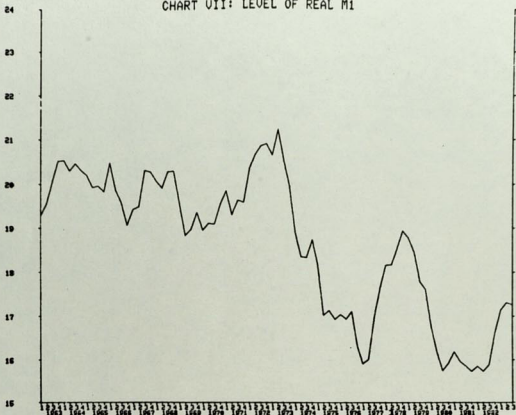
CHART UI: GROWTH RATES IN REAL STERLING M3



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.

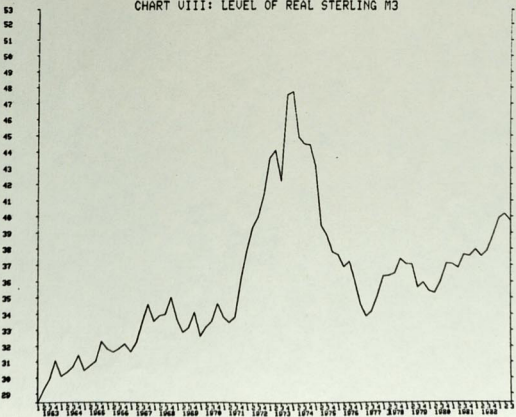
£bn
1975 prices

CHART VII: LEVEL OF REAL M1



£bn
1975 prices

CHART VIII: LEVEL OF REAL STERLING M3



Note: These charts use the quarterly monetary data.

CHART IX: LEVEL OF REAL PSL2 *

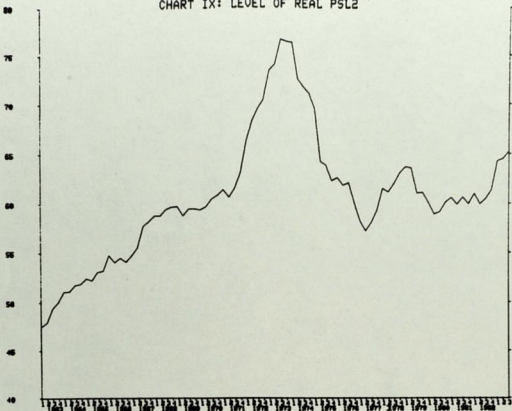
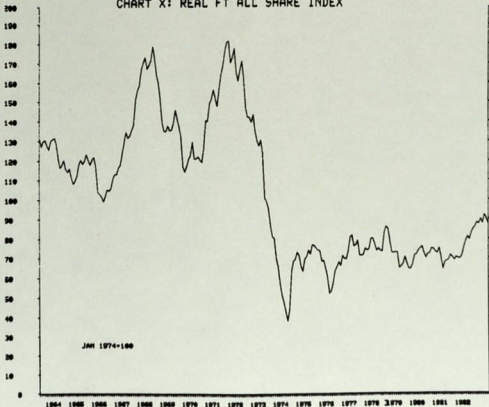


CHART X: REAL FT ALL SHARE INDEX



* 1983 Q3 Estimate

7. The recent fall in the six month growth rates of all the nominal monetary aggregates and the rise in RPI inflation have together involved a sharp fall in the growth of the real monetary aggregates. Whereas in the middle of the year the six month growth rates of the real broad aggregates were in the range of $8\frac{1}{2}$ - $13\frac{1}{2}$ per cent, they are now fairly low ($1\frac{1}{2}$ - $2\frac{1}{2}$ per cent in October). There have been sharp falls in the six month growth rates of real M1, NIBM1, and the composite indicator, and a slightly less dramatic fall for real MO.

8. Table 3 shows growth rates for total bank lending to the non-bank private sector. During the first half of 1983 bank lending decelerated so that by the middle of the year its six month growth rate was closer to the growth rate of broad money than it had been for some time. The latest information shows that this deceleration has come to an end - for the time being at least.

TABLE 3 : TOTAL BANK LENDING TO THE NON BANK PRIVATE SECTOR (lending by the 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 November	17.2	21.4
December	18.5	26.1
1982 January	19.9	33.0
February	22.1	33.2
March	23.3	37.1
April	25.5	39.6
May	27.1	32.7
June	28.2	30.4
July	29.9	27.4
August	28.9	25.1
September	30.0	23.6
October	30.4	22.2
November	28.0	23.7
December	26.9	23.4
1983 January	24.8	21.8
February	23.0	20.6
March	20.7	17.5
April	18.2	14.0
May	18.0	12.5
June	18.5	13.8
July	16.4	11.4
August	15.9	11.5
September	14.7	12.1
October	14.5	15.2

(3) OTHER INDICATORS OF MONETARY CONDITIONS

9. Table 4 shows data on the growth of money and real GDP. The 1983 Blue Book revised up the figures for 1981 and 1982, and it is possible that this could eventually occur with the figures available so far for 1983. At the moment these show growth rates for money GDP at or below those recorded for 1982, though a higher growth of real output (that appears to be being sustained in the second half of the year).

TABLE 4 : GROSS DOMESTIC PRODUCT (at market prices),
CSO's average estimate

	<u>Money GDP</u>		<u>Real GDP</u>
	<u>% change on a year earlier</u>	<u>% change over six months (annual rate)</u>	<u>% change on a year earlier</u>
1981 Q2	8.6	7.2	-3.4
Q3	10.1	11.1	-0.5
Q4	9.8	12.4	1.7
1982 Q1	9.8	8.6	1.5
Q2	10.3	8.2	2.5
Q3	8.9	9.2	1.8
Q4	8.2	8.1	1.1
1983 Q1	9.1	9.1	3.7
Q2	7.2	6.4	2.6
Q3*	(7-7½)	(5-6)	(3-3½)

*CSO projection

10. Table 5 shows the most recent data for retail and wholesale prices and average earnings (together with the latest estimates for earnings for recent months). The rate of retail price inflation has risen in recent months and is now very close to the rate of producer output price inflation, which has been stable in the range 5-6 per cent during 1983. The six month rate of inflation of producer input prices is still considerably lower than it was at the beginning of 1983 when the effects of the fall in the exchange rate coincided with rises in the world prices of commodities. The "underlying" rate of inflation of average earnings has risen very slightly since the middle of the year as a result of a rise in net overtime.

TABLE 5 : PRICES AND EARNINGS
(% change on same period a year before)

	<u>Retail Prices</u>	<u>Producer Price Index</u> (All manufactured products)		<u>Underlying</u>
		Output prices (home sales)	Input prices	<u>Average</u> <u>Earnings</u> (whole economy)
1981 Q1	12.7	10.3	3.7(14.5)*	16.0
Q2	11.7	9.3	9.8(15.6)*	13.3
Q3	11.3	9.0	13.4(12.1)*	11.5
Q4	11.9	9.7	15.0(14.5)*	11.2
1982 Q1	10.4	8.7	11.8(11.5)*	10.8
Q2	9.2	7.2	5.7(-2.6)*	10.1
Q3	8.0	7.4	4.8(-4.4)*	8.9
Oct	6.8	6.8	3.6(0.6)ϕ	8.8
Nov	6.3	6.4	3.5(5.5)ϕ	8.3
Dec	5.4	6.3	4.9(12.8)ϕ	8.0
1983 Jan	4.9	5.6	5.2(14.9)ϕ	8.0
Feb	5.3	5.2	5.7(18.8)ϕ	8.0
Mar	4.6	5.1	5.8(15.6)ϕ	7.8
April	4.0	5.4	5.9(11.7)ϕ	7.5
May	3.7	5.6	6.8(8.2)ϕ	7.5
June	3.7	6.0	7.3(2.0)ϕ	7.5
July	4.2	5.5	6.4(-1.4)ϕ	7.5
Aug	4.6	5.3	8.3(-1.3)ϕ	7.8**
Sept	5.1	5.4	9.5(3.6)ϕ	7.8**
Oct	5.0	5.5	8.1(4.6)ϕ	7.8**

*Increase over two quarters before at an annual rate

ϕIncrease over past six months (at an annual rate).

**Department of Employment estimate

CONFIDENTIAL

11. Nominal interest rates (Table 6) have been remarkably stable in the period since the last cut in base rates. Both the three month interbank and 20 year gilt rate are at levels very close to those in November of last year.

TABLE 6 : NOMINAL INTEREST RATES (period averages for calendar months & quarters)

	<u>Three month Interbank</u>	<u>Three month Eurodollar</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 Q1	14.3	15.1	14.1	14.7	0.4
Q2	13.4	15.1	12.8	13.7	0.3
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	1.4
Oct	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	11.2	9.0	10.7	11.9	0.7
Feb	11.3	9.1	11.0	11.5	0.2
March	10.8	9.4	10.7	11.2	0.4
April	10.3	9.3	10.2	10.6	0.3
May	10.3	9.0	10.0	10.6	0.3
June	9.9	9.8	9.7	10.4	0.5
July	9.8	10.0	9.5	10.9	1.0
Aug	9.8	10.3	9.5	11.0	1.2
Sept	9.7	9.9	9.5	10.7	1.0
Oct	9.4	9.6	9.1	10.6	1.2
Nov 10	9.3	9.8	9.0	10.4	1.1

12. The estimate of the real short term interest rate (Table 7) has fallen slightly (though its level is probably biased downwards because the outside forecasts of inflation that are used in its construction are too high - as they have been through most of 1983).

13. The yields on indexed gilts are sensitive to the assumption on inflation used in their calculation. Table 7 shows estimates of yields for the 1988 and 1996 IG's on the assumption of inflation rates of 5 and 7 per cent. The yields have fallen in recent months from the peak levels reached in July and August, but are still significantly higher than they were at the beginning of the year.

CONFIDENTIAL

TABLE 7 : REAL INTEREST RATES

	<u>Expected inflation over 12 months*</u>	<u>Real 3 month Interbank Rate**</u>	<u>Yield on 1988 indexed gilt***</u>		<u>Yield on 1996 indexed gilt***</u>	
			<u>Inflation assumption</u>		<u>Inflation assumption</u>	
			<u>5%</u>	<u>7%</u>	<u>5%</u>	<u>7%</u>
1981 Q1	10.7	2.6			2.3	2.2
Q2	10.0	2.6			2.7	2.6
Q3	10.3	3.9			3.4	3.3
Q4	10.1	5.5			3.5	3.4
1982 Q1	10.3	4.0	3.0	2.8	3.0	2.9
Q2	9.2	4.1	3.5	3.2	3.4	3.3
1982 July	8.2	4.2	3.5	3.2	3.4	3.3
Aug	8.1	2.9	3.6	3.4	3.3	3.2
Sept	7.7	3.0	3.8	3.4	3.2	3.1
Oct	7.5	2.3	3.0	2.8	2.8	2.7
Nov	5.4	3.9	2.7	2.5	3.0	2.9
Dec	5.9	4.6	2.4	2.1	2.8	2.7
1983 Jan	6.1	5.1	2.4	2.1	2.6	2.5
Feb	6.4	4.9	2.7	2.4	2.7	2.6
March	6.5	4.3	2.9	2.6	2.6	2.5
April	6.5	3.8	3.2	2.9	2.9	2.8
May	5.9	4.4	3.8	3.5	3.3	3.2
June	6.2	3.7	4.2	3.9	3.5	3.4
July	6.4	3.4	4.6	4.3	3.8	3.7
Aug	6.2	3.6	4.2	3.9	3.6	3.5
Sept	6.2	3.5	3.8	3.5	3.4	3.3
Oct	6.4	3.0	3.6	3.4	3.4	3.3
Nov 10	6.4	2.9	3.6	3.4	3.4	3.3

*Unweighted average of forecasts by Phillips & Drew, National Institute and the London Business School,; the expected rate of inflation for a given month is the change in the price level between six months earlier and six months ahead. This is assumed to approximate roughly to average inflation expectations over the 3 months immediately ahead.

**average for the month

***Last working day for each month with first of month settlement assumed.

14. Table 8 shows that the level of the effective exchange rate has continued to lie in a fairly narrow range since May though it has strengthened against the DM while weakening against the dollar.

TABLE 8 : EXCHANGE RATES (period averages)

	Effective rate	£/£ Rate	DM/£ Rate	uncovered differential*	
				£/\$	£/DM
1981 Q1	101.8	2.31	4.85	-3.1	1.0
Q2	97.8	2.08	4.71	-5.0	-0.7
Q3	90.6	1.84	4.47	-4.2	1.6
Q4	89.7	1.88	4.23	1.3	4.4
1982 Q1	91.1	1.85	4.34	-0.8	4.3
Q2	90.3	1.78	4.23	-1.7	4.2
1982 July	91.2	1.72	4.28	-1.8	3.0
Aug	91.3	1.72	4.28	-0.5	2.4
Sept	91.7	1.72	4.29	-1.0	2.9
Oct	92.5	1.70	4.34	-0.6	2.6
Nov	89.3	1.63	4.17	-0.4	2.3
Dec	85.4	1.62	3.92	1.0	4.2
1983 Jan	82.0	1.57	3.76	0.1	4.5
Feb	80.8	1.53	3.72	2.2	5.8
March	79.1	1.49	3.59	1.4	5.8
April	82.1	1.53	3.76	1.0	5.3
May	85.0	1.58	3.88	1.3	5.3
June	85.2	1.55	3.95	0.1	4.5
July	84.7	1.53	3.95	-0.2	4.7
Aug	85.0	1.50	4.02	-0.5	4.4
Sept	84.7	1.50	4.00	-0.2	4.0
Oct	83.5	1.50	3.90	-0.2	3.6
Nov 10	83.9	1.49	3.97	-0.5	3.3

*Between 3 month UK interbank rate and 3 month Eurodollar rate and the 3 month Euro DM rate.

(4) HOUSING FINANCE AND ASSET PRICES

15. As expected, building society retail inflows rose further in calendar September following the introduction by the top 5 societies and most of the medium-sized societies of 2-year term shares offering 9 per cent net of tax. In addition, towards the end of September, after the Abbey National building society announced its withdrawal from the interest rate cartel, there followed a short period when the net rates of interest on the relatively liquid 7-day and 28-day accounts were bid up to around $8\frac{1}{4}$ and $8\frac{1}{2}$ per cent respectively compared with the rates on banks' 7-day accounts of 6 per cent before tax before 4 October and $5\frac{1}{2}$ per cent thereafter. As a result, building society retail inflows in October are expected to reach record levels.

16. Net wholesale money raised in September fell to £90 million compared with £196 million in August. This probably reflects the increased repayment on maturity of CDs issued earlier, and net issues of CDs in future months are likely to continue at a lower level than was achieved over the summer. However, from 1 October, the societies have also been able to raise wholesale money in the form of time deposits. These are effectively non-negotiable CDs and are of interest mainly to the smaller societies which are not big enough names to issue marketable debt. Over £150 million of time deposits are thought to have been issued during October and similar figures are likely in the remainder of 1983 until (as with CDs over the summer) the major part of the initial stock adjustment is complete.

CONFIDENTIAL

TABLE 9 : BUILDING SOCIETY FINANCIAL FLOWS
(Calendar months and quarters,
seasonally adjusted)

	Liquidity ratio (end period)	Net increase in shares & deposits	Net inflows of whole- sale money (n.s.a.)	Net new commit- ments	Gross advances	Net advances
	%	£m	£m	£m	£m	£m
1982 Q1	19.3	2312	57	3260	2826	1401
Q2	19.5	2535	54	4095	3762	1996
Q3	19.7	2739	74	4255	3975	2003
Q4	19.8	2929	45	5289	4776	2747
1983 Q1	18.2	2287	58	5114	5198	2993
Q2	17.4	2079	365	4566	4823	2763
Q3	17.8	2890	486	4519	4514	2428
1982 Oct	19.8	1003	15	1670	1498	835
Nov	19.8	1089	23	1769	1587	910
Dec	19.7	837	7	1850	1691	1002
1983 Jan	19.3	724	21	1753	1705	948
Feb	18.8	740	10	1712	1708	994
Mar	18.2	823	27	1649	1785	1051
Apr	18.0	686	25	1583	1614	930
May	17.6	634	78	1534	1646	948
June	17.4	759	262	1449	1563	885
July	17.7	965	200	1462	1529	846
Aug	17.8	906	196	1436	1478	794
Sept	17.8	1019	90	1621	1507	788

17. With both wholesale and retail inflows at record levels, there have been suggestions that the societies may decide at their meeting on 11 November to reduce their "advised" rates from 1 December. The Abbey National building society in particular has been pressing for an early reduction in interest rates. The other large societies, however, are urging caution. The division between the societies probably reflects the varying state of mortgage queues and liquidity positions. Despite the very high level of inflows, many societies are not yet in the position where they have both eliminated mortgage queues and reached their desired liquidity ratio.

18. On the other hand, any society - such as presumably the Abbey National - which has reached its desired liquidity ratio without mortgage queues must now be investing its marginal funds in liquid assets at a considerable loss. The marginal cost to a building society of retail funds, including composite rate tax, is around 12 per cent while the returns on gilts (excluding revaluation) and monetary sector deposits are respectively about $1\frac{1}{2}$ and $2\frac{1}{2}$ percentage

CONFIDENTIAL

points lower than this. The cost to such societies of maintaining the present interest rate structure must therefore be high.

19. Nevertheless, the majority decisions at the 11 November meeting is likely to be in favour of maintaining the existing interest rate structure for the time being, or at best for reducing rates from 1 January rather than 1 December. If the other large societies refuse to cut their interest rates, it is unlikely that the Abbey National would fall out of line because of the prospect of a large outflow of funds to other societies.

20. The rate of growth of bank lending for house purchase continues to decline although in terms of the absolute levels of flows there has been little noticeable trend since the beginning of 1983. The 12-month growth rate of building society lending appears to be a plateau of about 20 per cent while the 6-month growth rate continues to decline. Both 6- and 12-month growth rates of the combined total of lending are declining to 20.8 and 23.4 per cent respectively in September. The downward trend may be halted or even reversed after the increase in building society commitments noted in September (and expected to continue) begins to be reflected in actual advances towards the end of the year.

CONFIDENTIAL

TABLE 10 : NET LENDING FOR HOUSE PURCHASE
(£m., seasonally adjusted, calendar months)

	<u>Building Societies</u>	<u>Banks (Est)</u>	<u>Total</u>
	October	835	1192
	November	910	1370
	December	1002	1352
1983	January	948	1244
	February	994	1308
	March	1051	1374
	April	930	1236
	May	948	1296
	June	885	1199
	July	846	1145
	August	794	1153
	September	788	1079

Percentage change in stock of lending

	<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
1982 Dec	16.6	18.9	89.1	73.6	24.1	25.7
1983 Jan	17.5	19.8	84.2	63.6	24.7	25.5
Feb	18.5	20.9	77.8	55.1	25.2	25.6
Mar	19.3	22.2	69.9	48.8	25.4	26.0
Apr	19.7	22.2	65.5	45.6	25.4	25.6
May	20.0	22.0	61.1	40.8	25.3	24.8
June	20.0	21.1	55.1	38.6	25.1	24.5
July	20.1	20.4	50.0	37.5	24.3	23.1
August	20.1	19.3	45.9	37.3	23.9	22.1
September	20.1	18.0	42.0	35.6	23.4	20.8

CONFIDENTIAL

21. The latest monthly figures for house prices confirm our earlier judgements ie that while there was a small upward shift in house price inflation in the third quarter, there is no evidence of a sustained acceleration of house prices. There are as yet no third quarter figures available for other asset prices. The second quarter figures showed annual rates of increase between 5 and 10 per cent with no sign of an upward trend.

TABLE 11 : HOUSE PRICES
(% change on a year earlier)

	<u>Based on mortgage approvals</u>	<u>Based on mortgage completions</u>	<u>Mix-adjusted (based on completions)</u>	<u>Nationwide (based on approvals)</u>
1982 Q1	-4.0	-4.9	0	2
Q2	-0.7	-3.0	1	2
Q3	4.0	0.5	2	3
Q4	12.2	6.8	6	8
1983 Q1	13.0	11.3	11	9
Q2	12.8	10.4	9	11
Q3	14.6	12.3	n/a	13
1982 October	9.9	3.1		
November	12.9	6.9		
December	14.2	10.4		
1983 January	13.8	9.6		
February	13.7	10.8		
March	12.4	11.8		
April	12.6	10.9		
May	12.4	9.5		
June	13.3	10.9		
July	15.5	11.7		
August	14.7	12.4		
September	13.8	12.8		

CHART XI: QUARTERLY HOUSE PRICES

% CH OVER PREVIOUS 12M

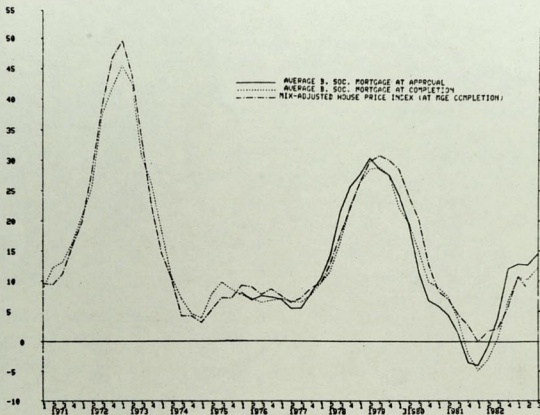
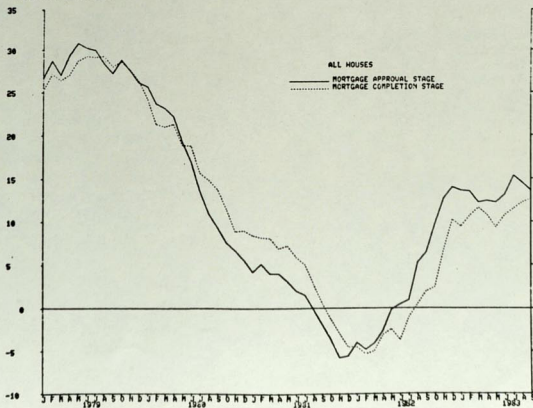


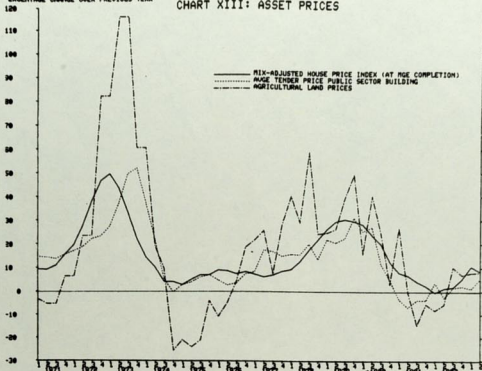
CHART XII: MONTHLY HOUSE PRICES

% CH OVER PREVIOUS 12M



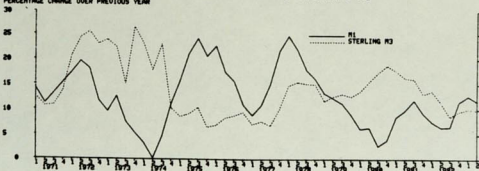
PERCENTAGE CHANGE OVER PREVIOUS YEAR

CHART XIII: ASSET PRICES



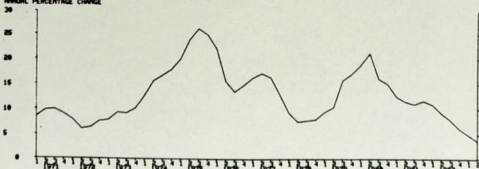
PERCENTAGE CHANGE OVER PREVIOUS YEAR

GROWTH RATE OF M1 AND STERLING M3



ANNUAL PERCENTAGE CHANGE

RETAIL PRICE INDEX



PERCENTAGE CHANGE OVER PREVIOUS YEAR

STOCK OF MORTGAGES OUTSTANDING

