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FROM: S N WOOD
18 April 1984

- Approved in draft.*
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18/4
1. MR LANKESTER ✓
 2. SIR PETER MIDDLETON ✓
 3. CHANCELLOR

cc Chief Secretary
Financial Secretary
Economic Secretary
Sir T Burns
Mr Littler
Mr Cassell
Mr Monck
Mr Battishill
Mr Lavelle
Mr Sedgwick
Mrs Lomax o.r
Mr Mowl
Mr Peretz
Mr Riley
Mr O'Donnell
Mr Willoughby
Mr Wynn-Owen
Mr Lord
Mr Ridley

The situation is rather like last year when we started with relatively rapid monetary growth. The path for the PSBR were lead them to expect the same profile for money this year. So we keep very calm. But the situation in the US and the money shock clearly add an extra dimension of risk this time.

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Mr George - B/E
Prof Sir A Walters -
UKTSD Washington
Mr Redwood - No 10

MONETARY PROSPECTS

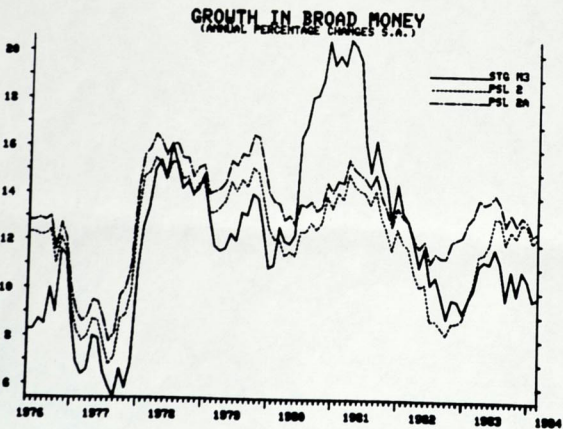
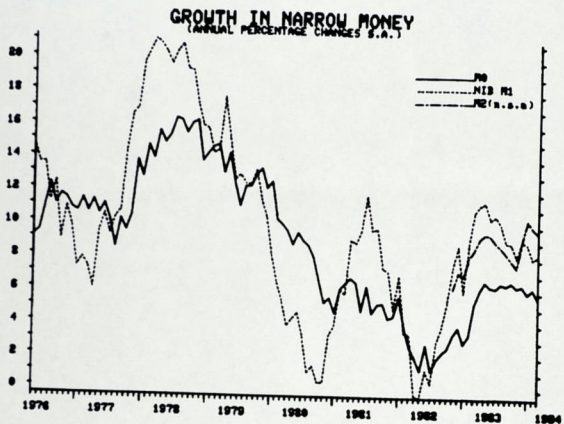
This minute summarises our latest assessment of the monetary situation and prospects, and the discussion at Sir Peter Middleton's usual monthly meeting with the Bank to review our approach to short-term interest rates and funding.

Monetary aggregates

2. All the aggregates rose quite strongly in banking March, as expected, following two months of fairly slow growth. However, three, six and twelve-month growth rates in both M0 and £M3 are within the new target ranges. Despite a slight slackening in building societies' inflows, PSL2 recorded its largest monthly rise for a year, probably because funding was unusually low. Among the other aggregates, part of the sharp rise in M1 was almost certainly due to special factors, including the success of Midland's new high interest cheque account and Budget uncertainties. M2 was

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inflated by a further classification change. There is little difference between the rates of growth of £M3 on the old and new definitions over the 1983/84 target period. Other measures of broad money are growing faster than £M3: over the past six months, M3 has risen by 15 per cent and PSL2A by 13½ per cent (both at annual rates).

Table 1: Monetary Aggregates; recent experience and forecast

	MO	M2*	£M3	PSL2	
			old defini- tion	new defi- nition	
monthly change:					(per cent)
February	0.2	-	-	0.1	1.0
March	0.6	1.2	0.9	1.3	1.7
growth at an annual rate:					
6 months to					
mid-March	5.1	..	9.6	10.1	13.0
mid-June (forecast)	5.3	..	n/a	9.5	15.9
1983-84 target period to					
mid-March	6.3	..	9.9	10.2	12.9
mid-April (forecast)	6.3	..	9.8	10.2	13.1
1984-85 target period to					
mid-June (forecast)	6.3	9.3**	n/a	13.1	17.1

Recent outturns and the forecast for the next three months are shown in tables 1 and 2 attached

* not seasonally adjusted

** 12 month percentage change.

3. Over the next three months MO may grow very slightly faster as a result of the latest cut in interest rates and in line with personal disposable incomes at about ½ per cent per month. The forecast for £M3 reflects expected substantial underfunding of the PSBR over the next three months. The PSBR is heavily "front end loaded", and we face large redemptions of gilts in June. £M3 is

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expected to rise by nearly 1 per cent a month on average over the next three months, with much of the growth occurring in June when a rise of about $1\frac{1}{2}$ per cent is expected. If the forecasts are right, £M3 would still be outside the new target range at mid-June, though the six-month growth rate would be below 10 per cent. It seems unlikely that PSL2 will decelerate. M2 is expected to continue to grow at around $9-9\frac{1}{2}$ per cent, year on year: classification changes in the pipeline will have only a small effect.

PSBR and Debt Sales

4. Over the forecast period both CG own account and public sector borrowing are expected to average £1- $1\frac{1}{4}$ billion a month, seasonally adjusted. The figure of £3.4 billion (sa) for the CGBR(0) in the three months to June compares with the PSBR forecast of £5.3 billion for the financial year. Front-end loading is greater than usual, owing to the timing of certain Budget measures, eg VAT on imports, and asset sales.
5. Gross gilt sales in banking April were only just short of the forecast: net sales to all sectors were £1.1 billion. The forecast assumes gross sales of £1 $\frac{1}{4}$ billion in each of May and June. This would imply net sales to non-banks of some £800 million in May, but because of large redemptions a zero or even negative figure in June. We expect net sales to overseas to remain at about £50 million a month, except in June, when a substantial volume of gross purchases will be needed just to replace overseas holdings of the high coupon stock due for redemption then.
6. We assume that the launch of British Telecom subscription certificates, which Ministers have agreed, takes place as planned at the beginning of calendar May, and we have allowed for modest initial sales of £25 million in banking May and £100 million in banking June.
7. National Savings contributed nearly £350 million to funding in March. Sales of the fixed interest certificate were strong, partly in anticipation of the withdrawal ^{of the 26th Issue} and both the Income Bond and INVAC continued to attract sizeable inflows. Competitiveness against building society accounts is broadly unchanged, and on the

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assumption that this continues net inflows of £265 million a month are forecast.

8. The PSBR remains slightly underfunded over the target period to date, but heavily overfunded since mid-April 1983. External flows have contributed about £1 billion to "funding" in each of these periods. The forecasts for the next three months as a whole imply underfunding of £1½ billion on both bases. For the 1983-84 target period as a whole, the forecast implies underfunding of over £¾ billion, on the conventional definition, and overfunding of £½ billion on the alternative presentation. For the 12 months to mid-April 1984, the comparable figures show overfunding of £1½ billion and £2½ billion respectively.

Table 2: The "PSBR" and Funding

	mid-Feb '83 - mid-Mar '84	mid-April '83 - mid-Mar '84	Forecast mid-March - Mid-June	£bn, sa
"PSBR"	12.9	9.9	3.9	
Debt sales to NBPS	-12.8	-12.2	-2.4	
Over(-) Under(+) funding	+0.1(-1.4)	-2.3(-4.3)	+1.5	
External finance of the public sector	-1.2	-1.0	-0.1	
Over (-) Under(+) funding alterna- tive definition	-1.1	-3.3	+1.4	

Figures in brackets are unadjusted

9. Money market shortages averaged £450 million a day during banking March, of which some £420 million was due to maturing assistance. Nearly £¾ billion of new assistance was provided. The outstanding stock of assistance at the end of the period was £12¼ billion. But

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the position should ease significantly over the next three months, and it is expected that some £3 billion of assistance will be unwound, concentrated in April and June, particularly the latter.

Sterling lending to the Private Sector

10. The March out-turn was slightly below forecast, although there was a sharp rise in foreign currency lending. The trend of both recorded and underlying lending since the beginning of the year appears fairly flat. There has been a spate of announcements of future new company issues since the Budget. Over the next three months, a string of high PSBRs may help to depress recorded lending. The forecast rate of underlying lending has been revised down from £1.3 billion to £1.2 billion.

Building Societies

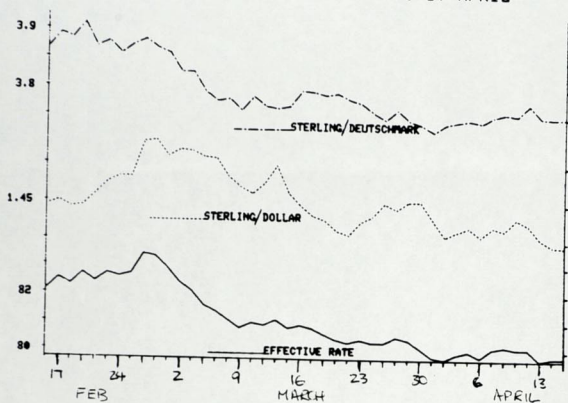
11. Retail inflows in banking March were a little down on the previous two months at £900 million. There are no signs of a slackening in mortgage commitments, and it seems likely that the societies will reduce their liquidity, perhaps by shedding some gilts. The reduction in mortgage and deposit interest rates effective from 1 April implies an improvement in margins of $\frac{1}{4}$ per cent (roughly offsetting the effect of the Revenue's recent decision on the taxation of gilts trading). The societies will still have a substantial, but slightly reduced, competitive advantage over the banks, and their position by comparison with National Savings is broadly unchanged, so only a slight fall in net inflows is expected in the coming months.

Other Indicators of Monetary Conditions

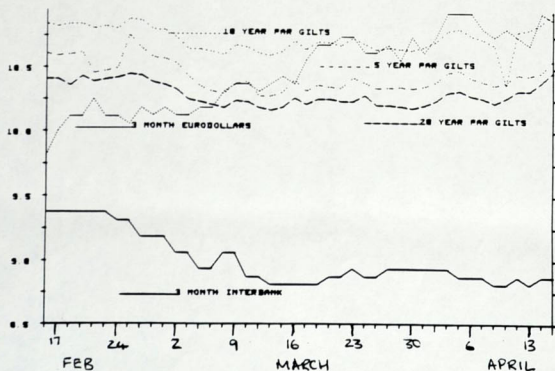
12. Over the past month, sterling has weakened against both the dollar and the deutschemark, and the effective rate has also fallen. The fall in the dollar/sterling exchange rate may reflect concern over the miners' strike and the widening in the gap between UK and US short-term interest rates, as UK rates have fallen following the Budget while US rates have hardened.

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EXCHANGE RATE 16 FEBRUARY TO 17 APRIL



INTEREST RATES 16 FEBRUARY TO 17 APRIL



13. Yields on indexed gilts have remained at very high levels, although estimated real short-term interest rates have fallen slightly. The average of outside inflation forecasts has been edging down. Latest indicators suggest house price inflation may have picked up again after easing in January.

Policy

13. The meeting agreed that the monetary situation looked a little fragile, and that there was some risk of upward pressures on interest rates emerging. This could happen through a combination of three main factors: the widening differential between sterling and dollar interest rates, possible concern about the front-end loading of the PSBR, and worries about the miners' dispute. On the first of these, the signs were that - if anything - US interest rates would rise. So far the sterling/dollar exchange rate had been reasonably stable, but this could change. As regards front-end loading of the PSBR, this was likely to produce faster monetary growth in the early part of the target period - which again might cause concern. On the other hand, it was possible that this had already been discounted in the market. Whether it would be desirable to draw attention in briefing to the PSBR profile would depend upon the market's reaction to the early months' PSBR figures.⁴

14. The meeting also agreed that if, against this background, upward pressure on interest rates did develop, it would probably not be desirable for the authorities to resist. At the same time, there was no case at present for the authorities to initiate any upward move. Although the recent movement in producer prices was slightly worrying, other evidence on inflation - including commodity prices, wage settlements and productivity - was consistent with the RPI forecast, and argued against any immediate firming of policy.

15. The meeting noted the high level of redemptions forecast for banking June. However, the Bank felt it would be difficult to achieve a higher rate of gross sales than the £1½ billion assumed in the forecast without either widening the range of stocks for sale or pushing up yields, which were already high in real terms. On National Savings, it was noted that work was being done on the

* The point is that the markets are already well aware of the profile, and we do not want them to think we are worried by embarking on an over-enthusiastic presentation.

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feasibility of staunching the net outflow from indexed NS instruments.

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Table 1: Percentage Changes in Monetary Aggregates
Seasonally adjusted data

Banking month	MO	NIB M1	M1	M2*	FM3		M3	PSL2	PSL2A
					Old defn	New defn			
<u>Outturn</u>									
- February	+ 0.2	+ 0.5	+ 0.7	-	-	+ 0.1	+ 0.7	+ 1.0	+ 0.9
- March	+ 0.6	+ 2.1	+ 3.2	+ 1.2	+ 0.9	+ 1.3	+ 1.3	+ 1.7	+ 1.5
Growth at annual rate over:-									
Latest 3 months	+ 4.5	+ 4.7	+15.7	..	+ 6.1	+ 7.0	+10.5	+ 16.3	+ 15.6
Latest 6 months	+ 5.1	+ 8.4	+15.7	..	+10.1	+ 9.6	+15.1	+ 13.0	+ 13.8
Latest 12 months	+ 5.7	+ 8.3	+13.3	+ 9.7	+ 9.6	+ 9.8	+11.9	+ 12.3	+ 12.6
Target period (1983/84)	+ 6.3	+ 9.5	+13.5	..	+ 9.9	+10.2	+12.2	+ 12.9	+ 13.0
<u>Forecast</u>									
(i) Percentage change in month									
- April	} ½ per cent a month		-	+ 1.4	+ 0.7	+ 0.8		+ 1.2	+ 1.2
- May			..	+ 0.2	..	+ 0.6		+ 0.9	+ 0.9
- June			..	+ 0.8	..	+ 1.5		+ 1.5	+ 1.4
(ii) Percentage change over latest 6 months (a.r.)									
- April	+ 5.0		+12.3	..	+ 8.5	+ 8.7		+ 13.6	+ 13.6
- May	+ 5.0		..	..	..	+ 9.5		+ 14.8	+ 14.3
- June	+ 5.3		..	..	..	+ 9.5		+ 15.9	+ 15.1
(iii) Percentage change since Feb 1983 (a.r.)									
- April	+ 6.3		+12.5	..	+ 9.8	+10.2		+ 13.1	+ 13.1
(iv) Percentage change since Feb 1984 (a.r.)									
- April	+ 6.6		..	+ 9.8**	..	+13.2		+ 18.9	+ 17.6
- May	+ 6.4		..	+ 9.5**	..	+11.1		+ 16.4	+ 15.3
- June	+ 6.3		..	+ 9.3**	..	+13.1		+ 17.1	+ 16.0

* not seasonally adjusted

**12 month percentage change

TABLE 2: £M3 COUNTERPARTS

£ millions
seasonally adjusted

Banking months	Outturns			Forecast			Mid-April 1983 - mid-April 1984
	Jan	Feb	Mar	Apr	May	June	
1. CGBR (CGBR n.s.a.)	+ 65 (-1,360)	+2,005 (- 65)	+ 410 (+ 135)	+1,640 (+3,505)	+1,250 (+ 795)	+1,295 (+2,335)	+13,935 (+13,710)
2. Debt sales to NBPS	-1,140	-1,250	- 500	-1,275	-1,075	- 75	-13,485
3. Other public sector	- 670	- 10	- 85	+ 415	- 365	- 280	- 1,990
Over (-)/Underfunding(+)	-1,745	+ 745	- 175	+ 780	- 190	+ 940	- 1,540
4. Sterling lending to private sector	+1,270	+ 995	+1,445	+ 535	+1,260	+ 935	+13,960
5. Externals	+1,325	- 560	+ 485	- 85	- 105	+ 55	+ 205
6. NNDLs	- 545	-1,050	- 500	- 400	- 400	- 400	- 4,440
Change in £M3	+ 305	+ 130	+1,255	+ 830	+ 565	+1,530	+ 8,185

Memo items:

"PSBR" (1 + 3)	- 605	+1,995	+ 325	+2,055	+ 885	+1,015	+11,945
"Underlying" bank lending	+ 435	+1,185	+ 945	+1,200	+1,200	+1,200	
Money market assistance	+1,635	+1,450	+ 735	-1,235	+ 505	-2,340	