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FROM: P N SEDGWICK

DATE: 11 MAY 1984

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Mr George)
Mr Coleby) Bank
Mr Goodhart) of
Mr Plenderleith) England
Mr W A Allen)
Mr Foot)

Professor A Walters No. 10

INTERPRETATION OF MONETARY CONDITIONS : MAY

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

P.N.S

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INTERPRETATION OF MONETARY CONDITIONS

(1) INTRODUCTION AND SUMMARY

UK short term interest rates have risen over the last ten days against the background of increasing dollar interest rates and a decline in the sterling/dollar exchange rate. Banks have raised their base rates to 9-9 $\frac{1}{4}$ per cent.

2. The two targeted monetary aggregates, £M3 and weekly averaged M0, have decelerated and growth rates are well within the target ranges. Some other measures of narrow and broad money continue to grow relatively rapidly. The previous slow down in the growth of notes and coin was reversed in April and non interest bearing M1 and M2 have accelerated. The shift out of bank time deposits and into interest bearing chequable deposits is continuing to boost the growth of M1 relative to £M3. The slow growth of retail deposits included in £M3 continued in April and there was also some slow down in the growth of wholesale deposits. Although the pace of building society inflows slowed again in banking April the growth in PSL2 is about three per cent faster than £M3.

3. Other indicators are giving mixed signals about monetary conditions. Growth of real money balances remains rapid, bank lending has accelerated, and producer output price inflation is edging up. The continuing attraction of equities when very high real yields are available on indexed linked stock suggests that investors are expecting even higher real returns on equities. However, the effective exchange rate is reasonably steady, retail price inflation and inflation expectations have declined a little and the growth of unit wage costs in manufacturing is very low. Real interest rates also remain high.

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(2) THE BEHAVIOUR OF THE MONETARY AGGREGATES

4. Table 1 and Charts I to V summarise the most recent information on the nominal monetary and financial aggregates as well as data for previous financial years. Charts I and II show the growth of narrow and broad money, Chart III shows the growth in weekly averaged M0 and Chart IV and V show private sector $\pounds M3$ and PSL2. Table 1A shows the growth of the components of PSL2.
5. The growth of weekly averaged M0 continued to decline in April because of a fall in bankers' operational balances, however, notes and coin increased on a weekly averaged basis and the six and twelve month growth rates of the end banking month series for notes and coin rose (Table 1A). The growth in the weekly averaged M0 has been stabler than the growth in notes and coin over the last twelve months suggesting that movements in bankers' balances and notes and coin have been offsetting during this period, however econometric work using longer runs of monthly data did not find that offsetting movements in the components of M0 were significant. The faster growth in notes and coin would be consistent with the effects of the recent falls in interest rates.
6. Non interest bearing sight deposits and nib M1 accelerated, probably reflecting the effects of recent falls in short term interest rates on the demand for non interest bearing balances, while interest bearing sight deposits continued to expand rapidly (the current 12 and 6 month growth rates are respectively 26 and 31 per cent). There was a further shift out of bank time deposits, which have fallen almost continuously on a partial seasonally adjusted basis for the past ten months, partly compensated in bank balance sheets by increases in bank interest bearing retail chequeable accounts, probably attracted by the new interest bearing chequeable accounts on offer with banks. These shifts boost M1 relative to $\pounds M3$ and M1 growth has risen in the last two months. Banks' interest bearing retail deposits continued to fall but total retail bank deposits (ie non interest bearing plus interest bearing retail deposits) have increased for the last two months. The growth of wholesale bank deposits slowed down in April - however, there is still a very marked difference between the behaviour of wholesale and retail deposits - and the twelve month growth of $\pounds M3$ fell to 8.3 per cent, although this reflects an erratically largely movement in the external counterparts.

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TABLE 1: PERCENTAGE GROWTH RATES IN THE NOMINAL AND FINANCIAL AGGREGATES

	Composite monetary indicator	Weekly averaged M0	Non- interest bearing			M2	EM3 ⁺⁺	M3	PSL2
			M1	M1	M1				
(a) <u>Financial years</u> (12 month changes to banking April)									
1981-82	5.4	2.0	-0.4	3.7		12.0	15.3	10.8	
1982-83	10.9	6.1	11.3	14.9	8.8	11.1	13.6	11.5	
1983-84	8.4	4.8	9.6	13.8	10.3	8.3	11.0	11.2	
(b) <u>Changes in 4 quarters to⁺</u>									
1982 (2)	6.0	2.8	1.2	6.2		12.0	13.0	10.3	
(3)	6.3	2.3	3.9	7.7		10.2	10.3	8.5	
(4)	8.9	4.0	8.8	11.5	6.6	9.6	11.3	8.7	
1983 (1)	10.6	5.3	10.9	13.3	7.7	10.1	13.3	10.3	
(2)	11.0	6.4	10.5	15.9	9.2	11.2	12.8	12.0	
(3)	9.9	6.5	9.1	12.4	8.5	9.7	11.5	12.0	
(4)	10.0	6.5	9.2	12.4	9.4	10.9	12.6	12.9	
1984 (1)	8.3	5.7	8.3	13.3	10.2	9.8	11.8	12.3	
(c) <u>Changes in 12 months to</u>									
1983 May	11.3	6.7	11.5	16.0	9.3	11.3	12.5	11.6	
June	11.0	6.4	10.5	15.9	9.2	11.2	12.8	12.0	
July	11.3	6.3	10.7	15.0	9.0	11.8	12.5	13.1	
August	10.8	6.6	10.3	13.8	8.8	11.2	12.1	13.1	
September	9.9	6.5	9.1	12.4	8.5	9.7	11.5	12.0	
October	9.9	6.7	9.4	13.7	7.1	10.9	12.3	12.1	
November	9.9	6.4	8.2	11.9	7.9	9.9	11.3	12.3	
December	10.0	6.5	9.2	12.4	9.4	10.9	12.6	12.9	
1984 January	9.6	6.0	9.0	11.1	10.8	10.5	12.6	12.8	
February	8.7	6.3	8.1	11.1	10.3	9.7	11.8	12.2	
March	8.3	5.7	8.3	13.3	10.2	9.8	11.8	12.3	
April	8.4	4.8	9.6	13.8	10.3	8.3	11.0	11.2	
(d) <u>Changes (at an annual rate) in 6 months to</u>									
1983 May	11.8	6.5	7.7	13.8	10.2	11.9	13.0	15.9	
June	13.6	7.5	8.0	16.8	11.5	13.6	13.2	17.4	
July	14.4	5.5	13.2	13.8	11.7	13.6	14.1	16.5	
August	11.7	6.2	10.5	14.2	9.6	12.8	11.7	14.7	
September	8.8	6.3	8.3	11.0	7.4	10.0	8.6	11.6	
October	7.6	5.7	8.6	11.8	6.4	8.8	9.2	9.4	
November	8.0	6.4	8.7	9.9	5.8	8.0	9.6	8.8	
December	6.5	5.5	10.5	8.2	7.3	8.2	12.1	8.6	
1984 January	5.0	6.6	4.9	8.6	9.9	7.5	11.3	9.2	
February	5.7	6.3	5.9	8.2	11.0	6.7	11.9	9.7	
March	7.7	5.1	8.4	15.7	13.1	9.6	14.9	13.1	
April	9.2	3.9	10.6	15.9	14.3	7.7	12.8	13.1	

Footnotes are on the following page.

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- ◆ The growth rates are adjusted for the changeover to the new monetary sector. The October 1982 figures are 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 partially seasonally adjusted by using a seasonally adjusted series for the NIBM1 component and adjusting retail time deposits for the seasonal effects of interest crediting. When proper seasonal adjustment of M2 is eventually possible its within year movements may differ from those shown.
- ++ Excluding public sector deposits.

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TABLE 1A: GROWTH OF COMPONENTS OF PSL2 (%)

	Notes and coin (i)	Non-interest bearing sight deposits with banks (ii)	Interest bearing deposits with the monetary sector		All other components of PSL2 (v)	Total £M3 (vi)= (i)+(ii) +(iii)+(iv)	Total PSL2 (vii)= (v)+(vi)
			Retail (iii)	Wholesale (iv)			
(a) Financial years (12 month changes to banking April)							
1981-82	3.5	-2.9	-	-	8.3	12.0	10.8
1982-83	7.2	14.0	5.9	14.6	12.1	11.1	11.5
1983-84	6.0	11.8	-1.4	16.5	15.4	8.3	11.2
(b) Changes in 4 quarters to							
1982 (2)	3.4	-0.1	-	-	7.6	12.0	10.3
(3)	3.5	4.3	-	-	6.5	10.2	8.5
(4)	4.8	11.4	4.0	18.5	7.5	9.6	8.7
1983 (1)	6.3	13.9	4.0	15.8	10.6	10.1	10.3
(2)	7.7	12.3	7.3	14.4	13.1	11.2	12.0
(3)	7.2	10.3	6.8	13.6	15.5	9.7	12.0
(4)	6.7	10.6	4.6	18.7	15.7	10.9	12.9
1984 (1)	4.9	10.4	0.3	21.2	15.7	9.8	12.3
(c) Changes in 12 months to							
1983 May	7.3	14.2	6.8	16.6	12.2	11.3	11.6
June	7.7	12.3	7.3	14.4	13.1	11.2	12.0
July	7.3	12.9	6.4	16.1	15.0	11.8	13.1
Aug	6.3	12.8	6.9	15.5	15.9	11.2	13.3
Sept	7.2	10.3	6.8	13.6	15.5	9.7	12.0
Oct	7.5	10.5	6.2	18.1	15.3	10.9	12.1
Nov	7.5	8.6	6.0	15.3	15.6	9.9	12.3
Dec	6.7	10.6	4.6	18.7	15.7	10.9	12.9
1984 Jan	6.0	10.8	3.1	18.8	16.2	10.5	12.8
Feb	5.4	9.7	1.7	18.5	15.6	9.7	12.2
Mar	4.9	10.4	-0.1	21.2	15.8	9.8	12.3
Apr	6.0	11.8	-1.4	16.5	15.4	8.3	11.2
(d) Changes (at an annual rate) in 6 months to							
1983 May	8.4	7.3	11.0	19.2	21.6	11.9	15.9
June	8.8	7.4	15.3	17.3	22.7	13.6	17.4
July	6.9	17.2	13.0	14.7	20.7	13.6	16.5
Aug	5.4	14.7	11.2	17.4	17.2	12.8	14.7
Sept	5.7	10.0	6.7	17.7	13.8	10.0	11.6
Oct	6.0	10.3	3.2	15.0	10.2	8.8	9.4
Nov	6.7	10.0	1.3	11.6	10.0	8.0	8.8
Dec	4.7	14.1	-5.2	20.3	9.2	8.2	8.6
1984 Jan	5.1	4.8	-6.0	23.4	11.9	7.5	9.2
Feb	5.5	6.1	-7.0	19.8	14.1	6.7	9.7
Mar	4.2	10.9	-6.4	24.9	18.0	9.6	13.1
Apr	6.0	13.4	-5.8	18.2	20.8	7.7	13.1

The split between retail and wholesale is that used for M2. Deposits of less than £100,000 are counted as retail. This split is only partially seasonally adjusted. The wholesale component contains a small amount of retail deposits with a residual maturity of greater than one month.

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CHART I: ANNUAL GROWTH RATES OF NARROW MONEY

% INCREASE OVER PREVIOUS 12 MONTHS

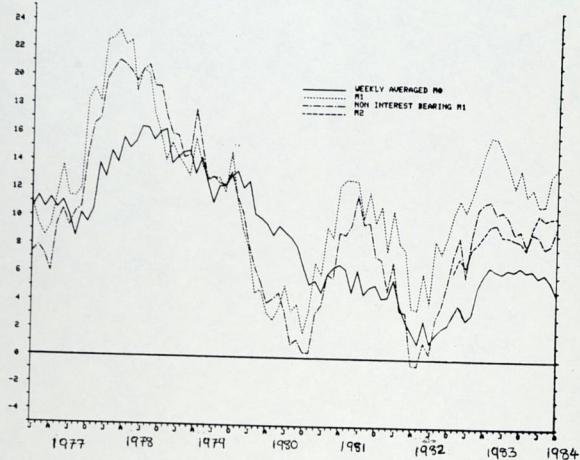


CHART II: ANNUAL GROWTH RATES OF BROAD MONEY

% INCREASE OVER PREVIOUS 12 MONTHS

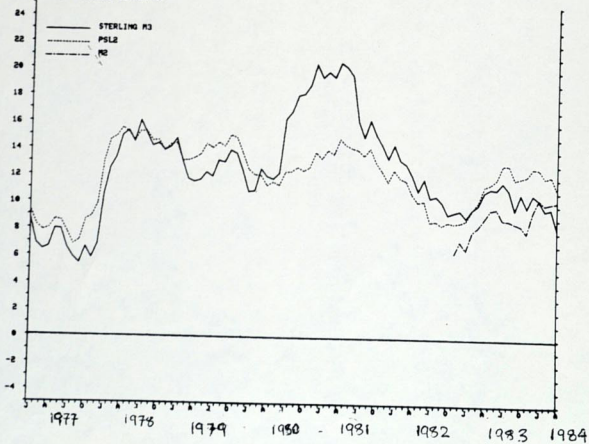


CHART III: GROWTH RATES IN WEEKLY AVERAGED M0

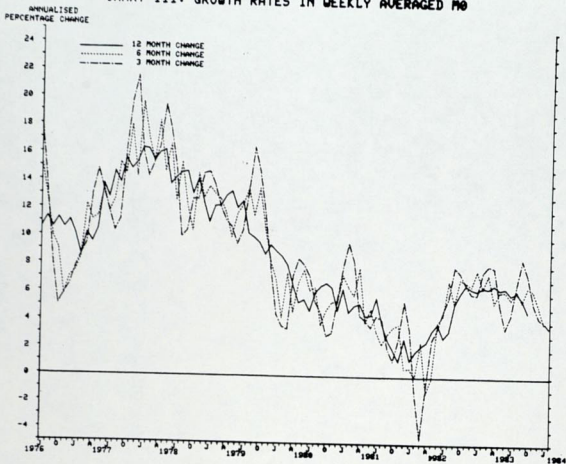
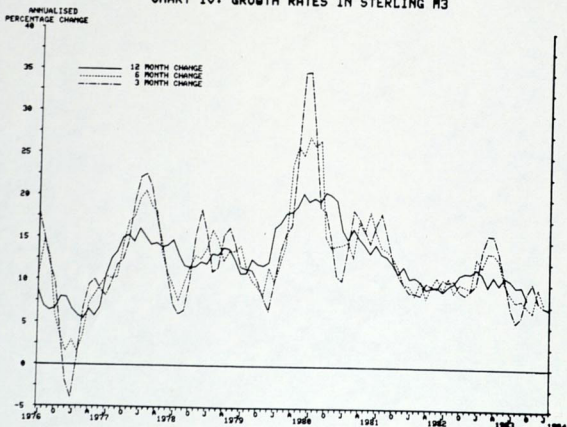


CHART IV: GROWTH RATES IN STERLING M3



NOTE: THE GROWTH RATES ARE SHOWN AS THE MIDPOINT OF THE PERIOD OVER WHICH THEY ARE MEASURED. THUS THE GROWTH FROM SEPT. 1981 TO SEPT. 1982 IS SHOWN AS MARCH 1982 AND THE SIX MONTH ANNUALISED GROWTH RATE FROM MARCH 1982 TO SEPT. 1982 IS SHOWN AS JUNE 1982.

CHART V: GROWTH RATES IN PSL2

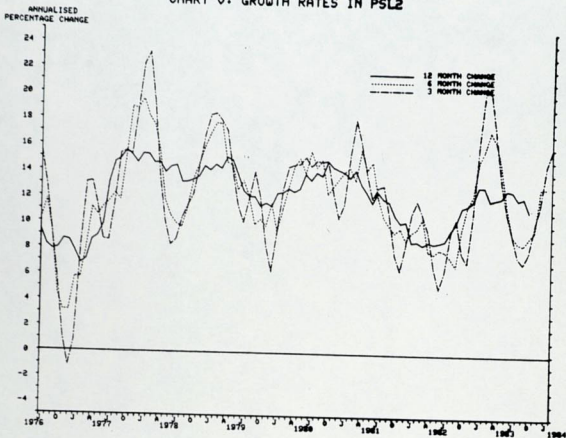
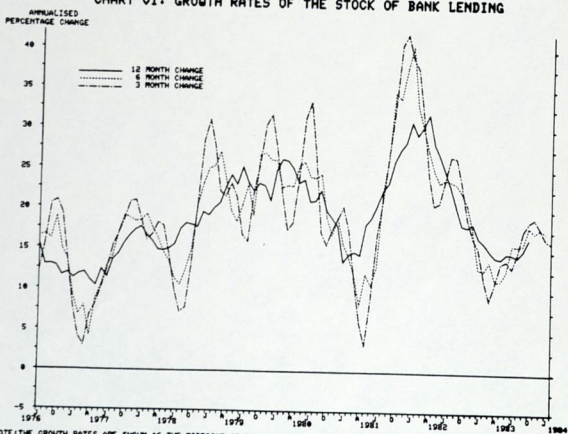


CHART VI: GROWTH RATES OF THE STOCK OF BANK LENDING



NOTE: THE GROWTH RATES ARE SHOWN AS THE MIDPOINT OF THE PERIOD OVER WHICH THEY ARE MEASURED. THIS THE GROWTH FROM SEPT. 1981 TO SEPT. 1982 IS SHOWN AS MARCH 1982 AND THE SIX MONTH ANNUALISED GROWTH RATE FROM MARCH 1982 TO SEPT. 1982 IS SHOWN AS JUNE 1982

7. The wider measures of narrow and broad money, M2 and PSL2 respectively, which include building society liabilities, continued to grow rapidly, at over 13 per cent on a six month basis. The M2 figures are affected by the reclassification of building society deposits. It is not clear that the interpretation of M2 should allow for these reclassifications since they change the liquidity of deposits, but even excluding them M2 has grown at 8-9 per cent on a six month basis over the last two months - much faster than M0. There was a slow down in the inflow of new funds to building societies, but a rather faster growth in some of the smaller components of PSL2 - National Savings and holdings of Local Authority Temporary Debt - and the twelve month growth of PSL2 has declined a little. However, the alternative measures of broad money, PSL2 and M3, continue to grow much faster than £M3.

8. The latest data on the growth of the real money stock are shown in Table 2 and Charts VII and VIII. Real money balances continue to grow rapidly on a twelve month basis. When interpreting the decline in the growth of weekly averaged M0 allowance should be made for the factors already noted and the underlying trend increase in velocity of the aggregate. The erratic seasonal pattern in retail prices makes it difficult to interpret the six month growth rates and not too much should be read into these figures. Charts IX-XII show the levels of real money and the real FT all share index. The real FT all share index advanced again strongly in April and is approaching the type of levels experienced in the 1960s and early 1970s. The all share index has advanced fairly steadily since October 1983. The stock of real PSL2 (Chart XI) has been rising rapidly since around the beginning of 1983, although the rise is not as steep as in 1971/72.

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

	Total RPI ⁺	RPI ⁺ less mortgage element	Composite monetary indicator	Weekly averaged M0	Non- interest bearing M1	M2	£M3	PSL2
(a) <u>Financial year</u> (12 month changes to banking April)								
1981-82	9.4	9.1	-3.8	-6.5	-8.7		2.9	1.6
1982-83	4.0	4.8	5.8	1.3	6.2	4.0	5.9	6.3
1983-84	(5.0)	(4.7)	3.5	0.0	4.6	5.3	3.4	6.2
(b) <u>Changes on same quarter in previous year</u>								
1982 (2)	9.2	8.8	3.0	-5.6	-7.0		2.9	1.3
(3)	7.3	7.3	-1.5	-4.7	-3.2		2.7	1.1
(4)	5.4	6.6	1.5	-2.5	2.1	0.7	2.8	2.0
1983 (1)	4.6	6.0	3.9	-0.6	4.6	2.3	3.9	4.0
(2)	3.7	4.5	6.3	1.9	5.8	5.1	6.5	7.2
(3)	5.1	5.2	4.4	1.2	3.7	3.3	4.3	6.4
(4)	5.3	4.8	5.0	1.7	4.2	4.6	5.8	7.8
1984 (1)	5.2	4.7	3.3	0.9	3.4	5.3	4.9	7.2
(c) <u>Changes in 12 months to</u>								
1983 May	3.7	5.6	5.4	1.0	5.5	3.9	5.4	5.7
June	3.7	4.5	6.3	1.9	5.8	5.1	6.5	7.2
July	4.2	4.7	6.3	1.5	5.8	4.1	6.8	8.0
August	4.6	5.1	5.4	1.4	4.9	3.6	5.8	7.6
September	5.1	5.2	4.4	1.2	3.7	3.3	4.3	6.4
October	5.0	5.0	4.7	1.7	4.2	3.4	5.7	6.8
November	4.8	4.9	4.8	1.5	3.2	3.0	4.8	7.1
December	5.3	4.8	5.0	1.7	4.2	4.6	5.8	7.8
1984 January	5.1	4.6	4.9	1.4	4.2	5.7	5.7	7.9
February	5.1	4.5	4.0	1.7	3.4	5.3	5.0	7.3
March	5.2	4.7	3.3	0.9	3.4	5.3	4.9	7.2
April	(5.0)	(4.7)	3.5	0.0	4.6	5.3	3.4	6.2
(d) <u>Changes (at annual rate) in 6 months to</u>								
1983 May	2.2	3.5	8.1	2.9	4.0	6.5	8.1	12.0
June	3.0	2.8	10.5	4.6	5.0	8.8	10.5	14.2
July	4.7	3.7	10.3	1.7	9.1	7.1	9.5	12.3
August	5.6	4.3	7.1	1.8	5.8	4.7	8.1	9.9
September	6.7	5.5	3.1	0.8	2.7	1.9	4.4	5.8
October	7.2	6.9	0.6	-1.1	1.6	-0.4	1.9	2.4
November	7.5	6.6	1.3	-0.2	2.0	-0.8	1.3	2.1
December	7.7	7.4	-0.8	-1.7	2.9	-0.1	0.8	1.1
1984 January	5.7	4.9	0.1	1.6	0.0	4.8	2.4	4.1
February	4.5	4.4	1.3	1.8	1.4	6.4	2.3	5.1
March	3.7	3.9	3.8	1.3	4.3	9.0	5.5	8.8
April	(2.8)	(2.7)	6.3	1.1	7.7	11.3	4.9	10.1

+ The simple method of seasonal adjustment for the RPI and for the RPI less mortgage component for use in calculation of the six monthly growth rates was described in the February 1982 Interpretation of Monetary Conditions.

The nominal money supply deflated using the RPI less mortgage element. This is the all items RPI after deduction of the mortgage interest rate payments component.

CHART VII: GROWTH RATES IN REAL WEEKLY AVERAGED M0

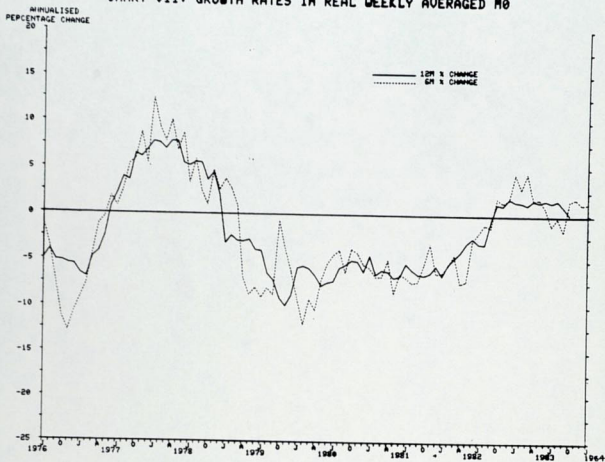


CHART VIII: GROWTH RATES IN REAL STERLING M3

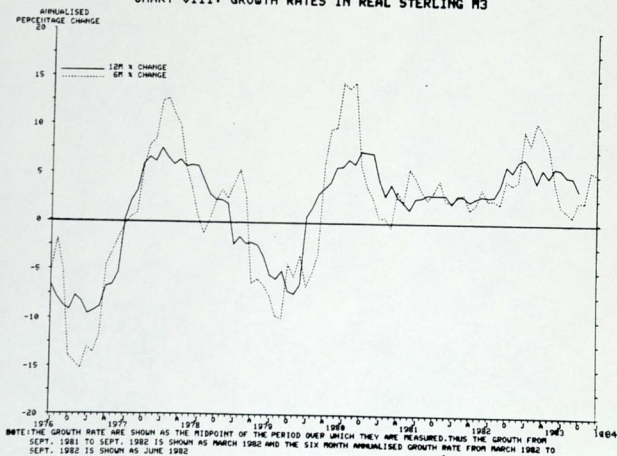


CHART IX: LEVEL OF REAL M0 (END CALENDAR QUARTER)

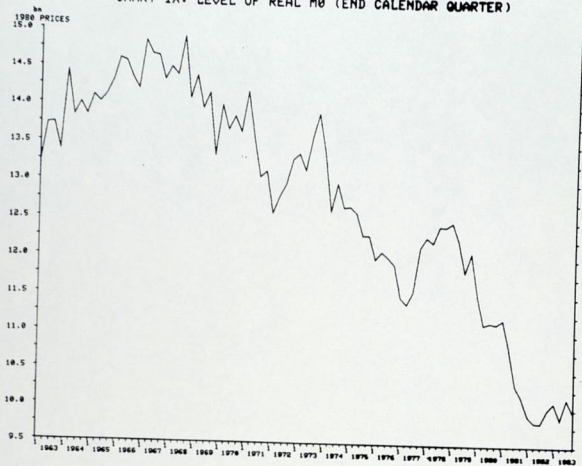


CHART X: LEVEL OF REAL STERLING M3

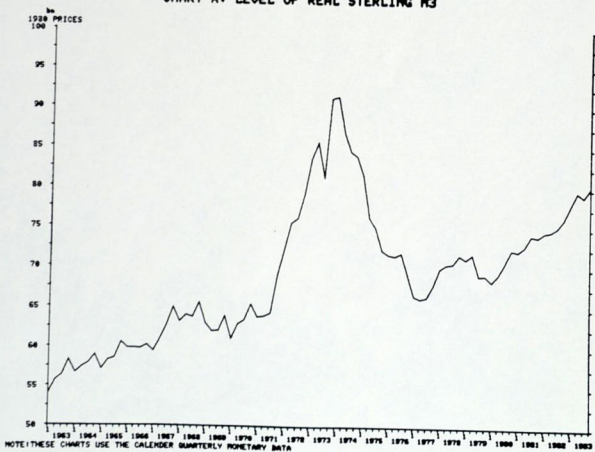
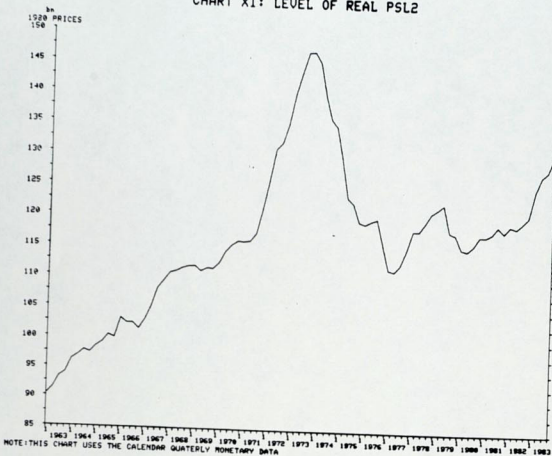
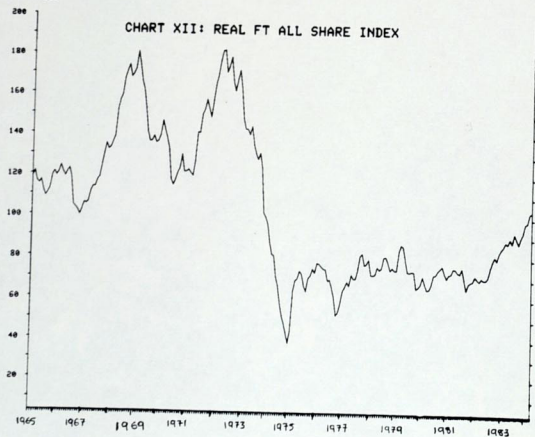


CHART XI: LEVEL OF REAL PSL2



JAN 1974=100

CHART XII: REAL FT ALL SHARE INDEX



9. Table 3 and Chart VI show the growth rates of total bank lending to the non bank private sector. (The stock figures on sterling lending now correctly include Issue Department holdings of commercial bills.) Growth of bank lending to the non bank private sector continued to rise to nearly 17 per cent on the twelve

TABLE 3: TOTAL STERLING BANK LENDING TO THE NON BANK PRIVATE SECTOR (1)

Banking months, SA	<u>Percentage change in stock of lending over</u>	
	<u>12 months</u>	<u>6 months (at annual rate)</u>
1983 May	18.0	12.6
June	18.5	13.6
July	16.4	11.3
August	15.9	11.4
September	15.0	12.6
October	14.1	15.6
November	14.1	15.6
December	14.9	15.7
1984 January	14.7	17.8
February	14.4	17.1
March	15.3	17.4
April	16.6	17.1

(1) Sterling Lending by the monetary sector, plus issued department purchase of commercial bills.

month calculation. The six month growth rate has averaged 17-18 per cent for the last four months. The provisional calendar 1984Q1 figures on the sectoral analysis of bank lending shows that the upturn in lending reflects a strong recovery in company borrowing. This rapid expansion is difficult to explain against a background of record company sector financial surpluses, although it may reflect the unrecorded acquisition of foreign assets by companies.

(3) OTHER INDICATORS OF MONETARY CONDITIONS

10. Table 4 shows the latest estimates of the growth of nominal and real GDP. The projection for 1984 first quarter money GDP looks low and could be substantially revised. The projection for real GDP growth implies some slow down in the pace of recovery.

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

	<u>Money GDP</u>		<u>Real GDP</u>
	<u>% change</u> <u>on a year</u> <u>earlier</u>	<u>% change</u> <u>over six months</u> <u>(annual rate)</u>	<u>% change</u> <u>on a year</u> <u>earlier</u>
1982 (1)	9.9	9.0	1.7
(2)	10.4	9.3	2.9
(3)	8.9	8.8	1.7
(4)	8.7	8.0	1.4
1983 (1)	10.0	11.2	3.2
(2)	7.6	7.2	2.4
(3)	8.6	6.0	3.1
(4)	8.3	9.4	3.5
1984 (1)	(6.3)*	(6.6)*	(2.2)*

*CSO projections

11. Table 5 shows the most recent data for the growth of retail prices, wholesale prices, average earnings and unit wage costs in manufacturing. The cut in mortgage rates announced in March is estimated to have contributed 0.2 per cent to the small fall in annual retail price inflation. Producer output prices have continued to edge up. About one third of the increase in producer prices between April and March reflects duty changes in the budget which are still coming through. The latest CBI survey does not, however, indicate any acceleration in manufacturing prices and there does not appear to be a detailed explanation of the rise in producer output prices. Companies may have been widening their profit margins.

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Input prices rose sharply in April probably reflecting in part the weakness of the sterling exchange rate against the dollar. Input price inflation has averaged 1½-2 per cent higher in the first four months of the year than the same period last year. The changes in unit wage costs in manufacturing remains very low and underlying average earnings have remained steady.

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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 Average Earnings</u>	<u>Unit Wage Costs in Manufacturing*</u>
		<u>Output Prices</u> (home sales)	<u>Input Prices</u>		
1982 (1)	10.4	8.7	11.8	10.8	4.0
(2)	9.2	7.2	5.7	10.1	5.7
(3)	8.0	7.4	4.8	8.9	5.5
(4)	6.2	6.5	6.3	8.4	5.8
1983 (1)	4.9	5.3	5.6	7.9	4.0
May	3.7	5.6	6.8	7.5	4.3
June	3.7	6.0	7.3	7.5	2.1
July	4.2	5.5	6.4	7.5	1.5
August	4.6	5.3	8.3	7.8	3.1
September	5.1	5.4	9.6	7.8	3.8
October	5.0	5.5	8.2	7.8	3.7
November	4.8	5.7	7.2	7.8	3.6
December	5.3	5.6	7.2	7.8	2.7
1984 January	5.1	5.7	7.6	7.8	3.3
February	5.2	5.9	7.0	7.8	2.7
March	5.2	6.4	7.1	7.8**	
April	(5.0)	6.5	8.6	7.8**	

* Percentage change of the latest 3 months on the same 3 months a year earlier.

** Department of Employment estimate.

12. UK short term interest rates have risen against the background of further increases in dollar rates and a weakening sterling/dollar exchange rate. The uncovered differential between short-term UK and euro-dollar rates remained around 2 per cent. Since the beginning of the year the uncovered differential between short-term sterling and dollar interest rates has widened by about $1\frac{1}{2}$ per cent because of rising dollar interest rates. There has been a similar widening in the uncovered differential between short-term dollar interest rates and short-term interest rates in France, Germany, Italy and Japan.
13. Two clearing banks have announced a rise in base rates to 9 per cent and two to $9\frac{1}{4}$ per cent. The increasing reliance of banks on wholesale and retail interest bearing deposits paying interest rates close to market rates means that changes in short term market rates relative to base rates exert increasing pressure on bank lending margins and increase the incentive to tie base rates more closely to market rates. This was reflected by the decision by Barclays to move their base rate in $\frac{1}{4}$ per cent steps. However, the seeming reluctance of banks to move their base rates immediately with market rates suggests that the banks are some way off from administering base rates as purely floating interest rates determined by an automatic formulae to market rates.
14. Prices in the long term gilts market have also eased along with the rise in short term interest rates and the yield gap with short term rates has remained steady. Bond prices in the US have fallen sharply.

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TABLE 6: NOMINAL INTEREST RATES (period averages for calendar months and 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>
1982 (1)	14.3	15.1	14.1	14.7	0.4
(2)	13.4	15.1	12.8	13.7	0.3
(3)	11.5	12.6	11.4	12.2	1.3
(4)	9.9	9.9	9.7	10.8	0.9
1983 (1)	11.1	9.2	10.8	11.5	0.4
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
August	9.8	10.3	9.5	11.0	1.2
September	9.7	9.9	9.5	10.7	1.0
October	9.4	9.6	9.1	10.6	1.2
November	9.3	9.8	9.0	10.3	1.0
December	9.4	10.2	9.0	10.3	0.9
1984 January	9.4	9.8	9.0	10.3	0.9
February	9.3	10.0	9.0	10.4	1.0
March	9.0	10.4	8.75	10.3	1.3
April	8.9	10.9	8.6	10.4	1.5
May 10	9.6	11.9	9 - 9.25	11.0	1.4

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15. Table 7 shows estimates of real short term interest rates and the yields on index linked gilts. Indexed gilt yields remain at high levels and the estimate of real short term interest rates has moved up with the rise in market rates. The current attraction of equities relative to index linked stock may indicate that investors expect even higher real returns from investing in equities. The expected inflation series, the average inflation forecasts of three outside forecasters, is relatively slow moving since two of the three forecast series on which it is based are revised only quarterly. This series has been edging down.

TABLE 7: REAL INTEREST RATES

	Expected Inflation over 12 months*	Real 3 month Interbank Rate	Yield on 1988 indexed gilt***		Yield on 1996 indexed gilt***	
			Inflation Assumption		Inflation Assumption	
			5%	7%	5%	7%
1982 (1)	10.3	4.0	3.0	2.8	3.0	2.9
(2)	9.2	4.1	3.5	3.2	3.4	3.3
(3)	8.0	3.4	3.6	3.3	3.3	3.2
(4)	6.3	4.8	2.7	2.4	2.6	2.5
1983 (1)	6.3	4.8	2.7	2.4	2.6	2.5
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
August	6.2	3.6	4.2	3.9	3.6	3.5
September	6.2	3.5	3.8	3.5	3.4	3.3
October	6.4	3.0	3.6	3.4	3.4	3.3
November	5.8	3.5	3.9	3.7	3.5	3.4
December	5.8	3.6	3.7	3.4	3.5	3.4
1984 January	5.9	3.5	3.9	3.6	3.5	3.4
February	5.8	3.5	4.0	3.7	3.6	3.5
March	5.7	3.3	4.4	4.1	3.8	3.7
April	5.6	3.3	4.4	4.1	3.6	3.5
May 10	5.6	4.0	4.2	3.9	3.6	3.5

* 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 of working day for the month or quarter.

*** Last working day for each month with first of month settlement assumed, or, for quarters, the average of the last working days of the three months.

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16. The dollar has been moving up against most major currencies reflecting inter alia, higher dollar interest rates. The sterling/dollar exchange rate has fallen to a record low and the deutschemark appears to have been adversely affected by industrial unrest in W.Germany. Sterling's effective exchange rate has been steadier and has even moved up very slightly, which may in part reflect the firmer trend in UK short term interest rates in the last few days. The fall in the sterling/dollar exchange rate over the past week, while the uncovered differential between the currencies has been maintained, suggests some reassessment of the future dollar/sterling exchange rate which is being reflected in the spot rate.

TABLE 8: EXCHANGE RATES (period averages)

	Effective Rate	\$/£ Rate	DM/£ Rate	Uncovered Differential*	
				£/\$	£/DM
1982 (1)	91.1	1.85	4.34	-0.8	4.3
(2)	90.3	1.78	4.23	-1.7	4.2
(3)	91.4	1.72	4.28	-1.1	2.8
(4)	89.1	1.65	4.14	0.0	3.0
1983 (1)	80.6	1.53	3.69	1.9	5.4
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
August	85.0	1.50	4.02	-0.5	4.4
September	84.7	1.50	4.00	-0.2	4.0
October	83.5	1.50	3.90	-0.6	3.6
November	83.6	1.48	3.96	-0.6	3.3
December	82.5	1.44	3.94	-0.8	3.2
1984 January	81.9	1.41	3.95	-0.4	3.5
February	82.2	1.44	3.89	-0.7	3.5
March	80.9	1.46	3.78	-1.4	3.3
April	79.8	1.42	3.78	-2.0	3.2
May 10	80.1	1.38	3.84	-2.3	3.5

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

(4) HOUSING FINANCE AND ASSET PRICES

17. Building society inflows were down slightly at £1.3 billion in calendar March compared with the peak levels of the two previous months, perhaps due to some anticipation of the interest rate cut which took effect on 1 April. Weekly figures from the top 17 societies suggest that inflows remained at a high level during April after the seasonal effect of Easter is taken into account. There was a net repayment of wholesale deposits of £8 million during March.

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

	Liquidity Ratio (end period)	Net increase in deposits	Net inflows* of wholesale money (nsa)	Net new commitments	Gross advances	Net advances
	£	£bn	£bn	£bn	£bn	£bn
1982 1	19.3	0.7	-	1.1	0.9	0.5
2	19.5	0.8	-	1.4	1.3	0.7
3	19.7	0.9	-	1.4	1.3	0.7
4	19.8	1.0	-	1.8	1.6	0.9
1983 1	18.2	0.2	-	1.7	1.7	1.0
2	17.4	0.2	0.4	1.5	1.6	0.9
3	17.8	0.3	0.5	1.5	1.5	0.8
4	19.0	0.4	0.7	1.7	1.6	1.0
1983 Feb	18.8	0.7	-	1.7	1.7	1.0
March	18.2	0.8	-	1.6	1.8	1.0
April	18.0	0.7	-	1.6	1.6	0.9
May	17.6	0.6	-	1.5	1.6	0.9
June	17.4	0.8	0.3	1.4	1.6	0.8
July	17.7	1.0	0.2	1.5	1.5	0.8
August	17.8	0.9	0.2	1.4	1.5	0.8
Sept	17.8	1.0	-	1.6	1.5	0.8
Oct	18.8	1.1	0.3	1.7	1.5	0.8
Nov	18.8	1.2	0.2	1.8	1.6	0.9
Dec	19.0	1.3	0.1	1.8	1.7	1.1
1984 Jan	19.4	1.4	0.2	1.8	1.7	1.0
Feb	19.8	1.4	0.1	1.8	1.7	1.1
March	19.7	1.3	-	2.2	1.8	1.1

* Estimate arrived at by grossing up weekly returns from the 17 largest societies.

18. Lending commitments were sharply up in March at £2.2 billion, with no signs from the weekly figures of any slackening in April (except around the Easter period). The higher level of commitments will be reflected in the lending figures in May and June, at which time net mortgage advances will overtake the net inflow of funds. The liquidity ratio fell by 0.1 percentage point in March from its peak in the previous month, but more rapid falls can be expected over the next few months.

19. Bank lending for house purchase has declined sharply over the past six months and the six- and twelve-monthly rates of growth in the stock of lending are now approaching those of the building societies. The six-monthly growth rate of building society lending has been increasing since November and this has begun to push up the six-monthly rate of total bank and building society lending, which now stands at 19.8 per cent.

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

	<u>Building Societies</u>	<u>Banks (Est)</u>	<u>Total Building Societies and Banks</u>
1982 December	1.0	0.3	1.3
1983 January	0.9	0.3	1.2
February	1.0	0.3	1.3
March	1.1	0.3	1.4
April	0.9	0.3	1.2
May	0.9	0.3	1.3
June	0.9	0.3	1.2
July	0.8	0.3	1.2
August	0.8	0.3	1.1
September	0.8	0.2	1.0
October	0.8	0.4	1.2
November	1.0	0.4	1.4
December	1.1	0.2	1.3
1984 January	1.0	0.2	1.2
February	1.1	0.2	1.2
March	1.1	0.1	1.2

Percentage change in stock of lending

	<u>12 months</u>	<u>6 months</u>	<u>12 months</u>	<u>6 months</u>	<u>12 months</u>	<u>6 months</u>
1982 December	16.6	18.9	83.0	70.9	23.7	25.4
1983 January	17.5	19.8	77.3	60.9	24.2	25.2
February	18.5	20.9	71.6	52.6	24.6	25.3
March	19.3	22.2	66.1	46.6	25.0	25.7
April	19.7	22.2	61.9	44.1	25.0	25.3
May	20.0	22.0	57.9	38.2	24.9	24.5
June	20.0	21.1	52.4	35.8	24.4	23.4
July	20.1	20.4	47.9	35.9	24.0	22.8
August	20.1	19.3	43.5	35.0	23.5	21.8
September	20.1	18.0	39.4	32.6	23.0	20.3
October	19.7	17.3	38.7	34.4	22.6	20.0
November	19.6	17.2	36.7	35.2	22.2	20.1
December	19.3	17.5	34.4	33.0	21.7	20.0
1984 January	19.0	17.7	22.6	29.4	21.2	19.6
February	18.8	18.3	30.5	26.3	20.7	19.7
March	18.5	19.0	28.1	23.7	20.1	19.8

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20. House price inflation at the approval stage rose slightly in March, but the rate of growth based on completions dropped back to the January low of 8.6 per cent. These indices have been rather erratic in recent months and it has become more

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

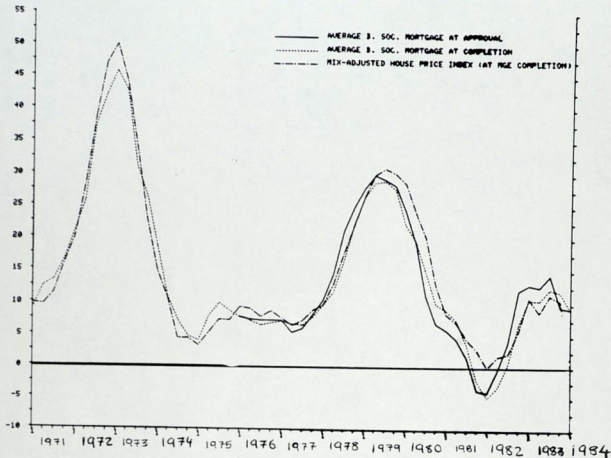
	<u>Based on mortgage approvals</u>	<u>Based on mortgage completions</u>	<u>Mix-adjusted (based on completions)</u>	<u>Nationwide (based on approvals)</u>
1982 Q1	-4.0	-4.9	0	2
Q2	-0.7	-3.0	1	2
Q3	4.0	0.5	2	3
Q4	12.2	6.8	6	8
1983 Q1	13.0	11.3	11	9
Q2	12.8	10.4	9	11
Q3	14.6	12.3	11	13
Q4	9.6	11.9	11	12
1984 Q1	9.3	9.2	-	13
1983 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		
October	10.8	12.7		
November	10.2	12.1		
December	7.6	11.0		
1984 January	8.4	8.6		
February	9.0	10.4		
March	10.0	8.6		

difficult to interpret the relative movements in the two series. On the basis of the approvals data, there has

been a clear rise from the single-figure rates of growth recorded during the winter, but there is still no sign as yet that house price inflation is likely to reach or exceed the levels of the first three quarters of 1983.

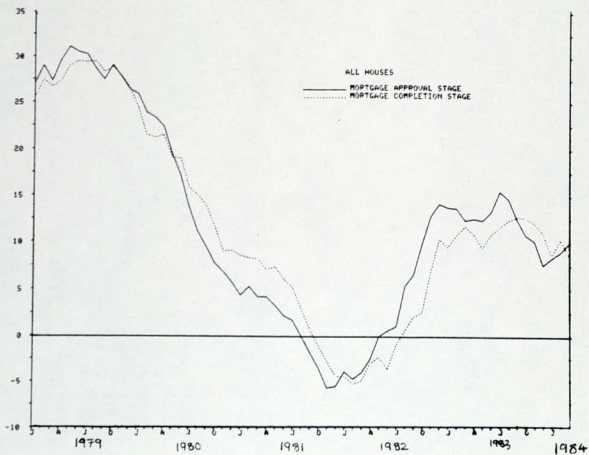
% CH OVER PREVIOUS 12M

CHART XIII: QUARTERLY HOUSE PRICES



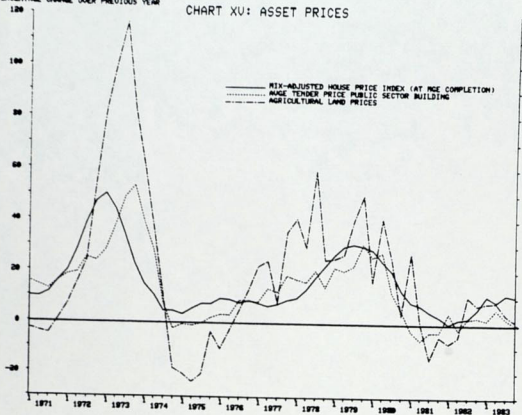
% CH OVER PREVIOUS 12M

CHART XIV: MONTHLY HOUSE PRICES



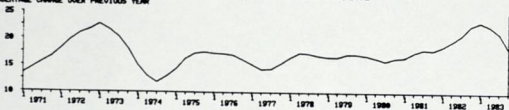
PERCENTAGE CHANGE OVER PREVIOUS YEAR

CHART XU: ASSET PRICES



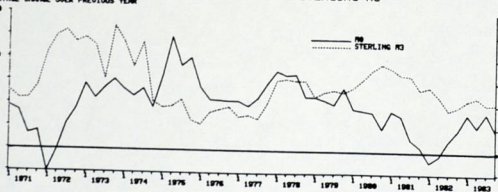
PERCENTAGE CHANGE OVER PREVIOUS YEAR

STOCK OF MORTGAGES OUTSTANDING



PERCENTAGE CHANGE OVER PREVIOUS YEAR

GROWTH RATE OF M0 AND STERLING M3



ANNUAL PERCENTAGE CHANGE

RETAIL PRICE INDEX

