PREM 19/180

Civil Service Department
Whitehall London SW1A 2AZ
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From the Private Secretary

26 November 1980

John Wiggins Esq
PS/Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON SW1P 3AG

Dear John,

DNS: SELLING MORE DEBT TO PERSONS

The Lord President has seen your letter of 14 November to Tim Lankester and has asked me to set out our views on the manpower implications.

As you know we are concerned about the lack of firm information, and consultation, on the manpower requirements of the various measures the Chancellor has in mind to raise more money through the DNS. It was helpful to have a copy of your letter for our discussions with DNS officials about their 1981/82 Estimates.

The Lord President appreciates the difficulties facing the Chancellor in making his dispositions for 1981/82 at this juncture. But it is essential that the manpower implications of the new DNS schemes, including BNOC bonds, should be established in some detail so that proper provision for staf numbers and expenditure can be made in the Estimates. We cannot hope to manage and control the rundown of the Service in an orderly fashion if manpower implications of the order mentioned in your letter are not worked out, and how they are to be accommodated in the Cabinet's reductions programme agreed, before overall policy decisions are made.

In all cases where colleagues are seeking additional staff for new functions the Lord President is expecting existing functions, and the efficiency with which they are being performed, to be examined rigorously for compensating savings. In the case of the DNS he suggests that economies might be identified in the programme of further Rayner scrutinies put forward in his letter of 14 November. This will be examined further by CSD officials when the DNS Estimates for 1981/82 are being discussed.

In the interests of flexibility of budgetary strategy the Chancellor's department have a single overall target. To the extent that DNS cannot absorb proposed staff increases, reductions will have to come from the Chancellor's other departments. A reduction to 630,000 must be achieved and we must see some progress in 1981/82 if there is

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to be no weakening in the Government's resolve to keep Civil Service numbers under control. The Chancellor's departments will have to play their part and this will be particularly important with the staffing implications of new policies such as TUB and TIB which are being considered.

The Chancellor mentioned in his previous correspondence with the Lord President that he might wish to make a claim on the contingency margin for DNS. The Lord President has asked me to say that he does not think that this will be possible. The forecast levels of unemployment in 1981/82 will require of the order of 10,000 extra staff in DHSS and Employment and significantly more in 1982/83 and beyond. The Lord President therefore believes that the requirements of DNS must be contained without recourse to the contingency margin.

I am copying this letter to Tim Lankester (No 10) and David Wright (Cabinet Office).

Yours sincerely,

Jim Buckley.

J BUCKLEY

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CHANCELLOR'S STATEMENT ON 24 NOVEMBER : MONETARY ISSUES

1. Three major monetary issues were covered in the statement:

i. MLR was cut by 2% to 14%;

ii. We shall continue with the present monetary target until the Budget next spring when a new target will be announced;

iii. Certain changes are to be made to the monetary control system, notably the abolition of the Reserve Asset Ratio.

2. The MLR cut, which follows the 1 point cut on 3 July, restores MLR to the level of June-November 1979. The cut should help to alleviate some of the problems faced by industry at present. Cutting interest rates should bring forward the time when the debenture market and new issues market come back to life, taking some of the pressure off bank borrowing.

3. It is proposed to maintain the present monetary target range for the rest of the target period. The target was originally announced by the Chancellor in his Budget statement on 26 March 1980. We set a target range for the growth of sterling M3 in the 14 months from mid-February 1980 to mid-April 1981 of 7 to 11 per cent at an annual rate. In the eight banking months since mid-February, sterling M3 has grown by 15.3% or 23.8% at an annual rate. This increase has been inflated by distortions caused by the ending of the Supplementary Special Deposits scheme or 'corset' in June. The underlying rate of growth of sterling M3 over the period from February to October is estimated at around 20% at an annual rate.

4. In the Budget statement in March, the Chancellor said he would review the monetary position and the target in the autumn once the distortions in monetary growth caused by the ending of the corset had worked their way through. Monday's announcement fulfills that commitment.

5. The Treasury and Bank of England have now completed consultations on the Green Paper on Monetary Control. While no firm decision for or against Monetary Base Control (MBC) has been made, a number of changes in the monetary control system have been proposed. One effect of these changes will be to allow us to gather information on the way in which a system of MBC might operate in the UK:

i. As foreshadowed in the Green Paper on Monetary Control, the Reserve Assets Ratio will be phased out and abolished completely as soon as alternative arrangements for prudential control of the banks can be introduced.

ii. Changes will be introduced in the Bank of England's methods of intervention in the money markets.

iii. The Authorities are exploring alternatives to the 1½% cash ratio as a basis for financing the Bank.

iv. Statistics are to be collected for "retail" money (akin to the old M2 series).

Supplementaries

MLR

i. Medium Term Financial Strategy. This is not an abandonment of the MTFS. We do not believe, however, that maintaining the current level of interest rates would be an appropriate means of achieving our monetary objectives. An excessive reliance on interest rates would imbalance the economy and might not even have the desired effect on the money supply - in the short run at least. But in any event the strategy is not to be interpreted as slavish and mechanistic concentration to the path of the £M3 statistic. We must look at other aggregates and also what is happening elsewhere in the economy.

ii. Financial Position of Companies. The overshooting of the monetary target so far this year has reflected to a considerable extent the sizeable deficit of the company sector, which has had no option but to borrow, accompanied by a large personal sector surplus. Raising interest rates could make matters worse in this respect because companies would face greater interest charges.

iii. Timing. We reduced MLR by 1 point in July. This was always intended as the first of a series of downward movements. A further move now is appropriate because inflation is falling fash and because companies are being put under increasing pressure by rising real interest rates.

iv. Pressure from the CBI. This is not a response to pressure by the CBI and others. It reflects our considered judgement about the level of interest rates appropriate to achieve the degree of monetary stringency necessary to maintain downward pressure on inflation. It would certainly have been wrong to cut MLR by 4 points as the CBI (and Mr Healey) have suggested.

Monetary Target

v. Suspension of target. There is no question of a suspension of the target. We accept that there will be some overshooting, but the rate of growth in £M3 will slow down appreciably in the remainder of the target period. We shall not be far above the top of the range by April, certainly nothing like as far as the growth so far might be thought to imply.

vi. An interest rate target has replaced a money supply target. No. The commitment remains to a reduction in the rate of growth of the money supply. Interest rates will need to be adjusted from time to time to that end.

vii. Accepting that excess growth has occurred, and will produce inflationary burst in 12-18 months. No. Important not to look at a short period and draw conclusions from that. The latest Greenwell's bulletin, not always supportive of

Government policy, points out the error of this approach. We expect second half-year growth to be much lower. Inflation is coming down sharply and the forecast for the next 12 months is [11 per cent]. It is essential that monetary growth should decelerate sharply to avoid a receleration of inflation as the economy returns to fuller use of capacity.

Monetary Control Techniques

viii. How Will More Flexible Interest Rates Help Monetary Control ? May change the way banks charge for advances and accelerate changes in overdraft system - bank lending will then become more responsive to market interest rates. Will reduce the drama associated with MLR changes. May pave the way for a later decision to set objectives for monetary base instead of interest rates.

ix. How do you Reconcile Cutting MLR at a Time when Money Supply is Out of Control with Moves to More Flexible Market-Determined Interest Rates. Haven't you just Over-Ruled the Market ?

Don't accept cut in MLR is inconsistent with monetary strategy. No question of over-ruling the market : assistance is necessary to prevent inappropriate changes in interest rates. Government will continue to set a range for interest rates (though it will not be announced).

Top Copy: Econ Pst, Pt 12, Econ Pol
Public Expenditure

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24 November 1980

ECONOMIC PROSPECTS TO END- 1981

The Industry Act (1975) requires the Government to publish economic forecasts twice yearly. This press notice reviews economic developments so far this year and looks at the prospects to the end of 1981.

Summary

2. The UK economy is confronted by the need to bring about a major adjustment to a higher exchange rate, by the need to bring about further reductions in inflation and by the problems of recession in the world economy. In these circumstances, output and employment are liable to decline.

3. Progress on reducing inflation this year has been rapid. Next year, especially the early months, should see a further major reduction in the year-on-year rate of inflation from 15½% in the fourth quarter of 1980 to perhaps 11% in the fourth quarter of 1981. There has been a sharp fall in output and employment this year, as firms have reacted to large increases in domestic costs and to financial pressures. Next year, there may be no further fall in total output from the level in the second half of 1980.

4. Great uncertainties surround the prospects for the economy over the coming year. The figures in this forecast must be interpreted in the context of the large margins of error to which all forecasts are subject.

RECENT ECONOMIC DEVELOPMENTS

5. In the Government forecasts published a year ago, and at the time of the Budget, 1980 was foreseen as a year of recession and falling inflation. A poor trade performance, because of weak overseas demand and adverse competitiveness, was expected, together with tight monetary and fiscal policies (with both the money supply and the PSBR as percentages of GDP expected to decline). 1980 is now clearly emerging as a recession year, and the inflation rate is falling; yet it is domestic demand, more than trade, which has led the recession.

6. Government borrowing in the first six months of the current financial year was £8 billion (seasonally adjusted). This PSBR and a high level of bank lending were the main reasons why the rate of growth of the money supply, at 15% between February and October 1980, was well above expectation. A number of factors have contributed to pushing up the exchange rate, among them: inflows of OPEC funds, the growing value of North Sea oil, the uncertainties over the Gulf war, the turnround in the current account and high levels of nominal interest rates in the UK. The rising exchange rate has been accompanied by a faster growth in costs and prices in the UK than in most competitor countries and hence there has been a large and indeed unprecedented loss of competitiveness. On the basis of relative labour costs, the level of competitiveness in 1980 is estimated to be some 40-50% less favourable than in 1978. Of this change in competitiveness, around three-fifths has been due to UK unit labour costs increasing faster than those of our competitors and the remaining two-fifths to exchange rate appreciation.

7. Up until the early part of 1980, output and employment had been maintained, despite mounting cash flow problems for some companies squeezed by a high exchange rate and rapidly rising domestic costs. But around the turn of the year, and still more in the spring, many companies were finding their financial position much worse than expected, with future prospects gloomier, because of: a widespread acceleration of domestic costs; a rising exchange rate; and falling profit margins. The result was a concerted fall in orders from the second quarter of 1980, accompanied by attempts to get rid of stocks by cutting prices,

and by reductions in output and in employment. These tendencies can be seen most clearly in successive replies to the CBI enquiries, which relate to the industrial sector of the economy, worst affected by the recession:-

Percentage balances of ups and downs

	Firms working below capacity	Trend in output volume over next 4 months	Present volume of stocks too high	Trend in average prices of domestic orders
1980 January	63	- 11	15	65
April	70	- 14	26	56
July	76	- 41	36	33
October	84	- 31	33	20

8. Thus companies, particularly in the more exposed parts of manufacturing, but also in distribution and elsewhere, are now adjusting rapidly. The second half of 1980 is seeing a further large fall in employment and further destocking, with profit margins being cut again.

9. A combination of strong recessionary pressures and a high and rising exchange rate has limited firms' abilities to pass on higher costs to their customers. This squeeze on profit margins in the private sector has taken several percentage points off this autumn's level of retail and wholesale prices.

10. The rate of inflation over the last six months has been running well below the rate of around 15% shown by the usual comparisons of the retail and wholesale price indices with the same period a year earlier. For both wholesale and retail prices, the annual rate of increase over the six months to October was 8½%. Particularly in the case of retail prices, this figure understates the underlying rate of increase in prices, mainly because of favourable trends in seasonal food prices and the tendency of prices to rise sharply in the spring. A rough adjustment for these special factors might not add more than three percentage points to the 8½% figure - confirming a substantial deceleration in retail price inflation.

11. Many domestic costs have been slow to respond to the slowdown in inflation. Average earnings, for the economy as a whole, rose by 22% over the year to the third quarter of 1980, although the underlying increase in manufacturing was lower, at 18%. There are, however, clear indications of a major reduction occurring in the current pay round in both wage claims and settlements. Important contributory factors, reflecting both the current position and future expectations, are: the Government's monetary and fiscal policies, companies' reduced ability to pay, the reduction in the rate of inflation and higher unemployment.

12. The reduction in price inflation ahead of a reduction in pay increases has led to a substantial rise in real earnings, for those in employment, over the past year. But with employment falling and some other elements in personal incomes rising more slowly than pay, the real value of consumers' disposable income over the past year has risen slowly. Nevertheless, and perhaps partly in response to the rise in inflation last winter and to the subsequent rise in unemployment, the personal sector's savings ratio has tended to rise, leaving personal consumption close to last year's level. Thus the burden of the recession has fallen mainly on the company sector and on the unemployed, but not in general on those in employment.

13. The trade balance this year has been much better than expected at the time of the Budget: a major fall in the volume of imports, induced by the sharp decline in industrial activity, has far outweighed the effects of poor competitiveness. Exports of manufactures in the first ten months of this year were close to the 1979 average. It seems likely that over much of this period the volume of world trade was well up on 1979: the loss of UK share this year, measured in volume terms, may be attributed mainly to a lagged response to worsening competitiveness. Imports of manufactures were 10% lower in the three months ending October than in the three months ending July, a downward trend that probably owes much to heavy de-stocking throughout the economy. The balance of payments is continuing to benefit from a surplus on invisible items, mainly reflecting high private service credits, partly offset by transfer debits. In total the current account is estimated to have been in surplus of over £1 billion in the first ten months of the year.

14. By the third quarter of this year, total output in the economy was perhaps 4% below the average of 1979, with a larger fall in industrial output. Partly in consequence, but also because of companies' needs to limit the deterioration in their cash and liquidity positions, employment has been falling, with a particularly rapid fall in manufacturing. Unemployment, in turn, has risen exceptionally quickly over the last six months. By acting promptly to reduce their labour forces and their stocks, companies this year have limited the extent of the rundown in their liquidity position. Even so, the net borrowing requirement of industrial and commercial companies in the first half of 1980 was exceptionally large.

ECONOMIC PROSPECTS

Introduction

15. This forecast takes account of the decisions on public expenditure and taxation announced by the Chancellor on 24 November. For 1981-82, tax receipts are projected on the conventional assumption that allowances, thresholds and specific tax rates are uprated in line with the growth of the RPI during 1980.

16. In addition to the National Savings initiative, a reduced rate of government borrowing and bank lending is expected in the course of the second half of the current financial year. Thus the forecast of underlying monetary growth over the target period of February 1980 to April 1981 is that it will come back towards the top of the 7-11% range. For 1981-82, the forecast assumes that monetary growth will be at the centre of the MTFS range of 6-10%.

17. It is assumed for the purposes of this forecast that the exchange rate in 1981 will be at a level similar to that in mid-November.

Inflation

18. In the current quarter, retail prices are likely to show an increase over a year earlier of around 15½%: 1% less than the Budget forecast. Over the past three months, and helped by some particularly favourable influences not all of which may persist, prices have been rising at little more than ½% a month. This lower trend seems likely to continue into next year, so that the year on year increase in the early part of 1981 should show another substantial fall. Thereafter much depends on the rise in costs. Earnings in the current pay round are assumed to rise by less than half the rate in the previous pay round, with earnings in the public services rising by less than in the rest of the economy. Other costs, especially imported materials and fuels, should continue to rise less fast than labour costs, though it is assumed that there are no further benefits on the sterling price of imports from a rising exchange rate. Profit margins have declined very sharply in 1980: the prospect for next year is highly uncertain, but margins may not decline as much again. The forecast is for a rise of 11% in retail prices between the fourth quarters of 1980 and 1981. There are however several ways in which single figure inflation could be achieved next year: such an outcome would be comfortably within the range of possible outcomes implied by the margin of error on the forecast.

World economy and UK trade

19. In the face of a 140% increase in the price of oil, activity in the industrial economies at first showed surprising resilience, growing by 3% in the year to early 1980. Since then a general slowdown has taken place. In the second quarter GNP fell in all the main economies except Japan. The drop was especially steep in the US, though there are now signs that the decline there has come to an end. Activity in the industrial economies is expected to remain weak in the second half of 1980 and early 1981, with a recovery starting around the middle of next year. In the face of stubborn inflation and, in some countries, a weak external position, most Governments are likely to continue following restrained fiscal and monetary policies.

20. The growth of UK export markets (world trade in manufactures, UK weighted) is expected to slow down substantially, from an estimated 8% in 1980 to possibly 3% or so in 1981, with a substantial margin of error in either direction. The surprisingly high figure for 1980 reflects partial information for the first half of the year. Moreover, markets which are relatively more important to the UK, in particular OPEC, have been the fastest growing.

21. The volume of UK exports of manufactures (less erratics) in the three months to October was 2% lower than the 1979 average. Some further decline is possible next year, in the context of slow growth in world trade and the continuing effects of past losses in competitiveness - working through both the supply of and demand for exports. While the consequences of large changes in competitiveness are extremely difficult to evaluate, evidence for this country and for other industrialised countries is consistent with the view that there are significant effects on trade, often with a considerable lag. Total exports, sustained to some extent by rising exports of oil and some other non-manufactured goods, are forecast to fall by 3% in 1981.

22. The fall in the volume of manufactured exports this year has been more than matched by the fall in imports: in the three months to October, the volume of manufactured imports (less erratics) was 9% less than the 1979 average, much of this fall reflecting de-stocking. Predictions of imports have proved notoriously fallible, but the judgement in this forecast is that the falling trend will soon stop: for 1981 as a whole, there may be little change in imports of goods and services.

23. The large surpluses on the current account in recent months reflect, in part, rapid de-stocking. If that lessens next year, and if adverse competitiveness effects continue to be felt, then the balance of trade in volume terms may tend to deteriorate but with a further improvement possible in the terms of trade, and with the benefit of the EC rebate, the current balance may remain in surplus.

Domestic demand and activity

24. The principal feature of the changes in demand in 1980 is the stock cycle: the immediate adjustment by firms has largely taken the form of cutting back on stocks. Whereas in 1979 stocks in total were built up by about £1½ billion, in 1980 they are being run down sharply. In the second half of 1980, other reductions in domestic demand - in consumers' expenditure, private investment and in some areas of public expenditure - are probably taking place. Next year may see less de-stocking, but a continuation of the fall in private and public fixed investment.

25. The real value of personal incomes has risen this year as a result of large increases in pay and the falling rate of inflation. Next year, with a further fall in activity and employment, with increased national insurance and health contributions, and with increases in some people's earnings falling short of the rate of inflation, real personal disposable income may well be lower than in 1980. But the savings ratio is likely to decline from its present high level, partly because of the usual lag between income and spending changes, partly because of the decline in the rate of inflation. Hence consumers' expenditure in 1981 may be close to its 1980 level.

26. Output in 1980, for the economy as a whole, is forecast to be 3% lower than in 1979. Within the total, manufacturing output may be 10% lower. The forecast of output in 1981 turns crucially on a very uncertain assessment of the second half of 1980, and on how much of the decline in output has been caused by de-stocking. The central forecast for 1981 is that, with a slower rate of de-stocking, there may be no further fall in output from the level in

the second half of 1980. This prospect is, however, extremely uncertain. It is quite likely that the bottom of the recession will be reached in the course of next year, with perhaps some recovery before the end of the year. For 1981 as a whole, GDP may be 1½% below the 1980 level; with manufacturing output 4% down. Output of North Sea oil and natural gas liquids is expected to have risen to around 80 million tonnes in 1980. Oil production next year is expected to be in the range 85-105 million tonnes, as forecast in the Report to Parliament by the Secretary of State for Energy, June 1980 (the Brown Book). Unemployment is at present rising rapidly. Further rises must be expected, though the flattening out in the path of output forecast for next year should contribute to a slower rate of increase in unemployment.

The Public Sector Borrowing Requirement

27. In the first half of 1980-81, the PSBR was £8 billion, seasonally adjusted. A much lower rate of borrowing is expected in the second half of the year, partly because of: the rebate on EC contributions, rising receipts of North Sea taxes and asset sales. The result is a forecast, still subject to a wide margin of error, of the PSBR in 1980-81 of £11½ billion or 5% of GDP at market prices. Of the upward revision to the forecast of the 1980-81 PSBR made at Budget time, much can be attributed to higher borrowing by local authorities and public corporations reflecting both higher than expected expenditure and the worsening of trading conditions. In the central government account, the main reason for higher borrowing is increased expenditure, including defence, in both volume and cash terms, much of the volume increase resulting from the effects of recession. The net change in revenue from Budget estimates is expected to be small as a result of offsetting effects from higher pay and from lower employment and output. North Sea oil and gas revenues in 1980-81, at current prices, seem likely to total about £4 billion, or 1½% of GDP at market prices.

28. For 1981-82, the continuing recession will tend to increase the PSBR. This should be more than offset by a combination of factors pointing in the opposite direction: by the effect of the

fiscal decisions announced on 24 November; by some improvement in the finances of public corporations as they continue to increase prices, mainly of energy, towards economic levels: and by a lower level of pay increases in the public services. After taking account of the proposed tax changes announced on 24 November, revenues from North Sea oil and gas in 1981-82 are expected to be in the range £4½-5 billion, at 1980-81 prices, a little higher than forecast at the time of the Budget.

29. The uncertainties over the estimated outturn for this year's PSBR are magnified in 1981-82. The 1980 FSBR indicated a margin of error for the year immediately ahead - which is no more than an average derived from past forecasts, and which by definition may therefore be exceeded - of £3 billion either way. At this stage, the margin of error on the 1981-82 PSBR is necessarily greater. On the basis of the fiscal and monetary policy assumptions used in constructing this forecast, the prospect is for some fall in the PSBR as a percentage of GDP.

Margins of error

30. Table 1 shows margins of error calculated from internal Treasury forecasts over the last ten to fifteen years. Two factors, in particular, suggest that such past averages may understate the risks of being wrong in present circumstances. The first is the uncertainty over the response of inflation, and of the economy in general, to the present stance of monetary and fiscal policy. The second is the uncertainty over the amount and timing of trade and output responses to the past loss of trading competitiveness.

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TABLE 1: ECONOMIC PROSPECTS TO END 1981

	Percentage changes		Margins of error// for 1981 forecast
	1979 to 1980	1980 to 1981	per cent
A. OUTPUT AND EXPENDITURE AT CONSTANT 1975 PRICES			
Gross domestic product (at factor cost)	- 3	- 1½	1½
Consumers' expenditure	0	- ½	1½
General Government expenditure on consumption and investment	- 1	- 2	1½ /
Other fixed investment	½	- 4	4 *
Exports of goods and services	1	- 3	3½
Change in stockbuilding as a percentage of GDP	- 4	1	1
Imports of goods and services	- 3	0	2½
	1980	1981	
B. BALANCE OF PAYMENTS ON CURRENT ACCOUNT	£ billion		£ billion
	2	2	2
C. RETAIL PRICE INDEX	Percentage changes		Per cent
	4th Quarter 1979 to 4th Quarter 1980	4th Quarter 1980 to 4th Quarter 1981	
	15½	11	3

// The errors relate to the average differences (on either side of the central figure) between forecast and outturn. The method of calculating these errors has been explained in earlier publications on government forecasts, notably in November 1978 (see Economic Progress Report Supplement or Economic Trends No. 301, November 1978). The calculations for the constant price variables are now derived from internal Treasury forecasts made during the period June 1965 to October 1978. For the current balance and the retail price index forecasts made between June 1970 and October 1978 are used. The errors are after adjustment for the effects of major changes in fiscal policy where excluded from the forecasts.

/ This margin applies to general government consumption only.

* This margin applies to private sector investment only.

TABLE 2

CONSTANT PRICE FORECASTS OF EXPENDITURE, IMPORTS AND GROSS DOMESTIC PRODUCT (1)

£ million at 1975 prices, seasonally adjusted

	Consumers' Expenditure	General government expenditure on goods and services: Final Consumption	Fixed Investment	Total	Other fixed investment	Exports of goods and services	Change in stocks	Total final expenditure	Less imports of goods and services	Less adjustment to factor cost	Plus statistical adjustment	GDP at factor cost	GDP index 1975 =100
1978	68100	23850	3550	27400	17300	32000	850	145650	31750	11950	0	101950	108.4
1979	70800	24350	3350	27700	17150	32900	1600	150150	35250	12350	700	103250	109.8
1980	70800	24550	2850	27400	17250	33200	-2650	146000	34200	12500	950	100250	106.6
1981	70300	24550	2300	26850	16550	32250	-1600	144350	34250	12250	950	98800	105.1
1978 First half	33600	11850	1850	13700	8750	15850	500	72400	15750	5900	-100	50650	107.7
Second half	34500	12000	1700	13700	8550	16150	350	73250	16000	6050	100	51300	109.1
1979 First half	35650	12100	1650	13750	8400	16050	1000	74850	17250	6300	350	51650	109.8
Second half	35150	12250	1700	13950	8750	16850	600	75300	18000	6050	350	51600	109.8
1980 First half	35700	12250	1500	13750	8700	16900	-500	74550	17750	6350	550	51000	108.5
Second half	35100	12300	1350	13650	8550	16300	-2150	71450	16450	6150	400	49250	104.8
1981 First half	35200	12300	1200	13500	8300	16250	-1300	71950	16900	6150	450	49350	105.0
Second half	35100	12250	1100	13350	8250	16000	-300	72400	17350	6100	500	49450	105.2
ANNUAL PERCENTAGE CHANGES													
1979-78	4	2	-5½	1	-1	3		3	11	3½		1½	
1980-79	0	1	-15	-1	½	1		-3	-3	1		-3	
1981-80	-½	0	-19½	-2	-4	-3		-1	0	-2		-1½	

(1) GDP figures in the table are based on 'compromise' estimates of gross domestic product.

Note - Figures in £ million are rounded to £50 million. Percentage changes are calculated from unrounded levels and then rounded to 0.5 per cent. The GDP index in the final column is calculated from unrounded numbers.

SECRET

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10 DOWNING STREET

From the Private Secretary

20 November 1980

Dear John,

As you know, the Prime Minister held a further Monetary Seminar on Tuesday. The following were present: Chancellor of the Exchequer, Chief Secretary, Financial Secretary, Sir Douglas Wass, Mr. Burns and Mr. Middleton; the Governor and the Deputy Governor of the Bank of England, Mr. Goodhart and Mr. George; Sir Robert Armstrong and Mr. Ibbs. They had before them the papers described in your letter of 14 November, including the letter of the same date from the Governor.

Smoothing the PSBR

Referring to the recent Treasury paper on this subject (your letter of 5 November refers), Sir Douglas Wass said that some areas for smoothing the PSBR had been identified, mainly on the revenue side. But one should not exaggerate how much could be achieved, and some of the options would cause administrative difficulties and would be inconvenient for industry. He proposed that further work should be done to refine the possible options.

The Prime Minister said that the further work should be done as proposed.

Abolition of the Reserve Asset Ratio (RAR)

It was explained that the abolition of the RAR and its replacement by a new system of prudential control had already been announced in the Green Paper on Monetary Control. But a new system of control had not yet been fully worked out, and until it was, the RAR - or some variant of it - would have to continue in its place. The Bank had published a Consultation Document on the new prudential control system, but it had not been possible to carry the consultations with the banks forward, pending decisions on other monetary policy issues such as the Lender of Last Resort facility (see below). However, it was essential that the new prudential system should be in place by the next Budget.

/ The Governor

GB

The Governor said that it would be desirable to make some early changes in the RAR so that, in its last few months of existence, it did not cause some of the difficulties which it had in the past. In particular, there was likely to be renewed pressure on the banks' liquidity in January, and it would be right to consider changing the definition of reserve assets before then so as to avoid - or at least reduce - the need for Bank assistance.

The Prime Minister said that it would be clearly undesirable to abolish the RAR before the new prudential system was in place. Even though the RAR was inadequate, to abandon it now would give the public the impression that the banks were being set free to "print money". But the new prudential system must be ready in time for the next Budget, and in the meantime it would be desirable to consider possible changes in the RAR on the lines suggested by the Governor.

Modification of Lender of Last Resort

It was explained that the Treasury and the Bank agreed on the need to move to a more flexible system of operations in the money market. This would include allowing short-term interest rates to be free to move within a predetermined (but unannounced) band, and the disappearance of MLR as such. Greater flexibility in interest rates could ease the political and technical tensions in our monetary operations. Moreover, the possibility of considerable fluctuation of short-term rates could encourage the banks to move towards more variable pricing for their lending, which would also be helpful for maintaining monetary control. The purpose of the band, rather than letting rates move completely freely, would be to avoid undue short-term volatility which might arise from technical factors and which might not be warranted by the underlying movement in the money supply. But it would be possible to change the band quickly if it appeared that the monetary target was not being achieved. The authorities would continue to intervene mainly by open market operations. The discount window would be used to relieve unexpected cash shortages, but this facility would be provided less predictably than at present and probably only at penal rates. The effect of changing over to a system on these lines, at least initially, should not be exaggerated. But it ought to be helpful in its own right, and it would be a move in the direction of a possible Monetary Base Control (MBC) system. It was proposed that the new method of operating should be announced by the Chancellor in general terms in next week's statement, and introduced in the next few months when the general guidelines for working it had been fully worked out.

In discussion, it was questioned whether it would be possible to keep the band secret. In response it was argued that the Bank could certainly resist pressure to publish on operational grounds; and although the market would get some idea of the band from the way the authorities intervened, it should still be possible to

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maintain a considerable degree of uncertainty about it. This was the experience in the USA, where the Fed operated an interest rate band.

The Prime Minister said she was content with the proposal in general terms: it should be announced in the Chancellor's statement, and the Bank and the Treasury should immediately embark on discussions on the form of the new guidelines for short-term interest rates and how the new system would operate. Her one concern was that the proposal was not radical enough and that it would result in the banks still being able to obtain large-scale assistance from the authorities. She hoped that the Bank would veer in the direction of providing cash via the discount window and charging a penal rate so as to make it more likely that the clearers would restrain their lending. It was also essential, in her view, that the Bank and the Treasury should be prepared to change the band as and when monetary conditions required it.

Funding Methods

The Financial Secretary said that, following an intensive review, he had concluded that the introduction of a Restricted Indexed Gilt (RIG), aimed principally at the UK pension funds, would be desirable. The intention would be to issue perhaps £1 billion in the first place and at least £2 billion if the market reception was favourable. The value of the gilts would be linked to the RPI. The new gilt would be a considerable help to the Government's funding problem; it would reduce the cost of borrowing by cutting out uncertainty; and it would help bring down long-term interest rates and thus bring forward the reactivation of the Corporate Bond market. Although there were arguments against, on balance he thought it was right to go ahead with it.

In discussion, it was pointed out that RIGs would reduce the PSBR (because the index-link would not show up as interest rate in the Government's accounts). Their announcement now would also be of advantage for the Chancellor's statement next week. On the other hand, it was argued that the Government was already raising huge amounts of debt from the institutions without indexation, and it was doubtful whether offering them an indexed gilt was necessary. This would be a much greater departure than the issuing of "Granny Bonds" - because in the latter case it had been considered necessary to issue them in order to increase the Government's borrowing from the personal sector. There was a risk that if an RIG was announced, the institutions would hold off buying conventional stock and wait for a further RIG issue. More generally, an RIG issue would give the impression that the Government was extending indexation just when it was trying to reduce indexation in other fields, such as social security and public service pay. Finally, certain legal difficulties had been raised by the Department of Trade

/(Mr. Nott's letter

(Mr. Nott's letter of 17 November to the Financial Secretary refers), so that it was now doubtful whether it would be possible to go firm on an RIG issue in time for the Chancellor's statement.

As regards other methods of funding, the Financial Secretary said that the first day of the new "Granny Bond" issue seemed to have gone well. The Chancellor said that he would like to consider the possibility of announcing a further extension of "Granny Bonds" in the New Year in his statement.

As regards the possibility that the nationalised industries might borrow in their own name, Mr. George said that the industries had frequently argued for this; but in practice it seemed very unlikely that they would take advantage of it if such a facility was allowed. Borrowing from the National Loan Fund was cheaper for them.

The discussion then turned to the possibility of new methods of debt marketing, and in particular the possibility of auctions. The Bank representatives explained that a change to an auction system would, in their view, seriously damage the structure of the market and, as a general proposition, they believed it would increase the cost of borrowing. But they were prepared to consider auction techniques on a limited scale in respect of short-term debt.

Summing up this part of the discussion, the Prime Minister said that on balance she was opposed to the immediate introduction of an RIG. But she did not preclude introducing one at some later date: it would be helpful if, in the meantime, the Financial Secretary would prepare a short paper setting out the pros and cons and taking account of the points raised in Mr. Nott's letter. The Chancellor could, if he wished, announce the extension of "Granny Bonds" in the New Year in his statement. Although she was disappointed that no other immediate funding changes seemed possible, she agreed that there was nothing else that the Chancellor could readily announce. She noted what the Bank representatives had said about auction techniques and she would like the Treasury and the Bank to conduct a joint study of possible new funding methods - which should also cover the possibility of new debt instruments.

Monetary Base Control

The Chancellor said that he would like to open up the possibility of moving to an MBC system in due course. In order to help the Bank and the Treasury develop their thinking on MBC possibilities, he had two immediate proposals. First, the 1½ per cent cash ratio should be abolished. This would enable them to study the properties of a non-mandatory system and, in particular, the banks' own requirement for reserves which was an essential feature of such a system. But some method would have

/to be

to be found of replacing the Bank's income which was presently derived from the 1½ per cent requirement. Second, he proposed that a new series of retail deposits (M2) should be compiled. This was desirable as the possible basis for a mandatory system. He intended to announce both of these measures in his statement; he would explain that they were necessary to enable the authorities to move to an MBC system in due course if they so wished.

The Governor said that he did not dissent from these proposals, though he emphasised that, with the abolition of the 1½ per cent ratio, a new source of income would have to be devised for the Bank, and it would be highly desirable if the banks continued to provide it rather than the Government. The Prime Minister said she was content, and that both measures should be announced in the Chancellor's statement.

I am sending copies of this letter to Tim Allen (Bank of England), Sir Robert Armstrong and Robin Ibbs.

Yrs ever,

Tim Lankester

A.J. Wiggins, Esq.,
HM Treasury.

S E C R E T

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

19 November 1980

T. Lankester Esq.
10 Downing Street
LONDON
SW1

Dear Tim,

The Chancellor thought the Prime Minister might like to see the attached note on the effects of a two point fall in MLR.

The Chancellor thinks the note, which reflects discussion with the Bank, sets out the issues very fairly. As it points out, the short run effect depends crucially on expectations. The monetary, PSBR and public expenditure background are of course not good and it will be necessary to see how recent press reports are taken. But it may be possible to convince the markets that a cut in interest rates of this size will not exacerbate monetary growth in the short run. They are clearly getting ready to believe this. And if they do believe it the consequences for £M3 could even be favourable.

Nevertheless, the risks of adverse monetary consequences pointed out in the note are real ones. Reducing interest rates will increase the growth of £M3 over a year to 18 months, so the prospects for the Government's medium term strategy will depend heavily on the forthcoming budget. Moreover, to get a neutral effect between now and then depends on putting a difficult series of announcements in a wider context in which the Government's medium term intentions for the money supply and inflation are seen to survive.

In the Chancellor's view, the reception of the various announcements he will be making next week depends on convincing people that the problems with the money supply are a combination of corset unwinding and imbalance between sectors. Neither of these can be dealt with by

/manipulating

S E C R E T

manipulating short term interest rates. The intersectoral problem has to await the budget. Meanwhile with inflation coming down, the current account strong, the exchange rate high because of the North Sea, and activity at a low level, the Government can afford to bring interest rates down in advance of the Budget.

If this analysis is right, the Chancellor thinks it unlikely that there would be a big fall in the exchange rate. But companies benefit from the lower interest rates regardless of whether the rate comes down and so does the Government in the form of a lower PSBR (and RPI) next year. Moreover some of the other measures - for example the ENIC and the extension of granny bonds - will be easier to sell if short term interest rates are seen to be coming down.

In short, there are risks about taking this step; but on balance the Chancellor thinks they are worth taking.

Yours

John

A.J. WIGGINS
Private Secretary

THE FINANCIAL EFFECTS OF A 2 POINT CUT IN MLR

This note describes our best assessment of the financial effects of a 2 point cut in MLR in present circumstances. The views outlined here are broadly in agreement with those of economists in the Bank.

Policy and Financial Background

2. The effects are assessed against a background in which if there were no change in MLR from its present level and no fiscal action affecting 1980-81, the growth in sterling M3, adjusted for distortions due to the corset, would probably exceed the top end of the target range by, say, around 4% over the period February 1980 to April 1981. Thereafter monetary growth could probably only be kept to the target in the MTFS for 1981-82 if interest rates are kept at around current levels until the end of 1981 unless action is taken to reduce the PSBR below the level of about £10½ billion in the Industry Act forecast. In terms of the policy background it is assumed that the cut in MLR would form part of an announcement in which:

(i) the PSBR forecast for 1980-81 is revised upwards to £11½ billion.

(ii) revised public expenditure plans are announced for 1981-82, implying higher expenditure than previously planned.

(iii) plans to raise taxes - probably PPT and employers' national insurance contributions - are announced in advance for 1981-82.

Effects on the Money Supply and the Exchange Rate

3. We have tried to assess the impact of just the MLR component, <u>not</u> all the measures taken together, and we have looked at the effects both up to the Budget and over the longer term - say a year to eighteen months. The shorter the timescale the more important in any assessment is the impact on expectations in

the markets, and hence the way in which the change is presented. If it were perceived as heralding a change in the Government's basic strategy, the short term impact on the money supply would be much more adverse than if it were perceived as being consistent with that strategy. By the same token, the reverse is true of the effect on the exchange rate: the more the move is seen as a change of strategy the more likely is there to be a significant fall in the rate. In the longer term, however, underlying economic considerations are likely to dominate purely expectational ones and we can probably be rather more confident about the nature and scale of the effects. Whatever the timescale involved, it is important to make appropriate allowance for the impact on banking sector liquidity: we think such considerations would tend to damp down any short run effect on the money supply but enhance the longer term impact as the effect on bank lending comes through.

4. The impact on the money supply in the period up to the Budget could, plausibly, go in either direction although our best guess is that on balance it is likely to be upward. We would expect the level of £M3 to be higher in March than it would have been in the absence of the MLR cut, but by a small amount - perhaps about 1% or even less - although we cannot be at all sure of this. We are more confident that lowering MLR by 2 points would mean higher money supply after a year to eighteen months, other things being equal, and we think the effect over that period could be perhaps 2-2½%. This would imply a higher growth rate during 1981-82, particularly if the effect before the Budget were to be small or even favourable, and this means that any target for 1981-82 would be that much more difficult to achieve.

5. As regards the exchange rate we expect that this would be lower as a result of lower MLR in both the short term and after a year or so, partly because interest rate differentials would be less favourable to the UK and partly because of the money supply effects. But as with the money supply effects

the impact in the short run is particularly uncertain. If the effect on confidence is good, this could affect both the gilts and the foreign exchange markets: for the same sort of reason as domestic investors might be encouraged to buy additional gilts, reducing or even reversing the adverse monetary impact, foreign investors might be encouraged to buy gilts and the downward exchange rate effect could be reduced or reversed. In other words if the short run impact on the money supply is particularly favourable we would be unlikely to see a pronounced fall in the exchange rate - and the reaction could even be perverse. On balance, however, we would expect a slightly lower rate - perhaps around 2% - in the short term, building up to nearer 3% after a year.

6. A two point cut in MLR might enable the Building Societes to reduce their rates somewhat. The 1 point rise in the mortgage rate which might otherwise occur in April next year because of the rise in the composite tax rate would probably be avoided and the rate could actually be reduced by up to a point. We cannot be sure that this would occur; especially since the Societies' share rate is at present uncompetitive, but the effects quoted here assume that it does. A lower mortgage rate would of itself tend to reduce the RPI somewhat, and this effect could well offset the positive impact of the lower exchange rate.

Effects on the Counterparts of the Money Supply

7. The effects on the money supply described above can be analysed in terms of the familiar counterparts, as follows:

(i) PSBR

This would be reduced by a cut in interest rates generally, mainly, though not solely, because debt interest costs would be reduced. Although the biggest effect is likely to be on short term rates, past experience suggests that long rates would also fall - perhaps by around 1 point. The effect on the PSBR would be small in the first instance - probably less than £50 million in

the remainder of 1980-81 - but would build up as progressively more public sector borrowing was financed at the lower rates. In 1981-82 the effect could build up to perhaps £500 million.

(ii) Gilt Sales

It is here where the greatest uncertainty lies. If the MLR cut was convincingly presented as being consistent with the strategy, and if it was thought to be the first of a series of cuts, the markets could actually be sufficiently encouraged to buy more gilts than they otherwise would have. But on the other hand even on an unchanged view about the appropriate level of interest rates in the longer term, the fact that they had been reduced would mean less capital gains in the future and this would adversely affect sales. The effect in the short run could go either way, but in the Bank's view sales might well be higher in the aftermath of the change. Whether this would be sustained throughout the period up to the Budget is another question, and on balance we think there would be lower sales over the whole four months. Sales could easily be, say, £500 million less over the period but the possibility of sales being greater by £500 million certainly cannot be ruled out. If the impact on sales up to the Budget were adverse as, on balance, we would expect, there might be little further effect after the first few months, but if it were favourable in the first instance some reduction in sales could be expected later as the adverse effect on bank lending (see below) came through.

(iii) National Savings

Normally, if the yield on National Savings were kept in line with yields on competing assets, one would expect little impact on inflows. But if it were decided not to reduce yields on, say, National Savings Certificates immediately some increase in inflows might be achieved. Granny Bonds would probably also look more attractive. Both these effects would tend to reduce £M3.

(iv) Bank Lending to the Private Sector

There would be at least two opposing influences at work here. The first is that interest payments on existing overdrafts would automatically be reduced and this would tend to reduce borrowing, particularly by those parts of the company sector facing the most serious liquidity problems: this effect would be partially offset by reduced interest receipts on financial assets. The second is that the cost of borrowing would be reduced, so tending to increase borrowing. This would take some time to build up - both internal Treasury research and, for example, the research recently reported by Christopher Johnson of Lloyds Bank suggest that the peak effect on the growth of bank lending might be after a year to eighteen months - but we are persuaded that it would eventually dominate the first effect. If, as expected, the exchange rate were reduced, the upward impact on prices would also take some months to come through fully. In the first few months - perhaps up to the Budget - the interest payments effect on company borrowing might match or even possibly exceed the other effects: on balance we would expect a negligible, though perhaps slightly positive, net effect over this period.

(v) External Factors

We would expect negligible effects, given that the exchange rate is floating.

Conclusion

8. Any assessment of the effects of cutting MLR now by two points is inevitably subject to very wide margins of error. This is particularly true for the effects in the first few months. Although we are persuaded that after a year there would be an adverse monetary impact - largely due to the effect on bank lending - and the exchange rate would be lower, we cannot be very sure of the magnitude of the effects. In the short run the impact on expectations is crucial, and the effects on both the exchange rate and the money supply

could go either way: but to the extent that the impact on the money supply was favourable the downward impact on the exchange rate would be reduced - or possibly even reversed. If the short term impact on the money supply were small or favourable, the adverse longer run impact would mean faster monetary growth - perhaps 2% or more - during 1981-82. This would cast some doubt on whether the monetary growth rate envisaged in the MTFS for that year could be achieved with the PSBR in the Industry Act forecast and no further change in interest rates.

FST
c. Mr Burns
Mr Middleton
Mr Britton
Mr Monck
Mrs Lomax
Mr Riley

For release on delivery
1:00 P.M., E.S.T.

Statement by

Paul A. Volcker

Chairman, Board of Governors of the Federal Reserve System

before the

Subcommittee on Domestic Monetary Policy

of the

Committee on Banking, Finance and Urban Affairs

House of Representatives

November 19, 1980

Mr. Chairman, Members of the Committee:

I very much welcome the opportunity to review with you the events of the past year in the area of monetary policy, and to outline our basic intentions and some of the key problems as we approach the future.

As you well know, this has been a turbulent year in the national economy and in financial markets. Partly because inflation and inflationary expectations are profoundly changing behavior patterns, economists and forecasters have been repeatedly surprised by developments in both the real and financial markets. Businessmen, consumers, and financial intermediaries have had to cope with more than usual uncertainty amid sharp fluctuations in sales, employment, and interest rates. Understandably, there has been a sense of frustration and disappointment, combined, I believe, with growing recognition of the fact that deeply seated economic problems building over a long period of years will take strong measures to solve.

Under the circumstances, Federal Reserve policy has understandably been the focus of a great deal of scrutiny. Some has concentrated on the techniques of policy implementation normally of concern only to specialists. Most commonly, the public discussion reflects broad concern about the fluctuations in, or level of, interest rates and their relationship to both inflation and sluggish economic performance. Constructive dialogue on these problems is always helpful -- and this Committee has contributed to it.

I hope that a common understanding can emerge from this discussion that monetary policy indeed has an indispensable role to play in the effort to restore a stable, vital economy. That role requires that the Federal Reserve apply the measured, persistent restraint on growth in money and credit that is necessary to drain the momentum from inflationary forces in the economy and to encourage a return to stability in prices and unit costs. Misperceptions of the Federal Reserve's intentions in that respect can only detract from the effectiveness of our actions. At the same time, fully effective results will require concerted, complementary efforts from other directions as well.

Our focus on the objective of dealing with inflation recognizes that inflation has been the single most disruptive element on the economic scene. Inflation places tremendous pressures on the budgets of many households, distorts spending and saving decisions, inhibits productivity-expanding business capital formation, erodes the foundations of the domestic and international financial systems, and in the process saps confidence at home and abroad in our future. More specifically, unless there is a sense that inflation is decelerating, there can be, in my judgment, little hope of bringing about the sustained, balanced growth of production and real income that we seek. That deceleration requires that excessive monetary expansion must be avoided.

That basic tenet of economic policy, on which economists of almost all schools can agree, is reflected in the broad concepts of monetary "targeting" that the Federal Reserve has adopted in recent years, a concept that looks toward a reduction in monetary growth over time, and which the members of this Committee and many others have strongly supported. I recognize that concept does not in itself resolve important questions about the precise magnitude of the targets or about the techniques of monetary control, matters about which, in fact, there are many differences of opinion. Nor does it offer exact guidance about how to react to new developments, surrounded as they inevitably are by uncertainty in interpretation and conflicting considerations.

The Federal Reserve's approach toward these problems can, I believe, best be clarified by reviewing the change in operating procedures introduced about a year ago and developments since that time. To that end, I am attaching to this testimony a statement reviewing our experience with the new operating techniques.

In reviewing that record, I trust that understandable questions and concerns about particular actions and techniques will not obscure the basic order and consistency in our efforts to control the growth of money and credit. Uncertainty on that point would be unfortunate. Let us recognize that slowing growth of money and credit in an inflation-prone economy, at best, is not a simple, painless job. Let us also recognize it must be done.

At least as important, we should be aware of the limitations of purely monetary actions. Acting on the basis of those

understandings, we should be able to change expectations, to develop consistent policies to share the burdens, and look forward to the ultimate success of the effort.

Looking at the most recent situation, I believe it should be unambiguously clear that the Federal Reserve has been leaning hard against excessive monetary growth, and that we mean to maintain firm control as we look ahead.

I believe that our new approach has, over the year as a whole, helped avoid excessive monetary growth. But I am sure you agree that we should learn all we can from our experience.

To assist in that process, I initiated in September, roughly a year after the change in technique, a systematic study of our recent experience, drawing on staff throughout the Federal Reserve, so that we do not neglect opportunities to achieve further improvement in operating techniques and can better address broader policy issues. We are also acutely conscious of the fact that implementation of the Depository Institutions Deregulation and Monetary Control Act is itself altering the institutional framework of our activities, raising some new questions that must be carefully considered, particularly in connection with the introduction of NOW accounts nationwide. We expect to take advantage of these studies in the review of our 1981 targets required early next year and will, of course, share any relevant results with you at the time of our regular "Humphrey-Hawkins" testimony. Whatever further insights we can gain from that systematic study, I believe certain points are worth emphasizing now.

As I have already indicated, 1980 has been an unusually turbulent and difficult year. Deeply embedded problems of inflation, low productivity and investment, the weakened competitive position of some key industries, and dependence on imported energy have made the economy vulnerable to non-monetary "shocks" and extremely sensitive to indications of changes in price trends, while impairing growth prospects. Expectations are highly volatile, and there is a sense of both impatience and confusion about setting the economy right.

All of this puts a special burden on those of us developing and implementing policy to "get it right," to communicate our purposes and intentions effectively, and to persevere with needed policies.

In that context, I am satisfied that the greater emphasis we have placed on monetary targeting in recent years, supplemented by the change in operating techniques, has assisted both in communicating what we are about and achieving the internal discipline necessary to act in a timely way. One can argue about the precise timing and degree of particular decisions. But the need for strong action last winter, prompted in part by growth in the aggregates, to head off an almost explosive rise in inflationary sentiment seems to me incontestable. Contrary to most expectations, the ominous "free fall" in economic activity during the spring quickly ended, in substantial part because our operating techniques led to a rapid "opening" of credit markets. And, while the episode is clearly not over,

we have acted more quickly to rein in recent excessive monetary growth than would have been at all likely under the previous operating techniques.

The record shows, unambiguously, that we do take the targets seriously. But it also strongly suggests that no single target can reasonably be interpreted in isolation, and that the lower order aggregates, M-1A and M-1B, can be extremely volatile. All of them -- and the interrelationships among them -- are affected by institutional change in a way that cannot be quantitatively pinned down in advance.

A clear case this year is the relationship between M-1A and M-1B. The half-point difference in the ranges for these two aggregates set almost a year ago reflected an <u>assumption</u> that growth of ATS, NOW and similar accounts would be limited; those new types of account make up the entire difference between M-1A and M-1B. As the year wore on, NOW and ATS accounts have grown more rapidly than anticipated, perhaps because passage of the Monetary Control Act prompted commercial banks with the authority to do so to market those accounts more aggressively before their power was extended to potential competitors. As a result, we now know the difference between M-1A and M-1B will be more like 2 percent rather than the 1/2 percent we earlier assumed. What we cannot know with any accuracy is the extent to which ATS and NOW accounts were fed by flows from savings deposits or other funds not counted in M-1B, and how much reflected shifts from demand deposits, depressing M-1A. Put differently, if we arbitrarily assume NOW and ATS accounts substitute for savings

deposits and demand deposits in roughly equal proportions, M-1A has been "artificially" depressed by 3/4 percent, and M-1B increased by about the same amount, relative to the targets set at the start of the year.

I make the point at some length because these shifts are expected to be much larger in the year ahead, when we will have nationwide NOW accounts, and will raise important questions of interpretation of both M-1A and M-1B. In essence, it is wrong to view either in isolation.

Other examples of institutional change abound, some of only negligible importance in interpreting the data but others significant. For instance, the explosive growth of money market funds earlier this year drew money into M_2 that otherwise would have been lodged in market instruments counted in none of the M's.

Without allowing for these institutional influences, the charts attached to this statement illustrate that the various aggregates now are running a little below or a little above the upper end of the ranges set almost a year ago. Obviously, for more reasons than pictorial or presentational nicety, I would be delighted to see the data gravitate more toward the mid-points of the established ranges as we receive data for the final two months. But I would warn you against attributing unwarranted importance to statistical precision in hitting the target in any given period. For one thing, a "bullseye" for one aggregate can imply a miss for another as

relationships evolve in the course of a year. More fundamentally, experience here and abroad strongly points to the fact that relationships of monetary targets to income, inflation, and interest rates -- the variables we really care about -- are not known with precision. Shifts in technology, regulation (such as deposit ceilings), and market incentives are all important at times. That is why it seems to me the better part of wisdom to think in terms of reasonable ranges.

In essence, I believe monetary targeting has been, and should remain, an invaluable discipline, a means for communicating our intentions, and a benchmark for performance. Whatever the debate about technique and the significance of possible "misses" over the course of the year, the broad thrust of our policy has plainly been one of restraint, working against the strong inflationary momentum. I take satisfaction, limited as that satisfaction must be, that the inflationary process has not gained fresh momentum, despite the strong "shocks" from energy and (more recently) food prices, the rigidities and strong momentum built into wages and prices, and the trend of government spending and deficits. The restraining effort has been accompanied by strains and instability in financial

and other markets. But I believe we have steered away from more treacherous inflationary storms -- storms that would have brought in their wake much more severe financial and economic dislocations.

Now we are opening a crucial new chapter -- the challenge of restoring growth, productivity, and employment while visibly reducing inflation. As we look ahead to that challenge, you should be aware that targets and performances for monetary growth in the general area in which we have been operating, or lower, seem bound to be restrictive so long as the momentum of inflation remains strong. If we are to deal with inflation, I see no alternative. At the same time I have spoken before about the potential for collision and conflict between restrained monetary growth and the financial needs of an expanding and inflating economy. Recent developments provide a taste of the potential problem.

The point is sometimes made that, in theory, monetary restraint, sustained strongly enough and long enough, can alone do the job of restoring price stability. Perhaps so -- in the long run. But over what period of time and at what unnecessary cost, in recurrent pressures on financial markets, in inhibiting investment and dampening productivity, in lost output and deferred growth? The alternative of trying to accommodate real growth while living with inflation by freely creating money is ultimately even more threatening. Expectations of inflation would roar ahead, the whole process of inflation would quickly accelerate,

and (I fear sooner rather than later) the growth and investment that is sought would crumble away, leaving us with an even more difficult situation.

These basic dilemmas and conflicts cannot be painlessly escaped by some technical change in monetary technique. I welcome informed debate on those matters -- after all they are part of our job and we want to draw on all the wisdom and evidence we can get to do our job better. But the world at large -- the real world of huge prolonged deficits, of wage bargaining building in rising costs for years ahead, of enormous pressure to protect established competitive positions and living standards even when productivity cannot support them -- will not focus on the technicalities of the various M's, the precise targets, or short-run fluctuations about those targets. What we must do is convey a general sense -- and make good on that message -- that excessive money and credit creation will not underwrite the inflationary process. Taken alone, as I have suggested, that commitment implies an extraordinarily heavy burden on monetary policy. So equally, we need the perception and the reality that essential monetary restraint will be combined with persistent and effective policies in other directions so that monetary restraint can be tolerable and sustainable.

In particular we must not flinch from the budgetary discipline necessary to complement the tax relief so desirable to foster incentives, investment, and increased productivity in

our society. We must seize other opportunities to deal with price and wage rigidities and to promote productivity. We need to face up to the hard job of achieving valid regulatory objectives at less cost. We need to keep our markets open to competitive forces at home and from abroad.

It is a difficult agenda for action. But the rewards are enormous, for along that road lies the opportunity for achieving growth as we restore stability. I know of no other.

* * * * * * * * *

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P E Middleton
Deputy Secretary

17 November 1980

T Lankester Esq
10 Downing Street

Dear Mr Lankester

I attach a note which may help with tomorrow's discussion.

I am sending a copy to Sir Robert Armstrong.

Yours sincerely

E. A. Clarke

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Agenda for Tuesday's Meeting

1. The objective at the last meeting was to get the Bank to provide a workable set of proposals to improve the present system of monetary control - consistent with and preferably as a step towards monetary base control. Relevant to this:

2. The Bank have produced 2 papers;

a. Funding techniques

b. Increasing the flexibility of official operations in the money markets.

The papers are covered by a personal letter from the Governor.

3. The Treasury have produced papers on:

a. Smoothing the PSBR

b. National Savings

c. A Restricted Indexed Gilt.

4. You also have a joint Treasury Bank paper on Monetary Control, setting out the outstanding issues, and highlighting points on which there is still disagreement. It is covered by a brief summary of the main points for discussion which you could use as an agenda for this part of the Seminar.

5. The objective of Tuesday's meeting is to take decisions which will enable the Chancellor to make a clear statement about monetary control in his announcement next week. There are a number of practical issues to be resolved. Commentators will also be expecting him to say something about the authorities' longer term intentions, notably on monetary base control.

The PSBR

6. It would be best to deal with the PSBR first. The prospect, consistent with the regular note on the monthly CGBR which you received last week is for a PSBR in 1980-81 of £11½ bn equivalent to 5% of GDP (the same proportion as last year). The Treasury have identified some areas for smoothing the path of the PSBR, mainly on the revenue side; you will wish to instruct them to press on urgently with this work.

Money Market Operations

7. The Bank have made some constructive suggestions to modify lender of last resort facilities and permit interest rates to fluctuate more - though still determined by the present discretionary system. These consist of:

i. Abolition of the Reserve Asset Ratio when consultations on prudential control are complete (by the Budget) - and its immediate modification to greatly reduce the need for special assistance.

ii. Modification of Lender of Last Resort - after consultations but also in time for the Budget. The Bank's proposals would allow interest rates to be free to move within a predetermined (but unannounced range). This system need have no posted MLR like the present one.

8. It is agreed that this would be an improvement. But you will want to press for details on:

i. The timetable for phasing out the Reserve Asset Ratio.

ii. The form of the new guidelines for short term interest rates.

Funding

9. Methods of Funding come next

a. More debt to persons. It is proposed to announce a further stage of National Savings. Plans are well advanced. The Financial Secretary has been supervising this work. You may wish to probe the question of indexed bonds for young people.

b. Restricted Indexed Gilt (RIG). All the necessary preparations have been made. We need to decide whether to go ahead and whether to announce it in the Chancellor's statement at the end of the month. The Governor advises against. The Financial Secretary has been supervising this work.

c. New Methods of Debt Marketing. The Bank paper resists changes in existing techniques but offers to experiment with short term bonds (when the reserve asset ratio has gone), nationalised industry issues (with HMG guarantee) and the Restricted Indexed Gilt. But as the Bank oppose the RIG and none of the others are immediate starters, there may be nothing we can announce by way of a change. The Governor is unlikely to change his strong opposition to changes in the Bank's traditional methods.

10. Decisions are needed on:

a. Whether Restricted Indexed Gilts should be issued (ever)

b. if so, whether now is the right time to do so

c. what else can be said about funding techniques in the statement.

Monetary Base Control

11. The Treasury would like to be able to announce our intention to change the present system so that it could, if we chose, evolve in the direction of montary base control. The choice between mandatory and non-mandatory systems would be left open at this stage. The immediate aim would be to find out more about the banks demand for base. The changes to money market

operations proposed by the Bank would fit well with an eventual move to MBC. Other necessary changes, to be decided in detail between now and the Budget, would include:-

i. Abolishing the 1½% cash ratio. This has no monetary control function but it provides the Bank with revenue. If an alternative source of revenue could be found to make good any shortfall it would be possible to abolish this ratio. This would mean we could study the properties of a non-mandatory system which depends on the banks' own requirement for reserves. This is the sort of system recommended by Karl Brunner and his colleagues. The Bank are willing to discuss this with us but may not be willing to have it announced as a possibility.

ii. Compiling a New Series for Retail Deposits (M2) This was suggested by the Treasury as the possible basis for a mandatory system - one in which the authorities lay down the amount of reserves to be held. The numbers do not exist at present and need to be collected.

The Bank are apprehensive about i. and reluctant to ask the banks for ii. But the Governor will probably agree to both provided he is not committed to changes until alternative sources of revenue are found. Decisions of principle are needed on both points at Tuesday's meeting.

12. You might conclude by asking the Chancellor to summarise how he proposes to deal with these issues when he makes his announcements next week.

Monetary Policy Issues

13. The Chancellor has sent you a minute about the measures he might announce next week including the rollover of the £M3 target and the related question of a reduction in interest rates. It would be best not to discuss these at such a large meeting.

18 NOV 19[illegible]

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Ref. A03583

PRIME MINISTER

"Monetary Seminar", 18th November

The annex to the Treasury's main paper (entitled "Monetary Control: The November Statement") summarises the main points for discussion, with points of agreement and points for decision separately identified. No doubt it will be convenient to build discussion round that summary. There would be something to be said for starting with the last section, on monetary control and monetary base: it would in a sense be more logical to consider the immediate questions of money market operations and debt management once agreement had been reached on the longer-range and more theoretical issues. But tactically it may be more sensible to follow the order in the paper, and deal with the shorter-range operational and debt management issues first: there is less scope for disagreement there, and it is in that area that decisions need to be taken at once.

2. The other decision that needs to be taken directly is that about the roll over of the monetary target, which is in the Chancellor of the Exchequer's separate minute.

Roll Over of Monetary Target

3. As the Chancellor says, this is very much a choice of evils. An announcement now that the target will not be rolled forward until the Budget will be difficult to present, because the existing target is likely to seem increasingly incredible as we come up towards the Budget. But, all things considered, that seems less difficult than any of the alternative possibilities.

Money Market Operations

4. There is agreement between the Treasury and the Bank of England on the introduction of a more flexible system of operations in the money market, including the "operational suppression" of Minimum Lending Rate (MLR) and some consequent change in the operation of discount window facilities. The authorities would not publish an MLR; but they would have in mind a band of interest rates within which money market interest rates would be kept. This should make for

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more flexibility and less political impact from transient short-term interest rate movements. The guidelines and interest rate bands would presumably be set by agreement between the Treasury and the Bank of England. The proposal is that they should not be published. Is this sustainable? There would no doubt be great pressure for publication, not only from the markets but from Parliament, including the Treasury Select Committee. Even if it were possible to maintain a decision not to publish the current guidelines and bands, how soon after the event could they be published: would they presumably have to form part of the periodic accounts of monetary events published in the Bank of England Quarterly Bulletin?

Debt Management

5. As is clear from paragraph 8 of the main note, this is one subject on which views differ between the Treasury and the Bank. The Treasury believe that a greater readiness to see the yields on gilts respond to market pressure, and a readiness to adopt new techniques such as auctions, would give greater assurance that a given programme of sales could be achieved within a certain period. The Bank believe that the greater volatility of yields would not necessarily increase the volume of sales outside the banking system, and they believe that the structure of the market and the prospects for selling debt in the longer term would be damaged.

6. Although there remained an area of disagreement, at any rate in theory, the Treasury seem in practice to have narrowed their proposal to the possibility of broadening the market at the short end, including experiments in auctions "at the boundary between the money and capital markets", where the Bank is less resistant.

7. One of the difficulties here is that it is the Bank of England who are responsible for managing Government debt and official market operations; in the last resort, it would be very difficult to force upon them changes which they were reluctant to adopt. This makes the more interesting the agreement between the Treasury and the Bank that a restricted indexed gilt (RIG) available to pension funds would be practicable. One of the decisions needed at this meeting is whether to go ahead with such a stock.

8. It could obviously be attractive to pension funds and the life funds of the insurance companies. Apart from the technical points, there are two presentational issues which you may like to have in your mind:

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(a) It is perhaps a superficial point, but it would be a pity if the new stock became known as RIG: the word has the wrong connotations.

(b) In issuing an indexed stock to pension funds, the Government would in effect be providing a partial guarantee against inflation to the beneficiaries of such funds. Is it consistent to be doing this, for understandable reasons of debt management, at a time when the Government is contemplating legislation to de-index tax allowances, social security benefits, public sector pensions, etc.?

9. If we were not announcing a new form of stock, there is not much that could be said in a November statement about debt management. The Chancellor could perhaps indicate that he was looking further into the possibility of borrowing by nationalised industries in their own name for part of their needs; but presumably the Bank would not want him to announce a more aggressive use of partly-paid gilts or greater use of unofficial tap stocks through the National Investment and Loans Office.

Monetary Control and Monetary Base

10. The Treasury's covering note commits itself to some statements which would, if they are accepted, have considerable implications for policy. It states, for example, that "precise short-run control of a broad aggregate like £M3 is not in practice possible", and also that "control of such an aggregate, even over a period of six to twelve months, could sometimes involve costs in terms of other objectives that are unacceptable". The annex says that £M3 is extremely difficult to control, even over longer time periods, and that "a major cause of this difficulty is that interest rate movements do not have a quick or reliable effect on bank lending or £M3".

11. If these statements mean what they say, they appear to call in question a monetary strategy based on targets for £M3 or any other monetary aggregate. If they are right, it would seem that the main purpose of monetary policy is to set a general direction and pace of trends over a period, and it could not be regarded as anything like a fine tuning instrument. On that hypothesis smoothing the PSBR becomes a secondary, though still desirable, objective.

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12. You will wish to see whether these propositions in the Treasury's covering note command general assent.

13. There seems to be agreement between the Treasury and the Bank that it is very uncertain whether a mandatory monetary base control system would be workable. The only question for decision here is whether to introduce a statistical series for retail deposits, to replace the old M2 series, on the ground that this would be a necessary precondition of a mandatory monetary base system. It is not clear that the new series would serve any other useful purpose (it was abandoned in 1972); but perhaps the fact that it would be costly for the banks is not in present conditions a very conclusive argument against doing that.

14. Nor is there agreement upon the viability, in the British system, of a non-mandatory monetary base control system. It is argued that the present cash ratio requirement - the requirement on the clearing banks to keep assets averaging $1\frac{1}{2}$ per cent of eligible liabilities as cash and non-interest bearing balances at the Bank of England - prevents us from discovering what cash the banks would hold for their own operational and prudential purposes - which would be relevant to the operation of a non-mandatory monetary base control system - and that, in order to find out how a non-mandatory monetary base control system might work, the cash ratio requirement should be abolished.

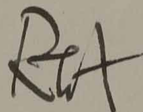
15. As the paper says, this would abolish the present source of the Bank of England's income, and it would be necessary to find an alternative source. The Bank of England can be expected to oppose this strenuously. They will be very reluctant indeed to contemplate any system whereby their income and therefore their expenditure are in some sense at the discretion of the Treasury.

16. I am not convinced that this has to be a problem at this stage. The reason why the existing cash ratio requirement conceals the size and variability of the banks' true demand for cash is that the requirement is an average: there is no obligation on the banks to reach a particular target balance on any one day; a degree of averaging is allowed; and the sharp rises in money market rates which have been evident recently in the days before make-up day suggest that the banks allow the ratio to run down in between make-up days. For the purposes of discovering the true demand by the banks for cash, it should be sufficient to make

the existing requirement invariable at all times, so that the banks would be required at all times without exception to keep a minimum $1\frac{1}{2}$ per cent in cash and would be penalised if they went below that figure. The amount by which their actual cash ratio exceeded the minimum would then become some measure of their true demand for cash; and we should not have put the Bank of England's source of income at risk.

Level of Interest Rates

17. If the meeting decides to go for the more flexible method of money market management proposed in these papers, you may also wish to think about the timing. It is implicit in the system that in future there will be no announcements about MLR. It may not be convenient to move straight into this system at the time of a November statement, if the Chancellor's hope and intention is to signal a reduction in interest rates as part of that statement. Thus we might need an MLR change at the time of the statement, and a switch to the new system from, say, 1st January 1981.



ROBERT ARMSTRONG

17th November, 1980

DEPARTMENT OF TRADE 1 VICTORIA STREET LONDON SW1H 0ET Telephone 01-215 7877

From the Secretary of State

FINANCIAL SECRETARY
REC. 17 NOV 1980
ACTION MR RILEY
COPIES TO SIR D WASS, MR BURNS, MR RYRIE, MR MIDDLETON, MR BRITTON, MR LA JELLE, MR PERETZ, MRS LOMAX, MR SHIELDS, PS/PM

CONFIDENTIAL

Nigel Lawson Esq MP
Financial Secretary
HM Treasury
Treasury Chambers
Parliament Street
London, SW1P 3HE

17 November 1980

Dear Nigel

RESTRICTED INDEXED GILTS (RIGS)

As requested in your letter of 6 November, I enclose a note by my officials which answers your specific enquiry about the impact of your proposal on life insurance business. It does seem to raise difficulties which if Geoffrey decides to go ahead as proposed we would have to study more deeply. I hope, at the same time, you will forgive me if I comment on the proposal in more general terms, since I oppose the principle of indexing gilts.

You and I have disagreed over several years on the value of indexation, of which this would be an extension. Who now would support the Rooker-Wise amendment; who now would support threshold agreements in the wages field; which country has gone down the indexation route and not spent years trying to disentangle itself from the consequences?

Your proposal would create, albeit on a small and experimental basis, an instrument which could either succeed or fail. If it fails then no lasting damage is done. If it succeeds, however, it will introduce, together with your extension of Granny Bonds, a form of competition for existing gilts. Yet there is nothing inherently wrong with the existing gilt arrangements. The Government successfully raises huge sums of money in this way, and over a period of years the national debt has declined substantially in real terms. The traditional market for gilts has provided a "cheap" means in real terms of raising funds for the Government. If RIGs succeed the market will look to further issues

From the Secretary of State

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of RIGs and/or Granny Bonds. This will make each new placing of gilts more difficult than the last and indeed more expensive.

This letter only goes to the Treasury - in case you decide to go for RIGs! If you do so, I shall support the experiment but we would have considerable problems in the technical area, on which you asked for my advice!

Yours ever
John.

JOHN NOTT

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Enclosure for a letter to the Financial Secretary to the Treasury

If it is decided to issue indexed stock there is a strong case for limiting the categories of eligible holders. Our conclusion is, however, that the criteria now proposed are unworkable as the life companies are organised at present. Whether the companies would be prepared to re-arrange their affairs to enable them to buy RIG's for their pension business can only be a matter of judgement. It seems improbable at present.

To be eligible insurance companies would have to undertake to hold RIG's against their pension liabilities only. The Department's advice is that this is not legally possible. Most life insurers do pensions and ordinary life business in the same company and do not set up separate subsidiaries for the two kinds of activity. They hold the assets for the whole of this business jointly and do not hypothecate them. The policyholders (pensioners and others) are legally entitled to a share of all the assets. It follows that such companies could not sign the declaration in the form of 7(1)(b)(i) of the prospectus.

The only way for insured pension funds to qualify for holding RIG's would be to establish separate pension subsidiaries. It is impossible to forecast with certainty what the reaction of the industry would be to this necessity. They are likely

to be strongly opposed. It would be administratively inconvenient to have the assets owned by separate companies and there would be very considerable legal as well as administrative difficulties in transferring existing pension business from mixed funds into separate pension subsidiaries. The approval of the Court would be required and it is not certain that in all cases it would be forthcoming since the security offered by a pension subsidiary might be significantly less than that of a major insurer. Reinsurance would however provide an alternative route for existing business.

If the companies for competitive or other reasons find RIG's particularly attractive they might be prepared to modify their structure. But they would be unlikely to do so unless they expected the attractions of RIG's as against normal gilt edged stock to be considerable. At a time of falling inflation this attitude seems improbable. They would try first to get ordinary life business to be eligible.

Even subsidiary companies limited to pension business might not be able to make the declaration exactly in the form proposed by Treasury. All the assets of a company have to be availble for example to meet a judgement debt and particularly in a winding up assets could not be hypothecated to the pension

business. It is possible that the Treasury could find a formula to get round this difficulty but probably not one which would appeal to the industry.

The life companies are likely to argue strongly that the declaration is a form of exchange control by the back door and very much contrary to the Government policy of liberalising the financial sector.

If the companies refuse to modify their structure the effect of the Treasury's proposal would be to limit the holding of RIG's almost exclusively to self administered pension funds. Mr Lawson's letter acknowledges the difficulty of this.

The Department of Trade's conclusion is that if there were to be restricted indexed stock the eligible holders would have to be self administered pension funds and companies authorised to do long term insurance business.

14 November 1980

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BANK OF ENGLAND
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SECRET

14 November 1980

The Rt Hon Margaret Thatcher MP
10 Downing Street
London SW1

My dear Prime Minister

I enclose two papers written in response to the remit given at your last seminar on possible improvements in funding methods and the practicalities of moving towards more flexibility in the determination of short-term interest rates. But it might be helpful if I set down some rather broader considerations on the question of monetary control. The experience of recent years, together with the consultations and discussions held this year on monetary base control, lead me to the following conclusions.

In view of the difficulties experienced in controlling £M3 it is natural to look for a different approach and to some form of monetary base control. As is now familiar ground, there are two possible forms of such control: one with a "mandatory" cash requirement, targeted in relation to another monetary aggregate; and one with "non-mandatory" cash holdings where only the base itself is targeted. A difficulty with either of these is that we have no experience of how they will work - whether there are any appropriate stable relationships and what they are. In either case, there would have to be a lengthy learning period. In the face of this difficulty - acknowledged I think by everybody - one is bound as a practical person to be sceptical about the virtues of declaring for either system wholeheartedly at this stage.

There is another consideration. It is very difficult to see that a system of monetary control under which short-term interest rates are increasingly generated by management of the base rather than by the discretion of the authorities could be compatible with membership of the EMS exchange rate regime. Yet it is to me

equally difficult to envisage that we can determine our policies on the basis that we shall continue to stand out from the EMS exchange rate regime for another two or three years.

Thus, while it may be sensible to ensure that such changes as we make in the methods and content of monetary policy are compatible with a gradual move towards some form of monetary base control, and while it may be worth deliberately developing our techniques in such a way that we derive useful information about how a monetary base control system might work, our immediate task is to improve our methods and techniques so as to help achieve the prime aims of government policy: a reduction in inflation and the resurgence of the market economy.

It is in this light that I would invite you to consider our two papers and my more general recommendations. The greater flexibility in short-term interest rates which we are putting forward for consideration could ease both the political and the technical tensions in our monetary operations. Moreover, the possibility of considerable fluctuation of short-term rates within an undisclosed band could encourage the banks to move towards more variable pricing for their lending, including their overdraft lending, which would also be helpful.

On the funding of government debt, important improvements are already in train, ie to tap the personal sector's surplus more directly and take some of the weight off the capital markets. Beyond that, we remain continually ready to explore and introduce further new instruments and improvements in technique. But we should be deceiving ourselves to believe that there are new techniques or instruments for selling marketable debt which would enable £M3 to be kept on track, whatever was happening to the economy and the other counterparts.

Another area in which we are eager to see progress is that of encouraging the corporate sector to move away from bank financing towards the capital markets. We have suggested a number of possibilities which are being examined in the Treasury and which I hope may prove fruitful.

Finally, I need hardly say that better control of the PSBR and a greater smoothness of its pattern through the year should greatly help to improve control of the money supply. I know that strenuous efforts are being made towards this end.

Yours sincerely

Gordon Richardson

SECRET

FUNDING TECHNIQUES

SUMMARY

1 The problem with existing funding techniques is not that they cannot produce massive and sustained finance for the Government over a period, but that they are vulnerable to short-term pauses caused by investor uncertainty.

2 Such pauses are often a symptom of the need for corrective policy action; and improved funding techniques cannot be seen as a substitute for such necessary policy action without imposing substantial damage on the capacity of the gilt-edged market in the longer term.

3 Against this background the aim is taken as being to establish techniques that will reduce the vulnerability to funding pauses and provide as much scope as possible for smoothing the path of £M3 in the shorter term.

4 Blanket techniques, such as auctions - whether or not they are underwritten - for achieving this aim would result in radical change to the present structure of the gilt-edged market, and of the capital market more generally; and the gilt-edged market that then emerged is likely to have a reduced capacity to provide finance for the Government over a period.

5 An alternative, piece-meal, approach might include a number of techniques, viz:

(a) diversification of the sources of government borrowing;

(b) a broader market in central government short-term debt;

(c) borrowing by nationalised industries in their own name for some modest part of their needs;

(d) aggressive use of partly-paid gilts;

(e) flexibility provided by unofficial tap stocks through NILO;

(f) flexible use of convertible stocks;

(g) use of Restricted Indexed Gilts (RIGS).

6 These techniques in combination can provide some protection against funding pauses, provided that confidence in overall policy is maintained.

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FUNDING TECHNIQUES

AIMS

1 The problem

(a) Capacity of the gilt-edged market over a period.

Over any period of more than about 6-8 weeks the existing techniques of gilt-edged market management have proved capable of achieving massive and sustained sales of stock to domestic non-bank investors, so financing a very large proportion of the PSBR, even at its level of recent years, in non-monetary form. Annual and quarterly figures for the PSBR and gilt-edged sales are shown in the attached charts. Chart II in particular shows that during the last 3 1/2 years for which figures are available, to mid-1980, net official gilt sales covered almost 90% of the PSBR of over £30 billion during the period, while gilt sales to the domestic non-bank private sector covered just over 75%.

The ability of existing techniques to raise adequate finance for the Government in the gilt-edged market over a period has not hitherto therefore been regarded as a problem. Indeed the more frequent criticism is that the authorities have relied too heavily on the gilt-edged market to fund the PSBR and that this has been an important factor in the exclusion of private sector borrowers from the capital market. Net official gilt sales have, for example, taken 91% of all net funds raised in the domestic long-term capital market during the past 3 1/2 years. Action is now being taken to correct this over-reliance on gilt-edged market funding through the shift of emphasis to National Savings instruments that will tap personal sector savings more effectively, and the first step will be taken with

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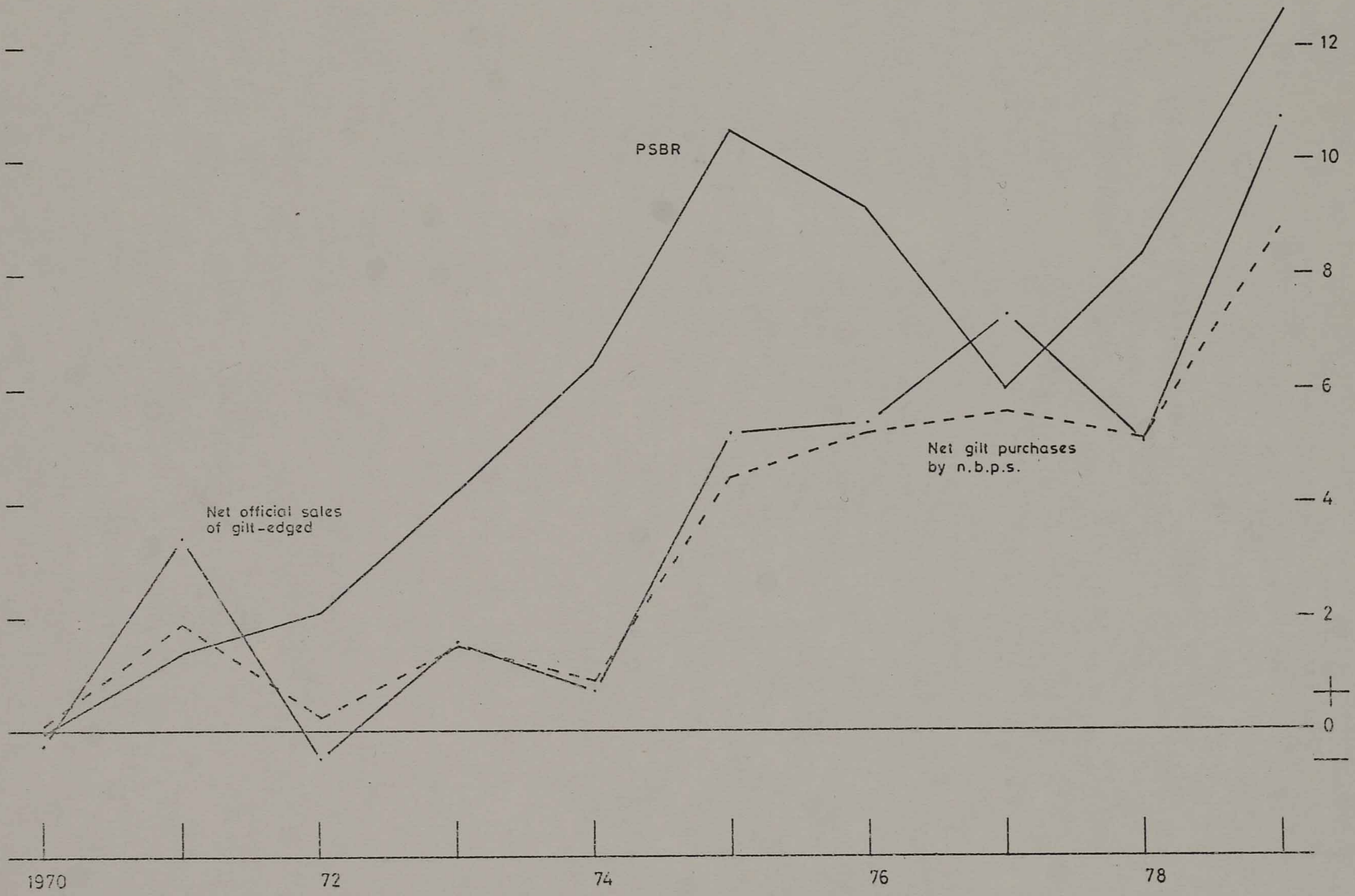
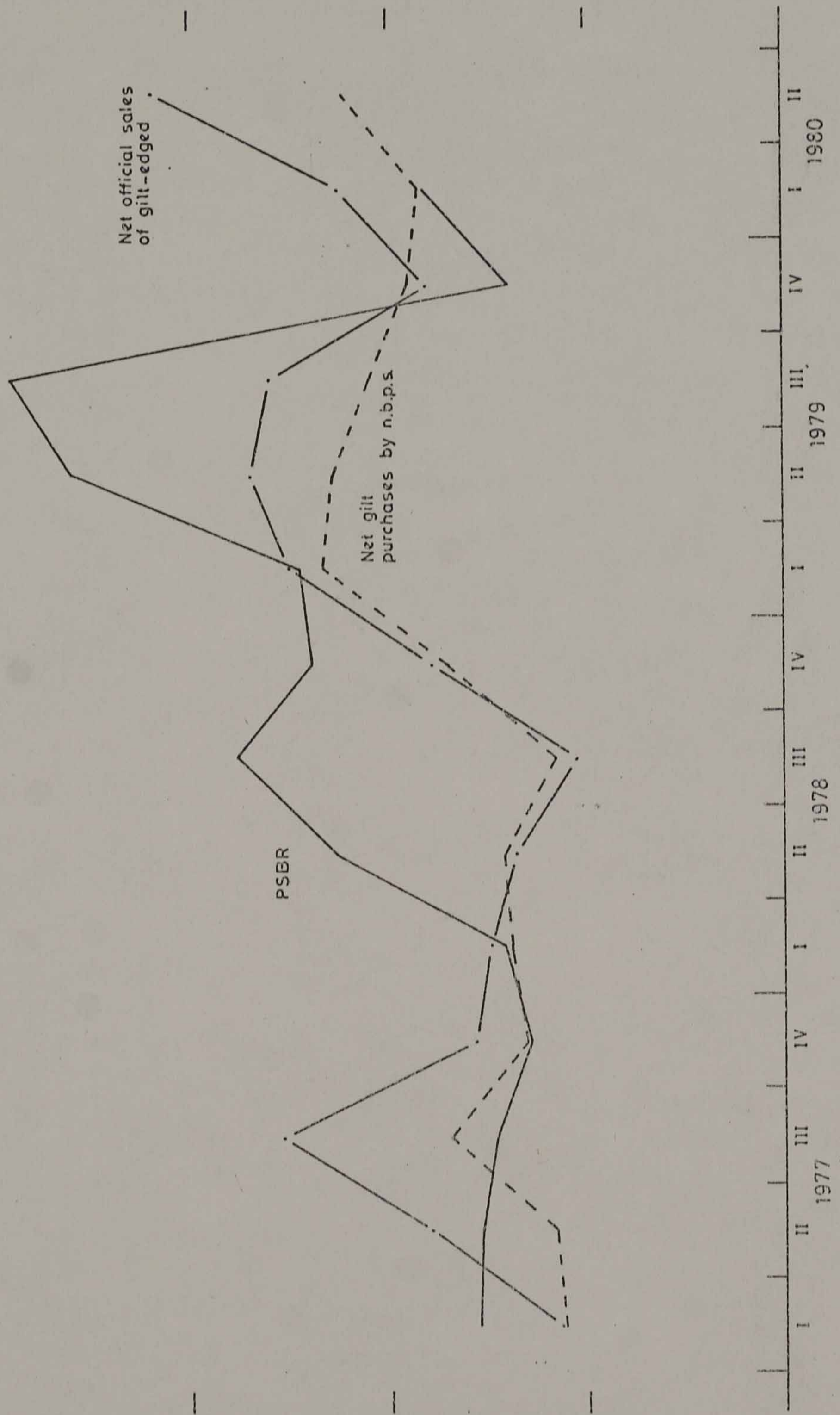
CHART I




Gilt sales and the PSBR (unadjusted)
- 2 quarter moving average
£ billions
4
3
2
1
Net official sales of gilt-edged
Net gilt purchases by n.b.p.s
PSBR
I
II
1977
III
IV
I
II
1978
III
IV
I
II
1979
III
IV
I
1980
II

the new issue of indexed savings bonds on 17 November; the proposed sale of BNOC bonds next year will work in the same direction. In addition, since August, new arrangements for setting the interest rate on Certificates of Tax Deposits are already enabling these instruments to compete more effectively for the liquid resources of companies - notably in present conditions oil companies.

Particularly if some more substantial part of the financing burden can be carried by other debt instruments in this way - and always assuming that the PSBR itself is reasonably controlled - there is no reason to suppose that existing gilt-edged market techniques will not continue to be able to raise adequate finance for the government over a period.

(b) Funding pauses.

The problem more usually identified is one of periodic pauses in the gilt-edged funding program which, even if they last for only a few weeks, can lead to an acceleration in £M3 growth which can in turn affect expectations, market interest rates and the exchange rate. In some instances monetary control can only be restored by a rise in MLR which can bring about a rise in gilt-edged yields to a point where the funding program can be resumed - a manoeuvre known journalistically as "The Duke of York".

This sequence of events has been much discussed but often in oversimplified terms.

It is frequently implied for example that the problem originates in the gilt-edged market, and so, it is concluded, it can be resolved in the gilt-edged market if only we had different techniques. In reality funding pauses do not develop out of thin air. (Still less do they arise from wilful ganging up by institutional investors as is often suggested by their characterisation as "buyers' strikes".) In general they are a symptom of investor uncertainty which in most instances stems from a sense - often justified by events - that policy is failing in some other area. The danger of the mistaken analysis which sees funding pauses as the cause of the problem is that it can, all too easily, suggest that different funding techniques would allow gilt sales to compensate for policy failures elsewhere, ie that if only the symptoms could be suppressed more effectively there would be no need to attend to the underlying disease, through corrective fiscal or interest rate action.

Similarly it is often implied that MLR is raised because it is the only way to restart the funding program, and that it is only raised for this purpose. Neither proposition is true. Depending on the circumstances it may take a fall rather than a rise in MLR to stimulate the gilt-edged market; or if the problem originates in an excessive PSBR, fiscal action alone may be the necessary response. Increases in MLR are invariably proposed on the basis of a much broader assessment that higher short-term interest rates are necessary to control the trend in the growth of the money

supply. It is of course true that a rise in MLR will often go to the cause of the uncertainty in the gilt-edged market (for example the MLR increases to 14%, and to 17%, last year were strongly influenced by the strength of private sector demand for bank credit, and in each case they took account of the accompanying fiscal action), and the Bank certainly always take into consideration the expected effect on the gilt-edged market - but on no occasion has an increase in MLR been proposed solely in order to allow the gilt-edged funding program to be resumed. It is therefore a considerable over-simplification to suggest that it is the funding pause, rather than the factors that prompted it, that has forced - or could force - a rise in MLR (and talk of the Duke of York or of cutting the price of all drinks to sell more coffee, is equally a caricature of the real position). The unspoken suggestion here too is sometimes that, with different gilt-edged funding techniques, policy action which is necessary on wider grounds can somehow be avoided. Quite clearly, in the Bank's view, if the attempt were made to use the gilt-edged market in this way - whatever the techniques that were used - the capacity of the market to continue to provide finance for the Government in the longer term would be put seriously at risk.

None of this is to suggest that a problem cannot originate in the gilt-edged market; clearly there can be occasions on which market concerns prove to be unjustified or exaggerated - though in practice the resulting pauses tend to be less severe and are generally short-lived. Nevertheless - given the central role of the gilt-edged market - we accept the importance of finding

techniques that will help to avoid pauses of this nature. But it is crucially important that what can and what cannot reasonably be expected of such techniques should be understood and agreed so that the potential costs and benefits of possible changes can be properly assessed.

2 The objective

Against this background there are two possible objectives that might be sought through different funding techniques:

(i) First, we might aim to achieve whatever volume of gilt-edged sales the forecasts suggested was necessary to offset the movements in the other counterparts of £M3 in any given banking month in the hope of achieving more stable short-term monetary growth; and

(ii) Secondly we might aim for techniques that could be relied upon more confidently to produce a regular volume of funding month by month, related to the expected gilt-edged funding need over a longer period, say, of 6 months or a year.

Both these approaches would be designed to avoid funding pauses in the context discussed above, and both could be described as "selling debt according to need" in line with the mandate given at the Prime Minister's last seminar.

The first approach is much the more ambitious: but, quite apart from the question of the operational techniques for achieving the given volume of gilt sales, the present short-term forecasts are nowhere near sufficiently reliable to be used to set a gilts target that could be used successfully for the kind of close, short-run monetary control envisaged. (As noted in the Treasury's recent paper, the short-term forecasts for the CGBR are accurate

only to within ± £500 mn. one month ahead and ± £750 mn. three months ahead; and uncertainty of this kind of order can persist until very late in the actual month in question.) Moreover, even if an adequate target could be set for total gilt sales, there is no technique that can possibly control the gilt-purchases of domestic non-bank private sector investors in isolation. While therefore this approach might be a desirable ideal, it is not likely to be practicable to aim more precisely than to sell rather more or rather less gilts in particular months, when we know of some particular major special factor in the opposite direction affecting the other £M3 counterparts. (If a substantially smoother PSBR profile could be achieved the position may be different; but we would need to see this in practice before we could assess what was likely to be possible.)

The second approach has the more modest aim of at least avoiding periods of famine in the gilt-edged market but not seeking to fine-tune gilt sales or therefore to smooth, month by month, the growth of £M3. Essentially it would be designed to limit the risk to £M3 of a major funding pause.

It is assumed in the remainder of this paper that it is this latter aim which is regarded as the more important; but that, beyond this, Ministers would want us to do what we could, given the unavoidable limitations of the forecasts, to smooth the path of £M3 - quarter by quarter if not month by month. These are indeed the objectives we currently pursue.

SECRET

TECHNIQUES

3 Auctions

The apparently obvious technique for guaranteeing regular, month by month, gilt sales in some sizeable minimum amount, but which would be capable of some degree of variation in the short run, is the auction - where we would simply announce to the market at regular intervals the quantities we wished to sell at which maturities, leaving the market to determine the terms on which the stock was taken up.

As a general approach this would add directly to the short-run price volatility of the market - since it would be the deliberate intention to secure sales irrespective of the state of market demand. It would mean too that virtually all official sales would be made directly by the Bank to final investors through the primary market; the secondary market dealings associated with tap stocks would be reduced, and this would add further to price volatility while at the same time the reduced turnover in the secondary market would have a major adverse impact on the profitability of the jobbers that now make the market. In these circumstances, with the risks increased and the rewards reduced, the gilt-edged jobbing system is unlikely in the Bank's considered judgment to survive in its present form.

The wider implications of this development are considered further below. In relation to the gilt-edged market the Government would need to consider how the transition could be managed without severe disturbance to the flow of finance; and it would

need to consider what kind of market mechanism might ultimately emerge. The risks are that gilt-edged would become a less readily marketable and more expensive form of borrowing, and that the capacity of the market over the longer term - especially for long-dated stocks - would be substantially reduced.

The changes in market structure that would result from an auction system for the marketing of gilt-edged would be likely to include: the dispersion of dealings in gilt-edged and in other securities outside the central market made on the Stock Exchange; and the end within the Stock Exchange of the separation of the market-making function provided by jobbers from the function of brokers. Both developments would require a reconstruction of the present arrangements for the supervision of the securities market.

The present central market is governed by the Stock Exchange Council and the Stock Exchange is a member of the CSI. The Council's writ over dealers in securities does not run outside the Stock Exchange and it would therefore have no authority to supervise such non-member market-makers as might come into existence. Unless it were envisaged that such market-makers should be allowed initially to operate with no more supervision and regulation than is provided either by existing statutes or by virtue of their membership, if any, of existing trade associations (which have little or no direct experience of regulating dealing in securities) a new set of arrangements would have to be devised beforehand. Establishing the nature and scope of these arrangements (allocation of responsibilities for drawing them up, their statutory or non-statutory form, identification of those to whom they should apply and consultation on and drafting of rules, securing co-operation and reference to the OFT) would clearly require much thought and a considerable period of planning.

Similarly, substantial change would be required within the Stock Exchange. The Council's existing arrangements for the regulation of dealings and the protection of investors rest heavily on the separation of capacity between jobbers and brokers. It would not be sufficient for the Stock Exchange only to amend its existing rules to take account of the end of this separation, which in itself would be a complex task. New rules would have to be thought out and drafted and this process would need to be closely co-ordinated with the study outlined in the preceding paragraph.

4 Underwriting

To moderate the effects of auctions on price volatility in the gilt-edged market, some commentators - including the Wilson Committee - have suggested that the auctions might be underwritten by the major institutional investors. Commercial underwriting can clearly provide an occasional borrower with the finance he needs at an assured price close to the market price. It does not follow at all that it could provide the same service for HMG's continuous funding program. It would need to be considered, for example, why the institutions - left to themselves - should in this case accept underwriting at a higher price than they would bid in a straight auction. If they were not prepared to do so, underwriting may not make much practical difference to the degree of price volatility associated with auctions. And whether or not the auctions were underwritten, the effect on secondary market dealing would be the same. Thus essentially the same questions about market structure would arise. Underwriting would, in addition, provide a constant temptation to the Government to seek to influence the decisions of the institutions, which could rapidly displace the present free market.

5 A piece-meal approach

Short of such a general approach of this kind there are a number of techniques which might be used and developed to help to achieve the objective defined earlier with less disturbance to existing market arrangements.

(i) Vulnerability to funding pauses in the gilt-edged market should be substantially reduced by the diversification of the sources of government funding mentioned earlier (National Savings, CTD's) provided these are now kept competitive. In particular personal savers and to some extent commercial companies, are likely to take more diverse views of actual and prospective financial developments, than institutional investors - who all being subject to the same influences and with the same objectives often behave in a herd-like way. This should make for a steadier flow of funding.

(ii) A further possibility would be the creation of a broader market in marketable central government short-term debt with a maturity initially of up to one year but perhaps extending eventually to 3 or 4 years. This possibility has been considered frequently in the past, but rejected because no clear non-bank market could be identified: persons, companies and institutions all hold the vast bulk of their liquidity in capital-certain, immediately encashable, deposits with banks or building societies, holding only minimal amounts of CD's for example.

Nevertheless, and especially in the context of the steps considered in the companion paper on greater money market flexibility, it may nevertheless be appropriate to seek to develop a non-bank market for this kind of instrument. It could also provide the opportunity to experiment with auctions at the boundary between the money and capital markets without the wider implications for the capital market structure that a general move to auctions in relation to gilt-edged would have.

Any move in this direction would be bound to take time before it could make a significant contribution to monetary control. Initially such bonds might be taken up largely by the banking system, and this may be necessary to the development of an effective market. And we will need to look closely at the implications for the maturity of the debt. We already have for example an annual average of over £4 bn. of gilt maturities during the next five years.

This possibility is being further explored.

(iii) Borrowing by nationalised industries in their own name
Discussions are being held with the nationalised industries to examine their request to be allowed to borrow in capital markets in their own names. If the question of cost can be satisfactorily resolved, this might allow some modest part of the PSBR to be funded outside the Bank's operations as is the case with local authority borrowing through techniques such as placings, outside underwriting, or, if they wished, through auctions, without this calling into question the structure of the gilt-edged market as a whole. This could provide a further modest element of more regular funding.

(iv) Aggressive use of the partly-paid gilt technique. This was already used vigorously during the spring and early summer of this year - as on earlier occasions - to tie up future funding for up to three months ahead. It meant that we were able to ride out almost without noticing it, the very pronounced funding pause which resulted from the shock of the July and August £M3 figures. Although virtually no new net official sales were made between 24 July and 3 September the take-up of gilts by domestic non-banks in banking August, September and October was £960 mn., £890 mn. and £680 mn. respectively, - in each case well above the average monthly amount expected to be needed for the year as a whole. We would hope to be able to use this technique again for example when the PSBR falls back later in the current financial year.

(v) Unofficial tap stocks from the National Investment and Loans Office. Discussions have been in progress for some time to give some additional flexibility to the Bank's gilt-edged market management by enabling the Bank to acquire stock more easily from the NILO which can then be sold into the market without publicity and without the price sensitivity that applies in the case of normal tap sales. This flexibility would be especially useful during periods when the market was seeking to establish a new yield basis below an established tap price; and between the exhaustion of one tap and the announcement of another. It could allow sales of, say, up to £400-500 mn. on technical rallies in a generally unsettled market (as it has during the past week).

(vi) Convertible stocks. These stocks attach to a conventional short-dated issue an option to convert, on one or a series of future dates, into a longer maturity at something close to the current long yield. They can, in principle, be used quite flexibly in a number of different situations. The option might for example be made available on generous terms but only if the stock was purchased within a specified period as a means of giving impetus to the funding program. Or the terms for the option might be made more aggressive if we wished to encourage a downward movement in long yields and the surrounding circumstances meant that such a movement would carry conviction with the market. We have in fact considered this possibility on a number of recent occasions but have not actually implemented it because of the uncertainty about the future size of the PSBR.

(vii) Restricted Indexed Gilts. Although a number of points remain to be settled, we now have a prospectus in an advanced state of readiness for an issue of indexed gilts with eligible holders restricted to pension funds and the pension fund business of life companies. The ability to sell such stock, if it were acceptable to the Government taking account of wider considerations, would be useful at times when market expectations were for an increase in inflation, and could then have the effect - as a result of switching and because of the effect on expectations - of pushing up the yield on conventional stocks to a point where they again became attractive. It would of course be important - on wider grounds - - that an initial issue should be made at a time when the Government was seen to be acting from strength rather than weakness, ie when the prospect for inflation, the money supply, and conventional funding, was reasonably bright; once successfully introduced, however, the instrument might then be used to support the funding program if it ran into difficulties. It needs to be recognised however that there would be a risk, if the RIG's proved attractive, that the institutions would stay out of the conventional market forcing pauses that might not otherwise occur.

These various possible techniques, used in combination, provide reasonable grounds for hoping that the risk of pauses in the gilt-edged funding program can be reduced, provided confidence in overall policy is being maintained. Without that we doubt whether there is any technique that could achieve the stated objective without major damage to the capacity of the gilt-edged market in the longer term.

SECRET

INCREASING THE FLEXIBILITY OF OFFICIAL OPERATIONS IN MONEY MARKETS

The Bank have prepared a technical paper (attached) describing the possibilities for introducing more flexible official operations in the money markets. This note is in part a summary, but its main purpose is to illustrate the steps that would be necessarily involved in taking this approach.

Feasibility

It would be possible to move cautiously from a system where the authorities maintain an adjustable peg for short-term interest rates, by setting MLR, to a system in which they floated much more freely. But inevitably the direction and momentum of any such float would be quite largely determined by the readiness with which we provided the system with cash, whether by open market operations or through the 'discount window'. So the system would be a 'dirty' rather than a 'clean' float, unless or until the discretionary element in official operations could be reduced or removed.

Market Involvement

Despite the disappearance of MLR itself, markets would continue to look for clues to the authorities' intentions, and the movement of very short-term interest rates would still be seen as largely the consequence of official actions. But there might develop more room than now for the rates for longer-term money, three months and over, to reflect market judgments about the level of rates needed to secure official objectives.

Institutional Change

Were we to embark on official operations in the inter-bank market, the size and central position of the big four clearing banks would be likely to involve us in daily negotiations between us and them. This would run quite contrary to the aim of allowing a free and open market more say in the determination of rates. It is largely in pursuit of that

aim that the Bank sees a need for the retention of market intermediaries, notably the discount houses.

This has several consequences. First, it implies that the Bank's open market operations should continue to be conducted in bills, including both Treasury and Commercial Bills, rather than in the inter-bank market. Second, it suggests that it would be wise to go on confining access to the discount window to the discount houses, albeit at a floating and "penal" rate. Third, the Bill markets would be required to adapt efficiently to new conditions in which the Bank operated at much more flexible rates. This adaptation would take time and care.

Operations

If the system sketched above were adopted, whether in practice as a transition to monetary base control or not, the important policy question would be how to set the guidelines for operating it. There must, of course, be a strong presumption that any persistent deviation of the money supply from its targeted path would require us to operate so as to encourage interest rates to move in the appropriate direction; and a key question for decision would be how quick and how large such moves should be, and whether any surrounding circumstances (other than the money supply) should be taken into account. We would also need to decide the upper and lower limits (if any) needed to prevent an excessive change in interest rates. There would be a strong case for not announcing such limits, partly to keep banks uncertain of the future cost of their money and partly to avoid, de facto, reintroducing a peg.

Supply Side Controls

It is often said that a "supply side" constraint on banks' cash would have an effect different in kind from a change in interest rates as such. But in a fully competitive system, which ours is, any single bank will always reckon to be able to attract extra reserves by bidding for them in the market. Thus a limitation on the quantity of cash would impinge on an individual bank in the form of a change in the price of cash rather than of some outright shortage or famine.

But the expected future price of cash can be made more variable and less predictable. Greater flexibility of official operation in the money market could help achieve this. This would in turn cause some changes in banking behaviour. There would be some helpful readjustment of the overdraft system. But in our view, based on lengthy consultation, such changes in behaviour would not be far-reaching in their helpful effects.

Cash Ratio

If it were to be decided to move towards a non-mandatory base control, the prior introduction of a more flexible interest rate system with a managed float would represent a necessary and coherent first step. There would then follow a long period of transition. In the light of experience the guideline for the float might gradually be changed so as to concentrate upon a target for the base itself. Likewise, the limits on interest rate movements could be steadily widened if that were found in practice to be desirable.

A mandatory base control relates the base by some required ratio to an aggregate money supply; and the purpose of having such a base would be to enable the authorities to respond to deviations of the money supply from target with a sizeable and automatic adjustment in interest rates.

We could operate a more flexible system with our present cash base or with one of the same kind spread more evenly between the banks. This would imply a very low ratio but there might still be some difficulties in learning sufficiently about the behaviour of a fully non-mandatory base.

We see no advantages in maintaining the present Reserve Asset Ratio and advocate its abandonment as soon as discussions with the banks, regarding the prudential need for liquidity, are complete.

Bank of England
14 November 1980

SECRET

INCREASING THE FLEXIBILITY OF OFFICIAL OPERATIONS IN MONEY MARKETS

A Introduction

1 At the seminar with the Prime Minister on 13 October, the Bank were asked to explore ways in which their present discount window operations[1] could be modified, and the Reserve Asset Ratio replaced, so as to permit a greater flexibility in short-term interest rates which was generated as far as possible by market forces.

2 This paper first outlines the main features of the present system (Section B). The changes that would be necessary, together with the implications of particular options, are the subject of Section C. There follows, in Sections D and E, consideration of how far the changes might:

(a) affect the rôle of the authorities in influencing interest rates; and the motivation of their operations;

(b) alter banks' behaviour in ways helpful to monetary control;

(c) facilitate evolution towards a form of monetary base control.

3 Because it is generally agreed that the Reserve Asset Ratio (RAR) should be abolished, the analysis which follows assumes only the existence of some prudential guidelines regarding banking liquidity. The nature of these prudential guidelines is not explored in this paper. Following the outcome of the present review of monetary control, discussions within the banks about the consultation document on banking liquidity, issued last March, will need to be brought to completion.

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(1) The phrase "discount window operations" is used in this note to describe the sort of facilities currently offered by the Bank to the discount houses at 2.30 pm each day; these generally involve the Bank in supplying funds on request, at MLR. They are to be distinguished from loans to institutions in financial difficulties, which are genuinely last resort loans, and also from assistance which is applicable only under the present Reserve Asset system and involves the Bank in swapping reserve for non-reserve assets to limit upward pressure on short-term interest rates.

B The present system

4 The present system can be likened to an exchange rate regime of the "adjustable peg" variety. MLR is fixed by the authorities; certain key interest rates may diverge from it but in response to sustained pressure the Bank has the choice of intervening to validate the level of MLR (the peg) or of adjusting it. Continuing the analogy, the changes being sought would amount initially to a form of "dirty" floating in the money markets: dirty rather than free because, as is explained later, official operations would have to continue being both active and discretionary rather than automatic.

(a) Minimum Lending Rate

5 MLR is the rate at which the discount market expect to be able to borrow from the Bank at 2.30 pm under the discount window provisions. When these facilities are used, the Bank usually lends overnight but on occasion offers funds only for seven days.

6 The effect of such lending is to inject cash into the system; and the fact that the discount houses can obtain funds at MLR provides some anchor for short-term rates generally. But, as recent experience has emphasised, it is quite possible for overnight rates in the interbank market to go some way above MLR before 2.30 and far above MLR later in the day. The present system does not, therefore, invariably protect the banks against the risks of volatile rates at the very short end of the market.

7 The influence of MLR is most powerful in the setting of very short-term rates by the market but it also affects slightly longer rates. This is because operators take the level of MLR and the associated tactics used by the authorities as saying something about official intentions for the future. For example, whenever MLR is raised three-month rates tend to reflect the new level fully, because the market have come to expect that a rise in MLR is unlikely to be followed by a fall in less than, say, 8-12 weeks.

8 Clearly the determination of short-term interest rates could be significantly different if MLR could be made to "disappear". But it is also clear that, deprived of one source of information about official desires and expectations, money market operators would look for another, and would expect to find it in the conduct of our open-market operations.

(b) Open market operations and the cash ratio

9 Two features in the present system complement discount window operations. The first is the cash ratio of 1½% Eligible Liabilities (ELs) which applies only to the London clearers. In the language of the MBC discussions, this is a form of cash requirement based on lagged accounting. There is no absolute obligation on the banks to reach a particular target balance at the Bank on any one day. A degree of averaging is allowed.

10 The second feature is the conduct of open market operations. Changes in the banks' cash will depend in the first instance on net flows between them and the Bank arising mainly from the transactions of the Exchequer and from movements in the note circulation. The Bank normally seeks to offset such flows, wholly or in part, through open market operations. These are usually conducted in Treasury, Local Authority, and Prime Commercial Bills (the Bank offering to deal at existing market rates rather than to move them up or down). The principal counterparties to the official operations are the discount houses, although Treasury and Local Authority Bills are also traded directly with the banks. It is by declining to buy paper to the full extent of the shortage of bankers' cash, and thereby causing the banks to withdraw call money from the discount houses, that the Bank can ensure that the discount window will be used. This provides the opportunity to exercise a desired influence on interest rates and is known in the literature as "making Bank Rate (MLR) effective". The discount window may however also be used if the market prefers, on a commercial judgment, to borrow at MLR rather than offer enough paper to the Bank.

11 It is normal official practice to engineer an initial position of moderate cash shortage week by week. This may be done if necessary by increasing the quantity of Bills offered at the weekly tender and relying on the obligation undertaken by the discount houses to bid for the whole amount.

C Options for Change

12 One change has already been assumed, namely the disappearance of the Reserve Asset Ratio. This Ratio did not feature in the above description of the present system because it is neither necessary nor efficient as an instrument for the control of short-term interest rates. It has however affected the operation of the money market and its disappearance would affect the environment in which open market operations are conducted.

13 The outcome will depend significantly upon the final form of the prudential guidelines on banking liquidity. But the most important effect now foreseen will be to release the banks from the obligation to hold a minimum quantity of, for example, Treasury Bills and call money. Hitherto the effect of the RAR has been to keep yields on reserve assets stable and relatively rather low even when pressures on other rates are strongly upwards. With the abolition of the RAR, banks would be much freer to reduce their holdings of call money and Bills at times of stringency. The differential with, for instance, comparable inter-bank rates would accordingly be more stable; and it would need to narrow considerably if call money and Bills were to continue to be held by the banks on the present scale. Such a narrowing of the differential might come about relatively easily in the Treasury Bill market but how in the new circumstances holdings of call money with the discount market - which in recent experience has provided a higher yield than Treasury Bills - would be adjusted is more problematic. The ability of the discount houses to accommodate periodic large fluctuations in the volume of call money would depend on the general level of the banks' holdings, the relationship between the call money rate and the yields on other money market assets, the degree of volatility in those yields, and the nature and terms of their access to the discount window at the Bank. These matters are discussed further in paras.16-27 below.

14 Apart from the abolition of the RAR, the options for change concern

(i) the form of the cash ratio,
(ii) the nature and operation of discount window facilities, and
(iii) the structure and conduct of open market operations.

15 The question of the cash ratio is closely related to the form(s) of monetary control system that it is desired to adopt or to make available for ultimate adoption. If a non-mandatory form of monetary base control is to be made available, it will be necessary to operate for a considerable period with no cash holding obligation whatsoever for the banks, in order to learn what their purely functional demand for balances is. Mandatory forms of base control would require the cash holding obligation to be related as closely as possible to the monetary aggregate (if it were other than the base itself) in terms of which the targets were to be set. It is well established that, because of the scope for disintermediation, no workable relationship can be found with broader monetary aggregates such as £M3. If any narrow aggregate other than M1 is to be considered, it would be necessary first to discover the characteristics of the aggregate, and unwise to construct a cash ratio related to it until they had been found to be suitable. If all that is required is - as hitherto - a fulcrum against which to operate a policy based on an intermediate interest rate target, the choice is wide. A fulcrum would exist with no obligatory cash balances at all, provided the penalty for being overdrawn was sufficiently deterrent; but if a requirement were to be retained, for other reasons, its form should reflect considerations of equity between banks and the need to avoid generating widespread disintermediation as a means of escape from it. Further consideration is being given to these questions in the light of very recent discussions between the Chancellor and the Governor.

16 Greater flexibility through open market operations and discount window facilities. Discussion of the discount window may be considered first. In the present system MLR serves as an anchor for short-term interest rates because market operators have a presumption that cash will be made available at that rate. The necessary condition for initiating greater flexibility in rates is to remove that presumption. It could be done in a variety of ways. It might, for example, involve -

R. A. → P.
Guidelines?

(a) no more than the exercise of the discretion which the Bank already has in principle to lend at rates above the posted MLR - while otherwise retaining the present arrangements; or

(b) the complete abolition of MLR, with lending through the discount window provided only at rates varying from day to day and designed to be penal in relation to those earlier established in the market.

On technical grounds, the one option that is not available in a system retaining either obligatory bankers' cash balances or normal voluntary holdings thereof is the abolition of discount window facilities. But a combination of unattractive discount terms and active open market operations could minimise their use and eliminate their abuse.

17 If option (a) above were adopted, it would remain evident that the authorities rather than the markets were dominating the setting of rates. If we attempted to create uncertainty about the rate at which the discount window would operate, the market would act to remove the uncertainty by testing the rate. If the authorities behaved consistently in setting the rate, that would in effect set a new level of, or a new formula for calculating, MLR. If, on the other hand, the choice of rate were deliberately capricious, markets would simply become confused, so that the setting of interest rates became a haphazard process.

18 If instead option (b) above were adopted, and if MLR were actually abolished, this would shift onto the conduct of open market operations both the expression of official influence on interest rates and the attempts of the market to discern what the official intentions were. This may best be illustrated by comparing how in such circumstances open market operations might be undertaken, first when the existing level of rates was regarded as satisfactory, and secondly when some upward movement was regarded as necessary.

19 In the first case (maintaining an existing level of rates), the object would be to maintain the level of bankers' cash consistent with prevailing interest levels. If the market and the Bank took the same view of the likely cash movements in the day, the Bank could readily buy

sufficient paper at prevailing rates to achieve the desired level of cash. This could be effected, as now, by the authorities inviting offers of paper at existing market rates and accepting what was offered. It could also, in principle, be achieved by the authorities making known the quantity of paper they were prepared to buy, and accepting the most favourable offers. The latter approach, which would require some development of our dealing techniques, would detach the authorities to some extent from appearing to set rates and, for that reason, would be preferable. But there would remain a need to take decisions involving at least implicit judgments about the level and prospective future developments of interest rates. In deciding which offers to accept, the Bank would have to choose between different maturities of paper, each probably offered at a different rate. The decisions reached would be eagerly studied by a market looking for indicators of official thinking.

20 In the second case, when some upward movement in rates was desired, the object would be to leave banks with less cash than they wanted at ruling interest rates. The market would then find themselves trying to sell more paper than the authorities were offering to buy and interest rates would tend to rise. Anyone unsuccessful in obtaining cash for his paper would then have to bid for it within the market, failing which he would have to take his chance at the discount window.

22 A vital assumption underlying the above description of a new style of open market operations was that the market's perception of the position on the day accorded with the official estimates. In the present system official estimates are frequently revised heavily during the day and still prove wrong in the event. Equally often, money gets 'stuck' somewhere within the banking system and its availability is unknown to the money markets. More resources could be devoted to improving information systems, but unpredicted influences on banks' cash would probably continue to be large in relation to the tolerance levels within which the new style of open market operations would be seeking to exert its influence. This means that the new technique would be a less precise means of bringing about a new level of

market interest rates than that of simply varying MLR. It also means that there would be some risk of market forces, under the influence of erratic shocks, producing needless gyrations in short-term interest rates. This risk could be met either by use of an unpublished ceiling rate at which the discount window operated freely, or by ceiling (and floor) rates at which open market operations were undertaken freely.

22 Some economists, commenting upon the corresponding practical problem envisaged with MBC systems, argue that variability in very short-term interest rates does not really matter, because over time markets learn how to distinguish genuine underlying influences on rates from the effects of random shocks. It does matter, however, if rate variability impairs the operations of short-term markets and makes it harder to conduct official open-market operations of the necessary size. Whether markets would be impaired in practice is difficult to judge; it would depend on how the system operated and what institutional developments there were. It is, for example, likely that we would have to give up the practice of engineering recurrent shortages of cash by "over-issuing" Treasury Bills through the weekly tender. If so, it would be important that the market was functioning well enough to permit us to withdraw cash at once by selling Treasury Bills, because the market's starting position would be one of underlying cash surplus much more frequently than it is now.

23 The health of the money market in its present, or a new, form is of major importance if we are to have the scope for sufficient official open market operations in the existing Bill instruments. It was indicated in paragraph 13 that the disappearance of the Reserve Asset Ratio would pose significant problems of adjustment for the discount houses. It is highly doubtful whether they would at the same time be able to withstand the additional load of being the vehicle through which an erratic variability in market interest rates was generated on a pronounced scale. If, in response to

such pressures they were to become only brokers in bills rather than dealers and market-makers, it would become a good deal less certain than now that official operations could be undertaken on the scale necessary to permit the desired management of banks' cash balances. Much greater weight might then have to fall on discount window lending, probably to banks directly.

24 If nonetheless the changes in fact encouraged the growth of an active market in Treasury Bills, including both banks and non-banks, the future role of the discount houses would be relatively less important. It was suggested in paragraph 13 that the banks might continue to have large - though compressible - holdings of Treasury Bills provided the supply was maintained at a sufficiently high level to preserve a reasonably attractive yield. It is questionable, however, how ample a supply could be maintained if Treasury Bill operations are to remain the residual means of financing the public sector, with the main emphasis placed, for reasons of control over £M3, on sales of debt to non-banks. Further, the only possible way we can see of persuading non-banks to prefer Treasury Bills in large amounts to CDs or bank deposits would be to engineer a steep increase in the supply. But in those circumstances, the banks would have a powerful incentive to intermediate by increasing deposits so as to hold more Bills, and the more likely outcome of an attempt to encourage non-bank holdings of Bills by this route would be to raise £M3.

25 It would accordingly be unwise to rely completely on Treasury Bills as the instrument for official open-market operations. Some form of private sector paper would therefore be needed as well. At the moment commercial bills are used. They have the desirable quality of being the most secure form of private sector paper - which explains their historic place in central banking operations. But their availability, in quantity, depends on the existence of market intermediaries to gather them together, a function currently performed by the discount houses.

26 If there were no ready market in prime commercial bills, the remaining vehicle for open market operations would be deposits with banks, either by our dealing in CDs or by our making straight deposits in the interbank market. There is no doubt that adjustments involving large sums could be undertaken by those means. But they would have two great disadvantages. There is first the presentational problem, already encountered with the existing gilt repurchase transactions, of supplying official funds directly to banks at times when their lending may appear to be contributing to difficulties in achieving the official monetary target. The second and more substantive disadvantage arises from the dominance in the inter-bank market of the operations of the clearing banks. Official provision, when necessary, of large amounts of cash would automatically coincide with large shortages to be met by three or four massive counterparties. Any structure of market rates that resulted would be inevitably the product of bilateral haggling, and would reflect the degree of official hard-headedness rather than a free market process of rate-determination. Development of that process therefore requires the retention of intermediary market-makers between the giant principals on either side.

27 All this leads to the conclusion that in starting down the road towards greater responsiveness of interest rates to free market forces, we should be careful to nurture rather than undermine the market mechanisms through which we can operate and through which the resulting market pressures can influence interest rate developments. That would imply retaining - but perhaps progressively widening - intervention points in open market operations, and a discount window safety valve which would continue to be available to the market intermediaries. The pace at which our intervention points might be widened would depend on how successfully market rates floated freely within them, rather than bouncing around in a random way between floor and ceiling.

D The exercise of judgment

28 Whatever the exact form of these suggested new arrangements, the judgments exercised by the authorities in running it would, at least for some time, continue to exercise a critical degree of influence over at least part of the interest rate spectrum. For the authorities' actions would be the dominant determinant of the supply of cash, and the implicit 'lending rate' set by these operations - while it might be less easily visible than the present published MLR and could certainly be operated as a rapidly moving range rather than as a set figure as at present - would be established by the market from the price at which we conducted business.

29 There might nonetheless be greater scope for independent market forces than at present in the determination of somewhat longer (say three-month) rates. Much as now, these forces could always be expected to do part of the authorities' work, in that all rates would tend to rise as soon as the market guessed that the authorities were dissatisfied or would have to become dissatisfied with the prevailing conditions. However, the longer-term effects on market expectations of a posted MLR would no longer exist and, while the market would undoubtedly look for substitute indicators, it might be possible to avoid providing a consistently reliable substitute.

30 In practice, of course, the way in which the system was operated would be heavily influenced by the wider policy aims being sought; and it would be important to be clear what the intermediate objectives of monetary policy are at any point in time. Currently, the guidelines for operating the suggested arrangements would be set primarily with regard to the achievement of annual targets for £M3. But it would be open to the authorities, in the constant adaptation of their tactics, to consider a wider range of economic and financial indicators and to change the balance of particular factors over time.

E The significance of the changes

31 The conclusions of Section D are that the changes outlined in C might permit:

(a) some extension of the influence of independent and free market forces in the setting of short-term interest rates;

(b) the creation of a veil over the authorities' dominant influence on very short-term money rates and the reasons for changes in the day-to-day conduct of policy.

Such development might well have presentational and psychological advantages. While moreover they would seem to do little of themselves to increase the sensitivity of £M3 to changes in interest rates they might make it somewhat easier to establish the level of rates which would produce the desired growth of £M3 over an appropriate time horizon.

32 It has been suggested that the adoption of a much more flexible system would cause the banks to modify the relative importance which currently they attach to their lending as opposed to their borrowing operations, such that a worth while restraint on the availability of credit could be obtained during a restrictive phase of policy. But it remains our view, in the light of all the consultations following the Green Paper, that such restraint would be unlikely and that banks individually would continue to respond to persistent stringency by bidding for additional resources in the money market.

33 It is, however, likely that greater volatility in very short-term rates would lead the banks either to abandon base-rate related lending in its present form or else to move base rates much more readily. Indeed, if they did not, round-tripping of the kind all too familiar in the present system could become an intolerable nuisance nothwithstanding the removal of the Reserve Asset Ratio. Such a change would be a desirable development[†]

[†] Other changes might well follow, for example, more frequent changes in deposit rates, with a possibly greater need for flexibility of rates offered by building societies.

and while the arrangements set out in Section C are not necessary for it to occur, they could well lead the clearing banks to adopt lending rates more closely related to market rates than at present. This would improve the control of £M3 to the limited extent of removing the short-term distortions presently caused, on occasion, by round-tripping.

34 It has also been suggested that changes of the kind outlined in Section C would significantly reduce the relative attraction of Treasury Bills to the banks, thereby making it more likely that some useful short-run smoothing of £M3 could occur because banks and non-banks could actively and easily trade in Bills with each other. The implications of the analysis in Section C are, however, not encouraging in this respect. For the banks' need for liquid short-term assets is likely to go on dominating the demand for Bills unless the supply were increased in a manner immediately damaging to constraint of £M3. Even then, there could be no assurance that interest rate relativities would thereafter generally move so as to permit regular trading in the right direction (smoothing £M3) between banks and non-banks, in response to pressure by the authorities on the system.

35 Questions regarding evolution towards monetary base control are discussed in another paper, to be circulated by the Treasury. It suffices to say here that the changes outlined in Section C would not preclude an evolution towards monetary base control of either the 'mandatory' or 'non-mandatory' variety.

Bank of England
14 November 1980

CONFIDENTIAL

Pse send - together with the papers for monetary seminar,

TL

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

14 November 1980

T.P. Lankester, Esq.,
Private Secretary,
10, Downing Street

Dear Tim,

SELLING MORE DEBT TO PERSONS

Since the Prime Minister's meeting on 13 October on monetary policy and control, the Financial Secretary has reviewed the plans for selling more debt to persons through the Department for National Savings (DNS). The Chancellor thought that the Prime Minister would wish to have a report on this before the next meeting.

The purpose of this initiative is of course to reduce reliance on the gilt market by tapping the personal sector surplus. This should help make it possible to meet monetary policy objectives at lower long term interest rates and to revive the new issue market for companies.

It has been announced that the Government expects to raise £1½ billion in 1980-81 from the new indexed certificate which DNS will put on sale on 17 November. If this is achieved, it would bring the DNS contribution to financing the central Government's borrowing requirement for 1980-81 to about £2 billion. For 1981-82 the object is to raise a larger sum of the order of £3-3½ billion. This will be an historically high share of personal savings and of the Borrowing Requirement. There is no guarantee that these figures will be achieved but we think it should be possible to do so, provided the terms of the instruments offered are sufficiently attractive to be competitive e.g. with the banks and building societies.

The new indexed certificate will be promoted on TV and in the Press. It will be on sale in Post Offices and Trustee Savings Banks. A Press Notice about the new certificate is at Annex A.

In case the new indexed certificate does not sell as well as is hoped, contingency plans have been made either for reducing the eligible age from 60 to 55 or for boosting sales of conventional certificates. Decisions on whether to implement one of these will be made in December on the basis of the latest information on sales.

/Plans for

CONFIDENTIAL

Plans for 1981-82 will be made in the run-up to the Budget. At present a progressive reduction in the eligible age for indexed certificates, probably to 50 or 45, looks the best best, though the BNOC bond will also help. Conventional certificates may also need to make a big contribution.

Some restriction of eligibility is necessary to ensure that the DNS is not swamped by the number of applicants. Treasury Ministers have considered the possibility of making indexed bonds available to teenagers and/or young married people rather than simply dropping the age limit from the top. Although this might have some political attractions, they do not on balance favour this course at this stage because it would be likely to conflict with the aim of getting in the maximum sums as quickly as possible through national savings for the minimum number of additional staff. There is evidence that people in their 50s have bank deposits and building society accounts nearly three times as large as those in their 20s. This suggests that the average purchase by the younger age group would be smaller. This would mean that given the limit on the number of applications that can be handled, the flow of money in any given period would be smaller and also that more staff would be needed for every £ taken. A further point is that younger people hold a larger proportion of their liquid assets with building societies than with banks in order to ensure they can get a mortgage. This is in line with the extension of home ownership. But it means that a given flow into national savings from people in their 20s would hit the building societies harder than an equivalent sum raised from the older age group.

The table in Annex B summarises the activities of the DNS, including the terms of the various instruments. Options for improving these have been tested against a number of criteria: genuine effects on monetary conditions, defensibility of the proposed terms, the need to avoid misleading signals about interest rates, minimising staff costs, and the desirability of affecting bank accounts more than building societies. Two modest changes have been agreed: an increase in the holdings for the National Savings Bank Investment Account and an increase in the number of premium bond prizes without any increase in the prize fund.

Within the overall target for the Chancellor's Departments in the 1984 staff reduction exercise a substantial contribution is being sought from the DNS. DNS estimate that the 2nd Index-Linked Certificate and the contingency and other plans described above for 1980-81 could add 150-250 to their continuing staff needs. The plans for 1981-82 cannot at present yet be costed but might involve a further 300-400. The temporary requirements in the rest of this year and in 1981-82 will be a good deal higher. The choices

/that have

that have been made have so far been angled so as to leave it still possible for the DNS to make a large manpower contribution to the savings exercise: and the Treasury and the DNS are considering further ways of saving staff that would be compatible with the expansion of the role of DNS. The CSD have been given details of the 1980-81 figures.

As was recognised on 13 October, greater Government reliance on personal savings is bound to provoke building society criticism and, since they too derive most of their funds from the personal sector, to reduce their inflows. The impact on the societies will depend on the proportion of funds the DNS attracts from them as opposed to the banks and on the demand for mortgages. To the extent that the societies find themselves short of funds, there is a risk of longer queues for mortgages and of mortgage rates being higher than they otherwise would be, though not necessarily above their present level. If the societies bid aggressively for deposits, this might lead eventually to a breakup of their cartel and to a permanent increase in the relative level of mortgage rates compared with other interest rates.

We envisage that the wider announcement in the week beginning 24 November will include a reference to sales of the new certificate and to the Government's intention to maintain this initiative in 1981-82 and to obtain a considerably larger amount of finance through National Savings in that year. It would also mention the two small changes in paragraph 7 above.

I am sending a copy of this letter to Jim Buckley (CSD), David Wright (Cabinet Office) and Tim Allen (Bank of England).

Yours

John

A.J. WIGGINS

ANNEX A

National Savings

Department for National Savings Press Office 4th Floor Charles House
375 Kensington High Street London W14 8SD Telephone 01-603 2000 ext 325/6

PRESS AND BROADCAST NOTICE

12 November 1980

A MILLION MORE INDEX-LINKED SAVERS

More than a million people will be able to buy index-linked National Savings Certificates for the first time next Monday, 17 November. On that date the new 2nd Index-linked Issue goes on sale at post offices and Trustee Savings Banks. The new Certificate replaces Retirement Issue - the original "granny bond".

Men and women aged 60 and over may buy the 2nd Index-linked Issue in units of £10 up to a maximum of £3,000. Prospective holders include the 1.3 million men aged 60 - 64 who are not eligible to buy the present Retirement Issue. Holders of the current issue may invest in the new Certificate, enabling those eligible to inflation-proof up to £4,200 of their savings with the two issues.

People wanting to increase their holdings of Retirement Issue have until Saturday 15 November to do so; from that date the Issue will be withdrawn from sale.

The 2nd Index-linked Issue Certificate may be held for five years, and like its predecessor, qualifies for repayment with index-linked adjustment on or after the first anniversary of purchase.

The terms of the issue allow the Treasury to pay an additional amount, above the index-linked increase, to maintain the attractiveness of the issue if a fall in the rate of inflation impairs the competitiveness of the investment in relation to other savings schemes.

Repayments of the Certificate are free of all rates of UK Income Tax (including the investment income surcharge) and Capital Gains Tax.

Notes to Editors

1. The date of introduction and terms of 2nd Index-linked Issue were announced on 14 October.
2. The Certificate will be sold in denominations of £10 (one unit), £20, £50, £100, £200, £500 and £1,000.
3. The payment of any supplement would be the subject of a notification in the London, Edinburgh and Belfast Gazettes at the relevant time.

PB 93/80

ANNEX B

	Sum held at 30 Sept. 1980	Notice	Return	80/81 Net inflow/ outflow to end Sept	Proposal (b)	Estimated intake	Staff Required	Cost of staff	Agency costs (mainly Post Office)
	£m			£m					
Savings Certs Indexed	2,111.0	8 working days but no indexation unless held for 12 mths	Inflation rate + bonus Tax free Accumulated	219.7	Reduce age to 55	To be judged once response known to new IL Issue. Otherwise £1.35bn gross, £1.0bn net	600 peak 100 continuing (but some of peak available perhaps)	£0.75m £0.5m pa	£6.3m
Savings Certs Conventional	5,189.1	8 working days but no interest unless held for a year	Current issue 10.33% Tax free Accumulated	-69.7	1. Retain current issue if rates drop. Raise maximum holding from £1500 to £5000. 2. New Issue maximum holding £3000	For either 1 or 2, £0.5 to £1.0bn gross depending on competitiveness of terms: about £0.4 to £0.75bn net	200-400 peak, 50-100 continuing 200-400 peak, 50-100 continuing	£0.25-£0.5m peak £0.25-£0.5m pa £0.25-£0.5m peak £0.25-£0.5m pa	£2.2m-£4.6m £2.2m-£4.6m
SAYE	526.5 (a)	14 days Penalty for wdl before end of contract	Inflation rate plus terminal bonus. Tax free Accumulated	10.5 (a)	(Already announced, date not fixed) £50 per month instead of £20	£10m pa	150 peak 35 continuing	£0.3m £0.2m pa	£0.1m
Premium Bonds	1,437.3	8 working days	Prize fund of 7%. Odds 18500:1. Tax free	32.0	Increase prizes from 75000 to 100,000 per month	£50m pa	60	£0.3m pa	£1.2m
Savings Bank Invac	1,717.6	1 month	15% taxable Accumulated	- 1.2	Holding limit: £200,000	£50m-£80m	Nil	Nil	£0.05
Savings Bank Ord A/c	1,780.4	On demand	5%. £70 of interest tax free Accumulated	-82.7					
British Savings Bonds (discontinued)	515.4 (a)	1 month	up to 9½%	-107.5 (a)					

(a) Department for National Savings and Trustee Savings Banks.

(b) Excludes 2nd Index-linked Issue already in pipeline.

(c) Interest on index-linked increase are a cost to the NLF only on repayment.

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

14 November 1980

T.P. Lankester, Esq.,
Private Secretary,
10, Downing Street

Dear Tim,

RESTRICTED INDEXED GILTS (RIGs)

With the papers we put to the Prime Minister before our last discussion on monetary control we included a short note on restricted indexed gilts. At the meeting the Prime Minister asked the Bank and the Treasury to press on with work on a possible prospectus. This note records the progress that has been made since then.

Earlier this year we looked in some detail at the advantages and disadvantages of an unrestricted issue of indexed gilts. The strength of the case for an issue of indexed gilts rests on the common interest of the Government and the institutions in reducing uncertainty as to the real cost of servicing the national debt. In some circumstances, the availability of such an instrument would also offer advantages for monetary control. But we concluded that there were other risks and that these were unacceptable. The main danger was that in view of their potential attractiveness to overseas investors indexed gilts might have the effect of increasing upward pressure on the exchange rate. But we decided that it would nonetheless be worthwhile to examine the possibility of a restricted issue, aimed principally at UK pension funds and which might offer us some increased flexibility but without the danger of attracting large-scale inflows.

The scheme we now contemplate would provide for an issue of indexed gilts by tender. Eligibility to purchase them would be restricted to pension funds in the UK, and to life insurance companies in respect of their approved tax-exempt pensions business in this country. We would propose in the first place to issue perhaps £1 billion with the clear intention of issuing at least £2 billion in the first year if the market reception was favourable. The value of the gilts would be linked to the RPI, and would carry a small coupon which we judge would be sufficient to make them attractive to purchasers.

/It would be

It would be fair to say that the eligibility criteria we have chosen are something of a compromise. On the one hand we could attempt to limit eligibility to UK self-administered pension funds only. But if we did so we would be open to the charge of discrimination, and of creating a new class of privileged pensioners. I am sure that this option is not one we would wish to look at further. On the other hand we could allow pension funds and all life insurance offices to buy RIGs with no restriction to pensions business. Our judgement is that this would create far too much risk of access by overseas residents, through life insurance policies written in the UK. The compromise is not watertight. It is not possible for us to say with absolute certainty that the RIGs bought by life insurance offices would be used in respect of their pensions business only. Although we have provided for a statutory declaration by such companies to the effect that they will use them only for approved business and, in cases of serious doubt, for spot checks on their balance sheets, the Bank cannot guarantee that policing of this kind will be totally effective. However, we regard the risk of sizeable access by non-residents in such circumstances as one we are prepared to take. The other side of the coin is that there may nonetheless be complaints by life offices. There may be some difficulties - which we are investigating further - in the case of companies which operate mixed life and pension funds, in stipulating that RIGs can only be held against pensions business liabilities. This requirement might be held to infringe the rights of other classes of policyholder.

Since we believe that the scheme we have developed so far could prove an attractive one, Nigel Lawson is consulting John Nott about the importance of the possible practical difficulties we have identified and the way in which the industry would react. We should be able to reach a view on this quite shortly.

There is another important issue of which you should be aware. We concluded when looking at unrestricted gilts that there was a danger of an adverse impact on company finances. The judgement is a nice one, since on the one hand if we were able to reduce interest rates in the economy generally this would be of benefit to industry. On the other hand, these instruments may be attractive to the institutions as a close substitute for equity. If the decision were to go ahead with the RIG we think this risk would be worth taking. We know that some interest is now being shown in the issue of index-linked debt by companies and the risks to the company sector could be countered by associating the issue of related indexed gilts with a move to ease the tax treatment of indexed securities issued by companies. But this would raise some difficult issues,

/which we

which we are examining with the Bank and the Inland Revenue.

It is agreed that it would be feasible to issue a RIG on these lines, subject to the comments of the Secretary of State for Trade. Whether to do so, and in particular whether to announce we are going ahead in the November statement, is still an open question. Meanwhile it is important that there should be no leak about the RIG because if there were one it would damage the market for conventional gilts. For the same reason, no announcement about the RIG scheme should be made until an issue is about to go ahead.

I am sending copies of this letter to Tim Allen and David Wright.

Yours

John

A.J. WIGGINS

SECRET

4

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

ROLLING OVER THE MONETARY TARGET

The monetary roll over is one of the subjects I shall need to cover in the wider announcements in the week beginning 24 November. I have discussed this with the Governor and I should like to report the conclusion we have reached, though it is very much a choice of evils.

2. The current target for the growth of sterling M3, which I announced in the Budget, covers the 14 months from February 1980 to April 1981. The target was 7 to 11 per cent at an annual rate, equivalent to 12.9 per cent over the 14 months. The actual growth from February to October has been about 15½ per cent or about 13 per cent after adjustment for corset distortions. So even on an adjusted basis there is no margin now for the remaining six months of the target period.

3. We expect the growth rate to slow down during this period but the prospect for the Borrowing Requirement in the next few months seems to be worsening and this suggests that the slow down is likely to come later and to be smaller than we had expected. Most of it will probably occur in the first quarter of 1981, and the January figure is the last that will be available by the time of the March Budget. So we will not have much evidence of slow down by then. Over the whole target period the current view is that growth at an annual rate after adjustment is likely to overshoot the top of the target range by, say, three percentage points.

/4.

SECRET

4. Announcing a new target now for the next 12 months would be hazardous and unconvincing. For the next 12 months running to October 1981 the mid point of the target range would need to be about 6 or 7 per cent if it was to be reasonably close to the MTFS path. The October economic forecast included such figures, but they were based on the assumption that present short term interest rates would be maintained at their present level until the end of 1981. It is unlikely that such a target would be found credible.

5. The Governor and I are therefore agreed that the least unattractive option is to announce that the target will not be rolled forward until the Budget. This will enable us to take the budgetary decisions and to settle the new monetary target simultaneously. That is an advantage of substance.

6. The presentation of this decision will clearly need great care. We shall need to ensure that the market do not expect measures to tighten the policy in the coming months and at the same time to establish that we intend to maintain the thrust of our medium term financial strategy, while not ruling out reductions in interest rate if they seem justified. We shall stress that our policies are already having their intended effect on prices and pay bargaining. Although we would recognise that the money supply has been growing fast, even allowing for distortions, we might explain that this was partly related to the scale of the financial imbalance between the personal and company sectors and go on to stress the signs that the growth of bank lending is falling. This, together with the prospect for the Borrowing Requirement in the January to March quarter, will on present policies start to bring down the rate of monetary growth by the time the new target is set in the Budget. The announcement on North Sea taxation and on employees' National Insurance

/contributions

contributions will help to establish that the Budget will be a tight one that will buttress the monetary strategy.

7. I am sending copies of this minute to the Governor and Sir Robert Armstrong.

(G.H.)

14 November 1980

SECRET

3.

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

14 November 1980

T.P. Lankester, Esq.,
Private Secretary,
10, Downing Street

Dear Tim,

PAPERS FOR MONETARY SEMINAR

You may like to have a note of the various papers relevant to the seminar on Tuesday, 18 November.

You already have the Treasury paper on "Smoothing the PSBR" and the monthly note on the CGBR and PSBR. The others are:

(a) Two papers which the Bank will be sending you on

(i) Debt Sales

(ii) "Increasing the flexibility of official operations in the money market".

(b) Treasury notes on "Monetary Control: Main points for discussion" and "Monetary Control: the November Statement" (attached).

(c) My letter to you about the restricted indexed gilts (RIG) of today.

(d) My letter to you about national savings of today.

The Chancellor has minuted the Prime Minister separately about the rollover of the monetary target.

The Chancellor hopes that discussion at the seminar will concentrate on (a) and (b). Decisions on these are needed for the statement in the week beginning 24 November.

I am sending copies of this letter to Tim Allen and David Wright.

Yours
John

A.J. WIGGINS

SECRET

CONFIDENTIAL

MONETARY CONTROL: MAIN POINTS FOR DISCUSSION

A. Money Market Operations

It is agreed:

(i) That a more flexible system of official operations be introduced. This would involve the operational suppression of MLR and some change in the operation of discount window facilities. Interest rates would be kept within a band by open market operations.

(ii) That the Reserve Asset Ratio be phased out and abolished as soon as alternative prudential arrangements can be established.

It remains for decision:

How would the guidelines, and interest rate banks, be set?

B. Debt Management

It is agreed:

that a RIG is technically feasible, and that the pursuit of further flexibility in debt management techniques more generally, and especially at the short end, be further explored by officials.

It remains for decision:

Whether a RIG should be announced for immediate issue in the forthcoming statement, **and what should be said about debt management more generally.**

C. Monetary Control and Monetary Base

It is agreed:

(i) That £M3 is extremely difficult to control not only in the short run, but even over longer time periods. The above measures may provide some help, but are not themselves likely to transform the picture.

(ii) A major cause of this difficulty is that interest rate movements do not have a quick or reliable effect on bank lending or £M3.

(iii) That a move to either version of monetary base control would require a transitional period of several years.

No

(iv) That a mandatory monetary base system would probably work better if related to a narrow monetary aggregate. Consequently, we will arrange for the collection of appropriate data for retail deposits, an M2 series.

(v) That, in order to provide more information on how a non-mandatory base system would work, it would be necessary to abolish any required cash ratio. The difficulty about this is that it would remove the basis of the Bank's main source of income.

It remains for decision:

(i) Whether it is possible to reconcile maintenance of a sufficient and sure source of income to the Bank with the abolition of the required cash ratio.

(ii) How far it would be desirable to express an intention now to move on towards a monetary base system; or more modestly to claim that the above changes were desirable in their own right and consistent, should further experience point that way, with moving on to a monetary base system.

For further discussion but not immediate decision.

(iii) Whether any measures can be introduced that will encourage companies to obtain funds other than through bank lending, ie through the capital markets.

(iv) Whether there are any means of inducing banks to fund such bank lending more through non-monetary liabilities.

MONETARY CONTROL: THE NOVEMBER STATEMENT

1. The consultations on monetary control following the publication of the Green Paper in March are now complete. An account of the Government's conclusions is planned as part of a wider statement about economic policy on [24] November. There are also some more immediate practical questions to be resolved. A series of meetings has been held between the Treasury and the Bank to prepare the ground for the Prime Minister's seminar on 18 November. There is a wide measure of agreement as to the steps which could be announced straight away. We are all very uncertain as to the merits of the case for monetary base control in the longer term and on this there is a continuing difference of view, or at least of emphasis, between Bank and Treasury officials.

2. The Treasury think that these issues need to be considered explicity now, whereas the Bank feel that the development of experience with the evolution of the changing system and the pressure of events, eg possible entry into EMS, makes it unwise to take an explicit position now on long distant changes, especially those that would involve major structural changes.

Control of £M3

3. The Green Paper argued that control of the target aggregate on a month-to-month basis was not necessary to the effect of monetary policy in reducing inflation, although it also recognised that even short-term deviations from the target path could influence market expectations. It is now generally accepted that precise short-run control of a broad aggregate like £M3 is not in practice possible and also that control of such an aggregate, even over a period of six to twelve months, could sometimes involve costs in terms of other objectives that are unacceptable. A major change in the definition of the target aggregate to one that might be more easily controllable, however, has not been considered as a "live" option at the present time. Whilst the Government may not be committed to the precise definition of £M3, the concept of the financial strategy would be changed significantly if there were no commitment to a broad monetary aggregate at all.

4. Discretionary changes in short-term interest rates, which in the short run are the main instrument at the authorities' disposal, do not, however, provide by themselves a satisfactory means of controlling £M3, largely because the relationship between the level of interest rates and the target variable which does not seem to be stable or well-understood. A wide aggregate like £M3 is probably influenced more in the short run by the relative yields expected on different assets than by the overall level of the interest rate structure. Certainly, this relationship between changes in MLR and their consequences is not well understood; some commentators are even convinced that it works under current circumstances in the wrong direction, at least in the short run.

5. A move to monetary base control would not provide a satisfactory method of controlling £M3.

(i) A mandatory system related to £M3 (or to any definition including the bulk of wholesale bank deposits) would result in disintermediation of the kind associated with the corset.

(ii) A non-mandatory system would control £M3 only if there were to be a stable and predictable relationship between that aggregate and the banks' demand for base money. There is no means of telling whether such a relationship would emerge.

6. We do not see any efficient means of exercising direct control over bank lending. It may be possible, however, to make it more responsive to market conditions. If banks were less confident that they had access to an unlimited supply of liquid assets at a known price, they would have more of an incentive to keep their lending rates in line with the market and they might adopt a different attitude to the provision of overdraft facilities. Even so, we expect that the relationship between bank lending and the level of short-term rates will remain too uncertain or too slow-acting to provide an adequate method of monetary control in the short run at least.

7. This means that, once the £M3 target has been announced and the main budgetary decisions taken, much of the burden of reconciling the two must fall on debt sales. Non-marketable debt is playing an increasing part in the finance of the PSBR, but there must remain a very important role for operations in the gilts market, where the authorities have greater flexibility.

8. The extent of that flexibility is one subject on which views differ between Treasury and Bank officials.

The Treasury believe that a greater readiness to see the yields on gilts respond to market pressure would give greater assurance that a programme of sales could be achieved within a period of, say, three to six months.

The Bank believe that the greater volatility of yields would not necessarily secure the sales outside the banking system. The structure of the market would be damaged and the prospects for selling debt in the longer term diminished.

Some forms of auction for short-term central government debt would not be open to all these objections. There is general agreement that the possibility of broadening the market at the short end should be examined as a means of providing greater flexibility to the government funding programme. If it were decided to introduce an indexed stock, restricted to institutional holders (the RIG), it could also be auctioned; it would then provide an alternative to conventional gilts to which the savings institutions might turn when the prospect for inflation was particularly uncertain.

Multiple Targets and Monetary Base Control

9. The advocates of monetary base control do not see it as a method of controlling £M3 or any broad aggregate - except very indirectly. They see it as controlling either a narrow monetary aggregate (a mandatory system) or simply the base itself (a non-mandatory system). If this were to be combined with the existing commitment to £M3, the Government would be committed to multiple targets. The narrow aggregate would be the short-run objective with the wider aggregate as the guide to medium-term policy. Again, there is a difference of view between the Treasury and the Bank on the possibility of operating such a system.

The Treasury see control of the base or a narrow aggregate as an appropriate basis for a market determination of short-term interest rates. They see fiscal policy and debt sales as the appropriate instruments for meeting the medium-term target for the wider aggregate. The possibility of conflict between

The Bank see a necessary role for short-term rates in controlling £M3, both as means of influencing bank lending (in the longer run) and of securing gilt sales (in the shorter run). Dual targets would often have conflicting implications for movements in short rates. So long as a £M3

the two targets would be much reduced if a new approach were adopted to the marketing of gilts.

target is maintained, therefore, they see a need for discretionary choices about the appropriate level of short rates.

10. There is considerable uncertainty over the workability of a mandatory monetary base system. A system based on retail deposits alone would create less of an incentive to offshore disintermediation, but it is not clear that an adequate definition could be found for control purposes. There is a danger that other distortions would be introduced, especially affecting competition between banks and building societies. We do not, however, need to close this option as a long-term possibility. It would, in any case, be valuable to introduce a statistical series for retail deposits to replace the old M2 series discontinued in 1972 (although it would be costly for the banks). We might then be able at a later date to asses its controlability and its economic significance.

Initial Steps

(a) Money Market Operations

11. During the debate following the Green Paper, there has been persistent criticism of the way that "lender of last resort" or discount window facilities are operated. It would be possible to exercise control of interest rates in a more flexible (and less visible) way by adopting rather different techniques in the conduct of open market operations. The instructions for these operations could eventually be framed in terms of either quantities or prices (or a combination of the two). Initially, the emphasis would have to be on the control of interest rates, but it would be possible, if we wished, to move gradually towards control of the monetary base.

12. The interest rate objectives could, from the start, be expressed as a band within which market rates could fluctuate. The choice of the limits to that band would remain, in a sense, a political act, but it is hoped that it might be somewhat "de-politicised". These limits would not be announced (in order to keep the banks uncertain of the terms on which they could certainly obtain funds), but if actual rates were to reach either intervention point, the market would be well aware of the fact. A decision would then have to be taken whether to move the band or whether to stabilise it at that level. Minimum Lending Rates, as such,

would be abolished, and discount window facilities would be provided less freely and probably only at penal rates. The new method of operating could be indicated in general terms in the November statement. It would brought into use over the next few months.

(b) The Cash Ratio

13. The existing cash ratio is not operated as the base for a system of monetary control. The Green Paper speaks of it as the "fulcrum" for open market operations, but it would be possible, nevertheless, to determine interest rates without any required cash ratio since the banks are unable to overdraw their accounts with the Bank of England. An associated effect of the present cash ratio requirement is to provide the Bank of England with the main source of its own income.

14. In its present form, the ratio could not be used in a mandatory system of monetary base control: it is too small a percentage and related to the wrong total of deposits. Whilst it remains, it conceals the size and variability of the banks' true demand for cash; it therefore prevents us from discovering any information relevant to the operation of a non-mandatory base control system. This points to the replacement of the cash ratio by some alternative means of financing the Bank of England. We shall be discussing further what possibilities exist. At a minimum, some reference to a review of the cash ratio would be made in the end-November statement.

15. We could also announce our intention of reviewing the case for monetary base control in due course.

It could then benefit from:

(i) experience of more flexible market operations, with their implications for interest rate volatility and bank behaviour;

(ii) some knowledge of the banks' true demand for cash (relevant to a non-mandatory system); and

(iii) some data on retail deposits (relevant to a mandatory system).

(c) The Reserve Asset Ratio

16. It is agreed policy, announced in the Green Paper, to abandon the reserve asset ratio as soon as a successor system for the prudential control of bank liquidity could be put in its place. Discussion of

new prudential arrangements between the Bank and the banks has gone as far as it can in ignorance of how the Bank's market operations and discount window facilities are to be structured in the future. Once that has been settled, it will be a matter of months - not earlier, say, than March - before permanent new arrangements can be agreed, and somewhat longer before they can be fully operational. But it should be possible almost immediately to make an interim adjustment to the reserve asset obligation, consistent with the Bank's objectives for the new liquidity regime, which will go a long way towards removing the problems of market management which have recently been experienced; though it might not wholly eliminate them. The nature and timing of this adjustment would form part of the November statement.

(CF) pm

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DOMESTIC FINANCIAL FORECAST

I. Introduction

This report considers the domestic monetary outlook embodied in the recently completed short term macroeconomic forecast. It should be read in conjunction with the summary report on that exercise circulated by Messrs Britton and Neuburger on 10 June. The focus is on the two financial years 1980-81 and 1981-82. The existence of both "lower output" and "higher output" forecasts, with the difference accounted for by a different judgement as to the effect of U.K. competitiveness on net trade performance, implies two domestic financial projections of equal status.

II. Recent Developments

2. It was announced in the Budget speech that the new target range for the annual growth rate of £M3 is 7-11% for the period from February 1980 to April 1981. The implicit "base drift" from the centre of the previous target range from June 1979 was 1½% and was justified in part by the need to make some allowance for the reintermediation into £M3 expected to occur as a result of the abolition of the SSD scheme, also confirmed in the Budget.

3. The actual growth in £M3 in the 11 months to banking May has been at an annual rate of 11.6%, and the annual rate over the last three months has been 12.1%: just above the top end of the target range in both periods. Banking May alone registered growth of 2.1%, largely attributable in counterpart terms to a very high CGBR. This marked a reversal of the pattern in the previous four banking months, when a number of special factors - particularly sales of forward oil and the unwinding of the effects of the P.O. strike - acted to produce very low CGBRs (an average of only £80m per month, compared with £880m average in the previous year) and low £M3 growth (£300m compared with £520m). Bank lending has continued to grow rapidly. The external adjustments to monetary growth have in general been moderately negative in recent months, attributable to the current account deficit and private sector capital outflows.

3. Short term interest rates have drifted down from the peaks recorded in the early spring, although MLR has not changed. Three month interbank rate, 18.4% in early April, is now about 17.0%. Over the same period U.S. short term rates have plummeted, from almost 20% to just over 9%: however, with domestic rates responsive mainly to domestic monetary conditions, the main effect of this has been on the exchange rate. 20 year gilt rate has also drifted down, from a peak of 14.8% to about 13.7%.

III. Main Assumptions

4. It is assumed that £M3 grows smoothly at the centre of the target ranges set out in the Medium Term Financial Strategy. This implies growth at an annual rate of 9% in the 14 months to April 1981, and 8% growth in 1981-82. Given the fiscal policy and other assumptions underlying the two forecast cases, interest rates vary so that the target is met. The changes in £M3 and its counterparts are summarised in Table 1.

5. The abolition of the SSD scheme (corset) is forecast to lead to reintermediation of some £1.3 billion of "leaked" bills - bank acceptances held by the non-bank private sector - thereby raising recorded bank lending. In addition, it is assumed that there is a combined impact of about £0.5 billion as a result of the unwinding of corset-induced switches into Eurosterling and within the parallel money market. The total effect, which is assumed to be accommodated within the monetary target, is equivalent to about 3% of £M3. About one third of the impact is felt in 1980 Q2, with the bulk of the remainder occurring in Q3. It should be emphasised that the size and timing of reintermediation is highly uncertain (see para 25 below), and that in this context the assumption of smooth growth in aggregate £M3 in 1980-81 must be seen only as a convenient simplication.

6. The forecast assumes that the institutional structure of the domestic monetary system is broadly unchanged. There is no move to monetary base control. The building society and banking cartels retain current rate-setting and general competitive practices, although there is a limited movement by banks towards greater lending for house purchase. The forecast reveals a

TABLE 1: £M3 AND THE COUNTERPARTS

	1979-80	Lower Output 1980-81	Lower Output 1981-82	Higher Output 1980-81	Higher Output 1981-82
PSBR	9.8	8.2	11.4	7.2	8.1
Less sales of public sector debt to non-bank private sector					
a) Gilts	-8.3	-5.6	- 7.3	-5.4	-7.9
b) Other Debt	-0.8	-1.7	- 1.5	-1.8	-1.6
Change in £ bank lending to					
a) Private sector	9.3	7.8	6.4	7.7	8.6
b) Overseas	0.5	0.4	-0.2	0.6	0.1
Domestic Credit Expansion	10.5	9.0	8.8	8.2	7.3
External adjustments	-2.6	1.9	-2.3	-1.1	-0.8
Change in non-deposit liabilities (including residual items)	-1.4	-1.7	-1.4	-1.7	-1.4
Change in £M3	6.4	5.4	5.1	5.4	5.1
(as % of level)	(12.4)	(9.2)	(8.0)	(9.2)	(8.0)

chronic reserve asset/primary liquidity shortage on the part of the banks (see para 39 below): this is assumed not to constrain their lending behaviour of result in, for example, very high short-term interest rates. However, the method of resolution of this severe problem is not specified.

7. It is assumed that there is no net intervention in the foreign exchange market - the exchange rate is freely floating.

IV. The Rest of the Forecast

8. Recipients are referred to the paper circulated by Messrs Britton and Neuburger for a report on the whole forecast. External developments as they affect the monetary sector in both forecast cases are summarised in Tables 40 attached. The central features are:

(i) In the lower output case (LO), real GDP falls by 4½% in financial year 1980-81 and by a further 3½% in 1981-82. In the higher output case (HO), the decline is "only" 3% in 1980-81 and 1% in 1981-82. Unemployment by the end of the period is 2.7 million in LO, and 2.3 million in HO.

(ii) The increase in the RPI on a year earlier in 1981 Q1 is 19% in LO (identical to the 1980 Q1 figure): inflation falls to 15% in 1982 Q1. In HO a higher exchange rate contributes to the reduction to 18½% in 1981 Q1 and to 13% in the next year.

(iii) The PSBR in LO is £8.2 billion in 1980-81 and £11.4 billion in 1981-82. The higher activity in HI results in figures of £7.2 billion and £8.1 billion respectively. The LO figure for 1980-81 as a proportion of GDP is just below that projected in the Medium-Term Financial Strategy: in 1981-82, the HO figure is broadly in line with the MTFS.

(iv) The current account deficit in LO is £2¼ billion in 1980-81 and £1¼ billion in 1981-82: in HO, balance in 1980-81 gives way to a £2 billion surplus in 1981-82.

(v) The company sector deficit in 1980-81 in LO is enormous, at £7 billion: it diminishes to £2¼ billion in 1981-82. The deficit in HO is £1 billion smaller than that in LO in 1980-81 but marginally larger in 1981-82.

9. The way in which the rest of the forecast interacts with the achievement of a strict monetary target is by now a depressingly familiar one. Adherence to monetary control to some extent restricts the growth of nominal incomes - particularly via a high exchange rate - but in the short term a large proportion of this restraint is on real income rather than the price level. Nevertheless, nominal income growth considerably exceeds that of £M3 in both cases (by more in the higher output case) and hence the velocity of circulation rises.

10. A parallel feature is the extent to which increases in private sector net and gross financial worth exceed those in £M3. On either income or wealth criteria, the message is clear: the monetary position tightens over the forecast period, limiting the scope for reductions in interest rates. The financial side of the forecasts are summarised in tables , for the high output case, and tables for the low output case. Matrices of sectoral financial flows in 1980-81 are also appended for both cases.

V. Interest Rates

11. As usual, a good deal of uncertainty is attached to the particular path of the interest rate forecasts. The quarterly paths projected in the lower output case appear in Table 2A and for the higher case in Table 2B. In the lower output case, market rates decline marginally, if at all, during the remainder of 1980. In 1981, as inflation improves, output continues to fall, and companies' defensive action on costs, investment and stocks reduces their need to borrow, rates come down. Short rate is forecast to fall from 15% in 1981 Q1 to 12½% in 1982 Q1, and long rate comes down from 13½% to 12%. Mortgage rate rises to 15¾% in 1980 Q4 and remains there until mid-1981. This reflects the increase in the building societies' composite tax rate, and the fact that both share and mortgage rates are currently perhaps 1½% below the levels which would be expected on the basis of market rates (i.e. they implicitly discount a fall in market rates which does not occur in 1980). Building society prospects are discussed in more detail in section XII below.

TABLE 2: INTEREST RATES

A. Lower Output Case

	3 month interbank	20 year gilt	Mortgage	3 month Eurodollar
1979 Q1	12.7	13.4	11.75	11.0
Q2	12.2	12.1	11.75	10.7
Q3	14.1	12.4	11.75	11.7
Q4	15.7	14.1	12.80	14.7
1980 Q1	17.7	14.5	15.00	11.8
Q2	16.9	14.2	15.00	11.8
Q3	17.0	14.0	15.00	11.5
Q4	16.5	14.0	15.75	11.0
1981 Q1	15.0	13.5	15.75	11.0
Q2	14.5	13.1	15.75	11.0
Q3	13.8	12.7	15.05	11.5
Q4	13.1	12.3	14.41	12.0
1982 Q1	12.5	12.0	13.90	12.5

B. Higher Output Case

	3 month interbank	20 year gilt	Mortgage	3 month Eurodollar
1980 Q1	17.7	14.5	15.0	17.0
Q2	16.9	14.2	15.0	11.8
Q3	16.1	13.6	15.0	11.5
Q4	15.5	13.5	15.0	11.0
1981 Q1	13.4	12.7	15.0	11.0
Q2	12.4	12.0	14.4	11.0
Q3	11.3	11.5	13.2	11.5
Q4	10.1	10.8	12.1	12.0
1982 Q1	8.9	10.2	11.2	12.5

12. Interest rates are expected to fall more sharply in the higher output case. Although there is more activity-induced demand for bank lending, this is partially offset by the reduced size of the financial deficit which the company sector must cope with. The PSBR is far lower. Importantly, the improved current account position is matched (under a floating exchange rate regime) by a capital account outflow, most of which comes from the non-bank private sector. Short rates are down to under 13½% in 1981 Q1, and under 9% in 1982 Q1. 20 year gilt rate declines to 12½% and then to 10%, re-establishing the conventional slope of the yield curve. Mortgage rate is unlikely to go above its current level, and is falling from early 1981.

13. Two identifiable areas of uncertainty qualify views about the immediate outlook for interest rates in both cases. The first is the problem posed by very rapid and large scale reintermediation within £M3 as the corset is removed. Any attempt to impose smooth month-by-month control of the money supply in these circumstances could entail large swings in rates (and could still fail). The second problem is that of the banks' chronic liquidity shortage. As noted above, the forecasters have assumed that this does not affect bank behaviour or interest rates: but it is easy to imagine circumstances in which a "scramble for liquidity" drove money market rates up.

VI. Gilt Sales to the Non-Bank Private Sector

14. The forecast for sales of gilts in 1980-81 has, to some extent, already been overtaken by events: the unexpected sale of 13½% Exchequer 1994 is estimated to have secured receipts from non-banks of £3.1 billion in 1980-81 to date. This compares with our forecast of £5.6 billion in the lower output case (£5.3 billion in the higher output case) for the whole of 1980-81 and £4.3 billion (£4.0 billion) respectively in the first half. This does suggest that we may have under-forecast sales to the non-bank private sector this year but the broad picture that we expect to emerge is not changed: we expect limited sales of gilts at the end of this financial year as the need to sell gilts to keep within the monetary target diminishes.

15. A crucial element in the gilts forecast is the treatment of expectations. Although we are aided by an equation for expected capital gains on gilts, a substantial degree of judgement is exercised by the forecasters in this area. On balance, we have projected mildly favourable expectations in the remainder of 1980-81 with the current market view that the government's policies will inevitably lead to a fall in long rates continuing, albeit sobered by the high observed rate of inflation. Thereafter, a powerful bull market is expected to develop as the steep decline in earnings growth reduces inflation quickly. The consequent increase in the demand for gilts can either be taken on extra gilt sales or a reduction in long term interest rates. The result depends on the need to maintain monetary growth on target. Our assessment is that some combination of these two will be possible with a somewhat greater decline in the high output case as the lower PSBR leads to less pressure on the target.

16. Tables 40B summarise the gilts forecast in terms of the private sector's total portfolio. In 1980-81 and 1981-82 holdings of gilts are forecast in both cases to increase at broadly the same rate as gross and net financial worth of the private sector before taking account of revaluations of existing gilt holdings due to changes in long rates. The decline in interest rates means, however, that the share of gilts in total portfolios rises, from just over 40% in 1980 Q1 to 45% in the lower case, and to almost 48% in the higher case, in 1982 Q1. This would require a fairly major switch towards gilts by investors similar to that which took place in 1976-77.

17. Allowance has been made in the gilts sales projection for the effect of two special factors. First the abolition of exchange controls on portfolio investment overseas by the institutions is thought to have increased the degree to which domestic holdings of gilts are a substitute for overseas assets. To capture this effect we have assumed that some 11% of outward portfolio investment permanently reduces the demand for gilts by the private sector at given interest rates, wealth etc. Columns 1 and 2 of table 3 below quantify the effects in the two cases. The reductions shown are in addition to those which operate via the inclusion of net overseas liabilities in gross worth of the private sector.

TABLE 3 : SPECIAL FACTORS IN THE FORECAST OF GILT SALES

	Flow effect on demand for gilts		Memo item Outward portfolio investment		Equity Market Effect on Flow demand for gilts (both cases)	Memo item Long Rate (%)	
	1 High	2 Low	3 High	4 Low	5	6 High	7 Low
1979 Q2	-		-	-		12.1	12.1
Q3	-125	-125	-1150	-1150		12.4	12.4
Q4	-100	-100	- 850	- 850		14.1	14.1
1980 Q1	-150	-150	-1300	-1300		14.5	14.5
YEAR 1979-80	-350	-350	-3300	-3300		13.3	13.3
1980 Q2	-125	-150	-1200	-1400		14.2	14.2
Q3	-100	-100	- 950	- 800	250	13.6	14.0
Q4	-100	- 75	- 950	- 750	250	13.5	14.0
1981 Q1	-100	- 75	- 850	- 600	250	12.7	13.5
YEAR 1980-81	-450	-400	-3950	-3550	750	13.5	13.9
1981 Q2	-100	-150	- 850	- 550	-	12.0	13.1
Q3	- 50	- 25	- 550	- 250	-	11.5	12.7
Q4	- 75	- 50	- 750	- 400	-150	10.8	12.3
1982 Q1	-100	- 75	- 850	- 600	-150	10.2	12.0
YEAR 1981-82	-350	-200	-3000	-1800	-300	11.1	12.5

Note: (1) Total may not sum exactly due to rounding

(2) No estimates have been made for the equity market effect for the period up to 1980 Q2.

18. Secondly, the combination of recession and high interest rates is expected to depress the new issues market in 1980-81 in both cases. This is likely to increase the institutional demand for gilts for given interest rates etc and we have made a special allowance for this. When interest rates begin to fall and inflationary prospects improve in 1981-82 new issues may increase, reversing the early effects on demand for gilts. Clearly the improvement is likely to be greater in the high output case where long term rates fall faster and output is much less depressed but because the numbers involved are small we did not allow for different effects in the two cases.

VII. Other Public Sector Debt

(i) National Savings

19. The forecast of net purchases of National Savings instruments reflects the outlook for the personal sector financial balance. It is assumed that the instruments remain broadly competitive. In the low output case persons' NAFA rises marginally in nominal terms from £14.6 billion in 1979-80 to £15.8 billion in 1980-81, and net take-up is projected to recover from an unusually low £0.8 billion to £1.5 billion (11½% of the stock). There is a small decline in NAFA in 1981-82 and take-up is only £1.4 billion (10%). In the higher output case, marginally higher NAFAs imply take-ups £0.1 billion higher in each financial year - 12% and 11% of the stock respectively.

(ii) Certificates of Tax Deposit

20. The dramatic run-off of CTD holdings in 1979-80, particularly in 1980 Q1, is not expected to be reversed in the near future. In the absence of a marked improvement in competitiveness (largely dependent on the re-establishment of a normal yield curve), sales are constrained by the corporate sector's low profitability and hence low net tax accruals. In both cases, net purchases of CTDs are forecast at only £150 million in 1980-81 and £500 million in 1981-82, taking the 1982 Q1 stock to £1.2 billion (compared with £1.5 billion in 1979 Q1).

(iii) Treasury Bills and L.A. Temporary Debt

21. Non-bank private sector holdings of LA temporary debt have

been somewhat inflated by the corset. The constraint on banks' IBELs have led them to reduce their net CD issue and their holdings of LA debt (the directly parallel money market asset): the non-bank private sector has in consequence substituted LA debt for CDs. However, Treasury bill holdings are at historically very low levels, reflecting the shortage of reserve assets in the financial system.

22. Reserve asset pressure is projected to continue (see section X), and the dominant influence during the forecast period is the unwinding of corset distortions. The combined total of non-bank private sector holdings of Treasury bills and LA temporary debt falls from £3.5 billion in 1980 Q1 to £3.2 billion in 1982 Q1 in both forecast cases.

(iv) Notes and Coin

23. The growth in holdings of cash remains relatively rapid in the forecast period, leargely induced by continued rapid inflation but also, to some extent, by falling interest rates. In the lower output case, the increases are £1.4 billion (13½%) and £1.8 billion (15½%). In the higher output case, greater output and lower interest rates are offset by slower inflation, and the figures are almost identical.

VIII. Bank Lending

24. As usual the outlook for the bank lending is one of the key elements of the forecast. It is, unfortunately, highly uncertain. The forecast is disaggregated into lending to companies, persons and OFIs (behaviourally this may be rather tenuous, as the personal sector includes unincorporated businesses, while much of lending to OFIs is indirect lending to persons via HP companies and the like). The overall view is shown in table 4 below.

TABLE 4: BANK LENDING

£bn change:	Actual	Forecast: Lower Output		Forecast: Higher Output	
	1979-80	1980-81	1981-82	1980-81	1981-82
lending to					
ICCs	5.1	5.9	3.2	5.5	4.4
Persons	3.4	1.9	2.7	2.1	3.5
OFIs	1.1	0.1	0.5	0.2	0.7
Private Sector	9.6	7.9	6.4	7.8	8.6
(%)	(24½)	(16)	(11½)	(16)	(15)

Despite reintermediation, the growth of recorded lending slows in 1980-81 - this is, of course, one aspect of meeting the tight £M3 target. What is marked, particularly in the lower output case, is the switch in emphasis of lending from persons and OFIs towards companies who bear the brunt of the early stages of recession. Falling interest rates reverse this switch in 1981-82, and generate (along with higher activity) the markedly greater growth in the high output case.

(i) Lending to Companies

25. The forecast of lending to ICCs involves critical judgements on the extent and speed of reintermediation into the recorded total of the bill leak (commercial bills issued by ICCs, endorsed by banks but held by the non-bank sector - probably mainly by other companies). In 1980 Q1 the bill leak totalled £1.8 billion on a quarterly basis and £2.2 billion on a banking month (corset penalty) basis: the £400m gap provides a minimum estimate of likely reintermediation. Of the remainder, some £600m represents a "normal" pre-corset ratio of bills outside the banks to £M3, while the forecasters have assumed that a further £300m will remain after the corset ends. Thus total reintermediation is forecast at £1.3 billion: one third occurs in 1980 Q2 and the remainder in 1980 Q3, as most of the bills concerned are very short-dated.

26. The other critical factor is the extent to which ICCs faced with an extremely difficult financial position, seek and receive bank finance. The forecast assumption is that pressure on corporate cash flow are partially offset by inflows from abroad [see the accompanying report on external flows], but in 1980-81 add about £400 million to lending in the lower output case and about £100 million in the higher case. In 1981-82 a less stringent cash flow position and an improved equity market allows a reversal of £200 million in the lower case and of £150 million in the higher case.

27. An additional special factor is the continued addition to lending resulting from capital outflows in the wake of the abolition of exchange controls. In the lower case, this adds £350 million in 1980-81 and a further £200 million in 1981-82: in the higher case, the higher exchange rate encourages further outflows, and the totals are £400 million and £300 million respectively.

28. The underlying lending to companies forecast is generated by an equation which postulates that lending responds proportionately to prices, with an elasticity of 0.75 with respect to real activity and a small response to the interest rate and inflationary expectations.

TABLE 5: BANK LENDING TO COMPANIES

£bn change:	Lower Output		Higher Output	
	1980-81	1981-82	1980-81	1981-82
Basic Equation Projection	3.5	3.2	3.4	4.2
Exchange control	0.4	0.2	0.4	0.3
Reintermediation	1.6	-	1.6	-
NAFA	0.4	-0.2	0.1	-0.1
Total	5.9	3.2	5.5	4.4
(%)	(20½)	(9)	(19)	(12½)

(ii) Lending to Persons

29. The recent rapid growth of lending to persons (29½% in 1979-80) is forecast to slow markedly in 1980-81 as the recession takes hold. The projection in both forecasts implicitly allows for a real income elasticity of 1.5 (i.e. bank borrowing is a "luxury" for persons) and for a response of 3% to a one point change in nominal interest rates. One area of some uncertainty is bank lending for house purchase, in the context of continued rationing of mortgage advances by building societies and some banks' already-expressed interest in expanding this profitable market. Both cases assume additional lending of £100 million in each of the quarters 1980 Q4 - 82 Q1 on this account (i.e. £200m in 1980-81 and £400m in 1981-82).

30. In the lower output case, the growth in total lending is 12½% in 1980-81 and 16½% in 1981-82. The figures are higher, at 14% and 20½% respectively in the higher output case.

(iii) Lending to OFIs

31. Recent research suggests that bank lending to OFIs is relatively sensitive to the level of activity and to the interest rate. In both forecast cases this contributes to a great deceleration in projected lending growth in 1980-81, from the 1979-80 figure of 31½%. In the lower output case, growth is 2½% and then 10½% in the successive financial years. The 1980-81 figure is 4½% in the higher case, and that for 1981-82 is 14½%.

IX. External Factors

32. The assumption of a floating exchange rate makes analysis of the external and foreign currency finance counterpart to the money supply rather complicated. Under such a regime the externals depend only on the composition of the balance of payments and it is hard to disentangle autonomous influences from those which are induced by the need to clear the foreign exchange market.

33. Ex post, the externals equal the sum of the current account, public and bank lending in sterling overseas and the non-bank private sector capital account (including, for these purposes, their net foreign currency position with U.K. banks). Ignoring the public sector element in the current account and public and bank lending in sterling overseas (which are included in the externals merely to offset their effect on DCE) this means that the externals are simply the non-bank private sector's net balance of payments position. Under a fixed exchange rate we can employ the simple rule that such flows have implications for the externals whereas all other flows (i.e. flows to public or banking sectors) do not.

34. In a floating rate world, however, ex ante inflows to the banking or public sectors induce matching outflows and may therefore have indirect effects on the external. Since some part of the induced outflow will in general be from the private sector, such an inflowswould lead to a contractionary external ex post. Ex ante inflows to the non-bank private sector must also generate offsetting outflow if the exchange rate is floating but only part of this will, in general, be from the non-bank private sector so that they will lead to expansionary externals, as would be the case with a fixed rate though their effect will be lessened. This means that a positive external ex post can be associated with either an ex ante outflow from the public/banking sectors or an inflow to the non-bank private sector.

35. Table 6 provides a breakdown of the externals projection. It shows the large contractionary external in 1979-80, associated with the current account deficit and capital outflows from the non-bank private sector thought to be partly the result of the abolition of exchange controls and partly induced by the demand for sterling by non-residents. In both the high and low output cases substantial negative externals are forecast. These result from continued outflows from the private sector following the abolition of exchange controls and induced by OPEC. In the low output case a further contractionary influence is the current account deficit. The externals would be even more negative but for a judgemental allowance for inflows to the non-bank private sector of £2 billion in 1980-81 and £1.0 billion in 1981-82 in response to liquidity pressures on companies.

36. The composition of the externals is quite different between the two cases. The HO case involves an exogenous improvement relative to LO. To clear the balance of payments an offsetting capital outflow must be induced, a large part of which stems from the non-bank private sector. Thus the non-bank capital account is in substantial deficit in the HO case particularly in 1981-82 when the current account is in surplus. However not all the outflows are from the non-banks so the contractionary extent of the externals is reduced in HO relative to LO, even when account is taken of movements in £ bank lending overseas.

37. The effect of balance of payments transactions on the demand for money for given prices, incomes and interest rates is generally overstated by the external adjustments because there tend to be offsets on bank lending and debt sales (or the PSBR). Nonetheless, external factors are forecast to exert a considerable contractionary influence on £M3 (or, given the target, on interest rates) in both cases.

X. Reserve Assets and Banks' Balance Sheets

38. The banking system has experienced severe reserve asset pressure in recent months, and the authorities have provided large scale assistance to the money market. At mid-April (the

TABLE 6 : EXTERNAL ADJUSTMENTS TO £M3

	Current Balance		Non-Bank Capital Account		Public and Bank £ lending overseas		Total external factors (= 1 + 2 + 3)		Memo item Official OPEC £ holdings (increase +)	
	High	Low	High	Low	High	Low	High	Low	High	Low
1979-80	-1.3	-1.3	-1.8	-1.8	-	-	-2.9*	-2.9*	1.3	1.3
1980-81	-	-2.2	-1.0	0.3	-0.2	-	-1.1	-1.9	1.3	1.3
1981-82	1.9	-1.7	-2.4	-0.6	-0.3	-	-0.8	-2.3	0.8	0.8

*In 1979-80 external factors do not sum to the components because, inter alia, of differences in the statistical coverage between the balance of payments and the money figures.

end of banking 1979-80), assistance in place took the form of sale-and-repurchase arrangements for £1 billion of gilts and £0.5 billion of commercial bills. This pressure is one natural concomitant of the tight monetary target, and is forecast to become more intense. The target limits the growth of bank's liabilities (deposits) while the demand for bank assets (loans) from the private sector remains high. Arithmetically, banks' assets and liabilities are equated by a reduction in lending to the public sector: however, this constitutes the main source of reserve assets/primary liquidity. An alternative way of viewing the issue is that the authorities "over fund" a given PSBR - massive sales of public debt to the non-bank private sector leave no room for bank acquisition of reserve assets.

39. Tables 7 and 7A demonstrate the consequences in 1980-81 in the two forecast cases. The forecasters conclude that in the course of the year, the banking system will require additional assistance of perhaps £1.8 billion in the lower output case, and £2.1 billion in the higher output case. In 1981-82 still further assistance would probably be required in both cases, particularly in the higher output case which features a much lower PSBR.

XI. Other Monetary Aggregates

40. The projected growth in narrower and wider monetary aggregates in both forecast cases is conditioned by the assumption that the £M3 targets are met. The forecasts are highly uncertain. M1 is largely demand-determined, and projected continued high inflation but declines in nominal interest rates (which lower the opportunity cost of holding cash, and more importantly sight deposits) suggest a reversal of the recent pattern, in which M1 has been growing far less rapidly than £M3. The converse is true of the wider aggregate, PSL1: reintermediation of the bill leak in 1980-81 and low net take-up of CTDs both imply slow growth relative to £M3. The rate of growth of the widest aggregate, PSL2, remains at the recent level and is greater than that in £M3 or PSL1 over the forecast period: building society deposits grow rapidly.

TABLE 7: BANKS' BALANCE SHEETS 1980-81

£m increase in banking Year:	Lower Output	Higher Output
£M3	5,730	5,730
Less notes and coin	-1,350	-1,300
Overseas £ deposits	1,650	1,040
Net D.C. deposits	-1,510	-1,480
Non-deposit liabilities	1,680	1,680
Total liabilities	6,190	5,660
Lending to:		
Private sector, and overseas	8,160	8,280
Discount market	-	-
Local authorities	700	410
Public corporations	-420	-420
Central government	-2,250	-2,610
Total assets	6,190	5,660

TABLE 7A: BANKS' RESERVE ASSETS 1980-81

	Lower Output	Higher Output
CGBR	8,320	7,330
External finance (-)	-1,720	-1,220
CG debt sales (-) to non-banks (including notes and coin)	-8,840	-8,720
("Overfunding")	(-2,240)	(-2,610)
Gilt sales to/SSD calls on banks (-)	770	770
Unspecified assistance	1,830	2,120
CG reserve assets	350	280
Discount market switch	350	350
Commercial bills	100	100
Reserve assets	800	730

TABLE 8: DIFFERENT MONETARY AGGREGATES

% growth	Actual	Forecast			
		Lower Output		Higher Output	
	1979-80	1980-81	1981-82	1980-81	1981-82
M1	7	17	18½	18½	23
£M3	13	9	8	9	8
PSL1	12	7½	7½	7½	7½
PSL2	11	11½	12	11½	12

XII. The Company Sector

41. The financial prospects for the industrial and commercial company sector are bleak even in the higher output case. The problem is not so much the size of the deficit to be financed in any one year, as the succession of substantial deficits for 1979, 1980 and 1981. For these years, the deficits cumulate to £15 billion, compared to about £5 billion in 1973 to 1974. The same point can be made by looking at the disposable income of the company sector (equal to its saving plus dividends) which is expected to _fall_ in 1980 in nominal terms, and only to recover rather weakly in 1981.

42. The financing of these deficits is not likely to be helped by new issues of either debentures or equities unless inflation falls sooner than is now forecast or interest rates at the long end ease sharply. This leaves companies dangerously dependent on bank finance and the money supply targets for that reason are clearly at risk. The changes that have been made to the forecast of earnings and the exchange rate since the pre-Budget up-date of the forecast are enough to make the company sector problem look rather a lot worse. This judgement illustrates the great uncertainty that must surround any assessment of the position of the company sector at the present time.

43. In the lower output case, companies must come under even greater financial pressure (although a lower exchange rate compensates in part for the worse trade performance). With interest rates remaining high and with the very poor outlook for profits, widespread bankruptcies would seem inevitable - a much worse

TABLE 9 COMPANY SECTOR : FINANCIAL INDICATORS

	Disposable Income as % of Total Domestic Income		N A F A as % of Total Domestic Income		Gross Liquid Assets Ratio	
1973	4.3		-1.9		10.4	
1974	1.8		-5.1		10.1	
1975	3.2		1.3		10.2	
1976	5.0		1.5		9.8	
1977	5.1		-		10.4	
1978	5.8		1.2		9.6	
1979	3.2		-2.2		8.3	
	High	Low	High	Low	High	Low
1980	1.1	0.4	-2.5	-3.0	7.5	7.4
1981	2.2	1.2	-1.3	-1.7	7.1	6.9

Notes:- Disposable Income is defined as savings + ordinary dividends

Disposable Income and NAFA refer to Industrial and Commercial companies excluding N.Sea,

Gross liquid assets of all Industrial and Commercial companies, financial years

trade performance). With interest rates remaining high and with the very poor outlook for profits, widespread bankruptcies would seem inevitable - a much worse prospect indeed than companies themselves seem to anticipate at the present time. It is very difficult to guess what would be the financial implications of such a deep recession - and the extent to which those implications would delay the recovery.

XIII. Financial Institutions

(i) Building Societies

44. Throughout 1979-80 building societies' share rates have remained uncompetitive with general short-term interest rates. We have assumed that societies are willing to accept a slow return to competitiveness brought about as short rates decline - they would regain their average competitive level in the first half of 1981. In the higher output case we have also assumed that they delay widening their margins (made necessary by the considerably increased composite tax rate in prospect) until the share rate is reduced. But in the lower output case we consider that the downward trend in competitive rates will not be sufficiently strongly established by the autumn of 1980 (when the composite rate is fixed) to prevent societies raising the mortgage rate - by $\frac{1}{4}$ percentage point - to maintain their reserves. However, there is a clear danger that they will raise both share and mortgage rates simultaneously, in which case the mortgage rate would rise still higher. Even if the share rate is not increased, inflows are forecast to recover strongly in the next two years as the savings ratio remains high and societies' competitive position improves. We forecast shares and deposits outstanding to grow by over 18% a year in both 1980-81 and 1981-82. As a result mortgage advances are expected to rise considerably faster than house prices, compensating for the sharp falls in real lending over the last two years.

(ii) Life Assurance Pension Funds

45. Net accruals to life assurance and pension funds are forecast to grow in line with wages and salaries, yielding £11.1 billion in 1981-82. Institutional purchases of company securities in 1980-81 are expected to remain limited by a relatively low volume of new issues and sales by the personal sector, so the share of

equities in their total portfolio is forecast to decline further. Investment in property is anticipated to remain at a normal level, but because of revaluations due to price increases property will account for a rising proportion of total portfolios. Net investment overseas is expected to grow strongly over the next year following the abolition of exchange controls and, partly as a result, net purchases of gilts are forecast to fall substantially in 1980-81 from the very high levels of 1979-80. Purchases of £3¼ billion, compared with £5.1 billion in 1979-80, nevertheless imply a rise from 25% to nearly 27% in the share of gilts in the institutions' portfolios because of revaluations of existing stocks as long rates fall. As a result of the relatively low gilts sales net short term assets, which were run down sharply in 1979-80, are forecast to rise back sharply in 1980-81, re-establishing a more normal relationship with their total flows of funds.

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Table HIGHER OUTPUT SU23

Date 6 JUNE 80

Forecast for 1980-81

£ million unadjusted

		C.G.	L.A.s	P.C.s	Overseas	Persons	I. & C. Cos.	Banks	O.F.I.s	Unallocated	
Capital account (Receipts +, payments -)											
Saving	1										1
Capital transfers (net)	2										2
Fixed investment	3										3
Stock building	4										4
Financial surplus/deficit	5	-2077	-1309	-1741	-13	16282	-5908	1327	-2471	-4050	5
Financial transactions (Receipts -, payments +)											
Accruals adjustments etc	6	1457	-87	-65		-115	-1190				6
Government lending	7	3809	-1316	-2573	240	-64	-96				7
P.C. lending (excl. hse. purchase)	8			168	-160		-8				8
P.C. trade credit (net)	9			-100			100				9
Loans for house purchase: building Societies	10					-7015			7015		10
Other (excl. banks)	11		480	-23		-557			100		11
Credit extended by retailers	12					-200	200				12
Other identified O.F.I. loans	13					-400	-700		1100		13
Life Ass. and Pen. Fds.	14	-210				11176			-10966		14
Unit Trust Units	15					300			-300		15
Capital Issues	16						-1000	-400 a. 50 b. 500	-50		16
Other company and overseas securities*	17	155		235	-500	-2000	1000		2010		17
UK priv. investment overseas	18				-7379	200	5779		1600		18
Overseas inv. in UK priv. sector	19				6065		-5300		-265		19
Other overseas transactions	20										20
Deposits with: Building Societies	21					9012	-100		-8912		21
NSB Inv. Acc./TSB New Dept.	22					900			-900		22
Other deposits with O.F.I.s	23					100			-100		23
Banks' net non-res. f.c. claims/deps.	24				-2134			2134			24
Bank lending: In f.c. for inv. overseas	25						-650	250	400		25
Other f.c. loans to priv. sector	26										26
In sterling	27				-262	-2067	-5458	7983	-196		27
Bank deposits: Domestic f.c. deps.	28					100	750	-1100	250		28
UK residents' £ sight deps.	29										29
Other £ deps.	30				1041	2330	545	-5467	1556		30
SUB-TOTAL	31	5211	-923	-2355	-3309	11700	-6600	3950	[illegible]		31
Unidentified	32	44	-36	143	1464	1300	350		[illegible]	-4050	32
Public Sector Borrowing Req.	33	-7332	-300	424	1392	3282	450	-2623	4407		33
External finance: Market Treasury Bills	34	26			-26						34
British Govt. Securities	35	-1213			1213						35
Direct borrowing (net)	36	599			-599						36
Reserves, etc (= currency flow)	37	-629			629						37
L.A. and P.C.	38		-175		175						38
TOTAL	39	-1217	-175		1392						39
Notes and coin	40	-1300				[illegible]	650				40
National Savings	41	-1517				1517					41
Treasury Bills	42	-160							160		42
Gilts - variable rate	43										43
Gilts - other	44	-5591				1150	-200		4641		44
Other CG debt	45	-154				15	100		39		45
CG transactions in L.A. debt and c. Bills.	46										46
Payment of ECS claims	47										47
L.A. temporary debt	48		233				-100		-133		48
Other L.A. debt	49		50			-50					49
P.C. debt	50										50
TOTAL NON-BANKS	51	-8322	233			3282	450		4407		51
Bank lending to pub. sector in f.c.	52										52
Bank lending to pub. sector in £	53	1604	-438	424				-2623			53

PSBR (borrowing -) = (CG 33) + (LA 33) + (PC 33) = 7208

DCE = (Banks 1/5 + 27 + 33 + 54) + (Overseas [illegible]) + (Persons + I.C.C.s 40) =

Δ Sterling M3 = (Persons + I.C.C.s 40) - (Banks 29 + 30) - (Overseas 30) = 5726

Change (increase -) in bank's non-deposit liabilities = (Banks cols. [illegible] + 6 + [illegible] 7c) = -1677

Liquid Assets = cols. 21 + 22 + 23 + 28 + 29 + 30 + 40 + 41 + 42 + 45 + 48:

Persons = ICCs = 1665

Banks a. = mainly bank take-up of shares of own subsidiaries

b. = bank take-up of shares of non-banks.

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Table SU23 LOW OUTPUT

Date 9th JUNE.

Forecast for 1980-81.

£ million unadjusted

		C.G.	L.A.s	P.C.s	Overseas	Persons	I. & C. Cos.	Banks	O.F.I.s	Unallocated	
Capital account (Receipts +, payments −)											
Saving	1										1
Capital transfers (net)	2										2
Fixed investment	3										3
Stock building	4										4
Financial surplus/deficit	5	-3005	-1336	-1873	2206	15762	-6896	1327	-2091	-4094	5
Financial transactions (Receipts −, payments +)											
Accruals adjustments etc	6	1320	-75	-56		-106	-1082				6
Government lending	7	4005	-1368	-2717	240	-64	-96				7
P.C. lending (excl. hse. purchase)	8			168	-160	-8					8
P.C. trade credit (net)	9			-100			100				9
Loans for house purchase:											
building Societies	10					-6373			6373		10
Other (excl. banks)	11		480	-23		-557			100		11
Credit extended by retailers	12					-200	200				12
Other identified O.F.I. loans	13					-350	-650		1000		13
Life Ass. and Pen. Fds.	14	-210				11040			-10830		14
Unit Trust Units	15					250			-250		15
Capital Issues	16						-875	-400 a. 50 b. 500	-50		16
Other company and overseas securities*	17	155		335	-500	-2000	1000		1885		17
UK priv. investment overseas	18				-3153	300	5357		1680		18
Overseas inv. in UK priv. sector	19				6259		-6000		-259		19
Other overseas transactions	20										20
Deposits with:											
Building Societies	21					3255	-100		-3155		21
NSB Inv. Acc./TSB New Dept.	22					300			-300		22
Other deposits with O.F.I.s	23					35			-35		23
Banks' net non-res. f.c. claims/deps.	24				-2160			2160			24
Bank lending:											
In f.c. for inv. overseas	25										25
Other f.c. loans to priv. sector	26						-650	250	400		26
In sterling	27				-35	-[illegible]	-5540	[illegible]	-109		27
Bank deposits:											
Domestic f.c. deps.	28					100	750	-1100	250		28
UK residents' £ sight deps.	29										29
Other £ deps.	30				1650	9893	147	-[illegible]	1830		30
SUB-TOTAL	31	5270	-963	-2443	-1865	11583	-[illegible]	3396	-7090		31
Unidentified	32	244	-[illegible]	[illegible]	[illegible]	460	342		[illegible]	-4094	32
Public Sector Borrowing Req.	33	-8319	-300	-234	1490	8319	451	-1969	4899		33
External finance:											
Market Treasury Bills	34	-77			77						34
British Govt. Securities	35	-1355			1355						35
Direct borrowing (net)	36	635			-635						36
Reserves, etc (= currency flow)	37	-1024			1024						37
L.A. and P.C.	38		225		-225						38
TOTAL	39	-1721	225		1496						39
Notes and coin	40	-1351				[illegible]	636				40
National Savings	41	-1463				1463					41
Treasury Bills	42	-168							168		42
Gilts - variable rate	43										43
Gilts - other	44	-5700				1200	-200		4700		44
Other CG debt	45	-152				25	75		52		45
CG transactions in L.A. debt and c. bills.	46										46
Payment of ECS claims	47										47
L.A. temporary debt	48		71				-100		29		48
Other L.A. debt	49		100			-50			-50		49
P.C. debt	50										50
TOTAL NON-BANKS	51	-5839	171			8319	451		4599		51
Bank lending to pub. sector in f.c.	52										52
Bank lending to pub. sector in £	53	2247	-596	424				-1969			53

PSBR (borrowing −) = (CG 33) + (LA 33) + (PC 33) = −8195

DCE = (Banks 17b + 27 + 53 + 54) + (Overseas 39) + (Persons + I.C.C.s 40) =

Δ Sterling M3 = (Persons + I.C.C.s 40) − (Banks 29 + 30) − (Overseas 30) = 5726

Change (increase −) in bank's non-deposit liabilities = (Banks col. 32-5 + 6 + 1 + 17a) = −1677

Liquid Assets = cols. 21 + 22 + 23 + 28 + 29 + 30 + 40 + 41 + 42 + 45 + 48;

Persons = , ICCs = 1048

*Banks a. = mainly bank take-up of shares of own subsidiaries.

b. = bank take-up of shares of non-banks.

HIGHER

TABLE B SUMMARY

	1	2	3	4	5	6	7	8	9	10	11	12
								EXCHANGE RATES		INTEREST		RATES
	GDP AT CONSTANT PRICES 1975=100	RPI% CHANGE OVER PREV. YEAR	EARNINGS % CHANGE OVER PREVIOUS YEAR	PSBR(1)	CURRENT BALANCE	PSBR/GDPM* (1)	ICC'S NAFA	EFFECTIVE EXCH.RATE	DOLLAR/£ RATE	INFLATION EXPECTATIONS (FINANCIAL)	3-MONTH INTER BANK	20-YEAR GILTS
1978	107.6	8.3	14.1	8401	927	5.18	595	63.00	1.920	9.7	9.23	12.40
1979	109.4	13.4	16.9	12496	-2437	6.63	-4655	67.60	2.122	15.0	13.66	12.99
1980	107.3	20.2	21.6	5965	-877	2.59	-6459	73.41	2.294	16.9	16.53	13.92
1981	105.1	10.3	16.9	7625	1812	2.95	-3634	73.01	2.369	11.9	11.78	11.74
1978/79	108.1	8.3	14.8	9282	-17	5.58	-1097	62.65	1.942	10.2	10.74	12.95
1979/80	109.7	15.8	18.7	9779	-1707	5.07	-4880	69.80	2.182	16.7	14.91	13.27
1980/81	106.4	20.0	20.4	7208	13	3.12	-5950	73.90	2.321	15.9	15.46	13.47
1981/82	105.1	15.0	15.7	8115	1809	3.07	-2426	72.16	2.369	10.7	10.66	11.12
1978 QTR 1	105.9	9.5	12.4	1639	-271	4.30	187	65.40	1.928	9.0	6.63	11.52
QTR 2	107.7	7.6	15.2	2008	411	5.04	382	61.50	1.836	9.0	9.05	12.68
QTR 3	108.3	7.8	14.6	2129	255	5.16	109	62.40	1.932	10.0	9.67	12.63
QTR 4	108.6	8.1	14.1	2625	532	6.22	-143	62.70	1.985	11.0	11.59	13.14
1979 QTR 1	107.7	9.6	15.1	2520	-1215	5.08	-1506	64.00	2.015	11.0	12.67	13.35
QTR 2	111.1	10.6	14.7	3266	-310	7.02	-472	67.40	2.081	14.0	12.22	12.13
QTR 3	109.0	10.9	17.7	3570	-238	7.37	-1237	71.00	2.233	17.0	14.08	12.38
QTR 4	109.8	17.3	19.9	3140	-674	6.26	-1439	68.80	2.159	18.0	15.69	14.10
1980 QTR 1	108.8	19.1	21.9	-197	-485	-0.38	-1730	72.00	2.254	18.0	17.66	14.40
QTR 2	108.1	22.4	22.1	2110	-389	3.79	-1785	73.50	2.290	18.2	16.88	14.16
QTR 3	106.5	19.1	21.8	2192	-190	3.80	-1601	73.85	2.309	16.4	16.09	13.55
QTR 4	105.6	20.2	20.7	1870	183	3.16	-1342	74.30	2.334	14.9	15.49	13.50
1981 QTR 1	105.5	10.6	17.3	1046	495	1.72	-1221	73.93	2.360	14.0	13.36	12.58
QTR 2	105.0	10.9	18.1	2353	203	3.70	-1110	74.25	2.374	12.6	12.36	12.03
QTR 3	104.9	15.6	16.7	2170	426	3.32	-804	72.10	2.350	10.9	11.34	11.47
QTR 4	105.1	14.4	15.6	2056	688	3.05	-498	71.75	2.371	9.9	10.06	10.78
1982 QTR 1	105.6	15.2	12.6	1536	482	2.22	-13	70.54	2.361	9.2	8.87	10.18

(1) FINANCIAL YEAR SEASONALLY ADJUSTED

LOWER

TABLE B SUMMARY

	1 GDP AT CONSTANT PRICES 1975=100	2 RPI% CHANGE OVER PREV. YEAR	3 EARNINGS % CHANGE OVER PREVIOUS YEAR	4 PSBR(1)	5 CURRENT BALANCE	6 PSBR/ GDPM* (1)	7 ICC'S NAFA	8 EXCHANGE RATES: EFFECTIVE EXCH.RATE	9 EXCHANGE RATES: DOLLAR/£ RATE	10 INTEREST RATES: INFLATION EXPECTATIONS (FINANCIAL)	11 INTEREST RATES: 3-MONTH INTER BANK	12 INTEREST RATES: 20-YEAR GILTS
1978	107.6	8.3	14.1	8401	927	5.18	595	63.00	1.920	9.7	9.23	12.49
1979	109.4	13.4	16.9	12406	-2437	6.63	-4655	67.80	2.122	15.9	13.66	12.99
1980	106.1	20.3	21.5	6439	-2204	2.84	-7332	71.88	2.246	17.9	17.01	14.16
1981	101.4	17.5	15.7	10323	-1782	4.12	-3747	67.97	2.205	13.1	14.10	12.90
1978/79	108.1	8.3	14.8	9292	-17	5.58	-1097	62.65	1.942	10.2	10.74	12.95
1979/80	109.6	15.8	18.7	9779	-1741	5.07	-4908	69.80	2.132	16.7	14.91	13.27
1980/81	104.6	20.3	19.9	8200	-2206	3.59	-6935	71.20	2.236	16.3	16.34	13.91
1981/82	100.8	10.4	14.6	11375	-1701	4.44	-2189	67.04	2.201	12.9	13.47	12.52
1978 QTR 1	105.9	9.5	12.4	1639	-271	4.30	187	65.40	1.928	9.0	6.63	11.52
QTR 2	107.7	7.6	15.2	2008	411	5.04	382	61.50	1.836	9.0	9.05	12.68
QTR 3	108.3	7.8	14.6	2129	255	5.16	169	62.40	1.932	10.0	9.67	12.63
QTR 4	108.6	8.1	14.1	2625	532	6.22	-143	62.70	1.985	11.0	11.59	13.14
1979 QTR 1	107.7	9.6	15.1	2520	-1215	5.80	-1506	64.00	2.015	11.9	12.67	13.36
QTR 2	111.1	10.6	14.7	3266	-310	7.02	-472	67.40	2.091	14.0	12.22	12.13
QTR 3	109.0	10.9	17.7	3570	-238	7.37	-1237	71.00	2.233	17.9	14.08	12.38
QTR 4	109.5	17.3	19.9	3140	-674	6.26	-1439	68.80	2.159	18.9	15.69	14.10
1980 QTR 1	108.8	19.1	21.9	-107	-519	-0.38	-1758	72.00	2.254	18.0	17.66	14.48
QTR 2	107.3	22.4	22.1	2104	-675	3.80	-2055	73.50	2.290	18.2	16.88	14.16
QTR 3	104.8	19.1	21.8	2342	-615	4.14	-1885	71.66	2.241	16.6	17.00	14.00
QTR 4	103.4	20.7	20.1	2189	-485	3.78	-1632	70.38	2.211	15.4	16.50	14.00
1981 QTR 1	102.3	19.1	16.3	1565	-431	2.64	-1361	69.27	2.211	14.8	15.00	13.50
QTR 2	101.4	10.1	16.8	2931	-586	4.75	-1166	69.19	2.231	13.8	14.50	13.10
QTR 3	100.7	17.1	15.3	2877	-502	4.55	-789	66.93	2.192	12.2	13.80	12.70
QTR 4	100.5	15.8	14.6	2950	-263	4.52	-429	66.48	2.197	11.4	13.10	12.30
1982 QTR 1	100.6	14.8	12.0	2617	-350	3.93	195	65.55	2.194	10.8	12.50	12.00

(1) FINANCIAL YEAR SEASONALLY ADJUSTED

TABLE C SUMMARY (PART II)

PERCENTAGE CHANGES ON PREVIOUS YEAR (EXCEPT COL. 12)

	1 TFE DEFLATOR	2 REAL TFE	3 REAL GDP	4 NOMINAL GDPM	5 PRIVATE SECTOR FINANCIAL WEALTH EXCLUDING REVALUATIONS	6	7 PRIVATE SECTOR FINANCIAL WEALTH INCLUDING REVALUATIONS	8	9 BANK LENDING TO PRIVATE SECTOR	10 PRIVATE SECTOR HOLDINGS OF GILTS	11	12	13 £M3	14 REAL MONEY SUPPLY	15 M1
					NET	GROSS	NET	GROSS		EXCL. REVALS.	INCL. REVALS.	AS A % OF GROSS WEALTH			
1978 QTR 1	9.29	3.23	1.71	14.32	11.21	16.02	13.39	17.46	11.88	16.05	19.58	41.52	14.51	4.77	23.05
QTR 2	8.84	2.55	3.20	14.87	14.07	14.38	14.40	14.58	13.46	16.81	17.33	40.44	14.64	5.33	20.18
QTR 3	8.27	3.96	3.47	14.26	14.38	12.73	6.01	7.23	14.39	11.91	-0.53	40.84	15.20	6.40	18.02
QTR 4	9.18	3.11	2.44	14.10	15.75	11.82	7.67	6.59	15.21	10.32	-1.65	40.27	15.20	5.51	16.67
1979 QTR 1	9.53	1.38	1.73	12.35	15.79	13.37	17.51	14.47	19.98	14.33	16.96	42.43	11.60	1.80	13.16
QTR 2	10.99	6.28	3.13	16.77	13.71	15.53	14.94	16.32	21.13	16.99	18.94	41.35	12.73	1.57	12.73
QTR 3	14.21	1.96	0.64	17.44	12.46	16.58	14.71	16.04	22.86	18.52	22.11	42.25	13.11	-0.96	11.01
QTR 4	16.05	2.50	1.06	18.88	12.62	17.42	7.77	14.24	23.77	20.70	12.82	39.77	13.35	-2.32	10.10
1980 QTR 1	18.34	2.34	1.06	20.77	12.84	13.73	2.50	6.97	24.59	17.70	1.77	40.36	12.92	-4.57	6.82
QTR 2	20.50	-2.49	-2.70	19.74	13.92	13.38	10.26	11.07	25.92	17.09	11.51	41.52	11.77	-7.25	7.15
QTR 3	18.68	-1.28	-2.28	18.35	13.24	12.78	10.62	11.13	23.75	15.68	11.76	42.49	10.91	-6.70	5.04
QTR 4	18.77	-2.39	-3.75	17.07	13.28	11.42	18.30	14.51	21.53	14.74	22.52	42.55	8.01	-8.38	3.95
1981 QTR 1	17.19	-2.34	-3.05	17.36	12.45	11.34	21.34	16.91	16.03	11.24	25.04	43.17	9.10	-6.83	10.28
QTR 2	15.00	-2.43	-2.86	14.08	12.46	9.81	21.11	15.22	12.34	10.96	23.92	44.68	8.18	-5.93	9.50
QTR 3	14.23	-1.47	-1.54	13.87	12.58	9.58	21.47	15.18	12.15	10.26	23.43	45.53	8.15	-5.34	12.33
QTR 4	13.68	-0.46	-0.53	14.09	12.58	10.05	24.67	17.76	13.63	11.31	29.43	46.76	8.13	-4.88	15.20
1982 QTR 1	13.19	0.35	0.04	13.84	12.95	10.91	24.95	18.71	15.21	13.23	31.30	47.75	8.00	-4.59	14.51

LOWER

TABLE C SUMMARY (PART II)

PERCENTAGE CHANGES ON PREVIOUS YEAR (EXCEPT COL. 12)

	1 TFE DEFLATOR	2 REAL TFE	3 REAL GDP	4 NOMINAL GDP(M)	5 PRIVATE SECTOR FINANCIAL WEALTH EXCLUDING REVALUATIONS	6	7 PRIVATE SECTOR FINANCIAL WEALTH INCLUDING REVALUATIONS	8	9 BANK LENDING TO PRIVATE SECTOR	10 PRIVATE SECTOR HOLDINGS OF GILTS	11	12	13 £M3	14 REAL MONEY SUPPLY	15 M1
					NET	GROSS	NET	GROSS		EXCL. REVALS.	INCL. REVALS.	AS A % OF GROSS WEALTH			
1978 QTR 1	9.29	3.23	1.71	14.32	11.21	16.02	13.39	17.46	11.88	16.05	19.58	41.52	14.51	4.77	23.05
QTR 2	8.84	2.55	3.20	14.87	14.07	14.38	14.40	14.58	13.46	16.81	17.33	40.44	14.64	5.33	20.18
QTR 3	8.27	3.96	3.47	14.26	14.38	12.73	6.91	7.23	14.39	11.91	-0.53	40.94	15.20	6.40	19.09
QTR 4	9.18	3.11	2.44	14.10	15.75	11.82	7.67	6.59	15.21	10.32	-1.65	40.27	15.20	5.51	16.67
1979 QTR 1	9.53	1.38	1.73	12.35	15.79	13.37	17.51	14.47	19.98	14.33	16.06	42.43	11.60	1.89	13.15
QTR 2	10.99	6.28	3.13	16.77	13.71	15.53	14.04	16.32	21.13	16.99	18.04	41.35	12.73	1.57	12.73
QTR 3	14.21	1.06	0.64	17.44	12.46	16.59	14.71	18.04	22.86	18.52	22.11	42.25	13.11	-0.96	11.01
QTR 4	16.05	2.50	1.06	18.88	12.62	17.42	7.77	14.24	23.77	20.70	12.82	39.77	13.35	-2.32	10.10
1980 QTR 1	18.34	2.27	0.98	20.69	12.80	13.73	2.46	6.97	24.59	17.70	1.77	40.36	12.92	-4.59	6.82
QTR 2	20.52	-2.86	-3.43	19.00	13.47	13.38	9.81	11.07	25.92	17.09	11.51	41.52	11.77	-7.26	7.09
QTR 3	19.20	-2.45	-3.80	16.59	12.47	12.98	8.15	10.25	24.41	16.17	9.71	42.05	10.91	-6.95	4.59
QTR 4	19.48	-3.96	-5.76	15.59	12.07	11.62	15.12	13.51	22.18	15.36	20.02	42.67	8.81	-8.93	1.83
1981 QTR 1	18.26	-4.38	-5.52	14.56	10.93	11.40	16.41	14.92	16.24	11.79	20.20	42.25	9.19	-7.67	6.66
QTR 2	16.49	-4.95	-5.64	11.49	11.13	9.83	15.23	12.38	11.97	11.27	17.42	43.33	8.19	-7.13	9.56
QTR 3	15.73	-3.83	-3.92	11.89	11.62	9.34	16.78	12.54	10.39	9.96	17.57	43.93	8.13	-6.57	13.05
QTR 4	15.04	-2.93	-2.80	12.47	12.05	9.65	18.89	13.93	10.71	10.67	20.83	44.62	8.13	-6.01	17.73
1982 QTR 1	14.36	-2.23	-2.12	12.39	13.32	10.63	19.59	14.61	11.42	12.90	22.31	45.09	8.00	-5.57	10.44

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TABLE D DCE AND MONEY SUPPLY SUMMARY TABLE

£ MILLION AT CURRENT PRICES, SEASONALLY ADJUSTED

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
		SALES OF PUB. SECTOR DEPT TO NON BANKS			BANK LENDING				EXT. & FOREIGN	NON-		INCR.	------VELOCITY OF £M3------			
	PSBR	GILTS	NATSAV	OTHER	PRIV. SECTOR	OVER-SEAS	RES.	DCE	CURR. FINANCE	DEP LIABS.	RES.	IN £M3	GDP BASED	GNP BASED	% CHG GDP BASED	% CHG GNP BASED
1978	8348	4302	1525	164	4693	1062	-32	8080	-425	887	-28	6740	3.31	3.39	-0.45	-0.97
1979	12613	8485	1105	1365	8709	-19	155	10598	-2044	804	-30	6820	3.42	3.37	3.31	-0.45
1980	6351	6816	1560	-284	9754	952	-552	8413	-1443	1797	-73	5100	3.67	3.65	7.29	8.22
1981	7322	6405	1598	-158	7506	256	-41	7198	-619	1459	1	5121	3.88	3.36	5.90	5.84
1978/79	9254	5721	1618	1154	6354	336	-34	7417	-1082	915	0	5420	3.31	3.36	-0.21	-1.64
1979/80	9998	8264	1020	-511	9570	495	-174	11116	-2876	1384	-116	6740	3.47	3.43	4.84	2.09
1980/81	7207	5341	1520	218	7771	645	-372	8172	-1087	1677	2	5410	3.73	3.72	7.44	8.57
1981/82	8115	7856	1546	54	8555	106	-1	7317	-806	1366	-1	5144	3.93	3.92	5.42	5.22
1978 QTR 1	1557	439	422	299	758	646	150	1951	373	-32	-16	2390	3.26	3.30	-0.16	2.69
QTR 2	1913	1569	348	-439	1641	294	12	2382	-667	341	-14	1360	3.31	3.37	0.21	-0.15
QTR 3	2320	1167	470	155	1106	47	-19	1662	-175	315	-2	1170	3.35	3.41	-0.92	-0.90
QTR 4	2558	1127	285	149	1188	75	-175	2985	44	313	4	1820	3.30	3.30	-0.06	-1.90
1979 QTR 1	2463	1856	515	1289	2419	-80	148	1288	-284	-54	12	1070	3.28	3.27	0.68	-3.71
QTR 2	3031	2484	190	84	2370	-18	-1	2624	-221	351	8	2060	3.43	3.40	3.59	0.68
QTR 3	3719	2044	140	109	2180	99	-35	3670	-1546	576	-38	1510	3.48	3.43	3.02	0.59
QTR 4	3400	2099	260	-117	1830	-15	43	3016	-893	-69	-12	2180	3.46	3.40	4.00	0.65
1980 QTR 1	-152	1637	430	-587	3190	429	-191	1806	-216	526	-74	990	3.51	3.49	6.05	6.50
QTR 2	2251	2160	200	380	3520	370	-351	3050	-850	500	0	1700	3.68	3.66	7.14	9.31
QTR 3	2237	1671	508	89	1508	98	-18	1715	-126	378	-1	1210	3.71	3.70	6.70	7.91
QTR 4	1965	1146	422	-157	1236	58	0	1842	-250	391	-1	1200	3.76	3.74	8.42	10.10
1981 QTR 1	704	162	390	-85	1206	121	1	1565	140	405	0	1300	3.78	3.76	7.49	9.10
QTR 2	2306	2497	415	-61	2167	126	-12	1795	-205	341	0	1249	3.88	3.86	5.45	4.93
QTR 3	2183	1870	403	39	1930	29	-12	1826	-202	351	0	1273	3.91	3.89	5.31	5.20
QTR 4	2069	1676	390	-42	2201	-23	-12	2016	-351	361	0	1298	3.96	3.94	5.52	5.37
1982 QTR 1	1497	1615	338	127	2256	-28	39	1684	-47	313	0	1323	3.98	3.97	5.41	5.47

COL 1 CALENDAR YEAR SEASONALLY ADJUSTED
COL 2 COMPRISES GILTS, LONG TERM LA DEBT AND PC DEBT
COL 4 COMPRISES TREASURY BILLS, LA TEMPORARY DEBT AND OTHER CG DEBT
COL 8 = COL1-(COL2+COL3+COL4)+COL5+COL6+COL7
COL13 = COL8+COL9-COL10
GDP-BASED £M3 IS THE RATIO OF GDP AT CURRENT MARKET PRICES EXPRESSED AT AN ANNUAL RATE TO £M3
GNP-BASED £M3 IS THE RATIO OF GNP AT CURRENT MARKET PRICES EXPRESSED AT AN ANNUAL RATE TO THE CENTRED QUARTERLY AVERAGE OF £M3
COLS 15 AND 16 ARE % CHANGES OVER PREVIOUS YEAR

LOWER

TABLE D DCE AND MONEY SUPPLY SUMMARY TABLE

£ MILLION AT CURRENT PRICES, SEASONALLY ADJUSTED

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
		SALES OF PUB. SECTOR DEBT TO NON BANKS			BANK LENDING				EXT. & FOREIGN CURR. FINANCE	NON-DEP LIABS.		INCR. IN £M3	----VELOCITY OF £M3----			
	PSBR	GILTS	NATSAV	OTHER	PRIV. SECTOR	OVER-SEAS	RES.	DCE			RES.		GDP BASED	GNP BASED	% CHG GDP BASED	% CHG GNP BASED
1978	8340	4302	1525	164	4693	1062	-32	8080	-425	887	-28	6740	3.31	3.39	-0.45	-0.97
1979	12613	8485	1165	1365	8799	-14	155	10598	-2044	804	-30	6820	3.42	3.37	3.31	+0.45
1980	6824	7101	1542	-311	10049	863	-546	8855	-1608	1797	-73	5100	3.63	3.61	6.13	7.07
1981	10029	5925	1447	-172	5930	-14	-42	8694	-2114	1459	0	5121	3.77	3.75	3.85	3.74
1978/79	9254	5721	1618	1154	6354	336	-34	7417	-1082	915	0	5420	3.31	3.36	-0.21	-1.64
1979/80	9998	8264	1020	-511	9570	405	-174	11110	-2876	1384	-116	6740	3.47	3.43	4.82	2.07
1980/81	8199	5603	1470	177	7875	494	-366	8952	-1866	1677	1	5410	3.67	3.66	5.65	6.70
1981/82	11375	7375	1397	56	6437	-165	-3	8816	-2305	1366	-1	5144	3.80	3.79	3.66	3.45
1978 QTR 1	1557	439	422	299	758	646	150	1951	373	-82	-16	2390	3.26	3.39	-0.16	2.69
QTR 2	1913	1569	348	-439	1641	294	12	2382	-667	341	-14	1360	3.31	3.37	0.21	-0.15
QTR 3	2320	1167	470	155	1106	47	-19	1662	-175	315	-2	1170	3.35	3.41	-0.92	-0.99
QTR 4	2558	1127	285	149	1188	75	-175	2085	44	313	4	1820	3.30	3.38	-0.96	-1.80
1979 QTR 1	2463	1858	515	1289	2419	-80	148	1288	-284	-54	12	1070	3.28	3.27	0.68	-3.71
QTR 2	3031	2484	190	84	2370	-18	-1	2624	-221	351	8	2060	3.43	3.40	3.59	0.68
QTR 3	3719	2044	140	109	2180	99	-35	3670	-1546	576	-38	1510	3.48	3.43	3.92	0.59
QTR 4	3400	2099	260	-117	1830	-15	43	3016	-893	-69	-12	2180	3.46	3.40	4.88	0.65
1980 QTR 1	-152	1637	430	-587	3190	429	-181	1896	-216	526	-74	990	3.51	3.49	6.67	6.52
QTR 2	2245	2160	260	380	3520	370	-345	3050	-850	500	0	1700	3.65	3.66	6.47	7.63
QTR 3	2447	2115	566	65	2092	61	-19	1894	-305	378	-1	1210	3.66	3.64	5.11	6.21
QTR 4	2284	1189	406	-169	1247	2	0	2108	-516	391	-1	1200	3.68	3.67	6.23	7.91
1981 QTR 1	1223	139	358	-90	1015	59	0	1899	-193	405	-1	1300	3.68	3.67	4.02	5.44
QTR 2	2944	2396	374	-66	1869	60	-12	2156	-506	341	0	1249	3.76	3.75	3.06	2.45
QTR 3	2890	1687	362	38	1489	-39	-12	2240	-615	351	0	1273	3.78	3.77	3.42	3.36
QTR 4	2963	1703	353	-45	1553	-94	-13	2397	-737	361	0	1298	3.83	3.81	4.01	3.91
1982 QTR 1	2578	1589	308	129	1522	-91	39	2022	-385	313	0	1323	3.83	3.82	4.07	4.20

COL 1 CALENDAR YEAR SEASONALLY ADJUSTED
COL 2 COMPRISES GILTS, LONG TERM LA DEBT AND PC DEPT
COL 4 COMPRISES TREASURY BILLS, LA TEMPORARY DEBT AND OTHER CG DEBT
COL 8 = COL1-(COL2+COL3+COL4)+COL5+COL6+COL7
COL13 = COL8+COL9-COL10
GDP-BASED £M3 IS THE RATIO OF GDP AT CURRENT MARKET PRICES EXPRESSED AT AN ANNUAL RATE TO £M3
GNP-BASED £M3 IS THE RATIO OF GNP AT CURRENT MARKET PRICES EXPRESSED AT AN ANNUAL RATE TO THE CENTRED QUARTERLY AVERAGE OF £M3
COLS 15 AND 16 ARE % CHANGES OVER PREVIOUS YEAR

TABLE E BANK LENDING

PERCENTAGE CHANGE IN AMOUNTS OUTSTANDING OVER PREVIOUS YEAR

		1	2	3	4	5	6	7	8	9
		£ TO PERSONS	£ TO I+C COMPANIES TOTAL	£ TO OFI'S	TOTAL £ PRIVATE SECTOR	FOREIGN CURRENCY TO PRIVATE SECTOR	TOTAL ADVANCES TO PRIVATE SECTOR	£ TO OVER-SEAS	PUBLIC SECTOR	
									£	FOREIGN CURRENCY
1978	QTR 1	15.51	10.24	12.51	11.88	4.83	10.44	30.24	6.27	-100.00
	QTR 2	19.57	9.90	20.66	13.46	9.04	12.54	31.72	35.88	-100.00
	QTR 3	21.58	10.32	21.38	14.39	7.49	13.02	27.30	-9.33	-100.00
	QTR 4	21.43	11.35	23.21	15.21	8.09	13.84	20.12	10.09	-100.00
1979	QTR 1	24.74	17.75	20.60	19.99	4.74	17.02	2.58	20.64	-100.00
	QTR 2	24.44	19.74	20.22	21.13	-0.25	16.84	-3.40	13.67	-100.00
	QTR 3	27.32	20.57	23.97	22.86	0.78	18.69	-2.36	62.35	-100.00
	QTR 4	28.60	20.05	32.87	23.77	3.07	19.98	-0.57	73.04	-100.00
1980	QTR 1	29.65	21.15	31.50	24.59	6.07	21.36	5.50	-9.98	-100.00
	QTR 2	25.42	26.11	26.20	25.92	-1.59	21.20	5.41	-25.04	-100.00
	QTR 3	19.04	27.20	16.86	23.75	0.88	20.08	5.62	-15.22	-100.00
	QTR 4	15.99	26.78	7.32	21.53	-0.77	18.02	7.14	-27.23	-100.00
1981	QTR 1	13.97	18.97	4.22	16.03	-3.15	13.11	4.95	11.99	-100.00
	QTR 2	16.70	11.30	5.41	12.34	5.47	11.39	7.62	11.87	-100.00
	QTR 3	18.89	9.61	7.87	12.15	1.35	10.70	6.19	11.97	-100.00
	QTR 4	20.56	10.73	10.96	13.64	1.67	12.05	4.70	12.06	-100.00
1982	QTR 1	20.40	12.71	14.71	15.21	2.00	13.49	1.91	11.92	-100.00

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TABLE E BANK LENDING

PERCENTAGE CHANGE IN AMOUNTS OUTSTANDING OVER PREVIOUS YEAR

	1 £ TO PERSONS	2 £ TO I+C COMPANIES TOTAL	3 £ TO OFI'S	4 TOTAL £ PRIVATE SECTOR	5 FOREIGN CURRENCY TO PRIVATE SECTOR	6 TOTAL ADVANCES TO PRIVATE SECTOR	7 £ TO OVER-SEAS	8 PUBLIC SECTOR £	9 PUBLIC SECTOR FOREIGN CURRENCY
1978 QTR 1	15.51	10.24	12.51	11.88	4.83	10.44	30.24	6.27	-100.00
QTR 2	19.57	9.90	20.66	13.46	9.04	12.54	31.72	35.88	-100.00
QTR 3	21.58	10.32	21.38	14.39	7.49	13.02	27.30	-9.33	-100.00
QTR 4	21.43	11.35	23.21	15.21	8.09	13.64	20.12	10.09	-100.00
1979 QTR 1	24.74	17.75	20.60	19.98	4.74	17.02	2.58	20.64	-100.00
QTR 2	24.44	19.74	20.22	21.13	-0.25	16.84	-3.40	13.67	-100.00
QTR 3	27.32	26.57	23.97	22.86	0.78	18.69	-2.36	62.35	-100.00
QTR 4	28.60	28.05	32.87	23.77	3.07	19.98	-0.57	73.04	-100.00
1980 QTR 1	29.65	21.15	31.50	24.59	6.07	21.36	5.50	-9.98	-100.00
QTR 2	25.42	26.11	26.20	25.92	-1.59	21.20	3.94	-25.04	-100.00
QTR 3	18.78	28.46	16.52	24.41	0.88	20.63	3.42	-15.22	-100.00
QTR 4	15.50	28.32	6.19	22.18	-0.77	18.57	3.91	-27.23	-100.00
1981 QTR 1	12.60	20.28	2.34	16.24	-3.15	13.29	0.70	11.99	-100.00
QTR 2	14.49	12.14	2.69	11.97	5.47	11.06	3.54	11.87	-100.00
QTR 3	15.90	8.67	4.36	10.39	1.35	9.18	1.60	11.97	-100.00
QTR 4	16.70	8.37	7.19	10.71	1.67	9.52	-0.27	12.06	-100.00
1982 QTR 1	16.42	9.14	10.59	11.42	2.00	10.19	-3.10	11.02	-100.00

TABLE F FINANCING THE PUBLIC SECTOR BORROWING REQUIREMENT

£ MILLION AT CURRENT PRICES, SEASONALLY ADJUSTED

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
		OVERSEAS				FINANCED BY									
						NON-BANK PRIVATE SECTOR						BANKS			
	PSBR	CHANGE IN RESERVES	DIRECT OFFICIAL F.C FINANCE	OTHER	TOTAL	NOTES AND COIN	TREAS + LA BILLS	NAT SAVINGS	GILTS ETC	OTHER	TOTAL	£	F.C	TOTAL	TOTAL
1978	8348	3020	0	755	3781	1178	-517	1525	4302	673	7161	-2594	0	-2594	8348
1979	12614	-2440	0	1703	-737	1001	39	841	8485	1105	11471	1880	0	1880	12614
1980	6170	-174	0	1905	1731	1421	-33	1557	6816	-190	9571	-5132	0	-5132	6170
1981	7283	559	0	1157	1716	1683	149	1597	6405	-307	9527	-3960	0	-3960	7283
1978/79	9253	2464	0	-327	2137	1101	-588	1618	5721	1735	9587	-2471	0	-2471	9253
1979/80	9828	-2739	0	2049	-690	863	-82	755	8264	-282	9519	999	0	999	9828
1980/81	7207	804	0	1363	2167	1300	160	1517	5341	121	8439	-3399	0	-3399	7207
1981/82	8115	232	0	1228	1460	1804	107	1545	7858	-52	11262	-4607	0	-4607	8115
1978 QTR 1	1548	-195	0	1498	1303	628	22	422	439	-94	1417	-1172	0	-1172	1548
QTR 2	1936	2019	0	-259	1760	126	-402	348	1569	-5	1636	-1460	0	-1460	1936
QTR 3	2273	520	0	-630	-110	337	-220	470	1167	541	2295	88	0	88	2273
QTR 4	2591	670	0	152	828	87	83	265	1127	231	1813	-50	0	-50	2591
1979 QTR 1	2453	-757	0	416	-341	551	-49	515	1858	968	3843	-1049	0	-1049	2453
QTR 2	3034	-1717	0	2051	334	37	18	184	2484	48	2771	-71	0	-71	3034
QTR 3	3695	-142	0	-831	-973	302	-9	153	2044	282	2772	1896	0	1896	3695
QTR 4	3432	176	0	67	243	111	79	-11	2099	-193	2085	1104	0	1104	3432
1980 QTR 1	-333	-1050	0	762	-288	413	-170	430	1637	-419	1891	-1936	0	-1936	-333
QTR 2	2251	401	0	527	928	470	-6	197	2160	449	3270	-1947	0	-1947	2251
QTR 3	2287	-121	0	286	167	254	166	508	1871	-86	2713	-593	0	-593	2287
QTR 4	1965	542	0	328	870	284	-23	422	1148	-134	1697	-602	0	-602	1965
1981 QTR 1	704	-78	0	220	142	292	23	390	162	-108	759	-197	0	-197	704
QTR 2	2353	424	0	289	713	512	26	414	2407	-87	3362	-1722	0	-1722	2353
QTR 3	2170	-142	0	306	164	453	94	404	1870	-63	2758	-752	0	-752	2170
QTR 4	2056	355	0	342	697	426	6	389	1876	-49	2648	-1289	0	-1289	2056
1982 QTR 1	1536	-405	0	291	-114	413	-19	338	1615	147	2494	-844	0	-844	1536

COL 5 = COLS 2+3+4 COL 11 = COLS 6+7+8+9+10
COL 14 = COLS 12+13 COL 15 = COLS 5+11+14
BALANCE FOR OFFICIAL FINANCING = COLS 2+3+13

LOWER

TABLE F FINANCING THE PUBLIC SECTOR BORROWING REQUIREMENT

£ MILLION AT CURRENT PRICES, SEASONALLY ADJUSTED

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
	PSBR	OVERSEAS				FINANCED BY									TOTAL
						NON-BANK PRIVATE SECTOR						BANKS			
		CHANGE IN RESERVES	DIRECT OFFICIAL F.C FINANCE	OTHER	TOTAL	NOTES AND COIN	TREAS + LA BILLS	NAT SAVINGS	GILTS ETC	OTHER	TOTAL	£	F.C	TOTAL	
1978	8346	3026	0	755	3781	1178	-517	1525	4302	673	7161	-2594	0	-2594	8347
1979	12614	-2440	0	1703	-737	1001	39	841	8485	1105	11471	1880	0	1880	12614
1980	6643	-602	0	2006	1404	1460	-32	1539	7101	-218	9850	-4611	0	-4611	6643
1981	9981	1010	0	1503	2513	1682	185	1448	5925	-356	8884	-1416	0	-1416	9981
1978/79	9253	2464	0	-327	2137	1101	-588	1618	5721	1735	9587	-2471	0	-2471	9253
1979/80	9828	-2726	0	2037	-689	863	-82	756	8264	-282	9519	918	0	918	9828
1980/81	8199	382	0	1556	1938	1351	168	1468	5603	71	8661	-2400	0	-2400	8199
1981/82	11375	810	0	1578	2388	1765	144	1397	7375	-86	10595	-1608	0	-1608	11375
1978 QTR 1	1545	-195	0	1498	1303	628	22	422	439	-94	1417	-1172	0	-1172	1548
QTR 2	1936	2019	0	-259	1760	126	-402	348	1569	-5	1636	-1460	0	-1460	1936
QTR 3	2273	526	0	-636	-110	337	-220	473	1167	541	2295	88	0	88	2273
QTR 4	2591	676	0	152	828	87	83	265	1127	231	1813	-50	0	-50	2591
1979 QTR 1	2453	-757	0	416	-341	551	-49	515	1858	968	3843	-1049	0	-1049	2453
QTR 2	3034	-1717	0	2051	334	37	18	184	2484	48	2771	-71	0	-71	3034
QTR 3	3695	-142	0	-831	-973	392	-9	153	2044	282	2772	1896	0	1896	3695
QTR 4	3432	176	0	67	243	111	79	-11	2009	-193	1995	1194	0	1194	3432
1980 QTR 1	-333	-1043	0	750	-293	413	-170	430	1637	-419	1891	-1931	0	-1931	-333
QTR 2	2245	365	0	558	923	470	-6	197	2160	449	3270	-1948	0	-1948	2245
QTR 3	2447	-349	0	316	-33	280	162	506	2115	-97	2966	-486	0	-486	2447
QTR 4	2284	425	0	382	807	297	-18	406	1189	-151	1723	-246	0	-246	2284
1981 QTR 1	1223	-59	0	300	241	304	30	359	139	-130	702	280	0	280	1223
QTR 2	2931	549	0	374	923	521	34	374	2396	-99	3226	-1218	0	-1218	2931
QTR 3	2877	7	0	393	400	440	104	362	1687	-65	2528	-51	0	-51	2877
QTR 4	2950	513	0	436	949	417	17	353	1703	-62	2428	-427	0	-427	2950
1982 QTR 1	2617	-259	0	375	116	387	-11	308	1589	140	2413	88	0	88	2617

COL 5 = COLS 2+3+4 COL 11 = COLS 6+7+8+9+10
COL 14 = COLS 12+13 COL 15 = COLS 5+11+14
BALANCE FOR OFFICIAL FINANCING = COLS 2+3+13

TABLE G NON-BANK PRIVATE SECTOR FLOW OF FUNDS

£ MILLION AT CURRENT PRICES, SEASONALLY ADJUSTED

	1 NOTES AND COIN	2 TREAS + LA BILLS	3 GILTS ETC	4 NAT SAV	5 TAX CERTS ETC	6 £ RETAIL DEPS	7 £ CD'S	8 LA DEPS	9 CHANGE IN ASSETS	10 £ BANK LOANS	11 NET F.C LIABS	12 NET MISC LIABS	13 TOTAL IN LIABS	14 NET SURPLUS/ DEFICIT
1978	1176	-517	4362	1525	280	5356	-23	393	12494	4832	-15	-2060	2757	9737
1979	1001	39	8485	841	144	6561	-464	961	17568	8700	-158	626	9168	8402
1980	1421	-33	6816	1557	-483	2919	703	293	13193	9753	-82	-6007	3664	9529
1981	1683	149	6405	1597	237	2945	412	-544	12884	7505	-499	-4736	2210	10674
1978/79	1101	-588	5721	1619	1034	4624	-312	701	13899	6482	211	-2466	4227	9672
1979/80	663	-82	8264	756	-958	6217	-328	676	15408	9569	295	-3696	6168	9241
1980/81	1300	160	5341	1517	154	3059	991	-33	12489	7771	-861	-3606	3304	9185
1981/82	1804	107	7658	1545	454	3098	161	-506	14521	8556	-489	-5141	2926	11595
1978 QTR 1	628	22	439	422	-269	1606	183	175	3206	669	-25	953	1597	1609
QTR 2	126	-402	1569	348	-27	1291	-82	22	2845	1661	26	-1604	83	2762
QTR 3	337	-220	1167	470	412	1052	-76	129	3271	1296	-10	-746	540	2731
QTR 4	87	83	1127	285	164	1407	-48	67	3172	1206	-6	-653	537	2635
1979 QTR 1	551	-49	1858	515	485	874	-106	483	4611	2319	201	547	3067	1544
QTR 2	37	18	2484	184	0	2159	-45	48	4885	2384	-116	1088	3356	1529
QTR 3	302	-9	2044	153	-62	1221	-23	344	3970	2183	95	-653	1625	2345
QTR 4	111	79	2099	-11	-279	2307	-290	86	4102	1814	-338	-356	1120	2984
1980 QTR 1	413	-170	1637	439	-617	530	30	198	2451	3188	654	-3775	67	2393
QTR 2	470	-6	2160	197	69	1210	0	360	4460	3520	-441	-741	2339	2142
QTR 3	254	166	1671	508	68	613	343	-154	3669	1808	-160	-295	1353	2306
QTR 4	264	-23	1108	422	-3	566	330	-131	2593	1237	-135	-1296	-194	2698
1981 QTR 1	292	23	162	390	20	670	318	-128	1747	1206	-125	-1374	-293	2039
QTR 2	512	26	2497	414	47	762	-44	-134	4060	2168	276	-1044	1400	2681
QTR 3	453	94	1370	404	78	758	42	-141	3558	1930	-525	-749	656	2901
QTR 4	426	6	1876	389	92	755	96	-141	3499	2201	-125	-1629	447	3053
1982 QTR 1	413	-19	1615	338	237	823	67	-90	3384	2257	-115	-1719	423	2960

COL 9 = COLS 1+2+3+4+5+6+7+8 COL 13 = COLS 10+11+12
COL 14 = COLS 9-13

EXIT EFPRIN.OUTJ

LOWER

TABLE G NON-BANK PRIVATE SECTOR FLOW OF FUNDS

£ MILLION AT CURRENT PRICES, SEASONALLY ADJUSTED

	1 NOTES AND COIN	2 TREAS + LA BILLS	3 GILTS ETC	4 NAT SAV	5 TAX CERTS ETC	6 £ RETAIL DEPS	7 £ CD'S	8 LA DEPS	9 CHANGE IN ASSETS	10 £ BANK LOANS	11 NET F.C LIABS	12 NET MISC LIABS	13 TOTAL IN LIABS	14 NET SURPLUS/ DEFICIT
1978	1176	-517	4302	1525	280	5356	-23	393	12494	4832	-15	-2060	2757	9737
1979	1091	39	8485	841	144	6561	-464	961	17568	8700	-158	626	9168	8402
1980	1460	-32	7101	1539	-480	2827	756	262	13433	10047	-82	-5190	4775	8658
1981	1662	185	5925	1449	259	2863	495	-615	12242	5929	-499	-3143	2287	9955
1978/79	1101	-588	5721	1619	1034	4624	-312	701	13899	6482	211	-2456	4227	9672
1979/80	803	-82	8264	756	-958	6217	-328	676	15408	9569	295	-3655	6109	9210
1980/81	1351	168	5603	1469	152	2941	1059	-81	12661	7875	-861	-2415	4599	8063
1981/82	1765	144	7375	1397	491	3029	268	-577	13892	6436	-489	-3492	2455	11437
1978 QTR 1	626	22	439	422	-269	1666	183	175	3206	669	-25	953	1597	1609
QTR 2	126	-402	1569	348	-27	1291	-82	22	2845	1661	26	-1604	83	2762
QTR 3	337	-220	1167	470	412	1052	-76	129	3271	1296	-10	-746	540	2731
QTR 4	87	83	1127	285	164	1407	-48	67	3172	1206	-6	-663	537	2635
1979 QTR 1	551	-49	1858	515	485	874	-106	483	4011	2319	201	547	3067	1544
QTR 2	37	18	2484	184	0	2159	-45	48	4885	2384	-116	1088	3356	1529
QTR 3	392	-9	2044	153	-62	1221	-23	344	3970	2183	95	-653	1625	2345
QTR 4	111	7	2099	-11	-279	2367	-290	85	4102	1814	-339	-356	1120	2984
1980 QTR 1	413	-170	1637	430	-617	530	30	198	2451	3188	654	-3744	98	2352
QTR 2	476	-6	2160	197	69	1210	0	389	4480	3520	-441	-454	2625	1855
QTR 3	280	162	2115	506	76	538	393	-173	3897	2092	-160	-92	1840	2056
QTR 4	297	-18	1189	406	-8	549	333	-143	2605	1247	-135	-900	212	2395
1981 QTR 1	304	30	139	359	15	644	333	-145	1679	1016	-125	-969	-78	1757
QTR 2	521	34	2396	374	52	732	-24	-151	3934	1869	276	-652	1493	2441
QTR 3	446	194	1607	362	94	749	64	-159	3341	1490	-525	-348	617	2723
QTR 4	417	17	1703	353	98	738	122	-160	3288	1554	-125	-1174	255	3034
1982 QTR 1	387	-11	1589	308	247	810	106	-107	3329	1523	-115	-1318	90	3239

COL 9 = COLS 1+2+3+4+5+6+7+8 COL 13 = COLS 10+11+12
COL 14 = COLS 9-13

CORRUPT PRINT

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10 DOWNING STREET

From the Private Secretary

13 November 1980

Dear John,

As you know, the Prime Minister held a meeting yesterday afternoon with the Chancellor and Sir Douglas Wass to discuss Sir Douglas' paper on policy options for taking the pressure off the corporate sector (your letter of 7 November refers). Sir Robert Armstrong was also present.

The Chancellor said that he had decided that the immediate aim must be to go for option II - i.e. an early, modest reduction in interest rates. He had in mind a reduction in MLR of 2 per cent. To enable this to take place, he would need to be able to demonstrate that the Government was not abandoning the monetary strategy; and he would therefore need to announce in his speech in the Debate on the Address a credible package of measures. His intention was to announce the following: a further extension of granny bonds and probably a restricted indexed gilt, the outcome of the current public expenditure review, the external financing limits for the nationalised industries in 1981/82, an increase in PRT [illegible] to bring in about £1 billion in 1981/82, and the increase in employee national insurance contribution. He would also have to announce the roll forward of the monetary target and the Government's conclusions on the monetary base control Green Paper. All this would be against the background of the Industry Act forecast which would be published at the same time. Final decisions still had to be taken on most of these matters; but he hoped that - even though the conclusion on public expenditure was likely to be disappointing - the various measures taken together would produce a setting in which a 2 per cent MLR reduction would be defensible. Nonetheless, it had to be recognised that it would involve a considerable element of risk: questions would be raised as to whether the Government was doing enough to get the fiscal balance right, and this might mean that the next budget would have to be even more restrictive; alternatively, it might conceivably be necessary to put MLR up again.

As regards the other options, the Chancellor said that he had concluded that option I - i.e. inflow controls - should not be adopted alongside a reduction in MLR. The two together would give the impression that the Government was moving to an exchange rate objective. But if it turned out towards the end of the month that an MLR reduction was not possible, it would probably be necessary to announce a package of inflow controls to show that the Government was "doing something", even though he did not think that they would have any significant effect. He had rejected the other options in

/Sir Douglas' paper

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Sir Douglas' paper, Option V - i.e. a significant tax switch to the benefit of companies - might be desirable in principle, but it was not possible in terms of cost. Nonetheless, it would be right to lean in the direction of making tax concessions for companies in the next budget.

In discussion the following points were made:-

(i) The proposed 2 per cent reduction in MLR, though desirable on industrial grounds, could very well have a perverse effect on the exchange rate - since it might well result in heavy foreign inflows into gilts. On the other hand, it was argued that a fall in MLR was already being discounted, and that the exchange rate would be just as strong if there was no early reduction. The Prime Minister suggested that, if a 2% reduction were likely to have a perverse effect on the exchange rate, a 2½% reduction might be considered; against this, it was argued that such a figure would look like fine tuning, and would not be understood.

(ii) The public expenditure figures for 1981/82 which the Chancellor would announce following the current review were likely to be £1b or more higher than the figures in the latest public expenditure White Paper; it was therefore crucial for the credibility of the strategy that the Chancellor should announce some of his intentions on tax for 1981/82 at the same time.

(iii) The Prime Minister said she hoped that, even if option I were not adopted, the Treasury would consider switching Bank "customers'" transactions off market again.

(iv) It had been suggested in some quarters that several £b of additional revenue could be raised from PRT rather than the £1b proposed by the Chancellor. But the marginal rate of tax on North Sea fields was already over 90%, and to take out more than an extra £1b could well put at risk the further development of the North Sea. As it was, the reaction of the oil companies was likely to be fairly hostile.

(v) The Prime Minister said she found it difficult to understand the administrative arguments against a fairly radical extension of "Granny Bonds". She hoped that Treasury Ministers would look at the problem, if there was one, imaginatively.

(vi) The Prime Minister said the most disappointing feature of the current PESC review was the deteriorating financial position of the nationalised industries. They had undermined the Government's whole public expenditure strategy. The Chancellor, who reported on a discussion he had had with Sir William Barlow, said that the

/ Government's

SECRET

Government's experience with the nationalised industries over the last 18 months reinforced the arguments for denationalisation and removing the nationalised industries' monopoly position wherever possible.

In conclusion, the Prime Minister said she was content for the Chancellor to proceed on the basis he had outlined.

I am sending a copy of this letter to Sir Robert Armstrong.

Yours ever,

Tim Lankester

S-P.

A.J. Wiggins, Esq.,
HM Treasury.

SECRET

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10 DOWNING STREET

From the Private Secretary

13 November 1980

Cost Sharing with the Banks on Fixed Rate Lending

The Prime Minister read the Chancellor's recent minute on the above subject, and has agreed his proposals.

I am copying this letter to the Private Secretaries to the Secretaries of State for Industry and Trade and the Governor.

T. P. LANKESTER

A.J. Wiggins, Esq.,
HM Treasury.

CS

CONFIDENTIAL

Prime Minister

told J Wiggins MA

Agreed MT

This proposal would be instead of a levy on bank profits. The Treasury need a decision by tomorrow (or at a pinch by Friday morning) so that they can put it to the clearers on Friday – with a view to announcement in the Chancellor's end-Nov statement. It would be less contentious than a levy, but have the same effect – and I think should be accepted. Content?

TL 12/11

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

cc Mr Hoskyns
Mr Wolfson

COST SHARING WITH THE BANKS ON FIXED RATE LENDING

Earlier in the year I considered imposing a levy based on the banks' non-interest bearing deposits as a way of obtaining for the Exchequer some of the profits accruing to banks when interest rates are high. We have not publicly ruled out this idea, but there are, as you know, considerable political disadvantages. I therefore now plan to pursue an alternative approach.

2. The interest subsidy on fixed rate export credit and home shipbuilding lending is expensive when interest rates are high. Interest support on fixed rate export credit is costing us about £500 million a year at present. Since some of this money is paid to the banks, the idea naturally arises of persuading them to take over part of these costs. The general proposal would be that the banks would meet part of the interest subsidy costs above a certain threshold level of interest rates.

3. Of course, the banks will not welcome this. I should need to assure them that the idea of a levy would be dropped if they were prepared to acquiesce

/in this arrangement.

in this arrangement. They would need that assurance if they were to be able to defend to their shareholders their contribution to interest subsidy costs.

4. A straightforward cost-sharing arrangement could well threaten the flow of new finance for exports and home shipbuilding since it would reduce the return on this lending considerably below market levels. The scheme that I propose to put to the banks would seek to avoid this difficulty by relating each bank's contribution not to its fixed rate lending but to its non-interest bearing deposits. John Nott and Keith Joseph, who are directly responsible for the export credit and home shipbuilding schemes, are prepared to accept the idea on that basis. It should largely eliminate the disincentive effect.

5. I have it in mind also to propose to the banks a reduction in the margin which they charge on short term ECGD-backed credit. This would benefit exporters rather than HMG since this credit is not subsidised, and it would only cost the banks about £5 million. It should be helpful in presenting the package at a later stage.

6. The PSBR savings arising from a cost sharing arrangement of this kind would depend on the level of interest rates and the precise parameters of the scheme negotiated with the banks. We would hope to secure cash savings of around £100 million in 1981-82 on the basis of current interest rate expectations.

7. There is a danger of a rebuff from the banks.

/They may judge

They may judge that it would be more in their interests to risk the levy itself than to accept this cost-sharing arrangement. This was one of the factors that led the Governor to advise against proceeding with the idea. But notwithstanding the risks I think that it would be well worthwhile for us to try this approach given the pressing need to reduce public expenditure to meet our targets and our difficulty in finding ways of doing this.

8. It is important to move quickly if we are to stand any chance of securing savings this year. Subject to your concurrence, I therefore propose to raise the idea with Sir Jeremy Morse (the Chairman of the Committee of London Clearing Banks) on ~~Thursday.~~ Friday.

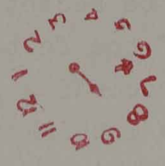
9. I am copying this minute to John Nott, Keith Joseph and the Governor.

PSJ

(G.H.)

12 November 1980

(Approved by the Chancellor and signed in his absence).


12 NOV 1980

Copy on CBI mtg file
Hz Read out by

1. City experts have recently cast doubts on the view that a much lower MLR would significantly increase money supply and some have argued that it would reduce it. These include Lloyds Bank and stockbroker James Capel. Carr Sebag and Messels have also called for lower interest rates. Some reasons are as follows:

a) Many companies would borrow less - 4 points off MLR would directly reduce companies' costs by £1 bn. per annum.

b) Borrowing would be further reduced because cash flow of companies improved by lower £ (would mostly come through after six months because of higher cost of imported materials).

c) 4% off MLR could reduce interest on the National Debt (and so PSBR) by as much as £1 bn. in a full year.

d) Gilt brokers have told us that adequate quantities of gilts could still be sold provided Government was still seen as committed to reducing inflation; and we are convinced that 4% off MLR would not jeopardise this aim.

e) The real interest rate is highly positive. Over the last four months the RPI has risen at annual rate of 8%. Bank overdrafts are 17-19%.

2. Strong message from Conference that £M3 figure bore very little relationship to pay and price behaviour. Firms making low pay settlements and low price increases because of recession, despite recent behaviour of £M3.

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

10 November 1980

T. Lankester, Esq.,
Private Secretary,
10, Downing Street

Not good. MT

Dear Tim,

SHORT-TERM PROSPECTS FOR THE CGBR AND THE PSBR IN THE FIRST HALF OF 1980-81

I am enclosing this month's note for the Prime Minister, in advance of Tuesday's publication of the figure for the CGBR in October, and the Prime Minister's meeting on 18 November on monetary affairs.

The CGBR was small in October - as expected. Large deficits are still expected in November and December and the total of the two months has been raised by new information since last month's forward look. The first shot at January is a surplus of ~~£1.6~~ £1.6 billion - rather less than that of a year ago.

The latest news on the PSBR as a whole suggests that the actual figure for the first half of the financial year was close to £8½ billion - about £½ billion above the part-forecast, part-estimate in last month's report. The prospect for the year as a whole is being reconsidered for publication in the Industry Act forecast later this month. The centre of the range may well be moving upwards, though not much.

Yours
John

A.J. WIGGINS

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THE PROFILE OF THE CENTRAL GOVERNMENT BORROWING REQUIREMENT (CGBR) TO JANUARY AND THE PUBLIC SECTOR BORROWING REQUIREMENT (PSBR) IN THE FIRST HALF OF 1980-81: NOTE OF NOVEMBER 1980

A. Outturn of the CGBR in October

The provisional estimate of the CGBR in October is £124 million. This will be published on 11 November. The outturn may later be increased a little by further information. The result is close to the one month ahead forecast of £100 million made at the beginning of the month. Tax receipts in total were as forecast: an excess of Inland Revenue receipts was offset by a shortfall of Customs and Excise receipts. Net issues to finance departments' expenditure were some £300 million less than forecast. Issues for regional and selective assistance to industrial undertakings (Class IV, Vote 1), which includes the payment of Regional Development Grants and issues to the National Enterprise Board, had been averaging £100 million per month in the first six months of the year; there were however no issues in October. This was the largest single element of the difference from forecast. The timing of certain transfers of funds between government accounts explained the excess of interest receipts compared with forecast and a significant part of the reduction in other central government funds and accounts. Table 1 compares the outturn with the figures forecast in Table 3 of last month's note.

2. The cumulative excess of the CGBR this year so far over the corresponding part of 1979-80 was £1.2 billion at the end of October, the same as at the end of September. Table 2 summarises the figures.~~and also the new forecasts for the remainder of the financial year~~.

3. The outturn of the CGBR in the October banking-month was £619 million, some £200 million lower than forecast. VAT receipts were concentrated more than hitherto in the early part of the calendar month of October. The equivalent figure seasonally adjusted was £408 million.

B. Rolling forecast for CGBR in banking November

4. Banking November runs from 16 October to 19 November. For the period up to 31 October the CGBR was £212 million and the current figure for the banking month as a whole is £1,340 million, in both cases before seasonal adjustment.

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C. Rolling forecast for CGBR in November - January

5. The latest working figures for the CGBR in the next three calendar months are as follows:

	£ million
November	2,150
December	1,350
January	-1,600 (net repayment)

As noted in last month's report these forecasts can deviate by around plus or minus £500 million for the first month and plus or minus £750 million for the third month.

6. The composition of the rolling forecast is summarised in Table 3. Receipts into the Consolidated and National Loans Funds are forecast to be high in January: this is the month for large Inland Revenue receipts of Corporation Tax and Schedule D Income Tax, as well as being the quarterly peak for receipts of VAT. The forecasts of Inland Revenue and Customs and Excise receipts are those supplied by the departments at the beginning of October. It is considered to be too early to revise these forecasts in the light of October's outturn. The figures for other Consolidated Fund receipts include £100 million in December and £210 million in January for refunds from the European Community under the 30 May agreement. It is expected that this will neccessitate a transfer across the exchanges from the EC of £100 million in January and that the remaining refunds in the period will be financed from the gross contribution from the UK and the running down of the balance on the Community's account at the Paymaster General's Office. Also, in December the Consolidated Fund is expected to receive £200 million from the Trustees Savings Banks following the assumption by the Banks of the financing of a further tranche of ECGD-guaranteed lending.

7. In total, expenditure from the Consolidated and National Loans Funds (including net lending) is lower in December than either November and January which are both heavy months for interest payments. Supply Issues, reassessed in the light of departments' new forecasts of outturn, are expected to be larger in January than in recent months: payment of Rate Support Grant increase orders of around £600 million is due in that month. The monthly pattern of net lending includes temporary borrowing by the nationalised industries in November and December which will be repaid partly in January and partly in March.

D. PSBR in April-September

8. The latest score for the PSBR in the first half year is around £8½ billion. Information is still incomplete. A first estimate will be published on 20 November. The outturn for the half year is higher than forecast in last month's note, reflecting the CGBR outturn for September, higher than expected borrowing by local authorities in September and higher borrowing by public corporations from the banking sector. The PSBR for the year as a whole is being reassessed for publication in the Industry Act forecast.

TABLE 1

CENTRAL GOVERNMENT BORROWING REQUIREMENT

CGBR IN OCTOBER

£ million

	Forecast	Outturn	Effect on CGBR
RECEIPTS			
Consolidated Fund			
Inland Revenue	2,850	3,024	+ 174
Customs and Excise	2,600	2,437	- 163
Other	700	680	- 20
National Loans Fund			
Interest etc receipts	400	533	+ 133
Total receipts	6,550	6,674	+ 124
EXPENDITURE			
Consolidated Fund			
Supply services and Contingencies Fund	5,700	5,372	+ 328
Other	250	253	- 3
National Loans Fund			
Service of the national debt	350	423	- 73
Net lending	550	577	- 27
Total expenditure	6,850	6,625	+ 225
Other funds and accounts	+ 200	- 173	- 373
of which: changes in the European Community's balance at PGO	(..)	(- 27)	(..)
CGBR	- 100	- 124	- 24

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TABLE 2

CENTRAL GOVERNMENT BORROWING REQUIREMENT

£ billion

			Cumulative		
	1979-80	1980-81	1979-80	1980-81	Difference
April	1.3	0.9	1.3	0.9	-0.4
May	1.5	2.3	2.8	3.3	+0.4
June	1.0	1.3	3.8	4.6	+0.8
July	-	0.8	3.8	5.4	+1.5
August	1.1	1.6	4.9	7.0	+2.1
September	1.7	0.8	6.6	7.8	+1.2
October	0.1	0.1	6.8	7.9	+1.2
November	1.8	(2.1)	8.5	(10.0)	(+1.5)
December	1.6	(1.3)	10.2	(11.3)	(+1.2)
January	-2.5	(-1.6)	7.7	(9.7)	(+2.1)
February	0.3		8.0		
March	0.1		8.2		

Note: Some rows may not across add because of rounding.
Each column is correctly rounded.

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TABLE 3

CENTRAL GOVERNMENT BORROWING REQUIREMENT

£ million and %

	(1) April — October	(2) November forecast	(3) December forecast	(4) January forecast	(5) 10 months to end January	(6) % change of col (5) on year earlier	(7) Budget forecast for whole year % change
Receipts							
Consolidated Fund							
Inland Revenue	17,534	2,100	2,250	5,300	27,200	+ 17	+ 17
Customs and Excise	12,808	1,950	1,750	2,600	19,100	+ 30	+ 33
Other	4,420	800	900	850	6,950	+ 20	+ 5
National Loans Fund							
Interest etc receipts	2,504	300	350	250	3,400	+ 4	+ 19
Total receipts	37,266	5,150	5,250	9,000	56,650	+ 20	+ 20
Expenditure							
Consolidated Fund							
Supply services	37,098	5,600	5,600	6,000	54,300	+ 24	+ 20
Other	1,787	250	250	250	2,550	+ 1	+ 12
National Loans Fund							
Service of the national debt	5,211	1,250	500	1,450	8,400	+ 21	+ 19
Net lending	2,354	300	250	- 50	2,850	+ 24	+ 27
Total expenditure	46,450	7,400	6,600	7,650	68,100	+ 23	+ 20
Other funds and accounts	+ 1,267	+ 100	-	+ 250	+ 1,600		1,350 (1)
of which: changes in the European Community's balance at PGO	(+ 7)	(- 15)	(- 25)	(- 40)	(- 73)		
CGBR	- 7,917	- 2,150	- 1,350	+ 1,600	- 9,850		

(1) £ million

11 NOV 1980

Econ Pol

2

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

5 November 1980

Prime Minister

Summary is at Flag A: main conclusion is that there may be scope for smoothing on the revenue side, but not on the expenditure side.

TL

T.P. Lankester, Esq.,
No.10, Downing Street

Dear Tim,

SMOOTHING THE PSBR

At the Prime Minister's seminar on 13 October Sir Douglas Wass reported that the Treasury were studying possible methods of improving the profile of the cash outflow of the public sector with a view to simplifying the problems of monetary management. The Prime Minister said that she was much interested in this work and would like to see its outcome, with a view to discussing it at the further meeting she is to have on 12 November.

I attach a copy of the report. It is a rather voluminous document, so I am also attaching a summary. The Prime Minister will find the report's principal conclusions and recommendations in paragraphs 59-61 of the main paper.

I am sending a copy of this letter, and of the summary, to Tim Allen at the Bank of England.

Yours

John

A.J. WIGGINS

5 NOV 1980

[SMOO]THING THE PSBR: SUMMARY OF REPORT OF WORKING GROUP

The Working Group, under Treasury chairmanship, was asked in its terms of reference,

> 'To determine the reasons for the uneven path of the PSBR in recent years; to assess whether the unevenness is likely to continue in future years; if so, to examine methods by which it could be corrected; and to make recommendations.'

The problem

2. There are two related, though conceptually distinct, variations in the PSBR path which can produce problems for monetary management:-

(i) front-end loading whereby - increasingly in the last few years - the bulk of the PSBR has had to be financed in the first part of the year;

(ii) month by month fluctuations.

Arguably, if a fluctuating path is predictable, and statistics are reported on a seasonally-adjusted basis, there ought in principle to be no problem for monetary management. However, seasonally adjusted forecasting is rarely so easy in practice both because past patterns are a far from infallible guide to present patterns and because non-recurring receipts (like asset sales) are difficult to predict. The result is divergence from the forecast path which the markets may find difficult to accept even if it does not, in fact, lead to increased borrowing overall. Apart from this problem of predictability, markets are anyway asked to take a great deal on trust when the PSBR is heavily weighted towards the beginning of the year and the Government's room for offsetting action, should an overrun develop, may be correspondingly circumscribed.

3. The Group therefore concluded (paras 6-12) that unevenness makes monetary management more difficult because:-

a. it makes predicting, and therefore controlling, monetary development harder;

b. 'front-end loading' causes financial markets to doubt the effectiveness of monetary control;

c. marked fluctuations from month to month complicate the management of debt sales.

This establishes a *prima facie* case for taking action to smooth the PSBR. Although the transition to a more even profile may itself cause problems by reducing the predictability of the system, the Bank

consider that this cost could be acceptable given the long-run benefits [illegible] smoother path.

The historical record

4. The historical record shows that the main cause of fluctuations in the PSBR lies within central government own account transactions - and these primarily on the revenue side (para 5). In considering the potential for smoothing the PSBR it was primarily to CGBR that the Group looked, largely because of the inadvisability of interfering with otherwise relatively stable patterns of local authority and nationalised industry borrowing to offset unevenness elsewhere (paras 23-25).

Scope for smoothing action

5. On central government expenditure the Group found the scope for worthwhile action limited (paras 26-33). The pattern of supply issues throughout the year is fairly regular, reflecting not only the month by month stability of items like pay and social security advances but also efforts already made to produce a smoother profile of issues. Accordingly there was little usefully to be done in the way of altering bill payments or of instituting cash limits for a period shorter than a year. But it would be worth investigating further, as an aid to monitoring and forecasting the CGBR, the possibility of securing more detailed profiles of selected departments' expenditure.

6. On the revenue side the Group identified three Inland Revenue taxes (Petroleum Revenue Tax, Mainstream Corporation Tax and tax payments by building societies) where a smoothing of receipts would help reduce front-end loading (paras 36-47). The Group recommends that in the separate study into future North Sea taxation arrangements due weight be given to the possibility of changing the timing and frequency of receipts amounting to several £ billions. Several options were identified for retiming corporation tax receipts, though at a potential cost in terms of staff numbers and PSBR impact. Shifting the timing of building society tax payments would not involve a significant staff cost, though there would also be less of an impact on the PSBR profile than if corporation tax receipts were retimed.

7. On the Customs and Excise side the main unevenness is in VAT and car tax receipts. Several possible ways of reducing this by switching to monthly (rather than quarterly) payments or altering the payment dates of particular groups of traders (at varying costs in terms of

staff numbers, PSBR and discrimination between traders) were looked at (paras 50-57).

8. On all the possibilities for retiming tax receipts the Group recommends that further work be undertaken to define them more carefully and to establish the costs and benefits of action. That work would need to take account of the effect that individual measures would have in combination, to ensure that the net effect on the expected PSBR profile would be helpful.

Forecasting and monitoring

9. To the extent that unevenness is bound to remain, even following action to secure smoothing, monetary management would be facilitated by improved forecasting and monitoring. The Group recommends that the momentum of recent developments here be maintained and that the scope for certain specific further improvements should be considered (paras 16-21).

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SMOOTHING THE PSBR

I INTRODUCTION

This report was commissioned against the background of difficulties in managing monetary growth in the first half of 1980-81 when the PSBR was running at an annual rate well above that expected for the year as a whole, which was itself likely to exceed the forecast in the FSBR.

2. It was agreed at the Prime Minister's 13 October meeting on monetary policy and control that the Treasury would consider what improvements might be made to effect a smoothing of the PSBR. The present report has been prepared by a Working Group under Treasury chairmanship with the following terms of reference:-

> "To determine the reasons for the uneven path of the PSBR in recent years, to assess whether the unevenness is likely to continue in future years; if so, to examine methods by which it could be corrected; and to make recommendations."

The Bank of England, the Central Statistical Office, Customs & Excise, and the Inland Revenue were represented on the Group.

3. The Report falls into three parts;-

(i) an examination of the flow of central government receipts and expenditure and of the borrowing of local authorities and public corporations to ascertain the causes of the unevenness in the path of the PSBR and the likelihood of its continuation in the future (Section II);

(ii) consideration of how unevenness in the PSBR path within the year could create difficulties for monetary control and whether these followed from the unpredictability of the figures or from unevenness itself (Section III);

(iii) examination of the ways of dealing with an uneven PSBR path. This covers not only the possibility of altering the timing of receipts and expenditure, so as to smooth the actual path of the PSBR, but also the possibilities for improving forecasting so as to reduce unexpected fluctuations in the PSBR path. Throughout there is a need to take account of the costs of action - whether in terms of additional manpower or, for example, the possible once-and-for-all effects on the PSBR and on the financial position of the private sector - of steps to retime receipts or expenditure. Possible areas in which action could prove worthwhile are recommended for further investigation with a view to preparation of detailed proposals (Sections IV and V).

II UNEVENNESS OF THE PSBR PATH: THE FACTUAL BACKGROUND

4. A CSO analysis of the path of the PSBR and of its main constituents covering the period since financial year 1976-77 is attached at Annex A. Only the main points are set out here. It is important at the outset to note the distinction between divergences from a smooth PSBR path which follow a regular seasonal pattern and so are in principle predictable and those which are irregular either because (like the Post Office billing dispute) they reflect transient random influences ("noise" in the figures) or (as with the growth of Petroleum Revenue Tax (PRT) revenues) they represent a transition from one state of affairs to another. Clearly, both regular and irregular divergence contribute to the month to month fluctuations and to the skewness quarter by quarter which together influence the path of the unadjusted PSBR figures with which the monetary authorities have to deal.

5. The main points to note from the historical record are:-

(i) On a quarterly basis there is a well established pattern of a much higher rate of public sector borrowing in the first part of the financial year than in the January to March quarter. The extent of this "front end loading" has varied from year to year - in the period examined, public sector borrowing over the first three quarters varied between 84 and 112% of the total for the year.

(ii) The quarterly series for the PSBR masks what are sometimes very sharp fluctuations from month to month. These fluctuations are partly random and partly due to the specific timing of particular transactions established by statute and otherwise. As things stand, the absolute variations in the path of the PSBR are likely to grow with increases in the nominal size of public sector transactions as prices rise. Moreover, variations in the path of the PSBR are likely to become larger in relation to transactions generally, because of the growth of PRT receipts, which are at present very unevenly spread, and of deliberate policy decisions - see (v) below.

(iii) Seasonal effects and other irregularities often affect the final quarter of the financial year more than other quarters. These are among the factors which contribute to the difficulty of assessing final year outturns with any certainty, even very late in the year.

(iv) Most (usually two-thirds or over) of the variability in the quarterly path of the PSBR over the past four years is, as indicated in Table 1 of Annex A, attributable to the CGBR, own account. This is mainly attributable to the revenue rather than the expenditure side. In recent years the pattern of supply issues has been fairly regular with a rise in expenditure during the year, reflecting inflation during the year, and something of a year end peak reflecting efforts by suppliers

and Departments to complete business before the end of the financial year. On the revenue side the pronounced seasonal pattern of the Inland Revenue receipts (particularly Mainstream Corporation Tax (MCT), and - a smaller item - Building Society taxes) is the main source of quarter by quarter variations. On the Customs side VAT receipts are on a rising quarterly trend through the financial year and there are sharp peaks in certain months.

(v) The largest variations in the path of the CGBR seem to flow from deliberate policy decisions (including Budget decisions) eg on the pattern of tax payments, EC refunds, and on asset sales (receipts from which tend to arrive late in the financial year). Big distortions have flowed from the effects of industrial action.

(vi) Fluctuations in the Local Authorities Borrowing Requirement (LABR) and the Public Corporations Borrowing Requirement (PCBR), which includes the nationalised industries) are smaller than those in the CGBR. Lack of frequent information from many of the bodies concerned makes analysis and forecasting in these areas difficult. Quite separately from the influence of these sectors on the PSBR, it is difficult to forecast how they will finance themselves from month to month - ie the split between borrowing from central government, borrowing from the private sector and from the overseas sector.

III MONETARY CONTROL AND EVENNESS IN THE PSBR

6. Monetary control is at present based on:

a. the three months forward look undertaken monthly and the financial year forecast (both seasonally adjusted) of £M3 and of its counterparts including the PSBR;

b. monitoring of actual statistics in order to judge whether achievement of the current monetary target requires corrective changes to be made in interest rates or the planned level of sales of gilts and other debt (possible changes in methods of selling debt are the subject of a separate paper by the Bank of England).

7. With a floating exchange rate, changes in the PSBR, or departures from its forecast path, will, under the present system of monetary control, generally lead £M3 to change in the same direction, though the size of the effect varies with the composition of the PSBR change. The path of the PSBR within the financial year thus has a marked influence on the path of £M3, though the £M3 target periods do not necessarily correspond to financial years.

8. Any variation in the quarterly or monthly unadjusted PSBR will of course be reflected in differing requirements for public sector finance. But some important variations in the PSBR occur for reasons that are recurrent and predictable or that are predictable even if they are non-recurrent. Since both the forecasts and the actual statistics referred to in paragraph 6 above are seasonally adjusted, it can be argued that variations that are predictable need not in principle cause difficulties for monetary control, and that only unpredictable variation need cause severe problems of interpretation and thus of market management. It is often impossible to explain such variations even after they have occurred and therefore to assess whether they are likely to be reversed in later months.

9. That argument, however, overlooks two important practical considerations. First, the techniques of seasonal adjustment (which are based on observation of past patterns) do not work well, even for variations that are predictable, unless the pattern is recurrent from year to year, and is either stable or changing only slowly. If the seasonal variations are extremely uneven, they may produce rapidly changing patterns, with unpredictable effects on £M3. MCT, and more particularly PRT, produce just such problems. It is true that steps to smooth the seasonal variations may themselves cause uncertainties in prediction and seasonal adjustment if they involve abrupt changes, and this could constitute an argument against change. (This does not apply to PRT where the growth has been too recent to be reflected in the estimated seasonal adjustments for £M3, but it is true for MCT). However, in view of the long term benefits they believe would result from a smoother path, the Bank consider that this risk should not stand in the way of change over a suitable transitional period.

10. Second, given the uncertainties of seasonal adjustment referred to above, it is important to be able to recognise whether variations from the projected PSBR path in the early months of the fiscal year do or do not identify an error in the forecast outturn for the year as a whole. This task is made considerably harder if the payment of certain taxes is heavily concentrated in the final months of the fiscal year - as it is under present arrangements, producing the marked front-end loading of the PSBR. There is consequently a delay before any necessary change in the monetary stance can be made, and it may come too late to effect offsetting debt sales within the target period.

11. Moreover, variations during the year from the projected PSBR path or the targeted monetary path, even though explicable in the eyes of the authorities as random movements which will be reversed before the end of the year, will not be so readily accepted as such in financial markets. Scepticism will greet an accumulated figure that is very large in relation to the projected total for the year, even if it can be explained away in terms of specific factors (and such explanations would carry greater weight if the expected path incorporating those factors had been fully spelt out at the beginning of the year). Financial markets will,

in particular, be unwilling - until they have actually happened - to take on trust projections on non-recurring receipts such as those from planned sales of assets. Market fears that the PSBR will be higher than is in fact likely to be the case and related concern about the course of the money supply will, other things being equal, discourage debt sales and could cause higher short term interest rates than would otherwise be necessary.

12. The broad conclusions of this section are that it is desirable:

i. to reduce the present front-end loading of the PSBR;

ii. to reduce the extreme unevenness of the month by month flows of revenue and expenditure, particularly of MCT and PRT (see paragraph 9), thus facilitating forecasting and monitoring.

13. It is not possible to quantify the benefits which might flow from particular degrees of smoothing in the two areas described in the preceding paragraph. A certain amount of unevenness in the PSBR is acceptable - any system has after all to have enough flexibility to cope with random influence on the month by month PSBR, for example - and the returns to specific actions designed to create a smoother expected path probably decline after a certain point.

14. Accordingly the approach adopted by the Working Group, and reflected in this Report, was to examine specific options for change - the impact they would have on either of the problems identified and their potential costs - and then to recommend which of them seem worth pursuing further. As explained in Section II above, the main source of unevenness in the expected course of the PSBR lies in CGBR own account transactions. It is to that area that we thus look for the options for change. In principle attempts could be made to offset unevenness in the CGBR by creating equal and opposite variations elsewhere - ie the PCBR or LABR. The Group, however, took the view - as explained in Section VI below - that it would not be productive to seek to disrupt existing practice in those areas in order to offset short run variations in central government's financing requirements. There is nevertheless scope for further improvement in forecasting and monitoring these elements of the PSBR - see Section V below. For similar reasons, our examination of the position in central government concentrated on those elements of the CGBR own account that gave rise to major variations in the aggregate during the year, and not on possible rearrangement of the presently smooth profiles of other items.

15. The following Section of the report looks at present practice in forecasting the PSBR and its various elements, at changes made recently and at the scope for further improvements. Section V sets out the Group's consideration of options for changing things "on the ground" so as to smooth the expected path of the unadjusted PSBR.

IV FORECASTING

Present approach

16. Forecasts of borrowing are produced by building up a complete account of each of the main parts of the public sector, explicitly considering the outlook for each item of receipts and expenditure. The forecasts of these items will reflect general developments (for example on interest rates and prices), as well as specific judgements relating to the public sector. The aim is to take account of the views of those involved in the monitoring and control of revenue, expenditure and borrowing, while retaining consistency with the forecast of developments elsewhere in the economy.

17. The forecasts produce quarterly paths of borrowing by central government, local government and public corporations. These paths are seasonally adjusted. Known factors affecting the quarterly paths - such as the pattern of wage and price increases and the effects of increases in the rent and rate income of local authorities - are allowed for. Where there is little or no information on individual quarters then a smooth path is projected. Until recently the main focus has been on the annual figures for borrowing, leaving the quarterly profile rather in the background.

Recent developments and scope for further work

18. The most significant development has been an increased emphasis on quarterly paths, at least for the first year or so of the forecast period. The aim has been to produce an unadjusted borrowing path, to complement the seasonally adjusted estimates. On the central government account this has involved drawing on the expertise of Treasury Central Accounts Division to a greater extent than previously.

19. For local authorities, the nationalised industries and other public corporations, government does not have the depth of up-to-date information and insight that it has on central government transactions. For local authorities, estimates of their borrowing are not available before the middle of the following month. The figures are not always easy to interpret, since information on the reasons for borrowing is available only much later (and at best for quarterly periods), but the cumulative totals are useful in indicating whether a forecast seems to have been on the right lines. For public corporations, full information on their borrowing is as yet less timely. Work is in hand to improve the situation and the Treasury and CSO are considering a new system for collecting data more speedily from public corporations.

20. In parallel with work to speed up information on actual borrowing, consideration is being given to the scope for seeking information about borrowing intentions, to supplement

other forward indicators as an aid to short-term monetary management or, looking at say the balance of the current financial year, for use in the context of the full scale forecasts of the PSBR. For local authorities we will be considering with DoE the potential for setting up a sample survey of local authority borrowing intentions -bearing in mind, of course, the costs to local authority contributors as well as the benefits for forecasting. Separately from this the Treasury already plans to undertake a survey of some nationalised industries to obtain their estimates of their bank borrowing over a rolling three month forward period, and also to seek more prompt delivery of their monthly cash flow forecasts for the year as a whole. Experience of the problems of interpreting intentions surveys in other areas (such as fixed investment) and the known difficulties of predicting short-term cash requirements, suggests that we should not expect too much too soon - but nevertheless there is scope for improvement on existing methods.

21. Apart from these specific steps to improve the provision of information, there is scope for improving the analysis applied to it. One development in hand for the next NIF forecast is the modification of seasonal adjustment throughout the public sector account in order to use CSO adjustments related to financial, not calendar, years. Another line of approach is to look at direct forecasting of the PSBR, based, for example, on statistical projections of the PSBR itself, and not of its individual components. This could be based on examination of past patterns or simple relationships with say output, inflation, expenditure plans, interest rates etc. We think this is worth trying as a supplement to the present approach.

Conclusion

22. Forecasts of the quarterly path of the PSBR are already receiving much more attention than they did in the late 1970s. Continuing efforts are being made, particularly in the forecasts of local government and public corporations, where the scope for changing the expected pattern of borrowing is limited, to improve the timeliness of statistics and to ensure that all known information is incorporated int he forecasts. There are plans for enquiries into borrowing intentions; and the forecasters, within the restrictions imposed by staff cuts are continuing to develop statistical and econometric methods of analysis for the PSBR as a whole.

V OPTIONS FOR CHANGING THE EXPECTED PATTERN OF THE PSBR

Public Corporations and Local Authorities

23. It was mentioned in Section III above that in looking at the options for changing the pattern of the unadjusted PSBR during the year the Group did not consider it would be productive to attempt to change the patterns of public corporation (primarily nationalised

industry) or local authority borrowing to deal with the variations arising on the CGBR own account. It may be worth spelling out a little more fully the reasons for this.

24. Nationalised industries' borrowing is the residual between much larger flows of trading revenue and expenditure. Their borrowing needs arise on a day to day basis reflecting both temporary fluctuations in cash flow and the need to finance part of their investment spending. In the nature of things, little can be done to influence the first of these, so that action to change the pattern of the industries' borrowing through the year would require Government intervention to defer or bring forward investments. Intervention of this kind would conflict with the Government's policy of as far as possible leaving the industries to manage their affairs as independent commercial bodies. As for local authorities, they borrow in anticipation of current revenue and to finance capital projects. They arrange their borrowing to bridge the gap between revenue and expenditure. On the revenue side, rates are generally payable in advance (and the scope for earlier payment is limited to the extent that actual payments occur after the due dates); the timing of government grants is already arranged to fit in with the requirements of the banking system; and fees and charges are paid as they arise. Taking expenditure, almost three quarters is on the regular payment of salaries and wages and the rest is a matter of settling bills as they fall due. All decisions to borrow, whenever taken and for whatever amount, are the individual responsibility of each local authority in relation to its own circumstances and requirements. There would appear to be little or no scope for the central Government to influence the timing of borrowing decisions, which is in effect the residual of the factors mentioned above.

25. Although for these reasons, we do not recommend action to try to change the expected in-year path of the PCBR and LABR there are worthwhile improvements to be made to forecasting and monitoring in these areas, as noted in Section IV above.

Supply issues

26. Supply issues are large (of the order of £65bn in 1980/81). Although a fairly small error may have a significant effect on the PSBR there is a fairly regular pattern of supply issues through the year, though with a rising trend reflecting inflation and in addition something of a peak in the Janaury to March quarter.

27. A number of large regular items of expenditure give the system its intrinsic stability. The most important of these are civil service pay, monthly or weekly cycle, the basic Rate Support Grant (excluding the increase orders paid in the January-March quarter), daily advances to National Health authorities some social security payments and other grants and subsidies. Action has been taken in the past to make the flow of such items as smooth as

possible.

28. One cause of disturbance to the regular pattern of Supply Issues is single large transactions such as the payment of Public Dividend Capital and payments under Section 18 of the 1975 Iron and Steel Act to British Steel. It would not be sensible to alter the timing of such payments away from when the industries need them, though advance notice from them of need for such payments might be improved. There would always be exceptions when advances of PDC or Section 18 moneys were not agreed until just before issue.

Bill payment

29. Another cause of fluctuations in the issue of Supply is the irregular presentation of bills by suppliers. The government pay bills as they are presented (subject to normal verification and processing). If bills are presented quicker than previously, issues will be increased. This is part of the explanation put forward by the Ministry of Defence of their high expenditure in the first six months of 1980-81.

30. In principle, government departments could be instructed to vary their speed of bill paying. Some arrangements with suppliers for retiming the presentation of bills may be legitimate (and negotiated in the context of streamlining bill paying procedures). But discretionary interference with the normal payment of bills that are due would go against the present principles of Parliamentary control over expenditure on a cash basis. Moreover, it would make it easier for departments to wriggle round the discipline of cash limits, effectively enabling them to finance overspending through trade credit. It would also tend to undermine the Government's general credit standing and (to the extent that longer lags develop) to raise costs as suppliers covered their need for extra working capital. Moreover, since the extra trade credit would be largely financed from bank lending, it would do little to help monetary control. An initiative in this direction is therefore not recommended.

Shorter-term cash limits

31. The need to accommodate short-term disturbances of the kinds described in the previous paragraphs is a main argument against fixing departments' cash limits for periods shorter than a year. To put it baldly, either the flow of payments is inherently stable, in which case a within year control adds nothing of substance to the annual limit; or it is unstable in which case short-term limits would in practice be unenforceable. The essential need is for correct interpretation of any divergence from the profile of expected spend, so that corrective action (eg delaying new commitments) can be put in hand promptly if judged necessary.

Monitoring expenditure against profile

32. At present departments provide early in the financial year a profile of expected spend quarter by quarter. This can be updated at any time and departments always provide a new assessment in October. Actual spend month by month is monitored against these profiles and discrepancies investigated. It would be possible to ask departments to provide a rolling monthly profile, looking say 3 or 4 months ahead, consistent with this, either universally or selectively. In areas where expenditure is not normally regular such a development might bring to the centre such additional information as a department has about the timing or scale of transactions within the quarter sooner and more systematically than it is now obtained. Though it would not be reasonable to expect much improvement to the rolling short-term forecasts of the CGBR such a selective development could be worthwhile.

Conclusion on Supply

33. Our conclusion is that what can realistically be done to smooth Supply Issues is already being done and there is now a fairly regular pattern of issues. There is little scope for altering the payment of bills without incurring costs in terms of both money and the government's reputation as a good payer. Cash limits covering less than a year do not appear feasible or desirable. However a selective scheme alerting Treasury to departments' expected expenditure in the following few weeks could be helpful for forecasting and monitoring purposes. We would recommend that the idea be explored further.

Debt payments

34. One important element in central government spending which varies from month to month is interest on the national debt. Within the technical constraints imposed by the marketing programme for gilts the Bank tries to match payments on new issues of debt to troughs in the CGBR. The path of debt interest is predictable and so the disruptive potential of its irregularity is small.

Inland Revenue taxes

35. About two-thirds of the total Inland Revenue yield comes from PAYE. This already flows in evenly, as it is linked to the payment of wages and salaries, and there is no scope for change here. The other major revenue raisers in the Inland Revenue field are MCT and PRT, and we consider these in turn. We have also identified as an area in which changes might be considered the arrangements under which the building societies and local authorities pay income tax on interest paid.

Mainstream Corporation Tax (MCT)

36. MCT is payable in one sum, either on 1 January (for companies in existence before

1965) or 9 months after the end of the company's accounting period (for those formed subsequently). The result is that more than half the tax is paid in the first quarter of the calendar year, most of this in January - in the case of January 1981 an expected £1.3 billion or 42% of the total MCT receipts.

37. One way of smoothing CT receipts would be to make mainstream tax payable in, say, two or four instalments. (Advance Corporation Tax, which is payable on distributions of dividends etc is already collected in this way.) But there are two major drawbacks to this. First, it would almost certainly mean, in the year in which the instalment arrangements were building introduced, the postponement of about 50% of the MCT yield to the following year. This is because in present circumstances it would be unrealistic to expect the company sector to be able to advance significantly the date of its tax payments. Moreover tax liabilities are often not agreed early enough for payment of an agreed amount to be made significantly before 1 December, so that a complicated system of advance payments on account would be needed. Second, an instalment arrangement would need extra Inland Revenue staff: about 200 for twice yearly instalments and 550 for a four instalment system.

38. An alternative possibility would be to withdraw the reserved right of pre-1965 companies to pay their tax on 1 January between 9 and 21 months after the end of their accounting period and to require them - like post -1965 companies - to pay 9 months after the end of their accounting period whenever that date falls. This change would result in the advancing of the payment of tax to the Exchequer; for the companies concerned it would mean bringing forward their tax bill by (in some cases) as much as twelve months.

39. Clearly a change of this order could not be implemented all at once - particularly in the present state of company liquidity. Transitional arrangements would be needed, for example moving from the present date to the new date by, say, 2 months each year. When these arrangements had reduced the gap between accounting period and payment date to 9 months or less, companies would switch to the "9 month" rule. This would be administratively untidy, but the staff cost would be relatively small: perhaps 20-30 in the first year of the transition and in principle reducing to nil once the new arrangements were fully in force.

40. With such arrangements, each year a number of companies would therefore drop out of the old rules. But the frictional costs would continue for the five or six years of the change, and the change would be no more palatable to companies merely because it was spread over time. In effect, companies would be paying a year's tax each ten months during the transition.

41. While such an arrangement has its attractions, there are obvious difficulties in withdrawing a practice which has been in force since 1965, particularly in the present financial circumstances of the company sector. In presentational terms at least, this difficulty would remain even though in later years of the transition period, as the economy emerges from recession, corporate profits and cash flow should be better able to stand the acceleration of tax payments. The CT yield, though smoother than now, would still be fairly lumpy, since company accounting dates are not spread evenly over the calendar; the peak would move from January to October but would be rather flatter. Of course the full effects on the PSBR path would not come through until the transition period was complete.

42. The following table shows the pattern of net mainstream corporation tax receipts in 1979-80 and what the pattern would look like if companies paid by half-yearly or quarterly instalments or if all companies paid tax 9 months after their accounting date.

	£billion			
	Present Pattern	Half-yearly instalments	Quarterly instalments	All on "9 monthly"
April-June Quarter) July-September Quarter)	0.6	1.4	1.4	0.9
October-December Quarter	0.7	0.5	0.7	1.3
January-March Quarter	1.5	0.9	0.7	0.6
Financial year	2.8	2.8	2.8	2.8

Petroleum Revenue Tax (PRT)

43. PRT is a large and fast growing source of revenue - and a highly seasonal one -which gives it added significance when considering action to smooth the PSBR. In practice virtually all PRT due comes in on 1 March and 1 September - something well over £1 bn on each of 1 September 1980 and 1 March 1981 for example. The size of these peaks will increase as nominal North Sea profits rise and the advance payments scheme comes into effect in 1981 and brings bigger sums in on the dates concerned. The pattern was originally designed to get in as much money as possible in financial year 1979-80. The possibility of changes in the system for taxing North Sea oil is being considered elsewhere, and the conclusions of the present study will be drawn to the attention of those concerned in that work.

Building societies and local authorities

44. The amount concerned here, though significant, is much less that under the two preceding categories; in the financial year 1980-81 the tax received will be about £1.2 bn. Under the composite rate arrangement the building societies pay one lump sum of tax, in

lieu of the basic rate tax deductible from the interest they pay to depositors, who then receive the interest free of tax at the basic rate. This lump sum is paid in one annual sum; it is generally due on 1 January, but interest does not run until 28 February, and many societies withhold payment until this date. It would be possible to legislate to require payment quarterly in respect of the deposit interest paid in the preceding quarter. This would produce a more even flow of revenue.

45. The staff cost to the Revenue of such arrangements would be negligible, since there are fewer than 300 building societies. There are also arguments for such a change on its own merits. The building societies might conceivably threaten in reply to pull out of the composite rate system, though this arrangement is generally in their interest; and they would no doubt argue that the effects on their cash flow of having to find the tax earlier than now would have implications for the level of mortgage interest rates - by delaying reductions, if not actually causing an increase.

46. The major part of tax deductible by local authorities from loan etc interest is also payable on 1 January. If the building societies were to go over to quarterly payments, there would be presentational advantages in making a similar change for local authorities, although it would probably be unpopular with the authorities themselves. Changes to the tax regime here would not however affect the path of the PSBR, since the effect would merely be to exchange local authority for central government borrowing. We have therefore not considered the point further.

Conclusions: Inland Revenue taxes

47. We have indentified three areas (PRT, MCT and building societies) where a smoothing of tax receipts would help reduce the front-end loading now apparent in the PSBR profile. The Group has made no specific study of PRT, where the increase in receipts in the next few years will mean that the newly-established March and September peaks will get sharper and even more significant in the context of the CGBR and PSBR paths. We recommend, however, that current work on future arrangements for North Sea taxation should take fully into account the possibility of changing the timing and frequency of tax receipts - so as to help smooth the PSBR. Several options were identified for retiming corporation tax receipts, though at a potential - if varying - cost in terms of staff numbers and in impact on the PSBR in the year of introduction (with potentially important implications for the company sector). The most promising option (paras 38-42) would not involve an immediate once-for-all PSBR cost though it has other difficulties. In the time available we have not been able fully to assess the feasibility of making changes in this complex and sensitive area. Nor however have we felt they should be ruled out. We therefore recommend that the possibility of changing the timing of corporation tax receipts be further investigated by officials (along with the costs of any action). Similarly, we recommend further study of the

retiming of building society tax payments, a course which though less significant for the PSBR profile also seems to involve correspondingly smaller costs than a change in the timing of corporation tax receipts.

Customs and Excise taxes

Introduction

48. Customs & Excise taxes comprise VAT (£12.5 bn receipt in 1980/81), excise duties (£9.7 bn), car tax (£0.5 bn), and customs duties and agricultural levies (£1.2 bn) which accrue to the European Community as own resources. Although there is some seasonal peaking, especially of wine and spirits, in the aggregate the contribution of the excise duties is relatively smooth. The main unevenness is concentrated in VAT and car tax:

(i) VAT (Budget estimate 1980/81: £12.5 bn). Most traders are required to pay quarterly, but they are organised in three "staggers" so that revenue is spread throughout the financial year, although on a rising trend because of rising prices and seasonal factors. Owing to the make up of the staggers the revenue peaks in the first month of each quarter. At its most extreme, in Q1, the VAT revenue in January 1981 is forecast to be more than the sum of February and March put together.

(ii) Car tax (£0.5 bn). There is some unevenness on a quarterly basis, with a peak in calendar Q3 reflecting seasonal sales of new cars. On a monthly basis there is a pronounced unevenness. The tax period for car tax corresponds to the VAT staggers of the traders concerned and so the largest payers account for tax in the first month of each quarter.

49. The Group has examined three possible ways of smoothing the pronounced month by month peaks in the pattern of VAT and car tax receipts.

Monthly payments of VAT

50. In principle, the monthly unevenness of VAT revenue could be greatly reduced by switching all traders who normally pay VAT (as opposed to getting repayments) from a quarterly to a monthly basis. Such a move - if phased in by bringing payments forward - would also achieve a once-for-all benefit to the PSBR of about £1,500 million spread over a three month period. However, this would involve imposing major costs on business in regard to:-

(i) Cash flow. There would be a temporary fall in business cash flow of about £1,500 million (the mirror image of the PSBR gain). Ignoring possible changes in commercial credit arrangements, about one-half of this would be felt by manufacturing industry, one-quarter by the distributional sector and about one-quarter by service industries. Those most affected would include the major oil companies, the

volume car manufacturers and one or two of the nationalised industries. Moreover, the period of adjustment would be much more highly concentrated than is proposed for the Mainstream Corporation Tax change. Additional bank borrowing by industry would have an adverse impact on monetary control.

(ii) Compliance costs. The costs imposed by the existing VAT system are recognised to bear proportionately more heavily on smaller firms. A system of monthly VAT payments would increase these effects and exacerbate criticism.

51. Moreover, such a scheme would be of highly doubtful practicability. It would apply to some 920,000 registered traders. As a result the six million forms issued now would more than double and an increase of 1,000 staff would be required centrally. Additional numbers - impossible to quantify at this stage - would be needed for the consequential extra enforcement work at local level. Moreover, extra computing capacity would be needed, as well as additional banking and data processing equipment. Allowing for specification and procurement there would be a lead time of about two years.

A restricted scheme of monthly payments

52. A much more restricted scheme of monthly payments would be more practicable since a very large proportion of VAT receipts come from a very small proportion of registered traders. If the likely adverse political reaction could be accepted, Customs & Excise could probably devise a predominantly manual scheme which might cover, say, the 3,500 or so largest payers who account for about 85% of the net VAT revenue. This would involve about 50 extra staff and could raise once for all additional revenue of about £1,000 million in the year of introduction. Subject to legal advice about the adequacy of the vires (which are contained in Regulations), such a scheme could probably be introduced by administrative direction, although it might be necessary to give a period of notice (which would mean that any changes could not take effect before the second half of 1981-82 at the earliest). The drawbacks are that it would be highly discriminatory, would retain most of the impact on business cash flow described in para 50 above and could be expected to attract considerable criticism. It might also give traders an incentive to rearrange their affairs and disaggregate into smaller units below the threshold.

Smoothing the unevenness of the VAT staggers

53. Alternatively, a smoother flow of revenue could be achieved by keeping quarterly returns but moving some traders from one stagger to another. The aim would be to eliminate the revenue peaks which occur in the first month of each quarter, and Customs and Excise' preliminary estimate is that this could almost certainly be achieved by moving some 50-100 of the largest payers from stagger 3 (due date for payment 31 March and every 3 months thereafter) to staggers 1 and 2. Again, subject to confirmation of the vires in the

existing Regulations, the change should be achievable by administrative direction. There could, however, be considerable problems of presentation.

54. The main difficulty might lie in countering criticism that to adjust the affairs of a very small group of taxpayers was discriminatory and arbitrary. Because the traders would be virtually handpicked, this could be more difficult to meet than criticism of the scheme of monthly returns discussed in para 52 above, where at least the 3,500 or so traders constitute an identifiable class whose VAT returns are currently covered by the Large Payers Unit. It might well be necessary to give a period of notice of some months for traders to prepare for the change (reprogramming of computers etc) followed by a transitional period which gave them a once-for-all cash flow advantage. A trader would not then be directed that his transitional VAT accounting period would last only one month (or two months) but rather that it would last four (or five) months. Even so, the reaction to such a scheme is by no means easy to predict.

Car Tax

55. As explained in paragraph 48 above, quarterly accounting periods for car tax traders are in line with their VAT staggers. Most of the car tax revenue comes from about 30 traders. If some or all of these were to be directed to account for VAT monthly it would be logical to make use of similar powers to direct them also to account for car tax monthly. Similarly, if some were to be directed to use a different VAT stagger, their accounting period for car tax would follow suit. The former could achieve an almost complete smoothing effect, the latter probably only a partial effect.

Conclusion on Customs and Excise Taxes

56. The Group considers that the burdens on businesses, together with the long lead time and the heavy staff costs, must be regarded as ruling out a comprehensive scheme of monthly returns. It recommends, however, that the more limited scheme described in paragraph 52, together with the possibility of smoothing out the staggers on the lines discussed in paragraphs 53-54, should be remitted to officials for further study. If either scheme were to be adopted, consequential changes should be made to car tax arrangements as recommended in paragraph 55.

57. A smoother spreading of VAT receipts through the year would potentially be of greatest benefit to the problem of month by month fluctuations in the PSBR rather than the front-end loading problem. But its usefulness in that context would depend on how it interacted with other elements in a set of proposals.

Cumulative Overshooting

58. Serious problems can also, of course, arise when, as this year, there is a prospect of a

substantial PSBR overshoot for the year as a whole, regardless of the particular profile this may take. This raises wider questions of control and fiscal adjustment that are not within the terms of reference of this study and have not therefore been considered. Some of our recommendations would, however, be relevant both insofar as they facilitated the earlier detection of problems and consideration of corrective action (eg by securing more detailed profiles of departmental expenditure) and also gave rise to a more easily forecastable path for the PSBR.

VI CONCLUSIONS AND RECOMMENDATIONS

59. The Group records the following conclusions:-

(i) the main reasons for unevenness in the PSBR lie within central government own account transactions - primarily on the revenue side;

(ii) the unevenness is likely to continue, in the absence of any changes in present arrangements, and the absolute variations are likely to increase in line with the price level. The rapid rise in the size of the very seasonal PRT receipts points to the possibility of absolute variations increasing faster than the price level over the next few years;

(iii) the unevenness makes monetary management difficult because (a) of the difficulty it creates for predicting and therefore controlling monetary developments, (b) "front-end loading" which causes financial markets to doubt the effectiveness of monetary control, (c) marked fluctuations from month to month complicate the management of debt sales.

60. The Group accordingly recommends that:

(i) the possible improvements in the statistics of the PSBR and forecasting path should be pursued (para 22);

(ii) to help with monitoring and forecasting the CGBR, investigation should proceed into the value and feasibility of securing more detailed profiles of departmental expenditure, confined to selected departments at least in the first instance (para 33);

(iii) officials should consider further, with the aim of enabling decisions to be taken before the 1981 Budget, the possibility of changing the timing of tax receipts in the following areas, with the aim of producing a set of options (with costings of their staff and PSBR implications and an assessment of the benefits they would bring for monetary management) for reducing "front-end loading" and, where possible, helping to reduce the amplitude of month by month fluctuations in the PSBR (paras 47 & 56);

a) mainstream corporation tax

b) building society tax payments on interest

c) VAT and car tax

(iv) in the separate review of North Sea taxation, under way currently, due weight should be given to the potential role of a smoother pattern of receipts from taxation in smoothing the PSBR.

61. Three general points should also be noted. First, whatever the effort put into smoothing, it is highly unlikely it will avoid entirely the occurence of random monthly fluctuations, even in the long term. Second, the PSBR consequences of transition to new tax collection arrangements and the corresponding impact on business cash flow would need careful assessment in the Budgetary context before any changes could be decided upon. Third, our first impression is that there is little prospect of the measures considered in this report having much of an impact until the later part of 1981/82 at the earliest. Some would require legislation and the others a period of administrative preparation.

HM Treasury
31 October 1980

LIST OF CHARTS

CHART I : PSBR, LABR and PCBR

II : CGBR

III : SUPPLY ISSUES - QUARTERLY PROFILE

IV : SUPPLY SERVICES EXPENDITURE - MONTHLY PROFILE

V : INLAND REVENUE DUTIES 1979/80

VI : CUSTOMS & EXCISE REVENUE

VII : VAT RECEIPTS

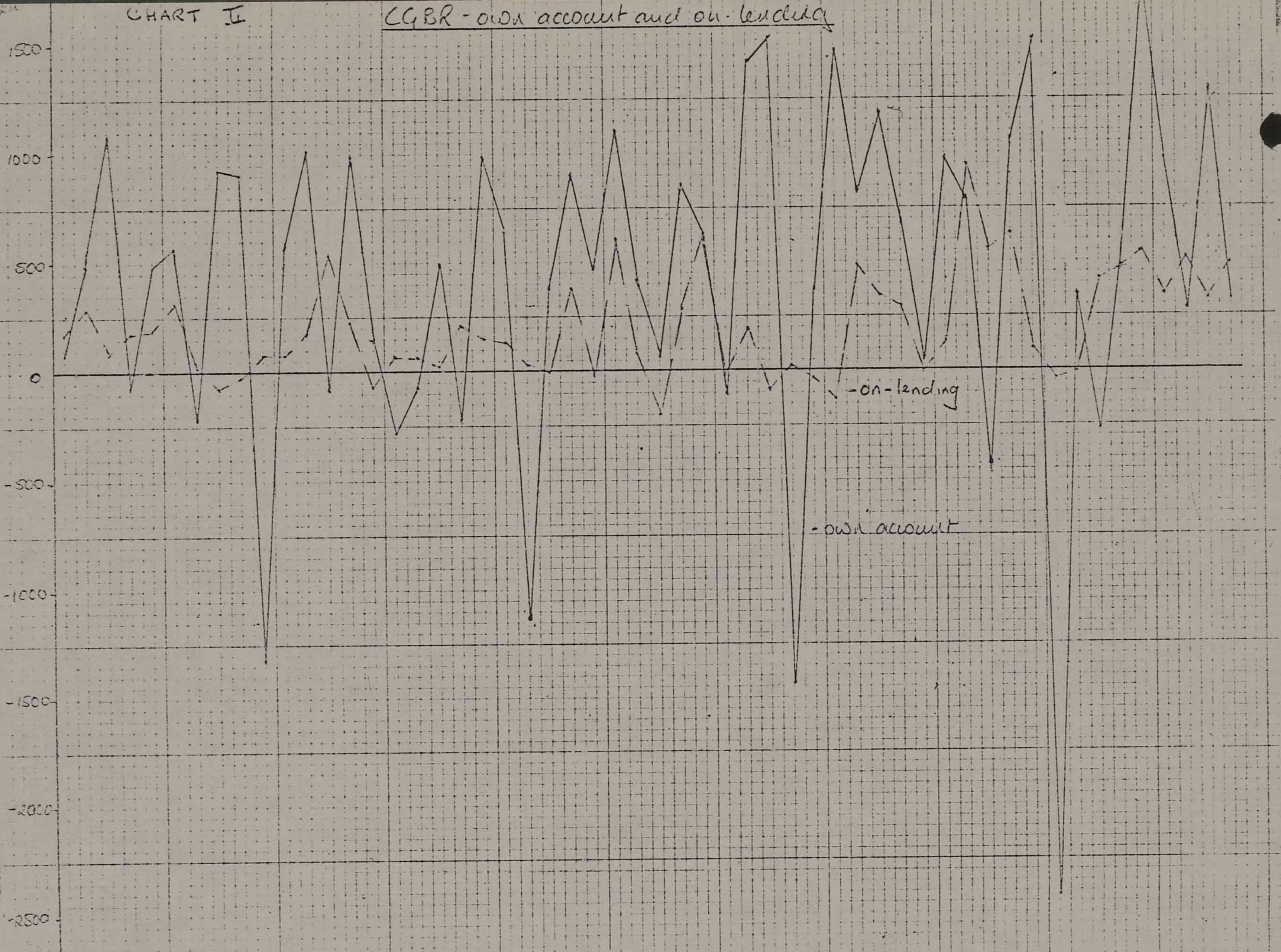
E.R.

CHART I

PSBR*, PCBR* and LABR

* Monthly average of quarterly data.

CHART II



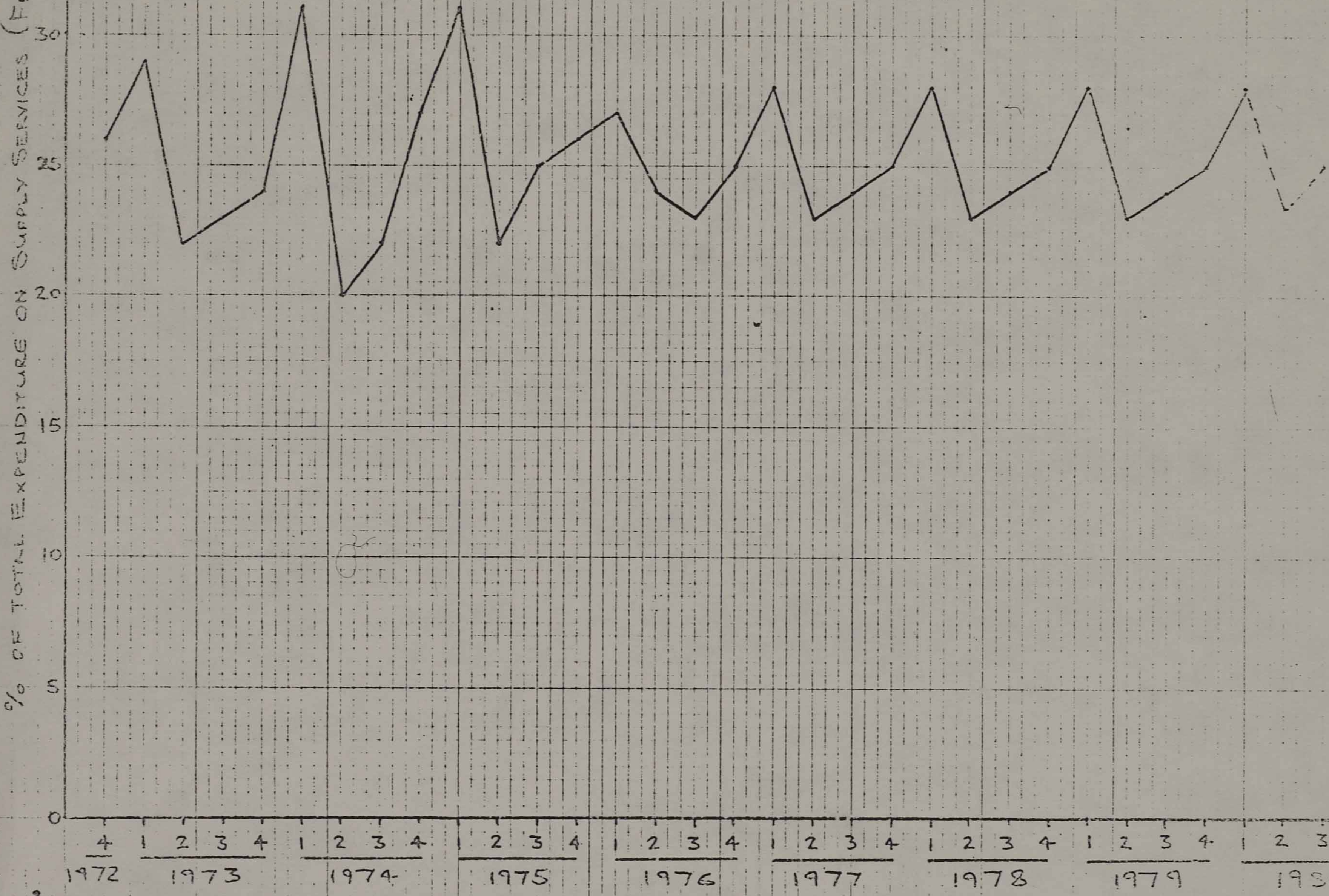
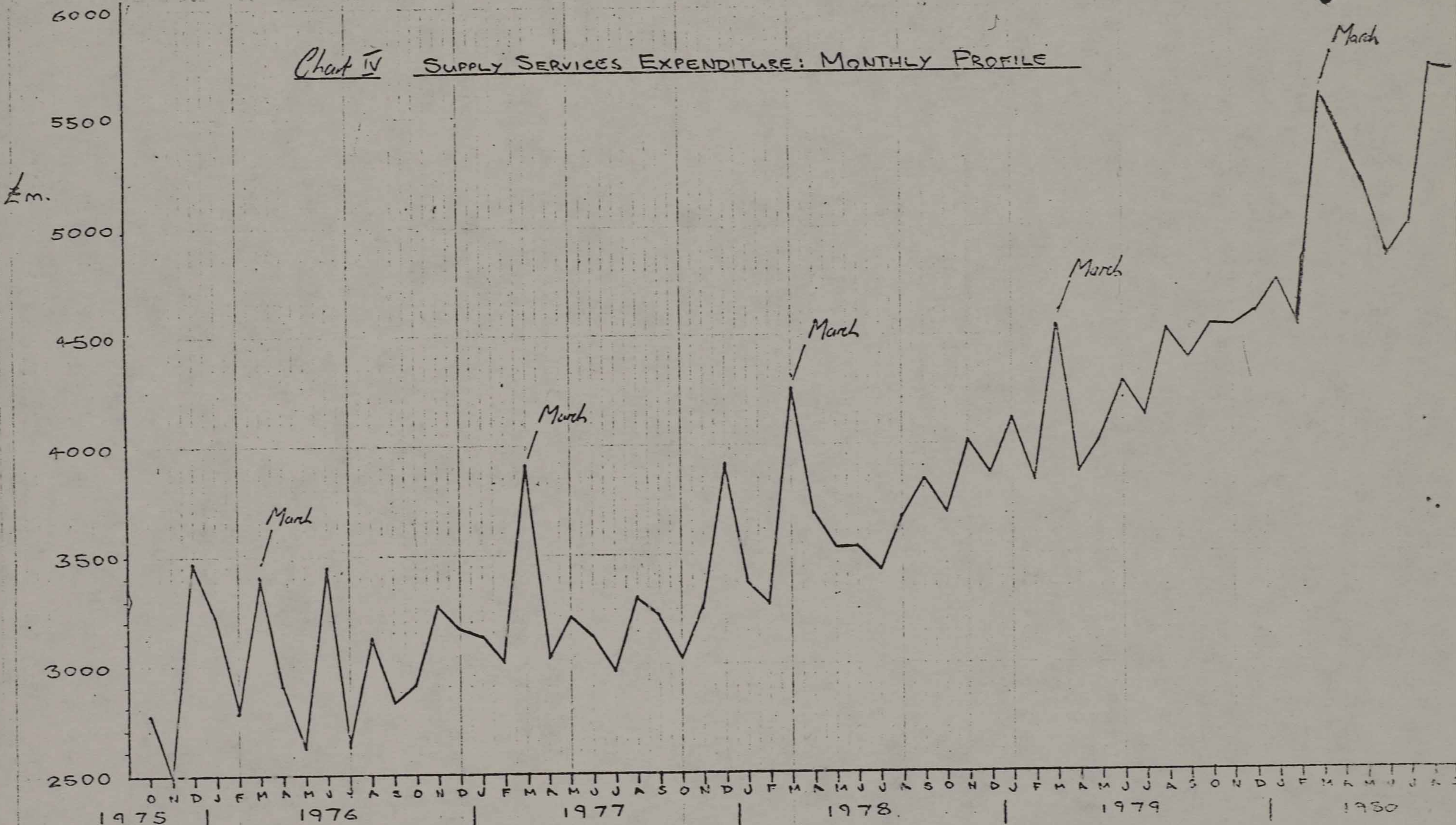


Chart III Quarterly pattern of Supply Issues as % of financial years totals
Percentages for 1980-81 based on NIF forecast £65.5 billion
% OF TOTAL EXPENDITURE ON SUPPLY SERVICES (FIN. YEAR)
35
30
25
20
15
10
5
0
4 1 2 3 4 1 2 3 4 1 2 3 4 1 2 3 4 1 2 3 4 1 2 3 4 1 2 3 4 1 2 3 4 1
1972 1973 1974 1975 1976 1977 1978 1979 1980 1981
DATE
Source: Fin Statistics

Chart IV Supply Services Expenditure: Monthly Profile



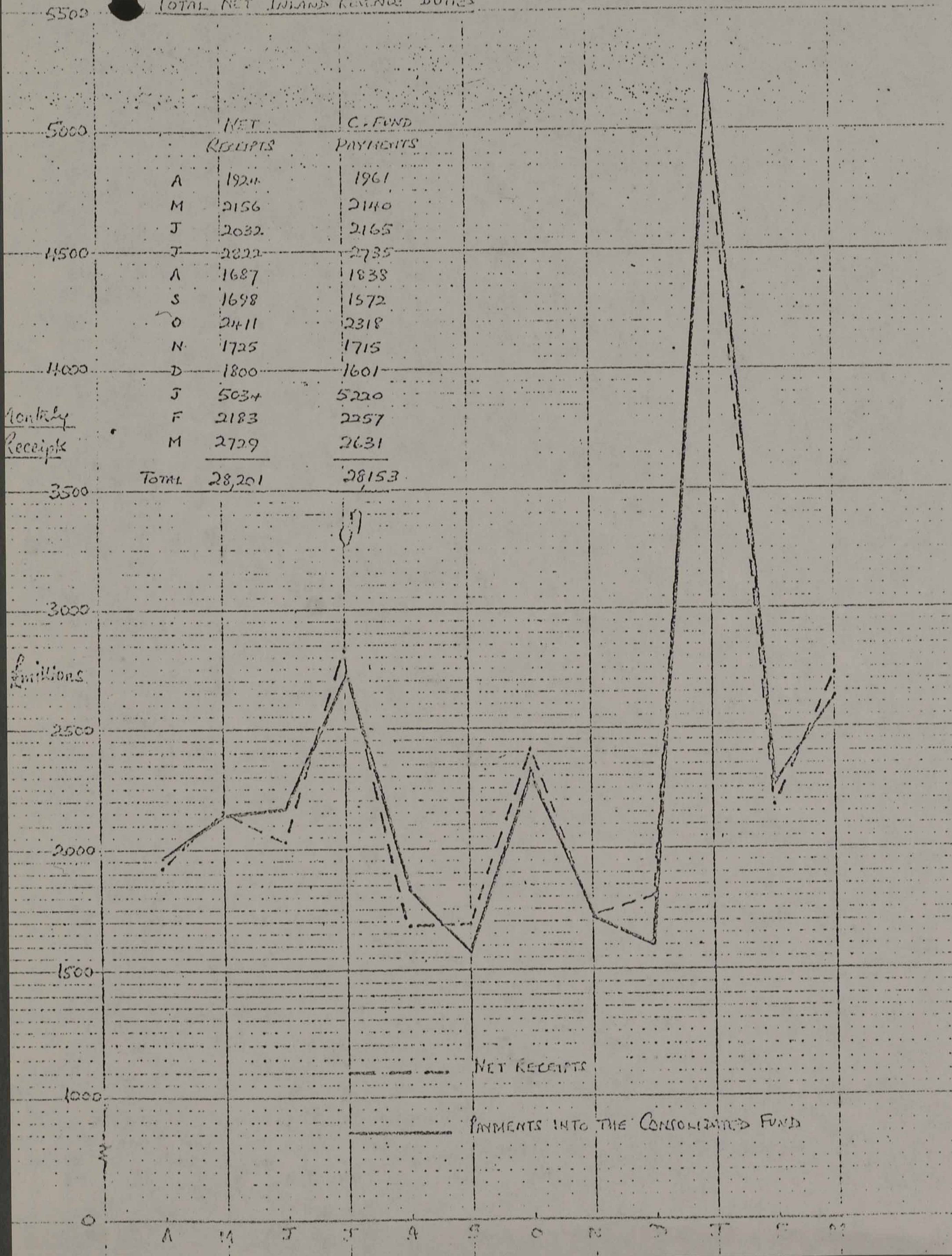


CHART V
1979-80
TOTAL NET INLAND REVENUE DUTIES
5500
5000
4500
4000
3500
3000
2500
2000
1500
1000
0
Monthly Receipts
£millions
NET RECEIPTS
C. FUND PAYMENTS
A 1924 1961
M 2156 2140
J 2032 2165
J 2822 2735
A 1687 1838
S 1698 1572
O 2411 2318
N 1725 1715
D 1800 1601
J 5034 5220
F 2183 2257
M 2729 2631
TOTAL 28,201 28153
NET RECEIPTS
PAYMENTS INTO THE CONSOLIDATED FUND
A
M
J
J
A
S
O
N
D
J
F
M

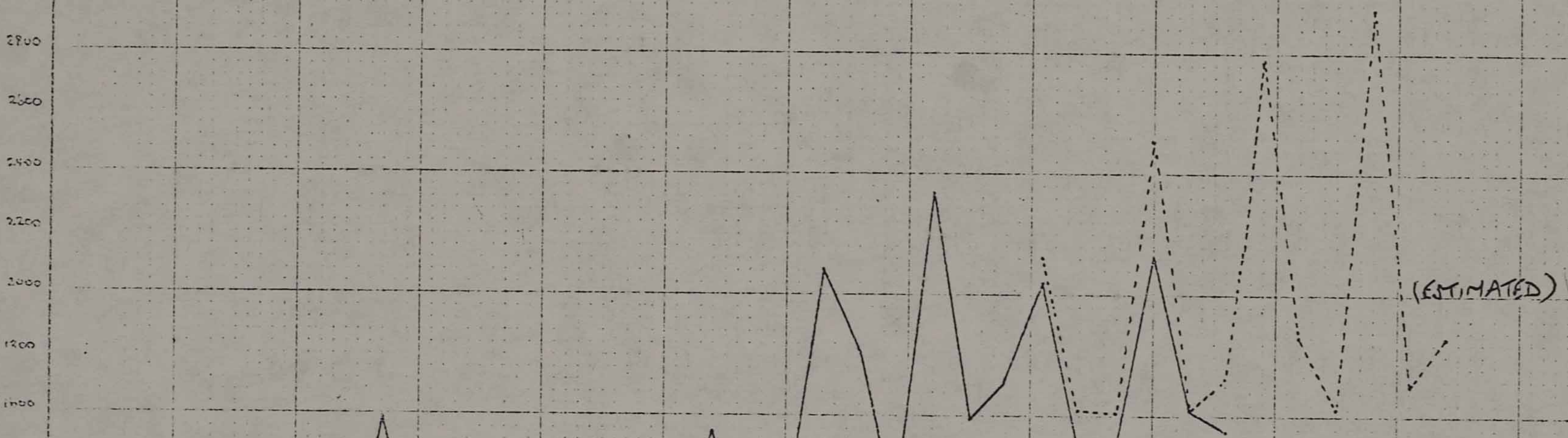


CHART VI: TOTAL CUSTOMS AND EXCISE REVENUE:
MONTHLY NET RECEIPTS
£ million
4000
3800
3600
3400
3200
3000
2800
2600
2400
2200
2000
1800
1600
1400
1200
1000
800
600
400
200
(ESTIMATED)
JAN FEB MAR APR MAY JUN JUL AUG SEP OCT NOV DEC
1978
JAN FEB MAR APR MAY JUN JUL AUG SEP OCT NOV DEC
1979
JAN FEB MAR APR MAY JUN JUL AUG SEP OCT NOV DEC
1980
JAN FEB MAR
1981

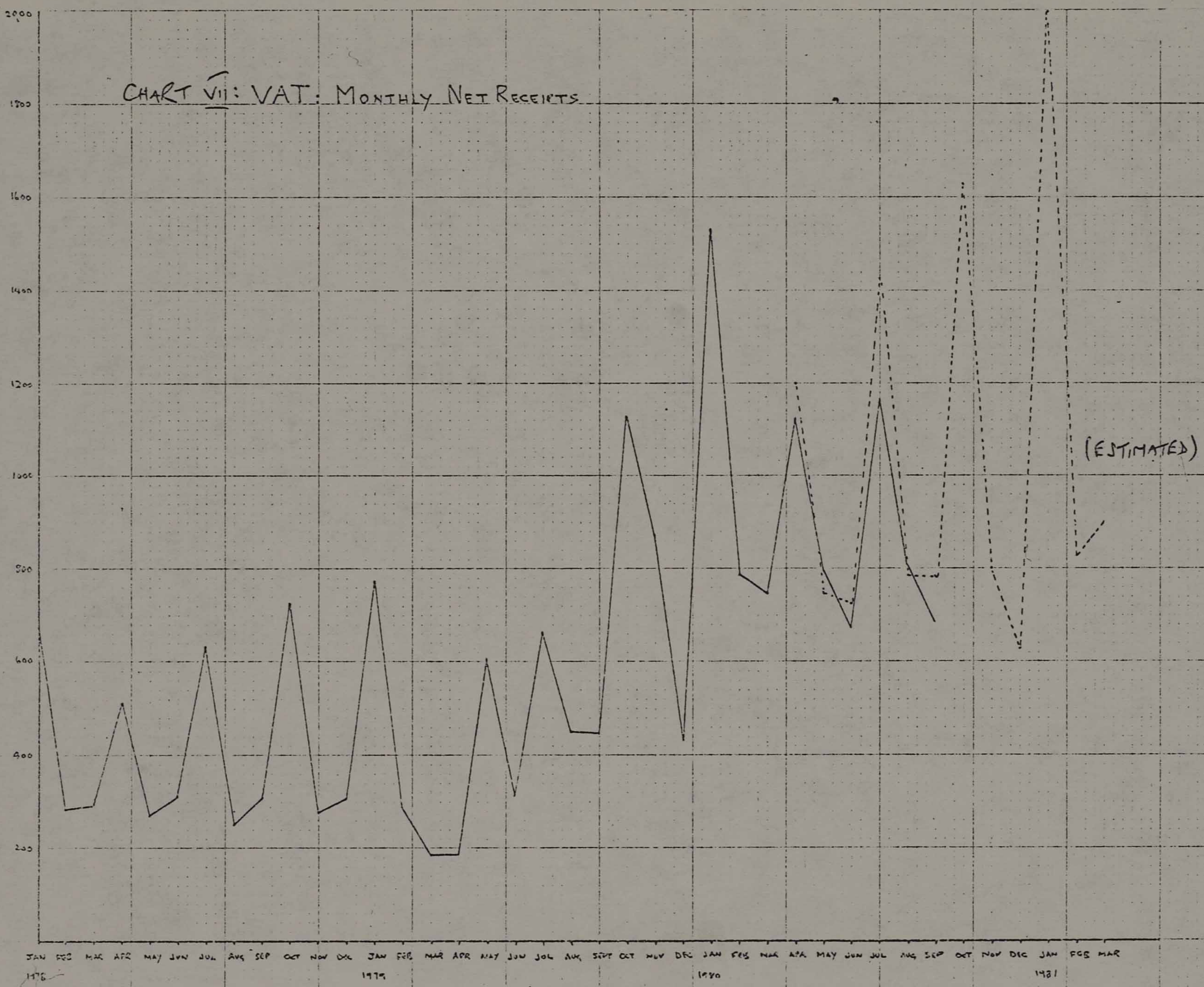


CHART VII: VAT: MONTHLY NET RECEIPTS
2000
1800
1600
1400
1200
1000
800
600
400
200
(ESTIMATED)
JAN FEB MAR APR MAY JUN JUL AUG SEP OCT NOV DEC JAN FEB MAR APR MAY JUN JUL AUG SEPT OCT NOV DEC JAN FEB MAR APR MAY JUN JUL AUG SEP OCT NOV DEC JAN FEB MAR
1978
1979
1980
1981

Covering CONFIDENTIAL

ANNEX A

SMOOTHING THE PSBR: SETTING THE SCENE

Note by the CSO

SUMMARY

1. Examination of the quarterly and monthly data readily available suggests that:

(1) The larger part of the irregularity in the PSBR over the past four years has been attributable to CGBR own account.

(2) Quarterly series mask big fluctuations from month to month.

(3) Irregularity in the CGBR is more attributable to the revenue than the expenditure series. Customs receipts are less seasonal than Inland Revenue receipts.

(4) Although many series have a marked seasonal pattern it is seldom sufficiently stable from year to year to enable seasonal changes to be anticipated with certainty.

(5) The largest distortions to the CGBR seem to follow from deliberate policy decisions.

(6) Seasonal effects and other irregularities often affect the final quarter of the financial year more than other quarters. This makes it difficult to assess financial year outturns with any certainty until very late in the year.

(7) Explaining irregularities in Local Authorities and Public Corporations borrowing is hampered by lack of frequent information on income and expenditure from the many bodies that make up these sectors.

INTRODUCTION

2. Table I illustrates how the quarterly pattern of the PSBR and its main components has changed over the past four financial years. The PSBR is compiled quarterly only, because monthly information is not available for public corporations. Quarterly series do however hide significant monthly fluctuations. Table II presents the series available monthly[a] ie. for the CGBR - own account and total - and the LABR. Charts I and II (see main report) show data for the PSBR and its components at the maximum frequency for which data are available. Charts III-VII show quarterly and monthly patterns of important items of expenditure and revenue.

[a] The impact of the PSBR on the monetary system and money stock is analysed in terms of banking months, whereas most of the commentary in this paper relates to calendar periods. This is not a serious difficulty, since causes of CGBR irregularities apply to both types of accounting period. Para 8 and Table IX deal specifically with banking months.

DETERMINING THE UNDERLYING TREND

3. Irregularities in the pattern of the PSBR through the year are caused by regular seasonal movements, changes in the seasonal pattern, and by 'one off' events. The problem facing interpreters of recent figures is to distinguish these elements sufficiently well from each other and from the underlying trend; seasonally adjusted figures are calculated to assist in this task. However, the danger of presenting seasonally adjusted data is that they are so frequently mis-interpreted by the user. It is not always possible to anticipate changes in the seasonal pattern occurring during the current year; this is illustrated in Table III which compares the assessment of the quarterly seasonal pattern of 1976/7 as it has changed since it was first estimated. Also users of the figures often forget that the effects of 'one off' events still remain in the seasonally adjusted figures. Clearly the smoother the path of the PSBR the easier it is to detect the underlying trend (although it must be realised that administrative action to bring about smoothness will introduce another element of unpredictability during the transitional period).

SEASONAL MOVEMENTS

4. Changes in seasonal patterns are a constant challenge to the understanding of the data and arise from many reasons. At the level of the individual series (eg. receipts from corporation tax) it may reflect the frequency of changes in tax rates and allowances, the timing of such changes and taxpayers' reactions. At a more aggregate level it may reflect a change in the relative size of the components or the introduction of new taxes or duties.

THE PSBR

5. Table I indicates that the pattern of the PSBR was far less regular in 1979/80 than in the earlier years and that in all years except 1978/79, CGBR (own account) has accounted for at least two thirds of the quarterly deviation from the average for the year. Columns 2, 10 and 12 of Table I illustrate the contribution of CGBR own account borrowing to the quarterly fluctuations in the PSBR.

THE CGBR

6. Detailed quarterly and monthly data readily available on transactions giving rise to the CGBR are given in Tables IV to VIII. Examination of the data indicates the following significant features in the series identified (values of receipts. expenditure etc given in each case relate to the Budget forecast for 1980/1). Receipts are generally far more seasonal than expenditure and in particular:

(1) Inland Revenue duties (Tables Va and b and Chart V) are subject to a regular seasonal pattern to a far greater extent than receipts from Customs and Excise duties (Table VI and Chart Va). Of the Inland Revenue receipts:

a) PAYE (£21.9bn) accounts for two thirds of Inland Revenue receipts. Monthly fluctuations in the total income tax series suggest that the quarterly series mask considerable irregularities. Relatively minor irregularities in this big item of revenue have big absolute affects on the CGBR.

b) Mainstream Corporation Tax (£3.2bn) is very seasonal, but the relative falling yields reduced its distorting effect on the CGBR in recent years. Concentration of receipts in the final quarter of the financial year delays accurate forecasting of that year's outturn.

(c) Advance Corporation Tax (£1.7bn) had a fairly consistent seasonal pattern from 1976/7 to 1978/9. That was disturbed in 1979/80 by the removal of dividend restraint. Within quarters receipts are concentrated in the first month of each quarter.

(d) Petroleum Revenue Tax (£2.6bn) has a short history and already the past seasonal pattern has been changed once by administrative action. One of its peaks has now shifted to the final quarter of the financial year.

(e) Building Society taxes (£1.2bn) are received almost entirely in the last quarter of the financial year. The big increase in Q1 1980 was attributable to higher interest rates paid by the Societies. The composite tax rate will rise in future, amplifying the end - financial year peak.

(f) Schedule D (£3.8bn) is markedly seasonal, receipts peaking in Q3 and Q1. From the quarterly data the pattern appears to be fairly stable.

(g) Other duties are detailed in Table Vb. Those for which receipts are forecast to exceed £400mn a year include capital gains tax (CGT), capital transfer tax (CTT) and stamp duties. Apart from a peak in January, monthly receipts from CGT are regular; CTT receipts are fairly regular. No particular seasonal pattern is evident in the stamp duties data, though the figures appear to have been less smooth recently than in earlier years.

(2) Customs and Excise receipts fluctuate less than Inland Revenue duties, but the following appear to have a marked seasonal pattern or to show other irregularities. The latter are often associated with Budget 'forecasting' by consumers. A special distortion in 1979 was the effect of the strike by Customs and Excise computer operators.

(a) VAT receipts (£12.5bn) are irregular as is emphasised in the monthly figures (see also Chart VII). The collection arrangements cause them to peak in the first month of each quarter; the irregularity has been much increased by the near doubling of the VAT rate in the June 1979 Budget. Recently the credit squeeze and very high interest rates have depressed revenue by causing traders to delay VAT payments.

(b) Wines etc and spirit duties (£1.7bn) peak, not surprisingly, in the October-December quarter. They also show the effects of pre-Budget buying; with the current recession traders have been reducing their stocks of drinks, thus depressing revenue. Beer duty receipts (£1.1bn) are fairly regular, but with a summer peak.

(c) Tobacco duty receipts (£2.8bn) appear to be fairly smooth on a quarterly basis, but the monthly figures are affected by pre-Budget buying.

(d) Customs duties (£1.2bn) follow a fairly smooth pattern reflecting the path of imports. The fluctuations in 1979 are attributable to industrial action - by the transport drivers and by Customs staff.

(3) Other departments' receipts include two large items, vehicle excise duties (VED) and the employer's national insurance surcharge (NIS) and oil royalties which are rising.

(a) NIS revenue (£3.5bn) is fairly smooth.

(b) VED receipts (£1.4bn) are irregular on a monthly basis, partly reflecting the pattern of new car sales.

(c) Oil royalties (£1.0bn) now have a smoother pattern than in the past following the introduction of payment in kind in place of half-yearly royalty payments.

(4) NLF interest receipts (£5.1bn) are shown in Table VII. Their irregularity stems from the fact that most are half yearly, but the amounts are predictable.

(5) The very irregular 'other transactions' items (Col(9) in Table IV) - receipts of £5 bn in 1979/80) is dominated by special items such as the sale of BP shares, advance oil sales etc.

7. (1) Supply Expenditure (£64.8bn) - Table VIIand Chart IV*. The pattern of supply issues has been fairly regular over recent years. There is a moderate rise between the first and third quarters and a large increase in the final quarter. The end year surge to some extent reflects suppliers presenting more bills earlier to complete business by the end of their financial year. Just over 60 per cent of supply is cash limited. There are a number of regular and fairly stable items within the cash limit total, eg wages and salaries, the RSG, advances to the NHS etc but the pattern of some others, for example, payments for defence procurement, is more uncertain. Outside the cash-limited area, more payments can be irregular, mainly reflecting two kinds of factor. First, the year's total as well as the in-year pattern can be changed, for example if inflation or economic activity differ from that assumed when the estimates for the year were set. Secondly, single large transactions such as payments of PDC or payments under section 18 of the 1975 Iron and Steel Act introduce considerable irregularity. All increases in supply expenditure not provided for in Main Estimates presented at the beginning of the year are subject to the Parliamentary approval of Supplementary Estimates.

(2) Payments to service the national debt (£10.0bn) have a marked seasonal pattern, with pronounced peaks in January, May, July, November, but these are predictable.

(3) The surplus on the National Insurance Fund (£0.8bn) is the difference between the Fund's revenue (£16.2bn) and its expenditure (£15.4bn). It is erratic to the extent that revenue is dependent on contribution rates, the numbers in employment and wage rates, and that the expenditure is dependent on seasonal influences on benefits and the annual upratings.

THE CGBR (BANKING MONTHS)

8. Table IX shows the estimated seasonal variation of the revenue and expenditure components of the CGBR in 1980; a plus indicates that receipts are higher or expenditure is lower than normal (and vice versa). No seasonal pattern has been detected in recent years in on-lending. The analysis of Inland Revenue receipts is done by local tax collectors in calendar weeks; "unallocated" is a residual difference between the collectors' figures and receipts into the Consolidated Fund. It therefore comprises:-

*Chart IV gives a rather exaggerated picture of irregularity because the y axis starts at £2500m not zero.

(a) conversion of calendar weekly data (Monday to Friday) to banking months;

(b) a deduction for funds in transit between the collectors and the Consolidated Fund.

The same applies to Customs and Excise receipts, but their "unallocated" is small and does not appear to be affected by seasonality or the make-up date. "Supply expenditure" includes an approximate adjustment to take account of changes in balances with the Paymaster General (approximate because the PMG holds some funds indistinguishably for public corporations).

LABR AND PCBR

9. The quality of information on the factors that lead to irregularities in LA and PC borrowing is markedly inferior to that for central government. Monthly information on income and expenditure is practically non existent and quarterly information is not completely articulated. Although the LABR and PCBR fluctuations are smaller than those of the CGBR, a change in the balance of their borrowing between the rest of the public sector and the private and overseas sectors could be masked in the total figures and this can have special significance for the path of money supply.

(1) The pattern of rate receipts must be a major irregular influence. It should be noted that the LABR peaks in the final quarter of the financial year. Factors contributing to this and which pose major problems for the forecasters include:

(a) Although there is usually a speeding up in the payment of accounts by local authorities at the end of the year, it is far more marked in some years than others. Therefore high spending often fails to show up until the end of the year.

(b) It is difficult to forecast interest payments because there is much short term borrowing, for which interest rates will be a major uncertainty.

(c) March and April borrowing tends to be high because in these months there are no receipts in respect of housing subsidies from central government nor payments from ratepayers on the 10-months instalment scheme.

(2) The PCBR is largely determined by the trading and investment activities of a large number of heterogeneous units. Distortions affecting the past year included the Post Office billing dispute, which increased borrowing needs significantly in the middle of the year.

Central Statistical Office

23 October 1980

TABLES

Table I — PSBR and Components - Quarterly Pattern

Table II — CGBR and LABR - Monthly Pattern

Table III — Revisions to Seasonal Pattern of Components of the PSBR

Table IVa — Central Government Funds Accounts: Quarterly Analysis

IVb — Central Government Funds Accounts: Monthly Analysis

Table Va — Inland Revenue Duties - quarterly analysis

Vb — Inland Revenue Duties - monthly analysis (FS Table 3.2)

Table VIa — Customs and Excise Duties - quarterly analysis

VIb — Customs and Excise Duties - monthly analysis (FS Table 3.3)

Table VII — Interest Receipts and Profits of Note Issue - quarterly analysis

Table VIII — Supply Expenditure - quarterly analysis

Table IX — Seasonal Pattern of the CGBR-Banking Months

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TABLE I - PSBR and Components - Quarterly Analysis

Financial Years		CGBR - own account		CGBR - other		LABR		PCBR		PSBR		PSBR less CGBR own account	
		£mn (1)	Diff from qtly av. (2)	£mn (3)	Diff from qtly av. (4)	£mn (5)	Diff from qtly av. (6)	£mn (7)	Diff from qtly av. (8)	£mn (9)	Diff from qtly av. (10)	£mn (11)	Diff from qtly av. (12)
1976/7	Q2	1711	+650	493	+68	578	+77	633	+65	2922	+792	1211	+142
	3	895	-166	760	+335	427	-74	937	+369	2259	+129	1364	+295
	4	1570	+509	-57	-482	269	-232	499	-68	2338	+209	768	-300
	1	68	-993	504	+79	731	+229	201	-366	1000	-1130	932	-137
	Year	4244		1700		2005		2270		8519		4275	
1977/8	Q2	1101	+436	702	+259	520	+147	464	+103	2085	+686	984	+250
	3	146	-518	64	-379	195	-178	602	+241	943	-455	797	+63
	4	1292	+627	592	+149	146	-227	529	+168	1967	+568	675	-59
	1	119	-545	415	-29	631	+258	-151	-512	599	-799	480	-254
	Year	2658		1773		1492		1444		5594		2936	
1978/9	Q2	2066	+574	593	+64	83	-239	68	-417	2217	-82	151	-656
	3	1567	+76	692	+162	221	-102	509	+24	2297	-2	730	-78
	4	2419	+927	500	-29	86	-236	713	+227	3218	+918	799	-9
	1	-86	-1577	333	-197	900	+577	651	+166	1465	-834	1551	+743
	Year	5966		2118		1290		1941		9197		3231	
1979/80	Q2	2684	+1626	1113	+121	270	-465	391	-291	3345	+870	661	-756
	3	1845	+788	997	+4	645	-91	1335	+653	3825	+1350	1980	562
	4	2117	+1059	1393	+401	472	-264	1340	+658	3929	+1453	1812	394
	1	-2416	-3473	466	-526	1556	+820	-339	-1020	-1199	-3673	1217	-200
	Year	4230		3969		2943		2727		9900		5670	
1980/81	Q2	3275		1312		600		960		4835		1560	
	3	1868		1321		593		1000		3500		1600	

Col(9) = Cols (1)+(5)+(7)

Col(11) = Cols(9)-(1)

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TABLE II CGBR AND LABR - MONTHLY PATTERN

		CGBR Own account		CGBR Other		CGBR Total		LABR*	
		£ mn	Dif from monthly average	£ mn	Dif from monthly average	£ mn	Dif from monthly average	£ mn	Dif from monthly average
1976/77	A	92	-283	168	47	260	-236		
	M	487	112	293	172	780	284		
	J	1077	702	91	-30	1168	672		
	J	-66	-441	177	56	111	-385		
	A	482	107	189	68	671	175		
	S	596	194	304	183	873	377		
	O	-219	-594	9	-112	-210	-706		
	N	923	548	-75	-196	848	352		
	D	903	528	-28	-149	875	379		
	J	-1319	-1694	75	-46	-1244	-1740		
	F	554	179	70	-51	624	128		
	M	1012	637	180	59	1192	696		
Year		4495		1453		5948			
1977/78	A	-96	-322	544	401	448	79	373	250
	M	995	769	226	83	1221	852	108	-15
	J	144	-82	-75	-218	69	-300	-29	-152
	J	-282	-508	69	-74	-213	-582	-52	-175
	A	-78	-304	59	-84	-19	-388	78	-45
	S	492	266	12	-131	504	135	90	-33
	O	-237	-463	208	65	-29	-398	272	149
	N	989	763	150	7	1139	770	-45	-168
	D	641	415	130	-13	771	402	-14	-137
	J	-1143	-1369	18	-143	-1123	-1494	35	-88
	F	381	155	-4	-147	377	8	80	-43
	M	902	676	384	241	1286	917	579	456
Year		2708		1721	-13	4429		1475	

*derived from monthly <u>sample</u> enquiry and not consistent with quarterly census data in Table I

.. continued overleaf

TABLE II CGBR AND LABR - MONTHLY PATTERN continued

		CGBR Own account		CGBR Other		CGBR Total		LABR*	
		£ mn	Dif from monthly average	£ mn	Dif from monthly average	£ mn	Dif from monthly average	£ mn	Dif from monthly average
1978/79	A	465	-101	-19	-126	446	-228	176	66
	M	1108	542	607	500	1715	1041	-16	-126
	J	413	-153	85	-22	498	-176	-129	-240
	J	57	-509	-200	-308	-143	-817	49	-62
	A	858	292	296	188	1154	480	81	-30
	S	630	64	618	510	1248	574	30	-80
	O	-108	-674	-28	-136	-136	-810	263	152
	N	1412	846	195	88	1607	933	-149	-260
	D	1543	977	-94	-202	1449	775	64	-46
	J	-1439	-2005	6	-102	-1433	-2107	88	-22
	F	374	-192	-40	-148	334	-340	100	-10
	M	1482	916	-136	-244	1346	672	769	658
Year		6795		1290		8085		1326	
1979/80	A	806	444	483	163	1289	607	660	395
	M	1188	826	348	28	1536	854	-135	-400
	J	673	311	299	-21	972	290	-185	-450
	J	41	-321	-14	-334	27	-655	319	54
	A	937	575	139	-181	1076	394	286	21
	S	790	428	949	629	1739	1057	106	-151
	O	-437	-799	556	236	119	-563	630	365
	N	1159	797	620	300	1779	1097	-218	-483
	D	1518	1156	95	-225	1613	931	117	-148
	J	-2419	-2781	-42	-362	-2461	-3143	193	-72
	F	348	-14	-3	-323	345	-337	326	61
	M	-264	-626	411	91	147	-534	1086	821
Year		4340		3841		8181		3185	
1980/81	A	481		451		932		603	
	M	1783		537		2320		57	
	J	982		345		1327		-105	
	J	282		511		793		-17	
	A	1274		322		1596		286	
	S	312		488		800		324	

* derived from monthly sample enquiry and not consistent with quarterly census data in Table I.

TABLE III

REVISIONS TO SEASONAL PATTERN OF COMPONENTS OF THE PSBR
FOR FINANCIAL YEAR 1976/7

Seasonal differences of £ million

CGBR own account

		Oct 77	Oct 78	May 80	Oct 80
1976/7	2	-227	-196	-455	-625
	3	+75	-2	+137	+186
	4	-900	-897	-469	-446
	1	+1,052	+1,095	+787	+885

CGBR - other

		Oct 77	Oct 78	May 80	Oct 80
1976/7	2	+141	+71	-104	-117
	3	+39	-78	-24	-55
	4	-102	+135	+101	+111
	1	-78	-128	+27	+61

LABR

		Oct 77	Oct 78	May 80	Oct 80
1976/7	2	-38	+77	-111	-127
	3	-209	-56	+27	+18
	4	+118	+4	-59	-43
	1	+129	-25	+143	+152

PCBR

		Oct 77	Oct 78	May 80	Oct 80
1976/7	2	+105	+58	+154	+157
	3	-52	-142	-204	-226
	4	-24	+173	+28	+22
	1	-29	-89	+22	+47

PSBR

		Oct 77	Oct 78	May 80	Oct 80
1976/7	2	-160	-61	-412	-595
	3	-186	-200	-40	-22
	4	-806	-720	-500	-467
	1	+1,152	+981	+952	+1,084

TABLE IVa: CENTRAL GOVERNMENT FUNDS AND ACCOUNTS: TRANSACTIONS (quarterly)

£ million

		Inland Revenue Duties	Customs & Excise Duties	Supply Expenditure	Interest receipts & profits of note issue	Service of National Debt	Net Lending	Surplus of National Insurance Fund	Departmental Balances	Other		CGBR
		− (1)	− (2)	+ (3)	− (4)	+ (5)	+ (6)	− (7)	− (8)	+ (9)	=	(10)
1976/7	Q2	4519	2492	8981	652	807	443	197	20	-147		2204
	Q3	4694	2615	8592	782	1305	496	318	72	-257		1655
	Q4	4490	2985	9374	863	1036	-214	74	-85	-356		1513
	Q1	7007	2808	10119	1104	1386	215	368	-354	-215		572
1977/8	Q2	5018	2840	9380	669	1072	549	160	192	-319		1803
	Q3	5176	3114	9521	916	1395	-47	265	454	-734		210
	Q4	4597	3329	10207	483	1106	159	-5	41	-1143		1884
	Q1	7126	3001	10935	904	1619	238	192	428	-607		534
1978/9	Q2	5203	3209	10751	514	1202	242	116	70	-424		2659
	Q3	5560	3423	10938	758	1744	453	230	402	-503		2259
	Q4	5288	3739	11592	828	1578	-155	-98	-463	-802		2919
	Q1	8029	3464	12482	1136	1934	-324	93	226	-897		247
1979/80	Q2	6266	3447	12238	961	1658	895	-162	-56	-538		3797
	Q3	6145	3945	13023	1001	2143	797	502	753	-775		2842
	Q4	5634	5073	13658	1036	1943	732	-30	-488	-1598		2510
	Q1	10108	5567	14855	1259	2656	-141	71	143	-2172		-1950
1980/81	Q2	6283	4999	15377	787	1975	789	289	374	-822		4537

TABLE IVb CENTRAL GOVERNMENT FUNDS AND ACCOUNTS : TRANSACTIONS (monthly)

£ million

		Inland Revenue Duties	Customs and Excise Duties	Supply Expenditure	Interest receipts & profits of note issue	Service of National Debt	Net Lending	Surplus of National Insurance Fund	Departmental Balances	Other		CGBR
		-(1)	-(2)	+(3)	-(4)	+(5)	+(6)	-(7)	-(8)	+(9)	=	(10)
1979	April	1961	998	3873	264	258	467	-25	-77	-188		1289
	May	2140	1234	4084	354	986	266	-5	-185	-262		1536
	June	2165	1215	4231	343	414	162	-132	206	-88		972
	July	2735	1513	4119	220	983	-90	417	-127	-227		27
	August	1838	1237	4522	239	452	113	-37	482	-302		1076
	Sept.	1572	1195	4382	542	708	774	172	398	-246		1739
	Oct	2318	2069	4535	363	399	391	270	-554	-740		119
	Nov	1715	1785	4525	386	1060	481	-141	-114	-656		1779
	Dec	1601	1219	4598	287	484	-140	-159	182	-199		1613
1980	Jan	5220	2283	4744	259	1201	-130	-16	257	-273		-2461
	Feb	2257	1669	4521	244	612	6	10	-96	-710		345
	Mar	2631	1615	5590	756	843	-17	77	27	-1163		147
	April	2477	2124	5368	376	360	200	-145	-116	-280		932
	May	1911	1472	5171	291	1147	316	86	124	-430		2320
	June	1895	1403	4838	120	468	273	348	366	-120		1327

TABLE V a INLAND REVENUE DUTIES

£ million

		Corporation Tax(1)	Advance Corporation Tax	Petroleum Revenue Tax	Building Societies' Taxes	Tax on local authorities' interest	PAYE	Schedule D	Schedule C.	Other(3)	Total(2)
		+(1)	+(2)	+(3)	+(4)	+(5)	+(6)	+(7)	+(8)	+(9) =	(10)
1976/77	Q2	132	204	–	6	45	3656	320	93	63	4519
	Q3	120	282	–	4	20	3461	430	215	162	4694
	Q4	306	259	–	0	15	3470	320	112	8	4490
	Q1	1016	315	–	641	220	3763	693	248	111	7007
1977/78	Q2	171	247	–	5	58	3985	340	179	33	5018
	Q3	214	347	–	4	24	3693	500	247	147	5176
	Q4	413	303	–	–	16	3278	345	183	59	4597
	Q1	1264	356	–	681	195	3577	731	302	20	7126
1978/79	Q2	231	256	–	5	57	4247	347	197	–137	5203
	Q3	219	422	–	4	25	3871	526	310	183	5560
	Q4	567	329	183	1	13	3709	308	250	–72	5288
	Q1	1434	414	–	653	200	4209	796	328	–5	8029
1979/80	Q2	266	345	266	5	55	4712	331	267	19	6266
	Q3	312	369	–	3	30	4598	559	345	–71	6145
	Q4	633	397	460	3	18	3853	346	266	–342	5634
	Q1	1450	822	709	910	240	5092	783	420	–318	10108
1980/81	Q2	253	301	–12	5	60	5476	348	290	–438	6283

(1) Includes taxes on capital gains.
(2) As published in Financial Statistics Table 3.1.
(3) Includes repayments of income tax.

Inland Revenue duties

Table Vb

£ million

	Net receipts by Board of Inland Revenue										Cumulative total in current financial year			
	Total[1]	Income tax	Surtax	Corporation tax[2]	Capital gains tax	Development land tax	Estate duty[3]	Capital transfer tax	Stamp duties[3]	Petroleum revenue tax	Net receipts by Board of Inland Revenue	Payments into Consolidated Fund	Payments of overspill relief[4]	Advance corporation tax[5]
Financial years[6]														
1974/75	14,235·8	10,270·9	186·3	2,858·7	381·6		338·9		198·0		14,235·8	14,191·2	24·6	1,157·8
1975/76	18,143·5	15,040·8	108·7	1,995·6	386·7		212·3	117·6	280·8		18,143·5	18,159·4	24·2	917·1
1976/77	20,711·0	17,013·7	62·2	2,655·0	323·4	1·1	124·4	259·2	271·6		20,711·0	20,710·0	20·9	1,059·7
1977/78	21,913·6	17,419·7	30·0	3,342·5	339·9	6·8	86·7	311·2	376·3		21,913·6	21,917·0	7·5	1,253·0
1978/79	24,055·1	18,748·4	15·0	3,940.2	352.9	13·1	46·2	322·8	433·4	182·8	24,055·1	24,080·1	1·9	1,421·0
1979/80	28,201·0	20,598·6	10·7	4,646·0	431·0	26·3	32·1	400·8	620·2	~~1,935·4~~ 1435·4	28,201·0	28,153·4	18·3	1,933·0
1977 J	3,443·2	2,238·6	4·7	1,113·1	39·1	0·2	7·4	18·2	21·9		17,275·2	17,206·0	0·9	290·0
F	1,755·8	1,539·9	4·4	134·4	23·5	0·3	6·7	22·7	23·9		19,031·0	19,007·2	0·2	14·8
M	1,675·0	1,472·9	4·0	103·6	33·2	0·4	9·7	25·2	26·0		20,706·0	20,710·0	0·4	10·5
A	1,762·6	1,365·6	3·6	314·6	24·8	0·3	7·2	21·1	25·3		1,762·6	1,794·0	0·2	224·7
M	1,664·1	1,516·8	3·8	47·8	29·4	—	10·1	26·0	30·2		3,426·7	3,428·5	1·6	15·5
J	1,590·4	1,451·3	2·8	56·0	22·8	0·5	10·9	21·2	24·9		5,017·1	5,018·0	0·6	7·0
J	2,162·4	1,678·1	3·2	396·4	23·0	0·7	6·9	24·4	29·6		7,179·5	7,172·3	0·3	322·3
A	1,608·7	1,449·4	2·9	67·8	26·4	0·7	7·7	24·0	29·8		8,788·2	8,853·2	0·3	12·4
S	1,355·1	1,167·6	2·0	96·8	22·0	0·7	6·2	28·5	31·3		10,143·3	10,194·2	0·7	12·4
O	1,843·5	1,317·1	2·2	419·6	26·6	0·6	7·2	35·2	34·9		11,986·8	11,993·9	1·0	246·2
N	1,599·7	1,412·0	2·2	83·9	29·7	0·3	7·6	29·6	34·4		13,586·5	13,593·5	1·3	36·6
D	1,287·4	985·1	1·7	212·1	30·4	0·4	6·6	22·7	28·4		14,873·9	14,790·8	0·5	19·6
1978 J	3,662·1	2,214·6	1·8	1,333·4	45·0	0·3	4·8	26·2	35·0		18,536·0	18·435·2	0·3	290·9
F	1,723·2	1,401·6	1·6	220·0	26·5	0·8	6·3	24·2	40·1		20,259·2	20,231·1	0·1	54·0
M	1,656·1	1,459·2	2·2	95·3	33·4	1·5	5·5	28·5	30·4		21,915·3	21,917·0	0·6	11·4
A	1,802·8	1,367·2	2·0	342·8	27·1	1·2	4·6	26·0	31·9		1,802·8	1,834·1	0·1	235·6
M	1,780·9	1,606·1	1·7	86·7	25·1	0·6	4·6	24·5	31·6		3,583·7	3,522·7	—	19·1
J	1,708·4	1,562·9	1·3	57·6	20·7	1·1	5·5	24·8	34·5		5,292·1	5,203·2	—	0·9
J	2,525·7	2,003·8	1·4	426·3	25·6	1·4	4·1	24·8	38·3		7,817·8	7,720·9	0·7	321·1
A	1,416·6	1,179·0	1·2	136·9	24·6	1·4	3·5	28·6	41·4		9,234·4	9,305·9	0·1	92·2
S	1,517·8	1,349·5	1·0	77·5	19·8	0·8	3·7	29·5	35·9		10,752·2	10,762·9	0·1	9·1
O	2,054·4	1,437·5	1·0	528·9	19·7	1·0	4·3	30·5	41·5		12,816·6	12,848·1	0·1	240·9
N	1,838·5	1,433·1	1·0	115·9	31·7	0·9	4·1	28·6	40·4	182·8	14,655·1	14,688·6	0·2	71·3
D	1,561·2	1,218·2	1·0	251·5	32·9	1·3	2·6	21·9	31·8	-	16,210·3	16,051·4	0·2	17·1
1979 J	4,175·7	2,475·6	1·1	1,566·1	61·8	0·9	3·1	25·9	41·2	—	20,392·0	20,299·2	—	349·9
F	1,875·9	1,538·8	1·4	247·3	23·1	1·2	3·4	26·4	34·3	—	22,267·9	22,476·2	0·2	55·4
M	1,803·2	1,592·5	0·9	102·9	40·8	1·2	2·6	31·7	30·6	—	24,071·1	24,080·1	0·3	8·4
A	1,923·6	1,361·6	1·2	461·9	32·4	1·8	2·6	25·0	36·9	0·2	1,923·6	1,961·4	—	297·2
M	2,156·4	1,658·2	1·6	91·8	25·7	1·5	3·4	38·2	70·2	265·8	4,080·0	4,101·2	0·3	34·9
J	2,032·2	1,871·6	1·3	57·7	22·1	1·3	2·6	28·4	47·2	—	6,112·2	6,265·9	0·3	12·7
J	2,822·0	2,257·7	0·9	434·5	37·1	1·7	3·9	37·1	49·1	—	8,934·2	9,001·0	0·1	306·2
A	1,687·5	1,468·4	0·9	97·2	32·2	2·3	2·0	34·8	49·7	—	10,621·7	10,839·0	—	46·8
S	1,697·5	1,440·3	0·5	148·9	27·8	1·6	2·3	31·4	44·7	—	12,319·2	12,410·7	0·3	16·5
O	2,411·5	1,706·3	1·1	561·3	37·0	2·3	4·5	44·0	55·0	—	14,730·7	14,729·0	0·2	269·4
N	1,724·8	970·1	0·1	162·2	30·5	1·5	1·5	36·3	62·9	459·7	16,455·5	16,444·4	16·6	104·1
D	1,799·7	1,379·2	1·2	306·4	42·2	1·3	1·6	25·4	42·4	—	18,255·2	18,045·4	—	23·1
1980 J	5,033·8	3,044·2	0·5	1,831·3	64·8	3·1	2·3	30·9	56·2	0·5	23,289·0	23,265·2	0·1	650·2
F	2,183·0	1,657·6	0·8	405·8	30·6	5·4	2·1	35·6	46·1	—	25,472·0	25,522·2	0·2	158·6
M	2,728·3	1,781·8	0·6	86·5	48·1	2·4	2·4	35·5	61·8	709·2	28,200·3	28,153·4	0·2	13·3
A	2,362·4	1,840·3	0·4	402·1	39·8	2·1	7·6	33·9	44·1	−7·9	2,362·4	2,477·3	—	233·3
M	1,895·9	1,680·9	0·5	103·8	28·9	1·5	1·7	35·4	48·2	−5·1	4,258·3	4,387·7	0·1	58·5
J	2,065·1	1,895·6	0·3	47·8	35·8	2·3	1·4	33·5	47·9	0·6	6,323·4	6,282·8	—	9·8
J	3,041·7	2,265·2	0·4	629·3	50·2	4·5	2·7	43·8	54·6	—	9,365·1	9,483·7	—	485·6
A	1,948·0	1,710·7	0·4	115·5	33·4	2·7	1·8	30·0	53·4	—	11,313·1	11;460·3	—	39·7[7]

[1] Including various duties not shown under separate headings. [2] Including gross advance corporation tax receipts shown separately in the final column. [3] From January 1974 the figures include receipts from Northern Ireland. Previously the revenue arising was retained by the Government of Northern Ireland. [4] Payments due in certain cases where the overseas rate exceeds the corporation tax rate (Section 84 Finance Act 1965). These are also included in Table 3.1 under Expenditure: supply services. [5] The figures include advance corporation tax addition, collected between September 1974 and November 1976. [6] The yearly totals include revisions which cannot be allocated to particular monthly periods. [7] Provisional.

Source: Board of Inland Revenue

TABLE VIa CUSTOMS AND EXCISE DUTIES

£ million

		Beer	Wines and Spirits	Tobacco	Customs Duties	VAT	Car Tax	Other	Total
1976/77	Q2	196	206	434	157	867	48	584	2492
	Q3	228	232	417	168	907	41	622	2615
	Q4	207	519	518	203	902	67	570	2985
	Q1	178	182	504	202	1093	62	587	2808
1977/78	Q2	228	177	537	226	884	60	728	2840
	Q3	238	273	575	215	1050	58	705	3114
	Q4	226	477	651	214	1040	72	649	3329
	Q1	201	244	294 (1)	205	1261	96	700	3001
1978/79	Q2	225	254	615	235	1097	69	714	3209
	Q3	242	313	616	248	1188	105	711	3423
	Q4	238	518	632	280	1310	118	643	3739
	Q1	187	362	590	204	1243	89	789	3464
1979/80	Q2	237	343	639	200	1110	103	815	3447
	Q3	246	231	617	302	1570	167	812	3945
	Q4	236	524	628	378	2439	127	741	5073
	Q1	198	430	700	299	3071	120	749	5567
1980/81	Q2	264	166	590	282	2598	121	978	4999

(1) Reflects change in method of raising tobacco duty.

Table VIb

£ million

Net receipts by HM Customs and Excise

	Total	Beer	Wines, cider, perry, and spirits[1]	Tobacco	Betting and gaming[2]	Hydro-carbon oils	Customs duties[3]	Value added tax	Car tax	Ship-builders' relief[4]	Other	Cumulative total: Receipts by HM Customs and Excise	Cumulative total: Net payments into Consolidated Fund
Financial years[5]													
1974/75	7,416·3	450·6	682·3	1,337·4	238·4	1,547·6	525·6	2,506·3	122·2	−4·9	10·8	7,416·3	7,406·5
1975/76	9,240·9	652·4	909·1	1,676·6	264·9	1,540·2	557·9	3,450·7	179·7	−5·3	14·7	9,240·9	9,176·4
1976/77	10,873·7	808·3	1,135·5	1,871·9	284·2	2,065·2	727·7	3,764·9	217·7	−6·8	5·1	10,873·7	10,900·1
1977/78	12,273·1	892·7	1,168·2	2,054·3	320·4	2,457·5	859·1	4,229·6	285·4	−10·8	16·7	12,273·1	12,284·1
1978/79	13,763·6[7]	892·9	1,443·3	2,445·3	338·4[7]	2,466·7	965·3[7]	4,831·5[7]	380·1	−9·1	9·2	13,763·6[7]	13,835·0[7]
1979/80[6]	18,228·3	916·1	1,525·8	2,579·5	406·4	2,925·8	1,177·1	8,179·4	516·2	−9·3	11·3	18,228·3	18,031·9
1976 O	1,119·7	70·9	138·6	158·2	25·4	173·9	62·0	441·8	48·1	−0·2	1·0	6,210·0	6,245·3
N	1,024·5	65·0	238·9	190·1	23·0	177·8	68·0	258·[illegible]	3·9	−1·8	0·9	7,234·5	7,276·7
D	866·9	70·6	139·9	170·0	21·1	176·6	72·5	201·9	15·2	−1·6	0·7	8,101·4	8,091·9
1977 J	1,079·8	68·0	34·1	169·2	17·9	160·2	66·8	525·1	37·8	−0·1	0·8	9,181·2	9,193·4
F	778·6	52·5	37·7	163·0	19·8	154·8	64·7	284·7	1·1	−0·4	0·7	9,959·8	9,976·9
M	926·6	57·4	110·2	171·2	27·2	184·5	70·0	283·1	23·0	−0·8	0·7	10,886·4	10,900·1
A	1,076·5	79·0	42·2	173·1	25·0	217·9	73·1	429·3	37·3	−1·3	0·9	1,076·5	1,085·2
M	872·0	70·2	60·1	165·0	25·6	220·0	72·9	256·5	1·0	–	0·7	1,948·5	1,983·6
J	892·9	79·2	74·5	198·8	25·5	215·6	79·9	197·8	21·6	−0·8	0·8	2,841·4	2,840·4
J	1,212·5	80·0	79·8	179·5	25·0	212·1	76·0	512·4	48·3	−1·4	0·8	4,053·9	4,055·6
A	895·7	81·1	86·2	190·0	26·6	199·3	67·9	242·7	2·6	−1·5	0·8	4,949·6	4,978·7
S	997·0	76·9	107·7	205·6	35·0	198·0	71·4	294·8	7·6	−0·8	0·8	5,946·6	5,954·2
O	1,369·8	72·4	151·5	217·9	29·9	203·7	66·9	557·7	69·2	−0·4	1·0	7,316·4	7,264·5
N	1,026·3	71·5	194·9	222·2	26·4	203·2	73·2	233·2	1·6	−0·8	0·9	8,342·7	8,330·9
D	978·5	81·6	130·5	210·8	23·7	208·1	74·2	249·5	0·8	−1·5	0·8	9,321·2	9,262·9
1978 J	1,123·0	75·0	55·0	−53·4	27·2	198·0	77·6	677·5	66·6	−1·2	0·8	10,444·2	10,409·6
F	856·6	62·5	75·8	158·0	22·4	184·4	66·2	284·4	2·7	−0·5	0·7	11,300·8	11,280·3
M	986·5	63·2	113·3	189·7	28·5	205·2	60·7	299·0	26·5	−0·5	0·9	12,287·3	12,284·1
A	1,291·6	75·5	103·6	238·4	27·9	202·1	65·8	518·1	60·2	−1·0	1·0	1,291·6	1,291·3
M	922·5	71·0	67·3	196·3	29·3	211·9	74·9	270·3	0·5	–	1·0	2,214·1	2,235·2
J	984·5	78·9	82·7	180·6	29·9	201·7	94·1	308·5	8·1	−1·0	1·0	3,198·6	3,208·8
J	1,430·1	87·4	90·2	203·8	26·4	210·4	79·8	632·7	98·7	−0·3	1·0	4,628·7	4,571·9
A	993·0	74·7	113·3	227·9	31·4	207·4	81·1	250·9	6·2	−1·0	0·8	5,621·7	5,631·9
S	1,006·1	79·8	109·8	184·2	35·2	207·4	86·7	304·2	0·4	−2·3	0·7	6,627·8	6,632·0
O	1,592·0	72·3	170·3	177·6	33·4	215·7	87·9	726·0	108·2	−0·5	1·1	8,219·8	8,155·4
N	1,123·4	80·3	215·9	207·7	30·8	215·4	93·5	279·0	0·5	−0·4	0·7	9,343·2	9,332·3
D	1,100·2	85·6	131·4	243·0	23·0	204·4	98·7	304·9	9·3	−0·9	0·8	10,443·4	10,370·8
1979 J	1,448·6	64·9	58·9	181·4	23·5	191·1	83·3	773·1	72·1	−0·4	0·7	11,892·1	11,797·0
F	941·8	59·6	114·0	206·4	20·7	183·2	72·0	283·4	2·1	−0·3	0·7	12,833·8	12,848·3
M	946·4[7]	62·9	188·7	202·2	27·3	216·2	48·7	186·4	14·2	−1·0	0·8	13,780·2[7]	13,835·0[7]
A	961·5	78·9	62·6	264·3	25·9	208·6	47·8	187·1	85·3	–	1·0	961·5[7]	998·1[7]
M	1,251·2	70·8	123·2	133·4	36·4	213·6	55·9	607·1	11·0	−1·0	0·8	2,212·7[7]	2,232·1[7]
J	1,169·5	87·4	157·6	240·8	33·1	231·6	96·0	315·9	6·4	−0·2	0·9	3,382·2[7]	3,447·3[7]
J	1,552·9	85·2	53·2	212·4	35·8	256·0	90·8	667·3	152·1	−0·8	0·9	4,935·1[7]	4,959·8[7]
A	1,186·8	75·7	75·6	179·9	34·5	259·4	101·2	452·9	7·7	−0·9	0·8	6,121·9[7]	6,196·9[7]
S	1,266·6	84·5	102·4	224·8	39·7	247·6	110·2	449·9	7·9	−1·3	0·9	7,388·5[7]	7,391·7[7]
O	2,037·2	71·4	180·7	180·2	36·5	268·4	117·4	1,127·4	105·1	−0·9	1·0	9,475·7[7]	9,461·2[7]
N	1,816·3	83·7	217·2	206·9	34·9	263·3	123·8	875·4	11·7	−1·5	0·9	11,292·0[7]	11,246·0[7]
D	1,296·7[7]	81·3	125·7	241·4	27·0	238·5	136·8[7]	435·7	9·9	−0·6	1·0	12,588·7[7]	12,464·5[7]
1980 J	2,347·2	64·6	81·8	187·1	35·0	252·0	93·4	1,534·0	98·8	−0·5	1·0	14,935·9	14,747·8
F	1,593·4	65·8	143·5	211·9	30·8	236·4	111·8	786·7	3·7	−1·1	0·9	16,529·3	16,416·4
M	1,720·8	67·1	204·2	300·5	36·9	253·6	93·6	746·9	17·3	−0·4	1·1	18,250·1	18,031·8
A	2,042·2	80·6	43·0	259·3	36·5	299·3	97·1	1,123·5	103·1	−1·3	1·1	2,042·2	2,124·4
M	1,482·3	88·6	51·2	119·0	39·2	293·8	90·1	798·8	1·6	−1·0	1·0	3,524·5	3,596·1
J	1,494·2	95·2	71·3	211·5	36·4	293·7	94·6	675·8	16·1	−1·7	1·3	5,018·7	4,999·1
J[6]	2,125·6	93·7	94·6	220·9	37·2	307·4	96·5	1,162·2	112·4	−0·6	1·3	7,144·3	7,216·6
A[6]	1,619·1	90·7	95·6	221·5	34·5	273·9	90·4	810·9	0·9	−0·2	0·9	8,763·4	8,864·0

[1] From October 1976 the figures in this column include receipts for cider and perry. [2] From January 1974 the figures given include receipts from Northern Ireland. Previously the duties imposed by the Government of Northern Ireland had been retained by them. [3] These were previously shown as protective duties. [4] Including a small amount of export rebate. [5] The sum of the twelve monthly receipts differs from the total shown for the financial year. The yearly totals include revisions, e.g. on account of amounts payable to the Isle of Man, which cannot be allocated to particular periods. [6] Provisional. [7] Distorted by industrial action.

Source: HM Customs and Excise

TABLE VII INTEREST RECEIPTS & PROFITS OF NOTE ISSUE

£ million

		POST OFFICE	ELECTRICITY COUNCIL	NEW TOWN DEVELOPMENT CORPORATION & COMMISSION	BRITISH STEEL CORPORATION	REGIONAL WATER AUTHORITIES	LOCAL AUTHORITIES	OTHER RECEIPTS		TOTAL
		+ (1)	+ (2)	+ (3)	+ (4)	+ (5)	+ (6)	+ (7)	=	(8)
1976/77	2	–	125	13	–	38	261	215		652
	3	153	34	74	32	–	241	248		782
	4	–	151	–	1	48	272	391		863
	1	155	–	106	39	–	324	480		1104
1977/78	2	–	120	5	–	48	215	281		669
	3	154	146	97	41	–	274	204		916
	4	–	24	–	–	45	306	108		483
	1	153	–	130	53	5	387	176		904
1978/79	2	–	117	4	–	52	227	114		514
	3	–	30	119	53	–	292	264		758
	4	142	125	–	–	–	322	239		828
	1	157	27	145	50	58	382	317		1136
1979/80	2	–	198	10	–	70	268	415		961
	3	155	33	120	43	–	307	343		1001
	4	–	40	22	–	80	354	540		1036
	1	113	8	168	38	1	446	485		1259
1980/81	2	–	163	11	–	9	261	343		787

TABLE VIII SUPPLY EXPENDITURE

£ million

		Current expenditure on goods & services: Military Defence	NHS	Other	Subsidies	Current grants to personal sector	Current grants to local authorities	Gross domestic fixed capital formation	Capital transfers to private sector	Capital transfers to local authorities	Net lending to public corporations	Other		Total
		+(1)	+(2)	+(3)	+(4)	+(5)	+(6)	+(7)	+(8)	+(9)	+(10)	+(11)	=	(12)
1976/77	Q2	1389	1360	823	920	1012	2153	284	206	33	128	673		8981
	Q3	1405	1357	829	580	988	2079	305	242	23	164	620		8592
	Q4	1584	1419	871	718	1116	2258	304	282	47	115	660		9374
	Q1	1657	1411	982	704	1018	2314	401	309	56	206	1061		10119
1977/78	Q2	1407	1511	905	708	1239	2335	223	247	24	99	682		9380
	Q3	1656	1530	931	711	1234	2138	271	230	22	178	620		9521
	Q4	1660	1578	901	694	1376*	2318	266	251	27	73	1063		10207
	Q1	1950	1652	1093	610	1265	2459	384	487	78	205	752		10 935
1978/79	Q2	1611	1642	1046	635	1533	2559	235	295	41	428	726		10 751
	Q3	1773	1769	1031	741	1575	2356	265	296	32	259	841		10938
	Q4	1912	1823	1054	764	1794*	2487	282	335	46	225	870		11 592
	Q1	2078	1830	1177	785	1601	2687	421	329	77	539	958		12482
1979/80	Q2	1771	1937	1132	808	2033	2804	261	319	45	233	895		12 238
	Q3	2426	2055	1270	822	1936	2652	347	295	53	273	864		13023
	Q4	2358	2152	1263	920	2138	2874	387	327	40	551	648		13 658
	Q1	2523	2267	1433	1019	2045	2949	460	381	107	546	1125		14 855
1980/81	Q2	2760	2522	1408	904	2374	3308	328	350	44	540	839		15377

* Includes about £100m for pensioner's Christmas bonus, which was paid from the National Insurance Fund in other years.

TABLE IX

SEASONAL PATTERN OF THE CGBR (BANKING MONTHS)

(Receipts +/Payments -) £ Millions

(Make-up date)	1980 JAN (16)	FEB (20)	MARCH (19)	APRIL (16)	MAY (21)	JUNE (18)	JULY (16)	AUG (20)	SEPT (17)	OCT (15)	NOV (19)	DEC (10)
Inland Revenue												
Corporation Tax - split into ACT	- 154	395	- 227	- 107	223	- 139	- 104	348	- 138	- 112	48	- 33
MCT	678	439	- 86	- 40	- 153	- 140	- 87	- 160	- 127	- 18	- 148	- 158
Income tax on unincorporated businesses, etc	482	474	136	- 126	- 172	- 149	173	- 112	- 129	- 196	- 183	- 198
PAYE income tax	- 140	198	- 139	- 238	312	20	34	280	- 94	- 241	+ 228	- 384
Residual income tax	- 14	39	- 88	54	14	- 88	- 7	111	- 56	26	- 49	58
Petroleum revenue tax	- 119	- 117	590	- 118	- 118	- 118	- 175	- 175	878	- 176	- 176	- 176
Other taxes	10	11	- 16	- 13	1	- 9	- 17	- 3	- 22	15	66	- 30
Unallocated - seasonal	520	- 455	- 38	107	- 134	0	228	- 212	- 5	36	- 47	0
make-up day effect	15	298	- 124	- 178	509	- 386	- 132	326	- 254	- 132	254	- 248
Total Unallocated	535	- 157	- 162	- 71	375	- 386	96	114	- 259	- 96	207	- 248
TOTAL INLAND REVENUE	1,278	1,282	8	- 659	482	-1,009	- 87	403	53	- 798	- 7	-1,169
Customs and Excise												
VAT split into - seasonal	262	373	- 295	91	194	- 551	202	237	- 453	345	159	- 564
make-up day effect	- 165	165	0	- 158	- 158	0	- 173	173	0	- 260	- 260	0
Total VAT	97	538	- 295	- 67	352	- 551	29	410	- 453	85	419	- 564
Other (including car tax)	385	- 57	- 180	- 14	50	- 125	26	59	- 120	105	229	- 542
TOTAL CUSTOMS AND EXCISE	482	481	- 475	- 81	402	- 676	55	469	- 573	190	648	-1,106
Other consolidated fund receipts	34	1	170	29	- 82	- 1	- 73	- 18	- 48	- 9	20	- 23
Supply expenditure	- 709	- 581	353	- 586	- 458	599	208	- 337	889	153	- 484	1,198
Standing services	- 15	- 3	6	- 4	1	- 6	+ 2	+ 6	- 4	2	7	8
Service of the National Debt	14	- 123	- 43	119	1	- 8	171	- 255	- 42	76	150	- 56
Receipts of interest & dividends by the NLF	- 36	- 77	32	184	- 33	- 19	- 17	- 101	+ 51	117	- 48	- 53
Other central government funds and accounts	- 62	+ 38	- 5	- 63	10	- 3	30	18	69	58	- 15	- 75
TOTAL CGBR	986	1,018	46	-1,061	323	-1,123	289	185	395	- 211	271	-1,276

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cc Press Office

Econ Pol

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Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

31 October 1980

T.P. Lankester, Esq.,
Private Secretary,
10, Downing Street

MF

Dear Tim,

OCTOBER MONEY SUPPLY FIGURES

You asked me to let you have the Bank's provisional estimate of money supply growth based on all banks' returns for banking October. £M3 grew by 2.1 per cent bringing the annualised rate of growth since February to 24 per cent (or just over 20 per cent if allowance is made for reintermediation during the period of pre-February business). Evidence of reintermediation this month is slight.

The counterparts of the growth in £M3 are shown in the attach table. As expected, the CGBR was relatively small this month (£400m). With Central Government debt sales of about £1 billion and a contribution to DCE by the rest of the public sector (£300m), the PSBR was over-funded by £350m. Bank lending to the private sector, at £1.1 bn, was roughly twice last month's level. Bank lending to overseas of £230m took DCE to just over £1 bn.

The big surprise is the positive external element (£450m). This has been negative for most of the year because of the outflows from the non-bank private sector; with hindsight it is best interpreted as a reversal of the unexpectedly large outflows last month.

The eligible liabilities and reserve assets figures are to be published on Tuesday 4 November and the Bank will indicate then that the preliminary estimate of money supply growth is "around 2 per cent". As this figure will doubtless disappoint the market, we should consider whether any additional guidance should be given.

There are certain positive points that can be made:

(i) Some increase in bank lending was to be expected as October was a 'spike' month in the three-month cycle. But the figure is somewhat lower than recent spikes. This may indicate that the slight weakening in the growth of bank

/lending

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lending evident in the last few months may still be occurring. Moreover, the figure again reflects a small amount of reintermediation - and possibly some round-tripping.

(ii) This month's figures for the Central Government's own borrowing (own-account transactions were actually in surplus by some £300 million) confirm the slowdown in the CGBR which we have been forecasting in recent months.

(iii) The externals may be the reversal of last month's large negative figure and, as such, should be regarded as erratic.

(iv) All other monetary aggregates rose by less than £M3 - M1 for instance by less than ½ per cent.

Yours

John

A.J. WIGGINS

PRELIMINARY DCE, £M3 IN BANKING OCTOBER 1980

		£ million (seasonally adjusted)
CGBR		+ 409
of which	own account	(- 302)
	on lending to public corps. & local authorities	(+ 711)
Sales of debt to the non-bank private sector		-1070
Sterling lending to the UK private sector		+1130
overseas sector		+ 234
DCE		+1016
Net externals		+ 446
Non-deposit liabilities (inc -)		- 124
£M3		+1338
% increase		2.17