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Prime Minister ②
S.J. Pike
Duty Clerk 6.5.

Econ Pol

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

6 May 1980

T P Lankester Esq
Private Secretary to the
Prime Minister

MS

Dear Tim,

BANKING FIGURES

The banking figures for the month to mid-April are due to be published tomorrow and they will show that there was a substantial rise (2.9%) in banks' eligible liabilities. But a large element of this rise was seasonal and preliminary indications are that the associated increase in sterling M3 was just ¼%. The Bank will release this figure to the markets when the banking figures are published.

This modest increase means that the cumulated growth of sterling M3 in the 10 months since June last year has come down to about 10% (at an annual rate), within the 7-11% range. Over the last six months, the rate of growth has been less than this, and just below the bottom end of the target range.

The direct public sector influence on money supply growth in banking April was strongly contractionary. The central government was in surplus and there were moderately large sales of gilts. However a worrying feature of the outturn is that there was a massive increase in bank lending to the private sector of £1½ billion. We had expected the figures to bounce back somewhat after the modest increase in banking March, but this record rise suggests yet again that the long awaited downturn has not started.

The continued buoyancy of bank lending is one of the factors that cause the Chancellor to be cautious about reducing MLR in the near future. We are currently revising our view of the prospects for monetary growth over the next few months, but there is a significant possibility that it will be higher than the figures of

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the last three months. We certainly do not expect the public sector to be in surplus as last month. The market seems to be expecting an early fall in interest rates and tomorrow's figures might encourage this expectation; the full details of the increase in bank lending will not be published until next week. The Chancellor will be careful in the meanwhile not to encourage unjustified optimism.

The Prime Minister may like to know that the Bank are planning to announce on Thursday a further rolling forward of the special measures taken to relieve the tight liquidity position in the money markets. Although three month interest rates have remained around 17-17½% in recent weeks, to unwind the special measures on the present schedule would cause severe shortages in the money markets in the middle of the month. The result would be upward pressure on short term interest rates and distortions to banks' balance sheets across make-up day. There will certainly be presentational difficulties in announcing further relief, although with careful briefing we should be able to avoid heavy criticism. We will be able to argue that there are signs that monetary growth is coming under control and that a further <u>rise</u> in short term interest rates was not necessary at this juncture. It is, however, becoming increasingly difficult to argue that the special measures are temporary; they are an inevitable consequence of relatively low monetary growth combined with high bank lending to the private sector. We are working on a longer term solution to this structural problem.

I am copying this letter to John Beverly (Bank of England).

Yours

John

J WIGGINS
Private Secretary

ANNEX

STERLING M3 AND ITS COUNTERPARTS

	Banking April, £ billion seasonally adjusted
CGBR (minus = surplus)	-0.58
Less sales of central government debt to non-bank private sector	-0.77
(of which, gilts)	(-0.80)
Net other public sector	+0.22
Sterling bank lending to:	
Private sector	+1.55
Overseas	+0.23
DCE	+0.65
External and foreign currency finance	-0.11
Net non-deposit liabilities, etc	-0.38
Change in £M3	+0.17

<u>CHANGE IN £M3 IN RECENT MONTHS</u>

	% seasonally adjusted
Monthly average banking July-October (4 months)	1.2
" " " November-February (4 months)	0.6
" " " March	0.4
" " " April	0.3

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