S E C R E T

4

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

PRIME MINISTER

24/

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.

S E C R E T

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