cc. Mr. Duguid.
Mr. Vereker.

Treasury Chambers, Parliament Street, SW1P 3AG
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MG

PRIME MINISTER

MONEY SUPPLY, INTEREST RATES, THE PSBR AND THE EXCHANGE RATE

We shall be providing 4 notes for our meeting on 13 October, dealing with:

Flag A (a) the underlying monetary situation after the abolition of the corset

Flag B (b) the roll forward of the £M3 target

Flag C (c) monetary control

Flag D (d) the exchange rate

Flag E 2. I shall also be letting you have a note summarising the present state of play on the public expenditure exercise, and the options and dilemmas to which it gives rise. There will be further separate notes on nationalised

Flags F, G industry pricing and public sector pay.

Flag H 3. To complete the list, the Treasury are also preparing, in accordance with the agreed work programme the first 3 monthly forward look at the CGBR and the forecast path on a quarterly basis for the PSBR over the rest of the year.

Flag I Also a note on Treasury's latest short-term forecast.

4. Meanwhile, I attach a note prepared by officials which gives the background to recent events. It is not intended to cover the ground in other papers, but to explain the background to monetary control decisions and to offer some pointers for the future. There is

/one point

one point which is worth emphasising at this early stage. We shall have to be careful not to take precipitate action which may increase uncertainty or make the attainment of the medium term strategy more difficult; this will involve paying great attention to the speed of change, particularly if fundamental changes in our financial institutions - affecting lender of last resort, the discount market, the overdraft system and leasing - are at issue. None of this, of course, reduces my conviction of the need to improve upon the present system.

(G.H.)

7 October 1980

MONEY SUPPLY, INTEREST RATES, THE PSBR AND THE EXCHANGE RATE

This note covers recent developments, the current procedures and policy approach, and work now in hand on these major and inter-related aspects of the economy. The note is largely factual and does not attempt to anticipate the conclusions of the full papers being prepared for the meeting with the Prime Minister on 13 October which will cover the monetary situation following the abolition of the corset, the rollover of the monetary target in the context of the forecast and of economic strategy generally, and the methods of monetary control.

2. The note has the following parts:

A. Money Supply Growth: Present Situation
B. Present Methods of Monetary Control: General
C. Control of the Money Supply: The PSBR
D. Control of the Money Supply: Bank Lending
E. Control of the Money Supply: External Factors
F. Exchange Rate

There is a separate Annex on monitoring the PSBR.

A. MONEY SUPPLY GROWTH: THE PRESENT SITUATION

Impact of the SSD Scheme

3. A detailed note has been prepared for the Prime Minister's meeting; what follows is a brief summary of some of the main points.

4. The money supply, £M3, grew at an annual rate of over 26% in the 6 months between banking February and August of this year, compared with the current target range of 7-11% pa. There was exceptional growth in banking July and August, after the end of the Supplementary Special Deposits scheme (the "corset") in June. The corset, which had been in place for 2 years, had given rise to substantial disintermediation as the private sector increased its holdings of "near-money" (assets not liable to corset penalties). With the end of the corset, the banks have been able to restructure their balance sheets; and there has been a surge in money supply growth as business that had been forced into non-bank channels returned to the banking sector.

5. The authorities have long been aware of the incentive which the SSD scheme gave to disintermediation. The problems

were spelt out in Chapter 2 of the Green Paper on Monetary Control. Distortions resulting from the corset were inevitably increased by the abolition of exchange control last October*. This gave residents access to the euro-sterling market. Though we have details of non-bank holdings of acceptances (the bill leak) we have very little timely information about residents' holdings of euro-sterling deposits. Most countries, without exchange controls, face exactly the same problem of determining, on the basis of evidence drawn from third countries, shifts between the domestic and overseas banking systems.

6. The SSD scheme also acted as a restriction on banks setting out to seek new forms of business. We have taken action to restrict their moving into the housing finance market in competition with the building societies. But there is still a question about how they will behave following the abolition of the corset and the effect of this on the money supply, which is to be dealt with in a separate paper by the Bank.

7. Our best central estimates for the underlying growth in £M3, allowing for corset distortions, is the "adjusted M3" series in Table 1. But these are still subject to substantial revision; the last 3 months figures are insufficient to enable us to estimate precisely the growth of residents' holdings of money and money-like assets. It is however clear that over the last 6 banking months it has been substantially above the 7-11% target.

8. Table 1 also shows movements in other measures of money and liquidity. The wider measures of private sector liquidity, which are less distorted than £M3 by the corset, have moved in a broadly similar way to adjusted £M3. M1, on the other hand, has grown much more slowly, being more sensitive to high interest rates.

9. It should be added that though the SSD scheme - especially since the abolition of exchange controls - has meant that we did not know exactly what the underlying rate of growth was, and made it difficult to know whether corrective action was necessary, we did know by the summer that it was outside the target range. What we did not guess was the extent to which it is currently exceeding it.

*This was pointed out in the Chancellor's minute of 11 October to the Prime Minister.

The Pattern of Recent Money Supply Growth

10. The greater than expected acceleration in "adjusted £M3" in recent months followed modest growth during the winter. This in turn followed a period of higher growth until the increase in MLR last November. Table 2 illustrates these three phases, and also shows the profile of the main counterparts of £M3 growth. Apart from the effect of the MLR increase itself, on gilt sales in the first instance and less distinctly on bank lending, the main feature which stands out is the similarity between the path of adjusted £M3 and that of the CGBR; the other counterparts were, in comparative terms, fairly steady. Although there are always interactions between the separate counterparts, it is reasonable to infer that the profile of the CGBR (and indeed the PSBR as a whole) has been a strong influence on the profile (if not the actual rate of growth) of £M3 over the period. At the same time bank lending has remained surprisingly buoyant. Section C discusses the PSBR and Section D bank lending.

B MONETARY CONTROL: PRESENT METHODS

11. The Green Paper on Monetary Control (Cmnd 7858) was published in March 1980 with the aim of completing discussions in 6 months time. The Bank of England has published a number of parallel consultative papers including one on measures of liquidity for prudential purposes. The Green Paper argued that, with the basic instruments of fiscal policy and interest rates, money supply growth could be controlled over the medium term, say, over a year or more. But it recognised that they could not ensure a smooth monthly growth path, it spelt out the advantages of shortening the period within which it was possible to exercise control, and discussed possible changes in methods of control. Many comments have been received from financial institutions, commentators and academics. Seminars with interested people from the UK and abroad were held on 29 and 30 September. A separate paper is being prepared for the Prime Minister's meeting.

The Discretionary Determination of Interest Rates

12. The present system depends on whether the authorities can judge the appropriate level of interest rates to meet the money supply target and whether Ministers are willing to sanction the necessary changes.

The authorities are able to virtually determine the level of short term rates through changes in MLR, and money market operations.

13. This technique is independent of the banks' reserve asset position. Throughout this year the banks have been short of liquid and reserve assets. But since the general level of interest rates has been judged appropriate the authorities have relieved this pressure on the banks and so maintained short term interest rates at the desired level.

14. The process of control works as follows. The quarterly economic forecast generates the interest rate path thought necessary to achieve the money supply target taking account of the forecast of the PSBR described in Section C. That gives the authorities some idea of the likely direction in which interest rates might be expected to move over the year and indicates the likely quarterly profile of the demand for money and hence interest rates. In practice, decisions on interest rates and gilt sales have to be made on a shorter time scale. To assist in this, the Bank and the Treasury each month look ahead over the next 3 months, taking a view on movements in the main counterparts of money supply growth, the PSBR in the light of the latest monitoring information (see Section C and Annex A), public sector debt sales, bank lending and external factors.

15. Thus, in principle, if, for example because of a fluctuation in central government borrowing as a result of the pattern of expenditure or revenue flows, unusually high money supply growth is expected, interest rates or debt sales can be changed accordingly. But existing gilt market techniques are based on securing gilt sales when they can be obtained rather than when they would be needed to smooth monetary growth. Something can be achieved by part payment if forecasts are accurate. But the present system does not allow us to smooth out unforeseen changes in monetary growth by selling stock when needed and thereby letting long rates of interest adjust.

16. Moreover:

a. the counterparts to money supply growth can fluctuate very substantially and unpredictably from month to month, and the profile of money supply growth over a quarter is extremely uncertain;

b. it takes some months for it to become clear that there has been a divergence from the target path, rather than simply fluctuations about it, and it is very difficult for the Government to move interest rates up unless it is sure that the move is justified. This carries the risk that unforeseen events like a surge in the PSBR become firmly embedded in the money supply.

c. Because of the uncertain impact of interest rate changes over the short term, it is difficult to be sure that the chosen level will be appropriate.

17. Swings in monetary growth have been substantial, not only from month to month, but from quarter to quarter. In the 12 months to banking June 1980, the increase in £M3 (after seasonal adjustment) was as high as £1,250 million (2.2%) and as low as £42 million (0.1%). In the eight quarters to Q1 1980, the increase in £M3 varied between £2.2 billion and £1.1 billion. The swings in the main counterparts have been even larger*. Chart I attached illustrates this.

18. Experience shows that swings cannot be foreseen at all reliably even over a period of 3 months. Our record in forecasting periods three months ahead during the first half of this year shows deviations averaging about 1/3% per month on the money supply. Just one month ahead, the differences between forecast and actual can on occasion be much worse. In individual months these differences soemtimes approached 2% of £M3. There was, however, no discernible bias towards either over or under forecasting on a one month ahead basis in the period preceding the abolition of the corset. Charts 2 and 3 show how the CGBR and £M3 banking month forecasts compare with what actually happened.

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*The range of the main counterparts over the 12 months to banking June 1980 was:

CGBR	+ £1.4 bn to - £0.6 bn
Other public sector (net)	+ £0.3 bn to - £0.6 bn
Central Govt debt sales	+ £1.4 bn to - £0.1 bn
Bank lending to private sector	+ £1.5 bn to - £0.2 bn
External factors	+ £0.8 bn to - £0.7 bn

The Movement of Interest Rates

19. Table 3 shows the movement of MLR and selected interest rates since May 1979. MLR moved up three points last November in response to rapid monetary growth - following a high PSBR and gilts pause. It was followed by an increase in the mortgage rate. The subsequent fall in the rate of growth of £M3 (and absolute fall in M1) suggested that the system of control was working as intended. But bank lending stayed high and the PSBR expanded again. Thereafter for a few months it looked as if the level of MLR was adequate - at least if the prospect of recession was taken into consideration. In banking May and June, £M3 seemed to be accelerating again. The one point reduction in MLR in July was therefore a calculated risk; it was not justified by the monetary situation to date but by the prospects of slower money supply growth in the future. Chart 4 shows the movement of the money supply as it looked when the decisions were taken.

Further Work

20. Apart from reintermediation following the corset there have been two basic problems of monetary control:

a. The Path of the PSBR

Though it can never be even throughout the year, the PSBR path over the last two years has been so extreme as to make smooth monetary growth a virtual impossibility. It is intended to examine, as a matter of great urgency, what can be done to smooth the path of the CGBR as soon as the new forecast is available. (This forecast is to be sent to the Prime Minister as set out in the work programme). There is no doubt however, that this will be a formidable task - the revenue, expenditure and lending components are not controllable with precision and there will be limits on how much further present procedures can be changed to give a better path.

b. The Method of Determining Interest Rates

The paper on monetary control for the Prime Minister's meeting will deal with techniques for adjusting interest rates both short term and for the range of debt instruments - so that less weight has to be put on tax and public expenditure decisions which are largely taken annually and which produce an uncertain path for the CGBR. The timely, and appropriate adjustment to interest rates is crucial to monetary control.

C CONTROL OF THE MONEY SUPPLY: FORECASTING AND MONITORING THE PSBR

21. The relationship between the PSBR and changes in money supply, is not at all direct or close in the short term. But the PSBR is potentially so important a counterpart that forecasts of it are important in managing the control of the money supply.

22. Forecasts of the PSBR are one output of the economic forecasts prepared in the Treasury. This means that the forecast for the PSBR is consistent with the simultaneous forecasts of output, unemployment, inflation and so on for the economy as a whole.

23. The preparation of the forecasts thus provides a regular clearing house for views about the economy and also for the judgements of those directly involved in the control and monitoring of public expenditure and the monitoring of revenues and borrowing. The PSBR forecasts incorporate, for example, up-to-date judgements on how fully cash limits will be spent (including a view on the chances of any breaches), how local authority employment will change, what nationalised industries will have to borrow, and how tax revenues will turn out.

24. The forecasts are constructed on a quarterly basis and so generate a quarterly forecast for the PSBR. The forecast for the PSBR is built up from all the income and expenditure components. In many of these areas, the raw material for the forecasts - expenditure plans, cash limits, EFLs, tax liabilities - relate to complete years and not to individual quarters. Where there is information about the path during a year - the pattern of wage settlements, the timing of asset sales, EEC contributions, tax payments, and so on - efforts are made to embody that information in the quarterly path. But for many items there is no such information and a smooth path is forecast. Thus the quarterly path of the PSBR combines items which are forecast with a smooth path and items with knowable irregularities.

25. The difficulties of foreseeing many of these irregularities,

and the large, and varying, seasonality of many of the series, has resulted in the focus of attention in the forecasts being concentrated much more on the financial year total as a whole than on the quarterly path.

26. In practice, the profile of the PSBR during a financial year is important for considering the rolling forward of money supply targets, and for monitoring the actual PSBR in order to judge whether deviations are a warning signal or not significant. Hence if, in fact, the PSBR is going to turn out very unevenly, but is not forecast to do so, then strategic judgements about the trend of interest rates and funding policy (eg the timing of initiatives on National Savings) will be based on wrong signals. Day-to-day tactical decisions, however, will be affected less since, as noted in Section B they are based on the rolling monthly forecasts of the central government borrowing requirement (CGBR) and such other short term forward indicators as can be found.

27. At the beginning of each month a new forecast of the major components of the CGBR is made covering the period to three months ahead. This rolling forecast forms the basis of the Bank of England's assessment of the money market's position in the short term and also provides the basic material for monitoring daily inflows and outflows. The rolling 3 monthly forecast takes account of factors, identified at the monitoring stage, which are thought to have affected the trends. The forecast for the first month can deviate by around plus or minus £500 million and for the third month plus or minus £750 million. Banking month forecasting of the CGBR for monetary control purposes is subject to wide and erratic fluctuations resulting from slight changes in the timing of receipts and payments, around the third Wednesday of the month. Chart 3 illustrates these divergences for the first half of the year. A further effort is currently under way to improve this forecast and relate it more closely to the quarterly forecasts.

28. The forecast at Budget time of the PSBR path in 1980-81 turned out to be seriously wrong. In the April-June quarter the PSBR was £4½-5 billion compared with the forecast at Budget time for the

quarter of £2¼ billion. The quarter showed exceptionally high levels of defence spending; unusually high borrowing by local authorities; and shortfall on tax receipts; very high borrowing by public corporations and other factors. Even with the benefit of hindsight it is hard to see how much of this could have been foreseen: some - such as the defence spending and the high local authority borrowing - could not have been.

29. That the PSBR was running high in April-June was known by June, through the rolling CGBR forecast and the monitoring procedures described in the annex. They relate to key elements of the accounts and are most timely in relation to the central government transactions which account normally for the bulk of the PSBR.

30. Much greater attention is now being paid to forecasting the quarterly path of the PSBR by ensuring that we take full account of all sources of information on the timing of transactions. This will improve our forecasting performance. But given that the margin of error on an annual forecast is plus or minus £3 billion, it is possible that quarterly forecasts would each have average errors of at least plus or minus £1 billion. Such a margin is not large, given that the PSBR is the balance between flows in excess of £100 billion a year on each side of the account.

D CONTROL OF THE MONEY SUPPLY: BANK LENDING

31. Bank lending has grown very rapidly in the last 2 years. In the year to mid 1980, the total stock of bank loans to the private sector grew by nearly 23%, following growth of 21% in the previous year. Table 4 attached gives greater detail on bank lending in recent years.

32. There are a number of possible explanations. The acceleration in inflation is the most obvious, though the present methods of monetary control may also play a part. Until the last few months inflationary expectations had probably been rising steadily since about mid-1977, and this will have offset the impact of rising nominal interest rates. The company sector has been in substantial deficit since late 1978, and this would be expected to increase the demand for bank finance. With the current high level of long term

interest rates the long term capital markets are not making a significant contribution.

33. But our understanding of bank lending, particularly in the short term, is far from good in spite of considerable research in both the Bank and the Treasury and a search of outside literature. The failure of research to yield robust results reflects distortions of the corset and earlier controls. But in any event, it is quite unrealistic to expect understanding of quarter by quarter movements to be anything other than sketchy.

34. The quarterly financial forecasts examine the path of bank lending with care in view of the implications for monetary growth or interest rates. The forecast for the 1980 Budget foresaw no significant falling off in the growth of bank lending until the fourth quarter, but it did not foresee the acceleration which actually took place in the first half of the year. The main difficulty at this stage of the economic cycle concerns the timing of companies' reaction to the recession (which has been greater than foreseen at the Budget) and in particular the speed with which they run down stocks and adjust their labour force. In the first stages of a recession the companies' need for finance may well rise rather than fall if adjustment is slow, or the recession os steep. There may well have been an element of the latter underlying recent behaviour, although interpretation is made rather difficult by the conflicting stories told by different indicators of the company sector's financial position.

35. There are large monthly fluctuations in bank lending. In the year up to June, when the corset was taken off, the seasonally adjusted monthly increase varied from £170 million in December to over £1.5 billion in April. Nevertheless the acceleration this year had been clearly noted by April and incorporated into the 3 month forecasts.

36. A further problem has been the difficulty of assessing the banks' position under the corset, which was increased by the abolition of exchange controls in November as new forms of finance become available to companies. That this additional difficulty would arise was clearly understood at the time of the exchange control

decision and also when the decision was taken in November not to abolish the corset then.

37. Once the distortions induced by the corset are fully unwound, the underlying features of bank lending should become clearer. But it would be misleading to suggest that very great strides can be made in our understanding. Given the overdraft system, under which even the clearing banks cannot forecast, and do not try to control, their own lending accurately from month to month, there is bound to be volatility. The Bank have regular discussions with the clearing bankers and it is clear that their analysts have much the same sort of problems in interpreting current behaviour as we do. The Bank of England are providing a paper assessing how the banking system is likely to develop post-corset.

E CONTROL OF THE MONEY SUPPLY: EXTERNAL FACTORS

38. The external adjustments to the money supply can be a particularly volatile element and one not susceptible to forecasting with precision on a monthly basis. Within the last year they have fluctuated between a positive value of £250 m and a negative one of over £800 m. Even in the absence of any net intervention in the foreign exchange market by the authorities, they can still be strongly influenced by movements in the current account of the balance of payments and by the structure of the capital account.

39. Forecasts for the external adjustments are based on projections of the current account and a complex set of developments and interactions on capital account. Because the exchange rate is determined by market forces, it is necessary to identify the net effect of a variety of flows in both directions across the exchanges. The abolition of exchange controls has made this difficult. Similarly, large inflows to pay PRT are a fairly new development and have probably given rise to very large monthly fluctuations of the externals.

40. There has been no systematic bias during this year in the forecast of the externals one month ahead, but some slight tendency to overpredict them (ie forecast too positive an influence on £M3)

looking three months ahead. But errors in any one month can amount to as much as 1% of £M3.

F THE EXCHANGE RATE

41. Although the pattern has been erratic, the effective sterling rate has risen since the beginning of 1979 from 64 to 76.5, almost 20%. This has taken place at a time when cost inflation has been much more rapid in the UK than in other countries. Consequently the loss of cost competitiveness has been much greater - of the order of 40%.

42. The rise in the exchange rate has been the result of a variety of factors. The rise in the price of oil and the uncertainties about future supplies have made sterling attractive to non-residents. Higher interest rates in the UK than in other countries have also been a factor. Some of the current strength of sterling may be reversed when UK interest rates come down, and if the outlook for oil supplies becomes more settled. But our possession of oil will almost inevitably produce an exchange rate higher than it otherwise would have been.

43. The high exchange rate has brought with it benefits to inflation: import prices for goods other than oil have been falling this year. But it has intensified the squeeze on manufacturing industry.

44. The removal of outward exchange controls was completed in October 1979. This has generated substantial outflows (of around £1 billion a quarter), though these have been more than matched by overseas inflows into sterling. The possibility of introducing controls on inflows was discussed with the Prime Minister on 18 September, and further work on this and other means of influencing the exchange rate is in hand.

45. Any such action, however, runs the risk of increasing both ifnlation and the pressure on the money supply targets. For example a 10% fall (to $2.15)could directly add around 2% to the rate of inflation in the course of a year. Significant market intervention would require a large increase in sales of gilts or other debt or a cut in the PSBR if it was to be contained within the present monetary target. The Bank of England's activity in smoothing upward

pressure over the past 18 months has probably itself cumulatively involved some addition to the money supply, even though total external influences on £M3 have been negative over this period.

G SUMMARY AND CONCLUSION

This note has brought out the following points:

a. £M3 cannot be controlled in the short run, and its counterparts are too variable to be predicted with precision month by month.

b. A great effort is already put into forecasting and monitoring monetary growth and the PSBR. An upsurge in the PSBR and monetary growth was foreseen. But the extent of the surge in adjusted £M3 since February was neither foreseen by us or anyone else. The PSBR for the first half of 1980-81 was underpredicted. So was the growth of bank lending. The fall in activity in manufacturing and the rise in the exchange rate have also been greater than was foreseen at the time of the Budget.

c. More work needs to be done - and is being done - to improve forecasting performance, particularly with regard to the short term movements in the PSBR. But the average error is likely to remain large.

d. Forecasts are not policy. The essence of monetary targets is that adjustments have to take place in response to unforeseen changes in order to prevent them causing an increase in the money supply over a period of time. This indicates two areas for further work on techniques:

i. a major effort is in hand to see whether the PSBR path can be made smoother and to see whether excessively skew paths of the sort we have seen this year can be avoided.

ii. This may help monetary control but it will be impossible to adjust the PSBR in order to achieve the desired rate and pattern of monetary growth. So techniques of control, including funding methods, are also being re-examined.

e. Events in the summer suggest the following considerations:

i. we must avoid new methods which like the corset operate by causing large scale disintermediation.

ii. more timely changes in interest rates would be a necessary feature of either improvements in existing techniques or completely new methods. This means changes both up and down in all interest rates, including base rates and mortgage rates, in response to blips in monetary growth.

iii. if possible new techniques should provide greater constraints on the banks.

iv. it is unlikely to be possible to combine improvements of this sort with an exchange rate objective.

HM Treasury
6 October 1980

TABLE 1

% at annual rate
seasonally adjusted

Banking months	M1	£M3	PSL1	PSL2	adjusted £M3 approximately
June 1978-June 1979	12.8	11.5	16.1	14.2	13
June 1979-June 1980	3.2	11.7	13.5	11.8	17
February-June 1980 (4 months)	0.2	12.1	18.1	15.4	22
February-August 1980 (6 months)	7.9	26.2	21.9	18.2	22

PSL1 = 'Money' plus other money market instruments (including bank bills) plus certificates of tax deposit.

PSL2 = PSL1 plus other savings deposits and securities (including building society deposits).

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TABLE 2

banking months, £ million
seasonally adjusted

Banking Months	Adjusted £M3 £m	Adjusted £M3 (% annual rate)	CGBR £m	CG debt sales to non-bank private sector £m	"Adjusted"* Other Public Sector Borrowing (ie contribution to DCE) £m	"Adjusted"* Bank Lending to the private sector £m	"Adjusted"* Bank Lending to the private sector (% annual rate)
June 1978- June 1979	6290	(13%)	8900	- 9720	780	7090	(21%)
June 1979- November 1979 (5 months)	3910	(19%)	4420	- 2310	- 80	4210	(26%)
November 1979- April 1980 (5 months)	2270	(10%)	1650	- 4070	470	4580	(27%)
April 1980- August 1980 (4 months)	4990	(27%)	5340	- 3210	260	3130	(21%)

* These figures have been adjusted for the estimated effects on the recorded figures of disintermediation induced by the imposition and subsequent removal of the corset.

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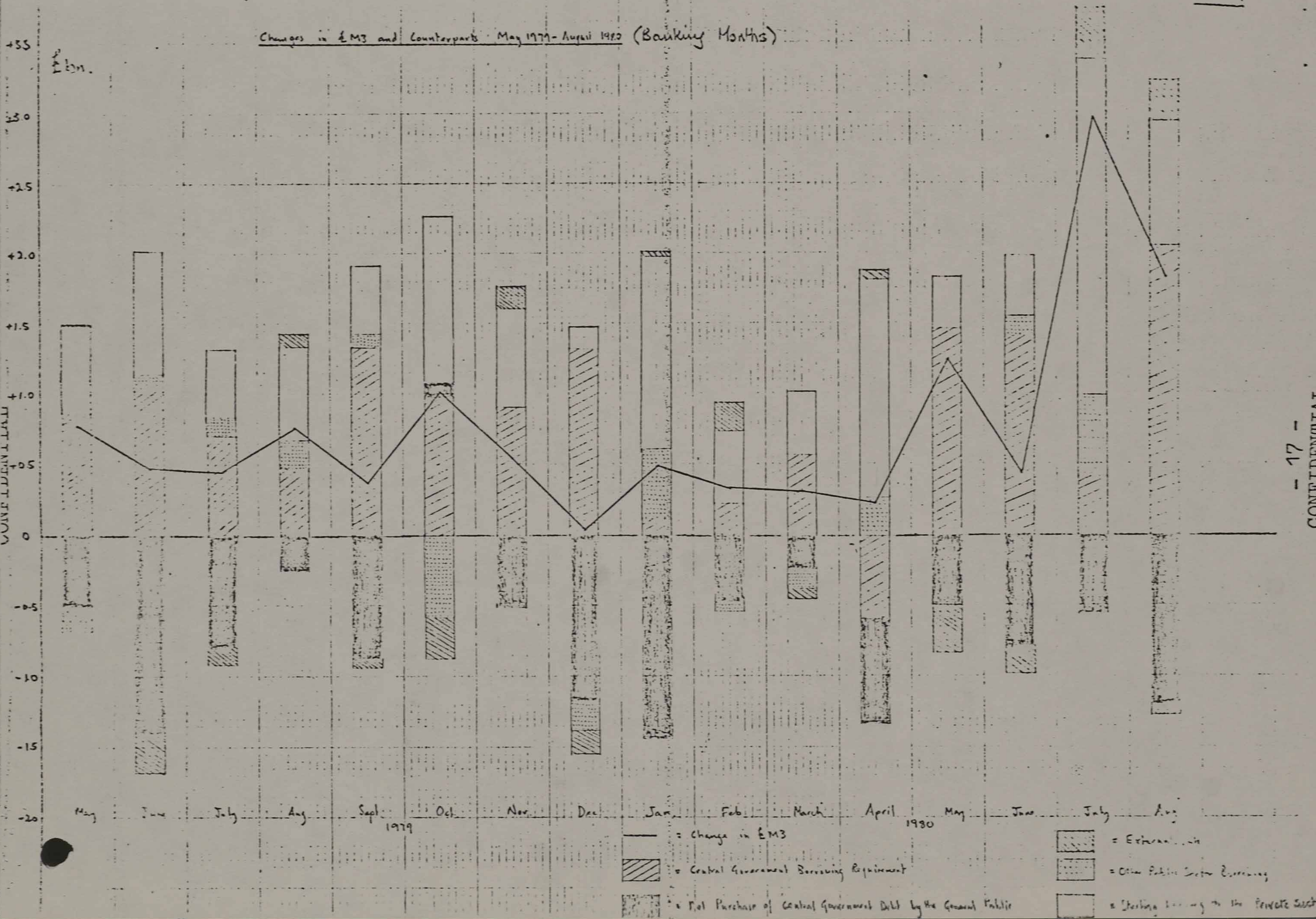
Chart 1



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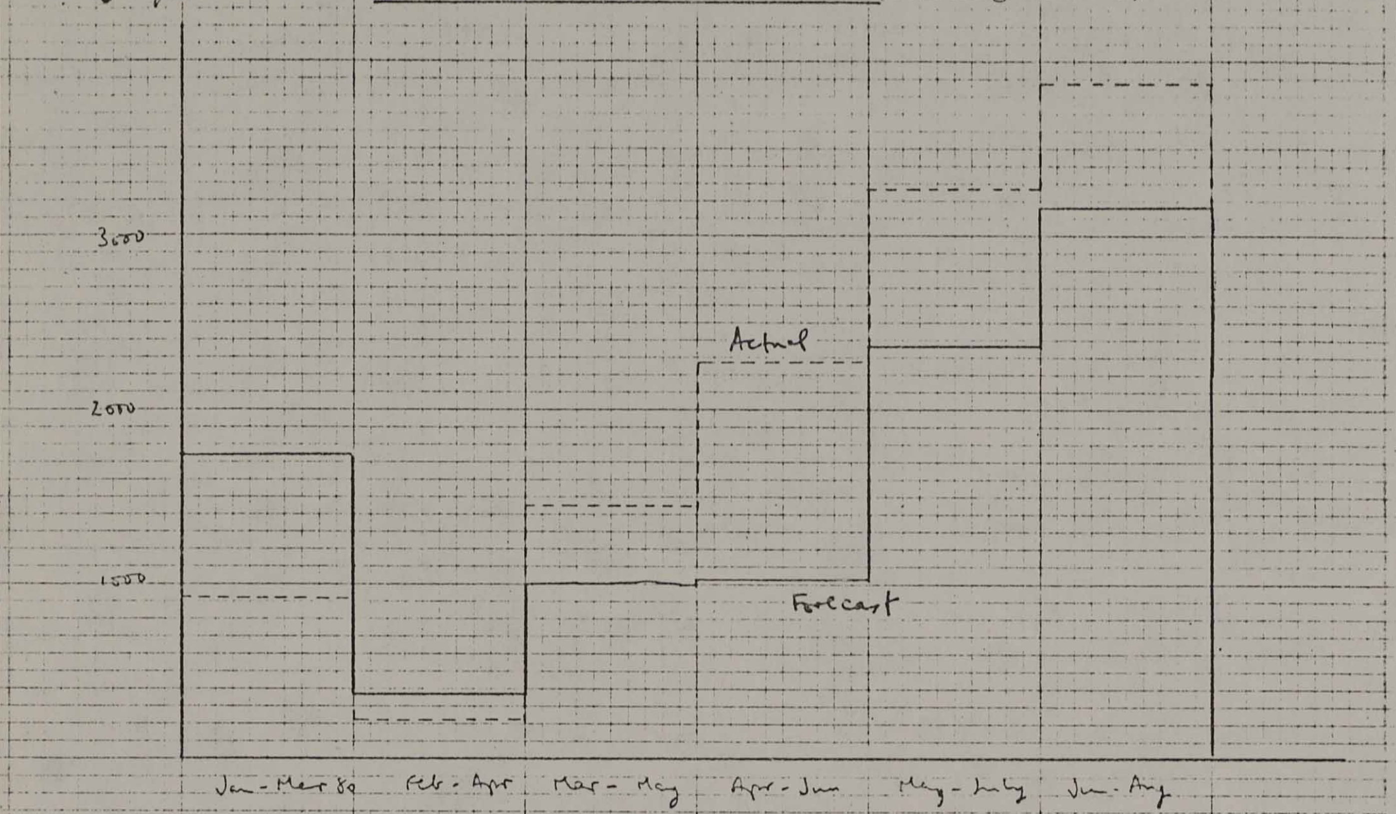
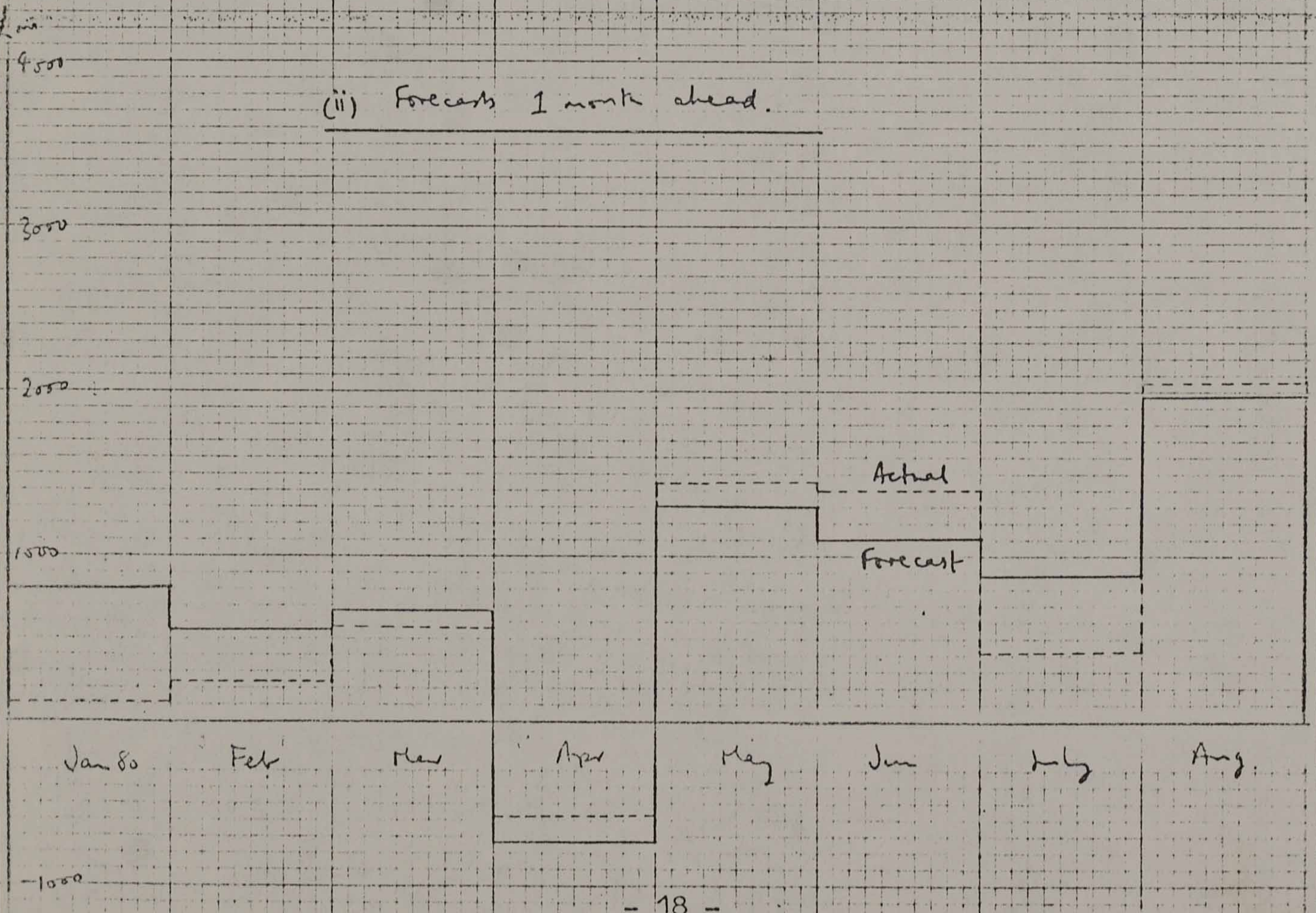
CGBR : forecasts and Actuals Jan - Aug 1980

Chart 2.

(i) Forecasts 3 months ahead (banking months)



(ii) Forecasts 1 month ahead.

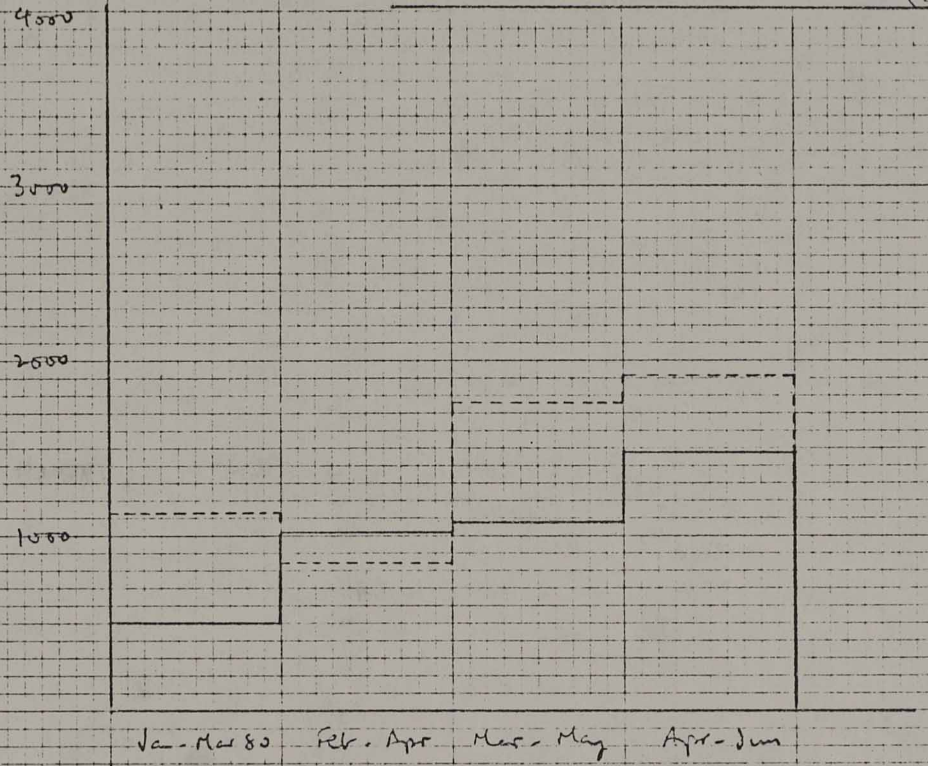


£M3: Forecasts and Actuals – the longer period

Chart 3

Jan - June 1980

(i) Forecasts 3 months ahead (banking months)



(ii) Forecasts 1 month ahead (banking months)

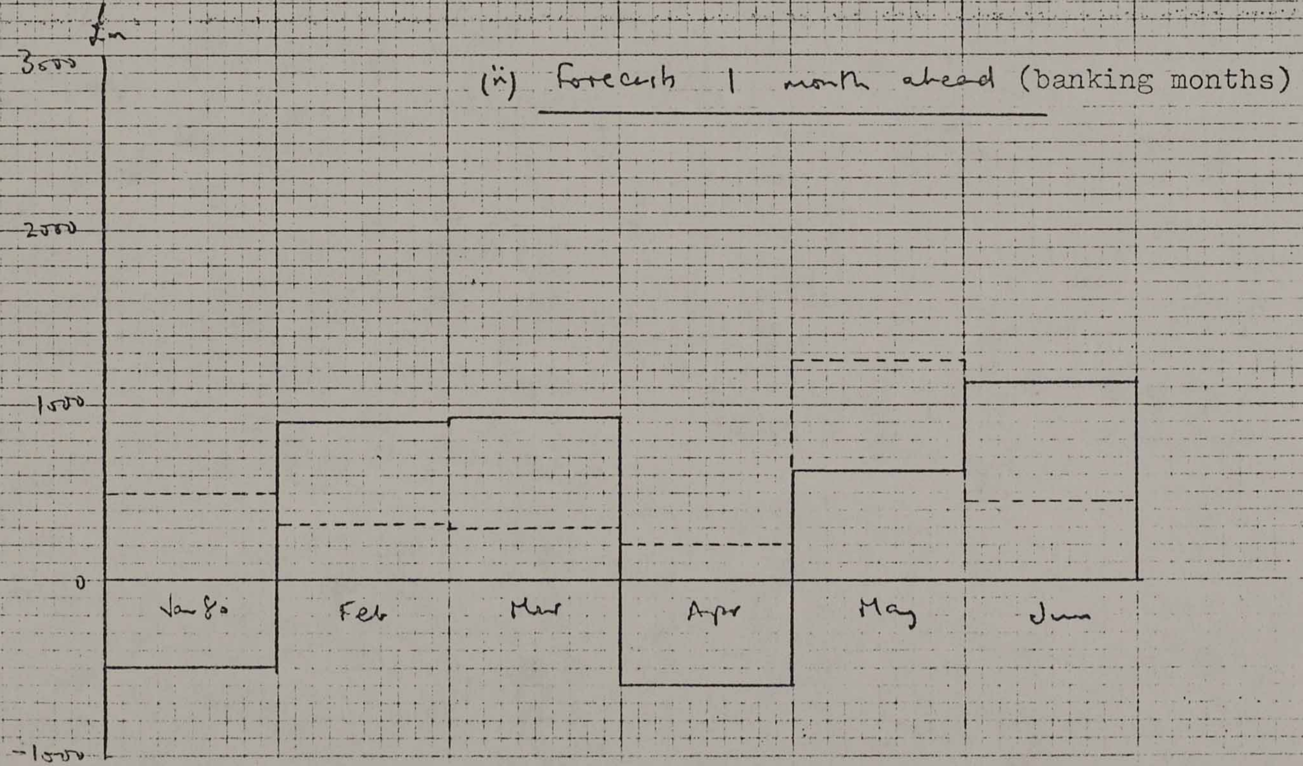


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Chart 4

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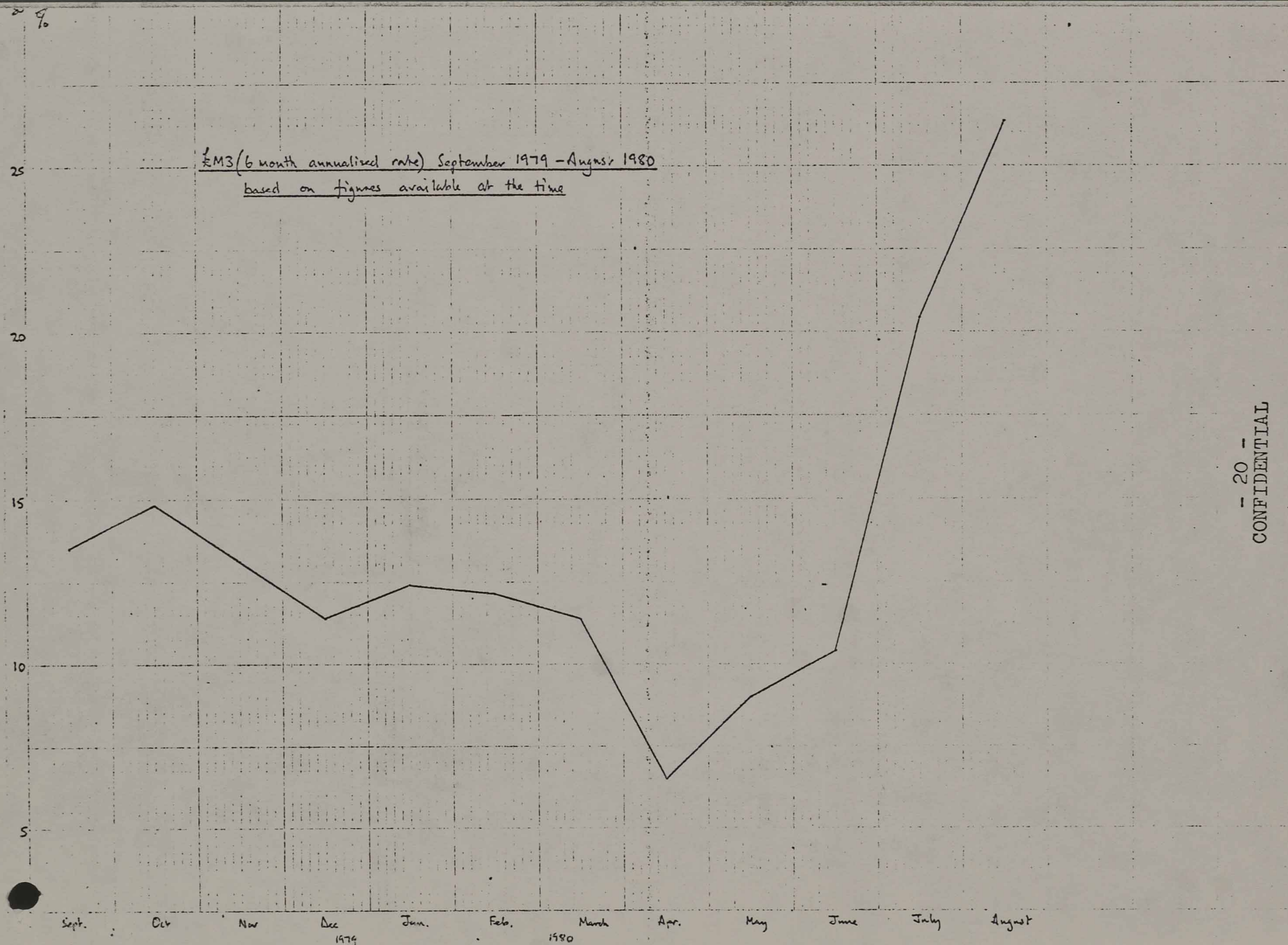

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TABLE 3

RELATIVE INTEREST RATES - MAY 1979-SEPTEMBER 1980

		MLR°	3-month inter-bank rate*	Mortgage Rate †	Government Stock Redemption Yield** 5 years	20 years
1979	MAY	12	11.88	11.75	11.29	12.24
	JUNE	14	14.07	11.75	12.34	12.80
	JULY	14	14.03	11.75	12.48	12.56
	AUGUST	14	14.25	11.75	12.17	12.41
	SEPTEMBER	14	14.16	11.75	12.24	12.57
	OCTOBER	14	14.75	11.75	13.31	13.45
	NOVEMBER	17	16.88	11.75	15.66	14.79
	DECEMBER	17	17.00	15,00	15.10	14.67
1980	JANUARY	17	17.32	15.00	14.99	14.07
	FEBRUARY	17	18.19	15.00	15.33	14.60
	MARCH	17	18.19	15.00	15.10	14.64
	APRIL	17	17.35	15.00	14.14	14.09
	MAY	17	17.07	15.00	14.08	14.01
	JUNE	17	16.88	15.00	13.09	13.75
	JULY	16	15.44	15.00	13.00	13.11
	AUGUST	16	16.88	15.00	13.95	13.92
	SEPTEMBER	16	15.75 ††	15.00	13.02 ††	13.33 ††

° At end month.

* Mean of the lowest bid and highest offer rates on the last Friday of the month.

† Rate recommended by the Building Societies Association. Calculated at end month.

** Calculated on the last working days of the month.

†† Most recent figure available.

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RECENT BANK LENDING BEHAVIOUR

TABLE 4

	Increase in bank lending (%)					Percentage increase in:					
	Personal sector	Industrial & commercial companies	Other financial institutions	Total private sector	Total including bill leak	Real GDP	RPDI	RPI	Book value of stocks	ICC's financial deficit	Short term interest rates
.2 months to											
mid-1977	13.4	14.7	5.4	13.5	13.4	2.4	-3.6	17.4	24.0	-168	8.05
mid-1978	19.3	9.8	21.6	13.4	12.6	3.8	10.0	7.6	10.2	293	9.02
mid-1979	24.4	19.8	21.0	21.2	23.6	3.2	5.8	10.6	16.5	-133	12.22
mid-1980	28.9	17.4	37.9	22.6	24.2	-4.3	2.0	21.5	15.5	-1250	17.16
;uarterly change :o											
1979 Q3	7.3	3.4	11.5	5.3	6.5	-5.2	-0.1	6.7	4.5	-695	14.09
Q4	6.0	2.4	9.8	4.2	4.5	3.8	3.9	2.8	5.0	-1478	15.69
1980 Q1	6.3	5.4	2.6	5.4	5.0	-0.8	-1.5	4.8	3.2	-503	17.68
Q2	6.6	5.2	9.8	6.1	6.3	-1.9	-0.3	5.8	2.0	-1250	17.16

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ANNEX A

MONITORING THE PSBR

A "monthly note on the borrowing requirement" is circulated to Ministers and senior management in Treasury. Copies also go to the Bank of England. This note is a round up of events to date and may include an appraisal of the prospect for the year in months when there is not an up to date national income forecast, containing a forecast of the PSBR. This note draws on the regular assessments of detailed aspects of public sector transactions that are produced in various parts of the Treasury.

2. Of central government transactions, tax collections by Inland Revenue and Customs and Excise and expenditure from votes by government departments are all monitored monthly against monthly or quarterly profiles prepared early in the financial year.

3. At budget time, detailed monthly profiles for each category of tax are obtained from the revenue departments. These profiles are consistent with the budget forecast for the year. These profiles are used to determine variance from forecast when the monthly actuals are received. Any deviations which is expected to lead to a change in trend is reported in the "monthly note on the borrowing requirement" which is circulated to Ministers and senior management.

4. Detailed quarterly profiles of expenditure from each Vote are obtained from departments four to six weeks after Budget day. Actual expenditure is compared with profiles each month by the Treasury and variations are examined. For cash limited expenditure explanations are sought from departments for any excess expenditure so that corrective action, if necessary, can be taken to ensure that the cash limits are not breached. For non-cash limited expenditure the Estimates and profiles depend on economic assumptions - unemployment, prices, interest rates etc. If these assumptions turn out wrong then this is an important reason for differences between

actual and budgetted expenditure. All variations from profile are reported to senior management.

5. Other central government transactions and the central government borrowing requirement are examined monthly, mainly by reference to the Budget forecast for the year as a whole, and to corresponding transactions in previous years.

6. Monitoring of borrowing by local authorities and public corporations is maintained, also using Budget forecasts and previous years as main reference points. In addition, attempts are made to assess quarterly local authority current expenditure, mainly from trends in employment, and also local authority capital expenditure, and to relate both to plans and controls for the year as a whole.