

MR. BATTISHILL

cc Financial Secretary
Sir Douglas Wass
Sir Kenneth Couzens
Sir Lawrence Airey
Mr. Middleton
Mr. Byatt
Mr. Barratt
Mr. Bridgeman
Mr. Hancock
Mr. Riley
Mrs. Lomax
Mr. M. Williams
Mr. Grice
Mr. Bell
Mr. A. Ridley
Mrs. Gilmore

CF
Banking to
mtg with
Chancellor
tomorrow.
R.

TARGET VARIABLES

I am replying to the enquiry in your minute of 3 September to Mr. Middleton, because I held a meeting with the Bank of England on Friday evening to take stock of the work being done to follow up discussion at the Prime Minister's seminar in July.

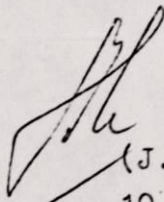
The main area to be covered is that of "monetary base control". The Bank of England have agreed to take the lead in preparing the joint papers, because we very much need for this stage of discussion to get the analysis right in terms of institutional and operational features of the banking system, etc. We identified three specifications of monetary base schemes, which we think adequate to give coverage of the spectrum of what might be prima facie practicable or at least worth positive examination (i.e. ruling out some of the naive extreme versions). We shall of course go over the Bank of England work and produce joint papers, whether fully agreed or reflecting differences of view.

A parallel exercise, which I think was not discussed at the Prime Minister's seminar in July but would need to be mentioned in the context of further discussion of the monetary base, is work which the Bank are initiating on the abolition of the banking "reserve assets ratio", and the substitution of some more appropriate liquidity norm for prudential purposes. They see this as something which should be done in the early stages of application of the new Banking Act, which certainly seems sensible. We are examining papers they have written on this subject, and on its relationship with

possible forms of monetary base control.

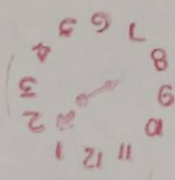
For the present, we are not re-examining arguments about the choice of monetary target, although there may be some implications for this in the paper on monetary base control, and of course the separate work which Mr. Bridgeman is doing on wider monetary aggregates will continue.

We are aiming to have papers to put to the Chancellor and Financial Secretary early in October, on the basis that the Prime Minister might wish to return to this subject fairly soon after the Party Conference is over. On the reserve assets ratio, and we think also on monetary base control, we shall want to build on the papers produced for the seminar documents which can be published to elicit comments from the banking system on the ratio question and the proposed substitute, and to contribute more widely to public debate on the monetary base, but this of course will be a point for consideration when Ministers have seen the papers.



(J.G.LITTLER)

10 September, 1979



10 SEP 1979