PRIME MINISTER

Banking Figures

Attached is the draft Press Statement.

You will want to focus particularly on paragraph 4, and ask the Treasury whether they still really believe that - even taking out reintermediation - we can achieve the 7-11 per cent target for this year. That is what paragraph 4 seems to imply.

There is obviously a dilemma here. If we imply that we are not going to meet the target, the markets will expect either a readjustment of the target or new policy measures (higher interest rates, a fiscal package?).

My hunch is that we are now unlikely to meet the 7-11 per cent target; but at the same time I do not think we are in a position to go for either of the alternatives mentioned above this month. More time is needed to assess the options. Hence, the Treasury will have to do their best to fudge. It may well be that that is precisely what they are trying to do in paragraph 4; but I think it would be wise to tone it down a bit with a phrase such as - "It will be another month also before it is possible to assess how the underlying growth of the money supply is developing in relation to the 7-11 per cent target".

I do not know whether you discussed with the Chancellor the decision to extend index-linked certificates (see paragraph 8 of the draft). You might like to ask whether there is scope for raising more than £1½ billion this year, and what are the arguments against introducing the new certificate more quickly.

You might also ask the Chancellor how he intends to handle the media. These latest figures certainly pose not just an economic problem but a political one too. You said in your Censure Debate speech - "We adhere firmly to our monetary strategy". The impression is getting around that not only are we not adhering to the strategy, but we do not even know ~~whether~~ where we are.

/You have

You have seen the Treasury's "plan of action" (Flag A). You may want to go over some of the points in this.

The Governor and the Deputy Governor and Mr. Goodhart are all away. Mr. Fforde and Mr. George will attend for the Bank.

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8 September 1980

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DRAFT STATEMENT

1. The growth of £M3 in banking August is estimated, on the basis of preliminary evidence, at 3 per cent. As in July, there is evidence that the recorded figure has been substantially increased by the reversal of distortions which have arise over the period since the corset was introduced in June 1978.

2. M1 is estimated to have increased by less than ½ per cent in August; over the 6 months from February it has grown at only 8 per cent at an annual rate.

3. The reintermediation of commercial bills amounted to about £1 billion in July and a further £350 million in August. In addition, there have been other forms of reintermediation probably involving local authority debt, as well as euro-sterling and foreign currency deposits. These effects cannot be quantified precisely but it is etimated that the underlying growth rate of £M3 both in July and in August was 1 to 2 per cent.

Put at end

will continue

4. ~~The Government remains determined~~ to pursue its ~~monetary~~ policies as set out in the Budget ~~Speech and the medium term financial strategy~~. The target is for growth in £M3 of ~~7 to 11 per cent annual rate from~~ February 1980 to April 1981. ~~The underlying growth in recent months has exceeded this rate.~~

There are grounds for believing that monetary growth will fall back in the months ahead.

The profile of public sector borrowing in the early months of the financial year and the difficulty of cutting back the growth of bank lending in the early stages of a recession, have contributed to this. But public sector borrowing is likely to be much reduced in the second half of the financial year. Bank lending is expected to moderate considerably as inflation abates; companies' borrowing needs will be reduced as costs are cut and stocks run down. Monetary growth in the months ahead is therefore expected to fall back.

The Path of the PSBR

5. The PSBR in the April-June quarter was £4¾ billion. Central government borrowing in July and August totalled over £2¼ billion. This high borrowing so far is similar to last year's pattern. Last year the PSBR was high in the first three quarters of the financial year and large repayments were made in the final quarter. Some important factors affect the profile of borrowing this year. Petroleum revenue tax is payable in September and March~~;~~ ~~receipts of~~ over £1 billion were received on 1 September ~~and will reduce the Government's need to borrow this month~~. Defence expenditure has been unusually high so far and is now being reined back. Receipts from special sales of assets are expected in the latter half of the financial year. Refunds arising from the 30 May agreement on the UK contribution to the European Community's budget will also occur towards the end of the financial year.

6. The effect of these factors is for the PSBR again to be concentrated in the early part of the financial year. Borrowing will be less in the second half of the year, especially in the final quarter. The next assessment of the PSBR for the year will be published later in the autumn, in the twice-yearly Industry Act forecast.

National Savings

7. In the past few years the Government has relied heavily

on the gilt-edged market to meet is funding needs. It is intended to shift this emphasis more directly towards personal savings so that National Savings once again make an appropriate contribution.

8. ~~The Government intends~~ it going ~~to make~~ index-linked certificates ~~more generally~~ available. ~~but this will be a gradual process.~~ It has been announced, ~~as a first step~~, that a new index-linked certificate will be issued; it will be available to everyone aged 60 and over, subject to a limit on individual holdings of £3,000. It is expected that sales of this new certificate will raise an additional £1½ billion through National Savings during the remainder of this financial year.

9. ~~It~~ The Government also intends, as soon as possible, to raise the limit on monthly payments under the National Savings SAYE scheme (3rd issue) from £20 to £50 as soon as possible to bring it into line with the limit on the new SAYE share option scheme to be launched in October.

8.9.80

PM would add para on MBC - that the discussion will be brought to a conclusion within 6 weeks.