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MRS THATCHER

I attach an interesting note in the latest Phillips & Drew Market Review for April which defines and offers statistics for a new and, in my view, better measure of money supply and liquidity than the old M3. The problem about any reasonably narrowly defined definition is that holders of cash and near-cash constantly adjust their holdings as interest rates change. For example, they may switch from bank deposits which are included in M3 to building society deposits which are excluded, or vice versa. If this happens the money supply statistics would record an increase (or reduction) in M3 which solely reflects the process of switching and involves in reality no change in the amount of liquidity available.

The interesting table included in this small article reveals two interesting points:

(i) The growth of money supply on the wider definition perhaps was rather less in the period up to 1974 than the crude M3 figures suggested. We knew this anyway, since the arbitrage opportunities involving Certificates of Deposit raised the rate of growth for a period because of "round-tripping". None-the-less, it is interesting to see that the gap between the two measures rose to as much as 10 per cent per annum for a short period in 1973 and lasted well on into 1974.

(ii) On the wider measure it rather looks as if monetary policy has been slackening since the last quarter of 1974 involving a rate of increase of liquidity of well over 10 per cent. This is not entirely surprising since it was at that time that Government borrowing and spending began to get seriously out of hand.

AR

Adam Ridley

Copy to: Sir Geoffrey Howe
John Nott
Economic Section