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Copies to the Deputy Govt
Mr Ffode
Mr Dow
Mr George
Mr Goodhart

NOTE OF A MEETING HELD IN THE CHANCELLOR OF THE EXCHEQUER'S ROOM, HOUSE OF COMMONS AT 6.00 P.M. ON WEDNESDAY, 2 JULY 1980

Mr Coleby
Mr Walker

JRB
4/7

Present:

Chancellor of the Exchequer (in the chair)
Governor of the Bank of England
Mr. Ryrie
Mr. J.S. Ffode (Bank of England)
Mr. Middleton
Mr. Bridgeman

MONETARY AFFAIRS

The meeting was held to consider further the possibility of a change in MLR on Thursday, 3 July.

2. The Governor noted that the June increase in sterling M3 was now likely to be about 0.7 per cent, rather than the 0.3 to 0.5 per cent expected earlier in the week. Bank lending had been higher than previously thought, but the bill leak was smaller. However, the long tap had now been exhausted, and prices had approached close to the point at which sales of the short tap might have been possible. £900 million of receipts had been secured for banking July, and £600 million for banking August.

3. The Governor did not feel that the June money figures could in themselves provide a convincing explanation of a reduction in MLR. The calendar June CGBR figures due on 9 July would be unhelpful, while the short-term forecasts of monetary growth in July and August gave no particular support to an immediate fall in MLR. If the Government were in a position to give a convincing assurance about public sector borrowing over the year

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as a whole, then a reduction in MLR on 10 July would appear reasonable in the light of the interpretation put upon the June CGBR figure; but it seemed unlikely that the Government would be in a position to give such an assurance. Given the lack of support from the statistics, the Governor concluded that if there were to be an early reduction in MLR this would need to be justified by reference to the state of the real economy; the signs of the recession had become very much clearer in recent weeks, and although a risk would remain in any reduction in interest rates it now seemed likely that as the recession made itself felt the growth in bank lending to industry would decelerate.

4. Meanwhile the growth of sterling M3 was outside the target range as defined from the February base, and considerably outside the range if allowance were made for the bill leak. With the abolition of the corset, the figures in the months immediately ahead were likely to be inflated by "reintermediation". Great care would be needed in these circumstances in presenting any change in MLR, so as to make clear that there had not been a shift in the Government's underlying stance, and that the reduction was judged to be fully consistent with achievement of the monetary target.

5. If a move were to be made, possible dates were 3 July, 10 July (i.e. after the eligible liabilities figures and the June CGBR figure) and 17 July (i.e. on the day of publication of the full June money and banking figures). A change on 3 July would probably surprise the markets; but if a move were not made this week the market reaction to next week's figures might well preclude a move at that stage, and there was no particular reason thereafter to expect propitious circumstances on any particular day. Meanwhile there were signs that at least one of the clearing banks was contemplating a reduction in its base rate - possibly by as much as 2 per cent - as a helpful gesture towards industry and as a response to public criticism of banks' windfall profits. If the



authorities were obliged in effect to counter such a move, it would be the more difficult to administer a small reduction in MLR.

6. In further discussion it was suggested that the longer the authorities waited, the more they would appear to be responding to industrial and political pressure; and the longer the delay, the more significant the change would appear. In practice a change should be presented as the adaptation of a policy instrument in the light of the developing situation, and as in no way implying any qualification of the Government's commitment to their monetary target. It was noted that there were some helpful features in the present situation; the June money figures were markedly better than the previous month's, the pace in supply expenditure in June seemed to have slowed down following the high rate of expenditure experienced during the two previous months, monetary growth was well within the target range if looked at over the last six months, and the recession was now much more clearly marked.

7. Most of the officials present thought the balance of advantage lay in favour of a 1 per cent reduction in MLR on 3 July; if this were not done, there might not be another opportunity for a considerable period of time. The Chancellor and the Governor arranged to discuss this question further with the Prime Minister at 9 a.m. on Thursday, 3 July.

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A.J. WIGGINS
3 July 1980

Distribution:

Financial Secretary
Sir Douglas Wass
Mr. Ryrie
Mr. Middleton
Mr. Bridgeman
Mr. Ridley
PS/ Governor of the Bank of England