CCP/6·1

13.11.79

NOTE OF A MEETING HELD IN THE CHANCELLOR OF THE EXCHEQUER'S ROOM AT THE TREASURY AT 4.30 P.M. ON MONDAY, 12TH NOVEMBER

Present:

Chancellor of the Exchequer	Deputy Governor of the Bank of England
Chief Secretary	Mr. Fforde
Financial Secretary	Chief Cashier
Sir Douglas Wass	Mr. Goodhart
Sir Kenneth Couzens	
Mr. Littler	
Mr. Bridgeman	
Mr. Middleton	
Mr. Unwin	
Mr. Ridley	

MONETARY SITUATION

The meeting considered the content and timing of the proposed announcement of a monetary package. The following records the main conclusions and points made in discussion.

Fiscal Measures

2. RSG. The Chancellor reported that Treasury Ministers had decided against re-opening the RSG decision, having examined the political and practical difficulties involved. The settlement should be presented as a firm and realistic one. The cash limit would not be increased.

3. Energy Measures. The Chancellor reported his discussion earlier in the day with the Secretary of State for Energy. None of the three proposals for reducing the PSBR was free from difficulty.

(a) BNOC Forward Sales of Oil. Additional forward sales would squeeze the liquidity of the oil companies, including BP; and invite further international complaint, especially from the US Administration.

cc 13/11

(b) Sale of Wych Farm. This seemed as elusive as ever. The Law Officers had advised that legislation would be needed. BP were unenthusiastic.

(c) Advancing of Payment of PRT. A one month advancement would yield £700 million in 1979/80. There were doubts both about the legal implications for the sale of BP shares and about the uncertain effects on confidence of tackling an excessive PSBR by adjusting the flow of Government revenue. On the first point the Financial Secretary and the Deputy Governor were inclined to discount the problem of the BP sale. The Law Officers' advice was being sought. As to the second, it was difficult to judge market reactions to a purely cash flow adjustment; but accelerating PRT could be represented as a legitimate response to a deterioration in PSBR due to delayed receipts of VAT and £400 million of Post Office telephone accounts. To ignore a prospective £1 billion PSBR overshoot would invite criticism of the Government for benign neglect. The market could be expected to show relief at the prospect of the oil companies taking a share of the additional funding requirement that would otherwise be needed. Against this, Mr. Fforde suggested that the funding benefit might be offset, perhaps significantly, by reduced holdings by the oil companies of certificates of tax deposit during the period from March to May.

(d) VAT Penalties. Customs and Excise had been asked to give urgent advice on the possibility of legislating for an interest charge on delayed payments of VAT as a means of deterring companies from retaining VAT balances in times of tight liquidity and high interest rates. If feasible, this could form useful support for a fiscal package, indicating the Government's resolve to check growth in PSBR.

(e) PAYE Receipts. Similarly, the Inland Revenue should be asked to consider whether more could be done to encourage prompter payment of PAYE receipts and national insurance contributions by employers.

(f) Stock Relief. The Financial Secretary mentioned the distorting effect on credit of artifically high end-year stocking by companies intended to maximise the tax advantages of the stock relief scheme. It was noted that this was a problem for longer-term consideration.

Monetary Measures

(g) SSD Scheme. After some discussion, the Chancellor decided to announce a continuation of the present 1 per cent guideline to June 1980. On the basis of the NIF, the Bank judged that this would maintain at least the same level of tightness in bank credit as recently. Despite the perceived re-entry problem of coping with ~~offshore~~ credit when controls were finally removed, it was not thought desirable to raise the guideline to 1½ per cent as a move to encourage re-intermediation before the SSD scheme can to an end. This would seem like a loosening of the Government's monetary control and there were presentational advantages in not disturbing the present guideline during the remaining months of the scheme. In any event, the problem of re-accommodating offshore credit could diminish if the level of bank lending came down in the next six months. The Chancellor's announcement should not include a terminal date for the SSD scheme, but should make clear the Government's intention not to continue indefinitely with physical controls on bank lending. A further announcement could follow in the Budget statement.

(h) Roll Forward of Monetary Targets. Of the three options in paragraph 9 of Mr. Bridgeman's note of 7th November, the first was open to the objection that it failed to remove base drift from the roll-forward. It would cast doubt on the Government's determination to keep the money supply under control. The second and third options implied much the same rate of monetary growth in the coming 12 months. The third had a spurious appearance of tightness because it retained base drift but reduced the target range. On balance, the second option appeared preferable: namely 7 to 11 per cent to apply for the 16 months from mid-June 1979. This combined recognition of the slippage of monetary growth in the past 4 months with acceptance of the need to regain lost ground and achieve the announced target over the following 12 months. A 7 to 11 per cent range could represent a very considerable deceleration of the underlying rate of M3 growth if some of the Bill leak was assumed to come back into the money supply figures. Careful presentation would be required. Even a reduction in the underlying figures from 14 per cent to 7 per cent could be thought to imply continuing high interest rates for some time to come. At the technical level, the progressive widening of the target band over a 16 month period made it desirable to focus more sharply on the middle of the range once money supply came back into control.

No.

(i) Monetary Base Control (MBC). Mr. Fforde said there were important prior questions for Ministers before decisions on a MBC could be made. The Chancellor said both he and the Prime Minister were anxious to see consideration of this issue brought to a speedy conclusion. His statement would need to include a firm undertaking by the Government to proceed quickly to consultations on an alternative basis of monetary control, though without showing predisposition towards a particular solution.

(j) Interest on Unpaid Tax. Mr. Bridgeman reported that this would have to be raised in the light of the MLR increase.

(k) Certificates of Tax Deposit. The interest on these, although increased only a week earlier, would also need to be raised again.

(l) National Savings Certificates. The possibility of a new issue would need to be settled in the next week or two. A £600 million issue could represent 1 per cent off the money supply over 6 months; but the effects on building societies would need careful assessment. The Financial Secretary asked if an increase in the geriatric bond limit could be considered also.

(m) Gilt Sales. The Chancellor referred to the importance of restoring gilt sales in the wake of the announcement. The Deputy Governor said the Bank would be better able to judge likely market response when they saw the completed package. It was crucial to persuade the institutions that interest rates had peaked. The Chief Cashier suggested that, market conditions permitting, the

Bank should announce a £1 billion new long dated stock maturing in 2003 for offer by tender in the usual way. The choice between an announcement on Thursday afternoon (up to 5.30 p.m.) or on Friday p m ~~morning~~ should be left for decision in the light of market reactions to the Chancellor's statement.

(n) Bank Lending. The Deputy Governor said the Bank would continue to give thought to ways of influencing the clearers. He did not think there was any particular action the Government could take to help the situation.

PSBR

4. Discussion showed no disposition to advance publication of the Industry Act forecast from 20th November to coincide with the statement. But Mr. Bridgeman thought the Chancellor should refer to the slippage in the 1979/80 PSBR, to avoid the risk to gilt sales if the information appeared a week later. The Chancellor said he was inclined to accept this advise provided he was able to include convincing references to corrective fiscal measures.

Timing of Announcement

5. It was provisionally agreed that:

(a) the Bank should announce an increase in MLR at 12.30 p.m. in the usual way;

(b) together with the continuation of a 1 per cent guideline for the SSD scheme;

(c) the Chancellor's statement at 3.30 p.m. would include

(i) the roll-forward of the monetary targets;

(ii) the forecast overshoot of the 1979/80 PSBR;

(iii) relevant fiscal measures;

(iv) reference to consultations on MBR;

(v) any other relevant information on bank lending etc.

(d) the tone of the statement, and its subsequent presentation to the media, would need to judged carefully to avoid appearance of crisis, whilst giving due recognition to the boldness of the measures and the Government's resolution to take necessary action to contain monetary growth.

Sterling

6. A number of references were made to the foreign exchange markets. The Chancellor recalled the agreed strategy to use intervention to support the stock shift abroad following removal of exchange controls, thereby helping the monetary aggregates. Sir Kenneth Couzens said that about £½ billion of net intervention had taken place since 23rd October; but this had naturally tailed off with the recent renewed strength of the pound. Private outflows in the same period had been about £1 billion. After a short discussion, the Chancellor confirmed that intervention policy should continue to aim to hold the pound broadly and at its present level.

Next Steps

7. A further meeting would be called on Wednesday, 14th November to consider the draft of the Chancellor's statement.

AB

(A.M.W. BATTISHILL)
13th November, 1979