SECRET until 12.30pm on 3.7.80.
then CONFIDENTIAL

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MR J PAGE

cc Chancellor
Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Sir D Wass
Sir K Couzens
Mr Burns
Mr Ryrie
Mr Barratt
Mr Middleton
Mr Bridgeman
Mr Britton
Mr Unwin
Mr Lavelle
Mrs Lomax
Mrs Gilmore
Mr Riley
Mr P G Davies
Mr Bottrill
Mr Shields
Mr Ridley
Mr Cropper
Mr Cardona

Mr Ingham, No. 10

Mr Prescott, PMG's Office

MLR

The Bank are announcing at 12.30pm today (Thursday) a reduction of MLR of 1% (to 16%). I attach a copy of their press release; the crucial point is to present the change as entirely consistent with the Government's monetary policy. It simply represents a slight adjustment in one of the instruments of monetary control in response to changing economic circumstances. More detailed briefing follows.

Positive

1. The change is warranted by the current and prospective trend of monetary developments. Thus:

(i) There are signs that monetary growth moderated during banking June. (The Bank will not give a precise figure at this stage, but if asked you can indicate that we/ are confident that £M3 growth in the 6 months to mid June was, at an annual rate, within the 7-11% target range
[You can agree that this implies that the figure was under 1% but do/ not leave the impression that it was ½% or under.])

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(ii) With increasing evidence of a downturn in the economy, there are signs that the underlying demand for credit may be beginning to ease. Although the timing of the CGBR has been such that it has been high in the first months of this year, this has been financed by large gilt sales; the long tap was exhausted yesterday and a flow of part payments extending to banking September has been secured. (In detail: part payments totalling over £0.8 billion are due on 13½% Exchequer 1994 and 13% Treasury 2000 in banking August, with a further £0.2 billion on 13% Treasury 2000 in banking September; part payments will also be due in August on 12¼% Exchequer 1985A, but their amount will depend on future sales of this tap.)

(iii) In view of these factors, a slight adjustment in MLR is appropriate for the achievement of the monetary target.

2. Thus the change is entirely consistent with the emphasis Ministers have put on meeting the 7-11% target. They have made clear that interest rates would fall as soon as monetary developments warranted it.

3. The change is <u>not</u> a response to pressure from the CBI or some Cabinet members; <u>nor</u> is it an attempt to secure a lower exchange rate.

4. Caution requires that the change should only be modest. Further falls will follow, but their timing will depend on future monetary developments and prospects.

<u>Defensive</u>

1. <u>Risks for Monetary Control</u>. MLR would not be reduced if we thought this was inconsistent with meeting the target. But clearly we will monitor the position. With the onset of the recession, and the associated easier demand for credit, not to have lowered MLR would have implied we risked undershooting the target.

2. Impact on the Exchange Rate. Interest rates are only one influence on exchange rate; given there is no change in underlying stance of policy we would expect only a modest effect. But the foreign exchange market is notoriously unpredictable.

3. Effect on Industry. The benefit to industry's cash flow will be slight. But it is a step in the right direction. Ministers are well aware of the impact of high interest rates on companies, and they have put considerable emphasis on the need to cut public spending and borrowing to make it possible to meet the money supply target with lower interest rates. Today's cut is a start.

4. Implications for Building Societies. The reduction will ease - but only partially - building societies present uncompetitive position. The implications for the mortgage rate is a matter for the societies, but this change - of itself - is unlikely to mean a reduction in the mortgage rate. However it will reduce the chances of the societies deciding that an increase in rates was required.

5. Impact on Inflation. In the long run, the rate of inflation will be determined by the rate of monetary growth. The short run impact will depend on how the exchange rate reacts.

6. Timing. Given we now have an indication of banking June figures, there seemed no reason to delay a change. [The timing was not linked to today's Cabinet meeting.]

7. CGBR. The CGBR was high in April/May, but it usually is in the first quarter of the year. Tax receipts were particularly affected by the absence of PRT receipts following the decision taken in November to speed up payment. Voted expenditure was over 30% higher than a year earlier in April/May. But movements in the CGBR are always erratic, and we have no reason to think that cash limits for the year will not hold and supply expenditure will not come in line with the forecast. (You can hint that supply issues in June were somewhat lower - the figures will be published on 9 June - hence the word"rather" in the notes to editors.)

3 July 1980 M L Williams M L WILLIAMS

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NOTES TO EDITORS

There are signs that monetary growth moderated during banking June, and also that the underlying demand for credit from the private sector may be beginning to ease, with increasing evidence of downturn in the economy. While the CGBR has so far been rather high in comparison to the forecast for the year as a whole, this has been financed by large debt sales: recent gilt sales have secured substantial funding for the next few months. In the judgement of the authorities this lower MLR is now appropriate by the achievement of the present monetary target of a 7-11 per cent annual rate of increase of £M3 in the fourteen months to mid-April 1981.