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FROM: P N SEDGWICK
DATE: 13 JULY 1984

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Mr Odling-Smee
Mr Folger
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Mrs Lomax
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Mr Wood
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Mr Milne
Mr Ridley

Sir J Boreham - CSO

Deputy Governor)
Mr George)
Mr Coleby) Bank
Mr Goodhart) of
Mr Plenderleith) England
Mr W A Allen)
Mr Foot)

Professor A Walters No. 10

INTERPRETATION OF MONETARY CONDITIONS : JULY

... I attach the note for this month which reflects the discussion at your meeting this morning.

P.N.S

P N SEDGWICK

INTERPRETATION OF MONETARY CONDITIONS

(1) Introduction and Summary

Turbulance in financial markets has pushed up UK short-term interest rates by 3 per cent since April. Pressures from the level of US interest rates combined with concerns about the miners' and dockers' strikes and the trend in oil prices have led to a fall in the exchange rate. The movement in interest rates and the exchange rate may also reflect concern about domestic monetary conditions.

2. There is conflicting evidence on monetary conditions in the recent past. PSL2 growth has been very high for several months and £M3 growth has now increased. On the other hand growth in weekly averaged MO has risen, but continues to be well within the announced target range.

3. Some other indicators suggest a firm trend in monetary conditions. Real interest rates, which were already high, have risen to exceptionally high levels, real equity prices have fallen back to their level at the beginning of the year, and there has been a further fall in house price inflation.

(2) THE BEHAVIOUR OF THE MONETARY AGGREGATES

4. Table 1 and Charts Ito V summarise the most recent information on the nominal monetary and financial aggregates as well as data for previous financial years. Charts I and II show the growth of narrow and broad money, Chart III shows the growth in weekly averaged MO and Chart IV and V show private sector £M3 and PSL2.

5. There has been a rise in the six and twelve month growth rates of weekly averaged MO and the end banking month series for notes and coin. Holdings of bankers' operational balances returned to a more normal level after falls in the previous two months. The trend growth in these aggregates

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TABLE 1: PERCENTAGE GROWTH RATES IN THE NOMINAL AND FINANCIAL AGGREGATES ϕ

	Composite monetary indicator	Weekly averaged M0	Non-interest bearing M1	M1	M2ϕϕ	£M3++	M3	PSL2
(a) Financial years (12 month changes to banking April)								
1981-82	5.2	2.0	-0.3	4.2		12.2	15.5	10.9
1982-83	10.9	6.1	11.1	14.8	8.9	10.9	12.7	11.4
1983-84	8.7	4.9	9.3	13.7	10.4	8.0	10.7	11.2
(b) Changes in 4 quarters to+								
1982 (2)	5.6	2.8	0.7	6.0		12.0	13.3	10.3
(3)	5.7	2.3	3.2	7.3		9.7	10.3	8.4
(4)	8.2	3.9	8.3	11.3	7.2	9.3	11.7	8.5
1983 (1)	10.1	5.3	10.4	12.9	8.4	9.8	13.2	10.2
(2)	11.0	6.4	10.0	15.5	9.2	11.1	12.7	11.9
(3)	10.2	6.5	8.9	12.5	8.5	10.4	12.1	12.4
(4)	10.2	6.7	8.8	12.4	9.3	10.9	12.7	12.8
1984 (1)	8.6	5.7	7.9	13.4	10.2	9.9	11.9	12.3
(2)	9.2	5.5	9.4	13.7	11.1	9.3	10.2	13.2
(c) Changes in 12 months to								
1983 July	11.2	6.3	10.0	14.4	9.0	11.6	12.4	12.9
August	10.7	6.6	9.4	13.1	8.7	11.0	12.0	12.9
September	10.2	6.5	8.9	12.5	8.5	10.4	12.1	12.4
October	9.9	6.7	8.7	13.1	8.2	10.9	11.4	12.0
November	9.9	6.4	7.5	11.6	7.7	9.9	11.3	12.1
December	10.2	6.7	8.8	12.4	9.3	10.9	12.7	12.8
1984 January	9.6	6.0	8.2	10.7	10.5	10.2	12.3	12.4
February	9.0	6.3	7.8	11.1	10.2	9.5	11.7	11.8
March	8.6	5.7	7.9	13.4	10.2	9.9	11.9	12.3
April	8.7	4.9	9.3	13.7	10.4	8.0	10.7	11.2
May	8.7	5.2	9.2	13.7	10.4	8.2	9.3	11.8
June	9.2	5.5	9.4	13.7	11.1	9.3	10.2	13.2
(d) Changes (at an annual rate) in 6 months to								
1983 July	12.5	5.5	9.2	11.0	10.5	12.8	13.2	15.2
August	11.4	6.2	8.5	12.8	9.0	12.3	11.3	14.4
September	9.2	6.3	7.0	10.6	7.0	10.7	9.2	12.6
October	8.1	5.7	7.9	11.1	6.2	8.3	8.8	10.0
November	8.4	6.4	7.8	9.4	5.5	7.1	9.0	9.4
December	6.9	6.0	9.4	7.8	7.1	7.3	11.3	9.3
1984 January	6.7	6.6	7.2	10.5	10.5	7.6	11.5	9.7
February	6.5	6.3	7.1	9.5	11.4	6.8	12.1	9.2
March	8.0	5.1	8.7	16.4	13.4	9.1	14.7	12.0
April	9.2	4.1	10.7	16.3	14.7	7.7	12.8	12.4
May	9.0	4.0	10.6	18.2	15.4	9.3	9.8	14.3
June	11.6	5.0	9.4	19.9	15.1	11.3	9.0	17.3

ϕ The growth rates are adjusted for the changeover to the new monetary sector. The October 1982 figures are greatly distorted by the over-subscription of the STC share issue. The figures shown here are the Bank of England/Treasury best estimates of what would have happened in the absence of the distortion.

\+ The quarterly figures are for the final banking month of the quarter.

ϕϕ M2 is partially seasonally adjusted by using a seasonally adjusted series for the NIBM1 component and adjusting retail time deposits for the seasonal effects of interest crediting. When proper seasonal adjustment of M2 is eventually possible its within year movements may differ from those shown.

++ Excluding public sector deposits.

currently appears to be in the range of 5-5½ per cent. Higher short terms interest rates may cuase the growth rates to decline.

6. The six month growth rates of <u>non interest bearing</u> sight deposits and nib M1 have slowed towards the twelve month growth rates. The twelve month growth rates have contained at the higher rates of recent months. The main developments in interest being retail deposits are shown in the table below.

<u>TWELVE MONTH GROWTH OF SELECTED COMPONENTS OF M2</u>

		Interest bearing chequable deposits	Other retail bank deposits	Retail building society deposits
1984	Jan	21.3	1.4	16.5
	Feb	21.6	-0.2	16.8
	March	35.0	-3.6	17.9
	April	41.7	-6.0	18.5
	May	41.5	-7.4	19.3
	June	50.8	-7.5	20.5

7. Total interest bearing sight deposits with banks, including overnight interbank deposits, continued to expand very rapidly (at around 28 per cent over the previous twelve months) and the six month growth of M1 has risen further. The faster growth of non interest bearing deposits with banks together with some reversal in the negative growth in interest bearing retail deposits and the continued very rapid expansion of wholesale deposits has reversed the slower growth rates in £M3 recorded up to the end of the last financial year.

8. The acceleration in retail deposits with building societies (these deposits continued to account for about 90 per cent of total building society inflows) and the recovery of retail deposits with banks raised the twelve month growth of M2 (including reclassifications) to over 11 per cent. Excluding reclassifications of deposits with building societies the twelve months growth rate of M2 has been steadier at 8.5 per cent.

9. Non monetary sector and currency components of PSL2 accelerated further in June (Table 1A). There were larger inflows into other money market instruments and CTDs. The twelve month growth of building society liabilities

TABLE 1A: GROWTH OF COMPONENTS OF PSL2 (%)

	Notes and coin (i)	Non-interest bearing sight deposits with banks (ii)	Interest bearing deposits with the monetary sector: Retail (iii)	Interest bearing deposits with the monetary sector: Wholesale (iv)	All other components of PSL2 (v)	Total £M3 (vi)= (i)+(ii) +(iii)+(iv)	Total PSL2 (vii)= (v)+(vi)
(a) Financial years (12 month changes to banking April)							
1981-82	1.6	-1.6	-	-	8.2	12.2	10.9
1982-83	7.5	13.5	5.5	15.8	12.1	10.9	11.4
1983-84	6.1	11.2	-1.9	15.4	15.8	8.0	11.2
(b) Changes in 4 quarters to							
1982 (2)	3.1	-0.8	-	-	7.5	12.0	10.3
(3)	3.6	2.9	-	-	6.5	9.7	8.4
(4)	5.0	10.5	3.4	16.0	7.5	9.3	8.5
1983 (1)	6.1	13.2	4.8	14.2	10.6	9.8	10.2
(2)	7.4	11.6	6.5	16.5	12.9	11.1	11.9
(3)	6.9	10.2	6.0	15.5	15.3	10.4	12.4
(4)	7.1	9.9	7.3	18.6	15.4	10.4	12.8
1984 (1)	5.0	9.7	-0.3	20.7	15.7	9.9	12.8
(2)	5.3	11.9	-2.3	19.1	18.9	9.3	13.2
(c) Changes in 12 months to							
1983 July	7.0	11.9	6.1	18.3	14.8	11.6	12.9
Aug	7.1	10.8	6.4	16.8	15.7	11.0	12.9
Sept	6.9	10.2	6.0	15.5	15.3	10.4	12.4
Oct	7.3	9.6	5.7	17.5	15.1	10.9	12.0
Nov	7.3	7.6	6.4	15.1	15.4	9.9	12.1
Dec	7.1	9.9	4.3	18.6	15.4	10.9	12.8
1984 Jan	5.9	9.5	3.1	18.2	15.8	10.2	12.4
Feb	5.3	9.4	1.7	17.9	15.1	9.5	11.8
Mar	5.0	9.7	-0.3	20.7	15.7	9.8	12.3
Apr	6.1	11.2	-1.9	15.4	15.8	8.0	11.2
May	4.7	12.0	-3.1	17.2	16.9	8.2	11.8
June	5.3	11.9	-2.3	19.1	18.9	9.3	13.2
(d) Changes (at an annual rate) in 6 months to							
1983 July	7.1	10.5	13.5	15.4	19.6	12.8	15.2
Aug	6.2	9.9	11.8	16.2	18.1	12.3	14.4
Sept	6.1	7.6	7.0	17.2	15.6	10.7	12.6
Oct	5.8	9.1	3.3	13.0	11.8	8.3	10.0
Nov	5.0	9.5	1.1	11.7	11.1	7.1	9.4
Dec	5.7	11.7	-6.6	18.0	10.6	7.3	9.3
1984 Jan	4.9	8.6	-6.5	20.8	12.2	7.6	9.7
Feb	4.3	8.8	-7.6	14.4	12.3	6.8	9.2
Mar	3.8	11.7	-7.2	24.1	15.7	9.1	12.0
Apr	6.5	13.2	-6.9	17.8	20.0	7.7	12.4
May	4.4	14.5	-6.8	22.9	22.9	9.3	14.3
June	4.9	12.2	2.1	20.7	27.8	11.3	17.3

The split between retail and wholesale is that used for M2. Deposits of less than £100,000 are counted as retail. This split is only partially seasonally adjusted. The wholesale component contains a small amount of retail deposits with a residual maturity of greater than one month.

CHART I: ANNUAL GROWTH RATES OF NARROW MONEY

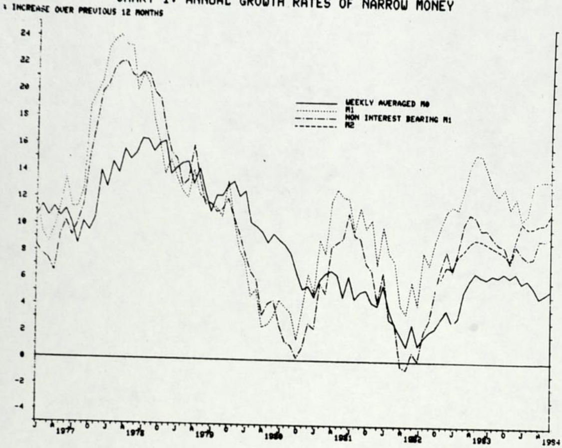


CHART II: ANNUAL GROWTH RATES OF BROAD MONEY

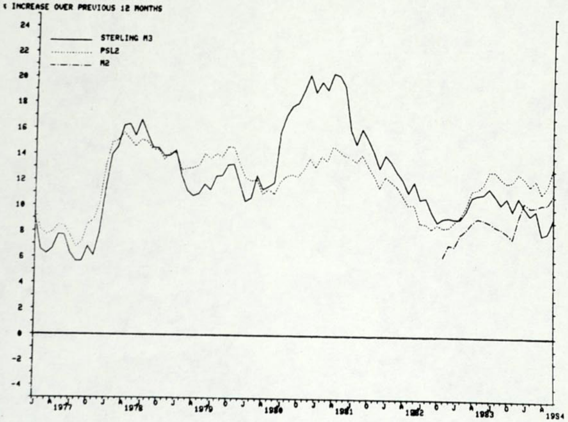


CHART III: GROWTH RATES IN WEEKLY AVERAGED M0

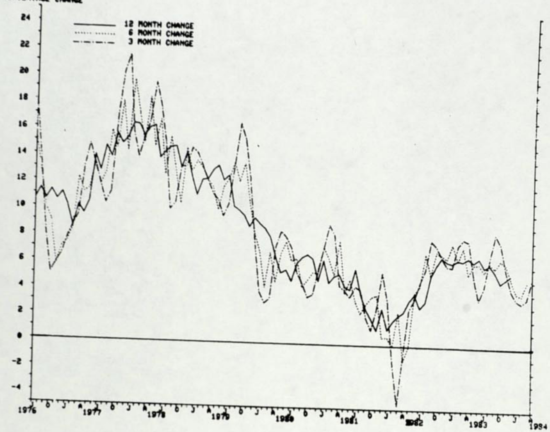
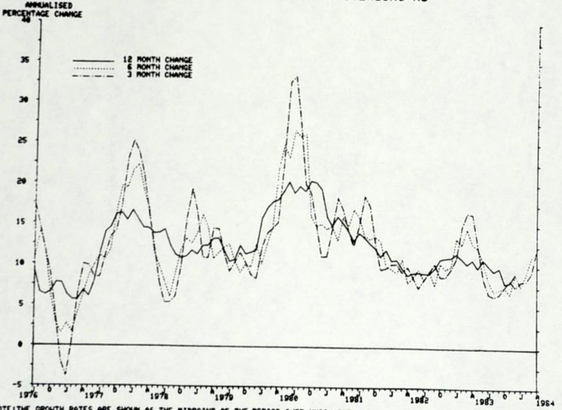


CHART IV: GROWTH RATES IN STERLING M3



NOTE: THE GROWTH RATES ARE SHOWN AS THE MIDPOINT OF THE PERIOD OVER WHICH THEY ARE MEASURED. THUS THE GROWTH FROM SEPT. 1981 TO SEPT. 1982 IS SHOWN AS MARCH 1982 AND THE SIX MONTH ANNUALISED GROWTH RATE FROM MARCH 1982 TO SEPT. 1982 IS SHOWN AS JUNE 1982

CHART V: GROWTH RATES IN PSL2

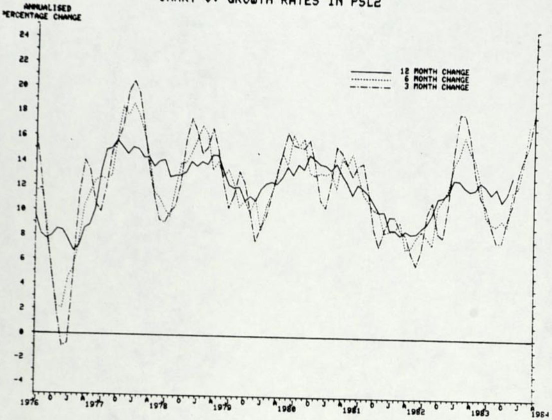
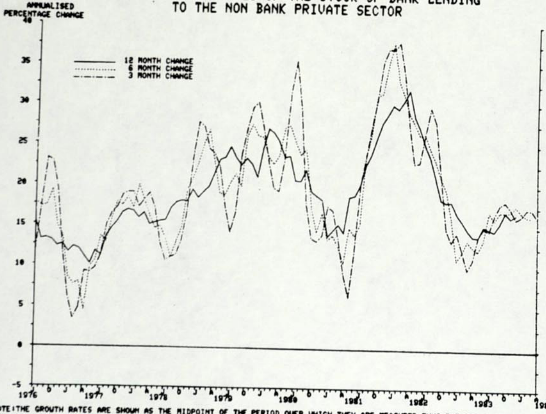


CHART VI: GROWTH RATES OF THE STOCK OF BANK LENDING TO THE NON BANK PRIVATE SECTOR



NOTE: THE GROWTH RATES ARE SHOWN AS THE MIDPOINT OF THE PERIOD OVER WHICH THEY ARE MEASURED. THUS THE GROWTH FROM SEPT. 1981 TO SEPT. 1982 IS SHOWN AS MARCH 1982 AND THE SIX MONTH ANNUALISED GROWTH RATE FROM MARCH 1982 TO SEPT. 1982 IS SHOWN AS JUNE 1982 inside PSL2 rose to 21.4 per cent in June. The six month growth of PSL2, which has risen fairly continuously since the beginning of the year, increased sharply in June and the twelve month growth rate has risen to 13.2 per cent.

10. There may be some concern that the latest figures for £M3 and PSL2 confirm an easier trend in monetary conditions which the M2 and PSL2 aggregates have been indicating for some months. Structural changes in the financial system however continue to make it difficult to interpret the faster growth in PSL2 and the importance of the difference between the twelve and six months growth rates of £M3 and PSL2 which have continued at around 4 per cent.

11. The latest data on the growth of the real money stock are shown in Table 2 and charts VII and VIII. The twelve month growth rates of the real aggregates have all turned upwards reflecting the increase in the growth rates of the nominal aggregates. The growth of the RPI excluding mortgage element has edged up for the fourth successive month. The six month growth rates are unreliable guides to the underlying growth rate of the real monetary aggregates. Charts IX to XII show the levels of the real money stock and the real FT index. There have been further set backs in the equity market reflecting continuing uncertainty in financial markets. The real FT index has fallen back sharply to about the level at the end of 1983.

TABLE 2: CHANGES IN THE REAL MONEY SUPPLY (%)

	Total RPI+	RPI+ less mortgage element	Composite monetary indicator	Weekly averaged M0	Non-interest bearing M1	M2	£M3	PSL2
(a) Financial year (12 month changes to banking April)								
1981-82	9.4	9.1	-3.6	-6.5	-8.7		2.8	1.7
1982-83	4.0	4.8	5.8	1.2	6.0	3.9	5.8	6.3
1983-84	5.2	4.8	3.8	0.2	4.3	5.4	3.1	6.2
(b) Changes on same quarter in previous year								
1982 (2)	9.2	8.8	-3.0	-5.6	-7.5		2.9	1.3
(3)	7.3	7.3	-1.5	-4.7	-3.9		2.3	1.0
(4)	5.4	6.6	1.5	-2.5	1.6	0.6	2.5	1.8
1983 (1)	4.6	6.0	3.9	-0.6	4.1	2.3	3.6	3.9
(2)	3.7	4.5	6.2	1.9	5.3	4.5	6.4	7.1
(3)	5.1	5.2	4.7	1.2	3.5	3.1	4.9	6.8
(4)	5.3	4.8	5.2	1.9	3.8	4.3	5.9	7.6
1984 (1)	5.2	4.7	3.6	0.9	3.0	5.2	4.9	7.2
(2)	5.2	5.0	4.2	0.5	4.2	5.9	4.1	7.8
(c) Changes in 12 months to								
1983 July	4.2	4.7	6.2	1.5	5.0	4.1	6.6	7.8
August	4.6	5.1	5.3	1.4	4.1	3.4	5.6	7.4
September	5.1	5.2	4.7	1.2	3.5	3.1	4.9	6.8
October	5.0	5.0	4.7	1.7	3.6	3.0	5.6	6.7
November	4.8	4.9	4.8	1.5	2.5	2.7	4.8	6.9
December	5.3	4.8	5.2	1.9	3.8	4.3	5.9	7.6
1984 January	5.1	4.6	4.8	1.4	3.5	5.7	5.4	7.5
February	5.1	4.5	4.2	1.7	3.1	5.4	4.8	7.0
March	5.2	4.7	3.6	0.9	3.0	5.2	4.9	7.2
April	5.2	4.8	3.8	0.2	4.3	5.4	3.1	6.2
May	5.1	4.9	3.8	0.3	4.1	5.3	3.2	6.6
June	5.2	5.0	4.2	0.5	4.2	5.9	4.1	7.8
(d) Changes (at annual rate) in 6 months to								
1983 July	4.6	3.7	8.4	1.6	5.2	6.6	8.7	11.0
August	5.6	4.3	6.8	1.8	4.0	4.4	7.7	9.7
September	6.7	5.5	3.5	0.8	1.5	1.5	5.0	6.7
October	7.2	6.9	1.2	-1.1	0.9	-0.6	1.3	2.9
November	7.5	6.6	1.7	-0.2	1.1	-1.0	0.5	2.7
December	7.7	7.4	-0.4	-1.3	1.9	-0.2	-0.1	1.7
1984 January	5.7	4.9	1.7	1.6	2.1	5.4	2.5	4.6
February	4.5	4.4	2.1	1.9	2.6	6.7	2.3	5.6
March	3.7	3.9	4.0	1.3	4.7	9.2	5.1	7.8
April	3.2	2.7	6.4	1.4	7.7	11.7	4.9	9.4
May	2.8	3.5	5.7	0.4	6.9	11.6	5.6	10.4
June	2.8	3.3	8.4	1.7	6.0	11.5	7.8	13.6

\+ The simple method of seasonal adjustment for the RPI and for the RPI less mortgage component for use in calculation of the six monthly growth rates was described in the February 1982 Interpretation of Monetary Conditions.

The nominal money supply deflated using the RPI less mortgage element. This is the all items RPI after deduction of the mortgage interest rate payments component.

CHART VII: GROWTH RATES IN REAL WEEKLY AVERAGED M0

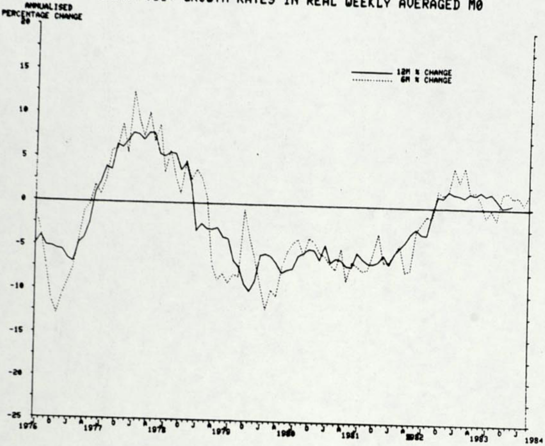
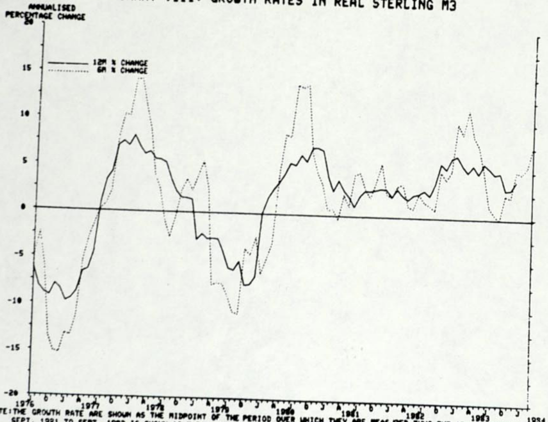


CHART VIII: GROWTH RATES IN REAL STERLING M3



NOTE: THE GROWTH RATE ARE SHOWN AS THE MIDPOINT OF THE PERIOD OVER WHICH THEY ARE MEASURED. THUS THE GROWTH FROM SEPT. 1981 TO SEPT. 1982 IS SHOWN AS MARCH 1982 AND THE SIX MONTH ANNUALISED GROWTH RATE FROM MARCH 1982 TO SEPT. 1982 IS SHOWN AS JUNE 1982

CHART IX: LEVEL OF REAL M0 (END CALENDAR QUARTER)

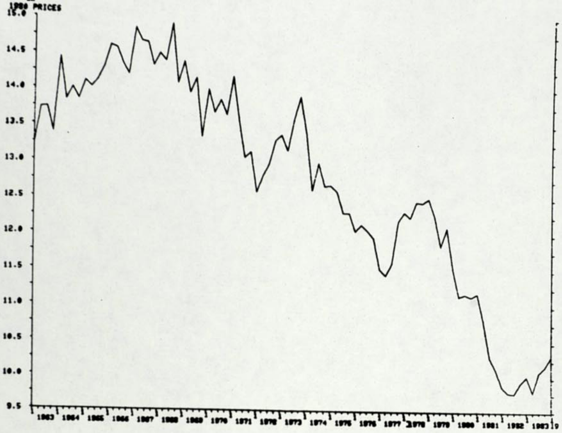
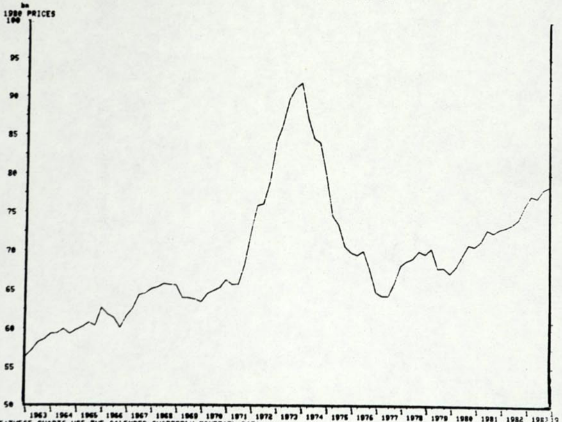
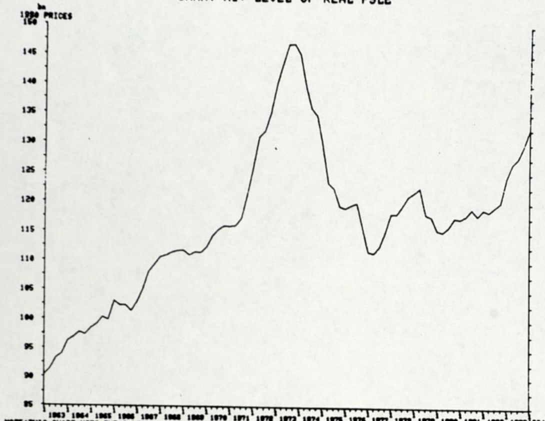


CHART X: LEVEL OF REAL STERLING M3



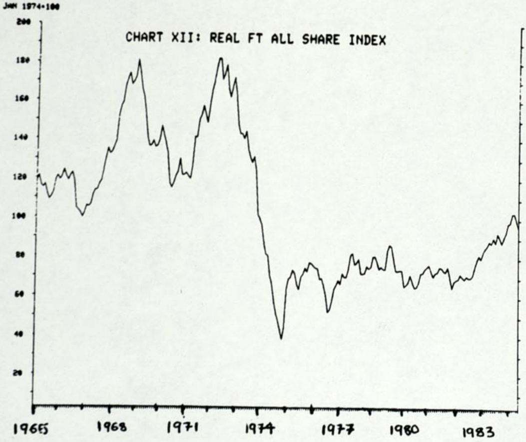
NOTE: THESE CHARTS USE THE CALENDER QUARTERLY MONETARY DATA

CHART XI: LEVEL OF REAL PSL2



NOTE: THIS CHART USES THE CALENDAR QUATERLY MONETARY DATA

CHART XII: REAL FT ALL SHARE INDEX



12. Table 3 and chart VI show the growth rates of total bank lending to the non bank private sector. The new seasonal adjustments have raised the growth rates in recent months. Both six and twelve month growth rates appear to have stabilised at a relatively fast pace in the range of 16-17% per annum. Up to end 1984 Q1 (calendar quarterly) the major contribution to the high growth of bank lending continued to come from lending to the personal sector. The analysis of bank lending to UK residents for the period banking February to banking May and returns from the weekly reporting banks suggest that this continues to be the case in the latest months.

TABLE 3: TOTAL STERLING BANK LENDING TO THE NON BANK PRIVATE SECTOR (1)

	Percentage change in stock of lending over	
Banking months, SA	**12 months**	**6 months (at annual rate)**
1983 July	16.7	12.7
August	15.8	12.2
September	14.8	13.5
October	14.0	17.0
November	13.9	16.0
December	15.2	17.0
1984 January	14.9	17.0
February	14.6	17.1
March	15.7	17.8
April	17.0	17.0
May	16.4	16.5
June	16.7	16.4

(1) Sterling lending by the monetary sector, plus issue department purchase of commercial bills.

(3) OTHER INDICATORS OF MONETARY CONDITIONS

13. Table 4 shows the latest data on the growth of nominal and real GDP. The recently released figures for 1984 Q1 reveal a fall in the growth rate of the GDP deflator below 4 per cent per annum. The twelve month growth of real GDP is put at a little under 3% in the first quarter. The miners' strike is estimated to have reduced the growth of real GDP by about ½ per cent. As a result both the twelve month and six month growth rate of money GDP has fallen to less than 7 per cent.

TABLE 4: GROSS DOMESTIC PRODUCT (at market prices) CSO's average estimate

	Money GDP % change on a year earlier	Money GDP % change over six months (annual rate)	Real GDP % change on a year earler
1982 (1)	10.1	9.6	2.0
(2)	10.5	9.5	3.0
(3)	9.2	8.9	2.0
(4)	8.7	7.8	1.7
1983 (1)	9.9	10.8	3.2
(2)	7.8	7.7	2.6
(3)	8.5	6.2	3.1
(4)	8.6	9.5	3.5
1984 (1)	6.6	6.9	2.7

14. Table 5 shows the most recent data for the growth of retail prices, wholesale prices, average earnings and unit wage costs in manufacturing. RPI inflation has remained flat in June. Producer price input inflation has fallen a little but has continued at a faster pace. Recent weakness in sterling may cause input price inflation to rise further. Underlying average earnings have maintained the slower growth rate experienced for the past year. The growth of unit wage costs in manufacturing remains flat and continues well below the rate of inflation.

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TABLE 5: PRICES AND EARNINGS (% change on same period a year before)

	Retail Prices	Producer Price Index (All manufactured products)		Underlying Average Earnings	Unit Wage Costs in Manufacturing*
		Output Prices (home sales)	Input Prices		
1982 (1)	10.4	8.7	11.8	10.8	4.0
(2)	9.2	7.2	5.7	10.1	5.7
(3)	8.0	7.4	4.8	8.9	5.5
(4)	6.2	6.5	6.3	8.4	5.8
1983 (1)	4.9	5.3	5.6	7.9	4.0
(2)	3.8	5.7	6.6	7.5	3.3
July	4.2	5.5	6.4	7.5	1.5
August	4.6	5.3	8.3	7.8	3.1
September	5.1	5.4	9.6	7.8	3.8
October	5.0	5.5	8.2	7.8	3.7
November	4.8	5.7	7.2	7.8	3.6
December	5.3	5.6	7.2	7.8	2.7
1984 January	5.1	5.7	7.6	7.8	3.3
February	5.1	5.9	7.0	7.8	2.7
March	5.2	6.5	7.0	7.8	3.9
April	5.2	6.6	8.7	7.8	2.7
May	5.1	6.3	8.5	7.5**	
June	5.1	6.2	8.2	7.8**	

* Percentage change of the latest 3 months on the same 3 months a year earlier.

** Department of Employment estimate.

TABLE 6: NOMINAL INTEREST RATES (period averages for calendar months and quarters)

	Three month Interbank	Three month Eurodollar	Base rate	Long Rate (20 Year) gilts	Yield Gap
1982 (1)	14.3	15.1	14.1	14.7	0.4
(2)	13.4	15.1	12.8	13.7	0.3
(3)	11.5	12.6	11.4	12.2	1.3
(4)	9.9	9.9	9.7	10.8	0.9
1983 (1)	11.1	9.2	10.8	11.5	0.4
(2)	10.2	9.4	10.0	10.5	0.3
July	9.8	10.0	9.5	10.9	1.0
August	9.8	10.3	9.5	11.0	1.2
September	9.7	9.9	9.5	10.7	1.0
October	9.4	9.6	9.1	10.6	1.2
November	9.3	9.8	9.0	10.3	1.0
December	9.4	10.2	9.0	10.3	0.9
1984 January	9.4	9.8	9.0	10.3	0.9
February	9.3	10.0	9.0	10.4	1.0
March	9.0	10.4	8.75	10.3	1.3
April	8.9	10.9	8.6	10.4	1.5
May	9.6	11.6	9.0	11.0	1.4
June	9.5	11.8	9.2	11.2	1.7
July 12	12.1	12.0	12.0	11.7	-0.4

15. Table 6 shows recent movements in short and long term sterling interest rates and three month euro dollar interest rate. Since April UK short term interest rates have risen by more than the three month euro-dollar rates and the uncovered differential has fallen from two per cent to -0.1 per cent (Table 8). The recent rise in UK money market and bank base rates have brought UK rates to their highest levels since the second quarter of 1982. After widening in June, the yield gap between 20 year gilts and three month sterling interbank rates has narrowed and become negative with the rise in short rates.

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TABLE 7: REAL INTEREST RATES

	Expected Inflation over 12 months*	Real 3 month Interbank Rate	Yield on 1988 indexed gilt*** Inflation Assumption 5%	Yield on 1988 indexed gilt*** Inflation Assumption 7%	Yield on 1996 indexed gilt*** Inflation Assumption 5%	Yield on 1996 indexed gilt*** Inflation Assumption 7%
1982 (1)	10.3	4.0			3.0	2.9
(2)	9.2	4.1	3.5	3.2	3.4	3.3
(3)	8.0	3.4	3.6	3.3	3.3	3.2
(4)	6.3	4.8	2.7	2.4	2.6	2.5
1983 (1)	6.3	4.8	2.7	2.4	2.6	2.5
(2)	6.2	4.0	3.7	3.4	3.2	3.1
July	6.4	3.4	4.6	4.3	3.8	3.7
August	6.2	3.6	4.2	3.9	3.6	3.5
September	6.2	3.5	3.8	3.5	3.4	3.3
October	6.4	3.0	3.6	3.4	3.4	3.3
November	5.8	3.5	3.9	3.7	3.5	3.4
December	5.8	3.6	3.7	3.4	3.5	3.4
1984 January	5.9	3.5	3.9	3.6	3.5	3.4
February	5.8	3.5	4.0	3.7	3.6	3.5
March	5.7	3.3	4.4	4.1	3.8	3.7
April	5.6	3.3	4.4	4.1	3.6	3.5
May	5.4	4.2	4.8	4.5	3.8	3.7
June	5.7	3.8	5.1	4.8	4.0	3.9
July 12	5.7	6.4	5.8	5.6	4.4	4.4

* Unweighted average of forecasts by Phillips & Drew, National Institute and the London Business School; the expected rate of inflation for a given month is the change in the price level between six months earlier and six months ahead. This is assumed to approximate roughly to average inflation expectations over the 3 months immediately ahead.

** Average of working day for the month or quarter.

*** Last working day for each month with first of month settlement assumed, or, for quarters, the average of the last working days of the three months.

16. Table 7 shows estimates of real short term interest rates and yields on indexed linked gilts. Indexed gilt yields have risen to the highest levels ever recorded.

TABLE 8: EXCHANGE RATES (period averages)

	Effective Rate	$/£ Rate	DM/£ Rate	Uncovered Differential* £/$	Uncovered Differential* £/DM
1982 (1)	91.1	1.85	4.34	-0.8	4.3
(2)	90.3	1.78	4.23	-1.7	4.2
(3)	91.4	1.72	4.28	-1.1	2.8
(4)	89.1	1.65	4.14	0.0	3.0
1983 (1)	80.6	1.53	3.69	1.9	5.4
(2)	84.1	1.55	3.86	0.8	5.0
July	84.7	1.53	3.95	-0.2	4.7
August	85.0	1.50	4.02	-0.5	4.4
September	84.7	1.50	4.00	-0.2.	4.0
October	83.5	1.50	3.90	-0.6	3.6
November	83.6	1.48	3.96	-0.6	3.3
December	82.5	1.44	3.94	-0.8	3.2
1984 January	81.9	1.41	3.95	-0.4	3.5
February	82.2	1.44	3.89	-0.7	3.5
March	80.9	1.46	3.78	-1.4	3.3
April	79.8	1.42	3.78	-2.0	3.2
May	80.0	1.39	3.82	-2.0	3.7
June	79.4	1.38	3.77	-2.3	3.8
July 12	77.7	1.31	3.73	0.1	6.3

* Between 3 month UK interbank rate and 3 month Eurodollar rate and Euro DM rate.

17. The continuing appreciation of the dollar has brought the £/$ rate to a record low (Table 8). The effective exchange rate had been fairly stable since March with movements against other currencies compensating for the fall in the £/$ rate. This pattern has changed since June and sterling has weakened against all major currencies despite increasing interest rate differentials between UK interest rates and those in the US, Germany and Japan.

CHART XIII

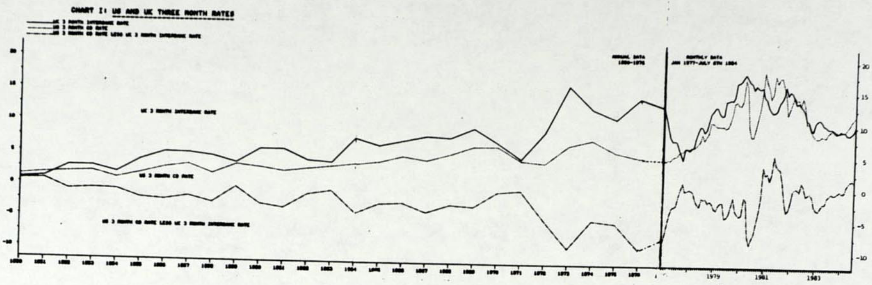


CHART I: US AND UK THREE MONTH RATES
20
15
10
5
0
-5
-10
1979
1981
1983

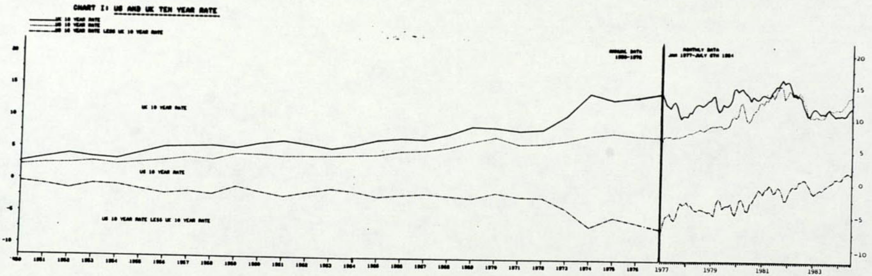
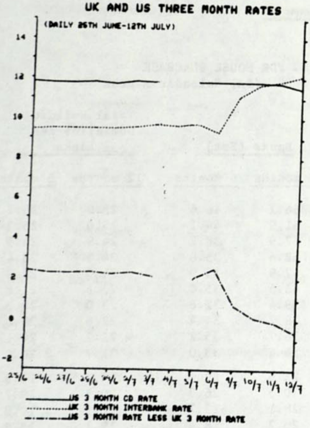
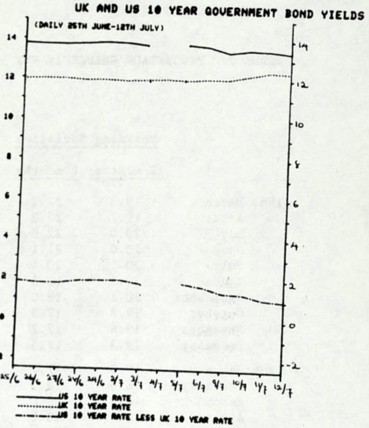


CHART I: US AND UK TEN YEAR RATE
20
15
10
5
0
-5
-10
1977
1979
1981
1983

18. Chart XIII shows US and UK short term and long term interest rates and interest rate differentials since the 1960s. Chart XIV shows the same series on a daily basis over the past two weeks. From the beginning of the year until June the UK-US differential rose steadily from zero to over 2 per cent. The last time the uncovered differential widened to and beyond this level in 1981 the sterling exchange rate fell sharply and this was followed by two sharp increases in sterling interest rates which raised the uncovered differential. A similar process has occured in recent weeks. The differential between UK and US ten year bands has remained positive because of the very high level of US bond yields.

CHART XVI





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(4) HOUSING FINANCE AND ASSET PRICES

19. Building society retail inflows have continued at a relatively low level in May and June and, despite bouyant wholesale inflows, total building society inflows are still insufficient to finance the current and prospective flow of mortgage lending, which continues to rise. Consequently, the seasonally adjusted liquidity ratio has declined from 19.7 per cent at the end of March to 18.7 per cent in May and probably around 18¼ per cent in June. The BSA have announced that they are likely to increase their "advised" mortgage rate by 2¼ per cent to 12½ per cent with effect from 1 August. This will have the effect of slowing the decline in the liquidity ratio.

20. Bank lending for house purchase appears to be running at only around £100 million a month and the six-month growth rate has collapsed to 13.4 per cent. The 12-month growth rates of the combined total of mortgage lending appears to be levelling out at just below 20 per cent.

TABLE 9: PERCENTAGE CHANGE IN NET LENDING FOR HOUSE PURCHASE (SA, Calendar months)

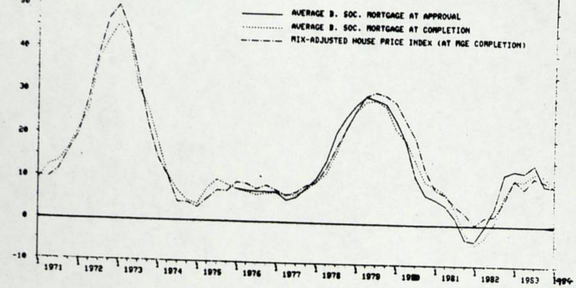
		Building Societies		Banks (Est)		Total Building Societies and Banks	
		12 months	6 months	12 months	6 months	12 months	6 months
1983	March	19.3	22.2	66.1	46.6	25.0	25.7
	April	19.7	22.2	61.9	44.1	25.0	25.3
	May	20.0	22.0	57.9	38.2	24.9	24.5
	June	20.0	21.1	52.4	35.8	24.4	23.4
	July	20.1	20.4	47.9	35.9	24.0	22.8
	August	20.1	19.3	43.5	35.0	23.5	21.8
	September	20.1	18.0	39.4	32.6	23.0	20.3
	October	19.7	17.3	38.7	34.4	22.6	20.0
	November	19.6	17.2	36.7	35.2	22.2	20.1
	December	19.3	17.5	34.4	33.0	21.7	20.0
1984	January	19.0	17.7	22.6	29.4	21.2	19.6
	February	18.8	18.3	30.5	26.3	20.7	19.7
	March	18.5	19.0	28.1	23.7	20.1	19.8
	April	18.7	20.1	26.2	18.4	19.1	19.8
	May	19.0	20.9	23.9	13.4	19.8	19.6

21. The monthly DOE figures for house prices at the approval and completion stage indicate some deceleration in house prices in May compared with April. Both growth rate series are now comfortably below 10 per cent. No information has yet become available for asset price growth in the second quarter. The first quarter figures showed growth of all three asset price measures under 10 per cent compared with a year earlier.

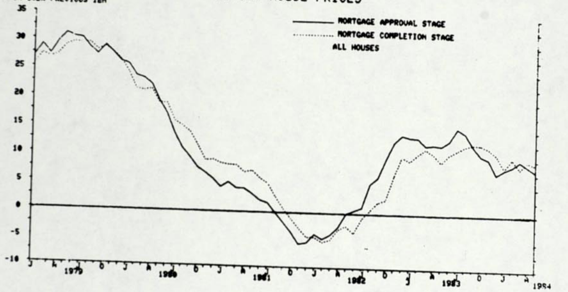
TABLE 10: HOUSE PRICES (% change on a year earlier)

	Based on mortgage approvals	Based on mortgage completions	Mix-adjusted (based on completions)	Nationwide (based on approvals)
1982 Q1	-4.0	-4.9	0	2
Q2	-0.7	-3.0	1	2
Q3	4.0	0.5	2	3
Q4	12.2	6.8	6	8
1983 Q1	13.0	11.3	11	9
Q2	12.8	10.4	9	11
Q3	14.6	12.3	11	13
Q4	9.6	11.9	11	12
1984 Q1	9.3	9.2	9	13
1983 June	13.3	10.9		
July	15.5	11.7		
August	14.7	12.4		
September	13.8	12.8		
October	10.8	12.7		
November	10.2	12.1		
December	7.6	11.0		
1984 January	8.4	8.6		
February	9.0	10.4		
March	10.0	8.6		
April	9.1	9.9		
May	8.2	9.4		

CHART XV : PANEL A: QUARTERLY HOUSE PRICES



PANEL B: MONTHLY HOUSE PRICES



PANEL C: INDICES OF RELATIVE HOUSE PRICES