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MONETARY CONTROL

1. The Chancellor of the Exchequer said in the Budget Speech that a number of improvements in monetary control would come into effect later in the financial year. The Bank of England has now completed its discussions with the financial institutions; the agreed detailed arrangements are set out in a note issued by the Bank today. They will come into effect on 20 August - the first day of banking September.

The Reserve Asset Ratio

2. Among the changes to come into effect on that day is the abolition of the requirement that the banks should maintain a minimum reserve asset ratio. The institutions to which it has been applied will discuss in advance with the Bank, as part of normal prudential supervision, any changes in their policies on liquidity management.

The Cash Requirement

3. The previous requirement on the London clearing banks to hold 1½% of their eligible liabilities with the Bank in non-interest bearing form will also be abolished. Instead there will be a uniform requirement on all banks and licensed deposit-takers to hold ½% of their eligible liabilities with the Bank. The fulcrum for the Bank's money market operations will in future be the balances - over and above the ½% requirement - which the clearing banks hold voluntarily with the Bank for clearing purposes.

Money Market Operations

4. Besides these changes, 20 August will mark a stage in a period of transition which we have been going through since last November. The Bank now relies mainly on open market operations - buying and selling bills - rather than on direct lending to the

money markets. Dealing rates are no longer quoted; the Bank responds to bids and offers from the market, making public the rate at which it has done business. In future, the Bank will aim to keep interest rates at the very short end of the market within an undisclosed band which will be moved from time to time.

5. The new arrangements are intended to reduce the "bias to delay" in changing interest rates - in both directions - which was identified in the Green Paper on Monetary Control. And the market will have a greater role in determining the term structure of short interest rates. Market pressure will show itself mainly in movements in rates at the longer maturities which the Bank does not influence so directly - and this experience of market conditions will be one of the factors taken into account in deciding on the position of the interest rate band.

Minimum Lending Rate

6. The Bank will cease to post a continuous Minimum Lending Rate from 20 August, as this would be inconsistent with the objective of the new arrangements to give the market more influence over the structure of interest rates. The option will, however, be retained for use in some circumstances of announcing in advance the minimum rate which for a short period ahead the Bank would apply to any lending to the market.

Changes in the Interest Rate Band

7. The undisclosed interest rate band will be changed by the Bank with the agreement of the Chancellor of the Exchequer primarily in response to the requirements of the annual monetary target, taking account of a range of factors indicated in the Budget Speech.

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NOTES TO EDITORS

The new monetary control arrangements announced today flow from work begun in 1980 with the publication of the Green Paper on Monetary Control (Cmnd 7858).

In the months following publication of the Green Paper the Treasury and Bank of England received submissions from and consulted a wide range of commentators and market participants on the issues raised in the Paper. In his statement to the House on 24 November 1980 the Chancellor reported on the outcome of these consultations and outlined a number of improvements in monetary control which it was proposed to introduce. These included the ending of the Reserve Asset Ratio requirement, and changes in the Bank's money market operations to allow the market a greater role in the determination of the structure of short-term interest rates. The Bank issued a background note on "Methods of Monetary Control" on 24 November (published in the December 1980 Quarterly Bulletin).

In his Budget speech on 10 March the Chancellor described some of the changes that had already taken place and explained that the Bank would be discussing further changes with the financial institutions. He said that when these consultations were complete the Bank would aim to keep interest rates within an unpublished band, but without an announced Minimum Lending Rate. On 12 March the Bank issued two papers "Monetary Control: Next Steps" and "The Liquidity of Banks" (published in the March 1981 Quarterly Bulletin).

On 2 July the Chancellor told the House that the Bank had issued on 22 June the final draft of the detailed provisions and that discussions with the financial institutions were well advanced. On 31 July he said in answer to a question from Mr Newens that the full system would come into operation on 20 August, the first day of banking September.

Today's Treasury Press Notice explains the major changes and their rationale. At the same time, the Bank of England are issuing a paper entitled "Monetary Control: Provisions", which sets out the details of the new arrangements.