



Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

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Andrew Turnbull Esq
10 Downing Street
LONDON SW1

New Andrew,

**PUBLIC SECTOR BANK DEPOSITS, THE PSBR
AND MONEY STOCK**

The Prime Minister may wish to be aware that the Chancellor proposes to announce on Friday a modest change to the statistical treatment of public sector bank deposits, excluding them from our definitions of the PSBR and of £M3. The draft Written Parliamentary Answer and Treasury press notice announcing the change are attached.

Currently, increases in public sector bank deposits increase the PSBR and also increase the money stock as measured by £M3 and M3. In future changes in these deposits will be recorded as financing items - increases being counted as negative financing of the PSBR, like other acquisitions of liquid assets by the public sector - and will be excluded from £M3 and M3. For the PSBR the change will take effect from the new financial year, and for £M3 it will apply from the beginning of the new target period (ie banking March). The Chancellor thinks it sensible to announce the changes in advance so that essentially statistical matters do not confuse the presentation of Budget decisions and the new MTFs.

The current treatment of public sector deposits has long been regarded as anomalous (eg by you) and the change now to be made has been considered for some time (eg by you). It will remove a small but very erratic element which has no economic significance but can distort the monthly figures for both the PSBR and £M3 by large amounts. It will bring the definitions of £M3 and M3 into line with all the other monetary and liquidity aggregates which already exclude public sector deposits. And, as you will recall, the new definition will be in line with IMF guidelines on Government financial statistics, which recommend excluding public sector deposits. Other countries, such as the USA and Switzerland, already exclude some or all public sector deposits from the broad money supply.

Since changes in public sector deposits are on average very small their exclusion should have little significant effect on the annual figures for the PSBR or the growth of £M3. The growth of £M3 through the target period to date would be about 10½ per cent on the proposed new definition, as against 10¾ per cent on the existing definition. If the PSBR had been similarly redefined this year it would have totalled £9.8 billion in the period to end-December as against the published figure of £10.1 billion.

There may be some press comment from the technical experts and City commentators. Both Treasury and the Bank of England press offices are being briefed to deal robustly

when I
was in
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with any suggestion of "fiddling the numbers". They will be explaining that these are modest statistical changes which are intended to improve the quality of our recorded PSBR and FM3 figures, and to bring them into line with international practice.

*Yours ever,
J O Kerr*

J O KERR
Principal Private Secretary

DRAFT WRITTEN PQ

To ask Mr Chancellor of the Exchequer, whether he is content with the treatment of changes in the public sector's holdings of bank deposits in the current definitions of the Public Sector Borrowing Requirement and £M3.

DRAFT REPLY

On current definitions, changes in deposits held by the public sector with UK banks affect the size of the PSBR; and these deposits are included in £M3 and M3 (but not in the other monetary aggregates). Although the level of public sector deposits is relatively small, changes in individual months can be large. These changes, however, are erratic, and tend to be reversed over a fairly short period. They ~~seem to be~~^{are} of no economic significance. In future therefore public sector deposits will be excluded from £M3 and M3 (with effect from the beginning of the next target period) and from the PSBR (with effect from the 1984-85 financial year). These changes in definition are likely to have only minor effects on annual totals.

Further details of the proposed re-definitions, and figures for earlier periods, will be given in 'Economic Trends' and the Bank of England Quarterly Bulletin.

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DRAFT PRESS NOTICE

PUBLIC SECTOR DEPOSITS: PSBR AND £M3

The Chancellor of the Exchequer announced in a Written Answer in the House of Commons this afternoon that a technical modification is to be made to the definitions of the PSBR and £M3, to exclude sterling bank deposits held by the public sector*.

2. The redefinitions will take effect from the start of the 1984-85 financial year (for the PSBR) and the 1984-85 target period (for £M3 and M3). More detail will be given in the February edition of 'Economic Trends' and in the March Bank of England Quarterly Bulletin.

3. Public sector bank deposits comprise:-

i. Central Government bank deposits, which are extremely small on average, but can show large temporary fluctuations (eg reflecting tax receipts in the form of uncleared cheques).

NLF balances held with the Bank of England under Section 12 of the National Loans Act are already excluded from the PSBR, £M3 and M3.

ii. Local authorities' bank deposits, which are also small relative to local authorities' expenditure, and subject to

* Foreign currency deposits of the public sector will also be excluded from the PSBR and the M3 measure of the money stock. Public sector holdings of other liquid assets will also be excluded from the PSBR, but this will not affect £M3 and M3.

considerable month-to-month volatility (eg because of temporary delays before they are used to repay borrowing).

iii. Public corporations' bank deposits. Since public corporations have guaranteed access to central government funds within set limits, they have less need to hold liquidity balances than private companies. Working balances are normally held within the public sector.

4. These changes in definition will remove a small but very erratic element, which has no significance either for the level of public expenditure or wider economic activity, but can sometimes distort the monthly figures for the PSBR and £M3 by large amounts. The effect on the annual figures is likely to be small - over the last six financial years public sector deposits and other liquid assets have risen on average by £180 million within a year. Changes have ranged from an increase of £500 million in 1980-81 to a fall of £100 million in 1979-80. In the first three quarters of the current financial year public sector deposits etc rose by £360 million.

5. This change will bring £M3 and M3 into line with other monetary aggregates (including PSL1 and PSL2), which already exclude public sector deposits. The effect of the change on the long-term behaviour of £M3 is likely to be very small: on average public sector deposits have grown by less than £20 million a month over the last eight years, and they amount to only some $2\frac{1}{2}$ per cent of the stock of £M3. Over short periods, however, sharp fluctuations in public sector deposits can distort the

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path of month-to-month changes in £M3. In individual months public sector deposits have risen by as much as £500 million and fallen by over £400 million. The growth in £M3 at an annual rate over the current target period to mid-January is $10\frac{1}{2}$ per cent on the revised basis, compared with $10\frac{3}{4}$ per cent on the existing definition. These changes in the definition of the PSBR will bring the UK into line with international conventions, as set out in the International Monetary Fund's guidelines on government financial statistics. Most other countries (eg US and Switzerland) exclude all, or some, public sector deposits from broad money measures.

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