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SECRET (AND PERSONAL UNTIL THURSDAY 18 JULY)

MONTHLY MONETARY REPORT: JUNE-SEPTEMBER

- The exchange rate, real interest rates and MO growth all suggest that monetary conditions remain tight. But £M3's 12-month growth rate at 12% is 3 points above the top of its target range.

- All the aggregates apart from MO were distorted by the oversubscription for Abbey Life which resulted in £4 billion being held on suspense accounts on make-up day. The Bank as usual assumed that 60% of the money will go back into bank deposits and 40% will reduce bank lending but the true unwinding is unknown.

- As the exchange rate has appreciated over recent months, private sector flows in the externals suggest that UK residents have been switching back into sterling. In the last three banking months private sector transactions with banks have registered an inflow of £2½ billion compared with an outflow of £1.3 billion in the previous year, adding to £M3.

- Over the last 3 banking months there has been no overfunding (seasonally adjusted) on the conventional definition but £¾ billion on the wide definition. The level of money market assistance over the same period has nevertheless fallen by £2¼ billion due to large unadjusted CGBR's.

- Over the next 3 months we expect MO's annual growth rate to stay at around 5% - the middle of its target range - while £M3's 12 month rate is forecast to increase to about 13%, 4 points above the top of its range.

- In July £M3 is expected to grow by around ½% if we achieve the gilts target of gross sales of £1¼bn and if the Abbey Life distortions unwind in the predicted manner. If in the remaining week of the banking month no more gilts are sold, £M3 could grow by around 1%.

HF3 July 1985

SECRET (AND PERSONAL UNTIL THURSDAY 18 JULY)

MONTHLY MONETARY REPORT: JUNE-SEPTEMBER

Monetary Aggregates

In banking June £M3 grew by 2 per cent, 0.3 per cent above forecast. MO grew by 0.7 per cent, slightly less than forecast. 12 month growth in £M3 is now 11.9 per cent, with 3 and 6 month growth substantially higher. Annual growth in MO is now 5.2 per cent close to the mid-point of its target range, and about ¼ per cent below the steady 5½ per cent annual growth rate experienced for most of the past year. Table 1 below shows recent growth in the target aggregates, and annex table 1 provides further detail, also covering real MO and real £M3. Other measures of money are shown in annex table 4. Growth in the broad and narrow aggregates over the past 8 years is shown in chart 1, while chart 2 provides a breakdown of the counterparts and components of changes in £M3 in recent months.

Table 1: Target Aggregates: Recent Experience

per cent, s.a.

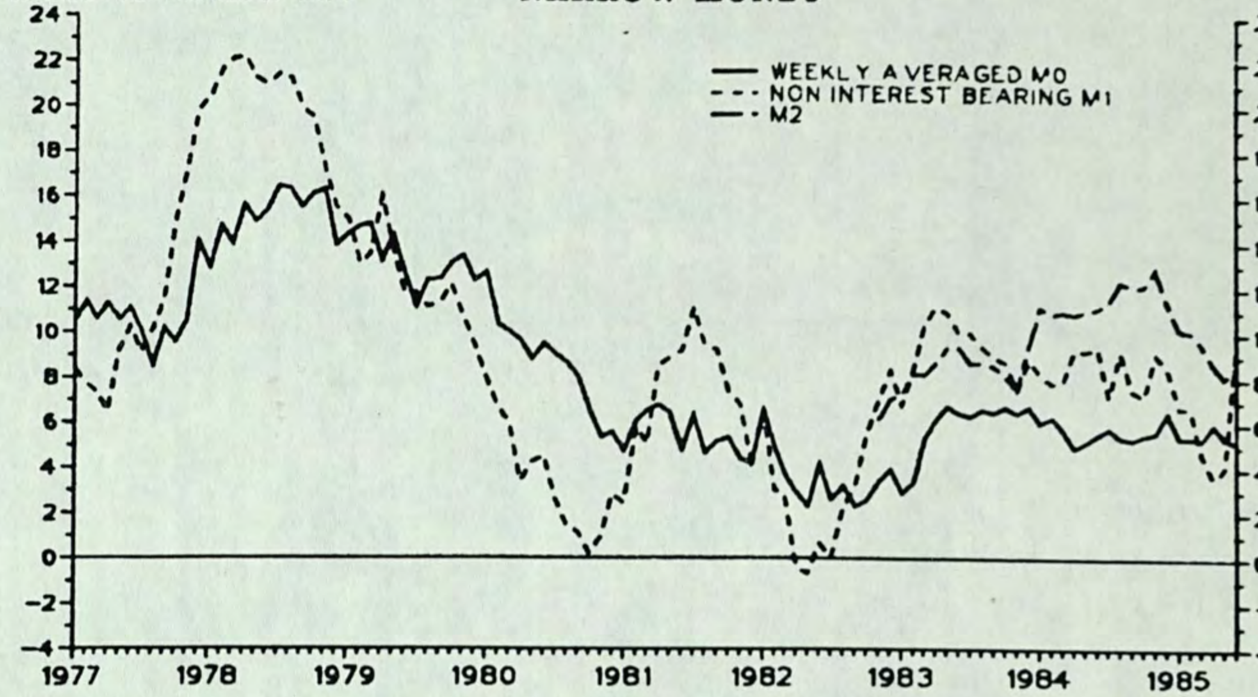
	MO	£M3
Monthly change		
April	0.7	2.9
May	-0.1	0.4
June	-0.7	2.0
Growth to mid-June at an annual rate over past:-		
3 months	5.7	23.5
6 months	2.9	16.1
12 months	5.2	11.9

2. The monthly path of MO continues to be erratic. But the 12 month growth rate has shaded down over the last few months, suggesting there is little reason to believe that underlying growth has risen. If anything, it may be moving down in response to the level of interest rates.

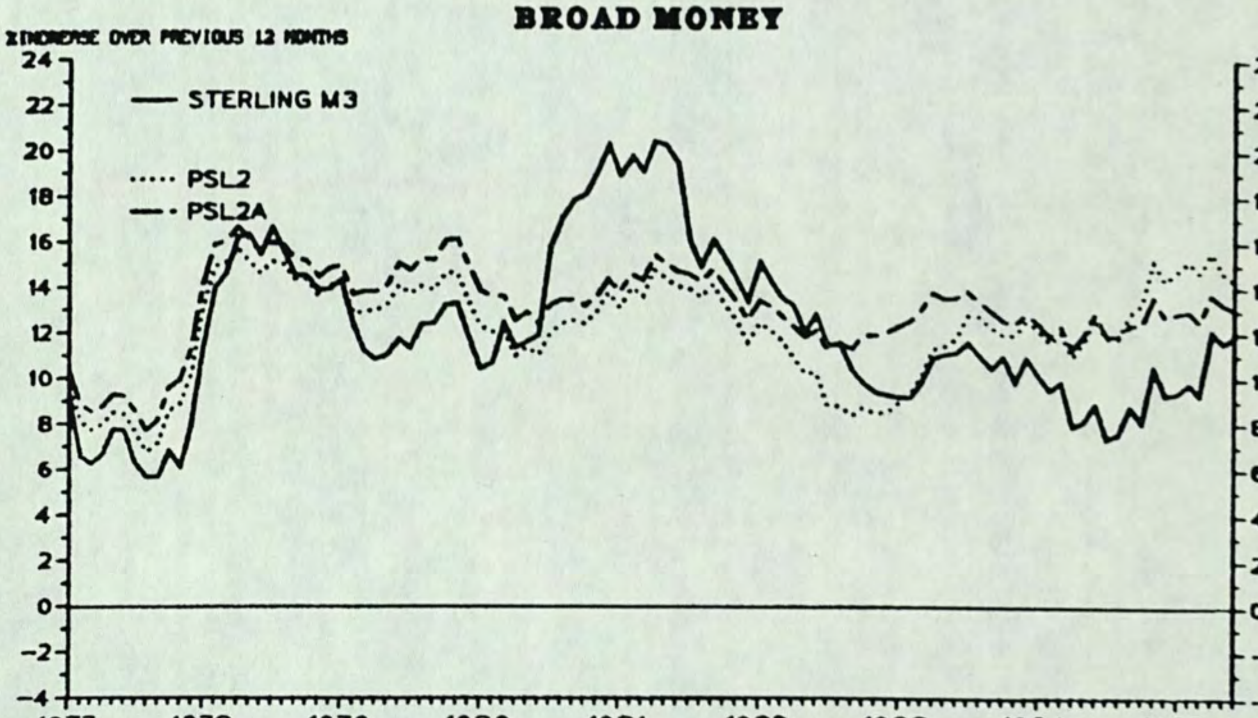
3. All the aggregates except MO are likely to have been affected by the Abbey Life oversubscription; £4.2 billion of application

CHART I : ANNUAL GROWTH RATES OF MONETARY AGGREGATES

NARROW MONEY



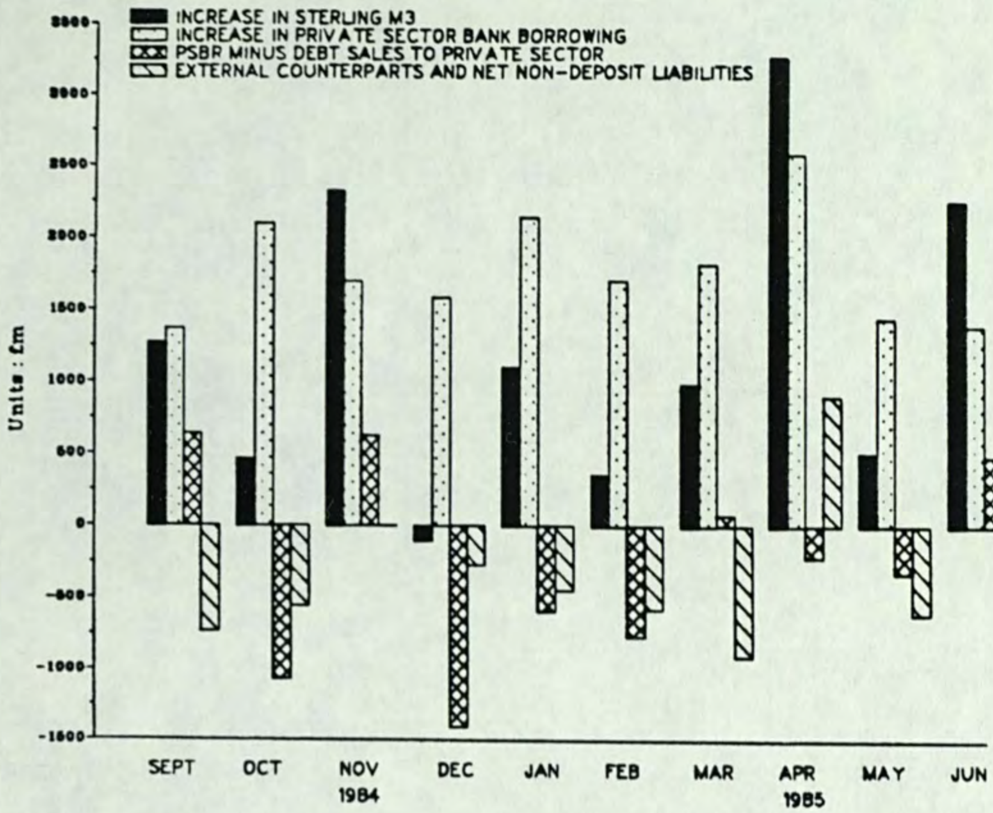
BROAD MONEY



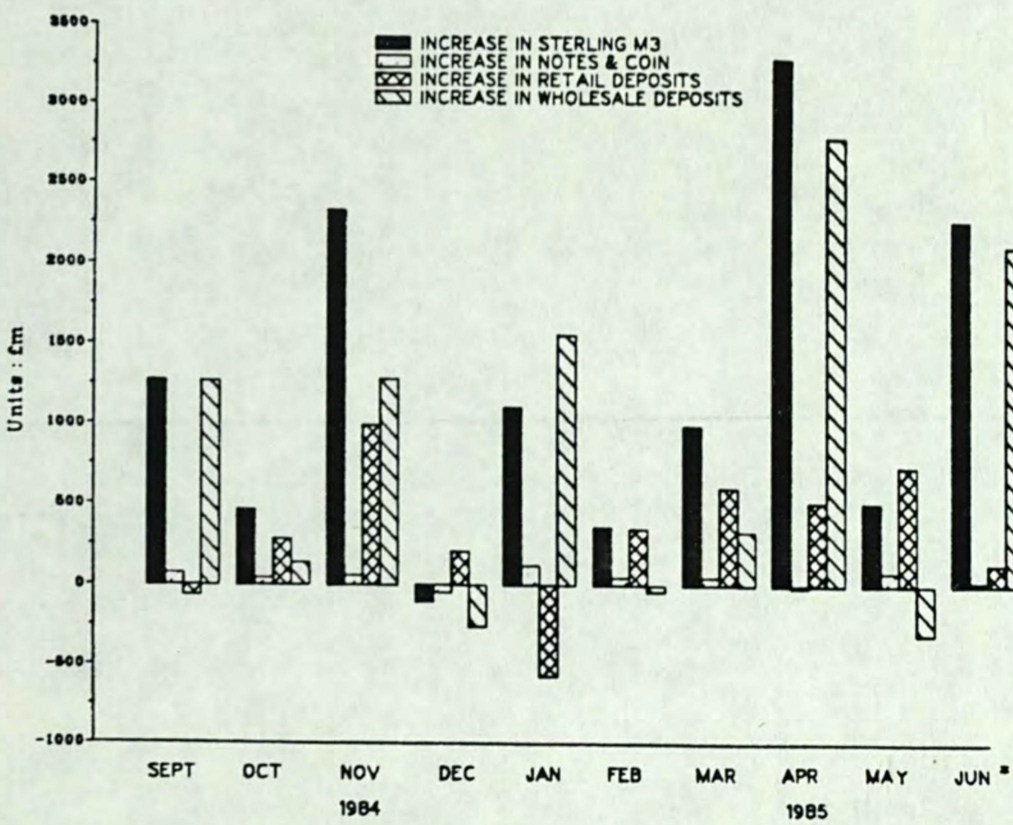
NOTE: THE GROWTH RATES OF M0 BETWEEN SEPTEMBER 1981 AND AUGUST 1982 ARE ADJUSTED TO REMOVE THE DISTORTION CAUSED BY THE CHANGED DEFINITION OF BANKERS BALANCES WITHIN M0

CHART II

INCREASE IN STERLING M3 AND COUNTERPARTS



INCREASE IN STERLING M3 AND COMPONENTS



* Adjusted for estimated effects of Abbey Life oversubscription

monies was in suspense account on make-up day. NIB M1 rose at a <u>monthly</u> rate of 6.2 per cent; an obvious distortion resulting from the conventional treatment of the money on suspense - 60 per cent allocated to increasing non-interest bearing deposits, 40 per cent to reducing sterling lending. The impact on £M3 is more difficult to assess. It depends on two factors:

(i) the proportion of the oversubscription representing deposits built up specifically to apply for Abbey Life shares.

(ii) The accuracy of the 60:40 split.

We think it likely that little "new" money will have been created, since the institutions, which formed the bulk of the applicants, are currently cash rich. The 60:40 split may, if anything, underestimate the proportion financed by deposits for the same reason. On the other hand, anecdotal evidence from the banks is that some institutions with substantial cash balances borrowed in order to finance their applications. We have worked on the assumption, therefore, that the 60:40 split is correct and that no new deposits were attracted specifically for Abbey Life.

4. The public sector impact on £M3 was expansionary by £½ billion, compared to a forecast expansionary impact of £1 billion. The CGBR was more than £½ billion lower than forecast, and the "other public sector" contribution was about £¼ billion less expansionary than forecast. But this was partly offset by no net sales of gilts to the nbps (and correspondingly high sales overseas), compared to forecast sales of £350 million.

5. Sterling lending rose by £1.4 billion. What this implies for underlying lending depends on how the Abbey Life effect is allowed for. If the 60:40 split is accurate this would be broadly consistent with our current assessment of underlying lending.

6. The other counterparts are on the new basis, with foreign currency net non-deposit liabilities included in the externals rather than in nndls. The externals were more than £½ billion more expansionary than forecast, probably because the strong pound

and high UK interest rates have attracted money into sterling. The foreign currency perpetual floating issues by UK banks, to the value of £1 billion had no net effect on £M3, having equal and offsetting effects within the externals. Nndls were flat this month compared to an average contractionary effect of about £¼ billion over the last year.

7. Building society inflows appear to be running at an underlying level of around £1200 million a month of which just under half represents accruing interest. We expect inflows to be fairly healthy over the next 3 months and there may be a small rise in their liquidity ratio.

Other indicators of monetary conditions

8. **Inflation:** The twelve-month increase in retail prices to May was 7 per cent, and is unlikely to be lower in June or July. A fall in retail price inflation is still expected later in the year. The twelve-month increase in the producer output price index (excluding food, drink and tobacco) has been in the range 6¼-6½ per cent since the beginning of the year. The index for materials and fuels purchased by manufacturing industry fell between May and June - the second consecutive monthly fall - and in June input prices were only 2.2 per cent higher than twelve months earlier. Average earnings continue to grow at an underlying annual rate of 7½ per cent, but unit wage cost growth appears to be higher than for some time, although the likelihood of revisions to the unit wage cost series makes interpretation of these figures difficult.

9. **House prices:** The latest evidence gives conflicting signals about the trend in house price inflation. A survey of estate agents by the Royal Institution of Chartered Surveyors suggested that prices rose much more slowly between February and May than is usual at this time of year. This slowdown appeared to be confirmed by figures from the DOE showing that house prices at the mortgage approval stage were 5.6 per cent higher in May than a year earlier and figures from the Abbey National Building Society

suggesting that prices rose by just 4.6 per cent between the second quarter of 1984 and the second quarter of 1985. However, the Halifax Building Society announced that their house price index rose by 8.3 per cent over the twelve months to June and the Anglia Building Society announced that house prices rose by 6.3 per cent in the first half of 1985.

10. **Real interest rates:** Real interest rates were little changed in June, although real long rates, as measured by the yields on index-linked gilts did increase slightly.

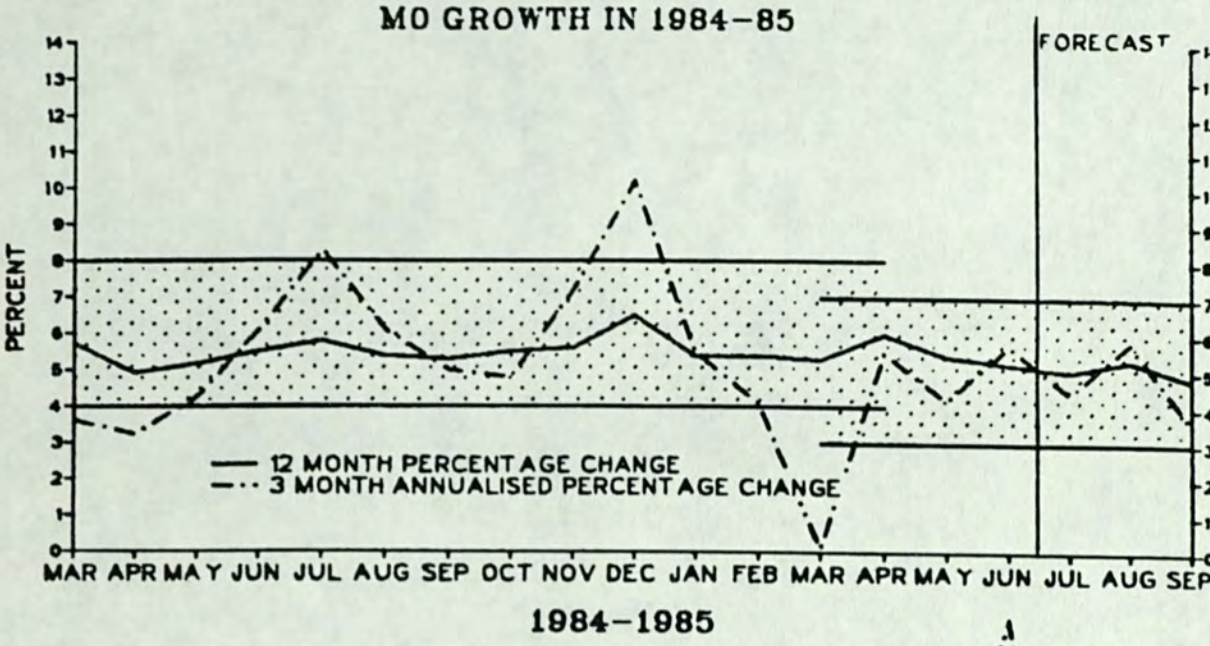
11. **Exchange rate:** The exchange rate improved against most currencies during June. Its index value against the EMS currencies was the highest monthly average since September 1983; the $/£ rate touched 1.40 and the DM/£ rate has remained above 4.

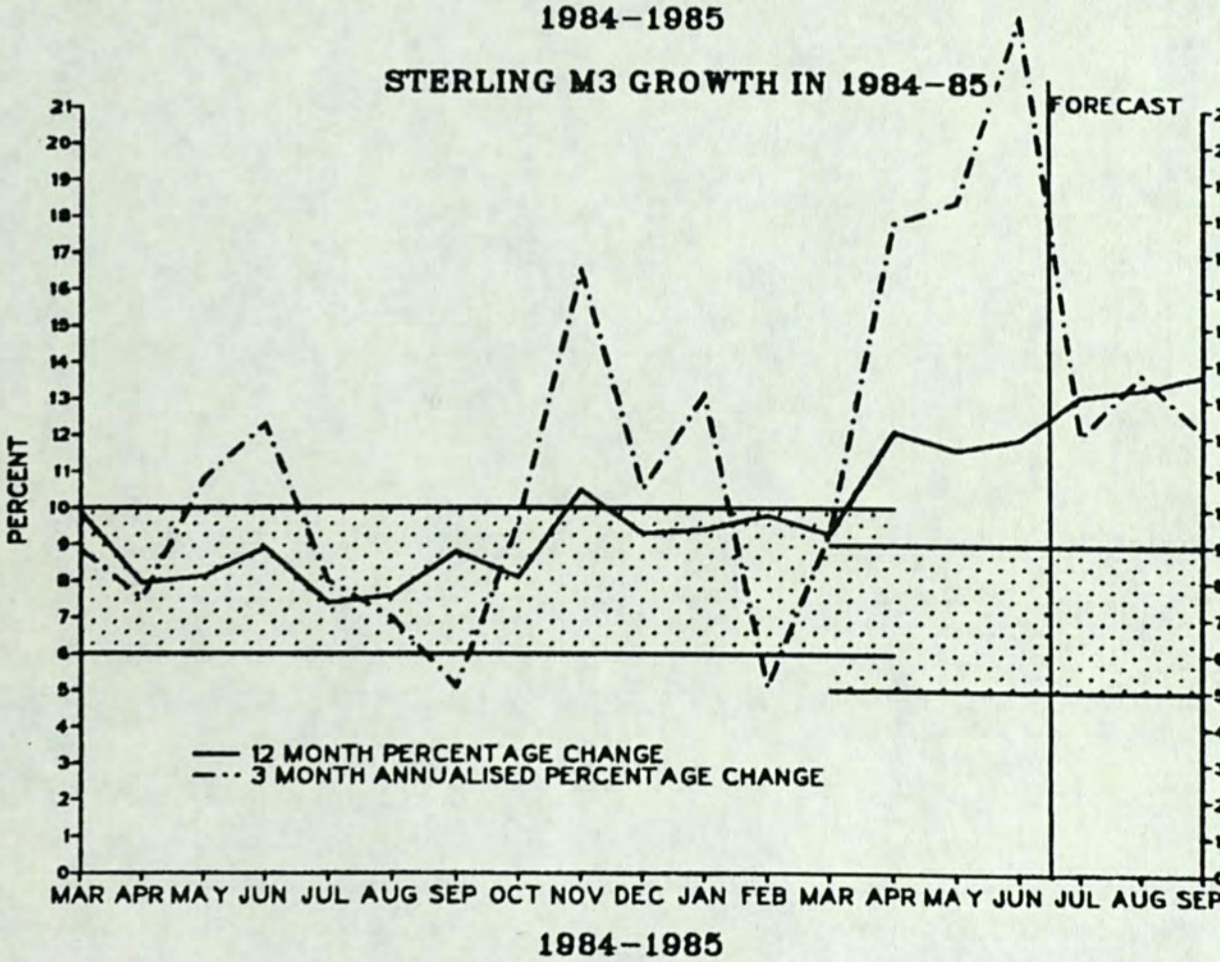
Three month forecast

12. The forecast assumes no change in interest rates (ie. base rates at 12½ per cent). The outlook for MO remains good. With continuing high interest rates the growth of MO is expected to decelerate to ¼ per cent a month from the average growth of just under ½ per cent over the last 3 and 12 months. At end September the 12 month rate is estimated to be 4¾ per cent. However monthly outturns have been erratic and could remain so, while the £1 coin is replacing the note.

13. In complete contrast to MO the outlook for £M3 remains poor. By the end of the forecast period 3 month growth is expected to be 12 per cent (saar), 6 month growth 17.6 per cent (saar) and 12 months 13.7 per cent. These are summarised in table 2.

14. During the forecast period the public sector contribution fluctuates from month to month, largely due to assets sales and gilt redemptions. Nevertheless, using the stylised projection of £1¼ billion gross gilt sales a month, which is unlikely to be reached in July, the public sector contribution is flat over the 3 months together, as it was during the last three. (If we sell no more gilts in the remainder of banking July, our £M3 forcast would be about ½ per cent higher.) The main


MO GROWTH IN 1984-85
FORECAST
PERCENT
12 MONTH PERCENTAGE CHANGE
3 MONTH ANNUALISED PERCENTAGE CHANGE
MAR APR MAY JUN JUL AUG SEP OCT NOV DEC JAN FEB MAR APR MAY JUN JUL AUG SEP
1984-1985


STERLING M3 GROWTH IN 1984-85
FORECAST
PERCENT
12 MONTH PERCENTAGE CHANGE
3 MONTH ANNUALISED PERCENTAGE CHANGE
MAR APR MAY JUN JUL AUG SEP OCT NOV DEC JAN FEB MAR APR MAY JUN JUL AUG SEP
1984-1985

explanation for continued fast growth is bank lending. The forecasters see no reason to revise down their underlying lending forecast of £1.6 billion which is close to the recent monthly averages. Another contributing factor to the strong 12 month growth of £M3 is the externals. Although projected to be only flat over July-September this is more positive than a year earlier. There must be a chance that in July, with the pound strong, residents could be switching back into sterling, leading to a faster growth than projected, and a faster growth of £M3.

15. We have considered an alternative case, with base rates at 12 per cent rather than 12½ per cent. There is little immediate impact on MO or £M3. MO's 6 month annualised rate might be around ¼ per cent higher by the end of the year, while £M3 growth could be 0.1 per cent lower in August and September - with national savings gaining relative to bank deposits, interest crediting lower, and the externals perhaps less positive. But eventually the growth in bank lending might increase somewhat, leading to faster £M3 growth.

Table 2: Target aggregates: Summary of forecast

per cent s.a.

	MO	£M3
Monthly change		
July	0.4	0.5
August	0.3	0.8
September	0.2	1.6
Growth to mid-June at an annual rate over past:-		
3 months	5.7	23.5
6 months	2.9	16.1
12 months	5.2	11.9
Growth to mid-September at an annual rate over past:-		
3 months	3.6	12.1
6 months	4.6	17.6
12 months	4.8	13.7

Public Sector Borrowing

16. In June the PSBR was £0.9 billion below forecast. This is explained partly by the change in seasonals (the unadjusted forecast was £0.6 billion higher than the outturn), a small underspend on supply and contributions to the EEC, and unexpectedly large repayments of borrowing by PC's, probably the Electricity Council. Although the CGBR in banking June was £250 million above forecast the calendar month outturn was as forecast.

17. The outlook for the path of the PSBR and the CGBR remains uneven month to month even in seasonally adjusted terms. The main explanation is the level of asset sales, with the BT second call, in particular, in banking July. Asset sales apart, July and August are similar (at £0.8 billion) but September remains high. The forecasts for the PSBR are nevertheless consistent with the Summer forecast.

18. Compared with the same period a year ago the CGBR(0) is around £300 million a month lower. This is largely explained by asset sales. However, working the other way is a large (£½ billion) grant to the NCB which will be used to pay off some PWLB borrowing. The LABR is slightly lower than a year earlier, mainly because companies are paying rate income monthly, which they used to pay semi-annually in May and November. The PCBR is also slightly lower than a year earlier, probably as the Electricity Council repays temporary borrowing.

Table 3 Public Sector Borrowing

£ million monthly average

	mid June 1984 -mid June 1985	mid June 85 -mid Sep 85	mid June 84 -mid Sept 84
CGBR (0)	398	606	884
'LABR'	270	79	115
PCBR	95	- 61	-
'PSBR'*	762	625	996

* PSBR less non-bank private sector transactions in other public sector debt.

Debt Sales

(a) Gilts

19. Gross gilt sales in the 5 weeks of banking June totalled £2,178 million compared to a target of £1¼ billion. The £1.2 billion redemption of 3 Treasury 1983, together with some £300 million buying in left net official sales at £713 million. This was more than accounted for by sales to the overseas sector; net sales to the nbps were zero.

20. Table 4 compares the June outturn with performance in the previous year and projections for the forecast period. The forecast for July assumes that the gross sales target of £1¼ billion is achieved. With only 4 working days of the month to go we are still over £800 million short of this target. The worst case - no further sales this month - would push £M3 up by about ½ per cent. With another substantial redemption (£755 million) in July, net sales to the nbps, assuming the gross target is reached, would amount to about £½ billion.

Table 4 Gilts Sales

Banking monthly averages £m

	Actual		Forecast		
	July 84-June 85	June	July	August	Sept
Gross Sales	1345	2178	1250	1250	1250
Redemptions	- 217	-1170	- 705	- 50	- 732
Next Maturities	- 110	- 295	- 16	- 150	-
Net Sales	1018	713	529	1050	518
of which:					
Monetary Sector*	67	18	- 65	100	90
Public Corporations	0	- 35	-	-	-
Overseas	207	730	70	300	195
Non-bank private sector	744	-	525	650	235

* excluding repos

21. The stylised assumption of £1¼ billion gilt sales has been retained for August and September. A high level of overseas purchases is also assumed. A further redemption - 8¾% Treasury Conversion 1985 - reduces net sales in September. Over the forecast period net sales to the nbps are reasonably smooth by

past experience. But, on these assumptions, with continuing heavy sales abroad, net gilt sales to the nbps would average less than two-thirds that achieved both over the last year and in the corresponding 3 months last year.

CTDs

22. Purchases were much as expected in banking June, but surrenders were lower, so CTDs exerted only a very slightly expansionary impact on £M3. With purchases steady at around £50 million per week we expect CTDs to continue to have a mildly expansionary impact over the forecast period as two substantial tax payments occur. In particular, high ACT payments in calendar July are projected to result in surrenders exceeding purchases by £125 million in banking August.

National Savings

23. National Savings contibuted £273 million (£378 million, seasonally adjusted) to funding in banking June, marginally higher than forecast. The major contribution came from accruing interest (£206 million) and from the Income Bond (£84 million). Inflows do not seem to have been distorted to any extent by the impending BT call or by the Abbey Life flotation.

24. Over the forecast period, we expect that accrued interest and the Income Bond will continue to be the only substantial funders. The introduction of the 3rd Index-linked Certificate is forecast to bring in some money, particularly from high rate taxpayers, but this is offset by the poor showing of the Conventional 30th Issue. In the three months to banking September we anticipate that National Savings will contribute £595 million (unadjusted) to funding, of which 72 per cent represents interest accruing.

25. Within these 3 months, we are forecasting a gentle decline in National Savings underlying inflows as tax-efficient purchases of the Certificates fall off slightly. By the end of banking September we may be somewhat below the striking rate required to attain the £3 billion target.

The PSBR and Funding

26. Table 5 summarises net funding over the last 12 months and that implied by the forecast. In June there was an underfund of £½ billion on a seasonally adjusted conventional basis (sacb) due mainly to no sales of gilts to the nbps. Nevertheless over the past year there has been overfunding of £3.6 billion (sacb). In the forecast period there is expected to be a full fund (sacb), but a £1¼ billion overfund in unadjusted terms.

27. In June, as in the last 5 months, there was some contribution to funding from the overseas sector. Indeed since the beginning of 1985 the overseas sector has purchased some £2 billion of gilts.

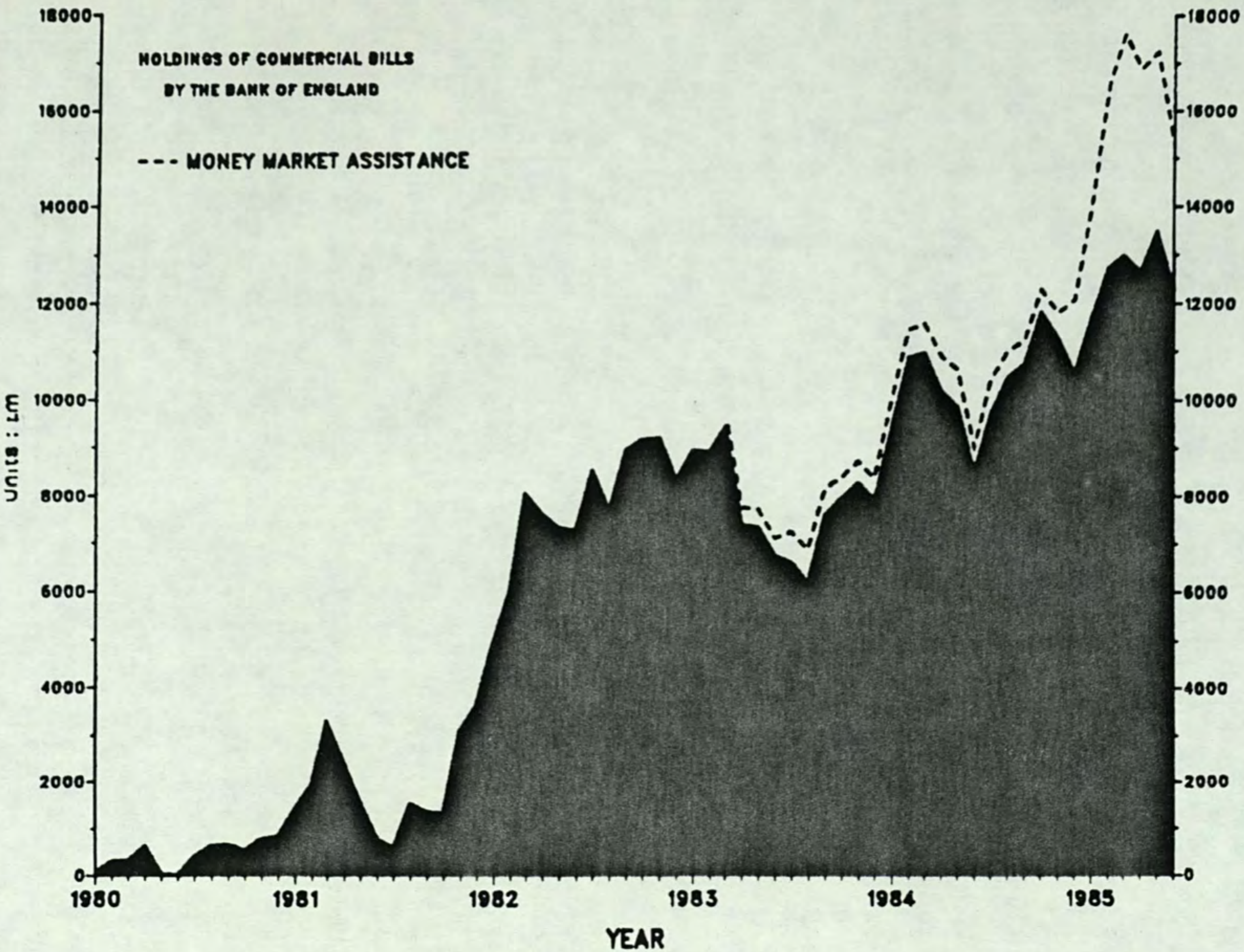
Table 5: The PSBR and funding

£ billion, seasonally adjusted

	Actual mid Jun '84-mid Jun '85	Forecast mid Jun '85 mid Sept '85	mid Jun '84-mid Sept '85
PSBR	9.1	1.9	3.0
Debt sales to nbps	-12.8	- 1.9	- 3.4
of which:			
Gilts	- 8.9	- 1.4	- 2.2
National Savings	- 3.3	- 0.8	- 1.4
CTDs	- 0.8	0.3	0.2
Over(-)/Underfunding(+)	- 3.6	-	- 0.4
(Unadjusted)	(- 2.5)	(- 1.2)	(- 1.0)
External finance of the public sector	- 2.5	- 0.6	- 0.7
Over(-)/Underfunding(+) alternative definition	- 6.1	- 0.6	- 1.2
(Unadjusted)	(- 5.0)	(- 1.7)	(- 1.7)

CHART IV

BILL MOUNTAIN RANGE



Money Market Influences

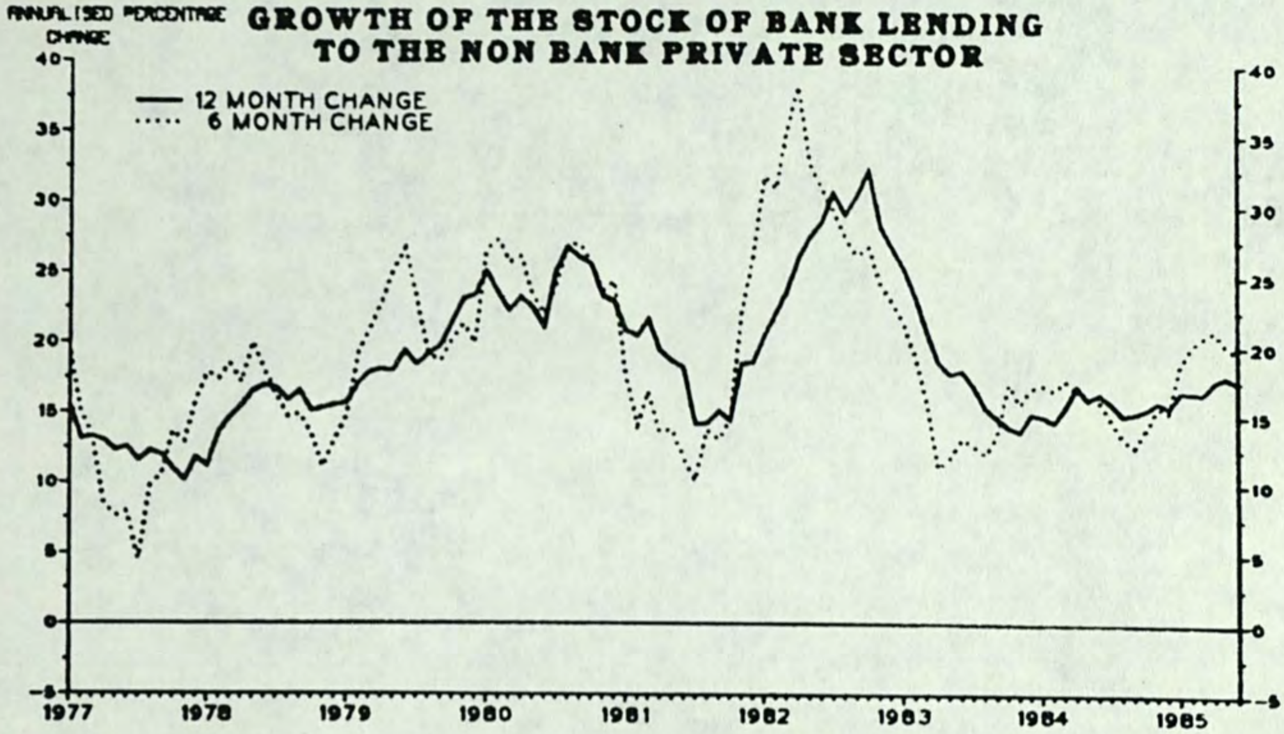
28. In June there was a large surplus (£2 billion) due mainly to the CGBR and the gilt redemption. The surplus allowed the Bank to reduce outstanding money market assistance to £15.3 billion at the end of June. (The growth of the bill mountain and money market assistance in recent years is shown in Chart 4.) In the forecast period the level of assistance rises sharply to £17.6 billion in July, mainly as a result of the BT second call combined with moderate debt sales. Thereafter it declines to £17.1 billion at the end of September.

Bank lending to the private sector

29. There are at last signs that the growth in recorded bank lending is slowing down. The 3 and 6 month percentage rates peaked in April at around 22 per cent, while the 12 month rates reached 18 per cent in May (see Table 6). However, we had expected some reduction in recorded lending because of the bringing forward of borrowing to April to take advantage of the 1984-85 rate of capital allowances. In underlying terms lending appears to be growing at around 18 per cent (or about £1600 million a month).

30. The June figures may have been distorted by the Abbey Life oversubscription. Around £4 billion was held on suspense account on make up day and, following the usual rules of thumb, it was assumed that 40 per cent of this amount (ie. £1.6 billion) would be used to run down bank lending. The 60:40 split is based on survey evidence about the eventual run down of relatively small amounts classified as transit terms. There is no reason to suppose the figure is appropriate in this case, particularly since an unusually high proportion of the money appears to have come from the institutions. They are known to have built up £ bank deposits over the last year, so they may not have needed to increase their borrowing greatly to finance their applications. On the other hand, the clearing bank economists claimed in their regular meeting with the Bank that about 50 per cent of the institutions'

CHART V : BANK LENDING AND FT INDEX



applications were financed by borrowing from banks. This is plausible since the Abbey Life issue was only announced about one week in advance and institutional funds may have been committed to 7 day or longer deposits. We decided that on balance there was insufficient evidence either way to support amending the 40:60 rules. Every 10 per cent change in the proportions alters bank lending and £M3 by £400 million. So if the true proportions were 35:75 the growth of £M3 and bank lending would have been under-estimated by £200 million in June and will be over-estimated by the same amount in July.

31. Over the next 3 months we expect <u>recorded</u> lending on average to increase by only around £1.3 billion (or 13 per cent at an annual rate) despite assumed underlying growth of £1600 million (18 per cent at an annual rate). This is partly because some of the lending for investment expected in these months was brought forward to April to get the higher capital allowances; and partly because throughout the period the PSBR is expected to be above trend, thereby reducing companies financing needs. The July figure may be boosted by £100 million extra borrowing to finance a small part of the £1.2 billion second call on BT.

32. So far in banking July there have been no opportunities for profitable bill arbitrage at either the 1 or 3 month levels. As usual we have assumed that no new round-tripping will take place over the forecast period.

33. Net issues by listed UK public companies raised £420 million in calendar June taking the total so far this year to £3.2 billion. This exceeds the annual total even for the record year of 1983. The reduction in the size of the queue suggests that the level of new issues may decline over the forecast period, presumably partly because of the signs that share prices have passed their peak value.

34. Hanson Trust are due to receive £275 million in banking July of the £520 million proceeds of their recent rights issue. The money could be used to reduce their bank borrowing; or

TABLE 6

STERLING LENDING TO PRIVATE SECTOR

Seasonally adjusted

		Moving Averages of Underlying Lending						Moving Averages of Recorded Lending					
		3 months		6 months		12 months		3 months		6 months		12 months	
		£m	%*	£m	%*	£m	%*	£m	%	3m	%	£m	%
1984	Jan	1116	15.1	1117	14.9	1157	15.9	1195	15.6	1271	17.1	1084	14.9
	Feb	1076	13.7	1171	15.3	1158	15.6	1283	16.5	1278	16.7	1076	14.5
	Mar	1095	13.7	1303	17.0	1200	16.1	1283	16.2	1340	17.5	1161	15.5
	Apr	1627	20.9	1396	17.9	1268	17.0	1445	18.4	1320	16.9	1273	17.0
	May	1424	17.7	1250	15.7	1240	16.2	1322	16.4	1302	16.4	1230	16.1
	June	1563	19.2	1329	16.5	1262	16.5	1297	15.8	1290	16.0	1267	16.5
	July	882	10.4	1255	15.5	1186	15.3	936	11.1	1190	14.7	1231	15.9
	Aug	1098	12.9	1261	15.3	1216	15.3	887	10.3	1104	13.3	1191	15.0
	Sept	1028	11.9	1295	15.4	1299	16.3	850	9.81	1074	12.7	1207	15.1
	Oct	1637	19.5	1260	14.9	1328	16.4	1430	16.9	1183	13.9	1251	15.4
	Nov	1716	20.2	1407	16.5	1329	16.1	1746	20.5	1316	15.4	1310	15.9
	Dec	1718	20.0	1373	15.9	1351	16.1	1786	20.9	1318	15.2	1304	15.6
1985	Jan	1687	19.3	1662	19.3	1458	17.4	1801	20.7	1615	18.8	1403	16.8
	Feb	1694	19.1	1705	19.6	1484	17.4	1803	20.4	1775	20.4	1440	16.9
	Mar	1632	18.1	1675	19.0	1486	17.1	1880	21.0	1833	20.9	1454	16.8
	Apr	1657	18.0	1672	18.7	1466	16.7	2027	22.4	1914	21.5	1549	17.6
	May	1617	17.3	1656	18.2	1532	17.3	1940	21.0	1872	20.7	1594	18.0
	June	1589	16.7	1610	17.5	1491	16.6	1800	19.1	1840	20.1	1579	17.6
Forecast													
	Jul	1550	15.9	1603	17.1	1632	18.1	1464	15.0	1746	18.6	1681	18.7
	Aug	1584	16.1	1601	16.8	1653	18.1	1420	14.3	1680	17.6	1728	18.9
	Sept	1590	16.0	1589	16.4	1632	17.7	1307	13.0	1554	16.0	1693	18.4

* Based on stock of recorded lending

might be kept on short term deposit. In the absence of any firm knowledge about the relatively likelihood of these alternatives, we have made no adjustment to bank lending or deposits.

Table 7: Issues by Listed UK Companies

Calendar month averages, £m

		Net Issues	Gross Issues Queue* (Equities)
1982		97	-
1983		234	-
1984		143	-
1984	Q1	51	850
	Q2	199	1510
	Q3	218	1030
	Q4	106	1215
1985	Q1	400	
	Q2	509	
1985	Jan	275	1610
	Feb	201	2943
	Mar	723	4100
	Apr	989	4332
	May	620	4350
	June	426	3356**

* Excluding privatisations, currently consisting of British Airways and Britoil

** As of 28 June 1985

Externals and net non-deposit liabilities (NNDL's)

35. These counterparts are now measured under the new definition which includes both sides of the foreign currency nndl's in the externals. In June the externals were again heavily positive (£0.4 billion). The main explanation for this comes from the private sector; the external finance of the public sector was negative for the sixth consecutive month. The private sector externals have been positive by £2½ billion in the latest 3 months compared with an otflow of £1.3 billion over the previous 12 months. The counterparty to the UK non-bank private sector inflows appears to be UK banks - which will have almost certainly

covered any net currency positions through the forward market.

36. Nndl's were more or less flat mainly because of a large positive interbank difference, which is expected to be partly reversed next month. In the forecast period nndl's and externals taken together are negative - a return to the pattern before April. However there must be a risk that the externals will be more positive, particularly in July when the exchange rate has been strong.

Building Socieites and broad liquidity

37. At £1140 million (seasonally adjusted), building society retail inflows were slightly above forecast despite the fact that an estimated £100 million was withdrawn for Abbey Life applications. The considerable distortions over the last 2 months have tended to obscure the strong competitive position of the societies' relative to the banks and to National Savings. We now believe that underlying inflows are running at over £1200 million per month, of which £520 million represents accruing interest.

38. Distortions affecting building societies over the forecast period are discussed in the next section on retail inflows. Taking these distortions into account, we expect that retail inflows, taken together with a fairly stable demand for new mortgages and a moderate level of wholesale funding, should be consistent with a small rise in the liquidity ratio by the end of banking September. (See table 8). Although the forecast suggests that the BSA's figure of £800 million net inflow of principal per month will not be reached, the improving liquidity position seems plausible since:

(a) Interest accruing is running at nearly £100 million per month more than the BSA assumed.

(b) The BSA assumed that the liquidity ratio would be kept at 18 per cent. Lower inflows are required to keep a constant 16.5 per cent ratio than to keep a ratio of 18 per cent.

Table 8

BUILDING SOCIETIES BALANCE SHEET FLOWS (UNADJUSTED)

£ Million

	Assets				Liabilities			
	Total Flow	Net Advances	Liquid Assets	Fixed Investment	Retail Inflows Principal	Interest Credi ted	Wholesale Inflows	Other (e.g. Reserves)
1983*	1066	911	143 (19.9)	13	570	310	136	50
1984+	1284	1189	79 (18.3)	16	710	387	136	51
1984 Q1*	896	977	-83 (19.2)	1	870	302	33	-309
Q2+	1145	1326	-201 (18.1)	21	598	414	99	34
Q3*	1476	1345	114 (17.6)	17	543	272	278	383
Q4+	1619	1109	486 (18.3)	24	831	560	134	94
1985 Q1+	604	1030	-445 (16,5)	19	504	354	- 68	- 186
Calendar Months								
Jan	-39	942	-999 (17.4)	18	823	726	-102	-1486
Feb	452	967	-533 (16.8)	18	474	64	-138	52
March	1086	1181	-113 (16.5)	18	214	272	151	449
April	1469	1149	302 (16.5)	18	507	417	149	396
May	1756	1301	437 (16.7)	18	615	136	185	820
June+	1243	1174	51 (16.5)	18	420	1045	20	-242
Banking Months								
July	1391	1181	192 (16.5)	18	713	725	81	-128
August	1854	1547	289 (16.5)	18	743	163	136	812
September	1652	1109	525 (16.7)	18	752	301	99	500

*Monthly Average in the period
( ) Brackets indicate liquidity Ratio

+ Provisional/Forecast

39. Last month's report highlighted the sudden renewal of interest in building society term shares. The figures for June suggest that this may only have been a temporary phenomenon and we expect that for the next 2 months inflows will do no more than match outflows. In banking September it is expected that a tranche of maturing stock will produce a net outflow distorting PSL2 up relative to PSL2A. Table 9 below shows the growth rates of PSL2 and PSL2A relative to that of £M3 over the last 12 months.

Table 9: Growth rates* of monetary aggregates

(12 month growth rates, %)

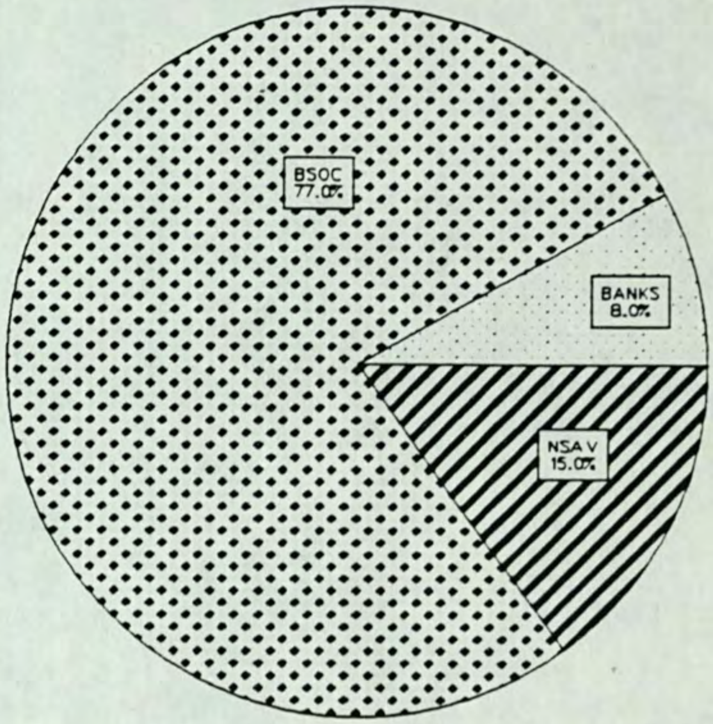
1984	PSL2 - £M3	PSL2A - £M3
Banking:		
July	4.4	4.5
August	4.2	4.3
September	4.1	3.6
October	5.2	4.3
November	4.7	3.1
December	5.0	3.4
1985		
Jan	5.4	3.5
February	5.4	3.3
March	5.4	3.2
April	3.5	1.6
May	3.2	1.8
June	2.5	1.2

* Twelve month growth rates (%)

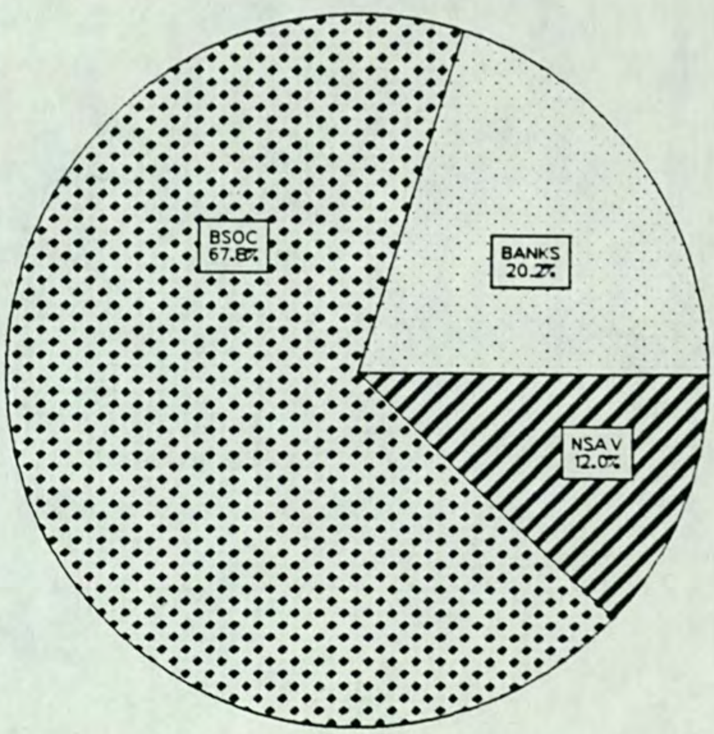
40. The table shows that over the last 3 months the wedge between the rates of growth of £M3 and the PSLs has been reduced. This reflects, in the main, the stronger competitiveness of retail bank deposits in the aftermath of CRT, and in particular the attractiveness of the new high-interest cheque accounts. Chart 6 shows how retail savings have been allocated in the first 5 months of 1985 compared with the same period last year. The salient feature is the improved performance of the banks.

CHART VI

SHARES IN RETAIL INFLOWS JAN–MAY 1984



SHARES IN RETAIL INFLOWS JAN–MAY 1985



Retail Inflows

41. Table 10 brings together our forecast for retail inflows to National Savings, building societies and banks. Greater uncertainty than usual surrounds the retail projections given the difficulties involved in interpreting the banking June figures.

42. The major problem of interpretation in the case of June relates to the very high figure for retail bank deposits resulting from the Bank's treatment of the money held on suspense accounts on make up day. In addition, retail bank deposits may have benefitted from a tranfer from buildings societies as investors prepared for the BT second call, but this was probably more than offset by the outflow of money unsuccessfully put up for BAe and money paid early in respect of the BT sale. The total effect of these distortions was to raise retail bank deposits by some £2.2 billion above their underlying level. For the building societies the outflow of money for BT and Abbey Life was to some extent counteracted by the length of the banking month which pushed up the positive seasonal still further.

43. Over the forecast period we expect that these distortions will fully unwind. As usual we are assuming that there is no change in interest rates over the forecast period, suggesting little or no change in the underlying pattern of inflows. In the light of the June figures, and in line with the Bank's calendar month forecast, we have revised up our view of the level of underlying building society inflows by £100 million to £1200 million or so per month. This reflects the increasing competitiveness of the smaller building societies and the continuing high level of the larger societies' premium rates. In contrast, we expect to see a gentle fall in National Savings underlying inflows as high-rate taxpayers come up against the holding limits on the tax-free instruments. The forecast implies that total retail inflows will remain fairly constant on a monthly basis at a level somewhat higher than over the last year, reflecting historically high interest rates.

SECRET

Table 10

RETAIL INFLOWS

£million (seasonally adjusted)

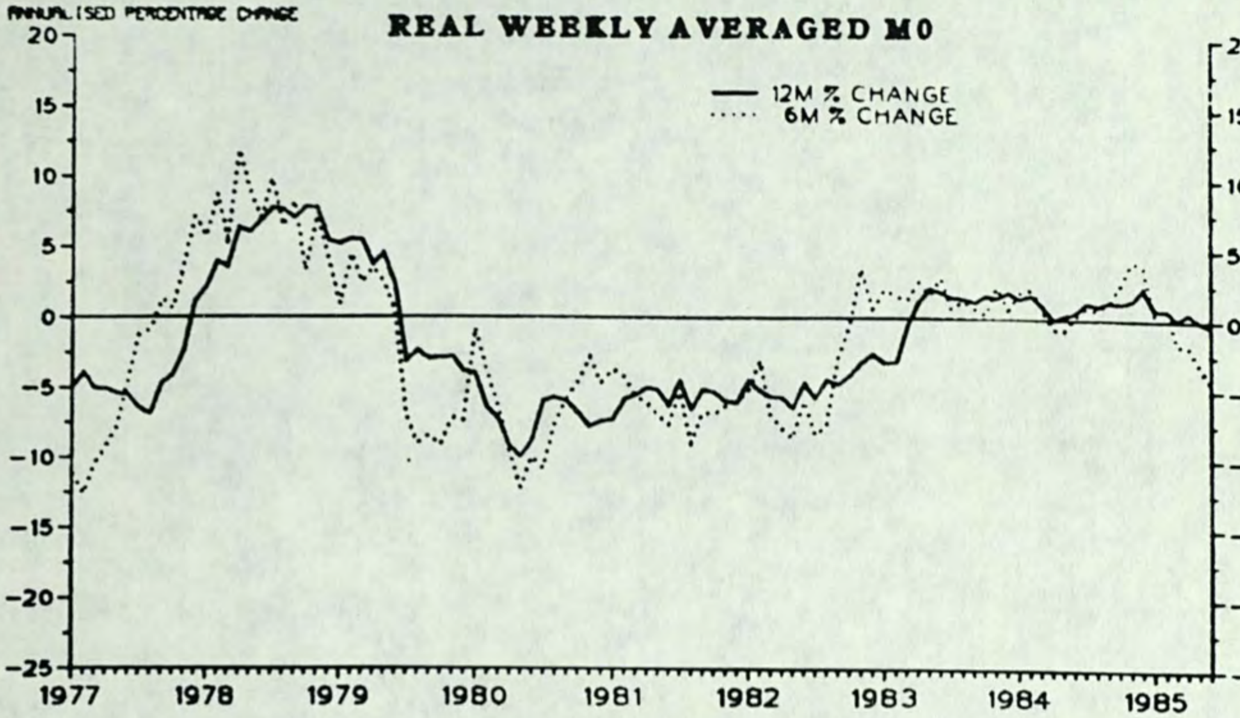
	OUTTURN			FORECAST		
	Average Monthly change since mid-May 1984	MAY	JUNE	JULY	AUGUST	SEPTEMBER
RETAIL BANK DEPOSITS						
NIB SIGHT	229	229	2269			
IB CHEQUABLE	217	529	486	-2430	375	425
IB OTHER	78	-28	-96			
TOTAL BANK	524	730	2659 [190] (425)	-2430 (425)	375 (425)	425 (425)
BUILDING SOCIETIES	1039	1039	1141 [1100] (1210)	1225 (1225)	1310 (1230)	1235 (1235)
NATIONAL SAVINGS	271	249	378 [370] (300)	290 (290)	330 (270)	160 (250)
TOTAL RETAIL	1819	2018	4178 [1660] (1935)	-915 (1940)	2015 (1925)	1820 (1910)

[ ] Last month's forecast

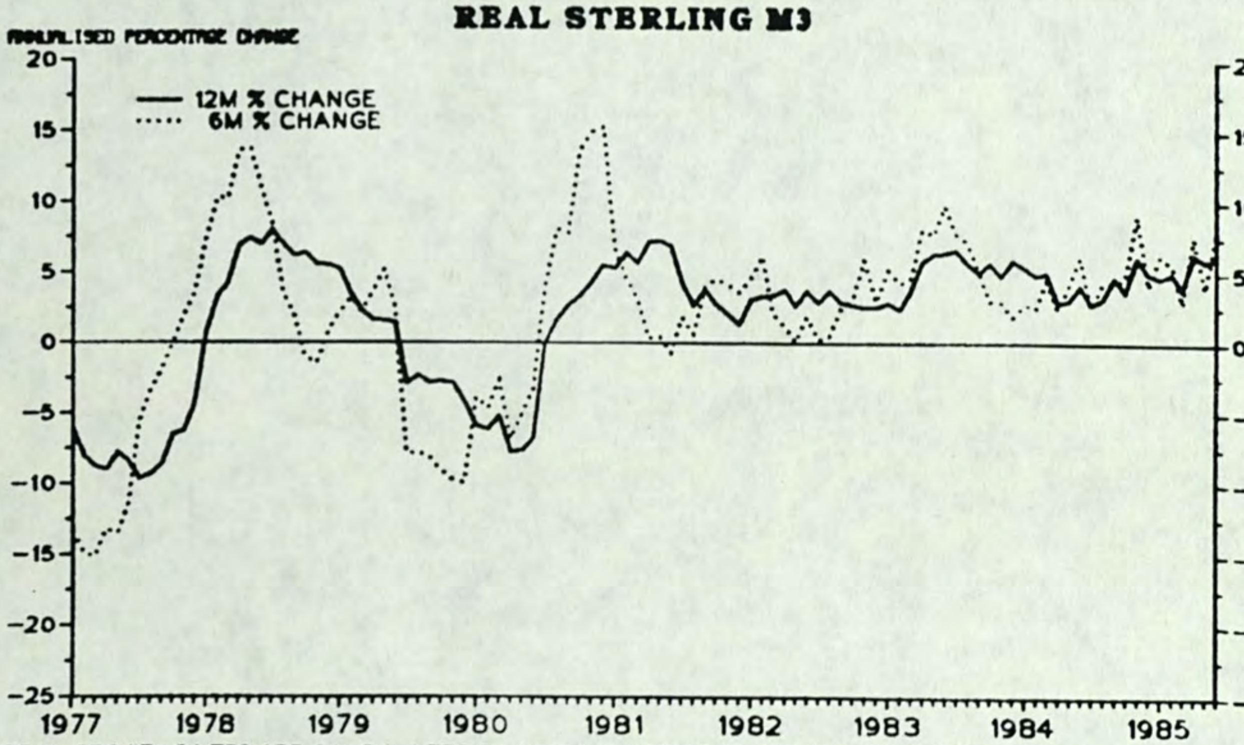
( ) Underlying inflows

CHART VII: GROWTH RATES OF REAL MONETARY AGGREGATES

REAL WEEKLY AVERAGED M0



REAL STERLING M3



REAL GROWTH RATES ARE CALCULATED BY DEFLATING BY THE GROWTH OF THE RPI EXCLUDING THE MORTGAGE ELEMENT

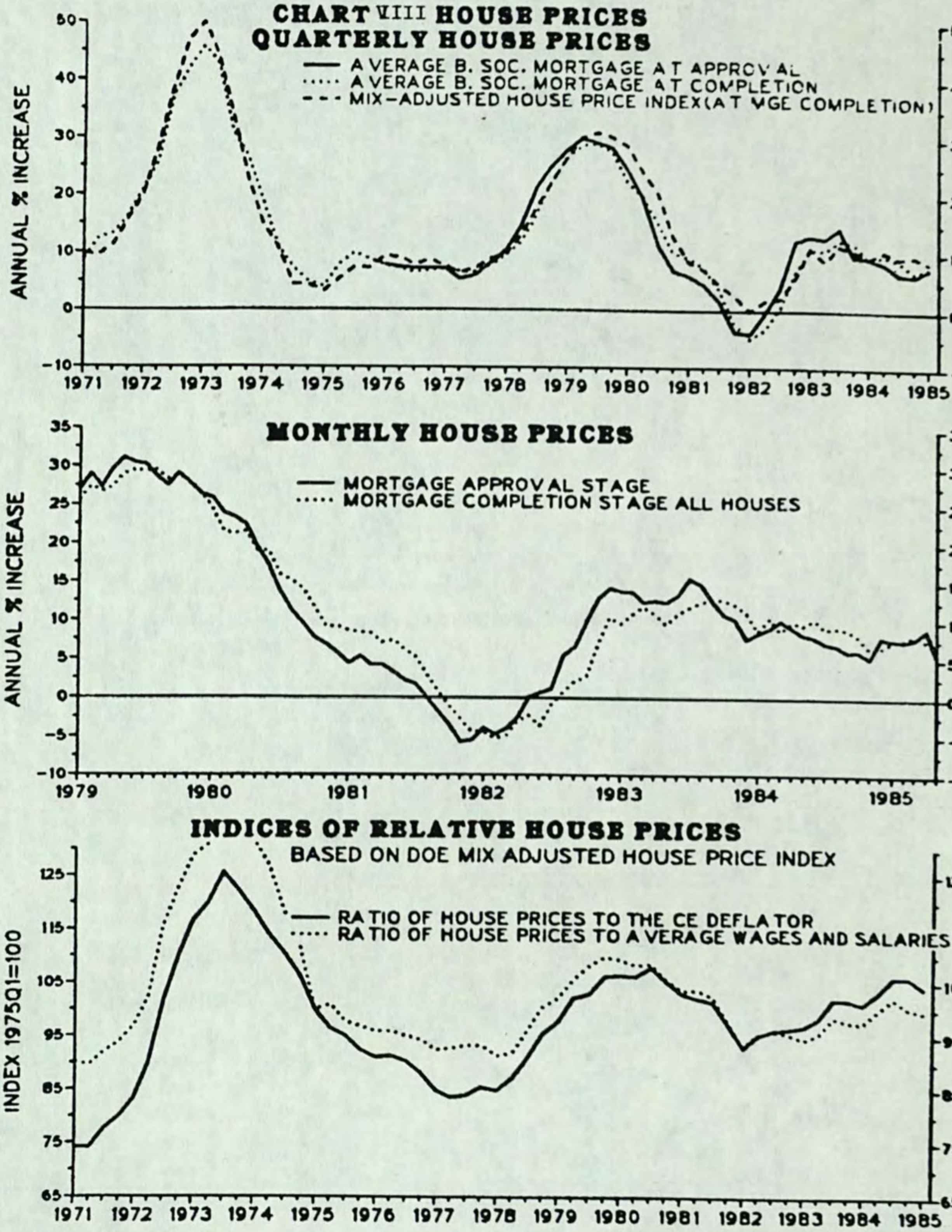
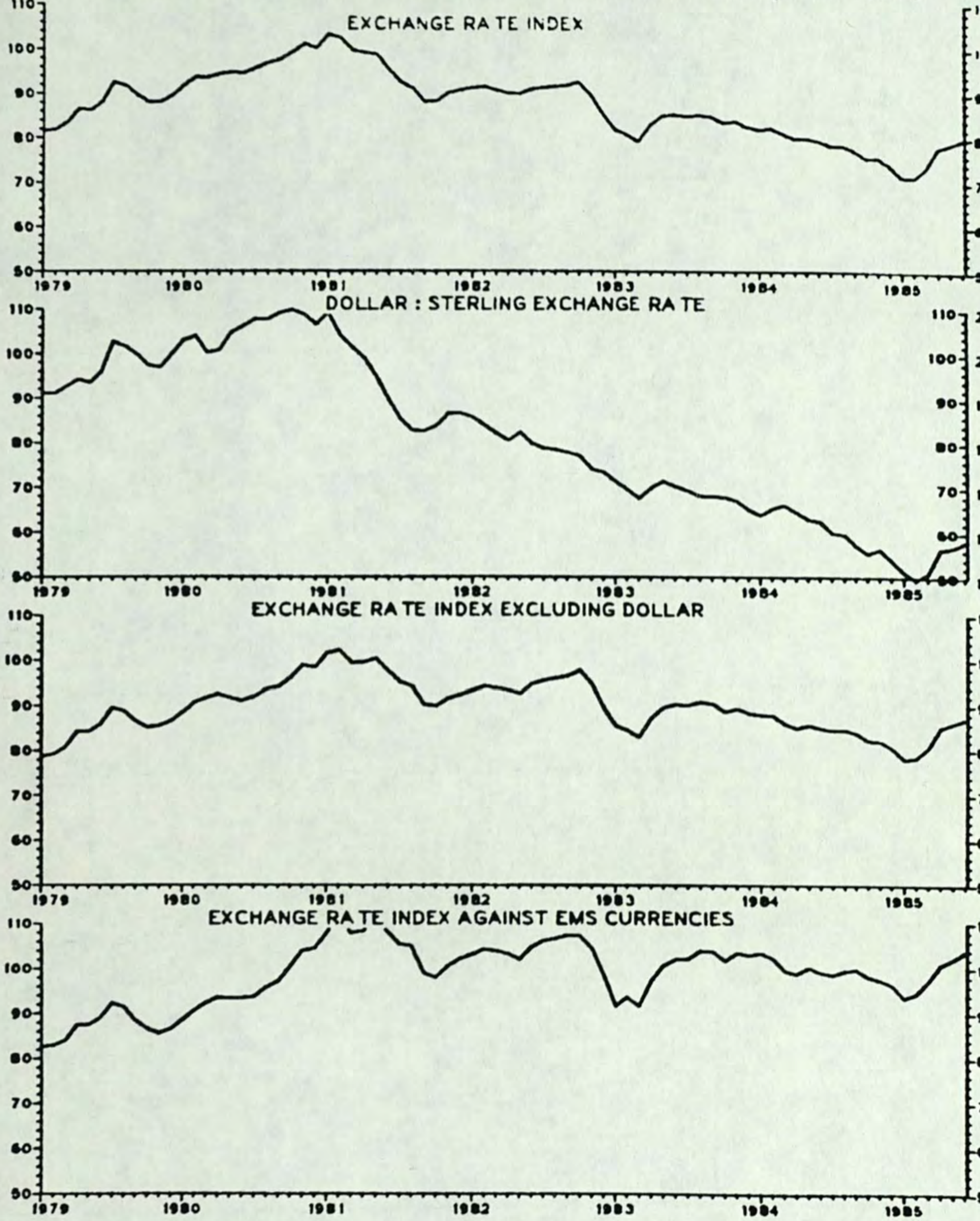


CHART VIII HOUSE PRICES
QUARTERLY HOUSE PRICES
AVERAGE B. SOC. MORTGAGE AT APPROVAL
AVERAGE B. SOC. MORTGAGE AT COMPLETION
MIX-ADJUSTED HOUSE PRICE INDEX(AT MGE COMPLETION)
ANNUAL % INCREASE
50
40
30
20
10
0
-10
1971 1972 1973 1974 1975 1976 1977 1978 1979 1980 1981 1982 1983 1984 1985
MONTHLY HOUSE PRICES
MORTGAGE APPROVAL STAGE
MORTGAGE COMPLETION STAGE ALL HOUSES
ANNUAL % INCREASE
35
30
25
20
15
10
5
0
-5
-10
1979 1980 1981 1982 1983 1984 1985
INDICES OF RELATIVE HOUSE PRICES
BASED ON DOE MIX ADJUSTED HOUSE PRICE INDEX
RATIO OF HOUSE PRICES TO THE CE DEFLATOR
RATIO OF HOUSE PRICES TO AVERAGE WAGES AND SALARIES
INDEX 1975Q1=100
125
115
105
95
85
75
65
1971 1972 1973 1974 1975 1976 1977 1978 1979 1980 1981 1982 1983 1984 1985

CHART IX: STERLING EXCHANGE RATE INDICES (1975=100)



NOTE : ALL SCALES ARE EQUIV ALENT