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MR NORGROVE

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FUNDING POLICY

The Prime Minister's monetary policy meeting in mid July decided to stop over-funding of the PSBR. At today's regular Treasury meeting on funding policy, it was reported that net sales of gilts to all sectors were a modest £600 million or so in the banking months of August and September combined - considerably below the PSBR. So the total stock of money market assistance fell dramatically from a peak of almost £17.5 billion in late July to around £14 billion now.

Because we raised so much less from the gilts market, Sterling M<sub>3</sub> grew rapidly. It has grown at an annual rate of well over 13%, compared with a target range of 5-9%.

It would be very worrying if the underlying position were as bad as the Sterling M<sub>3</sub> figures suggest. But there are reasons for believing they are misleading. Some of the increase in Sterling M<sub>3</sub> is accounted for by long-term interest-bearing savings, which will not be spent but will nevertheless fall within our definition of broad money. M<sub>0</sub> is within its target range. More widely, the PSBR seems to be reasonably well on track; interest rates are still high; inflation is at last coming down; and the City doesn't seem particularly jittery. But a plummeting oil price, or any

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suggestion of weakening resolution on public expenditure and the PSBR, could change all that. The Treasury are still cautious about cutting interest rates.

The forecast for the next few months envisages a slight improvement in the performance of Sterling M<sub>3</sub> - maybe growing at 1% a month. The hope is that the massive bill mountain may shrink further over the next couple of months.

Meanwhile, the relative stability in the domestic financial markets, and our low gilt sales, are bringing gilt yields down towards 10%. The 20-year gilt yield has not fallen below 10% under this Government. It would be very good news if it did fall below this crucial psychological barrier, though - as often in the City - there are signs of resistance whenever we approach it.

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