

GPS 650

RESTRICTED [cccc]

**RESTRICTED**

DESKBY 140900Z

FROM WASHINGTON 131720Z APR 83.

TO IMMEDIATE F C O

TELEGRAM NUMBER 970 OF 13-APRIL

AND TO ROUTINE BONN, PARIS, UKDEL OECD, UKREP BRUSSELS, ROME,  
TOKYO, OTTAWA.

US MONETARY POLICY

FOR PS TO CHANCELLOR AND LAVELLE (TREASURY).

1. IN HIS TESTIMONY BEFORE THE HOUSE BANKING COMMITTEE ON 12 APRIL, FED CHAIRMAN VOLCKER CONFIRMED THE GROWTH RATES FOR THE MONETARY AGGREGATES PRESENTED TO CONGRESS IN FEBRUARY, (4-8 PER CENT FOR M1, 7-10 PER CENT FOR M2 OVER A FEBRUARY MARCH BASE AND 6.5 - 9.5 PER CENT FOR M3). IN ADDITION HE STATED THAT IN VIEW OF THE VARIOUS INSTITUTIONAL DEVELOPMENTS WHICH HAD AFFECTED MONETARY RELATIONSHIPS, QUOTE WE HAVE PUT A GREATER PREMIUM ON JUDGEMENT AND LESS ON AUTOMATACITY IN OUR OPERATIONAL DECISIONS IN RESPONDING TO MOVEMENTS IN THE AGGREGATES IN RECENT MONTHS UNQUOTE.

2. THE MONETARY AGGREGATES, ESPECIALLY M2 HAD GROWN STRONGLY IN THE FIRST FEW MONTHS OF THE YEAR, MAINLY DUE TO INFLOWS INTO THE NEW MONEY MARKET ACCOUNTS. BUT THE FED BELIEVED THAT THE GROWTH OF THE BROADER AGGREGATES MAY BE SLOWING AND THAT MONETARY POLICY WAS CONSISTENT WITH THE OBJECTIVES SET OUT IN FEBRUARY. VOLCKER ADDED THAT THIS IMPLIED AN EXPECTATION THAT MONETARY GROWTH, ESPECIALLY M1 AND M2 WOULD SUBSIDE IN THE COMING MONTHS. PROLONGED GROWTH OF THE AGGREGATES AT HIGH LEVELS WOULD BE A CAUSE FOR CONCERN.

3. ON THE PROSPECTS FOR THE ECONOMY VOLCKER INDICATED THAT THE FED BELIEVED A MODERATE RECOVERY WAS UNDERWAY. BUT THERE WERE STILL RISKS AND UNCERTAINTIES IN THE MEDIUM TERM OWING TO THE UPWARD PRESSURE ON INTEREST RATES FROM THE LARGE BUDGET DEFICITS. IN SUBSEQUENT QUESTIONING. VOLCKER IS REPORTED TO HAVE SAID THAT LONG TERM INTEREST RATES WERE TOO HIGH FOR A SUSTAINED ECONOMIC RECOVERY, ESPECIALLY AS INFLATION HAD FALLEN.

4. MUCH OF VOLCKER'S TESTIMONY AND THE SUBSEQUENT DISCUSSION IN THE COMMITTEE CONCERNED THE SENSE OF CONGRESS PROVISION INCLUDED IN THE HOUSE VERSION OF THE FIRST BUDGET RESOLUTION REQUIRING THE FED TO ESTABLISH OBJECTIVES FOR THE MAIN ECONOMIC VARIABLES. VOLCKER INDICATED THAT SUCH A MOVE WAS INAPPROPRIATE SINCE IT IMPLIED A DEGREE OF FINE TUNING IN MONETARY POLICY WHICH COULD PROVE COUNTER-PRODUCTIVE.

**RESTRICTED**

## RESTRICTED

5. THE MINUTES OF THE FEBRUARY MEETING OF THE FEDERAL OPEN MARKET COMMITTEE AT WHICH IT ESTABLISHED THE RANGE FOR THE GROWTH OF THE MONETARY AGGREGATES FOR 1983 HAVE JUST BEEN RELEASED. FOUR OF THE 12 COMMITTEE MEMBERS DISSENTED FROM THE COMMITTEES RECOMMENDATION, AN UNUSUALLY HIGH DEGREE OF DISAGREEMENT. THOSE DISSENTING WERE CONCERNED THAT WITH THE NUMBER OF TARGETS ADOPTED (RANGES FOR THE 3 AGGREGATES AND BANK CREDIT) AND THAT THE DECISION TO GIVE LESS WEIGHT TO M1 WOULD MAKE IT MORE DIFFICULT TO CONTROL THE GROWTH OF THE MONEY SUPPLY.

6. THE MINUTES MAKE CLEAR THAT THE MAJORITY OF THE COMMITTEE CONCLUDED THEY HAD NO OPTION BUT TO ADOPT A MORE JUDGEMENTAL APPROACH TO THE INTERPRETATION OF MOVEMENTS IN THE AGGREGATES. THEIR ASSESSMENT OF THE APPROPRIATE GROWTH RANGES WAS CLEARLY COMPLICATED BY THE UNCERTAINTY OVER THE EFFECT OF THE NEW MONEY MARKET ACCOUNTS ON THE AGGREGATES, THE BEHAVIOUR OF VELOCITY IN 1983 FOLLOWING ITS SHARP FALL IN 1982, AND WHETHER THE NEW ACCOUNTS, ESPECIALLY THE SUPER-NOWS WITH THEIR SAVINGS ELEMENT WHICH ARE INCLUDED IN M1, WOULD ALTER THE RELATIONSHIP BETWEEN MOVEMENTS IN M1 AND GNP. THE DECLINE IN VELOCITY IN 1982 WAS ATTRIBUTED TO A STRONG PRECAUTIONARY DEMAND FOR MONEY AT A TIME OF ECONOMIC UNCERTAINTY. THE COMMITTEE ALSO CONCLUDED THAT AS A RESULT OF THE DECLINE IN VELOCITY, RIGID ADHERENCE TO THE 1982 TARGETS WOULD HAVE RESULTED IN A MUCH MORE RESTRICTIVE POLICY THAN HAD BEEN INTENDED.

FCO PLEASE PASS TO BOTTRILL (HMT), BROADBENT (FCO) AND WATSON(BANK).

WRIGHT

FINANCIAL  
NAD

(REPEATED AS REQUESTED)

- 2 -  
RESTRICTED