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FROM: S BROOKS/R D KERLEY  
 DATE: 17 AUGUST 1989  
 EXT: 4605/4614

1. MR PERETZ  
 2. CHIEF SECRETARY

cc Chancellor  
 Economic Secretary  
 Sir P Middleton  
 Sir T Burns  
 Mr Wicks  
 Mr Evans  
 Mr Odling Smee  
 Mr Scholar  
 Mr Sedgwick  
 Mr Grice  
 Mr O'Donnell  
 Miss O'Mara  
 Mr Ritchie  
 Miss Simspon  
 Ms Ryding  
 Mr Sheath  
 Mr Gray (No 10 Personal)  
 Sir A Walters (No 10 Personal)

The line to take and briefing do not draw attention to the faster growth of M0 since the end of July, in the first three weeks of August - nor do they need to do so. But in general I suggest that I DT keep a low profile in commenting on these figures.

*Del 17/8*

PROVISIONAL MONEY FIGURES - JULY 1989

(All figures are unadjusted unless specified otherwise)

1. The provisional money supply figures for July will be published by the Bank at 11.30am on Thursday 20 ~~August~~ These will be the first set of money figures published since the Abbey National converted from a building society to a bank, and the provisional press notice will not refer to M3 at all. We understand, however, that the final figures (published on 30 August) will permit M3 to be calculated easily, although even then it will not appear explicitly in the published figures.

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2. As usual M4 and M5 broad money figures are subject to revision.

3. Summary

Monetary Aggregates for July (per cent)

<u>Rate</u>	<u>Annualised Rates</u>				
	<u>Annual Growth Rate</u>		<u>Three Months</u>	<u>Six Months</u>	<u>Monthly Growth</u>
M0	5.2				1.9
	5.3	sa*	9.5	4.7	0.3
M4	16.7				0.9
		sa	16.3	18.3	0.6
M5	16.3				1.0
		sa	16.7	18.2	0.6

\* Seasonally adjusted

	<u>Lending £ billion</u>			<u>Per cent Growth Rates</u>	
	<u>This Month</u>	<u>Last Month</u>	<u>Average of Previous 6 months</u>	<u>Annual (Monthly) (unadjusted)</u>	<u>Previous Month Annual (Monthly) (unadjusted)</u>
Lending by					
Banks and	7.5	9.4	7.0	21.5	22.5
Building				( 1.6)	( 2.1)
Societies s.a.	6.9	7.2	7.0		



Table 2 attached gives the historical growth rates for M0, M4, M5, NIBM1, and bank and building -society lending. Tables 3 and 4 show respectively the components and counterparts for broad money together with the average change over the previous twelve months.

#### M0

4. M0 increased by 5.3 per cent (seasonally adjusted) in the twelve months ending in July, lower than June's 5.9 per cent and the smallest 12 month increase since February last year. Notes and coin rose by 0.4 per cent (seasonally adjusted) in July, less than June's rise of 0.9 per cent. But, while the July figures show further progress towards the target range, weekly figures for notes and coin in the first three weeks of August show larger increases on average than in July.

#### Broad Money

5. The twelve month growth rate of M4 was 16.7 per cent in July, well below June's figure of 18.5 per cent. This represents the smallest 12 month increase since May last year. The monthly increase of 0.6 per cent (seasonally adjusted) was well below the average increase of the previous six months.

6. Within the M4 components, the increase in total retail deposits was £2.2 billion (seasonally adjusted), a little below June's figure (£2.4 billion) and the average of the previous six months (£2.6 billion). The twelve month growth rate of the retail deposit component of M4 (seasonally adjusted) fell  $\frac{1}{2}$  per cent to 14 per cent. Analysis of the composition of the inflow is complicated by the Abbey's conversion. But it looks as if the switch away from non interest bearing sight deposits to the new interest bearing bank current accounts continued. Building societies retail inflows in July were much higher in July than in May or June in spite of the removal of the Abbey from the figures. The underlying inflow for the remaining building societies was probably similar to that of the first four months of the year. This recovery may ease the immediate pressures on some societies, making mortgage rate rises less likely.



7. The increase in wholesale deposits in July of £0.3 billion (seasonally adjusted) is very low by the standards of recent months, perhaps a reaction to June's very large increase of £6½ billion. The twelve month growth of wholesale deposits within M4 in July fell back to 27½ per cent (seasonally adjusted) from 32½ per cent in June. The July figure is close to those of the first five months of the year and June's figure now looks decidedly out of line with the others.

8. Within the M4 counterparts, the PSBR was overfunded by about £1 billion, in contrast to the underfunding of about £0.8 billion on average in the first three months of the financial year.

9. M4 lending was £6.9 billion on a seasonally adjusted basis, marginally lower than in June (£7.2 billion) and the average monthly increase in the first half of the year (£7.0 billion). Its twelve month growth rate fell by a full percentage point to 21.5 per cent, the seventh fall in a row. Last October's peak was 24.7 per cent. The six month growth rate of lending was 20 per cent in July, down from 21.3 per cent in June. The faster growth of M4 lending than of M4 in July is partly explained, arithmetically, by the increase in non-residents' sterling deposits which are not included in M4.

10. We have not yet seen the figures ourselves, but we understand from the Bank that CLSB banks' lending for consumption was low, about £40 million (of which credit cards £22 million). After applying their own unpublished seasonal adjustments, the Bank reckon that this implies an underlying increase of only around £100 million [NOT FOR USE], one of the lowest figures in the last two and a half years. The increase in lending for consumption has now fallen for four months in a row - but the series is erratic.

11. CLSB lending for house purchase was also low at £0.2 billion, both before and after the Bank's seasonal adjustment. This is less than half the average monthly increase (seasonally adjusted) in the second quarter [NOT FOR USE]. Lending by the building societies and the Abbey National was probably around £2 billion [NOT FOR USE], lower than in June (£2.3 billion) and a little below the second quarter monthly average (£2.1 billion). Overall the evidence is consistent with a continuing slowdown in mortgage lending as a whole, with the banks continuing to lose market share.



12. Lending to companies by CLSB banks was £1.8 billion, with the highest increases in the food drink and tobacco, property, and 'other services' sectors. But some sectors repaid debt, including hotels and catering, investment and unit trusts, and life assurance and pension funds.

Presentation

13. These figures should receive a mildly favourable reception from the markets. The average market expectation for M0 is broadly accurate this month, having been forecast more or less correctly from the Bank's weekly returns. M4 growth was very modest in July and well below market expectations. Both the six and twelve month growth rates fell back, the twelve month rate particularly sharply. As for bank and building society lending the rise was in line with the last three months but a little above the market expectation. However, the six and twelve month growth rates continued to decline steadily and the composition looks to be favourable, with the CLSB figures showing that lending for consumption was very low in July.

	Outturn June	"Average Market" Expectations
M0 - one month change: %	+1.9 (+0.3)	(+0.4)
M4 - one month change: %	+0.9 (+0.6)	(+1.4)
Bank and building society lending £ billion	+7.5 (+6.9)	(+6.4)

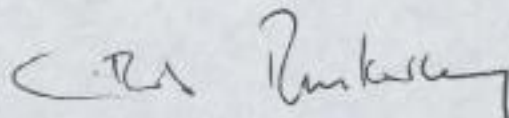
(figures in brackets seasonally adjusted)

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14. Against this background we recommend a line to take as follows:

"12 month growth rates of M0, M4 and bank and building society lending all lower than in June, as high interest rates have their expected effect."

15. We would be grateful for approval of the line to take and comments on the attached more detail briefing as early as possible tomorrow morning.



S BROOKS/R D KERLEY

cc Bank of England

Mr George  
Mr Thorp (Financial Statistics Division)



TABLE 2

S E C R E T (Until Publication)

£ million

## GROWTH RATES OF MONETARY AGGREGATES AND BANK &amp; BUILDING SOCIETY LENDING

			1988 Jul	Aug	Sep	Oct	Nov	Dec 1988	1989 Jan	Feb	Mar	Apr	May	Jun	Jul
M0	Monthly change	sa	147	157	256	-11	43	159	-130	-103	80	24	211	123	56
	Monthly % change	nsa	2.2	0.8	0.4	-0.6	0.5	7.5	-6.5	-2.2	1.9	0.1	1.6	0.3	1.9
	Monthly % change	sa	0.9	1.0	1.5	-0.1	0.3	0.9	-0.8	-0.6	0.5	0.1	1.2	0.7	0.3
	3-month annualised % change	sa	11.2	12.2	14.5	10.1	7.1	4.6	1.7	-1.7	-3.5	0.0	7.7	8.7	9.5
	6-month annualised % change	sa	8.6	10.9	12.4	10.7	9.6	9.4	5.8	2.6	0.5	0.9	2.9	2.4	4.7
	Annual % change	sa	6.9	7.6	8.5	7.7	7.7	7.7	7.2	6.6	6.2	5.7	6.2	5.9	5.3
M4	Monthly change	nsa	8062	2562	7528	2585	2906	5221	2114	3095	10026	1935	5555	9060	3545
	Monthly % change	nsa	2.5	0.8	2.2	0.7	0.8	1.5	0.6	0.9	2.8	0.5	1.5	2.4	0.9
	Monthly % change	sa	2.2	1.2	2.2	0.9	0.5	2.0	0.7	1.9	1.8	0.9	0.9	2.3	0.6
	3-month annualised % change	sa	20.8	23.6	25.0	18.5	15.3	14.1	13.5	20.0	19.3	20.4	15.8	18.0	16.3
	6-month annualised % change	sa	20.1	19.3	20.1	19.6	19.4	19.4	15.9	17.6	16.7	16.9	17.9	18.7	18.3
	Annual % change	nsa	17.4	17.3	18.7	17.4	17.7	17.6	18.1	18.6	18.1	18.0	18.2	18.5	16.7
M5	Monthly change	nsa	8289	2582	7795	2518	2963	4586	2273	3023	10151	2610	5550	9360	3947
	Monthly % change	nsa	2.4	0.7	2.2	0.7	0.8	1.2	0.6	0.8	2.7	0.7	1.4	2.4	1.0
	Monthly % change	sa	2.1	1.1	2.2	0.8	0.5	1.7	0.8	1.8	1.7	1.0	1.0	2.3	0.6
	3-month annualised % change	sa	20.2	22.6	24.3	18.0	15.2	12.8	12.6	18.3	18.7	19.8	15.8	18.6	16.7
	6-month annualised % change	sa	19.2	18.6	19.1	19.1	18.9	18.4	15.2	16.8	15.7	16.1	17.1	18.6	18.2
	Annual % change	nsa	16.8	16.6	18.0	16.7	17.1	16.6	17.3	17.8	17.1	17.4	17.6	18.0	16.3
M1B1	Monthly change	nsa	126	-284	1262	-353	141	1374	-3812	110	908	-1715	322	277	-596
	Monthly % change	nsa	0.3	-0.6	2.6	-0.7	0.3	2.8	-7.5	0.2	1.9	-3.6	0.7	0.6	-1.3
	Monthly % change	sa	0.9	-0.6	1.0	1.9	-1.6	3.5	-3.3	0.1	-0.1	-3.8	-1.0	-0.1	-1.1
	3-month annualised % change	sa	7.1	1.1	5.4	9.7	5.4	16.0	-5.8	0.9	-12.3	-14.2	-17.9	-18.0	-8.4
	6-month annualised % change	sa	11.1	6.7	4.9	8.4	3.2	10.6	1.6	3.1	0.8	-10.1	-9.0	-15.2	-11.3
	Annual % change	nsa	10.8	10.4	12.5	11.0	10.2	12.4	7.2	5.4	2.4	-1.3	-3.0	-3.4	-4.9
M4 LENDING	Monthly change	nsa	9075	4476	8864	6431	5321	7848	7407	4490	9830	4925	6077	9353	7453
	Monthly % change	nsa	2.4	1.2	2.3	1.6	1.3	1.9	1.8	1.1	2.3	1.1	1.4	2.1	1.6
	Monthly % change	sa	2.4	1.6	1.9	1.6	1.5	1.8	2.1	1.1	1.8	1.6	1.5	1.6	1.5
	3-month annualised % change	sa	27.2	26.8	26.4	22.7	22.0	21.4	23.7	22.0	22.1	19.9	21.7	20.6	20.1
	6-month annualised % change	sa	25.5	26.4	27.1	24.9	24.4	23.9	23.2	22.0	21.7	21.8	21.8	21.3	20.0
	Annual % change	nsa	23.5	24.1	24.2	24.7	24.5	24.6	24.4	24.3	24.2	23.4	23.2	22.5	21.5

TABLE 3 : PROVISIONAL BROAD MONEY COMPONENTS

£ millions

	JULY	AVERAGE GROWTH IN PREVIOUS 12 MONTHS
Notes and coins in circulation (M4ps)	-189	75
Bank & building society deposits (M4ps)		
Retail		
non interest bearing	-382	-223
interest bearing	2689	2825
Wholesale	1427	2377
<u>Change in M4</u>	<u>3545</u>	<u>5054</u>
Money market instruments (M4ps)	400	63
National Savings Bank (M4ps)	2	25
<u>Change in M5</u>	<u>3947</u>	<u>5141</u>

M4ps = non-bank, non-building society private sector



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TABLE 4 : PROVISIONAL BROAD MONEY COUNTERPARTS

		£ millions	
JULY 1989		M4	M5
1.	PSBR	-1398	-1398
2.	Debt sales to private sector (-)		
	Gilts	543	543
	Treasury Bills	-182	
	National Savings	30	32
	CTDs	-114	
	Other CG debt	2	2
	LA and PC debt	217	262
3.	External finance of the public sector (-)	-116	-116
4.	Public sector contribution (1+2+3)	-1018	-675
5.	Sterling lending to private sector	7453	7512
6.	Externals	-2857	-2857
7.	NNDLs	-33	-33
8.	Total change (4+5+6+7)	3545	3947
	(Percentage change)	( 0.9	1.0 )

## AVERAGE CHANGE IN PREVIOUS 12 MONTHS

1.	PSBR	-1075	-1075
2.	Debt sales to private sector (-)	1047	1133
	o/w Gilts	1029	1029
	Other public sector debt	72	81
3.	External finance of the public sector (-)	82	82
4.	Public sector contribution (1+2+3)	53	140
5.	Sterling lending to private sector	7008	7009
6.	Externals	-765	-765
7.	NNDLs	-1243	-1243
8.	Total change (4+5+6+7)	5054	5142
	(Percentage change)	( 1.4	1.4 )

**MONEY SUPPLY IN JULY: PRESS BRIEFING**

**A. LINE TO TAKE**

12 month growth rates of M0, M4 and bank and building society lending all lower than in June, as high interest rates have their expected effect.

**B. THE FIGURES IN DETAIL**

**i. Changes in main monetary aggregates**

	<u>M0</u>	<u>per cent</u> <u>M4</u>	<u>M5</u>
12 month growth rate	+5.2 ( +5.3)	+16.7 (+17.1)	+16.3 (+16.7)
Annualised six-month growth	(+4.7)	(+18.3)	(+18.2)
Annualised 3-month growth	(+9.5)	(+16.3)	(+16.7)
one month change	+1.9 ( +0.3)	+0.9 (+0.6)	+1.0 (+0.6)

(Figures in brackets seasonally adjusted s.a.)

**ii M0: growth rates (sa)**

	<u>3 month</u> <u>annualised</u>	<u>6 month</u> <u>annualised</u>	<u>12 month</u>
December	4.6*	9.4	7.7
January	1.7	5.8	7.2
February	- 1.7	2.6	6.6
March	- 3.5	0.5*	6.2
April	0.0	0.9	5.7
May	7.7	2.9	6.2
June	8.7	2.4	5.9
July	9.5	4.7	5.3

\* slightly distorted downwards by postal strike in 3 months to December and in 6 months to March



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- a. Annual growth rate (s.a) Fallen back again after pick up in May.
- b. Annual growth rate (unadjusted): Seasonally adjusted rate better guide to underlying monetary conditions.
- c. 3 month growth rate somewhat higher than in recent months, but very sensitive to uncertain seasonal factors due to timing of bank holidays.
- d. 6 month growth rate Shows pick up from June but still well down on peak levels experienced in 1988. Confirms slowdown from end of last year.
- e. One month growth (s.a) shows modest 0.3 per cent rise on June.

iii. Broad money

[Note - as announced on 29 June M3 (and M1 and M3C) no longer published following the large break in series caused by Abbey National's Conversion.]

M4: growth rates

	3 month+	6 month+	12 month*
May	15.2	15.5	16.0
June	15.4	15.5	16.8
July	20.8	20.1	17.4
August	23.6	19.3	17.3
September	25.0	20.1	18.7
October	18.5	19.6	17.4
November	15.3	19.4	17.7
December	14.1	19.4	17.6
January	13.5	15.9	18.1
February	20.0	17.6	18.6
March	19.3	16.7	18.1
April	20.4	16.9	18.0
May	15.8	17.9	18.2
June	18.0	18.7	18.5
July	16.3	18.3	16.7

+ sa and annualised

\* unadjusted

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- a. One month growth (sa) shows very modest 0.6 per cent rise on June.
- b. 3 month growth rate: Very erratic. Fell back sharply in July after pick up in June. Well below peak growth rates experienced in July-September 1988.
- c. 6 month growth rate: Declined slightly and remains below peak figures seen in latter half of 1988.
- d. 12 month growth rate: Unadjusted rate fell back sharply to lowest level since May 1988.

iv. Lending

- (a) One month changes:

	<u>Bank and building society lending</u>			
	sa		nsa	
	<u>£bn</u>	<u>%</u>	<u>£bn</u>	<u>%</u>
December	+7.4	+1.8	+7.8	+1.9
January	+8.7	+2.1	+7.4	+1.8
February	+4.8	+1.1	+4.5	+1.1
March	+7.8	+1.8	+9.8	+2.3
April	+7.1	+1.6	+4.9	+1.1
May	+6.6	+1.5	+6.1	+1.4
June	+7.2	+1.6	+9.4	+2.1
July	+6.9	+1.5	+7.5	+1.6

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## (b) Bank and building society lending: growth rates

	<u>3 month+</u> %	<u>6 month+</u> %	<u>12 month*</u> %
July	27.2	25.5	23.5
August	26.8	26.4	24.1
September	26.4	27.1	24.2
October	22.7	24.9	24.7
November	22.0	24.4	24.5
December	21.4	23.9	24.6
January	23.7	23.2	24.4
February	22.0	22.0	24.3
March	22.1	21.7	24.2
April	19.9	21.8	23.4
May	21.7	21.8	23.2
June	20.6	21.3	22.5
July	20.1	20.0	21.5

+ s.a and annualised

\* unadjusted

(c) 12 month growth rate (unadjusted): Further confirmation of slowdown after period of broad stability.

(d) 6 month annualised growth rate (adjusted): Last few months shown considerable slowdown.

(e) 3 month annualised growth rate (adjusted): Erratic, but slight fall and at level well down on peak growth rates experienced in summer 1988.

v. CLSB lending

Lending for consumption - £40 million. Lending for house purchase - £200 million. Both low.

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vi. Funding.

(a) Overfund (on M4 definition) in July of £1.0 billion;  
PSBR surplus in July of £1.4 billion.

(b) Cumulative over/underfunding:

Financial year 1989-90 to date: £1.4 billion underfund;  
(£2.2 billion overfund carried over from 1988-89 and  
earlier years.)

Last 12 months: cumulative overfund of £0.2 billion.

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C. DEFENSIVE

- i. M0 growth still not within target range? Annual growth rate slowed in July. [If pressed: Will re-enter target range soon.]
- ii. Broad money still growing strongly? Very modest growth in July and 12 month growth rate now lowest since May 1988.
- iii. Government should adopt Divisia Index as its target monetary aggregate. [A divisia index weights assets according to their liquidity - in fact weights vary inversely with interest rate on particular assets. Advocated in FT article on 16 August.]

No. M0 has proven track record. However, the components of such an index are monitored as part of Government's continuous and comprehensive assessment of monetary conditions, and as MTFS says (para 2.22) the interpretation of broad money, or liquidity, requires considerable judgement.

- iv. Relatively buoyant lending figures indicate interest rate rises having no effect? No. 6 and 12 month growth rates continue to decelerate and currently well down on last year's levels. CLSB figures show lending for consumption at £40 million very low in July.

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INTEREST RATES: BRIEFING ON GENERAL POLICY

i. Recent interest rate increases

(a) Future movements in interest rates? Interest rates will stay as high as is needed, for as long as is needed, to bring inflationary pressures under control. Chancellor said at Foreign Press Association on 11 July "Currently the rate is 14 per cent and I believe we will keep it at that level for some little while to come - if indeed we need to go higher we'll go higher, but certainly we need to keep it at 14 per cent for some time to come."

(b) Interest rates bearing excessive burden in adjustment process? Chancellor in Budget speech, 14 March: "Inflation is a disease of money; and monetary policy, is its cure.... Short term interest rates remain the essential instrument of monetary policy."

(c) Risk of 'hard landing'? Chancellor in Budget speech, 14 March: "But the question of just how soft or hard the so-called landing will be is not in the hands of the Government alone. The Government's task is to reduce inflation by acting, through monetary policy, to bring down the growth of national income in money terms. The task of business and industry is to control their pay and other costs. The more successfully they do so, the less costly in terms of output and employment the necessary adjustment will be."



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ii. Interest rates and industry

(a) Interest rate increases damage industry? [Latest figures show manufacturing output virtually unchanged between 1989Q1 and Q2.]

- Only to be expected that output growth would slow in response to tightening of policy. But manufacturing output still over 5 per cent above level a year ago.
- Rises in interest rates affects households far more than companies
- Have important influence on housing market (especially in South East) where rise in prices has been important influence on consumption growth and on household sector which is now substantial net payer of interest
- Companies, by contrast, now in far stronger position than for very long time and hence less effected by interest rate rises than in past
- Most larger firms can borrow long term and long term rates have risen much less than short rates. Now Government no longer making demands on gilt market, excellent opportunities for other borrowers, particularly for long term fixed interest debt.
- But even for those smaller businesses dependent on bank borrowing and adversely affected in short term, resurgence of inflation more likely to damage investment than period of higher interest rates. 1 per cent increase in interest rates, even if sustained for whole year raises costs by far less than 1 per cent rise in pay settlements.

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(b) Higher interest rates curb investment? [Latest CBI Quarterly Industrial Trends Survey showed fall in investment intentions.]

No. Latest CSO figures for manufacturing investment show rise of 13 per cent between 1989Q1 and Q2, although would expect investment growth to slowdown from exceptionally fast rates of last year. Even so, DTI Investment Intentions Survey (June) forecasts 15 per cent growth in manufacturing investment this year, and "further, though smaller" increase in 1990.

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