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From the Private Secretary

13 March 1987

1987 BUDGET- MTFS

The Prime Minister has seen the Chancellor's minute (undated) which set out his proposals for the PSBR and monetary targets for 1987/88 and the MTFS, and is content.

(David Norgrove)

Alex Allan, Esq.,
HM Treasury.

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Prime Minister

Content?

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PRIME MINISTER

1987 BUDGET: MTFS

Yes no

In my minute of 5 March, I set out my tax proposals and said I would let you have a further note on the PSBR and monetary targets for 1987-88.

Public Sector Borrowing

The latest estimates of the February PSBR show that cumulative borrowing in the first eleven months of the year was only £0.1 billion. Borrowing in March is always large, and there will be some special factors pushing it up further this year; these include the £680 million payment to Rover. The forecast I propose to publish for the out-turn for 1986-87 is £4 billion, though considerable uncertainties remain, particularly over likely borrowing by local authorities and public corporations.

That means the PSBR has now reached what I judge to be the appropriate level for the medium term: 1 per cent of GDP. I therefore propose to set the PSBR for 1987-88 at that level. Thanks to the strength of tax revenues, I can do that at the same time as implementing the £2.6 billion tax package we have agreed. Indeed, the resulting published PSBR of £3.9 billion will be underpinned by deliberately cautious estimates of revenue, including an assumption of a \$15 oil price.

For the remaining years of the MTFS period, I plan to show the PSBR remaining at 1 per cent of GDP. It is a major achievement to have reached this level well before we had earlier thought possible - a level recorded on only two previous occasions since the War.

Treasury now say that figures are only available from the early 50s and that in any case in some years in the late 40s there would probably have been surpluses.



Monetary Targets

As I mentioned when we spoke yesterday, for 1987-88 I intend to set a target for M0 but not for £M3. As you know, we have had increasing difficulties in interpreting changes in broad money; £M3 has for several years been erratic and shown a tendency to grow more rapidly than money GDP. This year, it has once again grown well above its target range. I do not think that dropping the £M3 target will cause any surprise at all: indeed, the markets would be surprised if it were not dropped. And as the Governor's Loughborough Lecture indicated, there is no point in switching to any other broad money target: all broad aggregates are in much the same boat.

The velocity of M0 has been much more stable, and M0 has remained within its target range of 2 to 6 per cent during 1986-87. For 1987-88, the illustrative range we set in last year's FSBR was also 2 to 6 per cent, and I see no reason to change that now. For the future years of the MTFS I shall also be publishing the same illustrative ranges as in last year's FSBR.

The dropping of a broad money target does not mean that the whole weight of monetary policy is thrown on to M0, though that has a very important role to play. I shall continue to assess monetary conditions in the light of all the available indicators, including in particular the exchange rate. And I will make it clear that, although I am not setting a formal target for £M3, I shall continue to take broad money into account in assessing monetary conditions.

This approach has been fully discussed with the Bank who support these recommendations.

These proposals will give us a solid financial framework for the medium term. I would be glad to know if you are content with them.

N.L.

XRL.