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19.12.79

MR.FFORDE

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MONETARY CONTROL

See 12.12.79

Having read the papers and listened to the arguments I do not find it easy to arrive at a view on how our proposal would be received by commentators if it were to form the main change in the consultative document. This is not to criticise the analysis which is impressive and far beyond anything the press will have seen, let alone written about. However, as I understand it, the argument turns importantly on how financial markets might interpret and react to changes in specified short-term interest rates triggered by movements in the selected aggregate; and if they have read the annex on the choice of aggregate they may be as puzzled and perplexed as me about how they should respond. Any such confusion would be compounded no end if seasonal adjustment problems or other technical difficulties affecting the weekly figures should emerge at an early stage of the game. Recent occasional episodes notwithstanding, the markets have been cast in a supporting role in London for so long they may find it very difficult to accept the lead. Perhaps this is what the consultative process is intended to reveal; but I would not be surprised to see a very mixed and uncertain press reporting of market views.

As for the pundits, the verdict may be mixed for different reasons. The monetary base purists, represented by the Banker, may complain about a side-step, particularly if no changes are to be contemplated in funding techniques. Disappointment on this latter score is likely to be expressed by the Financial Times, while Anthony Harris and, less predictably, Sam Brittan will also criticise the choice of trigger aggregate - whatever it might be. Since they do not have a known position it is more difficult to forecast the attitudes of the Guardian, Daily Telegraph or Economist; nor are the Sundays' preferences known. Broadly, I suppose the Guardian,

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Observer and Sunday Times would oppose automaticity, and the two Telegraphs welcome it. The Economist might dodge and join the complainers about funding. Of course, the press may also expect to participate in some sense in the consultative process, and this is something to which some thought will have to be given before the document is issued.

One point which strikes me is that the great weight of our deliberations in the Bank so far has been on the technical aspects of any changes in the system of controls. I wonder whether we ought not to be standing back a pace and asking much broader questions in the same general category as the EMS issue. Mightn't we be concentrating on devising a system equipped to handle particular pressures that may anyway ease substantially well within the next decade and be replaced by others? For example, might not the fiscal/monetary policy imbalance disappear under the influence of North Sea oil revenues in the next five years? What would this imply for private sector credit demands and financial markets generally? If this or a subsequent Government should adopt protectionist policies - not a remote possibility in my view - have we an idea how the financial system would be affected? Will large OPEC surpluses and no exchange controls bring different effects for UK financial markets from those which we saw after 1974?

The obvious retort to such questions is that they require that we should foresee the unforeseeable; and that one can only operate on the basis of existing policies. However, much of the criticism which the Bank has attracted on the consequences of Competition and Credit Control has been of precisely this nature - our failure to recognise the risks that a change in the financial structure would bring if this should be followed by a change in policy.

One particular criticism arising from that change sticks with me and may be worth recalling, namely that the Bank failed to appreciate that even a market-oriented Conservative Government would baulk at raising interest rates to the levels needed to clear the credit market. Almost all the signs point the other way at present. Nevertheless there are also signs that rising interest rates are not accepted with equanimity; and that there is a desire on the part of some Ministers to "get hold of the banks". Neither of these suggests that a scheme offering interest rate automaticity will suit all ministerial appetites; but it might commend itself to us for precisely the same reasons.

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