SECRET 10. 4.80

THE GOVERNOR

Copy to The Deputy Governor

He lunched and saw the Governors afterwards 11/4

POINTS FOR SIR DOUGLAS WASS

1. Markets

   (a) Domestic - the Bank's operations and the stock issue. ?Methods of announcements of operations. - Books pp. 8/4 behind

   (b) Foreign Exchange - the dollar in the light of recent events.

2. Indexation. - T/S protem
3. Interest sensitivity (CAEG's note of 3rd April attached). - Top filed in MP Dom
4. Select Committee. - incl. Forecasts - DOSS protem
5. Consultation Document - the consultative process. - MC doss
6. Banks' profits. - JMS safe - E2
7. ?Basle.
8. ?Hamburg.
9. ?CFI.

10 Consumer Credit — papers [illegible]

J.S.Beverly (4121),
Governors' Office.
10th April 1980.

Top filed in MP Doss CONFIDENTIAL 3. 4.80

THE GOVERNORS

Copies to: Mr.Fforde o/r
Mr.Dow
Mr.Page
Mr.Walker
Mr.Dicks-Mireaux
Mr.George
Mr.Coleby
Mr.Flemming
Mr.Quinn
Mr.C.T.Taylor
Mr.Foot
Mr.Green
Group 7/2

As I have suggested, we need to meet on this

GR 8/4

G.P.S. will arrange: at a convenient time JB

GR 20/4

1) Mr Goodhart

2) Gov. office

We tried to arrange a meeting last week but failed. Would a meeting still be useful please JB 7/5

Sir Douglas Wass's Meeting on
Interest Sensitivity, 3rd April 1980

1. Sir Douglas Wass took a meeting, re-arranged from an earlier date, on Thursday, 3rd April, to discuss the various papers on the interest sensitivity of monetary aggregates. The papers for this meeting were my own, Mr.Britton's, Mr.Middleton's covering note (all three of which have been previously circulated to you), and a final note on 'Interest rates and the control of the money supply' circulated by Bridgeman yesterday afternoon (a copy of which is attached).

2. The meeting itself turned out to be relaxed and analytical, indeed in something of a pre-Easter holiday mood. Wass saw the purpose of the session as providing mind-clearing analysis, which was not intended to have any direct operational or policy implications, but might help him to respond to subsequent operational problems when they occurred.

3. At the outset Wass suggested that the meeting should not consider the issue of whether £M3 was the most suitable target aggregate, but should confine itself to the question of whether, and how, interest rates in particular, but also other instruments, might affect £M3. Andrew Britton especially had queried whether movements in interest rates would be effective in controlling £M3 either in the short-run or in the long-run. Britton did not receive much support. It was widely agreed, and urged by both Middleton, Bridgeman, Burns and myself, that major changes in the level of interest rates, particularly in real terms relative to the rate of inflation, did have major effects in determining monetary conditions in the long-term. The real difficulty was the uncertainty about the speed and extent of the effect of interest rate changes on monetary growth in the shorter-term.

4. It was agreed that the authorities, the Bank and the Treasury, had actually been remarkably successful in stimulating gilt sales in response to short-term changes in MLR. It was, however, noted that this was perhaps easiest to do in those circumstances when public sector debt sales had fallen away, because of uncertainties, e.g. of the future path of inflation and interest rates, and an increase in interest rates was needed to 'unlock' the gilts market. Sir Douglas Wass was, however, worried whether there might be other circumstances leading to unduly fast monetary growth, especially when the monetary growth was caused by higher bank lending (but in which debt sales to the non-bank public were proceeding at quite a good pace), in which an increase in interest rates might have significantly less short-run response, so that the authorities would have to depend then on the longer-run, slow response of bank lending to such interest rate changes.

5. Under these circumstances, when monetary control required rather a reduction in the pace of bank lending than a further increase in debt sales, there might, Wass thought, be less possibility of relying on interest rates for a quick response. Under such circumstances there could be a case, he suggested, for some kind of direct control to lead to a shorter-term 'cosmetic' effect on monetary aggregates. However, he accepted that this would just lead to disintermediation, especially following the abolition of exchange control, which would have no real effect and would lead to the discrediting of the monetary target. These latter arguments against direct controls were strongly pressed by Bridgeman.

6. Britton, on the other hand, felt that there was still a case for trying to develop a shorter-dated public sector debt market, in such a way as to make sales to the non-bank public in this market a residual source of government financing. Again Bridgeman said that he doubted whether this would be effective; it would be difficult to achieve the development of such a market and even were it achieved at the short end, the flows between £M3 and liquid short-dated public sector debt would also seem to be largely cosmetic. I added at this point that at the moment, sales of public sector debt, other than gilts, often tended to have a perverse impact on monetary control, partly because certain interest rates could not be adjusted flexibly e.g. on national savings, and partly because some of the markets e.g. the local authority market, were not under our own control. Middleton again argued that there could be some advantages in cosmetic

shifts between money and other liquid assets, but Burns insisted that unless the effects netted out within six months there would tend to be severe disadvantages in misleading both the authorities and the public.

7. There was no discussion on techniques in the gilt market at all; Wass excluded the matter from discussion when Middleton tried to raise it. Wass did suggest that under certain circumstances, particularly when bank lending was growing excessively, the only effective response to cut back such monetary growth might be fiscal. There were difficulties in preparing a suitable short-term fiscal instrument for this purpose. The Regulator was the only available short-term fiscal instrument, but because of its effects on prices, it was particularly unsuitable for use in monetary control. There was need to think again whether it would be possible to devise a short-term fiscal instrument which could be varied quickly by decree, which would have a useful and quick effect on monetary growth. HMT officials thought it would be difficult to devise such a fiscal instrument. Middleton, rather unhelpfully, mentioned that the only quick source of money in the present circumstances might be oil companies and banks.

8. Besides the above possible exercise on fiscal instruments, the further work that was requested (not from me) was as follows. It was argued, particularly by Bridgeman, that more work was now needed on the banks' emerging and continuing liquidity problems, i.e. the difficulty and problems surrounding the shift in the banks' changing asset structure and the exhaustion of their holdings of public sector liquid assets. In addition Wass did agree that more work might be done on the possibilities of setting up and extending markets in short-term public sector debt. Finally, Bridgeman, in his attached note, did raise the question of channelling more of local authorities' borrowing through the central government, rather than have local authorities borrow directly on markets. Apparently he has already obtained the agreement of the Financial Secretary to this study, and is pursuing it at some speed.

CAEG

3rd April 1980.

C.A.E.Goodhart