

MR GOODHART

Copies to Mr Pforde o/r
Mr Dow
Mr George
Mr Gill
Mr Foot
Mr D W Green
GPS

POST MORTEM ON MONEY SUPPLY DEVELOPMENTS

I think we need several kinds of information in handy form. First, what has actually happened, since particular dates, to the aggregates and to the counterparts. Then estimates for the disintermediation and reintermediation and an analysis of the resulting underlying developments.

Secondly, we need an account of what we knew when. What warnings and estimates we gave of the effects of the corset and its removal. How inaccurate these were and what reasons may be deduced for any inaccuracies. It would be helpful to be able to recapture the flavour of expectations - our own and others - at particular times (in particular Pepper's celebrated warning that we were going to undershoot).

Thirdly, we need a major analysis of developments in bank lending and its components (especially lending to persons) perhaps since May 79. It might be helpful to compare developments this time with those during the previous recession and attempt an explanation as to why M3 and bank lending fell off so much more quickly then.

Fourthly (this will be especially relevant for the Chancellor's meeting with the clearers and will no doubt draw on what EAJG is learning from the CEOs), we need to be able to say as much as we can (a) about what the clearers know and can say about developments in bank lending at present; (b) what are the factors limiting how much they know; and (c) are there any ways in which they could improve their knowledge. A similar question but going wider than bank lending arises for us. What are the limitations on what we know

about

about all the counterparts of M3 at any point. Are there any ways in which we could improve our knowledge or get it more quickly.

This is not meant to be as inquisitorial as it may sound; and I imagine a lot of what I have asked for is already being prepared or already exists in different forms. But I think the Governor would find it helpful to have it assembled in as simple and clear terms as possible in something like this form.

Cwm

12 September 1980

MR LOEHNIS

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HER

MONEY SUPPLY PERFORMANCE: LESSONS FROM ABROAD

We need to prepare offensive and defensive briefing for coming meetings on the experience of other countries with their money supplies. The following questions in particular seem to me important.

First the United States. We are being told that if we had let interest rates rise very sharply a la Volcker earlier this year, they would have remained high for only a short time and now be lower than they are with less pain all round. Can we have a careful account of the circumstances in which the American experience occurred with particular reference to what happened to bank lending to persons on the one hand and companies on the other - with appropriate background on the development of personal consumption and the savings ratio; and the US corporate sector's profitability, liquidity and access to non-bank funds. How did their inflation rate compare with ours? What level of real interest rates was achieved? What part do we think quantitative restrictions played? Finally, how did we assess the result: what actually happened to money supply and what is the prospect now for inflation?

It might also be instructive to look at the US experience in the previous recession. I have an impression, which may be mistaken, that on that occasion they had problems similar to ours this time with bank lending and the money supply continuing high for longer than had been expected. Could we have tables for some of the main G10 countries for growths of various aggregates in recent years both in nominal terms and in real (deflated by total spending or whatever). Has the UK been unusual in the extent to which it has sustained a falling real money supply?

Are there any useful statements we can collect and quote from central bank governors abroad on the problems of controlling M3 over short periods; and what other conditions - such as a social consensus on incomes - need to be or should be met to ensure control (eg the Bundesbank's helpful paper for the Select Committee)?

Cwm

12 September 1980