

10. 9.79

SECRET

THE GOVERNORS

Copies to: Mr. McMahon o/r
Mr. Dow
The Chief Cashier
Mr. Cooke/Mr. Coleby
Mr. Goodhart
Mr. George

JP 10/9

REVIEW OF MONETARY CONTROL

1. We had a useful meeting with Littler, Bridgeman, and Middleton at the Treasury on Friday afternoon and came to the following agreed conclusions.

2. Our proposals for the reserve asset ratio and for prudential primary liquidity should remain on the table for the next few weeks while further work is done on monetary base control and on the future of 'direct' controls. Treasury officials recognise that the introduction of the Banking Act, together with the desire for further public debate about monetary base, argues for early publication of our intentions about the reserve ratio and prudential liquidity. But they correctly point out that nothing can be announced or published until the Treasury/Bank study of monetary base controls has been discussed with Treasury Ministers and with No.10. If everything went well both they and we would look to publication in the late autumn of:-

(a) A document containing proposals, for negotiation with the banks and discount market, regarding the reserve ratio and the primary liquidity 'norm'. Implementation of these proposals would be intended for next spring or summer.

(b) A parallel document, for discussion and consultation with the banking system, the academics, the professional critics, etc. about monetary base controls and the future (if any) of direct controls.

In our opinion,^{*} which HMT have not yet had time to consider, the proposals in paper (a) above do not foreclose on any reasonable options likely to be put up by paper (b).

3. Drafting of the Treasury/Bank study of 'monetary base' should be undertaken by the Bank. Treasury officials would like to be able

* see Annex to this note

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to send a 'final draft' to the Chancellor and the Financial Secretary early in October. So we have to give this job top priority over the next three weeks. On Treasury advice, which seems very sensible to us, the paper will be as 'practical' as possible. It will start by describing the situation that would prevail after abolition of the reserve ratio and the phasing-in of the liquidity norm. It will then go on to discuss in practical and institutional terms three alternatives from the exceedingly wide spectrum of possible base controls, namely:-

- (a) A scheme for 'negotiable base assets' or 'auctionable entitlements', of the kind scouted by Middleton in the papers sent to No.10 in July. The contingency of the abolition of exchange control on outward portfolio will have to be taken into account in this context.
- (b) A scheme, or perhaps it would be better termed a régime, under which the status quo post-reserve-ratio would be modified by some degree of quantitative restriction on the automatic 'rediscount' facilities possessed by the discount market; and under which there might (or might not) be a greater scope to develop wider markets in short-term public sector debt.
- (c) A scheme under which the monetary base were recalculated such that it might become a (? superior) indicator for the guidance of monetary operations.

It will be for consideration whether the paper should make recommendations (which invite governmental decisions) or whether it should indicate strong preferences which would guide the monetary authorities in the subsequent period of public debate.

4. The Cashier's Department and the Monetary Economics Division of EID will now start work on a draft of the above paper.

5. It was finally concluded that Treasury officials should prepare the first draft of a paper on the future of direct controls (i.e. the corset, etc.), taking into account the exchange control contingency mentioned above. We felt that our own drafting capacity was already fully committed, that we had already done quite a lot of work on direct controls, and that a Treasury version would not be unwelcome. Neither Bridgeman nor Middleton seemed at all sanguine that direct controls had a worthwhile future, though they both showed awareness that higher authority might find this difficult to accept.

6. Aside from the main business of the meeting, we agreed it would be useful to have a stocktaking session with HMT (HF) towards the end of September, when further forecasts are likely to become available and when the statistical outturn for 'banking September' will be becoming known. This stocktaking would begin consideration of the (possible) autumn roll-over of the £M3 target.

A handwritten signature in dark ink, appearing to be 'S.F.' with a flourish above the letters.

10th September 1979