

26/1/81

Mr Britton

What do you think?

Bm.

6/1/81
for him 3/2

MR MIDDLETON

CC Principal Private Secretary
 PS/Chief Secretary
 Sir D Wass
 Sir K Couzens
 Mr Burns
 Mr Ryrie
 Mr Monck
 Mr Britton
 Mr Turnbull
 Mrs Lomax
 Mr Ridley
 Mr Cropper
 Mr Cardona

PRESENTATION OF THE MONETARY AGGREGATES

The Financial Secretary has been reflecting on this issue, and has asked me to put to you the following thoughts.

At the present time we publish (via the Bank of England) series for five aggregates: M1, £M3, M3, PSL1 and PSL2. The decision has already been taken to construct and monitor a new series for M2, which - if successful - will presumably also be published. In addition, we already watch for internal purposes two series for monetary base: what might be termed "classical M0" (notes and coin plus banks' balances with the Bank of England) and "modish M0" (banks' balances with the Bank of England). As interest in the monetary base grows, the likelihood of the publication of these too, will grow. It seems to the Financial Secretary that the time has come for some rationalisation.

Of the five series already published, three - £M3, M3 and PSL1 - are very close together. Thus £M3 accounts for very nearly 95% of PSL1 and over 90% of M3. This serves no useful purpose, and indeed the situation owes more to history (the three series having been introduced at different times, as UK monetary thinking evolved) than to analysis. The time has come to plump for a single "broad money" series, which should simply be known as M3 and should be the aggregate in terms of which annual monetary targets are set (and hence the Medium-Term Financial Strategy denominated). Partly because of the grave deformation of the £M3 and M3 series by the corset episode, but also on its merits, the

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Financial Secretary would favour PSL1 for this purpose. However, given the abolition of exchange control, there is a case for enlarging PSL1 slightly to include UK residents' non-sterling deposits.

This would leave a single series for private sector liquidity, the existing PSL2, to be re-christened PSL. It is, in any case, somewhat farcical to have a measure of private sector liquidity which does not include building society deposits, and the existing PSL2 is the only series which does include them.

At the opposite end of the scale it is, the Financial Secretary believes, undesirable to have two different series for the monetary base. His own strong preference for the M0 series would be "classical M0", and he believes we should publish this series as soon as possible. One reason he has for preferring this measure is that the "modish" measure is excessively prone to very large month-by-month fluctuations. But there is no reason why we should not publish figures for banks' balances at the Bank of England, provided they are simply described as such.

Any decision on M2 will clearly have to await the conclusion of the work now being done. Meanwhile, we would be left with four published series if the suggestions the Financial Secretary is making are accepted: M0 (classically defined), M1, M3 (newly redefined) and PSL. This is, in all conscience, a wide enough range to give a general view of monetary conditions - and there is still, of course, DCE.

Finally, there is the question of the seasonally adjusted series. At present these are provided for all the published monthly aggregates: indeed, for PSL1 and PSL2 it is only the adjusted figures that are published. Yet the seasonal adjustment to the money figures are at once the most substantial (being frequently as large or larger than the changes in the monetary aggregates themselves) and the most suspect (and revision-prone) within the whole field of official statistics. The majority view among the overseas experts consulted in the Green Paper discussions was that we should not publish seasonally adjusted figures, and the Financial Secretary agrees with them. The only point of seasonal adjustments is to give a truer picture of monthly changes, yet the authorities continually (and rightly) insist that, at least so far as broad money is concerned, monthly fluctuations are of no

significance whatever. By publishing a monthly seasonally adjusted series, we are simply undermining our own thesis and creating unnecessary trouble for ourselves. A slightly better case can be made for publishing seasonally adjusted figures for narrow money, particularly if we intend to bounce short-term interest rates off them. The Financial Secretary thinks it worth noting, incidentally, that we do not publish seasonally adjusted figures for the calendar month CGBR; but that that does not stop us explaining to commentators that the crude figures are of course subject to seasonal distortion. This seems to him a much more sensible approach.

The Financial Secretary would be grateful for officials' reactions to the above.

SASL

S A J LOCKE

26 January 1981