

*Ev Bl*

PRIME MINISTER

Here is an anonymous (ie Peter Middleton) agenda for tomorrow's meeting on monetary policy.

Peter Middleton would be most grateful if you could avoid waving this piece of paper around. He has not admitted to the Chancellor or Treasury colleagues that he has produced it.

The Chancellor will bring Mr. Lawson, Terry Burns, Peter Middleton, and either Sir Kenneth Couzens or Mr. Geoffrey Littler - possibly the latter in view of your warning that the Treasury will need to defend its stance on public expenditure. The Governor will bring one official with him.

M. A. PATTISON

2 September 1980

## MONETARY CONTROL

1. Facts: money supply increasing at underlying 16% since February - excluding reintermediation. Has been over 15% since July 1978 on same basis:

- a. bank lending averaging about £1 bn a month - about 30% a year.
- b. PSBR £5 bn in 1st quarter. CGBR £2 bn in August.
- c. Reintermediation post corset much more than thought - now expected to be 6-10%.

### Problems with Present System

1. Can we do anything more to control the profile of the PSBR.
2. Can we do anything to restrain bank lending.
  - the banks simply respond to drawing down overdrafts
  - the 12 $\frac{1}{2}$ % reserve asset ratio does not bite because the Bank always relieve banks. If we sell gilts to neutralise high bank lending, we have to lend back to the banks - to prevent reserve asset pressure. Is there any alternative to this as long as interest rates are set at the discretion of the authorities.
  - is the increase in lending after the corset simply reintermediation - or is the banking system out of control and trying to expand in all directions. What is happening?
  - can we do anything by funding policy to take the pressure off bank lending by getting long rates of interest down. Sell fewer gilts and more National Savings: problems for building societies.

### More Fundamentally

- How can we get back to a system in which interest rates fluctuate and the market has more of a say?

- 2 possibilities
- a. monetary base
  - b. use present reserve asset system

Both of these at present would mean higher short term interest rates - including base rates + mortgage rates. Yet the economy is now in a sharp recession.

- An essential transitional stage is the Bank's discussions with the banking system on bank liquidity for prudential purposes (in a bit of a tangle) and cash ratios (not even issued yet).

- How are the present monetary base discussions to be brought to a conclusion in such a way as to ensure that at a very minimum we do not impede a move in this direction.

2.9.80