

Restricted Circ.

Mr. George

SECRET

DHS 24/12
14.1.80

BANK OF ENGLAND
LONDON EC2R 8AH

20th December 1979

see 4.1.80

14.1.80

(Dear Geoff)

Draft Consultative Paper on Monetary Control

With the agreement of the Governor, I now enclose five copies of the completed draft. It consists of a main paper accompanied by three annexes with appropriate appendices. Unlike the others, Annex 3 does not yet contain the 'Summary and Conclusions' which it clearly needs. We will repair this omission as soon as we can.

I think there are four additional comments to be made at this stage:-

- (i) Our exposition of the vital point about whether or not the Bank could or should refuse outright to provide all the cash needed to meet a mandatory requirement is still in process of evolution. The current version occurs in para. 38 of the main paper and in relevant paragraphs in Annex 3. We think that we have nearly got it right but will clearly want to go on refining it during the weeks before publication.
- (ii) The prior questions of exchange rate policy, and of full UK membership of the EMS, continue to loom rather large over the whole text. Some of us are inclined to think that it will suffice for the issues to be exposed and left open. But others worry lest the prospect of full entry into the EMS over the next year or two would make the consultative process seem somewhat academic to the bankers and others involved. Furthermore, the text has relatively little to say about how monetary policy would be targeted and conducted if sterling became linked to the other EMS currencies. We are accordingly looking over the ground covered in 1978 on this matter and will be drafting a fresh paper about it early in the new year.
- (iii) In discussions here of an earlier draft text, it was felt that the subject of funding through the gilt-edged market was rather conspicuously absent. Para. 16 of the main paper now attempts to meet this problem frontally. But the issue remains.

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(iv) It is suggested in the main paper, and elaborated in Annex 3, that an appropriate degree of automaticity in the rate of interest at which the Bank supplies cash to the system could be arranged by linking that rate to a moving average of weekly money supply figures rather than to a moving average of the monetary base. Either way, the weekly money figures would come to acquire considerably greater operational significance; and we ought not to run away with the idea either that these statistics are yet in a fit state to come to the centre of the operational stage or that it will be plain sailing getting them to a fit state. Indeed this matter could prove to be a very important part of the consultations, if we wanted to proceed in the way suggested. The statistical side here are expressing concern about this and it is right that I should pass on this concern to you.

We will look forward to discussing the text with the Treasury after Christmas.

(Yours sincerely,

JOHN FFORDE)

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