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Copies to
The Deputy Governor
Mr Fforde
Mr McMahon
Mr Dow
Mr Blunden
The Chief Cashier
Mr Goodhart

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NOTE OF A MEETING HELD AT NO.11, DOWNING STREET, AT 10.45 A.M. ON MONDAY, 5TH NOVEMBER, 1979

Present:

Chancellor of the Exchequer
Chief Secretary
Financial Secretary
Sir Douglas Wass
Governor of the Bank of England

MONEY SUPPLY FIGURES

The meeting discussed the prospectively high money supply and bank lending figures emerging for banking October, and the range of available policy measures for dealing with them.

2. The Governor reported uncertain conditions in the domestic and foreign exchange markets, with gilt-edged trading between one-eighth and one-quarter down on the morning and sterling trading at around 66.0 effective, with the dollar rate 2.064 (compared with 2.0655 on opening and 2.0570 at its lowest point). The pound was tending to be sold rather than bought and trading on expectations of better money supply figures than now seemed likely. Markets could be expected to act adversely, therefore, when the eligible liabilities figures appeared on Tuesday. The forecast money supply and bank lending figures were virtually unchanged from those reported on Friday.

3. In discussion, Ministers noted that officials were still expecting the banking November figures to fall back considerably, perhaps even to be flat. However, the continued high level of bank lending and the CGBR was bound to cast doubt on the degree of confidence attaching to forward estimates. Only a month ago, most commentators agreed with the authorities in expecting good figures for banking October and Mr. Pepper had been prophesying that money supply would fall below the target range. As it was, bank lending

had not really moderated, and there could be no confidence that Government borrowing figures would not be exceeded. Money supply, annualised over the five months since June, was now running at 14.2 per cent and, with the leakage into acceptance credits, the Governor felt this could represent an underlying monetary growth approaching 19 per cent. At best, this could only be described as fairly accommodating in relation to the underlying growth in nominal incomes. There was no single explanation for the high money figures: large (plus £600 million) sight deposits might be awaiting investment in gilts; differences between an actual and expected CGBR could be just a matter of timing; companies might be borrowing to finance income tax repayments; and there was considerable uncertainty over the pattern of VAT payments. Involuntary stockbuilding might also be increasing.

4. The Financial Secretary warned against reading too much into erratic monthly movements. Bank lending had been very low in September, and now seemed very high in October. The difficulty was to decide whether later figures were themselves erratic or whether they demonstrated renewal of a trend upwards. Action by the authorities would certainly be interpreted by the media as an indication of the latter. The September and October figures would need to be presented together. Sir Douglas Wass said he agreed with the Financial Secretary that if time allowed it would be far preferable to see another month's figures before advising the Chancellor to take further action. But inaction could lead to a worrying situation in the financial markets. The Governor agreed. The Chancellor needed to say something soon about rolling forward the monetary target, about the future of the corset and possibly also about a medium term financial plan. Action to validate public faith in the Government's control of the money supply would pose a difficult choice between acting straight away or announcing the whole package in mid-November.

5. The Chancellor said he was in no doubt that monetary growth was accelerating too fast, even though they might all remain confident of an eventual move downward. The Governor added that it was clear that the MLR increase in the Budget had not really deterred people from borrowing money at ruling interest rates.

6. The Financial Secretary asked how far ahead was the funding programme. The Governor replied that this depended on the level of borrowing to be funded. Because of redemptions, the contribution had been negative in October. Had only high October money figures been foreseen, the part-payments on the last tap could have been made to fall in October rather than in November.

7. The Chief Secretary agreed that the outlook was an uncertain one. He felt, however, that it was unwise to gamble on the next month's figures being better. Even at the risk of some over-kill it was better to act decisively now, either by moving MLR or by fiscal action. The other option was public expenditure which, even after the White Paper, would be taking a rising proportion of resources if GDP were to fall. The borrowing requirement was undoubtedly too high: the question was whether the Government could finance it. He was against anything which looked like a second Budget: for that reason he was not in favour of using the regulator, even though this would directly act on the PSBR. Further cuts in public expenditure, even if feasible, would not provide ready cash. An MLR increase could be justified by reference to international interest rates.

8. Reverting to the question of timing, the Financial Secretary agreed with the advice in Mr. Bridgeman's note in favour of deferring action until publication of the October money supply and bank lending figures on 15th November. Nothing done this week could possibly affect bank lending in the short term. He was confident it would soon turn down of its own accord. An MLR increase might have symbolic value and help to get debt sales moving.

The question was whether markets still believed in the Government's resolve to keep the money supply in check, or whether this needed reaffirmation by another early gesture. The Governor agreed that an early move on MLR could unlock funding, perhaps even to excess.

9. Sir Douglas Wass commented on the shift in world and domestic interest rates. At home, MLR was no longer a penal rate. The Chancellor said there was a complex of factors at work. Reactions to the White Paper had somewhat reduced the market's assurance; he expected the response to Tuesday's figures to be bad. He thought the market might well be looking for some further demonstration of the Government's resolve. The Financial Secretary said that Ministers should not reject fiscal action. On the other hand, Sir Douglas Wass argued that tax increases might be thought to take the pressure too easily off the Chancellor's spending colleagues. The regulator suffered from three drawbacks: there were only four months of the year remaining: it would add to the RPI at a difficult time: and might hit confidence if seen as a reaction to insufficiently tough cuts in public expenditure.

10. The Financial Secretary was worried about damage to confidence and the Government's future credibility if the PSBR overshot. The only quick contribution from public expenditure could come from re-opening the BNOC/BGC sales. The Chancellor thought this route was exhausted this year.

11. The Financial Secretary suggested that the best course was to live with the eligible liability figures and stand ready to increase MLR on the 15th. The Governor did not dissent, but said he would want to keep open the option of increasing MLR this week if the reactions to the eligible liability figures justified it. As for size of increase, he thought this depended on the scale of reaction. He agreed that 15 per cent would just put MLR on the

right side of the market - without forcing the building societies to re-open the mortage rate (though, in this respect, 16 per cent might be different). On the other hand, Sir Douglas Wass noted that the building societies were now attracting funds on a fairly substantial scale.

12. The Chancellor asked what would be needed if the November banking figures were equally bad. The Governor said this could require MLR to rise to 18 per cent. The Chief Secretary thought it was sensible to look only a few weeks ahead, given the extent of uncertainties. He was firmly opposed to anything that smacked of a second Budget. He would bite on the bullet and put up MLR: decisive action now would be better than having to take action again in a month's time.

13. Summing up, the Chancellor said he would like to send a short minute to the Prime Minister arriving if possible before his appointment with her at 5.30. The present group might need to meet again on Tuesday evening or on Wednesday.

14. The Governor said that in the foreign exchange markets the Bank would want to spend fairly freely to counter downward pressure on the rate without defending a particular floor. The Chancellor agreed.

(A.M.W. BATTISHILL)
7th November 1979

Circulation:

Those present
Sir Kenneth Couzens
Mr Bridgeman