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"MANSION HOUSE" SPEECH

Attached is the text of the speech made by the Chancellor of the Exchequer, the Rt Hon Norman Lamont MP, at the Lord Mayor's banquet for bankers and merchants of the City of London at the Guildhall tonight.

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MANSION HOUSE SPEECH

My Lord Mayor, Mr Governor, my Lords, Ministers, Aldermen, Mr Recorder, Sheriffs, ladies and gentlemen, I am very pleased once again to have the honour of addressing this distinguished audience.

Economic background

2. It is just six weeks since we left the ERM. But it is already clear that the decision marked a watershed. Though the aims of government policy remain the same, we are now in an entirely different policy environment. We are outside the ERM and are likely to remain so for some time. And with a floating pound we have had more flexibility to reduce interest rates without prejudice to our goal of permanently low inflation.

3. But the wider world has changed too.

4. Most significantly, there has been a further deterioration in the prospects for the world economy. Despite sharp cuts in interest rates, the US economy remains weak. At the same time, the Japanese economy has slowed sharply.

5. Closer to home, events in Europe have been dominated by Germany's unique economic circumstances. Having faced exceptionally high real interest rates over the last year as Germany dealt with the consequences of reunification, we are now having to contend with a rapid German slowdown, further depressing activity throughout the region.

6. Here in Britain, the frustrated hopes of the last year have led to a decline in business and consumer confidence, and this has been exacerbated by recent events. A deteriorating world environment, political uncertainties, a spate of industrial redundancies and the removal of a central pillar of the Government's monetary policy - this is an unusual, indeed an extraordinary, set of events. So it is not at all surprising that the surveys of business and consumer opinion that we have seen since 16 September have revealed confidence to be weaker.

7. Lord Mayor, I want to set out tonight why I believe that confidence can be recovered; and, more importantly, how the new conditions can be turned to Britain's advantage and at long last bring us out of recession.

Rebalancing policy

8. Our first priority has been to re-establish a stable and predictable policy framework. Since sterling was forced out of the ERM, we have re-emphasised the continuity of the Government's objectives - and re-affirmed our belief in sound money, low taxes, open markets and free trade.

9. But as the dust settles on the events of the last few weeks, it is crucial to recognise the relaxation of policy that has already been made.

10. The significant depreciation in sterling seen over the last six weeks - not just against the currencies of Europe, but also against the dollar - undoubtedly gives British exporters greater opportunities to win business in foreign markets.

11. And the greater flexibility we now have outside the ERM, together with the reduction there has been in German market rates, has also allowed me to take a further two points off interest rates. British industry now has interest rates which, apart from a few months in 1988, are the lowest since 1978. They are also the lowest in the European Community.

12. These developments have undoubtedly enhanced the prospects for recovery. But they have done so in a way that is sensible, responsible - and entirely appropriate our own economic circumstances.

13. Lord Mayor, soon after we left the ERM, I said in my speech to the Interim Committee of the IMF that monetary policy, at least in the last few months of our membership, had been tighter than was required to keep inflation on a downward track. That does not mean that the painful war we waged against inflation over the last few years was not worthwhile. Far from it - that was a war we had to win.

14. But the goal of the Government's macro-economic policy has never been simply to defeat inflation. Low inflation is not just an end in itself; it is also the means to sustainable growth and secure employment. Indeed, it is the vital precondition for the economic stability upon which a nation's future prosperity and living standards ultimately depend.

15. But just as prosperity can be jeopardised by too lax a monetary policy and too high a rate of inflation, so too, we have always recognised that policy can become too tight.

16. Leaving the ERM was a setback, but it has given us the opportunity to rebalance our policy to take greater account of the risks to the world economy. This does not mean that the Government has gone soft on inflation. But the dramatic progress we have made in getting inflation down does allow me now to give greater weight to securing an early resumption of growth.

Out of recession

17. The Prime Minister has spoken about the Government's hopes for recovery and of our determination to see Britain put this long and difficult recession behind us.

18. First and foremost, that means that Government and industry need to work together to re-build confidence. But economic confidence is an elusive quality; it cannot simply be drawn like a rabbit from a conjurer's hat. I may be dressed as a magician, but I am, in fact, just the Chancellor of the Exchequer.

19. But what the Government can do is to set out as clearly and precisely as possible how we intend to steer the economy back towards the growth we all want to see.

20. I have drawn attention already to the relaxation of monetary conditions I have made over the last few weeks. That was fully justified by the excellent medium-term prospects for inflation; and in making decisions about further cuts in interest rates, I shall continue to take no risks with our long-term inflation goal. But as Noel Coward might have said, cheap money is not as potent as cheap music. If slashing interest rates were all that was required to generate growth, there would not be a single poor country left in the world. But let me assure you - I have no desire to keep interest rates any higher than is necessary to meet the Government's inflation objectives.

21. Over the medium-term, Lord Mayor, the prospects for interest rates in this country will depend as much on fiscal policy as on the monetary stance. And that is why the new public expenditure plans I shall be announcing in the Autumn Statement are so important.

22. Last July, I set up a new system for the control of public spending, with two aims in mind. First, to ensure that the Government's spending plans are fully within the country's means. Nothing would damage business confidence more than a perception that the Government's fiscal plans did not add up. While it is perfectly sensible to allow the PSBR to rise at a time of recession, a tight fiscal position over the medium-term is absolutely essential if I am to keep interest rates down.

23. Second, I wanted to ensure that public money was directed towards the Government's priorities. In the package I shall be announcing on 12 November, my priorities will be to promote recovery and the long-term prosperity of the British economy. It must make strategic sense to ensure that, wherever possible, spending on the infrastructure is maintained at a time of recession.

24. But if capital programmes are to come first, Government has to take a lead from industry and keep a firm grip on its current expenditure. And I have also been determined to find ways of giving the private sector a greater role in financing capital projects. I am determined to ensure that our rules allow that to happen and I shall be announcing my proposals in the Autumn Statement.

25. I know that many people have been concerned, over the years, that the Government does not adequately distinguish between current and capital spending. There are good reasons for this, and in practice there are some difficult borderlines, particularly when it comes to human capital. But having looked at this issue again, I have concluded that the time has come to make a change. From the first Unified Budget in December 1993, I have decided that the Government accounts should be drawn up in a way which makes a proper distinction between current and capital transactions. I believe this will help to underpin the Government's commitment to infrastructure investment in the longer run.

Growth

26. Lower interest rates supported by sensible public expenditure priorities will put the economy on course for recovery. But the key to improving the economy's growth performance over the longer-term is continuing supply-side reform.

27. So the Government will be pressing on with our programme of deregulation and privatisation; with our reforms of education and our policies to promote fair competition both at home and abroad. A successful conclusion of the GATT round and the completion of the Single Market will provide enormous opportunities for British industry. British firms must be fully involved in the European market. That is why the Government attaches so much importance to ratifying the Maastricht Treaty. We cannot afford to be left on the fringes while our partners make the rules.

28. But growth does not come from governments. It comes from individuals. It comes from businesses up and down the country responding to the pressure to become competitive.

29. Above all, growth comes from human nature. At any time, in any field of activity, behind any commercial endeavour, there is always an individual, pushing at the frontiers of knowledge, striving for improvement. It is the human spirit and the desire of human beings to achieve, that, in the long run makes growth the natural course of affairs.

30. The Government cannot talk the economy out of recession. We cannot press a button and see the economy spring to life. But we can examine every development, every policy option, every idea and ask ourselves - does this support industry? Will it help confidence? Will this get the economy going? That is what we shall be doing in the weeks and months ahead.

Forecasting

31. Lord Mayor, I want now to turn to the process by which the Government's policy is formed and particularly to the much-discussed question of economic forecasting.

32. Much of the criticism of the Treasury's forecasting record has been misplaced. The last few years have been extremely difficult ones for forecasters all over the world. Everywhere, governments and international organisations, as well as academic and private sector forecasters have been getting it wrong.

33. It is not difficult to see why. Forecasters today are pioneering uncharted territory. Alan Greenspan recently referred to the impossibility of predicting how and when the US will emerge from a recession based on debt problems the like of which have not been seen for 60 years. There are similar problems throughout the industrialised world.

34. And there is, of course, a more fundamental problem with which forecasters always have to grapple. Forecasting means trying to predict the decisions of millions of individuals, all - thank goodness - with the freedom to spend, invest or save as they

chose. They go about their business as it pleases them, blissfully unaware of the economic laws which are supposed to govern their behaviour. With these forces to contend with, the surprise is not that forecasters sometimes get it wrong, but that they ever get it right!

35. In such difficult circumstances, no-one has a monopoly of wisdom, and the Treasury had always paid close attention to the work of outside forecasters. I want to take that further.

36. I propose to invite a number of independent forecasters to join a new Forecasting Panel, to meet at regular intervals, and then publish an assessment. This would include the full range of forecasts made by individual panel members, as well as some summary of the central view and the risks attached to it.

37. The Treasury will, of course, retain its own forecasting capability. But my proposals will underline that the Treasury forecast is only one of several which inform Government policy decisions and that such decisions do not depend on a single point estimate of future developments.

38. This change should help to strip away some of the mystique which surrounds forecasting and in this way, lead to a better elucidation of policy itself.

Monetary policy

39. My Lord Mayor, I turn now to monetary policy.

40. I set out a few weeks ago how monetary policy will operate now the pound is floating. This contains an important innovation: an explicit target range of 1-4 per cent for inflation. The Government aims to get inflation in the lower part of that range by the end of this Parliament.

41. In judging whether we are on track to meet that objective, we will take account of the behaviour of the monetary aggregates, narrow and broad; of asset prices, particularly house prices; other indicators of inflationary pressure; and of course, the exchange rate. Overall, policy will operate broadly in the way that it does in many other countries, like the United States, Japan and Germany.

42. But I think there are three aspects of this policy which are worth elaborating. One is that prospective, not current, inflation will be our guide. Monetary adjustments take time to have effect, and a low inflation rate today is not in itself a reliable cue for a relaxation of policy.

43. Another issue is the role of the exchange rate. Some people insist that movements in the exchange rate are just a change in relative prices which need not affect the rate of inflation. Others argue more pragmatically that disinflationary forces are currently so strong, that such pressures pose no threat.

44. I am not persuaded by either of these arguments. The first might apply to a large, relatively closed economy, but it certainly does not hold for Britain. And those who blithely

contemplate an ever lower exchange rate clearly have not understood what import higher costs mean for business. It would be a brave man who totally discounts the risk of these being passed through to domestic prices.

45. Finally, there is the argument that this set-up is too judgemental. Sometimes I think that this charge is levelled mainly by people working in the financial markets, who would simply like me to make their lives easier.

46. We are, of course, moving from a largely rules-based system to one that is more discretionary. But in the final analysis, all policy regimes rely on judgement. The difference is merely one of degree.

47. The need for judgement is obviously greater outside the ERM, which makes it all the more important that it is exercised in a consistent way. I propose, therefore, to implement three changes to make the formation of policy more transparent and our decisions more accountable.

48. First, I intend to publish a Monthly Monetary Report following the regular meetings which take place between the Governor and myself. This will, apart from certain market sensitive items, set out the information on which our policy judgements are based, showing the bad news with the good, from month to month.

49. Second, whenever a change in interest rates takes place - and this cannot, of course, conform to any timetable - we will provide an account of our reasoning, much as we did when I cut interest rates on 16 October. By comparing the accounts over time, the markets will be able to make up their own minds about whether or not a consistent approach is being applied.

50. Finally, I have asked the Governor to provide a regular report on the progress being made towards the Government's inflation objective. This will be published in the Bank's Quarterly Bulletin.

51. Together with my initiative on forecasting, these changes mark a welcome shift away from the excessive secrecy which has up to now shrouded much of the policy-making process. They will, I believe, lead to an improvement in the way economic debate is conducted in this country.

52. My Lord Mayor, openness and accountability. Clear policies, steadily pursued. Sound money, low inflation, a firm approach to public expenditure and a determined attempt to ensure that resources are allocated to programmes and projects that will support Britain's recovery. These are the objectives the Government has set itself and these are the objectives we will continue to pursue, with purpose, vigour and determination.