File- Monetary Policy Issues-Exchange Rate Intervention – Part E

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for information.

FROM: I POLIN

DATE: 1 November 1988

1. MISS O'MARA

2. ECONOMIC SECRETARY

Version as approved by Chancellor and Economic Secretary

Ian Polin

2.11.88

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THE RESERVES IN OCTOBER 1988

The reserves announcement for October will be made on Wednesday 2 November at 11.30 am. This month's announcement reports a fall in the reserves of $434 million and an underlying rise of $1,124 million.

2. As announced on 2 August, the $2.5 billion 1992 floating rate notes first issued in September 1985 have been fully repaid but the prepayment has been partly financed by forward purchases of $1 billion. The first tender of UK ECU Treasury Bills held on 11 October raised the equivalent of $1089 million.

Ian Polin

I POLIN

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DRAFT PRESS NOTICE

THE RESERVES IN OCTOBER 1988

The UK official reserves fell by $434 million in October. The following factors contribute to this total change:

(a) the early repayment of the $2,500 million 1992 floating rate notes (FRN);

(b) repayments of borrowing under the exchange cover scheme amounting to $249 million;

(c) the receipt of the $1,089 million proceeds of the first tender of the new UK ECU Treasury Bills issue;

(d) the valuation change arising out of the quarterly rollover of the EMCF swap which increased the reserves by $102 million.

After taking these factors into account, the underlying change in the reserves during October was a rise of $1,124 million; this includes the receipt of $1,000 million already purchased forward in order to help finance the repayment of the FRN, as foreshadowed in the Treasury press notice of 2 August. At the end of October, the reserves stood at $50,048 million (£28,284 million*) compared with $50,482 million (£29,942 million**) at the end of September.

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* When converted at the closing market rate on Monday 31 October £1=$1.7695

+ When converted at the closing market rate on Friday 30 September £1=$1.6860

Note to Editors

2. The underlying change is the result of a variety of transactions, both debits and credits, including, for example, transactions for Government departments and with other central banks, and interest receipts and payments. As noted above, it also includes the receipt of $1,000 million already purchased forward to help finance the repayment of the $2,500 million FRN, due to mature in 1992, referred to in the Treasury Press Notice of 2 August on the UK Government's foreign currency repayment and borrowing programme. The underlying change should not therefore be taken as an indication of market intervention during the month. The above figures can also be obtained from the Reuters Monitor (Code TREA) and on the Telerate Monitor (Code 22494).

3. There was no new borrowing under the public sector exchange cover scheme this month but repayments of such borrowing were as follows:

British Nuclear Fuels Plc, $156 million; British Steel, $33 million; British Coal, $32 million; Electricity Council, $6 million; Lothian Regional Council, $4 million; Strathclyde Regional Council, $4 million; North of Scotland Hydro Electricity Board, $3 million; Northumbrian Water Authority, $3 million; British Railways Board, $2 million; British Telecommunications Plc, $2 million; Humberside County Council, $1 million; Port of Tyne, $1 million; Others, $2 million.

4. The quarterly rollover of the European Monetary Cooperation Fund (EMCF) swap, ie 20 per cent of the UK's gold and US dollar reserves, entailed a valuation increase of $102 million. This partly reflects the appreciation of the dollar against the ECU in the last quarter and partly reflects the fall in the gold price, as valued by the EMCF. For the purpose of the swap, the EMCF values gold and dollars in terms of ecus at rates determined quarterly, whereas the UK values gold and ecus held in the reserves on an annual basis.

THE RESERVES IN OCTOBER 1988 : PRESS BRIEFING

Factual : Main features of markets in October

	3 Oct (cob)*	Month's High		Month's Low		1 Oct (Cob)*
£ ERI	75.9	76.9	(14th)	75.8	(5th)	76.4
$/£	1.6960	1.7820	(31st)	1.6910	(5th)	1.7695
DM/£	3.1608	3.1900	(14th)	3.1175	(24th & 27th)	3.1497
$ ERI	99.0	99.0	(3rd)	94.9	(26th)	95.2
DM/$	1.8637	1.8697	(3rd)	1.7645	(31st)	1.7800
Yen/$	136.62	133.90	(3rd)	124.55	(31st)	125.35

*cob = close of business.

Sterling was weak early in the month ~~initially depressed by news that the Government had instructed the KIO to reduce substantially its holdings of BP shares~~, and fell to the month's low against the dollar (and in effective terms) on 5 October. However, a recovery followed as the Chancellor ruled out an early fall in UK interest rates and after publication of poor US trade figures, sterling reached the month's high against the deutschemark (and in effective terms) on 14 October. Although the pound continued to secure gains against the weak dollar, it eased against other currencies on news of a 1% fall in UK retail sales in September and weakened sharply on 21 October on the Chancellor's references in his Mansion House speech to continuing balance of payments deficits and on the absence of any restatement of the UK's exchange rate policy. In the event, the UK trade figures were much better than expected and, from a low of DM3.1175, sterling advanced strongly reaching DM3.1460. For the remainder of the month it traded on the sidelines ending the month on a firm note at ERI 76.4, $1.7695 and DM3.1497.

Underlying sentiment towards the dollar was bearish throughout October as economic statistics confirmed that the pace of growth in the US was slowing and that the Federal Reserve Bank was unlikely to have to tighten monetary policy. The dollar fell sharply on worse than expected trade figures on 13 October and touched DM1.7950 and Yen 126.00 in the Far East on 17 October. The Bank of Japan's indication of its readiness to support the dollar subsequently sparked a recovery, but further setbacks in the shape of weaker than expected figures for US durable goods orders and for Q3 US GNP re-established a strongly bearish tone, causing the dollar to fall. However, it firmed on 28 October on rumours Syrian troops were about to invade Lebanon but eased on 31 October until visible intervention by the Fed and Bank of Japan helped to bring a steadier note to the currency.

Previous reserve changes

(i) Reserves changes since key dates:

$ million

End-period	Level of reserves at end-period
Labour	
End-December 1976 (Low)	4,129
End-March 1979 (High)	21,947
Conservative	
End-~~May~~ March 1985 (Low)	13,~~978~~ 528
End-August 1988 (High)	50,639
Recent Levels	
End-December 1986	21,923
End-December 1987	44,326

(ii) The underlying rise in reserves in 1987 totalled $20,475 million.

(iii) Recent reserve changes:

		Underlying change	Total change	Level of reserves at end period ($ million)
1987	October	+ 6,699	+ 6,591	41,399
	November	+ 31	- 118	41,281
	December	+ 3,737	+ 3,045	44,326
1988	January	+ 38	- 1,233	43,093
	February	· 25	- 166	42,927
	March	+ 2,225	+ 1,713	47,519+
	April	+ 514	+ 338	47,857
	May	+ 814	+ 676	48,533
	June	+ 84	- 14	48,519
	July	+ 910	+ 1,307	49,826
	August	+ 827	+ 813	50,639
	September	- 143	- 157	50,482
	October	+ 1,124	- 434	50,048
Total since October 1987		+16,835	+12,361	
Totals since December 1987		+ 6,368	+ 2,843	

+after revaluation of + $2,879 million.

(iv) October 1987 underlying change of $6,699 million was largest ever.

(v) Reserves in August of $50,639 million were highest ever.

Level of official debt

Latest published figure, $16.8 billion at end June* in Financial Statistics, September 1988, Table 10.6. But among other items, subsequently repaid $2.5 billion floating rate notes and borrowed around $1 billion in ECU's. (In May 1979 was $22 billion.) The Bank of England Quarterly Bulletin due out on 10 November will provide the end-July figure.

*at end June market rates.

Prepayment of $2.5 billion 1992 Floating Rate Note

(i) Prepayment made on 7 October 1988 in accordance with terms and conditions of notes.

(ii) $2.5 billion floating rate notes, first issued in September 1985 had original 7 year maturity and coupon of 3 months' LIBID (London Interbank Bid Rate) refixed and payable quarterly. Terms of notes included provision for early repayment on any interest payment date from 7 October 1988.

(iii) Government also has US $4 billion floating rate note issue outstanding with original maturity of 10 years and coupon of 1/8 per cent below 3 months' LIBID. Prepayment first becomes possible 24 September 1991

UK ECU Treasury Bills

(i) First tender oversubscribed at all three maturities. ECU 900 mns of Bills on offer were allotted in full.

Details are as follows:

	1-month Bills due 10 November 1988	3-month Bills due 12 January 1989	6-month Bills due 13 April 1989
Amount of Bills on offer	ECU 200 mns	ECU 500 mns	ECU 200 mns
Amounted applied for	ECU 924.5 mns	ECU 1733.5 mns	ECU 743.0 mns
Amounted allotted	ECU 200 mns	ECU 500 mns	ECU 200 mns
Oversubscription	4.6 times	3.5 times	3.7 times

(ii) Second tender will be held on Tuesday, 8 November. Details of the amounts and maturities of Bills to be offered at that tender were announced at 2.30 pm on Tuesday, 1 November, with Ecu 300 million offered at 1 month maturity, Ecu 250 million at 3 months and Ecu 200 million at 6 months.

Summary of reserve transactions for October which are disclosed

	$ millions
Maturities (of forward currency set aside for FRN prepayment)	+1,000
Other (ie "variety of transactions" - para 2 of Press Notice)	+ 124
Underlying change	+1,124
Repayment of ECS borrowing	- 249
Early repayment of FRN	-2,500
ECU Treasury Bills	+1,089
EMCF valuation change	+ 102
Change in reserves	- 434

POSITIVE

1. Reserves near record levels. Now stand around $50 billion, compared with $22 billion in May 1979.

2. Level of official debt has been reduced substantially.

Level at end-period		$ billion
May	1979	22.0
December	1986	19.3
December	1987	19.1
June	1988	16.8

As announced on 2 August, Government has repaid early $2.5 billion floating rate notes, issued in September 1985, and due to mature in 1992 on 7 October 1988.

3. First tender of new ECU Treasury Bills was resounding success. Tender was oversubscribed at all maturities (1, 3 and 6 months) and Bills on offer were allotted in full. Bills have subsequently held price well (trading at around 20-25 basis points below LIBID).

DEFENSIVE

(A) POLICY

1. **Exchange rate policy:** Exchange rate an important consideration in formulating monetary policy but not overriding one. Reasonable degree of exchange rate stability assists in the battle against inflation and also in promoting satisfactory economic performance.

2. **Conflict between interest rate and exchange rate policy?** In theory, could be conflict between requirements of anti-inflationary policy and exchange rate stability. But if purely short term conflict, intervention can be used, as earlier this year. [Chancellor in pre-IMF speech briefing, 27 September.]

3. <u>Tactics</u>: Available instruments - interest rates and intervention - will be used as seems right in circumstances. But not sensible to reveal operational details or be more precise.

4. **<u>Is Government targeting £/DM, £/$ or £ERI</u>?** Never focus exclusively on single indicator when setting monetary policy. Exchange rate is one of these indicators but look at various measures of level of sterling.

5. **<u>Continuing large deficits will diminish confidence in sterling</u>?** No reason why they should. Markets recognise the Government's strong fiscal stance and its commitment to firm monetary policy.

6. **<u>Current account position means Government should let exchange rate fall</u>?** [Chancellor said in IMF speech, 28 September, "The exchange rate cannot be assigned the task of balancing the current account, and it is a mistake to think that the automatic response to a current account deficit should be a lower exchange rate."]

Policy of depreciation would be wholly inappropriate. Present deficit is associated with high investment spending by private sector not with public sector deficit. Private investment is adding to productive capacity, which will boost exports and displace imports in future. Maintenance of firm monetary and fiscal policy will maintain confidence in UK economy and ensure any deficit can be readily financed.

7. **<u>Will Government allow exchange rate to fall to ease pressure on industry</u>?** [Chancellor also said in debate, on the State of the Economy in House on 25 October, ".... the battle against inflation mean that there can be no question of bailing out businesses that fail to curb their costs, and in particular their wage costs, by permitting the exchange rate to depreciate".]

Made it clear time and time again that Government will not accommodate inflation by exchange rate depreciation. Holding down unit costs - which is in industry's own hands - key to competitiveness.

8. **Stability of sterling?** As Chancellor made clear in House of Commons, 25 October, "throughout the past 12 months, with exception of a short-lived upsurge in April and May, the sterling index has never varied by even as much as 3 per cent from its present level."

9. **Will Government intervene or cut interest rates if sterling comes under renewed strong upward pressure?** Never discuss market tactics. But have indicated interest rates will remain high for some time.

10. **No mention in Mansion House Speech of exchange rate policy?** ['Financial Times', 21 October called it "disturbing" that Chancellor did not reiterate firm intention to avoid depreciation of sterling.] In House of Commons on 25 October, Chancellor said; "As I have said on innumerable occasions during the past two years - but see no need to repeat in every single speech I ever make - the battle against inflation means that there can be no question of bailing out businesses that fail to curb their wage costs, by permitting the exchange rate to depreciate." (OR Vol 139 No 203 col 185): 25 October.

(B) G7

11. **Does the Chancellor still stand by his managed floating plan?** Yes. Still on table. G7 "continuing their study of ways of further improving the International Monetary System and the co-ordination process". (G7 Communique, 24 September)

12. **International monetary co-ordination not working?** [G7 Communique of 25 September stated Ministers "noted with satisfaction" that policies and commitments undertaken in course of their cooperative efforts <u>were</u> producing desired results.]

International cooperation is alive and well, and reaffirmed in G7 communique of 24 September.

13. **G7 committed to exchange rate stability?** G7 communique issued in Berlin, 24 September reaffirmed commitment to pursue policies that will maintain exchange rate stability and to continue to cooperate closely on exchange markets.

(C) INTERVENTION

14. **Why a large underlying rise in reserves?** Underlying increase of $1,124 million includes $1,000 million previously purchased forward. This helped refinance repayment of $2.5 billion FRN so total fall in reserves was only $434 million.

15. **Value of intervention as instrument?** Intervention can certainly have role to play in short term. Can check undue exchange rate fluctuations in either direction which do not reflect underlying fundamentals.

16. **Intervention inflationary?** Intervention to sell sterling only poses inflationary threat if not funded. Government made clear intervention will be fully funded (as in 1987-88) so that effect on liquidity sterilised.

17. **Have other countries been intervening over last month/recently?** Never discuss details.

18. **Is intervention profitable?** Intervention undertaken to support exchange rate policy - not primarily to make profit. For intervention to be profitable, authorities would need to sell sterling when firm and buy it back when soft. This is, of course, what tends to happen over longer term. [N.B. See also BEQB, September 1983 Pgs 384-391.]

(D) <u>INTEREST RATES/MONETARY POLICY</u>

See also separate Q and A briefing on Full money figures provided to IDT etc on 27 October.

19. **<u>Monetary policy</u>:** Need to control inflation paramount. Government will always take whatever action is necessary to achieve this, however unpopular, as shown by recent rises in interest rates.

20. **<u>Interest rates now set on purely domestic criteria</u>?** Aim to maintain sufficiently tight monetary conditions to bear down on inflation, taking account of <u>all</u> monetary indicators, including exchange rate (<u>not</u> just sterling/deutschemark exchange rate).

(E) <u>EUROPEAN MONETARY INTEGRATION</u>

21. **<u>UK participation in exchange rate mechanism (ERM)</u>?** [Prime Minister in various speeches in her recent tour of Europe stated other countries must "catch up" with various UK reforms before UK can consider participation.]

As said many times before, matter kept under continual review. Will join when Government considers time is right. Decision matter for Government as whole.

22. **<u>Membership of ERM would have prevented recent fluctuations in sterling and avoided need for higher interest rates</u>?** No. Joining ERM <u>not</u> a soft option. Countries within ERM frequently change their interest rates.

23. **<u>Join ERM by 1992</u>?** No fixed timetable. Will join when Government considers time is right.

24. **<u>Capital liberalisation will undermine ERM</u>?** No. Plenty of pressures on ERM earlier this decade but mechanism survived them. May lead to greater monetary co-operation among member states or further modifications to mechanism along Basle/Nyborg lines but no reason to suspect collapse.

X 25. **Proposals for European Central Bank and common European currency?** (A) Prime Minister has said Community must focus on immediate and practical requirements - implementing commitment to free movement of capital; establishing genuine free market in financial services and making greater use of private ecu (UK's Ecu Treasury Bill programme good example of what can be done).

26. **UK should make positive input to Delors Committee/ publish its own views?** Governor playing full part in discussions. Unhelpful to leap into print before Committee has reported.

(F) ECU TREASURY BILLS

27. **How successful was first UK ECU Treasury Bill tender?** Resounding success. Tender over-subscribed at all three maturities and Bills on offer allotted in full. Bills have subsequently held price well trading at around 20-25 basis points below LIBID.

28. **How do you value Ecus received from first Ecu Treasury bill tender?** In line with basis for revaluing reserves annually, ecus are converted to dollar equivalents using average of relevant dollar exchange rate in three months up to end of March 1988 <u>or</u> using actual exchange rate on last working day in March 1988 whichever calculation gives lower dollar value. (Bank actually used average of thee months up to end-March 1988 ie $=0.8105)

29. **What will you do with the proceeds of the new UK Ecu Treasury Bill programme?** Will provide useful addition to European currency component of UK's foreign exchange reserves. But long standing practice of successive governments not to publish details of currency composition of reserves.

30. **Borrowing in ECUs to build up reserves because of growing current account deficit?** No. Reserves stand at near record levels.

(A) [Chancellor said in Mansion House speech on 20 October, "There are some who claim that the single market can operate successfully only if Europe moves to monetary union, by which they mean a common currency. This is manifest nonsense: a view held only by politicians who know little about economics and promoted by economists who are oblivious to the realities

31. <u>What is difference between private ECU (received from ECU Treasury Bill tender) and official ECU (received through EMCF swap)</u>? Official and private ecu have common definition as basket of fixed amounts of Community currencies but in all other respects, quite separate. Official ecu is created by Community central banks swapping 20% of their gold and dollars with EMCF for ecu. Private ecu are created by market on demand, independently from supply of official ecu. Official ecu can only be held by Community central banks and international monetary institutions which are recognised holders - not convertible into private ecu or national currencies. Private ecu may be held by both official and private bodies - fully convertible into national currencies.

32. <u>Monetary implications of UK's Ecu Treasury Bill programme</u>? Negligible effect on monetary aggregates.

33. <u>Why borrow at all when reserves so high</u>? ECU Treasury Bill will provide useful addition to European currency component of foreign exchange reserves and has wider advantages. Reserve levels not excessive by international standards.

(G) EARLY REPAYMENT OF UK $2.5 BILLION FRN

34. <u>Why did you repay $2.5 billion FRN early</u>? Part of prudent reserves management. Circumstances have changed since FRN issued - reserves have risen from $14 billion in September 1985 to $50 billion now - and no longer looked particularly cheap source of foreign currency finance, as did when drawn down. Option to prepay included when notes issued to allow for such change in circumstances. This was first opportunity to call notes. Repayments are often made ahead of schedule where there is financial advantage in doing so.

35. <u>Will you repay US $4 billion FRN early too</u>? Will take that decision when time comes. First call date is not until 24 September 1991.

36. <u>Is repayment of 1992 debt and refinancing by short-term Bill programme sensible in view of fall in reserves?</u> Separate decisions made but both part of overall reserves management. Reserves near record levels. New ECU Treasury Bill programme will be secure, flexible and economical source of funds.

(H) FORWARD PURCHASES

37. **<u>When did you buy foreign currencies forward for partial finance of prepayment?</u>** At earlier stage. Never reveal details of market operations.

38. **<u>Does Government hold further forward reserves/are forward purchases made for other purposes?</u>** Bank of England makes forward currency transactions on behalf of Government Departments from time to time, but it is not practice to reveal details.

39. **<u>Monetary implications of forward purchases?</u>** When forward purchases of currency mature, they will increase sterling funding requirement one for one, compared with what would otherwise have been case because sterling then has to be provided. Will be funded in usual way.

(J) EUROPEAN MONETARY COOPERATION FUND (EMCF) SWAP

40. **<u>What is EMCF swap?</u>** As member of EMS, UK required to put at disposal of European Monetary Cooperation Fund 20% of its gold holdings and 20% of its gross dollar reserves in return for right to use equivalent value of ECUs. Each of these swaps is for three months, at end of which swap is unwound and a new one (with whatever quantities of gold and dollars <u>then</u> comprise 20% of its total holdings) is entered into.

41. **<u>Why is valuation adjustment necessary</u>?** Because of different valuation practices by UK and EMCF. UK revalues its assets only once a year (at end March), but EMCF values dollars and gold at prices based on current market values. EEA will therefore provide gold and dollars at its own valuation; will receive ECUs to an equivalent value at current exchange rates, but which will be held in EEA at EEA's own valuation rate. Valuation difference which arises does <u>not</u> represent loss (or profit) since EEA's underlying holdings of gold and dollars are unchanged when swap expires; adjustment made purely for accounting purposes. EEA continues to earn dollar income in underlying dollar assets. October change of $102 million represents valuation difference on July's swap, less valuation difference on new swap undertaken in October.

TABLE 3 - TOTAL PUBLISHED RESERVES

$ billion

	Total reserves changes during month		Level at end of month
USA	-	(end September)	48
Japan	+ 1.0	(end September)	91
Germany	+ 1.2	(w/e 26 October)	40
France	- 1.4	(end August)	61
Italy	- 1.1	(end September)	56
Canada	+ 0.8	(end September)	15
United Kingdom	- 0.4	(end October)	50

Notes

1. The figures for Germany, France and Italy were originally published in local currencies; they have been converted to dollars at appropriate exchange rates.

2. Figures not strictly comparable because of different valuation conventions for eg gold.

FROM: S BROOKS

DATE: 4 November 1988

1. MR GRICE I hope this provides the background information you asked for JWG 4.11.88

2. FINANCIAL SECRETARY

cc Mr Scholar
Mr Peretz o/r
Miss O'Mara
Mr Hurst
Mr Owen
Mrs Ryding
Mr Williams

(MG paper on intervention not attached to copies)

DZ

NOTES ON THE SAVINGS RATIO AND ON INTERVENTION

At your meeting on 25 October you asked for notes discussing the savings ratio and sterilised intervention. These are attached, together with an earlier MG paper on intervention.

S BROOKS

58/90

Savings and the Savings Ratio

1. The personal sector saving ratio as defined by the CSO is shown in chart 1. Savings are the personal sector's disposable income less its current expenditure; the savings ratio is savings divided by disposable income. The savings ratio was low in the immediate postwar period as the personal sector ran down its savings accumulated when there were few possibilities of spending. It increased sharply in the early seventies as inflation raged. This rise has generally been interpreted as reflecting the need for a greater savings effort to maintain the level of the personal sector's real wealth at a time when it was being rapidly eroded by high inflation. With the fall in inflation this effect has been substantially reduced. In the last two or three years the savings ratio has fallen rapidly. Its recent behaviour is discussed in the Industry Act Forecast paragraphs 30 and 31 (see Annex). The very latest figures for the savings ratio may well be poor estimates because it is likely that both consumers' expenditure and personal disposable income have been underestimated in the National Accounts. On balance the savings ratio is probably underestimated.

2. The rest of this note sets out the concepts underlying the discussion of the personal sector savings ratio. The personal sector itself comprises households, unincorporated businesses, private non-profit making bodies serving persons (universities, private schools and colleges, charities, trade unions, private housing associations, etc), private trusts and life assurance and pension funds. The household sector is not the same as the personal sector and, on occasions, can behave in significantly different ways. Nevertheless, households account for by far the largest part of the personal sector (table 1).

(i) Personal sector income comprises:

- income from employment (including employees' and employers' National Insurance and pension contributions);
- income from self-employment;
- rent, dividends and net interest receipts;
- social security benefits and other current grants from general government;
- current transfers from companies and overseas.

(ii) Personal sector disposable income is personal sector income less deductions.

(iii) Deductions comprise:

- taxes on incomes;
- social security contributions;
- transfers from personal sector to other sectors.

(iv) Current expenditure equals consumers' expenditure on goods and services.

3. An important component of the personal sector which is excluded from the household subsector is the life assurance and pension fund subsector. The life assurance and pension funds are the ultimate owners of much of the company sector. Thus, while they have no income from employment or self employment, they account for around 2/3 of the personal sector's rent, dividends and net interest receipts.

4. Because employees' contributions to pension funds, and employers' contributions on their behalf, are obligatory, there is a non-discretionary, contractual element to an individual's

saving. For the personal sector as a whole this shows up in the surplus in the LAPF subsector, reflecting the fact that the pension funds are continuing to grow. 'Discretionary' saving, which reflects the deliberate choices of individuals is best seen in household saving, which was positive in the early eighties but which has become negative more recently (table 2).

5. As discussed in the Industry Act Forecast, one reason for the decline in household and personal sector savings has been higher net interest payments, mainly reflecting the rise in the personal sector's mortgage (and other) debt. The personal sector has elected to maintain or increase its consumption, so that, for given wage and salary income, the reduction in net interest receipts has shown up as a fall in savings - both in absolute terms and as a proportion of disposable income (ie as a fall in the savings ratio). Other reasons for the decline are discussed in the Annex.

6. The savings ratio is a key macroeconomic variable. It determines, for example, the extent to which reductions in personal income taxes will be reflected in consumer demand - the lower the savings ratio, the larger the impact of tax cuts. The corollary of this is that, for given incomes and taxes, a fall in the savings ratio increases consumers expenditure. The recent decline in the savings ratio has, of course, been associated with strong consumption growth.