15. Monetary Control

Consultants

18 June 1980

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In replying please quote:
FOREX

1. Our view about monetary base control.

   (1) We are in favour of the rejection of the use of direct quantitative controls, e.g. "corset" as a means of controlling the money supply.

   (2) Proposed three ways - lagged accounting, current accounting and lead accounting - of a mandatory relationship between the base money and deposits have their respective problems.

2. Our view about indicator system.
Green paper proposes that there should be a power for the authorities to override automatic interest rate changes.
However, if the authorities are to make frequent use of their override, the advantages of an indicator system would be weakened.

3. The implement of monetary base control and indicator system would results in unexpected fluctuation in short term interest.

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18th June, 1980

Mr. T. Kamoshida
Deputy Chief Representative
in Europe
The Bank of Japan
27-32 Old Jewry
London, EC2R 8EY

Dear Mr. Kamoshida,

Re: Monetary Control,
Consultation Paper March 1980

The following is our comments on the above Paper:

We understand it necessary for the Bank to have some measures to control the money supply over the medium term as well as in the short run.

Our Sterling assets, however, are too small to affect the effectiveness of monetary control measures. At least we do not wish the present arrangements be changed further since our Sterling liabilities rely largely on the market money such that new requirements of any kind suggested in the Paper shall significantly increase our cost of funding.

Yours sincerely,

Hirosuke Sakai
Deputy General Manager

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19th June 1980

Mr.T.Kamoshida,
Deputy Chief Representative in Europe,
The Bank of Japan,
27-32 Old Jewry,
London EC2R 8EY.

Dear Mr.Kamoshida,

As requested in para 6.4 of the Government's recent Green Paper on Monetary Control I am pleased to give hereunder our views on the problems outlined.

(1)In respect of the question a)we feel that new regulations should be mandatory on all banks,but take into account the variety of business undertaken by different sectors and be fair to all including branches of foreign banks.

(2)With regard to question b)we think that any change in the system for determining M.L.R. should provide for basic information being available to all banks in the London Market at the appropriate time.

Yours sincerely,

H. Myoga

H.Myoga
Deputy General Manager

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TO WHOM IT MAY CONCERN

18th June 1980

MONETARY CONTROL - GREEN PAPER MARCH, 1980

We are writing in connection with the above, and would like to put forward our bank's point of view regarding the proposals.

If the proposed control is applied rigidly and the banking sector as a whole faces a shortage of cash reserves, then their position can only be adjusted as follows:-

a) by decreasing deposits and loans by some multiple of the shortage of reserves;

b) by absorbing unutilised cash from the private sector; or

c) by shifting current deposits to time deposits (in the case of the lower ratio of reserve assets being applied to time deposits).

Then the results of banks making adjustments to meet the cash reserve requirements will be:-

1) disordered and sharp fluctuations in short term money rates - causing a generally unstable market; and

2) significant cost increases.

It will probably be necessary for banks to hold a margin of excess cash in order to avoid being caught short and increasing costs still further. These will also penalise foreign banks and merchant banks which depend for their sources of sterling fundings mainly on the money market, and favour the clearing banks, since they hold huge resources of stable sterling funds.

Another point we would now like to make is against the proposed extension of the cash requirement to all banks. Only the clearing banks have a genuine need to maintain Bank of England balances because of the

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functions these balances perform in inter-banks settlement. Other banks do not have this need. To force them to keep money at Bank of England would again increase their cost of funding, since they have already kept deposits with the clearing banks for inter-bank settlement.

To some extent these effects can be mitigated by Bank of England paying interest on these cash reserves, or by monetary base controls being applied loosely, say weekly or monthly.

Turning to the "Indicator System", it seems to us that this is fundamentally similar to the system linking MLR to the Treasury Bill Rate. This too is likely to cause practical problems and begs the questions below:-

1) How can we obtain reasonably accurate forecasts of sterling M3 or monetary base seasonally adjusted?

2) What will be the timing and frequency of changes in MLR? and

3) What constraints will be applied to the Bank of England's discretion to alter MLR?

Finally, we wish to point out that we understand Bank of England's concern regarding monetary control, and we welcome the ending of direct quantitative controls, in particular the abolition of "the corset".

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Mr. Shiro Yokota,
Chief Representative,
The Bank of Japan,
27/32 Old Jewry,
London, EC2R 8EY.

18th June, 1980.

Dear Mr. Yokota,

I have pleasure in enclosing our comments on Monetary Control for you to pass on to the Bank of England in due course.

Should you require any further information we would be delighted to be of assistance.

Yours sincerely,

AKIRA TAKAHASHI
General Manager

18th June, 1980.

Re: "Monetary Control"

A. It is perhaps most useful to comment on the position of this bank as regards the practical problems mentioned in the paper (reference in brackets are to paragraphs - and Appendix - in "Monetary Control").

1. Our liquidity requirement does not vary significantly from week to week (4.7).

2. We are not liable to calls by customers on overdraft facilities; but we cannot accurately forecast our balance sheet owing to the varying influx of foreign currency deposits (4.11 and B12).

3. We would be able to vary our liabilities to some extent in the face of monetary control penalties (4.11 and B14).

4. We would not, in order to meet uncertainties about the effects of government transactions and customers' requirements, tend to hold base assets above what we thought likely to be needed (B 13).

5. We could not readily provide weekly figures on the B/S basis. Otherwise, our ability to produce weekly figures would depend on the requirement.

6. A proposal to change the settlement of cheques to a following day basis would be unwelcome (B23).

7. We do not depend on the purchase from us by The Bank of England of "Money market instruments" (B24).

B. On more general grounds we consider that of the two alternatives described under base control systems, that with a mandatory requirement would work the better; but we share the doubts expressed in the paper that it would be an improvement. The idea of negotiable entitlements is interesting as a possible means of reducing the disadvantages of direct control for banking efficiency.

On balance we feel some preference for an indicator system, using £M3 and weekly figures, with over-ride, as the possibility most worth further attention.

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(a) It would seem to us that the basic ideas between the new scheme and the present system would be quite similar and we don't think the new monetary base control scheme would surmount the difficulties in both controling the amount of base money and the total growth of the money supply and using divergences of the base money figure from the desired trend as a trigger for a change in interest rates.

In this country which has had the well developed financial market, it would be right that monetary base control scheme would be unlikely to work well under the present situation where the authorities have little idea of the size of Bank's preferred holdings of, say, call money at the discount houses of Treasury Bills and of local authority short term deposits.

We would have some chances of seeing such a scheme work well only if the authorities could induce the banks to hold their prudential balances as bankers' balances at the Bank of England rather than in short term primary liquid assets.

But even in these circumstances, it would be still doubtfull whether any predictable relationship between monetary base and present or future monetary growth would be established even if bankers' balance at the Bank became the main form of primary liquidity.

So that, our conclusion is that due to these technical difficulties, we doubt wether monetary base control scheme would produce the desired result.

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(b) It would seem to us that automatic adjusting way of the Bank's lending rate would have some advantage compared with the present discretionary system if it has some override.

The main advantages of such an automatic arrangement would be that interest rates would be adjusted promptly in response to a divergence from the target rate of monetary growth and that such adjustments would be continued until the money supply came back on course.

On the other hand, this would have the transient and erratic fluctuations in monetary growth.

The desirable way of automatic system would be that the authorities could have the power to override, not too frequently, automatic interest rate changes if it is possible.