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Another output fall in 1993?

An embarrassing Autumn Statement ahead for Mr. Lamont

If output falls again in 1993, this recession would the longest in our peacetime history

Among Mr. Lamont's many embarrassments about his economic policies the presentation of the 1992 Autumn Statement will undoubtedly rank high. Somehow he has to present a forecast for 1993 which will be both credible and not too absurdly inconsistent with all his previous statements about "recovery". On present trends the prospect is that national output will drop again in 1993, to make the third year of decline in a row. If this were to happen, it would be the longest peacetime recession in British history. (In the 1930s output fell for only two years.) Can the Chancellor forecast lower output in 1993 and yet avoid an onslaught of criticism in the media? How would his rebellious backbenchers react? Or can he somehow pretend that 1993 will see higher output despite the countless facts which argue otherwise?

One of these facts, the current behaviour of mortgage lending, needs to be highlighted. Data on mortgage commitments are crucial in forming a view on the economic outlook, for at least three reasons. First, while changes in borrowing are the most volatile influence on changes in the savings ratio, borrowing to buy houses represents roughly 90% of total personal borrowing. If we know that mortgage lending is about to fall sharply, we can be confident that the savings ratio will rise. Secondly, credit to the private sector is the dominant counterpart to monetary expansion and mortgage credit typically constitutes 40% - 50% of credit to the private sector. So, if mortgage credit is sluggish, monetary growth is likely to be low. This has wider significance, as real money growth is a good leading indicator of economic activity. Finally, the purchase of a house is a large capital item, associated with substantial transaction costs (which boost, for example, solicitors' and estate agents' incomes) and heavy incidental expenditure on consumer durables. Both housing starts and sales of consumer durables, like the real money supply, are reliable leading indicators for the economy.

Weak mortgage commitments worrying for the economy even if interest rates unchanged

So low mortgage commitments now or in the near future serve as a warning that spending and output will be weak in the next two or three quarters. The demand for mortgages ought to have been artificially strong in July and early August, because of the stamp duty holiday which ended on 19th August. However, the latest Building Societies Association figures show that net new mortgage commitments in July were £3.4b., less than in July 1991 (£3.9b.). The message has to be that mortgage lending this autumn will be very depressed, lower than at any previous stage of the recession. If UK interest rates stay unchanged for the next six months, the prospects for early 1993 would be poor; if they rise in the wake of a "no" vote in the French referendum (or a "yes" vote, for that matter), the outlook would be dreadful. A number of key forward signals to the economy - mortgage lending, monetary growth, housing starts and sales of consumer durables - would start pointing to another significant fall in output.

Professor Tim Congdon 3rd September 1992

Summary of paper on

How much underfunding is consistent with 2% - 3% inflation?

Purpose of the paper The case for underfunding the PSBR to boost monetary growth has been widely discussed recently. The paper considers what level of underfunding would be appropriate under current circumstances, assuming a medium-term inflation target of 2% - 3%.

Main points

* **Broad money growth of 6% - 8% a year is consistent with 2% - 3% inflation over the medium term. This conclusion assumes that the underlying "potential" growth rate of the economy is about 2% a year and that desired money holdings grow by 2% - 3% a year faster than incomes.**

* **If the authorities maintain the "full funding" rule, bank and building society lending of £3b. - £4b. a month is needed to achieve broad money growth of 6% - 8% a year. (This rests on assumptions about the other credit counterparts to monetary expansion.)**

* **Lending has been running below the £3b. - £4b. a month target recently, averaging only £2.5b. in the latest six months. With little prospect of an early reduction in interest rates, a recovery in credit expansion looks unlikely over the next few months.**

* **The authorities have the option of underfunding the PSBR to compensate for deficient credit growth. To bring M4 growth up to 6% - 7% a year, an underfund of £1/2b. - £1b. a month would be required. Gross funding needs are likely to be about £3b. a month over the remainder of 1992 - 93, so this would imply reducing sales of gilts and National Savings to £2b. - £2 1/2b. a month. (The figure will be lower to the extent that the authorities continue to intervene to support sterling.)**

This paper was written by Simon Ward.

How much underfunding is consistent with 2% - 3% inflation?

A monetarist approach to the inflation problem, continued

Recent M4 growth too weak to support rcovery

The issue of funding policy has recently returned to centre-stage. At the heart of the debate has been the question of whether the authorities should "underfund" the PSBR under present circumstances (i.e., finance part of it by borrowing from the banking system, rather than by selling debt to the non-bank or overseas sectors). The case for a more flexible approach to funding has been put several times in this *Review* (see, for example, the issues of August 1989, May 1990 and September 1991). In recent months the argument for underfunding has been particularly urgent, because of the depth and gravity of the recession. The view in these *Monthly Economic Reviews* has been that the current rate of broad money growth is too low to support a sustained revival in economic activity. In particular, because the personal sector's demand to hold money has been boosted by increased saving and high real interest rates, companies are finding difficulty rebuilding their liquidity and balance-sheet strength to the levels which have preceded previous recoveries.

But if the case for underfunding is accepted, the question which follows is "how much underfunding would be appropriate under current circumstances?" This article attempts to give an answer. It follows the same basic approach as the *Monthly Economic Reviews* of July 1989, October 1990 and September 1991. The method is to propose a rate of broad money growth which is judged to be compatible with the current framework of economic policy. The "credit counterparts" approach to analysing of monetary expansion is then used to assess the implications of this target for bank and building society lending, assuming that the authorities maintain a "full fund". The resulting figure for "allowable" lending can be compared with the recent underlying trend in credit expansion. The difference represents an estimate of the amount of underfunding needed to raise broad money growth to its target level. (It should be recognised that the focus on monetary growth as the prime target of policy is somewhat unreal given the UK's participation in the European exchange rate mechanism. The authorities' freedom to adjust short-term interest rates in order to achieve their monetary objectives is now much constrained.)

Appropriate level of lending £3b. - £4b. a month, but recent trend only £2 1/2b. a month

Our conclusion will be that underfunding of £1/2b. - £1b. a month would be justified under present conditions. This rests on a target for M4 growth of 6% - 8% a year, which, given our assumptions about the other credit counterparts, implies an "allowable" lending figure of £3b. - £4b. a month. In recent months, lending has been running at only about £2 1/2b. a month. These results are broadly similar to those obtained when we last conducted this exercise in September 1991. But there is one important difference. At this time last year, interest rates were on a downward trend and it was possible to argue that a revival in credit demand might alleviate the problem of deficient monetary

growth. But base rates have now been stuck at 10% for several months and there is a risk that they will have to be raised to support sterling. With little prospect of an early recovery in credit expansion, the case for a change in funding policy is more pressing than ever.

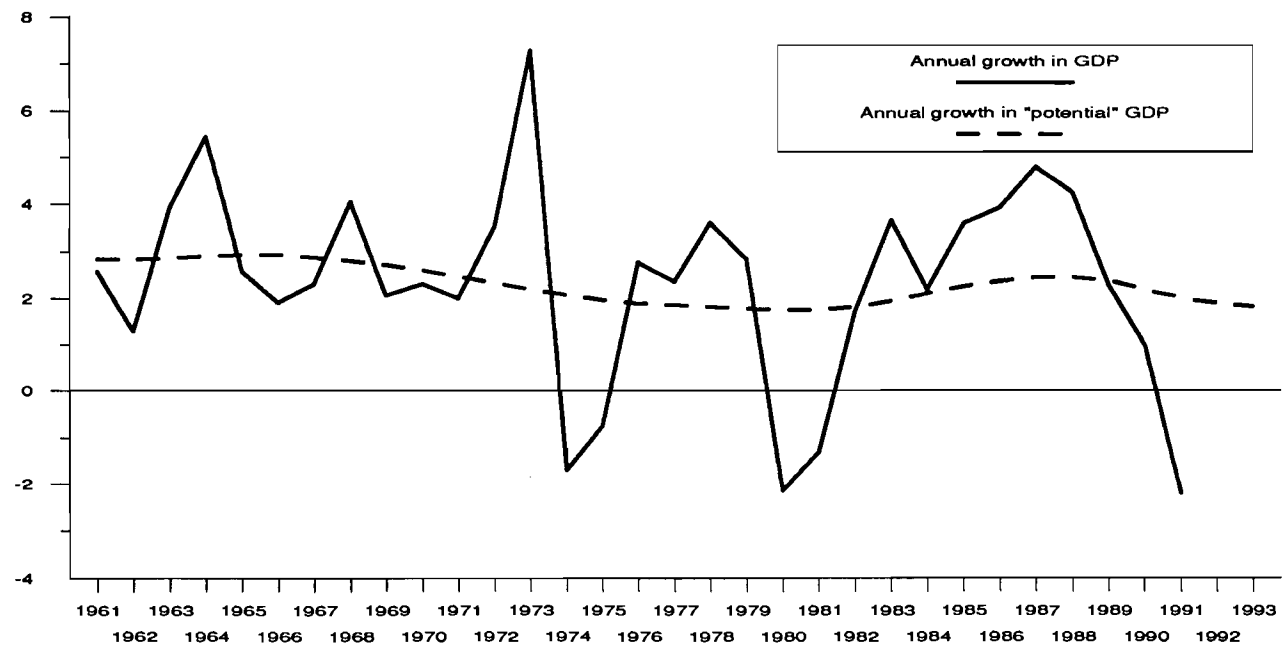
M4 growth target depends on:
1. inflation objective

The first step in the analysis is to propose an "appropriate" rate of broad money growth under present circumstances. Following the model provided by the Bundesbank, this can be set with three factors in mind:
- the authorities' target for inflation over the medium term,
- the economy's underlying or "potential" growth rate, and
- the rate at which money demand is expected to expand (or contract) relative to nominal incomes.

We shall consider these in turn.

So long as Britain remains within the ERM, the inflation target is effectively set externally by the need to match performance in other ERM countries. The average ERM inflation rate (excluding the UK) has come down from about 5% to 4 1/4% over the last year. But the figure is still being boosted by the inflationary problems in Germany. The Bundesbank is determined to bring German inflation back down to 2% over the medium term. We shall assume that UK inflation must fall to 2% - 3% to keep UK prices in line with those in other ERM countries over the next few years. (It should be emphasised that this is not an endorsement of 2% - 3% inflation, only a judgement that it would be compatible with the current policy framework.)

Actual and "potential" GDP growth



Source: *Economic Trends* and Lombard Street Research estimates

2. potential growth rate

The economy's potential growth rate is the rate at which GDP would increase if labour and capital were employed at "normal" levels. Since it cannot be measured directly, there is controversy over its precise level. The chart on p.4 shows estimates by Lombard Street Research derived with the help of a "production function", which relates the level of output to inputs of labour and capital. These suggest that potential growth rose from 1 3/4% - 2% a year to 2 1/4% - 2 1/2% a year between the first and second halves of the 1980s. The increase was due to a combination of faster labour force growth and higher investment. There also appears to have been an improvement in the underlying rate of productivity growth. More recently, however, the labour force has been contracting, as the recession has led some people to withdraw from the jobs market. With investment also much lower than in the late 1980s, the economy's potential growth rate may now be only about 2%.

3. relationship of desired M4 holdings to nominal incomes

Combining this with our inflation target of 2% - 3% implies nominal income growth of 4% - 5% a year. To translate this into a target for broad money growth, we need to allow for changes in the relationship of desired M4 holdings to incomes. As the chart on p. 6 shows, the M4/GDP ratio rose strongly during the 1980s. It grew at an annual rate of about 4% in the early 1980s, rising to 6% during the second half of the decade. But it would be wrong to assume that these increases were entirely due to growth in the underlying demand for money. There were certainly some important factors tending to increase desired M4 holdings during the 1980s, including rapid growth in private sector wealth and high real interest rates. In addition, financial liberalisation led to the introduction of more attractive terms on many bank and building society accounts. But liberalisation was largely complete by 1985. The acceleration of the M4/GDP ratio later in the decade reflected not only an increase in underlying demand, but also the creation of excess money balances. The private sector's attempt to eliminate these excess balances was a key motivating force behind the Lawson boom and subsequent inflation.

What about developments more recently? As the chart shows, the money/GDP ratio has stabilised since early 1991. However, just as the sharp rise in the late 1980s was indicative of excess money balances, the recent slowdown could simply reflect deficient monetary growth. This interpretation is supported by the continued weakness of economic activity. The alternative would be to argue that the underlying growth rate of money demand has fallen. But this seems difficult to sustain. True, private sector wealth has been depressed by the large fall in property prices since the late 1980s. However, the financial component of wealth has continued to grow recently, as people have built up their precautionary savings. Moreover, real interest rates remain very high, while the introduction of TESSAs and other changes have made bank and building society deposits more tax efficient compared with other forms of saving than they were during the 1980s. (There are also larger questions about the sustainability of the asset prices and real interest rates in recent years. If high asset prices and interest

rates have eventually to come to an end, the demand to hold interest-bearing money balances might fall compared with current levels.)

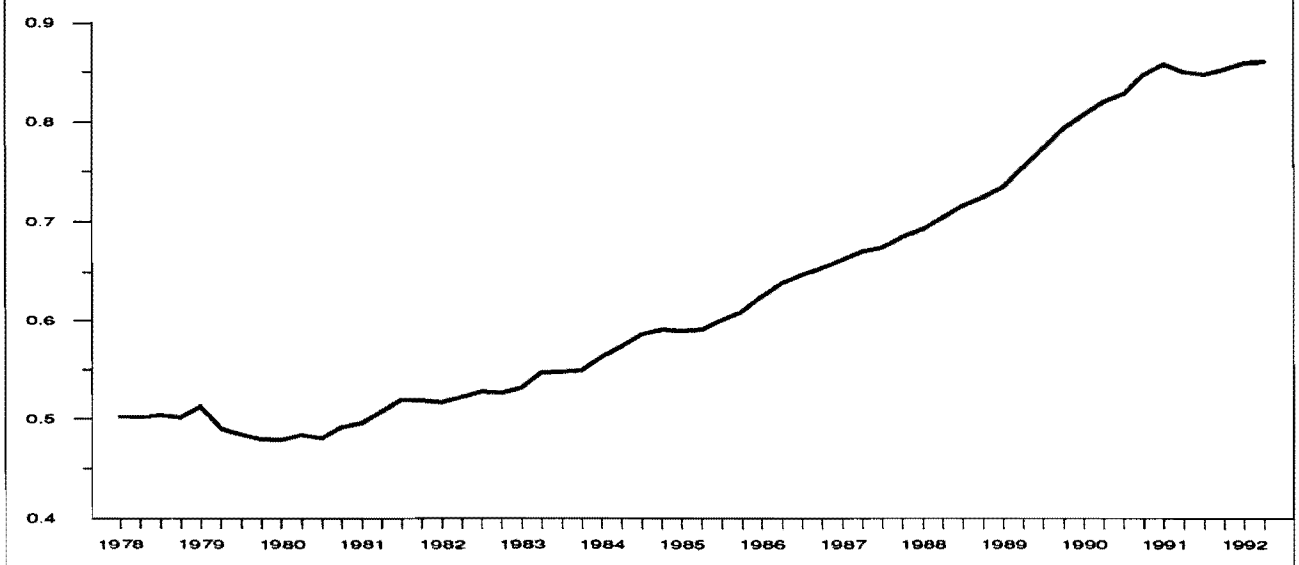
M4 growth of 6% - 8% p.a. consistent with 2% - 3% inflation

On balance, it seems likely that the desired M4/GDP ratio will continue to rise over the next few years, but possibly at a slower rate than during the 1980s. We shall make the working assumption that an increase of 2% - 3% a year would be sufficient to accommodate the underlying increase in demand for M4 balances. The choice of a particular figure is inevitably somewhat arbitrary and it could be argued that we are being over-cautious in light of the strong rise during the 1980s. But over the last 25 years the average growth rate has been about 2% a year. Given a target of 4% - 5% a year for the rate of increase of nominal incomes, our assumption implies an allowable growth rate of M4 of 6% - 8% a year. With the level of M4 standing at £515b. at the end of July, the annual increase in money terms would be £31b. - £41b.

"Credit counterparts" analysis allows M4 growth target to be related to lending and funding policy

M4 is made up entirely of liabilities of the monetary sector (i.e., commercial banks, building societies and the Bank of England). It follows that changes in M4 can be seen as the consequence of changes in other components of the monetary sector's balance sheet. This gives rise to the familiar "credit counterparts" analysis of M4 growth. There are four such counterparts: private sector borrowing from banks and building societies, public sector borrowing from the same sources, external and foreign currency banking flows and the change in net non-deposit liabilities. If £31b. - £41b. is the allowable increase in M4, then the sum of the four counterparts must come within this range. The aim of our analysis is to calculate an "appropriate" figure for lending to the private sector, assuming that the public sector is "fully funded" (i.e., does not borrow from the banking system). Given our target for M4 growth, this requires

Ratio of M4 holdings to nominal incomes



Source: *Financial Statistics*

us to make assumptions about the other two credit counterparts: external and foreign currency banking flows and the change in net non-deposit liabilities.

The other credit counterparts: ***1. external and foreign currency banking flows***

External and foreign currency banking flows comprise two items: net lending by banks and building societies in sterling to overseas residents; and net lending to all sectors in foreign currencies. The link with monetary growth is straightforward. When a bank makes a new overseas or foreign currency loan, it must fund this via an increase in its deposit base. If the new deposits are held by overseas residents or denominated in foreign currency, there is no impact on M4. But if they are sterling deposits held by UK residents, they count as an increase in M4. External flows have then contributed to monetary expansion.

In practice, external flows tend to act as a sort of "safety valve", reducing imbalances between money supply and demand. For example, when strong credit expansion was boosting monetary growth in the late 1980s, external flows became contractionary. In 1988 and 1989 they subtracted 4% a year from M4 growth (see the table on p.8). This helped to moderate the build-up of excess money balances. More recently, the sharp slowdown in credit expansion has been partially offset by a positive contribution from external flows. In the year to June, they boosted annual M4 growth by over 1%.

These swings can be seen as the consequence of people's and companies' attempts to achieve their desired level of money balances. When there is too much money in circulation, part of the excess is likely to be spent on increased purchases of foreign goods and assets, leading to a deterioration in the balance of payments. There will then be a transfer of money to foreigners, i.e. a contractionary external banking flow. Conversely, when money is tight, imports of goods and investment abroad will typically be cut back, resulting in an inflow of funds which helps to relieve the domestic liquidity squeeze.

These relationships have been formalised in the so-called "monetary theory of the balance of payments". According to this theory, the balance of payments and external banking flows automatically adjust to keep the supply and demand for money in equilibrium. Some commentators (notably Mr. Peter Spencer of Kleinwort Benson) have recently invoked the theory to criticise the case for underfunding. They argue that attempts to boost monetary growth would simply lead to a deterioration in the balance of payments and a corresponding transfer of money abroad. But this perspective is extreme. Most people would expect purchases of domestic, as well as foreign, goods and assets to increase in response to an increase in the money supply. Underfunding would therefore help to support domestic activity and any offsetting impact on monetary growth from external flows would probably be small.

For the purposes of the current exercise, we shall assume that external banking flows continue to have a positive impact on monetary expansion. However, the

aim in our analysis is to examine the implications for the credit counterparts of a rise in M4 growth to 6% - 8% from its current rate of about 5%. Since external flows normally move to counterbalance changes in the other counterparts, it is reasonable to assume that their positive influence will be less than that experienced over the last year. We shall use a figure of £2b. - £4b. a year, which would imply an annual contribution of about 1/2% to M4 growth. But it is important to stress the uncertainty involved. External flows can be very volatile and will reflect changes in the other components of the balance of payments. An improvement in the current or non-bank capital accounts would result in larger inflows of money to the UK. Given our target for M4 growth, this would imply a lower permissible level of bank and building society lending.

2. change in net non-deposit liabilities

Net non-deposit liabilities comprise banks' and building societies' sterling capital and reserves, less their investments in non-financial assets. These items are relevant to the counterparts analysis because they can allow lending to be expanded without a corresponding increase in deposits. A rise in non-deposit liabilities can come about through the retention of profits (including provisions against bad loans), new issues of equity or loan stock, or sales of land and buildings. When a loan is written off, they fall, since reserves are then cut. For any given level of overall lending, the larger is the increase in non-deposit liabilities, the smaller is the rise in deposits and the slower is monetary growth.

Non-deposit liabilities exerted a strong contractionary influence on M4 growth during the late 1980s, averaging about 3% a year (see the table on p. 8). This reflected buoyant profits and a desire to maintain capital ratios as balance sheets expanded rapidly. With the onset of recession, however, profits came under a severe squeeze, as lending growth slowed sharply, arrears climbed and costs continued to escalate. Higher loan write-offs also cut into reserves, while banks

M4 credit counterparts (contribution to M4 growth in %)

	1986	1987	1988	1989	1990	1991	1992*
Public sector contribution	-2.4	0.6	-1.6	0.0	0.2	-0.3	-0.5
£ lending to private sector	21.0	20.8	27.2	24.9	16.8	7.6	6.4
External/foreign currency banking flows	-0.4	-2.2	-4.0	-4.1	-2.6	0.3	1.2
Net non-deposit £ liabilities	-2.5	-3.2	-4.3	-2.8	-2.3	-1.5	-1.9
Change in M4	15.6	16.0	17.3	18.0	12.1	6.2	5.2

*12 months to end-June

Source: *Financial Statistics*

were generally reluctant to ask their shareholders for more cash. As a result, non-deposit liabilities reduced M4 growth by only 1 1/2% during 1991. More recently, they have increased again, with a contractionary influence of nearly 2% in the year to June. Judging by the clearing banks' first-half results, wider interest margins and cost-cutting have produced a slight improvement in operating profits. Although write-offs have remained at a high level, it has been possible to make small transfers to capital and reserves. Fund-raising in the capital markets (through bond issues) has also helped.

What about the outlook for the next year? Net non-deposit liabilities now amount to roughly 13% of banks' and building societies' sterling assets. If balance sheets expand by 6% - 8% a year, in line with our target for M4 growth, non-deposit liabilities would have to rise by £6b. - £8b. a year to keep them at 13% of total assets. Is this assumption reasonable? Despite recent very poor results, bank and building society capital ratios look relatively comfortable at present. (The clearing banks will have no problem meeting the Basle accord target of tier I and II capital of 8% of risk-adjusted assets by the end of 1992.) On the other hand, bad debts look set to remain at a high level and financial institutions may wish to boost their reserves further to provide a cushion against future write-offs. We shall therefore assume that non- deposit liabilities increase by £8b. - £10b. a year over the next couple of years, slightly higher than needed to maintain their ratio to total assets. This would imply a contractionary influence of about 1 3/4% a year on M4 growth.

Implications of credit counterparts arithmetic for level of lending

We are now in a position to work out the implications of our monetary growth target for bank and building society lending. Our guesstimates (in £b.) for external and foreign currency banking flows and the change in net non-deposit liabilities are as follows:

External banking flows	+2 to +4
Non-deposit liabilities	-10 to -8
Sum	-8 to -4

The key identity for our analysis (all items in £b.) is:

> Allowable lending to the private sector = Allowable increase in M4 - public sector contribution - external and foreign currency banking flows - change in net non-deposit liabilities.

We shall start by assuming that the "full funding" rule continues to be implemented, so that the public sector contribution to M4 growth is zero. We argued above that the M4 growth rate consistent with a medium-term inflation rate of 2% - 3% is 6% - 8% a year, or £31b. - £41b. in money terms. Plugging this into the identity, together with our assumptions about the other counterparts,

we arrive at an annual total for bank and building society lending of £35b. - £49b. (i.e. £31b. - £41b. plus £4b. - £8b.). This is equivalent to a monthly lending figure of £3b. - £4b. With the stock of bank and building society lending amounting to £617b. at the end of July, the central figure of £42b. (or £3 1/2b. a month) implies a growth rate of about 7% a year.

Lending now below £3b. - £4b. a month target, with few signs of recovery

How does recent credit growth compare with this target? In the six months to July, bank and building society lending averaged £2.5b. a month. The last couple of months have seen marginally higher figures, but this appears mainly due to the temporary impact of the stamp duty holiday on mortgage lending. Mortgage demand could slump in the autumn. The outstanding stock of building society mortgage commitments fell further in July and is now less than three-quarters of its level a year ago. Recent Gallup consumer survey results show that people have become markedly more pessimistic about their financial prospects, which will deter borrowing. The balance of interviewees expecting their financial situation to improve over the next twelve months has fallen from +14% immediately after the election to zero by July. Any rise in interest rates would deepen the gloom.

Nor is the outlook for corporate credit demand any better. *Euromoney* compiles lists of recently-arranged credit facilities to UK borrowers. Since there is normally a delay before these are utilised, they provide a pointer to future credit trends. The average monthly value of such facilities fell from £3.8b. to £1.4b. between 1989 and 1991. So far this year, they have been running at only £1.0b. a month. A major reason is the continuing weakness of corporate balance sheets. The liquidity ratio of industrial and commercial companies (i.e., their M4 holdings divided by bank borrowing) remained stuck at 50% during the first half of this year, well below its "normal" level of 55% - 60%. Until liquidity revives, the pressure to cut back borrowing will persist.

Underfunding of £1/2b. - £1b. a month needed to compensate for weak credit expansion

Total bank and building society lending therefore seems unlikely to rise much above its recent level of £2 1/2b. a month in the current environment, while our analysis suggests that an "appropriate" range would be £3b. - £4b. If the "full funding" policy were maintained, then our assumptions about the other credit counterparts imply that M4 would grow at an annualised rate of about 5% a year, more or less in line with the recent trend. But the authorities also have the option of underfunding the PSBR to compensate for deficient credit growth. To bring M4 growth up to 6% - 7%, the lower half of our target range, underfunding would need to be £1/2b. - £1b. a month, or £6b. - £12b. annually.

How practical is this suggestion? According to the latest Treasury survey of forecasters, the PSBR for 1992 - 93 is expected to come in at around £32b. In the first four months of the year it totalled £11.3b., so this implies a borrowing requirement of some £20b. between August and March. On top of this, there are three gilt redemptions before the end of the financial year, involving a total

amount of £3.9b. Gross funding needs over August to March should therefore be of the order of £24b., or £3b. a month. Assuming that National Savings inflows remain at their recent level of around £1/2b. a month, it should, in principle, be fairly straightforward to adjust new gilt issues to achieve an underfund of £1/2b. - £1b. a month.

Intervention could complicate achievement of funding target, but only temporarily

But one possible complication should be mentioned. In the last few days the weakness of sterling in the ERM has obliged the Bank of England to intervene on the foreign exchange markets. According to press reports, it spent up to £1b. on one day alone. Running down the reserves brings money into the Exchequer in the same way as sales of public sector debt needs to be taken into account in the funding arithmetic. As long as intervention is on a small scale or relatively infrequent, it should be possible to offset its impact on the funding position by lowering gilt sales correspondingly. (This is known as "sterilising" the intervention.) But if intervention becomes heavy and prolonged, the sums involved may be so large that the target level of funding is overshot even if the authorities stop issuing gilts altogether. The PSBR would then be overfunded, implying a negative influence on monetary expansion. (The precise impact on M4 growth would depend on possible changes in the other counterparts. In particular, strong downward pressure on sterling might be associated with a reduction in foreigners' net sterling deposits with UK banks or a rise in banks' net foreign currency exposure. Both would imply a positive impact of external banking flows on monetary expansion, which would partly offset the contractionary effect of overfunding.)

But this is a relatively minor qualification. Over a period of more than a few months, intervention is unlikely to play a dominant role and the authorities should be able to achieve an underfund of £1/2b. - £1b. a month without too much difficulty. It should be emphasised that this scale of underfunding would be unexceptional by historical standards. In 1974 and 1975 the public sector made a positive contribution to M4 growth of over £4b. a year, equivalent to about £20b. a year at current prices, well above our suggested range of £6b. - £12b. (Because of a collapse in private credit expansion, M4 growth actually decelerated sharply over this period.)

Public sector deficits underfunded in the US and Germany recently

Nor would underfunding be exceptional in an international context. Although the concept is unfamiliar in the United States, partly because of differences in terminology, analysis of the Federal Reserve's *Flow of Funds Accounts* shows that the US Federal deficit was underfunded by around $120b. during 1991. In an arithmetical sense this contributed about 3% to US M3 growth last year, which nevertheless was only 1.4%. The German public sector deficit has also been routinely underfunded in recent years. Indeed, figures published in the Bundesbank's *Monthly Report* for July 1992 show that the public sector contributed DM47b., or about 3%, to M3 expansion in the year to May. In parallel with the case for underfunding in the UK, an argument can be made

that the German authorities should overfund their PSBR under present circumstances to contain the impact of buoyant credit demand on monetary growth.

Authorities appear to have rejected case for underfunding

How likely is an early change in UK funding policy? Recent signals have been less than encouraging. There was no discussion of the issue in the latest *Bank of England Quarterly Bulletin*, while official operations in the gilt market suggest that the authorities are keen to press ahead with the funding programme. (The amount offered at the August gilt auction was kept in line with previous auctions, even though the PSBR has been overfunded so far in 1992 - 93.) It could be that the authorities have become more sympathetic to the case for underfunding recently, but are reluctant to announce a change in policy while sterling remains under downward pressure within the ERM. However, the more likely explanation is that they are continuing to attach a low importance to the behaviour of broad money, despite the lessons of recent years. Further clarification of the official position will no doubt come in the Mansion House speech next month.

Continued M4 growth of 5% a year would imply, on our assumptions, an eventual inflation rate of close to zero. The advantages of a stable price level, as opposed to 2% - 3% inflation, were set out in the *Monthly Economic Review* of July 1992. However, the costs associated with the transition to price stability must also be taken into account. The traditional monetarist view, associated with Milton Friedman, has been that the adjustment is best achieved via gradual reductions in monetary growth over a number of years. By allowing annual M4 growth to collapse from around 18% in early 1990 to 5% now, the authorities have effectively telescoped into two years a transition which would have been better managed over four or five years. In the process, heavy damage has been inflicted on the economy. It may be right to aim for a growth rate of M4 of about 5% a year over the longer term. But there is nonetheless a strong case for providing a temporary boost to monetary expansion until the economy shows clear signs of recovery.