

FROM: COLIN MOWL
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- 1. MR SCHOLAR *Approved in draft*
- 2. **CHANCELLOR** *OK - for the re scale of the Assp. -*

cc Economic Secretary
 Sir P Middleton
 Sir T Burns
 Mr Anson
 Mr Sedgwick o.r.
 Mr Peretz
 Mr Odling-Smee
 Mr A J C Edwards
 Mr Potter
 Mr Grice
 Mr Vernon
 Mr Franklin

(over X)
Content?
3/8

LOCAL AUTHORITY BANK DEPOSITS AND THE LABR

As you know, for speed and accuracy the PSBR, including the LABR, is measured from the transactions financing it. Changes in local authority (LA) bank deposits are one of the financing items used in compiling the LABR. You will recall that during the course of 1986-87 a large discrepancy emerged between the estimates of changes in LA bank deposits collected by the DOE from the LAs themselves and those collected by the Bank from the banks and used to compile the LABR. This discrepancy naturally led to doubts about the accuracy of the published LABR figures.

2. A number of changes were made to the collection procedures early in 1987-88, primarily clarifying the definition of a bank deposit on the DOE returns, but with no immediately apparent effect on the figures. In September 1987 we advised you that the statisticians had concluded that a full reconciliation between figures for individual authorities from the two sources was required. In the event the practical difficulties of mounting a full enquiry involving banks and LAs proved insuperable and instead the DOE mounted a small sample survey involving 30 local authorities, seeking further detail on the information they provided for the regular monthly LABR figures.

3. The survey identified four major items which could have given rise to the bank deposits discrepancy:

- (i) banks wrongly including deposits held by LA superannuation funds - these deposits should be counted as OFIs' deposits;
- (ii) difficulties in classifying LA assets managed by independent fund managers;
- (iii) difficulties experienced by LAs in distinguishing banks from other financial institutions even though they are provided with a list of banks;
- (iv) the treatment of LA companies.

4. The survey has had no direct implications for the bank deposit or LABR figures - ie it has not led to any changes in the published figures - but has identified key areas which DOE and Bank statisticians will keep a close-eye on when processing the monthly returns. There is now no real possibility that the discrepancy between the bank deposits estimates in 1986-87 will be revised away. There was also a discrepancy between the two estimates of changes in deposits in 1987-88 of a similar magnitude but with the opposite sign (see table attached). It is possible therefore that the discrepancy has permanently unwound but it is also possible that these movements are fortuitous and that the problem will re-emerge.

5. Although no direct changes to past figures have resulted from the survey and subsequent discussions, we have concluded that a change to the way future LABR figures are compiled would be advisable. It would in effect remove an anomaly which was created when the PSBR was re-defined in 1984. Prior to 1984 the LABR was based entirely on LA returns to the DOE. After the re-definition the LABR was a composite of figures provided by the LAs and banks and was not constrained to the LABR implied by LA figures. But the recent exercise has shown that while the LAs' allocation of their net financing among the available individual instruments might be suspect, the figure they report for their total net finance should be more accurate.

6. We propose therefore in future to constrain the published LABR figure to that implied by the LAs' returns to the DOE. As well as side-stepping the allocation problem this would also minimise timing and other inconsistencies which are liable to arise when taking figures from different sources. Published estimates for LA bank deposits (and for bank lending to LAs) would however continue to be based on the banks' figures to retain consistency with the monetary statistics and because we still believe that they are likely to be more accurate than the LAs'. The LAs are likely to provide the most accurate estimate of the LABR and the banks the most accurate estimate of LA bank deposits.

7. We propose to make this change with effect from the start of the current financial year, with the first figures on the new basis being published in the PSBR press notice on 16 August. This will almost certainly involve some revisions to the April to June figures already published, but revisions are always likely in August because of the incorporation of a complete set of end-quarter returns from LAs in place of the monthly sample used thus far. It should be possible therefore to introduce the change in a low-key way. We do not yet know the size or sign of the revisions but if they prove to be very large we could defer the change to later in the year (when some of the implied discrepancies between alternative sources may have unwound) or even implement it with effect from the beginning of 1989-90. We shall make a final recommendation on the timing when we put the draft press briefing to the Economic Secretary on 12 August.

8. The financing counterpart to any LABR revisions will be LA borrowing from the M4 private sector. The revisions will therefore not affect the funding position for 1988-89 to date.

9. It would be possible in principle to revise the LABR figures for previous financial years by constraining them to the totals from LA returns to the DOE. However there are two arguments for not doing so. The first is the pragmatic one of wishing to minimise revisions. The second, more substantive, is that only now we are into 1988-89 - after the changes to improve the LAs'

returns and the associated enquiries - can we be reasonably sure that the DOE estimate of the LABR is sufficiently reliable.

Conclusion

10 You are invited to note that:

- (i) discrepancies between alternative estimates of changes in LA bank deposits in 1986-87 and 1987-88 remain and are unlikely to be revised away;
- (ii) some possible areas where the discrepancies could have arisen have been identified and will be kept under review;
- (iii) a change in methodology for compiling the LABR, which should in principle produce more accurate figures, is proposed;
- (iv) it is provisionally proposed to introduce this change with effect from the beginning of 1988-89, in the August PSBR press notice, but it will be possible to defer the change if the revisions to the April-June figures prove very large.

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£ million

	<u>Changes in LA bank deposits*</u>		LABR
	DOE estimate from LAs	Bank of England estimate from banks	
1982-83	190	279	87
1983-84	92	213	1206
1984-85	301	302	2386
1985-86	665	726	1670
1986-87	586	1324	238
1987-88	1679	1114	1464

* + reducing LABR,
- increasing LABR