Transactions balances—a new monetary aggregate

- *This note introduces a new measure of deposits, which focuses on the transactions balances of the private sector.*
- *The new series has been constructed as one of the steps, announced by the Chancellor of the Exchequer in his Budget Statement on 10 March 1981, to improve the information available about the narrower measures of money; it is called M_2.*[1]

Purpose of the new series

The object was to design a new measure which could be expected to be more directly related to transactions in goods and services than sterling M_3, and somewhat less sensitive to relative interest rates than M_1.

The narrow aggregate M_1 comprises all sterling sight deposits held by the private sector with the monetary sector (plus notes and coin in circulation with the public). Thus it excludes certain deposits, such as the clearing banks' seven-day deposits, which, although nominally requiring notice of withdrawal, are in practice available on demand with very little penalty; and are therefore likely, in part at least, to be used as transactions balances.

Moreover, nearly four fifths of M_1 is non-interest-bearing (notes and coin and non-interest-bearing sight deposits). As interest rates rise, there is a tendency for holders to shift into alternative, interest-bearing, deposit accounts offering certain money transmission services; not all these deposits are in M_1. The resulting movements in M_1 generally exaggerate the impact of such changes in interest rates on underlying monetary conditions. M_1 also includes some large, interest-bearing, overnight balances held for investment rather than for transactions purposes.

On the other hand, the broader aggregate sterling M_3 includes *all* sterling sight and time deposits of the public and private sectors with the monetary sector. It includes balances held as investments which are close substitutes for non-monetary instruments such as bills and local authority deposits. These investment balances are not likely to be closely, or stably, related to movements in current expenditures and incomes in the United Kingdom.

An intermediate aggregate was therefore sought which would identify those types of deposits that can most readily be used for transactions purposes. So long as large investment balances are excluded, the aggregate should be less subject to shifts in the pattern of financial intermediation, since transfers from the deposits within such an aggregate into others (for example, into deposits held in offshore banking centres) would probably be inhibited by cost and inconvenience.

Definition of the new series

The following criteria might be used to distinguish between transactions balances and investment balances:

Maturity. To be suitable for transactions, a deposit must have a reasonably short maturity. Original maturity might be more closely related to the initial economic purpose of the deposit. But residual maturity, although it would bring in wholesale money market deposits as they approach maturity, reflects the effects of the passage of time on the liquidity of term deposits, and is easier for the banks to report.

Size. A limit on size would exclude most balances which are primarily held as investments, although any cut-off point must inevitably be arbitrary. What is regarded as a transactions balance by a large company may be very different from what an individual thinks of as a transactions balance. And fluctuations would arise from deposits moving into and out of the aggregate—for example, as a result of companies paying wages from large (excluded) deposits into small (included) accounts. It would be desirable to increase the size limit periodically in order to minimise the downward bias to growth in the aggregate which would result if inflation tended to increase the average size of deposits.

Type of deposit. Maturity and size limits would help to identify those deposits which could most readily be used for transactions purposes. But a more direct method would be to select those types of deposit which could be transferred to third parties on demand or at short notice, such as:

- non-interest-bearing sight deposits;
- all other chequable accounts;
- all accounts from which standing orders, etc, could be made;
- all small accounts of very short original maturity;
- accounts from which frequent transfers could be made without significant penalty (eg loss of interest for a short period only).

(1) The series introduced here differs from the old M_2 series which was dropped in 1971 following the introduction of *Competition and credit control.* The old series consisted of M_1 plus private sector deposit accounts with 'deposit banks' (which comprised the clearing banks and a handful of other banks doing similar business) and discount houses.

M_2—transactions balances

£ millions; *not seasonally adjusted*

	Level at 18 Nov. 1981(a)	Changes in months ended: 1981 9 Dec.	1982 20 Jan.	17 Feb.	17 Mar.	21 Apr.	19 May
Notes and coin in circulation with the public	10,337	+357	−277	− 25	+ 82	− 6	+ 10
Private sector sterling non-interest-bearing sight deposits	17,913	+ 82	−125	−736	+218	+721	− 55
less 60% of net debit transit, etc, items	− 1,451	+ 64	−307	+352	− 64	−299	+137
Non-interest-bearing M_1	26,799	+503	−709	−409	+236	+416	+ 92
Other private sector retail deposits(b)	27,738	−652	+714	− 73	+ 29	+198	+ 54
M_2	**54,537**	**−149**	**+ 5**	**−482**	**+265**	**+614**	**+146**
Public sector retail deposits	*1,113*	*−108*	*+410*	*−324*	*+ 49*	*+172*	*+ 77*
Overseas retail deposits	*2,289*	*−141*	*+198*	*− 13*	*+ 83*	*−124*	*+180*

(a) On the basis of the new monetary sector.

(b) The figures for some months are affected by the crediting of interest, particularly in the month to mid-January.

Discussions with the banks about providing additional information on such deposits met with their full co-operation and agreement was reached on the definition set out below. The banks set in hand the necessary changes to their reporting systems, which in some cases were quite extensive because the cut-off by size was an innovation in banking statistics.

The new aggregate includes the following sterling deposits:

(a) all non-interest-bearing sight deposits;(1)

(b) all other deposits (regardless of size and maturity) on which cheques may be drawn or from which standing orders, direct debit mandates or other payments to third parties may be made;

(c) other deposits of less than £100,000 having a residual maturity of less than one month on the reporting day, including deposits of less than £100,000 for which less than one month's notice of withdrawal is required. (Where a deposit is, by common practice, available to the depositor before its legal maturity without significant penalty, it is classified according to the earliest date at which it may be transferred or withdrawn; loss of interest for fourteen days or less is not normally considered significant.)

In addition the new aggregate, in common with the other monetary aggregates, includes notes and coin in circulation with the public.

Although statistics are being collected for all deposits of the kinds listed above, M_2 includes deposits held by the private sector only, as does M_1. Figures for overseas and public sector deposits are, however, given in the table.

As with M_1 and sterling M_3, the aggregate is restricted to cash and deposits, and does not include credit facilities available for the settlement of transactions, for which there are no adequate data.

If foreign currency deposits were to be used to a significant extent for transactions purposes within the United Kingdom, which at present seems unlikely, it might then be necessary to include them in M_2.

Institutional coverage

Figures for non-interest-bearing sight deposits are already supplied by monetary sector institutions as part of the regular banking statistics. At present the statistics for the deposits at (b) and (c) above are supplied by the seventy or so largest members of the monetary sector, which account for over four fifths of total private sector sterling deposits with the monetary sector. However, it is clearly desirable that the new series should not be limited to the liabilities of particular types of institutions, but should instead be based on economic criteria, and therefore that the banks' statistics should be supplemented by figures for comparable deposits with building societies. The provision of such statistics is being discussed with the Building Societies' Association.

Figures to date

The table shows the results of the banks' returns for the first six months, from mid-November 1981 to mid-May 1982. This is far too short a series for an analysis of the trend, and in particular for the estimation of seasonal adjustments (at least three years of monthly data are required for that). Subject to these qualifications, the series shows growth of $1\frac{1}{2}\%$ at an annual rate over the six months.(2)

For comparison, the annual rates of growth over the same period for other aggregates (seasonally adjusted) were:

Non-interest-bearing M_1(3): +1.7%
M_1: +4.3%
Sterling M_3: +8.6%

The new series will in future be published monthly, along with other monetary data, in the *money and banking figures* press release.

(1) Adjusted for transit items: these deposits are included in the narrower aggregate, M_1.

(2) The annual rate of growth remains at about $1\frac{1}{2}$ % if allowance is made for the seasonal adjustments to those components of M_1 which are included in the new aggregate (ignoring the possibility of seasonal movements between those components and other retail deposits).

(3) Included within M_2.