17. 9.80

BANK OF ENGLAND CONTACT WITH CLEARING BANKS

1 The Bank has contact with the clearing banks at various levels on a whole range of subjects varying from banking supervision to foreign exchange dealing. The main contacts which provide an opportunity for discussion about the monetary situation and the development of clearing bank lending are the following.

2 First, the Governor has regular meetings, at intervals of a month or so, with the clearing bank Chairmen. These meetings provide the opportunity for an exchange of views on the monetary situation.

3 Secondly, there is regular contact between Messrs Fforde/George and the Chief Executive Officers of the clearing banks which enable the Bank to discuss developments in an individual clearer's business.

4 Thirdly, there is a regular monthly meeting with the clearing bank economic advisers at which the monthly clearing bank figures are discussed. This enables the clearing bank representatives to comment on their own bank's experience over the past month in the light of the outturn for the clearers as a whole.

5 Fourthly, the Bank keeps in touch with the Treasurer's Departments of the clearing banks on a day to day basis for the purposes of forming a view on the money market situation.

6 To supplement these contacts the Bank has now instituted regular contact with those in the clearing banks, below Chief Executive level, who are operationally concerned with their bank's lending. This should provide an opportunity for the clearers to put some colour on the statistics which the Bank receives weekly from the clearers and should enable the Bank to discuss trends and features in clearing bank lending at operational level.

CONFIDENTIAL 17. 9.80

THE GOVERNOR

GR 12/9

Copies to The Deputy Governor
Mr Coleby)without
Mr Goodhart)attach-
Mr Gill)ments

(now at No 11, 5.30 p.m.)

CHANCELLOR'S MEETING WITH CLCB CHAIRMEN: 17 SEPTEMBER

I attach a copy of Monck's brief for the Chancellor for this afternoon's meeting. It is difficult to see what the purpose of the meeting can be other than for the Chancellor to lay out Ministers' concerns and to hear at first hand the Chairmen's defence.

I have now completed my latest round with the four main clearers and have arranged for regular meetings at an operational level to try to beef up our intelligence. A note summarising our arrangements on the monetary policy side is attached. We will also now seek to arrange further regular operational contact with the non-clearers.

The clearers' difficulties are familiar. In the case of industrial business they know the purpose of the facilities granted - working capital, stocks, financing of fixed investment, etc. - and the general condition of the business, at the time that the facilities are reviewed/agreed. They do not in general know at any particular time what immediately prompts utilisation. Detailed monitoring of the purpose of drawings would greatly encumber both the banks and their customers. Added to this there is a genuine problem in aggregating the evidence of thousands of different accounts around the country. Nevertheless, we believe that we may be able to get a more tangible sense of what is happening by discussing particular anecdotal instances of limit reviews, etc. in the context of the weekly figures on a bilateral basis.

Naturally enough the CEOs all rebutted the charges laid by the PM. On volunteering increased limits to companies they make three points -

(a) there is no question of this as their general policy - they cannot exclude the possibility of erratic behaviour by individual managers and would tap knuckles if they had chapter and verse;

(b) other banks - particularly US - are of course competing aggressively and therefore offering their facilities generally;

(c) but to the extent that these additional facilities are accepted drawings on them are in substitution for other borrowing that would take place anyway - no-one at present rates is borrowing more than he absolutely has to.

On credit card limits they all insist that they have been restrained - holding back on advertising, etc. and no general increase since last September. A list of steps by Barclaycard is attached. They point out that the main function of credit cards is as a means of payment: if limits do not rise in line with the value of transactions customers are - after checking by telephone at the point of sale - challenged for exceeding their limits to everyone's embarrassment. Actual credit given on the cards has not grown rapidly - Barclaycard claim £28 million since the beginning of the year. Finally they again make the point that consumer credit they give largely substitutes for other sources of consumer credit.

I believe this view is a good deal closer to the real world than the anecdotal and unsubstantiated "intelligence" being urged upon us from elsewhere.

CEOs had little to say about current lending that was new - though Barclays joined Midland in thinking that the corners may have been turned (up to yesterday Barclays' lending was -200 compared with an expected fall of 80 on seasonal grounds in banking September). They have little direct involvement in lending to Overseas; NatWest in particular have moved back into local authority lending - through Coutts Finance - as a result of putting back limits to 80% of their pre-corset level following the removal of the corset after extremely tight (corset-induced) restriction.

17 September 1980 (Typed from EAJG's manuscript
EAJG and circulated unseen)

Copied to The Deputy Governor
Mr Fforde
Mr Dow
Mr Page
Mr Loehnis
Lord Croham
Mr Coleby
Mr Cooke
Mr Dawkins
Mr Flemming
Mr George
Mr Walker
Mr Quinn

CHANCELLOR OF THE EXCHEQUER

cc. CST
FST
SIR D. WASS
MR BURNS
MR RYRIE
MR MIDDLETON.
MR BRITTON
MR MONCK
MR RILEY
MR RIDLEY
PS/GOVERNOR, B. of E.

Please note that the note of the meeting with Clearing Bank Chairman held on 17/9/80 should be classified "Confidential - commercial in confidence".

NOTE OF A MEETING HELD AT NO.11, DOWNING STREET AT 5.30 PM ON WEDNESDAY, 17 SEPTEMBER 1980

Present:

Chancellor of the Exchequer (in the chair)
Governor of the Bank of England
Sir Jeremy Morse (Lloyds Bank)
Sir Anthony Tuke (Barclays Bank)
Sir David Barran (Midland Bank)
Viscount Sandon (National Westminster Bank)
Sir John Hogg (Williams & Glyn's Bank)
Mr. Middleton

DISCUSSIONS WITH CLEARING BANK CHAIRMEN

The Chancellor welcomed the clearing bank representatives; he found regular, relatively very keen discussions with them particularly useful, and thought it important that his contacts with them should not be restricted to crisis situations. He invited the clearing bankers to comment on the extent of the recent "reintermediation" following the abolition of the corset.

2. Sir Jeremy Morse said that the banks did not know how much of the recent growth in lending should be regarded as reintermediation, and how much an underlying growth in lending; it seemed reasonable to assume that, apart from the clearly identified bill leak, about half of the growth in lending represented reintermediation. Sir Anthony Tuke admitted to some surprise at the sudden apparent growth in lending, but pointed out that loan amounts outstanding had increased by about 10 per cent in July on account of half-yearly interest debiting, which seasonal adjustments might not have smoothed out completely. It was noted that the clearing banks accounted for only about half of total bank lending, and probably less than half of total reintermediation. Sir Jeremy Morse commented on the difficulty of finding out about

underlying trends in lending, because of the long history of controls. Initially controls had been placed only on the lending of the clearing banks, as other banks moved in to undertake this business the clearing banks were prevented from doing; then in the 1960s the controls were extended to merchant and foreign banks, and this led to a further growth of credit through channels outside the controls. Then in the 1970s the corset had given a further stimulus to the development oc redit channels outside the banking system, and inevitably there was very little information about the scale of this and the mechanisms involved.

3. The Chancellor asked about the substantial banking sector purchases of gilts during banking July. How far did these represent a deliberate restructuring of balance sheets, and how much further was this process likely to be taken? Sir Jeremy Morse saw the clearing banks' purchases of gilts as a normal banking operation; as loan demand fell off at a certain point in the cycle, the banks would increase their holdings of gilts, and incidentally make useful profits as interest rates fell. This was a normal and traditional banking operation. The clearing banks would expect to build up their secondary liquidity by moderate amounts in this way over the coming months. Apart from the National Westminster Bank, which had bought £80~~0~~ million of gilts in July, the clearing banks' gilts purchases in July had been on a relatively small scale; and they were not expecting to undertake special initiatives to attract additional deposits with which to add very substantially to their gilt holdings. The clearing banks accepted that there were presentational difficulties in their making substantial purchases of gilts while the sale and repurchase arrangements with the Bank of England were in force; although these arrangements had no direct implications for the money supply, it did look as though the banks were buying gilts with the Government's money.

4. The Chancellor noted the clear indications that the real economy was in recession, while the money supply was still increasing very rapidly; did the banks see monetary conditions as tight? Was there really a credit squeeze? Sir Jeremy Morse drew a contrast between 1980 and 1970. Quantitative controls were no longer in operation, and the banks were not operating under direct ceilings which were apportioned to individual bank managers. Whereas in the years up to 1970 the banks had not had the liquidity necessary to support additional lending, there had recently been sufficient liquidity for them to meet "normal" loan demand from the personal sector which in previous years bank managersmight have been obliged to turn away. Sir Jeremy Morse's personal view was that the Government's stance on interest rates had been correct; a tougher liquidity squeeze would have much increased the difficulties faced by industry. Because of the much greater competition between the banks than in earlier years, aggregate lending was now much harder to control; the move by a consumer credit subsidiary of the Security Pacific National Bank to offer substantial funds for housing loans the day after the clearing banks had undertaken to exercise restraint on their own lending for house purchase was an illustration of this - and the institution in question was wholly outside any UK banking controls. The clearing banks had themselves observed the qualitative guidance to the letter; their lending to non-priority areas had risen much less than that of other banks, and they had accounted for only £300 million of the £1700 million total increase in bank lending over the three months to August [HS3 are trying to establish more precisely what Sir Jeremy Morse was referring to]. Although personal sector lending was a relatively small proportion of bank lending to the private sector, the clearing banks nonetheless attached considerable importance to the maintenance of their business in this area, since it was the most reliably profitable element in their loan business.

5. It was noted that lending to the personal sector by Barclays and National Westminster had grown more or less in line with prices, and had so remained static in real terms. Sir Anthony Tuke

admitted, however, that some individual bank managers were probably still looking for new loan customers despite any instructions to the contrary from headquarters - but these would be a small minority, and the general picture was one where the clearing banks were broadly meeting the expressed wishes of the authorities. He suggested that it might be possible to aim for some real reduction in the volume of personal lending.

6. The Chancellor asked how the clearing banks expected their lending to move in the months ahead. Both Barclays and Midland expected total lending to fall back somewhat in September, partly for technical reasons. Some renewed increase might be expected in October, with loan demands slackening thereafter. The National Westminster Bank did not expect any significant reduction until November, but foresaw a clear downward trend from then on for about a year. Viscount Sandon indicated that this expectation was based on their judgement of the size of the pay increases their industrial customers could afford, and on their hopes for better control of public expenditure. Mr. Middleton noted that the PSBR was expected to be very much lower in the second half of 1980-81 than in the first; in the past the PSBR and bank lending had tended to be inversely correlated. If the PSBR was low because, inter alia, of high tax payments, would not bank lending tend to be higher? Despite this argument, the clearing banks representatives maintained their view that aggregate bank lending would decelerate markedly towards the end of 1980.

7. Sir Jeremy Morse noted that the recent buoyancy of lending to the personal sector probably owed much to the recent rapid growth of money income; when money incomes were rising rapidly, people were readier to borrow more money but as expectations about the size of future pay increases were reduced, and fears of unemployment increased, demands for loans would probably drop away. Sir David Barron thought that personal sector demand for loans might also have been stimulated by the very attractive

prices now offered by the shops on a wide range of goods because of their need to improve their immediate cash flows; these opportunities might well induce people to make more use of their credit cards or to draw on established overdraft facilities. It was noted that although there had been some increase in the volume of credit card lending, this was still only a very small element in total lending to the personal sector; and Sir Jeremy Morse argued that this type of lending, which was very convenient and flexible for the borrower, was likely to be in substitution for rather than additional to other forms of personal sector borrowing from the banks.

settlement mechanism as well as lending

8. The Chancellor asked whether the banks saw any prospect of diverting part of the personal sector surplus directed towards the company sector through new issues of shares and debentures. Could the clearing banks help to encourage such a development? Sir Jeremy Morse said that the banks were very sympathetic indeed to the Government's objective; but the debenture market had now been dead for 7 years, and could prove very difficult to revive. There was a sharp contrast between the situation in the UK and that in the US; the US bond market had ridden out the first oil shock more or less without interruption, and although the market had come to a halt earlier this year when short rates reached 20 per cent, it had revived very sharply as soon as short rates fell back. In the UK, although there had been one occasion between the two oil price shocks when companies seemed once again to be on the point of issuing debentures, this had never actually happened. The City would now do everything possible to encourage the revival of the debenture market; but if this were to happen, there must be a clear prospect of continuing low inflation, and businesses would need to have some assurance that they would be able to earn the profit necessary to support new long-term interest borrowing. The Governor pointed out that the substantial increase now expected in the money collected by the Government through index-linked national savings would take much of the pressure off the gilts market, and make it possible for long-term rates to fall somewhat. It was generally agreed that the

institutions would be willing to invest in debentures at yields about 1 per cent higher than those of gilts. Mr. Middleton noted that monetary growth could equally well be restrained if the banks themselves raised longer term money in the markets, since the resulting liabilities would fall outside any definition of money.

9. The Governor asked whether the clearing banks had made any conscious change in their behaviour towards local authorities. A substantial part of the increase in lending in July had been to local authorities, and it was not clear whether this was simply a form of reintermediation, or an underlying increase in borrowing. The discussion suggested that - with the exception of a finance house subsidiary of the National Westminster, which had lent £200 million - the clearing banks had done little extra lending to local authorities in July; and they had made no change in their policy towards lending to local authorities. Viscount Sandon, however, noted that the corset had prevented the finance houses from undertaking a type of business which they had been developing, and suggested that much of the increase in lending might have come from this area. Sir Anthony Tuke noted that the local authorities were very quick to engage in round-tripping, and this might also have been a factor in the July figures.

10. Sir Anthony Tuke asked what the Chancellor expected to happen to pay in the public sector during the 1980-81 pay round. Although the banks had contained the size of the pay increases they gave to their staff rather better in 1980 than in 1979, they were very conscious of the influence exerted on the expectations of their staff by developments in the public sector. They were now themselves trying to point their managers towards an expectation of an increase in the region of 12-14 per cent. The Chancellor emphasised that the Government would be looking for increases well below this range; in the public services, the

Government would be calling attention to the example of Talbot and Lucas, where settlements had been in the range 8-10 per cent. They would try very hard to secure single figure settlements throughout the public services sector. Viscount Sandon drew attention to the overwhelming importance of pay for most companies; for a typical company, a pay increase of 20 per cent was likely to cost more than 20 times as much as a 4 percentage point increase in interest rates. Sir Jeremy Morse confirmed the clearing banks' determination to stand together against excessive pay increases in 1981, even if this meant strikes and serious disruption of the banking system.

PSJ

A.J. WIGGINS
18 September 1980

Distribution:

Chief Secretary
Financial Secretary
Sir Douglas Wass
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Mr. Ryrie
Mr. Middleton
Mr. Britton
Mr. Monck
Mr. Riley
Mr. Ridley

PS/Governor, Bank of England