1) The Deputy Governor
copies to: Mr Fforde
Mr Goodhart
Mr Iles

2) Govs Office

The Governor

GPS
any comments
[illegible]

NOTE OF A MEETING HELD IN THE CHANCELLOR OF THE EXCHEQUER'S ROOM, H.M. TREASURY, ON WEDNESDAY, 22 OCTOBER, 1980 AT 9.00 A.M.

The Governor asks whether you have any comments on this note, or whether you are content. 27/10

?

26/10

Present:

Chancellor of the Exchequer	Governor of the Bank of England
Financial Secretary	Deputy Governor
Sir Douglas Wass	Mr. Fforde GPS
Sir Kenneth Couzens	Mr. Goodhart
Mr. Ryrie	Mr. Iles
Mr. Middleton	
Mr. Britton	
Mr. Monck	
Mr. Riley	
Mr. Ridley	

NB 10/11
CWM

THE MONETARY ROLL-OVER

The discussion was based on the paper sent by the Chancellor to the Prime Minister on 10 October.

2. The Financial Secretary said that he would normally be in favour of a roll-forward of the monetary target; but he was persuaded that present uncertainties were such that it would be better not to do so on this occasion. Instead we should make clear that we would aim to keep the growth of sterling M3 on an adjusted basis to the top of the present target range over the whole period to April 1981. He thought any move away from a February 1980 basis would appear unduly artificial; we could not give a satisfactory explanation of a move back to October 1979.

3. The Bank of England representatives pointed to the very restricted scope there would be for monetary growth over the next few months if the present target were to be maintained. On the basis of present (confidential) estimates of "allowable dis-intermediation" - about 3 per cent - there was only room for about 2.8 per cent growth in sterling M3 between September

27/10

1980 and April 1981. The present forecast suggested that monetary growth in October would be about 1 per cent, so that there would then be less than 2 per cent available for the whole of the remainder of the period. There was a risk that the markets would soon become aware of this, and would come to expect the authorities to raise interest rates as a means of getting closer to the present target. The Bank therefore saw some advantage in stretching the target period further forward, so that the risks of the authorities failing to meet the target would not be so immediately apparent.

4. In further discussion it was noted that a target for a period running beyond April 1981 would have to allow for the present high forecast of the PSBR in 1981-82; given the high PSBR, markets could well consider that any target range which appeared consistent with the MTFS would require a still further tightening of monetary policy, while specifying a target for the 18 months to October 1981 would involve figures apparently too high to be compatible with the MTFS.

5. It was further argued that the markets were unlikely to be perturbed about failure to keep to the present target if it were to be reaffirmed, provided that the authorities were seen to be making some progress in getting down towards it; the markets appeared to be paying as much attention to the progress of inflation as to statistics of the monetary aggregates.

Conclusion

6. The Chancellor noted that this had been a useful exchange of views; he inclined towards reaffirmation of the existing target, subject to a suitable allowance for dis-intermediation before February 1980. He asked Treasury and Bank officials to give further thought to the question of the roll-over, and the presentation of the authorities' decision, in the light of the October money figures (where first estimates would be available on 24 October).

Foreign Exchange Markets

7. The Chancellor asked the Bank to give an account of recent events in the foreign exchange markets.

8. The Deputy Governor emphasised the importance of the weak DM; this had been combined with a strong dollar, which in turn - perversely - reflected bad US money figures and market expectations of higher interest rates. At the same time there were substantial shortages in the UK money markets which were tending to keep short rates up, and this situation would be intensified by a substantial call on gilts previously sold, due on 24 October. The Chancellor's and Governor's Mansion House speeches, which were seen as postponing the prospect of a reduction in MLR, were a further factor tending to strengthen market confidence in sterling.

9. It was noted that sentiment about the DM was much influenced by the Bundesbank Governor's forecast of a continuing large German current account deficit. The Arabs were at present putting their money into Japan rather than Germany, despite the favourable DM exchange rate.

10. As to the UK domestic situation, the Governor noted the exceptional tightness of money market conditions over the October make-up day, when overnight rates had exceeded 100 per cent, and substantial amounts of money had been taken at rates of 40-50 per cent. Although it was not clear that round-tripping would have added substantially to the monetary aggregates, fluctuations of this kind were clearly undesirable. The Bank were intending to remind commercial banks (and particularly US banks) that they were expected to observe the required reserve assets ratio (as long as it remained in force) on a daily basis, and not just on make-up day. The Bank would also attempt to smooth out the creation of reserve assets through the month by means of purchases of eligible commercial bills.

JW

(A.J. WIGGINS)
23 October 1980

Distribution

Chief Secretary

Financial Secretary

Minister of State (L)

Sir Douglas Wass

Mr. Burns

Sir Kenneth Couzens

Mr. Ryrie
Mr. Barratt
Mr. Middleton
Mr. Britton

Mr. Monck

Mr. Lavelle

Mr. Riley

Mrs. Gilmore

Mr. Ridley

PS/Governor

The Governor has a copy

Copies to: The Deputy Governor
Mr. Fforde
Mr. Dow
Mr. Page
Mr. Loehnis
Mr. George

23.10.80.

S41/1

NOTE OF A MEETING HELD IN THE CHANCELLOR OF THE EXCHEQUER'S ROOM, H.M. TREASURY ON WEDNESDAY, 22 OCTOBER, 1980 AT 10.00 A.M.

Mr. Goodhart
Mr. Walker

CAEC/ see also, note of mtg at 9.30. (M. control)

Present:

Chancellor of the Exchequer	Governor of the Bank of England
Financial Secretary	Deputy Governor
Sir Douglas Wass	Mr. D.A. Walker
Sir Kenneth Couzens	
Mr. Ryrie	
Mr. Middleton	
Mr. Britton	
Mr. Monck	
Mr. Mountfield	
Mr. Ridley	

FIXED RATE EXPORT CREDIT: COST SHARING WITH THE BANKS

The meeting had before it the Treasury paper on fixed rate lending and the banks submitted by Sir Kenneth Couzens to the Financial Secretary on 8 September.

2. The Chancellor, opening the discussion, noted that the Government were now spending £500 million a year subsidising long-term fixed rate export credit, and that this sum was tending to increase because of high sterling interest rates. At the same time the banks were enjoying substantial endowment profits from their non interest-bearing current account deposits. Although the Government had decided not to impose a special tax this year on bank profits, the Financial Secretary had specifically not ruled this out permanently. In the present fiscal situation it might be necessary to revert to this idea if the banks continued to make large profits while most of the corporate sector was being severely squeezed. A possible alternative would be for the Government to seek to restrict the public expenditure cost of subsidising export credit by asking the banks - who were benefitting from high interest rates - to share this cost. The Financial Secretary noted that securing a contribution of this kind from

the banks would meet the Governor's objective as presented in his Mansion House speech of reducing the PSBR without deepening the recession.

3. The Governor thought an arrangement of this kind could prove rather difficult to negotiate with the banks. The clearing banks' profits were already falling back, and might well turn out to be smaller in nominal terms in 1980 than they were in 1979. On the basis of a six month comparison there had already been a very sharp fall in current cost profits between the second half of 1979 and the first half of 1980. The banks were having to increase their provisions very rapidly to meet the impact of the recession; provisions had amounted to £50-60 million for each half of 1979, but already £180 million in the first half of 1980. If the banks felt obliged to pay what would in effect be a levy on their profits, they could well prove more reluctant to help the authorities in the areas of housing finance, loans for small firms, etc.

4. It was noted in further discussion that a levy apportioned by reference to each bank's NIBELs would not constitute a disincentive for individual banks to take on new fixed rate export credit business. (But if the total amount of the levy were increased from year to year by reference to the outstanding amount of fixed rate export credit, there could be some overall disincentive.) However, the attitudes of the clearing banks to the levy would differ according to the structure of their balance sheets; thus Lloyds would appear to get off relatively lightly, since they account for nearly 21 per cent of the outstanding export credit business but only 14.6 per cent of total clearers' NIBELs, while the National Westminster have only 22 per cent of the business against 24 per cent of NIBELs. It was also noted that total levy payments of £100 million would comfortably exceed the clearing banks' net returns from the fixed rate export credit business.

5. The question was raised whether the scheme would apply to banks other than the clearers. It was noted that the Trustee Savings Banks were in a special position, and could probably not be asked to contribute. As to other banks, it would make relatively little difference, since their NIBELs were very small. Thus extension of the obligation to other banks might prove a useful point to be conceded to the clearers in negotiation. The clearers were responsible for practically all outstanding sterling fixed rate export credit.

6. The Governor noted that the authorities would in effect be giving the banks a choice between sharing the cost of export credit or facing a levy on their profits imposed by statute. The public presentation of this choice would not be easy. Meanwhile the banks would be under increasing pressure as the recession made itself felt, and the strength of sterling was tending to reduce their profits worldwide. The imposition of a levy under the guise of sharing the cost of the export credit would reduce their ability to cope with the increasing financial difficulties of UK industry. His advice was therefore against proceeding with the idea.

Conclusion

7. The Chancellor, concluding the discussion, noted the difficulties such an approach to the banks would present. On the other hand, the Government could not easily give up the prospect of some contribution from the banks towards reducing the PSBR, particularly given the fact that the clearing banks tended to benefit from high interest rates which were very uncomfortable for most industrial and commercial companies. He would discuss the idea of asking the banks to make a contribution towards the cost of export credit with the Prime Minister and other Ministers concerned before any approach was made to the banks.

JW

(A.J. WIGGINS)
23 October 1980

Distribution

Chief Secretary
Financial Secretary
Minister of State (L)
Sir Douglas Wass
Mr. Burns
Sir Kenneth Couzens
Mr. Ryrie
Mr. Middleton
Mr. Monck
Mr. Mountfield
Mr. Perry
Mr. Pirie
Mr. Ridley

PS/Governor

SECRET

17.10.80

NOTE FOR RECORD

Copies to The Governor
The Deputy Governor
Mr Fforde
Mr Dow
Mr Blunden
Mr Page
Mr Loehnis
Mr Coleby
Mr Dawkins
Mr Flemming
Mr George
Mr Goodhart
Mr Holland
Mr Walker
Mr Quinn

OR 17/10.

The Chancellor of the Exchequer will be chairing a meeting at HMT on Wednesday 22 October at 9.00 am to deal with (i) the monetary target rollover and (ii) putting more of the burden of financing/subsidising export credit on to the banks. The Chancellor will be supported by the FST, Sir Douglas Wass, Sir Kenneth Couzens, Mr Ryrie, Professor Burns, Mr Middleton, Mr Monck and Mr Ridley, and for item (i) only, Mr Britton and Mr Riley, and for item (ii) only Mr Mountfield and Mr Pirie. The Governor has been invited to attend and to nominate a Bank team.

You will be supported by:
The Deputy Governor
Mr Fforde
Mr Goodhart } - Item 1 only
Mr Iles }
Mr Walker - Item 2 only

21/10

R C W Mayes

Governor's Office HO-P
17 October 1980

R C W Mayes (4421)

Addressed to GPS.

CHANCELLOR OF THE EXCHEQUER'S OFFICE: MEETING

SUBJECT	(1) THE MONETARY TARGET ROLL-OVER (2) PUTTING MORE OF THE BURDEN OF FINANCING/SUBSIDISING EXPORT CREDIT ON TO THE BANKS
DATE AND TIME	Wednesday 22nd October 9.00am
VENUE	Chancellor's Room, Treasury/~~No. 11/Conference Room/House of Commons~~
PAPERS	Letter from Sir K. Couzens to Mr D Walker 8/10 on item (2)
THOSE ATTENDING	Chancellor FST Sir D. Wass Sir K. Couzens Mr Ryrie Mr Burns Mr Middleton Mr Monck Mr Ridley ~~Governor + supporters~~ for item (1) only Mr Britton Mr Riley for item (2) only (standing by at 9.45am) Mr Mountfield Mr Pirie