

TELEPHONE
01 - 601 4444

BANK OF ENGLAND
LONDON EC2R 8AH

25th February 1980.

Dear Sir, 2/29/80

Bank Profits

In case it might be helpful in connection with the Prime Minister's appearance on Panorama, I enclose a note produced here which seeks to put bank profits into a current cost accounting context.

The backing figures are being checked with the clearing banks and if any corrections are necessary they will be telephoned to you.

Since this sort of material is not easily put across in debate, I also enclose a very short speaking note which is designed to shift a questioner from the gross figures on which he might be expected to base himself to the adjusted figures.

I am sending a copy to John Wiggins at the Treasury.

Yours sincerely,

Jasper Jackson

T.P.Lankester, Esq.

25 FEB 1960



BANK PROFITS

Main Points

1. Bank profits are of a cyclical character but the peaks and troughs do not coincide with industrial and commercial activity as a whole. When interest rates are high, business activity tends to be depressed; at that time bank profits are at their peak, which is presently the case.
2. Profits expressed in terms of historical cost are misleading for comparative purposes. They must be expressed in current cost terms and adjusted for inflation. On that basis the present level of profits is no more than adequate for the banks' needs.
3. The banks are particularly vulnerable in times of economic uncertainty. They need to earn good profits to support depositors' money; to maintain the confidence of the public at home and abroad; and to expand their business and their services to the public. They earn substantial sums of invisible exports.

Supporting figures

4. On the basis stated in paragraph 2, the profits remaining in the hands of the banks, after tax and the payment of modest dividends, were as follows:

	£ million	
1973	194	199
1974	13	21
1975	(52)	(39)
1976	45	57
1977	134	
1978	171	
1979 (estimated only)	107	

The cyclical nature of the retained profits will be noticed. There was a deficit in 1975 and, in real terms, the retentions even in 1978, and the estimated figures in 1979, have not reached the 1973 level.

(Note: The above figures are shown in graph form on the attached schedule)

5. For prudential reasons the banks are required to maintain a margin of "free" capital on a basis laid down by the Bank of England. This free capital is designed as additional cover against any possible loss falling on depositors. The following shows the figures for the last six years:

	<u>Deposits at year-end</u>	<u>"Free" Capital</u>	<u>Percentage of</u> <u>column (2) to</u> <u>column (1)</u>	
	£ million	£ million		
	(1)	(2)	(3)	
1973	36,676 36,717	1,135 1,094	3.1	3.0
1974	43,001 43,061	1,084 1,024	2.5	2.4
1975	47,212 47,279	1,198 1,131	2.5	2.4
1976	55,129 55,259	1,675 1,545	3.0	2.8
1977	62,885	2,267	3.6	
1978	70,151	3,051	4.3	

Having regard to the very large deposits held by the banks, the "free" capital is no more than is needed for prudential purposes.

6. In case it is needed for reference, a summarised statement for the past seven years is attached.

(Note: Arrangements are being made to verify these figures which have been prepared at short notice. It should be appreciated that the 1979 figures at this point of time are guesswork because the annual accounts for that year have not yet been published.)

Bank of England,
22nd February 1980.

Retained Inflation Adjusted Profits of Four Largest Clearers

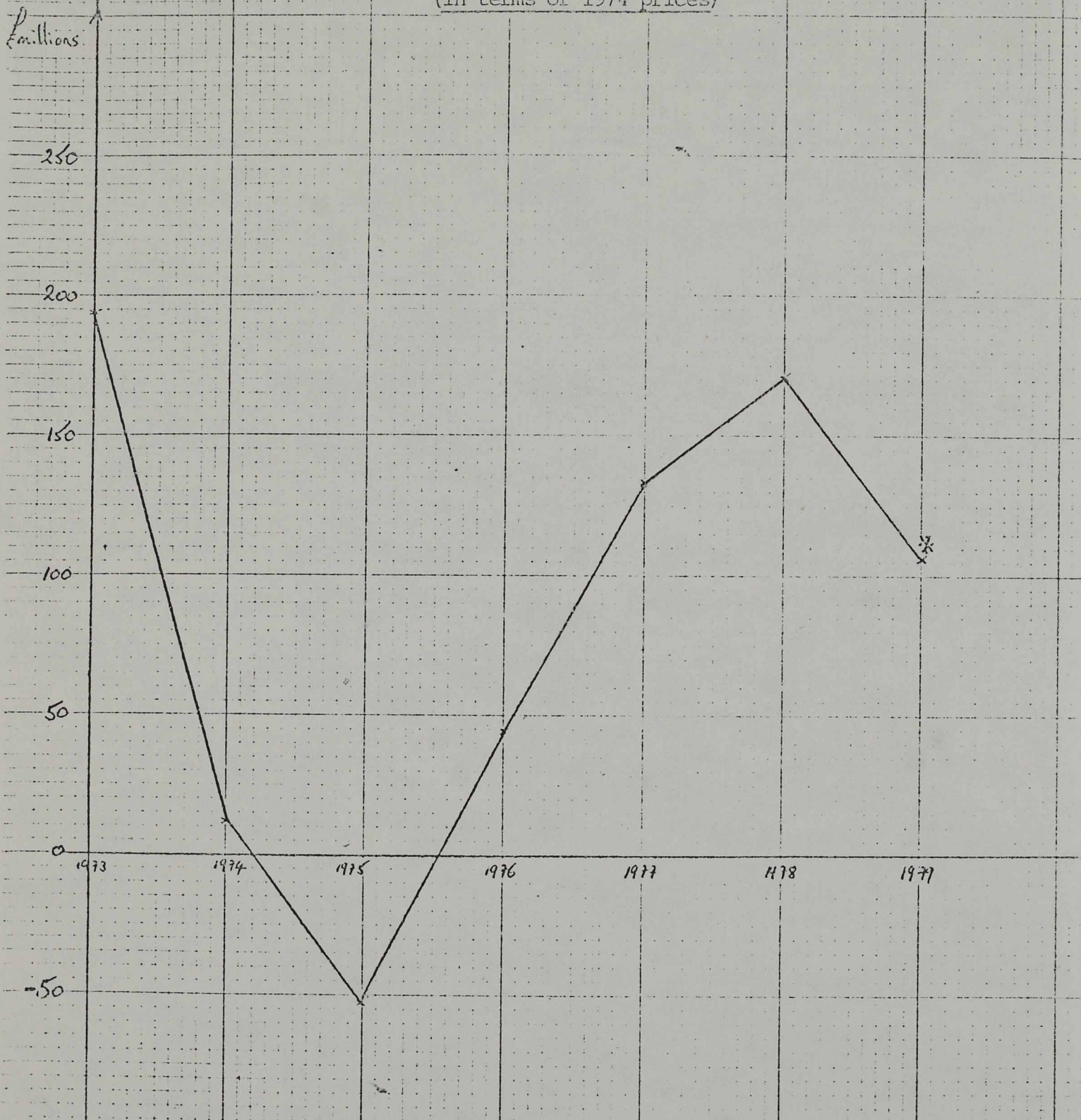
(In terms of 1974 prices)

Millions

250
200
150
100
50
0
-50

1973 1974 1975 1976 1977 1978 1979

* Estimated



Profits of the four largest clearers adjusted for
CCA and expressed in terms of 1974 prices

£ millions

Year	Pre-tax Profits in historical cost terms	Column 1	Column 2	Column 3	Column 4	Column 5	Column 6
		adjusted to 1974 prices	adjusted for Taxation	after CCA adjustments	Post-tax Profits after CCA adjustments	Dividends in 1974 prices	less Column 5
	1	2	3	4	5	6	
1973	580	620	349	246	52	194	
1974	449	414	188	58	45	13	
1975	424	315	137	(9)	43	(52)	
1976	700	446	197	90	45	45	
1977	896	492	291	180	46	134	
1978	1,083	549	331	223	52	171	
1979*	1,500	644	365	159	52	107	

*Estimated

SPEAKING NOTE

Bank Profits

You must remember that when looking at these figures you are using a measuring rod - money - which changes over time, because of inflation. So straight readings are misleading.

Remember too that money is the banks' working capital; and that with inflation the value of that working capital is continually evaporating away. That loss of real value must be made good before you can sensibly talk about profits.

If allowance is made for these points, it can be seen that both the banks' dividends and their retained profits have been modest. A run of figures for the four big clearing banks on a CCA basis and adjusted for inflation in terms of 1974 prices is as follows:

	£ millions	
<u>Year</u>	<u>Dividends</u>	<u>Retentions</u>
1973	52	194
1974	45	13
1975	43	(52)
1976	45	45
1977	46	134
1978	52	171
1979*	52	107

*Estimated