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NOTE FOR RECORD

- Copies to: *aware JB 14/4*
- The Governor
 - The Deputy Governor
 - Mr.Fforde
 - Mr.Dow
 - Mr.Blunden
 - Mr.Page
 - Mr.Loehnis
 - Sir Jasper Hollom
 - Sir Henry Benson
 - Mr.Balfour
 - Mr.Cooke
 - Mr.George
 - Mr.Goodhart
 - Mr.Holland
 - Mr.Somerset
 - Mr.Walker
 - Mr.Byatt
 - Mr.Best/Mr.Gough
 - Mr.Gill
 - Mr.Quinn

He called on C4E

The Governor will call on the Chancellor at 5.00 p.m.
on Thursday, 17th April.

J.S.
J.S.Beverly (4121),
Governors' Office.
14th April 1980.

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THE GOVERNOR

Copy to the Deputy Governor

POINTS FOR THE CHANCELLOR: 5.00 P.M. 17TH APRIL

There appear to be quite a number of matters which you may wish to raise. These are listed below in an attempted order of importance.

- (1) Markets
- (a) Domestic - interest rates; money market operations and announcements thereof. *- MP DOSS*
 - (b) Foreign exchange - intervention - the FST's interest; EMS. *L.R. DOSS*
- (2) Dispute at National Westminster. *MS - 3/6*
- (3) The Select Committee. *- DOSS problem*
- (4) British Aerospace. *T/S problem*
- (5) Basle
- (a) Iran. *} T/S problem*
 - (b) Euromarkets. *}*
- (6) US Monetary Policy
- (a) Volcker request for co-operation *} T/S problem*
 - (b) Grand Metropolitan/Liggett. *}*
- (7) Indexation. *- MP DOSS*
- (8) The Consultation Document - the consultative process; the cash ratio paper - ?1% balances; interest sensitivity. *- MC DOSS*
- (9) Hamburg meetings. *- DOSS problem*
- (10) ?The Banking Act. *- T/S problem (Basis)*
- (11) ?Industrial Society Conference. *- DOSS problem - 3/30/2*
- (12) ?Non-executive directors. *- T/S problem ED*

You may wish to mention to the Chancellor that Ian Stewart will be visiting the Bank on Monday, 28th April.

J.S.
J.S. Beverly (4121),
Governors' Office.
17th April 1980.

NOTE FOR RECORD

Copies to Mr Ffordes *24/4*
 Mr Dow
 Mr Blunden
 Mr Page
 Mr Loehnis
 Mr George
 Mr Walker
 Mr Flemming
 Mr Holland

The Governor saw the Chancellor at Number 11 yesterday evening. Wass and I were present. It was a particularly cordial and constructive meeting.

Select Committee

A good deal of the time was devoted to discussing the Select Committee. The Chancellor, who was obviously worried about his performance before them and about the many meetings that lie ahead, went out of his way to give what help and advice he could to the Governor. He asked Wiggins to pass over all the briefing he received (apart from that on public expenditure which would not be relevant). He said he had been firm in not disclosing any more parts of the financial forecast and he clearly hoped the Governor would take a similar line. Indeed he suggested that the Governor's general approach might be to lead the Committee out of the world of models and forecasts and into the practical business of how industry was faring, and how policy decisions had to be made. He felt that in answer to hostile questions about the unpleasant aspects of present policies, one could be robust in returning with the question "What is the alternative?"

The Chancellor said the Governor will probably find that the Select Committee would maintain a common front. Both the Chairman and the members had as their main interest the building of their positions as powerful inquisitors; this meant that they would normally go out of their way not to raise issues to divide them on party lines. He said he was struck to discover that throughout his session he had "no mates". It was a question

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whether the Governor would be regarded primarily as part of the executive and therefore also a legitimate quarry; or whether as the Chancellor thought more likely, they would look to him as someone semi-independent who could help them in their enquiries into Government policy.

Finally, the Chancellor said that he got detained for half an hour more than had originally been arranged by a sequence of individual questioners asking for just a few more minutes. He suggested that the Governor would do well to state firmly at the outset the constraints that his diary put on him, so that the originally planned time was not exceeded.

Iran

The Chancellor confirmed what we had already heard that by speaking first to the Prime Minister and then to the Cabinet that morning he had had rescinded the earlier decision to canvass initiatives on possibly legislating measures in the banking field with EEC partners. The Chancellor agreed with the Governor that had this been done - in COREPER or in Luxembourg on Monday - the risks of a leak (especially from the French) would be high; and if there were such a leak the damage to us could be severe.

The Governor said if, which he did not want, it were in the end decided to extend the banking measures it would be greatly preferable to continue it on a voluntary basis. The Chancellor agreed. He said if it did come to legislation, however, they were thinking of something very narrowly defined and with a time limit after which it would lapse unless renewed. Before the Chancellor arrived, Wass had indicated that officials were toying with the idea that if the legislation were necessary the Exchange Control Act might be invoked - so getting round the problem of advertising what we were doing before we had done it. It might be that the Exchange Control Act would not stand up for this purpose but the measures could later be ratified by law.⁷ The Chancellor said that despite the unsatisfactory passages in the Foreign Secretary's brief for the Ministerial meeting on the subject and the recommendations that had emerged from it, the Prime Minister in particular, and to a lesser extent the Foreign

Secretary, had now he thought fully taken on board the danger of meddling at all in the banking field. He said he thought the long evening at Number 10 after the visit of Nowbari had been extremely helpful in this respect.

There was then a slight awkwardness in that the Chancellor recalled the form of words that had finally been agreed during that evening which the Governor was to use with Nowbari. These had effectively said that we would not block unless the Iranians themselves provoked us or unless we were bound by a Security Council resolution. Although the Governor reminded him that he (the Governor) had in the event not been able to catch Nowbari to give this undertaking, the Chancellor appeared to think that when I saw Manavi-Rad I would have used the same words. This he felt was an added weapon preventing us from relying on an EEC decision. We did not go into the details of what I said, but it was in fact deliberately much less specific. I spoke as the Governor had spoken to Nowbari originally. Whereas on the earlier occasion Nowbari had apparently not been satisfied and had urged the Governor to get some undertaking from the Government, on this occasion Manavi-Rad had appeared to accept what I said and had not pressed for anything more specific. This is a possible loose end that may need watching.

Markets

There was a brief discussion about the volatility of exchange markets and about the improving tone in the domestic markets, the success of the morning tap issue. The Governor referred to the possibility we had mooted of a new convertible stock but said we were not yet in a position to make any formal recommendation.

Other matters

The Governor was then usefully able to fill the Chancellor in on the state of play in the Clearing Banks/BIFU dispute; the Basle Communique on euromarkets and possible dangers that this subject would be raised in Hamburg; and his own position on British Aerospace. On this last issue specifically, Wass said that the Treasury took exactly the same position as we did.

Cwm

18 April 1980

See copy to [unclear] 24 4 80

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original copy held in [unclear]



Ps / Goshwin M/K
Copies to the Deputy Governor:
Mr F. G. [unclear]
Mr Dow
Mr Blundell

NOTE OF A MEETING HELD AT NO. 11 DOWNING STREET AT 5 PM *Mr Page*
ON THURSDAY, 17TH APRIL 1980
Mr Loshkin

Present:

Chancellor of the Exchequer (in the chair) *Mr Barlow*
Governor of the Bank of England
Deputy Governor
Sir Douglas Wass
Mr Goodhart
Mr Holliday
St. Henry Benson
- paragraph 11.

JB
22/4

FINANCIAL AFFAIRS

Governor's Appearance before the Treasury and Civil Service Committee
The Governor reported that he had been asked by the Clerk to the Committee to appear on 21 April to talk about the general financial implications of the Budget, and recent operations by the authorities in the money and gilts markets. However, the Chairman had subsequently told him that he was anxious to discuss the practical effect of the Budget on the economy and on the corporate sector in particular, but would seek to steer the discussion away from recent money market operations so far as he could. But it might not be possible to maintain complete control over some members of the Committee.

2. The Governor expected to be closely questioned about the forecast of the financial deficit of the industrial and commercial company sector, where both the Bank and the Secretary of State for Industry had made qualitative remarks with the intention of influencing the climate of wage negotiations. The Chancellor was conscious of the difficulty of giving some of the information about sector surpluses and deficits (i.e. the PSBR and the current account) but refusing other information; there was inevitably an element of arbitrariness in this.

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3. It was agreed that both the Chancellor and the Governor, in appearing before the Committee, should try to avoid being defensive about medium term projections. The Chancellor could say that unemployment might be higher than the 1.8 million contemplated in Cmnd.7841 if pay negotiations failed to pay reasonable regard to the requirements of monetary policy; but it would be as well to emphasise that there were no realistic alternatives to present policies which did not carry with them substantial disadvantages and bad effects. It was clear, for example, that an attempt - as Dr. Bray had urged - to secure lower interest rates without any change in the Government's fiscal stance would imply serious risks for achievement of monetary targets, the exchange rate and the rate of inflation. The point should also be made to the Committee that UK industry was by no means necessarily condemned to continuing decline - although a high real exchange rate posed problems, very many firms had found ways of living with it and at the same time securing new business opportunities.

4. The Chancellor asked that the Governor should be provided with some of the briefing material which had been produced for his own use at the Committee on 14 April.

Iran

5. The Chancellor reported the agreement at Cabinet on 17 April that the UK should not even discuss with Community partners the possibility of legislation on financial sanctions against Iran at meetings to be held during the next few days. The Governor expressed his appreciation for the Chancellor's efforts; he emphasised his concern that the UK should nowhere appear as the proponent of financial sanctions. The UK had much more at stake than other members of the European Community, and the French would certainly take the opportunity - if it were available to them - of letting international financial markets know that the UK were contemplating an initiative to interfere with financial flows. It was hard to see how in practical terms legislation could be enacted and implemented in this area without very substantial



disruption to international financial flows, which could greatly damage the prospect for successful recycling of the current very large OPEC surpluses. If some intensification were to be needed of present measures it would be much better for this to be achieved voluntarily.

6. The Governor drew particular attention to the assurances he had already given to the Iranian Central Bank to the effect that the UK would not freeze Iranian assets. These assurances had been given to the Iranians before Christmas with the express agreement of the Prime Minister.

Domestic financial markets

7. The Governor commented on the good tone in the financial markets following the initial post-Budget hesitation. The signs in the US that interest rates had reached a peak (and the transformation of Mr. Kaufman from a bear to a bull) had led to a marked strengthening in the US and UK bond markets. It seemed likely that the new long tap would be sold out at £95.75, 75p above the minimum tender price. There were now good prospects for reasonable money figures for banking May as well as banking April, although there were some redemptions in May and June. The Bank were contemplating that a convertible stock might be issued in the near future, but only if interest rates were seen to be clearly on a downward path, so that a convertible would offer the prospect of useful reductions in debt servicing costs. The Bank would report further on this as the market situation became clearer.

Foreign exchange markets

8. The Governor commented on the sharp fluctuations in the US dollar deutschmark exchange rate. These fluctuations owed a good deal to the poor relations and communications between the US and German monetary authorities, and also, in his view, to failure to consider the impact of interest rate changes and to an unduly cautious approach to exchange market intervention. Germany was now in a new



situation at the bottom of the snake, and this made the Bundesbank reluctant to support the dollar by selling deutschemarks; the correct course for the Germans would be to borrow French francs and use them to support the dollar. It was noteworthy that sterling had been on the sidelines, and had been very little affected by these difficulties.

Pay problems in the banking sector

9. The Governor commented on the dispute concerning bank messengers which had arisen originally in the National Westminster Bank. The immediate issue concerned the present age/pay scale, whereby messengers were only paid the full rate on reaching 30 - only 68 people were directly involved, but if concessions were made, there would be repercussions on the pay of all junior banking staff throughout the clearing banks. The Chairman of the National Westminster Bank had called his colleagues together, and explained that he would only be able to resist the pressure if he had their support, which they had promised. For the time being the National Westminster Staff Association had instructed its members to ignore the BIFU pickets, and the town clearing had taken place on 17 April as usual. But there was likely to be a breakdown in communications between the National Westminster and the other banks in the near future, and the conflict was likely to spread. The clearing banks were contemplating threatening the withdrawal of the 18 per cent pay offer they had made to all their staff; this would be something of a gamble, although sympathy for BIFU in the National Westminster Bank would have been reduced by the fact that the Union had effectively prevented salary payments to the bank's own employees. The Bank of England would keep the Treasury in close touch with developments.

Supervision of the Euro-markets

10. The Governor drew attention to the communique following the last Basle meeting. This was now to be on the agenda for the G10 on 24 April. The Bundesbank had been under heavy pressure from



the Federal Chancellor to work for a system of minimum reserve requirements, but it was clear that there was no prospect of any early agreement on this, and no currency should be given to it as an early possibility.

Sale of shares in British Aerospace

11. The Governor reported that he had himself considered carefully the work Kleinwort Benson had done on the new issue the Government had been hoping to make in the course of the summer following the enactment of the British Aerospace Bill. He had concluded that there were no prospects of making such an issue in the near future; there were serious uncertainties about the level of defence orders, while no orders had been received for the 146. The Bank's judgement was that the 146 would never be profitable even on a historic cost basis, and that it was bound to make a substantial current cost accounting loss. It was very doubtful whether British Aerospace had the financial capacity to develop and produce this aircraft. Even the profitability of work on the airbus was greatly in doubt. Given these prospects, it seemed likely that the debt-equity ratio would rise to 130 by 1983. If the general public were to be induced to put their money into British Aerospace, a long term financial plan would be needed, which would show how launching aid for aircraft development would be guaranteed; but it seemed unlikely that the Government would want to undertake the sole responsibility for this. However, without it the Company would not have the financial capacity to develop medium or large aircraft. The Governor undertook to arrange early and detailed discussions between his officials and those of the Department of Industry.

JW

A.J. WIGGINS
18 April 1980



Distribution:

Financial Secretary
Sir Douglas Wass
Sir Kenneth Couzens
Mr. Ryrie
Mr. Middleton
Mr. Bridgeman
Mrs. Hedley Miller
Mr. Lavell

PS/Governor (Bank of England)

Mr. Hansford)
Mr. Monck) British Aerospace
Mrs. Case) item only
Mr. Kerr)

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TELEPHONE
01 601 4444

BANK OF ENGLAND
LONDON EC2R 8AH

A J Wiggins Esq
HM Treasury
Parliament Street
London
SW1P 3AG

24 April 1980

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Dear John,

MINUTES OF THE MEETING BETWEEN THE GOVERNOR AND THE CHANCELLOR
ON 17 APRIL

I am afraid the second sentence of paragraph 6 of these Minutes is not right. What happened was that the Governor gave general but not specific assurances to the Iranian Central Bank Governor that we would not freeze the Iranian assets. (He could not be specific because there was a possibility of a UN resolution which might conceivably have included blocking). Nowbari, who had been concerned because of the Prime Minister's press conference in Washington, pressed the Governor to obtain an assurance from HMG that there would be no freezing. A discussion followed in No 10 as a result of which a carefully-worded statement to make to Nowbari was agreed. However, when the Governor telephoned his hotel first thing the following morning, Nowbari had already left for Washington and it was at first impossible and later seemed artificial and counter-productive to get hold of him and give such a sensitive message across the telephone. Thus the assurance which had the agreement of the Prime Minister was in fact never given.

When the Overseas Director of the Central Bank of Iran called on me a week or so ago to ask about our intentions, I gave general assurances on the same lines as those that the Governor had given. He appeared satisfied by these and did not press me for an official statement as Nowbari had done. In these circumstances it would have aroused more doubts than it stilled to have made a formal statement with its necessary qualifications and I did not therefore make it.

In the light of this I suggest that the second sentence of paragraph 6 should be deleted and replaced by the following:

"The Deputy Governor had recently given similar assurances to the Overseas Director of the Iranian Central Bank when he had called on the Bank of England."

Yours ever

Kit McMahon

C W McMahon