Await outcome

CONFIDENTIAL 12. 3.80

NOTE FOR RECORD

Copies to: The Deputy Governor
Mr.Fforde
Mr.Dow
Mr.Blunden
Mr.Page
Mr.Loehnis
Mr.Coleby
Mr.George
Mr.Goodhart
Mr.Sangster
Mr.Walker
Mr.Quinn
Mr.Gill

1. After talking to the Governor, JSFf and Wiggins, I telephoned the secretaries to the Chairmen of Midland, Lloyds, National Westminster, Barclays and Williams & Glyn's to invite them to attend a meeting with the Chancellor at 5.30 p.m. on Thursday, 13th March at 11 Downing Street. I said that the Governor (and/or Deputy Governor) would be present. I used the following formula - agreed by JSFf with HMT -

> "The Chancellor has expressed a wish to meet the Chairmen to discuss recent and prospective developments in their lending and the monetary situation generally ahead of the Budget."

2. Lord Armstrong, Sir Jeremy Morse, Sir Anthony Tuke, Sir George Kenyon and Lord Sandon will attend - Lord Sandon in the absence of Mr.Leigh-Pemberton in Egypt.

3. JSFf has organised briefing - for the Governor and for the Chancellor.

4. The Governor will see the Chancellor at 9.45 a.m. on Friday, 14th March. The subjects to be discussed will be the meeting with the Chairmen, the monetary targets and the monetary situation generally. Sir Douglas Wass will be present and the Governor has been asked if he wishes to be accompanied.

Lord Armstrong's briefing pps.
12 3 80 note by J R Sargent
sent as encl to 20.3.80 Goss/JSB
Jcleal : ED

JSB

J.S.Beverly (4121),
Governors' Office.
12th March 1980.

CONFIDENTIAL

12. 3.80

NOTE FOR RECORD

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Mr.Quinn
Mr.Gill

Further to JSB's note of to-day's date, Williams & Glyn's have asked that Sir Michael Herries should represent them at the meeting with the Chancellor at 5.30 p.m. on Thursday, 13th March. I have advised the Chancellor's office accordingly.

2

Governors' Office,
12th March 1980.

P.W.F.Ironmonger (4122)

341/1

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12.3.80

G.P.S. [initials] 12/3

I am content with this. The Gov will wish to see in particular the last 2 paras.

MR. FFORDE

Copy to: Mr. George

We need to send to HMT tonight.

<u>Chancellor's meeting with Clearing Bank Chairmen</u>

I attach a revised version of the Bank contribution to the briefing for the Chancellor's meeting tomorrow.

Mr Fforde

— Copied to GMG

It will be important that the Chancellor should avoid giving the impression that he is opposed to interest rates going higher if they have to — what we want to avoid, I assume, is needlessly — ~~or~~ or avoidably — higher rates.

[initials] 12/3

[initials]

12 March 1980.

G.M.Gill (4019)

JSFf 12/3 13

12. 3.80

Draft Brief for Chancellor's meeting with Clearing Bank Chairmen

Introduction

This brief outlines recent trends in the clearing banks' balance sheets and explains the difficult liquidity problem the clearers could face if private sector borrowing continues at recent levels. It suggests that the Chancellor should, first, ask the Chairmen how they see the pattern and future growth of bank lending, as this is clearly crucial both for the Government's monetary policy and for the banks' own liquidity position: and secondly, in the light of what the Chairmen say, that the Chancellor might explore with them whether the clearers can provide more active discouragement to increased private sector borrowing by means other than by higher interest rates; and, in that context, whether additional directional guidance by the Bank would help to reinforce the banks' own efforts to discourage borrowing.

Clearing Bank Balance Sheets

The clearing banks account for over half of the sterling banking sector. Over the past year, their balance sheets have expanded rapidly in nominal terms but less significantly when adjusted for the rate of inflation. Sterling deposits are around 20% higher and, within the total, deposits from overseas residents have risen much faster (by nearly 40%) than deposits from residents.

On the assets side the main feature has been a marked shift from lending to the public sector to lending to the private sector. Public sector assets have fallen by over 10% whereas private sector assets have increased by 26%. Holdings of gilts are nearly halved (largely reflecting the recent sale and repurchase operation), Special Deposits have been released and Treasury Bill holdings are only slightly higher. But lending to the private sector has risen by over 20% , while off-balance sheet contingent liabilities in the form of acceptances have more than doubled. The expansion of the clearers' balance sheets has also brought them under reserve asset pressure which has only been relieved by releasing special deposits and the gilts repurchase operation.

Over the year most categories of lending have risen by between 20% and 30%, with the exception of "financial" (including property companies) which is little changed. In recent months lending for

JSFf 12/3 13

manufacturing has been strong, but personal lending shows signs of levelling off. /The most recent analysis is attached./

The growth of the clearers' interest-bearing eligible liabilities has brought them up against the "corset" limit and four of the clearers are now in the"corset" penalty zone.

The Prospect

A continuation of private sector borrowing from the clearers at the levels of recent months could maintain severe pressure on the clearers' balance sheets and reserve asset position. If lending to the private sector continues in excess of the underlying growth in money supply (as it has done over the past year) lending to the public sector will have to fall. But not only do the clearers have little scope for reducing their public sector lending: they would actually need more public sector assets to maintain the required liquidity. There may therefore be continuing pressure on short-term interest rates of the sort we have recently seen in the money markets: but whereas seasonal factors have played a large part in the recent pressures, the problem could in future become more persistent.

The clearers could also be vulnerable to liquidity pressures if there were any reversal of confidence in sterling and a withdrawal of their now large non-resident deposits.

Line to Take

The Chancellor will want to ask the Chairmen how they see the current pattern and future growth of bank lending; and whether they are concerned about the effect which restraint on money supply growth seems likely to have on their liquidity. If the Chairmen suggest that interest rates will have to rise further, the Chancellor might say that this would create problems which can hardly be in the clearers' own interests. Quite apart from the presentational problem over bank profits, higher interest rates will increase borrowing costs and could lead to more bad debts. What is needed is for borrowers to cut their other costs eg., pay increases. Can the clearers help to get the message across and so discourage lending which is being undertaken as an alternative to retrenchment elsewhere?

The Chancellor may also like to ask the Chairmen for their views on the usefulness of directional guidance both in the present context and more generally. Would it help to reinforce the banks' efforts to discourage borrowing if the Bank were to provide additional guidance? At present the guidance asks the banks to exercise restraint on lending to persons and property companies, and for purely financial transactions, in order that adequate finance is available for the manufacturing industry and for the expansion of exports and saving of imports. Would a different form of guidance be helpful, for example, asking the banks to look unfavourably on increased facilities associated with rising costs which are unlikely to be recouped; or more specific guidance for certain categories, for example personal lending other than for house purchase?

12 March 1980.
G.M.Gill (4019)

CONFIDENTIAL UNTIL 2.30 P.M. ON TUESDAY, 11TH MARCH, 1980

ANALYSIS OF ADVANCES TO U.K. RESIDENTS BY THE LONDON CLEARING BANKS' GROUPS

AS AT 20TH FEBRUARY, 1980

This table covers advances by offices of the London Clearing Banks and their subsidiaries (excluding Scottish and Northern Ireland banks) in Great Britain, the Channel Islands and the Isle of Man which are listed by the Bank of England as falling within the banking sector.

Loans under the special scheme for shipbuilding, other than those refinanced with the Bank of England, are included within item 6 "Shipbuilding"; but lending under the special export schemes is not included, since this is classified as advances to overseas residents.

£ million

	Total Outstanding (1)	Change on Quarter (2)	Change on Year (3)
MANUFACTURING			
1. Food, drink and tobacco	1,075	- 23	+ 111
2. Chemicals and allied industries	1,069	+ 118	+ 224
3. Metal manufacture	415	- 26	+ 63
4. Electrical engineering	644	+ 73	+ 103
5. Other engineering and metal goods	1,945	+ 226	+ 497
6. Shipbuilding (including special scheme lending)	420	- 8	+ 7
7. Vehicles	274	+ 9	- 23
8. Textiles, leather and clothing	715	+ 57	+ 114
9. Other manufacturing	1,516	+ 104	+ 324
Total 1-9	8,072	+ 530	+ 1,420
of which in sterling	*7,155*	*+ 441*	*+ 1,352*
OTHER PRODUCTION			
10. Agriculture, forestry and fishing	1,905	+ 75	+ 481
11. Mining and quarrying	325	- 6	+ 5
12. Construction	1,525	+ 103	+ 250
Total 10-12	3,755	+ 173	+ 736
of which in sterling	*3,627*	*+ 181*	*+ 760*
FINANCIAL			
13. Hire purchase finance companies	352	+ 27	+ 79
14. Property companies	1,087	+ 13	- 31
15. Insurance enterprises (including pension funds)	221	+ 2	- 13
16. Other financial	1,165	+ 8	- 93
Total 13-16	2,824	+ 51	- 59
of which in sterling	*2,219*	*+ 101*	*+ 172*
SERVICES			
17. Transport and communications	931	+ 51	+ 186
18. Public utilities and national government	990	+ 23	+ 19
19. Local government services	115	+ 21	- 7
20. Retail distribution	1,485	- 33	+ 224
21. Other distribution	1,521	+ 175	+ 349
22. Professional, scientific and miscellaneous	3,561	+ 417	+ 680
Total 17-22	8,602	+ 652	+ 1,451
of which in sterling	*7,498*	*+ 685*	*+ 1,622*
PERSONS			
23. House purchase	1,789	+ 55	+ 451
24. Other personal	4,145	+ 109	+ 857
Total 23-24	5,935	+ 165	+ 1,308
of which in sterling	*5,931*	*+ 166*	*+ 1,309*
TOTAL ADVANCES TO U.K. RESIDENTS	29,188	+ 1,570	+ 4,857
of which in sterling	*26,429*	*+ 1,574*	*+ 5,215*
in foreign currencies	*2,759*	*- 4*	*- 358*

JSFf 12/3 13

C.L.C.B. STATISTICAL UNIT

S41/1

SECRET 13. 3.80

THE GOVERNOR has seen. Copy to The Deputy Governor

1. Meeting with the Chancellor and the Chairmen of the London Clearers: 5.30 p.m. 13th March at No.11 Downing Street

The Govr attended

/Lord Armstrong, Sir Jeremy Morse, Sir Anthony Tuke, Lord Sandon and Sir Michael Herries/

2. Meeting with the Chancellor: 9.45 a.m. ~~(or 11.00 a.m.~~) 14th March

The Governors attended

JB 14/3

Herewith please find a folder of papers for these two meetings, including at the front the usual market information.

For (1) I attach GMG's draft brief for the Chancellor.

For (2) the following subjects may arise - although the meeting has been set up to deal with targets and the SSD Scheme and the previous evening's meeting. Relevant papers are attached:

(a) Targets and SSD Scheme - MP docs
(b) Consultative Document MC docs.
(c) Medium Term Finance Strategy MP docs.
(d) Select Committee
(e) The Budget JMS Safe
(f) EMS Ex Rate docs (March Basle)
(g) Banks' profits JMS safe
(h) Basle: Euromarkets in particular perhaps March 80
?(i) Dr.Zijlstra's visit Int S&V, docs.
?(j) British Aerospace — T/s.

JB

J.S.Beverly (4121),
Governors' Office.
13th March 1980.

COMMERCIAL IN CONFIDENCE

CONFIDENTIAL

Copies to the Deputy etc.
Mr Franks
Mr Dow
Mr Blunden
Mr Page
Mr Wehnis
Mr George
Mr Goodhart
Mr Coleby
Mr Walker

CHANCELLOR'S MEETING WITH CLEARING BANK CHAIRMEN

NOTE OF A MEETING AT NO 11 DOWNING STREET ON THURSDAY 13 ~~FEBRUARY~~ MARCH 1980 AT 5.30 PM

Present:

Chancellor of the Exchequer (in the Chair)
Governor of the Bank of England
Lord Armstrong, Chairman of the Midland Bank
Viscount Sandon, Deputy Chairman of the National Westminster Bank
Sir Anthony Tuke, Chairman of Barclays Bank
Sir Jeremy Morse, Chairman of Lloyds Bank
Sir Michael Herries, Deputy Chairman of Williams and Glyns and Chairman of the Royal Bank of Scotland Group
Mr Middleton

18/3

The Chancellor invited the Chairmen of the major clearing banks to meet him as part of his preparation for the Budget. He was particularly concerned to exchange views with them about the conditions and prospects facing their businesses, and especially the outlook for bank lending. He noted at the outset the discomfort present high interest rates were causing to the Government, the general public and even the banks themselves. The Government were making every effort to improve the fiscal balance, since this was the essential pre-condition for a sustained reduction in interest rates in the long run. In the short run, however, it seemed that it might even be necessary for interest rates to move above their present levels. Whether or not this became necessary would depend to a considerable extent on the course of bank lending. He invited the views of the Chairmen about immediate prospects.

/2. Lord Armstrong

2. Lord Armstrong expected lending to continue at a fairly high rate until the middle of the year. Although lending to the personal sector was now tending to fall, lending to the company sector and especially to manufacturing industry was still rising. It was impossible to predict with certainty when it would begin to fall away; but for the time being the average of the three months December to February probably gave a reasonable indication of the trend. There were now perhaps the first signs of some falling off in the growth of lending to the company sector, but Lord Armstrong did not expect this to become marked until the second half of 1980. Meanwhile Midland expected to go even more deeply into the SSD penalty area if they were to meet the drawings they expected customers to make on agreed facilities.

3. The Chancellor asked whether the banks could do more to hold back the expansion of lending, and so reduce the threat of a move to still higher interest rates. It was essential that pay bargaining should become more restrained, and the banks should play their part by making clear to their customers that they would not be ready to provide additional sums to meet imprudent pay settlements. Lord Armstrong emphasised the extent to which there was no dialogue between the banks and their customers as agreed facilities were drawn down; the overdraft limits having been fixed, the customers simply wrote the cheques. Facilities were reviewed periodically, but it was very hard to contemplate reducing them so far that customers had absolutely no further room for manoeuvre. On average up to

/50% of agreed

50% of agreed facilities were unused, and this allowed very large scope for the level of bank lending to vary without the banks being able to do anything in the short run to control it. Midland kept a very sharp lookout for impending bankruptcies and business failures, but there had been no sign as yet that present conditions were giving rise to a sharply increased number of these.

4. Viscount Sandon remarked on the extent to which the present increase in borrowing was concentrated on the 'blue chip' sector. The National Westminster had seen a rise in average utilisation of facilities from 51% to 58%. But did the Chancellor actually want the banks to pressurize a customer like Courtaulds, given the difficulties the textile industry was already facing? Lord Sandon drew attention to the possibility that local authorities might draw an extra £500 to £600 million of agreed facilities if they were unable to send out rate demands, and there would then be a cash shortfall of £1 billion a quarter.

5. Sir Anthony Tuke said that borrowing through Barclaycard was sharply down, and lending to the personal sector was falling. He thought involuntary stock building would continue for only about 2 more months, and thereafter he expected bank lending to the company sector to turn down. He pointed out that whereas in 1979, bank lending had increased by 26%, as against an inflation rate of 17%, lending was now growing more slowly than inflation.despite the continuing company sector borrowing.

/6. Sir Jeremy

6. Sir Jeremy Morse said that Lloyds' expectations were much like those of Barclays. The textile industry was the most obvious area of distress borrowing at present, although there were elements of this in the construction, haulage and advertising industries (following the ITV strike). Geographically, the Midlands were the area hardest hit, with steel users facing difficulty in securing supplies as well as higher input costs, while their sales were falling in response to lower demand from their customers like BL. We were now entering the credit crunch period, and firms were being further squeezed by the high exchange rate and the acceleration in inflation. However, Sir Jeremy Morse thought the level of industrial wage settlements had sometimes been exaggarated; many of these had been in the region of 10%, and had reflected the perceptions of the employees concerned that their firms simply did not have the money to pay more. It might have been expected that stock levels would have fallen after the end of the company years coinciding with calendar 1979 (the delay being due to the need to maintain stocks at end-year in order to minimise corporation tax liability); in practice, however, there had been little noticeable effect. This might again be a factor in April/May.

7. Sir Michael Herries said Williams and Glyns were beginning to notice problems of distress borrowing, which had been rather slow to emerge in Scotland. The agricultural sector was also a significant borrower.

/8. Sir William

Lord.

8. ~~Sir William~~ Armstrong, commenting on the possible problem of local authority cash flow, suggested that it should not be too difficult to smooth out the difficulties in the same sort of way as had been done with the Post Office when telephone billing was interrupted. However, it was noted that it was much easier to achieve this where only one enterprise was concerned than where it affected several hundred local authorities.

9. The Chancellor asked how the Government could help in present circumstances. Would there be any advantage in some new directional guidance to the banks? Lord Armstrong doubted whether there would be any advantage in such an initiative; but the Midland were expecting quite serious difficulties with the financing of the company sector. Their estimates suggested that the financial deficit of companies had been about £8 billion in 1979, and they were looking for a deficit of a comparable size in 1980. However, this year the banks would be much less able to meet demands for finance, because the high lending last year, combined with other monetary developments, had squeezed the liquidity out of the system, while the SSD scheme was operating as a further constraint. The Midland were worried that the banking system might be able to meet only 75% of company requirments for finance; if this was right, something would have to give, and there could be a sharp upward movement in interest rates in the middle of the year before they began to fall back again later. Meanwhile companies were locked into borrowing which they were unable to reduce because of the difficulty of moving stocks.

/10. The

10. The Chancellor suggested that the longer the moment of truth were postponed, the worse it would be. Would not banks be well-advised in their own interests to try more actively to restrain the growth of their lending? Sir Jeremy Morse agreed that the sooner managements took action to reduce activity and borrowing, the better. Firms which were maintaining previous levels of activity were in effect betting that pressure for higher earnings would continue to hold up real demand in the economy. But in 1974-75 demand fell away faster than people had projected, and banks were now saying whenever the occasion arose that their customers would be well-advised to try to reduce their drawings on their facilities. Lord Armstrong was concerned that enforced retrenchment by companies could lead to a rapid increase in unemployment. Lord Sandon thought the Government should stick to their present approach; the turning point in bank lending would come before long. Meanwhile the company sector should be encouraged to restructure by cutting out loss-making activities and reducing stocks, but should so far as possible avoid reducing basic productive capacity, since if that were lost it would only result in a resurgence of inflationary pressures when recovery began.

11. The Chancellor asked about progress in the banks' pay negotiations with their own staff. Lord Armstrong said that the banks had opened with an offer of 17%, which was the lowest they thought they could get away with without provoking a strike. Sir Anthony Tuke thought a ballot would secure acceptance of this figure; Sir Jeremy Morse noted that the CLCB were much more determined than last year to stand together, and they would not rule out facing a strike. Particular problems for the system could arise on their computer operations, and they had already given the Bank

/of England

of England a scenario assessing the impact of a prolonged strike on financial flows. Lord Armstrong suggested that this should be made available to the Treasury as well.

12. In a brief discussion about the level of bank profits, Sir Jeremy Morse emphasised their cyclical nature. He thought the financial press had treated recent announcements very sensibly. Lord Sandon said a high proportion of present profits were the result of foreign operations, and were not related to the UK domestic economy. In real terms profits had been higher in the past, but the position now looked 'worse' than it had done then because of the requirement on the banks to make a full disclosure.

13. Lord Armstrong mentioned his bank's Economic Adviser's advice that the monetary target should now be rebased at a higher level, perhaps with the target range reduced from 7-11% to 6-10%. He wondered what the Government were going to say about monetary targets in the medium term.

14. The Chancellor, concluding the discussion, thanked his visitors for their help. He reiterated his request that the banks should do all they could to restrain the growth of their lending.

JW

A J WIGGINS
17 March 1980

Distribution:
Financial Secretary
Sir Douglas Wass
Mr. Ryrie
Sir Kenneth Couzens
Mr. Middleton
Mr. Bridgeman
Mr. Britton
Mrs. Gilmore
Mr. Riley
Mr. Ridley

PS/ Governor
Bank/England