S41/1

CONFIDENTIAL 23. 6.80

NOTE FOR RECORD

Copies to The Deputy Governor's Private Secretary
Mr Fforde
Mr Dow
Mr Blunden
Mr Page o/r/Mr Cooke
Mr Loehnis
Mr Coleby
Mr George
Mr Goodhart
Mr Sangster
Mr Walker
Mr Gough
Mr Quinn

The Gov collect on C/E.

The Governor will call on the Chancellor of the Exchequer at 5.30 pm on Wednesday 25 June.

Governor's Office HO-G
23 June 1980

JSB

J S Beverly (4121)

G.P.S. [illegible] 24/6 CONFIDENTIAL 23.6.80

MR GEORGE
MR FFORDE

PC see Comment overleaf.

24/VI

Copies to Mr Coleby
Mr Goodhart
Mr Walker
Mr Kentfield
Mr Hewitt
Mr Latter

CHANCELLOR'S MEETING WITH CLEARING BANK CHAIRMEN

See 24 6 80 + 18 6 80

1 The Chancellor is seeing the Clearing Bank Chairmen on Thursday (26 June). We need to consider what line the Chancellor should be advised to take, especially in relation to bank lending to persons or for house purchase.

2 The Chancellor might begin by asking the Chairmen for their assessment of the latest trends in bank lending and, in particular, for any evidence that lending is slowing down as the level of economic activity falls. – This is the most important bit.

3 The Chancellor might then refer to the Governor's discussions with the Chairmen about the Bank's lending guidance. He could say that, quite apart from the need for general restraint on bank lending in the light of the Government's monetary target, he is concerned, for broader political reasons, about the extent of lending to persons and for house purchase. Any impression that the banks are encouraging consumers to borrow tends to conflict with the Government's efforts to create a climate of monetary restraint; and some of the Government's supporters have been critical of the apparently open-handed approach by the banks to personal lending. There is a slightly different problem about increased bank lending for house purchase. As the banks are aware, the building societies are worried about competition from the banks, now that the corset has come to an end. The Financial Secretary recently discouraged the building societies from becoming too adventurous; but increased competition from the banks could force the building societies to retaliate, with subsequent upward pressure on interest rates. Higher interest rates at present would not be in the general interest and so it would be helpful if the banks refrained from active promotion of new schemes for home loans.

4 The Chancellor could say that he understands that the banks are exercising some restraint in promoting home loans and in advertising credit cards; but he would be interested to hear from the Chairmen themselves what the banks are doing and what sort of instructions

EA[illegible] 23/6 35 JSFf 24/6 4

Might be wise not to threaten the banks unless their response is positively hostile (which it is v. unlikely to be).

they give to their managers about adherence to the Bank's lending guidance.

? might lead
? encourage forestalling by U.S. banks et al.

5 Depending on how the Chairmen respond, the Chancellor might go on to say that he is prepared to rely on the good sense of the banks for the time being to restrain these types of lending but that he ought to warn them that, if lending to these categories ~~continues~~ were to rise strongly, political pressures could become so great that the authorities might have to ask the banks to observe tighter constraints, [including some form of quantitative ceiling,] on lending to these categories. The Chancellor could say that he and the Governor have no wish to go down this road and are fully conscious of the problems it would cause but that some stiffening of the present arrangements could well become unavoidable if present trends continue.

6 Finally, the Chancellor might add that, as regards lending to industry, in case there is any misunderstanding arising from his previous discussion with the Chairmen, both he and the Governor accept that the amount of this lending must largely depend on the banks' own judgement. The Bank's lending guidance is intended to distinguish priorities within the total of bank lending and manufacturing is one of the priority categories. But the banks will have to make their own judgment of how much they can prudently lend to individual customers and, in addition, will need to have regard to the implications for their balance sheets of the Government's monetary target.

23 June 1980.
GMG

~~The Governor~~

We understand that the C/E is discussing all this with officials this afternoon, on the basis of Bridgeman's note to Ryrie on possible quantitative restrictions (of which you have a copy). Officials are not agreed among themselves; and we do not know whether & when there will be a further brief for the meeting with the CLCB. But it ? must be clear that there will be no move on direct controls at this stage (for one thing, no time to work out the details). Gill's note (above) is intended as a basis for you yourself to brief the C/E when you see him tomorrow p.m. I think it is all right; but would perhaps play up the message on house-mortgage provision — which is fairly specific to the clearers — and play down that on general consumer lending (which otherwise invites ripostes about what the C/E is proposing to do about the clearers' competitors in this field)

GMG ?

41/1

CONFIDENTIAL 24. 6.80

NOTE FOR RECORD

Copies to
The Deputy Governor's Private Secretary
Mr Fforde
Mr Dow o/r
Mr Blunden
Mr Page o/r
Mr Loehnis
Lord Croham
Mr Coleby
Mr Cooke
Mr George
Mr Goodhart
Mr Walker
Mr Gough
Mr Quinn
Mr Robson

G.R.(init) 26/6.

THE CHANCELLOR'S MEETING WITH THE
CLEARING BANK CHAIRMEN
5.00 PM THURSDAY 26 JUNE AT HMT

Meeting held
Governor attended.

See 23.6.80
+ 27.6.80

1 The banks will be represented as follows

Barclays	Sir Anthony Tuke
Lloyds	Sir Jeremy Morse
Midland	Sir David Barran
National Westminster	Mr Leigh-Pemberton
Williams & Glyn's	Sir George Kenyon

2 In making the arrangements for the meeting I have indicated that its precise nature is not clear and that I would relay to the Chairmen any further guidance we received from the Chancellor's office. I have not been pressed hard on what the Chancellor wishes to talk about but I have been asked.

Martin Hall has advised me this afternoon to say that the meeting is a continuation of the pre-Budget discussion and that the Chancellor will be interested in the Chairmen's views on how their lending is expected to develop, particularly post-corset.

3 I understand that the meeting will last about an hour and that the Chancellor may be joined by one or two of his colleagues (?probably official). I have said ad referendum that the Governor will probably not be accompanied.

Governor's Office HO-G
24 June 1980

JSB

J S Beverly (4121)

SECRET

24. 6.80

THE GOVERNOR has seen. Meeting held. JSF accompanied the Governor

JSB 26/6.

MEETING WITH THE CHANCELLOR
5.30 25 JUNE

I enclose the usual market briefing and relevant papers for the following subjects

(1) Monetary Policy. The borrowing requirement. Corporate sector problems. /Lord Sandon referred to the difficulties with which small firms were being faced. I am discussing how - if at all - we should pick up what Lord Sandon said. I understand from Priestley that Lord Sandon would prefer that nothing be done until post-Wilson Report./

(2) The Select Committee

(3) The Chancellor's meeting with the Clearing Bank Chairmen.

(4) Building Societies.

(5) The Wilson Report. - S323

(6) The Banking Act appeals. - T/S

(7) British Aerospace. T/S

(8) Cash Ratio paper.

You may care to say something to the Chancellor about the Bank dividend, which I understand is being discussed with HMT this afternoon. You may also care to consider saying something about Bank pay in the light of the press interest last weekend.

You have not yet received a draft response to the Chancellor's letter on public purchasing policy* and I am seeking to establish how matters stand.

JSB

Governor's Office HO-G
24 June 1980

J S Beverly (4121)

* I am told that this is coming forward very soon. It will not be raised by the C/E according to Wiggins but they would like an answer soon.

JSB 25/6

S 41/1 and to PPS

GPS

TELEPHONE
01-601 4444

BANK OF ENGLAND
LONDON EC2R 8AH

24 June 1980

A J Wiggins Esq
H M Treasury
Parliament Street
SW1P 3AG

Dear John

YOUR NOTE (20.6.80) OF THE MEETING BETWEEN THE CHANCELLOR OF THE EXCHEQUER AND THE GOVERNOR HELD AT 5.00 PM ON JUNE 18TH

The Governor has discussed these Minutes with me and has asked me to write to you suggesting a number of amendments of substance, as follows:-

(i) In paragraph 5, line 8, the sentence should read 'For banking May £900 million gross gilt sales had been achieved ....'; and the following sentence should begin 'In banking June, the CGBR has again been very high ....'.

(ii) On the remainder of paragraph 5, we feel that the present text does not fully record the Governor's expression of concern about the way the borrowing requirement seems to be developing. I therefore offer the following alternative to the second half of the paragraph (beginning at the top of page 3):-

> 'It would be desirable to make clear in briefing on the May money figures that the CGBR problem had continued beyond the end of calendar May. It seemed likely that the CGBR would be £1½ billion above the NIF forecast for the June quarter and that the forecast for the September quarter would also be substantially exceeded. There were no obvious explanations why borrowing should be very heavily ~~centred~~ concentrated! in the earlier part of the financial year and it was accordingly not easy to see how the forecast for the year as a whole was going to be validated. The problem seemed to result from high spending spread across the whole range of Government activity rather than from a revenue shortfall, while local authority borrowing also seemed to be running ahead. The Governor found these developments extremely worrying.'

(iii) On paragraph 10, we feel that the point made would be easier to understand if it were a little more spelt out, as follows:-

> 'The point was made that the Government had not been 'over-funding' in May and June given the high CGBR. If funding were now reduced, there was little prospect of long-term interest rates falling in consequence sufficiently to induce companies to issue fixed rate debentures and repay bank advances. In these circumstances if no attempt were made to achieve further gilt sales (in the hope of encouraging interest rates downwards) the result would simply be an excessive rise in money supply and the prospects for interest rates could then actually ~~only~~ worsen. The pace of funding could be reduced later, if the trends in the CGBR and bank lending warranted this.'

(iv) On paragraph 11 the Governor would prefer the sentence beginning 'However' in line 6 to begin 'Although he admitted that an early move ....' and would prefer the sentence to run on after 'levels' in line 9 with 'the Governor urged and it was agreed that the Bank and Treasury ....'.

(v) Finally, a small amendment is needed to paragraph 3 in the last line of page 1. The phrase 'and some members of OPEC' should be added to the sentence that now ends with 'Germany and the UK'.

Yours sincerely

John Fforde.

Add to BOS41/1
Secret Lop 1.d.c.

The Governor: to be aware of WFF's comment.
has seen

SECRET 25. 6.80

Int. GA. 25/6

Mr George
Mr Gill.

This was duly discussed and it was agreed that the C/E would make a firm request for the banks' help about mortgage lending 'while we are getting round this difficult corner'. No mention of threats of ceilings, or public amendment of guidance.

26/6

MR FFORDE
THE GOVERNOR — had another copy.

Copies to Mr Coleby
Mr Goodhart
Mr Gill

GOVERNOR'S MEETING WITH THE CHANCELLOR THIS AFTERNOON

After our meeting this morning I heard from Bridgeman that following discussion with Treasury officials the Chancellor is disposed to -

(i) agree with them that MLR should not be moved tomorrow; and

(ii) accept that we should undertake special assistance to the banking system, possibly on Friday, if that is what the arithmetic shows.

In relation to (ii) I have already circulated a separate note on what we presently know of the arithmetic and setting out our precise proposal; Bridgeman said that there had been some discussion of the longer-run problem of the banking liquidity predicament, and the Chancellor might mention this to the Governor as something that they would need to consider together quite soon (work on a paper on this subject is in hand between us and HMT).

Bridgeman also gave me an indication of the line that the Chancellor is inclined to take with the Clearing Bank Chairmen tomorrow. This is quite closely in accord with the approach suggested in GMG's note on which Mr Fforde has commented and which the Governor has already seen, except that the Chancellor is likely to go a good deal further in relation to lending for house purchase, and say that restraint in promoting mortgage facilities is not enough since if the facilities exist they will inevitably be used. In effect, as I understood it, he will be asking for an absolute ceiling on bank lending for house purchase and will offer to make a public statement to this effect and invite the Governor to bring this to the attention of other banks.

?

25/1

In my view a ceiling on lending for this purpose would be unduly tough. It would be unfair as between those clearers (Barclays and NatWest) that had not yet moved into the field but have recently announced their intention to do so deliberately to avoid promotion. It would also be extremely difficult to take off. There would also be problems over housing loans for staff. It would seem to me that a request for the utmost restraint in lending for house purchase, other than for staff, would be sufficiently effective for the Chancellor's (political) purpose but provide for a sensible degree of flexibility. In that case I would advise that we should, following a public statement by the Chancellor, issue an amendment to our directional guidance.

?

25 June 1980
EAJG

SECRET + PERSONAL PS/GOVERNOR

Rec'd p.m. 27/6

Copies to the Deputy Governor
Mr. Fforde 27/6
Mr. Dow
Mr. Blunden
Mr. Page
Mr. Walters
Mr. George
Mr. Goodhart
Mr. Coleby
Mr. Walker 27/6

NOTE OF A MEETING HELD AT NO.11, DOWNING STREET AT 5.30 PM ON WEDNESDAY, 25TH JUNE, 1980

Present:

Chancellor of the Exchequer (in the chair)
Governor of the Bank of England
Sir Douglas Wass
Mr. J.S. Fforde

I have passed the suggested amendment to John Wiggins. 1/7

MONETARY AFFAIRS

British Steel Corporation

The Chancellor warned the Governor that the Secretary of State for Industry would be making a statement about BSC on 26th June; this would be likely to give some indication of BSC's additional cash requirements over and above the £450 million external financing limit already announced for the current financial year. It seemed likely that BSC would need a further £400 million.

Foreign exchange markets

2. The Governor reported that Italy had supported the lire to the tune of about $1\frac{1}{2}$ billion over the last two ~~years~~ weeks; there were rumours in the foreign exchange markets of a 21 per cent devaluation this weekend. It seemed likely however, that Italy would prefer to postpone any such step until after the tourist season - and the impact of a devaluation of this magnitude on the Italian rate of inflation would be very serious.

Domestic monetary situation

3. The Governor reported that the presentation of the May money figures had gone well, and that the need for caution about the

CGBR had been understood. Following publication of the figures the funding programme had gone ahead; it appeared that about £600 million of the £1 billion long stop had been taken up on 25 June and some £70 million of the £600 million of the short, and the market had remained firm.

4. The first rough estimate of the June money figures would not be available until 27th; meanwhile there was modified moderate optimism in the Bank about the outcome on bank lending. Money market rates had tended to edge up on balance over the last week (there had been larger shortages in the markets than expected, which the Bank had relieved). In the Governor's view it would be wrong to move MLR on 26 June, although he would wish to get it down to this as soon as a suitable opportunity offered. His view was that monetary policy was now somewhat too tight, and that a modest reduction in interest rates would be appropriate; but it would be essential to achieve this in a way which did not convey the impression that the authorities were yielding to pressure to reduce rates prematurely. The limited scope for action by the authorities should be made clear; MLR was the only interest rate the Government could move directly, and even after some reduction in MLR the underlying problems of high interest rates and high exchange rates would remain. <u>The Governor</u> suggested that Ministers should, so far as possible, avoid saying anything about the circumstances in which interest rates might fall, so as not to preclude them from any particular course of action later even though one or other counterpart to the rate of sterling M3 might be moving in an undesirable way. He suggested that there would be advantage in the Chancellor distancing himself somewhat from movements in interest rates; the Governor's preference was for a system like that operated in Germany, where the initiative lay with the Bundesbank, with provision for a two-week grace period in the event of a disagreement between the Bank and the Government.

5. It was noted in discussion that there would always be difficulties about presenting a change in MLR in relation to the timing of information becoming available about successive months' money and banking figures. The Government would not want to be interpreted as moving in advance of changes in the underlying situation, although in practice the authorities were generally presumed to act with the benefit of more information than was available to the markets (and often more than the authorities actually had).

6. On the underlying situation, Sir Douglas Wass thought that the most serious problem was the developing overspend on defence. The shortfalls in Inland Revenue and Customs and Excise receipts should be made good in the coming months, while some allowance had already been made for the additional needs of nationalised industries. There was general agreement that every effort should be made to secure information as quickly as possible about trends in public expenditure and borrowing. Sir Douglas Wass undertook to investigate further what could be done about speeding up information about borrowing by local authorities. The Chancellor wondered whether anything could be done to mobilise the disciplines of the financial markets to restrain excessive local authority spending and borrowing; it appeared, however, that local authorities' guaranteed access to the PWLB when they were in difficulty in the financial markets would restrict the scope for changes.

7. On the condition of the money markets, it was noted that the shortage ~~on~~ up to the July makeup day was now estimated to be about £3 billion, after taking into account gilt sales on 25 June. The Bank could buy out about half of this in the course of its normal money market operations. There were substantial calls on gilts sold earlier which fell due on 4 and 11 July, and it seemed likely that further action would need to be taken (to
Omit accommodate these) if increases in short term rates were to be

avoided. The Bank proposed to announce on 27 June a sale and repurchase of gilts facility equivalent to 1½ per cent of Eligible Liabilities (£750 million) which would be open to all banks for value on 4 July. The banks hoped that this action would open the way for a reduction in MLR on 3 July. It would not be altogether easy to explain the need for this further assistance to the money markets; it would have to be justified by reference to the recent large volume of gilt sales and to the temporary expansion of the note issue during the holiday season.

8. In further discussion of the tight market position it was noted that, although there had been "under funding" in May and June, the previous assistance through the sale and repurchase of gilts had been run off, while the substantial receipts from gilts already in prospect for July came at a time when the unadjusted CGBR was very low. Since there was no reason for short term interest rates to increase further in order to achieve monetary control, there was a compelling case for a smoothing operation by the authorities. It was noted that a further decision would be required next week about possible action on 11 July; it seemed likely at present that a further £750 million of assistance would be required, and more if further gilt sales were achieved in the meanwhile.

<u>Chancellor's discussion with the London clearing banks</u>

9. <u>The Chancellor</u> said he would ask the chairmen of the clearing banks how they saw the prospects for their businesses in the light of the removal of the corset, and in particular how they expected lending to industry to move. The Governor was uncertain how the clearing banks would respond; borrowing by industrial and commercial companies was largely involuntary, while personal lending seemed to be decelerating. The advertisement campaign for credit card lending had not gone ahead, while the National Westminster and Barclays were holding

back on the development of mortgage lending. (Midland and Lloyds already had housing finance schemes in operation.)

10. On housing, both the Chancellor's and the Governor's instincts were against the maintenance of the building society cartel in the longer term; the Governor thought the pressures against the cartel would eventually become overwhelming. The Chancellor suggested, however, that when the Government were trying at one and the same time to ensure monetary control, to remove the corset and to prevent interest rates from rising, there were bound to be stresses in the system and the presumption would have to be against "adventures"; in these circumstances the Government would not want even an unadvertised incursion by the banks into the housing field. The Governor commented that he had already asked the banks to avoid eye-catching promotions; in his view the best course would be for the Chancellor to ask the clearing bank chairmen privately not to go ahead for the time being. The Chancellor recognised the force of this approach, but pointed out that the issue would need to be put clearly and firmly to the clearing banks; if there were now to be more competition for funds, mortgage rates would go up and the re-intermediation problem would be compounded. It would not be possible for the Government to prevent the building societies, who were at present holding their rates below market levels and rationing credit, from responding to the competition - and this would be bad for industry.

Treasury and Civil Service Committee

11. The Chancellor said that his private session with the Committee on 24 June had gone comparatively well, in that it had soothed ruffled feelings without involving any new commitments by the Government. The Treasury were reviewing which elements in the forecast could not be published, with a view to making more

material available at the time of the next Industry Act Forecast. The Committee had asked specifically for forecasts of the sector surpluses and deficits, but no promises had been made.

12. The Governor indicated that the Bank would shortly be sending in their reply to the Committee' monetary policy Questionnaire. The Chancellor noted this, commenting that he thought the Bank might obtain credit from the Committee for having answered each question specifically and in order - the Treasury's reply had been in the form of a memorandum, with annotations referring to the questions.

JW

A.J. WIGGINS

26 June 1980

Distribution:

Financial Secretary
Sir Douglas Wass
Mr. Burns
Mr. Ryrie
Mr. Middleton
Mr. Bridgeman
Mr. Britton
Mr. Lavelle
Mr. Ridley
PS/Governor of the Bank of England

Treasury Chambers, Parliament Street, SW1P 3AG
01-930 1234

CC FST
SIR D WASS
MR BURNS
MR RYRIE
MR MIDDLETON
MR BRIDGEMAN
MR BRITTON
MR LAVELLE
MR RIDLEY
PS/GOVERNOR, BANK OF ENGLAND

RE JOHN WIGGINS NOTE OF THE MEETING ON 25/6 ON MONETARY AFFAIRS (DATED 26/6)

PARAGRAPH 2, LINE 2 SHOULD READ "... $1½ billion over the last two weeks ..."

Correction made

JB 27/6.