

CONFIDENTIAL


30. 5.80

NOTE FOR RECORD

Copies to

The Deputy Governor  
Mr Fforde  
Mr Dow  
Mr Blunden  
Mr Page  
Mr Loehnis  
Mr Balfour  
Mr Coleby  
Mr Cooke  
Mr George  
Mr Goodhart  
Mr Holland  
Mr Sangster  
Mr Walker

The Governor will see the Chancellor at 9.45 am on Tuesday 3 June.

 Governor's Office HO-G  
30 May 1980  
J S Beverly (4121)

MEETING WITH THE CHANCELLOR 9.45 AM 3 JUNE

*held The Deputy Governor accompanied the Governor*

Possible points are

- 1 Markets
- 2 Monetary and exchange rate policy generally
- 3 Indexation
- 4 Select Committee: questionnaire etc
- 5 British Aerospace
- 6 Japanese Issue in London Capital Market
- 7 Banking Act: two tier system; appeals regulations
- 8 Dunlop
- 9 ?Banks' profits: levy schemes
- 10 ?Proprietorial role of the institutions
- 11 ?Tax clause in the Finance Bill to stimulate the bond market - DAW is providing material
- 12 ?Chancellor's letter on public purchasing policy

*JB*

SECRET



30-80  
SECRET sec 11 6-80  
Copies to the Deputy Governor \*

Mr. Frowde  
Mr. Dow  
Mr. Blunden  
Mr. Page  
Mr. Hoehris  
Mr. George  
Mr. Coleby  
Mr. Goswami

NOTE OF A MEETING HELD AT NO. 11 DOWNING STREET ON TUESDAY 3 JUNE AT 9.45 A.M.

Present: Chancellor of the Exchequer (in the Chair)  
Governor of the Bank of England  
Deputy Governor  
Mr. Ryrie

\* may I ask please if the action are  
x - paragraph 1 lies with the Bank?  
MONETARY AFFAIRS and re timing of meeting  
in paragraph 5

Japanese issue in the London market

The Governor mentioned that there was to be a Japanese issue in the London market of £25 million on 16th June. It seemed unlikely that there would be a very large volume of such issues, but the Bank would retain an informal queueing control to avoid "bunching".

X/ The Chancellor asked that the Prime Minister should be warned of this in advance. It was noted that the related issue of stamp duty exemption for foreign issues was currently under urgent examination, in case some change in the Finance Bill should prove appropriate.

Building Societies' composite rate

2. The possibility that an increase in the building societies' composite rate from about 3½ per cent was noted. The societies would need to widen their margins in order to absorb this, and there might need to be an increase in the mortgage rate if other interest rates had not begun to fall by the time the decision needed to be taken - probably in July.

Appointment of Chairman of BNOG

3. The Governor reported that Lord Armstrong had come to see him, expecting that he would have been consulted about Mr. Shelbourne's nomination. Lord Armstrong had had no warning, and no opportunity to think about the consequences for the Midland Bank's own



management. It was noted that the Chancellor had not been consulted until after the Prime Minister's consent to the appointment had been given, and that the Prime Minister had not been warned of the personality differences between Mr. Shelbourne and Mr. Morton. Practically every aspect of this appointment had been mishandled, and Sir Douglas Wass was contemplating writing to Sir Jack Rampton about this; he might usefully draw also on the Governor's report.

Position in the money markets

4. The Governor reported that the Bank's money market arithmetic suggested a total market shortage (i.e. after all the present outstanding assistance had been run off) at the June make-up day of about £2½ billion. The Bank would expect to be able to deal with about £1 billion of this by normal market operations buying in Treasury Bills and money market paper. But it would be difficult to provide as much as £1 - £1½ billion of further assistance through lending operations and covert techniques, so that there would be a strong case for prolonging some of the existing overt assistance to the money markets. For the time being very short rates were reasonably relaxed, but the Bank would want to be sure of avoiding any outward pressure over the make-up day.

5. The Governor's judgement was that the best course would be to allow the £1 billion of gilts repurchase agreements with the clearers to run off (in two instalments on 12 and 17 June) but to cancel the 1 per cent recalled special deposits due on 16 June. This would spread the assistance across the banking system as a whole rather than concentrating it on the clearers (which was the effect of the gilts re-purchase arrangements). The permanent relief afforded by the cancellation of the special deposits recall seemed appropriate in view of the prospective tightening in the Bank's position in July as a result of the holiday increase in the note issue, the gilts receipts already assured, and the prospective



low CGBR.

6. No formal decision was required on the gilts re-purchase arrangements, where the presumption would be that they would be run off, if there were no announcement to the contrary. The cancellation of the special deposit recall, which the Bank wished to announce on 5 June, required the Governor's consent. The Chancellor indicated that the Bank should go ahead as the Governor proposed.

The monetary prospect

7. The Governor said the money banking figures were still subject to considerable uncertainty, not least as the result of difficulties with the Bank's computer. But the present signs were that sterling M3 growth would be around 1½ per cent. Growth since February would still be within the target range at an annual rate despite this large increase, which mainly resulted from an abnormally high CGBR. It seemed likely that there would have been some contraction in bank lending, although there had been a resurgence of £300 million in the bill leak, much of which may have gone overseas. The Governor expected that publication of the May eligible liability figures, and the indication of very low bank lending, would stimulate still further pressure for a reduction in MLR. Such calls had already been made by the CBI, Greenwells and Barclays as well as political sources, as a means of easing the financial pressure on industry and restraining the upward movement of the exchange rate.

8. The Governor was concerned that the prospective monetary situation over the months immediately ahead would hardly justify a reduction in MLR. The underlying trend in bank lending remained obscure, although the fairest indication was probably given by taking the last two months together. Short-term forecasts made last month had suggested increases in sterling M3 of more than 1 per cent in both June and July, on the assumption of "re-intermediation" amounting to £500 million over the two months.



If this forecast were realised, the growth in sterling M3 would move outside the target range and remain there. The Governor had no confidence in an early fall in corporate demand for bank lending, given the recent movements in earnings, even after allowing for some destocking. He suggested a further talk with the Chancellor on Wednesday 11 June, when a new short-term forecast would be ready and the market's reception of the eligible liabilities figures would be known.

9. The Chancellor emphasised his wish to see a reduction in interest rates in order to help industry, as soon as this could be consistent with market sentiment and with the achievement of the Government's monetary target. The Governor commented that the industrialist members of the Court were now expressing very strongly the view that the Government should not persist in their present policy. However, he saw no grounds for thinking that achievement of the monetary target would be consistent with an immediate fall in MLR; there could even be a need for an increase. The recent good performance of the gilts market had owed much to the stimulus of foreign buying - domestic investors were much more reserved. The Governor was particularly concerned about the recent appalling increases in earnings and prices, and thought a monetary relaxation now could be interpreted as a signal to wage bargainers in the next round that the brakes were off. The Governor questioned whether the Government should reduce interest rates without some reinforcement of their policies in other directions - examples were a change in their stance on pay for the development of fiscal incentives for companies to raise funds outside the banking sector. The Governor suggested that a fiscal incentive for companies to raise money in the long-term capital market could be a cheap way of achieving the Government's monetary objectives; the Treasury and Bank were studying this.

10. The Chancellor emphasised that in the past reductions in interest rates had generally preceded reductions in the rate of



inflation. He accepted that a reduction in MLR would mean the Government taking some risks; but a temporary move of sterling M3 above the target range could perhaps be justified by reference to the problem of reintermediation. Once interest rates were established on a downward path, the prospect of further movement should generally be helpful to funding. Meanwhile the Government should look for ways of securing additional revenue more quickly from the North Sea, following any further increases in oil prices.

11. The Governor suggested that intervention to avoid increases in the exchange rate would be less damaging monetarily than interest rates too low to contain the growth of borrowing. He thought the exchange rate was more of a problem to companies than present high interest rates. In response to a question about the effect of a 2 per cent fall in MLR, the Governor said he thought this might lead to a sharp drop in foreign interest in UK securities, and so lead to a block in the way of further funding. If there were any implication that the monetary targets were being relaxed, the results could be still more awkward. The Deputy Governor suggested that a 10 per cent fall in the exchange rate, which at its present level must be regarded as extremely precarious, would be entirely consistent with the Government's policy, and would help industry more than a 2 to 3 per cent reduction in interest rates.

12. The Governor said that, despite his hesitations, he was anxious to get interest rates down as soon as possible and would propose reductions as soon as he thought this prudent. Meanwhile consideration should be given to all possible ways of improving the prospects for the next pay round, and of encouraging companies to go to the capital markets rather than the banks. He also wished to reconsider the authorities' tactics in the foreign exchange markets. For his part, he wanted to say as little as possible about interest rates for the time being, although if financial markets took rates down following the publication of next week's eligible liability figures, then the position on MLR would be different.



13. The Chancellor emphasised that, in wanting to present the monetary figures in such a way as not to sustain upward pressure on interest rates, he was not contemplating any significant departure from the present stance of policy. The Government were absolutely not contemplating any kind of pay freeze, and it would be important to dispel any expectations that the special Cabinet meeting fixed for 16 July would produce an initiative of this kind. However the Government were looking at the question of public sector pay, where the response to the recent 30 per cent increase (taking into account catching-up) for doctors suggested that the excuse of the "hangover" from the previous policy was wearing rather thin. Nevertheless the Government were determined to avoid mentioning any particular figures which could be interpreted as a pay norm for the next round, although they might point to the implications of the monetary target for pay and cash limits.

14. In a brief discussion of the assessment section of the June Bank of England Quarterly Bulletin, the Governor remarked that the Bank would emphasise how the United Kingdom had been uniquely profligate in the size of wage increases. It would show how in other countries earnings increases had been running below increases in prices, whereas in the UK the reverse had been true. Mr. Ryrle drew attention to the need to make clear also the differences between UK wage increases and those in other industrial countries, which had the most serious indications for competitiveness. Moreover, given the Government's monetary targets, large wage increases carried the most serious risks for employment. The Governor said that a further theme in the Quarterly Bulletin would be that different theoretical approaches to economic policy did not at present lead to different conclusions about the practical steps to be taken; the fact was that there were no viable alternative policies available to replace those the Government were now following.





Meeting with the clearing banks

15. The Chancellor mentioned that he would like to have a further meeting with the clearing bank chairmen in the near future. The Prime Minister remained anxious that the banks would start heading for a larger share of the market following the abolition of the corset, and the continuing advertisement campaigns for credit card facilities were also an irritant. He wished to emphasise again the need for restraint in the expansion of clearing bank activities. The Governor undertook to arrange a further meeting. He suggested that it would be useful for him and the Chancellor to have a discussion with the Prime Minister in the near future, to run over the monetary policy options. The Chancellor said he would arrange this.

MAH

p.p. A.J. WIGGINS  
3rd June 1980

-----  
Distribution:

Financial Secretary  
Sir Douglas Wass  
Mr. Burns  
Mr. Ryrle  
Mr. Middleton  
Mr. Bridgeman  
Mr. Britton

Mr. Lavelle  
Mr. Monck  
Mr. Unwin  
Mr. Ridley

PS/Governor

THE DEPUTY GOVERNOR

BANK OF ENGLAND  
LONDON  
EC2R 8AH

9 June 1980

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

copied to 3377  
3380  
33  
cc: SPS 33P  
POL  
CASSO  
RIC  
CARG  
Ans.  
11 6 80

Dear John,

MINUTES OF THE MEETING BETWEEN THE CHANCELLOR AND THE GOVERNOR  
ON TUESDAY, 3 JUNE

I am afraid there are several points in these Minutes which are not quite right and which I think are important enough to require correction.

The second sentence of the first paragraph should read "it was impossible to say how large a volume there would be of such issues; the Bank had no present intention of operating a queue, but the Bank would as usual let applicants know informally if several of them were intending to come to the market at the same time".

On the appointment of a new Chairman of BNOC, it should be recorded, in case Sir Douglas Wass does in fact write to Sir Jack Rampton, that in addition to the complaints referred to in the Minutes, the Governor mentioned that it was unsatisfactory that he, with his supervisory responsibilities for the City, had not been consulted at all.

Paragraph 7, third sentence: "abnormally" is probably misleading in relation to the May CGBR: it is much higher than previous months, but they were abnormally low. Unfortunately, present indications are that we shall have some more months' CGBRs not too different from May's level.

Paragraph 9: the reference to the views of the industrialist members of the Court is incorrect. They were not urging that the Government, "should not persist in their present policy". Rather, "they expressed great concern about the level of interest rates and the exchange rate and hoped that some alleviation might be possible on one or other of these fronts without an abandonment of the Government's overall policy". In the next sentence, the Governor's feeling that "there could even be a need for an increase" referred to long-term rates in the gilt market not to MLR.

Paragraph 11, last sentence, misrepresents what I said. I was making two rather separate points. First, that the present policies did not necessarily imply exactly the exchange rate we now had and that some lower rate could well be consistent with present policies; and secondly, a sort of rough arithmetical point that a 10% fall in the exchange rate would help industry more than a 2% or 3% reduction in interest rates.

*Yours ever*

*Kit McMahon*

C W McMahon