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CHANCELLOR'S MEETING WITH CLEARING BANK CHAIRMEN  
 NOTE OF A MEETING AT NO 11 DOWNING STREET ON THURSDAY 13  
 MARCH?  
 FEBRUARY 1980 AT 5.30 PM  
 Mr Walker

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

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.

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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 exaggerated; 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 Glyn's 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





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 requirements 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 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





X) 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      Mrs. Gilmore  
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Mr. Middleton      PS/ Governor  
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Mr Walker

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/2. Lord Armstrong