

STRICTLY CONFIDENTIAL

MEETING BETWEEN THE CHAIRMEN OF THE LONDON CLEARING BANKS
AND THE GOVERNORS

WEDNESDAY 10 SEPTEMBER 1980 AT 3.30 PM

AT THE BANK OF ENGLAND

The following attended:

CLEARING BANKS

Sir Anthony Tuke	Barclays Bank Limited
C J Montgomery Esq CBE	Lloyds Bank Limited
Sir Reay Geddes KBE	Midland Bank Limited
Robert Leigh-Pemberton Esq	National Westminster Bank Limited
Sir Michael Herries OBE MC LLD	Williams & Glyn's Bank Limited

BANK OF ENGLAND

The Governor
The Deputy Governor
J S Pforde Esq
E A J George Esq

Secretariat L W Priestley Esq (CLCB)
 T E Allen Esq (Bank of England)

1 Minutes of the meeting held on 30 July

There were no matters arising.

2 Monetary Situation and Prospects

The Governor said that monetary developments since the last meeting on 30 July had continued to be confused by adjustment to the ending of the corset. As it had become known that EM3 had grown by 5% in banking July, there had been a sharp setback to previously bullish expectations in the domestic financial markets; and the thought that there would be further rapid growth in banking August - confirmed by the previous day's announcement of a 3% rise - had been a depressing influence up until a week or so ago.

At the same time, the narrow money aggregates had continued to grow only modestly; and there had been further evidence of sharp decline in the real economy and some indication that the rate of inflation might be declining more rapidly than most people had expected. More recently the view that these developments provided for the time being a more reliable guide to the underlying situation - and to policy - seemed to have gained strength in the markets and to have revived hopes of lower interest rates. In the money market there had been renewed hopes of an early cut in MLR and the revival of the gilt market had allowed the Bank to resume funding, leading to the exhaustion of the 1991 tap stock before the Treasury's statement on 9 September.

The dichotomy between what was happening to EM3, and the other wider monetary aggregates, on the one hand and the evidence of other monetary and real indicators on the other clearly put the Bank and the Government in some considerable difficulty.

Thanking the Chairmen for the considerable help that the Chief Executive Officers had been able to give the Bank in disentangling the July figures, the Governor said that, allowing for the unwinding of corset distortions, we were left with underlying growth of EM3 in the last two months of the order of 1-2%. This meant that so far in the current target period monetary growth was running well above the top of the 7-11% range.

An important reason why EM3 had been growing as it had since the Spring was the rebound of the PSBR, which had been unusually low in the earlier months of the year. And although funding in the gilt market had also been stepped up very substantially, it had not been able to keep pace. As the Treasury had said in its statement on 9 September, there were reasons for believing that the borrowing requirement would fall away during the rest of the financial year and it was, the Governor said, clearly very important that it should be closely controlled. That was the responsibility of the Government.

The other factor in the growth of EM3 had been the continuing high underlying rate of growth of bank lending to the private sector - and that was more directly in the field of the Bank and the clearing banks. Both before the announcement of the ending of the corset and subsequently, the Governor said that he had preached to the Chairmen the importance, in the present difficult period, of restraint in the banks' lending and of observing the directional guidance on lending, and that he trusted and hoped that the banks had done all that they could in these respects. The Governor emphasised - in the confidence of the meeting - that both the Bank of England, as the central bank, and the clearing banks, as the core of the banking system, were under heavy criticism for not doing enough to exercise restraint. Of course, the Governor added, much of the lending was to support industrial customers in the present difficult climate. But the allegations were that loans were being irresponsibly pushed at customers that had no pressing need to borrow. A particular irritant in the political context was the belief - encouraged by remarks made to Ministers from industry and indeed some parts of the City - that increases in over-draft limits were being volunteered to companies that had not requested them and, what was worse, to credit card customers. The Bank was then criticised for providing the liquidity for the clearing banks to go on in this way through its special facilities without which, according to the argument, the clearing banks would show greater restraint.

The Governor said that he mentioned this, in the confidence of the meeting, not because he believed it was an accurate reflection of what was in fact happening, but because he believed it was important that the Chairmen should be aware of the present strength of feeling. It was critically important to the relationship between the Government and the banks in the longer run that there should be no grounds for this kind of accusation. The Governor added that he believed that the Chancellor would want to see the Chairmen again himself in the following week or so and would, no doubt, wish to be reassured as, no doubt, the Chairmen would wish to reassure him.

The Governor said that an associated aspect of the present concern was the apparent lack of intelligence about what was happening to underlying bank lending. This was something that the Bank and the clearing banks had considered together often in the past and the Bank well understood the clearing banks' difficulty in understanding with any precision the immediate reasons for their customers drawing on their facilities, but he believed that the Bank and the clearing banks were obliged to have another go at it. What the Governor thought was needed was an informal day-to-day contact at an appropriate operational level which would give the Bank a more specific feel for what was happening than it got at present through the monthly meeting with economists. With the Chairmen's agreement the Governor said that he proposed to ask Mr George to explore with CEOs what more could be done.

The Governor added that much of the current concern in Whitehall of course reflected the tension of the present position for policy. Nevertheless, he concluded that it was important for the banks themselves that they should show that they were doing all that they possibly could to support the Government's objectives and to see if there were anything more that could be done.

Mr. Leigh-Pemberton said that his own bank was still applying the qualitative guidance which had been long outstanding. A recent circular to branches had repeated the guidance and he had no knowledge of any serious breaches. Allegations of pushing loans were unfounded - indeed such behaviour would be contrary to the banks' own interest. Of course the banks were doing everything possible to see their customers through the current difficult period, even where this might not be fully justified on normal prudential grounds.

Mr Leigh-Pemberton thought that one explanation of the increase in personal borrowing might be to finance the purchase of "W" registration cars. He referred also to switching back to overdraft finance on make-up days, saying that there was some evidence of soft arbitrage but not, he believed, of hard arbitrage.

He said that the current experience was that the recession was now being felt more widely and deeply, especially in the north. Utilisation of overdraft facilities had risen from 55% a year ago to 60%. The service industries were also depressed, especially in London. The number of receiverships with which his bank was concerned was no greater than last year, but the number of accounts under observation had grown.

The Governor said that he hoped that it would be possible to pursue some of the points that Mr Leigh-Pemberton had made so that the case could be fully deployed. Mr Leigh-Pemberton replied that he would be happy to see this done.

Sir Anthony Tuke asked whether it would be possible for the lending figures of all the banks to be published on the same day so as to avoid unjustified criticism being cast on the clearing banks alone. He said that if there were any truth in the allegations the situation would not be satisfactory but he doubted whether there was any truth in them. Sir Michael Herries suggested that it was perhaps the American banks who were indulging in the sort of behaviour that had been mentioned.

The Governor said that, while the Bank had always emphasised that lending on credit cards was but a small part of personal lending, it had to be recognised that it was a particularly tempting target for critics. Sir Anthony Tuke said that while increased credit limits had previously been volunteered to credit card holders, he doubted whether this had been done during the last six months. Mr Leigh-Pemberton added that the tone of promotional leaflets sent to credit card holders had recently been kept deliberately in low key.

Sir Anthony Tuke said that abuse of overdraft facilities around make-up day was worrying, and asked whether the smaller banks could be made to maintain their liquidity on a day-by-day basis.

Sir Reay Geddes said that much of the increase in commercial lending was involuntary borrowing. Mr Montgomery said that he would be only too pleased to co-operate with Mr George in resolving the enigmas which have been mentioned. He had found no tangible evidence of hard arbitrage. There were suspicions of soft arbitrage, but it was difficult to pin down specific cases. He believed that the increase in his bank's personal lending was not out of the ordinary. As regards commercial lending, he stated that there was no question of pushing loans and that any increase in the use of existing limits and requests for higher limits reflected legitimate needs for more working capital in inflationary conditions.

Sir Michael Herries said that there had been no pushing of lending. The guidelines had been followed. He said that utilisation of facilities in the north was particularly high (now 67%). Much of the increase in lending was to deserving cases which needed help. He referred to the difficulties of farming and fishing.

The Governor expressed his gratitude for the points made by the Chairmen and hoped that they would be pursued further in the discussions which had been agreed. He added that he was also most appreciative of the constructive inter-changes which had developed between the Bank and the clearing banks in the cases of individual companies experiencing financial problems.

3 Monetary Control

Mr Fforde reported on progress in the consultations on the Green Paper. The Bank had now had written responses from almost all the banking associations, including the CLCB, and was now engaged in digesting and putting them together. Views had been received from the CBI, TUC, the Building Societies Association and certain firms and individuals. Consultations had also taken place with academic and applied economists in several fora and had indeed extended internationally. There was now some pressure to complete the exercise and come to conclusions. The Bank and the Treasury were to hold a seminar on 29 September to tie some of the loose ends together. Mr Fforde said that there were no immediate plans for further approaches to the banking associations, but the Bank would do so if it seemed necessary.

4 Iran

The Governor spoke of recent political and banking developments. He said that among other Cabinet nominations Prime Minister Rajai had named Mohammed Nourbakhsh as Minister of Economics and Finance, subject to approval by the Majlis. President Bani-Sadr had let it be known that he was unhappy about a number of the nominations, including Foreign Minister Moussavi, who had been described by his predecessor Qotbzadeh as incompetent. Many of the nominations were relative or complete non-entities and there seemed little popular support either for them or indeed for Rajai.

Governor Nobari, whose own position as an associate of Bani-Sadr was, the Governor said, by no means secure, had recently made a brave press statement drawing attention to the economic ills within the country - low oil revenues (he said exports were down to 0.6 mbd) which would leave an unmanageable budget deficit, unemployment and inflation. He had called for a stop to the political in-fighting and more attention to putting the economy right.

On the banking side, over the last two months deposits had been renewed (in some cases for up to six months) and some new money had been received. Some deposits had been lost, perhaps because rates were not competitive, but there was no evidence of a policy of withdrawal.

On the question of the main London court cases, which were planned to open on 3 November but which might well be delayed, the Governor expressed his regret that there had been considerable difficulty in securing British expert witnesses. He recognised that it was a difficult role to play, but felt that it would have been most regrettable had it not proved possible to find British bankers ready to testify to practices in a market of which London was the centre. He looked to the clearing banks for support in this matter. He was glad to say that three good names now seemed to have been secured.

Mr Leigh-Pemberton said that the huge reduction in oil production and its effect on the Iranian balance of payments would increase the risk of deposits not being renewed. His own bank had a large deposit shortly coming up for renewal and if it was not maintained would have a very unbalanced position. He felt that the situation could only deteriorate in the immediate future. The Governor said that there were indeed grounds for doubt, but that delicate walking had worked so far and more would yet be needed.

Mr Montgomery said that his bank was now looking at the need to provide for losses on some of its public, as well as private, sector lending, in Iran. Sir Anthony Tuke said that Barclays' position had improved, some new deposits having been received. He questioned whether, if the political climate were to grow more hostile and deposits were withdrawn to a large extent, there would be a case for attaching Iranian assets. The Governor said that careful steering and scrupulous behaviour had paid off thus far and that we were now closer to the shore. The Deputy Governor suggested that the banks should keep in close touch if there were any question of attachment and emphasised that some developments which might seem alarming had, and would again, prove to be merely the result of nothing more sinister than inexperience and incompetence.

5 Poland

The Governor said that there was still insufficient information available to quantify the economic implications (which were clearly adverse) of the agreements reached with various groups of workers in Poland. The agreements included a formula for the establishment of independent trade unions; recognition of the right to strike; the liberalisation of censorship; payment of wages during the recent strike; pay increases to be implemented gradually and pledges by the government to improve security arrangements, housing conditions, the supply of consumer goods and to speed up work on economic reforms aimed at de-centralisation. The immediate effect of the strikes - the loss of trade with the West - clearly must have an adverse effect on Poland's external situation. Polish claims of a hard currency loan from the USSR had not been quantified (or, indeed, confirmed by the latter) but unless such aid were very large, the Governor believed that the Poles had and would find it extremely difficult to finance their way in hard currency, notwithstanding the recently concluded \$325 mn Euro-dollar loan and the parallel DM 1.2 bn credit (partly covered by a Hermes guarantee), which had apparently been agreed in principle by German banks but not yet signed, and with signature of the latter being a prior condition for drawings on the former.

Mr Leigh-Pemberton asked whether there was any degree of pressure or influence on the banks from the UK Government to assist the Poles and thus reduce their dependence on the USSR. The Governor said that he was aware of none, nor of any request from the Poles for rescheduling of debt.

6 Building Society Deposit Protection Scheme

Mr Leigh-Pemberton said that the banks understood from a recent statement in the House of Commons that the Government had no immediate intention of legislating for such a scheme. The Governor agreed that this appeared to be a correct assessment. The Governor

enquired what had been the source of the understanding, mentioned by the Chairmen at the previous meeting, that no deposit protection scheme would be established under the Banking Act until the building societies were subject to a like scheme. Mr Leigh-Pemberton and Sir Anthony Tuke said they believed such an understanding was implied in correspondence between the CLCB and the Treasury in the summer of 1978, and said that the details would be looked into.

7 ICCH

Mr Leigh-Pemberton referred to earlier discussions of this issue. The Chairmen wished to raise it again in the context of the TSB takeover of 75% of UDT. He wondered whether this development made an acquisition of ICCH by the clearing banks seem even more desirable. He asked what was the Bank's view and said that he had in mind a possible joint approach from the clearing banks and the Bank of England to Endeavour to seek acquisition by the clearing banks. The Governor said that the Bank would consider what had been said and then revert to the Chairmen.

8 Any other business

AMC

Mr Fforde said that Mr Glyn, the Chairman of AMC, had indicated that he proposed to retire in the next year or two and had suggested that his immediate successor might be a caretaker pending a later appointment. He added that he thought it right before expressing any view to Mr Glyn to make sure that the shareholders did not wish to use the occasion of Mr Glyn's approaching retirement either to make changes in AMC's constitution or to review its raison d'etre generally. Mr Leigh-Pemberton

said that he had no feeling that radical change was required. Sir Anthony Tuke agreed. The AMC was not an exciting investment but the increased level of dividend was now acceptable. He thought that the AMC was at best likely to be a stationery organisation, given the clearing banks' own increased involvement in this sort of lending. He would be happy to see the present arrangements continue and was content with Mr Glyn's suggestion.

Bank of England
15 September 1980

NOTE FOR RECORD

Copies to Mr Fforde
Mr Dow
Mr Page o/r
Mr Cooke
Mr George
Mr Goodhart
GPS

When Sir Jeremy Morse called on the Governor yesterday on another matter the Governor told him that the Chancellor wished to see the clearing banks at 5.30 on Wednesday, 17 September. Sir Jeremy having been absent from the regular CLCB meeting the previous day, there was then some discussion of ministerial criticisms of clearing bank behaviour. Morse repeated the view he had expressed at NEDC some time ago that in the light of the UK inflation, the achieved growth in the money supply, though above the target, was in fact very tight. He felt that if there was dissatisfaction about the growth of the money supply and particularly of bank lending then the logical answer would be to let interest rates rise further - though he admitted that the effect in terms of reducing bank lending to companies of higher rates might be slight and slow.

He was quite vigorous in the defence of the banks' attitude on lending. He said all those below chief general managerial level in Lloyds felt they were to be extremely restricted in what they could do. They had many potential initiatives that they would like to launch and that they were holding back. They issued general qualitative directives to their branches but it was very hard to make these stick. Many branches, for example, had little business other than personal lending. Morse also said that he privately felt that the real area where they were vulnerable was pay.

Cwm

12 September 1980