

NOTE FOR RECORD

GA 30/3

Copies to: The Governor
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HUNGARY: THE GOVERNOR'S CONVERSATIONS
WITH POHL, LEUTWILER AND KERR

The Governor spoke on the telephone to Pöhl, who had just returned from his holiday in the United States, at 10.25 am this morning. Pöhl reported that the Bundesbank was now virtually ready to go ahead with its part (25) of the central bank support operation for Hungary. The Bundesbank had had since last Friday a written guarantee from the Government (Matthöfer). The lawyers were still talking with the Government on minor questions, but he expected that everything would be tied up by noon. Pöhl said that he had heard that the British Government were concerned by the political implications of the central banks' operation. What was the UK position?

The Governor briefly reviewed developments over the previous 10 days. When Schmidt and Matthöfer had been in England for the Anglo-German talks it had appeared that the Bundesbank were not prepared to act without a government guarantee and that, although Matthöfer's position was positive, there had been budgetary difficulties in providing such a guarantee. The American attitude had been regarded throughout as very important - if the Americans were seen to be prepared to differentiate between Hungary and the other bloc countries the commercial banks would be encouraged to maintain support for Hungary themselves. Pöhl thought that the Americans would at least not interfere with the central banks' operation. Genscher had talked to Haig.

The Governor explained his own position to Pöhl. Although he had made it clear to the Chancellor that he would shortly have to respond to the BIS cable, the Bank had still not got a guarantee from the Government. But, speaking particularly privately, the Governor said that the Bank of England might well, if necessary, be prepared to join in the operation at its own risk. That the Bundesbank was now firmly committed encouraged him to this view. The Governor said that he, or, in his absence this afternoon at the Select Committee, the Deputy Governor would keep Pöhl closely informed.

Having talked to Pöhl, the Governor telephoned Leutwiler at 10.55 am. Leutwiler said that his current understanding was that the German Government and the Bundesbank were ready, in principle, for the Bundesbank to join in the planned operation. The lawyers were still trying to find a suitable legal construction. The other central banks, Leutwiler said, had been waiting for the Germans to take a decision. He referred to the hesitation which he understood existed in Whitehall, and said that the German Foreign Ministry had also had reservations but that these had now been withdrawn. He added that Arthur Burns "had become active - in a negative sense".

Leutwiler said that he had talked to Friderichs (Chairman of the Dresdner Bank) as a precaution against things going wrong in the next few days before the central banks' package was in place. The Dresdner would see that, if necessary, funds were made available for this short period. Fekete, he added, was in Frankfurt today - as, said the Governor, was de Larosiere.

The Governor then set out his own position. He had not yet secured a guarantee from the UK Government, which was behaving with great caution. He understood that the question was likely to come up at the European Council today. The Governor explained that he was taking the position that he would very soon have to make a response to the BIS cable, whether or not the UK Government had come to a firm view. In a liquidity crisis of this sort it was not possible

to wait for a longer-term solution. The Governor assured Leutwiler that he would do his best to give a firm answer today, or perhaps tomorrow. Leutwiler said that there had as yet been no reply from the French. He added that he was leaving for Washington tomorrow (Tuesday) and would see Regan on Thursday. Hungary would be among the subjects he wished to discuss.

Following a discussion after Books, the Governor then telephoned John Kerr (Chancellor's Private Secretary) and set out the latest situation. German participation, with a Government guarantee, was now more or less finalised - the Germans taking it for granted that the Bank of England would join in too.

In these circumstances, the Governor said, the Bank clearly had to give the BIS a speedy response in principle and to be ready at any stage to make it concrete. It would be very hard not to give a positive answer today. The Governor explained that he quite understood the Chancellor's concern for public expenditure and said that he had no wish to act in a way that would cause difficulties for the Government, but, as a bank, the Bank of England had to make a decision without undue delay. The Governor said that he had it in mind - unless there was overriding political objection - to take the risk for our own account for the time being and thus give the Government longer to decide whether it was prepared to underwrite all or part of the risk. This, the Governor confirmed, went further than the position which he and the Chancellor had discussed at their 9.15 am meeting this morning.

Kerr said that he had learned that over the weekend the Prime Minister had expressed the view that the Bank of England should be given no guarantee. He went on to say that, as he understood it, there were two problems in the Chancellor's mind. The first was the attitude of the Americans. There was as yet no new and hard news of US attitudes, and thus still the possibility that they would behave in such a way as to undermine the whole operation, so that the Bank would lose its money. His second concern was that it would be unfortunate if the

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Bank of England were to move precipitously in advance of any decision that might be taken at the European Council meeting today or tomorrow. The Governor did not deny that the operation proposed was full of risks, not least the American risk that concerned the Chancellor, but it was aimed at averting worse consequences. As to the European point, he would do what he could - but in the circumstances delay might be very difficult. Kerr took this point and said that he had asked No 10 to alert him as soon as the issue was raised at the European Council - but this might not be soon enough to fit the Governor's timetable.

The Governor agreed that Kerr might pass on what he had said. He confirmed that it was his intention that Bank of England participation in the operation should go ahead, if necessary without guarantee, so long as there was no overriding political objection from the Government. The Bank, he made clear, did not need clearance to act on its own account in this way - but he was anxious to avoid action that would be offensive or politically unhappy. He added that government guarantees for the central banks concerned had the effect not merely of protecting their balance sheets but also added force to the psychologically beneficial effect that the operation was designed to have on the commercial banks' behaviour.

The Governor said that he would arrange for the Deputy Governor to speak to Lavelle, who was dealing with the question at the Treasury end.

TSA
Governor's Office HO-P
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