SIR KENNETH COUZENS

cc Mr Wiggins
Mr Ryrie
Mr Burns
Mr Barratt
Mr Hancock
Mr Middleton

THE EXCHANGE RATE

The Prime Minister called me over to No 10 last night for a talk on a number of issues which were on her mind. One of them was the exchange rate - hardly surprising in view of the rise in the price of sterling yesterday.

She said that Lord Lever had produced an idea which she wanted looked at. This was that the Bank of England should offer to sovereign governments and CMIs a sterling facility which would avoid their having to buy pounds on the open market and invest them in whatever assets took their fancy. In this way, it was asserted, upward pressure on the exchange rate would be diminished.

I replied that the Bank of England already themselves took official customers' orders and so avoided their having to buy on the market. No gain would accrue therefore to the exchange rate. I conceded however that the expansionary effects on the money supply would be avoided if, instead of leaving the Governments and CMIs to invest as they wished, we offered them a specific bond or a special deposit at the Bank of England. But if we started tricks like this we could not keep them secret and others would want to muscle in. The bond/deposit would have to match the best of what the market could provide. The Prime Minister said that she understood that the Bundesbank had just offered a similar facility to the Saudis. I said that I was unaware of this. But I agreed that we would prepare a note on the Lever idea and send it across. Perhaps you and Mr Middleton would put something together?

DW

DOUGLAS WASS
21 October 1980

10/8/10

Sir Kenneth Couzens

cc Mr Wiggins
Sir Douglas Wass
Mr Burns
Mr Barratt
Mr Hancock
Mrs Lomax

THE EXCHANGE RATE

I can add a bit to Sir Douglas Wass' minute of 21 October. As I told you, I was invited to have tea with David Wolfson of the Policy Unit, only to discover that it was taking place at 86 Eaton Square. It was quite like old times. Lord Lever expounded on two ideas.

2. The first was a modified Lever Bank, though the international aspects have been dropped. His suggestion was, as Sir Douglas Wass said, a scheme for the automatic sterilisation of inflows by an extension of the Bank's customer transactions. Lord Lever said that he would write to me by the end of the week setting out the idea in detail. But in a nutshell:

a. The Bank would accept any deposits in dollars which both governments and large investors cared to make.

b. Depositors would be offered a sterling bond in return, of any sort which they required, provided it had more than a year's maturity.

c. The UK would retain the dollars and the reserve would increase.

d. The objective would be to take pressure off the sterling exchange rate without increasing the money supply.

e. If sterling subsequently came under pressure and the bonds were cashed, the dollars would be automatically available to meet the claim.

f. He had it in mind that the Bank might set up a special subsidiary to conduct these operations.

g. Lord Lever did not think that the offer of bonds of this sort would produce greater inflows, but if it did he did not see any cause to worry about the consequences.

3. The second proposition was also one which I have heard before. It goes as follows:

a. The decline of the UK relative to others is primarily because investment is low.

b. This has nothing to do with inflation. The problem is the banks' attitude to industry and their refusal to lend (and borrow) long term.

c. He contrasts the terms on which persons receive finance for house purchase with the terms on which industry receive it for investment.

d. The solution is to compel (by threat of nationalisation) the banks to lend long and if necessary borrow long.

e. Rolled over overdrafts do not count for this purpose because of the risk that they may be called in. What he is talking about is term certain loans at variable rates. This would be much cheaper to the PSBR than fiscal tricks like leasing.

4. He agreed that this was something his own government had failed to do, but said that in present circumstances the banks ought to see their own interest in complying.

E K. Clarke

pp P E MIDDLETON
21 October 1980