ECP/6.1

FINANCIAL SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

With the Compliments of the Private Secretary to the Financial Secretary

The Chief Cashier.

-8 NOV 1979

8.11.79

...FIDENTIAL

LRB/11

...IANCIAL SECRETARY'S ROOM:

... delusion
... a share,
...my view.

Mr Fforde 12/xi
The Governors
First I have heard of this discussion
12/11

...inancial Secretary
...ir Kenneth Couzens
...r Barratt
...r Bridgeman
...r Middleton
...r Gill
...r Allan

... he had called the meeting because he ...gers of our monetary policy being weakened ...king in sterling. On his recent visit to the US he had found that many Americans were worried about the Fed's policy being undermined in a similar way. Tony Solomon in particular had expressed this concern; Paul Volcker had been less worried since he saw disintermediation at home as just as big a problem. The Financial Secretary wondered whether there might not be scope for some accord between the US and the UK (and any other country which was prepared to join in) to get central banks to lean on their own banks and their branches and subsidiaries overseas not just to reinforce their own domestic monetary policy but also the monetary policies of the partner countries. The UK domestic markets had become very disturbed recently, partly because they were disoriented by the ending of exchange controls and the feeling that the corset had as a result become useless. They might be reassured by an indication that the Government recognised this problem and was doing something about it.

2. Sir Kenneth Couzens outlined the background to the international discussions on controlling the Euromarkets. The Bank's and the Treasury's analysis did not point towards the Euromarkets being responsible for massive credit creation. Instead the reason for their growth lay more in the competitive advantage of offshore banking created by domestic monetary controls, and in particular the US and German non-interest-bearing reserve requirements. Monetary policy was made more difficult in those countries, but it was not

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NOTE OF A MEETING IN THE FINANCIAL SECRETARY'S ROOM:
8 NOVEMBER 1979

Mr Ford 12/xi

EUROMARKET CONTROLS

Both a delusion and a snare, in my view.

The Governor

First I have heard of this discussion

JSF 12/11

Present: Financial Secretary
Sir Kenneth Couzens
Mr Barratt
Mr Bridgeman
Mr Middleton
Mr Gill
Mr Allan

The Financial Secretary said he had called the meeting because he was concerned about the dangers of our monetary policy being weakened by a growth of offshore banking in sterling. On his recent visit to the US he had found that many Americans were worried about the Fed's policy being undermined in a similar way. Tony Solomon in particular had expressed this concern; Paul Volcker had been less worried since he saw disintermediation at home as just as big a problem. The Financial Secretary wondered whether there might not be scope for some accord between the US and the UK (and any other country which was prepared to join in) to get central banks to lean on their own banks and their branches and subsidiaries overseas not just to reinforce their own domestic monetary policy but also the monetary policies of the partner countries. The UK domestic markets had become very disturbed recently, partly because they were disoriented by the ending of exchange controls and the feeling that the corset had as a result become useless. They might be reassured by an indication that the Government recognised this problem and was doing something about it.

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clear that the solution lay through everyone else agreeing to tax its banking system similarly. The real initiative required, and the most practical one, was to push harder for better prudential supervision and better information.

3. The Financial Secretary said that he did not dissent from the general analysis but wanted to focus on the UK's position. If it was the case that because we did not have non-interest bearing reserve requirements we could stop worrying about offshore disintermediation then there was no problem. We could reassure the markets and could work out whatever system of domestic control seemed best suited to our needs. But he did not think the situation was this simple and we might well find ourselves impeded in bringing down the growth of the money supply by the potential for offshore disintermediation.

4. Mr Bridgeman thought that even if there was no domestic monetary incentive for offshore banking we could expect to see some modest growth in the Eurosterling market. There would be some UK residents who found it convenient to hold sterling outside the UK and perhaps some who would do so for tax evasion. It would not be easy to discover just what was going on but there would not be any great problems for monetary control - some change in the trend of velocity of circulation might have to be anticipated in setting monetary targets. But if we did have monetary controls which constrained domestic banking then there was the scope for very substantial growth in the Eurosterling market, and inevitably at just the time when it would be least welcome. Our information on domestic credit conditions would become seriously deficient and there was a risk that some of this offshire disintermediation would remain even after the domestic pressure had lifted. It was these arguments that worried Mr Bridgeman about continuing the corset now that exchange controls had been lifted.

5. Mr Middleton agreed. The problem was that we might have trouble persuading people that raising short-term interest rates was a sufficient policy for bringing the growth of the money supply back under control. Some other action might be necessary if only for presentational reasons. This immediately raised the difficulty about any direct controls being avoided by offshore disintermediation: the presentational advantage would be lost if it was clearly apparent

that the controls were totally ineffective. The Financial Secretary thought this summed up the problem well: the City seemed more concerned about offshore disintermediation and the corset than they did about the growth in the money supply itself. They were looking for some recognition on the part of the Government that there was a problem and some action to deal with it.

6. Sir Kenneth Couzens recognised the force of these arguments but wondered whether there was much in practice we could do. To the extent that the problem was a presentational one it seemed to stem from the markets looking for a crutch to get support from now that exchange controls had been lifted: in time they would learn to walk unaided. In the longer term it seemed essential to make sure that our system of domestic monetary management did not place domestic banking at a competitive disadvantage. Mr Middleton agreed with this but pointed out that the problem we faced was essentially a short-term one in getting the money supply back under control and, perhaps just as important, in convincing the markets that we were doing this.

7. Sir Kenneth Couzens felt that an arrangement with the Americans might have some initial impact, but if it was in practice unlikely to be effective the markets would soon realise this and much of the presentational effect would be lost. Unless nearly all G10 countries were involved, the loopholes that would exist would be substantial. The danger was that all we would do would be to damage British banks in their Eurodollar business; losing some sterling business might matter little to US banks but losing dollars business would hurt British banks considerably. Mr Barratt added that we also had to take care not to damage the efficiency of the Euromarkets at a time when we were relying heavily on them to see the OPEC surpluses intermediated and LDC deficits financed.

8. Mr Bridgeman also doubted whether an agreement with the Americans was likely in practice to be effective. It was doubtful how much could be achieved just by leaning on banks - the US had not been very successful in persuading US banks not to route domestic business through offshore centres and we had had problems over directional guidance and the commercial bill leak. It was also inevitable that

an agreement would have to try to slow down the growth of all US banks' sterling business outside the UK and of all UK banks' dollar business outside the US: it would not be enought just to discourage US banks in Paris from lending sterling to UK residents - they would simply lend to the overseas subsidiaries of UK residents or find some other way of adding an extra stage in the intermediation. It would be hard to get the banks to swallow such a comprehensive system especially if there were countries not party to the agreement whose banks would immediately gain a substantial competitive advantage.

9. Sir Kenneth Couzens wondered whether a UK/US agreement would in fact be easy to arrange. The US had worked closely with the Germans on this subject and there was a ~~danger~~ possibility that they would want to see any proposal of this sort included in the existing G10 central bank discussions. This would slow it down too much to be of any help to the UK's short-term problems.

10. The Financial Secretary said he was thinking in terms of a much more limited and less formal arrangement than those being discussed in the G10. He recognised that it might be ineffective in the longer-term but he saw the need for something to tide us over the next few months. Unless such a scheme was likely to be totally and instantaneously ineffective it was worth considering, even if its only effect was to slow a move to offshore disintermediation. There was no point in expecting any scheme to be costless and a part of British banks' eurocurrency business might be one of the casualties. But what was at stake was of such great importance that some cost might be acceptable.

11. Sir Kenneth Couzens agreed to consider further with the Bank whether there was anything which might be done. This would have to be done quickly if any scheme was to be introduced in time to help ease the short-term domestic monetary problems we faced.

ACS Allan

A C S ALLAN
8 November 1979

Distribution: Those present, plus

PS/Chancellor of the Exchequer
PS/Chief Secretary
Sir D Wass
Sir L Airey
Mr Littler
Mr Ryrie (UKTSD)
Mr Hancock
Mrs Hedley-Miller

Mr Unwin
Mrs Gilmore
Mr Riley
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