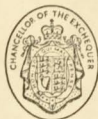


SECRET

6781  
Addressed to the Governor



Suggested alterations  
marked in text.

M  
10/7

NOTE OF A MEETING

MONETARY AFFAIRS

The Governor of the Bank of England called on the Chancellor of the Exchequer at the Treasury on Friday, 3 July 1981 at 9.45 a.m. Sir Douglas Wass was also present.

2. The Governor briefly reviewed the latest situation in the money and foreign exchange markets. The discount market seemed more comfortable than they had been in the disturbed conditions of early June, although they remained somewhat anxious; some increase in the Treasury Bill discount rate was expected on 3 July, although this was likely to be only modest. There was the prospect of a small shortage in the money market, which could allow the authorities to nudge interest rates upwards. (In the event there was a market swing, and the shortage did not materialise; thus rates were little changed.) Activity in the foreign exchange markets was likely to be on a relatively smaller scale, since part of the US market was on holiday and the next US money figures would not be published until 6 July. There was a question what the impact of Mr Stockman's optimistic statement on 2 July would be; he has forecast favourable trends on inflation and the fiscal balance, and had looked forward to lower interest rates in the medium term, although in the short run they would remain volatile and could even go higher.

3. The Governor emphasised that recent events showed that there had been an unfavourable market reassessment of the UK position; if difficulties persisted, we should not be able to rely exclusively on intervention. Moreover the falling exchange rate was to an extent a self-sustaining process, since as particular points were passed in a downwards direction, stop-loss orders to sell sterling were triggered. Nevertheless it would not be right to seek to defend any particular rate. However, the size of the reserves gave plenty of room for

/moderate intervention;



moderate intervention; taking the whole period since the beginning of February, there had been net purchases of \$1.6 billion (and net positive intervention had been considerably higher if the forward book was also taken into account).

JHS X

4. The deterioration in the outlook for inflation, unemployment and the exchange rate was noted; and preliminary indications were that the public expenditure survey would indicate - even after Treasury efforts to prune additional bids - an excess of £3 billion in 1982/83 above previously published plans, as against Treasury Ministers' reasonable desired outcome of a reduction of £2 billion. Mr Prior in particular had put in a very large additional bid for expenditure on employment support. The Governor remarked on the apparent over-optimism of the LBS forecast; the LBS projections of the money supply and output seemed hardly consistent with the enormous company sector financial deficits they were envisaging.

5. The Governor referred to the increasing concern about trends in bank lending, and in particular in lending to the personal sector. The Bank had prepared an analytical paper setting out their interim assessment; this had been seen by the Chancellor. A little more information was now available about the London Clearing Banks' lending to persons in banking June; this indicated a continuing high level of lending for house purchase (£100 million), although other personal lending (£100 million) was rather lower than in April and May, when it appeared that people might have been borrowing in order to invest in the 19th issue of National Savings. Recent developments meant that it would be much harder to restrain bank lending in accordance with the requirements of the monetary target, and higher interest rates could well be needed. Although the post-Budget forecast had contemplated a [2] per cent increase in the rate of growth of bank lending to the personal sector, the increase in the [last] quarter had been running at a rate of nearly 30 per cent, and an increase of about [15] per cent was now expected for the year as a whole. It was clear that the growth of bank lending to persons had not been falling in line with real incomes

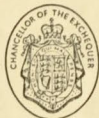
G probably not say

WAA/CXEL X

WAA/CXEL X  
WAA/CXEL X  
2  
cc  
later

forecast ✓ WAA/CXEL

/as earlier forecasts



as earlier forecasts had suggested.

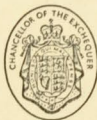
6. The Governor suggested that a significant change was now taking place in the structure of housing finance, which it would be worth examining separately. If a substantial part of mortgage lending now took place through the banks rather than the building societies, there might be a case for modifying the target; alternatively it might be necessary to pay relatively more attention to movements in PSL 2. It was noted that if the banks were to do more mortgage lending, it would be desirable for this to be matched by an increasing volume of deposits of longer maturity, which would fall outside the definition of sterling M3.

7. The difficulty of diagnosing the underlying situation on bank lending was again recognised; once the corporate sector was no longer benefiting from the consequences of the Civil Service dispute, there could well be a rebound in bank lending to companies. If this happened, the two main elements in bank lending would both be giving rise to concern; and the question would have to be faced before long whether action should be taken to head this development off. One possibility might be the reimposition of consumer credit controls, although in many respects this would be an unattractive course. The Chancellor asked that Treasury and Bank officials should give further consideration to recent developments in and future prospects for bank lending to the personal sector, in preparation for an early discussion of this issue and possible policy responses.

PLD

8. The Governor noted that the Saudi Finance Minister (Al Khail) had made a particular point of telling the Minister of State for Trade how unhappy the Arab countries were at the success of the US manoeuvre to postpone consideration of observer status for the PLD at the IMF/IBRD annual meeting sine die. The fact that they thought the US were bending the rules made the problem very much worse for them, the US

/administration seemed not



administration seemed not to recognise that progress was needed towards some form of compromise. This development was likely to oblige the Arab countries to take a much more reserved attitude towards the development of the work of the International Financial Institutions. Overall the Governor thought there were signs that the Arab countries were becoming increasingly distrustful of the consistency and continuity of US policy - Saudi Arabia <sup>and Kuwait</sup> had deliberately purchased aircraft from Europe in order to diversify sources of supply. The Chancellor noted that some flavour of the same message had come from the Kuwaiti Minister of Finance, who had also urged the need to set up a separate Energy Affiliate over which the surplus country lenders would enjoy a substantially larger measure of influence than they did over the World Bank.

#### Non-Executive Directors

9. The Governor noted that the Bank's modest initiative to establish a panel of people willing to serve as non-executive Directors had been leaked to the Press. He expected the scheme to get under way <sup>by the end of</sup> [in] September, and hoped to secure about 30 appointments during its first year of operation. The scheme had the support of the CBI, the Stock Exchange, the British Institute of Management, the clearing banks, the issuing houses and the accepting houses. [The Institute of Directors had been consulted at an earlier stage, but had not been willing to participate on the terms agreed by the other bodies. The Governor undertook to inquire further what the Institute's reservations were.]

#### Distribution:

Chief Secretary  
Financial Secretary  
Sir D Wass  
Mr Ryrie  
Sir K Couzens  
Mr Middleton  
Mr Lavelle  
Mr Monck  
Mr Ridley  
PS/Governor

The possibility of participation by the Inst-  
tute of Directors had been discussed at a much earlier stage, but the 10D had chosen to go its own way [using its own capability supported by a firm of headhunters/management consultants, and for whose services change is made].

R.S.T.,  
for,

A J WIGGINS  
6 July 1981

DKW

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DKW X

DKW