MEMORANDUM OF CONVERSATION

PARTICIPANTS:

United Kingdom:	Mr. Leigh-Pemberton, Governor Designate of the Bank of England Harry Walsh, British Embassy
Treasury:	Secretary Regan Deputy Secretary McNamar Under Secretary Sprinkel Helen Walsh, Recording officer

TIME AND PLACE: April 25, 1983; 10:00 a.m.; Secretary's office

SUBJECTS: The Bank of England, LDC debt, U.K. economic performance, intervention and multilateral surveillance

DISTRIBUTION: Mssrs. Leland, Korp, Fauver, Newman (London), Ms. Cannon.

SECRETARY REGAN began the discussion by questioning Mr. Leigh-Pemberton on the appointment process for Governor of the Bank of England (BOE), and the relationship of this position to other senior HMG posts. MR. LEIGH-PEMBERTON indicated that since his appointment as Governor to the Bank of England is a constitutional rather than a political appointment, no confirmation hearings before a Parliamentary committee need to be held. The Governor of the Bank of England reports directly to the Chancellor of the Exchequer, but may also be summoned by the Prime Minister. The SECRETARY explained that discussion in the U.S. Congress about changing the Federal Reserve System prompted his interest in the British system.

SECRETARY REGAN pointed out that Mr. Leigh-Pemberton was assuming his post at a very interesting time in international finance. He listed the major LDC debtor countries that USG is presently concerned about, and briefly focused on the debt problems of Brazil. He suspected that, due to a shortfall of some $1.5 billion in financing, Brazil may need to return to the IMF, commercial banks and central banks for additional funds. MR. LEIGH-PEMBERTON speculated that British commercial banks would be likely to commit additional loans to Brazil if additional IMF loans are appropriately conditional. SECRETARY REGAN stressed that Brazil is making an effort, and has adhered to its IMF program. He expressed deep concern, however, for Chile and Argentina.

Turning to the U.K. domestic economic scene, SECRETARY REGAN praised U.K. inflation performance, noting that the Bank of England has kept firm control of the various monetary aggregates. MR. LEIGH-PEMBERTON added that he felt the FY83-84 Budget was a good one. He pointed out that interest rate pressures are not due to internal forces, and commended Mrs. Thatcher and Chancellor Howe for adhering to the Medium Term Financial Strategy (MTFS). SECRETARY REGAN observed that while the U.K. economy suffered greatly in the first two years of the MTFS, rewards are now evident.

SECRETARY REGAN then initiated discussion of the intervention study. He described the Summit participants' views of intervention as covering a wide spectrum, with Italy and France -- proponents of massive intervention -- at one end and the United States at the other. The U.K. position is similar to the U.S. view, but could be closer. He argued that it is virtually impossible for Central Banks effectively to interfere with foreign exchange trading, since they do not have enough money to affect the market. (DR. SPRINKEL pointed out that the daily turnover in dollars alone is $100 billion.) The SECRETARY saw no benefits in "tokenism" -- the tactic of intervening minimally at particular exchange rate levels -- and insisted that the USG will continue to limit official intervention to incidences of market disorder.

MR. LEIGH-PEMBERTON agreed emphatically with Secretary Regan's views, and remarked that he is aware that the turnover at National Westminster's foreign exchange trading office alone is vastly larger than the reserves of the Bank of England. However, he voiced concern about the effects of exchange rate volatility and noted that there have been wide convolutions in the sterling rate. He emphasized the need for less volatility in exchange rates, but did not favor a return to fixed rates. He observed that often an unwelcome change in other policy instruments is needed to influence exchange rates, citing the reversal in the downward trend of U.K. interest rates -- a result of sterling's (November - March) decline.

MR. LEIGH-PEMBERTON advocated harmonization of domestic financial policies to bring about more stability in exchange rates. SECRETARY REGAN agreed, but observed that it is difficult to single out countries which are not in harmony, and added that while no one country wants to be out of step, some may be forced by domestic political reasons to follow a different course. He realized the difficulty in asking a country to change its political philosophy in order to harmonize its economic policy with others.

SECRETARY REGAN observed that the seven realignments in the European Monetary System (EMS), despite massive intervention, show that a parity system is not a solution to exchange rate volatility. If such a system cannot work in a tightly knit Europe, he argued, it certainly would not work in the world financial system. MR. LEIGH-PEMBERTON said he agreed -- despite the fact that he had initially supported U.K. participation in the EMS -- and added that a new Bretton Woods would bring with it the strain of formal devaluations.

DR SPRINKEL commented that the Summit will address strengthening multilateral surveillance, but that the French, calling for U.S. intervention to bring down the dollar, might not be wholly enthusiastic. He argued that an engineered dollar depreciation is not possible without a change in U.S. policy thrust. SECRETARY REGAN cautioned that the danger in such a strategy would be that a depreciation might lead to a weak dollar and a whole new set of related

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problems. SECRETARY REGAN briefly discussed the source of the dollar's stength, notably high U.S. interest rates, and said he felt interest rates should come down since loan demand is not that strong. Further, the SECRETARY observed, that strong bank earnings this quarter have enabled banks to reliquify, particularly on the asset side. He explained that this should permit increased bank lending, leading in the longer term to heightened competition and a fall in interest rates.

Discussion ensued on the impact of lower interest rates on LDC financing. MR. LEIGH-PEMBERTON felt that interest rates are as important to LDC debt as oil prices. SECRETARY REGAN emphasized that all debtors benefit tremendously from a decline in interest rates, but instead of waiting for interest rates to fall, major LDC debtors should be undertaking their own economic adjustment programs.

DR. SPRINKEL commented briefly on USG problems in persuading Congress to pass legislation for the IMF quota increase. MR. LEIGH-PEMBERTON mentioned that he did not realize that the feeling in Congress against commercial banks was so strong.

In conclusion, SECRETARY REGAN said that he was pleased by Mr. Leigh-Pemberton's appointment, and emphasized the need for more senior government officals who have had practical experience in the private sector. He offered every assistance to Mr. Leigh-Pemberton and said that he looked forward to their working together in the future.

Helen Walsh

Helen Walsh

Approve Beryl Sprinkel

Approve as Amended ____________

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