

9.7.79



NOTE OF A MEETING HELD IN THE CHANCELLOR OF THE EXCHEQUER'S ROOM AT THE TREASURY ON FRIDAY, 6TH JULY AT 4.00 P.M.

*Copies to Mr. Foote
Mr. Metterson
Mr. Dow
Mr. Blunden
The Chief Cashier
Mr. Walker
Mr. Goodhart
Mr. George*

*JB
11/7*

Present:

CR 11/7

Chancellor of the Exchequer
Financial Secretary
Sir Douglas Wass
Mr. Bridgeman
Mr. Middleton
Mrs. Gilmore
Governor of the Bank of England
Sir Jasper Hollom (Deputy Governor)

BUILDING SOCIETIES

Sir Douglas Wass reported on contacts between Mr. Leonard Williams, the Chairman of the Building Societies' Association and Mr. Brading the Chief Registrar of Friendly Societies. Mr. Williams was reported as very concerned not to preside over the disintegration of the Building Societies Association (BSA) as a consequence of actions to improve their financial position. Mr. Williams had concluded that the BSA would hold together only if the investment rate were raised, though he had some hope that an increase in the mortgage rate could be deferred for a period of some months. For that time, the Societies would meet a running loss from their liquidity. Mr. Williams thought it might not even prove necessary for the BSA to specify the date by which there needed to be a contingent rise in the mortgage rate, leaving this to be settled in the light of the Societies' liquidity, the level of inflows and movement of market rates. Sir Douglas thought that this represented the best arrangement the Government were likely to secure from the BSA in present circumstances: there was clearly no prospect that the Societies' would agree to leave the investment rate unchanged. Tactically, he thought that the proposition was better left to come from



the BSA than volunteered by Ministers. If Mr. Williams ideas commended themselves to Ministers he thought it would nevertheless be helpful to offer Mr. Williams an informal talk before he next met more formally with Ministers: this might be with officials or possibly with the Financial Secretary.

2. In discussion, there was a broad welcome for Mr. Williams initiative. There seemed a reasonable chance that the Prime Minister would find it acceptable, involving as it did no immediate move on the mortgage rate. Increasing the investment rate had the incidental advantage of helping the money supply by taking funds out of the banking system. The Financial Secretary suggested that this switch might be accelerated if the clearing banks could be asked to lower their deposit rate by say $\frac{1}{2}$ per cent. This was felt to be difficult. The banks had problems with their reserve asset ratio which the Bank of England had just eased by a release of supplementary special deposits. Moreover, whilst the clearers certainly needed to widen their margins, their right course in present circumstances was to raise the rate of interest on advances, rather than lower it on deposits. The Governor felt there was little prospect of them acceding to a request to reduce their deposit rate.

3. In further discussion it was suggested that careful thought needed to be given to the likely reactions of the Societies' at the end of the interim period if interest rates had not by then come down. In those circumstances the Societies' might well react by raising the mortgage rate to an even higher level to recoup their earlier losses. Against that, the purchase of time on the mortgage rate was well worth having. If the Societies' remained in difficulty in the autumn the Prime Minister would still be able to argue for an interest rate subsidy, though it would be difficult to represent this as a temporary phenomenon. A short term loan, unwinding by the end of the year, would be less easy to contrive and would not really meet the Societies' needs. So far as the Prime Minister was concerned, postponing action on the mortgage rate



for some months was consistent with her expectation that interest rate would begin to fall in the autumn from their present high level. There was undoubtedly a risk that if interest rates did not come down, building societies' would be forced to raise the mortgage rate well above the 12½ per cent which the Prime Minister regarded as critical; nevertheless, her primary concern was to avoid any increase at all. But an increase in mortgage rates in September would be more difficult to blame on the previous Administration.

4. Summing up, the Chancellor said that, given the Prime Minister's determination to avoid seeing the mortgage rate rise, the choice before Ministers lay between the virtual certainty of an immediate interest rate subsidy, with damaging consequences to the Government's whole financial stance, and the risk of a possibly larger move on the mortgage rate in the autumn if interest rates remained at their present level. On balance, he thought the Prime Minister should be advised to accept Mr. Williams proposal if he were able to carry the rest of the BSA with him. The Bank of England should consider whether there was any way of reinforcing the building societies' goodwill, for example by moving the clearing banks to reduce their deposit rate. Meanwhile, it would be helpful if Sir Douglas Wass would get in touch with Mr. Williams and ask how far he was progressing with his informal discussions, without giving any positive steer as to Ministers' likely reaction to his suggested package. Depending on what Sir Douglas learned, he would try to take the Prime Minister's mind at the weekend so that the Secretary of State for the Environment and the Financial Secretary could be in a position to respond constructively to any proposal which the BSA might make at the meeting on Monday.

Circulation

Those present
Mr. Littler

AMB
(A.M.W. BATTISHILL)

9th July, 1979