Dupes

STRICTLY CONFIDENTIAL

MEETING BETWEEN THE CHAIRMEN
OF THE LONDON CLEARING BANKS AND THE GOVERNORS

WEDNESDAY 16 JUNE 1982 AT 3.30 PM

AT THE BANK OF ENGLAND

The following attended:

CLEARING BANKS

Sir Donald Barron	Midland Bank plc
Sir Jeremy Morse	Lloyds Bank Plc
T H Bevan Esq	Barclays Bank PLC
Robert Leigh-Pemberton Esq DL	National Westminster Bank PLC
Sir George Kenyon DL	Williams & Glyn's Bank plc

BANK OF ENGLAND

The Governor
The Deputy Governor
A D Loehnis Esq
E A J George Esq
A L Coleby Esq

Secretariat L W Priestley Esq (CLCB)
T E Allen Esq (Bank of England)

1 The minutes of the previous meeting were agreed. There were no matters arising.

2 Monetary situation and prospects

The Governor briefly reviewed the paper (copy attached to these minutes) that had been circulated in advance of the meeting, noting that it had been prepared before the Falklands ceasefire. In addition, he particularly emphasised the importance of low pay settlements during the current round. There was in some quarters a disturbing tendency to think that after a period of restraint there should now be more substantial settlements. If we were to achieve real gains in the fight against inflation, it was essential that this did not take place. He then asked the Chairmen for their views on the questions that were raised in the paper.

Sir Jeremy Morse spoke first of the immediate situation as seen from his own bank's point of view. The corporate sector was not, he believed, as buoyant as some recent announcements suggested. He did not anticipate any large increase in corporate lending. As far as Lloyds were concerned, demand for home loans was somewhat lower in the most immediate recent period but lending to agriculture was particularly buoyant. As to the pace of lending over a longer period, the fastest growth had been in lending for house purchase, while other personal lending had grown rather less and lending to businesses least of all. His personal view was that the present pace of lending could not prudently be continued. Lending had been rising at a faster rate than that of retail deposits. His own bank had thus already taken steps to slow the growth of lending generally, not just for housing. He thought that it might soon be necessary to apply further restraint. Lending for house purchase was, of course, the easiest to reduce quickly, but he was anxious that in this area of lending there should be a smooth transition to a slower pace rather than any sharp braking.

Mr Bevan referred to the pattern of Barclays' lending in May. Lending to manufacturing had moderated, probably reflecting lower demand for funds for tax payments and a pattern of interest rates which favoured market borrowing. Sentiment in manufacturing industry varied in different parts of the country, but road hauliers were notably busier and house builders more optimistic. Mortgage lending was continuing, but there was, he believed, little monetising of equity except in a few cases where small businessmen were financing their enterprises by borrowing secured on their houses. (Mr George confirmed that such lending was in no way frowned upon.) Mr Bevan went on to say that his bank set its own internal prudential ratios for house lending and was at present well within these self imposed limits. In comparison with the aggregate figures set out in the note which had been circulated before the meeting, Barclays had been lending rather more to businesses and for house purchase and rather less to persons for other purposes. Turning to international lending, Mr Bevan saw a prospect of such lending being slowly reduced from the present rather over-extended position.

Mr Leigh-Pemberton referred first to the question of mortgage lending being used for purposes other than house purchase. At the end of a chain, when a house owner died, funds inevitably spilled out for other purposes. There was also the question of mortgage finance being used to purchase carpets, furniture, fixtures and fittings. This clearly occurred but was unquantifiable. Turning to lending to businesses, he mentioned that a number of customers who had thus far survived the recession and might have been expected to reach the shore safely, were finding the final effort too much and failing. Somewhat paradoxically, if there were a significant upturn many companies who had managed to survive so far might then fail, unable to bear the burden of the increases in working capital which would then be needed.

Mr Leigh-Pemberton said that his impression was that, contrary to the view expressed in the Bank's paper, commercial bill arbitrage had indeed gone on, although it was not clear on what scale. Referring to the prudential and liquidity position of his bank, he said that it was considered that the sharp increase in bank lending which had occurred as a consequence of the Civil Service strike and the move into the mortgage market would not continue. He thought that the rate of increase in bank lending would slow of its own accord. It had therefore not been thought necessary to introduce a measure of restraint on lending. Finally, Mr Leigh-Pemberton reported on conversations he had recently had on the US budget deficit, and some discussion ensued in which the Governor emphasised the importance of a steady and convincing reduction in the size of the Federal deficit. He referred to the shortening of time horizons that had occurred among both borrowers and lenders in the United States.

Sir George Kenyon said that his own bank's experience had been of rather lower lending to persons and rather higher lending to business than suggested by the aggregate figures in the note which had been circulated. No difficulty was foreseen in his bank's prudential position. He reported similar experience to Mr Leigh-Pemberton over the failure of businesses in the later stages of recovery from the recession.

Sir Donald Barron said that Midland's lending figures were also somewhat out of line with the aggregates, with greater increases in lending to manufacturing and to other production, especially farming. His bank had been looking closely at lending for house purchase and had found little evidence of equity being taken out. A considerable amount was clearly going towards financing the extension of existing houses. He thought that one significant explanation of the rise in house lending by the clearing banks had been the recent absence of local authority mortgages. As to the pace of lending and its relation to prudential ratios, his position was close to that of Sir Jeremy Morse. There had been no actual "braking" but the bank was now being more selective in the market place.

Sir Donald emphasised the importance of moderate wage increases in the current round. He agreed that there was a body of opinion in the trade unions that ground lost in the past few years should now be made up. It would indeed be serious if this were to occur. The question was how to get the right message across. The Governor said that he had the impression that the presentations made to managements by the CBI over the past two years had had an important influence. Sir Donald agreed, but said that it was important, too, that the message should reach the trade unions. This should be done before the negotiating stage - once the parties were round the table it was too late. Mr Bevan emphasised the importance of personnel directors taking the right line and Sir George Kenyon said that company boards should themselves take a greater and earlier interest in wage negotiations. Such decisions needed to be made at the top and not left to personnel directors. The Governor agreed and said that the same principle applied also to purchasing policy and to pension fund management. In many cases it seemed that important decisions were taken at too low a level.

The Deputy Governor referred to the particular difficulty which arose when "generous" firms settled early in the wage round. Sir Jeremy Morse agreed and cited the example, in a City context, of the insurance companies. The Governor reminded the Chairmen that during the course of the last pay round he had had a discussion with Mr Dugdale of the British Insurance Association, with a generally satisfactory effect. He was ready to apply a similar influence this year. Mr Bevan said that it would be helpful if the dates of the insurance company settlements could be compressed into a narrower band.

In conclusion, the Governor emphasised the difficulty in fully understanding and drawing conclusions from the fast rate of bank lending. But it did seem clear to him that the pace of lending within this country, especially for house purchase, was unsustainable. There was a need to look closely at the prudential implications, which interlocked closely with the economic questions. He and the Chairmen would no doubt wish to revert to the subject at future meetings.

3 Industrial rescue operations

Referring to the discussion that had taken place at the April meeting, Sir Jeremy Morse said that he would place particular stress on the importance of communication between the banks and the equity holders when contemplating industrial rescue operations. It was vital that they should meet to discuss their common concerns and understand each other's interests and motivations. On occasion, it might be that such discussions would give rise to constraints on their possibilities for action and might indeed in some cases prevent a rescue operation - but this was better than the consequence of acting in the dark.

The Governor said that the Bank was deliberately seeking to involve the banks and shareholders simultaneously in discussions on individual problem cases. There were indeed problems and tensions that quite reasonably reflected divergent interests, but he believed it was important to persevere. He said that it was pleasing that, by contrast with the unfortunate publicity that had followed the Stone Platt receivership, that following the recent cases of Wilkins and Mitchell and of Lesney had been very muted. This reflected in part that they had been smaller cases, but in addition was a consequence of the care and tact that had been shown by all those concerned. There were lessons for future cases - the need to ensure that all the major parties agreed that the conclusion reached, however unpalatable, was plainly necessary, and that delay may well in certain cases be justified until an agreed announcement can be made.

The Governor added that good progress had been made over the last two months towards establishing satisfactory financing arrangements in three important cases, although others, notably Massey Ferguson and International Harvester, were in worse shape. The Bank was now continuously involved in an array of smaller cases, the problems of many of which were likely to persist for a long time. From the standpoint of the Bank of England, relationships with those concerned in the clearing banks on these invariably difficult and often delicate matters were very good. The Bank emphatically did not want or need to be involved in the majority of situations where the banks could well cope without its help, but the close and good relationships that now existed were essential if the Bank were to be able to make an effective contribution in the minority of cases in which it was brought in.

The Governor said that despite the very general recognition that multi-banking tended to deprive a company of the support of a lead bank, vital if and when it moved into financial difficulties, many companies continued to exploit fine differences in lending margins and to accumulate banking relationships well beyond underlying trade needs. He said that the Bank of England would continue to take every opportunity to press home the message that every company should in its own interest have a committed lead banker. But he suggested that it would be well if the clearing banks themselves continued to put the message across as forcibly as they could, even to the point of losing business in occasional individual cases.

Sir Jeremy Morse referred to this last point and said that the clearing banks were indeed doing what the Governor urged, but it was not always easy. The Governor reiterated that the Bank of England would continue with its own efforts in this respect and Sir Jeremy Morse concluded by saying that the Chairmen very much welcomed the role that the Bank of England was so ably playing in these difficult industrial situations.

4 International indebtedness

The Governor said that at a number of recent meetings he and the Chairmen had discussed the debt problems of individual countries such as Iran and Poland and that latterly the problems of Poland had widened to include problems of the whole Eastern European area. More recently still, eyes had been abruptly turned to the situation in Argentina and this had centred attention on potential problems for a number of other Latin American countries. Some had suggested that the Falklands crisis had caused problems for other Latin American countries, but such claims did not bear examination. The problems had been there for some time and in many cases had been accentuated by the relative weaknesses in the oil market which had set in at the turn of the year. This accumulation of concern had excited speculation and comment in the press - not always very thoughtful - as well among bankers.

The increased concern at the possible cumulative effect of debt difficulties facing a number of countries derived in the main from two inter-connected worries. On the one hand there had been concern that further reschedulings or defaults could affect banks' profitability and capital and that sooner or later some banks' liquidity or solvency would come into question. On the other hand, there was the macro-economic concern that the caution which these prudential concerns might produce for bank lending (as much the result of bank managements' own choice as of supervisors' direction) might force on countries with balance of payments deficits to finance a degree of adjustment which could seriously threaten the prospects of the world economy moving on to a path of recovery within the foreseeable future.

These dangers had led the Governor himself, in his Bonn speech, and a number of others to urge banks to treat individual countries on their merits and not to impose guilt by regional association, and to stress the self-fulfilling dangers of a precipitate withdrawal of credit and deposit facilities from countries beginning to experience payment difficulties.

Referring to Argentina, the Governor said that it would be his aim to have the financial restrictions removed as soon as possible. But it must be prudent to wait to ensure that hostilities really had ceased throughout the area and to ensure that the removal of restrictions on our part was so far as possible reciprocated.

In conclusion, the Governor mentioned the dangers that arose, both for the countries concerned and for the banks themselves, from ill-considered comments made to the press, probably from junior management levels, which did not accurately represent the attitude or policy of senior management.

Sir Jeremy Morse said that there were perhaps three main points to be made in this area - the danger of using credit as a political weapon, the danger of ill-considered withdrawals by banks from problem countries and the need for differentiation. He thought that they had been largely got across. Towards Eastern Europe, in particular, there was now a general policy of differentiation. As for Latin America, he thought that attitudes towards countries other than Argentina would revert to normal within three or four months.

Argentina itself would remain difficult because of doubts about its political future.

Speaking more widely, he thought that in aggregate the commercial banks would do little new, net recycling during the next year. Extra credit would be made available to some countries, while there would be withdrawals from others. In these circumstances there was a need for the surplus countries, notably Japan, to play a greater role at official level and for the IMF and the BIS (the latter especially as regards Eastern Europe) to do more. His own view was that in general the borrowing countries now appreciated that they had to tighten their belts and that there was now a distinct constraint on what they could borrow from the banks.

The Governor responded that he found what Sir Jeremy had said of great interest. He was, however, less sure that all borrowing countries had indeed adopted such a realistic attitude. He had the impression that a number of developing countries had not in fact realised that lower growth among the industrialised countries required an adjustment from them too. Mr Loehnis agreed. Many of the developing countries seemed to be expecting that the major economies would return to growth rates of 4% or 5% by the mid-1980s.

The Deputy Governor expressed his concern that there would be a gap between the official flows that were possible and the degree of adjustment that the developing countries were able to undertake. Mr Loehnis added that the IMF's resources were relatively small. It was necessary, Sir Jeremy Morse said, for the international financial institutions to think big.

Mr Bevan noted that the Argentinian crisis made the US banks realise how vulnerable some of them were in Latin America. This could have a ripple effect unless it were carefully handled.

The Governor referred briefly to the statement on financial relations with Eastern Europe which had come out of the Versailles Summit. It had been essentially a statement of intention and not a major policy change. Official credit agencies had for some time been pursuing more cautious policies towards these countries and differentiating between them in just the way that banks had been encouraged to do. The only specific decision to emerge from Versailles had been to set up monitoring machinery in the OECD on all aspects of economic, commercial and financial relations. Precise arrangements had yet to be worked out. The Governor referred briefly to recent developments in the cases of Poland (on which the national agent banks had just met in London), Romania, and Yugoslavia. It had been expected that Mr Makic, the Governor of the National Bank of Yugoslavia, would come to London to make a direct presentation to the British banks but there had been no recent indication of when he proposed to do this. The Yugoslavs had been drastically controlling imports and had introduced other adjustment measures.

On Hungary, the Governor said that Manufacturers Hanover had been trying to put together a $250 mn credit and had said in a statistical presentation sent to a number of major banks that there had been further discussion with the Bank for International Settlements on a possible $300 mn standby facility. This would be in addition to the facilities totalling $210 mn made available through the BIS in two tranches in April and May. The Governor emphasised that, contrary to what had been suggested in the press, no new facility had been agreed. But there was a strong feeling that Hungary was at least one country in Eastern Europe that had really tried to adjust and to pursue responsible economic policies. It would certainly be a great pity if ways could not be found to help her to avoid more serious financial difficulties. The need had been pressed on the Hungarians to do everything they could themselves to strengthen their position. They had made a considerable start at adjusting their policies and the Governor believed that they would go further.

In conclusion, the Governor asked the Chairmen about their experience with the practical effectiveness of the pro rata clauses in syndicated loan agreements with respect to Argentina. The Chairmen's response was that the reaction of the other banks involved had varied. Some had paid, some were temporising, but Sir Donald Barron said that he was aware of only one case in which a bank had challenged the principle of the pro rata clauses, saying that they were not intended to apply in the case of war.

5 Any other business

The Governor said that he had recently received a letter from Sir Donald Maitland, the Permanent Under-Secretary at the Department of Energy, which expressed concern and surprise at the reluctance of industry to invest in energy conservation projects even when they had short pay-back periods. A discussion ensued in which Sir George Kenyon said that for very many years industry and house-builders had been extremely reluctant to undertake energy saving investment. There was indeed great scope for more to be done. Sir Donald Barron noted that whereas there was active encouragement for individuals to invest in home insulation, there were no such programmes for industry. Energy saving investment was particularly labour intensive and was thus especially appropriate to present circumstances.