A COURT OF DIRECTORS AT THE BANK

THURSDAY 2 JULY 1992

Present

The Rt Hon Robert Leigh-Pemberton, Governor
Edward Alan John George, Esq, Deputy Governor
Anthony Laurie Coleby, Esq
Sir Frederick Brian Corby
Sir Colin Ross Corness
Lord Haslam of Bolton
Sir Christopher Anthony Hogg
Gavin Harry Laird, Esq, CBE
Sir David Bryan Lees
Brian Quinn, Esq
Sir David Gerald Scholey, CBE
Professor Sir Roland Smith
Sir Colin Grieve Southgate

Hugh Christopher Emlyn Harris, Esq
Pendarell Hugh Kent, Esq

The Minutes of the last Court, having been circulated, were approved.

There being no comments on the weekly figures, Mr Coleby spoke about the foreign exchanges, including the Official Reserves figures for June, and the state of the domestic markets.

There were no items for discussion under the weekly executive report.

At the Governor's invitation:-

1 With reference to a Minute of 14 May, Mr Harris reported that pay negotiations for the Main Bargaining Unit had been concluded. The BIFU Section Council had accepted, by a majority vote, a settlement comprising a 4.5% across-the-board salary increase and certain minor non-pay elements. Negotiations with the Officials Bargaining Unit were continuing on a number of peripheral issues but the same across-the-board salary increase had been agreed. In the light of these developments, Mr Harris introduced a Governor's Recommendation concerning increases in Senior Officials' salaries reflecting the 4.5% across-the-board settlement. He recalled the Court discussion of 9 April when it was noted that implementation of the revised salary structure for Executive and Associate Directors gave scope for an additional point at the top of the salary scale for Senior Officials. There was no desire to introduce an additional point at this stage but the question might be revisited at the time of the Annual Review.

It was agreed by Court that the salaries of Senior Officials be revised with effect from 1 July 1992 as follows:-

Point A to be increased from £84,900 to £88,750
Point B to be increased from £78,400 to £81,950
Point C to be increased from £71,900 to £75,150
Point D to be increased from £68,450 to £71,550
Point E to be increased from £65,000 to £67,950
Point F to be increased from £61,550 to £64,350

2 Lord Haslam introduced a Report of the Charitable Appeals Committee and noted that donations in the year to February 1992 had been in line with budget. Court approved the recommendations contained in the Report, namely that an unchanged contribution of £7,000 be made to the National Council for Voluntary Organisations, that a donation of £2,000 a year for three years be made to Work Wise Ltd, that the Bank's guarantee of

£2,500 in respect of Work Wise Ltd be renewed for a further period of three years on its expiry in October, and finally that the Bank should match pound for pound, outside the Charitable Appeals budget, the £50,050 donated in 1991/92 by staff and pensioners under the Give As You Earn scheme.

In response to a question on the principles which governed whether donations were within or outside the Charitable Appeals Committee's budget, Mr Harris said that the matter would be dealt with in the paper he would be presenting to Court reviewing the scope of the Bank's community donations.

3 Mr Price, in the absence of Mr King, presented the Economic and Financial Report for June. While the Report showed little positive on real activity, there was at least no indication of any worsening in the situation. Indeed, it was possible that retail sales were close to breaking out of the top of the tunnel of the past two years. Since the Report was drafted, the GDP figures for the first quarter have been published; these showed a further fall of 0.5%. Fixed investment had, encouragingly, risen by 1.5% while stockbuilding was flat after five quarters of destocking. Overall domestic demand had increased by 0.2%, but this rise had been more than offset by a deterioration of the trade position, producing the decline in GDP in the quarter. The trade figures seemed to be improving in the second quarter.

Looking ahead, the figures for inflation, earnings and wage settlements all gave some grounds for optimism and the RPI was on course to fall below 4% by the end of the year and to 3% during 1993. But the prospects for growth in the economy were uncertain: GDP was expected to be flat in the second quarter and might rise at 0.5% per quarter in the second half of the year, producing a 0.5% fall year-on-year. It was surprising that other forecasters were still predicting growth of around 0.5% for 1992, which would require an implausibly sharp

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upturn in the second half of the year. An important factor in the economy's sluggish performance was the unwillingness of consumers to spend. The personal savings ratio in the first quarter had been 11.5%, higher than at any time since the early 1980s and difficult to explain by reference to previous patterns of behaviour. One significant factor may be the number of householders - perhaps approaching one million - with negative equity in their property. The majority of this group tended to be first-time buyers aged 25-35 with young families who would normally spend all their disposable income but who, anecdotal evidence suggested, were now trying to save their way out of the negative equity situation. Success in curbing inflation meant that this dampening effect on the economy could prove persistent.

4 Mr Coleby, introducing the monthly discussion of monetary policy, noted that narrow money had been very flat since November 1991 with the currency circulation growing at an annual rate of only 0.6%. This was now reflected in a declining year-on-year rise, down to 2% in May; June's figures will be lower. This performance reflected that of the value of retail spending, its volume having been flat and price rises moderate. It was doubtful that the latest developments in narrow money had any predictive content but, if they did, the news was not good.

Lending had been somewhat stronger over the past two months, rising at an annualised rate of 8%. Increased company borrowing had been the main factor. Other Financial Institutions account for part of the increase, but borrowing by industrial and commercial companies had also been stronger. Any explanation is largely guesswork, but there may have been some borrowing to finance stocks; if so, it is unclear whether the stockbuilding was voluntary or involuntary. The higher lending had not been reflected in M4 growth, which had been restrained by overfunding of the PSBR.

Thus M4 grew 5.2% year-on-year in May, down from 5.8% in March. This was probably close to the long-term growth rate consistent with the policy objectives for inflation and for trend growth; there was certainly no policy ground for wishing to depress it further.

There remained the - by now familiar - conflicting considerations for policy. The economy was sluggish and would benefit from a stimulus which, at this stage, would not undermine the progress on inflation unless the measures taken were radical. Thus, on domestic grounds, the case for a further easing of interest rates was strong. However, market movements since the Danish referendum had shown how little scope there was for such a move without threatening disturbance in the ERM; sterling's place in the latter remained central in the medium term to the inflation objective. So policy was, at the moment, undoubtedly in a box. Nevertheless it was questionable - given recent experience both in other countries and in the UK - whether interest rate reduction would in present circumstances provide much of a stimulus. We might need to await favourable global developments.

In the discussion which followed, Directors expressed concern at what would provide the trigger for an upturn. Mr Laird commented that there should be no surprise at the lack of consumer confidence in the light of the negative housing equity trap, the level of unemployment, the decline in manufacturing employment and the level of pay settlements. Some action was necessary to provide a stimulus, and a modest interest rate cut now would be preferable to facing the need for more dramatic action in the autumn.
Sir Colin Corness confirmed the seriousness of the problem of negative housing equity but noted that legislation limiting unsecured lending restricted what building societies could do to help. He recognised that the negative equity constraint would remain for

some time. Against this background, the impending end of the period of suspension of stamp duty would be a further discouragement; the case for abolition should be reconsidered. A major factor underlying the poor economic performance was the low level of housing transactions and related expenditure.
Recognising the external constraint on reducing interest rates, Professor Sir Roland Smith argued for a reduction in VAT to 15%, which should give a significant boost to confidence and activity without affecting the interest rate structure, even if the cost was a £3 billion increase in the PSBR.

In concluding the discussion, the Governor took up a suggestion from Sir David Lees that Court should discuss a paper which would draw together the various policy options to provide a stimulus to the economy and project their impact. Mr Coleby and Mr King would collaborate on the paper which the Governor hoped would be available within the next month.

E.A.J. George
9th July 1992

C Jennell
Assistant Secretary
9 July 1992

A COURT OF DIRECTORS AT THE BANK

THURSDAY 9 JULY 1992

Present

The Rt Hon Robert Leigh-Pemberton, Governor
Edward Alan John George, Esq, Deputy Governor
Sir George Adrian Hayhurst Cadbury
Sir Frederick Brian Corby
Sir Colin Ross Corness
Lord Haslam of Bolton
Sir Christopher Anthony Hogg
Sir Martin Wakefield Jacomb
Gavin Harry Laird, Esq, CBE
Sir David Bryan Lees
Brian Quinn, Esq
Sir David Gerald Scholey, CBE
Professor Sir Roland Smith
Sir Colin Grieve Southgate

Pendarell Hugh Kent, Esq
Ian Plenderleith, Esq

The Minutes of the last Court, having been circulated, were approved.

Details of the weekly figures and graphs relating to the state of the foreign exchanges and the domestic markets, were laid before Court.

Under the weekly executive report and with reference to a Minute of 9 April, Mr Quinn spoke about matters relating to banking supervision and to BCCI. He mentioned first the press conference held in the Bank on 6 July at which Mr Corrigan, President of the Federal Reserve Bank, New York, had introduced the proposals of the Basle Committee on minimum supervision standards. Press comments had been broadly helpful, seeing the proposals as sensible and appropriate. The following day the Bank had issued its response to the report of the Treasury Select Committee on BCCI. On the advice of the Clerk to the Committee, the Bank's paper had been sent to the library of the House. But the press somehow had become aware of this and elements of the Bank's response were reported in Wednesday's paper, giving the incorrect impression that journalists had had prior sight of the report. This had led to a rebuke from the Speaker. In addition, Mr Terence Higgins MP, the Chairman of the Committee in the last Parliament, had publicly stated that the Bank's response did not answer all the criticisms contained in the Committee's report. However, the Bank's response had been carefully considered, focusing on looking at proposals for banking supervision while leaving specific questions relating to the supervision of BCCI until the Bingham Report had appeared. The Governor noted that events had taken an unfortunate and unforeseeable turn which had derailed a considered approach by the Bank. He intended to write to the Speaker to set the record straight and hoped that she would make public the letter.

Mr Quinn then explained the next steps relating to the Bingham Report: the following day, the Bank would be submitting a detailed written response to a draft of Lord Justice Bingham's commentary, together with a letter from the Governor which would describe changes which it was proposed to introduce in the administration of Banking Supervision. These changes included an enhanced legal capability, more resources for investigations and steps to improve communication within the Bank, with the Board of Banking Supervision and with outside agencies. On the same day Gordon Langley QC would be making a formal submission to the inquiry on behalf of the Bank. The Report would then be finalised and it was now anticipated it might be delivered formally to the Chancellor and the Governor in the week beginning 27 July.

The next question to be addressed was what should be published and when, [redacted]

The consensus of Directors was that publication of the Report should be at the earliest opportunity, not least to minimise the risk of leaks, and as full as possible. It was recognised that there was a predisposition against the Bank over the BCCI affair and that criticism was inevitable, whether justified or not. In response to questions, Mr Quinn confirmed that the publication of information protected under the Banking Act was a criminal offence and explained that under the 1987 Act, though not the 1979 Act, the Bank could not be sued over its supervisory actions unless it could be shown not to have acted in good faith. [redacted]

At the Governor's invitation:-

1 Before asking Mr Kent to introduce the two papers on the condition of industry, the Governor invited Mr Charkham, his Adviser on finance and industry matters, Mr Smith, the Head of Industrial Finance Division, and Mr Wardlow, the author of the Bank's paper on this subject, to attend Court for the presentation of these papers.

In introducing the Bank's paper, Mr Kent said that it told three main stories:-

(i) that the 1960s and 1970s had largely been years of under-performance, under-investment and failed industrial policy;

(ii) that the 1980s had represented a turning point in the performance of British manufacturing;

(iii) that closing the gap further with our leading international competitors may be somewhat more difficult in the years ahead. Overall productivity remained only 70-75% of German and French levels and even less than those of the US and Japan. The average rate of return in the UK between 1982-88 had been around 9% compared with OECD levels of 13-20%. Our measured R&D levels compared poorly - and that after including R&D on defence which was now declining.

Manufacturing industry continued to occupy a very significant position in the UK economy and was central to Britain's trading efforts. The Bank's paper and the paper summarising the views of the Non-Executive Directors both emphasised the two-way link with the service sector. However, apart from Germany and Japan, the relative importance of manufacturing in GDP in the UK was roughly in line with other industrial countries. A large trade deficit on manufactured goods had emerged in the 1980s, following the sharp fall in output in the earlier part of the decade. If this reflected a lack of competitiveness, the only remedy appeared to be further improvements in cost control and in productivity. Investment continued to be too low but an appropriate increase could lead to a further shake-out of labour. Was there a role for inward investment in filling some of the gaps in Britain's manufacturing capacity? And would the external account place a constraint on the economy in the 1990s - or would the single market make this question unimportant?

On the role of the authorities, the paper referred to the over-riding importance of macro-economic stability and control of inflation. The Non-Executive Directors' paper mentioned short-termism but this, Mr Kent suggested, was a symptom of inflation. High-hurdle rates followed from high price risk and high discount rates, and quickly eliminated many projects which might have had a better return in a stable money environment. This was a problem as much for industry as for the City. Both papers discussed the importance of training and information flows between industry and science: this surely was a legitimate partnership for Government and Industry.

Since both papers had been written, the President of the Board of Trade had reorganised the DTI rather along the lines advocated by the Non-Executive Directors' paper and the NEDC had been abolished. It was too soon to judge the likely impact of the change but the Minister for Trade and Industry, speaking on the previous Monday, had said that the DTI wanted to demonstrate its concern and understanding of industry - not to pick winners but to back them.

The issues for the Bank were described on page (iii) of the paper's Executive Summary. While much of the Non-Executive Directors' paper pointed at the DTI rather than the Bank, it would be particularly helpful to have Directors' comments on:-

(a) whether they shared the analysis in the Bank's paper; and

(b) what they regarded as the most appropriate role for the Bank.

So far as the Non-Executive Directors' paper was concerned, Mr Kent was encouraged by a fair degree of overlap on issues if not on solutions. The Bank paper did not however mention Monopolies and Mergers Policy.

Sir Adrian Cadbury also saw a large measure of agreement between the two papers. Drawing on his own experience, he highlighted the dangers of Government intervention. He noted the persistence of policy regardless of minister or party; real power had remained with civil servants but the record for direct intervention had been poor. For instance, the attempts to encourage industry to locate in depressed regions using Industrial Development Certificates had discouraged expansion and the restructuring process. Turning to what should be the concern of government, he highlighted infrastructure (transport, water, energy, derelict land clearance) and a greater focus on education and training; these could not be separated from industry's productivity record, were vital to competitiveness and required major investment.

The failure of the industrial policy stance over much of the post-war period and the shortcomings in education and infrastructural investment were also stressed by Sir Colin Southgate. He saw UK governments as "bad buyers", contrasting with public procurement in other countries, notably France and the US, which had been much more important in terms of developing emergent industries such as computer software. In terms of future policy, the financing requirements of small and medium-sized firms were a key consideration: they needed access to more long-term funding if the UK was to close the gap with its competitors. But too much attention had been given to very small firms over recent years at the expense of medium-sized enterprises which were the key to future growth in the manufacturing base. For larger companies, the main issue was their relationship with their owners and the wider financial system - the way they communicated and interacted about long term business strategy and financing. Sir Colin agreed that transport infrastructure was an important concern but suggested that the provision of transport systems should be transferred to the private sector. The Government's role was to secure macroeconomic stability and to revitalise investment in education and training.

Sir David Lees agreed on the criticality of the macroeconomic environment. If this were right, much of the micro debate would become less important. Past failure at the macroeconomic level lay behind many of the problems of British industry and the Bank's key role was to make its contribution to providing the right macro environment in future. The DTI's role should be as enabler, representing industry to other departments so that government was fully aware of the costs implicitly imposed on companies, for instance energy costs and the uniform business rate, both of which had arguably been excessive during a time of recession. Better training provision was vitally important, not in the form of new initiatives but in continuity and in the development of the best of the existing schemes eg. TECs. Export promotion was another area where DTI assistance could be improved.

Sir Colin Corness believed that the Bank should encourage governments to maintain a more consistent long-term course. In the UK, predicting the future cost of capital was too much of a gamble when the viability of projects was being appraised. He also noted the Treasury's failure, because of the process of annual budgeting, to differentiate between current and capital expenditure. This was wholly inappropriate in deciding on appropriate funding for, and return on, major transport infrastructure projects, and he hoped the Bank could educate Treasury officials on the need to make distinctions. Citing the omission in both papers of any mention of design, he stressed the importance of the latter, both in terms of lower costs and product attractiveness.

The constraints imposed by the year-to-year approach of the Treasury were also noted by Mr Laird. His own experience with Scottish Enterprise, whose strength lay in its local organisation as opposed to direction by officials, led him to conclude that such organisations could pick potential winners to back but were hamstrung by their inabilities to adopt business plans beyond one year because of Treasury budgeting. Mr Laird also considered cultural attitudes, which gave low status to manufacturing, a hindrance in the UK as compared with competitor countries. He endorsed earlier comments on the need for greater investment in infrastructure - noting that only 35% of road tax revenues are reinvested in transport - and education and training, favouring a grant levy on employers for the latter. He felt that the Bank had a limited role to play in the question of an industrial policy.

Professor Sir Roland Smith stressed that a stable economic environment and the quality of the provision of credit were crucial to management decision-making. The UK was sometimes short on product and here inward investment was relevant in filling the gaps.

Recognising that, in practice, governments worldwide have a significant involvement in industry, the DTI's role should be to ensure that the contract process is effective and that the UK government understands its impact. He referred to his experience of the relationship between German companies and government in this respect - links were much closer and the effort of both was consistent; the difference lay in both content and tone. It was naive to think that governments were not closely involved in these matters elsewhere; closer links were therefore crucial in the UK between government and industry, and the DTI should undertake the enabling function.

Sir Christopher Hogg expressed surprise that Court was devoting time to a discussion of the condition of industry and industrial policy. Referring to the statement of core purposes, he said he would monitor closely how the Bank interpreted its responsibilities in relation to the efficiency and effectiveness of the financial sector.

Picking up on the theme of different attitudes towards industry in this country, Lord Haslam said he was struck by the lack of cohesion between government, industry and the financial sector in the UK; this contrasted with the tripartite co-operation which seemed more of a feature in competitor countries. The DTI suffered frequent ministerial changes and was, in any case, subordinate to the Treasury. The latter took the key decisions but used other departments as a shield.
He felt that the UK method of financing industry encouraged the short-term view, while acquisition policy was another hindrance: a major German chemical company would never have had to suffer the sort of distraction which the Hanson bid had caused for ICI. ECGD had now become a pathetic operation. Drawing on current experience with Bechtel, which was negotiating

a major contract in Algeria, he said that the policy of reducing subsidies, however sensible in theory, was naive in practice. Other countries were not following suit. One outcome would be that multi-nationals would direct contracts or procurement to group companies outside the UK.
In response to Sir Christopher Hogg's comments, Lord Haslam saw clear purpose in the discussion: the Bank should have a good feel about what was happening in industry if it was to be effective in its monetary policy role and he did not see how these matters could be separated. Welcoming the general input of the Bank's Agents, he believed they provided an effective way of tracking economic developments at grass roots. While tackling inflation was central, the Bank should not be blinkered in its implementation of monetary and exchange rate policy; indeed, an indication of awareness of the impact of policy on the real economy would be a valuable addition to the monthly economic reporting to Court.

Concurring with much that had already been said, Sir Martin Jacomb stressed the need for stable prices. But the concomitant need for a high interest rate and strong pound had implications for the cost of capital which were unconducive to industrial regeneration. Past experience had shown that the Government could help through appropriate tax policies but it was important to get the balance right; there had been fairly recent examples of unhelpfully high and excessively low corporate taxation. He reiterated criticism of the current stance of ECGD.
Consideration also should be given to how long the current policy to squeeze out inflation was socially sustainable if the cost was unemployment at or above the current level. In this respect, the Treasury's failure to distinguish between current and capital expenditure constrained infrastructual projects which would increase employment without inflationary

consequences. A further hindrance was the attitude of the regulators of the denationalised monopolies; their stance favoured today's consumers at the expense of profits and future investment and competitiveness.

Sir Brian Corby believed that, in relation to its main responsibilities - monetary policy and banking supervision - the Bank needed to be aware of the implications of its activities on the wider economy. Too much dogma had been inherited from the 1980s regarding policy, particularly export finance, and the UK could not ignore what other countries did. He did, however, recognise that the Treasury had to operate within the framework determined by government.

In drawing the discussion to a close, the Governor reiterated the need for the Bank to be abreast of conditions in industry. While economic and financial stability was the key objective, monetary policy, to be effective, should be informed by what was happening in the commercial world. The relatively modest resources devoted to industrial matters in the Bank provided a window on the interplay between policy and the real economy.

2 Before inviting Sir Adrian Cadbury to speak about the Draft Report issued by the Committee on The Financial Aspects of Corporate Governance, the Governor invited Mr Charkham and Mr Smith to remain at Court for the presentation of this paper.

Sir Adrian explained that the Draft Report should be seen in the context of the work of the Financial Reporting Council, the Accounting Standards Board and the Financial Reporting Review Panel and noted that the same issues were currently being addressed in the United States. The objective was to draw matters together rather than seek to introduce dramatic new initiatives, with the lack of effective accountability

of boards to shareholders - something that was difficult to tackle - being the main focus of attention. He recalled that the Committee's remit had been concerned with financial reporting and control only and not the whole spectrum of corporate governance: a misunderstanding over the terms of reference perhaps lay behind some of the criticisms which the Draft Report had attracted.
Turning to the content of the Report, Sir Adrian said that it elucidated three principles, openness in the disclosure of information, integrity in financial reporting and the accountability of boards to shareholders.

A Code of Best Practice based on these principles and covering the roles of executive and non-executive directors and the responsibilities of boards, lay at the heart of the recommendations. The apparent lack of awareness among directors of their legal responsibilities - some of which were admittedly implicit rather than explicit - was a cause for concern and highlighted the need for training new directors. Sir Adrian identified four factors which should encourage companies to comply with the Report's recommendations:-

(i) the requirement that the accounts of listed companies should include an explicit statement of compliance with the Code of Practice or an explanation if this were not the case;

(ii) the plan for a new group to be convened in May 1994 to monitor progress;

(iii) the threat of regulation if progress is seen as inadequate;

(iv) the checklist for discussion with the board which the Report, in effect, gave to shareholders.

The Draft Report had stimulated much comment and debate. Once the end-July deadline for submissions was past, the Committee would be reviewing the draft with a view to publishing the final version at the end of October.

In the discussion which followed, most Directors agreed with the general thrust of the Draft Report but there was a broad spectrum of opinion. Concerns raised by Directors reflected most of the criticisms which the Report has attracted elsewhere. It was important that, in its final form, the Code should convey that alternative practices were not excluded where they could be justified. A particular worry was that the compliance with the Code would, in practice, result in division between executive and non-executive directors and might lead to the emergence of two-tier boards. Other concerns were that the Code went too far down the road of diminishing the responsibilities of auditors and that it would prove a complicating and stultifying influence and might increase costs. Perhaps the whole debate on corporate governance had been too drawn out and the Code was a symptom of too much concern with form and not enough with achievement.

Taking up the Governor's invitation to respond, Mr Charkham said that his own contacts since the Draft Report had been published suggested that many companies agreed with its thrust and, indeed, already complied with suggested best practice. He had not encountered any evidence of concern about potential divisiveness between executive and non-executive directors but a recognition that the latter needed to be seen to be doing an effective job and acting as a check on executive directors when appropriate. The standards of the best companies were already entirely satisfactory; what was needed was to bring the rest up to scratch. While some fine-tuning might be necessary, he believed that the Draft Report represented a well-judged first step which reflected the general run of current thinking.

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Secretary

23rd July 1992

A MEETING OF DIRECTORS AT THE BANK

THURSDAY 16 JULY 1992

Present

The Rt Hon Robert Leigh-Pemberton, Governor
Edward Alan John George, Esq, Deputy Governor
Anthony Laurie Coleby, Esq
Andrew Duncan Crockett, Esq

Hugh Christopher Emlyn Harris, Esq

The number of Directors assembled being insufficient to form a quorum, those present proceeded to the business, subject to ratification by the next Court.

The Minutes of the last Court, having been circulated, were approved.

There being no comments on the weekly figures, Mr Coleby spoke about the foreign exchanges and the state of the domestic markets.

G. A. Croughton
Secretary.
23 July 1992.

A COURT OF DIRECTORS AT THE BANK

THURSDAY 23 JULY 1992

Present

Edward Alan John George, Esq, Deputy Governor
Sir David Gerald Scholey, CBE
Anthony Laurie Coleby, Esq
Sir Frederick Brian Corby
Andrew Duncan Crockett, Esq
Lord Haslam of Bolton
Sir Christopher Anthony Hogg
Mervyn Allister King, Esq
Gavin Harry Laird, Esq, CBE
Sir David Bryan Lees
Brian Quinn, Esq
Professor Sir Roland Smith
Sir Colin Grieve Southgate
Sir David Alan Walker

Hugh Christopher Emlyn Harris, Esq
Pendarell Hugh Kent, Esq
Ian Plenderleith, Esq

The Minutes of the Court of 9 July were confirmed and those of last week's Meeting, having been circulated, were approved.

Mr Quinn commented on the weekly figures and Mr Coleby spoke about the foreign exchanges and the state of the domestic markets.

Under the weekly executive report:-

6 1 With reference to a Minute of 10 October 1991, Mr Kent reminded Court that, following legislation the previous September, the shareholders of the Agricultural Mortgage

Corporation, the Bank - a major shareholder with 27% shareholding - and the other commercial banks, wanted to divest their shareholdings. There had been a concerted attempt by the shareholders to find a buyer but only one, had shown any interest and they had offered to buy at a price that represented a 50% discount of the net asset value. The shareholders had originally looked for some 80% of net asset value but might now accept 60% or even 55%. There would be a gross realisation of some £7-8 mn for the Bank if it sold within this range, against a book value of some £205,000.

Mr Martin Harper, the Director of the Agricultural Mortgage Corporation nominated by the Bank, had persuaded Mr Kent that the Bank should take the present opportunity to disinvest. Not to do so could lead to a long term commitment for the Bank to underwrite the Agricultural Mortgage Corporation or, alternatively it would lead to the run down of the Corporation, which they strongly opposed, and which would be very difficult to administer. It was the Bank's intention therefore to accept the lead given by the other shareholders and to disinvest.

Court were content with the proposed course of action.

2 The Deputy Governor drew Members' attention to a memorandum from the Governor concerning Lord Justice Bingham's Report on the supervision of BCCI which the Governor and the Chancellor expected to receive formally on 24 or 27 July. The expectation was that the Report would not be published until September. It was proposed therefore that the Report should be made available to Directors shortly to be followed by a discussion at Court on 6 August. If earlier publication is indicated, the discussion would be brought forward to 30 July.

At the Deputy Governor's invitation:-

1 By way of introduction to the Reports from the Heads of the Financial Markets and Institutions Division and the Industrial Finance Division, which would follow later in the year, Mr Kent emphasised that the work of these Divisions was not based on any statutory provision. There were two points, additional to those addressed in his introductory paper, which he wished to emphasise. The first was the extent to which the City had been criticised in the past for failing to comprehend and support industry and commerce. The Bank was often expected to show understanding and provide leadership so we necessarily had a locus in this area. Secondly there was an inherent tension in the role we performed because we needed to remember on the domestic front the interests of the individual savers and investors at one end of the spectrum and the users of capital at the other, ie the users of the City. On the international side however we were keen to support the intermediaries who made the City a leading global market. These were not always easy to reconcile.

2 In introducing his Report to Court, Mr Clark said he would like to make three additional points beyond those in the Report itself. First, although fostering the international competitiveness of the City was a major part of FMID's brief, he also felt that increasingly interconnections within the financial sector made it important to keep abreast of the wider picture and not just of developments in the areas of the Bank's immediate concern. That was very much part of FMID's role. Second, measuring the level of performance of the Division was very difficult. Targets were seldom quantitative. At the end of the day the Division's contribution could perhaps best be judged by the extent to which its counsel was sought and the esteem in which it was held in the City. Third, Mr Clark said that his Report focused on the Division's main involvements during the past year: in

the coming year the Division would be focusing particularly on the structure of regulation and of the London markets. The latter would be the subject of further discussion at Court early next year.

In response to Lord Haslam's comment about the apparent lack of experience among the senior members of the Division, Mr Clark said that the Division had not yet reached equilibrium following a restructuring some three years ago. It was his expectation that senior managers would remain in the Division for some four or five years in future, which was perhaps a little longer than the Bank norm for staff of their seniority. In response to Sir Brian Corby's question on availability of resources, Mr Clark said that he had not felt constrained in tackling major "crisis" issues but there had been limits on background work for example in relation to the debate on European matters.

Sir David Scholey was interested to establish the staffs' view of the work of the Division - was it seen as an opportunity to gain wider experience or, because of the difficulty in defining precise responsibilities for the Division, did the staff feel unsure of their role and thus look towards reverting to a more familiar central banking career? Mr Clark accepted that there may have been such concerns in the past but the clear relationship of the work of the Division with the Bank's core activities, as set out in the Statement of Purposes, Responsibilities and Philosophy, had helped to generate increasing enthusiasm for joining and staying in the Division. The Deputy Governor said that in the City the Bank was seen traditionally as the father figure - a view not necessarily shared in Whitehall - but as a result there were external expectations and the City brought its problems to the Bank, looking to us in the role of facilitator, for help and advice. In practice, the City used the FMID services to a quite remarkable extent.

Sir David Walker felt that the Bank had an important role to play in this area and needed to have good intelligence about the City and the markets in particular. It was important that the Bank was well informed and with that intelligence and knowledge of the City, represented the City's views to Government.

3 Messrs Kentfield and Allsopp attended Court to introduce a paper "Interbank Credit Risk in Payments Systems" which focused on some of the issues following the presentation to Members earlier that month.

Mr Kentfield reminded Members that the presentation had identified three particular problems inherent in the current net settlement arrangements. There was an unacceptable degree of risk to the Bank in effectively underwriting the settlement system overnight and also during the day to the extent that the Bank was exposed to any individual bank failure. Secondly, the present system could not be linked to other settlement systems, such as those for securities and foreign exchange transactions, in such a way as to provide true delivery against payment; and finally the rest of the world was moving toward Real Time Gross Settlement and it was important that we should not be left behind, particularly in the European context.

However, the banks were still reluctant about moving to RTGS, basically for three reasons. First was a question of cost: the present system was free and they would incur costs of collateral and system changes in moving to RTGS. Second, there was a concern among member banks that others who currently settled indirectly would wish to join in their own right; and third, the banks argued that whilst the outlook on EMU remained uncertain they did not wish to go down a particular road which might, in the event of EMU, be obsolete.

During the discussion which followed, Sir David Lees asked if the extent of the risk and the cost of eliminating it, could be quantified? Mr Kentfield responded that the risks were very large, running into £bn per day but the capital cost of eliminating the risk was relatively modest, of the order of £20 mn. Mr Allsopp suggested that in a peak day the flow through the payment systems could reach some £200 bn.

The Deputy Governor noted that the net daytime liabilities of a single bank had been monitored at as much as £10bn and commented that the issue being debated was in fact far broader than this. The sterling payment system was the basis even for other sterling settlement systems; there was therefore an accumulation of risks.

In response to Lord Haslam's suggestion that the incidence of risk was very small, Mr Kentfield accepted that the record of failures had been small but suggested that the risks would escalate as the number of banks grew, possibly to include banks from Europe, and the circle of participating banks would undoubtedly widen. The criteria for their joining were simple - they must be regulated, ie supervised institutions; they must have a settlement account at the Bank; and they must meet an objective volume criterion.

In response to Sir David Scholey's question about the systems in operation in the US and Germany, Mr Allsopp said that both central banks were working on reforming their current systems; the French, too, were currently considering proposals along similar lines to ours.

Sir Christopher Hogg said that it was important that, whatever system we chose to adopt, it was vital that it would not become displaced or obsolete with the onset of EMU. Mr Kentfield supported that view and said that the most likely development on that front would be a linking of systems in Europe, and RTGS, in particular, was entirely compatible with that.

Reverting to the elimination of the risks inherent in the payments system, Sir Colin Southgate said that the Bank should not carry any risk, it should be eliminated entirely. Sir Brian Corby endorsed this view saying in particular that the Bank should certainly move in that direction, as any failure to do so would inevitably invite severe criticism of the Bank in the event of a failure or any other problems.

Sir David Scholey enquired whether the extent of a bank's collateralised commitment would be publicised normally, or only if called, and questioned whether this would have an impact on depositors. Mr Allsopp said that such transactions would not be publicised, since at the end of the day when the settlement was paid the collateral would be returned to the bank. The Deputy Governor said that in practice the position of the banks' depositors would remain unchanged under RTGS.

In reverting to an earlier question about the relationship between banking supervision and payments systems, Mr Quinn said that sufficient attention had not been paid to the ability to settle intra-day. Supervision had been a bit behind the game in this respect and should now focus on the extent to which banks were exposed as a result of payments transactions.

Finally, the Deputy Governor explained that this subject had been brought to Court at the present time because the Governor would be focusing on payment systems in a speech to be delivered in October. Since 1989, the Bank had been trying to educate the banking system to move towards RTGS. It was felt that we were now moving towards a decision to implement such a system. He was grateful to Members of Court for their support.

Secretary. 30 July 1992

A COURT OF DIRECTORS AT THE BANK

THURSDAY 30 JULY 1992

Present

The Rt Hon Robert Leigh-Pemberton, Governor
Sir David Alan Walker
Anthony Laurie Coleby, Esq
Sir Colin Ross Corness
Andrew Duncan Crockett, Esq
Lord Haslam of Bolton
Sir Martin Wakefield Jacomb
Mervyn Allister King, Esq
Sir David Bryan Lees
Brian Quinn, Esq
Professor Sir Roland Smith
Sir Colin Grieve Southgate

Hugh Christopher Emlyn Harris, Esq
Pendarell Hugh Kent, Esq
Ian Plenderleith, Esq

The Minutes of the last Court, having been circulated, were approved.

On behalf of Members of Court, the Governor congratulated Mr King on his election as a Fellow of the British Academy.

Mr Quinn commented on the weekly figures and Mr Coleby spoke about the foreign exchanges and the state of the domestic markets.

At the Governor's invitation:-

1 Mr King spoke first about the draft Assessment from the Quarterly Bulletin due to be published on 18 August. He commented that in August 1991 the Quarterly Bulletin had described the economy as "bumping along the bottom" and that phrase seemed as appropriate now as it did then. It prompted the question - what has changed over the past year?

Non-oil output had continued to fall - at a very much slower rate than in the first half of 1991 - but domestic demand had risen, albeit by only 1/2% between the middle of last year and the first half of this. Output had fallen because of a worsening in the trade balance. The deterioration in the net real trade balance was not the result of any deterioration in competitiveness, but a change in the relative cyclical positions of the UK economy and our major trading partners. Most of the news of the past year concerning the G3 economies had been disappointing. Despite 23 reductions in interest rates in three years, the US was only just emerging from recession, growth in Germany was falling, and in Japan a sharp fall in the growth rate had coincided with a serious deterioration in the position of financial institutions.

The divergence of monetary policy between the US and Japan on the one hand, and Europe on the other, had increased. Over the last month interest rates in the US and Japan had fallen further and money market rates in Europe had risen and there was little expectation that this divergence would narrow - if anything it might increase further.

As time had passed, it had become clear that the present recession was not only longer than earlier post-war recessions but was now almost as deep as that in the early 1980s. The important difference between the present recession and earlier recessions lay in the behaviour of consumption. Consumption had fallen by much more than in earlier recessions and it was this which accounted for the duration of the recession. The high debt burden of households remained a problem and it was estimated that there were between 3/4 and 1 million households in Britain with negative net equity where the value of their house was less than the value of their mortgage. There was no short cut to reducing this debt burden other than a sharp and unanticipated increase in inflation and although a reduction in interest rates would help, it would not in itself solve the problem, as evidenced by the slow response of the American economy to reductions in interest rates. In the past we had used inflation as a means of reducing debt burdens but that option was no longer open. The prospects for reducing inflation to the lowest level for a generation were bright and underlying inflation would continue to fall possibly to a point that could be described as "price stability".

The policy dilemma was that, along with the American, Japanese, and other economies which saw rapid increases in borrowing in the late 1980s, there was a strong case for a reduction in domestic interest rates in the UK but our membership of the exchange rate mechanism precluded that.

However there were other options which had been identified in a separate paper. These included monetary and exchange rate policy options on the one hand and other measures focused on fiscal policy and the housing market.

In the monetary area there were three options: to stick with the present policy; to devalue within the ERM; and to leave the ERM. The first represented no change in policy, whilst the second might stretch credibility if we abandoned our commitment after a period of less than two years. Leaving the ERM altogether was probably the only way in which interest rates could be reduced significantly at present. A substantial depreciation of sterling, perhaps in excess of 20% would be required. This would add to inflationary pressures and more importantly would destroy the Government's credibility in respect of its commitment to price stability.

Other options that could be considered included fiscal policy. The overall fiscal stance was in fact rather expansionary at present. But the recent changes to the control of public expenditure left the hope that public expenditure would be controlled rigorously thereafter. Further selected measures could include temporary tax changes on spending. The most promising was a temporary reduction in Value Added Tax from 17 1/2% to, say, 15% for a period of some 6 months but, following the agreement on minimum VAT rates in the European

Community, such a change might be politically sensitive. The Chancellor's comment earlier that week appeared to rule that option out. None of the other options described in the paper were likely to alter the picture radically but that was no reason for not trying to do something. The basic dilemma, therefore, was that monetary policy was severely constrained by our membership of the ERM and the choice was between staying with that commitment or being seen to abandon it altogether.

2 Mr Coleby endorsed Mr King's conclusion that the only coherent option for change in monetary policy was to leave the ERM: but the implications of doing so for the exchange rate/interest rate menu that the markets would provide made it a certain recipe for reigniting a high rate of inflation. As regards funding, the only merit of moving towards underfunding would be if it enabled bond yields to come down. That could only happen if the change were announced, and if the new basis for funding was not judged in the market as likely to lead to a renewal of inflation. Moreover, the scope for yields to fall was limited; it could not be more than a fraction of the yield differential over DM bonds, currently 120 bp at the ten year maturity. So, while the idea was well worth exploring, there was no certainty that pursuing it would deliver worthwhile benefit.

Sir Colin Corness said that he felt the Government should take steps to ease the present situation. They were not experiencing any difficulty in funding the PSBR through gilt sales so he questioned why there was a need to offer such a high interest rate on National Savings instruments. This was causing a drain on building society funds as investors switched to National Savings. If this trend continued building society margins would become insufficient. Despite comments about lower repossessions, the position was not getting any better. There were fewer repossessions only because building societies could do nothing with further repossessed properties and the activity in the housing market reported in June was only taking advantage of the stamp duty holiday before it ceased. He also supported the CBI's comment that Government made no distinction between investment and other expenditure. He encouraged the Bank to take any opportunity to focus Government's attention on the need to encourage capital investment and keep control of current expenditure.

In responding to Sir Colin's comment on the level of National Savings, Mr Coleby said that the PSBR for the current year was twice that of the previous year and savings available from the private sector had correspondingly doubled. National Savings had been running at roughly twice the rate of the previous year and was, therefore, not taking a larger share of savings. Moreover, there had been a one-off character to some of the inflows, attracted by the availability of new products. Sir Colin suggested that building societies were having difficulty in maintaining their share because many savers were repaying debt and if National Savings were holding their own they were doing so at the expense of the building societies.

Sir David Lees commented on the recent Agents' Summary which he said was close to the CBI survey and rather more gloomy than the picture painted in the Quarterly Bulletin. He had no difficulty with the Bank's analysis of the monetary situation but he was disappointed that none of the fiscal options appeared attractive to the Bank. He accepted that any increase in the PSBR was unattractive but felt that the Government must take some action particularly on the housing front. Those in the younger age group who might otherwise be expected to boost consumption were experiencing considerable difficulty with mortgages etc. Accordingly, the CBI's view was that Government should maintain its capital investment programme and keep tight control on current expenditure; should focus attention on what might be done for the housing sector, targeting that part of the economy in particular; and, through increased efficiency and a policy of value for money, should aim to reduce the PSBR.

Sir David Walker also agreed with the assessment of the monetary situation. The erosion of the asset base in the private sector was also true of the business sector where assets in the form of real estate had greatly reduced in value. He endorsed Mr Coleby's assessment of underfunding but questioned whether companies would be attracted to the bond market even if the UK was able to achieve yields to match the Germans. He too was in favour of a sympathetic examination of modest fiscal measures.

Sir Martin Jacomb also supported Mr King's assessment and said that the problem was the relationship of sterling to the dollar. All we could attempt to do was to persuade other ERM members to reduce their interest rates. He was supportive of an investment-led recovery by fiscal measures but these should not be temporary: they needed to be permanent to ensure a long-term benefit. Overall he was concerned about the social consequences of the housing market and the employment situation of the younger generation.

Mr Crockett said that from his experience of other countries there was always a short-term cost for a longer-term benefit and what we observed now in the UK was not fundamentally different from what we expected with a policy to run down inflation - to change course now would lose credibility. Fiscal measures could be used and should focus particularly on the housing sector. Sir Colin Southgate shared that view saying that support should be focused on the areas in need of help - housing in particular - rather than across the economy generally. Sir Roland Smith said that if zero inflation was the centre of policy the present situation was inevitable but this policy was too severe and some fiscal measures should be adopted to ease the situation.

Lord Haslam said that the Government faced a confidence and credibility crisis. He remained in favour of membership of the ERM but said that we had joined at the wrong time and at the wrong level. He suggested that the UK, during its Presidency, should take the lead in opening discussions on re-alignment and, following an adjustment of the sterling/deutschemark relationship along with that of other currencies, the UK should underline its continuing commitment to the ERM by joining the narrow band at the new level. He too was concerned about the industrial and social consequences if no action was taken to ease the current position.

Adrian Cadbury
6th Aug. 1992.

G. A. Coghlan.
Secretary. 6th August 1992

A COURT OF DIRECTORS AT THE BANK

THURSDAY 6 AUGUST 1992

Present

The Rt Hon Robert Leigh-Pemberton, Governor
Sir George Adrian Hayhurst Cadbury
Anthony Laurie Coleby, Esq
Sir Frederick Brian Corby
Sir Colin Ross Corness
Mervyn Allister King, Esq
Gavin Harry Laird, Esq, CBE
Sir David Bryan Lees
Brian Quinn, Esq
Professor Sir Roland Smith
Sir Colin Grieve Southgate
Sir David Alan Walker

Hugh Christopher Emlyn Harris, Esq
Pendarell Hugh Kent, Esq

The Minutes of the last Court, having been circulated, were approved.

There being no comments on the weekly figures, Mr Coleby spoke about the foreign exchanges including the Official Reserves figures for July, and the state of the domestic markets.

There were no items for discussion under the weekly executive report.

In introducing the discussion on the Report of Lord Justice Bingham on the supervision of BCCI, the Governor said that there were a number of areas where he would welcome the views of Members of Court.

The Bank was inclined to accept Lord Justice Bingham's judgements about our lack of reaction to warnings but was not disposed to accept that our supervisory judgements were inadequate.   Would Members of Court support that view?

Lord Justice Bingham had concluded that it could only be a matter of speculation what might have happened had all three parties, the Bank, Price Waterhouse and the Abu Dhabi authorities, been fully open and frank with one another. Therefore the Bank felt that it was right to have continued to work towards a solution that could have avoided closure until the full picture was available. Having read the Report, did Members of Court feel this was a sustainable position? The Bank accepted and was ready to implement the majority of Bingham's recommendations but the Governor said that he would welcome Members' reaction to those recommendations. Finally and more generally, the Governor asked what Members of Court thought would be the public reaction to the Report.

Before inviting comments from Members, the Governor asked Mr Quinn to speak about the likely timetable for publication of the Report and some of the preparations which were in hand.

Mr Quinn said that there was a desire to publish the Report as soon as possible after the summer holidays and 16 September was a probable date. However this would be subject to advice from the Law Officers. The Report was being examined by the Law Officers and by the Serious Fraud Office before any decision could be made on what could be published.

HM Treasury and the Bank were disposed to publish volume 1 "Banking Supervision 1972-92, Report and Conclusions and Recommendations" but not volumes 2, 3 and 4 which contained detailed narrative.

A joint Bank/HM Treasury Working Party had been established to prepare a co-ordinated, but not joint, response to the Bingham Report. The Bank was also preparing a response to the Treasury and Civil Service Select Committee Report on criticisms of the Bank which had not been dealt with in the Bank's earlier paper issued on 30 July.

It was still possible that legal advice would suggest that the Report should be published as a House of Commons paper after Parliament reassembled in October, thereby avoiding some of the legal problems. This may be resolved by end-August but in the meantime the Bank were assuming a mid-September date for publication and were planning accordingly. The Governor and the Chancellor of the Exchequer planned to meet early in September to review the Report of the joint Bank/HM Treasury Working Party.

Mr Quinn explained that the Working Party would prepare separate papers giving views on what could and should be published; a paper was being prepared in the Bank on changes that may be needed to legislation (on the duty on auditors to report; and on powers relating to unsupervisable structures, etc). Bank papers would also be prepared on developments in international banking supervision addressing the problems that had been identified by BCCI; and on the implications of BCCI for EC Directives.

Finally, Mr Quinn said that certain administrative changes in the way the Bank carried out its supervisory responsibilities would be made. It was proposed to establish a Special Investigation Unit and a Legal Unit. It was also proposed to introduce new procedures and guidelines for improved communication both within the Bank and with the Board of Banking Supervision and with other authorities and agencies in the UK and abroad. Revised decision-taking procedures would be introduced which would involve the Executive Director with responsibility for Banking Supervision and the Governors more directly. [redacted] Mr Quinn hoped that many of these changes would be in place by the time the Report was published in September.

Sir Colin Southgate said that he thought the recommendations were very sound. In his view and with the benefit of hindsight he felt that the Bank had never drawn together all the available information to get the full picture. Secondly, the Report suggested that the Bank was a rather trusting institution and perhaps a little naive on supervisory matters. It was appropriate therefore that supervisory staff should be more inquisitive. Thirdly, efforts should be made to improve communications within the Bank, in all directions, and finally, he strongly supported the proposal that if the Bank felt it was ever unable to supervise an institution effectively that institution should not be allowed to operate.

Sir David Lees agreed with the points made by Sir Colin Southgate. Additionally, he felt that steps should be taken to improve communications between the Bank and auditors, if necessary by introducing changes in the law as suggested by the Bank and endorsed by Lord Justice Bingham.

Sir David Walker endorsed Sir Colin Southgate's views and suggested that the Bank needed to be much more street-wise. The individual skills required for effective supervision differed from those of fine judgement and perception normally associated with central banking. In this respect he felt the Bank had a cultural problem. Communications were particularly important; with banking supervision a function of the Bank, communications on supervisory matters should not be restricted within that Division. Sir David also focused on the time that had been absorbed in international discussions and suggested that there was a danger of action being delayed because further discussions were imminent or pending. While discussions were valuable they were not necessarily effective in getting to grips with the situation and taking positive action.

Referring to the draft press notice, Sir David suggested that the Governor's comments on the Report should focus on the need for new additional powers - possibly even suggesting that had they been in place a few years ago, the problems of BCCI might have been avoided - and should also include a statement on the Bank's proposed action in establishing an Investigation Unit.

Sir Brian Corby also endorsed the earlier comments and said that the Bank should accept the recommendations. He focused particularly on the fact that there had been a considerable knowledge about BCCI in the Bank but it had not been pulled together. He also endorsed Sir David Walker's comments that the press notice should be more positive. Sir Brian accepted that the Bank's supervisory role only made news when it went wrong and he endorsed therefore the need to strengthen resources in this area. He also proposed that Court and the Board of Banking Supervision should be more involved in supervisory matters with problems being brought to their attention earlier and more frequently.

In response, the Governor said that the sheer volume of cases raised a problem in itself and posed the question of how much and when to bring such issues to Court, noting that that in itself was no reason for not doing so.

Sir Roland Smith questioned whether the proposed press notice was sufficiently robust to deal with the media. He suggested that it should be less apologetic and more positive.

Sir Adrian Cadbury felt that the Report had identified that the perception of some of the junior staff in the Bank was very much on the ball but that the organisational structure had not enabled these perceptions to be communicated to the right levels and turned into effective action. The area of internal communications, therefore, was something that the media would focus on in particular and the Bank should be robust in responding to it. He had also been particularly concerned at the enormous workload that had been generated in the case of BCCI and this pointed to the need to have resources of the right quality and in the right quantity.

In reverting to the press notice, Sir Colin Southgate said that whilst he was always impressed with the quality of the Bank's output he felt that it was often too long and too wordy: a shorter, sharper presentation would be more effective.

In taking up the comments on delegation Mr King said that one of the main complaints of staff in the Bank was that there was not enough delegation. In general terms therefore it would be a sad outcome if junior staff were unable to take decisions. However he accepted that there had been problems in this case and said that there was scope for improvement in this area. In focusing on the comments about the Bank's cultural problem, Mr Kent agreed that in the Bank generally there was a need for staff to have a greater appetite and hunger to pursue issues where things were not right. He also endorsed Sir Roland Smith's comment that the press notice was not sufficiently robust.

At the Governor's invitation, Lord Laing introduced the Annual Report and Summary of Audited Accounts of the Printing Works for the year ended 29 February 1992, together with a Summary of the Audited Accounts of Debden Security Printing Ltd for the same period, which were laid before Court.

Adrian Cadbury
13th Aug 1992.

Secretary. 13. Aug 1992.

A COURT OF DIRECTORS AT THE BANK

THURSDAY 13 AUGUST 1992

Present

Edward Alan John George, Esq, Deputy Governor
Sir George Adrian Hayhurst Cadbury
Anthony Laurie Coleby, Esq
Sir Colin Ross Corness
Andrew Duncan Crockett, Esq
Lord Haslam of Bolton
Sir Martin Wakefield Jacomb
Mervyn Allister King, Esq
Gavin Harry Laird, Esq, CBE
Sir David Bryan Lees
Sir David Gerald Scholey, CBE
Professor Sir Roland Smith
Sir Colin Grieve Southgate

Hugh Christopher Emlyn Harris, Esq
Pendarell Hugh Kent, Esq

The Minutes of the last Court, having been circulated, were approved.

Details of the weekly figures and graphs relating to the state of the foreign exchanges and the domestic markets, were laid before Court. Mr Coleby spoke about recent activity in the foreign exchange markets.

Under the weekly executive report the Deputy Governor confirmed that the publication of the Bingham Report was still scheduled for mid-September and that the extent to which it would be published rested with law officers who were examining it in detail.

Before asking Mr Kent to introduce the paper "Future of the City", the Deputy Governor invited Sir Peter Petrie, an Adviser to the Governors on European and Parliamentary Affairs, Mr Clark, Head of Financial Markets & Institutions Division and his colleague Ms Lawrie to attend Court for the discussion.

In introducing the paper, Mr Kent said that London was strongly placed to retain its place as Europe's premier financial centre but needed to address five principal issues covering the regulatory structure, legal and tax rules, major financial infrastructure projects, the maintenance of a well-trained workforce, and an acceptable location for the European Central Bank. The Bank was faced with a dichotomy in deciding its own role, namely between providing leadership or leaving the future to be shaped by market forces. Mr Kent felt that the right balance might be a bit of both, with leadership needed in the case of the infrastructure, eg transportation systems and payment settlement systems. The paper had been written from the perspective primarily of London's wholesale markets ie the intermediaries but it was important not to forget the fundamental raison d'etre of the financial system to intermediate funds from savers to the users of capital. The Bank's domestic role was often seen as relating primarily to the intermediaries, but it was important also that the interests of the users of the markets were properly served. There may well be an inherent tension between the City's international and domestic roles; for example, regulation designed to protect the individual might impair efficiency of the intermediaries wholesale business. The paper also brought out the issue of the location of the European Central Bank and suggested that this decision may not make much difference at least in the short term.

In the discussion of the paper, Sir David Scholey said that it covered the issues admirably except that it did not emphasise the sheer weight of the City within the UK economy, a relationship that was not found elsewhere except perhaps in the USA with Wall Street; this relationship set the City

apart as not just another financial centre. A further point which had not been covered was how the different interests in promotion and protection of the City could be mobilised and what the Bank's involvement might be. Promotion of the City was not handled particularly well by the relevant professional associations and it was an issue which required further thought. The fact that there was no single spokesperson or committee speaking for the City was one of its strengths but nevertheless it was important that efforts in this direction should be co-ordinated to attract business here. There was now a Treasury Minister with experience in, and responsibility for, the City and there was a need for better organisation to get across to him and Government the need to protect and promote the City. On the subject of regulation the concern from the outset had been the protection of the private investor rather than the professionals and this was an issue that needed to be addressed. Practitioners needed to make representation on this issue although there was perhaps also a role here for the Bank to speak on their behalf to Government. Generally, he suggested that the Corporation of London and major firms rather than the Bank should make the running.
Mr Laird commented that the financial services sector was very significant in terms of employment but the paper was all about competition and that would get tougher. We should look critically to see what else we could do and what we could do better. He was very surprised that the paper had made no mention of other UK cities in particular Manchester and Edinburgh. In focusing on the five areas identified in the paper as suitable for possible Bank intervention he suggested that the Bank's role should be one of co-ordinator, and that the Bank should take the initiative particularly in the areas of training and transport. He said that there was a tendency for London to accept and live with its problems. If cities like Barcelona could develop an efficient transport infrastructure surely London could too.

Sir Martin Jacomb supported fully Sir David Scholey's comments on the importance of the City within the UK economy;

it was on a completely different level from that in other European countries and it was important that this should be maintained. He was concerned however that there was a danger of complacency creeping into the City. We had for so long regarded and described ourselves as better than others and in doing so we had excited the ambitions of our competitors. There were also some issues which had done nothing to enhance London's reputation; the lack of support from the authorities on the Local Authority Swaps issue was a case in point. We were also vulnerable because, with the advance of technology and communications, there was less importance paid to physical location and the need to have a presence in London. Sir Martin also endorsed Sir David Scholey's comments on regulation and the failure of the present system to recognise different types of deal: there was a need for that to be corrected. It would also be excellent if London had a multi-currency settlement system for all types of transactions. This would certainly enhance London's reputation. Sir Martin went on to say that the location of the European Central Bank was a very important issue and he felt that the paper expressed a certain defeatism on this issue. The location of the ECB in London was very important particularly as financial institutions would want to be close to it.

Sir Colin Southgate said the paper demonstrated the City to be no different from other industry sectors in many respects. If the City was to secure its future it must keep moving forward on a number of fronts, legislation and regulation in particular. He was concerned however that there was some complacency in the paper about education: it was not as good as was assumed. The City had acquired extremely bright graduates by overpaying them but had not attracted the right mix of people and a mix of staff was required in every institution. At lower educational levels there was an appalling lack of quality and the City should do more to pressurise Government about the educational system. On the location of the ECB Sir Colin said that it was important that it should be located in London and we should work to secure this, but if it went elsewhere he would prefer it to be in a weaker rather than stronger financial centre.

Sir Roland Smith said that the financial sector had been successful but there was a danger in such situations of complacency setting in. It was a highly personalised business requiring personal and innovative skills but the question was how do you keep innovation going? It required education, training and social development. There was a major education problem and a need for a programme of education for the financial industry. He felt there was a strategic role for the Bank within the financial services industry and a persuasive role with respect to education and the development of system infrastructure.

Sir Colin Corness said that the City paid too little regard to its international customers compared with industry. The City could not expect them always to come to London so financial institutions should consider whether to stay in London or locate close to the customer. Legal and taxation aspects also needed to be addressed, particularly Advance Corporation Tax which had hit the industrial sector badly and could also affect the financial sector. Sir Colin Corness endorsed Sir Colin Southgate's comments about the poor standard of education and said that in the Nationwide Building Society it had been necessary to embark upon a basic re-education programme.

Mr Harris said that he had just received a draft of the Robson Rhodes Report prepared for the City and Inner London North TEC which was based on interviews carried out in 80 companies in the financial services sector. The findings suggested that firms lacked a clear sense of direction, that there was over capacity, that there was a surprisingly narrow perspective and no strategic direction for the sector, that there was public doubt about the feasibility of self-regulation and that there was a lack of world class leadership. In response, the draft Report suggested that the financial sector should establish an industry-wide body

to raise standards and promote the industry; the Government should appoint a team to sponsor the industry and also should ensure improvements in education and training. There should also be a review of the self-regulatory system, and professional associations should work with regulatory organisations to improve training.
Although the Report presented a rather gloomy view it did support some of the comments made by Members of Court. However the Deputy Governor suggested that if the report had covered another industry sector a similar result would probably have been obtained.

Sir Adrian Cadbury focused on two issues: he said that the UK generally and the Bank in particular had been slow to take action on modern technology which undermined the need for intermediaries and made location less important. Secondly, he said that the City had functioned on a "club" system despite the conflicts of interest that necessarily arose. However the City had expanded and that network could not take the strain. There was a need therefore to establish a new structure that was efficient and maintained standards and confidence.

Lord Haslam commented that the paper was extremely good but had said nothing about the interplay between the City and other industry sectors. He questioned how much of the City's financial activity was entirely free-standing rather than being on behalf of industry. He was also surprised that there had been no mention of Canary Wharf in the Report. He suggested that the City should have a view on whether Canary Wharf was desirable or not. He felt that there had been no leadership in stating the case for or against. So far as the ECB was concerned he shared Sir Martin Jacomb's view but felt that the inclusion of the "opt-out" clause might prove to be the decisive factor against locating the ECB in London. He felt that during the UK Presidency, the Prime Minister should work to reverse that decision and the Bank should help.

Sir Peter Petrie, commenting on the opposing views on the importance of the location of the ECB in London, said that he felt that in the short run it mattered particularly to the ECB to be in London as there could be operational problems if it was located elsewhere. In the long run however, the advantage would be for the UK. Sir Peter said that the City had to justify its pre-eminence by its actions not by words - it was its competitive edge that counted - it either had it or it did not. He pointed to the different approach of the City and other European financial centres. In an article in the Financial Times that day it had been suggested, albeit on the political front, that the French system was based on power, the German system on law and the federal concept, and the British on common law and common sense. The latter was harder to formulate and harder to sell. But this difference in style could be applied equally to the financial sector and so we had to demonstrate that we had a system and that we believed in it. Perceptions of the City were important both within the UK and abroad, and so public relations efforts should be conducted in both directions.

Commenting on the role of the Bank, Sir Peter said that the Bank had an advisory and supportive role in the Lord Mayor's campaign to secure the ECB for London. The theme was that London was pre-eminent and London was where financial institutions should locate. The campaign would be taken to Washington at the time of the annual meetings of the IMF and IBRD, when emphasis would be placed on London being the place to do business wherever the ECB was located.

Mr Kent said that although Sir Brian Corby was unable to be present, he had commented on the paper. Sir Brian had said that London had achieved its pre-eminence partly by accident, for example, because of the effect of regulations particularly in the USA and because of our trading experience over the past 200 years. But we needed to fight to retain this position since others would fight even harder to wrest it from us. Technology, to some extent, destroyed geographical considerations but it was very important for producers, more so than consumers, to get it right, partly because of the enormous costs involved. Sir Brian had also said that the insurance market needed a re-insurer of last resort, a role performed by Lloyds. From the insurance market point of view it need not be in London but it was important for the UK that it should be. His overall conclusions were that we must temper the ideal free market approach and fight harder in promoting our self interest. There was a role here for the Government and for the Bank, for example, in the field of export credit insurance.

Mr Kent went on to mention that the Bank had been approached recently by two chartered institutes seeking the Bank's advice on the limited appeal of single body professional qualifications and floating the need for wider qualifications for the financial services industry generally, perhaps through a grouping of the professional standard setting organisations. Subsequently other institutions had joined the debate and the views of Members of Court encouraged him to suggest that the Bank's co-ordinating role should continue in this area. There was an important need to co-ordinate the setting of professional educational standards with National Vocational Qualifications.

In commenting on the role of the Bank, Sir David Lees said that there were a number of areas where the Bank could make a useful contribution but it was dangerous to move away from areas of core business. However, the Bank could be proactive on key issues that were fundamental to the City, in particular Advance Corporation Tax, as mentioned by Sir Colin Corness, and export credit cover, where the UK was disadvantaged, the point raised by Sir Brian Corby.

Mr Crockett said that he did not think the City was complacent and agreed with Sir Peter's comments on difference in style compared to other financial centres. He felt there was a difference between what was said by the Bank publicly and in private. Maybe the tone of the Report reflected some of the more public comments. He felt that the other major

financial centres, particularly New York and Tokyo, did not spend so long considering their global position or what their central banks should do. London was concerned about Europe because of the European Central Bank issue and because European centres were becoming more competitive. Much appeared to be happening in Paris with efforts being directed to improve the City's reputation as a financial centre. The Bank's traditional view was that adopting a market-led approach achieved the best outcome. Mr Crockett felt it was best to use the markets' ingenuity but that the Bank may need to intervene more in certain areas particularly those of infrastructure and education. The Bank needed to find an appropriate dividing line between intervention and non-intervention but the Robson Rhodes Report was suggesting too much intervention.
Mr Crockett felt the location of the European Central Bank was important because, although new technology meant location was less important than in the past, practitioners do need to meet. If the European Central Bank were located elsewhere it might take with it other financial institutions particularly the Japanese. London would stand to lose less if the European Central Bank were located in a minor financial centre. He wondered if London could aspire to the New York Fed. role in the American style central bank system. If in negotiation the themes of conducting operations through the national central banks, and efficiency did predominate, London could gain disproportionately.

Sir Martin Jacomb agreed that it would be more of a problem for London if the ECB went to a major foreign centre. It was the international business that was crucial for London especially that of securities and foreign exchange. If London was the best, companies needing financial services would come here. However he felt there was a potential problem with London being so dominant in financial services and attracting the interest of foreign governments who might discourage their corporates from using London. So the more overtly London was promoted by the Bank and others as the pre-eminent European financial centre the more difficult it might be to attract or keep business here. Equally it was not necessarily in our interest to have harmonisation of securities regulation as that too might detract from London and business coming here. The Bank's role therefore should be in promoting to HM Government the importance of the financial services sector in the economy, in particular, the importance of the net earnings of the City and the substantial employment provided. The Bank also needed to emphasise to HM Government the difference between wholesale and retail regulation in financial services; the importance of export credits both to corporates and financial services intermediaries; the importance of tax policy especially ACT; and suggest the re-introduction of tax incentives for individuals at Lloyds. The Bank should also work on promoting the introduction of a multi-currency settlement system. This was a very important area in which we had the advantage. The Bank should also exert pressure on the Stock Exchange to restrict its involvement in commercial activities and focus on running the market. TAURUS had become a disaster.

In responding to Lord Haslam's comments on Canary Wharf, Sir David Scholey said that it was difficult for the City to have a view. The issues were simply whether the City wanted to finance it or occupy it and it was unrealistic to expect City firms to come down one way or the other. With respect to the future of the City, Sir David went on to say that because of its diffuse nature it was important that various views were taken into account, particularly those of non-British international institutions who were part of the structure. In this sense he felt that it was important to seek wider views.

In conclusion, Mr Clark made three main points: he questioned whether the City would be very different in the future and therefore whether it was possible now to find ways of measuring its success. Second, he accepted Sir David Scholey's comment that the paper omitted to discuss the role of professional representative bodies. He added that the Bank was currently involved with the futures and derivatives industry with the aim of helping them establish an appropriate professional body; and third, regarding ACT, the Bank was aware of the problem and had been involved in discussions with practitioners and the Revenue on the subject. He also apologised for the omission in the paper of the role played by cities such as Manchester and Edinburgh in financial services.

Adrian Cadbury.
27/8/92.

Assistant Secretary
27th August 1992

A MEETING OF DIRECTORS AT THE BANK SC0052

THURSDAY 20 AUGUST 1992

Present

Edward Alan John George, Esq, Deputy Governor
Anthony Laurie Coleby, Esq
Andrew Duncan Crockett, Esq
Mervyn Allister King, Esq
Sir David Alan Walker

Hugh Christopher Emlyn Harris, Esq
Pendarell Hugh Kent, Esq
Ian Plenderleith, Esq

The number of Directors assembled being insufficient to form a quorum, those present proceeded to the business, subject to ratification by the next Court.

The Minutes of the last Court, having been circulated, were approved.

Mr Coleby commented on the weekly figures and also spoke about the foreign exchanges and the state of the domestic markets.

Under the weekly executive report:-

1 With reference to the Minutes of the previous week and earlier, the Deputy Governor reported that the Working Group considering Real Time Gross Settlement for wholesale payments would report to APACS in September recommending such a system be introduced. The aim was that this should take place by the middle of 1995.

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[illegible]
Assistant Secretary
27th August 1992

Adrian Cadbury
27/8/92

A COURT OF DIRECTORS AT THE BANK

THURSDAY 27 AUGUST 1992

Present

Edward Alan John George, Esq, Deputy Governor
Sir George Adrian Hayhurst Cadbury
Andrew Duncan Crockett, Esq
Sir Christopher Anthony Hogg
Sir Martin Wakefield Jacomb
Mervyn Allister King, Esq
Gavin Harry Laird, Esq, CBE
Brian Quinn, Esq
Professor Sir Roland Smith
Sir David Alan Walker

Hugh Christopher Emlyn Harris, Esq
Pendarell Hugh Kent, Esq
Ian Plenderleith, Esq

The Minutes of the Court of 13 August were confirmed and those of last week's Meeting, having been circulated, were approved.

There being no comments on the weekly figures, Mr Plenderleith spoke about the foreign exchanges and the state of the domestic markets.

Under

1

2

The Deputy Governor, having declared his potential interest in the Court Pension Scheme together with those of Sir David Walker and Messrs Quinn, Crockett and King, invited Sir Adrian Cadbury to present a Report of the Trustees of the Bank of England Court Pension Scheme, together with the Annual Report and Accounts for the year ended 29 February 1992 which were laid before Court.

Mr Harris introduced a Report of the Trustees of the Bank of England Pension Fund, together with the Annual Report and Accounts for the year ended 29 February 1992, which were laid before Court.

In a discussion that arose from the presentation of these Reports, concern was expressed about two particular aspects. Firstly, the composition and role of the Trustees of the Staff Fund and, secondly, the use by Pension Funds of their votes in connection with the affairs of companies in which their funds were invested. The Deputy Governor said he shared the concerns that had been expressed, and it was proposed to take a fundamental look at these matters in light of the Goode Review.

In response to a question on why the investment performance of the Fund had been below average over the past eight years, Mr Harris undertook to provide Court with further information. In conclusion, the Deputy Governor asked members if they would advise him outside the meeting on the practice of including in the Reports and Accounts of both Funds detailed comments on investment policies. The Reports were semi-public documents and he questioned whether it was necessary or desirable for the Central Bank to make such comments especially when pensioners' receipts did not depend on the performance of the Fund.

Mr King presented the Economic and Financial Report for August. The news about economic activity during this month had been decidedly mixed. On the positive side, manufacturing output rose slightly in June, and had now risen for two consecutive quarters. The second quarter also saw an increase in non-oil output, the first for two years. Manufacturing investment rose in the second quarter. But these positive signs were accompanied by disappointing news on retail sales, which fell in July, and by a significant turn downwards in measures of consumer and business confidence. The figures on retail sales for this year had been revised and now showed a series almost completely flat for a year.
Survey measures of consumer confidence had now fallen back to the levels of the first half of last year, and the Gallup measure fell again in August, its third consecutive monthly fall. The Agents' reports from around the country were pessimistic; housing turnover rose in anticipation of the end of the Stamp Duty holiday, but there was as yet no sign of an end to falls in house prices. The growth of the monetary aggregates, as Mr Plenderleith would confirm contained mixed signals, and work in the Bank to weight together these different series according to their degree of moneyness - known in the trade as a divisia index - suggested that there had been a very rapid deceleration of money growth right through the year, which as yet showed no clear sign of reversing.

The counterpart to this uncertain outlook for aggregate demand and output was a more rapid fall in inflation than had been anticipated. In the absence of any new shocks, it was quite possible that both headline and underlying inflation would be close to 3 1/2% by the end of the year. The headline rate itself was already down now to 3.7% and there continued to be further downward pressure on inflation. The chart in this

month's Commentary showed that the retail sales deflator was currently below 3% a year.
The continuing fall in house prices, and the falls in share prices that had occurred over the last month, meant that there had been a significant drop in personal sector wealth. In turn, this made an early recovery in consumption spending less likely. Market interest rates had already risen significantly which made the outlook even more uncertain.

The nature of our predicament was clear. The mix between monetary and fiscal policy in Europe was being dictated by the balance between the two adopted in Germany following unification. The preferred course of action would be to change this mix by a collective decision of the member countries of the ERM. That, of course, was easier said than done. Any rise in base rates and mortgage rates that might follow a tightening of monetary policy in order to sustain our position in the ERM would in itself obviously be damaging to both confidence and activity. It would also, of course, lead to higher headline inflation in the short run. In those circumstances the case for compensating action on the fiscal front - provided it consisted solely of temporary measures - would start to appear more compelling than it had to date. But we might not have to cross that bridge. The underlying position remained one in which it will take time to reduce debt burdens.

Mr Plenderleith, in the absence of Mr Coleby, and in introducing the monthly discussion of monetary policy, commented that monetary developments had not been so dramatic as those in the markets. The latest monetary aggregates, for July, confirmed that the recent deceleration in monetary growth was flattening out.
Narrow money - notes and coins - had risen by 0.6%, the largest rise for 18 months. August was showing the increase continuing. There was not any obvious explanation; it was too soon to conclude that it was of any significance.
Broad money, M4, had picked up by 0.8% in July taking the annual rate up to 5.7%. The relatively respectable rate of

growth in July had been achieved despite little change in the level of personal deposits. Within M4, lending by banks and building societies had grown by 0.5%, continuing the somewhat more expansionary path evident since the election. But the composition was less comforting: the principal component of M4 lending in July had been lending to the personal sector for mortgages; this tended to conceal a fall back in corporate borrowing which, in turn, might reflect greater use of capital market funding by companies or that companies were not borrowing at all.
The performance of inflation was encouraging. The rate was declining and could reach 3 1/2% by the year end - but this would still be at the upper end of the best performance of the countries in the ERM. However, the case for monetary easing on domestic grounds was currently overshadowed by external disturbances: the immediate task, in the face of external pressures such as those that had been witnessed during the past few days, was to try to avoid the need for a rise in rates.

In discussion, Mr Laird said that the comments he had heard that morning on our financial position verged on complacency. He welcomed the way inflation was being tackled even though some steps were superficial. However, no mention had been made of the sucking in of imports nor the affect on our exporters of the strength of the pound in comparison to the dollar.
Professor Sir Roland Smith drew attention to the Agents' reports. They reflected the world we lived in with further shocks to come. There was a reduction in orders in the construction industry and the August sales of cars had been disappointing. Medium size firms as opposed to the large conglomerates were feeling a sense of frustration not knowing what they should do. Heads were down. There was frustration that the President of the Board of Trade had not highlighted the situation more. There was a particularly relevant point in the Agents' reports concerning the change in production systems. Once a company reduced its capacity it seldom if ever retrieved the position.

Sir Martin Jacomb said that experience in the high street showed there was no inflation in the cost of food or clothing - a situation which had been realised by the consumer. In a non-inflationary period people did not want borrowing on their personal balance sheets. The answer was an investment led recovery. A particularly worrying feature of the present situation was the weakness of the balance of payments at a time of deep recession.

In answer to the points that had been made Mr King said that the Bank had tried to be realistic in the comments they had made on the economy in the latest Quarterly Bulletin. There was, however, optimism on the question of inflation - both from the containment of costs and the rate of increase in earnings. But a period of sustained low inflation was outside most people's memories. We were seeing a flat economy and it was difficult to draw conclusions on whether we were witnessing a recovery or downturn. The hardest question arose over the significance of the balance of payments position. Doubts about the way in which the figures were measured made it difficult to judge the extent of our competitiveness.

RA Hoffman
Assistant Secretary
3rd September 1992

E.A.J. George
3rd September 1992

A COURT OF DIRECTORS AT THE BANK
THURSDAY 3 SEPTEMBER 1992

Present

The Rt Hon Robert Leigh-Pemberton, Governor
Edward Alan John George, Esq, Deputy Governor
Sir George Adrian Hayhurst Cadbury
Sir Colin Ross Corness
Sir Christopher Anthony Hogg
Gavin Harry Laird, Esq, CBE
Brian Quinn, Esq
Sir David Gerald Scholey, CBE
Professor Sir Roland Smith
Sir David Alan Walker

Hugh Christopher Emlyn Harris, Esq

[redacted] One of the administrative changes the Bank proposed in Banking Supervision Division was to strengthen the existing Legal Unit by appointing a senior lawyer to head the Unit with the rank of Adviser to the Governors. It was the intention that the Unit would be free standing with the head having direct access to the Governors and Mr Quinn. Two names were being considered for this position, [redacted]

The Bank also intended to set up a Special Investigations Unit. Two names were being considered to head this Unit. [redacted]

The Governor said the Bank would like to make the announcements when the Bingham Report was made public. However, this would not be until 19 October when Parliament reassembled, as the Government felt the Report could only be published under the Parliamentary Papers Act of 1840.

[redacted]

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The Executive Directors having joined Court, the Minutes of the last Court, having been circulated, were approved.

Mr Quinn commented on the weekly figures and Mr Plenderleith spoke about the foreign exchanges, including the Official Reserves for August, and the state of the domestic markets. He then went on to speak about the hurdles facing sterling. The Bundesbank Council were due to hold a meeting that day and the US unemployment figures, which could affect the dollar, were due to be announced the following day. The weekend would see an informal meeting of the Community finance ministers and Governors followed by the monthly meeting of Central Bank Governors in Basle. Both occasions would be seen by the markets as an opportunity when the realignment of currencies might be discussed. Against this background, we had been thinking how further to fortify sterling and as a result had developed an initiative in conjunction with the Treasury. Later that day, it would be announced that the Government was arranging to borrow the equivalent of ECU 10bn in a variety of foreign currencies. Half would be in the form of revolving credit already arranged with a group of banks led by the four main London clearing banks and the other half in the form of a programme of security issues to be made in the international markets. The intention of the arrangements was to demonstrate the Government's determination and ability to maintain sterling's position in the ERM at the existing central rate regardless of the outcome of the forthcoming French referendum on the Maastricht treaty. A further beneficial effect of the initiative would be that utilisation of the proceeds would reduce the amount of gilts the Government would need to sell to meet their sterling funding requirement.
We would face a difficult few days around the weekend and thereafter we could face further disturbance around 20 September depending on the outcome of the French referendum. It was the intention of the Chancellor to try to persuade the Community finance ministers at their weekend meeting to issue a communique that even if there was a no vote in France each member country would maintain its existing parities in the ERM. A courageous stance was being taken but we would need to be resolute to hold our line. The biggest risk to this stance could come from the pressure on the Italian lira.

There were no items for discussion under the weekly executive report.

With reference to a Minute of 6 August, the Governor introduced a number of papers which had been produced concerning the implications of the Bingham Report and on which he asked members for their views.

Taking the draft press release he said there would be some small changes in phrasing. He also drew members' attention to the paragraphs dealing with the Bank's proposals for changing the supervisory framework by a new Banking Act power to refuse or revoke authorisation on the sole ground that an applicant or authorised bank could not be effectively supervised and, also, an amendment to Section 47 of the Banking Act. The Governor said that the Government might be reluctant to legislate on these parts. If they decided against doing so the Bank could continue to operate without the proposed legislation and in any case Bingham had said our existing powers were adequate. The need not to make legislative changes could also prove helpful to the Government in maintaining their support for the Bank.

Sir David Walker commented that he felt it was important that we said an Investigations Unit and an in-house Legal Unit had been set up and that training was being undertaken as opposed to stating the intention to do so.

In looking at the Bank's further response to the Treasury and Civil Service Committee Sir Colin Corness felt it would be advantageous if the total of the number of banks we supervised was given in the section summarising the role of our power and remedial action. This would put the number of institutions we had helped over the years into better perspective besides illustrating the work load of the Division. Mr Kent was in favour of including such details in the press release as well although Mr Laird warned against the danger of these figures creating uncertainties in the banking system.

In considering the draft paper of the Bank's response to the Bingham recommendations the question was raised of whether or not the Bank needed explicit powers to refuse or revoke authorisation on the grounds that an applicant or bank could not be effectively supervised. As had been mentioned, Bingham had said the powers were there already and the Treasury would not wish to acknowledge any deficiency in the present legislation. In light of this if the Treasury Solicitor advised then an amendment was not needed we might have to accept that.

Mr Quinn mentioned that the draft papers responding to the TCSC and Bingham's recommendations were essentially working notes and not in final form. Their use was not yet clear.

In the context of the paper outlining the proposed administrative changes in BSD, Professor Sir Roland Smith enquired if in the event of litigation lawyers would be able to discover the documents. He was informed that, as regards most of the papers, a point had been made of recording that they had been prepared after legal advice, which we understood protected them from discovery.

Sir David Scholey asked if the Board of Banking Supervision had discussed their response to Bingham - which they had, much in parallel with Court. Sir David Scholey went on to say that he had identified a dichotomy of responsibilities between the Board and Court. He wondered whether the question had been addressed of the extent in future to which Court should be aware of the activities of the Board. The Governor responded by saying that it had but it was a question of how much we should put before the Board and how much before Court without adding unduly to the latter's workload. This had been a question that had arisen during the deliberations of the Court Working Party. The view had been taken that the role of the supervisors and the workings of the Board could impact on the Bank as a whole and therefore have relevance to members of

Court. As a result a more positive attitude had been adopted in keeping Court informed of supervisory matters. This point would be focused on again in the light of the Bingham Report and at the time of the annual review of the workings of Court.

G. A. Coghlan.   E. A. J. George

10th September 1992

Secretary

10th September 1992

A COURT OF DIRECTORS AT THE BANK

THURSDAY 10 SEPTEMBER 1992

Present

The Rt Hon Robert Leigh-Pemberton, Governor
Edward Alan John George, Esq, Deputy Governor
Anthony Laurie Coleby, Esq
Sir Colin Ross Corness
Andrew Duncan Crockett, Esq
Sir Christopher Anthony Hogg
Sir Martin Wakefield Jacomb
Sir David Bryan Lees
Brian Quinn, Esq
Sir David Gerald Scholey, CBE
Professor Sir Roland Smith
Sir Colin Grieve Southgate

Hugh Christopher Emlyn Harris, Esq
Pendarell Hugh Kent, Esq
Ian Plenderleith, Esq

The Minutes of the last Court, having been circulated, were approved.

Details of the weekly figures and graphs relating to the state of the foreign exchanges and the domestic markets were laid before Court. In view of the continuing pressures and general nervousness in the lead up to the French referendum on 20 September, Mr Plenderleith spoke about the foreign exchanges and explained that sterling had been under rather less pressure during the past week following the announcement of the Government's borrowing operation which he had mentioned to Court the previous week.

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The Governor spoke about the reaction of EC Finance Ministers and Central Bank Governors to the current situation at their meeting in Bath the previous weekend and of the discussions at the BIS monthly meeting of Central Bank Governors which followed in Basle.

Under [redacted]

1 [redacted]

2 [redacted]

3 The Governor reminded Court that the Rt Hon Michael Heseltine would be joining Members of Court for lunch on 24 September and that he proposed to suggest three particular topics for discussion on that occasion,

namely, the Government's attitude towards industry, industry's tolerance of Government policy during the recession, and Government policy on investment on infrastructure.

At the Governor's invitation:-

1 In introducing the paper 'EC Money Laundering Directive: Supervision of Bureaux de Change, Money Transmission Services' Mr Quinn said that the EC Directive would come into force on 1 January 1993. The Directive would require bureaux de change to maintain adequate systems and controls against money laundering and would require that bureaux de change and other money transmission services be monitored.

Government Departments were putting pressure on the Bank to assume this supervisory role but we were resisting. The Bank had little inclination to regulate bureaux de change because there was no real central banking or systemic banking reason for doing so and it would require a very different approach from that currently undertaken by the Bank.

The costs of undertaking this responsibility would be quite considerable too. There were thought to be some 1,000 bureaux de change in the UK and additionally there were other centres offering currency exchange facilities - such as those situated in airports, ports, railway stations, hotels and travel agencies, as well as unofficial Hawalla banking - that would be caught by the Directive.

In response to Sir David Scholey's question on the licensing of bureaux de change, Mr Quinn said that Government had assumed that licences would be issued to those institutions covered by the Directive; but it required only that suitable systems and controls should be put in place. There is a clear distinction between the two ideas. But Government had concluded that licensing would be needed in practice to enable monitoring of systems so that the necessary standards were maintained. Sir David Scholey suggested that one option might be to require each bureau de change effectively to be sponsored by a licensed bank in a way not dissimilar to the authority delegated to banks under the Exchange Control Act of 1947. But it was acknowledged that this would place a considerable burden on the banks who would have to ensure that appropriate systems etc were in place; and it would not necesarily exclude the Bank from ultimate responsibility given our statutory duties to supervise banks.

There was general agreement that the supervisory role in respect of bureaux de change was not consistent with the Bank's core purposes - although it was noted that some other EC central banks did undertake this function - and that the Bank should continue to resist taking on the role of supervising bureaux de change etc for compliance with the provisions of the EC Money Laundering Directive.

2 Before asking the Deputy Governor to introduce a series of papers relating to internal matters, the Governor invited Mr Rumins, the Head of Finance and Resource Planning Division, Mr Sweeney, the Officials' Development Adviser, and Mr Sharp, the Head of Personnel Division, to attend Court for the discussion.

In introducing the Bank's Statement: Purposes, Responsibilities and Philosophy, the Deputy Governor said that as agreed the previous year the Executive had considered the Statement and proposed a number of changes.

The two main changes proposed in the Statement of the Bank's Purposes were designed to reflect more accurately the Bank's role in promoting the efficiency and effectiveness of the financial sector in meeting the needs of industry, and to focus on the international work of the Bank as an integral part of the Bank's overall effort, but emphasising in particular the European dimension. Other changes in the statement of the Bank's Responsibilities acknowledged the Bank's commitment to

Equal Opportunities and the importance of Health and Safety in respect of its staff. The proposed change in the statement of the Bank's Philosophy directly reflected the comment in the Bingham Report on the need for vigilance.
Members of Court endorsed the value of the statement and supported the proposed changes, subject to some minor drafting amendments.

The Deputy Governor then focused on the Administrative Framework: Review of Priorities 1993/1994. He said that progress on the Bank-wide priorities established the previous year had been satisfactory. The main constraint had been in the context of the provision of technical assistance because of the lack of adequate people of the right calibre which, of course, had wider implications in the Bank. There was a particular need for 25-35 year old experienced analysts and the Bank was now looking to the recruitment of second jobbers to redress this position. Current staffing pressures facing the Bank were the subject of the Annex.
Looking ahead, those areas identified the previous year, the Centre for Central Banking Studies, Europe, the City, and Payment and Settlement Systems would continue to have high priority in the coming year as would the effective career planning for the generality of Bank staff. No entirely new areas of priority had been identified but there would be a number of important changes implemented in Banking Supervision Division in the wake of the Bingham Report, as discussed at Court the previous week.

In commenting on the current staffing pressures, the Governor posed the question whether the Bank had a public duty to consider the bottom line as first priority or whether there might be an overriding public duty to ensure adequate staff of appropriate calibre even if this involved running with extra staff from time to time. In the past the Bank had felt it right to run a taut operation.

Sir David Scholey said that the Bank's experience was common in that a cut back in recruitment inevitably led to staffing difficulties 5-10 years on and in his view there was no substitute for recruiting and training one's own staff. In this respect he felt that the Bank's training should be of the highest order.

In response to Sir Christopher Hogg's question whether the problem arose through an inability to recruit or an unwillingness to spend, the Deputy Governor explained that the present situation had arisen because of a number of unforseen circumstances, particularly the demands for technical assistance, because of past fluctuations in recruitment, and the loss of good quality staff through severance where the mix of voluntary departures had not been ideal. Our response to this situation would be to recruit regularly each year 25-35 graduates who met our standards. This might not be ideal on an annual basis but it could be a price worth paying to ensure that we could accommodate unexpected demands such as those for technical assistance and secondments to the European Central Bank. We could not compare with the high salaries available in the City. For the best staff, however, we could use the salary flexibility built in to the Scheme of Classification. Sir Christopher Hogg supported this line saying that quality should not be sacrificed for cost.

Sir Roland Smith noted that 50 graduates would be recruited in the current year and asked whether the Bank was geared to cope with this sort of intake in terms of training, development and career planning and in providing stimulating work. Mr Harris said that the graduate training programme was made up of different modules that could be undertaken on a flexible basis. This enabled graduates to be employed on live work from the outset and for them to take time off for training, hopefully but not always, at times convenient to the demands of the job. This policy however had influenced

the recruiting policy in that there was a need to have meaningful jobs available for recruits to undertake. Sir Colin Southgate said that the Bank should take on a steady number each year and that it should be perfectly possible to absorb 50 recruits into an overall staff of 4,000. It was important that they should pursue their training programme diligently and be subject to regular and continuous assessment. During recent visits around the Bank he had noted that the latter was working well in the Bank but he had also heard pleas by the staff for more frequent moves. Whilst he noted Sir Roland Smith's comments on the need to provide stimulating work, in the present conditions graduates were thankful to be employed.
The Governor suggested that some analysis might be appropriate to establish why graduates wanted to join the Bank - was it to be involved in public work and in the formulation of public policy? - and why some became disillusioned early on in their careers and then left. Mr Sharp said that the main reasons for departure had been identified as a lack of responsibility in the early years and a lack of the identification of a clear path ahead. Sir Roland Smith said that there was always likely to be a fall out after two years as staff learned a few things about themselves and their aspirations, and their working environment. Sir Colin Southgate endorsed that view and thought that the Bank's turnover rate was in fact too low.

Reverting to the priorities for the coming year, Sir David Scholey asked whether some of the problems identified in the Wholesale Markets Supervision Division and Registrar's Department were already known or were being flagged in anticipation? Mr Coleby responded that from WMSD's view the continuing financial situation would inevitably lead to the need for close and careful monitoring of a number of institutions. So far as the Registrar's Department was concerned, the Deputy Governor explained that over provision of capacity at Gloucester

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reflected the falling off in core registration business. This had been identified during the construction period but it had been decided to carry on with the building as planned to provide future capacity if the number of account holders should recover, or to let. So far as staffing was concerned, however, many of the staff were now on contract so their numbers could be run down if necessary. Distinct considerations applied to the Branches and options for closure had been considered in the context of the Banking Department review. But the case was not conclusive and to remove the uncertainties of continuous reviews it had been agreed to put the Branches question aside for a further five years.
Mr Quinn commented that although there was excess space at the Branches it was difficult and expensive to equip it for alternative use, and even more expensive to equip it for use by tenants.

The Deputy Governor introduced the paper on the Budgetary Framework for 1993/94 which set the context for the forthcoming annual budget round. He reminded Members that the financial framework which had been first presented to Court in 1990 had been based on three assumptions, full recovery from HMT for cash limited services, a gradual reduction in the real level of cash ratio deposits, and an adequate return on capital. When looked at originally this had produced a requirement for substantial real expenditure savings in some areas supplemented by a reduction of 1.25% across-the-board for five years. This formula had been applied flexibly with allowance made for added emphasis on particular functions and for new activities.
As the next budget round approached it was necessary to consider whether this framework was still appropriate and to decide on the level of savings for the new outline year, 1996/97. The annual financial estimates suggested that the financial objectives could be achieved without a further across-the-board reduction in real expenditure in this outline year. Accordingly the Executive had agreed

that a further across-the-board reduction should not be sought in that year. This would be a helpful signal to the staff that the Bank was not continually contracting. Court agreed that the framework continued to be appropriate and supported the termination of the taper in the outline year.

At the Governor's invitation, Mr Harris introduced the Equal Opportunities - 1992 Report, the first of an annual series, which focused particularly on the Bank's commitment to the Opportunity 2000 campaign which the Bank had joined in October 1991 and on a number of initiatives to help the disabled.
Sir David Lees enquired whether any targets had been set to measure equal opportunities particularly in respect of opportunities for ethnic minorities and women. In response Mr Harris said that the Bank was not setting numerical targets. Promotion opportunities would continue to be based on merit and in other areas staff were being encouraged to adopt flexible arrangements to accommodate the demands of home and job. The Deputy Governor said that he was reluctant to set targets but the initiatives described by Mr Harris would be monitored vigorously.

Finally Mr Harris introduced a Report on Health and Safety 1991/92 and explained that this was his first Report to Court as the Director with personal responsibility for Health and Safety matters throughout the Bank.

David Scholey

G Jennell
Assistant Secretary
17 September 1992

A COURT OF DIRECTORS AT THE BANK

THURSDAY 17 SEPTEMBER 1992

Present

The Rt Hon Robert Leigh-Pemberton, Governor
Sir David Gerald Scholey, CBE
Anthony Laurie Coleby, Esq
Sir Frederick Brian Corby
Sir Colin Ross Corness
Andrew Duncan Crockett, Esq
Mervyn Allister King, Esq
Sir David Bryan Lees
Brian Quinn, Esq
Professor Sir Roland Smith
Sir Colin Grieve Southgate
Sir David Alan Walker

Hugh Christopher Emlyn Harris, Esq
Ian Plenderleith, Esq

The Minutes of the last Court, having been circulated, were approved.

There being no comments on the weekly figures, Mr Coleby spoke about the foreign exchanges and the state of the domestic markets.

[redacted] In the event, they had

encountered general understanding that the position had been unsustainable, the attempts to hold the line through intervention - probably at the highest level ever by a single central bank in one day - and through interest rate increases having demonstrably failed. It had also been recognised that a realignment of Sterling's bilateral rates within the ERM was not feasible given the impossibility of establishing a pattern of exchange rates which would be sustainable over the next two days and also appropriate for economic and financial management subsequently. Although pressed, the UK representatives had avoided any commitment as regards the timing or conditions for a resumption of ERM obligations for Sterling.

Once the UK position had been accepted, attention had turned to the position of other currencies. After discussion, it had been agreed that Italy should temporarily suspend ERM obligations in respect of the Lira and that the Spanish Peseta should be devalued within the ERM by 5%. The other countries represented at the meeting - all other members except Greece - had accepted a commitment to do whatever was necessary in the days prior to the French referendum on Maastricht to maintain their currencies within ERM limits. A resumption of ERM obligations for the Lira or Sterling would require prior formal application to the Monetary Committee.

E.A.J. George
24th September 1992

G. A. Coyle.
Secretary.
24 September 1992.

A COURT OF DIRECTORS AT THE BANK

THURSDAY 24 SEPTEMBER 1992

Present

The Rt Hon Robert Leigh-Pemberton, Governor
Edward Alan John George, Esq, Deputy Governor
Sir George Adrian Hayhurst Cadbury
Anthony Laurie Coleby, Esq
Sir Frederick Brian Corby
Sir Colin Ross Corness
Andrew Duncan Crockett, Esq
Lord Haslam of Bolton
Sir Martin Wakefield Jacomb
Mervyn Allister King, Esq
Gavin Harry Laird, Esq, CBE
Sir David Bryan Lees
Sir David Gerald Scholey, CBE
Professor Sir Roland Smith
Sir Colin Grieve Southgate
Sir David Alan Walker

Pendarell Hugh Kent, Esq
Ian Plenderleith, Esq

The Minutes of the last Court, having been circulated, were approved.

In commenting on the weekly figures and the state of the markets, Mr Plenderleith focused particularly on recent developments in the ERM. The dramatic events of the previous week - the devaluation of the lira, sterling and lira's subsequent withdrawal from the ERM, devaluation of the peseta and the result of the French referendum - had not defused the tensions in the market but had diverted pressure from sterling and the lira on to the remaining currencies of the ERM and the French franc in particular. Sterling had initially fallen sharply and although still in a precarious position was now holding at DM 2.55 - showing a depreciation of 8% from the ERM limit - helped by some supporting factors; some modest reflows into sterling, the focus off sterling and onto the French franc, and some temporary benefit with UK interest rates still higher than German rates. However these supporting factors could quickly vanish and, on the down-side, fund managers might well want to lighten further their sterling positions now that the currency was no longer in the ERM.

Within the ERM the main pressure was on the French franc, which had survived so far with the help of considerable intervention, an increase in short term interest rates, and visible assistance from the German Government and the Bundesbank, both in word and deed. This posed the question of why the French franc had survived when sterling had not. Apart from the support of the Germans a further factor was probably the apparent acceptability to public opinion in France of temporary increases in interest rates.

On the domestic front, as sterling steadied after its initial fall, it had been judged reasonable to accept the market's view that a cut in interest rates to 9% was justified. This had been implemented earlier that week but since then we had discouraged hopes of a further downward move in the near future. In the longer term, however, the markets were probably looking to the possibility of a further cut towards the end of the year.

In commenting on the fact that German support had been forthcoming for the French franc but not for sterling, the Governor said that at the recent meetings in Washington he had gained the impression that this derived from the time of our entry into the ERM when we had not observed the correct procedures - this was probably still being held against us.

At the Governor's invitation, Mr Coleby spoke about the policy implications of these recent developments. Dealing first with the immediate conjuncture he said that for many months the story

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had been one of a widening gap between output and capacity, continuing growth of unemployment and falling inflation. This provided grounds for wishing to ease policy. But monetary policy was constrained by membership of the ERM and we had therefore been looking for ways to compensate by easing fiscal policy.

Although the state of the economy had not changed, the ERM constraint on monetary policy had gone and as a result we could adjust the mix between fiscal and monetary policy. The depreciation in the exchange rate had already provided a form of monetary easing but its focus was narrow and we would prefer to see something of more general benefit to those parts of the economy that were suffering severely, for example housing and construction. Moreover, the lower exchange rate posed a greater threat of renewed inflation than, in present circumstances, did lower interest rates. The problem was that cutting interest rates was likely to push the exchange rate even lower, so it was not easy to judge how much scope there was for easing monetary policy by interest rate reduction without risking the ultimate objective of eliminating inflation. This week we had concluded that there was room for a cut of 1%; ideally this cut was just the first step but the timing and extent of any further cuts would depend on other elements, particularly the course of the exchange rate and the success of fiscal restraint.

Moving on to consider the framework for policy, Mr Coleby said that what recent events had again demonstrated was the fragility of basing monetary policy on a rule, because it might cease to provide as satisfactory a basis for the conduct of policy as initially supposed. In the absence of a reliable rule we were back to using our discretion, "taking everything into account", without too much precision in weighting the different elements. The problem with this, however, was that it was difficult to gain credibility for the approach of saying "trust us". A lack of credibility was reflected in a risk premium in the exchange rate and that in turn could seriously limit the scope for policy adjustment.

We were, therefore, now faced with the major task of building credibility for our policy. Some would argue for reverting to an exchange rate target by quickly rejoining the ERM, but this did not seem to be an attractive option, at least in the short term, while tensions remained on account of continuing high interest rates, particularly in Germany. We had accepted that situation in the short term, while it still seemed to offer medium term benefits, in the hope that a reduction in German rates would not be too long coming. While German rates remained at their present level and we reduced ours, the sterling exchange rate would remain depressed below an equilibrium rate for the medium term. There was therefore little attraction in an early return to the ERM.

We were currently looking to see whether analytical work might offer some guidance on the weighting to be assigned to the different indicators. In practice, however, it was unlikely to yield results of a sort that would be durable and form the basis for rebuilding credibility. The only concrete alternative, that of "trust us", was particularly unconvincing where the decision-makers were subject to political pressures. Therein lay the case, supported in the academic world, for giving the responsibility for monetary policy to an institution that was independent of political direction. In practice, that meant an independent central bank.

In commenting on Mr Coleby's remarks the Governor had three points to make: it had been generally accepted in Washington that even if the strength of the deutschemark were the source of tension in the ERM, the Germans could not be expected to operate against their country's best interest. If that was accepted then the whole concept of the ERM was questionable as it must have a main anchor or currency within it. Secondly, he said that at his recent meeting with the Clearing Bank Chairmen they had been unanimous in their support for a return to the ERM; and finally, when looking at the long term prospects for a reunified Germany, he suggested that there had been a general underestimate of the costs and it was likely, therefore, that the problems would persist for longer than many had thought.

Sir Martin Jacomb said that the UK would need to earn its way back into the ERM which would be long and hard. The UK problem remained our adverse balance of trade and policy needed to address this issue. Sir Brian Corby suggested that there was a fundamental systemic instability in the way we ran things - such as the system for house purchase whereby long-term assets were financed by short-term liabilities - in comparison with other European countries. He suggested that we should perhaps look critically at how our system operated. He too was also concerned about the tensions in Germany and the problems of Eastern and Central Europe.

Sir David Walker expressed concern that the impact on consumer spending of interest rate reductions might be ineffective because of a growing tendency to debt aversion and that such reductions could put pressure on the exchange rate. With softer monetary and exchange rate policy he suggested that there should be tighter fiscal policy and public spending on infrastructure etc should be conducted within an organised framework.

In response to Mr Laird's question about responsibilities within the ERM, the Governor said that perhaps too much emphasis had been placed on the fact that there had been no realignment for five years. On the other hand, the more flexibility that was built into the system, the less credibility there was that the commitments made within it would be upheld and endure.

Focusing on the role of an independent central bank, Sir Adrian Cadbury cautioned against the Bank being pushed into such a position at the present time without ensuring that it had sufficient power and authority to carry out its responsibilities.

Sir David Lees agreed that re-entry to the ERM was not plausible in the short term, not least because he felt our credibility had been damaged by our undignified exit from the ERM. On a policy framework, he suggested that on the fiscal side, Government

E. A. J. George
1st October 1992

G. A. Croughton.
Secretary. 1. October '92

A COURT OF DIRECTORS AT THE BANK

THURSDAY 1 OCTOBER 1992

Present

The Rt Hon Robert Leigh-Pemberton, Governor
Edward Alan John George, Esq, Deputy Governor
Sir George Adrian Hayhurst Cadbury
Sir Colin Ross Corness
Andrew Duncan Crockett, Esq
Lord Haslam of Bolton
Sir Christopher Anthony Hogg
Mervyn Allister King, Esq
Sir David Bryan Lees
Brian Quinn, Esq
Sir David Gerald Scholey, CBE
Professor Sir Roland Smith
Sir Colin Grieve Southgate
Sir David Alan Walker

Pendarell Hugh Kent, Esq
Ian Plenderleith, Esq

The Minutes of the last Court, having been circulated, were approved.

There being no comments on the weekly figures, Mr Plenderleith spoke about the foreign exchanges and the state of the domestic markets.

Under the weekly executive report:-

1 With reference to a Minute of 10 September concerning the risk of litigation against the Bank following the publication of the Bingham Report on BCCI and a subsequent question from Sir David Scholey about the risk of litigation

against individuals, Mr Quinn said that he had been advised that the chances of anyone mounting a successful action against an individual were even lower than mounting one against the Bank.

The Banking Act 1987 provided explicit protection to individual members of the Bank, including Members of Court, for their actions in discharging their duties under the Act. It would be necessary therefore for potential litigants to be able to show either that the individual had acted in bad faith or that the acts committed before the 1987 Act had caused the damages claimed. In the latter case, it would be necessary to establish a duty of care owed by an individual as distinct from the Bank.

The position in other jurisdictions was less clear but probably not substantially different as a plaintive would probably have to show a relationship between a defendant's action and the loss suffered. All in all, the risk of an

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3 The Deputy Governor reminded Court that earlier in the year when discussing the Bank's Annual Report and Accounts he had said that negotiations continued with the Inland Revenue on the tax position in respect of wives accompanying their husbands on Bank business abroad.

Under the provisions of the Income Tax Acts, any expenditure paid by an employer in respect of an employee's spouse is taxable unless it can be shown to be wholly, exclusively and necessarily incurred in the performance of the employee's duties. The Revenue normally only allow such expenses to be paid free of tax if the wife acts as interpreter or secretary; acts as hostess of a series of functions throughout the trip; or if she has to accompany her husband because of his ill-health.

In the case of Bank travellers, none of these criteria currently apply and all expenditure is theoretically taxable. However, the Revenue have exercised their discretionary powers to make concessions and as a result have conceded the following which we now propose to agree:-

(a) They will not seek arrears of tax before the 1987/88 tax year although they could revert as far as 1983/84.

(b) They will ignore expenses of less than £500 per individual per year.

(c) They will allow a proportion of the expenses to be tax free, ie:-

For years to 1990/91	The Governor	60%
	The Deputy Governor	50%
	Executive Directors	25%
From 1991/92	The Governor	60%
	The Deputy Governor	50%
	Executive and Associate Directors	30%
	Senior Officials deemed to be representing the UK	20%

4 In commenting on the press reports earlier that day about the statement that had been issued by the German Embassy on behalf of the Deutsche Bundesbank, the Governor said that the Bundesbank had submitted a confidential brief to the German Ambassador and had asked him to make representations on their behalf to the Foreign Office and to HMT as they felt that their case had not been adequately expressed in the UK. The Embassy had subsequently released the text of the confidential briefing to the Financial Times.

Subsequently the Governor spoke to President Schlesinger who had expressed surprise that the document had been disclosed by the Embassy and said that he had tried unsuccessfully to withdraw it from publication in the press. Having explained to President Schlesinger that the Bank could not accept some of the facts expressed in the Bundesbank statement, the Bank sent them a document setting out our corrections: the Bank had also issued a brief statement to the press saying that we regretted that the Bundesbank had issued the statement, that we did not entirely recognise their version of events and that moreover we believed that the dialogue between central banks should take place in private and we would continue to observe that. We had hoped that the matter would rest there, as had the Chancellor of the Exchequer.

However, it transpired later that there was some dissension between the German Government and the Bundesbank about the status of the briefing prepared by the Bundesbank and we must await the outcome of the traditional press conference that would follow the Bundesbank Council meeting the following day.

Sir David Scholey asked whether recent events had adversely affected the personal and working relationships between the Bank and the Bundesbank. The Governor and members of the Executive confirmed that relations remained cordial, professional and effective and there was a determination on both sides that they should so continue. The Governor said that it would be appropriate and helpful for Members of Court to mention this to colleagues and contacts if challenged.

Court gave their approval to Sir David Scholey joining the Board of The General Electric Company plc as a non-executive director.

At the Governor's invitation:-

1 Sir Peter Petrie, Adviser to the Governor on European matters, and Mr Foot, the Head of European Division, attended Court for the discussion of a paper on possible developments in the European Community following the French referendum.

In introducing the paper, Mr Crockett said that there was a feeling in some quarters that the narrow result of the French Referendum might slow down the ratification of the Maastricht Treaty. However, he was persuaded that the majority of our European partners were determined to press ahead with ratification. Moreover, he thought that, while there would continue to be tensions, the ERM was more likely to survive than had seemed likely two weeks ago. Looking ahead, it was possible that if the UK and Denmark failed to ratify the Treaty, this might revive doubts elsewhere, particularly in Germany, of seeking to proceed so fast. But there might equally be pressure to move ahead anyway. In the meantime, if the UK was to adopt a negative position, there was a danger that we would not carry full weight in the Community.

Sir Peter Petrie thought that Maastricht would be ratified in some form. He identified several issues - notably subsidiarity - where the UK had successfully started a debate in the Community. Public opinion was moving behind us and we needed to build on that.

Sir David Lees felt that, currently, the UK could hardly claim to be "at the centre of Europe", especially if we were determined to delay ratification until the Danes had reconsidered their position. Ratification of the Maastricht Treaty was the key short-term issue.

Sir David Scholey asked whether it had become harder since the Treaty was negotiated for most member States to reach the EMU convergence criteria? Mr Crockett felt that for many member states the answer was "yes". But, while fiscal and price inflation developments had not been favourable, the criteria that really mattered could be met with sufficient effort by all member States except Greece.

Lord Haslam asked what was left of Maastricht for the UK if we were outside the ERM, opted out of the Social Chapter and favoured subsidiarity? He hoped that, on the last point, the UK would not take too parochial a view. Many questions, in particular, the environment and competition, could not safely be left to national level.

Sir Colin Corness asked why the UK was so keen to enlarge the Community? Mr Crockett said that the UK had always taken the view that the Community should be open to all European states which met the political and economic requirements. Most of the current applicants had relatively high income levels (which would help with budgetary problems) and in some respects - though this could be over-stated - held views similar to those of the UK.

Sir David Walker said that the Prime Minister's politically astute stance and his version of Europe had stood him in good stead for two years but these had been damaged by the events of the last two weeks. The UK now needed quickly to satisfy others that it had an economic policy that would

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Mr Quinn introduced the paper on "Small Banks".

The paper had been produced following a study to identify those institutions that might be at risk taking into account

the long-term effects of a lack of recovery in the economy and the continuing economic decline. Mr Quinn suggested that property was the key variable in determining the survival of many of these institutions with interest rates particularly important, in the sense that they would directly affect ability to service the loans and therefore the level of provisions, rather than property values directly. It was likely that there would be a number of wind-downs over the coming two or three years as any recession of this duration coupled with a collapse of property values was bound to take its toll. The main objective therefore would be to ensure that this happened in an orderly manner.

Sir Colin Corness said that the National House Price Index for September would be published shortly and would show that house prices had fallen sharply following the re-imposition of stamp duty at the beginning of the month. The continuing difficulties in the housing market would put great pressure on banks and building societies alike whose security was linked to house purchases. It had been hoped that house prices would recover but with the withdrawal of the temporary assistance with stamp duty, they had not been sustained.

Sir David Scholey said that if the current position continued, there would be an increasing likelihood of the Bank's support for these small banking institutions becoming known. Rather than this becoming public knowledge inadvertently, Sir David enquired whether thought had been given to the possible advantages that might be gained from it being known that certain banks were being supported by the Bank.

In response, the Deputy Governor said that there were a number of considerations. Hitherto the problem we had faced was essentially a liquidity problem associated with the withdrawal of wholesale funding and our judgment had been that nervousness would intensify if it was known that we had had to give support, though at some point the fact that we were prepared to intervene might have become positively helpful had a broader liquidity problem emerged. With reducing asset values the greater potential problem was now becoming one of solvency and we would not wish to convey the impression that we might be prepared to stand behind clearly insolvent banks. Our current judgement, therefore, remained that it would not be helpful at the present time for our support operations to become public knowledge.

Commenting on the banks referred to in the paper, Sir Colin Southgate noted that a number of the institutions were ethnic community banks.

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E. A. J. George

8th October 1992

G. A. Croughton

Secretary 8th October 1992

A COURT OF DIRECTORS AT THE BANK

THURSDAY 8 OCTOBER 1992

Present

The Rt Hon Robert Leigh-Pemberton, Governor
Edward Alan John George, Esq, Deputy Governor
Sir George Adrian Hayhurst Cadbury
Anthony Laurie Coleby, Esq
Sir Frederick Brian Corby
Sir Colin Ross Corness
Andrew Duncan Crockett, Esq
Sir Martin Wakefield Jacomb
Mervyn Allister King, Esq
Gavin Harry Laird, Esq, CBE
Sir David Bryan Lees
Professor Sir Roland Smith
Sir Colin Grieve Southgate

Hugh Christopher Emlyn Harris, Esq
Pendarell Hugh Kent, Esq
Ian Plenderleith, Esq

Details of the weekly figures and graphs relating to the state of the foreign exchanges and the domestic markets were laid before

With the agreement of Members of Court, Sir Peter Petrie, the Governor's Adviser on European matters, and Mr Tucker, the Governor's Private Secretary, attended Court for the ensuing discussion.

With reference to a Minute of 24 September, the Governor said that he welcomed the opportunity to continue the discussion on the policy implications of recent events in the markets. He drew attention to his letter of 28 September addressed to Members of Court where he had outlined a framework for the discussion; Lord Haslam's written response to that letter; the early draft text of a speech which the Governor would be delivering that evening; and a copy of a letter from the Chancellor of the Exchequer to Mr John Watts MP, the Chairman of the Treasury and Civil Service Committee, outlining a proposed framework for monetary policy to replace that previously provided by the ERM; the latter was being released to the press later that morning.

The Governor said that he and the Deputy Governor had been involved in discussions with H M Treasury in the preparation of the statement that the Chancellor proposed to issue. There were in fact two important points where their advice had gone unheeded by the Chancellor. First, the Bank had challenged the proposed objective of keeping underlying inflation within a range of 1%-4% as being unrealistic at this point in time. It represented a difficult target which would require a very heavy constraint on output or would be missed. The Bank's preference had been for a 2%-5% target range.

The second issue related to the proposition that it would be helpful to have some idea of the values of the growth of M4 beyond which there would be cause for concern, and the need therefore to establish monetary ranges for M4. The Bank's concern was that the range could be so wide that it would be meaningless or if it was more disciplined the target might again not be achievable, damaging credibility.

Finally, the Governor said that there had been a major difference of opinion on a point of principle. He was aware that many would argue that there was nothing new in the Chancellor's statement and that it did nothing to replace the framework of the ERM. In an attempt to rectify that, the Governor and Deputy Governor had sought to persuade the Chancellor to adopt an open attitude by introducing to Parliament and more widely, a regular report on progress towards reducing inflation. Early indications had been that the Chancellor was attracted to that idea but it had been deleted from the final text, probably on the grounds that it was early days for such a move and once introduced there could be no way back. Nevertheless, the Governor suggested that openness was an important issue and one that should not be lost sight of. It raised the question of the form in which any such report might be made - perhaps a public report on a quarterly basis - and indeed whether it should emanate from the Bank, H M Treasury, or be a joint exercise. A regular progress report seemed a very credible proposition so the real issue was how rapidly we might pursue it. In the immediate future opportunities would arise to bring the issue into the public domain when the Chancellor appeared before the Treasury and Civil Service Committee the following week, or when the Governor appeared later that month. These occasions would be followed by the Mansion House Speech which might also provide a suitable opportunity to express publicly the concept of open

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accountability for our policy to replace the structure afforded by membership of the ERM. The adoption of an open policy also had to be seen against the advocacy in various quarters for an independent central bank. As a tactical matter, it was therefore perhaps inappropriate for the Bank to press for such a change.

Sir Adrian Cadbury supported the move towards openness but said that the critical issue might be the origin of the report or statement and the need for it to have credible authorship.
In response, the Deputy Governor said that that was an important issue. There was in fact a spectrum of possibilities ranging from a report on the influences bearing on inflation to one which covered also the policy implications, prepared by either the Bank or the Government. A minimal, but still useful step would be a factual report by Government, whereas a policy paper prepared by the Bank would represent a major step towards independence. At this stage we might reasonably hope to advance to a factual paper prepared by the Bank; tactically it may be unwise to press for more than this.

Sir Brian Corby said that the British public lacked the will and discipline to press for price stability and he felt that openness would represent a sound way forward in educating them. He suggested that it might be appropriate to open discussions with H M Treasury to seek their views and see if they were prepared to move in that direction. He understood the implications this had for central bank independence but said that that would come about as we moved towards EMU and there was, therefore, nothing to be gained by pushing for it now. Nevertheless he suggested that following discussions with H M Treasury it might be possible to point up the issue in the forthcoming Mansion House Speech.

Sir Martin Jacomb fully supported the idea of openness particularly at the present time when confidence was at a low ebb. Such a move would help to improve the position. He suggested that one way of achieving a more open stance might be to publish retrospectively minutes of various meetings which would enable the Bank's views to be made known.

Sir David Lees felt that the move towards openness was a tactical issue and one on which the Bank should be cautious because of the independence issue. He suggested that it would be unwise to pursue this strongly at the present time and that it would be appropriate to wait until the Bingham Report had been published and the BCCI issue was less prominent. Focusing on the Chancellor's statement, Sir David said that in his view it would be seen as disappointing particularly because of its lack of substance on fiscal policy. It was likely to increase the debate taking place outside the Bank for greater independence of the central bank.

It having been noted that the text of the Governor's speech had been updated in certain respects, Mr Laird questioned the suggestion in the speech that inflationary pressures would remain subdued in the period ahead. It was his view that they would in fact build up on account of sterling's depreciation, a view shared by Sir Roland Smith who said that following a devaluation of 15% it would require an enormous squeeze on the economy to achieve inflation within the 1%-4% range. He supported Sir David Lees' comments on the lack of substance on fiscal policy and said that the public would be very disappointed that there was still no positive lead coming from Government.

The Governor said that this raised the question of the validity of the basic thrust of policy to bring down or reduce inflation as first priority leaving the productive side of the economy to take second place. Sir Colin Corness challenged that stance and said that in his view it was not right to go for minimal inflation with no regard to the consequences for the rest of the economy.
Sir Colin said that there were bound to be increasing inflationary pressures following sterling's fall because of our reliance on imports. He was particularly disappointed that in neither the Chancellor's letter nor the Governor's speech was there evidence of any new initiative or policy.

In commenting on the market's likely reaction to the Chancellor's letter, Mr Plenderleith said that he shared the view that there would be disappointment that the statement contained nothing new. The market generally had believed in the ERM and were now looking for something equally sound to replace it. However, he was hopeful that the Governor's speech which acknowledged that our entry into the ERM had been right, and that it had also been right to come out when we did, would be better received by the market.

Mr King said that it was important to distinguish between immediate economic measures and a framework for policy. As to the latter, comments from Members of Court had illustrated the need for openness in identifying and explaining policy options. The Chancellor's statement had spelled out an aim to achieve a rate of inflation in the long-term of 2% or less. For the current year, the range suggested by the Bank of 3%-5% was not unrealistic, but it was impossible to be confident that the various factors at work would keep inflation within a range of 1%-4% for the remainder of the current Parliament. It was vital to distinguish the long-term objective from the path downwards. By opting for a single range of 1%-4%, the Chancellor had combined two different things, with a risk that inflation might lie outside the target range. As to the impact of sterling's depreciation, Mr King said that it would have an effect but, given the position of the economy a range of 3%-5% for the next year represented the likely outcome.
As to the policy framework, the Chancellor's letter to Mr Watts offered a reasonable description of how policy was effected, not only here, but throughout the world. It was, however, important to address the problem of a wholly discretionary approach to policy lacking credibility. There were two ways of overcoming this: a track record of success, which would take time, and greater openness. Statistics were all in the public domain so why should the arguments not be brought into the public domain also. He felt that a greater degree of openness could have added considerably to the credibility of the Chancellor's stance.

The Governor said that the Bank had already done some work on a report on inflation which could be the basis of a quarterly statement. He suggested that this might be made available to Members of Court.

Sir Roland Smith said that he was amazed that while HMT's credibility was at such a low level they could produce an inflation objective of 1%-4%. He asked if they had a clear programme on how to keep to this objective if other factors changed. In response, the Deputy Governor said that it was neither the Bank's nor HMT's view that there would be an inflation explosion. Sterling's fall was a significant inflationary factor taken on its own but the depressed state of the economy would subdue those pressures. Furthermore, as the economy recovered, then so sterling could be expected to rise. The difference between target rates of 1%-4% and 2%-5% had to be seen in that context. The impact of the devaluation would put inflation outside the 1%-4% target so in our view a target of 2%-5% would have been better.

Sir Brian Corby said that the text of the Governor's speech did not accept that devaluation could be inflationary and it would be dangerous to ignore that risk. Sir Colin Southgate was concerned that the Chancellor's statement would further damage his credibility, and would do nothing to offer support or encouragement for the economy to move forward.

In focusing on the conclusions that might be drawn from recent events, Mr Crockett said that he agreed that an independent central bank was the best solution. Short of that, there were various ways of trying to impose a discipline on the political decision makers. One was monetary targets, but we had tried that and they did not work on account of their unreliable relationship with money GDP. The ERM was another source of discipline and Mr Crockett remained of the view that it was not in fact a bad framework for us, although the UK had happened to join at the worst possible time on account of the German situation. He would prefer that we now adopt an open-minded attitude, stating clearly that the ERM was the best framework for us, and that when Germany had overcome its problems it would be appropriate for the UK to seek re-entry.

Sir Brian Corby said that Court had discussed advancing capital expenditure as a way of regenerating the economy, but HMT did not draw a distinction between current and capital expenditure as did other businesses. The approach the Government adopted was very out of line. Mr Laird said he was particularly concerned that the new government was not prepared to make hard decisions now at the beginning of their period of office. The Government was seen by many as being quite rudderless and there was no confidence that they knew where they were going or what they were hoping to achieve. Government seemed unwilling to help industry who had tried hard to be more competitive over recent years.

The Governor asked whether it would help for the Government to place priority on capital expenditure within its total expenditure and what the inflationary effects of that would be, and also whether Court felt that sterling should rejoin the ERM at some future point when the current imbalances were reduced.

Noting that he too saw a serious gap in the Chancellor's policy statement, Mr Kent said that he thought there would be disappointment in the real economy. Notwithstanding some views that balance of payments deficits did not matter provided they could be financed, he did feel that the persistent trade deficit illustrated a weakness in the UK economy whose cumulative effect could have a serious impact. He felt that, for European policy reasons, sterling should return to the ERM in due course, but the government should make a pact with industry. The government should show the lead with restraint on current account expenditure in the public sector, and urge industry to counter the second round inflationary effects of depreciation. Mr Kent said that, in relative terms, a priority should be given to capital expenditure by the government; good transport delivery systems were essential to an efficient economy and we certainly lagged seriously in this area.

Mr King noted the difficulties which had been experienced in the past with so-called "scientific measurements" of capital investment by government. Moreover, given the political difficulties of remaining within the global spending total, any attempt to provide special protection for capital expenditure would almost inevitably lead to a higher rather than a lower overall total given the pressures on current spending. Having said that, however, there were important questions in this area which needed to be answered. For example, raising taxes and increasing public expenditure, in order to maintain a capital expenditure programme, might give a net stimulus to the economy. There was scope for imaginative thinking.

Mr Laird suggested that such was the position that measures such as, say, a penny on income tax would gain support if it was seen to be in the interest to the nation. Sir Roland Smith, Sir Colin Southgate and Sir David Lees indicated their agreement.

Returning to the Governor's question about ERM entry, Sir David Lees said that immediate re-entry was not feasible but that the entry should not be closed out for the future, he therefore fully supported the position taken by the Governor in his speech.

Sir Martin Jacomb indicated that he also agreed but he was concerned that problems had arisen from the ERM coming to be seen as a stepping-stone to EMU - and that is a permanently fixed state of exchange rates - rather than as a fixed but flexible regime. The Governor agreed with this but noted that any decision to realign could damage the credibility of the system and therefore it was a difficult matter of judgment. The important thing was to monitor the economic performance of the members of the mechanism to see what was sustainable over time.

Moving on to the operation of monetary policy in Stage 3, Mr Crockett said that in view of recent events the timetable, which provided for Stage 1 of EMU to give way to Stage 2 on 1 January 1994 when the European Monetary Institute would assume its functions, and the move to Stage 3 by 1 January 1999, seemed perhaps artificial. However, the Bank continued to be involved in sub-committees in Basle working towards the setting up of the EMI and a single monetary policy once Stage 3 became effective.

Mr Coleby said that the paper before Court explored the options for formulating monetary policy, and the likely options for conducting monetary operations, in Stage 3. We needed to develop views on the monetary arrangements that would be best suited to achieving the objectives for the European Community as a whole, and to identify how best to serve UK interests at an operational level. At present, most ERM countries followed a simple policy rule of maintaining a pegged exchange rate against the Deutschemark. In Stage 3, for the community as a whole such an approach would require pegging to something outside the ERM, such as the US dollar, which was not a realistic option. The approach to policy formulation would therefore have to be closer to that currently adopted by the Bundesbank, which relied heavily on broad money targets. Our own experience put in doubt the wisdom of expecting such an approach to be viable and we ought to be able to make a valuable and distinctive contribution to the debate, though in all probability being in a small minority. At an operational level it was our objective to find a framework which allowed transactions to migrate to the most effective and efficient markets, and to ensure that London was that market. But we had not so far identified now to do that in a satisfactory way.

In response to a question from Mr Laird, the Governor said that national governments would continue to be responsible for fiscal policy but the ECB would set monetary policy for the Community. Mr Coleby said that the centrally determined monetary policy would very probably incorporate an official objective for interest rates, which would need to apply in an identical way in all financial centres in the community. A requirement for the single area was that all financial centres were linked by a same-day money payments transfer system.

The Governor said that the EMI would come into operation on 1 January 1994 and would look very much like the existing Committee of Central Bank Governors. That body had been charged with working out the details for the European Central Bank so that when the time came there would be a smooth transition from the EMI. Even though the UK were not in the ERM we would still be members of the EMI.

Sir David Lees asked whether the ratification of the Maastricht Treaty meant that we must move towards independence for the Bank. The Governor responded that this would be necessary in the later stages of Stage 2 if we wished to go to Stage 3, when statutory independence of central banks was a requirement. This would entail amendment to the Bank of England Act 1946 but such amendments were not necessary in order to make progress towards that objective.

Sir Peter Petrie said that in political circles support was increasing for a change towards the independence of the central bank within as little as the next six to eight months, though opinions still differed about the precise form such an independent body should take. As regards the ERM, the dominant impression at the Conservative Party Conference in Brighton, and probably elsewhere, was of confusion and a hankering for firm leadership. There was a desire for people to have the position explained clearly to them and in that context the Governor's speech that evening would be timely. To those outside the UK, our short-term political problems seemed less important than the apparent lack of investment in training, research and the industrial base.

Sir Roland Smith asked whether the events of the past three weeks had been reflected in a tougher attitude by our European partners towards UK participation in Community projects. Mr Crockett said that in practice there had been some sympathy for the UK and an acceptance that we had had no alternative but to leave the ERM. However, it remained up to us not to distance ourselves from the European Community.

E.A.J. George
22nd October 1992

[illegible signature]
Assistant Secretary
22nd October 1992

A MEETING OF DIRECTORS AT THE BANK

THURSDAY 15 OCTOBER 1992

Present

The Rt Hon Robert Leigh-Pemberton, Governor
Edward Alan John George, Esq, Deputy Governor
Anthony Laurie Coleby, Esq
Mervyn Allister King, Esq
Sir David Alan Walker

Pendarell Hugh Kent, Esq

The number of Directors assembled being insufficient to form a quorum, those present proceeded to the business, subject to ratification by the next Court.

The Minutes of the last Court, having been circulated, were approved.

There being no comments on the weekly figures, Mr Coleby spoke about the foreign exchanges and the state of the domestic markets.

E.A.J. George
22nd October 1992

Assistant Secretary
22nd October 1992

A COURT OF DIRECTORS AT THE BANK

THURSDAY 22 OCTOBER 1992

Present

The Rt Hon Robert Leigh-Pemberton, Governor
Edward Alan John George, Esq, Deputy Governor
Sir George Adrian Hayhurst Cadbury
Anthony Laurie Coleby, Esq
Sir Frederick Brian Corby
Sir Colin Ross Corness
Andrew Duncan Crockett, Esq
Lord Haslam of Bolton
Sir Christopher Anthony Hogg
Sir Martin Wakefield Jacomb
Mervyn Allister King, Esq
Gavin Harry Laird, Esq, CBE
Sir David Bryan Lees
Brian Quinn, Esq
Sir David Gerald Scholey, CBE
Professor Sir Roland Smith
Sir Colin Grieve Southgate
Sir David Alan Walker

Pendarell Hugh Kent, Esq
Ian Plenderleith, Esq

The Minutes of the Court of 8 October were confirmed and those of last week's Meeting, having been circulated, were approved.

There being no comments on the weekly figures, Mr Coleby spoke about the foreign exchanges and the state of the domestic markets. At the invitation of the Governor, he went on to comment on the latest reduction in interest rates and the current policy debate. There had been an entirely respectable economic case for the previous Friday's cut in rates from 9% to 8%: in essence, this was that inflationary pressures in the short run were sufficiently quiescent that stimulus in this form was consistent with the long-run objective of getting inflation down. There had been a valuable move towards greater openness in explaining decisions, through the issuing of a press release in the Chancellor's name setting out the case, and stating that the cut could and would be reversed if inflationary pressures reappeared. The Bank had envisaged base rates coming down fairly quickly to 8% after sterling's exit from the ERM, but the timing had not been of our choosing. We had been and remained fearful that it would be damaging to the credibility of policy, and particularly to confidence in the foreign exchange market, for policy moves to be made at a time when the influence of extraneous political factors was obviously so strong. The market could see that influence clearly enough in this instance and, in the circumstances, it was surprising that the fall in the exchange rate had not been greater: this was probably attributable to the accompanying increase in expectations of cuts in German interest rates.

The markets have read the latest developments as indicating a significant change in the policy stance, encouraged in this interpretation by statements from Westminster, notably from the Prime Minster. This had put in question the new framework for policy set out by the Chancellor to the Select Committee, which would now have to be clarified by the Autumn Statement, due next month. The Statement must, in any event, announce decisions on public spending plans and reveal their implications for fiscal or borrowing decisions. The challenge to be addressed was how best to stimulate the economy in the short term without damaging objectives for the longer term. While lower interest rates would go most directly to the source of the problem as the Bank analyses it - debt deflation - they would be slow-acting and would risk a rise in inflation through a weaker exchange rate, especially if confidence in the policy framework were weak; thus the scope for further interest rate cuts remained sensitive to the prospect, and realisation, of cuts in German rates. If quicker-acting measures were desired, thoughts might turn to providing stimulus in different ways for instance through public investment.

Inviting the comments of Directors, the Governor indicated that these would be particularly helpful in framing his Mansion House speech next Thursday.

Sir Martin Jacomb said that the interpretation of business and the markets was likely to be that, because of the debt overhang, control of inflation was no longer the priority. He was in no doubt that policy had changed but was very concerned about PSBR financing and the trade balance. Concurring, Sir Christopher Hogg suggested that this highlighted the need for monetary policy discipline, whether monitored through regular statements or enshrined institutionally.

Lord Haslam welcomed what he saw as a change of focus to economic growth rather than inflation, though the policy stance was still confused. In his view, sterling was now affected as much by the weakness in the economy as by interest rates. There would never be a safe time to reduce interest rates to the level needed to get the economy moving but it was not an option to carry on in a quasi-ERM mode: what was happening in Germany was a factor but not an overwhelming one.

Sir David Scholey highlighted the need to distinguish between strategy and policy, citing inflation as an example. He agreed with Sir Martin Jacomb's interpretation but said that it would be wrong and damaging not to make it clear that inflationary pressures would be resisted in the medium term. There was a clear need for wage restraint in the public sector, which had not matched industry and business in improving efficiency.

Responding to a question from Sir David, Mr Crockett said that the Bank had had no specific discussions with the Bundesbank on the possible scale and pace of interest rate reductions in Germany. He agreed that the German authorities and business had perhaps been slow to recognise the deterioration in the German economy but now saw evidence, at least among the Bundesbank Direktorium, of a willingness to look at a wider range of indicators and at the scope for interest rate cuts.

Agreeing with Lord Haslam's analysis, Sir David Lees was concerned about the sharp downturn in business confidence. In the short term, the deterioration in the economy rather than inflation should be the main concern. The impact of deflationary factors was such that there was little danger of a surge in inflation or pay. Even lower interest rates and a public sector capital spending programme were needed to rebuild confidence.

Noting that short term interest rates in the UK were 150 basis points lower than in Germany, Sir David Walker suggested that the current exchange rate stability may prove fragile. While the debt overhang, which will only be dealt with through lower servicing costs, also affects the United States and, to a lesser extent, France, it is not a factor in Germany; this may mean that the likelihood of help from cuts in German interest rates could be overstated. He saw a need for a focus now on fiscal policy, cutting current spending but safeguarding capital projects.

In responding to a request for the Bank's view, Mr King noted that while the UK was clearly suffering from debt deflation, the actual signals from the economy were mixed. Against this background, it was difficult to judge the right level of interest rates - and difficult to bring rates down if there was no belief they would be raised in future if necessary. The balance between monetary and fiscal policy needed to be right, with a clear distinction between current and capital spending. While Sir David Scholey's observation on the need to distinguish between strategy and objectives was valid, the practical difficulty was to combine a current stimulus with strategy for monetary policy and balanced public finances in the medium term.

Agreeing that the short-term imperatives were in conflict with medium to long-term requirements, Sir Brian Corby suggested that there was need for a more open debate on policy options and for the Bank to be more open in its comments.

The Governor, in concluding the discussion, suggested that it would be timely for Court to discuss a paper on the independence of the Bank. While the issue was straightforward in some ways, there were a number of difficult questions which the paper might address including the answerability of an independent central bank; whether it would be appropriate to continue as the centre of Banking Supervision; and the composition and role of Court. Directors welcomed the proposal for such a paper, which might displace previously-planned items at a long Court before the end of the year.

Under the weekly executive report:-

1 The Governor spoke briefly about the arrangements for

2 [redacted]

3 Mr Plenderleith spoke about the setting up of the Financial Law Panel. The report of the Legal Risk Review Committee, set up by the Bank in April 1991, would be published on 29 October. While the Committee had concluded that the legal underpinning of the UK wholesale financial markets was basically sound the report included a number of

recommendations, most importantly for the establishment of a permanent new body of market and legal practitioners - the Financial Law Panel. Lord Donaldson had agreed to chair the Panel. Before the report was published the Bank would be looking for the support of some 125 City firms; this should ensure that the Panel was seen to have wide backing. In response to a question from Mr Laird, Mr Plenderleith confirmed that the report recognised that the different legal system in Scotland was a matter which the Panel would have to address.

Court gave their approval to Professor Sir Roland Smith joining the Board of the Medical Defence Union Ltd.

At the Governor's invitation:-

1 In introducing his Report to Court in his capacity as Chief Registrar, Mr Bridger said that, having successfully overcome the challenge of relocation itself, the Department was now in a phase of consolidation: the focus was on achieving improved productivity and service levels with the mainly less-experienced staff now in place. For the future, managing the further contraction of the Department - at a faster rate than had been anticipated - was the key issue. Because of a rather more rapid decline in work volumes coupled with greater efficiency, surplus capacity in accommodation, computing systems and staff was already emerging. Options for consideration to utilise this overcapacity included seeking to take over the National Savings Stock Register and also, taking advantage of the lower costs at Gloucester, other Bank work from London. The spare accommodation was on the market while the future direction of the Department's computer services was being reviewed. The fact that substantial numbers of staff at the junior end were on fixed-term contracts could also give some room for manoeuvre.

Responding to a question from Sir Adrian Cadbury, Mr Bridger said that the quality of staff recruited locally had been entirely adequate, while staff wastage at Gloucester was currently minimal.

Sir David Walker noted the Department was, prima facie, well placed to offer back-up and standby computer facilities to other local firms.

The Governor concluded by expressing his appreciation of the efficient way in which the relocation of the Department had been handled.

2 Lord Haslam introduced a Report of the Charitable Appeals Committee and noted that the number of appeals received in the year to date was some 25% higher than in the same period last year. He anticipated, however, that the Committee would be able to discharge their responsibilities within their current budget.

3 In accordance with the terms of reference of the Sealing Committee, the Minute Book of that Committee was laid before Court for inspection.

P. A. Hoffmann
Assistant Secretary
29th October 1992

E. A. J. George
29th October 1992

A COURT OF DIRECTORS AT THE BANK

THURSDAY 29 OCTOBER 1992

Present

The Rt Hon Robert Leigh-Pemberton, Governor
Edward Alan John George, Esq, Deputy Governor
Sir George Adrian Hayhurst Cadbury
Anthony Laurie Coleby, Esq
Sir Frederick Brian Corby
Andrew Duncan Crockett, Esq
Sir Christopher Anthony Hogg
Sir Martin Wakefield Jacomb
Mervyn Allister King, Esq
Sir David Bryan Lees
Brian Quinn, Esq
Sir Colin Grieve Southgate

Hugh Christopher Emlyn Harris, Esq

The Minutes of the last Court, having been circulated, were approved.

There being no comments on the weekly figures, Mr Coleby spoke about the foreign exchanges and the state of the domestic markets.

Under the weekly executive report:-

The Governor spoke about the reaction to the Bingham Report

The Governor said he was due to meet the Treasury Select Committee the following Wednesday to discuss the Bingham Report and there was also the prospect of a debate in the House, possibly on Friday week. The Governor concluded by expressing his appreciation for the support that had been received from the Treasury.

At the Governor's invitation:-

1 The Deputy Governor spoke about the Report and Accounts of BE Property Holdings Ltd for the year ended 29 February 1992, which were laid before Court.

2 Mr Harris went on to present the Report and Accounts of BE Museum Ltd for the year ended 29 February 1992, which were laid before Court.

3 Mr King spoke about the draft assessment from the November edition of the Quarterly Bulletin. It was the first Quarterly Bulletin since events leading up to, and the aftermath of, 16 September. The starting point, therefore, was the economic situation in Europe and the strains that existed in the ERM. The Assessment contrasted two consequences of German unification. Firstly, the ripple effect of increased demand in Germany on production elsewhere in Europe - which was naturally greater for neighbouring countries and diminishing in the periphery of Europe. Secondly, there was the domino effect, as the level of interest rates in Germany came to be seen as inappropriate for the state of domestic economies. Speculation about currency links led to higher interest rates, and in some cases, changes in exchange rates - as witnessed by Finland, Sweden and Italy and then 16 September.

For the UK, the problem was the imbalance between monetary and fiscal policy. This became increasingly severe as expectations of growth in the rest of the world were revised down. Over the past twelve months, the forecast for the level of world trade in 1993 had been revised downwards by no less than 6%. And in parts of the rest of the world, a debt deflation, similar to that occurring here, had been taking place in US, Japan, Scandinavia and Australia. Our problems were clearly much closer to those of this group of countries than to the continent of Europe.

Inflation was falling faster than had been expected. The published measure was coming down slowly and steadily if one looked at the measures of inflation over a shorter period. Outside the ERM, therefore, there was an opportunity for the UK to change the mix between monetary and fiscal policy. There had already been changes in this mix. The UK now had the lowest short-term interest rates in Europe but long term interest rates were still higher here than in either Germany and its group of satellite currency countries or France, reflecting expectations of higher inflation in the UK than in other countries in the medium-term.

The main problem in the UK at present was the enormous uncertainty about economic prospects. There was clear evidence of a downturn in the economy. House prices were still falling - down 7.5% on a year ago; employment was falling faster - there were 100,000 fewer jobs in manufacturing; vacancies were falling; the growth rate of credit and M4 lending was falling - the level of M4 lending actually fell in September. And, of course, sharp falls in business and consumer confidence across the board in all surveys with the latest CBI quarterly trends showing a change in the balance of general business optimism from -9% in July to -23% in the survey results announced the previous Tuesday. The main problem lay in the household sector where debt burdens had not yet fallen significantly. There had been some fall in income gearing but no fall in capital gearing. However, some indicators pointed in the opposite direction. Retail sales had been on a clear upward trend for the past few months. The latest statistics from the US showed that GDP in the third quarter grew by 2.7% at an annual rate rather than the 1.5% that was expected.

Interest rates in Europe, generally, were on a downward trend and market interest rates in Germany had fallen by around 1% recently. The impact of the fall in the effective exchange rate of sterling - some 12-14% - and the reduction of interest rates of some 2% already had not yet had time to take effect.

When these indicators were put together with the difficulty of knowing the quantitative impact of higher debt burden - the debt deflation story - it became especially difficult to make any sensible prediction of the evolution of demand and output over the next year. This implied that whatever policy measures were taken, we must be ready to tighten monetary policy if demand started to rise quickly - in order to prevent the upturn in inflation which is the possible consequence of the monetary policy easing, especially the fall in the exchange rate, that had followed the events of 16 September.

Mr King concluded by saying that there was a new framework for policy - inflation targets - together with a greater openness.

The Governor endorsed Mr King's comments. Referring to his appearance before the Treasury Select Committee the previous day, he said it was important to question whether or not there had been a sea change in policy as evidenced by the Prime Minister's move for growth at all costs. The key question was whether we would be courageous enough to recognise when it might be necessary to tighten monetary policy. Also, after recent events, would the Government be able to retrieve its credibility for policy management.

4 Following on from Mr King, Mr Coleby said that the September money numbers illustrated the difficulty of judging with any precision where the economy was headed.

Narrow money, notes and coin, had continued their recent strong growth with September showing an increase of 0.3% to

produce annualised growth over the quarter at 5 1/4%. It looked as if there would be further growth in October of 0.5% preserving the 3 month growth rate and taking the 6 month rate above 3 1/2%. This seemed not only to support the upward trend in retail sales already being observed, but to imply that it was continuing.
Broad money by contrast was giving further evidence of the depressed state of the economy. This was less so in the aggregate itself, which was flat on the month and showed a year on year decline from 5.5% to 5% - perhaps a rather smaller decline than might have been expected in view of the exchange market activity but was conspicuously so in the lending counterpart. The absolute fall in lending on the month was unprecedented and the year on year figure had come down from 5.2% to 4.6%. This seemed to provide strong support for the debt deflation hypothesis.

In commenting on what had gone before Sir Martin Jacomb said there were two points he wished to make. Firstly, would the political resolve be there when inflation re-emerged? Verbal assurances were not sufficient, specific action was necessary. Secondly, the position shown by statistics did not always match up to actuality - as the man in the street was only too well aware. It was critical to be able to identify, for instance, the moment when house prices stopped falling and the public regained confidence. It would be helpful if some way could be found of identifying when such changes took place - particularly those in the retail sector. Subsequently, Mr King said consideration had been given to this point, with which he agreed entirely, but it had not been possible to identify a sufficiently reliable source.

Sir Colin Southgate felt it was important to recognise that the manufacturing base in the UK had gone down in the past decade. Retailers now went overseas. This would lead to any consumer boom sucking in exports. He went on to say that increases in pay should be self financing and that more emphasis should be placed on the world trade situation -

many of the economies this country was dealing with were in a lousy situation themselves.

For his part Sir Christopher Hogg felt the general doom and gloom was being overdone. From a parochial viewpoint there was some good news. On fundamentals trade had improved; the benefits of cost control were still with us and there was also a sensible approach to the question of wage increases where it was accepted that these should not necessarily take place if they could not be paid for.

Sir David Lees found the level of confidence extremely low. He considered it was very important as monetary policy was eased for industrialists to say, and to say it now, that as we came into a recovery situation and the risk grew that inflation would revive, policy must be tightened.

There was endorsement of Sir Christopher Hogg's comments by Sir Brian Corby who felt there was a danger in overdoing the gloom, especially if we were not certain exactly what was happening.

E.A.J. George
12th November 1992

G. A. Croughton
Secretary.
12 Nov. 1992

A MEETING OF DIRECTORS AT THE BANK

THURSDAY 5 November 1992

Present

The Rt Hon Robert Leigh-Pemberton, Governor
Edward Alan John George, Esq, Deputy Governor
Anthony Laurie Coleby, Esq
Andrew Duncan Crockett, Esq
Mervyn Allister King, Esq
Brian Quinn, Esq
Sir David Alan Walker

Hugh Christopher Emlyn Harris, Esq
Ian Plenderleith, Esq

The number of Directors assembled being insufficient to form a quorum, those present proceeded to the business, subject to ratification by the next Court.

The Minutes of the last Court, having been circulated, were approved.

There being no comments on the weekly figures, Mr Coleby spoke about the foreign exchanges including the Official Reserves figures for October, and the state of the domestic markets.

G. A. Croughton
Secretary.
12 November 1992

E. A. J. George
12th November 1992

A COURT OF DIRECTORS AT THE BANK

THURSDAY 12 NOVEMBER 1992

Present

The Rt Hon Robert Leigh-Pemberton, Governor
Edward Alan John George, Esq, Deputy Governor
Sir George Adrian Hayhurst Cadbury
Anthony Laurie Coleby, Esq
Sir Frederick Brian Corby
Sir Colin Ross Corness
Andrew Duncan Crockett, Esq
Lord Haslam of Bolton
Sir Christopher Anthony Hogg
Mervyn Allister King, Esq
Gavin Harry Laird, Esq, CBE
Sir David Bryan Lees
Brian Quinn, Esq
Sir David Gerald Scholey, CBE
Sir Colin Grieve Southgate
Sir David Alan Walker

Hugh Christopher Emlyn Harris, Esq
Pendarell Hugh Kent, Esq

The Governor informed Court that Mr J G W Davies, who had been an Executive Director of the Bank with responsibility for Staff Matters from 1969-1976, died on 5 November.

The Minutes of the Court of 29 October were confirmed and those of last week's Meeting, having been circulated, were approved.

Details of the weekly figures and graphs relating to the state of the foreign exchanges and the domestic markets were laid before Court.

There were no items for discussion under the weekly executive report.

Court gave their approval to Mr Coleby joining the Board of Corpus Christi Development plc.

At the Governor's invitation and with the agreement of Members of Court, Mr Price, the Head of Economics Division and Mr Enoch, a Senior Adviser on monetary and exchange rate policy, attended Court for the ensuing discussion.

Mr King said that the announcement of the Autumn Statement later that day had prompted a change in the Court agenda and had provided a timely opportunity for Court to discuss the independence of the Bank, and in particular two main issues. First, the role of Court in furthering the debate and secondly the new openness of monetary policy announced in the two Mansion House speeches.
Three papers had been circulated. The first set out the arguments for and against independence of the central bank, and set out a list of questions that Members might wish to address. The second paper was a very brief summary of the announcement of the measures concerning "openness" at the Mansion House and the final paper was a draft of the Bank's new Inflation Report that was prepared in advance of discussions on this subject between the Governor and the Chancellor. The final product would appear for the first time the following February. In addition copies of the lecture which the Governor had delivered at the London School of Economics the previous evening had also been made available to Members.
The question of independence for the Bank had risen to the surface of political debate recently. Most editorials in the press were in favour of independence and it was important to note that this was not simply a reflection of the current political situation in this country. The arguments for independence were based on a change in the intellectual climate of opinion about how monetary policy should be determined, and reflected a movement throughout the industrialised world in favour of changing the institutional nature of the formulation of monetary policy. A necessary condition for success in our counter-inflationary policy was a widespread and accepted commitment to price stability. Speeches

such as the Governor's lecture the previous evening were part of that process. But it was not sufficient. Governments were tempted to exploit the short-term trade-off between inflation and output, and follow policies which were hence "time-inconsistent". Knowing this, it paid a government genuinely committed to price stability to try to precommit itself to such a policy. It did not, unlike Ulysses, necessarily have to tie itself to the mast of, say, a single monetary aggregate, but it would be better to delegate the job of steering monetary policy to a captain with a well-defined single objective of price stability. Delegating statutory responsibility for monetary policy to a central bank with that objective - and accountable to Parliament - was a time-consistent means of achieving the objective of price stability. And, since there was no long-run trade-off between inflation and output, there was no reason not to do so.
However, if responsibility for monetary policy were to be delegated to the central bank, what should be the structure for the governance of that central bank? It was crucial that there should be clarity about where responsibility for monetary policy lay. There were, at least, two possible models. The first was one in which responsibility was delegated to the Governor or Governors who were personally responsible for the conduct of monetary policy, as in New Zealand. The second was one in which responsibility rested with a council on which each member had one vote. This was obviously closer to the Bundesbank or Federal Reserve models, and the example of the full time governors of the Federal Reserve might be a possible example for the UK to follow.
The issues for discussion raised in the paper posed some questions concerning both the case for independence, the governance of an independent central bank, the way in which accountability should operate, the range of responsibilities for which the central bank should be responsible, and, last but not least, the role of Court itself in raising these questions for discussion outside the Bank.

Sir Christopher Hogg said that in the relatively short time that he had been a Member of Court he had come to question whether there was a contribution for Non-Executive Directors to make in the current circumstances. The main problem was the inadequately defined remit for the Bank, but a secondary problem was the way in which Court operated within that remit. This was not a criticism of the Bank - the problem with the remit was reflected in the Statement of Purposes, Responsibilities and Philosophy. The debate on independence provided the opportunity for Non-Executive Directors to make their collective views known. He suggested that the Non-Executive Directors might meet under the chairmanship of the Governor and produce a combined view for Government to consider, which might include the possibility that Court, as presently constituted, might cease to exist. Sir Christopher said that it was difficult to see how Court could be involved in advice on monetary policy because of the inevitable conflicts of interest. This pointed to a two-tier arrangement of the Executive and a Council. The composition of these bodies should depend on the precise remit.

The Governor accepted that it would be difficult for captains of industry to serve on the Court of an independent Bank but nevertheless said there was still a need for Non-Executive Directors to give advice. If the operation of monetary policy became the direct responsibility of a full-time Executive, that did indeed point to establishing a second body, and one without conflicts of interest.

Sir Colin Corness agreed with Sir Christopher Hogg. During his time as a Member of Court there had been a number of changes for the better but he felt there was still room for a wider opinion to be introduced to the Bank's decision making. It was a valid criticism of HM Treasury that they excluded the outside world from informing their decision-making processes and he would not want that said of the Bank.

Sir Brian Corby felt that the debate should go beyond independence and should consider the national viewpoint as well as that of the Bank. He accepted the logic of the Bank having independence from Government in the field of monetary policy. However this raised the question of whether this was compatible with retaining a supervisory role and suggested that it might perhaps be appropriate at this point to look at the future and examine all of the Bank's functions. He had become particularly concerned about the supervisory and monetary policy roles being carried out within the same institution now, although he had felt comfortable with this arrangement when he joined Court. In particular he felt that criticisms of the Bank as a supervisor would damage the reputation of the Bank generally and impair its authority in the operation of monetary policy. He suggested that it would be pertinent for the Bank to carry out a review now before others suggested it. The time was right with the prospective changes in Europe, an increasingly legalistic world, and a more open environment. In his view there was an inevitable conflict between the supervisory role and the concept of openness. If, after consideration, it was felt that supervision should leave the Bank, this could be done at the present time against the background of the Bingham Report. Sir Brian also commented on the improvements that had taken place in the operations of Court. The move towards more openness during his period of service on Court had been in the right direction. Members of Court were provided with much more information now than they had been in the past but he felt there was still room to pursue this further. In focusing on the appropriate system for the Bank to adopt in respect of the operation of monetary policy, he said that he felt uncomfortable with the system where one person had the ultimate responsibility as in New Zealand. His preference would be to provide a Council, prepared to defend their decisions.

Sir David Walker said that he very much agreed with the comments of his colleagues. He fully accepted the economic logic of the case for a monetary policy authority being independent of the Government and felt that the central bank was the best agency to take on this responsibility. So far as an appropriate governing structure was concerned, he suggested that the spectrum stretched from a single person, the Governor - though involving the Executive, to the other extreme of a Board or Court with collective responsibility. A point towards the latter end would be his preference because he felt that there would otherwise be too much power in the hands of one of two individuals. Sir David suggested that this option was likely to be the Government's preferred choice too. He went on to suggest that in those circumstances Court should be considerably smaller and might consist of people drawn from three particular backgrounds - economists, who would be able to discuss the detail of issues such as those considered in the Report on Inflation; those familiar with the financial services sector, but in view of possible conflicts of interests, it might be appropriate that they should be drawn from those not currently involved on a day to day basis in the financial sector; and business people from the non-financial sector and commerce. Such a body, he suggested, might need to devote more time to the Bank and it might be appropriate for them to spend as much as the whole day or a day and a half in the Bank. So far as the appointment of the Governor and Executive Directors was concerned, Sir David felt that this should continue to be the prerogative of the Prime Minister perhaps after consultation with other Members of Court and possibly the Leader of the Opposition. Accountability for monetary policy might be established not only through publication of the Report on Inflation but also through more frequent appearances before an enhanced Treasury Select Committee.

In focusing on the Bank's functions as supervisor and its responsibilities for arranging Government financing in the primary markets, Sir David felt that the Bank's advice on Government financing was particularly important and the Bank should retain that role. He suggested that inevitably there would be problems in retaining the supervisory role and the Bank should not seek to keep it at the cost of losing other key functions. He doubted that the Board he was proposing would be suitable for overseeing banking supervision and would like to see the establishment of a separate Supervisory Commission. Sir David agreed with Sir Christopher Hogg's suggestion that further discussion was required on the future role of Court and endorsed the suggestion that a Report should be submitted to the Chancellor although he had reservations about it reflecting only the views of the Non-Executive Directors.

Mr Laird said that he agreed with a great deal of what had been said already. He did not want to repeat points but he thought this was a very important issue and so would set out his views briefly. He agreed with Sir Christopher Hogg that the time might have come for the Bank's remit to be defined more precisely. But he felt that those politicians who favoured this route were chasing the holy grail. They thought that by making the Bank independent they would avoid responsibility and have someone else to blame. They were likely to be disappointed. Nevertheless he did think that the time had come to press this case and if Members of Court were to write to the Government on the issue he thought it should be the

Non-Executive Directors as the Executives would be seen as having an axe to grind.

Mr Laird said that there had been a substantial change in the way Court was conducted in the period during which he had served; the long Court discussions were a good example of an important innovation. Nevertheless he considered that further change was needed. Mr Laird did not think that the current structure of the Bank's governance would be right with a changed remit. It would need a Board of Directors to take the key economic decisions. He thought that it was a nonsense to set a single target as the personal responsibility of any one individual because the achievement of such a target would not be under his direct control, it would always be subject to external influences. He also thought it inevitable that the appointment of the Governor would have to be in the gift of the Government but nevertheless he suggested that only the Bank's Board of Directors should have the power to sack him or her. He added that he thought there was an important role for industrialists on that board although he suggested that there was no longer a distinct role for a trade unionist.

In commenting on the Bank's combined responsibilities for monetary policy and supervisory responsibility, Mr Quinn said that the debate was usually conducted in terms of the costs of combining the two functions. These costs were identified as a dilution of the central bank's adherence to appropriate monetary policy; a dilution of its reputation and authority, and the effect this had on its ability to carry out its responsibilities in the field of monetary policy; and the combination of the two major functions within one institution making it too powerful. These were real questions requiring consideration and he proposed to revert on these issues in due course. In the meantime however he said that the dilution of the central bank's authority in respect of monetary policy was of greater concern where the Bank did not have statutory support for its monetary policy responsibility and where interest rates were set through market operations rather than by dictat. Mr Quinn said that, nevertheless, there would be losses to the central bank from the separation of the monetary policy and supervisory functions. Its supervisory reputation contributed to the Bank's overall authority. If separated, the supervisory authority might lose vision; the quality of the staff that a supervisory authority might recruit was likely to be less high than those recruited by the Bank; and the interaction of the two functions made for better supervisors and better central bankers.

In commenting on whether the Bank of England should continue to be responsible for banking supervision, Mr Kent recalled the handling of third world debt in the 1980s. He felt that if the central banks had not acted together at that time there could have been an international 'meltdown' of the financial system. In fact, the central banks who provided leadership - mainly the Bank of England and the Federal Reserve - were able to do so effectively because they were responsible for monetary policy and supervision together. Another example lay in the support operations of certain small banks. Mr Kent was also concerned that the constitution of an independent central bank might be very tightly specified to ensure accountability and so make it impossible to provide leadership in non statutory ways - for example the current initiative on the wholesale payments system: the Bundesbank was an example of this rigidity. The costs of a highly restricted central bank would be higher to London as a diverse international centre than to Frankfurt.

The Deputy Governor agreed that the main questions were the scope of the remit and governance. It was important to recognise that there were two distinct issues within the supervisory role, consumer protection and the systemic aspect. The systemic aspect must remain part of the central bank's responsibility for monetary stability so that could not be divorced from the Bank. The consumer protection aspect was a different matter and changes outside, in Europe and the UK, made it likely that it would move away from the central bank in due course in a general sweep-up of the financial services sector. When it did, it would be important to focus on the terms in which it would be done and the nature of our involvement because of the systemic aspect.

On the question of governance, the Deputy Governor said that it was difficult to see how non-full time Directors could be involved in decisions relating to monetary policy. Sir David Walker had suggested involving economists but on a part-time basis; this would present problems and additionally, there would almost certainly be conflicts of interest with their other employment.

The same constraints were likely in respect of others in the financial services sector. That apart, he did not deny the need for input from such sources but on an advisory basis.

The Governor suggested that we may now have come full circle. He recalled that in the past the Executive Directors did not have an executive function but were engaged to advise the Governors. Also Committee of Treasury was originally a small group of Directors consulted by the Governors to advise on interest rate movements etc. It was perhaps possible to envisage Committee of Treasury comprised of four Directors without conflicts of interest, meeting after Court to help the Executive take policy decisions.

Sir Adrian Cadbury said that he was uneasy about "independence". We were talking about independence of operation but in a defined way and with accountability. Whatever responsibility the Bank sought it must also seek the appropriate power to carry it out. He agreed that Court had an unclear remit. The Non-Executive Directors' role should be to define strategy and to secure the appointment, and removal, of the Executive, but in practice they had neither. The main role, however, was the constitutional one. In this respect there were two essential aspects - disclosure or openness, and checks and balances in the system. This suggested that there should be a Council and a Board, with the Council there for constitutional reasons focusing on long term issues, acting as a sounding board, being able to stand back from the day to day, but supporting and protecting the Executive. Members would need to be knowledgeable and the kind of people who would inspire public trust and confidence in the system. The Council should have some say in the appointment of the Governor whose term should be fixed - but the appointment should remain with The Crown on the advice of Government.

Sir Adrian suggested that the next step should be to decide precisely the tasks for the Bank; once the purpose was defined the appropriate structure could then be put in place. He endorsed the suggestion that Court should produce a collective view on these issues.

Sir David Scholey thought that the issues concerning independence were particularly difficult for him to analyse since he had, rightly, never been made privy to where the strains lay between the Bank and the Treasury. He hoped to hear more from the Governors as to the source of the drive towards independence - did it come from the Bank or the Government? The issue was whether it was thought desirable now to make a very dramatic change in the situation of the Bank. This was ultimately a question of the handling of the economy.

In Sir David Scholey's view the answer could go either way. Perhaps one should keep broadly with the existing structure, leaving monetary policy responsibility with the Chancellor. One might modify the existing supervisory areas; Sir David Scholey agreed with the Deputy Governor on the difference between consumer protection concerns and systemic issues. He also agreed on the increasing degree of seamlessness between bank deposits and securities. He disliked turf contests, between regulatory agencies as evidenced in IOSCO. Thus, although the Bank should be involved in supervision, one should examine the possibility of a Board of Financial Supervision across the spectrum of financial assets.

Sir David said that he would be concerned if the Bank were to make any serious dash for UDI against the government's wishes as he thought the government would win. He thought that the structure of Court had become outdated, in particular in the context of external developments in how decisions were now being made. Outside perceptions of the role of Court were very different from reality. Sir David saw his responsibility as being there to provide advice to the Governors on any issue on which they wished to be advised. The Bank was part of the public sector - it was unrealistic to think that it was not and to keep the Bank in a 'magical no man's land'. The expertise of the Bank would have to be made more directly relevant to Bank concerns if the Bank were separated from the Treasury. Greater accountability to Parliament would then also be necessary - perhaps along the lines of the Humphrey Hawkins testimony in the US. Sir David thought it a sad reflection of the low regard in which Non-Executive Directors were held outside the Bank in that he had never been asked to give advice outside the Bank on matters affecting the Bank.

Sir David hoped that any move towards independence should be promoted solely through the Governors with the support of Court if necessary. He thought that the likelihood of any radical change being achieved successfully would depend on the subtlety with which the case was made.

Lord Haslam agreed with Sir David Scholey that it was difficult to understand what the key issues in the independence debate were when he did not know the relative positions of the Bank and the Treasury. However, he supported greater independence for the Bank, and thought that it would be likely to occur as part of the Maastricht process. He did not think the governance of the Bank need be very different from that of a large commercial bank. However, he saw a serious dilemma for any independent central bank: whether to direct policy solely to achieve price stability, or whether also to be concerned over recession and to make moves to stimulate growth. The US, for instance, had gone down the latter route. In any case, given the dilemma, it would be better to have a 'wider Church' of Directors involved. Nevertheless if the executive were highly professional their contribution to the success of the Bank would overwhelm any contribution the Non-Executives could make unless the Executive were completely off-track.

Sir David Lees said that the most important issue was the independence of monetary policy which should be vested in the Bank. His original thoughts on supervision were that they should be separated from the Bank but he was now inclined to the Deputy Governor's view. The question of governance could only be addressed once the Bank knew exactly what it wanted to be. As a Non-Executive Director he saw himself in an advisory role, largely because key issues did not come to Court. Court in its present form, therefore, was probably not right but there was no way forward until objectives had been determined. A fuller paper drawing together the issues raised in the discussion should be the next step forward.

Sir Colin Southgate said that it was clear that the public wanted consistency and stability in monetary policy. This meant independence from politics and the role should be given to the central bank and managed by full-time professionals. This would create a two-tier structure with a Board of Executives running the Bank on a day to day basis with an Advisory Board, with membership biased towards the real economy. It was important that there should be consistency within the Executive team and Government should consult the Advisory Board for views on appointments: changes should not be made at the will of a newly elected Government.

Sir Colin said that he had found Court one of the most difficult groups on which to serve because it was difficult to know the Non-Executive Director's role. It was important therefore to get that role right for the future, and the supply of information too which required a somewhat greater degree of trust: this could lead to more valuable advice being available from Non-Executive Directors.

The Governor commented that he could certainly report on his meetings with the Chancellor but they tended to be relatively predictable and, for example, over questions of timing of changes in interest rates. It was clear that the Government had the final say on these matters which, as Mr Laird observed, was the cause of the problems.

Returning to the issue of independence for monetary policy, Sir Brian Corby asked if it would be possible to see what form the new statutes might take. It was agreed that these could be drawn up on the basis of the experience in Germany, New Zealand and Canada.

Mr King agreed with Sir Christopher Hogg that the Bank needed a clear remit identifying the areas of responsibility and accountability. He also agreed with the Deputy Governor that decision-making should rest with full-time Directors and a Council structure to provide some barrier against external pressure on those Directors. He commented that the Treasury had too great an accretion of power and hence too many pressures. There was a need to create a confidential structure which required policy-makers to persuade their colleagues of the correctness of their approach and to force them to listen to other views.

Mr Crockett said that he also thought that the responsibility for monetary policy should be vested in a group rather than in an individual. A board or a council would provide protection for the decision-takers but would also provide greater responsiveness to the aspects that needed to be taken into account as well as continuity in the decision-making process. There was a risk that if this responsibility were vested in one individual, policy over the medium-term might not be consistent as the individuals changed. Alternatively, there might be too much continuity in that a particular individual's views might be less likely to change - reflecting changes in the balance of relevant influences - than those of a group. He agreed that those on such a board would have to be full-time specialists in monetary policy and not involved in other activities in case this provided a conflict. Mr Crockett said that he did not think that the interests of a Financial Ministry would be the same as those of a body specifically responsible for the achievement of price stability. But if such a body were established it would be important to establish a mechanism to ensure that it could listen to all relevant opinion. He therefore favoured the proposal for an Advisory Board but felt that the members should be separate from those who had responsibility for making the judgments.

Mr Crockett observed that most central banks did report to parliamentary authorities and felt that this was the appropriate way to establish accountability. Few, in fact, had Advisory Boards. He commented that many central bankers he had spoken to thought that an arrangement such as the Court of the Bank of England sounded very useful and one which other central banks might wish to have. Mr Crockett suggested that it was not inevitable that major legislative change was required to bring about the changes in economic management that most of the Members of Court seemed to favour. He argued that other countries had groped towards greater independence of the central bank rather than making a sudden change. He argued that the new Inflation Report was one important step along that road. A further potential and important step would be if the Government declared that it would ask the Bank of England to make the day-to-day decisions about monetary policy. This would not require legislative change and would enable the Government to retain the power to over-ride the Bank's decisions if it wished to do so. But it would be a major step in changing the balance of power between the Bank and the Treasury and would greatly enhance the credibility of economic policy if it were seen that monetary decisions would be based on a stable medium-term strategy.

The Governor said that he thought this last point was particularly worth considering. He thought that a mechanism that changed the balance of power between the Bank and the Treasury could be quite significant. He said that Court would need to consider its next step and he would like the opportunity to reflect on these most thoughtful contributions which had been made by Members of Court. He proposed that the Bank should prepare a further paper which might include a part which would be suitable for submission to the Government.

The Governor said that he thought the morning's discussion had distinguished a number of possible routes to achieve the goal of a more stable monetary policy. He had previously thought that this might only be achieved by constitutional change. It may be, however, that it would be possible for monetary policy to be operated more independently as a result of an administrative act taken by the Government if they were so minded. If that were generally accepted as an effective route then it might be a more feasible route and would have the advantage of allowing the Bank to retain the best parts of the existing structure. He thought the discussion may have indicated a broad consensus that the judgments should be taken by a group of full-time professionals who would be separate from Court but that Court itself could remain as a body which would advise the Executive and keep them in touch with the real world. The Members of Court would not then have a conflict of interest by being put in a privileged position. Court would have the opportunity to consider the decisions that were taken by the Executive Board and to advise on them ex post facto. The Governor said that he would greatly value the further contributions of the Members of Court on this subject when they had had a chance to read the Minutes of this meeting and the further papers produced by the Bank.

[signature]
Assistant Secretary
26th November 1992

E. A. J. George
26th November 1992

A MEETING OF DIRECTORS AT THE BANK

THURSDAY 19 NOVEMBER 1992

Present

The Rt Hon Robert Leigh-Pemberton, Governor
Edward Alan John George, Esq, Deputy Governor
Sir George Adrian Hayhurst Cadbury
Anthony Laurie Coleby, Esq
Mervyn Allister King, Esq

Pendarell Hugh Kent, Esq
Ian Plenderleith, Esq

The number of Directors assembled being insufficient to form a quorum, those present proceeded to the business, subject to ratification by the next Court.

The Minutes of the last Court, having been circulated, were approved.

Mr Coleby commented on the weekly figures and spoke about the foreign exchanges and the state of the domestic markets.

Under the weekly executive report the Governor mentioned that there would be vacancies for three new Non-Executive Directors with effect from 1 March 1993. He suggested that the industrial sector was currently well represented on Court and felt that the new appointments might be drawn from the City or the academic world with a view to strengthening the expertise on monetary matters. A number of names of possible candidates, including some women, were mentioned.
The Governor said that he would raise the issue again at Court the following week.

BA Hoffmann
Assistant Secretary
26th November 1992

E.A.J. George
26th November 1992

A COURT OF DIRECTORS AT THE BANK

THURSDAY 26 NOVEMBER 1992

Present

The Rt Hon Robert Leigh-Pemberton, Governor
Edward Alan John George, Esq, Deputy Governor
Sir George Adrian Hayhurst Cadbury
Anthony Laurie Coleby, Esq
Sir Frederick Brian Corby
Andrew Duncan Crockett, Esq
Lord Haslam of Bolton
Sir Christopher Anthony Hogg
Sir Martin Wakefield Jacomb
Mervyn Allister King, Esq
Sir David Bryan Lees
Brian Quinn, Esq
Sir David Gerald Scholey, CBE
Professor Sir Roland Smith
Sir Colin Grieve Southgate
Sir David Alan Walker

Hugh Christopher Emlyn Harris, Esq
Pendarell Hugh Kent, Esq
Ian Plenderleith, Esq

The Minutes of the Court of 12 November were confirmed and those of last week's Meeting, having been circulated, were approved.

Mr Quinn commented on the weekly figures and Mr Plenderleith spoke about the foreign exchanges and the state of the domestic markets.

Under the weekly executive report:-

1 Mr Crockett spoke about the meeting of the EC Monetary Committee held over the previous weekend to discuss the

position of the Spanish peseta and Portuguese escudo. The Spanish were looking for as large a devaluation as they could get, with 6% the minimum acceptable, whilst the Portuguese were intent on minimising any move that was made but in doing so would keep eventually to the same figure as the Spanish. The Danes and the Irish were keen merely to resist any pressure to change their rates.
Overlying the individual positions of the countries was an awareness that a credible package was required otherwise there would be doubts, in view of the previous realignments, as to what purpose the ERM actually served. There was a theme that the meeting had to come up with the right answer and not have to make further changes shortly afterwards.
Whether or not the mechanism would survive was quite questionable but it did underline the importance of convergence. Mr Crockett added that the commitment of Governments to make the mechanism work should not be underestimated although Ministries of Finance were rather more optimistic in this regard than Central Banks.

2 With reference to a Minute of 19 March 1992, Mr Quinn reminded Court that in presenting a paper dealing with supervisory issues in Gibraltar arising from the implementation of the Second Banking Co-ordination Directive, a number of alternative arrangements had been proposed which reflected Court's concern with the position in which the Bank had been placed. Following lengthy Ministerial discussions the options had boiled down to two. Firstly, the direct route by which the Bank would be given full powers to supervise Gibraltar banks in accordance with our own legislation and standards. Or, secondly, a "colonial option" for supervision. It had been the latter option that had been chosen by the Government. This involved a number of points:

1 Gibraltar law would be brought in line with UK law in all relevant aspects and deposit protection and investor protection arrangements would be established as soon as possible funded by banks and other financial institutions in the territory.

2 Supervisory standards for the banks and other financial institutions would be the same as in the United Kingdom.

3 The Financial Services Commissioner would be appointed by the Foreign Secretary acting on the advice of the Treasury, DTI, Bank and SIB.

4 A Financial Services Commission would be established with members from the UK and Gibraltar, with the former in a majority.

5 Teams of United Kingdom experts would periodically visit Gibraltar to audit procedures and agree with the Commissioner any action necessary to improve them.

The Chancellor had asked the Bank if we could provide technical staff to give advice and carry out the audits. Also, could we find a Financial Services Commissioner. Mr Quinn mentioned that a former member of the staff was being considered for this position. Whoever was appointed would find themselves in a tricky position and one that would not be easy to make work. Already the first meeting that had been held with the Finance Minister of Gibraltar had proved difficult. However the responsibility for the function and system of supervision of financial services lay clearly with HMT and the Bank's role was strictly advisory.

3 Mr Harris drew the attention of Members of Court to the pay negotiations that were taking place between the Bank's London-based computer staff and BIFU for implementation with effect from 1 October 1992. The Bank were contractually committed to implement an increase automatically linked to the annual salary survey by Computer Economics Ltd - the results of which were expected the following day. He had told BIFU that the Bank wished to suspend the link as it was considered that the average performer was being paid too highly in comparison with the market. BIFU were not happy with this position. At the

same time the Bank was trying to manage a reduction in staff numbers of some 65 - 30% of the total - over the next 3 years as the Information Systems Strategy was being implemented. There is very little natural wastage, partly because of the levels of the Bank's remuneration package. He would try to negotiate a settlement taking account of the Chancellor's Autumn Statement on pay policy ie an increase of no more than 1.5% across the board. Failing that, he would impose a settlement, which would meet current obligations, and give 3 months notice to change the arrangements to exclude the link. Technically this would be the termination of employment of all the staff and their re-employment. The new approach would also take note of the Autumn Statement.

4 With reference to a Minute of the previous week, the Governor said that, bearing in mind Court's discussions of a more independent approach to monetary policy, and after consultations with colleagues, there were three names plus one reserve he wished to present to Court for consideration as replacements for the retiring Non-Executive Directors. After some discussion, Court were content that the Governor proceeded on the basis he proposed.

Court gave their approval to Sir Brian Corby joining the Board of Pan-Holding SA of Luxembourg.

At the Governor's invitation:-

1 The Deputy Governor drew Court's attention to the Banking Department's profit and loss for the six months ended 31 August 1992 and the forecast for the year ending 28 February 1993. Taking fixed income, the income from the Gilt-Edged portfolio had been maintained. There had also been a useful improvement in Banking Commission and Fees stemming mainly from support operations and foreign currency services. Variable income for the year was likely to be some £11mn to £12mn less than previously estimated last March as a result of lower interest rates and lower Bankers Balances. Total income was likely to be down on that originally forecast and

significantly down on the previous year - but this was not surprising in view of lower interest rates and the reduction in Cash Ratio Deposits the previous January.

Moving to expenditure, personnel costs for the year were expected to be a little below budget having benefitted from lower interest rates feeding through into mortgage subsidy payments. The decrease in Premises and Equipment costs at the half year were due to the timing of payments. Other expenditure was ahead of budget as a result of the legal costs of the Bingham Inquiry, plus £1.8mn, and the cost of a number of supervisory investigations.

Operational profit was likely to be close to £162mn. The major question for the year was the size of the additional provision that should be made for support operations for National Mortgage Bank. It might be necessary to make a further provision of £60mn, although this could come down with the reduction of interest rates.

The Deputy Governor said he would appreciate the advice of Court on whether to off-set the impact on pre-tax profits of possible additional provisions by taking realised profits to the profit and loss account from the sale of part of the Gilt portfolio - where we had a surplus of some £200mn. This would, however, be at the expense of future income. Court were agreed that such a course be adopted.

2 Sir Martin Jacomb introduced a Report of the Committee to consider the Securities of Certain Funds covering the period 1 February to 30 September 1992, which was laid before Court.

3 In introducing the monthly Economic and Financial Report for November, Mr King said that it provided an opportunity to look back on the Autumn Statement, two weeks previously, which completed the series of changes to policy since our departure from the Exchange Rate Mechanism in September. Monetary policy was no longer constrained by the ERM. There was a new framework for monetary policy. Policy itself had been eased significantly, with a 13% fall in sterling's effective exchange rate and a cut of 3 percentage points in interest rates. Despite these measures, or was it perhaps because of

them, business and consumer confidence had fallen sharply and were lower now than for some two years. Perhaps members of Court could throw light on the reasons for the fall in confidence.

It was not easy to square this fall in sentiment with the available statistics on the economy. Total output was completely flat in the third quarter although non-oil GDP had fallen by 0.3%. Retail sales were on an upward trend. The shape of the current recession was illustrated by the rapid falls in output in 1990 and the economy broadly flat through much of 1991 and 1992. A similar pattern was evident for the change in unemployment, where the rate of change had risen very sharply during 1990 and the beginning of 1991. It then fell and had changed rather little on average during the course of the year. The monthly foreign trade figures showed a fall in September which had increased in October. Mr King reminded Court that there would be no figures for the first six months of next year for trade with the European Community.

There was still, as yet, no evidence to suggest that the factors such as debt deflation which had been prominent in our thinking had done more than prolong the recession rather than lead to a significant further downturn. The fall in house prices, which came late in the recession and after the major falls in output, were consistent with debt deflation being not the cause of the recession but a factor intensifying its depth and length. The monetary figures too, about which Mr Coleby would speak, would provide no additional evidence for the proposition that the economy was likely to undergo a further downturn.

Not surprisingly, given the duration of this recession, the rates of increase of prices and wages continued to fall. As was discussed in the Bulletin Assessment, the three month on three month measures of inflation were now down to just over 2%. But we had not yet seen much feedthrough from the depreciation of sterling to consumer prices. Underlying average earnings had risen over the past twelve months at 5 1/2% - still higher than was comfortable given the inflation target - and wage settlements over the past three months were now increasing at a rate below 4%. If we were to achieve the inflation target it would obviously be important that these sorts of numbers become the norm rather than levels achieved only at the bottom of a recession. Given the conflicting signals provided by the retail sales and output statistics, on the one hand, and the rather dramatic fall in confidence, on the other, the construction of a package of measures for the Autumn Statement was no easy matter. Court had discussed on previous occasions the need to change the mix between monetary and fiscal policy following our departure from the ERM. And there has been a significant easing of monetary policy. Mr King said he thought it was possible to argue that fiscal policy might now be a little tighter than would have been the case had we stayed in the ERM, but one could push this too far. And the medium term prospect for the public finances was truly unwelcome. Of course, any projections for PSBR are subject to very substantial error because they are the difference between two very large numbers. The public sector deficit was higher than anything for a very long time. There also appeared to have been some change in the sensitivity of tax revenues to changes in output. Nevertheless, the prospect of such large fiscal deficits did not provide a happy background against which to maintain credibility in monetary policy in medium term while easing in the short term. The tax measures announced in the Autumn Statement - the temporary incentives for investment and the abolition of car tax - would provide some switching of expenditure into next year from the following year. The control total for public expenditure had been maintained while finding some room for spending on infrastructure projects. It was important that any change in policy be presented as part of a coherent package. That had now been done. It would be right to wait and see the effects before contemplating further policy action.

Mr Coleby, in introducing the regular discussion of monetary policy said the money figures for October were buoyant. The currency circulation grew on the month by 1/2%, continuing of the recent pattern of strong growth which was at an annual rate of 5 1/2% over the past three months. In November it seemed to be accelerating. This lent support to the belief that the trend increase in retail sales was well founded.

Broad money and lending showed growth of 1% and 0.8% respectively in October. But both had been very depressed in September, and this was probably just a correction. It restored the previous picture of a 5% to 6% growth rate in both M4 and M4 lending which had been steady for about a year. Within lending counterparts, mortgage lending had been weak whilst borrowing had been concentrated on Industrial and Commercial companies.

The Sterling exchange rate had been agreeably steady amid the market turmoil. This was no doubt helped by the disappearance of any early expectation of interest rate cuts, following the Autumn Statement.

The Autumn Statement itself had arrived at policy settings based on judgments, inevitably of considerable uncertainty, as to where the economy was at the time. It was still much too early to be able to observe any response by the economy to monetary easing that had taken place in the past two months. It therefore made sense to await further evidence, and to consider changing the policy settings only if it became evident that the state of the economy was not as it had been supposed to be.

In the discussion that followed, and responding to Mr King's earlier question, Sir Martin Jacomb said he was mistrustful of the retail sales series. Morale in the High Street was low in view of the continuing increase in unemployment as well as rising food prices. There were also concerns about the re-emergence of inflation. The problem was worse in the South-East of the country than elsewhere where many factories were very busy.

Sir Brian Corby mentioned that the feeling at the recent CBI Conference was that the Government had messed matters up and as a result there was a general lack of confidence although the Autumn Statement had been a step in the right direction. These sentiments were endorsed by Sir Colin Southgate, who added that the previous week he had noted the first upward trend in sales - some 4 weeks behind a similar movement this time last year.

Sir David Walker felt there was some difference between presentation and substance. Investment incentives were limited.

For his part, Professor Sir Roland Smith thought that the euphoria as a result of our withdrawing from the ERM had been overdone. There were signs people were responding in trading terms but in doing so they were looking for value and not quality.

In conclusion, Mr King said a new survey had been used for the retail sales figures and it was not possible to be certain of the pattern of seasonal adjustments.

Adrian Cadbury
3/12/92.

G. A. Croughton.
Secretary. 3rd December 1992.

A COURT OF DIRECTORS AT THE BANK

THURSDAY 3 DECEMBER 1992

Present

The Rt Hon Robert Leigh-Pemberton, Governor
Sir George Adrian Hayhurst Cadbury
Anthony Laurie Coleby, Esq
Sir Colin Ross Corness
Lord Haslam of Bolton
Sir Christopher Anthony Hogg
Mervyn Allister King, Esq
Gavin Harry Laird, Esq, CBE
Sir David Bryan Lees
Brian Quinn, Esq
Professor Sir Roland Smith
Sir Colin Grieve Southgate

Hugh Christopher Emlyn Harris, Esq
Pendarell Hugh Kent, Esq
Ian Plenderleith, Esq

The Minutes of the last Court, having been circulated, were approved.

Mr Quinn having commented on the weekly figures, Mr Plenderleith then spoke about the Official Reserves figures for November and about the successful issue, earlier that week, of a UK Government $3 bn 10 year Euro-dollar Bond, the proceeds of which would be added to the foreign currency reserves. The Governor commended Mr Plenderleith and his colleagues in the Markets Division on setting up the issue so efficiently and in a short period of time.

Mr Plenderleith went on to speak about the foreign exchanges and the state of the domestic markets.

Under

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The Governor explained that there were legal difficulties not only for the Bank, in that if an individual resigned from the banking institution, they were no longer within our jurisdiction, but also for the individual because in those circumstances the matter remained unresolved.

In response to Sir David Lees, who questioned whether an individual who was not "fit and proper" under the Banking Act should be allowed to become a Director in other institutions, Mr Quinn said the Bank informed other regulators within the financial sector of such findings but it was then up to those regulators to make their own decisions on an individual's suitability to hold office. In areas outside the financial sector, the Bank had no powers to disclose its findings to other parties.

2 The Governor explained that following the discussion on "Independence" at Court on 12 November, he had promised Members a further opportunity to consider that issue. Accordingly, he had commissioned Mr King to prepare a further paper in the form of a first draft which the Bank could submit to Government, if Court so approved. It was proposed that this draft should be circulated to Members in time to allow for comment well in advance of the next discussion which the Governor proposed, should take place at the long Court on 14 January. The Governor explained that Mr Quinn was also preparing a paper addressing the implications of independence for the Bank's supervisory responsibilities. This paper would also be considered on 14 January.

There was also an important paper on the Future of Regulation which had some urgency. The Governor proposed therefore that this paper be discussed at Court on 7 January, but that Court should convene at 11.30 am to allow adequate time for that discussion. Finally, the Governor said that with Members' agreement, Court would rise at 12.45 pm on Thursday 17 December.

At the Governor's invitation:-

1 In introducing his Report to Court, Mr Everett, Head of Premises Division, said that although most companies and institutions had within their organisation some area akin to the Premises Division, no two companies were the same. Many of the financial institutions operated high technology services in purpose-built buildings whereas our high technology had been introduced into an historic building: this produced its own problems. In addition, there was a high security overlay which called for secure staff for security jobs and security vetting of contractors' staff which could create problems on urgent, and particularly on one-off, jobs. Nevertheless, resources were not a constraint and staff numbers had been reduced quite considerably from over 600 in 1980 to 350 at the present time, with a planned reduction to around 300 by 1994/95. In this process two layers of management, at technical and administrative level, had been removed.

Since 1989/90 the Division had operated a computerised planning and control system for maintenance programmes etc. The system incorporated a user charge-out facility but this had not been developed for use within the Bank as users were not always accountable for the demands made on the Premises Division's resources. Mr Everett explained that the Division was continually aiming to improve relationships with users and in this connection they were trialling service agreements covering nature, quality and cost of service.

Finally, Mr Everett mentioned his responsibility for the Bank's Sports Complex at Roehampton where he was on course to achieve a planned reduction of 25% in the Bank's subsidy.

In response to Sir Colin Corness' question about the surplus capacity in the Bank's properties, Mr Harris explained that this was the responsibility of the Property Manager's Office rather than Premises Division, whose remit was largely maintenance. In practice all of the surplus in the New Change building had now been let and the Bank was actively looking for tenants to occupy surplus areas in other properties. The surplus overall, however, was relatively small.

Mr Laird endorsed the proposed introduction of service agreements: they were good for morale and ensured that the service areas were not taken for granted.

Sir Christopher Hogg enquired to what extent the staff reductions had reduced costs or had the work been contracted out? Mr Everett said that contracting out accounted for some 20% of the reduction but the bulk of the saving had been achieved through greater efficiency. In response to Lord Haslam's suggestion that staff numbers of 350 still seemed rather high, Mr Everett said that regular comparisons were made with other banks and institutions and cost comparisons were made with statistics produced by the Royal Institute of Chartered Surveyors. He accepted, however, that staff numbers were higher than in some similar organisations but these were justified on grounds of needing to turn critical operations round very quickly; the need to respond immediately to emergency situations within this building; and because it was not possible to engage suitably vetted contractors at speed.

The Governor said that the maintenance of Head Office was a particular problem. The building was listed by English Heritage who imposed a very high standard on all building and maintenance work. He commended the quality of the work of the Bank's staff, citing in particular recent work on the Court Room ceiling.

2 In his capacity as Head of the Banking Department, Mr Kentfield introduced his Report to Court and said that there were three aspects that he wished to emphasise. First, the Banking Department was much larger than most other areas of the Bank with 750 banking staff and 250 security and other staff. One of the main features of running the Department, therefore, was management. Secondly there was a wide variety of work within the Department covering a range of operational, non-operational and policy work which often required rapid response. This

was all additional to the routine business of being bankers to the Government and the issuers of the nation's banknotes. Finally, as his Report indicated, the Department faced important challenges with the imminent introduction of a real time gross settlement system and the project to modernise the Department's own computer systems.
The important issues currently, therefore, were to maintain morale, to maintain standards against a background of continuing costs and to manage change.
The Governor said that it was easy to underestimate the calls that were made on the Banking Department, particularly in some of the difficult international situations of recent years, for example the implementation of sanctions. He was also conscious of how effectively the Department was managed in that so little of his time was devoted to their activities. Mr Quinn, with his responsibilities for the Banking Department, also congratulated Mr Kentfield on the management of constant change, particularly in the field of information technology.
Sir Christopher Hogg said that during his recent visit to the Department he had been interested to learn that the Bank felt it could not take for granted that Government Departments would continue to use our banking facilities. He also enquired about the Investment Unit which Mr Kentfield said managed the Bank's Pension Fund and some other funds of which the Governor was a Trustee. The Unit operated behind substantial chinese walls and was part of the Banking Department purely for administrative reasons.
Sir Roland Smith was interested to learn whether there was regular liaison between the Banking Department and other Departments in the Bank who might be interested in regular updates on flows of funds etc in the banking system. Those concerned said that in practice the Financial Statistics Division was the prime source of their statistical data and indeed hour by hour information could often be misleading

and distracting. Details of significant transactions etc were, however, brought to the Executive's attention at the daily 'Books' meeting.

Adrian Cadbury
10/12/92.

Assistant Secretary
10 December 1992

A COURT OF DIRECTORS AT THE BANK

THURSDAY 10 DECEMBER 1992

Present

The Rt Hon Robert Leigh-Pemberton, Governor
Sir George Adrian Hayhurst Cadbury
Anthony Laurie Coleby, Esq
Sir Frederick Brian Corby
Sir Colin Ross Corness
Andrew Duncan Crockett, Esq
Sir Martin Wakefield Jacomb
Gavin Harry Laird, Esq, CBE
Sir David Bryan Lees
Brian Quinn, Esq
Sir David Gerald Scholey, CBE
Sir Colin Grieve Southgate
Sir David Alan Walker

Hugh Christopher Emlyn Harris, Esq
Pendarell Hugh Kent, Esq
Ian Plenderleith, Esq

The Minutes of the last Court, having been circulated, were approved.

With reference to the Minutes of 26 November, Sir David Walker queried the record of the discussion of the Deputy Governor's report on the Banking Department's profit and loss figures. It was agreed that the final sentence of the Minutes in question should read "Court took the view that it was not appropriate to sell gilts solely with the view of off-setting the impact of provisions on pre-tax profits".

Details of the weekly figures and graphs relating to the state of the foreign exchanges and the domestic markets were laid before Court. In response to a question from Sir David Lees, Mr Coleby said that the proximate cause of sterling's weaker performance against the DM in the previous two days had been remarks by individual members of the new panel of Treasury forecasting consultants on the need for further interest rate cuts and a further devaluation of sterling. Court agreed that this had been an unfortunate episode.

Under the weekly executive report and with reference to a Minute of 26 November, Mr Harris reported on the outcome of recent negotiations with BIFU in relation to the London-based computer staff, for whom a pay increase was due with effect from 1 October 1992. The increase was contractually related by formula to the increases shown in the annual salary survey by Computer Economics Ltd. The Bank wished to break this automatic link. Negotiations had duly reached the stage where BIFU were prepared to recommend a settlement rather than having one imposed by the Bank. The recommended settlement has now been accepted by 126 votes to 29 on an 85% turnout in a consultative ballot.
Under the terms of the settlement, the Bank has agreed to make a non-pensionable lump sum payment equal to the pensionable increases otherwise due in the period from 1 October to 28 February - representing two months back payment plus three months contractual notice of change of terms of service - plus 1.5% (under public sector pay policy) from 1 March 1993 for 12 months. The automatic link had thus been broken.
In addition, as part of the attempt to increase natural wastage to meet the expected surplus of 65 EDP staff over the next three years, the Bank has agreed to introduce a number of measures related to retraining as well as giving greater opportunity for community secondments as part of outplacement packages.

At the Governor's invitation and with the agreement of Members of Court, Mr Wright, a Senior Adviser in the Industrial World Division attended Court for the ensuing discussion.

Mr Crockett, in introducing the paper entitled 'The World Economy: from slowdown into slump?' said that economic news in the past few weeks had helped lift some of the gloom over the world economy. Revised GNP and employment figures from the United States suggested that recovery there was finally under way; and recent data in the UK encouraged hopes that our period of "bottom-bumping" would at least not get worse. So the concern that had motivated the paper - that the current slowdown in the world economy might turn into something worse - seemed to have diminished for the time being. But experience of economic forecasting bred mistrust of shifts in conventional wisdom based on the latest batch of statistics. The mood of commentators was fickle, and one or two weak indicators could quite quickly, and just as unjustifiably, revive the gloom of last summer. Thus it was still worth asking the questions: what are current prospects for the world economy, and what are the downside risks.

Reviewing the Bank's latest World Economic Forecast, Mr Crockett noted that virtually all forecasts tend to exhibit a reversion to trend after eighteen months or so. This was a measure of ignorance, not knowledge: forecasters knew little about the disturbances that would affect the economy, and so sought to make the smallest mistake by forecasting the average of past experience. Thus most forecasters, ourselves included, now expected the industrial countries to register a growth rate of around 2 3/4% (the long-term potential rate) in 1994. Activity was expected to pick up gradually during the course of 1993 but, because of the flat profile of growth in 1992, 1993 was expected to have a growth rate of only about 2 1/4%. Taking account of countries outside the industrial world made little difference to this broad picture.

It was important to consider the sources of downside risk to the projected return to growth. Three sources warranted special attention in present circumstances: the consequences of continued declines in asset prices in Japan, the United States and the UK; the continuation of an unbalanced policy mix in Europe, resulting in high interest rates; and an adverse outcome to the GATT round. As to the first risk, falling asset prices were the classic mechanism by which an economic slowdown could become a slump. When assets were financed at least partially by borrowing, declining asset prices translated into even sharper declines in the asset-holder's net worth. At the limit, this could result in bankruptcies and thus undermine the net worth of lenders and financial intermediaries as well. The danger of debt-inflation could be exacerbated by risk-averting private behaviour while, if expectations were formed in a extrapolative manner, an initial price fall could be destabilising by initiating further selling rather than stabilising purchases. Falling property prices meant that this danger could not be excluded in the UK, US and Japan. The second source of danger was the continuation of high interest rates in Germany. Most forecasters now expected Germany to have negative growth in the first half on 1993. High nominal and real interest rates would also result in very sluggish activity in the rest of continental Europe. Forecasters were assuming that German rates would fall during next year leading to a revival of economic activity. The danger was that, by the time rates began to fall, the downward momentum of activity would have become too strong to be reversed just through an easing of monetary conditions. The third major danger, failure of the GATT round, would have its main effect on confidence, but could quite quickly have effects that were hard to estimate ex ante. Economic models were not particularly useful in calculating the impact of these various dangers on the world economy but, if there were to be a substantial impact, the danger was that it would become cumulative.

Moving on to the role for policy, Mr Crockett suggested that a co-ordinated stimulus would be appropriate if freedom of manoeuvre was constrained by international considerations, eg, fear of exchange rate or balance of payments consequences of monetary easing; but this did not seem to be the case at the moment as regards the three major economies. It was, however, a consideration within Europe, where most countries were severely constrained by German monetary policy on the one hand, and their desire to meet the Maastricht criteria on the other. Any deliberate move to economic stimulus in Europe would have to involve policy co-ordination.

Taking the major economies in turn, Mr Crockett noted that, in the US, the Federal Reserve had shown its willingness to act aggressively to bring down interest rates when needed. If weakness were to re-emerge, it would presumably do so again, though short-term rates were already very low. A fiscal stimulus from the new administration seemed unlikely given the existing budget deficit, and would require a tricky balancing act to carry credibility. Japan was better placed for a fiscal stimulus - as already announced - and further monetary easing later. For the UK and continental Europe, Germany was of key importance both as the largest European economy and because German interest rates were transmitted to other countries both in and outside the ERM. The Bank and most of its European counterparts believed that a cut in German interest rates was now justified on domestic grounds and would do a great deal to improve the economic outlook in Europe. The Germans were likely to be resistant, however.

In conclusion, Mr Crockett identified a number of points on which Directors' views would be helpful. The Bank's forecast saw a world in which the US strengthens, though not as quickly as recent euphoria suggest, and Europe and Japan remain in the doldrums. How did this chime with what members of Court were picking up from their own contacts? What was their assessment of the risks of a sharper downturn? Was inflation dead? On Europe, the prospect was of significant risk of continued high interest rates leading to painful increases in unemployment. Would this lead the ERM to break up? How quickly? Would the consequences for the UK be favourable or unfavourable? And what was the role for UK/Bank economic policy? Should we advocate an early economic summit (G-7)? Or was it unrealistic to expect the policy logjam to break while France remained desperate to stay with Germany? Should we make contingency plans for a break-up of the ERM? Was there scope for an exchange rate arrangement without the deutschmark?

Sir Colin Corness said that evidence from the building industry confirmed a slow recovery in the US and Japan. In the former, housing activity was forecast to rise by 18% in 1992 and by 10% next year; but housing starts were expected to stabilise at 1.3mn pa and will not this century recover to the level of 2mn starts recorded in the early 1980s. In Japan, housing starts were up 10% this year. The situation in the UK was much bleaker, with prices falling throughout 1992 and probably through Q1 1993. The cumulative fall of 12-15% in a 15-month period was an enormous deterrent to buyers. Transactions were down 50% and many of those taking place were involuntary. All this had an impact on mortgage lenders' profits and there was concern as to how depositors would react if a major building society recorded a loss. Equally worrying would be the impact on building societies if house prices did not prove to be at bottom but declined even further. Turning to continental Europe, Sir Colin agreed that France, Italy and Spain were all likely to experience a decline in economic activity in 1993; but he was less gloomy about Germany where the considerable improvement in housing activity this year seemed set to continue next given the level of unsatisfied demand - attributable partly to immigration.

Responding to a question from the Governor, Sir Colin confirmed that the fall in house prices in the UK meant that it was now uneconomic to build a new house but said that some builders were starting new properties in the hope that matters would have improved by the time these were completed. This would be encouraged by the measures announced in the Autumn Statement, which would in practice stimulate purchases of new rather than second hand housing.

Sir David Lees said that, from the point of view of the motor vehicle industry, his perspective on Germany was far more gloomy. Car production was projected to decline by some 12% in 1993 and the commercial and agricultural vehicle markets would also be in retreat. Overall, he saw little prospect of much growth at all in Germany and felt that the Bank's forecast might prove over-optimistic. In the UK, the prospects for the motor industry were, in contrast, quite favourable: car production was likely to show an increase of 10%+, with the Japanese-owned plants contributing strongly. But he was more pessimistic about the speed of a general recovery in the UK and foresaw the need for a further relaxation of economic policy to get the economy moving. So far as the US was concerned, the signs were much more encouraging than three months ago and, in both anecdotal and practical terms there was movement towards stronger growth next year.

Asked by the Governor whether his German contacts were supportive of the thrust of the Bundesbank's policy or saw the latter as too rigid, Sir David said that he detected a feeling among German industrialists that the Bundesbank were out of touch with what was happening in the real economy. His own concern was how long the current stance of French policy was sustainable. The Governor acknowledged that this was a very real concern and a key question for the future of the ERM. On the face of it there was a case for a realignment but it was, in practice, impossible to explore this possibility even informally with the French.

Sir Brian Corby said he knew there was pressure from members of the Patronat for the case for an ERM realignment to be made but their leaders were reluctant to raise the issue with the French authorities. He felt that a realignment was ultimately essential if a break-up of the ERM and the attendant risk of a series of competitive devaluations was to be avoided; but, for political reasons, now was not the time. In Germany, he found BDI and BDO leaders somewhat apologetic about the Bundesbank's stance and thought that there were significant pressures from the industrial side for an easing of monetary policy. As for the US, it was common ground that the economy was emerging from recession. A worry was that any fiscal stimulus from the Clinton administration might prove too much and thus revive inflationary pressures.

Turning to some of the more general questions posed by Mr Crockett, Sir Martin said it would be dangerous to think that inflation was dead; rather, broad price stability needed to be an on-going objective. On providing a stimulus, he said that the recent Delors proposals seemed to be based on the assumption that there was money waiting to be spent; he was not sure if that were true but there was certainly anecdotal evidence that this was a good time to initiate infrastructural projects given the current low levels of costs, for example.

Reverting to the situation in the UK, Sir Martin highlighted two areas of difficulty for insurance companies. The first was the emerging concern about cover against terrorist damage to office and commercial premises. Government policy appeared muddled and unrealistic, and would have the effect of further depressing property values which could in turn hit investment by foreign companies. Meanwhile, inflexible regulatory criteria meant that, following the sharp fall in interest rates, life insurance companies were faced with the choice of having to restrict new business or translate much of their equity portfolios into gilts. The Government Actuary was considering the problem but the Bank should be aware of the potential impact on the equities and gilt markets.

Sir Colin Southgate was encouraged from a recent visit to Italy that people were at last being realistic about the need to address both the overhang of indebtedness and the associated social problems; but he had no doubt that 1993 would be a hard year for the Italian economy. Prospects for France in 1993 were also gloomy; unemployment was now a major cause for concern but no policy change was likely before the elections next Spring. In the US the economy was definitely improving but Sir Colin shared the concern over too great a fiscal stimulus from the incoming administration. His contacts in general were very pleased at the outcome of the presidential election: the fact that the economy would be on the move outweighed the prospect of higher taxes. For his own industry, Sir Colin saw little improvement in Japan because of the high level of personal debt, no real improvement yet in the UK and only a slow pick up in the first half of 1993, but fairly good prospects in Germany on the back of continuing infrastructural improvements. On a recent visit, he had been struck that the link between Germany and France was closer than ever, with an evident mutual determination that France should survive in the ERM; by the Bundesbank's belief that German industrialists supported the monetary stance; and by the importance attached to progressing Maastricht as a check on right-wing nationalism.

Mr Quinn agreed with the proposition that debt deflation was bad for banks and financial intermediaries. This raised questions both as to the stability of these institutions and their capacity to provide the finance necessary as the upturn comes. He was less pessimistic than some commentators. The US money centre banks were now much stronger than a year ago while in Japan he took some comfort from the authorities' recognition of the threat to the banking system and moves to implement appropriate measures; the core of the Japanese banking system was, he believed, sound. He detected no strain on the stability of European banks. Turning to the UK, asset quality and capital indicators showed that major banks were in a tight though still comfortable position, but strains were evident in a number of the smaller institutions.

As regards capital to finance the upturn, Mr Quinn found no sense of feeling in banks that they would not be able to cope. Some banks had already built up their capital base while others were considering how best to do so; and experience showed that the clearing banks, at least, tended to find the flexibility to accommodate demand for credit when it came. On the ERM, he shared the concerns expressed about its durability and, in particular, questioned whether the French would prove able to stand the strain until the Spring elections: the pressure on banks or exporters would prove unsustainable. The idea of an exchange rate arrangement without Germany was, in his view, a non-starter.

Sir David Walker agreed on the difficult position France was in and observed that the elections were still some way off; accordingly, he had doubts about the stability of the franc and of the ERM as currently constituted. On Japan, he noted that the fiscal package, though announced in the Summer, was still in the pipeline: was there a message in this? Turning to the UK, he agreed with Mr Quinn about the position of banks but said that it was also necessary to consider the balance sheets of the putative borrowers. In Sir David's view the depth of the recession in this country was attributable both to high interest rates and to the high level of corporate sector borrowing. He drew comfort from the better capital gearing noted in the Bank's paper but suspected that the figures hid a substantial divergence within the sector: while the gearing of large companies had certainly improved, he did not believe this was true of small and medium businesses and the data excluded unincorporated businesses which had reduced access to equity capital and were already highly geared. What needed to be addressed was not so much the question of banks' capacity to lend as the structural problem of how to ensure that small and medium companies had access to adequate risk capital. As for the personal sector, individuals were showing a clear reluctance to borrow which had not been allayed by lower interest rates; rather, there was enthusiasm to repay indebtedness, which could be attributed in part to the negative equity overhang. Recovery of individuals' confidence and spending would be slow and so too would be the pick-up in the UK economy.

Mr Coleby said his confidence in the economy moving ahead was less strong in the case of Japan than of the US. In his view the Japanese authorities seemed too complacent and to be spurred only by the risk of fragility in the financial system. He was sceptical, therefore, whether Japan would contribute as much to growth of the world economy as the Bank's forecast suggested. On ERM fragility he saw a race against time. The French elections were one key factor but more important was the speed at which German interest rates came down. In France, concerns over unemployment were growing and he thought that politicians would have to respond after the elections even if the markets did not. Turning to the UK, Mr Coleby noted that banks sought to improve their position by offering customers a poorer deal, widening their margins and being cautious in taking on risk. Accordingly, echoing Sir David Walker's point, it was difficult to see a comfortable situation for small businesses until there was a general improvement in the economy.

Sir Martin Jacomb was in general agreement with Mr Quinn's assessment of the banks' position and also with the views expressed about the UK housing market, where aspects of the tax regime were unhelpful. However he did not view diminished personal confidence as wholly bad because it acted to curb imports at a time when the adverse trade balance was still a major concern. In view of the depth of the recession it was virtually certain that, following the reductions in the exchange and interest rates, 1993 would see some revival. But the UK's advantages would be eroded by any devaluations of other European currencies or by failure to contain unit costs. Japan had the advantage of the strong economic performance of China and of other countries in the Far East but the prospects for Europe were gloomy; a more widespread Balkan war was possible, levels of unemployment were becoming politically unsustainable and the competitive position was much inferior to that of the US. In the short term, abandonment of price stability in favour of action on unemployment seemed inevitable but Sir Martin hoped that the framework of the ERM remained to minimise the chance of competitive devaluations. All in all, the prospects for UK exports to Europe were gloomy.

The Governor said he had doubts that the fall in interest rates would, in practice, do much to get the economy moving. This led one to consider fiscal measures but only Japan among G-7 countries looked to have budgetary scope for such measures. Thus there did not seem to be capacity for recourse to the Keynesian response which succeeded in the 1930s. He asked to what extent the lack of capacity in public finances was attributable to the high level of entitlement payments which did not feed through to increased consumption.

Taking up the Governor's point about why the 1990s were different from the 1930s, Sir David Walker highlighted the speed of capital movement today. Because the markets' response could be instantaneous, the authorities now had to be far more concerned about market reactions.

Mr Kent was struck by what he saw as the beginning of a loss of confidence by government in the ability of market mechanisms to stimulate recovery. Officials were now thinking about ideas such as a national investment bank or contingency planning should the primary or secondary capital market for medium-sized companies disappear; two or three years ago such matters would not have been given a moment's thought. Nonetheless he still sensed that the Government was looking to the City and the financial sector to pull the chestnuts out of the fire. On the other hand, he foresaw the possibility of the current insurance "strike" spreading to other areas, eg regulatory insurance and that pressure for the authorities to underpin the financial system would increase.

Invited by the Governor to respond to the discussion, Mr Wright first explained that the UK was indeed treated separately from the rest of Europe in the Bank's forecast because the models of the downturn were different. He noted the risk to the outlook in the UK and Japan, and perhaps also in the US, of the property overhang. On Germany he agreed that the Bank's forecast was now considerably more optimistic than most others; there had been a clear hardening of views over the past 6-8 weeks. On France and ERM, the picture was confusing. French industry had clearly suffered a squeeze on competitiveness which seemed unsustainable. In addition, a premium existed on French and other European interest rates against those in Germany which could increase the longer the French hung on in the ERM; prospects for France were thus very uncertain. In the US, the outlook was now better than when the forecast was completed but some drags on economic performance were still present: the fall in interest rates might reduce the need to restructure balance sheets while prospects for employment were still uncertain. Mr Wright said that the forecast dealt separately with each major economy but it was important to consider country linkages. If there were to be an external stimulus, where would it come from? The US might contribute but who else? What was the risk that countries would seek to engineer growth through competitive devaluation? Even though countries may be willing to consider a fiscal stimulus the medium to long-term need is for budgetary consolidation. The necessity of switching the composition of fiscal deficits from current spending to financing infrastructural projects was evident but, as the Governor noted, the scope was limited.

Mr Crockett observed that the longer Court's discussion had continued, the greater had been the general pessimism he sensed. He thought that governments perhaps no longer had as much power as hitherto to pull a few levers and get economies moving. The current difficulties over asset prices and trade linkages mirrored the situation in the 1930s even if the extent was not yet the same, but a weaker outlook in one country had cumulative effects elsewhere. He shared the general pessimism over the ERM, which begged the question as to what would be the consequences of attempts to preserve it and of an ultimate breakdown. All in all, there was room for a greater sense of international purpose in addressing the world's economic problems, but there was little point in a G-7 summit until a positive outcome was in prospect; for the immediate future the intractability of French and German policy ruled this out.

E.A.J. George

17th December 1992

G. A. Clayton
Secretary.

A COURT OF DIRECTORS AT THE BANK

THURSDAY 17 DECEMBER 1992

Present

The Rt Hon Robert Leigh-Pemberton, Governor
Edward Alan John George, Esq, Deputy Governor
Sir George Adrian Hayhurst Cadbury
Anthony Laurie Coleby, Esq
Sir Frederick Brian Corby
Sir Colin Ross Corness
Andrew Duncan Crockett, Esq
Sir Christopher Anthony Hogg
Sir Martin Wakefield Jacomb
Sir David Bryan Lees
Brian Quinn, Esq
Sir David Gerald Scholey, CBE
Professor Sir Roland Smith
Sir Colin Grieve Southgate
Sir David Alan Walker

Hugh Christopher Emlyn Harris, Esq
Pendarell Hugh Kent, Esq
Ian Plenderleith, Esq

The Minutes of the last Court, having been circulated, were approved.

There being no comments on the weekly figures, Mr Coleby spoke about the foreign exchanges and the state of the domestic markets.

Under the weekly executive report, Sir David Lees asked the state of play on the possible lack of insurance cover for damage from terrorist attack. Mr Kent replied that the Bank were currently involved with discussions taking place in Whitehall. There was considerable urgency behind the problem as the current re-insurance arrangements mostly expired on 1 January 1993. Thereafter, the insurance companies effectively had two options open to them - to continue to accept the whole risk themselves or to withdraw cover under policies already in place for damage arising from terrorist activity and to refund part of the premiums accordingly. Government wished to avoid being in the position of effectively underwriting the situation as the costs could be extremely high. Discussions were currently focused on identifying a threshold below which the market would cover losses in the normal way with Government providing some form of cover for amounts in excess of that threshold. Another possible solution was to establish a compulsory pooled insurance arrangement covering the nation as a whole.

Sir Brian Corby suggested that it might be difficult to establish such a fund on an equitable basis because of the very different level of risk according to location, but thought that the professional insurance bodies could not alone act as insurers of last resort. Sir Martin Jacomb said that the implications of lack of insurance cover were severe, not only in respect of commercial property but because of the interruption it would cause to commercial activity.

Court gave their approval to Sir Christopher Hogg joining the Board of SmithKline Beecham plc as a Non-Executive Director.

At the Governor's invitation:-

1 In introducing the Report of the Audit Committee, Sir David Scholey drew attention to the Committee's comments on the proposal to defer the Bank's contribution to the Pension Fund in March 1993 until after the Actuaries' Report on the accumulated surplus in the Fund. The wording of the Report implied some criticism of the Executive in taking the decision without either Court or the Trustees of the Fund being involved. Sir Brian Corby explained that he had voiced that view as a Member of the Audit Committee although as a Trustee of the Pension Fund he supported the proposal. The Deputy Governor explained that at that stage it was no

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more than a proposal and it would be put to both the Trustees and to Court, in due course, for implementation in March 1993. Mr Harris, in his capacity as Chairman of the Trustees, endorsed the Deputy Governor's comments: the Trustees were now all aware of the situation and were content, as the Fund was currently in surplus.

Sir David Scholey said that the Committee had also agreed that there should be a revision of the way Bank property was handled in the accounts and that consideration would need to be given to the treatment of the Bank's support operations in the annual accounts for 1993.

In response to a question from Sir Christopher Hogg, Sir David explained that, because of the timing and surrounding sensitivities at that time, it had been agreed that it would be inappropriate to disclose the provisions relating to the Bank's support operations in the 1992 accounts, which the Auditors had accepted were not material. However, the circumstances surrounding these operations had changed; it might be appropriate therefore for disclosure to be made in the current year's accounts. The Deputy Governor explained that the threat of widespread withdrawal of wholesale funding from smaller banks, which was the reason for support, had now substantially diminished, though problems associated with deteriorating assets values had increased. He hoped that it would be possible to make full disclosure, to both Parliament and the public, when the Bank's accounts were published in the summer.

Sir David Scholey emphasised that, in making such a disclosure in 1993, it was important not to preclude the opportunity for non-disclosure in the future should the occasion warrant it. It was important that the Bank should retain the flexibility that it might need in this respect, which was why the phrase "in so far as they are appropriate to a central bank" had been added to the Notes to the Accounts.

The Committee had also noted that the external auditor's fee was £10,000 higher than the estimated cost and accepted that the fees were reasonable taking into account the additional work entailed in respect of the support operations.

The Committee had also endorsed the suitability of Messrs Coopers & Lybrand as external auditor for the year 1992/93 but had suggested that it would be appropriate to adopt a system of rotation of the partner responsible for managing the Bank's audit. Coopers & Lybrand had accepted this suggestion and would submit proposals for such a rotation in due course.

The Report of the Audit Committee was laid before Court.

Sir David Scholey went on to introduce the revised Terms of Reference for the Audit Committee. These had been drawn up by the external auditor and incorporated observations made by the Executive and the Audit Committee. The Terms of Reference had been drawn up in the light of the Cadbury Committee Report and were now much in line with those of any substantial public company.

It was agreed that the Terms of Reference of the Audit Committee should be revised to read as follows:-

Constitution

The Audit Committee is established as a Committee of Court to assist the Court in meeting its responsibilities in respect of financial reporting and to provide a direct channel of communication between the external auditors and the Court. Whilst the Committee shall have no executive duties or powers, it is invited and encouraged to make recommendations to the Court and management of the Bank.

Membership

The Committee shall consist of not less than four members and shall be appointed on the recommendation of the Governors by Court from amongst the non-executive Directors together with an executive Director, if any, with

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responsibility for internal audit. A quorum shall be two non-executive members.

Members shall be appointed for an initial three year term of office after which they shall be eligible for reappointment as Court may determine but not for more than five years in total. The Chairman of the Committee shall be appointed by the Governors.

Attendance at Meetings

The Deputy Governor shall attend meetings on request and, in particular, meetings relevant to the preparation of the annual accounts. The Head of Finance and Resource Planning Division, the Auditor and the external auditors shall have access to the Committee at any time and shall normally attend relevant parts of the meetings. However, at least once a year the Committee shall meet separately with the external auditors, and, separately, with the Auditor, without any executive management present.

The Secretary or Assistant Secretary shall be the Secretary of the Committee.

Duties

The duties of the Committee shall be:

- to review the internal audit programme;
- to keep under review the effectiveness of internal control systems;
- to consider the major findings of internal audit investigations and management's response;
- to review the scope, resource and effectiveness of the internal audit function;
- to consider and make recommendations on the appointment of the external auditor, rotation of responsible partner(s), the audit fee and any questions of resignation or dismissal;

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- to discuss with the external auditor before the audit commences the nature and scope of the audit;
- to review the co-ordination between the internal and external auditors;
- to review the accounting policies and practices adopted in the preparation of the annual financial statements and satisfy itself that where applicable the appropriate policy has been adopted from the alternatives available in so far as they are appropriate to a central bank;
- to review the annual financial statements before submission to Court, with particular attention to:

  - the major judgemental areas and estimates;
  - findings of the external auditors, including significant adjustments resulting from the audit;
  - the adequacy of the disclosures made;

- to discuss problems and reservations arising from the audit and any matters the external auditor may wish to discuss;
- to consider the letter of representation to the external auditor;
- to review the external auditor's management letter and any other audit findings together with management's response;
- to receive a statement of any non-audit services provided by the external auditor to the Bank.

Frequency of Meetings

The Committee shall meet at least three times a year to consider, inter alia, the following matters:

Winter - The Bank's accounting policies and accounting issues.
- The external audit scope and proposed fees.

- The Auditor's report on the work of Audit Division.
- The forthcoming Audit Division audit programme.

Spring
- The draft annual accounts prior to their presentation to Court.
- The Auditor's report on the work of Audit Division.
- The report to HM Treasury on the audit of the Exchange Equalisation Account.

Autumn
- The external auditor's management letter and finalisation of external auditor's fees.
- The Auditor's report on the work of Audit Division.

Additional meetings may be held at the request of the Governors, the Committee, external auditors or internal auditors.

Reporting Procedures

The Chairman of the Committee shall report to Court on the proceedings of the Committee after each meeting and make other reports and recommendations as the Committee may see fit.

Amendments to Terms of Reference

The Committee shall recommend to Court such revisions of its terms of reference as from time to time the Committee considers appropriate.

E.A.J. George
7th January 1993

G. A. Croughton.
Secretary.

A MEETING OF DIRECTORS AT THE BANK

THURSDAY 24 DECEMBER 1992

Present

Edward Alan John George, Esq, Deputy Governor
Brian Quinn, Esq

Pendarell Hugh Kent, Esq
Ian Plenderleith, Esq

The number of Directors assembled being insufficient to form a quorum, those present proceeded to the business, subject to ratification by the next Court.

The Minutes of the last Court, having been circulated, were approved.

There being no comments on the weekly figures, Mr Plenderleith

G. A. Croughton
Secretary

E. A. J. George
7th January 1993

A MEETING OF DIRECTORS AT THE BANK

THURSDAY 31 DECEMBER 1992

Present

Edward Alan John George, Esq, Deputy Governor
Andrew Duncan Crockett, Esq
Anthony Laurie Coleby, Esq
Mervyn Allister King, Esq

Hugh Christopher Emlyn Harris, Esq

The number of Directors assembled being insufficient to form a quorum, those present proceeded to the business, subject to ratification by the next Court.

The Minutes of the last Meeting, having been circulated, were approved.

Mr Coleby commented on the weekly figures and then went on to speak about the foreign exchanges and the state of the domestic markets.

G. A. Croughton.
Secretary.

E. A. J. George
7th January 1993