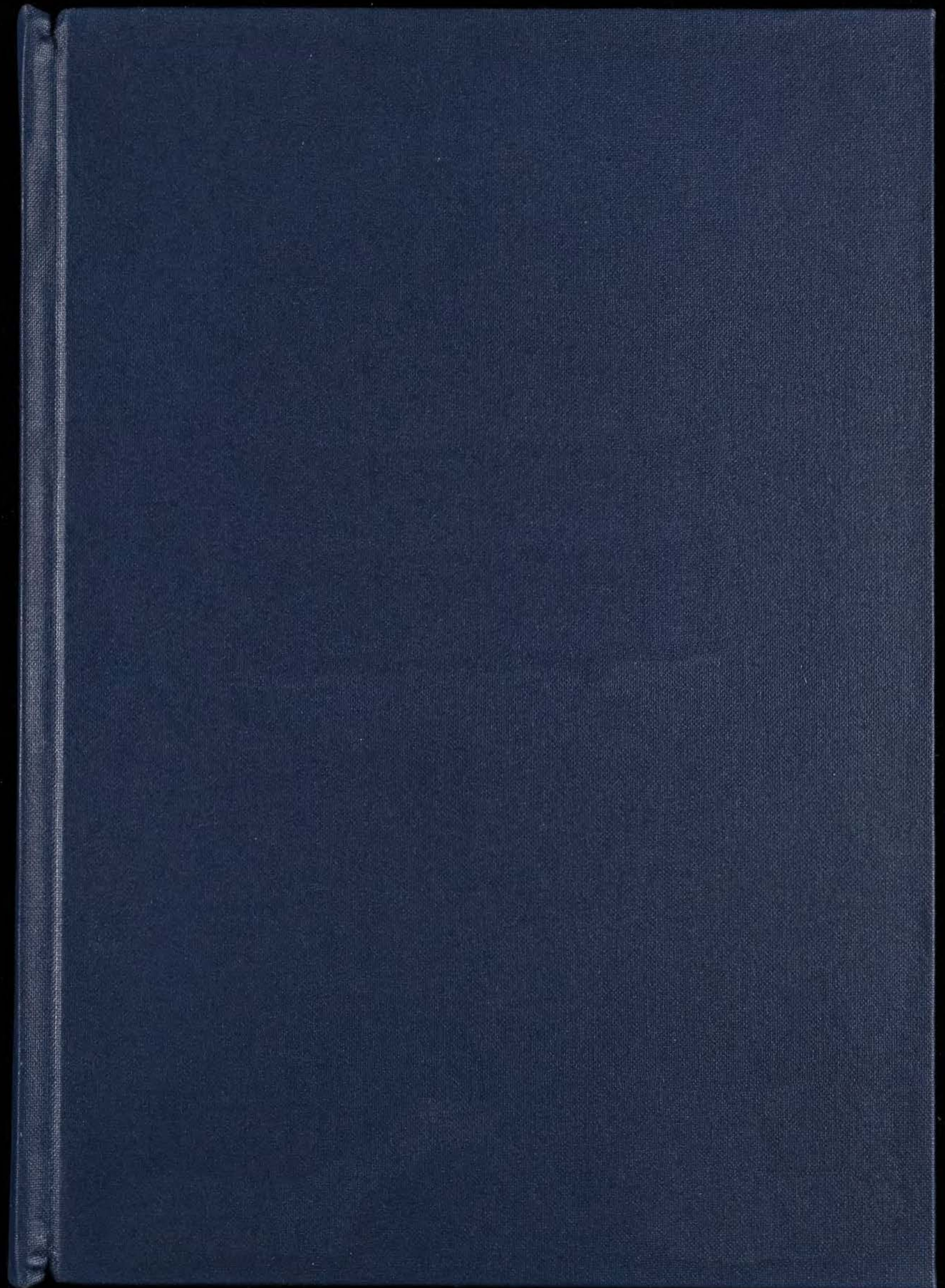

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12A110/8

A COURT OF DIRECTORS AT THE BANK

THURSDAY 7 JULY 1994

Present

Edward Alan John George, Esq, Governor
Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Sir Christopher Anthony Hogg
Pendarell Hugh Kent, Esq
Sir John Chippendale Lindley Keswick
Mervyn Allister King, Esq
Sir David Bryan Lees
Ms Sheila Valerie Masters
Ian Plenderleith, Esq
Brian Quinn, Esq
Professor Sir Roland Smith

Hugh Christopher Emlyn Harris, Esq

The Minutes of the Court of 16 June and of the Meetings of 23 and 30 June, having been circulated, were approved.

There being no comments on the weekly figures, Mr Plenderleith 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.

B.A. Hoffmann
Assistant Secretary
14th July 1994

[signature]

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A COURT OF DIRECTORS AT THE BANK

THURSDAY 14 JULY 1994

Present

Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Sir David Gerald Scholey, CBE
Sir David James Scott Cooksey
Sir Colin Ross Corness
Sir Christopher Anthony Hogg
Pendarell Hugh Kent, Esq
Sir David Bryan Lees
Ms Sheila Valerie Masters
Sir Christopher Jeremy Morse, KCMG
Ian Plenderleith, Esq
Brian Quinn, Esq
Professor Sir Roland Smith

Hugh Christopher Emlyn Harris, 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.

Court gave their approval to Sir Chips Keswick joining the Board of IMI PLC.

At the Deputy Governor's invitation, and with the agreement of Members of Court, Mr Clark, Deputy Director with responsibility for regulatory policy in the Financial Stability Wing, and Mr Taylor, an official in that area, and the author of the

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paper "Wholesale and Retail Regulation", attended Court for the ensuing discussion.

The Deputy Governor invited Mr Kent to introduce the paper. Mr Kent said that although the paper had been produced within FMID, in future these topics would be his responsibility jointly with Mr Quinn, and would fall to the Regulatory Policy Division under Mr Clark. He then asked Mr Taylor to make a few introductory remarks on the paper.

Mr Taylor said that the immediate justification for the paper had been a question raised by Sir Colin Corness at the March Court concerning wholesale and retail regulation. However, the issues considered were also relevant to the Treasury Select Committee's current investigation into the operation of the Financial Services Act. The Bank, in the form of Mr Quinn, had been invited to give evidence, probably in the autumn. The paper was intended to assist in a mind-clearing exercise prior to the formulation of the Bank's evidence to the TCSC. It considered three basic models for change to the regulatory system: (i) a modification to the status quo; (ii) separate prudential and conduct of business regulators; and (iii) a single financial services commission. Court's views would be welcome, especially on the extent to which the existing structure was in need of reform, and whether or not institutional change was the key to remedying any defects which might exist.

Mr Kent added that it would be helpful if Court could consider whether or not there was a case to be made for change, and if an evolutionary approach might be preferable to a more radical review of the system.

Sir Colin Corness said that the Bank had clearly to consider its view prior to giving evidence to the TCSC enquiry. He thought that the wholesale/retail divide was not a practical way of organising the regulatory structure. The distinction between wholesale and retail was becoming blurred. For example, as a result of the Government's proposals for Building

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Society deregulation and Lloyds's attempted acquisition of the Cheltenham and Gloucester. An additional factor was the emergence of the PIA, to which he thought most of the regulated community would eventually join up. There was a danger that radical change, following rapidly on the heels of the PIA formation, would simply be the cause of deep confusion. He favoured, therefore, an evolutionary approach which should concentrate on achieving greater co-ordination between regulators.

Sir Jeremy Morse also thought that the wholesale/retail distinction was not one to pursue. He believed that there was no great need for change, but thought it important that the Bank should have a view on these matters, given the pressures for change coming from other quarters. The blurring of boundaries between banking, insurance and securities products meant that supervisors needed to familiarise themselves with these different businesses, but it should not lead to a change in the style of supervision; different types of business required different approaches to regulation. On conduct of business regulation, he thought that there was an important distinction to be drawn between banking products and more complex and opaque investment products. Although recognising that conduct of business regulation was essential for the latter, he thought it was important not to lose sight of the caveat emptor principle, and to avoid giving the impression that accidents would never happen. There was a need to impress on investors the limitations of what a system of regulation could reasonably be expected to deliver.

Sir David Lees thought that the paper did not identify adequately the nature of the problem. For example, it did not explain whether the problems with the existing system were those of inefficiencies, costs or regulatory gaps; until the problem was defined, it was not possible to come up with a solution. He was doubtful that there was a serious problem with the existing system of regulation, and did not believe that it inhibited the Bank in the performance of its core

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functions. The Deputy Governor agreed that the costs of regulation needed to be more carefully considered.

Sir Christopher Hogg said that there was a sense that the existing system of regulation was unduly complex, but thought there was no real alternative to it in prospect. He did not think it appropriate for the Bank publicly to set out an alternative model for the regulatory system; its role should be to bring the discussion out into the open, and ensure that all relevant matters were given a proper airing. He agreed with the paper's proposition that the most important issue was to ensure that regulators had high calibre staff. There was also a case for encouraging greater transparency in the financial markets; those active in them tended to underestimate the influence of vested interests.

Mr Quinn said he was also of the view that the distinction between wholesale and retail, and between consumer protection and systemic protection objectives, did not provide a workable basis for a redesign of the regulatory system. There were, essentially, two sources of dissatisfaction with the existing arrangements. The first was the Financial Services Act, which had experienced a number of teething problems in the years immediately after its introduction. However, he sensed that the system had now bedded down and was being made to work better. The most important source of dissatisfaction was in the consumer protection field, where there had been a number of recent, and high profile, cases, which were seen in some quarters as indicating regulatory failure.

Turning to the Bank's role, Mr Quinn said that he thought this was broader than the lender of last resort function, and should embrace crisis management more generally. Crisis management required rapidity of action, a depth of knowledge of the system and markets, and, increasingly, the capacity to act on an international scale, which meant that the central bank was best placed to provide it. No matter how the regulatory system was structured, the Bank would always have a leading role to play in crisis management. In addition, however, it was important

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to try to prevent crises from occurring, and this was the role of supervision.

Mr Quinn thought that there was scope for making the existing system tidier, perhaps by reducing the number of SROs. He said a valuable exercise would be to compare the costs of regulation in the UK with those in other centres; little work appeared to have been done on this. In addition, there would be dangers in making the regulatory authority directly answerable to politicians. The problems closely parallelled those which arise in the field of monetary policy.

Sir David Scholey remarked that the UK's regulatory system was looking increasingly out of step with the rigid and prescriptive approach adopted in the United States and the Continent. He thought it important to resist the import of this type of regulation into the UK, and described the Bank as one of the last bastions of the flexible and pragmatic approach. There was also a sense in which the regulatory system was being judged by multiple and inconsistent criteria - providing the customer with total protection, ensuring deep liquidity in the markets, and ensuring fair dealings between a firm and its clients. The trade-offs between these objectives had to be recognised.

In Sir David's view, the regulatory system was not in need of root and branch reform, but it did require better management. Issues which required particular attention were regulatory overlaps and underlaps, and inconsistent regulatory rules. Sir David differed from the other speakers in viewing the wholesale/retail distinction as important. As the paper argued, there were significant differences between interprofessional trading, and dealings between professionals and non-professionals, and this pointed to the need for a different approach to regulation in these cases.

Sir David suggested that the Bank needed to do more analysis in conjunction with firms' compliance staff, who were best placed to judge the costs and burdens of the existing system. He

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wondered about the extent to which contact with compliance people already took place. Mr Clark said that, to the best of his knowledge, contacts were maintained with compliance departments, although there would be scope for examining how these might be deepened. Sir David also said that it would be helpful to see more work done on the comparative costs of regulation. The subject was one which needed much more study, and he thought the Bank was best placed to take this work forward.

The different criteria for judging the regulatory system were also relevant to the issue of transparency. Sir David said it had to be recognised that there was a balance to be struck between liquidity and transparency. Mr Plenderleith said that transparency, in the sense of disclosure rules for investment products, was a rather different matter to the transparency of markets. The latter was a market structure issue rather than a regulatory one, and it was difficult to argue that it was a matter affecting the retail investor.

On the issue of regulatory structure, Mr Plenderleith said that, although the existing system was not the most coherent imaginable, it nonetheless had started to bed down and worked reasonably well. He agreed with Sir David Lees that there was a problem of retail conduct of business regulations creeping into the wholesale markets, and thought this was being accentuated by European directives, particularly the Investment Services Directive.

Sir Jeremy Morse returned to the question of the Bank's evidence to the TCSC. The sense of the discussion appeared to support the line proposed by Mr Quinn, which was essentially defensive; it would be presentationally important to ensure that this message was put forward in positive terms. He thought it would be important for the Bank's evidence also to point out the difficulties which would be associated with a rethink of the existing system. Sir Jeremy wondered whether or not the TCSC saw a connection between their current enquiry and the question of independence for the Bank; the Deputy Governor

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said that the Committee did not appear to regard them as connected.

Mr Kent said that the answer to Sir David Lees's earlier question was that many people did apparently consider that the system of regulation was flawed. They included sections of the press, Members of Parliament and the Labour party. In formulating its position, the Bank would need to ensure that its position was sufficiently robust to withstand a change of government. Mr Quinn noted that the Bank's evidence to the TCSC would need to take into account this wider audience.

Summing up the discussion, the Deputy Governor said that he thought it would be helpful for Court to have a further discussion based on the draft of the Bank's evidence to the TCSC when this was ready.

At the Deputy Governor's invitation, and with the agreement of Members of Court, Mr Jarvis, the General Manager of the Printing Works, attended Court for the discussion of the Printing Works' Annual Report to staff and the Report and Financial Statements of Debden Security Printing Ltd for the year ended 28 February 1994. At the conclusion of Mr Jarvis's review of the year, Mr Kent mentioned that the Economic Secretary, Anthony Nelson, had visited the Printing Works recently. The outcome had been generally satisfactory, with both parties deriving encouragement from the visit. The Economic Secretary had felt the Works were efficient and, at the same time, he was surprised by the complexity of the operation. He did not consider the case for privatisation was made; it was not one which he would support. This said, the issue would never go away entirely. The Economic Secretary was concerned over the risks to the public through the forgery of notes, although these concerns were linked as well with money laundering. Mr Kent concluded by saying that, in line with government departments generally, we were facing demands to do something in the context of the Fundamental Expenditure Review. HM Treasury had to make its own contribution, and much of its expenditure consisted of payments for services to HMT.

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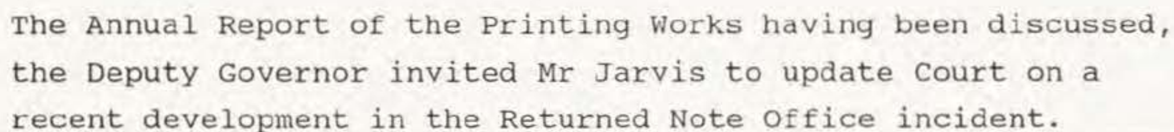

The Annual Report of the Printing Works having been discussed, the Deputy Governor invited Mr Jarvis to update Court on a recent development in the Returned Note Office incident.

At the Deputy Governor's invitation and with the agreement of Members of Court and in the absence of Mr King, Mr Allen, a Deputy Director and Head of Analysis in the Monetary Stability Wing, and Mr Bowen, Head of the Group, who is responsible for

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the production of the Inflation Report, attended for the discussion of the Inflation Report.

Mr Allen said that the Inflation Report was to be published on 2 August and they were still in the process of deciding what it should say. He intended to review the background to the report and then invite Members of Court to comment on some of the questions it was thought the report needed to address.

Recent developments in inflation had been favourable. The 12-month increase in the target measure RPIX increased by 2.4% in June, and our preferred measure, RPIY, increased by 1.7%. In both cases this was about 0.3% less than we forecast in the May Inflation Report, and it was the fourth time out of five that, in the short term, inflation had turned out below our forecast.

Among the monetary aggregates, MO had continued to grow faster. It rose by 6.8% in the year to June, compared with 5.6% in the year to March; and was plainly well outside its medium-term monitoring range of 0 to 4%. Our research suggested that it should decelerate over the rest of this year. By contrast M4 was in the lower half of its monitoring range of 3 to 9%: it had increased by 5.4% in the year to May. It was thought borrowing by individuals would be a bit lower in the second quarter than the first, but industrial and commercial companies seem to have re-started net borrowing from banks on a modest scale after a period of heavy net repayments.

There had, of course, been continued turbulence in the capital markets since the last Inflation Report, with bond yields up further and equity prices down. Taken at face value this suggested that inflationary expectations in the bond market had worsened, and that they were inconsistent with the inflation target.

Output had been growing at a rate of about 2½ - 3% a year, probably a little above the rate that would be sustainable in the long term. Consumer spending growth had continued: there was no sign so far that it had been inhibited by the recent

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increases in indirect taxes. Turnover in the housing market had been subdued and prices had, broadly, been flat, perhaps affected by the increased cost of fixed-rate mortgages. Land prices had risen, however. Corporate profitability was strong and business optimism was picking up, and fixed investment turned up in the fourth quarter of last year and the first quarter of 1994.

In the labour market, the underlying rate of increase of average earnings went up to 4% in March but dropped back to 3¾% in April and May. Unemployment had continued to fall steadily, which was unusual at such an early stage in an economic recovery. Job counts, however, suggested that the amount of employment fell in the first quarter of 1994.

There were two clouds on the horizon for the medium-term outlook for prices. First, we had seen over the last year a large increase, of 30% or so, in non-oil commodity prices measured in sterling. This sounded alarming, but in fact material and fuel imports accounted for only about 5% of the value of manufactured output, so it was perhaps less alarming than it looked: manufacturing input prices in total had risen by only 1.6% in the year to June.

The second cloud was that the CBI monthly survey for June showed a sharp increase in the balance of firms expecting to raise prices in the next four months.

Some of the questions which had arisen in the course of considering what the report should say, and on which comments would be welcome, were:-

1 There was a large difference between published forecasts of inflation and the inflationary expectations implied by bond yields, which were much higher. How seriously should we take bond yields as an indicator of inflationary expectations?

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2 What should we make of the CBI survey result on prices? Would competitive pressures allow producers and retailers to widen profit margins?

3 Consumer demand seemed to have held up remarkably well so far, despite the indirect tax increases. Could it continue?

4 Was there still substantial spare capacity in the economy? Were skill shortages emerging?

5 Were recent increases in commodity prices the result of supply developments, and perhaps of speculative purchases, or did they reflect general increases in demand?

Sir David Lees opened the ensuing discussion by saying that CBI Quarterly data for price expectations would be available on 26 July. It would be important for us to look at these numbers as soon as possible. Manufacturers would put up prices when they could, particularly as recovery in Western Europe gathered pace.

Sir Colin Corness commented that many prices were now below their level in the late 1980s. This raised the question of restoration of previous levels and profit margins. They were not real price increases. The housing industry would remain very subdued. When recent fixed-rate mortgages come up for their interest rate reviews, rates might go up a lot.

Ms Masters questioned the reliability of the figures for the return on capital. She asked what the consequences would be of an increase to mid-1980s levels for inflation. There was a fear that attempts to restore profitability might push up inflation.

In response, Mr Allen wondered how firms would attempt to increase returns on capital. It depended on their expectations

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of inflation. Increasing their selling prices was not the only way for them to increase profitability.

Firms, said Mr Plenderleith, could increase profitability by reducing costs, as they had done, instead of putting up prices. The more efficient utilisation of capital was, Sir David Lees said, another way.

Sir David Scholey asked what the track record was of future inflation rate expectations desired from the gilts market. He was not surprised by the rates the Bank had desired and enquired what was happening overseas.

Mr Plenderleith said there had been a slight fall recently in measured expectations. The measure could reflect bond market turbulence; not all movements necessarily indicated a true change in price expectations.

Mr Allen commented that we were in much the same position as the US. The Federal Reserve thinks the bond market is too pessimistic, but there are market suspicions that the Federal Reserve is too optimistic about inflation.

In response to Sir David Scholey's remark that the bond market had been disorderly, Mr Plenderleith said he agreed entirely. If rates were compared with a year ago, there had not been a tremendous change. What had happened over the last year was that the bond market got overheated and had then burnt out.

This, Sir David Scholey said, illustrated that how central banks informed markets about their expectations and intentions was very important. The Federal Reserve announcement in February had been signalled clearly, but no-one seemed to pay much attention to the warning.

The Deputy Governor concluded the discussion by saying Court would return to the subject at the following month's Long Court after the Inflation Report had been published.

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Under the weekly executive report:-

(i) The Deputy Governor mentioned that, with the advent of the Long Courts starting at 10.00 am in September, the Minutes would be shorter, and not as literal or as formal as in the past.

(ii) The Deputy Governor said that the arrangement whereby Non-Executive Directors could make use of the Bank's facilities to stage a charitable or non-commercial function once during each term of office had been reviewed. The concept was considered a good one and it had been agreed that use of this arrangement be extended to once a year for each Non-Executive Director, but that the Bank would pay for only one such function during each term of office, and then only for one of a non-commercial nature.

(iii) With reference to a Minute of 16 June, Mr Kent updated Court on the flotation of 3i. He said it had been successful, being covered 1.1 times, and that the price in difficult market conditions had been right. Our own proceeds would be £122mn, net, which would be fed into our accounts. This raised the question of whether or not we should make a special dividend payment to HM Treasury. We would, of course, lose income from the sale of our shares and would need to retain some £40mn from the sale proceeds to compensate for the reduction in dividend income. Our shareholding in the company had decreased from 14.5% to 6.5%.

Sir David Scholey said that he would like to congratulate both past and present Executive Directors of the Bank on the fact that 3i had reached the position it had. It was a considerable achievement on their parts.

(iv) Mr Kent mentioned that for the past two or three years, the clearing banks had been trying to release themselves

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from ownership of the London Clearing House because of the financial risks they faced in the event of a disaster. They had been trying to transfer ownership to the derivatives exchanges, but so far had not been successful. This was beginning to have an effect on the reputation of the market and we had, therefore, concluded we should try to broke a successful solution. The parties had all agreed.

David Scholey

G. A. Coughton.
Secretary
11 August 1994

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MINUTES OF A MEETING OF DIRECTORS AT THE BANK

THURSDAY 21 JULY 1994

Present
Pendarell Hugh Kent, Esq
Ian Plenderleith, Esq

In the absence of the Governor and the Deputy Governor, Mr Kent was chosen Chairman pursuant to the provisions of Clause 6(2) of the Charter of 1 March 1946.

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 noted.

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

G. A. Croughton.
Secretary 11 August 1994.

David Scholey

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A MEETING OF DIRECTORS AT THE BANK

THURSDAY 28 JULY 1994

Present

Edward Alan John George, Esq, Governor
Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Pendarell Hugh Kent, Esq
Mervyn Allister King, Esq
Ian Plenderleith, 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 and those of the Court of 14 July, having been circulated, were noted.

In commenting on the weekly figures Mr Plenderleith explained the changes in the Bank's Weekly Return resulting from the repayment of £11 mn of "Government debt" after 300 years, and the purely accounting changes in the treatment of repos. He went on to speak briefly about the markets.

G. A. Croughton
Secretary 11 August 1994

Brian Scholey

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A MEETING OF DIRECTORS AT THE BANK

THURSDAY 4 AUGUST 1994

Present

Edward Alan John George, Esq, Governor
Brian Quinn, Esq
Pendarell Hugh Kent, Esq
Mervyn Allister King, Esq
Sir Christopher Jeremy Morse, KCMG

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 noted.

Mr King commented on the weekly figures and went on to speak about the foreign exchanges, including the Official Reserves figures for July, and the state of the domestic markets.

Secretary 11 August 1994

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A COURT OF DIRECTORS AT THE BANK

THURSDAY 11 AUGUST 1994

Present

Edward Alan John George, Esq, Governor
Sir David Gerald Scholey, CBE
Sir Colin Ross Corness
Mrs Frances Anne Heaton
Sir Christopher Anthony Hogg
Pendarell Hugh Kent, Esq
Sir John Chippendale Lindley Keswick
Mervyn Allister King, Esq
Sir David Bryan Lees
Ms Sheila Valerie Masters
Sir Christopher Jeremy Morse, KCMG
Ian Plenderleith, Esq
Brian Quinn, Esq
Sir Colin Grieve Southgate

Hugh Christopher Emlyn Harris, Esq

The Minutes of the Court of 14 July and those of the Meetings of 21 and 28 July, and 4 August, 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 Plenderleith spoke briefly about the events surrounding the Treasury Bill tender which took place on 29 July.

With reference to a Minute of 5 May, the Governor introduced a Resolution appointing Mr I D Saville, the CREST Project Controller, to exercise the Bank's powers as shareholder in

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CRESTCO. Mr Kent explained that, while the intention had been that the Bank should have no shareholding in the company, this stance had changed for reasons of tax efficiency and to give the Bank operational control while the CREST software was built. This power would lapse on hand over to the owners.

Court RESOLVED that, consequent upon the appointment of Messrs P H Kent and I D Saville to the Board of CRESTCO Ltd and pursuant to Section 375 of the Companies Act 1985, as amended and extended by the Companies Act 1989, and until otherwise resolved by the Court of Directors, Mr I D Saville be appointed to represent the Bank, and exercise powers on behalf of the Bank, at any meeting of CRESTCO Ltd.

In general discussion, Members expressed a number of concerns about the Bank's involvement with the CREST project, particularly in the event of any cost overrun. Mr Kent agreed to present a short paper describing the commercial arrangements between the Bank and the future owners. He pointed out that, by the time Court considered the paper, the contract between the Bank and the future owners would be at an irrevocable stage. However, this contract would meet many of those concerns.

The Governor, having declared his potential interest in the Court Pension Scheme, together with those of Messrs Quinn, King, Kent and Plenderleith, invited Sir Colin Corness to present a Report of the Trustees of the Court Pension Scheme, together with the Annual Report and Accounts for the year ended 28 February 1994.

Sir Colin explained that the Trustees had recommended in their Report that Court accept the Actuary's suggestion that the annual contribution rate to the Court Pension Scheme, for the year beginning 1 March 1994, should be set at 25% per annum of pensionable remuneration on which pensions can be provided from the scheme; for Mr Pennant-Rea and Mr King, pensionable remuneration was restricted to £76,800. This rate also took

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into account the increase from 50% to 55% in allowances to widows over the age of 80.

In approving the recommendation, Court also endorsed the Trustees' congratulations to the Chief Investment Manager and his team on their outstanding performance in achieving a total asset return for 1993 of 35.3%, some 7.1% above the weighted average of the WM All Funds Universe.

The Report and Accounts of the Court Pension Scheme for the year ended 28 February 1994 were laid before Court.

Mr Harris presented a Report of the Trustees of the Bank of England Pension Fund, together with the Report and Accounts of the Fund for the year ended 28 February, which were laid before Court.

The Governor thanked the Trustees for their commitment to both the Court and Staff Pension Schemes.

At the Governor's invitation, and with the agreement of Members of Court

Division, attended Court for the discussion of the Inflation Report, which had been published on 2 August.

In introducing the Inflation Report, Mr King said that the main question for monetary policy at this juncture was how strong was the evidence of a future pick-up in inflation. Recent inflation out-turns had been encouraging. Underlying inflation had continued to fall, by more than expected, and might well continue to fall for another quarter or so. It was now 1.7% on the Bank's measure (RPIY), and 2.4% on the Government's measure (RPIX). Mr King said that it was encouraging that service sector inflation had continued to fall in 1994, showing that the tightening in monetary policy had reached every sector of the economy. However, inflation appeared to have reached its trough at the beginning of 1994.

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The disinflationary impact of spare capacity, right across the economy, had been larger than anticipated, both during the recession and also into the first stages of recovery. At some point this downward pressure on inflation would be offset by the upward pressure coming from growth above trend and increases in the costs of inputs and raw materials. So far, output growth had not exceeded the safe "speed limit". But, as the output gap narrowed, inflation was likely to rise slowly.

In the May Inflation Report, three main risks to the inflation outlook were identified - monetary growth, the rise in earnings, and inflation expectations. None of these had become worse, and monetary growth had started to decline a little. Equally, of the four principal indicators used by the Government, three appeared to be no worse - with M0 starting to decelerate, M4 growth lower than three months ago, especially for households, and house prices falling over the past six months - and only the fourth was giving concern, with the sterling effective exchange rate index lower than at the time of the May Inflation Report.

With the recovery proceeding at a somewhat faster pace than projected in May, there were two main challenges for policy:

(i) we were another quarter nearer to the date for the target to bring inflation within the lower half of the 1-4% band;

(ii) there had been a series of warnings from potential leading indicators of inflationary pressure - "straws in the wind" some might call them - which raised concerns that inflationary pressures might be building up in some sectors. These included reports of rising costs in the construction sector, reports of some recruitment difficulties, increases in import prices, and further evidence in the CBI survey of a desire by firms to raise prices.

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At this stage these "straws in the wind" had not led to the revisions in the Bank's medium-term projection for inflation, which was broadly unchanged from May. But we continued to monitor the risks to the inflation outcome very closely. At the current level of interest rates, our best guess - and it can be no more than that - was that underlying inflation would be just above the mid-point of the target range in two years or so.

Mr King then asked the Members of Court for their views of these "straws in the wind"; how serious were they, if at all?

Sir Colin Corness said that the housing market remained weak. While most figures indicated that year-on-year there had been growth in the housing market, these were all weaker than would have normally been expected, ie below trend. On pricing in construction, he said that contractors' margins remained wafer thin, but manufacturers had been able to raise prices by 3-4%. This, though, was an increase in list prices; achieved prices were probably lower.

Sir Chips Keswick commented that the recent attention paid to land prices might be misleading. While it was true that builders had paid increasingly high prices for land recently, they might well be unable to pass them on to their customers. Higher land prices did not necessarily mean higher house prices in the future.

Mr Plenderleith asked for Court Members' views on why the housing market was weak - did they feel that there was a problem with the current price structure?

Sir Colin Corness said that nominal house prices had risen within the last year, but in real terms were unchanged on the year. He felt that the "soft" housing market was explained by a lack of consumer confidence. People were still uncertain about their employment prospects and the political climate. They remained worried about the possible withdrawal of mortgage

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interest tax relief, and the impact of the recent tax increases was also an important factor.

Sir Colin Southgate felt that the weakness in the housing market was probably a good thing. Previously, the housing market had been the driving force for inflation. He reported that, at least in his area, the economy in recent months had been flat. However, he remained bullish, expecting 5% growth during 1994 in his business.

Discussing the Inflation Report directly, he felt that highlighting particular issues of concern with regard to future inflation was very useful, and played a helpful role in projecting our concerns to the markets and the wider economy. He felt that future reports should continue to build on this, reinforcing the attention paid to these topics. He was particularly keen to see more research done on the merits of profit-related pay, feeling that the closer workers wages' were related to performance, the better.

With regard to economic growth, Sir David Scholey wondered whether we should be less concerned with capacity constraints, and more concerned with attempting to raise the level of trend growth. Mr King noted the benefits of increasing trend growth, even by 0.1 percentage point, but felt that, aside from technological improvement and reorganisation within specific sectors, opportunities for boosting the trend growth rate were limited. Countries undergoing technological "catch up", as Germany and Japan were post-war, would have faster rates of growth; but once this had occurred, their growth rates had fallen to levels similar to the UK's. Also, as the Inflation Report had shown, there had been a trend decline in labour supply in the UK, which will reduce the prospects for output growth.

Sir David Scholey felt that the Bank's work on market-based expectations of inflation, and the comparisons with other macroeconomic forecasts, should be continued. He also said that there did not appear to be a general awareness of the move

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from a target range for RPIX from 1-4%, to 1-2.5% by the end of the parliament. The Inflation Report could remind the wider community of this move.

Sir Jeremy Morse asked to what extent the next rise in interest rates would be due to the psychological importance attached to rising rates - ie the message this communicated to the markets - or would it be dependent upon our expectations of the future outcomes of the economy as a whole (the mechanics of the economy, as he put it). The Governor said that the Bank was continuously monitoring the mechanics of the economy and, whilst aware of the impact that market psychology could have, any judgement on interest rate movements would be based on the expectations of the economy's future performance - ie the mechanics.

Sir Christopher Hogg asked to what extent the Bank was certain that an increase in interest rates would affect the economy in a manner similar to previous increases. The Governor said that we could not be confident of the impact of any interest rate rise. We did not have a perfect understanding of the transmission mechanism - the way that interest rate changes affect the economy; this process took at least two years before the full effects came through. Any interest rate change would always involve an element of judgement. However, he felt that the increased transparency in policy making, and the publication of the Inflation Report and of the minutes of the monthly Governor/Chancellor meetings, had improved the understanding of the process involved in monetary policy. As press reaction to the Inflation Report had shown, views may differ but the underlying debate seemed to have been absorbed. Improved transparency had led to a clearer understanding of the transmission mechanism among the wider community, and the objectives of the current monetary stance.

Mr Townend, a Deputy Director with responsibility for Market Operations, and Mr Tucker, the Head of Gilt-Edged and Money Markets Division, attended Court for the discussion of the paper "Recent Developments in the Sterling Money Markets".

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In introducing the paper, Mr Townend said that it was an attempt to remove some of the mystique about the money markets and our operations in particular.

There were two general points to make. First, there was no such thing as the sterling money market, but a whole series of parallel markets, from deposits to cash instruments and the derivative markets. Second, we and other central banks were interested in these markets for a number of reasons, but mainly because the level of short-term interest rates was the instrument of monetary policy. We secured the level that we and the Government thought right by our operations in the money market.

The Bank operated in a broadly similar way to other central banks. Essentially the banking system was kept regularly short of cash in the knowledge that the only replenishment can come from ourselves. If we did not provide sufficient cash on the day, the only result, at the end of the day, would be that the main settlement banks' accounts at the Bank of England would be drawn down. We placed on these banks an obligation not to go overdrawn and they paid a penalty if they did, so there was an incentive to participate in our operations.

Mr Townend explained that liquidity was provided by buying eligible bank bills (either outright or on repo) from our counterparties - the discount houses - who stood between us and the banking system. The stock of assistance provided was constantly rolling over, which itself generated shortages; but we could add to these if necessary, by increasing the weekly Treasury bill tender. The Bank published a daily forecast of the expected shortage, and operated at a number of set times in the day to relieve it.

The rate at which the Bank bought bills signalled the level of interest rates with which we were content, so at present we were buying bills up to one month in maturity at 5 1/8% rate of discount, which equated to a yield of 5 1/4%. And we expected market rates to be broadly in line - but this highlighted the

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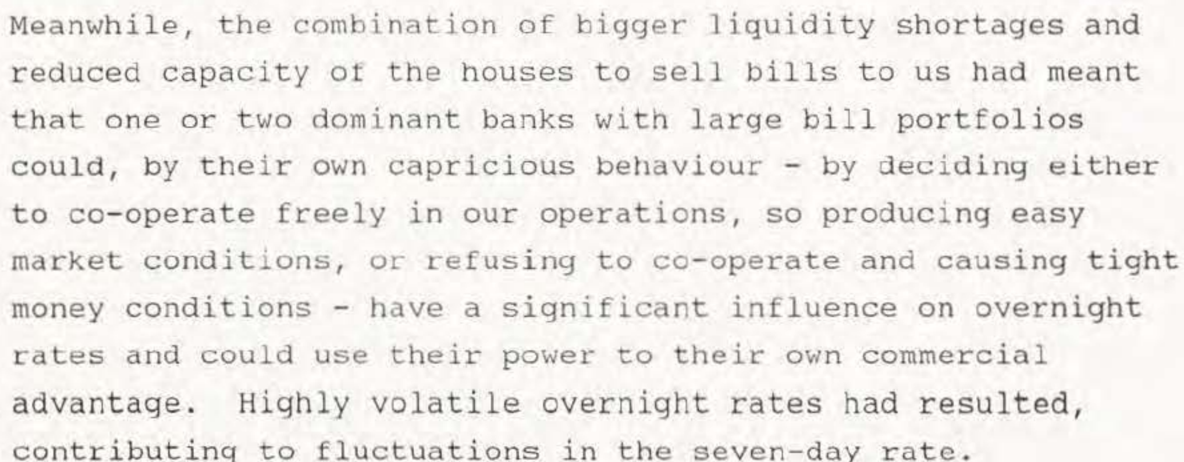
fact that our influence did not extend much beyond this, quite short, maturity. If we wanted to change the official level of interest rates, we could deal at different bill rates - higher or lower than before - or we could signal our intentions by reintroducing Minimum Lending Rate for a short period, like a day. If we wanted to influence market expectations of rates, we could do so by changing our operations in ways ranging from the very subtle to the very obvious.

Mr Townend indicated that the rest of the paper was in broadly three sections; past, present and future. The section on the past identified a problem which had arisen in particularly acute form two years ago, just before the ERM-exit. Foreign exchange market intervention had drained sterling cash from the banking system, and this had to be replaced through our money market operations, so increasing the stock of assistance. With the increased stock had come increased daily shortages, much more than needed to control short-term interest rates, and putting intolerable strains on the system; this problem was subsequently exacerbated by the scale of our gilt funding last year. The increased daily shortages during this period occurred at a time when the discount houses had been shrinking in size, as a result of capital losses and as the main banks changed their own liquidity behaviour away from placing secured deposits with the houses towards holding bills on their own balance sheet.



Meanwhile, the combination of bigger liquidity shortages and reduced capacity of the houses to sell bills to us had meant that one or two dominant banks with large bill portfolios could, by their own capricious behaviour - by deciding either to co-operate freely in our operations, so producing easy market conditions, or refusing to co-operate and causing tight money conditions - have a significant influence on overnight rates and could use their power to their own commercial advantage. Highly volatile overnight rates had resulted, contributing to fluctuations in the seven-day rate.

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The Bank had been determined to address this problem. This was not because we thought that volatile overnight rates disturbed economic behaviour, or were even influential on the exchange rate, nor because they cast doubt on our ability to secure the officially-desired level of interest rates. But they did risk damaging London's reputation for deep and liquid markets.

Our solution came in two parts. First, to change the funding rule to allow monetary sector gilt purchases to count towards funding (and backdating the change by a year), which would have the effect of reducing the stock of assistance considerably by the end of the current financial year. And second, by augmenting our daily operations through offering regular fortnightly repo transactions in gilts to a broad set of banking counterparties, providing liquidity for either two or four weeks in maturity. This new technique simultaneously:

- mobilised a greater pool of eligible paper, gilts in addition to bills;

- provided a slice of assistance off-market, and so reduced the residual daily shortages; and

- provided liquidity well spread around the banking system.

As the charts in the paper showed, this mechanism had been very effective in reducing the volatility of overnight interest rates: so we judged it, to date, a success.

Finally, looking to the future, the Bank was conscious that no market stayed static. We had identified three possible changes: one was to our counterparties, where we were ready to move away from the discount houses if we needed to, but were content to continue dealing through them at present. The second involved more complex changes to the instruments through which we provided liquidity, perhaps dealing ourselves in a generalised gilt repo market - which for this purpose might be thought of as a kind of secured money market - if our present deliberations led us in this direction. Finally, European

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developments could serve as a catalyst to bring even closer together the monetary operations performed by the different European national central banks; much work on this remained to be done.

The paper concluded, Mr Townend noted, by inviting comments on a number of questions:

- did the money markets perform their function well or were there still deficiencies?

- was the Bank's evolutionary approach, working with the grain of the market, the right one?

- would Court be interested in companion papers on our gilt and foreign exchange market operations?

Mr Plenderleith welcomed the opportunity to brief Court about the machinery of the Bank's money market operations. He noted, reinforcing what Mr Townend had said, that this was an area undergoing a continuing process of evolutionary change and invited any comments on how the Bank should manage that process.

Sir Christopher Hogg identified a general reluctance to change what seems to work. In his own experience, markets were not what they seemed: current developments in the equity market illustrated this point. He would very much welcome papers on the technical aspects of the Bank's various market operations from time to time.

Sir Jeremy Morse, who welcomed the development of repos, commented that a substantial Government debt market was the foundation for a financial centre. In his view, the paper underplayed the impact of the Government's finances in money markets. Mr Townend agreed that, on a day-to-day basis, shortages or excesses in the market reflected the flow of funds to and from Government; but, taken over a year, the impact of Government funding should be flat given the full fund policy.

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Sir Chips Keswick had no doubt that the Bank understood and could control the cash markets, but he was less certain about the derivatives markets. Developing the point, Mr King wondered whether the latter markets might produce a body of information helpful in the formulation of monetary policy, in the way that studies of the gilt markets had done. He also noted the benefits, discussed earlier, in the more open and transparent stance taken towards the formulation of monetary policy. He suggested that the events surrounding the Treasury Bill tender on 29 July highlighted the need for clarity and transparency in the signals given by the Bank's money market operations.

In responding, Mr Plenderleith said that the Bank viewed the futures and derivatives markets as part of the overall money market. He agreed that awareness of activity in these markets was relevant to the Bank's understanding of what was going on in the markets generally so we were actively expanding contacts with market operators in futures and derivatives.

Mr Quinn highlighted the connections made in the paper between the arrangements for implementing monetary policy through money market operations and payments systems and supervisory issues. This reinforced, in his view, the value of having the supervisory function in or close to the central bank.

With reference to a Minute of 10 February, Mr Johnson, an Analyst in the Business Finance Division, attended Court for the discussion of the Private Finance Initiative (PFI).

In introducing the discussion, Mr Kent opened by setting out the two main issues; the potential macro-economic implications of the PFI; and the micro aspects, ie the policy, its implementation and the role of the Private Finance Panel as an intermediary smoothing the way. Describing the initiative with reference to the Prime Minister's recent speech (27 July 1994 - "The Role and Limits of the State"), Mr Kent summarised the policy, philosophy and objectives thus: the objective of the PFI was to renew the nation's capital stock in an affordable

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way through a partnership between the public and private sectors, such that the synergy achieved allowed this goal to be reached more swiftly and effectively than either side could afford, or manage, on its own. It occupied somewhat uneasily middle ground between pure public sector and outright privatisation.

In his speech, the Prime Minister had reaffirmed the Government's commitment both to privatisation and to bringing in private capital to make better use of taxpayers' money, at the same time introducing the skills of private enterprise into the public sector. A list of projects suitable for private finance was soon to be published, and the political will existed to overcome any legal obstacles that might inhibit certain departments from following suit. In future, Ministers would have to demonstrate to EDX (the Cabinet Committee which allocates public spending) that they had fully explored private finance options. To a certain degree, the PFI represented additionality, but should perhaps best be seen as levering in private capital, sharing risk with the private sector and harnessing its management flair.

Mr Kent noted that the Private Finance Panel (PFP) was intended to perform a catalytic/broking role, much like the well-established London Approach company support framework. It would essentially be an "unblocker of obstacles to the conduct of projects", and most definitely not involved in prioritising/evaluating projects. Equally, it would neither become the negotiator of the actual terms of a contract nor spend other people's money. This said, he was puzzled that the Government was not willing to give greater resources to the Panel, when it was simultaneously employing a multitude of professional consultants. To illustrate the honest broker role, Mr Kent cited the generalities of his involvement in the Channel Tunnel Rail Link.

The Governor expressed some nervousness that the PFI could be misconstrued as simply financial engineering - the "free lunch". Mr King developed this theme by questioning whether

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the burden of renewing the capital stock could really be reduced by bringing in private finance, since the same finite amount of resources was consumed. He saw advantages to the PFI in making projects more efficient, both through competition and bringing in particular management skills. On the downside, he said that the PSBR was not a "given" and one could not simply move projects off balance sheet and spend more. Equally, he challenged the assumption that the private sector and its capital were always good: certain projects were in the public sector for good reason. Thus he was supportive of the concept of boosting efficiency and expertise, but remained wary of the "free lunch".

Ms Masters (also a PFI member) highlighted the long-term pressures on public expenditure that could be exerted by a need to service projects driven by additionality. She was mindful of the need for the effective prioritisation of projects. Rather than being an off-balance sheet device, she saw the policy as prompting a fundamental shift in the public and private sectors' relationship.

The Governor was concerned that the conceptual framework necessary to ensure the initiative's economic success was not yet in place, but that there was already a drive to initiate high profile projects. The macro implications for the conduct of monetary policy were not, at this stage, sufficiently clear. In response to a question from Sir David Scholey testing the Bank's locus in this matter, the Governor saw a clear role for the Bank under the third core purpose.

Sir Colin Southgate thought that HMT were nervous about the PFI, especially since several Ministers had gone on record as indicating the potential for increased public spending. He was quite scathing of the initiative, and questioned the wisdom of employing more expensive private capital in many instances. His view was that the PFI needed to revisit the drawing board and that the Bank should, at this stage, not be supporting/endorsing it. The Governor saw scope for greater efficiencies in what might typically be considered public

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sector projects (eg prisons), through the private sector management of such projects. Sir Chips Keswick saw the PFI as "a good idea, but going nowhere", given the lack of significant results to date.

Sir Jeremy Morse was concerned that the Bank might end up pushing the banks into supporting PFI projects. The Eurotunnel company support operation was possibly similar, and he wondered whether the Bank felt in retrospect that there were lessons to be drawn from it. The Governor made it clear that this was not the Bank's role. The Governor and Mr Kent outlined the history of the Bank's involvement in Eurotunnel, and agreed that it was far less likely that it would engage to the same extent in such a company-support case today. Sir Colin Southgate cited Eurotunnel as an illustration of a failure in both private sector finance and project management. By contrast, with the PFI the perception was that the private sector was typically better placed to manage such risks.

Mr Kent clarified the PFI's role in "unblocking problems". Such problems, he said, were more likely to be found in the relationship between the Government and the private sector rather than the financing of projects per se.

Under the executive report:-

1 The Governor mentioned that Court on 19 October would focus on a number of internal matters concerning work priorities, staffing issues and the administrative and budgetary framework. It was proposed to start the meeting at 9.00 am and he asked that those who were unable to attend at that time should let him know.

2 The Governor also mentioned that some Members of Court had expressed concern about receiving copies of the Minutes of the Board of Banking Supervision, as details of particular

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cases mentioned therein might raise conflicts of interest and thus place them in a difficult position. He suggested that Members may wish to consider their individual position in advance of a further discussion on this issue.

Rupert Pennant-Rea

G. A. Croughton.
Secretary. 8 September 1994

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MINUTES OF A MEETING OF DIRECTORS AT THE BANK

THURSDAY 18 AUGUST 1994

Present

Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
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 noted.

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

Rupert Pennant-Rea

G. A. Croughton

Secretary 8 September 1994

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MINUTES OF A MEETING OF DIRECTORS AT THE BANK

THURSDAY 25 AUGUST 1994

Present
Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Ian Plenderleith, Esq

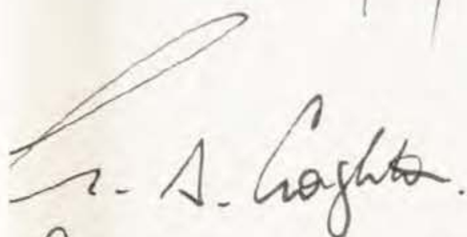
Hugh Christopher Emlyn Harris, Esq

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 noted.

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

Rupert Pennant-Rea



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MINUTES OF A MEETING OF DIRECTORS AT THE BANK

THURSDAY 1 SEPTEMBER 1994

Present

Edward Alan John George, Esq, Governor

Pendarell Hugh Kent, Esq

Mervyn Allister King, Esq

Ian Plenderleith, Esq

Brian Quinn, 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 noted.

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

Rupert Pennant-Rea

G. A. Croughton. Secretary.

8 September 1994

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MINUTES OF A COURT OF DIRECTORS AT THE BANK

THURSDAY 8 SEPTEMBER 1994

Present
Edward Alan John George, Esq, Governor
Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Sir David James Scott Cooksey
Sir Colin Ross Corness
Pendarell Hugh Kent, Esq
Ms Sheila Masters
Sir Christopher Jeremy Morse, KCMG
Ian Plenderleith, Esq
Brian Quinn, Esq
Sir David Gerald Scholey, CBE
Professor Sir Roland Smith

Hugh Christopher Emlyn Harris, Esq

The Minutes of the Court of 11 August and those of the Meetings of 18 and 25 August, and 1 September, 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.

The Governor, in noting that this was the last appearance at Court of Mr Croughton, the Secretary of the Bank, thanked him for the contribution he had made to the Bank generally and, over the past ten years, to Court in particular.

Martin G. Jacomb
21 Sep '94

[illegible signature]
21 Sept. 1994

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MINUTES OF A MEETING OF DIRECTORS AT THE BANK

THURSDAY 15 SEPTEMBER 1994

Present
Edward Alan John George, Esq, Governor
Mervyn Allister King, Esq
Ian Plenderleith, Esq
Brian Quinn, 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 Governor welcomed the new Secretary.

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

There being no comments on the weekly figures, Mr Plenderleith spoke about the foreign exchanges and the state of the domestic markets. The market had taken Monday's rise in interest rates well, and by and large this response had been maintained.

Martin W. Jacomb
21. Sep '94

Informa
21 Sept. 1994

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A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 21 SEPTEMBER 1994

Present

Edward Alan John George, Esq, Governor
Sir Martin Wakefield Jacomb
Mrs Frances Anne Heaton
Sir Christopher Anthony Hogg
Pendarell Hugh Kent, Esq
Sir John Chippendale Lindley Keswick
Mervyn Allister King, Esq
Sir David Bryan Lees
Ms Sheila Valerie Masters
Ian Plenderleith, Esq
Brian Quinn, Esq
Professor Sir Roland Smith

Hugh Christopher Emlyn Harris, Esq

The Minutes of the Court of 8 September, and the Meeting of 15 September, having been circulated, were approved.

Monthly Economic and Markets Report

At the Governor's invitation, and with the agreement of Members of Court, Mr Bowen, Head of the Inflation Report Division, attended Court for the discussion of the Monthly Economic and Markets Report.

The Governor noted that the MEMR would be laid before Court in those months when there was no Inflation Report to discuss.

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In the third month, the Inflation Report itself would provide the basis for discussion. This would, in practice, have to be after publication because of the timing of long Courts, although the main lines of the Report would be apparent from the MEMR laid before Court during the previous month. However, at the long Court on 19 October there would, exceptionally, be no time to discuss an MEMR, but it would be possible to schedule a half-hour routine Court for this purpose on 27 October if Members would find that helpful. Court agreed that this should be arranged.

Introducing the MEMR, Mr King said that the main developments since the August Inflation Report had been the emergence of more evidence of price rises in intermediate goods - coming from surveys, the Agents, anecdote (including from Members of Court) and from the PPI figures themselves - and significant upward revisions to GDP. Despite a slowing of consumption growth, investment and export demand were rising strongly and it was clear that the output gap was both smaller, and closing more rapidly, than we had previously thought.

These were the factors behind the interest rate judgment reached earlier in the month and put into effect on 13 September. This had been well received in the markets and in the press.

Mr King sought views particularly on the extent to which prices of intermediate goods were really starting to rise; whether such rises were simply a reflection of commodity price increases or included other elements; and whether investment spending was rising, and how quickly increased capacity would come through.

Mr Plenderleith, commenting on the market charts laid before Court, said that the markets had, for some time before the interest rate rise, had a sense of steady recovery combined with incipient cost pressures, but had been uncertain about how and when the authorities would react (and had indeed feared that the move, when it came, would be inept). Reactions to

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the move, when it did come, had been positive. The subsequent bond market weakness had been driven more by international events than by any reappraisal of a domestic stance.

Referring to Mr King's questions about cost pressures, Sir Roland Smith said that there had indeed been significant increases in the costs of chemicals, aluminium and steel products; these continued and were being reflected in input prices. The pressures were global; indeed, in concentrating on the UK alone, the Bank risked seeing only part of the picture. Cost pressures had not yet been reflected at the stage of final prices, but would be, perhaps by the first half of 1995, once stocks had adjusted. He did not yet see manufacturers putting on capacity; but in areas where business conditions were strong, margins were an issue.

Sir David Lees said that manufacturers were keen to raise prices. Whether or not they could do so would depend on spare capacity: where they were running below potential output, they would not argue over prices, preferring to keep volumes up. Capacity utilisation was now improving, reflecting both UK and European demand, and that was giving manufacturers the confidence to push for higher prices.

Sir Christopher Hogg agreed that global developments were important. There was pressure from raw material prices; the output gap was closing fast, if not already closed; and companies would be more inclined to concede higher wages in these circumstances, simply in order to maintain production.

Sir Chips Keswick commented that some bank lenders were cutting margins. In international capital markets, the issue was not so much inflation as the scale of individual countries' deficits; lenders were keen to penalise deficit countries.

Sir Martin Jacomb endorsed the views expressed on costs. But he felt that margins remained under pressure: in the electrical supply industry, for example, higher copper prices had led to smaller margins despite two price increases. At

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present, companies were aiming to fill capacity, where at a European level there was a surplus. In many businesses, managers had not yet realised that in a non-inflationary world, margins would, inevitably, not recover fully.

The Governor suggested that the macroeconomic data had not been showing pressure on margins - rather the reverse - and had also suggested that company profits were exceptionally strong, creating an environment for new investment in capacity. He invited views on how our pre-emptive move on interest rates last week would affect this. Mr King confirmed that profits were strong in the corporate sector, and that the evidence on margins, although statistically less robust, suggested that they had held up well except in retailing. Sir Christopher Hogg thought that the aggregate figures would have benefitted from weaker companies going out of business; Sir David Lees suggested that cost controls and better use of existing capacity had helped margins. But capacity was now the issue, and skilled labour shortages a particular concern.

In terms of public presentation of policy, Sir David Lees added that the lower part of the target range was not so deeply embedded in the public's mind as it should be, and suggested that this should be given more emphasis over the coming months.

The November Budget

The Governor invited Mr King to introduce the paper concerning our Budget advice to the Chancellor, copies of which had been laid before Court. Mr King said that our main message was that the Chancellor should adhere to his existing plans, and this had to involve adjusting cash spending targets downwards to reflect the lower inflation outturn. The real test for the Government would be whether they could be as firm on public spending as the original strategy implied. In response to a question from Sir Roland Smith, both Mr King and Mr Plenderleith confirmed that the PSBR for this year was currently a bit better than on track.

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Ms Masters asked whether we were concerned about the Government's evident aim of holding recorded public spending down by shifting it into private or semi-private categories, for example through the private finance initiative. Mr King said that this was a worry, particularly if it understated the macroeconomic pressures on demand, and the Governor added that it was particularly worrying if the Government saw such devices as some kind of "magic". If there were real efficiency gains, that was indeed a saving - but it certainly was not a 100% saving. But the PFI was politically sensitive, and it was not easy to make such points in the Budget advice.

European Monetary Institute

At the Governor's invitation, and with the agreement of Court, Mr Collins, Head of the Policy Planning Group, attended for the discussion of his paper on the EMI. Introducing his paper, Mr Collins said that it illustrated the range of issues being addressed by the EMI and the pace at which the technical work was proceeding. The Bank was playing a very full part in this. Taking up this last point, the Governor said that he himself was participating fully in Council meetings, and that the Bank had made a significant contribution to the staffing of the EMI. The Governor referred to a letter that he had received from Sir Jeremy Morse, who was unable to attend Court that day. Sir Jeremy, reading Mr Collins' paper, had the sense that we were rather tentative and defensive about our involvement, perhaps reflecting the UK's current political doubts about sovereignty. The Governor, for his part, was quite clear that we were participating fully at a technical level. At that level, of course, we could make clear our technical doubts about the EMU process, and particularly the pace of monetary integration; but that was quite separate from the political issues, and we had to be clear about that in our own minds.

Sir Christopher Hogg welcomed the Governor's comments. This was an area in which the Bank should make a full contribution. It would be a pity if the Bank was thought to be infected by

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the UK public sector's reluctance to participate in European initiatives.

The Governor said that there was, of course, a big resource issue for the Bank. The people the EMI were likely to want were precisely those in short supply here. But Professor Lamfalussy, President of the EMI, had been entirely happy with the support that we had given thus far. Mr Quinn added that we were certainly perceived in the EMI as pulling our weight, even if this was not always the view in Brussels.

Sir David Lees was surprised at the current lack of public debate on these issues, given the pace at which work was proceeding. He noted that the European commercial banks had recently declared a rapid introduction of an ECU currency to be impractical. The Governor said that this took us straight to one of the key technical issues - whether there should be a "big bang", or alternatively a phased introduction, "stage 3A". With the latter, the banks' worries would disappear. But even technical issues could have large political implications - for instance, the design of banknotes, and whether they could retain national characteristics.

Sir Martin Jacomb felt that the Bank's stance was right. We must have a strong influence. There was, of course, a difficult PR point, as our involvement might be seen as implying that we saw a common currency as a good idea. We would have to stress that we were making sure that the technical work was being done properly, so that the political issues were identified correctly and publicly at the right time. That might have to be done very soon. The Governor agreed: it would soon become public knowledge that we were chairing the Committee on the design of a European note. Sir David Lees stressed the need for these issues to be aired in the Bank's Annual Report.

Centre for Central Banking Studies

At the Governor's invitation, and with the agreement of Court, Mr Price attended Court for the discussion of his paper on the

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future role of the Centre for Central Banking Studies. Introducing his paper, he said that the issue for him was making the best use of the resources at his disposal. He had financial help from the European Community and from the UK Know-how Fund, but most of his resources came from the Bank, either directly or through the provision of speakers for his courses. Mr Price's aim was to continue to raise the level of training, running workshops and seminars, and improving handout material.

Sir David Lees asked whether there was a statement of the objectives of the CCBS: what was it for, why wasn't it self-financing? Mr Price said that the Bank had a long tradition of providing such training to orient other central banks to our way of doing things and, prospectively, to bring business to this country. Many City firms saw it as good PR to participate; moreover, other central banks did the same, and did it free. The Governor, nevertheless, said that it would be useful to provide a statement of objectives for the CCBS at this stage.

Sir Chips Keswick thought that it would be a mistake to charge for training, given the clear benefits to the United Kingdom. Sir Martin Jacomb stressed the benefits of bringing people to London for training - it would be good for the UK, and establish contacts which would last a long time.

Ms Masters asked how training was rationed. Mr Price said that there was an internal view on priorities, based on the "reformability" of countries, and work in some areas was allocated by the IMF among different providers of training. But we could not be sure of getting the balance right - there was no market process. Equally, there was no robust way of measuring success.

Sir Christopher Hogg suggested that involvement in technical assistance was a good way of using Bank people who might not immediately be in demand here. Mr Price agreed, but added that he did not want the CCBS itself to be used as a dumping

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ground for surplus Bank staff. He wanted a spell in the CCBS to be seen as a good career move for staff in, say, their mid-thirties. The Governor agreed.

CREST

At the Governor's invitation and with the agreement of Court, Mr Saville attended the Court discussion of his paper on the risks posed to the Bank by involvement in the CREST project. The Governor summarised Mr Saville's paper as saying that CREST posed little financial or legal risk to the Bank, but a major reputational risk if we got it wrong. Mr Saville added that there were several controls on the project over and above the Bank's normal monitoring: these came from the Advisory Committee and from external audit.

Sir David Lees was concerned that finance was not guaranteed through to the end of the project. Mr Saville said that the project was deliberately structured with break-points. The next major one was at the end of 1995. At that stage we were due to hand over the software. This would absorb £12 mn, which was fully committed by the shareholders.

If the project stopped at that stage for any reason, we could still walk away; the risk was the shareholders'. They had no difficulty with that.

Ms Masters wondered whether we could really separate financial from reputational risk in this way. If things went wrong, were we not bound in reality to accept some financial liability - and were we not consequently exposed to it now? Mr Saville said that the financial agreements would be in place in October, and Mr Kent added that we had, in practice, had no option but to continue with the project ahead of these agreements as an act of faith; a loss of momentum at this stage would be fatal.

In response to questions from Sir Roland Smith, Mr Saville confirmed that the project was on schedule, and that the technology was tried and tested - the technical risks, he said,

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were "extraordinarily low". There were risks of legislation or regulation not being put in place, but those were beyond our control. There was significant support for the project, both from the shareholders and from customers.

Mr Quinn wondered what was meant by "a degree" of external audit. Given the extent of trust involved, the Bank had an interest in pinning down this part of the control environment. Mr Saville said that the scope and intensity of the audit would be discussed with the Advisory Committee.

Derivatives

At the invitation of the Governor, and with the agreement of Court, Mr Bond attended for the discussion of his two papers.

Sir Christopher Hogg said that he saw the issues raised as being essentially for regulators rather than for legislators. The players in these markets were professionals, and when things had gone wrong the issues were clearly for company boards, and the main governing theme therefore had to be proper disclosure.

The Governor said that this was our instinct too, and that other central banks were moving in this direction. Corporate involvement in derivatives was not yet a major problem here, but was emerging as one of the United States, where the losers were resorting to litigation. One problem with disclosure was that everybody had a different view as to what would need to be disclosed, and it was not clear what self-selected disclosures would actually achieve.

Sir Martin Jacomb said that it was unfortunate that the accountancy profession was so far from agreeing on a proper disclosure regime. Sir Chips Keswick noted the difficulty of valuing risk, and Ms Masters said that no simplistic rule could be made to work in this area. It was an area that should, nevertheless, be pursued with the Accounting Standards Board. Mr Bond said that, in the United States, disclosures had tended to be qualitative rather than attempting to quantify risk.

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Mr Quinn noted that banks had many possible ways of valuing the risks on their own books; the regulators had to keep these under close review, and to strike a balance between their own concerns and the needs of the market. For non-supervised firms, rating agencies might well have a role. Sir Chips Keswick noted that the market could be damaged if regulators needlessly increased the capital requirements.

Executive Report

Under the Executive Report:

City Arts Trust

The Governor mentioned Mr Quinn's Directorship of the City Arts Trust, and this was noted by Court.

Nomination of NEDs

The Governor reported that Sir Martin Jacomb and Sir Colin Corness had indicated that they would be retiring from Court at the end of February. He invited Members to contact him if they had any suggestions about suitable replacements.

National Mortgage Bank

With reference to a Minute of 5 May, the Governor said that the Bank's purchase of National Mortgage Bank was likely to be completed on 30 September.

Personnel Director

The Governor reported that Mr Roy Lecky-Thompson had been recruited as Personnel Director of the Bank, and that a press statement had been issued the previous day.

Treasury Fundamental Expenditure Review

Mr Kent said that HM Treasury were undertaking a fundamental review of all spending attributable to the Treasury itself: and a very large proportion - £86 mn out of £116 mn - related to the Bank of England. There were five areas of interest: Printing Works and Issue Department, where the Bank was in effect a principal; and Registrar's, Debt Management and the

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Exchange Equalisation Account, where the Bank acts as Agent for HM Treasury. The hierarchy of possibilities being considered in each area ranged from abolition, through privatisation, market-testing, the introduction of commercial management, tighter cash limits, no change, and a "Review". In the Printing Works area, the Treasury were pressing the case for the introduction of commercial management - essentially removing the existing tier of Bank management, and inviting a commercial printer to take advantage of our capital. In note issue, they wanted commercial banks to take on more work. In the Registrar's area, market testing seemed to be the favoured solution, though initially across only a small range of the Department's work (which would in fact be impractical). In Debt Management, concerns had been raised about the effective subsidy to CGO. There seemed to be no concerns about the Exchange Equalisation Account side. This exercise raised significant issues for the Bank and for Court. Our provisional answers thus far had been that we would not accept any interference with our own management of the Bank, and that we would take no responsibility for services provided by third parties. Partial market testing, we had said, was nonsensical. We had also pointed out that our performance under cash limits had been outstanding; if there were concerns, they could be addressed by seeking lower quality services.

The Governor said that these issues would be brought back to the Long Court on 19 October, which would be discussing the management of the Bank. Sir Chips Keswick thought that it might re-open the uncertainty over whether or not the Printing Works, or the Bank as a whole, really made profits.

Review of Branches and Agencies

The Governor referred to a letter written to the Agents by the Deputy Governor, copies of which had been placed in folders. He said that the review, which would cover all of the functions of the Branches and Agencies, was independent of but relevant to the concerns expressed under the previous item, and would inevitably result in a period of uncertainty,

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but it was necessary to keep cash handling, in particular, under review.

October Court Timings

The Governor outlined plans for the October Court, which would start at 9 am on 19 October, and cover the new Purposes and Responsibilities statement, as well as reports on the new organisation of the Bank and on staffing issues. This would continue over lunch, which would involve the Non-Executives and the Governors only.

Rupert Pennant-Rea

[illegible]
Secretary
19 October 1994

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MINUTES OF A MEETING OF DIRECTORS AT THE BANK

THURSDAY 29 SEPTEMBER 1994

Present

Edward Alan John George, Esq, Governor
Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Mervyn Allister King, Esq
Ian Plenderleith, Esq
Brian Quinn, 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 noted.

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

Rupert Pennant-Rea

Jim Footman
Secretary
19 October 1994

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MEETING OF DIRECTORS AT THE BANK

THURSDAY 6 OCTOBER 1994

Present

Edward Alan John George, Esq, Governor
Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Brian Quinn, Esq
Sir Christopher Jeremy Morse, KCMG

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 noted.

There being no comments on the weekly figures, The Governor spoke briefly about the foreign exchanges, including the Official Reserves figures for September, and the state of the domestic markets.

Rupert Pennant-Rea

Confirmed
Secretary
19 October 1994

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A MEETING OF DIRECTORS AT THE BANK

THURSDAY 13 OCTOBER 1994

Present
Edward Alan John George, Esq, Governor
Pendarell Hugh Kent, Esq
Mervyn Allister King, Esq
Sir Christopher Jeremy Morse, KCMG

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 noted.

There were no comments on the weekly figures, the foreign exchanges or the state of the domestic markets.

Rupert Pennant-Rea

Chairman

Secretary

19 October 1994

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A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 19 OCTOBER 1994

Present

Edward Alan John George, Esq, Governor
Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Sir David James Scott Cooksey
Sir Colin Ross Corness
Mrs Frances Anne Heaton
Pendarell Hugh Kent, Esq
Sir John Chippendale Lindley Keswick
Mervyn Allister King, Esq
Sir David Bryan Lees
Ms Sheila Valerie Masters
Ian Plenderleith, Esq
Brian Quinn, Esq
Sir David Gerald Scholey, CBE
Professor Sir Roland Smith
Sir Colin Grieve Southgate

Hugh Christopher Emlyn Harris, Esq

The Minutes of the Court of 21 September and the Meetings of 29 September, 6 and 13 October, having been circulated, were approved.

At the Governor's invitation and with the agreement of Members of Court, Mr Midgley, Finance Director, attended Court.

The Bank's Purposes, Responsibilities and Philosophy

With reference to a Minute of 24 February 1994, the Deputy Governor introduced a revised statement on the Bank's Purposes, Responsibilities and Philosophy.

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The Deputy Governor said that the previous text, settled in 1991, had been discussed on several occasions since, but the possible changes had not previously been drawn together. The revised version had now been discussed at ExCo, and a "pocket" version prepared with the intention of getting the staff to identify more closely with it. If approved by Court, the Deputy Governor would hold a series of presentations for the staff.

Sir David Scholey asked whether the new language in the PRP statement was intended to mark a reduction in our readiness to become involved in third core purpose issues; he also felt that the reference to the "public good" sounded archaic. The Deputy Governor said that Court had agreed that there remained a distinctive third core purpose, though people might still feel that the balance in the paper was wrong. Mr Kent said that the changed language did not in his view imply a change in substance. Rather the language now better described what we had been doing and still were doing. The Governor said that over the long term there probably had been a change. Going back even 10 years, it was possible to see the Bank as having been more inclined to intervene. As one moved from the second into the third core purposes, there was inevitably a spectrum of issues. CREST was closer to the second core purpose: but the further we went down the spectrum, the more we were inclined to ask ourselves whether we were justified in becoming involved. He thought it less likely now, for example, that we would get involved again in EuroTunnel.

Sir Colin Corness felt that "promoting the public good" was a useful expression: it recognised that the Bank was not working in narrow isolation. The Governor agreed that it was fundamental to perceptions of the Bank that we did exist for a public policy purpose. If the language was old fashioned, then it served to underline the point.

Sir Chips Keswick asked if the Treasury supported the PRP statement. The Governor said that we had not sought to agree it with them. At official level, they were aware of it, and

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had accepted it as an internal management tool of the Bank's; the Bank managed its own affairs, and we had felt it would be wrong to ask them to endorse it. In response to a question from Sir David Scholey, the Governor said that we had not published the earlier statement but had not been secretive about it either.

Mrs Heaton felt that the new text, in its treatment of the Bank's international work, made the Bank seem more inward-looking than in the past. The Deputy Governor said that he had received an identical comment, with drafting changes, from Sir Jeremy Morse, and would be amending the text.

Subject to this, Court were content with the statement. The Deputy Governor said that it would be reviewed again in a year's time, and any further comments - including from staff - would be incorporated then.

Administrative Framework

With reference to a Minute of 11 August 1994, the Governor introduced a paper entitled "Administrative Framework: Review of Priorities 1995/96". On the monetary policy side, the Governor said, the Bank had made real progress over the past year in reinforcing the stability message. The concern now was the high level of structural unemployment, and the task was to try to explain that this could not be directly addressed by short-term macroeconomic policy. This was important because the temptation to do so was continually there. The Bank was now better geared to address this issue, with the formation of a structural economics team in the Monetary Analysis Unit. There was an obvious read-across to the EMU debate, where it was possible that countries would achieve the Maastricht Treaty criteria while still having high and varied levels of structural unemployment. Monetary policy could make a contribution, but it was an indirect one - ensuring a stable macroeconomic environment in which companies could plan and invest. The Bank could also contribute through the initiative

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on small firms, and through its contribution to the private finance initiative.

Macroeconomic stability would help the stability of the banking system. Our focus in supervision was therefore likely to be on particular cases and areas of concern. These included money laundering and the pursuit of fraud. There was a tide of concern here, and we had to be sensitive to it. Another tide, of course, was consumerism - there, we had to be more cautious, and encourage people to analyse the costs against the potential benefits.

Internally, we had to let the new structure of the Bank bed down and to address the personnel issues left over from Ashridge.

Sir Chips Keswick said that we were operating against a background of more mobile capital, and a key question for us was how open we would let London remain to branches of some overseas banks. Sir David Scholey agreed that the integration of global capital markets was immensely important; in this connection he wondered if the Bank was looking at the relationship with securities supervision. More generally he asked what possible priorities had been filtered out or held over in the drafting of the present document. The Governor said that the supervisory framework was one such area. Another was the independence debate.

Sir Colin Corness welcomed the emphasis on unemployment, which he thought would get consistently worse, especially as the service sector started shedding labour. The Governor agreed, but said that the Bank had to be clear about its own role. It could not comment directly on social issues, but could help by promoting a stable framework for investment. Ms Masters felt that the existing approach to public information sounded reactive; we could be more proactively pressing for benefits of price stability.

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Sir David Lees suggested that the papers offered for this Court could usefully be drawn together in future years into a single strategic plan. The Governor said we would explore this for next year.

Priorities in the Monetary Stability Wing

At the Governor's invitation and with the agreement of Members of Court, Messrs Allen, Kentfield and Townend, Deputy Directors in the Monetary Stability Wing, attended Court to talk about priorities in their respective areas of the Wing.
Mr Plenderleith said that the priorities in his part of the Monetary Stability Wing were to improve the flow of market information and our ability to monitor fast-changing markets, and to maintain the standards and cost-effectiveness of the banking and note issue operations. Mr Townend described in more detail the priorities and pressures in Market Operations. His was a small team, just over 80 people, and it required staff of the highest calibre. Retaining them was a problem. The area depended heavily on the successful delivery of a number of major IT projects now under way. Much of the work was for the Treasury, and a formal remit now covered the funding task; another was planned for the foreign exchange area. For the coming year, maintaining high standards was a key objective. There would be a major change in the gilts market when a repo market was introduced. Work on EMU issues would absorb an increasing amount of resources. Mr Townend added that the new Bank structure had already helped to improve the interaction between the markets and analytical sides of the Bank.

Sir Chips Keswick asked if there were any plans to put the EEA out to private management. The Governor said that there were not, although the funds were the Treasury's not the Bank's. Sir David Scholey asked how we compared ourselves with other debt issuers, for example, other central banks.
Mr Plenderleith said that we were increasingly finding ways to measure performance - not against other central banks, which were often not good comparators, but against benchmarks. We

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had started this with the EEA, and were moving on to gilts. Sir Colin Southgate asked whether we tested the views of gilt market participants. Mr Plenderleith said that we had done so through our own surveys and through market liaison. The Treasury had not been ready to pay for an independent survey.

Mr Kentfield spoke about the Banking and Market Services area. The basic objective was to be as cost-effective as possible. A lot of Government business had been put out to tender, and we bid for that, competing on costs and service. The major issue was the review of note distribution and the Branches; and the two big projects were BITS and RTGS. The biggest challenge, in Mr Kentfield's view, was to maintain staff morale and motivation during a period of fundamental change.

Mr King, introducing the monetary analysis area, said that the major changes had been the development of links and interaction with the operational side, and the integration of parts of the International Divisions. These changes, and the changed role of the Bank itself, had greatly improved the performance and motivation of staff in the area.

Mr Allen described the roles of the Monetary Analysis Divisions, and the benefits that had flowed from involving the Agents more directly in the monthly monetary assessment process. The reorganisation had required a cultural change, but had made people feel more involved in the policy process, and therefore more responsible for their part of it.

Sir Chips Keswick asked whether the Agents were less effective if they did not have their own managerial responsibilities. Mr Allen said their status had not changed - some had Branches, some didn't; their input was just better focused. Sir Roland Smith asked whether, in the absence of Ashridge, the potential pressures in the three areas would have been any different. Mr Townend and Mr Kentfield said not, and the Governor said that the main effect had been to help interaction between two sides of the wing. Sir David Cooksey asked about the

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involvement of the National Audit Office: Mr Townend confirmed that their interest was increasing.

Priorities in the Financial Stability Wing

At the Governor's invitation and with the agreement of Members of Court, Messrs Clark and Foot, Deputy Directors and Messrs Page, Allsopp, Bond and Smith, Heads of Function from within the Financial Stability Wing, joined Court to talk about the priorities of their respective areas of the Wing. Mr Quinn said that the aim of the new Financial Stability Wing was to integrate all relevant tasks under a unified structure. His greatest concern was with the numbers and quality of staff available. In some areas Managers were operating greatly below budget. We were trying to attract suitable people, inside and outside the Bank. This was difficult, even within the Bank. There was a risk of the Financial Stability Wing becoming a "Cinderella" area. It was something that he was very conscious of and would be working on. It would involve improved staff management, training, development and motivation. There was always a tendency for parts of an organisation to drift apart: we were dealing with this through the surviving cross-Bank Committees. But we needed to be alert to the risks: if monetary stability and financial stability began to develop as different organisations, then the question of hiving-off might become prominent again.

Mr Foot described the supervisory functions of the S&S area: essentially those of the old BSD, absorbing 275 of the 350 budgeted staff. The particular pressure points identified by Mr Foot included the large UK banks, where the question was how they were going to use what were by historical standards high levels of capital; the systems and profitability of the main securities trading banks; work on derivatives and market risk (the CAD); and the smaller banks, where the concern was rather about their long-run viability than imminent collapse. Internationally, we still had major question marks over the health of the Japanese banking system, and had to deal with awkward requests for new branches and subsidiaries from banks

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in less well-regulated parts of the world, like Russia and China. We had a major task ahead in getting to know more about the supervisory systems of other countries which have banks in the UK. Fraud remained a major issue, increasingly requiring international co-operation. We would be taking on some responsibilities for Gibraltar in the coming months. Illegal deposit-taking cases had increased. Mr Foot added that the Special Investigations Unit and the Legal Unit had become an extremely useful resource, and indispensable partners in S&S operations. Returning to the point raised by Mr Quinn, Mr Foot said that the pressure on senior staff in the S&S area was currently excessive. It could only be met over time by improving the quality and experience below Head of Division level. Another issue was the retention of key junior staff, many of whom were attracted to the private sector.

Ms Masters suggested that the Bank's traditional approach in moving people round seemed not to be what was required: S&S needed highly specialised people. Mr Quinn confirmed that the average length of stay of more senior people in S&S was long, but permanent supervisors tended to get tunnel vision - it was a world-wide problem. Mr Foot said that his ideal was to have the right mix of skills such as accountancy.

Sir David Scholey asked if our involvement internationally was as strong as it had been, and whether our concerns about Japanese banks was shared internationally. Mr Foot said that international supervision involved us very heavily. He mentioned Mr Smout's appointment as Chairman of the Model Assessment Group in Basle. We had many worries; Japanese banks were difficult to assess; another concern was the level of authorisation standards in the Netherlands. Mr Quinn said that we needed to have more contact with other supervisors because of the perceived deficiencies with the Banking Act. He did not think that in general our reputation had suffered at all from BCCI: the Bank's supervisors were greatly respected internationally. Sir David Scholey said that in that case he did not understand the problem identified by Mr Quinn of financial stability becoming a "Cinderella" area. But

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Sir Chips Keswick thought he understood it: it was because the S&S people underplayed and undersold themselves. There was too much cost cutting, not enough willingness to incur expense, boring language to describe their functions - they looked permanently on the back foot. Mr Foot said that one particular manifestation of the "Cinderella" problem was the role in the Bank of economists. It was difficult to convince them that S&S was the place to go to. Though Michael Foot himself, and many of the other S&S Heads of Division, were economists with wide Bank experience. The Governor said it was vital to get the flow going both ways.

Mr Page described the role of WMSD. As with the S&S area, WMSD was currently running well under its staff budget. He spoke about the need to strengthen the area's contacts with non-Bank players in the wholesale financial markets for the benefit of the FS wing as a whole. For 1995/96, beyond our daily supervision, the largest continuing exercise was the implementation of the Capital Adequacy and Investment Services Directives - requiring the complete reconstruction of five capital adequacy regimes which apply to the different types of firm supervised. This work was just about on schedule. A second key task would be, together with the Market Operations area, to anticipate and respond to the pressures for structural change in the gilts and money markets. The main pressure for change on both markets was Gilt repo, but there were a host of others. The last major change in the gilts market was Big Bang. The next year could see a second revolution.

Mr Allsopp spoke about the Payment, Settlement and Clearing Systems Division. The work priorities for the coming year included the long-term structure and governance of the sterling payment systems, where there could be proposals to restructure the way in which CHAPS was owned and controlled; international work to eliminate cross-currency risk in the settlement of foreign exchange transactions; the reform of national and cross-border payments systems in the European Union; and efforts to reform the ECU clearing. Mr Allsopp stressed that none of these and other priority subjects could be pursued in

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isolation; to an important degree they fed off each other, and off work going on elsewhere in the Bank. Mr Allsopp said that his Division now represented the Bank on nine separate groupings of central banks, in Basle, in Frankfurt and in Brussels. At all of these, he had to make sure that the Bank was represented at a sufficiently senior level to carry weight. That imposed an increasingly onerous burden on the officials in his Division.

Sir David Scholey thought that WMSD must be a difficult area to get people into given its rather diffuse activities. But Mr Page said that staff in fact liked WMSD because it combined supervision with contact with the markets - diversity was in fact its strength.

Sir Roland Smith said that the papers heard thus far had talked about challenges, had in many cases talked about pressures on staff and management, but had seldom discussed reward mechanisms. He could not understand why not. Mr Foot said that we clearly did have packages to attract and keep people. Some of these, for Officials and Officers, were centrally determined. Where we had Contract Officials we determined the salaries locally, and paid effectively market rates within existing budgets. Sir David Lees commented on the absence of any attempt to measure performance. It would be useful to have some way of doing this. The Governor said that we would need to have a general discussion of that issue.

Mr Smith spoke about the three Financial Infrastructure Divisions. The main priorities for the three Divisions had been listed in papers already circulated: one of the common features was the recognition of the changes taking place in the capital markets, for instance in the way companies raised finance, the challenges facing the Stock Exchange over the sustainability of the existing structure. Derivatives was likely to be a major area of concern, as was the competitive challenge facing London as a financial centre. Within the Business Finance Division the financing of small firms and the Private Finance Initiative were important. Staffing was a

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problem for management, as in other areas, particularly where one of the three infrastructure Divisions was newly created. Already management saw a need for a different mix of staff, embracing those with experience of markets in the City, with possibly less reliance on conventional graduate recruitment.

Mr Clark spoke about the Regulatory Policy Division and his own role as Co-ordinator of the Financial Stability Wing. The agenda for Regulatory Policy would include further review of the institutional structure of regulation in the UK, including associated issues such as lender of last resort arrangements and the problems posed for regulators by growing consumerism. The Bank was likely to be asked to contribute to the TCSC review of the regulatory system. He saw it as part of the area's role to provide the Bank with early warning of issues that might have broad implications for financial stability. The role also included reconciliation, where necessary, of activities under Core Purposes Two and Three, an example of which arose with the current negotiations on the financing and ownership of the London Clearing House.

Priorities in Central Services

The Deputy Governor said that Central Services, for which he was now responsible, had three core areas: Secretary's, Personnel, and Finance. Secretary's had absorbed the Information Division in the reorganisation, and this had produced an immediate saving in the number of staff involved. There was scope for further saving, including an outsourcing arrangement. Priorities for the coming year were to service Court, to maintain the high standards of the Press Office, to continue to improve the Bank's procedures for dealing with the public correspondence, and to continue to improve internal communication.

Mr Harris introduced the Annual Report on Banking Staff. In particular he commented on the recent recruitment round, and the recruitment of 21 "second jobbers" this year, a feature which was likely to become a regular part of recruitment. We

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had lost a number of staff by resignation, including some good ones; but that had always been a feature of life in the Bank, and came back essentially to pay. The Bank had always had a problem of being a public sector body in the City, and with more second jobbers in the Bank, being paid market salaries, the pressures on us would become that much greater. We expected the public sector pay policy to continue in the coming year, but even within it we managed to pay a small increase.

The Deputy Governor spoke about the Staff Issues Working Party, whose work was now almost complete. Most proposals had been agreed by ExCo, but there were three major outstanding ones: pay, where a new approach was proposed; the performance assessment system; and the task of defining the management skills needed in various parts of the Bank. The problems for the new Personnel Director would include the need to recruit the right mix of staff, to put in place suitable arrangements for career development and planning, and for training. Another issue was the balance between the Centre and the Wings: each of the Wings had developed Resource Administrations Groups as outposts; they were large and potentially influential.

Sir Colin Southgate asked whether second jobbers were recruited under contract. The Deputy Governor said they were.
Sir Roland Smith said that it was quite clear that there had been a major shift in delegation in the Bank, with more responsibility passing down the hierarchy. It was also clear that the culture was becoming more performance-oriented. This implied that remuneration would have to change if there was not to be friction. There had, of course, always been comparisons with City institutions, and he accepted that they were a constant; but there were also new features in the environment which effected everyone. The Deputy Governor said that he hoped that the Staff Issues Working Party conclusions would address this. Sir David Scholey asked if there would be an opportunity for a policy discussion with Court before the Staff Issues Working Party proposals became crystallised. The Deputy Governor said that he would report to Court on 16 November, before any conclusions were promulgated.

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Moving on to Finance and Premises, Mr Midgley said that a major feature of the Bank's cost controls in coming years would be contracting out. This was not new, but had been developing rapidly. By way of example, when we set up the Central Moneymarkets Office, 25% of the staff involved had been from agencies; with CREST and RTGS, the equivalent figure was 70%. We now knew that we could bring in resources, at management as well as operational level. We had already put out the IBM mainframe computer to facilities management. Cleaning had also been partly contracted out. He was now proposing to review all aspects of Property Services, where more than 300 staff were involved, and over the next six to nine months develop a series of options for the Governors and Directors to consider.

Another change was in the budget process. His intention was that this should become less of a chore, and more of a management tool. There would be a greater emphasis on transferring costs between budget centres, so that those using the resources got to pay for them. There would be an attempt fully to integrate capital spending into budgets. Mr Midgley wanted to shift the emphasis from counting inputs to counting outputs. He also wanted to change the way in which the Bank looked at its balance sheet, a focus on income rather than just expenditure. We would need to look at all decisions in the Bank that might affect our income.

Sir David Cooksey asked about outsourcing: while this was a trend to be encouraged, there was a cost in monitoring the performance of contractors. Sir Colin Southgate supported this.

Sir David Scholey asked how we reached an overall view on the Bank's capital allocation. We could, at one extreme, choose to run the Bank on the minimum possible capital. Mr Midgley said that we had had a general objective of achieving an 8% return on capital, combined with a target of keeping within cash limits, and maintaining the real 1986 level of cash ratio deposits. That, in fact, was how we developed our expenditure

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targets. But we didn't have a specific capital objective. We would be addressing that, and by implication how much capital the Bank needed, in the coming year, and a paper would be brought to Court.

Sir Roland Smith wondered whether controlling expenditure by some notional return on capital was appropriate for the Bank; should not the Bank decide what it needed to do, in the most economical way, and then do it?

Budgets 1995/96

With reference to a Minute of 11 August 1994, and in introducing the discussion on Budgets for 1995/6, Mr Midgley said that the Ashridge process had released resources equivalent to £2 1/2 mn. But the post-Ashridge bids from areas had absorbed all of that, and an extra £2 mn. There was undoubtedly some double counting in this, and the £2 mn would be clawed back. The Deputy Governor emphasised that our spending targets were the same as a year ago. Sir David Scholey said that one benefit of the Ashridge process should have been to re-assess what cost base and performance measurements were appropriate. It was not desirable to remain a prisoner of cash limits or other artificial external constraints. From a management point of view, the determinants of total spending were less relevant. It was not clear, for example, why an 8% return on capital target was objectively relevant. If we approached the decisions the other way round, we might be able more easily to reach a view on the level of capital we required. The Governor said that we would come back to the question of the need for capital. It was clear that we needed capital to perform our central banking responsibility, as lender of last resort. Ultimately that meant that the level of capital was not a commercial judgement.

Ms Masters asked why the Ashridge reorganisation hadn't resulted in a more decisive reduction in costs. The Deputy Governor said that this had not in fact been an objective: and

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the Bank was still broadly on a declining spending path. Ms Masters said that she would have expected to see a step-change in expenditure as a result of a reform as radical as Ashridge, but Sir Colin Southgate said that one could only expect that if there was a reduction in the number of functions, which in this case there had not been. Sir David Lees warned about the risks of multi-tiered administration implied by the Resources Administration Groups. The Deputy Governor said that we would be attacking the RAGS with great vigour in the coming budget round.

Fundamental Expenditure Review

With reference to a Minute of 21 September 1994, Mr Kent introduced the discussion of HM Treasury's paper on the Fundamental Expenditure Review. Mr Kent said that the areas targeted by the Treasury team had been the Printing Works, Note Issue, Registrars, Debt Management and the Exchange Equalisation Account. We had pointed to the enormous reductions in expenditure over the past 10 years, and to our own expectation of getting further savings at the Printing Works of £6-7 mn. The Treasury had been looking for more and had targeted the Printing Works and the Registrars areas in particular (the EEA seemed now to be exempt). Their preferences seemed now to be to sack our senior Printing Works managers and replace them with managers from a commercial company, who would use our plant to make their notes and in the process satisfy our need for notes; to privatise the note distribution system, relying on commercial banks and eliminating the Bank of England's branches; and to partly market test the Registrar's Department.

We have said, in response, that we would stand on our record for control of expenditure; that partial market testing was absurd, and if the Government wanted to take Registrar's business away from us then they should contract it out properly; and, importantly, that we would not accept responsibility for delivery to HMT of a service that had previously been contracted to us but was now contracted to a

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third party. The Governor confirmed that this last point was the line that we proposed to take with the Treasury; taken to an extreme, it meant that if the Treasury wanted to take over the printing of notes, then they could issue Treasury Notes. If they pursued Registrar's Department, we would insist on full privatisation rather than market testing, and we would put in a bid ourselves. So far as the Issue Department was concerned, we were already looking at the arrangements, and it was feasible for the commercial banks to play a larger part in the distribution process. Sir David Scholey asked if that would involve effectively franchising; and if we were prepared to do that, did that not undermine the line we were taking with the Treasury? The Governor said it was not franchising business out, it was simply changing the point at which we sold notes to the commercial banks.

Sir David Cooksey said that he had seen a number of reports of this kind, and thought that the quality of the Treasury report was extraordinarily low. He strongly supported the line we proposed to take. He added that we did need to have a range of performance indicators and arguments to rebut the suggestions of excess cost. Mr Kent confirmed that we did have those, and could show a good record. Court were content with the line proposed by the Governor and Mr Kent.

Sir Colin Corness - A Directorship

Court gave their approval to Sir Colin Corness joining the Board of Glaxo Holdings plc in November, with a view to him becoming non-executive Chairman in May 1995, when he will retire as Chairman of Redland PLC.

Mr Kent and Ms Masters - Directorships

Court gave their approval to Mr Kent and Ms Masters, becoming directors of the Private Finance Panel Limited.

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Boards of Bank Subsidiary Companies: A Resolution

The Governor introduced a Resolution concerning changes to the Boards of certain Bank Subsidiaries. It was RESOLVED that consequent upon the retirements of Messrs H C E Harris, J S Rumins, G A Croughton and P G Mitchell, and pursuant to Section 375 of the Companies Act 1985, as amended and extended by the Companies Act 1989, and until otherwise resolved by the Court of Directors:-

1 MR G MIDGLEY shall become a Director of Securities Management Trust in place of MR H C E HARRIS. The Board will then consist of Messrs Quinn (Chairman), Midgley, Kentfield and Bridger.

2 MR G MIDGLEY and MR J R E FOOTMAN shall become Directors of Houblon Nominees in place of MR H C E HARRIS. The Board will then consist of Messrs King (Chairman), Midgley and Footman.

3 MR M A KING, or failing him MR G MIDGLEY, or failing him MR J R E FOOTMAN be authorised to act as representative of the Governor and Company of the Bank of England at any meeting of Houblon Nominees.

4 MR G MIDGLEY, MR J BARTLETT and MR R LECKY-THOMPSON shall become Directors of BE Services Ltd in place of MR H C E HARRIS and MR P G MITCHELL. The Board will then consist of Lord Laing of Dunphail (Chairman) and Messrs Midgley, Jarvis, Watts, Bridger, Bartlett and Lecky-Thompson.

5 LORD LAING OF DUNPHAIL or failing him MR G MIDGLEY, or failing him MR A W JARVIS, or failing him MR B T WATTS, or failing him MR D A BRIDGER, or failing him MR J BARTLETT, or failing him MR R LECKY-THOMPSON be authorised to act as representative of the Governor and Company of the Bank of England at any meeting of BE Services Ltd.

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6 MR G MIDGLEY shall become a Director of BE Property Holdings Ltd in place of MR H C E HARRIS and MR J S RUMINS. The Board will then consist of Mr Pennant-Rea (Chairman) and Mr Midgley.

7 MR R L PENNANT-REA, or failing him MR MIDGLEY, or failing him THE SECRETARY OF THE BANK, be authorised to act as representative of the Governor and Company of the Bank of England at any meeting of BE Property Holdings Ltd.

8 MR J M KEYWORTH, MR G MIDGLEY AND MR B T WATTS shall become Directors of BE Museum Ltd in place of MR H C E HARRIS AND MR G A CROUGHTON. The Board will then consist of Messrs Footman (Chairman), Keyworth, Hills, Midgley and Watts.

9 MR J R E FOOTMAN, or failing him MR J M KEYWORTH, or failing him MR D F HILLS, or failing him MR G MIDGLEY, or failing him MR B T WATTS, be authorised to act as representative of the Governor and Company of the Bank of England at any meeting of BE Museum Ltd.

National Mortgage Bank - A Resolution

With reference to a Minute of 21 September, the Governor introduced a Resolution concerning National Mortgage Bank. It was RESOLVED that, following the acquisition by the Bank of the share capital of The National Mortgage Bank plc, and pursuant to Section 375 of the Companies Act 1985, as amended and extended by the Companies Act 1989, and until otherwise resolved by the Court of Directors:

> The Chief Cashier for the time being, or such other person as may be nominated by him in writing, shall be authorised to act as representative of the Governor and Company of the Bank of England at any meeting of The National Mortgage Bank plc.

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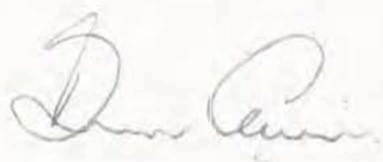
Executive Report

Under the executive report:-

(i) The Governor mentioned that the Bank will be launching a public information campaign about the security features of banknotes on 31 October 1994. Leaflets are to be distributed through main post offices, banks and building societies for one month. In addition, the Bank has produced a short training film for professional cash handlers. The timing reflected the completion of the introduction of the new series of notes this year rather than particular concerns about the level of counterfeits in circulation.

(ii) Mr Plenderleith reported that an error had been made in calculating the first interest payment on the Floating Rate Gilt, issued in March. The interest payment due on 9 September should have been calculated by reference to three month interest rates on 9 June. As the result of a clerical error, it had been calculated by reference to rates on 10 June. Had our procedures been correct, the rate would have been set 1/64% higher than it had been. Having discovered this error, we would now be paying holders of the Stock additional interest amounting to £175,000. £100,000 of this would be paid by HM Treasury, £75,000 by the Bank. We took this incident extremely seriously, and had looked very hard at the procedures involved to ensure no repetition.



Assistant Secretary
27 October 1994

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A COURT OF DIRECTORS AT THE BANK

THURSDAY 27 OCTOBER 1994

Present

Edward Alan John George, Esq, Governor
Brian Quinn, Esq
Mrs Frances Anne Heaton
Sir Christopher Anthony Hogg
Pendarell Hugh Kent, Esq
Sir John Chippendale Lindley Keswick
Mervyn Allister King, Esq
Sir David Bryan Lees
Sir Christopher Jeremy Morse, KCMG
Ian Plenderleith, Esq

Hugh Christopher Emlyn Harris, Esq

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

There were no comments on the weekly figures.

At the Governor's invitation, and with the agreement of Court, Mr Bowen, Head of Function, Inflation Report Division joined Court for the Monthly Economic and Markets Report discussion.

Mr King, noting that publication of the Inflation Report and the monthly meeting between the Governor and the Chancellor would be on the following Tuesday and Wednesday respectively, asked Mr Bowen to introduce the MEMR.

Summarising the Report's conclusions, Mr Bowen said that the outturn for retail price inflation had remained good, although

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there was evidence of emerging pressures from increases in input and output prices. However, the Bank view was that, because of the scope for squeezing retail margins further and of continued innovation in the retail sector, it would be possible to achieve the Government's medium-term inflation objective. He invited Court's comments on this evaluation, as well as on the following matters:-

(i) prospects for the current wage round, and whether reduced inflationary expectations would be a factor;

(ii) why narrow money, previously a fairly reliable indicator, was growing rapidly and was outside its monitoring band;

(iii) why investment had not picked up more.

The Governor added a further question: the price pressures at early stages in the production process were clear, and capacity constraints were emerging in some sectors; but would these pressures be absorbed along the production chain or passed on?

Sir Chips Keswick commented first on housing market developments, which were mentioned in the MEMR but had not been specifically raised by Mr Bowen. He said that both the primary and secondary housing markets were stagnant because house ownership was no longer seen as a hedge against inflation; thus people were neither buying nor moving unless they had to, and negative equity was still an inhibiting factor. Put another way, houseowners were convinced that low inflation would continue, but this had an adverse effect on the contribution of the housing sector to economic activity. Turning to narrow money growth, Sir Chips suggested that there were leads and lags in spending, the effect of which on the monetary aggregates was not clearly understood.

Sir Jeremy Morse identified two strands in growing evidence of disinflationary attitudes/expectations: first, people were no longer motivated to rush out and buy goods in anticipation of

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future price increases; second, for various, somewhat elusive, reasons - including the bad press for the Government - there was no feel-good factor in prospect. He endorsed Sir Chips Keswick's comments about the housing market.

Agreeing on the absence of the feel-good factor, Sir David Lees suggested that a sustained period of low inflation inevitably impacted less favourably on the general public than on the monetary authorities. On prices, he said that the battle between elements in the production chain was clearly beginning to bubble: this had not been the case three months ago. But it was too early to say whether producers, intermediaries or consumers would have to absorb price increases. On wages, he saw straws in the wind of emerging pressures. Settlements in the current round would undoubtedly prove more difficult to achieve (eg Jaguar, although he was unsurprised at the rejection), but this trend might not really be apparent until well into 1995.

Sir Christopher Hogg endorsed the balance of the Report's conclusions. He agreed that price pressures were evident, particularly commodity prices; but there was real difficulty in passing price rises on. On investment, he was unsurprised at the general caution, which he attributed to the continued pressure on margins. Responding to a question from Mr Quinn, Sir Christopher thought that investment project decisions were still predicated on high expected rates of return: he himself continued to look for a double-digit return.

Picking up on the question of commodity prices, Mr King noted that two factors had served to shield the UK economy from the general increase in non-oil commodity prices; these were lower oil prices and the strong performance of sterling.

Rupert Pennant-Rea

Assistant Secretary
3 November 1994

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MINUTES OF A COURT OF DIRECTORS AT THE BANK

THURSDAY 3 NOVEMBER 1994

Present

Edward Alan John George, Esq, Governor
Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Mrs Frances Anne Heaton
Sir Christopher Anthony Hogg
Pendarell Hugh Kent, Esq
Sir John Chippendale Lindley Keswick
Mervyn Allister King, Esq
Sir David Bryan Lees
Ms Sheila Valerie Masters
Sir Christopher Jeremy Morse, KCMG
Ian Plenderleith, Esq
Brian Quinn, Esq

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

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

Sir Christopher Hogg asked about the difficulties that had arisen over the press briefing for the Inflation Report. The Governor, recognising that the Report attracted a great deal of attention, said that procedures were being reviewed; he accepted a request from Sir David Lees that Court should have the opportunity to discuss the matter when the review was complete.

[Signature] Secretary
16 November 1994

Rupert Pennant-Rea

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MINUTES OF A MEETING OF DIRECTORS AT THE BANK

THURSDAY 10 NOVEMBER 1994

Present
Edward Alan John George, Esq, Governor
Pendarell Hugh Kent, Esq
Sir John Chippendale Lindley Keswick
Ms Sheila Valerie Masters
Brian Quinn, 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 noted.

The Governor commented on the weekly figures and spoke briefly about the foreign exchanges.

Rupert Pennant-Rea

Chairman
Secretary

16 November 1994

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A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 16 NOVEMBER 1994

Present

Edward Alan John George, Esq, Governor
Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Sir David James Scott Cooksey
Sir Colin Ross Corness
Mrs Frances Anne Heaton
Sir Christopher Anthony Hogg
Pendarell Hugh Kent, Esq
Sir John Chippendale Lindley Keswick
Mervyn Allister King, Esq
Sir David Bryan Lees
Ms Sheila Valerie Masters
Sir Christopher Jeremy Morse, KCMG
Brian Quinn, Esq
Professor Sir Roland Smith

Hugh Christopher Emlyn Harris, Esq

The Minutes of the Court of 3 November and the Meeting of 10 November, having been circulated, were approved.

Circulation of agendas and papers

Sir Colin Corness asked if the Secretary could circulate agendas further in advance of Long Court Meetings, and to send out the papers as a package rather than in bits and pieces as at present. It would be particularly helpful if papers could be circulated a good week before the Meeting, and an outline agenda circulated some time ahead of that. The Governor agreed that this should be done.

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The November Inflation Report

At the invitation of the Governor and with the agreement of Court, Mr Alex Bowen, Head of the Inflation Report Division, attended Court for the discussion of the Inflation Report.

Opening the discussion, Mr King said that the most interesting feature of the present position was the contrast between retail price inflation (falling, and faster than expected) and producer price inflation (starting to turn up). The figures that morning had underlined the point: inflation in October was lower than the market expected, remaining constant at exactly 2%. The Bank's measure - RPIY inflation - had fallen again, to exactly 1%. But producer output prices, excluding the volatile components, had risen by 2.3% over the past 12 months, up slightly on the September figure; and even that did not fully reflect the increases in prices of intermediate goods used in manufacturing production.

The explanation lay in the nature of the recovery. Consumption growth had slowed, and the growth rate of real domestic demand had fallen through this year. But manufacturing output had risen, and export growth had been strong. Output was growing above trend, led by net trade. Unemployment was falling.

With nominal demand growth basically flat, there were few pressures on inflation: and this was reflected in the Bank's November Inflation Report, in which the central projection had been revised downwards by just over half a percentage point. About two thirds of the revision represented the impact of the rate rise in September.

The Bank's Inflation Report suggested that inflation would rise a little next year, and into 1996, to reach the top of the lower half of the target range. But underlying that projection was a probability distribution, and in present circumstances we had judged that distribution not to be symmetrical: the probability of inflation being above the

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central projection was greater than it being below. In part, this was simply because negative inflation is unlikely. Moreover, the rise in input prices might feed through to retail prices more quickly than in the past, particularly if earnings picked up more rapidly, making it more difficult to absorb those increases in costs.

Sir David Lees asked whether we had analysed the speed of stock turnover as between recent cycles. One reason for producer prices feeding through more quickly into retail prices could be more efficient stock holding. Mr Bowen said that there had been a trend in industry towards holding fewer stocks, and that the stock recovery had been more subdued this time round. It was difficult to be sure, because statistics on stocks were notoriously unreliable, but he thought that Sir David's analysis was probably correct, and meant a faster transmission of input prices through to the retail level.

Sir Roland Smith noted that rising producer prices were an international phenomenon. Company boards were pushing managers to increase prices everywhere, and he felt that this would come through in the first half of next year. But Sir Christopher Hogg said that he thought there might be some producer price reductions later - some prices were now exaggerated relative to long-term supply and demand. Mr King agreed that rises had been patchy - non-oil commodities as a whole were not rising very strongly. The Governor pointed to table 5A of the Inflation Report, which showed the rises concentrated in materials and fuels, but weighted average costs rising only 1.9%. What had clearly gone up were nominal margins: but that was a different story.

Sir Colin Corness said that, while prices in paper and packaging had risen, they had not yet come back to 1988 levels, which the companies would see as consistent with price recovery. The industry itself was operating at full capacity, so customers had no choice but to pay. In time such increases would flow through into other companies' costs. The Governor said that it was one thing to identify specific products - and

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there were many - where prices had risen, but the issue then was what percentage of overall costs were affected.

Sir Jeremy Morse noted that the nearer you got to the individual consumer, the less inflation there seemed to be, and wondered whether there were implications for the choice of policy instrument; did the interest rate have a differential effect on consumers as against producers. Mr King agreed that monetary policy would have an impact first of all on household demand. He noted that the fall in unit labour costs had absorbed many of the specific cost increases identified. But it was useful to consider what would happen should that be reversed: in the first place, costs would be higher; in the second place, demand would be higher as well. Under this scenario, an earnings rise would cause a worsening in our inflation projection. Sir Jeremy Morse suggested that this meant that policy would hit the consumer hardest: but the Governor pointed out that the economy was growing at 3 1/2% annually, faster than could be sustained in the medium-term.

The Governor noted that company boards were said to want to raise prices: but he wondered how this squared with the evidence that real profitability now was as high as anyone could remember. Sir Colin Corness said that the figures did not square with his experience. Ms Masters asked whether companies were trying to revert to where they had been in <u>nominal</u> terms in 1988/89, a form of money illusion. The Governor agreed that money illusion could be an element: unless the published figures for profitability were totally erroneous, the table showed very clearly that hurdle rates of return were being based on "funny money". (Mr King volunteered a paper on the return on assets in the UK.)

Sir David Lees entered a caution about hurdle rates of return. He said that they were indeed an important benchmark, but management could and often did override them. The Governor said his concern was less with the rate of return on investment than with pricing policies. If companies were pushing prices up to maintain some target level of nominal profitability, then

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that was potentially damaging. We were getting a lot of support from industry on our campaign for price stability, but we needed tangible contributions as well. Sir Jeremy Morse suggested that the Bank should be giving more speeches along these lines.

Handling of the Inflation Report

With reference to a Minute of 3 November, the Governor spoke about the arrangements for releasing the Inflation Report to the press. The present system was that the Inflation Report was published at 4.00 pm on a Tuesday afternoon, together with Bank Briefing. Journalists were allowed to read the Report under lock-up conditions from 2.00 pm; an off-the-record briefing took place at 3.00 pm, to assist in interpretation of the Report. Wire service journalists were allowed to file stories direct from the briefing room, via portable PCs, at 4.00 pm, when the lock-up ended.

It had been clear that different people were taking different messages from the briefing. In the circumstances of the last Report, this was not surprising: the charts and forecasts looked benign enough, but the words contained cautions about the risks. We had been considering how best to deal with this difficulty, and had concluded that it would be sensible to issue the Report on a Wednesday morning rather than a Tuesday afternoon and to ensure that it contained in its summary and conclusions the same key sentences, in bold, that would encapsulate the basic message of the Report. We would put the summary of the Report on our own market screens at the moment of publication. We would not circulate Bank Briefing at the time the Report went to the press, as recipients tended to be driven by the Bank Briefing headline. Rather, we would send it out at the end of the day.

This left the question of the press briefing. We were thinking of having the press briefing immediately after publication, in order to explain the reasoning behind the

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Report. But there was a question as to whether it should be on or off the record.

Sir Christopher Hogg asked why it was necessary to have a press briefing at all: could we not say that the Report spoke for itself? The Secretary said that in those circumstances, individual journalists would all expect to be briefed bilaterally over the telephone, so there would then be an even greater risk of mixed messages; and such briefing would inevitably have to be off-the-record to avoid inadvertently creating new tablets of stone.

The Governor said that he could see the advantages of on-the-record, but we had to be aware of the implications: one would be that the television cameras would inevitably expect to be admitted. Sir Christopher Hogg added that it would be transmitted live to dealing desks. Sir Jeremy Morse felt that the potential gains were outweighed by these disadvantages; and the Governor felt that a high profile on-the-record briefing was not our normal way of doing things. But the Deputy Governor said that there was a real problem, because of the perception that we were giving special briefings to journalists, and these were then fed to the markets by Chinese whispers. This had made many of the analysts particularly angry.

Mrs Heaton wondered whether issuing the Report separately from the press conference would result in two separate stories appearing during the day. Sir Colin Corness and Sir Roland Smith both pointed out that in normal company announcements it was customary to brief analysts before the press, and then to talk to fund managers; Sir Jeremy Morse, though, thought that this was not the right analogue for the Bank's Inflation Report. Sir David Lees thought that it might be more sensible to brief the press inside the lock-up and prior to expiry of the embargo.

The Governor, thanking Members for their comments, said that he would consider further and revert to Court in January.

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Staff Issues Working Party

At the invitation of the Governor, and with the agreement of Court, Mr Lecky-Thompson attended for this discussion.

Introducing the paper, the Deputy Governor said that the new organisational structure had been put in place in July but that the Staff Issues proposals had only been presented to ExCo in November; this was indicative of the complexity of the issues. If he could caricature the Bank's problem, it was that we were losing the people we wanted to keep and keeping the people we wanted to lose. This was why the paper gave such an emphasis to training and career development but above all to the assessment and reward of performance. It was on that issue in particular that he hoped to hear Court's views. He noted that selling the proposals to the staff was going to be difficult.

Sir Christopher Hogg welcomed the general direction of the report, but noted that when he had lost people it was not usually because of pay, but because they could not see things the same way as management: so the emphasis in the report on management skills was very welcome. He noted that the report made upward appraisal an option. He felt that upward appraisal should be strongly encouraged, and ought to be part of the scheme. Ms Masters, also supporting the direction taken by the report, warned that it contained a complex series of changes, and that there was a danger in rushing implementation. It would be easy to get implementation wrong. The Deputy said that we would not be implementing the report all at once, and the new pay and performance arrangements, in particular, would not really bite until early 1996.

Sir Roland Smith said that while it was important that senior management should be involved in graduate recruitment, it was essential that young and successful management were the main recruiters. He noted the link between assessment and pay but it should not be direct. Management should act as tutors, and it would be necessary to get people to see appraisal in that light. In this context he wondered what we were to do about

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the people who were 90% good but needed help towards achieving the other 10% of performance.

Sir David Lees said that he saw the report as a carefully thought out document, but he was concerned about the collectivist, bureaucratic tone of parts of it: the introduction of a Salaries Committee, the role of ExCo, and so on. He saw decisions on individual pay as part of the job of line management. The Personnel Director and the Divisional Directors should together have responsibility for making sure that the right answer was reached, without too much bureaucracy. Sir Chips Keswick noted that where there was a steep pyramid, people at the top always got pressed to take snap decisions. The danger of a de-centralised system was anarchy, and the Personnel Director being ignored. If all Executive Directors were simply able to pay what it took to keep or get the right people, then the system would become uncontrollable. Sir Colin Corness warned about expecting bonuses to be cheaper in the long run: in fact bonuses rapidly became factored into the expectations of large numbers of staff. He also asked about the Bank's housing support arrangements: were these to be dropped? The Deputy Governor said that he had thought of including fringe benefits in the review, but had found the issue too complex. Sir Roland Smith said that he was extremely sceptical about large personnel functions: the wise Personnel Director was the one who kept his organisation very small.

BCCI Litigation

At the invitation of the Governor, and with the agreement of Members of Court, Messrs Peddie and Choyce attended Court for this discussion.

Mr Peddie said that the appeal on our technical strike out was now awaiting judgement. The defence itself, on the assumption that both the technical and the substantive strike out actions failed, was now in its final form, and had been seen by many current and former members of the Bank. The Bank was

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currently seeking the consent of certain overseas supervisors to refer to information originally supplied by them.

Sir Roland Smith said that he was interested in the paragraphs of the defence that sought to identify the Governor of the day with "the Bank". He wondered if this meant that the focus of the action would be very much on the two previous Governors: did it mean, for example, that Lords Richardson and Kingsdown had to attend Court for months on end, and to bear untoward consequences if the case was lost. The Governor said that the identification of "the Bank" with "the Governor" was not a general one, but one devised for the purposes of this action. Mr Peddie added that the personal involvement of Lords Richardson and Kingsdown was necessary only in so far as their evidence was relevant, and in the case of Lord Richardson, at least, the involvement was fairly narrow. The idea of pleading the case by reference to them personally was to establish who had the authority and the responsibility to commit the Bank; and after a lot of debate and discussion it had been resolved to be primarily a matter for the Governor of the day.

The Governor said that part of the claim related to the concept of "acting in bad faith". The idea was to put the plaintiff to prove that those individuals had acted in bad faith. Mr Peddie added that it would have to be shown that they had the degree of knowledge necessary to satisfy the allegation of bad faith.

Sir Jeremy Morse said that if things didn't go well the case would be long drawn out and the only winners would be the lawyers. He suggested that if we did not win the technical and substantive strike out actions, we ought to pause before going down the long route of a full defence. On the question of involving Lords Richardson and Kingsdown, he recalled Lord Aldington, as chairman of an insurance company, being put up to "front" a case, with damaging effects on him personally.

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Mr Peddie said that we had to bear in mind that the plaintiffs were using the particular tort of "misfeasance in public office" because all other options were closed to them. It was a big policy issue for us. Mr Quinn agreed. It was correct to question and consider the case for continuing to defend this action. But we should also remember that the 1987 Act was intended to ensure that supervisors could do their job without the fear of court action. We were not defending this case mindlessly: it was for the protection of the Bank, its staff and its supervisory function. Sir Jeremy Morse said that he would be prepared to debate that when the time came, but noted that, apart from "macho" reasons, the other standard reason for pursuing any case to its conclusion was the fear of creating a precedent. Court agreed that there should be a further discussion of the BCCI litigation if the strike out actions proved unsuccessful.

Small Firms

At the invitation of the Governor, and with the agreement of Court, Mr Piper and Ms Cleland joined Court for this discussion.

Mr Kent, introducing the Bank's second report on Finance for Small Firms, said that the earlier report had been mainly diagnostic: it had concluded that there needed to be more training for bankers and entrepreneurs and a change in attitude on both sides; that something should be done about delayed payments; that there should be a better choice of financing packages; and that the banks should look again at the way in which they priced risk. We had talked to a very wide range of people, and were continuing to do so; the Annex to the paper illustrated this. He summarised the conclusions of the report, set out on page 25 and page 26, and asked whether Court endorsed the conclusions, and agreed that we should continue to press forward this exercise; indeed, whether there were any other things that we should be doing.

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Sir Jeremy Morse said that he thought the initiative was an excellent one. The banks were bound to be involved in the Small Firms Sector. It was at the heart of their business. The question was how they could be involved in the most efficient way. He noted that a perennial worry in the small firm financing market was the problem of late payment. Furthermore, he was concerned over the reluctance of entrepreneurs to accept outside equity into their companies. He wondered whether the report might say more about that; and he wondered too if there was any indication of how the Small Firms Sector as a whole was doing. His own impression was that small companies were currently facing quite a struggle.

Sir David Cooksey said that the progress made thus far had been encouraging, and it was right for the Bank to try to keep the momentum up. On specific points from the report, he noted that while lending margins might not be widening, fees charged by banks for specific services had been increasing massively. For some companies the increase in fees had equated to a rise in overdraft charges of between 2% and 3%. On equity investment, Britain's traditional problem had been that, despite generating many small companies, very few grew to be big ones. People tended to want to withdraw equity for reasons both of tax and of security. On the banks' contribution to equity investment, this was in practice very small except in the limited area of big buyouts. Mr Kent said that the banks were enthusiastic, but Mr Piper confirmed that the clearers did not want themselves the direct involvement in high-risk ventures: rather to channel it through specialist subsidiaries. Among the clearing banks themselves there was a range of views, with Midland at the positive end.

Sir David Cooksey said that with 3i now effectively out of the smaller end of the venture capital market, there was a problem of supply. He felt this was a problem that the report failed to address sufficiently, and that Court should come back to it. Sir Chips Keswick felt that it was unnatural for any bank to support equity for small business. The clearers had got themselves into a false position by paying lip service to this

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ideal. The only way in which they could contribute significantly was through managing venture capital funds or through separately capitalised venture capital subsidiaries. He knew that a number of "Business Angel" investors would like to become involved in small firms' finance; but for this market to take off properly required a change in tax arrangements, to make losses easier to offset against earnings.
Sir Christopher Hogg said that liquidity was the key to investing in small companies, and noted the success of the US NASDAQ market. Sir David Cooksey noted that the EASDAQ initiative had been launched the previous day, with eight major US market makers signed up to it. Mr Kent, however, suggested that such markets were not for the smaller firms covered by the Bank's studies. Sir David Lees suggested that more work could usefully be done on international comparisons.

Summing up the discussion, the Governor said that a seminar with those interested would take place in January 1995, with a view to the paper being published thereafter.

Gilt Repo Market

At the invitation of the Governor, and with the agreement of Court, Mr Townend and Mr Tucker joined Court for the Gilt Repo Market discussion.

Introducing the paper, Mr Townend said that at the time of the Big Bang, in 1986, it had been decided to leave the arrangements for lending and borrowing Stock unchanged: it was thought that one miracle at a time was sufficient. This meant that Stock borrowing had been confined, as a privilege, to GEMMS. They were obliged to borrow Stock from Stock Exchange money brokers, who in turn had to borrow Stock from institutions approved by the tax authorities. What we now proposed was a generalised open market in Stock borrowing and lending: anyone could borrow Stock, from anyone. We had taken soundings from the market, and found a general belief that there would be positive benefits: a broader interest in Gilts; easier financing; the introduction of the price

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mechanism into Stock borrowing, enabling hard-to-borrow Stocks to be dislodged; it would create a continuum between the money market and the Gilts market, analogous to the United States; and it would cut short any development of the Repo market offshore. Although the GEMMS would be losing a privilege, the majority of them thought they would gain from the initiative: a few smaller ones might withdraw. The Stock Exchange money brokers, meanwhile, would have to re-think their business. We ourselves did not plan to operate in Gilt Repos as part of our money market operations, but if an active gilt repo market developed this increased our range of options for the future. There would be close surveillance of the new market, and a code of conduct.

Sir Chips Keswick said that unless the Treasury were prepared to allow all interest to be paid gross, a two-tier market in Repos would develop, which would not provide the benefits that we sought. Mr Townend said that we had been in active discussion with the Treasury and Inland Revenue about the tax point and they were well seized of it.

Sir Jeremy Morse asked whether we would be able to supervise the market: could we make our authority stick; what were the dangers? Mr Townend said that we could require the core players to comply with the master agreement with mark-to-market requirements and so on; and establishing high standards at the centre of the market should encourage others to comply. One couldn't legislate against cowboys at the fringe of the markets.

Mr Kent noted that in the equity market, the Stock Exchange was now committed to T+5 settlement by June 1995. One condition of this was that the Stock borrowing lending regime could be designed to accommodate the new system; there was bound to be a read across from Gilts to Equities. Mr Townend said that he would be discussing the new Gilts Stock borrowing arrangements with the Stock Exchange in the near future.

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A Resolution arising from the retirement of H C E Harris

The Governor introduced a Resolution concerning changes arising from the retirement of Mr Harris. It was RESOLVED that, consequent upon the retirement of Mr H C E Harris, and pursuant to Section 375 of the Companies Act 1985, as amended and extended by the Companies Act 1989, and until otherwise resolved by the Court of Directors -

> MR R LECKY-THOMPSON shall become a Member of the Governing Council of Business in the Community in place of Mr H C E Harris and shall be authorised to act as representative of the Governor and Company of the Bank of England at any meeting of the Governing Council.

The Governor noted that Mr Lecky-Thomson would also be succeeding Mr Harris as a Trustee of the Staff Pension Fund.

Merseyside Special Investment Fund Limited: a Resolution

The Governor tabled a Resolution relating to Merseyside Special Investment Fund Limited. Introducing the proposal, the Deputy Governor said that Merseyside was classified as Objective One by the European Community ie as one of the most depressed areas in Europe; and the proposal, worked out with local business leaders, was for a fund to channel European Community and private sector money into small and medium-sized enterprises in the region. £10mn had been forthcoming from the EIB, matched by £5mn from local institutions. The private sector participants wanted the local Chamber of Commerce and the Bank of England to be involved as "overseeing" bodies. The scale of this should not be exaggerated: our financial liability would be very small, no more than £10, although we had to acknowledge that there was a bigger reputational risk in the event that the enterprise failed. But in Liverpool there was arguably a case of market failure. Our presence on the letterhead would be part of the encouragement to local providers of capital to help.

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Sir David Cooksey asked when the initiative would be announced; the Deputy Governor said it would not be immediate, but that the term of the proposed facility would be for five years, from 1995 to 2000.

Sir Christopher Hogg said that there seemed to him only an extremely tenuous connection with the Bank's third core purpose. The Governor said that in one sense he agreed. Nevertheless the case could be made that there was a market failure in Liverpool, and an opportunity for the Bank to help get the region off the ground. The Governor thought he could stretch the third core purpose that far. It was, moreover, a very small involvement for the Bank. Sir Christopher Hogg said that if the involvement was trivial, then it ought to be left to others; if it was not trivial, then it would inevitably take up management time. The Governor said that it would take up the local Agent's time; and indeed the local Agent could not treat such an involvement as trivial.

Sir Jeremy Morse asked if the investment was time-limited. It did seem to stretch the third core purpose, and we needed to have some form of exit. The Deputy Governor said that the life of the fund was five years. We could certainly limit our involvement to that. Sir David Lees asked whether this was an isolated issue, or whether it was bound to go down as a precedent. He said that he shared Sir Christopher Hogg's view about the initiative; and was uneasy about lending the Bank's name in this way. Ms Masters asked why the Bank had to be involved at all. The Deputy Governor said that it was because the private sector in Liverpool had been badly burnt in the past, and that a symbolic gesture from the Bank would be helpful in this context. The Governor felt that if we declined this initiative, then that itself would send a harsher message than we wanted to convey. Ms Masters was not sure that our lending our name to remedy a case of market failure was supportable; and at another level, whether throwing a lot of money at an economy that wouldn't revive anyway was justifiable. The Governor said that he understood the reservations, and asked whether Members of Court would be

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prepared to support the Resolution or would prefer the Executive to withdraw it. Sir Jeremy Morse felt that given the time-limited nature of the involvement, he could on balance support the Bank's initiative; other Members of Court agreed.

Court RESOLVED that, pursuant to Section 375 of the Companies Act 1985, as amended and extended by the Companies Act 1989, and until otherwise resolved by the Court of Directors -

> shall be authorised to act as representative of the Governor and Company of the Bank of England at any meeting of Merseyside Special Investment Fund Limited.

Sir Roland Smith - A Directorship

Court gave their approval to Sir Roland Smith joining the Board of Associated British Foods plc.

Executive Report

1 **Court Membership**
The Governor said that he would be writing to Members of Court shortly to give them the list of names that he was submitting to the Chancellor of the Exchequer as possible Members of Court from March 1995. He would be grateful for any further suggestions in the next few days.

2 **Board of Banking Supervision Minutes**
With reference to a Minute of 11 August, the Governor said that some Members of Court had expressed a concern that the very detailed information given in the minutes of the Board of Banking Supervision, which were now being circulated to them, might give rise to a conflict of interest. The Secretary had been circulating minutes only to those who did not feel that a conflict arose; but that procedure itself had been criticised, as it left the burden of decision entirely on individual Directors. The Governor said that there were various ways in which this issue could be tackled. At one extreme we could stop circulating the minutes. Or we could carry on on the

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present basis. In between, we could think of ways of expurgating the minutes, or perhaps preparing a special note.

Mrs Heaton said that she had reservations about whether Members should see such sensitive documents, and about leaving it to individuals' discretion. It would be better for Members of Court if they had limited themselves to information on policy questions arising from the supervisors' work. The Governor asked whether anyone would object if we excluded individual cases. Sir Chips Keswick said that the objective was to get adequate warning and information about issues on the supervisory side, for which information on cases was relevant. The Governor suggested that the purpose of circulating the minutes was to enable Court to oversee the supervisory role of the Bank and the operation of the Board of Banking Supervision. He wondered whether these objectives might be met if we provided a summary of the Board of Banking Supervision minutes, but left it open for individual Directors to ask for more information if they wanted it. Ms Masters asked whether the minutes could be doctored by using code names for individual cases; but Sir Jeremy Morse thought that such codes would be easily penetrated, particularly by those whose conflicts were on the face of it greatest. Either Court had to decide to avoid the conflict, or it had to decide to manage it. Sir Roland Smith, and a number of other Directors, said that they would prefer to see the minutes in their unexpurgated form. Mrs Heaton thought that the proceedings could be criticised should they become publicly known; but the Governor felt that the discussions that Court had had, including this one, would demonstrate very clearly that the issue had been considered and that Members were well aware of the need to manage the conflicts of interest that inevitably arose.

3 **Membership of the Board of Banking Supervision**

The Governor noted that Sir Dennis Weatherstone was to join the Board of Banking Supervision. An announcement would be made the following day.

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4 **Insurance Strategy Review**

The Governor referred to the paper already circulated to Members of Court summarising the recent changes in our insurance policies. The trend was towards greater self-insurance, which would reduce the annual costs. The principal areas of uninsured risk were set out in the paper; and by this and other means we had made considerable economies in our insurance requirements. The proposals had been discussed in the Audit Committee; the Governor hoped that Court would feel able to endorse them.

5 **EMI**

With reference to a Minute of 21 September, the Governor said that the first meeting of the EMI at its Frankfurt offices had been held on the previous day. A number of significant issues were being brought to the Board of the EMI, and we had tabled a discussion for the following long Court in December.

6 **CREST and the Stock Exchange**

The Governor said that Mr Kent had now become Chairman of CRESTCO, and had given his first address to the shareholders in that capacity. Copies had been circulated to Members. Mr Kent's address had contained something of an olive branch for the Stock Exchange with which relations had been rather ragged recently, and he asked Mr Kent to comment. Mr Kent said that he had indeed offered an olive branch to the Stock Exchange, but the Exchange had promptly demanded the entire tree. Discussions were indeed very difficult. He had looked again at the document which the Stock Exchange had presented to us earlier in the year, and it was quite clear that their agenda was to take over the entire settlement system, and in the process to destroy the CREST project. The Governor said that we had a real difficulty with the Stock Exchange at Chief Executive level. They had aspirations and saw it as part of their vision to have a seamless system between making a bargain and settling it. This involved, inevitably, the effective rebirth of TAURUS. Whether this was wise was not entirely clear: we couldn't take their decisions for them. But we did have a responsibility for CREST and for delivering CREST on

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time and within budget, and we couldn't stop that process in order to have a debate with the Stock Exchange about their own ideas for the future. They themselves would have to go to their members as part of that debate, and it wasn't clear that they would get much support there.

Finally the Governor noted this was Mr Harris's last long Court. He could not let the occasion pass without recording thanks to Mr Harris for his 35 years in the service of the Bank, including six years as an Associate Director.

Rupert Pennant-Rea

John Footman
Secretary
24 November 1994

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A COURT OF DIRECTORS AT THE BANK

THURSDAY 24 NOVEMBER 1994

Present

Edward Alan John George, Esq, Governor
Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Sir David James Scott Cooksey
Mrs Frances Anne Heaton
Sir John Chippendale Lindley Keswick
Mervyn Allister King, Esq
Sir David Bryan Lees
Ms Sheila Valerie Masters
Sir Christopher Jeremy Morse, KCMG
Ian Plenderleith, Esq
Brian Quinn, Esq
Professor Sir Roland Smith

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 executive report and with reference to a minute of 16 November, Mr Quinn reported the outcome of the appeal by the liquidator in the "Three Rivers Action". The appeal had been allowed, and the stay on the writ lifted, on the grounds that the amendments made by the liquidators at a late stage had cured the Bank's objections. We would proceed now to a substantive strike-out action.

The Governor reported on his visit to Dubai and Saudi Arabia.

Rupert Pennant-Rea

Chairman
Secretary
21.12.94.

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MINUTES OF A MEETING OF DIRECTORS AT THE BANK

THURSDAY 1 DECEMBER 1994

Present
Edward Alan John George, Esq, Governor
Pendarell Hugh Kent, Esq
Mervyn Allister King, 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 noted.

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

Rupert Pennant-Rea

Chairman
Secretary
21/12/94

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MINUTES OF A MEETING OF DIRECTORS AT THE BANK

THURSDAY 8 DECEMBER 1994

Present

Rupert Lascelles Pennant-Rea, Esq, Deputy Governor

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 Meeting, having been circulated, were noted.

There were no comments on the weekly figures or on the state of the markets.

Rupert Pennant-Rea

Chairman

Secretary

21/12/94

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MINUTES OF A MEETING OF DIRECTORS AT THE BANK

THURSDAY 15 DECEMBER 1994

Present

Edward Alan John George, Esq, Governor

Rupert Lascelles Pennant-Rea, Esq, Deputy Governor

Pendarell Hugh Kent, Esq

Mervyn Allister King, Esq

Ian Plenderleith, Esq

Brian Quinn, 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 noted.

There were no comments on the weekly figures or on the state of the markets.

Rupert Pennant-Rea

Chairman

Secretary

21/12/94

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MINUTES\CAA1937

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 21 DECEMBER 1994

Present

Edward Alan John George, Esq, Governor
Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Sir David James Scott Cooksey
Mrs Frances Anne Heaton
Sir Christopher Anthony Hogg
Pendarell Hugh Kent, Esq
Sir John Chippendale Lindley Keswick
Mervyn Allister King, Esq
Sir David Bryan Lees
Ms Sheila Valerie Masters
Sir Christopher Jeremy Morse, KCMG
Ian Plenderleith, Esq
Brian Quinn, Esq
Professor Sir Roland Smith
Sir Colin Grieve Southgate

The Minutes of the Court of 24 November and of the Meetings of 1, 8 and 15 December, having been circulated, were approved.

Monthly Economic and Market Report (Mr Collins and Mr Bowen in attendance)

Introducing the paper, Mr King said that inflation seemed to have passed its trough. Short-run pressures were coming from cost increases; although the acceleration of commodity prices seen in the Spring had slowed, and input price growth too, producer output prices had started to pick up. Over the past year, falling unit wage costs had enabled companies to absorb such pressures, and the modest growth in consumer spending had

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squeezed retail margins. It was not clear how long these countervailing pressures would continue. The recent news - of significant upward revisions in output - suggested a higher inflation profile over the coming years, and that had prompted the interest rate rise earlier in the month.

Turning to the Chancellor's two Budgets, Mr King said that we had been encouraged by the tight fiscal stance, while recognising the uncertainty over whether plans for medium-term spending cuts could really be delivered.

Mr Plenderleith, commenting on the market charts, said that the markets had, more than the press, accepted the interest rate change as driven by monetary rather than political factors; and this was reflected in the significant reduction in the inflation and interest rate expectations derived from the yield curve.

Sir Jeremy Morse suggested that the November monetary minutes, released that morning, might add to the impression that the December rate rise had been politically motivated. The Governor disagreed. In the November meeting we had said that there was a case for a rise, but that it made sense to wait and see how inflation pressures developed. Since then we had seen the GDP revisions and the continued strength of industrial production, as well as further evidence, in surveys, of cost and price pressures. By the time of the December meeting we had felt bound to recommend a rise. Given that our perception was broadly shared by the financial markets both before and after the Commons vote on VAT - coincidentally the night before the meeting - we had called the meeting forward so that a rise, if agreed, could be announced ahead of the gilt auction. Politics had not entered into our recommendation - even if they had made it more likely that the Chancellor would accept it.

Sir Jeremy Morse asked if we still had the option of meetings between the monthly meetings. The Governor said that he hoped to avoid that, but it could happen - and if it did, it would certainly be minuted.

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Sir Roland Smith said that the public generally were reluctant to accept the case for pre-emptive rate rises: they would prefer to see the problem first, so as to validate the reaction. Sir David Lees said that the industrial members of Court needed to support our policy in their speeches, as he had done. The Governor welcomed that. The point to make was that by moving early we might not need to move so far; our perception of future inflation was far below that implied by the gilt market yield curve.

Sir Chips Keswick thought that confidence in policy could be undermined by fiscal developments: the market was concerned that the Budget arithmetic did not add up convincingly. Sir Colin Southgate added that there was a perception that spending had been allowed to slip - in the extremely helpful circumstances of 1994, there could have been much sharper nominal cuts. Mr King felt that the Government had kept a proper control on a cash basis, and had also taken in the form of PSBR cuts a sizeable part of the "inflation dividend" - and that the stated plans made sense. The Governor added that against a background of backbench calls for the inflation dividend to be spent in the form of windfall tax cuts, he had been very pleased with the Budget as proposed.

Other points made on the economic conjuncture: that retailers were likely to be under pressure in the new year from over-capacity, and were likely to shed labour; that labour was being taken on in manufacturing, predominantly by the smaller firms; that prices of some key industrial commodities were, in effect, cartelised, and thus slow to respond to economic stimuli; and that housing prices could rise because of a tightening of local authority planning restrictions. On the second point, the Governor agreed that we would consider publishing in the Inflation Report an analysis of employment growth by sectors and size of firm.

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Further developments in Stage 2 of EMU (Sir Peter Petrie and Mr Collins in attendance)

With reference to a Minute of 21 September, Mr Collins, introducing his paper, said that among key issues at present were the convergence criteria, where the Maastricht Treaty was arguably deficient; the transition to a single currency; and the design of a common banknote. The Governor added that although few countries were likely to meet the convergence criteria within the Maastricht timetable, one of them was certainly the UK. We had as good a chance as anyone of joining EMU at the outset if we wanted to. The question was whether the convergence criteria were adequate. The Germans were increasingly focusing on that. Structural convergence was becoming a real issue, even to the point of separating Germany and France. The Governor agreed with Ms Masters that it would be a mistake to present structural convergence as a new criterion: the point was that convergence should be <u>sustainable</u>, and that politicians should not snatch at some fortuitous coming-together of the indicators that suited their own timetable. Sir Christopher Hogg noted that a common currency area could be successful without convergence: for instance the United States. Sir David Lees felt that it was very important to clarify the convergence issues within the EMI, and it was agreed that a table showing countries' movement towards the convergence criteria would be made available to Court.

Several Members felt that the Bank's advocacy of an extended Stage 3A could be mistaken; the Deputy Governor said that he shared this view. The Governor said that it was clear that the sheer practical difficulties of rapidly introducing a new currency were immense. However easy coping with a new currency might seem to sophisticates in the financial sector, the bulk of the population would be deeply perplexed. There had to be a period of dual operation. Mr King argued that, logically, the only necessary condition for EMU was that there should be a single monetary <u>policy</u>. Subsitution of a single currency for national units of account, which were anyway arbitrary, was not urgent and could indeed be delayed

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indefinitely. But Sir Jeremy Morse noted that by adopting such a stance we were preserving the ability of the Union to blow apart again.

The Governor agreed that the Bank would produce a further paper on this aspect. The EMI Annual Report in April 1995 would provide comprehensive information on the convergence criteria.

A Report of the Audit Committee (Mr Midgley in attendance)

Sir David Lees introduced a Report of the Audit Committee. He made the following points:

(i) the Committee had decided to have shorter and more action-based minutes, and the intention was that these, rather than a separate report, should be provided to Court.

(ii) the Committee had been looking at its terms of reference, and would be suggesting revisions essentially to tidy up discrepancies.

(iii) in the light of the Treasury guidelines for the governance of public bodies, the Committee had come to the view that the Deputy Governor should be present for most of their meetings; the Deputy Governor had agreed to this.

(iv) the Committee had taken the view that the CREST project represented a sufficiently large risk to the Bank - financial and operational - to merit a quarterly report to Court.

(v) although there were some concerns, reflected in the minutes, that the Treasury might have an exaggerated view of the extent of Coopers & Lybrand's audit, we did not see any merit in drawing HMT into this debate.

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(vi) it had been agreed that the Bank would, with effect from the next Annual Report, seek to comply with the Cadbury Code so far as was appropriate.

(vii) the internal Auditor's terms of reference were going to be re-examined.

(viii) the Committee had adopted procedures that enabled both the internal Auditor and the external Auditors to communicate matters in the absence of the Executive; he could tell Court that no adverse comments had been made on this occasion.

The Governor thanked Sir David for his report. Mr Kent sought confirmation that any additional costs incurred in monitoring the CRESTCO audit would be a charge on the Bank. It was agreed that this should be the case.

Financial Report (Mr Midgley in attendance)

Introducing his paper, Mr Midgley said that the focus inevitably was on controls and the level of expenditure, rather than on profitability. The major change had been in CREST. With the confirmation in May that the CREST build would go ahead, we had written in the relevant expenditure for this year; we would be recovering money from the CRESTCO proprietors, but this had not started until October. We expected our contribution to the EMI this year to be £8 mn. There was a continuing debate with the Treasury over the treatment of 3i's profits.

The Governor added that we had that morning received proposals from the EMI about a capital contribution: they were looking for £81 mn, or 15% of ECU677 mn. This was the capital they needed to generate income to finance themselves for three years. The sum could become payable before the end of the current financial year. Up until now, the EMI had been financed on a pay-as-you-go basis, but the Treaty had implied that the EMI should have its own capital, which it would invest

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to cover its expenses. Control of EMI spending would be via the Finance Committee of the EMI Council - for an international organisation, the budgetary procedures did not seem too bad.

Sir Jeremy Morse thought it inconceivable that HMT could claim more than half of the 3i profit. Ms Masters thought that the argument would be that we don't need the capital; but the Deputy Governor pointed out that as well as merely crystallising assets that had all along been on the Bank's balance sheet, we had lost an income stream, and needed to replace it. Sir Roland Smith thought that the prospective demands from the EMI would be a good reason to keep the 3i profit. Sir Chips Keswick felt that the Bank was grossly under-capitalised as it stood, and the Governor agreed that the question did go back to the level of capital that the Bank required. Basically we needed to have capital for lender of last resort purposes only: it was debatable how far we should have own resources for this, and how far we should expect to rely on guarantees from the Government. He said that it would be sensible for a paper on the question to be prepared for Court.

The balance between cost and benefit in regulation (and, later, Mr Clark in attendance)

Introducing her paper, said that she had attempted to identify a number of issues that bore on the regulatory balance. There were pressures for tighter regulation, especially after the Maxwell affair, but there were also suggestions that disclosure could in many cases provide an adequate substitute for detailed regulation: this had been seen in New Zealand, and was indeed a part of the Fisher report on derivatives. But in the derivatives area, there was emerging in the United States the doctrine of suitability, which implied considerable levels of regulatory protection for quite sophisticated players.

Mr Quinn said that it was important to bring this matter before Court at the moment. The Treasury and Civil Service Committee would be calling the Bank to give evidence. The Labour Party

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had published its own ideas, including ideas on institutional arrangements. It was true that these were not well developed, but it did mean that there was a chance for us to influence Labour's thinking. The forces were always for more regulation. Most recently this had been seen in the derivatives area.

The Governor added that the development of the suitability doctrine in relation to professional counterparties was a considerable threat: there was also the problem in the United States of multiple jeopardy, where for example Bankers Trust had been censured by the Federal Reserve, then had to face the SEC and the CFTC, and then face the prospect of litigation. Clearly regulation brought some benefits, and that was recognised in the paper. But the question was whether we thought the tide had run too far, and whether we should now be leaning against it.

Sir Roland Smith thought that there was a need for much greater public awareness of the real costs of regulation. When LAUTRO fined an insurer, it was not often realised that the costs fell directly on the generality of policyholders. He doubted that people knew how much regulation was costing - and until they did, there was little chance of holding back the tide.
Ms Masters felt that the paper ought to have said more about costs: it was not enough to assert that regulation was costly, we ought to get ourselves into a position to be able to produce figures to support the arguments. Sir Jeremy Morse was sure that the Bank should lean against the increases in costs, and more fundamentally that the Bank should be pointing out that complex societies will not work without some element of caveat emptor. Mr Kent agreed, but felt that our case would be stronger if we could point to other ways of helping consumers. He suggested a greater use of rating agencies. There was also a case for reducing the number of FSA supervisors.

Sir Roland Smith - A Directorship

Court gave their approval to Sir Roland Smith joining the Board of Sula Group Plc.

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Executive Report

1 Mr Quinn spoke about the TCSC's Report on the supervision of building societies. Although not wholly clear in its conclusions, the Report appeared to be suggesting that the Bank of England should eventually take over the supervision of building societies.

2 The Governor thanked Members of Court for their comments about potential non-executive Directors. The Chancellor would be sounding out the Prime Minister about the possibility of appointing two candidates; they were unlikely to be approached until early in the new year.

3 The Governor advised Court that, outside the Bank's normal charitable appeals budget, he had authorised donations to the Westminster Cathedral Appeal of £1,000 a year for the next five years.

4 With reference to a Minute of 24 November in relation to BCCI, Mr Quinn mentioned that the Bank's defence had now been tabled.

5 The Governor mentioned that the oil painting of Court in session was now on display in the Museum, where it will remain on view to the staff and public.

Rupert Pennant-Rea

Secretary
4.1.95

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A MEETING OF DIRECTORS AT THE BANK

THURSDAY 29 DECEMBER 1994

Present

Rupert Lascelles Pennant-Rea, Esq, Deputy Governor

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 noted.

There were no comments on the weekly figures or on the markets.

It was noted that in future, all meetings of Court would be held on a Wednesday, so that the weekly figures would not be available for discussion. It was agreed that the weekly return of the figures should be discontinued, but that the Director responsible for the Bank's banking operations would inform Court of any significant changes in the Bank's balance sheet as and when necessary.

Rupert Pennant-Rea

Chairman

Secretary

4.1.95

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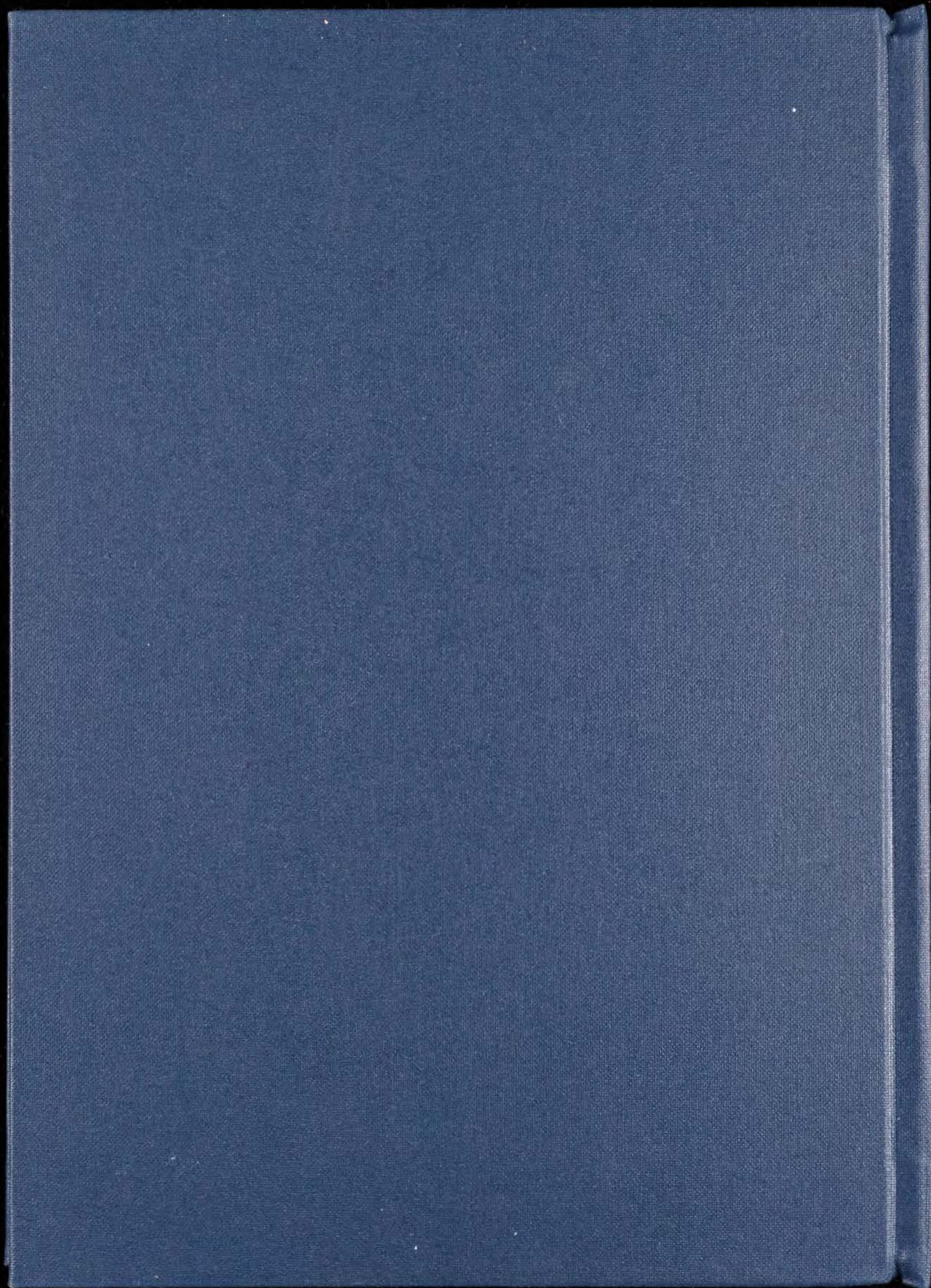

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