Speech by

THE GOVERNOR OF THE BANK OF ENGLAND,

at a Dinner given by the Lord Mayor to the Bankers and Merchants of the City of London on the 20th October, 1960

In the monetary field the past twelve months have been notable for three things; a strong swing in the pendulum of monetary policy, the introduction of a new technical device, and a heavy movement of international funds between different markets.

From early 1958 until late 1959 monetary policy had been directed towards countering a mild recession. It was on this occasion at the Mansion House last year that the first notes of caution were sounded that demand might again be running too fast and that the economy might again be in danger of getting overloaded. During the first half of 1960 these dangers became more apparent and monetary policy was progressively tightened to help in combatting them.

It is too early to assess exactly the part played by monetary measures, individually or collectively, in restraining the boom which was gathering force in the spring. But experience since September, 1957, suggests that monetary policy in general, and Bank Rate in particular, exercises greater influence now, when there is more underlying stability in the economy, than it could in the early years after the war, when the economy was distorted and inflationary pressures overwhelming. Indeed it may well be the case that, had the Radcliffe Committee taken its evidence two years later, witnesses would have ascribed considerably more force to monetary measures than they did at the time. The one proviso remains, now as in earlier years, that monetary policy can only carry a part of the burden of economic adjustment, and cannot be effective if it is expected to work against, rather than in support of, government policies in fiscal and other fields.

The Special Deposits Scheme, as the Chancellor has said, is not particularly mysterious, and indeed it is very similar to schemes which have been in use elsewhere. I am not myself enamoured of any of these technical devices. Their usual purpose is to correct an excess of liquidity, which it would be better to prevent at the source. But prevention is not always possible, and Special Deposits have this year proved a useful addition to our monetary armoury. Without going too far into technicalities I would add two comments on this subject. Experience so far has confirmed us in the view which we expressed to the Radcliffe Committee that this device is to be preferred to other similar arrangements having approximately the same effect. And I still have the feeling that any prolonged or frequent use of this system (or indeed of any form of credit squeeze on the banks, voluntary or compulsory) is both unfair to the organised banking community, and in the long run liable to be ineffective, unless some similar restraint can be applied to wider categories of short-term lenders.

In the exchange markets significant changes had already taken place in 1959. The greater sense of stability of currencies and the higher degree of convertibility had meant that different levels of interest rates in different centres were having more effect on the movement of funds from one country to another than in earlier post-war years.

This tendency has become more pronounced in recent months. It is a sign of freer trade and payments and of more international confidence. Provided that movements do not get too big and that there is no underlying disequilibrium, it need not bother us unduly. I see no cause to cheer when these short-term money movements cause our reserves to rise: nor shall I see cause to complain if our reserves fall because they go the other way. This is what reserves are for. And a good deal of what now looks like short-term money may in fact turn out to be more permanent investment.

I hope that we shall all get more used to regarding the International Monetary Fund as a second line of reserves for this sort of purpose. Too little importance has been attached to the very large increase in their facilities which was arranged last year, and to the part which they can play in offsetting these movements. Provided that countries are pursuing proper financial policies the Monetary Fund will doubtless be willing to stand behind them. I should like to see countries draw on these facilities as a matter of ordinary business when they need to reinforce reserves, and repay when reserves are rising: recent advance repayments by Her Majesty's Government have been an instance of this policy. If drawing on the Monetary Fund is regarded as only a last resort, then half its utility is lost because it will come to be seen as a crisis measure which may cause as much nervousness as it allays.

Yet we cannot be wholly confident that these movements of funds between markets can always be kept within reasonable bounds. Any major and persistent movement which went unchecked might threaten stability. The mere fact that interest rates are materially higher in some countries with a balance of payments surplus than in some others with a deficit suggests that, in the Central Banks and Treasuries of the world, we have still a good deal of hard thinking to do on this subject.

What judgment should we make, then, of our present position? Sterling is strong in the markets, but our underlying balance of payments, and particularly our exports, are not as good as they should be. Investment demand is still heavy, and, though there are soft spots, consumer demand as a whole is at least maintained. The rising boom of the early summer and the upsurge of bank credit of the past eighteen months have gone 'off the boil', but business remains very active and demand for credit brisk.

It would be unwise to make any changes until we are satisfied that it would not risk starting the pot boiling again. It would be equally unwise (having also in mind developments in other centres) to maintain too much rigidity for too long in our credit restrictions, merely for fear that minor adjustments might be misinterpreted as a change of direction.

I have been speaking of monetary technicalities, because that is my trade. But the fundamental issues for the next decade are different. What really matters is whether the British people and British Governments will choose to live within their means, or to live right up to them and sometimes beyond them. Shall we be content to limit demands on our resources to what we can manage without causing shortages, price rises and too large a bill for imports? Shall we be content to limit our overseas spending and lending to what we earn? If the decisions on these fundamental issues are right, then the monetary technicians can help to keep an even balance. If the decisions on these issues are wrong there are no monetary gimmicks or international credit schemes which can put them right.

My Lord Mayor, I have had the privilege of attending this annual banquet since 1933, and I am now responding to this toast for the twelfth time. I thank you my Lord Mayor and the many financial leaders, present and represented in this room, who give me so much help and friendship. I like to feel that, despite the vicissitudes of the past thirty years, the Bank of England can still claim, in fact as well as in form, to respond on behalf of the Bankers and Merchants of the City of London. The Bank of England is first and foremost a bank, with a duty to work in the service and to earn the confidence, not only of the Government of the day, but also of the business community at whose centre it stands.