The new Governor looks forward

*The **Governor** indicates some directions in which he hopes further progress can be made over the next five years.*[1] *He discusses:*

- *the need to maintain momentum on **monetary policy** and says '. . . you will find that I am no less dedicated to this aim than was my predecessor, and no less determined';*
- *international collaboration to reduce **exchange rate variability** where '. . . countries should not overlook the implications for exchange rates of their [domestic] policies';*
- *developments in **financial markets**, including the Stock Exchange where he hopes the continuing debate '. . . will keep prominently in mind the twin objectives . . . assurance of a central market and investor protection'; and*
- ***the international debt** situation where '. . . if we are to see healthy growth in the world as a whole, and in the developing countries in particular, there will be a need for considerably more non-bank finance than in recent years'.*

I am very conscious of the honour and privilege of speaking for the first time as Governor of the Bank of England.

The Governor's speech is normally an occasion for giving some account of stewardship over the last year, but for a new Governor it is more suitable for me to look forward. I would like to indicate some directions in which I hope we can make progress over the next five years.

Monetary policy: the need for continuity and judgement

The economic situation is fortunately very different from that which we faced only a few years ago. It is true that on the international front, the debt problems of a number of developing countries are still a major preoccupation. At home, too, the economy has been through a difficult period: unemployment is high and still edging up, and many companies have been facing and still face difficulties. But we now have low inflation combined with economic recovery, and this offers the prospect of sustained improvement for the first time in many years.

Some argue that we can now relax in our battle against inflation, but in my view that would be quite wrong. I speak here from deep conviction, born of my experience in industry and in banking. Sound, long-term investment judgements, essential to lasting prosperity, are possible only when monetary values can be relied on. Nothing would be more damaging to our prospects than failure to sustain the improvement in inflationary expectations, so painfully won.

Maintaining this momentum depends much on monetary policy, and our objective must be to continue the progress which has already been achieved. You will find that I am no less dedicated to this aim than was my predecessor, and no less determined.

I know that the Chancellor, like his predecessor, is equally dedicated and determined in his hard and wider task. What I have seen since taking office confirms me in my view of the need to be continually engaged in the struggle to contain public expenditure. The Chancellor's prompt action in July demonstrated his commitment, and he can count on my full support.

In taking up our new responsibilities, he and I are fortunate to have inherited a high degree of confidence in the steadfastness of monetary policy. This matters more than technical difficulties in interpreting monetary developments. The way in which different measures of the money supply are related to our national income has not proved easy to predict, but this should not be surprising at a time when the structure of the monetary system is changing rapidly, partly because financial controls have been dismantled. I do not think we should fear this process or its continuance.

We need guidelines to help us when adjusting the instruments of policy; but they cannot be treated as automatic rules, as the Chancellor has emphasised. We will still have to draw our conclusions about monetary developments, including the course of the target aggregates, after looking at movements in the exchange rate and other evidence about what is happening in the economy. This need to use judgement, and to base it on a number of indicators, need not, I think, confuse financial markets or

(1) In a speech at the Lord Mayor's dinner to the bankers and merchants of the City of London on 20 October 1983.

the public, provided that we are seen to aim consistently at our broad objectives.

Exchange rates: a way forward

I have mentioned the exchange rate. From discussions with many people in both the public and the private sectors, and in many different countries, I know that few are satisfied with how the exchange rate mechanism works. When the major countries first moved to floating exchange rates, many hoped that markets left to themselves would quickly produce orderly adjustments.

The two oil shocks of the 1970s certainly caused large disturbances. But after ten years of floating rates, with oil prices recently more stable and OPEC surpluses having disappeared, might we not have hoped to see exchange rates becoming steadier?

In fact, we still see the world's major currencies moving erratically from week to week, or even day to day. Short-term fluctuations perhaps may not damage trade much, though the tension and instability they cause can hardly be helpful. But there are also larger, longer swings in exchange rates, which are not always warranted in any fundamental sense. As we know, these can seriously undermine the competitiveness of industrial companies, and make business decisions more uncertain. The growth of protectionism is partly an attempt to shield existing investment from the losses caused by such movements.

The practical question is whether we can do anything to limit currency fluctuations without producing worse effects. Recent discussion of central bank intervention has narrowed earlier differences of view, and most people, perhaps, now see a place for intervention in certain circumstances. But there is clearly a strict limit to what can be achieved by these means.

This suggests that to achieve progress we need to think of a more conscious collaboration between nations on exchange rates. The Williamsburg communique commits us to improving consultation and co-operation to this end. What this implies, I think, is that countries should not overlook the implications for exchange rates of their policies and, as we make progress with reducing inflation, we should look for better performance on this front. This seems to me a more fruitful way forward over the next few years than trying to produce a brand new system, or harking back to an unattainable old one.

The importance of domestic financial markets

Let me turn now to the domestic financial markets which are not only important for the well-being of the economy but where significant changes are under way. In a world where financial markets are becoming ever more interdependent, particularly under the influence of technological advance, we must stand ready to embrace such changes, while seeking to ensure that the integrity and efficiency of our markets is not undermined by them. Over the past year attention has focused on two of our most important City institutions: Lloyd's and the Stock Exchange.

The Lloyd's Act now provides the basis for a stronger regulatory framework; and the Chairman and the Council, assisted by the new chief executive, are to be congratulated on the vigour which they are bringing to the task of strengthening the working and reputation of this unique institution and ensuring the large contribution that it makes to our invisible earnings.

The Stock Exchange: two tests for changes to come

The agreement between the Government and the Stock Exchange deserves welcome and support, since it reopens opportunities for an orderly process of change, to which the vote of the Exchange membership last week marks their commitment. The first moves in implementing the changes proposed have now been taken and I know that discussion is actively in train on the next steps.

It is understandable that both Government and the Bank should have been pressed to enlarge on their intentions and preferences for the future. Individual firms need to make plans and dispositions in an environment that is already changing rapidly, quite apart from the changes—in particular the dismantling of minimum commissions—that will follow from the present agreement. Attention has concentrated on the trading system, and on the Secretary of State's words in the House in July about single capacity being maintained in its present form, at least for the time being.

But it has to be recognised that competitive pressures will do much to determine what sort of trading structure is needed for a flourishing stock exchange. We are, of course, giving all this close attention; it would make no sense, however, for the Government or the Bank now to lay down rules which made the securities market less able to evolve and adapt to such pressure. That would be a sure way to make the central market in the Stock Exchange lose business, much no doubt to overseas competitors.

It may be helpful nonetheless to indicate some important considerations in the minds of the authorities. The present trading system gives effective protection to the investor, and any alternative arrangements will need to provide comparable safeguards. It also provides an effective central market, including a very efficient one in government debt; and the jobbing system ensures that there is a continuous market when trading conditions are difficult as well as when they are easier. A further necessary test for any alternative arrangements is thus whether they could assure a comparable market-making capability, avoiding fragmentation and a reduction in efficiency.

But none of these considerations leads either the Bank or, I am sure, the Government, to be wedded to any particular ways of doing business. The market is confronted not only with intensifying competitive pressures, but also with new technological possibilities which should in time allow costs to be reduced and service improved for both those in the market and their customers. These are large and exciting challenges, and the Stock Exchange will no doubt be reviewing possible responses to them. Part of the reason for having lay members on the Stock Exchange Council is to provide for their continuous involvement in such discussions. We look forward in positive spirit to seeing proposals that come forward from such review. But I hope that the continuing debate among member firms, in the City and in the press, about the trading system of the Stock Exchange will keep prominently in mind the twin objectives I have mentioned, namely assurance of a central market and investor protection. We for our part will be concerned that changes take place in an orderly way, and in the meantime look for the continuity that is provided by present arrangements.

International debt: perseverance needed from all concerned

My final remarks concern international debt. For the past twelve months we have all been coping pragmatically, as the situation developed, with the debt problems of a number of major developing country borrowers; and we can take encouragement from the progress made. But as the Chancellor has noted, there are bound to be difficult cases, some already with us, some perhaps to come. A durable and satisfactory solution to the debt problem may take a number of years to achieve, and will require perseverance and success on a number of fronts.

First, it will require that indebted countries continue to pursue firm but balanced policies of financial restraint and adjustment, agreed as necessary with the IMF. Second, it will require sustained non-inflationary growth in the industrial countries, which will expand debtor countries' export markets and improve their terms of trade. These two will make it easier to achieve the third requirement: the continued provision of finance from both the international institutions and the world's capital markets. Some new finance from the banking system will be necessary. But if we are to see healthy growth in the world as a whole, and in the developing countries in particular, there will be a need for considerably more non-bank finance than in recent years. The interests of both banks and of borrowing countries dictate this.

In the past decade, bank finance for sovereign borrowers grew very rapidly, taking on the predominant role previously played by official financing. In the inflationary climate of the times, only the banking system proved flexible enough to meet the needs of both lenders and borrowers. But banks now need to strengthen balance sheets, liquidity and capital ratios; and so they will not be able to sustain increased lending at the pace seen in the 1970s.

Borrowers, on their side, will need genuinely long-term finance more closely adapted to their needs, and this suggests that developing countries should give a warmer welcome to private non-bank finance and, in particular, private investment. Direct investment is often highly suitable finance for development. It avoids the mismatch, for the host country, of financing long-term investment by short-term borrowing; it is related directly to the growth of the productive sector of the developing economies; and it is more likely to result in commercially effective investment.

These are developments which will not be quickly or easily achieved. An enlightened approach, initiative and perseverance will be required from all concerned—international institutions, governments and banks—together and each in their own way.