Domestic financial markets: progress and problems

*The **Governor**[1] reviews progress over the past year: on monetary policy;[2] on plans for the future of The Stock Exchange where so many of the problems that seemed intractable have been successfully resolved; and on investor protection where, too, there has been much dedicated and creative work so that the broad shape of the regulatory system is now clear.*

He goes on to comment on the recent difficulties encountered at Johnson Matthey Bankers and the lessons to be drawn from this affair.

Monetary policy

There has been no weakening in commitment to the battle against inflation, a battle in which success has been considerable. The prospect now of achieving the figure given by the Chancellor at Budget time for inflation at the end of this year is far better than most outside commentators believed possible—and this in a period when unexpected outside developments have not been uniformly helpful.

Within the framework of monetary targets provided by the government for this steadfast commitment, I also stressed [last year] the need for judgement and a belief that some interpretative flexibility would be less damaging to confidence in policy than an overrigid adherence to detailed arrangements which might be overtaken particularly by institutional developments.

The need for careful interpretation—by market analysts no less than by the authorities themselves—has been well illustrated by the volatile behaviour of the monetary aggregates during the past year, and most notably by the events of the spring and the summer.

At that time, against a background of uncertainty associated with industrial disputes here in the United Kingdom and with financial pressures in and from the United States, the monetary figures, and the figures for public sector borrowing, were viewed by the market as evidence that monetary conditions were not under firm control. This was not our interpretation, as we made clear at that time. But having resisted—largely successfully—upward pressure on interest rates for some months, we were obliged to accept a steep rise, by about $2\frac{1}{2}$ percentage points, in July. In the atmosphere of the time an attempt to contain the intense market pressure could all too easily have been seen as evidence of a weakening of our resolve, which would have made the situation worse.

In the subsequent period, developments in the United States have in some respects become more helpful, and the market perception of underlying monetary conditions, of which the exchange rate is only one element, has become closer to our own. Much of the interest rate rise has consequently been reversed. I would suggest that there is now a general appreciation that monetary policy is on course, with no grounds, at this stage, for supposing that we shall not be able to achieve our stated objectives.

Encouraging progress on stock market reform

Let me now turn to The Stock Exchange. At this time last year, The Stock Exchange and its members were contemplating a future which to some may have seemed bleak, which was certainly challenging, and which above all was populated by a host of questions to which no easy answers were discernible. It is a great tribute to that institution and its distinguished Chairman that so many problems which then seemed intractable have now been successfully resolved and that the way ahead in terms of the broad structure of the future dealing system is now clear. In saying this, I do not underestimate the difficult decisions that remain to be taken and the hard work that will be required to ensure that all the new arrangements and the supporting technology are in place in good time. But what has been achieved within so short a time span gives good grounds for confidence that the remaining tasks will be successfully completed.

Throughout much of the past year, while the technical debates about dealing systems and market structures were in progress, other developments of major importance for the future of The Stock Exchange were in train. I speak, of course, of the emergence of new financial groups which will provide the additional capital necessary to fuel the prospective trading system and which are likely to have a substantial impact on the whole of the financial services sector in this country. We are glad to see foreign houses participating in those groupings, as befits an international financial centre, and we look forward to seeing them play their full part. But I know you will understand if tonight I express particular satisfaction at the number of strong formations which are wholly British and which promise to provide a greatly increased national capacity to compete with the best that the rest of the world can offer.

(1) In a speech at the Lord Mayor's dinner to the bankers and merchants of the City of London, on 18 October 1984.
(2) The Governor discusses monetary policy at greater length in his Kent University lecture reprinted on page 474.

The way ahead on securities regulation is now clear

The other topic that has occupied much City attention since the publication of Professor Gower's 'Review of Investor Protection' is the future of the regulatory system. Here, too, there has been much dedicated work and creative thought. If I may, I will mention just two names among the many who have given me advice, support and counsel for which I am very grateful. I should like to pay tribute to Sir Patrick Neill for his statesmanlike leadership of the Council for the Securities Industry (CSI) during a period which has been particularly difficult for that Council; and I should like to thank very warmly Martin Jacomb and the members of the advisory group which I set up to provide practical advice on the best form of securities regulation.

All these developments reached an important point only yesterday when the Secretary of State, Mr Tebbit, was to have given an important speech. Speaking on Mr Tebbit's behalf, Mr Fletcher announced the main conclusions which the Secretary of State and he had reached. I am glad to say that they have welcomed the proposal I had put to Ministers for a single practitioner-based body to oversee the whole of what we have come to call the securities and investment industry. This would be paralleled by another body, as proposed by the group chaired by Mr Marshall Field, which would oversee the marketing of, in particular, life insurance policies and unit trusts. In support of these proposals, Mr Fletcher announced the Secretary of State's intention to seek appropriate statutory powers, which he would be able to delegate to the new bodies. This means that here too the way ahead is now clear and we can start to move towards a coherent structure of self-regulation operating within a statutory framework.

As I have said before, I am convinced that this general structure offers the best means of achieving regulatory arrangements which are capable of meeting the challenges ahead, without needlessly impeding the efficient conduct of business and without impairing this country's ability to compete.

What has now been agreed is only the broad outline. Much important detail remains to be filled in. Although new structures of the kind now in prospect cannot be created overnight, it is my intention that the new securities and investment body should be firmly in place and operating well before the new securities bill is introduced in Parliament in the 1985-86 session. The task will be a large one but so also is its urgency, and I look forward to making rapid headway. To achieve this, and avoid the dead hand of bureaucratic regulation, will require the whole-hearted collective support of practitioners throughout the City.

In the meantime life goes on, and we must ensure that the present regulatory structure continues to function effectively. For that reason, the CSI must continue to carry the supervisory burden that it first took up more than six years ago and there must be no flagging in the support for the Council pledged by the City and other bodies at that time.

Difficulties at Johnson Matthey Bankers

This case for collective endeavour in managing problems in the City was brought home to us all during the last few weeks in dealing with the difficulties encountered by Johnson Matthey Bankers. We felt it was vital to prevent any contagious spread to other members of a central and traditional London market, any failure within which could have quickly sent serious shock waves through the UK banking system. To this end, prompt and decisive action was essential, and if some aspects of the arrangements made under these pressures seem less than wholly satisfactory to some, I would remind them that one cannot always deliberate over the design of the house when the kitchen is on fire.

The principal point which I should like to emphasise is that despite the urgency and speed of the exercise, it was a collective operation. A large number of banks, including some from overseas, came together and quickly subordinated their direct and immediate interests to those of the wider system. Despite the substantial resources involved, this whole operation was thus undertaken with no expenditure of public funds beyond the pound coin handed over as consideration in the early hours of that Monday morning.

In this respect, as well as others, the rescue operation was characteristic of the City of London. It is, however, important that the ability to act in this way should not be taken for granted, and it should be seen that, against the background of international developments in recent years, any extra burdens placed on the banking system must necessarily affect the willingness of the banks and their shareholders to see their funds used in an essentially discretionary way to help sustain the system.

The Johnson Matthey affair doubtless has lessons for the Bank of England too, illustrating as it does the challenge for devising a supervisory regime which achieves regulation without strangulation. I can assure you that we shall be working on these lessons very seriously. At the same time, and without complacency, we draw satisfaction from the fact that the bank did not fail and the markets remained undisturbed.

We are now setting our hands to the task of reconstruction and recovery. We fully support Johnson Matthey Bankers, though, of course, our working relationships are conducted at an appropriately arm's length distance. The tasks we face cannot be completed quickly—certainly they will take more than a few months. But when finally we have developed the intrinsic strengths of the bank and sorted out its problems it is our intention that it will be sold to an appropriate private sector bank on a going-concern basis.