ERM entry and improvements in the City

In a subsequent speech,[1] *the **Governor** again welcomes sterling's entry into the ERM and the potential benefits of membership, and stresses the need for both sides of industry to adapt their behaviour to the disciplines inherent in ERM membership—so that wage settlements and productivity growth move rapidly towards continental performance—if the social costs are to be minimised. The **Governor** goes on to review progress made in the past year in improving the City's infrastructure, and particularly its trading and settlement systems; and urges continuing efforts in order to maintain the City's pre-eminence as an international financial centre.*

ERM entry

It is a particular pleasure to follow the Chancellor of the Exchequer tonight. This is his first attendance at this splendid occasion as Chancellor and therefore as the star attraction, and I know the merchants and bankers welcome him to it most warmly, as I do. I believe that all of us here recognise that that welcome is his due, both by virtue of the unflinching resolution with which he has pursued the necessary counterinflationary policy; and by the way in which he has brought to fruition something which will be to the benefit of our economy, which I know is warmly appreciated by everyone here, and which has long been my ambition.

There has been a good deal of comment on how ERM entry fits into the broader canvas. I do not want to go into this, except to say that what is immediately relevant is that, having joined the ERM and thus having made a major new commitment, we should be in a better position to play an influential role in the debate about greater monetary integration in the Community and in the realisation of the single market programme, to which we are enthusiastically committed.

What about the more immediate impact of ERM membership on markets, industry and the economy generally? For financial markets, entry resolves an uncertainty that had been building up tantalisingly over recent months, during which sterling's value rose significantly. Industry had of course repeatedly demanded entry over five years or more; and will also welcome the resolution of uncertainty, not least because ERM membership will allow long-term decisions, especially investment plans, to be based on a more stable exchange rate.

Industry will also benefit from the lower inflation that ERM membership will help bring. But I must repeat that the ERM is no miracle cure for our economic problems and no soft option—though perhaps with the present combination of interest and exchange rates, industry is unlikely to be under any illusions on this point. This is clear enough from the French experience. They have shown since 1983 how an inflationary situation can be turned round within the ERM; but since France was already a member of the ERM and could not therefore benefit in 1983 from the potential positive effect on expectations of entering the mechanism, the French government was obliged to allow unemployment to rise in order to signal its determination to hold its position in the system and to get on top of inflation.

There are lessons in this for us—and I mean for both sides of the wage bargaining process. Our ability to compete—and thus to preserve or create jobs—will deteriorate unless both wage settlements and productivity growth move rapidly towards Continental performance. But if those concerned recognise the disciplines inherent in ERM membership and reflect this in their approach to what lies ahead, I am hopeful that we can match the French performance at a lower social cost.

We did, of course, combine ERM entry with a one percentage point cut in interest rates. Perhaps the first thing to make clear about this is that, when taking the decision, we knew that, while the real economy was softening and inflationary pressures were easing, the inflation rate itself had not yet peaked. Because of this, some in the financial markets said the interest rate cut was premature. To such doubters I would make three points: first, the most recent economic and monetary data provide clear evidence that the conditions necessary to reduce inflation are now coming into place; secondly, at 14%, interest rates remain high; and thirdly, the continuing restraining influence of high real interest rates has been considerably reinforced by ERM entry itself. It would be quite wrong to see the steps taken a fortnight ago as designed to bring about any significant easing of our policy stance.

Others have said that the interest rate reduction was both too small and too late; that we should do more, and quickly.

(1) At the Lord Mayor's dinner for the bankers and merchants of the City of London, on 18 October.

But I am afraid that that would not be compatible with getting inflation decisively lower. In fact, complaints about policy, from whatever source, would have been more appropriate when monetary conditions became too relaxed. For some time now we have been working to reduce the unsustainable rate of growth of domestic demand that was allowed to develop by low interest rates a few years ago. Easy credit conditions not only fuelled demand, but did so partly by encouraging firms and individuals to take on debt which, in the event, they have struggled to support—and in some sad cases have failed.

The lessons of excessive floating-rate borrowing were learned painfully by the developing world about ten years ago, and are no less true for British firms now, or indeed for British households. Our determination to maintain a tight policy will, I am afraid, not allow any immediate easing in this pain. All I can say is that it is necessary to get us back on track—to restore the conditions for sustainable non-inflationary growth. We must correct the consequences of past mistakes, and I am confident that we will be helped in this by the discipline of the ERM—a discipline on policy-makers, on lenders and borrowers, and on wage bargainers.

Improvements in the City

Our entry into the ERM comes just over two years before the planned completion of the 1992 legislative programme. Taken together, the new monetary framework and the advent of the internal market in the Community will significantly change the environment for the financial services industry. More than ever therefore, the City must be equipped to compete effectively. I am glad to say that a great deal of progress has been made in this respect, and perhaps you will allow me just a few moments, my Lord Mayor, to enumerate some of the achievements of the past twelve months.

First of all, there is much to applaud in the institutional arrangements for trading. I am thinking in particular of The International Stock Exchange's reorganisation, which will boost its efficiency and give a sharper focus to its activities; of the imminent establishment of the London Derivatives Exchange, through the merger of LIFFE and the London Traded Options Market; and the welcome news that the non-financial futures exchanges are moving in the same direction.

Advances are also being made with the City's settlement systems, which on this occasion last year I highlighted as a priority. The Bank of England has recently launched the Central Moneymarkets Office; and the Stock Exchange is on target to meet its October 1991 deadline for starting the TAURUS system. Both systems will replace existing paper-based settlement arrangements, and will take us a long way to catching up with competing centres. But I should not omit to stress that more is still needed if we are to take the lead in the settlement and payments area.

Improvements have not been confined to market systems. The regulators have also done much to allay the criticism they faced a few years ago. The Securities and Investments Board has simplified its rule-book; the Self Regulatory Organisations are working towards the same goal; and some welcome streamlining of the SRO structure is in prospect, through the prospective merger of The Securities Association with the Association of Futures Brokers and Dealers.

These and other changes are individually, and even more collectively, major achievements. But we cannot sit back and wait for others to recognise our strengths. We need to promote them—and that means individual firms, trade associations, government agencies and others. I therefore draw considerable satisfaction from the current plans to reorganise and strengthen the British Invisible Exports Council—or rather British Invisibles, as we should now call it. Equally, I welcome the Corporation's initiative to finance a study of the comparative costs of doing business in the City. And I also look forward to the results of the Transport Task Force which, my Lord Mayor, you have set up to follow on the useful work of the City Commuter Services Group. Transport is an area where much improvement is needed.

As most of you will know, the Bank has been closely involved with many of the developments I have touched on. Our actions in this area are guided by one overriding aim, and let me therefore leave no-one in any doubt about this. I am absolutely determined that the City should remain the pre-eminent—not just leading, I mean pre-eminent—financial centre in this time zone. And that determination is matched only by my confidence that we shall do so—confidence which is based on the major contribution which you, as practitioners, make and must continue to make to its achievement.