14. Monetary Control

Consultants

8 July 1980

The Committee of Scottish Clearing Bankers

19 Rutland Square, Edinburgh EH1 2DD

Telephone 031-229 1326

8th July, 1980.

E.A.J. George, Esq.,
Assistant Director,
Bank of England,
Threadneedle Street,
LONDON,
EC2R 8AH.

Dear Mr. George,

Monetary Control

In the Chairman's absence, I am writing to advise you that the Scottish Clearing Banks have considered the Green Paper entitled "Monetary Control" and, through the courtesy of The Committee of London Clearing Bankers (CLCB) have been given the opportunity to read that Committee's Submission on the subject. The Scottish Clearing Banks consider the Submission to be an acceptable assessment of the matter which they fully support. Rather than present a separate Submission, the Scottish Clearing Banks would endorse the comments of the London Clearing Banks but, in addition, would make the following two points.

Paragraph 10 of the CLCB Submission concerns the proposal to introduce a cash requirement for all banks and licensed deposit-taking institutions. The Green Paper does not deal with the Scottish Banks' cash holdings at the Bank of England covering the Scottish Banks' notes in circulation and it is submitted that these could serve also as the cash requirement now proposed.

While agreeing totally with what is written in paragraph 27 of the CLCB Submission on the merits of an indicator system linked to sterling M3, the Scottish Clearing Banks support also the statement in paragraph 5 that the deposits of other major deposit-taking institutions such as building societies should be taken into account when assessing monetary conditions.

Yours sincerely,

J.C. Sutherland

J.C. SUTHERLAND,
Secretary.

EABG 9/7 2

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16 July 1980

HER MAJESTY'S TREASURY

MONETARY CONTROL CONSULTATIONS

COMMENTS BY JAPANESE BANKS

Note by the Secretaries

A number of comments on the Green Paper have been received from the Japanese banks in London. These are attached for Treasury members of the group only; they have already been circulated in the Bank (additional copies may be obtained from Mr Foot). To the extent I (MLW) am able to isolate common themes running through the Japanese banks' comments, they are:

(i) The need to avoid increasing the statistical burden.

(ii) Extending the cash ratio to all banks would be inequitable since many do not need cash balances at the Bank.

(iii) Monetary base control is inadvisable for the reasons set out in the Green Paper.

(iv) The indicator system might have some advantages, but the authorities should retain scope for override (in particular to avoid excessive interest rate volatility).

M D K W FOOT
M L WILLIAMS

H M Treasury

Copied to D.G. P.S.
Mr Fforde
Mr Dow
Mr George
Mr Page
Mr Loehnis
Mr Coleby
Mr Goodhart
Mr Spooks
Mr Gill
Mr Walker
Mr Wallett
recd 2 - JUL 1980 11 00am
Mr Somerset
Mr Quinn
Mr Foot

THE BANK OF JAPAN

LONDON

SHIRO YOKOTA

CHIEF REPRESENTATIVE IN EUROPE

SY.JMB.

1st July, 1980.

Dear Governor Richardson,

With reference to your letter dated the 5th June in which you invited, through me, whatever comments the Japanese Banks in London wished to make on the Green Paper "Monetary Control" (cmnd 7858), I now have pleasure in sending you written comments by the seventeen of these banks that responded, out of the total of twentytwo.

I first thought that I would make some kind of a summary of these comments, however, I have decided after deliberation that it would be more appropriate for me to pass them on to you directly, since not only the nuances differ considerably from one comment to another, but too many points have been raised to make a collective response practicable.

I should be delighted if I could be of any further help.

Yours Sincerely,
S. Yokota

The Rt. Hon. Gordon Richardson, M.B.E.,
Governor,
Bank of England,
Threadneedle Street,
London, EC2 R 8AH

27/32 OLD JEWRY, LONDON, EC2R 8EY TEL: 01-606 2454

FUJI BANK LIMITED
25 31 MOORGATE,
LONDON, EC2R 6HQ
TELEPHONE 01 628 4477
TELEX NO 886317 & 886352

We would like to comment on the paragraph 4 of Chapter 6. as follows:-

(A) There are several difficulties surrounding the idea of monetary base control on a day to day basis; first of all the change of monetary base is under the influence of both the size of the public sector debt and the ways they are financed, over both of which the monetary authorities have no direct power to control on a day to day basis. Secondly, since the U.K has a so-called "open economy" , the monetary base is vulnerable to the erratic and unpredictable swing of short-term cash inflow. Finally, the relation between monetary base and money supply is unstable with regard to their patterns of response to short-term interest rates which play an important role in the transmission mechanism of monetary policy.

In conclusion, the shift to monetary base control is properly the matter to be decided by the monetary authorities and such questions are not easily judged by us.

(B) The indicator system would be better than the other direct controls. However the new proposal would bring about uncertainty to the economy as a whole since the deviation of the actual M3 from the desired M3 might be caused by extraneous elements which the monetary authorities have not predicted.

Even though they are allowed an overriding power, any decision taken as to scaling would be subject to amendment since such decision could only be made on a trial and error basis which increase the uncertainty of the economy. Therefore we would have to be cautious about the implementation of the automatic sliding proposal.

The Fuji Bank Ltd.,
London Branch

THE DAI-ICHI KANGYO BANK, LTD.

(INCORPORATED IN JAPAN)

LONDON BRANCH

TELEPHONE:
01-283 0929 (15 LINES)

TELEGRAPHIC ADDRESS:
BANKDAIKAN LONDON EC3

TELEX:
884042 LONDON
885521 LONDON

P. & O. BUILDING,
LEADENHALL STREET,
LONDON EC3V 4PA.

18th June, 1980

Comments

(A) It seems to take time to surmount difficulties and it might be impossible to solve these problems completely.
This scheme would theoretically be most effective to control the growth of money supply with a substantial time lag. However, it does not seem practicable to be introduced in a country such as the United Kingdom where money markets have been highly developed.
A method of minimizing the distortions which arise from the gap between the base desired by the authorities and that needed by the banks to meet their requirement in the business operations should be exploited before adopting this scheme.

(B) Indicator system seems more practicable compared to monetary base control. However, to make automatic adjustment effective, informations precise in quality and much in quantity are required. Therefore the authorities should be careful not to impose much burden of report on financial institutions.

CABLE ADDRESS
TAKUGIN LONDON EC2
TELEX
884353
888840

THE HOKKAIDO TAKUSHOKU BANK, LTD.

(INCORPORATED IN JAPAN)
LONDON BRANCH
6 BASINGHALL STREET,
LONDON EC2P 2DR

TELEPHONE
01-606 8961/6

Our Ref: TKL/274-hm

Your Ref:

18th June, 1980

Bank of England
Threadneedle Street
London EC2R 8AH

Dear Sir,

MONETARY CONTROL

We are writing in response to the invitation to comment contained in chapter 6 of the Green Paper on Monetary Control.

The proposals outlined have points both for and against but which of them would be the more advantageous is difficult for us to say: there are too many unknown factors.

We are inclined to think however, as regards monetary base control as outlined in section 4, that the difficulties could be overcome but only at considerable extra expense, e.g. the institutions will have to supply the authorities with a great deal of extra data and this we find worrying.

On the whole we doubt whether there would be any real advantage in a change as proposed. Certainly a lot more discussion will be necessary.

As to whether the indicator system of automatic adjustment of the Bank's lending rate would be advantageous or not we are of two minds. On balance perhaps we rather feel that the variations in the Bank's lending rate should be discretionary. relating to economic policy based on the widest possible statistical data. Unfortunately this also would mean much more work for the institutions.

We apologise for this rather negative response but without a deeper knowledge of the subject it is difficult to be more constructive.

Thanking you for your inquiry.

Yours faithfully,

H. Mizutani
Deputy General Manager

THE KYOWA BANK, LIMITED
(INCORPORATED IN JAPAN)
LONDON BRANCH

95 GRESHAM STREET LONDON EC2V 7NA

TEL: 01-606-9231~6
CABLE: KYOWABK LONDON EC2
TELEX: 883317

AKIRA ITOH
GENERAL MANAGER

HH/LCT

18th June 1980

The Bank of Japan
27-32 Old Jewry
LONDON
EC2R 8EY

Dear Sirs

Re: Monetary Control

We have much pleasure in informing you of our views on:

(a) Whether the difficulties with monetary base control outlined in section 4 and developed move fully in Annex B could be surmounted.

(b) Whether the system outlined in Chapter 5 of automatically adjusting tbe Bank's lending rate, would, on balance, be advantageous.

(a) There are many banks and financial institutions operating in London, but the types and fields of each bank are quite different to each other. For example, the structure of our deposits is different from that of the London Clearing Banks. Therefore we consider that the Authorities should not impose liquidity requirements on all banks and financial institutions in the same way. We realise however that there would be many difficulties to overcome in order to resolve this situation.

(b) To be frank we feel there is already a big burden in completing the current monthly returns. In order to achieve the system of automatically adjusting the Bank's lending rate, the Bank will require a more accurate and prompt indicator system and this means that the Bank might put further burdens on us.

More over, the market interest rate depends not only on demand and supply of money but also on the market's expectation. For example, the market is sensitive to the news on the level of MLR. So we feel it doubtful whether the indicator systems adjust the bank lending rate correctly.

Yours faithfully

H. Harama

H. Harama
Deputy General Manager
The Kyowa Bank Limited
London

(L957 72.8)

THE LONG-TERM CREDIT
BANK OF JAPAN, LIMITED

London Branch

18th June, 1980.

Reference Chapter 6 Paragraph 4
of "Monetary Control"

(a) From the view-point of the individual bank, schemes without a Mandatory Requirement are more attractive, but it is as much in the interest of a bank, even a foreign bank established in the U.K., to take an empirical view of Monetary Control as it is in the interests of the Authorities responsible for implementing the Government's policy, which is set out in the Introduction to the discussion paper.

Accordingly, monetary base control would require a Mandatory scheme. However, it seems from the discussion paper and Annex B that the difficulties are too numerous to be overcome and the system of penalties would be highly unpopular amongst banks. To avoid these penalties every ingenuity would be utilised by them to devise legitimate means of escaping control, and the resultant disintermediation would reduce the value of the control as a means of combatting inflation. With so many banks in the scheme the disintermediation would leave the authorities guessing. In addition, the practical administrative difficulties would both neutralise the value of the control and be time-consuming and, therefore, costly to banks.

On balance, there would, it appears, be no advantage in a change to Monetary Base Control.

(b) It is agreed that a wider and more efficient system of Monetary Control is desirable, in order to meet the Government's aim of a progressive reduction in the rate of growth of the money stock as a prerequisite to a permanent reduction in inflation.

The closely reasoned paragraphs of the discussion paper lead one to agree with the details presented in Chapter 5 under the heading "Indicator System".

The obligation for a bank to adhere to a mandatory base would in most cases be nothing new. Presumably consideration has already been given to the problem in this respect of the branches of foreign banks in the U.K.

Cont'd...

The continuance of lender of last resort facilities would ease transition to the new, from the present, arrangements. The whole structure of the London financial system would not be jeopardised and its functioning would be unimpaired.

The disadvantage would be an extension of the present "sample" weekly return by 80 banks to all banks large and small. There would then be no "sample" element, and every bank would be expected to render each week accurate returns of £M3 figures. Doubtless the co-operation of all the banks would be forthcoming if there were ultimate means of sanction retained by the Bank.

For the reasons stated in Chapter 5, the Indicator System would seem to offer efficacy, transitional smoothness and relatively painless control. This method of automatically adjusting the Bank's lending rate would, on balance, be advantageous.

MR

View on "Morctary Control"

The effect of introducing "Monetary Control" designed by the Bank of England and H.M. Treasury such as the instability of domestic short-term interest rates and foreign exchange markets, and creating an incentive for banks to hold excess reserves, would be a severe burden for Branches in the U.K. of foreign banks.

It is our view that Branches in the U.K. of foreign banks should be treated differentially from U.K. Banks, mainly because of their different liability structure from that of U.K. Banks.

The Mitsubishi Bank, Ltd.

LONDON BRANCH
8-13 King William Street,
London EC4P 4HS
(Registered Office)
Telephones: 01-626 4721/9

The MITSUBISHI TRUST and Banking Corporation

Telex: (General Banking) 887208 MTBCLN G
(Foreign Exchange) 884113 MTBCFX G
Cable Address: MiBTRUST LONDON EC4
Registered No: F 7499

INCORPORATED IN JAPAN

General Manager: HIROSHI WATANABE

MONETARY CONTROL

RE 6.4 (a)

1) The various difficulties with money base control could be surmounted for the practical installation stage, but, before the installation of the scheme, it must be agreed that the direct relationship between the growth of the monetary base under the control system and the growth of £M3 by the relative change of the short-term interest rate is presumed, even if all banks consent to keep a certain amount of base money as assets and the authorities monitor the daily movements in the base.

2) It is also a matter for consideration that it is unreasonable to request all types of banks to hold a certain level of base money with the Bank, because it is necessary for some banks, eg clearing banks, to hold a certain amount of base money for their normal banking operations, even without a mandatory requirement to do so, whereas other banks, eg foreign banks, do not need to hold their liquidity assets in the form of base money, except for a very small proportion which they need to keep in hand for operational use. Therefore, even if the basic system were to become compulsory for all types of banks, it is unrealistic to expect all banks to conform to the same standard as this would cause some banks to make quite fundamental changes in their current operations.

RE 6.4 (b)

1) The Indicator System is advantageous in that it enables the authorities to promptly readjust the market trend to the desired direction without having to delay the decision until the new trend has been clearly established. However, before the installation of the scheme, the authorities must be entirely confident that they will be able to obtain, on a regular basis and without delay, accurate statistical data relating to the money growth from the whole banking system.

2) Before the installation of the system, it must also be clarified to what extent the authorities intend to rely on it to judge when they should adjust the Bank's interest rate, and how often they would intervene to keep on a smooth path to the target in practical market movement.

3) It should be considered whether it is possible to obtain weekly returns from all banks without the production of these statistics placing a considerable burden on the banks.

17th June, 1980

Deputy General Manager
for H. Watanabe, General Manager