

cc PM Aug. 84
Mtg with Governor
of the B/EPRIME MINISTER

MEETING WITH THE CHANCELLOR AND THE GOVERNOR

The Governor will arrive with the Chancellor at 1830 and leave around 1900. I have grouped the items to be discussed while he is there and those for the Chancellor alone.

I Chancellor and Governori) Disclosure and Gilts - Flag A

You and the Chancellor feel that the legal advice given to the Bank is extreme and unworkable. Though the Bank may feel so too, they are unwilling to challenge it and even, at one stage, asked for a Treasury indemnity if they were required to act against it. You should allow the Governor a chance to make his case but stress that the Government, as the taxing authority and as the collector of market sensitive statistics, cannot be equated with other market operators.

ii) JMB - Flag B

The Bank have issued a press notice reporting the £100m injection of capital to replace its £100m deficit; and the write-off of £245m of bad loans. After deducting the £180m of capital put in by Johnson Mathey PLC, the holding company, £65m remained to be shared between the Bank and the commercial banks. You could ask the Governor whether he believes the Bank will recoup its £100m when JMB is sold and whether the process of writing down loans is complete.

You could ask the Chancellor and the Governor for a report on the handling of the JMB affair. I understand the Governor will attach an annex to the Bank of England's annual report which is due to be published in June, chronicling the history of the JMB affair. At the

same time, the Chancellor will publish the report on the implications for banking supervision and will make a statement to the House. It would be best to leave a substantive discussion of these issues until these documents have been received.

iii) Foreign Currency Borrowing - Flag C

Although the Bank has managed to take in \$1bn in market intervention since the beginning of the year, this has been largely offset by the foreign exchange supplied to Government departments, leaving a net increase of only £200m. Replenishing the reserves by this route will be very slow. The indirect borrowing conducted in the 1970's via the nationalised industries is now much more difficult with BT, BGC and BA in or heading for the private sector. The Chancellor therefore recommends \$1½ - 2bn of Euro dollar borrowing. This appears to be a sensible course but you might want to check with the Chancellor and the Governor that they have covered all of the presentational pitfalls.

II Chancellor Only

iv) Mercury - Flag D

Following extensive but unsuccessful talks with the Treasury, Mr. Tebbit raised with you his dissatisfaction about the extent to which Mercury was securing Government business. You asked him to minute you so that you could take this up with the Chancellor. This he has now done and his minute in effect puts forward the infant industry argument - that even though Mercury may be more expensive now, it is in HMG's long run interest to use Mercury so that it is established as a competitor to BT and so that in the long run prices are lower. The Chancellor will no doubt want to put his side of the case.

v) Public Expenditure Priorities - Flag E

At the post mortem discussion in January on the 1984 public expenditure round, the suggestion of a priorities meeting outside the normal run of Cabinet business was put forward. Arguments for and against were raised and no final decisions were reached. A number of spending Ministers have argued in favour of such a meeting while the Treasury fears that it could prove counter productive if spending Ministers use the occasion to fight their own corner and if decisions are taken which close off options before the bilaterals have even started.

I suspect the Chancellor is rather unenthusiastic but feels that there might be a diplomatic case for such a meeting. The options for Chequers meetings on a Sunday appear to be:

i) Before the public expenditure season starts, eg 16 June.

ii) After the economic Cabinet on 4 July. Diary difficulties limit the choice to 7 July or 28 July. The former is rather too soon as it may cast a shadow over the Cabinet meeting and make it more difficult to secure agreement to the public expenditure totals. 28 July is leaving it rather late.

iii) September, before the bilateral discussions get seriously under way. I understand Lord Whitelaw may favour this course.

If you favour a meeting on any of the dates before the recess, a decision is needed quickly as Ministers will otherwise have committed themselves elsewhere.

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