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P E Middleton
Deputy Secretary

23 September 1981

T Lankester Esq
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Dear Jim,

We spoke about the funding programme following your letter of 21 September to Peter Jenkins. As we agreed I attach the papers on derestricting the indexed gilt.

The issues are summarised in my minute of 11 September. The two key areas of concern are the overseas political problems (paras 17-24 of the main paper) and the tax problems (paras 28-38 of the paper), and you may wish to direct the Prime Minister's attention to these. There are also the general problems associated with any extension of indexation with which the Prime Minister is familiar but which are brought out in Mr Ryrie's minute. These difficulties have to be set against the problems of issuing conventional, long-dated stock at present yields and its implications for the Government's confidence in its own strategy, and the advantages of indexed gilts in terms of the immediate cost to the PSBR. These points were made in my minute of 16 September to the Chancellor.

You will see from that minute that we are very well aware of the urgency of the situation. The Chancellor has taken the papers with him so that he and the Governor can settle the question in Washington if necessary. Meanwhile we have been going over the arguments with the Minister of State and he will have a further meeting with Treasury and Bank officials later this week so that we can make final recommendations on the funding programme. We want to be in a position to take the best opportunity which the market affords to get on with the funding programme, so I hope that the Prime Minister will feel able to leave the decision to the Chancellor. If however there are points which the Prime Minister wishes to discuss further I hope we can try to resolve them before she leaves.

Perhaps I could also deal briefly with the other point in your letter - preparation of the markets for the high CGBR's expected in September and October. You will see from this morning's papers that we have already started doing this - rather successfully I think because we managed to pin the news to some positive action to mop

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up a possible money market surplus, and get it out in calm market conditions. I think we can continue to get the message over without frightening the markets in advance of a funding operation which everyone can see coming.

Yours wa

Peter

P E MIDDLETON

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