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PRIME MINISTER

INDEXED GILTS

1. Recent meetings with the Treasury and Bank (Deputy Governor etc) have rehearsed the arguments for indexation of debt and for issuing unrestricted IGs. The net result shows that the Bank now put very little emphasis on the OPEC argument and it is now agreed that there would be probably only a small take-up of unrestricted indexed gilts by foreigners.
  
2. There is a powerful isomorphism of the OPEC argument which so far has not been put forward and which you may wish to advance at the meeting. A substantial issue of unrestricted index gilts will enable domestic residents who hold sterling to hedge against the risks of a change in Government. As the Election approaches we are more likely to see a run on sterling, just as occurred in France and all the attendant difficulties. If, however, residents can buy unrestricted index gilts in any quantity they wish, this will be a very attractive alternative to taking one's money out of the country. As you can see, it is part of your general argument that issuing unrestricted index gilts and converting much of the nominal debt to index debt will be a process by which you bind successive governments. At the same time it will serve as a bulwark against a run on sterling over the next two years.
  
3. The tax argument was also substantially settled. Only the Bank has been vigorous in pursuing the alleged tax disadvantages of unrestricted index gilts. But this is an inconsistent position by the Bank because they have always argued that favourable tax treatment of gilts is essential for their marketability. And what is good for conventional gilts is really good also for unrestricted index gilts.
  
4. My overall impression is that from the Deputy Governor downwards the Bank has no zeal in arguing the case against derestricted index gilts. I believe that the main opposition will come from the Governor himself who will regard this as a matter of face at the various meetings of Central Bank Governors.

21 January 1982

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