

PRIME MINISTER

Prime Minister (2)

Econ. Pol

ms 1073

THE GILT MARKET AND THE BUDGET

1. You will recall that at the January seminar the Bank were arguing very strongly that derestricting indexed gilts and introducing indexed capital gains tax would have the most frightful effect on the market for conventional gilts, and, as Jock Bruce-Gardyne suggested also, the market for equities. It was forecast that there would be an immense fall in the price of conventional gilts and also equities.
2. On the other hand, I was convinced that, if anything, the measures would improve the market for gilts and equities. You also thought that the Governor's fears were without foundation. The Bank, however, continued this rearguard action through all the budget discussions of the Cockfield CGT reform. But, supported by Peter Middleton, the Chancellor doggedly pursued this reform and it appeared in the Budget.
3. Although we have only one day's reaction after the Budget, the market has moved diametrically opposite to the direction predicted by the Governor. Instead of conventional gilts falling, they have risen very strongly. The equity market also is on the rise. (I suspect that bank deposits will be the main losers - but we need shed no tears on that score.) You may wish to mention this to the Governor on some suitable occasion.
4. The banks have not yet adjusted their base rates. I believe that this is probably due to a discussion about whether they should move down by half a percent or one percent. However, we expect this to occur by next week at the very latest.



10 March 1982

ALAN WALTERS