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Prime Minister <sup>(2)</sup> 19 July 1982  
ALAN WALTERS

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PRIME MINISTER

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FUNDING AND INTEREST RATES

Interest Rates

1. As anticipated, the American money supply figures turned out to be much better than the market expected. These figures, combined with the ending of the ASLEF strike, have produced great expectations in financial markets. Before 11am today the Bank had sold £300 million and was talking about the need for "steadying the markets". What they really meant was opening the discount window! (Eddie George was away - and we missed him.)

They sold 11  
£ 935.9m  
by close

Including  
£ 486.2m  
part payments  
on gilts sold  
earlier!

MCS

This seemed to me to be quite the wrong move. Sterling and confidence were both high. It was an excellent opportunity to let the market produce yet another fall in interest rates. Peter Middleton agreed and we prevailed upon the Bank to allow the pressure to vent itself on interest rates. So Band 2 will go down by a sixteenth, and Band 3 by one-eighth.

3. Provided there are no serious setbacks there is likely to be a  $\frac{1}{2}\%$  cut in base rates soon. The exact timing is difficult to predict - recently the clearers have been rather coy. I suspect it will be next week, but I may well be wrong either way. This fall will answer the criticism that Patrick Minford rightly levelled at us in today's Telegraph.

Funding

4. The temptation to sell a lot of gilts while the going is good is difficult to resist. But resist we must. With the existing state of the money supply we must not over-fund. So far there is no obvious danger of over-funding, but we need to be vigilant and not slip into it accidentally by the current enthusiasm of the market.

5. Most of the activity has been in the 1984-92 conventionals and in the 2011 indexed gilts. None of the recent funding has been in terms of long-dated conventional stock. The Bank is still interested in issuing some more long-dated conventionals, but they recognise that they must make a very special case. I cannot see any obvious case for them, though there may be good technical reasons for a very small issue. The basic policy remains, however, to starve the long end and to fund in shorts, or short-mediums, or through IGs.

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