

SECRET

Prime Minister

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PRIME MINISTER

CONVERSION OF THE NATIONAL DEBT

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Ms 13/10

At last I can report a tentative step towards a conversion operation. At least it is a tentative step for us, but the Bank regards it as a giant leap forward.

The great success with selling short-dated stock has meant that we have tended to overfund. Under my continuous bickering, the Bank has offset some of this by buying in long-dated stock. The amount at the moment is small, only a little over £100 million. (But even this modest amount saves us annual interest costs of about £1 million a year and much more on the refinancing operation.)

While the yields on mediums are about one per cent above those on shorts, we should go on with the conversion. As long as the yield gap remains, the sky is the limit. We can finance this operation either, as I have said, by selling low yielding shorts, or we can push through more index linked gilts. Sales of ILs have been picking up remarkably recently and we are running out of our taps.

The advantages of buying in long-dated securities reinforce both strategic and technical market advantages. At the strategic level it keeps the yield on longs following a downward trend and so will encourage the issue of new industrial debentures. This will take the weight off the banking system, reducing the pressure on M3, and help with the restructuring both of corporate and bank balance sheets. Technically it will give the Bank more leeway in locking in yields and in providing marketability, in the absence of a tap long.

Of course I would have preferred more progress by now. But at least this is a start, and I am anticipating that over the next two or three weeks we will see at least £1 billion converted in this way.

I have a lingering suspicion that the Bank has done this £100 million merely to try and keep Number Ten off its back. If that is the case then we shall soon know about it. But Eddie George seems so pleased with the results that he may have been himself a little surprised. But I will keep a close eye on developments over the next week or two.

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ALAN WALTERS

13 October 1982