

SECRET

Prime Minister (1) Econ Pol

PRIME MINISTER

Told J Kerr. Decided
not to write. Mrs 25/10
Very much so
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Endorse the line
Alan is taking? Z1
Mrs 21/10

FUNDING AND INTEREST RATES

I am happy to report something of a coup today. As you will recall, the price of indexed gilts has shown some quite sharp gains over the past few days. I have been badgering the Bank to hurry up with their next IG tranch, and finally it was put on tap this morning. By 3 o'clock all £400 million were exhausted. The institutions were buying in quite a big way and Eddie George reports there was one large swop operation of £120 million longs against the IG. In fact the total longs which were bought in amounted to about £230 million or £240 million. So the conversion operation was done on the spot.

The yield to maturity was a very satisfactory 2.5%. And since the tap was exhausted, the price has moved up a little in a very satisfactory way. It shows that there is a high degree of resilience and firmness in the market.

Although I think this operation should have been carried out last week, I still thought it right to congratulate Eddie George on his technical coup. Happily the Bank regards itself as the initiator and innovator of such conversion operations. This helps our policy considerably.

Peter Middleton asked me what I thought about a new move downwards on interest rates. Apparently there is considerable pressure in the Treasury from Terry Burns and others, to keep going the process of reducing interest rates.

My view is that we should only move downwards now when there is obvious and considerable market pressure upon us. I do not think that we should lead the market at this stage.

In my judgement the monetary aggregates are likely to expand quite fast enough in response to the movements we have already made. I still believe that 9% is the limit at which we should examine the case for further reductions very carefully indeed. At this stage of the cycle, it is so easy to slip up and promote monetary growth which one will have to eliminate, perhaps rather painfully, at a later stage.

21 October 1982

SECRET

Alan Walters
ALAN WALTERS