

SECRET

Prime Minister 40

Comforting.

FRB

25.5.

MR. BUTLER

FUNDING AND INTEREST RATES

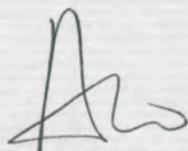
With less than one week into Banking June and more than three weeks to go, gross sales have been over £1250 million. This means that we have less than £100 million to go to hit our target for the month, and that target figure is high, representing a "safety first" posture.

This heavily funded position should enable us to deal readily with most contingencies that may arise over the next three weeks, apart from, of course, any dramatic fall in the polls. The dominant determinant of the market strength is the high likelihood of the Conservative Government being re-elected. I doubt very much whether the trade figures or even a hiccough in American interest rates will have a discernible effect on the markets.

We are already seeing much of the appreciation of sterling which we anticipated would appear as the probability of a Conservative victory increased. This may become a bone of political contention in the next week or two. The Bank is rightly taking the opportunity to replenish its reserves of foreign currency and other assets, but this intervention will have little or no effect on the rate.

The long run interest rates are now equal to, or in some cases rather below those in the United States (comparing gilts with treasuries). At the short end our interest rates are about one percentage point above the Americans. Our yield curve is either flat or actually falling. This indicates a belief that interest rates are more likely to fall in the United Kingdom than in the United States.

In my view the markets are about as well behaved as one could wish them to be under the circumstances.



ALAN WALTERS
25 May 1983

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