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21 February 1984
Policy Unit

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PRIME MINISTER To me AT 21/2

File

FUNDING

I attended the Funding meeting today.

The meeting agreed that the National Savings target for 1984-5 would be raised from £3 billion to £3.5 billion. The actual increase over this year is likely to be less than £0.5 billion, as this year will probably see some overshoot of the funding target.

The meeting reviewed recent progress with gilt-edged funding. A reasonable level of sales has been maintained, but the Bank of England decided that it had to issue a longer stock in order to maintain the momentum, and persuaded the Economic Secretary of this view between Funding meetings. The resulting stock, £1,000 million Exchequer 9.75 per cent 1998, flopped. The market was worried that the stock was wrongly priced, and took it as a sign of weakness. Investors felt it meant that the Government wished to over-fund in order to offset too rapid a growth in bank lending, and took it as a major reversal of the longstanding policy of not funding in the long end of the market.

At previous meetings, the Bank had been warned that this was a strong possibility, and that the very instrument which they thought would sell well would jeopardise their market operations. They are now arguing that it is inappropriate to introduce a new short-dated stock until sales of the longer gilt build up some momentum: so far, they have sold practically nothing.

I suggested at the meeting that the moral of this tale was that they should now avoid any further major long-medium or long-dated tap stock, and should attempt to win the market's confidence back through a mixture of short stocks, index-linked and possibly convertibles. The Bank seemed somewhat chastened by the experience, and admitted that they now did not wish to go ahead with a major long-dated issue programme. The problem of "re-entry" into the longer-dated market is still one which they have on their mind, and I am sure they will return to the charge when they have recovered their balance.

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The dollar is at last falling and the pound is making some progress. This is a welcome sign. The large dollar deficits on both trade and government accounts at last seem to be having an impact, and this offers a modest respite for us.



JOHN REDWOOD

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