LAST MEETING J BACKGROUND PAPERS

### PERSONAL AND CONFIDENTIAL



pr

# MINUTES OF A MEETING IN CHANCELLOR'S ROOM HM TREASURY AT 3.30 PM ON THURSDAY 12 MAY

## Present:

Chancellor
Sir P Middleton
Sir T Burns
Mr Anson
Mr Scholar
Mr Peretz
Mr Sedgwick
Mr Hibberd
Miss O'Mara
Mr Cropper
Miss Wheldon T.Sol

## RPI AND THE COMMUNITY CHARGE: INDEX-LINKED GILTS

Sir P Middleton said that the Attorney General had supported the view that if an item in the Retail Price Index disappeared, there was a sound argument that its disappearance did not constitute a change in the coverage; nevertheless, the Attorney had concluded that the Courts would be most likely to take the view that the aim of the Article in the prospectus was to protect the investor against inflation, and they would thus hold that the disappearance from the RPI of something as significant as rates would constitute a change in coverage. Sir P Middleton noted that if the Bank took the view that the change was "materially detrimental" to stockholders, we should be at risk of having to redeem all indexed stock at par. The capital uplift involved would add about £3 $\frac{1}{2}$  billion to the PSBR (with an offsetting reduction in future years). And it would deal a major blow to the indexed gilt market, which would add to the cost of funding in the future.



In discussion, the following points were made:

- i. It was not clear whether, if the Courts took the wew predicted by the Attorney, they would feel that it was necessary to substitute the community charge for rates in the RPI, or whether it would be sufficient to add something equally as buoyant as rates, for example by expanding the weights on some other component of housing costs.
- ii. It would, however, not be at all attractive to increase the weight on mortgage interest payments; and it was quite possible that rents would be more buoyant than rates. It would in any case be somewhat tricky technically to continue to uplift other weights every year.
- iii. The Government had not yet formed a collective view on whether or not it would be desirable in principle for the community charge to be included in the RPI or not. While there seemed to be a strong case for excluding it, the Department of the Environment had been arguing that it should be included on the grounds that it was a charge for local services.
- iv. There might in some circumstances be a case for considering a change to the prospectus of new index gilts issues to make the position for new issuer clear beyond doubt. But it would certainly be inappropriate to do this until the existing position had been clarified.
- v. It had always been accepted that housing costs had to be in the Index, but there had long been difficulties in agreeing what the best way of including them was. It had early on been decided that house prices themselves were



not appropriate; we had started with rents or imputed rents, before switching from imputed rents to the present mortgage interest formula.

It was agreed that the next step was to consult the Bank of England on which of the possible options would or would not, in their view, constitute "a fundamental change in the index which would be materially detrimental to the interest of stock holders".

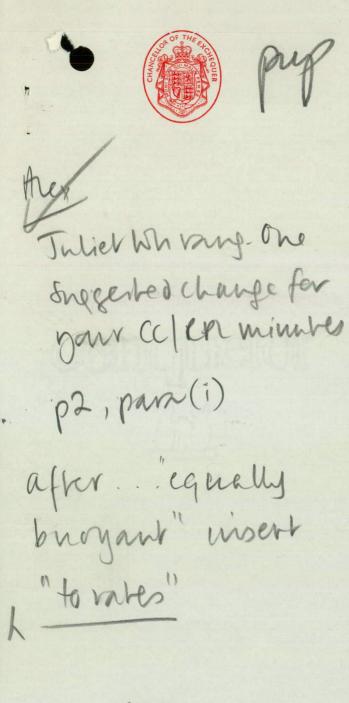
A C S ALLAN

17 May 1988

Distribution

Those present

PS/Chief Secretary PS/Economic Secretary



M.

CHANGE TO THE STATE OF THE STAT

Juliet ca David Pert

I should be grateful for any connect or the attacked draft minutes

Alex Alla 13/5 NOTE OF A MEETING IN THE CHANCELLOR'S ROOM HM TREASURY AT 3.30 PM ON THURSDAY 12 MAY

Present:

Chancellor
Sir P Middleton
Sir T Burns
Mr Anson
Mr Scholar
Mr Peretz
Mr Sedgwick
Mr Hibberd
Miss O'Mara
Mr Cropper
Miss Wheldon T.Sol

#### RPI AND THE COMMUNITY CHARGE: INDEX-LINKED GILTS

Sir P Middleton said that the Attorney General had supported the view that if an item in the Retail Price Index disappeared, there was a sound argument that its disappearance did not constituent a change in coverage; nevertheless, the Attorney had concluded that the Courts would be most likely to take the view that the aim of the Article in the prospectus was to protect the investor against inflation, and they would hold that the disappearance from the RPI of something as significant as rates would constitute a change in coverage. Sir P Middleton noted that if the Bank took the view that the change was "materially detrimental" to stockholders, we should be at risk of having to redeem all indexed year The capital uplift involved would add for he year (with a ffething reductive him to the PSBR). And it would a stock at par. to about £3½ billion devastating blow to the indexed gilt market, which putted would add to the cost of funding is the future.

In discussion, the following points were made:

if the Courts i. to the he view predicted Altoney, they

It was not clear whether the Courts would feel that it was necessary to substitute the community charge for rates in the RPI, or whether it would be sufficient to add something equivalently buoyant, for example by expanding the weights on some other component of housing costs.

- ii. It would, however, not be at all attractive to increase the weight on mortgage interest payments; and it was quite possible that rents would be more buoyant than rates. It would in any case be somewhat tricky technically to continue to uplift other weights every year.
- iii. The Government had not yet formed a collective view on whether or not it would be desirable in principle for the community charge to be included in the RPI or not. While there seemed to be a strong case for excluding it, the Department of the Environment had been arguing that it should be included on the grounds that it was a charge for local services.

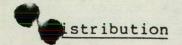
iv.

There might in some circumstances be a condend a charge he case for changing the prospectus of new index gilts issues to make the position for the clear beyond doubt. But it would certainly be inappropriate to do this until the existing position had been clarified.

It was agreed that the next step was to consult the Bank of England about whether they would regard a proposal not to include the community charge in the RPI when rates dropped out (with the weights adjusted appropriately to prevent any discontinuity) as constituting a fundamental change in the index which would be materially detrimental to the interest of stock holders". "It would be helpful if the submission to the Bank brought out clearly that it had always been accepted that housing costs had to be in the Index, but there had long been difficulties in agreeing what the best way of including them was. It had early on been decided that house prices themselves were not appropriate; and so we had started with rents or imputed rents, subsequently switching from imputed rents to the present mortgage interest formula. This presentation would bring out more clearly the difference between rates and the community charge.

on which of the possible also options would not contribute, whereview,

Distribution
Those vesent
PS/Chief Secretary
13 May 1988



Those present
PS/Chief Secretary