(copy sent to GE 14.12.82 with Indexation papers 14.12.82)

20.1.82.

NOTE OF A MEETING IN SIR DOUGLAS WASS' OFFICE, TREASURY CHAMBERS, ON WEDNESDAY, 20 JANUARY AT 15.00

Those present:

Sir Douglas Wass (in the chair)	The Deputy Governor (Bank of England)
Mr Burns	Mr Fforde " "
Mr Ryrie	Mr George " "
Mr Middleton	Mr Goodhart " "
Mr Britton	Lord Cromwell, Government Broker
Mr Monck	Prof. Walters, 10 Downing St. (to para. 6 only)
Mr Turnbull	
Mr Davies (Secretary)	

INDEXED GILTS AND GILT SALES TECHNIQUES

1. Mr Davies' agenda note of 18 January referred to the two topics which remained outstanding after the last discussion on 16 December. Sir Douglas Wass said he proposed first to take derestriction of indexed gilts and then, if time permitted, the future of the jobbing system.

(a) Derestriction

2. The issues had been set out clearly in the Governor's letter of 2 November last and Mr Middleton's minute of the same date but Sir Douglas Wass thought it would nonetheless be useful to focus on the specific issues raised by derestriction and to assume for the purposes of discussion that the general principle of indexation of debt had been conceded. The Deputy Governor and Mr Ryrie both believed that derestriction was such an important step that it did raise the general questions again in a more acute form but agreed that the meeting should first consider the technical problems.

(i) International Implications

3. The Deputy Governor said that the UK would certainly be criticised for resorting to indexed borrowing at a time when its

balance of payments position was strong. We would also be accused of breaking ranks in offering OPEC indexed assets. OPEC investors might not necessarily find debt of this kind irresistibly attractive, but they could be expected to want to include some of it in their portfolios.

4. On the other hand, Mr Burns argued that it was not immediately clear why it was in some sense more neighbourly to offer debt at 17 per cent nominal. There was general agreement, however, that the international arguments against could not be regarded as decisive. We would come in for criticism, but the Chancellor would have a reasonable defence against it.

(ii) Effects on equity market

5. Sir Douglas Wass said the argument in the papers was that IGs would be regarded, to an extent at least, as a substitute for equities. There might therefore be some adverse effect on the equity market if we were to issue them in sizeable quantities. Companies might be induced to shift from equities to fixed interest loans. If IGs encouraged a drop in long-term interest rates as the Government issued fewer long conventionals then the overall cost of capital for companies might not be increased significantly. Mr Fforde pointed out that if IGs were to prove attractive to persons they would accelerate the secular shift out of direct equity ownership by the personal sector. But it was agreed that, again, the argument was not overriding. We would certainly wish to avoid any unnecessary damage to the equity market, but the impact seemed likely to be small.

(iii) Tax

6. Mr Middleton said that Inland Revenue had recommended that derestricted IGs should benefit from the CGT exemption (after one year) granted on conventional stock. Mr Fforde thought it would be difficult to defend refusing a similar exemption to companies. Sir Douglas Wass said it would be necessary to bear in mind the possibility of Budget changes in the CGT regime.

(iv) Funding Profile

7. Sir Douglas Wass said that although this consideration of the disadvantages of IGs led him to the conclusion that the case against was weak, he was also sceptical about some of the advantages claimed. We were now much less confident of our ability to sell IGs in any circumstances. Mr George agreed. The market had tended to take the announcement of an IG as an indication that the funding programme was in difficulty and to react accordingly. But the principal problem was the method of sale. He would favour the regular issue of IGs in both weak and strong markets. A continuous IG tap would probably increase the Bank's flexibility in funding. But the use of IGs was more a tactical question.

(v) Exchange Rate

8. Mr Burns recalled that our original worry had been about the effects of derestricted IGs on the exchange rate. But it had derived from concern about the effects on £M3 of the reduction in interest rates needed to lower sterling in the face of a rise induced by overseas demand for IGs. If we are now less troubled by short-term movements in £M3 we can afford to be more relaxed about foreign purchases. The Deputy Governor thought, however, that a large stock of IGs in foreign hands could be destabilising in the future. Sterling could become more vulnerable to speculation.

(vi) Principle of Indexation

9. Sir Douglas Wass concluded that if we believed the principle of debt indexation was not at issue the case for derestriction was evenly balanced. It could be argued, indeed, that those in favour of the restrictions needed to justify themselves, since the circumstances that had originally justified them no longer obtained. But he recognised that the Bank, in particular, regarded this as more than a technical move. The Deputy Governor said he remained unconvinced by the arguments for an extension of indexed debt, and thought that it would encourage the spread of indexation elsewhere in the economy. He did not accept that long-term indexed debt contracts were sui generis.

10. Sir Douglas Wass thought it would nonetheless be possible to agree on a presentation of the main points of the arguments for and against. (It was subsequently decided, after the Prime Minister's meeting on 22 January, that a further paper was not necessary.)

(b) The future of the jobbing system

11. Sir Douglas Wass said that there was no time to take the third agenda point. He would discuss it with the Deputy Governor.

H J D.

H J DAVIES

Copies: those present