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Treasury Chambers, Parliament Street, SW1P 3AG

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13 July 1987

Prime Minister²

Dear David

DHS
13/7.NATIONAL SAVINGS

This is to let you know that DNS will be announcing tomorrow the size of the supplement to be paid in 1988 to holders of the first and second issue index-linked savings certificates. They will also be announcing that a further supplement on these certificates will be paid in 1989.

The first and second issues have been replaced and are no longer on sale, but there is an outstanding stock of £3.4 billion. Most were purchased in the late 1970s and early 1980s. They offered protection against inflation. As inflation has fallen, so has the popularity of index-linked certificates. Since 1983, our strategy has been to minimise outflows. The mechanism used has been annual supplements in addition to protection against inflation.

This year the supplement is 4%, and will be paid on 1 August. When we announced this, we promised at least one further annual supplement. The first of the two decisions is therefore the size of the 1988 supplement. Because interest rates generally have come down in recent months, we have set the 1988 supplement at 3%.

Secondly we have decided to announce at the same time a further annual supplement for 1989, the amount to be decided later. This will signal to holders that we intend to continue to provide a real return, and will be an incentive not to cash in. On present inflation and interest rate forecasts there is no doubt that a further supplement would be justified on cost of funding grounds.

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C O N F I D E N T I A L

Delaying announcement of the amount makes it possible to set it in the light of circumstances nearer the time.

Yours sincerely,

P D P Barnes

P D P BARNES
Private Secretary

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