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~~Domestic Monetary Policy~~: May 79
Meetings with Gordon Pepper

NOTE FOR THE RECORD

Mr. Gordon Pepper called on the Prime Minister at 1030 hours on Wednesday, 18 July. Most of the discussion turned on the argument about issuing long gilts as opposed to short and medium gilts. This is recorded separately in my note of 18 July. Other points which came up were:

- (i) Mr. Pepper said that the banks were likely to make very high profits this year, and this was likely to result in high pay settlements in the banking sector. This could have an impact on Civil Service pay next year because of the P.R.U. comparability arrangements.
- (ii) The Prime Minister said that local authority three-month bonds appeared to be taking money away from the building societies. These bonds were secured, as she understood it, on the local authority rates. Would it not be a good idea to take away this security? Mr. Pepper said that the problem of diverting funds from the building societies was basically about high interest rates generally. If local authority bonds were no longer available, the building society money would be going somewhere else. And interest rates would stay high as long as inflation stayed high.
- (iii) Mr. Pepper said that he hoped the Government would seriously consider proposals for Monetary Base Control (MBC). A serious study was now needed of different detailed options. But before coming to any final decisions, it would be important for the Government and the Bank to consult widely with bankers and market operators. The Prime Minister told Mr. Pepper that she was chairing a seminar later that day which would be looking at MBC.

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PRIME MINISTER *Sum*

You may want to be reminded of Gordon Pepper's arguments against the Bank issuing too many long stocks. These were:

- i) It is expensive if we genuinely expect inflation to come down. Since our whole policies are aimed at this, it is an admission of defeat to borrow from long stock.
- ii) Borrowing long at high normal rates into the 1990s makes it more difficult to bring inflation down. High interest payments add to the burden of public expenditure and add to the PSBR.
- iii) Borrowing long at high rates makes it difficult/^{if not impossible}for industry to borrow long; yet it is industry which really needs to come in for long term borrowing.

You argue that we should not take on long term debt if this means being back in "debased currency". But this of course assumes that inflation continues at a high rate. And moreover, one can argue that if the institutions want to lend long, then it is up to them to take the risk.

Despite his preference for shorter term borrowing, Gordon Pepper does not think we should rule out long term borrowing altogether. He emphasised this after your meeting. Thus, it is more a matter of emphasis than of ruling out long stocks altogether. The Treasury paper in fact says that there may be a case for shifting from the very long to the medium stocks (ie ten years rather than 20 years).

18 July 1979

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