



MR MONCK

cc Principal Private Secretary
 Sir D Wass
 Mr Ryrie
 Mr Burns
 Mr Middleton
 Mr Britton
 Mr Unwin
 Mr Turnbull
 Mr C Ward
 Mr H Davies

A CONVERTIBLE GILT

The Financial Secretary discussed your minute of 22 January with Mr George, yourself and Mr Turnbull at 11.45 this morning.

The Financial Secretary started by saying that he was anxious that a new stock of the type proposed might disappoint many people, given what they would see as the interest rate and inflation expectations implied in the terms of conversion. Nor was he particularly happy with the comparison in paragraph 3 of your minute between the yield implied by the proposed conversion terms of this stock with the yield on a 1992 stock now, since the stock will have moved back along the yield curve by the time the conversion date comes. Thus he saw the most meaningful comparison as being between the 1981 terms and the yield on a comparable 1991 stock now, and between the 1983 terms and the yield on a comparable 1989 stock now. On this basis, he noted that your terms implied a fall in the yield on short/medium stocks of less than 1% between now and 1983.

He did however take Mr George's points that a new short tap was needed in any event; and that the attached conversion option ^{was useful} because it was possible in this way for the Government to fund long ^{more cheaply} if the option was exercised; while if the option was not exercised, the stock would be simply no more than a conventional short. Mr George added that to make the option sufficiently attractive, the redemption yield on conversion needed to be pitched at a level above the ^{current} market expectation of future yields.

In the light of these considerations, the Financial Secretary was prepared to agree to a convertible stock, broadly on the basis outlined. However,

he preferred to see the lowest redemption yield on conversion (that for 1983) put at a level below the ^{initial} redemption yield for the first period of the stock. Mr George confirmed that it would be possible to set the former at $12\frac{1}{2}\%$, which would meet the Financial Secretary's conditions.

The Financial Secretary stressed finally that correct presentation was crucial: above all, every opportunity should be taken to get across the fact that the new stock carried no implications whatever for the authorities' expectations on interest rates and inflation. He noted that the Bank would also be making the point that the Government were not prepared to fund at yields higher than those prevailing at present.

SAIL

S A J LOCKE

23 January 1981