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4 May 1984

MR TURNBULL

I saw Eddie George at the Bank of England yesterday, and discussed the following items.

1. The future of the gilt-edged market.

The Bank's proposals are:

(a) To extend the number of people making a market in gilts by approving a new group of market-makers. They would need adequate capital, would have access to the Government broker for the supply of new stock and, in return, would be required to deal in a certain size at reasonable prices at any time in normal training hours.

(b) The Government broker would cease to be based at Mullens, but would move to the Bank and work with Eddie George.

(c) A wider group would be licensed dealers in gilts with lesser obligations and fewer privileges.

(d) In order to avoid crooked dealing, the contract note rendered to each client would have printed on it the time of the deal, the price charged, and the average market price which would be computed, minute-by-minute, based on the screen prices of all the market-makers.

The provisions for disclosure of information and rendering contracts are ideal, and should prevent any undue scandal. We cannot judge yet whether the Bank's wish to preserve a central market under its own control will work or not: it will depend on how many people wish to be market-makers, how many have to be turned away, and how stringent the requirements on these market-makers might be. There is one danger in the Bank's programme. The Bank sees itself as becoming a more active dealer in gilt-edged stock under this new regime. Its relationship with the market-makers would need careful watching to avoid it becoming either too cosy, or unduly authoritarian and interventionist in the market - this could damage the market and could be costly, as foreign exchange activities have been at times.

2. Current funding

Eddie remains very pessimistic about the prospects for funding, but is certainly in no mood to issue a full-sized new long tap in the wake of the most recent upset when they tried that mechanism.

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3. Equity sales programme

The Bank are reluctant to see the equity sales programme speeded up, despite the fact that the equity market is very strong and would take more stock at the moment, thereby easing the funding problem. Their main argument seems to be that selling too much equity now would make the sale of BT more difficult, coupled with their fear that having published a clear target for equity asset sales, the market would take it amiss if this target were then exceeded.

I fear there are two misconceptions here. Firstly, selling stock into a strong market in May is unlikely of itself to make the sale of British Telecoms any more difficult in November. The market receives new money on a month-by-month basis, and the time gap is too great for May sales to have any real impact. Secondly, it is true that the market would be unhappy if there were a massive increase over the published target for equity sales, although many people in the market have been very sceptical about the low target, and have pencilled in a higher figure in their forecasts. However, the enormous size of the BT issue projected on the first call in November is in itself quite difficult for the market to digest. Further spreading out of the calls on BT would help the market, and would mean that more stock could be sold before the summer recess in the equity market, and some compensating reduction made in the first call on BT in the autumn. I also fear that people are still being too optimistic pencilling in £8 billion as a valuation for BT. BT will only succeed if it is realistically priced; and it will only succeed politically if the powers of competition are strong enough and are seen to be strong enough. Any strengthening in the powers of competition does, of course, lower the future stream of potential profits for BT as perceived by the market; and this in turn has some impact on its valuation.

I have been putting these points to Eddie, John Moore, Ken Baker and others as the discussions continue in the run-up to the BT sale.

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