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SECRET

THE DEPUTY GOVERNOR

FOREIGN EXCHANGE AND GOLD MARKETS

Thursday, 5th February 1981

A variety of influences made for a strange and unusual day's trading in sterling. MLR expectations created a marked underlying weakness this morning but this was masked by the appearance of a single, large buying order. Later, as the unchanged rate looked set to restore the pound's inherent strength, a newswire reported that the Prime Minister was considering ways of achieving some depreciation and a good deal of nervousness ensued. Finally, with the dollar advancing strongly behind Volcker's latest prognostication of continuing high interest rates, sterling held up remarkably well, the ERI recovering to an unchanged 104.1 (80.3 on the old basis), after 103.5 this morning.

Sterling lost a cent in New York yesterday before recovering half its losses to close there at 2.3480. The dollar was otherwise little changed. This morning the pound began at 2.3382 and traded uncertainly on the early exchanges, falling to 2.3355 at one stage as fears of a reduction in MLR gripped the market. A steady recovery then ensued as a commercial buyer of £100mn. (for payment of PRT) entered the lists. As this order began to be felt, so the advance accelerated and the pound was driven up to 2.3610 by early afternoon. Further nervousness over interest rates brought sterling back nearly a cent by 12.30 p.m. but the announcement of an unchanged MLR sparked a recovery to 2.3580. At this point the newswire carried the story of the Prime Minister's deliberations on the rate. Sterling became an extremely nervous market and was marked back defensively to 2.3425 by mid-afternoon. Thereafter, however, it held its level surprisingly well and closed at 2.3455, despite a late upward surge in the dollar. Three-month Euro-dollars were off by  $\frac{1}{8}\%$ . Sterling's three-month forward premium narrowed by  $\frac{1}{8}\%$  to 4% p.a. and the intrinsic premium fell to 3/16%.

The pound regained  $\frac{1}{8}\%$  in Paris (11.53 $\frac{1}{2}$ ),  $\frac{1}{2}\%$  in Frankfurt (5.01 $\frac{1}{2}$ ) and  $\frac{1}{8}\%$  in Zurich (4.54 $\frac{1}{2}$ ). The dollar improved in all these centres to 4.9205, 2.1387 (later 2.1480) and 1.9365 (later 1.9450). EMS was fully stretched at the close with both the Belgian franc (34.27) and deutschemark (at the bottom) marginally more than 2 $\frac{1}{2}\%$  distant from the French franc. The lira (1013) was 3 $\frac{3}{8}\%$  adrift. The French bought \$4mn. of deutschemarks. The Bundesbank sold \$33mn. (following net sales of \$6mn. for deutschemarks by the Federal Reserve yesterday), the Italians \$67mn. and the Irish \$13mn. The Danes, however, bought \$12mn. and the Norwegians \$24mn. (forward). The yen closed at 202.85 in Tokyo and 202.45 in London.

Gold was sold down to \$487 in New York yesterday before closing there at \$491. This morning it made a steady recovery, fixing at \$497 and advancing to \$504 before New York returned to sell again. The later fixing set a level of \$498.50.

Operations:	Market	-	\$5mn.
	Ghana	-	5
	Interest	+	7
	Sundries	+	2
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		-	\$1mn.
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5th February 1981.

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