

SECRET

1981/9

FOREIGN EXCHANGE AND GOLD MARKETS

Week ending 4th March 1981

Sharp fluctuations in interest rates, both in Continental Europe and the U.S., made for an active and rather erratic week on the exchanges. Although German short-term rates moved up, a rise in Fed. Funds made for a generally firmer dollar. The prospect of lower U.K. rates led to further pressure on sterling and the ERI fell 0.5 to 98.7.

There was an active two-way market in sterling on most days during the week. Fears about the size of the likely cut in MLR in the Budget continued to overhang the market and there was heavy selling either side of the weekend. Sterling closed in New York on Wednesday night at 2.2315, opened in London on Thursday at 2.2297 and, after touching 2.23, quickly came under sizeable professional selling pressure from Switzerland, falling to 2.2197 before some recovery occurred. Following the announcement of an unchanged MLR, sterling rose during Thursday afternoon against a weaker dollar to 2.2307, but professional and commercial selling the following day took the rate back to 2.2032 by Friday evening. Heavy selling, prompted by MLR considerations, in the Middle East on Saturday and in the Far East early on Monday morning meant that sterling had lost $3\frac{1}{2}$ cents by the London opening on Monday at 2.1660. However, after touching 2.1637 the rate started to move up steadily on small demand and the firmer tendency was also helped by the shortage of sterling associated with the payment of Petroleum Revenue Tax. Further commercial buying, together with some Middle East demand was seen on Tuesday and, as the dollar eased back, sterling returned above the 2.20 level on Wednesday to reach 2.2225 in early business. At this point a large Far Eastern selling order entered the market and the rate then again gave ground to end the period at 2.1970, 3 cents down over the week. Sterling was a little stronger on the continent, rising $\frac{1}{8}\%$ against the deutschemark to 4.70 $\frac{3}{8}$, $\frac{1}{8}\%$ against the French franc to 11.07 $\frac{7}{8}$ and $\frac{1}{8}\%$ against the Swiss franc to 4.27 $\frac{7}{8}$. Against the ECU sterling went to 1.8437 a premium of 16 $\frac{3}{8}\%$ on the notional central rate. After allowing for technical factors, three month Euro-dollars were a little lower but sterling's forward premium was unchanged 4 $\frac{1}{16}\%$. However, a rise in sterling inter-bank rates meant that the covered differential moved to $\frac{3}{8}\%$ in favour of London.

The dollar had a volatile week in Europe but ended overall rather firmer. Although all major banks reduced their prime rates to 18 $\frac{1}{2}\%$ in the latter part of the week, Federal Funds moved back above the 16% level in New York on Tuesday, helping to keep Euro-dollar rates firm. German short-term interest rates rose sharply as the Bundesbank commenced lending under its new Lombard facility at 12% and the mark (2.1410) firmed to move closer to the top of the EMS. By the close the guilder (2.3495) headed the arrangement, 2 $\frac{1}{8}\%$ above the Belgian franc (34.88) with the lira (1030.50) 3 $\frac{3}{8}\%$ adrift. Belgian Lombard rate was raised by 1% to 13% and the National Bank sold French francs worth \$110mn. and guilders worth \$60mn. The French franc (5.0425) closed just behind the guilder after sales of \$20mn. The Germans sold \$75mn. and the Italians \$400mn. Elsewhere the Swiss franc (1.9465) was under pressure at times amidst rumours of the imminent introduction of a package of support measures. The yen weakened in the middle of the week as hopes of a discount rate grew but it closed only $\frac{1}{8}\%$ lower at 208.55. The Swedish crown remained comfortable and the Swedes were able to buy \$115mn.

Gold was very weak, dismayed at the continuing high level of U.S. interest rates. The first fixing was at \$495.25 but thereafter the price gave ground steadily, falling to \$465.50 at the afternoon fixing on Wednesday, a 15-month low and a fall of \$35 over the week.

4th March 1981.

TRS

RATES, ETC.

10.15 a.m.

10.15 a.m.

26th February 1981

5th March 1981

2.2220

£/\$

2.2030

99.3

Effective exchange rate index

98.7

4% pre.

Forward 3-months

4 $\frac{1}{4}$ % pre.

16 $\frac{1}{4}$ %

Euro-\$ 3-months

16 11/16%

$\frac{1}{4}$ % disc.

I.B. Comparison

$\frac{1}{4}$ % pre.

2.1205

\$/DM

2.1280

4.71 $\frac{1}{2}$

£/DM

4.68 $\frac{1}{2}$

11.05 $\frac{1}{2}$

£/FF

11.04 $\frac{1}{2}$

207.55

\$/Yen

207.92

\$496

Gold

\$457

1.9360

\$/S.Fc.

1.9357

4.30 $\frac{1}{2}$

£/S.Fc.

4.26 $\frac{1}{2}$