

SECRET

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FOREIGN EXCHANGE AND GOLD MARKETS

Week ending 6th May 1981

Further rises in US interest rates dominated the markets this week. Following a 1% increase in the Fed's discount rate to a record 14%, the dollar strengthened in all centres and new lows were recorded for some European currencies. Sterling fell back against the dollar but gained ground on the Continent; the ERI was unchanged at 98.9.

Sterling was a good two-way market in the early part of the week but following the sharp increase in US interest rates, strong commercial demand for the pound emerged. Although the rate fell to a two-year low against the dollar, there were few sellers of sterling and gains were recorded against the Continental currencies. After closing in New York on Wednesday night at 2.1485, sterling opened in London on Thursday at 2.1395 and, having dipped to 2.1343 during the morning, was taken up in active trading during the afternoon to 2.1475 shortly before the close. With most of Europe closed for May Day, markets were quiet on Friday and sterling ended at 2.1425 in London before the weekend. Although the London market was closed on Monday, sterling was in strong commercial demand from both Europe and the United States, but gave ground gradually against a strengthening dollar. Following the increase in the Fed's discount rate that night in New York, sterling fell back in a thin and nervous market to close at a two-year low of 2.0970 but with the dollar setting new highs in other centres. On Tuesday, after touching 2.1007 in early business, a large buying order from Switzerland carried the rate up to 2.1167 before the close at 2.1095. Rather quieter conditions prevailed on Wednesday and against an easier dollar sterling was traded up to 2.1271 before ending the week at 2.1170. The pound made further gains on the Continent, rising by $\frac{1}{8}\%$ against both the deutschemark (4.77%) and the Swiss franc (4.35%) and by $\frac{1}{8}\%$ against the French franc (11.30%). Against the ECU sterling's premium over its notional central rate rose to $\frac{1}{8}\%$. Euro-dollar rates were $2\frac{1}{2}\%$ higher over the week, three-month deposits closing at 18 15/16% but sterling's forward premium widened to 6 15/16% and there was again interest parity.

Last week's speculation that the Fed was in the process of tightening monetary policy was confirmed on Monday when, following the unexpectedly large increases in the money supply figures announced on Friday (M1B +\$4.2bn.), the discount rate was increased by 1% to 14% and the surcharge on large borrowers by a similar amount to 4%. Prime rates rose by 1% to 19% and the dollar surged to new highs in most centres. There was again no intervention from the Fed and although the Bundesbank was active in defence of its currency, selling \$320mn., the mark fell 3% to a 3½ year low of 2.2750 before recovering to close at 2.2563. With the opinion polls suggesting the possibility of a left-wing victory in the Presidential Election, the French franc (5.3387) weakened further in the EMS despite sales totalling \$700mn. by the Bank of France. The Belgian franc (36.76) remained at the bottom of the band, which was only 1 9/16% wide, with the lira (1124.50) only $\frac{1}{8}\%$ below the mark. The Belgians bought \$80mn. and the Danes sold \$100mn. Elsewhere, the Swiss franc (2.0590) weakened by $2\frac{1}{2}\%$, in line with the deutschemark, but the yen closed only 1% weaker at 216.67. The Canadian dollar required some support and the Bank of Canada sold \$100mn.

The gold market was subdued but steady, as the return of record interest rate levels was offset by increased tension in the Lebanon. The first fixing was at \$481 but, having touched \$490 in New York on Friday, the price fell to \$476.25 at the afternoon fixing on Tuesday. The price ended the week at \$482, a rise of \$5 since last Wednesday.

6th May 1981.
TRS

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RATES, ETC.

10.15 a.m.

30th April 1981

2.1382

98.8

4½% pre.

16 15/16%

1/16% pre.

2.2167

4.74

11.23¾

215

\$479

2.0235

4.32¾

E/\$

Effective exchange rate index

Forward 3-months

Euro-\$ 3-months

I.B. Comparison

\$/DM

E/DM

E/FF

\$/Yen

Gold

\$/S.Fc.

E/S.Fc.

10.15 a.m.

7th May 1981

2.1125

98.9

7 3/16% pre.

19 15/16%

¾% disc.

2.2646

4.78¾

11.33¾

217.05

\$479

2.0656

4.36¾