FINANCIAL SECRETARY

Principal Private Secretary
Sir D. Wass
Mr Burns
Sir K. Couzens
Mr Barratt
Mr Middleton
Mr Britton
Mr Lavelle
Mr Monck
Mr Unwin
Mrs Lomax
Mr Riley
Miss O'Mara
Mr Spencer
Mr Towers
Mr Mitchell
Mr Ridley
Mr Cardona
Mr Anson - UKTSD
Mr Sangster
Mr Byatt
Mr Gill
Mr Smeeton
B/E

INTERVENTION IN SEPTEMBER 1980

I attach our usual note about the Bank's intervention tactics last month.

2. There were two short periods of strong demand for sterling during September; the first over the period 29 August-5 September, as the rate broke through the psychologically important $2.40 barrier; and the second at the outset of the Iran-Iraq war, before the market concluded (rightly or wrongly) that the Middle East conflict was likely to remain limited and that the world oil market could easily absorb a temporary loss of Iranian and Iraqi supplies. At the end of September both the effective and the £/$ rates were at much the same level as they had been at the beginning of the month.

3. This was in spite of a narrowing during the month of the differential between UK and US interest rates from 4½% to under 2%, as US rates rose.

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Either the exchange rate is proving less sensitive to interest rate differentials than it was earlier in the year, or some further factor may have been at work offsetting their effect.

4. Taking spot and forward market and off-market transactions together, total intervention during the reserves month was $154 million, the lowest monthly figure since May. In banking September the contribution of official transactions (changes in the reserves and in the level of official overseas debt) to the externals was + £92 million, within an overall external adjustment to £M3 of - £573 million.

DLCP

D L C PERETZ
10 October 1980

INTERVENTION IN SEPTEMBER 1980

This note discusses the Bank's intervention tactics in "dealing September" ie 28 August to 26 September 1980. It also comments on the intervention figures for banking September. Tables showing reserve transactions for September and on a cumulative three and six month basis are attached.

Prospects at the beginning of September

2. At the start of dealing September the Bank had advance knowledge of calls on the reserves totalling $1286 million, mainly representing Government expenditure, interest and debt repayment (including $900 million early repayment of HMG III). These would be partially offset by $548 million of maturities of forward purchases of foreign currencies which had been swapped out of previous months. In addition about $200 million was likely to accrue to the reserves as a result of interest received and new borrowing.

September as a whole

3. The main features of September were:

(a) The rate breached the $2.40 barrier in New York on 29 August and remained around this level for the whole month. Some nervousness in the third week of September, partly linked to fears of a dock strike, was followed by a further short-lived surge at the start of the Gulf war. Despite these events, by the end of dealing September both the dollar rate and the effective were roughly back to their levels at the start.

(b) The Bank bought $122 million spot from the market (and sold $5 million forward) offsetting the sharp upward pressures on the rate experienced at the beginning of the month and on 22 and 23 September at the start of the Gulf war.

(c) Bank customers' purchases of sterling amounted to \$248 million, just below the average for the last six months. This figure was \$14 million more than off-market sales of sterling for Government payments.

(d) Maturing forward swaps amounted to \$548 million and in the absence of forward market intervention the underlying rise in the spot reserves (ie ignoring net debt repayments) would have been \$708 million. \$475 million of this was swapped forward to bring the underlying rise in the spot reserves down to \$233 million, a figure likely to be in line with market expectations.

(e) The forward book fell by \$79 million. Total intervention (spot and forward) was therefore \$154 million, the second lowest monthly figure this year.

Intervention in dealing September

4. At the start of dealing September the rate stood at \$2.3936 and 76.29 in effective terms. During the first seven days of the month as the rate went over \$2.40 and touched \$2.42, the Bank made some modest purchases from the market. Subsequently, net intervention balanced out until the last few days of the month. On 22 and 23 September sterling, and to a lesser extent the dollar, came under strong upward pressure at the start of the Gulf war. The effective rate reached a 5½ year high of 77.3. The Bank bought 50 in the market in the course of the two days. The details are:

(\$ million)

Period	28 Aug-5 Sept	8 Sept-19 Sept	22 Sept-26 Sept
Closing \$ rate	2.4155	2.3855	2.3945
Closing effective	76.00	75.61	76.11
Market intervention	+64	-2	+60
Customer transactions	+24	+169	+73
Net forward transactions	-73	-91	+85

Banking September

5. Intervention in banking September (21 August-17 September) was as follows:

(£ million)

Market intervention	+ 62
Central banks (customer transactions)	+ 83
Government, interest receipts etc	-194
Public sector borrowing (net)	-189
Swaps outside the banking month-	
new swaps	-147
maturities	+185
Total (change in reserves)*	-199
Official borrowing (inc. -)	+290

*Components do not sum to total, largely because of different conversion rates.

Official transactions' contribution to external and foreign currency finance adjustment to £M3	+ 91

The fall in the reserves during the banking month is largely accounted for by repayments of the HMG III loan, reflected also in the official borrowing figure. The market figure includes the intervention around the end of calendar August when the rate went above $2.40. The swaps and maturities are those that happened to fall outside the banking month; no new swaps were undertaken over the September make up day to assist in money market operations.

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10 October 1980

RESERVE TRANSACTIONS FOR SEPTEMBER

		$ million	
1.	End August levels	SPOT	FORWARD
		28,291	1,974
2.	Transactions in September		
	(i) Market	+122	-5
	(ii) Swaps	-475	+475
	(iii) Maturities	+548	-548
	(iv) EEC Commission drawings	-	-
	(v) Other bank customers	+248	-
	(vi) Government		
	(a) departments' expenditure	-234	-1
	(b) public sector debt interest	-45	-
	(c) HMG debt interest	-34	-
	(vii) Interest on the reserves	+103	-
	TOTAL INTERVENTION	+233	-79
	(viii) Public sector borrowing under ECS		
	(a) borrowing	+100	
	(b) repayment	-87	
	Net	+13	
	(ix) HMG III capital repayments	-900	
	CHANGE IN THE RESERVES	-654	-79
3.	End-September levels	27,637	1,895

During this period the rate fell from $2.3940 to $2.3883 and from 76.20 to 75.97 in effective terms.

RESERVE TRANSACTIONS FOR JULY-SEPTEMBER 1980

	$ million	
	SPOT	FORWARD
1. End-June levels	28,172	1956
2. Transactions July-August		
(i) Market	+391	-13
(ii) Swaps	-1295	-1295
(iii) Maturities	+1277	-1277
(iv) EEC Commission drawings	-	-
(v) Other Bank customers	+747	-
(iv) Government		
(a) departments' expenditure	-639	-8
(b) public sector debt interest	-153	-
(c) HMG debt interest	-131	-
(vii) Interest on the reserves	+408	-
TOTAL INTERVENTION	+605	-3
(vii) Public sector borrowing under ECS		
(a) borrowing	+309	
(b) repayment	-275	
Net	+34	
(ix) IMF oil facility repayment	-82	
(x) HMG III capital repayments	-1150	
(xi) Revaluation arising from renewal of EMCF swap	+58	-58
CHANGE IN THE RESERVES	-535	-61
3. End-September levels	27,637	1,895

During this period the rate rose from $2.3470 to $2.3883 and from 74.41 to 75.97 in effective terms.

RESERVE TRANSACTIONS FOR APRIL-SEPTEMBER 1980

	$ million	
	SPOT	FORWARD
1. End-March levels	26,936	2,617
2. Transactions April-September		
(i) Market	+934	+249
(ii) Swaps	-2818	+2818
(iii) Maturities	+2788	-2788
(iv) EEC Commission drawings	-	-
(v) Other Bank Customers	+1630	+1
(vi) Government		
(a) departments' expenditure	-1402	-13
(b) public sector debt interest	-488	-
(c) HMG debt interest	-455	-
(vii) Interest on the reserves	+953	-
TOTAL INTERVENTION	+1142	+267
(viii) Public sector borrowing under ECS		
(a) borrowing	+724	
(b) repayment	-857	
Net	-133	
(ix) IMF oil facility repayment	-162	
(x) Long-term debt repayments	-12	
(xi) HMG III capital repayments	-1150	
(xii) Revaluation arising from renewal of EMCF swap	+989	-989
CHANGE IN THE RESERVES	+674	-722
3. End-September levels	27,637	1,895

During this period the rate rose from $2.1640 to $2.3883 and from 72.6 to 75.97 in effective terms.

Somefolks

NOTE OF A MEETING HELD AT NO.11 DOWNING STREET ON SATURDAY, 11TH OCTOBER, 1980 AT 10.30 A.M.

Present:

Chancellor of the Exchequer (In the Chair)
Financial Secretary
Sir Douglas Wass
Mr P Middleton

There was a short discussion about the Bank's likely attitude towards a number of the issues which were raised in the papers submitted to the Prime Minister under cover of the Chancellor's covering minute of 10 October about monetary affairs. The Chancellor and the Financial Secretary, supported by Sir Douglas Wass and Mr Middleton, were due to meet with the Governor and Deputy Governor immediately after the meeting.

2. The Chancellor recognised the need for some change to present methods of monetary control and said that the principal objective of the meeting with the Governor must be to establish whether he recognised this and if so what changes he would contemplate. Mr Middleton noted that the experience with targets over a number of years had been that monetary growth had mostly exceeded them. The Bank might well say that the reason for the current over-shoot was an excessive PSBR. On the other hand, there had been over-shooting even when the borrowing position had been better. This suggested weaknesses in monetary control.

3. Sir Douglas Wass, reporting on Mr Ryrie's and his discussions with the Governor and Deputy Governor the previous day, said that the Governor, in view of the Bank's assessment of the position and prospect for the real economy, might well in effect suggest that monetary policy be relaxed, or, at the least, not intensified, by seeking to recover all of the ground which re-intermediation had

/revealed as being lost.

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revealed as being lost. The Governor probably favoured a two to three per cent cut in MLR, the reduction in the exchange rate to which that might lead .. and some over-shoot of the present target. If the Medium Term Financial Strategy was to retain its primacy, as Ministers intended, the need was to convince the Governor that his preference was not an option and the issue was how to keep to the MTFS.

4. The Financial Secretary noted that the Bank's forecast was more pessimistic than the Treasury's forecast on wages. If this was not validated the position of the corporate sector would be better than was implied in the Bank's forecast. He himself thought that present competition in markets might well result in a low outturn on wages.

5. Sir Douglas Wass reported that differences between officials and the Bank about rolling-over the monetary target had narrowed: the Bank could well go for Mr Middleton's favoured solution, ie, in view of the great uncertainties of the trend of monetary policy, that there should be no roll-over. It was noted that such a decision could be taken by the markets as a sign of weakness and would therefore need careful presentation. However, reference to the MTFS should help here.

R.I.T.

R I TOLKIEN
13 October 1980

Distribution

Those present
PS/Chief Secretary
Mr. Ryrie
Mr. Burns
Mr. Monck
Mr. Britton
Mr. Unwin