SECRET

THE DEPUTY GOVERNOR

FOREIGN EXCHANGE AND GOLD MARKETS

Friday, 7th November 1980

Sterling finished the week on an unusually soft note. Further increments to Euro-dollar deposit rates sent the dollar sharply firmer again. The pound initially retreated in concert with the European currencies. This afternoon, however, sterling was heavily sold from Chicago and New York and the downtrend was halted only by a late and substantial decline in dollar deposit rates. Sterling's ERI fell from 80.2 to 79.6.

The pound closed at 2.4335 in New York yesterday. With the dollar firmer from the outset today, sterling opened at 2.4295 and moved quickly down to 2.4210 on some early Scandinavian selling before steadying to trade around 2.4250 into the afternoon. At first light in the USA a large commercial selling order sparked massive offering of pounds on the IMM and the movement quickly spread to New York. Underlying the trend was the market's sudden realisation that uncovered interest rate differentials were at last against the pound. Coupled to this was a growing feeling in the USA that there will soon be a substantial outflow of funds from Europe - which, in effect, means London - into the United States as Reagan's presidency gets under way. The pound lost over a cent to 2.4052 and would clearly have fallen further but for a late reaction in Euro-dollars which lost up to ¾% from their peak levels. This was caused initially by a lower level for Federal Funds and by the Federal Reserve's willingness to provide money to the market even at the lower level (14⅞%). The trend was later reinforced when the US Producer Price Index for October came in somewhat lower than expected and the latest American unemployment figures purported to show rather less vigour in the economy than had been supposed. The dollar then gave up most of its gains on the Continent and sterling recovered to 2.4145 at the close. Following the pattern of Euro-dollars, forward margins moved this morning to a discount for the dollar on all periods out to a year. By the close, however, only the one-month remained at a discount. The cost of three-months' cover widened overall to 9/16% and the covered differential against London rose to ½%.

Sterling lost ½% in Paris (10.89), ¼% in Zurich (4.22¼) and ⅛% in Frankfurt (4.71½). The dollar improved in these centres to 4.5105 (after 4.5295), 1.7510 (after 1.7627) and 1.9517 (after 1.9620). The Federal Reserve yesterday sold $155mn. for marks (of which $20mn. forward). The Bundesbank today sold $90mn. for the Americans and $14mn. for themselves. The French package of inflow controls and other monetary measures depressed their franc and took some pressure off EMS. The guilder (2.1165) closed narrowly ahead of the French franc, 2¼% distant from the Belgian franc (31.40). The deutschemark finished a comfortable ⅛% off the bottom of the band. The Dutch bought $3mn. of Belgian francs and the French took in $4mn. of Belgian francs and $29mn. of marks. The Belgians sold $17mn. of guilders and $21mn. of the French currency. The Germans spent French francs worth $42mn. The lira (920.75) closed 3% below the florin. The Italians sold $23mn. and the Irish lost $12mn. Elsewhere the Swedes sold $30mn. but the Norwegians bought $33mn. The yen eased to 213.20 in Tokyo and 213.50 in London.

Gold was routed as interest rates continued to bite. Having shed a further $10 between yesterday's London and New York closes, it opened this morning at $619 and drifted nervously lower. The fixing was very active but the price was set at $603 before the $600 level could be tested. Heavy selling continued, however, and the metal was traded down to $590 before the turn in interest rates brought a fixing at $596 and a modest but nervous recovery thereafter to around $600.

Operations:	Market	-	$18mn.
	Iran	+	15
	Sundries	+	7
		+	$4mn.

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