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INTERVENTION IN OCTOBER 1980

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

2. The effective exchange rate rose by over 3 points during the month from 76.0 to 79.2 and the rate against the dollar came under particularly strong upward pressure in the period leading up to 24 October. Total intervention taking the spot and forward markets together, came to just over \$320 million. This compares with an average monthly figure over the last 6 months of \$230 million. During that period the effective rate has risen by 6.6 points from 72.6 to 79.2, giving an average of around \$200 million bought in "smoothing" for every one point rise in the effective rate. So the October figure might be considered relatively modest in the circumstances.

- * These figures as usual encompass not only market intervention, but also off market transactions for "customers" and Government payments, and net interest receipts on investment of the reserves.

663/11

304/81

Impact on the money supply

3. As you will know, the "externals" adjustment to £M3 was unexpectedly positive in banking October for the first month since May. This followed an unexpectedly large negative figure for September. In many ways we find the two months' figures easier to interpret when taken together. The following table shows the details for both months:-

	<u>Banking September</u>	<u>Banking October</u>	<u>£M Total</u>
Change in reserves and official f.c. borrowing	+ 95	+ 354	+ 449
Overseas holdings of public sector debt (increase -)	+ 49	+ 93	+ 142
Overseas holdings of £ deposits (increase -)	- 276	- 329	- 605
Banks net f.c. liability (increase -)	- 364	+ 296	- 68
"Externals" adjustment (not seasonally adjusted)	- 496	+ 414	- 82

4. As noted above the Bank were not intervening during October at a vastly greater rate than in preceding months. A particular factor affecting the figure for the change in reserves over banking October, mentioned in paragraph 5 of the attached note, was the £160 million of forward swaps carried out in the last few days of banking October as part of the general assistance given to banks to help ease upward pressure on interest rates in the money market. Leaving that transaction on one side - and in principle I am told it should not have affected the money supply - the banking October figure for intervention was higher

than the £100 million or so average for preceding months; but certainly not sufficiently higher to explain the turn around in the externals between September and October.

5. There may in practice have been several contributory factors. But one to which we are inclined to attach weight is the very large current account surplus achieved over both September and October. A current account surplus tends to make the externals adjustment positive; and the large swing between the two months could reflect the effect of payments lags in current account flows. If this last hypothesis were correct and other factors remained unchanged the large October current account surplus might be reflected in the November "externals".

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14 November 1980

October as a whole

3. The main features of October were:

- (a) In the first two weeks of October the rate showed a slight upward trend both against the dollar and in effective terms. The pound strengthened sharply from 25 October, responding to high short-term interest rates and a weak Deutsche Mark. A peak of \$2.857 was seen on 24 October with the effective rate over 5% and the cross-rate against the Mark 4.61. At the end of dealing October the dollar rate was 2% higher than at the start; the effective 4% higher, and the cross-rate against the Mark 6% higher.
- (b) The Bank bought \$270 million spot from the market, offsetting the steady upward pressure in the first three weeks of the month and the sharp pressure in the last week.

INTERVENTION IN OCTOBER 1980

This note discusses the Bank's intervention tactics in "dealing October" ie 29 September to 29 October 1980. It also comments on the intervention figures for banking October. Tables showing reserve transactions for October and on a cumulative three and six month basis are attached.

Prospects at the beginning of October

2. At the start of dealing October the Bank had advance knowledge of calls on the reserves totalling £474 million, mainly representing Government expenditure, interest and debt repayment. These would be more than offset by £726 million of maturities of forward purchases of foreign currencies from previous months' operations. In addition nearly £300 million was likely to accrue to the reserves as a result of interest received and new borrowing.

October as a whole

3. The main features of October were:

- (a) In the first two weeks of October the rate showed a slight upward trend both against the dollar and in effective terms. The pound strengthened sharply from 16 October, responding to high short-term interest rates and a weak Deutschemark. A peak of £2.4645 was seen on 24 October with the effective rate over 79 and the cross-rate against the Mark 4.61. At the end of dealing October the dollar rate was 2½% higher than at the start; the effective 4% higher, and the cross-rate against the Mark 6% higher.
- (b) The Bank bought £270 million spot from the market, offsetting the steady upward pressure in the first three weeks of the month and the sharp pressure at the end.

- (c) Bank customers' purchases of sterling amounted to \$251 million, \$3 million more than in September and \$42 million more than off-market purchases of sterling arising from Government payments. The Bank again turned away a substantial amount of customer business.
- (d) Maturing forward swaps amounted to \$726 million and in the absence of forward market operations the underlying rise in the spot reserves (ie ignoring net debt repayments) would have been \$1056 million. \$765 of this was swapped forward to bring the underlying rise in the spot reserves down to \$291 million.
- (e) The net effect of forward operations was to increase the overbought forward position by \$32 million.

Intervention in dealing October

4. At the start of dealing October sterling stood at \$2.3867 and 76.05 effective. The rate was generally steady in the first week and intervention was minimal. During the next fortnight as upward pressure increased, the Bank made a number of individually modest purchases. Sterling then came into strong and widespread demand to reach a 7 year high against the dollar on 24 October, and the Bank bought \$90 million in the market in five days. The last few days of the month were relatively quiet. The details are:

(\$ million)	Period			
	29 Sept-3 Oct	6 Oct-17 Oct	20-24 Oct	27-29 Oct
Closing \$ rate	2.3895	2.4170	2.4495	2.4430
Closing effective	75.83	77.23	78.92	78.95
Market intervention	+22	+134	+90	+18
Customer transactions	+15	+228	+20	-1
Net forward transactions	-371	+442	-57	-9

Banking October

5. Intervention in banking October (18 September - 15 October) was as follows:

(£ million)

Market intervention	+65
Central banks (customer transactions)	+120
Government, interest receipts etc	-263
Public sector borrowing (net)	+44
Swaps outside the banking month -	
new swaps	+59
maturities	+179
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Total (change in reserves)*	+213
Official borrowing (inc. -)	+141
Official transactions' contribution to external and foreign currency finance adjustment to £M3	+354

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

The market figure includes the intervention on 22 and 23 September when sterling came under strong upward pressure at the start of the Gulf war. Early repayments of the HMG III loan amounted to -£188 million in banking October and this is included in the figures for Government and interest receipts.

In the last few days of banking October the EEA engaged in a currency swap of £160 million with the banks to ease upward pressure on interest rates in the money market.

RESERVE TRANSACTIONS FOR OCTOBER

	\$ million	
	Spot	Forward
1. End-September levels	27,637	1,895
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2. Transactions in October		
(i) Market	+270	-6
(ii) Swaps	-765	+765
(iii) Maturities	+726	-726
(iv) EC Commission drawings	-	
(v) Other bank customers	+251	
(vi) Government		
(a) departments' expenditure	-209	-1
(b) public sector debt interest	-44	
(c) HMG debt interest	-79	
(vii) Interest on the reserves	+141	
TOTAL INTERVENTION	+291	+32
(viii) Public sector borrowing under ECS		
(a) borrowing	+152	
(b) repayment	-56	
Net	+96	
(ix) IMF oil facility repayment	-80	
(x) Revaluation arising from renewal of EMCF swap	+82	-82
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CHANGE IN THE RESERVES	+389	-50
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3. End-October levels	28,026	1,845

During this period the rate rose from $\text{£}2.3883$ to $\text{£}2.4375$ and from 76.0 to 79.2 in effective terms.

RESERVE TRANSACTIONS FOR AUGUST-OCTOBER 1980

	£ million	
	Spot	Forward
1. End-July levels	28,272	2,005
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2. Transactions August-October		
(i) Market	+566	-13
(ii) Swaps	-1667	+1667
(iii) Maturities	+1726	-1726
(iv) EEC Commission drawings	-	-
(v) Other Bank customers	+660	-
(vi) Government		
(a) departments' expenditure	-632	-6
(b) public sector debt interest	-132	-
(c) HMG debt interest	-169	-
(vii) Interest on the reserves	+385	-
TOTAL INTERVENTION	+737	-78
(viii) Public sector borrowing under ECS		
(a) borrowing	+327	
(b) repayment	-162	
Net	+165	
(ix) IMF oil facility repayment	-80	
(x) HMG III capital repayments	-1150	
(xi) Revaluation arising from renewal of EMCF swap	+82	-82
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CHANGE IN THE RESERVES	-246	-160
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3. End-October levels	28,026	1,845

During this period the rate rose from £2.3440 to £2.4375 and from 74.7 to 79.2 in effective terms.

RESERVE TRANSACTIONS FOR MAY-OCTOBER 1980

	\$ million	
	Spot	Forward
1. End-April levels	28,008	1,789
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2. Transactions May-October		
(i) Market	+932	+156
(ii) Swaps	-2972	+2972
(iii) Maturities	+2920	-2920
(iv) EC Commission drawings	-	-
(v) Other Bank customers	+1486	-
(vi) Government		
(a) departments' expenditure	-1278	-12
(b) public sector debt interest	-406	-
(c) HMG debt interest	-438	-
(vii) Interest on the reserves	+947	-
TOTAL INTERVENTION	+1191	+196
(viii) Public sector borrowing under ECS		
(a) borrowing	+751	
(b) repayment	-740	
Net	+11	
(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	+140	-140
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CHANGE IN THE RESERVES	+18	+56
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3. End-October levels	28,026	1,845

During this period the rate rose from \$2.2550 to \$2.4375 and from 72.6 to 79.2 in effective terms.