

SECRET

THE DEPUTY GOVERNOR

FOREIGN EXCHANGE AND GOLD MARKETS

Monday, 26th January 1981

Both sterling and the dollar were extremely strong today. The degree of strength exhibited by the dollar was just a little surprising, following the sharp reductions in the US monetary aggregates announced on Friday (M1A down \$8.7bn., M1B down \$2.3bn.) and the easier tone to dollar interest rates today. It was based partly on the weakness of the deutschemark, which was heavily sold today from both the Middle East and Europe, and partly on favourable market reaction to the arrival in office of the Reagan administration. Sterling remained largely on the sidelines, giving only a little ground as the dollar strengthened. As a result, further sharp gains were made in Europe and the ERI rose 0.6 to a record 81.0.

Sterling rose $\frac{1}{4}$ of a cent against a generally firmer dollar on Friday night in New York to close at 2.4140. This morning it opened at 2.4155 and after moving ahead, to 2.4164 in early business, the rate started to ease as the dollar strengthened rapidly on the Continent. A trading range either side of 2.41 was soon established and sterling remained there for most of the day, dipping temporarily to 2.4045 at noon but recovering quickly thereafter. Turnover was fairly modest and sterling's firmness was less a reflection of demand than a general absence of sellers. The rate closed at 2.4110. Three-month Euro-dollars were $\frac{1}{2}$ % lower over the day and with sterling's forward premium falling 1/16% to 4 $\frac{1}{2}$ %, the intrinsic discount against London narrowed to 1/16%.

Sterling again rose to new highs on the Continent, gaining 1 $\frac{1}{2}$ % in Germany, to 4.95 $\frac{1}{2}$, 1 $\frac{1}{2}$ % in France to 11.42 and 1 $\frac{1}{2}$ % in Switzerland to 4.46 $\frac{1}{2}$. The dollar, too, rose to its best level for 2 $\frac{1}{2}$ years in Frankfurt, closing at 2.0541 (after 2.0570) and recent highs were also set in Paris (4.7367) and Zurich (1.8533). Some modest support was provided for the mark: on Friday the Fed sold \$35mn. against marks and today the Bundesbank sold a further \$40mn. for the Fed and \$27mn. for their own account. The French, too, provided some support in the EMS where they bought \$47mn.-worth of deutschemark. Although the mark moved closer to the bottom of the narrow band it closed above the Belgian franc (32.93) which finished 2 $\frac{1}{2}$ % below the French franc with the lira (974.50) 3 $\frac{1}{2}$ % below. The Danes sold \$30mn., the Irish \$14mn. and the Italians \$13mn. Elsewhere the Swedish crown was again under heavy pressure and \$150mn. of support was provided. The yen was a little easier, closing at 202.20 in Tokyo and 203.22 in London.

The strength of the dollar and the continued high cost of running a gold position sparked off heavy liquidation by Middle East and other investors. In active trading the price fell through the \$550 level in the Far East this morning to fix at \$530.25 and \$528.50 in London. The price ended the day a little off its low at \$530.

Operations:	Market	+	\$24mn. -
	Crown Agents	+	10 -
	Interest	+	5 -
	Tax Office	+	23 -
	New Zealand	-	17 -
	Sundry	+	1 -
			<hr/> <hr/>

26th January 1981.

TRS