SECRET

1981/8

FOREIGN EXCHANGE AND GOLD MARKETS

Week ending 25th February 1981

The exchanges resumed their normal preoccupation with interest rates during the week but in nervous, and at times thin, markets the volatility of rates increased further. With a large cut in MLR widely expected, sterling became a weak market and the ERI fell 3.0 to 99.2. The deutschemark strengthened sharply following a rise in German short-term interest rates, and the dollar weakened in other continental centres as well.

A forecast in the weekend press that the Budget would include a 3%-4% cut in MLR caused sterling to fall sharply after the weekend while the Government's handling of the dispute with the miners over pit closures, and the spread of industrial action by the water workers, added to the weak tone. Selling of sterling was not particularly heavy, although some sizeable orders were seen, but seemed to stem more from an increase in leading and lagging. After closing in New York on Wednesday at 2.2675 sterling opened at 2.2670 in London on Thursday and traded quietly throughout the day. However, the dollar weakened sharply that night in New York as the Fed allowed Fed Funds to ease to 14%, and sterling gained 5 cents moving to 2.3307 in London on Friday, on the back of a large order on official account. On Monday, following the forecast of the reduction in MLR, sterling opened 6 cents lower at 2.2710 and traded down thereafter. Selling by the IMM that evening took the rate to 2.24 by the New York close, and further selling in the Far East saw the rate touch 2.21 early on Tuesday morning. Although sterling recovered quickly to trade in the 2.22-2.24 range for most of the balance of the week, it remained an understandably nervous, but rather featureless, market. The rate closed the period at 2.2277, a fall of 5 cents on the week. Further sharp losses were recorded against the Continental currencies: sterling fell by 5% against the deutschemark (4.69), 4¾% against the Swiss franc (4.26⅝) and 3% against the French franc (11.01). Against the ECU sterling went to 1.8418, a premium of 16⅜% on the notional central rate. Euro-dollar rates fell over ½% during the week, three-month deposits closing at 16 11/16%. The premium for three-months' forward sterling was 4 1/16% but with sterling interbank rates discounting a cut in MLR, the covered differential moved to ¼% against London.

The dollar had an erratic week but ended overall some 2½% weaker against the major Continental currencies. The Bundesbank suspended the banks' right to borrow at the 9% Lombard rate, introducing in place a new facility with a changeable interest rate, and this immediately had the effect of driving up German short-term rates. Furthermore, both the Bundesbank and the Fed intervened to support the mark, selling $175mn. and $80mn. respectively. The mark moved to the upper part of the narrower band of the EMS closing at 2.1052. The volatility in the markets caused some tension at times in the arrangement and it closed fully stretched between the Belgian franc (34.44) and the French franc (4.9425). The French and the Dutch each bought some $15mn.-worth of Belgian francs and the Belgians sold French francs worth $90mn. In addition the French sold $100mn. and DM worth $40mn., the Danes sold $100mn. and the Dutch $80mn. The lira (1017.50) closed 3⅞% below the French franc after support of $300mn. Elsewhere, the Swiss increased their discount rate by ½% to 4% and the franc (1.9155) firmed with the deutschemark. The yen remained relatively steady losing ½% to close at 207.12. The Canadian dollar was firm and the authorities were able to buy some $70mn. while the Swedes recouped a further $50mn.

Although at times actively traded, gold continued unusually steady. The first fixing was at $505½ and although the price moved up to $514.75 at the morning fix on Friday, it soon returned to move narrowly around the $505 level, ending the week at $500.50, $4 down on the week.

25th February 1981

TRS

RATES, ETC.

10.15 a.m.		10.15 a.m.
19th February 1981		26th February 1981
2.2739	£/$	2.2220
102.1	Effective exchange rate index	99.3
4⅜% pre.	Forward 3-months	4% pre.
17⅛%	Euro-$ 3-months	16⅝%
3/16% pre.	I.B.Comparison	⅛% disc.
2.1637	$/DM	2.1205
4.92	£/DM	4.71¼
11.42⅜	£/FF	11.05½
205.82	$/Yen	207.55
$505	Gold	$496
1.9540	$/S.Fc.	1.9360
4.44⅛	£/S.Fc.	4.30¼