

SECRET

THE DEPUTY GOVERNOR

FOREIGN EXCHANGE AND GOLD MARKETS

Wednesday, 3rd June 1981

The increasing uncertainty and nervousness which has accompanied the recent decline of sterling came to a head today as the dollar rate approached the psychologically important 2.00 level and a full-scale bear attack on the pound developed. The proximate cause was the sharp reduction in Mexican oil prices but this merely served to crystallize the market's latent doubts about the decreasing value of U.K. oil, the supposed deterioration in the trade account, the Civil Servants' dispute and the resultant uncertainty over the monetary aggregates, the underlying upturn in the inflation rate and the relatively low level of U.K. interest rates. Sterling was widely sold throughout the day, although the dollar lost a little ground elsewhere. The ERI fell from 98.1 to 96.9, the lowest level since it was rebased.

The pound closed quietly at 2.0425 in New York yesterday. This morning the dollar opened firmer and sterling began at 2.0355 but quickly traded down to around 2.03, even though the dollar itself was going into reverse. Sellers were many and varied. The merchants were reported active in the Far East and Middle East sellers were prominent through the morning. French, Dutch and Swiss professionals joined the fray and the pound fell away to 2.02 by late morning. A wave of selling from Germany then hit the market and sterling was dealt down to 2.0115 soon after mid-day, before a firmer hand on the tiller steadied the ship. The afternoon remained extremely nervous. Short-covering in London was interspersed with further bear selling from New York. However, sterling never fell below 2.0130 before closing at 2.0155. Three-month Euro-dollars were $\frac{1}{8}\%$ easier at $17\frac{3}{8}\%$. Sterling's forward premium narrowed to 5 5/16% p.a. and the covered differential rose to 3/16% against London.

The pound cheapened by $1\frac{1}{4}\%$ in Zurich (4.21), $1\frac{3}{8}\%$ in Frankfurt (4.75 $\frac{1}{2}$) and $1\frac{3}{8}\%$ in Paris (11.24 $\frac{3}{8}$). The dollar remained generally firm on the Continent but never achieved yesterday's peaks and closed a touch softer in most centres. The deutschemark was 2.3603 and the Swiss franc 2.0885. EMS was $1\frac{3}{8}\%$ spread between the deutschemark and Belgian franc (38.46). The Bundesbank sold \$22mn., the Danes \$21mn. and the Belgians \$5mn. The Italians bought \$65mn. and the Irish \$16mn., while the French took in \$57mn.-worth of deutschemarks. The yen weakened to 224.40 in Tokyo but recovered to 223.25 in London.

Gold was very steady around yesterday's levels. Fixings were \$474 and \$475.50.

Operations:	Market	-	\$59mn.
	Interest	+	9
	Sundries	+	4
			<hr/>
			\$46mn.
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	Overnight	-	\$28mn.
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