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THE DEPUTY GOVERNOR

FOREIGN EXCHANGE AND GOLD MARKETS

Friday, 2nd October 1981

The brighter outlook for sterling, created by the events of the past week, was somewhat clouded today by a sudden resumption of speculation on an EMS realignment. The movement was sparked by an authoritative article in an Italian newspaper and the lira was thus the first to come under pressure, falling quickly to an all-time low against the deutschemark and drawing nearly \$½bn. of support from the Central Bank. Given the source, it was some time before speculation elsewhere mounted to any size. The French franc evidently gained useful protection from the recently enhanced exchange controls and official support in Paris was comparatively modest. After a bright start, sterling was heavily sold by one or two professionals but only later did it attract the attention of the smaller fry. The dollar naturally eased in consequence but was anyway turning softer, as pressure eased on Federal Funds and the bond market turned better. Sterling's ERI fell from 88.5 to 87.3.

The pound closed a little better at 1.8355 yesterday in New York where the dollar was otherwise little changed. This morning the dollar began easier and weakened progressively throughout the day, the pace quickening later as activity in EMS mounted. Sterling opened today at 1.8407 but was quickly marked back to around 1.83 on professional selling of pounds for deutschemarks. No pressure of any substance, however, was felt until late morning when the pound fell to 1.8240. Official support brought a run back to around 1.83 but persistent sellers, both small and large, forced another retreat. This afternoon the dollar weakened further on the better tone in American domestic markets (Federal Funds opened very firm at 17½% but soon tended easier). Sterling, however, remained generally calm and steady, declining to 1.8230 on one bout of selling pressure from the United States but otherwise moving narrowly around 1.8275 before closing at 1.8250. Three-month Euro-dollars closed a little softer at 17¾%, comparable sterling deposits a touch firmer at 16 15/16%. The forward premium narrowed to 1% p.a. and the covered differential moved a little further in London's favour.

The pound lost most of the gains of the last two days on the Continent, falling by 2% against the French franc (10.00%), 2½% against the deutschemark (4.16½) and 2½% against the Swiss franc (3.52). The dollar weakened by 1½%-2% against these currencies, closing respectively at 5.48, 2.2817 and 1.9285. In EMS the deutschemark stood at -79 on the index of divergence. At London's close, the lira (1174½) was 3½% distant from the deutschemark, the Belgian franc (37.32) a little less than 2%. The Italians sold \$319mn. and \$136mn.-worth of deutschemarks. The Belgians spent \$50mn., \$10mn.-worth of Swiss francs and \$149mn.-worth of deutschemarks. The French lost \$25mn. and deutschemarks worth \$103mn. The Danes sold \$72mn. and the Irish \$46mn. The Bundesbank took in \$75mn. Elsewhere the Swedes spent \$60mn. The yen firmed to 231.67.

Having lost ground overnight, gold regained its losses over the day as the dollar weakened. Fixings were \$433.25 and \$435.

Operations:	Market	-	\$114mn.
	Bangladesh	-	9
	IDA	+	6
	Interest	+	6
	Surpluses	-	1
		-	<u>\$112mn.</u>
	Overnight	-	<u>\$12mn.</u>

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