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SECRET

THE DEPUTY GOVERNOR

FOREIGN EXCHANGE AND GOLD MARKETS

Monday, 5th October 1981

EMS was realigned yesterday. The deutschemarek and florin were revalued by 5½% and the French franc and lira were devalued by 3%, the Irish, Danish and Belgian currencies remaining notionally intact. Sterling stayed without the system. The market took some time to attune to the realignment. The initial tendency was for a weaker dollar: partly on fundamentals (the US bond market was very much better and the latest monetary aggregates were encouraging) and partly because the deutschemarek seemed deserving of some general revaluation. By mid-day the shape of EMS was more or less inverted but any reflux of funds from strong to weak was slow in coming and then hardly substantial. Sterling started better but soon met resistance to any further improvement and the mood of the market was soon depressingly soured. This afternoon, however, the tone turned for the better and, as the dollar weakened further, the pound moved ahead in lockstep with the deutschemarek. The ERI rose from 87.3 to 88.1.

The pound closed quietly at 1.8285 in New York on Friday. This morning it began at 1.8350 at first light in the Far East but fell back there to 1.8250 before some modest encouragement from a distant but guiding hand induced a starting price of 1.83 in London. The early exchanges were quiet. The pound touched 1.8290 and improved at times to 1.8355 but was never able to better that level during the morning, whatever the performance of the deutschemarek. Two-way business was seen but the major players appeared still to be selling. This afternoon saw a radical change in sentiment. The dollar eased further, to be sure, but sterling coasted comfortably ahead, quickly cresting 1.84 on some modest American demand, and advancing steadily thereafter to close at 1.8512, the day's best level. Three-month Euro-dollars fell by over 1% to 16 11/16%, eliminating the adverse uncovered differential (the sterling deposit was a little easier at 16½%). The forward premium narrowed to a little under ½% p.a. so that sterling enjoyed a substantially favourable covered differential of somewhat over ½%.

The pound closed ½% lower in Switzerland (3.50½), ¼% off in Germany (4.12½) but ¾% firmer in France (10.33½). The dollar was respectively 1.8910, 2.2292 and 5.5815 in these centres. This afternoon three major US banks lowered Prime Rate to 19%. By London's close the Dutch florin (2.4660) had edged past the deutschemarek at the bottom of the band, which was fully stretched, the French franc at the top. The French regained \$86mn.-worth of deutschemareks and \$70mn.-worth of florins. The Dutch sold \$85mn.-worth of French francs and a handful of deutschemareks. The lira (1182.20) spent much of the day beyond the upper extreme of the 2½% band but came under pressure this afternoon and closed only 1¼% above the guilder. The Italians spent \$150mn. The Irish, too, sold \$11mn. but the Danes recouped \$13mn. Elsewhere the Swedes sold \$30mn. The yen improved to 228.47.

Gold was better on the weaker dollar but, inhibited perhaps by the threat of Russian sales for grain, showed no marked inclination for substantially higher levels. The fixings were \$440.75 and \$441.25.

Operations:	Market	-	\$16mn.
	Iran	+	5
	Sundries	+	8
		-	\$3mn.

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