

SECRET

THE DEPUTY GOVERNOR

FOREIGN EXCHANGE AND GOLD MARKETS

Thursday, 8th October 1981

Sterling was a good two-way market today as a fascinating tug-of-war developed between those - chiefly in Europe - who still view the pound as overvalued in deutschemark terms and those - mainly Americans, who still have large short positions to cover against dollars. The latter, as often, prevailed, the more so since the Bundesbank reduced their Special Lombard Rate by 1% to 11%, and sterling scored substantial gains. The ERI rose from 88.4 to 89.8.

The pound closed at 1.8815 in New York yesterday, maintaining its new-found strength, although the volume of actual demand proved to be fairly insubstantial. Federal funds traded very much higher, albeit on make-up day. This morning eurodollars began considerably firmer and the dollar was marked up from the outset. Sterling began at 1.8727 (but well over DM 4.18) and initially tended firmer only to meet selling, from Germany, in particular, for deutschemarks. The pound retreated to 1.8690 and the dollar turned back in consequence, but other erstwhile bears, Americans in London prominent amongst them, took up the cudgels and bid sterling back up to 1.8750. Some solid two-way commercial business, too, was observed in this period. Later, a wave of buying interest swept sterling strongly up to 1.8897. New York dealers were seen, amongst the buyers, even at this very early hour of the day. Once again the Germans returned to sell and the pound retreated to 1.8830 at midday. A similar pattern prevailed this afternoon. Fresh American demand, spurred also by the official reduction in German interest rates, drove sterling through 1.89. Another relapse followed. News of another large North Sea oil discovery then sparked a further rally and with at least two of sterling's recent tormentors now prominent amongst the buyers, the pound peaked at 1.8992 before closing at 1.8935. Eurodollars were 5/16% firmer at 16 5/16%, sterling deposits 1/2% easier at 16%. The three-month forward margin reverted to a premium for sterling of 5/16% p.a. and interest parity prevailed on the covered comparison.

The pound gained 1 1/4% in Switzerland (3.54) and Germany (4.18 1/2), 1 1/2% in France (10.52 1/2%). The dollar finished softer in these centres - partly, no doubt, due to sterling's strength - at 1.8690, 2.2115 and 5.56 respectively. EMS, though well stretched this morning, closed at only 2% in width between the French franc and Dutch florin (2.45). The French bought \$15mn.-worth of guilders, the Dutch sold \$112mn.-worth of French francs and a few Danish Crowns. The Bundesbank sold \$14mn. to steady their fixing following the announcement of the cut in Special Lombard Rate. The Italians took in \$30mn. The yen eased slightly to 229.

Gold slipped back in the Far East this morning and was fixed in London at \$441.75. The later fixing saw some advance to \$443.25. Towards the close, stories of clashes in Egypt and skirmishes elsewhere in the Middle East caused a run up to \$448 but this level was not maintained.

Operations:	Market	+	\$52mn.
	Sundries	+	8
		+	\$60mn.
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	Overnight	+	\$30mn.
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*Jm* 8th October 1981

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