

GPS

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\$ bn.

Exchange markets since the EMS realignment

1. General

During the past six months or so markets have been more volatile and erratic than at any time since mid-1973, when general floating started and it was confidently asserted that such behaviour was merely the teething troubles of the new system.

2. The dollar background

Currently the dollar at DM 2.25½ is just over 1% lower than on the eve of the realignment (2.28¼). In the meantime, however, it has been down to 2.16¼ and back up to 2.32¼, a range of some 7%. Eurodollar rates are some 2% lower. This level of eurodollar rates was initially reached shortly after realignment, and expectations of further falls led to the sharp decline in the dollar in the first week of the period. Subsequently the dollar recovered on the Kaufman predictions, budgetary and funding concerns, which led to some re-firming of interest rates, and intermittent scares about Poland and the Middle East. In the last few days the lower level of Federal funds and a run of depressing economic statistics have led to a renewed fall in both the dollar and dollar interest rates.

3. EMS

The realignment brought the EMS back to the position where there is least strain, i.e., when the deutschemark is the weakest currency.

4. The devaluers

- (a) The French franc has been on top almost throughout, thus permitting a substantial recapture of foreign exchange and some reduction in interest rates. Call money is down 2¼%. In all the French have recaptured 2.6 of the 4.4 they had spent in the period since speculation on devaluation surfaced at the beginning of August.

It will be recalled that in the six months up to February of this year they had gained approximately 5 but lost 9 in the run up to and aftermath of the two elections.

- (b) The lira has been comfortably in the top half of the snake but initially at the cost of quite substantial intervention, part of which has since been recovered. The Italians have lost 0.4 net since realignment.

They had had to support heavily for a year to June but regained reserves during the summer.

5. The unchanged currencies

- (a) The Belgian franc rather surprisingly has remained in the middle of the snake but latterly only at the expense of allowing some substantial public sector borrowing to be absorbed in the market; this has totalled about \$135 mn. in the past two weeks.

Belgium has had to intervene steadily over the past 2½ years and lost 1¼ in the two months preceding realignment.

- (b) The Danish krone has been continuously near the top of the snake and occasionally taken over the top position, but the Nationalbank has so far recovered less than 0.1 of the 0.6 lost in the two months preceding realignment.
- (c) The Irish pound has mostly been in the bottom half, of the snake but comfortably away from the limit. In the two months preceding realignment the central bank lost 0.7. Since then intervention has been negligible but this is probably largely for seasonal reasons.

6. The revaluers

- (a) The Dutch guilder has been near the bottom throughout the past month but only 0.3 has been spent in support, mainly in the first week. There has, however, been substantial criticism in Holland for taking the guilder all the way up with the deutschemark.
- (b) The deutschemark has been at the bottom of the snake almost throughout, and 3.1 has been spent. Apart from the capital reversal, Germany's improving current account has been offset by budgetary problems, concern about the coalition itself and repeated scares about Poland.

In the two months preceding realignment the Germans had not gained much exchange, since they intervened heavily in dollars in August as the US dollar was reaching its peak.

7. Sterling

Apart from an uncomfortable spell in the third week of October, at the time of the Conservative Party Conference, sterling has been reasonably quiet. On the basis of its new imputed ECU rate it has ranged from being close to the top of the narrow  $2\frac{1}{4}\%$  snake to about  $2\%$  above it; currently it is about  $1\frac{1}{4}\%$  above it.

8. Other currencies

- (a) The Swiss franc has advanced a further  $3\%$  against the deutschemark, mainly on monetary but partly also on political grounds.
- (b) The yen is not much changed. Lower interest rates have been offsetting all Japan's other advantages.
- (c) The Canadian dollar is also little changed, but only at the expense of short-term interest rates some  $3\%$  higher than in the USA.

9. Gold

Gold has remained very subdued because of the high level of interest rates and the fear and fact of Russian sales. Its recovery since the August low point of around \$390 has been largely a dollar movement. Its recovery in terms of deutschemarks is minimal, and in Swiss franc terms it has continued to decline.

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JLS

