FOREIGN EXCHANGE AND GOLD MARKETS

Week ending 25th November 1981

The uneven effects on the exchanges of a further sharp fall in US interest rates were very apparent this week. Sterling and the yen were the main beneficiaries, while the political uncertainties surrounding Chancellor Schmidt's government contributed to the softness of the deutschemark and inhibited the advance of all EMS currencies. Sterling saw good demand and the ERI rose 0.9 to 91.2.

The widening uncovered differential between UK and US interest rates gave the pound a firm tone and once again considerable portfolio investment interest was apparent. In New York on Wednesday night sterling rose to touch 1.9275 before closing at 1.9225. The rate opened in London on Thursday at 1.9217 and although good commercial demand was initially seen, professional selling from both the US and Middle East was encountered during the afternoon. With the dollar rather stronger on Friday on IMM interest, sterling gave up ground only reluctantly helped by the comforting trade figures released that day. The rate closed at 1.9065 before the weekend but further gains were recorded against the Continental currencies. The increase in the US money supply figures made for a rather firmer dollar on Monday and sterling fell back to 1.8915 before some sizeable intervention by the Bundesbank halted the dollar's advance. Sterling recovered quickly and, after some hesitation while a large commercial order was absorbed, consolidated and increased its gains on Tuesday and Wednesday when heavy buying interest was evident. The pound rose steadily as the dollar weakened, touching 1.9370 on Wednesday afternoon, before ending the period at 1.9363. Sterling made further gains against the currencies in the EMS, rising 1% in Germany (DM 4.30⅞) and France (F.Fcs.10.87½) but only ¼% in Switzerland (S.Fcs.3.43¾). Against the ECU sterling's premium on its notional central rate rose to 5⅜%. Three-month Euro-dollars shed a further 13/16% during the week to close at 12%. Sterling's forward discount widened to 2 9/16% and the intrinsic premium rose to ¼% in favour of London.

As indicators suggested that the US was moving swiftly into a sharp recession and inflation started to show signs of abating, dollar interest rates continued to fall rapidly. Federal Funds moved below 12% and most banks reduced their prime rate ½% to 16% with Chase Manhattan alone of the majors going to 15¾%. Although the dollar was generally a little easier it remained particularly resilient against the EMS currencies which were restrained by the weakness of the deutschemark. Over the week the mark improved by less than 1% to 2.2252 after sales of $450mn. by the Bundesbank. The mark continued at the bottom of the EMS, 2% below the Danish crown (7.1550). The French franc closed at 5.6162. The Italians bought $70mn. Elsewhere, the Swiss franc (1.7750) continued relatively firm closing at 0.79¾ against the deutschemark. The yen (216.32) strengthened further as the differential between US and Japanese rates narrowed. The Canadian dollar remained firm and the Bank of Canada bought $170mn. but the Swedes sold $100mn.

Activity in the gold market increased. For much of the week the price moved fairly narrowly either side of $400 but it rose quickly on Wednesday as the dollar weakened. The final fixing was at $409.50, a rise of $6 over the week.

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