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SECRET

THE DEPUTY GOVERNOR

FOREIGN EXCHANGE AND GOLD MARKETS

Thursday, 3rd December 1981

A reduction in clearing bank base rates by $\frac{1}{2}\%$ (to $14\frac{1}{2}\%$) and a similar decline in official interest rates in Germany, the Netherlands and Switzerland, ensured that the dollar was restored to its best levels for over a week. Not surprisingly, the markets were in uncertain mood with the backdrop changing so frequently and sterling in particular, was tossed to and fro with each fresh change of sentiment. By the end of the day, however, the dust had settled and the pound seemed little worse affected than most others. The ERI fell from 91.8 to 91.4.

Sterling slipped back to 1.95 at the close yesterday in New York, although the dollar was otherwise weaker following persistent rumours that misfortune had befallen President Reagan. This morning the dollar started considerably better and continued firmer. The pound opened at 1.9472, touched 1.9490 and drifted quietly around the opening level for some time. Eventually light professional selling in London brought a relapse of some half a cent. The first of the base rate cuts saw sterling marked quickly back through 1.94. An American corporation sold pounds in size and the rate fell to around 1.9350, pausing awhile before continuing down to 1.9305 where it steadied. The initial reaction to the Bundesbank's $\frac{1}{2}\%$ reduction in the special Lombard rate was perverse, as the dollar eased. Sterling rallied to 1.9395 as cheap buyers took advantage of the lower levels. With Federal Funds still tight, however, at $12\frac{1}{2}\%$, Americans bid the dollar and the pound was sold from the USA. The rate fell to 1.9295 but recovered naturally to close at 1.9345. With three-month Euro-dollars $\frac{3}{8}\%$ firmer at 13% and the sterling deposit 3/16% softer at $14\frac{1}{8}\%$, the cost of cover narrowed substantially to 1 11/16% p.a. leaving a modest covered differential in London's favour.

The pound lost $\frac{3}{8}\%$ in Paris (10.90 $\frac{1}{2}$) and $\frac{1}{4}\%$ in Frankfurt (4.32 $\frac{1}{2}$) but was only fractionally softer in Zurich (3.47 $\frac{1}{2}$). The dollar strengthened in all these centres to 5.6350, 2.2345 and 1.7957 respectively. EMS was fully stretched at the close between the Danish krone (7.2050) and Belgian franc (37.98). The Danes bought \$7mn. and the Dutch took in \$11mn.-worth of deutschemarks. The Germans sold \$50mn. and the Belgians served a pot-pourri worth \$35mn. The Swiss swapped in \$1,425mn. and the Norwegians bought \$25mn. The yen eased to 216.85.

Gold was bid up to \$421 by New York's close yesterday but the Far East sold the metal down to \$415 again. London's opening session was very active and the price ran up to \$420.60 before consolidating in the fixing at \$419. This afternoon was steadier. The price was fixed at \$416.50 and it closed around \$414.50.

Operations:	Market	-	\$13mn.
	Government	+	7
	Interest	+	6
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JGH 3rd December 1981.

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