SECRET 1982/11

FOREIGN EXCHANGE AND GOLD MARKETS

Week ending 17th March 1982

Most major currencies came under pressure during the week as dollar interest rates moved higher following renewed growth in money supply and signs that the worst of the US recession might have passed. Tensions within EMS grew and the French franc required heavy support while, elsewhere, the yen was particularly weak. Only sterling was relatively unaffected by the strength of the dollar and the ERI rose 0.6 to 90.7.

For much of the week sterling was steady and comfortable with some regular official demand, and perhaps also some investment demand, providing support for the rate. The ½% cut, to 13%, in the clearing banks' base rates was already discounted in the market and the continued tightness of the domestic market kept short-term sterling rates very firm. After touching 1.8215 in New York on Wednesday night, sterling closed there at 1.8147. Some early selling on Thursday morning, in anticipation of the base rate changes, took sterling down from its opening level of 1.8119 to 1.8066 before short-covering and good commercial demand brought a recovery. With the dollar firming on Friday, on expectations of a sizeable increase in the US money supply, sterling encountered some selling pressure falling below the 1.80 level to touch 1.7965 before closing at 1.7986. Selling by the IMM in New York on Friday night took the pound down to 1.7940 but it had recovered on Monday to trade between 1.80 and 1.81 despite, again, a very firm dollar. Good buying of sterling was seen in New York on Monday night and sterling touched 1.8175 but the rate then settled back to trade comfortably half a cent either side of 1.80¾ for the remainder of the period, helped by the firmness of sterling interbank rates. The rate ended at 1.8095. Sterling was firm on the Continent, gaining 1½% against a weak French franc (11.09⅝), 1⅛% in Switzerland (3.40⅜) and ½% in Germany(4.29). Against the ECU sterling's discount on its notional central rate narrowed to ¾%. Three-month Euro-dollars rose 5/16% over the week to close at 15 1/16%. Three-month interbank sterling was also firmer, leaving the forward premium little changed and the covered differential still in favour of London.

Evidence of the further sharp reduction in the US rate of inflation was ignored by the market which was concerned at renewed growth in the money supply (M1 +$3.4bn.) and the tightness of Fed Funds (around 15½%). Those major banks which had earlier dropped their prime rates to 16%, increased them to 16½% on Tuesday and the dollar ended the week firm. The deutschemark fell ½% to 2.3705, after support totalling $50mn. by the Bundesbank. Increasing pressure within EMS became apparent and the band widened to 1 13/16%. The French franc (6.1320) was particularly weak amidst rumours of imminent devaluation and the Bank of France provided $880mn. in support. The Belgian franc (44.32) finished narrowly bottom of the band and the National Bank sold the equivalent of $280mn. The guilder (2.6033) closed a little behind the Danish crown (7.9665) at the top of the arrangement. The Italians sold $400mn. and the Irish $90mn. Elsewhere, the Swiss franc (1.8810) eased to 0.79⅝ against the mark. The yen (240.85) weakened further as the adverse interest rate differential against the dollar widened and capital outflows from the stock market increased. The Bank of Japan sold $450mn.

In another week of very active trading the gold price tumbled under weight of Middle Eastern selling, to set a new 2½ year low of $312 at the afternoon fixing on Monday. The price ended at $316, $17 lower over the week.

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