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SECRET

THE DEPUTY GOVERNOR

FOREIGN EXCHANGE AND GOLD MARKETS

Thursday, 6th May 1982

Overnight reports that President Reagan and the Congressional Budget Committee had reached agreement on proposals to reduce the US budget deficit, taken in conjunction with market expectations of a reduction of some \$5bn. in M1 tomorrow, set the scene for a move towards lower interest rates today. As expected, the Bundesbank abandoned special Lombard rate at 9½% and UK inter-bank rates also eased sharply. Sterling's fortunes fluctuated in accordance with the latest statement on the Falklands crisis but, generally, the pound had a much more comfortable day. The ERI closed 0.5 higher at 90.1, after 90.3 at the opening.

The New York market was quiet yesterday evening and sterling closed there at 1.8060. The Far East's reaction to news of progress on the US budget issue was to mark the dollar down and sterling benefitted, too, from rising hopes that the UN might negotiate a ceasefire in the South Atlantic. Sterling opened at 1.8235 and with first reports that the UK would respond "positively" to the Secretary General's proposals, there was some good buying in London in the first hour of business. Sterling rose quickly to 1.8280 before encountering some selling from Europe at the higher levels. The rate then gave ground to trade rather erratically either side of 1.82 for the remainder of the morning, with the dollar also recovering elsewhere. New York were sellers of the dollar and a strong opening by the US bond market led to slightly softer Eurodollar rates and the dollar turned down. Sterling at this time saw some good Far East commercial demand and the rate reached 1.8247 during the afternoon. However statements by Government Ministers that the Argentines must withdraw before the UK could agree to a ceasefire and the Prime Minister's statement to the House that Britain would continue military activities while any negotiations were in progress, provoked some selling and the rate dipped to 1.8175 shortly before the close at 1.8203. Three month Eurodollars ended the day ¼% lower at 14 11/16%. Sterling's forward premium widened to 1¼% and the covered differential in favour of London was 3/16%.

Sterling was firmer in some places on the continent, gaining ½% in Germany (4.20) and France (10.95) but was a touch easier in Switzerland (3.49). The dollar closed lower in all these centres, at 2.3073, 6.0150 and 1.9167 respectively. In EMS the Belgian franc (43.57) ended 2½% below the deutschemark and the lira improved to 2 7/8% distant. The French sold \$70mn. and the Italians \$20mn. The yen failed to keep pace with the improvement in the European currencies, closing at 233.12.

The absence of any further hostilities around the Falklands contributed to some easing in the gold price. Fixings were at \$335.25 and \$334.50.

Operations:	Market	+ \$27mn.
	PSB:-	
	B.Rail	+ 18
	Humberide	+ 7
	Sundries	+ 2
		<u>          </u>
		+ \$54mn.
		<u>          </u>
	Overnight	- \$9mn.
		<u>          </u>

6th May 1982

TRS

US BOND AND MONEY MARKETS

Thursday 6th May 1982

Federal Funds

Opening: 14 7/8%  
Range: 14 7/8-15 3/8%  
Close: 15 1/4%

US Governments (NY closing bids)

2-year: 100 1/4 (+1/2) 13 3/4%  
5-year: 101 3/8 (+7/8) 13 9/16%  
10-year: 106 5/8 (+2 1/8) 13 1/2%  
30-year: 106 3/4 (+1 5/8) 13 1/8%

Euro-dollars (Today's opening  
London bid)

7-day: 15 3/16%  
1-month: 14 13/16%  
3-months: 14 1/2%  
6-months: 14 1/2%

Federal Reserve Operations:

Indicators

Comment:

The progress on the US budget deficit issue and hopes for a large decline in M1 brought a sharp change in sentiment in the market. Throughout most of the day turnover was heavy, with strong overseas buying interest. Prices jumped up at the opening and within minutes the long bond was showing a gain of a point. Prices then stabilised until after mid-day but started to move up again when the Fed failed to appear to drain liquidity, as some operators had feared. Although activity diminished towards the end of the day, prices improved further, closing near the highs.

7th May 1982.

TRS