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PRIME MINISTER

At noon sterling had fallen to 2.016 against the dollar.

The Bank's view is that without some significant intervention, sterling could fall below $2 before the end of the day. They believe that with intervention of up to somewhat less than $100 million, they can hold the rate above $2.

Ken Couzens is recommending to the Chancellor that they be authorised to spend up to $70 million today in order to prevent the rate from falling further. Anything more than $100 million on the day would be regarded as massive intervention, and a complete turnabout on our exchange rate policy of allowing the exchange rate to move with the market, subject to some smoothing. But even $70 million will be noticed, and will be taken as something of an aberration. However, my own view is that it is justified. A fall in the rate below $2 would, I believe, be psychologically rather damaging at this point - coming after the substantial decline over recent weeks. But if the downward pressure continues, the position will obviously have to be reviewed. We cannot go on spending $70 million a day for very long without it being seen as a change in basic policy.

Since dictating the above, Ken Couzens has telephoned me with one gloss. If the Bank judge that spending $70 million will not stop the rate from falling below $2, they will not spend that much - for in that case, the $70 million will simply be wasted. So if the rate does fall below $2, and they have not spent $70 million today, we should not be surprised. Ken emphasised that we should not put ourselves in the position of being seen to defend a particular rate: in that case, we would be in a new ball game altogether.

3 June 1981

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