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PRIME MINISTER

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FOREIGN CURRENCY BORROWING

The issue of a floating rate dollar note is to be announced on Monday. I have asked for revised briefing to be available for you before the weekend.

DAVID NORGROVE
12 September 1985

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12 September 1985

From the Private Secretary

FOREIGN CURRENCY BORROWING

PM BOX

The Prime Minister has seen the Chancellor's minute to her of 11 September. She agrees to the Chancellor's plan for a $2 billion floating rate note early next week and she notes that if the market reaction was particularly favourable and terms would not be sacrificed, the Chancellor would propose to raise the size of the issue.

The Prime Minister is however doubtful about the line suggested in the Chancellor's final paragraph. She has commented that to present the operation as a natural evolution of the previous nationalised industry borrowing programme would give the Opposition good opportunities for adverse comment on the side effects of de-nationalisation. They would say among other things that the Government have sold off the nation's assets and now are having to borrow.

Points 3 and 4 of the defensive briefing might be expanded to cover the accusation that the Government ran down the reserves in order to be able to make claims about the repayment of debt inherited from the Labour Government. This new borrowing shows that the Government's claims were spurious.

BF

The Prime Minister is leaving for the Middle East on Monday. Could I please have revised briefing for use as necessary by her, by close of play tomorrow?

In Go PM

SMH

(David Norgrove)

Mrs. Rachel Lomax.
H.M. Treasury.

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Line to take

1. Part of prudent reserves management.

2. Reflects judgement of appropriate level of foreign currency reserves for UK to hold at time of exchange market uncertainty. At end of 1982, by when most of the more expensive of the foreign currency debt inherited from the last Labour government had been repaid, convertible currency reserves stood at the equivalent of $9.6 billion (and total reserves at $17.0 billion). They now stand at $7.5 billion (and $14.3 billion). HMG issue will restore them broadly to the level which seemed appropriate at the end of 1982 and does so now.

3. In last few years official foreign currency borrowing has been undertaken indirectly through the nationalised industries under the exchange cover scheme (with details published monthly in reserves press announcements). Decision now to borrow in Government's own name reflects judgement about market opportunity which now exists to borrow at very advantageous terms as well as smaller number of potential nationalised industry borrowers as a result of privatisation programme.

4. The rightness of that judgement reflected by market response. [Largest FRN ever at finest terms available to any borrower for maturity even of this type.] Indication of market view of quality of UK name.

Defensive

1. **ERM**

Position unchanged. Situation under continuous review.

2. **Intervention**

No change in policy. Not borrowing to support sterling. Chancellor has made clear on many occasions his attitude towards the use of intervention to influence exchange rate. But, as experience in early part of the year showed, in certain circumstances co-ordinated intervention can have a useful role to play (and can be undertaken profitably).

3. **Reversal of policy on debt repayment**

[Economic Secretary said in Written Answer on 24 November 1984 (col 448) that official debt had been reduced by $10 billion from figure reached by Labour Government and that "a proper balance between the figures that we have now reached may well be where we should rest for the time being".]

Policy was to repay substantial part of expensive foreign debt inherited from Labour Government. This we have done. Official debt at end of August was $10 billion lower than in May 1979 and $14 billion below peak at end 1977. After this issue it will still be $8 billion below inherited level and $12 billion below peak. Moreover in contrast to most of Labour debt the new issue is on very fine terms indeed. Reflects facts that this is a step taken from a position of strength, not weakness.

4. **Reasons for changes in reserves**

Changes in reserves over time reflect number of factors - intervention, valuation changes and net borrowing. Over whole period since April 1979 there has been a substantial reduction in net borrowing, a number of valuation changes in different directions and a small plus from intervention. The reduction since end-1982 partly reflects valuation changes and partly intervention undertaken at the beginning of 1983.

5. **Comparisons with other borrower**

[Largest FRN ever at finest terms available to any borrower for an FRN of comparable maturity.]

6. **[If questioned about EC issue**

EC launched a $1.8 billion 5 year floating rate note on 22 May 1985 at a margin of 1/16 over LIBID, ie sub-LIBOR. This was for a shorter maturity and had a poor market reception.]

7. **Exchange rate/monetary effects**

The issue will not have any significant effects on either the exchange rate or the monetary aggregates.

8. **Effect on the dollar**

Proceeds will be added to the reserves. So we will be adding the same amount to the demand for dollar assets (to hold in our reserves portfolio) as to the supply (in terms of the new HMG liabilities). There will therefore be no significant effect on the dollar exchange rate.

9. **Silly time to acquire dollars**

We will be adding the same amount both to our dollar assets and to our dollar liabilities. Our net dollar liability as a result of this operation will remain unchanged. So any change in the value of the dollar will have no significant effect on the value of our net assets.

OFFICIAL DEBT AND RESERVES FACTSHEET

Level of official reserves

$ billion

End-period	Total	o/w convertible currencies
1979	22.5	18.0
1980	27.5	18.6
1981	23.3	13.5
1982	17.0	9.6
1983	17.8	9.0
1984	15.7	7.6
1985 (August)	14.3	7.5

Level of official debt

	Total	o/w HMG borrowing
1979	20.7	9.7
1980	17.4	7.7
1981	13.3	4.6
1982	12.1	3.9
1983	12.0	3.7
1984	11.3	3.4
1985 (August)	11.9	3.4

Peaks and troughs $ billion

		Reserves		Official debt	
		Total	Convertible currencies	Total	HMG
Under Labour	high	21.9 (Mar '79)	19.3 (Jan '78)	22.5 (Dec '77)	12.9 (Sept '77)
(Mar '74-Apr 79)	low	4.1 (Dec '76)	2.5 (Dec '76)	8.7 (Mar '74)	4.5 (Sept '74)
Under Conservative	high	28.4 (Feb '81)	19.7 (May '80)	22 (May '79)	10.1 (May '79)
(May '79 to date)	low	14.0 (May '85)	6.8 (Mar '85)	11.0 (Sept '84)	3.2 (Apr (84)

Major HMG borrowings since 1974

Date	Amount	Description	Terms	Repayment/amount outstanding
March 1974	\$2.5 bn	Eurodollar bank credit 10 years on a rollover basis with a 3, 6 or 12 month option	Floating rate yrs 1 & 2: LIBOR + 3/8% 3, 4 & 5: LIBOR +½% 6 & 7: LIBOR +5/8% 8, 9, 10: LIBOR +¼%	Repaid in monthly instalments from May-July 1981
Jan 1976	SDR 1 bn	1975 oil/facility	Floating rate (based on IMF charges)	Equal quarterly repayments from Apr '79 to Jan '83

Date	Amount	Description	Terms	Repayment/amount outstanding
May 1976	SDR 700 mn	1975 stand by arrangement	Floating rate (based on IMF charges)	Repaid by Apr '79.
Jan-Aug 1977	SDR 3.36 bn (Note only SDR 1.64 bn drawn down)	1977 stand-by arrangement. To be drawn down over 2 years	Floating rate (based on IMF charges)	Repaid by Apr '79
April 1977	$677 mn (equivalent)[1]	Foreign currency bonds denominated in: $ issued with 5, 7 and 10 yr maturities for $202 mn, $82 mn and $18 million respectively. Others: DM 365 mn, Swfr 360 mn and Yen 21,500 mn issued with single maturity of 7 yrs	5 yr S bonds at 8 3/8% 7 yr $ bonds at 8 5/8% 10 yr $ bonds at 8 7/8% 7 yr DM bonds at 7½% 7 yr Swfr bonds at 5 7/8% 7yr Yen bonds at 8%	Bulk of repayments made in Apr 1984. Remaining $18 million due for repayment in '87
February 1977	$1.5 bn	Eurodollar bank credit. 7 yrs on a rollover basis with a 3, 6 or 12 month option. Loan drawn down in 2 tranches: $1 bn and $0.5 bn	Floating rate yrs 1 & 2: LIBOR +7/8% yrs 3 to 7: LIBOR+1%	Repaid in monthly instalments from July to Dec 1980
May 1978	$350 mn	$ bond issue in New York: $200 mn with a 7 yr maturity and $150 mn with a 15 yr maturity.	Fixed rate 7 yr : 8½% 15 yr : 8 7/8%	7 yr bonds repaid in May 1985. 15 yr bond due 1993

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Prime Minister
Content for the issue to go ahead next week?
DRS
4/9.

PRIME MINISTER

FOREIGN CURRENCY BORROWING

We discussed, in May and more recently, the question of a substantial foreign currency borrowing in the Government's own name in order to replenish the reserves. You agreed that such a borrowing should be undertaken, with the details to be decided in the light of market circumstances at the time.

A very attractive opportunity has now arrived and, if prompt advantage is taken of it, I believe that the market reception of an HMG eurodollar bond issue would be very favourable and command fine terms.

The issuing houses advise we move as quickly as possible, and this is fully endorsed by the Bank of England. I propose, therefore, to plan on the basis of a $2 billion floating rate note early next week. This would be the largest ever issue of its kind. If the market reaction was particularly favourable, and terms would not be sacrificed, I would propose to raise the size of the issue.

Presentation will obviously be important. My intention would be to present the operation as a natural evolution of the previous nationalised industry borrowing programme, and a prudent exercise in the management of the reserves. I attach a fuller note of the line I believe we should take.

N.L.

N.L.
11 September 1985

I think this will give the Labour party great opportunities for adverse comment on the side effects of denationalisation: no