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Prime Minister

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Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

13 September 1985

David Norgrove Esq
10 Downing Street
LONDON SW1

Dear David

FOREIGN CURRENCY BORROWING

... I attach a revised version of the briefing on the $2 billion floating rate note issue. Subject to anything untoward happening between now and then we now plan to announce it early on Monday morning, 16 September.

The new version of the briefing includes a suggested line to take (defensive point number 4) on the Prime Minister's point about running down the reserves to pay off the Labour debt.

Yours ever
Rachel

RACHEL LOMAX
Principal Private Secretary

~~SECRET~~ Unclassified

HMG DOLLAR FLOATING RATE NOTE ISSUE

Factual

An announcement will be made early on Monday morning (16 September) that HMG is issuing US $2 billion of floating rate notes (FRNs).

2. The notes have a 7 year maturity and carry a coupon of 3 months' LIBID with no margin, reset and payable quarterly.

3. The issue is being organised by the Bank of England on the Treasury's behalf and is jointly lead-managed by Warburgs and Credit Suisse First Boston.

4. The notes are being sold in the international market in the normal manner for a eurobond operation.

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). The

size of the operation on this occasion makes it sensible to borrow in the Government's own name.

4. Market response very favourable. Largest FRN ever at finest terms available to any borrower for an issue 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, though, as experience in early part of the year showed, in certain circumstances coordinated 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 be 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 fact that this is a step taken from a position of strength, not weakness.

4. **Running down of reserves to repay Labour debt**

Of course a substantial part of the debt repayments were financed from the reserves. How else would it have been done? What the Government was doing, and taking credit for, was getting rid of large amount of expensive liabilities we did not need.

And NB: (i) Even so, net reserves are nearly $3 billion higher than they were in April 1979 (as a result of valuation factors, SDR allocations and small amount of intervention).

(ii) The UK's total net external assets, private and public sector combined, have increased by over £60 billion since the end of 1979 (from £12.4 billion at end-1979 to £73.5 billion at end-1984).

5. **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.

6. **Comparisons with other borrowers**

This is the largest FRN ever issued and HMG has obtained the finest terms available to any borrower for an issue of this type.

7. **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 but with lower front-end fees than our own issue and a slightly lower all-in cost).

The two issues are not comparable. HMG's issue is larger, and its maturity is longer. The only sensible comparison is with where the EC issue is currently trading, and on that basis the two issues are virtually level.

If pressed.

The real difference is that the EC issue was too tightly priced, very badly received in the market, and has still not yet fully sold into firm hands. By contrast, the initial reception for HMG's issue is excellent.

8. **Mismatch or capping features**

Specialist features of this type can be useful to some issues, but we are confident that HMG's issue will sell on its merits without any need for gimmicks.

9. **Exchange rate/monetary effects**

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

10. **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.

11. **Silly time to acquire dollars**

We will be adding the same amount to both our dollar assets and 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.

12. **Cost of the issue**

The issuing expenses are expected to total around £200,000.

13. **Tax evasion**

The issue follows standard Eurobond practice in paying interest gross. Any UK resident investors will, of course, have to fulfil their legal obligations in reporting details of interest received to the Inland Revenue.

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

INTERNATIONAL COMPARISON OF RESERVES

End-July 1985, $ billion

	Total	of which convertible currencies
UK	11.5	8.1
Germany	44.5	35.9
US	35.5	8.0
Japan	29.0	23.8
France+	26.5	21.7
Italy	23.8	19.5

* gold valued at SDR 35 per oz

\+ June data.

Peaks and troughs

$ billion

		Reserves		Official debt	
		Total	Convertible currencies	Total	HMG
Under Labour (Mar '74-Apr 79)	high	21.9 (Mar '79)	19.3 (Jan '78)	22.5 (Dec '77)	12.9 (Sept '77)
	low	4.1 (Dec '76)	2.5 (Dec '76)	8.7 (Mar '74)	4.5 (Sept '74)
Under Conservative (May '79 to date)	high	28.4 (Feb '81)	19.7 (May '80)	22 (May '79)	10.1 (May '79)
	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 +¾%	Repaid in monthly instalments from May-July 1981
Jan 1976	SDR 1 bn	1975 oil/facility	Floating rate	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	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	Repaid by Apr '79
April 1977	$677 mn (equivalent)	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 $ 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