

EMP X/12

1. (MR KELLY s/l - not available) *N.J. Dett.*
2. ECONOMIC SECRETARY *3/iii*

FROM: D McSHARRY

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THE RESERVES IN FEBRUARY 1986

The reserves announcement for February will be made on Tuesday 4 March at 2.30 pm. This month's announcement reports a rise in the reserves of \$250 million and an underlying rise of \$112 million. I attach for the Economic Secretary's approval a draft of the press notice, together with Q and A briefing.

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THE RESERVES IN FEBRUARY 1986

The UK official reserves rose by \$250 million in February. Accruals of borrowing under the exchange cover scheme amounted to \$190 million; repayments of such borrowing amounted to \$50 million. Capital repayments on assignments to HMG of other public sector debt taken out under the exchange cover scheme amounted to \$2 million. At the end of February, the reserves stood at \$15,810 million (£10,900 million*) compared with \$15,560 million (£11,046 million⁺) at the end of January.

Note to Editors

2. After taking account of foreign currency borrowing and repayments, the underlying rise in the reserves during February was \$112 million. The underlying change in the reserves is the result of a variety of transactions, both debits and credits including, for example, transactions for Government departments and with other central banks, and interest receipts and payments. The underlying change should not therefore be taken as an indication of market intervention during the month. The above figures can also be obtained from the Reuters Monitor (Code TREA).

3. Accruals of borrowing under the public sector exchange cover scheme were as follows :

South of Scotland Electricity Board, \$161 million; West Midlands County Council, \$19 million; Merseyside County Council, \$10 million.

* When converted at the closing market rate on Friday 28 February
£1 = \$1.4505

+ When converted at the closing market rate on Friday 31 January
£1 = \$1.4086

Repayments of such borrowing were:

National Coal Board, \$25 million; British Steel Corporation, \$12 million; South of Scotland Electricity^{Board} \$5 million; British Telecommunications plc, \$3 million; British Airways, \$2 million; British Railways Board, \$1 million; North West Water Authority, \$1 million; Others, \$1 million.

THE RESERVES IN FEBRUARY 1986 : PRESS BRIEFINGFactual : Main features of markets in February

	<u>£ ERI</u>	<u>\$/£</u>	<u>DM/£</u>	<u>\$ ERI</u>	<u>DM/\$</u>	<u>Yen/\$</u>
3 February	73.5	1.3870	3.3267	123.7	2.3985	191.41
7 February	74.4	1.4020	3.3739	123.3	2.4065	190.92
20 February	74.7	1.4540	3.3515	118.9	2.3050	180.60
28 February	73.2	1.4505	3.2368	117.0	2.2315	180.70

Sterling began February sharply lower as oil prices weakened, but unexpectedly good money supply and reserves figures helped the pound to strengthen. Sterling strengthened further as the dollar declined and oil prices firmed on the back of rumours that some Middle Eastern producers were contemplating reductions in output. As the dollar continued to weaken, particularly against the deutschemark, sterling briefly kept pace but fell behind at the end of the month, as oil prices weakened again, falling to an all-time low of DM 3.2335 on 28 February.

Positive

Second month in succession that underlying increase has been registered [IF PRESSED: last month's statement noted special factor of EC abatement - part of the payments connected with the abatement was taken off-market to minimise risk of market disruption].

DefensiveQ1. Underlying increase implies intervention against pound

Underlying change not a good guide to market intervention. Reflects a large number of other transactions, for example, government departments and interest receipts and payments.

Not practice to discuss detailed reserve transactions, especially those involving the Bank's customers.

Q2. Exchange and interest rate policy

Government policy unchanged. No exchange rate target, but rate taken into account in assessing monetary conditions. Priority is to maintain firm downward pressure on inflation. While no one likes high interest rates, government has shown that it will not hesitate to take action if necessary.

Q3. Effect of oil price falls on exchange rate

Markets have been naturally disturbed by recent falls in oil prices. But the actual relationship is complex and uncertain.

Q4. Weakness of sterling in December-February

Well known that sterling can react to oil market developments in a way which other leading currencies do not. Some grounds to believe that some market operators exaggerate significance of oil to UK economy. Effect of fall in oil price on output and inflation expected to be broadly neutral, if anything slightly beneficial.

Q5. ERM

Position unchanged. Matter kept under continuous review. Government views most recently stated by Economic Secretary in HC debate on 29 January (Hansard vol. 90 no. 46 cols 979-1009).

Q6. Intervention details/tactics

General practice of governments not to comment on market tactics.

Q7. Exchange rate and competitiveness

Depreciation not way to improve competitiveness. Recent fall in sterling due to fall in oil price. Vital that British companies do not regard lower exchange rates as an easy option. Key is realistic pay deals and better

productivity. Government providing best environment by pursuing responsible domestic policies.

Q8. Exchange rate stability

Greater stability clearly desirable. But markets bound to be affected by recent sharp fall in oil prices.

Q9. UK reserves dangerously low

No. Rose this month and last. UK reserves at end-February higher than 12 months earlier (end-Feb 1985 : \$15.4 billion). Valuation differences affecting gold and non-dollar reserves make precise comparisons difficult.

Q10. SSEB commercial paper programme increase suggests change in borrowing strategy

No. Planned for some time. New borrowings and repayments under the exchange cover scheme tend to net out over time but individual months can show large increases or decreases in net borrowing, ie timing of borrowings and repayments do not necessarily coincide.

MOVEMENTS IN STERLING

MAY 1ST 1985 - FEBRUARY 28TH 1986



