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BIP to
bilateral
 Prime Minister (2)
 Agree for discussion at
 bilateral? AT 10/15

8

(C)

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

PRIME MINISTER

FOREIGN CURRENCY BORROWING

At our meeting on 13 February to discuss the EMS you asked me to consider how best to augment the foreign exchange reserves. You will recall that, although there is no very precise way of determining the level of the reserves we ought to have, I expressed the view then that they were too low for comfort, even if we remained outside the EMS exchange rate mechanism. At the end of April total reserves stood at the equivalent of \$14.0 billion of which the convertible currency reserves accounted for \$5.8 billion.

2. I have concluded that in current circumstances the most appropriate way to augment the reserves would be to make a substantial eurodollar bond issue in the Government's own name.

3. This would be the first direct HMG dollar borrowing since 1978. Our recent policy has been to obtain the foreign currency we needed to refinance existing debt as it matured by indirect borrowing through the nationalised industries under the exchange cover guarantee scheme. This has proved to be low-key and uncontroversial. It has also allowed us to exploit relatively lost cost borrowing opportunities such as the New York commercial paper market which are not accessible to us in our own name. I therefore intend to continue with it to the extent that opportunity offers.

4. But it has become very difficult to put together a sufficiently large programme relying on indirect borrowing alone even to raise the \$1 billion a year or so we need simply to



stand still. A number of the nationalised industries on which we used to rely have now been privatised. Others soon will be, or are expecting to, run down their debt rather than to increase it. In consequence there was a shortfall in the programme of about \$100 million last year and we are again facing considerable problems in finding enough suitable borrowers this year. A significant addition to the reserves can therefore only be achieved by direct HMG borrowing.

5. The market reception of a direct issue in current circumstances is likely to be very favourable. I would not wish to proceed with it unless that were the case. A UK Government issue will now have considerable scarcity value and I have little doubt therefore that it will be able to command fine terms, comparing favourably with those achieved by other recent sovereign borrowers such as Sweden or France. We could no doubt make something of this as reflecting confidence in the policies we have been following.

6. The exact form and amount of the issue would be for decision in the light of advice from the issuing houses. But what I have in mind at present is something of the order of \$1½ billion to \$2 billion, probably in the form of some kind of floating rate note.

7. An issue of this kind will undoubtedly attract attention both because of its size, because it will be the first time we have gone to the markets in this form and because of the credit we have previously taken for repaying so much of the overseas debt inherited from the Labour government. Its presentation will therefore need careful handling and it will be important to maintain strict secrecy until we are ready. But we ought to be able to present it as a sensible development

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of policy in response to changing circumstances and a step taken from strength particularly if, as seems likely, it proves to be in strong demand.

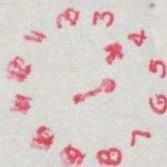
M.

N.L.

8 May 1985

Euro Post: EMS Pt2 .

150 MAY 1985



CONFIDENTIAL

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10 DOWNING STREET

From the Private Secretary

16 May 1985

Dear Rachel,

FOREIGN CURRENCY BORROWING

The Prime Minister discussed with the Chancellor his minute of 8 May. It was agreed that HMG should undertake a substantial foreign currency borrowing in its own name. The precise form and amount should be decided in the light of market circumstances at the time. If the market reaction was particularly favourable the size of the issue could be raised.

*Yours sincerely
Andrew*

ANDREW TURNBULL

Mrs Rachel Lomax
HM Treasury

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