

PRIME MINISTER

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VALUATION OF THE RESERVES

I attach two notes the Treasury have prepared in response to your earlier queries.

First, at Flag A, a note on the book loss during 1987 on the UK's dollar holdings. This stemmed from the discussion you had with Alan Walters on 9 January. The figure is in fact surprisingly small at £0.4 billion reflecting the fact that our net dollar assets are currently only \$12 billion. This is because we still have significant dollar liabilities (\$14 billion) and ~~the~~ reasonable progress ^{has been} made in diversifying the reserves into other currencies (the non-dollar proportion of our net foreign currency reserves is up to 48 percent). None of this means of course that you should take any more relaxed attitude towards acquiring more dollars should we face renewed upward pressure on sterling.

Second, at Flag B, an explanation of the valuation affect of the EMCF swap, which led to a \$660 million fall in the January reserves. This is all rather complex but the essential points are in Alex Allan's covering letter. There is nothing here to worry about - it simply reflects different valuation conventions between the EMCF and EEA.

PCCG.

(PAUL GRAY)

12 February 1988