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Dear Anthony

INTERVENTION

I think I ought to write to bring up to date our understanding about day to day policy on intervention for the immediate future.

When the Chancellor and the Governor met on Monday, 6 December, it was agreed that it would be worth trying a rather higher level of exchange market intervention for a strictly limited period, in the hope that this would steady the exchange rate and reduce upward pressure on sterling interest rates. They agreed initially to a maximum figure of $250 million for intervention over the period from the evening of Monday, 6 December, up to New York close on Tuesday, 7 December. The amount actually used was significantly less than this and we subsequently agreed a limit of $200 million for the period from New York close on Tuesday, 7 December, to New York close on Wednesday, 8 December.

Since Monday, 6 December, I understand that sterling has also had the benefit of about £200m of sterling purchases by the European Commission, who are accumulating sterling for our 1982 rebate. Most of this has been put through the market. However, it has fortunately proved possible to scale down ordinary market intervention and to ease the upward pressure on interest rates. The situation is still not easy on either the exchange rate or the interest rate front, but I think we can say that there has been a measure of success with the policy agreed on 6 December.

At the 6 December meeting the Chancellor made it clear that he wanted to avoid any impression that there had been anything like a change of policy on the exchange rate. He said very clearly in Parliament on 18 November that the policy was to allow the rate to

be broadly determined by market forces. He has repeatedly said that intervention is confined to smoothing. The Chancellor did not wish a sustained period of substantial intervention to lead to the impression that policy had been changed. That was why a limited period of high intervention was envisaged and I think that we have in fact had no more than that.

Against this background I think we should now regard ourselves as back on the earlier pattern of intervention and governed by the principles which then apply. We cannot exclude a review of this if strong and sustained new pressures arise and if there were good reason to believe that another short burst of intervention would help on domestic interest rates. But I think we should try to restore our room for manoeuvre by consciously returning to earlier levels of intervention (or non intervention) so as to maintain the basic policy and conserve the reserves. I suppose that on this basis an odd day of strong pressure ought not to lead to intervention of more than $100 million (rather than $200 million).

I hope too that we can apply similar principles to the remaining transactions for the EC rebate. I understand that there is perhaps another £550 million to come. We shall not get another such rebate for at least a year and meanwhile we have to face the continuing outflow of net payments to the EC. And the Chancellor was anxious to rebuild the reserves. So, subject to your judgement about daily market conditions, I very much hope it will be possible to take the greater part of those transactions still to come as off-market additions to the reserves.

I am sending a copy of this letter to Derek Byatt in view of your and Malcolm Gill's absence today in Basle.

Yours ever

Ken

K E COUZENS