

RESTRICTED

From: MISS E A CLARKE
Date: 19 October 1984

DEPUTY GOVERNOR)
MR E GEORGE) Bank of
MR A LOEHNIS) England
MR GILL)

cc (for information)
Mr Sedgwick
Mr Lavelle

MR LITTLER
MR CASSELL
MR LANKESTER
MR C KELLY
MRS LOMAX

EXCHANGE MARKET INTERVENTION

Sir Peter Middleton will be holding a meeting on Exchange Market Intervention at 5.15 pm on Thursday 1 November in his room 78A/2, HM Treasury.

Relevant papers

- (1) Mr McMahon's letter of 12 October to Sir Peter Middleton: Intervention, the Reserves and Official Borrowing; ^{- JGC}
- (2) Mr Littler's letter of 3 October to Mr Loehnis: Foreign Exchange Intervention. ^{JGC}

E A Clarke

MISS E A CLARKE
Assistant Private Secretary

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NOTE OF A MEETING HELD AT 5.15 pm THURSDAY 1 NOVEMBER, 1984
IN SIR PETER MIDDLETON'S ROOM, HM TREASURY

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| Present: Sir Peter Middleton | <u>Bank</u> | <i>Cum</i> |
| Mr Littler | Deputy Governor | |
| Mr Cassell | Mr George | |
| Mr Lankester | Mr Loehnis | |
| Mr Kelly | Mr Gill | |
| Mrs Lomax | | |

INTERVENTION, THE RESERVES AND OFFICIAL BORROWING

The meeting considered the paper attached to the Deputy Governor's letter of 12 October to Sir Peter Middleton.

2. On intervention, Sir Peter Middleton said the essential questions related to whether a neutral stance was desirable and whether intervention could be expected to affect the interest rate/exchange rate mix. The Deputy Governor said that neutral intervention, compared to the position where there was a continuing net drain on the reserves from government expenditure requirements, would tend to lead to a lower exchange rate and/or higher interest rates than would otherwise be the case.

3. The meeting discussed whether there could be any such effects where intervention was sterilised. It was pointed out that, in practice, sterilisation took place with respect to the monetary base but not with respect to sterling M3. To the extent that less intervention sales of dollars led to downward pressure on the exchange rate, there would be an expansionary influence on sterling M3 and that, together with the lower exchange rate, could lead the authorities to the conclusion that domestic monetary conditions were easier than otherwise. In such circumstances downward pressure on interest rates might be resisted and perhaps the authorities might seek to increase interest rates. But there could be no certainty about the reliability and the size of intervention effects.

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In practice a great deal of intervention might be necessary to produce what might be a small effect although it was noted that this might not be the case where market perceptions were changed, as had been illustrated by recent Bundesbank intervention tactics.

4. The meeting agreed that intervention was likely to have some consequences for the exchange rate but, as the Jurgensen Report had concluded, the effects would probably not be very large. There was also a complication regarding sterilisation where it was noted that offsetting the impact of intervention on sterling M3 would require additional gilt operations as well as money market intervention. It was also agreed that there should be greater neutrality in day-to-day intervention operations.

Reserves and official borrowing

5. The meeting agreed that the present level of the reserves was uncomfortably low and it was noted that the composition was also not helpful. Sir Peter Middleton said that the main questions concerned how the reserves could be built up and to what use they should be put.

6. Mr Littler said that if the reserves were built up then they should be maintained as a fund for contingencies, possibly in the event of difficulties on the debt front. Sir Peter Middleton agreed that the presumption should be against using up increments to the reserves for intervention purposes.

7. As for how the reserves could be built up there were several options:

(i) Routine intervention ("creaming off"). The meeting agreed that this would have monetary consequences. The Deputy Governor noted that it would be difficult to "cream off" if sterling was weak.

(ii) Privatisation receipts. The meeting noted that intervention could take the form of adding to the reserves

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the foreign currency receipts of the overseas BT offering.

(iii) Official foreign currency borrowing. The Deputy Governor said that it was important to initiate with Ministers a proposal to undertake HMG own-name borrowing. The meeting agreed that there were strong reasons for undertaking such an operation.

8. Sir Peter Middleton invited Mr Kelly to submit a revised version of his borrowing submission to encompass all three options discussed. The meeting agreed that Mr Littler should pursue separately with Mr Loehnis the proposed intervention guidelines attached to Mr Littler's letter of 3 October.



S P HANNAH

6 November 1984

cc: Those present
Sir Terence Burns
Mr Unwin
Mr Lavelle
Mr Sedgwick

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