

PRIME MINISTER

FOREIGN EXCHANGE MARKETS

The Chancellor of the Exchequer held a meeting with the Bank this afternoon to discuss the foreign exchange market. The Bank took the view that if the right opportunity arose there should be massive intervention and perhaps a precautionary rise in interest rates.

The Chancellor did not share that view. He is, however, concerned that sterling has been falling with the dollar and he wants to make sure that if the Germans intervene to push the Mark down we do not get the worst of both worlds by then going down with the Mark, having already fallen with the dollar.

The conclusion is that the Bank of England will talk to the Bundesbank to discover their intentions. If the Germans are planning to intervene and if market conditions are right the Bank of England will intervene tomorrow probably to sell some \$100 - 200 million worth of Deutschemarks. The intention is simply to signal that the Government is not indifferent to the course of the exchange rate.

This proposal comes within the definition of market smoothing: it is modest and not intended to run counter to market forces. Sterling has fallen by 6 pfennigs in the past 24 hours, a very sharp move. The effective exchange rate closed today at 69.4, against the previous record low of 70.0 reached in February 1985 at a time when the dollar was approaching parity with sterling. Conditions are of course now rather different with the collapse in the price of oil. A substantial depreciation was inevitable and indeed welcome in the circumstances. But if the markets are building up to a further dramatic move in the dollar we should not want to be dragged along with it willy nilly.

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