

File- Monetary Policy Issues-Exchange Rate
Intervention – Part B

Reference MG-MAMC/D/0002/001

File begins 01/06/1987

File ends 10/09/1987

Pages 39-60

39-

FROM: M CONATY
DATE: 5 June 1987

MR GRICE

cc: Mr Carr
Mr Pike
Ms Bronk
MAMC DJ

You asked me how one might assess the quantitative impact of intervention on broad money. Having discussed this with various people it would appear that there are three ways in which work could proceed. I would welcome your comments before progressing further.

- (i) Simulation using the Treasury Model.
- (ii) Estimate an M3 equation using current and lagged values of intervention as explanatory variables.
- (iii) Counterparts analysis. This would involve obtaining the deviation from trend of both NBPS net foreign currency deposits and overseas net sterling deposits. Then regress each of these on current and lagged values of intervention. Or alternatively, to calculate the average ratio of the two deviations from trend, for months in which there was heavy intervention.


M CONATY

From Jane Mason

D3

Copies to	Mr George	Mr De Hoest 7/2 ED
	Mr Flemming	Miss Denny
	Mr Coleby	Mr Enoch
	Mr Plenderleith	Miss Grey
	Mr Althaus	Mrs Jackson
	Mr Farrant	Mr Jennings
	Mr Threadgold	Mr Kerr
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	Mr Bull	Mr Milne
	Mr McConnachie	Mr Pennington
	Mr Brisk	Mr T Pike
	Mr Clark	Mr Pratt
	Mr Craig	Mr Thorp
		Grp 9, I&T

Attached is an updated list of sterling issues for 1987.

Jane L Mason

Gilt-Edged Division HO-G
8 June 1987

Mrs J L Mason (4410)

STERLING ISSUES IN 1987

		<u>Date</u>	<u>Amount</u>	<u>Maturity</u>	<u>Coupon</u>	<u>Yield</u>
BULLDOG ISSUES						
		-	-	-	-	-
B	DOMESTIC ISSUES					
1	TR Trustees Corporation	25. 2.87	£ 20 mn	30 yrs	10 1/2	-
2	London Edinburgh Trust	25. 2.87	£ 35 mn	25 yrs	9 1/4 - 11 1/4 (stacked)	
3	TR City of London Trust	12. 3.87	£ 10 mn	15 yrs	10 1/4	10.379
4	Town Centre Securities	2. 4.87	£ 15 mn	34 yrs	10 1/2	
5	Nationwide B S	3. 4.87	£ 30 mn	34 yrs	3 7/8 I-L	
6	Tribune	8. 4.87	£ 15 mn	25 yrs	9 1/8	
7	City Site Estates	9. 4.87	£ 10 mn	18 yrs	10 (1M)	9.986
8	Land Securities	15. 4.87	£ 200 mn	38 yrs	10	
9	Vaux Group	23. 4.87	£ 25 mn			
10	North Housing Association	8. 5.87	£ 66.3 mn	50 yrs	8 3/4%	
11	North Housing Association	8. 5.87	£ 110 mn	50 yrs	0	
12	North Housing Association	8. 5.87	£ 80 mn	32 yrs	0	
13	Peachey Property Corp	12. 5.87	£ 30 mn		9.5 (1M)	
14	Capital & Counties	27. 5.87	£ 12 mn	40 yrs	9 7/8	10.301
15	TR Industrial & General	28. 5.87	£ 50 mn	29 yrs	10	
16	Dares Estates	1. 6.87	£ 15 mn	25 yrs	10.25	
			£ 723.3 mn			

C EURO-STERLING - FIXED RATE. COMMERCIAL UK ISSUERS

		<u>Date</u>	<u>Amount</u>	<u>Maturity</u>	<u>Coupon</u>	<u>Yield</u>
1	Burton Grp	14. 1.87	£ 110 mn	14 yrs	4 3/4	4.75
2	Asda - MFI	9. 2.87	£ 120 mn	15 yrs	4 3/4	4.75
3	Redlands	9. 2.87	£ 60 mn	15 yrs	7 1/4	7.25
4	W H Smith & Sons	10. 2.87	£ 50 mn	15 yrs	7 1/8	7.125
5	Tesco	2. 3.87	£ 115 mn	15 yrs	4	4.000
6	Pirelli UK Int	5. 3.87	£ 50 mn	5 yrs	10	9.608
7	Storehouse	9. 3.87	£ 69 mn	14 yrs	4 1/2	4.250
8	ICI	11. 3.87	£ 100 mn	18 yrs	9 3/4	9.601
9	Rowntree Mackintosh	12. 3.87	£ 69 mn	15 yrs	4 1/2	4.5
10	Metal Box	13. 3.87	£ 65 mn	15 yrs	5 3/4	5.750
11	British Land	18. 3.87	£ 33 mn	15 yrs	7 1/2	7.304
12	Land Securities	18. 3.87	£ 100 mn	20 yrs	9 1/2	10.00
13	DRG PLC	19. 3.87	£ 40 mn	15 yrs	6 1/4	6.25
14	MEPC	19. 3.87	£ 75 mn	17 yrs	9 7/8	9.922
15	Smith & Nephew Ass	31. 3.87	£ 90 mn	15 yrs	4	4
16	Investors In Industry	6. 4.87	£ 50 mn	7 yrs	9 3/8	9.126
17	Consolidated Goldfields	6. 4.87	£ 110 mn	15 yrs	6 3/4	6.75
18	British Airways	8. 4.87	£ 100 mn	10 yrs	9 1/2	9.264
19	Blue Circle	16. 4.87	£ 60 mn	15 yrs	6 7/8	6.875
20	Ultramar	22. 4.87	£ 40 mn	15 yrs	6	6
21	Wates City of London	25. 4.87	£ 30 mn	7 yrs	6 7/8	6.875
22	Slough Estates	27. 4.87	£ 50 mn	20 yrs	10	10.315
23	News International	11. 5.87	£ 75 mn	5 yrs	9 5/8	9.495
24	P & O	13. 5.87	£ 75 mn	15 yrs	4 3/4	4.750
25	Dee Corporation	4. 6.87	£ 60 mn	15 yrs	5	5
			£1,796 mn			

		<u>Date</u>	<u>Amount</u>	<u>Maturity</u>	<u>Coupon</u>	<u>Yield</u>
EURO-STERLING - FIXED RATE. FINANCIAL UK ISSUERS						
1	Halifax Building Society	9. 2.87	£ 100 mn	10 yrs	10 3/8	10.231
2	Alliance & Leicester Building Society	9. 2.87	£ 40 mn	5 yrs	10 1/4	9.954
3	Cheltenham & Gloucester BS	19. 3.87	£ 50 mn	5 yrs	9 1/4	8.929
4	Leeds Permanent BS	24. 3.87	£ 50 mn	5 yrs	9 1/4	9.025
5	Woolwich & Equitable BS	26. 3.87	£ 50 mn	5 yrs	9 1/2	9.081
6	National Westminster Bank	27. 4.87	£ 100 mn	5 yrs	9	8.587
7	Prudential Finance	8. 5.87	£ 150 mn	20 yrs	9 3/8	9.319
8	Halifax Building Society	8. 5.87	£ 50 mn	5 yrs	8 3/4	
9	Anglo & Overseas Trust	19. 5.87	£ 35 mn	25 yrs	9	10.142
			<u>£ 625 mn</u>			

EURO-STERLING - FIXED RATE. COMMERCIAL NON UK ISSUERS						
1	Amro	5. 1.87	£ 50 mn	5 yrs	10 3/8	10.045
2	IBRD	15. 1.87	£ 100 mn	12 yrs	10 3/8	10.338
3	GMAC	19. 1.87	£ 40 mn	5 yrs	10 1/2	10.071
4	Elders IXL	22. 1.87	CF £ 85 mn	10 yrs	7	
5	CNT	6. 2.87	£ 70 mn	10 yrs	10	9.798
6	Finland	6. 2.87	£ 100 mn	10 yrs	10 1/8	10.023
7	McDonalds	9. 2.87	£ 50 mn	5 yrs	10	9.738
8	Australia	16. 2.87	£ 100 mn	10 yrs	10 1/4	10.127
9	Norsk Hydro	17. 2.87	£ 50 mn	15 yrs	10	9.901
10	American Brands	5. 3.87	£ 50 mn	7 yrs	9 1/2	9.551
11	Sweden	9. 3.87	£ 100 mn	10 yrs	9 1/2	9.303
12	Norsk Hydro	10. 3.87	£ 50 mn	6 yrs	9 7/8	9.507
13	ECSC	13. 3.87	£ 100 mn	5 yrs	9 3/8	8.958
14	New Zealand	13. 3.87	£ 100 mn	8 yrs	9 5/8	9.579
15	Chrysler Fin Corp	25. 3.87	£ 50 mn	5 yrs	9 1/2	9.209
16	Aetna Life	6. 4.87	£ 36 mn	5 yrs	9 1/4	8.961
17	Gillette Canada	9. 4.87	£ 70 mn	6 yrs	9 5/8	9.285
18	Air Products & Chem	27. 4.87	£ 50 mn	10 yrs	9 1/2	9.460
19	Societe Generale	27. 4.87	£ 50 mn	5 yrs	9	8.618
20	GMAC Corp	27. 4.87	£ 50 mn	5 yrs	9	8.650
21	General Cinema (convertible into Cadbury Schwepps)	19. 5.87	CF £ 110 mn	15 yrs	5	5.063
22	Goodman Fielder	1. 6.87	CF £ 85 mn	10 yrs	5	5
			<u>£1,546 mn</u>			

EURO-STERLING - FIXED RATE. FINANCIAL NON UK ISSUERS						
1	Kreditbank	2. 1.87	£ 50 mn	5 yrs	10 5/8	10.26
2	Deutschebank	2. 1.87	£ 100 mn	5 yrs	10 1/2	10.071
3	Creditanstalt	8. 1.87	£ 50 mn	7 yrs	10 1/2	10.293
4	Algemene Bank	9. 1.87	£ 75 mn	5 yrs	10 1/2	10.136
5	Phillips Finance	6. 2.87	£ 40 mn	7 yrs	10	9.745
6	Banque Indosuez	9. 2.87	£ 50 mn	5 yrs	10 1/4	9.791
7	Banque Nationale de Paris	27. 2.87	£ 50 mn	7 yrs	10	9.645
8	Commerzbank	2. 3.87	£ 50 mn	5 yrs	9 5/8	9.301
9	Deutsche Bank Fin	3. 3.87	£ 75 mn	10 yrs	9 7/8	9.595
10	Dai-Ichi Kangyo Bank	4. 3.87	£ 50 mn	5 yrs	9 3/4	9.297
11	American Express Overseas	4. 3.87	£ 40 mn	7 yrs	10	9.62
12	Genfinance Luxembourg	7. 4.87	£ 50 mn	7 yrs	9 1/4	9.002

		<u>Date</u>	<u>Amount</u>	<u>Maturity</u>	<u>Coupon</u>	<u>Yield</u>
EURO-STERLING - FIXED RATE.		FINANCIAL NON UK ISSUERS				
13	Toronto-Dominion Bank	24.	4.87 £ 50 mn	5 yrs	9 1/4	8.771
14	Morgan Guaranty	30.	4.87 £ 75 mn	5 yrs	9	8.618
15	Nippon Credit (Fin)	6.	5.87 £ 50 mn	5 yrs	9 1/8	
16	Asian Development Bank	2.	6.87 £ 50 mn	10 yrs	9 1/2	9.210
17	World Bank	4.	6.87 £ 200 mn	20 yrs	9 1/4	9.39
			<u>£1,105 mn</u>			
D EURO-STERLING - FRNs						
1	NHL First Funding	20.	1.87 £ 50 mn	7 yrs	3 mnth Libor + 20bp	-
2	Stripes	26.	2.87 £ 100 mn	9 yrs	3 mnth Libor + 20bp	-
3	TMC Mortgage Securities	5.	3.87 £ 200 mn	27 yrs	3 mnth Libor + 25 bp	-
			<u>£ 350 mn</u>			
E EURO STERLING WARRANTS						
		<u>*Amount</u>	<u>Maturity</u>	<u>Yield</u>	<u>Warrant Price</u>	<u>Exercise Period</u>
1	Trusthouse Forte	<u>£ 85 mn</u>	5 yrs	5. 7.68	39.2 pence	

C convertible
 * nominal value into which warrants are exercisable
 / not yet priced
 ∅ mortgage backed
 E with "money back" equity warrant
 1M 1st mortgage

FROM: J W GRICE
DATE: 9 June 1987

MR S W MATTHEWS

cc Mr Savage
Mr Conaty

STERLING'S REAL EXCHANGE RATE

I read with regular interest IF2's monthly note on World Economic Developments. However, I was slightly surprised by the path for sterling's real exchange rate over time depicted in Chart 14. Mr Conaty has recently been looking at this issue and concluded that the real exchange rate was now close to the low point reached in 1976. By contrast, Chart 14 of your note suggests the real exchange rate still to be high.

2. I understand that the main reason for the discrepancy is that your chart approximates the real exchange rate by taking into the calculation a weighted average of the inflation rates in only a few of the countries whose exchange rate feeds into the ERI.

3. As you are aware, senior officials seem to place considerable weight on the real exchange rate as a guide to monetary conditions. If Chart 14 is to continue to be circulated, I think that it would avoid confusion if extra resources were devoted to it so that the real exchange rate is calculated more comprehensively.

JWG

J W GRICE

R

FROM: C W KELLY
DATE: 10 June 1987

MA
D 3

MRS LOMAX

cc Mr Peretz
Mr Ilett
Mr Neilson
Mr Richardson

CAPITAL MARKET ISSUES IN STERLING

Your request for comments on Mr Plenderleith's letter of 8 June.

2. It is no business of mine any more. But I was surprised by the suggestion that it would be possible to negotiate a reciprocal arrangement for lead management with the French confined to Euro issues. The line with the Japanese always used to be that we could not make a distinction between Euro and domestic issues in our own markets, so that evidence that UK firms had lead managed Euro yen issues was an insufficient basis for reciprocity until there had been some instances of British firms lead managing domestic yen issues as well. Are the Bank not in danger of shooting themselves in the foot?

3. I imagine you will be taking up the Bank's implied invitation to ask them to maintain the status quo for the time being on enlarging the scope for local authority borrowing.

CWK

C W KELLY

FROM: I. POLIN
DATE: 29 JUNE 1987

MS. GOODMAN

cc Mr. Peretz
Mr. Sedawick
Mr. Boltzill
Mr. Kelly
Mr. Richardson
Mr. Brook
Mr. Flitton

Mr. Gill
Mr. D. J. Reid
Mr. C. Bailey
Mr. J. Milne
Mr. D. J. Chetwin
Mrs. J. Jupp

THE RESERVES IN JUNE 1987

I attach the draft press notice, Q and A briefing and the press material for the Thursday's announcement.

2. Could Mr. Bailey please look at the factual comment on the markets in June. Could Mr. Boltzill please confirm he is content with the current draft of Q9 of the Q and A briefing. I would also appreciate any comments from Mr. Richardson / Mr. Brook on Questions 3, 5 and 7 in particular.

3. With apologies for the tight deadline
may I please have any comments by
close of play tomorrow (30th) ?

I. Folini

I. C. FOLIN

4317.8

ERMP C/8

FROM: I POLIN
DATE: 1 July 1987

1. MR KELLY
2. ECONOMIC SECRETARY

Distribution

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Mr Pickford
Mr Ross Goobey

THE RESERVES IN JUNE 1987

The reserves announcement for May will be made on Thursday 2 July at 11.30 am. This month's announcement reports a fall in the reserves of million and an underlying fall of million.

I POLIN

Mr Norgrove - No 10
Mr Lankester - Washington (after publication)

Mr Gill)
Mr D J Reid)
Mr J Milne) - B/E
Mr D J Chetwin)
Mrs Jupp)

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DRAFT PRESS NOTICE

THE RESERVES IN JUNE 1987

The UK official reserves fell by million in June. Accruals of borrowing under the exchange cover scheme amounted to million, repayments of such borrowing amounted to million. Repayment of long-term North-American debt amounted to \$ million. Capital repayments on assignments to HMG of other public sector debt taken out under the exchange cover scheme amounted to million. At the end of June, the reserves stood at million (million*) compared with \$34,679 million (£21,299 million⁺) at the end of May.

Note to Editors

2. After taking account of foreign currency borrowing and repayments, the underlying fall in the reserves during June was million. The underlying change in the reserves is the result of a variety of transactions, both debits and credits, including, for example, transactions for Government departments and with other central banks, and interest receipts and payments. The underlying change should not therefore be taken as an indication of market intervention during the month. The above figures can also be obtained from the Reuters Monitor (Code TRE A).

3. New borrowing under the public sector exchange cover scheme was as follows:

* When converted at the closing market rate on Tuesday 30 June
£1=\$1.

+ When converted at the closing market rate on Friday 29 May
£1=1.6282

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Repayments of such borrowing were:

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THE RESERVES IN JUNE 1987 : PRESS BRIEFINGFactual : main features of markets in June

	<u>£ ERI</u>	<u>\$/£</u>	<u>DM/£</u>	<u>\$ ERI</u>	<u>DM/\$</u>	<u>Yen/£</u>
1 June	72.8	1.62½	2.98	102.3	1.83	145
11 June	73.4	1.66	2.98	100.9	1.79½	142½
15 June	72.9	1.63	2.98	102.1	1.83	145
22 June	71.8	1.60	2.94	102.5	1.84	146

Sterling was steady in the first half of June trading in the range 72½ to 73½ in effective terms. Following the General Election victory by the Conservatives, which was largely discounted by the markets, sentiment turned against Sterling which was believed to be capped at DM3 and subsequently it eased against the stronger dollar to around \$1.59½. However towards the end of the month it firmed above \$1.61 helped by a better outlook for the UK economy.

The dollar traded nervously during June. News that Volcker had declined to serve a third term as Fed. chairman and the markets disappointment at the outcome of the G7 meeting in Venice pushed the dollar below DM1.80. However it rose on 23 June to DM 1.8460 and Yen 146.75 on better than expected US economic indicators, but came off these high's towards the end of the month on rumours of Central Bank intervention.

Previous reserve changes

(i) Reserve changes in recent months have been:

		\$ million	
		<u>Underlying</u>	<u>Total</u>
1986	September	- 372	+ 3502
	October	- 668	- 434
	November	+ 35	+ 14
	December	+ 96	- 83
1987	January	+ 72	+ 29
	February	+ 287	+ 305
	March	+ 1785	+ 1892
	April	+ 2912	+ 2768
	May	+ 4760	+ 4872
	June		

(ii) Last month's underlying change was the largest ever. The previous largest was in October 1977 (\$3,036 million).

Bank Base Rates

Bank rate changes in recent months have been:

		<u>Base Rate</u>	<u>Change</u>
1987	10 March	10½	Down ½%
	18 March	10	Down ½%
	29 April	9½	Down ½%
	11 May	9	Down ½%

POSITIVE

1. The strength of sterling and the large growth of the reserves in last few months reflect the market's confidence in Government's policies and UK's economic prospects.

2. Fall this month in no way overturns seven successive months of underlying plus' on reserves, even taking account of intervention last autumn. Reserves still very strong.

3. Strong productivity growth and present pattern of exchange rates offer industry best selling opportunity abroad for years, provided pay costs controlled. In recent quarters UK unit labour costs have risen broadly in line with those of competitors so that sterling's 1986 fall has been reflected in improved competitiveness.

DEFENSIVE

1. Exchange rate target. Period of stability desirable but no explicit target or target ranges.

2. Is Paris agreement dead? Venice meeting produced nothing? No - agreed at Paris in February that period of stability desirable. Position reaffirmed in Venice where G7 agreed that "substantial shifts in exchange rates could prove counter productive to efforts to increase growth and facilitate adjustment".

3. No increase in Sterling or prospect of interest rate cuts represent market verdict on Government policies? Market already discounted Conservative victory. No surprises, so no need for any adjustments.

X 4. Recent falls in exchange rate shows monetary conditions too lax? Volatility in exchange rates caused by a number of factors as well as domestic conditions, including shifts in oil prices and in international sentiment following recent Washington meetings and statements by US and Japanese authorities. Changes in exchange rate only one of the factors taken into account in assessing monetary conditions.

5. Recent Intervention figures show holding interest rates higher than necessary, damaging to British industry? Base rates have come down by 2% since beginning of March. Further reductions will only be made if prudent to do so. Nothing would be more damaging to British industry than relaxation of financial strategy and return of inflation. Intervention helps to prevent overshooting of exchange rate with consequent damage to industrial conditions.

6. At what point in month did intervention take place? Policy never to discuss intervention details.

7. Implications for funding? Policy is full fund of PSBR over financial year as a whole by debt sales to non-bank private sector and external and foreign currency finance of public sector (efcfps). Change in underlying spot reserves is part of latter. Other things being equal increases in reserves means additional sales of debt outside monetary sector are required to achieve a given quantity of funding. But reserves changes only one element of efcfps (others include eg sales of Central Government and other public sector debt overseas).

8. UK membership of ERM. No change in Government position. Matter kept under continual review. Will join when satisfied that balance clearly favours doing so.

[9. 1987 current account forecast. The current account is performing better, so far, than predicted. (If pressed: But it is too early to revise the forecast).]

RMP C/8

→ Mr. Richardson

FROM: I POLIN
DATE: 1 July 1987

1. MR KELLY ^{1.7}
2. ECONOMIC SECRETARY

Version as amended by the
Chancellor and the Economic
Secretary.

Ian Polin

2.17/87

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Mr Bottrill
Mr Grice
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Ms Goodman
Mr Pickford
Mr Ross Goobey

THE RESERVES IN JUNE 1987

The reserves announcement for ^{June}~~May~~ will be made on Thursday 2 July at 11.30 am. This month's announcement reports a fall in the reserves of \$315 million and an underlying fall of \$230 million.

Ian Polin

I POLIN

Mr Norgrove - No 10
Mr Lankester - Washington (after publication)

Mr Gill)
Mr D J Reid)
Mr J Milne) - B/E
Mr D J Chetwin)
Mrs Jupp)

DRAFT PRESS NOTICE

THE RESERVES IN JUNE 1987

The UK official reserves fell by \$315 million in June. Accruals of borrowing under the exchange cover scheme amounted to \$68 million; repayments of such borrowing amounted to \$149 million. Repayment of long-term North-American debt amounted to \$1 million. Capital repayments on assignments to HMG of other public sector debt taken out under the exchange cover scheme amounted to \$3 million. At the end of June, the reserves stood at \$34,364 million (£21,311 million*) compared with \$34,679 million (£21,299 million⁺) at the end of May.

Note to Editors

2. After taking account of foreign currency borrowing and repayments, the underlying fall in the reserves during June was \$230 million. The underlying change in the reserves is the result of a variety of transactions, both debits and credits, including, for example, transactions for Government departments and with other central banks, and interest receipts and payments. The underlying change should not therefore be taken as an indication of market intervention during the month. The above figures can also be obtained from the Reuters Monitor (Code TREA).

3. New borrowing under the public sector exchange cover scheme was as follows:

Newcastle City Council, \$19 million; Cheshire County Council, \$16 Million; Shetland Islands Council, \$16 million; Essex County Council, \$7 million; Durham County Council, \$6 million, Dyfed County Council, \$4 million.

* When converted at the closing market rate on Tuesday 30 June
£1=\$1.6125

+ When converted at the closing market rate on Friday 29 May
£1=1.6282

UNTIL 11.30 Thursday 2 July
thereafter UNCLASSIFIED

Repayments of such borrowing were:

British Coal, \$55 million; Electricity Council, \$32 million; British Rail, \$18 million; British Telecommunications PLC, \$17 million; British Nuclear Fuels PLC, \$7 million; North West Water Authority, \$4 million; British Airways PLC, \$3 million; Northumbrian Water Authority, \$2 million; South West Water Authority, \$2 million; British Steel Corporation, \$1 million; Anglian Water Authority, \$1 million; Severn Trent Water Authority, \$1 million; Yorkshire Water Authority, \$1 million; Lancashire County Council, \$1 million; Strathclyde Regional Council, \$1 million; Others, \$3 million.

until 11.30 Thursday 2 July
thereafter UNCLASSIFIED

THE RESERVES IN JUNE 1987 : PRESS BRIEFINGFactual : main features of markets in June

	<u>£ ERI</u>	<u>\$/£</u>	<u>DM/£</u>	<u>\$ ERI</u>	<u>DM/\$</u>	<u>Yen/\$</u>
1 June	72.8	1.62½	2.98	102.3	1.83	145
11 June	73.4	1.66	2.98	100.9	1.79½	142½
15 June	72.9	1.63	2.98	102.1	1.83	145
22 June	71.8	1.60	2.94	102.5	1.84	146
30 June	72.3	1.61	2.94½	102.3	1.82½	147

Sterling advanced during the run up to the Election and peaked at ERI 73.6 on 11 June. Following the General Election victory by the Conservatives, which was largely discounted by the markets, sterling's rally ran out of steam, *profit-taking and the non-arrival of the anticipated "wall of money" led to a fall in Sterling but,* ~~partly on fears that the authorities would cap it at DM3. The markets perceived the OECD survey to be forecasting a deteriorating inflation and trade outlook for the UK which triggered a fall in Sterling on 22 June but,~~ after touching a low of \$1.59, it rose to end the month on a firmer note.

The dollar traded nervously during June. News that Volcker had declined to serve a third term as Fed. chairman and the markets disappointment at the outcome of the Venice Summit pushed the dollar below DM1.80. However, encouraging US indicators caused it to recover to a high of DM1.8460 on 23 June, but fell subsequently on rumours that the Federal Reserve Bank of New York (FRBNY) and other central banks had intervened to sell dollars.

Previous reserve changes

(i) Reserve changes in recent months have been:

		\$ million	
		<u>Underlying change</u>	<u>Total change</u>
1986	September	- 372	+ 3502
	October	- 668	- 434
	November	+ 35	+ 14
	December	+ 96	- 83
1987	January	+ 72	+ 29
	February	+ 287	+ 305
	March	+ 1785	+ 1892
	April	+ 2912	+ 2768
	May	+ 4760	+ 4872
	June	- 230	- 315

(ii) ~~Last month's underlying change was the largest ever. The previous largest was in October 1977 (\$3,036 million).~~ Reserve transactions have shown a healthy profit.

Bank Base Rates

Base rate changes in recent months have been:

		<u>Base Rate</u>	<u>Change</u>
1987	10 March	10½	Down ½%
	18 March	10	Down ½%
	29 April	9½	Down ½%
	11 May	9	Down ½%

POSITIVE

- ~~The strength of sterling and growth of the reserves in last few months reflect market's confidence in Government's policies and UK's economic prospects.~~ Sterling has remained broadly stable, in line with February agreement at the Louvre, which is holding well.
- ~~Despite fall this month, reserves still very strong after seven successive months of underlying increases.~~ Three successive months of substantial increases.

DEFENSIVE

○ Exchange rate target. Chancellor made clear now that period of stability for sterling and other currencies desirable. But no explicit target or target ranges.

Latest position on Louvre accord?

2. Is Paris agreement dead? No. Position reaffirmed at Venice Summit: communique said "substantial shifts in exchange rates could prove counter productive to efforts to increase growth and facilitate adjustment".

3. Post-election behaviour of sterling and gilts markets show market verdict on Government policies? Market already discounted Conservative victory. No surprises, so no need for any adjustments.

4. Recent intervention show holding interest rates higher than necessary, damaging to British industry? Base rates down by 2% since beginning of March. ~~Relaxation of monetary policy, fuelling inflation far greater threat to industry than current levels of interest rates. Intervention smooths path of exchange rate.~~ Interest rates set at level necessary to keep monetary conditions on track. Industry clearly doing very well, with buoyant prospects.

5. At what point in month did intervention take place? Policy never to discuss intervention details.

6. Implications for funding? Policy is full fund of PSBR over financial year as a whole by debt sales to non-bank private sector and external and foreign currency finance of public sector (efcfps). Change in underlying ~~spot~~ reserves is part of latter. Other things being equal increases in reserves ^{require} ~~mean~~ additional sales of debt outside monetary sector ~~are required~~ to achieve a given quantity of funding. ~~But reserves changes only one element.~~

7. UK membership of ERM. No change in Government position. Matter kept under continual review. Will join when satisfied that balance clearly favours doing so.

8. 1987 current account forecast. The current account to April performed better than predicted.

output, investment, orders exports etc.