

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

Reference MG-MAMC/D/0002/001

File begins 03/05/1988

Pages 323-333

(B) G7

14. Next meeting of G7? Chancellor earlier stated no need for early G7 meeting. Since been calls for meeting soon after new US administration is inaugurated. UK will, of course, consider in consultation with G7 partners.

15. How important is G7 cooperation? G7 proved their worth. Shown whole world economy is stronger when act together to sustain policies of low inflation, steady growth and open markets.

16. International monetary co-ordination not working? International cooperation alive and well, and reaffirmed in G7 communique of 24 September.

17. G7 committed to exchange rate stability? G7 communique issued in Berlin, 24 September reaffirmed commitment to pursue policies that will maintain exchange rate stability and to continue to cooperate closely on exchange markets.

(C) INTERVENTION

18. Value of intervention as instrument? Intervention can certainly have role to play in short term. Can check undue exchange rate fluctuations in either direction which do not reflect underlying fundamentals.

19. Have other countries been intervening over last month/recently?  
Never discuss details.

D) EUROPEAN MONETARY INTEGRATION

20. Sterling's participation in exchange rate mechanism (ERM)? [Governor said to Forex Club, Luxembourg, 15 November, not obvious conditions for UK participation in ERM were yet right; involvement of sterling would introduce new element of complexity into its operation.]

As said many times before, matter kept under continual review. Will join when Government considers time is right. [IF PRESSED: Decision matter for Government as whole.]

21. Membership of ERM would have prevented recent fluctuations in sterling and avoided need for higher interest rates? No. Joining ERM not a soft option. Countries within ERM frequently change their interest rates.

22. Join ERM by 1992? No fixed timetable. Will join when Government considers time is right.

23. Capital liberalisation will undermine ERM? No. Plenty of pressures on ERM earlier this decade but mechanism survived them. May lead to greater monetary co-operation among member states or further modifications to mechanism along Basle/Nyborg lines but no reason to suspect collapse.

24. Proposals for European Central Bank and common European currency? Must avoid being committed to institutional changes with far-reaching ramifications which have scarcely begun to be explored. Securing successful completion of single market by end of 1992 must be priority.

(E) ECU TREASURY BILLS

25. Treatment of proceeds of UK Ecu Treasury Bill programme Will provide useful addition to European currency component of UK's foreign exchange reserves. But long standing practice of successive governments not to publish details of currency composition of reserves.

26. Why borrow when reserves so high? Reserve levels not excessive by international standards. Proceeds from Ecu Treasury Bill tenders will provide useful addition to European currency component of foreign exchange reserves. Programme also has wider advantages in developing role of private ecu and in establishing London as centre of Ecu market.

(F) CHANGE TO THE OFFICIAL STERLING EXCHANGE RATE INDEX (ERI)

See also briefing provided to IDT etc on 9 November.

27. Why change index? New index significant improvement on old. No policy significance in change.

28. Move to new sterling ERI allows UK to shadow EMS de facto? [In new index, weighting of EC countries rises from 47.5 to 55.6 per cent and dollar weighting falls from 24.6 to 20.4 per cent. In "Financial Times", 24 November, Sam Brittan argued that because of this, paying attention to sterling ERI will in future resemble monitoring rate against EMS much more closely.]

Absurd to draw such inferences from minor changes in weights. No policy significance. Never focus exclusively on single exchange rate indicator when assessing monetary conditions.

TABLE 3 - TOTAL PUBLISHED RESERVES

			<u>\$ billion</u>
	<u>Total reserves changes</u> <u>during month</u>		<u>Level at end</u> <u>of month</u>
USA	+ 1.05	(end October)	50
Japan	+ 1.3	(end October)	92
Germany	+ 2.3	(w/e 22 November)	42
France	+ 1.6	(end October)	63
Italy	- 1.1	(end September)	56
Canada	+ 1.5	(end October)	16
United Kingdom	+ 1.0	(end November)	51

Notes

1. The figures for Germany, France and Italy were originally published in local currencies; they have been converted to dollars at appropriate exchange rates.
2. Figures not strictly comparable because of different valuation conventions for eg gold.
3. Figures are taken from different sources. (Italy, France and Germany from Reuters, US from Telerate, Japan and Canada from official press releases.)

88/12

FROM: G J J YOUNG  
DATE: 6 December 1988

MR PERETZ — 84/e

cc Mr Grice

THE DEUTSCHEMARK STERLING FORWARD RATE

You asked me to prepare the following charts:

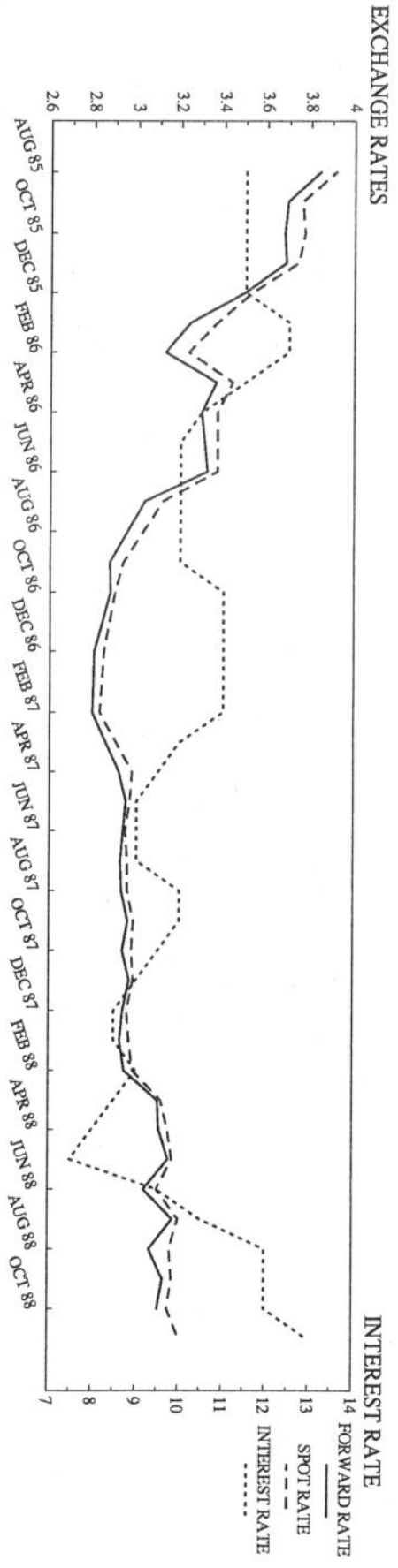
(i) the 12 month deutschemark-sterling forward rate on a weekly basis from about March, together with the spot rate and interest rate changes. Unfortunately, the forward rate is not easily accessible on a weekly basis so a monthly series has been used. As some compensation, the attached charts show the desired series on a monthly basis from August 1985 using the 3, 6, 9 and 12 month forward rates;

(ii) a plot of how the forward rate for delivery in, say, November has varied over the past 12 months. This may be interpreted as the market's prediction of the November rate. This is attached. (Some of the rates required are not available and so have been estimated by interpolating the available figures.)

2. I also attach a chart showing the 3-month forward and the spot rates from July 1978. My interpretation of the charts is that the forward rates follow the spot rate too closely to be a useful predictor of future spot rates.

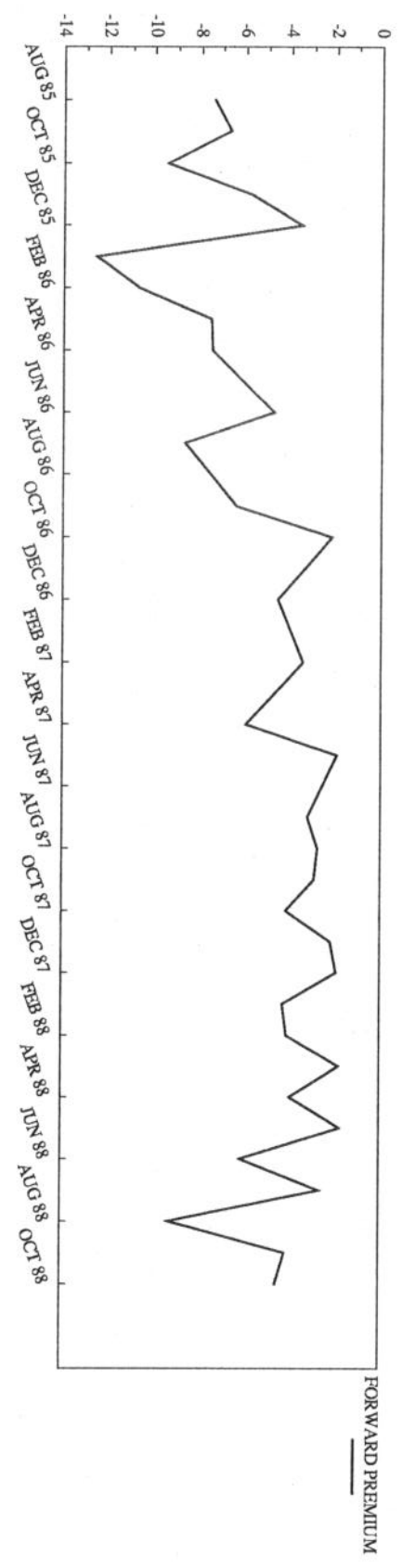
GARRY YOUNG

COMPARISON OF DEUTSCHMARK SPOT AND FORWARD RATES

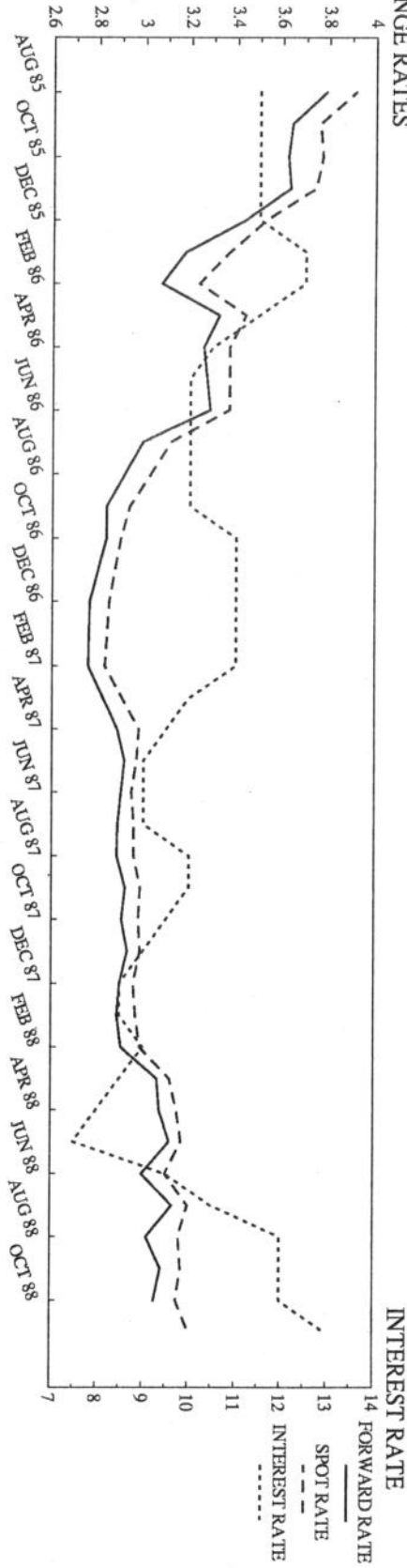


USING 3 MONTH FORWARD RATES

FORWARD PREMIUM (pfennigs)

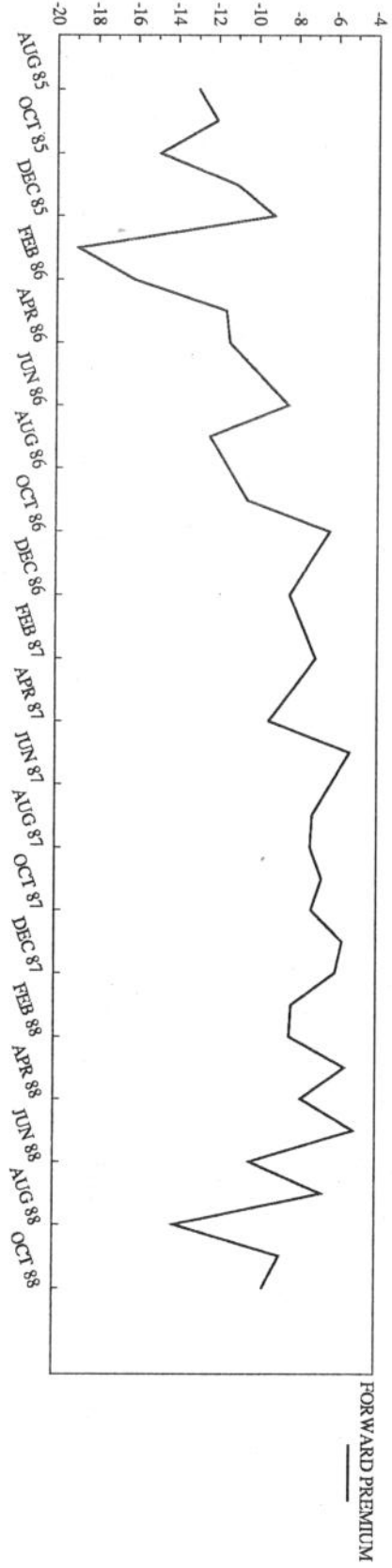


COMPARISON OF DEUTSCHMARK SPOT AND FORWARD RATES



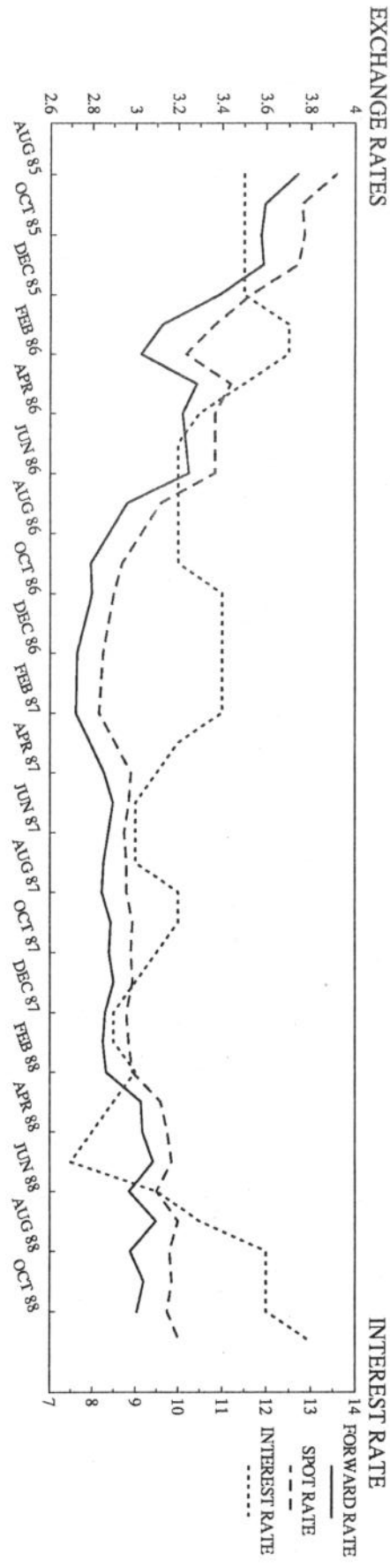
USING 6 MONTH FORWARD RATES

FORWARD PREMIUM (pfennigs)



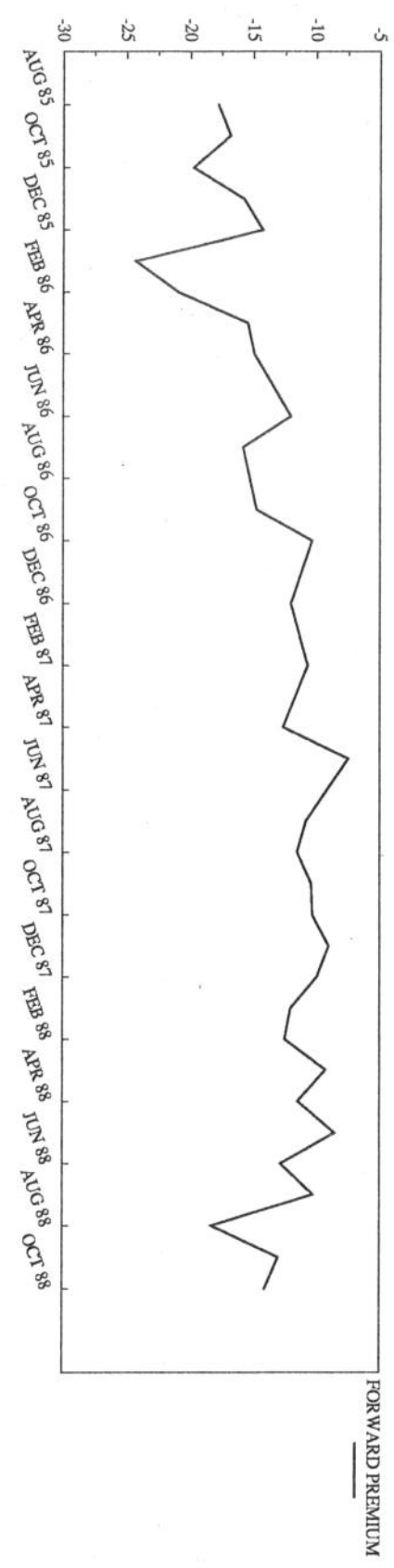


COMPARISON OF DEUTSCHMARK SPOT AND FORWARD RATES

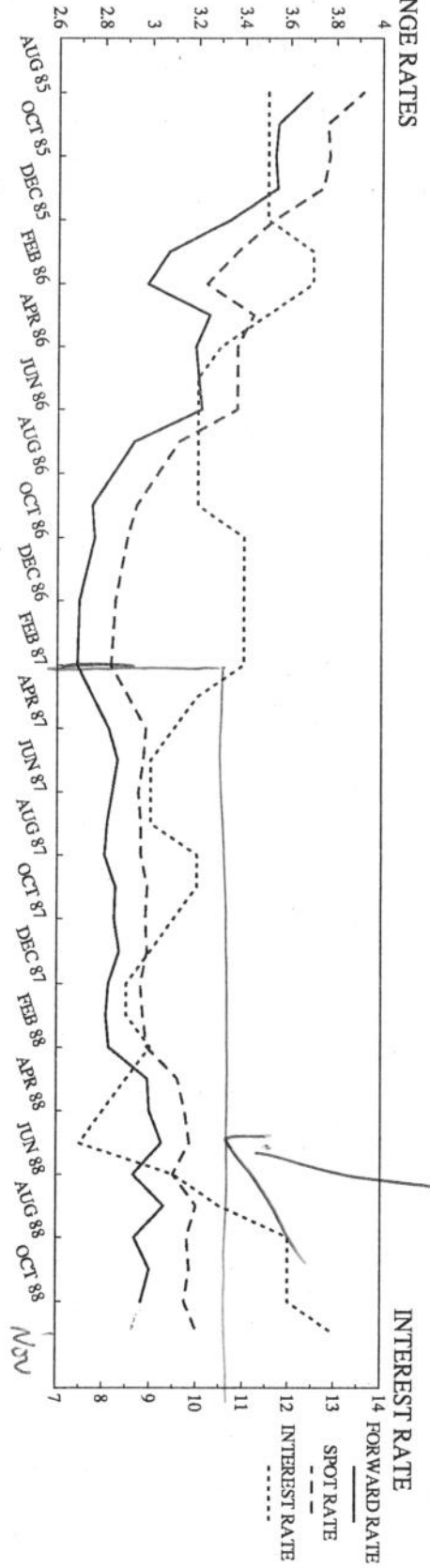


USING 9 MONTH FORWARD RATES

FORWARD PREMIUM (pfennigs)



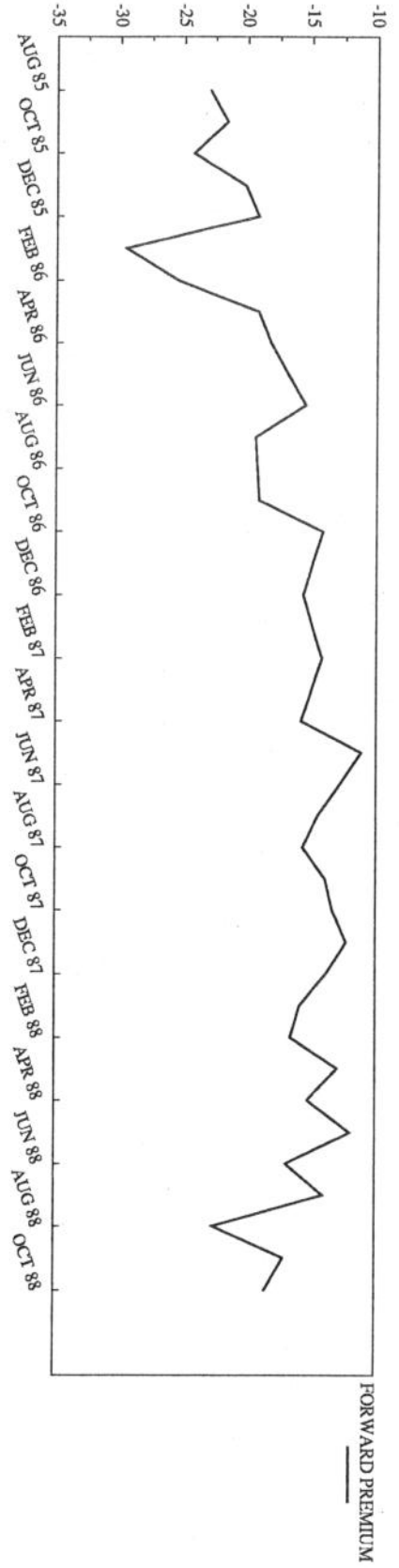
COMPARISON OF DEUTSCHMARK SPOT AND FORWARD RATES



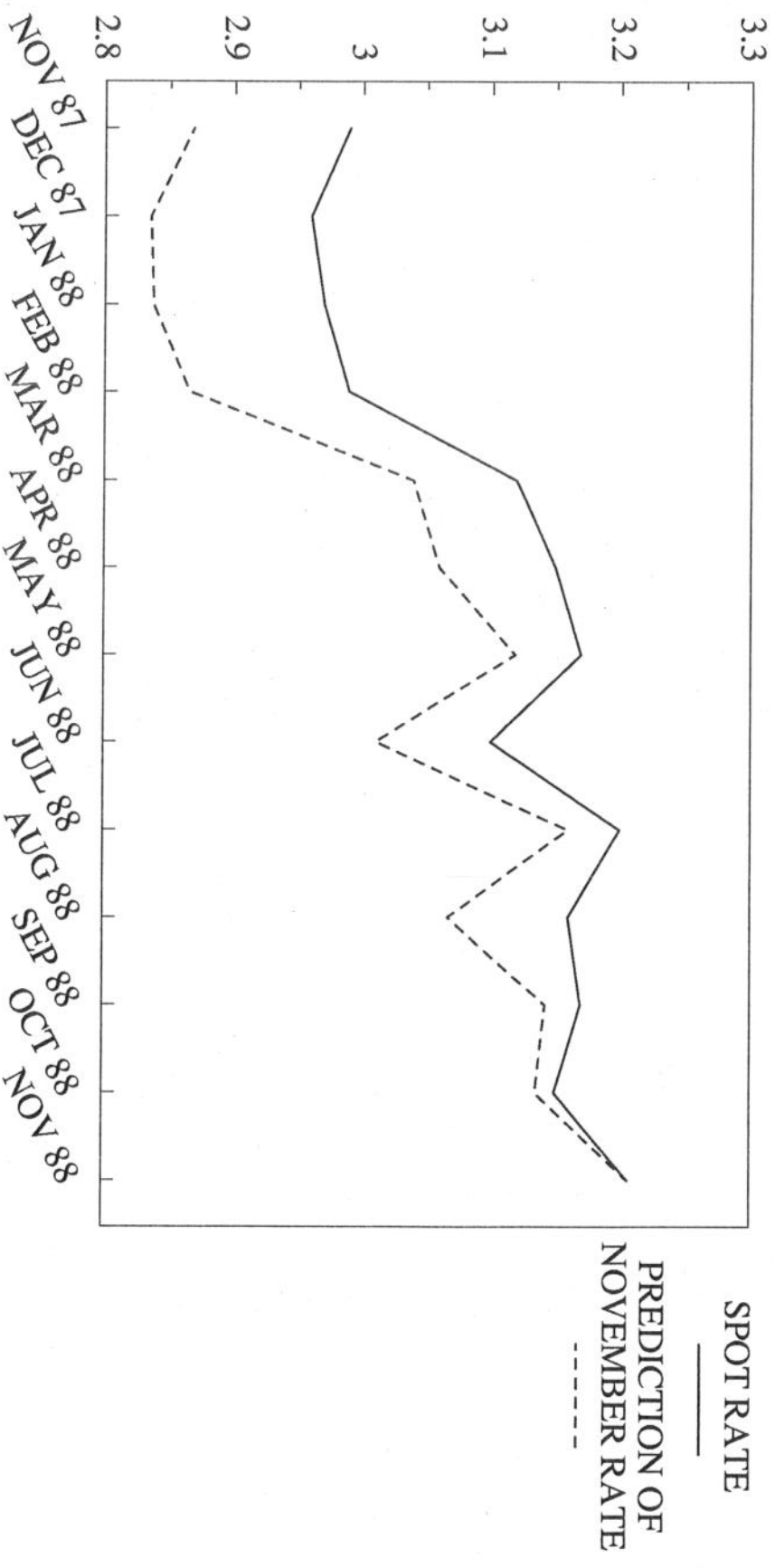
Mr. Young  
 Thanks! Could I have a beam up version of the chart below pl. from Feb '87, updated to Nov 88 & holding '89, & without the interest rate line  
 DJC

USING 12 MONTH FORWARD RATES

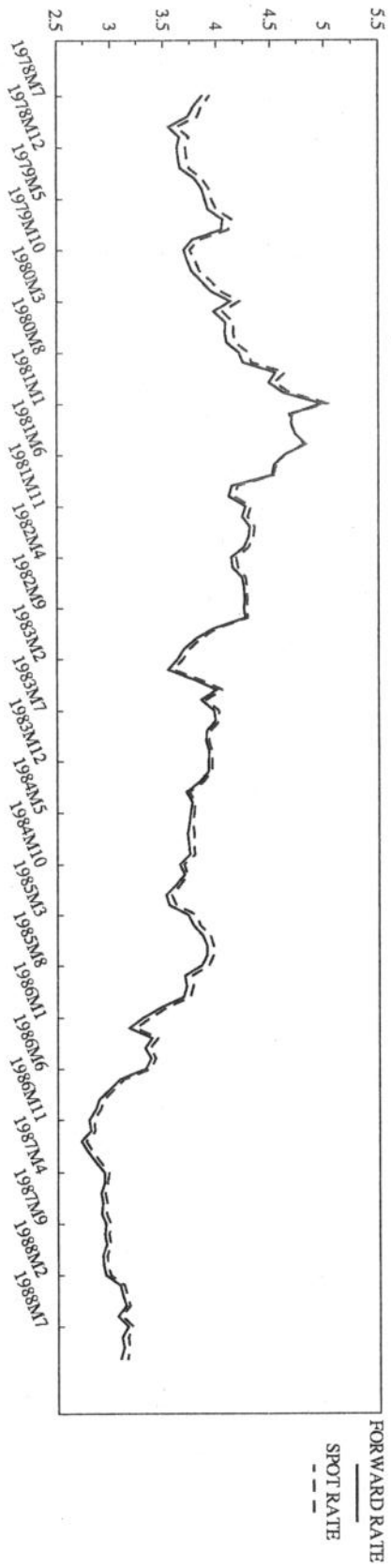
FORWARD PREMIUM (pfennigs)



# PREDICTION OF NOVEMBER 1988 DM/£ EXCHANGE RATE USING FORWARD RATES



COMPARISON OF DEUTSCHMARK SPOT AND FORWARD RATES



USING 3 MONTH FORWARD RATES

FORWARD PREMIUM

