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

Reference MG-MAMC/D/0002/001

File begins 11/09/1987

File ends 23/12/1987

Pages 79-100

1777.1

D3

79

FROM: H C GOODMAN

DATE: 1 November 1987

1. MR ~~KELLY~~ 2.11

2. ECONOMIC SECRETARY

cc: Mr Cassell
Mr Peretz
Mr Grice
Mr Richardson
Mr Nelson

INTERVENTION: OTHER COUNTRIES' EXPERIENCE

You asked in Mr Barnes' minute of 14 October, how much intervention other countries have been prepared to countenance before yielding to upward pressure on their exchange rate.

2. Attached are graphs showing the effective exchange rates and monthly intervention by Switzerland, Germany, Japan and the US since 1979 - the period for which we can most easily retrieve the data. These are the figures reported by the central banks in the regular concertation procedures. They are not the same as changes in the Reserves which cover also debt and off market transactions.

3. Taking each in turn:-

(a) Switzerland in 1979 carried out substantial intervention in both directions, but in two brief periods they bought \$2 billion and \$1½ billion respectively, probably steadying the rise in the effective rate from 142 to 149. After 1980 they carried out very little intervention as far as we know. Although not formally part of the Louvre Accord they have co-operated in buying dollars this year and have seen an increase in their Reserves of \$705 million up to 29 October; this may have had some delaying effect on the rise in their effective rate from 166 to 175.

559/87

b) Germany as you can see most German intervention in the period has been negative - in other words dollars were being sold and D-mark bought providing support for their currency during the long rise of the dollar. But in June and July of 1979 $1.4 billion was bought before the September EMS re-alignment which saw the D-mark rise 2 per cent. A further $¾ billion was bought later that year, which was presumably aimed at steadying the rise from 125.9 to 133. The levels of intervention preceeding subsequent re-alignments were relatively small:- plus $200 million, before the 5.5 per cent rise in October 1981; a cessation of the running down of the Reserves before the 4.25 per cent revaluation in June 1982; plus $150 million before the 5.5 per cent revaluation in March 1983 and plus $55 million before the 2 per cent increase at the July 1985 revaluation; plus $121 million before the April 1986 3 per cent revaluation. In every case this was followed by subsequent unwinding of the intervention.

However, this year the pattern has been very different. Before the realignment in January in which the D-mark central rate was increased by 3 per cent $4 billion was bought and this has not since been unwound. Moreover, under the Louvre Accord the Germans have carried out $2,300 million between end-February and 29 October.

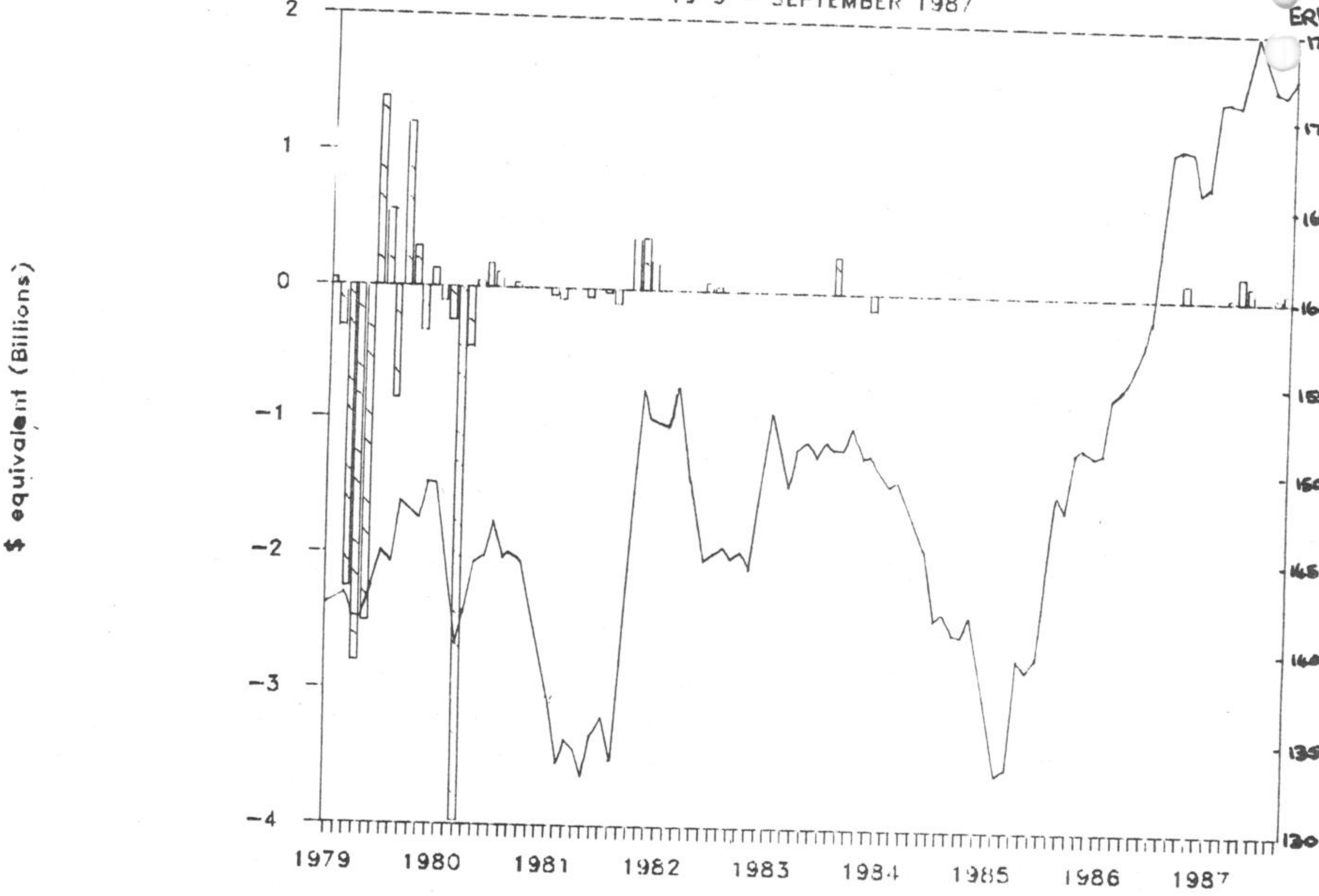
(c) Following some large reductions in their Reserves in 1979, the Japanese in three successive bouts of intervention in 1980-81 bought of $3 billion, $2 billion, and $1½ billion respectively. This appears to have steadied the yen rise from 124.7 to 148. Between 1980-81 and the Plaza agreement the Japanese were carrying out intervention to support the yen against the dollar's remorseless rise. In the three months following the Plaza agreement they supported the yen at a cost of over $3 billion. But, in 1986 when the pressure on the yen was again upwards they carried out over $11 billion purchases of dollars and in January this year they saw an increase in their Reserves of $8.6 billion. This may explain why the yen exchange rate in the first part of 1986 rose from 177.7 to 218 but in the latter part was held back to 205. Since the Louvre Accord they have carried out a further $17.8 billion purchases, which may have had some impact on holding the rate below 230.

(d) When looking at the US intervention graph, it is important to remember that the figures are a mirror image of the other countries. In the summer of 1979 the American intervention to hold down the dollar totalled a net $5.8 billion. This seems to have had little effect on the dollar ERI though it may have held it back between 92 and 95. In 1980-81 $6.2 billion of intervention was carried out before the rate was allowed to rise from 99.8 to 113. As the dollar rose over the next four years little intervention was carried out until after the Plaza agreement when they did $3.6 billion when the rate reached 138.4 and threatened to rise again. In August this year, when there was upward pressure on the ceiling of the Louvre range the Americans intervened with $½ billion before continuing with the general pattern of spending to halt the dollar's fall.

H. Goodman.
H C GOODMAN

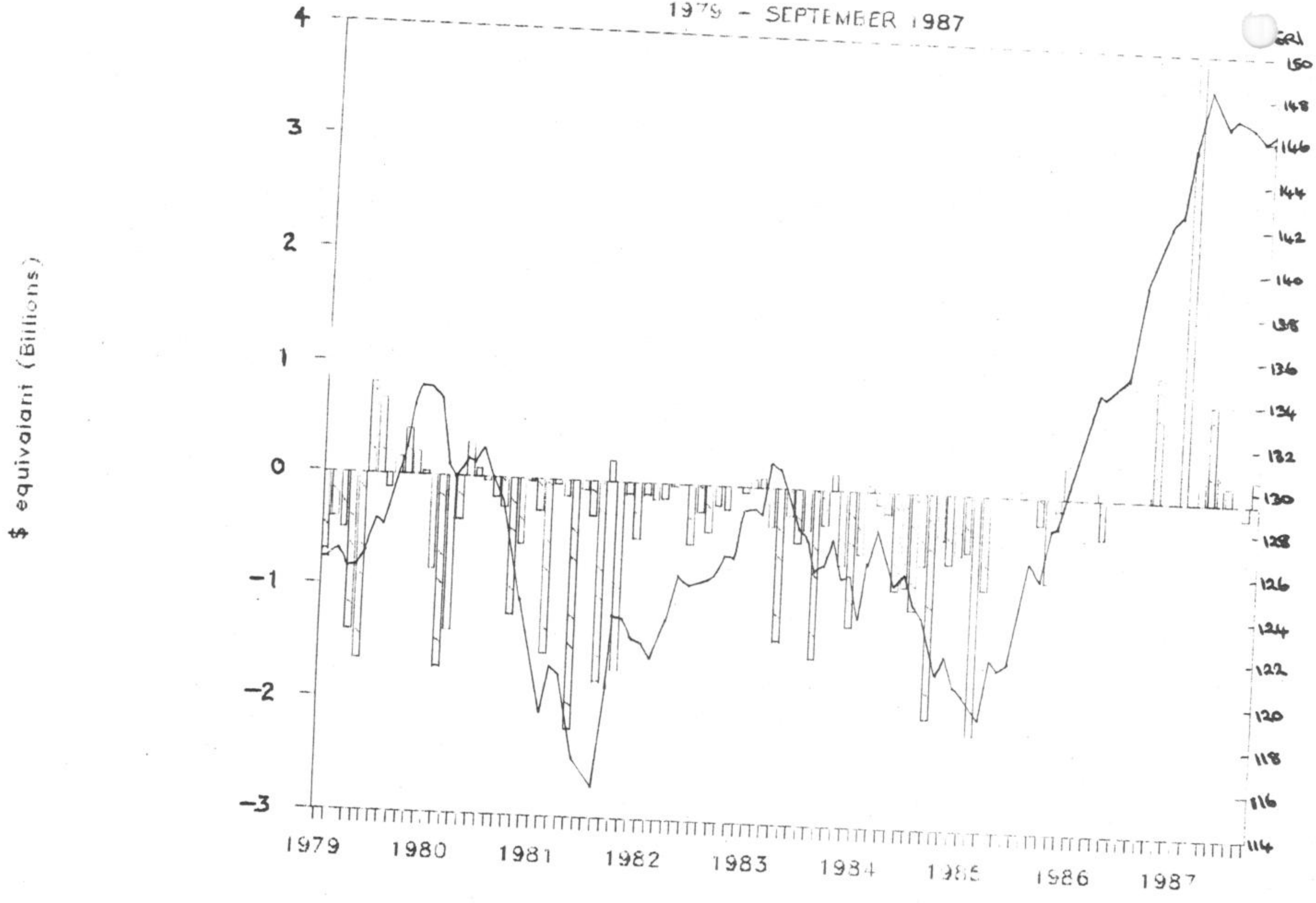
SWISS INTERVENTION/ERI

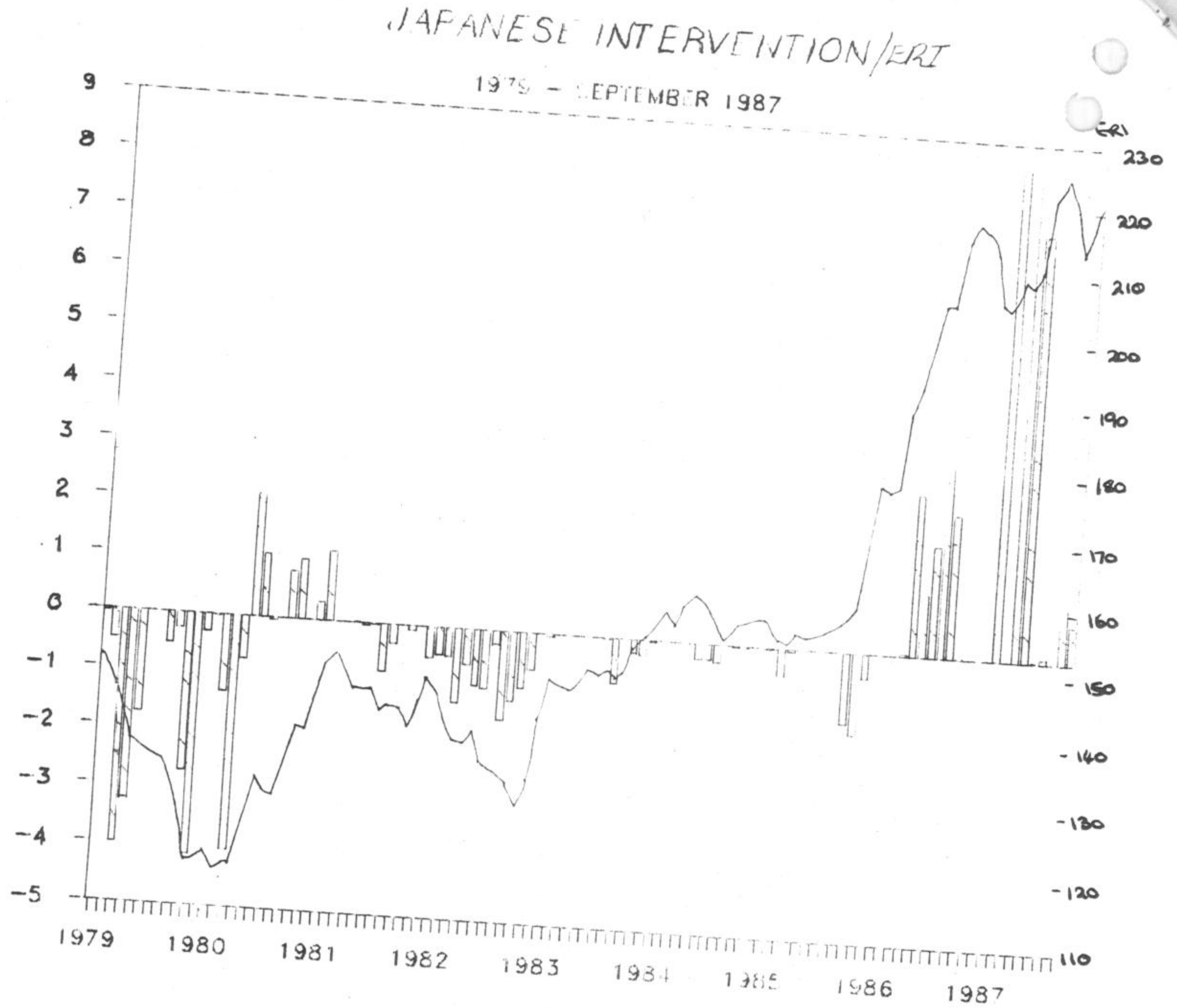
1979 – SEPTEMBER 1987



GERMAN INTERVENTION/ERI

1979 - SEPTEMBER 1987

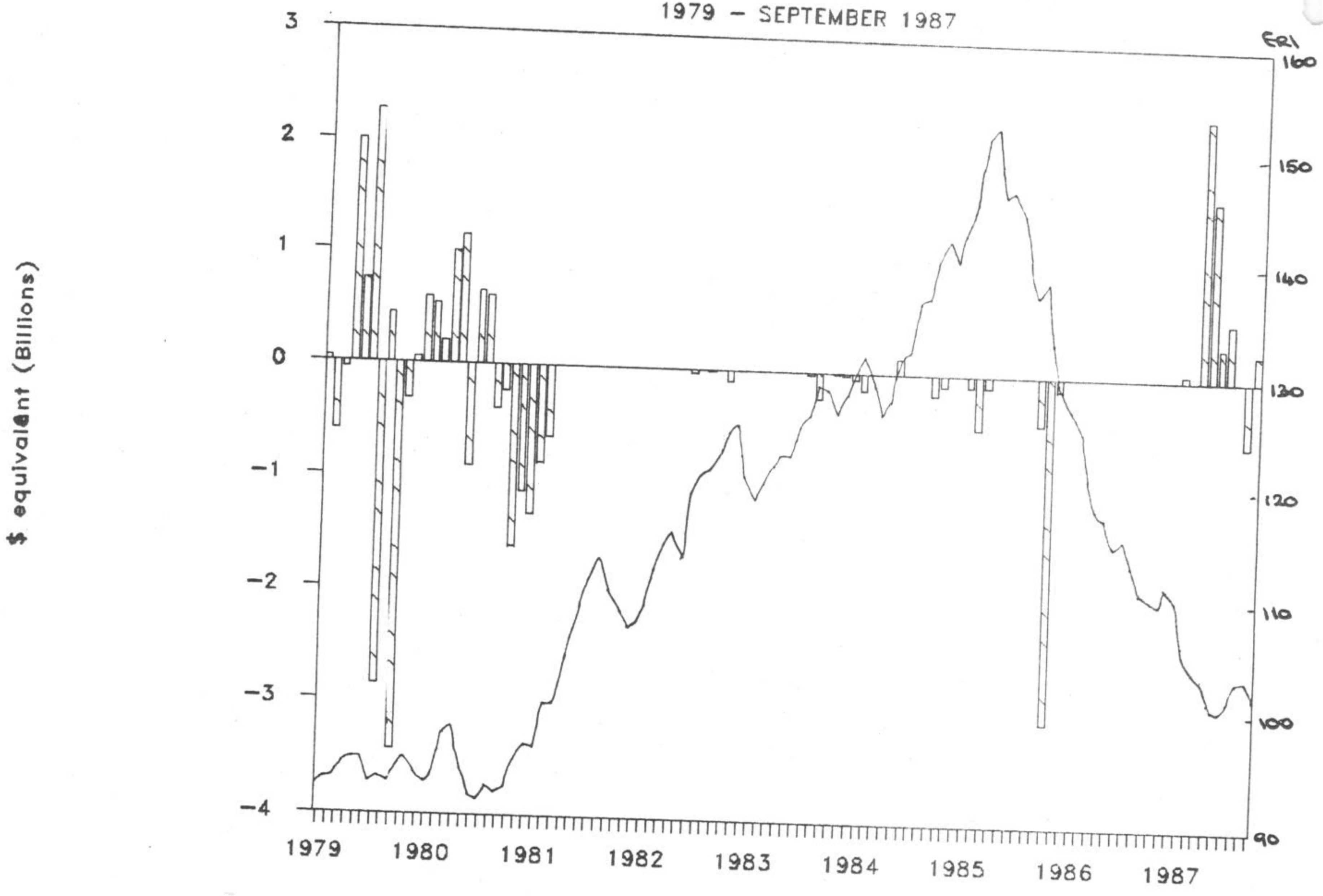




JAPANESE INTERVENTION/ERI
1979 – SEPTEMBER 1987
$ equivalent (Billions)
ERI
9
8
7
6
5
4
3
2
1
0
-1
-2
-3
-4
-5
230
220
210
200
190
180
170
160
150
140
130
120
110
1979
1980
1981
1982
1983
1984
1985
1986
1987

US INTERVENTION/ERI

1979 – SEPTEMBER 1987



85

4317.8

86

MAMC: D3

ERMP C/8

FROM: I POLIN
DATE: 2 November 1987

1. MR KELLY ✓ cwk 2.11

2. CHANCELLOR OF THE EXCHEQUER

Distribution

PPS
PS/EST
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Cassell
Mr Peretz
Mr Sedgwick
Mr R Allen
Mr Botttrill
Mr Hibberd
Mr Grice
Miss O'Mara
Mr Pickford
Ms Goodman
Mr Call

THE RESERVES IN OCTOBER 1987

The reserves announcement for October will be made on Tuesday 3 November at 11.30 am. This month's announcement reports a rise in the reserves of $6591 million and an underlying rise of $6699 million. Foreign currency receipts from the US, Canadian and Japanese offers of BP shares amounted to $1537 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
Miss J Plumbly)
Mrs Jupp)

14/226

87

D FT PRESS NOTICE

THE RESERVES IN OCTOBER 1987

The UK official reserves rose by $6591 million in October. Foreign currency receipts from the US, Canadian and Japanese offers of BP shares amounted to $1537 million. Accruals of borrowing under the exchange cover scheme amounted to $51 million; repayments of such borrowing amounted to $284 million. Capital repayments on assignments to HMG of other public sector debt taken out under the exchange cover scheme amounted to $3 million. The valuation change arising out if the quarterly rollover of the EMCF swap amounted to a rise of $128 million. At the end of October, the reserves stood at $41,399 million (£24,027 million*) compared with $34,808 million (£21,368 million+) at the end of September.

Note to Editors

2. After taking account of foreign currency borrowing and repayments, the underlying rise in the reserves during October, including the BP receipts, was $6699 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).

---

* When converted at the closing market rate on Friday 30 October £1=$1.7230

\+ When converted at the closing market rate on Wednesday 30 September £1=1.6290

88

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

South of Scotland Electricity Board, $29 million; Manchester City Council, $16 million; Staffordshire County Council, $3 million, Powys County Council, $2 million; Cheshire County Council, $1 million.

Repayments of such borrowing were:

Electricity Council, $105 million; British Coal, $56 million; British Airways plc, $37 million; Yorkshire Water Authority, $25 million; North West Water Authority, $20 million; Northumbrian Water Authority, $19 million; British Nuclear Fuels plc, $5 million; Grampian Regional Council, $5 million; Lothian Regional Council, $3 million; North of Scotland Hydro Electricity Board, $3 million; British Rail, $2 million; British Telecommunications plc, $1 million; Humberside County Council, $1 million; Port of Tyne, $1 million; Others, $1 million.

4. The quarterly rollover of the EMCF swap, ie 20 per cent of the UK's gold and US dollar reserves, entailed a valuation increase of $128 million. This largely reflects the rise in the ECU value of gold, as valued by the EMCF. For the purposes of the swap, the EMCF values gold and dollars in terms of ecus at rates determined quarterly, whereas the UK values gold and ecus held in the reserves on an annual basis.

89

THE RESERVES IN OCTOBER 1987 : PRESS BRIEFING

Factual : main features of markets in October

	£ ERI	$/£	DM/£	$ ERI	DM/$	Yen/$
1 October	72.8	1.61¼	2.98½	102.4	1.84½	147
8 October	73.3	1.64¼	2.99¼	101.3	1.82¼	145
14 October	73.3	1.65½	2.99½	100.5	1.81	142½
20 October	73.4	1.65½	2.99	100.8	1.80½	143¾
23 October	73.5	1.66	2.99½	100.7	1.80¼	143½
27 October	74.1	1.69¼	2.99½	99.6	1.77	142
30 October	74.6	1.72¼	2.98	98.5	1.73	138½

Sterling began the month around $1.62 and 73.0 in effective terms, but then it rose against the dollar with the markets continually testing the DM3 level. During the middle of the month it traded thinly and was mostly on the sidelines, as the markets focused their attention on the dollar and world equity markets. On publication of better-than-expected UK trade figures for September on 23 October it rose sharply to 73.5, $1.6615 and DM 2.99½. The Bank then signalled a ½% cut in their dealing rates. This signal had little immediate effect on the exchange rate, nor did the decision by most high street banks to lower their base rates. It reached a five-year high of $1.73 on 29 October but the deutschemark benefitted more than sterling from the dollar's decline, easing the cross rate to DM 2.97¾.

The dollar began the month trading around DM 1.84½ and Yen 147 showing a slightly firmer tendency evident since September's meeting of G7 ministers. Fears that US interest rates would have to rise in order to counter the rise in long-term rates in Japan and news of an improved US unemployment rate of 5.9% underpinned the currency. However failure to breach DM 1.85 and Yen 147½ and firming German and Japanese interest rates pushed the currency down to DM 1.8230 and Yen 145.30. News o. a ½% rise in US prime rates on 7 October temporarily stabilised the currency. But publication of a worse-than-expected US trade deficit for August of $15.7Bn caused the dollar to fall sharply to DM 1.8090 and Yen 142.50. Following US Treasury Secretary Baker's criticism of other countries' interest rate levels the dollar fell to DM 1.77. However the Baker/Stoltenberg 19 October meeting and Stoltenberg's subsequent statement underscoring Louvre Accord brought a dollar rebound above DM 1.81. Initially falls in the equity markets had little impact on the foreign exchange markets. But they contributed to a very bearish nervous mood and rumours of a G7 meeting took the dollar to DM 1.8032 on 23 October and to a seven year low of DM 1.7210 on 29 October not helped by Delors' speech about the US being prepared to see a DM 1.60 level (subsequently denied by US Treasury). At the end of the month concerted intervention steadied it at DM 1.7285 and Yen 138.35.

Previous reserve changes

(i) Reserve changes this year have been:

		Underlying Change	Total Change
			$ million
1987	January	+ 72	+ 29
	February	+ 287	+ 305
	March	+ 1785	+ 1892
	April	+ 2912	+ 2768
	May	+ 4760	+ 4872
	June	- 230	- 315
	July	+ 499	+ 551
	August	- 457	- 550
	September	+ 380	+ 443
	October	+ 6699	+ 6591
	Totals	+16707	+16586

(ii) This month's underlying change is the largest ever. The previous largest was in May this year ($4,760 million). Before that the largest underlying change was in October 1977 ($3,036 million).

(iii) Previous monthly underlying increases exceeding $1 billion were:

	$ million
October 1987	+ 6,699
May 1987	+ 4,760
October 1977	+ 3,036
April 1987	+ 2,912
January 1977	+ 1,915
July 1977	+ 1,794
March 1987	+ 1,785
September 1977	+ 1,768
March 1977	+ 1,075

(iv) Previous highest levels of spot reserves were;

	$ million
July 1987	34,915
September 1987	34,808
May 1987	34,679
August 1987	34,365
June 1987	34,364
April 1987	29,807
March 1981	28,469
February 1981	28,434
January 1981	28,394
August 1980	28,291
May 1980	28,284

Bank Base Rates

Base rate changes this year have been:

		Base Rate	Change
1987	10 March	10½	Down ½%
	19 March	10	Down ½%
	29 April	9½	Down ½%
	11 May	9	Down ½%
	7 August	10	Up 1%
	26 October	9½	Down ½%

93

POSITIVE

1. Further substantial rise this month. Reserves now very strong after substantial underlying increase of $17 billion in year so far. Reserves now stand at record level of $41.4 billion.

2. Since the Budget sterling has remained broadly stable.

3. Recent statements by Baker, Stoltenberg and Poehl have reaffirmed continued support for Louvre Accord.

DEFENSIVE

(A) **POLICY**

1. **Is sterling pegged to the DM?** Under Louvre Accord agreed to seek a period of stability in major currencies (including yen and dollar). Bound to affect bilateral rates.

(B) **LOUVRE/G7/WASHINGTON**

2. **Louvre Accord coming unstuck?** No. Both US Treasury Secretary Baker and German Finance Minister Stoltenberg have reaffirmed commitment to cooperate on monetary and exchange rate policies.

3. **Recent dollar fall means Louvre Accord falling to pieces?** See above. Concept of managed floating does not rule out adjustments from time to time in response to significant events.

4. **Will there be another G7 meeting in the near future to discuss recent market events?** No present plans for a meeting. But Chancellor said on 30 October in radio interview that he was in favour of holding a G7 meeting to discuss falling stock exchanges and the weak US dollar if a "sensible package" was prepared beforehand. G7 countries have been in constant communication with each other about recent events.

5. **Details of intervention?** Policy never to discuss.

6. **Have other countries been intervening over the last month/recently?** Ask them. Don't discuss details, but statements by other authorities do indicate this.

7. **Concerted intervention in foreign exchange markets pointless before underlying fundamentals have been resolved?** Intervention is one instrument in Louvre Accord. Chancellor said in House on 27 October "we did not intervene in order to stabilise markets until we had first intervened in a massive way following the Plaza agreement to drive the dollar down, and we only intervened to stabilise it after the deutschemark and yen had risen by as much as 50 per cent against the dollar in order to give that massive change in exchange rates time to work through."

(C) **INTEREST RATES/MONETARY POLICY**

8. **Prospects of further co-ordinated interest rate cuts?** Wait and see. Unhelpful to speculate.

9. **German monetary policy not helpful?** Chancellor said in speech to Stock Exchange on 26 October: "It would be helpful if German monetary authorities were to show more awareness of [unhelpful consequences of] undue monetary tightening."

10. **Is exchange rate now only thing driving UK interest rates?** Not at all. Interest rates continue to be set in the light of a range of factors affecting financial conditions including asset prices. But for all G7 countries exchange rate stability is an increasingly important objective.

11. **Interest rate cut made because sterling near DM 3 level?** No change in policy. No explicit target; decision on interest rate taken in the light of monetary conditions as a whole.

12. **Why did Government act to lower interest rates on 23 October?** Sharp falls in share prices throughout world will tighten monetary conditions somewhat. Judged ½ per cent reduction in interest rates consistent with prudent policy.

13. **Implication of recent heavy intervention for UK monetary conditions/funding?** Policy is full fund of PSBR over financial year as a whole. Intervention will be sterilised.

14. **Aren't you going to make a loss buying dollars on this scale in a falling market?** Much to early to tell. [Smoothing intervention has been profitable in the past, although that of course is not the reason it is undertaken].

15. **Is it true that the Bank have been switching dollars into deutschemarks and yen to limit the risk of losses on intervention?** [FT article 2 November 1987].
Never discuss detailed reserves transactions.

(D) **IMF SPEECH**

16. **What are current exchange rate bands for the dollar?** Not helpful to comment.

17. **Return to Bretton Woods?** No: in his speech Chancellor explicitly spelt out why he was not advocating return to Bretton Woods. Good idea if you were to read the speech. In it he defined objective as .... "to maintain the maximum stability of key exchange rates, and to manage any changes that may be necessary in an orderly way."

(E) **EXCHANGE RATE MECHANISM (ERM)**

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

19. **Conditions required for UK participation?** Not possible to specify precisely. Number of factors and their interaction need to be taken into account. It would be wrong to commit Government in advance; circumstances change, nor would it help conditions in the foreign exchange market to be too specific.

(F) **RECENT MARKET EVENTS**

20. **Stock market collapse due to "volatility" shifting out of forex markets?** No reason to think so. Stability in all markets desirable.

(G) **SALE OF BP SHARES**

21. **Did all the underwriters from Japan, Canada and the US meet their obligations?** Yes.

22. **Why aren't sales to Europe included?** Paid in sterling and will be received in November.

23. **Have previous privatisation issues with an overseas element added to level of Reserves?** Yes, in those cases where share issues made overseas were paid for in foreign currency eg British Gas and British Telecommunications Plc.

24. **What does the Bank BP arrangement mean for the Reserves?** Nothing, it is a sterling transaction.

97

TABLE 3 - TOTAL PUBLISHED RESERVES

	Total reserve changes during month	$ billion Level at end of month
USA	- 0.9 (end September)	45
Japan	+ 1.4 "	72
Germany	+ 1.0 (w/e 23 October)	50
France	- 0.4 (end August)	69
Italy	- 3.3 "	46
Canada	+ 0.1 "	6
United Kingdom	+ 6.7 (end October)	41

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.

MG1 file

R Peretz
Yes. Fine.
[initials] 10/11

98

From : D L C Peretz
Date : 6 November 1987

SIR G LITTLER

cc PPS
PS/EST
Sir P Middleton
Sir T Burns
Mr Cassell
Mr C W Kelly
Mr R I G Allen
Ms H Goodman o/r
Mr Cropper

Mr Gill - B/England

D3

The Chancellor said in the House yesterday that "we have been buying dollars, deutschemarks and yen" for the reserves.

2. Although we have not, I think, before confirmed in public that we have intervened to buy deutschemarks, I do not think that causes any particular difficulty. The Bundesbank know that the Bank of England were doing this, regularly, up to a few weeks ago - and they were happy with this at a time when the dollar was relatively strong against the DM. And while on the whole it has served us well to comment as little as possible on the details of intervention, I see no harm in letting it be known that we sometimes intervene in currencies other than the $.

3. The Bank of England, however, are a little more concerned that they might get asked about this by the Bank of Japan. The Bank of Japan asked some time ago that we should avoid selling £s for yen in the market : and in fact the Bank of England have not done so (though we have found other ways to switch some of our dollars into yen).

4. As I told you earlier today, I have agreed with the Bank of England that if any questions about this do come up we should simply say that the yen proceeds of the BP sale were of course paid into the reserves on 30 October. That is the line the Bank will take with the Bank of Japan if they have noticed the reference (apparently their London representative is very assiduous).

DLCP

S60/87

D L C PERETZ

psl/21A

99

1 Ms Goodman
I assume you will tell the Bank

2 Mr Peretz o/R

I have already (?) I have

FROM: A C S ALLAN
DATE: 25 November 1987

MR PERETZ

cc PS/Economic Secretary
Sir P Middleton
Sir G Littler
Mr Cassell
Miss O'Mara
Mr R I G Allen
Ms Goodman

NOVEMBER RESERVES

The Chancellor was grateful for your minute of 24 November and is content with what you and Mr Gill propose.

ACSA

A C S ALLAN

file

S61/87

COVERING

Reference 100

FROM: I. POLIN
DATE: 27 NOVEMBER 1987

1. MISS O'MARA
2. MR. PICKFORD

D3

c Mr. Cassell
Mr. Peretz
Mr. Sedgwick
Ms. Goodman
Ms. Ryding
Mr. Gill
Mr. Reid
Mr. Smeeton
Mr. Milne
Miss. Plumbly
Mrs. Jupp
BANK

THE RESERVES IN NOVEMBER 1987

I attach the draft press notice, Q and A briefing and press material for Wednesday 2 December announcement.

2. I would appreciate any comments and/or suggestions from recipients by close of play next Monday (30th)?

3. Please excuse the very tight deadline and manuscript changes to the briefing.

Ian Polin

MG1

x 5556

CODE 18-77