

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

Reference MG-MAMC/D/0002/001

File begins 03/05/1988

Pages 223-242

hi

From : D L C Peretz
Date : 22 August 1988

CHANCELLOR

D2

cc Sir G Littler
Mr Scholar o/r
Miss O'Mara o/r
Mr N Williams

END MONTH RESERVES

We need to take a provisional decision about what reserves figure to publish on 2 September, to guide the Bank's swapping operations over the next few days.

2. Friday 26 is the last dealing day for August. As things stand at present the true underlying rise in the reserves in August (which includes some substantial intervention done at the end of July for value in August) is about \$500m. This will not surprise the market. It may of course be reduced or increased by any intervention this Thursday and Friday after the trade figures.

3. Either way, I would recommend publishing a more or less true figure this month.

↑

DLCP

D L C PERETZ

940/ks



FROM: MISS M P WALLACE

DATE: 23 August 1988

*MISS O'MARA
OIR*

MR PERETZ

cc Sir G Littler
Mr Scholar
Miss O'Mara
Mr N Williams

D2

File

END MONTH RESERVES

The Chancellor has seen your minute of 22 August. He has commented that he agrees with your recommendation, in principle - but may want to consider the issue again if the position changes at all.

Mpw.

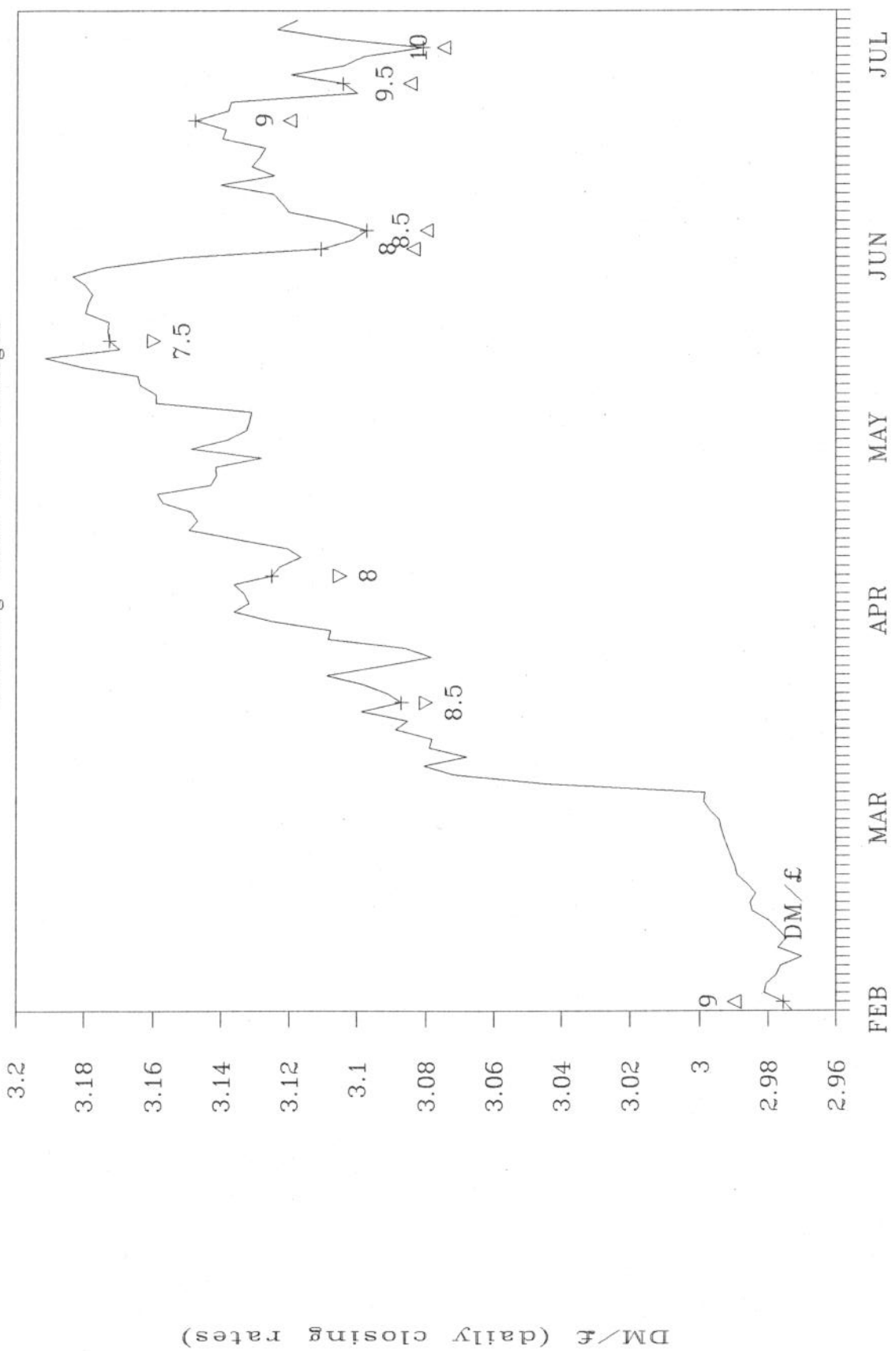
MOIRA WALLACE

94/88

DM/Sterling Exchange Rate

72

showing base rate changes



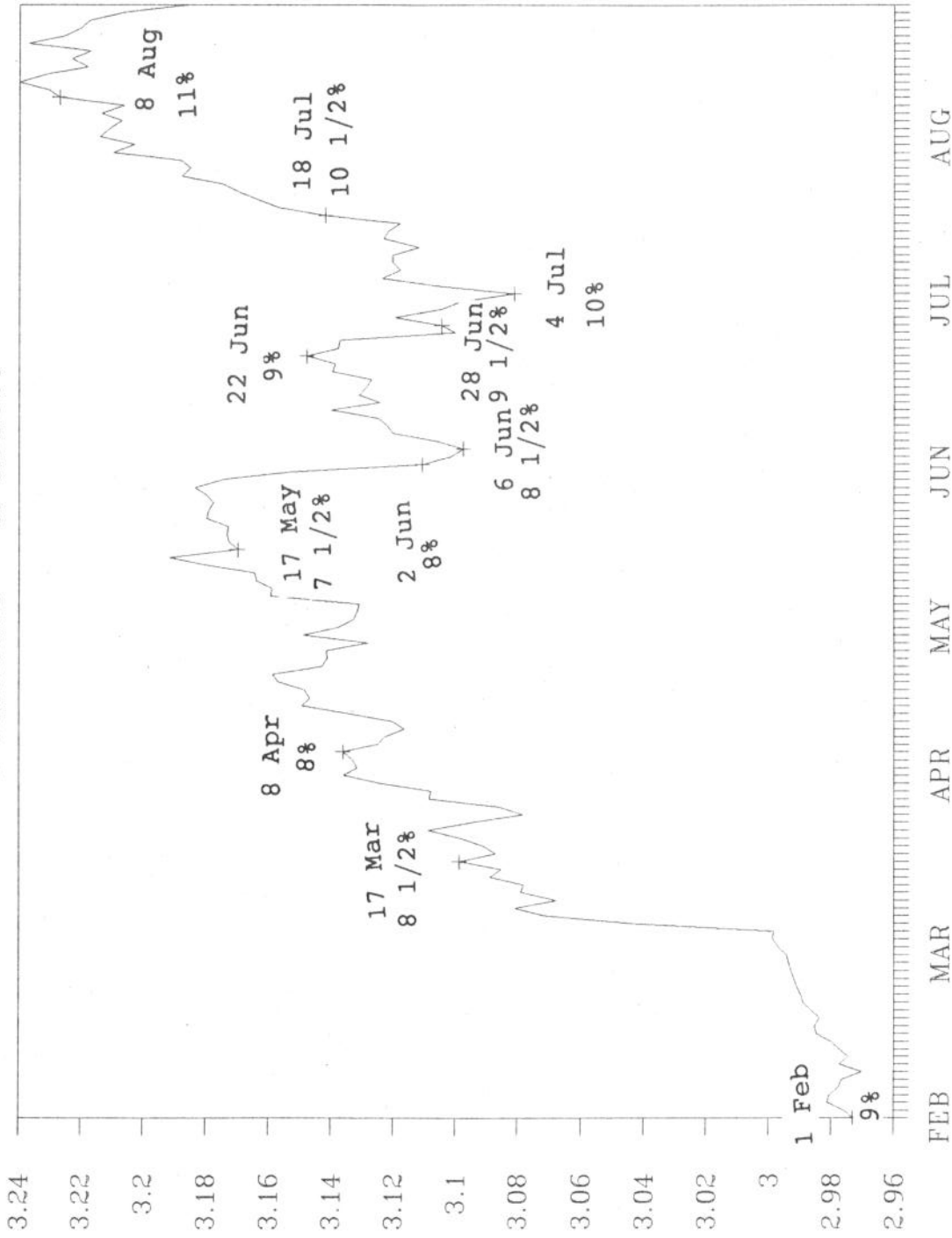
1988

22

72

DM£/INTEREST RATES

1 FEBRUARY - 24 AUGUST



(Daily Data)

— DM£

1 *ck*
221

From : D L C Peretz
Date : 30 August 1988

CHANCELLOR

A N

cc PS/CST
PS/EST
Sir G Littler
Mr Scholar o/r
Miss O'Mara o/r
Mr N Williams
Mr Bush

Mr M Foot - B/E

AUGUST RESERVES : BRIEFING

You asked to have in your box tomorrow morning a draft of the briefing for Friday's reserves figures. This is attached.

2. We do not yet have the final figures for the month (there may be a few one or same day-value transactions to come) but it looks as if the total underlying rise in the reserves will be of the order of \$940 million, of which \$612 million represents US and Canadian dollar proceeds from the BP part payment.

3. We may of course have to adjust the Q and A briefing to take account of any development or relevant press comment between now and Friday. We aim to put the final version to the Chief Secretary, for clearance, on Thursday evening.

DLCP 942/55

D L C PERETZ

228

FROM: I POLIN
DATE: 30 August 1988

- 1. MR PERETZ
- 2. PS/CHANCELLOR

DUP 30/8

cc PS/CST
PS/EST
Sir G Littler
Mr Scholar ^{o/r}
Miss O'Mara ^{o/r}
Mr Bush
Mrs Ryding
Mr N P Williams
File: ERMP C/11

THE RESERVES IN AUGUST 1988

I attach the first draft of the August Reserves briefing for your box this evening. The final version will be circulated as normal, on Thursday 1 September.

2. The reserves announcement for August will be made on Friday 2 September at 11.30 am. This month's announcement reports a rise in the reserves of \$[925] million and an underlying rise of \$[939] million. US and Canadian dollar receipts from second call of BP shares amounted \$[612] million.

Ian Polin
I POLIN

DRAFT PRESS NOTICE

THE RESERVES IN AUGUST 1988

The UK official reserves rose by \$[925] million in August. US and Canadian dollar receipts from second call of BP shares amounted to \$[612] million. Repayments of borrowing under the exchange cover scheme amounted to \$[14] million. There was no borrowing under the exchange cover scheme this month. After taking account of the repayments of foreign currency borrowing, the underlying change in the reserves during August, and including BP receipts, was a rise of \$[939] million. At the end of August, the reserves stood at \$[50,751] million (£[30,128] million*) compared with \$49,826 million (£29,112 million+) at the end of July.

Note to Editors

2. The underlying change 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) and on the Telerate Monitor (Code 22494).

* When converted at the closing market rate on Wednesday 31 August [£1=\$1.6845]

+ When converted at the closing market rate on Friday 29 July £1=\$1.7115

3. There was no new borrowing under the public sector exchange cover scheme this month but repayments of such borrowing were as follows:

THE RESERVES IN AUGUST 1988 : PRESS BRIEFING

Factual : Main features of markets in August

	<u>1 August</u> <u>(cob)*</u>	<u>Month's</u> <u>High</u>	<u>Month's</u> <u>Low</u>	<u>31 August</u> <u>(Cob)*</u>
£ ERI	76.6			
\$/£	1.7127			
DM/£	3.2142			
\$ ERI	98.7			
DM/\$	1.8767			
Yen/\$	132.80			

*cob = close of business.

[Text to be supplied by the Bank.]

Previous reserve changes

(i) At beginning of January 1987, reserves stood at \$21,923 million; at end of December 1987, they stood at \$44,326 million, a rise of \$22,403 million (including 1987 revaluation of + \$2,879 million).

(ii) The underlying rise in reserves in 1987 totalled \$20,475 million.

(iii) Reserve changes since from beginning of 1988 have been:

		<u>\$ million</u>		
		<u>Underlying change</u>	<u>Total change</u>	<u>Level of reserves at end period</u>
1988	January	+ 38	- 1,233	43,093
	February	- 25	- 166	42,927
	March	+ 2,225	+ 1,713	47,519+
	April	+ 514	+ 338	47,857
	May	+ 814	+ 676	48,533
	June	+ 84	- 14	48,519
	July	+ 910	+ 1,307	49,826
	August	-----	-----	
	Totals	+ 4,560	+ 2,621	

+after revaluation of + \$2,879 million.

(iv) October 1987 underlying change of \$6,699 million was largest ever.

(v) Reserves in August of \$ million were highest ever.

Level of official debt

Now stands at \$16.7 billion at end July*. Latest published figure, \$17.3 billion at end April in Bank of England Quarterly Bulletin, August 1988, Table 17.2. (In May 1979 was \$22 billion.)

*at end July market rates.

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POSITIVE

1. Reserves remain very strong Now stand at record level of \$[51] billion.
2. Level of official debt has been reduced substantially. At beginning of 1987 was \$19.3 billion and at end of July 1988 was \$16.7 billion. (In May 1979 was \$22 billion.)

DEFENSIVE

(A) POLICY

1. Exchange rate policy: Government maintaining firm monetary policy to ensure downward pressure on inflation. Exchange rate policy is part of total economic policy. Government uses available levers, both interest rates and intervention, to affect rate as seems right in circumstances.
2. Abandoned managed floating ideas? No. But always made clear first priority must be defeat of inflation. Budget Speech etc. Normally will not be any conflict between domestic and external criteria. And exchange rate significantly lower than May peak. Within context of anti-inflationary strategy, policy remains to seek to achieve reasonable exchange rate stability.
3. Tactics: As Prime Minister reminded House on 17 May, available instruments - interest rates and intervention - will be used as seems right in circumstances. But not sensible to reveal operational details or be more precise.
4. Is Government targetting sterling - deutschemark, sterling - dollar rate/sterling exchange rate index (FERI)? Not helpful to talk about any particular level/rate.
5. Current account position means Government should let exchange rate fall? No. Made it clear time and time again that Government will not accommodate inflation by exchange rate depreciation. Holding down unit costs - which is in industry's own hands - key to improved competitiveness.

6. International monetary co-ordination not working?

International cooperation is alive and well; Commentators should not always look for headline catching response to exchange rate fluctuations. Essence of coordination lies in consultation and that has been taking place.

7. Were recent international interest rate rises coordinated? G7 ministers keep in close touch with each other.

(B) INTERVENTION

8. Why an underlying rise in reserves after fall of sterling last week? Never discuss details of intervention but remember figure include BP proceeds and it also covers period at beginning of August [and IF PRESSED figure includes last two working days of July.]

9. Value of intervention as instrument? Has important role to play in checking undesirable fluctuations in either direction in exchange rates which do not reflect underlying fundamentals.

10. Intervention inflationary? Only poses inflationary threat if not funded. Government made clear intervention will be fully funded (as in 1987-88) so that effect on liquidity sterilised.

11. Details of intervention? Policy never to discuss.

12. Have other countries been intervening over last month/recently? Never discuss details but well known there has been concerted intervention over recent period.

13. Have Bank been selling dollars for deutschemarks? Never discuss detailed reserves transactions.

(C) INTEREST RATES/MONETARY POLICY

See also separate Q and A briefing on interest rate rise provided to IDT etc on 25 August.

14. Monetary policy: [Policy recently stated by Chancellor to Institute of Economic Affairs, 21 July.]

Ultimate objective of stable prices stands. Abolition of various controls within financial system, well justified on merits, has made it difficult to rely solely on monetary targets; inevitably places more weight on short term interest rates as essential instrument of monetary policy.

15. Why raise interest rates when exchange rate against deutschemark so high? Interest rates now set on purely domestic criteria? No. Aim to achieve further monetary tightening (continuing process begun in February) taking account of all monetary indicators including the exchange rate and not just sterling/deutschemark and sterling exchange rate index (£ERI) but rate against dollar also important.

(D) EUROPEAN MONETARY INTEGRATION

16. UK membership of exchange rate mechanism (ERM)? Matter kept under continual review. Will join when Government considers time is right.

17. Recent interest rate moves would not have been necessary if UK had been in ERM? Joining ERM would not be soft option. Countries within ERM frequently change their interest rates.

18. Sterling's recent fluctuations would not have occurred if UK had been in ERM? Countries within ERM not protected from realignments.

19. Join ERM by 1992? No fixed timetable. Will join when time is right.

20. Proposals for European Central Bank and common European currency? UK's own position perfectly clear. Proposals for common currency/European Central Bank presuppose readiness to surrender national control over monetary policy and that all Member States pursuing same economic policy. Not in prospect. Should focus on practical developments. UK's new ecu bill programme good example of what can be done.

(E) GOVERNMENT FOREIGN CURRENCY BORROWING PROGRAMME AND FORWARD PURCHASES

[NB Avoid any reference to forward book.]

See also separate Q and A briefing on FRN prepayment and ECU bill programme provided to IDT etc on 1 August 1988.

21. When will further details be available for new UK ECU Treasury Bills? Full details will be provided by Bank of England later this month.

22. Is repayment of 1992 debt and refinancing by short-term bill programme sensible in view of recent events? Reserves at record level of \$[51] billion (increased by [\$2.2 billion] in last two months). Decision made as part of overall reserves management. FRN not particularly cheap source of foreign currency finance. First opportunity to call US \$2.5 billion FRN. New ECU bill programme will be secure and flexible source of funds.

23. Have authorities bought forward currency other than that required to prepay FRN? Never comment on operations in markets. [But National Audit Office (NAO) report published in January noted MOD now makes forward purchases of deutschemarks and dollars from Bank.]

24. How much currency have authorities bought forward? No comment.

25. How long have authorities been buying currency forward? No comment.

26. Have forward purchases been used to ease pressure on sterling? No comment.

27. Have forward purchases distorted underlying change in reserves? Never comment on market operations. But in any case wrong to assume underlying change reflects market intervention in month; as Government has always made clear.

23'
(F) SALE OF BP SHARES

28. Why are you only receiving dollars and Canadian dollars from the overseas element of second call of the BP share issue?

Receipts cover partly paid BP shares in American Depositary Receipts (ADR) form held in US and Canada payable in dollars and Canadian dollars on 30 August. (An ADR is a certificate traded in dollar form, quoted and paid for in dollars representing an entitlement to securities in non-dollar currencies).

29. Why aren't sales to Europe and Japan included? Paid in sterling.

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



Mr. Peretz
Mr. Grice
Miss O'Mara
Mr. Brooks ✓
Mr. Nelson

23⁸

H M Treasury

Parliament Street London SW1P 3AG

Switchboard 01-270 3000
Direct Dialling 01-270 4369

30 August, 1988

Sir Geoffrey Littler KCB
Second Permanent Secretary
E.A.J. George, Esq.,
Executive Director,
Bank of England,
Threadneedle Street,
LONDON, EC2R 8AH.

D/2

Dear Eddie,

INVESTMENT OF THE RESERVES

----- We discussed your six-monthly review paper of 26 July, and two background papers, on 28 July and I am writing to confirm the decisions we took. I also attach a more detailed note of the meeting.

2. We agreed that it was sensible to plan on the basis that the dollar would weaken from current levels, although the timing is uncertain. I agreed with your suggestion that the yen may well rise less than the DM in the short term. In the light of these considerations we agreed that the EEA's exposures shown in paragraph 22 of your paper are broadly appropriate in current circumstances.

3. We also agreed the various recommendations set out in the introduction to your paper. We will switch up to a further \$1 $\frac{3}{4}$ billion out of the dollar at levels above DM 1.90 and Y 150. We also agreed that, in the event of a sharp fall in the dollar, we should look to reduce the short dollar position, principally by sales of DM, and that we should be willing to start going short of DM and Yen at around DM 1.70 and Y 130. I agreed with your proposal that we should switch from DM into Yen as the DM strengthens so that we hold mostly Yen against the short dollar position at cross rates above 75.

4. You explained that your view of interest rate prospects was more tentative than for exchange rates. We agreed to begin to reduce progressively the short position in the US market as yields rise from current levels and consider the establishment of a long position in the US market at 4-year yields above 9 $\frac{1}{2}$ %. We also agreed with your proposals for the DM and Yen markets in paragraphs 51-53 of your paper.

5. Since both the dollar interest rate and exchange rate prospects are more clouded than usual, because of the US election, we agree we should keep all these conclusions under careful review in the light of developments.

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/6. We

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We had a useful discussion of your paper of 6 July on the profitability of reserves management. I am particularly pleased to note the progress in this area since our last meeting, and we agreed that the work is broadly on the right lines. We agreed that a neutral currency exposure of 40% dollars, 40% DM bloc and 20% Yen is appropriate in present circumstances. We envisaged circumstances in which the ratio might change, but agreed that it is not useful to alter the ratio by small amounts frequently. We also agreed that the normal ranges for net currency exposures are a useful basis for currency decisions, but the ranges should have soft edges. We agreed that while we would not wish to change these assumptions very often it would be helpful to review these in six months' time and thereafter at successive six-monthly meetings. I was interested to hear of your work on developing an interest rate neutral assumption, and ranges, to mirror the treatment of currency exposures. It would be helpful to discuss progress in this area at the next meeting.

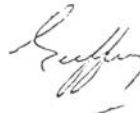
7. I noted your proposal to introduce a further component - the cost of liquidity - into the calculations of profitability. We also agreed that the enhancement of your computer systems would mean that the calculations take account of the prices of individual deals.

8. We agreed that in future gold will not be purchased to cover publicly explainable sales (for coinage, medals, etc.). We also agreed to keep the idea of gold sales in mind if other opportunities for sale arise, especially if and when we go through a period of reduction of reserves. However, there is no need for immediate action on this last idea, and we should ensure that our operations remain low profile.

9. Finally, we agreed to your proposals on:-

- (i) renewal of the existing annual limit on our gold deposit business;
- (ii) EEA issuer limits;
- (iii) limited trading in futures; and
- (iv) seeking legal advice on whether EEA assets are held in a manner which takes maximum advantage of sovereign immunity.

Yours,



GEOFFREY LITTLER



FROM: MISS M P WALLACE

DATE: 31 August 1988

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MR D L C PERETZ

cc: PS/Chief Secretary
PS/Economic Secretary
Sir G Littler
Mr Scholar o/r
Miss O'Mara o/r
Mr N Williams
Mr Polin
Mr Bush

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AUGUST RESERVES: BRIEFING

The Chancellor was grateful for your minute of 30 August, with the draft reserves briefing. He had the following comments.

Draft Press Notice

- (i) First para - amend first sentence to read: "...in August, of which US and Canadian dollar receipts from the second call of BP's shares..."
- (ii) First para, penultimate sentence, amend to read: "...the underlying change in the reserves during August, including the BP receipts was a rise..."

Press Briefing

- (iii) Positive 2 - add at end a reminder of the forthcoming FRN^{re} payment.
- (iv) Defensive 2 - add new second sentence: "But requires international agreement. Moreover, always made clear..."

944/88



- (v) Defensive 6 - amend answer to read: "International co-operation is alive and well, as recent events have shown." (Delete rest of answer).
- (vi) Defensive 8 - end answer after "BP proceeds".
- (vii) Defensive 14 - amend last sentence to read: "...inevitably places more weight on exchange rates. Short term interest rates essential instrument of monetary policy."
- (viii) Defensive 15 - delete "No" and amend rest of answer to read: "Aim was to achieve further monetary tightening (continuing process begun in February) taking account of all monetary indicators including the exchange rate (and not just sterling/deutschemark exchange rate).
- (ix) Defensive 18 - amend to read: "Countries within ERM not necessarily protected..."
- (x) Defensive 20 - in final sentence, we should give the ecu Treasury Bill programme its full name.
- (xi) Defensive 22 - delete third and fourth sentences *of answer*


MOIRA WALLACE

242

Polin

FROM: I POLIN
DATE: 1 September 1988

- 1. MR PERETZ
- 2. CHIEF SECRETARY

- cc Distribution
 PPS
 PS/EST
 Sir P Middleton
 Sir T Burns
 Sir G Littler
 Mr Lankester
 Mr Scholar
 Mr H Evans
 Mr Odling-Smee
 Mr Sedgwick
 Mr Gieve
 Mr Grice
 Mr Pickford
 Mr Bush
 Mrs Ryding
 Mr N P Williams
 Mr Hudson
 Mr Segal
 Mr Cropper
 Mr Call

2

THE RESERVES IN AUGUST 1988

The reserves announcement for August will be made on Friday 2 September at 11.30 am. This month's announcement reports a rise in the reserves of \$813 million and an underlying rise of \$827 million. US and Canadian dollar receipts from second call of BP shares amounted \$495 million. The attached note by Mr Jarvis in PE division explains why the original estimate of \$612 million for BP share receipts has been reduced.

Polin

fp
I POLIN

Also copies to:

- Mr Gray - No 10
- Mr Cassell - Washington (after publication)

- Mr M Foot)
- Mr D J Reid)
- Mr J Milne) B/E
- Miss J Plumbly)
- Mrs Jupp)