Note
Discussed with PM who decided to wait for market developments over the next 24 hours before deciding whether to discuss with the Chancellor.
PRCG 3/3

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PRIME MINISTER

EXCHANGE MARKET INTERVENTION

For most of yesterday and today sterling has been hard up against DM3. Throughout yesterday and today in London it has regularly bounced off that "ceiling" of its own accord but overnight in New York the Bank of England engaged in heavy intervention. I was told last night this might be some $50 million; in the event I learned this morning it had been $400 million. And this afternoon they have intervened a further $50 million when New York opened.

There has been no intervention in London.

Yesterday's intervention in New York was in dollars. But the whole amount has been switched into ecus in London today. This afternoon's intervention has been in DM and FF.

I have made clear to the Treasury your opposition to this policy. I have also probed with them the terms of the Chancellor's authority to the Bank to undertake intervention. They are coy about this. But as far as I can see it amounts to:

- carte blanche for overnight intervention;
- effectively carte blanche for intervention during the day but on the basis that the Treasury is immediately told what is going on.

Following the decision to raise interest rates on 1 February, I wrote to the Treasury (attached) stressing your opposition to intervention to hold sterling below DM3. The Treasury seek to defend last night's action by saying that it will not add to domestic liquidity because we have already over-funded it.

I have warned the Chancellor's office that you may want to have an early word with him about all this. He is free from 5.00 pm today. Would you like us to call him in?

PRCG.

PAUL GRAY

3 March 1988

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10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

1 February 1988

Dear Alex,

INTEREST RATES

The Chancellor discussed with the Prime Minister this morning the position in the markets and proposed that the Bank of England should signal a half per cent increase at noon. Given that sterling had fallen during the morning against the dollar and deutschmark he did not expect a half per cent increase to lead to sterling pushing up against DM3. He also did not expect this to lead to any increase in building society rates.

The Prime Minister said she was content for some tightening of the monetary stance. However, if in the event higher interest rates did lead to sterling pushing up against DM3, she would be strongly opposed to any intervention and hence to a boost to domestic liquidity offsetting the impact of the interest rate rise. It was only on this basis that she was prepared to agree to the half per cent interest rate rise.

The Prime Minister also noted that the end January Reserves figure had been reduced by an EMCF revaluation of $600 million. The Chancellor agreed to provide a note setting out the background to this adjustment.

Yours,

Paul.

(PAUL GRAY)

Alex Allan, Esq.,
H.M. Treasury.

SECRET