a été 'tapé' pour lecture à partir de son manuscrit

7th December 1987

STERLING SINCE OUR LAST MEETING

The policy dilemmas of which I have often spoken at this meeting have become particularly acute.

- It is a prime objective of policy to maintain sterling at approximately its current parity with the Deutsche Mark. This is considered to be an appropriate anti-inflationary discipline without imposing a penal loss of competitiveness on UK industry.

- At the same time the rate of growth of the UK economy, anyway before the stock market fall, is now soon to be faster than we had supposed. Consumption has been buoyed up by rapidly rising personal income and an apparent fall in savings ratio. Trade performance has been better than in the past and despite rapid growth in domestic demand, current account deterioration has been more gradual than we had forecast. It's yet too early to feel the effect of the stock market fall, but a first survey of CBI members since has been remarkably bullish on investment intentions and order books.

- Domestic inflationary pressures are still a cause for concern. Year-on-year RPI rose from 4 1/4 per cent. in September to 4 1/2 per cent. in October. Year-on-year earnings increase in September was 7 3/4 per cent., as in August. Money supply aggregates are still very strong - even narrow money is strengthening, albeit within target. Sterling bank lending is still increasing by £ 3 billion or more per month. Heavy intervention in the market also has its effect.

- In such circumstances, it is not at all clear that lower domestic interest rates are appropriate, although we have had 3 x 1/2 per cent. reductions since 19th October to reflect tighter monetary conditions as a result of the stock market fall, as well as to participate in a concerted international effort. We abstained from the 24th November round, because for most of November we had not been hard pressed against our DM ceiling, but last week the pressures increased again and we joined with others in last Thursday's fall.

- The other monetary weapon available to us is foreign exchange intervention. As you can see from Table 1, we have been prepared to use this on a massive scale. In the first 11 months our US$ interventions have

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amounted to US$ 23 1/2 billion, nearly twice as much as our Spanish friends, five times as much as our German friends and nearly four times as much as our French friends.

- We are obviously more than prepared to do our part in any attempts to stabilise the dollar, and are second to none in our conviction that is should be stabilised, but clearly a significant proportion of that intervention was aimed at stabilising our own rate against the Deutsche Mark [- to the extent we have an E/R target - and our Chancellor and Prime Minister do not always sing quite the same tune in that respect - it is a DM target].

- We have been giving thought therefore to ways in which our intervention might be made more effective. It has been noticeable over the past week, for instance, that the upward pressures on sterling have come in the afternoon from New York, rather than from Europe. Maybe our massive dollar interventions have been giving the wrong signal the other side of the Atlantic.

- Our particular situation might, in isolation, suggest a case for intervention in Deutsche Mark - but that too would be a misleading signal:

- no wish to destabilise the ERM;
- no wish to suggest indifference to further dollar falls.

- It's better to intervene in the ECU. We were very disappointed to discover on Friday that only one of nine banks we approached would quote a £/ECU rate, and that one came not from Luxembourg or Brussels, but Dublin. We did what we could with them, but then intervened in a number of other European currencies in the lower part of the ERM band - French francs, Belgian francs, Italian lira. In all, this amounted to 270 million equivalent. Its effect on the market was somewhat neutralised by the concerted NY Fed/BB intervention in New York at the same time, but it is a formula we should like to repeat if the pressures on sterling continue.

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