



Treasury Chambers, Parliament Street, SW1P 3AG  
01-270 3000

7 September 1987

David Norgrove Esq  
10 Downing Street  
LONDON  
SW1

Dear David,

**FINANCIAL MARKETS**

You asked for a note on developments in the financial markets since the Chancellor and the Prime Minister last met (ie. just ... before the 6 August base rate rise). This is attached.

Yours  
Cathy

CATHY RYDING  
Assistant Private Secretary



## FINANCIAL MARKETS SINCE 5 AUGUST

The attached table and graphs show the main developments in domestic and foreign exchange markets since before the 1 per cent base rate rise on 6 August. Domestic markets, in particular the equity market, have been jumpy at times, with market makers, depleted by absences on holiday, unwilling to take positions and moving prices sharply without any great volume of business. They now appear to have settled down, with share prices some 7 per cent below their all-time high in mid-July. In the foreign exchange market the main factor has been the strength of the dollar in early August, partly reflecting Gulf tensions, reaching a peak of over DM 1.89 (with the \$/£ rate under 1.56); and its subsequent decline following the disappointing US trade figures on 14 August, to below DM 1.80 (with this \$/£ rate above 1.65).

### 5-7 August

2. Although unexpected, the 1 per cent rise in interest rates announced on 6 August had little impact in the foreign exchange market: the DM/£ rate remained steady at DM 2.96½. Much of the initial comment welcomed the move as a sensible tightening of policy made, as the Chancellor explained, on an assessment of a range of evidence. Nevertheless both gilts and equities fell sharply, with market participants fearing the interest rate rise meant the authorities knew of bad news on the way.

### 10-14 August

3. There was a particular worry that the June trade figures published on 11 August would be bad. When in the event the June current account deficit turned out to be much less than the £½ billion May deficit the market began to settle down, with both the gilt and equity markets gradually recovering though not to their 5 August levels. By Friday 14 August the three month interbank rate had settled back to 10 per cent.



17-21 August

4. The next event was publication of the July money figures, on 20 August. Again it was the gilt market, and to some extent the equity market, which fell sharply - with commentators focussing particularly on the high bank lending figure. Long gilt yields rose well above 10 per cent, reaching the highest level since January. There was little impact on the exchange rate, with the ERI on Friday 21 August standing at much the same level as a week earlier, despite a falling oil price.

24 August - 4 September

5. The pre-Bank Holiday week was relatively quiet in all markets, with domestic markets beginning to look ahead to the July trade figures published on 1 September. The current account deficit (over £300m) was at the top end of the range of market expectations, and all markets - including the exchange rate - initially fell a little. But they subsequently recovered on second thoughts about the closer analysis of the trade figures. On the following day the announcement of a larger than expected fall in the reserves in August had no effect; and the Chancellor's remarks on the radio at midday helped take both gilts and the exchange rate ahead (with the Bank taking the opportunity to intervene to steady sterling's rise, and recoup some of the dollars spent defending sterling against the dollar at the beginning of August).

6. The main focus of attention in recent days has been the weakness of the dollar. There has been concerted intervention by central banks (including the Fed) to support the dollar on most days since 28 August, and the Fed raised its discount rate on 4 September by ½ per cent, to 6 per cent, the first change in the discount rate since it was lowered to 5½ per cent in August 1986 and the first increase since 1984. (This move had little immediate impact on the dollar, which remained below DM 1.80).

4 September 1987



MARKET MOVEMENTS SINCE 5 AUGUST (CLOSING RATES)

|                  | £(ERI) | 3 month<br>interbank            | gilt<br>index | Equities (FTSE<br>100 index) | Oil Price<br>spot Brent<br>\$ per barrel |
|------------------|--------|---------------------------------|---------------|------------------------------|--|
| <u>August</u>    |        |                                 |               |                              |  |
| Wed 5            | 72.1   | 9 <sup>5</sup> / <sub>16</sub>  | 87.63         | 2317                         | 20.05                                    |
| Fri 7            | 72.0   | 10 <sup>7</sup> / <sub>32</sub> | 86.24         | 2226                         | 19.55                                    |
| Tues 11          | 72.2   | 10 <sup>1</sup> / <sub>8</sub>  | 86.57         | 2276                         | 19.20                                    |
| Fri 14           | 72.5   | 10                              | 86.93         | 2295                         | 19.25                                    |
| Wed 19           | 72.6   | 10 <sup>3</sup> / <sub>16</sub> | 86.36         | 2198                         | 18.60                                    |
| Thurs 20         | 72.4   | 10 <sup>5</sup> / <sub>16</sub> | <u>84.74</u>  | <u>2185</u>                  | 18.35                                    |
| Fri 21           | 72.6   | 10 <sup>3</sup> / <sub>16</sub> | 85.02         | 2206                         | 18.40                                    |
| Fri 28           | 72.5   | 10 <sup>7</sup> / <sub>16</sub> | <u>84.87</u>  | 2250                         | 18.47                                    |
| <u>September</u> |        |                                 |               |                              |  |
| Tues 1           | 72.8   | 10 <sup>7</sup> / <sub>16</sub> | 85.19         | 2273                         | 18.42                                    |
| Fri 4            | 73.0   | 10 <sup>1</sup> / <sub>4</sub>  | 85.71         | 2275                         | <u>18.20</u>                             |



# MOVEMENTS IN STERLING

3 AUGUST 1987 - 4 SEPTEMBER 1987

