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SECRET 4. 2.83

THE GOVERNOR

Copies to The Deputy Governor
Mr Coleby

MEETING WITH THE CHANCELLOR

You may wish to have the following points in mind for this morning's meeting.

1 The main message is that we need to have some contingency plan on how to react to a further precipitate downward move in the exchange rate, because that could reach a point, or proceed at such a market-disorientating pace that the whole of government strategy was put at risk.

2 Further decline of sterling as a result of oil price fears should probably not be resisted (although if it seems excessive, propaganda to show why the effects will not be so damaging should be mounted).

3 The most dangerous contingency would be a run on account of pre-election jitters if the current administration was thought unlikely to be returned. The weapons to deal with this are as usual - interest rate rises, intervention and (a outrance) exchange controls in circumstances of panic capital flight, all three might be needed if the government wanted to stop it.

4 In such circumstances intervention to be effective might have to be on quite a large scale: in April 1978 there was a true underlying fall in the reserves of $2.4 bn, with support on some days approaching $300 mn. To have much impact could require a willingness to expend sums of at least that sort of scale. (Note the size of intervention which the French and Belgians have been obliged to indulge in.)

5 It should be remembered that our reserves could not stand intervention at that pace for long, without a risk of further

deterioration of confidence through the loss of reserves. There would of course be swap facilities ($3 bn with the Fed, and possibly the "soutien" under the short-term monetary support mechanism, in which we have a debtor quota equivalent to some $1.7 bn. Additionally, some ad hoc short-term arrangement with the BIS might be feasible). Otherwise, the reserves are only likely to be capable of increase through renewed foreign currency borrowing. The only circumstances in which this might be feasible without it appearing to be a U-turn would be if US interest rates fell and we could validate a claim that it was sensible to be in the market when conditions were ripe.

6 We are of course not advocating this, but simply raising a marker that, should heavy intervention be required, our resources are already getting pretty low.

4 February 1983
Dictated by ADL

246