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TO IMMEDIATE FCO

TELEGRAM NUMBER 2211 OF 5 AUGUST

INFO BONN, PARIS, TOKYO, ROME, UKREP BRUSSELS AND OTTAWA

**US INTERVENTION IN FOREIGN EXCHANGE MARKETS**

1. WICKS AND EXETER CALLED ON DALLARA (DEPUTY ASSISTANT SECRETARY FOR INTERNATIONAL MONETARY AFFAIRS, U S TREASURY) AND AXILROD (STAFF DIRECTOR FOR MONETARY AND FINANCIAL POLICY, FED) TODAY TO DISCUSS THE U S INTERVENTION IN EXCHANGE MARKETS, AND TO ASCERTAIN WHETHER THIS MARKED A CHANGE OF POLICY.

2. THEIR CONVERSATIONS INDICATED THAT THE INITIAL REASON FOR THE INTERVENTION IN EXCHANGE MARKETS ON FRIDAY, 29 JULY WAS THE DESIRE TO SMOOTH THE VOLATILITY OF THE DOLLAR/DEUTSCHEMARK RATE AND TO A LESSER EXTENT THE DOLLAR/YEN RATE. IN ADDITION, DALLARA MENTIONED THAT TREASURY SECRETARY REGAN FELT IT A SUITABLE OPPORTUNITY TO SHOW THE ADMINISTRATIONS COMMITMENT TOWARDS THE UNDERSTANDING ON INTERVENTION AND EXCHANGE MARKETS REACHED AT WILLIAMSBURG FOLLOWING THE CIRCULATION OF THE JURGENSEN REPORT. IT HAD ALSO BEEN CONCLUDED THAT INTERVENTION MIGHT BE MORE SUCCESSFUL IF IT WERE CO-ORDINATED WITH OTHER COUNTRIES WHOSE CURRENCIES WERE UNDER PRESSURE, AND IF THE CO-ORDINATED INTERVENTION WERE WELL PUBLICISED.

3. IT APPEARS MOST UNLIKELY THAT THIS INTERVENTION MARKS ANY CONSIDERED CHANGE OF POLICY BY THE ADMINISTRATION. THE OBJECTIVES OF THE ACTION APPEAR TO HAVE BEEN LIMITED TO STEMMING THE RISE IN THE DOLLAR AND TO CALMING DISORDERLY MARKETS. ALTHOUGH THE ADMINISTRATION REMAINED CONCERNED OVER THE LEVEL OF THE DOLLAR, THERE WAS NO SUGGESTION THAT THEY WERE ATTEMPTING TO LOWER THE RATE.

4. AXILROD EXPLAINED THAT DURING THE FIRST PART OF THIS WEEK, MARKETS HAD CONTINUED TO BE UNSTABLE DESPITE THE INTERVENTION, MAINLY IN RESPONSE TO THE LARGE U S TREASURY FUNDING REQUIREMENTS AND SOME INCREASE IN THE FEDERAL FUNDS RATE, THE LATTER FOR REASONS WHICH COULD NOT WHOLLY BE EXPLAINED. PARTLY FOR THESE REASONS, THE INTERVENTION HAD BEEN LARGER AND MORE FLEXIBLE THAN ON PREVIOUS OCCASIONS WHEN THE ADMINISTRATION HAD INTERVENED. AXILROD CONFIRMED THAT THE INTERVENTION WAS STERILISED SO THAT IT HAD NO EFFECTS ON THE MONEY SUPPLY. IT IS CLEAR THE INTERVENTION IS BEING CARRIED OUT AS A DAY-TO-DAY OPERATION. BOTH AXILROD AND DALLARA WERE MODERATELY PLEASED WITH THE WEEK'S WORK.

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5. OUR ASSESSMENT IS THAT THE DECISION TO INTERVENE SEEMS TO HAVE RESULTED FROM A NUMBER OF SPECIFIC FACTORS PARTICULARLY THE VOLATILITY OF THE DOLLAR/DEUTSCHEMARK RATE, AND DOES NOT MARK ANY CHANGE OF POLICY BY THE ADMINISTRATION. BUT IN VIEW OF BOTH THE TREASURY'S AND THE FED'S COMMENTS ON THE COMPARATIVE SUCCESS OF THE OPERATION, IT MAY MAKE IT EASIER FOR THOSE MORE IN FAVOUR OF INTERVENTION TO ARGUE THEIR CASE ON SUBSEQUENT OCCASIONS SHOULD THE DOLLAR CONTINUE TO RISE AND IF U S INTEREST RATES WERE TO RISE FURTHER. THERE IS NO CHANGE IN THE VIEW THAT INTERVENTION CAN AT BEST HAVE ONLY A LIMITED EFFECT IN THE FACE OF STRONG CAPITAL FLOWS. NOR IS THERE ANY INDICATION THAT THE WEEK'S EVENTS HAVE PERSUADED THE ADMINISTRATION TO RE-EXAMINE THE FUNDAMENTALS OF ECONOMIC POLICY AS IT EFFECTS INTEREST RATES AND THE BUDGET DEFICIT.

6. FCO PLEASE ADVANCE TO LITTLER AND PERETZ (HMT) AND GILCHRIST (BANK OF ENGLAND).

THOMAS

FINANCIAL  
ERD  
NAD

COPIES TO  
MR LITTLER }  
MR PERETZ } TREASURY  
MR GILCHRIST B/ENGLAND