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Base rate cut hangs on sterling

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THE Treasury and the Bank of England are expected to react to any post-election flow of funds into London with official intervention to steady the exchange rate. If the inflow this week becomes overwhelming, the Government may sanction a half percentage point cut in bank base rates to 8½ per cent.

But the first tactic will be to take money into the reserves, and wait to assess the strength of foreign demand for sterling.

Despite all the previous speculation, post-election euphoria was distinguished by its absence from the foreign exchange markets on Friday.

This was not just attributable to the thinning of City ranks on Friday—'their celebrations at home have proved too much for them,' said one City observer. It was principally because market attention focused on the dollar.

The US currency had weakened earlier in the week after President Reagan referred in Venice to the possibility of a further fall. Since one of the main aims of the Venice summit had been to stabilise the dollar,

the presidential remark caused a stir.

The dollar recovered after a White House 'correction,' and in response to better US inflation figures on Friday.

But there is widespread disappointment in international financial circles with the outcome of the Venice summit—where no serious new initiatives were taken—and the dollar could well come under further pressure this week.

There is speculation in the City that the Government will formally put the pound into the exchange rate mechanism of the European Monetary System. Although the Chancellor, Nigel Lawson, is attending an EC meeting on EMS in Luxembourg tomorrow, this is to discuss some of the more arcane technical aspects of the mechanism.

There is no evidence yet that the Prime Minister has relaxed her opposition to full EMS entry.

While the formal EMS debate remains unresolved, the Treasury and Bank of England are continuing their policy of trying to conduct monetary and exchange rate policy as if the pound were already in the EMS exchange rate mechanism.