

# Pound under Pressure Again

THE battle to defend the pound which has been quiescent for some weeks has begun again. Everybody is waiting to see what reserves Britain can throw into the line. With devaluation rumours escalating last week, the pound came under severe pressure on the international market. A malicious rumour from Paris hinted at a 10 per cent devaluation. Among London commodity firms, the impression spread that this might become "devaluation week-end", and New York offices were cabled accordingly. The pressure against the pound, particularly in the crucial days before the Budget, has been mounting steadily and sterling weakened last week-end in both spot and forward markets. Indeed, the pound was quoted at \$2.78 15/16ths—its lowest point since November 25 and below the recent support point of \$2.79. The discount on forward sterling also widened. There is no doubt that the biggest problem is in the forward market.

Forward discounts continue to be wide. Foreign operators were prepared to borrow overnight pounds at no less than 13 per cent per annum in order to renew their open positions rather than buy pounds outright.

Foreign money has not come back to London, and the leads and lags in the pattern of commercial payments which developed last autumn continue. Traders are still tending to buy their foreign exchange earlier than usual, and foreign holders of sterling to hedge their positions by selling short, despite the high level of interest rates which now rules in the international money market. Earlier on in the week, the Bank of England had withdrawn its support for forward sterling that had been given regularly since November. As a result, the discount widened to the point where confidence in the pound was in danger of being further impaired, and support from the Bank of England had to be renewed.

An interesting feature of the present situation is the support tactics of the Bank of England have come under criticism. The Bank, of course, never discloses the latest facts and so no one is in a position to know whether, in fact, it is actually managing the currency efficiently. The Bank's tactics are organised to prevent speculators against the pound, ever-knowing that it may be losing in the battle. A revival of uneasiness regarding the

ability of the UK authorities to go on maintaining the \$2.80 parity was one of the prime causes of the pressure on sterling. The Bank of England has now to decide how to handle the foreign exchange market in the difficult weeks that lie ahead.

There had been general hope that recovery would take place in the spring when payments returned to normal and exports were at their seasonal peak. This, alas, has not happened so far. All the hopes held out at the end of January that the improvement of sterling and the renewed growth in exports would allow a reduction of the Bank Rate well before the Budget have gone.

It is understood that the Chancellor of the Exchequer is expecting the strain on the pound to continue between now and Budget day—April 6. However, Cabinet Ministers seem confident that there are ample resources to withstand the attack, despite the anxieties being expressed in the City.

## Devaluation Ruled Out

There is no doubt at all that the present Government has made it quite clear that it has no intention of devaluing the pound. In a speech over the week-end, Harold Wilson said quite categorically that "a vigorous pound" was the overriding priority in every one of his Government's actions. It is unlikely, had there been any chance of devaluation, that, the Prime Minister would have linked his Government's prestige so directly with the strength of the pound.

The pressure on the pound has been caused by a combination of technical weakness and an underlying lack of confidence. City bankers attribute the setback simply to a lack of confidence abroad in advance of the Budget. Fresh doubts have arisen as to whether the British Government will be able to hold the present rate of the pound sterling. The recurring attacks on sterling are caused by the crisis of confidence in the long-term future of the pound and the dollar in banking and business quarters on the Continent.

Although the Treasury assurance over the week-end which said, "this is the last of a long series of rumours against the pound and it is just as baseless as the previous rumours have proved,<sup>1</sup> may do something to restore confidence, the market will continue to be in a suspicious mood until the

Budget is announced. There is no doubt at all that the Budget Will be regarded everywhere as a crucial test of the Government's determination to maintain the present exchange rate. Although foreign observers admit the disadvantages—including the political impracticability of massive deflation—they seem unable to suggest any alternative policy capable of restoring confidence fully.

Indeed, it is the persistent lack of confidence which has seriously weakened the pound. There is a general belief that the Government has not yet brought the demands on Britain's economic resources within the limit that can be supplied. Of the gold reserves of £844 million, some £357 million is on loan from the International Monetary Fund, and well over £200m is outstanding under the \$3,000 million credit granted last November from Basle. Many also believe that the Government is not really in command of the situation. There is a general belief that the Cabinet is divided on this crucial point, with the Treasury and the Bank of England in favour of deflation, but the Department of Economic Affairs under the ebullient George Brown in favour of expansion.

Not that people question the desire of the Government to maintain the pound. For a country like Britain, devaluation is not a policy, it is a defeat.

All this pre-Budget activity in the foreign exchange market obviously makes much more complex the planning of the Budget. It is impossible for the present Budget to appear to pass measures which are irrelevant to Britain's balance of payments problems. This is what triggered off the really serious attack on the pound in November, and certainly sterling cannot stand a similar strain.

However, it appears unlikely that the Government will be politically foolish enough to embark on a massive deflationary programme to impress foreigners. Even European bankers and traders realise that a repetition of July 1961 would do nothing to solve Britain's problems. Britain has to repay her short-term debts and then achieve longer term growth that is free from balance of payments troubles. Any Government that accepts stagnation to keep pressure off the pound will be as unpopular abroad as one which can achieve growth only at a cost of periodic payments crises.

Sterling has been affected by the uncertainty about all currencies triggered off by General de Gaulle's call for an end to the gold exchange standard. Many overseas holders of sterling have been switching into gold. The uncertainty about the gold-dollar parity generated by the French demand for restoration of the gold standard has prompted the central banks of other countries besides France to strengthen the gold element in their reserves at the expense of the dollar element. Since the beginning of this year, out of a total outflow of some \$900 mn French transactions account for about

\$400 mn.

President Johnson's steps to secure a rapid reduction in the US payments deficit involving restrictions on overseas investment and loans, has reversed the flow of short-term capital. Dollars are now scarce and pounds are being sold to obtain them.

Some of the new strains on sterling are partly the result of the recent strengthening of the dollar and the consequent sudden increase in demand for dollars against sterling, but in the long run, since dollars and sterling are so closely linked, the United States, in its own interests, must help to

support sterling. It is generally believed that the USA would not be able to stand up to a sizable British devaluation; *any* doubt about Britain's ability to support the pound at its present parity would have repercussions on the dollar and would lead to the conversion of official dollar balances into gold. Thus the US has an even stronger motive to support the pound in its present difficulties.

In these circumstances, it is unlikely that there will be any devaluation of the pound, although the pressure on it will continue till the Budget is presented.

## The Disarmament Stalemate

*(From a Correspondent)*

THERE has been little progress on the disarmament front since 1963 when the "hot line" was installed, the test ban was signed and Russia and America pledged themselves not to put nuclear weapons into orbit. The Eighteen-Nation Disarmament Conference, which had been plodding along unspectacularly since March 1962, was adjourned indefinitely in September 1964. It is good news therefore that the British Foreign Minister, Michael Stewart has got Andrei Gromyko to agree in principle to its reconvening.

### Proposals Not New

Evidently, Stewart also pressed Gromyko to suggest a date, but the latter wanted agreement on the agenda first. He has proposed a list of eleven partial disarmament measures for inclusion: a reduction of military budgets; removal of foreign troops from areas where they did not belong; the abolition of foreign bases; an agreement to prevent the spread of nuclear weapons; prohibition of the use of nuclear weapons; establishment of de-nuclearised (atom-free) zones: destruction and banning of bombing aircraft; prohibition of under-ground nuclear tests; a non-aggression pact between the NATO and Warsaw pact countries; measures for the prevention of surprise attacks; and reduction of military forces.

None of these proposals is new. Most of them have already been the subject of negotiations at Geneva. The reduction of military budgets is not likely in itself to lead to greater international security, though it will accompany measures such as a reduc-

tion of military forces, which might. To be really effective as an isolated measure, reductions would have to be drastic, and would require a much greater degree of verification than the Russians, on present indications, are willing to accept.

Removal of foreign troops from areas where they do not belong, and abolition of foreign bases are linked in the sense that the former necessarily includes the latter. Neither measure is likely to be acceptable to the Americans, because each involves an American military withdrawal from Europe, the dismantlement of NATO, and a drastic change in the military balance in Asia. As part of a comprehensive (that is, covering all nations) and general (covering all categories of arms) disarmament programme the withdrawal of troops and bases to home-soil finds a place in the American GCD plan, as it does in the Russian. But as a partial measure, the Americans are bound to reject it.

The prohibition of the use of nuclear weapons, and a non-aggression pact between NATO and the Warsaw pact countries are examples of the sort of paper pledges which have proved useless in the past. They imply a much greater faith in the efficacy of legal or treaty obligations than international realities justify.

### Atom-Free Zones

The delineation of atom-free zones has for long been the theme of various proposals covering Latin America, Africa and Central Europe. The Fapacki Plan for disengagement in Central Europe, first propounded by Polish premier Rapacki, proposed the setting

up of a neutralised and nuclear-disarmed zone, consisting of Poland, Czechoslovakia and the two Germanies, under joint East-West guarantee. More recently the Poles have canvassed a watered-down version of the Rypacki Plan, the Polk Plan, which envisages the 'freezing' of nuclear weapon; *in* the zone at a fixed level, instead of eliminating them altogether. Britain has responded favourably, if cautiously, and has asked the Poles to tell them more about the arrangements for verification they envisage. The two likely stumbling blocks to the Plan's adoption are West German suspicion of anything that smacks of discrimination against them and Russian opposition to on-site verification in the Warsaw Pact area. In fact, the Polk proposal never reached the green-table at Geneva on account of Russian opposition.

The destruction and banning of bomber aircraft is referred to in disarmament jargon as the "bomber bonfire". It originated as an American proposal at Geneva for a limited bonfire of 480 American B-47s and 480 Russian TU-16s. The Russians counter-proposed the destruction of all bombers in a definite and short period of time. They later reassured the smaller powers that only the major powers would be affected. The Americans replied that a total bonfire would have to be part of a general and comprehensive programme; otherwise, it would upset the military balance. Apart from this, the impracticability of securing the assent of France and others to a destruction of their bomber forces, whether nuclear or conventional, is obvious.

Underground tests escaped the net