

CONFIDENTIAL



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Dear David

Prime Minister<sup>2</sup>  
JWS  
7/10.

**MOD FORWARD PURCHASES**

The Chancellor mentioned to the Prime Minister some time ago that the Treasury was discussing with the Ministry of Defence an arrangement which would allow them to buy forward from the Bank of England the bulk of their foreign currency requirements for the year ahead. The advantage of such an arrangement for the Ministry of Defence is that it provides them with certainty about the exchange rates they will be paying, which helps in the management of their cash limit. It does not involve the Treasury in exchange rate exposure. Forward sales to the Ministry of Defence are matched by forward assets in the Exchange Equalisation Account.

The same facility is available to other departments. But the Ministry of Defence are something of a special case because of the size of their foreign currency requirements.

1-2 — At the beginning of June, the Ministry of Defence bought forward the whole of their foreign currency requirement for 1988-89 - \$12 billion and DM3.4 billion (\$1.9 billion equivalent). We expect shortly to conclude an agreement with them which will allow them to buy forward the rest of their foreign currency requirement for the current year and to move on to an arrangement which will provide forward sales to the MOD for years after 1988-89 on a routine basis. After this year's sales to the MOD are complete the total demand they place on the Bank for foreign currency will be broadly the same as it is now, but with forward purchases substituting for spot purchases for most of their requirements.

Yours  
Alex

ALEX ALLAN