soften the impact of the bubble's bursting rather than to take away the fuel for the party.

Black Wednesday 1992

The term *global macro* first entered the general public's vocabulary on Black Wednesday, or September 16, 1992. Black Wednesday, as the sterling crisis is called, was the day the British government was forced to withdraw the pound sterling from the European Exchange Rate Mechanism (ERM)—a mere two years after joining—sending the currency into a free fall. The popular press credited global macro hedge fund manager George Soros with forcing the pound out of the ERM. As Scott Bessent (Bessent Capital), head of the London office of Soros Fund Management at the time, noted, "Interestingly, no one had ever heard of George Soros before this. I remember going to play tennis with him at his London house on the Saturday after it happened. It was as if he were a rock star with cameramen and paparazzi waiting out front."

The ERM was introduced in 1979 with the goals of reducing exchange rate variability and achieving monetary stability within Europe in preparation for the Economic and Monetary Union (EMU) and ultimately the introduction of a single currency, the euro, which culminated in 1999. The process was seen as politically driven, attempting to tie Germany's fate to the rest of Europe and economically anchor the rest of Europe to the Bundesbank's successful low interest rate, low inflation policies.

The United Kingdom tardily joined the ERM in 1990 at a central parity rate of 2.95 deutsche marks to the pound, which many believed to be too strong. To comply with ERM rules, the UK government was required to keep the pound in a trading band within 6 percent of the parity rate. An arguably artificially strong currency in the United Kingdom soon led the country into a recession. Meanwhile, Germany was suffering inflationary effects from the integration of East and West Germany, which led to high interest rates. Despite a recession, the United Kingdom was forced to keep interest rates artificially high, in line with German rates, in order to maintain the currency regime. In September 1992, as the sterling/mark exchange rate approached the lower end of the trading band, traders increasingly sold pounds against deutsche marks, forcing the Bank of England to intervene and buy an unlimited amount of pounds in accordance with ERM rules. Fears of a larger currency devaluation sent British companies scrambling to hedge their currency exposure by selling pounds, further compounding pressures on the system.

In an effort to discourage speculation, UK Chancellor Norman Lamont raised interest rates from 10 percent to 12 percent, making the pound more expensive to borrow and more attractive to lend. However, this action only served to embolden traders and further frighten hedgers, all of whom continued selling pounds. Official threats to raise rates to 15 percent fell on deaf ears. Traders knew that continually raising interest rates to defend a currency during a recession is an unsustainable policy. Finally, on the evening of September 16, 1992, Great Britain humbly announced that it would no longer defend the trading band and withdrew the pound from the ERM system. The pound fell approximately 15 percent against the deutsche mark over the next few weeks, providing a windfall for speculators and a loss to the UK Treasury (i.e., British taxpayers) estimated to be in excess of £3 billion. (*See Figure 2.5.*)

It was reported at the time that Soros Fund Management made between \$1 billion and \$2 billion by shorting the pound, earning George Soros the moniker "the man who broke the Bank of England." But he was

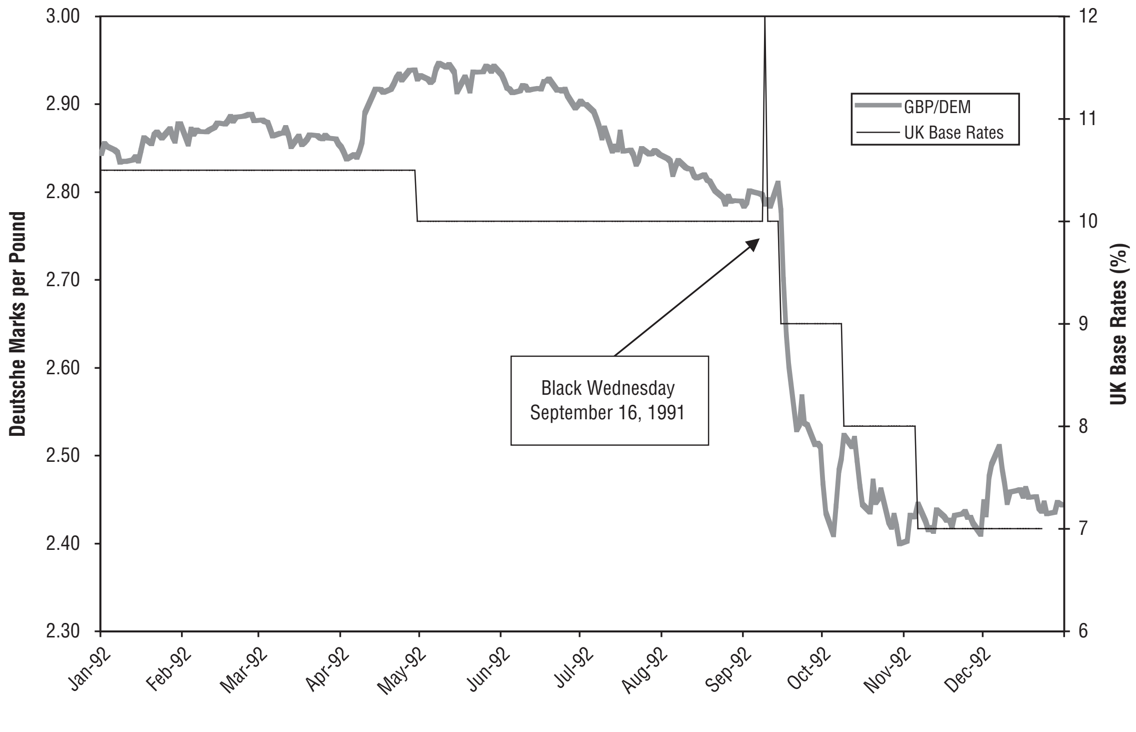

FIGURE 2.5 Sterling/Mark and UK Base Rates, 1992
Source: Bloomberg.

certainly not alone in betting against the pound. While he may have borne a disproportionate amount of the criticism because of his significant gains, the government's own policies are believed by many to have been the root cause of the problem, the speculators merely a symptomatic presence.

The pound eventually traded as low as 2.16 deutsche marks in 1995 but then rose as high as 3.44 in 2000 as the British economy recovered from recession and Germany suffered from the negative effects of euro integration. (*See Figure 2.6.*) Some credit today's strength in the British economy with the interest rate and currency flexibility afforded by its position outside of the euro system. This is especially striking when the United Kingdom's economic growth over the last decade is compared to the growth rates of formerly strong euro area countries such as Germany and France.

Yra Harris amusingly claims in his interview that Great Britain should erect a statue of George Soros in Trafalgar Square as an expression of gratitude for taking the pound out of the ERM. Bessent adds, "A lot of credit should go to the UK officials . . . they knew to fold their hand quickly. UK Chancellor Norman Lamont and Prime Minister John Major suffered short-term humiliation for long-term good. I mean, look at the muddle France and Germany are still in."

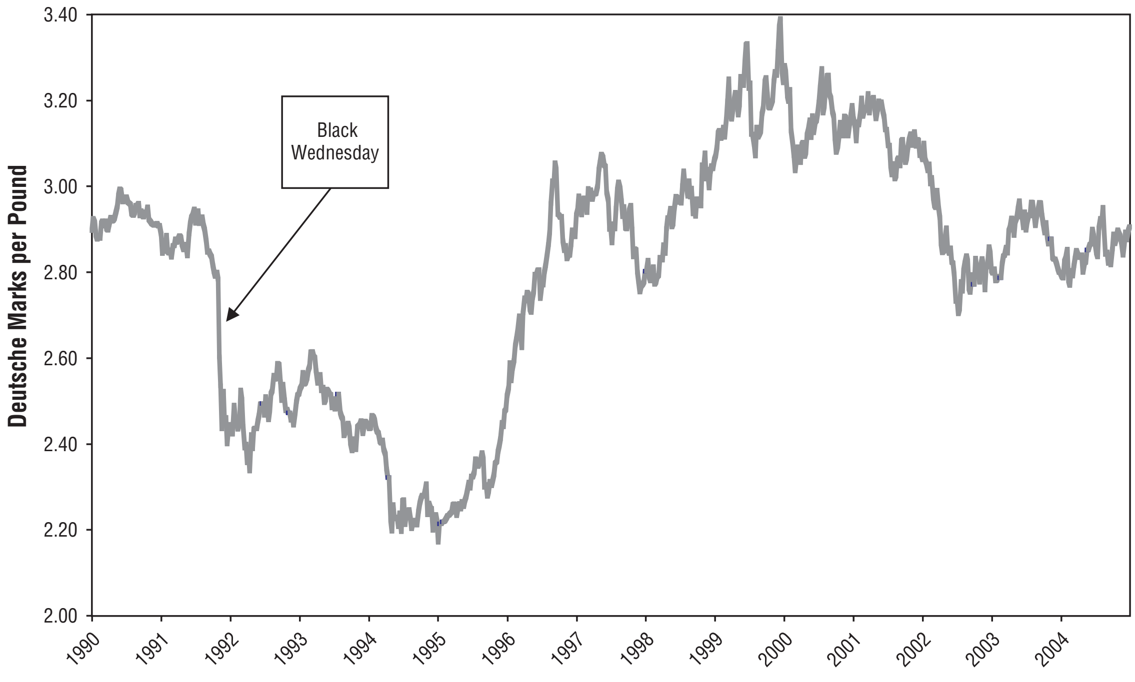

FIGURE 2.6 Sterling/Mark, 1990–2005
Source: Bloomberg.