

PO CH / NL / 0081

PART B

Part B.

SECRET

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Begins: 21/2/87
Ends: 31/3/87.



PO -CH /NL/0081



PART B

Chancellor's (Lawson) Papers:

GROUP OF FIVE AND GROUP
OF SEVEN MEETING 1987

Disposal Directions: 25 years

Phillips

27/7/95.

PO -CH /NL/0081

PART B

CONFIDENTIAL

GRS 300

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FM ROME

TO DESKBY 210800Z FCO

TELNO 133

OF 210615Z FEBRUARY 87

AND TO DESKBY 210900Z PARIS

AND TO IMMEDIATE BONN, WASHINGTON, OTTAWA

AND TO PRIORITY TOKYO

AND TO SAVING UKDEL OECD

G5/G7

SUMMARY

1. ITALY TRIES TO STOP THE G7 MEETING IN PARIS BY URGING CANADA NOT TO ATTEND.

DETAIL

2. CANADIAN AMBASSADOR INFORMED ME LATE FRIDAY THAT THE STRONGLY NEGATIVE ITALIAN REACTION TO PLANS FOR THE MEETINGS IN PARIS THIS WEEKEND HAD CAUSED A HECTIC DAY BETWEEN ROME AND OTTAWA. ON FRIDAY MORNING RUGGIERO, SECRETARY-GENERAL MFA, TOLD HIM THAT ITALY DID NOT WISH TO ATTEND A G7 MEETING WHICH MERELY RUBBERSTAMPED AN EARLIER G5 UNDERSTANDING AND WOULD WITHIN AN HOUR ISSUE A PRESS RELEASE STATING AN ITALIAN DECISION TO THIS EFFECT. TERMS OF ANNOUNCEMENT HAD ALREADY BEEN AGREED BY THE FOREIGN MINISTER AND PRIME MINISTER. BUT IT LATER EMERGED THAT THE FINANCE MINISTER, ADVISED BY SARCINELLI, HAD NOT AGREED TO THIS AND A DEBATE CONTINUED ALL DAY. THE CANADIANS TOLD THE ITALIANS THAT THEY COULD NOT ASSENT TO THIS IDEA, IN SPITE OF STRONG APPEALS FROM ROME. AT MIDNIGHT ON FRIDAY NO DECISION HAD BEEN TAKEN IN ROME ABOUT ITALIAN ATTENDANCE IN VIEW OF CANADIAN ATTITUDE, WHICH REMAINED THAT THEIR FINANCE MINISTER WOULD BE IN PARIS AND HAD INSTRUCTIONS TO TAKE PART IN THE G7 SESSION ON SUNDAY.

3. A COMPROMISE HAD BEEN FLOATED BY THE CANADIANS THAT THE SEVEN MINISTERS COULD MEET ON SATURDAY OVER DINNER BUT THIS HAD BEEN REJECTED BY BALLADUR.

4. NEWS OF THIS LATEST ARGUMENT HAS NOT YET BROKEN IN ROME. TV NEWS BULLETINS LATE FRIDAY ONLY REFERRED TO PRIOR CONSULTATIONS BETWEEN US, FRG AND JAPAN IN PARIS BEFORE THE G7 ON SUNDAY.
FCO PSE PASS SAVING OECD PARIS

(REPEATED AS REQUESTED)

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G5/G7 - ITALIAN PRESS COMMENT

MY TEL 133 REFERS.

SUMMARY

1. MOST PAPERS EMPHASIZE ITALIAN GOVT'S WORRY THAT IMPORTANT EXCHANGE RATE DECISIONS IN PARIS WILL BE MADE BY G5 TODAY AND MERELY RATIFIED BY G7 TOMORROW.

DETAIL

2. GENERAL DISSATISFACTION OVER THE G5 MEETING TAKING PLACE IMMEDIATELY BEFORE G7 AND EMPHASIS ON UNACCEPTABILITY OF ITALY BEING ASKED TO RUBBER-STAMP G5 DECISIONS. ALTHOUGH THERE IS NO GOVERNMENTAL ANNOUNCEMENT ON THE SUBJECT THE PRIME MINISTER'S OFFICE IS QUOTED AS SAYING THE ITALIAN DELEGATION WOULD NOT GO TO PARIS JUST FOR DINNER. OTHER PAPERS EXPRESS ANGER AT CONTINUED EXCLUSION OF ITALY FROM VITAL DECISION-MAKING MEETINGS. LA STAMPA WRITES FROM PARIS THAT EXCHANGE RATE DECISIONS ARE TAKEN ESSENTIALLY BY THE USA, JAPAN AND GERMANY AND THAT IT IS ILLOGICAL FOR ITALY AND CANADA TO BE EXCLUDED FROM AN ENLARGED GROUP WHILE FRANCE AND THE UK ARE INCLUDED.

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3. UNDER A HEADLINE 'ITALY AT ECONOMIC SUMMIT - REASON AND LOGIC PREVAIL', AND EDITORIAL IN THE SOCIALIST PARTY PAPER AVANTI MAKES NO MENTION OF ANY DISPUTE AND EXPRESSES SATISFACTION THAT ITALY WILL TAKE PART IN SUNDAY'S G7 MEETING. IT ADDS THAT IT WOULD BE 'ENTIRELY BEYOND ANY INTERNATIONAL LOGIC AND THE PRESENT RELATIONSHIP OF STRENGTH WITH THE FIVE GREAT WORLD ECONOMIC POWERS TO EXCLUDE FROM THE DECISIONS WHICH WILL BE TAKEN TOMORROW, A COUNTRY LIKE ITALY'.

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CN RIM415

221940 :U.K. ANALYSTS =6 LONDON

"One must have the suspicion that the best intent was merely to gain a bit of breathing space," Chertkow said.

"But then you are getting into a very dangerous game of dollar crisis. The danger is that they (the markets) will sell tomorrow, not in three months time."

Skeoch and Chertkow said other elements of the statement did little to boost confidence that the meeting achieved anything significant towards currency stabilisation.

A U.S. promise to cut its budget deficit to 2.3 pct of GNP in 1988 from a projected 3.9 pct in 1987 meant little, as the decision rests with Congress, Chertkow said.

MORE

222001 :U.K. ANALYSTS =7 LONDON

An announcement that West Germany will propose an increase in the level of tax cuts already enacted for 1988 came as little surprise, Skeoch said, and was likely to have been decided upon more for domestic reasons than to aid currency stability.

A currency dealer with a U.K. clearing bank said the effect of the German tax cut would in any case have a very lagged effect on trade figures, and hence on the currency situation.

This dealer said the market was likely to test the downside of the dollar, although some nervousness ahead of the U.S. trade figures was to be expected.

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ZZ RIM419

CK 222016 NNNN

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CN RIM420

222018 :U.K. ANALYSTS =8 LONDON

He noted that with the dollar now hovering just above 1.80 marks, the market could be encouraged now to test its historic lows around 1.70.

"I would have thought it would encourage them to go for that sort of level," he said, adding that today's statement would have done nothing to change the market's existing bearishness.

According to Skeoch, the problem is that the dollar is still seen in the markets as having some way to fall.

Whereas the Plaza Agreement succeeded because by then the dollar had obviously been overbought, there is no evidence yet that it has been correspondingly oversold, he said.

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AA ZP (QY) RIM412

221925 :/OTEIBA SEES NO NEED FOR EMERGENCY OPEC TALKS

DOHA, Feb 22 - UAE Oil Minister Mana Said al-Oteiba said he did not believe an emergency OPEC meeting was necessary to take further measures to bolster oil prices.

He was speaking to reporters after a meeting of oil ministers from the six-nation Gulf Cooperation Council, grouping Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the UAE.

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AA ZP (QY) RIM413

221927 :OTEIBA SEES =2 DOHA

"No, no, I don't think so," Oteiba, who chaired the meeting, told reporters when asked if an emergency OPEC meeting was necessary.

Asked if OPEC was exceeding its output ceiling of 15.8 mln bpd set in December, he said: "No, I don't think so."

Oteiba also denied reports that the UAE was exceeding its OPEC quota.

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CN RIM414

221928 :U.K. ANALYSTS =5 LONDON

"But the longer term implications are that absolutely nothing has changed," Chertkow said, "except that when people start talking about G-5 meetings in the future an awful lot of people are going to be yawning."

Both Skeoch and Chertkow said there was likely to be an initial period of caution on the foreign exchanges, caused by the threat of central bank intervention, but the longer term decline of the dollar was unlikely to be deterred.

"Central bank intervention is not going to be a fundamental restraint," Chertkow said, adding that perhaps the G-5 only wanted to slow the dollar's decline without yet halting it.

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CN RIM409

221916 :MARKETS WILL =6 FRANKFURT

Dealers said specific measures called for, such as increased tax cuts next year in West Germany, and a commitment to trim the budget deficit and hold down government spending in the U.S., were surprisingly good results for the talks.

"They came out with the maximum that could be expected. That's why I don't see any massive move to test the low tomorrow," said one dealer, adding the dollar would probably ease to 1.80 marks as traders tested the waters.

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CN RIM410

221917 :MARKETS WILL =7 FRANKFURT

But Rob Bauer, senior dealer at Commerzbank AG, was more sceptical.

"I think we'll see levels of 1.75 marks tomorrow morning," he said. "The dollar is heading downwards because the fundamentals are wrong. You can meet all you want, you're not going to change it," he said.

Bauer warned the way down for the dollar was open if markets decided the meeting had not really achieved anything.

The agreements on taxes and budget spending must still be approved by national parliaments, such as Congress, economists and dealers noted.

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CN RIM411

221919 :U.K. ANALYSTS =4 LONDON

"If the dollar starts to go down we will have to see heavy and coordinated action to hold it back," Skeoch said, adding that the authorities will have to fire a "warning shot" fairly quickly to show their resolve to intervene if necessary.

"Someone is going to test it in the next couple of weeks," he said, perhaps as early as next Friday, when the latest set of U.S. trade figures are released.

Paul Chertkow, Currency Economist at stockbrokers Hoare Govett, takes a similar line to Skeoch.

The threat of central bank intervention will at best cause only a brief pause in the dollar's fall, he says.

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CN RIM406

221910 :MARKETS WILL =3 FRANKFURT

Nor was there any mention of target zones or reference ranges for currencies, an idea floated by France and the U.S. recently to steady exchange rates within broad bands.

But dealers said they suspected the meeting had set secret levels to be defended.

"That will be the aim of the markets, to find out over the next few days whether there is any agreement on this," said one senior dealer for a major German bank.

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CN RIM407

221912 :MARKETS WILL =4 FRANKFURT

The dollar was quoted at 1.8200/50 marks late today in Bahrain, after closing in New York on Friday at 1.8185/95. It has held in a 1.80-90 mark range for the last two weeks after dipping to a 6-1/2-year low of 1.76 marks last month.

If the six have agreed to defend certain exchange rates, it is not surprising they want to keep them secret, dealers said. Publishing them would merely be a challenge to speculators.

"If they had established target zones openly, the first thing for any forex dealer would be to test the target zone and test the resolve of central banks," said another dealer for a German bank.

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CN RIM408

221915 :MARKETS WILL =5 FRANKFURT

"But the only hope for us is to slowly test the downside ... we're going into uncharted territory from here," the German bank dealer added.

The agreement potentially lays to rest a long-running dispute between the allies by calling on countries with big trade surpluses to stimulate their domestic economies, and on the U.S. to encourage steady growth while cutting its trade and budget deficits.

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CN RIM403

221904 :U.K. ANALYSTS =3 LONDON

"My immediate reaction is why did they bother?" Keith Skeoch, chief economist at stockbrokers James Capel and Co, told Reuters.

There was nothing in the communique to make him change his current forecasts that the dollar will fall to 1.70 marks, 145 yen and 1.55 to the pound sterling by end 1987, he said.

"If the meeting is going to have some impact it has got to come up with the goodies, the way the Plaza pact did," he said.

Instead, the lack of substance in the statement leaves currencies at the mercy of market speculation and operators' desire to test the resolve of central banks, he said.

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CN RIM404

221908 :/MARKETS WILL PUT CURRENCY AGREEMENT TO TEST

By Jonathan Lynn, Reuters

FRANKFURT, Feb 22 - When currency markets open tomorrow traders are likely to test the resolve of six leading industrial countries who agreed to foster exchange rate stability, dealers and banking economists said.

The likely result is a nervous decline in the dollar, as markets try to find out whether central banks have decided to defend certain exchange rates, and how they intend to do so.

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CN RIM405

221909 :MARKETS WILL =2 FRANKFURT

Some dealers were sceptical about the agreement, announced after talks in Paris between the finance ministers and central bank governors of the United States, Japan, West Germany, France, Britain, who form the Group of Five (G-5), and Canada.

But others said the pact, which called for greater economic policy coordination among the six allies in order to remove world trade imbalances, had achieved more than expected.

The lengthy communique gave no details of any measures to defend current rates, such as central bank intervention in currency markets. British Chancellor of the Exchequer Nigel Lawson said however the meeting agreed on joint intervention.

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CN RIM400

221900 :PARIS ACCORD =4 PARIS

Analysts said the U.S. apparently intervened in financial centres to support the dollar when the currency eased against the yen following the January agreement reached by Miyazawa and U.S. Treasury Secretary James Baker.

The dollar-yen exchange rate had moved in a narrow range for about two months since Miyazawa and U.S. Treasury Secretary James Baker said on October 31 last year they would cooperate to bring about currency stability.

But the dollar momentarily plunged to a historic low of 149.98 yen on January 19, prompting Miyazawa to fly to Washington to seek U.S. support for greater stability.

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CN RIM401

221902 :/U.K. ANALYSTS DOUBT IMPACT OF PARIS STATEMENT

LONDON, Feb 22 - Today's statement by the G-5 nations and Canada pledging cooperation in maintaining currency exchange rate stability around present levels is unlikely to bring that goal any closer, London-based analysts said.

The lack of firm detail and commitment in the statement may even have an adverse effect by undermining G-5 credibility and so creating a temptation for foreign exchange markets deliberately to test currency levels, they said.

The Group's statement, issued after a meeting in Paris, said the six nations "agreed to cooperate closely to foster stability of exchange rates around current levels."

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CN RIM402

221903 :U.K. ANALYSTS =2 LONDON

The statement said currency moves since the September 1985 Plaza Agreement by the G-5 to bring down the value of the dollar had "brought their currencies within ranges broadly consistent with underlying economic fundamentals."

But it made no mention of the French suggestion of setting currency ranges or target zones, nor did it go into specific detail on how the six nations would go about achieving exchange rate stability.

Foreign exchange dealers here said before the meeting that it would take a very strong statement from the Paris talks to prevent the dollar's long term downward trend.

MORE

221841 :/PARIS ACCORD SAID TO GIVE JAPAN A BREATHING SPACE

By Tsukasa Maekawa, Reuters

PARIS, Feb 22 - The currency agreement by six major industrial nations is likely to set Japan free from worries about exchange rates at least until next time they are scheduled to meet in April, Japanese officials said.

But Japanese monetary analysts differed, saying the dollar may come under selling pressure against the yen.

Japanese Finance Minister Kiichi Miyazawa said he was satisfied with the outcome of the meeting between finance ministers and central bank governors from Britain, Canada, France, Japan, the United States and West Germany.

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CN RIM398

221842 :PARIS ACCORD =2 PARIS

The monetary leaders are expected to gather in April for the interim committee meeting of the International Monetary Fund.

"Things turned out to be almost as Japan wished to achieve," Miyazawa told a press conference.

The final statement said the six nations will "cooperate closely to foster stability of exchange rates around current levels." Japanese finance ministry sources said the statement neither specified at what levels the exchange rate should stabilize, nor mentioned what concrete measures each participating nation will take to bring exchange rates back to "current levels" if they move off the levels.

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CN RIM399

221852 :PARIS ACCORD =3 PARIS

Analysts said the market may try to push the dollar lower to see at what levels the nations will move to stabilize exchange rates and what measures they will take.

But the dollar may not be sold aggressively as exchange market operators will become wary of market intervention by Japanese and U.S. monetary authorities if the U.S. currency falls too fast.

Sources close to Miyazawa said last month's U.S.-Japan understanding still remains effective.

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CN RIM384

221631 : /STOLTENBERG SAYS ACCORD REFLECTS SITUATION NOW

PARIS, Feb 22 - West German finance minister Gerhard Stoltenberg said this weekend's accord to stabilize currencies reflects the current situation but he would not say if present exchange rates would be "appropriate" in the long-term.

He was speaking to reporters after the Group of Five (G-5) countries plus Canada agreed to cooperate closely to foster stability of exchange rates around current levels.

"It is not the job of our group to to say what is right in the long-term", he said.

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CN RTM385

221634 : /STOLTENBERG SAYS =2 PARIS

Talks today were to have been between the G-7 countries, the U.S., Japan, West Germany, Britain, France, which make up the G-5, as well as Canada and Italy, but Italy dropped out at the last moment, saying it had not been sufficiently consulted.

Stoltenberg said he regretted the Italian decision and added he would welcome Italian participation in the decisions taken to stabilize currencies.

As part of its contribution to promoting growth, West Germany said it proposed an increase in the scope of tax cuts already decided for 1988. Stoltenberg did not say by how much they would be increased.

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CN RIM386

221635 : /STOLTENBERG SAYS =3 PARIS

The 1988 tax cuts amount to some 10 billion marks and the government has been under domestic pressure to introduce them already this year. However, Stoltenberg said Bonn had not come under pressure for early implementation at the weekend talks.

Next year's tax cuts are mainly aimed at cutting taxes for the middle-to-higher range earners, but officials in Bonn have said one possibility of increasing the 1988 package would be to incorporate reductions for lower paid employees.

A communique released after the talks also made specific reference to a comprehensive tax reform which the government has scheduled for the 1990's.

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CN RIM387

221636 :/MIYAZAWA SAYS =3 PARIS

Miyazawa said he believes the agreement will contribute to the stability of exchange rates.

Asked why exchange rates were included as an economic indicator used to promote multilateral surveillance arrangements, Miyazawa said the recent exchange rate volatility was the reason for it to be on the list.

But it is not certain if exchange rates will continue to be regarded as an indicator in the future, he said.

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CN RIM388

221637 :/MIYAZAWA SAYS =4 PARIS

Asked if Japan will support U.S. efforts to get the newly industrialized developing countries to adjust their currencies to be more consistent with economic fundamentals, Miyazawa said Japan does not plan to take specific action regarding the matter now.

But he said Japan is interested in the issue.

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CN RIM382

221616 :/MIYAZAWA SAYS SIX WILL MOVE TO STABILIZE RATES

PARIS, Feb 22 - Japanese finance minister Kiichi Miyazawa said finance ministers and central bank governors of the six major industrial nations agreed to cooperate to bring back exchange rates to "current levels" if they move off these levels.

Miyazawa told a news conference that there are various cooperative measures to stabilize rates. But he declined to say if the measures include concerted market intervention.

He said in general terms market intervention is effective when it is undertaken without mentioning it publicly in advance.

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CN RIM383

221617 :/MIYAZAWA SAYS #2 PARIS

"Such a raw expression (intervention) is not shown in the statement of the six nations," Miyazawa said.

The statement issued jointly earlier today by Britain, Canada, France, Japan, the U.S. and West Germany said the nations agreed to "cooperate closely to foster stability of exchange rates around current levels.

"Around current levels" means a rather wide range of exchange rates," Miyazawa said.

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CN RIM366

221534 : /SUMITA SEES NO FURTHER JAPANESE DISCOUNT RATE CUT

PARIS, Feb 22 - Bank of Japan Governor Satoshi Sumita said the Japanese central bank does not plan to further cut discount rate.

The Bank announced Friday that it will reduce its discount rate by one half point to 2.5 pct, effective tomorrow.

The Bank of Japan will maintain its policy of easy credit conditions, Sumita told journalists after an agreement by the G-5 Finance ministers and Canada on a package of economic measures designed to stem the slide of the dollar and promote growth.

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CN AA RIM367

221538 : /LAWSON CALLS =2 PARIS

The final statement issued after today's meeting contained few new concrete commitments from Britain to stimulate demand, unlike explicit pledges by West Germany to increase planned tax cuts and the U.S. to reduce its budget deficit.

"The share of public expenditure in the (U.K.) economy will continue to fall and the burden of taxation will be reduced, while public sector borrowing is maintained at a low level," the statement said but gave no figures or other details.

It made no mention of sterling but Lawson said the rate "is broadly where I would like it to be. I certainly don't want it to fall and I would not like a rise to be significant, either."

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CN AA RIM368

221539 : /LAWSON CALLS =3 PARIS

Lawson also told journalists there had been a substantial amount of "pre-cooking" of the final text over the past few weeks, adding that he favoured this approach.

"The last thing I wanted to see was a repetition of last September's G-5 meeting which wasn't properly prepared and whose outcome was not satisfactory," he said, referring to the meeting in Washington and which dealt inconclusively with the topic of objective economic indicators.

Asked if the absence of Italy at today's scheduled G-7 meeting would diminish the effectiveness of the accord, he replied "I don't think this makes the slightest difference."

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CN RIM359

221514 :RRRRRUSUMITA SAYS BANK OF JAPAN PLANS NO FURTHER
DISCOUNT RATE CUT

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CN AA RIM360

221516 :/LAWSON CALLS PARIS MONETARY MEETING PLAZA TWO

PARIS, Feb 22 - British Chancellor of the Exchequer Nigel Lawson described the accord here of the Group of Five nations and Canada to promote world economic stability as "Plaza Two".

Referring to the September 22, 1985 G-5 meeting at New York's Plaza Hotel, he said he saw today's gathering as its lineal descendant, Plaza Two. "Then we all agreed the dollar should fall, now we all agree we need stability," he said.

But he told journalists he did not know how markets will react. "It is quite possible this agreement will be tested on Monday or later," he said, adding that was when participants would show their resolve to defend currencies.

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CN RIM357

221459 :/BAKER SAYS =3 PARIS

It adds, "In current circumstances, therefore, they agreed to cooperate closely to foster stability of exchange rates around current levels."

Baker said he would not agree with a description of the accord as "Plaza Two", a characterisation used by British Chancellor of the Exchequer Nigel Lawson.

Instead, he said it was an extension of the Tokyo Summit accord to intensify international economic cooperation.

Lawson said that in the Plaza accord "we all agreed the dollar should fall, now we all agree the time has come for a period of stability."

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CN RIM358

221508 :/BAKER SAYS =4 PARIS

Baker said ministers of the six -- the U.S., Japan, West Germany, Britain, France and Canada -- discussed the debt situation including the Brazilian suspension of interest payments on debt owed to private banks. He did not elaborate.

He added that the meeting was not called as a result of the Brazilian action and there was no link between the potential instability resulting from the Brazilian interest payments suspension and stabilising currencies.

"It really did not come about as a result of the debt," he said.

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CN RIM355

221455 :/BAKER SAYS HE HAS NOT TALKED DOWN THE DOLLAR

PARIS, Feb 22 - U.S. Treasury Secretary James Baker said he has not talked down the dollar in recent months but declined to speculate on the currency's value.

At a news conference after the six-nation agreement on exchange rates and economic policies, Baker said "we have not been talking down the dollar for over a year" but declined to say if the agreement meant the dollar has fallen enough.

Baker said the accord meant the six countries should "do what we ought to do, what we can do, to foster stability around current levels."

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CN RIM356

221457 :/BAKER SAYS =2 PARIS

Baker also declined comment on the implications the accord has for intervention.

Asked to comment on whether the agreement implied there were reference ranges or zones Baker said the accord spoke for itself. "The current rates are a matter of public knowledge."

The final paragraph of the pact says the six nations agreed that substantial exchange rate changes since the Plaza Agreement "will increasingly contribute to reducing external imbalances and have now brought their currencies broadly consistent with underlying economic fundamentals, given the policy commitments summarized in this statement."

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CN ZP RIM341

221322 : ~~REUTERS~~ U.S. TO CUT BUDGET DEFICIT TO 2.3 PCT GNP FISCAL 1988 FROM
1987 ESTIMATED 3.9 PCT - COMMUNIQUE

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CN ZP RIM343

221335 : /BAKER SAYS MEASURES WILL FOSTER CURRENCY STABILITY

PARIS, Feb 22 - U.S. Treasury Secretary James Baker said measures by the six leading industrial democracies will foster greater currency stability.

"These measures will foster greater stability of exchange rates around current levels," Baker told a news conference.

He said he particularly welcomed West Germany's tax rate reduction, plans for tax reform and proposals to increase tax cuts. He said he was equally pleased with Japan's discount rate cut and economic stimulus.

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CN ZP RIM344

221338 : /WESTERN NATIONS TO COOPERATE TO STEADY CURRENCIES

PARIS, Feb 22 - The Group of Five industrial countries and Canada agreed at a meeting of Finance Ministers and central bank governors here to cooperate to stabilise the exchange rates of their currencies around present levels, a communique issued after the meeting said.

The six countries agreed that further substantial exchange rate shifts could damage economic growth prospects, but concluded that changes in parities in the past few months would contribute to a sustainable pattern of current account balances, it added.

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CN ZP RIM345

221340 : /PARIS MEETING AGREES ON MORE ECONOMIC COOPERATION

PARIS, Feb 22 - The meeting of finance ministers from the Group of Five countries and Canada agreed to intensify economic policy coordination to promote growth, a final statement said.

The six nations also reaffirmed their concern over continuing protectionist pressures and agreed that countries with surpluses should commit themselves to follow policies to strengthen demand.

The statement also said the West German government would propose an increase in tax cuts agreed for 1988 and the U.S. would cut its budget deficit to 2.3 pct of GNP in fiscal 1988 from an estimated 3.9 pct in 1987.

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CK 221355 NNNN

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CN ZP RIM347

221356 :/WESTERN NATIONS =2 PARIS

However the communique made no mention of a long-standing French suggestion that reference zones should be set up establishing trading ranges for major currencies.

"We talked about stabilisation of currencies around current levels," Bundesbank president Karl Otto Poehl told Reuters.

The dollar has fallen by around 40 pct against major currencies over the past two years to just above 150 yen, 1.80 marks and 1.50 stg with the active encouragement of the U.S. authorities, who have been anxious to cut the country's record 170 billion dlr trade deficit.

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CN ZP RIM348

221409 :WESTERN NATIONS =3 PARIS

The Finance Ministers and central bankers also agreed to additional refinements in the use of economic indicators for monitoring each others' economies, moving forward from an accord reached at the Group of Seven summit in Tokyo last May.

They agreed to periodically review medium-term economic objectives and projections, and assure that the two were consistent.

And they agreed to examine regularly whether economic developments were consistent with those medium-term projections, or whether corrective action was necessary.

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ZP (QY) CN RIM349

221415 :WESTERN NATIONS =4 PARIS

The initial key indicators used to assess objectives and projections will be growth, inflation, the current account and trade balances, budget performance, monetary conditions and exchange rates, the communique said.

"Further substantial exchange rate shifts among their currencies could damage growth and adjustment prospects in their countries," the communique said.

"In current circumstances, therefore, they agreed to cooperate closely to foster stability of exchange rates around current levels," it added.

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AA CN RIM350

221428 :PARIS MEETING AGREED ON CENTRAL BANK INTERVENTION POLICY -
LAWSON

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CN ZP (QY) RIM351

221436 :WESTERN NATIONS =5 PARIS

"I see this meeting as the lineal descendant of the Plaza meeting," British Chancellor of the Exchequer Nigel Lawson told reporters.

"Then we all agreed that the dollar should fall. Now we all agree we need stability," he said.

The statement referred to the "serious economic and political risks" posed by the large trade and current account imbalances of some countries.

It was agreed that cutting these deficits was a high priority and "the achievement of more balanced global growth should play a central role in bringing about such a reduction."

MORE

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CN ZP (QY) RIM352

221436 :WESTERN NATIONS =6 PARTS

The final statement listed separate undertakings given by each participating country.

Japan pledged it would follow policies to expand domestic demand and help cut its trade surplus, promising to prepare a comprehensive economic program after the approval of the 1987 budget.

The United States said that in order to trim its budget deficit growth in government spending would be held to less than one pct in the 1988 budget year.

REUTER

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CN ZP (QY) RIM353

221437 :/PARIS MEETING AGREES ON BANK INTERVENTION POLICY

PARIS, Feb 22 - The Group of Five industrial countries and Canada agreed at a meeting of finance ministers and central bank governors on policy for joint central bank intervention, British Chancellor of the Exchequer Nigel Lawson said.

"We had full discussions on circumstances under which we would intervene jointly," Lawson told journalists after the meeting. "We are privately agreed," he said without elaborating.

"If you are involved in serious agreement involving intervention you need to have central bankers around," he added.

REUTER

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CN RIM332

*for Bank
Nikhil Shrivastava
them*

- Niger

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grateful*

221304 :/PARIS MEETING DISCUSSED CURRENCY STABILISATION

PARIS, Feb 22 - The meeting of finance ministers of six industrialised nations discussed stabilisation of currencies around present levels, Bundesbank president Karl Otto Poehl told Reuters.

"We talked about stabilisation of currencies around current levels," he said as he entered a conference room at the French Finance Ministry for the announcement of the final communique.
REUTER

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CN RIM313

221129 :~~PARIS~~PARIS MONETARY MEETING ENDS, OFFICIAL STATEMENT AT 1300 GMT.

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CN ZP (QY) RIM314

221132 :/MONETARY MEETING IN PARIS ENDS

PARIS, Feb 22 - Finance Ministers and central bankers from leading industrialised nations ended a meeting here after 2-1/2 hours of talks.

Journalists saw ministers begin to leave the French Finance Ministry around noon (1100 gmt).

The meeting, originally planned as the Group of Seven (G-7) was reduced to six nations after Italy pulled out.

A Finance Ministry spokesman said an official statement would be issued at 1400 local time (1300 gmt).

REUTER

CN RIM333

221307 : PARIS MEETING AGREES FURTHER SUBSTANTIAL
EXCHANGE RATE SHIFTS COULD DAMAGE GROWTH

NNNN

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CN RIM334

221309 : PARIS MEETING REAFFIRMS CONCERN OVER CONTINUING
PROTECTIONIST PRESSURES

NNNN

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CN ZP RIM335

221310 : PARIS MEETING AGREES TO INTENSIFY ECONOMIC
POLICY COORDINATION TO PROMOTE GROWTH

NNNN

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CN ZP RIM336

221311 : SURPLUS COUNTRIES COMMIT THEMSELVES TO FOLLOW
POLICIES TO STRENGTHEN DEMAND - PARIS MEETING

NNNN

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CN RIM337

221311 : WEST GERMANY TO PROPOSE INCREASE IN TAX CUTS AGREED FOR
1988 - PARIS COMMUNIQUE

NNNN

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CN ZP RIM338

221313 : BAKER SAYS SIX STATE MEASURES WILL FOSTER GREATER
EXCHANGE RATE STABILITY AROUND CURRENT LEVELS

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CN ZP RIM339

221315 : WESTERN COUNTRIES TO COOPERATE TO STABILISE
EXCHANGE RATES AROUND CURRENT LEVELS - COMMUNIQUE

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FXUF RIM421

222032 :/-U.S. DOLLAR TRADING QUIETLY ACTIVE IN WELLINGTON

WELLINGTON, Feb 23 - Early trading in the U.S. dollar was quietly active in Wellington, around similar levels to Bahrain, with no clear direction emerging after the meeting of six industrial nations in Paris, dealers said.

Spreads for quotes of both the dollar/mark and dollar/yen are very wide in a thin market, making it difficult to determine any exact trading levels, they added.

Dealers reported the dollar opened at 1.8150/1.8225 marks compared with a quoted 1.8200/50 in Bahrain and a 1.8185/95 finish in New York on Friday. The dollar opened at 153.00/50 yen from 153.50/60 in New York and its 153.74/81 close here Friday.

MORE

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FXUG RIM422

222035 :U.S. DOLLAR TRADING =2 WELLINGTON

"We've not seen a lot of business this morning and mostly it's been European banks looking to sell the dollar", one senior dealer said.

However, another trading bank dealer said: "There's been good interest to sell and buy from the Middle East and Europe with people covering positions they took before the group of six meeting in Paris".

Most dealers described the agreement of the meeting to foster exchange rate stability as a non-event and were sceptical about moves to stabilize exchange rates.

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OF 231524Z FEBRUARY 87
INFO ROUTINE WASHINGTON, BONN, TOKYO, ROME, OTTAWA, UKREP BRUSSELS
INFO ROUTINE UKDEL WASHINGTON

G5/G7 MEETINGS, PARIS, 21 AND 22 FEBRUARY: FRENCH PRESS COVERAGE.

SUMMARY

1. FAVOURABLE COVERAGE OF MEETINGS. MOST PAPERS EXPECT EXCHANGE RATE TO STABILISE NOW. BALLADUR CLAIMS SUCCESS FOR FRENCH POLICIES AND A STEP TOWARDS INTERNATIONAL MONETARY REFORM. ITALIAN WITHDRAWAL RECEIVED LIMITED ATTENTION OVERNIGHT, BUT TODAY MITTERRAND HAS LET IT BE KNOWN HE WILL FLY TO ROME ON WEDNESDAY.

DETAIL

2. THE G5/G7 MEETINGS HAVE BEEN WIDELY REPORTED HERE. ALL PAPERS REFER TO A CERTAIN LACK OF SUBSTANCE IN THE AGREEMENT BUT MOST JUDGE THAT NEVERTHELESS IT WILL BRING STABILITY TO THE FOREIGN EXCHANGE MARKETS. PAUL FABRA COMMENTS IN LE MONDE THAT, IN RETURN FOR FLOWERY WORDS FROM THE AMERICANS, THE JAPANESE, WEST GERMANS AND TO A LESSER DEGREE THE FRENCH HAVE ALL AGREED TO REFLATE THEIR ECONOMIES. LES ECHOS (BUSINESS DAILY) QUOTES FOREIGN EXCHANGE DEALERS AS SAYING THAT THIS RATHER VAGUE AGREEMENT WILL CAUTION THE FOREIGN EXCHANGES AGAINST FURTHER DEPRECIATION, WITHOUT ENCOURAGING THEM TO SEND THE DOLLAR SOARING UPWARDS. THE PAPER CONCLUDES THAT AS THE PLAZA AGREEMENT SUCCEEDED DURING SEVERAL MONTHS IN PROVIDING FOR AN ORDERLY DEPRECIATION OF THE DOLLAR, THERE IS NO REASON WHY THE LATEST AGREEMENT SHOULD NOT SUCCEED IN STABILISING EXCHANGE RATES. MOST PRESS REPORTS END IN A SIMILAR VEIN AND ONLY LE MATIN (SOCIALIST) IS UNEQUIVOCALLY SCEPTICAL.

3. THE ONLY SUGGESTION THAT THERE IS MORE TO THE AGREEMENT THAN HAS SO FAR BEEN PUBLISHED COMES FROM LIBERATION (LEFT-OF-CENTRE) WHICH QUOTES A MEMBER OF THE FRENCH DELEGATION AS REFERRING TO A MORE PRECISE, BUT SECRET, QUOTE UNDERSTANDING UNQUOTE ON EXCHANGE RATES THAN THAT INCLUDED IN THE PLAZA AGREEMENT. A SIMILAR REPORT FROM TOKYO HAS BEEN PICKED UP IN SEVERAL RADIO NEWS BULLETINS ON 23 FEBRUARY.

4. LIBERATION REPORTS THE CHANCELLOR OF THE EXCHEQUER AS SAYING THAT THE LATEST AGREEMENT IS A LOGICAL EXTENSION OF THE PLAZA AGREEMENT, BUT DOES NOT QUOTE THE REMARK (REPORTED IN THE FT) THAT THE CONSENSUS WAS NOT NECESSARILY ETERNAL. LE MONDE REFERS TO THE NEED FOR A PERIOD OF CALM TO ALLOW THE EFFECTS OF THE FALL IN THE VALUE OF THE DOLLAR TO WORK THROUGH INTO THE AMERICAN TRADE BALANCE AND THOSE OF ITS PARTNERS. A SIMILAR THEME IS PICKED UP BY BALLADUR IN AN INTERVIEW WITH LE FIGARO, (RIGHT-WING). BALLADUR ALSO CLAIMS THAT THE MEETING TOOK PLACE BECAUSE FRANCE'S PARTNERS FINALLY ACCEPTED THE FRENCH THESIS THAT STABLE EXCHANGE RATES CAN ONLY BE ACHIEVED THROUGH ECONOMIC AND POLITICAL CO-OPERATION. HE ADDS THAT HE SEES THE LATEST AGREEMENT AS A STEP TOWARDS A THOROUGH REFORM OF THE INTERNATIONAL MONETARY SYSTEM AND THAT FRANCE WILL CONTINUE TO WORK TOWARDS THIS OBJECTIVE.

5. ONLY MARGINAL ATTENTION IS GIVEN TO THE LAST MINUTE ITALIAN WITHDRAWAL FROM THE MEETING. MOST PAPERS SUGGEST THAT THE ITALIAN MOVE WAS MADE CHIEFLY FOR INTERNAL POLITICAL REASONS AND ONLY ONE, LIBERATION, HAS SO FAR REFERRED TO A POSSIBLE CANCELLATION BY THE ITALIANS OF THE SEVEN POWER SUMMIT.

6. AN AFP REPORT THIS AFTERNOON QUOTES ELYSEE SOURCES AS SAYING THAT MITTERRAND WILL GO TO ROME ON WEDNESDAY FOR TALKS WITH COSSIGA AND CRAXI.

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CN ZP (QY) RIM480

230207 :/CURRENCY PACT SUCCESS SEEN HINGEING ON U.S. MOVES

By Jeremy Solomons, Reuters

NEW YORK, Feb 23 - Market judgment of how willing the U.S. is to take concrete action to defend the dollar will be the key test of the success of the weekend accord of leading industrial nations to promote exchange rate stability, bond and currency market analysts said.

"If the market feels that what is in the communique is all it's going to get, then it'll want to test the downside again for the dollar," said Christiane Mandell of Barclays Bank Plc.

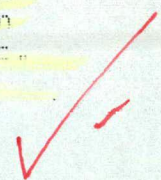
"But if they believe that the Fed is going to act, that would make all the difference," she added.

MORE

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CN ZP (QY) RIM481

230207 :/CURRENCY PACT #2 NEW YORK

The analysts noted that as expected, the Paris meeting produced a bland communique in which officials of the Group of Five nations plus Canada pledged to "cooperate closely to foster stability of exchange rates around current levels."

The six nations undertook to step up individual domestic measures to help redress world economic imbalances but did not specify interim measures, such as open market intervention, to smooth out any short-term turbulence in the currency markets.

"The communique on its own will not mean a lot to the U.S. market, which still wants to sell the dollar," said a chief dealer at a major European bank.

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CN ZP (QY) RIM482

230208 :/CURRENCY PACT #3 NEW YORK

Since the so-called Plaza agreement of September 1985, the U.S. has favoured an orderly decline in the dollar as an effective way of paring its massive trade deficit. Many market participants suspect that this is still the case.

The trade gap widened to a record 169.8 billion dlrs in 1986 and many analysts fear the January deficit, to be announced on Friday, will widen to about 12 to 14 billion dlrs from 10.66 billion in December.

"If we get a bad trade number on Friday, we could see record lows for the dollar very soon afterwards," said Steven Cerier of Manufacturers Hanover Trust Co.

MORE

230212 :/CURRENCY PACT =4 NEW YORK

In late January, the dollar dipped to 149.98 yen for the first time in about 40 years and touched a 6-1/4 year low of 1.7690 marks. In early Tokyo trading today, the U.S. currency was quoted at 153.80 and 1.8270 respectively.

Other analysts were less bearish about the dollar, sensing perhaps a subtle shift in U.S. strategy.

They noted that although U.S. Treasury Secretary James Baker stopped short of saying the dollar had fallen enough at a press briefing in Paris, he did say that the six nations should do what they can do to foster stability around current levels.

MORE

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CN ZP (QY) RIM486

230213 :/CURRENCY PACT =5 NEW YORK

Meanwhile, U.K. Chancellor of the Exchequer Nigel Lawson said the six nations had privately agreed on a joint central bank intervention policy.

"It is quite possible this agreement will be tested on Monday or later", he said, adding that at such time the participants would show their resolve to defend currencies.

"The U.S. seems to have made a commitment to intervene, if necessary. It can't risk a collapse of the dollar," said James O'Neill of Marine Midland Bank N.A.

"The Fed would probably intervene to scare people," added Chris Bourdain of BankAmerica International.

MORE

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CN ZP (QY) RIM487

230213 :/CURRENCY PACT =6 NEW YORK

Federal Reserve Chairman Paul Volcker said last Thursday that another downward dollar drive would "undermine hard won gains against inflation and would risk dissipating the flows of foreign capital we, for the time being, need. The stability of the financial markets would be jeopardised."

However, analysts warned that while such intervention could be effective in the short term, it would be no substitute for determined action on the underlying economic imbalances.

"The relative fundamentals still need to change," said Barclays' Mandell.

MORE

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CN ZP (QY) RIM488

230214 #/CURRENCY PACT #7 NEW YORK

"The trouble is that Volcker and Baker can not promise anything on the budget deficit. Congress has to see to that," said Barclays' Mandell.

Some analysts, including Stephen Slifer of Shearson Lehman Government Securities Inc, said that while the budget deficit remains uncomfortably high, they did note some signs of improvement in that area.

"We may not achieve the 108 billion dlr Gramm-Rudman target next year but we should still get 130 to 140 billion, which would be something," Slifer said.

MORE

CN ZP (QY) RIM488

230216 #/CURRENCY PACT #8 NEW YORK

The deficit reached a record 220.7 billion dlrs in fiscal 1986 but forecasts are for a deficit in the range of 160 to 180 billion dlrs this year.

Shearson's Slifer also noted some slow progress on the trade front.

"Even if the deficit goes to 14.5 billion dlrs in January, on a seasonally adjusted basis it would still be below the fourth quarter average," he said.

"We have begun to turn the corner," he added.

REUTER

GRS 560

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FM ROME

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INFO PRIORITY BONN, OTTAWA, TOKYO, PARIS, WASHINGTON, UKDEL IMF/
INFO PRIORITY IBRD, UKDEL OECD

MY TELNO 134: G5/G7 - ITALIAN PRESS COMMENT

SUMMARY:

1. QUALIFIED APPROVAL OF ITALIAN WITHDRAWAL FROM G7 MEETING.
BLAME IS ATTRIBUTED TO FRANCE RATHER THAN BRITAIN.

DETAIL:

2. TODAY'S PRESS IS DIVIDED ALONG THE USUAL LINES REGARDING ITALY'S LATE WITHDRAWAL FROM THE G7 MEETING. MOST NATIONAL PAPERS SUPPORT THE GOVERNMENT'S INTERPRETATION OF THE TOKYO STATEMENT TO MEAN THAT FOR ALL PRACTICAL PURPOSES G5 SHOULD BE REPLACED BY G7. THE RIGHT-OF-CENTRE PAPERS TEND TO DISAPPROVE OF ITALY'S PRECIPITATE ACTION, WHILE THE LEFT-WING PRESS SEES IT AS AN EMPTY GESTURE AND EMPHASISES THE KEY ROLES OF USA, GERMANY AND JAPAN. THERE IS LITTLE ATTEMPT TO APPORTION RESPONSIBILITY FOR THE CONTINUATION OF G5 AMONG ITS MEMBERS ALTHOUGH BALLADUR'S ROLE IS MOST PROMINENTLY REPORTED, GIVEN THE PARIS VENUE. STOLTENBERG IS ALSO QUOTED AS REBUTTING ITALY'S CLAIM TO G5 MEMBERSHIP. HOWEVER THREE PAPERS REFER TO ITALY'S SUPPOSED ECONOMIC OVERTAKING OF BRITAIN AS A RELEVANT FACTOR.

3. ON THE SUBSTANCE, THE AGREEMENT REACHED ON SUNDAY BY THE SIX COUNTRIES IS SEEN AS SUCCESSFUL IN ITS RECOGNITION OF PRESENT EXCHANGE-RATE PARITIES AS BEING APPROPRIATE ALTHOUGH THE MARKET IS EXPECTED TO HAVE THE FINAL WORD ON THE SUBJECT.

4. ON SUNDAY THE PRIME MINISTER'S OFFICE IN ROME ISSUED AN ANNOUNCEMENT STATING THAT FRANCE HAD BEEN WELL AWARE WHAT ITALY'S POSITION WOULD BE IF THE TOKYO AGREEMENT WAS NOT RESPECTED AND PUTTING IN DOUBT THE VENICE ECONOMIC SUMMIT. CLARIFICATION OF THE UNDERSTANDING REACHED AT TOKYO WAS NOW REQUIRED: WITHOUT IT 'THE VENICE SUMMIT CANNOT TAKE PLACE IN THE FORM AND TERMS ENVISAGED'. A SPOKESMAN IS QUOTED AS ADDING THAT THIS CLARIFICATION SHOULD TAKE PLACE QUICKLY, CERTAINLY BEFORE THE NEXT MEETING OF THE INTERNATIONAL MONETARY FUND IN APRIL. HE WENT ON 'IT MUST BE CLARIFIED WHETHER THE UNDERSTANDINGS AT TOKYO ARE VALID OR WHETHER IT WAS THE FINANCE MINISTERS OF THE FIVE WHO WERE MISTAKEN...IT IS CLEAR THAT THERE HAS BEEN A DECEPTION ON THE PART OF COUNTRIES TRYING TO DEFEND POSITIONS OF PRESTIGE WHICH, BECAUSE OF THE GROWTH

OF ITALY, THEY HAVE NO LONGER GROUNDS TO RETAIN... THE INTENTIONS OF THE FIVE ARE AIMED AT DEFENDING PRIVILEGES OF THE PAST'. SOME PAPERS ALSO ALLUDE TO APPARENT DIFFERENCES BETWEEN LEADING MEMBERS OF THE GOVERNING COALITION WITH ANDREOTTI (DC) DISTANCING HIMSELF AND THE MFA FROM CRAXI'S HARD LINE, AND THE REPUBLICAN DEFENCE MINISTER SPADOLINI REPORTEDLY SAYING DURING A VISIT TO THE USA THAT ITALY'S MEMBERS OF THE G7 SHOULD NOT BE PUT IN DANGER AND THAT IT WOULD BE SERIOUS TO REFUSE TO HOST A VENICE SUMMIT.

5. THE RIGHT-WING 'IL GIORNALE' REGARDS ITALY'S WITHDRAWAL FROM THE MEETING AS A PRE-ELECTION GESTURE BY CRAXI AND SAYS THAT A MEASURED PROTEST AGAINST DISCRIMINATORY TREATMENT WOULD HAVE BEEN PREFERABLE. IT ATTRIBUTES ITALY'S EXCLUSION TO A GENERAL FEELING THAT THE COUNTRY IS UNTRUSTWORTHY. 'CORRIERE' CONSIDERS THAT THE TOKYO AGREEMENT WAS NOT RESPECTED BY THE FIVE BUT THAT ITALY'S REACTION WAS CLUMSY. THE CENTRIST 'STAMPA' BELIEVES THE TOKYO AGREEMENT WAS NOT RESPECTED BUT THAT FRANCE'S EFFORTS TO RESOLVE THE DISPUTE WERE CLUMSY. IT QUOTES GORIA AS SAYING, IN ANSWER TO STOLTENBER, THAT HE KNEW G5 WAS COMPOSED OF THOSE COUNTRIES WHOSE CURRENCIES FORM THE SDR BASKET BUT THE PARIS TALKS COVERED GROUND ENVISAGED BY THE TOKYO AGREEMENT. THE SOCIALIST PARTY PAPER 'AVANTI'

SAID ON 22 FEBRUARY 'SINCE TOKYO, ITALY HAS BECOMT THE 5TH LARGEST INDUSTRIAL POWER AND COULD SOON BE THE 4TH... TO INCLUDE BRITAIN AND EXCLUDE ITALY CAN ONLY HAVE AN HISTORIC SIGNIFICANCE, WHILE IN TERMS OF THE NATIONAL ACCOUNTS OF THE TWO COUNTRIES IT IS MEANINGLESS'.

BRIDGES

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LIMITED

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WED

MR BRAITHWAITE

MR THOMAS

MR RATFORD

MR MAUD

COPIES TO:

~~PS/CHANCELLOR OF EXCHEQUER~~

SIR G. LUTHER, TREASURY

MR EVANS, TREASURY

✓✓

Pls Chancellor
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CN RIM794

A, B, C + C3.

231048 :/PARIS MEETING DISCUSSED BRAZIL DEBT - MIYAZAWA
TOKYO, Feb 23 - Japanese Finance Minister Kiichi Miyazawa
said the Paris meeting of major industrial nations took up the
issue of the Brazilian debt problem but did not discuss any
specific measures to cope with it.

He told reporters upon his return from Paris that the
Brazilian government will discuss its debts in detail with the
so-called Paris club of creditor governments and with private
creditor banks.

Last Friday, Brazil suspended payment of interest on its
commercial bank debt. Britain, Canada, France, Japan, the U.S.
and West Germany met last weekend in Paris.

REUTER

230001 :/JAPAN PAPER SAYS LOWER DOLLAR LIMIT SET AT 150 YEN
TOKYO, Feb 23 - Major industrial nations have set a lower limit for the dollar at 150 yen, the Mainichi Shimbun reported in this morning's edition.

The daily newspaper quoted unidentified sources as saying that major nations will prevent the dollar from falling below that point.

In a statement released yesterday, Britain, Canada, France, Japan, the U.S. and West Germany agreed to cooperate to stabilize exchange rates around present levels.

Mainichi said the six countries agreed to allow the dollar to rise to 160 to 170 yen, if the market pushes it up.

REUTER

Handwritten initials or mark.

CN RIM768

A, B, C, C1.

231016 :/MEASURES TO STABILIZE CURRENCIES AGREED - MIYAZAWA

TOKYO, Feb 23 - Major nations agreed on detailed measures to stabilize currencies when they met last weekend in Paris, Finance Minister Kiichi Miyazawa said.

But they also agreed not to reveal them, he told reporters upon his return from the Paris meetings.

He said the major nations thought the measures would be more effective if they were not publicly revealed, he said.

That is why the statement issued yesterday by Britain, Canada, France, Japan, the U.S. and West Germany was so vaguely worded, he said.

MORE

CN RIM777

231024 :MEASURES TO STABILIZE =2 TOKYO

Referring to the agreement to foster currency stability around current levels, Miyazawa said stability does not mean fixed rates. When asked about the difficulties Japanese industry faced with a yen/dollar rate of 150, he said currency stability is the most important element at that the moment.

Currency movements, such as occurred in the middle of last month, should not be repeated, he said. The dollar fell to a record low of 149.98 yen in hectic trading here last month.

Miyazawa said the economic fundamentals of each country will change over time and currency levels will change with them, as dictated by economic theory.

MORE

CN RIM780

231026 :MEASURES TO STABILIZE =3 TOKYO

Asked to comment on Japan's pledge to expand domestic demand, Miyazawa said parliamentary approval of the 1987/88 budget is a prerequisite before other action to stimulate the economy can be taken.

He declined to say what possible expansionary measures might be taken after the budget is approved.

Opposition parties have held up approval of the budget for the year beginning April 1, to protest against the government's plans to introduce a sales tax.

REUTER

From: Sir G.Littler
Date: 23 February 1987

CHANCELLOR

c.c. Sir P.Middleton

WEEKEND MEETINGS

I attach a draft minute to the Prime Minister and Foreign Secretary, reporting on the meetings and raising the point on Italy and possible approaches to the US as we discussed.

It is a little long and could well be cut, but I thought you might want, for both recipients, to give some of the background.

(Geoffrey Littler)

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keep down length

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SECRET

DRAFT MINUTE FROM CHANCELLOR

To: Prime Minister

c.c. Foreign Secretary
Governor (B/E)

MEETINGS OF FINANCE MINISTERS AND CENTRAL BANK GOVERNORS

main points from aspects of
There are two ~~aspects of~~ the meetings ~~which I attended with the~~
~~Governor of the Bank of England~~ in Paris over the weekend in
which you and Geoffrey Howe will be interested: the agreement
reached (between only six countries in the event); and the Italian ~~attitude of the~~
~~problem.~~

It is very much a true line of the draft I showed you last week, and includes

I attach the text of the Communique issued yesterday afternoon.

You will see that the UK passage in paragraph 7 ~~is as we agreed~~.

This and the other national passages state existing policies and
broad intentions - ^{there is} no new action except ^{for} the Japanese interest rate
cut announced on Friday. The ^{main} ~~important~~ paragraph is the last, ^{one (para 10)}
stating the agreement to cooperate to foster stability of exchange
rates "around current levels" ~~(much better than the wording of~~
~~"recent ranges" which we thought had been agreed under US pressure~~
~~but which proved to have got lost, probably on advice from Volcker~~
~~and Poehl!)]~~ ~~[Incidentally I suspect Balladur is less devoted to~~
~~"target zones" than most of the French bureaucracy and theorists.]~~

Behind the text there are some understandings on future policy
developments, and on intervention. The Germans will be increasing
the scale, although probably not accelerating the timing, of tax
reductions announced for 1988; and they envisage a new programme
of reform and reduction of taxes thereafter, said again to be big.
But ^{they will not say anything in public} ~~[nothing can be publicly specified]~~ until the negotiations in

SECRET

the coalition are finished. The Japanese will offer something more in a supplementary budget when the main budget has been passed by the Diet in April or May. (Miyazawa struck me as being more genuinely anxious than his predecessor or colleagues to [get an] expanding ^{domestic} demand and cut into the trade surplus, ^{through} [but] he may well have [to fight]). The US claim again to be determined to get on with promised reductions in their fiscal deficit.

On intervention, the understanding is [basically between US, Japan and Europe (with Germany obviously in the lead) and] in terms of "current levels" of DM 182.5 = 1 dollar and Yen 153.5 = 1 dollar. The Japanese made a strong pitch for a range of 150-165, but I supported others in arguing against this and insisting that they must not seek an advantage in lesser appreciation against the dollar than that of the DM and others. It was agreed that, [in both directions symmetrically,] somewhere around 2.5% above and below the current levels [as defined,] concerted intervention would be invoked. If there were divergence of as much as 5% either way there might be need to reconsider. But there will be continuous consultation; none of the "limits" is rigid - they have to be interpreted in the light of market behaviour.

No limits were suggested for sterling. I said that, against a background of more stable currency relationships, we would expect sterling to fit in, and would reckon to avoid moving or operating inconsistently with the spirit of the agreement. [We confirmed privately with Poehl (who is bound to take a coordinating position in the Community, and more widely in Europe in discussions with

SECRET

the US) that we should be free to carry on very much as we have been doing (the fact that we can operate at need in either dollars or DM or yen gives us a good deal of leeway to protect our own interests without conflicting with those of others, as long as they stay within their agreement).]

It is now very important that we should have an end to the cross-fire of comments between US and Japan that has upset markets in recent weeks. I made this point, and it was agreed. [Also it is important that the US are seen to act, if need arises, and they accepted this point too. Given those conditions, there is certainly a good case for a period of stability while effects of past changes come through; and I think markets could be ready to accept it.]

although we would not want to
As far as the UK is concerned, I think we can be well content with an outcome which does not involve us in onerous commitments and which, if successful, could helpfully provide a more stable external background for us in the coming weeks.

I turn now briefly to the Italian problem. Their complaint was against the fact that the G5 met prior to the G7, who would then simply have to rubber-stamp the deal. We had sought to shelter them by keeping the G5 meeting informal, with no press contact, and mingled with several bilateral consultations, including with Italy and Canada. The Canadians accepted this throughout, in spite of Italian attempts to persuade them otherwise.

The eventual decision by Italy not to participate came as a surprise to everyone - and the high drama of the threat to cancel

SECRET

Formally

Craxi's motives,

the Venice Summit caused even more astonishment. We all concluded however, are clear. Having succeeded in getting the G7 off to ground at the Tokyo Summit, he is now set on getting the G5 abolished. All G5 members are opposed to that - we (and the French) have of course an additional reason. Already in recent weeks we have seen specially close relations between the US, Germany and Japan, although I think at no stage a G3 meeting and we and the French have been kept fairly closely in touch throughout. But the G3 development is a clear threat.

Particular reason is from it. But Jim Baker is fearful that President Reagan will succumb, given the threats Craxi is putting to make: you will recall that this was precisely how the Italian secured American backing for the G7 in the first place.

Balladur and Stoltenberg both feel that the G5 can and should be preserved, as I do. Jim Baker shares our wishes, but is fearful that his President will succumb to Italian pressure for general political reasons - [you will recall] that this was how we got into the G7 in the first place, when Reagan yielded to the Italian complaints over [the] G5 meeting [I chaired in London early last year].

between the Italian and Baker → *takers*
 I wonder whether Geoffrey Howe could find an early opportunity of *enlist* Schultz's support, and indeed whether you would *consider conveying a possible* feel it possible to convey a message to Reagan. I would at least like to avoid having our position pre-empted, as happened before. *Again,*

I am copying this only to Geoffrey ^{Howe} and to the Governor.

(N.L.)

I saw Sir Lupton address the work you have fully done with respect to Baker. I have discussed the work with Baker for some time now.

but also for readiness to engage in concerted activities
in the foreign exchange markets to achieve the objective.

"Current levels" were agreed as 182.5 DM to the \$ and
153.5 Yen to the \$. It was agreed that, depending on
market conditions, interventions might be needed if
when rates diverge by ~~the~~ some 2 1/2 % on either
side, and that a 5% divergence would give grounds for
strong concern. No ~~specific~~ limits ~~were~~ of this kind
were suggested for ~~the~~ No 7, but I
indicated that I would expect strong efforts to be made to
prevent a breakdown of stability, and that should we need
to intervene we would endeavour to avoid doing so
in a way that was contrary to the spirit of
the overall agreement.

I stress the happy to amplify all this when we
next ~~the~~ meet. Meanwhile,

[Then continue 1/2 way
down p 3 of No 6 letter signed]

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HD/ ECD (E)

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10/8

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SIR G LITTLE
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HM TREASURY

(50) T
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OBA [it in MONET series]

241220Z FEB
GRS 420

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TO IMMEDIATE FCO

TELNO 143

OF 241220Z FEBRUARY 87

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IMMEDIATE

G5/G7

SUMMARY

1. VENICE ECONOMIC SUMMIT EXPECTED TO TAKE PLACE. ITALY FAVOURS A NEW PROCEDURE TO PREVENT FURTHER MISUNDERSTANDINGS.

DETAIL

2. WHEN I CALLED ON THE SECRETARY-GENERAL MFA, I ASKED HOW HE SAW MATTERS AFTER THE G6 PARIS MEETING. RUGGIERO REPLIED THAT IT WAS ESSENTIAL TO ARRIVE AT A NEW PROCEDURE WHICH WOULD CLEAR UP THE AMBIGUITIES IN THE AGREEMENT REACHED AT THE TOKYO ECONOMIC SUMMIT. THIS SHOULD BE DONE BEFORE THE VENICE MEETING, WHICH HE WAS CONFIDENT WOULD TAKE PLACE. HE RECOGNISED THAT IT WOULD NOT BE EASY TO DEFINE FRESH PROCEDURES, PERHAPS PARTICULARLY FOR THE FRENCH AND THE AMERICANS WHO SUFFERED FROM INTERNAL DIFFERENCES. BUT TRICKY AS SUCH DISCUSSIONS WOULD BE, WE HAD TO AVOID OPEN DISAGREEMENT IN THE FUTURE. SHERPAS WERE THOSE BEST EQUIPPED TO HANDLE THIS SITUATION FOR GOVERNMENTS, AND HE SEEMED TO BE THINKING OF A SEPARATE MEETING TO PUT SUCH AN AGREEMENT IN PLACE BEFORE THE FINANCE MINISTERS MET IN APRIL. BUT IT WOULD NOT BE EASY, AND THE RESPONSIBILITY OF FINANCE MINISTERS

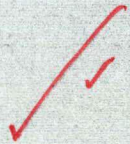
WOULD NOT BE EASY, AND THE RESPONSIBILITY OF FINANCE MINISTERS WOULD HAVE TO BE RESPECTED.

3. ON THE EVENTS OF THE WEEKEND, RUGGIERO DID NOT COMMENT MUCH. BUT HE DID BELIEVE THAT THE POSITION OF THE ITALIAN GOVERNMENT WAS SUPPORTED BY ALL THE MINISTERS CHIEFLY RESPONSIBLE, AND THAT IT WAS WRONG TO SUGGEST (AS SOME HAVE BEEN DOING) THAT INTERNAL POLITICAL DIFFERENCES IN ITALY HAD PLAYED ANY SIGNIFICANT ROLE. WHAT HAD OCCURRED CERTAINLY PRODUCED POLITICAL EFFECTS WITHIN ITALY (HERE HE PRESUMABLY MEANT THE RELATIONSHIP BETWEEN THE VENICE SUMMIT AND THE STAFFETTA, WHO WOULD BE PRIME MINISTER AT THE TIME). HE WAS STRONGLY CRITICAL OF THE FRENCH, IN HAVING ISSUED AN OFFICIAL STATEMENT THAT THERE HAD BEEN NO MEETING OF THE G5, WHEN THIS WAS KNOWN TO BE THE CASE. HE WAS TODAY CONSIDERING WHAT ADVICE HE SHOULD OFFER TO CRAXI AND ANDREOTTI ABOUT THE LINE TO TAKE WITH MITTERRAND TOMORROW. IT SOUNDED AS IF THERE WOULD BE AN ACCUSATORY PART, FOLLOWED BY A SUGGESTION THAT SHERPAS SHOULD BE ENTRUSTED WITH DRAWING UP AN AGREEMENT ON NEW PROCEDURES.

COMMENT

4. THERE IS, IN FACT, RATHER MORE DISAGREEMENT BETWEEN ITALIAN MINISTERS ON THIS QUESTION THAN RUGGIERO ADMITS. THE COURSE OF EVENTS ON FRIDAY (MY TELNO 133) CLEARLY INDICATES THAT GORIA WAS RELUCTANT TO ABSENT HIMSELF FROM THE MEETING. SUBSEQUENT COMMENTS BY THE PRIME MINISTER'S OFFICE HAVE BEEN NOTABLY TOUGHER THAN THOSE MADE BY ANDREOTTI, WHOM THE PRESS REPORT AS SPEAKING OF THE VALUE OF THE ECONOMIC SUMMITS AND THE NECESSITY TO CONTINUE WITH THIS SERIES OF MEETINGS.

BRIDGES



RF
P/S Chancellor
12/2

241513 :/VOLCKER WARNS AGAINST EXCESSIVE MONEY GROWTH ABC

WASHINGTON, Feb 24 - Federal Reserve Board Chairman Paul Ci
Volcker said the Fed wants to encourage continuing growth but
is also concerned that the expansion last as long as possible. GS

"To that end, the threat of renewed inflation will require
continuing caution to avoid excessive increases in money and
credit," Volcker said.

Financial markets are bound to be alert to any adverse
change in the inflation trend, Volcker said in testimony before
the Senate Budget Committee.

MORE

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CN RIM824

241513 :/VOLCKER WARNS =2 WASHINGTON

"Neither the internal nor external setting permits
thinking of trading off more inflation for more growth," he
said.

Further sizable declines in the federal budget deficit
would make the job of the central bank easier, Volcker said.

He said imbalances in the economy of the United States and
of the world must be dealt with or they "will impair both
growth and price stability."

REUTER

Pls. Chancellor ^{Ref}
12/2

CN RIM441

A, B, C, Ci

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240715 :/SUMITA DECLINES TO DETAIL PARIS ACCORD

TOKYO, Feb 24 - Bank of Japan governor Satoshi Sumita declined to reveal details of the Paris agreement among leading industrialised democracies on the grounds that silence would better help stabilise exchange rates.

Speaking to reporters on his return from the weekend meeting, Sumita would only reiterate that the Group of Five and Canada agreed to cooperate closely to stabilise exchange rates at around current levels.

MORE

240719 :/SUMITA DECLINES =2 TOKYO

The 1985 Plaza agreement was aimed at correcting the high dollar value. Last weekend's agreement was aimed at stabilising the dollar, Sumita said.

However, economic policy coordination is a prerequisite for currency market stability, he said. The Group of Five and Canada agreed at the talks on the importance of correct fiscal policies, regardless of whether a nation was running a trade deficit or a surplus.

The nations also agreed to avoid any further currency market turbulence, he said.

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240735 :/SUMITA DECLINES =3 TOKYO

Sumita said he believed that currency market stability should continue over a considerable period of time and such stability would help sustain Japan's steady economic growth.

He also said G-5 nations were expected to review the degree of currency stability when they next meet.

International monetary sources expect the G-5 to meet in April prior to an interim committee meeting of the International Monetary Fund in Washington.

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YOUR TELNOS 281 AND 282 TO WASHINGTON: MEETING OF FINANCE MINISTERS, PARIS, 21 AND 22 FEBRUARY.

1. THETMEYER, WHO ACCOMPANIED STOLTENBERG TO THE WEEKEND MEETING IN PARIS, MADE THE FOLLOWING POINTS AT AN EC AMBASSADORS' LUNCH ON 23 FEBRUARY:

(A) JAPANESE LEAKS HAD VERY NEARLY RUINED THE CAREFUL PROCESS OF PREPARATION BY WHICH ALMOST EVERY WORD IN THE COMMUNIQUE HAD BEEN AGREED BEFOREHAND AND INCORPORATED CONCRETE UNDERSTANDINGS:

(B) IT WAS NOT TRUE THAT THE GERMAN ELECTION ON 25 JANUARY HAD PREVENTED THE PARIS MEETING BEING HELD EARLIER. CONTACTS HAD BEGUN IN EARLY JANUARY, AND IT WAS JAPAN WHICH HAD CANCELLED (APPARENTLY FOR DOMESTIC POLITICAL REASONS) A G.5 MEETING PLANNED FOR 8/9 FEBRUARY:

(C) IF BRITAIN HAD BEEN MORE RELUCTANT TO MEET THAN SOME OTHERS, THIS WAS NOT SURPRISING GIVEN THE ENVYABLE POSITION OF THE POUND STERLING AS AGAINST THE DOLLAR AND OTHER EUROPEAN CURRENCIES RESPECTIVELY:

(D) THE US HAD TAKEN IMPORTANT STEPS IN UNDERTAKING TO REDUCE ITS BUDGET DEFICIT (A PROCESS ALREADY UNDERWAY) AND TO IMPROVE ITS OWN COMPETITIVENESS, THUS ACKNOWLEDGING THAT A LARGE SHARE OF RESPONSIBILITY LAY ON ITS OWN SIDE OF THE ATLANTIC/PACIFIC:

(E) JAPAN TOO HAD MADE THE IMPORTANT PROMISE TO INTRODUCE A COMPREHENSIVE ECONOMIC PROGRAMME (IN LATE MARCH/EARLY APRIL, PROBABLY) TO STIMULATE DOMESTIC DEMAND. THETMEYER CONCEDED THAT WE HAD HEARD THIS KIND OF TALK BEFORE, BUT HE THOUGHT THAT THIS PASSAGE IN THE PARIS COMMUNIQUE WOULD GIVE A LEVER TO THE AMERICANS, WHO IN TURN HAD LEARNED FROM THEIR BAD EXPERIENCE LAST AUTUMN, WHEN JAPANESE PROMISES MADE TO THEM ON A BILATERAL BASIS HAD PROVED TO BE LARGELY EMPTY:

(F) THE FRG HAD ALSO MADE A SIGNIFICANT MOVE IN PROMISING - ON TOP OF ITS EXISTING CONTRIBUTION IN THE SHAPE OF LOW INTEREST RATES AND AN IMPORT/EXPORT RATIO WHOSE TRUE LEVEL WAS MASKED BY THE WINDFALL CHANGE IN THE TERMS OF TRADE IN 1986 - TO INCREASE THE SIZE OF THE TAX REDUCTIONS ALREADY DECIDED UPON FOR 1988. THIS WAS QUITE SEPARATE FROM THE SO-CALLED TAX REFORM FOR 1989 AND AFTER, NOW UNDER DISCUSSION IN THE COALITION, ALTHOUGH THAT TOO WAS DESIGNED TO HAVE A STIMULATORY EFFECT:

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(9)

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(G) THE MAIN ACHIEVEMENT OF THE LOUVRE MEETING WAS OF COURSE THE AGREEMENT THAT CURRENT EXCHANGE RATES WERE BROADLY CONSISTENT WITH UNDERLYING ECONOMIC FUNDAMENTALS AND THE UNDERTAKING TO COOPERATE IN MANAGING THESE 'AROUND CURRENT LEVELS'. THIS AMOUNTED TO SAYING THAT EXCHANGE RATES WERE ABOUT RIGHT FOR THE TIME BEING, A MESSAGE WHICH SHOULD ELIMINATE FEAR OF A FURTHER FALL IN THE DOLLAR AND CREATE THE NECESSARY SECURITY OF EXPECTATIONS FOR THE PURPOSES OF INVESTMENT, THE PACEMAKER TO GROWTH. TALKING THE DOLLAR DOWN BELONGED TO THE PAST, ALONG WITH BENIGN/MALIGN NEGLECT. THETMEYER'S EXPECTATION WAS THAT EXCHANGE RATES WOULD IN FACT REMAIN ROUGHLY WHERE THEY ARE FOR 1987 AT LEAST. HE THOUGHT HE HAD BEEN IN THE BUSINESS LONG ENOUGH TO KNOW THE DIFFERENCE BETWEEN AN AGREEMENT IN WORDS AND AN AGREEMENT IN SUBSTANCE:

(H) ASKED WHETHER THE FRG MIGHT BE CRITICISED FOR NOT MOVING TOWARDS SUCH A DEAL EARLIER, WHEN THE DOLLAR HAD BEEN HIGHER, THETMEYER SAID THAT THE AMERICANS HAD NOT BEEN READY FOR IT UNTIL NOW. IT HAD TAKEN TIME TO NEMLLZPZZTUHJGADDZPC — *it usually does!*

(I) IF THE PASSAGE IN THE COMMUNIQUE ON THIRD WORLD DEBT WAS UNSATISFACTORY, THERE WERE REASONS FOR THIS. WESTERN GOVERNMENTS HAD SHOWN THE NECESSARY FLEXIBILITY, IMAGINATION ETC (THETMEYER PAID A COMPLIMENT TO THE PARIS CLUB AND FRENCH CHAIRMANSHIP OF IT), BUT WESTERN BANKS WITH THEIR DIFFERENT RULES AND STRUCTURES HAD STILL FAILED TO ANSWER THE QUESTION HOW THEIR CONTRIBUTION TO THE PROBLEM WAS TO BE MADE.

2. THETMEYER SPOKE RATHER FRANKLY. HE SHOULD BE GRATEFUL IF HIS CONFIDENCE COULD BE RESPECTED.

BULLARD
BPLMAN 3720

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YOUR TELNOS 281 AND 282 TO WASHINGTON: MEETING OF FINANCE MINISTERS,
PARIS, 21 AND 22 FEBRUARY

SUMMARY

1. OUTCOME OF THE PARIS MEETING GREETED WITH SOME SATISFACTION, THOUGH THERE IS SCEPTICISM OVER THE LONG-TERM EFFECTS ON THE INTERNATIONAL ECONOMIC SITUATION. THE AGREEMENT MAY COMPLICATE COALITION DIFFICULTIES OVER TAX REFORM HERE, ALTHOUGH THERE ARE SIGNS THIS EVENING OF A BREAK-THROUGH.

DETAIL

2. THE PARIS COMMUNIQUE, AND FINANCE MINISTER STOLTENBERG'S PART IN IT, HAVE COME IN FOR WIDESPREAD COMMENT IN THE FRG MEDIA. BECAUSE OF THE COMMITMENT TO FIRMER FISCAL MEASURES, MOST COMMENTATORS HAVE LINKED THE OUTCOME DIRECTLY TO THE COALITION NEGOTIATIONS HERE WHICH HAVE RUN INTO DIFFICULTY OVER TAX REFORM PROPOSALS. THE COMMUNIQUE ITSELF IS GENERALLY SEEN AS COMPATIBLE WITH FRG ECONOMIC POLICIES BUT THERE IS SOME SCEPTICISM THAT AN APPARENTLY BLAND DOCUMENT WILL HAVE ANY LASTING PRACTICAL INFLUENCE ON THE INTERNATIONAL ECONOMIC SITUATION. DIE WELT (ULTRA-CONSERVATIVE) SUGGESTS THAT THE RESULT OF THE MEETING WAS DOUBTFUL. THE SUEDEUTSCHE ZEITUNG (INDEPENDENT CENTRE) SAYS THAT THE OFFER OF FURTHER TAX CUTS WAS ONLY OF TOKEN VALUE TO THE US. THE FRANKFURTER ALLGEMEINE ZEITUNG (CONSERVATIVE AND PRO-GOVERNMENT) AND HANDELSBLATT (LIBERAL/FREE TRADE) BOTH QUESTION THE PRACTICAL EFFECTS OF THE FISCAL OPTIONS OPEN TO STOLTENBERG.

3. THE WORDING OF THE COMMUNIQUE WILL HAVE DONE LITTLE TO EASE THE PROTRACTED NEGOTIATIONS OVER FUTURE COALITION POLICIES WHICH HAVE STALLED OVER THE QUESTION OF TAX REFORM. OVER THE LAST FEW DAYS THERE APPEAR TO HAVE BEEN SOME EFFORTS TO FIND A COMPROMISE BY BRINGING SOME SMALL TAX CUTS INTO OPERATION ALONGSIDE THOSE ALREADY PROGRAMMED FOR JANUARY 1988 (THIS WILL HAVE FACILITATED STOLTENBERG'S PROMISE IN PARIS), BUT EVEN THIS HAS RUN INTO DIFFICULTY OVER THE DETAILS. THERE ARE, HOWEVER, PROMISING SIGNS THIS EVENING THAT SOME FORM OF COMPROMISE MAY HAVE BEEN REACHED DURING THE DAY.

4. IN FRANKFURT, THE BANKING AND FINANCIAL COMMUNITIES' REACTION HAS MIRRORED THAT OF THE MEDIA. FOREIGN EXCHANGES HAVE ADOPTED A WAITING ATTITUDE: THE US ECONOMIC INDICATORS DUE LATER THIS WEEK ARE SEEN AS

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THE FIRST TEST FOR THE AGREEMENT.

5. GOVERNMENT STATEMENTS HAVE EMPHASISED THAT THE COMMUNIQUE IS IN LINE WITH CURRENT FRG ECONOMIC POLICY.

6. STOLTENBERG'S ROLE IN THE PARIS MEETINGS HAS DONE HIM NO HARM DOMESTICALLY BUT NEITHER HAS IT IMPROVED HIS STANDING IN THE COALITION NEGOTIATIONS OVER FISCAL REFORMS.

BULLARD

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BPLNAN 3721

FINANCIAL

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cc: RC, CD, ES
PPS; SSS letter ✓

Rud
12/2

241828 :CRAXI SAYS ITALY HOPES G-7 ROW CAN BE OVERCOME

ROME, Feb 24 - Prime Minister Bettino Craxi said Italy hopes a dispute that led to Rome boycotting a meeting of its Group of Seven partners in Paris on Sunday can be patched up.

"We now hope that the difficulties that have arisen can be overcome and that everything can be contained within the framework of an isolated incident," Craxi said in his first formal statement on the row.

But Italy wanted clarification of its partners' view of its status and of an accord reached at the G-7 Tokyo summit of leading industrial nations that had been the subject of opposition within the group, he said.

MORE

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CN RIM040

241829 :CRAXI SAYS =2 ROME

Craxi, who tomorrow receives French President Francois Mitterrand in a meeting seen by both sides as a chance to heal the wounds, did not mention the Venice summit of G-7 heads of state, scheduled for June, which a senior aide had said on Sunday could be jeopardised by the row.

He said Italy still had faith in collaboration with G-7 but added: "We maintain that a clarification is needed to verify the significance of the fruit of this collaboration."

Italian Treasury Minister Giovanni Goria refused to attend the G-7 finance ministers' meeting after the G-5 held separate talks the previous night.

MORE

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CN RIM041

241830 :CRAXI SAYS =3 ROME

Italy said the meeting of G-5, which groups the United States, Japan, West Germany, France and Britain, had reduced Italy's role to rubber-stamping its agreements and broken last May's Tokyo accord.

Officials said the move was a snub to Italy which is poised to replace Britain as the world's fifth largest economy after four years of fast growth.

In Tokyo, the seven nations agreed that Italy and Canada should be admitted to G-5 talks on manipulating currency and interest rate movements whenever a G-5 decision affected them.

MORE

241919 :CRAXI SAYS =4 ROME

The agreement was reached only after Italy threatened to abandon the summit completely and Craxi said today that opposition to the accord was still obvious from within the group.

"The truth is that for many months, opposition, denials and reticence which aimed in reality to erode and reduce to nothing the accord reached at Tokyo have been appearing," he said. He did not elaborate.

Craxi said Goria had been right to pull out of a meeting "which was to ratify agreements already made by others."

MORE

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RIM076

241919 :ALBANIA PLANS =2 VIENNA

"The fundamental features of the next five-year plan are the complete reliance on our material, financial and foreign currency resources, with no aid or credits from abroad, to attain our targets," Gjyzari said in the speech in which he presented the plan to parliament.

Albania, a country of three mln people, runs its economy on orthodox Stalinist lines of rigid centralization and is constitutionally barred from accepting foreign loans or credits. Over the five year plan period Albania will increase its exports by 7.8 pct to boost its foreign currency income, Gjyzari said.

REUTER

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CN RIM077

241920 :CRAXI SAYS =5 ROME

Italian and French officials said Mitterrand, who supported Italy at the Tokyo summit, was sure to discuss the weekend's events with Craxi in Rome tomorrow.

Mitterrand's visit, which also includes talks with President Francesco Cossiga, had been planned before the Paris G-7 meeting as part of the president's regular European consultations, French officials added.

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GRS 110

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MY TELNO 51: MEETING OF FINANCE MINISTERS IN PARIS

SUMMARY

1. THE BELGIAN GOVERNMENT AND MEDIA GIVE A GUARDED WELCOME TO THE OUTCOME OF THE FINANCE MINISTERS' MEETING.

DETAIL

2. BELGIAN FINANCE MINISTER EYSKENS ISSUED A STATEMENT ON 23 FEBRUARY SAYING THAT THE PARIS MEETING MADE A VERY IMPORTANT CONTRIBUTION TO STABILIZING THE MAJOR CURRENCIES AT CURRENT RATES. HE HOPED THAT IN ADDITION TO AGREEING ON POLICY, THE 6 HAD WORKED OUT OPERATIONAL MEASURES TO PREVENT A FURTHER FALL IN THE DOLLAR. THE COOPERATIVE ATTITUDE OF THE UNITED STATES WAS REASSURING, AS WAS THE AMERICAN STATEMENT REJECTING PROTECTIONISM. THE AGREEMENT OF THE 6 TO REDUCE FISCAL PRESSURES WAS A CHALLENGE TO SMALL COUNTRIES LIKE BELGIUM WHERE FISCAL REFORM WAS ALSO URGENTLY REQUIRED.

3. EDITORIAL COMMENT MOSTLY FOLLOWS EYSKENS LINE, BUT WITH SOME DOUBTS EXPRESSED ABOUT THE LIKELY REACTION OF THE MARKETS TO THE AGREEMENT. THE PRINCIPLE FLEMISH FINANCIAL DAILY SAID THAT AMERICAN PRESSURE ON GERMANY AND JAPAN TO ADOPT MORE EXPANSIONIST POLICIES HAD PAID OFF. MOST PAPERS REPORT THE ITALIAN DISPLEASURE AT BEING EXCLUDED FROM THE G5 DINNER. THERE IS NO DIRECT SUPPORT FOR THE ITALIAN POSITION, BUT SOME NEWSPAPERS REFLECT THE FAMILIAR COMPLAINT THAT IN TAKING FINANCIAL DECISIONS THE BIG COUNTRIES IGNORE THE INTERESTS AND VIEWS OF THE SMALL.

PETRIE

YYYY

BWLNAN 2484

MONETARY

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WED

THIS TELEGRAM
WAS NOT
ADVANCED

REPEATED AS REQUESTED

ps

From: Sir G.Littler
Date: 25 February 1987

MR ALEX ALLAN

c.c. PS/CST
PS/FST
PS/MST
PS/EST
Sir P.Middleton
Mr Lavelle
Mr Huw Evans
Mr Loehnis (B/E)

ITALY AND PARIS MEETINGS

I thought it might be useful to circulate the attached note to Treasury Ministers and colleagues who might be asked about the circumstances of the Italian refusal to attend last Sunday's G7 meeting - with an explanation of what it is!

2. When messages came in to the meeting (chaired by Balladur, French Finance Minister) that the Italians had issued a statement and would be holding a press conference in Paris, Balladur rather sensibly proposed that all present should agree a line to take. Shortly thereafter he circulated a draft text and there was some discussion leading to amendments and a potential final version. That version is the attached note. It was never recirculated in this amended form, however, and was not definitively agreed. The reason for that was that the further piece of drama of the Italian threat to cancel the Venice Summit prompted Balladur to propose (and all others to agree) that the less they all said, the better. Nevertheless, I think the line in the note is valid.

GL

(Geoffrey Littler)

LINE TO TAKE ON ITALY/G7

1. Both G5 and G7 have official existence in accordance with the Tokyo Summit Declaration, which:
 - reaffirmed "the undertaking at the 1982 Versailles Summit to cooperate with the IMF in strengthening multilateral surveillance, particularly among the countries whose currencies constitute the SDR" (i.e. the G5); and
 - "requested the Group of Five Finance Ministers to include Canada and Italy in their meetings whenever the management or the improvement of the international monetary system and related economic policy measures are to be discussed and dealt with".
2. The G5 might thus properly have convened an official meeting on matters of multilateral surveillance as it does regularly, before today's G7 meeting.
3. Instead, there was a series of bilateral discussions and informal meetings and a private dinner. Our Italian colleague was informed in advance.
4. Bilateral and informal contacts were established also with Italy and Canada before the meeting of the G7.
5. We regret that Italy did not find it possible to attend the meeting. We hope they will maintain active participation in the G7 and look forward to their doing so at future meetings.

(NOTE: Canada was very happy to be associated with this)

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G5-G7: JAPANESE REACTIONS**SUMMARY**

JAPANESE GOVERNMENT SEE PARIS AGREEMENT AS BENEFICIAL IN PROVIDING SOME STABILITY IN THE SHORT TERM. DISCOUNT RATE LOWERED TO 2.5 PER CENT. NO INTERNAL CONSENSUS ON SCOPE OR FORM OF STIMULATORY PACKAGE, WHICH REMAINS HOSTAGE TO DIET DELIBERATIONS ON THE BUDGET AND SALES TAX. BELIEF THAT IN THE LONGER TERM, EXCHANGE RATE STABILITY DEPENDS ON U.S. WILLINGNESS TO CUT THEIR BUDGET DEFICIT.

DETAIL

2. THE JAPANESE GOVERNMENT ARE GENERALLY PLEASED WITH THE OUTCOME OF THE PARIS MEETINGS. FOR THEM THE MAIN OBJECTIVE WAS TO ACHIEVE GREATER STABILITY OF THE YEN EXCHANGE RATE. IN A PRESS CONFERENCE HERE ON 23 FEBRUARY MR MIYAZAWA SAID THAT THERE HAD BEEN AGREEMENT ON THE FORM AND TIMING OF CONCRETE COOPERATION TO ACHIEVE CURRENCY STABILITY, BUT THAT THIS SHOULD BE DONE WITHOUT PUBLICITY. THE AGREEMENT THAT CURRENT RATES BROADLY REFLECTED THE ECONOMIC FUNDAMENTALS OF EACH COUNTRY WAS IMPORTANT. TO TALK OF STABILITY WAS NOT TO RETURN TO FIXED RATES; THERE COULD BE ADJUSTMENTS IN FUTURE, BUT FURTHER APPRECIATION AT THIS STAGE WOULD BE DETRIMENTAL TO THE PROSPECTS FOR INDUSTRIAL RESTRUCTURING AND INCREASING DOMESTIC DEMAND IN JAPAN.

3. THE JAPANESE DISCOUNT RATE WAS LOWERED TO 2.5% ITS LOWEST EVER LEVEL, ON 23 FEBRUARY. THE GOVERNOR OF THE BANK OF JAPAN MADE CLEAR IN ANNOUNCING THIS LAST WEEK THAT HE SAW THIS AS THE LIMIT OF THE CONTRIBUTION OF MONETARY POLICY TO THE STIMULATION OF THE ECONOMY. FURTHER MEASURES WOULD HAVE TO COME ON THE FISCAL SIDE.

4. SINCE HIS RETURN MR MIYAZAWA HAS TAKEN THE LINE THAT THE PARIS STATEMENT DID NOT COMMIT JAPAN TO ANY CONCRETE STIMULATORY MEASURES, AND THAT THE SINE QUA NON WAS THE EARLY PASSAGE OF THE BUDGET THROUGH THE DIET. HE CLAIMED THAT THE IMPLEMENTATION OF THE GOVERNMENT'S TAX REFORM PROPOSALS, WHICH ARE THE CENTRAL CAUSE OF DELAY IN PROCESSING THE BUDGET, WOULD HAVE A POSITIVE EFFECT ON DEMAND (THOUGH THE GOVERNMENT'S OWN ECONOMISTS ASSESS THIS AS VERY SMALL). THE PRIME MINISTER HAS STATED THAT THE GOVERNMENT ARE CONSIDERING FURTHER MEASURES TO BE INTRODUCED AFTER THE BUDGET BUT HE IS REFUSING TO SHOW HIS HAND UNTIL ITS PASSAGE IS MORE FIRMLY ASSURED. THE EXTENT OF ANY STIMULATORY PACKAGE IS STILL UNDER INTERNAL DEBATE, AND WE BELIEVE THERE IS NO CONSENSUS ON THIS AT PRESENT. NAKASONE

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HAS ALREADY TALKED OF BRINGING FORWARD PUBLIC WORKS IN FY 87 AS FAR AS POSSIBLE. MIYAZAWA IS THOUGHT BY SOME TO BE SEEKING SUPPORT, INTERNATIONALLY AND DOMESTICALLY, FOR THE MORE EXPANSIONARY DEMAND

POLICIES WHICH HE ESPOUSED BEFORE HIS RE-ENTRY INTO THE CABINET. THE CHAIRMAN OF THE LDP GENERAL AFFAIRS COMMITTEE, ABE, HAS ALSO CALLED PUBLICLY FOR A MEASURE OF REFLATION. MFA AND MITI WOULD PROBABLY SUPPORT SUCH PLANS. THE MAIN OBSTACLE REMAINS THE ATTACHMENT OF NAKASONE AND THE MINISTRY OF FINANCE TO ELIMINATING THE DEFICIT AND THE POLITICAL ONE FOR THE GOVERNMENT OF MODIFYING ITS BUDGET AT THIS STAGE. NAKASONE'S LIKELY VISIT TO WASHINGTON IN MAY PROVIDES A POSSIBLE DEADLINE FOR NEW MEASURES.

5. IN THE BANKING AND BUSINESS COMMUNITY THE VIEW IS BROADLY THAT THE MEETINGS HAVE USEFULLY BOUGHT SOME TIME FOR THE YEN. THERE IS HOWEVER NO UNANIMITY ON WHETHER THE TIME THUS BOUGHT IS A MATTER OF WEEKS, OR OF MONTHS. THE LONGER IT IS, THE EASIER IT WILL BE FOR THE ECONOMY TO MAKE ITS NECESSARY ADJUSTMENTS, AND THE GREATER THE CHANCES THAT THE HOPED-FOR CORRECTION IN THE TRADE IMBALANCE WILL TAKE PLACE. BUSINESSMEN AND OFFICIALS FEAR HOWEVER THAT IN THE ABSENCE OF MEASURES BY THE US GOVERNMENT TO REDUCE ITS DEFICIT, THIS AGREEMENT MAY BE SHORT-LIVED AND THAT THE DOWNWARD PRESSURES ON THE DOLLAR WILL INEVITABLY REASSERT THEMSELVES.

WHITEHEAD

YYYY

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TELNO 416
OF 252300Z FEBRUARY 87

AND TO ROUTINE BOWN, PARIS, NEW YORK, OTTAWA, ROME, TOKYO
AND TO ROUTINE UKREP BRUSSELS, UKDEL OECD

UNITED STATES REACTIONS TO PARIS MEETINGS OF FINANCE MINISTERS
SUMMARY

1. US FINANCIAL MARKETS EXPECT PARIS AGREEMENT TO STABILISE DOLLAR BUT BELIEVE THAT THIS COULD REQUIRE GREATER INTEREST RATE DIFFERENTIAL BETWEEN UNITED STATES AND OTHERS. PRESS AND CONGRESSIONAL REACTION GENERALLY FAVOURABLE REGARDING PROMISED GERMAN AND JAPANESE STIMULUS AND RECOGNITION OF NEED FOR TAIWAN AND KOREA TO REDUCE SURPLUSES.

DETAIL

2. THE PARIS STATEMENT IS BEING DESCRIBED HERE BY THE PRESS AS A "DOLLAR ACCORD" WITH THE US AGREEING TO HOLD THE DOLLAR BROADLY AT ITS CURRENT LEVEL IN RETURN FOR PLEDGES OF FISCAL STIMULUS FROM GERMANY AND JAPAN (WITH LITTLE ATTENTION PAID TO PROMISED ACTION BY THE UK, FRANCE OR CANADA).

3. SENATE FINANCE COMMITTEE CHAIRMAN BENTSEN WELCOMED THE AGREEMENT BUT DOES NOT EXPECT THE US TO GAIN MUCH FROM THE STIMULUS IN JAPAN AND GERMANY. HE WELCOMED THE REFERENCES TO THE NEED FOR TAIWAN AND SOUTH KOREA TO ADJUST THEIR CURRENCIES AND ADDED "THIS MEANS WE CAN FURTHER CONCENTRATE ON SOME OF THESE NON-TARIFF BARRIERS".

4. ITALY'S REFUSAL TO ATTEND THE SECOND MEETING HAS NOT ATTRACTED MUCH COMMENT. THE WALL STREET JOURNAL (WSJ) QUOTED SECRETARY BAKER AS SAYING THAT THE SITUATION "WILL WORK ITSELF OUT". FEW BELIEVE THAT ITALY WILL CARRY OUT ITS THREAT OF REFUSING TO HOST THE VENICE SUMMIT.

5. ANALYSTS IN THE FOREIGN EXCHANGE MARKET EXPECT THE ACCORD TO STABILISE THE DOLLAR, AT LEAST TEMPORARILY. THE POSSIBILITY OF CONCERTED INTERVENTION IS THOUGHT LIKELY TO PROVE IF ANYTHING MORE EFFECTIVE THAN THE REALITY. BUT THEY ARE SCEPTICAL ABOUT THE ABILITY OF THE AGREEMENT TO SECURE RAPID PROGRESS IN THE US TRADE DEFICIT. THE WSJ HAS SUGGESTED THAT THE AGREED LOWER LIMITS OF THE DOLLAR WERE 1.8 MARKS AND 150 YEN BUT THE MARKET HAS SO FAR NOT SHOWN ANY DESIRE TO TEST THESE LIMITS.

6. TWO FACTORS COULD DISTURB THE FOREIGN EXCHANGE MARKETS THIS WEEK AND MAY WELL PROVIDE THE FIRST TEST OF THE DOLLAR'S STABILITY. FIRST, TRADE FIGURES FOR A NUMBER OF THE MAJOR COUNTRIES ARE DUE OUT THIS WEEK. IN THE UNITED STATES THE PRELIMINARY ESTIMATE OF JANUARY'S MERCHANDISE TRADE BALANCE WILL BE PUBLISHED ON FRIDAY, FEBRUARY 27, AND MARKET EXPECTATIONS ARE FOR A DEFICIT OF AROUND DOLLARS 15 BILLION. SECOND, THE MARKETS ARE WORRIED THAT TREASURY SECRETARY BAKER MAY BE PERSUADED BY THE

/PRESIDENT

ch/your info is otherwise
PRESIDENT TO TAKE OVER FROM REGAN (SEE OUR TELNO 400). IF BAKER WERE TO LEAVE THE TREASURY, OR IF THE JANUARY DEFICIT WERE TO BE WELL ABOVE THE MARKET EXPECTATION, THE DOLLAR COULD COME UNDER SIGNIFICANT SELLING PRESSURE. IF IT STARTS TO DECLINE, FOR THESE OR OTHER REASONS, THE MARKETS BELIEVE THAT THE DOLLAR CAN ONLY BE SUSTAINED BY A WIDENING OF THE DIFFERENTIALS BETWEEN US INTEREST RATES AND THOSE IN GERMANY AND JAPAN. ON BALANCE THEY EXPECT THAT US INTEREST RATES WILL BE PUSHED UP AS RATES IN GERMANY AND JAPAN ARE NOW AT VERY LOW LEVELS (AT LEAST IN NOMINAL TERMS).

7. MANY ECONOMISTS BELIEVE THAT THE DOLLAR WILL AT SOME POINT HAVE TO DEPRECIATE FURTHER. FOR EXAMPLE, ON THE WEDNESDAY BEFORE THE PARIS MEETINGS, FELDSTEIN (EX-CHIEF OF COUNCIL OF ECONOMIC ADVISERS) WROTE IN THE WSJ THAT THE DOLLAR NEEDED TO DECLINE BY A FURTHER 20 PER CENT OVER THE NEXT 4 OR 5 YEARS TO ELIMINATE THE TRADE DEFICIT. HE ARGUED THAT "IT IS SIMPLY WRONG TO BELIEVE THAT FASTER GROWTH ABROAD CAN BE A SUBSTITUTE FOR A FURTHER MAJOR DECLINE OF THE DOLLAR". FRED BERGSTEN (INSTITUTE FOR INTERNATIONAL ECONOMICS) HAS FOR SOME TIME BEEN ARGUING ON SIMILAR LINES.

8. IN THE IMF BOARD YESTERDAY, CAMDESSUS (MANAGING DIRECTOR) WELCOMED THE AGREEMENT WHICH HE CONSIDERED INVOLVED SIGNIFICANT COMMITMENTS BY THE COUNTRIES INVOLVED IN TERMS OF BOTH DOMESTIC POLICIES AND ACTION TO STABILISE EXCHANGE RATES. ON BOTH COUNTS HE THOUGHT THAT COMMENTATORS HAD BEEN TOO DISMISSIVE OF WHAT HAD BEEN AGREED. HE SUGGESTED THAT THE NEW AGREEMENT MARKED AN IMPORTANT RECONFIRMATION OF THE PRINCIPLE OF COORDINATION BETWEEN THE MAJOR COUNTRIES THAT BEGAN WITH THE PLAZA AGREEMENT. IT ALSO CONSTITUTED A FURTHER VALUABLE STEP FORWARD IN THE USE OF ECONOMIC INDICATORS AND HE REGARDED PARA. 9 OF THE AGREEMENT, WHICH CALLED FOR AN INTENSIFICATION OF THE WORK ON INDICATORS, AS AN IMPORTANT TEXT FOR THE IMF.

9. TREASURY ASSISTANT SECRETARY MULFORD, SPEAKING AT A NATIONAL ASSOCIATION OF BUSINESS ECONOMISTS' CONFERENCE IN WASHINGTON ON FEBRUARY 24, WAS ASKED WHY FISCAL STIMULUS IN GERMANY AND JAPAN SHOULD RAISE THE DOLLAR WHEN EXCESSIVE FISCAL STIMULUS IN THE UNITED STATES WAS GENERALLY AGREED TO HAVE CAUSED THE DOLLAR OVERVALUATION IN THE EARLY 1980S. HE REPLIED THAT THE UNITED STATES WANTED GERMANY AND JAPAN TO ADOPT STRUCTURAL CHANGES, SUCH AS RADICAL TAX REFORMS, NOT KEYNESIAN PUMP PRIMING. HE DECLINED TO SAY HOW THE ADMINISTRATION WOULD RESPOND IF THE DOLLAR STARTED TO DECLINE AGAIN.

COMMENT

10. THE AGREEMENT HAS BEEN WELL RECEIVED IN THE UNITED STATES AND WILL ADD TO BAKER'S STANDING, ESPECIALLY SINCE MOST OTHER SENIOR MEMBERS OF THE ADMINISTRATION ARE ENTANGLED IN THE IRAN/CONTRA ARMS AFFAIR. BUT IT ALSO REPRESENTS A VICTORY FOR VOLCKER'S VIEW--THAT FURTHER DOLLAR DEPRECIATION WOULD INVOLVE UNACCEPTABLE RISKS FOR INFLATION--OVER THOSE IN THE TREASURY WHO HAD BEEN ARGUING FOR A FURTHER DOLLAR DECLINE. MARKET PARTICIPANTS ARE SCEPTICAL BUT SEEM UNLIKELY TO SPECULATE HEAVILY AGAINST THE DOLLAR FOR A WHILE, GIVEN THE THREAT OF CONCERTED INTERVENTION. A NEW WORRY IS THAT INTEREST RATES VOLATILITY WILL

REPLACE DOLLAR VOLATILITY WHICH COULD PROVE NO LESS DAMAGING TO THE DOMESTIC ECONOMY. THERE IS ALSO WIDESPREAD SCEPTICISM ABOUT THE ABILITY OF THE UNITED STATES TO FULFIL ITS PART OF THE BARGAIN, I.E. GROWTH IN GOVERNMENT EXPENDITURE OF LESS THAN ONE PER CENT IN FY88. THE INCLUSION OF THIS REFERENCE TO ONE PER CENT GROWTH (WHICH TREASURY CONFIRM IS IN NOMINAL TERMS) IS WIDELY SEEN AS AN ADMINISTRATION TACTIC TO HELP KEEP CONGRESS TO THE EXPENDITURE LEVEL PROPOSED IN THE PRESIDENT'S BUDGET.

11. FCO PLEASE ADVANCE TO PS/CHANCELLOR, SIR G. LITTLER, SIR T. BURNS, AND HUW EVANS (TREASURY), LOEHNIS (BANK OF ENGLAND), AND BRAITHWAITE AND BROADBENT (FCO).

ACLAND

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PM/87/011

PRIME MINISTER

Meeting of Finance Ministers
and Central Bank Governors

X1

1. I have seen Nigel Lawson's minute to you and his recommendations for messages to Reagan and Shultz to resist Italian attempts to get the G5 in effect replaced by the G7. I share Nigel's irritation with Craxi's antics, and his astonishment at Italian threats to call off the Venice Summit. Craxi is almost certainly playing to his domestic audience in a pre-election period. He can rely on the general Italian desire to cut a figure internationally; which is hardly likely to lead the Italians to make good their threat to cancel the Venice Summit. But Italy has many friends in Washington. Craxi may yet get what he wants from Reagan: the effective emasculation of the G5.

HOWE
→
PM
25/2

2. As Nigel says, our aim must be to resist this. We need to stress to the Americans the G5's proven track record and the value of restricted membership. If we are to succeed, it is essential in my view that the French, Germans and ourselves should speak in Washington with a common voice on G5. We know that Balladur and Stoltenberg are solidly against its dissolution or disappearance. I am not so sure where Kohl and Mitterrand stand. I propose to instruct Sir Julian Bullard to speak to Kohl's office and solicit his support for G5. I am putting this in hand today.



3. Mitterrand has, however, been equivocal in the past. As in Italy, so in France there are domestic political considerations to bear in mind. The Embassy in Paris have confirmed that Mitterrand will be in Rome today for "private" talks with President Cossiga and with Craxi. I understand that Balladur has advised him to stand firm on the G5. We shall have to see: I have asked our Embassies to report. If Mitterrand declares his support for Craxi, the game is not lost; his Ministers may still persuade him. But it would certainly undermine an approach of our own in Washington. Conversely, if Mitterrand rebuts Craxi, the way is open for us to ask the French to join us in lobbying the Americans.

4. In Washington, both Reagan and Shultz will be distracted this week by the Tower Commission report. Shultz leaves for China on Friday 27 February, and in any case would not, in the Embassy's view, be inclined to involve himself in a matter which he regards as Baker's preserve. That leaves the President; but I do not think you should send a message to him on this issue alone. You may well need to send a reply to the message that Nitze and Perle will convey to you today on SDI. That will give our Ambassador an opening to deliver an oral message from you on G5/7, and I recommend that he do so. At the least, this should make the President cautious in what he says to Craxi, who I expect will be sending further messages to his G7 colleagues about the events of last weekend. On this timetable, we shall almost certainly find ourselves taking action in advance of the French and Germans, but I hope that by the end of the week we shall have some grounds to expect their subsequent support. This lobbying may well leak in Washington back to the Italians; which is a further argument for proceeding in company, or at least for being reasonably confident that others will follow our example.



5. I hope that my officials will have an opportunity to comment on the text of the message that our Ambassador will deliver on your behalf. The main points are clear enough, but it will need careful presentation.

6. I am copying this minute to Nigel Lawson and to the Governor of the Bank of England.

A handwritten signature in black ink, appearing to be 'G. Howe', written in a cursive style.

(GEOFFREY HOWE)

Foreign and Commonwealth Office

25 February 1987

FROM: NICOLAS TOWERS
DATE: 25 FEBRUARY 1987

PPS

cc Sir P Middleton
Sir G Littler *Sir G. Littler*
Mr Cassell
Mr Lavelle
Mr Peretz
Mr C Kelly
Ms Goodman

G7/6 PARIS MEETING 22 FEBRUARY

I attach the remaining on-the-record interviews etc given by the Chancellor as follows:

- interview with David Chater from ITN 22 February (not actually transmitted, but observed by other journalists, therefore in the public domain);
- inserts (A), (B), and (C) from the press briefing (originally omitted from the edited version circulated on Monday;
- interview with Dominic Harrod, Radio 4 Today programme 23 February;
- interview with James Long, BBC TV News 22 February (much edited from the original recording).

2. We are hoping to transcribe, for the record, the remarks of the other finance ministers* at the joint press conference, and also the Chancellor's non-attributable briefing at No 11.

**Baker's remarks
now in copy of [unclear]*

Nicolas Towers

NICOLAS TOWERS

JOINT PRESS CONFERENCE ON PARIS G7/6 MEETING

MR BAKER : Thank you very much Mr Chairman. Let me start by saying that I am pleased with the agreement which we have reached here today. The surplus ^{countries} have committed to strengthen their growth prospects while the deficit countries will reduce their domestic imbalances.

I particularly welcome the Federal Republic of Germany's recent actions to lower their interest rates and as well their plans to proceed with a major tax reform and increase the size of their tax cuts scheduled for 1988. I am equally pleased with Japan's cut in their discount rate to 2 1/2% as well as their commitment to prepare a comprehensive economics programme to stimulate their domestic demand. For our part we intend to continue to press forward with reductions in our Federal budget deficit. And in that connection, as most of you know, we have recently submitted to the Congress a budget for fiscal year 1988 that meets the Gram, Rudman, Hollins, Law targets. In addition we will continue to oppose protectionist pressures which exist today in the United States. I believe, Mr Chairman, that these actions and commitments, as well as the others which are outlined in this statement, help establish the basis for more balanced growth and a reduction in imbalances between the surplus and the deficit countries. These measures and the continued co-operation of us all will foster greater stability of exchange rates around current levels. In sum, I believe that today's efforts represent another step forward in our efforts to achieve closer and more effective co-ordination of economic policy among the major industrial countries of the world. This process is essential to achieving durable economic expansion and open markets. We in the United States are fully committed to this process. It is not an easy one, requiring as it does that all of us find common ground from which to move forward. As today's meeting demonstrates however, genuine progress can be made if we continue to persist in our co-operative efforts. T

CHANCELLOR - INTERVIEW ON PARIS G5/G7 MEETING

Transcript from recording made in Paris by ITN 22 Feb. 1987

PLEASE NOTE: THIS INTERVIEW WAS 'PUBLIC' IN THE SENSE THAT AT LEAST ONE OTHER REPORTER CHIPPED IN.

INTERVIEWER: (David Chater) Chancellor, could you tell me exactly what you think this agreement will achieve?

CHANCELLOR: I think it'll achieve what is highly desirable, that is, a period of stability in the foreign exchange markets. Which will be good for Britain because our own economy is doing very well. But there's always the problem of what's happening in the outside world and if we can have a period of stability in the foreign exchange markets I think that completes the satisfactory picture.

CHATER: How easy will it be for the Japanese Minister particularly to deliver on his promises?

CHANCELLOR: I think he has every intention of doing so.

CHATER: And how will it affect the £ sterling?

CHANCELLOR: What it implies is that currencies generally will now be going through a period of stability, and that includes the £. No great change. I've said for some time that I have - long before this meeting - that I have no wish to see the £ fall any further, by the same token I have no wish to see a substantial increase in the value of the £. I think it's satisfactory, satisfactory for British exporters who are doing very well. And also not so low as to pose inflationary problems for us. And so this meeting has come at a time from the point of view of the United Kingdom.

AMERICAN REPORTER: Sir, if the markets do discount this agreement and begin bidding down the \$ again in dealing tomorrow, what are the Ministers prepared to do concretely?

CHANCELLOR: I think that this agreement has gone with the grain of the market. I think that the market is ready for a period of stability and that is very important. Obviously we have agreed between ourselves what we would do should the agreement be put to the test by the market. But equally obviously that is a private agreement among us.

AMERICAN REPORTER: So there is a private agreement then?

CHANCELLOR: Yes of course, behind the communique there are practical steps which we have discussed among ourselves.

AMERICAN REPORTER: Does that include intervention?

CHANCELLOR: That includes intervention.

CHATER: So this agreement will chase away the speculators from currency?

CHANCELLOR: I think as I said that it should provide the foreign exchange markets with a period of stability which will be good for everybody.

Q. Disappointment that Germans did not offer to bring forward a recovery plan ...?

A. Well I think it is quite likely that if they had said that, no doubt the Americans in particular would have been very pleased. But everybody is a sovereign state and they have to do what they think is right. The important point is that we were all, particularly the Americans, satisfied with what the Germans had said they would do and the Americans along with everybody else were prepared to participate fully in the agreement on that basis.

Q. Any indication of how large the West German tax cuts might be?

A. No, you have to ask, to speak to Herr Stoltenberg. He is in a difficult position on this because he's still in the process of negotiating with his coalition partners over all this. That happens after the elections. So I think it is difficult for him to say anything publicly at this stage.

Q. So many commitments have been made which are very difficult to deliver ... won't the markets be sceptical?

A. I think the important question is that posed by Chris Huhne: in being prepared to intervene collectively, are we working with the grain of the market or against the grain of the market? And I believe we would at this point in time be working with the grain of the market.

Q. What is it that the Germans are now going to do which they were not before?

A. I don't think that is the plot. I think the Germans have revealed more at this meeting of what they had in mind than they have hitherto revealed. But, as I say, this is a private discussion. I believe that it is almost impossible to say to

what extent they would have done this anyway in their judgement about what was appropriate in the economic conditions and the political pressures there are in Germany, and to what extent they had been influenced by the views of the rest of the international financial community. You can't separate out this.

Q. You appeared to doubt the good faith of the Germans in comparison with the Japanese.

A. No, No. I was saying that what is called for in Japan is really a change in the Japanese approach and the Japanese way of looking at things, and I believe that Mr Miyazawa is anxious and indeed was anxious before his appointment and has remained anxious to make that change. There are elements in the Japanese bureaucracy who I suspect may be resistant to that change. That was all I was saying. It is not a question of accusing anybody of bad faith.

Q. Growth forecasts examined?

A. We have at the beginning of the meeting, the surveyance exercise, this time with the new Managing Director of the Fund, Michel Camdessus, who put forward the Fund's projections for growth in the coming year and indeed the projections for growth in 1988 as well for each of the countries. I don't think anybody was - although probably we all have minor things about whether they got our own countries right - the broad picture, nobody quaralled with, which is a picture which is pretty well known probably to you: a slow down, quite a marked slowdown, in growth in 1986 as compared with 1985, but some pickup expected this year.

Q. Including Germany, which seems to have stalled?

A. We shall have to see. The problem of forecasting what domestic demand will be in Germany is obviously difficult. There is obviously scope for slightly greater growth in domestic demand in both Germany and Japan - particularly in Japan. But we shall have to see what happens.

Q. Will this require a further set of meetings at deputy level to negotiate yet another further advance towards more stable exchange rates? Or is this a one off?

A. No. As I said, this is like Plaza. It is complete in itself.

Q. Is the G7 now dead? Do we have a G6?

A. I must say I think the action of the Italian Government in securing the right not to attend is slightly surprising, but I regret that my friend and colleague Giovanni Goria was not permitted by his Government to be here. I hope he will be present at the next appropriate meeting.

Q. Not Goria's choice?

A. You heard what I said.

Q. Are you now saying you welcome the Italian and Canadian presence at G5 proceedings in future?

A. No, it is not a G5 proceedings. The Tokyo summit Communique was very clear. It created a G7 while affirming the continued existence of the G5 ...

Q. The G5 didn't actually meet yesterday - it was an informal gathering?

A. We had a number of informal discussions, and then we had a dinner and we discussed matters further over dinner.

Q. So it wasn't a G5 meeting.

A. Not in any formal sense. But then G5 meetings don't need to be formal.

Q. So how would journalists - and the Italians - distinguish a G5 meeting from an informal session of the five ministers?

A. I don't think it matters one way or the other. I think it is certainly a likelihood that in April there will be the normal G5 that there is in the margins of the Spring meeting of the Interim Committee, and I think it is likely there will be a meeting of the G7 as well. I don't see why that should cause any problems, except possibly for those Ministers who have to attend two meetings.

INSERT (B) CHANCELLOR'S PRESS BRIEFING, PARIS 22 FEBRUARY

Q. What is the evidence for your view that this agreement will now be working with the grain of the market?

A. Oh! it's just an old man's instincts!

Q. Nothing greater?

A. What greater ... than that?

Q. Were the central bank governors in the G7 meeting this morning?

A. Yes.

Q. The Tokyo Communique specified only the finance ministers?

A. That's right. And we could I suppose, if we had wanted to be hostile to the Italians, have insisted on the letter of that. But in fact if you are actually engaged in a serious agreement involving intervention then you have to have central bank governors present - it doesn't make sense not to. And therefore Governor Ciampi was invited and indeed all the G5 governors were there - notably the Governor of the Bank of England! - and Governor Ciampi was invited; and I believe that both he and Goria did turn up here before going back to Rome.

Q. But Ciampi did not actually attend ... ?

A. No no, because the Italian Government took a political decision that they should not attend.

Q. Do you think that augurs badly for the Venice Summit?

A. I think its a pity but I hope that common sense will prevail.

Q. Do you think it augurs badly for this agreement?

A. No I don't think it makes the slightest difference to this agreement.

Q. You emphasised that this should be seen as a Plaza type agreement but with rather different objectives. Did you discuss the rather different approach outlined in the Tokyo Summit - looking at the whole thing under a large number of indicators?

A. That's a separate exercise. That exercise will continue but it wasn't what this meeting was about.

Q. Debt and Brazil?

A. There was a brief discussion about that, arising from Michel Camdessus's remarks. We shall obviously have to discuss the whole debt issue, I suspect at rather greater length, at the Spring meeting in April.

Q. No immediate measures after the Brazilian moratorium?

A. No. There is continuing cooperation among the various central banks, commercial banks, governments, all within the framework of the IMF. We certainly did not feel the need at this stage for any dramatic initiative. The Communique does express some concern: Para 6 says:

"They noted that the progress achieved by many debtors towards these ends has not solved all the problems and stressed the importance of all participants in the strengthened strategy reinforcing their cooperative efforts."

That is an uncomplacent signal.

Q. Did the question of a Paris Club agreement without IMF backing come up?

A. We didn't discuss matters in that detail at all. We obviously had various people present at the time - the Managing Director of the Fund, the Chairman of the Paris Club - not in that capacity, he was there as Balladur's chef du cabinet but Trichet happens

to be the Chairman of the Paris Club - and of course the Americans. And so we were to have an up-to-date assessment and an exchange of views about the situation. But there were no initiatives agreed.

Q. Were there 4 people in the American delegation?

A. There was a compromise: the American team was Baker, Volcker and Darman, but Mulford was permitted to eat with us.

Q. How much of this text was negotiated during the weekend and how far was it all precooked?

A. There was a substantial amount of precooking. And that is what I insisted on, because the last thing I wanted to see was a repetition of the September meeting of the G5 which had not been properly prepared and where the outcome was not satisfactory.

INSERT (C) CHANCELLOR'S PRESS BRIEFING, PARIS 22 FEBRUARY

Q. US current account deficit projections?

A. The IMF projections do show a reduction in the deficit in both 1987 and 1988. It is in percentage terms ^{only} a gradual small reduction. Of course you have to remember in volume terms its a much more substantial change, but the fall in the value of the dollar means that they have to export a great deal more and import a great deal less to have only a small change in dollar terms. And I think that has to be borne in mind. Of course, one would like to see them doing better on that front. They would like to see themselves doing better on that front, but the current account and the balance of payments is one of the hardest things to predict because you are talking about the difference between two very large magnitudes. But always bear in mind that the adjustment in volume terms is actually quite substantial.

Q. UK aims to keep current account broadly in balance: is that £3 billion eitherway?

A. It's not meant at this stage to be more precise than the words. I shall obviously be publishing a new set of forecasts at the time of the Budget which is very soon. Maybe I ought to go away now and prepare it!

Q. Currencies are roughly where they are now ... are you going to be discreet?

A. Yes I am.

Q. Was the Communique toughened up?

A. It couldn't have been done by remote control.

Q. So its tougher than the draft?

A. I didn't say that, but there was verious places in the draft where there were alternative wordings which hadn't been agreed. But there was no softening.

CHANCELLOR - INTERVIEW ON PARIS G5/G7 MEETINGS

Transcript from: BBC Radio 4, Today, 23 February 1987

PRESENTER: (Peter Hobday) Six of the 7 leading industrial nations agreed in Paris last night on moves to calm the foreign excahnges. There should have been 7 but the Italins felt slighted at not being invited to dinner by their French hosts so they went home. Nonetheless Finance Ministers of the remaining countries; Japan, Germany, France, the US, the UK and Canada seemed pleased with their decisions - as Dominic Harrod heard from the Chancellor, Nigel Lawson, when he asked him if he thought the meeting would achieve its objective, that is, to bring some calm to the foreign exchange markets?

CHANCELLOR: If you choose the right time I think you can and I think we have chosen the right time. There have been considerable signs lately that after a tremendous change in the value of the \$, the \$ falling very greatly in terms of the German Mark and the Japanese Yen, that things were settling down. So that given that we were working with the grain of the market I think we can stabilise it. And that was certainly what we sought to do. And at a time when the British economy is doing very well, when the only threats come from possible untoward events overseas, I was particularly glad to, from our point of view, to join in this stabilisation exercise which might remove that kind of threat.

INTERVIEWER: (Dominic Harrod) One of the aspects of all this is of course the very large amount of money that moves around; does this mean that there is equally now a commitment by Governments to spend a very large amount of money if it's needed?

CHANCELLOR: There's certainly a commitment to spend money in the markets in a concerted fashion if and when it's needed.

INTERVIEWER: Now supposing this does work and the markets are convinced, which we shall know very soon, will this in fact on the home front allow a more likely consideration of lower interest rates in Britain and elsewhere in Europe?

CHANCELLOR: I don't think you can draw any conclusion like that. I think it is clearly helpful. It's helpful to everybody, it's helpful to businessmen, exporters and traders to have a period of stability in the foreign exchange markets. But I don't think you can draw any direct conclusions from that to the level of interest rates.

INTERVIEWER: The assumption in all this is of course that you reckon that the rate of exchange for the £ is about right now, is that a fair assumption?

CHANCELLOR: That is a fair assumption. For some time, long before this meeting, I had been saying that I didn't want to see the £ go any lower, and by the same token I wouldn't want it to see it go substantially higher. British exporters are now doing very well and they're taking advantage of the competitive rate they now have. But on the other hand if it were to go lower then I think there would be a danger of inflationary forces coming back into the economy and I'm determined that that shan't happen.

INTERVIEWER: In the communique Britain vouchsafed - and I am told that each country writes its own entry in the communique - that the burden of taxation will be lowered. Should we take that seriously bearing in mind what you'll be up to on 17 March?

CHANCELLOR: You should certainly take that seriously, although you will note that I didn't put any particular date on that.

CHANCELLOR - INTERVIEW ON PARIS MEETINGS 22 FEBRUARY

Transcript from BBC Television News, 22 February

James Long: When the world's top economic powers act together it is usually the Americans who are pulling the strings. The US Treasury Secretary came to Paris looking for a deal. Eighteen months back ^{they'd} moved to bring the Dollar down. Now it was time to put the ^{brakes} on. But for the Italian row, it would have looked ^{pretty} unanimous: the Germans in particular making an important new contribution in agreeing to cut taxes further and get the German public to buy more. There had been hopes the deal could bring down interest rates. On his return to London the Chancellor denied that.

Chancellor: No, I don't think it has any bearing on interest rates either in this country or in any of the other countries who signed the agreement. But, as I say, I think it will be very helpful to British business if there is a period of stability now in the foreign exchange markets.

*Maybe Baker - specific call to ask no I have a reason - I believe so
used me PM ← & think I agree with what was said
GWS do I agree with what was said
below*

SECRET

From: Sir G. Littler
Date: 25 February 1987

CHANCELLOR

G5/G7

I have just seen a copy of the minute from the Foreign Secretary to the Prime Minister, following your minute of 23 February. Indeed Mr Braithwaite talked over his advice with me before submitting his draft. It seemed to me that the advice against making a high-profile approach to President Reagan this week and on our own must be right. Also, given the Mitterand/Craxi bilateral today, and the FCO anxiety (which I share) not to get the UK into the position of being quoted to Italy as the only opposition, there is merit in waiting a day or so and trying to mobilise parallel French and German lines with the US.

2. FCO will let me know as soon as we have any news from the Mitterand/Craxi talks - from either side. (There must be some hope that Mitterand will not immediately give Craxi an answer which could be read as "confessing a French mistake"). I shall report again as soon as I have further news. Meanwhile I suggest we do not quarrel with the Foreign Secretary's advice, and have no need to offer comment.

(Geoffrey Littler)

Littler
→
CH/EX
25/2

RF

252312 :ITALY SEES G-7 FUTURE BRIGHTER AFTER ASSURANCES

By Clare Fallon, Reuters

ROME, Feb 26 - French President Francois Mitterrand's support for Italy's role in the Group of Seven (G-7) has partially appeased Italian leaders offended by a row last weekend and smoothed the path towards the group's June summit, political observers said.

Mitterrand assured Prime Minister Bettino Craxi during talks yesterday of France's backing for Italy within the group, Italian officials said.

MORE

252313 :ITALY SEES G-7 =2 ROME

His remarks, following reassurances from two other partners - the United States and Japan - had brightened prospects for the group's forthcoming Venice summit, official sources said.

A senior Craxi aide said on Sunday that the Venice summit, planned for June, could be in jeopardy unless Italy received clarification over a dispute which prompted it to boycott a Paris meeting of G-7 finance ministers.

Officials later toned down the threat to the summit but Craxi said on Tuesday Italy wanted its status within the group clarified.

252314 :ITALY SEES G-7 =3 ROME

Italy's boycott followed talks between finance ministers of the Group of Five (G-5) - which includes the U.S., Japan, West Germany, France and Britain - on Saturday, the night before the Paris meeting.

Italian officials charged that Italy and Canada were being brought into the G-7 meeting on monetary policy the next day only to rubber-stamp G-5 decisions.

On Monday, President Reagan made assurances about Italy's future role in international monetary talks and Japanese Prime Minister Yasuhiro Nakasone said Japan would consult with the other partners to make a full explanation to Italy.

MORE

252314 :ITALY SEES G-7 =4 ROME

Mitterrand, one of the chief supporters of an agreement made in Tokyo last May to include Italy and Canada in monetary talks, said yesterday the two countries had the right to be involved.

"Italy and Canada have full responsibility, as much as the other five countries, to manage, to influence, to reform the international monetary system," he told reporters after separate meetings with Craxi and President Francesco Cossiga.

Craxi's office described the Prime Minister's talks with Mitterrand as "very cordial and friendly." Craxi himself declined to speak to reporters afterwards but stood smiling while the French President made a statement.

252316 :ITALY SEES G-7 =5 ROME

Mitterrand's brief private visit to Rome was arranged before Sunday's meeting, which went ahead without Italy.

He said no snub to Italy had been intended. French observers said the Paris host, Finance Minister Edouard Balladur, whose office denied that G-5 talks were being held on Saturday, had not been at the Tokyo meeting and may have under-estimated the strength of Italian feeling.

Italy's booming economy has positioned the country to take over from Britain this year as the world's fifth largest economy.

REUTER

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CN RIM097

252309 :MITTERRAND AND CRAXI SMOOTH OVER G-7 ROW

ROME, Feb 25 - Italy has an automatic right to be a complete member of any group making decisions on the international monetary system, French President Francois Mitterrand said on a visit to Rome.

Mitterrand, smoothing over a row which led to Italy boycotting the Paris meeting of the Group of Seven (G-7) leading industrialised nations on Sunday, met Prime Minister Bettino Craxi and Francesco Cossiga during a brief private visit to the capital.

MORE

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CN RIM098

252310 :MITTERRAND AND CRAXI =2 ROME

He told reporters his hour-long meeting with Craxi had covered the role of the G-7 in relation to the Group of Five (G-5), which excludes Italy and Canada.

"Italy and Canada have full responsibility, as much as the other five countries, to manage, to influence, to reform the international monetary system," Mitterrand said.

He said an accord reached in Tokyo last May, bringing Italy and Canada into monetary discussions, was slightly confusing but its intention was that "Italy is automatically a full member of this institution."

MORE

NNNN

#

CN RIM099

252311 :MITTERRAND AND CRAXI =3 ROME

Italian Treasury Minister Giovanni Goria refused to attend Sunday's meeting of G-7 finance ministers after the five - the United States, Japan, West Germany, France and Britain - had separate talks the previous night, despite French denials that a G-5 meeting was being held.

Italy said the behaviour of the five had reduced its role to rubber stamping pre-arranged policies and ignored its growing economic importance.

SECRET



10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

CH/EXCHEQUE	
REC.	27 FEB 1987
ACTION	SIR G. LITTLE 27/2
COPIES TO	PS/EST
	SIR P. MIDDLETON
	SIR T. BURNS
	MR H. P. EVANS
	MR CULPIN

26 February, 1987.

Alex,

MEETING OF FINANCE MINISTERS AND CENTRAL BANK GOVERNORS

The Prime Minister has seen the Foreign Secretary's minute of 25 February which discussed the possibility of messages to President Reagan and George Shultz about the G5 and G7.

The Prime Minister agreed with the Foreign Secretary that there would be little point in sending a message to President Reagan in the next day or two, and that at this stage it would be preferable for our Ambassador to be instructed to speak to those who would have influence on the decision. However, I now understand there are signs that the Italians may be regretting their action, and looking for a way out. In these circumstances, it would seem as well not to take action with the Americans at present. But no doubt you will advise if an intervention by the Prime Minister would be useful.

I am sending copies of this letter to Tony Galsworthy (Foreign and Commonwealth Office) and John Footman (Office of the Governor of the Bank of England).

Yours,
David.

David Norgrove

Alex Allan, Esq.,
HM Treasury.

SECRET

1 Agree.
2. Ps. For C. Littler (has spoken to Spindler)
S. Littler
FEO.
L. Spindler

CONFIDENTIAL

From: Sir G. Littler
Date: 26 February 1987

MR ALEX ALLAN

c.c. Sir P. Middleton

G5/G7

I have just had a very interesting call from Daniel Lebegue, and have promised to consult the Chancellor and telephone back as soon as possible today.

2. There are two developments:

- first, Lebegue reported that Mitterand's visit to Craxi in Rome yesterday "went very well": he explained the G5 position on the lines of the note largely agreed among the six last Sunday morning; he insisted that G5 and G7 are both valid and that no error had been committed by the French hosts; he urged a settlement of the matter at Finance Minister level before the Venice Summit: Craxi, who was evidently looking for a solution (recent reports suggest growing doubt whether the weekend reaction was sensible), accepted what Mitterand said as a helpful explanation and appeared to agree on the assumption that there could be a G7 meeting in April (although it is not clear whether this was made explicit).
- Mulford contacted Lebegue yesterday (starting with him because French were hosts last weekend) to report that Baker wants to make a very early announcement of a G7 meeting in Washington in April, as a way of helping the Italians back on to the rails; he was seeking Balladur's agreement. Balladur has taken the view that he would

CONFIDENTIAL

accept such an announcement, but considers it should be accompanied by an announcement also of a G5 surveillance meeting around the same time: he is anxious to establish clearly the parallel existence of both groups. Lebegue wants our reaction (and will be contacting the Germans) before replying to Mulford later today.

3. I told Lebegue I would try to get an answer from the Chancellor by the end of the morning. I also said I was minded to advise, as I now do, agreement with Balladur's reaction, subject to an important condition: that the US should obtain the prior agreement of the Italians to the announcement (otherwise, it seems to me we could risk exacerbating the problem).

4. Does the Chancellor agree? Any other comments, please?



(Geoffrey Littler)

CONFIDENTIAL

Re X, good.

From: Sir G.Littler
Date: 26 February 1987

MR ALEX ALLAN

c.c. Sir P.Middleton

G5/G7

Having heard from Mr Kuczys of the Chancellor's agreement on my minute of this morning, I spoke to Lebegue again. He said that Balladur also agreed that the Italians must be warned before an announcement. On that basis we are at one. He is still waiting for a German reaction. I mentioned that Genscher seemed to be very feeble on the subject: Lebegue made rude remarks about Foreign Ministers in general and German Foreign Ministers in particular!

2. Then David Mulford rang. (He had tried to contact me yesterday - my phone failed during the afternoon and was not restored until mid-morning today). He tried rather casually to get my agreement to a simple G7 announcement, saying that he was expecting agreement from the others. I said I could not agree to it just like that, because it would make a G5 meeting in Washington impossible (or at least fraught with danger of causing the same problems again) and I thought that a G5 meeting was likely to be highly desirable and the option must in any case be preserved. I told him I had in fact discussed this with Lebegue and that the Chancellor shared Balladur's view that the best would be to announce both a G7 meeting and a G5 surveillance meeting - but of course one could not do so without warning the Italians first. (Lebegue will be phoning Mulford similarly).

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3. Mulford was put out by this. He said rather unguardedly that the French were trying to get the credit for resolving the Italian problem, whereas Baker was going to be host! I repeated that we could not agree to conceding a G7 meeting unless we were clear that there could also be a G5 meeting. He said he would discuss this now with Baker.



(Geoffrey Littler)

Ch

X |

Later, Mulford ring Geoff back to say that Baker had accepted (X) above. He is sending Geoff a draft announcement accordingly as soon as it is approved by Baker.

AWK
26/2

SECRET



Handwritten initials: EA and RS

FROM: P D P BARNES
DATE: 26 February 1987

PS/CHANCELLOR

cc Sir P Middleton
Sir G Littler
Sir T Burns
Mr H Evans
Mr Culpin

G5/G7

X/ The Economic Secretary has seen Sir G Littler's submission to the Chancellor of 25 February.

2. The Economic Secretary agrees with Sir G Littler that we should try to enlist French and German support before lobbying the US about G5.

Red arrow pointing from the handwritten note to the second paragraph.

Handwritten note in red ink: This complex analysis is written by Middleton

Handwritten initials: PB

P D P BARNES
Private Secretary

Confidential

CONFIDENTIAL
 FM ROME
 TO IMMEDIATE FCO
 TELNO 151
 OF 261650Z FEBRUARY 87
 INFO IMMEDIATE PARIS
 INFO ROUTINE WASHINGTON BONN TOKYO OTTAWA

YOUR TELNO 101 TO PARIS: G5/G7

SUMMARY:

1. THE SUBJECT OF G5/G7 WAS RAISED AT MITTERRAND'S MEETINGS WITH BOTH PRESIDENT COSSIGA AND PRIME MINISTER CRAXI. THERE WAS LITTLE DISCUSSION OF SUBSTANCE APART FROM ITALIAN SATISFACTION AT MITTERRAND'S STATEMENT MADE BEFORE HE LEFT PARIS ON ITALIAN PARTICIPATION IN G5.

DETAIL:

2. WE HAVE CHECKED WITH THE PRIME MINISTER'S OFFICE AND WITH THE FRENCH EMBASSY HERE, BOTH OF WHICH CONFIRM THE REPORTS IN TODAY'S ITALIAN PRESS THAT THE SUBJECT OF G5/G7 CAME UP IN MITTERRAND'S DISCUSSIONS WITH CRAXI, AND ALSO WITH COSSIGA. BY THE TIME MITTERRAND ARRIVED, NEWS HAD ALREADY REACHED ROME OF HIS STATEMENT IN PARIS FOLLOWING THE MINISTERIAL MEETING THERE THAT ITALY AND CANADA SHOULD AUTOMATICALLY TAKE PART IN ALL THE DISCUSSIONS CONCERNING THE MANAGEMENT AND REFORM OF THE INTERNATIONAL MONETARY SYSTEM. (THE PRECISE WORDING VARIES FROM ONE REPORT TO ANOTHER.)

3. FOLLOWING MITTERRAND'S DISCUSSION WITH CRAXI, CRAXI'S OFFICE ISSUED A STATEMENT THAT THE SUBJECT OF THE TOKYO AGREEMENT CONCERNING THE RESPONSIBILITY OF THE 7 MOST INDUSTRIALISED COUNTRIES HAD COME UP BUT GIVING NOE DETAILS.

4. CRAXI'S OFFICE HAVE TOLD US THAT THEY WERE VERY SATISFIED WITH MITTERRAND'S CLARIFICATION OF THE FRENCH POSITION. FRANCE HAD ALWAYS SUPPORTED ITALY'S INCLUSION IN G5 MEETINGS AFTER THE PLAZA MEETING, AND PARTICULARLY AT THE TOKYO SUMMIT. MITTERRAND HAD EXCUSED BALLADUR FOR HAVING FAILED TO MANAGE THE PARIS MEETING PROPERLY BECAUSE THIS WAS THE FIRST TIME THE GROUP OF 7 FINANCE MINISTERS WAS MEETING FOLLOWING TOKYO. THE ITALIANS DID NOT FIND THIS A CONVINCING EXPLANATION. CRAXI'S OFFICE TOLD US THAT MITTERRAND UNDERTOOK WHEN HE RETURNED TO PARIS TO ENSURE THAT FOR THE NEXT SUCH MEETING IN NEW YORK THE PROCEDURAL CONFUSIONS OF PARIS SHOULD BE AVOIDED, AND A FORMAL INVITATION BE ISSUED TO ALL THE SEVEN.

5. COMMENTING ON THE DISCUSSIONS WITH MITTERRAND, CRAXI'S OFFICE POINT OUT TO US THAT THERE APPEARS TO BE A DIFFERENCE BETWEEN MITTERRAND'S INTERPRETATION AND THAT OF BALLADUR. HOWEVER SINCE MITTERRAND REPRESENTS THE HIGHEST POLITICAL LEVEL, AND IT IS AT THIS LEVEL THAT THE TOKYO AGREEMENT WAS NETERED INTO, THEY BELIEVE MITTERRAND'S INTERPRETATION MUST PREVAIL. CRAXI'S OFFICE ALSO COMMENTED.

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Confidential

COMMENTED THAT THEY DID NOT DENY THE CONTINUED EXISTENCE OF THE G5 (AS THE PRESS HAD SOMETIMES SUGGESTED). THEY HAD NO OBJECTION TO FINANCE MINISTERS OF THE 5 MEETING INFORMALLY FOR THE PURPOSE OF AN EXCHANGE OF VIEWS, BUT INSISTED THAT THE TOKYO AGREEMENTS SETTING OUT THE COMPETENCE OF THE GROUP OF 7 MUST BE RESPECTED.

6. THE FRENCH EMBASSY HAVE CONFIRMED TO US THAT, ALTHOUGH THE STATEMENT ISSUED BY CRAXI'S OFFICE WAS THE LATTER'S RESPONSIBILITY ALONE, THE STATEMENT ISSUED FOLLOWING MITTERRAND'S TALKS WITH COSSIGA HAD BEEN JOINTLY AGREED. THIS STATES THAT THE COOPERATION BETWEEN THE 7 MOST INDUSTRIALISED COUNTRIES WAS JUDGED TO BE ENTIRELY POSITIVE FOR THE PURPOSES OF THE BALANCED MANAGEMENT OF THE WORLD ECONOMY AND THE STABILISATION OF THE INTERNATIONAL MONETARY SYSTEM, . . . IN THIS CONTEXT THE IMPORTANCE WAS REAFFIRMED OF RESPECT FOR THE AGREEMENTS UNDERTAKEN ON THE OCCASION OF THE SUMMITS OF THE 7 REGARDING THE MANAGEMENT AND IMPROVEMENT OF THE INTERNATIONAL MONETARY SYSTEM AND FOR THE ADOPTION OF CONNECTED ECONOMIC MEASURES.

7. THE FRENCH EMBASSY HAVE FURTHER COMMENTED THAT BOTH MITTERRAND AND THE FRENCH GOVT. AGREE THAT ITALY AND CANADA SHOULD BE ASSOCIATED WITH THE G5 IN DELIBERATIONS ON THE MANAGEMENT AND REFORM OF THE WORLD MONETARY SYSTEM. HOWEVER MITTERRAND SAW A CONTINUING ROLE FOR THE G5, WHOSE CURRENCIES MADE UP THE SDR BASKET. THUS THE ITALIANS WERE ENTITLED TO PARTICIPATE IN DECISIONS ON THE WORLD MONETARY ORDER, BUT NOT TO TRY TO DENY THE POSSIBILITY OF FURTHER MEETINGS OF G5.

BRIDGES

YYYY

RFHPAN 5339

MONETARY

CRD

WED

MR BRAITHWAITE

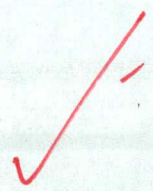
MR THOMAS

MR MAUD.

-2-
Confidential

CS

PPS Chancellor
12/2



NNNN

CN RIM463

ABC Ci

271339 :/U.S. JANUARY MERCHANDISE TRADE GAP 14.8 BILLION
WASHINGTON, Feb 27 - The U.S. merchandise trade deficit
rose to 14.8 billion dlrs in January from 10.7 billion dlrs in
December, the Commerce Department said.

The department also revised upward December's trade deficit
to 12.7 billion dlrs in a separate calculation incorporating
new information on actual shipments but cautioned against
comparing revised and unrevised monthly deficit figures.

The department said imports rose in January by 7.1 pct from
December levels to 31.2 billion dlrs from 29.1 billion dlrs.
MORE

NNNN

Handwritten notes:
The department said...
in the amount of present...
Link

CONFIDENTIAL

Ch
See also letter
from No. 10 (below)

From: Sir G. Littler
Date: 27 February 1987

MR KUCZYS

c.c. Sir P. Middleton

G5/G7

Think
not make
have
w/ 2/27
also
2/27

I have been unable to contact Mulford since lunch-time yesterday. (On my last effort at 4 p.m., "they were all at the White House"!) However, I have just spoken to Lebegue, who gave me an account of his talk with Mulford early yesterday evening. Two very welcome points (as far as they go):

- Mulford had said he was now satisfied himself with the UK/French proposal (simultaneous announcement of a G5 Surveillance meeting and a G7 meeting, both in Washington at the time of the IMF/IBRD meetings in April);
- Mulford had tried this on Sarcinelli, who had said that he would be prepared to accept it and thought that Gorla would also.

2. We still of course need Baker's personal agreement * (perhaps Mulford has simply not been able to focus him on this during the last 24 hours or so!). Even more delicate, we need endorsement of the Italian Treasury agreement by Craxi.

(Geoffrey Littler)

*Ch
I had thought (wrongly) yesterday that Baker had agreed in principle. But he has been completely pre-occupied on other matters (? Tower Report). However, Geoff thinks the fact that Mulford has approached Sarcinelli means he is pretty confident of getting Baker's agreement. AWK

Ch
What do you think
of para 4 below?
AA

1. I agree with para 5.
2. As to para 4, this has
no sense of a simultaneous
announcement: G7s occur v.
infrequently, but we always
From: Sir G. Littler 'announced'
Date: 3 March 1987
G5s occur much more
frequently & are
c.c. Sir P. Middleton 'announced.'
xt

MR ALEX ALLAN

TELEPHONE CONVERSATION WITH MULFORD

Secretary Baker is out of town until Thursday, and I think Darman may be with him. But I have just had quite a friendly chat with Mulford on several points.

G5/G7

2. He said that the Italians will not accept at the moment the idea of a simultaneous announcement of G5 and G7 meetings to be held next month. Gorla was personally content; it is Craxi's office who have refused, although not making a fuss about the suggestion being made.

3. I asked about the White House and State. Mulford said that there is no pressure on Baker from them on this issue. He was not aware that the Italians had made special high-level approaches and we both surmised that they might well have thought it prudent to hold off last week. He will keep in touch, but at the moment did not think Baker would want to suggest help at White House level.

4. Mulford was himself wondering whether there might be any mileage in the idea of an announcement of G7 only, preceded by an exchange with the Italians in writing in which they were told that there would be a G5 also, and would accept this. I said that I would not rule it out from our point of view, provided the Italians accepted the situation in advance (which might be just as difficult for them as simultaneous announcement), but I would sound you and contact him again before Baker's return.

5. Given that Craxi is now on his way out, there could be some advantage in waiting a couple of weeks.

BRAZIL

6. He asked about Funaro's visit to you and I gave him a brief account: I said that the Chancellor had emphasised that commercial bank debt negotiations were a matter for the commercial banks, and that Brazil needed to present to creditors a credible programme of policies, IMF or otherwise. Mulford said the US Treasury had given the same two messages. He added that Funaro's performance with them had been blustering and unconvincing. He remains sure that much of the approach is a negotiating ploy with the banks, combined with a demonstration for domestic opinion; that there will probably be a rapprochement at some stage, but the poker-game will continue for some time.

LOUVRE AGREEMENT

7. Baker is pleased with market behaviour since the agreement in Paris, especially the way in which it has taken unmoved the bad run of news late last week. I mentioned in low key our current strength and said we were confident our action was in the spirit of the agreement and not disruptive: he said that was his impression also.



(Geoffrey Littler)

GRS 180

RESTRICTED

[CULL]
RESTRICTED
FM OTTAWA
TO PRIORITY FCO
TELNO 135
OF 042130Z MARCH 87
AND TO ROUTINE ROME, BONN, TOKYO, PARIS
INFO SAYING WASHINGTON

YOUR TELNOS 281 AND 282 TO WASHINGTON

G5/G7 MEETINGS PARIS 21-22 FEBRUARY: CANADIAN REACTION

SUMMARY

1. CANADIANS KEEN TO MAKE G7 TO WORK AND REGARD ITALIAN WITHDRAWAL FROM G7 MEETING AS UNHELPFUL.

DETAIL

2. COLEMAN, ASSISTANT DEPUTY MINISTER, FINANCE, TOLD US CANADA WAS JUST AS FRUSTRATED BY ITALIAN BEHAVIOUR AS ANY OF THE OTHER PARTICIPANTS. IT WAS NOT HELPFUL WHEN CANADA WANTED TO SEE THE G7 ESTABLISHED AS A CREDIBLE FORUM. AS FOR THE G5, CANADIAN POSITION WAS NOT TO DENY ITS EXISTENCE AND CURRENT UTILITY BUT TO HOPE THAT IN TIME THE NEED FOR IT WOULD WITHER AWAY.

3. THERE WAS FAIRLY EXTENSIVE, MAINLY FACTUAL, PRESS COVERAGE OF THE AGREEMENT OF THE G7 TO TRY TO STABILIZE EXCHANGE RATES. SOME DOUBTS WERE EXPRESSED AS TO WHETHER JAPAN AND GERMANY WOULD UNDERTAKE THE NECESSARY STIMULATIVE ACTION. CANADIAN PARTICIPATION IN STABILIZING THE US DOLLAR WAS RECOGNISED AS MINIMAL: ONE HEADLINE READ "CANADA PLAYS CAMEO ROLE ON GLOBAL MONETARY STAGE". THE ITALIAN WITHDRAWAL FROM THE MEETING WAS NOTED BUT NOT HEAVILY CRITICISED. IT WAS HOWEVER SUGGESTED THAT THE DECISION OF CANADIAN FINANCE MINISTER WILSON TO STAY HELPED THE ITALIANS MAKE THEIR POINT WITHOUT FEAR OF REAL COST. WILSON WAS QUOTED AS SAYING THAT NOT ALL THE DECISIONS WERE MADE AT THE G5 MEETINGS.

DAY
ODWBAH 7937

FINANCIAL
ERD
HAD

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Mr Alex Allan

The Chancellor might care to
glance at this - I thought it
worth reassuring ourselves that
the position of £ in the SDR 5
remains secure!

SIR GEOFFREY LITTLER

JH 4/3

*Thank. I wd
hope not
we can keep
same
WESL
on France
when no time
com. v*

FROM: S W MATTHEWS
DATE: 4 March 1987

cc Mr Evans
Mr Sheridan
Mr Barnes

G5 AND SDR

Our files do indeed indicate that Sir K Couzens first put forward the suggestion that the Versailles Summit communique on international monetary cooperation should place special responsibility on the SDR group of countries. The French hosts also appear to have picked the idea up with some alacrity, while the Italians do not seem to have been particularly keen to have their economy subject to additional multilateral surveillance and did not press strongly to be involved.

2. The reduction in the number of currencies in the SDR from 16 to 5 was agreed in 1980 and took effect on 1 January 1981. The principal objective was to increase the international acceptability of the SDR by simplifying the calculation of its value, making it easier to cover SDR risks in the market, etc. The SDR was made up of fixed amounts of dollars, deutschemark, yen, francs and sterling with the initial weights of 42, 19, 13, 13 and 13 per cent respectively. These weights were derived on the basis of exports of goods and services and official balances of these currencies held by IMF members.

3. The 1980 decision provided for a revision of the currencies making up the SDR basket and their weights every 5 years, and laid down principles for the first review in 1985 (and implicitly for subsequent reviews too).

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(a) The five currencies to make up the SDR were to be those of the members whose exports of goods and services during the five year period 1980-84 had the largest value. The staff's figuring for the review showed UK exports over this period were only 5% less than French exports, but were 50% greater than the next largest country (Italy).

(b) The weights of these currencies were then to be determined by a combination of exports of goods and services and official holdings of these currencies. The calculation is shown in the upper part of the attached table. As a result of the revision, the yen gained share at the expense of the franc and sterling, but sterling was not isolated at the bottom.

4. The next revision of the SDR's composition and weights is not due until 1990. The composition will be based on average exports of goods and services over the period 1985-89. The WEP forecast suggests that Italy would be the most likely challenger to the UK. Canada and the Netherlands would be slightly further behind, while Saudi Arabia would be knocked out of contention by low oil prices. The gap between Italy and the UK will almost certainly be closer over the period 1985-89 than over the period 1980-84, when both oil prices and sterling's ^{real exchange} rate were higher. We estimate, though, that the UK's exports of goods and services would still be about 20% higher than Italy's. The UK would probably, however, stand on its own with the lowest weight in the SDR. | X

5. Although official reserve holdings of a currency are used only to determine the weights of the SDR and not its composition, it should be possible to make something of the point that both private and official use of the lira as a reserve asset are

RESTRICTED

negligible. It is perhaps also worth noting that in the July 1985 review most Directors felt that the present rules had worked reasonably well, although some concern was expressed that the SDR had not proved such a stable unit of value as had been hoped. A Japanese suggestion that GNP should be one of the factors taken into account was rejected on the grounds that external factors should be paramount. A US suggestion that allowance should be made for other factors such as the currency composition of bond issues was also rejected, largely on the grounds that the weight given to the dollar was already large enough.

84.

S W MATTHEWS

Table 3. Basis for Determining the Weights of Currencies
in the SDR Valuation Basket

Currency	Issuing countries' exports of goods and services 1/		Total of cols. (1) and (2)	Weights as percentage of totals in col. (3)	Rounded percentage weight (5)	Actual percentage weight (6)
	Official holdings of currency 2/	(In billions of SDRs)				
	(1)	(2)	(3)	(4)	(5)	(6)
I. Latest data for 1980-84						
U.S. dollar	312.6	185.6	498.2	42.04	42	
Deutsche mark	193.4	34.8	228.2	19.25	19	
French franc	138.5	3.5	142.0	11.98	12	
Japanese yen	164.3	12.8	177.1	14.94	15	
Pound sterling	132.4	7.3	139.7	11.79	12	
<u>Total</u>	<u>941.1</u>	<u>244.1</u>	<u>1,185.2</u>	<u>100.00</u>	<u>100</u>	
Relative weight, in percent	79.4	20.6	100.0			
II. 1980 data 3/						
U.S. dollar	166.7	129.1	295.8	43.9	44	42
Deutsche mark	124.3	15.7	140.0	20.8	21	19
French franc	76.8	1.7	78.6	11.7	12	13
Japanese yen	79.3	3.4	82.7	12.3	12	13
Pound sterling	73.4	3.7	77.1	11.4	11	13
<u>Total</u>	<u>520.5</u>	<u>153.6</u>	<u>674.1</u>	<u>100.1</u>	<u>100</u>	<u>100</u>
Relative weight, in percent	77.2	22.8	100.0			

1/ Annual average figures; 1984 data for France are the available partial data for 1984 expressed at annual rates.

2/ Average of year-end figures.

3/ Actual figures for the 1975-79 period available at the time of the 1980 Decision.

87-03-17 02:53

*
262405 TRSY G
MSB PEF169
TO: NIGEL LAWSON
CHANCELLOR OF THE EXCHEQUER
UNITED KINGDOM

FM: DEPARTMENT OF TREASURY WASHINGTON DC

DEAR COLLEAGUE:

I AM PLEASED TO INVITE YOU TO A MEETING OF OUR SMALL GROUP ON WEDNESDAY APRIL 8, 1987. THE MEETING WILL TAKE PLACE AT THE TREASURY DEPARTMENT, 15TH & PENNSYLVANIA AVENUE, N.W., WASHINGTON, D.C. BEGINNING AT 11:00 A.M., CONTINUING THROUGH A WORKING LUNCH AND CONCLUDING BY 2:00 P.M.

I PROPOSE THE FOLLOWING AGENDA FOR THE MEETING:

- (1) MULTILATERAL SURVEILLANCE, INCLUDING ECONOMIC POLICIES AND PERFORMANCE AND PROSPECTS FOLLOWING THE FEBRUARY PARIS MEETING.
- (2) EXCHANGE MARKET DEVELOPMENTS
- (3) INTERIM/DEVELOPMENT COMMITTEE ISSUES

THE IMF MANAGING DIRECTOR WILL JOIN US FOR THE MULTILATERAL SURVEILLANCE DISCUSSION AND WILL CIRCULATE A BRIEF NOTE AS BACKGROUND FOR THE DISCUSSION.

PLEASE ADVISE YOUR CENTRAL BANK GOVERNOR AND FINANCE DEPUTY OF THESE ARRANGEMENTS.

SINCERELY,

JAMES A. BAKER, III

19/9128/PF

WUW US

*

262405 TRSY G.....

✓

EXCHEQUER	
17 MAR 1987	
ACTION	SIR G. LITTLE
COPIES TO	EST
	SIR P. MIDDLETON
	MR LAUELLE
	MR H. P. EVANS
	MR MOUNTFIELD
	MR CULPIN
	MR PERETZ
	PS/ GOVERNOR

87-03-16 22:05

262405 TRSY G
248492 TRES UR
MSG PEF156
FM DEPT OF TREASURY/WASH DC
TO NIGEL LAWSON
CHANCELLOR OF THE EXCHEQUER
UNITED KINGDOM

DEAR COLLEAGUE:

I AM PLEASED TO INVITE YOU TO A MEETING OF THE GROUP OF 7 ON APRIL 8, 1987. THE MEETING WILL TAKE PLACE AT THE TREASURY DEPARTMENT, 15TH & PENNSYLVANIA AVENUE, N.W., WASHINGTON, D.C., BEGINNING AT 3:00 P.M. AND CONCLUDING BY 6:00 P.M.

I PROPOSE THE FOLLOWING AGENDA FOR THE MEETING:

- (1) ECONOMIC POLICY COORDINATION
FOLLOW-UP TO PARIS MEETING
USE OF ECONOMIC INDICATORS
- (2) PROGRESS REPORT FOR THE VENICE SUMMIT
- (3) LDC DEBT SITUATION
- (4) INTERIM/DEVELOPMENT COMMITTEE ISSUES (TIME PERMITTING)

THE IMF MANAGING DIRECTOR WILL JOIN US FOR A PORTION OF THE MEETING DEALING WITH ECONOMIC POLICIES AND PERFORMANCE, AND WILL CIRCULATE A NOTE AS BACKGROUND FOR THE DISCUSSION.

PLEASE ADVISE YOUR CENTRAL BANK GOVERNOR AND FINANCE DEPUTY OF THESE ARRANGEMENTS.

SINCERELY,
JAMES A. BAKER, III

19/9127/GJ

248492 TRES UR

262405 TRSY G

MAR 16 1707 RESPOND TO 248492 TRES UR

TELEX RCA FYI 285130 FOR NEWS GENERAL INFORMATION AND GRAPHICS

CH/EXCHEQUER	
REC.	17 MAR 1987
ACTION	SIR G. LITTLE
COPIES TO	EST
	SIR P. MIDDLETON
	MR LAVELLE
	MR H. P. EVANS

MR MOUNTFIELD
MR PERETZ
MR CULPIN
PS/ GOVERNOR

FROM: A M DOLPHIN

DATE: 20 March 1987

MR KUCZYS

cc Sir G Littler
Mr Evans
Mr Matthews

G5/G7

*What are the
questions in the
statement?*

Your minute of 3 March to Sir G Littler raised two issues: Deputy Secretary Grimm's personal views on G5/G7 and the planned revisions to Italian GDP.

2. Deputy Secretary Grimm (of the Federal Chancellery in Bonn) was reported in a telegram from our Bonn Embassy as saying that Chancellor Kohl had only supported the expansion of the G5 after various forms of sympathy from the other four members of G5. The Chancellor pointed out this was rubbish. As you may remember it was Kohl who indicated German support for an expansion of the G5 at a press conference after the German-Italian Summit in February 1986. This was before either Japan or the UK had offered their support. We have written to the FCO reminding them of the true sequence of events and asking that the Ambassador in Bonn also is informed of them.

3. The latest information we have on revisions to Italian GDP is that the Italian statistical institution, ISTAT, will be publishing revised national accounts for the period 1980-86 on 31 March. They have already released provisional figures for 1982 - the base year for the new figures. These indicate that the revisions will add about 15 per cent to previous estimates of Italian GDP.

4. Our Embassy in Rome have discovered some details of the revisions. It seems clear that they are designed to incorporate into the national accounts previously unrecorded activity - ie some aspects of the black economy. It is not yet apparent, however, how the new Italian estimates will compare with UK GDP estimates. The income estimate of UK GDP already incorporates an estimate of factor incomes excluded from Inland Revenue income estimates: this is the so-called "evasion adjustment". This allows

the income measure to be consistent with the expenditure measure. But no attempt is made to estimate that part of the hidden economy which is concealed from the expenditure estimates as well as the income estimates.

5. The OECD will obviously need to see details of the Italian methodology before deciding whether or not to accept the revised Italian estimates of GDP. In the past they have accepted revisions provided they were consistent with the United Nations system of national accounts. But they have never had to consider a revision of the scale of 15 per cent before. One problem may be that the UN system is somewhat imprecise on the treatment of the black economy. However, it seems likely that the Italian revisions will be accepted, unless the methodology can be shown to be inconsistent with the UN system.

6. The British Embassy in Rome are well aware of our continuing interest in the exercise to revise the Italian national accounts and have promised to let us have any information they can obtain from ISTAT before March 31. They will also be reporting fully on the revisions when they are announced.

A.M. Dolphin

A M DOLPHIN

Ch
Below are notes on G10
and Problem Countries
AA

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RSP

We have meeting fixed
for Wed to discuss this
& other issues for Spring
meetings.
AA

From: Sir G. Littler
Date: 23 March 1987

MR ALEX ALLAN

Ma -
new jargon!

c.c. Sir P. Middleton
Mr Lavelle
Mr Huw Evans
Mr Mountfield

SIR G.
LITTLER
→ ALLAN
23/3

G5/G7

I attended WP3 and G10D meetings in Paris last week, and in the margins we had a G5D dinner and a very useful G7D meeting on Saturday in Frankfurt. (For the only action see last paragraph).

2. I am sending to you a separate minute on G10 (forthcoming Washington meeting and the vexing membership question). I am also copying to you and others a note on some interesting discussion of problem debtor countries, addressed to Mr Mountfield. This minute covers:

- appraisal of the Louvre agreement;
- the G5/G7 argument;
- Washington G5/G7 meetings;
- report to Venice Summit;
- "indicators".

The Louvre Agreement

3. There is general satisfaction among the participants (and others in Europe including the Italian Treasury!) over the impact of the agreement so far. Our handling of sterling was accepted as right (I drew on the Chancellor's interview remarks last week).

4. Mulford was careful to confine his approval to the markets: he was very gloomy over the lack/delay of further Japanese action, and over the sagging performance of the German economy.

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5. There was general optimism about the chances of holding steady until the April meetings, and a desire that those meetings should confirm/extend the agreement on exchange rates and focus on carrying forward the agreed internal policies. But we noted - and Gyohten and Tietmeyer confirmed - that for obvious reasons it is unlikely that Japan will have progressed on new measures, or that German performance will be showing much greater strength, as early as April. This led to worry that markets might begin to lose confidence in the period between April and the early June Summit. All wanted to avoid if possible an exchange crisis in the immediate run up to the Summit.

6. Mulford was throughout the one expressing the most doubt and worry - and some of this clearly reflected disappointment with Japan and Germany and a wish to keep them up to the mark. He said that any renewal of the Louvre Agreement in Washington would have to be subject to review; but he accepted the unanimous insistence of others that there must be no public hint of time-limits. He emphasised ominously that Baker - and Congress - were increasingly impatient with Japan and Germany. We left it at that.

The G5/G7 Argument

7. Nearly two hours of discussion by G7 deputies (Sarcinelli and Drabble joined the usual five). At the request of Tietmeyer (host), Sarcinelli gave an account of the Italian position. The main points were:

- the problem was not just an Italian political faction: there were basic differences of interpretation of the Tokyo agreement;

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- although he acknowledged that some in Italy would like to get rid of the G5 altogether, he repeatedly asserted that the official Italian view was that the existence of the G5 was acknowledged and respected;
- but the role of the G5 needed to be clarified and must be identifiably different from that of the G7;
- also the G7 must not be merely peripheral, but should have its own structure, including Governors, a series of meetings, and Deputies to undertake preparations;
- it was intolerable to Italy to have G5 and G7 in close juxtaposition - in either order: if G5 came first, the impression would be that G7 was merely rubber-stamping; but if G7 were immediately followed by G5, there would be a suspicion that the real decisions were being kept back for the G5;
- he therefore proposed two separate sequences of meetings with identifiably separate agendas (one thought he had was that the G5 might focus on the debt problem);
- finally, nothing he had said should be understood as ruling out informal bilateral or similar exchanges ahead of a G7 meeting; but there should be no collective gathering on G7 agendas apart from the G7 itself.

8. After several comments about the logistic impossibility of Sarcinelli's idea of two separate sequences of meetings, Drabble said that Canada naturally shared Italy's concern, but took a different view. He paid tribute to Balladur's stage-management: the idea of only an informal G5 gathering with no announcements

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had been helpful: the less visible the G5, the better (Tietmeyer interjected that Stoltenberg would still prefer G5 meetings to be as secret as possible, and I said that we were attracted by the idea of never announcing or giving public statements from G5 but regularly announcing G7). Drabble went on to make two very helpful points:

- he said that the G7 Louvre meeting had not just been a rubber-stamp operation - there had been genuine exchanges of views; he thought the meeting had been a good way of implementing the Tokyo agreement and was sorry that the Italians felt differently;
- he was very conscious of the logistic problems - and the political unrealism - of trying to segregate meetings and agendas of G5 and G7 and was very uneasy about attempts to define their respective roles in detail.

9. Gyohten made a very good speech. He opened by welcoming Sarcinelli's assertion that Italy acknowledged and respected the existence of the G5. In his view the Tokyo agreement had clearly done so, while also establishing the G7 in an overlapping field and making clear that the two extra countries must be brought in when certain matters were to be dealt with. As he saw it the Louvre arrangements had respected this. But for greater clarity in future he would propose an agreement that G5 meetings should never be announced, should never give rise to public statements, and should be kept as secret as possible (although in practice no guarantee of secrecy could be offered); whereas G7 meetings could be announced, and any public statements should carry G7 authority.

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10. Sarcinelli commented that Gyohnten's proposal would recreate the Paris problem. Tietmeyer, Lebegue and Mulford all argued that it was the best way forward. I agreed and added that success or failure of appearances in practice could be influenced by the way in which Ministers behaved (and spoke or stayed silent in public) both before and after meetings: I referred to Michael Wilson's public comments establishing Canada's locus. Drabble endorsed this and said he thought his Minister would accept the proposal and try to make it work: he urged Sarcinelli that Italy should give it a try and attend the Washington G7 on that basis.

11. A brief and accurate summary by Tietmeyer prompted a sad qualification from Sarcinelli that Italy's continued recognition of the G5 was dependent on resolving the problem and he felt we had not reached that point. We all urged Sarcinelli to present the proposal we had made in the spirit of Drabble's 'giving it a try' for the Washington meeting. Mulford put rather brutally the point that a G6 meeting could work; Tietmeyer more delicately urged that Italy think carefully what would be their best course.

12. Finally, Lebegue said that Balladur had instructed him to say that this whole question was one for Finance Ministers - or in the last resort for Heads of State and Government - and must not be discussed (as Italy had tentatively proposed) by Sherpas. Mulford said that this point had been discussed between Baker and Schultz, who had agreed together on the same view as Balladur. Gyohnten and I - and Tietmeyer who is the German Sherpa - said we had not thought it necessary to raise the point with our Ministers but were confident they would agree.

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Washington G5/G7 Meetings

13. It became clear that both Drabble and Sarcinelli knew on an informal basis of the proposed G5 meeting in Washington as well as the G7 meeting, although the former was not mentioned openly at the meeting of G7 deputies.

14. The plot is that the G5 meeting will be kept out of the public eye as far as possible - cloak and dagger arrangements to get to the US Treasury by an underground passage! (I shall liaise with Tim Lankester).

Report to Venice Summit

15. Sarcinelli asked for help on the kind of draft report his Minister should prepare to meet the request in paragraph 7 of the Tokyo Summit Declaration. He offered a first oral sketch and we gave him some ideas. We all agreed in recommending a short piece, briefly rehearsing market and general economic developments since the Tokyo Summit, emphasising increasing cooperation (we thought it should be possible to do this without explicitly mentioning the Plaza or Louvre agreements or dramatis personae!).

16. Assuming Italy attends, Goria will circulate a draft for the Washington G7 meeting. Sarcinelli hopes to send to deputies a preliminary draft in a week's time.

"Indicators"

17. Mulford re-tabled his draft at a dinner of G5 deputies on 18 March in Paris. I made a strong attack on the exchange rate section and succeeded at the time in getting it much reduced and

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below
improved. The resulting annexed version is what the Chancellor has already seen down to the second sentence under "The Role of Exchange Rates" on page 3; what follows is at least shorter and a good deal less troublesome than the earlier version.

18. However in tabling this version among G7 deputies later, Mulford said he had consulted Baker, who insisted on putting back into the draft a sentence about the possibility of "making use of ranges". Gyohden and I restated our objections; so did Tietmeyer but less strongly. We ran out of time and had to leave it that Mulford would circulate a somewhat edited version including in square brackets the "ranges" sentence. After Mulford had gone I represented to the others that Mulford's proposal of this draft as a purely private document was silly and disingenous: Baker would surely want to make public use of it, and this was one reason why I had been so argumentative about it in general, and still disliked it. All the others took the point and agreed to reflect again on the next version with this in mind!

Action

19. No action for the Chancellor is immediately necessary. Briefs will be available on much of this ground before the Knokke informal ECOFIN, and on all of it for the Washington meetings. You might like for courtesy to confirm to Baker's office (and with the Governor's office) acceptance of the G5 and G7 telexed invitations.

we'll do this



(Geoffrey Littler)

Economic Policy Coordination

We have agreed on refinements of the Tokyo arrangements on closer economic policy coordination. The objectives of the agreement are (1) simplification of the indicators and (2) the provision of greater discipline to the process.

The Establishment of Economic Objectives and Projections

In order to provide a framework for surveillance, each country will present, early in the year, the medium-course of its intended policies and establish its economic projections and objectives. In this context, a small group of indicators that measure domestic and external economic performance and policies will be used with a special focus on those which reflect interactions among our economies. The projections and objectives will in some cases be quantified; in others they may be more general in nature. Broad, mutually consistent objectives will be developed also for the group as a whole. Both the collective and individual country objectives and projections are to be consistent and will serve as standards against which to assess country policies and performance. Initially, the objectives and projections involve the following key variables: growth, inflation, current accounts/trade balances, budget performance, monetary conditions and exchange rates.

ECONOMIC
POLICY
COORDINATION

Review Process

The Ministers and Governors will meet regularly to develop objectives and projections, to review national economic policies and performance, and to assess current trends and prospects.

In order to assist in these meetings, the IMF will develop further the approach taken in the initial surveillance exercise by preparing papers for each meeting. Such papers, including tables on the indicators, will examine economic developments and prospects in each country, and assess the progress and problems in achieving the objectives and projections. In this context, an assessment will be made of the possible need for policy action to assure that current and prospective trends are consistent with achievement of the objectives or to modify them.

In order to assist in this assessment, interim performance indicators will be developed. In selecting the interim performance indicators, attention will be focused on specific measures from a range of variables such as those referred to in the Tokyo Communique. The selection of interim performance indicators may vary from year to year to cover in the best possible way the full range of the underlying economic policies and performance.

Ministers and Governors will meet to review progress and prospects and undertake best efforts to reach understandings regarding appropriate remedial action if necessary. The Managing Director of the Fund would participate in a part of any surveillance discussions among the Ministers and Governors, and would be invited to present a short note in advance of each meeting. Substantial deviations from the intended course will lead to consultations. When circumstances warrant, a special meeting of Ministers and Governors would be convened.

The Role of Exchange Rates

Exchange rates are one of the key variables in the international adjustment process. A common understanding of the role of exchange rates is essential to reaching judgments concerning the extent to which imbalances are expected to be reduced through exchange rates or by other adjustment measures. In connection with their consideration of desirable adjustments of underlying policy fundamentals, Ministers and Governors will seek to reach informal, confidential understandings on the appropriateness of exchange rates and, if necessary, of desired exchange rate changes, taking into account the established economic objectives and projections. If they agree that it would be helpful either to stabilize or to promote adjustment of exchange rates, they will seek joint action to that end.

Much less objectionable.

Role of IMF Managing Director

The Managing Director of the IMF would be invited to express his views about underlying economic policies, performance, and prospects and to offer his advice on improvements in policies, including exchange rates, necessary for the smooth functioning of the international monetary system.

Old indicators paper
(met for Paris meeting)

ANNEX 4

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"INDICATORS" EXERCISE

It is agreed that this should not be on the agenda for the present meeting. But there is an understanding that the work will be carried forward with a view to Ministerial discussion at the April meeting. Balladur and Baker will both want to confirm this and ensure that appropriate further work is set in hand.

2. The Chancellor will want to judge in the light of the discussion how far to get drawn into some key points of procedure and substance. On the one hand, postponing argument may appeal - the passion shown by US (and to lesser degree France) might just diminish when the subject is separated from immediate operational worries of this meeting. On the other hand, there is no doubt that there are fundamental differences of approach between the US and France at one extreme, the UK at the other, with Germany and Japan much nearer to the UK but at Deputy level lamentably quiet.

3. The points which might be worth making are the following.

I give more detail below, drawing on long talks among deputies:

- there is no Tokyo Summit requirement for a report to the next Summit on the "indicators" exercise;
- the progress report G7 are to make to the next Summit is not defined and can be quite short on meetings and work (the main concern of Heads is how the G5/G7 mix works!);
- both G5 and G7 are to consult, using indicators;
- "objective indicators" does not mean "objectives" in the sense of committed targetry;
- publication of details of the process and substance of G5 and G7 surveillance would undermine cooperation;
- and much of the Mulford draft won't do at all.

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TOKYO SUMMIT REQUIREMENTS

4. The "indicators" exercise really goes back to the Interim Committee in early 1986 (Ruding was very active in promoting it, with encouragement from Baker). It became an issue at the Tokyo Summit and figures in the notorious paragraph 7 of the Declaration dealing with G5 and G7 financial cooperation. The main argument on the subject at Tokyo was over "objectives" (see below), and it was a scrappy affair, largely overshadowed by the G5/G7/G8 fracas.

5. But already in his press interviews at and after Tokyo Baker was building up his edifice of disciplined cooperation based on "objective indicators".

6. Recently the position has been that both US and France have repeatedly asserted that the Tokyo Summit required Finance Ministers to "complete the work" (an US phrase) on indicators for the next (Venice) Summit. I have asserted equally regularly and with growing support from my Japanese colleague that this is just not true. The text requests the 7 "to review their individual economic objectives and forecasts using the indicators specified below"; in a later passage which is under the code for the 5 "their individual forecasts should be reviewed taking into account indicators such as"; finally Finance Ministers (which are unspecified but I think it is common ground that 7 are meant) are "to report progress at the next Economic Summit meeting".

7. There is nothing here about an obligation to develop a new system of indicators, and certainly no obligation to report or publish on that. (In fact my memory is that the real reason for the request to report was that it was felt desirable to cover the question whether the new G5/G7 relationship was working!).

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8. I therefore believe that the Chancellor will be on firm ground if he simply denies any obligation "to complete the work on indicators" for the Venice Summit.

G5 or G7

9. The foregoing quotations from the Tokyo Summit Declaration make it clear that both groups are to review their economies and to use indicators as part of the process. What could be more natural and obvious? Neither group is charged with developing a new system of indicators. It would of course be natural for both to seek to improve techniques, but they have no specific remit.

10. As observed above, I think it is common ground that the report on progress should be from the 7. In fact Goria sees himself as responsible. At a recent gathering of G7 deputies, nobody dissented. Sarcinelli suggested an informal report and I suggested it should be brief, recording our meetings and any actions agreed. Again (on that occasion) nobody dissented.

OBJECTIVES

11. The US (with sympathy from France) continue to try to say that "objective indicators" means "objectives". Germany and Japan are of course strong allies on this. The second line of US attack is that "objectives" are necessary to express the sense of commitment in the process of cooperation. I have not tried to deny this proposition, but have argued against the particular parameters which the US want to choose as "objectives".

12. We have of course seen this argument in paragraph 8 of the draft statement for this meeting. It has been resolved by the device of bracketing "objectives and projections" - even on that

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we and others have flatly refused to include interest rates and hesitated a good deal about exchange rates. (The "real economy" framework which the US are trying to palm off in their approach to what should be the objectives - and whose responsibility to make corrections - is unacceptable to others as well as the UK).

PUBLICATION

13. The US - and this means Baker himself - wants to publish a great new accord which will show that cooperation is working. To this end he appears (in what Mulford says) to envisage publishing details of the nature of the objectives and indicators agreed (probably leaking the magnitudes, although they say not), and details of the programme of regular meetings, including contingent arrangements for special meetings to be triggered if particular objectives, etc are not being met.

14. I have argued that G5 and G7 cooperation will be less full and frank if in the glare of publicity; and that to feed the press with tempting morsels about the process of consultation will be to invite them to harry us with well-focussed questions at every stage - threating to unsettle markets and drive any elected government representatives into their shells. Germany and Japan with me throughout (and I think Italy and Canada but based on no more than brief and peripheral discussion). But with the US a complete lack of mutual understanding.

BASIC APPROACH

15. Mulford (and I presume Baker) are fundamentally not wanting to waste time over economic analysis. They simply want commitment to some figures as a basis for demanding action if those figures


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are not met. And they want to get public advantage from the whole arrangement, apparently genuinely believing that Congress and others in the US would be helped (to desist from protectionism) if they knew that G5/G7 had adopted an effective process.

16. For all others, the aim of surveillance consultations is to try to agree whether policies are pointing in the right direction and how to improve their compatibility, based on some common understanding of the analysis. We know that this is difficult for the US - we are all of that "school of thought" which holds that the US domestic deficit has some bearing on the problem - and we see indicators simply as analytical parameters.

17. The approach I have adopted among deputies is:

- on no account should we go public or semi-public on the details of surveillance;
- we should discover by using them which indicators are most helpful for our consultations, and be prepared to change from time to time (given that most of us try to develop indicators and analysis all the time for our own domestic decisions, we should not suppose there is any easier route for multilateral surveillance);
- at the level of deputies we have wasted hours on sterile discussions of procedure, instead of arguing about the facts, projections and analysis of them: we should do better than that;
- if we need ground-rules written at all, which I doubt, it must not be for publication and must be flexible.



(Geoffrey Littler)

Economic Policy Coordination: Next Steps

We have agreed on

with special focus on those which reflect interrelations between many countries.

Agreement has been reached with regard to refinements of the Tokyo arrangements on closer economic policy coordination. ~~A practical procedure including a manageable number of indicators has been agreed upon to assess the consistency and mutual compatibility of economic policies and performance.~~ The initial multilateral surveillance exercise based on the indicators in September 1986 has been developed further, both analytically and operationally.

The objects of this agreement are:

As a result, the economic policy coordination process has been made more effective through: (1) simplification of the indicators mechanism and (2) the provision of greater discipline to the process.

The Establishment of Economic Objectives and Projections

In order to provide a framework for surveillance, each country will present, early in the year, the medium-term course of its intended policies and establish its economic projections and objectives. In this context, a small group of indicators that measure domestic and external economic performance and policies will be used. The projections and objectives will in some cases be quantified; in others they may be more general in nature. Broad, mutually consistent objectives will be developed also for the group as a whole. Both the collective and individual country objectives are to be consistent and will serve as standards against which to assess country policies and performance. For 1987, the objectives and projections involve the following key variables: growth (GNP), inflation, current accounts/trade balances, monetary aggregates, budget performance, interest rates and exchange rates.

and projections

to submit to subsequent results and approval

Review Process

and Government

The Ministers will meet regularly, (three times each year) to review national economic policies and performance and assess current trends and prospects within the context of established mutually consistent objectives and projections. In order to assist in these meetings, the IMF will develop further the approach taken in the initial surveillance exercise by preparing papers for each meeting. Such papers, including tables on the indicators, will examine economic developments and prospects in each country, and assess the progress and problems in achieving

???

1.6.87
Annual
+ early in year

to be done?

Focus on what matters

the established objectives and projections. In this context, an assessment will be made of the possible need for policy action to assure that current and prospective trends are consistent with achievement of the established objectives or to modify them.

In order to assist in this assessment, interim performance indicators will be developed. [Such indicators can help Ministers in reaching judgments as to whether efforts are on track to achieve the established objectives and projections.] In selecting the interim performance indicators, attention will be focused on specific measures from the range of variables referred to in the Tokyo communique. The ^{selection of} interim performance indicators will vary from year to year, and be selected in light of the established objectives and projections and with a view to covering the full range of the underlying economic policies and performance.

will be used such as those - and others would occur planning

could be used while we?

As part of the review process, the Deputies will prepare a note outlining key issues for Ministerial consideration, Ministers and Governors will meet ~~at least twice a year~~ to review progress and prospects and undertake best efforts to reach understandings regarding appropriate remedial action. ~~On one of those occasions, Ministers and Governors are to establish individual and collective objectives and projections for the coming year~~, The Managing Director of the Fund would participate in a part of any surveillance discussion of the Ministers and Governors, and would be invited to present a short note in advance of each meeting. [When circumstances warrant, a special meeting of Ministers and Governors would be convened.]

The Role of Exchange Rates

Exchange rates are one of the key variables in the international adjustment process. Thus it will be important to monitor closely developments in the exchange market and to ensure effective cooperation on exchange market issues, focusing on underlying policy fundamentals. For this purpose, Ministers and Governors will reach informal, confidential understandings on the broad directions, and orders of magnitude, of exchange rate changes which are desired to achieve the established objectives and projections. Such understandings are essential to reaching judgments concerning the extent to which imbalances are expected to be reduced through exchange rates or by other adjustment measures.

A common understanding of the role of exchange rates is

With such understandings for exchange rate developments over the medium term (i.e., the next year or two), it will then be possible to develop a sense of the desired path of exchange rate evolution in the interim. Such a sense will involve the use of ranges which could be seen at any point in time as broadly consistent with underlying fundamentals and the achievement of the ultimate objectives.]

The IMF staff will not provide any estimates of "equilibrium" or in any other sense "correct" exchange rates, although the staff and the Managing Director would be invited to express their view about the broad compatibility of exchange rates with the fundamental economic conditions and established objectives, and about improvements in underlying economic policies which may be required to foster the smooth functioning of the exchange rate mechanism. Ministers and Governors will take into account the IMF analysis in seeking to reach understandings regarding appropriate exchange rate trends, as outlined above, as well as regarding interim exchange rate developments. These understandings will normally remain confidential.]

*done by [unclear]
for [unclear]
in [unclear]*

Thanked.
Re EMS, when I (Cush)
a week) told Ballardur &
to ~~write~~ apply to the
Commission, & we just
asked. If so, that was
the main issue, I
think Ballardur
was a good
idea as soon
as a mutually
convenient
time can be fixed.

SECRET

From: Sir G. Littler
Date: 27 March 1987

Alex
I've asked
Sir TB for
this & will

CHANCELLOR

c.c. Sir P. Middleton
Sir T. Burns
Mr Cassell
Mr Peretz
Mr C W Kelly

BALLADUR ON EXCHANGE RATES

I am sorry you were caught unbriefed yesterday by Ballardur's remarks about the recent Monetary Committee work and exchange rate management.

2. A main agenda item for Knokke is "Strengthening the EMS". This arises primarily from dissatisfaction with the realignment in January and the (?) mismanagement which led to it; the French produced for the Monetary Committee (not for Ministers as Ballardur implied) a paper making a wide range of suggestions on rules for intervention and its financing, holding/use of partner currencies, realignment procedures, and "reference zones" for relations with the dollar and the yen; this and other ideas have been discussed in the Monetary Committee, leading to a report of which I hope to have the near-final text tomorrow. It will be covered in your Knokke brief.

3. Ballardur was raising with you a related point, probably the result of Lebeque's having reported to him some talk at and in the margins of recent meetings which I had intended to cover in the Knokke brief, but now report separately.

[PS: HESA -
I wd like -
for my
eyes
only -
Sir TB's
instructions
on
Sir GL's
notes
for
personal
files -
m]

SECRET

4. This began with my opposition to public use of the language of "ranges", "target zones", "reference zones", in the course of which I had argued that the public, press and markets would not go along with subtle interpretations. With Lebegue I then talked about the Louvre agreement in this context. I recalled that a couple of years ago (among G10 Deputies) Camdessus had made an eloquent speech about the infinite possible gradations of "zones de reference"; one of his categories being very like what we had agreed for dollar/yen and dollar/DM at the Louvre. Lebegue appeared to accept that to have stated publicly that we had agreed "ranges" or "target zones" would have prompted outsiders to assume and look for something very specific and clearly quantified, and that this could have been damaging. I said we must develop such arrangements pragmatically and avoid "systems" language. He then said reflectively that it might be possible to find some common ground here.

5. I would recommend a conversation on this with Balladur who seems, as you remarked after the Louvre meeting, to be more of a pragmatist and less doctrinaire than predecessors or officials. I attach a note of the line I would recommend.

OK
Given your plans for Knokke weekend, I doubt that there will be sufficient opportunity there. Geoff is looking at the possibility of, say, dinner with Balladur while you are both in Washington. Depends on Balladur's plans, of course. AWK 27/3



(Geoffrey Littler)

SECRET

NOTES FOR POSSIBLE TALK WITH BALLADUR

Internal ERM arrangements

- Not the main issue here.
- There are points to discuss on how to make the mechanism work better internally (intervention points, partner currencies, relative interest rates, etc) but separately.
- If/when sterling joins ERM we shall not be looking for changes or exemptions on the existing format of the parity grid and its operation.

External Stability:

- Obviously helpful for ERM to have more stable background of world currencies, especially dollar.
- UK continues to insist that adjustment via exchange rate changes must be allowed a role: the form of discipline acceptable in ERM cannot be extended to apply to others who are not committed to common aims and policies.
- But time has come to give higher priority to stability in world exchange rates, and to reinforce pressures for more consistent and compatible domestic policies which would help sustain greater stability.
- Perhaps some common ground:
 - when satisfactory relationships once in place, we should seek pressures to hold them (with emphasis on basic domestic policies);
 - drift of exchange rates could be a signal of need to reexamine policies;

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- some quantitative ideas on extent of drift making signal would be a natural mechanism.

"Reference Zones", etc:

- Acknowledge that points just made are very much in the "reference zone" family of ideas.
- But there is a real problem in public acceptance of this language, which applies to all synonyms or new verbal tricks: the authorities may among themselves have very subtle and sophisticated understandings about meanings, but public, press and markets are unavoidably cruder.
- Publicly, any such language will be held to imply such "interesting" features as defined limit-rates and intervention points (and an open invitation to outsiders to identify them - and then test them), obligations in the event of failure, etc, and the counterpart of loss of credibility if the authorities seem to fail what others have interpreted as their intention.

Techniques

- We cannot avoid continual skirmishes with markets and the press, but to keep the initiative we have to operate with secrecy about our detailed intentions, and flexibility to vary them from time to time.
- Louvre agreement a good example: we have understandings but with fuzzy edges and the important qualification that we are operating flexibly in the light of events and of reactions in markets.

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Strategy

- Overall we still see the maintenance of sound domestic policies as the key.
- We see stability of exchange rates as a desirable result which should help support the right domestic policies.
- We see scope for using the exchange rate as a signalling mechanism (we use it that way ourselves as an element in assessing - and influencing - monetary conditions).
- We do not see - outside the ERM - the way to restoring the full discipline of exchange rate systems, indeed we positively prefer to keep some scope for movements.
- We insist on operating pragmatically, therefore, and we place great value on retaining secrecy on methods and objectives for successful market management.

A Possible Future System

- In reality the problem is to induce the United States to accept exchange rate discipline.
- Can they be trusted? They do not at present share our kind of analysis of the relationships between domestic policies, external performance and exchange rates. And their philosophy remains that the duty of the world is to adapt to their performance and to the dollar. Doubtful if they draw the same lessons as we do about the history of the dollar over recent years.
- The Chancellor might like to float his idea of building on a "low-inflation" club.

✓ PPs Chancellor Alex -
28 12/2 presumably
to long after
event.

PARIS MEET AGREED NOT TO PUBLISH BANDS - LAWSON NRIL
LONDON, MARCH 30 - U.K. CHANCELLOR OF THE EXCHEQUER NIGEL
LAWSON SAID THE MEETING OF SIX MAJOR INDUSTRIAL NATIONS IN
PARIS LAST MONTH AGREED NOT TO PUBLISH ANY BANDS IN CONNECTION
WITH THEIR PACT TO STABILISE CURRENCIES.
QUESTIONED BY A PARLIAMENTARY SELECT COMMITTEE ABOUT WHY
THE PARTICIPATING COUNTRIES HAD NOT ANNOUNCED ANY BANDS, LAWSON
REPLIED, "WE ALL AGREED IT WOULD BE MUCH MORE SENSIBLE NOT TO."
WHEN ASKED WHETHER THAT MEANT AN INFORMAL JOINT CURRENCY FLOAT
WITH SET RANGES WAS ARRANGED IN PARIS, LAWSON SAID "I DO NOT
WANT TO REVEAL THE PRECISE NATURE OF THE AGREEMENT, SO AS NOT
TO MAKE IT EASY FOR" SPECULATION AGAINST THE ACCORD.
30-MAR-1919 SEC634 MONK

CONTINUED ON - NRIM

MONITOR SEE AAAA 0951

PARIS MEET =2 LONDON NRIM
LAWSON SAID THE PARIS ACCORD PRESUMED THAT INDIVIDUAL
COUNTRIES WOULD TAKE CORRECTIVE ACTION IF THEIR CURRENCY BEGAN
REACTING SIGNIFICANTLY TO DOMESTIC MACROECONOMIC FACTORS.
BUT IF SUCH MOVEMENTS WERE DUE TO EXTRANEIOUS FACTORS,
LAWSON SAID THE OTHER PACT COUNTRIES WOULD COME TO ITS AID
THROUGH CONCERTED INTERVENTION ON THE FOREIGN EXCHANGES.
"IT IS CLEAR THAT BOTH GERMANY AND JAPAN ARE HAVING
DIFFICULTY ADJUSTING TO THEIR VERY LARGE EXCHANGE RATE
APPRECIATIONS AND MAKING THEIR ECONOMIES MORE DOMESTICALLY
ORIENTED, JUST AS IT IS TAKING TIME FOR THE UNITED STATES TO
MAKE ITS OWN ECONOMY MORE EXPORT ORIENTED," LAWSON SAID.
30-MAR-1921 SEC635 MONK

CONTINUED ON - NRIN

MONITOR SEE AAAA 0951

PARIS MEET =3 LONDON NRIN
IN HIS ORAL EVIDENCE TO PARLIAMENT'S SELECT TREASURY
COMMITTEE, LAWSON REPEATED THAT HE WAS HAPPY WITH THE POUND'S
CURRENT LEVEL, ADDING THAT "IT IS AN OBJECTIVE ... TO TRY TO
KEEP IT AROUND THAT LEVEL."
HE SAID THE PERCEPTION OF STERLING ON FOREIGN EXCHANGES HAD
CHANGED SINCE THE STEEP DROP IN OIL PRICES, LARGELY BECAUSE THE
POUND HAD WEATHERED THAT PERIOD SO SUCCESSFULLY. "THERE HAS
BEEN A REASSESSMENT OF STERLING'S FUNDAMENTALS," LAWSON SAID.
HE DISAGREED WITH WHAT HE TERMED "THE GROSSLY EXAGGERATED
CLAIM" THAT REAL U.K. INTEREST RATES WERE MUCH HIGHER THAN
THOSE OF OTHER MAJOR INDUSTRIALISED COUNTRIES.
30-MAR-1926 SEC644 MONK

PARIS MEET =4 LONDON NRIN
USING AS A REFERENCE THE KEY THREE-MONTH STERLING INTERBANK
RATE AS QUOTED IN LONDON, LAWSON SAID BRITAIN NOW HAD A REAL
INTEREST RATE LEVEL OF 5.75 PCT - THE SAME AS JAPAN DID AND
ONLY A 0.75 PERCENTAGE POINT ABOVE THE GROUP OF FIVE AVERAGE.
LAWSON CONFIRMED THAT "OVER THE MEDIUM AND LONGER TERM, THE
GOVERNMENT'S OBJECTIVE IS ZERO INFLATION."
HE SAID THE GOVERNMENT'S INTENTION OF ITS PSBR CONSTANT AT
1.0 PCT OF GDP "IS THE MODERN EQUIVALENT OF THE BALANCED BUDGET
DOCTRINE." HE ADDED THAT "TO ALLOW THE DEBT/GDP RATIO TO
REMAIN CONSTANT ON ANYTHING OTHER THAN ZERO INFLATION BASIS IS
SIMPLY A RECIPE FOR ACCELERATING INFLATION."
30-MAR-1932 SEC654 MONK

REUTER

RT8.27

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pmf
Washington background

FROM: A W KUCZYS
DATE: 30 March 1987

SIR G LITTLER

✓

cc Sir P Middleton
Sir T Burns
Mr Cassell
Mr Peretz
Mr C Kelly

6/F 7/4
(spk to Sir GL)

BALLADUR ON EXCHANGE RATES

The Chancellor was grateful for your note of 27 March.

2. On the EMS, what he (rightly or wrongly) took Balladur to be implying was that the Germans should hold other EMS currencies, and not just the \$, in their reserves. If so, it would be in our interest to support the proposal.

3. On the wider issue, the Chancellor agrees that a conversation with Balladur would be a good idea as soon as a mutually convenient time can be fixed. [I think you were looking into the possibility of finding an opportunity in Washington next week?]

After Dinner on Friday at Knokke now looks the best bet
AWK
2/4

AWK
A W KUCZYS

BALLADUR ON EXCHANGE RATES



Il Ministro del Tesoro

CH/EXCHEQU	
REC.	3-APR 1987
ACTION	SIR G. LITTLE 3/4
DOWNES TO	EST SIR P. MIDDLETON MR HAVELLE MR H. P. EVANS

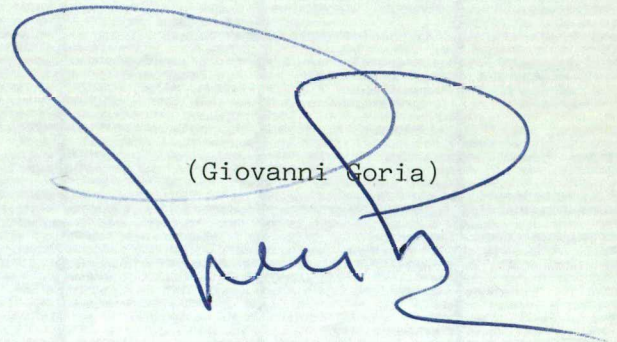
Rome, March 31, 1987

Dear colleague:

I take the liberty to send you copy of the letter I have addressed to Secretary Baker, regarding the agenda of the next meeting of the G-7 to be held in Washington on April 8th. I do hope that you will agree that a "modus vivendi" has to be found between the G-5 and the G-7, lest the problem falls again on our Heads of State or Government.

Looking forward to seeing you soon, I remain

Yours sincerely



(Giovanni Goria)

The Right Honorable
Nigel LAWSON
Chancellor of the Exchequer
H.M. Treasury
The Parliament Street
LONDON SW 1 3AG



Al Ministro del Tesoro

Rome, March 27, 1987

Dear James,

I wish to convey my acceptance of your kind invitation to attend the G-7 meeting, which will start at 3 p.m. on April 8, 1987 at the Treasury Department, as suggested in your communication dated March 24th, last.

In this connection, however, I wonder whether the proposed agenda might be integrated by an ad hoc point on the competence of, and relationship between, the G-5 and the G-7.

This proposition has, in fact, been compelled on me by both the relatively inconclusive meeting of the G-7 deputies held at Frankfurt/M on March 21st, 1987 and the urgency to avoid that, due to the absence of any agreement, the question might be seized by the coming Summit at Venice, as it already happened in Tokyo.

As you know, the above-mentioned Frankfurt meeting of the G-7 deputies has ended, as regards the respective rôles of G-5 and G-7, in a deadlock on almost all of the main aspects. In fact, my deputy has proposed at least two lines of distinction between the G-5 and the G-7, but the G-5 deputies have discarded them as unworkable. While Italy has suggested that an attempt should be made to establish a kind of demarcation line between the responsibilities of the two Groups (may I recall that those of the G-7 are spelled out in the Tokyo communiqué) or, failing this, a chronological separation between the meetings of the two Groups

Hon. James A. BAKER III
Secretary of the Treasury
Washington



Al Ministro del Tesoro

would be in order to avoid speculation about which one was rubber-stamping the other's decisions, the members of the G-5 have offered only to maintain the G-5 informal (that is, no announcement and no communiqué would mark its meetings) and G-7 formal (i.e., its meetings would be announced and closed by communiqués). What has happened during the IDB General Assembly Meeting, when AP Dow Jones cast the news of a forthcoming gathering of the G-5 in Washington, thus prompting the reaction of an Italian official, is a further proof of the embarrassment that chronological contiguity will continue to cause to us and, I presume, to Canada.

In my opinion a full parallelism as regards the structure of the G-5 and the G-7 (Deputies Group, participation of the Governors when we Ministers talk about surveillance, participation of the Managing Director), a minimum number of ministerial meetings during the year, and a full association of Italy and Canada to the G-5 since the beginning of negotiations concerning the management or the improvement of the international monetary system are required to solve the problem, as well as to appease political sensitivities. They are, anyway, topical items for our discussion.

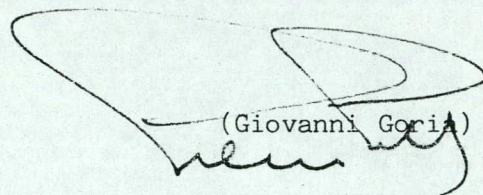
As it already happened in Tokyo last May, I sincerely hope that through your endeavours a solution to this "vexata



Al Ministro del Tesoro

quaestio" will be found. It remains, indeed, my wish and my intention that every possible effort be done, in Washington and on this occasion, to overcome the "impasse" in a way that may be acceptable to all our colleagues, in order to avoid that, against our very will, it might reappear during the dealings of the Summit in Venice.

Sincerely,



(Giovanni Goria)