

PO-CH/NK/0677 PART A

3/3



Treasury Chambers, Parliament Street, SW1P 3AG  
01-270 3000

3 December 1987

The Hon James A Baker III  
Secretary to the Treasury  
Room 3330  
Main Treasury Building  
15th & Pennsylvania Ave NW  
WASHINGTON DC 20220  
USA

A handwritten signature in black ink, appearing to read 'Jim Baker'.

I thought it might be helpful if I wrote to you and other G7 colleagues to spell out what I believe we need as the basis for a successful G7 agreement.

We can, of course, all welcome the actions taken and proposed on economic fundamentals: in particular the promised United States action on the fiscal deficit and the action which Germany has announced for its 1988 Budget. I believe Japan will similarly aim to take appropriate fiscal action in 1988. These joint moves should reinforce each other. We must get them properly understood as important moves to help correct imbalances, and ones which do not add to risks of either recession or inflation. We must also make it clear that we all intend to persevere with whatever further measures may become necessary later.

But this alone will not be enough. I am convinced we must address the two basic and linked problems of exchange rates and the financing of the United States fiscal and current account deficits.

With the best will in the world - on the part of all of us - the United States is bound for some time to run substantial though diminishing deficits. And these deficits, even allowing for some improvement in domestic savings following the stock market fall, mean the United States still has to attract large net capital inflows from other countries.

Official intervention has in effect financed the major part of the United States' external deficit this year. Though intervention has an important role to play, it obviously cannot be the sole or major source of external funds. Spontaneous private flows have to meet this need.





I believe it is unrealistic to hope to restore sufficient private capital flows to the US as long as the market harbours expectations of dollar depreciation, which could be self-fulfilling.

Unless we can co-operate to prevent it, I see a real risk of further dollar depreciation spiralling out of control. All experience suggests that financial markets, left to their own devices, overshoot badly, until such time as sentiment turns and the belief forms that future movements can only be upwards. Enormous damage could be done in this process. I cannot see how the United States could avoid serious inflationary consequences, and sooner or later the markets would inevitably drive up US interest rates. I am sure, too, that this would open the door to much greater risks of recession - in all our countries.

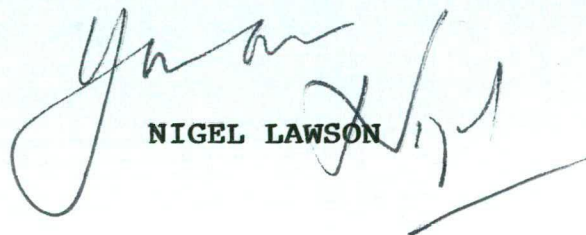
This is why I think it is vital that we should restore the expectation of dollar stability. We need to do this openly and convincingly, and to equip ourselves with the necessary means to do so. It will not be enough to rely on vague statements of hopes and intentions.

We need clear agreements. In particular:

- we must spell out our view that the current levels of G7 exchange rates do reflect economic fundamentals, in the sense that they are consistent with the eventual adjustment of the major imbalances, given the policies we have put in place and intend to continue;
- we must all be prepared to commit ourselves to use monetary policy to encourage the needed capital flows at these exchange rates: this may not be easy and may require compromises with other domestic objectives at first, but would become much easier once we recreate the expectation of stability;
- we need to demonstrate that we have resources for official funding which will still be needed from time to time if the market tests our resolution;
- the United States could make a major contribution to confidence if it undertook some sizeable borrowing in foreign currencies: this would also minimise the risks of a rise in United States' interest rates. I am sure we would all be ready to help on both the substance and the presentation of this.

We cannot afford to be vague; and none of us can responsibly allow an uncontrolled further dollar decline, given the damage it would quickly do in terms both of recession risks and of inflation risks.

I am sending a copy of this letter to our other G7 colleagues.

  
**NIGEL LAWSON**



MINISTERO DEL TESORO  
Direzione Generale del Tesoro

Roma,

3/12/87

TELECOPIA - TELECOPY - TELECOPIE

Indirizzata a:

Adresse a :

Adressed to :

MR. LAWSON NIGEL  
CHANCELLOR OF THE EXCHEQUER'S  
LONDON

Expéditeur - Sender

DIREZIONE GENERALE del TESORO  
Segreteria del Dr. SARCIWELLI

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To the Chancellor of the Exchequer's Private Office

With reference to your telefax addressed to Hon. Giuliano Amato, Minister of Treasury, through fax no. 4744950 I duly acknowledge its reception message has been already delivered to Hon. Amato's Office.

Regards

*Anna Maria Bignardi*  
Secretary to Mr. Sarcinelli



MINISTERO DEL TESORO  
Direzione Generale del Tesoro

Roma, 3/12/87

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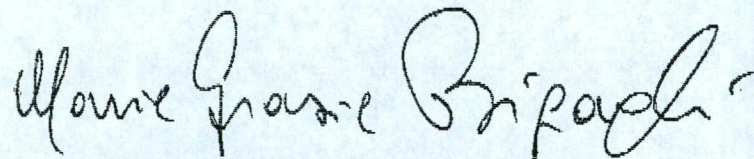
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part ✓



## Other countries

	<u>Cut</u>	<u>New Rate</u>	<u>Description</u>
Germany	$\frac{1}{2}\%$	$2\frac{1}{2}\%$	Discount rate
France	$\frac{1}{4}\%$	$7\frac{3}{4}\%$	Intervention rate
Austria	$\frac{1}{2}\%$	$\left\{ \begin{array}{l} 3\% \\ 4\frac{1}{2}\% \end{array} \right.$	Discount rate Lombard rate
Dutch	$\frac{1}{4}\%$	$3\frac{3}{4}\%$	Discount rate
Swiss	$\frac{1}{2}\%$		
UK	$\frac{1}{2}\%$	$8\frac{1}{2}\%$	Bank rate

*Lowest for all countries.*



U.K. RATE CUT WAS COORDINATED - TREASURY

NRJB

LONDON, DEC 3 - THURSDAY'S HALF POINT CUT IN U.K. INTEREST RATES WAS IN CONCERT WITH WEST GERMANY AND FRANCE, AND REFLECTED A SPIRIT OF COOPERATION NEEDED FOR ANY FUTURE GROUP OF SEVEN ECONOMIC AGREEMENTS, THE TREASURY SAID.

BRITAIN WAS THE FIRST TO CUT ITS BORROWING COSTS.

THE TREASURY LATER SAID, "THE U.K. MOVE IS PART OF CONCERTED ACTION WITH WEST GERMANY AND FRANCE, AND IS TAKEN IN THE LIGHT OF CURRENT FINANCIAL CIRCUMSTANCES." IT WELCOMED SUBSEQUENT RATE REDUCTIONS BY AUSTRIA AND THE NETHERLANDS.

INFORMED SOURCES SAID THE CONCERTED MOVES WERE IN PREPARATION FOR AN EVENTUAL G-7 MEETING.  
03-DEC-1509 MON290 MONC

REUTER

P

REUTER MONITOR 1516

BUNDESBANK CUTS DISCOUNT RATE TO 2.50 PCT.

NREE

FRANKFURT, DEC 3 - THE BUNDESBANK SAID IT IS CUTTING THE DISCOUNT RATE TO 2.50 PCT FROM 3.00 PCT, EFFECTIVE DECEMBER 4.

IN A STATEMENT AFTER ITS REGULAR POLICY-MAKING COUNCIL MEETING, THE BUNDESBANK SAID THE LOMBARD RATE REMAINS UNCHANGED AT 4.50 PCT. IT WAS CUT FROM 5.0 PCT EFFECTIVE NOVEMBER 5.

03-DEC-1337 SEC505 MONP

CONTINUED ON - NREG

P

REUTER MONITOR 1516

BUNDESBANK CUTS =2 FRANKFURT

NREG

THE CUT TO 2.50 PCT BRINGS THE DISCOUNT RATE TO A RECORD LOW. THE PREVIOUS LOW WAS IN 1959 WHEN IT WAS AT 2.75 PCT FOR EIGHT MONTHS. THE DISCOUNT RATE WAS LAST CUT ON JANUARY 22 OF THIS YEAR TO 3.00 PCT FROM 3.50 PCT AS PART OF A PACKAGE OF MONETARY MEASURES.

"WITH THIS REDUCTION OF THE DISCOUNT RATE THE BUNDESBANK IS TAKING INTO ACCOUNT THE DECLINE IN INTEREST RATES ALREADY IN MOTION," THE BUNDESBANK SAID IN A STATEMENT ON TODAY'S MOVE. "PROMOTING THIS EASIER TREND IS PARTICULARLY ADVISABLE TO CONTRIBUTE TO STABILIZATION OF THE CURRENCY MARKETS," IT SAID.

03-DEC-1349 SEC516 MONP  
CONTINUED FROM - NREE

REUTER

P

REUTER MONITOR 1516



03-DEC-1402 SEC529 MONP

REUTER

P

REUTER MONITOR 1516

BANK OF ENGLAND CUTS MONEY MARKET RATE HALF POINT NREO  
LONDON, DEC 3 - THE BANK OF ENGLAND SAID IT CUT ITS MONEY  
MARKET DEALING RATE BY 1/2 PERCENTAGE POINT TO 8-3/8 PCT IN ITS  
ROUTINE MARKET INTERVENTION THIS MORNING.

THE BANK OF ENGLAND SAID THE CHANGE IN INTEREST RATES WAS A  
RESPONSE TO TIGHTENING OF MONETARY CONDITIONS BROUGHT ABOUT BY  
DEVELOPMENTS IN THE CURRENCY MARKETS AND BY UNCERTAINTIES IN  
FINANCIAL MARKETS GENERALLY.

THE CUT WAS PROMPTED BY A COMBINATION OF A VERY WEAK  
DOLLAR, STERLING STRENGTH AND MARKET SENTIMENT TOWARDS A LIKELY  
SLACKENING IN THE ECONOMY, IT ADDED.

03-DEC-1403 SEC531 MONP

REUTER

P

REUTER MONITOR 1516

AUSTRIA CUTS DISCOUNT, LOMBARD RATES NREW  
VIENNA, DEC 3 - THE AUSTRIAN NATIONAL BANK SAID IT WAS  
CUTTING ITS DISCOUNT RATE TO THREE PCT FROM 3.5 PCT AND ITS  
LOMBARD RATE TO 4.5 PCT FROM FIVE PCT.

THE MOVES WERE MADE BECAUSE OF SIMILAR ACTION BY THE WEST  
GERMAN BUNDESBANK, THE BANK SAID. IT SAID IT WOULD USE SIMILAR  
INSTRUMENTS OF THE OPEN MARKET SYSTEM TO FINE-TUNE THE DOMESTIC  
MONEY MARKET.

THE BANK SAID IT EXPECTED ITS MOVE TO HAVE A POSITIVE  
EFFECT ON DEPOSITS AND CREDIT INTEREST RATES IN AUSTRIA.

03-DEC-1408 SEC541 MONQ

CONTINUED ON - NRHT

P

REUTER MONITOR 1516

BANGEMANN SAYS RATE CUT SHOWS GERMAN COOPERATION NROX  
BONN, DEC 3 - WEST GERMAN ECONOMICS MINISTER MARTIN  
BANGEMANN SAID THE BUNDESBANK'S DECISION TO CUT THE DISCOUNT RATE  
WAS ABOVE ALL A CLEAR SIGN BY WEST GERMANY OF ITS INTERNATIONAL  
COOPERATION ON ECONOMIC AND CURRENCY POLICIES.

HE ADDED THAT THE RATE CUT TO 2.50 PCT FROM THREE PCT WAS  
COUPLED WITH THE GOVERNMENT'S MEASURES TO SPUR THE ECONOMY BY  
OFFERING CHEAP CREDITS.

THE DECISION TO CUT THE KEY DISCOUNT RATE HAD BEEN NECESSARY  
AND ITS IMPACT ON THE ECONOMY WOULD NOT BE LOST, BANGEMANN SAID.

03-DEC-1431 MON210 MONA

REUTER



REUTER MONITOR 1516

FRENCH FINANCE MINISTRY SAYS CUTS SHOULD HELP DOLLAR NRHA  
PARIS, DEC 3 - THE FRENCH FINANCE MINISTRY SAID THE  
COORDINATED INTEREST RATE CUT BY THE BANK OF FRANCE AND THE WEST  
GERMAN BUNDESBANK ANNOUNCED TODAY SHOULD CONTRIBUTE TO  
SUPPORTING THE DOLLAR.

"THE FINANCE MINISTRY WELCOMES THIS NEW DEMONSTRATION OF  
CLOSE COOPERATION BETWEEN FRENCH AND GERMAN POLICY WITHIN THE  
FRAMEWORK OF THE EUROPEAN MONETARY SYSTEM (EMS)," IT SAID,  
NOTING THAT IT IS THE THIRD EXAMPLE OF SUCH JOINT ACTION SINCE  
NOVEMBER 5.

*Not  
v helpful!*

"THIS NEW INITIATIVE... SHOULD CONTRIBUTE TO STRENGTHENING  
THE DOLLAR," THE MINISTRY SAID.  
03-DEC-1441 MON223 MONB

CONTINUED ON - NRHB

P

REUTER MONITOR 1516

FRENCH FINANCE #2 PARIS NRHB

THE FINANCE MINISTRY POINTED OUT THAT WHILE THE BUNDESBANK  
HAS CUT ITS DISCOUNT RATE BY A HALF-POINT TO 2.5 PCT, THE BANK  
OF FRANCE TRIMMED ITS INTERVENTION RATE BY JUST A QUARTER POINT  
TO 7-3/4 PCT.

THE RESULT HAS BEEN TO CUT THE DIFFERENTIAL BETWEEN THE WEST  
GERMAN AND FRENCH SHORT-TERM MONEY MARKET RATES TO 4.5 PCT FROM  
THE 4.75 PCT LEVEL IT REACHED ON NOVEMBER 5.

"THIS DEMONSTRATES THE COHESION OF THE EMS AND THE HEALTHY  
CONDITION OF THE FRANC," THE STATEMENT SAID.

03-DEC-1442 MON224 MONB

CONTINUED FROM - NRHA

REUTER

P

REUTER MONITOR 1516

DUTCH CENTRAL BANK CUTS KEY RATES BY 1/4 POINT NRHJ

AMSTERDAM, DEC 3 - THE DUTCH CENTRAL BANK SAID IT CUT ITS  
THREE KEY OFFICIAL INTEREST RATES BY 1/4 POINT EFFECTIVE  
TOMORROW, LOWERING THE DISCOUNT RATE TO 3.75 PCT FROM 4.00 PCT.

THE MOVE FOLLOWS EARLIER CUTS IN INTEREST RATES BY THE  
BUNDESBANK AND THE BANK OF FRANCE IN WHAT THE FRENCH CENTRAL  
BANK SAID WAS A 'CONCERTED MOVE.'

IN A PRELIMINARY COMMENT, A SPOKESMAN FOR THE DUTCH CENTRAL  
BANK SAID, "WE WAITED FOR THE BUNDESBANK, THIS IS A CONCERTED  
ACTION." THE DUTCH CENTRAL BANK'S SECURED LOANS RATE WAS CUT TO  
4.25 PCT FROM 4.50 PCT AND THE PROMISSORY NOTES RATE TO 4.75  
PCT FROM 5.0 PCT.

03-DEC-1446 SEC585 MONB

CONTINUED ON - NRHK

P



STOLTENBERG SAYS RATE CUT WILL STABILISE MARKETS

NREH

BONN, DEC 3 - WEST GERMAN FINANCE MINISTER GERHARD STOLTENBERG SAID THURSDAY'S DECISION BY THE BUNDESBANK TO CUT THE DISCOUNT RATE TO 2.5 FROM THREE PCT WAS AN IMPORTANT CONTRIBUTION TO MARKET STABILISATION.

A MINISTRY STATEMENT QUOTED STOLTENBERG AS SAYING, "THE DECISION OF THE BUNDESBANK ... IS AN IMPORTANT CONTRIBUTION TO THE STABILISATION OF THE STOCK AND CURRENCY MARKETS."

03-DEC-1351 SEC517 MONP

MORE

P REUTER MONITOR 1516

FRANCE SAYS RATE CUT PART OF COORDINATED MOVE

NREM

PARIS, DEC 3 - THE BANK OF FRANCE SAID THE CUT IN ITS INTERVENTION RATE BY 1/4 POINT TO 7-3/4 PCT WAS PART OF A COORDINATED MOVE.

IT GAVE NO DETAILS. BUT THE INTEREST RATE ANNOUNCEMENT FOLLOWED IMMEDIATELY ON NEWS OF A BUNDESBANK CUT BY A HALF POINT TO 2.50 PCT IN ITS KEY DISCOUNT RATE.

THE FRENCH CENTRAL BANK ADDED IN A STATEMENT THAT "IN THE FRAMEWORK OF A CONCERTED MOVEMENT," IT ALSO TRIMMED BY 1/4 POINT THE RATE ON THE ALLOCATION OF LIQUIDITY THROUGH SEVEN-DAY REPURCHASE AGREEMENTS TO 8-1/4 PCT.

03-DEC-1357 SEC528 MONP

REUTER

P REUTER MONITOR 1516

DISCOUNT RATE INT'L SIGNAL ON GROWTH - BONN

NREN

BONN, DEC 3 - WEST GERMAN FINANCE MINISTER GERHARD STOLTENBERG SAID THURSDAY'S DECISION BY THE BUNDESBANK TO CUT ITS DISCOUNT RATE TO 2.5 FROM THREE PCT WAS AN IMPORTANT INTERNATIONAL SIGNAL ON GROWTH AND STABILITY.

A FINANCE MINISTRY STATEMENT QUOTED STOLTENBERG AS SAYING: "THE INTEREST RATE MOVE ... IS AN IMPORTANT INTERNATIONAL SIGNAL, WHICH, EVEN BEYOND (GERMANY'S) BORDERS, WILL BE SEEN AS A CONTRIBUTION TO THE PROMOTION OF STABILITY AND GROWTH."



FRENCH SOURCES SEE PROGRESS TOWARDS G-7 MEET -RPT NRKJ

PARIS, DEC 3 - PROGRESS IS BEING MADE TOWARDS A MEETING OF THE GROUP OF SEVEN FINANCE MINISTERS BUT IT IS TOO EARLY TO PREDICT A DATE WHEN ONE MIGHT BE HELD, SOURCES CLOSE TO FINANCE MINISTER EDOUARD BALLADUR SAID.

BALLADUR HAS CALLED REPEATEDLY FOR ACTION FROM THE U.S., WEST GERMANY AND JAPAN BEFORE A GROUP OF SEVEN MEETING CAN TAKE PLACE.

THE SOURCES SAID ON THURSDAY THAT THE FRENCH GOVERNMENT WELCOMED THE 21 BILLION MARK ECONOMIC PACKAGE APPROVED BY THE WEST GERMAN CABINET YESTERDAY, BUT REGRETTED THAT THERE WAS LITTLE PROSPECT OF GERMAN TAX CUTS BEING BROUGHT FORWARD.

03-DEC-1522 MON323 MOND

CONTINUED ON - NRKK

F

REUTER MONITOR 1516

FRENCH SOURCES =2 PARIS NRKK

THE SOURCES SAID BALLADUR HAD SPOKEN WITH U.S. TREASURY SECRETARY JAMES BAKER BY TELEPHONE YESTERDAY, AND THAT THEY HAD DISCUSSED THE PROSPECTS OF CONGRESSIONAL PASSAGE FOR THE U.S. BUDGET DEFICIT REDUCTION PACKAGE.

BALLADUR HAS PROPOSED A SPECIFIC AGENDA FOR AN EVENTUAL G-7 MEETING, INCLUDING A PROPOSAL FOR A PERMANENT SECRETARIAT TO MONITOR THE APPLICATION OF THE LOUVRE ACCORDS ON CURRENCY STABILITY.

BUT THE FRENCH SOURCES REITERATED TODAY THAT THERE WAS LITTLE POINT IN HOLDING A G-7 MEETING UNTIL CONCRETE RESULTS COULD BE ASSURED.

03-DEC-1524 MON326 MOND

CONTINUED FROM - NRKJ

REUTER

F

REUTER MONITOR 1516

KOHL SAYS RATE CUT TO SOLVE OTHER NATIONS' WOES NRKO

BONN, DEC 3 - WEST GERMAN CHANCELLOR HELMUT KOHL SAID THE BUNDEBANK'S DECISION TO CUT ITS KEY DISCOUNT RATE WOULD HELP SOLVE OTHER NATIONS' ECONOMIC PROBLEMS. !!

IN AN APPARENT REFERENCE TO THE U.S. TRADE DEFICIT, KOHL SAID IN A STATEMENT, "LOWER GERMAN INTEREST RATES AND STRONGER GERMAN DOMESTIC DEMAND HELP OUR FOREIGN PARTNERS SOLVE THEIR ECONOMIC PROBLEMS -- AS HAS BEEN THE CASE IN THE PAST."

THE MOVE TO CUT THE DISCOUNT RATE TO 2.5 PCT FROM THREE WAS A REALISTIC CONTRIBUTION BY WEST GERMANY TO INTERNATIONAL ECONOMIC COOPERATION, HE ADDED.

03-DEC-1523 MON324 MOND

REUTER



U.S. TREASURY CHIEF PRAISES EUROPEAN RATE CUTS NRKS  
WASHINGTON, DEC 3 - TREASURY SECRETARY JAMES BAKER SAID HE  
WAS DELIGHTED BY INTEREST RATE CUTS ANNOUNCED BY WEST GERMAN  
AND OTHER EUROPEAN CENTRAL BANKS AND SAID THEY WERE AN AID TO  
INTERNATIONAL ECONOMIC POLICY COOPERATION.  
"THESE INTEREST RATE CUTS, TOGETHER WITH THE MEASURES  
ANNOUNCED YESTERDAY BY THE FEDERAL REPUBLIC OF GERMANY, SHOULD  
HELP TO STRENGTHEN GROWTH IN EUROPE AND REDUCE TRADE  
IMBALANCES," BAKER SAID IN A STATEMENT.  
"THEY REPRESENT AN IMPORTANT CONTRIBUTION TO OUR  
INTERNATIONAL ECONOMIC POLICY COORDINATION EFFORTS," HE SAID.

03-DEC-1540 SEC688 MONE

P

CONTINUED ON - NRKT  
REUTER MONITOR 1516

U.S. TREASURY CHIEF =2 WASHINGTON NRKT  
THE WEST GERMAN BUNDESBANK REDUCED ITS DISCOUNT RATE TO A  
POST-WAR RECORD LOW OF 2.5 PCT FROM THREE PCT, EFFECTIVE  
FRIDAY.

EARLIER, BRITISH BANKS CUT THEIR BASE LENDING RATES  
FOLLOWING A SIGNAL FROM THE BANK OF ENGLAND, BRITAIN'S CENTRAL  
BANK.

THE BANK OF FRANCE ALSO SAID IT CUT ITS MONEY-MARKET  
INTERVENTION RATE BY 1/4 POINT TO 7-3/4 PCT.

"SECRETARY BAKER IS DELIGHTED WITH THE ANNOUNCEMENT BY THE  
GERMAN BUNDESBANK AND OTHER EUROPEAN CENTRAL BANKS TO CUT  
INTEREST RATES," THE TREASURY DEPARTMENT STATEMENT SAID.

03-DEC-1542 SEC689 MONE  
CONTINUED FROM - NRKS

P

REUTER  
REUTER MONITOR 1516



SECRET

From: Sir G.Littler  
Date: 4 December 1987

CHANCELLOR

*Handwritten in red:*  
brought  
with h.c.l.

CONVERSATION WITH TRICHET

At 6-30 this evening I had a long telephone talk with Trichet, who said that he and Balladur are very worried indeed about what the Germans, Americans and (possibly) Japanese are up to.

2. The first point was that they fear Stoltenberg will present us on Monday with an altogether too flabby draft - and one which he would claim to have been so extensively "negotiated" with Baker already as to be "take it or leave it". I said I shared this fear - but also that I did not think you would be minded simply to acquiesce in that approach: you would want a real discussion and, as your recent letter showed, you wanted real commitments.

3. The second point concerns deputies. As you may remember, there is a meeting of Working Party 3 of the OECD on Wednesday and Thursday morning of the coming week, under my Chairmanship. Long ago we arranged (as is normal) both G5 and G7 meetings of deputies in the margins. Nobody suggested cancelling these when a special G7 Ministerial meeting began to be projected - indeed we all felt that they might even be timely, and in any case we have other items for our agenda as well. The plan was G5 on Tuesday evening, G7 early Wednesday morning.



SECRET

4. Mulford has now been in touch with Trichet to say that Baker has refused to let Mulford attend, because he does not want any meeting of deputies before the 12/13 December Ministerial - which he is plainly now assuming will take place. Also, Mulford has asked Trichet (as host) to cancel quickly "so that Gyohten can change his travel plans". Trichet suspects (and I agree) that what Mulford wants is to get Gyohten to go to Paris via Washington so that a G3 caucus can be completed. Suspicion is strengthened because Mulford says Tietmeyer now cannot manage our meetings of deputies, although Tietmeyer has not mentioned this in any of two conversations with me and one with Trichet this afternoon.

5. Balladur insists on some preparation by deputies so that Trichet can compile "un dossier adequat"! I explained to Trichet that I had not felt it necessary to consult you on whether or not I should meet my G5/G7 colleagues quietly in Paris, and I could not speak for your view. But I was happy for him to tell Mulford that I continued to hold myself available and that we could decide our agenda on instructions if necessary. (Incidentally our agenda must at some stage take in the tedious business of 'indicators' on which Mulford suggested to Trichet a meeting in Paris 18 December "after the G7 Ministerial"!).

6. Thirdly, according to Trichet, Mulford said he thought your letter was "a typically unhelpful and aggressive" move; Trichet refused to share that view because Balladur had agreed with every word of it! The remark is typical Mulford - I doubt that he spoke on instructions (he did not say so), although I don't expect Baker entirely liked it!



SECRET

7. We can discuss on the plane, but if you were to feel that the meetings of deputies should be cancelled (which I do not recommend), perhaps you could give me a call at home.

A handwritten signature in dark ink, appearing to be 'GL' with a flourish underneath.

(Geoffrey Littler)



A, B, C, Cii, Pos.

NO G-7 MEET TILL AFTER U.S. BUDGET TALKS--MIYAZAWA NRKQ  
TOKYO, DEC 4 - JAPAN'S FINANCE MINISTER KIICHI MIYAZAWA  
SAID THE GROUP OF SEVEN (G-7) INDUSTRIAL NATIONS SHOULD NOT  
MEET UNTIL THE U.S. COMPLETES ITS BUDGET DEFICIT-CUTTING  
ACCORD.

THERE IS NO POINT IN HOLDING A G-7 MEETING UNLESS THIS IS  
COMPLETED, HE TOLD A PRESS CONFERENCE.

HE ALSO SAID HE UNDERSTANDS THAT THE U.S. BUDGET TALKS MAY  
HAVE TO CONTINUE THROUGH DECEMBER 17 BECAUSE THERE ARE STILL  
SOME PROBLEMS TO BE IRONED OUT REGARDING POSSIBLE TAX  
INCREASES.

04-DEC-0043 MON765 MONA

CONTINUED ON - NRKQ

P

MMS - SEE EMMS 0823

NO G-7 MEET #2 TOKYO

NRKQ

MIYAZAWA ALSO SAID JAPAN HAS NO PLANS TO INTRODUCE NEW  
MONETARY OR FISCAL MEASURES AFTER WEST GERMANY AND OTHER  
EUROPEAN COUNTRIES CUT THEIR KEY INTEREST RATES ON THURSDAY.  
THE WEST GERMAN BUNDESBANK LOWERED ITS DISCOUNT RATE TO  
2.5 PCT, A RECORD LOW, AND WAS JOINED BY CUTS IN OFFICIAL  
RATES IN FRANCE, BELGIUM, AUSTRIA, BRITAIN, THE NETHERLANDS  
AND SWITZERLAND.

THE JAPANESE FINANCE MINISTER SAID HE EXPECTS THE DOLLAR  
TO STABILISE NOT ONLY AGAINST THE MARK BUT ALSO AGAINST THE  
YEN AS A RESULT OF THE DISCOUNT RATE CUTS.

04-DEC-0045 MON766 MONA

CONTINUED ON - NRKQ

CONTINUED FROM - NRKQ

P

MMS - SEE EMMS 0823

NO G-7 MEET #3 TOKYO

NRKQ

MIYAZAWA SAID HE UNDERSTANDS THE U.S. ALSO THINKS THE G-7  
SHOULD NOT MEET UNTIL IT COMPLETES ITS DEFICIT-CUTTING BUDGET  
AGREEMENT.

04-DEC-0046 MON767 MONA

REUTER

CONTINUED FROM - NRKQ

P

MMS - SEE EMMS 0823



pan

**SECRET**

From: Sir G.Littler  
Date: 4 December 1987

**CHANCELLOR**

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3. The second point concerns deputies. As you may remember, there is a meeting of Working Party 3 of the OECD on Wednesday and Thursday morning of the coming week, under my Chairmanship. Long ago we arranged (as is normal) both G5 and G7 meetings of deputies in the margins. Nobody suggested cancelling these when a special G7 Ministerial meeting began to be projected - indeed we all felt that they might even be timely, and in any case we have other items for our agenda as well. The plan was G5 on Tuesday evening, G7 early Wednesday morning.



**SECRET**

4. Mulford has now been in touch with Trichet to say that Baker has refused to let Mulford attend, because he does not want any meeting of deputies before the 12/13 December Ministerial - which he is plainly now assuming will take place. Also, Mulford has asked Trichet (as host) to cancel quickly "so that Gyohten can change his travel plans". Trichet suspects (and I agree) that what Mulford wants is to get Gyohten to go to Paris via Washington so that a G3 caucus can be completed. Suspicion is strengthened because Mulford says Tietmeyer now cannot manage our meetings of deputies, although Tietmeyer has not mentioned this in any of two conversations with me and one with Trichet this afternoon.

5. Balladur insists on some preparation by deputies so that Trichet can compile "un dossier adequat"! I explained to Trichet that I had not felt it necessary to consult you on whether or not I should meet my G5/G7 colleagues quietly in Paris, and I could not speak for your view. But I was happy for him to tell Mulford that I continued to hold myself available and that we could decide our agenda on instructions if necessary. (Incidentally our agenda must at some stage take in the tedious business of 'indicators' on which Mulford suggested to Trichet a meeting in Paris 18 December "after the G7 Ministerial"!).

6. Thirdly, according to Trichet, Mulford said he thought your letter was "a typically unhelpful and aggressive" move; Trichet refused to share that view because Balladur had agreed with every word of it! The remark is typical Mulford - I doubt that he spoke on instructions (he did not say so), although I don't expect Baker entirely liked it!



**SECRET**

7. We can discuss on the plane, but if you were to feel that the meetings of deputies should be cancelled (which I do not recommend), perhaps you could give me a call at home.

A handwritten signature in black ink, appearing to be 'GL' with a flourish underneath.

(Geoffrey Littler)



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FM TOKYO

TO IMMEDIATE FCO

TELNO 980

OF 040600Z DEC 87

AND TO IMMEDIATE HM TREASURY, BANK OF ENGLAND, WASHINGTON,  
AND TO IMMEDIATE PARIS, BONN , ROME, OTTAWA

JAPANESE ATTITUDES TO G5/G7

1. THE JAPANESE AUTHORITIES BELIEVE THAT THERE IS NO POINT IN HOLDING A G5/G7 MEETING UNTIL THE US IS ABLE TO PRODUCE MORE CONVINCING EVIDENCE, FIRST THAT THE US PROPOSALS TO CUT THE DEFICIT WILL WORK, AND SECONDLY THAT THEY WILL INDEED GO AHEAD WITHOUT SIGNIFICANT AMENDMENT BY CONGRESS. THE NEED, ABOVE ALL, IS TO ENSURE THAT A MEETING CAN SIGNAL TO THE MARKETS THE END OF THE CURRENT PERIOD OF UNCERTAINTY.

2. AT THE SAME TIME, HOWEVER, THE JAPANESE REMAIN EXTREMELY CONFUSED ABOUT THE US ATTITUDE TO THE DOLLAR, AND WOULD INEVITABLY BE ATTRACTED BY THE PROSPECT OF A MEETING WHICH CLARIFIED THE POSITION , IDEALLY WITH SOME SORT OF REAFFIRMATION OF THE LOUVRE ACCORD.

3. THE BANK OF JAPAN HAS BEEN PARTICULARLY ACTIVE THIS WEEK IN SUPPLYING FUNDS TO THE MONEY MARKETS. THIS HAS BEEN INTERPRETED BY SOME OBSERVERS HERE AS INDICATING THAT THE BOJ IS TRYING TO GUIDE MARKET RATES DOWNWARDS AS PART OF AN INTERNATIONALLY COORDINATED EFFORT ALONGSIDE ACTION TAKEN IN EUROPE IN ADVANCE OF A G7 MEETING. THE BANK OF JAPAN TELL US THAT THEIR MAIN MOTIVE HAS BEEN TO EASE THE VERY SEVERE SEASONAL CASH SHORTAGES WHICH ARE LIKELY TO PERSIST DURING DECEMBER, AND WHICH WOULD OTHERWISE PROMPT DISRUPTIVE INCREASES IN SHORT-TERM INTEREST RATES: BUT THEY ARE QUITE PLEASED AT THE INTERPRETATION OF THEIR ACTIONS BY COMMENTATORS.

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Cc. Mr. A. Allan

1 T...  
2 Andrew  
3 PUP

SECRET

CHANCELLOR



From: Sir G. Littler  
Date: 8 December 1987

c.c. Sir P. Middleton  
Sir T. Burns  
Mr Peretz

TALKS IN BRUSSELS

I attach a note of the talks among European members of G7 held in Brussels yesterday. I also attach the draft text circulated by Stoltenberg (the result of his talks with Baker) with annotations of the handful of amendments we want.

2. No news yet from Tietmeyer (or others) to me. I shall make contact with them if this is still the case later this afternoon, before I leave for Paris.

3. Our impression was that Stoltenberg had been allowing himself to get drawn in to a meeting to serve Baker's immediate purposes rather than ours. The solidity of the French and Italian response with our own was gratifying - I think that your message last week was effective and timely!

4. I shall let you have later a suggested draft U.K. passage for the possible communique. In mulling this over, I have had one additional thought: if we publish a statement without a meeting - and particularly if we cannot get U.S. agreement to the changes we suggested on exchange rates, I would be inclined to do some drastic shortening of paragraphs 5 and 8.

5. Although we are not holding a meeting of deputies in Paris now, all of us will be there and gossiping together in the margins and I shall report anything I pick up.

(Geoffrey Littler)



SECRET

Note for the Record

MEETING OF EUROPEAN MEMBERS OF G7

A meeting was held in the UKREP office in Brussels at 11 a.m. on Monday 7 December. Those present were:

U.K.	:	Chancellor, Littler
France	:	Balladur, Trichet
Germany	:	Stoltenberg, Tietmeyer
Italy	:	Amato, Sarcinelli

2. Stoltenberg was invited by the Chancellor to say how his recent discussions with the U.S. Treasury Secretary (Baker) had gone. He explained that Baker had asked him some days ago to try to work out a formula as the basis for an early G7 meeting, and he had agreed while fully reserving his own position and his need to consult European colleagues. He had held six hours of telephone conversations with Baker, with exchange of fax drafts. He then circulated the draft of a possible G7 Communique which was the result. (See Annex, and covering Notes).

3. In reply to the Chancellor, Stoltenberg said that there were no supplementary or private agreements envisaged, except that he thought there would have to be a clear understanding about intervention. He had no formula for that yet: from discussing the possible outlines he had the impression that Baker was thinking of a collective agreement to commit \$15 billion, one-third each for the U.S., Japan and Germany (with European arrangements still to be settled); Baker would make no greater commitment than that, and no commitment on interest rate management.

4. Balladur expressed the view that this was insufficient - even with some necessary improvements - to calm markets and avert the risk of a crisis. The measures taken in recent weeks were frankly inadequate and had achieved no effect: that applied to the U.S. deficit reduction, to the German measures which fell far short of what was needed, and to the recent European reductions of interest rates. And the draft now presented added nothing. He did not regard it as a credible proposal - it could be damaging. Unless there were a prospect of announcements of more fiscal action from Germany and commitments from the United States, including interest rate management and something to help finance their deficit, he saw no point in a meeting.

5. Stoltenberg said that Germany could do no more at present and he was persuaded that Baker would go no further. The choice was between the risk of a meeting with this kind of outcome and the risk of the effect of having no meeting. He was not himself committed to a meeting.



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6. Amato said he had talked with Baker just over a week earlier and encouraged him to pursue talks with Stoltenberg. But he had at that stage made clear to Baker his own view that the U.S. must accept a stronger commitment, including interest rates, and he thought Baker had understood that there were such prior conditions for an acceptable meeting. Independently of the detail of the Communique we must have an understanding on interest rate differentials and also on the ability of Europe to sustain growth. He shared Balladur's view that the proposed draft would be more damaging as the outcome of an important meeting than to have no meeting. He also shared Balladur's concern - in terms of European interests as well as those of world equilibrium - over the disappointing scale and type of action offered by Germany.

7. Stoltenberg pointed out that Baker was heavily tied by the limits of what he could sell to the White House, and these were severely constraining. At one point he had thought that Baker was near agreement on extending and using 'swaps', but he had then consulted - and shied off.

8. The Chancellor said he agreed generally with Balladur and Amato. A G7 meeting would be a dramatic media event, with its results judged against the considerable expectations it would raise. The proposed draft offered nothing new - it even went back on early formulae. To rest a meeting on this would in his view risk a very bad market reaction and risk damaging the ability of the G7 to command credibility ever again. A meeting should wait for a time - which he thought would come - when the U.S. had shown some change of attitude, in particular some real sense of worry about a dollar collapse and the attendant inflation risks. He saw no possibility of Baker being persuaded during a meeting over the coming weekend.

9. The Chancellor said his judgement was that the lesser risk was to hold no meeting now. It was helpful that press and markets were not expecting a meeting before the Congress decisions on the Budget. What might be worth considering was the idea of issuing a document (perhaps built on the draft before us) without having a meeting. It could take credit for the measures adopted so far and the cooperation involved in them. And for the future it might be very useful to have established the novel possibility of action and agreements in G7 without the drama of a meeting.

10. Stoltenberg continued to express concern over the absence of a meeting, possibly coupled with a failure of Congress to agree on the Budget - which could by no means be ruled out. He also wondered whether the U.S. attitude would improve later - it might even deteriorate as the shadow of their election approached. But others were attracted to the Chancellor's suggestion and Stoltenberg began to think more favourably of it. He was asked whether he knew the Japanese view and said that Miyazawa's attitude towards the U.S. position seemed very close to the European attitude - especially in wanting some U.S. understanding on interest rates.




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11. Worries were then expressed generally about the risk of a further fall of the dollar and its impact on the European system. The Chancellor suggested that this might prove unavoidable in any case: what we had to decide now was the lesser of evils.

12. There was then a brief discussion of the draft text and a number of points were suggested - not as constituting adequate amendment to justify a meeting, but simply to produce a better text for possible publication. (These points were collated by deputies immediately afterwards and checked by Ministers at a brief meeting after lunch: they are noted on the attached text).

13. It was agreed:-

- Stoltenberg would report views to Baker and seek his acceptance of the few amendments proposed; he would report back to European colleagues;
- the U.S. refusal to allow a meeting of deputies later in the week in Paris should be accepted.

  
(Geoffrey Littler)  
8 December 1987.



## NOTES

In the attached draft:

- Words set in [ ] are in the United States draft but not accepted by European colleagues;
- Words underlined are alternatives and additions which the European group of Ministers want.



SECRET

DRAFT: STATEMENT OF THE GROUP OF SEVEN

1. Following extensive consultations the Finance Ministers and Central Bank Governors of seven major industrial countries today reaffirmed their conviction that the [basic] objectives and ~~[broad]~~ economic policy directions agreed in the Louvre Accord remain valid ~~[in full]~~ and provide for a positive development of the world economy.

2. The Ministers and Governors reemphasised their view that the major external imbalances in the world economy must be corrected. The policies which have been implemented this year are gradually showing the intended effects. In particular, the balance between domestic demand and output in the United States and in Japan and the Federal Republic of Germany has shifted in a direction which promotes external adjustment and in volume terms their trade imbalances are clearly diminishing. The greater stability of exchange rates achieved for much of the past year, following the earlier substantial exchange rate changes, contributed to this adjustment. The marked exchange rate changes over the past few weeks, however, stress the need to strengthen underlying economic fundamentals and to continue policy cooperation.

3. Developments in stock markets since mid-October may have some adverse effect on prospects for economic growth for the industrialised countries as a group. The Ministers and Governors believe, however, that with sound economic policies and effective



SECRET

coordination the rate of growth should be substantial. To this end they agreed that appropriate policies for strengthening non-inflationary growth in their countries are necessary.

4. Accordingly the Ministers and Governors have welcomed and endorsed the recent actions taken and initiated by each of their governments as follows:

[Individual country passages, which should take credit for past "Louvre-type" actions as well as proposals, in particular show the continuity of U.S. attack on deficit]

5. The Ministers and Governors are of the view that the recent ~~[relaxation of monetary policy]~~ monetary policy decisions and the reduction of interest rates in some countries were appropriate and will contribute to a restoration of stability to financial markets. They agreed that monetary policies should continue to be directed towards providing adequate monetary conditions to achieve strong growth in the context of price-stability and to foster financial market stability ~~[including stability of exchange rates.]~~

6. The Ministers and Governors strongly rejected protectionist measures as a means of dealing with present imbalances. Protectionism constitutes a direct and serious danger to world prosperity and equilibrium and would have harmful consequences for those countries which resort to it. They reaffirmed their determination to fight protectionism and to promote an open world trading system.



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7. The Ministers and Governors believe that the reduction of world trading imbalances requires cooperative action by other countries, particularly those with surpluses. They expressed particularly serious concern that some newly industrialised economies have failed to take adequate action to deal with large and growing trade surpluses which are exacerbating global imbalances and fostering protectionist pressures. They urged the newly industrialised economies to implement without delay trade and exchange rate policies that will facilitate the reduction of excessive trade surpluses and allow their currencies to fully reflect the strong competitive position of their economies.

8. The Ministers and Governors agreed that either excessive fluctuation of exchange rates; or a further decline of the dollar; or a rise in the dollar to an extent that becomes destabilising to the adjustment process ~~could~~ <sup>4</sup> ~~would~~ be counter-productive by damaging growth prospects in the world economy. They reemphasised their common interest in more stable exchange rates among their currencies and agreed to continue to cooperate closely in monitoring and implementing policies to strengthen underlying economic fundamentals ~~(to foster stability of exchange rates)~~. ~~It~~ In addition, ~~to foster stability of exchange rates,~~ they agreed to cooperate closely on ~~exchange markets~~ <sup>du,</sup> ~~[when to do so would be helpful]~~. The Ministers and Governors stressed the need for consistent and mutually supportive policies and believe that the measures being taken will accelerate progress towards the



**SECRET**

increased, more balanced economic growth, and sustainable external positions necessary for greater exchange rate stability.

[9. Pursuant to the arrangements for economic policy coordination endorsed at the Venice Summit, the Ministers and Governors underlined the need to continue reviewing their economic policies and performance and to reach understandings on the medium-term economic objectives, projections, and performance indicators that will be utilised in 1988.]



Ch

Elm

prop

Reette Peter not Terry  
seems to have done anything with  
this. I shall check with  
Geoff Reette we really need  
to send this tomorrow  
to please you.

SECRET

SIR TERENCE BURNS

From: Sir G.Littler  
Date: 8 December 1987

. c.c. Sir P.Middleton ✓

G7 COMMUNIQUE: UK CONTRIBUTION

As you know it is possible we may want shortly a passage on the UK for inclusion in a G7 statement issued without a meeting having been held. The object will be to take credit for "useful" action by participants, and perhaps refer to intended action. Passages should be short.

2. I have had a first very rough shot, attached. I also attach for convenience the page of the Louvre Accord with the UK passage in it.

3. Could you (and Peter) perhaps reflect on this? I shall be back from Paris on Friday morning (possibly late Thursday p.m.) and I hope it can wait until then. (Incidentally I shall try to sound colleagues in Paris about their ideas for national pieces). But if the Chancellor starts agitating for a draft, I leave it to you!

*Handwritten signature*

(Geoffrey Littler)

Where are we  
on this now following  
the Chancellors talk  
to SAH today and night

Proceeding, let study



The United Kingdom Government, in the context of the British economy's continued vigorous growth of output and domestic demand, coupled with moderately low rates of inflation and an acceptable small current account deficit, is maintaining the focus of its financial and economic strategy on sound public finance, on monetary policies to exert gentle downward pressure on inflation, and on measures to free the operation of markets and increase the efficient use of resources in the economy. Interest rates have recently been lowered, in part counteracting the impact on monetary conditions of a higher effective exchange rate and of reduced asset prices. Further tax reform and reduction of the burden of taxation is planned.



The Government of Japan will follow monetary and fiscal policies which will help to expand domestic demand and thereby contribute to reducing the external surplus. The comprehensive tax reform, now before the Diet, will give additional stimulus to the vitality of the Japanese economy. Every effort will be made to get the 1987 budget approved by the Diet so that its early implementation be ensured. A comprehensive economic program will be prepared after the approval of the 1987 budget by the Diet, so as to stimulate domestic demand, with the prevailing economic situation duly taken into account. The Bank of Japan announced that it will reduce its discount rate by one half percent on February 23.

The United Kingdom Government will maintain conditions for continuing the steady growth of GDP of the past five years and will continue to work to reduce inflation by following a prudent monetary policy. On external account the aim will be broad balance over the medium term. The share of public expenditure in the economy will continue to fall and the burden of taxation will be reduced, while public sector borrowing is maintained at low level. These and other measures to strengthen the supply performance of the economy, such as the privatization programme, will reinforce improvement over recent years in the growth of productivity.

The United States Government will pursue policies with a view to reducing the fiscal 1988 deficit to 2.3 % of GNP from its estimated level of 3.9 % in fiscal 1987. For this purpose, the growth in government expenditures will be held to less than 1 percent in fiscal 1988 as part of the continuing program to reduce the share of government in GNP from its current level of 23 percent. The United States will introduce a wide range of policies to improve its competitiveness and to enhance the strength and flexibility of its economy. Monetary policy will be consistent with economic expansion at a sustainable non-inflationary pace.

8. The Ministers and Governors noted that a number of newly industrialized economies were playing an increasingly important role in world trade. These economies have achieved strong growth based significantly on their access to open, growing export markets. Recently, some have accumulated trade surpluses which have contributed importantly to the present unsustainable pattern of global imbalances, thus increasing protectionist pressures. The Ministers and Governors considered that it is important that the newly industrialized developing economies should assume greater responsibility for preserving an open world trading system by reducing trade barriers and pursuing policies that allow their currencies to reflect more fully underlying economic fundamentals.





BEI | EIB

Den europæiske Investeringsbank  
Europäische Investitionsbank  
Ευρωπαϊκή Τράπεζα Επενδύσεων  
European Investment Bank  
Banco Europeo de Inversiones  
Banque européenne d'investissement  
Banca europea per gli investimenti  
Europese Investeringsbank  
Banco Europeu de Investimento

The Rt. Hon. Nigel LAWSON, M.P.  
Chancellor of the Exchequer  
Governor  
of the European Investment Bank

Board of Governors  
Secretariat

LONDON

Luxembourg, 26 November 1987 ref. AG/S/Sec/VM/nh no. 9873

Subject : EIB financing for the TAG III/ENI - TRANS AUSTRIA GASLINE  
Project (Austria)

Dear Governor,

/. Please find enclosed the minutes recording the decision of the Board of Governors dated 16 November 1987, concerning the approval of an EIB loan operation under Article 18 (1) of the Statute for financing the TAG III/ENI - TRANS AUSTRIA GASLINE Project (Austria).

/A12

CH/EXCHEQUER	
REC.	08 DEC 1987
ACTION	MR MORTIMER
COPIES TO	PAUL SIR G. LITTON AS EDWARDS

Yours sincerely,

Dieter Hartwich  
Secretary General

Enc. : 1



B O A R D O F G O V E R N O R S

Minute of the decision of 16 November 1987 requested by telex

TAG III/ENI - TRANS AUSTRIA GASLINE Project (Austria)

LOAN OPERATION UNDER ARTICLE 18 (1) OF THE STATUTE

C O N F I D E N T I A L

For



B O A R D O F G O V E R N O R S

TAG III/ENI - TRANS AUSTRIA GASLINE Project (Austria)

LOAN OPERATION UNDER ARTICLE 18(1) OF THE STATUTE

At its meeting on 6 October 1987, the Board of Directors had agreed to grant an EIB own resources loan to Ente Nazionale Idrocarburi (ENI), to be on-lent to Trans Austria Gasline Finance Company Ltd (TAG Finco), for the financing of a project concerning the construction of a gas pipeline across Austria from the Austrian/Czechoslovakian border to Italy. As the project would be located outside the European territories of the Member States, this approval had been made subject to the granting by the Board of Governors of the derogation provided for in Article 18(1) of the Statute.

On 22 October 1987, the authorisation of the Board of Governors was sought by telex, in accordance with the written procedure provided for in Article 5 of the Rules of Procedure.

The favourable votes of Messrs POOS, SIMITIS, SIMONSEN, SOLCHAGA, RUDING, CADILHE, EYSKENS, MACSHARRY, AMATO, STOLTENBERG, LAWSON and BALLADUR were received.

Consequently, the CHAIRMAN noted that, acting on a proposal from the Board of Directors, in accordance with the second paragraph of Article 18(1) of the Bank's Statute, the BOARD OF GOVERNORS unanimously authorised the Bank to contribute with a loan operation from own resources towards the construction of a gas pipeline across Austria from the Austrian/Czechoslovakian border to Italy.

Done at Luxembourg, 16 November 1987

The Chairman :  
(signed) G. Stoltenberg

The Secretary :  
(signed) D. Hartwich

Certified true translation :  
The Secretary :  
(signed) D. Hartwich



FROM: R I G ALLEN  
DATE: 10 DECEMBER 1987

PPS

cc Sir P Middleton  
Sir T Burns  
Sir G Littler (or)  
Mr Peretz  
Mr Matthews  
Mr Pickford

WP3

Huw Evans called me from Paris this lunchtime to say that, at the conclusion of the WP3 meeting, Sir Geoffrey Littler had given a short press conference. A copy of his statement on behalf of the Committee is attached.

2. Sir Geoffrey stressed that he was speaking to the press wearing his Chairman of WP3 hat, and not as a UK or G7 official.

3. After his statement, Sir Geoffrey answered a few questions. The main points he noted were that:

- the level of exchange rates in 1987 had been about right. There would be concern among WP3 members were the markets to be thrown into future major convulsions;
- on future fiscal/monetary policy adjustments that were needed, there were some differences of view in the Committee. Some thought that the German fiscal measures had not gone far enough;
- some members had also expressed concern about the build up of liquidity in the system, and the potential inflationary risks which this was creating in some countries.

4. There is nothing in this which, I think, is wildly inconsistent with what the Chancellor was saying to the TCSC yesterday.

  
R I G ALLEN



RCV BY: XEROX TELECOPIER 7010 ; 10-12-87 5:19PM ;  
EXP: \*\*\*\*\*

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To Richard Allen  
H.M.T. FAX 270 5244  
From Huw Evans, OECD

Notes for Press Statement by Sir G Littler, in his capacity as  
Chairman of WP3

First meeting since Stock Market upsets of late October - built  
our topical discussion around that.

We looked at some questions of the functioning of markets  
during that testing time. Some comfort:

- broadly, services to customers maintained, even at  
cost to some market-makers
- liquidity difficulties in some markets countered by  
prompt willingness of authorities to ease liquidity
- systemic threat not apparent, partly because of  
attitude of authorities
- but, rapidity and simultaneity across markets took many  
of us by surprise - may owe something to irreversible  
modern developments of technology, professionalism,  
globalisation. Working party is interested in pursuing  
review of financial standards and supervision of  
securities operations. This will need time, experience  
and care.



Nobody challenged the theory, or suggested a different direction of change. But a good deal of doubt was expressed about the likely scale of change - although with many reservations on uncertainties. Several reasons:

- granted the proposed wealth effects of the fall of prices, did previous forecasts fully incorporate the wealth effects of the previous high level of prices? If not, be careful not to overdo it.
- there is some recent evidence especially in Japan, United States, United Kingdom, perhaps even Germany - that expansion in the few months before October was stronger than had been predicted.
- business intentions and expectations post October have varied between countries, but by no means universal pessimism
- individual country forecasts in most cases now give little weight to October Stock Market falls - rather more to exchange rate changes.
- Finally, policy actions taken and expected.

The broad conclusion - with consciousness of great uncertainty - seems to be that recent events will of themselves tend slightly to depress prospects for growth over the next year, and help keep inflation down, but the scale could well be muted for the reasons given. On the other hand, there are undoubted



downside risks, not least of which is the threat to confidence - especially from any renewed turbulence of stock or foreign exchange markets.

The Working Party naturally touched on the underlying problems of imbalances which remain unresolved. They noted that evidence continues to accumulate of gradual improvement. They noted also that actions taken recently should be helpful : fiscal action in the United States assuming Congress agrees the proposed measures which will carry forward the programme of reduction of the deficit; German intention announced to expand investment in addition to the already planned and substantial 1 January tax reductions; reductions of European interest rates.

The problems remaining are well-recognised. The aim of the countries represented here is to reduce the imbalances gradually by means which will minimise risks of recession and inflation while avoiding also an overshooting which could simply create another and reverse set of imbalances. This will take time. It will also need further action as we go along. There is a common interest in pursuing that course steadily. The more stable the financial setting, the better the prospects.

OECD

Paris

10 December 1987



We looked at causes - not just the proximate causes which were clearly changes of market perception and expectation which can be linked to a sequence of particular events - but causes in the context of the preceding rise of prices. Dramatic visual message of graphs plotting bond and share prices for all markets - something which had prompted some to foresee a correction at some stage, even if not its scale, speed and precise timing.

The question whether the falls were simply a correction of a temporary overshoot, or represented some major change, is very relevant to assessment of the likely impact on economic prospects. Correction an important part.

In looking at prospects, we have to take account of both falls in stock prices and some important exchange rate changes. Also some actions and declared intentions of Government policies, and central bank policies.

Immediate reactions of most accredited forecasters to the events of late October were to write down prospects of growth for the coming year and also shade down inflation expectations. The familiar theory of wealth effects was a major part of this, coupled with assumed effects of exchange rate changes on the economies mainly affected.





FROM: J M G TAYLOR  
DATE: 10 December 1987

SIR G LITTLER

cc Sir P Middleton  
Sir T Burns  
Mr Peretz

**TALKS IN BRUSSELS**

The Chancellor was grateful for your note of 8 December.

A handwritten signature in dark ink, appearing to be "J M G TAYLOR".

J M G TAYLOR



SECRET

CHANCELLOR

From: Sir G.Littler  
Date: 8 December 1987

c.c. Sir P.Middleton  
Sir T.Burns  
Mr Peretz

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(Geoffrey Littler)



SECRET

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3. In reply to the Chancellor, Stoltenberg said that there were no supplementary or private agreements envisaged, except that he thought there would have to be a clear understanding about intervention. He had no formula for that yet: from discussing the possible outlines he had the impression that Baker was thinking of a collective agreement to commit \$15 billion, one-third each for the U.S., Japan and Germany (with European arrangements still to be settled); Baker would make no greater commitment than that, and no commitment on interest rate management.

4. Balladur expressed the view that this was insufficient - even with some necessary improvements - to calm markets and avert the risk of a crisis. The measures taken in recent weeks were frankly inadequate and had achieved no effect: that applied to the U.S. deficit reduction, to the German measures which fell far short of what was needed, and to the recent European reductions of interest rates. And the draft now presented added nothing. He did not regard it as a credible proposal - it could be damaging. Unless there were a prospect of announcements of more fiscal action from Germany and commitments from the United States, including interest rate management and something to help finance their deficit, he saw no point in a meeting.

5. Stoltenberg said that Germany could do no more at present and he was persuaded that Baker would go no further. The choice was between the risk of a meeting with this kind of outcome and the risk of the effect of having no meeting. He was not himself committed to a meeting.



SECRET

6. Amato said he had talked with Baker just over a week earlier and encouraged him to pursue talks with Stoltenberg. But he had at that stage made clear to Baker his own view that the U.S. must accept a stronger commitment, including interest rates, and he thought Baker had understood that there were such prior conditions for an acceptable meeting. Independently of the detail of the Communique we must have an understanding on interest rate differentials and also on the ability of Europe to sustain growth. He shared Balladur's view that the proposed draft would be more damaging as the outcome of an important meeting than to have no meeting. He also shared Balladur's concern - in terms of European interests as well as those of world equilibrium - over the disappointing scale and type of action offered by Germany.

7. Stoltenberg pointed out that Baker was heavily tied by the limits of what he could sell to the White House, and these were severely constraining. At one point he had thought that Baker was near agreement on extending and using 'swaps', but he had then consulted - and shied off.

8. The Chancellor said he agreed generally with Balladur and Amato. A G7 meeting would be a dramatic media event, with its results judged against the considerable expectations it would raise. The proposed draft offered nothing new - it even went back on early formulae. To rest a meeting on this would in his view risk a very bad market reaction and risk damaging the ability of the G7 to command credibility ever again. A meeting should wait for a time - which he thought would come - when the U.S. had shown some change of attitude, in particular some real sense of worry about a dollar collapse and the attendant inflation risks. He saw no possibility of Baker being persuaded during a meeting over the coming weekend.

9. The Chancellor said his judgement was that the lesser risk was to hold no meeting now. It was helpful that press and markets were not expecting a meeting before the Congress decisions on the Budget. What might be worth considering was the idea of issuing a document (perhaps built on the draft before us) without having a meeting. It could take credit for the measures adopted so far and the cooperation involved in them. And for the future it might be very useful to have established the novel possibility of action and agreements in G7 without the drama of a meeting.

10. Stoltenberg continued to express concern over the absence of a meeting, possibly coupled with a failure of Congress to agree on the Budget - which could by no means be ruled out. He also wondered whether the U.S. attitude would improve later - it might even deteriorate as the shadow of their election approached. But others were attracted to the Chancellor's suggestion and Stoltenberg began to think more favourably of it. He was asked whether he knew the Japanese view and said that Miyazawa's attitude towards the U.S. position seemed very close to the European attitude - especially in wanting some U.S. understanding on interest rates.




SECRET

11. Worries were then expressed generally about the risk of a further fall of the dollar and its impact on the European system. The Chancellor suggested that this might prove unavoidable in any case: what we had to decide now was the lesser of evils.

12. There was then a brief discussion of the draft text and a number of points were suggested - not as constituting adequate amendment to justify a meeting, but simply to produce a better text for possible publication. (These points were collated by deputies immediately afterwards and checked by Ministers at a brief meeting after lunch: they are noted on the attached text).

13. It was agreed:-

- Stoltenberg would report views to Baker and seek his acceptance of the few amendments proposed; he would report back to European colleagues;
- the U.S. refusal to allow a meeting of deputies later in the week in Paris should be accepted.

  
(Geoffrey Littler)  
8 December 1987.



## NOTES

In the attached draft:

- Words set in [ ] are in the United States draft but not accepted by European colleagues;
- Words underlined are alternatives and additions which the European group of Ministers want.



SECRET

DRAFT: STATEMENT OF THE GROUP OF SEVEN

1. Following extensive consultations the Finance Ministers and Central Bank Governors of seven major industrial countries today reaffirmed their conviction that the [basic] objectives and [broad] economic policy directions agreed in the Louvre Accord remain valid [in full] and provide for a positive development of the world economy.

2. The Ministers and Governors reemphasised their view that the major external imbalances in the world economy must be corrected. The policies which have been implemented this year are gradually showing the intended effects. In particular, the balance between domestic demand and output in the United States and in Japan and the Federal Republic of Germany has shifted in a direction which promotes external adjustment and in volume terms their trade imbalances are clearly diminishing. The greater stability of exchange rates achieved for much of the past year, following the earlier substantial exchange rate changes, contributed to this adjustment. The marked exchange rate changes over the past few weeks, however, stress the need to strengthen underlying economic fundamentals and to continue policy cooperation.

3. Developments in stock markets since mid-October may have some adverse effect on prospects for economic growth for the industrialised countries as a group. The Ministers and Governors believe, however, that with sound economic policies and effective



THE UNIVERSITY OF CHICAGO

PHYSICS DEPARTMENT

PHYSICS 350

PROBLEM SET 1

DATE: \_\_\_\_\_

NAME: \_\_\_\_\_

PROBLEM 1

PROBLEM 2

PROBLEM 3

PROBLEM 4

PROBLEM 5

PROBLEM 6

PROBLEM 7

PROBLEM 8

PROBLEM 9

PROBLEM 10

PROBLEM 11

PROBLEM 12



SECRET

coordination the rate of growth should be substantial. To this end they agreed that appropriate policies for strengthening non-inflationary growth in their countries are necessary.

4. Accordingly the Ministers and Governors have welcomed and endorsed the recent actions taken and initiated by each of their governments as follows:

[Individual country passages, which should take credit for past "Louvre-type" actions as well as proposals, in particular show the continuity of U.S. attack on deficit]

5. The Ministers and Governors are of the view that the recent [relaxation of monetary policy] monetary policy decisions and the reduction of interest rates in some countries were appropriate and will contribute to a restoration of stability to financial markets. They agreed that monetary policies should continue to be directed towards providing adequate monetary conditions to achieve strong growth in the context of price-stability and to foster financial market stability including stability of exchange rates.

6. The Ministers and Governors strongly rejected protectionist measures as a means of dealing with present imbalances. Protectionism constitutes a direct and serious danger to world prosperity and equilibrium and would have harmful consequences for those countries which resort to it. They reaffirmed their determination to fight protectionism and to promote an open world trading system.



SECRET

7. The Ministers and Governors believe that the reduction of world trading imbalances requires cooperative action by other countries, particularly those with surpluses. They expressed particularly serious concern that some newly industrialised economies have failed to take adequate action to deal with large and growing trade surpluses which are exacerbating global imbalances and fostering protectionist pressures. They urged the newly industrialised economies to implement without delay trade and exchange rate policies that will facilitate the reduction of excessive trade surpluses and allow their currencies to fully reflect the strong competitive position of their economies.

8. The Ministers and Governors agreed that either excessive fluctuation of exchange rates; or a further decline of the dollar; or a rise in the dollar to an extent that becomes destabilising to the adjustment process [could] would be counter-productive by damaging growth prospects in the world economy. They reemphasised their common interest in more stable exchange rates among their currencies and agreed to continue to cooperate closely in monitoring and implementing policies to strengthen underlying economic fundamentals [to foster stability of exchange rates]. In addition, to foster stability of exchange rates, they agreed to cooperate closely on exchange markets [when to do so would be helpful]. The Ministers and Governors stressed the need for consistent and mutually supportive policies and believe that the measures being taken will accelerate progress towards the



**SECRET**

increased, more balanced economic growth, and sustainable external positions necessary for greater exchange rate stability.

[9. Pursuant to the arrangements for economic policy coordination endorsed at the Venice Summit, the Ministers and Governors underlined the need to continue reviewing their economic policies and performance and to reach understandings on the medium-term economic objectives, projections, and performance indicators that will be utilised in 1988.]



SECRET

*C. M. A. Allen*  
*15 minutes*  
*2 prep.*

From: Sir G. Littler  
Date: 14 December 1987

CHANCELLOR

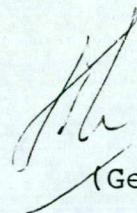
c.c. Sir P. Middleton  
Sir T. Burns

**G7 STATEMENT: DEVELOPMENTS**

The U.S. want to include in the body of the statement a passage referring to the main actions by themselves, Germany and Japan. The proposed text (so far I think agreed with Germany but not yet Japan) is at Annex A. I see no objection.

2. You may like to look at the drafts for the Annex proposed by the U.S. (Annex B), Germany (Annex C) and Japan (Annex D).

3. In a long telephone conversation this morning, mainly on other matters, Gyohten told me that the U.S. are now proposing that the paragraph on 'indicators' be attached as an extra Annex to the statement. His view was against this: any reference to the indicators exercise in the statement or its annexes would attract too much interest which might prove embarrassing when we are trying to meet early next year. I said I liked his argument! I don't think we want to die in any ditches over this but I shall encourage playing the passage down, if not out of sight!



(Geoffrey Littler)



BMF 5300 BONN

927 P02

4. [Accordingly, the Ministers and Governors agreed to intensify their economic policy coordination efforts. Their common efforts are directed towards reducing external imbalances. In particular, the United States has implemented the agreement between the President and the bipartisan Congressional leadership on a two year package of additional budget savings that will reinforce progress in reducing the budget deficit. Japan has implemented a major stimulus program to strengthen domestic demand and has committed to continue the expansionary effect of the program in the next fiscal year. The Federal Republic of Germany is supplementing the previously announced increase in tax reductions in 1988 with new measures to increase investment and will not seek to offset the budget revenue losses arising from recent developments. There have also been coordinated reductions in interest rates in Europe which should contribute to the expansion of domestic demand and reduce trade imbalances. The specific policy intentions and undertakings by each country are set forth in the annex to this statement.]



DraftU.S. Paragraph

The President of the United States and the Leadership of the Congress have reached agreement on a two year package of budget savings to reduce the U.S. budget deficit. This agreement provides for budget savings in excess of the \$23 billion already required by existing legislation and will permit, through a combination of spending restraint and increased taxes, total savings in fiscal 1988 and 1989 of approximately \$76 billion. The United States commits to the full and timely implementation of this agreement.

The budget agreement is part of an ongoing process of deficit reduction provided for under the recently revised budget legislation. It will reinforce the progress already achieved in reducing the deficit (including a fiscal 1987 cut of \$73 billion or 1.7 percent of GNP) that has brought the deficit down to 3.4 percent of GNP from a peak of 6.3 percent.

The Administration will also continue to oppose steadfastly protectionist trade measures while working for legislation authorizing negotiations to foster a more open and fair system for the international exchange of goods, services and investment.



BMF 5300 BONN

927 P03

German paragraphDraft

The Federal Republic of Germany has increased the amount of the tax reductions for 1988 and the following years to about 14 billion DM and will not seek to offset the budget revenue losses arising from recent developments. In addition, the necessary decisions are taken for the structural tax reform with a further net reduction of 20 billion DM from 1990 on.

In order to strengthen private and public investment the Federal Government will provide special loans for the next years of about 21 billion DM at preferential conditions. Moreover, it will accelerate investment in telecommunication infrastructure and take initiatives for further deregulation of markets.

The Bundesbank has reduced short-term interest rates substantially during the last few weeks. Monetary policy will continue to maintain appropriate conditions for sustained non-inflationary growth.



BMF 5300 BONN

927 P05

DraftJapanese paragraph

The Government of Japan noted that the Japanese economy is in a rigorous expansionary phase led by domestic demand.

It will steadfastly continue implementing the 6 trillion-yen-plus package decided last May. ~~It~~ will see to it that in the FY1988 budget, the expenditure for general public works should not be less than that ~~for~~ the FY1987 budget after July supplementation. 財務省

The Bank of Japan is to follow appropriate and flexible monetary policy supportive of non-inflationary growth and exchange rate stability.





FROM: A C S ALLAN  
DATE: 14 December 1987

SIR G LITTLER

cc Sir P Middleton  
Sir T Burns

**G7 COMMUNIQUE: UK CONTRIBUTION**

The Chancellor has seen your minute of 8 December to Sir T Burns. He feels the UK passage should be amended to read as follows:

"The United Kingdom Government, in the context of the British economy's continued vigorous growth of output and domestic demand, coupled with sound public finances, will continue to strive to reduce inflation by pursuing a prudent monetary policy, while increasing its capacity for non-inflationary growth by further measures designed to free the operation of markets and increase the efficient use of resources, including tax reduction and tax reform. Public expenditure will continue to increase less rapidly than the growth of the economy as a whole, and the Government will continue to work for the dismantling of barriers to trade both within the European Community and in the context of the Uruguay round of the GATT."

2. Subject to any comments you, Sir P Middleton and Sir T Burns have, the Chancellor would be grateful if you could transmit this to the others in the G7.

*ACS*  
A C S ALLAN



Ch

Right Peter not Terry  
seems I have done anything with  
this. I shall deal with  
Geoff letter we want need  
to send this tomorrow  
to please you.

SECRET

SIR TERENCE BURNS

*[Handwritten initials]*

From: Sir G. Littler  
Date: 8 December 1987

c.c. Sir P. Middleton

I have  
answered -  
There is also  
a new  
(Baker-  
inspired)  
I have done  
via S'berg  
who I have  
not yet  
seen.  
me

G7 COMMUNIQUE: UK CONTRIBUTION

As you know it is possible we may want shortly a passage on the UK for inclusion in a G7 statement issued without a meeting having been held. The object will be to take credit for "useful" action by participants, and perhaps refer to intended action. Passages should be short.

2. I have had a first very rough shot, attached. I also attach for convenience the page of the Louvre Accord with the UK passage in it.

3. Could you (and Peter) perhaps reflect on this? I shall be back from Paris on Friday morning (possibly late Thursday p.m.) and I hope it can wait until then. (Incidentally I shall try to sound colleagues in Paris about their ideas for national pieces). But if the Chancellor starts agitating for a draft, I leave it to you!

*[Handwritten signature]*

(Geoffrey Littler)

Where are we  
on this now following  
the Chancellors talk  
to SAT on 1st night

Proceeding, be steady.



The United Kingdom Government, in the context of the British economy's continued vigorous growth of output and domestic demand, coupled with <sup>sound public finances,</sup> ~~moderately low rates of~~ <sup>inflation and an acceptable small current account deficit,</sup> ~~inflation and an acceptable small current account deficit,~~ <sup>will continue to strive to reduce inflation by pursuing a prudent monetary policy, while monetary, its capacity</sup> ~~is maintaining the focus of its financial and economic strategy on sound public finance, on monetary policies to~~ <sup>for some non-inflationary growth by further measures</sup> ~~exert gentle downward pressure on inflation, and on~~ <sup>measures</sup> ~~measures~~ to free the operation of markets and increase the efficient use of resources <sup>which will include further</sup> ~~in the economy.~~ <sup>tax reduction and tax reform.</sup> ~~Interest~~ <sup>Public expenditure will</sup> ~~rates have recently been lowered, in part counteracting~~ <sup>continue to increase, but less rapidly than the growth</sup> ~~the impact on monetary conditions of a higher effective~~ <sup>of the economy as a whole, as HMG will continue to</sup> ~~exchange rate and of reduced asset prices.~~ <sup>works for the dismantling of barriers to trade both</sup> ~~Further tax~~ <sup>reform and reduction of the burden of taxation is planned.</sup> ~~reform and reduction of the burden of taxation is planned.~~ <sup>within the European Community and in the context of</sup> ~~the Uruguay round of the GATT.~~ <sup>the Uruguay round of the GATT.</sup>

including



The Government of Japan will follow monetary and fiscal policies which will help to expand domestic demand and thereby contribute to reducing the external surplus. The comprehensive tax reform, now before the Diet, will give additional stimulus to the vitality of the Japanese economy. Every effort will be made to get the 1987 budget approved by the Diet so that its early implementation be ensured. A comprehensive economic program will be prepared after the approval of the 1987 budget by the Diet, so as to stimulate domestic demand, with the prevailing economic situation duly taken into account. The Bank of Japan announced that it will reduce its discount rate by one half percent on February 23.

The United Kingdom Government will maintain conditions for continuing the steady growth of GDP of the past five years and will continue to work to reduce inflation by following a prudent monetary policy. On external account the aim will be broad balance over the medium term. The share of public expenditure in the economy will continue to fall and the burden of taxation will be reduced, while public sector borrowing is maintained at low level. These and other measures to strengthen the supply performance of the economy, such as the privatization programme, will reinforce improvement over recent years in the growth of productivity.

The United States Government will pursue policies with a view to reducing the fiscal 1988 deficit to 2.3 % of GNP from its estimated level of 3.9 % in fiscal 1987. For this purpose, the growth in government expenditures will be held to less than 1 percent in fiscal 1988 as part of the continuing program to reduce the share of government in GNP from its current level of 23 percent. The United States will introduce a wide range of policies to improve its competitiveness and to enhance the strength and flexibility of its economy. Monetary policy will be consistent with economic expansion at a sustainable non-inflationary pace.

8. The Ministers and Governors noted that a number of newly industrialized economies were playing an increasingly important role in world trade. These economies have achieved strong growth based significantly on their access to open, growing export markets. Recently, some have accumulated trade surpluses which have contributed importantly to the present unsustainable pattern of global imbalances, thus increasing protectionist pressures. The Ministers and Governors considered that it is important that the newly industrialized developing economies should assume greater responsibility for preserving an open world trading system by reducing trade barriers and pursuing policies that allow their currencies to reflect more fully underlying economic fundamentals.



SECRET

*Spare 2nd  
copy of same  
minute*

FROM: MISS M P WALLACE  
DATE: 14 December 1987

## NOTE FOR THE RECORD

cc PS/EST  
Sir P Middleton  
Sir T Burns  
Sir G Littler  
Mr Cassell

**TELEPHONE CONVERSATION WITH MR AMATO**

The Chancellor spoke to Mr Amato on the telephone this afternoon.

2. Amato said that the Bank of England's activities had caused some disappointment in Europe. The Chancellor explained that since the Louvre Britain had purchased more than \$25 billion in dollars - more than all other European countries put together. This explained the decision to buy deutschemarks to prevent the pound rising too high against the Mark. By buying French francs as well, Britain hoped to avoid overstraining the EMS.

3. Amato expressed concern that the UK was selling dollars in order to buy marks. The Chancellor said that Britain was not doing this, and had no wish to push the dollar down. Amato said that Britain's behaviour had come in for harsh criticism from Poehl. The Chancellor said that he would make sure that the Bank of England was not selling dollars.

4. Amato said that he had spoken to Baker since Thursday's trade figures. Baker had not been inclined to attach great importance to the figures, and suggested that they might merely be the result of pre-Christmas imports. Amato thought the situation was very dangerous - although, as the Chancellor pointed out, the dollar had recovered today following helpful statements from the US.

5. Amato asked if the Chancellor expected that the G7 communique would be agreed. The Chancellor said he hoped so. Amato recalled





that some time ago the Chancellor had remarked that everyone in the US was wedded to the idea that the exchange rate must be set by the market. Amato saw more and more evidence of this.

6. Amato's parting shot was to ask the Chancellor to take care of the pound, but also the dollar.

*mpw.*

M P WALLACE



*pry*

Department  
of the Treasury

to: DISTRIBUTION  
Assistant Secretary  
room: \_\_\_\_\_ date 12/18/87 (International Affairs)

*✓*

Attached is press guidance which Secretary Baker will be using after the fact. We hope that you could also respond along similar lines to questions which may arise.

Distribution

- Dr. Hans Tietmeyer
- Mr. Toyoo Gyohten
- Mr. Jean-Claude Trichet
- Sir Geoffrey Littler
- Ms. Wendy Dobson
- Mr. Mario Sarcinelli

David C. Mulford  
room 3432  
phone 566-5363



December 1987

Press Guidance

1. Question: Why did you issue a communique without a meeting?

Answer: Meetings are not necessarily required to produce successful economic policy coordination.

We have been engaged in intensive consultations on a daily basis since mid-October which has produced major accomplishments that are greater than could have been achieved in a single meeting.

2. Question: Have you agreed to stabilize exchange rates around current levels?

Answer: Paragraph 8 of the statement indicates clearly the view that a further decline of the dollar could be counterproductive.

3. Question: Do you really think that the dollar could appreciate as suggested in paragraph 8?

Answer: A rise of the dollar cannot be ruled out. As the statement indicates, however, a rise of the dollar to an extent that becomes destabilizing to the adjustment process could be counterproductive.

4. Question: Why doesn't the statement contain a clear commitment to stabilize exchange rates around current levels as provided in the Louvre agreement?

Answer: Circumstances have changed since the Louvre. The statement reemphasizes the common interest in strengthening underlying economic fundamentals to foster stability of exchange rates.

5. Question: Will monetary policy be used to prevent a further decline of the dollar?

Answer: We will not comment on this issue beyond Paragraph 5 of the statement which speaks for itself.



6. Question: What makes you think that this agreement will be any more successful than its predecessors in reducing external imbalances?

Answer: There has been considerable adjustment in exchange rates since the Louvre. The coordination process is working and, as the statement records, governments are taking additional actions to reduce imbalances. Global economic growth is being maintained.

7. Question: Are you satisfied with Japanese and German efforts to promote growth or will you be seeking additional measures, including larger tax cuts and lower interest rates?

Answer: The U.S. is pleased by the actions taken by Japan and Germany to improve growth and reduce external imbalances. We believe that the measures being taken are in the right direction and will have their intended effects.

8. Question: The U.S. trade deficit continues to grow despite a substantial dollar depreciation. Doesn't this suggest the need to reduce domestic consumption and growth in order to achieve meaningful reductions in the trade deficit?

Answer: The general trend has been for the trade deficit to improve in volume terms. Exports are up and our external account is a major factor in U.S. growth.

With the measures referred to in the statement, we should see a decline in external imbalances without reducing U.S. growth.

9. Question: When can we expect to see a lower U.S. trade deficit?

Answer: The U.S. trade deficit is improving in volume terms and we would expect this trend to be reflected in the value figures during 1988.



10. Question: Does this statement mean that the Louvre is dead?

Answer: This statement builds on the Louvre. As paragraph 1 makes clear, the basic objectives of the economic policy coordination process are the same as in the Louvre.





*Per*

FROM: A C S ALLAN

DATE: 15 December 1987

SIR G LITTLER

cc Sir P Middleton  
Sir T Burns**G7 STATEMENT: DEVELOPMENTS**

The Chancellor was grateful for your minute of 14 December. He had the following comments:

- (i) The text proposed for the main statement (Annex A) and for the US paragraph (Annex B) are inconsistent in their references to whether or not the US budget package will have been "implemented". These should be aligned;
- (ii) The reference in the main text to an "increase in tax reductions" in Germany is clumsy, and might perhaps be replaced by an "enlargement of tax reductions".
- (iii) In Annex D, it should read a "vigorous expansionary phase", not a "rigorous" one!

*ACSA*

A C S ALLAN



SECRET

From: Sir G.Littler  
Date: 14 December 1987

CHANCELLOR

c.c. Sir P.Middleton  
Sir T.Burns

**G7 STATEMENT: DEVELOPMENTS**

The U.S. want to include in the body of the statement a passage referring to the main actions by themselves, Germany and Japan. The proposed text (so far I think agreed with Germany but not yet Japan) is at Annex A. I see no objection.

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*CL*  
I queried the US text with Geoff, on the grounds that it read as if it was designed for use before Congress passed the legislation. But Geoff says "implementation" comes after that "agreement" (?).  
*[Signature]*  
(Geoffrey Littler)  
*[Signature]*



BMF 5300 BONN

927 P02

4. [Accordingly, the Ministers and Governors agreed to intensify their economic policy coordination efforts. Their common efforts are directed towards reducing external imbalances. In particular, the United States has implemented the agreement between the President and the bipartisan Congressional leadership on a two year package of additional budget savings that will reinforce progress in reducing the budget deficit. Japan has implemented a major stimulus program to strengthen domestic demand and has committed to continue the expansionary effect of the program in the next fiscal year. The Federal Republic of Germany is supplementing the previously announced <sup>enlargement of</sup> increase in tax reductions in 1988 with new measures to increase investment and will not seek to offset the budget revenue losses arising from recent developments. There have also been coordinated reductions in interest rates in Europe which should contribute to the expansion of domestic demand and reduce trade imbalances. The specific policy intentions and undertakings by each country are set forth in the annex to this statement.]

*v. clumsy!*



DraftU.S. Paragraph

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BMF 5300 BONN

927 P03

German paragraphDraft

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BMF 5300 BONN

927 P05

DraftJapanese paragraph

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It will steadfastly continue implementing the 6 trillion-yen-plus package decided last year. <sup>概算</sup> It will see to it that in the FY1988 budget, the expenditure for general public works should not be less than that for the FY1987 budget after July supplementation. <sup>財務省</sup>

The Bank of Japan is to follow appropriate and flexible monetary policy supportive of non-inflationary growth and exchange rate stability.



SECRET

CHANCELLOR

*OK.  
2. Re para 3,  
1 agree.  
vs.*

From: Sir G.Littler  
Date: 16 December 1987

c.c. Sir P.Middleton  
Sir T.Burns

G7 DRAFT STATEMENT

I have just received from Mulford the attached collated version of the proposed Annex of individual country statements. I think this is all right (except that the Japanese economy should be "vigorous", not "rigorous", as you pointed out - I have relayed this to Tietmeyer who took the point at once).

2. I am still waiting for a complete new version of the main statement (the only changes I know of from what we saw earlier seem likely to be acceptable). The U.S. have of course not given any ground on exchange rate support.

3. I am told (Tietmeyer after Stoltenberg/Baker talks) that Congress may complete its work successfully by Friday or Saturday of this week, in which case Stoltenberg and Baker both think it would be good to get the statement issued, simultaneously in all capitals, as soon as possible thereafter during the weekend.



(Geoffrey Littler)



## Annex

### Policy Intentions and Undertakings

The Government of Canada's fiscal strategy has succeeded in achieving a drop in the rate of growth of its spending and substantial, on-going declines in the budget deficit. Marked progress has been made in slowing the growth of debt, and towards the medium-term objective of stabilizing the debt-to-GDP ratio. Fiscal restraint has been accompanied by impressive growth of domestic demand, output and employment. Major structural initiatives directed at enhancing competitiveness and the underlying potential of the economy have been undertaken, particularly tax reform and the negotiation of a free trade agreement with the United States. Monetary policy remains geared to non-inflationary growth in a climate of orderly exchange markets.

The Government of France has more than fully met its commitment to reduce its fiscal deficit and tax burden. The fiscal deficit will be reduced by 0.8% of GNP from 1986 to 1988. Over the same period of time, tax cuts will amount to 1.3% of GNP. A further reduction of 45 billion french francs in the fiscal deficit and an additional 45 billion french francs in tax cuts are scheduled in a 1989-1991 three year program which constitutes the long term strategy of the government and will be implemented in the yearly budgets. The privatization program decided upon in early 1987 is being carried out, and its initial objectives have even been surpassed. The full implementation of the program will be resumed as soon as market conditions permit.

The French Government will continue to pursue its adjustment and liberalization policies. New measures to sustain household savings, develop financial markets and improve the competitiveness of firms have been taken. Additional steps will be taken in the same direction in 1988.

The Government of the Federal Republic of Germany has increased the amount of the tax reductions for 1988 and beyond to about 14 billion DM, and will not seek to offset the budget revenue losses arising from recent developments. In addition, the necessary decisions have been taken for the structural tax reform with a further net tax reduction of 20 billion DM from 1990 onward.

In order to strengthen private and public investment, the Federal Government will provide special loans for the next 3 years of about 21 billion DM under preferential conditions. Moreover, it will accelerate investment in telecommunication infrastructure and take initiatives for further deregulation of markets.

The Bundesbank has reduced short-term interest rates substantially during the last few weeks. Monetary policy will



continue to maintain appropriate conditions for sustained non-inflationary growth.

The Government of Italy has taken restrictive measures in 1987 to halt the deterioration of the balance of payments due to a higher rate of domestic demand in Italy than in other industrial countries. For 1988 the objective embodied in the Finance Bill is to maintain a relatively high level of growth and to keep the average inflation rate constant, while making progress in correcting the public sector imbalance.

In the medium-term, to alleviate unemployment the Italian authorities intend to achieve satisfactory rates of growth while maintaining the balance of payments current account near equilibrium, to stabilize the debt/GDP ratio, and to devote more resources to the financing of productive as well as infra-structural investments, thus improving the quality of public services.

The Government of Japan noted that the Japanese economy is in a rigorous expansionary phase, led by domestic demand growth. The Government will steadfastly continue implementing the 6 trillion-yen-plus package decided on last May, and will see to it that in the FY 1988 budget the expenditure for general public works will not be less than that for the FY 1987 budget, including the July supplemental.

The Bank of Japan will follow appropriate and flexible monetary policy supportive of non-inflationary growth and exchange rate stability.

The United Kingdom Government, in the context of the British economy's continued vigorous growth of output and domestic demand, coupled with sound public finances, will continue to strive to reduce inflation by pursuing a prudent monetary policy, while increasing its capacity for non-inflationary growth by further measures designed to free the operation of markets and increase the efficient use of resources, including tax reduction and tax reform. Public expenditure will continue to increase less rapidly than the growth of the economy as a whole, and the government will continue to work for the dismantling of barriers to trade both within the European Community and in the context of the Uruguay round of the GATT.

The United States Government has secured Congressional action to implement the agreement between the President and the bipartisan leadership of the Congress on a two-year package of



budget savings to reduce the U.S. budget deficit. This agreement provides for budget savings in excess of the \$23 billion already required by existing legislation and will permit, through a combination of spending restraint and increased taxes, total savings in fiscal 1988 and 1989 of approximately \$76 billion.

The budget agreement is part of an ongoing process of deficit reduction provided for under the revised Gramm-Rudman-Hollings legislation. It will reinforce the progress already achieved in reducing the deficit (including a fiscal 1987 cut of \$73 billion or 1.9 percent of GNP) that has brought the deficit down to 3.4 percent of GNP from a peak of 6.3 percent.

The Administration will also continue to oppose steadfastly protectionist trade measures, while working for legislation authorizing negotiations to foster a more open and fair system for the international exchange of goods, services and investment.



*psp*



FROM: A C S ALLAN  
DATE: 16 December 1987

SIR G LITTLER

cc Sir P Middleton  
Sir T Burns

*G7*  
DRAFT STATEMENT  
*^*

The Chancellor was grateful for your minute of 16 December. He is content with the collated version of the annex of individual country statements. He agrees with you that it would be good to get the statement issued, simultaneously in all capitals, as soon as possible after Congress has completed its work.

*ACSA*

A C S ALLAN



SECRET AND PERSONAL

*Pop*

FROM: R I G ALLEN  
DATE: 16 DECEMBER 1987

*AA*  
*Re X, we might discuss @ the Party*  
*Re Y, I'd do it*  
*Would you see if the radio can cut that for Mr. ...*

SIR GEOFFREY LITTLER

cc (PBS)

G7 STATEMENT

You asked me to give some thought to press handling should a simultaneous statement be made in the G7 capitals this weekend.

2. Depending on developments with the US budget, I assume the idea is to make the statement when the markets are closed, namely from about 0300 hours on Saturday morning (Tokyo closing) to 0000 hours on Monday morning (Tokyo opening). The ideal timing would be sometime earlyish on Saturday afternoon so that we can catch both the Sunday and Monday papers: giving a double bite at the cherry.

*Overtaken  
11AM on  
Sunday*

3. I think this is all quite manageable in media terms:

- a final text should be in my hands as soon as possible;
- I will arrange for someone from IDT to be in the office on Saturday or Sunday to fax copies of the text to radio/TV journalists and the press, and to ring round the key people to alert them to what is happening;
- we would release the text to Reuters/PA for immediate use on their screens;
- we will need to make sure the Bank of England have a copy of the text, and to co-ordinate the briefing line;
- I would propose to handle all substantive press enquiries personally over the weekend.



4. To reinforce this effort, I would recommend two further actions:

X | - when the statement is released on Saturday or Sunday, we should attach to it a short (two or three sentence) comment by the Chancellor for use by Reuters/PA and the rest of the media;

Y | - we should also arrange for the Chancellor to be interviewed either on BBC Radio 4's "The World this Weekend" on Sunday lunchtime (if the statement is released on the Saturday afternoon or the Sunday morning) or on the Monday morning BBC Radio 4 "Today" programme and, possibly, LBC/IRN News (if the statement is made on the Sunday afternoon or evening). This would provide some further helpful input for the markets before they open on Monday morning. Weekend TV slots are not generally to be recommended.

5. We need to start thinking seriously about setting these arrangements in hand as soon as possible.

RA

R I G ALLEN



Mr Michael Wilson - M/Finance - Ottawa, Canada

M. Edouard Balladur, Trésor Paris

Hans Gerhardt Stoltenberg M/Finance, Bonn

Mr. Kiichi Miyazawa - M/Finance - Tokyo, Japan.

Hon. James Baker III, U.S. Treasury Wash.

Mr. ~~Giuliano Amato~~ Finance Minister For  
Giuliano Amato. ~~For~~ Rome.  
Treasury.

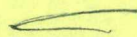


ITALY : 010 39 6 4744 950  
FRANCE: 010 33 142965245  
GERMANY: 010 49 226 682 4466  
CANADA: 010 1 613 993 5017  
USA : 010 1 202 566 8066  
JAPAN : 010 1 202 535 3807.  
010 81 3 581 0460

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581-0460





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*A, B, C  
RO'S*

EUROPEANS SCEPTICAL BUT CAUTIOUS ON G-7 STATEMENT  
BY JONATHAN LYNN

ECSD

FRANKFURT, DEC 23 - EUROPEAN CURRENCY DEALERS AND ANALYSTS EXPRESSED SCEPTICISM THAT THE LATEST STATEMENT FROM THE GROUP OF SEVEN (G-7) COUNTRIES WOULD BE SUFFICIENT TO TACKLE THE ROOT CAUSES OF DOLLAR WEAKNESS.

BUT MOST DEALERS AND ANALYSTS POLLED BY REUTERS WARNED AGAINST DISMISSING THE STATEMENT AS COMPLETELY WORTHLESS.

"THERE'S A LOT OF RHETORIC AND NO AMMUNITION," SAID KEITH SKEOCH, CHIEF ECONOMIST AT LONDON STOCKBROKERS JAMES CAPEL. "THE AGREEMENT WILL BE TREATED WITH NERVOUS SCEPTICISM."

23-DEC-1451 MON770 MONC ETPF COAV CSAK CMAD CGAP SHNH BONG FFUD  
MORE

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REUTER MONITOR

1532

MARKETS SHOULD TRUST G-7 STATEMENT, KOHL SAYS

NRIV

BONN, DEC 23 - WEST GERMAN GOVERNMENT SPOKESMAN FRIEDHELM DST QUOTED CHANCELLOR HELMUT KOHL AS SAYING THAT CURRENCY AND FINANCIAL MARKETS SHOULD TRUST THE LATEST STATEMENT BY THE GROUP OF SEVEN (G-7) LEADING INDUSTRIAL NATIONS REAFFIRMING ECONOMIC AND CURRENCY STABILITY.

DST SAID AT A NEWS CONFERENCE: "THE CHANCELLOR JUDGES THE AGREEMENT AS AN IMPORTANT BASIS FOR FURTHER NECESSARY INTERNATIONAL COOPERATION ON ECONOMIC AND CURRENCY POLICIES. CURRENCY AND FINANCIAL MARKETS SHOULD PLACE THEIR TRUST IN IT."

23-DEC-1457 MON783 MONC

REUTER

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REUTER MONITOR

1532



BONN EXPECTS STATEMENT TO IMPROVE G-7 COOPERATION NRJA  
BONN, DEC 23 - THE WEST GERMAN GOVERNMENT EXPECTS THE LATEST  
STATEMENT BY THE GROUP OF SEVEN (G-7) LEADING INDUSTRIAL NATIONS  
REAFFIRMING CURRENCY AND ECONOMIC STABILITY TO LEAD TO IMPROVED  
G-7 COOPERATION, THE FINANCE MINISTRY SAID.

FINANCE MINISTRY SPOKESMAN KARLHEINZ VON DEN DRIESCH TOLD A  
NEWS CONFERENCE, "ONE CAN EXPECT THE NEW AGREEMENT TO WORK  
BETTER THAN THE FORMER LOUVRE ACCORD."

LAST FEBRUARY, THE G-7 MET IN PARIS AND PLEDGED TO FOSTER  
CURRENCY STABILITY UNDER AN AGREEMENT GENERALLY KNOWN AS THE  
LOUVRE ACCORD.

23-DEC-1518 MON816 MONC

CONTINUED ON - NRJB

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REUTER MONITOR 1532

BONN EXPECTS #2 BONN NRJB

VON DEN DRIESCH SAID SINCE FEBRUARY SOME STEPS HAD BEEN  
TAKEN TO REDRESS GLOBAL ECONOMIC IMBALANCES, THE MOST IMPORTANT  
BEING THE DECISION BY THE UNITED STATES TO REDUCE ITS FEDERAL  
BUDGET DEFICIT BY 76 BILLION DLRS OVER THE NEXT TWO YEARS.

23-DEC-1519 MON819 MONC  
CONTINUED FROM - NRJA

REUTER

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REUTER MONITOR 1532



CHANCELLOR 12/2.

*PP*

DELORS WELCOMES G-7 STATEMENT

NRIG

BRUSSELS, DEC 23 - JACQUES DELORS, PRESIDENT OF THE EUROPEAN COMMUNITY'S EXECUTIVE COMMISSION, WELCOMED THE STATEMENT FROM THE GROUP OF SEVEN INDUSTRIALISED NATIONS ON THE DOLLAR.

"THE MARKETS WERE WAITING FOR THE STATEMENT. IT HAS BEEN MADE. IT IS A GOOD THING," DELORS SAID IN A STATEMENT.

A COMMISSION SPOKESMAN DECLINED TO SAY WHETHER DELORS REGARDED THE STATEMENT OR THE FACT THAT IT HAD BEEN ISSUED AS A GOOD THING.

23-DEC-1236 MON609 MONA

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REUTER

REUTER MONITOR

1401



mpf

December 1987

STATEMENT OF THE GROUP OF SEVEN

1. The Finance Ministers and Central Bank Governors of seven major industrial countries have conducted close consultations in recent weeks on their economic policies and prospects in light of developments in financial markets. They reaffirmed their conviction that the basic objectives and economic policy directions agreed in the Louvre Accord remain valid and provide for a positive development of the world economy. They will continue to carry forward their economic policy coordination efforts in 1988 under the arrangements endorsed at the Venice Summit.
2. The Ministers and Governors reemphasized their view that the major external imbalances in the world economy must be corrected. The policies which have been implemented this year are gradually showing the intended effects. In particular, the balance between domestic demand and output in the United States and in Japan and the Federal Republic of Germany has shifted in a direction which promotes external adjustment and in volume terms their trade imbalances are diminishing. The greater stability of exchange rates achieved for much of the past year, following the earlier substantial exchange rate changes, contributed to this adjustment. The marked exchange rate changes over the past few weeks, however, stress the need to strengthen underlying economic fundamentals and to continue policy cooperation.
3. Developments in stock markets since mid October may have some adverse effect on prospects for economic growth for the industrialized countries as a group. The Ministers and Governors believe, however, that with sound economic policies and effective coordination the rate of growth should be substantial. To this end they agreed that appropriate policies for strengthening non-inflationary growth in their countries are necessary.
4. Accordingly, the Ministers and Governors agreed to intensify their economic policy coordination efforts. Their common efforts are directed towards reducing external imbalances. In particular, the United States has secured Congressional action to implement the agreement between the President and the bipartisan Congressional Leadership on a two-year package of additional budget savings that will reinforce progress in reducing the budget deficit. Japan has implemented a major stimulus program to strengthen domestic demand and will see to it that in the FY 1988 budget the expenditure for general public works will not be less than that for the FY 1987 budget including the July supplemental. The Federal Republic of



-2-

Germany is supplementing the previously announced increase in tax reductions in 1988 with new measures to increase investment and will not seek to offset the budget revenue losses arising from recent developments. There have also been coordinated reductions in interest rates in Europe which should contribute to the expansion of domestic demand and reduce trade imbalances. The specific policy intentions and undertakings by each country are set forth in the annex to this statement.

5. The Ministers and Governors are of the view that the recent monetary policy decisions and the reduction of interest rates in some countries were appropriate and will contribute to a restoration of stability to financial markets. They agreed that monetary policies should continue to be directed towards providing adequate monetary conditions to achieve strong economic growth in the context of price stability as well as to foster financial market stability.
6. The Ministers and Governors strongly rejected protectionist measures as a means of dealing with present imbalances. Protectionism constitutes a direct and serious danger to world prosperity and equilibrium and would have harmful consequences for those countries which resort to it. They reaffirmed their determination to fight protectionism and to promote an open world trading system.
7. The Ministers and Governors believe that the reduction of world trading imbalances requires cooperative action by other countries, particularly those with surpluses. They expressed particularly serious concern that some newly industrialized economies have failed to take adequate action to deal with large and growing trade surpluses which are exacerbating global imbalances and fostering protectionist pressures. They urged the newly industrialized economies to implement without delay trade and exchange rate policies that will facilitate the reduction of excessive trade surpluses and allow their currencies to fully reflect the strong competitive position of their economies.
8. The Ministers and Governors agreed that either excessive fluctuations of exchange rates, a further decline of the dollar, or a rise in the dollar to an extent that becomes destabilizing to the adjustment process, could be counterproductive by damaging growth prospects in the world economy. They reemphasized their common interest in more stable exchange rates among their currencies and agreed to continue to cooperate closely in monitoring and implementing policies to strengthen underlying economic fundamentals to foster stability of exchange rates. In addition, they agreed to cooperate closely on exchange markets. The Ministers and Governors stressed the need for consistent and mutually supportive policies and believe that the measures being taken



will accelerate progress towards the increased, more balanced economic growth, and sustainable external positions necessary for greater exchange rate stability.



Annex

Policy Intentions and Undertakings

The Government of Canada's fiscal strategy has succeeded in achieving a drop in the rate of growth of its spending and substantial, on-going declines in the budget deficit. Marked progress has been made in slowing the growth of debt, and towards the medium term objective of stabilizing the debt-to-GDP ratio. Fiscal restraint has been accompanied by impressive growth of domestic demand, output and employment. Major structural initiatives directed at enhancing competitiveness and the underlying potential of the economy have been undertaken, particularly tax reform and the negotiation of a free trade agreement with the United States. Monetary policy remains geared to non-inflationary growth in a climate of orderly exchange markets.

The Government of France has fully met its commitment to reduce its fiscal deficit and tax burden. The fiscal deficit will be reduced by 0.8% of GNP from 1986 to 1988. Over the same period of time, tax cuts will amount to 1.3% of GNP. A further reduction of 45 billion french francs in the fiscal deficit and an additional 45 billion french francs in tax cuts are scheduled in a 1989-1991 three year program which constitutes the long term strategy of the government and will be implemented in the yearly budgets. The privatization program decided upon in early 1987 is being carried out, and its initial objectives have even been surpassed. The full implementation of the program will be resumed as soon as market conditions permit.

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In order to strengthen private and public investment, the Federal Government will provide special loans for the next 3 years of about 21 billion DM under preferential conditions. Moreover, it will accelerate investment in telecommunication infrastructure and take initiatives for further deregulation of markets.

The Bundesbank has reduced short-term interest rates substantially during the last few weeks. Monetary policy will



continue to maintain appropriate conditions for sustained non-inflationary growth.

The Government of Italy, in the context of continuous significant growth, has taken temporary measures to halt the deterioration of the balance of payments due to a higher rate of domestic demand in Italy than in other industrialized countries. For 1988 the objective embodied in the Finance Bill is to maintain a relatively high level of growth and to reduce inflation, while making progress in correcting the public sector imbalance.

In the medium-term, to alleviate unemployment the Italian authorities intend to achieve satisfactory rates of growth while maintaining the balance of payments current account in substantial equilibrium, to stabilize the debt/GDP ratio, and to devote more resources to the financing of productive as well as infra-structural investments, thus improving the quality of public services.

The Government of Japan noted that the Japanese economy is in a vigorous expansionary phase, led by domestic demand growth. The Government will steadfastly continue implementing the 6 trillion-yen-plus package decided on last May, and will see to it that in the FY 1988 budget the expenditure for general public works will not be less than that for the FY 1987 budget including the July supplemental.

The Bank of Japan will follow appropriate and flexible monetary policy supportive of non-inflationary growth and exchange rate stability.

The United Kingdom Government, in the context of the British economy's continued vigorous growth of output and domestic demand, coupled with sound public finances, will continue to strive to reduce inflation by pursuing a prudent monetary policy, while increasing its capacity for non-inflationary growth by further measures designed to free the operation of markets and increase the efficient use of resources, including tax reduction and tax reform. Public expenditure will continue to increase less rapidly than the growth of the economy as a whole, and the government will continue to work for the dismantling of barriers to trade both within the European Community and in the context of the Uruguay round of the GATT.

The United States Government has secured Congressional action to implement the agreement between the President and the bipartisan Leadership of the Congress on a two-year package of



budget savings to reduce the U.S. budget deficit. This agreement provides for total budget savings, through a combination of spending restraint and increased taxes, in fiscal 1988 and 1989 of approximately \$76 billion.

The budget agreement is part of an ongoing process of deficit reduction provided for under the revised Gramm-Rudman-Hollings legislation. It will reinforce the progress already achieved in reducing the deficit (including a fiscal 1987 cut of \$73 billion or 1.9 percent of GNP) that has brought the deficit down to 3.4 percent of GNP from a peak of 6.3 percent.

The Administration will also continue to oppose steadfastly protectionist trade measures, while working for legislation authorizing negotiations to foster a more open and fair system for the international exchange of goods, services and investment.



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ORRECTED - U.K. WELCOMES OECD REPORT

NRIT

LONDON, DEC 22 - THE BRITISH TREASURY WELCOMED THE ORGANISATION FOR ECONOMIC COOPERATION AND DEVELOPMENT (OECD) REPORT URGING WESTERN NATIONS TO TAKE ACTION TO BOOST ECONOMIC GROWTH FOLLOWING THE WORLDWIDE STOCK MARKET CRASH.

"WE AGREE WITH THE EMPHASIS IN THE REPORT ON THE NEED FOR GOVERNMENTS, PARTICULARLY OF THE THREE LARGEST COUNTRIES, TO MAINTAIN THE MOMENTUM OF ADJUSTMENT OF INTERNATIONAL FISCAL AND TRADE IMBALANCES," A TREASURY SPOKESMAN SAID.

BUT HE SAID THE OECD WAS OVERLY PESSIMISTIC ABOUT THE PROSPECTS FOR BOTH U.K. AND WORLD GROWTH IN 1989. "AT THIS STAGE, PROSPECTS ARE TOO UNCERTAIN," HE SAID.

22-DEC-1658 MON722 MOND

CONTINUED ON - NRIU

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COMMODITIES - INFO 1443

U.K. WELCOMES #2 LONDON

NRIU

COMMENTING ON THE OECD'S ASSESMENT OF THE U.K. ECONOMY, THE TREASURY SPOKESMAN SAID, "WE WELCOME THE REPORT AND ITS RECOGNITION OF THE GENERAL STRENGTH OF THE U.K. ECONOMY AND THAT THE STOCK MARKET FALL HAS EASED CONCERN ABOUT OVERHEATING."

BUT HE SAID THE OECD FORECAST OF A WIDENING CURRENT ACCOUNT DEFICIT IN THE NEXT TWO YEARS WAS VIEWED AS TOO GLOOMY. LOW U.K. UNIT WAGE COSTS SHOULD HELP MAINTAIN COMPETITIVENESS, HE SAID.

THE OECD FORECAST A SHARP FALL IN MANUFACTURING EXPORTS NEXT YEAR, WITH THE DELAYED EFFECTS OF THE POUND'S STRENGTH THIS YEAR AND RELATIVELY HIGH U.K. INFLATION ERODING U.K. BUSINESS COMPETITIVENESS.

22-DEC-1610 MON661 MOND

CONTINUED FROM - NRIT

CONTINUED ON - NRIU

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COMMODITIES - INFO 1443

U.K. WELCOMES #3 LONDON

NRIU

THE OECD FORECAST A U.K. 1988 CURRENT ACCOUNT DEFICIT OF 5.75 BILLION DLRS, WIDENING TO 9.5 BILLION IN 1989, AGAINST A 2.75 BILLION DEFICIT THIS YEAR. THE TRADE SHORTFALL IS FORECAST TO WIDEN TO 22 BILLION DLRS IN 1988, FROM THIS YEAR'S 15 BILLION, AND TO 27 BILLION IN 1989.

BRITAIN'S REACTION TO THE RELEASE OF THE HALF-YEAR REVIEW BY THE 24-NATION OECD'S ECONOMIC AFFAIRS "THINK TANK" WAS IN MARKED CONTRAST TO WEST GERMANY'S RESPONSE EARLIER ON TUESDAY.

BONN REPLIED TO OECD CALLS FOR IT TO BOOST ITS ECONOMY WITH AN OFFICIAL COMMUNIQUE CATEGORICALLY STATING THAT BONN SAW NO NEED FOR ANY FURTHER SUCH ACTION.

22-DEC-1650 MON709 MOND

CONTINUED FROM - NRIU

REUTER

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COMMODITIES - INFO 1443





cc: Sir P Middleton  
 Sir T Burns  
 Sir G Lither

*M*

Treasury Chambers, Parliament Street, SW1P 3AG  
 01-270 3000

David Norgrove Esq  
 No 10 Downing Street

21 December 1987

*Dear David*

G7

You wrote to Alex Allan on 18 December about the G7 agreement. There is quite a history to this.

Already in October there were moves within the G7 to try to restore the co-operation which had effectively been damaged during the second and third weeks of that month. Most of the group, including the Chancellor, were thinking in terms of an early G7 meeting and hoping for a reasonably solid agreement. But as bilateral discussions proceeded it became clear: first, that in the common view of the UK, Japan, France, Italy and also (though a little ambivalently) Germany, an effective agreement required a willingness by the US to raise their domestic interest rates (or take other action to finance their external deficit such as foreign currency borrowing); and secondly, that the US were not prepared to accept this condition.

The main task of negotiating on an earlier draft (which covered the points the UK and others believed necessary) was undertaken by Baker and Stoltenberg. On 7 December, in the margins of an ECOFIN meeting, the Finance Ministers of the four European G7 members met and Stoltenberg produced a draft very like the present one as the maximum the US would accept. It was then agreed by the four that such a draft was not good enough for a G7 meeting - indeed it would be better to hold no meeting than one with such a poor outcome. Stoltenberg agreed to try again for two or three key additions and amendments, but offered little hope of success (and this was later shown to be right).

Concern was expressed however that failure to hold a G7 meeting might itself create disappointment and hence market problems. The Chancellor then offered the idea that the statement as it stood, which did record some economic and monetary action of the required kind, might be worth publishing without a meeting. Particularly since G7 meetings have become such media events, it could perhaps be useful to show that consultation was taking place and some relevant action was being taken without the necessity for a meeting. This might also be a useful precedent for the future. The others found this idea attractive - as also did Baker when it was put to him.





The Chancellor continues to see advantage in this arrangement, even though the statement lacks new substance. The idea of a separate understanding about co-operative intervention, intended to operate as soon as the statement has been published, did not emerge until very much later, as a result of discussions between the US, Germany and Japan. On the substantive point the Prime Minister has raised, the Chancellor entirely agrees, and indeed has frequently pointed out, that the need is for the US authorities to be willing to use interest rates to help inter alia to attract the private funds to meet the continued external financing need at current exchange rates. The trouble with letting the dollar find "its own level" is that such a level, if determined solely by a nervous and disappointed market, may in the short term be so slow as to cause a good deal of damage to world economic activity, and set off a legacy of new distortions for the future. None of this would help the UK. While the current US policy posture is far from satisfactory, the fact that they are apparently now ready to intervene in support of the dollar may lead them to take more substantive steps later. Meanwhile, any UK contribution to concerted intervention under this agreement would be minimal.

Yours sincerely  
*Jonathan Taylor*

J M G TAYLOR  
Private Secretary



DR. GERHARD STOLTENBERG  
BUNDESMINISTER DER FINANZEN

5300 Bonn 1, 16. Dezember 1987

Graurheindorfer Straße 108  
Postfach 1308  
Telefon: (0228) 682-4240

The Hon.  
Nigel Lawson  
Chancellor of the Exchequer  
Parliament Street  
London SW 1 P 3 AG

Durch Telekopie  
erhalten/übermittelt  
am: 16. 12. Uhrzeit:  
Name: K

Sehr geehrter Herr Kollege,

wie ich Ihnen schon an Telefon dargelegt habe, sind Bundesregierung und Bundesbank sehr besorgt über die DM-Käufe der Bank of England an den Devisenmärkten in der vergangenen Woche. Unabhängig von der Situation des heutigen Tages handelt es sich hierbei um ein so gewichtiges Problem, daß ich Ihnen hierzu nochmals unsere Auffassung darlegen möchte.

Nach dem Abkommen der Zentralbanken über die Funktionsweise des EWS können Guthaben in Gemeinschaftswährungen über die sog. working balances hinaus nur mit Zustimmung der betreffenden Zentralbank gehalten werden. Für die DM-Käufe der Bank of England hat die Deutsche Bundesbank die erforderliche Zustimmung verweigert, weil in der gegenwärtigen Situation solche Interventionen den Aufwertungsdruck auf die DM sowohl gegenüber den EWS-Währungen als auch gegenüber dem Dollar verstärken würden. Dies kann sehr rasch zu erheblichen Spannungen und einer politischen Krise im EWS führen. Außerdem würden durch DM-Käufe unsere gemeinsamen Bemühungen um eine Stabilisierung der Wechselkurse gegenüber dem Dollar beeinträchtigt, da Dollar-Käufe gegen DM damit konterkariert würden.

Eine Fortsetzung bzw. Wiederaufnahme von DM-Käufen an den Devisenmärkten durch die Bank of England würden sowohl gegen formales Recht als auch gegen die Grundsätze unserer bisherigen



- 2 -

Zusammenarbeit verstoßen. Das gilt für die Zusammenarbeit in der europäischen Währungspolitik und ebenso für die Zusammenarbeit in der Fünfer- bzw. Siebener-Gruppe.

Ich möchte Sie deswegen dringend bitten, dafür Sorge zu tragen, daß die Bank of England die Praxis der DM-Käufe ohne Einvernehmen mit der Bundesbank nicht wieder aufnimmt. Auch im Hinblick auf den bevorstehenden Abschluß unserer Bemühungen um eine gemeinsame Position im Kreis der Siebener Gruppe muß ich eine entsprechende Zusicherung von Ihnen erwarten.

Mit freundlichen Grüßen

*So Gottschalk*



5300 Bonn 1, 16. Dezember 1987

Graurheindorfer Straße 108  
Postfach 1308  
Telefon: (0228) 682-4240

The Hon.  
Nigel Lawson  
Chancellor of the Exchequer  
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Durch Telekopie  
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am: 16. 12. Uhrzeit:  
Name: K

Sehr geehrter Herr Kollege,

wie ich Ihnen schon an Telefon dargelegt habe, sind Bundesregierung und Bundesbank sehr besorgt über die DM-Käufe der Bank of England an den Devisenmärkten in der vergangenen Woche. Unabhängig von der Situation des heutigen Tages handelt es sich hierbei um ein so gewichtiges Problem, daß ich Ihnen hierzu nochmals unsere Auffassung darlegen möchte.

Nach dem Abkommen der Zentralbanken über die Funktionsweise des EWS können Guthaben in Gemeinschaftswährungen über die sog. working balances hinaus nur mit Zustimmung der betreffenden Zentralbank gehalten werden. Für die DM-Käufe der Bank of England hat die Deutsche Bundesbank die erforderliche Zustimmung verweigert, weil in der gegenwärtigen Situation solche Interventionen den Aufwertungsdruck auf die DM sowohl gegenüber den EWS-Währungen als auch gegenüber dem Dollar verstärken würden. Dies kann sehr rasch zu erheblichen Spannungen und einer politischen Krise im EWS führen. Außerdem würden durch DM-Käufe unsere gemeinsamen Bemühungen um eine Stabilisierung der Wechselkurse gegenüber dem Dollar beeinträchtigt, da Dollar-Käufe gegen DM damit konterkariert würden.

Eine Fortsetzung bzw. Wiederaufnahme von DM-Käufen an den Devisenmärkten durch die Bank of England würden sowohl gegen formales Recht als auch gegen die Grundsätze unserer bisherigen



- 2 -

Zusammenarbeit verstoßen. Das gilt für die Zusammenarbeit in der europäischen Währungspolitik und ebenso für die Zusammenarbeit in der Fünfer- bzw. Siebener-Gruppe.

Ich möchte Sie deswegen dringend bitten, dafür Sorge zu tragen, daß die Bank of England die Praxis der DM-Käufe ohne Einvernehmen mit der Bundesbank nicht wieder aufnimmt. Auch im Hinblick auf den bevorstehenden Abschluß unserer Bemühungen um eine gemeinsame Position im Kreis der Siebener Gruppe muß ich eine entsprechende Zusicherung von Ihnen erwarten.

Mit freundlichen Grüßen

*So Gottschalk*



NOTES

pyf

In the attached draft:

- Words set in [ ] are in the United States draft but not accepted by European colleagues;
- Words underlined are alternatives and additions which the European group of Ministers want.

Ch  
There does not appear to be a definitive text. This was last typed version.

AA



SECRET

*has made but close  
available to some  
work on their economic  
policy and program in  
light of developments in  
the world economy*

DRAFT: STATEMENT OF THE GROUP OF SEVEN

1. Following extensive consultations the Finance Ministers and Central Bank Governors of seven major industrial countries today reaffirmed their conviction that the [basic] objectives and [broad] economic policy directions agreed in the Louvre Accord remain valid [~~in full~~] and provide for a positive development of the world economy.

2. The Ministers and Governors reemphasised their view that the major external imbalances in the world economy must be corrected. The policies which have been implemented this year are gradually showing the intended effects. In particular, the balance between domestic demand and output in the United States and in Japan and the Federal Republic of Germany has shifted in a direction which promotes external adjustment and in volume terms their trade imbalances are clearly diminishing. The greater stability of exchange rates achieved for much of the past year, following the earlier substantial exchange rate changes, contributed to this adjustment. The marked exchange rate changes over the past few weeks, however, stress the need to strengthen underlying economic fundamentals and to continue policy cooperation.

3. Developments in stock markets since mid-October may have some adverse effect on prospects for economic growth for the industrialised countries as a group. The Ministers and Governors believe, however, that with sound economic policies and effective



SECRET

coordination the rate of growth should be substantial. To this end they agreed that appropriate policies for strengthening non-inflationary growth in their countries are necessary.

4. Accordingly the Ministers and Governors have welcomed and endorsed the recent actions taken and initiated by each of their governments as follows:

[Individual country passages, which should take credit for past "Louvre-type" actions as well as proposals, in particular show the continuity of U.S. attack on deficit]

5. The Ministers and Governors are of the view that the recent ~~[relaxation of monetary policy]~~ monetary policy decisions and the reduction of interest rates in some countries were appropriate and will contribute to a restoration of stability to financial markets. They agreed that monetary policies should continue to be directed towards providing adequate monetary conditions to achieve strong growth in the context of price-stability <sup>as well as</sup> ~~and~~ to foster financial market stability including stability of exchange rates.

6. The Ministers and Governors strongly rejected protectionist measures as a means of dealing with present imbalances. Protectionism constitutes a direct and serious danger to world prosperity and equilibrium and would have harmful consequences for those countries which resort to it. They reaffirmed their determination to fight protectionism and to promote an open world trading system.



SECRET

7. The Ministers and Governors believe that the reduction of world trading imbalances requires cooperative action by other countries, particularly those with surpluses. They expressed particularly serious concern that some newly industrialised economies have failed to take adequate action to deal with large and growing trade surpluses which are exacerbating global imbalances and fostering protectionist pressures. They urged the newly industrialised economies to implement without delay trade and exchange rate policies that will facilitate the reduction of excessive trade surpluses and allow their currencies to fully reflect the strong competitive position of their economies.

8. The Ministers and Governors agreed that either excessive fluctuation of exchange rates; or a further decline of the dollar; or a rise in the dollar to an extent that becomes destabilising to the adjustment process ~~could~~ would be counter-productive by damaging growth prospects in the world economy. They reemphasised their common interest in more stable exchange rates among their currencies and agreed to continue to cooperate closely in monitoring and implementing policies to strengthen underlying economic fundamentals ~~to foster stability of exchange rates~~. In addition, ~~to foster stability of exchange rates~~, they agreed to cooperate closely on <sup>the</sup> exchange markets, ~~when to do so would be helpful~~. The Ministers and Governors stressed the need for consistent and mutually supportive policies and believe that the measures being taken will accelerate progress towards the



**SECRET**

increased, more balanced economic growth, and sustainable external positions necessary for greater exchange rate stability.

[9. Pursuant to the arrangements for economic policy coordination endorsed at the Venice Summit, the Ministers and Governors underlined the need to continue reviewing their economic policies and performance and to reach understandings on the medium-term economic objectives, projections, and performance indicators that will be utilised in 1988.]



SECRET

cc. Mr. A. Allan  
1 Jonath  
2 Ando  
3 py

From: Sir G. Littler  
Date: 16 December 1987

CHANCELLOR

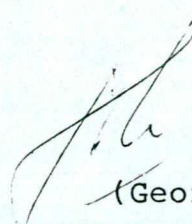
c.c. Sir P. Middleton  
Sir T. Burns

**G7 DRAFT STATEMENT**

I have just received from Mulford the attached collated version of the proposed Annex of individual country statements. I think this is all right (except that the Japanese economy should be "vigorous", not "rigorous", as you pointed out - I have relayed this to Tietmeyer who took the point at once).

2. I am still waiting for a complete new version of the main statement (the only changes I know of from what we saw earlier seem likely to be acceptable). The U.S. have of course not given any ground on exchange rate support.

3. I am told (Tietmeyer after Stoltenberg/Baker talks) that Congress may complete its work successfully by Friday or Saturday of this week, in which case Stoltenberg and Baker both think it would be good to get the statement issued, simultaneously in all capitals, as soon as possible thereafter during the weekend.

  
(Geoffrey Littler)



## Annex

### Policy Intentions and Undertakings

The Government of Canada's fiscal strategy has succeeded in achieving a drop in the rate of growth of its spending and substantial, on-going declines in the budget deficit. Marked progress has been made in slowing the growth of debt, and towards the medium-term objective of stabilizing the debt-to-GDP ratio. Fiscal restraint has been accompanied by impressive growth of domestic demand, output and employment. Major structural initiatives directed at enhancing competitiveness and the underlying potential of the economy have been undertaken, particularly tax reform and the negotiation of a free trade agreement with the United States. Monetary policy remains geared to non-inflationary growth in a climate of orderly exchange markets.

The Government of France has more than fully met its commitment to reduce its fiscal deficit and tax burden. The fiscal deficit will be reduced by 0.8% of GNP from 1986 to 1988. Over the same period of time, tax cuts will amount to 1.3% of GNP. A further reduction of 45 billion french francs in the fiscal deficit and an additional 45 billion french francs in tax cuts are scheduled in a 1989-1991 three year program which constitutes the long term strategy of the government and will be implemented in the yearly budgets. The privatization program decided upon in early 1987 is being carried out, and its initial objectives have even been surpassed. The full implementation of the program will be resumed as soon as market conditions permit.

The French Government will continue to pursue its adjustment and liberalization policies. New measures to sustain household savings, develop financial markets and improve the competitiveness of firms have been taken. Additional steps will be taken in the same direction in 1988.

The Government of the Federal Republic of Germany has increased the amount of the tax reductions for 1988 and beyond to about 14 billion DM, and will not seek to offset the budget revenue losses arising from recent developments. In addition, the necessary decisions have been taken for the structural tax reform with a further net tax reduction of 20 billion DM from 1990 onward.

In order to strengthen private and public investment, the Federal Government will provide special loans for the next 3 years of about 21 billion DM under preferential conditions. Moreover, it will accelerate investment in telecommunication infrastructure and take initiatives for further deregulation of markets.

The Bundesbank has reduced short-term interest rates substantially during the last few weeks. Monetary policy will



continue to maintain appropriate conditions for sustained non-inflationary growth.

The Government of Italy has taken restrictive measures in 1987 to halt the deterioration of the balance of payments due to a higher rate of domestic demand in Italy than in other industrial countries. For 1988 the objective embodied in the Finance Bill is to maintain a relatively high level of growth and to keep the average inflation rate constant, while making progress in correcting the public sector imbalance.

In the medium-term, to alleviate unemployment the Italian authorities intend to achieve satisfactory rates of growth while maintaining the balance of payments current account near equilibrium, to stabilize the debt/GDP ratio, and to devote more resources to the financing of productive as well as infra-structural investments, thus improving the quality of public services.

The Government of Japan noted that the Japanese economy is in a rigorous expansionary phase, led by domestic demand growth. The Government will steadfastly continue implementing the 6 trillion-yen-plus package decided on last May, and will see to it that in the FY 1988 budget the expenditure for general public works will not be less than that for the FY 1987 budget, including the July supplemental.

The Bank of Japan will follow appropriate and flexible monetary policy supportive of non-inflationary growth and exchange rate stability.

The United Kingdom Government, in the context of the British economy's continued vigorous growth of output and domestic demand, coupled with sound public finances, will continue to strive to reduce inflation by pursuing a prudent monetary policy, while increasing its capacity for non-inflationary growth by further measures designed to free the operation of markets and increase the efficient use of resources, including tax reduction and tax reform. Public expenditure will continue to increase less rapidly than the growth of the economy as a whole, and the government will continue to work for the dismantling of barriers to trade both within the European Community and in the context of the Uruguay round of the GATT.

The United States Government has secured Congressional action to implement the agreement between the President and the bipartisan leadership of the Congress on a two-year package of



budget savings to reduce the U.S. budget deficit. This agreement provides for budget savings in excess of the \$23 billion already required by existing legislation and will permit, through a combination of spending restraint and increased taxes, total savings in fiscal 1988 and 1989 of approximately \$76 billion.

The budget agreement is part of an ongoing process of deficit reduction provided for under the revised Gramm-Rudman-Hollings legislation. It will reinforce the progress already achieved in reducing the deficit (including a fiscal 1987 cut of \$73 billion or 1.9 percent of GNP) that has brought the deficit down to 3.4 percent of GNP from a peak of 6.3 percent.

The Administration will also continue to oppose steadfastly protectionist trade measures, while working for legislation authorizing negotiations to foster a more open and fair system for the international exchange of goods, services and investment.



SECRET



FROM: MISS M P WALLACE

DATE: 14 December 1987

*mpw*

NOTE FOR THE RECORD

cc PS/EST  
Sir P Middleton  
Sir T Burns  
Sir G Littler  
Mr Cassell

**TELEPHONE CONVERSATION WITH MR AMATO**

The Chancellor spoke to Mr Amato on the telephone this afternoon.

2. Amato said that the Bank of England's activities had caused some disappointment in Europe. The Chancellor explained that since the Louvre Britain had purchased more than \$25 billion in dollars - more than all other European countries put together. This explained the decision to buy deutschemarks to prevent the pound rising too high against the Mark. By buying French francs as well, Britain hoped to avoid overstraining the EMS.

3. Amato expressed concern that the UK was selling dollars in order to buy marks. The Chancellor said that Britain was not doing this, and had no wish to push the dollar down. Amato said that Britain's behaviour had come in for harsh criticism from Poehl. The Chancellor said that he would make sure that the Bank of England was not selling dollars.

4. Amato said that he had spoken to Baker since Thursday's trade figures. Baker had not been inclined to attach great importance to the figures, and suggested that they might merely be the result of pre-Christmas imports. Amato thought the situation was very dangerous - although, as the Chancellor pointed out, the dollar had recovered today following helpful statements from the US.

5. Amato asked if the Chancellor expected that the G7 communique would be agreed. The Chancellor said he hoped so. Amato recalled





that some time ago the Chancellor had remarked that everyone in the US was wedded to the idea that the exchange rate must be set by the market. Amato saw more and more evidence of this.

6. Amato's parting shot was to ask the Chancellor to take care of the pound, but also the dollar.

*mpw.*

M P WALLACE



SECRET

*purp.*

From: Sir G.Littler  
Date: 17 December 1987

MR ALEX ALLAN

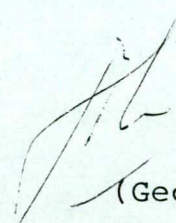
c.c. Sir P.Middleton  
Sir T.Burns

**INTERVENTION AND STOLTENBERG**

You were going to include our tentative line to take in your record of our discussion with the Chancellor this afternoon.

I have had a go at it myself - attached - developing also an extra point which occurred to me and which probably would need further consideration. I am checking the need for or desirability of the reservation in brackets in the third indent.

*Done.*



(Geoffrey Littler)



SECRET

LINE TO TAKE

- The U.K. is prepared to join fully with others in any concerted operation to support the dollar. [In practice we would buy dollars against sterling normally].
- The U.K. would also of course be prepared should the need arise to join in a similar operation in the opposite direction. [In practice we would sell dollars against either sterling or DM].
- The U.K. problem of the £/DM rate has for the present receded, and seems unlikely to come back immediately. In these circumstances we shall not be buying further DM for the time being (~~?~~ except and as needed <sup>for customers, including</sup> ~~to defray~~ BAOR expenditures).
- Should the U.K. problem re-emerge, we would propose in the interests of both global and ERM co-operation to follow a tactic of buying for sterling equal amounts of DM and French francs (and small amounts of other ERM currencies if necessary to avoid creating problems within the ERM) and to match such transactions by buying dollars to the same sterling total.

It is a question whether to add something on the following lines:

- We undertake to 'consult' before undertaking any such transactions and would be prepared to consider possible variations which did not weaken the effects we would be seeking for sterling. But the basic mix proposed is not inconsistent with G7 or ERM objectives. An attempt to veto it would in our view not be in the spirit of the Nyborg understandings.





Treasury Chambers, Parliament Street, SW1P 3AG  
01-270 3000

17 December 1987

M. E Balladur  
Le Ministre d'Etat  
Ministre de l'Economie, des Finances  
et de la Privatisation  
Trésor  
93 rue de Rivoli  
F-75001 Paris

*Alan Bond*

Thank you for your message of 10 December. As I explained to you when we spoke on the telephone this afternoon, we have no intention of diversifying our exchange reserves towards deutschemarks in the sense of selling dollars in order to buy deutschemarks or other currencies. All we have done is to decide that our foreign exchange market intervention to prevent sterling rising too strongly, particularly against the deutschemark, should be undertaken by the purchase of non-dollar currencies. The United Kingdom has done more than all the other major industrial countries in terms of supporting the dollar: since the Louvre accord we have purchased some \$25 billion, far more than the Bundesbank has done. The UK cannot continue to carry so large a share of this burden.

I am very conscious of the need to avoid a disruption to the European Monetary System. That is why, particularly in the light of points made by the French authorities, we agreed to buy equal amounts of deutschemarks and French francs. And I can assure you that we plan to do no more than the minimum intervention necessary to meet our exchange rate objectives.

As I told you, the upward pressure on sterling has, for the time being, abated: we have not had to intervene in the foreign exchange markets since last Friday in New York.

*Nigel Lawson*

NIGEL LAWSON





Treasury Chambers, Parliament Street, SW1P 3AG  
01-270 3000

17 December 1987

M. E Balladur  
Le Ministre d'Etat  
Ministre de l'Economie, des Finances  
et de la Privatisation  
Tresor  
93 rue de Rivoli  
F-75001 Paris

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I am very conscious of the need to avoid a disruption to the European Monetary System. That is why, particularly in the light of points made by the French authorities, we agreed to buy equal amounts of deutschemarks and French francs. And I can assure you that we plan to do no more than the minimum intervention necessary to meet our exchange rate objectives.

As I told you, the upward pressure on sterling has, for the time being, abated: we have not had to intervene in the foreign exchange markets since last Friday in New York.

NIGEL LAWSON



SECRET

16 December 1987

*Presley  
for signature*

*a  
OK?*  
*AA*  
*OK on ...  
Last ...  
is all ...  
won't: 1  
have ...*

M. E Balladur  
Le Ministre d'Etat  
Ministre de l'Economie, des Finances  
et de la Privatisation  
Paris

Thank you for your message of 10 December. As I believe you will have been informed, we have no intention of diversifying our exchange reserves towards deutschemarks in the sense of selling dollars in order to buy deutschemarks or other currencies. All we have done is to decide that, from now on, <sup>any</sup> ~~our~~ foreign exchange market intervention to prevent sterling rising too strongly, particularly against the deutschemark, should be undertaken <sup>by the purchase of</sup> ~~in~~ non-dollar currencies. The United Kingdom has done more than all the other major industrial countries put together in terms of supporting the dollar: since the Louvre accord we have purchased some \$25 billion; this is nearly ten times more than the Bundesbank has done. The UK cannot continue to carry this burden on its own.

I am very conscious of the need to avoid a disruption to the European Monetary System. That is why, particularly in the light of points <sup>made</sup> ~~by the French authorities made~~, we <sup>agreed</sup> ~~decided~~ to modify our policy so that we would buy equal amounts of deutschemarks and French francs. And I can assure you that we plan to do no more than the minimum intervention necessary to meet our exchange rate objectives.



As you <sup>may</sup> ~~will~~ know, the upward pressure on sterling has, for the time being, abated; we have not had to intervene in the foreign exchange markets since last Friday in New York. ~~If upward pressure on sterling does resume, we will consult you before deciding in which currencies we should intervene.~~

NIGEL LAWSON



TRANSLATION OF TELEGRAM FROM MR BALLADUR

I have learnt that since yesterday the Bank of England under instructions from the Government has been making sizable purchases of deutschemarks. I have to tell you that an unilateral act of this kind is totally contrary to the spirit and letter of the European monetary system. It is also totally contrary to the obvious interest of European nations, which is to maintain stable parities at the heart of the system.

I have to add that if it were known that the Bank of England is beginning to diversify towards the deutschemark its exchange reserves, there would be a risk of a very significant effect of contagion and destabilization in all markets. I am therefore asking you to put a stop to this intervention from the Bank of England at once.

Cordially

EB

*Charles de Gaulle  
 President of France  
 meets the press*



 *Le Ministre d'Etat*  
*Ministre de l'Economie, des Finances*  
*et de la Privatisation*

Paris, le 10 décembre 1987

Télégramme à Monsieur LAWSON  
Chancelier de l'Echiquier  
Grande-Bretagne

J'apprends que, depuis hier, la Banque d'Angleterre, sur instruction de son Gouvernement, a procédé à des achats de deutschemarks pour un montant important.

Je tiens à vous rappeler que pareille action unilatérale est totalement contraire à l'esprit et à la pratique du système monétaire européen. Elle est également totalement contraire à l'intérêt évident des pays européens qui est de maintenir des parités stables au sein du système.

J'ajoute que si l'on apprenait que la Banque d'Angleterre commence à diversifier vers le DM ses réserves de change, on risquerait d'enregistrer un très puissant effet de contagion et de déstabilisation sur l'ensemble des marchés.

Je vous demande donc instamment de mettre fin à ces interventions de la Banque d'Angleterre.

Cordialement

Edouard BALLADUR



DR. GERHARD STOLTENBERG  
BUNDESMINISTER DER FINANZEN

5300 BONN 1, 17. December 1987  
POSTFACH 1308  
FERNRUUF (0228) 682-1  
GRAURHEINDORFER STRASSE 108

Telefax

Mr. Nigel Lawson  
Chancellor of the Exchequer  
Parliament Street

London SW 1 P 3 AG

Fax-Nr. 00441/270 55 89  
oder 839 20 29

Urgent/Confidential

Dear colleague,

following our today's telephone conversation I send you a strictly confidential paper with Understandings on Intervention and Consultations. This paper contains the result of a discussion with our colleague Baker. I hope very much that you and Governor Leigh-Pemberton can agree to cooperate on this basis.

Best regards

*Yours faithfully  
Gerhard Stoltenberg*



SECRET

December 1987

## UNDERSTANDINGS ON INTERVENTION AND CONSULTATIONS

1. The participants would hold regular consultations on financial market conditions. On the basis of these consultations, they would make ad hoc decisions on exchange market intervention at levels which the participants consider appropriate under present circumstances. Intervention will be considered if the dollar on the one hand had a tendency to fall below present levels and on the other hand if it approached levels prevailing at the time of the April 1973 meeting of the Group of Seven in Washington.
2. The United States, Japan and Germany/Europe would be expected to undertake intervention up to a total of \$15 billion defined in terms of net purchases/sales of dollars against yen and -- according to the following understanding -- DM/other European currencies, with approximately equal shares over time up to \$5 billion each. As a general rule, the European share of \$5 billion should be provided by Germany in DM on the one hand and the other European countries (EMS-countries in the exchange rate mechanism, plus United Kingdom, Switzerland and Austria) on the other hand in equal parts. If these other European countries intervene for a higher amount, the total European share will be increased correspondingly.
3. If intervention in the view of the participants is required, they will consult on the appropriate daily amounts and their respective shares, taking into account market developments and the respective shares of the participants mentioned in para 2. It is understood that for all intervention by European countries the situation in the European Monetary System will be considered.
4. With regard to the currency of intervention, the following would be:
  - For the United States, equal priority to DM/dollar and yen/dollar, depending on market pressure;
  - For Europe, priority to DM/dollar, supplemented by intervention in other European currencies against dollar;
  - For Japan, priority to yen/dollar;
  - Intervention in dollar/yen by the Deutsche Bundesbank and dollar/DM by the Bank of Japan will be subject to consultation between these two central banks and the U.S. Federal Reserve. This consultation should take place when either the dollar/yen rate or the yen/dollar rate is under pressure.



- 2 -

SECRET

5. Central banks would continue to maintain close contacts on intervention operations pursuant to established channels. Finance ministries would continue to discuss matters of mutual interest through their bilateral channels of communication.
6. This agreement would enter into effect when adopted by the participants in connection with the December G-7 statement and remain in force until the early 1988 meeting. In the event that the \$15 billion of resources are exhausted prior to that meeting, participants would immediately consult.

1478



DR. GERHARD STOLTENBERG  
FINANZMINISTER DER FINANZEN

5300 BONN 1, 17. December 1987  
POSTFACH 1308  
FERNRUF: (0228) 682-1  
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Best regards

*From your recovery*



December 1987

UNDERSTANDINGS ON INTERVENTION AND CONSULTATIONS

1. The participants would hold regular consultations on financial market conditions. On the basis of these consultations, they would make ad hoc decisions on exchange market intervention at levels which the participants consider appropriate under present circumstances. Intervention would be considered if the dollar on the one hand had a tendency to fall below present levels and on the other hand if it approached levels prevailing at the time of the April meeting of the Group of Seven in Washington.
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3. If intervention is in the view of the participants is required they will consult on the appropriate daily amounts of intervention and their respective shares, taking into account market developments and the respective shares of the currencies mentioned in para 2. It is understood that for all intervention by European countries the situation in the European Monetary System will be considered.
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  - For Europe, priority to DM/dollar, supplemented by intervention in other European currencies against dollar;
  - For Japan, priority to yen/dollar;
  - Intervention in dollar/yen by the Deutsche Bundesbank and dollar/DM by the Bank of Japan will be subject to consultation between these two central banks and the US. This consultation should take place when either the dollar/yen rate or the yen/dollar rate is under pressure.



5. Central banks would continue to maintain close contacts on intervention operations pursuant to established channels. Finance ministries would continue to discuss matters of mutual interest through their bilateral channels of communication.
6. This agreement would enter into effect when adopted by the participants in connection with the December G-7 statement and remain in force until the early 1988 meeting. In the event that the \$15 billion of resources are exhausted prior to that meeting, participants would immediately consult.

1478



✓

Q  
Just in case you have to  
do world this weekend  
AA

December 1987

STATEMENT OF THE GROUP OF SEVEN

1. The Finance Ministers and Central Bank Governors of seven major industrial countries have conducted close consultations in recent weeks on their economic policies and prospects in light of developments in financial markets. They reaffirmed their conviction that the basic objectives and economic policy directions agreed in the Louvre Accord remain valid and provide for a positive development of the world economy. They will continue to carry forward their economic policy coordination efforts in 1988 under the arrangements endorsed at the Venice Summit.
2. The Ministers and Governors reemphasized their view that the major external imbalances in the world economy must be corrected. The policies which have been implemented this year are gradually showing the intended effects. In particular, the balance between domestic demand and output in the United States and in Japan and the Federal Republic of Germany has shifted in a direction which promotes external adjustment and in volume terms their trade imbalances are diminishing. The greater stability of exchange rates achieved for much of the past year, following the earlier substantial exchange rate changes, contributed to this adjustment. The marked exchange rate changes over the past few weeks, however, stress the need to strengthen underlying economic fundamentals and to continue policy cooperation.
3. Developments in stock markets since mid October may have some adverse effect on prospects for economic growth for the industrialized countries as a group. The Ministers and Governors believe, however, that with sound economic policies and effective coordination the rate of growth should be substantial. To this end they agreed that appropriate policies for strengthening non-inflationary growth in their countries are necessary.
4. Accordingly, the Ministers and Governors agreed to intensify their economic policy coordination efforts. Their common efforts are directed towards reducing external imbalances. In particular, the United States has secured Congressional action to implement the agreement between the President and the bipartisan Congressional Leadership on a two-year package of additional budget savings that will reinforce progress in reducing the budget deficit. Japan has implemented a major stimulus program to strengthen domestic demand and will see to it that in the FY 1988 budget the expenditure for general public works will not be less than that for the FY 1987 budget including the July supplemental. The Federal Republic of

G7  
STATEMENT



-2-

- Germany is supplementing the previously announced increase in tax reductions in 1988 with new measures to increase investment and will not seek to offset the budget revenue losses arising from recent developments. There have also been coordinated reductions in interest rates in Europe which should contribute to the expansion of domestic demand and reduce trade imbalances. The specific policy intentions and undertakings by each country are set forth in the annex to this statement.
5. The Ministers and Governors are of the view that the recent monetary policy decisions and the reduction of interest rates in some countries were appropriate and will contribute to a restoration of stability to financial markets. They agreed that monetary policies should continue to be directed towards providing adequate monetary conditions to achieve strong economic growth in the context of price stability as well as to foster financial market stability.
  6. The Ministers and Governors strongly rejected protectionist measures as a means of dealing with present imbalances. Protectionism constitutes a direct and serious danger to world prosperity and equilibrium and would have harmful consequences for those countries which resort to it. They reaffirmed their determination to fight protectionism and to promote an open world trading system.
  7. The Ministers and Governors believe that the reduction of world trading imbalances requires cooperative action by other countries, particularly those with surpluses. They expressed particularly serious concern that some newly industrialized economies have failed to take adequate action to deal with large and growing trade surpluses which are exacerbating global imbalances and fostering protectionist pressures. They urged the newly industrialized economies to implement without delay trade and exchange rate policies that will facilitate the reduction of excessive trade surpluses and allow their currencies to fully reflect the strong competitive position of their economies.
  8. The Ministers and Governors agreed that either excessive fluctuation of exchange rates, a further decline of the dollar, or a rise in the dollar to an extent that becomes destabilizing to the adjustment process, could be counter-productive by damaging growth prospects in the world economy. They reemphasized their common interest in more stable exchange rates among their currencies and agreed to continue to cooperate closely in monitoring and implementing policies to strengthen underlying economic fundamentals to foster stability of exchange rates. In addition, they agreed to cooperate closely on exchange markets. The Ministers and Governors stressed the need for consistent and mutually supportive policies and believe that the measures being taken



-3-

will accelerate progress towards the increased, more balanced economic growth, and sustainable external positions necessary for greater exchange rate stability.



## Annex

### Policy Intentions and Undertakings

The Government of Canada's fiscal strategy has succeeded in achieving a drop in the rate of growth of its spending and substantial, on-going declines in the budget deficit. Marked progress has been made in slowing the growth of debt, and towards the medium term objective of stabilizing the debt-to-GDP ratio. Fiscal restraint has been accompanied by impressive growth of domestic demand, output and employment. Major structural initiatives directed at enhancing competitiveness and the underlying potential of the economy have been undertaken, particularly tax reform and the negotiation of a free trade agreement with the United States. Monetary policy remains geared to non-inflationary growth in a climate of orderly exchange markets.

The Government of France has fully met its commitment to reduce its fiscal deficit and tax burden. The fiscal deficit will be reduced by 0.8% of GNP from 1986 to 1988. Over the same period of time, tax cuts will amount to 1.3% of GNP. A further reduction of 45 billion french francs in the fiscal deficit and an additional 45 billion french francs in tax cuts are scheduled in a 1989-1991 three year program which constitutes the long term strategy of the government and will be implemented in the yearly budgets. The privatization program decided upon in early 1987 is being carried out, and its initial objectives have even been surpassed. The full implementation of the program will be resumed as soon as market conditions permit.

The French Government will continue to pursue its adjustment and liberalization policies. New measures to sustain household savings, develop financial markets and improve the competitiveness of firms have been taken. Additional steps will be taken in the same direction in 1988.

The Government of the Federal Republic of Germany has increased the amount of the tax reductions for 1988 and beyond to about 14 billion DM, and will not seek to offset the budget revenue losses arising from recent developments. In addition, the necessary decisions have been taken for the structural tax reform with a further net tax reduction of 20 billion DM from 1990 onward.

In order to strengthen private and public investment, the Federal Government will provide special loans for the next 3 years of about 21 billion DM under preferential conditions. Moreover, it will accelerate investment in telecommunication infrastructure and take initiatives for further deregulation of markets.

The Bundesbank has reduced short-term interest rates substantially during the last few weeks. Monetary policy will



- 2 -

Continue to maintain appropriate conditions for sustained non-inflationary growth.

The Government of Italy has taken restrictive measures in 1987 to halt the deterioration of the balance of payments due to a higher rate of domestic demand in Italy than in other industrial countries. For 1988 the objective embodied in the Finance Bill is to maintain a relatively high level of growth and to keep the average inflation rate constant, while making progress in correcting the public sector imbalance.

In the medium-term, to alleviate unemployment the Italian authorities intend to achieve satisfactory rates of growth while maintaining the balance of payments current account near equilibrium, to stabilize the debt/GDP ratio, and to devote more resources to the financing of productive as well as infra-structural investments, thus improving the quality of public services.

The Government of Japan noted that the Japanese economy is in a vigorous expansionary phase, led by domestic demand growth. The Government will steadfastly continue implementing the 6 trillion-yen-plus package decided on last May, and will see to it that in the FY 1988 budget the expenditure for general public works will not be less than that for the FY 1987 budget including the July supplemental.

The Bank of Japan will follow appropriate and flexible monetary policy supportive of non-inflationary growth and exchange rate stability.

The United Kingdom Government, in the context of the British economy's continued vigorous growth of output and domestic demand, coupled with sound public finances, will continue to strive to reduce inflation by pursuing a prudent monetary policy, while increasing its capacity for non-inflationary growth by further measures designed to free the operation of markets and increase the efficient use of resources, including tax reduction and tax reform. Public expenditure will continue to increase less rapidly than the growth of the economy as a whole, and the government will continue to work for the dismantling of barriers to trade both within the European Community and in the context of the Uruguay round of the GATT.

The United States Government has secured Congressional action to implement the agreement between the President and the bipartisan Leadership of the Congress on a two-year package of



- 3 -

budget savings to reduce the U.S. budget deficit. This agreement provides for total budget savings, through a combination of spending restraint and increased taxes, in fiscal 1988 and 1989 of approximately \$76 billion.

The budget agreement is part of an ongoing process of deficit reduction provided for under the revised Gramm-Rudman-Hollings legislation. It will reinforce the progress already achieved in reducing the deficit (including a fiscal 1987 cut of \$73 billion or 1.9 percent of GNP) that has brought the deficit down to 3.4 percent of GNP from a peak of 6.3 percent.

The Administration will also continue to oppose steadfastly protectionist trade measures, while working for legislation authorizing negotiations to foster a more open and fair system for the international exchange of goods, services and investment.



to: DISTRIBUTION

Department  
of the Treasury

Assistant Secretary

room: \_\_\_\_\_ date 12/18/87

(International Affairs)

Attached is press guidance which Secretary Baker will be using after the fact. We hope that you could also respond along similar lines to questions which may arise.

Distribution

Dr. Hans Tietmeyer  
Mr. Toyoo Gyohten  
Mr. Jean-Claude Trichet  
Sir Geoffrey Littler  
Ms. Wendy Dobson  
Mr. Mario Sarcinelli



David C. Mulford

room 3432

phone 566-5363



Press Guidance

1. Question: Why did you issue a communique without a meeting?  
Answer: Meetings are not necessarily required to produce successful economic policy coordination.  
  
We have been engaged in intensive consultations on a daily basis since mid-October which has produced major accomplishments that are greater than could have been achieved in a single meeting.
2. Question: Have you agreed to stabilize exchange rates around current levels?  
Answer: Paragraph 8 of the statement indicates clearly the view that a further decline of the dollar could be counterproductive.
3. Question: Do you really think that the dollar could appreciate as suggested in paragraph 8?  
Answer: A rise of the dollar cannot be ruled out. As the statement indicates, however, a rise of the dollar to an extent that becomes destabilizing to the adjustment process could be counterproductive.
4. Question: Why doesn't the statement contain a clear commitment to stabilize exchange rates around current levels as provided in the Louvre agreement?  
Answer: Circumstances have changed since the Louvre. The statement reemphasizes the common interest in strengthening underlying economic fundamentals to foster stability of exchange rates.
5. Question: Will monetary policy be used to prevent a further decline of the dollar?  
Answer: We will not comment on this issue beyond Paragraph 5 of the statement which speaks for itself.



6. Question: What makes you think that this agreement will be any more successful than its predecessors in reducing external imbalances?

Answer: There has been considerable adjustment in exchange rates since the Louvre. The coordination process is working and, as the statement records, governments are taking additional actions to reduce imbalances. Global economic growth is being maintained.

7. Question: Are you satisfied with Japanese and German efforts to promote growth or will you be seeking additional measures, including larger tax cuts and lower interest rates?

Answer: The U.S. is pleased by the actions taken by Japan and Germany to improve growth and reduce external imbalances. We believe that the measures being taken are in the right direction and will have their intended effects.

8. Question: The U.S. trade deficit continues to grow despite a substantial dollar depreciation. Doesn't this suggest the need to reduce domestic consumption and growth in order to achieve meaningful reductions in the trade deficit?

Answer: The general trend has been for the trade deficit to improve in volume terms. Exports are up and our external account is a major factor in U.S. growth.

With the measures referred to in the statement, we should see a decline in external imbalances without reducing U.S. growth.

9. Question: When can we expect to see a lower U.S. trade deficit?

Answer: The U.S. trade deficit is improving in volume terms and we would expect this trend to be reflected in the value figures during 1988.



10. Question: Does this statement mean that the Louvre is dead?

Answer: This statement builds on the Louvre. As paragraph 1 makes clear, the basic objectives of the economic policy coordination process are the same as in the Louvre.



SECRET

py

From: Sir G. Littler  
Date: 17 December 1987

CHANCELLOR

c.c. Sir P. Middleton  
Sir T. Burns

## PROSPECTIVE CALL FROM STOLTENBERG

Tietmeyer telephoned me last night: a 10-minute conversation which was interesting both for what was and what was not said! He said that Stoltenberg would want to call you some time this morning, for the following purposes:

- to check that you are content with the latest draft of the G7 statement he has agreed with Baker: the text was sent over last night and is attached;
- to tell you of the private arrangements he has made with Baker and Miyazawa about intervention (Tietmeyer would not or could not give me the details in advance);
- to seek your agreement to the form of announcement - the proposal is that, assuming the U.S. confirm success with Congress by Friday night (the process probably not to be completed until Saturday), there should be simultaneous announcement in all G7 capitals, probably at 11 a.m. our time on Sunday 20 December;
- to seek your response to his message to you about U.K. intervention in DM.

2. The last point was presented very much more as an extra than as anything like a climax. It seems clear that the message to you was drafted before I spoke with Tietmeyer following my talk with you yesterday - and sent as drafted. Tietmeyer's first



SECRET

reaction to what I said at lunch-time was strong disappointment that I refused to give a categorical assurance that "we would not in any circumstances buy DM without Bundesbank consent". But he did not revert to this in last night's conversation. My guess is that Stoltenberg does not want a row with you - quite possibly sent his message as a sop to the Bundesbank - and will be willing to be persuaded to 'hope for the best' without pressing you now for a more explicit assurance of the kind his message sought.

3. The draft statement contains no surprises. I have only two comments at this stage:

- first, simply to draw your attention to the last sentence of the first paragraph, which is a clever way of meeting the U.S. wish for a reference to the 'indicators' work!
- secondly, the language is American in parts: e.g. in para 1 "in light of".

The only change I would like to press is another of Mulford's split infinitives - "to fully reflect" at the end of para 7.

4. It will be interesting to hear the details of the private intervention agreement - I guess one of cross-rate upper and lower limits. We can cope with the proposed publication arrangements and I suggest should not try for anything different.



(Geoffrey Littler)



~~SECRET~~

top sent  
to CH  
21/12

mp



10 DOWNING STREET  
LONDON SW1A 2AA

CH/EXCHEQUER	
REC.	21 DEC 1987
ADDRESSEE	SIR H. LITTLE
ADDRESSES TO	SIR P. MIDDLETON SIR T. BURNS

From the Private Secretary

18 December 1987

Dear Alex,

G7

The Prime Minister has asked me to write to record that she disapproves most strongly of the G7 agreement on concerted intervention which is now in prospect. She believes it is simply tinkering and that intervention without policy measures to improve the economic fundamentals will be damaging rather than helpful, as she and Secretary Shultz agreed in their recent conversation. My understanding of her views is that the US should be prepared to raise interest rates. But if they do not, the dollar should be allowed to find its own level.

The Prime Minister was also most concerned that she learned about the possible agreement only at 1800 on a Friday evening. She believes that it must have been at least in the wind for some hours, if not days, and she would prefer to have had an earlier opportunity to express her views.

Yours,  
David

DAVID NORGROVE

Alex Allan, Esq.,  
H.M. Treasury.

SECRET



SECRET

Sir G. Lister a PPS  
my

G7 STATEMENT: AWKWARD QUESTIONS

had welcome your early comments  
on this: are they in filing in  
the States! RA. 17/12

1. Why the Statement?

To help reassure financial markets by demonstrating that the G7 countries have been working closely together in recent weeks.

2. Why no G7 meeting?

Timing not yet right. Taking longer than expected to get all the components of a dollar stabilisation deal in place. But making progress.

3. Will there be a G7 meeting early in the New Year?

Yes, I hope so, provided that <sup>conditions are right for achieving agreement</sup> ~~appropriate agreement has been reached~~ with the US on a dollar stabilisation package.

4. When will such agreement be reached?

Cannot say at this stage.

5. What if the United States refuses to play ball?

Don't accept that this will <sup>1</sup> be the outcome. Working closely with the Americans.

6. Surely US right not to take measures which would drive economy into recession?

if any, then domestic demand falling too strongly

No indication of any downturn in US economy: Rapid dollar depreciation much the more dangerous policy, as UK experience in 1960s and 1970s showed.

7. Nothing has been achieved of any value in recent weeks?

Not true. Value of recent policy adjustments in Europe, Japan and the US should not be underestimated.



DEURK

8. Louvre in tatters?

Not true. Statement restates many of the <sup>main</sup> elements in Louvre, eg the commitment to carry forward with economic policy coordination efforts in 1988 under Venice Summit arrangements; and the emphasis on coordinated <sup>in</sup> policy towards reducing external imbalances.

9. But nothing <sup>in Statement</sup> on monetary policy/exchange rates?

Not true. Statement clearly says that monetary policies should continue to be directed towards achieving strong economic growth and price stability, as well as financial market stability. And ~~Statement~~ emphasises the value of more stable exchange rates and the need for Governments to cooperate closely on exchange markets.

10. What is now the right level of exchange rates? No mention of ~~Louvre-form of words:~~ stabilising rates around current levels?

↑ on in Louvre

Not possible to reach an agreement on <sup>exchange</sup> rates without US participation. For the European currencies, the EMS will provide a protection against extreme movements. And UK policy will continue to focus on <sup>prohibition</sup> ~~achieving~~ maximum stability, particularly against the DM.

11. What prospects that US will eventually agree to dollar stabilisation package?

Cannot say at this stage. UK and other countries will continue to press US authorities for a commitment on dollar stabilisation/interest rates.

12. Are German measures sufficient?

We shall have to wait and see. <sup>Root</sup> ~~Part~~ of the German problem is inadequate growth in domestic demand and massive external surplus. Fiscal reflation on its own is not the answer to these problems. Lower interest rates and improved supply side performance also required. German policies certainly moving in the right direction.



13. Thirty-three international economists say US budget deal not enough?

In general, <sup>economists'</sup> statement unduly alarmist. Choice not as stark as presented (either <sup>the</sup> proposed measures or <sup>the</sup> prospects of a world recession). Chancellor has welcomed US budget deal as going beyond Gramm-Rudman in year ~~one~~ and including a second year <sup>with new measures</sup>. Have to recognise that Americans had very difficult political balancing act to perform: much credit to them that they brought it off.

14. What does paragraph 4 of Statement mean by Germans not seeking "to off-set the budget revenue losses arising from recent developments"?

[ ]

15. Paragraph 8 of Statement refers to "further decline of the dollar, or a rise in the dollar to an extent that it becomes destabilising": why this apparent asymmetry?

[ ]

16. What does "more stable exchange rates" (paragraph 8 of Statement) mean? Is this not a retreat from Louvre?

Still working towards re-establishing a firm exchange rate agreement on Louvre lines. This is as far as we can go at this stage.

17. The Annex says that UK Government "will continue to strive to reduce inflation": is this no longer an aim of policy?

Of course it is, over the medium term. But have to recognise that further progress in 1988 will be limited.



For the Attention of Miss Goodman

*pyg*

G7 TOTAL PUBLISHED RESERVES

US\$ bn

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GERMANY †	47.4	63 (w/c 23 Nov)	+16
ITALY	49.4	46 (end Sept)	- 3
JAPAN	52.8	73 (end Oct)	+20
USA	49.4	46 ( " )	- 3
CANADA	6.5	6 (end Aug)	- 1
UK	22.3	41	+19

NB

1 Figures are not strictly comparable because of different valuation conventions for e.g. gold

2 French and German figures were published in local currencies; they have been converted to US\$ at end-month exchange rates.

(+19.8 for use - large increase probably due to receipts for military purposes)



prop (G7)



Per  
know  
have  
help  
I am  
frankly  
puzzled  
to have  
with

Ch

Geoff has spoken  
to Mulford, who  
says it is most  
unlikely we will  
manage a Sunday  
morning G7  
communique. He  
will ring Geoff early  
Sunday morning if  
there is to be one.

AA



PPS 12/2

ppp

ABC  
POs

U.K. SAYS G-7 MEETING HINGES ON U.S. COMMITMENT NRGB  
LONDON, DEC 18 - LEADERS OF THE GROUP OF SEVEN INDUSTRIAL COUNTRIES HAVE BEEN IN REGULAR CONTACT SINCE OCTOBER ON CURRENCY AND ECONOMIC ISSUES, BUT THE U.K. REMAINS AGAINST A G-7 MEETING IN THE ABSENCE OF A COMMITMENT BY THE UNITED STATES TO HELP STABILIZE THE DOLLAR, BRITISH TREASURY SOURCES SAID.  
IN BONN, GOVERNMENT SOURCES SAID G-7 LEADERS HAD DISCUSSED POSIBILITIES FOR RENEWING CURRENCY AND ECONOMIC ACCORDS.  
A U.K. TREASURY OFFICIAL LATER SAID, "CONSULTATIONS HAVE BEEN GOING ON SINCE OCTOBER. WITH REGARDS TO THE TIMING OF A G-7 MEETING, THERE'S NOTHING NEW TO ADD. WE STILL NEED A FIRM (DOLLAR) COMMITMENT FROM THE U.S. BEFORE THAT."  
18-DEC-1257 MON813 MONG

P

REUTER  
REUTER MONITOR 0819



ChEx  
Room 14/2

A, B, C. All P's M. O'Brien

prof

MAJOR NATIONS MAY ISSUE WEEKEND CURRENCY STATEMENT NRAS  
TOKYO, DEC 18 - MAJOR NATIONS MAY ISSUE A STATEMENT THIS  
WEEKEND REAFFIRMING THE NEED FOR CURRENCY STABILITY, JAPANESE  
GOVERNMENT SOURCES SAID.

THE STATEMENT COULD COME IF THE U.S. CONGRESS PASSES  
LEGISLATION CUTTING AMERICA'S BUDGET DEFICIT, THEY SAID. THE  
STATEMENT WOULD BE ISSUED BECAUSE THE G-7 WOULD BE UNABLE TO  
MEET AT SUCH SHORT NOTICE OVER THIS WEEKEND.

GOVERNMENT SOURCES SAID ON THURSDAY THAT MAJOR NATIONS  
MIGHT HAVE TO CONSIDER THE POSSIBILITY OF ISSUING A STATEMENT  
IF NEEDED TO CALM MARKETS AFTER CONGRESS ACTS. FINANCE  
MINISTER KIICHI MIYAZAWA THIS MORNING DECLINED TO COMMENT.  
18-DEC-0827 MON377 MONA

CONTINUED ON - NRAT

P

REUTER MONITOR 0819

MAJOR NATIONS #2 TOKYO NRAT

MIYAZAWA THOUGH DID SAY THIS MORNING THAT HE SAW THE NEED  
FOR THE GROUP OF SEVEN TO DISCUSS THE POSSIBILITY OF GOING  
SOMETHING TO STABILIZE CURRENCIES AFTER THE U.S. CONGRESS  
ACTS. HE DID NOT ELABORATE.

A SENIOR GOVERNMENT SOURCE SAID MIYAZAWA HAS BECOME MORE  
CONCERNED ABOUT THE DOLLAR'S FALL RECENTLY.

HE SAID THAT MIYAZAWA HAS PRIVATELY HEARD COMPLAINTS ABOUT  
THE STRONGER YEN FROM SOME INDUSTRIALISTS. BEFORE THOSE RECENT  
COMPLAINTS, JAPANESE INDUSTRY HAD BEEN RELATIVELY RELAXED  
ABOUT THE DOLLAR'S DECLINE BECAUSE DOMESTIC DEMAND WAS RISING  
RAPIDLY.

18-DEC-0842 MON401 MONA

CONTINUED FROM - NRAS

CONTINUED ON - NRAU

P

REUTER MONITOR 0819

MAJOR NATIONS #3 TOKYO NRAU

"MAJOR NATIONS ARE AT A FAIRLY ADVANCED STAGE OF  
CONSULTATIONS," SAID ONE INTERNATIONAL MONETARY SOURCE HERE.  
BUT HE SAID HE WAS UNSURE WHETHER THAT WOULD RESULT IN A  
STATEMENT OR A MEETING OF THE G-7.

THE SOURCE SAID THAT HE UNDERSTOOD THAT U.S. TREASURY  
SECRETARY JAMES BAKER WAS ACTIVELY INVOLVED IN THE  
CONSULTATIONS AND WAS PUTTING CONSIDERABLE TIME INTO THEM.

HE CERTAINLY DOES NOT LOOK AS IF HE IS WALKING AWAY FROM  
THE LOUVRE AGREEMENT," THE SOURCE SAID.

AT LOUVRE, THE G-7 AGREED ON THE NEED FOR STABLE EXCHANGE  
RATES AND FOR JOINT ACTION TO CUT EXTERNAL IMBALANCES.

18-DEC-0848 MON406 MONA

CONTINUED FROM - NRAT

CONTINUED ON - NRAU

P

REUTER MONITOR 0819

MAJOR NATIONS #4 TOKYO NRAU



MAJOR NATIONS #4 TOKYO

NRAV

A BANK OF JAPAN SOURCE SAID THAT THE PACE OF THE YEN'S APPRECIATION HAS RECENTLY ACCELERATED TO A POINT THAT WAS BECOMING WORRYING.

"IT'S NOT SO MUCH THE LEVEL OF THE EXCHANGE RATE, BUT THE RAPID PACE OF THE RISE," HE SAID.

OTHER SIGNS OF JAPANESE UNEASE WITH THE EXCHANGE RATE SURFACED ON FRIDAY WITH THE NEWS THAT JAPANESE LIFE INSURERS MAY CURB THEIR PURCHASES OF FOREIGN BONDS, INCLUDING U.S. TREASURY ISSUES, IF THE DOLLAR CONTINUES TO FALL.

LIFE INSURANCE ASSOCIATION PRESIDENT YASUYUKI WAKAHARA MADE THE REMARK TO JAPANESE REPORTERS, A SPOKESMAN SAID.

18-DEC-0906 MON425 MONA

CONTINUED FROM - NRAV

CONTINUED ON - NRBK

REUTER MONITOR 0819

MAJOR NATIONS #5 TOKYO

NRBK

THE ISSUANCE OF A STATEMENT HINGES ON U.S. CONGRESSIONAL ACTION ON THE BUDGET, GOVERNMENT SOURCES SAID. REPRESENTATIVES OF THE SENATE AND CONGRESS HAVE REACHED A TENTATIVE AGREEMENT ON 23 BILLION DLRS IN TAX RISES OVER TWO YEARS IN ORDER TO CUT THE U.S. BUDGET DEFICIT.

BUT JAPANESE GOVERNMENT SOURCES SAID CONGRESSIONAL NEGOTIATORS COULD STILL FACE DIFFICULTIES HAMMERING OUT A PACT ON SPENDING CUTS, ESPECIALLY ON ENTITLEMENT PROGRAMS.

ONE SOURCE ADDED THAT THERE WAS A DANGER IF THE G-7 ISSUED A STATEMENT NOW, IT WOULD HAVE LITTLE MORE TO SAY IF IT DECIDED TO MEET IN JANUARY OR FEBRUARY.

18-DEC-0920 MON447 MONB

CONTINUED FROM - NRAV

CONTINUED ON - NRBL

REUTER MONITOR 0819

REUTE

NRBL

18-DEC-0920 MON447 MONB

CONTINUED FROM - NRBK

REUTER

REUTER MONITOR 0819



For the Attention of Miss Goodman

*page*

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NB

1 Figures are not strictly comparable because of different valuation conventions for e.g. gold

2 French and German figures were published in local currencies; they have been converted to US\$ at end-month exchange rates.

(+ US\$ for use - large increase probably due to receipts for military purposes)



CONFIDENTIAL

cc Sir P Middleton  
Sir T Burns  
Sir G Little

TRANSLATION OF A FAX FROM MR STOLTENBERG, DATED 16 DECEMBER

MFA  
16/12.

Dear Colleague,

As I have already made plain to you on the phone, the Federal Government and the Bundesbank are extremely concerned about the Bank of England's purchases of Deutschemarks in the last week. Leaving to one side the current [literally "today's"] situation, this matter is one of such seriousness, that I would like to put our position to you one more time. ¶ According to the Central Bank agreement on the functioning of the EMS, balances in community currencies which exceed the so called "working balances" can only be held with the agreement of the Central Bank in question. The German Bundesbank has refused to give the Bank of England its consent for the purchases of Deutschemarks, because in the current situation intervention of this kind would increase the upward pressure on the Deutschemark against other EMS currencies as well as against the dollar. This could very quickly lead to significant tensions and a political crisis in the EMS. Furthermore, purchases of Deutschemarks would have a <sup>detrimental</sup> influence on our common efforts to stabilize world currencies against the dollar, because they would counteract the effects of dollar purchases with Deutschemarks.

For the Bank of England to continue or resume its purchases of Deutschemarks on the currency markets would clash not only with formal law but also with the principles of our co-operation until now. This applies to our co-operation on European currency policy [or "politics"] and equally to our co-operation in G5/G7.

I would therefore urge you most strongly to ensure that the Bank of England does not resume Deutschemark purchases without the Bundesbank's consent. I must ask for the same assurance from you in the context of the forthcoming conclusion of our efforts to reach a common position in G7.

Sincerely

GS



DR. GERHARD STOLTENBERG  
BUNDESMINISTER DER FINANZEN

5300 Bonn 1, 16. Dezember 1987

Graurheindorfer Straße 108  
Postfach 1308  
Telefon: (0228) 682-4240

The Hon.  
Nigel Lawson  
Chancellor of the Exchequer  
Parliament Street  
London SW 1 P 3 AG

Durch Telekopie  
erhalten/übermittelt  
am: 16. 12. Uhrzeit:  
Name: H

Sehr geehrter Herr Kollege,

Wie ich Ihnen schon an Telefon dargelegt habe, sind Bundesregierung und Bundesbank sehr besorgt über die DM-Käufe der Bank of England an den Devisenmärkten in der vergangenen Woche. Unabhängig von der Situation des heutigen Tages handelt es sich hierbei um ein so gewichtiges Problem, daß ich Ihnen hierzu nochmals unsere Auffassung darlegen möchte.

Nach dem Abkommen der Zentralbanken über die Funktionsweise des EWS können Guthaben in Gemeinschaftswährungen über die sog. working balances hinaus nur mit Zustimmung der betreffenden Zentralbank gehalten werden. Für die DM-Käufe der Bank of England hat die Deutsche Bundesbank die erforderliche Zustimmung verweigert, weil in der gegenwärtigen Situation solche Interventionen den Aufwertungsdruck auf die DM sowohl gegenüber den EWS-Währungen als auch gegenüber dem Dollar verstärken würden. Dies kann sehr rasch zu erheblichen Spannungen und einer politischen Krise im EWS führen. Außerdem würden durch DM-Käufe unsere gemeinsamen Bemühungen um eine Stabilisierung der Wechselkurse gegenüber dem Dollar beeinträchtigt, da Dollar-Käufe gegen DM damit konterkariert würden.

Eine Fortsetzung bzw. Wiederaufnahme von DM-Käufen an den Devisenmärkten durch die Bank of England würden sowohl gegen formales Recht als auch gegen die Grundsätze unserer bisherigen



- 2 -

Zusammenarbeit verstoßen. Das gilt für die Zusammenarbeit in der europäischen Währungspolitik und ebenso für die Zusammenarbeit in der Fünfer- bzw. Siebener-Gruppe.

Ich möchte Sie deswegen dringend bitten, dafür Sorge zu tragen, daß die Bank of England die Praxis der DM-Käufe ohne Einvernehmen mit der Bundesbank nicht wieder aufnimmt. Auch im Hinblick auf den bevorstehenden Abschluß unserer Bemühungen um eine gemeinsame Position im Kreis der Siebener Gruppe muß ich eine entsprechende Zusicherung von Ihnen erwarten.

Mit freundlichen Grüßen

*so form herweg*



CONFIDENTIAL

cc Sir P Middleton  
Sir T Burns  
Sir G Little

TRANSLATION OF A FAX FROM MR STOLTENBERG, DATED 16 DECEMBER

MPW  
16/12.

Dear Colleague,

As I have already made plain to you on the phone, the Federal Government and the Bundesbank are extremely concerned about the Bank of England's purchases of Deutschemarks in the last week. Leaving to one side the current [literally "today's"] situation, this matter is one of such seriousness, that I would like to put our position to you one more time. ¶ According to the Central Bank agreement on the functioning of the EMS, balances in community currencies which exceed the so called "working balances" can only be held with the agreement of the Central Bank in question. The German Bundesbank has refused to give the Bank of England its consent for the purchases of Deutschemarks, because in the current situation intervention of this kind would increase the upward pressure on the Deutschemark against other EMS currencies as well as against the dollar. This could very quickly lead to significant tensions and a political crisis in the EMS. Furthermore, purchases of Deutschemarks would have a <sup>detrimental</sup> influence on our common efforts to stabilize world currencies against the dollar, because they would counteract the effects of dollar purchases with Deutschemarks.

For the Bank of England to continue or resume its purchases of Deutschemarks on the currency markets would clash not only with formal law but also with the principles of our co-operation until now. This applies to our co-operation on European currency policy [or "politics"] and equally to our co-operation in G5/G7.

I would therefore urge you most strongly to ensure that the Bank of England does not resume Deutschemark purchases without the Bundesbank's consent. I must ask for the same assurance from you in the context of the forthcoming conclusion of our efforts to reach a common position in G7.

Sincerely

GS



**DR. GERHARD STOLTENBERG**  
BUNDESMINISTER DER FINANZEN

5300 Bonn 1, 16. Dezember 1987

Graurheindorfer Straße 108  
Postfach 1308  
Telefon (0228) 682-4240

Durch Telekopie  
erhalten/übermittelt  
am: 16. 12. Uhrzeit:  
Name: K

The Hon.  
Nigel Lawson  
Chancellor of the Exchequer  
Parliament Street  
London SW 1 P 3 AG

Sehr geehrter Herr Kollege,

wie ich Ihnen schon an Telefon dargelegt habe, sind Bundesregierung und Bundesbank sehr besorgt über die DM-Käufe der Bank of England an den Devisenmärkten in der vergangenen Woche. Unabhängig von der Situation des heutigen Tages handelt es sich hierbei um ein so gewichtiges Problem, daß ich Ihnen hierzu nochmals unsere Auffassung darlegen möchte.

Nach dem Abkommen der Zentralbanken über die Funktionsweise des EWS können Guthaben in Gemeinschaftswährungen über die sog. working balances hinaus nur mit Zustimmung der betreffenden Zentralbank gehalten werden. Für die DM-Käufe der Bank of England hat die Deutsche Bundesbank die erforderliche Zustimmung verweigert, weil in der gegenwärtigen Situation solche Interventionen den Aufwertungsdruck auf die DM sowohl gegenüber den EWS-Währungen als auch gegenüber dem Dollar verstärken würden. Dies kann sehr rasch zu erheblichen Spannungen und einer politischen Krise im EWS führen. Außerdem würden durch DM-Käufe unsere gemeinsamen Bemühungen um eine Stabilisierung der Wechselkurse gegenüber dem Dollar beeinträchtigt, da Dollar-Käufe gegen DM damit konterkariert würden.

Eine Fortsetzung bzw. Wiederaufnahme von DM-Käufen an den Devisenmärkten durch die Bank of England würden sowohl gegen formales Recht als auch gegen die Grundsätze unserer bisherigen



- 2 -

Zusammenarbeit verstoßen. Das gilt für die Zusammenarbeit in der europäischen Währungspolitik und ebenso für die Zusammenarbeit in der Fünfer- bzw. Siebener-Gruppe.

Ich möchte Sie deswegen dringend bitten, dafür Sorge zu tragen, daß die Bank of England die Praxis der DM-Käufe ohne Einvernehmen mit der Bundesbank nicht wieder aufnimmt. Auch im Hinblick auf den bevorstehenden Abschluß unserer Bemühungen um eine gemeinsame Position im Kreis der Siebener Gruppe muß ich eine entsprechende Zusicherung von Ihnen erwarten.

Mit freundlichen Grüßen

so form herweg



mpw



FROM: MISS M P WALLACE  
DATE: 18 December 1987

**NOTE FOR THE RECORD**

cc Sir P Middleton  
Sir G Littler  
Sir T Burns

**TELEPHONE CALL WITH STOLTENBERG**

The Chancellor spoke briefly with Stoltenberg on the telephone this afternoon.

2. The Chancellor said that Britain could take part in the understanding on intervention set out in Stoltenberg's note. Stoltenberg welcomed this. The Chancellor asked when a communique could be expected. Stoltenberg said that he had agreed with Baker that they would get in contact once the US Budget package had been ratified by Congress, and aim to publish the communique in all countries at the same time. It was now less likely that it would be possible to publish on Sunday. Stoltenberg was to leave Bonn tomorrow (Saturday); Tietmeyer would be leaving on Sunday, but would remain in contact with his office. The timing of the announcements could be sorted out by officials.

3. Both the Chancellor and Stoltenberg agreed that it had been most unhelpful of Miyazawa to hint at the possibility of communique. This would undoubtedly already have weakened the effect of a communique. The Chancellor and Stoltenberg hoped that the uncertainty in Congress would soon be over.

mpw.

MOIRA WALLACE



748/37

Covering SECRET

FROM: R I G ALLEN  
DATE: 21 DECEMBER 1987

PS/CHANCELLOR

cc Sir Peter Middleton  
Sir G Littler  
Sir T Burns

G7 STATEMENT: AWKWARD QUESTIONS

I enclose a copy of the Q/As as approved by the Chancellor.



R I G ALLEN

Encs



SECRET

**G7 STATEMENT: AWKWARD QUESTIONS****1. Why the Statement?**

There has been considerable progress made in discussions between G7 countries recently and it seems appropriate to record that in an agreed communique. It demonstrates the continuing cooperation between G7 countries.

**2. Why no G7 meeting?**

We were able to agree this communique without the need for a meeting.

**3. Will there be a G7 meeting early in the New Year?**

Possibly. It would be an opportunity to build further on the cooperation demonstrated by this statement.

**4. What if the United States refuses to play ball?**

US has played a lead part on this communique.

**5. Surely US right not to take measures which would drive economy into recession?**

Talk of recession is absurd. No indication of any downturn in US economy: If anything domestic demand growing too strongly and may be inhibiting improvement of US current account. Rapid dollar depreciation much the more dangerous policy, as UK experience in 1960s and 1970s showed.

**6. Nothing has been achieved of any value in recent weeks?**

Not true. Value of recent policy adjustments in the US, Japan and Europe, should not be underestimated.



## 7. Louvre in tatters?

Not true. The Louvre Accord identified the right objectives and the necessary adjustments of economic policies to bring about a reduction of external imbalances. Present Statement confirms those elements of Louvre, and the further actions taken to carry them forward.

## 8. But nothing in Statement on monetary policy/exchange rates?

Not true. Statement clearly says that monetary policies should continue to be directed towards achieving strong economic growth and price stability, as well as financial market stability. And emphasises the value of more stable exchange rates and the need for Governments to cooperate closely on exchange markets.

## 9. What is now the right level of exchange rates? No mention of stabilising rates around current levels, as in Louvre?

The Statement (para 8) makes clear that ".... either excessive fluctuation of exchange rates, a further decline of the dollar, or a rise in the dollar to an extent that becomes destabilising to the adjustment process, could be counterproductive by damaging growth prospects in the world economy."

## 10. Paragraph 8 of Statement refers to "further decline of the dollar, or a rise in the dollar to an extent that it becomes destabilising": why this apparent asymmetry?

Reflects the fact that recent movement has been almost entirely in one direction; and that the dollar is now probably undervalued.

## 11. What does "more stable exchange rates" (paragraph 8 of Statement) mean? Is this not a retreat from Louvre?

Events have moved on since the Louvre. Exchange rates have clearly not been "stable" over the last few weeks. This marks a return to the Louvre principles of working to secure stability.



12. But no US commitment to raise interest rates to defend dollar?

See para 5 of Statement. You will have to wait and see what happens in practice.

13. Are German measures sufficient?

We shall have to wait and see. Root of the German problem is low growth as a result of supply-side weaknesses. Fiscal reflation is not the answer to these problems. Current low interest rates and promised tax cuts will help, but improved supply side performance required. German policies moving in the right direction.

14. Thirty-three international economists say US budget deal not enough?

In general, economists' statement unduly alarmist (large groups of economists not always sensible - 364). Choice not as stark as presented (either on proposed measures or on prospects of a world recession). Chancellor has welcomed US budget deal as going beyond Gramm-Rudman in year 1 and including a second year of further measures. Have to recognise that Americans had very difficult political balancing act to perform: much credit to them that they brought it off.

15. What does paragraph 4 of Statement mean by Germans not seeking "to offset the budget revenue losses arising from recent developments"?

Some indirect tax increases which had been planned as partial offset to revenue losses from tax reductions have been deferred.

16. The Annex says that UK Government "will continue to strive to reduce inflation": is this no longer an aim of policy?

Of course it is. There is no change in UK policy here.



*mpw*



FROM: MISS M P WALLACE

DATE: 21 December 1987

SIR G LITTLER

cc Sir P Middleton  
Sir T Burns

G7

We have told the Chancellor about David Norgrove's letter of 18 December. He sees no need for an immediate response, but will consider the matter when he sees the letter and your draft reply, (sent by box, lunchtime today).

*mpw*

MOIRA WALLACE





*Ministero del Tesoro*  
GABINETTO DEL MINISTRO

Roma, 21 dicembre 1987

CC Sir P. Middleton  
Sir G. Little  
Sir T. Burns

CONFIDENTIAL

To  
The Right Honorable  
Nigel Lawson  
Chancellor of the Exchequer  
H.M. Treasury  
Fax 00441 - 8392029 or 2705653

Encl.n.2

*See Mr Lawson's letter to  
Mr Lawson: out (S.M.)  
to contact (La Spina)*





*Il Ministro del Tesoro*

Roma, 21 dicembre 1987

Dear colleague,

having considered the whole text of our statement,  
I have decided to propose some changes in the section devoted to  
the Italian economy.

Please find the new text in the annex.

With my best regards,

Giuliano Amato

A handwritten signature in black ink, consisting of stylized, overlapping letters that correspond to the name Giuliano Amato.



The Government of Italy, in a context of a continuous significant growth, has taken temporary measures to halt the deterioration of the balance of payments due to a higher rate of domestic demand in Italy than in other industrialized countries. For 1988 the objective embodied in the Finance Bill is to maintain a relatively high level of growth and to reduce inflation, while making further progress in correcting the public sector imbalance.

In the medium term, to alleviate unemployment the Italian authorities intend to achieve satisfactory rates of growth while maintaining the balance of payments current account in substantial equilibrium, to stabilize the debt/GDP ratio and to devote more resources to the financing of productive as well as infrastructural investments, thus improving the quality of public services.



cc: Sir P Middleton  
Sir T Burns  
Sir G Lifford



Treasury Chambers, Parliament Street, SW1P 3AG  
01-270 3000

David Norgrove Esq  
No 10 Downing Street

21 December 1987

Dear David

G7

You wrote to Alex Allan on 18 December about the G7 agreement. There is quite a history to this.

Already in October there were moves within the G7 to try to restore the co-operation which had effectively been damaged during the second and third weeks of that month. Most of the group, including the Chancellor, were thinking in terms of an early G7 meeting and hoping for a reasonably solid agreement. But as bilateral discussions proceeded it became clear: first, that in the common view of the UK, Japan, France, Italy and also (though a little ambivalently) Germany, an effective agreement required a willingness by the US to raise their domestic interest rates (or take other action to finance their external deficit such as foreign currency borrowing); and secondly, that the US were not prepared to accept this condition.

The main task of negotiating on an earlier draft (which covered the points the UK and others believed necessary) was undertaken by Baker and Stoltenberg. On 7 December, in the margins of an ECOFIN meeting, the Finance Ministers of the four European G7 members met and Stoltenberg produced a draft very like the present one as the maximum the US would accept. It was then agreed by the four that such a draft was not good enough for a G7 meeting - indeed it would be better to hold no meeting than one with such a poor outcome. Stoltenberg agreed to try again for two or three key additions and amendments, but offered little hope of success (and this was later shown to be right).

Concern was expressed however that failure to hold a G7 meeting might itself create disappointment and hence market problems. The Chancellor then offered the idea that the statement as it stood, which did record some economic and monetary action of the required kind, might be worth publishing without a meeting. Particularly since G7 meetings have become such media events, it could perhaps be useful to show that consultation was taking place and some relevant action was being taken without the necessity for a meeting. This might also be a useful precedent for the future. The others found this idea attractive - as also did Baker when it was put to him.





The Chancellor continues to see advantage in this arrangement, even though the statement lacks new substance. The idea of a separate understanding about co-operative intervention, intended to operate as soon as the statement has been published, did not emerge until very much later, as a result of discussions between the US, Germany and Japan. On the substantive point the Prime Minister has raised, the Chancellor entirely agrees, and indeed has frequently pointed out, that the need is for the US authorities to be willing to use interest rates to help inter alia to attract the private funds to meet the continued external financing need at current exchange rates. The trouble with letting the dollar find "its own level" is that such a level, if determined solely by a nervous and disappointed market, may in the short term be so slow as to cause a good deal of damage to world economic activity, and set off a legacy of new distortions for the future. None of this would help the UK. While the current US policy posture is far from satisfactory, the fact that they are apparently now ready to intervene in support of the dollar may lead them to take more substantive steps later. Meanwhile, any UK contribution to concerted intervention under this agreement would be minimal.

*Yours sincerely*  
*Jonathan Taylor*

J M G TAYLOR  
Private Secretary



SECRET

*OK as per [unclear]*

*Ch/Content?*

From: Sir G.Littler  
Date: 21 December 1987

MR J M G TAYLOR

*W 21/12*

c.c. Sir P.Middleton  
Sir T.Burns

G7 STATEMENT - P.M.'S VIEWS

*behind* | You will no doubt be sending a copy of Mr Norgrove's letter of 18 December to the Chancellor. I attach a draft Private Secretary reply which he might like to consider.

*[Handwritten Signature]*  
(Geoffrey Littler)

*[Red circular stamp with handwritten numbers and initials]*



SECRET

DRAFT LETTER TO:

David Norgrove Esq  
No 10 Downing Street

G7

You wrote to Alex Allan on 18 December about the G7 agreement. There is quite a history to this.

Already in October there were moves within the G7 to try to restore the cooperation which had effectiv<sup>e</sup>ly been badly damaged during the second and third weeks of that month. Most of the group, including the Chancellor, were thinking in terms of an early G7 meeting and hoping for a reasonably solid agreement. But as bilateral discussions proceeded it became clear: first, that in the common view of the U.K., Japan, France, Italy and also (though a little ambivalently) Germany, an effective agreement required a willingness by the U.S. to raise their domestic interest rates (or take other action to finance their external deficit such as foreign currency borrowing); and secondly, that the U.S. were not prepared to accept this condition.

The main task of negotiating on an earlier draft (which covered the points the U.K. and others believed necessary) was undertaken by ~~Stoltenberg and Baker.~~ <sup>Baker - Stoltenberg.</sup> On 7 December, in the margins of an ECOFIN meeting, the Finance Ministers of the four European G7 members met and Stoltenberg produced a draft very like the present one as the maximum the U.S. would accept. It was then agreed by the four that such a draft was not good enough for a G7 meeting -



SECRET

indeed it would be better to hold no meeting than one with such a poor outcome. Stoltenberg agreed to try again for two or three key additions and amendments, but offered little hope of success (and this was later shown to be right).

Concern was expressed however that failure to hold a G7 meeting might itself create disappointment and hence market problems. The Chancellor then offered the idea that the statement as it stood, which did record some economic and monetary action of the required kind, might be worth publishing without a meeting. Particularly since G7 meetings have become such media events, it could perhaps be useful to show that consultation was taking place and some relevant action was being taken without the necessity for a meeting. *(This might also be a useful precedent for the future.)* The others found this idea attractive - as also did Baker when it was put to him.

The Chancellor continues to see advantage in this arrangement, even though the statement lacks new substance. *The idea of a separate* Germany and Japan *understandings about co-operative intervention,* and the United States also attach importance to the private understandings reached about cooperative intervention, which are intended to operate as soon as the statement has been published, and - although this is also inadequate - the fact that the U.S. *did not emerge until very much later, as a result of discussions between the US, Germany & Japan.* are willing to reach such an agreement may be a hopeful sign for a more effective agreement later.

*(indeed)* On the substantive point the Prime Minister has raised, the Chancellor entirely agrees, *(and indeed has frequently pointed out,* that the need is for the U.S. authorities to be willing to use interest rates to help *attract funds*



SECRET

*The private funds to meet*

at current exchange rates, the continued external financing need

The trouble with letting the dollar find "its own level" is that

such a level, if determined solely by a nervous and disappointed

market, in the short term may be so low as to cause a good deal of damage to world

economic activity, and set off a legacy of new distortions for

the future. None of this ~~will~~ <sup>would</sup> help the U.K. *While the current US*

*policy posture is far from satisfactory, the fact that they are*  
*apparently now ready to intervene in support of the dollar may*  
*lead them to take more substantive steps later. Moreover, any UK*  
*contribution to concerted intervention under this agreement would be*  
*minimal.*

(Jonathan Taylor)



SECRET



10 DOWNING STREET  
LONDON SW1A 2AA

CH/EXCHEQUER	
REC.	21 DEC 1987
ACTION	SIR G. LITTLE
COPIES TO	SIR P. MIDDLETON
	SIR T. BURNS

From the Private Secretary

18 December 1987

*Dear Alex,*

G7

The Prime Minister has asked me to write to record that she disapproves most strongly of the G7 agreement on concerted intervention which is now in prospect. She believes it is simply tinkering and that intervention without policy measures to improve the economic fundamentals will be damaging rather than helpful, as she and Secretary Shultz agreed in their recent conversation. My understanding of her views is that the US should be prepared to raise interest rates. But if they do not, the dollar should be allowed to find its own level.

The Prime Minister was also most concerned that she learned about the possible agreement only at 1800 on a Friday evening. She believes that it must have been at least in the wind for some hours, if not days, and she would prefer to have had an earlier opportunity to express her views.

*Yours,  
David.*

DAVID NORGROVE

Alex Allan, Esq.,  
H.M. Treasury.

SECRET





*Comp Spare I Think*

*Ministero del Tesoro*  
GABINETTO DEL MINISTRO

Roma, 21 dicembre 1987

CONFIDENTIAL

To  
The Right Honorable  
Nigel Lawson  
Chancellor of the Exchequer  
H.M. Treasury  
Fax 00441 - 8392029 or 2705653

Encl.n.2

*Sent to Ch,  
Head out to Geoff.*



prop Spare / Italy



*Al Ministro del Tesoro*

Roma, 21 dicembre 1987

Dear colleague,

having considered the whole text of our statement,  
I have decided to propose some changes in the section devoted to  
the Italian economy.

Please find the new text in the annex.

With my best regards,

Giuliano Amato

Sent to Gh,  
Head out to Geoff



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In the medium term, to alleviate unemployment the Italian authorities intend to achieve satisfactory rates of growth while maintaining the balance of payments current account in substantial equilibrium, to stabilize the debt/GDP ratio and to devote more resources to the financing of productive as well as infrastructural investments, thus improving the quality of public services.

Sent to Ch,

Head out to Geoff





pong Spare I think

Ministero del Tesoro  
GABINETTO DEL MINISTRO

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*purp*

*✓*

*C&A, PM, GWT, M O'connor*

JAPAN SOURCES SEE POSSIBILITY OF G-7 STATEMENT NRME

TOKYO, DEC 17 - MAJOR NATIONS MAY HAVE TO CONSIDER THE POSSIBILITY OF ISSUING A JOINT STATEMENT, IF NEEDED, TO CALM FINANCIAL MARKETS AFTER THE U.S. CONGRESS PASSES A BUDGET CUTTING PACT, GOVERNMENT SOURCES SAID.

FINANCE MINISTER KIICHI MIYAZAWA SAID EARLIER THIS WEEK THAT THE G-7 WOULD REAFFIRM THE LOUVRE ACCORD ON CURRENCY STABILITY, THOUGH HE ADDED THAT HE DID NOT KNOW WHEN OR HOW THAT WOULD TAKE PLACE.

THE SOURCES SAID THE G-7 WOULD PROBABLY NOT MEET THIS WEEKEND, ADDING THIS WAS BECAUSE OF DELAY IN CONGRESSIONAL PASSAGE OF THE PACT.

17-DEC-1121 MON23 MONR

CONTINUED ON - NRMF

F

REUTER MONITOR 1247

JAPAN SOURCES =2 TOKYO NRMF

THE GOVERNMENT SOURCES ALSO SAID IT MAY BE DIFFICULT FOR THE U.S. TO ISSUE FOREIGN CURRENCY DENOMINATED BONDS.

SOME JAPANESE BANKERS HAVE ADVOCATED THEIR ISSUANCE TO HELP PROP UP THE DOLLAR.

17-DEC-1126 MON233 MONR

CONTINUED FROM - NRME

REUTER

F

REUTER MONITOR 1247



**SECRET**

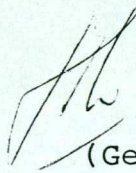
*PMP*  
From: Sir G. Littler  
Date: 21 December 1987

**MR J M G TAYLOR**

c.c. Sir P. Middleton  
Sir T. Burns

**G7 STATEMENT - P.M.'S VIEWS**

You will no doubt be sending a copy of Mr Norgrove's letter of 18 December to the Chancellor. I attach a draft Private Secretary reply which he might like to consider.

  
(Geoffrey Littler)



SECRET

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. SECRET

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The Chancellor continues to see advantage in this arrangement, even though the statement lacks new substance. Germany and Japan and the United States also attach importance to the private understandings reached about cooperative intervention, which are intended to operate as soon as the statement has been published and - although this is also inadequate - the fact that the U.S. are willing to reach such an agreement may be a hopeful sign for a more effective agreement later.

On the substantive point the Prime Minister has raised, the Chancellor entirely agrees that the need is for the U.S. authorities to be willing to use interest rates to help attract



SECRET

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(Jonathan Taylor)



SECRET

Sir G. Lister

cc PPS

## G7 STATEMENT: AWKWARD QUESTIONS

Wd. welcome your early comments  
on this: are they in filing in  
the States! RA. 17/12

## 1. Why the Statement?

To help reassure financial markets by demonstrating that the G7 countries have been working closely together in recent weeks.

## 2. Why no G7 meeting?

Timing not yet right. Taking longer than expected to get all the components of a dollar stabilisation deal in place. But making progress.

## 3. Will there be a G7 meeting early in the New Year?

Yes, I hope so, provided that <sup>conditions are right for achieving agreement</sup> ~~appropriate agreement~~ has been reached with the US on a dollar stabilisation package.

## 4. When will such agreement be reached?

Cannot say at this stage.

## 5. What if the United States refuses to play ball?

Don't accept that this will<sup>1</sup> be the outcome. Working closely with the Americans.

## 6. Surely US right not to take measures which would drive economy into recession?

if any (thing) domestic demand growing too strongly.  
No indication of any downturn in US economy: Rapid dollar depreciation much the more dangerous policy, as UK experience in 1960s and 1970s showed.

## 7. Nothing has been achieved of any value in recent weeks?

Not true. Value of recent policy adjustments in Europe, Japan and the US should not be underestimated.



SECRET

8. Louvre in tatters?

Not true. Statement restates many of the <sup>main</sup> elements in Louvre, eg the commitment to carry forward with economic policy coordination efforts in 1988 under Venice Summit arrangements; and the emphasis on coordinated <sup>in</sup> policy towards reducing external imbalances.

9. But nothing <sup>in Statement</sup> on monetary policy/exchange rates?

Not true. Statement clearly says that monetary policies should continue to be directed towards achieving strong economic growth and price stability, as well as financial market stability. And ~~Statement~~ emphasises the value of more stable exchange rates and the need for Governments to cooperate closely on exchange markets.

10. What is now the right level of exchange rates? No mention <sup>of</sup> ~~of Louvre-form of words:~~ stabilising rates around current levels?

in the Louvre

Not possible to reach an agreement on <sup>exchange</sup> rates without US participation. For the European currencies, the EMS will provide a protection against extreme movements. And UK policy will continue to focus on <sup>prohibiting</sup> ~~achieving~~ maximum stability, particularly against the DM.

11. What prospects that US will eventually agree to dollar stabilisation package?

Cannot say at this stage. UK and other countries will continue to press US authorities for a commitment on dollar stabilisation/interest rates.

12. Are German measures sufficient?

We shall have to wait and see. <sup>Root</sup> ~~Part~~ of the German problem is inadequate growth in domestic demand and massive external surplus. Fiscal reflation on its own is not the answer to these problems. Lower interest rates and improved supply side performance also required. German policies certainly moving in the right direction.



PERUK

13. Thirty-three international economists say US budget deal not enough?

<sup>economists'</sup>  
In general, [Statement unduly alarmist. Choice not as stark as presented (either [proposed measures or [prospects of a world recession). Chancellor has welcomed US budget deal as going beyond Gramm-Rudman in year ~~one~~ and including a second year<sup>or two more years</sup>. Have to recognise that Americans had very difficult political balancing act to perform: much credit to them that they brought it off.

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[ ]

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[ ]

16. What does "more stable exchange rates" (paragraph 8 of Statement) mean? Is this not a retreat from Louvre?

Still working towards re-establishing a firm exchange rate agreement on Louvre lines. This is as far as we can go at this stage.

17. The Annex says that UK Government "will continue to strive to reduce inflation": is this no longer an aim of policy?

Of course it is, over the medium term. But have to recognise that further progress in 1988 will be limited.



SECRET

M

From: Sir G.Littler  
Date: 22 December 1987

MR J M G TAYLOR

c.c. Sir P.Middleton  
Sir T.Burns  
Mr R I G Allen

**G7 STATEMENT**

The Italians have proposed a small revision of the passage about Italy in the Annex, which is acceptable and should therefore be substituted for the earlier version.

2. The text from which we are working is that circulated as an attachment to my minute of 17 December. The sheet attached to this minute should be substituted for page 2 of the annex in that earlier version.



(Geoffrey Littler)



continue to maintain appropriate conditions for sustained non-inflationary growth.

The Government of Italy, in the context of continuous significant growth, has taken temporary measures to halt the deterioration of the balance of payments due to a higher rate of domestic demand in Italy than in other industrialized countries. For 1988 the objective embodied in the Finance Bill is to maintain a relatively high level of growth and to reduce inflation, while making progress in correcting the public sector imbalance.

In the medium-term, to alleviate unemployment the Italian authorities intend to achieve satisfactory rates of growth while maintaining the balance of payments current account in substantial equilibrium, to stabilize the debt/GDP ratio, and to devote more resources to the financing of productive as well as infra-structural investments, thus improving the quality of public services.

The Government of Japan noted that the Japanese economy is in a vigorous expansionary phase, led by domestic demand growth. The Government will steadfastly continue implementing the 6 trillion-yen-plus package decided on last May, and will see to it that in the FY 1988 budget the expenditure for general public works will not be less than that for the FY 1987 budget including the July supplemental.

The Bank of Japan will follow appropriate and flexible monetary policy supportive of non-inflationary growth and exchange rate stability.

The United Kingdom Government, in the context of the British economy's continued vigorous growth of output and domestic demand, coupled with sound public finances, will continue to strive to reduce inflation by pursuing a prudent monetary policy, while increasing its capacity for non-inflationary growth by further measures designed to free the operation of markets and increase the efficient use of resources, including tax reduction and tax reform. Public expenditure will continue to increase less rapidly than the growth of the economy as a whole, and the government will continue to work for the dismantling of barriers to trade both within the European Community and in the context of the Uruguay round of the GATT.

The United States Government has secured Congressional action to implement the agreement between the President and the bipartisan Leadership of the Congress on a two-year package of



A B C PPS 12/2  
POS

KOHL COUNTS ON COOPERATION AMONG G-7 NATIONS NRCL  
BONN, DEC 21 - WEST GERMAN CHANCELLOR HELMUT KOHL, IN A  
NEWSPAPER INTERVIEW, CONFIRMED THE GROUP OF SEVEN (G-7) LEADING  
INDUSTRIAL NATIONS IS WORKING TO STABILISE INTERNATIONAL  
FINANCIAL MARKETS.

"WE (WEST GERMANY) ARE COUNTING ON A CLOSE COOPERATION WITH  
THE UNITED STATES AND OTHER INDUSTRIAL NATIONS, AIMED AT  
STABILISING THE SITUATION ON THE INTERNATIONAL FINANCIAL  
MARKETS," KOHL TOLD THE CONSERVATIVE DAILY DIE WELT.

KOHL ADDED THAT WEST GERMAN FEARS OF AN ECONOMIC RECESSION  
FOLLOWING THE RECENT TURMOIL ON GLOBAL MARKETS WERE UNFOUNDED.

21-DEC-1133 MON964 MONQ

CONTINUED ON - NRCM

P

COMMODITIES - INFO 0541

KOHL COUNTS =2 BONN NRCL

"THE LATEST TURBULENCE ON STOCK AND CURRENCY MARKETS WILL  
CERTAINLY HAVE SOME NEGATIVE IMPACTS (ON THE ECONOMY). BUT THE  
FORECASTS THAT OUR (THE WEST GERMAN) ECONOMY REMAINS ON AN  
EXPANSIONARY COURSE, ARE FAVOURABLE," KOHL TOLD DIE WELT.

BUT WITH REGARD TO CALLS FROM OTHER G-7 COUNTRIES THAT WEST  
GERMANY SHOULD TAKE ON THE ROLE AS THE LOCOMOTIVE FOR THE  
WORLD'S, OR AT LEAST EUROPE'S, ECONOMY, KOHL SAID, "WE SHOULD  
NOT OVER-ESTIMATE OUR (ECONOMIC) ABILITY DESPITE FAVOURABLE  
ECONOMIC DATA."

HE ADDED THAT WEST GERMANY WAS AWARE OF ITS SPECIAL  
RESPONSIBILITY AS ONE OF THE WORLD'S LARGEST ECONOMIES.

21-DEC-1134 MON966 MONQ

CONTINUED ON - NRCM

P

QUOTES - SEE AAGA 1447

KOHL COUNTS =3 BONN NRCL

"I HAVE BEEN TO FIVE INTERNATIONAL ECONOMIC SUMMITS (OF G-7  
MEMBERS) IN THE PAST FIVE YEARS WHERE WE ALL MADE SPECIFIC  
PROMISES (TO BOOST ECONOMIC GROWTH)," KOHL TOLD DIE WELT.

WEST GERMANY HAD KEPT ITS PROMISES, KOHL SAID, REFERRING TO  
MOVES TO CUT TAXES BY 50 BILLION MARKS BY 1990, NOVEMBER'S  
PACKAGE TO BOOST GROWTH BY OFFERING CHEAP LOANS AND THE  
BUNDESBANK'S DISCOUNT RATE CUT TO A HISTORIC LOW OF 2.5 PCT.

"IF ALL (THE G-7 MEMBERS), JUST TO TAKE AN EXAMPLE, HAD  
REDUCED THEIR DEFICITS PUNCTUALLY, WE WOULD BE IN A MUCH  
BETTER POSITION TODAY," KOHL SAID IN THE INTERVIEW.

21-DEC-1135 MON967 MONQ

REUTER

P

QUOTES - SEE AAGA 1447



Part

23 December 1987

STATEMENT OF THE GROUP OF SEVEN

1. The Finance Ministers and Central Bank Governors of seven major industrial countries have conducted close consultations in recent weeks on their economic policies and prospects in light of developments in financial markets. They reaffirmed their conviction that the basic objectives and economic policy directions agreed in the Louvre Accord remain valid and provide for a positive development of the world economy. They will continue to carry forward their economic policy coordination efforts in 1988 under the arrangements endorsed at the Venice Summit.
2. The Ministers and Governors reemphasized their view that the major external imbalances in the world economy must be corrected. The policies which have been implemented this year are gradually showing the intended effects. In particular, the balance between domestic demand and output in the United States and in Japan and the Federal Republic of Germany has shifted in a direction which promotes external adjustment and in volume terms their trade imbalances are diminishing. The greater stability of exchange rates achieved for much of the past year, following the earlier substantial exchange rate changes, contributed to this adjustment. The marked exchange rate changes over the past few weeks, however, stress the need to strengthen underlying economic fundamentals and to continue policy cooperation.
3. Developments in stock markets since mid October may have some adverse effect on prospects for economic growth for the industrialized countries as a group. The Ministers and Governors believe, however, that with sound economic policies and effective coordination the rate of growth should be substantial. To this end they agreed that appropriate policies for strengthening non-inflationary growth in their countries are necessary.
4. Accordingly, the Ministers and Governors agreed to intensify their economic policy coordination efforts. Their common efforts are directed towards reducing external imbalances. In particular, the United States has secured Congressional action to implement the agreement between the President and the bipartisan Congressional Leadership on a two-year package of additional budget savings that will reinforce progress in reducing the budget deficit. Japan has implemented a major stimulus program to strengthen domestic demand and will see to it that in the FY 1988 budget the expenditure for general public works will not be less than that for the FY 1987 budget including the July supplemental. The Federal Republic of



- Germany is supplementing the previously announced increase in tax reductions in 1988 with new measures to increase investment and will not seek to offset the budget revenue losses arising from recent developments. There have also been coordinated reductions in interest rates in Europe which should contribute to the expansion of domestic demand and reduce trade imbalances. The specific policy intentions and undertakings by each country are set forth in the annex to this statement.
5. The Ministers and Governors are of the view that the recent monetary policy decisions and the reduction of interest rates in some countries were appropriate and will contribute to a restoration of stability to financial markets. They agreed that monetary policies should continue to be directed towards providing adequate monetary conditions to achieve strong economic growth in the context of price stability as well as to foster financial market stability.
  6. The Ministers and Governors strongly rejected protectionist measures as a means of dealing with present imbalances. Protectionism constitutes a direct and serious danger to world prosperity and equilibrium and would have harmful consequences for those countries which resort to it. They reaffirmed their determination to fight protectionism and to promote an open world trading system.
  7. The Ministers and Governors believe that the reduction of world trading imbalances requires cooperative action by other countries, particularly those with surpluses. They expressed particularly serious concern that some newly industrialized economies have failed to take adequate action to deal with large and growing trade surpluses which are exacerbating global imbalances and fostering protectionist pressures. They urged the newly industrialized economies to implement without delay trade and exchange rate policies that will facilitate the reduction of excessive trade surpluses and allow their currencies to fully reflect the strong competitive position of their economies.
  8. The Ministers and Governors agreed that either excessive fluctuation of exchange rates, a further decline of the dollar, or a rise in the dollar to an extent that becomes destabilizing to the adjustment process, could be counter-productive by damaging growth prospects in the world economy. They reemphasized their common interest in more stable exchange rates among their currencies and agreed to continue to cooperate closely in monitoring and implementing policies to strengthen underlying economic fundamentals to foster stability of exchange rates. In addition, they agreed to cooperate closely on exchange markets. The Ministers and Governors stressed the need for consistent and mutually supportive policies and believe that the measures being taken



will accelerate progress towards the increased, more balanced economic growth, and sustainable external positions necessary for greater exchange rate stability.



## Annex

### Policy Intentions and Undertakings

The Government of Canada's fiscal strategy has succeeded in achieving a drop in the rate of growth of its spending and substantial, on-going declines in the budget deficit. Marked progress has been made in slowing the growth of debt, and towards the medium term objective of stabilizing the debt-to-GDP ratio. Fiscal restraint has been accompanied by impressive growth of domestic demand, output and employment. Major structural initiatives directed at enhancing competitiveness and the underlying potential of the economy have been undertaken, particularly tax reform and the negotiation of a free trade agreement with the United States. Monetary policy remains geared to non-inflationary growth in a climate of orderly exchange markets.

The Government of France has fully met its commitment to reduce its fiscal deficit and tax burden. The fiscal deficit will be reduced by 0.8% of GNP from 1986 to 1988. Over the same period of time, tax cuts will amount to 1.3% of GNP. A further reduction of 45 billion french francs in the fiscal deficit and an additional 45 billion french francs in tax cuts are scheduled in a 1989-1991 three year program which constitutes the long term strategy of the government and will be implemented in the yearly budgets. The privatization program decided upon in early 1987 is being carried out, and its initial objectives have even been surpassed. The full implementation of the program will be resumed as soon as market conditions permit.

The French Government will continue to pursue its adjustment and liberalization policies. New measures to sustain household savings, develop financial markets and improve the competitiveness of firms have been taken. Additional steps will be taken in the same direction in 1988.

The Government of the Federal Republic of Germany has increased the amount of the tax reductions for 1988 and beyond to about 14 billion DM, and will not seek to offset the budget revenue losses arising from recent developments. In addition, the necessary decisions have been taken for the structural tax reform with a further net tax reduction of 20 billion DM from 1990 onward.

In order to strengthen private and public investment, the Federal Government will provide special loans for the next 3 years of about 21 billion DM under preferential conditions. Moreover, it will accelerate investment in telecommunication infrastructure and take initiatives for further deregulation of markets.

The Bundesbank has reduced short-term interest rates substantially during the last few weeks. Monetary policy will



continue to maintain appropriate conditions for sustained non-inflationary growth.

The Government of Italy, in the context of continuous significant growth, has taken temporary measures to halt the deterioration of the balance of payments due to a higher rate of domestic demand in Italy than in other industrialized countries. For 1988 the objective embodied in the Finance Bill is to maintain a relatively high level of growth and to reduce inflation, while making progress in correcting the public sector imbalance.

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The United States Government has secured Congressional action to implement the agreement between the President and the bipartisan Leadership of the Congress on a two-year package of



budget savings to reduce the U.S. budget deficit. This agreement provides for total budget savings, through a combination of spending restraint and increased taxes, in fiscal 1988 and 1989 of approximately \$76 billion.

The budget agreement is part of an ongoing process of deficit reduction provided for under the revised Gramm-Rudman-Hollings legislation. It will reinforce the progress already achieved in reducing the deficit (including a fiscal 1987 cut of \$73 billion or 1.9 percent of GNP) that has brought the deficit down to 3.4 percent of GNP from a peak of 6.3 percent.

The Administration will also continue to oppose steadfastly protectionist trade measures, while working for legislation authorizing negotiations to foster a more open and fair system for the international exchange of goods, services and investment.