48

Safe keep [illegible] Let the Chancellor [illegible] done [illegible] record [illegible] Whether he has asked [illegible] should be sent to me. Transcripts of [illegible] conversations – record [illegible] the [illegible] telegrams [illegible]

PRIME MINISTER

Attached are the telegrams reporting yesterday's meetings in Brussels on currency. There is no report of the restricted meeting, which was attended only by the Chancellor of the Exchequer and the Governor.

Mr. Hunt tells me that the Chancellor of the Exchequer is pleased with the outcome of the meeting. Relationships among the European Finance Ministers have, in his view, never been better. Our difficulties are well understood. It was clear that there was no prospect of achieving the grand design. In the circumstances, he feels, the outcome is satisfactory for us.

It is also satisfactory for the French and German Finance Ministers. The French have secured the objective of an upward revaluation of the DM, coupled with the right to retain their two-tier market so that the financial franc is not fixed by the new arrangement. The Germans have not been forced to float alone, and have not been obliged to pay too high a price for a Community float.

But there are other aspects of the affair which are disquieting. Mr. Hunt tells me that there was a notable lack among financiers present, both at Ministerial and at official level, of any sense of the wider political implications. Indeed, the Finance Ministers tended to brush these on one side. The Finance Ministers tend to be no less a specialist club than the Agricultural Ministers, and it is becoming increasingly clear that we need to find some means of bringing them more closely into the political ensemble.

I think that it is likely to be Treasury policy that sterling should continue to float throughout this year and much of next year. They foresee a steady deterioration in the balance of payments, and fear that fixing during that time would simply lead to early speculative runs on sterling. If we fix, and we are then forced to devalue, we experience another round of J-curve effects; and of course these effects would be worse if, as a result of our joining Community arrangements, the sterling rate had been dragged up in the meantime. If one is to justify fixing at an early date, one has either to show that the Treasury forecasts are probably wrong, or to show that the other consequences of failing to fix are so serious as to justify fixing, despite the risks, or to make arrangements which minimise the risks. In practice, one presumably needs a combination of the three approaches.

We have probably managed to minimise the consequences of not going into the Community arrangements this weekend. But the longer we stay out, the greater the damage will be. From this point of view, I should have thought that the ideal course was to refix before 30 June 1973, by which date wider support arrangements are supposed to be agreed. It is possible that we could be in a position where we could refix plausibly at that point, if by then Phase II of the counter-inflation policy is securely established and industrial action against it is no longer dominating the headlines as it is now.

If we want to be able to do this, however, we ought also to be considering very seriously what action can now be taken to improve the balance of payments prospects in the medium term. The increase in interest rates should help. But it is for question whether there should be more direct action, possibly by means of operations on Government expenditure overseas.

I attach a draft minute to the Chancellor of the Exchequer which might form a basis for an early discussion with the Chancellor and his senior advisers on where we go from here.

RA

12 March, 1973