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RECORD OF A CONVERSATION BETWEEN THE PRIME MINISTER AND THE CHANCELLOR
OF THE FEDERAL REPUBLIC OF GERMANY AT SCHLOSS GYMNIICH ON THURSDAY,
1 MARCH 1973 AT 5.35 P.M.

Present:

Prime Minister	Herr Willy Brandt
Mr. R.T. Armstrong	Herr Schilling
	Herr Heinz Weber

Foreign exchange situation

The Federal Chancellor, after welcoming the Prime Minister, said that he would have to break off his conversation with the Prime Minister at about 7.00 p.m. to hold a meeting of his Finance Committee to discuss the foreign exchange situation. During the day the Germans had taken in \$2.7 billion. The Dutch had taken in more than \$500 million by 3.00 p.m. The French and the Danes had also been taking in dollars. The situation with which we were now confronted was one which he had expected might come six or eight months after the settlement reached three weeks ago; he had not expected the crisis to come so soon. The question now was what degree of concerted action the Community countries could take. He understood that the Commission was sitting in Brussels, and might recommend an early meeting of Finance Ministers. He was sure that over the weekend there would need to be contact between the British, the French and the German Governments and between the three of them and the rest of the Community. It might perhaps be helpful if the Prime Minister and he had some discussion of the matter immediately, and then resumed their discussion after dinner with experts, in the light of the decisions taken by his Finance Committee.

CONFIDENTIAL

CONFIDENTIAL

- 2 -

The Chancellor said that the Finance Committee had to decide whether to close the German exchange markets the following day, or to stay open and to take the risk of being obliged to take in a further very large amount of dollars. He himself would prefer an arrangement reached by agreement with other Community countries whereby the German and other European exchange markets were closed. He feared that, if the Germans closed their exchange markets by themselves, it might give rise to expectations that they were about to revalue the Deutschemark or to float on their own. There could now be a chance of a joint European float. He realised that the French did not like the word "float", but he thought that they were prepared to agree to an arrangement which was in effect the same thing. The Chancellor also recognised the problems facing Britain and Italy. He suggested that it might be possible to combine a joint float with special measures to take care of the problems of Great Britain, or to set up a joint floating arrangement without Britain and Italy, on the basis that Britain and Italy would come into them later.

* The Prime Minister said that decisions on the action to be taken depended partly on the explanation for the resumption of the massive movement of dollars. He could see no reason for the moves in the underlying economic situation of the United States or in that of Germany. Not enough time had elapsed since the changes three weeks ago for it to be established that these changes were insufficient to deal with the problems they were designed to resolve. He was therefore driven to the conclusion that the object of the movements was purely speculation. The Chancellor interjected that the money was coming from many quarters but mainly from the United

CONFIDENTIAL

States itself. The Prime Minister supposed that this reflected domestic lack of confidence in the United States, and readiness to move into Deutschemark, guilder, kroner or even sterling - wherever they thought they could make some money as a result of a joint Community float. If Community countries were going to stop speculative movements, they had either to hold out and beat the speculators or to find some way of protecting themselves.

The Chancellor said the Governor of the Bundesbank was still ill, but had expressed his opinion. He thought that it was right to meet the challenge, keep the markets open and take in whatever amount of dollars this involved. No doubt from the point of view of the central banker this made sense. From the political point of view it did not seem to make sense to take on this fight, which was likely to be interpreted as a fight with the United States.

The Prime Minister supposed that in that event the Germans would have to take steps to identify the movements, isolate them so far as possible from having an impact on the domestic economy, and discourage them by negative interest rates and other measures. He did not think that President Nixon would interpret this as a fight with the United States. The President had certainly been very relaxed when the Prime Minister discussed these problems with him in Washington; but that was at the beginning of the last episode, and he had not succeeded in holding the dollar. That episode had started because the U.S. Administration had announced a \$6 billion deficit in their balance of trade, and had at about the same time announced Phase III of their pay and prices policy. There was no doubt that domestic opinion thought that the move to Phase III was

CONFIDENTIAL

- 4 -

premature, and that inflation in the United States was likely to get worse as a result.

The Chancellor remarked that the French Government would not want the Germans to take a unilateral decision. On the other hand it would be difficult for the French Government themselves to make any move two days before their elections.

The Chancellor asked whether, if this new difficulty had not developed, Britain would have needed more than six months to achieve a situation in which the parity could be refixed. The Prime Minister said that it was difficult to say. The best judgment he could make was that it would have probably taken longer than that. The consequence of the fall in the exchange rate since sterling floated in June 1972 had been an immediate rise in the value of imports, while the volume of exports had not yet begun to respond. This was the familiar 'J' curve. Moreover the British economy was only now beginning to respond to the measures which had been taken to stimulate growth. That growth was now coming through, and joining the Community should bring further benefits. We were also, as the Chancellor knew, going through a period of industrial trouble. It was clear that the Trades Union Congress did not want to go to the brink, but there was a certain amount of sporadic trouble, though it was less serious than might appear from the television and the newspapers. The legislation for the Government's Counter Inflation Programme was now through the House of Commons. Once this was through and we were able to move into Phase II of the Counter Inflation Programme, and once we were through this period of industrial trouble, the sterling rate could be expected to rise and that would help in keeping down prices. But we did not want

to refix the parity, and then within a short time be faced with a situation in which we had once again either to borrow large amounts in order to support the rate or to abandon the parity again. That would do the greatest possible damage, not only to us but to the Community.

The Chancellor asked whether Britain would be able to contemplate a combination of fixed parities between the Community countries, plus a certain amount of assistance for sterling and the lire, plus a common float; or, if that was not possible, whether we could consider some combination of two out of these three elements. The Prime Minister remarked that, after the last episode three weeks ago, there had been discussions at Basle between Dr. Emminger and Sir Leslie O'Brien, in which they had concluded that the Community could not yet make a joint float work because it had no machinery for the purpose. That machinery still did not exist; but he did not exclude the possibility which the Chancellor had outlined, or the possibility of some arrangement whereby the rest of the Community would go for a joint float, on the basis that Britain and Italy would come in later. The Chancellor said that, if the Germans decided not to close their exchange markets, they would have to introduce very heavy controls (the word he used was "dirigisme"), which they had the power to do. Looking at possible solutions, he thought that the Dutch would be prepared to go along with the Germans. It would be difficult for the French Government to make any move, because of their elections; but they would hate the Germans moving without them. He thought that Finance Ministers should in any case meet during the weekend, probably in Brussels. The Prime

CONFIDENTIAL

- 6 -

Minister said that on this occasion it would clearly have to be a meeting of Finance Ministers of the Nine. The Chancellor agreed, though he said that the British, French and German Finance Ministers could no doubt meet privately beforehand.

The Chancellor went on to say that the French Government might, even at this time, find it not impossible to contemplate action on a European basis, which would be a popular thing to important elements in the French electorate. As far as he himself was concerned, he would not hesitate to take action which was contrary to what the German Government had said three weeks ago, if it was part of a European decision. In the last episode, the German Government had been content that the upshot was that there had been no significant changes in the currency arrangements between Community countries; but he would not hesitate to accept changes in the context of a joint Community policy which would help to stabilise the situation.