

Prime Minister 1



Agree the Chancellor's proposals for further relaxing exchange

Yes *ms*

Treasury Chambers, Parliament Street, SW1P 3AG controls?

01-233 3000

(He wants to discuss them with the Commission tomorrow, Tuesday)

PRIME MINISTER

EXCHANGE CONTROLS

TZ 9/7

I refer to my minute of 23rd May in which I described the proposals for exchange control relaxation that were subsequently announced in the Budget Speech.

2. The strength of sterling since the Budget partly reflects the effect on confidence of the Government's determination to squeeze inflation out of our economy by firm monetary discipline and strict control over public expenditure. It may also owe something to the high level of sterling interest rates, which are necessary to maintain monetary control. But it is mainly due to our favourable position as an oil producer at a time of rising oil prices. The effective rate for sterling today is over 70.5, an increase of some 4 per cent since the Budget. We spoke last night about the extent to which this is causing anxiety about the effect on competitiveness; the CBI will raise this matter when we see them later today.

3. At the time of the Budget I had planned to announce a second package of exchange control relaxations in October. As I mentioned last night, I still regard as valid the arguments (which I explained in my minute of 23rd May) for making relaxations one step at a time. But the recent strong upward pressure of demand for sterling does enable me to bring forward the October package. I therefore plan to make a new announcement on 19th July.

Flag A

/4. Exchange



4. Exchange control notices are now being prepared to implement the following relaxations:-

(i) Unlimited official exchange for all securities denominated in EEC currencies.

(ii) Unlimited official exchange for investment in the bonds of international organisations of which the United Kingdom is a member, including those issued by Community institutions.

(iii) Permission to repay with official exchange all foreign currency borrowing taken out for portfolio investment one year or more before the date of the announcement.

(iv) Unlimited official exchange for outward direct investment.

5. Items (i)-(iii) constitute, in combination, a substantial first step in the relaxation of our controls over portfolio investment. It would not be possible in July to abolish controls on portfolio - a good deal more work will have to be done on the technical consequences of such a move before we are in a position to implement it. In any case, as I said earlier, I believe that the arguments for proceeding one step at a time remain valid.

6. The choice of securities denominated in EEC currencies as the first main block of securities which UK investors will be free to buy with official exchange will clearly please the Commission. The Americans on the other hand will be disappointed. Mr. Blumenthal expressed his satisfaction with the fact that my Budget package removed most of the elements in our controls which discriminated in favour of the Community. But I propose to write to him before the announcement and assure him that it is our intention to move steadily towards complete freedom for

/UK residents



UK residents to invest in securities denominated in any currency, including the dollar.

7. The international organisation bond proposal will also meet a point raised by the Commission - Mr. Ortoli hoped that I would be able to include such a relaxation for the bonds of Community institutions in the Budget package. The relaxation will also apply to the bonds issued by other international organisations including those that help the developing countries such as the World Bank. We shall therefore be able to take some credit for this change in discussions both at home and abroad about our relations with the developing countries; and this might have some modest value in counteracting the disappointment caused by cut-backs in our aid programme.

8. Many institutions do not like being obliged to borrow foreign currency to buy securities without paying the premium and will welcome the opportunity to repay with official exchange borrowing outstanding for a year or more. Taking this step now should also reduce the size of the outflow that will result from the abolition of the remaining controls over portfolio when we are able to do that.

9. The fourth constituent of the package is to give unlimited official exchange for outward direct investment - i.e. to increase the £5 million ration included in the Budget package to permission to use official exchange for direct investment at will. It might seem a bit soon to change policy within a few weeks of the Budget. But given the strength of sterling I do not think anyone will be very surprised and I will be able to explain that the continued strength of sterling permitted me to bring forward the time at which it was possible to complete the dismantling of controls over the financing of outward direct investment. The TUC reaction to the Budget package has been rather muted and this further step is unlikely to make much difference to their attitude. The CBI will obviously be very pleased.

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10. I know you agree that it is appropriate to accelerate our planned programme for the dismantling of exchange controls along these lines. Although the ^{rumour} ~~removal~~ of this relaxation is said to have had some downward effect on Friday, we cannot be sure that the announcement will reduce pressure on sterling in the short term. Indeed, it is still possible that the immediate effect could be to drive the rate up because this reaffirmation of the Government's intentions may make sterling seem an even more attractive currency to hold. But in the longer term we would expect the relaxations to result in capital outflows and to cause the exchange rate to be lower than would otherwise be the case. Perhaps even more important, dismantling these controls will improve the functioning of the markets and give investors greater freedom of choice. The combination of these new relaxations with those already announced in the Budget will constitute a very big step in the direction we all want to go.

11. I am sending copies of this minute to the Secretaries of State for Foreign and Commonwealth Affairs, Industry and Trade, to the Governor of the Bank of England and to Sir John Hunt.

G.H.

(G.H.)

July, 1979

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