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EUROPEAN MONETARY SYSTEM
Brief by H M Treasury

OBJECTIVE

1. To avoid ambitious declarations about early progress in 'developing' the European monetary system (EMS), since the reality is that nothing of significance is practical for the foreseeable future (Germans likely to take the lead in this sense).

POINTS TO MAKE

2. Convergence of economic performance is key to currency stability and well-being of EMS. Recent pressures resulting in 12 June realignment demonstrated this; the realignment conference rightly placed emphasis on economic measures accompanying the central rate changes agreed.

3. Best to acknowledge that the search for technical improvement to EMS mechanisms of a kind which would have real significance for the working of the system, has failed for the time being. Can be pleased about the EMS's achievements in the face of recent pressures and need not at present attempt new developments.

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4. (Sterling and the EMS). Position is kept under review. Certain features of sterling - international position as widely traded currency, oil effects etc - set it apart from other EMS members. With our difficult economic history important for the UK to give first priority to achieving lasting success in control of inflation.

BACKGROUND

5. The March European Council asked Finance Ministers to report on the scope for non-institutional developments in the EMS. Finance Ministers have completed their considerations, although there will be no written report to the European Council, and the topic may not be discussed. If it is, we can leave others to make the running.

6. It has been acknowledged by all Finance Ministers that there is currently no hope of reaching agreement on changes to the EMS of any significance. At their informal meeting on 17 May, Finance Ministers heard from the chairmen of the Monetary Committee and the Committee of Central Bank Governors, which had both discussed an ambitious draft resolution proposed by the Commission, that there was no scope for anything of this kind. The Germans in particular had difficulties with many of the Commission's specific proposals, eg for changes to the ecu acceptance limits and the rules for intra-marginal intervention. There was also a general feeling even among those keenest to see progress that the current exchange market position was not conducive to ambitious further development of the EMS. All Finance Ministers accepted that they had to endorse these conclusions.

7. The Belgians, the French and the Commission (Ortoli) still hanker a little after some further developments to the EMS. They may seek to persuade their European Council colleagues to call for further work by Finance Ministers and officials. No purpose would be served by such a request, as the options have been thoroughly ventilated in the last six months. Given the strains which have recently been placed on the system, it is extremely unlikely that the Germans will agree to any significant technical changes in the immediate future.

8. As to sterling's membership of the EMS, there have been few recent suggestions that we should join quickly. Indeed there have been signs that some members are relieved at our absence given the recent buffetings within the system. We have continued to state that we keep the position under review, and to point to the exceptional characteristics of sterling which make it difficult to join in present circumstances.

9. The EMS exchange rate mechanism has faced recurring strains since shortly after the previous realignment in February. Following several days of heavy market intervention by the French authorities the 12 June realignment conference agreed devaluations of the French franc by 5.75 per cent and the Italian Lira by 2.75 per cent, while the Deutschemark and Dutch Guilder were revalued by 4.25 per cent. Since 12 June the EMS currencies have traded quietly.

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10. The French franc has now been devalued by over 18 per cent against the Deutschemark since last summer. The French have taken policy measures designed to reduce expenditure, tighten economic policy and lower inflation. These measures should ensure at least a temporary period of calm for the franc. Whether they will achieve their objective or be accepted by the market as sufficient remains to be seen. Current sentiment in the foreign exchange markets is that until inflation rates (particularly in France) are perceived to be converging more EMS realignments will be inevitable.

H M Treasury
15 June 1982

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