



Treasury Chambers, Parliament Street, SW1P 3AG

01-233 3000 15 December 1981

Michael Scholar Esq
Private Secretary
Prime Minister's Office
No.10 Downing Street
LONDON SW1

Dear Michael,

PRIME MINISTER'S MEETING WITH SIR S WARBURG AND
DR GUTH, FRIDAY, 18 DECEMBER

... As you requested in your letter to Peter Jenkins
of 20 November, I attach briefing material for
this meeting. The passage on European Union was
contributed by the FCO.

Yours sincerely,

Jill

JILL RUTTER
Private Secretary

PRIME MINISTER'S TALK WITH SIR SIGMUND WARBURG AND DR GUTH
18 DECEMBER 1981 AT 4.30 P.M.

Introduction

This is to be a short meeting. Sir Sigmund Warburg has suggested that one of the subjects for discussion might be Anglo-German relations within the EC.

General

2. Essential facts about the German economy are given at Annex 1.

European Council

3. The outcome of the recent European Council will be fresh in the Prime Ministers's mind. It is disappointing that the UK and Germany have not formed a more united front on the crucial budgetary issues in the Mandate, despite our common interest as the sole net contributors to the Community Budget. There are signs that the Germans still revert to the old Franco-German alliance at key moments in Community negotiations on the Mandate, budget and CAP.

4. At the Council the UK gave a general welcome to the German/Italian proposals for a 'European Act'. Their draft document will now be discussed by the Community's Foreign Ministers. A more detailed background note on this initiative is at Annex 2.

European Monetary System

5. The standard brief on sterling's participation in the exchange rate mechanism is attached at Annex 3.

Eastern Europe and German Banks

6. If time permits the Prime Minister might ask Dr Guth how he expects German banks to act in response to current fears about the creditworthiness of Eastern European countries where they have a high exposure. A brief is attached at Annex 4.

Warburg and Paribas Not to be raised

7. Finally the Prime Minister may wish to note the problems that Warburg's are experiencing following the French moves to nationalise Paribas. These two banks are currently linked by a complex series of shareholding relationships in both Europe and the USA. But following the French nationalisation measures Warburgs wish to dissolve this relationship whilst remaining on good business terms with Paribas. The situation is obviously delicate. We understand that Warburgs are in the process of negotiating a deal which would give them full ownership of their operations in America but allow the French ownership of their current European interest. (The Prime Minister should not herself raise this matter as details have been given to the Bank of England in confidence).

THE GERMAN ECONOMY

1. The second oil shock has hit Germany much harder than the first. The recession in 1975 was shortlived. Growth between 1976-1979 averaged about 4 per cent a year. This time round the recession is longer, the current account has gone deep into deficit, unemployment is rising rapidly and there are fears that the economy may have shifted onto a permanently lower growth path. The difference in the German experience second time round is probably due to the expansionary policies Germany was following when oil prices started to rise. A gradual return to internal and external balance can now be discerned. The budget and current account deficits should both fall next year, modest growth of about 1 per cent is expected, inflation should decline and the Dmark strengthen. Relative to its trading partners, except Japan, therefore Germany is still doing well.

2. Nevertheless the economic situation has had severe political repercussions. Significant divisions in the Social Democrat party as well as between the Social Democrats and their Free Democrat coalition partners were revealed when it came to cutting the automatic increase in the 1982 budget deficit due to the recession. The fortuitous achievement of massive profits by the Bundesbank which can be transferred to the Government has helped paper over the cracks. But if the Government's economic assumptions are still too optimistic as the five major economic institutes report suggests, and the number of unemployed rises above the Government's own forecast of 1.6 million, further cuts may have to be made if the budget deficit is to be contained. Chancellor Schmidt may find it difficult therefore to appease the left-wing of his own party as well as keep the coalition together.

RECENT ECONOMIC DEVELOPMENTS AND PROSPECTS

3. GNP declined slightly in the first half of 1981 after falling about $\frac{1}{2}$ per cent in the second half of 1980. A more severe downturn was avoided by a strong export performance which compensated partly

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for very depressed domestic demand. The five institutes expect no significant upturn in the economy until the middle of next year. The unemployment rate was about 6 per cent in September. The number unemployed has increased from about 1 million to 1.4 million over the last year. The Government expects it to rise from 1.4 to 1.6 million next year but the five institutes expect it to be higher.

4. Consumer prices increased by nearly $6\frac{1}{2}$ per cent in the year to September. This acceleration mainly reflects higher import prices because of the weak Dmark earlier in 1981. The original forecast was for consumer price inflation of less than 5 per cent in 1981. It is now likely to average about 6 per cent. A decline, perhaps to around $4\frac{1}{2}$ per cent, is expected next year as the Dmark's recent and prospective appreciation works through. The FRG's underlying inflation performance remains good. This year wage settlements averaged about $5\frac{1}{2}$ per cent despite unusually bitter and lengthy negotiations.

5. The current account deficit in 1980 was the largest in the OECD at DM28bn (£6 $\frac{1}{2}$ bn). Improving price competitiveness due to the Dmark depreciation has boosted German export performance this year. The volume of exports increased nearly 17 per cent in the year to September. This should bring about a decline in the current deficit this year to perhaps DM24 bn. The European Commission expect it to fall to around DM 7 bn in 1982 although the five institutes are less optimistic.

6. A deteriorating current account and a rising interest rate differential against the U.S. resulted in a sharp weakening of the Dmark from the beginning of 1980 to August 1981. The dollar rate went from about DM 1.70 in January 1980 to DM 2.5 in August 1981. Its effective exchange rate fell 13 per cent in the same period. Falling U.S. interest rates and market perception of the return to internal and external balance have since resulted in an appreciation of the DM rate to around DM 2.20. In October the DM was revalued 5 per cent in the EMS. The five institutes and the European Commission expect this appreciation to continue next year.

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POLICY DEVELOPMENTS

7. The 1981 budget deficit will be larger than originally planned at around DM 34bn because of the effects of the recession. The Government has with great difficulty agreed to reduce this to DM26½bn in 1982, through spending cuts, cuts in tax allowances, subsidies and transfers. Very soon after the budget was thought to have been settled, gloomier economic prospects brought to light a DM 7.8bn (£1.9bn) increase in the deficit. This was plugged by the transfer of more profits from the Bundesbank to the Government, the raising of unemployment contributions and a further DM 1bn cut in planned spending.

8. The expected improvement in the budget deficit and current account as well as falling U.S. interest rates should increase the Bundesbank's scope to lower interest rates without undermining the DM. Monetary policy was relaxed for the first time in two years at the beginning of October when the special Lombard rate was reduced one per cent to 11 per cent.

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EUROPEAN UNION

The draft 'European Act' was circulated to the Ten in October by the German and Italian Governments. Its central proposals are to unify the Community and political cooperation under the European Council, expand the role of the European Parliament, enable the Ten to coordinate policy on security questions, create Councils of culture and justice, and permit the Community to make more decisions by majority vote. If approved as it stands, it would require the preparation within five years of a new treaty among the Ten. The Ten have not yet begun to look at those proposals in detail.

We have given a general welcome to this initiative motivated as it is by a desire to impart renewed momentum to Community development.

STERLING AND THE EMS

We fully support the EMS as an important step in monetary cooperation and towards closer integration in the Community. We are members of the system, deposit 20% of our gold and dollar reserves in the European Monetary Cooperation Fund and participate fully in Community discussions on the possible future development of the system. We welcome the exchange rate arrangements as a contribution to stability in the exchange markets. We have repeatedly made it clear that we will join the exchange rate arrangements when conditions are right for the system and ourselves.

Defensive

2. We do not yet feel able to join the exchange rate mechanism; but it is a matter we keep under constant review as circumstances change.

Defensive (if pressed further)

3. Over the two and a half years since the EMS began there have been strong pressures on sterling of a different nature from those on other Community currencies. As one of the 4 or 5 major world currencies backed by highly developed domestic financial markets sterling is particularly susceptible to such pressures. For example over the first 6 weeks of this year sterling rose against the deutschemark by 8%; and since then

it has fallen by nearly 20 per cent.

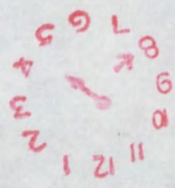
4. Clearly as the UK rate of inflation comes down and stays down, as the balance of payments of the major economies complete their adjustment to the 1979/80 oil price rises, and as the prospects in the oil market continue to settle then the balance of arguments will shift towards UK membership.

EASTERN EUROPE AND GERMAN BANKS

There are fears that a default or a declaration of a moratorium on its external debt by Poland might lead to a domino financial collapse spreading to other Eastern European countries (other than USSR). Romania and Yugoslavia are already in financial difficulties. The convertible currency debts of these countries are estimated at nearly \$80 billion at the end of 1980. We think this domino scenario unlikely, particularly if Western governments and commercial banks address the problems of each country individually rather than as a group.

The major British banks are likely to be able to absorb the effects of balance of payments problems in these countries without undue difficulty. But some large German banks are understood to have a high exposure in Eastern Europe. Decisions on these debts must be a commercial matter for the banks concerned. But it is not likely to be in the banks' own interests to take precipitate action (eg by a sharp reduction in exposure) which would increase the prospect of default and put at risk all their present exposure.

It would be useful to seek the views of Dr Guth on the dangers he may see of any banks, either German or in other countries, taking individual action which could prejudice banking interests generally and how the banks could best protect themselves from a runaway situation.



15 DEC 1981



10 DOWNING STREET

From the Private Secretary

20 November 1981

The Prime Minister has agreed to have a short general discussion with Sir Sigmund Warburg and Dr. Wilfried Guth (who is one of the two heads of Deutsche Bank A.G., Frankfurt) on Friday 18 December at 4.30 p.m. Sir S. Warburg has suggested that one of the subjects for discussion might be UK/German relations within the EEC.

I would be grateful for a short brief on any particular points of which you feel the Prime Minister should be aware, if possible by Friday 11 December.

I am copying this letter to Roderic Lyne (FCO).

M. C. SCHOLAR

Peter Jenkins, Esq.,
HM Treasury.

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5th November, 1981.

Dear Miss Stephens,

I refer to our yesterday's talk on the telephone and hereby confirm that Sir Siegmund Warburg will bring Dr. Wilfried Guth, who is one of the two heads of Deutsche Bank A.G., Frankfurt, to meet the Prime Minister on Friday, 18th December, at 4.30 p.m. Sir Siegmund will be attending the meeting jointly with Dr. Guth.

If this is agreeable to the Prime Minister, the subjects to be discussed will - in line with the last talk between the Prime Minister and Sir Siegmund - be:

British/German relations within
the European Economic Community
and altogether the question how
Britain and Germany jointly could
improve the organism of the European
Economic Community.

Yours sincerely,

Doris Wasseman

Secretary to Sir Siegmund Warburg.

Miss Caroline M. Stephens,
10 Downing Street,
London, S.W.1.

DW

SECRET
NOV 1951

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NOV 1951

25th November, 1951

Dear Sir,

I refer to our recent day's call on the telephone and
very cordial that the British Government will be sending
one of the two heads of Delegation to the United States
the same Minister as the one who is going to the United States
will be attending the meeting in London. The subject to
be discussed will be the relations between the United States
and the United Kingdom.

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The British Government will be sending
and discuss the question how
Britain can best contribute
improve the relations of the two
European Communities.

Yours sincerely,

Secretary to Sir Sturges

Miss Caroline
12 Downing Street
London, S.W. 1

Please file
cf.
5/11



10 DOWNING STREET

87
BF
Mr Scholes

Confirmed for
16.30 on Fri 18 Dec.

Do you want
Sir Siegmund to
stay for meeting or
only to introduce?

Topics coming
from Westways.
Assume you will
request briefing when
they arrive.

Cf.

4/11 Miss Stephens

I think Sir S.G.W. shd probably
stay: yes, I'll ask for briefing when the
topics come. Thanks MJS 4/11

PM
Mand



10 DOWNING STREET

PRIME MINISTER

You will remember that you agreed to see Dr. Guth from Deutsche Bank in Frankfurt. The request came from Sir Siegmund Warburg. The meeting arranged for a couple of months ago had to be cancelled and Warburgs now wonder whether you would receive Dr. Guth on the afternoon of Friday 18 December. You will be entertaining the Spanish Prime Minister for lunch, but have nothing, as yet, in the diary in the afternoon.

Agree to receive Dr. Guth?

Yes not
EJ.

3 November 1981



MS

PM

10 DOWNING STREET

Prime Minister

When you saw
 Giscard working in
 May, you agreed that
 he should bring Dr
Guthrie, a prominent
 French banker and
 industrialist, to see you.
Guthrie's C.V. is attached.

MS cancelled.

cc 6/8.

12

5/8

EXTRACT FROM INTERNATIONAL WHO'S WHO

GUTH, Wilfried, DR.RER.POL.; German banker; b. 8 July 1919; member of Managing Board Deutsche Bank, AG: Chairman Supervisory Board, Daimler-Benz AG, Philipp Holzmann AG, Knorr-Bremse KG, LINCAS Electro Vertriebs-Gesellschaft mbH, Hamburg; Deputy Chairman Supervisory Board, Allianz Versicherungs AG, Siemens AG; member Supervisory Board, Henkel KGaA, Munchener Ruckversicherungs-Gesellschaft AG Metallgesellschaft AG, Frankfurt, Reemtsma Cigarettenfabriken GmbH, Hamburg, Schering AG, Berlin, Thyssen AG (formerly August Thyssen-Hutte AG), Omv. Address: Deutsche Bank AG, 6000 Frankfurt am Main, Grosse Gallusstrasse 10-14, Federal Republic of Germany.



10 DOWNING STREET

Tim.

any briefing
required?

es.

4/8.

No

JFF



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ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB

TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

Secretary of State for Industry

18 March 1981

Tim Lankester Esq
Private Secretary to the
Prime Minister
10 Downing Street
LONDON
SW1

Dear Tim

.. Sir Keith Joseph has asked me to arrange for the enclosed letter from Sir Siegmund Warburg to be shown to the Prime Minister. Sir Keith says that Sir Siegmund placed great emphasis on his admiration of the Prime Minister.

Yours ever

lan

I K C ELLISON
Private Secretary

Encl

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*Jan.
Pl. speak
M 14/3*

11th March, 1981.

Dear Sir Keith,

Thank you for your yesterday's letter. What you say recapitulates with wonderful precision the chief points which were discussed between you and me last week.

May I re-emphasize one statement which I made to you, namely my immense admiration for the courage of the Prime Minister and my prayer that the success which she deserves through her courage will not be spoiled by ineffective handling in the carrying out of Government policy at certain executive levels.

It was a great joy for me to see you again after a rather long interval. As I told you, I hate to intrude on my friends in Whitehall unless they specially want to see me. Thus, whenever you feel that there is the slightest matter on which you would like to talk to me and hear my views I am entirely at your disposal and even if at the time I should be far away I will come like a shot to call on you.

*With best wishes and
warm personal attachments*

The Rt. Hon. Sir Keith Joseph, Bt., P.C., M.P.,
Department of Industry,
Ashdown House,
123 Victoria Street,
London, SW1E 6RB.

Yours

Henry Watney

SGW/DW

cc Prime Minister ✓
Tim Lankester ✓



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Secretary of State for Industry

Carstairs
As arrange -
(The PM mentioned
this to me)

10 March 1981

Sir Siegmund Warburg

R.

Sir Siegmund

It was a pleasure to see you on Friday. You told me that in your view the United States, France and the Federal Republic of Germany are all afflicted with burdens of servicing accumulated past debt from Government overspending just as we are.

☞ You suggested that they are better placed than we but only to the extent that the average quality of their management is better. You underestimated, in my view, the extra burdens we face from nationalised industries and trade unionist attitudes.

|| I spoke of the other views you expressed to me, about exchange rate and the handling of our debt, to the Prime Minister, who would like to talk with you.

Her office may be getting in touch with yours.

Carstairs

Keir
