



cc sent to Engad Prime Minister

10 DOWNING STREET

From the Private Secretary

21 December 1981

Dear John,

The Prime Minister had a short discussion on Friday afternoon with Sir Siegmund Warburg and Dr. Wilfried Guth, one of the two heads of Deutsche Bank.

Dr. Guth said that he thought that the US recession, although deep, would not be long lived. He expected recovery to begin early enough in 1982 for 1983 to be a good year for business. He did not himself believe that US interest rates would go sky-high; in spite of the prospect of a huge federal deficit. He thought there would be defence cuts, and that new taxes would be introduced.

After a very general discussion on international economic prospects, the Prime Minister asked Dr. Guth about the position of the German banks. Dr. Guth thought that their banks were much less well managed than British banks. He had great worries about their profitability (that of Deutsche Bank apart); but as to their soundness he had no misgivings. They had substantial reserves and a valuable portfolio of industrial shareholdings. He was more concerned about the position of the US banks with their high exposure in Latin America and elsewhere.

The Prime Minister invited Dr. Guth to give her his views about the present UK position. Dr. Guth said that he had no criticisms of the underlying thrust of economic policy here over the last 2½ years. He was not one of those who thought the monetary stance had been too severe. But he felt that the time had come to relax somewhat. He was not arguing for a fiscal stimulus, but for a move downwards in UK interest rates towards the general international level. He thought that it would be helpful to have a somewhat lower exchange rate for sterling, in spite of the inflationary consequences. Dr. Guth also commended to the Prime Minister Chancellor Schmidt's practice of holding a series of informal discussions with trade unionists and employers together. German trade unionists spoke sometimes very roughly on these occasions, but he had noticed that - whether it was as a result of Chancellor Schmidt's persuasiveness, or of the relaxed and pleasant atmosphere - the trade unionists seemed subsequently to speak much more moderately in public.

Both Sir Siegmund Warburg and Dr. Gurth urged the Prime Minister to consider full EMS membership, on the basis of a lower

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sterling exchange rate. The Prime Minister commented that membership of EMS had not helped the Belgians or the Italians to manage their economies well. She also spoke of the problems for monetary policy which could arise through EMS membership.

I am sending a copy of this letter to Tim Allen (Bank of England).

Yours sincerely,

Michael Schelen

John Kerr, Esq.,
H.M. Treasury.

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