



RECORD OF A DISCUSSION BETWEEN THE CHANCELLOR AND THE
FEDERAL GERMAN FINANCE MINISTER IN BONN
AT 7.00 P.M. ON 8 NOVEMBER 1983

Present:-	Chancellor Mr Unwin Miss Pestell Mr Kerr	Herr Stoltenberg Dr Pieske Dr Heck
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International Issues

a. Brazil

Herr Stoltenberg said that the Germans were still being pressed by the Americans to help bridge the "financing gap". There was however no question of a move from the position which he had reported in Washington in September. The FRG would not, and indeed could not, commit itself to a specific quantum of new commercial credit, but was prepared to allow some very limited and very short term cover to continue, and to take part in a Paris Club rescheduling, which should take place quickly.

2. The Chancellor said that the British banks were signing up for a contribution of nearly \$1 billion for the new commercial loan. HMG would be contributing a very substantial figure on top of that because, like the Germans, we were prepared to agree to a rescheduling of official debt. There was no case for an additional contribution from HMG in the form of new commercial credit: if the "financing gap" proved real, the US would ensure that it was filled. Herr Stoltenberg agreed.



b. IMF Quota Increase

3. Herr Stoltenberg said that he was concerned that the IMF Bill had still not gone through the US Congress. Mr Unwin reported that the US Treasury seemed fairly optimistic that it would go through before 17 November. The Chancellor thought it crucial that it should do so, and Herr Stoltenberg agreed.

c. International Debt

4. The Chancellor said that a number of grandiose overall solutions to the problem of mounting international debt were on offer. None however seemed feasible or attractive. It would be important to go on handling the issues case by case. They would become less critical if dollar interest rates fell, reducing debt service burdens, and if the recovery in the industrialised world gained strength, creating new export opportunities for debtor developing countries. Herr Stoltenberg agreed that this was the real issue. He was however pessimistic about the likely future course of US interest rates. There seemed no hope of any action to reduce the US deficit before the Presidential election.

d. International Monetary Reform

5. Herr Stoltenberg said that the Germans had now submitted an answer to the questionnaire circulated by Dini to G10 Deputies. Like the UK, the FRG wished to discourage a sweeping G10 exercise, and to try to channel the work into studies of a limited number of practical issues. The various grander ideas, raised in the past by the Americans and the French, lacked substance; even US and French officials were not clear about their import.

FRG and UK Economies

6. Herr Stoltenberg said that the prospects for the FRG economy were improving. New industrial orders in September were up by some 8 per cent on an annual basis. Exports too were up, also by about 8 per cent. Real output growth of some 2½ to 3 per cent was expected for 1984, after about 1 per cent in 1983. (The official forecasts for 1984 were for 2½ per cent, but Herr Stoltenberg thought that 3 per cent would probably be achieved.) The Chancellor said that the UK too expected growth of 2½ to 3 per cent next year, as in this



year. And employment had started to rise, for the first time since 1979, while unemployment was showing signs of having peaked. Both economies could benefit from lower interest rates, and it would be easier for both to de-couple their domestic interest rates from US rates if both did so in parallel. Herr Stoltenberg said that German interest rates had dropped satisfactorily until May, when the rate on Government bonds was down to 7.4 per cent. It had since gone up to 8.4 per cent, but was now back at 8 per cent. Real interest rates were already $3\frac{1}{2}$ per cent below US levels, and, while it would be good if the gap could be further widened, it was not certain that this would be possible. The Federal deficit in 1984 would be some 2 per cent of GNP: the overall Government deficit a little over 4 per cent. This was much too high, by the strict standards formerly applied in Germany. But the deficit would have risen to at least 6 per cent if the policies of the previous Government had been followed. Further downward pressure would be required, though it would take some 3 years to get back to a satisfactory position.

EMS

7. In response to a question from Herr Stoltenberg, the Chancellor confirmed that there was no change in the UK attitude to membership of the exchange rate mechanism of the EMS. The position was regularly reviewed in London, but the problem of sterling's petrocurrency status remained. Herr Stoltenberg said that the FRG would in principle welcome the adherence to the exchange rate mechanism of another strong currency, and another country following prudent fiscal and monetary policies. Whether the EMS would survive would depend on whether the French were to maintain, and succeed with, their anti-inflationary strategy. The crisis at the time of the March re-alignment had taken the EMS to the brink. Its long-term future was a subject of very serious internal debate in Bonn. It was difficult satisfactorily to control domestic monetary supply while so much short term money swilled about in the system. The FRG would make all reasonable efforts to keep the EMS going, but the French were very demanding. The Commission's ideas on expanding the role of the EMS attracted little support in Bonn.

8. The Chancellor said that the real value of the EMS in current circumstances was the discipline which it imposed on French economic policy. Delors was undoubtedly helped, in his internal debates in Paris, by the existence of the system. It also put a brake on French protectionism. The discipline which the system imposed was not, in present circumstances, needed in London; and the UK had historically been much less protectionist than France. It



followed that the benefits for Europe which would accrue from UK membership of the ERM were much less than those accruing from continued French membership. But the question was in any case rather academic, for the UK Parliament and public opinion would simply not understand or accept UK accession to the ERM unless and until the problem of our excessive contribution to the European Budget was solved.

9. Mr Unwin suggested that the Commission and the Greeks should be discouraged from suggesting that the Athens European Council should contemplate a great leap forward to the EMS, and a wider role for the ecu. These ideas were premature. Herr Stoltenberg and the Chancellor agreed.

A handwritten signature in dark ink, appearing to be 'J O Kerr'.

J O KERR

11 November 1983

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