

FCO

~~MR DERRICK THOMAS~~
~~MR G THOMAS~~
MR RENWICK
MR BRAITHWAITE

~~RESIDENT OFFER~~
HD/ECD(I) (3)
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HD/ERD
HD/
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HD/

PLUS FCO

CABINET OFFICE

MR D WILLIAMSON
MR G STAPLETON
~~MISS S J LAMBERT~~
MR T J BURR
MR M H JAY

DTI

PLUS OGD's

MR P KENT
HM CUSTOMS & EXCISE

H M TREASURY ^{St. P. Morrison}
~~MR G B JAMES~~
MR J G LITTLER ^{by}
MR J E MORTIMER ^{Tube}
MR G W HOPKINSON
MR R G LAVELLE
N ^{franked}

MAFF
PERMANENT SECRETARY

IMMEDIATE

OO LUXEMBOURG

OO ROME

OO UKREP BRUSSELS

OO WASHINGTON

GRS 980

Copenhagen }
N BARFOUR } BANK
N GILL } of interest
Sir M. FRANKLIN }
N KOOY MAFF
N TURNBULL NO 10 DS

CONFIDENTIAL

DESKBY 221430Z

FM PARIS 221147Z JUL 85

TO IMMEDIATE FCO

TELEGRAM NUMBER 628 OF 22 JULY

AND TO IMMEDIATE ATHENS, BONN, BRUSSELS, COPENHAGEN, DUBLIN, THE HAGUE, LUXEMBOURG, UKREP BRUSSELS, WASHINGTON.

REALIGNMENT OF EUROPEAN CURRENCIES.

FOLLOWING FROM LITTLER, HM TREASURY.

1. THIS IS A BRIEF REPORT OF THE SPECIAL MEETING OF THE EC MONETARY COMMITTEE HELD AT THE BIS OFFICES IN BASLE ON 20 JULY, BEGINNING AT 3.30PM WHICH LOCHNIS (BANK OF ENGLAND) AND I ATTENDED AS UK MEMBERS.

2. THE MEETING HAD BEEN CALLED AT THE REQUEST OF THE ITALIAN MEMBERS. THEY FORMALLY REPORTED THE DIFFICULTIES THEY HAD ENCOUNTERED IN THE FOREIGN EXCHANGE MARKET ON THE PREVIOUS DAY. (IT SEEMED THAT THESE MIGHT HAVE STEMMED FROM LEAKAGE OF GOVERNMENT INTENTIONS TO SEEK A REALIGNMENT AND THE COMMITTEE HOPES TO HAVE TECHNICAL DISCUSSIONS OF WHAT HAPPENED AT A FUTURE MEETING). THE ITALIANS THEN OUTLINED MAIN ELEMENTS IN THE DETERIORATION OF THEIR POSITION IN THE FIRST HALF OF 1985, ESPECIALLY THE INCREASE OF SOME LIT 10 TRILLION (ANNUAL RATE) IN THE PUBLIC DEFICIT AND THE SHARP WORSENING OF EXTERNAL COMPETITIVENESS AND THE EXTERNAL CURRENT ACCOUNT. FINALLY, THEY ANNOUNCED A SERIES OF MEASURES TO CORRECT THE INCREASE IN THE PUBLIC DEFICIT, INCLUDING ABOUT LIT 1 TRILLION OF EXPENDITURE REDUCTIONS, ABOUT LIT 1 TRILLION OF ACCELERATED REVENUES AND ABOUT LIT 3-4 TRILLION OF REVENUE INCREASES. THEY ALSO DREW ATTENTION TO THE AGREEMENT WITH TRADES UNIONS TO SLOW DOWN THE SCALA MOBILE TO REVIEW INTERVALS OF 6 MONTHS. THEY ASKED FOR A REALIGNMENT AGAINST OTHER COMMUNITY CURRENCIES OF 9 PERCENT, RETAINING THE

AGAINST OTHER COMMUNITY CURRENCIES OF 9 PERCENT, RETAINING THE EXISTING WIDER MARGINS.

3. IN A BRIEF ROUND OF COMMENTS, SEVERAL MEMBERS INCLUDING THOSE OF FRANCE MADE IT CLEAR THAT THEY WERE NOT LOOKING FOR CHANGES IN VALUES OF THEIR OWN CURRENCIES IN RELATION TO OTHERS APART FROM THE LIRA. THERE WAS SOME CRITICISM OF THE PROPOSED ITALIAN MEASURES AS RELYING TOO HEAVILY ON EXCHANGE RATE ADJUSTMENT AND NOT ENOUGH ON DOMESTIC ADJUSTMENT. THE 9 PERCENT CHANGE WAS GENERALLY REGARDED AS BEING AT OR EVEN ABOVE A REASONABLE MOVE, BUT THE NEED FOR A MOVE WAS NOT CHALLENGED.

4. THE MEETING THEN ADJOURNED TO ALLOW BILATERAL CONSULTATIONS CONDUCTED BY THE CHAIRMAN, AND WAS RECONVENED AT ABOUT 7.30PM. THE CHAIRMAN THEN PROPOSED DEALING FIRST WITH SUBSTANCE, THEN WITH PRESENTATION.

5. ON SUBSTANCE HE SAID HE SAW A POSSIBILITY OF UNANIMOUS AGREEMENT ON TWO POINTS:

A) THE LIRA AND OTHER ERM CURRENCIES SHOULD MOVE RELATIVELY BY 8 PERCENT.

B) OTHER ERM CURRENCIES SHOULD RETAIN THEIR PRESENT RATES VIS-A-VIS EACH OTHER.

BOTH POINTS WERE IMMEDIATELY CONFIRMED BY ALL MEMBERS.

6. ON PRESENTATION THE CHAIRMAN SAID THAT THE ITALIANS HAD ASKED THAT ALL OTHER ERM CURRENCIES SHOULD REVALUE BY 4 PERCENT AND THE LIRA DEVALUE BY 5 PERCENT. HE INVITED COMMENTS ON A POSSIBLE 3/5 SPLIT, OR 2/6, OR 2 1/2/5 1/2. SEVERAL MEMBERS EXPRESSED WILLINGNESS TO ACCEPT ANY OF THIS RANGE SOME PREFERRED THE 2/6 SPLIT. THE DUTCH MEMBERS SAID THAT 2/6 WAS THE LIMIT OF THEIR WILLINGNESS AND THEY WOULD PREFER 1/7. AFTER SOME HEATED EXCHANGES, THE ITALIANS SAID THEY WOULD RELUCTANTLY ACCEPT THE CHAIRMAN'S RULING AND HE SETTLED FOR 2/6 WHICH WAS THEN UNANIMOUSLY ENDORSED.

7. THERE FOLLOWED AN INTERLUDE DURING WHICH IT WAS EVENTUALLY POSSIBLE FOR THE COMMISSION TO GIVE AN ASSURANCE THAT THE PROPOSED CHANGES WOULD NOT (EXCEPT FOR THE LIRA) IMMEDIATELY AFFECT AGRICULTURAL RATES. (THE PRESENCE OF EDDY OF MAFF TO ADVISE THE UK MEMBERS AND CONFIRM AND EXPLAIN THIS TO THEM AND OTHERS WAS VERY USEFUL).

8. THE COMMISSION THEN PRESENTED THE COMPLETE LIST OF NEW ECU CENTRAL RATES INCLUDING UPDATED VALUES FOR STERLING (ABOUT PLUS 5 1/2 PERCENT) AND THE DRACHMA (ABOUT MINUS 12 PERCENT) TO REFLECT MARKET RATES (AGAINST THE DUTCH FLORIN) ON 19 JULY. THIS IS NORMAL AND REQUIRED PROCEDURE.

9. THE DRAFT TEXT OF THE COMMUNIQUE WAS AGREED (SEE MIFT). AFTER A BRIEF INTERVAL FOR CONSULTATION WITH CAPITALS, THE MEMBERS RECONVENED AT 10 PM AS REPRESENTATIVES OF MINISTERS. UNANIMOUS AGREEMENT WAS CONFIRMED. THE PROPOSED MEETING AT MINISTERIAL LEVEL WAS CALLED OFF. THE COMMUNIQUE WAS THEN ISSUED.

10. THE REASON FOR THE UNUSUAL VENUE WAS AN EFFORT TO AVOID THE PRESS AND PUBLIC INTEREST OF A MEETING KNOWN TO BE TAKING PLACE IN BRUSSELS. UNFORTUNATELY THE CHANGED VENUE LEAKED TO THE PRESS OVER FRIDAY NIGHT, BUT VERY FEW PRESS REPRESENTATIVES TURNED UP AND THE MEETING WAS CONDUCTED QUIETLY AND PRIVATELY. ALL CONCERNED WERE VERY PLEASED - ESPECIALLY AFTER THE DRAMA OF THE PREVIOUS REALIGNMENT IN MARCH 1983 - TO HAVE ACHIEVED A NECESSARY CHANGE BY TECHNICAL AGREEMENT AND WITHOUT PUBLIC OR POLITICAL EXCITEMENT.

11. THE PROCESS OF AGREEMENT IN THIS WAY WAS CRUCIALLY EASED BY THE CLEAR INSISTENCE FROM THE OUTSET THAT FRANCE DID NOT WANT ITS OWN VALUE VIS-A-VIS THE DM TO CHANGE, AND BY GENERAL WILLINGNESS OF

11. THE PROCESS OF AGREEMENT IN THIS WAY WAS CRUCIALLY EASED BY THE CLEAR INSISTENCE FROM THE OUTSET THAT FRANCE DID NOT WANT ITS OWN VALUE VIS-A-VIS THE DM TO CHANGE, AND BY GENERAL WILLINGNESS OF MEMBERS TO AGREE TO SOME PRESENTATIONAL HELP TO THE ITALIANS IN THE APPEARANCE OF REVALUATIONS AS WELL AS DEVALUATION OF THE LIRA.

FCO PLEASE PASS ADVANCE COPIES DESKBY 221430Z TO:-

HM TREASURY	:	PS/CHANCELLOR.
	:	SIR P.MIDDLETON.
	:	MR LAVELLE.
	:	MR FITCHEW.
BANK OF ENGLAND	:	GOVERNOR.
	:	MR BALFOUR.
	:	MR GILL.
	:	SIR M.FRANKLIN.
MAFF	:	MR EDDY.
NO 10.	:	MR TURNBULL.

FRETWELL

NNNN

SENT AT 221310Z JW