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FM PARIS

TO IMMEDIATE FCO

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THE FRANC AND THE EMS

SUMMARY

1. INCREASING PRESS SPECULATION ABOUT THE NEW GOVERNMENT'S INTENTIONS TOWARDS THE FRANC. FEW CLEAR SIGNS OF THE GOVERNMENT'S THINKING, BUT THE AGRICULTURE MINISTER TODAY STATED THAT BALLADUR HAD RULED OUT A DEVALUATION.

DETAIL

2. THE NEW GOVERNMENT MUST HAVE GIVEN THOUGHT TO THE POSSIBILITY OF A RAPID DEVALUATION OF THE FRANC (OR REVALUATION OF THE MARK, AS THEY WOULD NO DOUBT HOPE TO PRESENT IT). A QUICK DEVALUATION, BLAMED ON THE FOLIES OF THE PREVIOUS GOVERNMENT, SEEMED TO BE PART OF OPPOSITION PLANS SOME MONTHS AGO, BUT THEIR SPOKESMAN SUBSEQUENTLY WENT QUIET, PRESUMABLY FOR FEAR OF BEING ACCUSED OF ENCOURAGING SPECULATION. IN THE MARKETS, THE FRANC HAS LOST SOME GROUND ON THE DEUTSCHMARK BUT IN GENERAL HAS BEEN HOLDING UP WELL, WITH ONLY OCCASIONAL INTERVENTION TO SUPPORT IT, NOTABLY BEFORE WEEKENDS WHEN EXCHANGE DEALERS SEEK TO COVER THEIR POSITIONS. THE FALL IN OIL PRICES HAS REMOVED, AT LEAST TEMPORARILY, ANY CONCERN OVER THE BALANCE OF PAYMENTS. AND MOST EXPERTS HERE SEEM AGREED THAT, ON PAST FORM, A DEVALUATION WOULD DO NOTHING TO CURE THE UNDERLYING LACK OF COMPETITIVITY OF FRENCH INDUSTRY AND COULD EVEN DELAY NECESSARY ACTION.

3. HOWEVER IT REMAINS THE CASE THAT SINCE THE LAST EMS ADJUSTMENT IN 1983, INFLATION IN FRANCE HAS SIGNIFICANTLY OUTPACED THAT OF HER BIGGEST TRADING PARTNER, THE FRG, SO THAT A FURTHER ADJUSTMENT MAY ULTIMATELY BE NECESSARY. MOREOVER LOWERING THE FRANC COULD, THROUGH ITS EFFECT ON GREEN CURRENCIES, BRING POLITICALLY IMPORTANT COMPENSATION TO FRENCH FARMERS IT CAP PRICE-FIXING DECISIONS FALL SHORT OF THEIR NOW HIGH EXPECTATIONS. REMOVAL OF CONCERN ABOUT THE FRANC MIGHT ALSO MAKE IT EASIER TO LOWER FRENCH INTEREST RATES, HISTORICALLY HIGH IN REAL TERMS AND A DISCOURAGEMENT TO THE INVESTMENT THE ECONOMY NEEDS, ALTHOUGH THIS WOULD CLEARLY DEPEND ON THE SHAPE OF THE PACKAGE OF MEASURES WHICH WOULD HAVE TO ACCOMPANY A DEVALUATION.

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4. THE GOVERNMENT HAD SAID LITTLE OR NOTHING ON THE ISSUE UNTIL TODAY, WHEN GUILLAUME TOLD A PRESS CONFERENCE THAT BALLADUR, THE MINISTER OF ECONOMY AND FINANCE, HAD RULED OUT A DEVALUATION. IN ANY EVENT THE NEW GOVERNMENT WILL NEED TO ACT QUICKLY IF THEY WISH TO TAKE ADVANTAGE OF THE SOCIALIST HERITAGE ARGUMENT TO CHANGE THE PARITY OF THE FRANC. THEY WILL ALSO NEED TO CONCERT WITH THE GERMANS, PARTICULARLY SINCE ACCORDING TO THE FRENCH PRESS THE LATTER REMAIN OPPOSED TO REVALUING THE MARK. THE ODDS MUST NOW BE ON PRESERVATION OF THE STATUS QUO FOR THE TIME BEING. WHEN I SAW BALLADUR ON MONDAY HE DID NOT SOUND LIKE A MAN WITH AN EARLY DEVALUATION ON HIS MIND.

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