

Confidential

CONFIDENTIAL

FM BONN

TO IMMEDIATE FCO

TELNO 009

OF 071730Z JANUARY 87

INFO IMMEDIATE PARIS, WASHINGTON

INFO PRIORITY BRUSSELS, LUXEMBOURG, THE HAGUE, ROME, COPENHAGEN

INFO PRIORITY TOKYO, UKDEL OECD

FRAME ECONOMIC

EUROPEAN MONETARY SYSTEM (EMS)

SUMMARY

1. GERMAN ATTEMPTS TO PLAY DOWN REPORTED FRANCO-GERMAN DIFFERENCES OVER EMS EXCHANGE RATES. EXPRESSIONS OF SYMPATHY WITH THE FRENCH POSITION MIXED WITH A FIRM RESOLVE TO STAVE OFF ANY REALIGNMENT UNTIL AFTER THE FEDERAL ELECTIONS. EVENTS MIGHT MAKE THIS IMPOSSIBLE BUT EVEN SO THERE WAS UNLIKELY TO BE ANY DAMAGE TO THE GOVERNMENT'S ELECTORAL POSITION.

DETAILS

2. THE GERMANS ARE ATTEMPTING TO PLAY DOWN THE APPARENT TENSION WITH FRANCE OVER EMS EXCHANGE RATES WHICH WAS GIVEN PROMINENT COVERAGE BY THE BRITISH MEDIA TODAY. CONTACTS IN BONN AND FRANKFURT AT ALL LEVELS HAVE EMPHASISED THAT RECENT PRESSURES ON THE FOREIGN EXCHANGES HAVE RESULTED FROM THE MARKET PERCEPTION OF DOMESTIC POLITICAL DEVELOPMENTS IN FRANCE AND THAT, BEYOND FULFILLING NORMAL OBLIGATIONS UNDER EMS ARRANGEMENTS, NO FURTHER ACTION WAS CONTEMPLATED TO BRING THE DMARK IN LINE WITH OTHER CURRENCIES. IN WORDING WHICH HAD OBVIOUSLY BEEN CAREFULLY PREPARED, THE CHANCELLERY TOLD US THAT THEY THOUGHT CHIRAC HAD YESTERDAY SPOKEN RATHER HASTILY AND WITHOUT CONSIDERATION FOR THE EFFECT WHICH HIS STATEMENTS WOULD HAVE ON THE FINANCIAL MARKETS. THEIR TONE WAS, HOWEVER, ONE OF UNDERSTANDING RATHER THAN ANGER AT THE FRENCH POSITION. THE FEDERAL ECONOMICS MINISTER, BANGEMANN HAS SINCE REPEATED MUCH THE SAME THING TO JOURNALISTS. HE RULED OUT ANY REVALUATION, CLAIMING THAT "THE DM HAS AN APPROPRIATE VALUE WITHIN THE EMS AT THE MOMENT".

3. WE UNDERSTAND FROM THE FEDERAL FINANCE MINISTRY THAT A SIMILAR LINE WAS TAKEN AT A MEETING OF THE WINNER CABINET THIS AFTERNOON, AT WHICH STOLTENBERG WAS PRESENT. TURBULENCE CAUSED BY A FRENCH POLITICAL CRISIS DID NOT JUSTIFY AN EMS REALIGNMENT. IF NOT CONTINUED, "OTHER MEASURES" MIGHT BE NECESSARY, IN WHICH FRANCE WOULD BE REQUIRED TO PLAY A PART, BUT THE POLITICAL CONSEQUENCES OF A REALIGNMENT BEFORE THE FEDERAL ELECTIONS - ALIENATED FARMERS, DISSATISFIED INDUSTRY- RULED THAT OPTION OUT.

Confidential

4. ONE IMPORTANT REASON BEHIND GERMAN RELUCTANCE WAS A GENUINE WORRY OVER A LOSS OF COMPETITIVE EDGE FOR THEIR EXPORTS. THEY CAN CITE MANY ARGUMENTS TO SUPPORT THEIR CASE: FIGURES ISSUED RECENTLY FOR THE THIRD QUARTER SHOW EXPORTS 1.5 PER CENT DOWN ON A YEAR EARLIER: SOME IMPORTANT SECTORS OF INDUSTRY, EG CHEMICALS AND MACHINE TOOLS, HAVE WARNED OF A MARKED DECLINE IN EXPORT PERFORMANCE: THE STOCK MARKET HAS INDICATED A LACK OF CONFIDENCE: AND MANY OF THE RECENT INDEPENDENT ECONOMIC FORECASTS HAVE EMPHASISED THE RISKS FOR THE ECONOMY THIS YEAR FROM FALLING EXPORTS.

5. THERE WAS, HOWEVER, A GROWING BELIEF, PARTICULARLY AMONG THOSE IN FRANKFURT CONCERNED WITH THE FOREIGN EXCHANGES, THAT THE GOVERNMENT CANNOT HOLD THIS LINE MUCH LONGER. SCHLESINGER (BUNDESBANK) COMMENTED TO ME THIS EVENING THAT ALTHOUGH THE F.R.G. WAS FULFILLING ITS OBLIGATIONS UNDER THE EMS, BUYING DANISH KRONER TODAY AS WELL AS FRENCH FRANCS, THEY COULD NOT INDEFINITELY CONTINUE TO PAY OUT SUCH SUMS. THE QUESTION THEREFORE AROSE WHETHER THERE WOULD BE A REALIGNMENT, OR WHETHER THE PROBLEM WOULD SOLVE ITSELF BY OTHER MEANS. AS OF NOW THIS QUESTION WAS STILL OPEN. ASKED WHETHER A REALIGNMENT WOULD BE FEASIBLE IN THE LAST FORTNIGHT OF THE FRG ELECTION CAMPAIGN, SCHLESINGER SAID IT WAS NOT EXCLUDED, BUT POLITICIANS HERE AND IN FRANCE HAD RATHER TIED THEIR OWN HANDS BY THEIR PUBLIC STATEMENTS: MAKING A DRAMA OUT OF WHAT OUGHT TO BE TREATED AS A TECHNICALITY.

COMMENT

6. WE FEEL SURE THAT THE AUTHORITIES HERE WILL DO ALL THEY CAN TO STAVE OFF ANY REALIGNMENT INVOLVING UPWARD REVALUATION OF THE DEUTSCHMARK UNTIL AFTER THE ELECTION ON 25 JANUARY. BUT IF EVENTS MADE THIS UNAVOIDABLE BEFORE THEN, WE DO NOT BELIEVE THAT THE COALITION'S PROSPECTS IN THE ELECTION WOULD BE SERIOUSLY DAMAGED.

BULLARD

YYYY

BPLNAN 3200

NNNN

FRAME ECONOMIC
ECD(1)