

PRIME MINISTER

BILATERAL WITH THE CHANCELLOR

The main subject for discussion, as for the last few weeks, is the markets. In the margins of ECOFIN today it was agreed that there was no point in a meeting of G7 in the run up to Christmas. Instead, Stoltenberg, Balladur and the Chancellor agreed to work towards a written G7 communiqué which would not be issued until after Congress had approved the budget. News of this decision will no doubt emerge before too long and may prove a disappointment to the markets, putting some further downward pressure on the dollar.

The Chancellor discussed with Stoltenberg the question of intervention to buy DM in exchange for sterling. Stoltenberg was sympathetic, but of course Poehl is the stumbling block. The Governor will have seen Poehl in Basle and the Chancellor should know the outcome by the time of the bilateral.

You will want to express your own concerns very forcibly to the Chancellor, making it clear that if intervention in DM does not do the trick you will certainly be prepared to contemplate allowing sterling to rise through DM 3. The risks to inflation increasingly outweigh the short term risks to growth. If the Chancellor protests, you could point out that even full membership of the EMS allows the occasional realignment.

The Chancellor may mention to you his concerns about the latest minute from Sir Robert Armstrong on "Next Steps".

The Chancellor is likely to show you some new coins which he has it in mind to issue.



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