

*Mr. Gray*

*Mr. Walters*

*FA*

*Thank you*

*Very much with you.*

*W L W  
19.9*

Confidential

*R2C6  
11/9*

Mr. Paul Gray,

The ERM, CBE, and 1990/2

I am enclosing a letter that I received today (11th Sept) from Bernard Connolly of Brussels. It represents an inside view of the Commission from a supporter of the Prime Minister and her policies.

Although there are allusions to conspiracies, to which I can neither attest nor subscribe, the general thrust of his arguments is consistent with all that I know of the disposition of the eurocrats in Brussels. In particular he also suggests that my fears about the imposition of capital controls are shared by many in Brussels.

Connolly has asked me to keep this letter confidential. However I am sure that he would not wish to keep these views from the Prime Minister.

Alan Walters  
Sept 11 1988.



The World Bank  
1818 H St NW  
Washington  
DC 20433

file

August 8th 1988

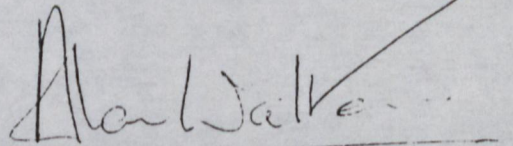
Mr. B.J. Connally,  
Rue Major Petillon 4,  
1040 Brussels,  
Belgium.

Dear Mr. Connally,

I am writing to express both my agreement and pleasure with your letter in the Financial Times of today's date. At times I have felt quite beleaguered and, since I am now effectively muzzled, frustrated by the analytical nonsense that ignores elementary logic and simple evidence, but which is alas characteristic of the press when the subject is the EMS. Along with Patrick Minford's article two weeks ago in the Telegraph, your brief but pungent letter are islands of sanity and sense.

For reasons which are alas only too obvious, I must ask you to regard this as for your eyes only.

Yours sincerely,



Alan Walters.



F.T. Aug 8 88

## 'This year's sterling appreciation is justified'

From Mr B.L. Connolly.

Sir, Mr Samuel Brittan's analysis of real interest rate differentials between Britain and Germany (Economic Viewpoint, July 28) is seriously in error.

For some time, prospective real returns on capital have been higher in Britain - benefiting from the Thatcher revolution - than in an over-regulated and "stagnationist" Germany. It is therefore appropriate that real interest rates should be higher in Britain than in Germany.

Mr Brittan is wrong in claiming that capital controls are a

necessary condition for the existence of such real interest rate differentials. Rather, a sufficient condition is that there should be an expected real depreciation of sterling against the Deutsche Mark.

In this perspective, this year's sterling appreciation, which has so dismayed Mr Brittan, is wholly justified.

It has created the expectation of a future real depreciation, thus allowing a real interest rate differential to be maintained.

Moreover, it will switch demand away from (currently) strained domestic output, thus

reducing the extent to which short-term real appreciation comes about via fast British inflation. If sterling's rise had come earlier, as Mrs Thatcher wanted, the inflationary risk could have been reduced further.

The future real depreciation of sterling will be accompanied by falling real interest rates in Britain as the investment boom gradually reduces the excess return on capital. That real depreciation might involve either a nominal depreciation or a rate of inflation lower in Britain than in Germany.

But Mr Brittan would have

Britain both fix its nominal exchange rate against the Deutsche Mark and tie its rate of increase of traded goods prices to that of Germany. Were his prescription to be followed, the Thatcher revolution could not bear fruit in a sustainably higher level of output in the future; instead, Britain would be locked into the growth and investment performance of the country referred to in your editorial of July 27 as the "sick man of Europe".

B.L. Connolly,  
Rue Major Pétillon,  
1040 Brussels,  
Belgium

## Divided we fall

From Mr J.C. Attfield.

Sir, Why only two? The FT could have been divided into at least eight sections. This would surely guarantee minimum advertising response and maxi-

mum inconvenience for your commuter readers.

J.C. Attfield,  
The Field House,  
Maggot's End,  
Manuden, Hertfordshire

## Divided we stand

From Mr Christopher Toop.

Sir, Congratulations on your new format. It is good to see that you have acknowledged the rise of the "Dinky" ("dual-income-no-kids-yet") by mak-

ing it so easy to share the FT on the train into town.  
Christopher Y. Toop,  
10 Marksbury Avenue,  
Kew Gardens,  
Richmond, Surrey