

CONFIDENTIAL
FM MADRID
TO DESKBY 080630Z FCO
TELNO 578
OF 071725Z JUNE 89
INFO IMMEDIATE UKREP BRUSSELS AND OTHER EC POSTS
INFO IMMEDIATE BANK OF ENGLAND, TREASURY, DTI

FRAME ECONOMIC

MY TELNO 563: SPAIN AND THE EMS

1. SOURCES IN THE MONCLOA (PRIME MINISTER'S OFFICE) TELL US THAT THE ANNOUNCEMENT OF THE SPANISH GOVERNMENT'S INTENTION TO JOIN THE EMS BEFORE JULY 1990 WAS TO HAVE BEEN MADE LATER IN THE YEAR. IT WAS BROUGHT FORWARD BECAUSE OF SPANISH SENSITIVITY TO ACCUSATIONS OF BEING UNDECIDED ON THE ISSUE AT THE EUROPEAN COUNCIL. AN ANNOUNCEMENT BEFOREHAND HAS THE ADVANTAGE OF TAKING THE PRESSURE OFF SPAIN AND ENABLING GONZALEZ TO PRESIDE MORE COMFORTABLY OVER THE DISCUSSION. THE ANNOUNCEMENT IS IN TERMS WHICH DO NOT MAKE THE COMMITMENT IRREVOCABLE SHOULD CIRCUMSTANCES CHANGE.
2. THE ECONOMIC REASONS FOR THE DECISION ARE THE COMBINATION OF HIGH INTEREST RATES 14.65% FOR 3 MONTH INTERBANK) DESIGNED TO TACKLE INFLATION BUT GIVING UNWANTED STRENGTH TO THE PESETA, COMBINED WITH ARAPIDLY INCREASING TRADE DEFICIT. IT IS FELT THAT THE RECENT FLOWS OF SPECULATIVE MONEY PROMPTED BY FLUCTUATIONS IN THE DOLLAR WOULD HAVE BEEN AVOIDED HAD THE PESETA BEEN WITHIN THE EMS. THE GOVERNMENT ALSO BELIEVES THAT IT WOULD HAVE STRENGTHENED THEIR HAND IN NEGOTIATIONS WITH THE UNIONS.
3. OFFICIALS CLAIM THAT FOR MOST OF THE LAST DECADE THE PESETA HAS IN ANY CASE REMAINED WITHIN A 6% MARGIN. ENTRY IS THEREFORE NOT EXPECTED TO CAUSE GREAT DIFFICULTY. THE PRECISE TIMING OF ENTRY WILL NOT, OBVIOUSLY, BE ANNOUNCED BEFOREHAND. THE FIRST OPPORTUNITY WILL BE WHEN THE PESETA JOINS THE ECU BASKET OF CURRENCIES IN SEPTEMBER THIS YEAR. IT SEEMS MORE LIKELY TO AWAIT 1990.
4. THE SAME SOURCE TELLS US THAT THERE IS CURRENTLY INTERNAL DISCUSSION OF THE POSSIBILITY OF REDUCING THE WIDTH OF THE 6% EMS BAND BY ONE OR TWO POINTS, IF ITALY CAN BE PERSUADED TO AGREE.
5. PLEASE ADVANCE TO KERR (AUS).

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