

Ria Minister

Why intervene

Exchange Rate at all. ~~But~~

I have had ^{We cannot go on} further words ^{day} of ^{Monday}

with London, making clear the without
extent of your concern. ^{have high} ^{inflation}

The problem is that ^{following} ~~the~~ ^{not}

Banks have not been intervening

in DM, because they don't

want to offend the Bundesbank,

but only in dollars, where the

effect is less direct. ^{Nevertheless it acts} ^{upon the DM through} ^{X-axis}

The Chancellor is now
calling in the Governor &
intents to be very firm with

him. He will insist that
the Bank intervene in DM. If
the Governor protests - as he
will - the Chancellor will say
that ^{central-} inter-Bank arrangements
will simply have to be over-
ridden. If we were in the
EMS, we would intervene in
DM. If the Governor still
protests, the Chancellor
intends to say that he will
find some-one else to run the
~~EFA~~ (Exchange Equalization Account) CD

SECRET

9.

PRIME MINISTER

has seen
C.D.P.

EXCHANGE RATE

The Chancellor has now had a meeting with the Governor. It turned out to be fairly difficult. The Governor said that, for the Bank to buy deutchmarks, would give rise to considerable problems with the Bundesbank because it would mean over-riding inter-Central Bank arrangements, and would increase the strains within the EMS. He later confirmed this after having spoken to Poehl. Indeed Poehl apparently expressed great indignation and said that he might need to telephone Chancellor Kohl in Copenhagen and get him to raise the matter with you. The Chancellor takes a dim view of this. If we were full members of the Exchange Rate Mechanism of the EMS, it would be a perfectly natural thing to do. The Germans are exploiting a technicality to make life difficult for us.

However, the Chancellor has agreed that for the remainder of the day we should buy other EMS currencies rather than the deutchmark, while insisting that from Monday we should start buying deutchmarks whatever the Bundesbank say. He has a strong case. At the moment we are virtually single-handedly supporting the dollar while the Germans are doing virtually no intervention. If we start buying deutchmarks, the Germans will be forced to support the dollar as well. This is a point you could use with Chancellor Kohl if he does raise the matter.

That is all what has been said. The reality seems to be slightly different. Since midday our total intervention has been \$140 million of which \$75 million has been in deutchmarks!

The advice continues to be that to let the pound go through three deutchmarks would be a very major step and damaging in the present slightly fragile state of confidence (revealed at your dinner for the CBI). The feeling is that we shall not go just through but a long way through that barrier.

C.D.P.

CHARLES POWELL

4 December 1987