Pc. BG to file

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From the Private Secretary

14 January, 1987.

EMS

The Prime Minister has seen your letters to me of 13 January about the currency realignment at the weekend, and about the EMCF mobilisation by Belgium. She was grateful for these reports.

(David Norgrove)

A.C.S. Allan, Esq.,
HM Treasury.

ps2/97R

Treasury Chambers, Parliament Street, SW1P 3AG
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13 January 1987

David Norgrove Esq
10 Downing Street
LONDON
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Prime Minister
This adds little which will be new to you.
DRN 13/1

Dear David,

EC CURRENCY REALIGNMENT

As you know, the Chancellor and the Governor of the Bank of England attended the meeting of EC Finance Ministers and Central Bank Governors in Brussels on Sunday, 11 January.

The outcome of the meeting was a 3 per cent revaluation of the German mark and Dutch guilder against the French franc, and a 2 per cent revaluation of the Belgian and Luxembourg francs. The Irish punt, Danish krona and Italian lira remained unchanged against the French franc. The 3 per cent revaluation of the mark and guilder against the franc had been agreed bilaterally before the meeting, but the unexpected insistence of Belgium on an intermediate position required a full Ministerial meeting.

These changes are probably less than the markets were expecting, and it remains possible that the new limits may be tested before too long, particularly if the dollar weakens further. There was no pressure yesterday as the markets digested the new rates, though only the Italians were able to recoup reserves. The French franc was at the top of the ERM and - perhaps significantly - the Belgian franc at the bottom.

As is standard practice, sterling was revalued in the ecu basket to reflect its current market value. Sterling's depreciation since the previous realignment (in August last year) meant a relative devaluation of 7¾ per cent. This is of course a purely formal procedure and makes no difference to the market value of the pound.

I attach a copy of the communique agreed at the end of the Ministerial discussion. In addition to the customary statement of the relative currency changes and the consequential new ecu central rates, it contains two other passages.

The first, about economic and monetary policies, stems from an initiative by Delors. He was keen to include commitments on concerted action on intervention and on interest rates, including - inevitably - a greater role for the Commission. This was unacceptable to most of those present, including ourselves. The agreed text is so watered down as to amount to very little.

The second passage is on the CAP consequences, something inevitably covered in these communiques. The key element - wrung out of Delors on this occasion only with great difficulty - is that the Commission is not left free to propose what could be expensive adjustments in Monetary Compensation Amounts ahead of the forthcoming price-fixing.

I am writing separately about the putative ecu swap with the Belgians about which you asked recently.

Copies of this letter go to the Private Secretaries to the Governor of the Bank of England, the Foreign and Commonwealth Secretary and Minister of Agriculture (one of whose experts on the agri-monetary price problems was helpfully available in Brussels during the meeting.)

Yours
Alex

A C S ALLAN
Principal Private Secretary

ENC.

EUROPEAN COMMUNITIES Brussels, 12 th January 1987

COMMUNIQUE

On 12 January 1987, the Ministers and Central Bank Governors of EEC member countries have by mutual agreement, in a common procedure involving the Commission and after consultation of the Monetary Committee, decided on an adjustment of central rates within the European Monetary System.

The new bilateral central rates result from the following relative changes :

German mark	:	3.0 %
Dutch guilder	:	3.0 %
Belgian franc	:	2.0 %
Luxembourg franc	:	2.0 %
Danish krone	:	0.0 %
French franc	:	0.0 %
Italian lira	:	0.0 %
Irish pound	:	0.0 %

The new ECU central rates are the following :
(in units of national currency per ECU)

DM	2.05853
HFL	2.31943
BFR	42.4582
LFR	42.4582
DKR	7.85212
FF	6.90403
LIT	1483.58
IRL	0.768411
UKL	0.739615
DRA	150.792

The new bilateral central rates and the compulsory intervention rates will be communicated by the monetary authorities in time for the opening of foreign exchange markets on 12 January 1987.

Having conducted a thorough examination of the monetary situation, the ministers of finance and the central bank governors of the countries of the European Community have agreed to pursue the coordination of the policies which are necessary for the maintenance and consolidation of monetary stability, for the control of inflation and for economic growth in Europe, and which will contribute to greater stability of the exchange rates of the major international currencies.

The realignment which has been decided upon today is consistent with this overall outlook and will establish the conditions which will permit the orderly functioning of the EMS.

With a view to improving economic and monetary cooperation among member countries, the ministers have asked the Monetary Committee and the Committee of Central Bank Governors to examine measures to strengthen the operating mechanisms of the European Monetary System.

The agrimonetary consequences of the present realignment will be examined by the competent bodies. The MCA's resulting from the present realignmentwill be dealt with at the next agricultural price-fixing round. At the request of the finance ministers, the Commission declares that it will seek the agreement of the Member States before proposing in certain special cases agrimonetary measures which flow from the present realignment. This will not affect relevant decisions already taken by the agricultural ministers.

001/

CCBG

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13 January 1987

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Prime Minister 2

This seems to be a modest and largely costless* arrangement (entirely costless if we refuse to accept any diminution in the liquidity of our reserves). DRN 13/1

* The cost is in terms of inconvenience rather than money, if there is any cost at all.

Dear David,

THE RESERVES : EMCF MOBILISATION BY BELGIUM

You asked about the arrangements under which we were asked to contribute $100 million to the mobilisation by Belgium of part of their official ecu holdings.

The facility under which the Belgians made the request was agreed in June 1985 and announced to Parliament shortly thereafter. It is open to all member states participating in the European Monetary System, and not just those in the Exchange Rate Mechanism. It is therefore a facility we could ourselves draw on, should we need to. Our current maximum entitlement is 1.6 billion ecu, or about $1.7 billion.

The purpose of the arrangement is to allow member states temporarily to convert their holdings of official ecus into currencies which can be used for intervention. Since the transaction is merely a swap, its effect is on liquidity rather than on the quantum of reserves. Countries making use of it receive spot dollars or, by mutual agreement, other currencies. Countries contributing to the mobilisation receive official ecus in return. Remuneration is at market rates. Our participation would not therefore cost us anything, nor lead to any reduction in the level of the reserves (apart from a small artificial change caused by the use of different valuation conventions). The swap is for three months in the first instance, renewable for a further three months.

Countries making use of the facility are not required to justify their requests in detail. But the understanding is that they would only make a request in the event of a serious liquidity need. Contributing countries are allowed to opt out entirely or in part "in exceptional circumstances". What those circumstances might be is not spelt out in the relevant agreement. But the understanding is that it would only be done with good cause. If some member states do opt out, the others may be asked to increase their own contribution. Contributions are calculated by reference to relative shares of total dollar deposits with the EMCF (and are therefore proportionate to the relative size of total dollar reserves compared with those of other member states).

The Chancellor's agreement on this occasion was based on the assumption that other member states were also contributing, that there was a clear case of need (the Belgium reserve loss since the beginning of November had totalled almost $2 billion), that there would be no cost to the EEA and that there would be no significant effect on the liquidity of our own reserves. Had the French, with their much larger entitlement, made a similar request our response might well have been rather different.

As it happens, as a result of the EMS realignment at the weekend the Belgians have now withdrawn their request.

Yours
Alex

A C S ALLAN
Principal Private Secretary

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