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10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

9 January 1990

Dear Sir,

ERM: LIRA REALIGNMENT

Thank you for your letter of 8 January which the Prime Minister has seen and noted.

I am copying this letter to Stephen Wall (Foreign and Commonwealth Office), Andy Lebrecht (Ministry of Agriculture, Fisheries and Food) and Paul Tucker (Bank of England).

*Yours
Paul*

Paul Gray

John Gieve, Esq.,
H.M. Treasury.

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Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

8 January 1990

Paul Gray Esq
Private Secretary to the
Prime Minister
10 Downing Street
LONDON
SW1A 2AA

Prime Minister²
Confirmation of the details.

Dear Paul

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ERM : LIRA REALIGNMENT

I told you on Friday afternoon of the proposal for an ERM realignment involving a commitment by the lira to operate in the narrow ERM band. As you know, the Chancellor and Governor participate in ERM realignment proceedings even though sterling is not a member. On this occasion it was possible to reach agreement by telephone, on Friday afternoon and evening, so no weekend meetings were needed. I enclose a copy of the agreed Communique put out by the EC Monetary Committee just before midnight GMT on Friday.

The only change in the ERM is in the value of the lira. Intervention margins and central cross rates between all other member currencies have been left unchanged. For the lira the margins of fluctuation have been narrowed from ± 6 per cent to the $\pm 2\frac{1}{4}$ per cent margins followed by all other member currencies apart from the peseta. The lower limits for the lira have been left unchanged. The central rates have been reduced by around $3\frac{1}{2}$ per cent, setting them roughly in line with Friday's market rates. As is normal practice at realignments, new notional central rates against the ecu for the non-ERM currencies - sterling, the drachma and the escudo - were set in line with the latest market rates.

The Italians have been largely successful in presenting the move as a shift to the narrow margins arrangement and not as a devaluation. Nevertheless, we know that the move was precipitated

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sooner than the Italians wished by market pressures on the lira last week.

It is significant that no other ERM country took the opportunity to devalue against the DM, despite some recent strains in the mechanism. We believe the French welcomed the opportunity to reinforce the message they have been giving to the market that they do not intend to devalue.

In the market this morning the lira strengthened by around $\frac{1}{2}$ per cent against the DM, putting it temporarily at the top of the ERM narrow band.

As with all ERM realignments, there will be consequences for Community agricultural expenditure and green rates. We cannot yet be sure what these will be, but we believe that on this occasion any effect on expenditure will be modest.

I am copying this letter to Stephen Wall (FCO), Andy Lebrecht (MAFF), and to Paul Tucker (Bank of England).

Yours sincerely
JG.

JOHN GIEVE
Principal Private Secretary

MONETARY COMMITTEE OF THE
EUROPEAN COMMUNITY

Brussels, 5 January 1990

C O M M U N I Q U E

Following a decision by the Italian government to reduce the fluctuation margins of the lira in the exchange rate mechanism of the EMS to + 2.25%, the Ministers and Central Bank Governors have by mutual agreement, in a common procedure involving the Commission and after consultation of the Monetary Committee, decided to fix a new central rate for the lira at approximately its market rate, with the result that its lower intervention limits will remain unchanged.

The Ministers, the Governors and the Commission welcome this as a contribution to strengthening the EMS. It is also an expression of the commitment of the Italian authorities to the implementation of Stage One of Economic and Monetary Union. They encourage the Italian government, in view in particular of the implementation of the 1988 EEC Directive on full capital liberalization, to undertake the necessary measures for further reduction of the fiscal deficit. This will also foster greater economic convergence in the Community.

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

FB	42.1679
Dkr	7.79845
DM	2.04446
FF	6.85684
IrL	0.763159
Lit	1529.70
Flux	42.1679
Hfl	2.30358
Pta	132.889
Dr	187.934
Esc	177.743
UKL	0.728615

The bilateral central rates between all the other currencies participating in the ERM remain unchanged.

The new bilateral central rates and the compulsory intervention rates for the lira will be communicated by the monetary authorities in time for the opening of foreign exchange markets on 8 January 1990.