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Treasury Chambers, Parliament Street, SW1P 3AG  
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**PRIME MINISTER**

**EXCHANGE RATE MECHANISM**

At our discussions yesterday you asked for a note on the mechanics which would be required if you were to announce at your Conference Speech on 12 October that we were joining the ERM that weekend.

... 2. I attach a note which sets out in schematic form possible alternative forms of words for you to use together with the different sequences of events which would be required in each case.

A handwritten signature in blue ink, appearing to read 'John M.'.

[j.m]

4 October 1990

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OPTION 1

Prime Minister simply announces entry - interest rate cut follows later.

Alternative A: PM's announcement in Conference Speech takes limited form - says government committed to joining, ERM membership a tough anti-inflationary policy, "time is rapidly approaching when we will join".

Sequence

of events:

- (i) PM's announcement at say 3.00pm; afterwards possible Bank intervention to keep market rate close to [£1 = DM2.95].
- (ii) Around that time N Wicks (in Washington) sounds out Chairman of EC Monetary Committee who sounds out other members as to whether they can agree our request, with central exchange rate at [£1 = DM2.95] and 6 per cent margins without a meeting; or whether meetings (in Brussels on Saturday/Sunday) required.
- (iii) Simultaneously Bank of England phones other central banks to secure their agreement.
- (iv) Chancellor speaks to Carli; faxes sent to other ECOFIN Ministers, Commission, Chairman of Central Bank Governors' Committee etc.
- (v) Cabinet Ministers contacted if possible, and told, shortly before
- (vi) Chancellor confirms after markets' close (10pm) we have applied and terms agreed/under discussion.
- (vii) If Monetary Committee/ECOFIN have to meet Chancellor announces result once agreed.
- (viii) Chancellor statement to Commons on Monday 15 October.

(ix) Probable interest rate cut either soon after entry following £ strength; or somewhat later following £ stability.

Alternative B: PM's announcement more precise: says "applying to join, at a central rate of [£1 = DM2.95] and 6 per cent margins".

Sequence

of events:

(i) PM's announcement; afterwards, possible Bank intervention to keep market rate close to [DM2.95]; shortly before speech Cabinet colleagues told in Bournemouth.

(ii) N Wicks consults as in Alternative A(ii); his task more awkward (Monetary Committee treated as a rubber stamp) but judged manageable.

(iii) Bank of England phones other central banks to secure their agreement.

(iv) Chancellor speaks/faxes as in Alternative A(iv).

(v) Chancellor confirms result of Monetary Committee/ECOFIN's deliberations as to rate and terms.

(vi) Chancellor statement to Commons on Monday 15 October.

(vii) Probable interest rate cut either soon after entry following £ strength; or somewhat later following £ stability.

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OPTION 2

Involves combined announcement of ERM membership and 1 per cent interest rate reduction on 12 October.

Alternative A: (i) Bank announces 1 per cent interest cut before speech at one of regular dealing times;  
(ii) PM announces ERM membership in speech, in following terms:

- disappointing September RPI; continuing oil price problems;
- but clear signs inflationary pressures now in check eg MO, low demand. Inflation will fall sharply next year;
- so scope for modest interest rate reduction today;
- but must keep policy tight;
- therefore have decided to join ERM now to reinforce firm anti-inflationary discipline. Proposing to member states rate [close to] [DM2.95] plus 6 per cent margins.

(iii) Bank intervenes to try to keep rate close to [DM2.95]; very difficult to achieve in interval between interest rate cut and ERM membership announcement.

(iv) [Shortly before speech Cabinet colleagues told in Bournemouth; or is this too risky?]

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(v) N Wicks/Bank/Chancellor telephoning and faxing follows same arrangements as in Option 1; but weekend meetings much more likely because proposition more complex;

(vi) Chancellor announces result of Monetary Committee/ECOFIN deliberations as to central exchange rate and terms.

(vii) Chancellor statement to Commons on Monday 15 October.

Alternative B: (i) PM announces interest rate cut and ERM membership in speech in same terms as in Option 2, Alternative A.

(ii) Bank intervenes as necessary after speech to try to keep rate close to [DM2.95]; success cannot be guaranteed.

(iii) N Wicks/Bank/Cabinet Ministers/Chancellor telephoning faxing and weekend statement as in Option 2, Alternative A.

(iv) Chancellor Statement to Commons on October 15.

Alternative C: (i) PM announces ERM membership in speech in same terms as in Option 2, Alternative A, except that she omits passage on interest rate cut;

(ii) Bank intervenes as necessary after speech to try to keep rate close to [DM2.95]; success cannot be guaranteed.

(iii) N Wicks/Bank/Cabinet Ministers/Chancellor telephoning and faxing as in Option 2, Alternatives A and B; but negotiations with EC much more difficult, perhaps not deliverable, than with a fait accompli on interest rates.

(iv) Chancellor announces results of EC deliberations plus interest rate cut on Sunday.

(v) Chancellor statement to Commons on October 15.

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cc COP  
BP  
ED



FROM: JOHN GIEVE  
DATE: 4 October 1990  
EXT: 4330

SIR P MIDDLETON

cc Sir T Burns  
Mr Wicks  
Mr Scholar  
Mr P R C Gray  
Mr O'Donnell

PS/Governor - B/E

HM TREASURY PRESS NOTICE

... Following the discussion with the Prime Minister and some comments from the Chancellor, I attach a redraft of the press release which reflects discussion with Messrs Wicks, Scholar and Gray. I would welcome very quick comments so that I can send it for approval to the Prime Minister's office by 8.30 am on Friday.

JC

JOHN GIEVE



Text of HM Treasury Press Notice to be issued at 4.00 pm on Friday, 5 October 1990

UK REDUCTION IN INTEREST RATES AND ENTRY TO ERM

At 4.00 pm today the Chancellor of the Exchequer, the Rt Hon John Major MP issued the following statement:

"It has become increasingly clear [~~in recent months~~] that the Government's tough policies of high interest rates and firm budgetary control are having their effect in reducing inflationary pressures in the economy. Monetary growth has fallen sharply and the growth of demand has slowed ~~markedly~~. ~~Although prices are still rising under the impact of the increase in oil prices,~~ <sup>This rise in oil prices will continue to feed through for some time but</sup> the prospect is for a substantial reduction in inflation ~~next~~ <sup>over the coming</sup> year both in absolute terms and in relation to inflation in other European countries.

In these circumstances, a reduction in interest rates is now justified, so from Monday morning the Bank of England will reduce interest rates by 1 per cent to 14 per cent.

A tight monetary policy and a firm exchange rate remain essential to bring inflation down. To reinforce our framework of monetary discipline, we have decided that the UK should now join the Exchange Rate Mechanism of the European Monetary System. We have proposed therefore to our European partners that we should join the ERM on Monday morning with a central exchange rate around DM2.95 and with 6 per cent margins."