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15 October 1990

Andrew Turnbull Esq  
Principal Private Secretary  
to the Prime Minister  
10 Downing Street  
LONDON  
SW1

*Dear Andrew*

**CHANCELLOR'S STATEMENT ON ERM**

... I attach a copy of the Statement which the Chancellor proposes to make to the House of Commons this afternoon on sterling's entry to the ERM.

I am copying this to the Chief Press Secretary, and to the Private Secretaries to the Governor of the Bank of England and Lord Hesketh.

*Yours sincerely*  
*Kate Gaseltine*  
**MISS K GASELTINE**

15 OCTOBER 1990

EXCHANGE RATE MECHANISM: ENTRY OF STERLING

Mr Speaker, I should like to make a statement about sterling's entry to the exchange rate mechanism of the European Monetary System, which took effect on Monday 8 October. I understand the House will soon be able to discuss economic affairs, but I wanted to take the first available opportunity to make a statement about this important step.

2. Sterling now has a fixed central rate against each of the other currencies in the ERM. The entry rate is set against the ecu and translates to a central rate against the deutschemark of DM2.95. This was marginally above the market level when the decision to enter was announced on Friday 5 October and is a little below the current market rate.

3. Sterling is able to move by a maximum of 6 per cent above or below the central rates. Our choice of the wider 6 per cent margins is intended to allow sterling to settle into the system, and follows recent precedent. In due course we will move to the narrow band of  $2\frac{1}{4}$  per cent margins. The terms of entry we have agreed with our partners are those we sought.



4. Mr Speaker, the Government has long made it clear that sterling would enter the ERM during Stage 1 of EMU which began in July. It has now done so at the earliest appropriate time. I would like to explain how our decision fits into the Government's wider economic strategy.

5. It has become abundantly clear that policy is now reducing inflationary pressures in the economy. Monetary growth on all measures has fallen sharply, and the growth of narrow money is within its target range. The growth of demand has slowed. Although the rise in oil prices will continue to feed through for a while, the prospect is for a substantial reduction in inflation over the coming year. This will be so both in absolute terms and in relation to inflation in other European countries. It was for these reasons that we felt able to reduce interest rates by one per cent.

6. A firm exchange rate is a vital part of our policy to maintain tight monetary conditions in order to reduce inflation. As I have repeatedly made clear, membership of the ERM will be an additional discipline for the UK economy. In no sense is it a soft option.

7. Monetary policy will remain tight. I must emphasise that I will not make a further reduction in interest rates until I am sure that it is safe and prudent to do so.

8. Membership has important implications for British companies and their employees. They must contain their costs. If they fail to do so, they will not be bailed out by a devaluation of the currency. This is the key message for those engaged in pay bargaining this Autumn and subsequently.

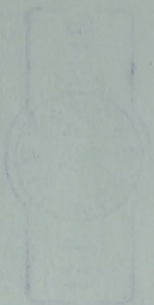
9. But in addition to acting as a discipline on costs, membership of the ERM offers significant benefits for British industry. It will help to provide greater stability of exchange rates with our main trading partners and thus the certainty which business needs to plan for the future. It will also make Britain even more attractive for inward investment.

10. Although entry to the narrow band of the ERM will fulfil our obligations under Stage 1 of EMU, it does not imply any change in our opposition to the imposition of a single currency. In the IGC in December we shall continue to argue against that plan and for the proposals I first set out in June. As the House knows, these propose an evolutionary and market-based approach, based on the creation of a new European Monetary Fund and a common currency, the "Hard ecu".

11. In summary, Mr Speaker, the mechanism has a proven record of success over recent years in producing greater stability of exchange rates and lower inflation. The Government believes that



Britain too will benefit from membership. The ERM will reinforce our counter-inflationary policies, help to provide the stability and certainty that industry needs, and will set the right framework for a resumption of soundly-based and non-inflationary growth.





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