

Meeting Record

SUBJECT

cc MASTER

SECRET AND PERSONAL



FILE SLH  
2a-b

10 DOWNING STREET

LONDON SW1A 2AA

*From the Private Secretary*

20 December 1990

*Dear John,*

PRIME MINISTER'S MEETING WITH THE CHANCELLOR AND  
GOVERNOR OF THE BANK OF ENGLAND

Following this morning's meeting with the Chancellor, the Governor, the Deputy Governor and senior Treasury officials, the Prime Minister indicated - and I subsequently confirmed with the Chancellor - that the note of the meeting should record only the action points which emerged.

Nonetheless, this letter contains matters of a sensitive nature and I should be grateful if it could be given a very limited distribution only.

There was concern that, against the background of difficult economic conditions over the next few months with economic indicators showing a further slowdown in activity, the Government's decision to join the Exchange Rate Mechanism (ERM) of the European Monetary System might come under attack. It would be essential for No. 10, the Treasury and the Bank to give a clear and consistent defence of the Government's ERM strategy.

Three points in particular would need to be fully brought out. First, the Government had joined the ERM at the right time. Second, the rate of £1 = DM 2.95 was and remained the appropriate central rate. Third, however, it was vital to get across the positive advantages of the strategy. The objective was to get inflation down and keep it down to levels broadly comparable to those in Germany and France. Moreover, all the indications were that the economy was on track for a very good inflation performance with sharp falls in headline inflation over the next few months and a near halving of the headline rate by 1991 Q4.

It would need to be made absolutely clear that the decisions on joining the ERM and setting the rate had been agreed and fully supported in No. 10 and the Treasury, and at the Bank. It might also be useful to point out that, with the weakness of the dollar against European currencies, in particular the DM, if sterling had remained outside ERM, the Government could be facing a lower and falling exchange rate with no possibility of interest rate cuts. Such an argument would, however, have to be used carefully in the light of further developments on interest rates and the exchange rate.

SECRET AND PERSONAL

21

It would therefore be desirable for the Treasury to develop a robust statement setting out the strategy, which could be made available also to No. 10 and the Bank. This common statement could be drawn upon in preparing for further speeches and press interviews over the next few months. The statement should be sent to the Treasury, No. 10 and the Bank as soon as possible.

The Prime Minister would use two television interviews planned for early January to put the message across. The Chancellor would be providing the traditional Q&A article in the Financial Times: it would be especially important that the strategy emerged clearly from that article. There could also be other useful opportunities for the Treasury to enunciate the strategy in speeches and in the press. Finally, the Governor should use the opportunity of speeches, which he was planning in mid-January, to reinforce the strategy.

I am copying this letter to Paul Tucker (Bank of England).

*Yours ever,*

*Barry*

BARRY H. POTTER

John Gieve, Esq.,  
H. M. Treasury