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PRIME MINISTER

16 January 1991

Your discussions tomorrow on EMU

John Redwood (who is standing in for Peter Lilley) has politely alerted me to his intention to raise the issue of whether the EMF would be credit-creating. He has also alerted the Treasury, so ministers should be briefed.

There has been a certain amount of discussion on this point, led by Tim Congdon, following last year's Treasury bulletin discussion of the hard ecu plan.

Very briefly:

There are two separate points which tend to be blurred.

- Whether the EMF, as proposed by HMG, poses a threat to national monetary independence. In that central banks could be obliged to repurchase national currencies from the EMF, it clearly does have consequences for domestic policy-makers. There are those, like John Redwood, who worry further about the degree of discretion it would have in requesting repurchase, ie whether it should or should not be obliged to match the basket perfectly, all the time, in its mix of national currency assets, or should be allowed a limited degree of freedom in deciding whether to do so.

Here, I gather, the line is that this is still all for discussion.

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- Whether the EMF's activities would lead to uncontrolled credit creation. Here, I gather, the proposals have been misunderstood by Congdon and co. He supposed the EMF could not hold hard ECU assets; since it could, it would be able to control the hard ECU money supply by setting ECU interest rates through money market operations, in the traditional manner. So there would not be a danger of uncontrolled credit creation. No need for monetarist worry: the total EC money supply would still be under control.

Of course, the operations of the EMF would affect the proportions of the total EC money supply that were held in national currencies and hard ECUs respectively - though it would be perfectly open to national central to affect the proportion by their own actions, too. This reality, of course, could still be construed by some as involving "EMF interference" - but that takes you back to point one.

Conclusion:

So the first point is still open, and the second involves a misunderstanding. But of course the proposals would have an impact on domestic policy-makers; that is the nature of the currency competition the hard ECU is intended to offer.

John Redwood will also raise general points about HMG's attitude to a single currency, but that will not pose you any difficulty.

*Sarah*

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