3884/009 SECRET

Prime Minister

DRW 8/12

FROM: C W KELLY

DATE: 8 December 1986

MR PERETZ

cc Principal Private Secretary
PS/Economic Secretary
Sir P Middleton
Mr Cassell
Mr H Evans
Mr Grice
Ms Goodman

FRENCH INTERVENTION

Sir Geoffrey Littler phoned earlier this morning to say that M. Lebegue had made an impassioned speech at the Monetary Committee about the failure of others to honour the Gleneagles Agreement.

2. Lebegue said that since August the French had spent $7 billion in deutschemark without any help from anyone else (meaning the Bundesbank) and that they had had enough. In future they would refrain from intra-marginal intervention altogether, though they would, of course, continue to meet their obligations in respect of intervention at the margins.

3. Tietmeyer's response was apparently fairly restrained. He said he understood the French position. So did the Bundesbank, who were also prepared to meet their intervention obligations at the margins. Decisions about intra-marginal intervention were for each country to take individually.

4. The French have been partly responsible for their own difficulties. They have been determined to remain within the upper half of the mechanism, in sight of the deutschemark, rather than to make use of the full 2¼ per cent flexibility allowed within the ERM rules. This is, however, only partly amour propre. They have been fearful, as we would be in similar circumstances, that once they begin to get towards the lower margin the markets would begin to scent a realignment in the offing, and make that expectation self-fulfilling.

5. The French Franc opened softer against the deutschemark this morning. The cross rate was 3.28¾ compared with 3.27 5/8 at close on Friday. The absence of any central bank intervention was generally noted.

6. Since then, it has strengthened slightly. At noon it stood at 3.28¼. But the French authorities are unlikely to derive much comfort from that. The improvement will largely reflect the unwinding of positions taken up on Friday, when a realignment over the weekend looked possible. The pressure could well build up again before next weekend.

7. To help prepare their defences, the Bank of France this morning raised the seven day money market rate from 7½ per cent to 8½ per cent. This reverses a cut made only last week from 8¼ per cent, where it had stood for the previous 18 months.

C W KELLY