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MJ.

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From the Private Secretary

8 November 1990

Dear John,

PRIME MINISTER'S MEETING WITH THE PRESIDENT OF BUNDESBANK

The Prime Minister had a private talk this evening with the President of the Bundesbank. Herr Poehl was accompanied by Herr Gierenstein. He was as so often all things to all men.

Poehl recalled that his last meeting with the Prime Minister had been on the day that the DM had been extended to East Germany. On the whole, reunification had not had an inflationary impact. There had been a considerable increase in imports, helpfully reducing Germany's trade surplus. There had also been a dramatic increase in unemployment in the former East Germany: he expected unemployment in Germany as a whole next year to touch 3.5 million. The decline in industrial production in the former East Germany was of the order of 50 per cent. A massive transfer of funds from East to West was needed and there had been an enormous increase in public sector borrowing. Fortunately the economic situation in the Western part of Germany was very good. In the short run at least, Germany was acting as a growth locomotive. He was not too worried about the prospect of inflation because of the unemployment situation, which was exerting downward pressure on wages.

On the exchange rate situation, Poehl said that he was not too worried about the US dollar, which he thought had reached bottom. The interest rate differential had now moved against the dollar. But if the dollar did come down further, he feared pressure for Louvre-type arrangements. The Prime Minister said these should be resisted.

Turning to EMU, Poehl said he did not understand why we made the single currency such an issue. Even if one took the conclusions of the Rome European Council literally, it would not come about for at least eight years. In practice it would be much longer, because the conditions for Stage II could not be met by 1994. Moreover Europe would look very different in four or five years time, with several new or prospective members. It might become little more than a free trade area, and there was nothing wrong with that. Personally he was not fussed about it. He would be happy to stay with the existing situation. But he could live with a single currency provided there was a fully independent European Central Bank, no less committed to keeping down inflation than the Bundesbank. But his influence on the debate was not very great: it was the German Government which decided policy and they had opted for a single currency. He had to accept this hypothesis. If the Prime Minister was so opposed she should just block the IGC, given that unanimity was needed for Treaty amendment. The Prime Minister said that the others, or some of them, would presumably then go ahead separately. Poehl said that a de facto monetary union was already forming between Germany and smaller states like Netherlands, Belgium and Austria. They had surrendered effective sovereignty over their monetary policy, simply following the Bundesbank.

Poehl added that he personally saw little point in focussing on the final destination. It would be better to concentrate on the next step. What he really disliked was that if anyone dared criticise any element of the Delors plan, Delors immediately accused them of being immoral or anti-European. It was interesting that in France only the socialists were really interested in EMU: Balladur had affected very much the same attitude as the Prime Minister. Poehl added that we should make more of the point that you could not have a genuine monetary union when so much of industry in some Member States was nationalised, in particular the banking industry in Italy and France.

I am copying this letter to Stephen Wall (Foreign and Commonwealth Office).

Yours sincerely,

Charles Powell

John Gieve Esq
HM Treasury.