

MRS. LOMAX ✓

FROM: SIR GEOFFREY LITTLER  
DATE: 19 SEPTEMBER, 1985cc Sir P. Middleton  
Sir T. Burns  
Mr. Culpin  
Mr. C. KellyGovernor, Bank of England  
Mr. Loehnis dittoG.5 DISCUSSIONS

We have kept to a very limited circle, and it has so far not leaked, that there is to be a G.5 meeting of Ministers and Central Bank Governors in New York this weekend. This stems from an American initiative, reflecting a considerable change of attitude on the part of Secretary Baker compared with his predecessor, and his desire to take an important initiative. His primary objective is to counter protectionist pressure in Congress by demonstrating that the US Government and others are doing something about the problem, including particularly the high value of the dollar.

--- 2. I attach:

- B - the latest versions of the draft Statement;
- A - comments and drafting-points on the Statement;
- C - an agenda of points for discussion on intervention, which Baker may table or use as a guide);
- D - a note of UK objectives;
- E - a provisional line to take for IDT.

Timetable and Logistics

3. The sequence of events will be:

- Luxembourg, Friday, 5.30 p.m.: meeting with French and German colleagues (in the absence of the Governor I have asked that Mr. Loehnis be admitted);
- Luxembourg, Friday, 7.30 p.m.: I have an arrangement to telephone David Mulford in Washington (1.30 p.m. his time) to report any special points and particularly views of European Ministers on the press conference problem.

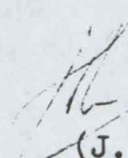
SECRET

We then move on to ECOFIN and return to London during Saturday afternoon, meeting the Governor in the VIP lounge at Heathrow around 6 p.m. before catching the 7 p.m. Concorde to New York.

- Heathrow, Saturday, 6.15 p.m.: IDT available for a call from me if there is need;
- New York, Saturday evening: I shall see David Mulford, who has agreed to go over with me his latest version of the texts (I shall give him our latest UK passage then). We shall have the useful opportunity of seeing these texts before others do, and perhaps doing some tidying up;
- New York, Sunday, approx. 10.15 a.m.: G.5 meeting begins, expected to continue until possibly 5 p.m. or even a little later (Stoltenberg appears to have found a slightly later plane than I was told earlier).. A press conference would have to be during the last hour of this period.;
- I have arrangements to contact IDT, who will have initial copies of the Statement and line to take, so that we can readily telephone amendments;
- we catch the plane from New York at 9p.m., arriving back at Heathrow about 08.40 a.m. on Monday. The intention would be to avoid press at the airport on return.

Line to Take With Press

4. It might be particularly helpful if the Chancellor could find time to look at the annexed line to take for IDT. I have in mind simply that any amendments we could make before leaving for Luxembourg will in turn make it easier to telephone any further amendments from New York.

  
(J. G. LITTLER)

COMMENTS ON STATEMENTStatus of Drafts

There are two versions immediately below:

- Annex B 1 is the draft agreed by G.5 Deputies last weekend, but with no time for editing, and containing one or two slight oddities. I include this in case it is the only version available to European colleagues in Luxembourg.
- Annex B 2 (double-spaced) is the main statement incorporating some editing comments I sent by telex to my colleagues, plus the United Kingdom passage revised by Sir Terence Burns (not yet seen by representatives of any other countries). You may find this easier to work on.

You will be telling your European colleagues in Luxembourg that we are travelling out on Saturday night. You could add that I have made an arrangement to contact Mr. Mulford that evening in New York. Therefore, if at Luxembourg the three European countries agree to any proposals for amendment, I could conveniently feed them in, so that they could be at least incorporated in square brackets for easier handling at the full G.5 session.

The United States will present fresh drafts incorporating (and marking) any other editing revisions immediately before we meet in New York on Sunday.

Detailed Comments

I take the paragraphs in sequence:

Paragraphs 1 - 5: no change. Paragraph 5 is of course the first major statement on exchange rates.

Paragraph 6: the last couple of sentences are clumsy but all right in substance. Leave until Saturday evening.

Paragraph 7: a neater opening would be: "The current sustained expansion is accompanied by declining inflation". This also avoids repeating the ugly phrase already in the previous paragraph.

Paragraph 8: not all interest rates have fallen, and real interest rates have risen. But the sentiment matters for the US, and I suggest we accept it.

Paragraphs 9 - 11: I think we can be content with our revised version (Annex B 2), but two points to make. First, at the Chancellor's suggestion, I asked by telex for deletion in paragraph 10 after the reference to appreciation of the US dollar of the words: "reflecting the attractiveness of the US economy to international investors". The point is that this phrase could undermine what we want, but we may need to persuade others. Secondly, the Germans have been wriggling to get out of the reference to themselves at the end of paragraph 10. We should not let them off the hook.

Paragraph 12: my apologies. I failed to telex an amendment to the unsatisfactory last sentence. I suggest it should read: "Ministers and Governors agreed that each of them needs to open markets in order to help others resist protectionist pressures. This and the maintenance of non-inflationary domestic growth will ensure that the current expansion continues in a more balanced fashion. They committed themselves to policies to that end."

Paragraphs 13 - 15: no comment.

Paragraph 16: we want none of the words in square brackets. "worldwide" was suggested as an alternative to "outside the United States", on which the US themselves were insisting.

Paragraph 17: the problems arise only on the square-bracketed language. We would omit "some" and our choice of the three options would be "desirable". We want the last sentence included, or something very like it, and it is the United States who are resisting.

9/15/85

D R A F T

Announcement of the Ministers of Finance and  
Central Bank Governors of France, Germany,  
Japan, the United Kingdom, and the United States

1. Ministers of Finance and Central Bank Governors of France, the Federal Republic of Germany, Japan, the United Kingdom, and the United States met today September 22, 1985 in the context of their agreement to conduct mutual surveillance and as part of their preparations for wider international discussions at the forthcoming meetings in Seoul, Korea. They reviewed economic developments and policies in each of their countries and assessed their implications for economic prospects, external balances, and exchange rates.

2. At the Bonn Economic Summit in May 1985 the Heads of State or Government of seven major industrial countries and the President of the Commission of the European Communities issued an Economic Declaration Towards Sustained Growth and Higher Employment. In that Declaration the participants agreed that:

The best contribution we can make to a lasting new prosperity in which all nations can share is unremittingly to pursue, individually in our own countries and cooperatively together, policies conducive to sustained growth and higher employment.

3. The Ministers and Governors were of the view that significant progress has been made in their efforts to promote a convergence of favorable performance among their countries on a path of steady noninflationary growth. Furthermore, they concluded that their countries are restoring the vitality and responsiveness of their economies. As a result of these developments, they are confident that a firm basis has been established for a sustained, more balanced expansion among their countries. This sustained growth will benefit other industrial countries and will help ensure expanding export markets for developing countries, thereby contributing importantly to the resolution of international debt problems.

4. They believe that this convergence of favorable economic performance has been influenced increasingly by policy initiatives undertaken by our countries. Moreover, each of our countries is committed to the implementation of further policy measures which will reinforce favorable convergence and strengthen the sustainability of the current expansion.

5. Ministers and Governors were in agreement that recent shifts in fundamental economic conditions among their countries, together with policy commitments for the future, have not been reflected fully in exchange markets.

SECRET

Recent Economic Developments and Policy Changes

6. Real growth in aggregate for our countries will be about 3 per cent this year, compared to negative growth of -0.7 per cent in 1982. Although this figure is down slightly from 1984, growth will be more balanced than at any time in the last four years. After the particularly rapid U.S. growth of 1983-84, there is now increased evidence of internal growth in the other countries. In particular, private investment is picking up strength. The current expansion is occurring in a context of fiscal consolidation; it is not dependent on short-lived fiscal stimulus. As a result of the changes in the components of growth, real growth in our countries can be expected to remain strong as U.S. growth moderates.
7. The current sustained expansion is occurring within a framework of declining inflation, a phenomenon that is unprecedented in the past three decades. Inflation rates are at their lowest rate in nearly 20 years, and they show no signs of reviving.
8. There has been a significant fall in interest rates in recent years. Apart from welcome domestic effects, this has been particularly helpful in easing the burden of debt repayments for developing countries.
9. This successful performance is the direct result of the importance given to macroeconomic policies which have reduced inflation and inflationary expectations, the consistent vigilance over excessive government spending, greater emphasis on market forces and competition, and prudent monetary policies.
10. These positive economic developments notwithstanding, there are large imbalances in the external positions of our countries which pose potential problems, and which reflect a wide range of factors. Among these are: the deterioration in external position which the US experienced from its period of very rapid relative growth; the particularly large impact on the U.S. current account of the economic difficulties and the adjustment efforts of some major developing countries; difficulty of trade access in some markets; and the steady appreciation of the U.S. dollar reflecting the attractiveness of the U.S. economy to international investors. The interaction of these factors -- relative growth rates, the debt problems of developing countries, and exchange rate developments -- has contributed to large, potentially destabilizing external imbalances among our countries. In particular, the United States has a large and growing current account deficit, and Japan, and to a lesser extent Germany, large and growing current account surpluses. The U.S. current account deficit is now contributing to protectionist pressures which, if not resisted, could lead to mutually destructive retaliation with serious damage to the world economy: world trade would shrink, real growth rates could even turn negative, unemployment would rise still higher, and debt burdened developing countries would be unable to secure the export earnings they vitally need. Ministers and Governors agreed that it was essential that these protectionist pressures be resisted.

### Policy Intentions

11. The Finance Ministers and Governors affirmed that each of their countries remains firmly committed to its international responsibilities and obligations as leading industrial nations. The SDR currency countries also share special responsibilities to ensure the mutual consistency of their individual policies. The Ministers agreed that establishing more widely strong, noninflationary domestic growth and growing markets will be a key factor in ensuring that the current expansion continues in a more balanced fashion, and they committed themselves to policies towards that end.

12. Ministers recognized the importance of providing access to their markets for LDC exports as those countries continue their essential adjustment efforts. To ensure such market access, they all agreed to avoid protectionist policies. They welcome the GATT preparatory meeting scheduled for late September and expressed their hope that it will reach a broad consensus on subject matter and modalities for a new GATT round.

13. In this context, they recalled and reaffirmed the statement in the Bonn Economic Declaration on the debt situation.

Sustained growth in world trade, lower interest rates, open markets and continued financing in amounts and on terms appropriate to each individual case are essential to enable developing countries to achieve sound growth and overcome their economic and financial difficulties.

14. The Ministers agreed that they would monitor progress in achieving a sustained noninflationary expansion and intensify their individual and cooperative efforts to accomplish this objective. To that end, they agreed to statements of policy intentions by each of their countries.

### Conclusions

15. The Ministers of Finance and Central Bank Governors agreed that recent economic developments and policy changes, when combined with the specific policy intentions described in the attached statements provide a sound basis for continued and a more balanced expansion with low inflation. They agreed on the importance of these improvements for redressing the large and growing external imbalances that have developed. In that connection, they noted that further market opening measures [outside the United States] [world wide] will be important to resisting protectionism.

16. The Ministers and Governors agreed that exchange rates should play a major role in adjusting external imbalances. In order to do this, exchange rates must fully reflect fundamental economic conditions which, in spite of some recent response to changes in performance and prospects, is not yet the case. Specifically they believed that [some] further appreciation of the main non-dollar currencies against the dollar is [warranted/justified/desirable]. [They stand ready to take appropriate action in close cooperation to encourage this.]

SECRET

The Government of Japan, noting that the Japanese economy is in an autonomous expansion phase mainly supported by domestic private demand increase, will continue to institute policies intended to ensure sustainable noninflationary growth; provide full access to domestic markets for foreign goods; and internationalize the yen and liberalize domestic capital markets.

In particular, the Government of Japan will implement policies with the following explicit intentions.

1. Steady implementation of the Action Program announced on July 30 for the further opening up of Japan's domestic market to foreign goods and services.
2. Full utilization of private sector vitality through the implementation of vigorous deregulation measures.
3. Flexible management of monetary policy with due attention to the yen rate.
4. Intensified implementation of financial market liberalization and internationalization of the yen, so that the yen fully reflects the underlying strength of the Japanese economy.
5. Fiscal policy will continue to focus on the twin goals of reducing the central government deficit and providing a progrowth environment for the private sector. Within that framework, local governments may be favorably allowed to make additional investments in this FY 1985, taking into account the individual circumstances of the region.
6. Efforts to stimulate domestic demand will focus on increasing private consumption and investment through measures to enlarge consumer and mortgage credit markets.

The Federal Republic of Germany, which is already embarked on a course of steady economic recovery based increasingly on internally generated growth, will continue to implement policies to sustain and extend the progress achieved in strengthening the underlying conditions for continuing, vigorous, job-creating growth in the context of stable prices and lower interest rates.

In particular, the Federal Republic of Germany will implement policies with the following explicit intentions.

1. The priority objective of fiscal policy is to encourage private initiative and productive investments and to help maintain price stability.
2. Toward this end, the Federal Government will continue to reduce progressively the share of the public sector in the economy through maintaining firm expenditure control. The tax cuts due to take effect in 1986 and 1988 form part of the ongoing process of tax reform and reduction which the Federal Government will continue in a medium-term framework.
3. The Federal Government will continue to remove rigidities inhibiting the efficient functioning of markets. It will keep under review policies, regulations, and practices affecting labor markets in order to enhance the positive impact of economic growth on employment. The Federal Government and the Deutsche Bundesbank will provide the framework for the continuing evolution of deep, efficient money and capital markets.
4. The fiscal policy of the Federal Government and the monetary policy of the Deutsche Bundesbank will continue to ensure a stable environment conducive to the expansion of domestic demand on a durable basis.

The British Government will continue to pursue policies designed to maintain downward pressure on inflation; promote conditions that will sustain economic growth; limit the burdens imposed on the economy by the public sector; foster an economic environment which encourages innovative industrial investment and enterprise; and remove impediments and increase incentives to people and firms creating and looking for jobs.

In particular, the British Government intends:

1. to maintain a firm counter-inflationary monetary policy and strict control of the level and rate of growth of public sector expenditure.
2. to reduce the burden of taxation, in order to improve employment incentives;
3. to transfer further substantial areas of public sector industry to the private sector;
4. to take additional measures to remove impediments to the effective working of the labour market, including the reform of Wages Councils;
5. to get rid of or ease a wide range of bureaucratic burdens on industry in the fields of planning, taxation, health and safety, transport and elsewhere;

SECRET

The United States Government is firmly committed to policies designed to: ensure steady noninflationary growth; maximize the role of markets and private sector participation in the economy; reduce the size and role of the government sector; and maintain open markets.

In order to achieve these objectives, the United States Government will:

1. Continue efforts to reduce government expenditures as a share of GNP in order to free up resources for the private sector.
2. Implement fully the deficit reduction package for fiscal year 1986. This package passed by Congress and approved by the President will not only reduce by over 1 per cent of GNP the budget deficit for FY 1986, but lay the basis for further significant reductions in the deficit in subsequent years.
3. Implement revenue-neutral tax reform which will encourage savings, create new work incentives, and increase the efficiency of the economy, thereby fostering noninflationary growth.
4. Conduct monetary policy to provide a financial environment conducive to sustained growth and continued progress toward price stability.

The French Government intends to pursue its policy aimed at reducing inflation, moderating income growth, and achieving continued improvements in external accounts. It will further intensify its efforts to speed up structural adjustment and modernisation and thus lay the basis for job creating growth.

Therefore, it is committed:

1. To maintain an appropriate policy mix in order to bring down inflation to the level experienced by its main partners.
2. To secure the attainment of monetary aggregates growth targets, consistent with decelerating inflation.
3. To continue controlling public expenditures so as to allow for a reduction in the tax burden while reducing the government borrowing requirement.
4. To foster investment recovery by continuing to improve financial conditions in the business sector.
5. To take further steps towards liberalisation and modernisation of financial markets, increase competition in the financial sector so that the leading role of interest rates be comforted and and financial intermediation costs be alleviated.
6. To improve the functioning of labor markets and facilitate job creation, by designing a most innovative and active policy in the field of education and training and by fostering constructive discussions between social partners.

D R A F TAnnouncement of the Ministers of Finance and  
Central Bank Governors of France, Germany,  
Japan, the United Kingdom, and the United States

1. Ministers of Finance and Central Bank Governors of France, the Federal Republic of Germany, Japan, the United Kingdom, and the United States met today September 22, 1985 in the context of their agreement to conduct mutual surveillance and as part of their preparations for wider international discussions at the forthcoming meetings in Seoul, Korea. They reviewed economic developments and policies in each of their countries and assessed their implications for economic prospects, external balances, and exchange rates.

2. At the Bonn Economic Summit in May 1985 the Heads of State or Government of seven major industrial countries and the President of the Commission of the European Communities issued an Economic Declaration Towards Sustained Growth and Higher Employment. In that Declaration the participants agreed that:

The best contribution we can make to a lasting new prosperity in which all nations can share is unremittingly to pursue, individually in our own countries and cooperatively together, policies conducive to sustained growth and higher employment.

SECRET

Recent Economic Developments and Policy Changes

6. Real growth in aggregate for their countries will be about 3 per cent this year, compared to negative growth of -0.7 per cent in 1982. Although this figure is down slightly from 1984, growth will be more balanced than at any time in the last four years. After the particularly rapid U.S. growth of 1983-84, there is now increased evidence of internal growth in the other countries. In particular, private investment <sup>has picked up</sup> strength. The current expansion is occurring in a context of fiscal consolidation; it is not dependent on short-lived fiscal stimulus. As a result of the changes in the components of growth, real growth in their countries can be expected to remain strong as U.S. growth moderates.

7. The current sustained expansion is occurring within a framework of declining inflation, a phenomenon that is unprecedented in the past three decades. Inflation rates are at their lowest rate in nearly 20 years, and they show no signs of reviving.

8. There has been a significant fall in interest rates in recent years. Apart from welcome domestic effects, this has been particularly helpful in easing the burden of debt repayments for developing countries.

SECRET

economy: world trade would shrink, real growth rates could even turn negative, unemployment would rise still higher, and debt burdened developing countries would be unable to secure the export earnings they vitally need. Ministers and Governors agreed that it was essential that these protectionist pressures be resisted.

Policy Intentions

12. The Finance Ministers and Governors affirmed that each of their countries remains firmly committed to its international responsibilities and obligations as leading industrial nations. The SDR currency countries also share special responsibilities to ensure the mutual consistency of their individual policies. The Ministers agreed that establishing more widely strong, noninflationary domestic growth and growing markets will be a key factor in ensuring that the current expansion continues in a more balanced fashion, and they committed themselves to policies towards that end.

13. Ministers recognized the importance of providing access to their markets for LDC exports as those countries continue their essential adjustment efforts, and saw this as an important additional reason to avoid protectionist policies. They welcomed the GATT preparatory meeting scheduled for late September and expressed their hope that it will reach a broad consensus on subject matter and modalities for a new GATT round.

SECRET

17. The Ministers and Governors agreed that exchange rates should play a major role in adjusting external imbalances. In order to do this, exchange rates must fully reflect fundamental economic conditions which, in spite of some recent response to changes in performance and prospects, is not yet the case. Specifically they believed that [some] further appreciation of the main non-dollar currencies against the dollar is [warranted/justified/desirable].

(X) [They stand ready to take appropriate action in close cooperation to encourage this.]

The United Kingdom which has been experiencing steady growth of output and domestic demand over the past four years will continue to pursue policies designed to reduce inflation; to promote sustained growth of output and employment; to reduce the size of the public sector; to encourage a more competitive, innovative, market orientated private sector; to reduce regulation and increase incentives throughout the economy; and to maintain open trading and capital markets free of foreign exchange controls.

In particular, the British Government intends:

1. to operate monetary policy to achieve further progress towards price stability and to provide a financial environment for growing output and employment; and to buttress monetary policy with a prudent fiscal policy;
2. to continue to reduce public expenditure as a share of GDP and to transfer further substantial parts of public sector industry to private ownership;
3. to reduce the burden of taxation in order to improve incentives and to increase the efficient use of resources in the economy;
4. to take additional measures to improve the effective working of the labour market, including the reform of Wages Councils and improvements in youth training; to continue to reduce regulation in the areas of planning, health and safety, transport and elsewhere; and to implement proposals to liberalise and strengthen competition within financial markets.

INTERVENTION: POINTS FOR DISCUSSION

1. Rates:
  - for the dollar (not "targets" rather "horizons");
  - cross-rates of other currencies (? unchanged).
2. Strategy:
  - drive down sharply;
  - encourage some (how much) downward movement;
  - allow falls but resist rises;
  - smoothing.
3. Overall scale (ball-park figure)
  - cumulative over two or three months;
  - maximum in short period;
  - combination of how much and how quickly.
4. Choice of currencies:
  - concentrated or spread over range of currencies;
  - inclusion of non G5 currencies;
  - relevance of other "normal" interventions (EMS, Government purchases, etc).
5. Diversification of reserves
6. Division of total between G.5 members
7. Visibility:
  - in markets;
  - in media.
8. Operating in each other's markets:
  - making cooperation more evident;
  - avoiding time-zone variations.
9. Need for flexible response without ambiguity
10. Mechanisms for close contact:
  - between banks;
  - between Finance Ministries.
11. Interest Rates:
  - avoiding inconsistent action;
  - effects of intervention on interest rates/monetary conditions.

UK OBJECTIVESGeneral

We warmly share the US Administration objective of resisting protectionist pressures in Congress. We are therefore willing to join and support them in a strong move designed to help the US Administration in this.

We can accept the objective of getting the dollar to lower levels, although we remain troubled that the total mix of US strategies will have continuing inconsistencies. We are particularly worried about the impact on interest rates.

Intervention

We have two main objectives: that any intervention should be tactically sensible; and that the UK share should be limited.

We have to find some way of combining flexible response to market movements and changes in sentiment with minimum ambiguity and misunderstanding among the G.5 authorities. We envisage occasional and well-timed bursts of intervention, rather than some pre-calculated onslaught.

Our marker for the limit of direct UK intervention (sterling against dollars) should be a maximum of, say, \$1 billion. If we are thinking of a ball-park total of combined intervention of as much as \$20 billion - not unreasonable - our share would be 5%.

Exchange Rates

Again we have two main objectives:

- that sterling should certainly not rise more than the German and Japanese currencies, and preferably slightly less;
- that the Yen should not rise less than the DM.

We do not favour setting targets, but it would be sensible to talk about "horizons", i.e. points beyond which we would feel satisfied that we had done enough for the time being.

**PRESS HANDLING/LINE TO TAKE**

Latest information from Mulford is that Baker is now inclined to a joint press conference in New York on Sunday evening, if it can be managed. This would probably be confined to Finance Ministers (ie not Governors).

2. Invitations to a New York press conference would probably have to go out on Saturday morning (New York time) - so the news that something is afoot may break in time for our Sundays. If it does, the line is:-

- Confirm there is a G5 meeting
- Initiated by Secretary Baker
- The Chancellor is attending
- Often have these things before IMF
- Wait and see.

**Sunday/Monday: line to take**

3. News of the outcome will reach London sometime between 9pm and midnight on Sunday evening.

4. If there is no agreement -

- Chancellor very pleased to have this opportunity of G5 discussion, because not at Seoul.

If there is an agreement, draw attention to the communique, adding the following glosses:-

- G5 meeting was initiated by Secretary Baker
- Prompted by worry, which we all share, about the rising threat of protectionism in the US. A serious problem

SECRET

for us all; welcome what the US Government are doing to resist it.

- Communique reaffirms determination to resist protection by all countries including US.
  - Pressures for protection in US stem from the deterioration in US external trade, which in turn reflects a number of factors (eg relative growth rates, adjustment to debt problems in Latin America, lack of open markets in some countries, and the high value of the dollar).
  - G5 Ministers all agree that an early realignment of the dollar with other major currencies is desirable.
5. If applicable - Ministers and Governors have made it clear that they stand ready to take appropriate action in close co-operation to encourage this. (NB. this quotation from the end of the draft statement is still far from agreed).

Supplementaries

6. The description of UK policies and intentions annexed to the statement contains nothing new. It summarises the main features of UK financial and economic strategy, which are working. The same is broadly true of the passages on other individual countries, with emphasis by the Japanese on their recent undertakings to seek more open markets.

7. This is not a fundamental change in US policy. In particular it follows naturally from the agreement reached at G5 in January 1985. Note especially that this agreement:-

- Was implemented
- Specifically did not confine intervention to disorderly markets (the gloss about disorderly markets was added subsequently by Beryl Sprinkel).

SECRET

8. If pressed:-

- The UK continues to believe that a better balance of US policy would be achieved if the Administration could reduce the Budget deficit more rapidly.

9. Along with a new sense of urgency from the United States, the statement demonstrates increased co-ordination among countries who are essentially following the same economic strategy.

10. Deny any targets/target zones for exchange rates, for any currencies. On sterling, we would not expect a dramatic effect on our ERI as a result of some readjustment in present rates of dollar/deutschemark/yen.

11. Confirm that UK will fully co-operate in any proposed actions.

Press arrangements in London

12. Whether or not there is a press conference in New York, the Chancellor does not intend to give interviews at the airport. There may be a press conference in HM Treasury at noon on Monday, the content of which depends on the outcome of the meeting. (If no agreement - pre-IMF subjects; if there is an agreement, obviously the G5 agreement etc).

~~SECRET~~ *Unclassified*HMG DOLLAR FLOATING RATE NOTE ISSUEFactual

An announcement will be made early on Monday morning (16 September) that HMG is issuing US \$2 billion of floating rate notes (FRNs).

2. The notes have a 7 year maturity and carry a coupon of 3 months' LIBID with no margin, reset and payable quarterly.

3. The issue is being organised by the Bank of England on the Treasury's behalf and is jointly lead-managed by Warburgs and Credit Suisse First Boston.

4. The notes are being sold in the international market in the normal manner for a eurobond operation.

Line to take

1. Part of prudent reserves management.
2. Reflects judgement of appropriate level of foreign currency reserves for UK to hold at time of exchange market uncertainty. At end of 1982, by when most of the more expensive of the foreign currency debt inherited from the last Labour government had been repaid, convertible currency reserves stood at the equivalent of \$9.6 billion (and total reserves at \$17.0 billion). They now stand at \$7.5 billion (and \$14.3 billion). HMG issue will restore them broadly to the level which seemed appropriate at the end of 1982 and does so now.
3. In last few years official foreign currency borrowing has been undertaken indirectly through the nationalised industries under the exchange cover scheme (with details published monthly in reserves press announcements). The

~~SECRET~~

size of the operation on this occasion makes it sensible to borrow in the Government's own name.

4. Market response very favourable. Largest FRN ever at finest terms available to any borrower for an issue of this type. Indication of market view of quality of UK name.

### Defensive

#### 1. ERM

Position unchanged. Situation under continuous review.

#### 2. Intervention

No change in policy. Not borrowing to support sterling. Chancellor has made clear on many occasions his attitude towards the use of intervention to influence exchange rate, though, as experience in early part of the year showed, in certain circumstances coordinated intervention can have a useful role to play (and can be undertaken profitably).

#### 3. Reversal of policy on debt repayment

[Economic Secretary said in Written Answer on 24 November 1984 (col 448) that official debt had been reduced by \$10 billion from figure reached by Labour government and that "a proper balance between the figures that we have now reached may well be where we should rest for the time being".]

Policy was to repay substantial part of expensive foreign debt inherited from Labour Government. This we have done. Official debt at end of August was \$10 billion lower than in May 1979 and \$14 billion below peak at end 1977. After this issue it will be still be \$8 billion below inherited level and \$12 billion below peak. Moreover in contrast

to most of Labour debt the new issue is on very fine terms indeed. Reflects fact that this is a step taken from a position of strength, not weakness.

4. Running down of reserves to repay Labour debt

Of course a substantial part of the debt repayments were financed from the reserves. How else would it have been done? What the Government was doing, and taking credit for, was getting rid of large amount of expensive liabilities we did not need.

And NB: (i) Even so, net reserves are nearly \$3 billion higher than they were in April 1979 (as a result of valuation factors, SDR allocations and small amount of intervention).

(ii) The UK's total net external assets, private and public sector combined, have increased by over £60 billion since the end of 1979 (from £12.4 billion at end-1979 to £73.5 billion at end-1984).

5. Reasons for changes in reserves

Changes in reserves over time reflect number of factors - intervention, valuation changes and net borrowing. Over whole period since April 1979 there has been a substantial reduction in net borrowing, a number of valuation changes in different directions and a small plus from intervention. The reduction since end-1982 partly reflects valuation changes and partly intervention undertaken at the beginning of 1983.

6. Comparisons with other borrowers

This is the largest FRN ever issued and HMG has obtained the finest terms available to any borrower for an issue of this type.

7. If questioned about EC issue

(EC launched a \$1.8 billion 5 year floating rate note on 22 May 1985 at a margin of 1/16 over LIBID but with lower front-end fees than our own issue and a slightly lower all-in cost).

The two issues are not comparable. HMG's issue is larger, and its maturity is longer. The only sensible comparison is with where the EC issue is currently trading, and on that basis the two issues are virtually level.

If pressed.

The real difference is that the EC issue was too tightly priced, very badly received in the market, and has still not yet fully sold into firm hands. By contrast, the initial reception for HMG's issue is excellent.

8. Mismatch or capping features

Specialist features of this type can be useful to some issues, but we are confident that HMG's issue will sell on its merits without any need for gimmicks.

9. Exchange rate/monetary effects

The issue will not have any significant effects on either the exchange rate or the monetary aggregates.

10. Effect on the dollar

Proceeds will be added to the reserves. So we will be adding the same amount to the demand for dollar assets (to hold in our reserves portfolio) as to the supply (in terms of the new HMG liabilities). There will therefore be no significant effect on the dollar exchange rate.

11. Silly time to acquire dollars

We will be adding the same amount to both our dollar assets and our dollar liabilities. Our net dollar liability as a result of this operation will remain unchanged. So any change in the value of the dollar will have no significant effect on the value of our net assets.

12. Cost of the issue

The issuing expenses are expected to total around £200,000.

13. Tax evasion

The issue follows standard Eurobond practice in paying interest gross. Any UK resident investors will, of course, have to fulfil their legal obligations in reporting details of interest received to the Inland Revenue.

OFFICIAL DEBT AND RESERVES FACTSHEETLevel of official reserves

| <u>End-period</u> | <u>Total</u> | <u>\$ billion</u><br><u>o/w convertible</u><br><u>currencies</u> |
|-------------------|--------------|------------------------------------------------------------------|
| 1979              | 22.5         | 18.0                                                             |
| 1980              | 27.5         | 18.6                                                             |
| 1981              | 23.3         | 13.5                                                             |
| 1982              | 17.0         | 9.6                                                              |
| 1983              | 17.8         | 9.0                                                              |
| 1984              | 15.7         | 7.6                                                              |
| 1985 (August)     | 14.3         | 7.5                                                              |

Level of official debt

|               | <u>Total</u> | <u>o/w HMG</u><br><u>borrowing</u> |
|---------------|--------------|------------------------------------|
| 1979          | 20.7         | 9.7                                |
| 1980          | 17.4         | 7.7                                |
| 1981          | 13.3         | 4.6                                |
| 1982          | 12.1         | 3.9                                |
| 1983          | 12.0         | 3.7                                |
| 1984          | 11.3         | 3.4                                |
| 1985 (August) | 11.9         | 3.4                                |

## INTERNATIONAL COMPARISON OF RESERVES

|                     | <u>End-July 1985, \$ billion</u> |                                 |
|---------------------|----------------------------------|---------------------------------|
|                     | Total                            | of which convertible currencies |
| UK                  | 11.5                             | 8.1                             |
| Germany             | 44.5                             | 35.9                            |
| US                  | 35.5                             | 8.0                             |
| Japan               | 29.0                             | 23.8                            |
| France <sup>+</sup> | 26.5                             | 21.7                            |
| Italy               | 23.8                             | 19.5                            |

\* gold valued at SDR 35 per oz

+ June data.

Peaks and troughs

\$ billion

ReservesOfficial debt

|                    |      | <u>Total</u>   | <u>Convertible<br/>currencies</u> | <u>Total</u>    | <u>HMG</u>      |
|--------------------|------|----------------|-----------------------------------|-----------------|-----------------|
| Under Labour       | high | 21.9 (Mar '79) | 19.3 (Jan '78)                    | 22.5 (Dec '77)  | 12.9 (Sept '77) |
| (Mar '74-Apr 79)   | low  | 4.1 (Dec '76)  | 2.5 (Dec '76)                     | 8.7 (Mar '74)   | 4.5 (Sept '74)  |
| Under Conservative | high | 28.4 (Feb '81) | 19.7 (May '80)                    | 22 (May '79)    | 10.1 (May '79)  |
| (May '79 to date)  | low  | 14.0 (May '85) | 6.8 (Mar '85)                     | 11.0 (Sept '84) | 3.2 (Apr '84)   |

Major HMG borrowings since 1974

| <u>Date</u> | <u>Amount</u> | <u>Description</u>                                                                                | <u>Terms</u>                                                                                                        | <u>Repayment/amount<br/>outstanding</u>                  |
|-------------|---------------|---------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------|
| March 1974  | \$2.5 bn      | Eurodollar<br>bank credit<br>10 years on a<br>rollover basis<br>with a 3, 6 or 12<br>month option | Floating rate<br>yrs 1 & 2: LIBOR + 3/8%<br>3, 4 & 5: LIBOR + 1/2%<br>6 & 7: LIBOR + 5/8%<br>8, 9, 10: LIBOR + 3/4% | Repaid in monthly<br>instalments from<br>May-July 1981   |
| Jan 1976    | SDR 1 bn      | 1975 oil/facility                                                                                 | Floating rate                                                                                                       | Equal quarterly<br>repayments from<br>Apr '79 to Jan '83 |

| <u>Date</u>   | <u>Amount</u>                                     | <u>Description</u>                                                                                                                                                                                                        | <u>Terms</u>                                                                                                                                                  | <u>Repayment amount outstanding</u>                                                  |
|---------------|---------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------|
| May 1976      | SDR 700 mn                                        | 1975 stand by arrangement                                                                                                                                                                                                 | Floating rate                                                                                                                                                 | Repaid by Apr '79.                                                                   |
| Jan-Aug 1977  | SDR 3.36 bn<br>(Note only SDR 1.64 bn drawn down) | 1977 stand-by arrangement. To be drawn down over 2 years                                                                                                                                                                  | Floating rate                                                                                                                                                 | Repaid by Apr '79                                                                    |
| April 1977    | \$677 mn (equivalent)                             | Foreign currency bonds denominated in \$ issued with 5, 7 and 10 yr maturities for \$202 mn, \$82 mn and \$18 million respectively. Others: DM 365 mn, Swfr 360 mn and Yen 21,500 mn issued with single maturity of 7 yrs | 5 yr \$ bonds at 8 3/8%<br>7 yr \$ bonds at 8 5/8%<br>10 yr \$ bonds at 8 7/8%<br>7 yr DM bonds at 7 1/2%<br>7 yr Swfr bonds at 5 7/8%<br>7yr Yen bonds at 8% | Bulk of repayments made in Apr 1984. Remaining \$18 million due for repayment in '87 |
| February 1977 | \$1.5 bn                                          | Eurodollar bank credit. 7 yrs on a rollover basis with a 3, 6 or 12 month option. Loan drawn down in 2 tranches: \$1 bn and \$0.5 bn                                                                                      | Floating rate<br>yrs 1 & 2: LIBOR +7/8%<br>yrs 3 to 7: LIBOR +1%                                                                                              | Repaid in monthly instalments from July to Dec 1980                                  |
| May 1978      | \$350 mn                                          | \$ bond issue in New York: \$200 mn with a 7 yr maturity and \$150 mn with a 15 yr maturity.                                                                                                                              | Fixed rate<br>7 yr : 8 1/2%<br>15 yr : 8 7/8%                                                                                                                 | 7 yr bonds repaid in May 1985.<br>15 yr bond due 1993                                |