

R. Norgrove
FSECRETPRIME MINISTERG5 DISCUSSIONS

I attach an internal Treasury submission, sent to me on a personal basis, about G5 discussions on possible large scale foreign exchange intervention intended to lower the value of the dollar. The Treasury emphasise that this submission does not necessarily reflect the Chancellor's own views and so should not be quoted against him (please protect my source - the Chancellor's Principal Private Secretary).

The submission covers:-

Flag A - a draft of a G5 statement, including Sir Terry Burns' text on the UK's economic policy intentions (see the preceding Annex B1 for drafts for the other countries).

Flag B - some question points for the Chancellor's intervention in discussions.

Flag C - a statement of UK objectives.

Flag D - a draft press line.

The timetable is that the Chancellor is now in Luxembourg talking to the French and Germans, will fly late afternoon tomorrow to Heathrow and then take Concorde to New York for further discussions there.

The Treasury say that the French, Germans and ourselves are agreed that the US has to take the main responsibility for this exercise. There is also some scepticism whether they are in fact ready to intervene on the scale required. These doubts are reinforced by US reluctance to agree to the inclusion of the square bracketed sentence - marked X - at the end of paragraph 17 of Flag A.

Then the whole plan will fail

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As you know, the objective of the exercise is to lower the value of the dollar in the hope that this will reduce protectionist pressures in the US. All well and good. But there is still some scepticism about how such an exchange rate re-alignment can be achieved and sustained. The paper seems to contemplate (Flag C) total market intervention (by all concerned) of as much as \$20 billion. But that may not be enough by itself. For the lower dollar level to be sustained, the Fed. must, presumably, be willing to keep US interest rates down, and perhaps even to lower them, when all the market pressures may be forcing rates up. That could require the Fed. to relax monetary policy, with all consequent risks for inflation. Is Volcker willing to do that?

Note also that from Flag C that the limit for direct UK intervention is ^{put} up at maximum of say £1 billion (sic). When I took fright with the Treasury at this figure (40 per cent of our international borrowing this week), the Treasury emphasised that this was a maximum which might be expended over a period of several months. Nevertheless, I must say that I am leery of spending so much in such an undefined exercise.

** She now says the Ch of Ex would like to talk to you first thing in morning. When you are ready ask switch to make the call. N.L.W.*

I have warned the Chancellor's Private Secretary that I think that you might like to talk to the Chancellor on the telephone (e.g. when he passes through London airport at around 6pm tomorrow, Saturday afternoon* or at his Luxembourg hotel first thing tomorrow). I suggest that you caution him on pledging UK foreign exchange reserves, on the scale indicated, without absolutely cast-iron assurance that other countries, especially the US, supported in the first place by Japan and in the second place by Germany, are taking the main brunt of the effort. After all, the US and Japan have the biggest interest in stopping the spread of ^{US} protectionist pressures. *N.L.W.*

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