

SUBJECT
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MT2 Box

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10 DOWNING STREET

From the Principal Private Secretary

18 February 1986

Mr Terence Higgins, M.P., called upon the Prime Minister this afternoon to give his views on the Exchange Rate Mechanism (ERM).

Mr Higgins recalled that the TCSC had, essentially concluded in their October report that the United Kingdom should join the ERM at some time, but not then because of the high sterling rate. Since then sterling had declined considerably against the Deutschmark. This had led Mr Higgins to change his long standing opposition to sterling's membership of the ERM and to conclude that if we were ever to join, now was the time to do so. Sterling's membership of the ERM would also, in his view, reduce interest rates as holders of sterling were reassured about the exchange rate. He believed that this effect might reduce UK interest by as much as 1-1½ per cent. Concluding, Mr Higgins explained certain electoral advantages which he saw in sterling's early membership.

The Prime Minister disagreed with Mr Higgins' assessment. The level of UK reserves was relatively low so that any pressure on the exchange rate would quickly reflect into increases in interest rates. Nor did the UK, unlike many Continental countries, have exchange control. She doubted whether sterling's membership would help UK interest rates. She believed that sterling's membership would give currency speculators an exchange rate to attack. Nor could she accept Mr Higgins' analysis of the electoral advantage of early membership; she believed that the argument pointed the other way. The Prime Minister said that the time for the UK to consider joining the ERM was after the election.

N.L. Wicks

SWH

Mrs Rachel Lomax
HM Treasury.

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