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Prime Minister 2

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PRIME MINISTER

EUROPEAN EXCHANGE RATE REALIGNMENT

I thought you might like to have a few comments on the conduct and outcome of the Meeting of Community Finance Ministers and Central Bank Governors which I attended over the weekend in the Netherlands. The business planned for an informal meeting before this week's IMF and IBRD meetings in Washington caused no problem and other minor items went well, but the planned business was of course pre-empted in large part by the need to confer about the realignment requested by the French.

I attach a copy of the communique recording the outcome, which has been reasonably well received in the markets so far.

The French originally asked for a larger move (8 per cent) against the Deutschmark and hoped that several others would join them all or part of the way so that it would look more like a revaluation of the DM. This was not entirely reasonable, and they had not done any effective lobbying in advance. The others generally proved resistant and initially wanted no more than a 4-5 per cent change between the franc and DM, within which they could slot in without too much disturbance. The compromise outcome is quite sensible for all parties, and was reached without undue difficulty.



The French will be announcing later today their basic economic and financial strategy: maintenance of control over wages, firm fiscal and monetary policies (including a slight strengthening of monetary policy); an extensive liberalisation (though not yet abolition) of both price controls and exchange controls, and a substantial programme of privatisation of financial and industrial companies.

The procedure was punctuated by a good deal of bilateral discussion. In public terms it was handled effectively. The press were kept out and later taken by surprise. As no announcement was made on Saturday evening they assumed deadlock and need for many hours of argument the next day. In fact a mere half an hour on Sunday morning sufficed for confirmation of what had in fact been settled on Saturday afternoon, and the press had to be summoned from their beds to hear the news!

Balladur may have suffered a little from being new to this kind of gathering. He also suffered, I think, from a ricochet effect. Many had expected a move by the new French government immediately after the elections last month. Not only did that not happen, but denials were circulating and the markets were just about beginning to accept that there might not be a change. In the absence of market pressure and against this background, the French request seemed to some of the smaller countries a gratuitous rocking of the boat.

Inevitably, I played little part, and sterling has been strong since the weekend, with the latest news on Norwegian oil more influential than the EC moves.

One important loose end remains. It seems certain that a reason for the French move is to secure for their farmers the scope for an increase in domestic currency income which would flow from an

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adjustment of Monetary Compensation Amounts to offset the devaluation. This could also have some important costs, on preliminary calculations by MAFF officials, for the Community Budget. We have ensured that all this falls to be considered in the Agriculture Council with the coming Price Review. It may ease as well as complicating part of the battle impending there. But the battle will still be a severe one, with the Germans particularly difficult.

I am copying this minute to Geoffrey Howe, Michael Jopling, and to Sir Robert Armstrong.

Rachel Homax

N.L.

8 April 1986

(approved by the Chancellor & signed in his absence)

COMMUNIQUE

On 6 April 1986, the Ministers and Central Bank Governors of EEC Member countries have by mutual agreement, in a common procedure involving the Commission and after consultation of the Monetary Committee, decided on an adjustment of central rates within the European Monetary System.

The new bilateral central rates result from the following relative changes :

- German mark :	+	3.0	%
- Dutch guilder :	+	3.0	%
- Belgian franc :	+	1.0	%
- Luxembourg franc :	+	1.0	%
- Danish krone :	+	1.0	%
- Irish pound :		0.0	%
- Italian lira :		0.0	%
- French franc :	-	3.0	%

The new ECU central rates are the following :
(in units of national currency per ECU)

DM	2.13834
HFL	2.40935
BFR	43.6761
LFR	43.6761
DKR	7.91896
IRL	0.712956
LIT	1496.21
FF	6.9628
UKL	0.630317
DRA	135.659

The new bilateral central rates and the compulsory intervention rates will be communicated by the monetary authorities in time for the opening of foreign exchange markets on 7 April 1986.

The Ministers have requested that the agri-monetary consequences of this adjustment be examined immediately by the appropriate bodies.

Notwithstanding other provisions, Member States participating in the exchange rate mechanism of the EMS for whom negative Monetary Compensatory Amounts are created or modified by these central rate adjustments will not request changes in the Compensatory Amounts now introduced before the end of the current agricultural price fixing round, and it is noted that the Commission will not make any proposal to that effect.