

PRIME MINISTER

BILATERAL WITH THE CHANCELLOR: SUPPLEMENTARY BRIEF

You may like to be aware of three further points before you see the Chancellor this afternoon:

- (i) he may report to you that the bridging loan for Yugoslavia was agreed by Central Bank Governors yesterday;
- (ii) he may also mention to you arrangements for recruiting a new Director General of NEDO when John Cassels retires. I gather the Treasury plan to advertise and then convene a selection board comprising ~~of~~ Peter Middleton, John Banham and Norman Willis;
- (iii) the markets today have paid a lot of attention to a report of an interview the Chancellor gave to the Wall Street Journal (attached). \* During the morning, the markets seem to have interpreted this as signalling the possibility of higher interest rates; money market rates moved up and equities are well down with the FTSE-100 off over 40 points at 1750. The exchange rate is little changed on the day at \$1.884 and just over DM3.16.

\* The Treasury line on the report is that, while the exact quotes are accurate, the general flavour of the article is misleading.

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PAUL GRAY

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# Lawson Urges Linking Pound, Deutsche Mark

By PETER TORDAY

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LONDON—U.K. Chancellor of the Exchequer Nigel Lawson renewed his support for a close link between sterling and the Deutsche mark, suggesting he would like to resume tight management of the pound.

Mr. Lawson said in an interview that he advocates a stable relationship between the two currencies as the best way to curb inflation and boost business confidence in Britain. His stance implies that he has yet to resolve a two-month-old dispute with Prime Minister Margaret Thatcher over exchange-rate policy.



Nigel Lawson

In early March, Mrs. Thatcher pressed Mr. Lawson to abandon a tightly controlled target zone for sterling because she feared that massive currency intervention to stabilize the soaring pound against the Deutsche mark would reignite U.K. inflation. The chancellor accordingly let sterling break through a year-old ceiling of DM3.

But yesterday Mr. Lawson said it would be "pretty good anti-inflationary discipline" if the pound "can stick close" to a level against the West German currency. He declined to specify a particular Deutsche mark level. He said a stable pound encourages British businesses to control costs and discourages expectations of a future devaluation.

The pound rose in late New York trading yesterday to \$1.8832 from \$1.8815 Monday after jumping 1.1% on Monday to \$1.8815 from \$1.8605 Friday. Sterling slipped to DM3.1625 yesterday from DM3.1637 Monday.

## Rift With Thatcher

Mr. Lawson's remarks about exchange-rate stability and some other issues—such as the European Monetary System—seem to reflect a continuing rift between him and the prime minister. The split has distressed him deeply, associates say. Nevertheless, the chancellor indicated he currently plans to remain in office at least until next March, when the next budget is due.

Britain has limited its currency intervention to curb sterling's strength since Mrs. Thatcher objected to Mr. Lawson's tight management. But the pound's advance during the past two months prompted Mr. Lawson to twice direct commercial banks to cut base rates, which now stand at 8%.

Mr. Lawson soon may have to direct a base-rate increase and tolerate a further unwelcome rise in sterling because of new inflationary pressures, such as recent steep increases in money-supply growth and consumer credit. The chancellor showed little concern in yesterday's interview, however. "Inflation fluctuates a bit, but I don't believe there are any signs of a resurgence," he said. "The rise in the exchange rate has itself tightened up monetary conditions. There wouldn't necessarily need to be" higher rates.

## Differences Over EMS

The differences between the chancellor and Mrs. Thatcher also were clear from his sympathetic attitude toward British membership in the European Monetary System's fixed exchange-rate program. The prime minister has shown her antipathy to Britain's acquiring full EMS membership by repeatedly refusing to say when the nation will join. In contrast, Mr. Lawson displayed his enthusiasm by proposing EMS reforms, apparently for the first time.

Mr. Lawson said sterling's recent volatility might have been lessened if major EMS members held larger quantities of each other's currencies. That would lead to closer cooperation between the countries, he said, by making joint intervention easier. Such holdings also would make things smoother for the chancellor when he swaps dollars for Deutsche marks to enlarge Britain's reserves of the West German currency and effectively rein in the pound's advance.

In the past, these actions have drawn fire from Mr. Lawson's European colleagues, especially from the Bundesbank. The chancellor scorned the West German central bank's reluctance to let the Deutsche mark enjoy a bigger role as a reserve currency. "It is unrealistic in today's world that the dollar can be the only reserve currency. It's

# Lawson Renews Call For Linking Pound To the Deutsche Mark

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not just the mark, it's also true of the yen," he said.

On the world stage, the chancellor predicted that the Group of Seven major industrial nations would maintain their commitment to stabilize the dollar despite the U.S. presidential election in November. He also said there could be an internationally coordinated boost in interest rates, following the U.S. Federal Reserve's likely increase in short-term rates to curtail U.S. inflation.

A coordinated effort by West Germany, Japan and other leading nations "is certainly possible. We did have very close coordination in the immediate aftermath" of the October stock-market crash, Mr. Lawson said.

Any Fed action on U.S. rates also would seek to underpin the dollar, the U.K. chancellor added. West Germany and Japan have held back on increasing their interest rates before the U.S. does for fear of weakening the dollar.

Mr. Lawson also dismissed market concern that the U.S. would resume a hands-off approach to the dollar after next fall's elections by allowing the U.S. currency to fall again. Washington ended a strict free-market attitude toward the dollar in September 1985, when the economic damage of the high-flying dollar became too great. "I don't think people want to go through that again, least of all the Americans," the chancellor said.

Turning to his own future, Mr. Lawson said he wouldn't be "around forever" but currently intends to deliver the government's fiscal 1990 budget in March. "I am planning and working on the early stages of next year's budget."