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Prime Minister

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RECORD OF A MEETING BETWEEN THE CHANCELLOR OF THE EXCHEQUER  
AND THE GOVERNOR OF HONG KONG:  
4.00 P.M., 7 OCTOBER, NO.11 DOWNING STREET

Sir E Youde said that he had been very grateful for the recent advisory visit by Mr Peretz and Mr Goodhart in connection with the proposed scheme to stabilize the Hong Kong exchange rate. They had done an excellent job. The Hong Kong Financial Secretary was preparing a paper on the scheme for EXCO: he would see it on his return to Hong Kong on 9 October; and EXCO would consider the paper on 12 October. If they approved the scheme, it would be introduced on the evening of 13 October. Predicting EXCO's reactions was difficult: their reactions might in part be affected by the health of the Hong Kong \$ during the course of next week.

2. The Chancellor said that Peretz and Goodhart had thought the scheme workable and appropriate. It was of course important not to expect too much of it. The awkward Hong Kong political situation was bound to have an adverse financial manifestation; and no financial scheme, however ingenious, could prevent that. The question was where to take the strain, on interest rates or on the exchange rate. If the Governor thought it best to shift it away from the exchange rate, we would certainly not wish to dissuade him. Moreover the scheme would remedy a long term weakness in the Hong Kong monetary system, to which the Bank of England had long drawn attention, and which had been highlighted by the political crisis.

3. Sir E Youde thought that some in EXCO might feel, if the movement of the Hong Kong \$ next week was similar to this weeks, that the crisis had passed, and did not call for a major change, such as the introduction of the scheme. He was however inclined to feel that considerable underlying instability would remain. But if the scheme were introduced, and the next round of talks with Peking went well and produced no adverse reactions, he might be criticised for an unnecessary "panic measure". The Chancellor thought that such criticism would be unreasonable. The insulation provided by the scheme was bound to be





tested at some stage over the year ahead; and indeed the present apparent stability might be largely because the Hong Kong markets were awaiting an expected announcement. It would of course be a considerable advantage to introduce the scheme at a time of relative stability: this would reduce the risk that interest rates would rise sharply. And stabilization would become more painful if postponed to a period of higher inflation.

4. Sir E Youde said that he expected to be asked what alternative measures he had considered, and some would have in mind pegging the Hong Kong \$ to the £. The Chancellor pointed out that this too would provide no solution to the underlying problems; and might have additional disadvantages. There would be a problem of credibility; and, with so much of Hong Kong's trade being in US \$, the dual currency system would undoubtedly remain, so that the shift away from the Hong Kong \$ might actually be quicker. The US \$ seemed the right currency to use in the scheme, given that most of Hong Kong's trade, financial, and entrepot dealings were only US \$-denominated. Sir E Youde agreed that Hong Kong tended to think in US \$. He also agreed that the further alternative of massive intervention to try to hold the exchange rate would not make sense.

5. Sir E Youde said that his conclusion was that the Chancellor did not wish to dissuade him from going ahead with the scheme; and that if Hong Kong were to decide to do so, the Chancellor's view was that it might be best to do so as soon as possible. The Chancellor agreed; and said that we would continue to watch developments with particularly close and sympathetic attention.

J O KERR

10 October 1983

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9 OCT 1983