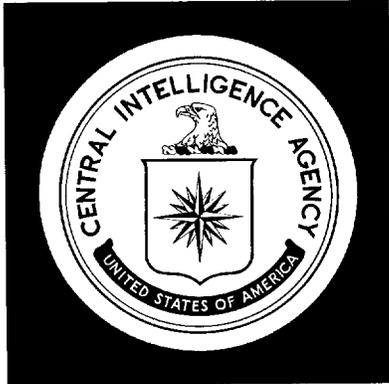


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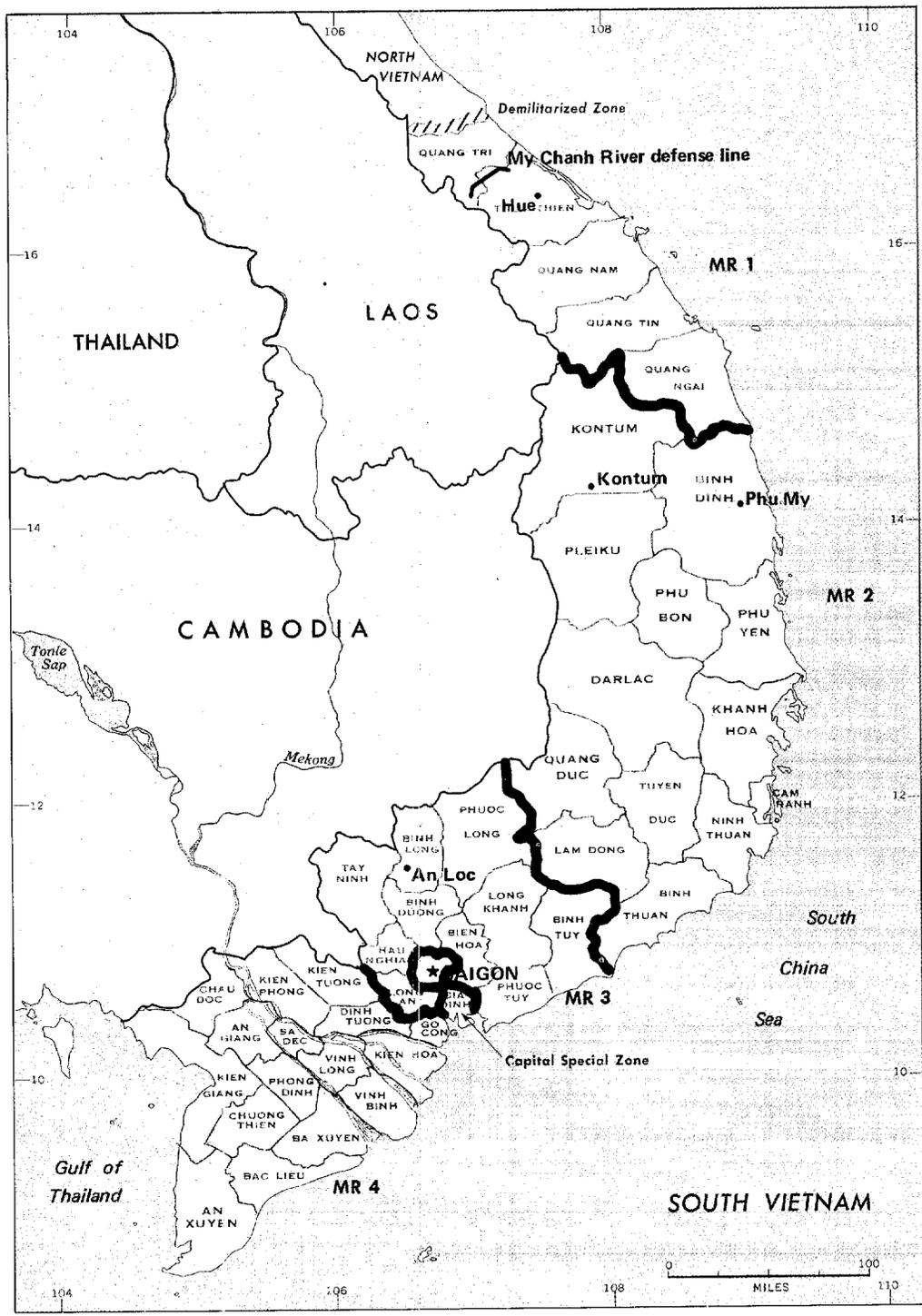
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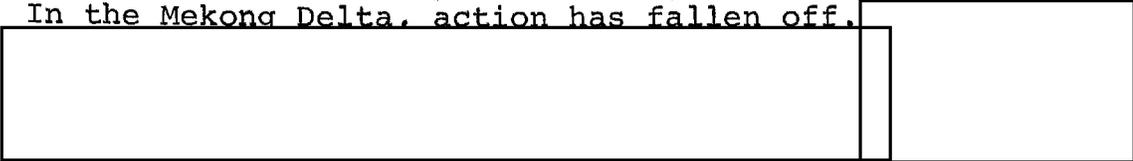
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VIETNAM: Communist forces continue their attacks against government defenses north of Hue, but elsewhere in the country the situation is essentially unchanged.

South Vietnamese troops are containing the thrusts thus far against the western segment of the My Chanh River defense line. Meanwhile, some South Vietnamese Marine units are still conducting operations inside Quang Tri Province, encountering only sporadic shelling and light ground contact.

Fighting persists south of Kontum City in the western highlands, and on the coast, North Vietnamese units are maintaining pressure against government positions around Phu My District town in Binh Dinh Province. Shelling of An Loc continues, but at a low level, and only light contact is reported by South Vietnamese troops patrolling out from the city. In the Mekong Delta, action has fallen off.



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EUROPEAN COMMUNITIES: Meetings of the foreign ministers of the Ten next week and the Brandt-Pompidou talks on 3-4 July probably will determine whether the West European summit will be called off.

President Pompidou again has insisted that the EC summit should not be held unless the preparations show prospects for "real progress." At the same time, there have been hints that France may be willing to discuss the development of European institutions, including the political secretariat, which has become a crux of the summit debate.

Although virtually none of France's partners agrees with Pompidou's approach to the EC's institutional problems, they are uncertain how to respond to his "threat" to call off the summit. Some of them would prefer to postpone it rather than make concessions to French views. The EC Commission, however, favors increasing the pace of summit preparations. Although the British have publicly played down irritation over Pompidou's recent pronouncements, Heath is known to have told the French President privately as long ago as last March that he preferred Brussels as the site of the political secretariat, and the prime minister publicly took this position the following month during Brandt's visit to London. In his talks with the Danes earlier this month, he made a strong--and for the Danes--convincing case that the institutions of political and economic integration must be closely linked. The UK's domestic troubles, and now the deepening problem of sterling, could have an effect on his ability to maintain the firm attitude he has privately shown.

While Brandt apparently shares Heath's views about the community, its organization, and its relation to the US, his attitude toward the summit and whether to lean toward the French or British will be influenced by what he thinks would help most with the electorate he expects to face this fall.

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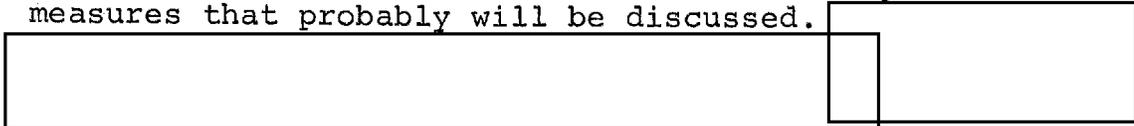
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UK: The decision to allow sterling to float poses a challenge to the currency realignment of last December.

Heavy speculation against the dollar yesterday required about US\$2 billion of European support operations in just a few hours following London's announcement and forced all major European markets to close before noon.

The floating of the pound took the foreign exchange markets by surprise, because Britain's reserves, which were US\$7.2 billion at the end of May, are large, and its current account is still in surplus. Within the UK, reaction to the float was favorable because the rapid decline in the trade balance had indicated a growing need for a downward adjustment of sterling. Exports in the first five months of this year grew only five percent compared with the same period in 1971. Sterling depreciation would improve Britain's international competitiveness and ease the burden of foreign exchange costs associated with entry into the EC.

European officials generally have expressed approval of the sterling float. Several international meetings are scheduled this weekend to consider the implications for the US dollar and for the EC's narrow exchange rate band. Tighter European controls over capital movements and the collective floating of EC currencies against the dollar are among the measures that probably will be discussed.



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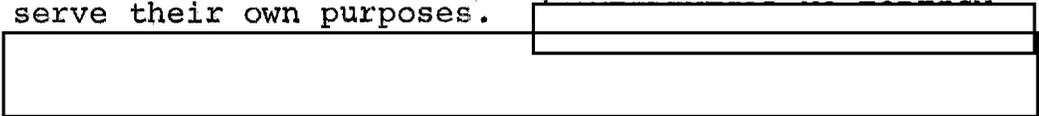
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NATO: The British continue to press for an extremely cautious Western approach to East-West explorations on mutual and balanced force reductions (MBFR).

In a paper recently submitted to NATO, the British emphasize the dangers of MBFR and note that negotiations should come only after thorough explorations. The paper reflects the nearly unanimous sentiment in NATO that MBFR is too complicated to be negotiated at a Conference on Security and Cooperation in Europe (CSCE). It proposes, however, that the CSCE create a special "security commission" to consider MBFR. This proposal is similar to Moscow's suggestion that force reduction talks be held in a body established by a CSCE. The British apparently favor this general approach at least in part because it would delay the opening of negotiations.

While the British share the French fear that any force reductions would be harmful to Western security, they apparently calculate that their tactics hold greater promise of delaying reductions. The French, meanwhile, have been trying to create the impression that Moscow sympathizes with their position on MBFR. Soviet Foreign Minister Gromyko, in his recent talks in Paris, clearly catered to French opposition to MBFR, but it appears that the French have been overstating Gromyko's comments to serve their own purposes.



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**SECRET**CHINA - HONG KONG: 

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Peking may be moving toward a new relationship with Hong Kong.

The Crown Colony--Victoria Island and the immediately adjacent mainland littoral of Hong Kong Bay--was ceded to Britain at the conclusion of the Opium War of 1820; a more extensive hinterland area on the mainland was leased to Britain at the end of the last century. This leased area, called the "new territories," is due to revert to China in 1997, and its loss would make the British position in the Crown Colony, which already is partly dependent on the PRC for water, wholly dependent on China. This Damocles sword has hung over the colony since the Communists came to power in 1949.

Hong Kong's entrepot trade, however, has been the PRC's major source of hard currency receipts, and in the wake of the agreement last February to raise the level of diplomatic representation in both countries to embassy level, Peking seems to be exploring the possibility of defining its relationship to the colony in a new way. In an official letter to the UN Colonialism Committee in March, the Chinese delegation described Hong Kong as a part of China that had been detached under now invalid "unequal" treaties but allowed discussion of the question to be deferred. This suggests that the Chinese are prepared not to foreclose on the "new territories" if the British at least tacitly acknowledge that the Crown Colony itself is still in some residual sense a part of China.

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both sides may be looking toward their eventual renegotiation on an "equal" basis, but on terms that would preserve British administration of Hong Kong, and hence the present trade arrangements, essentially intact.

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JAPAN: Tokyo cut the central bank discount rate yesterday to 4.25 percent, placing it at its lowest level since World War II, and dropping it below the US rate. Although billed largely as a measure to stimulate domestic investment, it probably will be more effective in encouraging international institutions and foreign governments to float bonds in Japan. Industry, already burdened with excess capacity, is not likely to increase spending on plant and equipment, but domestic businesses probably will seek more local trade credits.

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GUYANA-CHINA: Prime Minister Burnham is taking another step in his oft-stated policy of political nonalignment and diminished economic dependence on the West. He intends to announce today the establishment of full diplomatic relations with China,

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[redacted] Guyana has been moving in this direction since the inception of contacts with Peking last fall. A permanent Chinese trade mission arrived in Georgetown last March, and a technical assistance agreement was signed in April. His announcement may affect the attitude of other small Caribbean nations. In particular, Jamaican Prime Minister Manley, who sent a trade delegation to Peking and several other Communist states last week, will probably feel more inclined to establish closer contacts with these nations.

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COSTA RICA: A provisional settlement reflecting concessions on both sides has terminated a ten-day walkout by social security workers. Strong pressures were at play to end the strike. The government faced growing threats by several unions in the public sector to launch sympathy strikes, and pro-government deputies believed themselves so vulnerable to criticism that many boycotted assembly sessions to break quorum and deprive the opposition of a forum. On the other side, the strikers were in financial trouble and losing their ability to carry on the fight. Although the strikers' gains were less than desired, their success in temporarily crippling one of the government's largest institutions must be considered a triumph. The strike may also have future implications by encouraging union militancy and hampering government efforts to gain some control over the developing labor movement.

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