

PREM 19/2282

Internal Situation

M.T.

JAPAN

Part 1

PTI:

November 1979

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
3-1-79		10-2-82		22-9-86			
4-1-80		1-6-82		1-10-86			
9-4-80		25-2-82					
17-5-80		13-7-82					
20-5-80		4-7-82		PTI			
2-6-80		15-10-82		ENDS			
5-6-80		23-10-82					
6-6-80		2-11-82					
25-6-80		25-11-82					
1-7-80		21-1-83					
17-7-80		28-6-83					
24-7-80		27-11-83					
14-8-80		19-12-83					
17-4-80		23-12-83					
22-12-80		29-12-83					
29-12-80		10-9-84					
25-3-81		1-11-84					
8-12-81		24-4-85					
		25-4-85					
		20-6-85					
		26-9-85					
		21-12-85					
		6-3-86					
		6-86					
		27-6-86					

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● PART 1 ends:-

Tokyo Saving Tel No 8. 1.10.86

PART 2 begins:-

Tokyo Saving Tel No 2 5.3.87

Foreign and Commonwealth Office document

The following FCO documents, which were enclosed on this file have been removed and destroyed.

Such documents are the responsibility of the Foreign and Commonwealth Office. When released they are available in the appropriate FCO CLASSES.

1. DS No. 12/80, 9 December 1980: 'Mr Suzuki's Government: Performance and Prospects'
2. DS No. 4/81, 20 January 1981: 'Industry, Government and Bureaucracy in Japan'
3. Diplomatic Report No. 8/83, 31 December 1982: 'Japan: Annual Review for 1982'

Signed

A Wayland

Date

21 January 2016

PREM Records Team

BY BAG

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Addressed to FCO Telegram No 8 Saving of 1 October 1986

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JAPAN: MONTHLY ECONOMIC REPORT - SEPTEMBER 1986

Summary

- On 19 September the Government announced a Y3.6 trillion (\$23 billion) package of economic measures to stimulate domestic demand. The bulk of the expenditure will be on public works and housing construction. The package also included additional financial aid for small and medium-sized businesses, and a number of administrative measures designed to relax planning controls and encourage investment by the private sector.
- Full details of how the package will be financed are not yet available, although it is known that a proportion at least will be financed by the issue of additional construction bonds.
- Reactions to the package have been mixed. Few commentators believe that it will enable the Government to reach its proposed target of 4% real GNP growth in FY 1986/87, and some industrialists have criticised it as being too small and likely to be too slow in its impact on the economy. Its effect on the current account will be very modest; one estimate is that the surplus will be reduced by \$0.5 billion this fiscal year and by \$1.9 billion next year.
- Real GNP grew by 0.9% in the June quarter, after a 0.5% decline in the March quarter. Consumer spending and private sector housing were buoyant, but for the second quarter in succession the external sector contracted sharply in net terms.
- Industrial Production fell by 0.2% in July and preliminary figures suggest a larger fall in August.

- Unemployment returned to its peak level of 2.9%, and the indications are that the 3% barrier will soon be breached.
- The current account surplus rose to \$7.1 billion in July against \$6.7 billion in June. Preliminary figures suggest that the surplus rose further, to \$7.5 billion, in August.
- Net capital outflows, which were weak in May and June, rose to \$12 billion, close to the record seen in April this year. Increased outward portfolio investment, and some profit-taking on the Tokyo Stock Exchange by foreign investors, were mainly responsible.

TABLE 1A

		1985 JAN-MAR	1986 APR-JUN	PREVIOUS MONTH	LATEST MONTH	LATEST MONTH SHOWN
GNP* - NOMINAL - REAL	) % Change on) Previous period	0.0R -0.5	2.0 0.9			
Industrial Production*	"	0.2	0.2R	0.3R	-0.2	July
Unemployment*	% of labour force average for period	2.7	2.8	2.7	2.9	July
Wages	% change on year ago	4.7	3.9	4.8R	3.4	July
Wholesale Prices	% change on year ago	-6.3	-9.7	-10.7	-11.2	August
Consumer Prices (Tokyo)	% change on year ago	1.6	1.6	0.2R	0.5	August
Money Supply (M2 + CDs)	% change on year ago	9.0	8.5	8.7	8.9	August
Short-term interest rate	% pa (3-month Gensaki)	5.155	4.640	4.655	4.680	August
Long-term interest rate	% pa (10-year Government Bond)	4.52	4.77	4.68	4.48	August
Current Account*	\$ Million	15,493	21,840	6,693	7,078	July
Overall Balance	\$ Million (SA)	-2,870	-5,945	-3,384	-1,577	July
	\$ Million *	-5,695	-4,627	-2,430	-629	July
Change in Reserves	\$ Million	-1,407	5,988	4,425	2,884	August
Exchange Rate	Y/\$ (end-period)	179.60	165.00	154.30	156.10	August
	Y/£ (end-period)	261.83	254.68	230.52	232.90	August

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JAPAN: PACKAGE OF ECONOMIC MEASURES

SUMMARY

1. ON 19 SEPTEMBER THE GOVERNMENT ANNOUNCED A Y3.6 TRILLION PACKAGE OF ECONOMIC MEASURES TO STIMULATE THE ECONOMY. THE BULK OF THE FUNDS WILL BE ALLOCATED TO INCREASED PUBLIC WORKS BY THE NATIONAL GOVERNMENT AND BY LOCAL AUTHORITIES, AND TO THE PROMOTION OF HOUSING CONSTRUCTION. OTHER MEASURES INCLUDE THE EXTENSION OF THE SCHEME TO ASSIST SMALL AND MEDIUM-SIZED ENTERPRISES ADVERSELY AFFECTED BY THE STRENGTH OF THE YEN. IT IS BY NO MEANS CLEAR HOW MUCH OF THE PACKAGE WILL INVOLVE GENUINELY NEW EXPENDITURE. INITIAL RESPONSE HERE HAS BEEN RATHER SCEPTICAL, WITH DOUBTS EXPRESSED WHETHER THE PACKAGE WILL DO MUCH TO SATISFY EITHER DOMESTIC OR INTERNATIONAL CRITICS OF THE GOVERNMENT'S ECONOMIC POLICY.

DETAIL

2. THE PACKAGE CONSISTS OF THE FOLLOWING:

(I) ADDITIONAL PUBLIC WORKS SPENDING TOTALLING Y1.4 TRILLION. THIS INCLUDES PROVISION FOR DISASTER RELIEF (A REGULAR FEATURE OF SUPPLEMENTARY BUDGETS) AND THE BRINGING FORWARD OF PUBLIC WORKS CURRENTLY SCHEDULED FOR FY 1987 INTO THIS FISCAL YEAR.

(II) INCREASED SPENDING ON ROADS, TOTALLING Y100 BILLION.

(III) AN INCREASE IN PUBLIC WORKS SPENDING BY LOCAL AUTHORITIES TOTALLING Y800 BILLION.

(IV) AN INCREASE OF Y700 BILLION IN THE LOAN FACILITIES OF THE HOUSING LOAN FINANCE PUBLIC CORPORATION. A NUMBER OF THE TERMS FOR HOUSING LOANS WILL ALSO BE IMPROVED, ALTHOUGH THE CURRENT INTEREST RATE OF 6.15% WILL BE UNCHANGED.

(V) AN INCREASE OF Y400 BILLION IN THE INVESTMENT SPENDING OF UTILITY INDUSTRIES.

(VI) SUBSIDIES (OF UP TO 5% OF TOTAL COSTS) TO ENCOURAGE LARGE SCALE DOMESTIC PROJECTS TO START WITHIN FY 1986 OR FY 1987.

(VII) AN EXTENSION OF THE SCHEME TO PROVIDE ASSISTANCE TO SMALL AND MEDIUM-SIZED ENTERPRISES SERIOUSLY AFFECTED BY THE YEN'S APPRECIATION (ADDITIONAL EXPENDITURE IS ESTIMATED AT Y100 BILLION (£450M). (THE WORDING OF THE ANNOUNCEMENT ON THIS SECTION IS OBSCURE, BUT APPEARS TO ENVISAGE PRIMARILY LOANS FOR BUSINESS CONVERSION AND EXTENSION OF CREDIT GUARANTEE SCHEMES FOR SMES. WE WILL MAKE SOME FURTHER ENQUIRIES)

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(VIII) OTHER ADMINISTRATIVE MEASURES DESIGNED TO EASE PLANNING RESTRICTIONS AND PROMOTE PRIVATE SECTOR INVESTMENT.

COMMENT

3. ALTHOUGH THE PACKAGE APPEARS LARGER THAN THE Y3 TRILLION WHICH HAD BEEN SUGGESTED A FEW WEEKS AGO, THERE IS A CERTAIN AMOUNT OF W I O W DRESSING IN THE FIGURES. FOR EXAMPLE, THE Y700 BILLION ALLOCATED FOR HOUSING DEPENDS UPON THE DEMAND FOR HOUSING LOANS, AND THE PROVISIONS FOR DISASTER RELIEF AND INCREASED LOCAL AUTHORITY SPENDING ARE NOT WHOLLY GENUINELY ADDITIONAL EITHER. NO DETAILS OF HOW THE EXPENDITURE WILL BE FINANCED, AND THEREFORE HOW MUCH OF A STIMULUS IT WILL PROVIDE, WILL BE AVAILABLE UNTIL A SUPPLEMENTARY BUDGET BILL IS PREPARED IN OCTOBER.

4. THE GOVERNMENT ESTIMATES THAT THE PACKAGE WILL PROVIDE A 1.5% BOOST TO GNP IN THE NEXT 12 MONTHS. THE LEADING BUSINESS NEWSPAPER, "THE NIKKEI", REPORTS TODAY THAT ON ITS OWN ECONOMETRIC MODEL, THE PACKAGE WILL BOOST GNP BY 0.6% IN FY 1986 (STILL LEAVING GNP AT ONLY 2.4% FOR THE FISCAL YEAR AS A WHOLE), AND BY 0.5% IN FY 1987. GIVEN THE SLOW SPEED OF DISBURSEMENT OF PUBLIC WORKS, EVEN THE NIKKEI FORECAST BOOST TO GNP IN THIS FISCAL YEAR LOOKS RATHER OPTIMISTIC. "THE NIKKEI" ALSO ESTIMATES THAT THE MEASURES WILL REDUCE THE CURRENT ACCOUNT SURPLUS BY DOLLARS 500 MILLION THIS FISCAL YEAR, AND BY DOLLARS 1,900 MILLION IN THE NEXT.

5. THESE VIEWS OF THE PACKAGE ARE, OF COURSE, ONLY IMMEDIATE REACTIONS, AND VIEWS MAY CHANGE AS FURTHER DETAILS EMERGE. IT IS UNLIKELY THAT THE GOVERNMENT HAS DONE ENOUGH TO SATISFY ITS CRITICS, EITHER IN DOMESTIC INDUSTRY OR INTERNATIONALLY.

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JAPAN: MONTHLY ECONOMIC REPORT - JUNE 1986

Summary

- Real GNP fell by 0.5% in the March quarter, the first quarterly decline in 11 years. A 5% fall in exports in real terms was chiefly responsible for the decline, but a sharp deceleration in private fixed investment also helped to slow growth.
- Other components of domestic demand were also weak. Consumers' expenditure (nearly 60% of GNP) registered its strongest quarterly growth in the fiscal year but was significantly weaker than usual in a normally strong quarter.
- Private housing, responding to recent fiscal incentives, recorded its best quarter for 3 years but remains relatively weak.
- Despite the poor March quarter figures, the economy grew by 4.2% in real terms in the fiscal year as a whole, in line with the Government's revised forecast, but significantly more slowly than the 5% finally achieved the previous year. Domestic private demand accounted for 3.7% of the total. Public sector demand overall fell by 0.2%, mainly reflecting weak capital expenditure. Net exports made their lowest contribution to GNP for 6 years.
- The poor performance of the domestic economy in the March quarter has reinforced private sector conviction that the official target of 4% growth in real terms this year is not attainable without additional fiscal support. Despite this pressure, no early package of measures is in prospect, although some additional public works expenditure in the autumn supplementary budget remains a possibility.
- Meanwhile, coincident and leading indicators continue to weaken. Industrial production in May fell for the second successive month. Private sector investment and housing seemed to have weakened further, though consumers' expenditure has been slightly stronger than predicted.

- Unemployment fell to 2.7% in May but the labour market remains weak. Consumer prices in the year to May rose by no more than 1.1% and the rate of increase is expected to decline further as consumers benefit from lower utility and energy costs.
- April's record trade surplus of \$7.2 billion was further increased by a \$200 million surplus on invisible account, only the second such surplus recorded post-war. Preliminary figures for May suggest a further increase in the current account surplus in dollar terms, with export volumes also recovering and imports slack.
- The yen weakened briefly to Y176 to the dollar early in June but subsequently strengthened to trade at around Y166, despite reported intervention by the authorities.

KEY INDICATORS
TABLE 1A

		1985 OCT-DEC	1986 JAN-MAR	PREVIOUS MONTH	LATEST MONTH	LATEST MONTH SHOWN
GNP* - NOMINAL	) % Change on	1.8R	0.1	-	-	-
- REAL	) Previous period	1.4R	-0.5	-	-	-
Industrial Production*	*	-0.9	0.2	-0.2	0.0	April
Unemployment	% of labour force average for period	2.8	2.7	2.7	2.9	April
Wages	% change on year ago	3.5	4.7	4.3R	2.6	April
Wholesale Prices	% change on year ago	-3.7	-6.3	-9.0	-9.8	May
Consumer Prices (Tokyo)	% change on year ago	2.4	1.6	1.1R	1.3	May
Money Supply (M2 + CDs)	% change on year ago	9.0	9.0	9.0	8.4	April
Short-term interest rate	% pa (3-month Gensaki)	7.035	5.155	4.530	4.660	May
Long-term interest rate	% pa (10-year Government Bond)	5.60	4.52	4.40	4.96	May
Current Account*	\$ Million	15,564	15,577	5,635	7,369	April
Overall Balance	\$ Million (SA)	-3,663	-2,836	-508	-1,824	April
	\$ Million	-3,233	-5,695	756	-1,335	April
Change in Reserves	\$ Million	-1,013	1,407	3,196	1,362	May
Exchange Rate	Y/\$ (end-period)	202.85	179.60	168.30	171.80	May
	Y/\$ (end-period)	290.42	263.83	258.55	252.98	May

J. Brown

RECENT ECONOMIC DEVELOPMENTS

TABLE 1B

GNE (Real, SA, Base year = CY 1980)

(Unit: Y billion; Percentage changes over the preceding quarter)

	1985				1986
	JAN-MAR	APR-JUNE	JULY-SEPT	OCT-DEC	JAN-MAR
Consumers' Expenditure	161106.4 (1.2)	161900.4 (0.5)	162777.8 (0.5)	163661.5 (0.5)	164746.8 (0.7)
Private Housing	13913.9 (1.2)	14227.9 (2.3)	13881.0 (-2.4)	14188.1 (2.2)	14539.1 (2.5)
Private Investment	48574.5 (0.3)	51114.2 (5.2)	52981.2 (3.7)	54303.4 (2.5)	54487.1 (0.3)
Private Inventories	2112.0 (8.3)	1825.3 (-13.6)	1438.2 (-21.2)	1838.4 (27.8)	1471.9 (-19.9)
Government Current Expenditure	26979.1 (1.1)	27081.5 (0.4)	27192.9 (0.4)	27369.9 (0.7)	27796.4 (1.6)
Government Capital Expenditure	21615.5 (-1.8)	19954.0 (-7.7)	20495.6 (2.7)	20924.9 (2.1)	20794.1 (-0.6)
Government Inventories	27.9 (-34.5)	77.6 (178.1)	515.6 (564.4)	604.4 (17.2)	17.5 (-97.1)
External (Net)	11096.4 (-8.3)	13256.4 (19.5)	12097.6 (-8.7)	12639.3 (4.5)	10106.9 (-20.0)
Exports	54833.7 (-0.8)	57176.9 (4.3)	55077.6 (-3.7)	54720.5 (-0.6)	52036.1 (-4.9)
Imports	43737.3 (1.3)	43920.5 (0.4)	42980.0 (-2.1)	42081.2 (-2.1)	41929.2 (-0.4)
GNE	285425.7 (0.4)	289437.3 (1.4)	291379.9 (0.7)	295529.9 (1.4)	293959.8 (-0.5)

MARCH QUARTER AND FISCAL YEAR 1985-86

Preliminary figures released by the Economic Planning Agency on 24 June show that seasonally-adjusted real GNP fell by 0.5% in the three months to 31 March this year. (Table 1B.) This is the first time that GNP has fallen in real terms since the March quarter of 1975 when, in the immediate aftermath of the first oil crisis, output fell by 0.8%. On this occasion, a substantial fall in real exports (in national income terms) combined with a sharp deceleration in private fixed investment was chiefly responsible. Despite the poor performance of the economy in the March quarter, however, real GNP in the fiscal year 1985/86 rose by 4.2%, exactly in line with the Government's revised forecast. Growth in the year as a whole therefore slowed, as predicted, from the 5% finally recorded for 1984/85.

The decline in GNP in the March quarter overwhelmingly reflects the contractionary influence of the external sector, where net exports fell at an annual rate of 20% in real terms. Even after seasonal adjustment, exports have now fallen in real terms in four of the past five quarters, though the effect in 1985 was disguised by the very rapid growth of exports in the June quarter. The accelerating decline shown in the latest figures is widely ascribed to the appreciation of the yen that began at the end of September 1985. Recent balance of payments figures suggest, however, that March quarter exports may have been artificially depressed towards the end of the fiscal year as US quotas were exhausted: exports to the United States in April and May seem to have accelerated very sharply and it may therefore be that the March quarter figure overstates the decline.

The contractionary influence of the fall in exports was to some extent offset by a smaller fall in imports, which have now declined in three successive quarters in real terms. The modest 0.5% decline in the March quarter probably understates the impact of falling oil prices, however, as the trade figures suggest that the price effects only began to come through in April and May.

Domestic demand in the March quarter, as current indicators suggested, grew rather erratically. Consumers' expenditure increased steadily rather than spectacularly, continuing to reflect the slow growth in real income. Despite seasonal adjustment, a strong quarterly pattern has established itself in recent years and the March quarter of both 1984 and 1985 was significantly stronger. Continued slow growth in consumer spending (which accounts for 57% of GNP) has been the most striking feature of the economy over the past 3 years.

Private housing, in contrast, seems at last to be slowly pulling out of the depressed state into which it settled in 1980. Spending in the last two quarters in real terms has for the first time been significantly above the levels achieved in 1980/81 and housing expenditure made a significant contribution to the economy at a time when other influences were strongly negative. The official target of 1.25-1.3 million units is nevertheless substantially below the 1.5 million units considered to be necessary to replace the housing stock adequately. This level was achieved regularly in the latter half of the 1970's and remains the target of the private sector.

Private sector capital investment in contrast was very weak, remaining broadly unchanged compared with the figure for the December quarter. As both the September and December quarter figures were themselves revised sharply downwards from the preliminary estimates previously published, it seems probable that the widely predicted downturn in investment is now finally taking place.

The domestic economy received no net support from the public sector in the quarter, despite the fact that Government current expenditure grew more rapidly than at any time for the last 3 years. Public sector capital spending was, however, very weak running nearly 7% below the level recorded for the same quarter two years ago and some 4% below the level recorded for the March quarter of 1985, which was itself weak. A sharp fall in public sector inventories ensured that the public sector was substantially contractionary in the quarter.

Real economic growth in 1985/86 therefore fell to 4.2%, compared with the revised figure of 5% now recorded for 1984/85. Although the figure has been described as disappointingly low, it is the second highest rate of real growth recorded by the Japanese economy since the second oil price rise of 1979, substantially exceeding the low levels of real growth recorded in 1981 and 1982 in particular. Domestic demand contributed 3.5% points of total growth of 4.2%, the highest proportion for the last 4 years. The net public sector contribution, in contrast, was negative for the first time in that period, with the decline in public sector capital spending noted above a particularly noticeable feature.

ECONOMIC DEVELOPMENTS IN APRIL AND MAY

The latest statistics released for April and May suggest that domestic economic activity has continued to decline. The Economic Planning Agency's coincident indicator series, which was very weak from August to November last year but which then began to pick up, reaching 45.5 in February, has subsequently weakened again, falling to 18.2 in April. Officials are more concerned, however, at the recent weakening of the leading series which has until recently been suggesting a recovery in output later in the summer. Doubt has now been cast on this forecast, as the series seems to have peaked in January at 66.7 before falling through February and March to reach 25 in April. Although the provisional forecast for industrial output issued monthly by MITI continues to predict some recovery in mining and manufacturing production in June, the latest forecast month (July) shows a seasonally-adjusted fall of 1.9% in output.

The EPA's monthly economic report for June confirmed the Agency's earlier cautious view that economic activity was slackening and that industrial production, particularly in the electrical machinery and steel industries, was weakening as export earnings in yen terms continue to fall. The sharp rise in unemployment recorded in April was partly reversed in May but the underlying state of the labour market is weak, with the decline in manufacturing jobs a particular source of concern. In commenting on the latest report, EPA officials have pointed out that activity in non-manufacturing sectors has held up well and that fixed capital investment by major companies seems to be remaining reasonably strong.

Industrial production figures for May (reported in more detail in the second section of this report) show that output fell on a year-on-year comparison for the second successive month, something that has not been seen since early 1983. Production in major export-orientated industries has weakened particularly quickly and there are some signs that inventories are rising again as shipments fall.

Although recent figures for retail sales have been reasonably strong, particularly from the major department stores in the metropolitan area, consumer spending overall continues to grow slowly. Particular attention has therefore been focused on the 1986 wage round (preliminary figures were contained in last month's report). The Ministry of Labour has recently published its final survey of the wage round, covering 286 major unionised corporations which suggests that the weighted average wage increase was 4.55%, compared with union demands for 7.4%. This is the third lowest increase in the history of the shunto, which dates back to 1956, following the very low increases awarded in 1983 (4.4%) and 1984 (4.46%).

Declining corporate profitability and the very low rate of increase in consumer prices, even before the beneficial effects of falling oil prices were passed on, has enabled companies to hold settlements to this low level. The pattern of settlements between industries showed a marked variation from service industries, where increases often ran as high as 5.75% to the shipbuilding and steel industries where increases averaged no more than 2.5%. Preliminary indications are, too, that summer bonuses currently under negotiation will be agreed at levels little changed from last year. One company in four is expected to reduce bonuses this year, with the electronic and other export-orientated industries cutting back severely. In contrast, securities firms are offering increases in bonuses approaching 7% and the retail sector is predicted to settle at around 6%.

BUSINESS CONDITIONS

A recent Ministry of Finance survey on corporate earnings confirms earlier anecdotal evidence of falling corporate profits. The survey, covering 16,500 companies in the non-financial sectors, showed that corporate pre-tax income in the three months ending March 1986 fell by 8% compared with the same quarter the previous year. This was the third successive quarterly decline shown by this survey. Manufacturing industries' profits fell by 15% while non-manufacturing companies' profits were largely unchanged. Sales were unchanged in real terms.

In a survey of business prospects conducted at about the same time but covering a slightly smaller sample of companies, there was a marked decrease in optimism over the prospects of a recovery in the three months ending September. Whereas the previous survey had showed that a majority of companies were optimistic of improved business conditions by the autumn, the latest survey showed a substantial majority predicting lower production and profits for the same period.

Finally, the latest MITI Investment Intention Survey suggests that total plant and equipment investment by private sector companies in the current fiscal year will rise by no more than 2.9% but that manufacturing investment is likely to fall by 9%. The survey covers some 1,500 firms in 13 key sectors and contrasts with an 8.7% predicted rise in overall investment (+ 10.8% for manufacturing) reported in the February survey.

ECONOMIC OUTLOOK

Despite the poor current figures and the weakening forward indicators, the Government remains outwardly confident that the economy will recover strongly in the second half of the year and that growth will approach the 4% target first set in December last year. Private sector forecasters, who have been sceptical from the start, see the latest indicators as confirmation that growth is unlikely to reach even 3% without some additional fiscal stimulus. Many officials would not dissent from this view in private but the current election campaign makes it more than usually difficult for further demand-boosting packages to be discussed, even informally. The increasingly pessimistic tone of the EPA's monthly economic report has been reflected in the Bank of Japan's latest monthly report which concludes that the impact of yen appreciation is now permeating deeply through the economy, which is slowly decelerating. The official view remains that the poor March quarter figures were a predictable consequence of the yen's appreciation before the benefits of this and of lower oil prices fed through. In addition, the effect of economic packages announced successively in October, December and earlier this year, combined with three cuts in the discount rate, are still to be felt. The Governor of the Bank of Japan has made it clear that no further cut in the discount rate is conceivable unless a further sharp appreciation in the yen precipitates a severe business recession.

Business reactions to the latest GNP figures have been more critical, though perhaps muted by the election campaign. A joint statement by leaders of the four largest economic organisations towards the end of June strongly supported the Government's long-term administrative and fiscal reform programme but urged further emergency steps to stimulate domestic demand and assist small and medium-sized enterprises. The President of Keidanren in particular predicted a deepening recession in the absence of early action and supported the concept of a substantial supplementary budget in the autumn.

In response to these pressures, Prime Minister Nakasone commented that the latest figures reflected the expected initial impact of yen revaluation but that the benefits of increased real incomes and lower oil prices would be felt strongly from now on. He asserted that the Government's target of 4% growth could be achieved without further stimulatory measures. On the same day, Ministry of Finance officials confirmed that they will continue to impose stringent budget guidelines for 1987 appropriation requests and, in private, remain opposed to a substantial supplementary budget.

LATEST JAPAN ECONOMIC RESEARCH CENTRE FORECAST

The JERC has today published its latest short-term forecast for the economy, covering the period up to the end of 1987. Full details are not yet available but the principal points are as follows:

- (i) Real GNP growth will fall to 2.3% in 1986/87 but will recover to 4.5% in calendar 1987 as a whole.
- (ii) Industrial production will fall by 1% in 1986/87 with unemployment remaining at current record levels. The general picture for the domestic economy will be mixed, with consumers' expenditure and housing showing some improvement but private investment very weak (rising by 4.5% compared with 12.5% in the year just ended).
- (iii) The current account surplus will exceed \$81 billion in the fiscal year and will fall only slightly to \$76 billion in calendar 1987. Exports in national income terms will fall by 8.5% and the external sector will be sharply contractionary.
- (iv) This forecast assumes continued slow growth in the US, an average exchange rate of Y170 to the US dollar and average crude oil prices of \$15 per barrel.

DETAIL

Industrial Production

Industrial production in the year to end May fell on the year for the second successive month. Leading indicators have weakened sharply. Bankruptcies attributed to the high yen are increasingly rapidly. Some recovery in output predicted in the June quarter as a whole.

1. Industrial output on a seasonally-adjusted basis remained unchanged in April but the unadjusted figures showed the first year-on-year fall for more than 3 years. Primary industrial output was particularly weak and the recession in the steel and shipbuilding industries continued, more than offsetting some recovery in the important precision machinery sector.

2. Preliminary figures suggest that output recovered only slightly in May with the seasonally-adjusted index of industrial production (mining and manufacturing) rising by 0.3%, rather more slowly than expected. Industrial output is therefore now 1.8% lower than in the same period a year ago, with inventories again rising as shipments fall.

3. The Economic Planning Agency's coincident indicator series, which had strengthened in February before falling to 27.3% in March, weakened to 18.2% in April, returning to the very low levels recorded towards the end of last year. The renewed weakness of the leading indicator series, which fell sharply to 25.0% (compared with 66.7% in January, for example) is beginning to cause concern that the negative effect of the yen's strength may be rather more prolonged than originally predicted. This series had been strengthening steadily since the autumn before flattening out in February and March.

4. MITI's seasonally-adjusted forecast for manufacturing and mining output in May has been revised accordingly sharply downwards to an increase of 0.5% compared with the initially predicted rise of 1.5%. Production in June is expected to recover slightly (to 0.8% rise) with, however, a continuing sharp divergence in sectoral performance.

5. Business failures continue to run at a high level. Although the number of failures in May was slightly larger than in the same month last year, total indebtedness of bankrupt companies in the month decreased sharply, though this was from a near record level in April. Total liabilities were, however, 36% higher than in the same month last year.

6. Bankruptcies claimed to be directly related to the higher yen totalled 50 in the month, with a cumulative total since October reaching 164. These figures are not official statistics but are issued by private research organisations and probably need to be treated with some caution as an absolute measure. But they compare unfavourably on a relative basis with the 107 bankruptcies attributed to exchange rate problems in the previous "high-yen" period of July 1977 to February 1978 reflected in the same private sector survey. Failures are said to be concentrated in the electrical machinery (36), machinery (33) and metal-working (24) sectors but to be spreading to related service industries.

Public Works, Housing and Construction

Public work disbursements, down on the year to end March, have weakened further. Public sector capital contracts have decreased, but private sector orders remain reasonably strong. Housing starts, which grew more slowly than expected in 1985/86, have since weakened further.

7. The 1985/86 total for housing starts of 1.25 million units is regarded as a disappointing response to recent measures to stimulate housing construction. The rate of increase in the financial year was barely half that recorded in the previous year and the declining trend in starts towards the end of the year was seen as particularly discouraging. Public sector housing has been particularly weak in recent months.

8. A recent private sector survey suggested that total starts for the current year are unlikely to reach 1.3 million units without further official support, preferably in the form of fiscal incentives, with no improvement foreseen in 1987/88. The industries' own target of 1.5 million units a year (which was achieved consistently in each of the four years 1976-79) therefore looks unrealistic, particularly if deregulation and land-release procedures remain slow.

9. Total public works disbursements in May showed the usual seasonal fall despite an unusually high figure for April. The Government recently confirmed plans to disburse some 78% of total public works spending for the year in the first six months, but total spending in April and May was only 1.4% higher than in the same, weak months last year. Public works disbursements are in fact still running 2%-4% lower at current prices than in 1983/84 and 1984/85.

10. Total industrial construction orders which have been moving very erratically in recent months, were again weak in April. The earlier decline in public sector construction orders resumed and contract values once again fell (-15.6%) compared with the same month a year ago. Private sector orders in contrast strengthened, rising by 9.3% in April compared with the same month last year.

11. Total domestic machinery orders, which fell by 1.8% in 1985/86, continued to fall in April and are now running some 2.5% lower than last year, if shipping orders are excluded. Seasonally-adjusted private sector orders rose by 6.4% on the month, but public sector orders weakened further.

Wages, Employment and Prices

April's sharp rise in unemployment reversed. The job opportunities ratio continues to deteriorate. Consumer price increases remain negligible and decline in wholesale prices continues.

12. The seasonally-adjusted number of unemployed rose to 1.63 million in March and again to 1.72 million in April, equivalent to an unemployment rate of nearly 2.9%. This increase returned unemployment to the record post-war level seen last year and is a sharp reversal of the improving trend seen in the early part of 1986. The preliminary May figures, which show a seasonally-adjusted fall in the rate to 2.7%, were therefore greeted with some relief, although it was noted that, while 200,000 more people were in employment compared with the same period last year, the number of unemployed in absolute terms was still 90,000 higher. Manufacturing and agricultural employment fell in the month, while service and construction sector jobs increased.

13. The job opportunities ratio weakened from 0.65% in February to 0.63% in April. This ratio (indicating that 63 jobs were available for every hundred applicants) has now fallen further to its lowest level for two and a half years with the May preliminary figures indicating a ratio of 0.61%.

14. Consumer price increases were once again minimal, with the National Consumer Price Index rising by only 0.9% in the year to April following a 0.1% rise on the month. Consumer prices in May in Tokyo rose by 0.1% and the year-on-year rise consequently rose to 1.3%, still close to the lowest level in 30 years. The National Consumer Price Index rose to an annual figure of 1.1% in May but lower utility and energy costs reduced the increase in Tokyo for the 12 months to end June to 0.8%.

Consumers' Expenditure

Retail and car sales remain reasonably strong. Real incomes continue to grow slowly.

15. The rate of growth of real income of working households in the year to March rose to 4.1%. Real disposable income in the year grew rather more slowly, however, and the living expenditure of these households has fallen by 0.6% over the last 12 months. The average propensity to consume weakened further and is now more than 3 full points below the low early 1985 figure of 79.6%.

16. Retail sales maintained much of their recent resilience. The metropolitan department stores once again continue to show a strong rise in sales in the year to April of nearly 7% compared with the same month a year ago. The rise in overall retail sales, however, remained almost unchanged at 1.9%, reflecting slackening demand outside the main metropolitan areas.

17. Domestic car sales showed their usual seasonal weakness in volume terms in May but sales of 211,831 were nevertheless nearly 7% higher than in the same month in 1985.

Monetary Developments

Growth of the money supply has moderated and short term interest rates remain low. Longer term rates have edged up slightly.

18. In April, the year-on-year growth of the broad money supply (M2 + CDs) fell to 8.4%, a significantly slower rate than the corrected 9.0% now recorded in March and preliminary figures for May indicate a similar rate of increase for that month.

19. Although these figures suggest that the first quarter surge in broad money is subsiding, the Bank of Japan continues to be concerned at excessive liquidity in the market, although some of the distortions may reflect the effects of deregulation combined with 3 cuts in the discount rate. Rate structures are continuing to adjust to those cuts rather slowly: the average rate charged on existing bank lending remains at 6.124%, a fall of no more than 0.5% compared with the same month two years ago, when market rates were generally much higher.

Table 2A

	<u>Call Loan</u> <u>(Unconditional</u> <u>median)</u>	<u>Bill Discount</u> <u>(over 2</u> <u>months)</u>	<u>Gensaki</u> <u>(3 month</u> <u>average)</u>
End September	6.75	6.375	6.33
End December	7.9375	7.875	7.035
End March	5.9375	5.9375	5.930
End May	4.250	4.625	4.660
End June	4.250	4.625	4.640

19. Government bond rates (Table 2B below), which fell steadily through April, touched record low levels in mid-May but have now stabilised and, in some cases, edged upwards. The June issue of long-term Government bonds of Y900 billion yielded an unchanged 5.1% to maturity, based on a par issue price, which was the lowest ever post-war yield. Terms for the July issue of Y450 billion have, however, been set at a revised issue price of Y98.5 on an unchanged coupon of 5.1% indicating a yield to maturity of 5.329%.

Table 2B

	<u>6.1%</u> <u>No 10</u>	<u>7.7%</u> <u>No 22</u>	<u>8.0%</u> <u>No 25</u>
End September	6.09	5.76	5.71
End December	6.15	5.60	5.59
End March	5.40	4.97	4.99
End May	4.93	4.96	4.92
End June	5.11	4.90	4.93

The Balance of Payments

Further record surplus on current account of \$7.4 billion, with exports up by 7% and imports up by only 0.5%.

Current account surplus substantially increased by an invisible account surplus of \$200 million, with the gross services surplus for the month reaching \$375 million. This is only the second post-war monthly invisible surplus recorded.

Very large gross capital outflows resumed, exceeding \$14 billion in the month. Substantial fall in capital inflows (Table 3B).

Preliminary figures for May (on a customs clearance basis) suggest further record trade surplus of more than \$7.5 billion, with exports F.O.B 24% up on the year and imports down by 6% in dollar terms.

Exports to the US in the month expected to have increased by more than 20%, with car exports rising by 33% on the month.

Import totals are now reflecting declining oil prices. Value of oil imports in May fell by 60% on the year, while volume fell by no more than 15%. Average crude oil costs in May fell to \$12.89 per barrel compared with \$16.46 in April and levels around \$27 in January and February.

The yen fell briefly to Y176 to the dollar at the beginning of the month but has since risen to trade at around Y166, despite reported heavy intervention by the monetary authorities.

Table 3A

<u>LONG TERM CAPITAL</u>	<u>1986</u>					
	<u>1985</u>	<u>JAN</u>	<u>FEB</u>	<u>MAR</u>	<u>1985/86</u>	<u>APRIL</u>
<u>OUTWARDS</u>						
Direct						
Investment	7.5	0.7	0.5	1.1	7.6	0.5
Trade Credit	3.0	0.1	-	0.3	1.8	0.1
Loans	10.6	0.4	0.3	1.0	8.8	0.9
Securities	59.8	6.2	7.0	6.3	71.0	11.9
Others	-2.2	0.4	0.5	0.2	3.1	0.7
	<u>82.1</u>	<u>7.8</u>	<u>8.3</u>	<u>8.9</u>	<u>92.3</u>	<u>14.1</u>
<u>INWARDS</u>						
External Bonds	12.8	0.6	0.8	1.8	12.4	0.8
Stocks	-0.7	-0.2	0.6	1.7	-0.1	0.7
Bonds	4.5	0.1	-0.9	1.7	6.3	0.4
Other	0.7	-	-0.1	-	0.6	-
	<u>17.3</u>	<u>0.5</u>	<u>0.4</u>	<u>5.2</u>	<u>19.2</u>	<u>1.9</u>
Net Total	<u>64.8</u>	<u>7.3</u>	<u>7.9</u>	<u>3.7</u>	<u>73.1</u>	<u>12.1</u>

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TABLE 3B

	FY 1984 (APR 84 - MAR 85)	FY 1985 (APR 85 - MAR 86)	1985 OCT-DEC	1986 JAN-MAR	1986	
					MARCH	APRIL
Exports (SA)	168,740	180,940	47,311	48,007	15,650	16,725
Imports (SA)	123,139	119,298	29,962	30,555	9,491	9,553
Trade Balance (SA)	45,601	61,642	17,349	17,452	6,159	7,172
Services	-7,064	-4,763	-1,348	-1,163	-114	374
Transfers	-1,522	-1,810	-437	-712	-410	-177
Invisibles Balance	-8,586	-6,573	-1,785	-1,875	-524	197
Current Account*	37,015	55,069	15,564	15,577	5,635	7,369
Long-Term Capital	-54,197	-73,137	-18,712	-18,947	-3,704R	-12,196
(Assets)					-8,952)	(-14,070)
(Liabilities: inc +)					(5,248)	(1,874)
Basic Balance*	-17,182	-18,068	-3,148	-3,373	1,931	-4,827
Short-Term Capital	-2,799	-1,398	-1,431	-1,039	-1,265R	-665
Errors and Omissions	5,437	3,867	916	1,576	-1,174	3,668
Overall Balance*	-14,544	-15,599	-3,663	-2,836R	-508	-1,824
Overall Balance (NSA)	-14,544	-15,599	-3,233	-5,695	756	-1,335
Change in Reserves	1,429	1,379	-1,013	1,407	335	3,196
Change in banks' short-term (external liabilities inc-/dec-)			-1,512	-10,419	-44	-3,529
Other Monetary Movements			-708	3,317	465	-1,002
Customs Clearance Basis						
Not Seasonally adjusted						
(% change on same period of previous year)						
Exports - \$ Value			10.3	18.2	21.5	19.4
Volume			2.2	0.0	-2.1	-0.2
Price - \$			7.9	18.3	24.2	19.7
Y			-7.3	-12.3	-14.2	-15.9
Imports - \$ Value			0.5	1.7	-3.0	-5.9
Volume			3.5	3.6	2.2	7.3
Price - \$			2.9	-1.9	-5.0	-12.3
Y			-15.3	-26.6	-34.3	-38.4
Seasonally adjusted (% change on previous similar period)						
Exports - \$ Value			9.8	-0.1	0.2	8.6
Volume			1.8	-3.8	-2.4	5.9
Imports - \$ Value			1.6	-0.8	-11.3	5.0
Volume			-2.2	4.4	-6.6	12.9

* Using seasonally-adjusted trade figures.

STATISTICS
(Seasonally-adjusted except where specified NSA)

	UNIT	LATEST MONTH	LATEST MONTH	PREVIOUS MONTH	LATEST MONTH % CHANGE OVER		
					PREVIOUS MONTH	YEAR AGO (NSA)	
PRODUCTION	Manufacturing production capacity	1980=100 NSA	APR	121.1	120.8		4.1
	Manufacturing operating ratio	1980=100	APR	98.4	99.0	-0.6	-4.5
	Mining and manufacturing prodn	1980=100	APR	121.7	121.7	0.0	-0.4
	Producers' Shipments	1980=100	APR	116.9	115.0	1.7	-0.1
	Inventories of finished goods	1980=100	APR	108.5	110.1	-1.5	1.4
	Inventories to shipments ratio	1980=100	APR	101.0	104.7	-3.5	3.2
INVESTMENT	Business failures (over Y10 mn)	No NSA	MAY	1,632	1,569		-6.9
	- Liabilities	Y bn NSA	MAY	387.1	616.2		36.5
	Housing starts: Total	Units NSA	APR	115,805	106,165		-0.8
	- Floor area	1000m2 NSA	APR	10,302	9,357		-1.4
	- Public-funded	Units NSA	APR	45,557	45,195		-6.3
	- Private-funded	Units NSA	APR	70,248	60,970		3.1
	Public Works: Disbursements	Y bn NSA	MAY	300.5	1,406.1		1.4
	Construction orders: Total	Y bn NSA	APR	756.4	1,555.4R		0.4
	- Private	Y bn NSA	APR	562.3	994.3R		9.3
	- Public	Y bn NSA	APR	127.7	463.1R		-15.6
	Machinery orders: Total domestic	Y bn NSA	APR	998.4	1,010.6	-1.2	-0.9
- Private excl ships	Y bn NSA	APR	662.8	622.8	6.4	-2.4	
EXPENDITURE	All households real living exp (ave)	Y NSA	MAR	256,899	208,077		7.1
	Workers' households: Real income	1980=100	MAR	114.5	113.0	1.3	4.1
	- Real disposable income	1980=100	MAR	109.8	107.5	2.1	3.7
	- Real living expenditure	1980=100	MAR	107.1	105.5	1.5	-0.6
	- Ave consumption propensity	%	MAR	76.2	76.7R	-0.7	-3.9
	Retail sales	1980=100	APR	113.7	111.6R	1.9	4.2
	Major retailers' sales	1980=100	APR	130.1	129.6	0.4	5.2
	- Department store sales	1980=100	APR	129.0	127.9	0.9	6.7
	- Supermarket sales	1980=100	APR	131.2	131.6	-0.3	3.7
	Domestic car sales (over 550 cc)	Units NSA	MAY	211,831	237,241		7.6
	Banknotes in circulation (ave)	Y bn NSA	MAY	20,398	20,566		6.9
EMPLOYMENT	Earnings: all industries: nominal	1980=100	APR	125.8	126.4R	-0.5	2.6
	- Real	1980=100	MAR	110.1	109.8	0.3	3.2
	Labour productivity in mfg	1980=100 NSA	FEB	123.1	123.7R		2.8
	Unit labour cost	1980=100 NSA	MAR	113.4	112.8	0.5	3.0
	Employment: regular workers	1980=100	APR	105.8	105.8R	0.0	0.7
	Regular hours worked: all ind	1980=100	APR	99.0	98.0	1.0	-1.1
	Overtime hours worked: all ind	1980=100	APR	106.2	105.4	0.8	-3.1
	Unemployed	Mn NSA	APR	1.82	1.83		15.9
	Unemployed	Mn	APR	1.72	1.63	5.5	
	Unemployment rate	%	APR	2.06	2.71		
	Job openings/Job seekers	Ratio	APR	0.63	0.64		
PRICES	Wholesale prices: Total	1980=100 NSA	MAY	90.7	91.6	-1.0	-9.8
	- Domestic	1980=100 NSA	MAY	96.8	97.0	-0.2	-3.9
	- Imports	1980=100 NSA	MAY	59.9	63.6	-5.8	-39.4
	Consumer prices: National	1980=100	APR	114.9	114.8	0.1	0.9
	- Tokyo	1980=100	MAY	116.7	116.6R	0.1	1.3

	UNIT	LATEST MONTH SHOWN	LATEST MONTH	PREVIOUS MONTH	LATEST MONTH % CHANGE OVER		
					PREVIOUS MONTH	YEAR AGO (NSA)	
MONEY	Money supply (M2 + CDs, average)	Y bn NSA	APR	314,681	315,332		8.4
	Deposits: all banks	Y bn NSA	APR	228,535	239,146		9.3
	Loans and discounts: all banks	Y bn NSA	APR	240,916	242,477		12.8
	Ave interest rate: all banks loans	% NSA	APR	6.124	6.266		
	TSE Index (1st \$): Average Price	1968=100 NSA	MAY	1,264.45	1,233.83		28.5
	= Sales vol (daily ave)	Mn shs NSA	MAY	589	578		
FOREIGN TRADE	IMF Basis: Exports	\$ mn NSA	APR	17,468	17,312		18.4
	Imports	\$ mn NSA	APR	9,807	9,889		-7.2
	Trade balance	\$ mn NSA	APR	7,661	7,423R		
	Customs Clearance Basis						
	Exports: Total	\$ mn NSA	MAY	17,900	17,152R	4.4	
	Total	\$ mn NSA	MAY	17,889	17,751		24.0
	- To USA	\$ mn NSA	MAY	6,931	7,021		21.6
	- W Europe	\$ mn NSA	MAY	3,125	3,062		77.1
	- EC	\$ mn NSA	MAY	2,538	2,565		78.4
	- UK	\$ mn NSA	MAY	565	546		57.0
	- Middle East	\$ mn NSA	MAY	952	1,016		-5.2
	- S E Asia	\$ mn NSA	MAY	3,493	3,405		25.0
	Imports: Total	\$ mn NSA	MAY	10,035	10,699	-6.2	
	Total	\$ mn NSA	MAY	10,357	10,931		-6.3
	- From USA	\$ mn NSA	MAY	2,874	2,253		25.6
	- W Europe	\$ mn NSA	MAY	1,340	1,693		36.8
	- EC	\$ mn NSA	MAY	1,034	1,160		42.3
	- UK	\$ mn NSA	MAY	210	327		53.2
	- Middle East	\$ mn NSA	MAY	1,102	1,596		-55.9
	- SE Asia	\$ mn NSA	MAY	2,323	2,498		-9.4
	Crude oil imports: Value	\$ mn NSA	MAY	1,101	1,713		-61.6
	- Volume	1,000kl NSA	MAY	13,582	16,061		-15.7
	Ave cif Price	\$ pb NSA	MAY	12.89	16.38		-54.5
	Exports: Volume	1980=100 NSA	MAY	141.2	144.7		-0.2
	- Unit value \$	1980=100 NSA	APR	113.5	111.4		19.7
	Imports: Volume	1980=100 NSA	MAY	86.3	89.6		-17.7
	- Unit value \$	1980=100 NSA	APR	73.6	80.2		-12.3
	Terms of trade (Y)	1980=100 NSA	MAY	51.4	57.7		-45.1
	Export contracts) of major	Y bn NSA	APR	169.9	155.3		51.0
	Import Contracts) trading cos	Y bn NSA	APR	800.0	2,775.4		-18.3
	Export letters of credit	\$ mn NSA	APR	1,310.8	1,953.3		-22.9
		\$ mn NSA	MAY	9,660	9,863	-2.1	7.5
JAPAN'S PAY	Japanese external loans (inc-)	\$ mn NSA	APR	- 886	-1,016		
	Net Japanese purchases (-)/	\$ mn NSA	APR	-11,865	-6,281		
	sales(+) of foreign securities	\$ mn NSA	APR				
	Net foreign purchases (+)/	\$ mn NSA	APR	389	1,695		
	sales(-) of - Japanese bonds	\$ mn NSA	APR	656	1,709		
	- Stocks	\$ mn NSA	APR	824	1,757		
Japanese external bond issues	\$ mn NSA	APR	824	1,757			
Official reserves (end-month)	\$ mn NSA	MAY	32,475	31,113			

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THE JAPANESE ECONOMY

SUMMARY

1. THE DOMESTIC ECONOMY CONTINUES TO WEAKEN BUT THE EXTERNAL SURPLUS IS GROWING FASTER. GROWING CONCERN OVER THE DEFLATIONARY IMPACT OF THE APPRECIATION OF THE YEN DESPITE LOWER OIL PRICES. INCREASING PROBABILITY OF A PACKAGE OF MEASURES DESIGNED TO BOOST DOMESTIC DEMAND BUT THESE WILL PROBABLY BE TOO MODEST.

DETAIL

2. ALTHOUGH THE GOVERNMENT REMAINS PUBLICLY CONFIDENT THAT THE 4.2% TARGET FOR REAL ECONOMIC GROWTH IN 1985/86 WILL BE ACHIEVED, RECENT INDICATORS SUGGEST THAT THE DOMESTIC ECONOMY CONTINUES TO SLOW. THE RATE OF GROWTH OF INDUSTRIAL PRODUCTION MORE THAN HALVED IN 1985 TO 4.7% AND HAS DECLINED FURTHER IN JANUARY. OFFICIAL FORECASTS ARE THAT INDUSTRIAL OUTPUT IN THE THREE MONTHS TO MARCH WILL DECLINE FOR THE THIRD SUCCESSIVE QUARTER, RESULTING IN THE MOST EXTENDED DOWNTURN FOR MORE THAN 10 YEARS; AND THAT INDUSTRIAL OUTPUT, AND CAPITAL SPENDING ARE LIKELY TO FALL FURTHER BEFORE THEY RECOVER. MANUFACTURING INVESTMENT IN PARTICULAR, WHICH HAS HELPED TO SUSTAIN DOMESTIC DEMAND OVER THE LAST YEAR, IS NOW EXPECTED TO FALL BY NEARLY 5% IN THE FIRST SIX MONTHS OF 1986, REFLECTING A SHARP FALL IN GROWTH OF PROFITS IN 1985. ALTHOUGH INTEREST RATES HAVE FALLEN TO A RECORD POST-WAR LOW, THE SLOW INCREASE IN REAL INCOMES CONTINUES TO CHECK THE GROWTH OF CONSUMER DEMAND. CONSUMER SPENDING ROSE BY NO MORE THAN 0.3% IN REAL TERMS LAST YEAR.

3. THE EXTERNAL SURPLUS, IN CONTRAST, CONTINUES TO GROW RAPIDLY. THE CURRENT ACCOUNT SURPLUS IN 1985 ROSE TO A RECORD DOLLARS 49 BILLION, WITH GROWTH ACCELERATING IN THE FOURTH QUARTER. IMPORTS FELL BY 4% IN VALUE IN THE YEAR, REFLECTING ABOVE ALL A DECLINE IN THE VALUE AND VOLUME OF OIL IMPORTS. THE CURRENT ACCOUNT SURPLUS WAS FURTHER INCREASED BY A DOLLARS 2 1/2 BILLION CONTRACTION IN THE INVISIBLES DEFICIT. BALANCE OF PAYMENTS FIGURES FOR JANUARY SHOW RECORD 1.9 BILLION SURPLUS FOR THIS MONTH. THE TRADE SURPLUS FOR THE MONTH ROSE TO DOLLARS 2.4 BILLION AS EXPORTS INCREASED BY 16% IN DOLLAR TERMS (BUT FALLING BY 8.7% IN YEN TERMS).

4. THERE IS GROWING POLITICAL CONCERN THAT JAPAN MAY THEREFORE COME TO THE SUMMIT AT THE BEGINNING OF MAY AGAINST A BACKGROUND OF STAGNANT DOMESTIC GROWTH AND A BURGEONING EXTERNAL SURPLUS

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SURPLUS. PRIME MINISTER NAKASONE LAST WEEK GAVE A CLEAR INDICATION TO THE DIET THAT THE GOVERNMENT IS CONSIDERING A FURTHER PACKAGE OF MEASURES TO STIMULATE DOMESTIC DEMAND, PROBABLY TO BE ANNOUNCED IN APRIL. SUCH MEASURES WOULD PROBABLY INCLUDE A FURTHER CUT IN THE DISCOUNT RATE; AN ACCELERATION OF PUBLIC WORKS SPENDING; EARLY ASSISTANCE TO INDUSTRIES BADLY HIT BY THE APPRECIATION OF THE YEN; FURTHER MEASURES TO STIMULATE HOUSING CONSTRUCTION AND SOME ACTION TO DISTRIBUTE THE BENEFIT ENJOYED BY UTILITY COMPANIES AS A RESULT OF A FALL IN OIL PRICES. THERE HAVE BEEN CLEAR OFFICIAL HINTS TO INDUSTRY THAT THOSE COMPANIES WHOSE PROFITS HAVE NOT BEEN HIT TOO BADLY BY THE APPRECIATION OF THE YEN SHOULD CONTEMPLATE SUBSTANTIAL PAY INCREASES IN THE SPRING ROUND. THE GOVERNMENT HAS AGAIN COMMITTED ITSELF TO 4% GROWTH IN 1986/87 BUT, ALTHOUGH THE BENEFICIAL IMPACT OF OIL PRICES HAS NOT YET BEEN FULLY EVALUATED, MOST PRIVATE SECTOR ECONOMISTS REMAIN SCEPTICAL OF THIS FIGURE IN THE ABSENCE OF EVEN MORE SUBSTANTIAL MEASURES THAN ARE BELIEVED TO BE CONTEMPLATED. THE GOVERNMENT HAS, HOWEVER, AGAIN RULED OUT AN EARLY CUT IN INCOME TAX.

5. THERE IS CONCERN, TOO, OVER THE FURTHER APPRECIATION OF THE YEN IN THE LAST THREE WEEKS. WHILE WELCOMING THE STRONGER YEN IN PRINCIPLE, BOTH THE FINANCE MINISTRY AND THE BANK OF JAPAN HAVE MADE CLEAR THEIR VIEW THAT Y180 SHOULD BE THE UPPER LIMIT OF APPRECIATION FOR THE TIME BEING. FINANCE MINISTER TAKESHITA HAS HINTED PUBLICLY AT THE POSSIBILITY OF INTERVENTION TO PREVENT FURTHER EARLY APPRECIATION IN ORDER TO ALLOW THE ECONOMY TO ADJUST.

6. AGAINST THIS BACKGROUND, DISCUSSION CONTINUES WITHIN AND OUTSIDE THE GOVERNMENT ON THE APPROPRIATE LONGER TERM MEASURES TO REDRESS EXTERNAL IMBALANCES. NAKASONE'S PERSONAL ADVISORY COMMITTEE UNDER MAEKAWA WILL REPORT LATER THIS MONTH. ITS RECOMMENDATIONS SEEM LIKELY TO ENCOMPASS CONTINUED INTERNATIONAL COORDINATION OF MACRO-ECONOMIC POLICIES WITHIN THE CURRENT FRAMEWORK, FURTHER LIBERALISATION OF JAPAN'S FINANCIAL MARKETS, THE PROMOTION OF JAPANESE DIRECT FOREIGN INVESTMENT AND INDUSTRIAL COLLABORATION, THE DEVELOPMENT OF JAPAN'S DOMESTIC DEMAND THROUGH RENEWAL OF INFRASTRUCTURE, PROMOTION OF LEISURE ETC, AND MORE OVERSEAS AID. THIS REFLECTS A GENERAL CONSENSUS THAT THE TRADE SURPLUSES ARE NOW A REAL PROBLEM, AND THAT JAPAN MUST ACCEPT ITS GREATER RESPONSIBILITIES TO THE INTERNATIONAL COMMUNITY, AND PARTICULARLY THE LDC'S. BUT AT THE SAME TIME IT IS GENERALLY HELD THAT THE FEATURES WHICH DISTINGUISH JAPAN'S ECONOMY, SUCH AS ITS HIGH SAVINGS AND LOW IMPORT PROPENSITIES, WILL CHANGE VERY SLOWLY. THE IDEA OF AN IMPORT TARGET HAS VERY LITTLE DOMESTIC SUPPORT. THE PRESENT GOVERNMENT'S ATTACHMENT TO REDUCING THE BUDGET DEFICIT IS / LIKELY

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LIKELY TO LIMIT THE SHORT-TERM IMPACT OF ANY POST-MAEKAWA POLICY CHANGES. THE JAPANESE THEME AT THE SUMMIT IS LIKELY TO BE THAT THE EXTERNAL IMBALANCES MUST BE TACKLED THROUGH JOINT EFFORTS TO ACHIEVE GROWTH IN THE WORLD ECONOMY, IN WHICH JAPANESE TECHNOLOGY AND CAPITAL WILL BE READY TO PLAY AN INCREASING PART.

7. SEE MY TELNO 25B FOR A REVIEW OF THE DOMESTIC POLITICAL SCENE.

HITCH

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DR WILSON

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OUR TELNO 891: NAKASONE FAILS THE TEST

SUMMARY

1. NAKASONE'S EFFORTS TO SECURE PASSAGE OF AN ELECTORAL REFORM BILL IN THE CURRENT EXTRAORDINARY SESSION OF THE DIET HAVE FAILED. A REVISED BILL WILL BE INTRODUCED IN THE NEXT SESSION BUT ITS PROSPECTS ARE UNCERTAIN. THIS IS A MAJOR SETBACK FOR NAKASONE.

DETAIL

2. NAKASONE ACCEPTED ON 19 DECEMBER THAT NO CONSENSUS COULD BE REACHED WITH THE OPPOSITION ON HIS PROPOSALS FOR THE REDISTRIBUTION OF SEATS IN THE LOWER HOUSE. THE GOVERNMENT'S BILL, THE MAIN PIECE OF LEGISLATION PUT BEFORE PARLIAMENT IN THE CURRENT EXTRAORDINARY SESSION, WILL THEREFORE BE WITHDRAWN. INSTEAD, GOVERNMENT AND OPPOSITION HAVE ACCEPTED THE MEDIATION OF THE SPEAKER TO THE EFFECT THAT IN THE FORTHCOMING ORDINARY SESSION OF THE DIET A RENEWED EFFORT SHOULD BE MADE TO TACKLE THIS PROBLEM ON THE BASIS OF THE ADVANCE CENSUS RETURNS TO BE PUBLISHED ON 24 DECEMBER. THE SPEAKER'S MEDIATION PROPOSALS PROVIDE THAT

(A) THERE WILL BE NO CHANGE IN THE PRESENT NUMBER OF SEATS IN THE LOWER HOUSE:

(B) SEATS WILL BE REDISTRIBUTED SO THAT THE NUMBER OF VOTES PER MP IN THE MOST POPULOUS CONSTITUENCIES WILL NOT BE MORE THAN TREBLE THE NUMBER IN THE LEAST POPULOUS:

(C) NO TWO MEMBER CONSTITUENCIES WILL BE CREATED:

(D) FURTHER REDISTRIBUTION WILL OCCUR WHEN THE DEFINITIVE CENSUS RETURNS ARE PUBLISHED NEXT AUTUMN.

3. NAKASONE FAILED BECAUSE THE OPPOSITION PARTIES WERE DETERMINED TO RESIST THE BILL AND HE HAD ONLY LUKE-WARM SUPPORT FROM HIS OWN PARTY. HIS VEILED THREAT TO CALL AN ELECTION ON THIS ISSUE HAS BEEN DISREGARDED. THE SPECIFIC POINTS OF RESISTANCE, SUCH AS THE OPPOSITION'S HOSTILITY TO THE CREATION OF TWO-MAN CONSTITUENCIES, WERE LESS IMPORTANT THAN THE GENERAL WISH SHARED BY OPPOSITION AND NAKASONE'S RIVALS IN THE LDP ALIKE, TO DENY THE PRIME MINISTER FREEDOM TO EXERCISE HIS RIGHT TO DISSOLVE THE DIET AT A MOMENT OF HIS OWN CHOOSING. THIS HAS PREVAILED OVER THE NEED TO CARRY THROUGH AN ELECTORAL REFORM PRESCRIBED BY THE SUPREME COURT.

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4. THIS IS A SERIOUS PARLIAMENTARY DEFEAT FOR NAKASONE. IT HAS DEMONSTRATED ONCE AGAIN THE WEAKNESS OF HIS BASE WITHIN THE LDP AND THE DISTRUST WITH WHICH HE IS VIEWED BY HIS PARTY COLLEAGUES. GOVERNMENT AND OPPOSITION ARE COMMITTED BY THE SPEAKER'S MEDIATION TO CONTINUE TO SEARCH FOR A WAY OUT OF THE IMPASSE. BUT IT WILL IN PRACTICE BE VERY DIFFICULT TO GET AGREEMENT ON A NEW DRAFT BILL DURING THE NEXT SESSION OF THE DIET. NAKASONE'S AUTHORITY WITHIN HIS OWN PARTY AND HIS SCOPE FOR TAKING INITIATIVES, EG ON ECONOMIC POLICY, WHICH ARE CONTROVERSIAL IN DOMESTIC POLITICAL TERMS, ARE LIKELY TO BE DIMINISHED. THE FUTURE PROSPECT MAY BECOME CLEARER WHEN, AS IS EXPECTED, HE CARRIES OUT A CABINET RESHUFFLE TOWARDS THE END OF THIS MONTH.

GIFFARD

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SAVING TELEGRAM

BY BAG

CULL
 FROM TOKYO TO FCO
 UNCLASSIFIED
 TELNO 12 SAVING

Addressed to FCO Telegram No 12 Saving of 17 December 1985

Repeated for information saving to:

Paris, Rome, Bonn, Washington, Brussels, Dublin, Stockholm, UKREP Brussels, UKMIS Geneva, UKDEL OECD, Ottawa, Bangkok, Canberra, Peking, Seoul, Jakarta, Singapore, Manila, Kuala Lumpur, Governor Hong Kong, BTC Hong Kong, Osaka.

JAPAN: MONTHLY ECONOMIC REPORT - DECEMBER 1985

Summary

- In the three months to September 1985, the Japanese economy grew in real terms at an annual rate of 2.6%, less than half the increase recorded in the previous quarter. The underlying rate of growth is now probably slower than at any time since early 1983.
- Slow export growth was largely responsible for the less rapid expansion of the economy, although this was partly offset by a deceleration in import growth.
- Domestic demand grew only slowly. Private investment remained reasonably strong, but far below the levels seen earlier in the year. Private housing investment was unexpectedly weaker. Consumers' expenditure saw steady but unspectacular growth.
- The official growth target for 1985/86 remains at 4.6%, but most forecasters are revising their estimates downwards towards 4%. The latest indicators suggest that industrial output is rising more slowly than expected and that retail sales remain weak. Unemployment rose again in October and short-term interest rates remain high.
- Exports grew strongly in October and the trade surplus reached a near record \$5.2 billion. Preliminary figures for November suggest that exports continued to be buoyant and that imports rose only slowly.
- Long-term capital outflows, which had fallen to \$3 billion in September, returned to a near record \$7 billion in October.

The Yen rose briefly above Y200 to the US Dollar on 25 November for the first time in nearly 5 years. Latest official comment indicates that the authorities are now unwilling to see further appreciation and the rate appears to have stabilised at around Y203, some 20% above mid-September levels.

KEY INDICATORS

TABLE 1A

		1985 APR-JUN	1985 JUL-SEP	PREVIOUS MONTH	LATEST MONTH	LATEST MONTH SHOWN
GNP* - NOMINAL	) %Change on	1.6R	1.4			
- REAL	) Previous period	1.4R	0.6			
Industrial Production*	"	2.7	-0.1	-1.1	1.3	October
Unemployment	% of labour force average for period	2.5	2.6	2.7	2.8	October
Wages	% change on year ago	3.0	4.5	3.6	3.6	October
Wholesale Prices	% change on year ago	0.2	-1.7	-3.2	-3.8	November
Consumer Prices (Tokyo)	% change on year ago	1.7	2.5	2.6R	2.2	November
Money Supply (M2 ± CDs)	% change on year ago	8.3	8.3	8.3	8.6	October
Short-term interest rate	% pa (3-month Gensaki)	6.295	6.330	7.110	7.435	November
Long-term interest rate	% pa (10-year Government Bond)	6.04	5.76	6.53	6.16	November
Current Account*	\$ Million	12,127	11,986	3,991	4,539	October
Overall Balance	\$ Million (SA)	-3,055	-6,100	- 388	-2,840	October
	\$ Million (NSA)	-1,920	-4,751	504	-2,606	October
Change in Reserves	\$ Million	1,031	- 46	-1,151	- 69	November
Exchange Rate	¥/\$ (end-period)	248.95	217.00	211.50	202.00	November
	¥/\$ (end-period)	325.63	302.39	305.30	300.37	November

200 by CP

RECENT ECONOMIC DEVELOPMENTS

Preliminary quarterly national income statistics for the three months to September 1985 were published on 6 December (Table 1B). The figures confirm the evidence of recent monthly indicators that suggested that the economy had slowed noticeably in the third quarter. The annual rate of real growth halved from 5.8% to 2.6% in the quarter and the underlying rate of real growth is probably now slower than at any time since the first quarter of 1983. The EPA's diffusion index for coincident indicators recovered slightly in September but its quarterly average of 45.5 remains well below the 78.8 recorded in the June quarter. The lagging indicator also remains weak at 33.4 compared with 59.5 for the earlier quarter. The September index of leading indicators, however, showed another small rise to stand at 58.3, compared with the low recorded in May of 29.2. This distribution of the indicators would normally point to a recovery in the economy in the first quarter of next year but the consolidation of the yen at its new high level against the US dollar, and uncertainties over the prospects for the US economy next year, seem to be leading the Japanese authorities to draw cautious conclusions on the outlook for the final two quarters of 1985/86.

The external sector made a substantial negative net contribution to growth in the September quarter. Exports in national income terms fell by 3.5% in the quarter, the first substantial fall since the beginning of the recovery in 1983, although imports also fell, mainly reflecting weakening commodity and oil prices.

The slowdown in the external sector was, however, partly offset by the strongest quarterly growth of domestic economic activity since the same quarter last year. Domestic demand overall grew by a little over 4% in real terms at an annual rate in the quarter, compared with well under 3% in the previous quarter. The private sector accounted for barely half the growth on this occasion, in contrast to recent quarters. The most disappointing feature was undoubtedly the continued weakness of housing which decreased at an annual rate of 10% in real terms, after four quarters of steady growth. This poor performance in the quarter suggest that it will be difficult for housing to play the role assigned to it in the 15 October domestic demand package. These difficulties will probably be compounded by recent interest rate changes and the announcement that tax concessions planned for next year will be substantially watered down.

Private investment, in contrast, remained reasonably strong in the quarter. The apparent deceleration shown in the figures, compared with the previous quarter, needs to be treated with some caution, as there seem to have been some end-fiscal year distortions. The good September quarter figure probably reflects second-round investment decisions taken towards the end of last year, when there were signs that some larger companies were implementing plans in the light of continued strong growth in export markets.

Consumer expenditure in the quarter continued to grow steadily but unspectacularly. Annual real growth of about 2.5%, distributed erratically between the quarters, seems to be establishing itself as a pattern and there are no indications of a sustained growth in this sector that would support the economy in the next two quarters, if the expected down-turn in investment occurs. There has been some recovery in real disposable income in recent months, but overtime hours, particularly in manufacturing industry, are now falling and it seems likely that this trend will continue into the autumn. Summer bonuses this year reflected in general the greatly increased profitability of most companies but disappearing profitability in export markets, coupled with higher interest costs at home, probably combined to reduce the growth of the winter bonuses to 4.2%. A recent survey illustrated the changing pattern of the disposal of these bonuses, with more than 70% being used for savings and loan repayments.

A recent Nikkei survey covering the profitability of major publicly listed companies in Japan in the six months to end September, suggest that profitability is already falling fast. Twenty-one out of thirty-three industries reported lower pre-tax recurring profits which had fallen on average by nearly 17% compared with the previous half-year. Although some half recovery is expected, this will largely be confined to non-manufacturing industry and the pre-tax profits of export orientated industries such as motor vehicles, electronics and precision instruments are expected to show only a moderate recovery before falling sharply again in the first half of next year.

SHORT-TERM OUTLOOK

The revision of GNP figures onto a new 1980 base (an up-dating process that is carried out every five years in Japan) means that a number of adjustments have to be made both to past figures and current forecasts. Thus real growth in the fiscal year ending March 1985 has now been revised downwards from 5.7% to 5.0%. The recently published national income accounts reflect this and a number of other important revisions. It is probably also necessary to adjust the forecast for the current year downwards from 4.6 to about 4.4% as a result of these revisions, but no official announcement is likely to be made. One reason for this is that business confidence has been badly shaken over the last six months, first by the threat of protectionism and, secondly, by the extent and speed of the revaluation of the Yen against the US dollar. The authorities are therefore likely to be anxious to avoid making public even a technical adjustment to the forecast.

The recent quarterly Bank of Japan survey on business confidence and investment intentions illustrates the extent to which manufacturing industry has become more pessimistic about prospects in the last three months. Of the major corporations surveyed, the number of pessimistic responses outweighed the optimistic ones for the first time in almost two years. Respondents to the survey suggested that they had revised their projected export and general earnings downwards. Total sales by manufacturing firms in the October to December quarter are expected to be sluggish. The major non-oil manufacturing industries project a rise in sales in the second half of the year as a whole of no more than 0.2%, compared with the 1.7% recorded in the first half of the year. Current profits among these same firms are expected to fall by 9.3% in the second half of the year after falling by 5% in the first half. Nevertheless, the more than 7,000 companies surveyed remain reasonably optimistic about the volume of sales, albeit at declining profit margins.

One area of particular uncertainty at present is the extent to which private sector investment will hold up over the next six months. There is considerable speculation that companies will now be reluctant to implement investments to which they had tentatively committed themselves earlier in the year. There is for the moment little hard evidence but an October survey conducted by the Small Business Finance Corporation suggested that, in the case of medium and small manufacturing companies, capital investment had increased by more than 15% in the first half of the year but was expected to decrease by 4% in the second half. This sector has been particularly badly hit by the appreciation of the yen and may not be typical of Japanese industry as a whole, but there is some evidence that the unusually prolonged period of capital investment by the private sector during the 1983-85 recovery owed much to the investment plans of smaller companies.

RECENT ECONOMIC FORECASTS

The winter forecast round by private sector bodies has been delayed by uncertainties over the outturn for the second quarter (which have now been resolved) and by the need to take into account any consequential changes made in the 1986/87 budget, which is now undergoing final adjustments before it is formally adopted by the Government at the end of this month.

The latest indications are that general expenditure (total current expenditure less debt service and revenues transferred to local governments) will be reduced to Y32.53 trillion next year, marginally lower than the original total set for the 1985/86 budget. After taking into account transfers to local authorities, total general account expenditure for next year is expected to fall by 3.4%, rather than rising by 7.3% as envisaged in the original budget submissions made by departments to the Ministry of Finance in August. Totals for individual budget lines are not available, but it is reported that Ministry of Finance officials have been concentrating their attention on reducing social security and public works expenditure in this part of the budget.

In contrast, it is now widely expected that the Fiscal Investment and Loan Programme will rise to some Y2 trillion next year, somewhat higher than the level originally requested by Government agencies. Additional funds are expected to be allocated for major public works construction in the Tokyo Bay and Inland Sea areas. Within the overall total, additional sums are expected to be allocated to local governments' public works projects and the loan quotas of the Small Business Finance Corporation.

The Government's official forecast for next year will be published towards the end of this month, but the Minister of the Economic Planning Agency has already indicated that real growth will probably fall below 4% next year and may be no higher than the 3.5% forecast by OECD.

The few private sector forecasts yet available tend to be more pessimistic, with the Bank of Tokyo (see last month's Economic Report) at the upper end of the range with 3.4%. The latest forecast from one of the major life insurance companies puts growth this year at 4.1%, falling to 3.1% next year, producing a current account surplus of 54.5 billion. This forecast assumes a yen rate of Y203 to the dollar and a cut in the official discount rate to 4.5%. A major city bank (Mitsui) is considerably more pessimistic, predicting real growth of 2.9% but a slightly lower current account surplus of \$52 billion. This forecast assumes additional public works expenditure of Y1 trillion and a cut in the official discount rate to 4.5%. Finally, one of the smaller city banks predicts an outturn of 4% for the current year and 2.8% for next year. Private sector investment in this forecast is expected to grow by no more than 4.3% and the current account surplus is expected to be largely unchanged at 53.5 billion. This forecast assumes a yen rate of Y199 to the dollar and, once again, a cut in the official discount rate in the middle of the year to 4.5%.

DETAIL

Industrial Production

Industrial production rose in October but much more slowly than predicted. The recovery is not expected to extend into November. The September quarter's leading indicators show an upward trend but coincident and lagging indicators remain weak.

1. Industrial output in October recovered, with the seasonally adjusted index of industrial production (mining and manufacturing), which fell by 1.1% in September, rising by 1.3%*, far less than the (revised) official forecast of 3.1%. The year-on-year rise declined to 1.9%, the lowest since April 1983.
2. Although most sectors had a better month, primary producers and older industries, such as textiles, showed only a modest recovery. The most rapid rise in output again occurred in the transport sector, but most other high technology sectors, with the exception of general industrial machinery, did rather better. Despite growing problems of over capacity, electronics industry production rose by 2.7% in the month and the precision machinery sector was again supported by strong demand for cameras, output in this sector as a whole rising by 6.1% on the month.
3. The diffusion indices issued by the EPA for September reinforce the view that the economy has slowed down markedly in recent months. Although coincident indicators rose to 31.8, compared with August's 18.2 (by far their lowest level since the recovery began), lagging indicators remained at 28.6, less than half the level of the June quarter. The leading indicator series has in general moved more smoothly and it has pointed steadily upwards since May's low figure of 29.2, reaching 58.3 in September. The overall diffusion index, however, has reached its lowest level since the June quarter of 1983.
4. MITI's seasonally adjusted forecast for manufacturing and mining output in November has been revised upwards, from a fall of 1.3% to one of 0.4%, with a particularly sharp recovery in machinery and iron and steel sectors. Production in December is expected to rise by 1.0%, as these gains are consolidated.

* This has now been revised downwards to a rise of 1%.

HOUSING

Housing and Construction

Housing starts, particularly in the private sector, strengthened again after two weak months. Private sector industrial construction orders declined but machinery orders strengthened. Public sector investment continues to weaken.

5. Total housing starts in October rose to 110,395 compared with 101,454 in October. There was again a similar rise in starts in terms of floor area. Publicly funded housing grew strongly on the month but remains well down on the year and the market is again being sustained by privately funded housing. Recent tax changes may in due course stimulate some further revival in this sector, but housing loan rates have risen to 7.68% for new loans and, with no offsetting tax relief, are very high in real terms.

6. One further factor that may hold back projected increases in housing is that the expected housing tax reduction proposed for next year will be much more modest than originally envisaged. The system proposed by the Ministry of Construction would have cost some Y100 billion in a full year and would have permitted 1% of the construction cost or purchase price of a house to be deducted from income tax over five years. The Tax Council of the LDP is reported to have decided instead, however, to double the present modest exemption permitted at a cost of some Y25 billion.

7. Industrial construction orders seem to have resumed the erratic path seen earlier in the year after remaining virtually unchanged in September for the second successive month. The continued decline in public sector construction orders, reflecting budgetary restraints, was again broadly offset by a rapid rise in private construction orders. Public works disbursements have fallen by 7.4% in the financial year to date compared with 1984/85, although the underlying trend seems to be gradually upwards.

8. Domestic machinery orders recovered sharply in October following their second successive quarterly decline in 18 months in the three months to September. While the June quarter figures were probably distorted to some extent by end year factors, the continued decline into the third quarter suggested that private sector investment was slowing. The October figures, however, are the highest in absolute terms for well over a year and may indicate some recovery.

Consumers' Expenditure

Retail sales were reasonably strong in the September quarter as a whole but grew only slowly in October. Real disposable income rose strongly for the first time in two years but real living expenditure grew very slowly in the period.

9. All households' real living expenditure fell slightly in September after reasonable growth in August. The September quarter showed the slowest growth for two and a half years. Real disposable income of working households in the month in contrast fell by 0.2% but the strong July figure, reflecting increased summer bonus payments, boosted quarterly growth to 2.9%, the highest figure for two years. Real living expenditure by these households remained weak and the figures for consumption propensity continued to drift downwards.

10. Retail sales in the September quarter were reasonably firm, rising by 2.6%, mainly in response to July's strong outturn. Department store sales in particular showed some recovery but the underlying picture remains one of weak demand, with October sales rising only slowly. Domestic car sales in November fell by 3% compared with the previous year, confirming that the Autumn selling season has been disappointing. The recent relaxations proposed in terms control seem to have offered little support.

Employment and Prices

Unemployment again rose sharply to 2.76% in October. The ratio of job seekers improved slightly. Consumer prices increased by no more than 2.3% in the year to October and the recent strength of the Yen suggests that this trend is unlikely to be reversed. Wholesale prices fell again.

11. The number of unemployed, which fell to the lowest level for two years (1.45 million) in the Spring, increased to 1.65 million in the October returns, equivalent to an unemployment rate of 2.76%. At the same time, the ratio of jobs available to the number of those actively seeking work improved to 0.67.

12. In the year to September, unit labour costs rose slightly (1.2%), suggesting that the downward trend of recent months may have been reversed. Total nominal earnings of regular workers in all industries in October were up by 3.6% on the year, and real earnings rose by 2.6% in the same period.

13. Consumer price increases were once again modest, with the national consumer price index rising by only 2.3% in the year to October, following a 1.1% rise on the month. Consumer prices in November in Tokyo fell by 0.2% and the year-on-year rise declined to 2.2%.

14. Wholesale prices have now been declining steadily for some months. Wholesale import prices in particular fell by more than 2.8% in the last month and the continued strength of the yen against most currencies has helped to hold down manufacturers' costs. Domestic wholesale prices accordingly fell again by 0.8% on the month.

Monetary Developments

Growth of the broad money supply in the year to end October rose to 8.6%, compared with 8.3% in September. Short-term rates have continued to strengthen but long-term rates have weakened sharply. Underlying stance of monetary policy is officially described as accommodative.

15. In October, the year-on-year growth of the broad money supply (M2 CDs) rose to 8.6%, reflecting the generally easy stance of monetary policy for much of the last two years. The rise in short-term rates engineered by the authorities in the last week in October in support of exchange rate objectives, has continued to be effective, with rates hardening even further (see table 2A). The increase in rates has had a major impact on the funding of foreign banks, making operating conditions extremely difficult for them.

Table 2A

	<u>Call Loan</u> <u>(Unconditional</u> <u>median)</u>	<u>Bill Discount</u> <u>(Over 2</u> <u>months)</u>	<u>Gensaki</u> <u>(3 month</u> <u>average)</u>
End September	6.75	6.375	6.33
End October	7.125	7.75	7.11
End November	7.6875	8.0625	7.435
Mid-December	8.4375	8.125	7.435

16. Government bond rates fell steadily over the six months to end October when the authorities, having raised money market rates, took steps to ensure a similar rise in longer rates. Rates in the bond market continued to rise until mid-November, triggering rises in other long-term rates (see paragraph 17) but have since softened to a point only slightly above their mid-October low. This is said to reflect a widespread conviction that the authorities would welcome an opportunity to lower rates provided that this can be done without leading to a weakening of the yen.

17. Following the initial rise in rates, long-term prime rate rose by 0.5% to 7.5% in early December. Five-year bank debenture rates also rose by a similar amount to 6.6% from late November. The coupon for the November issue of ten-year Government bonds also rose by 0.5% and the yield to maturity was set at 6.708%, 0.588% higher than the October issue. Total issues in the month, however, were reduced to ¥500 billion, compared with ¥1,500 billion in October. Finally, housing loan rates were raised by 0.3% for new fixed-interest loans and by 0.5% for floating-rate loans.

Table 2B

	<u>6.1%</u> <u>No 10</u>	<u>7.7%</u> <u>No 22</u>	<u>8.0%</u> <u>No 25</u>
End September	6.09%	5.76%	5.71%
End October	6.96%	6.53%	6.58%
Mid-November (peak)	7.38%	6.79%	6.76%
Mid-December	6.56%	5.96%	5.96%

The Balance of Payments

The October trade surplus rose to a near record \$5.2 billion, as exports increased by 7.7% on the month and imports drifted up by only 3.2%. A current account surplus of \$4.5 billion was recorded on the month, despite a substantially increased deficit on invisible accounts. Net long-term capital flows in the month doubled compared with September, returning to the higher level seen in the summer. The yen consolidated its recent strength against the US dollar.

18. In October, the seasonally adjusted trade surplus rose to \$5167 million. Exports rose by 7.7% on the month but imports rose by only 3.2%. The trade surplus therefore increased by some \$800 million to near record levels. Preliminary details (on a customs clearance basis) for November suggests that the surplus increased still further in that month, with exports of cars to the United States 45% higher than a year ago and exports of other consumer goods rising in value by nearly 30%.

19. Net long-term capital outflows (Table 3A) which halved from their recent high levels in September, accelerated once again. Outflows of more than \$9 billion were again directed mainly to overseas securities, principally in North America. Direct overseas lending in October fell to \$0.6 billion. Inward long-term capital flows in contrast showed a significant decrease from September, reflecting further substantial net disinvestment in Japanese stocks by foreign holders. An increase demand for external bonds did little to offset outward flows and the net outward total for the month exceeded \$7 billion.

20. The yen rose rapidly against the US dollar following the monetary policy changes in late October described above, in what the authorities have since described as a second phase of adjustment. It traded briefly above Y200 on 25 November but retreated below that level to trade at around Y203 in subsequent weeks, following clear official signals that it had appreciated far enough, at least for the moment.

Table 3A

<u>LONG TERM CAPITAL</u>					
<u>1985</u>					
<u>OUTWARDS</u>	<u>FY 1985/5</u>	<u>APR-JUN</u>	<u>JUL-SEP</u>	<u>SEP</u>	<u>OCT*</u>
Direct					
Investment	5.7	1.7	1.7	0.5	0.6
Trade Credit	5.5	1.4	0.5	0.2	0.4
Loans	12.7	1.0	2.7	1.1	0.6
Securities	35.3	16.1	17.0	3.1	7.0
Others	2.9	0.6	1.0	0.7	0.4
	—	—	—	—	—
	62.1	20.8	22.9	5.6	9.0
	—	—	—	—	—
<u>INWARDS</u>					
External					
Bonds	8.9	2.4	3.7	1.7	0.9
Stocks	-2.5	-0.9	-0.3	-0.1	-0.4
Bonds	1.4	0.8	1.0	0.8	1.2
Other	-0.1	0.1	-	0.1	0.1
	—	—	—	—	—
	7.7	2.4	4.4	2.5	1.8
	—	—	—	—	—
<u>Net Total</u>	-54.4	-18.4	-18.5	-3.1	-7.2

* "October" figures in previous report referred to September.

TABLE I B

GNE (Real, SA, Base Year = CY 1980)*
 (Unit: ¥ billion, percentage changes
 over the preceding quarter)

	1984				1985		
	I	II	III	IV	I	II	III
Consumers' Expenditure	157131.4 (1.0)	157557.2 (0.3)	158375.9 (0.5)	159240.9 (0.5)	161106.4 (1.2)	161900.4 (0.5)	162753.3 (0.5)
Private Housing	13613.2 (-1.6)	13500.5 (-0.8)	13624.8 (0.9)	13742.5 (0.9)	13913.9 (1.2)	14227.9 (2.3)	13892.6 (-2.4)
Private Investment	44371.5 (3.0)	45512.3 (2.6)	46575.3 (2.3)	48452.9 (4.0)	48574.5 (0.3)	51124.5 (5.2)	52770.0 (3.2)
Private Inventories	1162.1 (-22.2)	1356.5 (16.7)	1957.3 (44.3)	1950.7 (-0.3)	2112.0 (8.3)	1825.3 (-13.6)	1384.0 (-24.2)
Government Current Exp	26250.6 (1.1)	26429.6 (0.7)	26538.4 (0.4)	26675.0 (0.5)	26979.1 (1.1)	27081.5 (0.4)	27190.4 (0.4)
Public Sector Investment	22395.2 (-1.6)	22694.8 (1.3)	22507.2 (-0.8)	22014.9 (-2.2)	21615.5 (-1.8)	19954.0 (-7.7)	20456.1 (2.5)
Public Sector Inventories	73.8	-38.7	594.0	42.6	27.9	77.6	515.6
External (Net)	8234.0 (25.3)	9365.0 (13.7)	8055.5 (-14.0)	12096.4 (50.2)	11096.4 (-8.3)	13256.4 (19.5)	12336.9 (-6.9)
Exports	49638.7 (5.0)	51680.7 (4.1)	52691.0 (2.0)	55256.5 (4.9)	54833.7 (-0.8)	57176.9 (4.3)	55149.3 (-3.5)
Imports	41404.7 (1.7)	42315.7 (2.2)	44635.5 (5.5)	43160.1 (-3.3)	43737.3 (1.3)	43920.5 (0.4)	42812.4 (-2.5)
GNE	273231.9 (1.6)	276377.2 (1.2)	278228.4 (0.7)	284215.8 (2.2)	285425.7 (0.4)	289447.6 (1.4)	291298.9 (0.6)

* Note change of base year.

R = Revised

STATISTICS
(Seasonally adjusted except where specified NSA)

	Unit	Latest Month Shown	Latest Month	Previous Month	Latest Month % Change Over		
					Previous Month	Year Ago (NSA)	
PRODUCTION	Manufacturing production capacity	1980=100 NSA	Oct	119.3	118.3		4.2
	Manufacturing Operating Ratio	1980=100	Oct	103.0	101.2	1.8	0.6
	Mining and Manufacturing Prodn	1980=100	Oct	123.0	121.4	1.3	1.9
	Producers' Shipments	1980=100	Oct	118.4	116.7	1.5	2.6
	Inventories of finished goods	1980=100	Oct	108.3	108.7	-0.4	6.6
	Inventories to shipments ratio	1980=100	Oct	98.0	99.0	-1.0	3.4
	BUSINESS INVESTMENT	Business failures (over ¥10 mn)	No NSA	Nov	1,525	1,763		-11.6
- Liabilities		¥ bn NSA	Nov	279.7	239.5		-6.0
Housing starts: Total		Units NSA	Oct	110,395	101,454		5.4
- Floor area		1000m ² NSA	Oct	8,874	8,312R		4.2
- Public-funded		Units NSA	Oct	39,710	35,457		-3.6
- Private-funded		Units NSA	Oct	70,685	65,997		11.2
Public Works: Disbursements		¥ bn NSA	Nov	422.7	389.6R		0.0
Construction Orders: Total		¥ bn NSA	Oct	1,161.6	1,507.5R		28.7
Private		¥ bn NSA	Oct	630.1	929.9R		30.4
Public		¥ bn NSA	Oct	262.2	416.2R		-5.7
Machinery orders: Total domestic		¥ bn	Oct	1,046.4	845.9R	23.7	6.4
- Private, excl ships	¥ bn	Oct	681.9	541.7	25.9	3.7	
CONSUMERS' EXPENDITURE	All hseholds real living exp (ave)	¥ NSA	Sep	217,451	234,680R		-0.2
	Workers households: Real income	1980=100	Sep	112.2	112.4	-0.2	2.1
	- Real disposable income	1980=100	Sep	108.1	108.3	-0.2	0.9
	- Real living expenditure	1980=100	Sep	108.5	106.6	1.8	0.7
	- Ave consumption propensity	%	Sep	78.5	76.9	2.1	-0.2
	Retail sales	1980=100	Oct	112.2	110.5	1.5	3.0
	Major retailers' sales	1980=100	Oct	127.1	125.8	1.0	5.2
	- Department store sales	1980=100	Oct	125.5	123.5	1.6	6.0
	- Supermarket sales	1980=100	Oct	128.9	129.0	-0.1	4.3
	Domestic car sales (over 550 cc)	Units NSA	Nov	249,122	244,632		-3.0
	Banknotes in circulation (ave)	¥ bn NSA	Nov	19,368.1	19,062.6		4.7
WAGES/EMPLOYMENT	Earnings: all industries: Nominal	1980=100	Oct	124.3	124.1	0.2	3.6
	- Real	1980=100	Sep	108.8	109.9	-1.0	2.0
	Labour productivity in mfg	1980=100 NSA	Aug	124.1	124.1R		3.9
	Unit labour cost	1980=100	Sep	108.9	107.2	1.6	1.2
	Employment: regular workers	1980=100	Oct	104.9	104.9	0.0	0.1
	Regular hours worked: all ind	1980=100	Oct	99.8	99.6R	0.2	-1.1
	Overtime hours worked: all ind	1980=100	Oct	105.9	106.2	-0.3	0.5
	Unemployed	Mn NSA	Oct	1.59	1.58		0.0
	Unemployed	Mn	Oct	1.65	1.63	1.2	
	Unemployment Rate	%	Oct	2.76	2.72		
	Job openings/job seekers	Ratio	Oct	0.67	0.68		
PRICES	Wholesale prices: Total	1980=100 NSA	Nov	96.9	97.7	-0.8	-3.8
	- Domestic	1980=100 NSA	Nov	99.4	99.7	-0.3	-1.8
	- Imports	1980=100 NSA	Nov	87.0	89.5	-2.6	-11.1
	Consumer Prices: National	1980=100	Oct	115.3	114.1	1.1	2.3
	- Tokyo	1980=100	Nov	116.6	116.8R	-0.2	2.2

	Unit	Latest Month Shown	Latest Month	Previous Month	Latest Month % Change Over		
					Previous Month	Year Ago (NSA)	
MONETARY	Money supply (M2 ± CDs, average)	¥ bn NSA	Oct	299,040	300,345		8.6
	Deposits: all banks	¥ bn NSA	Oct	217,602	226,831		9.9
	Loans and discounts: all banks	¥ bn NSA	Oct	226,501	226,642		12.8
	Ave interest rate: all banks loans	% NSA	Oct	6.480	6.487		
	TSE index (1st Sn): Average price	1968=100 NSA	Nov	1,006.23	1,028.35		17.6
	- Sales vol (daily ave)	Mn shs NSA	Nov	289	388		
FOREIGN TRADE	IMF basis: Exports	\$ mn NSA	Oct	15,992	14,612		8.1
	Imports	\$ mn NSA	Oct	10,591	9,343		2.3
	Trade balance	\$ mn NSA	Oct	5,401	5,269		
	<u>Customs clearance basis</u>			Provisional	Revised		
	Exports: Total	\$ mn	Nov	16,423	15,909R	3.2	
	Total	\$ mn NSA	Nov	15,454	16,035R		10.6
	- To USA	\$ mn NSA	Nov	6,048	6,039R		15.4
	- W Europe	\$ mn NSA	Nov	2,342	2,432R		26.5
	- EC	\$ mn NSA	Nov	1,822	1,945R		23.4
	- UK	\$ mn NSA	Nov	365	451R		19.5
	- Middle East	\$ mn NSA	Nov	947	1,034		-0.4
	- S E Asia	\$ mn NSA	Nov	2,772	2,945R		-7.5
	Imports: Total	\$ mn	Nov	10,564	11,818R	-10.6	
	Total	\$ mn NSA	Nov	10,673	11,675R		-1.9
	- From USA	\$ mn NSA	Nov	2,016	2,354R		-0.6
	- W Europe	\$ mn NSA	Nov	1,122	1,149R		1.5
	- EC	\$ mn NSA	Nov	790	813		-2.8
	- UK	\$ mn NSA	Nov	192	184R		3.0
	- Middle East	\$ mn NSA	Nov	2,184	2,658		-13.7
	- S E Asia	\$ mn NSA	Nov	2,604	2,739		-1.0
	Crude oil imports: Value	\$ mn NSA	Nov	2,687	2,991		-11.9
	- Volume	1,000kl NSA	Nov	15,422	16,095R		-7.3
	- Ave cif price	\$ pb NSA	Nov	27.70	27.37R		-5.0
	Exports: Volume	1980=100 NSA	Nov	100.0	149.3		2.3
	- Unit value \$	1980=100 NSA	Oct	99.3	94.7		5.0
	¥	1980=100 NSA	Nov	94.4	97.4R		-7.3
	Imports: Volume	1980=100 NSA	Nov	107.8	117.6R		0.3
	- Unit value \$	1980=100 NSA	Oct	84.7	84.0		-3.6
	¥	1980=100 NSA	Nov	77.7	82.4		-16.2
	Terms of trade (¥)	1980=100 NSA	Nov	121.5	118.2R		10.6
Export contracts) of major	¥ bn NSA	Oct	819.1	3,046.6		-11.2	
Import contracts) trading cos	¥ bn NSA	Oct	1,601.2	2,659.3		11.1	
Export letters of credit	\$ mn	Nov	9,515	8,660	7.4	4.2	
CAPITAL FLOWS BAL OF PAYTS	Japanese external loans (inc-)	\$ mn NSA	Oct	-646	-1,113		
	Net Japanese purchases (-)/ Sales (+) of foreign securities	\$ mn NSA	Oct	-6,997	-3,105		
	Net foreign purchases (+)/ sales (-) of - Japanese bonds	\$ mn NSA	Oct	1,211	874		
	- Stocks	\$ mn NSA	Oct	-375	-140		
	Japanese external bond issues	\$ mn NSA	Oct	940	1,725		
	Official reserves (end-month)	\$ mn NSA	Nov	26,303	26,372		

	1983	1984	1984	1985		
	YEAR	YEAR	FISCAL	APR-JUN	JUL-SEP	OCTOBER
Exports (SA)	145,946	168,541	168,740	42,527	43,373	15,628
Imports (SA)	114,507	123,757	122,398	29,469	29,659	10,461
Trade Balance (SA)	31,439	44,784	46,342	13,058	13,714	5,167
Services	-9,106	-7,747	-7,064	-611	-1,387	-451
Transfers	-1,549	-1,507	-1,522	-320	-341	-177
Invisibles Balance	-10,655	-9,254	-8,586	-931	-1,728	-628
Current Account*	20,784	35,530	37,756	12,127	11,986	4,539
Long-Term Capital (Assets) (Liabilities: inc #)	17,700	-49,651	-54,197	-17,166	-18,501	-7,226
Basic Balance*	3,496	-14,121	-16,441	-5,039	-6,515	-2,687
Short-Term Capital	23	-4,295	-2,587	155	946	-1,077
Errors and Omissions	2,055	3,743	5,490	1,829	-531	924
Overall Balance*		14,673	-13,538	-3,055	-6,100	-2,840
Overall Balance (NSA)	5,177	-15,200	-14,544	-1,920	-4,751	-2,606
Change in Reserves	1,234	1,817	1,429	1,031	-46	-1,151
Change in banks' short-term (external liabilities (inc-/deci)			-15,386	-3,039	-2,687	-588
Other Monetary Movements	3,943	-17,017	-587	88	-2,018	-867
<u>Customs Clearance Basis</u>						
<u>Not Seasonally adjusted</u>						
(% change on same period of previous year)						
Exports - \$ Value	5.8	15.8	11.1	0.6	2.7	7.5
Volume	8.7	16.0	13.6	7.0	4.6	2.5
Price - \$	-2.7	-0.1	-2.4	-6.0	-1.8	5.0
¥	-6.7	-0.4	0.7	3.8	-2.0	-5.6
Imports - \$ Value	-4.2	8.0	4.0	-7.0	-8.0	3.1
Volume	1.2	10.8	7.4	-0.5	-2.3	6.9
Price - \$	-5.4	-2.5	-3.1	-6.5	-5.9	-3.6
¥	-9.2	-2.7	-0.4	3.3	-6.2	-13.4
Seasonally adjusted (% change on previous similar period)						
Exports - \$ Value				4.9	2.6	10.3
Volume				7.2	-1.0	4.2
Imports - \$ Value				1.9	0.0	10.6
Volume				2.4	-0.7	8.5

* Using seasonally-adjusted trade figures.



Denis-Beaumont et Associés
conseil en stratégie de communication

CD 4x

Paris, September 26, 1985

Dear Sir,

As public relations adviser in France and the EEC for the Electronic Industries Association of Japan I am enclosing documentation published in Japan.

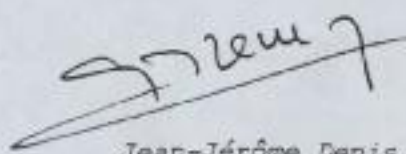
I hope this will provide you with a useful source of reference. This is designed to clarify the facts about the Japanese Electronics Industry and to create a better understanding between the EEC and its member countries and Japan.

For example direct investment in Europe by Japanese manufacturers of electronic equipment has quadrupled since 1980 and now stands at almost dollar 300 million. Such contribution to the European economy should be underlined.

If you require further information please contact Mr Tamotsu Harada of the EIAJ's Overseas Public Affairs Office in Tokyo (Telephone 3 211 2765-9).

I would be delighted to receive your suggestions and comments which would assist in the production of future editions of this documentation.

Yours sincerely



Jean-Jérôme Denis

BY BAG

FROM TOKYO TO FCO

(CULL)
TELNO 6 SAVING

UNCLASSIFIED

Addressed to FCO Telegram No 6 Saving of 20 June 1985

Repeated for information saving to:

Paris, Rome, Bonn, Washington, Brussels, Dublin, Stockholm, UKREP Brussels, UKMIS Geneva, UKDEL OECD, Ottawa, Bangkok, Canberra, Peking, Seoul, Jakarta, Singapore, Manila, Kuala Lumpur, Governor Hong Kong, BTC Hong Kong, Osaka.

JAPAN: MONTHLY ECONOMIC REPORT - JUNE 1985

- The Japanese economy recorded real growth of 0.4% at an annual rate in the first quarter of 1985, the slowest quarterly growth since early 1975, and one which reflects essentially slower export growth to the United States.
- Despite the poor figure for the first quarter, the economy grew in real terms in 1984/85 at 5.7% in real terms, compared with 3.9% for the previous fiscal year. This is the fastest rate of growth recorded in Japan since 1972 and exceeds by a substantial margin even the official revised forecast of 5.3%.
- Growth through the year as a whole has been export led, despite the slower rate of increase in the first quarter of 1985. Exports rose by 16.2% in the year, the fastest rise since 1980. Imports also grew more quickly than at any time since the mid-seventies, but growth was concentrated in the first half of the fiscal year and has since tapered off.
- The rapid growth in private capital investment stimulated by exports has been the major feature of the domestic economy during the year and the overall total for the year (an increase of 11%) is higher than at any time since the first oil crisis. Despite a sharp decline in investment spending in the first quarter, recent investment surveys suggest that it will continue to support domestic demand for at least the next two quarters.

- The disappointing feature of the year remains the very sluggish growth in consumer spending. Although growth accelerated in the first quarter of 1985, consumer spending in the fiscal year as a whole was little more than 2½% up on the year and private housing spending remained sluggish.
- Industrial production figures for April and investment indicators suggest that the economy is now growing more rapidly than in the first quarter. The pace is once again being set by an acceleration in export growth, above all to the United States. As a result, Japan recorded its fourth largest ever current account surplus in April of a little short of \$4 billion.
- The decline in the invisible deficit accelerated in April and Japan recorded its first every post war invisible surplus.
- Unemployment fell sharply in April to 2.4%, the lowest level for two years. Consumer price increases remain negligible.

KEY INDICATORS

Table 1

		1984 OCT-DEC	1985 JAN-MAR	PREVIOUS MONTH	LATEST MONTH	LATEST MONTH SHOWN
GMP* - Nominal - Real	) % change on } Previous period	2.4R	0.8			
		2.4R	0.1			
Industrial Production*	"	2.7R	-0.7	-1.4R	3.0	April
Unemployment	% of labour force average for period	2.69	2.5	2.6	2.4	April
Wages	% change on year ago	4.3	3.5	2.4	3.7	April
Wholesale Prices	% change on year ago	0.4	0.8	0.6	-0.1	May
Consumer prices (Tokyo)	% change on year ago	2.4	2.2	2.0	1.7	May
Money Supply (M2 + CDs)	% change on year ago	7.9	7.9	7.9	8.4	April
Short-term interest rate	% pa (3-month Gensaki)	6.294	6.270	6.250	6.285	May
Long-term interest rate	% pa (10-year Government Bond)	6.27	6.50	6.39	6.18	May
Current Account*	\$ Million	11,711	9,413	2,496	3,805	April
Overall Balance	\$ Million (SA)	-3,370R	205	-1,148	-1,444	April
	\$ Million (NSA)	-3,545	-2,414	-189	-1,122	April
Change in Reserves	\$ Million	869	225	303	487	May
Exchange Rate*	¥/\$ (end-period)	250.25	252.50	252.25	251.85	May
	¥/\$ (end-period)	290.84	315.25	311.53	326.71	May

SAVING TELEGRAM

BY BAG

[CULL]

FROM TOKYO TO FCO

TELNO 4 SAVING

UNCLASSIFIED

Addressed to FCO Telegram No 4 Saving of 25 April 1985.

Repeated for information Saving to:

Paris, Rome, Bonn, Washington, Brussels, Dublin, Stockholm, UKREP Brussels, UKMIS Geneva, UKDEL OECD, Ottawa, Bangkok, Canberra, Peking, Seoul, Jakarta, Singapore, Manila, Kuala Lumpur, Governor Hong Kong, BTC Hong Kong, Osaka.

JAPAN: MONTHLY ECONOMIC REPORT - APRIL 1985

- The Japanese Government announced on 9 April an economic package designed to deflect growing criticism of Japan's external surplus. In contrast with the previous occasions, no tariff cuts or regulatory changes were proposed. The report offers instead a set of guidelines for future action, implicitly acknowledging that there is little prospect of any early shift in the current pattern of Japan's growing trade surpluses.
- Following the announcement of the package, and partly in response to its unenthusiastic reception by Japan's trading partners, the Government has begun to examine urgently ways in which the domestic economy might be stimulated in an attempt to increase imports and reduce the growth of exports. A direct stimulus to domestic demand through tax cuts or increased public spending nevertheless seems unlikely. Priority will probably be given to further deregulation of the internal market and a programme of tax reform designed to lighten the burden of direct taxation.

/Preliminary

- Preliminary figures for Japan's external surplus in 1984/85 emphasized the scale of the problem. On a customs clearance basis, the trade surplus rose from \$23 billion to \$35 billion, with exports increasing by 11% and imports by no more than 4%. On these figures, Japan's annual trade surplus with the United States alone rose to \$34 billion. The trade surplus on a full balance of payments basis will be substantially greater.
- The Yen remains weak against the US Dollar, although it has recovered some of the lost ground in recent weeks. Interest rate differentials with the Dollar are now considered to be a less critical factor but substantial net outward flows of capital continue. And the total for the year will probably approach \$50 billion.
- Domestic demand continues to be led by private investment and there are few signs that consumer expenditure is recovering from its long slump. The Spring wage round which has just finished, however, seems likely to result in average settlements of rather more than 5% compared with 4½% in 1984.

KEY INDICATORS

Table 1

	UNIT	1984 JULY-SEP	1984 OCT-DEC	PREVIOUS MONTH	LATEST MONTH	LATEST MONTH SHOWN
GNP* - Nominal	) % change on	0.9	2.0			
- Real	) Previous period	0.6	2.3			
Industrial Production*	"	1.5	2.8	-0.2	0.8	February
Unemployment	% of labour force average for period	2.78	2.69	2.4	2.6	February
Wages	% change on year ago	4.0	4.3	4.6	3.3	February
Wholesale Prices	% change on year ago	0.2	0.4	0.8	0.9	March
Consumer Prices (Tokyo)	% change on year ago	2.6	2.4	1.5R	1.8	March
Money Supply (M2 + CDs)	% change on year ago	7.8	7.9	7.9	7.9	February
Short-term interest rate	% pa (3-month gensaki)	6.320	6.294	6.315	6.270	March
Long-term interest rate	% pa (10-year Government Bond)	6.80	6.27	6.75	6.50	March
Current Account*	\$ Million	6,266	11,711R	4,244	2,673	February
Overall Balance	\$ Million (SA)	-4,736	-3,953R	1,076	277	February
	\$ Million (NSA)	-3,323	-3,545	-2,368	143	February
Change in Reserves	\$ Million	236	869	226	-295	February
Exchange Rate	¥/\$ (end-period)	245.50	250.25	259.50	252.50	March
	¥/\$ (end-period)	303.38	290.84	278.18	315.25	March

* Seasonally adjusted

GR 750

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INFO ROUTINE WASHINGTON, BONN, PARIS, ROME, OTTAWA, UKREP BRUSSELS

M.I.P.T.

MR NAKASONE'S DOMESTIC POLITICAL POSITION

SUMMARY

1. THE BASIS OF THE JAPANESE PRIME MINISTER'S SUPPORT HAS BEEN DISTURBED BY TANAKA'S ILLNESS AND DIVISIONS WITHIN THE TANAKA FACTION. MR NAKASONE'S POSITION IS NOT IMMEDIATELY THREATENED, THOUGH THERE ARE CURRENTLY DIFFERENCES WITHIN THE CABINET ON THE FUTURE DIRECTION OF HIS ECONOMIC POLICY. HIS POPULARITY WITH THE ELECTORATE REMAINS HIGH. IF THE PUBLIC CONTINUES TO ENDORSE HIS LEADERSHIP AFTER THE BONN SUMMIT HE COULD BE ENCOURAGED TO SEEK AN AUTUMN ELECTION THOUGH MANY IN HIS PARTY WOULD PREFER IT TO BE DELAYED.

DETAIL

2. TANAKA'S RECENT STROKE WILL NECESSITATE A LONG PERIOD OF RECUPERATION. IT IS NOW EXPECTED THAT HE WILL BE LEFT WITH A SPEECH DEFECT. HE IS THEREFORE NOT LIKELY EVER TO REGAIN THE PIVOTAL POSITION HE HAS ENJOYED WITHIN THE LIBERAL DEMOCRATIC PARTY SINCE 1972. A TUG-OF-WAR WITHIN HIS FACTION IS BEING FOUGHT BETWEEN THE DEP'S VICE PRESIDENT, SUSUMU NIKAI DO, AND THE YOUNGER FINANCE MINISTER, NOBORU TAKESHITA, TO ESTABLISH WHICH MAN WILL BE ABLE TO SUCCEED TO THE BROAD SUPPORT OF THE FACTION. ODDS ARE ON TAKESHITA. HE, FOREIGN MINISTER ABE AND KIICHI MIYAZAWA ARE STILL REGARDED AS THE MOST LIKELY CANDIDATES TO SUCCEED NAKASONE IN LATE 1986. NIKAI DO'S HOPE WILL REST WITH THE POSSIBILITY THAT NAKASONE MAY MAKE A MISTAKE OF SUFFICIENT SERIOUSNESS TO CAUSE THE PARTY TO REPLACE HIM BEFORE HIS TERM OF OFFICE EXPIRES NEXT YEAR. NIKAI DO MIGHT THEN BE INSTALLED AS AN INTERIM PRIME MINISTER.

3. NAKASONE HIMSELF CONTINUES TO PICK HIS WAY THROUGH THE MINEFIELD OF POLITICAL RIVALRIES IN THE LDP WITHOUT LOSING HIS HOLD ON POWER. NOT POPULAR WITH HIS PARTY, WHO DISLIKE HIS STYLE OF LEADERSHIP, HE NEVERTHELESS COMMANDS A HIGH GENERAL RATING IN THE COUNTRY. JAPAN'S TRADING RELATIONS AND BALANCE OF PAYMENT SURPLUSES HAVE SERIOUS IMPLICATIONS FOR THE US-JAPAN BILATERAL RELATIONSHIP AND HAVE PRODUCED A SHARP DIVISION OF OPINION WITHIN THE PARTY AND CABINET OVER THE FORMATION OF ECONOMIC POLICY. (THE DIVISION IS NOT ENTIRELY ON FACTIONAL LINES). NIKAI DO, MIYAZAWA AND KOMOTO FAVOUR EXPANSION OF INTERNAL DEMAND, WHICH NOW ALSO SEEMS TO ATTRACT ABE, BUT THE PRIME MINISTER, SUPPORTED BY TAKESHITA, PREFERENCES TO MAINTAIN STRICT CONTROLS ON THE

CONFIDENTIAL

/Budget

CONFIDENTIAL

BUDGET AND TO CONCENTRATE ON MARKET LIBERALISATION. IN APPROACHING THE BONN SUMMIT NAKASONE WILL SEEK TO REDUCE THESE DIFFERENCES. HOWEVER, THE ISSUE WOULD NOT SEEM TO BE CRITICAL FOR HIM AT PRESENT IN TERMS OF HIS DOMESTIC POLITICAL POSITION UNLESS INTERNATIONAL CRITICISM OF HIS ECONOMIC POLICIES IS SUCH AS TO ENABLE HIS OPPONENTS TO CLAIM THAT HE HAS FAILED TO PROTECT THE NATIONAL INTEREST. HE EXPENDED A GOOD DEAL OF POLITICAL CAPITAL IN PREPARING AND PRESENTING THE 9 APRIL PACKAGE OF MEASURES. STRONG DOUBTS WERE CAST ON THE LIKELY EFFECTIVENESS OF THE ACTION PROGRAMME TO IMPLEMENT THESE. IF JAPAN'S SUMMIT PARTNERS ARE STRONGLY CRITICAL, NAKASONE'S RIVALS WILL NOT HESITATE TO MOVE AGAINST HIM. ALTHOUGH HIS INTERNATIONAL STATURE IS HIGH IT BEARS ONLY LIMITED RELATIONSHIP TO HIS POLITICAL STANDING IN JAPAN, WHERE INTERNATIONALISM IS STILL NOT HIGHLY REGARDED AMONG POLITICIANS AND WHERE ATTITUDES CHANGE SLOWLY. NONE OF HIS POTENTIAL RIVALS WOULD SEEM TO HAVE THE SAME ZEAL FOR THIS AREA OF POLICY. OUR INTERESTS ARE THEREFORE LIKELY TO BE BEST SERVED IF HIS TERM OF OFFICE IS NOT CUT SHORT.

4. IF, AFTER BONN, THE PRIME MINISTER'S POPULARITY REMAINS HIGH AND HIS APPROACH TO THE HANDLING OF THE PROBLEM OF JAPAN'S TRADE SURPLUS, ESPECIALLY, IS ENDORSED BY THE PUBLIC, AS WELL AS BEING ACCEPTED BY JAPAN'S TRADING PARTNERS, HE COULD BE TEMPTED TO SEEK AN AUTUMN ELECTION. A SUCCESSFUL OUTCOME COULD STRENGTHEN HIS POSITION IN THE PARTY AND ENHANCE HIS ABILITY TO GUIDE POLICIES THROUGHOUT 1986. MANY IN THE PARTY WOULD PREFER TO AVOID AN ELECTION THIS YEAR BUT THIS WOULD NOT NECESSARILY PREVENT THE PRIME MINISTER FROM CALLING ONE IF THE RIGHT POLITICAL OPPORTUNITY PRESENTED ITSELF. IN TANAKA'S ABSENCE, HIS SUPPORT IS NO LONGER SO FIRMLY ASSURED, AND HE WOULD UNDOUBTEDLY WELCOME A CHANCE TO BUTTRESS HIS POLITICAL POSITION MORE FIRMLY. IT SEEMS TO ME AT PRESENT UNLIKELY THAT AN AUTUMN ELECTION WOULD PROVE ADVANTAGEOUS TO HIM.

GIFFARD

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PRIME MINISTER'S
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OO TOKYO

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PM PCO 011300Z NOV 84

TO IMMEDIATE TOKYO

TELEGRAM NUMBER 574 OF 1 NOVEMBER

YOUR TELNO 827: RE-ELECTION OF MR NAKASONE

1. THE PRIME MINISTER HAS APPROVED A MESSAGE TO MR NAKASONE,
WHICH YOU SHOULD PASS ON AT THE EARLIEST APPROPRIATE MOMENT IN
THE LIGHT OF THE CONSIDERATIONS IN YOUR TUR.

2. MESSAGE READS AS FOLLOWS:

BEGINS: PLEASE ACCEPT MY SINCERE CONGRATULATIONS ON YOUR
RE-ELECTION AS PRESIDENT OF THE LIBERAL DEMOCRATIC PARTY OF JAPAN.
I WAS DELIGHTED. I VALUE VERY HIGHLY THE CLOSE RELATIONS BETWEEN
OUR TWO COUNTRIES AND THE MANY TALKS WE HAVE HAD. I LOOK FORWARD
TO FURTHER COOPERATION WITH THE JAPANESE GOVERNMENT UNDER YOUR
CONTINUING LEADERSHIP. ENDS.

HOWE

NNNN

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10 DOWNING STREET

From the Private Secretary

1 November 1984

Japan: Re-election of Mr. Nakasone

Thank you for your letter of 30 October enclosing a draft message of congratulations to Mr. Nakasone on his re-election. The Prime Minister has agreed to the message with some minor changes which I gave you on the telephone.

(C.D. POWELL)

C.R. Budd, Esq.,
Foreign and Commonwealth Office.

g



Foreign and Commonwealth Office

London SW1A 2AH

*Not quite sure
enough. Have
consulted
me*

30 October 1984

Dear Charles,

*Prime Minister
Agree proposed
message of
congratulations.
CDP*

Japan: Re-election of Mr Nakasone

You may have seen from the newspapers that Mr Nakasone's re-election as President of the Liberal Democratic Party, and thus as Prime Minister of Japan is now certain. The likelihood is that Mr Nakasone's official reappointment will be confirmed on 31 October at a meeting of Liberal Democratic Party members of the Diet. HM Ambassador at Tokyo has reported that, although only an intra-party affair, the Japanese view Mr Nakasone's re-election as significant, particularly as he is the first Japanese Prime Minister to achieve re-election since 1972. The Ambassador's recommendation (which we endorse) is that the Prime Minister should send a message of congratulations.

I enclose a draft telegram to our Embassy in Tokyo with a message that could be handed over at the appropriate time. In the Embassy's view that would be as soon as possible after the meeting on 31 October. Perhaps you could telephone me if the terms of the telegram are approved?

Yours ever,

Colin Budd

(C R Budd)
Private Secretary

C D Powell Esq
10 Downing Street

OUT TELEGRAM

		Classification and Caveats UNCLASSIFIED	Precedence/Deskby IMMEDIATE
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ZCZC	1	ZCZC
GRS	2	GRS
CLASS	3	UNCLASSIFIED
CAVEATS	4	
DESKBY	5	
FM FCO	6	FM FCO
PRE/ADD	7	TO IMMEDIATE TOKYO
TEL NO	8	TELEGRAM NUMBER
	9	YOUR TELNO 827: RE-ELECTION OF MR NAKASONE
	10	1. The Prime Minister has approved a message to Mr Nakasone,
	11	which you should pass on at the earliest appropriate moment in
	12	the light of the considerations in your TUR.
	13	2. Message reads as follows:
	14	BEGINS: Please accept my sincere congratulations on your
	15	re-election as President of the Liberal Democratic Party of Japan.
	16	<i>I am delighted.</i> I value very highly the close relations between our two countries
	17	and look forward to further cooperation with the Japanese
	18	Government under your continuing leadership. ENDS.
	19	
	20	HOWE
	21	NNNN
///	22	
//	23	
/	24	
	25	

↓
*and the way
let's we have
back together.!*

NNNN ends telegram		BLANK		Catchword	
File number		Dept P/Office		Distribution LIMITED FED NEWS DEPT PS PS/MR LUCE PS/PUS Sir W Harding Mr Boyd	
Drafted by (Block capitals) C R Budd					
Telephone number					
Authorised for despatch					
Comcen reference		Time of despatch			
cc: No 10					

BY BAG

SAVING TELEGRAM

First page only
C.D.?

FROM TOKYO TO FCC

TELNO 8 SAVING

UNCLASSIFIED

(C.D.)

Addressed to FCC Telegram No 8 Saving of 10 September 1984

Repeated for information Saving to: Paris, Rome, Bonn, Washington, Brussels, Dublin, Stockholm, UKREP Brussels, UKMIS Geneva, UNDEL OECD, Ottawa, Bangkok, Canberra, Peking, Seoul, Jakarta, Singapore, Manila, Kuala Lumpur, Governor Hong Kong, BTC Hong Kong, Osaka

JAPAN: MONTHLY ECONOMIC REPORT - AUGUST 1984

- Output continued to grow strongly in July and there was some recovery in housing investment and consumer expenditure. Unemployment fell slightly from June's record level.
- Despite seasonal shortages, monetary conditions remain easy, with the midsummer rise in interest rates now largely reversed. The underlying trend of consumer price increases both nationally and in Tokyo remains negligible.
- The seasonally adjusted trade surplus for the first six months of the year exceeded \$21 billion, compared with \$15 billion in the same period in 1983. Exports were up in value by 16% and imports rose by 9%. The current account surplus in the first six months of the year exceeded \$16 billion, compared with \$9.1 billion in the same period in 1983. Most private sector forecasters now expect a trade surplus for 1984 as a whole approaching \$45 billion and a current account surplus of around \$35 billion.
- Net outflows of long-term capital reached record levels in June and July, exceeding \$13 billion for the two months. Total outflows in the first half of the year, at \$20 billion, were greater than in the whole of 1983. Gross outward investment flows into foreign bonds accounted for the greater part of the increase in the earlier part of the year, but external lending has now begun to rise rapidly.
- Preliminary 1985 budget figures announced at end August showed general expenditure almost unchanged over the current Fiscal Year, but the overall budget total is estimated to rise by 8% reflecting heavy increased debt service costs and transfers to local authorities.

/KEY INDICATORS

KEY INDICATORS

Table 1

	UNIT	1984 Jan/Mar	1984 Apr-June	Previous Month	Latest Month	Latest Month Shown
GNP* - Nominal Real	% change on previous period	2.0	-			
		1.8	-			
Industrial Production*	"	3.2	2.3	0.5	0.2	July
Unemployment*	% of labour force, average for period	2.71	2.69	2.81	2.79	July
Wages	% change on year ago	4.2	5.2	5.5	4.1	July
Wholesale Prices	"	- 1.3	- 0.4	- 0.4	0.0	July
Consumer Prices (Tokyo)	"	2.9	2.6	2.8	2.2	August
Money Supply (M2 + CDs)	"	7.9	7.6	7.6	7.5	June
Short-term interest rate	% p.a. (3-month pensaki)	6.303	6.319	6.319	6.327	July
Long-term interest rate	" (10-year government bond)	6.73	7.22	7.22	7.19	July
Current Account*	\$ million	7,246	9,170	3,131	2,519	July
Overall Balance	" (SA)	- 675	- 5,861	- 3,507	- 3,356	July
	" (NSA)	- 3,070	- 5,262	- 2,254	- 2,665	July
Change in Reserves	"	613	99	- 115	- 85	July
Exchange rate	¥/\$ (end-period)	224.70	237.50	237.50	245.50	July
	¥/£ (end-period)	323.91	322.41	322.41	318.78	July

*Seasonally-adjusted

ECONOMIC OUTLOOK

The official forecast for growth in GNP in 1984/85 remains unchanged at 4.1% but this figure (incorporating a current account surplus of \$23 billion) looks increasingly unrealistic in the face of continued rapid expansion in exports. Earlier economic reports have referred to increasing evidence that capital investment in the private sector has almost remained more buoyant than originally predicted. Figures for June quarter GNP growth, to be released around 20 September, are expected in addition to show some rise in consumer spending, although the underlying rate of growth is still slower than in the two previous recoveries.

Against this background, the EPA have been giving increasingly public indications of their previously private view that the current official forecast needs to be revised upwards if it is to remain credible. Provided that there is no sudden reversal in export growth later in the year, a revised forecast of a current account surplus of \$35 billion and GNP growth of 5% would probably be closer to their current views.

Opposition to an officially published revision, however, is likely to come from two quarters. First, the Ministry of Finance would be reluctant to endorse any new forecast that suggested a

growth in revenue sufficient to finance either a further cut in income taxes or an increase in public spending. The budget guidelines to spending departments this year (a 10% cut in current spending and a 5% in capital spending) were as tightly drawn as in previous years, despite an intense period of lobbying in June which seemed likely at one time to result in some relaxation. Secondly, MITI is believed to fear that official support for a forecast trade surplus of \$35 billion would rekindle trade friction, while confirmation that domestic demand is picking up steadily would undermine arguments that the economy was not in the period of self-sustaining recovery and therefore required additional fiscal stimulus.

Private sector forecasters on the other hand, uninhibited by such considerations, have been busy revising their forecasts upwards. After the latest round of revisions, the highest and lowest estimates for real GNP growth changed from February's 4.9% (JERC) and 3.6% (Hokkaido Takushoku Bank) to 5.5% (Sumitomo Trust Bank) and 4.5% (Tokai Bank) at the end of July. The change in view from Sumitomo Trust Bank is particularly striking in that in their earlier forecast, they were considerably more cautious than most of the other major banking groups. In general, the margin of revision in nominal growth rates was much smaller than in real ones, reflecting increasing optimism over prospects for inflation in the current year. The average margin of revision was 0.75% upwards in real terms, compared with 0.4% upwards in nominal terms.

The major factor underlying most of these upward revisions was the strength of private non-residential fixed investment estimates, based partly on a strong performance in the first quarter of 1984, partly on investment intention surveys published in the spring and early summer which suggested that such investment was continuing to grow strongly. In contrast, many of the forecasts for consumers' expenditure were revised downwards, despite indications (referred to above) that consumers' expenditure has in fact continued to pick up slowly. This apparent contradiction reflects the fact that initial forecasts for the year from many bodies seemed at the time to take too optimistic view of growth in this area at a time when real incomes were growing very slowly.

On the external account, most organisations revised their current account surplus sharply upwards. Only one of the 25 forecasts issued in July expected a trade surplus of less than \$40 billion and more than half the forecasts put the figure at close to \$45 billion. A current account surplus of the order of \$35 billion emerged in ten of the organisations surveyed, reflecting a slightly greater divergency of views on the strength of the invisible account in the year.

The widest point of divergence among the forecasts covering the external account was, however, that for outflows of long-term capital. The recent acceleration of these flows (examined in more detail later in this report) has been very rapid indeed and may well not be sustained throughout the year. Nevertheless, five recent forecasts put net outflows for the year in excess of \$30 billion.

1985 Preliminary Draft Budget

Preliminary budget figures for 1985/86 were submitted to the Ministry of Finance on 31 August, in accordance with the usual timetable. Despite the budgetary guidelines referred to above, which called for a 10% cut in current spending and a 5% cut in capital

spending, general account expenditure will still rise by 0.9% compared with the current year. This is the lowest ever year-on-year increase. Within this total, the only significant increases to have been proposed are in defence spending and in official development assistance. In contrast social security, although still representing the largest item of general expenditure, have increased by only 0.5% over the past four years and public works spending would on these proposals have fallen by 4% over the same period.

The most rapid growth in the budget, however, continues to occur outside general expenditure. Debt service costs are estimated to rise by 35% next year, exceeding ¥12 trillion for the first time and representing the largest single item in the budget. Tax revenue transfers to local governments will also rise substantially, amounting to some ¥9½ trillion. Local governments depend heavily on central government subsidies for their welfare programme and it seems unlikely that, despite central government pressure, this item will be reduced. Finally, growth of the fiscal investment and loan programme has been cut back this year to 4.9% but this important source of funds, which is often referred to as the second budget, will nevertheless provide some ¥22 trillion of investment funds in 1985/86.

As a result of these proposals, budget spending will rise to ¥54.75 trillion in 1985/86, an 8.1% increase over the current year's figure and nearly ¥3 trillion in excess of revenue projections for the year. The Ministry of Finance's initial target in the budget negotiations is believed to be for budget requests totalling no more than ¥52 trillion. It is difficult to see, however, how this target can be achieved against a background of increasing political pressure for additional spending on public works.

/DETAIL

DETAIL

Production, Shipments and Inventories

Output continued to grow strongly in July but despite a rise in shipments, inventories increased. The official forecast is for a further rise in output in August.

1. The seasonally-adjusted index of industrial production (mining and manufacturing, preliminary) rose by 0.2% in July and by 12.7% on an annual comparison, confirming the steady upward trend seen throughout the first half of 1984.
2. Following several months in which sectoral production figures had tended to move rather erratically, many sectors continued to show strong upturns in July. Particularly strong growth was again recorded in chemicals (3%) with iron and steel production continuing its recent recovery (1.0%).
3. Production of consumer durable goods has been noticeably more buoyant than in 1983 and this trend continued in July. The production of capital goods also maintained its recent high level, the year-on-year increase rising to 19.4%, the most rapid rise in two years. The weaker sector remains consumer non-durable goods, where a promising start to the year has not been maintained. Production in the first quarter of 1984 rose by 3.4% but remained almost unchanged in April and May before recovering slightly in June and July.
4. Producers' shipments rose by 0.8% on the month and by 10.7% on the year to July. Inventories of finished goods again recovered slightly from the fall seen at the turn of the year and rose in the year-on-year comparison for only the third time in 15 months.
5. MITI's forecast for manufacturing production (seasonally-adjusted) in August has been revised sharply upwards from 0.3% to 1.4%, mainly reflecting a continued strong surge in the machinery sector. Overall production in September, however, is expected to fall by 0.6% largely because production in the iron and steel and machinery sectors is forecast to decline.

Business Conditions and Investment

Business failures remain high but housing recovers.

6. Business failures in July amounted to 1663 cases, a decrease from May's all time record. Liabilities, however, rose very sharply indeed to ¥461 billion, 142.5% up on the year, reflecting the fourth major bankruptcy of the year when Riccar filed for bankruptcy, declaring debts of over £300 million. This was also the fourth largest bankruptcy since the war and a number of subsidiaries of the main company have been declared insolvent.
7. Housing starts in July were 107,625 units, up by 6.3% on the year and a further improvement over the good June figure. The smaller rise in floor area (2.9% on the year) reflects the continued trend towards cheaper and smaller units. Privately funded starts rose by 14% on the year, but publicly funded starts were 3% lower. Despite this improvement, however, private housing construction

1 DE PAGE 36D

depressed and most forecasts continue to point to no more than gradual revival.

8. Disbursements for public works in July fell by 19.4% compared with the same month a year ago. Spending in the first four months of the financial year is now running 5% below the same period in 1983/1984 despite the government's announcement that public works programmes would again be front loaded. The figures for contract awards are no longer published, partly because the series moved so erratically that it was not a helpful short-term indicator.

9. New orders for construction in the private sector continued to increase although the pace has slowed since the first quarter of the year. Public sector construction orders, however, which had been very slack in the June quarter rose by 29% compared with the same month a year ago.

Consumers' Expenditure

Retail sales rose strongly, partly in response to seasonal factors but the underlying turn also seems to be improving slowly. Household expenditure and real incomes showed a modest rise.

10. All households' living expenditure rose by 0.2% in real terms in the year to June. Real disposable income of working households maintained its recent improvement, although it rose only slightly on a year-on-year comparison. The average consumption propensity fell to 76.5%, well below the very high figures recorded in the spring.

11. The overall level of retail sales in June rose by 2.9% on the month and by 2.3% on the year. Major retailers' sales were supported by unexpectedly high seasonal sales of summer goods and rose by 2.8% on the month and by 6.2% on the year. Department store and supermarket sales also recovered the better levels seen earlier in the year. Car sales were substantially up on the month but down on the year-on-year comparison. The underlying picture is unclear because tax changes both this year and last year had distorted sales figures. The indications are, however, that the car market continues to grow only very slowly.

Wages and Employment

Unemployment fell slightly, but remains at near record levels. The labour market continues to be weak, but there are some signs that the steady growth in industrial output is leading to a gradual improvement.

12. In the year to May, unit labour costs fell by 5.5% confirming the downward trend seen since the autumn of last year. Monthly seasonally adjusted figures also fell by 3.5%.

13. Total nominal earnings of regular workers in all industries in July were up by 4.1% on a year ago. Seasonally-adjusted figures in real terms are not yet available but the unadjusted figures for June show a rise of 3.5% on the year.

14. Monthly hours worked in all industries (seasonally-adjusted) fell by 0.9% in July with manufacturing industry hours weakening seasonally. Overtime hours (seasonally-adjusted) worked in all industries in July also rose and remain substantially above last year's figures.

15. The number of unemployed in July fell slightly (after seasonal adjustment) to 1.57 million and the seasonally-adjusted unemployment rate fell to 2.7%. The ratio of job vacancies to applicants (0.64) remained unchanged from the April level, close to its lowest point for several years.

Prices

The underlying trend of consumer price increases both nationally and in Tokyo remains negligible.

16. The national consumer price index in July rose by 2.6% on the year compared with 1.8% seen at the turn of the year. Wholesale prices which had been falling in recent months were unchanged and import prices actually rose on the month by 1.1%.

17. The Tokyo consumer price index (seasonally-adjusted) for August fell by 0.1% reducing the year-on-year increase to 2.2%, compared with 3.4% in the year to April. Consumer prices generally in 1984 are predicted to rise by about 2.34%.

Monetary Developments

Despite seasonal shortages of funds in the money markets, monetary conditions overall remain easy. The Tokyo Stock Market made a modest recovery from the sharp falls seen in May and June.

18. In June the year-on-year growth of the broad money supply (M2+CDs) fell to 7.5%. The average interest rate on all bank loans edged down once again from 6.66% to 6.65% as older loans at higher rates continued to run off.

19. There was a fall of ¥0.9 trillion in the circulation of banknotes in July. This was accompanied by net flows to the Treasury of ¥1.3 trillion. Reserve requirements were unchanged, so that Bank of Japan credit to the market increased by ¥0.4 trillion, made up of purchases of securities of ¥0.1 trillion and bill purchases of ¥0.3 trillion.

20. Short-term call money market rates, which had edged downwards in July rose slightly in August but longer rates fell more sharply. Nevertheless, recent movements in interest rates in Japan have been much smaller than in some other centres and the authorities have been able to avoid triggering an increase in Long Term Prime Rate.

/Table 2A

Table 2A

	<u>Call Loan (unconditional median)</u>	<u>Bill Discount (over 2 months)</u>	<u>Genseki (3 month average)</u>
End June	6.125	6.250	6.359
End July	6.125	6.3125	6.327
End August	6.1875	6.3125	6.327

21. One consequence of the relatively slow rate of change in interest rates in the Tokyo market is that the government bond underwriting syndicate and the authorities were unable to agree terms for issues of long term bonds in June and July. The syndicate were asking for a rise in the coupon rate of 0.3% at a time when market yields of long-term government bonds had risen by about 0.4%. The authorities were, however, unwilling to see such a rise and it was only in late July that terms were eventually agreed for the August issue of ¥500 billion. The authorities conceded the 0.3% rise in the coupon requested by the syndicate and the issue price was lowered by ¥0.25, giving a yield to maturity of 7.608%.

22. These changes were largely reversed when terms for the September issue of ¥600 billion were announced in late August. The coupon rate was lowered by 0.2% and the price was raised by ¥0.25 giving a yield to maturity of 7.538%. As a result of this swift reversal of the August increase, the issue price for five-year bank debentures (which had not been altered in response to the rise in rates in the summer) will remain unchanged in September, as will long-term prime rate.

Table 2B

	<u>10-Year Government Bond Yields</u>		
	<u>6.1%</u> <u>No 10</u>	<u>7.7%</u> <u>No 22</u>	<u>8.0%</u> <u>No 25</u>
End June	7.47%	7.22%	7.04%
End July	7.47%	7.19%	7.08%
End August	7.04%	6.93%	6.84%

23. The Tokyo Stock Market which had begun to fall sharply in mid-May, following a period of 20 months during which the index had risen by over 60%, steadied in August. The index, after hovering close to 10,000 for much of June could not sustain the brief rally seen towards the end of the month and, with the weakening of the yen in July, fell below 10,000 on 20 July, its lowest level for seven months. Thereafter it slowly recovered to close at 10,620 on 1 September.

/The Balance of Payments

The Balance of Payments

The surplus on trade and current accounts remained at near record levels in June and July. Imports rose by 3% in July but exports also rose by 1%. Net long-term capital outflows broke all previous records in both months, exceeding \$7 billion in July alone, compared with less than \$6 billion for the entire first quarter of 1984. The yen, which fell below ¥246 in late July, began to recover in August and finished the month at around ¥241 to the US dollar.

24. In July, the seasonally-adjusted current account surplus fell to \$2519 million. Exports rose by 1% on the month but imports rose faster (by 3%) lowering the trade surplus by over \$150 million to some \$3.4 billion. The invisible deficit, however, rose from \$461 million to \$914 million.

25. The net outflow of long-term capital which in May had fallen back from April's record levels reached new heights in June and July, totalling over \$13.3 billion in the two months, compared with \$18 billion in the whole of 1983. Although net dis-investment by foreign holders of securities has contributed to these large outflows, the most striking feature of recent months has been the very rapid acceleration in outward investment by Japanese residents, as seen in Table 3A.

Table 3A

	FY 1983	APRIL	MAY	\$ bns	
				1984	
				JUNE	JULY
<u>OUTFLOWS</u>					
Direct Investment	4.2	0.5	0.4	0.9	0.5
Trade Credit	3.2	0.4	0.5	0.3	0.5
Loans	8.7	0.6	0.7	1.4	2.5
Stocks	0.8	-	-	-	-0.1
Bonds	16.0	2.3	2.1	2.1	2.5
Other	1.2	0.4	-	1.1	0.1
TOTAL	<u>34.1</u>	<u>4.2</u>	<u>3.7</u>	<u>5.8</u>	<u>6.0</u>
<u>INFLOWS</u>					
External Bonds	5.5	0.4	1.0	0.7	1.2
Stocks	4.8	-1.1	-1.7	-1.0	-1.0
Bonds	2.2	0.5	0.5	-0.1	-1.0
Other	0.3	-	0.2	-	0.4
TOTAL	<u>13.2</u>	<u>-0.2</u>	<u>-</u>	<u>-0.4</u>	<u>-1.2</u>

26. The rapid growth in external lending (from \$6 billion in April to \$2.5 billion in July) is a striking feature of recent months, but it is also noticeable that increased investment in foreign bonds by Japanese residents (now running at an annual rate of \$27 billion, almost double that of 1983/84) has not been accompanied by greater interest in foreign equities, of which Japanese holders were actually net sellers in July. Despite the impact of these outflows on the exchange rate, official restraining action seems unlikely. In a speech to the Japan Life Insurance Association on 4 September, Finance Minister Takeshita indicated that the authorities intend, if anything, to relax the present guidance which limits their investments in overseas stocks and bonds to 10% of their assets.

27. The yen, which fell briefly below ¥247 in Tokyo on 24 July recovered to trade at around ¥244 in early August before strengthening further to around ¥241 by the end of the month.

GIFFARD

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\$ Millions ○	1982	1983	1984	1984	1984	
	Year-	Year	Jan-Mar	Apr-June	June	July
Exports (SA)	137,663	145,946	40,223	42,661	14,158	14,331
Imports (SA)	119,584	114,507	30,234	31,569	10,566	10,898
Trade Balance (SA)	18,079	31,439	9,989	11,092	3,592	3,433
Services	- 9,848	- 9,106	- 2,248	- 1,591	- 353	- 848
Transfers	- 1,381	- 1,549	- 539	- 331	- 108	- 66
Invisibles Balance	-11,229	-10,655	- 2,787	- 1,922	- 461	- 914
Current Account*	7,544	20,784	7,202	9,170	3,131	2,519
Long-term Capital (Assets) (Liabilities: inc +)	-14,969 (-27,418) (12,449)	-17,400	- 5,809	-14,376 (-13,759) (- 617)	- 6,229 (- 5,841) (- 388)	- 7,146 (- 6,034) (- 1,112)
Basic Balance*	- 8,119	3,496	1,393	- 5,206	- 3,098	- 4,627
Short-term Capital	- 1,579	23	- 2,073	- 82	- 14	880
Errors & Omissions	4,727	2,055	6	- 573	- 395	391
Overall Balance*			- 674	- 5,861	- 3,507	- 3,356
Overall Balance (NSA)	- 4,971	5,177	- 3,070	- 5,262	- 2,254	- 2,665
Change in Reserves	- 5,141	1,234	613	99	- 115	85
Change in banks' short term external liabilities (inc -/dec +)	559		- 3,460	- 5,494	- 3,610	1,252
Other Monetary Movements	- 389	3,943	- 223	133	1,471	- 1,328
<u>Customs Clearance Basis</u> Not seasonally-adjusted (% change on same period of previous year)						
Exports - \$ Value	- 8.7	5.8	17.3	20.4	20.1	17.3
Volume	- 2.3	8.7	16.2	16.3	16.9	14.9
Price - \$	- 6.5	- 2.7	0.8	3.4	2.6	2.1
¥	5.2	- 6.7	- 0.3	- 0.4	- 0.4	1.6
Imports - \$ Value	- 7.9	- 4.2	9.3	13.5	3.8	18.8
Volume	- 0.5	1.2	15.4	13.8	2.8	21.0
Price - \$	- 7.4	- 5.4	- 5.3	0.0	1.0	- 1.7
¥	4.4	- 9.2	- 6.6	- 3.9	- 2.0	- 2.3
<u>Seasonally-adjusted (% change on previous similar period)</u>						
Exports - \$ Value			5.3	4.3	0.7	- 3.1
Volume			6.4	3.7	2.0	- 3.0
Imports - \$ Value			0.2	1.8	- 6.5	0.9
Volume			1.0	1.3	- 9.3	4.3

*Using seasonally-adjusted trade figures.

STATISTICS
(Seasonally-adjusted except where specified NSA)

	Unit	Latest month shown	Latest month	Previous month	Latest month % change-over		
					Previous month	Year ago (NSA)	
Production	Manufacturing production capacity	1980=100 NSA	June	111.8	111.2		2.6
	Manufacturing operating ratio	"	"	102.2	103.3	- 1.1	10.1
	Mining and manufacturing prod'n	"	July	117.1	116.9	0.2	12.7
	Producers' shipments	"	"	112.9	112.0	0.8	10.7
	Inventories of finished goods	"	"	100.6	100.0	0.6	3.8
	Inventories to shipments ratio	"	"	96.3	97.2	- 0.9	- 5.1
Business/Investment	Business failures (over ¥10 mn)	No NSA	July	1,663	1619		14.3
	- Liabilities	¥ bn	"	461.0	317.8		142.2
	Housing starts: Total	Units	"	107,625	106,009		6.3
	- Floor area	1000sq ²	"	9,293	9,363		2.9
	- Public-funded	Units	"	44,441	41,292		- 3.0
	- Private-funded	Units	"	63,184	64,717		14.0
	Public Works: Disbursements	¥ bn	"	311.8	356.8		-19.4
	- Contract awards	"	"				
	Construction orders: Total	"	"	853.4	736.7	15.8	19.2
	- Private	"	"	480.5	455.5	5.5	7.1
	- Public	"	"	295.2	252.3	17.0	28.9
Machinery orders: Total domestic	"	June	857.9	913.8	- 8.3	- 2.3	
- Private, excl. ships	"	"	568.6	568.8	0.0	-14.6	
Consumers' expenditure	All hseholds real living exp(ave)	1980=100 NSA	June	224,101	224,495		0.2
	Workers' households: Real income	"	"	109.1	108.2	0.8	2.0
	- Real disposable income	"	"	106.1	104.9	1.1	2.0
	- Real living expenditure	"	"	103.8	105.8	-1.8	0.1
	- Ave. consumption propensity	%	"	76.5	78.8	-2.9	-1.1
	Retail sales	1980=100	"	111.7	108.5	2.9	2.3
	Major retailers' sales	"	July	123.6	120.2	2.8	6.2
	- Department store sales	"	"	119.4	115.9	3.0	5.7
	- Supermarket sales	"	"	128.8	125.0	3.0	6.9
	Domestic car sales (over 550 cc)	Units NSA	"	289,895	231,853		-18.9
Banknotes in circulation (ave)	¥ bn	"	18,890.2	17,961.3		4.7	
Wages/employment	Earnings: all industries: Nominal	1980=100	July	119.0	119.9	- 0.8	4.1
	- Real	"	May	105.0	107.9	- 2.7	2.2
	Labour productivity in mfg.	1980=100 NSA	"	118.1	114.3		11.4
	Unit labour cost	"	"	106.0	109.9	- 3.5	- 5.5
	Employment: regular workers	1980=100	July	103.4	103.5	- 0.1	0.1
	Regular hours worked: all ind.	"	"	99.4	100.3	- 0.9	0.8
	Overtime hours worked: all ind.	"	"	105.8	105.2	0.6	6.0
	Unemployed	Mn NSA	"	1.57	1.63		9.0
	Unemployed	"	"	1.65	1.66	- 0.6	
	Unemployment rate	%	"	2.79	2.81		
Job openings/job seekers	Ratio	"	0.64	0.64			
Prices	Wholesale prices: Total	1980=100 NSA	July	101.0	100.4	0.6	0.0
	- Domestic	"	"	101.4	101.2	0.2	0.1
	- Imports	"	"	98.0	96.9	1.1	- 2.1
	Consumer prices: National	"	"	112.2	111.5	0.6	2.6
	- Tokyo	"	August	112.9	113.0	- 0.1	2.2

		Unit		Latest month shown	Latest month	Previous month	Latest month % change over	
							Previous month	Year ago (NSA)
Monetary	Money supply(M2 + CDs, average)	Y bn	NSA	June	271,756	268,126		7.5
	Deposits: all banks	"	"	"	199,604	199,583		7.6
	Loans and discounts: all banks	"	"	"	193,561	190,642		12.1
	Ave. interest rate: all banks' loans	%	"	July	6.650	6.663		
	TSE index(1st Sn): Average price	1969=100	"	"	774.56	785.77		17.1
	- Sales vol (daily ave)	Yn.shs	"	"	285	346		
Foreign trade	IMF basis: Exports	\$ mn	NSA	July	14,837	14,649		18.7
	Imports	"	"	"	10,713	9,804		23.6
	Trade balance	"	"	"	4,124	4,845		
	Customs clearance basis				(provisional)	(revised)		
	Exports: Total	"		July	14,033	14,480 R	- 3.1	
	Total	"	NSA	"	14,807	14,760 R		17.3
	- To USA	"	"	"	5,566	5,228 R		51.0
	- W Europe	"	"	"	1,945	2,003 R		- 6.2
	- EC	"	"	"	1,578	1,603 R		- 3.7
	- UK	"	"	"	420	426 R		-17.2
	- Middle East	"	"	"	1,226	1,196 R		-18.3
	- S E Asia	"	"	"	3,009	3,196 R		- 5.5
	Imports: Total	"		"	11,476	11,369 R	0.9	
	Total	"	NSA	"	11,608	10,744 R		18.8
	- From USA	"	"	"	2,313	2,197 R		6.9
	- W Europe	"	"	"	1,167	991 R		40.1
	- EC	"	"	"	831	723 R		31.2
	- UK	"	"	"	203	151 R		41.1
	- Middle East	"	"	"	2,695	2,173 R		13.5
	- S E Asia	"	"	"	2,671	2,594 R		23.8
	Crude oil imports: Value	"	"	"	3,202	2,751		16.4
	- Volume	1,000kl	"	"	17,055	14,584		16.4
	- Ave. cif price	\$ pb	"	"	29.50	29.63 R		- 0.1
	Exports: Volume	1980=100	"	"	141.8	139.4 R		14.9
	- Unit value \$	"	"	"	96.5	97.8		2.1
	¥	"	"	"	101.8	100.1		1.6
	Imports: Volume	"	"	"	110.1	100.5 R		21.0
- Unit value \$	"	"	"	90.1	91.3		- 1.7	
¥	"	"	"	94.4	92.8 R		- 2.3	
Terms of trade (¥)	"	"	"	107.9	107.9		4.2	
Export contracts) of major	Y bn	"	"	1,165.3	1,068.7		-10.8	
Import contracts) trading cos.	"	"	"	1,554.6	2,131.1		6.8	
Export letters of credit	\$ mn	"	"	9,000	8,972	0.3	11.8	
Capital flows (Bal. of payts basis)	Japanese external loans(inc -)	\$ mn	NSA	July	- 2,501	- 1,396		
	Net Japanese purchases (-)/ sales(+)/of foreign securities	"	"	"	- 2,474	- 2,156		
	Net foreign purchases (+)/ sales(-) of - Japanese bonds	"	"	"	- 943	- 63		
	- stocks	"	"	"	- 981	- 1,048		
	- gensaki	"	"	"	504	- 126		
	Japanese external bond-issues	"	"	"	1,184	720		
Official reserves (end-month)	"	"	"	25,123	25,208			

SUBJECT

Pr. 2/25 5/12
to master
2

Prime Minister

This must have crossed with
your own message to Mr
Nakasone after his (TEXT)
re-election. *Dus*

PRIME MINISTER'S
PERSONAL MESSAGE
SERIAL No. T 232/83

Dear Prime Minister, 29/12

I am pleased to inform you that my new Cabinet was inaugurated on December 27 after my government received the renewed confidence of the Japanese people in the recent General Election.

In the light of recent situations where East-West relations have been further strained and conflicts and acts of violence have been recurring frequently throughout the world, I strongly feel the further need for us, representing the Summit member nations, to renew our determination in order to cope effectively with these difficult tasks and to work yet further towards ensuring freedom, peace and stability, revitalizing the world economy and securing prosperity for nations all over the world.

I wish to assure you that I, on my part, will continue my endeavours to strengthen further our bilateral relationship. I wish also to reaffirm that our governments, sharing the basic values of freedom and democracy, will co-operate and work together at the forthcoming London Summit Meeting for the maintenance of world peace and stability, the upholding of the free trading system, and the recovery of the world economy.

Looking forward to our meeting in London, I warmly reciprocate your best wishes for the New Year.

Yours sincerely,

YASUHIRO NAKASONE
Prime Minister of
Japan



10 DOWNING STREET

From the Private Secretary

29 December 1983

I enclose a copy of a message to the Prime Minister from Mr. Nakasone, which was forwarded to us by the Japanese Ambassador on 28 December. It was presumably despatched before the Prime Minister's own message arrived (your letter to John Coles of 22 December and mine of 23 December refer).

We have acknowledged the Prime Minister's message with thanks. If you feel that any more substantial reply is called for, I should be grateful for a draft.

David Barclay

Peter Ricketts, Esq.,
Foreign and Commonwealth Office.

29 December 1983

I am writing on behalf of the Prime Minister to thank you for your letter of 28 December conveying a message from Prime Minister Yasuhiro Nakasone. I will lay this before the Prime Minister, who I know will be delighted to receive it.

David Barclay

His Excellency Mr. Tsuyoshi Hirahara.

NR



EMBASSY OF JAPAN
CHANCERY BUILDING

London, 28th December 1983

Dear Prime Minister,

I am asked by Prime Minister
Yasuhiro Nakasone to forward to you the text
of his message which I have just received in
London.

... I have pleasure in enclosing
herewith this text.

Yours sincerely,

Tsuyoshi Hirahara
Ambassador

The Rt.Hon. Margaret Thatcher, MP,
Prime Minister and First Lord of the Treasury,
10, Downing Street,
London, S.W.1.

SUBJECT

do MS

cfra *Fernando*
CPS



10 DOWNING STREET

THE PRIME MINISTER

28 December 1983

PRIME MINISTER'S

PERSONAL MESSAGE

SERIAL No. T 733/83

Dear Prime Minister,

I send you my warmest congratulations on your re-appointment as Prime Minister of Japan.

As you know, I attach great importance to good relations between our two countries, and I believe that the pattern of co-operation which we have established during your first term as Prime Minister has done much to strengthen these links. I look forward to working with you in the future.

With best wishes for the New Year.

Yours sincerely
Royce Ingham

His Excellency Mr. Yasuhiro Nakasone

JK

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10 DOWNING STREET

From the Private Secretary

23 December 1983

Japanese Prime Minister

Many thanks for your letter of 22 December to John Coles.

The Prime Minister agrees that it would be appropriate to send a message to Mr. Nakasone, assuming he is re-appointed as the Japanese Prime Minister on 26 December. She is content with the draft message attached to your letter. I should be grateful if you could arrange for its despatch as soon as Mr. Nakasone's re-appointment is confirmed.

David Barclay

P.F. Ricketts, Esq.,
Foreign and Commonwealth Office.

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(1)



Foreign and Commonwealth Office

London SW1A 2AH

Prime Minister

Agree telegram, for
despatch if Mr Nakasone

22 December 1983

Dear John, is reappointed?

DMS
22/12

Yes no

Japanese Prime Minister

Mr Nakasone is likely to be reappointed as the Japanese Prime Minister on 26 December during an extraordinary session of the Japanese Diet. The Liberal Democratic Party only just managed (with the help of independent candidates) to maintain a majority in the Diet. The occasion of Mr Nakasone's reappointment (provided it takes place) would therefore be the most appropriate one for a message of congratulations from the Prime Minister.

I enclose a draft message of congratulations cast in the form of a telegram to Tokyo. If the Prime Minister is content, we shall arrange for its despatch as soon as Mr Nakasone's reappointment is confirmed. In the unlikely event of another Prime Minister being appointed, we would offer further advice to the Prime Minister.

Yours ever,

Peter Ricketts

(P F Ricketts)
Private Secretary

A J Coles Esq
10 Downing Street

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7 TO IMMEDIATE TOKYO

8 TELEGRAM NUMBER

9 PRIME MINISTER'S MESSAGE TO MR NAKASONE

10 1. Please deliver the following message from the Prime Minister
11 to Mr Nakasone.

12 Begins: I send you my warmest congratulations on your reappointment
13 as Prime Minister of Japan.

14 As you know, I attach great importance to good relations
15 between our two countries, and I believe that the pattern of
16 cooperation which we have established during your first term as
17 Prime Minister has done much to strengthen these links. I look
18 forward to working with you in the future.

19 With my best wishes for the New Year. Ends.

20

21 HOWE

22 NNNN

23

24

25

NNNN ends telegram	BLANK	Catchword
File number	Dept Private Office	Distribution
Drafted by (Block capitals) P F Ricketts		
Telephone number 233 4641		
Authorized for despatch		
Comcon reference	Time of despatch	

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TO IMMEDIATE FCO

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Mr Giffard

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JAPANESE GENERAL ELECTION

1. YESTERDAY'S GENERAL ELECTION PROVIDED A SURPRISE UPSET FOR THE LIBERAL DEMOCRATIC PARTY (LDP). NOT ONLY DID THE PARTY LOSE ITS SECURE MAJORITY (MORE THAN 271 SEATS WHICH ENABLES IT TO CONTROL DIET COMMITTEES); NOMINALLY IT LOST ITS OVERALL MAJORITY AS WELL (250 SEATS COMPARED TO THE 256 REQUIRED). BUT 9 OF THOSE RUNNING ON AN INDEPENDENT TICKET WILL BE JOINING THE LDP IN THE NEXT FEW DAYS. THE CONTINUATION OF LDP GOVERNMENT IS THEREFORE SECURE BUT THE PARTY HAS RECEIVED A SEVERE SHOCK AND NAKASONE'S POSITION AS PRIME MINISTER HAS BEEN MARKEDLY WEAKENED.

2. THE FINAL RESULT WAS AS FOLLOWS (FIGURES AT THE TIME OF THE DISSOLUTION IN BRACKETS):-

LDP	250	(256)
JSP (JAPAN SOCIALIST PARTY)	112	(101)
KOMEITO (CLEAN GOVT PARTY)	58	(34)
DSP (DEMOCRATIC SOCIALIST PARTY)	38	(31)
JCP (JAPAN COMMUNIST PARTY)	26	(29)
NLC (NEW LIBERAL CLUB)	3	(10)
DEMOCRATIC SOCIALIST FEDERATION	3	(3)
INDEPENDENTS	16	(4)

3. THE LDP REVERSE IS BEING ATTRIBUTED TO A VARIETY OF CAUSES: THE COMPLACENCY OF ITS SUPPORTERS, FOSTERED IN PART BY THE MEDIA WHICH SUGGESTED ALMOST UNANIMOUSLY THAT A SECURE MAJORITY WAS LIKELY, WHICH LED TO THE LOWEST POLL

~~3. THE LDP REVERSE IS BEING ATTRIBUTED TO A VARIETY OF CAUSES: THE COMPLACENCY OF ITS SUPPORTERS, FOSTERED IN PART BY THE MEDIA WHICH SUGGESTED ALMOST UNANIMOUSLY THAT A SECURE MAJORITY WAS LIKELY, WHICH LED TO THE LOWEST POLL (67.9%) SINCE THE WAR; THE BAD WEATHER; WIDESPREAD CO-OPERATION BETWEEN THE OPPOSITION PARTIES; AND THE PARTY'S FAILURE TO RESTRICT SUFFICIENTLY THE NUMBER OF ITS OWN CANDIDATES IN MULTIPLE CANDIDATE CONSTITUENCIES. THE TANAKA ISSUE AND NAKASONE'S OWN (BY JAPANESE STANDARDS) SOMEWHAT ABRASIVE STYLE HAVE ALSO BEEN BLAMED. ALTHOUGH THE LDP HAD EXPECTED TO LOSE SOME SEATS, THEY HAD NOT ANTICIPATED SUCH WIDESPREAD LOSSES; THESE WERE FELT BY EACH OF THE FACTIONS BUT MOST SERIOUSLY BY THE SUZUKI FACTION (13 LOSSES).~~

4. BOTH THE CENTRE PARTIES (KOMEI TO AND DEMOCRATIC SOCIALIST PARTY) WILL NOW HOLD MORE SEATS THAN EVER BEFORE. THE KOMEI TO, PARTLY THROUGH CO-OPERATION AGREEMENTS WITH OTHER OPPOSITION PARTIES, DID PARTICULARLY WELL. THE JSP EXCEEDED EXPECTATION WITH 11 GAINS BUT IS STILL WELL BELOW ITS 1977 LEVEL (125).

5. THE RESULT IS A CLEAR DISAPPOINTMENT FOR PRIME MINISTER NAKASONE, ALTHOUGH THE LDP NOW HAS TWO MORE SEATS THAN IT WON IN THE 1979 ELECTION (THE 1980 ELECTION WAS EXCEPTIONAL BECAUSE OF THE SYMPATHY VOTE FOLLOWING PRIME OHIRA'S DEATH) THERE HAS SO FAR BEEN NO CLEAR CALL FOR HIS RESIGNATION FROM WITHIN THE LDP (NOR WOULD ONE EXPECT THIS) BUT THERE IS LIKELY TO BE INCREASING PRESSURE ON HIM AND THE PROSPECTS ARE FOR AN EXTENDED WRANGLE OVER THE FORMATION OF THE NEW CABINET. THE LDP'S POOR PERFORMANCE HAS ALSO PUT IN DOUBT THE POSSIBILITY OF NAKASONE BEING RE-ELECTED AS THE PARTY PRESIDENT (AND HENCE PRIME MINISTER) IN NOVEMBER 1984.

CORTAZZI

NNNN

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Handwritten:
28/11

JAPAN'S PARLIAMENT TO BE DISSOLVED

TOKYO, SUNDAY - THE JAPANESE GOVERNMENT TOMORROW WILL FORMALLY CALL AN EARLY GENERAL ELECTION FOR NEXT MONTH AFTER DISSOLVING PARLIAMENT FOLLOWING WEEKS OF POLITICAL DEADLOCK OVER THE TANAKA AFFAIR, GOVERNMENT SOURCES SAID TODAY.

THE ELECTION, TO BE HELD SIX MONTHS BEFORE THE CURRENT LOWER HOUSE TERM IS DUE TO EXPIRE, FOLLOWS AN OPPOSITION BOYCOTT OF PARLIAMENTARY BUSINESS LINKED WITH THE OCTOBER 12 CONVICTION OF EX-PRIME MINISTER KAKUEI TANAKA IN THE LOCKHEED BRIBERY SCANDAL.

PRIME MINISTER YASUHIRO NAKASONE HAS REJECTED OPPOSITION DEMANDS FOR TANAKA'S RESIGNATION FROM PARLIAMENT ON THE GROUNDS SUCH A DECISION SHOULD BE MADE EITHER BY TANAKA HIMSELF OR BY THE VOTERS.

PARLIAMENTARY APPROVAL OF A PACKAGE OF IMPORTANT BILLS, THE CONDITION NAKASONE IMPOSED FOR CALLING THE DECEMBER 18 ELECTION, WILL COME AT A PLENARY SESSION OF THE UPPER HOUSE TOMORROW MORNING, THE SOURCES SAID.

THE CABINET WILL THEN HOLD AN EMERGENCY MEETING AND DECIDE TO DISSOLVE THE LOWER HOUSE WITHIN THE DAY, THE LAST OF THE CURRENT SESSION OF PARLIAMENT, THE SOURCES SAID.

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TELEGRAM NUMBER 342 OF 28/6/83
INFO PRIORITY WASHINGTON

JAPANESE UPPER HOUSE ELECTIONS.

SUMMARY.

1. IN ELECTIONS FOR HALF THE SEATS OF THE UPPER HOUSE ON 26 JUNE, THE RULING LIBERAL DEMOCRATIC PARTY WON 58 SEATS OUT OF A TOTAL OF 126. IT HAS THEREFORE INCREASED BY 3 THE ABSOLUTE MAJORITY WHICH IT ALREADY ENJOYED IN THE HOUSE. THE PRIME MINISTER'S POSITION WILL HAVE BEEN STRENGTHENED BY THE RESULT.

DETAIL.

2. THE BREAKDOWN OF SEATS IS AS FOLLOWS(PRE-ELECTION FIGURES IN BRACKETS):

	LOCAL CONSTITUENCIES	NATIONAL CONSTITUENCY	SEATS NOT UP FOR ELECTION	GRAND TOTAL IN UPPER HOUSE
LDP	49(45)	19(20)	69	127(134)
JSP	13(17)	9(9)	22	44(48)
KOMEI TO	6(5)	8(9)	13	27(27)
DSP	2(2)	4(3)	5	12(11)
JCP	2(2)	3(3)	7	14(12)
NLC/ SHANNINREN	1(2)	1(2)	1	3(5)
MINOR PARTIES AND INDEPENDENTS	3(1)	4(4)	5	12(10)

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3.

3. THE VOTER TURN-OUT (57 PER CENT) WAS A RECORD LOW BUT ON THIS OCCASION DISPROVED THE CONVENTIONAL WISDOM THAT THIS WORKS AGAINST THE LDP. THE LDP HAS DONE WELL, LARGELY AT THE EXPENSE OF THE JAPAN SOCIALIST PARTY, WHOSE INTERNAL BICKERING CONTINUES TO UNDERMINE ITS CREDIBILITY. IN THE LOCAL CONSTITUENCIES IT MADE GAINS WHICH ENABLED IT EASILY TO SURPASS THE OVERALL TARGET FIGURE OF 63 SEATS SET BY THE PRIME MINISTER. IT DID NOT DO AS WELL AS IT HOPED IN THE NATIONAL CONSTITUENCY WHERE IT INDEED LOST A SEAT AND OBTAINED ONLY 35 PER CENT OF THE VOTES. WE SHALL BE ANALYSING THIS FURTHER BUT IN GENERAL THE RESULTS WILL GIVE NAKASONE FURTHER CONFIDENCE IN ESTABLISHING HIS OWN POSITION AND IN APPROACHING THE NEXT LOWER HOUSE ELECTION WHICH, FROM HIS RECENT STATEMENTS, HE SEEMS UNLIKELY TO CALL BEFORE NEXT YEAR.

4. WITHIN THE LDP THE TANAKA FACTION'S STRENGTH IN THE UPPER HOUSE INCREASED FROM 43 TO 47 WITH GAINS OF 1 SEAT IN THE LOCAL CONSTITUENCIES AND 3 IN THE NATIONAL CONSTITUENCY. TANAKA HAD HOWEVER HOPED FOR A MORE SIGNIFICANT INCREASE IN HIS INFLUENCE. ALTHOUGH ALL 11 OF HIS CANDIDATES FOR THE NATIONAL CONSTITUENCY WERE ELECTED BECAUSE OF THE HIGH POSITIONS THEY HAD BEEN GIVEN ON THE LDP'S LIST OF 30 (AND ONE MORE HAS JOINED SINCE THE ELECTION), 7 OF THE FACTION'S 19 CANDIDATES FOR THE LOCAL CONSTITUENCIES FAILED, INCLUDING 1 INCUMBENT MEMBER. THIS WILL UNDOUBTEDLY HAVE BEEN A DISAPPOINTMENT TO TANAKA AND THOUGH DIRECT ELECTORAL OPPOSITION TO HIM MAY NOT HAVE BEEN THE ONLY REASON BEHIND THE FAILURES THEY MAY FURTHER UNDERMINE HIS POSITION BY SHOWING THE LIMITS OF HIS POWER. NAKASONE HIMSELF WILL DRAW COMFORT FROM THIS AS HE GRADUALLY STRENGTHENS HIS OWN POSITION WITHIN THE PARTY. HE CAMPAIGNED VIGOROUSLY BEFORE THE ELECTION CONCENTRATING ON THE ISSUES OF ECONOMIC RECOVERY, TAX REDUCTION AND PRICE STABILITY BUT ALSO GIVING A CLEAR EXPLANATION FOR HIS SUPPORT FOR THE WILLIAMSBURG STATEMENT. THE OPPOSITION PARTIES APPEAR TO HAVE MADE LITTLE HEADWAY WITH THEIR ATTEMPT TO HIGHLIGHT DEFENCE ISSUES.

5. THE NEW SYSTEM OF VOTING FOR THE NATIONAL CONSTITUENCY, BY PROPORTIONAL REPRESENTATION, ENABLED MINOR PARTIES TO CAPTURE 12.6 PER CENT OF THIS VOTE. TWO NEW MINOR PARTIES (THE SALARYMAN'S PARTY AND THE WELFARE PARTY) WON A TOTAL OF 3 SEATS. THE WELFARE PARTY MAN, A MEMBER OF THE NEW LIBERAL CLUB UNTIL THE ELECTION, WAS ALREADY WELL KNOWN TO THE ELECTORATE AND THEREFORE RETURNED ON THE STRENGTH OF HIS OWN PERSONALITY. BUT THE TREND SHOWS THAT ONE ISSUE PARTIES CAN PROJECT THEMSELVES IN A WAY WHICH DILUTES THE VOTE FOR THE MAJOR PARTIES AND THIS HAS IMPLICATION FOR THE LDP IN THE FUTURE.

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From the Principal Private Secretary

SIR ROBERT ARMSTRONG

This is just to let you know that I showed the Prime Minister the letter from Mr Wicks of the Treasury, which was attached to your minute of 17 February (A083/0577) about relations between the Civil Service and Industry in Japan; and the Prime Minister read it with interest.

F.E.R.B.

21 February 1983

AH

Prime Minister

You may be interested to see the attached.

Ref. AO83/0577

MRS BROWN

FERB

18.2.

- cc Mr Butler
- Mr Cassels
- Mrs Sloman
- Mr Peterson
- Mr Priestley

--- The Lord Privy Seal may be interested to glance at the attached copy of a letter which I have received from Mr Wicks of the Treasury, summarising what he learnt at a recent Civil Service - Industrialist dinner about relations between the Civil Service and Industry in Japan.

ROBERT ARMSTRONG

ROBERT ARMSTRONG

17th February 1983



HM Treasury

Parliament Street London SW1P 3AG

Direct Line 01-233 5806

Switchboard 01-233 3000

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FILE No.	_____

to dictate

Sir Robert Armstrong KCB, CVO
Cabinet Office
Whitehall
LONDON SW1A 2AS

11 February 1983

Dear Robert,

You might like the following brief report of the dinner which Peter Hunt hosted at the Travellers' Club yesterday evening.

It was more successful than the previous occasion. This was, I think, because the talk given by Mr Morikiyo, Special Representative of MITI at the Japan Trade Centre here, gave the discussion a theme, which united the interests of both civil servants and businessmen present.

You may already know about Government/civil service relationships in Japan. But for the record I summarise here the main points of what Mr Morikiyo told us.

Oxbridge bias!

(i) MITI "high flyers" were mainly drawn from Tokyo University. This University also provided many of the future leaders of Japanese industry. Most of the MITI people from Tokyo University had been trained as lawyers. So were many of the entrants into private industry. The emphasis of civil service training was "on the job". !!

(ii) MITI high flyers changed jobs frequently within the Ministry. Many left in their late 40s, without any stigma of failure, to take up senior positions in private industry. Permanent Secretaries ("Vice Ministers") in departments held their positions for only 12-18 months. This transient top-hammer meant that important decisions were made by, and advice tendered from, lower level officials (according to Mr Morikiyo at "Principal" level).

This must be because they know that they are so competitive that they can make profits.

(iii) An important function of MITI is the establishment of "plans" for the various sectors of Japanese industry. These plans map out production and quality targets. Profit did not seem to be an important factor. The plans were agreed in a spirit of consensus and co-operation, with "Trade Associations", on which see below. The plans did not normally allocate production between different firms. This was done subsequently by the Trade Associations

(like one enormous cartel, as one of the businessmen present commented). When asked how a Japanese businessman appraised an investment case for, say, a new factory, Mr Morikiyo said that it was considered against the requirements of the plan. Again, profit did not seem to be an important investment criterion.

(iv) Trade Associations played a key part in linking the civil servants in MITI with private business. They are often staffed by ex-MITI people. Their councils included top level representatives of major firms in the relevant industrial sector. They helped "create a co-operative climate".

I do not know Mr Morikiyo's status in MITI, but the CV which Peter Hunt read out suggested that he had had the career expected of one of our Assistant Secretaries, with experience in an industry division, "welfare section" (establishment division), and in private office. He certainly was well briefed with all the right jargon about the British civil service - high flyers, Civil Service Commission, Deputy Secretaries, Private Office and so on.

I hesitate to draw parallels with our lessons from Japanese experience. Certainly Mr Morikiyo's account suggests that the Japanese civil service system contains some very "un-Fulton like" arrangements. But my main impressions from his talk are the obvious ones - close co-operation between civil service and business in a consensual climate without our private/public sector dichotomy; a shared belief in central planning; and the availability of tools to implement planning.

Yours sincerely
Nigel Wicks

N L WICKS

Japan

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TO IMMEDIATE F C O

TELEGRAM NUMBER 712 OF 25/11/82

AND REPEATED FOR INFO PRIORITY WASHINGTON.

MIPT: THE JAPANESE POLITICAL SCENE: NAKASONE.

1. YASUHIRO NAKASONE (64), THE SON OF A LEADING TIMBER MERCHANT, ENTERED POLITICS AT 28 AFTER SERVING IN THE IMPERIAL NAVY AND THE INTERIOR MINISTRY. HE BECAME A CABINET MINISTER AT 41 AND HAS HAD HIS OWN FACTION, NOW NUMBER 1 (THE FOURTH LARGEST) SINCE 1967.

2. DURING HIS CAREER NAKASONE HAS HELD IMPORTANT GOVERNMENT POSTS INCLUDING DIRECTOR GENERAL OF THE SCIENCE AND TECHNOLOGY AGENCY (1959-1960), DIRECTOR GENERAL OF THE DEFENCE AGENCY (1970-1971) AND MINISTER FOR INTERNATIONAL TRADE AND INDUSTRY (1972-1974). HE HAS ALSO HELD SENIOR PARTY POSTS.

HE IS CONSIDERED THE LAST OF THE OLD GENERATION OF LDP LEADERS (TANAKA, MIKI, FUKUDA AND OHIRA) WHO DOMINATED JAPANESE POLITICS IN THE 1970S , ALTHOUGH HE IS ALSO MARKEDLY THE YOUNGEST OF THEM .

3. NAKASONE HAS ALWAYS BEEN REGARDED AS A STRONG NATIONALIST. HE HAS PROPOSED, IN THE PAST, THAT JAPAN SHOULD PLAY A LARGER ROLE IN THE INTERNATIONAL COMMUNITY BY BOOSTING ITS OWN DEFENCE CAPABILITY. HE IS AMONG THE MANY LDP POLITICIANS WHO HAVE ADVOCATED REVISION OF THE POST WAR JAPANESE CONSTITUTION BUT MAINTAINS THAT ITS IMPORTANT ELEMENTS INCLUDE THE MAINTENANCE OF BASIC HUMAN RIGHTS, PEACE AND INTERNATIONALISM. ON ECONOMIC ISSUES HIS PERSONAL VIEWS ARE LESS CLEAR BUT THE BUSINESS COMMUNITY HAS WELCOMED HIS ELECTION BECAUSE OF THE EMPHASIS WHICH HE HAS PLACED ON THE CONTINUATION OF THE POLICIES OF CUTTING PUBLIC EXPENDITURE AND THE RESTRUCTURING OF NATIONAL FINANCES. HE HAS SO FAR BEEN CAUTIOUS ABOUT SUGGESTING ADDITIONAL ECONOMIC STIMULI WHICH MIGHT BURDEN THE GOVERNMENT WITH FURTHER DEBTS.

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4. MANY LDP DIET MEMBERS HAVE NEVER BEEN PREPARED FULLY TO TRUST NAKASONE AND HAVE CRITICISED HIM FOR HIS POLITICAL OPPORTUNISM CALLING HIM A "WEATHERVANE". HE IS CONSIDERED BY MANY TO HAVE THE POTENTIAL TO BECOME A STRONG LEADER BUT IT REMAINS TO BE SEEN HOW MUCH BOTTOM HE REALLY HAS AND THE EXTENT TO WHICH HE CAN DISTANCE HIMSELF FROM TANAKA. HE CAN SPEAK PERSUASIVELY ON OCCASSIONS AND IS SOMETIMES FLAMBOYANT. IN RECENT YEARS HE HAS CONCENTRATED ON DOMESTIC POLITICS BUT WHEN MINISTER OF INTERNATIONAL TRADE AND INDUSTRY HE PAID PARTICULAR ATTENTION TO THE MIDDLE EAST WHERE HE HAS TRAVELLED WIDELY. HE VISITED THE UK IN 1957 AND AGAIN, AS MITI MINISTER IN 1974 BUT DOES NOT KNOW EUROPE WELL. HE HAS OFTEN VISITED THE USA. HE IS SAID TO UNDERSTAND AND SPEAK SOME ENGLISH.

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TO IMMEDIATE F C O

TELEGRAM NUMBER 707 OF 24/11/82

AND REPEATED FOR INFO IMMEDIATE WASHINGTON

MY TEL NO 632: JAPANESE POLITICAL SCENE.

1. THE FINAL RESULT OF THE PRIMARY ELECTION FOR THE LDP PRESIDENCY HAS JUST BEEN ANNOUNCED. OUT OF A TOTAL OF 1.04 MILLION LDP MEMBERS ELIGIBLE TO VOTE, 974,150 VOTES WERE POLLED. OF THESE NAKASONE GAINED 559,673, KOMOTO 265,078, ABE 80,443 AND NAKAGAWA 66,041.
2. NAKASONE, KOMOTO AND ABE ARE THEREFORE ELIGIBLE TO STAND IN THE FINAL ELECTION BY LDP DIET MEMBERS. HOWEVER THE RESULT IS BEING HAILED AS A LANDSLIDE VICTORY FOR NAKASONE, WHO HAS OBTAINED AN OVERALL MAJORITY OF THE VOTES. KOMOTO AND ABE HAVE THEREFORE DECIDED NOT TO RUN, AND THEY AND NAKAGAWA HAVE ALL INFORMED THE CHAIRMAN OF THE LDP'S ELECTION COMMITTEE THAT THEY WILL NOT STAND. SINCE NAKASONE IS THEREFORE THE ONLY CANDIDATE, THE FINAL ELECTION WILL NOT BE HELD AND HE WILL BE APPOINTED LDP PRESIDENT AT THE LDP SPECIAL CONVENTION TOMORROW.
3. THE 97TH EXTRAORDINARY SESSION OF THE DIET OPENS ON FRIDAY 26 NOVEMBER, AT WHICH THE LDP PRESIDENT IS SCHEDULED TO BE APPOINTED PRIME MINISTER. NAKASONE IS LIKELY TO RESHUFFLE HIS CABINET QUICKLY, POSSIBLE OVER THE WEEKEND. COMMENT WILL FOLLOW.

CORTAZZI

FCO/WHITEHALL
FED

cc USA - Econ Sit, P42
 Denmark, Oct 79, Int Sit
 Belgium, Oct 79, Int Sit
 Germany, Int Sit, P42
 France, Int Sit, P42



Prime Minister

(2)

A useful list.

MS 11/11

Treasury Chambers, Parliament Street, SW1P 3AG
 01-233 3000

10 November 1982

R Bone Esq.
 Foreign and Commonwealth Office

Dear Roger,

OTHER COUNTRIES FISCAL POLICIES

The Chancellor thought that Cabinet colleagues might, in addition to other briefing material being circulated this week, find it helpful to have a background note containing examples of fiscal measures that have been taken or are in prospect in other countries.

I attach a short paper that has been prepared here with some illustrative material of this kind.

I am sending copies of this letter to Michael Scholar (No. 10) and to the Private Offices of other Cabinet members.

Yours sincerely,

Jill Rutter

JILL RUTTER
 Private Secretary

OTHER COUNTRIES' FISCAL POLICIES

Budget plans for 1983 have now been announced in most countries. It is clear that governments are determined to restrain borrowing even if this involves hard decisions to cut spending or raise taxes.

2. In the wake of the first oil price increase many industrial countries allowed public expenditure to rise. Following the second increase countries recognised that they faced large deficits which would not disappear in the foreseeable future. Subsequently the main emphasis of policy has been to reduce these deficits, cut national cost overheads and seek to improve market efficiency. Within tightly controlled expenditure limits governments are also trying to change the balance of expenditure from current to capital expenditure, and to switch the burden of taxation from industry. Any increase in expenditure has generally taken the form of aid to industry or employment programmes.

3. Some illustrations of measures taken or in prospect are set out below:

Social Security benefits

- (i) The French government intends to index social benefits to the inflation target rather than the inflation outturn. Pension increases are to be delayed by 6 months.
- (ii) The German government is to introduce means-testing for child benefits as well as delaying pension increases for 6 months.
- (iii) The Belgian government intends to reduce family allowances. Unemployment benefit has also been reduced for some groups.
- (iv) The Danish government is to de-index social security payments.

Social security contributions

- (i) The French government plans to raise the contributions of people who have taken early retirement and levy a 1 per cent contribution from some civil servants (previously they were exempted).
- (ii) The Danish government is increasing employees and employers contributions.

(iii) The Belgian government intends to increase personal contributions.

Health expenditure

(i) The French government intends to introduce a "hotel" charge for some hospital patients, of 20 Francs per day.

(ii) The German government plans to make patients contribute to the cost of in-patients' hospital treatment for the first 14 days.

(iii) The Belgian government has banned further hospital building.

(iv) The American government has cut \$13 billion from planned expenditure on its Medicare programme.

Public sector pay and numbers

(i) The German government will be limiting pay increases for public servants to 2 per cent.

(ii) Japanese public servants are to receive no cost of living adjustment this year.

(iii) The Belgian government has stopped recruitment and intends to reduce the numbers employed by $1\frac{1}{2}$ per cent.

(iv) The Danish government intends to impose a ceiling of 4 per cent for public sector wages increases in 1983-85.

Income tax

(i) The German government plans to raise a special levy from higher tax payers.

(ii) The French government will raise the top rate of tax on earned income from 60 per cent to 65 per cent.

Japan

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FM TOKYO 230300Z OCT 82
TO PRIORITY F C O
TELEGRAM NO 632 OF 23 OCTOBER
RFI WASHINGTON

MY TELNO 620: JAPANESE POLITICAL SCENE

1. AFTER PROTRACTED BUT FRUITLESS TALKS THROUGH LAST NIGHT AMONG LDP LEADERS, IT HAS BECOME CLEAR THAT A WEEK OF TOP LEVEL DISCUSSIONS HAS FAILED TO FIND A NEGOTIATED SOLUTION TO THE LDP PRESIDENCY. THE BRAKE ON THE PRELIMINARY ELECTION CAMPAIGNS HAS THEREFORE NOW BEEN REMOVED. THE FOUR CANDIDATES, NAKASONE, KOMOTO, ABE AND NAKAGAWA, WILL NOW GET THEIR CAMPAIGNS INTO FULL SWING.

2. THE ELECTION ITSELF WILL BE BY POSTAL VOTE, TO BE RETURNED TO THE CENTRAL POST OFFICE ACCORDING TO THE CURRENT SCHEDULE BY CLOSE OF PLAY ON 23 NOVEMBER. THE FINAL SELECTION, FROM THE THREE LEADING CANDIDATES IN THE PRELIMINARY ELECTION, WILL BE MADE BY LDP DIET MEMBERS. THIS IS SCHEDULED TO TAKE PLACE ON 25 NOVEMBER, AT THE MEETING OF THE LDP PARTY CONVENTION. THE LDP ELECTION COMMITTEE HOWEVER ARE CURRENTLY CONSIDERING THE POSSIBILITY OF ADVANCING BOTH VOTES BY ONE WEEK TO AVOID A PROLONGED POLITICAL VACUUM

CORTAZZI
FCO/WHITEHALL
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THIS TELEGRAM
WAS NOT
ADVANCED

Prime Minister

CABINET OFFICE

A-J-C. 15/10

70 Whitehall, London SW1A 2AS Telephone 01-233 8319

From the Secretary of the Cabinet: Sir Robert Armstrong KCB, CVO

Ref. A09771

15 October 1982

I have seen telegram no 607 from Tokyo about the Japanese political scene.

When I saw the Japanese Prime Minister's Personal Representative on 13 October, I invited him to speculate privately about the succession to Mr Suzuki. He seemed to think that Mr Nakasone was a likely successor; he would not naturally commend himself to Mr Fukuda and his fraction, but he would have supporters who might well in present circumstances be influential in persuading Mr Fukuda to accept him.

I should be grateful if this information, given in confidence, could be treated with great discretion.

I am sending a copy of this letter to John Coles.

ROBERT ARMSTRONG

Sir Antony Acland KCMG KCVO

Sapan

30

15 October 1982

JAPANESE PRIME MINISTER

The Prime Minister has noted the contents
of your letter of 13 October.

AJC

John Holmes, Esq.,
Foreign and Commonwealth Office.



Foreign and Commonwealth Office

London SW1A 2AH

13 October 1982

Prime Minister

13/10

Dear John,

Japanese Prime Minister

You asked for an assessment of the position of the Japanese Prime Minister, Mr Suzuki, after the announcement of his intended resignation, bearing in mind the Prime Minister's recent visit to Japan.

I enclose, for convenience, a copy of Tokyo telegram number 607, which gives the Embassy's assessment. Conversation today with the Japanese Ambassador and other Foreign Ministry officials who are visiting London confirms Sir H Cortazzi's assessment that Mr Suzuki could go within the next few days. His resignation is connected with the likelihood that he would be opposed in the intra-Party elections for the Presidency of the LDP, for which nominations close on 16 October. There is a strong chance that members of the LDP will be able to agree among themselves over the next 48 hours on a single candidate for the succession to Mr Suzuki; if they do, then Mr Suzuki would be able to resign immediately and his successor would be assured of an uncontested election in 6 weeks' time. The alternative, which is at least as possible, is that the various factions of the LDP will not be able to agree among themselves, and that Mr Suzuki will therefore remain in office until the elections are held and a clear successor emerges. In any event the position today is that Mr Suzuki is still Prime Minister of Japan, and there is therefore no call for messages.

We agree with the main points of the Embassy's assessment of the background, and with some of their views on the likely alternative candidates. Mr Komoto is perhaps the slight favourite in that the opposition to him from the elder statesmen of the Party is somewhat less entrenched than is the opposition to Mr Nakasone. Mr Komoto is at present Director-General of the Economic Planning Agency

 /and is



and is aged 71; Mr Nakasone is Director-General of the Administrative Management Agency and is aged 63. We believe that it is rather less likely that the former Prime Minister, Mr Fukuda, who is now 77, will wish to stand again himself, although his views will be of great importance. The other younger candidates include the present Minister of International Trade and Industry, Mr Abe (now 58), and the Director-General of the Science and Technology Agency, Mr Nakagawa (now 57), both of whom played a part during Mrs Thatcher's recent visit to Tokyo.

You asked whether the impending change of Prime Minister in Japan would be likely to reduce the impact of the Prime Minister's recent visit. We are confident that this will not be the case. The Japanese political system is accustomed to very frequent Cabinet changes (and a shuffle is certain to follow the change of Prime Minister) and almost as accustomed to changes of Prime Minister. The Liberal Democratic Party will in practice unite behind whoever emerges as its leader, and it is very unlikely that there will be any major change in policy, at least in international affairs. The message which Mrs Thatcher gave to the Japanese Government and the Japanese people will have been absorbed and understood, and the successors to the present Government should have it as clearly in mind as their predecessors.

Yours ever
John Holmes

(J E Holmes)
Private Secretary

A J Coles Esq
10 Downing Street

QRS 300
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Mr Coles,

N° 10 D. Sbr.

FM TOKYO 120830Z OCT 82

TO IMMEDIATE F C O

TELEGRAM NUMBER 607 OF 12/10/82

REPEATED TO IMMEDIATE WASHINGTON, ROUTINE PEKING, SEOUL,
UKREP BRUSSELS, BONN AND PARIS.

JAPANESE POLITICAL SCENE.

1. PRIME MINISTER SUZUKI DECIDED TODAY NOT TO STAND FOR RE-ELECTION AS PRESIDENT OF THE LIBERAL DEMOCRATIC PARTY. EFFECTIVELY THIS MEANS HE HAS A MAXIMUM OF SIX WEEKS STILL IN OFFICE BUT HE COULD GO VERY MUCH SOONER THAN THAT, POSSIBLE WITHIN THE NEXT WEEK OR SO.
2. THE DECISION SEEMS TO HAVE BEEN VERY MUCH A PERSONAL ONE AND HAS TAKEN EVEN SENIOR MEMBERS OF HIS OWN FACTION BY SURPRISE. IT WAS COMMUNICATED TO THE FOUR TOP EXECUTIVES OF THE PARTY AT A MEETING THIS AFTERNOON AND ANNOUNCED IMMEDIATELY AFTER THAT MEETING BY MIYAZAWA, CHIEF CABINET SECRETARY. THE REASON GIVEN FOR THE DECISION IS THAT SUZUKI "WANTED TO AVOID THROWING THE PARTY INTO DISARRAY". THIS SNACKS OF THE TRUTH. PRESSURE ON SUZUKI HAD BEEN BUILDING UP IN THE PAST FEW DAYS PARTICULARLY FROM FUKUDA AND KOMOTO. SUZUKI WAS ALWAYS THE MIDDLE OF THE WAY MAN OF COMPROMISE AND PROBABLY DID NOT HAVE EITHER THE PERSONALITY OR THE HEART FOR A BITTERLY CONTESTED RE-ELECTION CAMPAIGN.
3. THE NEXT MOVES ARE NOT CLEAR ALTHOUGH THE REFERENCE TO "DISARRAY" SUGGESTS THAT THE PARTY WILL NOW MAKE CONSIDERABLE EFFORTS TO COALESCE ROUND A SINGLE ALTERNATIVE CANDIDATE. A DECISION ON THIS IS REQUIRED BY 16 OCTOBER WHEN THE LISTS FOR CANDIDATES CLOSE. ATTENTION MUST FOCUS PRIMARILY ON FUKUDA OR KOMOTO BUT IT IS NOT CLEAR HOW THEY MIGHT AGREE ON WHICH OF THEM SHOULD RUN AND IT IS QUITE POSSIBLE THAT THE SUZUKI AND TANAKA FACTIONS WILL SEEK TO ENSURE THAT A THIRD AND PERHAPS YOUNGER CANDIDATE OBTAINS THE JOB IN PREFERENCE TO THE TWO WHO WILL BE DEEMED TO HAVE BROUGHT DOWN SUZUKI.

CORTAZZI
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MR BIFFARI
MR DONAH

COPY TO:

Mr Coles, N° 10 Downing Str.

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Mr COLES, No 10 DS

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FM TOKYO 080445Z OCT 82

TO PRIORITY F C O

TELEGRAM NO 601 OF 8 OCTOBER

L5H101

FOR SIR ROBERT ARMSTRONG FROM WHITEHEAD (IN THE ANBASSADOR'S ABSENCE ON TOUR)

TOKYO TELNO 589: ECONOMIC SUMMIT

1. ENDO (UNDER SECRETARY IN MFA WHO WORKS DIRECT TO MATSUNAGA ON SUMMIT MATTERS) HINTED VERY STRONGLY TO ME LAST NIGHT THAT NEGOTIATIONS WERE NOW UNDERWAY FOR SUZUKI TO STEP DOWN AS PRIME MINISTER IN EARLY SUMMER NEXT YEAR. THIS WAS AFFECTING JAPANESE ATTITUDES TO THE TIMING OF THE NEXT ECONOMIC SUMMIT. SINCE THE NEGOTIATIONS WERE TAKING PLACE IN THE CONTEXT OF THE PRELIMINARIES TO THE LDP PRESIDENTIAL ELECTION WHICH WAS LIKELY TO LEAD TO THE RE-ELECTION OF SUZUKI AND A CABINET RESHUFFLE THERE COULD BE CONSTRAINTS ON WHAT MATSUNAGA COULD SAY ABOUT THE TIMING OF THE SUMMIT AT THE NEXT MEETING OF PERSONAL REPRESENTATIVES IF THAT WERE TO TAKE PLACE BEFORE THE DOMESTIC POLITICAL PACKAGE HAD BEEN TIED UP IN JAPAN.
2. NONE OF US HAS AS YET OBTAINED ANY CORROBORATION OF THE POSSIBILITY THAT SUZUKI MIGHT STEP DOWN NEXT SUMMER, ALTHOUGH IT HAS LONG SEEMED POSSIBLE THAT IF RE-ELECTED THIS AUTUMN HE WOULD NOT STAY AS PRIME MINISTER FOR A FULL 2 YEAR TERM. IN PARTICULAR I HAVE NOT FOUND AN OPPORTUNITY SO FAR TO SOUND OUT MATSUNAGA ON THIS. PLEASE THEREFORE PROTECT ENDO'S CONFIDENCE, WHICH IN ANY CASE WAS ESSENTIALLY PREDICTION RATHER THAN ACCOMPLISHED FACT.
3. SPECIFICALLY ENDO MADE THE FOLLOWING POINTS:
 - (A) THERE WOULD PROBABLY BE A NATION-WIDE ELECTION FOR THE UPPER HOUSE OF THE DIET IN LATE JUNE (IT HAS BEEN RUMORED THAT THERE COULD BE AN ELECTION FOR THE LOWER HOUSE AT THE SAME TIME):
 - (B) SUZUKI WAS LIKELY TO STEP DOWN BEFORE THEN. ARRANGEMENTS FOR THIS WERE BEING DISCUSSED WITHIN THE PARTY NOW AND WOULD INCLUDE AGREEMENT ON THE RE-ELECTION OF SUZUKI IN NOVEMBER, OR JUST POSSIBLY LATE OCTOBER, FOLLOWED BY A CABINET RESHUFFLE:
 - (C) BECAUSE OF COMMITMENTS IN THE DIET THE EASIEST TIME FOR SUZUKI TO GET AWAY FROM JAPAN FOR THE SUMMIT WOULD BE BETWEEN ABOUT 25 APRIL AND 20 MAY:

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(D) A SUMMIT IN THAT PERIOD WAS THEREFORE LIKELY TO BE
SEEN BY SUZUKI AS HIS SWAN SONG AS PRIME MINISTER.

CORTAZZI

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HJ/ER

HJ/FE

PS

PS/PUS

SIR J. BULLARD

MR GIFFARD

MR EVANS

MR DONAH

MR THOMAS

COPIES TO:

SIR R. ARMSTRONG,
CABINET OFFICE

MR COLES No 10 DSL

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TO IMMEDIATE F C O

TELEGRAM NO 541 OF 13 SEPTEMBER

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Mr Spiffard

Mr Donald

No 10 D.S.

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PRIME MINISTER'S VISIT: SITUATION IN JAPAN

1. MR SUZUKI WILL BE MUCH PREOCCUPIED WITH DOMESTIC POLITICS WHEN HE RECEIVES THE PRIME MINISTER IN THE NEXT FEW DAYS. THE ODDS ARE STILL ON HIM BEING RE-ELECTED AS PRESIDENT OF THE LIBERAL DEMOCRATIC PARTY (LDP), AND HENCE PRIME MINISTER, IN OCTOBER/NOVEMBER FOR THE NEXT TWO YEARS. BUT AGAINST A BACKGROUND OF INCREASING ECONOMIC DIFFICULTIES AND SUZUKI'S OWN DECLINING POPULARITY THERE ARE THE FIRST INDICATIONS OF SERIOUS MOVES AGAINST HIM FROM WITHIN THE PARTY.

2. THE LATEST OPINION POLLS SUGGEST THAT HE AND HIS CABINET HAVE THE SUPPORT OF ONLY 30% OR LESS OF THE POPULATION WITH 50% EXPRESSING OPPOSITION. THE LDP AS A WHOLE HAS MAINTAINED A CONSIDERABLY HIGHER LEVEL OF POPULAR SUPPORT AND THIS HAS LED TO DOUBTS ABOUT WHETHER SUZUKI IS THE RIGHT MAN TO LEAD THE PARTY INTO THE NEXT GENERAL ELECTION WHICH HAS TO TAKE PLACE WITHIN THE NEXT TWO YEARS.

3. MRS THATCHER WILL BE MEETING ALMOST ALL OF THE PRINCIPAL ACTORS IN THIS POLITICAL DRAMA. THE CRITICAL MOMENT WILL COME IN OCTOBER WHEN NOMINATIONS OF CANDIDATES FOR THE PRESIDENCY CLOSE. POTENTIAL RIVAL CANDIDATES ALL OF WHOM THE PRIME MINISTER WILL MEET ARE NAKAGAWA, DIRECTOR GENERAL OF THE SCIENCE AND TECHNOLOGY AGENCY, KIMOTO, DIRECTOR GENERAL OF THE ECONOMIC PLANNING AGENCY, NAKASONE DIRECTOR GENERAL OF THE ADMINISTRATIVE MANAGEMENT AGENCY AND FORMER PRIME MINISTER FUKUDA, WHO MAY WELL HOLD THE KEY.

4. PERSONALITIES COUNT MUCH MORE THAN POLICIES

AND MOST ISSUES ARE DECIDED ON THE BASIS OF WHO CAN DELIVER

ECONOMIC POLICIES, SPECIFICALLY FOR DOING NOTHING TO
REFLATE THE JAPANESE ECONOMY AT A TIME OF VIRTUAL STAGNATION.
STATEMENTS ON ECONOMIC POLICY IN JAPAN IN THE NEXT FEW WEEKS
WILL HAVE MUCH MORE TO DO WITH THE LDP PRESIDENTIAL ELECTION
THAN WITH THE MANAGEMENT OF THE JAPANESE ECONOMY.
SUBSTANTIAL CHANGES WILL, HOWEVER, HAVE TO BE MADE IN 1983
TO ESTABLISHED GOVERNMENT POLICIES ON ELIMINATING THE BUDGET
DEFICIT OR INTRODUCING NEW TAXES.

CORTAZZI

NNNN

SAVING TELEGRAM

Japan
Telex

BY BAG

FROM TOKYO TO FCO

TELNO 6 SAVING

UNCLASSIFIED [CULL]

Addressed to FCO Telegram No 6 Saving of 13 July 1982

Repeated for information Saving to: Paris, Rome, Bonn, Washington, Brussels, The Hague, Dublin, Stockholm, UKREP BRUSSELS, UKMIS GENEVA, UKDEL OECD, Ottawa, Bangkok, Canberra, Peking, Seoul, Jakarta, Singapore, Manila, Kuala Lumpur, Governor Hong Kong, BTC Hong Kong, Osaka.

JAPAN: MONTHLY ECONOMIC REPORT - MAY/JUNE 1982

Key Indicators

		% Change Over	
	<u>May</u>	<u>Previous Month</u>	<u>Year Earlier</u>
Industrial Production (SA)	145.0	- 1.6	1.4
	<u>June</u>		
Wholesale Prices (NSA)	135.9	0.2	1.1
Consumer Prices (Tokyo) (SA)	107.8	0.8	2.5

Official Discount Rate: 5.5% from 11.12.81

<u>Balance of Payments</u> <u>(\$ Million)</u>	<u>May</u>	<u>April</u>
Exports (SA)	11,676	12,319
Imports (SA)	9,933	10,450
Trade Balance (SA)	1,743	1,869
Invisibles (NSA)	- 1,225	- 856
Current Balance*	518	1,013
Long-term Capital (NSA)	- 567	- 1,975
Basic Balance*	- 49	- 962
Short-term Capital and E & O (NSA)	1,762	- 1,749
Overall Balance*	1,713	- 2,711

*Using seasonally-adjusted trade figures

	<u>Foreign Exchange Reserves</u> <u>(\$ Million)</u>	<u>¥/\$ Exchange Rate</u> <u>(Central Trading Rate)</u>
End-April	26,807	235.10
End-May	26,543	243.50
End-June	25,487	254.00
9 July		256.60

General

1. The Japanese economy continues to stagnate with production and shipments falling and inventories rising. An incipient recovery in personal consumption is not yet firmly established and business fixed investment is weakening. Public sector investment has not yet responded to the Government's policy of accelerating public works expenditure into the first half of the Fiscal Year, and housebuilding is still in slump. /2.

2. A major reason for the recession is the weakness of exports, with the result that export-related industries, such as cars and electrical machinery, are now joining the so-called structurally depressed industries such as aluminium-smelting, pulp and paper and petro-chemicals, in laying off labour or at least taking on no new employees. The steel industry, too, is suffering from lack of demand both at home and abroad.
3. Most surveys reveal an expectation that business conditions will improve, if only gradually, in the second half of the Fiscal Year as domestic demand (largely personal consumption) and the world economy begins to recover. The general outlook is for real GNP growth of about 3% this year, only a marginal improvement on FY 1981, but that a return to more normal growth, if still below the 5% to which Japan had been accustomed after the first oil crisis, is possible for FY 1983.
4. In the meantime labour conditions are deteriorating, but inflation, with the effect of the weakening exchange rate being offset by falling world commodity prices, remains stable at a low level.
5. The current account surplus is tending to fluctuate quite widely from month to month, but for the first five months of this Calendar Year it amounted to a seasonally-adjusted \$2.5 billion. The long-term capital outflow in May was much reduced from recent months but this is expected to be only temporary. In addition there was a large short-term capital inflow, so that the overall balance turned from deficit to surplus. With the interest-rate differential as wide as ever, the exchange rate has continued weak, tending to stabilise at just below ¥260 = \$1.
6. In these conditions Government policy is taking a distinct wait-and-see attitude. On the exchange rate there is no inclination to invoke exchange controls or the special discount rate (the so-called Lombard rate) and given the state of the economy there is little scope for a concerted rise in interest rates. The Bank of Japan through its money market operations has kept short-term interest rates up and in the bond market yields have risen under pressure of the Government's future funding requirements. In addition the Bank of Japan has been intervening in the exchange market but its ambitions there are restricted to limiting and smoothing the weakening yen. At the same time the Ministry of Finance has offered some informal guidance to restrain capital outflows.
7. The shortfall in budget revenue for FY 1981 finally amounted to ¥2.5 trillion, made up of a shortfall in tax revenue of ¥2.9 trillion, a surplus of non-tax revenue of ¥0.1 trillion and unspent votes of ¥0.3 trillion. This shortfall will be met in the first instance by means of borrowing, largely, from the National Debt Consolidation Fund. These funds, however, have to be repaid by the end of FY 1983, so that further decisions on financing will have to be taken eventually.
8. In addition no decision has been taken yet on the means of funding the prospective revenue shortfall for the current Fiscal Year, which is likely to be in the region of ¥4 trillion. And, a final element of indecision, the Government will wait until at least September, when the April-June GNP figures are available, before deciding whether to provide some stimulus to the economy in the form of additional public works spending in a supplementary budget.
9. It is in these conditions that the process of formulating the FY 1983 budget has just begun. The Ministry of Finance are calling for an increase in general expenditure, i.e. other than grants to local authorities, which are fixed at 32% of certain tax revenues, and debt service costs, of only ¥477 billion or 1.46% above the level of FY 1982. Within this total some expenditure items will rise quite markedly as in recent years, e.g. defence + 7.3%, ODA + 11.4%, energy measures +15.3%, pensions + 5%. But for the rest, the ceiling is set at minus 5%, although certain other exemptions mean that in effect the 5% cut will apply to only about 17% of total general expenditure.

Production, Shipments and Inventories

10. The seasonally-adjusted index of industrial production (mining and manufacturing, preliminary) fell in May by 1.6% (the April figure has been revised substantially downwards) and now stands only 1.4% above its level of a year earlier. Apart from an isolated rise in March this index has now fallen every month since last November.
11. As before, sluggish exports combined with stagnant domestic demand are the causes of the fall in output. Falls in production in May were widespread and occurred in general machinery (- 4.7%), precision machinery such as watches and cameras (- 4.7%), transport machinery (- 4.2%, with output of motor vehicles falling by 4.9% and dropping below its year-earlier level for the fourth time in 5 months), non-ferrous metals (- 3.9%), chemicals (- 2.6%), petroleum and coal products (- 2.4%), iron and steel (- 2%) and miscellaneous goods (- 3%). The only marked rise was noted in electric machinery (+ 1.1%), where demand for refrigerators, air-conditioners, colour TV sets, integrated circuits and video tape-recorders remained stable. The boom in video tape-recorders, however, seems to be levelling out which could begin to show up in the statistics in coming months. Other production increases occurred in the metal product and ceramics industries.
12. The seasonally-adjusted index of producers' shipments also fell slightly in May, by 0.1% from an April figure which again had been revised substantially downwards; the index stood only 0.8% above its year-earlier level.
13. The seasonally-adjusted index of producers' inventories rose in May by 0.4%, for the sixth successive month, to stand 2.2% above its level of a year earlier. And finally, the seasonally-adjusted producers' inventory to shipments ratio continued its climb of recent months, rising by 0.3% in May and standing 1.1% above its year-earlier level.
14. The latest MITI forecast for manufacturing production is for an increase of 2.7% in June followed by a fall of 1.1% in July,

Business Conditions

15. In the January-March quarter, according to a Ministry of Finance report, the operating profits of nearly 20,000 companies (excluding banks, securities and insurance companies with capital over ¥10 million) were 6.4% above their level of the corresponding quarter of the previous year. This represented an acceleration in profits growth from the 4.7% registered in the October-December 1981 quarter. The growth of sales, however, was slower, falling from 9.7% on a year earlier in October-December to 7.6% in January-March. Manufacturing companies followed this trend with an increase in profits growth from 9.4% to 27% accompanied by a decline in sales growth from 10% to 7.9% over the two quarters in comparison with a year earlier. In the case of construction companies, however, both profits and sales growth declined.
16. In the Bank of Japan's latest short-term survey of major enterprises the general attitude revealed is that while the first half of the current Fiscal Year is proving difficult, it is expected that there will be an improvement in the second half. This view is based on the expectation of a gradual recovery in exports, but the Bank of Japan questions this attitude in the light of the weakness of the world economy, implying that it does not see much prospect of any significant recovery being based on exports.
17. The survey of 4,586 companies suggested that manufacturers expect production and sales, which declined in the January-March quarter, to
- /show

show little improvement over the next two quarters. In the first half of the current Fiscal Year, therefore, they expect pre-tax profits to decline from a year earlier. In the second half-year, however, they expect sales to rise 5.8% above their year-earlier level as exports and domestic demand recover.

18. All of the big 4 securities companies have recently produced business surveys. Again the picture is declining sales and profits in the first half of the Fiscal Year to be followed by a recovery in the second half.

19. Finally, a quarterly survey of 1,900 companies capitalised at ¥100 million or more conducted in mid-May by the Economic Planning Agency reported that most business managers expect the domestic economy to remain in the doldrums for some time, but the view that it will begin to recover in the final quarter of this year is increasingly gaining ground.

Investment

20. A survey of 280,000 companies with capital of ¥10 million or more by the Ministry of Finance reports that in the January-March quarter equipment investment rose only 1.8% from the year before. Reflecting the current economic uncertainty, both large and small companies are tending to hold back on investment spending. As a result corporate liquidity is increasing with holdings of both bank deposits and securities rising sharply.

21. The Small Business Finance Corporation reports that plant and equipment investment by small and medium-size companies (defined as those between 20 and 299 employees) rose 3.7% in FY 1981 but that in the current Fiscal Year it will decline by 21.8%. It is in this area that the Government in its official economic forecast was expecting a recovery in investment this year.

22. In the steel industry, too, there are reports that faced with poor profits prospects major companies are planning to cut back sharply on their planned investment expenditure. For the industry as a whole fixed investment originally planned for this year amounted to ¥1,111 billion, an increase of 36% on last year. It now seems likely that the figure will fall below ¥1 trillion.

23. In contradiction to this bleak outlook, however, private domestic orders for machinery (excluding ships) in May were sharply up on the previous month's depressed level and stood nearly 21% higher than a year earlier. The increase was partly attributable, however, to orders for new computer models recently introduced. Construction orders, too, both private and public, rose sharply in May compared with the previous month, but on the year-ago comparison they were 19% and 12% down respectively.

24. Housing starts in May, at 97,000 units, were 11% down on the month and 22% down on a year earlier. By floor area housing starts were 16.5% down on the year. The Government has for some time been seeking to boost house building, but so far there has been no sign of success for their efforts. However, applications for housing loans are said to be on the rise and the fall in house building may soon level off.

25. Public works disbursements in June were marginally below those of May and 3.3% down on a year ago. There is little sign yet of the results of the Government's policy of bringing forward public works expenditure into the first half of the Fiscal Year.

Consumers' Expenditure

26. The indications are that the recovery in consumer spending is continuing though it still lacks strength. In April, the latest month for which figures are available, expenditure by all households was 1.1% above its year-earlier level. This is the fourth consecutive month of increase, but the rate of increase is slower than in the past two months when it stood at over 3%.

27. In wage-earners' households the increase in real income in April was 3.5% and in disposable income as much as 3.9%. Consumption spending, however, was only 0.6% above a year ago, partly because in the previous year there was a rush of spending to beat increased taxation on cars and liquor. Nevertheless, in the latest month there was an increase in spending on durable consumer goods such as furniture and on non-essential items which reflects increasing consumer confidence.

28. The rate of growth in bank notes outstanding slowed in June to 6.7% from 7.6% in the previous two months. The Bank of Japan attributed this partly to the fact that mid-summer bonuses were up only 5% from a year before and partly to a slow down in sales of summer clothing. In May, however, summer clothing sales had been brisk, contributing to a rise in Department Store sales of 4.2% on the year. Sales of Supermarkets (up 10.2% on the year) and Chain Stores also rose strongly in May, although the growth of food sales slowed down to 6.5% from the previous month's 8.5%. The overall retail sales index rose 0.2% on the month in May to stand 3.7% below its year-earlier level.

29. In June, a bonus month, sales of motor vehicles rose sharply, by 21%, to stand 9% up on the year. But this strong performance was caused partly by a slump in sales in June 1981 after the imposition of increased taxation. Sales of small cars (550 - 2,000 c.c.), which make up over 70% of all vehicle sales, rose 18.1%, but sales of larger cars fell by 16.4%, while those of trucks were down 8.1% and buses down 1.4%. Sales of mini vehicles (under 550 c.c.) were up 5.7% from the year before.

Labour and Employment

30. The employment situation continues to deteriorate. Although there was no rise in the seasonally-adjusted unemployment rate in May, which remained at 2.35%, the number of unemployed edged up from 1.35 million to 1.36 million and, more significantly, the job openings/job seekers ratio fell sharply from 0.62 to 0.58, the lowest level for nearly 4 years. The number of job offers in depressed industries such as civil engineering and construction continues to fall; and in addition such export-related industries as machinery, cars and electric machinery have now cut back sharply on job offers because of slack production. As a result the Labour Ministry is calling for emergency employment measures to be taken by prefectural governments including the application of the Employment Adjustment Subsidy System* to give financial help to hard-pressed companies to encourage the employment of new workers.

*Under this system when companies whose volume of business has decreased as a result of recession lay off workers temporarily or give them education and training to avoid outright dismissal, the Government grants a subsidy for the payment of a part of the allowances paid to such workers by their employers. The industries eligible for this subsidy are those whose production in the latest 3 months has fallen by more than 5% compared with the same 3 months of the previous year and is not expected to recover quickly thereafter. The Labour Ministry selects such designated industries of which at April 1982 there were 243.

31. The weak economic and labour situation is reflected in the index of hours worked in manufacturing industry which fell to 95 in May from 100.6 in April; and in the index of overtime hours worked, down from 98.2 in April to 90.3 in May.

32. Faced with slowing economic growth trade unions are beginning to turn their attention towards securing shorter working hours and better working conditions. In this context the Government have recently accepted guidelines setting a limit of 50 hours a month to the amount of overtime that can be worked. This follows recommendations from a panel of management, unions and academics and is not legally binding. The new guidelines, which the unions have been calling for since 1977, take effect from January next year. At present they would not have much effect since overtime hours are at a low level, averaging about 21 hours a month in the car industry and 16 hours in steel mills.

Prices

33. Wholesale prices in June rose by 0.2% on the month to stand only 1.1% above their level of a year earlier. The depreciation of the exchange rate contributed 0.6%, but a large part of this was offset by falls in commodity prices.

34. The all-nation consumer price index for May rose by 0.4% on the month to stand 3.2% up on a year earlier. The rise was more than accounted for by seasonal factors and the seasonally-adjusted index fell by 0.2% on the month.

35. In June the Tokyo consumer price index rose 0.1% to stand 2.5% up on the year. The main factor was the declining prices of seasonal vegetables and fruit, resulting in a fall of 0.2% in the price of food. The seasonally adjusted index rose 0.8%, a sharper rise than in recent months.

36. The only threat to the continued stability of prices remains the weakness of the yen, but this appears to have had no appreciable effect so far. However, on the domestic scene, the steel industry, in weak economic conditions, are about to introduce a price increase of 5% after negotiations with their major customers.

Monetary Developments

37. The money supply (M2 + CDs) in May registered a year-on-year growth rate of 9.4%, marginally above that of the previous month. The seasonally-adjusted rise on the month was 0.7% reversing a fall of the same order in April. The Bank of Japan continued to absorb surplus funds from the money market in order to keep short-term interest rates up. The Bank of Japan's projection for broad money-supply growth in the July-September quarter is around 9%, rather below the previous quarter's 10-11%.

38. The average interest rate on all bank loans continued its long decline in May, despite the modest rise in money-market rates, falling to 7.21% from 7.236% in April.

39. The Bank of Japan's window guidance on bank lending for the July-September quarter maintains the relaxed monetary stance, but the permitted increases are lower than for previous quarters and reflect the Bank of Japan's feeling that the money supply has been growing at near the top end of its range and cannot be allowed to grow more rapidly.

40. In the corresponding quarter of last year actual lending was allowed to exceed the window guidance ceilings by a substantial margin, so that the

new ceilings, while they represent a considerable increase on the previous ceilings, are relatively modest in relation to the actual lending in the corresponding quarter of last year. For City banks the ceiling on incremental lending over the same quarter a year ago is raised by 26.3% (actual increase 1.5%); for Trust banks the ceiling is raised by 16.3% (actual 3.5%); and for Long-Term Credit banks by 18.4% (actual down 6.9%).

41. Short-term money market rates have tended to stabilise in June and the early part of July:

	Call Loans (Unconditional Median)	Bill Discount (Over 2 months)	Gensaki (3 months' repurchase)
End-May	7.125	7.25	7.079
End-June	7.125	7.3125	7.195
9 July	7.125	7.3125	7.166

42. In the bond market, the weakness of the yen and uncertainty over the Government's issuing intentions led to thin trading and selling by City banks. In these circumstances yields have continued to rise markedly:

	<u>10-Year Government Bonds</u>	
	6.1% <u>No. 10</u>	8% <u>No. 25</u>
End-May	8.76	8.08
End-June	9.15	8.52
9 July	9.10	8.50

At this level secondary-market yields are well above the prevailing Government issue yield of 7.81% and negotiations are in train between the Ministry of Finance and the underwriting syndicate for an increase in the issue yield. The syndicate are seeking an increase of around 0.8%, while the Ministry of Finance are suggesting 0.3% or 0.4%. At the time of writing the negotiations have not been completed and it is not yet clear whether an issue of 10-year bonds will be made in July. The banks have made it clear that they will not underwrite the bonds unless the issue yield is raised. However, an issue of ¥101.2 billion of 2-year bonds will be made at an average price of ¥98.61 giving a yield of 7.998%.

43. The stock market, too, has suffered from the weakness of the yen and from the slump in the US stockmarket and trading has been at a low level. Prices have fallen steadily and although there was a mild recovery towards the end of June, gains were quickly lost in early July as Hitachi and other computer company shares were affected by the industrial espionage case.

The Balance of Payments

44. The seasonally-adjusted current account surplus in May was almost halved from its April level to \$518 million. Both exports and imports fell in value, by 5.2% and 4.9% respectively, and in volume by 8.4% and 7.8% respectively. As a result the seasonally-adjusted trade surplus was little changed at \$1,743 million.

45. On an unadjusted basis the current surplus fell from \$541 million in April to only \$76 million in May. Compared with a year ago exports fell in value by 6.3% and imports by 11.1%. The decline in the value of exports was more than accounted for by a fall of 7.1% in volume, but the volume of

imports fell only 1% so the decline in value was largely accounted for by lower prices.

46. On a commodity basis, falls in exports or smaller rises were widespread, but the main weakness was in exports of ships which in May were 39% down on a year earlier. The value of car exports was little changed, with increasing shipments to the United States and the Middle East being offset by a sharp drop in exports to Europe. The main cause of the decline in imports rests with crude oil, which was down 31% in value on a year ago (volume down 24%, prices down 9%). Imports of other raw materials were down by 6% in value, while imports of manufactured goods were up by 3%.

47. There is no sign of any reversal of the weak trend of exports over the next few months: the value of export contracts won by 13 major trading companies showed the first year-on-year decline for 4 months, while import contracts showed a sharp rise as a result of price increases for coal and iron-ore. Export letters of credit in June (seasonally-adjusted) were down 2.7% on the month and 5.3% on their year-earlier level.

48. The invisibles deficit widened from \$856 million in April to \$1,225 million in May largely because of a net outflow of investment income: there was a sharp reduction in receipts of direct investment income and an outflow of interest payments resulting from quarterly interest on Government bonds.

49. The outflow of long-term capital was much reduced, from \$1,975 million in April to \$567 million in May. There was a reduction in Japanese purchases of overseas securities largely as a result of informal guidance to insurance companies; but the main cause was a sharp increase in foreign purchases of Japanese securities, which occurred largely in the early part of May when the yen was tending to strengthen. Net purchases of stocks amounted to \$143 million following net sales in the previous month of \$70 million; and net purchases of bonds rose from \$157 million in April to \$1,230 million in May. It is likely that the net outflow of long-term capital will rise sharply again in June.

50. The short-term capital account recorded an inflow of \$623 million following the previous month's large outflow as a result of a net inflow of \$1,224 million into the gensaki market as securities companies sold bonds on a repurchase basis to overseas subsidiary companies. In addition there was an increased inflow of unidentified capital under errors and omissions amounting to \$1,139 million. The unidentified inflow so far this Calendar Year amounts to \$4.1 billion and is causing some puzzlement to the authorities.

51. The overall balance, using seasonally-adjusted trade figures, recorded a surplus in May of \$1,713 million for the first time since January. On an unadjusted basis the overall surplus was \$1,271 million. The reserves fell by \$264 million and the banks reduced their net short-term foreign liabilities by \$1.6 billion.

52. The yen weakened steadily against the dollar for most of June from ¥243.50 at end-May to ¥258.70 just before the end of the month. The rate then fluctuated close to this level and stood at ¥256.60 on 9 July.

Recent Forecasts

53. A spate of recent short-term forecasts put real GNP growth for FY 1982 in the range 2.3% to 3.2%. Most represent a downward revision to earlier forecasts and all see some acceleration of growth towards the end of the Fiscal Year. Mitsubishi Economic Research Institute, which is at the upper end of the range for FY 1982, forecasts 4.6% growth in FY 1983. For FY

1982 the Japan Economic Research Centre puts real growth at 2.5%, with real consumer spending growing by 2.9%. Of total growth 2.1% is expected to come from domestic demand and 0.4% from the external sector. JERC put the current account surplus in FY 1982 at \$11.5 billion. Other forecasts, with a slightly higher growth rate, predict a slightly lower current account surplus.

54. The Economic Planning Agency, commenting on the OECD's latest Economic Outlook, took issue with the forecast of 2% for Japanese real GNP growth in CY 1982 on the grounds that it was too low and that consumer spending would recover and the results of the Government's acceleration of public works expenditure would in due course produce results.

55. Finally, a forecast from the Long-Term Credit Bank of Japan - it has been predicted that with the present birth-rate of 1.7 to a family the population of Japan will fall to about 2,000 in 2000 years' time, bringing an end to all budget problems.

56. And on the trade front, despite the self-sufficiency syndrome and apparent trade barriers, the latest issue of the Sumitomo Bank Review reports that one sector of Japanese imports rose by 84% in 1981 - feathers, to a total of 4,404 tons.

WHITEHEAD

FINANCIAL
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THIS TELEGRAM
WAS NOT
ADVANCED

S T A T I S T I C S

Latest Month MAY - except where stated

All statistics seasonally adjusted, except where stated

R - Revised

	Latest Month	Previous Month	% change over	
			Previous Month	Year ago (NSA)
Industrial Production	145.0	147.3R	- 1.6	1.4
Shipments	137.3	137.5R	- 0.1	0.8
Inventories of Finished Goods	118.0	117.5R	0.4	2.2
Inventories to Shipments Ratio	93.5	93.2R	0.3	1.1
Wages and Salaries				4.6
Job Openings/Job Seekers	0.58	0.62		
Number of Unemployed	1.36 M	1.35 M	0.7	
Number of Unemployed (NSA)	1.34 M	1.43 M		1.5
Rate of Unemployment (NSA)	2.3	2.5		
Rate of Unemployment	2.35	2.35		
Department Store Sales (NSA)	161.1	157.3	2.4	4.2
Index of Retail Sales	119.7	119.5R	0.2	- 3.7
Wholesale Price Index (NSA) JUNE	135.9	135.6	0.2	1.1
Consumer Price Index (NSA) (all nation)	106.6	106.8	- 0.2	2.3
Consumer Price Index (NSA) (Tokyo) JUNE	107.8	106.9R	0.8	2.5
Average Interest Rate on Bank Loans	7.215	7.236		
Bank of Japan Notes in Circulation (NSA) JUNE				6.7
Money Supply M2+CD (NSA)				9.4
Stock Exchange Index (First Section) JUNE	540.6	555.7		
No of Business Failures (Tokyo Shoko)	1,456	1,486		
Housing Starts (Private) (1000 SQ M) NSA	8,561	9,948		- 16.5
Public Works Disbursements (Billion Yen) NSA JUNE	320.6	324.7		- 3.3
Private Domestic Orders for Machinery (Less ships) (Billion Yen)	642.4	455.6	41.0	20.8

	Latest Month	Previous Month	% change over	
			Previous Month	Year Ago (NSA)
Trade Balance SA	¥M	¥M		
NSA	1,743	1,869		
Invisible Balance (NSA)	1,301	1,397		
Current Account (SA)	-1,225	- 856		
Long Term Capital (NSA)	518	1,013		
Short Term Capital and Errors and Omissions (NSA)	- 567	- 1,975		
Overall Balance NSA	1,762	- 1,749		
SA	1,271	- 3,183		
Total Imports (IMF basis, NSA)	1,713	- 2,711		
" " (IMF basis, SA)	10,105	10,741		- 11.1
Japanese Imports from UK (Customs Clearance Basis, NSA CIF)	9,933	10,450	- 4.9	
Japanese Imports from the EEC (CC, NSA)	163	206		- 21.0
Japanese Imports from the USA (CC, NSA)	664	693		- 1.1
Total Exports (IMF basis, NSA)	2,009	2,245		3.7
" " (IMF basis, SA)	11,406	12,138		- 6.3
Japanese Exports to UK (CC, NSA)	11,676	12,319	- 5.2	
Japanese Exports to the EEC (CC, NSA)	368	432		- 33.5
Japanese Exports to the USA (CC, NSA)	1,328	1,613		- 27.4
Export Letters of Credit JUNE	3,107	3,258		1.9
Foreign Exchange Reserves (Japanese definition) at end JUNE	7,887	8,102	- 2.7	- 5.3
Ratio of Imported Raw Materials held by Producers to Consumption APRIL	25,487	26,543		
Export Prices (Yen basis, NSA)	130.0	130.3R	- 0.2	12.4
Import Prices (Yen basis, NSA)	109.2	111.5	- 2.1	2.8
Trade Terms	165.8	169.7	- 2.3	4.0
Export Volume (NSA)	85.3	82.6		
Import Volume (NSA)	155.9	170.4		- 7.1
	122.6	129.5R		- 1.0

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FM TOKYO 250710Z FEB 82
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TELEGRAM NUMBER 9010F 25 FEBRUARY
INFO WASHINGTON, BONN, PARIS, UKREP BRUSSELS, UKDEL DECD

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Japan

JAPAN : THE ECONOMY

1. THE YEN EXCHANGE RATE, HAVING WEAKENED ALMOST CONTINUOUSLY FROM AROUND Y218 EQUALS US DOLLARS 1 AT THE BEGINNING OF JANUARY TO A LOW POINT OF Y240.90 ON 16 FEBRUARY, SUDDENLY RECOVERED ON INDICATIONS OF A FALL IN US INTEREST RATES TO Y230.30 ON 22 FEBRUARY. IT IS TOO EARLY TO SAY WHETHER US INTEREST RATES ARE FIRMLY OFF THEIR PEAK AND THEREFORE WHETHER THE YEN IS SET TO STRENGTHEN, BUT THE BANK OF JAPAN VIEW IS THAT FROM NOW ON THE EXCHANGE RATE WILL REFLECT MORE CLOSELY THE FUNDAMENTALS OF THE ECONOMY. WHILE THE YEN WAS WEAKENING AGAINST THE DOLLAR THE BANK OF JAPAN INTERVENED MODESTLY TO EASE THE FALL, BUT NO SPECIFIC MEASURES HAVE BEEN TAKEN OR ARE IN THE PIPELINE TO RESTRAIN THE OUTFLOW OF JAPANESE CAPITAL. IN THE MEANTIME JAPAN HAS ADDED ITS VOICE TO THOSE CALLING ON THE UNITED STATES TO PAY MORE ATTENTION TO THE EFFECT ON OTHER COUNTRIES OF ITS OWN MONETARY POLICY.

2. ALL THE INDICATIONS ARE THAT REAL GNP GROWTH IN THE OCTOBER-DECEMBER QUARTER, DETAILS OF WHICH WILL BE RELEASED TOWARDS THE MIDDLE OF MARCH, WILL TURN OUT TO HAVE BEEN NIL OR EVEN NEGATIVE. THIS IS LIKELY TO GIVE RISE TO PRESSURE FOR SOME STIMULATORY FISCAL ACTION. NEITHER THE BANK OF JAPAN NOR THE LEADERS OF THE KEIDANREN ARE IN FAVOUR OF ANY MAJOR STIMULUS, THOUGH MITI, THE EPA AND SOME PARTS OF INDUSTRY, EG CONSTRUCTION, ARE. MR KOMOTO IS LIKELY TO MEET THE PRESSURE BY ANNOUNCING THE INTENTION OF ACCELERATING THE AWARDED OF PUBLIC WORKS CONTRACTS IN THE FIRST HALF OF THE COMING FISCAL YEAR TO A LEVEL OF 75% OR MORE OF BUDGETED EXPENDITURE (THE EQUIVALENT FIGURE IN THE CURRENT FISCAL YEAR WAS AROUND 70%). HE MAY ALSO INTRODUCE SOME MEASURES TO EASE FINANCING TO SMALL BUSINESS. BUT NO FURTHER FISCAL BOOST SEEMS LIKELY UNLESS THE ECONOMY CONTINUES TO STAGNATE UNTIL THE APRIL-JUNE QUARTER. THE LIKELIHOOD IS THAT THERE WILL BE A GRADUAL RECOVERY IN CONSUMERS' EXPENDITURE, FIXED INVESTMENT (ESPECIALLY BY SMALL AND MEDIUM-SIZE FIRMS), HOUSING AND INVENTORIES, SO THAT REAL GNP GROWTH, WHICH WILL REACH ABOUT 3.5% IN THE CURRENT FISCAL YEAR, WILL RISE TO AROUND 4% NEXT YEAR.

3. THE MINISTRY OF FINANCE ARE EXPECTING A FURTHER SHORTFALL IN TAX REVENUE THIS YEAR OF ABOUT Y1 TRILLION OVER AND ABOVE THAT ALREADY ALLOWED FOR IN THE SUPPLEMENTARY BUDGET, BUT THIS WILL BE FINANCED OUT OF RESERVES OF THE NATIONAL DEBT CONSOLIDATION FUND AND THEREFORE CAUSES NO CONCERN. IT IS THE POSSIBILITY, ENGENDERED BY LOWER GROWTH THAN THE OFFICIALLY EXPECTED 5.2% , OF A FURTHER SUBSTANTIAL SHORTFALL NEXT YEAR THAT IS MORE WORRYING TO THE GOVERNMENT SINCE IT WILL NECESSITATE THE ABANDONMENT OF ITS AIM OF ELIMINATING DEFICIT-COVERING BONDS BY FY 1984.

4. IN THE OCTOBER-DECEMBER QUARTER PRODUCTION AND SHIPMENTS CONTINUED TO INCREASE WHILE EXPORT VOLUME DECLINED.

RESTRICTED

/THIS

THIS IS BEING TAKEN AS A SIGN THAT THE HOPED-FOR UP-TURN IN DOMESTIC DEMAND HAS AT LAST BEGUN TO APPEAR. IT IS TOO EARLY TO SAY THAT JAPAN'S EXPORT PERFORMANCE IS WEAKENING: EXPORTS TO THE UNITED STATES ARE CONTINUING STRONG, WHILE THOSE TO EUROPE AND TO SOUTH-EAST ASIA HAVE MERELY LEVELLED OFF. THERE HAS AT THE SAME TIME BEEN AN INCREASE IN IMPORTS BUT THIS IS ATTRIBUTED PARTLY AT LEAST TO TEMPORARY FACTORS, SUCH AS A JUMP IN IMPORTS OF CRUDE OIL AND NONMONETARY GOLD. AS A RESULT IN NOVEMBER AND DECEMBER THE CURRENT ACCOUNT TURNED INTO MODEST DEFICIT, SO THAT THE OUT TURN FOR THE CURRENT FISCAL YEAR NOW SEEMS LIKELY TO BE IN THE REGION OF A 7 BILLION DOLLAR SURPLUS RATHER THAN THE OFFICIALLY EXPECTED 10 BILLION DOLLARS.

5. MEANWHILE INFLATION REMAINS UNDER CONTROL WITH WHOLE SALE PRICES IN JANUARY 2.1 PER CENT UP ON A YEAR EARLIER AND TOKYO CONSUMER PRICES 3.4 PER CENT UP. APART FROM THE EFFECTS OF THE WEAKNESS OF THE YEN THERE ARE NO MAJOR INFLATIONARY FACTORS IN THE OFFING: THE OUTLOOK FOR THE COMING SPRING WAGE OFFENSIVE IS FOR SETTLEMENTS IN THE REGION OF 7 PER CENT GIVING ONCE AGAIN ONLY A MODEST REAL INCREASE IN PERSONAL SPENDING POWER AFTER ALLOWING FOR A FURTHER YEAR'S TAX-BRACKET CREEP.

6. THERE APPEARS TO BE NO GREAT PROSPECT THAT THE GOVERNMENT WILL RESPOND IN ANY MAJOR WAY TO THE VARIOUS PRESSURES, BOTH DOMESTIC AND EXTERNAL, ON IT TO REFLATE. THERE ARE TWO REASONS FOR THIS. ONE IS THAT THE GOVERNMENT ARE HOPING THAT WITH THE ACCELERATION OF PUBLIC WORKS EXPENDITURE, THE START OF RE-BUILDING OF INVENTORIES, THE MODEST ENCOURAGEMENT IT HAS GIVEN TO HOUSING, SOME RECOVERY OF INVESTMENT BY SMALL AND MEDIUM-SIZE BUSINESS AND AN UP-TURN IN CONSUMER DEMAND, THE GROWTH RATE WILL RECOVER ANYWAY, EVEN IF ONLY SLOWLY. BUT EVEN IF THIS TURNS OUT NOT TO BE THE CASE, THE GOVERNMENT WOULD HAVE DIFFICULTY IN PROVIDING A FISCAL STIMULUS WHEN THE PRIME MINISTER IS SO STRONGLY COMMITTED TO THE CAUSE OF ADMINISTRATIVE REFORM COUNCIL, MR DOKO, MEANS REDUCING THE SIZE OF BUREAUCRACY AND THE PROPORTION OF GOVERNMENT IN NATIONAL EXPENDITURE. IF THE CUTS TO BE RECOMMENDED BY MR DOKO IN SUBSIDIES TO FARMER, THE RAILWAYS AND THE HEALTH INSURANCE SCHEME WERE TO BE REPLACED BY INCREASED EXPENDITURE ELSEWHERE, THE EXERCISE WOULD BE DEEMED TO HAVE FAILED.

7. NEVERTHELESS AN ECONOMIC, IF NOT A POLITICAL CASE CAN BE MADE FOR THE GOVERNMENT DECIDING NOW TO INCREASE PUBLIC WORKS EXPENDITURE, WHICH WILL TAKE EFFECT IN THE SECOND HALF OF FY 1982 AND FILL THE GAP LEFT BY THE EXPENDITURE BROUGHT FORWARD INTO THE FIRST HALF. IT WOULD ALSO SERVE TO FORESTALL CRITICISM WHICH WOULD BE FORTHCOMING IN INTERNATIONAL ECONOMIC FORA IF DOMESTIC DEMAND WERE OTHERWISE TO REMAIN STAGNANT AND GROWTH WERE TO BE RESUMED ON THE STRENGTH OF EXPORTS ENCOURAGED BY THE BEGINNINGS OF A RECOVERY IN OTHER INDUSTRIAL COUNTRIES.

8. OUR MONTHLY ECONOMIC REPORT HAS BEEN FORWARDED BY BAG.

CORTAZZI
FINANCIAL
FED

MFJ

20/2/82

SIR ROBERT ARMSTRONG

Japanese Economy

The Prime Minister saw over the weekend your minute of 10 February and the attached report on the Japanese economy prepared by Dr. F.G. Marshall. She has noted your comments.

JC

16 February 1982

PRIME MINISTER

Japanese Economy

*Robert - Perkins
we have been looking
for the way
referred to
last CPRS
and*

(2)

I attach a report on the Japanese economy prepared in the course of last year by Dr. F.G. Marshall, the Science and Technology Counsellor at the British Embassy in Tokyo. It presents a striking - and in many ways frightening - account of the background to Japan's present technology-based prosperity.

2. In addition to presenting succinctly the main facts and statistics of Japan's current economic performance, the report explores both the technological, cultural and organisational backgrounds to this. Some of the facts and figures here are staggering. Page 10, for example, shows that 94 per cent of Japanese children stay at school until the age of 18; and 37.5 per cent (due soon to rise to 50 per cent) go forward to higher education. The comparable figures in the United Kingdom - though there may be some definitional differences - are some 22 per cent and 12 per cent respectively. Page 15 also shows that in absolute terms Japan is training over 10 times as many engineers as Britain.

3. The report has received fairly wide circulation both within Whitehall and outside. It was recently distributed, for example, with the background papers to a seminar arranged by the Department of Industry with representatives of United Kingdom computing companies and other relevant interests to discuss the ambitious Japanese plans for research and development into so-called "fifth generation computers". This is a generic term to describe a range of ambitious projects designed to achieve a significant step improvement in the capacity of computers (e.g. increasing the speed of the fastest current computer by 10,000 times and creating machines exhibiting their own "intelligence") and give Japan a dominant world lead. They have already caught up with the Americans in most aspects of computing technology; their next objective is to pull ahead of them. We have outstanding skills ourselves in this field in the United Kingdom, which the Japanese would like to tap. The

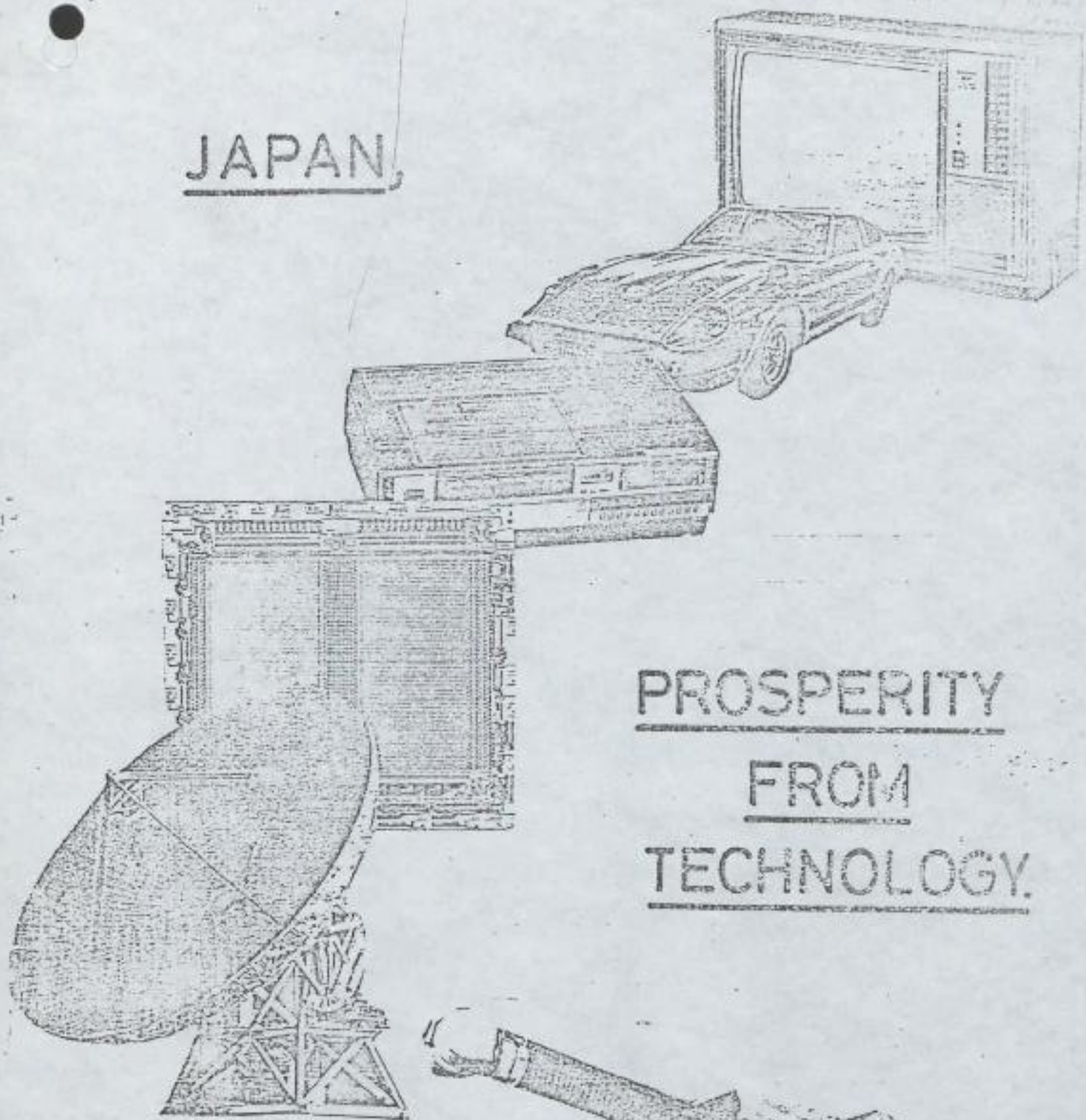
Department of Industry are considering urgently with industry and the universities and research institutions how we can best get our own act together and exploit the strengths we have. But, as this report makes clear, it will be a formidable task even to maintain our present relative position with Japan.

RA

Robert Armstrong

10th February 1982

JAPAN,



PROSPERITY
FROM
TECHNOLOGY.

F.G. MARSHALL
BRITISH EMBASSY
TOKYO
1981



JAPAN,
PROSPERITY FROM TECHNOLOGY

Teamwork, long term planning, imaginative funding of industry by Central Government and a broad range of culture derived incentives unique to the East have brought a technology based prosperity to Japan.

After first summarising technology oriented statistics and observations comparing Britain with Japan this report concentrates on recent advances in the application of intelligent electronics in both offices (telematics) and factories (robotics).

The central role of Japan's government in supporting innovation by means of 'National Plans' is described and the roles of the universities and government research establishments are considered.

Although the cultures of Japan and the West are very different, Japan has prospered by unashamedly copying those ideas and practices of Western countries that it could adapt to its advantage.

The report concludes that Britain could now benefit from copying certain aspects of Japanese practice and an attempt is made to identify these.

This report is derived from material prepared for a series of lectures presented by the author in various cities in the UK during the period 15th June to 3rd July 1981. The format of a visual presentation is maintained in the hope that this enables the busy reader to scan the text rapidly.

F. G. Marshall

Dr F G Marshall
Counsellor
Science and Technology
British Embassy, Tokyo

1) PROLOGUE

While Britain, with huge reserves of oil and coal, suffers deep depression, Japan, with no energy resources of its own, enjoys a booming economy.

A comparison of newspaper headlines collected in early 1981 from the British press and the English language Japanese press places the two economies in stark contrast:-

Nearly 10% of labour force out of work Britain failing in chip race report

Sharp third-quarter setback for -----

British Steel to get £880m more from state Further loss for -----

ICL to close plant as exports decline

Output down sharply with record rise in spending

UK

MITI hopes to boost space ind. mkt to ¥1 trillion scale in 1981-85

Matsushita will score all-time profit for fifth consecutive year

Color TV Output Up 12.4% in Sept. Fiscal 1981 Growth Of 5.3% Seen by EPA

Top Electrical Firms Score Record Sales Auto Exports Reach Record High in Sept.

Electronics output in 1980 climbs 22.9% to ¥8.6 trillion

Rising Japanese exports push the current account into surplus Auto exports record 37% gain

Five steel companies will boost plant-equipm't spending 41.5%

Nippon Steel's profits rise by 23 per cent in six-month period.

1980 Output of Color TV Sets All-Time High Sales continue to rise for Japan's electronics makers

JAPAN

JAPAN HAS OVER
75000 ROBOTS.....

WORKER PRODUCTIVITY
ROSE BY 12% IN 1980.

- Japan made more motor cars than the USA in 1980 but now the electronics industry is even larger than the motor manufacturing industry.
- Toyota will invest £600 M in 1981 in new plant (80% more than 1980). They will introduce 930 robots similar to Unimate.
- At Sharp a production line manned/by just 6 men produces 6 million electronic calculators per month. (There is no longer a financial incentive to manufacture off-shore.)
at any one time
- Toshiba has made over 10 million magnetrons for microwave cookers.
- Japan manufactured 100 million electronic watches in 1980.

JAPAN HAS TWO
INDEPENDENT GROUPS
ABLE TO LAUNCH
SPACE SATELLITES.

- * In the spring of 1981 it was reported that Matsushita produced 28 million IC and 245 million discrete semiconductors PER MONTH (45% up on the year before).
- * At the new Fujitsu Fanuc factory near Mt Fuji robots build robots 24 hours per day.
- * A 14" colour TV with stereo sound costs about £100 in Tokyo. A video recorder can be bought for £300.

PEOPLE SEE JAPAN AS THE SUPREME MANUFACTURER OF CONSUMER GOODS. THIS IS TRUE, BUT ONE OF THE MAIN MESSAGES OF THIS REPORT IS THAT JAPAN HAS BEEN MOVING RAPIDLY UP MARKET TO PRODUCE PROFESSIONAL GOODS OF HIGH ADDED VALUE BUT WITHOUT ABANDONING ITS CONSUMER BASE.

One reason why Japan prospers? - or perhaps a symptom of a deeper reason?:-

JAPAN TRAINS TEN
TIMES AS MANY
ENGINEERS AS
BRITAIN....

....EMPLOYS MORE IN
R&D THAN FRANCE
GERMANY AND UK
COMBINED.

...and, at those times when it
benefits Japan, they work together
as a team.

Put very simply...

JAPAN HAS CLEARLY BEEN DOING SOMETHING RIGHT AND BRITAIN, WITH ALL THE BENEFITS OF A STABLE ENERGY SUPPLY MUST HAVE DONE SOMETHING WRONG.

In this report I attempt to show how, BY DEVELOPING AND EXPLOITING ADVANCED TECHNOLOGY, Japan prospers in the face of a world depression. The cultures are very different but THERE ARE IMPORTANT LESSONS THAT BRITAIN CAN LEARN FROM JAPAN. This report aims to identify them.

2) INTRODUCTION

5.

This report will cover the following areas:-

3. JAPAN IN A NUTSHELL
4. ROLE OF GOVT.
5. ELECTRONICS
6. AUTOMATION
7. UNIVERSITIES & INSTITUTES
8. WHY? - CULTURE
9. WHAT CAN WE DO?

Section 3 is an attempt to present fairly digestible comparative statistics. Sections 5 and 6 represent the main body of the report.

But first, a few facts about the Science and Technology Office at the British Embassy, Tokyo.

Our role is to support-

- 1) Government enquiries
- 2) Government visitors, and then on a time available and priority basis
- 3) Company enquiries
- 4) Company visitors

But we also allocate time to-

- 5) Seek potential areas where joint technical ventures between Japanese and British companies might be mutually beneficial and
- 6) Report on initiative, to "ring the firebell" when a new technical development in Japan could pose a long term threat to British industry if competitive reaction were to be delayed.

The staff of 6 includes two British and two Japanese science trained staff. The information from this office and that of the Science and Technology Counsellors in Washington, Bonn, Paris and Moscow is distributed through the -

Overseas Technical Information Unit
Department of Industry
Abell House
John Islip Street
London SW1P 4LN.

A word of warning.....

Please beware of instant experts!

In a one or two week visit to Japan it is very easy to receive a biased impression.

It is said that:-

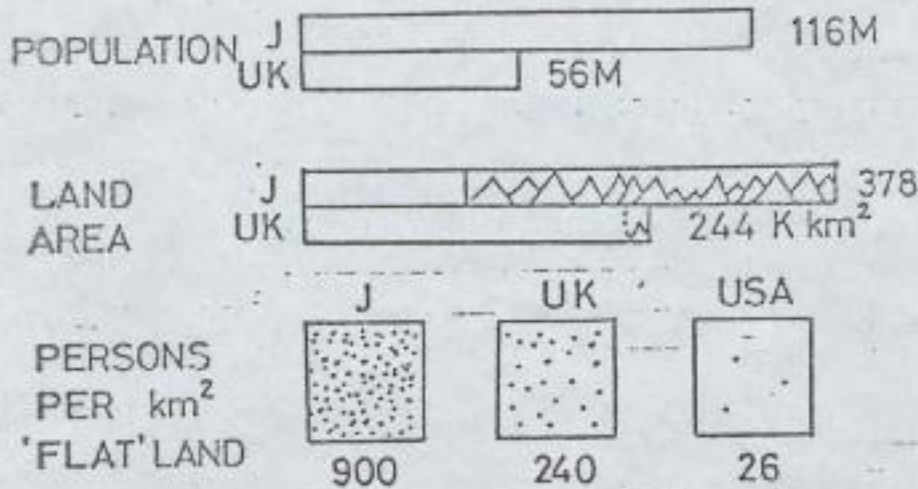
After one week you feel you are expert.

After six months.... you know you are expert.

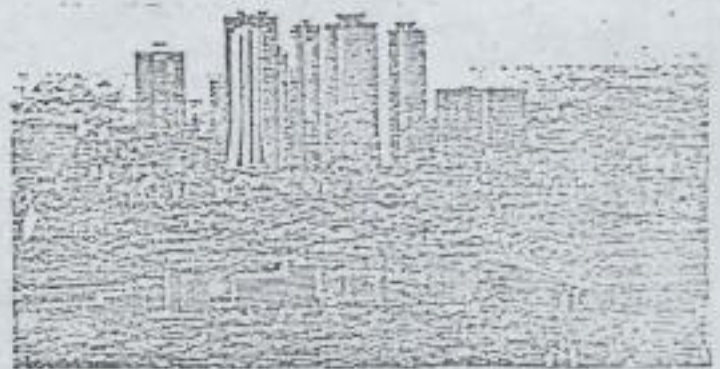
But after a year or more you have to admit how difficult it is for a Westerner to understand Japanese thinking, culture and procedures. After 4000 years of separate cultural development it is not surprising that the Japanese and British peoples, and certainly those in power in industry, government and civil service have an entirely different outlook on life.

3) JAPAN IN A NUTSHELL

This section presents simplified statistics comparing Japan with Britain.

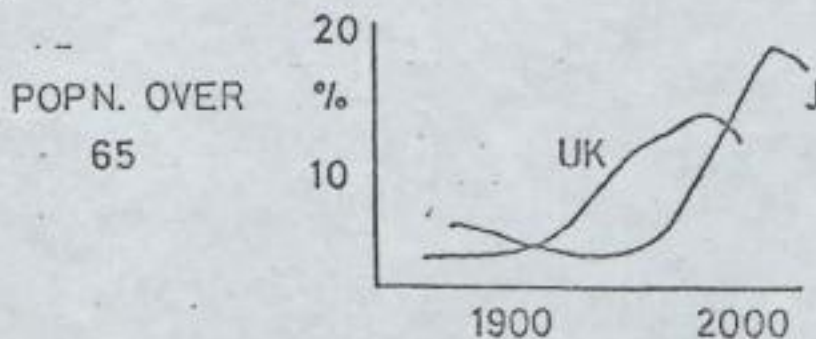


Clearly the population density would be thought to present a major problem. 14 million people live in greater Tokyo alone and 13 million join them each day to work.



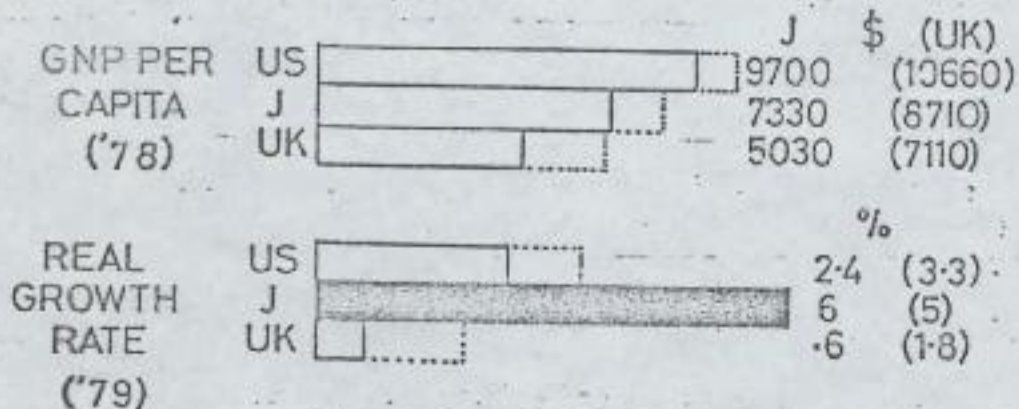
However, even though many Japanese people visit abroad and American television programmes showing the western lifestyle are screened every night, Tokyo residents seem content, even happy, with their lot.

One problem frequently referred to is that of the ageing population:-



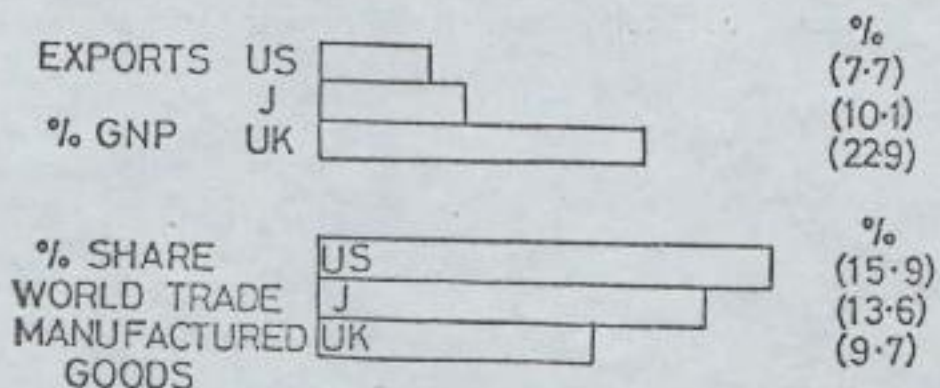
- it is claimed that Japan's GNP must rise by 3 or 4% per year simply to maintain the current standard of living.

Accurate statistics are notoriously difficult to obtain. The figures below (full lines on the diagrams) are from Japanese government sources while those in brackets (dotted lines) are from the UK.



Nevertheless, the message is clear. The Japanese are richer than the British now and will very soon be richer than the Americans. Some observers claim that they will have twice the wealth of the Americans by the end of this decade.

Note that although Japanese exports of cars and electronics create international problems Britain, with a broader distribution of products, in fact depends more on exported goods than does Japan:-



Many statistics similar to the following could be presented:-

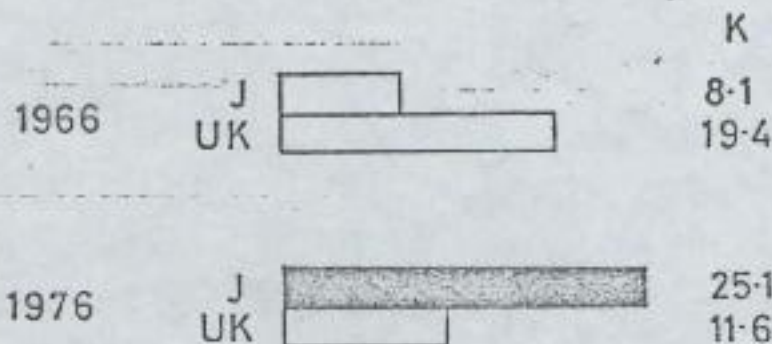
STEEL PRODN.	J		243
1000T/EMPLOYEE.UK			115

- but even with such manufacturing efficiency unemployment is not a problem:-

UNEMPLOYMENT USA			7.6
NOV 80	J		2.1
	UK		7

It is widely held that the Japanese are not innovative. Certainly British scientists have received ten times as many Nobel Prizes as their Japanese colleagues. However, if we compare the numbers of those patentable incremental inventions that create wealth we find:-

US PATENTS ISSUED

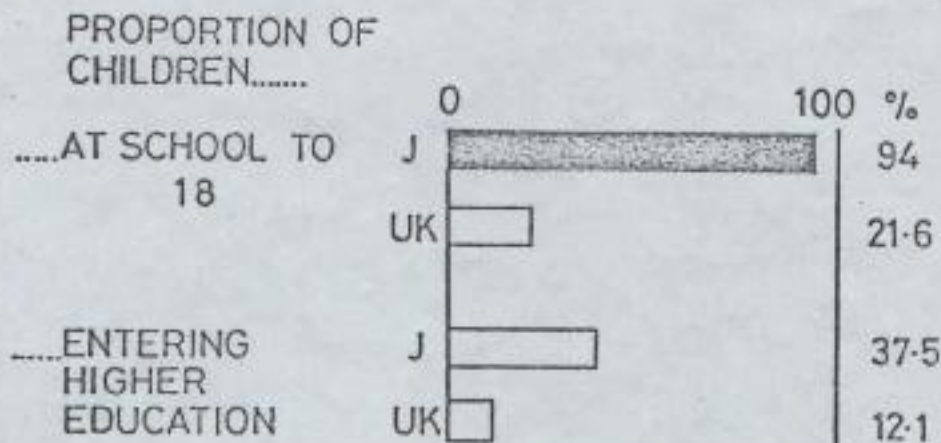


NOTE PARTICULARLY THAT OVER THIS 10 YEAR PERIOD THE UK HAS SLIPPED BACK IN ABSOLUTE TERMS.

Education

Education is seen as the future security of the Japanese.

Indeed it is agreed that Japan's only resource is its people and it invests heavily to prepare them for employment in the 'brain intensive' industries of the future.



+ 44% AT CRAMMER SCHOOL
1-2 HOURS PER DAY,
6-7 DAYS PER WEEK,

Some would argue that the term 'higher education' in Britain and Japan would be defined differently and certainly the difference between the best and the worst universities in Japan is much greater than in Britain. However, the attitude towards the desirability of higher education is profoundly different in the two countries.
 In Britain the investment in education is to be reduced -

Cuts galore

Funding for UK universities in the academic year 1981-2 will represent a reduction of 3% in real terms over the 1980-81 figure, according to the Secretary of State for Education and Science in March.

- but in Japan, in a few years time, some 50% of children will go forward to higher education and the declared long term objective of the government is to provide university level education for every child.



Because of LIFETIME EMPLOYMENT (to be discussed in more detail in Section 8) in Japan it is IMPERATIVE to start your career with the right company. To obtain a position in the senior civil service or at one of the most prestigious companies one must be educated at the top (Tokyo) university. Although schools are state financed it is essential to attend a 'good' school to enter Tokyo University and this chain extends right down to the privately funded kindergarten level. It can cost parents £250 just to register their child.

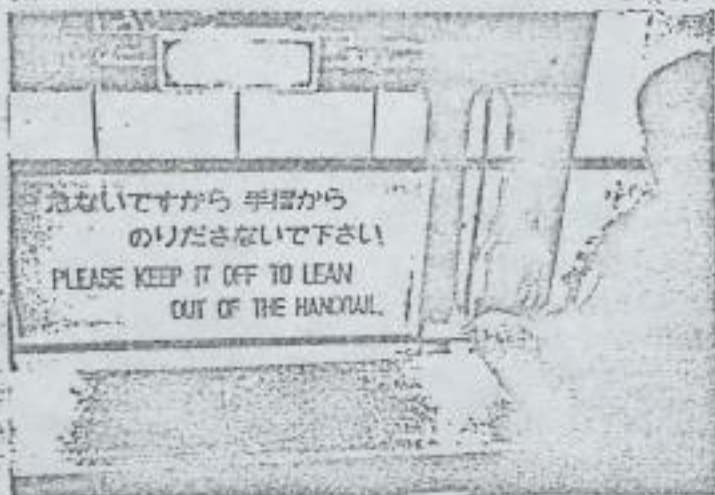


The pressure is intense. Japanese children never have the free time to follow the enjoyable pursuits of a "western" childhood, even attending privately funded crammer schools during the short vacations. Under such pressure an average of 100 children per year commit suicide.

In contrast, failure at university, once entered, is almost unthinkable, (the University would have been seen to have failed and would "lose face"). For men their years at university are their only years of (comparative) freedom. Demonstrations against university involvement in industrial projects are common, I even observed experimental solar cells destroyed by students, (future salarymen!) on the roof of Tokyo Institute of Technology.

All children learn English and those entering university must reach a defined standard. The advantage of having access to the technical literature of the world is well understood and the proficiency in reading English is normally very high.

Writing English presents a few problems!



Just as French is used in British restaurants, there is kudos to be gained if you provide your product with an English name. However, the finer points of the use of English can be missed! A soft drink for the use of sportsmen is sold widely in Japan:-



The "Engineering Dimension"

Japan employs well over twice as many professional practising engineers per head of population as Britain. Many others with engineer training enter employment normally reserved in the West for arts graduates. Indeed, in absolute terms, Japan trains over 10 times as many engineers as Britain and these receive a four year degree course of a style similar to that taught in France or Germany.

		UNIVERSITY DEGREES (78)		
		UK	JAPAN	
SCIENCE	11878	<input type="checkbox"/>	<input type="checkbox"/>	10688
ENGINEERING	6897	<input type="checkbox"/>	<input checked="" type="checkbox"/>	71167
AGRIC.	671		<input type="checkbox"/>	13536
MEDICAL	4054	<input type="checkbox"/>	<input type="checkbox"/>	11618

In Britain we now discuss the importance of the "Engineering Dimension". In Japan this is a reality. Half of the members of the boards of the large manufacturing companies are trained in engineering and science. In high technology companies the number lies between 70 and 100%. In 1981 it was announced that, for the first time, the new presidents of the top electronics companies were to be engineers:-

PRESIDENTS

HITACHI	K.MITA	56	<u>ELEC.ENG</u>
FUJITSU	K.YAMAMOTO	55	<u>ELEC.ENG</u>
NEC	T.SEKIMOTO	54	<u>PHYSICS</u>
TOSHIBA	S.SABA	62	<u>ELEC ENG</u>

However, it must be emphasised that when a large company accepts a new engineering graduate it subjects him to 2 to 5 years of formal and 'on the job' training, including service in sales, finance or even with the company union. This creates a "company man" who has the interests of the whole of his company at heart.

The following table summarises the rise of new technologies in Japan.

TIME	TECHNOLOGY	PRODUCT
1940 <small>war</small>	<u>AGRIC.</u>	SILK STEEL
1960	<u>MECHANICAL</u>	SHIPS MOTOR CYCLES
1970	<u>ELECTRO-MECHANICAL</u>	RADIO CARS TV CALCULATORS VIDEO WATCHES
1980 <small>now</small>	<u>ELECTRONIC</u>	C & C
1990	<u>BIOTECH.</u> <u>ENERGY</u>	PROFESSIONAL HIGH ADDED VALUE SYSTEMS DEFENCE?

SPACE!

In my personal opinion, Japan has available now all of the electronic technologies necessary to sell defence equipment to the emerging nations of the world. Public sentiment and the pacifist constitution make this difficult politically, but if the future holds a combination of American pressure to increase defence spending, a further rise in oil prices and extended trade friction from car exports then the temptation might prove irresistible.

This Section, "Japan in a nutshell", ends with the ultimate condensation of the facts!

JAPAN IN 4 LINES.....

1. NO MATERIAL RESOURCES.
2. GOVT. UNDERSTANDS
TECHNOLOGY.
3. EDUCATED POPULATION.
4. LIFETIME EMPLOYMENT.

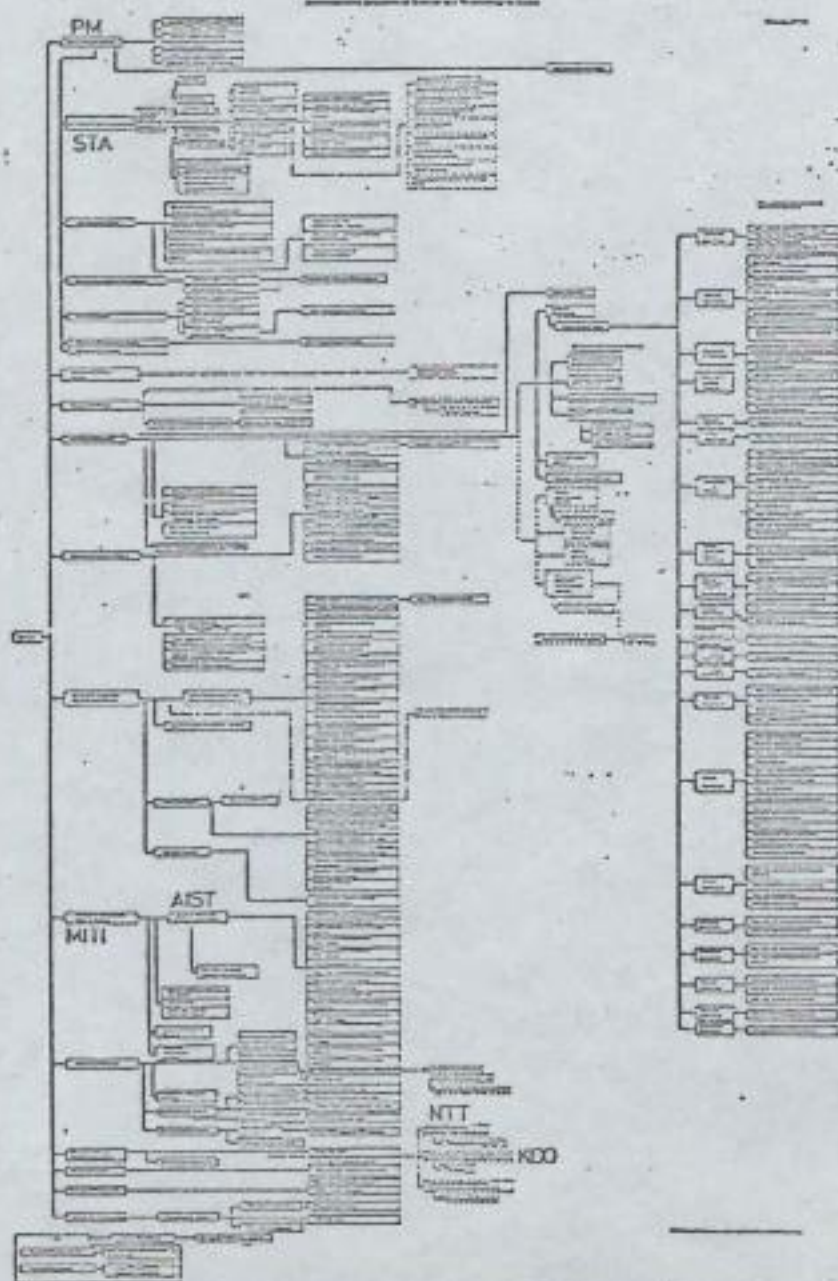
These facts deserve further comment. The words stressed below have been chosen with care:-

- ⊗ FACT ONE | Japan has no material resources. It's wealth is based on the EFFICIENT and TIMELY manufacturing of SOPHISTICATED science based products.
- ⊗ FACT TWO | The Japanese Government, Civil Service and senior industrialists understand that THE ELECTRONIC REVOLUTION IS ONLY JUST BEGINNING and that the pace will ACCELERATE. They understand THE IMPORTANCE OF INVESTMENT in new technologies. The Science and Technology Agency steers the long term balance of technology investment and reports directly to the Prime Minister.
- ⊗ FACT THREE | Japan's only resource is the skill of its people. The work force is the most HIGHLY EDUCATED in the world.
- ⊗ FACT FOUR | The tradition of LIFETIME EMPLOYMENT by one firm encourages:
- 1) Staff training schemes
 - 2) A cooperative workforce who encourage company investment in automation
 - 3) An expanding share of world markets. (When automation is introduced to reduce costs and increase quality people are freed. There are then only two actions available to the management of the company. Since staff cannot be sacked the company must either invest in a second production line or diversify. Growth is the result.)

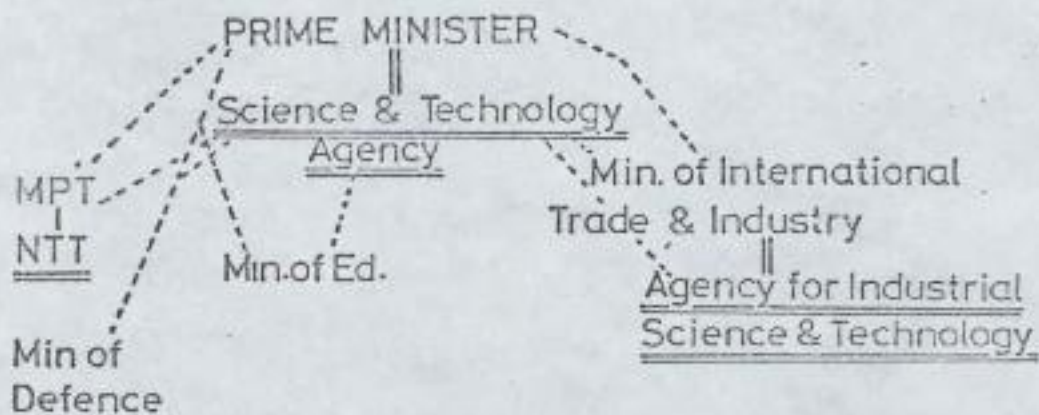
4 THE ROLE OF GOVERNMENT

The ruling Liberal Democratic Party is conservative, (with a small "c"), is clearly interventionist and has ruled Japan continuously for 26 years. Stability, long term planning, generous central funding of industrial innovation and a sufficient proportion of brilliant and technically educated senior civil servants have all played their part in Japan's spectacular advance.

The accompanying table is not intended to be completely legible but shows how complex is the administrative structure of science and technology in Japan. Indicated, however, are the relative positions of the Prime Minister (PM), the Science and Technology Agency (STA), the Ministry for International Trade and Industry (MITI - please note the significance of the first "I"), the telecommunications wing of the Post Office (NTT) and the international communications company (KDD).



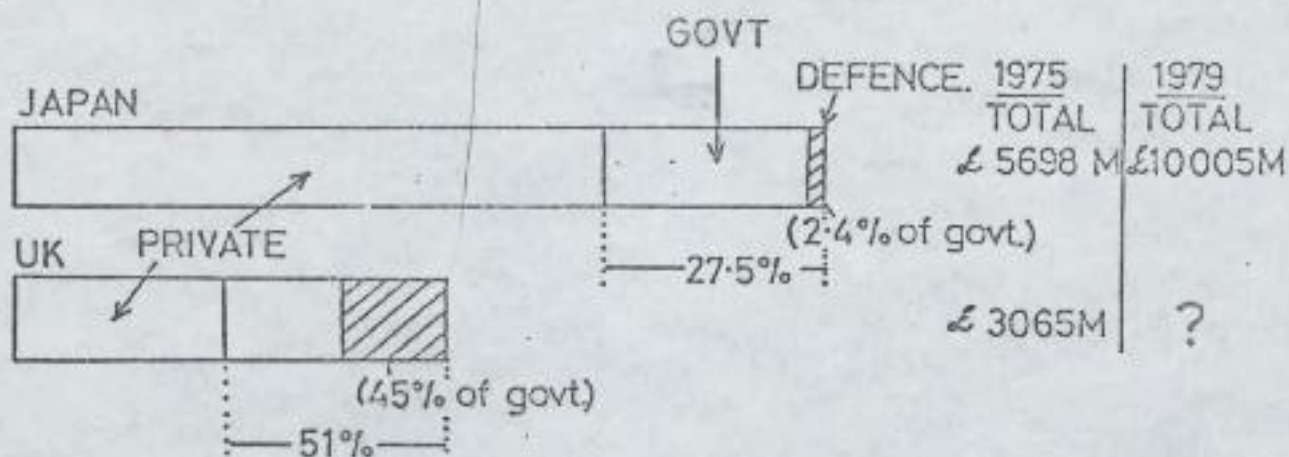
The significant sources of central funding for research and development are included in the following simplified table:-



SOURCES OF GOVT. R&D FUNDING

There is a clear point at the top of the pyramid where the "Council for Science and Technology" of the STA reports directly to the Prime Minister. MITI might dispute the relative status of the STA and certainly the AIST (part of MITI) clearly complements the role of STA in the areas that they fund. It must be stressed however, that behind the formal facade exists a horizontal informal organisation of peer groups. Over 80% of the yearly intake to MITI and other departments are taken from Tokyo University. The "Class of '81" will rise relentlessly and in accurate synchronization through the hierarchy of all sections of the civil service and the senior industries and its members will maintain close and regular liaison. The university professors also maintain close contact with their old students and in each technology represent an important and unbiased focus of the Japanese consensus of opinion. It was under the advice of one such professor that Japan chose to fund silicon device technology (the VLSI National Plan) so heavily in 1976.

In absolute terms the British Government claims to spend as much on the funding of science and technology research and development as does the Japanese Government.



FUNDING OF R&D

However, most of Britain's central funding is absorbed for defence development and a fair proportion of this is absorbed by headquarters functions. MITI has gained the enviable reputation of choosing to fund the right topic at the right time while many in Britain bemoan the waste represented by projects such as TSR2 and Concorde. In fairness, however, if as in the case of Japan the policy is to "copy and improve" the products of industrial rivals (IBM for example) the risk factor is small. To build a Concorde represents a bold step into the unknown. It can now be argued that, in Britain, certain electronic and automatic production technologies now stand where Japanese technology stood 6 years ago and that perhaps Japan's "copy and improve" policy might itself be worth copying in Britain.

It should also perhaps be a matter for concern that while in Japan statistics on research and development spending are gathered yearly a similar exercise is undertaken in Britain only at 5 yearly intervals.

The current "National Plans" of AIST are listed below. In general the companies receive non-recoverable 100% grants from government.

AIST CURRENT PROJECTS

	£M*	PERIOD
5TH GENERATION COMPUTERS	70?	81 - 90
POST ROBOTICS (FMS)	28	77 - 83
OPTOELECTRONICS	42.8	79 - 86
CARBON CHEMISTRY	35.7	80 - 86
JET ENGINES	47.4	71 - 81
STEEL	33.3	73 - 80
OIL CHEMISTRY	32.8	75 - 81
RESOURCE RECOVERY	26.2	76 - 81
SUBSEA OIL	35.7	78 - 84

Total annual funding £260M, 70% directly to industry.

AIST PAST PROJECTS

	£M	PERIOD
HIGH PERFORMANCE COMPUTERS	20	66 - 71
VLSI TECHNOLOGY	70	76 - 80
ELECTRIC VEHICLES	13.5	71 - 77
AUTOMOBILE TECHNOLOGY	17.6	73 - 79
DESALINATION	23.6	69 - 77
DESULPHURISATION	6.3	66 - 71
SUBSEA OIL	10.7	70 - 75

*Yen 420 = £1.00

The more expensive technologies of strategic significance are funded by the STA:-

SCIENCE & TECHNOLOGY

AGENCY

	£ M
ATOMIC.	363
SPACE (NASDA).	184
OCEAN.	10.2
AVIATION +MISC.	72
TOTAL	£ 630 M

ENERGY, £ 3500M , 80-90

The lack of indigenous energy resources has spurred the Japanese Government to dedicate an amazing sum of money for energy saving and new energy technologies. This funding will help to generate an entirely new range of energy efficient industrial products that will find ready markets in an energy starved world. The "breathing space" offered to Britain by North Sea oil is perhaps not entirely beneficial.

Most of the funding of AIST is in the form of 100% grants and in such cases AIST maintains the right to patents. The MITI divisions also fund directly but usually in the form of 50% "repayable grants". The VLSI National Plan was one case where AIST used this procedure. Whether such funding is regarded as a grant or a loan is open to debate. Certainly in the early years of a project the companies treat the funding as if it were a direct grant. Now that the electronics companies proudly declare that their largest computers are, at last, faster and more powerful than those of IBM, MITI is reported to have started to discuss with the companies how they should begin to repay the funding for the VLSI project. One gains the impression that this is run on a "gentleman's agreement" basis rather than by formal legal obligation.

When AIST was drawing together the companies cooperating in the current solar cell development programme (Report FGM1981/10) it was obvious that the 20 strong team at Sanyo would have to be included (perhaps even against Sanyo's wish!). MITI now funds this and other teams as part of a combined national effort on the understanding that new patents become the property of MITI for eventual redistribution to the members of the cooperative group.

There are very strong similarities between the working methods of AIST and the British Ministry of Defence CVD organisation. CVD provides direct funding to industry to develop electronic device technologies regarded as having long term strategic importance. The Liaison Groups of CVD successfully draw together the research teams of different British companies into cooperative national groups. Once the device technology has become established the companies compete to build systems using the new devices but while the basic technology is being developed in Britain there is clear cooperation. AIST work in a very similar manner, the only real differences being in the total level of funding and the fact that the aim of AIST is to boost the level of technology for the benefit of Japan's civil, rather than military, industry. 100% grants are clearly a very strong incentive toward mutual cooperation. The AIST National Plans have played a critically important part in the development of Japan's "Sunrise Industries". A gardener knows that the cost of seed is trivial when compared to the value of his produce. Similarly the \$212M per year spent by AIST on "seedcorn" projects is a minute proportion of the budget of government. However, the catalytic effect of introducing new technology efficiently at the right time is regarded by the Japanese as being of profound importance to the future economic health of the nation.

Current Policy

Japan Must Develop Original Science And Technology in 1980s, Agency Says

There is now a consensus of opinion that, at least in the fields of electronics and manufacturing technology, Japan has equalled or drawn ahead of the rest of the world. While MITI might believe that a broad range of incremental innovations in the application of existing electronic technologies still remain to be exploited, STA declares publicly that the era of "copy and improve" is drawing to a close. Genuine "lateral thinking" innovation is relatively common in western cultures where good people are free to change employment and congregate at the current centre of excellence and where assertive and able individuals are given free play. STA is conscious that Japan's lifetime employment system and consensus culture has a stultifying effect on lateral thinking and by various funding schemes are trying to legislate for true innovation, perhaps a contradiction in terms.

With characteristic pragmatism MITI also has declared long term future plans:-

TUESDAY, JULY 14, 1981

THE JAPAN ECONOMIC JOURNAL

ADVISORY BODY APPROVES 10-YEAR POLICY

MITI plans spending ¥104 billion for next generation technologies

Twelve topics have been chosen

	Period (Year)	Cost (¥B)	Cost (£M)
1. Fine Ceramics	10	13	28.3
2. High-efficiency Substance-separating membrane materials	10	10	21.7
3. Electrically conductive high-polymer materials	10	5	10.9
4. Highly-crystalline high-polymer materials	10	6	12.2
5. High-efficiency crystallization-controlled alloys	8	8	17.4
6. Compound materials	8	11	23.9
7. Bioreactors	10	11	23.9
8. Massive (biotechnical) cell cultures	9	5	10.9
9. Gene recombination application technology	10	10	21.7
10. Super-lattice (exceptional atomic structure) (electronic) elements	10	8	17.4
11. Three-dimensional (electronic) circuit elements	10	9	19.6
12. (Electronic) elements intensified in anti-environment resistance	8	8	17.4

In Summary

POLICY FOR THE '70s	CATCH UP WITH THE WEST. COPY AND IMPROVE.
POLICY FOR THE '80s	LEAD IN TECHNOLOGY BY INNOVATION WITHIN JAPAN.

In the future, as in the past, the government will lead the consensus, plan long term and fund new technologies generously in the formative years. In the "follow on" phase the banks will continue to invest with long term growth in mind.

5) ELECTRONICS

27.

The managers of the device and system research and development groups of Japan's electronics companies share a confident, almost science fiction, view of a future in which almost anything is possible.

This vision is based on the extrapolation of current growth curves, very few of which show any sign of saturation. It is claimed that a computer that can play chess like a grand master now costs £4M. In ten years it will be available for £10,000 and by the year 2000 will cost just £100. The comment "Imagine what you might buy then for £1M!" is heard. It is claimed that Japan created 10,000,000,000,000 transistors in 1980, one hundred times as many as the number of stars in the Galaxy! There is serious talk of colour moving picture telephones brought into every home by fibre-optic guides, pocket telephones, cheap voice input typewriters, voice to voice language translators and computers 1000 times faster than the CRAY. This is no longer the idle chatter of the scientists coffee break but the subject of serious, budgeted, long term planning by top company managements, civil servants and member of NTT. After fifteen months in Japan I do not believe that such talk is over optimistic, indeed for most advances the necessary technology has been demonstrated in Japanese laboratories.

The electronic industry is thought currently to produce some £9000M worth of product, roughly equal in size to the car industry. Some of the key product areas include:-

<u>PRODUCT</u>	<u>SALES</u>	<u>ANNUAL</u>
	<u>(£M)</u>	<u>GROWTH</u>
		<u>(%)</u>
SEMICOND.	2000	25-42
COMPUTERS	650	45
CALCULATORS	380	12
WATCHES	540	25
CAMERAS	690	12
VIDEO	1390	60
COPIERS	500	22
FACSIMILE	135	45
SWITCHING	243	30

£6528M

The growth figures are startling and the curves show little sign of leveling. In how many of these key growth areas does Britain still compete? Japan has 90% of world capacity in VTR, one of the "professional technology" areas British industry once thought to be safe from Far Eastern competition, and never likely to be a consumer item. 14 million units will be produced in 1985. 600,000 colour video cameras were produced in 1980, double the 1979 figure. Britain's refuge of "high added value professional product" is now under siege.

New products just around the corner include:-

- * Pocket TV with liquid crystal display (the transistor radio of the 80's?)
- * Hand portable electronic home movies (the Box Brownie of the 80's?)
- * Digital audio, tape and disc
- * Video discs - including later discs for home recording.
- * Cheap facsimile units
- * Low cost "second generation" micro computers, with enhanced performance, for small business application.
- * A typewriter that accepts dictation directly has been demonstrated
- * Voice input and output language translators

Silicon

While Britain has yet to prove that it takes the silicon micro-chip seriously as a long term growth industry, Japan's companies will invest massively in 1981 to add to their large investments of previous years.

	£ M	
HITACHI	43	
MATSUSHITA	43	
mitsubishi	22	
NEC	65	<u>SILICON</u>
OKI	26	<u>INVESTMENT</u>
SANYO	17	<u>PLANS</u>
SHARP	7	1981
SONY		
TOSHIBA	22	
FUJITSU	48	
TOTAL	£ 293M	

Within Japan investment in silicon processing plant is infectious; a shoe company, a glass company and two camera companies have now opened silicon chip manufacturing facilities. Silicon IC production rose 44.6% in value in the year up to March 1981.

Professional Electronics

At the professional end of the market the growth rates and investments are also large. Sales of office equipment will be worth £2000M in 1981 rising to £5000M in 1985. NEC, Fujitsu and Oki will invest a total of £340M in the development of office equipment this year.

Three times in the past Japan has declared National Plans aimed at drawing level with IBM in computer technology. The first two attempts met with failure when in 1964 and 1970 IBM brought out a new model one generation ahead of the newly developed Japanese machine. The stunning effect of these failures finally brought the companies together in the VLSI Technology Research Association which from 1976 to 1980 absorbed £60M of direct AIST funding.

Now three companies, at least, claim that their machines are ahead of those of IBM and in 1980 both Fujitsu and Hitachi sold more computers in Japan (by value) than did IBM.

HIGH SPEED COMPUTERS

	FUJITSU M-380	HITACHI M-280	NEC ACOS 1000	IBM 3801
MAX MEMY. (Mbyte)	128 64 (6/81)	32	64	32
POWER (KVA)	28	40	-	32
GATES/ CPU CHIP	1300	1500	1200	704
GATE DELAY (nsec)	0.35	0.45	0.5	1-2
MEMORY CHIPS (Kbits)	64	16	64	16

The new declared objective is to match IBM in world sales value. A glance at the size of IBM relative to that of the other companies in the top ten reveals the boldness of this aim.

IBM	18.5	TOP TEN COMPUTER COMPANIES. REVENUE \$m 1979
BURROUGHS	2.46	
NCR	2.4	
CONTROL DATA	2.27	
SPERRY	2.2	
DIGITAL EQ.	1.8	
FUJITSU	1.5	
HONEYWELL	1.4	
ICL	1.3	
CII-HB	1.2	

A New Trade Barrier?

The Japanese people are now delighted to find that the cost of computer memory and processing power is no so low that they can build machines able to receive and print data in their own language. A 1MBit read only memory (ROM) is now in pilot production that can store 3700 Kanji characters on a single chip of silicon (please see page 13). Soon every machine from banking terminals to Coke dispensing machines will be able to communicate interactively with their customers. Telephones exist that display messages in Kanji and a full Japanese word processor is available at a price within the range of a small business office. The procurement of telephone systems may now be open to international competition but surely the requirement to handle Kanji will be quite a reasonable specification and this surely represents a new potential barrier to trade.

5th Generation Computers

The major electronics companies are now in the process of forming a new consensus with government that defines how Japan should act over the next decade to maintain a world lead in computing technology. After two years of funding the study phase AIST is rumoured to have committed between £100M and £200M over the next ten years to directly support innovative developments in industry. A large and complex structure of committees have been formed to guide the advance of the plan. The definition of what is meant by "5th generation" is still unclear but there are essentially two parts as follows:

a) Hardware

Post silicon technology is stressed. Josephson Junction devices (working at liquid helium temperatures) are taken very seriously indeed as are cooled III-V devices such as the High Electron Mobility Transistor, (HEMT). However, I suspect that the companies are more interested in the support also included within the overall plan that will press silicon technology to the very limits imposed by the physics of the transistor itself. One, and even ten megabit random access memory (RAM) chips are seen as legitimate rungs on the ladder of the progression to the "5th generation" machine.

b) Software

The intention is to create a machine exhibiting true intelligence, the phrase "man level" intelligence is even seen in some documents. The machines are to be "user friendly" and able in some configurations to converse in natural language. Applications include the word processor that accepts verbal input and the assembly robot that together with visual and tactile sensors can display the ability to reason and cope with totally unforeseen problems. Very little has yet been said about how such major feats of programming will be tackled but certainly funded teams will be deployed with these objectives.

Research managers in industry seem to have a twinkle in their eye when they quote such objectives but clearly rungs 3, 4 and 5 of this 10 year ladder are very attractive to them and funding is very welcome. Certainly generation 4½ is seen as a saleable product.

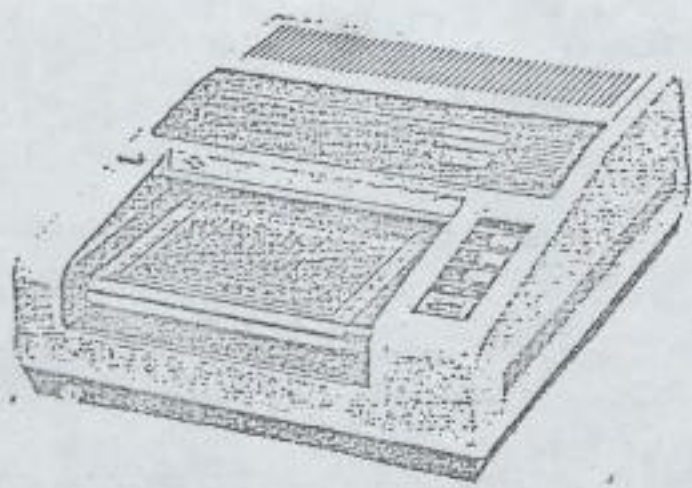
The Role of NTT

Outside of Japan it is not generally realised how powerful has been the role of Japan's telecommunications corporation in fostering the development of new electronic technologies and systems in Japan's industry. It is now acknowledged that at the time of the celebrated VLSI plan funded by AIST, NTT placed contracts in the industry for advanced devices and systems of value similar to the £60M government funding. While not paying for research contracts as such, when NTT procures a system the price includes a proportion of the development cost of the necessary technology. NTT runs three large research facilities employing 3000 staff. The Musashino facility is now regarded by leading American silicon technology companies with very great respect, a 256K RAM having been demonstrated in 1979 and a 1MBit ROM in 1980. High speed 1 and 4K RAM devices are currently being developed on oxide isolated silicon with performance better than silicon on sapphire.

It is typically Japanese to build on success and not content with this level of effort a new laboratory will open at Atsugi in 1982 employing 500 people to develop all the hardware required for 5th generation computers. There is a very strong measure of competition between AIST and NTT with both wishing to be seen to be developing the most advanced technologies.

The large M-380 computer offered commercially by Fujitsu bears a striking resemblance to the large DIPS machines developed by Fujitsu under NTT funding. (NTT offers banks and other large companies not only data networks but full computing facilities procured to their specifications).

Until very recently it was not possible to code or transmit Japanese letters written in the usual Kanji characters and most business letters are still hand written and sent by mail. This provided NTT with the incentive to develop facsimile machines and these are now available at very low cost.



NTT FACSIMILE

The machine above is being manufactured for a production cost of just £200. It can send an A5 (half A4) message over standard telephone network in 90 seconds at a cost of 1p (for a local call). NTT is still awaiting government approval to launch this service which undercuts the traditional mail by a factor of two in price as well as offering near instantaneous transmission. The image quality is excellent.

The art of fibre optic communication has been advanced by the combined efforts of NTT and KDD, the international communications company. The emphasis is now on the deployment of single mode high bandwidth systems using lasers at 1.56 μm . A deep water link between Japan and Hawaii is planned for 1985.

SPACE

Japan's space programme is ambitious and deserves to be reported in a separate document. It seems clear that the dominant reason for developing the technology is to be able to offer communications systems to Pacific nations independently of American launchers. Rumours of plans for a Japanese space shuttle programme persist.


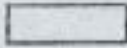




6) AUTOMATION - ROBOTS

The explosive growth in the use and manufacture of robots in Japan is the subject of an earlier report* and has been covered in some depth by the press. The Japanese Robot Association has summarised the situation as follows:

ROBOTS

FIXED SEQUENCE - JAPAN 75000

MICROPROCESSOR CONTROLLED -

J		10 000
US		3 000
WG		850
SWE		600
F		200
UK		185

	NOW	ON ORDER
NISSAN	460	350
TOYOTA	420	500

The figure of 75000 robots much quoted by the press includes many simple pick and place machines that hardly deserve to be called robots. Nevertheless the figure of 10000 reprogrammable machines is quite outstanding. Each one of these replaces at least one person on a production line.

Japan claims to have 130 robot manufacturers and almost all of these seem to be doubling their production at least every year.

/Kawasaki

Kawasaki will manufacture 1200 robots in 1981/82. The projected demand within Japan will be 11,500 in 1985 rising to 72,000 in 1990. Cost reductions are expected but even now it is estimated that it costs only £4300 per year to employ a welding robot as compared to £8600 per year for a man. Statements such as "The entire technical staff of Matsushita have been turned to developing robots" are common in the Japanese press.

It is reported that of the 75000 robots manufactured only 50 have so far been exported. There is still claimed to be a shortage of 30000 welders and 18000 paint sprayers in Japan.

A recent survey reports that the following companies manufacture significant numbers of robots:

<u>APPLICATION</u>	<u>MAJOR ROBOT MANUFACTURERS</u>	
	<u>WELL KNOWN COMPANY</u>	<u>NEW COMPANY</u>
WELDING	KAWASAKI HEAVY INDUSTRIES YASUKAWA ELECTRIC HITACHI, MITSUBISHI HEAVY INDUSTRIES SHIN-MEIWA, TOSHIBA SEIKI FUJIKOSHI, TOKICO KOBELCO	MATSUSHITA ELECTRIC MITSUBISHI ELECTRIC OSAKA TRANSFORMER DAINICHI KIKO OKAMURA SEISAKUSHO
PAINTING	KOBELCO, TOKICO MITSUBISHI HEAVY INDUSTRIES, HITACHI, FUJIKOSHI KAWASAKI HEAVY INDUSTRIES	TAIYO TEKKO
ASSEMBLING	HITACHI FUJITSU FANUC, KAWASAKI HEAVY INDUSTRIES, DAINICHI KIKO TAIYO TEKKO	NEC, NIPPO SEIKO YAMADA ENGINE, SAIYO SEIKI FENDEL, SUMITOMO, JUKIKAI KOGYO
MACHINE TOOL	FUJITSU FANUC, ICKGAI TEKKO SHINKO DENKI TOYODA KOKI	DAINICHI KIKO
PLASTIC MOLDING	SAILOR FOUNTAIN PEN, TOSHIBA SEIKI, STAR SEIKI, KAWAGUCHI TEKKO, ICHIKO ENGNG.	
PRESS	AIDA ENGINEERING, ORII DAIDO TOKUSHUKO, SHINKO ELECTRIC, TOSHIBA SEIKI	
OTHERS	HITACHI, MITSUBISHI, NHI FUJI ELECTRIC, OJI SEIKI	PILOT FOUNTAIN PEN KOBELCO, IHI

Fujitsu Fanuc is certainly the star performer. At the new factory near Mount Fuji 100 staff produce 100 robots, 150 electrospark machines and 100 NC lathes per month. The staff is present for one shift per day but most of the work is performed by robots and automatic stores, machine tools and distribution systems which are in operation around the clock. By the end of this year 120 staff will manufacture produce worth £1M per man per year. No more staff will be employed, future growth coming from the extended use of advanced assembly robots. One quarter of Fanuc's staff is engaged in research and development.

The intense competition between companies in Japan has proved a powerful incentive to develop or use robot systems. The government has also been active. MITI continues to provide substantial funds to encourage the development of modern manufacturing techniques. Direct grants and loans at 3% less than commercial interest rate have been available. Between 1977 and 1983 £26M will be spent on developing an integrated flexible manufacturing system. The Japan Robot Leasing Organisation expects to have leased robots of value £84M to small companies before 1984, much of the finance necessary for this is derived from government sources at low interest rates. Similarly the government supported Small Business Finance Corporation loaned £12M in 1980 to enable companies to purchase robots. Any company investing in robots can claim 13% extra depreciation for tax purposes in the first year of ownership.

7a) THE UNIVERSITIES

38.

Although in Japan the difference in salary between the highest and lowest paid jobs is smaller than in the West, (when asked, over 95% of Japanese regard themselves as "middle class"), the prestige and security of a position with one of the old established corporations is highly prized. Academic qualifications are seen as the key to this happy state and over the last decade the standard of education of the population has risen dramatically. Almost all Japanese children are educated to age 18 while more than a third of these enter higher education. In addition to long hours at the state schools, almost half of the senior pupils attend 1 or 2 hours per day of extra tuition, at their parents expense, primarily to study mathematics, English and Japanese.

There is, in fact, no specialisation of subjects studied up to age 18 and consequently degree courses at University last for 4 years. To gain a PhD a student must add 3 years to the 6 years required for a MSc degree, a total of 9 years at University.

Many visitors to Japan expect to find that one reason for the success of the new science based industries is that university research is geared to the needs of industry and the the problem, much discussed in Britain, of exploiting commercially the technologies developed in the universities has been solved. It is surprising to find that this is not the case. JAPANESE UNIVERSITIES ARE, ABOVE ALL ELSE, SUPPLIERS OF VERY LARGE NUMBERS OF WELL TRAINED ENGINEERS TO INDUSTRY, RESEARCH HAVING ONLY A SECONDARY ROLE.

Very strong personal links are forged between individuals in the companies and the universities and small contracts may be placed and equipment loaned to cement such relationships. However, the prime aim of the company providing such support is to obtain the best possible students for the company development programme. The coupling becomes so close in this informal manner that the professor may be asked to directly appoint students of his choice to posts in the firm. It has been mentioned before that it is by these same strong ties between the professor and engineers in industry that the consensus of national science policy is formed.

In 1979 the private universities supported 1160 science researchers and 10,083 engineering researchers while the national state financed universities supported 8929 scientists and 16,159 engineers. Although the staff of the private universities may receive direct financial support for research and consultancy work those in state financed universities do not in general do so. It is reasoned that such staff are receiving a salary for full time employment and cannot logically accept further support. Such arrangements are encouraged in the USA and Britain where it is accepted that consultancy agreements and industrial support via formal research contracts enhances the level of contact between university and industry, and so stimulates relevant research. In Japan both research staff and students would not welcome closer industrial control of research, seeing this as an intrusion on academic freedom. Equally, industry would not wish to support further applied research believing that it has the strongest incentive to perform such research itself.

In summary, industrialists do everything in their power to encourage the universities to perform a professional job of supplying sufficient numbers of the very best quality engineers and scientists. Although not hostile to the research effort within the universities the attitude is generally one of apathy.

7b) THE INSTITUTES

Tsukuba Science City

In 1970 when the rate of growth of the Japanese economy was particularly high and the confidence in and the expectation of science and technology were at a peak, the Government decided to build a complex of scientific research establishments in the country area of Tsukuba, some 50 miles north-east of Tokyo. As building progressed 43 different institutes were eventually re-located from in and around Tokyo to spacious new accommodations of the highest quality in the Science City. Opinions as to the value of this move seem very mixed and most observers would prefer to allow more time to pass before making a judgement. Certainly the Agency for Industrial Science and Technology, (a section of MITI), has decided that the staff numbers projected in the enthusiastic planning phase in the early 1970s are too large, partly as a result of pressure from industry not to absorb too many of the nation's engineers, (even in Japan they are in short supply), but also because the cost of funding a researcher has risen as alarmingly in Japan as elsewhere. Several of the establishments are running down staff numbers at 1 or 2% per year although, conversely, the funding for the purchase of capital equipment seems unrestrained.

In Western nations innovative research benefits strongly from the mobility of research workers between the laboratories of different employers. A first class research team will grow spontaneously as high quality staff are attracted to it from outside. Thus the reputation of the team grows still further, it is able to attract the necessary funding and innovations flow as a natural consequence. In America the Stanford University research park and the Route 128 complex near Boston are prime examples of this mechanism in action. Researchers may settle their families in a location convenient to the area and move their employment between laboratories freely. The spontaneous growth of the microchip companies in Silicon Valley illustrates how a similar process can stimulate the growth, in one geographical area, of a cluster of high technology companies.

Some believe that the artificial creation of a science complex in Japan could never stimulate the same thriving community of science based institutes and industries as are found in the United States. The main obstacle in Japan is undoubtedly the tradition of life-time employment of an employee for one organisation. It seems that even amongst those institutes funded by AIST there is very little movement of staff and transfer between these institutes, the STA institutes and the University of Tsukuba is not very common. Provision for companies to build research establishments at Tsukuba was made in the original plan but the larger companies, (or perhaps their staff), seem, as yet, unwilling to relocate.

MITI calls freely on the advice of the research managers of the research institutes when formulating science policy. For this reason and also because of the traditionally strong Japanese family ties, many managers maintain homes both in Tokyo and at Tsukuba, at great personal expense.

Thus for various reasons the enthusiasm for the Science City concept appears currently to be at a low ebb. However, government administrators in Japan traditionally take the long term view and the original schedule is still being maintained.

Indeed the authorities could do little else. Some 11,400 people now work at the institutes including 6,400 research staff. The land for the town was purchased from 2,500 landowners and this land, the public utilities and the building works represent an investment of some £2,000M.

To stimulate the public and industry's awareness of this national asset the government is planning an international exhibition at Tsukuba in 1985. This will cost over £500M and 20 million visitors are expected, including perhaps 1.5 million foreigners. Again, by firm long term planning, generously funded, the Government will launch Tsukuba Science Town into the consciousness of Japan and the world. The exhibition and Tsukuba itself represent a reaffirmation of faith

/by the

by the Government that Japan requires a full spectrum of scientific research establishments to underpin the knowledge intensive, high technology industries essential to the country's prosperity in the coming decades.

8) WHY? CULTURE

43.

Why does Japan act as it does?

It is now understood that many of our individual actions and reactions subconsciously derive from the inborn responses to the environment inherited from our distant ancestors. In a loosely analogous way the actions of a nation and its people derive from their culture. There is a long delay between the change in the environment (brought about in this case by exposure to new technology) and the adaption of the culture itself.

For the Japanese the era of the peasant economy and feudal hierarchy is more recent than for any other advanced nation. Traditionally the peasant works hard, saves hard, obeys his masters and has no faith that the next year's harvest will be adequate. The Japanese enjoy their new prosperity but cannot quite believe that it is here to last and still cannot relax. Indeed with no energy resources the situation is still precarious.

What are the differences?

(a) Companies

COMPANY MOTIVATIONS	
<u>JAPAN</u>	<u>UK</u>
GROWTH	PROFITABILITY
————— INCREASED PRODUCTIVITY —————	
DIVERSIFICATION	SPECIALISATION
LONG TERM PLANNING	SHORT TERM PLANNING

Oversimplification can be dangerous. However most Japanese companies consciously plan for long term growth and especially during a time of world recession their policy is to increase investment so that they emerge from the recession with a more competitive product.

/To quote

To quote the head of the Nippon Steel Corporation:

"Fiscal 1981 is going to be a severe year when steel demand is going to drop. For achieving a cost down at a time when production curtailment is under way, there is no other way than realizing a technological renovation through capital expenditure."

Non profitable sections of a British company are often closed down even if as a consequence the company is then unable to offer a complete service to its customers. When NEC sells communication systems to South American countries they pride themselves in being able to offer a complete package of technology from their own resources. Competing British companies are now forced to link hands with (even) other Japanese companies to offer the same facilities.

(b) Individuals

It is said that subconsciously a Japanese places his loyalties in the priority order,

1. TO JAPAN
2. TO HIS COMPANY
3. TO HIS FAMILY
4. TO HIMSELF

while a Briton would be loyal

1. TO HIMSELF
2. TO HIS FAMILY
3. TO HIS COMPANY
4. TO BRITAIN.

Clearly such a statement is unfair to both the British and Japanese people but many would observe a tendency towards such extremes.

It is perhaps fair to say that for a Japanese person life is

WORK CENTRED

NOT

HOME CENTRED

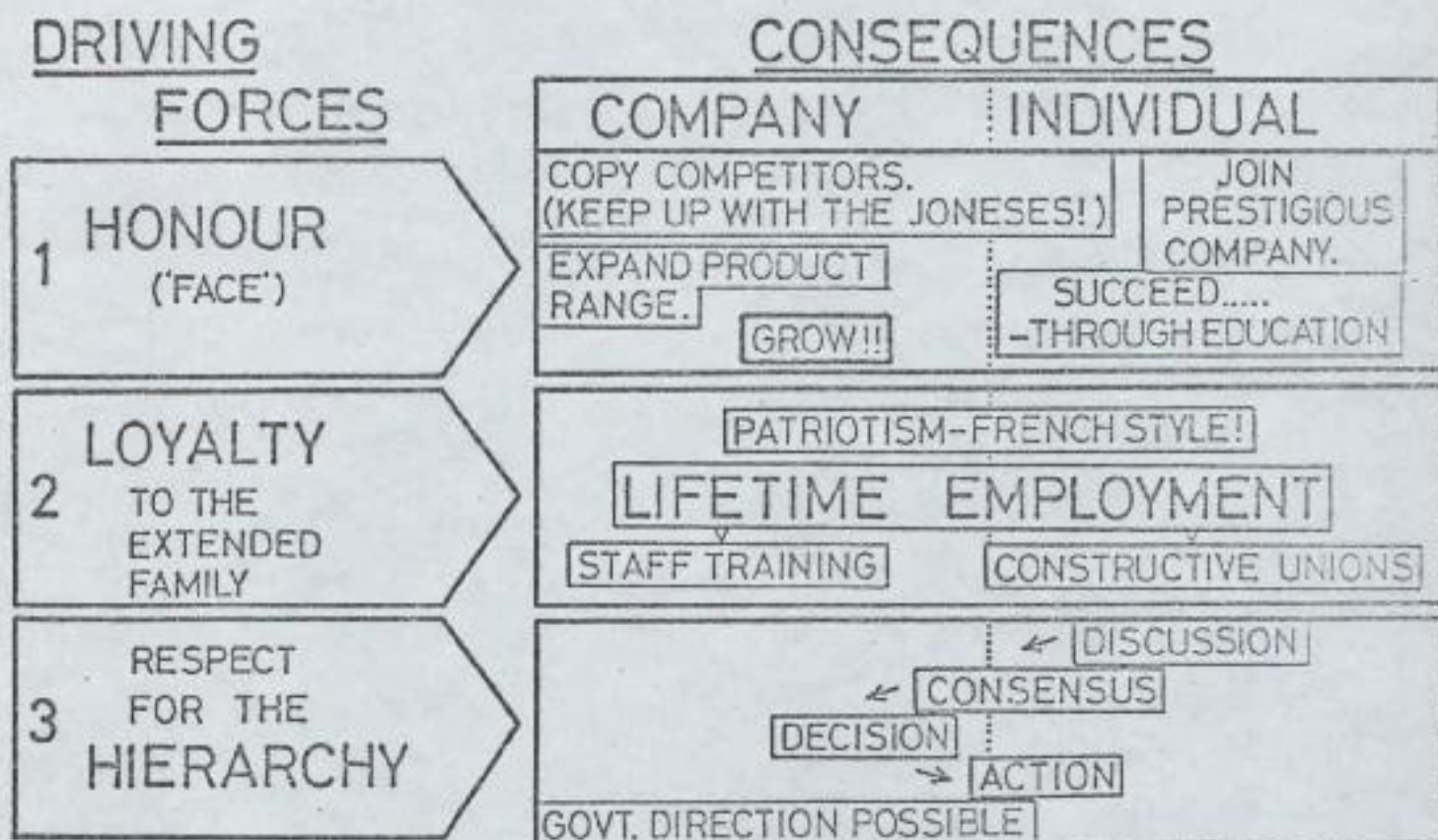
/while

while again in Britain the reverse order applies.

Driving Forces

Deeply engrained in the traditional Japanese culture are the concepts of honour (face), loyalty and respect for the hierarchy. These driving forces although perhaps not consciously acknowledged have many consequences that have been touched on earlier in this presentation.

Their consequences are summarised as follows:



This simplified analysis shows that most of the consequences of these culture derived pressures are positively beneficial to a modern manufacturing and trading nation. The one negative result of respect for the hierarchy is the apparent unwillingness of individual research workers to claim innovations that would draw attention to themselves.

/The

The Matsushita motto claims:-

"One step forward by one hundred is mightier than one hundred steps forward by one."

Every Japanese child knows the proverb:-

"The nail that sticks up will be hammered down."

In a peasant culture there is a feeling that it is dishonourable to return home before dark. However, when it was suggested that daylight saving time be introduced into Japan to save energy there was a great outcry from those who calculated that they would then be honour bound to remain at work for another hour at night!

9)WHAT CAN WE DO?

47.

After spending only eighteen months in Japan and having no direct experience of working inside a British company, I offer the following paragraphs with great humility. Most of the statements are surely obvious to the reader, but are included for completeness.

1. BECOME MORE AWARE OF JAPAN

a) The Japanese electronics market is the second largest in the world but the majority of the largest British electronics companies do not have an office in Tokyo.

b) At the important International Astronautical Conference in Tokyo in 1980 only two representatives from Britain were included amongst the 900 delegates. The premier international conferences now all include Tokyo on their itineraries.

c) The Japan Economic Journal (English edition) should be required reading for all senior managers in Britain.

d) Companies without a Tokyo office should at least appoint a "Mr Japan" in the UK to coordinate and stimulate Japan related activities.

2. USE MORE ROBOTS

3. PLAN FOR GROWTH

4. RETREAT NO FURTHER

Maintain (and develop) the manufacturing base to sell to mass markets. Do not abandon the office equipment market in addition to the consumer electronics market. Unemployment that arises from an efficient manufacturing sector is a disease far more easily cured than unemployment resulting from the rapid decay of an industry attempting to use out of date techniques.

5. Plan to introduce QUALITY CIRCLES into manufacturing.

/6. Do

6. Do all possible to MAINTAIN INVESTMENT when times are bad.
7. Promote more people with ENGINEER TRAINING to senior posts.
8. Develop JOINT COMPANIES. Consider the possibility of "paired joint companies" i.e. new companies owned 50/50 by Japanese and British firms, one based in Britain and one based in Japan. Just as in the British development areas the Japanese prefectures offer financial incentives for companies to set up new factories.
9. Make full use of the services offered by the Departments of Industry and Trade.
10. Finally we stress that Japan
 - (a) declares a funded 10 year policy for science and technology (the MITI "visions")
 - and (b) ensures the efficient and accelerated introduction of new technologies into Japan through funded cooperative research programmes in Industry (the "National Plans").

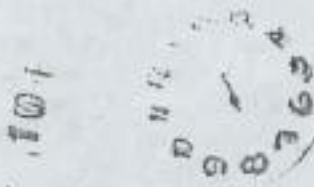
In short, although Japan is isolated from Britain by both culture and distance, it surely does exist and represents a challenge that must be faced squarely and with urgency.

Recommended Reading

1. The Japan Economic Journal
Subscription \$99 per year to Nikkei Sales Centre Inc., P.O. BOX 500
Tokyo, Japan.
Published by Nihon Keizai Shimbun Inc., 9-5 Ohtemachi 1-chome,
Chiyoda-ku, Tokyo 100.

2. EDP Japan Report (Computing, communications, electronics)
Published by International Data Corporation Japan, 4-7 1-chome
Kudankita 3179, Chiyoda-ku, Tokyo 102.
Subscription \$150 per year plus \$21 for air mailing.

3. Journal of Electronic Engineering
DEMPA Publications Inc, 11-15 Higashi Gotanda 1-chome,
Shinagawa-ku, Tokyo 141.



Keep in touch—with the Overseas Technical Information Unit

How does your organisation keep up to date with the rapidly changing technological scene overseas?

Are you able to take advantage of technological developments which are taking place all over the world?

Are you aware of the threats and opportunities which are presented to United Kingdom industry by these developments?

Remember—more than 95% of all research and development is undertaken outside the UK.

Overseas Technical Information Unit

The Overseas Technical Information Unit (OTIU) can help you to keep in touch with these developments.

The OTIU is a part of the Department of Industry and acts as a focal point for the activities of five UK Science and Technology Counsellors stationed at our embassies in Paris, Bonn, Moscow, Tokyo and Washington. All the Counsellors are qualified engineers or scientists able to report on a wide cross-section of topics, including industrial automation, microelectronics, energy technology and pollution control.

OTIU is also able to call on the services of a number of British Council Science Officers in posts throughout the world. OTIU is therefore in a strong position to monitor technological developments on an international scale and to make the information available quickly to British industry.

A great deal of valuable information is available in the technical and general press, but there is no substitute for reports from trusted representatives on the spot. Reports can also cover foreign government policy, for example on pollution, energy and national standards, which may have significant implications for the UK, particularly in relation to exports.

The OTIU, backed by its overseas network, exists to provide a service to industry.

Why not take advantage of it?

How to find out more

Contact Dr I.C. Goldstone on 01-211 3500
 Overseas Technical Information Unit
 Department of Industry
 Abel House
 John Isles Street
 London SW1P 4LN

Overseas Technical Information Unit

If your organisation requires information on technological developments and policy overseas please complete the tear-off form and return it to:

Overseas Technical Information Unit
 Department of Industry
 Room 701, Abel House
 John Isles Street
 London SW1P 4LN
 Telephone 01-211 3500

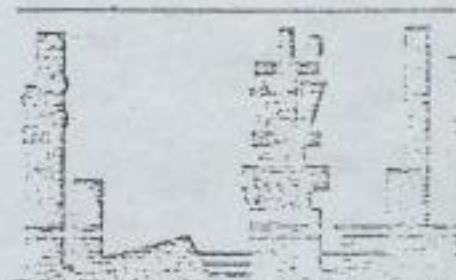
Request for Information on Overseas Technology

I would like to be kept aware of technological information received by the OTIU—

On the following topics:

From the following countries (please tick)

- West Germany USA
 France USSR
 Japan Other: (please specify)



Name _____

Position held _____

Organisation _____

Address _____

Postcode _____ Telephone _____

GOVERNMENT RESHUFFLE

Cabinet positions

Prime Minister Zenko Suzuki has announced changes in his administrative team on 30th November. A complete list of Cabinet members is shown below. The timing of the Cabinet reshuffle was dictated by the fact that the terms of office of Liberal Democratic Party officials expire in December.

<u>Position</u>	<u>Name</u>	<u>Age</u>
Prime Minister	Zenko Suzuki	70
Justice Minister	Michita Sakata	65
Foreign Minister	Yoshio Sakurauchi	69
Finance Minister	Michio Watanabe	58
Education Minister	Heiji Ogawa	71
Health & Welfare Minister	Motoharu Morishita	59
Agriculture, Forestry & Fisheries Minister	Kichiro Tazawa	63
International Trade & Industry Minister	Shintaro Abe	57
Transport Minister	Tokusaburo Kosaka	65
Posts & Telecommunications Minister	Noboru Minowa	47
Labour Minister	Takiichiro Hatsumura	68
Construction Minister	Ihei Shiseki	74
Home Affairs Minister (concurrently Chairman, National Public Safety Commission)	Masataka Seko	58
State Minister (Chief Cabinet Secretary)	Kiichi Miyazawa	63
State Minister (Director General, Prime Minister's Office and Okinawa Development Agency)	Kunio Tanabe	68
State Minister (Director General, Administrative Management Agency)	Yasuhiro Nakasone	63
State Minister (Director General, Defence Agency)	Soichiro Ito	57
State Minister (Director General, Economic Planning Agency)	Toshio Komoto	70
State Minister (Director General, Science & Technology Agency; Chairman, Atomic Energy Commission)	Ichiro Nakagawa	56

<u>Position</u>	<u>Name</u>	<u>Age</u>
State Minister (Director General, Environment Agency)	Bunbei Hara	68
State Minister (Director General, National Land Agency; Director General, Hokkaido Development Agency)	Yukiyasu Matsuno	73
Director, Cabinet Legislative Bureau	Reijiro Tsunoda	60

GOVERNMENT TO CONSIDER STREAMLINING IMPORT PROCEDURES AS PART OF ADMINISTRATIVE REFORM

Seeking ways to improve regulations

At a meeting on 28th November, the Second Special Committee of Inquiry on Administrative Affairs decided to examine ways of improving certain regulations so as to remove non-tariff trade barriers. The Committee is to consider the abolition or relaxation of licensing and approval procedures in 24 cases, among them safety and pollution standards for motor cars. It is hoped that a draft report will be ready by January and that the final report can be submitted to the Government by spring of 1982.

Covering three areas

The Committee embarked on its examination of the question of non-tariff barriers at the request of Prime Minister Suzuki. A sub-committee will be considering regulations in three areas: (1) customs procedures; (2) industrial, health and safety standards, e.g. for motor cars; (3) packaging and labelling regulations (Japan Agricultural Standards etc.).

24 items to be considered

The 24 items to be considered - including drugs, cosmetics, cars, agricultural chemicals and animal and plant quarantine regulations - are those on which West European and American demands for the removal of non-tariff barriers have been concentrated. It is hoped, therefore, that action on these items will help to ease trade frictions swiftly.

TOKYO-ROUND TARIFF CUTS TO BE BROUGHT FORWARD

Effective from 1st April 1982

Prime Minister Zenko Suzuki instructed his new Cabinet on 30th November to speed up by two years the schedule of tariff cuts agreed during the Tokyo round of GATT negotiations. The schedule laid down during the 1978 negotiations specified that the agreed tariff reductions would be spread evenly over the eight years from 1980 to 1987. Mr. Suzuki's instruction would mean that reductions scheduled for 1983 and 1984 would be added to the 1982 cuts, all to come into effect on 1st April 1982.

2,600 items include whisky, biscuits and chocolate

The approximately 2,600 items to be affected by the cuts will include whisky. The import duty for Scotch whisky is already at the final rate agreed during the Tokyo round, ¥343 (c. £0.80) per litre. The planned additional reduction is in response to British requests that it should be reduced to the same level as that applied to the Bourbon whiskies, chiefly imported from the United States and Canada. This would mean a reduction from the 30% level to 24.5% on an *ad valorem* basis. The Ministry of Finance estimates that the import tariff on

biscuits containing added sugar will be cut from 38.5% to 36.3% and for other biscuits from 33.8% to 31.9%. Chocolate tariffs will be cut by the same amount as other biscuits.

KEIDANREN NAMES CHAIRMEN OF SPECIAL TRADE COMMITTEES

*Nakamura of
Mitsubishi Bank
and Morita of
Sony*

Keidanren (Federation of Economic Organisations) has announced the names of the Chairmen of the two special committees recently set up by Keidanren as a contribution to easing trade frictions between Japan and the EEC and Japan and the US (see *Japan* No.166, 19th November 1981). Mr. Toshio Nakamura, Chairman of Mitsubishi Bank, is to chair the committee dealing with trade frictions with Europe, while the international investment and technology exchange committee will be under the chairmanship of Mr. Akio Morita, Chairman of Sony.

MATSUSHITA PROFESSORSHIP FOR HARVARD

*Chair of
Business
Leadership*

A chair of 'Business Leadership' in the name of Konosuke Matsushita is to be instituted in the Harvard Business School. Mr. Matsushita, now aged 86, is the founder of Matsushita Electric Industrial Company. The Japanese style of business management, as typified by the Matsushita methods, will be the main subject of the new professorship.

*To be filled
next
September*

An agreement establishing the chair has been signed by Mr. Matsushita and Mr. J.H. McArthur, Dean of the Business School, at Matsushita's head office in Osaka. The chair is expected to be filled next September. It is to be endowed with \$1 million donated by Matsushita, Japan's biggest home electric appliance manufacturer.

*First
non-American*

The professorship is believed to be the first of its kind in that it bears the name of a non-American business leader. A full-time member of the faculty is expected to be appointed to the post. Mr. Matsushita is expected to visit the Harvard Business School during a visit to the US to inspect plant and offices of the company's American subsidiary.

ADDITIONAL ISSUE OF NATIONAL BONDS

*To cover
revenue
deficit on
salaries*

The Finance Ministry announced on 26th November its intention of making an additional issue of national bonds to the value of ¥270b. (c. £613m.). The last time that an additional issue of bonds in mid-fiscal year was made was in 1978. This year's additional issue is necessary because it has become clear that there will be a revenue deficit as a result of Government employee salary increases recently authorised by the National Personnel Authority.

*Full
reduction in
bond issue
is not now
possible*

FY 1981 is the first year of the Government's fiscal reconstruction programme and it had been planned to reduce the issue of national bonds by ¥2,000b. (c. £4.5b.). The additional issue means that the full reduction will not be possible. Plans for FY 1982 call for the issue of national bonds to a total value of ¥10,440b. (c. £23.7b.), which represents a reduction of ¥1,800b. compared with FY 1981.

FORMER VICE PRESIDENT MONDALE MEETS WITH PRIME MINISTER

Exchange of views on trade friction

Prime Minister Suzuki and former US Vice President Walter Mondale exchanged views, mainly on Japan-US trade frictions, during a one-hour meeting at the Prime Minister's Official Residence on 26th November. Mr. Mondale was visiting Japan on his way home from a trip to China and South Korea.

Identifying non-tariff trade barriers

In response to Mr. Mondale's request for the removal of non-tariff barriers to trade, Mr. Suzuki made clear his intention to take positive steps to re-assess the question, which is one of the causes of trade friction between the two countries. He emphasised that his policy was to have the competent permanent vice-ministers re-examine the procedures of each ministry and agency involved in order to identify non-tariff barriers. In this connection he said that he wanted Japan and the US to give the question joint consideration and that he hoped the US would point out any facts they considered relevant.

New forum for assessing problem?

Chief Cabinet Secretary Miyazawa stated later that the Government would be considering whether joint examination of the problem could be carried out by the existing Japan-US Trade Facilitation Committee or whether a new forum should be set up.

JAPAN-IRAN PETROCHEMICAL PLANT

Suspended due to war

Reports in the Russian media that construction work on the Japan-Iran petrochemical plant in Iran has been suspended because of pressure from Washington have been categorically denied. Counsellor Komarovskii, of the Soviet Embassy in Tokyo, was summoned to the Foreign Ministry and told that Japan had suspended the construction at its own discretion, calling the Russian reports groundless and ill-motivated. The joint project has been suspended since last year as a result of the prolonged Gulf War.

ARTIFICIAL EARTHQUAKES

Quake-resistant buildings

A joint Japan-US project to collect detailed data for designing buildings capable of withstanding powerful earthquakes was recently started at a Construction Ministry laboratory in Tsukuba Academic City, Ibaraki Prefecture. The project is being undertaken by Japan's Science and Technology Agency, the Construction Ministry and the US National Science Foundation.

Force seven - ultimate goal

In an initial experiment, seven computerised jacks were affixed to a giant building, applying simulated earthquake forces to the building. Starting with artificial quakes with a force of four on the Japanese scale of seven, an earthquake with a force of seven is to be created in the experiment in the final stage. According to the Construction Ministry, if the building withstands a force seven earthquake, the cost of medium height buildings in Japan would be reduced by 1%. This means that Japan could save some ¥70b. annually in construction costs.

RECENT AND FORTHCOMING EVENTS

- 28 Nov. 95th Extraordinary Session of Diet ends (extended from 17 November).
- 30 Nov./1 Dec. First meeting of Japan-France Industrial Co-operation Committee. (Tokyo)
- 3-4 Dec. Third meeting of Indonesia-Japan Joint Economic Commission. (Jakarta)
- 4-6 Dec. Meeting of Independent Commission on Disarmament and Security (Palme Commission). (Tokyo)
- 7 Dec. One-day Workshop on Disarmament and International Security, sponsored jointly by UN University, Hiroshima City and Hiroshima University. Participants to include Palme Commission. (Tokyo)
- 21 Dec. 96th Ordinary Session of Diet due to be convened.

JAMA-SMMT TALKS

LCV's mentioned

The Japanese Automobile Manufacturers' Association (JAMA) and the Society of Motor Manufacturers and Traders (SMMT) mentioned light commercial vehicles (LCV's) for the first time in their joint communique, following three days of talks in London.

Prudent marketing

Although figures are not mentioned between the two sides the communique calls for continued prudent marketing of cars and prudent marketing of LCV's. In the past this has resulted in the Japanese share of the British car market remaining at around the 11% mark.

Likely market size

The SMMT are forecasting that the UK market in 1982 will be around the 1.52m. to 1.55m. mark for passenger cars and 170,000 to 175,000 for light commercial vehicles. This compares with a likely result for the current year of 1.48m. cars and 165,000 LCV's.

NTT WANTS TO BECOME SEMI-GOVERNMENTAL

To achieve administrative and fixed reform

Japan's governmental monopoly, the massive Nippon Telegraph and Telephone Corp. (NTT) has drafted a plan to turn itself into a semi-governmental body similar to Japan Airlines. The draft comes as a result of investigations aimed at Japan's public corporations achieving administrative and fiscal reform. The alternatives examined by NTT included it becoming a private company on the one hand or altering the existing NTT establishment law on the other.

Government to hold block of shares

The draft proposes that NTT should be capitalised at about ¥1 trillion (c. £2.3b.), with a block of the shares held by the Government. The highest body of authority would be a general assembly of shareholders, which would approve business results, although the telecommunications rates would be controlled by law.

IMPORT CONTRACTS TOP EXPORTS FOR OCTOBER

*Imports up
12.7%
year-to-
year*

The 13 major Japanese trading houses which account for about 60% of the country's trade saw import contracts soar 12.7% year-to-year during October, according to the Japan Foreign Trade Council. The import surplus was ¥276.4b. (c. £647.8m.), compared with an export surplus of ¥67b. (c. £157m.), for September. The major source of increased imports came from the US (up 34.8%), Middle East (up 56.7%) and Latin America (up 2.92 times).

UNEMPLOYMENT UP IN OCTOBER

Up 90,000

Unemployment in October rose 90,000 year-to-year, keeping the total above the 1.2m. mark for the second consecutive month, according to the Statistics Bureau of the Prime Minister's Office.

*2.1%
unemployed*

The jobless ratio remained the same as in September at 2.1%, although this is up 0.1% year-to-year. The country's labour force itself rose 430,000 and totalled 57.59m. Employment in the manufacturing sector now stands at 13.7m., up 20,000 in October.

JAPAN BOOSTS ASEAN EMPLOYMENT

*3,000,000
jobs
created*

Investment by Japanese firms in the five members of the Association of South-East Asian Nations (ASEAN) has created some 3,000,000 jobs in those countries. This is the estimate of JETRO (Japan External Trade Organisation). The five ASEAN countries are Indonesia, Malaysia, the Philippines, Singapore and Thailand. JETRO estimates that Japanese firms employ more than 330,000 throughout the group of nations and that the additional jobs come from indirect employment through sub-contractors, transport, etc.

*Direct
investment
increasing*

The JETRO survey shows that direct investments by Japan in ASEAN have been steadily increasing. This has been a major contribution to creating employment in the five countries. Accumulated Japanese investment in ASEAN countries had totalled about \$7b. by March this year. This is second only to the estimated \$8.8b. invested by Japanese firms in the United States.

*Japan a
major
investor*

Japan was the top investor in Thailand and Indonesia, second in the Philippines and Malaysia and fourth in Singapore. The JETRO survey covered 2,363 Japanese corporations, mostly in manufacturing, operating throughout ASEAN.

JAPAN LEADING IN US PATENTS

*Over 7,000
patents taken
out by
Japanese*

Patents granted to foreign enterprises in the US totalled 25,603 cases in 1980, according to the Commerce Department's Patent and Trademark Office in Washington. Of these, 7,442 cases were accounted for by Japanese companies. They were followed by West German companies (5,867) and British (2,517). Thus the Japanese took a clear lead among overseas companies in acquiring patents in the US, which is Japan's largest single overseas market. The number of overall patent acquisitions by American concerns in the same year was reported to be 40,284.

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TELEGRAM NUMBER 162 OF 25 MARCH
INFO WASHINGTON

YOUR VISIT: THE JAPANESE SCENE

1. DOMESTICALLY THE SUZUKI GOVERNMENT HAS WEATHERED THE BUDGET SQUALLS AND CONTINUES TO COPE WITH OTHER BUSINESS COMPETENTLY IF UNEXCITINGLY. MR SUZUKI HIMSELF HAS SOMEWHAT GAINED IN CONFIDENCE IN RECENT WEEKS AND IS TALKING OF LONG-RANGE PLANS FOR ADMINISTRATIVE REFORM AS WELL AS RECONSTRUCTION OF THE GOVERNMENT'S FINANCES WHICH SUGGEST HE MAY BE HOPING TO REMAIN PRIME MINISTER BEYOND THE END OF 1982 (WHEN THE NEXT PARTY ELECTIONS TAKE PLACE).

2. ON THE INTERNATIONAL SCENE SENIOR MINISTERS ARE ALMOST ENTIRELY PREOCCUPIED WITH THE AMERICANS. THE PROBLEM OF JAPANESE CAR EXPORTS TO THE UNITED STATES PREDOMINATES, BUT THE JAPANESE MORE GENERALLY WISH TO TAKE THE MEASURE OF THE REAGAN ADMINISTRATION; MR ITO IS AT PRESENT IN WASHINGTON ESTABLISHING HIS CREDENTIALS WITH HAIG, WEINBERGER AND BROCK AS WELL AS WITH PRESIDENT REAGAN HIMSELF. MR TANAKA, THE MITI MINISTER, WILL PROBABLY VISIT WASHINGTON NEXT MONTH AND MR SUZUKI GOES THERE IN EARLY MAY. MR ITO'S LINES GENERALLY WHILE IN WASHINGTON ARE THAT JAPAN WOULD WELCOME A CLEAR INDICATION, WHICH HAS SO FAR BEEN LACKING, OF WHAT THE AMERICANS WANT ON CARS, AND THAT JAPAN WILL DO WHAT IT CAN INTERNATIONALLY TO PLAY ITS PART AS A LOYAL ALLY OF THE UNITED STATES, ALTHOUGH THERE ARE WELL-KNOWN LIMITS TO WHAT IT CAN DO IN STRICTLY DEFENCE TERMS. JAPAN WILL THEREFORE SEEK TO PLAY UP ITS ECONOMIC COOPERATION (AID) POLICIES, PARTICULARLY IN ASIA AND TO A LESSER EXTENT IN THE MIDDLE EAST.

3. ON EAST/WEST RELATIONS, JAPAN CONTINUES TO MAKE THE RIGHT NOISES - ON AFGHANISTAN, ON ECONOMIC POLICIES TOWARDS THE SOVIET UNION, ON POLAND, AND ON BREZHNEV'S SPEECH TO THE PARTY CONGRESSES FOR EXAMPLE. - BUT IN THIS THERE IS, I THINK, A MEASURE OF WISHING TO DEMONSTRATE SOLIDARITY WITH THE AMERICANS. THE DISPUTE OVER THE NORTHERN TERRITORIES WITH THE SOVIET UNION ACTS AS A FOCUS FOR THE LATENT HOSTILITY TOWARDS THE SOVIET UNION. MORE GENERALLY, THE JAPANESE REALISATION THAT THEIR VITAL INTERESTS CAN BE SERIOUSLY AFFECTED BY THE STATE OF EAST/WEST RELATIONS IS STILL DEVELOPING AND ANYTHING WHICH YOU CAN DO TO DRIVE THIS MESSAGE HOME WILL BE USEFUL. IN FORMULATING THEIR OWN POLICIES THE JAPANESE WELCOME THE ROOM FOR MANOEUVRE PROVIDED BY THE DIVERGENCE BETWEEN THE ATTITUDES TOWARDS EAST/WEST RELATIONS OF THE REAGAN ADMINISTRATION AND THOSE OF THE GERMANS AND FRENCH.

4. ON BILATERAL MATTERS, THE JAPANESE SEEM SET ON EMPHASISING THE IMPORTANCE OF DEVELOPING GOOD POLITICAL LINKS WITH US AND PLAYING DOWN AS FAR AS POSSIBLE THE PROBLEMS ARISING FROM THE ADVERSE VISIBLE TRADE BALANCE AND THE CONCENTRATION OF JAPANESE EXPORTS ON COMPARATIVELY NARROW SECTORS. WHEN DISCUSSING ECONOMIC RELATIONS,

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THE JAPANESE WILL ALMOST CERTAINLY EMPHASISE THE IMPORTANCE OF INVESTMENT IN THE UK (NISSAN IN PARTICULAR) AND WILL PROBABLY SEEK TO SUGGEST THAT WE ARE BEING FAVOURED IN THIS WAY BECAUSE OF OUR MORE FRIENDLY ATTITUDE TOWARDS THE JAPANESE (COMPARE FRENCH, ITALIAN AND BELGIAN ATTITUDES). IT WILL BE RIGHT, I SUGGEST, TO RESPOND POSITIVELY TO SUCH APPROACHES BY JAPANESE MINISTERS WHILE AT THE SAME TIME BRINGING HOME TO THEM THE IMPORTANCE WHICH WE ATTACHE TO PROGRESS IN EASING EC/JAPAN TRADING PROBLEMS AND EMPHASISING OUR SOLIDARITY WITH OUR EUROPEAN PARTNERS OVER THIS ISSUE. THERE IS STILL LACK OF PERCEPTION ON THE PART OF THE JAPANESE OF THE PRESSURES UNDER WHICH EUROPEAN MINISTERS AT PRESENT FIND THEMSELVES ON ECONOMIC ISSUES.

5. TANGIBLE EVIDENCE OF THE JAPANESE WISH TO ADD NEW WARMTH TO OUR BILATERAL RELATIONS COULD BE PROVIDED IN THE NEXT FEW WEEKS BY THEIR WILLINGNESS TO CONSIDER ESTABLISHING A FRAMEWORK FOR CLOSER COOPERATION WITH THE UK TECHNOLOGICALLY AND COMMERCIALY IN THE TELECOMMUNICATIONS AND INFORMATION INDUSTRY FIELDS. IN THIS CONNECTION YOU MAY WISH TO REFER TO MR BAKER'S FORTHCOMING VISIT TOWARDS THE END OF APRIL.

CORTAZZI

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JAPAN: FY 1981 BUDGET

1. THE GOVT TODAY ANNOUNCED ITS BUDGET FOR FY 1981.
2. THE GENERAL ACCOUNT BUDGET IS PUT AT YEN 46.8 TRILLION, UP 9.9% ON THE INITIAL BUDGET FOR FY 1980. ON THE EXPENDITURE SIDE, DEBT SERVICING COSTS ARE UP 25.3% AND LOCAL ALLOCATION TAX (GRANTS TO LOCAL AUTHORITIES) BY 23.5%. GENERAL GOVT EXPENDITURE RISES BY ONLY 4.3%. THIS REPRESENTS THE LOWEST INCREASE FOR 22 YEARS AND IS DICTATED BY THE GOVERNMENT'S DECLARED AIM OF REDUCING BOND ISSUES BY YEN 2 TRILLION TO A LEVEL OF YEN 12.3 TRILLION.
3. ITEMS OF EXPENDITURE WHICH SHOW ABOVE AVERAGES INCREASES ARE INTEREST SUBSIDIES TO LOCAL AUTHORITIES (UP 19.3%), ENERGY MEASURES (17.3%) AND ECONOMIC COOPERATION (11.2%). EXPENDITURE ON DEFENCE REISES BY 7.6% THE SAME AS THAT ON SOCIAL SECURITY. AS LAST YEAR, THE NOMINAL INCREASE IN EXPENDITURE ON PUBLIC WORKS IS PUT AT ZERO.
4. ON THE REVENUE SIDE, THE NATURAL INCREASE IN TAXATION IS PUT AT YEN 4.5 TRILLION AND NON-TAX RECEIPTS AT YEN 2.2 TRILLION. THUS THE NEED ARISES FOR TAX INCREASES AMOUNTING TO YEN 1.4 TRILLION. THESE ARE TO BE MEY BY A 2% INCREASE IN CORPORATION TAX PRODUCING YEN 620 BILLION, A 100% INCREASE IN STAMP DUTY PRODUCING YEN 350 BILLION, AN INCREASE IN LIQUOR TAX PRODUCING YEN 280 BILLION AND INCREASES IN COMMODITY TAX AND SECURITIES TRANSACTIONS TAX TOGETHER PRODUCING YEN 140 BILLION.
5. THE FISCAL INVESTMENT AND LOAN PROGRAMME FOR FY 1981 TOTALS YEN 19.5 TRILLION, UP 7.2% ON FY 80. WITHIN THIS TOTAL EMPHASIS HAS BEEN PUT ON SECURING SUPPLIES OF NATURAL RESOURCES AND ENERGY, AND ON AID TO MEDIUM AND SMALL ENTERPRISES.
6. AS A RESULT OF SUPPLEMENTARY CHANGES, THE FY 80 GENERAL ACCOUNT BUDGET HAS BEEN INCREASED BY YEN 1.1 TRILLION TO YEN 43.7 TRILLION.
7. PLEASE PASS FCO SAVING ADDRESSES

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[REPEATED AS REQUESTED]
THIS TELEGRAM
WAS NOT
ADVANCED

Japan
Prime Minister

You may like to glance through this summary.

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TELEGRAM NUMBER 723 OF 22 DECEMBER
INFO UKREP BRUSSELS UKDEL OECD WASHINGTON

Japan

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JAPAN: OFFICIAL ECONOMIC OUTLOOK

1. THE GOVERNMENT HAS PUBLISHED ITS ECONOMIC FORECAST FOR FISCAL YEAR 1981 (BEGINNING 1 APRIL 1981), WHICH HAS BEEN APPROVED IN PRINCIPLE BY THE CABINET AS A PRE-REQUISITE FOR THE FORMULATION OF THE BUDGET.
2. FY 1980 IS SEEN AS THE YEAR IN WHICH THE ADVERSE EFFECTS OF THE SECOND OIL CRISIS WERE ABSORBED AND OVERCOME. THE GOVERNMENT SEE FY 1981 AS THE YEAR IN WHICH THE ECONOMY SETS OUT ON A STABLE GROWTH PATH.
3. FOUR PRINCIPLES OF ECONOMIC MANAGEMENT HAVE BEEN ENUNCIATED:-
 - A) THE STEADY EXPANSION OF THE ECONOMY BASED ON PRIVATE SECTOR DEMAND, AND A STABLE LEVEL OF EMPLOYMENT;
 - B) PRICE STABILITY;
 - C) A STABLE SUPPLY OF ENERGY AND A SHIFT TOWARDS A LOWER DEPENDENCE ON OIL;
 - D) A ROLE IN THE WORLD COMMENSURATE WITH THE SIZE OF THE ECONOMY, WITH THE AIM OF PREVENTING THE EMERGENCE OF PROTECTIONISM, PROMOTING COOPERATION BETWEEN NORTH AND SOUTH AND PROMOTING THE IMPORT OF MANUFACTURED GOODS (THOUGH NO SPECIFIC TARGETS HAVE BEEN SET). THE ORDER OF THE FIRST TWO PRINCIPLES REFLECTS THE CHANGE IN POLICY PRIORITIES THAT HAS TAKEN PLACE IN THE SECOND HALF OF THE CURRENT FISCAL YEAR.
4. THE FORECAST IS AS FOLLOWS:

	FY 1980 FY 1979	FY1981 FY 1980
	(% CHANGE)	
GNP - NOMINAL	8.0	9.1
- REAL	4.8	5.3
FINAL PRIVATE CONSUMPTION		
- NOMINAL	8.3	9.9
- REAL	2.8	4.9
PRIVATE HOUSING INVESTMENT		
- NOMINAL	-1.6	8.5
- REAL	-9.7	4.3
PRIVATE PLANT INVESTMENT		
- NOMINAL	18.1	18.7
- REAL	5.1	7.3

5. ON EMPLOYMENT, THE LABOUR POPULATION IS FORECAST TO RISE BY 500,000 AND PERSONS EMPLOYED BY 550,800, LEADING TO A FALL IN UNEMPLOYMENT FROM 1.15 MILLION TO 1.10 MILLION, BUT THE UNEMPLOYMENT RATE REMAINS UNCHANGED AT 2%.

6. MINING AND MANUFACTURING PRODUCTION IS FORECAST TO RISE BY 5.3% (CF 4.5% IN FY 1980).

7. WHOLESALE PRICES ARE FORECAST TO RISE BY 4.1% (CF 14% IN FY 1980) AND CONSUMER PRICES BY 5.5% (7%).

8. THE CURRENT ACCOUNT IS FORECAST TO BE IN DEFICIT BY YEN 1.3 TRILLION (DOLLARS 6.1 BN ON THE EXCHANGE RATE ASSUMPTION USED OF OF YEN 213 = US DOLLAR 1), COMPARED WITH YEN 2 TRILLION (DOLLARS 9.4 BN) IN FY 1980. THE VISIBLE BALANCE WILL SHOW A SURPLUS OF YEN 1.7 TRILLION (DOLLARS 8 BN), WITH EXPORTS RISING BY 11% IN VALUE TERMS (20.8% IN FY 1980) AND IMPORTS 8.4% (14.3%).

9. THUS FOR FY 1980 THE REAL GNP OUTTURN IS EXPECTED TO BE CLOSELY IN LINE WITH THE ORIGINAL OFFICIAL FORECAST. PRICE INCREASES HOWEVER WILL BE LARGER THAN FORECAST BECAUSE OF BIGGER THAN EXPECTED OIL PRICE INCREASES AND THE EFFECT OF UNFAVOURABLE WEATHER ON FOOD PRICES. FOR THE REST OF FY 1980, AS PRICES STABILISE, PRIVATE CONSUMPTION IS EXPECTED TO INCREASE MORE RAPIDLY, BUT THE GROWTH OF PRIVATE INVESTMENT AND EXPORTS WILL SLOW DOWN. THE CURRENT ACCOUNT OUTTURN FOR FY 1980 WILL BE CLOSE TO THE OFFICIAL FORECAST OF ABOUT DOLLARS 9 BILLION.

10. IN FY 1981, WORLD ECONOMIC ACTIVITY IS EXPECTED TO BOTTOM OUT IN THE SECOND HALF OF CALENDAR 1980, TO REMAIN DEPRESSED IN THE FIRST HALF OF CALENDAR 1981 AND TO REVIVE ONLY SLIGHTLY IN THE SECOND HALF OF NEXT YEAR. NO SPECIFIC ASSUMPTION ON OIL PRICES IS GIVEN.

11. THE GROWTH OF REAL PRIVATE CONSUMPTION IS EXPECTED TO INCREASE IN FY 1981 TO A RATE MORE THAN DOUBLE THAT OF FY 1980, AS PRICES STABILISE. PER CAPITA EMPLOYEE INCOME IS FORECAST TO RISE BY 7.5%. THE RECOVERY IN PRIVATE HOUSING INVESTMENT WILL COME FROM LOWER PRICE RISES FOR CONSTRUCTION MATERIALS AND LOWER INTEREST RATES FOR HOUSING LOANS. PRIVATE INVESTMENT GROWTH WILL REMAIN STRONG WITH SOME FALL-OFF IN INVESTMENT BY LARGE FIRMS MORE THAN OFFSET BY FASTER GROWTH OF INVESTMENT BY SMALL AND MEDIUM SIZED FIRMS. EXPORTS WILL GROW LESS RAPIDLY BECAUSE OF THE DEPRESSED WORLD SITUATION.

12. DOMESTIC DEMAND WILL CONTRIBUTE 4% TO FORECAST GROWTH (1.5% IN FY 1980) AND EXTERNAL DEMAND 1.3 (3.3%). GROWTH IS EXPECTED TO

BE FASTER IN THE SECOND HALF OF FY 1981 THAN IN THE FIRST HALF WHEN SOME DEFLATIONARY EFFECTS OF THE OIL CRISIS ARE EXPECTED TO BE STILL OBTAINING. IN ADDITION, THE HIGH LEVEL OF US INTEREST RATES IS KEEPING RATES IN JAPAN HIGHER THAN THEY OTHERWISE WOULD BE, IMPLYING THE POSSIBILITY OF A FURTHER CUT IN THE OFFICIAL DISCOUNT RATE WHEN US RATES COME DOWN.

13. THE DRAFT BUDGET FOR FY 1981 IS BEING SUBMITTED BY THE MINISTRY OF FINANCE TO OTHER MINISTRIES BEFORE BEING FINALISED IN ONE WEEKS TIME. THE OUTLINE CONSISTS OF A GENERAL ACCOUNT BUDGET OF YEN 46,788 BILLION (UP 9.9% FROM FY 1980) AND A FISCAL INVESTMENT AND LOAN PROGRAMME OF YEN 19,863 BILLION (UP 4.9% FROM FY 1980).

CORTAZZI

FCO WHITEHALL
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SAVING TELEGRAM

BY BAG

FROM TOKYO

TELNO 13 SAVING

DATED 18 DECEMBER 1980

UNCLASSIFIED

Primi Mustafa

Toqtaua

MP 29/11

Addressed to FCC Telegram No 13 Saving of 18 December 1980

Repeated for information Saving to Paris, Bonn, Rome, Washington, Brussels, The Hague, Dublin, UKREP Brussels, UKMIS Geneva, UKDEL OECD, Ottawa, Bangkok, Canberra, Peking, Seoul, Jakarta, Singapore, Manila, Kuala Lumpur, Governor Hong Kong, BTC Hong Kong, Osaka.

JAPAN: MONTHLY ECONOMIC REPORT: NOVEMBER 1980

ms

General

1. Industrial production showed a further slight recovery in October, and ex-factory shipments recovered more firmly. Inventories of finished goods fell for the first time since April, and the inventories to shipments ratio declined sharply. Private consumption expenditure showed some faint signs of recovery.

2. Both wholesale and consumer prices were roughly stable in November. The year-on-year rate of increase in wholesale prices fell markedly once more, to 11.7%, but that of consumer prices rose to 7.7% as seasonal price declines in November 1979 were not matched in November 1980.

3. The current account of the balance of payments was in approximate equilibrium in October as continued growth in exports was overtaken by a sharp recovery in imports. However, there was a reversal of capital flows as net purchases of Japanese securities by non residents fell away, and the basic balance showed a \$1 billion deficit compared with a \$1.2 billion surplus in September. The yen, which continued weak in the second half of November, recovered in the first half of December, and on 18 December was about ¥209 to the dollar.

Key Indicators

	Latest Month (October)	% Change Over	
		Previous Month	Year Earlier
Industrial Production (SA)	142.3	0.4	4.3
Wholesale Prices	133.2	0.1	11.7
Tokyo Consumer Prices	140.9	- 0.1	7.7
	October \$M	September \$M	
Exports (SA)	11,442	11,063	
Imports (SA)	10,681	9,632	
Trade Balance (SA)	761	1,431	
*Current Balance	- 88	435	
Long Term Capital	- 927	763	
*Overall Balance	- 1,095	428	

*Taking seasonally adjusted trade figures.

Key Indicators (Cont'd)

Official Discount Rate	7 $\frac{1}{2}$ % (from 8 $\frac{1}{2}$ % on 6 November 1980)	
Foreign Exchange Reserves	24,936 (end November)	24,736 (end October)

Internal Developments

4. The provisional index of industrial production, seasonally adjusted, showed a further, although slight, recovery of 0.4% in October, but was nevertheless no higher than in March. Production in the three months August/October was 2.6% lower than in the previous three months. The MITI forecast for industrial production in November has been revised downwards to show a 2.1% decline compared with October, but the new forecast for December shows a recovery of 2.5%. If these forecasts are realised industrial production in the December quarter will show a slight improvement compared with the September quarter.
5. Ex-factory shipments also recovered further in October, rising 1.5%, but shipments in the three months ended October were 2.1% lower than in the previous three months.
6. The index of producers' inventories of finished goods, seasonally adjusted, fell by 0.4% in October, the first monthly decline since April. The inventories to shipments ratio declined sharply, by 3.9%, to approximately its June level. However, the index was still 1% higher than in October 1979. Planned inventory reduction in industry is probably still not complete.
7. The value of private domestic orders for machinery (excluding ships), seasonally adjusted, was dramatically higher in October than in September, rising by 74%. The value of orders in the three months ended October was 5.4% higher than in the previous three months. Large orders from the power generating industry were mainly responsible for the sharp jump in orders in October. The Bank of Japan's November quarterly short-term economic survey of principal enterprises showed a rather more optimistic picture of fixed capital formation than other recent surveys, indicating continued firmness in this sector.
8. The seasonally adjusted index of the value of retail sales rose by 1.2% in October, the third monthly increase in succession, but remained 2.1% lower than in October, 1979. The seasonally adjusted index of department store sales, however, fell by 0.3% in October, although it was 8.9% higher than a year earlier. New car registrations (excluding mini cars) were 16.6% lower than in October 1979, the eighth consecutive monthly decline on a year-on-year basis. Despite the improvement in retail sales, it is too early to say whether the expected pick up in the volume of private consumption has begun.
9. The rate of unemployment, seasonally adjusted, rose from 2.02% in September to 2.16% in October, the highest rate since August 1979, and the number of unemployed rose from 1.15 million to 1.22 million. The ratio of job openings to job seekers, however, remained at 0.72. The employment index of regular workers also remained steady. The slowdown in the rate of growth now seems to be beginning to affect the labour market.
10. The wholesale price index rose by 0.1% in November as the temporary slight weakness of the yen affected import prices. However the year-on-year rate of increase continued its rapid decline, falling to 11.7%.

11. The Tokyo consumer price index fell slightly in November, by 0.1%, from the final October figure, which was revised upwards. However, the prices of seasonal goods did not fall as far as in the same period of 1979, and the year-on-year rate of increase in November was 7.7%, compared with 7.3% (revised figure) in October.

Gross National Expenditure

12. Gross National Expenditure in the September quarter, at constant 1970 prices and seasonally adjusted, was 1.5% higher than in the June quarter, an annual rate of growth of 6.1%.

13. An increase in the volume of exports of goods and services at a relatively modest annual rate of 9.6% combined with a very sharp and possibly temporary drop in the volume of imports of goods and services accounted for the whole of the increase in GNE. Domestic demand, in aggregate, was flat.

14. The expansionary elements of domestic demand in the September quarter were private fixed capital formation, although to a lesser extent than in previous quarters, private consumption expenditure, which grew at an annual rate of 1.3% which, although low, was better than in the previous quarter, and, surprisingly, public sector fixed capital formation. Although statistical and administrative anomalies were probably responsible for the apparent sharpness of the increase in public fixed capital formation in the September quarter, policy measures taken at the beginning of September should ensure further growth in the December quarter.

15. These expansionary elements in domestic demand were offset by a decline in private dwelling investment and a further decline in private sector inventory accumulation.

Monetary Developments

16. The deceleration in the expansion of the money supply (M2 + CDs) continued in October, with the year-on-year growth rate falling to a record low of 7.6% from 8% in September. The low rate of growth was attributable to a reduction in the corporate sector's liquidity and a move to higher-yielding assets, coupled with a slackening in credit demand in anticipation of lower interest rates. The average interest rate on bank loans also fell further in October, to 8.656% from 8.739% in the previous month.

17. In November and the first half of December the disparity between Japanese and foreign interest rates widened as the cut in the Bank of Japan's discount rate was accompanied by rising rates in the United States. Other major rate changes in November consequent upon the discount rate reduction (in addition to those reported last month) were bank time deposits (down by between 0.75% and 1%) and the banks' long term prime rate, which came down by 0.7% to 8.8%. In uncertain conditions there was a degree of instability in the domestic money and bond markets, with rates edging up towards the end of the month. However, the money markets were less tight than in recent months, with a sizeable outflow of Treasury funds in part attributable to support purchases of bonds by the Trust Fund Bureau. The market surplus was absorbed by repayment by the banks of Bank of Japan credit and by Bank of Japan sales of bills. Conditions are expected to be tighter in December for seasonal reasons.

18. Money market interest rates generally fell during November. The call loan rate (unconditional median) slipped from 10.8125% at the end of October, before the discount rate cut, to a low point of 9.125%,

before edging up to 9.375% at the end of the month. The bill discount rate (over two months) fell from 10.125% to 9.265%. In the gensaki (bond repurchase) market the 3-month rate was stable for most of the month at just over 9.5%, but rose in the last week to 9.8%. The average weekly CD rate (over 150 days) fell, with some fluctuation, from 9.74% to 9.17%. In the first half of December there was little further change in either the call loan rate, despite some fluctuation in the early days of the month, or the bill discount rate, but the gensaki rate continued to rise to just over 10%.

19. The bond market was weak in November with the level of trading low as investors stayed clear to await the effects of rising US interest rates, and in these conditions some samurai issues were postponed. The yield on a representative 10-year Government bond, which had fallen in October, turned up again in November from 9.5% to just over 10%, despite the supportive effect of Government buying operations. In the first half of December, however, the yield came back slightly to just under 10%. The new issue yield for December was set at 8.227%, down from the previous 8.546% (coupon down 0.5% to 8%, price down ¥1 to 98.75) and considerably below the secondary market yield. The amount of bonds on offer was reduced given the uncertain conditions in the market, but demand turned out to be reasonably strong, giving rise to the slightly firmer market in the first part of December.

Foreign Exchange Control Law

20. The new Foreign Exchange and Foreign Trade Control Law came into effect on 1 December. It is liberal in tone, allowing all external transactions in principle, and replaces the two existing laws which generally prohibited all external transactions except those specified as free. However, the new law retains reserve powers whereby external transactions can be restricted in times of emergency, defined as disequilibrium in the Japanese balance of payments, wide fluctuations in the exchange rate of the yen, or disruption to the domestic financial markets.

21. On current account transactions there has been a relaxation in bureaucratic procedures for exports and imports and some changes in permitted payments terms. The main impact, however, will be on capital account, and particularly in three main areas. First, Japanese residents are now unrestricted in their holdings of foreign currencies. Secondly, Japanese companies are unrestricted in their foreign currency borrowing. And thirdly, non-residents are now freer, though not entirely free, to purchase shares in Japanese companies, except in 11 specified companies, mostly oil companies, designated as restricted on national interest grounds.

The Balance of Payments

22. The current account in October was virtually in balance, with a very small deficit of ¥0.1 billion, seasonally adjusted. After dropping for three successive months, the dollar value of imports recovered sharply in October and although exports continued to grow the trade surplus was about half the September level. The deficit on invisibles declined for the second month in succession. The current account was also in approximate balance in the three months August/October, compared with a deficit of \$3.9 billion in the previous three months. The main reason for the improvement between the two periods was a turnaround from deficit into surplus on the trade balance, as imports fell by 8.2% and exports rose by 2.5% but a decline in the deficit on invisibles also contributed.

23. The dollar value of exports, seasonally adjusted, was 3.4% higher in October than in September. Exports of automobiles and tape

recorders continued to show above average increases on a year-on-year basis and exports of ships again performed strongly, but exports of chemicals and iron and steel remained dull. Exports in the three months August/October were 2.5% higher than in the previous three months, an annual rate of increase of only just over 10%.

24. The dollar value of imports in October, seasonally adjusted, was 10.9% higher than in September, but it was nevertheless still below the July figure, and imports in the three months ended October were 8.2% less than in the previous three months.

25. Although the price of imported oil in October was much the same as in September, according to customs clearance figures volume increased by 24%. This increase does not reflect the underlying trend, and is probably the result of some delay in clearance through customs in September because of full storage facilities. Imports in the three months ended October were 8% lower in volume and 3% higher in price than in the previous three months, and 18% lower in volume than in the same period of the previous year.

26. The dollar value of export letters of credit received, seasonally adjusted, was 1.5% higher in November than in October, and the value of export letters of credit received in the three months September/November was 6.9% higher than in the previous three months, despite a dip in October. The annual rate of growth in the last three months of over 30% is not consistent with the expectation that the rate of growth of Japanese exports will slow down further in the next few months.

27. The deficit in invisibles, including transfers, in October was \$0.1 billion less than in September, and the deficit in the three months ended October, at \$3 billion, was nearly 9% less than in the previous three months. However, these figures are not seasonally adjusted, and there does appear to be some seasonal pattern. The deficit on invisibles also dipped in the same period of 1979 and it is too early to say whether the underlying upward trend in Japan's deficit on invisible transactions is changing.

28. There was a net outflow of long term capital in October of \$0.9 billion, compared with a net inflow of \$0.7 billion in September. Purchases of Japanese securities by overseas residents fell by \$1.7 billion between the two months and this effectively accounted for the whole of the turnaround: changes in capital movements under other headings were minor. The net inflow of long term capital in the three months ended October was \$0.9 billion, compared with \$7.0 billion in the previous three months.

29. Taking the seasonally adjusted trade figures, the basic balance showed a deficit of \$1.0 billion in October, compared with a surplus of \$1.2 billion in September. However, in the three months ended October, the basic balance was in surplus by \$0.8 billion, compared with a deficit of \$0.9 billion in the previous three months. After taking account of short term capital movements and errors and omissions there was a surplus of \$0.6 billion in the three months ended October, compared with near balance in the previous three months.

30. The foreign exchange reserves rose very slightly in November to \$24.9 billion. The yen, which had been about ¥207 to the dollar in mid-October weakened thereafter and by the beginning of December was about ¥218. However, as the view gained ground that dollar interest rates were reaching their peak the rate strengthened and by mid-December was back to roughly the mid-October level. On 18 December the yen was about ¥209 to the dollar. No Bank of Japan intervention has been reported since the first half of October.

/Prospects

Prospects

31. The publication of the September quarter GNP figures, which were better than expected, has led to renewed optimism about the possibility of attaining the official target of 4.8% growth in the current fiscal year. Most forecasters expect some recovery in the rate of growth of domestic demand, particularly private consumption in the second half of the fiscal year, and a continued, although lesser, contribution from the external sector.

32. The increases in oil prices now in train will affect the balance of payments, prices, and activity adversely but they are of the order of magnitude which forecasters have taken into account in their projections. The official outlook for fiscal 1981 is due for publication shortly; according to Press reports it will show a higher rate of growth than in 1980.

CORTAZZI

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S T A T I S T I C S

Latest Month OCTOBER - except where stated

All statistics seasonally adjusted, except where stated

R - Revised

	Latest Month	Previous Month	% change over	
			Previous Month	Year ago (NSA)
Industrial Production	142.3	141.7R	0.4	4.3
Shipments	137.0	135.0R	1.5	2.2
Inventories of Finished Goods	113.7	114.2R	- 0.4	8.6
Inventories to Shipments Ratio	87.6	91.2R	- 3.9	13.1
Wages and Salaries				7.8
Job Openings/Job Seekers	0.72	0.72		
Number of Unemployed	1.22 M	1.15 M	6.1	
Number of Unemployed (NSA)	1.13 M	1.09 M		1.8
Rate of Unemployment (NSA)	2.0	1.9		
Rate of Unemployment	2.16	2.02		
Department Store Sales	146.1	146.6	- 0.3	8.9
Index of Retail Sales	129.6	128.1	1.2	- 2.1
Wholesale Price Index (NSA) NOV	133.2	133.1	0.1	11.7
Consumer Price Index (NSA) (all nation)	140.2	140.0	0.1	7.8
Consumer Price Index (NSA) (Tokyo) NOVEMBER	140.9	141.0R	- 0.1	7.7
Average Interest Rate on Bank Loans	8.656	8.739		
Bank of Japan Notes in Circulation (NSA) NOVEMBER				5.0
Money Supply M2 + RCD (NSA)				7.6
Stock Exchange Index (First Section) NOVEMBER	494.3	494.1		
No of Business Failures (NSA) (Tokyo Shoko) NOVEMBER	1,631	1,668		- 3.0
Housing Starts (Private) (1000 SQ M) NSA	7,762	7,968	- 18.0	- 22.0
Public Works Disbursements (Billion Yen) NSA NOVEMBER	397.7	418.8R		- 7.7
Private Domestic Orders for Machinery (Less ships) (Billion Yen)	848.9	487.9	74.0	61.8

	Latest Month	Previous Month	%	
			change over Previous Month	Year Ago (NSA)
Trade Balance SA	761	1,431		
NSA	776	1,949		
Invisible Balance (NSA)	- 849	- 996		
Current Account (SA)	- 88	435		
Long Term Capital (NSA)	- 927	763		
Short Term Capital and Errors and Commissions (NSA)	- 80	- 770		
Overall Balance NSA	-1,080	946		
SA	-1,095	428		
Total Imports(IMF basis, NSA)	10,763	9,514		17.8
Japanese Imports from UK (Customs Clearance Basis, NSA CIF)	218	129		71.7
Japanese Imports from the EEC (CC, NSA)	707	159		10.8
Japanese Imports from the USA (CC, NSA)	2,085	1,942		10.6
Total Exports(IMF basis, NSA)	11,539	11,463		32.2
Japanese Exports to UK (CC, NSA)	275	334		7.9
Japanese Exports to the EEC (CC, NSA)	1,481	1,593		25.6
Japanese Exports to the USA (CC, NSA)	2,832	2,687		27.8
Validated Exports NOVEMBER	11,476	12,278	- 6.5	20.5
Export Letters of Credit NOV	7,719	7,607	1.5	9.2
Licensed Imports (NSA) NOVEMBER	11,458	13,688		0.3
Foreign Exchange Reserves (Japanese definition) at end NOVEMBER	24,936	24,736		
Ratio of Imported Raw Materials held by Producers to Consumption SEPTEMBER	119.9	117.7	1.9	
Export Prices (Yen basis, NSA)	102.5	103.5	- 1.0	2.3
Import Prices (Yen basis, NSA)	150.1	153.8	- 2.4	21.5
Export Volume (NSA)	161.3	162.3		20.0
Import Volume (NSA)	126.4	112.6		- 4.7

ITO'S UN SPEECH

Outline of UN General Assembly speech

At a Cabinet meeting on 16th September, Foreign Minister Ito revealed the gist of his speech scheduled to be delivered on 23rd September at the UN General Assembly. Recognising that the prospects for the international situation in the 1980's do not warrant any optimism, as exemplified in the Afghan issue, his speech will consist of the following main points:

International issues

1) To explain Japan's basic stand on the major international issues including Cambodia, Afghanistan, the refugee problem, the American hostages in Tehran, the situation in the Korean Peninsula and the problems in the Middle East and South Africa.

Economic concerns

2) After touching on the question of disarmament, Mr. Ito will emphasise the need to solve various world economic problems, especially the North-South issue, by means of international co-operation. He will also explain Japan's active role in economic development aid.

Peace-keeping

3) Japan's line of thinking on improving the effectiveness of UN efforts for the maintenance of peace.

LORD CARRINGTON'S TOKYO VISIT

13th Regular Anglo-Japanese Consultations

Foreign Secretary Lord Carrington will visit Tokyo from 29th September to 2nd October. During his four-day stay in the capital, he will exchange views with Foreign Minister Ito at the 13th Anglo-Japanese Regular Consultations. The Japanese Foreign Minister and the British Foreign Secretary are expected to discuss the general international situation and bilateral relations. In order to take part in the Consultations, Ambassador Fujiyama will arrive in Tokyo on 25th September and will return to London during the second week in October.

JAPAN'S BASIC POLICY

Foreign Minister in US 18th-29th September

In connection with Foreign Minister Ito's trip to Washington, D.C., (18th-29th September) and New York, where he will have a series of talks, the Gaimusho has set out Japan's basic policy on the following points:

TALKS WITH US LEADERS

Steady improve- ment of defence capability

On the question of improving Japan's defence capabilities, Mr. Ito will ask the US leaders to await the final outcome of the 1981 Budget. He will convey the Government's basic policy of a steady and

continuous improvement of defence capabilities with the consensus of the Japanese people, in spite of the prevailing difficult financial conditions.

Bilateral issues

On Japan-US relations, Japan will give further support to the US as the leader of the free world. As to bilateral economic problems, the automobile issue should be reconsidered when the final outcome of the US's International Trade Committee's investigation is known and the procurement issue should be left until after the Okita-Askew discussions.

TALKS WITH SOVIET FOREIGN MINISTER GROMYKO

Japan's stand on various issues

The basic attitude is to wait and see what move the Soviet side will make. Japan's stand on various issues is as follows:

- 1) Japan will continue to seek the removal of Soviet military bases from Japan's Northern Territories and of Soviet invasion forces from Afghanistan. The current economic sanctions against the USSR will be maintained.
- 2) Japan will not respond to the apparent Soviet strategy of treating economic and diplomatic issues separately.
- 3) Japan will not propose a visit by Mr. Gromyko to Japan.
- 4) Should the Soviet Union propose the resumption of working-level consultations Japan will show a flexible attitude.

PRUDENT MARKETING TO CONTINUE

Free trade re-affirmed

The Japanese Automobile Manufacturers Association (JAMA) and the British Society of Motor Manufacturers and Traders (SMMT), after their two days of talks in Tokyo last week, re-affirmed the principle of free trade.

Aims of meetings

The purpose of this series of meetings is to exchange views with the aim of understanding the two associations' problems in each country. The current talks covered the economic and industrial outlook in each country, the re-structuring of BL Ltd. and the sales of imported cars in both countries.

Satisfaction for both sides

Both sides expressed satisfaction with the talks saying that a greater mutual understanding of the problems had been achieved. The SMMT indicated that BL's reconstruction was well under way but JAMA expressed concern about BL's situation because of its decreased market share and expressed the hope that the new models programme would be successful.

Higher penetration due to sudden market contraction

SMMT noted the prudence with which the Japanese car makers have been undertaking marketing in the UK whilst expressing concern at the rise in their market share during July and August. JAMA explained that the sudden UK market contraction following the first quarter had not been expected by Japanese car makers and JAMA expected the higher penetration to be temporary, assuming that SMMT's market forecast for the year is fulfilled.

1981 market smaller still

The SMMT indicated a lower level of sales for 1981 emphasising a need for even greater prudence in marketing. JAMA said they were

sympathetic to the problems of the British Motor industry, expressing the hope that their association members would exercise marketing prudence throughout 1981.

*Meet again
as necessary*

SMMT drew attention to British concern over recent developments in the UK affecting heavy commercial vehicles. JAMA observed that the numbers involved were small and that they were being shipped from third countries. However, it was agreed to keep the position under constant review alongside developments in the UK market. It was agreed to meet again as necessary to discuss problems facing both sides.

*Press
conference*

The joint communique was issued at a press conference following the ninth meeting in the series since 1975. At the following press conference SMMT President Sir Bernard Scott said car sales in Britain would probably drop 8% below this year's predicted level of 1.5m. units. To achieve a maximum of 11% share the Japanese car makers would need to drastically reduce shipments for the remaining three months of this year and further slash exports next year to below this year's levels. JAMA President Takashi Ishihara told newsmen that a further session between the two sides to review developments was planned within six months.

GAIMUSHO PROTESTS OVER SOVIET UNION'S PRESS REPORTS

*Strong verbal
protest
issued*

Japan lodged a strong protest with the Soviet Union on 12th September over critical and unfriendly reports on Japan in the Soviet press. Acting Soviet Ambassador Zinovyev was summoned to the Gaimusho and a sharp verbal protest from the Japanese Government was delivered to him by Toshiaki Muto, Director General of the Gaimusho's European and Oceanic Affairs Bureau. It is extremely unusual for the Japanese Government to take such a strong attitude, especially in view of the talks between the two countries' Foreign Ministers due to take place on 24th September in New York and the protest is likely to exercise a complicated influence on the cool relations between the two countries. The gist of the protest was as follows:

*Distorted
reporting*

A tendency has been noticeable in recent reports on Japan in the Soviet press to distort historical facts and to give a distorted and one-sided account of Japan's position and intentions.

*Militarisation
under US and
Chinese
pressure*

These reports have implied that Japan is increasing militarisation under pressure from the US and China and that the movement for the return of the Soviet-occupied Northern Territories is an "unrealistic campaign by anti-Soviet groups".

*Northern
Territory
claim
distorted*

Recent Soviet legal claims concerning the Northern Territories are based on an incorrect interpretation of international documents and a distortion of historical fact. The claims are without foundation and the claim that the demand for the return of the Northern Territories is restricted to anti-Soviet groups is a distortion of, and an affront to, the feelings of the Japanese people.

*Occupation
against
friendly
relations*

The Soviet Union is continuing its unlawful occupation of the Northern Territories and is persisting in strengthening its military installations there in spite of repeated protests by the Japanese Government. This is against the spirit of the good-neighbourly and friendly relations which the Soviet Union itself has continuously advocated.

*USSR
Ambassador's
reply*

In reply to the protest, Acting Ambassador Zinovyev maintained that:
1) there is no territorial problem with Japan, and the Soviet Union can do what it wishes in its own territory; 2) the Soviet media have made no attacks against Japan; on the contrary, it is the Japanese media that are carrying reports unfriendly to the Soviet Union.

*Refusal to
relay protest
to Moscow*

He further claimed that the Soviet leaders wish to promote friendly relations with Japan. He refused to relay the protest to Moscow, maintaining that such a protest, coming just before the talks between the two countries' Foreign Ministers to take place on the occasion of the forthcoming UN General Assembly session, is not conducive to the improvement of Japanese-Soviet relations. Director-General Muto countered by pointing out that:

*Territorial
problem outstanding
since 1956*

1) it is an incontrovertible fact that the territorial problem has been an outstanding question ever since the joint Japanese-Soviet declaration of 1956 (normalising diplomatic relations); and that

*Media critical
of USSR in
Afghanistan and
Northern
Territories*

2) Japanese media criticism of the Soviet Union is directed at the strengthening of Soviet military installations in the Northern Territories, the Soviet military intervention in Afghanistan and other actions of the Soviet Union itself. Furthermore, the protest is being made now because silence might be misunderstood as implying acceptance of the Soviet claims.

JAPAN'S CONCERN OVER KIM DAE JUNG

*Agreement - no
charges for
activities
in Japan*

The Japanese Government is deeply concerned about the fate of South Korean dissident leader Kim Dae Jung as South Korea's military prosecutors demanded his death last week, claiming that he had led an anti-state movement and had sought the violent overthrow of the South Korean Government. After Mr. Kim was abducted from a Tokyo hotel to Seoul apparently by Korean agents in 1973, the Japanese and South Korean Governments agreed, in the so-called "political settlement", that the former South Korean presidential candidate was not to be charged with his activities in Japan.

*Explanation
sought*

When the newly-appointed South Korean Ambassador called upon Foreign Minister Ito last week, Mr. Ito renewed Japan's serious concern over Mr. Kim. Prime Minister Suzuki also expressed his deep concern and revealed last week that his Government had repeatedly told the South Korean Government of its concern. Gaimusho officials also made clear last Friday that the Government was now seeking an explanation from the South Korean Government to see whether there is any infringement of the "political settlement".

BLUEPRINTS FOR SUEZ CANAL PROJECT

*First phase
completion
November*

The Transport Ministry has submitted a blueprint to the Egyptian Government to double track the whole Suez Canal by 1994. The plans are based on a technological survey requested by the Egyptian Government for the projected second-phase Canal expansion work. The first phase, undertaken with Japan's co-operation, is expected to be completed this November.

*Canal will take
150,000 ton
tankers*

When the projected widening of the Canal is completed at a cost of \$1.2b., tankers of up to 150,000 deadweight tons will be able to use the facility instead of vessels up to 60,000 tons at present. Canal

RECENT AND FORTHCOMING EVENTS

12th September	Japan signed the Convention on the Conservation of Antarctic Marine Life Resources (in Canberra).
15th September	National holiday (Respect for the Aged Day).
15th-23rd September	George Younger, Secretary of State for Scotland, visits Japan.
17th-18th September	Third meeting of the Japan-Australia Mixed Cultural Committee (in Tokyo).
17th-21st September	Zambia's President Kenneth Kaunda visits Japan.
18th-29th September	Foreign Minister Ito visits Washington, DC and New York for UN General Assembly.
20th-28th September	Preparatory Survey Mission for the International Science and Technological Exhibition 1985, to be held in Tsukuba City, visits Japan.
29th Sept.-2nd Oct.	Foreign Secretary Lord Carrington visits Japan.

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revenues it is estimated, will reach close to \$1.7b. a year, compared with an estimated \$800m. for this year and will go a long way to strengthening the economic foundation of Egypt.

JAPAN'S POSTAL UNION CALLED FOR MORE CONSCIENTIOUS WORK ATTITUDE

Strike attitude not to affect work attitude

At its 33rd annual general meeting, Japan's postal union, Zentei, called for its 183,000 members to take a more conscientious attitude towards work. Tosuke Furui, the executive member responsible for planning appealed to its members not to allow their difference of opinion with the employers to interfere with the undertaking of their normal daily duties. "They should not allow the attitude taken during strikes to enter normal working life", he said. This unique and remarkable statement was made as a result of the Zentei's continuous weakening with a mass desertion of its members following the numerous long-lasting strikes in its recent history.

Attempting to improve image

The Zentei, which once boasted a membership of over 250,000 as one of the top three in the Sohyo, is now desperate to improve its image and to restructure its organisation. The Zentei leaders are particularly concerned about the tendency among the union members to pay little attention to the accumulation of unfinished daily work and the importance for each member to master his assigned duty. They point out that such negligence on the part of the members gives the employers an excuse to interfere and weaken the union.

(Yomiuri)

ANTI-POLLUTION PROGRAMME EXTENDED FIVE YEARS

Clean-up efforts continue

The current ten-year anti-pollution programme, due to expire at the end of this fiscal year, will be extended for a further five years. The decision came at a meeting of the Ministerial Council for Pollution Prevention on 9th September, because the original goals have not yet been reached. In 1971, 47 areas were designated as being seriously polluted and the central and local governments set about rectifying the situation. However, Government-sponsored projects to install anti-

pollution equipment have fallen behind schedule. The extension of the programme will now cover nine specific areas in eight prefectures.

ENERGY CONSUMPTION UNDER CONTROL

*Oil prices
in 2000?*

The Japanese will not be forced into a life of austerity due to the crude oil situation, experts assured on 11th September. A report, compiled by Institute of Energy Economics experts, said Japan's energy consumption would grow only slightly even at current living standards, but warned of a severe blow if crude oil prices rose by more than the Institute's estimates. The report took two scenarios - an optimistic and a pessimistic one. Under the former, the oil price will be \$70 a barrel in 1990 and \$125 in 2000, making Japan's average annual economic growth projected at 4.7% and 3.7% for the 1978-90 and 1990-2000 periods respectively. The pessimistic scenario assumed oil costing \$90 in 1990 and \$210 in 2000, contributing to lower growth rates of 4% and 3% for the equivalent periods.

POLITICAL FUNDS HIT RECORD HIGH

*3 elections in
18 months pull
in funds*

Political funds have swelled to record proportions due to the fact that Japan has seen three major elections in the last 18 months. A report published by the Home Affairs Ministry on 10th September shows the total funds declared by parties and other political organisations reached an all-time high of ¥96,646m. in 1979 and immediately aroused strong protest against money-power politics.

The ranking of political parties remained with the Japan Communist Party topping the list with an income of ¥16,927m., then the Liberal Democratic Party with an income ¥14,309m. and in third place, the Komeito party.

WORLD'S NO. 1 IMPORTER OF FARM AND FISHERY PRODUCTS

*Both prices and
quantities
increased*

Japan became the top importer of agriculture, forestry and fishery products for the first time in 1979. The Japan External Trade Organisation said such imports, excluding raw cotton and wool, rose 33.2% year-to-year to \$23,990m. and increases in both price and quantity are cited as the causes.

KON ICHIKAWA TO STAGE AGATHA CHRISTIE PLAY

*"Witness for
the Prosecution"*

The distinguished film director, Kon Ichikawa is to bring Europe's 'queen of mystery' to the Japanese stage by producing one of her best works, "Witness for the Prosecution". The main characters who display this tragedy of a German woman who loved her younger husband "too" much will be played by movie actress Keiko Kishi with actors Toshiyuki Hosokawa and Asao Koike in support.

SAVING TELEGRAM

BY BAG

FROM TOKYO

TELNO 10 SAVING

DATED 16 SEPTEMBER 1980

UNCLASSIFIED [CULL]

*Prime Minister
To see
summary MAF*

MS

Addressed to FCO Telegram No 10 Saving of 16 September 1980

Repeated for information Saving to Paris, Bonn, Rome, Washington, Brussels, The Hague, Dublin, Stockholm, UKREP Brussels, UKMIS Geneva, UKDEL OECD, Ottawa, Bangkok, Canberra, Peking, Seoul, Jakarta, Singapore, Manila, Kuala Lumpur, Governor Hong Kong, BTC Hong Kong, Osaka.

JAPAN: MONTHLY ECONOMIC REPORT: AUGUST 1980

General

1. Industrial production and ex-factory shipments declined in July for the third month in succession, and the inventory to shipments ratio rose further. The GNP figures for the June quarter confirmed the fact of the expected slowdown in the economy, and the July figures suggest that this will continue in the current quarter.

2. Consumer prices fell slightly in August, but the year on year rate of increase returned to a peak level of 8.5%. However, the rate of increase is expected to moderate in the near future. Wholesale prices rose in August, but the year on year rate of increase fell to 17.5%, and this downtrend is expected to continue.

3. The balance of payments on current account deteriorated slightly again in July, mainly because of a larger drop in exports than in imports, and the net inflow of long term capital also fell, so that the basic balance was in deficit by 30.8 billion. There was, however, a sizeable inflow of short term capital and the deficit on overall balance was only 30.2 billion. The yen strengthened markedly against the dollar towards the end of August, after weakening a month earlier, apparently because of larger capital inflows, and this firmer tone was maintained in the first half of September. On 16 September the yen was about ¥212 to the dollar.

4. Against this background, on 5 September the authorities announced a package of measures to support the level of activity in the economy. The main impact is likely to come from the reversal of the previous deferment of public works expenditure. In real terms the impact of this expenditure could add roughly 1% to GNP in the December quarter. The effect of the other measures announced is difficult to quantify; they are all designed to support activity without reversing the recent favourable trends in prices and without affecting the fiscal position adversely.

Key Indicators

	Latest Month (July)	Previous Month	% Change Over
			Year Earlier
Industrial Production (SA)	142.0	- 0.1	5.8
Wholesale Prices	134.5 (August)	0.7	17.5
Tokyo Consumer Prices	138.4 (August)	- 0.2	8.5
	1		<u>/Key</u>

Key Indicators (Cont'd)

	July \$M	June \$M
Exports (SA)	10,719	10,936
Imports (SA)	11,146	11,214
Trade Balance (SA)	- 427	- 278
*Current Balance	- 1,570	- 1,334
Long Term Capital	799	1,200
*Overall Balance	- 218	- 405

*Taking seasonally adjusted trade figures.

Official Discount Rate	8 $\frac{1}{4}$ % (from 9% on 20 August 1980)	
Foreign Exchange Reserves	23,048 (end August)	22,793 (end July)

Internal Developments

5. The provisional index of industrial production, seasonally adjusted, was 0.1% lower in July than in June, the third successive monthly decline. MITI forecasts for July had indicated a recovery. Industrial production in the three months ended July was 1.7% lower than in the previous three months, the first three-monthly drop for some years. MITI forecasts for August show a further, much sharper, decline, followed by a partial recovery in September.

6. Ex factory shipments also fell in July, by 0.9% seasonally adjusted. As in the case of industrial production, this was the third monthly reduction in succession. Shipments in May/July were 3% lower than in February/April, and were only 2.7% higher than in May/July 1979.

7. The index of producers' inventories of finished goods, seasonally adjusted, rose further in July, by 2.3%. The inventories to shipments ratio also rose by 2.3%, and is now at its highest level for several years.

8. The value of private domestic orders for machinery, excluding ships, seasonally adjusted, recovered partially in July after a sharp decline in June, rising by 8.3%. The value of private domestic orders for machinery was over 20% higher in the three months ended July than in the previous three months. Surveys of private sector investment intentions continue to indicate buoyant demand from this sector, and the behaviour of orders for machinery is consistent with these projections.

9. According to a survey carried out by the Japan Development Bank in August and published in September, covering the investment plans of 1,500 companies capitalised at more than ¥1 billion, private fixed capital formation in the current fiscal year is planned to be 23.5% higher, in nominal terms, than in 1979. The rate of increase in manufacturing and non-manufacturing industry is roughly the same, although spending by the electric power industry is planned to grow much faster than average. The Bank of Japan's August quarterly survey supports the conclusions of the JDB's survey.

10. The seasonally adjusted index of the value of retail sales fell again in July, for the fifth month in succession, and was 3.7% lower than the July 1979 level. Although the seasonally adjusted index of
/department

department store sales also fell in July, by 3.4%, it was nevertheless 6.1% higher than the July 1979 level. New car registrations in August fell sharply, by over 17% compared with August 1979. New car registrations have been lower than the 1979 level for the past five months. The unusually cool weather affected consumers' expenditure in July adversely, but the stagnation of real private disposable income is the underlying cause of the dullness in personal consumption expenditure.

11. The rate of unemployment, seasonally adjusted, rose in July to 2.09% from 1.89% in June, and the number of unemployed from 1.07 million to 1.18 million. However, the ratio of job openings to job seekers rose from 0.75 to 0.77 and the employment index of regular workers in all industries also rose slightly. It is too early to say whether the slowdown in the economy is yet having an impact on the labour market.

12. Wholesale prices were 0.7% higher in August than in July, but the year on year rate of increase fell again, to 17.5%. The increase in August was affected by an increase of nearly 60% in the price of heavy oil for electricity generation, which had been under negotiation for some time, and the underlying rate of increase in wholesale prices is still declining.

13. The Tokyo consumer price index fell slightly, by 0.2%, in August, but the year on year rate of increase returned to a peak level of 8.5%. There was a sharp drop in the index in August 1979, and the September figure may look more favourable, but the prices of non-seasonal items are still rising. Consumer prices do not yet appear to be safely past their peak, although forecasters expect the year on year rate of increase to slow down significantly in the next quarter.

Gross National Expenditure

14. Gross national expenditure in the June quarter of 1980, at constant 1970 prices and seasonally adjusted, was 0.6% higher than in the March quarter, an annual rate of growth of only 2.5%. To some extent the economy's performance in the June quarter represents a reaction from the exceptionally rapid growth in the March quarter, but there was nevertheless a marked reduction in the underlying rate of expansion. However it is worth noting that even if the three succeeding quarters of fiscal year 1980 show no further growth in the level of activity, gross national expenditure at constant 1970 prices in the fiscal year will still be about 3% higher than in Fiscal 1979.

15. Although the surplus of the nation made an important contribution to growth in the June quarter, it was not so marked as in the three previous quarters. Exports of goods and services, at constant prices and seasonally adjusted, rose by over 5%, an annual rate of nearly 22%, but the volume of imports, which had declined in the previous quarter, rose even more rapidly, by 5.6%. The expansion in the economy, which had been entirely export led in the March quarter, owed as much to the expansion of domestic demand in the June quarter, the contribution to growth coming equally from the external and domestic sectors.

16. The expansionary elements of domestic demand in the June quarter were private fixed capital formation, which continued its well established upward trend as expected, and, surprisingly, investment in dwellings, which had declined during the three previous quarters. The figures indicating a recovery in investment in dwellings are not supported by other evidence of activity in this sector, and it is possible that the seasonal pattern has shifted, giving rise to misleading results.

17. Private consumption expenditure, accounting for over half gross national expenditure, was stagnant as rising prices held back the growth of real incomes. Private sector inventory accumulation declined as expected, a reaction from a degree of preemptive buying in the previous quarter. The impact of both government current, and, more significantly, government capital expenditure was negative, in accordance with previous policy decisions.

Monetary Developments

18. The growth of the money supply (M2 + CDs) slowed further in July to 8.8% over a year earlier, the smallest rise since money supply statistics have been compiled. The low growth is attributed to low interest rates on deposits and a consequent move into savings deposits and to some extent to withdrawals by corporations for investment in higher-yielding assets both at home and abroad. Money supply growth has now slowed almost continuously from a peak rate of around 13% in early 1979. Reflecting the tightness of funds, the average interest rate on bank loans rose to 8.89% in July from 8.81% in June. This figure has now risen for 16 months consecutively from a low point of 5.87% in March 1979.

19. In August Treasury funds were again in sizable surplus, largely accounted for by Government bond sales. The market shortage was relieved by Bank of Japan purchases of bills. Bank lending rates continued their rise in the first part of August but probably fell with the reduction of 0.75% in the official discount rate which took effect from 20 August. In line with the discount rate cut, banks lowered their short-term prime lending rate from 9% to 8.25%.

20. A major factor in the financial markets in August has been an unprecedented net inflow from abroad. This has been estimated at \$2.5 billion, of which some \$1 billion is thought to have come from OPEC countries. A large part of the inflow has gone into stocks which has been instrumental in both the Tokyo Stock Exchange and the Nikkei-Dow indices hitting all-time highs in early September. But there have also been substantial purchases of bonds (estimated at \$500 million) with reports of banks selling bonds direct to Middle Eastern countries; and inflows into the Gensaki (\$400 million) and CD and Free Yen markets (\$800 million together).

21. Interest rates in the money markets remained relatively firm until the discount rate cut, but fell thereafter. The call-loan rate (unconditional median) slipped slowly from 12.62% to 12.437% just before the discount rate cut. Thereafter it quickly came down to 11.5%, around which it fluctuated only narrowly for the rest of the month. Similarly with the bill discount rate (over two months), which over the same periods moved slowly from 12.687% to 12.562% and then dropped to 11.2% before edging up slightly to 11.4375 - 11.5% at the end of the month.

22. The gensaki (bond repurchase) market was subject to an outflow of funds in the early days of the month and the three-month rate hardened from 11.534% to 11.616%. Thereafter the rate fell to just below 11% by the end of the month as foreign funds began to flow in. Similarly the CD rate (over 150 days), which hovered around 11.4% in the first half of the month, dropped to 11.0% in the last week and further to 10.06% in the first week of September.

23. The bond market was weak in the early part of August in the face of a rise in US short-term rates and the yield on 10-year Government bonds rose from 9.35% to 9.62%. The yield then fell steadily to 9.25% at the time of the discount rate cut, but subsequently edged up again to 9.6% in early September.

24. At the beginning of September the Government offered 3-year bonds at auction with a coupon of 8.3%, down 0.1% from August's offer. The average price bid was 99.44 producing a yield of 8.537%, only marginally lower than the issue yield on 10-year bonds at 8.546%.

The Balance of Payments

25. The deficit on current account in July, at \$1.6 billion, seasonally adjusted, was a little higher than in June, as both the visible and invisible deficits rose slightly. However, the current account deficit in the three months ended July, at \$3.9 billion, was substantially lower than the deficit in the previous three months of \$5.7 billion.

26. The dollar value of exports, seasonally adjusted, was 2.0% lower in July than in June, breaking the strong upward trend of the past few months. Nevertheless the value of exports in the three months ended July was 12% higher than in the previous three months, an annual rate of increase of almost 60%. Exports of a number of items in July, notably chemicals, were lower than a year earlier. Exports of iron and steel again showed a below-average increase, but exports of automobiles, motorcycles and taperecorders continued to perform outstandingly, while exports of other electrical goods also showed above average increases. Exports of ships continued their upward trend of recent months, and showed an above average increase compared with July 1979.

27. The dollar value of imports, seasonally adjusted, was slightly lower in July than in June, following a sharp increase between May and June. The value of imports in the three months ended July was 5.3% higher than in the previous three months, an annual rate of increase of 23%. The slight decline in imports occurred despite a rise of nearly 3% in the price of imported oil between June and July. The volume of oil imports in July was much the same as in July 1979. The average price of oil imported in the three months ended July was over 6% higher than in the previous three months, and accounted for a major part of the growth of imports during the period.

28. The dollar value of export letters of credit received, seasonally adjusted, was 3.1% higher in August than in July. However, the August figure was very little higher than the May total, and the value of export letters of credit received in the three months ended August was 1% less than in the previous three months. The figures still indicate a slowdown in the growth of Japanese exports.

29. The deficit on invisibles (including transfers) in July, at \$1.1 billion, was much the same as in the previous few months, and there were no particularly significant changes in the composition of receipts and payments. Net invisible payments in the three months ended July were a little lower than in the previous three months.

30. The net inflow of long term capital in July, at \$0.8 billion, was \$0.4 billion less than in June. Nevertheless the net inflow in the three months ended July, at \$3 billion, represented a turnaround of over \$5 billion in capital flows as compared with the previous three months. The key element in the continued net inflow in July was further investment by non-residents in Japanese securities. However, Japanese residents' purchases of overseas securities increased sharply, and the

and the net balance on security transactions, at \$0.9 billion, was \$0.6 billion less than in June. Overseas direct investment by Japanese residents also recovered to more normal levels, but these movements were to some extent offset by an increase of nearly \$0.2 billion in offshore bond issues.

31. Taking the seasonally adjusted trade figures, the basic balance was in deficit by \$0.8 billion in July, after two months of approximate equilibrium. The deficit on basic balance in the three months ended July, at \$0.9 billion, was \$7 billion less than in the previous three months. After taking account of short term capital movements and errors and omissions the overall balance in July was in deficit by \$0.2 billion. The overall balance in the three months ended July was in approximate equilibrium, compared with a deficit of \$10 billion in the previous three months.

32. Despite a reportedly very large inflow of capital foreign exchange reserves rose only slightly in August, by \$255 million to \$23 billion. Reserves have risen steadily since the low point of \$18.5 billion in March. The yen, which had been about ¥226 to the dollar in mid-August, strengthened markedly in the last week of the month, and continued firmer in the first half of September. On 16 September the yen was about ¥212 to the dollar.

Prospects

33. The July figures and the National Income Statistics for the June quarter provided further evidence of a slowdown in the economy, and the current quarter is not expected to show any recovery in the rate of growth. The Bank of Japan's August quarterly survey showed that businessmen have become less optimistic about the short-term outlook for production and sales, although investment intentions remain very firm.

34. The authorities have reacted to the situation by reducing the official discount rate by $\frac{1}{2}\%$ to $8\frac{1}{2}\%$, effective 20 August, and by announcing a package of measures on 5 September. Besides a reversal of the deferment of public works expenditure, which should add about ¥650 billion (say \$3 billion) to the value of contracts for public works projects in the December quarter, the announcement referred *inter alia* to the encouragement of small businesses, smoothing the flow of funds for housing, promoting energy saving investment and removing obstacles to the implementation of the power industry's building programme.

35. Price trends, while not wholly satisfactory, are relatively encouraging. Although the improvement in the current account of the balance of payments seems somewhat erratic and the prospects for exports, according to a recent EPA survey, are not encouraging, the capital inflow has become more sustained and the yen has held firm. At the same time, the Prime Minister has called for a reduction of ¥2 trillion in the Government's borrowing requirement in the Fiscal year 1981 budget. This can almost certainly only be achieved by some increase in tax rates.

36. In these circumstances monetary policy is the main instrument available if further measures are needed to support the level of activity. The Bank of Japan's window guidance for the December quarter is due at the end of the month, and this may allow some easing of the restrictions on bank lending. A further cut in the official discount rate is also reported to be under discussion and banks' reserve requirements could also be reduced. Looking further ahead, the carry over of unspent public works allocation from fiscal 1979 could be disbursed in the current fiscal year without affecting the 1981 fiscal target.

37. The EPA published a tentative revision of the official forecast for the current fiscal year with the policy announcement on 5 September. While alterations were made to the forecasts of some components of demand, these were self-compensating, and the overall target for GNP growth in real terms remains 4.8%. Opinion remains divided on whether or not it will be achieved, but the most realistic estimate at present is that the rate of growth in the current fiscal year will be about 4%.

WILFORD

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**THIS TELEGRAM
WAS NOT
ADVANCED**

S T A T I S T I C S

Latest Month JULY - except where stated

All statistics seasonally adjusted, except where stated

R - Revised

	Latest Month	Previous Month	% change over	
			Previous Month	Year ago (NSA)
Industrial Production	142.0	142.2	- 0.1	5.8
Shipments	135.4	136.6	- 0.9	3.1
Inventories of Finished Goods	112.8	110.3	2.3	11.1
Inventories to Shipments Ratio	89.1	87.1	2.3	17.5
Wages and Salaries				8.2
Job Openings/Job Seekers	0.77	0.75		
Number of Unemployed	1.18M	1.07M	10.3	
Number of Unemployed (NSA)	1.12M	1.05M		- 3.4
Rate of Unemployment (NSA)	1.9	1.8		
Rate of Unemployment	2.09	1.89		
Department Store Sales	140.3	145.3	- 3.4	6.1
Index of Retail Sales	126.4	129.0R	- 2.0	- 3.7
Wholesale Price Index (NSA) AUG.	134.5	133.5	0.7	17.5
Consumer Price Index (NSA) (all nation)	138.1	137.8	0.2	7.7
Consumer Price Index (NSA) (Tokyo) AUGUST	138.4	138.7	- 0.2	8.5
Average Interest Rate on Bank Loans	8.893	8.818		
Bank of Japan Notes in Circulation (NSA) AUGUST				5.7
Money Supply M2 + CD (NSA)				8.8
Stock Exchange Index (First Section) AUGUST	473.7	469.2		
No of Business Failures (Tokyo Shoko) AUGUST	1,473	1,505		10.4
Housing Starts (Private) (1000 SQ M) NSA	10,332	10,262		- 28.7
Public Works Disbursements (Billion Yen) NSA AUGUST	344.3	295.3R		0.2
Private Domestic Orders for Machinery (Less ships) (Billion Yen)	584.5	539.8	8.3	18.0

	Latest Month	Previous Month	% change over	
			Previous Month	Year Ago (NSA)
Trade Balance SA	SM -427	SM -278		
NSA	113	127		
Invisible Balance (NSA)	-1,143	- 1,056		
Current Account (SA)	-1,570	- 1,334		
Long Term Capital (NSA)	799	1,200		
Short Term Capital and Errors and Omissions (NSA)	553	- 271		
Overall Balance NSA	322	0		
SA	- 218	- 405		
Total Imports(IMF basis, NSA)	11,128	10,680		30.1
Japanese Imports from UK (Customs Clearance Basis, NSA CIF)	147	171		- 18.2
Japanese Imports from the EEC (CC, NSA)	700	657		2.8
Japanese Imports from the USA (CC, NSA)	2,086	2,072		20.3
Total Exports(IMF basis, NSA)	11,241	10,807		29.2
Japanese Exports to UK (CC, NSA)	335	450		24.0
Japanese Exports to the EEC (CC, NSA)	1,498	1,455		43.7
Japanese Exports to the USA (CC, NSA)	2,750	2,731		20.7
Validated Exports	11,094	11,759	- 5.7	22.1
Export Letters of CreditAUGUST	7,495	7,271	3.1	11.7
Licensed Imports (NSA)	12,111	14,001	- 13.5	4.9
Foreign Exchange Reserves (Japanese definition) at end AUGUST	23,048	22,793		
Ratio of Imported Raw Materials held by Producers to Consumption	N/A			
Export Prices (Yen basis, NSA)	104.0	103.1	0.9	8.6
Import Prices (Yen basis, NSA)	152.8	151.2	1.1	39.8
Export Volume (NSA)	163.4	156.3	4.5	25.1
Import Volume (NSA)	129.0	126.5	2.0	- 0.2

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FM TOKYO 190830Z AUG
TO IMMEDIATE FCO
TELNO 500 OF 19 AUGUST AND TO IMMEDIATE UKREP BRUSSELS,
UKDEL OECD, WASHINGTON, PARIS, BONN.

Japan
Prime Minister

You might like to see these two Tokyo tabs on the Japanese economy.

1. THE BANK OF JAPAN ANNOUNCED TODAY A REDUCTION OF -.75% IN ITS DISCOUNT RATE, TAKING IT TO 8 AND A QUARTER PERCENT FROM THE RECORD LEVEL OF 9% AT WHICH IT HAS STOOD SINCE 19 MARCH. THE CHANGE IN THE RATE TAKES EFFECT FROM TOMORROW, 20 AUGUST. THIS REPRESENTS THE FIRST RELAXATION IN MONETARY POLICY WHICH HAS BEEN PROGRESSIVELY TIGHTENED SINCE THE SPRING OF 1979. DURING THIS PERIOD THERE HAVE BEEN FIVE SUCCESSIVE INCREASES IN THE DISCOUNT RATE, TWO INCREASES IN BANK RESERVE REQUIREMENTS AND INCREASINGLY RESTRICTIVE QUARTERLY GUIDELINES ON THE BANKS' LENDING ACTIVITIES.

2. THE REDUCTION IN THE DISCOUNT RATE COMES AT A TIME WHEN BUSINESS CONDITIONS HAVE BEGUN TO DETERIORATE. PERSONAL CONSUMPTION SHOWS SIGNS OF SLACKENING UNDER THE INFLUENCE OF WAGE INCREASES LOWER THAN THE RATE OF INFLATION SEMICOLON HOUSEBUILDING HAS BEEN AFFECTED BY HIGH INTEREST RATES SEMI COLON PUBLIC EXPENDITURE, PARTICULARLY IN THE FIELD OF CONSTRUCTION, HAS BEEN TIGHTLY REINED BACK SEMI COLON AND THE GROWTH OF EXPORTS, WHICH HAS BEEN STARTLING, IS LIKELY TO SLACKEN IN THE SECOND HALF OF THE FISCAL YEAR.

3. THE MAIN OBJECTIVE OF MONETARY POLICY HAS BEEN TO CURB INFLATION AND IT IS LIKELY THAT EVEN TODAY'S SLIGHT RELAXATION WOULD NOT HAVE BEEN FORTHCOMING HAD THERE NOT BEEN SIGNS OF IMPROVEMENT ON THIS FRONT. AS IT IS, THE WHOLESALE PRICE INDEX SHOWS A YEAR-ON-YEAR INCREASE IN JULY OF 18.5% WELL DOWN FROM THE PEAK OF 24% REACHED IN APRIL SEMI COLON AND THE TOKYO CONSUMER PRICE LEVEL STANDS 7.1% ABOVE ITS YEAR EARLIER LEVEL, ALSO LOWER THAN IN RECENT MONTHS, ALTHOUGH THE PICTURE HERE IS AFFECTED BY SPECIAL FACTORS AND THE BANK OF JAPAN HAS WARNED THAT THE RISE IN WHOLESALE PRICES HAS NOT YET FED FULLY THROUGH TO CONSUMER PRICES. THE OTHER BULL POINT, ACCORDING TO THE BANK OF JAPAN, IS THE RECENT RELATIVE STABILITY OF THE YEN EXCHANGE RATE AND CALM IN THE EXCHANGE MARKET.

4. THIS IS A MODEST FIRST STEP. FOR THE FUTURE THE BANK OF JAPAN STATE THAT MONETARY POLICY WILL BE IMPLEMENTED SO AS FURTHER TO STABILISE PRICES, BUT AT THE SAME TIME TO PAVE THE WAY FOR A STABLE EXPANSION OF THE ECONOMY, AND TO CONTRIBUTE TO THE APPROPRIATE MANAGEMENT OF TOTAL DEMAND.
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TELEGRAM NUMBER 581 OF 28 AUGUST

SAVING UKREP BRUSSELS, UKDEL OECD, WASHINGTON, PARIS, BONN

MS

JAPANESE ECONOMY

1. FURTHER DECLINES IN INDUSTRIAL PRODUCTION AND EX-FACTORY SHIPMENTS IN JUNE, COMBINED WITH AN INCREASE IN THE INVENTORY/SHIPMENT RATIO, CONFIRM THE IMPRESSION GIVEN BY THE MAY FIGURES OF A SLOWDOWN IN THE ECONOMY. THERE WAS ALSO FURTHER EVIDENCE OF WEAKNESS IN PRIVATE CONSUMPTION EXPENDITURE. ALTHOUGH EXPORTS INCREASED AGAIN IN JUNE, IT WAS AT A SLOWER PACE THAN IN APRIL AND MAY, AND IMPORTS WERE SHARPLY HIGHER. HOWEVER, RECENT SURVEYS STILL POINT TO CONTINUED STRENGTH IN PRIVATE FIXED CAPITAL FORMATION APART FROM HOUSING.
2. THERE WAS A SLIGHT DETERIORATION IN THE BALANCE OF PAYMENTS ON CURRENT ACCOUNT AS THE TRADE BALANCE MOVED BACK INTO MODEST DEFICIT, BUT THE NET INFLOW OF LONG-TERM CAPITAL INCREASED A LITTLE AS THE HIGH RATE OF INVESTMENT BY NON-RESIDENTS IN JAPANESE SECURITIES WAS MORE THAN MAINTAINED, AND THE BASIC BALANCE REMAINED IN APPROXIMATE EQUILIBRIUM. THE YEN, WHICH HAD CONTINUED FIRM IN JUNE AND THE EARLY PART OF JULY AT ABOUT YEN 218 TO THE DOLLAR WEAKENED IN THE LAST TEN DAYS OF THE MONTH. AFTER THE INITIAL WEAKNESS THE RATE TENDED TO STABILISE, AND ON 18 AUGUST THE YEN WAS ABOUT YEN 226 TO THE DOLLAR. NO BANK OF JAPAN INTERVENTION IN THE LAST MONTH HAS BEEN REPORTED.
3. AS AN INITIAL STEP TOWARDS SUPPORTING THE LEVEL OF ACTIVITY IN THE ECONOMY, THE BANK OF JAPAN ANNOUNCED YESTERDAY A REDUCTION IN THE OFFICIAL DISCOUNT RATE, EFFECTIVE TODAY 28 AUGUST OF THREE QUARTERS PERCENT TO EIGHT AND QUARTER PERCENT (SEE MY TELNO 500 OF 19 AUGUST). BANKS' RESERVE REQUIREMENTS, WERE UNCHANGED AS WERE REGULATED DEPOSIT RATES, BUT BOTH THE SHORT AND LONG TERM PRIME RATES WERE REDUCED BY THREE QUARTERS PERCENT TO EIGHT AND HALF AND EIGHT AND THREE QUARTERS PERCENT RESPECTIVELY. THE REDUCTIONS FOLLOW STATEMENTS BY MINISTERS AND OFFICIALS INDICATING THAT MEASURES TO SUPPORT THE LEVEL OF ACTIVITY IN THE ECONOMY WERE UNDER CONSIDERATION.
4. THE MODEST SHIFT IN THE EMPHASIS OF ECONOMIC POLICY ALSO FOLLOWS AN IMPROVEMENT IN THE TREND OF PRICES. ALTHOUGH BOTH WHOLESALE AND RETAIL PRICES ARE RISING, THE YEAR ON YEAR RATE OF INCREASE IN WHOLESALE PRICES HAS FALLEN BY FIVE AND HALF POINTS SINCE THE PEAK IN APRIL AND THE DOWNTREND SEEMS LIKELY TO CONTINUE. THE SHARP FALL IN THE YEAR ON YEAR RATE OF INCREASE IN RETAIL PRICES IN JULY OWED MUCH TO HIGH SEASONAL GOODS PRICES IN JULY LAST YEAR, AND AUGUST MAY THEREFORE SEE SOME REVERSAL OF THIS TREND. IN ADDITION, INCREASES IN WHOLESALE PRICES ARE STILL FILTERING THROUGH TO RETAIL PRICES. NEVERTHELESS, THE RATE OF INCREASE IN RETAIL PRICES SEEMS TO BE PASSING ITS PEAK.

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5. THE OBJECTIVES OF POLICY CONTINUE TO BE A REDUCTION IN THE RATE OF INFLATION, A REDUCTION OF THE GOVERNMENT'S BORROWING REQUIREMENT, A FIRM YEN AND CONTINUED GROWTH OF THE ECONOMY. THE REACTION OF THE FOREIGN EXCHANGE MARKET TO THE REDUCTION IN THE DISCOUNT WAS CALM, WITH A SLIGHT FIRING OF THE YEN. MONETARY POLICY REMAINS RESTRICTIVE, AND THE BANK OF JAPAN, COMMENTING ON THE CHANGE IN THE DISCOUNT RATE, REFERRED TO THE NEED TO CONTINUE THE TREND TOWARDS STABLE PRICES.
6. A NUMBER OF FURTHER MEASURES TO SUPPORT THE LEVEL OF ACTIVITY ARE REPORTED TO BE UNDER CONSIDERATION, BUT THEIR PRECISE CONTENT AND TIMING REMAINS UNCERTAIN. IT IS LIKELY THAT MINISTERS WILL ASSESS THE INDICATORS WHICH WILL BECOME AVAILABLE IN THE NEXT FEW WEEKS BEFORE MAKING FURTHER ANNOUNCEMENTS. PROBABLE MEASURES INCLUDE A REVERSAL OF THE PRESENT DEFERMENT OF PUBLIC WORKS EXPENDITURE, AN EASING OF THE CONDITIONS GOVERNING LENDING BY THE HOUSING LOAN CORPORATION, ADDITIONAL SUPPORT FOR PLANT EXPORTS THROUGH THE EXPORT-IMPORT BANK AND THE EXPORT INSURANCE DIVISION OF MITI, AN ACCELERATION OF JAPAN DEVELOPMENT BANK LENDING FOR OIL SUBSTITUTION INVESTMENT, AND THE REMOVAL OF OBSTACLES TO THE ACHIEVEMENT OF THE ELECTRIC POWER INDUSTRY'S INVESTMENT PLANS.
7. THE SIZE OF THE GOVERNMENT'S BORROWING REQUIREMENT IMPOSES CONSTRAINTS ON GENERAL FISCAL MEASURES, AND MONETARY POLICY IS LIKELY TO BE USED IF FURTHER LESS PIECEMEAL ACTION IS REQUIRED.
8. OUR USUAL MONTHLY REPORT HAS BEEN FORWARDED BY BAG.

FCO PLEASE PASS SAVING ADDRESSEES
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[REPEATED AS
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THIS TELEGRAM
WAS NOT
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SAVING TELEGRAM

Japan

BY BAG

FROM TOKYO

TELNO 9 SAVING

DATED 19 AUGUST 1980

UNCLASSIFIED

[CWU]

Prime Minister

M *MA* 27/8

Addressed to FCO Telegram No 9 Saving of 19 August 1980

Repeated for information Saving to Paris, Bonn, Rome, Washington, Brussels, The Hague, Dublin, Stockholm, UKREP Brussels, UKMIS Geneva, UKDEL OECD, Ottawa, Bangkok, Canberra, Peking, Seoul, Jakarta, Singapore, Manila, Kuala Lumpur, Governor Hong Kong, BTC Hong Kong, Osaka.

JAPAN: MONTHLY ECONOMIC REPORT: JULY 1980

General

1. Further declines in industrial production and ex-factory shipments in June, combined with an increase in the inventory/shipment ratio, confirm the impression given by the May figures of a slowdown in the economy. There was also further evidence of weakness in private consumption expenditure. Although exports increased again in June, it was at a slower pace than in April and May, and imports were sharply higher. However, recent surveys still point to continued strength in private fixed capital formation, apart from housing.
2. Consumer prices again increased modestly in July, but the year on year rate of increase fell markedly for the first time for a year. Although the extent of the fall was largely due to exceptionally high vegetable prices in July 1979, it does appear that the underlying rate of increase in consumer prices is passing its peak. Wholesale prices also rose modestly, but the rate of year on year increase also declined to 18.5% in July, compared with 20.3% in June and 24.0% at the peak in April.
3. There was a slight deterioration in the balance of payments on current account as the trade balance moved back into modest deficit, but the net inflow of long-term capital increased a little as the high rate of investment by non-residents in Japanese securities was more than maintained, and the basic balance remained in approximate equilibrium. The yen, which had continued firm in June and the early part of July at about ¥218 to the dollar weakened in the last ten days of the month. After the initial weakness the rate tended to stabilise, and on 18 August the yen was about ¥226 to the dollar.

As an initial step towards supporting the level of activity in the economy, the Bank of Japan announced today a reduction in the Official Discount Rate, effective tomorrow 20 August, of $\frac{1}{2}$ % to $8\frac{1}{2}$ %.

Key Indicators

	Latest Month (June)	% Change over	
		Previous Month	Year Earlier
Industrial Production (SA)	142.2	- 0.9	7.4
Wholesale Prices	133.5 (July)	0.4	18.5
Tokyo Consumer Prices	138.5 (July)	0.2	7.1

Key Indicators (Cont'd)

	June ¥M	May ¥M
Exports (SA)	10,936	10,585
Imports (SA)	11,214	10,461
Trade Balance (SA)	- 278	124
*Current Balance	- 1,334	- 985
Long Term Capital	1,200	979
*Overall Balance	- 405	541

*Taking seasonally adjusted trade figures.

Official Discount Rate 8½%
(from 9% on 20 August 1980)

Foreign Exchange Reserves 22,793 22,642
(end July) (end June)

Internal Developments

4. The index of industrial production in June, seasonally adjusted, was 0.9% below the May level, the second monthly decline in succession. Industrial production in the June quarter was only 0.1% higher than in the March quarter, an annual rate of growth of less than ½%, the lowest for some time. MITI forecasts of industrial production show a recovery in July but a further very sharp decline in August.

5. Ex-factory shipments also declined in June, by 0.6%, also the second monthly decline in succession, and shipments in the June quarter, seasonally adjusted, were 0.6% below the level of shipments in the March quarter.

6. The index of producers' inventories of finished goods, seasonally adjusted, rose by 1.7% in June, following an increase of 2.9% in May, and the ratio of inventories of finished goods to shipments rose again in June from the high level reached in May.

7. The value of private domestic orders for machinery, excluding ships, seasonally adjusted, fell by 14% in June from the May level. However, the value of orders in the June quarter was 16.5% higher than in the March quarter.

8. A survey conducted by the Economic Planning Agency in June, covering the investment intentions of over 16,000 companies, published in August, appears to confirm the strength of private fixed capital formation, excluding housing, and to indicate that sustained growth of this component of demand will be broadly maintained until the end of the year. At current prices, investment by all industries, seasonally adjusted, is planned to be nearly 11% higher in the September quarter than in the June quarter, when fixed investment was estimated to have been 16% higher than in the March quarter. Further, although slower, growth of 6% is predicted in the December quarter. Volume increases will be at lower rates because of continuing inflation, but the figures nevertheless indicate a marked increase in private fixed capital formation in real terms in the current year. Among manufacturing industries, chemicals, steel, other metal industries and the engineering industry show particularly marked increases in expenditure plans. Investment by non-manufacturing industries, which has sustained the growth of private fixed capital formation in the first half of the year, is expected to slow down in the final quarter largely because of a pause in investment by the electric power industry.

9. The seasonally adjusted index of the value of retail sales fell again in June, for the fourth month in succession, and was 1.4% lower than the June 1979 level. Nevertheless the value of Department Store sales, seasonally adjusted, was 0.7% higher in June than in May, and 9.6% higher than a year earlier. New car registrations in July were again lower than in the same month of 1979, but the drop of 0.2% was much less than for the previous three months.

10. The rate of unemployment, seasonally adjusted, fell from 1.98% in May to 1.89% in June, and the number of unemployed from 1.11 million to 1.07 million. The ratio of job openings to job seekers was stable at 0.75%. The employment index of regular workers was also unchanged.

11. Wholesale prices rose in July, by 0.4%, after two successive monthly declines, but the year on year rate of increase fell again to 18.5% from 20.3% in June. The increase in prices in July was partly due to higher prices of oil and of cereals, as well as to the slight weakening of the yen, but prices of domestic finished products rose 0.5% to a level 7.9% higher than in July 1979.

12. The Tokyo consumer price index rose slightly, by 0.2%, in July, but the rate of year on year increase dropped sharply from 8.3% in June to 7.1% in July. The sharp reduction in the year on year rate of increase reflected the effect on vegetable prices in July 1979 of unusually wet weather. Nevertheless, excluding seasonal items the year on year rate of increase in Tokyo consumer prices fell from 8.7% to 8.5%.

Monetary Developments

13. On 19 August the Bank of Japan announced a reduction of $\frac{1}{2}$ % in its discount rate, taking it to 8 $\frac{1}{2}$ % from the record level of 9% at which it had stood for five months. The need for the cut was indicated by the slowdown, actual and prospective, in business activity; and the opportunity was given by the fact that the rise in wholesale prices had passed its peak and by the recent relative calm in the foreign exchange market.

14. In June the growth of the money supply (M2 + CDs) slowed further under the influence of restrictions on bank credit to show a record low growth of 9.6% on a year earlier compared with 10.3% in May. At the same time the average interest rate on bank loans continued rising to reach 8.818% in June from 8.609% in May.

15. In July Treasury funds were in large surplus, owing to increased tax receipts and postal savings deposits and reduced government disbursements; in addition the Trust Fund Bureau sold back to the banks a substantial block of government bonds bought with a repurchase agreement a year earlier. The Bank of Japan relieved the market shortage mainly through large purchase of bills.

16. In the money markets the bill discount rate (over two months) continued its recent fall; from 13.1875% at the end of June it had dropped to 12.6875 - 12.8125% at end-July and further to 12.5625% by the middle of August. The call-loan rate (unconditional median) has shown very little change, fluctuating narrowly from 12.6875% at end June to 12.75% at end July. By mid-August, however, it had fallen to 12.4375%. In the gensaki (bond repurchase) market the three-month rate, which had fallen sharply in June, turned up again during July: from 10.86% at the end of June the rate had reached 11.542% by end-July. The rise continued to mid-August when it stood at 11.616%. Likewise the average weekly CD rate (over 150 days), which had fallen to 10.9% at the beginning of the month, turned up to reach 10.35% towards the end of July. These rises
/are

are attributed to the general shortage of funds in the market and to an outflow of short-term funds caused by an up-turn of rates in the United States and the Euro-dollar market and to some expectation of a weakening yen.

17. The bond market was generally weak during July: yields, which had already discounted a reduction in the official discount rate, began to turn up as expectations of a cut were frustrated. Thus the yield on a 10-year 6.1% government bond, which stood at 9.03% at end-June, rose to 9.4% during the third week of July before recovering slightly to 9.2% at the end of the month. In August, with the yen slightly weaker and international rates turning up, the yield rose to 9.3% by mid month. A government offer of 3-year bonds in August carried a coupon of 8.4%, up 0.2% on the 3-year bonds offered in June and the 4-year issue in July.

18. Meanwhile, the difficulties which the government faces in drawing up its budget for FY 1981 have been highlighted by a decision taken by the syndicate of banks and securities houses which underwrites the major part (62% in FY 1980) of government bond issues. They are to submit to the Government the proposal that they should take a maximum of ¥7 trillion of government bonds in FY 1981 compared with an initial allocation of ¥8.86 trillion planned in the FY 1980 budget. Thus the bulk of the planned reduction in government bond issues of ¥2 trillion in FY 1981 will fall to the syndicate, leaving little scope for reductions elsewhere.

The Balance of Payments

19. The deficit on current account in June, at \$1.3 billion, seasonally adjusted, was \$0.3 billion higher than in May as imports increased sharply while the growth of exports slackened. Nevertheless, the current account has shown some improvement in the last few months. The deficit in the June quarter of \$4.1 billion was materially lower than the \$5.2 billion deficit in the March quarter.

20. The dollar value of exports, seasonally adjusted, was 3.3% higher in June than in May, continuing the upward trend of recent months, although at a less immoderate pace. Nevertheless, exports in the June quarter were 11.8% higher than in the March quarter, an annual rate of increase of nearly 60%. Once again all categories of exports were higher in June than a year earlier, with increases in exports of automobiles, motorcycles and tape-recorders being particularly outstanding. Exports of iron and steel, however, showed a below average increase. The dollar value of imports, seasonally adjusted, was 7.2% higher in June than in May, after two months of modest decline. Imports in the June quarter were 7.6% higher than in the March quarter, an annual rate of increase of 34%. The average dollar price of oil imported in June was 3% higher than in May, and the volume of oil imports was about 4% higher than in June 1979. The average dollar price of oil imported in the June quarter was over 6% higher than in the March quarter and this accounted for a major part of the increase in imports during the period.

21. The dollar value of export letters of credit received, seasonally adjusted, showed some recovery in July, rising by 3.9% following a sharp fall in June. However, it remained below the May level, and the dollar value of export letters of credit received in the three months May/July was 1.9% less than in the previous three months. The trend of export letters of credit received still points to a slowdown in the growth of Japanese exports later in the year.

22. The deficit on invisibles (including transfers) in June, at \$1.1 billion, was much the same as in April and May. There were no particularly

larly significant changes in the composition of receipts and payments, but net invisible payments in the June quarter were slightly lower than in the March quarter, breaking the usual pattern of steadily increasing invisible deficits.

23. There was an increased net inflow of long-term capital in June. Overseas direct investment and lending by Japanese residents was lower than in May, but once again the overriding influence was a large continued net investment by non-residents in Japanese securities. This amounted to \$1.6 billion in June compared with \$1.4 billion in May. The long-term capital account was in approximate balance in the June quarter as a net outflow of \$2.2 billion in April was offset by inflows in May and June.

24. Taking the seasonally adjusted trade figures, the basic balance was again in approximate equilibrium in June. However, the basic balance in the June quarter showed a deficit of \$4.2 billion, only \$0.1 billion less than in the March quarter, because of the large deficit in April. After taking account of short-term capital movements and errors and omissions the overall balance in June was in deficit by \$0.4 billion. The overall deficit in the June quarter was \$5.1 billion, again because of the record April figure, compared with \$4.9 billion in the March quarter.

25. Foreign exchange reserves rose slightly, by \$151 million, in July to \$22.8 billion. The yen, which had been fairly stable since the middle of June with small fluctuations around ¥218 to the dollar, began to weaken in the last two weeks of July, partly because of firmer North American interest rates, dropping to around ¥226 to the dollar and was at about that level on 18 August. No Bank of Japan intervention has been reported in the past month.

Prospects.

26. The June figures confirm the impression of a slowdown in the economy, and today's announcement of a reduction of $\frac{3}{4}\%$ to $8\frac{1}{4}\%$ in the Official Discount Rate follows statements by Ministers and officials indicating that measures to support the level of activity in the economy were under consideration.

27. The modest shift in the emphasis of economic policy also follows an improvement in the trend of prices. Although both wholesale and retail prices are still rising, the year on year rate of increase in wholesale prices has fallen by $5\frac{1}{2}$ points since the peak in April and the downtrend seems likely to continue. The sharp fall in the year on year rate of increase in retail prices in July owed much to high seasonal goods prices in July last year, and August may therefore see some reversal of this trend. In addition, increases in wholesale prices are still filtering through to retail prices. Nevertheless, the rate of increase in retail prices seems to be passing its peak.

28. The objectives of policy continue to be a reduction in the rate of inflation, a reduction of the Government's borrowing requirement, a firm yen and continued growth of the economy. The initial reaction of the foreign exchange market to the reduction in the discount rate was calm, with a slight firming of the yen. Monetary policy remains restrictive, and the Bank of Japan, commenting on the change in the discount rate, referred to the need to continue the trend towards stable prices.

29. Looking further ahead, a reversal of the deferment of public works expenditure is also reported to be under consideration, but it may be that further measures will await a review of the economic indicators which will be available in the next few weeks.

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S T A T I S T I C S

Latest Month JUNE - except where stated

All statistics seasonally adjusted, except where stated

R - Revised

	Latest Month	Previous Month	% change over	
			Previous Month	Year ago (NSA)
Industrial Production	142.2	143.5	- 0.9	7.4
Shipments	136.6	137.4	- 0.6	5.1
Inventories of Finished Goods	110.3	108.5	1.7	9.4
Inventories to Shipments Ratio	87.1	86.4	0.8	14.8
Wages and Salaries				6.5
Job Openings/Job Seekers	0.75	0.75		
Number of Unemployed	1.07 M	1.11 M	- 3.7	
Number of Unemployed (NSA)	1.05 M	1.09 M		- 5.4
Rate of Unemployment (NSA)	1.8	1.9		
Rate of Unemployment	1.89	1.98		
Department Store Sales	145.3	144.3	0.7	9.6
Index of Retail Sales	131.0	134.5R	- 3.6	- 1.4
Wholesale Price Index (NSA) JULY	133.5	133.0	0.4	18.5
Consumer Price Index (NSA) (all nation)	137.8	137.4	0.3	8.4
Consumer Price Index (NSA) (Tokyo) JULY	138.5	138.2	0.2	7.1
Average Interest Rate on Bank Loans	8.818	8.609		
Bank of Japan Notes in Circulation (NSA) JULY				6.7
Money Supply M2 + CD (NSA)				9.6
Stock Exchange Index (First Section) JULY	469.2	467.9		
No of Business Failures (Tokyo Shoko) JULY	1,505	1,384		18.3
Housing Starts (Private) (1000 SQ M) NSA	10,262	9,573	7.2	- 20.2
Public Works Disbursements (Billion Yen) NSA JULY	295.4	299.4		- 14.6
Private Domestic Orders for Machinery (Less ships) (Billion Yen)	539.8	627.8	- 14.0	12.0

	Latest Month	Previous Month	% change over	
			Previous Month	Year Ago (NSA)
Trade Balance SA	278	124		
NSA	127	- 664		
Invisible Balance (NSA)	- 1,056	-1,109		
Current Account (SA)	- 1,334	- 985		
Long Term Capital (NSA)	1,200	979		
Short Term Capital and Errors and Omissions (NSA)	- 271	547		
Overall Balance NSA	0	- 247		
SA	- 405	541		
Total Imports(IMF basis, NSA)	10,680	10,962		42.9
Japanese Imports from UK (Customs Clearance Basis, NSA CIF)	171	129		7.8
Japanese Imports from the EEC (CC, NSA)	657	705		1.3
Japanese Imports from the USA (CC, NSA)	2,072	2,184		25.4
Total Exports(IMF basis, NSA)	10,807	10,298		26.7
Japanese Exports to UK (CC, NSA)	450	318		42.9
Japanese Exports to the EEC (CC, NSA)	1,455	1,299		38.9
Japanese Exports to the USA (CC, NSA)	2,731	2,516		22.0
Validated Exports JULY	11,759	11,037	6.5	31.5
Export Letters of Credit JULY	7,271	6,999	3.9	17.1
Licensed Imports (NSA)JULY	14,001	12,909	8.5	32.3
Foreign Exchange Reserves (Japanese definition) at end JULY	22,793	22,642		
Ratio of Imported Raw Materials held by Producers to Consumption	109.3	93.2	17.3	15.3
Export Prices (Yen basis, NSA)	103.1	105.5	- 2.3	8.1
Import Prices (Yen basis, NSA)	151.2	155.2	- 2.6	45.5
Export Volume (NSA)	156.3	152.9	2.2	17.2
Import Volume (NSA)	126.5	130.4	- 3.0	- 0.2

File

Japan

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24 July 1980

I enclose a copy of a message which the Prime Minister has received from the Prime Minister of Japan. No further action is required.

M. O'D. B. ALEXANDER

Roderic Lyne, Esq.,
Foreign and Commonwealth Office.

TR

File

DSC

24 July 1980

I am replying on the Prime Minister's behalf to your letter to her of 23 July. The message from the Prime Minister of Japan has of course been brought to the Prime Minister's immediate attention.

M. O'D. B. ALEXANDER

His Excellency Mr. Naraichi Fujiyama.

EMBASSY OF JAPAN
UNITED KINGDOM

London : 23rd July 1980

Dear Prime Minister,

I am asked by the Prime Minister
of Japan, Mr. Zenko Suzuki, to forward a
message to you.

It gives me much pleasure to
... enclose this message herewith.

Yours sincerely
Naraichi Fujiyama

Naraichi Fujiyama
Ambassador

The Rt.Hon. Margaret Thatcher, MP,
Prime Minister and First Lord of the Treasury,
10, Downing Street,
London, S.W.1.

SUBJECT

fs. ^{cc Market}
Ops (2)
Prime Minister

TEXT

**PRIME MINISTER'S
PERSONAL MESSAGE**

Dear Prime Minister, SERIAL No. T149/80

Thank you very much for your
kind congratulations on my appointment as
Prime Minister.

I share the same view with you
on the vital need for us, the industrialised
democracies, to work in harmony to tackle the
difficulties which we all face now, and I also
look forward to working with you for further
strengthening the existing co-operative links
between Japan and Britain.

With best wishes and warm regards,

Yours sincerely,

ZENKO SUZUKI
Prime Minister
of Japan

The Rt.Hon. Mrs. Margaret Thatcher, MP,
Prime Minister and First Lord of the Treasury,
London.

Japan

SUBJECT.

CONFIDENTIAL

PRIME MINISTER'S
PERSONAL MESSAGE
SERIAL No. T 144 A/80

GRS 200

CONFIDENTIAL

FM FCO 170833Z JULY 80
TO IMMEDIATE TOKYO
TELEGRAM NUMBER 283 OF 17 JULY 80

*cc. Minister sec
ops*

YOUR TELNO 437: MR SUZUKI

1. PLEASE PASS THE FOLLOWING MESSAGE FROM THE PRIME MINISTER TO MR SUZUKI AS SOON AS HIS APPOINTMENT AS PRIME MINISTER IS CONFIRMED BY THE DIET:

BEGINS

I SEND YOU MY WARMEST CONGRATULATIONS ON YOUR ELECTION AS PRIME MINISTER.

I ATTACH THE HIGHEST IMPORTANCE TO THE CLOSE AND FRIENDLY RELATIONS BETWEEN OUR TWO COUNTRIES. EVENTS OVER THE PAST YEAR HAVE UNDERLINED THE VITAL NEED FOR BRITAIN, JAPAN AND OTHER INDUSTRIALISED DEMOCRACIES TO WORK TOGETHER IN TAKLING THE DIFFICULT POLITICAL AND ECONOMIC ISSUES WHICH WE ALL FACE. MY CABINET COLLEAGUES AND I LOOK FORWARD TO CONTINUING CO-OPERATION WITH THE JAPANESE GOVERNMENT UNDER YOUR LEADERSHIP.

I HOPE THAT WE WILL HAVE AN EARLY OPPORTUNITY TO MEET.

ENDS.

[COPIES SENT TO NO 10 DOWNING ST]

CARRINGTON

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LORD BRIDGES
MR BULLARD

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MR DUNNING CRE2/3 DOT

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Foreign and Commonwealth Office

London SW1A 2AH

15 July 1980

Dear Michael,

Pm's Answer

Apex list?

D

Yes no

Pm's 15/

FCO informed of approval
cc. 16/Japanese Prime Minister

Mr Zenko Suzuki was elected President of the Liberal Democratic Party on 15 July and his appointment as Japanese Prime Minister is certain to be confirmed by the Diet, probably on 17 July. The Prime Minister may wish to send a congratulatory message. I enclose a draft in the form of a draft telegram to Tokyo.

I also enclose a biographical note on Mr Suzuki, who is 69 and was a compromise choice for the leadership of the Liberal Democratic Party. He has had a number of government and party jobs, but has never held any of the most senior Cabinet posts. Though an effective domestic politician he is very little known outside Japan and his foreign affairs experience is confined to fisheries negotiations with the Soviet Union and New Zealand. It seems unlikely that he will have the same international impact as his predecessor, at any rate in his early days.

I will hold the top copy of the telegram here. We should like to despatch it by the close on 16 July, so that Sir M Wilford can deliver it as soon as Mr Suzuki has been elected Prime Minister.

yours ever

Rodric Lyne

(R M J Lyne)
Private SecretaryM O'D B Alexander Esq
10 Downing Street

File No.
 Department
 Drafted by
 (Block Capitals)
 Tel. Extn.

OUTWARD
 TELEGRAM

Security Classification CONFIDENTIAL
Precedence IMMEDIATE
DESKBYZ

FOR COMMS. DEPT. USE	Despatched (Date) (Time)Z	POSTBYZ
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PREAMBLE

(Time of Origin) Z (G.M.T.) (Restrictive Prefix)
 (Security Class.) CONFIDENTIAL (Caveat/
 Privacy marking)
 (Codeword) (Deskby) Z

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- NO 10
- Mr Dunning, CRE
- 2/3, DOT

[TEXT]

Your telno 437: Mr Suzuki

1. Please pass the following message from the Prime Minister to Mr Suzuki as soon as his appointment as Prime Minister is confirmed by the Diet:

BEGINS

I send you my warmest congratulations on your election as Prime Minister.

I attach the highest importance to the close and friendly relations between our two countries. Events over the past year have underlined the vital need for Britain, Japan and the other industrialised democracies to work together in tackling the difficult political and economic issues which we all face. My Cabinet colleagues and I look forward to continuing co-operation with the Japanese government under your leadership.

I hope that we will have an early opportunity to meet.

ENDS

SUZUKI, ZENKO

Chairman, LDP Executive Council.

Born 1911.

Graduated from the Fisheries Training Centre in 1935. Elected to the House of Representatives from Iwate Prefecture since 1947, first as a socialist and then since 1949 in the Liberal and Liberal Democratic Parties. Minister of Posts and Communications July 1960. Chief Cabinet Secretary 1964. Minister of Health and Welfare June 1965. Chairman of the LDP Executive Board from November 1968 until January 1970 and again from July 1972 to 1976. Has also served as Deputy Secretary General on three occasions. Minister of Agriculture and Forestry 1976-77.

Suzuki's change of party in 1949 was apparently due to his feeling that it was necessary to be on the side of the majority for the benefit of one's constituents. He was one of Ikeda's most active supporters behind the scenes, and two of his Cabinet posts were under Ikeda; he was Chief Cabinet Secretary at the time of Ikeda's death. He is a prominent member of the Ohira (qv) faction, and although he was originally thought to be not as close to Ohira as he was to Maeo, the former leader of the faction, he has since succeeded in gaining the confidence of Ohira and is now considered to be his right-hand man. He played a major part in Ohira's campaign to become LDP President. He was Ohira's first choice for the position of Secretary-General of the party in 1978, but was prevented from assuming the position due to a strong reaction from the opposition factions.

Reflecting his own origins in a fishing family Suzuki is "Mr Fish" of the LDP, having virtually sole political control of the fishery cooperatives and other organisations in Japan. Their considerable political and financial power is the source of much of his influence. After becoming Minister of Agriculture and Forestry in December 1976 he had had a rough ride, presiding over the difficult period of Japan's subjection to other countries' 200 mile economic zones, and spending an unprecedentedly long and uncomfortable time negotiating an interim fisheries agreement in Moscow in May 1977.

Suzuki is a careful person, known for his deliberate manner of speech. He was selected by the government to persuade the people of Aomori to accept the berthing of the nuclear vessel, Mutsu, in Mutsu port, and later faced an equally difficult task in trying to impress moderation upon the rice farmers. Has the warm and sincere personality of his native Tohoku region.

He is supposed to be popular among the rank and file members of the party because of his unassuming style and good humour. He is a Kendo 5th Dan and is keen on golf.

74
Supplies

1 July, 1980.

I enclose a copy of a message received by the Prime Minister from Mr. Masayoshi Ito. The message has been acknowledged. No further action is required.

M. O'D. B. ALEXANDER

R.M.J. Lyne, Esq.,
Foreign and Commonwealth Office.

TBR

1 July, 1980.

I am writing on the Prime Minister's behalf to thank you for your letter of 30 June. The letter which you enclosed from Mr. Masayoshi Ito has, of course, been brought to the Prime Minister's immediate attention.

M. O'D. B. ALEXANDER

His Excellency Mr. Naraichi Fujiyama

TJR



Prime Minister ^②

EMBASSY OF JAPAN
UNITED KINGDOM

Ant 8/6

30th June 1980

mt

Dear Prime Minister,

I have been asked by Mr. Masayoshi Ito,
Prime Minister ad interim of Japan, to
forward a message to you.

... I have much pleasure in enclosing it
herewith.

yours sincerely

Naraichi Fujiyama

Naraichi Fujiyama
Ambassador

The Rt. Hon. Margaret Thatcher, MP,
Prime Minister and First Lord of the Treasury,
London.

SUBJECT.

TEXT

PRIME MINISTER'S
PERSONAL MESSAGE
SERIAL No. T 136/80

Dear Prime Minister,

I thank you very much for your warm congratulations on our election result. We also look forward to continued close cooperation with you and hope that the good relations between our two countries will be further enhanced.

I wish to take this opportunity to thank you and your colleagues for the kind attitude to our Foreign Minister and the other Japanese representatives at the Venice Summit, which enabled them to accomplish their mission under the special circumstances caused by the sudden death of Prime Minister Ohira.

Yours sincerely,

MASAYOSHI ITO

Subject *Asahi*

Japan
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FM FCO 251500Z JUN 60
TO IMMEDIATE TOKYO
TELEGRAM NUMBER 251 OF 25 JUNE

**PRIME MINISTER'S
PERSONAL MESSAGE
SERIAL No. T 133A/80**

YOUR TELNO 408: JAPANESE ELECTIONS

1. PLEASE PASS THE FOLLOWING MESSAGE FROM THE PRIME MINISTER
TO MR ITO: BEGINS

I EXTEND MY WARMEST CONGRATULATIONS ON THE SPLENDID ELECTION
RESULT ACHIEVED BY YOUR PARTY. I LOOK FORWARD TO CONTINUED CLOSE
CO-OPERATION WITH THE JAPANESE GOVERNMENT IN THE DIFFICULT TIMES
WHICH LIE AHEAD. ENDS.

CARRINGTON

NNNN
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PS/PUS
SIR D MAITLAND
LORD BRIDGES
MR DONALD

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Japan

25 June 1980

Japanese Elections

The Prime Minister has seen your letter to me of 24 June about the outcome of the Japanese elections and has agreed the text of the message enclosed with your letter from her to Mr. Ito.

MODBA

R.M.J. Lyne, Esq.,
Foreign and Commonwealth Office.

SL

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Foreign and Commonwealth Office

London SW1A 2AH

24 June 1980

Prime Minister

Agree text?

Yes
no *Am*

Dear Michael,

Japanese Elections

You will have seen that the ruling Liberal Democratic Party has won a clear victory in the Japanese parliamentary elections held on 22 June. Contrary to most expectations, they have substantially increased their majorities in the two Houses of the Diet and will not need to look to other parties for support.

It may be some time before a successor to Mr Ohira is chosen and a new government is formed. But the election result provides a welcome assurance of continued stability in Japan and we consider that it would be appropriate for the Prime Minister to send a congratulatory message to Mr Ito, the Acting Japanese Prime Minister. I attach a draft in the form of a draft telegram to Tokyo, the top copy of which I shall hold here.

yours ever

Roderic Lyne

(R M J Lyne)
Private Secretary

M O'D B Alexander Esq
10 Downing Street
London

RESTRICTED

OUT TELEGRAM

	↓	Classification and Caveats RESTRICTED	Precedence/Deskby IMMEDIATE
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CLASS	3	RESTRICTED
CAVEATS	4	
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PRE/ADD	7	TO IMMEDIATE TOKYO
TEL NO	8	TELEGRAM NUMBER
	9	YOUR TEL NO 408: JAPANESE ELECTIONS
	10	1. Please pass the following message from the Prime Minister
	11	to Mr Ito: Begins
	12	I extend my warmest congratulations on the splendid election
	13	result achieved by your Party. I look forward to continued close
	14	co-operation with the Japanese government in the difficult times
	15	which lie ahead. Ends.
	16	
	17	CARRINGTON
	18	NNNN
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NNNN ends telegram	BLANK	Catchword
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Prime Minister
MS
MAD 23/6

GR 120
UNCLASSIFIED
DESKBY 230900Z
FM TOKYO 230815Z JUNE 80
TO IMMEDIATE FCO
TELEGRAM NUMBER 407 OF 23 JUNE
SAVING EC POSTS, WASHINGTON, SEOUL, PEKING, HONG KONG

JAPANESE ELECTIONS

1. CONTRARY TO MOST EXPECTATIONS THE LDP HAS WON AN OVERWHELMING VICTORY IN THE LOWER HOUSE ELECTION. THE RESULTS ARE AS FOLLOWS (FIGURES IN BRACKETS REPRESENT PARTY STRENGTHS BEFORE THE DISSOLUTION:-

LDP	294	(238)
JSP	107	(107)
KOMEITO	33	(58)
JCP	29	(41)
DSP	32	(36)
NEW LIBERAL CLUB	12	(4)
SHAMINREN	3	(2)
INDEPENDENTS	11	(4)
		(1 VACANT)

TOTAL 511 511

- 2. THE VOTING RATE (74.5%) WAS THE HIGHEST FOR 22 YEARS. THIS UNDOUBTEDLY HELPED THE LDP. NISHIMURA (LDP VICE PRESIDENT) AND TAGAYA (JSP SECRETARY GENERAL) LOST THEIR SEATS.
- 3. THE LDP ALSO APPEAR CERTAIN TO WIN A MAJORITY IN THE UPPER HOUSE. T

FCO PASS SAVING EC POSTS, WASHINGTON

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Prime Minister

W.F.O.
H.C.

Ant-4/6

② Japan

**PRIME MINISTER'S
PERSONAL MESSAGE**
SERIAL No. T123/80

EMBASSY OF JAPAN
UNITED KINGDOM

6th June 1980

Dear Prime Minister,

I am asked by Mr. Masayoshi Ohira, Prime Minister of Japan, to transmit the following message to you:

"Dear Prime Minister,

"I thank you very much for your warm words of sympathy and appreciate your concern about my illness.

"Thanks to the care taken by all the friends of mine, I am now making a steady recovery, so that I can expect to resume my duty shortly.

"I am also looking forward to seeing you in Venice.

"Yours sincerely,"

MASAYOSHI OHIRA

Prime Minister of Japan

*Yours sincerely
Naraichi Fujiyama*

Naraichi Fujiyama
Ambassador

The Rt. Hon. Margaret Thatcher, MP,
Prime Minister and First Lord of the Treasury,
London.

GPS 75

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FM FCO 051554Z JUN 80
TO IMMEDIATE TOKYO
TEL NO 218 OF 5 JUNE 1980
INFO IMMEDIATE PARIS

PRIME MINISTER'S
PERSONAL MESSAGE
SERIAL No. T122/80

PARIS FOR ARMSTRONG

JAPANESE PRIME MINISTER

1. PLEASE PASS THE FOLLOWING PERSONAL MESSAGE TO MR OHIRA FROM
THE PRIME MINISTER:

"I HAVE BEEN FOLLOWING REPORTS OF YOUR ILLNESS WITH MUCH SYMPATHY
AND CONCERN. PLEASE ACCEPT MY BEST WISHES FOR A SPEEDY AND
COMPLETE RECOVERY. I LOOK FORWARD TO YOUR WISE COUNSEL AT
VENICE."

CARRINGTON

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MR EVANS
MR DONALD

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Foreign and Commonwealth Office

London SW1A 2AH

5 June 1980

Telegram Dispatched.

For: [unclear] - 5/6

Dear Michael,

Japanese Prime Minister

We discussed Paris telegram 150 in which Sir R Armstrong recommended to you that the Prime Minister should send a personal message to Mr Ohira enquiring after his health and sending best wishes for his recovery.

We agree with Sir Robert Armstrong. I enclose a possible message in the form of a draft telegram to Tokyo.

There has been speculation that Mr Ohira may not recover in time to attend the Venice summit but he clearly intends to do so if he can. It would be appropriate for Mrs Thatcher to express the hope that she will see him there.

yours etc

Roderic Lyne

(R M J Lyne)
Private Secretary

M O'D B Alexander Esq
10 Downing Street

RESTRICTED

File No.

Department **FED**

OUTWARD

Drafted by
(Block Capitals) **R J T McLAREN**

TELEGRAM

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[TEXT] Japanese Prime Minister

1. Please pass the following personal message to Mr Ohira from the Prime Minister:

'I have been following reports of your illness with much sympathy and concern. Please accept my best wishes for a speedy and complete recovery. I look forward to your wise counsel at Venice'.

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Japan.

GR 278

(AMENDED DISTRIBUTION 2 JUNE 1980)

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FM TOKYO 020700Z JUN

TO PRIORITY FCO
TELNO 348 OF 2 JUNE.

MR OHIRA

1. MR OHIRA WAS TAKEN INTO HOSPITAL IN THE SMALL HOURS OF 31 MAY, SUFFERING FROM EXHAUSTION. PRESS REPORTS ON 31 MAY MENTIONED THAT DOCTORS HAD ALSO FOUND HIS HEARTBEAT IRREGULAR AND THERE WAS SOME SPECULATION THAT HE MIGHT NOT BE RECOVERED IN TIME TO CAMPAIGN BEFORE THE DOUBLE ELECTION DATE OF 22 JUNE OR TO GO TO THE VENICE SUMMIT. HIS DOCTORS GAVE A PRESS CONFERENCE ON 2 JUNE IN WHICH THEY DESCRIBED MR OHIRA'S CONDITION AS "ANGINA CAUSED BY FATIGUE" BUT SAID THAT IT WAS NOT SERIOUS AND THAT ONE WEEK OF REST SHOULD RESTORE HIM. HIS HEARTBEAT HAD RETURNED TO NORMAL.

2. THE LDP SECRETARY GENERAL, SAKURAUCHI, HAS TOLD THE PRESS THAT THERE WILL BE NO EFFECT ON THE POLITICAL SITUATION; OTHER LDP LEADERS WILL REPLACE MR OHIRA FOR HIS SPEAKING ENGAGEMENTS IN THE COMING WEEK. THE PRIME MINISTER'S OFFICE HAVE TOLD US THAT THEY ARE WORKING ON THE ASSUMPTION THAT HE WILL GO TO VENICE FOR THE SUMMIT AS PLANNED.

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TO IMMEDIATE FCC

TELEGRAM NUMBER 319 OF 23 MAY

SAVING UKREP BRUSSELS, BONN, COPENHAGEN, THE HAGUE, PARIS, BRUSSELS, DUBLIN, LUXEMBOURG, ROME, WASHINGTON, SEOUL, PEKING.

MY TELNOS 306/9

ELECTIONS

1. THOUGH SOME PRESS REPORTS I HAVE SEEN HAVE BEEN EQUIVOCAL I HOPE IT IS CLEAR THAT MR OHIRA'S GOVERNMENT WAS BROUGHT DOWN NOT BY THE OPPOSITION, BUT BY HIS OWN PARTY. THE OPPOSITION VOTE OF CONFIDENCE WAS A ROUTINE AFFAIR POSED WHEN AGREEMENT HAD ALREADY BEEN REACHED ON BUSINESS FOR THE REMAINING DAYS OF THE SESSION BEFORE THE RECESS FOR THE UPPER HOUSE ELECTION. THE ISSUES DETAILED IN THE MOTION WERE ESSENTIALLY TACTICAL AND INSUBSTANTIAL. I DINED WITH THE PM THE NIGHT BEFORE, HAD A LONG TALK WITH HIM AFTER DINNER AND HE DID NOT EVEN MENTION THE VOTE OF CONFIDENCE. MY GERMAN COLLEAGUE DINED WITH MIYAZAWA WHO GAVE A TALK ON THE POLITICAL SCENE AND IT WAS NOT MENTIONED THERE EITHER. EVEN THE SOCIALIST PAPER THE FOLLOWING AFTERNOON SAID THE GOVERNMENT WOULD WIN THE VOTE. YET WISEACRES ARE NOW SUGGESTING THAT THE PLOT WAS HATCHED SOME TIME AGO AND WIDELY LEAKED.

2. NOR WERE THE INTRA-LDP ISSUES SUCH AS TO DEMAND A CONFRONTATION NOW. THE CONFIDENCE VOTE WAS EXPECTED ANY TIME FROM 2PM, BUT THE LDP'S OWN MEETING WENT ON AND ON. AT 7PM THE PM OBVIOUSLY FELT HE COULD NOT DEFER THE VOTE FURTHER. THE FUKUDA AND MIKI FACTIONS ACCUSED HIM OF ARROGANCE IN PROCEEDING TO THE VOTE AND, ALTHOUGH ALMOST ALL WERE IN THE DIET BUILDING, DELIBERATELY ABSTAINED.

3. AS I SAID IN MY ANNUAL REVIEW, AFTER EBC UNDIGNIFIED POWER STRUGGLE AMONG THE PARTY LEADERSHIP WHICH FOLLOWED LAST YEAR'S GENERAL ELECTION IT WAS ON THE CARDS THAT MR FUKUDA WOULD PREFER TO SEE MR OHIRA FAIL RATHER THAN SEE THE PARTY WIN THE UPPER HOUSE ELECTION HANDSOMELY. THE VICIOUSNESS IN THIS RESPECT OF TWO BITTER OLD MEN (FUKUDA AND MIKI) AGAINST OHIRA IS NOT AN EDIFYING SIGHT.

4. WHAT NOW? THE FIRST QUESTION IS WHETHER MR OHIRA WILL EXPEL THE REBELS FROM THE PARTY OR DISCIPLINE THEM EG BY REFUSING TO NOMINATE SOME OR ALL AS "OFFICIAL" LDP CANDIDATES FOR THE ELECTION. NO CABINET MINISTERS VOTED AGAINST HIM OR ABSTAINED, BUT FOUR PARLIAMENTARY VICE-MINISTERS INCLUDING MATSUMOTO OF THE MFA AND KOIZUMI OF MOF DID: THEY MAY HAVE TO RESIGN OR BE SACKED. THREE PARTY OFFICERS (INCLUDING ABE, FUKUDA'S SON-IN-LAW) HAVE ALREADY BEEN REPLACED: I THINK HE WOULD PREFER NOT TO EXPEL THE REBELS WHOLESALE AND THUS FORCE THEM INTO THE CREATION OF A NEW PARTY. NAKASONE HAS TAKEN THIS ATTITUDE SO FAR. MIKI HAS SAID THAURALL HIS FACTION SHOULD BE NOMINATED AS OFFICIAL CANDIDATES. FUKUDA IS NOT COMMITTING HIMSELF ON THE POSSIBILITY OF A SPLIT. NAKAGAWA, LEADER OF A SMALL

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/RIGHT WING

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RIGHT WING FACTION, TALKS OF CREATING HIS OWN PARTY, BUT SUPPORT FOR HIM WOULD BE SMALL (ALTHOUGH HE MAY BE A MAN TO WATCH LATER). THE T KELIHOOD IS THEREFORE THAT THE LDP WILL ENTER THE TWO ELECTIONS AS ONE PARTY BUT WITH EACH FACTION DOING ITS BEST TO DO DOWN THE CANDIDATES OF THE OTHERS. THUS THERE WILL BE TWO OUTCOMES TO WATCH (A) WILL THE LDP LOSE SEATS TO CENTRIST PARTIES, AND THUS THEIR OVERALL MAJORITY?

(B) WILL THE BALANCE ALTER BETWEEN THE FACTIONS? (AT PRESENT OHIRA 52 AND TANAKA 47: NAKASONE 39: FUKUDA 48 AND MIKI 28)

5. IT IS FAR TOO EARLY TO PREDICT THE OUTCOME OF EITHER STRUGGLE BUT CERTAIN POINTS NEED TO BE BORNE IN MIND:

(A) BIG BUSINESS IS HORRIFIED AT THE WAY THE LDP HAVE TORN THEMSELVES APART, BUT WOULD NOT WISH TO SEE A GOVERNMENT LED BY THE JSP, THOUGH THEY MIGHT ACCEPT INCLUSION OF THE DSP:

(B) THE ECONOMY IS STILL MOVING WELL AND THE VOTERS MAY WELL NOT WISH TO HAND IT TO THE DEVIL THEY DON'T KNOW:

(C) ON THE BASIS OF PRESENT FACTIONS AND ASSUMING NO RELATIVE CHANGE THE LARGEST PARTY (BUT WITHOUT AN OVERALL MAJORITY) COULD STILL BE THE LDP AND ITS LARGEST BLOC THE FACTIONS LED BY OHIRA, TANAKA AND NAKASONE, SUPPORTED PERHAPS BY SOME POWER-LOVING DEFECTORS FROM THE MIKI AND FUKUDA FACTIONS: BUT TO GOVERN IF OPPOSED BY THE REST OF THE LDP THEAEWOLKANEED AT LEAST THE KOMEITO AND DSP IN COALITION, AND EVEN THEN FIND THEMSELVES IN OCCASIONAL MINORITY POSITIONS:

(D) SINCE NO COALITION WILL INCLUDE BOTH THE KOMEITO AND JCP A COALITION OF THE CENTRIST PARTIES FROM JSP TO DSP WOULD ON THE PRESENT BASIS HAVE NO MORE THAN 200 SEATS AND REQUIRE ALL THE DISSIDENT LDP (IF THEY STICK TOGETHER) FOR AN ABSOLUTE MAJORITY (THIS IGNORES OF COURSE THE MANY SPLITS WITHIN THE JSP.

6. MR OHIRA AS HEAD OF A CARETAKER GOVERNMENT HAS SAID THAT HE INTENDS, IF POSSIBLE, TO PURSUE HIS DIPLOMATIC POLICIES AND ENGAGEMENTS INCLUDING HAVING HUA GUOFENG HERE FROM 27 MAY TO 1 JUNE AND ATTENDING THE SUMMIT IN VENICE.

7. THE ELECTORAL CAMPAIGN BEGINS ON 31 MAY (UPPER HOUSE)/ 3 JUNE (LOWER HOUSE).

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TELNO 389 OF 17 MAY INFO IMMEDIATE WASHINGTON, ROME (FOR S OF S)

SAVING TO UKREP BRUSSELS, AND OTHER EC POSTS

MY TELNO 386 DEFEAT OF OHIRA GOVERNMENT.

1. THE PASSING OF A VOTE OF NON-CONFIDENCE AGAINST MR OHIRA'S GOVT HAS COME AS A MAJOR SHOCK TO ALL PARTIES. THE JSP'S INTENTION SUPPORTED BY ALL OTHER OPPOSITION PARTIES, WAS TO FOCUS ATTENTION ON THE GOVERNMENT'S FAILURE TO IMPLEMENT THE LEGISLATIVE PROGRAMME, FAILURE TO DEAL ADEQUATELY WITH VARIOUS "SCANDALS" AND THE LACK OF INDEPENDENT FOREIGN POLICY.

2. INTENSIVE NEGOTIATIONS WITHIN THE LDP DURING THE WDY WERE EXPECTED TO RESULT IN THE PARTY CLOSING RANKS AS SO OFTEN BEFORE. DISCONTENT WITH THE ANTI-OHIRA FACTIONS ALSO FOCUSED ON SCANDALS AND THE FAILURE TO REFORM THE PARTY. OHIRA, THINKING IT WOULD BE POSSIBLE TO PERSUADE HIS OPPONENTS TO JOIN HIM, THEN SET A TIME FOR THE VOTE. IN THE EVENT HE WAS UNABLE TO CONVINCE THEM AND THE MIKI AND FUKUDA FACTIONS ABSTAINED EN BLOC (UNDERLINED) ALONG WITH THE NAKAGAWA GROUP. OF 256 LDP MEMBERS ONLY 183 (PLUS 4 INDEPENDENTS) VOTED AGAINST THE MOTION.

3. THE LDP IS NOW IN A VERY CONFUSED STATE. OHIRA WILL DISSOLVE THE LOWER HOUSE AND THE ELECTION WILL BE FOUGHT BY A SHARPLY DIVIDED PARTY. FUKUDA AND MIKI HAVE EXPRESSED DOUBTS ABOUT FIGHTING AN ELECTION UNDER OHIRA'S LEADERSHIP AND FUKUDA HAS EVEN HINTED AT FORMING A NEW PARTY (THE FUKUDA AND MIKI FACTIONS TOTAL ABOUT 80 OUT OF 256 LDP MEMBERS IN THE LOWER HOUSE). NAKAGAWA (WITH ABOUT 37 MEMBERS) HAS BEEN CONSPICUOUSLY QUIET.

4. THE OPPOSITION PARTIES AFTER THEIR INITIAL ELATION ARE SETTling DOWN TO SERIOUS REFLECTION. WHAT WAS INITIALLY A TACTICAL DEVICE TO FOCUS POPULAR CONTENT WITH THE LDP HAS LEFT THEM TO FACE AN ELECTION FOR WHICH THEY ARE ILL-PREPARED. THE DSP HESITATED OVER JOINING THE OTHER PARTIES FOR JUST THIS REASON ALTHOUGH THEY, LIKE ALL OTHERS,

DO NOT SERIOUSLY EXPECT TO WIN. ONLY THE COMMUNISTS WITH THEIR STRONG FINANCES AND ORGANISATION CAN VIEW THE COMING CAMPAIGN WITH EQUANIMITY.

5. THE PRIME MINISTER PRIVATE SECRETARY TOLD ME ON 17 MAY THAT A CABINET MEETING ON MONDAY WOULD DECIDE TO HOLD THE ELECTIONS TO BOTH UPPER AND LOWER HOUSES ON 22 JUNE. I CANNOT SEE HOW JAPAN CAN THEREFORE BE PROPERLY REPRESENTED AT A VENICE SUMMIT.

FCO PLEASE PASS SAVING ADDRESSEES
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Ohira has
said he will go.

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Private Secretary

(2)

DEFEAT OF JAPANESE GOVERNMENT

- A 1. Mr Ohira's government was today defeated in a vote of no confidence in the Lower House of the Diet (Japanese Parliament). The Diet will now be dissolved. New elections will take place at the end of next month, probably on 22 June. Further details are given in Tokyo telno 304.
2. The Ohira government will meanwhile continue in a caretaker capacity. We have just heard from the Japanese Embassy that Dr Okita will still come to Europe as planned and looks forward to seeing Lord Carrington on 20 May.
3. There is however speculation in Japan that Mr Ohira may not be able to attend the Venice summit.

R J T McLaren
Far Eastern Department

16 May 1980

copied to: PS/Lord Privy Seal
PS/Mr Hurd
PS/Mr Blaker
PS/PUS
Sir D Maitland
Lord Bridges
Mr Murray
Mr Evans
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Mr Alexander, No 10
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TO IMMEDIATE FCO

TELNO 304 OF 16 MAY INFO IMMEDIATE VIENNA (FOR PRIVATE SECRETARY) PRIORITY PEKING, SEOUL, WASHINGTON AND EC POSTS.

TELECON ELLIOTT/JAJC: DEFEAT OF OHIRA GOVERNMENT.

1. AGAINST ALL EXPECTATION, MR OHIRA'S GOVERNMENT WAS DEFEATED IN A VOTE OF NO CONFIDENCE TABLED BY THE JSP IN THE LOWER HOUSE OF THE DIET ON 16 MAY. THE VOTING WAS 243 AGAINST THE GOVERNMENT, 197 FOR. ABSTENTIONS FROM THE FUKUDA AND MIKI FACTIONS APPEAR TO HAVE BEEN LARGELY RESPONSIBLE. ALL THE OPPOSITION PARTIES VOTED TOGETHER, ALTHOUGH THE DSP WERE INITIALLY UNCERTAIN.

2. MR OHIRA HAD THE OPTION OF RESIGNING WITH HIS ENTIRE CABINET, AND LEAVING IT OPEN TO ANOTHER LDP LEADER (PROBABLY MR FUKUDA) TO ATTEMPT TO FORM AN ADMINISTRATION PERHAPS WITH THE HELP OF SOME MEMBERS OF THE DSP OR KOMEITO; OR OF DISSOLVING THE LOWER HOUSE AND CALLING AN ELECTION.

HE HAS NOW DECIDED ON DISSOLUTION. THE ELECTION MUST BE HELD WITHIN 40 DAYS OF DISSOLUTION (FOR WHICH A DATE HAS NOT YET BEEN FIXED). IT IS LIKELY THAT BOTH LOWER AND UPPER HOUSE ELECTIONS WILL BE HELD ON THE SAME DAY, THOUGH NOT NECESSARILY THE DAY (29 JUNE) ORIGINALLY FIXED FOR THE UPPER HOUSE ELECTION.

3. MFA OFFICIALS AVAILABLE FOR IMMEDIATE COMMENT THOUGHT THE OKITA VISIT TO EUROPE WOULD GO AHEAD AS PLANNED; HE IS DUE TO LEAVE ON 18 MAY.

4. COMMENT FOLLOWS. IMMEDIATE REACTIONS ARE CONFUSED; THE EVENT IS UNPRECEDENTED AND NOBODY ON EITHER SIDE WAS PREPARED FOR A GENERAL ELECTION.

IMMEDIATE

WILFORD

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Japan PRIME MINISTER

FM TOKYO 090500Z APR
TO ROUTINE FCO
TELNO 223 OF 9 APRIL
SAVING TO WASHINGTON, BONN, BERNE.

ys

mb

THE JAPANESE YEN

1. HAVING CLOSED AT THE END OF MARCH AT YEN 249.70 TO THE DOLLAR THE YEN FELL PAST THE 250 MARCK ON 1 APRIL AND DESPITE AGGRESSIVE INTERVENTION BY THE BANK OF JAPAN CONTINUED TO WEAKEN UNTIL THE CLOSE OF BUSINESS ON MONDAY 7 APRIL WHEN IT STOOD AT YEN 260.50. AFTER OPENING LOWER AT YEN 263.50 ON TUESDAY THE MARKET REACTED WITH PROFIT TAKING AND THE RATE STRENGTHENED TO CLOSE AT YEN 260.70, STILL SLIGHTLY DOWN ON THE DAY.

2. THE MAIN REASON FOR THE YEN'S WEAKNESS, AS WITH MAJOR EUROPEAN CURRENCIES, IS THE WIDENING GAP BETWEEN US AND JAPANESE INTEREST RATES. IN ADDITION THE JAPANESE CURRENT ACCOUNT IS STILL IN HEAVY DEFICIT AND INFLATION CONTINUES TO ACCELERATE. THE MARKET HAS SHOWN CONCERN THAT HEAVY BILLS FOR HIGH PRICED OIL CONTRACTED TOWARDS THE END OF LAST YEAR WILL FALL DUE BETWEEN NOW AND JUNE AND WILL MORE THAN OFFSET EXPANDING EXPORTS. IN THESE CIRCUMSTANCES, JAPANESE IMPORTERS, ESPECIALLY TRADING COMPANIES AND OIL COMPANIES, HAVE BEEN BUYING DOLLARS FORWARD, WHILE EXPORTERS HAVE BEEN RETAINING THEIR DOLLAR EARNINGS.

3. DESPITE LAST MONTH'S INCREASE IN THE BANK OF JAPAN'S OFFICIAL DISCOUNT RATE AND OTHER MEASURES DESIGNED TO ATTRACT AN INFLOW OF CAPITAL AND TO RESTRAIN PRICE RISES, THE YEN WAS HELD ABOVE YEN 250 TO THE DOLLAR ONLY BY SUBSTANTIAL INTERVENTION BY THE BANK OF JAPAN, THE OFFICIAL RESERVES AT THE END OF MARCH STOOD AT DOLLARS 18.5 BILLION, HAVING FALLEN BY DOLLARS 2.2 BILLION OVER THE MONTH. THE EXTENT OF INTERVENTION WAS REPORTEDLY IN EXCESS OF DOLLARS 3 BILLION, WITH THE BANK OF JAPAN DRAWING ON HIDDEN RESERVES WITH THE COMMERCIAL BANKS. IT IS THOUGHT, TOO, THAT JAPANESE RESIDENTS BOUGHT MORE THAN DOLLARS 1 BILLION OF U S TREASURE BILLS DURING MARCH.

4. IN THESE CIRCUMSTANCES THE BANK OF JAPAN HAVE RECENTLY CONCLUDED A SWAP AGREEMENT, WHICH HAS NOT YET BEEN DRAWN ON, OF YEN 200 BILLION WITH THE SWISS NATIONAL BANK, AUGMENTING THE DOLLARS 5 BILLION FACILITY WITH THE US FEDERAL RESERVE ALREADY ACTIVATED AND THE CONCERTED INTERVENTION BY THE US, GERMAN AND SWISS CENTRAL BANKS.

5. THE GOVERNOR OF THE BANK OF JAPAN, MR HARUO MAYEKAWA, HAS POINTED OUT IN A PRESS CONFERENCE THAT IN PRESENT CIRCUMSTANCES THERE ARE LIMITS TO THE EFFECTIVENESS OF MARKET INTERVENTION IN SEEKING TO HALT THE DECLINE OF THE YEN. HE HAS

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/REFERRED

REFERRED TO THE POLICY ACTIONS ALREADY TAKEN BY THE JAPANESE AUTHORITIES TO COUNTER INFLATION AND STRENGTHEN THE YEN. THESE INCLUDE, ON THE MONETARY FRONT, THE RECENT INCREASES IN THE OFFICIAL DISCOUNT RATE, CONTINUED RESTRICTIONS ON BANK LENDING AND INCREASES IN BANKS' RESERVE REQUIREMENTS SEMI COLON ON THE FISCAL FRONT, A REDUCTION IN THE EXECUTION RATE OF GOVERNMENT CONTRACTS SEMI COLON N THE PRICES FRONT, A 7-POINT PROGRAMME, CONSISTING LARGELY OF CLOSER MONITORING, TO RESTRAIN PRICE RISES IN MAIN COMMODITIES SEMI COLON AND ON THE EXTERNAL FRONT, CONCERTED INTERVENTION WITH OTHER CENTRAL BANKS AND MEASURES TO DISCOURAGE OUTFLOWS AND ENCOURAGE INFLOWS.

6. FOR THE FUTURE THE GOVERNOR HAS SAID THAT THE BANK OF JAPAN WILL CONTINUE TO INTERVENE ON THE FOREIGN EXCHANGE MARKET AS THE SITUATION DEMANDS. SUCH INTERVENTION, HOWEVER, IS LIKELY TO BE LESS FORCEFUL THAN OF LATE AND MORE IN THE NATURE OF A SMOOTHING OPERATION. HE HAS EXPRESSED THE HOPE THAT US INTEREST RATES WILL SOON TURN DOWN AND HAS POINTED TO SIGNS THAT SOME US RATES—FEDERAL FUNDS, C DS AND TREASURY BILLS— MAY HAVE REACHED A PEAK. IT IS HERE THAT HE SEES THE MAIN HIPE FOR AN EARLY STRENGTHENING OF THE YEN. LOOKING SLIGHTLY FURTHER AHEAD, THE GOVERNOR HAS ALSO POINTED TO SIGNS OF IMPROVEMENT IN THE JAPANESE CURRENT ACCOUNT, WITH THE VOLUME OF EXPORTS INCREASING RAPIDLY AND THAT OF IMPORTS STEADY OR FALLING SEMI CONLON AND TO THE HOPE THAT JAPANESE INFLATION RATES, AT PRESENT STILL ACCELERATING, WILL REACH A PEAK IN THE NOT TOO DISTANT FUTURE.

7. IN THE MEANTIME IT IS REPORTED THAT THE BANK OF JAPAN IS NEGOTIATING TO SELL GOVERNMENT BONDS TO MIDDLE EAST OIL -PRODUCING COUNTRIES (SAUDI ARABIA AND KUWAIT ARE MENTIONED) TO THE EXTENT OF SOME YEN 50 BILLION A MONTH AT THE PRICE PREVAILING IN THE SECONDARY MARKET. SUCH A TRANSACTION WILL PROVIDE A FOREIGN CAPITAL INFLOW TO HELP OFFSET THE CURRENT ACCOUNT DEFICIT AND WILL BOOST THE OFFICIAL RESERVES.

8. DESPITE ITS PRESENT EXCESSIVE WEAKNESS AND LIKELY TURBULENCE IN THE IMMEDIATE FUTURE, SOME JAPANESE OBSERVERS ARE PREDICTING THE THE YEN WILL BEGIN TO STRENGTHEN EARLIER RATHER THAN LATER IN THE SECOND HALF OF THE YEAR, AS THE FUNDAMENTALS OF INFLATION AND THE BALANCE OF PAYMENTS BEGIN TO TAKE A TURN FOR THE BETTER.
FCO PLEASE PASS SAVING ADDRESSES
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Japan

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10 DOWNING STREET

From the Private Secretary

1 April 1980

MESSAGES FROM THE JAPANESE PRIME MINISTER

Roderic Lyne wrote to me on 27 March enclosing a draft reply from the Prime Minister to Mr. Ohira's messages of 18 and 19 March. I enclose the signed text. It is identical to your draft. You may care to despatch the draft telegram and to send the signed text by bag.

I am sending copies of this letter, without enclosure, to John Wiggins (HM Treasury), Stuart Hampson (Department of Trade), Geoffrey Needham (Department of the Environment), Bill Burroughs (Department of Energy) and David Wright (Cabinet Office).

M. O'D. B. ALEXANDER

8

Paul Lever, Esq.,
Foreign and Commonwealth Office.

Subject

c. FCO
HMT
D/TRADE
Sport
D/NPRIME MINISTER'S
PERSONAL MESSAGE
SERIAL No. T 72/80copied as
Master
opsEcon Pol (Summit)
PT 3

T 72/80

10 DOWNING STREET

Afghanistan September PT 4)

THE PRIME MINISTER

1 April 1980

Thank you for your messages of 18 and 19 March, setting out your view of Soviet actions in Afghanistan, and explaining your recent economic measures. I found these most helpful.

I agree with you about the significance of the Soviet invasion of Afghanistan which has deeply disturbing consequences not only in an East-West context but also for other neighbouring countries, other Islamic countries and for all non-aligned nations.

The Soviet leaders must be brought to realise that they cannot continue to enjoy detente in East-West relations while flouting it in the Third World. This must be the principal objective of our response to their intervention. Otherwise they will be tempted to try again elsewhere with even graver risks for world peace.

There can be no satisfactory outcome without the withdrawal of Soviet troops. I am encouraged by your welcome for the concept of a neutral and non-aligned Afghanistan and by your intention to maintain close contacts with us on this matter.

We have put the proposal to the Soviet Union who have not rejected it. We have deliberately not presented cut-and-dried ideas. This has made it more difficult for the Soviet

/Union

5

Union to reject the proposal. But, if they are to be brought to consider it seriously, we shall need to attract the declared support of as many other countries as possible, especially among the non-aligned. You will have seen that the EC/ASEAN Political Statement of 8 March supported our concept. We would much welcome Japanese support in commending the concept to non-aligned countries.

We see this initiative as an accompaniment and not an alternative to the robust line which we have taken with the Soviet Union in East-West relations. I agree with you about economic and trade relations with the USSR, particularly the need for us all to consult closely. We also hope that agreement will soon be reached among COCOM partners on tightening export controls. In the meantime, we have decided, in respect of the Soviet Union, not to submit general exceptions cases to COCOM.

The British Government consider that the Olympic Games should not take place in Moscow following the Soviet invasion of Afghanistan and that, if they do, British athletes should not participate. We regret the decision of the British Olympic Association to accept the invitation to the summer games, but there is still time for second thoughts. It is for the governing bodies of individual sports to decide in the light of events nearer the time whether or not they will nominate teams to participate in Moscow.

In South Asia it is in all of our interests to encourage better relations between India and Pakistan. I think that both countries are themselves seriously considering how to make progress over their bilateral relations. We must also do what we can to bring about improved relations between India and China, and we ourselves have stressed to the two countries the importance of a more harmonious relationship.

/Like you,

Like you, we are committed to doubling our economic assistance to Pakistan in the next financial year. We hope that this will encourage their confidence.

I understand that a very helpful report on Mr. Sonoda's tour of the Middle East and South West Asia has now been delivered to the Foreign and Commonwealth Secretary.

It is vital that we and other industrialised democracies concert our response to events in Afghanistan. We shall certainly keep in touch with you as our ideas develop. I consider it important that we should have ample opportunity to discuss these matters at the Venice Summit.

As to your message of 19 March about your Government's recent economic measures, I very much agree that it is imperative, not only for Japan but for us all, to bring inflation under control. By doing so, we can make a contribution to the health of the world economy. As you know, the control of inflation is also our own primary objective in the formulation of economic policies. The reduction of inflation inevitably involves difficult decisions. We believe that the price mechanism has a crucial role to play in reducing demand for oil; and that consumer prices should adequately reflect the full cost of world oil supplies. This would help to deal with the difficult energy situation which the world is now facing. Your determination to promote energy conservation is most welcome and your measures are a valuable contribution to our common efforts to reduce energy consumption.

The Chancellor of the Exchequer, Sir Geoffrey Howe, will shortly be writing to your Minister of Finance about our own Budget.

I look forward to meeting you again in Venice.

(SGD) MARGARET THATCHER

His Excellency Mr. Masayoshi Ohira

Copied to

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Afghanistan
Stuart: Pt 4

Foreign and Commonwealth Office

London SW1A 2AH

27 March 1980

Please type for
PAs signature.

RMJ 2/3

Dear Michael,

Messages from the Japanese Prime Minister

^{see Afghanistan file etc.}
You wrote to me on 20 March and to John Wiggins at the Treasury on 21 March about two recent messages from the Japanese Prime Minister.

I enclose a proposed reply covering both messages, incorporated in a draft telegram to our Ambassador in Tokyo. Where appropriate the draft message has been cleared at official level with the Treasury and the Department of Trade. I enclose as background copies of FCO telegrams 108 and 110 and of Tokyo telegram 193.

I am sending copies of this letter and enclosures to John Wiggins (HM Treasury), Stuart Hampson (Department of Trade), Geoffrey Needham (Department of Environment), Bill Burroughs (Department of Energy) and David Wright (Cabinet Office).

yours ever
Rodent Lyne

(R M J Lyne)
Private Office

M O'D B Alexander Esq
10 Downing Street
London

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GR 450
CONFIDENTIAL
FM TOKYO 250725Z MAR 80
TO PRIORITY FCO
TELEGRAM NUMBER 193 OF 25 MARCH
SAVING WASHINGTON, PARIS, BONN, ROME, OTTAWA.

YOUR TEL NO 108: MESSAGE FROM MR OHIRA

1. THE DEPUTY DIRECTOR GENERAL OF THE EUROPEAN AFFAIRS BUREAU, MFA, CALLED A MEETING OF THE BRITISH, FRENCH, GERMAN AND ITALIAN MINISTERS/COUNSELLORS ON 24 MARCH TO HAND OVER COPIES OF THE MESSAGE AND TO DESCRIBE THE BACKGROUND.
2. DONOWAKI SAID THAT MR OHIRA HAD DECIDED THAT HIS REGULAR EXCHANGES OF LETTERS WITH PRESIDENT CARTER SHOULD BE MATCHED BY MORE FREQUENT EXCHANGES WITH HIS EUROPEAN COUNTERPARTS, WHOM HE WAS ABLE TO MEET ONLY AT THE ANNUAL ECONOMIC SUMMITS. THE MESSAGES TO THE FOUR PRIME MINISTERS/HEADS OF STATE (AND A SIMILAR MESSAGE TO THE CANADIAN PRIME MINISTER) HAD BEEN IN PREPARATION FOR SOME TIME, AND WERE BASED ON A MESSAGE SENT IN MID-FEBRUARY TO PRESIDENT CARTER. THE TEXTS COULD NOT HOWEVER BE FINALISED UNTIL AFTER THE VISIT TO TOKYO OF THE GERMAN FINANCE MINISTER, BECAUSE OF THE POSSIBILITY THAT THE PASSAGE ON AID FOR TURKEY MIGHT HAVE TO BE CHANGED (IN THE EVENT IT WAS NOT CHANGED). THE MESSAGE ON ECONOMIC QUESTIONS (YOUR TELNO 110) HAD SIMILARLY ARISEN FROM AN INITIATIVE FROM MR OHIRA BUT HAD BEEN DIFFERENTLY HANDLED WITHIN THE MFA AND THIS ACCOUNTED FOR THE DIFFERENCE IN DATE AND METHOD OF DELIVERY.
3. DONOWAKI EXPLAINED THAT THE REFERENCES TO FUTURE EXCHANGES OF VIEWS ON AFGHANISTAN HAD BEEN CAREFULLY DRAFTED SO AS NOT TO IMPLY THAT THE AFGHANISTAN ISSUE SHOULD BE ON THE SUMMIT AGENDA. THE STATEMENT BY THE CHIEF CABINET SECRETARY AFTER MR OHIRA'S LUNCH ON 15 MARCH (MY TELNOS 182 AND 187 NOT TO ALL) HAD GONE FURTHER THAN THE MFA WISHED IN RESPECT OF DISCUSSION OF POLITICAL MATTERS AT THE SUMMIT, AND MIGHT BE MISLEADING. DONOWAKI GAVE IT AS HIS PERSONAL VIEW THAT IT WOULD BE BETTER FOR AFGHANISTAN TO BE DISCUSSED IN THE MARGINS OF THE SUMMIT. IN ANSWER TO A QUESTION, HE SAID THAT THE JAPANESE WERE NOT PROPOSING ANY SPECIFIC CHANNEL FOR DISCUSSIONS OF AFGHANISTAN AND BELIEVED THAT DILATERAL EXCHANGES COULD CONTINUE IN PARALLEL WITH THE MEETINGS OF AMBASSADORS IN WASHINGTON.

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PP TOKYO

PP MOSCOW

GHS 353

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FM FCO 191910Z MAR 30

TO PRIORITY TOKYO

TELEGRAM NUMBER 108 OF 19 MARCH

AND TO PRIORITY WASHINGTON, MOSCOW

AND SAVING TO PARIS, BONN, ROME, OTTAWA, KABUL, ISLAMABAD, DELHI

YOUR TEL NO 182 (NOT TO ALL): MESSAGE FROM MR OHIRA TO THE PRIME MINISTER: AFGHANISTAN

1. DURING A CALL ON THE LORD PRIVY SEAL THIS AFTERNOON THE JAPANESE AMBASSADOR DELIVERED MR OHIRA'S PROMISED LETTER TO THE PRIME MINISTER. AS FORESHADOWED, THIS GIVES HIS VIEWS ON A NUMBER OF FOREIGN POLICY ISSUES POST-AFGHANISTAN. TEXT BY PAC: MAIN POINTS ARE:

FOLLOWING AFGHANISTAN, JAPAN ATTACHES GREAT IMPORTANCE TO COOPERATION AMONG THE INDUSTRIALISED DEMOCRACIES AND WISHES ITS OWN VIEWS UNDERSTOOD. IT REGARDS THE SITUATION IN AFGHANISTAN AS A SERIOUS THREAT TO PEACE AND SECURITY. IT CALLS FOR PROMPT WITHDRAWAL OF SOVIET FORCES AND SELF-DETERMINATION FOR THE AFGHAN PEOPLE. AS TO SPECIFIC POLICIES:

A) JAPAN SUPPORTS THE CONCEPT OF NEUTRALITY AS A MEANS TO ACHIEVE SOVIET WITHDRAWAL AND AFGHAN SELF-DETERMINATION:

B) JAPAN IS STUDYING HOW BEST TO DEAL WITH ECONOMIC AND TRADE RELATIONS WITH THE SOVIET UNION. WESTERN SOLIDARITY THROUGH CONTACTS AND CONSULTATIONS IS VITAL. JAPAN WILL DO NOTHING TO TAKE ADVANTAGE OF MEASURES TAKEN BY OTHER WESTERN COUNTRIES AND EXPECTS OTHERS TO BEHAVE SIMILARLY. JAPAN WILL COOPERATE TOWARDS TIGHTENING EXPORT CONTROLS IN COCOM.

C) THE JAPANESE OLYMPIC COMMITTEE HAS BEEN ADVISED TO PAY SERIOUS ATTENTION TO THE SOVIET INVASION AND TO TAKE APPROPRIATE

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PP TOKYO
GRS 83
CONFIDENTIAL
FM FCO 1815Z MARCH 80
TO PRIORITY TOKYO
TELEGRAM NUMBER 110 OF 20 MARCH 1980
INFO SAVING TO WASHINGTON, BONN, PARIS, ROME, OTTAWA,
UKREP BRUSSELS

MY TEL NO 108: MESSAGE FROM MR CHIRA: JAPANESE ECONOMIC MEASURES
1. THE JAPANESE AMBASSADOR TODAY DELIVERED TO SIR D MAITLAND
A SECOND MESSAGE FOR THE PRIME MINISTER FROM MR CHIRA, ABOUT
RECENT JAPANESE MEASURES TO CONTROL INFLATION. SIMILAR MESSAGES
ARE BEING SENT TO THE OTHER HEADS OF GOVERNMENT PARTICIPATING
AT THE VENICE SUMMIT. TEXT BY BAG.

CARRINGTON

NNNN

FILES
FED
FRD
ECD(E)
TRED
PS
PS/MR BLAKER
PS/MR RIDLEY
PS/PUS
SIR D MAITLAND
LORD BRIDGES

ADDITIONAL DISIN.
ECONOMIC SUMMIT

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File No.
Department FED
Drafted by
(Block Capitals) S D M JACK
Tel. Extn.

OUTWARD

TELEGRAM

Security Classification CONFIDENTIAL
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DESKBY Z

FOR COMMS. DEPT. USE	Despatched (Date) (Time) Z	POSTBY Z
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PREAMBLE

(Time of Origin) Z (G.M.T.) (Restrictive Prefix)
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 (Codeword) (Deskby) Z

TO PRIORITY TOKYO Tel. No. of
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 SAD Mr Evans
 EESD Mr Murray
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 Planning Staff
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 PS/LPS
 PS/Mr Blaker
 PS/Mr Hurd
 PS/Mr Ridley

Copies to:-
 No 10
 Miss E E M Baker,
 HM Treasury
 Mr A Turnbull, HM
 Treasury
 Mr D I Richardson,
 CRE4, DOT
 Mr P Mehew, MOD

[TEXT]

MIPT

1. Following is text of the Prime Minister's message:

QUOTE Thank you [redacted] for your messages of
 18 and 19 March setting out your view of Soviet actions
 in Afghanistan, and explaining your recent economic
 measures. I found these most helpful.

I agree with [redacted] you [redacted] about the significance of the
 Soviet invasion of Afghanistan which has deeply
 disturbing consequences not only in an East-West context
 but also for other neighbouring countries, other
 Islamic countries and for all non-aligned nations.

The Soviet leaders must be brought to realise that
 they cannot continue to enjoy détente in East-West
 relations while flouting it in the Third World. This
 must be the principal objective of our response to their

intervention. Otherwise they will be tempted to try again elsewhere with even graver risks for world peace.

There can be no satisfactory outcome without the withdrawal of Soviet troops. I am encouraged by your welcome for the concept of a neutral and non-aligned Afghanistan and by your intention to maintain close contacts with us on this matter.

We have put the proposal to the Soviet Union who have not rejected it. We have deliberately not presented cut and dried ideas. This has made it more difficult for the Soviet Union to reject the proposal. But, if they are to be brought to consider it seriously, we shall need to attract the declared support of as many other countries as possible, especially among the non-aligned. You will have seen that the EC/ASEAN Political Statement of 8 March supported our concept. We would much welcome Japanese support in commending the concept to non-aligned countries.

We see this initiative as an accompaniment and not an alternative to the robust line which we have taken with the Soviet Union in East-West relations. I agree with you about economic and trade relations with the USSR, particularly the need for us all to consult closely. We also hope that agreement will soon be reached among COCOM partners on tightening export controls. In the meantime, we have decided, in respect of the Soviet Union, not to submit general exceptions cases to COCOM.

The British Government consider that the Olympic Games should not take place in Moscow following the Soviet invasion of Afghanistan and that, if they do, British athletes should not participate.

We regret the decision of the British

/Olympic

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Olympic Association to accept the invitation to the summer games, but there is still time for second thoughts. It is for the governing bodies of individual sports to decide in the light of events nearer the time whether or not they will nominate teams to participate in Moscow.

In South Asia it is in all of our interests to encourage better relations between India and Pakistan. I think that both countries are themselves seriously considering how to make progress over their bilateral relations. We must also do what we can to bring about improved relations between India and China, and we ourselves have stressed to the two countries the importance of a more harmonious relationship.

Like you we are committed to doubling our economic assistance to Pakistan in the next financial year. We hope that this will encourage their confidence.

I understand that a very helpful report on Mr Sonoda's tour of the Middle East and South West Asia has now been delivered to the Foreign and Commonwealth Secretary.

It is vital that we and other industrialised democracies concert our response to events in Afghanistan. We shall certainly keep in touch with you as our ideas develop. I consider it important that we should have ample opportunity to discuss these matters at the Venice Summit.

As to your message of 19 March about your Government's recent economic measures, I very much agree that it is

imperative, not only for Japan but for us all, to bring inflation under control. By doing so, we can make a contribution to the health of the world economy. As you know, the control of inflation is also our own primary objective in the formulation of economic policies. The reduction of inflation inevitably involves difficult decisions. We believe that the price mechanism has a crucial role to play in reducing demand for oil; and that consumer prices should adequately reflect the full cost of world oil supplies. This would help to deal with the difficult energy situation which the world is now facing. Your determination to promote energy conservation is most welcome and your measures are a valuable contribution to our common efforts to reduce energy consumption.

The Chancellor of the Exchequer, Sir Geoffrey Howe, will shortly be writing to your Minister of Finance about our own Budget.

I look forward to meeting you again in Venice.

UNQUOTE

File No.....

Department FED

Drafted by
(Block Capitals) S..D..M..JACK

Tel. Extn. 233 5184

OUTWARD

TELEGRAM

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 - PS/Mr Blaker
 - PS/Mr Hurd
 - PS/Mr Ridley
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MY TELS NOS 108 AND 110 AND YOUR TEL NO 193:
 MESSAGES FROM THE JAPANESE PRIME MINISTER

1. MIFT contains the text of a reply from the Prime Minister to Mr Ohira. Please arrange for delivery.
2. We see no need to coordinate replies with our EC partners. This would only delay and complicate matters.

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6/A26/380

Japan

DSG

10 DOWNING STREET

From the Private Secretary

21 March 1980

MESSAGE FROM THE JAPANESE PRIME MINISTER

I enclose a copy of a message received by the Prime Minister from the Prime Minister of Japan about the measures taken by the Japanese Government to control inflation. The Foreign and Commonwealth Office will no doubt be getting in touch about a reply from the Prime Minister to Mr. Ohira.

I am sending copies of this letter and its enclosure to Stuart Hampson (Department of Trade), Bill Burroughs (Department of Energy) and David Wright (Cabinet Office): and without enclosure to Stephen Gomersall (Foreign and Commonwealth Office).

M. O'D. B. ALEXANDER

KBY

John Wiggins, Esq.,
H.M. Treasury.

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Foreign and Commonwealth Office

London SW1A 2AH

20 March 1980

Dear Mr. Thatcher,

MESSAGE TO THE PRIME MINISTER FROM THE JAPANESE
PRIME MINISTER

My letter of 19 March covered a letter to the Prime Minister from Mr Ohira about Afghanistan which the Japanese Ambassador delivered to the Lord Privy Seal.

I now enclose the original of a second message, on Japanese measures to control inflation, which was handed to Sir D Maitland when Ambassador Fujiyama called on him this afternoon. As with the first message, we will provide advice on a draft reply as soon as possible.

Yours ever
Stephen Gomersall

S J Gomersall

M O'D B Alexander Esq
10 Downing Street

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EMBASSY OF JAPAN
DAILY KINGDOM

London : 20th March 1980

Dear Prime Minister,

Mr. Masayoshi Ohira, Prime
Minister of Japan, has instructed me to hand
to you the text of a further message. *filed on Afghanistan
Pt 4
situation.*

I am attaching this message
to this note.

*Yours sincerely
Naraichi Fujiyama*

Naraichi Fujiyama
Ambassador

The Rt.Hon. Margaret Thatcher, MP,
Prime Minister and First Lord of the Treasury,
10, Downing Street,
London, S.W.1.

SUBJECT

T E X T

PRIME MINISTER'S
PERSONAL MESSAGE
SERIAL No. T604180

Tokyo,
March 19, 1980

Dear Prime Minister,

In view of the fact that inflation is our growing common concern in the present world economy, I am writing to inform you that my Government has decided today to introduce new composite price policies designed to check inflation.

In order to control inflation, we had already raised the official discount rate several times over since April last year, and instituted the composite price policies in November, 1979.

However, the recent price trends show that the conspicuous increase in wholesale prices, caused by higher costs of oil and other imported commodities as well as weakened exchange rate of the Yen, is gradually sliding in consumer prices, and the public utility charges for such items as electricity and gas must be upwardly revised with the impact of the oil price rise. With these trends underway, the prospect of the price movements in Japan requires more careful attention.

Under these circumstances, the Government of Japan considered it imperative to make every effort for the stabilization of prices by way of appropriate management of aggregate demand and various measures for curbing price increases, for the time being, so that the increase in oil prices will not be channelled into home-made inflation through upsurge of inflationary expectations. We also expect all the industries

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concerned to strengthen efforts for further improvement of the productivity. With these in mind, the Government of Japan has decided upon the composite price policies whose tenor is as follows.

I wish to add that the Government of Japan took these measures in the hope that the stabilization of prices will ensure the sustained economic growth of Japan and also contribute towards a more stable exchange market and thus towards a more stable international economy. The Government of Japan is determined to keep utmost vigilance upon the phase of the business cycle and to continue its efforts to sustain economic conjuncture through timely application of appropriate economic policies.

1. Fiscal and Financial Policies

(1) In implementing public works and other Government projects, most careful attention will be paid to price trends. Implementation programmes are to be soon drawn up after passage of the Budget for Fiscal 1980 to implement projects with restraint for the time being.

(2) With regard to financial policies, tight-money policy should be steadfastly maintained, and also money supply should be monitored for the purpose of pursuing appropriate financial management.

In line with this policy, the Bank of Japan raised the official discount rate on March 18.

2. Measures for Individual Commodities

Considering the recent commodity market situation,

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the Government will closely monitor supply-demand situation and price trends of individual commodities, and as for the commodities registering large price increase, the Government will take such measures as release of reserved stocks to secure necessary supply.

3. Measures relating to the Revision of Public Utility Charges

The Government of Japan will urge the industries concerned to make every effort to rationalize production process and to absorb increased production cost resulting from the revision of the public utility charges for such items as electricity and gas and thus to avoid any unwarranted price raise. The Government will also closely monitor supply-demand situations and price movements of the products involved.

4. Promotion of Energy and Resource Conservation

With a view to curbing inflation, the Government of Japan will further encourage the public campaign to conserve energy and resources and seek broader public understanding on the importance of the policies to reduce the consumption of oil and to save resources.

Yours sincerely,

MASAYOSHI OHIRA
Prime Minister of Japan

The Rt.Hon. Margaret Thatcher, MP,
Prime Minister and First Lord of the Treasury,
London.

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RH

BF/26380

20 March 1980

Message from the Japanese

Prime Minister

Stephen Gomersall sent me, under cover of his letter of 19 March, the original text of the message to the Prime Minister from Mr Ohira, the Prime Minister of Japan. He undertook to let me have advice on a reply. I should be grateful if this could reach me by close of play on Wednesday, 26 March.

I am sending copies of this letter together with copies of the Japanese Prime Minister's message, to John Wiggins (HM Treasury), Stuart Hampson (Department of Trade), Geoffrey Neddham (Department of the Environment) and David Wright (Cabinet Office).

M. O'D. B. ALEXANDER

R M J Lyne, Esq
Foreign and Commonwealth Office

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TO IMMEDIATE FCO

TELEGRAM NUMBER 671 OF 13 NOVEMBER, 1979

INFO ROUTINE PEKING, MOSCOW, SEOUL, HONG KONG AND WASHINGTON.

MYTEL NO 660.

POLITICAL SITUATION.

AM

1. THE LAST MONTH HAS BEEN A SINGULARLY UNHAPPY ONE FOR JAPAN'S GOVERNING POLITICAL PARTY, THE LDP. WHILE IT IS TRUE THAT MR OHIRA GAINED VERY LITTLE IN THE 7 OCTOBER GENERAL ELECTION, EQUALLY HE LOST NOTHING OF SIGNIFICANCE. IN FACT THE LDP INCREASED THEIR PERCENTAGE OF THE POLL FOR THE FIRST TIME FOR MANY YEARS. WHERE THEY FAILED IT WAS BECAUSE TOO MANY OF THEIR CANDIDATES, DRIVEN BY FACTIONAL CONSIDERATIONS, CUT ONE ANOTHER'S THROATS - A MISTAKE NOT REPEATED BY THE JCP WHO WITH NO INCREASE IN VOTE DOUBLED THEIR REPRESENTATION IN THE LOWER HOUSE OF THE DIET. IN FACT IN NO LESS THAN 54 CONSTITUENCIES THE LDP CAME PROXIME ACCESSIT. THIS IS NOT AN UNUSUAL STATE OF AFFAIRS.

THE LDP IS APT TO SUFFER FROM A SURFEIT OF CANDIDATES. BUT MR OHIRA GAMBLED THAT THEY WOULD DO BETTER THAN USUAL. IN FACT THEY DID WORSE. SO HE MUST SUFFER.

2. SO WE HAVE SEEN A HIGHLY REGRETTABLE PUBLIC LEADERSHIP STRUGGLE INVOLVING MESSRS MIKI, FUKUDA AND OHIRA. EACH OF THESE OUSTED HIS PREDECESSOR. MIKI HAD MENDED HIS FENCES WITH FUKUDA AND WAS URGING HIM TO GET HIS OWN BACK ON OHIRA: FUKUDA, THOUGH AT FIRST RELUCTANT, WAS PERSUADED TO FIGHT. THE SHADOWY FIGURES LESS INVOLVED WERE MESSRS NAKASONE AND TANAKA. NAKASONE WAS NOT AT THIS STAGE A CREDIBLE FIGURE AS PRIME MINISTER, ALTHOUGH HIS DAY MAY COME. TANAKA WAS EXCLUDED FROM CONSIDERATION BECAUSE HIS INVOLVEMENT IN THE LOCKHEED AFFAIR IS STILL UNDER JUDICIAL INVESTIGATION. NO COMPROMISE FIGURE WAS EVER IN VIEW. THUS OHIRA AS THE SITTING INCUMBENT SEEMED CERTAIN TO PREVAIL. AND HE DID.

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3. BUT THE OUTCOME HAS BEEN DEPLORABLE FOR THE LDP. DESPITE THE THEORETICAL ABOLITION OF FACTIONS SOME YEARS AGO THEIR EXISTENCE AND STRENGTH HAS BEEN RECONFIRMED. MR OHIRA WHOSE FACTIONAL STRENGTH WAS INCREASED BY THE ELECTION, WITH THE SUPPORT OF MR TANAKA DISCOMFITED HIS OPPONENTS AND WON THROUGH IN A STRAIGHT VOTE FOR THE PRIME MINISTERSHIP AGAINST MR FUKUDA OF HIS OWN PARTY. THE RESULT IS FAR FROM HAPPY FROM THE LDP'S POINT OF VIEW.

4. MR OHIRA HAS FORMED A CABINET OF SECOND RATE POLITICAL PERSONALITIES, THOUGH THE APPOINTMENT OF MR SABURO OKITA AS FOREIGN MINISTER IS AS GOOD AN APPOINTMENT AS COULD HAVE BEEN MADE. HE IS AN ECONOMIST WITH A WORLDWIDE REPUTATION, A GOOD FRIEND OF THE WEST AND IF HE HAS NO POLITICAL STATURE OR FOLLOWING HE IS WELL ENOUGH KNOWN IN JAPAN TO ENSURE A WIDE MEASURE OF SUPPORT. (SINCE HE UNSUCCESSFULLY STOOD AS A NLC CANDIDATE FOR THE UPPER HOUSE IN 1977 HE HAS ESCHEWED POLITICS.)

5. AT A MOMENT WHEN THE JAPANESE ECONOMY STILL ENJOYS BOOM-CONDITIONS IT CAN BE ARGUED THAT MR OHIRA CAN VIEW THE SITUATION WITH EQUANIMITY. IT WOULD BE VERY HELPFUL TO MR OHIRA IF HE COULD COUNT UPON 9 MONTHS MORE OF GOOD ECONOMIC PERFORMANCE AS HE MUST IN THAT PERIOD FACE A VITAL ELECTION TO THE UPPER HOUSE. PERSONALLY I THINK THAT HE CAN, BUT THE SIGNS ARE THAT THE ECONOMY MAY "PLATEAU" OUT OR POSSIBLY EVEN TURN DOWN DEPENDING UPON THE OIL PRICE SITUATION. IN ANY EVENT, IF MR OHIRA CANNOT RESTORE ORDER WITHIN THE LDP AND FIGHT THAT ELECTION WITH A PARTY UNITED BEHIND HIM HE RISKS A SERIOUS REVERSE AND INEVITABLE REPLACEMENT AT THE ELECTION FOR THE PARTY LEADERSHIP DUE AT THE END OF 1980.

6. I REGRET THE DEPARTURE OF MR ESAKI AS MUCH AS I DO THAT OF MR SONODA. OF THE NEWCOMERS MR SASAKI AS MITI MINISTER HAS NO LESS EXPERIENCE AND WISDOM, BUT IN MR ESAKI I THINK WE HAD A FRIEND. MR TAKESHITA, THE SUCCESSOR OF MR KANEKO AS FINANCE MINISTER, WILL NO DOUBT PERFORM AS HIS PREDECESSORS HAVE DONE - WITHOUT DISTINCTION, BUT WITHOUT DAMAGE TO OUR INTERESTS AND WITH INTERNATIONAL REPRESENTATION RESTING IN THE HANDS OF HIS OFFICIALS FOR LACK OF HIS ENGLISH.

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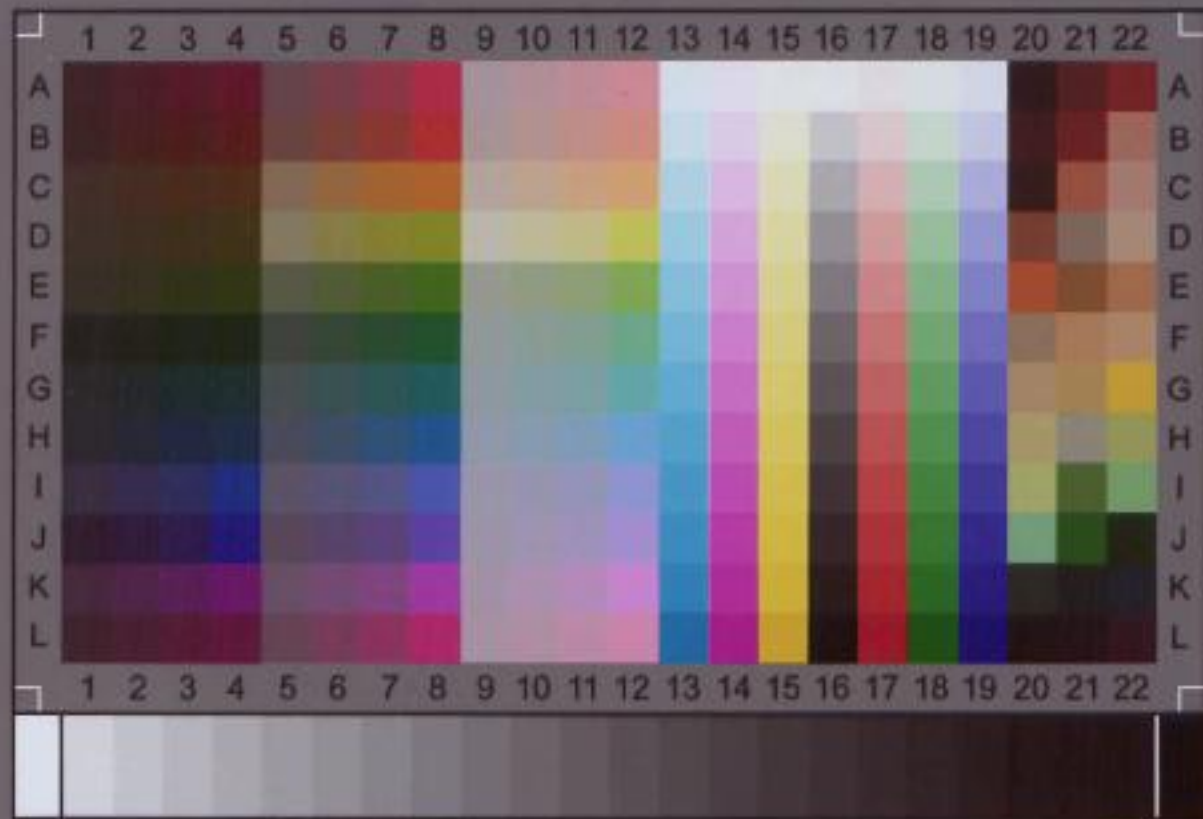
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7. WE SHALL NOW BE IN FOR A PERIOD OF SULKING ON THE PART OF THE UNSATISFIED SECTIONS OF THE LDP. THIS WAS EXEMPLIFIED IN THE CABINET MAKING PERIOD AND ACCOUNTS FOR MANY OF THE NONENTITIES BEING APPOINTED. BUT ABSTENTION AND DISINTEREST WILL BE LESS EASY WHEN THE GOVERNMENT PUT THEIR BUDGET FORWARD IN THE NEW YEAR, GIVEN THAT THE OPPOSITION PARTIES HAVE TOGETHER A MAJORITY OF SEATS ON THE IMPORTANT BUDGET COMMITTEE, MR OHIRA MAY BE ABLE TO COUNT ON SUPPORT FROM THE VERY SMALL NUMBERS OF NLC. HE WILL ALSO BE ABLE TO EXPECT SOME SUPPORT FROM THE DSP AND KOMEITO, BUT THIS IS NO WAY FOR AN LDP PREMIER TO RULE. I STILL BELIEVE (MY TELNO 649) THAT SINCE ALL NOW KNOW THAT IT IS HE WHO HAS THE CLOUT, VESTED INTEREST WILL BRING THE PARTY IN BEHIND HIM WHEN THE DIET RESUMES IN LATE JANUARY FOR ITS FULL SESSION. BY THEN PERHAPS THERE WILL BE MINISTERIAL CHANGES REFLECTING THIS WHICH COULD MEAN THAT THE UPPER HOUSE ELECTIONS CAN YET BE THE SUCCESS DENIED TO MR OHIRA IN OCTOBER.

[F C O PASS SAVING ADDRESSEES]

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