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10 DOWNING STREET

From the Private Secretary

9 September 1985

Dear Rachel,

THE YEN

Charles Powell here has received privately an advance copy of the letter which is to be handed to the Economic Secretary tomorrow afternoon (copy attached).

Mr Nikaido apparently intends to release the letter to the press tomorrow night, our time. Mr Powell expressed regret at this, pointing out that it would mean a sharper reply from us which we would in turn also want to release.

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The Prime Minister is not back in London until Wednesday night, but we shall no doubt want to issue a reply to Mr Nikaido's letter very smartly.

I am copying this letter to John Bartlett (Bank of England) and John Mogg (Department of Trade and Industry).

Yours sincerely,

David

DAVID NORGROVE

Mrs Rachel Lomax,
H M Treasury

SM



Treasury Chambers, Parliament Street, SW1P 3AG

David Norgrove Esq
10 Downing Street
London
SW1

*cc Press Office
(ready to discuss if you wish)*

1. Charles Powell 10 September 1985
2. CF to await X.

Dear David

THE YEN

Further to your letter to Rachael Lomax of yesterday I enclose the letter which Mr Nikaido has sent to the Prime Minister. Mr Shiozaki, the Liberal Democratic Party Vice Administrator, who passed the letter to the Economic Secretary this afternoon, said that it would not be released until tomorrow morning (our time) and it therefore will not, presumably, be in time for tomorrow's press.

X) Officials here are, as requested, drafting a reply.

*Yours aw,
A M Ellis*

**A M ELLIS
PRIVATE SECRETARY**

DRAFT LETTER

From : Prime Minister
To : Susumu Nikaido
Vice-President
The Liberal Democratic Party
11-23 Nagata-Cho 1-Chome
CHIYODA-Ku
Tokyo 100
Japan

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DGZAN

Dear Mr Nikaido,

Thank you for your letter of 6 September. I very much enjoyed my participation in the IDU Party Leaders Conference in Washington. I was particularly glad of the opportunity provided by the meeting to discuss world economic problems with you and other participants.

2. I am most grateful to you for the stimulating and thoughtful note, enclosed in your letter, on Japan's role and in particular that of the Yen in the world economy.

3. I am reassured by what is said in your note that there is no real difference between us in our diagnosis of the position of the Yen and of the factors affecting it. We are both agreed that the large capital outflows from Japan in recent years, in particular to the United States, have contributed to keeping the value of the Yen on the foreign exchange markets lower than is justified and desirable in the light of Japan's international competitiveness and that this has in turn been a factor in the persistence of large current account imbalances.

4. There is also, I believe, a large measure of agreement between us on what now needs to be done. In particular, I share your views on the importance of action to liberalise and internationalise your financial and capital markets and to encourage the international use of the Yen. I am encouraged by the steps which Japan has already taken or announced and look forward to further progress in this direction. As you say, it is particularly desirable that these measures should increase demand for the Yen, thus attracting capital inflows into Japan and promoting a stronger exchange rate. With this in mind it would seem that action to remove any remaining disincentives there may be to inward capital flows and to ensure the availability of a wide range of Yen assets, at competitively-determined interest rates, should merit particular priority. Without this there is a risk that the welcome measures Japan has taken to remove controls on outward capital flows could have the opposite effect.

5. More generally, I welcome what you say in your note about Japan's determination to play its part in rectifying present external imbalances and in contributing to balanced world economic growth, both through measures to increase domestic demand and to open up your internal market. As regards Japan's distribution system, we welcome the willingness expressed by your Government to study ways in which the present structure may represent a serious barrier to the penetration of the market by foreign suppliers.

6. I am most grateful to you for setting out your views so fully. I look forward to further progress in all the areas you have described.

JAPAN: Kels
AS