E.R.

CONFIDENTIAL

Record of a conversation between the Prime Minister and the Japanese Minister of Finance at 1610 on 20 September, 1982, in Tokyo

Present:

Prime Minister Sir Hugh Cortazzi Mr. R. Gray Mr. J. Coles Mr. I. Kydd	Mr. M. Watanabe, Minister of Finance. Mr. K. Watanabe, Vice Minister of Finance. Mr. Matsuo, Director General, Customs Bureau. Mr. Ohba, Director General, International Finance Bureau. Mr. Hirahara, Ambassador to UK. Mr. Asami, Secretary to Minister of Finance.

Mr. Watanabe apologised for a late arrival. He had left an important Cabinet meeting which had been discussing wages policies. The Prime Minister said that she had read an account of this problem in Mr. Suzuki's recent speech.

Mr. Watanabe said that he had just told the Japanese Cabinet that it would be necessary to follow the UK's example. Britain had been successful in curtailing wage rises to around 7%. He understood that we now aimed at rises of no more than 4-5%. The Prime Minister commented that the British record on pay was not as good as the Japanese. In the past, 4 incomes and prices policies, all of which had been breached, had led the trade unions to expect an annual increase in pay, regardless of whether output increased. In Japan pay rises had gone hand in

CONFIDENTIAL

/hand

hand with productivity. This was part of the explanation of Japan's success in exports. We aimed to lower the rate of inflation by persuading people that, as a matter of common sense, you could not expect to be paid more unless you produced more. It was easier to achieve results in the private sector than in the public. Workers in the public sector believed they had access to a bottomless purse. She wished the Japanese Government every success in its economic policy. She thought that that policy, as described in Mr. Suzuki's speech, was absolutely right.

Mr. Watanabe said that he always read the Prime Minister's speeches in Parliament with interest. His impression was that she addressed the basic economic principles rather than technical issues. That was the way to revive the economy. The Prime Minister agreed. If one departed from basic principles, one could make no economic progress. Moreover, people understood basic principles, but found technicalities less comprehensible. Japan had a high savings ratio. So it should be able to obtain extra money with relative ease in order to finance an unexpected deficit. Mr. Watanabe said that so far it had been easy to finance the deficit. The amount outstanding from Government bonds was around $350b. But in the coming year Japan was facing a situation where it would need an additional flotation of bonds amounting to $65b. It would not be possible to finance this at a low rate of interest. The Prime Minister agreed. The more one borrowed, and the more one was in competition for money, the higher the interest rate that had to be paid. Mr. Watanabe said that the value of Government bonds amounted to 6% of GNP and 33% of total Government expenditure, whereas in Europe they tended to represent about 10% of total expenditure. The Prime Minister said that she imagined that the Japanese Government had kept the interest rates on bonds down because the rates that banks could charge on deposits were controlled. Mr. Watanabe said that the interest rate on time deposits was 6%. This was quite high in relation to the inflation rate.

The Prime Minister asked whether the low value of the yen was producing a rise in the consumer price index. Mr. Watanabe agreed that it was. Or, more accurately, the depreciation of the yen would lead to a rise in wholesale prices, after a time lag. But the country was experiencing some weakness in demand, and people were economising. So a rise in wholesale prices would not easily find its way through to retail prices. Therefore profits would be squeezed.

The Prime Minister asked what the prospects were for the exchange value of the yen. Mr. Watanabe replied that there was no reason why the yen should not appreciate in the long run in view of Japan's good economic performance, but he would not wish to comment in detail on the perspective. The Prime Minister said that European currencies were weak against the dollar. No one knew whether lower interest rates in the US would hold because the size of the budget deficit was not known.

Mr. Watanabe explained that yen-denominated imports were only 3% of total Japanese imports. Even if Japan wished to increase the proportion, people would not wish to retain the yen. The Prime Minister commented that Japan could quickly make the yen popular. It had a strong economy, and could therefore make the yen strong. But that was a matter for Japan. Mr. Watanabe said that in a volatile situation no one wished to take refuge in the yen.

The Prime Minister asked whether she was right in thinking that Japan's fundamental problem arose from the fact that for the first time in recent years it was entering a period of slow growth. Financial and economic policy, as well as expenditure, had been geared to fast growth. It would come as a shock to people that public and private expenditure now had to be geared to lower growth. Mr. Watanabe entirely agreed. Japan had enjoyed a high growth economy for 8 years. But this situation had been brought to an end by the rise in the price of oil; expenditure on social welfare, and public works were still rising. The Prime Minister said that she was familiar with the problem of demands for increased social welfare, usually at indexed rates. There was also the problem of an ageing population. Mr. Watanabe said that rising public expenditure was a universal disease. The Prime Minister agreed, but said that we had to fight it together. She wished Japan well in its pursuit of sound policies.

Mr. Watanabe presented the Prime Minister with a copy of the speech he had made at the recent meeting of the IMF. The meeting ended at 16.40.

A.J.C.

20 September, 1982.