

RESTRICTED

062740  
MDHIAN 3123

RESTRICTED

FM TOKYO

TO DESKBY 281230Z FCO

TELNO 849

OF 281130Z OCT 87

AND TO IMMEDIATE PARIS, ROME, WASHINGTON, BONN

AND TO ROUTINE BERNE, SINGAPORE, HONG KONG, UKREP BRUSSELS

AND TO ROUTINE UKDEL OECD

WASHINGTON TELNO 2301: JAPANESE REACTION TO THE FALL IN WORLD  
STOCK MARKETS

#### SUMMARY

1. FALL IN TOKYO LESS SEVERE THAN ELSEWHERE, DUE PARTLY TO CONFIDENCE IN STRENGTH OF THE JAPANESE ECONOMY AND PARTLY TO OFFICIAL GUIDANCE AND INSTITUTIONAL CHARACTERISTICS OF THE JAPANESE MARKET. WITHDRAWAL BY FOREIGN INVESTORS A MAJOR CONTRIBUTOR TO FALL. POLICY MEASURES TO MAINTAIN PUBLIC CONFIDENCE, STABILISE MARKETS AND SUPPORT THE U S DOLLAR. MARKET AND GOVERNMENT LOOKING FOR SIGNS OF US ACTION TO CUT DEFICITS. FEAR OF CONSEQUENCES OF LOSS OF CONFIDENCE IN DOLLAR, BUT JAPANESE INSTITUTIONS WEIGHING CAUTIOUSLY THE RISKS OF PURCHASING MORE US TREASURY BONDS.

#### DETAIL

2. THE NIKKEI'S AVERAGE, AT THE CLOSE ON 28 OCTOBER, OF 22,577 REPRESENTS A 15% FALL FROM ITS PEAK ON 14 OCTOBER, BUT IS STILL 20% ABOVE ITS LEVEL AT THE BEGINNING OF THE YEAR. THE MAIN SELLING HAS COME FROM FOREIGN INVESTORS, INCLUDING MANY LONDON AND NEW YORK BASED FUND OPERATORS NEEDING TO RAISE CASH, WHO HAVE SOLD AN ESTIMATED DOLLARS 10 BILLION, OR 9% OF NON-RESIDENT HOLDINGS OF JAPANESE EQUITY. ALTHOUGH SOME JAPANESE PRIVATE INVESTORS SOLD HEAVILY LAST WEEK AS FOREIGN MARKETS FELL, THEIR WEIGHT IS RELATIVELY SMALL, AND SOME ARE REPORTEDLY BUYING AGAIN. JAPANESE INSTITUTIONAL INVESTORS WITH OFFICIAL ENCOURAGEMENT HAVE REFRAINED FROM SELLING. JAPANESE BROKERS HAVE BEEN BUYING SOME LEADING STOCKS ON THEIR OWN ACCOUNT TO TRY TO STABILISE THE MARKET AND IMPROVE THE CLIMATE FOR GOVERNMENT FLOTATIONS. SO FAR THERE HAVE BEEN NO REPORTS OF LIQUIDITY PROBLEMS EITHER AMONG BROKING COMPANIES OR CORPORATIONS. JAPANESE INVESTORS IN DOLLAR ASSETS SEEM TO BE SITTING TIGHT FOR THE MOMENT, THOUGH WATCHING THE DOLLAR CAREFULLY.

RESTRICTED

062740  
MDHIAN 3123

3. THE JAPANESE AUTHORITIES SEE THE FALL IN TOKYO AS THE RESULT OF THE CRISIS IN KS MARKETS, OCCASIONED BY LACK OF CONFIDENCE IN U S FISCAL POLICY AND EXACERBATED BY PANIC SELLING OF STOCKS BY PRIVATE INVESTORS. THEY BELIEVE THAT, WHILE U S STOCK PRICES HAD RISEN SERIOUSLY OUT OF LINE WITH DEVELOPMENTS IN THE REAL ECONOMY, THE SAME IS NOT TRUE IN JAPAN, WHERE A SOUNDLY BASED RECOVERY FROM LAST YEAR'S RELATIVE RECESSION IS WELL UNDER WAY, WITH CONSUMPTION, AND TURNOVER AND PROFITS IN LEADING DOMESTIC-DEMAND RELATED INDUSTRIES SHOWING VERY HEALTHY GROWTH. THESE POINTS WERE HEAVILY EMPHASISED IN ANNOUNCMENTS ON 27 OCTOBER BY THE ECONOMIC PLANNING AGENCY AND BANK OF JAPAN. ALTHOUGH CONSUMPTION MAY FALL A LITTLE THEREFORE, OVERALL THE FALL ON THE TOKYO MARKET SO FAR IS THOUGHT LIKELY TO HAVE A RELATIVELY SMALL EFFECT UPON ECONOMIC ACTIVITY HERE. BUT WHILE PUBLICLY OPTIMISTIC, THE AUTHORITIES ARE STILL CONCERNED THAT THE MORE SEVERE EFFECTS OF THE CRISIS UPON BUSINESS IN THE US MAY CAUSE A LOSS OF CONFIDENCE AND RAPID FALL IN THE DOLLAR, AND THAT THIS WOULD IN TURN HAVE SEVERE CONSEQUENCIES FOR JAPAN.

4. EFFORTS OVER THE LAST FEW DAYS HAVE THEREFORE BEEN AIMED AT STABLIZING THE TOKYO STOCK MARKET AND DIRECTLY AND INDIRECTLY SUPPORTING THE DOLLAR EXCHANGE RATE. THE MINISTRY OF FINANCE HAVE CALLED IN THE BROKER, INSURANCE COMPANIES, TRUST BANKS ETC IN TURN AND, UNDER THE GUISE OF HEARINGS ON THE CURRENT SITUATION, ENCOURAGED THEM TO REFRAIN FROM SELLING OF STOCKS. REPORTS HAVE ALSO SURFACED ON FURTHER EMERGENCY MEASURES WHICH COULD BE TAKEN IN FUTURE TO PEG THE SALES OF SHARES. MOF HAVE ALSO PEGGED THE LONG-TERM PRIME RATE AT 5.7% AND DECIDED NOT TO PROCEED WITH A PLANNED GOVERNMENT BOND ISSUE IN NOVEMBER, WHICH WOULD HAVE RAISED INTEREST RATES. IN THE INTEREST OF PREVENTING A FURTHER FALL IN THE MARKETS, THE BANK OF JAPAN HAS PUBLICLY SOFTENED ITS RECENT SHIFT IN POLICY IN FAVOUR OF TIGHTER MONETARY CONDITIONS TO FORESTALL DOMESTIC INFLATION. SHORT AND LONG-TERM COMMERCIAL INTEREST RATES HAVE FALLEN SLIGHTLY IN RESPONSE. THE GOVERNMENT IS ALSO PLANNING TO GO AHEAD WITH ITS MAJOR FLOATATION OF GOVERNMENT HELD NTT SHARES ON 10-12 NOVEMBER AND OF JAL SHARES IN DECEMBER. LDP SOURCES HAVE ALSO INDICATED AN INTENTION TO CONTINUE THE MILDLY REFLATIONARY LINE OF THE LAST SUPPLEMENTARY BUDGET IN NEXT YEAR'S MAIN XUDGET.

5. THE BANK OF JAPAN HAS BEEN INVOLVED IN CONCERTED INTERVENTIONS

RESTRICTED

062740  
MDHIAN 3123

TO SUPPORT THE DOLLAR, WHOSE RATE AGAINST THE YEN TODAY FELL TO BELOW YEN 141. THE BANK SEE IT AS AN AMERICAN PREREQUISITE TO DEFEND THE DOLLAR EXCHANGE RATE IN CURRENT CIRCUMSTANCES. FROM THE POINT OF VIEW OF THE JAPANESE ECONOMY THEY REGARD A GRADUAL UPWARD MOVEMENT OF THE YEN AS BOTH TOLERABLE AND LIKELY IN DUE COURSE.

6. THE ATTITUDE OF JAPANESE INSTITUTIONS TOWARDS THE NEXT ISSUE OF U S TREASURY BONDS EXPECTED IN EARLY NOVEMBER, IS ALSO OF GREAT CONCERN TO THE JAPANESE AUTHORITIES. THE MINISTRY OF FINANCE DENY ANY INFLUENCE OR GUIDANCE, BUT THERE IS AN EXPECTATION IN THE MARKET THAT THE MOF ARE HOPING THAT JAPANESE INVESTORS WILL CONTINUE TO MAKE QUOTE A POSITIVE CONTRIBUTION UNQUOTE. HOWEVER, SECURITY COMPANY SOURCES TELL US THAT DESPITE THE OBVIOUS RISK OF A SHARP FALL IN THE DOLLAR IF THEY FAIL TO BUY, THEIR ATTITUDE IS EXTREMELY CAUTIOUS, BECAUSE OF LOW EXPECTATION OF RETURNS, AND BECAUSE THEY FEEL THAT JAPANESE INSTITUTIONS PURCHASED TOO EXPENSIVELY IN PREVIOUS ROUNDS.

7. WHILE CONFIDENCE STILL REMAINS IN THE DOMESTIC ECONOMY, PRESS AND POLICY MAKERS ALIKE POINT TO THE STRUCTURAL IMBALANCES IN THE WORLD ECONOMY AS THE FUNDAMENTAL CAUSE OF THE CURRENT CRISIS. WHILE THE NIKKEI HELPFULLY CONCLUDES THAT JAPAN CANNOT BE EXEMPTED FROM FURTHER EFFORTS TO OPEN ITS MARKETS AND BOOST DEMAND TO COMPENSATE FOR A FALL IN U S ACTIVITY, PRESIDENT REAGAN'S RESOLVE IN REDUCING THE DEFICIT, PARTICULARLY NOW IN ACCEPTING TAX INCREASES, IS SEEN, NOT ONLY BY THE PRESS, BUT BY THE FINANCIAL SECTOR AS WELL, AS THE KEY TO RESTORING CONFIDENCE AND CALM TO THE MARKETS.

WHITEHEAD

YYYY

DISTRIBUTION

272

MAIN

269

FINANCIAL  
WHITEHALL  
FED

ERD  
NAD

ADDITIONAL

3

BUCKINGHAM PALACE

PAGE 3  
RESTRICTED

UNNN