

Japan breathes easier on yen but danger lurks.By **Chaitanya Kalbag**

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TOKYO, Aug 20 (Reuter) - The Japanese government heaved a sigh of relief on Friday after action by the United States yanked the yen back from a close brush with parity with the U.S. cent.

But currency traders served notice that the rampant yen was a long way from being reined in, dumping dollars in the latest skirmish in a war that has severely tested Prime Minister Morihiro Hosokawa's young government.

After a routine cabinet meeting, minister after minister welcomed the dollar's dramatic recovery overnight to near 106 yen from a nadir earlier this week of 100.40 yen.

The yen's surge has been largely fuelled by perceptions that Washington is willing to see the dollar slip to help cut Japan's bulging trade surplus.

Economic Planning Agency (EPA) Minister Manae Kubota said she was relieved by the yen's overnight fall because without it poor business sentiment would decline further.

U.S. analysts surmised there may have been a behind-the-scenes deal before Washington's about-face on Thursday, but Finance Minister Hirohisa Fujii said Japan and the United States had no agreement to counter the dollar's sharp fall.

"I cannot comment on which currency levels Japan would favour but foreign exchange rates need to stabilise without drastic fluctuations," Fujii said.

He also said there was no direct connection between the yen's fall and Thursday's announcement by Japan that it was setting up an emergency economic council to craft measures to boost the economy.

But the coincidence was marked. Japanese ministers stressed on Friday that they aim to get tough with factors that have hurt ties with America and crippled "Japan Inc."

These include the unbridled trade surplus, sickly domestic demand, a lack of government stimulation and a failure to translate the strong yen into lower prices for consumers.

Minister of International Trade and Industry Hiroshi Kumagai said Japan should keep taking steps on the yen as long as the country had a surplus and its economy remained sluggish.

Hosokawa and U.S. President Bill Clinton agreed on Thursday to hold an early meeting to discuss reducing Japan's trade surplus, a government official said.

Japan is going through its worst recession since World War Two and its recovery has been severely hobbled by the yen's near-20 percent surge this year.

Weeks of solitary struggle by the Bank of Japan to prop up the dollar abruptly ended when U.S. Treasury Undersecretary Lawrence Summers said: "We are concerned that the recent rapid rise in the value of the Japanese yen could retard growth in the Japanese and world economies."

That olive branch was followed by seven rounds of dogged dollar-buying intervention by the New York Federal Reserve.

As a result, the dollar shot to a peak of 106.75 yen, then fell back a bit to 105.78 at the end of New York trade, but was still way above Tokyo's 101.98 yen close on Thursday.

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