#JAPAN

Japanese cut may have been planned by G7

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THE central bank of Japan cut its discount rate by half a point to 5.5 per cent yesterday in what could be the opening move in a secret plan by the Group of Seven to ensure healthy world growth.

Tokyo, concerned by the fragility of its stock market and worsening outlook for investment, has long wanted lower rates, but has been inhibited by the inflationary pressures of the yen's weakness. Yesterday's cut was the first by Japan for over four years.

It was the Japanese who insisted on calling the surprise meeting of G7 finance ministers and central bankers in London only nine days ago. Although the communiqué after the session showed little outward change since the previous meeting in April, it is believed that a deal was struck behind the scenes to try to bring down interest rates.

Keen to underpin its own recovery, America has been pressing its G7 partners to give more attention to combating world recession rather than inflation. The Germans have been publicly dismissive of Washington's request, but the Bundesbank left its interest rates unchanged last Thursday, despite growing fears about inflationary pressures. Remarks by Bundesbank officials pointed to a possible tightening at the next council session on July 11, but the Japanese move should reduce pressure on the Germans to raise their rates.

For Britain, easier world conditions increase the chances of more cuts in domestic rates.

Some economists regard the Japanese interest rate cut as justified on economic grounds alone. Gerard Lyons, chief economist at DKB International, said the move was "not politically motivated, but economically justified". He noted that growth in Japan had clearly peaked, arrested by high interest rates, and saw last week's abolition by Japan of quantitative controls on bank lending as part of an easing in monetary policy.

But according to Brendan Brown, chief economist at Mitsubishi Finance International, the cut was the "main out-turn of last week's G7 meeting", as Japan was the only country in a position to take such action.

With annual inflation in Japan running at above 3 per cent, and the economy set to grow 3.8 per cent this year, he foresaw little room for paring interest rates further.

Stock and bond markets around the world reacted favourably, taking the Japanese easing of rates as a harbinger of better growth.

A dull foreign exchange market saw the dollar gain almost half a pfennig against a jittery mark to DM1.8170 at the London close. It moved slightly higher against the yen too to finish at 138.30, with dealers displaying some wariness ahead of the July 4 holiday in America. Sterling ended little changed against the mark at DM2.9362, but lost 30 points against the rising dollar to $1.6155.

In New York, the dollar rose to its highest level against the mark in 19 months. Several dealers said the US currency was becoming "top heavy", but others predicted further gains. Nearly all noted that volume was very thin. The market reaction to a cut overnight in Japanese interest rate was muted in comparison with the dollar's moves against the mark.

The dollar ended at DM1.8307 and 138.45 yen, up from the opening of DM1.8105 and Y137.80.

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