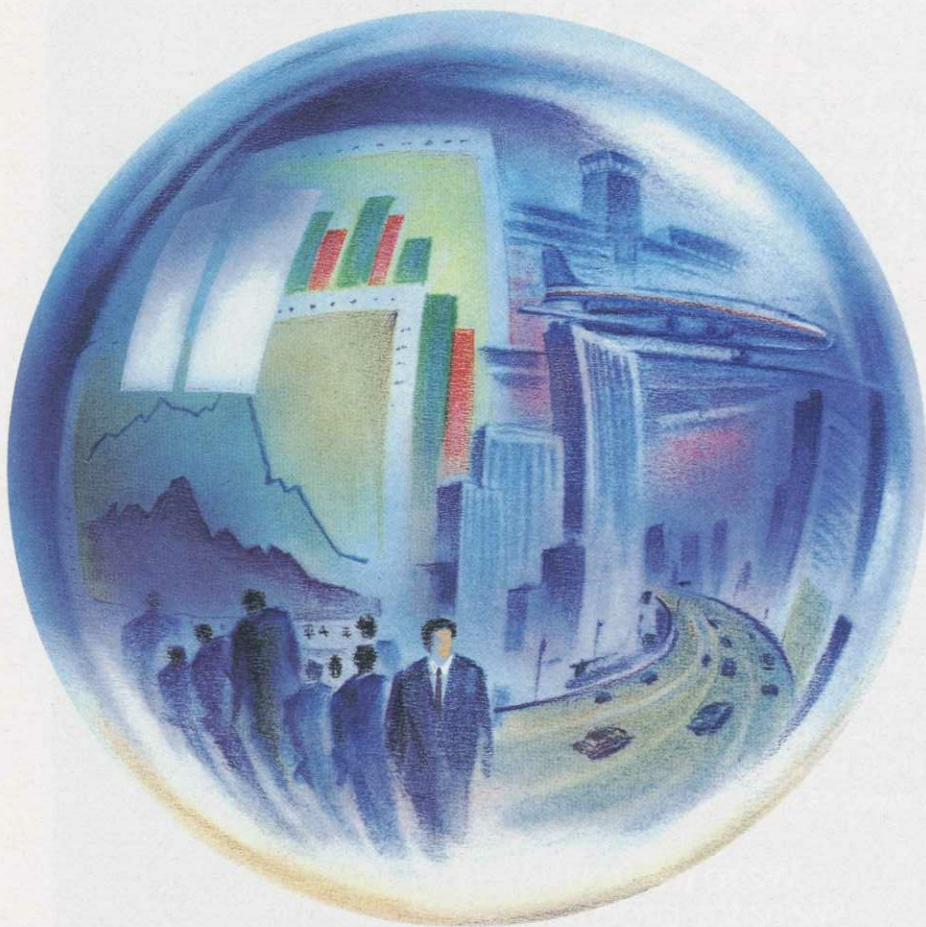


The Japanese Economy In 1992



Year of Adjustment

By Hisao Kanamori

The condition of the Japanese economy in 1992, if likened to a weather forecast, will be "rainy but clearing up later."

The expansion of the economy, which had continued strongly for more than four years from November 1986, began to show signs of a marked slowdown in the summer of 1991. GNP growth reached 4.9% in fiscal 1987, 5.9% in 1988, 4.8% in 1989 and 5.7% in 1990. In fiscal 1991, however, it is likely to drop to 3.3%.

The industrial production index (see Fig. 1) rose 7.1% in the October-December quarter of 1990 from a year earlier. In the July-September quarter of 1991, however, it climbed only 1.1%.

One major reason for the slowdown is stock correction. Over the previous four years, activity in such important areas as capital investment, housing construction and auto production expanded rapidly. As a result, stocks of plant and equipment, housing, autos and other assets reached such high levels that the desire to hold more of these and other items declined.

Tighter credit

Another reason is the tightening of the Bank of Japan's credit policy. The central bank had eased monetary policy, starting in 1987, to overcome the deflationary impact of the yen's sharp appreciation. In fact, in February 1987 the official discount rate was down to a postwar low of 2.5%. However, the easy-credit policy was reversed in 1989, and the discount rate was raised several times in the months that followed, reaching 6% in August 1990.

Still another reason for slower economic growth is the plunge in stock prices in 1990, which made it difficult for businesses to raise money through equity financing. A key market barometer, the Nikkei stock average, tumbled from ¥38,915 in late December 1989 to ¥20,222 on Oct. 1, 1990. While the stock market was up, businesses were able to raise low-cost funds by issuing warrant

and convertible bonds. The market slump closed this route.

Banks' reluctance to lend money, or the so-called credit crunch, also contributed to credit tightness. This attitude stemmed in part from the stringent capital adequacy requirements imposed by the Bank for International Settlements (BIS). In addition, the outbreak of scandals involving securities companies and banks in the summer of 1991 only served to worsen financial conditions. High levels of inventory and the tightening of credit had a synergistic effect on business activity and dampened corporate psychology. As a result, enthusiasm for capital investment declined markedly.

Private capital spending had continued to rise by about 15% a year from 1988 to 1990. In fiscal 1991, however, the rate of growth was expected to tumble to 4.8%, according to a survey conducted by the Economic Planning Agency in September 1991.

Housing construction dropped even more sharply. Construction starts in the first half of fiscal 1991 were down more than 20% from a year earlier. Car sales plunged 6%. Thus the slowdown was most evident in such key areas as capital investment, housing construction and car sales—a strong indication that stock correction is the cause of the present economic slowdown.

Product inventories in fact began to rise in the summer as GNP growth slowed. The second half of fiscal 1991 will thus be a period of inventory correction as well.

A slowdown in economic growth usually shows itself in a higher unemployment rate. In Japan's case, however, unemployment remains at an extremely low level. Far from declining, the number of job holders in the autumn of 1991 was up 2% from a year earlier. The jobless rate stood at only 2.1%. This shows that part of Japan's labor demand was not met, reflecting the continued shortage of labor. It also shows that production cuts were met by reducing working hours, not jobs. As a result, overtime dropped about 10%. On the other hand, business failures increased rapidly. The number of bankruptcies exceeded 1,000 in October 1991

alone, up sharply from 646 in the same month of 1990.

Corporate profits will consequently decline. According to a survey by the *Nihon Keizai Shimbun*, the leading economic daily, pretax profits of major manufacturing companies are likely to drop an average 8.8% in fiscal 1991.

Adjusting excess capacity

The economic slowdown is showing its effect also in the balance of international payments. The surplus on current account is likely to reach about \$80 billion in fiscal 1991 from \$33.8 billion in fiscal 1990, as Japan is running a large trade surplus with many of its trading partners, including the United States, West European countries, Taiwan and South Korea. The surplus arises largely from the slowing of the domestic economy, which causes a drop in imports.

Once again Japan is coming under fire from abroad for its growing external surplus. The government is now plagued domestically by a revenue shortfall resulting from the corporate profit squeeze and externally by the rapid growth of the current account surplus.

The expansion of the economy began to slow down in the spring of 1991 and decelerated further in the second half of the year. The slowdown is likely to continue

into the first half of fiscal 1992 with capital and inventory investment declining. But the downtrend is not expected to last very long. My projection is that a recovery will begin in the second half of fiscal 1992.

My optimism is based on the fact that the slowdown is not a vicious one, not a kind that stems from serious difficulties in the economy. What is happening is just a pause, a period of adjusting excess capacity. Most of the plants built during the last boom use advanced technology. Such new facilities therefore will provide a fresh catalyst for growth and prosperity once the pause has ended.

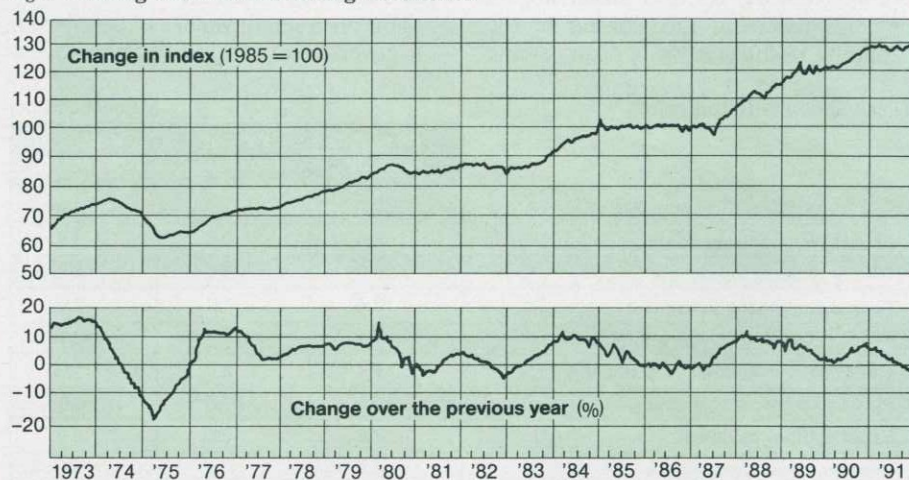
I expect a recovery in the second half of 1992 for a number of reasons:

(1) The current level of excess capacity is not excessively high, so the redundancy should disappear in about a year and a half.

As noted earlier, capital spending increased about 15% on average between 1988 and 1990. However, producers generally maintained a cautious attitude toward such investment in this period, an attitude much more restrained than in previous expansionary periods. Thus excess capacity reached only a moderate level, with the result that operating rates were generally maintained at a high level.

(2) The strong investment in construction will help prevent a sharp downturn in economic activity. There are many large construction projects under way, including projects to build a new international

Fig. 1 Mining and Manufacturing Production



airport in Osaka Bay and a bridge to span Tokyo Bay.

(3) Consumer spending is firm. The rate of growth of consumer spending will dip, largely because of decreases in bonus payments and falls in stock prices. But the number of job holders will rise and wages will also increase. With workers making more money, the firmness in consumer spending will continue.

(4) Technological innovations and labor-saving investment will continue.

The upward momentum in technological innovations remains strong, especially in computers and communications. Investment in these areas is generally not affected much by changes in business conditions. Once stock correction is over, such technology-oriented investment will help push up the rate of economic growth.

(5) The U.S. economy is back in a recovery phase.

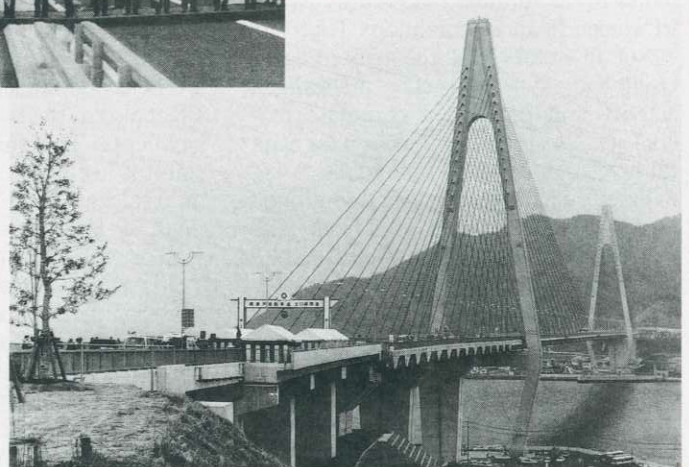
The recession in the U.S. economy lasted nine months, from the October-December quarter of 1990 to the April-June quarter of 1991. A recovery began in the July-September period, with GNP growing slightly at an annual rate of 2.4%. But thus far growth has been slow. My forecast is that the U.S. economy will grow about 2% in 1992. Growth in Western Europe will also be higher in 1992 than it was in 1991. A recovery in the world economy will have a positive impact on Japan's domestic economy.

(6) Inflation remains low. Price increases at the wholesale level remain extremely low thanks to a slackening of demand reflecting the slowing of the economy, declines in world oil prices and



Photos: Kyodo News Service

The opening ceremony of Ikuchibashi Bridge, which forms part of the network connecting Honshu, the largest of Japan's four main islands, and Shikoku. The bridge is part of the aggressive investment being made in public projects to spur an economic recovery in 1992.



the yen's rise. In the second half of 1991, the wholesale price index even declined marginally from the year-before level, while consumer prices rose a modest 3% or so. The low inflation rate is attributed to the fact that wage increases were held at a moderate level of about 4%. What is notable is that a reasonable balance has been maintained between productivity gains and wage increases.

This price stability makes it possible for the government to take reflationary mea-

sures without worrying too much about stoking the inflationary fire.

(7) Interest rates are coming down. Credit will be further eased because the slowdown will continue for some time. The official discount rate was cut three times in 1991, in July, November and December, from 6% to 4.5%. A further reduction is likely in early 1992.

(8) The government is likely to follow a positive fiscal policy.

In the Japan-U.S. Structural Impediments Initiative (SII) talks, the Japanese government promised to spend ¥430 trillion over 10 years, starting in fiscal 1991, to improve the infrastructure. This program now faces difficulties, because the economic slowdown is expected to cause a large falloff in tax revenue.

In these circumstances, some argue that the government should cut spending or increase taxes. The Miyazawa administration, however, is publicly committed to improving the quality of life through stepped-up public investment. In addition, the growing current-account surplus makes it mandatory that the government

Table 1 Economic Indicators

	(percent change)		
	FY1990 (actual)	FY1991 (estimate)	FY1992 (forecast)
Real gross national expenditure	5.7	3.3	3.5
Private final consumption expenditure	3.6	3.3	3.5
Private housing investment	10.2	-8.0	3.0
Private equipment investment	13.4	4.0	-2.0
Private inventory investment (contribution rate)	(-0.1)	(-0.1)	(0.0)
Gov't final consumption expenditure	1.4	2.0	1.5
Public fixed capital formation	3.1	5.5	6.0
Exports, other incomes	7.8	3.0	6.0
Imports, other payments	7.2	0.2	2.0

The Global Sick Ward

By Johsen Takahashi

expand domestic demand. It is unlikely, therefore, that the government will pursue a policy of achieving fiscal balance on a short-term basis. Instead it is likely to adopt a positive public investment policy in order to stimulate growth.

Shape of recovery

All these factors considered, it is unlikely that the economy's expansion will continue to decelerate for an extended period of time. As shown in the table, consumption will maintain a firm trend. Housing investment will also pick up once the stock correction is over. Inventory investment will continue to drop. Public investment will be stepped up. Exports will expand more rapidly while imports will stagnate. The current-account surplus will keep growing, further pushing up the yen rate.

Most important is the future trend of business capital investment. My prediction is that it will decline further in 1992. According to a survey conducted by the *Nihon Keizai Shimbun* in November 1991, many companies plan to cut back on capital spending in the year ahead.

The government's initial forecast of GNP growth for fiscal 1991 is 3.8%. My estimation, however, is that the growth rate will drop to 3.3%, as I mentioned at the outset of this article. The economy will continue to stagnate in the first half of fiscal 1992 but will begin to recover in the second half. Consequently, the growth rate for all of fiscal 1992 is likely to be 3.5%, slightly higher than that for fiscal 1991.

The coming year will be a period of economic adjustment, as was 1991. The economy will mark time only temporarily; in the longer term, it still maintains strong growth potential. My projection is that GNP growth will rise again to its more customary level of 4% to 5%, beginning in 1993. ■

Hisao Kanamori, chairman of the Japan Center for Economic Research, is a leading economist who served at the Ministry of International Trade and Industry and the Economic Planning Agency until 1973.

The new Miyazawa administration, which took office last November, faces more than just a mountain of problems. It faces an entire mountain range of problems, many of them totally new to Japan and not amenable to easy solution. Not only are there the urgent issues of reforming the political system and opening the rice market, but also the road ahead is strewn with such land mines as how to restructure Japan-U.S. relations in the wake of the end of the Cold War, how to conceptualize Japan's relations with the rest of Asia, how to develop a coordinated international contribution including support for the former Soviet Union, and many, many more.

It is also time the government started work on devising a grand design for Japanese foreign policy in this new era. Nor is there any time to lose in coming up with policies to deal with global stagflation, the worldwide capital crunch and other economic issues. It will obviously be extremely difficult to respond to all of these issues without at least a few missteps, but I doubt if there are any easy answers even for just the economic issues. The Japanese economy is like someone beset with a host of degenerative diseases, and we do not even have a clear diagnosis of what is wrong, much less efficacious medicine.

Having grown for about four and a half years to record the second-longest boom in Japan's postwar history, the economy entered a correction phase in the middle of 1991.

The automotive, housing and real estate, semiconductor, home appliance and other industries all report that demand peaked out in the second half of 1990 and that they are fighting to stay alive today. Textiles, paper and pulp, chemicals and other industries were in the dumps even before that, getting the wind knocked out of their sails in early 1990. Although companies serving the strong capital investment demand were doing well until recently, the machine tool industry saw its orders fall off until it had less work on

the books in mid-1991 than it did in mid-1990, and pessimism seems to be the order of the day. As a result, 1991 steel shipments have also been less than in 1990 from August on, and the whole industry is being forced to cut back on production.

With this sluggishness in demand, production has also been off since early last year, and by the summer of 1991 production was back down to about the same levels as the summer of 1990. Yet despite these production cutbacks, inventories continue to pile up and there is a decided sense that inventory levels—which by summer were 10% over those of the summer of 1990—are too high.

Fears of stagflation

Having come to power in this inhospitable climate, Miyazawa is being looked to to do something dramatic for the economy. In the summer of 1986, Miyazawa took over the Ministry of Finance at a time when the economy was languishing and managed to pull the economy's chestnuts out of the fire with bold Keynesian initiatives. Thus it is that many people look to Miyazawa to work his magic once more and to get the economy back on its feet. Yet this is a recession of a different color, and it is essential that it be dealt with not with yesterday's tried-and-true remedies but with new approaches geared to the new imperatives.

The first thing to remember is that, even though the economy is deteriorating rapidly, this deterioration has not made much of a dent in the painful labor shortages or the near-capacity operating rates. Even though the economy is losing steam, we are still at full employment of both labor and equipment. This is stagflation in the true sense of the term.

Given the circumstances, strong stimulative medicine could very well provoke a vicious bout of inflation. Conversely, not doing anything for fear of inflation could well let the economy sink deeper into