The Japanese Economy in 1997

Photo: Honda Motor Co., Ltd.

Moderate industrial recovery continued in FY96

Since hitting bottom in the autumn of 1993 the industrial economy has headed along the road to an extremely fragile recovery, showing signs in early fiscal 1996 of a more certain, although moderate, rebound. While mining and manufacturing indices have fluctuated, they have shifted into the plus column compared to the same month of the previous fiscal year and the seasonally adjusted figure of 101.1 of October 1996 was the first time in about five years that it had exceeded 100. The employment environment has also come through the worst period and, seen by rates of wage increases and job offers to vacancies, has steadily recovered.

Of course, although industry as a whole turned in moderate growth, favored by continued stable exchange rates, low interest rates and other advantageous external environmental factors, individual industry trends were not uniform. Although Japanese industry sensed a recovery in fiscal 1996 it could be described as a year of substantial disarray depending on the type of industry.

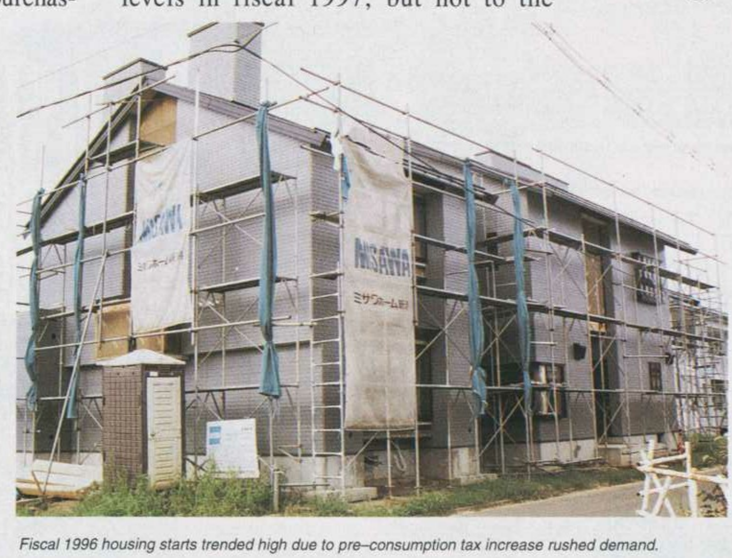
The automotive and telecommunications and information, particularly mobile telecommunications, industries could be cited as the mainstays of the fiscal 1996 economy. Cellular phone subscribership had surpassed the 18 million mark by the end of 1996 and the number of subscribers has steadily grown since. Capital expenditures related to mobile telecommunications were extremely brisk as cell phone companies invested aggressively in increased capacity and digitalization to cope with the rapid increase in new subscribers and PHS (personal handyphone system) providers also quickly invested in area expansion soon after starting up operations. The car industry was likely to have seen a reversion to growth in domestic production volumes for the first time in six years as recovered competitiveness overseas resulting from the weak yen led to solid exports on the one hand while demand grew in domestic sales compared to the year before due to demand for replacement of cars purchased during the bubble period and a rush to buy before the consumption tax hike. The weak yen and restructuring resulted in the realization of substantial profit growth, and investments in plant and facilities were also strong as replacement investments were postponed as a result of the strong yen.

Housing starts also trended at high levels due to sentiment that interest rates had hit bottom, demand related to reconstruction following the Great Hanshin–Awaji Earthquake and pre–consumption tax increase rushed demand. Housing investment had a favorable impact on the economy, extending to production goods and triggering purchases of furniture and a wide variety of other consumer durables.

However, the broadly declining semiconductor industry which had previously served in the role of pulling up the markets led to an abruptly worsening situation for the markets. Although semiconductor sales volumes increased steadily, bolstered by growth in information processing, the margin of price declines exceeded the growth of volume, leading to steadily worsening profitability in the electronics and electrical machinery industry's semiconductor sector and a freeze in capital expenditures.

Economy continues slow recovery

Fiscal 1997 industry trends do not indicate many sectors in which the tone of their recovery will increase in strength compared to fiscal 1996 and it is highly possible that the recovery will continue to be sluggish. Consumer trends would also appear to indicate that demand will probably decline after the rush in demand in fiscal 1996 prior to the rise in the consumption tax, leading to sluggish consumption growth. The industries that sustained economic recovery in fiscal 1996 are also expected to lose the strength to propel an overall industrial recovery. Strong growth is expected in telecommunications, primarily mobile telecommunications, but because growth has been so rapid up to now a slower rate of expansion is forecast. Although domestic demand will be firm in the car industry, spurred by demand for replacement of vehicles sold during the bubble period, expectations are that it will decline in response to the rush demand preceding the increase in the consumption tax and even if exports are maintained at the level of fiscal 1996 a slight production decline is highly probable. With favorable domestic consumption demand along with solid exports due to expanded demand in Asia and renewed profitability led by the weak yen, the petrochemicals industry is expected to maintain high production levels in fiscal 1997, but not to the extent of surpassing the previous year. A decline in reaction to fiscal 1996 is already certain in housing and new housing starts are forecast to fall substantially.



Fiscal 1996 housing starts trended high due to pre–consumption tax increase rushed demand.

Compiled by the Industrial Research Department of the Industrial Bank of Japan, Ltd.

Notes: 1. Years are calendar years unless specified.
2. The fiscal year is from April to March.
3. Figures and tables provided by the IBJ unless otherwise specified.

Investment in plants and facilities has also played an important role in the economy's recovery up to now, but it is difficult to envision substantial increases in fiscal 1997. In fiscal 1996 capital outlays moved in tandem with the tone of market recovery, but compared with previous recoveries investments targeted at improved business efficiency and labor reduction exceeded those designed to boost capacity and corporate sentiment regarding investment has remained weak. With the maturation of domestic markets yielding no expectations of rapid expansion, few companies will undertake large scale domestic investments in plants and facilities and a strong recovery in overall capital expenditures is not anticipated.

Compelling need to change high cost structure

This latest economic recovery has been described as an "upswing that does not seem like a sound recovery." The structural problems confronting Japanese industry are behind this sentiment. Although there has been a respite from the yen's one time abrupt appreciation, domestic production costs remain relatively higher than manufacturing costs in Asia and elsewhere. Moreover, when seen together with the rapid development of southeast Asian nations' manufacturing bases along with economic growth, rapidly adjusting the substance of high domestic costs through deregulation and other methods are urgently needed to maintain Japan's international competitiveness and further improve domestic industry trends from here on. Promotion of deregulation has long been trumpeted as a means of ensuring stable economic growth, but in reality has not been promoted expeditiously. Deregulation must be implemented at a faster pace than ever to break out of the current situation.

Converting industrial structure to ensure employment and growth

Regulatory protection for industry and export-based manufacturing expansion have been behind post-war Japanese industrial growth. However, efforts to promote economic growth can no longer focus on exports as in the past. Rather, in today's global marketplace, which has become a "borderless economy" and in which computerized networking has grown, the question is how best to open the domestic market to imports. Additionally, wages and employment must also be ensured in future and conditions for the enjoyment of high living standards must be maintained. To achieve this there are hopes for growth in new sectors that will sustain Japanese industry and compensate for production that export industries have shifted overseas due to the strong yen. But the current reality is that new industries have not been fully cultivated. Certainly, growth has been noted in new industries, as represented by the telecommunmications industry's rapid expansion. There have also been moves to encourage new industries' and companies' growth through the establishment of secondary over-the-counter markets and funding assistance for new technologies, but, if only in view of employment considerations, these have not been vigorous enough. In view of the strong possibility that the yen will continue to appreciate and internal and external prices differ in future, it is vital that new industries with the power to absorb employment and added value grow as soon as possible.

Conclusion

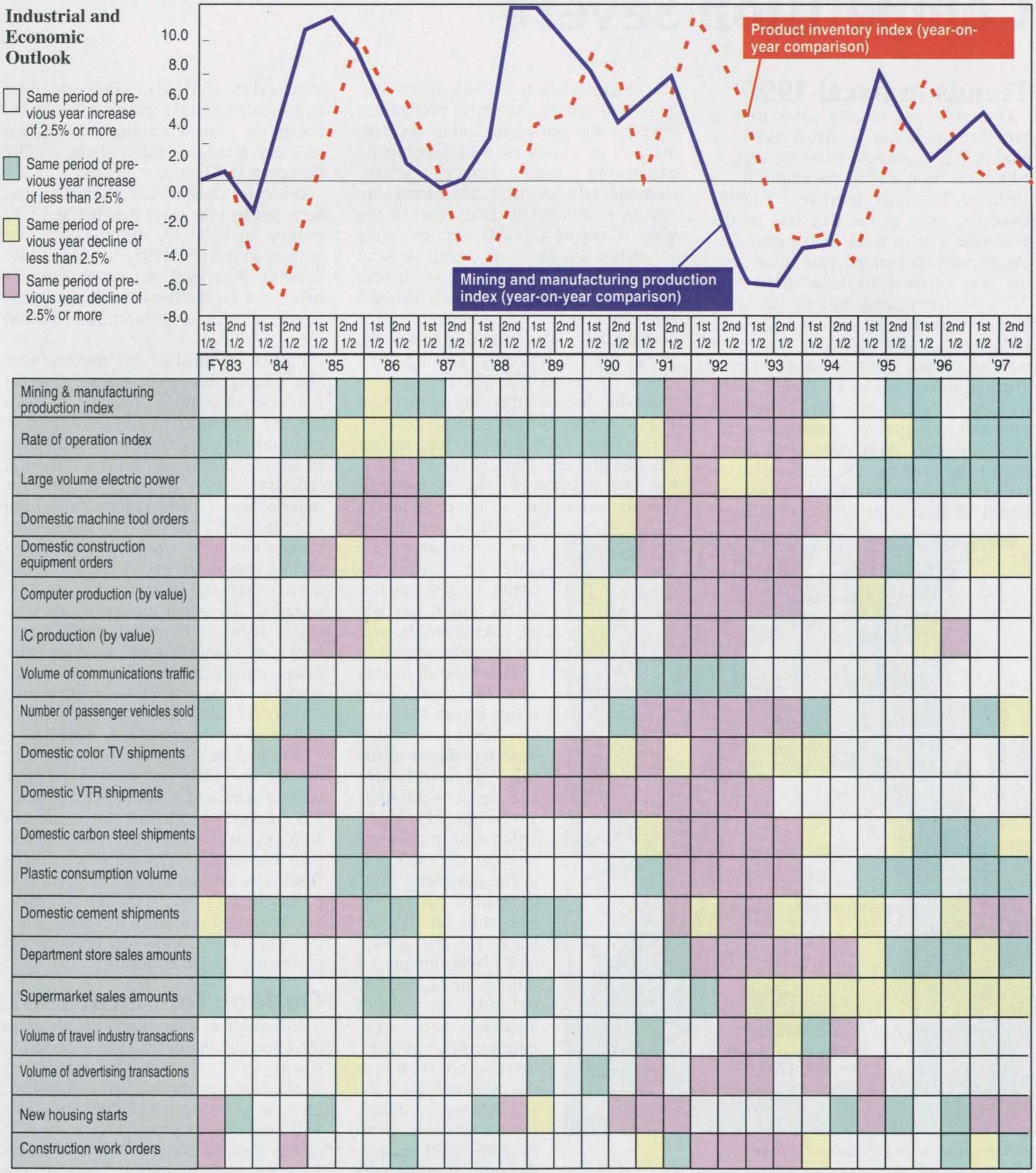
The Japanese economy's moderate recovery has continued, but most domestic market sectors have already matured and cannot look forward to rapidly expanding demand. In terms of manufacturing, production continues to be shifted overseas and growth is expected to remain even more sluggish than demand. The outlook for fiscal 1997 is that an upswing is more difficult to predict than in 1996, with an undeniable possibility that it will decelerate more than at present, depending upon the yen's strength.

To shake loose from this situation it will be important to redevelop domestic markets that accord with global standards. New capital is not invested in heavily regulated, difficult to enter markets and the growth of industries with growing power is also restricted. If no efforts are made to provide a domestic investment climate, Japan will become a market with scant appeal and companies will conti-nue to move overseas, with mounting anxieties that no improvements will be made in the employment situation. This would doubtless mean difficulty in escaping the economic slump.

The development of enterprises that point to an attractive market is natural corporate behavior. Japan's economy cannot expect new growth and development if no attempt is made to reinvigorate industry by creating a domestic market with few regulations. Structural reforms through deregulation will be painful, but it is now extremely important for Japan to promote structural reform without fear of the pain, creating new industries that are competitive and have the strength to grow.

(Torii Nobuhiro, senior economist)

Japanese economy in pursuit of "upswing that does not seem like a sound recovery;" structural reform is a major issue. (3rd strip mill, Chiba Ironworks, Kawasaki Steel Corp.)



Note 1: FY1996 and FY1997 estimates
Note 2: Year–on–year communications traffic volumes
Note 3: Department store and supermarket sales based on existing outlets