

Japanese Economy and Policy Tasks

By Chikao Tsukuda

Since the economy does not move in accordance with the calendar, economic situations do not change abruptly at the turn of the year except by chance. Many problems facing the Japanese economy in 1986 will be carried over into 1987. Nevertheless, it is of significance to discuss economic trends in the new year in that the prevailing economic conditions are confirmed, those elements that will continue into the coming year and those that are expected to change are identified, and ways of coping with them in the national economy and by business are considered.

What was most characteristic of the Japanese economy in 1986 is that the effect of the yen's sharp appreciation gradually spread from trade goods to nontrade goods, with the impact of sagging foreign demand steadily felt in production, corporate profits, capital spending and employment. The deflationary effect of the higher yen will continue in 1987. We ought to consider the possibility of its negative impact worsening on the employment front in particular. On the other hand, the stronger yen has one positive aspect—boosting real purchasing power through improved terms of trade. In order for this effect to result in actual expansion of spending by business and households, it is necessary that price declines on imported goods are passed to the final consumption stage without being absorbed in the distribution process and that corporate and household prospects for the future improve. As for the latter condition, it is difficult to foresee a visible improvement in future prospects. It is my judgment, therefore, that few benefits of the yen's rise can be expected to materialize.

Policy tasks expected to assume greater importance in 1987 are international coordination of economic policies externally and, domestically, adjustment of the economic structure.

The joint statement issued by Finance Minister Kiichi Miyazawa and U.S. Treasury Secretary James Baker at the end of October 1986 was welcomed as an agreement contributing to exchange rate stability in line with bilateral policy coordination since the "Plaza Agreement" in September 1985. It is not clear what measures the two countries have agreed to take to substantiate the statement. I

think it an underestimation to say that the statement is aimed simply at a psychological effect. But it is also wrong to play it up as demonstrating establishment of a "target zone" designed to limit rate swings between the yen and the dollar to a certain range. It should be considered as an agreement having—and aimed at—the effect of exchange rate stability within a range to be determined by the economic fundamentals of the two countries. Given the weight of Japan and the United States in the world economy and their bilateral relations, policy coordination by the so-called G-2 is natural and desirable. The task to be tackled is to explore ways of orchestrating such coordination on a multilateral basis.

The main causes of the continued expansion of Japan's trade surplus in dollar value despite the yen's sustained appreciation in 1986 were the "J-curve" effect and declining crude oil prices. The surplus is expected to begin shrinking as the J-curve effect runs its course and crude oil prices recover. But the question of the external imbalance cannot be expected to ease visibly in a short period of time in view of sluggish domestic demand and strong competitiveness of Japanese industry in aspects other than price, such as product quality. It is necessary to continue policy efforts to expand domestic demand. But there are no prac-

tically feasible policies that contribute to improving the external imbalance to the tune of several billion dollars in a short period.

This leaves us the last choice—structural adjustment—which will be spotlighted in 1987. But it is not a *deus ex machina* for the present external imbalance issue, but rather should be viewed in the medium- and long-term contexts. What is important in discussing policies for restructuring is not to reduce the effects of exchange rate adjustments, but to aim primarily for their smooth penetration into the economic system. Furthermore, in my view, the centerpiece of restructuring policies is to prepare a climate that will permit the economy to maximize its self-adjustment mechanism and for this it is very important to promote relaxation and abolition of government regulations. One primary consequence of the yen's appreciation is expansion of direct overseas investment by business and increased purchases of parts and raw materials from abroad. This is not only a natural choice by business, but is expected to contribute to structural improvement of the Japanese economy and correction of the external imbalance. The so-called industrial hollowing is a source of anxiety over a possible decline in Japan's economic vitality as a result of expansion of overseas corporate production and procurement, which is the outcome of nothing more than a display of business energy. This will probably be one of the most important issues in and after 1987. It requires searching discussions, but the effect of structural improvement must not be forgotten in doing so. ●

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Strong Yen, Slow Growth

By William P. Sterling

The Japanese economy faces major challenges in 1987. With the clear prospect for continued strength of the yen and sluggish growth abroad, Japan's business leaders and government policymakers are painfully aware of the need to reorient the economy toward domestically led growth. However, despite ambitious visions such as that of the Maekawa Report of April 1986, the transition from export growth to domestically

led growth is likely to be slow and somewhat painful. Accordingly, we expect 1987 to be a year of sluggish growth, continued trade friction and stagnant industrial production and employment.

Our current forecast anticipates real GNP growth of only 2.0% in 1987, with the yen strengthening to ¥145 per dollar and the unemployment rate rising to 3.6% by the year's end. We expect large trade surpluses to be a continuing source