Think Tanks Predict Export Led-Recovery in 1995

By Sakamoto Sakae

Last December, think tanks associated with the four leading securities firms released their fiscal 1995 economic forecasts (April 1995 to March 1996). Yamaichi Research Institute (YRI), the most optimistic, predicted 2.4% real growth, while Nomura Research Institute's (NRI) 1.2% estimate is the most cautious. The announced figures differ substantially, but all agree that exports will lead the economic recovery. With a sustained favorable business climate in Asia again this year and higher growth in Europe than in Japan, they forecast increased exports to those regions.

The Nikko Research Center (NRC) forecast calls for 1.8% real growth in fiscal 1995, citing the following primary growth promotion factors: corporate inventory adjustments, which determine short-term business cycles, have run their course; Asia's continued growth and the European economic recovery will bolster export strength; and despite flat growth in nominal income, lower commodity prices will induce expectations for increased real individual consumption.

Regarding the reasons behind the belief that exports will rise, YRI notes that, while the U.S. economy will probably show clear signs of decelerating around mid-1995 and the Chinese growth rate will decline broadly due to further belt-tightening, economic recovery will gather steam in the EU. Moreover, in Asia high growth will continue in the ASEAN nations. On the whole there will be no changes in an environment that favors export growth, as in fiscal 1994.

In other words, exports bound for advanced European nations will compensate for the small decline in the U.S. market, and for exports to Asia, the continuing boom in Southeast Asian markets will make up for the slight downturn in the Chinese economy.

From a corporate standpoint, instead of simply relying on an environment that favors exports, companies are making efforts to export. YRI explains this situation as follows: "In combination with the economic upturn overseas the export sector is taking price conversion steps to compensate for the strong yen by, among other efforts, adding value and the current level of the yen's strength will not be an export-impeding factor." Parenthetically, YRI forecasts that the fiscal 1995 year-end exchange rate will be ¥100 to the dollar (as in fiscal 1994, while the actual year-end fiscal 1993 rate was ¥107.80).

U.S. economy to slow to the level of 2%?

To what extent will the U.S. economy decelerate? NRI forecasts that although it will decline to the level of the potential growth rate (about 2.5%) by mid-1995, it should maintain a 3.5% rate over the entire year. The specific scenario is described below.

In the fourth quarter of 1994, the U.S. economy continued to expand at an annual pace of around 4%, broadly higher than the potential growth rate, based on individual consumption and plant and equipment investments. A high annual growth rate of around 3.5% is also forecast for the first half of fiscal 1995. However, as a smooth shift to stable growth encouraged by monetary policies becomes difficult, predictions are that restrictions on the money supply will slow growth to a level of around 2.5% by late fiscal 1995.

Regarding predictions for a full economic recovery in Europe, NRI sees "forecasts for a slow recovery bolstered by exports and plant investments." At the same time, the institute notes the following individual national issues: a striking lag in renewed consumption in Germany, where large tax increases will be implemented at the beginning of the year; the presidential election France faces in spring will make it difficult to effect fiscal restraint, leading to instability in financial markets, which in turn will serve as a factor hindering an economic recovery; and although the U.K. is strongly influenced by U.S. economic trends, a firm expansion is forecast for the first half of fiscal 1995.

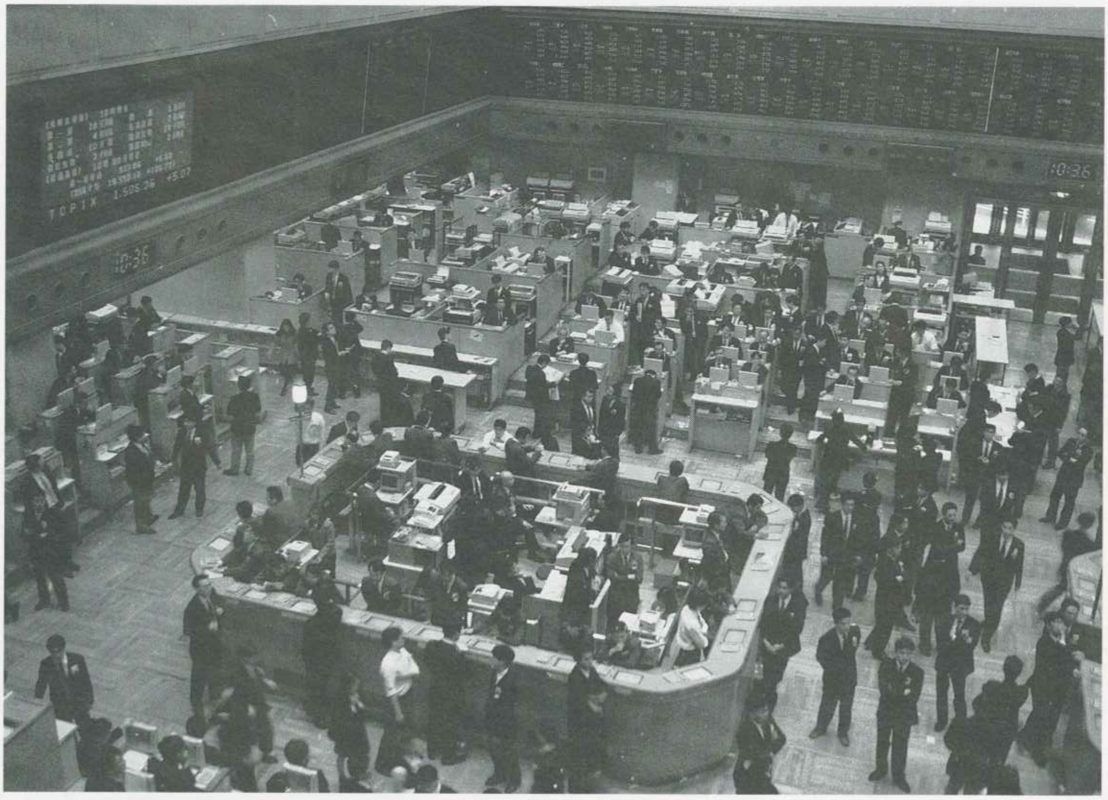
What is predicted for Asian economies in 1995? NRI predicts that Northeast and Southeast Asia will see actual growth of 7.1% while China can expect an 8.4% growth rate. However, overheating is also an issue for the Chinese and Southeast Asian economies.

In other words, supported by the global economic upturn, the newly industrializing ASEAN nations of Southeast Asia have been rapidly boosting exports, firming up domestic plant and facilities investments. However, NRI points out this "has led to worsening payment balances and increased inflationary pressures." Regarding China, NRI emphasizes the issue of economic reform, the questions of a post-Deng Xiaoping China, and the overheating economy, forecasting that "the handling of economic management will be especially difficult."

Rapid increase in exports to Asia

With rapid growth in Northeast and Southeast Asia, Japan's trade structure has also been changing. According to "Regional Export Volume Indices," produced by NRC (using 1990 as 100), exports to Asia approached 140 at the end of 1994, 90 for the U.S., and 80 for Europe, both showing a decline. Previously primarily geared toward the markets of advanced Western nations, Japan's export structure is now shifting toward Asia because, along with increased investments in plants and facilities in Asian regions, exports of capital assets to these areas are also on the rise.

Further, Daiwa Institute of Research (DIR) compares the factors in past eco-



Signs of a recovery are steadily beginning to appear. (Tokyo Securities Exchange)

nomic recovery periods with this latest upturn in its forecast of fiscal 1995 corporate results, pointing out that the three primary factors in overcoming the last recession were "expanded overseas demand, completion of inventory adjustments, and the widening effects of restructuring."

Reviewing the factors in overcoming the previous three recessions, we find that after the first oil shock of 1976 it was the recovering U.S. economy, increases in public works investments, and increased investments in electric power facilities. Following the second oil shock in 1983, it was the expanding U.S. economy, recovering investments in domestic plants and equipment, and the materials "recession cartel." For the *endaka* recession of 1987, it was cheaper oil and lower interest rates, recovering domestic demand, and strong yen countermeasures. Judging by these comparisons alone, the previous recovery (1987) was driven by domestic demand, but this time there has been a reversion to export dependency.

Japanese corporate profits up 20%?

Bearing these economic forecasts in mind, what will Japanese corporate results look like in fiscal 1995? NRI predicts that ordinary profits will rise 24.1% compared to the previous year while YRI, NRC, and DIR forecast 20.4%, 25.5%, and 18.5% increases, respectively. Since ordinary profit growth for fiscal 1994 is expected to remain at approximately 10%, corporate results appear ready to pick up steam in fiscal 1995.

Even so, NCR notes that fiscal 1995 profit levels will not reach those of the peak during the bubble period in fiscal 1989. According to NCR's analysis, fiscal 1995 industry-wide ordinary profit levels will be 71% of fiscal 1989, while those for the manufacturing sector will be 69% of 1989 levels.

NRI cites three factors in substantial fiscal 1995 profit growth. First, the positive effects of the expansion of the global economy. This point resembles the element made in the preceding economic forecasts, but NRI specifically notes that "processing and materials industries will benefit from buoyant exports due to expanded semiconductor, car, and machinery demand along with a rising materials industry operating ratio in the U.S. and expanding demand for parts and materials due to rising production in Asian regions."

Second, flat domestic private demand will begin to rebound. NRI indicates that domestic private demand has been slowly recovering since summer 1994, noting, by leading industries, growth in personal computers, cellular phones, and other information processing and telecommunications equipment, a rebound in trucks, semiconductor manufacturing equipment, robots, and some other capital assets, and replacement demand for consumer durables, primarily household appliances and automobiles.

Third, NRI notes that companies are continuing to reduce costs, shrink fixed costs, and make other efforts to restructure and that "along with reduced initial costs due to integration of components, overseas materials procurement, and expanded overseas production, lower depreciation costs and personnel expenses will be linked to improved corporate profitability."

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