

Japan's Economy on Track for a Recovery

By Sakamoto Sakae

As of mid-June, Bank of Japan (BOJ) Governor Matsushita Yasuo judged that Japan's economy was "generally in a moderate recovery trend" and on fiscal policy said, "as before, our primary emphasis will be on creating a firm basis for an economic recovery and I will cautiously observe the unfolding situation." This means, in other words, that it is still too early to move toward revising the ultra-low interest rate policy in place since last fall, but few market sources accept these statements at face value. As noted in the previous issue's article, "BOJ Poised to Raise Interest Rates," most people believe that the BOJ wants to shift away from its current anti-deflationary monetary policies (a 0.5% official discount rate and a target rate of under 0.5% for short-term interest rates) as quickly as possible and revert to an "ordinary" low interest rate policy. Pressure to maintain the ultra-low rates is strong both domestically and externally, but the BOJ will act to raise interest rates this summer at the earliest and in the fourth quarter of this fiscal year at the latest.

Two economic indicators have emboldened monetary authorities. One was first-quarter GDP and the other was the BOJ's early June announcement of the results of its *Quarterly Tankan Survey* (its quarterly poll of corporate confidence in large, midsize, and small companies, the latest conducted in May 1996). Without presenting the detailed data here, the findings are summarized below.

1. With underlying improvements in sales and profitability and an upturn in manufacturing and non-manufacturing sectors alike, industry sentiment in large corporations is that the outlook is favorable.

2. Similar to major corporations, industry sentiment in midsize and small companies has improved.

3. Underpinned by gradually recovering capital spending and individual consumption, perceptions of excess inven-

tories are diminishing.

4. With buoyant overseas markets and corrections to the strong yen, the trend toward collapsing product prices has halted and, conversely, purchase prices are rising.

5. Large corporations and the manufacturing sector are laying plans for increased revenues and profits for the third consecutive year, and the ratio of current profit to net sales will rise.

6. This fiscal year, major corporations plan a 6% increase in capital spending over the previous year.

7. Perceptions of over-employment still remain, but appear to be decreasing.

Recovery mechanisms

Noting these findings, Matsushita cites two processes in an autonomous economic upturn. In the first process, "a rebound in corporate production and profitability results in a widened base for the strength of the recovery in private sector capital expenditures." Focusing in particular on the upswing for midsize and small companies and the non-manufacturing sector, where recovery had lagged, he determined, "The ripples of the economic recovery have finally begun to spread to the non-manufacturing sector and midsize and small companies. For example, in the non-manufacturing sector, major companies in every industry sector except the construction industry, forecast increased profits this fiscal year. Although the level can still be said to be low, small to midsize companies also expect increased profit margins." Regarding facilities investment, he noted, "Large firms in both the manufacturing and non-manufacturing sectors plan more capital expenditures than the previous year and we are also seeing gradual movement in facilities outlays by small and midsize companies."

The second mechanism is the process through which "the recovery in corporate activity sparks consumer activity

and housing expenditures through expanded employee compensation." While Matsushita says, "this process is more limited than the route of capital expenditures," he also notes, "Employment conditions have recovered from their low point in pace with the economic upswing and, while very slow, are turning upward. Macro employment indicators are trending favorably on the whole. Consumer confidence has become more optimistic than before and housing investment is continuing at high levels, also reflecting these changes in the employment environment."

Sources for concern in the latter half of this fiscal year

This year's first quarter (January-March) GDP figures released by the Economic Planning Agency (EPA) in mid-June have also encouraged the BOJ as it ponders the timing of a monetary policy shift, because the real 3.0% growth over the previous quarter would translate into a 12.7% per annum increase, high growth that would surpass that of the "bubble" economy period. The *Nihon Keizai Shimbun* editorialized, "The January-March GDP growth rate was such that one was suddenly moved to ask which country's figures these were. The last time the growth rate reached this point was 23 years ago, in January-March 1973. Amidst the groaning about (financial institutions') bad debt problems, the economy was actually running with the vigor of the boom that grew out of efforts to rebuild the Japanese archipelago (during the era of former prime minister Tanaka Kakuei). This is a leap year, but the EPA discounted its impact in basing its estimate of 2.5% on the average fiscal year. In any case, per annum growth is moving at a double digit clip."

Of course, it is probably somewhat necessary to take these figures with a

grain of salt. As noted in the editorial, February had one more day than usual this year, resulting in boosted individual consumption, and the effects of the expanded public works spending generated by last fall's economic stimulus package concentrated in January-March.

This is the reason behind comments made by a certain economist, who has a cautious view of the economy's prospects: "An April-June reaction will inevitably lead to a major downturn. Moreover, doubts remain as to whether it will actually get on track for an autonomous recovery through individual consumption and so on. There are also fears regarding sluggish external demand (in terms of contribution to GDP, external demand was minus 0.3 points compared to plus 3.4 points for domestic demand in the January-March period) so there is a need to take a cautious view." As factors of unease for the economy, Matsushita himself also points out, "Trends that bear careful note include the effects of reduced external demand (exports, due to the weak yen), worsening demand for the semiconductors that have bolstered the economy up to now, and public expenditures."

Nomura Research Institute, which revised its real growth forecast for this year upward from 1.3% (this year's forecast as of March) to 1.8% late in June, also views the future cautiously. As factors for unease, NRI notes the deceleration of the global economy since midyear, slack semiconductor demand, the post-public works spending slump, and the rise in the consumption tax (from April next year), noting, "The external environment that has had a positive effect on the economy up to now is expected to act as a factor in restraining the economy in the future.

Along with this, the situation in the financial system (the bad debt problem) is still unstable." NRI notes the need to continue a moderate tone in fiscal policies and, at the same time, that around ¥2-3 trillion in additional public works spending will have to be added to this fall's supplementary budget.

a means of shifting policy. In appearing to readily accept rising market interest rates, the mid-June speech quoted below could be described as offering a hint of the BOJ's interim interest rate strategy.

Matsushita declared, "Longer long-term interest rates have fluctuated somewhat more substantially this year. That said, long-term rates for government bonds, which have the longest residual periods, rose all the way to 3.5% in February this year after dropping down to 2.8% last fall. Later they fell to 3.1%, but rose a bit after the *BOJ Quarterly Tankan Survey* was released and currently remain at around 3.2%." What he wants to say here is that, although the discount rate and short-term rates remain at last fall's levels, bond market interest rates, which move in concert with readings of the economy's future, have already risen 0.4%, probably indicating that, at some point, policy rates will have to be brought into line with market rates.

Up to now, the BOJ has placed priority on economic recovery and correcting the strong yen-weak dollar situation, employing an extremely low interest rate policy to achieve this, but, unmistakably believes that an overly cheap yen will be undesirable from the standpoint of domestic commodity prices, corporate exports and companies' international investment activities. If the tendency toward a weak yen (¥110 to the dollar as of the beginning of July) resulting from the correction to the strong yen appears to accelerate, the exchange rate policies in place since last year may also be modified. ■



Up-beat consumer attitudes and resurgence in popularity of brand-name goods accompany mild economic recovery.

Photo: Takai Masahiko

BOJ ponders timing of rate rise

However, viewed as a whole, including commodity price movements, it is certain that the ultra-low interest rate policy no longer reflects the actual state of the economy. The Clinton administration in the U.S. has indicated at every opportunity that it would like to see Japan's current economic policies (adhering to expanded government expenditures and extremely low interest rates) maintained. On the other hand, the Ministry of Finance dislikes increased spending from the standpoint of reducing the public finance deficit and is considering shifting the emphasis of its policy mix to monetary policy. In other words, the BOJ is receiving both internal and external pressure, including from NRI, to continue an ultra-low interest rate policy, but it appears that Matsushita is looking to market rates as

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