Bank, Security Think Tanks Foresee Decelerated Growth in the Next Fiscal Year

By Sakamoto Sakae

In mid–October, think tanks associated with Japanese securities companies and banks announced in quick succession their various economic predictions for fiscal 1997 (April 1997 to March 1998). Each think tank projected a different real rate of growth, but all agreed that Japan's economy would grow more slowly in fiscal 1997 than it had in fiscal 1996. They offered two explanations. First, they predicted that the increase in the consumption tax (from 3% to 5%) due to take effect in April 1997 would act as a damper on personal consumption and home–buying. Second, they believed that fiscal constraints on the government would prevent the fiscal 1997 budget from creating public works to stimulate the economy.

Moderate rise in consumption tax in April sparks rushed demand in private housing starts. But what about next fiscal year?

Nomura Research Institute (NRI) produced the most pessimistic forecast, predicting that in fiscal 1997 gross domestic product (GDP) would rise at a real rate of 0.7% (compared to the 1.8% predicted real growth for fiscal 1996). Says the institute, "It is difficult to see how the economy could return to a path of recovery in the mid–term."

Growth in fiscal 1997 will fall short of 1%, explains NRI, because "the consumption tax will restrain demand and spur corporate restructuring (rebuilding and rationalization of management); slower growth in overseas business poses an additional hurdle." NRI notes that the top issues for the Japanese economy will be the "drastic relaxation or eradication of regulation, administrative reform, the resolution of issues of bad debt (for fiscal institutions), and a complete overhaul of the cost structure of private corporations."

On average, the think tanks forecast growth in fiscal 1997 at around 1.6%. Daiwa Institute of Research (DIR) has released the most optimistic of these predictions. DIR predicts that although growth in fiscal 1997 will be slower than in fiscal 1996 (forecast at 2.8% real growth), it should still reach 2.6%.

Expansion of capital investment in information systems

DIR explains the context of its forecast in this way: "Private demand, which fell off in the first quarter of fiscal 1996 (April to June), began to recover in the July to September period and toward the end of fiscal 1996. Lower wage costs and narrowing price differentials between Japan and other countries have spurred private–sector capital investment in communications and information systems. Lower interest rates and the higher consumption tax (which will spur consumption before it goes into effect) will conspire to keep private investment in housing on an upswing through the end of fiscal 1996. Individual consumption, which got off to a late start, began to take off in the third quarter (October to December) of 1996. Household demand, including individual consumption and housing investment, is expected to be temporarily blunted by the introduction of the consumption tax in the April to June period of fiscal 1997. But as the labor market continues to recover and real interest rates to decline, nothing should stand in the way of the recovery of the household sector, particularly individual consumption."

Fuji Research Institute (FRI) puts fiscal 1997 growth at 1.8%, a figure more optimistic than that of NRI, but still more cautious than DIR. FRI sees fewer public works projects and a higher consumption tax as pushing down growth. At the same time, it expects capital investment in information systems to create a modest base for recovery. FRI points out, "In the context of progress in information systems, companies are aggressively investing in the information sector to increase their productivity and cut costs. We cannot overlook the significant impact that deregulation has already had on capital investment. One sign of this impact is the tremendous expansion of capital investment in the communications sector, with the introduction of the system in which cellular phones can be bought rather than leased acting as the trigger."

The FRI forecast is also notable for its prediction that economic growth slightly under 2% will become the norm for the nation. With the maturation of the Japanese economy, structural changes, and the rapidly aging society, FRI sees lower growth as a given for the mid–term future. In light of this view, the under 2% growth that FRI predicts for fiscal 1997 is "of course not high; but it is a rate of growth that must in the future be rated highly as the capability of the Japanese economy."

Continued adjustment of "three excesses"

Nikko Research Center (NRC), which predicts growth in fiscal 1997 to drop to 1.5% (its prediction for real growth in fiscal 1996 is 2.4%), reasons that weakening end–user demand in the private sector is due to "four excesses" created by the bubble economy: excess consumption, excess employment, excess equipment, and excess credit. Although excess consumption has all but disappeared, elimination of the other three "excesses" is an ongoing process. Let us look more carefully at these three "excesses."

According to NRC, the bursting of the economic bubble has prompted companies to adjust their hiring practices. They have made, however, no dent in the 3.4% excess employment that exists in the manufacturing industry. Weak demand for labor has stifled increases in workers' wages and the number of new hires. Although the labor market is emerging from its worst period, it will be a long time before companies begin full–scale recruiting.

The excess credit problem is at its worst at small to mid–size companies, where the priority on paying off debts to improve balance sheets has eaten into profits. As a result, NRC says, capital investment by small and mid–sized companies will be slow for quite some time.

On the issue of excess equipment, NRC notes that there has been no increase in the rates of operation of equipment in the manufacturing industry, and says, "stagnant operation rates are proof of the lingering problem of excess investment in the bubble economy."

NRC also warns against expecting too much from investment in information systems, as FRI does: "Investment in intraoffice systems is expanding rapidly at information service, communications and general businesses. But investment in such information systems accounts for just over 10% of overall investment, much less than the 25% share it commands in the U.S."

Varied forecasts of the exchange rate

Forecasts on interest and exchange rates also differ according to think tank. Although most predict that the current, extremely low interest rates will remain that way in the context of slower economic growth, Yamaichi Research Institute of Securities & Economics (YRI, which forecasts fiscal 1996 growth at 2.7% and fiscal 1997 growth at 2.0%) expected higher interest rates in December 1996. Among its reasons: "Inventory adjustment in the second quarter of 1996 (July through September) boosted production in the mining and manufacturing industries." The Bank of Japan's Tankan quarterly survey, released late last November, points out that industry conditions for major manufacturing industries have improved since the previous survey announced last August. And finally, "the revised budget for fiscal 1996 was firmed up at the end of December." The increase in interest rates will be slight, however, with short–term rates targets predicted to rise from just below 0.5% at present to around 0.75%.

FRI also foresees a rise in interest rates: "The Bank of Japan will take note both of the modest recovery in the economy in the second half of fiscal 1996, and of trends in commodity prices, and have revised its extremely low interest rate policy to raise rates by December 1996 or later. Long– and short–term interest rates will rise in response, and then will remain flat for a while."

On the external trade surplus and exchange rate market, DIR and NRC have opposite views. DIR notes that the external trade surplus is growing at a slower rate due to lower exports and increased imports, and points out, "From April to June 1996, real exports were just about equal to imports. The structural external trade surplus that has persisted since the 1980s is beginning to fall apart. The current account surplus, which stood at 3% of GDP two years ago, will have shrunk to close to 1% at the end of fiscal 1997. The result will likely be a weakening of the yen."

NRC, by contrast, says that "Fears are surfacing that the trade surplus, which has shrunk in real terms since 1993, may be on the rise again due to sluggish domestic demand." It predicts that as inventory adjustment continues in the face of slow domestic demand, (1) pressure to export will mount as the weak yen affects export profits, and (2) imports, which have had a huge price advantage under the strong yen, will lose that advantage at the ¥110=U.S.$1 level. For this reason, NRC says that "it cannot be ruled out that an increasing trade surplus may create instability (strong yen) in the exchange markets."

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