Market Intervention After GDP Upturn

By Sakamoto Sakae

Japan's real gross domestic product (GDP) for the January-March quarter of 1999, notched a 1.9% growth over the previous quarter, exceeding by far most economists' projections. The upturn broke a string of quarter-on-quarter negative growth that began in the fourth quarter of 1997 following the failure of banks and securities firms one after another raising the specter of deflation. The GDP plunged to minus 0.9% in that quarter and kept on sliding — by 1.2%, 0.7%, 0.3%, and 0.8% in successive quarters. The first economic turnaround in many months, announced in June, surprised and delighted the market, causing Tokyo Stock Exchange prices and the exchange rate of the yen to soar.


Photo: Kyodo News

EPA Director General Sakaiya Taichi said in June that caution about the economy was still necessary despite the unexpected surge of the January-March GDP

Japan's monetary and financial authorities, however, remained as cautious as ever about the state of the economy and in the 10 days immediately following the announcement of the GDP rise, conducted massive exchange market interventions buying yen worth over $20 billion. As a result, the yen's value which had been ¥117 to the U.S. dollar eased back to somewhere between ¥120 and ¥125.

A financial executive of a major trading house thought that the intervention was aimed at helping Japanese life insurance companies to dispose of their foreign bond holdings at an advantage and recover their health. This is because the yen's appreciation against the dollar would have reduced what the dollar and euro bonds fetched in terms of the yen.

A retired official of the Bank of Japan disagreed. He said, "Since last year the government has pulled out all the stops to avoid deflation. The BOJ has implemented a zero-interest rate policy, and public works projects were expanded through huge government expenditures. To be frank, the only course of action left is to increase exports by lowering the value of the yen." According to his analysis, the monetary intervention reflected efforts to create a favorable environment for exports by keeping a check on the yen's value, which in the eyes of monetary authorities, had appreciated too much spurred by the improved GDP showing.

Both of the analysis probably hold some truths. Whichever is the case, the government, undeterred by the fleeting ups and downs of the economy, is apparently bent on seeing the Japanese economy revitalized beyond a doubt now that it is on the last lap of its recovery. It needs to remove anything that stands in the way even at the risk of going against market forces. Finance Minister Miyazawa Kiichi implied that the latest BOJ intervention stemmed from this attitude.

Miyazawa said, "Among other things, the first quarter (GDP) growth rate has emboldened many investors and economists to conclude that the Japanese economy was now definitely rebounding. I myself didn't feel that way, but such optimistic views prevailed and there followed the sign of a sudden surge of yen buying. I thought it best to send a message [in the form of a huge market intervention] that we do not want overly-destabilizing moves." He cautioned that January-March GDP rates can be misleading as indicators. He said, "The first quarter figure is highly biased because it is seasonally adjusted."

The G7 summit held in Cologne in June agreed that Japan would continue stimulating the economy until it began positive growth led by domestic demand. This means that the Japanese economy would depend on domestic demand but not on exports for regaining its health. But it is not clear if the other G7 countries support such intervention. According to some news reports, the U.S. Treasury Department was necessarily agree to Japanese moves to guide the yen lower.

Unemployment Seen Increasing As Corporate Restructuring Makes Headway

The first quarter GDP figures which

indicated a seemingly robust economic turnaround were not convincing to some economic analysts and corporate executives, who stressed that the figures should be read with caution. Their comments follow: "With unemployment at an all-time high of around 5%, the economic situation will continue to be harsh"; "It's hard to think that this unexpected rise in personal consumption and capital investment will turn into a lasting trend. I'm worried about a downturn"; "Quarterly figures are sensitive to minute changes — they don't accurately reflect the actual status of the economy"; "I don't see any indication that the economy has bottomed out."

Said one business leader, "I don't think the economy is going to rise straight up without some dips along the way. I'm not that optimistic. What's important is not to get lulled into a false sense of security by these figures but to keep working to sustain the upward trend." Probably the blunders of the Hashimoto Ryutaro government were still fresh in the mind of this business leader. When economic indicators improved from spring to autumn 1997, the Hashimoto government took them at their face value and went ahead with a number of options normally reserved for good times — raising the consumption tax and health care charges. They caused the economy to cool overnight to set in a period of negative growth, which resulted in the successive negative growth shown above.

The Economic Planning Agency (EPA) Director General Sakaiya Taichi commented on the January-March GDP growth as follows: "The largest contributing factor was an unexpectedly sharp rise in consumption. The greatest recession Japan has seen since the end of the Second World War is reaching bottom." Yet, he hastened to add, "I think it is premature to say that the Japanese economy is on its way up. We have to remain cautious and keep an eye on economic conditions." The EPA head gave the following reasons for his cautious attitude:

Unemployment: The problem is likely to become more serious in the future as Japanese companies will continue to downsize. A GDP pickup in a single quarter alone would not wipe out the problem. Employment is the heart of the economy as it touches the lives of individuals, so this problem must be addressed without delay.

Structural Reform: Structural reform has just gotten under way in Japan, and much change is still needed in business operations and industrial structures, employment practices and ways of thinking about individual consumption, and lifestyles should be altered to suit a society with an aging population and fewer children. Given these challenges, it must be said that the nation faces very tough times ahead economically.

Equipment Investment: Equipment investment increased in the January-March 1999 quarter over the previous one, but the pickup was due to the steep falls registered in the previous two quarters. In fact, it was more than 10% lower than the levels of a year earlier. This negative growth tells us that equipment investment has yet to recover.

Bank of Japan to Maintain Zero-Interest Rate Policy

EPA Director General Sakaiya used the analogy of a baseball game to illustrate the nation's economic recovery plan saying that public works investment would be the first in the batting lineup, followed by housing investment and personal consumption in that order. He added, "...then we can't be sure whether consumption is on base, but at any rate I believe exports could become batting cleanup. Exports will emerge definitely as the fourth batter if the Asian economy recovers and America's prosperity continues. Seen in this way, it is extremely vital to Japanese interests that the Asian economy recover and the strong American economy persist."

More than likely, the rush by the Japan's monetary and financial authorities to force the value of the yen downward on the heels of the GDP announcement is evidence that they think the same way (i.e., that exports are batting cleanup).

Moreover, Governor of the Bank of Japan Hayami Masaru has this to say about the first quarter upturn: "This is but one indication that the recession might have reached bottom, but seen in the context of the economy as a whole, I don't believe the latest GDP is a proof that private-sector demand has begun to grow unaided and on a sustainable basis. The assessment by the BOJ remains the same as before: although the recession has reached bottom, there are no clear signs yet that the nation is going through economic recovery."

The BOJ assessment is based on the following: Construction projects are well under way thanks to massive public works investment and housing investment is rallying. But there are somber spots, namely, (1) equipment investment is basically not strong enough though it grew somewhat at the beginning of the year, and (2) personal consumption has not recovered fully as a whole.

Hayami added, "We cannot hope for an independent recovery of the economy in the second half of fiscal 1999 when the public works investment will start to taper off. Moreover, there still remains a latent downward pressure on prices. In this light, the current situation does not allow for hopes of an end to worries over deflation." The BOJ has decided to continue its zero-interest rate policy introduced last February (a policy of keeping both long and short-term interest rates low by effecting reduction of the real short-term market interest rate to virtually zero). JTI

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