

Koizumi Reorganizes His Cabinet

Prime Minister Koizumi Jun-ichiro carried out a major reshuffle of his cabinet on Sept. 22 following his triumphant re-election as president of the ruling Liberal Democratic Party (LDP). Koizumi retained Minister of State for Financial Services, Economic and Fiscal Policy Takenaka Heizo and Foreign Minister Kawaguchi Yoriko, defying calls for their removal from within the LDP. By keeping Takenaka and Kawaguchi and appointing Tanigaki Sadakazu, the former minister in charge of industrial revitalization, as finance minister, the prime minister underlined his intention to ensure the continuity of his policy line and push for his reform initiatives. Prior to the cabinet reorganization, Koizumi replaced LDP Secretary General Yamasaki Taku with Abe Shinzo, a 49-year-old junior Dietman, who is highly popular with voters for the tough diplomatic stance he took against North Korea as deputy chief cabinet secretary in the previous cabinet. Yamasaki was given the nominal position of LDP vice-president in view of the strong demands for his dismissal from the party because of his alleged involvement in an adultery scandal. Abe's appointment to the No.2 position in the LDP despite a short political career reflected Koizumi's aim to exploit Abe's popularity to win the coming general election in which the LDP faces a strong challenge from the Democratic Party of Japan, which has been reinforced through its absorption of the Liberal Party.

Koizumi also retained several other key ministers, including Chief Cabinet Secretary Fukuda Yasuo, Minister of State for Defense Ishiba Shigeru, Agriculture, Forestry and Fisheries Minister Kamei Yoshiyuki, and Health, Labour and Welfare Minister Sakaguchi Chikara (a member of New Komeito, which is a junior partner of the coalition). Ishihara Nobuteru, who had served as minister of state for administrative reform, was transferred to the post of minister of land, infrastructure and transport.

Other appointments were Aso Taro, chairman of the LDP's policy research



Koizumi (front center) launched his new cabinet on Sept. 22

council, as minister of public management, home affairs, posts and telecommunications; Nakagawa Shoichi, former minister of agriculture, forestry and fisheries in Obuchi Keizo's Cabinet, as minister of economy, trade and industry; Kawamura Takeo, former vice education minister, as education, culture, sports, science and technology minister; Motegi Toshimitsu, former vice foreign minister, as state minister for Okinawa and Northern Territories affairs; Kaneko Kazuyoshi, a former banker, as state minister in charge of industrial revitalization and administrative reforms; Koike Yuriko, a former television newscaster, as environment minister; Nozawa Daizo as justice minister; and Ono Kiyoko, a former gymnast who won a bronze medal at the 1964 Tokyo Olympics, as chairwoman of the National Public Safety Commission. Nozawa and Ono are members of the Upper House. Inoue Kiichi of the New Conservative Party, another junior coalition partner, was named state minister in charge of disaster management.

In the LDP presidential election, Aoki Mikio, the leader of the LDP's Upper House members, supported Koizumi's re-election, even though he belongs to former Prime Minister Hashimoto Ryutaro's faction, which opposed Koizumi's re-election. The virtual split of the Hashimoto faction, the largest in the LDP, forced Nonaka Hiromu, one of the heavyweights of the Hashimoto faction and a representative figure among the old guard resisting Koizumi's reform plans, to decide to

retire from politics. These developments showed that the conflicts between Koizumi and the old guard opposing Koizumi's reform initiatives, which had characterized the LDP landscape since Koizumi came to power in April 2001, are now giving way to monolithic control of the party by a new mainstream group which supported Koizumi's re-election.

The recent rebound in stock prices and the widespread public sentiment that the Japanese economy has bottomed out boosted public support for Koizumi's reform line, which in turn prompted LDP politicians to support Koizumi's re-election.

In a general policy speech at the outset of the extraordinary Diet session convened on Sept. 26, Koizumi expressed his strong determination to fight the general election under the slogan of the privatization of postal services and the Japan Highway Public Corp.

Hopes Growing for Full Economic Recovery

The Tokyo stock market surged ahead in September amid growing expectations that Japan's economy is headed for a full-fledged recovery, lifting its key gauge, the 225-issue Nikkei Stock Average, above the 11,000-yen level for the first time in a year and three months. Foreign investors continued to put their funds into Japanese stocks, resulting in heavy trading that often swelled to a daily turnover of

more than 1 billion shares.

Against that background, business sentiment has somewhat improved. A Kyodo News survey covering 100 major Japanese companies found that the proportion of business executives who think the economy is in recession declined while more than 80% believe economic activity is leveling off. There appear to be two factors behind the improvement in business confidence. One is progress in workforce cuts and other streamlining measures that have helped earnings prospects to turn for the better. The other is the stock market rebound that has boosted business psychology.

According to a survey on economic activity announced in September by the Japan Association of Corporate Executives (Keizai Doyukai), 40.8% of those polled believed the economy is more or less expanding. This represented a steep rise of 38.6 percentage points from the previous survey taken in June. "Economic activity as felt by business executives is moving in the right direction," the association's chairman, Kitashiro Kakutaro, told a press conference. "I think the Japanese economy may have reached a turning point more than a decade after the collapse of the bubble economy."

Given these developments, the government released a monthly economic report on Sept. 12 in which it revised its economic assessment upward from "leveling off as a whole" to "moves toward recovery seen." As reasons, the report cited several factors, including a recovery in exports, which has helped corporate capital spending and profits improve, and the burgeoning perception that declines in employment and wages are coming to a halt. The report also reflected the fact that the nation's gross domestic product (GDP) in real terms grew 1.0% in the April-June period from the previous quarter, or an annualized rate of 3.9%, both figures representing solid upward revisions from the preliminary data announced earlier. "The economy is emerging out of a plateau," Takenaka Heizo, minister in charge of economic and fiscal policies, told a press conference on the day when the government released its monthly economic report.

But long-term interest rates have temporarily soared to their highest level in two and a half years, with the running yield on a new 10-year government bond issue climbing over 1.6% per annum at one point. This was the level prevalent before March 2001, when the Bank of Japan (BOJ) adopted the current policy of relaxing credit controls further by pouring huge amounts of money into the capital market. The BOJ is increasingly concerned about a rising trend in short and medium-term interest rates which has been induced by the long-term rate surge. The current long-term rates are still lower than international levels. But a sudden steep rise in such rates adversely affects corporate capital spending as well as household spending that is subject to higher rates on homebuilding loans. In this sense, the government and the BOJ are expected to seek adequate policy options.

China Under Pressure to Revalue the Yuan

China is under increasing international pressure to revalue its currency, the yuan. The U.S. trade deficit with China in July jumped 13.5% to \$11.338 billion, the largest monthly deficit ever, and some projections put the aggregate U.S. deficit with China for 2003 at \$130 billion. The deficit with China has expanded five times over the past 10 years and now accounts for almost a quarter of the total U.S. trade deficit.

Amid growing concerns that the yuan's undervaluation allows Chinese products to flood world markets, causes trade imbalances and boosts unemployment in major economies, the Congress and U.S. industries are stepping up their demand for the Chinese currency's revaluation with support from Japan and European countries. The yuan has become an issue at international meetings as well. The annual meeting of finance ministers of the 21-member Asia Pacific Economic Cooperation (APEC) held in Phuket, Thailand, Sept. 4-5, implicitly referred to the necessity of the yuan's revaluation in the future. A communiqué adopted at a meeting of Group of

Seven (G7) finance ministers and central bank governors in Dubai on Sept. 20 called for flexible exchange rates, practically urging China to widen the yuan's trading band.

But Horst Köhler, managing director of the International Monetary Fund (IMF), has stated that he could not identify himself with suggestions that the world should act in concert to force China to change its currency policy, thus underlining his opposition to collective international pressure on Beijing to widen the yuan's trading band. Dai-ichi Life Research Institute also took a dim view of putting pressure on China to revalue its currency, noting that if the yuan was revalued to the level of purchasing power parity, China would lose its export competitiveness and a resultant increase in unemployment and stagnation of domestic demand would reduce the country's economic growth by 3.3 points. This in turn will decelerate Japanese and U.S. exports to China and trim Japan's exports by 0.9 points and GDP by 0.1 points.

The Chinese government has ruled out any change to the yuan's peg to the dollar on the grounds of currency stability. Beijing's hesitation to revalue the yuan is attributed to the following factors: 1) its economic vulnerability, including rising unemployment figures and snowballing non-performing loans, 2) reluctance to drastically change economic policy under the fledgling government of Hu Jintao, who took over from Jiang Zemin only a year ago, and 3) unwillingness to act under international pressure.

But China has indicated its readiness to practically revalue the yuan by widening the trading band or shifting to a system of linking the yuan to a basket of major currencies. This scheme has the merit of curbing import inflation, restraining foreign exchange reserves that are now increasing excessively and avoiding trade friction with the United States.

China watchers say that Beijing will not move while other countries are making a fuss. But most currency analysts believe that China will eventually introduce flexibility in its currency, although with some delay and so the yuan's revaluation is a matter of "when," not "if."