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The Business Outlook in the Far East

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The Business Outlook in the Far East*

Reed J. Irvine

Over the past decade, economic analyses of the Japanese position have often been characterized by what I would like to call "reverse-Micawberism"-- that is, the conviction that something bad will turn up. This attitude has arisen in part from the feeling that Japan's economic performance was just too good to be true and that the only sensible thing to do was to demonstrate that it couldn't last.

I learned long ago how dangerous it was to pursue this line of analysis with respect to Japan. The pessimistic prognostications have been proved wrong year after year, as Japan has gone on adding miracle to miracle. Let us just bear in mind that this is a country that has succeeded in doubling its exports and more than doubling its industrial production between 1955 and 1960. One assessment of the Japanese situation prepared in 1955 held that it would be extremely unlikely that Japan would be able to double its exports in even ten years and that this could only be done if the Japanese could develop new export markets in the underdeveloped countries. Further significant expansion of trade with the U.S. and Western Europe was not to be expected. Since the outlook for trade expansion was not particularly hopeful, it was thought that Japan might very well become heavily dependent on external aid and invoke tighter exchange and import controls.

It is well to keep this bleak forecast in mind as we consider Japan's position today. As I have already noted, Japanese exports last year were double the 1955 level, exceeding \$4 billion. The largest gains were made in precisely those markets--the U.S. and Europe--which the forecasters thought to be the least promising five or six years ago. Sales to both the U.S. and Western Europe have risen about 140 per cent over the past five years, and the increase in sales to Europe has come in spite of the fact that the European countries have persistently denied Japan most-favored-nation treatment.

Japan has not found it necessary to tighten up exchange and import controls. On the contrary, she is in the process of liberalizing her restrictions. Approximately 62 per cent of commodity imports are now free of quota restrictions, and this will rise to 65 per cent in July when additional commodities are scheduled to be liberalized. This is still a low percentage compared with other industrialized countries, but progress is being made. As recently as a year and a half ago only about a third of Japan's imports had been liberalized. Japan is under considerable pressure to speed up liberalization, and I believe that rapid progress can be expected. It is now quite generally agreed that Japan has no valid balance-of-payments justification for the maintenance of restrictions. The Japanese themselves have been somewhat slow in recognizing this, largely, I think, because of "reverse Micawberism." With confidence in the future taking a stronger hold, there is less inclination to cling to the old restrictive mechanism.

*Remarks delivered at the annual meeting of the National Industrial Conference Board in New York City, May 18, 1961.

No one would think of Japan as being a likely candidate for foreign aid today. Japan, in fact, prefers to think of herself as among the aid-giving countries, and she has extended credits to the underdeveloped countries and is paying out fairly substantial amounts to a few countries in the form of reparations. However, Japan is still very much a debtor country and is borrowing heavily in the capital markets of the West. Short-term liabilities alone now total about \$1.4 billion. Most of this represents borrowing in the New York market to finance Japanese trade. However, since July 1960, when the Government began to permit non-residents to hold convertible yen deposits in Japan, over \$200 million has been attracted to such accounts to take advantage of the higher interest rates available there. About half of these funds have been channelled through Japanese branch banks in Europe, which have been redepositing the funds with their head-offices in Tokyo. The Government has also taken action to make direct and portfolio investment in Japan more attractive to foreigners. Prior to June 1960, six years was required to fully repatriate an investment in Japan. It is now possible to completely repatriate an investment at any time through the security yen market which was inaugurated on May 1st. This, of course, may give the person repatriating his investment a rate somewhat less favorable than the official rate of exchange. However, validated investments may now be repatriated at the official rate after a waiting period of only two years. The adoption of the security yen system should clear the way for the introduction of the American Depositary Receipts system, which is designed to facilitate the trading of selected Japanese stocks in this country.

Japan has been a fairly heavy borrower from the World Bank and now owes that institution \$362 million. Both the Japanese Government and private corporations have begun to borrow in the New York market. Loans totaling nearly \$90 million have been placed in the last two years. Of this total \$40 million has been borrowed by Japanese steel companies, which have paid 7 and 7-1/2 per cent for credits maturing in 14 to 15 years. Even at these high rates, borrowing in this country has been attractive to the Japanese firms, since the interest cost on seven year bonds issued by a top ranking company in Japan amounts to over 9 per cent per annum. This is something of an offset to low labor costs in capital intensive industries.

Japan's success in borrowing large sums of money in private money markets abroad indicates that there are ways for developing countries to get foreign assistance other than through the medium of government-to-government grants and credits. The prerequisite, of course, is confidence that the country will maintain a reasonable degree of financial stability and will develop along lines that will augment its capacity to meet its international liabilities. Japan has succeeded on both counts, and has, moreover, grown at an exceedingly rapid rate.

Though I am wary of pessimistic views of Japan's future, I don't think we should assume that Japan has solved the problem of the business cycle. The cycle has been in a strong boom phase since mid-1958. The industrial production index, seasonally adjusted, rose 85 per cent in the 33 months from June 1958 through March of this year. The previous boom of 1954-57 saw the index rise by only 68 per cent over a 33 month period. The latest boom has therefore been even stronger than the earlier one which produced the phrase "Jimmu Keiki"--the greatest prosperity since the time of the Emperor Jimmu. It is still to be seen whether

it will be more sustained. We are now in the testing period. The boom seemed to be losing steam for a few months. Industrial activity rose only a little more than 1 per cent between November 1960 and February of this year, but preliminary seasonally adjusted figures for March show a whopping 4 per cent increase over February.

The first quarter increase in industrial production was at an annual rate of 20 per cent. One may be pardoned for wondering how much longer this hectic pace can be sustained.

There is no evidence right now that domestic demand is likely to be a limiting factor, but we have seen some evidence in recent months that foreign demand for Japanese goods may not keep up with output. Exports, seasonally adjusted, declined from an annual rate of \$4.2 billion in the third quarter of 1960 to a rate of \$4.1 billion in the first quarter of this year. In April, they recovered to an annual rate of \$4.4 billion, and while this could mark the beginning of a new upward surge, all we can say at the moment is that the trend of exports has been down a little for the past six months. The trade deficit for the first four months of this year, at a seasonally adjusted annual rate, exceeded \$1 billion. Half to two-thirds of this may be covered by other net earnings on current account and donations, and the balance has been more than covered by capital inflow. Japan's foreign exchange reserves rose by more than \$200 million from December through April. Nevertheless, Japan will encounter balance-of-payments troubles if output continues its rapid rise, sucking in a larger volume of imports, and if exports fail to keep pace.

Another factor that is causing concern and which may operate to curb the boom is the price trend. Wholesale prices have been creeping up since June 1960, when they were less than 1 per cent above the 1953 average. In April, they were nearly 5 per cent above the 1953 average. The increase was especially sharp in March and April. The cost-of-living index rose more sharply than wholesale prices in 1960, reportedly because of the rising cost of services caused by a growing shortage of labor. The attraction of workers to the better paying jobs in manufacturing is reported to be having a noticeable impact on the level of wages in the service sector. The price increases no doubt reflect a growing tightness in the economy, which may impinge upon efforts to expand output and exports. So far, however, export prices, which are available only through February, have been remarkably stable.

The latest Japanese official projections call for a doubling of gross national product and a 130 per cent rise in exports by 1970. Looking at past performance, one would be rash to call these ambitious goals impossible. However, it would be equally rash to assume that there are not going to be periods of recession as well as boom over the coming decade.

Since the Asian countries other than Japan are all distinguished by the fact that they are more agricultural rather than industrial, there is some temptation to lump them together and speak of the outlook in the primary producing countries. However, the development of industry in several of these countries merits attention.

The countries of South and Southeast Asia have been pressing forward toward industrialization with varying degrees of success. Manufacturing and construction generate from 10 per cent to a quarter of the gross domestic product of those countries, with the highest degree of industrialization in Hong Kong, Taiwan, the Philippines, Thailand and India. Hong Kong has undergone the most remarkable transformation in recent years in terms of industrial development. Factory employment in Hong Kong has risen 130 per cent since 1953, exceeding even the rate of expansion in Japan by a wide margin. In 1960, exports of goods produced in Hong Kong totaled U.S. \$500 million, or about \$165 per capita. This is evidence that Hong Kong industry is highly competitive as well as fast-growing. American firms have recently been showing greater interest in the potentialities of investment in Hong Kong, but our direct investments there are still very small.

Taiwan and the Philippines have had a very rapid industrial expansion. Of the two, Taiwan appears to have had more success in exporting manufactured goods. The Philippine policy toward industrialization has been largely directed toward replacing imports with goods of domestic manufacture, and despite a rapid rise in industrial output the country still depends on four agricultural and forestry products for three-quarters of its export earnings. This is only slightly less than the ratio that prevailed in 1955. Taiwan, on the other hand, last year derived only a little over half of its export earnings from the four agricultural exports that had provided four-fifths of its earnings in 1955. About a quarter of Taiwan's exports in 1960 were manufactured goods, with textiles accounting for the largest share. This development of new export potential is very important for Taiwan in view of the possibility that rice exports, which until last year were Taiwan's second largest foreign exchange earner, may be sharply reduced in the future.

The official statistics indicate that the expansion of industrial production in India has been considerably slower than in the other Asian countries which publish indexes. For example, with 1953 as 100, Japanese production last year exceeded 260, Taiwan's exceeded 200 in the third quarter, while the Indian third quarter figure was only 158. The Indian index is believed to understate the true rate of industrial growth, since it probably does not give adequate weight to the new industries that have developed since 1951. However, Indian expansion definitely lagged in 1957-58 as the result of slow demand for Indian cotton textiles and jute, together with shortages of needed supplies that resulted from the import restrictions imposed to curb the drain on foreign exchange. There was a sharp pick-up in 1959 and 1960, in spite of continuing raw material shortages. Inventories of raw cotton and jute were drawn down to very low levels.

India has had little success in expanding exports in proportion to her industrial growth, while imports have expanded at an even more rapid rate than industrial output. This has resulted in a widening trade deficit. Export earnings in 1960 could pay for only two-thirds of India's imports. The balance had to be financed by small net earnings on invisibles, gifts, and loans, and a drawdown of foreign exchange reserves. India's reserves are now down to below \$700 million, and the Government does not think they can safely be allowed to go much lower. The third five year plan, which began the first of April, will tend to greatly expand

import demand, while only modest export expansion is projected. The plan calls for balance-of-payments deficits averaging \$1,350 million a year, which is roughly double the deficits in 1958 and 1959. The realization of the plan targets will therefore depend heavily on the amount of foreign assistance that can be obtained. India's growth, in contrast with that of Japan, Hong Kong, and Taiwan, has not been export-oriented and has therefore not as yet demonstrated its self-sustainability. There is a growing awareness in Indian official circles of the importance of emphasizing exports. There is evidence of export recovery in the last quarter of 1960. If this can be sustained the Indian prospects will be considerably brightened.