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Recent Economic Developments in Japan, July-September 1964 — 6 pages

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RECENT ECONOMIC DEVELOPMENTS IN JAPAN, JULY-SEPTEMBER 1964

SUMMARY

Japanese authorities have been successful in virtually restoring international economic equilibrium, but there are signs that it may be a tenuous equilibrium. The large trade deficit of the first quarter has been cut by about 70 per cent and international reserves have risen in the past two months. Money supply and credit expansion have also been reduced and interest rates have generally moved up.

Production has continued to expand, although at a slower rate, and investment demand continues to remain strong. Wholesale prices reversed their decline in June and edged up slightly in July and August. Exports fell in August. Inventories of imported finished goods have been drawn down substantially. September also saw the first partial relaxation of the tight money policy when import deposit requirements were lowered.

International Equilibrium Virtually Re-established

In the relatively short period of eight months, Japan has been able to overcome a large deficit in its balance of payments and virtually restore international equilibrium. This has been accomplished the hard way through a substantial expansion in exports and a reduction in imports.

The Japanese trade balance first began to deteriorate in the second quarter of 1963 and worsened steadily through early 1964. International reserves, buoyed temporarily by heavy foreign borrowing, began to decline after October of 1963. Beginning in December of last year, a series of actions were taken to restore equilibrium. These involved an increase in commercial bank reserve requirements in December, the establishment in January of maximum quarterly credit expansion quotas, and an increase in the Bank of Japan's discount rate in March.

Japan experienced an 18 per cent rise in exports (seasonally adjusted) from the monthly average between the first quarter of 1964 and the July-August period. During the same period imports declined 7 per cent. As a result of the improvement on trade account, the seasonally adjusted trade deficit 1/ narrowed from an average monthly deficit of $183 million in the first quarter to $50 million in July-August. This current rate of deficit is roughly equivalent to the establishment of equilibrium in the balance of payments since Japan has substantial earnings from U.S. military expenditures and the trade account (when imports are measured on an f.o.b. basis) to balance off the large net payments for services.

The current account in the balance of payments, as measured on an exchange transactions basis, had a surplus of $65 million in August of this year, the first surplus since December 1962. This was due entirely to the substantial improvement on trade account rather than to any marked changes in net payments for services.

As a result of this improvement, international reserves stopped declining and increased during the past two months. At the end of July, reserves were $1,915 million, down $187 million from the previous October's peak. Reserves increased $12 million each month in August and September, bringing the total to $1,939 million.

The improved balance-of-payments position in recent months has been all the more substantial since it has been accomplished in spite of net outflows of short-term capital. These totaled $69 and $36 million in July and August, respectively. In contrast, net short-term capital receipts were registered each month during the first half of 1964, averaging $103 million per month.

1/ Exports f.o.b. and imports c.i.f. on a customs basis.

The reversal in the short-term capital flows is reportedly attributable mainly to an increase in the holdings of export acceptance bills by Japanese foreign exchange banks and a decline in import acceptance bills outstanding.

Adjustment Process Continuing in Domestic Economy

Many of the statistical indicators show a continuing upward trend in the Japanese economy in spite of the restrictive monetary policy. Industrial production in the January-August period showed a rise of 9 per cent. This is lower than the 13 per cent gain recorded in the same months in 1963, but it is a very substantial rise even by Japanese standards. There was a modest dip of 1.4 per cent in wholesale prices between November 1963 and June 1964, but the cost-of-living index rose nearly 4 per cent in the first half of this year.

All of this might suggest the uninhibited continuation of a boom, but recent reports from Tokyo indicate that signs of recession are becoming more apparent all through Japanese industry. Sales are said to be lagging behind output, with the result that manufacturers and dealers are plagued with excessive inventories of finished goods. Some industries are planning to cut back production in the near future. Profits have fallen, and they will be further squeezed by the need to cut prices to unload the large inventories.

Businesses are feeling the pinch of tight money, even though bank credit and money supply have continued to expand. Bank loans and discounts rose at a seasonally adjusted rate of 19 per cent in July compared with 25 per cent last January. The growth of money supply, seasonally adjusted, was down to an annual rate of 14 per cent in June, less than half the January rate. However, the figures on credit expansion may not tell the whole story. A recent report states that banks have been increasing requirements for compensating balances as a condition of making business loans. Also the big companies are said to have started off this year with a relatively high degree of liquidity. This has now been largely used up. Pressure on liquidity is therefore greater than the statistics on bank loans might suggest.

The Bank of Japan plans to keep the pressure on in spite of growing demands for relaxation. The Bank is limiting the expansion of credit by the city banks in the fourth quarter of this year to around four per cent compared with the six per cent rise permitted in 1963.

The tightening of money was reflected in a rise in interest rates through the first seven months of the year, but rates leveled off in August and September. The rate for unconditional call loan money even declined from 11.315 per cent to 10.95 per cent on October 1, 1964. The interest rate movements do not bear out the reports that money has continued to tighten in recent months. However, the movement of true interest rates as well as the amount of credit extended may be obscured by changes in the level of compensating balances which the commercial banks require of their borrowers.

The stock market has reflected the deflationary pressure in the economy in recent months. In general the market has trended down since July 1961. There was a brief summer rally this year, and the market index reached a high for the year in July. Since then it has declined. On October 5, the index reached ¥1,207, only slightly higher than the low for the year of ¥1,203 reached on April 9. To a large extent, the generally poor performance of the market in recent years can be attributed to the excessive rise between 1958 and 1961 when stock prices increased 171 per cent.

Economic Outlook

Early in August the Minister of Finance told the House of Councillors (Upper House) that the tight money policy would be maintained until at least the end of the year. On September 1, however, there was a partial relaxation of this policy. Advance import deposit rates on 24 items were reduced from 35 to 5 per cent, and for 31 items they were cut from 5 to 1 per cent. It is estimated that this move affected approximately 20 per cent, in value terms, of Japan's imports. Assuming present trends continue, the Japanese authorities are likely to be under pressure to relax substantially the tight money policy in early 1965, if not sooner.

As was the case last year, however, fresh balance-of-payments difficulties could re-emerge in a period of only a few months. Under the present circumstances, this might occur even in the absence of a relaxation of the tight money policy. As pointed out above, inventories of imported goods are relatively low and will sooner or later need to be rebuilt. Export growth since February of this year has been very rapid and some moderation of this growth in the coming months would appear likely. Exports in August were off 7 per cent from the previous month. Price adjustments have been very mild compared to other cycles, and in recent months wholesale prices have actually begun to rise again. In addition, Japan has been faced with rising net payments for services. Comparing the first six months of the year, and using exchange transactions data, these rose from $102 million in 1962 to $155 million in 1963 and to $217 million in 1964.

On the other hand, the success of the Japanese in restoring balance-of-payments equilibrium with such ease will no doubt enhance confidence in

Japan in international money markets. The IBRD and the Export-Import Bank have reportedly agreed to consider extending credits to Japan totaling $150 million for each institution in the coming year. Other borrowing plans include the issue of $105 million in long-term bonds in Europeans markets by next April. This will be mainly Government and Government-guaranteed issues. Short-term capital flows are more problematic. There was a net outflow of short-term capital in July and August for the first time since December 1963. The Japanese authorities have tried to restrain short-term borrowing abroad by various devices. They have also made a number of revisions in the maximum rates which Japanese banks are permitted to pay for Euro-money in order to permit their banks to continue to attract these funds. The maximum rates which the Japanese banks are allowed to pay appear to have been consistently kept 5/16 of a percentage point above the rates quoted for Euro-money. Barring any sharp change in the money markets of the U.S. and Europe, the Japanese will probably continue to attract some short-term funds.

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