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Recent Economic Developments in Japan, January-June 1967

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Economy Continues Strong Advance

The Japanese economy advanced strongly during the first half of the year, continuing the general uptrend since October of 1965. Industrial production has been increasing about 1-1/2 per cent a month, and in May was up 20 per cent over the level a year earlier. The advance has been particularly strong for producers' and durable consumers' goods.

The use of manufacturing facilities has intensified. The operating ratio, which is a ratio of the seasonally adjusted production index to the production capacity index, rose steadily last year and early this year. During the first quarter the index (1960=100) was 113.0, as against 98.6 in the first quarter of 1966.

After leveling off during the first quarter of last year, outstanding orders for machinery began to rise, and they increased substantially during the first quarter of this year. In March, the level of machinery orders outstanding was 25 per cent higher than a year earlier. Machinery sales have also increased and in March they were 21 per cent higher than in the same month a year earlier.

Data on department store sales indicate stronger consumer demand. In April, seasonally adjusted department store sales were 15 per cent higher than in April of 1966, compared to a 9 per cent increase in the same period a year earlier.

Current profits of corporate business appear to be rising. In the six months ending March 1966, profits of 330 top corporations were up

22.0 per cent over the previous six months as against a 19.8 per cent rise in the six months ending in September of 1966. The ratio of profits to sales also increased slightly for the same periods.

Ministry of Finance Concerned About Overheating

The generally buoyant conditions in the economy have aroused concern in the Ministry of Finance that the economy may be about to begin a period of overheating. The business community reportedly feels that the Ministry of Finance is overly concerned, and Governor Usami of the Bank of Japan stated in late June that he saw no danger of overheating. In recent months, prices have been relatively stable.

Various data do indicate, however, a substantial rise in investment activity and a significant worsening in the foreign trade balance. According to a survey of 176 major corporations, plant and equipment investment in the first quarter of this year was up 25 per cent over the previous quarter, and 63 per cent over the same period a year earlier. Another survey of 1,817 principal enterprises made by an advisory council to the Ministry of International Trade and Industry, estimated that plant and equipment investment for 15 major industries in the year beginning April 1, 1967, will be 29 per cent higher than a year earlier. This would be the highest rate of increase in the postwar period except for 1960. The Government's official forecast of private investment in plant and equipment for this period projects a 15 per cent increase.

The increased rate of capital investment has been reflected in a faster rate of bank credit expansion. In mid-1966, seasonally adjusted bank loans and discounts were increasing at an annual rate of 13 per cent.

By April of this year, the rate had moved steadily up to 16.3 per cent. Besides investment and working capital needs, some of the loan demand reportedly reflects the pressure on business resources of higher tax payments in line with the generally buoyant economic conditions. Seasonally adjusted money supply expanded at an annual rate of 13 to 16 per cent during the first four months of this year.

Although Bank of Japan credit operations during most of the first half of this year were expansionary, both local and city banks have been sufficiently pressed for funds that they have been liquidating some of their bond holdings. As a result, there have been downward pressures on bond prices, and yields have increased slightly. The average yield on bank debenture bonds, for example, increased from 7.33 per cent in February to 7.43 per cent in April.

Although money market conditions were relatively easy in April, they began to tighten in May and June. Call loan rates increased in June to the same levels that had prevailed in March. This tightness reflected in part heavy net receipts by the Treasury. Both the Bank of Japan and the Bankers' Association of Japan suggested to the Government that it reduce the volume of its planned bond issues this year, or at least postpone some of the issues until the second half of the fiscal year which begins in October.

Partly in response to these suggestions, the Ministry of Finance announced in mid-June that it would reduce the planned volume of national bond issues from ¥30 billion each month in July and August, to ¥10 billion a month. However, September issues would be increased from the original target of ¥100 billion to ¥140 billion. Close to half of the July-August issues are to be earmarked for public subscription through securities firms.

Rate of Inflation Slackens

Both wholesale and consumer price indexes, seasonally adjusted, have been increasing at a slower rate than a year ago. Wholesale prices have been stable since January, while consumer prices were off slightly in the March-May period following a high in February.

Wholesale prices in May of this year were up 2.4 per cent over the same month a year earlier, in contrast with a rise of 3.4 per cent in the previous twelve months. The index of consumer prices in May was up 3.2 per cent, as against a rise of 4.8 per cent twelve months earlier.

Part of the stability in the wholesale index reflects a drop in iron and steel prices. Last year there was an excessive buildup in iron and steel inventories. A substantial drawdown of these inventories contributed to lower iron and steel prices earlier this year. Consumer prices may rise later this year after the Government increases the minimum price of rice paid to the producer. Last year the Government did not increase producer rice prices in order to hold down the rate of inflation.

Money wages in manufacturing rose at slightly faster rates this spring than in earlier periods. In February-April, wages increased at an annual rate of 12 per cent. This compares with the 11 per cent rate that prevailed during most of last year, and the average annual increase in wages of 10 per cent since 1960.

After declining during most of last year, stock prices moved to generally higher levels this spring. On March 1 a high for the year was reached when the Dow Jones average hit ¥1,506. Following a dip in April, the same high was reached again on May 31. During June and early July, the stock average was moderately lower.

Despite the generally buoyant conditions domestically and improving corporate profits, stock prices have not yet reached the high's of 1966, let alone the postwar high of 1961. This is probably due in large part to the substantial volume of stock still held by two special stock-buying agencies created by the Government during 1964-65. Sales of these stocks last summer tended to depress the market.

Trade Balance Continues to Deteriorate

Japan has continued to experience a deterioration in the seasonally adjusted trade balance. On a quarterly basis the surplus on trade account declined steadily last year, and since January of this year, the trade account has been in deficit every month.

Seasonally adjusted exports reached a peak last December and then remained at generally lower levels through May. During the March-May period, exports were up only 6 per cent over the level a year earlier.

On the other hand, seasonally adjusted imports in the March-May period were 22 per cent higher than in the same period a year earlier. Imports rose rapidly during 1966, but then leveled off in January-April of this year. In May, however, imports increased 5 per cent over the previous month.

As a result, the seasonally adjusted trade balance declined steadily from a surplus of $39 million in the first quarter of 1966 to a deficit of $61 million a year later. In April and May the deficits were $43 and $112 million, respectively.

Although Japan has had a surplus in its trade with the U. S. for the last several years, this changed to a deficit in the first quarter of this year. Last year Japan's exports to the U. S. were $3.0 billion (f.o.b.) and imports (c.i.f.) were $2.7 billion, producing a surplus of about $300 million. In the first quarter of this year, however, exports were $635 million and imports were $775 million, producing a deficit of $140 million.

Primarily as a result of the deterioration on trade account and a larger deficit on the services account, the current account (not seasonally adjusted) registered deficits in January, March and May of this year. (The January deficit, however, was partly seasonal.) In May, the deficit of $128 million was particularly large. Despite this trend, international reserves have generally risen as a result of increased foreign borrowing by Japan.

Rise in Foreign Borrowing Offsets Trade Deterioration

The adverse impact on international reserves of the deterioration on trade account has more than been offset by the rise in Japanese foreign liabilities. The increase in foreign borrowing has taken the form primarily of a rise in import acceptance credits and in Euro-dollar borrowings.

After reaching a low of $1,862 million at the end of October last year, the outstanding volume of foreign import acceptances increased $418 million to $2,280 million by the end of May of this year. Although some of the increase in late 1966 was seasonal, the rise also reflected a substantial increase in Japanese imports, the shift from domestic yen financing of imports to dollar acceptance financing, and lower interest rates in the United States. Japanese Euro-dollar borrowings also reportedly increased about $150 million between September of last year and April of this year.

Largely reflecting this increase in acceptance credits, short-term claims on Japan reported by U. S. banks have also been rising. After reaching a low of $2,389 million last November, short-term claims rose $113 million in December, and a further $144 million in the January-April period this year. This reversal marks the first increase in short-term claims since they began to decline in mid-1965. U. S. long-term claims on Japan continued to decline through April of this year when $278 million was reported. The previous peak was in May of 1965 when $483 million was reported outstanding.

These movements have been reflected in the capital account of the balance of payments. Short-term capital switched from a net outflow in most of 1966, to a net inflow in every month this year from January through May. Although the overall balance of payments, excluding bank borrowing, has been in deficit every month in 1967 except in February, international reserves rose during the March-May period, mainly because of the increase in Japanese banks' short-term foreign liabilities. Between the end of September last year and the end of March this year, the excess of Japanese total short-term liabilities over assets increased from $541 million to $819 million, or by $278 million.

Official international reserves reached a low of $2,019 million at the end of October 1966, and then increased to $2,110 million by the end of May this year--a postwar high. In June, however, reserves fell $36 million to $2,074 million, the same as at the end of 1966.

Bond Issue Postponed and Direct Investment Liberalized

Japan had planned to issue dollar bonds in the United States this summer. The first issue was to have been a $20 million bond of the Japan Development Bank. It has recently been reported, however, that this and other Japanese issues will be postponed until later this year or next year. The reasons for the postponement include unsettled market conditions following the Middle Eastern conflict, a continued large volume of U. S. domestic bond issues, and the rise in long-term bond yields in the United States.

Early in June, details were announced by the Japanese of the long-awaited program to liberalize direct foreign capital investment in Japan. In general, investment approvals have now been grouped into three categories:

Category I: Foreign investment of up to 100 per cent foreign ownership will be approved automatically for 17 specified industries, such as ordinary steel industries, cement, breweries, and two-wheel vehicles.

Category II: Foreign investment of up to 50 per cent of foreign ownership will be approved automatically for 33 specified industries, including autos, electrical machinery, foodstuffs and non-ferrous metals.

Category III: Foreign investment in all other industries will be approved on a case-by-case basis as in the past.

The above program applies only to new ventures and is to be operative from mid-1967 to mid-1972.

In addition to the above measures, the authorities also increased the automatic approval limits on foreign investment in securities. The automatic approval limit for nonrestricted industries was raised from 15 to 20 per cent and for restricted industries (e.g., mining, transportation, banking) from 10 to 15 per cent. The automatic approval limit for an individual foreign investor was raised from 5 to 7 per cent.

Although the moves are regarded as a step in the right direction since approval of foreign investment in 50 industries is now supposedly automatic, only a moderate increase in investment is expected. It has been reported that no foreign firms have applied in the past for entrance into industries included in Category II, and the industries in Category I are closely held by Japanese interests.

Conclusion

The strong economic advance in Japan has recently created some concern about the possibility of overheating. Prime Minister Sato has asked businessmen to exercise discretion in their investment, and banks to restrain their supply of funds for plant and equipment investment so as to prevent economic overheating.

Japan's sharp advance has already contributed to a deterioration in the international trade account. To a large extent, increased foreign borrowing has so far prevented a decline in international reserves. However, foreign capital sources are not unlimited and Japan may eventually have to tighten its monetary and fiscal policies in order to restore external equilibrium.

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