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Recent Economic Developments in Japan:
July-December 1966

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Recent Economic Developments in Japan, July-December 1966

Summary

The rate of economic recovery in Japan this year has been faster than expected and in October the Government revised upward the predicted rate of increase in real GNP for the current fiscal year from 7.5 to 8.7 per cent. ^{1/} Other economic data such as those on shipments, orders, corporate profits, and operating ratios, indicate that recovery is proceeding strongly and smoothly. One minor exception is a decline in bank profits.

Monetary policy continues to remain easy and bank credit has been rising at a slightly faster rate than earlier in the year. Both long-term and short-term interest rates have generally been declining, although deposit rates have remained unchanged.

The Government plans to replace this year's expansionary budget with a less expansionary budget next April, although the expected elections early next year may delay specific action in this field. National bond issues are to be continued, but at a proportionately smaller volume.

Wholesale prices have been rising at a substantial rate for Japan, and the index of export prices has also been increasing since January. Consumer prices, on the other hand, have risen less rapidly

^{1/} The Japanese fiscal year is April 1, 1966, to March 31, 1967.

than in earlier years and the Government has committed itself to prevent an increase of more than 5.5 per cent during the current fiscal year. Stock prices have slowly declined since April, in part because of the actual and potential unloading of shares by two special stock-buying agencies.

Although the seasonally adjusted trade balance has been in deficit in recent months, the trade performance for most of 1966 has been very good. The overall surplus on trade account has more than offset a heavy net outflow of long-term capital. Official reserves have declined moderately, but private foreign exchange holdings have increased and short-term foreign liabilities have fallen, with the result that net liabilities declined \$362 million during January-September this year.

Economy Recovers Faster than Expected

Last January the Government forecast an 8 per cent increase in industrial production for fiscal 1966. ^{1/} The pace of economic recovery turned out to be faster than anticipated and in October the Government increased its forecast to 14.5 per cent. Even this figure, however, may be a bit on the low side since the increase will actually be 16 per cent if the rate of increase in April-October is maintained through the coming March. In October, industrial production, seasonally adjusted, was 18 per cent higher than a year earlier, and 16 per cent higher than the previous peak level reached in September 1966.

^{1/} April 1, 1966, to March 31, 1967.

Since the fourth quarter of last year an increasing proportion of production capacity has been utilized. Data on production utilization indicate that between the third quarter of 1965 and the same period in 1966, the operating ratio index rose from 96.0 to 108.1 (1960 = 100). The operating index is a ratio of the seasonally adjusted production index to a production capacity index.

Industrial production has generally been rising since a low was reached in October of last year. Since then the most rapid gains have occurred in the production of producer goods and durable consumer goods. Increases in output have been particularly large for iron and steel, machinery, chemicals and petroleum products.

Adjustments indicative of economic recovery have also been taking place in shipments and inventories. After remaining relatively level in the first half of 1965, the index of producers' shipments, seasonally adjusted, began to rise in August and by October of this year had increased 18 per cent. Producers' inventories generally declined from September of last year through July of this year, and have since increased slightly. Raw materials inventories, which had been relatively stable for two years, began to rise slowly in March of this year, increasing 6 per cent through October.

Business Performance Improves

Along with the recovery in output, the corporate sales and profit picture has also improved substantially. A survey of 539 major corporations, comprising 43 per cent of the companies listed on the

Tokyo stock exchange, indicates that during the April-September period this year, sales increased 9 per cent over the previous six-month period. This contrasts with a rise of only 4 per cent in the October 1965-March 1966 period over the previous six months. The gain in profits was even sharper. They rose 28 per cent in April-September of this year, in contrast to a gain of only 4 per cent during the previous six months. The ratio of profits to capital was also higher in April-September, reaching 13 per cent, as compared to a 10 per cent ratio in the previous six months.

Business has also improved this year for smaller firms, though not as noticeably as for the larger firms. In a survey of 5,281 firms, 74 per cent reported increased orders and better sales during the July-September period as compared to a year earlier. Only 44 per cent, however, reported increases in profits.

Business bankruptcies, both in terms of number and the amount of debts involved, continued to decline during 1966. During the first nine months of this year, the average number of monthly bankruptcies was 481, in contrast to 512 in 1965. The average amount of monthly debts involved fell from ¥47 billion in 1965 to ¥30 billion in January-September this year. A sharp jump occurred in October, however, when the number of bankruptcies was 578 involving ¥47 billion in debts.

Policy of Monetary Ease Continued

Recent interest rate trends and official policy statements indicate that the current easy money policy will be maintained in the coming months. Early in December, Governor Usami of the Bank of Japan told a conference of cabinet ministers that an easy money policy would be pursued in 1967 since the balance of payments outlook was still favorable. In a similar vein, the new finance minister, Mr. Mikio Mizuta, is reported to favor a further decrease in interest rates in order to improve both the financial position of corporations and to bring interest rate levels closer to those in the U. S. and Europe.

Bank credit in recent months has been expanding at a slightly faster rate than earlier in the year. Bank loans and discounts have generally been increasing at an annual rate of 14 per cent since mid-year in contrast to a rate of 13 per cent during the first half of this year. Money supply expansion, which averaged an annual rate of 15.5 per cent in August-October, has been erratic and has not registered a very clear trend.

The average interest rate charged by commercial banks has been declining and in October was 7.41 per cent. This contrasts with the previous high of 7.99 per cent reached at the end of 1964. Call loan rates have remained low and generally unchanged since October of 1965. Long-term interest rates have been lowered twice this year in January and

October, upon orders of the Government. Deposit rates have generally remained unchanged and the narrowing spread between these rates and bank lending rates has undoubtedly contributed to the poor profit performance of the large city banks.

General Account Budget Unbalanced

For the first time since 1950, the Japanese Government unbalanced the General Account Budget in January of this year, and financed the deficit by a series of issues of national bonds. This move was taken in order to stimulate the economy and speed economic recovery.

During the first quarter of this calendar year (the fourth quarter of fiscal 1965), ¥299 billion in national bonds were issued. ^{1/} For the current fiscal year, the Government plans to float about ¥730 billion in national bonds. Of this amount, about ¥710 billion is to be taken up by the private sector and ¥20 billion by the Government's Trust Fund Bureau. During the April-October period this year, the Government received ¥443 billion from the issue of long-term government securities. Excluding receipts from these issues from total revenue, only 92 per cent of government cash expenditures (as based on data for the Government's General Account and Special Accounts Budgets) of ¥5,762 billion were covered by cash receipts. For the same period a year earlier, cash receipts covered 96 per cent of total expenditures of ¥4,894 billion.

^{1/} Special legislation in January 1966 authorized the issue of ¥262.7 billion in January-March in national bonds. Actual issues were higher during the quarter because other types of central government bonds were also issued.

Complete data on the purchasers of these national bonds is not available, but it is known that the Trust Fund Bureau's holdings of government securities increased ¥164 billion during April-September of this year. The Trust Fund has reportedly been able to absorb this large amount of securities by selling off a substantial part of its holdings of other securities to the Bank of Japan.

The national bonds were formally listed on the Tokyo and Osaka exchanges on October 1, 1966. So far, however, transactions have been disappointingly low, averaging no more than about ¥10 million (\$27,800) daily. Lack of an active market is ascribed in part to the high minimum unit transaction that has been established of ¥1 million (\$2,780), in contrast to the average individual subscription of ¥300,000 (\$830).

On December 15 the Minister of Finance introduced a supplementary budget of ¥200 billion for fiscal 1966, mainly to meet a deficit in the foodstuff control special account due to last July's decision to raise the price paid to rice producers but not the price paid by consumers. Unlike last year when most of the supplementary budget was financed by the issuance of national bonds, most of this year's supplementary budget will be financed from an expected increase in tax revenues.

Less Expansionary Budget to be Introduced

The Finance Minister also indicated in mid-December that he would introduce a less expansionary budget in January of 1967 since the economy was already recovering faster than expected. The budget will

be less expansionary because bond issues are to be a smaller proportion of total revenues and government expenditures are not to be increased as much as last year. The General Account Budget will be increased only about 15 per cent (as against an 18 per cent boost last year) and the FLIP (Fiscal Loans and Investment Program) only 20 per cent (as against 25 per cent last year). National bond issues will be about ¥840 billion, and will provide a smaller proportion of total revenues than in fiscal 1966. Income tax rates will be reduced in fiscal 1967, but in view of the rapid rate of economic expansion projected, tax revenues are expected to register a substantial increase.

New parliamentary elections may be held early in 1967 and if this occurs, final adoption of the budget is likely to be delayed. In the interim, a provisional budget may be approved in the spring.

Substantial Rise in Wholesale Prices

With the recovery in economic output, wholesale prices have risen at a much faster rate than in earlier years. In November, the wholesale index was 4.5 per cent higher than a year earlier. For the year as a whole, it is estimated that wholesale prices will be up 3.8 per cent over 1965. This contrasts with annual increases of 1.8, 0.2 and 0.8 per cent in 1963, 1964 and 1965, respectively.

Part of the increase has been due to higher copper and rice prices, but these two products account for only a relatively small proportion of the rise. Price increases have been substantial for

raw materials, construction materials, and--on the consumption side-- for non-durable consumer goods. These are sectors where productivity gains are more difficult to achieve, and this may account in part for the upward pressures.

Consumer prices, on the other hand, have not increased as rapidly as in earlier years. In October the new, national consumer price index was 3.9 per cent higher than a year earlier, whereas in October of 1965 the index was 5.9 per cent higher than a year earlier. Since 1960, the consumer index has registered an average annual increase of about 6 per cent.

Money wages in manufacturing have been increasing slightly faster than in earlier years. During the first 10 months of 1966, seasonally adjusted wages were 11 per cent higher than a year earlier. The average annual increase in wages since 1960 has been about 10 per cent.

Japanese data on unemployment are not very good indicators of the degree of tightness or ease in the labor market, but newspaper reports indicate that labor is in short supply and some consideration is being given to encouraging immigration from nearby cheap labor countries.

Stock market prices have been weak since April 1, 1966, when a three-year high was reached. Although there have been occasional rallies, stock prices have generally declined and on December 5 the Dow Jones average reached a new low for the year, down 14 per cent from the April high.

A substantial part of the market weakness has been due to the possibility of large sales of stock by the two special stock-buying agencies created during 1964-65. Both agencies have been advised by the Bank of Japan to unload all of their stocks by March 1968. During the March-May period the two agencies reduced their holdings from ¥428 to ¥367 billion. Additional sales have been withheld since June because of the generally depressed state of the market.

Moderate Deterioration in International Trade Position

During 1965 and early 1966 exports continued to expand at a substantial rate while imports rose very slowly. In February, however, seasonally adjusted imports increased to a higher level and then rose substantially during August-November. Although exports continued to rise, imports increased faster and in October-November there was an average monthly deficit on trade account of \$42 million. This contrasts with an average monthly trade surplus of \$28 and \$23 million registered during the second and third quarters of this year, respectively. Exports in October-November were 20 per cent higher than in the same period a year earlier, but imports were up 27 per cent.

Although the seasonally adjusted trade data indicate a moderate deterioration in recent months, the unadjusted trade data for the first ten months of 1966 indicate that a trade surplus of \$1,730 million was achieved as against a surplus of \$1,456 million in the same period a year earlier. In the same period, both the deficit on services account and for transfers were higher in 1966, although by only \$54 million.

Net long-term capital outflow increased substantially this year, hitting \$558 million in the first ten months as against \$335 million in the same period a year earlier. Net short-term capital outflow, although higher this year, has remained relatively small. Although official reserves declined from \$2,107 to \$2,019 million through October, there was an increase of \$374 million in non-official reserves during the period. This has been reflected in a healthy rise in short-term foreign assets and an even larger decline in short-term foreign liabilities. Reserves rose \$25 million in November. During the first nine months of this year, the net excess of Japanese short-term foreign liabilities over assets fell from \$903 million to \$541 million. At the end of March 1965, the figure had been as high as \$1,268 million.

On the basis of January-September data, it now appears that the United States' trade deficit with Japan will more than double this year. During 1965 the U. S. exported \$2,058 million (f.o.b.) in goods to Japan and imported \$2,414 million (f.o.b.), or a difference of \$356 million. For 1966, exports are estimated at \$2.3 billion and imports at \$3.1 billion, or a difference of about \$800 million. Prior to 1965 the U. S. usually had a surplus in its commodity trade with Japan.

Because of the relatively low interest rates in Japan and the generally high rates in the U. S. and Europe, some Japanese importers have switched from dollar acceptance financing to yen acceptance financing. This helps explain in part the reduction in short-term foreign liabilities. The switch to yen financing has reportedly moderated in

recent months, and according to the Bank of Japan it has now virtually ended. The authorities, however, were sufficiently concerned about the switching to remove in August all interest rate ceilings on dollar import acceptances except for a rate of 8.125 per cent on three-month acceptances with letter of credit. Earlier in July all interest rate ceilings on Euro-dollars borrowed by Japanese foreign exchange banks were removed in order to give the banks greater flexibility in obtaining Euro-dollars.

The Economic Outlook

Official Japanese data are not yet available on the economic outlook for fiscal 1967, but many of the large city banks have published predictions. They foresee an increase in real GNP of about 9 per cent and a rise in plant and equipment investment of about 13 per cent. Wholesale prices are not expected to rise by more than 2 per cent, but consumer prices should rise at least 5 per cent. An 11 per cent rise in exports is forecast and about a 16 per cent rise in imports.

The predicted rise in wholesale prices may be on the low side in view of the relatively rapid rate of increase recently. The GNP growth rate is similar to the current rate, but the plant and equipment investment forecast represents a substantial rise over the 6 per cent currently anticipated in fiscal 1966. Although imports are forecast to grow more rapidly than exports, the import base is smaller, with the result that no substantial changes in international reserves are forecast.

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