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Recent Economic Developments in Japan,  
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Recent Economic Developments in Japan--October-December 1963Summary

During 1963 the Japanese domestic economy continued to recover from its third balance of payments crisis in the past decade. Industrial production rose steadily from January through October of 1963, increasing 18 per cent over the December 1962 cyclical low. Since the spring of 1963, inventories of finished goods and raw materials have been rising, as well as the level of outstanding orders for machinery.

The domestic recovery has been accompanied by a rapid rate of credit and monetary expansion, financed largely by an inflow of foreign exchange and a reduction in the deposits of financial institutions and the Government with the Bank of Japan. In the year ending September 1963, money supply rose 38 per cent compared to a 12 per cent rise in the same period a year earlier. This has created upward pressures on prices, with wholesale and consumer prices currently rising at annual rates of 3 and 8 per cent, respectively. Despite these inflationary pressures, the stock market has remained depressed, down about one-third from the postwar high in July of 1961.

In addition to the problem of excessive credit and monetary expansion domestically, Japan also finds itself currently facing several balance of payments problems. These include a widening deficit on trade account, a rising volume of payments for services not matched by rising receipts, and a problem of obtaining sufficient amounts of foreign capital.

Explicit concern with the balance of payments situation was openly evidenced in December when the Bank of Japan doubled the reserve requirements of the large city banks. Further tightening measures appear likely in 1964, unless the balance of payments shows marked improvement. Such a development appears

unlikely in view of the commitments Japan has made to liberalize further as it joins the O.E.C.D. in February or March, and moves to Article VIII status in the I.M.F. in April. The Japanese, however, have demonstrated their ability three times in the past decade to take strong measures to restore equilibrium and it is likely that they will do so again should such action be necessary.

Economy in expansion phase of cycle

During 1963 the Japanese domestic economy continued to recover from its third balance of payments crisis in the past decade. Industrial production reached a low at the end of 1962 and then rose steadily during the first ten months of 1963. (See Table 1). In October the index was 18 per cent above the cyclical low in December 1962. Output increased substantially in most sectors except for utilities, mining and lumber.

Table 1. Japan: Industrial Production 1960--October 1963<sup>1/</sup>  
(Index numbers, 1960=100, seasonally adjusted)

	<u>1960</u>	<u>1961</u>	<u>1962</u>	<u>1963</u>
January	91.3	111.2	130.8	128.2
February	94.0	110.4	127.6	131.0
March	95.2	113.5	130.2	130.7
April	97.4	114.5	130.5	136.5
May	97.5	116.8	130.7	136.6
June	98.1	118.8	129.6	136.9
July	100.2	121.6	128.3	143.6
August	102.1	123.7	129.5	144.2
September	103.9	123.4	129.7	148.2
October	105.0	125.8	128.6	149.8
November	107.6	126.5	128.6	
December	107.6	127.5	127.3	

<sup>1/</sup> Mining and manufacturing.

SOURCE: Economic Statistics Monthly, Bank of Japan

The level of outstanding orders for new machinery hit a peak in November of 1961 and fell through April of 1963. There was a general uptrend in the following

six months and in October the index was 5 per cent above the cyclical low. This is a somewhat slower rate of recovery than the 8 per cent rise that occurred over the same time period in the previous cycle.

Raw materials inventories reached a peak in February of 1962 and then declined through March of 1963. Since then there has been a general, though somewhat uneven rise, and in October the index was up 10 per cent from the March cyclical low. Producers' finished goods inventories declined only moderately and briefly during January-April of 1963 and in October were at the same level as the January 1963 peak. Producers' shipments reached a plateau in April of 1962 and changed relatively little through January of 1963. There has been a general rise since, with the October index up 14 per cent over the January level.

#### Problems caused by excessive credit expansion

Japan's economic recovery in 1963 was accompanied by a rapid rate of credit expansion and a continuation of the earlier rise in international reserves. This contributed to upward pressures on prices relatively early in the cycle and to a widening trade deficit as imports rose more rapidly than exports. The monetary authorities showed their concern with the balance of payments situation in December of 1963 by raising commercial bank reserve requirements.

In October of 1963, commercial bank credit was 25 per cent higher than one year earlier. In contrast, commercial bank credit rose only 17 per cent in the year ending October 1962. This more rapid rate of credit expansion has been reflected in the money supply which increased 38 per cent in the year ending in September 1963 compared to a 12 per cent rate of expansion in the previous twelve months. Time and savings deposits rose substantially in 1963. The net impact from other sectors, as reflected in "Other Accounts," has been relatively minor.

Table 2. Japan: Factors Changing Money Supply<sup>1/</sup>  
(In billions of yen)

	<u>Year ending 9/30/62</u>	<u>Year ending 9/30/63</u>
1. Total Money Supply	+ 539	+1,878
2. Loans of Financial Institutions	+2,327	+4,094
3. Change in Time & Savings Deposits	-1,738	-2,370
4. Treasury Operations Excluding Foreign Exchange Fund	- 74	- 1
5. Operations of Foreign Exchange Fund	- 73	+ 168
6. Other Accounts	+ 97	- 13

<sup>1/</sup> Plus indicates a factor expanding money supply, minus, a factor contracting money supply.

SOURCE: Economic Statistics of Japan, Bank of Japan

The unusually large expansion of money supply in the year ending September 1963 was due mainly to a reduction in the deposits of financial institutions and the government with the Bank of Japan, and to the inflow of foreign exchange. These developments combined to expand the credit base by ¥364 billion. The Bank of Japan reduced its loans and discounts during this period but it made substantial investments in securities. Net central bank credit outstanding rose by ¥22 billion. The reduction in deposits of financial institutions with the Bank of Japan came about as a result of a reduction in commercial bank reserve requirements on November 1, 1962, and sharp reductions in import deposit requirements in October and December 1962. There has also been a decline in the ratio of currency in circulation to deposit money over the past year. The ratio in September 1963 was 1 to 4.3, compared with 1 to 3.3 a year earlier. The smaller drain of funds into currency has contributed to the large expansion of money supply.

The purchase of debentures by the Bank of Japan, offset largely by reductions in loans and discounts, reflected an effort by the Bank to reduce the importance of its discount window operations and to introduce open market operations. The scope for the latter is limited by the fact that Japanese commercial banks hold very few government securities, and so the Bank of Japan has chosen to invest in high grade debentures, including those of government corporations. Net purchases of such securities totaled ¥211 billion in the first eleven months of 1963.

The substantial rise in credit and money supply has contributed to some of the sharpest advances in prices in the past decade. Wholesale prices in November were up 3 per cent over the same month a year earlier. During Japan's previous recovery in 1958, wholesale prices rose only 0.9 per cent in the first eleven months of the recovery. In this latest cycle, the rise was 2.9 per cent.

Consumer prices have continued to rise much faster than wholesale prices and this rate of increase was an important issue in the latest Japanese elections

in November of 1963. Consumer prices for 28 major cities in October were up 8 per cent over the same month a year earlier. Except for a 9 per cent rise in 1961, as measured on a December-to-December basis, this is the highest rate of increase in a decade. During 1954-62, the average December-to-December increase in consumer prices was 2.7 per cent. Further details are provided in Table 3.

Table 3. Japan: Price Indexes - 1961-63  
(1960 = 100)

	<u>Wholesale Prices</u>	<u>Consumer Prices</u>	<u>Export Prices</u>	<u>Import Prices</u>
1961 - December	100.8	110.2	97.7	99.2
1962 - March	99.6	110.7	98.0	99.5
June	98.7	112.1	98.0	98.9
September	98.7	112.8	97.3	97.1
December	99.4	115.6	98.8	98.6
1963 - March	100.5	119.3	102.5	101.5
June	101.2	122.2	102.8	104.1
July	101.1	122.6	102.1	103.5
August	101.3	121.0	102.0	103.2
September	101.5	123.0	101.9	103.3
October	101.9	122.6	102.0	104.7
November	102.2	n.a.	n.a.	n.a.

SOURCE: Economic Statistics Monthly, Bank of Japan.

Although both import and export prices have been rising, as shown in Table 3, import prices have risen somewhat faster since the spring of 1963, indicating a deterioration in Japan's terms of trade. In October, the import price index was up 7 per cent over a year earlier, compared to a 4 per cent rise for the export index.

The general domestic recovery since December of 1962 has not yet stimulated a recovery in the stock market. Stock prices reached a postwar peak in July of 1961--about the time when the authorities realized that Japan faced another serious balance-of-payments crisis--and have generally been trending down since. The announcement in July of 1963 by the United States of a proposed interest

equalization tax merely caused an already weak market to weaken further. Although corporate profits have improved during the recovery period, this has not been reflected in a new uptrend in the market. The widening deficit on trade account in recent months and a tighter domestic monetary policy in December have probably contributed to the continuing weakness of the market.

Tight money policy officially established

During the last half of 1963 the Bank of Japan took progressive steps to restrain credit expansion, with a tight money policy being explicitly stated in December. Beginning in July, the Bank announced that it planned to follow a "more neutral" policy which in effect meant a policy of mild restraint. This took the form of less generous credit accommodation for the commercial banks.

Beginning in September, Bank of Japan credit operations, both in terms of direct credit and securities operations, had a net contractionary impact on the economy. During the September-November period this amounted to ¥237 billion. In October, the credit quotas of the major banks at the Bank of Japan were reduced 5 per cent.

By early December it was evident to the Bank of Japan that the balance of payments performance was a matter of serious concern. The Bank is reported to have desired an increase in the discount rate, but there were political objections to this, and the Bank confined itself to raising commercial bank reserve requirements. Effective December 16, the reserve requirements for the larger banks were doubled for all deposit liabilities except time deposits, the latter remaining unchanged. This meant an increase from 0.75 and 1.5 per cent for certain banks, to 1.5 and 3.0 per cent, respectively. At the time of the increase, Bank of Japan officials are reported to have said that the action was prompted by the rapid expansion of credit, the unfavorable trend in the balance of payments, and the upward

trend in prices.

Although the Japanese monetary authorities have been pursuing an increasingly tight monetary policy in recent months, this has not yet been reflected in an increase in the average level of commercial bank interest rates. Through September of 1963, the average interest rate for commercial bank loans and discounts continued to decline, reaching 7.68 per cent. This compares to the September 1962 peak of 8.24 per cent.

Increasing balance-of-payments difficulties

Rather early in the recovery period of this latest cycle, Japan has been confronted with several serious developments in its balance of payments. These include a widening deficit on trade account, a rising volume of payments for services not matched by rising receipts, and a problem of continuing to obtain foreign capital in sufficient amounts and on reasonable terms.

Following the tight money policy inaugurated in July and September of 1961, the balance of payments showed steady improvement during the first nine months of 1962. As shown in Table 4 below, the trade deficit was smallest in the third quarter of 1962. As the monetary restraints were relaxed in October of 1962 and subsequent months, the deficit continued to widen. By October and November of 1963, the monthly deficits were at the very high level of \$1.9 billion, seasonally adjusted annual rate. Japan is likely to have difficulties financing a deficit of this size for very long. The gap between imports and exports will have to be narrowed.

Table 4. Japan: Foreign Trade, Seasonally Adjusted, 1961-63  
(In millions of dollars; monthly average or month)

<u>Quarter</u>		<u>Imports c.i.f.</u>	<u>Exports</u>	<u>Balance</u>
1961	I	430	346	--84
	II	473	348	-125
	III	506	355	-151
	IV	531	362	-169
1962	I	496	375	-121
	II	474	407	- 67
	III	448	430	- 18
	IV	460	420	- 40
1963	I	490	412	- 78
	II	551	441	-110
	III	571	465	-106
<u>Month -- 1963</u>				
	June	532	436	- 96
	July	573	438	-135
	August	587	488	- 99
	September	552	468	- 84
	October	652	488	-164
	November	633	478	-155

SOURCE: Economic Statistics of Japan, Bank of Japan.

The main problem on trade account is that imports have risen faster than exports. Although exports in October-November were up 15 per cent over the same period a year earlier, imports were up 41 per cent.

Another problem facing Japan is that of rising payments for services not matched by a similar rise in receipts on service account. During the first ten months of 1963, total payments for services, excluding transportation, as measured on an exchange transactions basis, were up about \$150 million or by about 20 per cent compared to the same period a year earlier. On the other hand, receipts for services for the same periods were up only \$53 million or by 8 per cent. This meant an additional net expenditure of \$97 million in the first ten months of 1963

compared to the same period a year earlier.

There are several factors accounting for this rise in net payments for services. Japan has continued to negotiate many technical assistance contracts with foreign companies. The burden of royalty and other payments in connection with these contracts has accumulated and increased through the years. In recent years the Japanese have borrowed substantial sums overseas, both on a long-term and a short-term basis, and the burden of servicing this debt has risen along with the total amount of debt outstanding. Also, United States procurement in Japan has tended to decline in recent years.

In addition to the problems on trade and service account, Japan also faces a problem of raising sufficient foreign capital to meet its needs in the coming months and years. The interest equalization tax proposed by the United States has caused American investment in Japanese securities to drop sharply. Except for a few issues previously scheduled, there have been no known public or private placements of Japanese securities in the U. S. since September 1963. Foreign purchases of Japanese stocks, whether directly or through the stock market, have declined sharply since July. Such purchases totaled \$34 million in August-October of 1963 compared to approximately \$120 million in May-July of 1963. The Japanese are still planning, however, to float about \$52 million in public securities in the U. S. once the U. S. Congress has acted on the interest equalization tax.

As a result of this problem and the expense in obtaining capital from the U. S., Japan has turned actively to the European capital market. Although several new issues were floated in London in December totaling \$10 million, the Japanese have indicated that the European market will not be able completely to fill the void caused by the interest equalization tax. The Japanese have accordingly turned to the World Bank for additional loans beyond those that had been originally planned.

They are reported to be seeking \$140 million in new loans in 1964 from the World Bank.

As a result of these developments, the upward trend in reserves was halted in the last half of 1963 when reserves more or less leveled off. After a steady rise since January of 1962, reserves fell \$24 million during the last half of 1963. (See Table 5).

Table 5. Japan: Official International Reserves 1960-63  
(In millions of dollars, end of month)

	<u>1960</u>	<u>1961</u>	<u>1962</u>	<u>1963</u>
January	1,328	1,885	1,510	1,884
February	1,321	1,937	1,514	1,856
March	1,361	1,997	1,561	1,863
April	1,385	2,035	1,559	1,878
May	1,419	1,966	1,586	1,894
June	1,451	1,912	1,623	1,902
July	1,505	1,837	1,635	1,883
August	1,569	1,721	1,648	1,909
September	1,658	1,610	1,720	1,906
October	1,717	1,506	1,805	1,922
November	1,760	1,489	1,793	1,911
December	1,824	1,486	1,841	1,878

SOURCE: Economic Statistics Monthly, Bank of Japan.

### The economic outlook

For the past year Japan has been experiencing a new economic upswing, but recent balance-of-payments problems may mean that the pace of this recovery will have to be moderated. Nevertheless, Japan is taking important steps toward full convertibility of the yen in the near future.

In February or March of this year Japan is expected formally to become a member of the Organization for Economic Cooperation and Development. On November 20, Japan removed restrictions on 50 of the 64 O.E.C.D. liberalization items upon which it had previously pledged itself to take action. On the basis of the 1959

composition of commodity trade, Japan has achieved a 92 per cent degree of liberalization. The O.E.C.D. can be expected to press Japan for further liberalization on current-account transactions.

Japan has also committed itself to move to Article VIII status in the International Monetary Fund on April 1, 1964. This will involve additional liberalization, particularly with respect to restrictions on sales of foreign exchange for travel abroad. The Government fears the sudden emergence of a heavy expenditure for tourist travel and is currently considering imposing a "travellers tax" on departing Japanese in order to keep such expenditures down. It has been reported that, beginning in April of this year, overseas Japanese tourists will receive a maximum foreign exchange allocation of \$500 excluding travel expenses.

In conclusion, Japan will be assuming new commitments in the near future with a much less healthy balance of payments situation than a year and a half earlier. Foreign liabilities have continued to remain large and a considerable portion of the gain in international reserves in 1963 reflected an increase in these liabilities. On the positive side, Japan has demonstrated three times in the past decade that it can take strong, corrective measures to deal with economic disequilibrium when the occasion arises. There is no reason to doubt that Japan will do so again when the circumstances clearly call for forceful action.

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