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RFD 476

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Division of International Finance

REVIEW OF FOREIGN DEVELOPMENTS

March 17, 1964

Recent Economic Developments in Japan,
January - March 1964

4 pages

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Summary

Although the Japanese domestic economy has continued to advance, the balance of payments has deteriorated. Policies of monetary restraint, begun last summer, have so far failed to slow the foreign exchange drain, but stronger action was taken on March 18 when the Bank of Japan's basic discount rate was raised 0.73 percentage points to 6.57 per cent. The Japanese have increased their borrowing from Europe and have arranged a $305 million standby credit with the IMF.

Worsening balance of payments problem

The Japanese balance of payments showed signs of further deterioration in January and February. International reserves continued to decline; the trade deficit reached an all-time high in January; there was an accelerated rise in foreign short-term indebtedness; and the general trend in net long-term capital receipts has been down. In addition to these developments, the Japanese are also confronted with a rising volume of payments for services not matched by rising receipts.

Last October, Japan's international reserves reached a peak of $1,922 million after having increased $436 million from a low at the end of December 1961. In the following four months, reserves dropped by $121 million to $1,801 million at the end of February. The decline in January and February was $23 and $54 million, respectively.

Japan's seasonally adjusted trade deficit reached an all time high of $242 million in January or $2.9 billion at an annual rate.

Although the deficit was $176 million in February, this is still substantially above the monthly averages in the third and fourth quarters last year of $120 and $154 million, respectively. The deficits have been due to a much more rapid expansion of imports than exports.

Japanese short-term debt to U. S. banks increased $107 and $154 million in November and December, respectively. This is equivalent to about two-thirds of the total rise in such indebtedness during 1963, and reflects primarily a rise in import acceptance financing.

Continuing rise in domestic output

Industrial production has been rising since early 1963 and increased a further 2.4 per cent in January on a seasonally adjusted basis. This brought the index to a level 21 per cent above that of a year earlier. Output rose substantially in most sectors except for mining, food products, lumber and ceramics.

Both the level of outstanding orders for new machinery, and producers' inventories of finished goods, seasonally adjusted, reached cyclical lows in April of last year and then rose 8 per cent during the May-December period. Raw materials inventories were at a cyclical low in March last year and then rose 11 per cent through October. During November-December inventories remained relatively stable.

Credit and monetary expansion appear to have slowed slightly in recent months and prices have stabilized. Bank credit rose 5.8 per cent in the fourth quarter last year, compared to 6.2 per cent a year earlier. Bank note issue, seasonally adjusted, was up 1.2 per cent in January against 1.4 per cent in December. Wholesale prices reached a high last November and then declined steadily through February, down 0.4 per cent. Consumer prices appear to have been relatively stable since last October.

Whereas the Japanese Government is counting on an increase in real GNP in the fiscal year ending March 31, 1965, only slightly less than that in the previous year, the actual rate of growth may be less than predicted because of the recent measures of monetary restraint. Even the official estimate of a 7 per cent rise in real GNP in the coming fiscal year indicates that the authorities do not expect much increase above the rate of activity that appears to have been attained in the final quarter of the current fiscal year.

Recent measures to deal with the balance of payments problem.

As early as last July the Japanese began to take some measures to improve the balance of payments. Bank of Japan credit accommodation for commercial banks was reduced somewhat, and in October and November, the bank carried out operations involving net sales of securities. On December 16, the reserve requirements for banks were doubled for all deposit liabilities except time deposits. In January, the Bank of Japan announced that during the first quarter of 1964 credit expansion by the 13 large city banks would be limited by means of "window guidance" operations to an amount 10 per cent less than a year earlier. The expansion is expected to be limited to 2.8 per cent of the outstanding loan balance of these banks at the end of 1963.

As of March 18, the bank of Japan increased its basic discount rate from 5.84 to 6.57 per cent. During the previous period of monetary relaxation the rate was lowered in four steps from 7.3 per cent on October 27, 1962, to 5.84 per cent on April 20, 1963. The Japanese also increased the advance import deposit requirements, from 1 per cent to 5 per cent for raw materials and industrial machines, and from 5 per cent to 35 per cent for foodstuffs and specified nonessential imports.

Because of the proposed U.S. interest equalization tax, the Japanese have turned actively to the European capital markets to meet part of their long-term needs. Since August of last year, $71 million has been raised in Europe (including conversion of an 1899 bond issue), and Japan reportedly expects to borrow there an additional $115 million during the rest of 1964.

Because of current pressure on international reserves and the decision to move to an Article VIII status in the IMF on April 1, the Japanese have grown apprehensive of a continuation of the drain on their reserves. They have various resources, however, that could be utilized to bolster the reported reserve figures. These include use of the $305 million IMF stand-by arrangement approved on March 11, 1964, use of the $150 million Federal Reserve "swap" arrangement, and borrowing from U.S. banks. It is not yet clear whether the series of measures taken to date will be sufficient to restore balance-of-payments equilibrium, but past experience suggests that the pressure on reserves will now ease somewhat. Further action may be required this year, including use of some of the resources indicated above.