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Recent Economic Developments in Japan,
October-December 1964

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RECENT ECONOMIC DEVELOPMENTS IN JAPAN, OCTOBER-DECEMBER 1964

Summary

The fourth quarter was marked by a formal easing in Japan's tight money policy as commercial bank reserve requirements were lowered in December and the Bank of Japan's basic discount rate was reduced in January. Credit and monetary expansion continued to slow through October and November, but there were signs of some retrogression in the trade balance on a seasonally adjusted basis. On an unadjusted basis, however, there was a trade surplus in November-December, and international reserves turned up during this period.

Production fell 2 per cent in November, but the October-November average was still 1.3 per cent above the third quarter average and 13 per cent above the level a year earlier. Wholesale prices rose moderately through the last half of the year and inventory levels failed to decline during 1964 in response to the tight money policy. Heavy stock-buying operations, financed in part by the Bank of Japan, were unsuccessful in halting a decline in over-all stock market prices in the fourth quarter.

Mild Deterioration in the External Sector in Recent Months

Primarily as a result of the tight money policy instituted late in 1963 and reinforced in early 1964, Japan's balance of payments tended to register a steady improvement in the January-August period

last year. But since September, both trade and current account data on a seasonally adjusted basis indicate that there has been a moderate regression. This mild deterioration was not evident in the unadjusted data in the fourth quarter since exports are seasonally strong, and imports weak, during this period.

The seasonally adjusted trade deficit fell from \$548 million in the first quarter of 1964 to \$192 million in the third quarter. However, the average monthly trade deficit rose moderately to \$233 million in the fourth quarter. Although exports were 11 per cent higher in fourth quarter than in the previous quarter, imports were up 12 per cent over the same period. Imports generally trended down last year through August, but have since risen substantially, and as indicated above, at a faster rate than exports. Presumably part of this expansion reflects a moderate easing in September of advance import deposit requirements and efforts to build up inventories in view of their relatively low level in relation to rising economic activity.

Similarly, the current account in the balance of payments registered a general improvement from late in 1963 through August of 1964, but since then has shown a moderate deterioration. The seasonally adjusted balance on current account changed from a deficit of \$318 million in the fourth quarter of 1963 to a surplus of \$25 million in the June-August period in 1964, but then registered a deficit of \$100 million in the September-November period. This latest deterioration

has been due to a more rapid rate of increase in payments than in receipts, in part as a result of developments on trade account.

This mild deterioration since September has not yet shown up in Japan's international reserve figures since this period was one of seasonal strength and the reserve figures reflect in part the trade performance on an unadjusted basis. Reserves reached a 1964 low of \$1,906 million at the end of October, down \$196 million from their previous peak at the end of October 1963. In November they rose \$18 million and in seasonally strong December, a further \$75 million to a level of \$1,999 million. Reserves would have increased even more during the September-November period except for \$80 million in repayments during this period against an earlier Federal Reserve swap drawing.

Japan continued to experience net outflows of short-term capital in October and November, thus continuing the trend begun in July. These more than offset the net receipts of long-term capital in July-October, but in November long-term receipts were slightly larger. Normally Japan experiences a loss of Euro-currencies in December, but last year there was a moderate gain, due mainly to a flight from assets denominated in sterling. The Ministry of Finance raised the recommended rates that Japanese foreign exchange banks may pay on Euro-dollars in November and early December as a result of a change in the United Kingdom's bank rate and other interest rate changes. During the last half of December, however, the rates were lowered to approximately the level prevailing at mid-year.

Rate of Credit and Monetary Expansion Continues to Slow

Credit and monetary expansion slowed further in the fourth quarter, continuing a trend since early in 1964. The liquidity squeeze--partly evident in the third quarter--intensified in the fourth quarter, and the rate of business bankruptcies rose to new highs.

Bank credit rose at a decreasing rate during the January-October period last year. Loans and discounts of commercial banks, seasonally adjusted, rose 14 per cent during this period compared to 23 per cent a year earlier. The increase in money supply was also much slower. During the January-September period, seasonally adjusted money supply rose 9 per cent against 30 per cent a year earlier.

While this relative reduction of credit availability served to raise commercial bank lending rates moderately in the first half of 1964, the average rate tended to stabilize during the July-October period. Following the institution of tighter money policy in late 1963, the average bank interest rate for loans and discounts rose from a low of 7.67 per cent in February of 1964 to 7.99 per cent in July, where it remained through October. Interest rates in the call loan market remained relatively stable in the fourth quarter, but then fell sharply in the first week of January in line with the usual seasonal trend at that time of the year. The unconditional call loan rate (repayable at a day's notice) fell from 10.95 per cent in late December to 8.76 per cent in early January. With the cut in the central bank's discount rate on January 9, the rate fell further to 8.4 per cent.

In spite of the generally tighter monetary policy prevailing throughout most of 1964, wholesale prices tended to rise during the last half of the year. The wholesale price index declined 1.4 per cent from a peak in November of 1963 through June of 1964, but it crept up 0.7 per cent in the last half of the year. After remaining relatively stable from mid-1963 through March of 1964, the cost of living index rose 3.6 per cent during the April-November period. Price gains were registered mainly in metal, chemical and lumber products. Money wages rose at a moderately lower rate in the January-September period in 1964 than a year earlier, with the result that wage gains were brought closer to productivity gains. During the last half of 1963, wage increases exceeded the rise in productivity, but during the first half of 1964 both rose at approximately the same rate.

From the previous cyclical low in April 1963 through November of 1964, total inventories increased steadily, rising 28 per cent. Raw materials inventories, on the other hand, leveled off after January of 1964 and remained at about the same level through November. Inventories of imported raw materials fell moderately in June-August and then rose moderately in September-October. However, in contrast to previous cycles, seasonally adjusted inventories of producers' goods failed to decline in 1964 in response to the tight money policy. These developments indicate that inventory adjustments in response to the tighter money policy of 1964 have been very moderate.

The stock market remained at a low level during the fourth quarter, with the stock price average of 225 stocks holding above the ¥1,200 level only by extensive support-buying operations of the Japan Joint Securities Company, financed in part by the Bank of Japan. These operations, however, failed to stem a decline in the overall market value of all listed stocks in December, and in January a second cooperative company was formed to help support stock prices. Entitled the Japanese Securities Holding Association, it will purchase about ¥200 billion (\$556 million) of the less important stocks in January-February and will hold them off the market for up to three years. The market reacted favorably to this development. The stock average rose .5 per cent in the first five days of trading in January and tended to remain at this higher level through mid-January. In November, the Bank of Japan provided ¥100 billion in credits to the J.J.S.C., and it is reported to have committed an additional ¥100 billion in credit to the new J.S.H.A.

Tight Money Policy Relaxed in December and January

Although the Government stated in August that it would maintain its tight money policy through the end of 1964, the Bank of Japan relaxed the policy in December and January by lowering reserve requirements and the Bank's basic discount rate. These actions were reported to be prompted by an improved foreign trade performance, the high rate of business bankruptcies, and the desire to stem the spread of a recession

psychology. Several moderate actions had already been taken earlier to ease the temporarily tighter money policy. These included a partial lowering of advance import deposit requirements in September, the extension of substantial central bank credits to support the stock market, and an easing of commercial bank credit ceilings in December.

The reduction of commercial bank reserve requirements against demand deposits by approximately one-half on December 16--from 3.0 to 1.5 per cent for large banks--is reported to have reduced commercial bank deposits at the Bank of Japan by about ¥90 billion from the end of November level of ¥220 billion. Governor Yamagiwa, who was reportedly cautious about easing the monetary policy, resigned suddenly on December 17. He was immediately succeeded by Makoto Usami, President of the Mitsubishi Bank. On January 9, the Bank's basic discount rate was cut from 6.57 to 6.21 per cent, or halfway toward the 5.84 per cent level prevailing prior to the establishment of the tight money policy. These actions still left in force the restraints from both the advance import deposit requirements and the quarterly credit expansion quotas for the large city banks.

Stable Growth Forecast

Newspaper reports suggest that the Bank of Japan may act again in March or April to lower further its basic discount rate. Further easing would probably complicate the problem of maintaining balance in Japan's international accounts. However, the Economic Planning Agency

believes that the trade deficit will narrow substantially in the fiscal year ahead. The agency projects a gain of 12.5 per cent in exports and 9.8 per cent in imports during fiscal year 1965 (April 1965-March 1966). It is not clear whether this projection, which was made in December, took the subsequent relaxation of monetary policy into account. Since import growth has been relatively restrained during the past year, they may show greater buoyancy under a relaxed policy than the official project assumes.

For the economy as a whole, the Agency is predicting a 7.5 per cent gain in real GNP during fiscal 1965 compared to an expected gain of 9.4 per cent in fiscal 1964. The E.P.A. estimates have generally been on the low side and it appears likely that this may again be the case this year. Consumer spending is expected to increase at a slightly lower rate, and private investment at a higher rate, than last year.

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