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Recent Economic Developments in Japan,
January-March 1965

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Summary

Japanese industrial activity rose at a slower rate in the fourth quarter last year and declined slightly in January-February of this year. Bank credit also expanded at a slower rate through January, but money supply accelerated as the Bank of Japan and the central government supplied increased funds to the business community. Consumer and wholesale prices continued their earlier advance. The near bankruptcy of a large steel firm in March contributed to a decline in stock prices below an earlier support level, and these developments have reportedly contributed to a more cautious lending attitude on the part of commercial banks. In general, the outlook is for a continued moderate rise in economic activity.

On the international side, the balance of payments continued to improve in recent months. In January-February there was a very sharp improvement in the trade balance in contrast to the mild deterioration that occurred in the fourth quarter. The capital account was in surplus during January-February, compared to a deficit in the previous two months. Should the recent improvement in the trade account continue through the year, it should assist in countering to some extent the impact from recent measures to reduce the deficit in the U.S. balance of payments which are likely to decrease somewhat the availability of foreign capital.

Econcmic Advance Marred by Company Reorganizations

Japanese industrial production rose less rapidly in the fourth quarter last year and declined slightly in January-February from the December level. February output was 5 per cent higher than a year earlier, and 2.6 per cent below last year's high in October. In recent months, above-average gains were registered in the output of textiles, chemicals and non-ferrous metals. Primarily as a result of last year's tight money policy, industrial production on a year-end basis increased only 10 per cent in 1964 in contrast to a rise of 21 per cent in 1963.

Since early last fall, producers' inventories of finished goods, seasonally adjusted, have generally increased. This is counter to the usual cyclical trend of a leveling, or decline, in such inventories in response to a tight money policy. Mounting inventories have placed pressure on many corporations' financial resources and last year this contributed to lower profit margins. Raw materials inventories, also seasonally adjusted, remained relatively stable during the same period, a decline in imported raw materials inventories offsetting a rise in domestic inventories. In January, imported raw materials inventories (not seasonally adjusted) were at their lowest level since April of 1963 and were off 12 per cent from an earlier peak in June of last year.

The number of monthly bankruptcies rose steadily in 1964 and reached an all-time high in December. On the basis of firms with debts exceeding ¥10 million, the number of bankruptcies fell from 596 in December to 402 in January. They rose again to 521 in February, however, and are expected to set a record in March. In addition, a new unfavorable development was a spate of technical insolvencies for three major Japanese companies. All of this has created some uncertainty regarding the outlook for further business investment and growth. Early last December Nippon Special Steel indicated it was on the verge of bankruptcy by applying for reorganization under the Corporation Reorganization Law. Then in mid-December, Sunwave Industry, a large manufacturer of kitchen equipment, also took the same step. On March 6 the Sanyo Special Steel Company, with annual sales of $52 million and short-term liabilities of $133 million also moved to invoke the Corporation Reorganization Law. Major creditors included city banks and trading firms such as Mitsui Co., Mitsubishi Shoji, and C. Itoh & Co. as well as about 120 small firms which are reportedly on the verge of bankruptcy. Sanyo reportedly has overseas debts to three major foreign banks totaling $12 million. A major producer of special steel, Sanyo last year accounted for 60 per cent of the market for steel used in the manufacturer of ball bearings.

This illustrates the danger inherent in the high level of credit between business firms. This increased from $50.3 billion in mid-1964 to $54.7 billion at the end of the year. It is estimated that the end-of-March figure will total $55.6 billion. This volume of interfirm credit is very large, and is higher than the $46.8 billion in total loans and discounts extended by all banks in Japan at the end of 1964.

Continued Easing of Credit Restraints

The Bank of Japan continued to relax its credit policy during the first four months of this year. After lowering commercial bank reserve requirements in mid-December, the Bank of Japan reduced its basic discount rate from 6.570 to 6.205 per cent on January 9. In mid-March, the Bank announced that commercial bank loan ceilings for the second and third quarters this year would be relaxed. During the fourth quarter of 1964 and the first quarter of 1965, city banks were requested to limit their loan expansion to 78 and 99 per cent, respectively, of the actual expansion in the same quarter a year earlier. The rates for the second and third quarters this year have each been set at 115 per cent, and banks are now to observe the ceilings over a six-month, rather than three-month, period. On April 1, Japan also reduced advance import deposit requirements to the previous level prevailing on March 18, 1964. The rate for raw materials and industrial machinery was reduced from 5 to 1 per cent, and the rate for foodstuffs and specified non-essential imports was cut from 35 to 5 per cent. Effective April 3, the Bank of Japan again lowered its basic discount rate to 5.84 per cent thus returning it to the level prevailing prior to the inauguration of the tight money policy in December 1963.

In recent months, monetary expansion has accelerated. Money supply, seasonally adjusted, increased less rapidly through December of last year when it was up only 13 per cent over the level a year earlier, but in January it was 16 per cent higher than a year earlier. The average issue of bank notes, seasonally adjusted, also increased at a faster rate in both January and February of this year. However, loans and discounts of all banks, seasonally adjusted, continued to rise at a slower rate through January. Bank of Japan operations had a net expansionary impact of ¥113 billion in January-February in contrast to a net contractionary impact of ¥269 billion in the previous two months. Budget operations during the current fiscal year have generated a cash deficit and this trend is expected to continue during the next fiscal year beginning in April. While banks are thus experiencing an increase in their liquidity, there are indications that they are reluctant to expand credit at accelerated rates in view of the uncertainties regarding short-term business prospects.

In spite of the credit restraints in effect through last December, there has been a relatively moderate rise in prices. From a low in June of 1964, wholesale prices increased 1.2 per cent through February. After some stability in late 1963, consumer prices have generally risen since early 1964 and in February of this year were up 7 per cent over the level a year earlier. Money wages of workers in manufacturing rose 8 per cent on a year-end basis last year. This increase is identical with the rise in productivity as based on changes in the production and employment indexes.

Stock Market Average Falls Below Earlier Support Level

Despite the extensive efforts of two quasi-governmental stock-buying agencies to bolster prices last year and early this year, the Dow Jones 225 stock average fell below the ¥1,200 support level on March 8 to ¥1,191. The decline was attributed largely to the announced insolvency of the Sanyo Special Steel Company on March 6. During the rest of March the average remained below the ¥1,200 level, dipping as low as ¥1,110 on March 29. At the end of the month, the average was ¥1,133.

Bank of Japan credit extended to these two stock-buying agencies has been substantial, totaling approximately ¥350 billion (almost $1 billion). Last year the Bank reportedly extended ¥150 billion in credit to the Japan Joint Securities Company which began operations in January of 1964. This company raised funds totaling ¥230 billion which were used primarily to purchase stocks included in the Dow Jones average of 225 stocks. In January of this year the Japan Securities Holding Association was formed to purchase those stocks not included in the Dow Jones average. The Bank of Japan reportedly extended a loan of ¥150 billion at 7.3 per cent to this company. The company is reported to have purchased about ¥130 billion in stock during the January-February period.

Improving Trade Balance Possible Offset to U.S. Restraints on Foreign Borrowing

Turning to the international side, Japan's trade and international reserve position continued to improve during the quarter.

These favorable developments, however, may be somewhat offset later this year as a result of new measures announced by the U.S. in February to reduce the deficit in its balance of payments.

During the first quarter, international reserves rose $54 million to a level of $2,053 million. This reflected primarily an improved trade performance in January-February and the seasonally large, net receipts of short-term capital in January. On a seasonally adjusted basis, there was an average monthly trade surplus in January-February of $3 million in contrast to an average monthly deficit of $84 million in the previous two months. This was due to a rising level of exports and a lower level of imports. Thus the trade performance during the first two months of this year represents a very sharp improvement over the mild deterioration that occurred in the fourth quarter.

The current account balance, as measured on an exchange transactions basis, also improved during January-February. On a seasonally adjusted basis, there was an average monthly surplus of $62 million during January-February compared to an average monthly deficit of $14 million in November-December. Average monthly net receipts on capital account in January-February, not seasonally adjusted, were $59 million compared to an average monthly deficit of $12 million in the previous two months. Net long-term capital receipts have remained relatively stable since November, ranging between $26 and $32 million monthly. Net short-term capital flows have fluctuated sharply, however, and except for the seasonally heavy net receipts in

January, Japan has experienced net outpayments on short-term capital account since last July. Net short-term capital receipts and payments in January and February were, respectively, $128 million and $63 million, compared to average monthly net payments of $41 million in November-December.

In general, the Japanese reaction was favorable to the February announcement by the United States that Japan would receive a $100 million per year exemption from the Interest Equalization Tax (I.E.T.) on government and government-guaranteed issues floated in the U.S. This action helped to offset the impact of the U.S. administration's move on February 10 to apply the I.E.T. to bank loans abroad of one year or more, and to seek voluntary restraints on the expansion of foreign credit and investment on the part of financial institutions, investors and businesses.

According to official government estimates, Japan expects to obtain $250 million in net foreign capital receipts in fiscal year 1965 (April 1965-March 1966). During fiscal 1964, estimated net capital receipts were the same, or $250 million. Fiscal 1964 data are not yet available, but in calendar 1964 Japan received on a gross basis $618 million in short- and long-term credits from the United States. Security flotations in Europe brought in an additional $204 million last year. With a less favorable outlook for security issues in Europe, and the recent U.S. balance of payments measures, however, it would appear that Japan will have difficulty in obtaining as much foreign capital this year as last. Nevertheless, the official projections anticipate a net improvement on trade account sufficient to bring the payments position into balance during fiscal 1965.

The recent U.S. measures to reduce the balance of payments deficit had a moderate impact on Japanese foreign exchange markets and Euro-dollar holdings. The spot rate for the yen weakened in late February as the inflow from impact loans decreased dollar availabilities, and the yen continued to remain relatively weak during most of March. Japanese losses of Euro-dollars were relatively heavy early in March but negligible through March 25.

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