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Recent Economic Developments in Japan, April-June 1964

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RECENT ECONOMIC DEVELOPMENTS IN JAPAN, APRIL-JUNE 1964

SUMMARY

The tight money measures taken by Japan during the recent December-March period have increased the general level of interest rates, and slowed credit and monetary expansion. Industrial production appears to have been influenced by the tight money policy, and output has leveled off since February. The seasonally adjusted trade deficit has also narrowed since January, but, except for March, Japan has continued to lose international reserves. Japanese foreign borrowing has also continued to rise at substantial rates, and because of the favorable reception accorded Japanese issues in European markets, larger amounts than those originally scheduled have been floated in several cases.

Tight money policy beginning to take effect

There are now clear signs that the tight money policy instituted last December to reduce the pressure on international reserves has begun to take effect. To date the tight money measures have included: (1) a doubling of commercial bank reserve requirements for deposit liabilities other than time deposits (December); (2) the establishment of maximum quarterly credit expansion quotas for Japan's 13 large city banks (January); (3) an increase in the Bank of Japan's basic discount rate from 5.84 to 6.57 per cent (March); and (4) an increase in advance import deposit requirements from 1 to 5 per cent for raw materials and industrial machines, and from 5 to 35 per cent for foodstuffs and specified nonessential imports (March).

Since December there has been a slowing in the rate of expansion of both bank credit and the money supply. Bank lending rates stopped declining in January-February and increased in March, while call loan rates have generally risen since the end of December. The trade deficit has narrowed since January, and industrial production leveled off in March-April.

Commercial bank loans and discounts, seasonally adjusted, rose by 4 per cent in the first quarter compared with an average of over 5 per cent in each of the two previous quarters. Data for the 13 large city banks indicate a further slackening in the rate of credit expansion in April.

Interest rates in the call loan market began to firm last December and through mid-June showed a general upward tendency. The average rate for unconditional call money (repayable at a day's notice) rose from 7.3 per cent in late November to 10.6 per cent during the first half of June. The average interest rate for bank loans and discounts rose from 7.67 per cent in January-February to 7.73 per cent in March, the latest month for which data are available.

Price trends have been mixed. Wholesale prices declined by 1.2 per cent from November through May. Consumer prices, on the other hand, showed virtually no change in the five months ending February of this year, but then rose 2 per cent in March-April.

<u>Slower advance in industrial production</u>

Industrial production advanced rapidly in January-February of this year, but leveled off in March-April. From the previous cyclical low in January of 1963, industrial production rose 25 per cent through February 1964 on a seasonally adjusted basis. The gain in the first two months of this year exceeded 6 per cent. This was followed by a decline of 0.6 per cent in March and a 0.5 per cent rise in April, according to preliminary figures. This may mark the end of the rapid rise which pushed the index in April to a point 18 per cent higher than a year earlier.

Inventory data already show a response to the tight money policy, with one series registering a decline as early as February. Producers' inventories of finished goods, seasonally adjusted, rose steadily from a cyclical low in April 1963 through February of this year except for a dip in June of last year. In March and April, however, inventories fell below the February level, presaging a leveling off in response to the tight money policy. Raw materials inventories, after rising from the cyclical low in March of 1963 through January of this year, dropped below the January level during February-April. Reports from Japan indicate that businesses have been under pressure to cut prices and liquidate inventories. Bankruptcies in terms of the total value involved reached a record high in April, as did the total number of dishonored bills in May.

Despite an improvement in corporate profits since mid-1963, the stock market has remained relatively depressed. Since reaching a high for the year on April 5, 1963, the general market trend has been down. There were brief advances this year in January and May, but in mid-June, the index of stock prices was still 18 per cent below the April 1963 high.

Moderate improvement in trade balance fails to halt reserve decline

The trade balance since January of this year has shown a moderate improvement, but the deficit in May was still large for Japan. Despite this improvement, however, international reserves continued the general downtrend which began last November.

The seasonally adjusted trade deficit (customs basis) reached a peak of $188 million in January, the highest level since November 1961, and then narrowed to $136 million in May. The improvement reflected mainly an expansion in exports. Exports in April-May registered a 10 per cent gain over the monthly average in the fourth quarter last year. Imports were up only 3 per cent. The sharp rise in exports in recent months offers hope that the Japanese balance of payments deficit may be corrected without a steep decline in imports. Foreign markets offer favorable prospects. The primary producing countries are relatively well off as a result of the rises in commodity prices, and U. S. imports are on the rise. In addition, the Japanese are moving into European markets quite aggressively. They see good export possibilities there. Sales to the EEC in 1963 were 21 per cent higher than in 1962.

Although there have been substantial net receipts of both short-term and long-term capital, these have generally been smaller than the current account deficits, and since last October, Japan has lost reserves except in the month of March. At the end of May, reserves were down $172 million from the peak last October. In March, reserves rose $15 million, but in April they declined $21 million. The drop in May was $40 million, bringing the total down to $1,930 million.

Largely as a result of increased borrowing in European markets, Japan has continued to experience substantial net inflows of long-term capital. These ranged between $30 and $39 million monthly during the February-April period this year as measured on an exchange transactions basis. Net short-term capital receipts have also been substantial, and totaled $298 million in the first quarter and $74 million in April.

Japanese short- and long-term liabilities to U. S. banks continued to rise in January-April, although not as rapidly as in the fourth quarter of last year. Short-term liabilities increased $219 million in the first four months of this year, reaching a total of $2,368 million, or over 37 per cent of total U. S. bank-reported short-term claims on foreigners. Long-term liabilities to U. S.

banks increased $64 million in January-April of this year as against $102 million in the last quarter of 1963. At the end of April these liabilities totaled $307 million. A large part of Japan's long-term borrowing since July 1963, when the proposed interest equalization tax was announced, has taken the form of bank term loans with maturities for periods of slightly under three years.

From the first of December last year through mid-June, Japan floated $171 million in public and private securities issues in European capital markets. Of this amount, $65 million was issued during the first half of June. The Japanese have been encouraged by the favorable European response to their issues and reportedly plan to float a total of $166 million in government and government-guaranteed issues alone in Europe in the year ending March 31, 1965.

In the foreign exchange market, the yen has remained relatively weak since Japan's balance of payments problem first began to appear in the spring of 1963. From mid-May 1963 through mid-June 1963, the spot rate has tended to remain at, or near, the official support level.

The rate in the three-month forward market has also remained stable at a depreciated level since May of 1963. The stability has been due to an approximate balance between the demand for forward foreign exchange, primarily in connection with Euro-dollar borrowings, and the supply, mainly from those holding unexpired export acceptance bills. Because of the relatively depreciated rate in the spot market, the three-month forward discount has remained relatively small, usually averaging less than one per cent per annum.

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