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Recent Economic Developments in Japan,
April-June 1965

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Summary

During the second quarter there were signs that the easing of the tight money policy earlier in the year was not having the desired effects. Industrial production dropped 3 per cent in April-May after edging up slowly in the previous four months. Inventories remained at high levels and showed few signs of a downward adjustment. Bankruptcies remained high in April and May. Productive capacity expanded at a faster rate than its utilization. Corporate profits failed to show any signs of rising again.

The quarter was also marked by serious difficulties in securities markets and investment firms. In May and June the Bank of Japan and other financial institutions, undertook a series of measures aimed in part at saving two of the country's large securities companies from bankruptcy. Investors continued to cash in investment trust contracts and to demand the return of deposited bonds. In the first such action since the financial crisis of 1931, the Bank of Japan arranged special credits for all financially-pressed securities companies. Reductions in the Bank of Japan's basic discount rate of April 3 and June 26 failed to revive the sagging stock market.

In March and April there was a slackening in bank credit and monetary expansion. Interest rates continued to decline during the second quarter. Wholesale prices declined very slightly in the March-May period, but consumer prices continued to rise substantially.

International reserves fell during the second quarter, reflecting net capital and service payments which more than offset the relatively high surplus on trade account. Partly because of the U. S. balance-of-payments program, the Japanese have revised downward their estimates of net long-term capital receipts this fiscal year by $100-200 million. In consequence, they expect balance but no surplus in their total international payments.

Industrial Recovery Falters in April-May

Industrial production continued to recover slowly in December and the first quarter of this year following a sharp 2 per cent decline last November. By March almost half of the November drop had been regained, but in April the seasonally adjusted production index fell 1 per cent and preliminary data for May indicate a further decline of 2 per cent.

The reaction of the economy to last year's tight money policy has been different from that during the previous cycle. After monetary restraints were introduced in September of 1961, industrial production leveled off in 1962. This time, the tight money policy introduced in March of 1964 did not induce a decline in production until November, and, following this sharp one-month decline, the index rose slowly, but steadily, until the April-May relapse.

Another way in which the latest cycle differs from the previous one is the sluggishness of inventory adjustment. In the previous cycle, both finished and raw materials inventories were eventually drawn down in conjunction with the adjustments in production levels. In this latest cycle, there has been only a leveling off rather than a decline in inventories. In April, the seasonally adjusted index of producers' inventories of finished goods was at about the same level as in January of this year. The index of raw materials fluctuated in a narrow range (between 123 and 127) during the period from January of 1964 through April of this year. This apparent inability of industry to work off its excess inventories may serve as a retarding factor in the months ahead by discouraging new investment spending, and thereby slowing the rate of economic growth.

New orders received for machinery have also failed to follow the usual cyclical pattern. Instead of declining, the seasonally adjusted level of outstanding orders roughly leveled off from August of 1964 through April of this year. Production capacity in manufacturing increased 7 per cent between the second quarter of last year and the first quarter of this year. But industry has not been able to keep pace with this increase, and the ratio of use to capacity fell 4 per cent over the same period.

Retail sales, seasonally adjusted, rose 4 per cent in March after remaining relatively unchanged during the previous six months. Governmental forecasts of consumer spending for the period from April 1964 to March 1965, however, predict a slower rate of spending than in the previous twelve months. This reduction is based mainly on an estimated decline in wage and salary increases from last year's level.

Business Distress

Corporate profit positions appear to have worsened in the six months ending in March of this year. A survey of 333 leading corporations indicated that profits were off 3.8 per cent in this period compared with the previous six months. This contrasts with a decline in profits of 2.0 per cent in April-September last year compared with the previous six months. The squeeze on profits has been more severe for many firms than these modest percentage declines would suggest. This has forced many firms to adopt economy budgets, and to reduce sharply expenditures for such things as entertainment, cars and even executive salaries.

Beginning last December, three large Japanese firms have applied for reorganization under the Corporation Reorganization Law. These are Nippon Special Steel, and Sunwave Industry, in December, and Sanyo Special Steel Company in March. In May it was revealed that Japan's second and fifth largest securities companies were also threatened by insolvency, and special measures were adopted to keep them afloat. Other signs of financial stress include reports that certain public land development corporations are having difficulty meeting interest payments on loans and bonds. Various government organizations, which had expended large amounts of money for purchasing and developing land for private industry, now find that with the current business recession they have a shortage of customers.

The number of bankruptcies remained relatively high in April-May. Among firms with debts exceeding ¥10 million ($27,778), the number of bankruptcies rose to a peak of 596 last December, eased to a monthly average of 477 in the first quarter, jumped to 584 in April, but then declined to 450 in May.

During May and June Japan's securities companies came under increasing financial pressure as investors liquidated their holdings. Following an announcement on May 21 that the Yamaichi Securities Company (Japan's second largest) was virtually insolvent, the Government announced on May 23 that joint action would be taken with the financial community to prevent the firm from failing. Creditor commercial banks agreed to a three-year moratorium on the monthly interest payments due them on the ¥20 billion in loans extended to Yamaichi.

All of these developments disturbed investors, however, and many people continued to withdraw bonds that had been deposited with the securities companies for a fee, and to cash in their investment trust contracts. On May 28 the Bank of Japan announced that special credits would be extended to the main commercial banks so as to facilitate the extension of special credits to the securities companies as needed. This was the first time since the financial crisis of 1931 that the Bank of Japan had resorted to such emergency measures. Bond withdrawals and investment trust redemptions continued to remain high, however, and on June 9 the Bank of Japan extended two special loans totaling ¥10.5 billion ($29 million) to the Yamaichi Securities Company through three city banks. At this time Japan's fifth largest securities company, the Oi Securities Company, applied for special financial assistance from the Bank of Japan for about $5.5 billion ($15.5 million). As pressures on other securities companies mounted, the Bank of Japan on June 18 authorized ¥60 billion ($167 million) in emergency loans for any companies needing assistance in the redemption of investment trust contracts. The heavy rate of redemption, which almost doubled in May, posed a problem for the companies since liquidation of the securities comprising the trusts would have placed further downward pressures on the stock market and involved the securities companies in substantial losses, as well as possible bankruptcy. The Bank of Japan loan will be used by the companies to buy the bonds in the investment trust portfolios. This will provide the trusts with cash to redeem shares, but it will also give them a heavier concentration in equities, making them more vulnerable to declines in share values.

Two securities companies were successful in mid-June in obtaining government approval to defer for one year redemption of two unit type investment trusts normally due to mature in July. Over the past five years, the principal in both trusts had fallen by more than one-half.

The stock market continued its general downtrend during the second quarter. A new five-year low was reached on June 17 when the Dow Jones average hit ¥1,056. This represents an 18 per cent decline from the year's peak reached in January. Apart from declining prices, a declining stock volume has also adversely effected the securities companies. During the second quarter, the average daily volume of shares traded on the First Section of the Tokyo Stock Exchange was 58 million or 52 per cent lower than the 121 million daily average in the same period a year earlier.

Slowing in Bank Credit and Monetary Expansion

Data indicate that commercial banks have been pursuing a more cautious lending policy. Although monetary restraints were relaxed in both December and January, bank credit expansion continued to slow through April. Seasonally adjusted loans and discounts in April were up 15 per cent over the level a year earlier, as compared with an expansion rate of 19 per cent last October. Seasonally adjusted money supply rose less rapidly in March-April after accelerating moderately in January-February. At the end of April, money supply was 15 per cent higher than a year earlier as against an expansion rate of 18 per cent in February of this year.

Government operations had a net expansionary impact on the economy in April and May. This contrasts with large net cash receipts during the first quarter. Heavy net payments of the Treasury in April were largely offset by Bank of Japan sales of securities. In May, net Treasury payments were small and were more than offset by Bank of Japan sales of securities.

Interest rates continued to decline during the second quarter as the Bank of Japan lowered its basic discount rate twice. On April 3 the rate was reduced from 6.205 to 5.84 per cent, and on June 26 the rate was cut again to 5.475 per cent. This brought the rate to its lowest level since 1951 and to 1.095 percentage points below the recent peak of 6.57 per cent effective prior to January 9. Call loan rates also declined during the second quarter, the rate for unconditional call money (repayable at a day's notice) falling from 8.40 per cent at the end of March to 6.94 per cent by mid-June. During the first four months of this year the average interest rate on bank loans and discounts fell from 7.99 to 7.92 per cent.

At the same time that the Bank of Japan lowered its basic discount rate on June 26, it also abolished its system of commercial bank credit expansion quotas. These quotas, which applied to 13 major city banks, were discontinued in order to stimulate the generally sagging economy.

Price indexes registered mixed trends in recent months. The wholesale index rose 1.2 per cent between June of 1964 and February of this year, but then declined 0.2 per cent through May. The Tokyo consumer price index, however, continued its generally rising trend of recent years and in May of this year was 7.4 per cent higher than a year earlier. Money wages have recently been rising faster than productivity. In March the index of money wages in the manufacturing field was up 10 per cent over the level a year earlier. The rise in productivity, however, was only 7 per cent over the same period, as based on changes in the production and employment indexes.

Good Trade Performance Offset by Net Capital and Services Payments

The trade balance continued to improve in April and May as exports increased sharply. The average monthly surplus in the seasonally adjusted trade balance during these months was $37 million compared with $20 million in the first quarter and a deficit of $79 million in the fourth quarter of last year. Exports in May were 36 per cent higher than a year earlier, while imports were up only 3 per cent.

In spite of this excellent trade performance, however, official international reserves began to decline in April and at the end of June were $1,980 million, down $77 million from the March peak. This decline reflected mainly a rising service deficit and net payments on both long-term and short-term capital account. The net payments on long-term capital account, evident in both March and April, are unusual; no such payments had occurred in any substantial volume since 1960.

Japan successfully returned to the United States bond market in April. The Nippon Telegraph and Telephone Corporation offered a $22.5 million, 15-year, 5-3/4 per cent bond at a price of $97.25 with a yield to subscribers of 6.031 per cent. This bond was the first issue eligible under the $100 million exemption from the Interest Equalization

Tax granted by the United States to Japan in February. In June, the Metropolis of Tokyo also successfully placed a $20 million, 15-year, 6 per cent bond in the United States. It was priced at $95.25 to yield 6.50 per cent.

Japan's Euro-dollar and certain other short-term borrowings fell moderately in the spring. During the last three weeks of May the Japanese authorities increased the maximum authorized rates on Euro-dollar deposits, but then lowered them during the first half of June.

On June 1, Japan relaxed its foreign currency reserve requirement system. Prior to this time, Japanese foreign exchange banks were required to maintain a 25 per cent reserve in liquid foreign assets (such as cash, deposits with foreign banks, call loans, and short-term government securities) against short-term foreign liabilities outstanding in July 1964, and 35 per cent against any excess above the July 1964 balance. Under the new system, the 35 per cent requirement has been abolished and only the basic 25 per cent requirement retained against all current liabilities.

Because of the United States balance-of-payments program and tightening capital market conditions in Europe, the Bank of Japan recently revised its balance-of-payments forecast for the fiscal year ending March 31, 1966. The net long-term capital account is now expected to be approximately in balance instead of registering a surplus of $200 million. With this revision, plus an upward revision of $50 million in the services deficit, no gain is now expected in international reserves this fiscal year, in contrast to the original estimate of an increase of $250 million.

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