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RFD 588

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Division of International Finance

REVIEW OF FOREIGN DEVELOPMENTS

June 30, 1966

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10 pages

Recent Economic Developments in Japan:  
April-June 1966

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Recent Economic Developments in Japan, April-June 1966Summary

Following an upturn late last year, the Japanese domestic economy continued to recover in April and May at a moderate pace. Industrial production in April was up 8 per cent over the level a year earlier, and 7 per cent over the level in October. Other signs of recovery included rising orders for machinery, a general recovery in the stock market, improved business profits, and rising inventories and shipments.

Money and credit conditions have remained easy and bank lending rates continued to decline through April. Bank credit expanded at a slower rate through April and there has also been a slower rate of increase in money supply. Wholesale prices registered a sharp spurt in November-February, but have since leveled off. Consumer prices continued to rise through May, although at a slower rate than in the previous twelve months.

After rising generally from a low last July, stock prices leveled off during April-June as two special stock-buying agencies gradually began to unload some of the ¥428 billion of stocks purchased in 1964-65. At mid-June stock prices were 3 per cent below the year's high on April 1.

At the same time that the domestic economy was recovering, the international trade situation showed signs of a mild deterioration. Exports rose to substantially higher levels early this year, but by May were only 9 per cent above the level a year earlier.

Imports have risen more rapidly than earlier and in May were 13 per cent higher than a year earlier. Seasonal weaknesses apparently contributed to a leveling off in international reserves in March and to a slight decline in April-May after a general rise earlier during August-February. In recent months there has been a decrease in net short-term capital outflows and this has helped to mitigate a sharp decline in reserves. Rising U. S. interest rates raise the possibility of a shift in Japanese trade financing from foreign to domestic sources, but so far such shifting has been relatively small.

Domestic Economy Continues to Recover at a Moderate Pace

Economic recovery is now well underway in Japan. Preliminary data indicate that seasonally adjusted industrial production rose 1 per cent in April to a level 8 per cent higher than a year earlier. Most of this increase took place after last October, the production index registering a rise of 7 per cent between October and April. Major sectors showing substantial gains included chemicals, machinery, iron and steel, textiles, and rubber.

Other data also indicate that economic recovery is continuing. The outstanding level of new orders for machinery has been rising since last July, and in March and April of this year the seasonally adjusted volume of new monthly orders for machinery was running at a rate 10 to 20 per cent above the level a year

earlier. Producers' shipments held at about the same level in the twelve months through August of last year, but by April of this year the monthly volume had risen 11 per cent. Inventories of producers' goods and raw materials have also been slowly rising since the spring of last year, and in March of this year were 4 and 3 per cent higher than a year earlier, respectively.

Other indications of business upswing include a substantial recovery in the stock market and an improved corporate profits position. Estimates indicate that profits for 340 top corporations in the six months ending March 31, 1966, were up 15 per cent over the previous six months. This compares with a 21 per cent decline in the April-September period last year in relation to the previous six months. The Government's planning agency in May also revised upward its estimate of the increase in private plant and equipment investment for fiscal 1966 (which ends March 31, 1967) from 1.1 per cent to 2.2 per cent. In addition, there has been an increased use of plant capacity since the first of the year. After declining steadily from the second quarter of 1964, the index of use of plant capacity jumped from a low of 94.5 (1960=100) in the fourth quarter of last year to 97.2 in the first quarter of this year.

Bank credit expansion continued to slacken during the first quarter and in April. From an average annual rate of increase of 13.9 per cent in the fourth quarter of last year, seasonally adjusted, bank credit expansion eased to 13.3 per cent in the first quarter and 12.8 per cent in April. There has also been a slackening in the rate of

increase of inter-business credits as based on fiscal year data. After rising 25 per cent in fiscal 1963 (year ending March 31, 1964), trade receivables of all enterprises rose 18 per cent in fiscal 1964 but only 9 per cent in fiscal 1965. The slackening pace of inter-business credits has generally been attributed to slack domestic demand and an improvement in business liquidity positions.

Bank of Japan credit operations were expansionary last year and during the first quarter of this year. In April, however, the Bank both reduced its loans and sold securities in order to offset heavy net payments by the Treasury. In May and June the Bank of Japan reportedly began to shift to a somewhat less expansive monetary policy in view of the steady recovery of the domestic economy.

Bank lending rates continued to decline through April following the high reached at the end of 1964. The average rate on bank loans and discounts in April was 7.53 per cent in contrast to the approximately 8.0 per cent rate at the end of 1964. As of June 11, 1966, interest rates in the call loan market had remained unchanged from their relatively low level first reached on October 1, 1965.

The slackening in the rate of increase of bank credit has been reflected in a slower rate of increase in money supply, at least through February. Last October, seasonally adjusted money supply was rising at an annual rate of 19 per cent, but by February

the rate had eased somewhat to 15 per cent, which is still a comparatively high rate. In March, however, money supply rose 3.6 per cent over February to a level 19 per cent higher than a year earlier.

Prices have registered somewhat mixed trends. Consumer prices in May were up 5 per cent over the level a year earlier, but this was less than the 7 per cent rise that occurred a year earlier. Wholesale prices on the other hand, rose sharply between November and February, and in April were 3.4 per cent higher than a year earlier. This is the sharpest rise since 1963 and reflected increases in the prices of non-ferrous metals (particularly copper), timber products, and foodstuffs (especially rice). In March-May, wholesale prices rose very slightly. The index of money wages has also risen recently. After dipping slightly last September-December, seasonally adjusted wages rose to a higher level in the first quarter of this year and in March were 10 per cent above the level a year earlier.

#### Stock Prices Level off as Special Units Unload Stocks

Stock prices reached a high for the year on April 1 and then eased very slightly as stocks were unloaded by the two special stock-buying agencies created in 1964-65. At mid-June the market was slightly below the April high, but 51 per cent above last year's low in July. In order to reduce downward pressures on the market, stock margin requirements were lowered from 50 to 30 per cent on June 4.

During the March to early May period, the Japan Stock Holding Association (JSHA) and the Japan Joint Securities Company (JJSC) sold ¥61 billion in stocks previously purchased. This reduced the holdings of the two groups from ¥428 billion to ¥367 billion (on the basis of original purchase value). The JSHA announced on May 27 that it would sell an additional ¥20-30 billion in stocks by June 22 when the Finance Committee of the lower house of the Diet meets to discuss the future of the two agencies. The Bank of Japan has advised both agencies to unload all of their stocks by March 1968 when the revised Securities Trading Law goes into effect.

A further indication of the general improvement in the stock market was the decision of the authorities in mid-May to abolish restrictions on increases in corporations' capital, effective this coming October. In February 1965 the authorities decided to restrain further boosts in corporate capital in order to hold down the flow of new stocks onto the market, and thus reduce the downward pressure on the prices of stocks. Although the quantitative restrictions will be dropped, certain minimum requirements must still be observed before new stocks can be issued.

The recovery in the stock market has not yet encouraged a net increase in purchases of equity investment trusts as pre-maturity redemptions continued to exceed new purchases. However, bond trusts have about been holding their own in terms of the outstanding amount invested.

### Progress in the Sale of National Bonds

In line with other efforts to stimulate domestic economic recovery, the Japanese Government issued ¥299 billion in national bonds in the first quarter of the year. With redemptions of ¥20 billion, the outstanding amount of internal, long-term, central government debt rose ¥279 billion to a total of ¥688 billion.

Data are not yet available for March, but most of the issues in January-February of this year were picked up by the government's Trust Fund Bureau, whose funds derive largely from the postal savings system. Sale of bonds to the Trust Fund Bureau does not, of course, increase the supply of funds available to the government. Data on holdings of government securities indicate the following increases in January-February: Trust Fund Bureau, ¥184 billion; commercial banks, ¥70 billion; and ¥3 billion each for life insurance companies, mutual loan and savings banks, and the Central Cooperative Bank of Agriculture and Forestry.

For the fiscal year beginning in April of this year, the government plans to float ¥730 billion in national bonds, or approximately ¥60 billion per month. Data for April indicate that national bond issues purchased by non-government groups were ¥138 billion, or well above the projected rate.

### Mild Deterioration in Balance of Payments

Japan racked up a record trade surplus in 1965 of \$1.9 billion, compared with only \$375 million the previous year. Deficits on invisible and capital accounts whittled away most of this, with the result that official reserves rose only \$123 million.

The rise in Japan's international reserves slowed down in the first quarter of this year and a decline, though modest, appeared in April and May. This probably reflects some seasonal weakness in the trade performance during these months more than any fundamental shift in the balance-of-payments outlook. However, excluding January, which appears to have been badly distorted by changes in the timing of trade caused by a seamen's strike, the seasonally adjusted trade surplus is not as large this year as it was in the comparable period in 1965. This reflects the fact that imports have been creeping up more or less steadily for a year, while exports slumped in the last four months of 1965. Exports have risen quite sharply from the depressed December figure, but in May they were only 9 per cent above May 1965, while imports showed a 13 per cent rise.

The developments in trade have been in part offset by a reduced net outflow of short-term capital in recent months. International reserves fell \$13 million in March-May to a level of \$2,096 million. This reversed the general uptrend in reserves that began following last July's low of \$1,950 million.

Although Japanese short-term borrowing from the U. S. (as reported by U. S. banks) has generally increased since last October, the level outstanding is still below the peak reached in June of 1965. Short-term claims on Japan fell \$129 million during the last half of 1965, but increased \$16 million during the first four months

of this year to a level of \$2,777 million. U. S. long-term claims on Japan have generally been declining since May of 1965 and in April were down \$15 million from the December figure to a level of \$430 million. Japan has not issued any bonds in the U. S. since last November, and in March decided to postpone indefinitely a \$15 million issue that had already been registered with the SEC, largely because of high U. S. interest rates.

#### Rising U. S. Interest Rates Pose Problems

Rising U. S. interest rates have also posed an increasingly difficult problem for the Japanese. Between December 4, 1965, and June 4, 1966, the U. S. rate for 90-day prime bankers' acceptances rose from 4.25 per cent to 5.38 per cent. Since the interest rate for Japanese dollar import acceptance credits is based on the U. S. rate (plus commissions for U. S. and Japanese banks), the Japanese have had to steadily increase the rates charged on dollar import acceptances. The prime rate for a 4-month acceptance with letter of credit rose from 7.0 per cent on December 10, 1965, to 7.5 per cent by May 28. The latter rate, however, is now higher than the comparable rate of 7.3 per cent charged for domestic commercial bills. The general level of rates on dollar import acceptances was increased further on June 13, but by establishing a new, more restricted prime rate, the rate for the very best customers was held at 7.5 per cent.

There has reportedly been some shifting from foreign to domestic sources of financing, but not yet in large amounts. The authorities are worried that if the shifting occurs on a large scale, there will be substantial downward pressures on Japanese international reserves as foreign credits are repaid.

With the object of discouraging such shifting so as not to decrease official reserves, several measures were taken in mid-May by the Japanese authorities. Exchange banks were ordered to lower their commission rates, to differentiate their rates according to industries and enterprises, and to adhere to newly established maximum limits on import acceptances. Although the Bank of Japan indicated on June 1 that it would attempt to keep money rates low despite the rising trend overseas, it may be forced later this summer to make further adjustments to cope with the problem.

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