

Japan enters deepest post-war recession

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Japan has now entered its worst post-war recession with all signs pointing to a deepening of the slump in the coming months. Figures released last week showed that the Japanese economy shrank by 0.8 per cent for the June quarter, following a 1.3 per cent contraction for the March quarter and a 0.2 per cent decline in the December quarter of 1997.

Even more significant than the overall result was the rapid fall capital investment and the failure of repeated government stimulus packages to make any impact.

According to a spokesman for the firm Barclays Capital the figures on capital expenditure were 'disastrous.' 'Capital investment was minus 5.2 percent in the first quarter and minus 5.5 percent in the second quarter, giving two consecutive quarters of negative annualised growth of 20 percent,' he said.

The latest monthly figures show that the slump is continuing. Construction orders fell 14.3 percent in July compared with the same period a year ago, the seventh consecutive monthly fall. Retail sales were down 3.7 percent below the level a year ago, while industrial production was down 9.3 percent.

In a further effort to try to stimulate the economy, the Bank of Japan eased monetary policy by cutting the overnight interest rate from 0.5 percent to 0.25 percent. The bank's policy board said the measure had been taken 'to ensure that the economy does not worsen further and to prevent the economy from falling into a deflationary spiral.'

What is meant by this term is a situation in which falling prices and asset values result in increases in the real cost of loans and a consequent rise in bad debts as companies, because of falling prices and demand, are unable to generate sufficient revenue to repay the banks. At the same time these indebted companies are unable to sell the assets used as collateral for the bank loans because their value has fallen below the amount of the initial loan. Consequently, the amount of non-

performing loans held by the banks increases. This in turn leads to a 'credit crunch' as the banks, holding ever-larger amounts of bad debt, become increasingly reluctant to issue new loans, thereby choking off business activity and deepening the economic slump.

The operation of this economic vicious circle is what lies behind the failure of repeated government spending programs to stimulate the Japanese economy.

Since April 1993 Japanese authorities have unveiled six fiscal packages amounting to an estimated \$651 billion. According to Avinash Persaud, the head of currency research at JP Morgan, this is a bigger fiscal stimulus than the New Deal of the 1930s and bigger than the expenditure on the Vietnam War in the 1960s. The Japanese budget has deteriorated from a surplus of 1.5 per cent of gross domestic product in 1992 to an expected deficit of 4.6 percent in 1998 - the highest of the G-7 industrial nations. Yet despite this massive spending program the economy has failed to show any sign of revival.

And all predictions are that the deflationary contraction will continue. The senior analyst with Shroder Securities, Andrew Shippley, warned that Japan was 'on the road to ruin'.

'We have deflation building, a policy paralysis, companies not restructuring and the value of Japanese assets tumbling,' he said.

The Economic Planning Agency in its September report downgraded its assessment for the second consecutive month saying the economy 'is in a prolonged slump and in a very severe situation.' It noted that flat consumer spending, sluggish capital investment were causing decreased production.

The director-general of the EPA Taichi Sakaiya said that while Japan had not yet fallen into a deflationary spiral 'we are at the entrance of one.' 'There is a danger of being sucked into one, and the main reason for that is the international environment.' He said the Japanese

economy would enter an 'extremely dangerous' phase should the situation outside the country continue to worsen.

But many private sector economists maintain that the EPA's assessment is too optimistic. According to the chief economist at the Sanwa Bank, Mitsuru Saito: 'There is no doubt Japan is in the grip of deflation, with household incomes falling, the wholesale price index down 2.2 per cent year-on-year and the consumer price index declining by 0.2 per cent.'

In a comment on the situation, the business editor of Yomiuri Shimbun wrote: 'It appears that the economy is about to slide into a depression. Signs of this include large-scale corporate failures, high unemployment and a drastic downturn in corporate performance. Major companies, such as electronics manufacturers and steelmakers, have revised downward their half-year earnings projections.'

Big companies are announcing losses. Hitachi, the world's largest producer of electrical machinery and computer ships has announced it will make a loss of 100 billion yen--the first loss in post-war history, and will cut 4000 jobs. Matsushita Electric is said to be in the same situation. Toa, Japan's second largest electric furnace steelmaker announced its closure earlier this month, after announcing debts of 250 billion yen.

Toshiba, the country's second largest electronics group, has announced that it will incur its first loss in 48 years, increasing concern over the impact of the collapse of the semiconductor market on Japan's electronics industry. Toshiba cited the rapid decline in the price of memory chips and computer accessories as the main reason for the loss.

The economic situation is being compounded by political paralysis. The Obuchi government came to office six weeks ago pledging reconstruction but has so far failed to secure the passage of any economic measures. The restructure plan for insolvent banks is still under discussion in the Diet (parliament), even though it was drawn up months ago, while measures to provide income and corporate tax cuts has been blocked by opposition parties.

The continuing contraction in Japan--equivalent to withdrawing one economy the size of Australia from the world economy each year--has led to increased fears of a global slump. Already there is worldwide over-production in computer chips, whitegoods of all

kinds and cars. The global capacity of the car industry is 60 million vehicles, but only 44 million are being sold.

Following the meltdown in Asia and Russia, the financial storm centre has shifted to Latin America. The Central Bank of Brazil was last week forced to lift interest rates from 29.75 percent to 49.75 percent in a bid to halt the outflow of foreign currency from the country which has seen reserves fall by an average of \$1.5 billion a day during this month.

If the Brazilian currency collapses or a debt moratorium is imposed this could set off similar processes in both Argentina and Mexico--the two next biggest economies in Latin America--with direct implications for the United States.

And the growing fears of a world slump are being compounded by the political crisis in the United States. In an editorial last Saturday, the *Financial Times* warned that with 'the spectre of recession, perhaps even of a financial collapse' falling across markets, bankers and governments in Russia, Latin America, Japan and even industrial Europe this was 'no time for the world's richest and most dynamic economy to be without an effective leader.'

Warning that political instability could lead to a further decline in stock markets, the editorial pointed to a report by the investment bank Goldman Sachs which predicted growth of only 1.9 per cent for the countries of the Organisation for Economic Co-operation and Development, compared to the OECD's own forecast of 2.5 percent last June. And if the shocks in Asia and Latin America, combined with the 15 percent decline in stock prices, had further effects growth in the OECD could fall to just 1 percent.

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