

# Japanese economy plunges

John Roberts  
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The terror attack on New York, combined with growing evidence that Japan is entering its most severe downturn since the 1973 oil crisis, has produced a frantic call that the government of prime minister Junichiro Koizumi abandon its proposed agenda of economic restructuring and budget austerity.

The *Yomiuri Shimbun*, Japan's largest daily newspaper which has encouraged Koizumi since his inauguration in late April, reversed its position on September 13. In an editorial entitled "Government must change its reform plan", the paper declared: "The terrorist attacks in the United States have delivered a blow to the Japanese economy. There are growing concerns that this could trigger global recession. If the sharp drop in Japanese stock prices brought on a financial panic at home, the global economy could reach a critical phase."

Outlining an emergency program of tax cuts, job creation schemes, urban renovation public works projects and relaxed monetary policy, the *Yomiuri Shimbun* recalled: "About 70 years ago, then Prime Minister Osachi Hamaguchi pushed deflationary policies at a time when his country was in the throes of deflation. The result of his policies was that the economy collapsed under the global financial panic triggered by the Depression in the United States. The same mistake should never be repeated."

The Tokyo stock market had already slumped to just 10,000 points before the destruction of the World Trade Center. Last week's events, and the fear it will push the US into recession, sparked panic selling. The Nikkei 225 index fell to 9,487 points on September 13, the lowest level since December 1983.

The level reached by the Nikkei was just 25 percent of its level in December 1989. Over 300 trillion yen or \$US2.5 trillion in stock market values have now been wiped out in the decade since the collapse of the Japanese share and property market bubble in the early 1990s. The fall took place despite restrictions being placed on share trading and the Bank of Japan pouring over \$US16 billion into the banking system on September 12 in an effort to restore investor confidence. Yesterday, the Nikkei fell back to 9,500 points, after reviving late last week.

Underlying the panic are economic indicators pointing to a deep and protracted recession. On September 14, figures were released showing that the current account surplus plunged 28.2 percent in July compared with 12 months ago. The surplus in goods collapsed by 50.1 percent, due to declining exports and rising imports.

These grim statistics followed others showing that the Japanese economy, the world's second largest, contracted by 0.8 percent in the April to June quarter. The slump was produced by a fall in domestic demand and in new equipment and building investment, combined with declines in industrial production and profits.

Corporate capital investment fell by 2.8 percent in the quarter, the second quarterly decline in a row, and housing investment fell by 8.8 percent. Exports fell by 2.9 percent. Monthly statistics for industrial production also demonstrated a steady decline. In July, the index used to measure output fell by 2.8 percent, the fifth consecutive month of decreased production. Output by the electric machinery industry fell by 5.4 percent.

Economy, Trade and Industry Minister Takeo Hiranuma told the media on the release of the figures: "The economy's footing has become very weak. Whether the economy will even attain zero growth this fiscal year is doubtful."

Technically, Japan is not yet in recession as it has not experienced two quarters of negative economic growth. There is little doubt, however, that the next September quarter will produce negative growth figures for Gross Domestic Product (GDP).

The country's steel producers have all reduced their profit expectations for the year ending March 2002. The largest firm, Nippon Steel, has cut its profit forecast by two thirds to just 20 billion yen (\$US165 million). The steel maker blamed falling prices in Japan due to rising inventories, as well as falls in orders from East Asia due to the downturn in the US.

The slump in profitability and cutbacks to production are not confined to traditional manufacturing. High technology sector firms have announced massive losses and layoffs in the past two months. These include computer chip producer Toshiba and semiconductor and hard-drive manufacturer

Fujitsu, which, combined, have announced cuts of 36,400 to their worldwide workforces.

The position of the steel makers and the high-tech sector underlies the dilemma affecting whole areas of the economy. The intensified crisis in Japan is coinciding with a global downturn that undermines attempts to counter internal problems by increasing exports. Heightening the difficulties for Japanese exporters, the US dollar has fallen sharply against the yen in recent weeks.

Domestically, things are going from bad to worse. Last week, one of Japan's major supermarket chains, Mycal, filed for bankruptcy with debts exceeding \$US10 billion. Under the terms of a court-controlled rehabilitation program, large numbers of the company's 60,000 staff will be laid off. Thousands of job cuts are also expected by Mycal's 10,000 suppliers.

Even before such job-shedding begins, unemployment reached an official level of 5 per cent in July—the highest since 1953. The number of unemployed included in the official figures rose 230,000, an increase of 7.5 percent from one year ago to 3.3 million, or 3.8 million in seasonally adjusted terms. Cabinet Office official Satoru Ishikawa told the press on September 2 that if 4.2 million people who had given up looking for work were included, the unemployment rate would be 10.4 percent.

Koizumi and his key ministers have responded to the economic turmoil by restating their determination to carry through with their restructuring agenda. Koizumi won the leadership of the ruling Liberal Democratic Party (LDP) in April pledging to reform Japan's moribund economy by tackling both the high debt of the government and of the banking system. On September 14, Koizumi told the press he would end Japan's "addiction to debt" and "go on with my reforms".

Estimates of the bad loans held by the banks range from \$US270 billion to \$US1.9 trillion. The crisis is so severe that the International Monetary Fund (IMF) has taken the unprecedented step of sending its own team into Tokyo to make an independent assessment. The group is to be operational by September 30, the day that Japanese banks are supposed to estimate their stock and real estate investments at their current (and written down) market value. Moody's Investors Service meanwhile is reviewing Japan's credit rating.

Any effort to clean up the banking system, however, will dramatically increase the severity of recession in Japan. Goldman Sachs estimates that writing off debts would remove 1.5 percent from annual economic growth and cut a further 648,000 jobs. Richard Katz, an author and analyst on the Japanese economy, believes the job losses from a clean up could reach four million.

Adding to the impact of any bank restructuring will be Koizumi's proposed measures to control the Japanese public debt, which stands at 666 trillion yen (\$US5.5 trillion), or 130 per cent of GDP—the highest of any major industrial nation. For a decade, Japanese governments have borrowed to finance vast public works projects and handouts to business, aimed at shoring up the domestic economy and preventing wholesale corporate collapses.

As part of Koizumi's program, the government has committed itself to only issuing 30 trillion yen (\$US248 billion) in new bond issues. He has pledged to cut public works spending by 10 percent and outlined a two trillion yen anti-unemployment package instead, consisting of meager social security payments.

Intense opposition exists to this agenda within the LDP and sections of the business elite. The construction and retail industries, the most indebted sectors of the economy, are intimately connected with factions of the ruling party and would be the most severely affected by the calling in of bad debts or cuts to public works spending. Especially under conditions of recession, large numbers of these LDP-connected companies would be forced into bankruptcy if Koizumi proceeds.

Koizumi's opponents have already registered one success in derailing attempts to restructure the economy. On September 3, government ministries and agencies rejected his plan that 74 state-owned corporations be privatised or abolished. The state spent a staggering 29.7 trillion yen (\$US249 billion) propping up these bodies in the 2001 fiscal year. Despite this, the agencies reported back that only four of the 74 could be sold off or liquidated.

Koizumi's promised bond cap is their next target. The *Yomiuri Shimbun* editorialised on September 17: "Following the plunges of European stock markets late last week, aftershocks from the terrorists' act of mass murder in the political and economic nerve centres of the United States continue on financial markets around the world. The situation does not warrant any optimism..."

"We should emphasize that, for its part, the Japanese government should promptly carry out drastic measures to weather the crisis. This means compiling a supplementary budget effectively, without sticking to the administration's earlier pledge to cap the issuance of government bonds."



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