Official figures show: Japan in worst postwar recession

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International Monetary Fund (IMF) managing director Horst Koehler last week gave an upbeat assessment of the world economy claiming recession had been avoided and recovery was on its way. Much still rested on the performance of the US, where there were mixed signals, but overall picture was one of recovery.

The European economy would also strengthen, he said, although its recovery would lag behind the US. However, the IMF chief made no comment on the world's second largest economy, Japan, which stands in stark contrast to the optimistic forecasts for the US and Europe.

Just prior to Koehler's remarks, the government announced that Japan had recorded a 1.2 percent contraction for the final quarter of 2001, higher than the expected 1.0 percent decline forecast by the government and economists. The annualised fall of 4.5 percent was also higher than the 4.0 percent previously forecast.

This contraction means that the economy has experienced three quarters of consecutive decline for the first time in almost a decade. The last time the economy shrank for three consecutive quarters was 1993, but then the contractions were limited to less than 0.1 percent each quarter.

The current recession is the worst in the postwar period with analysts blaming a massive 12 percent plunge in business investment, stagnant consumer demand and continuing deflationary pressures. The decline in business investment was the worst since 1980.

There does not appear to be any relief in sight. Wholesale prices fell 1.3 percent in February on a year-by-year basis representing the 17th straight month of decline. Although there was a rise in consumer spending of 1.9 percent for the final quarter of 2001 this was not seen as a sign of recovery but was attributed to one-off seasonal factors. Consumer spending is expected to stagnate or even fall in the current quarter.

Commenting on the outlook for domestic spending, Nobuhiro Okuyama, a research director at Mitsubishi Research Institute said: "High unemployment rates and falling incomes might curb it during the first quarter of this year. Bonuses for salary workers declined in December and companies are still not slowing the pace of corporate restructuring. Those factors could all mean domestic demand remains at its current weak level."

Business investment also continued to fall as evidenced by the 4.6 percent fall in bank lending in February, the 50th consecutive monthly drop. The Koizumi government does not see any relief and is projecting zero economic growth for the coming financial year starting on April 1.

The recent surge in the stock market—the Nikkei index has been hovering around 12,000 after hitting a low in February of 9,420—has led to some claims that a recovery may be on the way. But most observers maintain that the rise in the Nikkei has more to do with strengthening the position of the banks than any upturn.

Banks, which hold large share portfolios as security on loans, are required to report their financial position before March 31 and value their share holdings at current market prices.

Describing the Nikkei surge as "the most unlikely of bull markets", a recent article in the *Australian Financial Review* pointed out that the parlous state of the banks' loans portfolios was the real reason for the upturn.

"Many of these loans are non-performing. Most hold real estate as collateral, which has slumped 70 percent in value since the bursting of the Japanese bubble in the late 1980s. The towering burden of these loans could put some of Japan’s major banks in a position where they are unable to meet global rules on the level of capital reserves to offset failing loans.

“Japan’s banks are huge holders of shares, so a simple way to avoid this scenario would be to pump up the value of their capital base. In other words, the stock market rally may help prevent a number of Japanese banks being declared technically insolvent soon after the new fiscal year.”

Another factor in the recent rise in the stock market is the government clamp down on short selling of shares—the practice of selling borrowed shares in the expectation that they can be bought back at a lower price in the future.

One of the mechanisms through which the stock market is being propped up and the banks kept solvent is the injection of money from the government’s pension funds. Officials from the Government Pension Investment Fund have announced the fund will buy 1.7 trillion yen ($13 billion) worth of Japanese stocks and 3 trillion yen in foreign stocks and bonds and that a further 9 trillion yen will be invested next financial year.

The fund, which is said by analysts to be seriously under funded in terms of the government’s pension liabilities, currently controls around $276 billion. As of December 2001, the pension fund had 43 percent invested in high-risk areas and from April 1 plans to invest 50 percent of new funds in high-risk investments.

But in the first three quarters of the current fiscal year the pension fund has already lost some 925 billion yen.

Not only do Japanese workers face the prospect of the government gambling away their retirement funds in a bid to prop up the banks, they could also lose their savings if a bank goes under.

From April 1 this year, the government will limit its liability for certificates of deposit held at banks to $77,000 if a bank collapses. From April 1, 2003, the same limit will apply for ordinary savings accounts. This has led to many people buying up gold bullion as a safe haven for their money.

The threat of banking failures is a real one, as was underscored by the recent bankruptcy of Chubu Bank, a second tier regional bank established in 1916. With the fragility of the banking sector becoming increasingly apparent and the government moves to remove full deposit coverage, worried customers could start withdrawing their funds, possibly leading to a run on the banks.