IMF says Japan’s economy is "serious concern'

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International Monetary Fund chief Horst Koehler has called on the Japanese government to speed up the implementation of economic reforms in order to revive its deteriorating economy.

Speaking on the eve of last weekend’s IMF and Group of Seven meetings in Washington, Koehler said the Japanese economic situation was of “serious concern” and criticised the Koizumi government for the delays in carrying out economic reforms.

“There is now hope that the recession is bottoming out. But the return to a growth performance that corresponds to Japan’s size and potential demands decisive action for the disposal of non-performing loans, industrial deregulation and restructuring of its banking and corporate sector. Japan’s ongoing recession is still a drag on global growth, in particular on activity in the region,” Koehler said.

Koehler’s comments echo sentiments expressed in the IMF’s semi-annual World Economic Outlook report released last week. It warned that the combination of “deflation and structural problems” was a “serious concern” necessitating “additional monetary easing and aggressive structural reform”.

Pressure is mounting on the Koizumi administration to push ahead with plans to resolve the mounting bad debt problems in the banking sector and to initiate structural reforms throughout the economy. This includes reigning in the mounting public debt, which stands at 130 percent of Gross Domestic Product, the highest in the industrialised world.

It has been a year since Koizumi came to power pledging to restructure the economy, eliminate the bad debt problems in the banking sector and reduce public spending and debt, but so far little has been done.

In fact, in the eyes of its critics in the international financial markets, the Koizumi government is looking like its predecessors—issuing pledges to carry out “reforms” but implementing very little.

In a statement issued earlier this month, the Japanese Cabinet Office offered an upbeat assessment. While the economy was still in a “severe situation,” it said, the recession was showing signs of bottoming out due to the growth in exports.

But the increase in exports is largely the result of a fall in the value of the yen. Critics of the government say that its reliance on a rebound in overseas demand is a case of wishful thinking and an excuse for not tackling reform measures. Moreover, the recovery in the US and Europe, upon which the expansion of Japanese exports depends, could prove to be fragile.

The government’s hopes for a turnaround could be dashed overnight by a rapid increase in the price of oil, touched off by a worsening of the crisis in the Middle East or the launching of an attack on Iraq by the US.

A recent report by Osamu Tanaka and Robert Feldman of Morgan Stanley in Tokyo examined the impact of an oil price of $40 per barrel on the Japanese economy, which imports 90 percent of its oil requirements.

A permanent shift in oil prices to that level, they said, would squeeze corporate profits and then translate into a rollback of capital spending. “Then, as it becomes difficult for corporations to absorb higher oil prices, firms are likely to start transferring the burden to households by raising output prices and cutting wages. Accordingly, with a decrease in purchasing power and income conditions, consumers are likely to restrain spending.”

According to their analysis, the resulting drag on the real growth rate of gross domestic product would be - 0.8 percent for 2002 and -1.2 percent for 2003. “This hit to growth,” they continued, “would cause serious damage to the economy since the long awaited recovery is only finally coming into view”.

Despite the claims of the government and some commentators that the recession is bottoming out, and that an export-led recovery is around the corner, a number of statistics point to a continued economic deterioration.

Corporate bankruptcies in Japan rose for the third straight month in March with an increase of 5.9 percent on a year-on-year basis. The 2001 fiscal year, which closed on March 31, was the second worst year for bankruptcies since 1984. Of particular note were the collapses of general contracting firm Sato Kogyo with debts of $3.41 billion and First Credit with liabilities of $1.97 billion. Both were listed on the Japanese stock exchange. The 2001 fiscal year saw 21 listed companies go bust compared to 15 in 2000.

A recent survey of large private companies by the Nihon Keizai Shimbun showed that capital investment is expected to slump by almost 13 percent on average in the 2002 fiscal year, the second straight year of decline. The most affected areas include electronics, autos and steel, which will slash manufacturing capital investment by 10.7 percent. The non-manufacturing sectors are looking at a 14.8 percent decline in investment.

Wholesale prices continue to drop, indicating that the economy is still in the grip of deflation. Domestic wholesale prices fell 1.1 percent for the 2001 fiscal year, the fourth consecutive annual decline. Prices of electrical machinery, including personal computers, slumped by 5 percent largely due to the bursting of the information technology bubble.

April saw Japan record its largest corporate loss in history. The Nippon Telegraph and Telephone Corp., the country's largest telecommunications carrier, posted a $6.5 billion loss for the 2001 fiscal year. NTT is set to write off more than $15 billion from failed investments in other telecommunication companies—Verio Inc. and AT & T in the United States and KPN NV of the Netherlands. The company made huge investments in these firms at the height of the tech stock bubble and suffered massive losses when it collapsed.

In the finance sector, the bad debt problems keep mounting. A recent Financial Services Agency report indicated that a realistic figure of bad debts held by the banks was a massive 37 trillion yen or $283 billion.

The FSA report noted that although none of the top 13 banks in Japan had fallen below required capital adequacy ratios—an event that had been widely feared when new accounting laws came into effect on March 31—the nation's banks were in "intensive care".

Credit rating agency Standard and Poors has scotched claims that the economy has bottomed out and recovery is imminent. Last week it cut Japan's long-term local and foreign currency rating by one notch from AA to AA-minus, giving Japan the lowest credit rating of the G7 economies.

Announcing the downgrade, the agency said: "We had hoped that the Junichiro Koizumi administration would press for private sector and governmental reform. But given the government's falling popularity and the problems that have beset key ministers and aides, Standard and Poors has lowered its expectations in three key areas."

The three key areas are public debt, the bank sector and public spending and deregulation. On public debt the agency said it expected the government deficit to remain at around 8 percent of GDP for several years. "The deficit, coupled with weak economic growth prospects, makes Japan's fiscal stance 'unsustainable'."

In the banking sector, the provision for bad loans was "inadequate" and consequently, in the absence of proper capitalisation, "the financial sector will be reluctant to expand lending, thus hurting growth and blunting monetary policy".

On the issue of cutting government spending and deregulating the economy, Standard and Poors offered the following assessment: "The Koizumi administration is unlikely to trim pension and health entitlements, or to open protected sectors to greater foreign competition."

It seems that with its popularity sliding and an administration wracked with conflicts and scandals, the Koizumi regime is no longer regarded as either willing or able to carry out the Thatcher-style program demanded by key sections of Japanese and international capital.