# More signs of recession in Japan

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After weeks of wild fluctuations on the Japanese and global stock markets, further indications have emerged this week that the world's second largest economy is in recession. Assessments from the government and the Bank of Japan have painted a grim picture of the state of Japan's economy.

A Cabinet Office evaluation released on Monday declared that the "economy had weakened further" after describing it as "weakening" last month. It downgraded six elements of the overall assessment—exports, industrial production, corporate sentiment, bankruptcies, the labour market and consumer spending—the most since April 1998.

Economic and Fiscal Policy Minister Kaoru Yosano told reporters: "Japan's economy will stay on a downward trend amid the global slowdown. We just need to keep enduring it." Fumihara Nishizaki, director of macroeconomic analysis at the Cabinet Office, cautiously commented: "The downside risks are becoming clearer. This isn't an official judgment but Japan seems to be in a recession."

The Cabinet Office report warned that Japan's economic outlook might get even worse "due to the deepening financial crisis in the US and Europe and large fluctuations in the stock and foreign-exchange markets." Judging that the US was already "in a recession", it pointed to the risk that the US economy would worsen due to the credit crisis. The report also warned that the risk of recession in Europe was growing.

A recession in the US and Europe, which also is in line with IMF predictions, will inevitably impact on Japanese exports and the economy as a whole. In the second quarter, the economy shrank by 3 percent of GDP on an annualised basis—the fastest rate in seven years. Japan will also be hit by the slowing Chinese economy, which recorded a growth rate of 9 percent for the third quarter—well below predictions of 9.7 percent and down from the second quarter figure of 10.1 percent. China overtook the US in July as Japan's largest export market.

A Bank of Japan (BoJ) survey, also released on Monday, cut back its assessment of all nine of the country's regions—for the first time since the regional report was initiated in April 2005. Bank of Japan governor Masaaki Shirakawa told the media that the economy was stagnant because of high energy and material prices and the international slowdown, adding that it was "highly probable that the economy will remain stagnant as it has become clear that overseas economies continue to slow down."

Masahiro Samejima, BoJ's Osaka branch manager, told Reuters that orders for machine tools and construction material from emerging economies were slowing. He pointed in particular to China and other parts of Asia and noted that the rising value of the yen was hitting exporters hard. Yesterday the Japanese currency hit a three-year high against the euro and continued to gain against the US dollar and other currencies.

Like their counterparts in the US and Europe, Japan's major auto manufacturers are already feeling the impact of the global slowdown. Japan's biggest car maker, Toyota, posted a fall of 16 percent in sales volume for August compared to the previous year—the sharpest decline since May 1998. Its domestic sales fell by 19 percent and exports by 7.5 percent. The decline continued in September with sales to the US down 10 percent and sluggish in Europe. The latest figures cast doubts on Toyota's plans to boost sales in China by 40 percent this year.

Japan's third largest car maker, Nissan, has announced cutbacks to production in the US, Japan, the UK and Spain. Nissan sales in September plunged by 37 percent in North America, by 27 percent in the UK and 5.5 percent across Europe. In Spain, where sales fell by 23 percent, the company announced that it was cutting 1,680 jobs at its assembly plant in Barcelona.

Yasuo Yamamoto, senior economist at Mizuho Research Institute, told Reuters: "Japan may go into a deeper recession if exports and capital spending decelerate further. The impact of the global credit crisis on Japan's financial system has been limited, but chances are increasing for it to hit the economy hard towards the end of the year."

Reassurances from the government and Bank of Japan about the strength of the country's banks and financial system may be premature. The bankruptcy of Yamato Life Insurance on October 10 raised fears that Japan's smaller banks, financial institutions and insurers are vulnerable.

Yamato, a middle-level insurer, collapsed after it was unable to raise the capital to cover huge losses from its holdings of the US subprime assets.

Most Japanese institutions are not believed to be heavily exposed to toxic US debt, but a slowdown and increased bankruptcies could hit some banks. Economy Minister Yosano played down the Yamato collapse as "a special case". But as one credit analyst told the *Financial Times*: "It looks like a precursor of things to come in Japan."

**Stimulus packages**

In an attempt to stave off recession, Prime Minister Taro Aso pushed a 1.81 trillion yen ($US19.8 billion) stimulus package through parliament last week and has already announced a second package to be unveiled next week. Next week's package is mainly aimed at providing relief for small and mid-sized businesses and support for regional financial institutions but may include income tax cuts and deductions for people with home loans.

Critics have already pointed out that the packages will only add to the public debt, which at 180 percent of GDP is already the highest among industrialised countries. "The first one [package] wasn't large enough to really help the economy and the second one won't be either," Yasuhide Yajima, senior economist at NLI Research Institute, told *Bloomberg.com*.

Soichi Okuda, chief economist at Sumitomo Research Institute, said that the government faced a dilemma: it could not completely abandon its goal of fiscal reconstruction, but it had to find ways to stimulate the economy. The ruling Liberal Democratic Party (LDP) had previously pledged to end the budget deficit by the 2010-11 fiscal year. Okuda added that tax cuts would not help the economy, but were "more like a political show to appeal to voters before an election."

Aso, who took office on September 24, is not only seeking to prop up the economy, but his political popularity as well. His predecessor Yasuo Fukuda resigned after just a year in office amid falling popularity and growing signs of an economic slowdown. LDP leaders calculated that Aso's installation would give the government's poll rating a boost and lay the basis for an early election. Instead, Aso's initial poll rating was just 48.6 percent—far lower than Fukuda's initial 60 percent when he was installed last year.

The latest *Mainichi* newspaper poll shows that Aso's popularity has fallen by a third in one month—by 9 percent to 36 percent. The proportion declaring they did not support the Aso cabinet rose by 15 points to 41 percent, with nearly half of those expressing their disapproval of the prime minister's policies. The Aso administration has already suffered its first resignation. Transport Minister Nariaki Nakayama stepped down after creating a public uproar by describing a teacher union as "a cancer" and describing Japan as "ethnically homogeneous"—a slight on the country's Ainu minority.

More fundamentally, however, the plunge in the new government's ratings reflects broad alienation from the LDP, which, except for one brief period, has governed for more than half a century. Rising unemployment, inflation and economic uncertainty are all contributing to the hostility. Among young people, many of whom face an uncertain future as part-time and temporary workers, the disaffection extends to the entire political establishment, including the opposition Democratic Party of Japan (DPJ).

Within corporate circles, there is concern that Aso and the government's stimulus packages represent a return to the traditional LDP policies of large public spending on infrastructure and other public projects that benefit political allies, particularly in rural areas. Significant sections of the business elite view the DPJ as the means for pushing through the type of economic reform that was begun under former Prime Minister Junichiro Koizumi, but dropped under his successors.

Calling an early lower house election in the present climate of economic turmoil is a huge gamble for Aso. The DPJ already has control of the upper house. Voting intentions recorded by the *Mainichi* poll found that the DPJ would trounce the LDP by 48 percent to 36 percent in an early poll. But if the ratings of the previous governments are any guide, to leave calling an election until next year risks an even greater drubbing as the economy sinks further into recession and Aso's popularity plunges to unelectable levels.