Amid new recessionary signs, Japan unveils major stimulus package

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The Japanese government of Prime Minister Yukio Hatoyama announced an emergency stimulus package on Tuesday worth 7.2 trillion yen or $US81 billion for the first quarter of 2010 in a bid to stave off what officials warn could be a “double-dip recession”. The announcement came just a week after the Bank of Japan, under pressure from the government, injected 10 trillion yen ($114 billion) in low-interest, short-term loans into the banking system.

The stimulus package is an extension of one drawn up by the previous Liberal Democratic Party (LDP) administration, which was defeated by Hatoyama’s Democratic Party of Japan (DPJ) at elections in late August. The spending includes consumer subsidies and handouts to regional governments for public work projects. The overall price tag rises to 24.4 trillion yen if measures not requiring immediate outlays, such as loan guarantees to small companies, are included.

The Japanese economy represents one of the weakest links in the global economy. This week the official GDP figures for the second and third quarters were revised sharply downward from an annualised 1.2 to 0.3 percent and from 4.8 to 1.3 percent respectively. Indicated a continuing downturn, the Cabinet Office yesterday announced that core machinery orders had slumped by 4.5 percent in October, month-on-month, and were down by 21 percent compared to October 2008.

The *Wall Street Journal* commented on Wednesday that Japan’s fragile recovery in the second and third quarters had been largely due to demand from China. Expressing concern over the latest stimulus package, the article stated: “[A]s the effect of the previous government’s hefty stimulus spending begins to wear off and the yen’s sharp rise cuts into corporate profits, worries are growing that Japan may be pulled back into a recession early next year.”

The stimulus package will add to Japan’s huge public debt, which the International Monetary Fund predicts will hit 218 percent of GDP this year. Tax revenues for the fiscal year 2009 are expected to bring in only 37-38 trillion yen—the lowest figure since 1946 and far less than the previously predicted 46 trillion yen. To finance the latest stimulus package, the government will issue new bonds of around 9.3 trillion yen, bringing total debt issuance for the current fiscal year to a record 53.5 trillion yen. A majority of economists polled this week by Reuters did not believe that Japan would default within 10 years, but did forecast that its credit rating would slump from AA to A within five years.

The *Financial Times* on Tuesday warned the Japan was facing a “debt trap”, commenting: “With 10-year interest rates at, say 1.5 percent, Japan needs to run a primary budget surplus of 3 percent of GDP merely to meet interest payments. Shrinking its debt mountain requires an even bigger surplus—or faster growth.” As fast growth was almost impossible, the newspaper concluded: “At some point, the government will have to cut spending—just not now.” In other words, the government is caught in a bind: it has to cut debt levels, but to do so now risks sending the economy back into recession.

The dilemma has created tensions between the government and the country’s central bank, the Bank of Japan (BoJ). Last month Japan officially registered deflation—indicating economic stagnation—for the first time since 2006. The government used the issue of deflation to justify its stimulus package and to press the BoJ to stimulate the economy by injecting money into the banking system. The central bank, however, claimed that the economy was "picking up" and held interest rates in November at 0.1 percent rather than lowering them. It expressed concerns about the dangers of new financial instabilities being created by cheap credit.

The Democrats took office in September promising to boost social spending, while reining in the budget deficit by cutting back on waste and politically-motivated infrastructure projects. With a fragile economy plagued by weak exports, deflation and a 14-year high yen, the government's economic plans are in tatters. Hatoyama is under pressure from big business to cut public spending and speed up pro-market restructuring, but is also facing calls from within the DPJ and its coalition allies for spending measures to prop up political support.

The DPJ, which was established in 1998, is an unstable mixture of breakaway LDP factions and former Socialist Party groupings. Most of the top leadership backs an accelerated pro-market agenda, which is opposed by sections of the party and the DPJ's small coalition allies—the Social Democratic Party (SDP) and Peoples New Party (PNP). The PNP was formed by LDP lawmakers who were expelled by former prime minister Junichiro Koizumi for opposing the privatisation of Japan Post—the country's largest public saving institution.

The government's stimulus package was stalled last week by the PNP's opposition. The PNP approved the package only after DPJ agreed to provide 100 billion yen to regional governments—a return to the LDP's practice of buying rural votes, which the Democrats criticised heavily during the election campaign. While the finance minister is Hirohisa Fujii, a longtime advocate of market restructuring, PNP leader Shizuka Kamei holds the post of finance services minister.

Reflecting anxieties in business circles, the *Financial Times* on Tuesday described Kamei as "an obstacle to economic liberalisation". The *Wall Street Journal* article bluntly declared: "To come up with bold growth strategies, Mr. Hatoyama needs to show strong leadership and better manage his relationship with two small coalition partners whose views on some key issues are quite different from the DPJ's."

Uichiro Niwa, chairman of Itochu Corp, said Hatoyama's caving in to Kamei was "a case of the tail wagging the dog". He warned: "Japan's economy will not revive unless the government stops drifting and starts to choose and focus."

If Hatoyama fails to heed these warnings, other pressures can be brought to bear. Less than four months into office, he is embroiled in a scandal involving accusations that he breached electoral laws by misrepresenting, as small individual donations, 900 million yen given to him by his wealthy mother over five years to 2008. Although Hatoyama's position is not immediately threatened, such a scandal could be exploited to whip him and his government into line.

At the same time, the DPJ is dependent on the PNP and SDP to pass legislation in the upper house, where it lacks a clear majority. With the upper house elections due in mid-2010, Hatoyama's popularity is already falling. A poll released by *Yomiuri Shimbun* on Monday shows that the support for the cabinet has fallen below 60 percent for the first time, down from more than 70 percent immediately after its August 30 election win. If it fails to secure an upper house majority next year, the government will be even more politically dependent on its coalition partners.

In winning office, the DPJ ended more than 50 years of virtually continuous LDP rule. The tensions that have rapidly emerged within the new government point to deepening political instability as the economic crisis in Japan and internationally worsens and class tensions sharpen.