



insight *Japan*

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Away from it all

**Japan in Asia . . . in
Germany . . . artists in
France**

**What young Japan thinks
of England**

Opportunities Ahead

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Compared with Britain's fragile recovery and Continental Europe's deepening recession, economic prospects in the Far East appear bright. China and other South-East Asian countries are booming, as they try to recreate Japan's post-war economic success, helped by large capital inflows by western investors. But what is happening in Japan?

Japan is still overcoming the problems of the 'Bubble economy'. Recent economic indicators are mixed, suggesting the economy may be near the bottom of the 'growth recession'. It is necessary to distinguish between public sector activity, which is rising, and the private sector, where conditions are still fragile and have not been helped by the latest surge in the yen.

The Government's fiscal packages of August 1992 and April 1993 are gradually feeding through, boosting construction activity, and with more public works spending in the pipeline this should gather momentum towards year-end. However, it is difficult to find any improvement in confidence as a result of the Government's measures and the picture from the private sector is varied. Consumers remain cautious, limiting spending and repaying debts. In May, Tokyo's department store sales were 9.3 per cent down on a year ago. Production remains sluggish, as industry continues to restructure in the face of high fixed costs, sluggish demand and a strong yen. Indeed, the latest quarterly *Tankan* survey by the Bank of Japan shows that a net 49 per cent of large manufacturing firms regard business conditions as 'bad', twice as many as replied so a year ago.

YEAR-END SIGNALS

But by year-end, there should be evidence of recovery in Japan. By then, the Government's spending packages will have had more impact and stock adjustment in the industrial sector should have been completed. And if forthcoming data disappoints, there will be intense pressure in both Japan and from the USA for further Government pump-priming, or indeed another interest rate cut.

Recovery is likely to be sluggish by Japanese standards. As has been seen in the USA, the aftermath of a debt overhang can take a long time to feed through: banks are reluctant to lend, while people and companies are cautious about spending. These problems could be particularly acute in Japan, where land prices continue to fall.

In the past, European companies have found it difficult to penetrate the Japanese market, even in boom conditions. This time round things should be different, even if the recovery is sluggish.

Encouragingly for European exporters, the structure of the Japanese economy is changing, albeit slowly. Two developments in particular should boost import growth into Japan.

First, the strong yen will favour domestic consumption in Japan at the expense of Japanese exports. In the late 1980s the Japanese Government pursued a strong yen, or *endaka* policy. The current strength of the yen has, however, been forced on them by US concerns over Japan's large trade surplus. The net result has been a slowdown in the rate of Japanese export growth, as foreign goods have become more competitive.

The initial impact of a strong yen is deflationary. A recent report from the Bank of Japan showed that if the yen remained at Yen 110 to the US dollar compared to Yen 119 this would lower Japanese growth this fiscal year by 0.6 per cent to 2.3 per cent (even this lower forecast seems too optimistic). But eventually the strong yen will depress Japan's already low inflation rate, allowing real incomes to rise and contributing to a further boost in consumption. In recent years, more of Japan's growth has been accounted for by consumer spending and this should remain the case in coming years.

The second important effect is deregulation. Britain has very strong and efficient retail and financial sectors but a manufacturing sector that is too small. By contrast, Japan has a highly efficient manufacturing sector but its retail and financial sectors are yet to mature fully. Deregulation could change all this, as it forces change, including the opening up of the retail distribution system. This should make it easier for foreign firms selling the right, high quality products to access Japanese markets.

So, how should European companies respond? In their home markets, it is clear Europeans will face increased competition from Japanese firms rebasing production overseas and from a wave of high quality products from the new tigers of South East Asia. But there will also be tremendous opportunities for European exporters in the years ahead, not least in the Japanese economy when it recovers.

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