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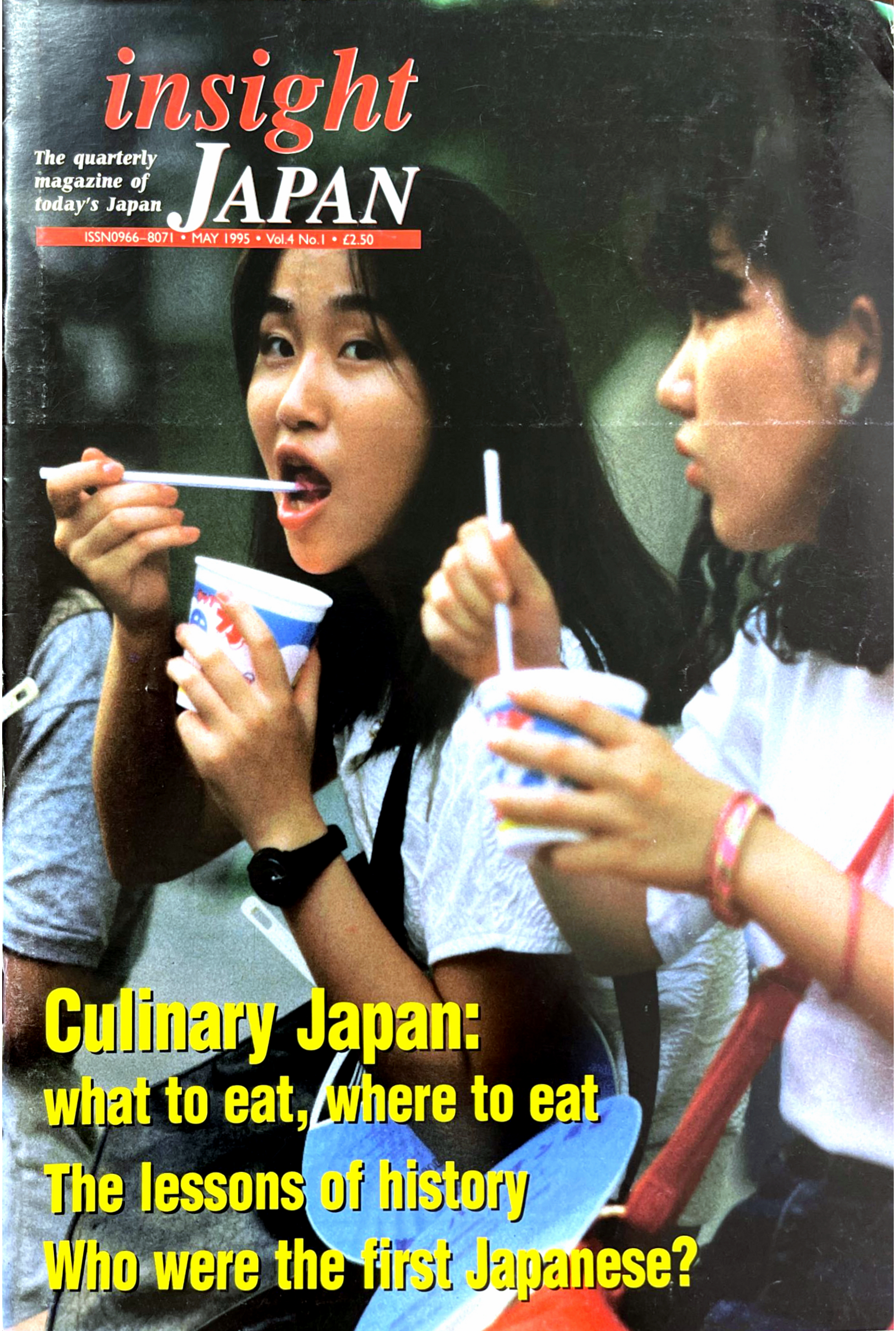

Culinary Japan: what to eat, where to eat

The lessons of history

Who were the first Japanese?

Strong yen flexes

One of the clearest trends in economics in recent years has been the strength of the yen. Since 1985 the yen has appreciated from ¥:$251.5 and ¥:£291.5 to its current ¥:$87.3 and ¥:£140.5, respectively. Now the yen has reached the level where many people believe that it cannot appreciate any further. The trouble is that much the same thing was being said a year and two years ago, when the yen was weaker. It will probably be said in a year's time, only then the yen will be stronger.

There are two important messages. The first is that the yen can strengthen further. The second is that any further appreciation will accelerate deindustrialisation, or 'hollowing out', of the Japanese economy.

There are several reasons for the yen's strength. Japan's sizeable trade surplus is one key factor. Another important reason has recently been the desire of Japanese investors to keep their funds at home. In some respects this is a self-fulfilling exercise. Japanese investors have been unwilling to buy US assets, because the dollar was weak. But one reason why the dollar was weak was because too few international investors wanted to buy US assets.

In view of growing financial problems, investors are putting their money where it is safest. For American investors this naturally means keeping money in dollars, but for nearly everyone else it points to investments in Deutsche marks and yen. For Japanese investors such as pension funds and insurance companies this means keeping money at home in Japan or repatriating it from overseas, thus giving the yen a boost. Yet investors are not putting their money into the Japanese stock market, instead it is being invested in Japanese government bonds or just left in cash.

"The impact of the yen's strength should sow the seeds of its own downfall, but the mechanism by which this will occur will be some time away"

What we are witnessing is the early emergence of three reserve currencies for the world. Currently the dollar remains the world's reserve currency, but in time the Deutsche mark and the yen should continue to become more important than they already are.

ECONOMIC TRADING BLOCS ARE ALREADY EMERGING: in Europe, in the Americas and in Asia. Intra-regional trade is rising in all these areas. So European countries are trading increasingly with one another and intra-regional trade in Asia is also rising, albeit from a low level. These economic and trade trends reinforce the case for a strong currency in each region: DM, dollar and yen. But if the yen is to become a true reserve currency it requires the Japanese Government to accept increasing international responsibilities, including allowing the financial markets to become more open.

In many respects it reinforces the case for deregulation. At the end of March the Government unveiled its new deregulation measures. It is clear from these, however, that it intends the pace of change to be slow. This is hardly surprising, given the number of vested interest groups that do not want change. However, change is happening almost regardless of the Government, and here the strong yen is playing a very important role.

THE STRONG YEN AND INCREASED COMPETITIVE PRESSURES in Japan are forcing deindustrialisation, as Japanese companies move production offshore at a dramatic pace.

The latest Bank of Japan survey shows that this year one-fourth of investment and one-fifth of production by Japanese firms will be outside Japan. Rising investment overseas will be at the expense of investment in Japan. Large Japanese firms plan to cut investment at home by 1 per cent in the coming year and small firms plan a sizeable 24.5 per cent reduction. This is just one of the reasons why the Japanese recovery will be mild by previous standards.

One might ask then, surely the yen's strength cannot continue if it is contributing to such change in Japan. In some respects this is right. The impact of the yen's strength should sow the seeds of its own downfall, but the mechanism by which this will occur will be some time away. Just as it has taken many years for a weak dollar and weak sterling to allow US and UK firms, respectively, to become more competitive so it will take some time for a strong yen to erode fully Japan's competitiveness.

Japan's trade surplus will get smaller in coming years, partly because of the strong yen. It will be cheaper for Japanese consumers to buy foreign goods and deregulation at home will allow them greater access to buy them. This is already happening. At the end of last year the volume of imports into Japan rose by a phenomenal 18.6 per cent from a year earlier. Higher imports will reduce the trade surplus, but only very slowly, because Japanese exports are still quite strong.

Amazingly, despite the surge of the yen during the last year, which has made Japanese goods extremely expensive for foreigners, exports are still rising. Last December, the volume of exports rose 6.8 per cent from a year earlier. This partly reflects the fact that Japanese goods are not price sensitive. People still buy them for

its muscles

GERARD LYONS

their quality. Strangely, however, exports are also rising as a result of the yen's strength. As the strong yen forces Japanese companies to shift production offshore, the initial plant, machinery and intermediate goods needed to establish offshore companies will probably have to come from Japan. This boosts Japanese exports, though in time, once the overseas operations and plants are fully operative, Japanese exports will suffer. This will result in the switching of production out of Japan.

The financial sector is not escaping the impact of the strong yen and of deregulation, as the recent merger between Mitsubishi Bank and the Bank of Tokyo showed. The combined impact of the recession, a collapse in the stock market and a continuous fall in land prices since 1990 has left many financial firms nursing large bad loans that will take some years to write off.

On top of this, Japanese banks and financial institutions are being exposed to increased competitive pressure, as the barriers and regulations that separated them are removed and as foreign firms are allowed greater access into Japan. DKB, for instance, was allowed to open up a securities subsidiary in Tokyo last November. All this points to greater competition, further rationalisation and mergers throughout the financial sector.

There are two schools of thought in Japan. The first assumes that once the economy recovers then Japan, as usual, will experience strong future growth.

I would include myself in the other school of thought, which believes the economic future will not be the same in Japan. Deflation will favour consumers at the expense of industry whilst deindustrialisation will see firms shift production offshore, resulting in a move towards the service sector in Japan, much as experienced in other industrial countries. This inevitably points to slow future growth and to Japan living off the interest, profits and dividends of its overseas assets, much as Britain did at the turn of this century. □

The state Japan's in

NORIKO HAMA

The State We're In is a title that appears well on the way to topping the best-seller charts in bookshops across London. Written by journalist Will Hutton, this recently published book is a critical analysis of the established British way of doing things: how it has gone wrong, and how deep-rooted the causes of the malaise are. Its jacket trails:

"One of the world's great success stories – the British state and the British economy which it supported – is in serious trouble as it nears the twenty-first century. *The State We're In* is a passionate denunciation of the institutions that have brought us down, and a demonstration of the underlying systematic nature of our problems..."

Substitute the word 'Japanese' for 'British' in these sentences and one arrives at a startlingly near-perfect picture of the arguably even greater success story of this century that has gone even more gravely wrong as it nears the twenty-first century. Well might many a hard-working Japanese businessman cry out in perplexity: "Just look at the state we're in! Where did we go wrong? What is happening to us?"

The state we're in today presents a sorry sight indeed. The economy has lost its capacity to grow, the stock-market has plunged and the yen is caught in a whirlwind that takes it to ever dizzier heights from which there seems no escape. The Japanese economy as measured by real GDP shrunk by an annualised 3.4 per cent in the three months to December 1994. As expected, public spending has run out of steam, housing investments are on the decline and there is nothing to take their place as alternative sources of growth. The first three months of 1995 are also likely to have registered negative GDP growth, given the effect of the Kobe earthquake, coupled with the soaring yen.

As financial year 1995 drew to a close on March 31, the Nikkei stock market index stood at 16,139.95 – down effectively 3,000 points from where it was just a year before. The index has fallen through the crucial 16,000 floor on a number of occasions. No amount of price keeping operations (PKO), or indeed price lifting operations (PLO) can do it much good now. Barings trader Nick Leeson's aborted flutter in the Osaka Stock Exchange and elsewhere was but another ripple on the