

insight **JAPAN**

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A photograph of two men walking from left to right. They are wearing matching blue blazers with a crest on the sleeve, white trousers, and white hats with blue bands. The man in the foreground is carrying a black briefcase. In the background, there is a large mural of a woman in a white dress, with the word 'Lively' written in cursive below her. The scene appears to be outdoors, possibly on a sidewalk or near a building entrance.

**Japan and Italy
time to celebrate
Space : the new milestone
Web-surfer's way into Japan**

living that keeps intense hardship by and large at bay. Yet size alone cannot ensure strength, as Samson found to his cost. And as he found to his gain, a humble admission of one's weakness and a genuine plea for help can lead to miracles. The private sector has awakened to the need to mend old habits, and the humility with which self-scrutiny is taking place at least in some segments of industry is a potential source of renewed future strength. The same cannot be said of policy makers; admitting to weakness has never been their strength.

The postwar drama has come to an end: a new post-war drama has to be written, by those who recognise the new seeds of strengths and are able to identify the weaknesses embedded in the strengths of past years. The new production needs to be unveiled quickly. For it is the public who suffer from an outdated show, through boredom, disillusionment and unnecessary and unproductive cost. The Japanese public of today are impatient for something new – hence their reckless voting into office of two municipal governors both of whose major area of expertise is laughter and entertainment. Maybe it is comedy and witticism that

the people now hanker for, after all the intense heroism of the past fifty years.

This then, is a difficult time to be talking of Japan's strengths and weaknesses, for the two are so intricately intertwined, and what were once strengths in their assurance of stability have now become weaknesses that are the sources of rigidity and self-suffocation. So much is changing; so much change is required. And as the changes proceed, as they must do, for the alternative can only be tragic death for the hero, strengths that were once hidden and buried beneath the postwar structures will come to the fore and a new Japan will emerge. Let us hope that will be a place of great diversity, spontaneity and virtuosity. Samson's regained strength brought destruction on his foes and salvation for his people. For Japan, a new lease of life from reinvented strengths would be a welcome outcome. □

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Back from the brink

GERARD LYONS

In recent months the Japanese Government and the Bank of Japan have pulled the economy back from the brink of recession and financial melt-down. The Bank of Japan has continued to intervene to force the yen weaker. Official interest rates are now only 0.5 per cent and look set to remain low for some time. In September, the Government unveiled another huge fiscal stimulus, of £90 billion.

Without increased public demand, GDP would have fallen for the last three years and would be set for another decline this year. As it is, the economy grew by a meagre 0.6 per cent last year and is set to rise by a similar amount this year. By next year the economy should have gathered sufficient momentum to grow at just under 2 per cent – a very weak recovery by Japanese standards.

Many factors have accounted for Japan's recent problems. Like other industrialised countries Japan has had to recover from the excesses of the late 1980s, particularly the surge in debt; it has also had to overcome structural, or deep-rooted problems, such as the need to deregulate its economy. The yen's appreciation in recent years has made the adjustment difficult. So much so, that Japan has lost its competitive edge, and many firms are now 'hollowing out', shifting production to low cost countries elsewhere.

Japan's greatest problem is deflation. The combination of deregulation, intense competition and cost-cutting has forced consumers to search for value-for-money, prompting a surge of imports into Japan, and squeezing profit margins in the process. In this environment, worries about jobs and wages have

intensified, undermining consumer confidence. The same disinflationary pressures evident in other countries can thus be seen in Japan, only on a greater scale.

As if this wasn't enough, the financial sector has faced a number of bankruptcies, further sapping consumer confidence. Even if the economy was doing well there would have been the need for a shake-out in the financial sector, which has been too protected by regulations in the past. But with the economy in a poor way the fall-out in the financial sector is high.

All this raises the question as to whether Japan is now on the slippery slope to economic ruin (after all, some are suggesting that its budget outlook is worse than Italy's). Despite all the doom and gloom it is far too early to take a pessimistic view of Japan.

THERE ARE CURRENTLY TWO SCHOOLS OF THOUGHT in Japan. The first is that recent economic problems will not fundamentally alter the outlook for Japan, which will continue to experience relatively rapid growth rates by western standards. This is almost the "as you were" view. The second school, into which I would include myself, takes the view that Japan is experiencing far more than a cyclical downturn. Structural change is under way, which will have a significant impact on the economic outlook. Future growth will be modest, not buoyant.

I am cautious about Japan's prospects, but not pessimistic. Hollowing out will not just result in lower cost, lower quality production shifting offshore. High quality production will also shift. Evidence is already there, and not just in the car industry. Japanese

electronics companies are to start production of Digital Video Disks (DVD) overseas – the first case of Japanese firms starting production of such an advanced product outside Japan. As high quality production shifts, this leaves Japan itself with a more service sector economy, implying a slower pace of trend growth. The trend on trade will also be less supportive, with export growth slowing as production shifts overseas and as deregulation and increased consumer spending sucks in more imports.

Will this prevent Japan from being regarded as an economic superpower? Probably not. After all, the USA's economic track record has been far from distinguished and it is the world's main economic superpower. According to the World Economic Forum's annual survey Japan has lost its competitive edge in recent years, slipping from being the world's most competitive economy to fourth. America now occupies number one spot. This survey is very qualitative and is not the best guide, but in the case of Japan it gives a good flavour of what is currently happening.

Much depends on how Japan overcomes its present uncompetitive position, how it copes with the need to deregulate and addresses its future demographic problems. The worst scenario would be if vested interest groups halted the pace of deregulation. Yet if deregulation occurs there will be casualties, not just within the financial sector but also amongst small and medium-sized firms. The result will have to be further pump-priming by the Government, adding to investors' worries about the fiscal outlook.

The movement of production out of Japan will be good news for the Japanese manufacturing companies, but not so good for the Japanese economy itself. Japan's success has been built on a relatively straightforward economic formula: the country has saved a lot and this, in turn, has created a healthy pool of money for investment. This investment has been directed at education and manufacturing. So much so that Japan has many of the world's top industrial companies. Investment in the infrastructure had not been a priority, but that too is now being addressed.

THE CLEAREST EVIDENCE OF JAPAN'S ECONOMIC MIGHT is the way its overseas assets have built-up. Its continued large trade surpluses, which have contributed to the strong yen, have enabled Japan to accumulate a vast stock of assets. At the end of 1994, Japan's net overseas assets were \$689 billion. That is a phenomenal rise from only a decade earlier – at the end of 1984 net overseas assets were just over \$74 billion, and the bulk of these assets are held by the private sector.

During the 1980s there was often talk of a Japanese wall of money. As the yen appreciated foreign goods became so cheap the Japanese could often be seen on foreign shopping trips. More Japanese started to travel overseas, spending heavily as they did. Yet what attracted the world's attention was the large scale Japanese buying of 'big ticket items'. Mitsubishi bought New York's Rockefeller Centre in 1989, Sony purchased Colombia Pictures the same year. London was not immune to the inflow, with Bracken House and the former GLC building County Hall both going to the Japanese.

The money flowing out of Japan peaked in 1989, coinciding with the bursting of the bubble economy back home. Since then, many of the assets Japanese

bought overseas have fallen in value, particularly in real estate. Despite this, the Japanese still remain large investors abroad.

Overseas direct investment fell from \$67.5 billion in 1989 to \$34.1 billion in 1992 but has now started to climb again, reaching \$41.1 billion last year. These are big flows, but the speculative buying of overseas assets has fallen away. There is still no guarantee that the Japanese are investing in the right areas, but the figures remain impressive. During the last year, apart from Japanese firms building plants abroad there is evidence of increased bank lending overseas by the Japanese and, more recently, evidence of buying of foreign securities.

As the world's major exporter of foreign capital Japan has to be considered economically powerful. Yet the ageing population could start to sow the seeds of Japan's own downfall. As the population ages this will soon eat into Japan's high savings, removing the source of much of the investment that has propelled the economy. The most dramatic consequence of this will be not just a decline in Japan's trade surplus but early next century a move into trade deficit.

So it is important for leading Japanese firms to continue to invest in high growth areas, maintaining a competitive edge. Even though much of the production may take place outside Japan, the interest, profits and dividends can flow back to Tokyo.

JAPAN'S LOCATION REMAINS A STRONG POSITIVE FACTOR. It should benefit from the emergence of Asia as the major growth area of the world in the next thirty years. As Japanese firms shift production to elsewhere in Asia, the ties between Japan and the rest of the continent will grow.

What then will happen to the yen? Its relentless rise came to a halt this summer. Clearly the speed at which the yen has appreciated and the levels to which it had moved earlier this year became destabilising. Japan's present problems justify a period of relative yen weakness. But two factors remain supportive of the yen in the medium-term.

First, Japan is relatively rich when compared to other countries. Looking at net assets and liabilities in relation to the size of each economy, Japan has net external assets of about 14.5 per cent of GDP. By contrast the US is a net debtor, with overseas liabilities of 10.4 per cent of its GDP. Second, growing intra-regional trade and the early emergence of three trading blocs, centred on the US, Europe and Asia has boosted the attraction of the yen and the DM against the dollar. The dollar now accounts for just over 60 per cent of global foreign exchange reserves, down from 80 per cent in 1977, whilst the DM has moved from 9.3 per cent to 16.1 per cent and the yen from 2.5 per cent to 9 per cent. There is clearly a long way to go before the yen could be regarded as a reserve currency, but its importance has grown, reflecting the growth of Japan.

It is therefore ironic that a weaker yen is a key part of present policy. Even if the yen does weaken further, it would be premature to suggest Japan's economic power is on the wane. Instead, much needed breathing space would have been found. □

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