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**Notable Points in the Economic Report for Workers, FY2001-FY2002
“Overcoming Deflation and Reviving the Japanese Economy”**

RENGO-RIALS

Since we entered the 21st century, the Japanese economy has continued to struggle along under the dark shadow of pessimistic outlook. The economy may indeed be described as having slipped into an unprecedented pit of deflation, marked by two consecutive years of drops in consumer prices as well as the continuing decline in stock and land prices. The recent report of further rise in unemployment rate to 5.5% in November was yet another piece of gloomy news that dampened the future prospects of the nation's economy, causing considerable anxiety and a heightened sense of uncertainty across the country.

This economic report for FY2001-FY2002, then, represents an analysis of the economy in the grip of such extremely severe conditions, both internal and external.

1. Ever-Deteriorating Economic Conditions:

Japan's economy is currently on a recessionary phase, as it is forced to deal with a serious deflationary pressure as well as high unemployment rate in excess of 5%. Furthermore, with the precipitous slowdown in the United States economy, which, showing a remarkable prowess, had been pulling along the world economy for some time, many other economies in the world now appear to be showing stronger signs of slipping further into recession simultaneously; the terrorist attacks of September 11 on the U.S. also seem to have had a serious negative impact, deepening the sense of murky uncertainty about the future around the world.

The Gross Domestic Product of Japan in real terms has shown little growth, stagnating at about the same level since the April-June quarter in FY2000; the nominal GDP showed negative growth in all major demand categories for the first time ever in the country's postwar economic history, signifying the seriousness of the deflationary pressure.

A look into the background for causes that may have been responsible for bringing about the recession points to several structural problems that have long plagued the economy since the 90s, in addition to cyclical factors. The apparent threat of deflation is one; the persistent problem of non-performing assets another. One may want to cite the slowdown of the American economy as yet another contributing factor.

2. Economy's Weaknesses Exposed by Recession

The economic recovery since 1999 proved rather short-lived, as consumption remained stagnant throughout and the economy slid back into another recession without showing visible signs of a

strong recovery even temporarily. Major causes often cited include slower growth in exports mainly due to the slowdown in the U.S. economy, collapse of the information technology (IT) bubble, stagnant consumption, and inadequate government spending to shore up the economy. The export volume reached a peak in February, 2000, but has been on a downslide since, plummeting further into negative growth in 2001.

What characterized the economic recovery from 1999 to 2000 was what has been described as the "IT" boom. After late 2000, however, both the output and investments of the electric and electronic equipment industry dropped significantly. This appears to reveal that the so-called IT boom was not a self-generated phenomenon, firmly based on the country's domestic economy, but was rather something resulting largely from an explosive demand from the U.S., directly or indirectly through other parts of Asia.

It should also be noted that even during the recovery phase from 1999, consumption remained stagnant: real consumption continued a negative trend in comparison with the same periods of a year before. One of the major reasons suspected has been the prolonged standstill in growth of real wage and income levels, coupled with progressively aggressive corporate restructurings, which forced consumers to hold off resuming their spending out of their continued worries over the future.

At the same time, increasing criticism against the ever-growing national debt helped weaken the government's will and ability to shore up the economy through fiscal measures; through the fiscal year of 2000, the government's fiscal policy program remained largely neutral.

3. Causes of Deflation

Through the recovery period from 1999 to 2000, prices continued declining. Comparison of monthly consumer price indices with those of a year before indicates that the indices either stayed on the level or showed negative growth from mid-1998, continuing on a downward slide from late 1999 with widening negative gaps.

Prices of both goods and services are continuing to decline. Various factors may be considered contributing to this. Increase in cheaper imports and further cuts in production cost would lower the prices of goods. Another apparent cause is the continuing weakness in demand for consumer goods. On the other hand, the fact that prices of services also remain in a negative-growth range seems to reflect that personnel costs are being held down low by employers. A similar declining trend has also been observed in GDP deflator that has shown a drop of close to (minus) two per cent, which is greater than the rate of decline in consumer prices. This seems to indicate clearly that the deflationary pressure is making further inroads.

The deflationary trend is particularly conspicuous in asset prices: the commercial land price, for instance, on the nationwide basis in 2001 dropped down to about 80% of the 1985 level, while stock prices in terms of Tokyo Stock Exchange Price Index similarly plummeted by July, 2001, to about 40% of the level at the end of 1989.

In the meantime, the money supply has been on a firm increase, though it has not translated into higher prices. This plainly illustrates weak corporate demand for funds. The phenomenon that the money supply increase has not caused neither price increases nor economic revitalization may be explained by the belief generally held by the public that in long term, the Bank of Japan would

likely maintain a tight monetary policy, as well as a widely-held pessimistic outlook of the overall future of the Japanese economy.

A variety of dire effects on the economy are being pointed out, should such price declines be allowed to continue. One fear being expressed by some observers is that such continuing price drops could cause even nominal decreases in sales, generating a profoundly negative psychological impact on people and aggravating their already negative outlook on the economy. Should such a negative psychological impact be allowed to remain strong, it is feared, the price decline and recessionary pressures may progress at an accelerated pace, pushing the economy into a deflationary spiral, leading to much worse consequences.

We should also note that the sharp decline in asset prices have had an extremely serious effect on the balance sheets of business corporations and banking institutions.

4. Non-Performing Assets Problem

Weaknesses inherent in the Japanese economy began to loom large and more worrisome in 2001. As one of the underlying factors, the problems related to the huge amounts of non-performing assets on the books of financial institutions once again came to emerge as one of the major issues for serious public debate. The reality is that the public anxiety and concern over the health of financial institutions appears to be growing and many fear that the amount of non-performing loans may further increase sharply, as the economy remains mired in another recession. If the asset prices continue to decline and the overall economic conditions worsen, non-performing assets would likely increase, further eroding the capital base of banking institutions and making their liabilities position untenable. Such dire developments are now conceived as a real possibility.

Exactly what ill effects such an excessive amount of non-performing assets has actually brought upon the overall economy is not entirely clear. One view is that banks which hold large amounts of non-performing loans on their books would likely restrain their lending (“credit crunch”) in order to minimize risk, which would adversely affect the overall state of the economy through constraints placed on investments in plant and equipment. Another explanation offered is that the real problem lies in the serious inefficiency in corporate management and operations, where many businesses hold idle assets, on which they carry large amounts of debt. According to this argument, allowing such inefficient businesses to continue to exist has dragged down the whole economy into mire.

Looking from another perspective, one could also argue that the existence of such huge amounts of non-performing assets has helped aggravate public anxiety and distrust of financial institutions, which in turn heightened the sense of uncertainty and murkiness over the future of the economy and led the public to form a pessimistic outlook in general. Such progression of developments, the argument goes, has laid the whole economy on the skids.

If such has indeed been the case, it would follow that what is immediately necessary to resolve the non-performing assets problem would be for the banks to redouble their self-help efforts to improve their profitability, to gradually and steadily dispose of such bad assets, and eventually to regain the public trust in their institutions. If such a task should be judged too difficult for an institution to achieve, a direct intervention by the national government may be necessary for the good of the entire economy. In such an event, the government should readily step in to forcibly

reorganize, rebuild and strengthen the institution so that public trust could be restored to a desirable level. One of the means available for doing this is an injection of public funds. When public money is going to be used, however, it is indispensable to hold the management of the financial institution fully accountable in order to circumvent the question of moral hazard as well as gain the understanding and cooperation of the people. An important challenge, at the same time, is to accomplish a fundamental reform of the nation's financial system so that it would enable an effective management reform (of the affected institution) within the framework of a well-designed public scheme and subsequent re-privatization of the (restructured) institution.

5. Developments in Employment and Labor Market

Under the deteriorating economic conditions, the nation's unemployment rate broke the five per cent mark in July, 2001, for the first time in history, a record that has since continued to be rewritten for the worse. The situation is getting quite serious, indeed. The number of new job offers has declined sharply, with the ratio of job offers to applicants also showing a negative slide. In the job market for new school graduates, the situation for new high school graduates is particularly dismal, with both employment rate and the ratio of job offers to job applicants recording historical lows every month.

Against the backdrop of further deterioration of the economy, the feeling among corporate managers that their workforce might still be too large appeared to be intensifying again, particularly in manufacturing and construction industries. The number of business bankruptcies remains at a high level; since we should expect in the near future further developments such as disposition of non-performing assets on a major scale, employment adjustments at a number of businesses (to further reduce their workforce) are feared to increase their severity, as time progresses.

6. Unemployment Trend

The unemployment rate averaged 4.7% through 2000, but it has since turned upward to reach 5.4% in October, 2001. Especially noteworthy about unemployment lately is the fact that the rate is higher among men than women, indicating a particular difficulty existing in the current labor market.

The number of the totally unemployed averaged 3,200,000 people in 2000, as the number of those categorized as involuntary unemployment has showed a steady increase. In terms of age groups, the unemployment rates among youth and the elderly are found to be particularly high. It is also notable that the number of those who remain unemployed for more than a year has been rising and that the number of those attributing their unemployment to reasons such as reduction in force and corporate bankruptcy has also shown a marked increase.

As to major reasons for such a high level of unemployment, we could point to the rising trend in the structural and frictional unemployment rates over the recent years. Major factors contributing to such a trend may include: the "hollowing" of industries accompanying the ever-growing globalization of the economy, the proportionate increase (in the labor force) of workers, other than regular staff who tend to get frequently unemployed because of widening mismatches on account of their age, industry or profession, and recent attitudinal changes towards work and employment particularly among young workers.

7. Programs for Employment Recovery

In order to achieve adequate recovery in employment, we should, more than anything else, endeavor to bring about a steady economic recovery, setting the nation's economy back on a firm track toward an appropriate growth; it would be essential to wipe off the gloomy murkiness out of the future outlook of the economy and turn around the corporate growth prospects upward. The greatest safety net for employment consists in stable (and secure) employment; what is urgently called for is positive and creative measures to generate employment opportunities.

At the same time, when we take into account the likelihood of continued severity in employment and unemployment conditions, it is obvious that we also need to address and meet a variety of specific challenges such as strengthening the job and employment referral and counseling service function, providing stronger government support for programs designed to develop and enhance the skill and knowledge levels of (unemployed) workers, relaxing the age restrictions on job seekers, development of adequate programs to address specific concerns of young people and workers, improvement of the unemployment insurance program including increase in the amount of benefit payment and extension of the payment period, and creation and expansion of new employment opportunities in the public sector.

Work-sharing in some form is also occasionally proposed in various discussions as one of the possible measures to deal with the serious situation. The concept does appear to offer some significant benefits in that it helps to sustain and create employment and alleviate the fear of unemployment. It also seems to help create a variety of employment opportunities and different ways to work. For such a scheme to work and produce desired benefits, however, it would definitely require strong government support as well as broad social agreement between management and labor on work modes under such a scheme and desirable social framework (for facilitating effective implementation of such a system). It goes without saying that similar social agreement and consensus should be worked out to address the cost aspects of such a proposition.

8. Necessary Macroeconomic Measures

For Japan to extricate itself from the extremely difficult economic straits, it would be imperative for the nation and its government to effect a total mobilization of all policy tools available in order to first crawl out from under the deflationary pressure. At the same time, as actual implementation of the much publicized "structural reform" is expected to exert a deflationary impact on the economy, the government is strongly urged to map out and execute a set of appropriate macroeconomic policy programs, which would include adequate and sufficient employment improvement measures, adequate fiscal policy, and continuation for the time being of the current loose monetary policy.

It goes without saying, however, that as such policy programs are carried into effect, the government's administrative efficiency and substantive specifics of fiscal expenditures need to be constantly monitored and reviewed, so necessary adjustments could be effected in a timely fashion.