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EIR Economics

The 'virtual recovery' in Japan won't last long

by William Engdahl

From early June onward, financial market gurus have seized on the idea that the world's second largest industrial economy, Japan, is waking to the dawn of an economic recovery. Since the beginning of this year, the Tokyo Nikkei Dow stock index has risen 42%. At the same time, Japan's currency, once predicted on the verge of collapse to levels of 200 yen to the dollar, is surging to nearly 100 yen as of Sept. 22. Indeed, so strong has the yen become in recent weeks, that Japanese Finance Minister Kiichi Miyazawa sent his deputy minister, Haruhiko Kuroda, to Washington on Sept. 20 to win an agreement with Treasury Secretary Larry Summers that would bring the dangerously high yen back to earth and ease mounting pressures against Japanese exports.

The most astonishing aspect of this remarkable recovery in the past four months is that it is based on "virtual recovery," with no basis for a serious sustainable revival of Japan's depressed economy anywhere in sight.

'Reality, virtual and actual'

"The whacko world of finance believes that Japan may be in a recovery," remarked a well-placed European banker to *EIR*. "On this issue there is simply no debate. The idea of a Japan recovery now has a life of its own, helped on by bogus Japan economic data. These financial markets don't care; they are trading on a Japanese virtual recovery, in hopes of making a lot of money, quick." The virtual recovery was kicked into gear in early June, when the Japanese Economic Planning Agency announced that the country's GDP grew at an impressive 2% rate in the first three months of 1999 compared with the fourth quarter of 1998—an annual growth of 8%! That data signalled to international investors that they were in danger of missing the long-awaited turnaround in Japan's worst economic depression since 1945. Funds began flooding into yen and Japanese stocks.

A brief, cautious pause in fund inflows in August was reversed, after Sept. 13, when the EPA again released GDP data, for the second quarter through June 30. That data showed, not the expected return to negative growth, but a second rise, albeit only 0.2%. But, it was enough to trigger a major shift of international investment flows into the yen market. With a rising yen, the currency rapidly rose from 115 in early September to 104 by Sept. 16, a jump of more than 13% since only June.

Informed market sources say the unexpected yen rise above 115 triggered not only investment flows into Japan which pushed the currency higher, but also forced the troubled Princeton Global Fund of Martin Armstrong to frantically buy yen in a rising market, pushing the currency even higher. The rising yen set off a near-panic response at Japan's Finance Ministry, with Kuroda rushing to Washington on Sept. 18 to try to win U.S. backing for a coordinated Group of Seven yen stabilization policy, perhaps along the lines of the G-7's 1985 Plaza Accords to hold the U.S. dollar in check.

Kuroda failed. Washington reportedly had great concern that a public commitment to support a given yen-dollar value point would only give speculators, including aggressive hedge funds, a fixed target to hit, at U.S. expense. Acting alone to try to halt the yen rise, the Bank of Japan has spent at least $40 billion since June in buying U.S. Treasury bills and selling yen. The effect? The yen continues to rise.

The vulnerability of Japan's recovery to the rising yen is demonstration in itself that Japan is far from any economic turnaround from the depression of the last eight years. At a level of 110 yen to the dollar, most Japanese export companies begin to incur losses. A cheap yen *had* been official Japanese policy, as it desperately tried to push exports to revive its economy. It normally takes six to nine months for a major currency shift to affect trade flows. This would mean that,

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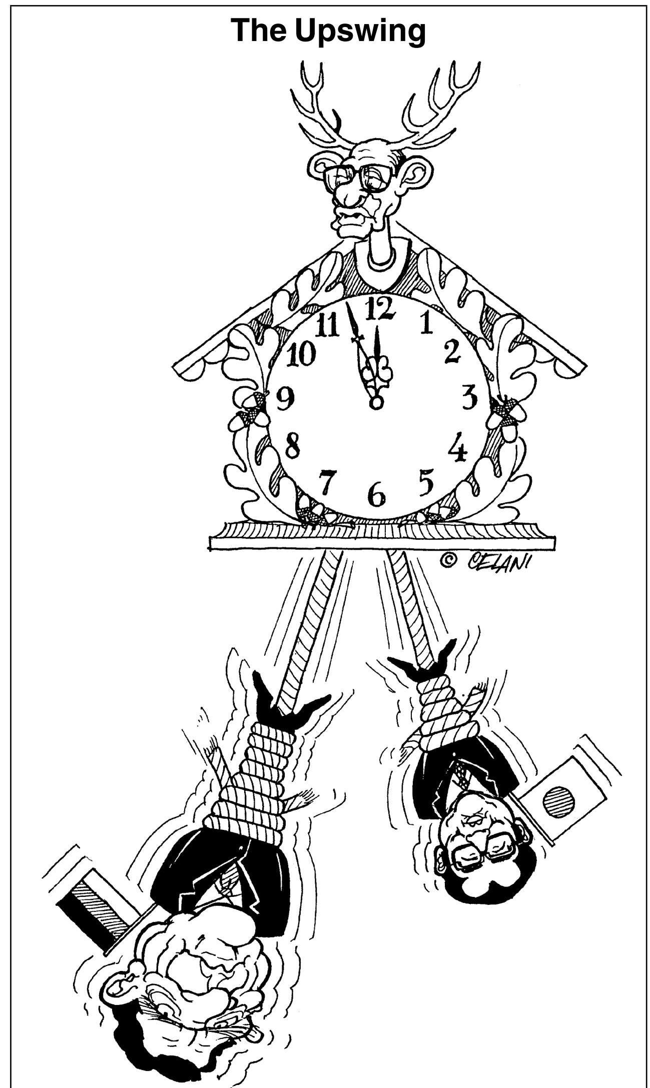
barring a turnaround soon, by January-March at the latest, Japanese exports will begin to plunge. Such concerns prompted International Monetary Fund Managing Director Michel Candessus to warn on Sept. 23 that a further yen rise could "threaten Japan's fragile economic recovery."

But a closer look at the components of the latest GDP growth yields more evidence that there is hardly a recovery. One key to a recovery in growth is a revival of the real purchasing power of consumers. International investors jumped for joy when personal consumption rose in the second quarter by 0.2%. Most of this rise came, however, from housing, due to short-term tax incentives, about to expire, and from a record heat wave which drove purchases of home air conditioners.

But the major component driving the consumer spending is pre-set to worsen. Japanese corporations have huge excess capacity which they have only begun to close down or sell off. Today Japan's official unemployment rate stands at its highest since data began to be gathered in 1953, at 4.9%, or 3.3 million jobless. This does not include some 5 million additional working short-contract government-aided jobs, due soon to expire as the huge public fiscal spending runs out in the next two to three months. Add to that 1.1 million Japanese working as temporary employees, and the labor crisis is alarming. Japanese corporations only began to restructure in June, in a sharp break with the tradition of lifetime employment.

In order to return to profits, companies have to shut loss-making units and drastically reduce total jobs. While foreign investors see that as "good for shareholder value," in reality, it is a disaster in the making for consumers who, after all, are also employees facing unemployment. A recent survey of leading Japanese companies reveals plans to slash jobs by an annual rate of 4% for the next three years. Indeed, far from investing in new productive capacities, Japanese companies are cutting. The second-quarter GDP revealed a sharp 4% fall in corporate investment compared with the first quarter, and company estimates indicate the 1999 level will be 7.5% below the very depressed 1998 level.



The Upswing

The machine-tool indicator

Nowhere does this lack of new investment show up more than in the machine-tool sector. Total value of Japanese machine tool orders in July, the latest figures available from the Japan Machine-Tool Builders Association, fell 26.2% year-on-year from July 1998, itself a depressed rate. This marks the 17th consecutive month of decline in Japanese machine-tool orders. Domestic machine-tool orders fell 24.9%, mostly due to lack of new orders from the troubled auto sector. Export orders in July, before the impact of the rising yen hit, were also down 27.2%. After almost a decade of economic decline and lack of vigorous spending on R&D and modernization, the world-class Japanese machine-tool sector is rapidly facing technological obsolescence.

Further, the possibility of significant economic growth from dynamic new Japanese small and mid-sized companies, a major theme among eager foreign investors seeking the next "Japanese Microsoft," is set to come to a halt. In Tokyo, economists and government officials already whisper about an "October crisis." Tens of thousands of these companies, received special government credit guarantees in October 1998, loans that were part of the Obuchi government's efforts to jump-start the business sector at a time when the banking sector was still choking on $2 trillion in bad loans from the bubble collapse of 1991. The special small business loans carried a one-year grace period—meaning repayments begin in October. As a result, Teikoku Databank Ltd. expects a sharp increase in corporate failures, already at record numbers.

Even if Third Wave yuppie fund managers prefer to ignore these sobering facts, the Obuchi government is aware that it faces big problems. As the government public works pump-priming is about to run out, the government is preparing to introduce a new public spending package. Estimates are it could run as high as $100 billion.

A colossal debt trap

But further injections of taxpayer money to keep the "recovery" on life support face another major problem. After ten years of economic policy paralysis and mistakes, Japan's public debt is out of control. Since the beginning of the 1990s, Tokyo has poured more than $800 billion into eight major public stimulus packages, with almost nothing lasting to show for it beyond an exploding public debt.

According to Prof. James Savage of the University of Virginia, who was posted to the Japanese Finance Ministry in 1998, "Japan's budgetary position is the most precarious in the industrialized world." In 1999, Japan's public budget deficit, 12% of GDP, will surpass the worst deficit of the United States during the Great Depression.

Gross debt has doubled since 1990 to now stand at 109% of GDP, more than double that of the United States. Worse, Japan faces the worst aging crisis of any G-7 nation. Costs of financing Social Security for the elderly, in a country with the lowest fertility rate in the industrialized world, and longest life expectancy, set up a fiscal crisis in the coming five to ten years, even were Japan to undergo a growth renaissance comparable to the 1952-72 era. Fears of how to finance the aging led the previous government to impose sharp hikes in taxes to control public debt costs. That plunged Japan into new depression just as the Asia crisis hit in 1997.

Costs of servicing Japan's public debt, despite the official near-zero interest rates, are the largest single budget item, consuming 24% of the 1999 budget. Social Security costs are the second largest, consuming 20% of budget outlays.

This hints at the reality of Japanese economic prospects. Details only amplify cause for alarm in the face of failure of Tokyo to undertake any fundamental long-term economic reform, beyond the present unsustainable crisis management. The mood in recent weeks has become euphoric at the reports of the huge foreign fund inflows. Weary Japanese see this as confirmation that they are finally doing the "right thing." They aren't. The banking system is still drowning in $2 trillion in bad loans. The industrial sector is obsolescent. The workforce is demoralized and fears job loss. Public debt is out of control and due to rise from here. This is the actual backdrop for the investor euphoria, Japan's "virtual recovery." Some might call it an old-fashioned suckers' rally.

It's time for the Japanese to take a serious look at the advice Lyndon LaRouche gave them last year, in his widely circulated Sept. 21, 1998 statement "Save Japan! Not Banks!" (see *EIR,* Oct. 2, 1998). LaRouche outlined the internal measures Japan must take (none of which have occurred) and the necessity for the nation's leaders to hook up with leaders in China, the United States, and other nations to establish a new monetary system devoted to international economic development based on scientific and technological progress. Without such measures, no "good press" can save Japan from the financial disaster.

Malaysia shows national sovereignty works

by Richard Freeman and Gail Billington

On Sept. 1, 1998, the nation of Malaysia exerted its sovereignty, by adopting selective exchange controls and other emergency nationalist measures. It showed the world that a nation can survive by rejecting entirely the advice of the British-American-Commonwealth (BAC) faction and its International Monetary Fund, which demand monetarism, globalism, and free trade. It is now one year later, and we shall show that Malaysia has succeeded, while nations that followed the BAC's prescriptions face economic breakdown and even ruin.

In the course of the 1998 crisis, Malaysia's survival depended on forthright and courageous action. A worldwide financial disintegration was ripping Asia apart. Within this setting, the BAC's assets, such as hedge fund speculator George Soros and the IMF, steered an attack to devastate the currencies and economies of Malaysia, Thailand, South Korea, and Indonesia.

On Sept. 1, 1998, Malaysia's Prime Minister Dr. Mahathir bin Mohamad, acting on behalf of the Malaysian nation, stunned the City of London and Wall Street. He adopted the principle of national sovereignty: that a nation-state has the moral responsibility and power, if it uses it, to protect its population and economy against private predators. It is the nation-state, not the so-called "free markets," that should regulate the economy and affairs of state. This concept was understood at the original 1944 meeting in Bretton Woods, New Hampshire, that set up the Bretton Woods monetary system; it traces back to the Leibnizian-Hamiltonian American System of Economics. Dr. Mahathir imposed selective capital controls, as well as exchange controls—hot money flows would not be allowed to enter Malaysia, rake off some quick loot, and scurry out. He effectively shut down the activity of the Singapore-based Central Limit Order Book, from which venue speculators had attacked Malaysian stocks. He increased bank lending to manufacturing and agriculture, and made significant budget expenditures for infrastructure building.

Feeling endangered, the City of London financiers and their minions responded with rage and threats. A sampling of responses shows the policy fight at the time:

"The recent imposition of exchange controls has seriously undermined foreign investors' confidence in Malaysia and set the economy on an unsustainable path that could adversely