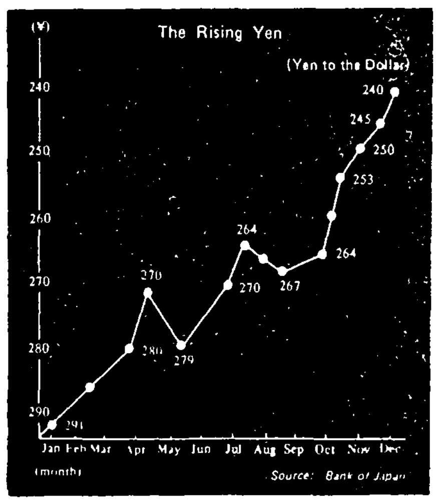
THE YEN

At least three of the main international currencies moved up strongly against the plummeting value of the dollar in 1977, but the Yen was the leading one. Its value against the dollar which stood at Y 305 at the beginning of 1976 moved to about Y 290 at the beginning of 1977. By the end of 1977 however, it had climbed to about Y 240, floating upwards by more than 20 per cent over the year. The sharp rise in the exchange rate of the Yen by the end of last year came as no surprise with the growing imbalance between Japan's international trade surplus and the USA's deficit. But it was not a strong Japanese economy that accounted for the surplus; it came more as a reaction to the world recession the Japanese feared and was brought about as a result of Japanese determination to increase exports while importing less and less.

The upheavals in the international monetary market arising from the growing weakness of the U.S. dollar have been caused largely by the massive U.S. foreign trade deficit — the United States has been importing far more than what it sells abroad. For instance last year U.S. imports from Japan surpassed its exports to that country by $ 8.5 billion; while its deficit with the E.E.C. countries was in the region of $5.2 billion. This U.S. trade deficit is covered by dollars flowing into foreign banks and these banks have accumulated the "key currency" in amounts exceeding all standards of monetary security.

But inspite of Washington's heavy pressure on Tokyo during six months of trade talks in late 1977, the results were not very significant for the United States. Japan agreed to lower customs duties for 300 items and increase quotas for some farm products. The remaining part of the agreement concluded in January, especially as regards limiting Japan's trade expansion in the U.S. market, carried no concrete pledges. The dollar pressure on the Yen in 1977 led to its revaluation by 22 per cent in relation to the U.S. currency. This measure has been interpreted as amounting to introducing customs duties on all Japanese goods exported to the United States.

Financial analysts interpret the growing value of the Yen as one result of building tensions in the world economy. The U.S., Japan and Europe in trying to produce more and more have each denied respons'bility for the worldwide recession and an impending economic crisis thus created. Also the vast sums of dollars pumped into the world economy by the U.S. since the Vietnam War and the upsetting of the balance with the oil price hike has led to speculation in international currency. The main target of the speculators was the Yen whose value was continuously pushed upward as a result. Dismayed at this stuation the U.S. turned on Japan rather than taking responsibility for destabilising the dollar itself through massive spending. U.S. retaliation against Japan resulted in a revaluation of the Yen.



The 1977 revaluation of the Yen was regarded as the most significant development for the Japanese economy since the oil shock of 1973. Japan's economy, which had the highest growth rate in the world since the late 1950's suffered a severe blow from the oil crisis in late 1973. Japan seemed to recover fast from the shock and her export growth continued with the trade surplus estimated to reach nearly dollars 7.5 billion in 1977. But though shop windows and department stores continued to indicate cities of flourishing consumption many areas of this island country were within the shadow of recession. The massive Japanese surplus not only forced exchange markets to take notice of the Japanese currency but the Yen itself had become an issue for U.S. retaliation. The result was not only a yen revaluation but also a control of Japan's exports of steel and other products to the U.S. and pressure on Japan's tariff wall.

The Japanese economy is being criticised for performing two well, to the extent of hurting others, and now it has to face the consequences. A big part of the Japanese industrial machine is in serious trouble, suffering from what is called a "structural" recession, and the traditional remedies are not working. The excess capacities are so great that normal economic recovery would not help much to close the supply-demand gap. Among the notable industries affected are special steel, cardboard, sugar-refining, shipbuilding, PVC resin, plywood and machine tools where enormous investments in capacity expansion were made shortly before and after the oil shock of 1973 in the hope that demand would keep growing at previous high levels.

If these industries are in critical condition there are many others which are in serious straits: blast furnace steel, non-ferrous metals and petrochemicals in general, which are also operating well below capacity and whose profits are stagnating. A difficult financial problem arises for Japanese companies during recession. The industry here as a whole was able to achieve remarkable growth largely through the peculiarly Japanese method of corporate financing, that is, depending heavily on borrowing rather than on its own capital. It is this unusually high debt-equity ratio in financing which has allowed Japanese industries to expand capacity, operate at high utilisation ratio and become competitive in a short period. Conversely, however, Japanese industry has, by and large, a very high break-even point: companies have to operate near capacity to repay debts and still show profits. The current long recession has thus sapped the energy of Japan's industry."

Japanese officials have continued to maintain that the weakness of the domestic economy is the underlying cause behind the massive rise in the trade surplus, and hence the upward appreciation of the Yen. Not only has this increased the need for Japanese industries to export, but it has also restricted import demand. The picture on the domestic front does indeed contrast strikingly with the external sector, since for some time now industry has been in a depressed state with low rates of capacity utilisation and profitability, and high inventories of both finished products and imported raw materials. This has had its inevitable effect on industrial investment. Particularly badly affected have been the iron and steel, shipbuilding, chemicals, petrochemicals, textiles and paper and pulp industries, where capacity utilisation now stands at between 75%—80% of the maximum obtainable. In addition, bankruptcies have been running at the high level of about 1500 a month, as firms have failed to adapt to changed market circumstances.

Last year 18,471 Japanese companies with debts of Y 10 million or more were officially declared bankrupt, leaving behind them Y 2900 bm. ($12bn.) worth of debts.

The commonest cause of business failure in Japan was the difficulty to find buyers for whatever the company concerned happened to be producing. "Sluggish Sales" were found to have caused 41 per cent of all bankruptcies during the first nine months of 1977.

In addition to falling sales the survival of small, and sometimes even medium, Japanese companies was threatened by the danger of getting caught up in a chain reaction of business failures set off by a big company which has numerous smaller "dependants". The other menace of course has been the revalued Yen and the effect it has been having on the profits of companies which derive a large part of their income from exports.

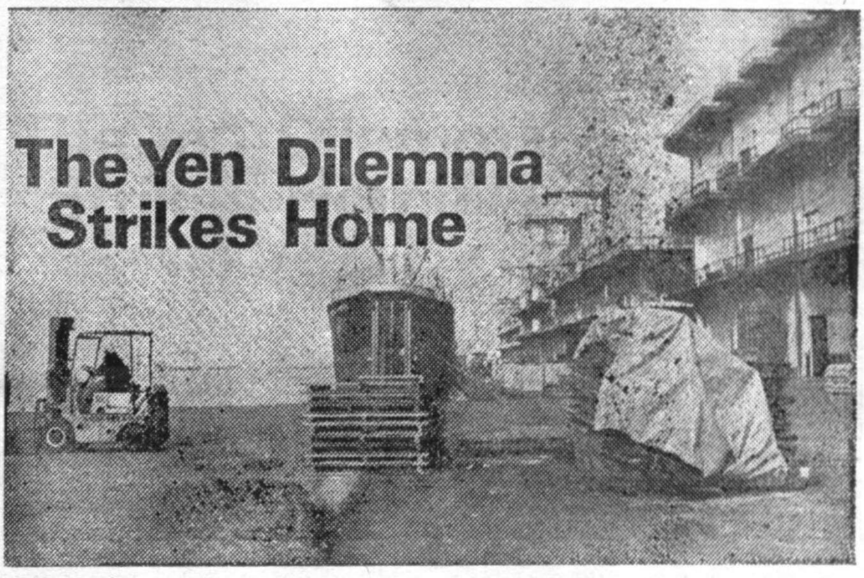
No accurate estimate has been made of the big companies facing problems which might force them to start "dumping" subsidiaries or affiliates. According to a recent estimate by a Tokyo research agency at least 60 concerns listed on the nations stock exchanges were currently in a situation of chronic and excessive indebtedness where their survival depended on the willingness and the ability of their banks to waive interest payments or stretch on debt maturities.

The actual state of Japan's economy is said to be abnormally close to what it was during the war periods with bankruptcies and unemployment, and with increases in the cost of living index higher only during World Wars I and II, and only during the wars has Japan's national debt represented as high a percent (30 percent) of the national budget. The one reason, however, why a general crisis has been averted is that Japan's exports to the US and Europe have continued to grow.

The end result is that the strengthening Yen is going to force Japan to develop a trading pattern more in line with the other developed countries. As the *London Economist* predicts:

"Japan will import many capital goods to reshape its industries; it will leave the door open to imports of basic products made more cheaply by others. But top level missions and ministerial hectoring from Japan's competitors are going to produce concessions only in specific areas where the Japanese are convinced that protectionist barriers might be erected. Japan is expert at working out when its trading partners are bluffing..... A strong yen means cheaper fuel and raw material imports. Japan's present import structure works as a gearbox to wind down the effect on competitiveness of a rise in the yen. Japan's new strategy is to move upmarket into high-value, higher-technology goods. This will not pose the same direct threat as its lower-technology industries pose now to European and American industries. It is unlikely that there will be a flood of Japanese computers into Europe or America. But other countries should look warily at protection of Japan's now infant industries. Japan's infants grow quickly into giants."

There are several reasons for thinking that pressure on the Yen could be reduced, including the prospect of increased output and the likelihood of accelerated import purchases. On the other hand the continuing weakness of the dollar and lack of any indications to increase any domestic demand and Japan's favourable competitive position points to the possibility that the Yen will be under pressure to rise further on foreign exchange markets. There is no doubt that the Yen will remain strong for most of 1978. Considering that the equally strong Deutsche Mark has been revalued by more than 45 per



A desolate view of Yokohama harbour, largest outlet for Japan's export flow. (Courtesy—Japan Focus) cent since 1971 the Yen's modest gain to only 25 per cent seems to indicate that the peak has not yet been reached.

Taking the dollar-deutsche mark parity as a yardstick the Yen is still seriously under valued; it has appreciated less than the deutsche Mark against the dollar. To reach parity with the D-mark, the Yen would have to climb to about $1 = Y182 equivalent to a 30 per cent revaluation from its February 1978 parity of $1 = Y238.80. Obviously, it is not likely to reach this point in the immediately foreseeable future. But the Yen-DM comparison would seem to indicate that there is scope for some further revaluation of the Yen, perhaps to $1 = Yen220 in the not-too-distant future.

How this would affect Japan's trade would depend on the way the revaluation occured. A sharp upward movement like that of last Aug-Sept (when the rate moved up by about 13 per cent. over two and a half months) could severely damage business confidence in Japan, and set back economiic recovery prospects. This in turn would dampen the demand for imports and no one would benefit much.

A more gradual Yen appreciation might on the other hand make foreign goods cheaper in Japan, although perhaps not by the full amount of the revaluation, and should also oblige Japanese exporters to raise their prices in foreign markets.

Business circles predict that at Y 220 or Y 210 to the dollar, Japan would still retain a competitive edge in its strongest industries, such as steel and cars, but weak industries like textiles which face competition from South Korea and Taiwan, might have to be phased out almost completely.

A commentator from Tokyo summed up the situation on this note "the ones to watch will be the Japanese trading companies, for once they decide to sell their Yen and take profits, the "high-Yen shock" will have done its work for good or for evil — depending on which team you belong to. When that happens, Japanese business and finance can begin to pick up the pieces and put together a new and perhaps improved economy."