Record slump in Japan: a sign of deepening global recession

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A dramatic slump in the Japanese economy in late 2008 is another ominous sign that the global economic crisis is continuing to snowball, with no end in sight. Economic data released on Monday revealed that the world's second largest economy contracted at an annualised rate of 12.7 percent for the final quarter of 2008—the third straight quarterly fall and the steepest decline since 1974. Deutsche Bank in Tokyo bluntly predicted a "severe depression" in Japan, lasting at least until late 2010.

Just months ago, Japan was regarded among the best placed of the advanced industrialised countries to weather the international financial turmoil that erupted in the US in September. Hard hit by a collapse in global demand for its exports, however, Japan is now the worst affected. Its December quarter contraction eclipsed the sharp declines of 3.8 percent for the US and 1.2 percent for the euro zone.

Forecasts for 2009 are uniformly bleak, despite a series of government stimulus packages. Economy minister Kaoru Yosano warned that Japan was facing "without a doubt, the worst crisis since World War II". The International Monetary Fund (IMF) forecast last month that Japan's economy would shrink by 2.6 percent in 2009, compared to contractions of 1.6 percent for the US and 2 percent in Europe. Last November, the IMF predicted Japan would do better than its rivals.

Azusa Kato, an economist with BNP Paribas, told Reuters that she expected the Japan's economy to shrink by 11.3 percent in the first quarter of 2009 if, as forecast, industrial output plunged by 20 percent. Kato said Japan had been "hit the hardest by the global slump in high-price goods and capital spending and the slump will drag on". She predicted that the economy would not return to stable growth until April-June 2010 and even then at a level barely above zero.

Monday's announcement sent a shudder through global share markets. In Tokyo, the Nikkei fell by 1.5 percent on Tuesday to its lowest point in almost three months. Markets in Asia's export-dependent countries all fell, with the exception of China. The S&P/ASX 200 in Australia dropped by 1.2 percent—Japan is the largest Australian export market. European markets fell by between 1 and 2 percent on Monday on the news from Japan and again on Tuesday. In the US, the Dow Jones Industrial Average fell by 3.8 percent on Tuesday, after a holiday on Monday.

Last year's optimistic assessments of Japan's economic prospects were based on the calculation that its banking and financial system was not heavily exposed to the mountain of toxic debt in the US that was creating havoc in global markets. But as the financial tsunami swept around the world, the sudden withdrawal of foreign funds needed to shore up institutions elsewhere undermined the already weakened Tokyo share market, and, in turn, hit the banks, which in Japan are permitted to include share holdings as part of their capital base.

As the financial turmoil began to impact globally on the so-called real economy, Japan's major exporters suffered a precipitous decline. Sharp declines in consumer spending, in the US and Europe in particular, immediately hit Japanese exports of vehicles and hi-tech electronic goods. The trend was further accentuated by a sharp rise in the value of the yen, as the speculative "carry trades"—borrowing at low interest rates in Japan to invest in riskier emerging markets—collapsed.

The implosion of Japan's share and property bubbles of the late 1980s produced a decade of stagnation in the 1990s—the so-called lost decade. The country's economic recovery from 2002 to 2008 was largely driven by exports, particularly to neighbouring China. Exports as a share of GDP rose by more than half from 10.6 percent to 16.5 percent.

The *Economist* magazine explained: "That strength is now a weakness as consumers around the world have cut their spending and global trade flows have shrunk; in December, for instance, the value of Japan's exports fell by 35 percent compared with a year earlier, after falling by 27 percent in November… A near vertical fall in Japan's industrial production in a few short months has swiftly wiped out all the gains from six years of recovery. Economists reckon that by the end of February industrial output will be back to levels last seen around 1987."

The consequences have been devastating for Japan's major corporations. Among the many companies downgrading financial predictions, Toyota, the world's largest automaker, is now forecasting its first loss in 70 years. The 10 biggest electronic firms expect to collectively lose $20 billion over the next year. The Reuters Tankan survey of corporate sentiment hit a low of minus 74 among manufacturers this month—the lowest reading since the index began in June 1988.

Corporations are shedding jobs, cutting inventory and slashing costs. "Manufacturers have been left with big structural excesses in capacity that need to be worked out. It'll take years," Hiroshi Shiraishi, an economist with BNP Paribas, told Bloomberg. Pioneer announced last week that it will axe 10,000 jobs globally. Sony is shedding 8,000 workers. Nissan and NEC are each cutting 20,000.

The unemployment rate jumped to 4.4 percent in December from 3.9 percent in November but is expected to rise sharply in coming months and exceed the previous post-war high of 5.5 percent in 2002. Those currently losing their jobs are mainly temporary workers, who now form more than a third of the workforce after a decade in which Japan's lifelong employment system has been dismantled. Permanent employees are facing cuts to pay and bonuses. Levels over homelessness and poverty are on the rise.

The ruling Liberal Democratic Party (LDP) is confronting a deep political crisis that may well result in its defeat—for only the second time in half a century—at elections later this year. This week, the approval rating for Prime Minister Taro Aso collapsed to a new low of 9.7 percent. Sharp divisions have emerged inside the LDP over the government's latest economic stimulus package. Another sign of the government's disintegration was yesterday's resignation of finance minister Shoichi Nakagawa after appearing, apparently drunk, at a G7 news conference last weekend.

The impact of Japan's precipitous economic decline will be felt internationally. Significantly, the fourth quarter contraction in Germany, the world's largest exporter, at an annualised 8.4 percent, was not far behind Japan's. Both countries are exporters not only of vehicles and hi-tech consumer goods, but also of machinery and other capital goods. The sharp downturn in these exports is symptomatic of falling business investment around the world as companies axe plans for future expansion.

A sharp indicator of the decline in this sector is Japan's falling exports to China and the rest of Asia. After expanding by 12 percent in the first half of 2008, exports to China began to fall in October and collapsed by 36 percent in December. Japanese exports of high-tech materials and production machinery to China was a major factor in lifting Japan out of the slump of the 1990s. These products were mainly used in Japanese companies for export back to Japan or to the markets in the US and Europe.

The *Wall Street Journal* cited the case of Union Tool, a Tokyo company that manufactures drills used to make holes in printed circuit boards. "Our sales in China began to falter around July, collapsed in October and are still dropping," a spokesman explained. Half the company's revenue comes from sales in Asia and it recorded a 19 percent drop in net profit for the year ending November.

The falling sales of capital goods to China are part of a broader trend. Beijing announced on Monday that foreign direct investment in January had plunged by 33 percent compared to the same month last year—the fourth straight monthly decline. As global demand has fallen, so too has foreign investment in the world's largest cheap labour platform. China's growth rate has fallen from 13 percent in 2007 to 6.8 percent in the final quarter of last year and forecasts point to further declines in 2009.

US Secretary of State Hilary Clinton touched down in Tokyo this week as Japan's disastrous economic data was being announced. Ironically she made her first foreign visit to Asia in order to underscore the region's importance to the Obama administration, particularly in the economic sphere. The US is heavily dependent on funds from both Japan and China to cover its massive current account and budget deficits. China and Japan are the world's two largest holders of US bonds. The collapse of Japanese and Chinese exports may well rebound on the American economy in form of a slowdown or even withdrawal of investment funds, further compounding the economic turmoil in the US.

Under conditions of a vast expansion of globalised production over the past three decades, the economic contraction registered in Japan is not simply an indicator of that country's profound difficulties but another sign of the crisis reverberating throughout the interlocking international chains of production and finance.

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