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DIRECTORATE OF
INTELLIGENCE

# Intelligence Memorandum

## *Japan: Balance-of-Payments Developments Since the Smithsonian Agreement*

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
January 1973

INTELLIGENCE MEMORANDUM

# JAPAN: BALANCE-OF-PAYMENTS DEVELOPMENTS SINCE THE SMITHSONIAN AGREEMENT

## SUMMARY

1. Japan recorded another huge trade and payments surplus in 1972. The trade surplus totaled US $9.0 billion, compared with $7.8 billion in 1971, partly because of the initial perverse impact of the yen revaluation. Roughly three-fourths of the yen revaluation has been passed on in the form of higher dollar prices, and as a result exports in dollar terms rose 19%. The volume of exports was up by less than half this rate. Imports also increased sharply, but again much of the rise reflected higher dollar prices. Although Japan came out of its largest postwar economic slump during the year, import volume rose only about 10% because raw material inventories remained high throughout most of 1972.

2. The trade surplus was partly offset by a record level of long-term capital outflows, and Japan emerged as a major supplier of long-term capital. Outflows reached $4.9 billion in 1972, compared with $1.3 billion in 1971. The outflow reflected Tokyo's dismantling of restrictions on such movements in an effort to limit the buildup of foreign exchange reserves. Short-term capital inflows were relatively small during the first half of the year, but, with the trade surplus mounting, pressure for another yen revaluation intensified and Tokyo had difficulty limiting speculative inflows in the last half of 1972. Although the situation has eased somewhat. Japan is still considering another revaluation.

3. The 1973 Japanese trade balance will not be affected by price distortions caused by yen revaluation unless, of course, there is another currency adjustment. Without such price distortions, Japan's trade surplus is likely to fall this year, although still remaining at a high level of about

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Approved For Release 2006/04/19 : CIA-RDP85T00875R001700050009-6

25X1

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$7.5 billion. This decline assumes a modest increase in the dollar value of exports of about 12% and a rapid 25% growth in the dollar value of imports resulting from accelerated domestic economic expansion and from the rebuilding of inventories, which had fallen to relatively low levels. A continuing large deficit on the services and long-term capital accounts will help bring Japan close to its goal of a near zero basic balance in 1973.

4. The US bilateral trade balance with Japan is unlikely to improve very dramatically this year. Japan recorded a surplus with the United States in 1972 in excess of $4 billion, and Japan accounted for nearly two-thirds of our record $6.5 billion trade deficit. The record Japanese surplus largely reflects higher dollar prices for goods exported to the US market. At the same time, Japanese purchases from the United States failed to keep pace with overall Japanese imports, partly because sales of machinery and equipment -- where the United States weighs heavily -- continued to lag. Another element influencing Japanese imports from the United States is that Japan is developing alternative suppliers to meet its growing need for several important US export commodities such as coal.

5. Given these trends, we do not believe Tokyo will meet its goal of lowering its trade surplus with the United States to $3 billion in 1973. Because exports to the US market are likely to grow at a pace close to Japan's global export expansion rate, such a reduction would necessitate an extraordinary 40% hike in Japanese purchases of US goods. Actually, we expect import growth to approximate 30% -- about double the 1972 rate. Under these conditions, Japan's 1973 trade surplus with the United States would be about $3.5 billion -- roughly the same as in 1971.

6. Beyond 1973, we expect the situation will improve only gradually. While the torrid pace of export growth in recent years may slow, Japan will retain a strong competitive position internationally. Indeed, relative to Western Europe, Japan has already regained the price advantages lost through the Smithsonian parity changes. In any case, it is far from certain that Tokyo wants to reduce its global trade surplus very greatly. Japanese leaders have repeatedly stated that they are aiming for a current account surplus by 1975 equal to about 1% of gross national product. This would mean a global trade surplus on the order of $6 billion or more.



Approved For Release 2006/04/19 : CIA-RDP85T00875R001700050009-6

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## DISCUSSION

### Prelude to 1972

7. Since the start of the 1970s, Japan has been running enormous trade and payments surpluses. In most earlier years also, exports grew much faster than imports, but the gap generally was not large and, more often than not, was substantially offset by heavy net service payments. As a consequence, foreign exchange reserves remained relatively low and at the beginning of the decade were only $3.6 billion.

8. The situation changed dramatically in 1970, when the trade surplus reached the $4.0 billion level and foreign exchange reserves rose to $4.5 billion. Then, in 1971, a year-long economic slowdown depressed import growth to only 5% while exports jumped by about 24% as Japanese industrialists sought to keep their factories operating close to capacity. As a result, the trade surplus reached an extraordinary $7.8 billion. In addition, international monetary turmoil generated sizable short-term capital inflows in mid-year, and, by the end of 1971, Japan's reserves had risen a massive $11 billion to reach more than $15 billion.

9. In the wake of all this, Tokyo was forced to make some adjustments in its international economic policies. The major change was a yen revaluation. Under the December 1971 Smithsonian agreement, the yen was revalued 16.9% – from 360 to 308 yen per dollar. Some 60% of Japan's trade is with countries which devalued along with the dollar. The yen revaluation against other currencies, meanwhile, varied considerably, ranging from 2.9% with West Germany to 22.7% with South Africa.[1] When the change in each currency's parity relative to the yen is weighted by that country's share in Japan's total foreign trade, the result is an average effective yen revaluation of 13.5%.

### Japan's Balance of Payments in 1972

10. Japan's trade surplus increased in 1972 in spite of yen revaluation. Indeed, the short-term impact of the parity change was probably perverse – in dollar terms it tended to increase the value of exports more than the value of imports. Japan's purchases from abroad consist mainly of food, raw materials, and fuel, demand for which is little affected by prices. Moreover, prices are determined largely by world market conditions and thus tend to rise by substantially less than the parity change. In the case of exports, mainly manufactures, prices could in many instances rise by all or nearly all of the revaluation without suffering much loss of sales

1. Since the Smithsonian agreement, South Africa has devalued by an additional 4%.



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volume in the short term. Thus revaluation tended to boost export more than import prices, while the impact on either import or export volume was probably not large.

11. Apart from the price shifts stemming from revaluation, Japan's foreign trade in 1972 was influenced by the country's business cycle. During the year, the economy was in a sharp upswing and this tended to reduce pressure for exporting as a means to maintain production levels. On the import side, purchases from abroad picked up as aggregate demand accelerated. The impact was delayed, however, because inventory levels remained excessively high during at least the first half of the year, and this influenced purchases of raw materials. In addition, industrial machinery and equipment, another major category of imports, responds to industrial investment, which remained depressed during the year.

12. As a result of all these factors, export growth in dollars slowed in 1972 from the 1971 pace while imports accelerated and grew somewhat faster than exports. Nevertheless, the trade surplus increased about 15%, reaching $9 billion – the largest of any country in the past 25 years (see Table 1). Increasing service payments and an enormous rise in long-term capital outflows to nearly $4.9 billion for the year as a whole, however, helped keep the basic balance surplus to about $2.2 billion -- $2.5 billion less than in 1971. The overall balance-of-payments surplus, including short-term capital flows, also registered a sizable decline, to about $4.7 billion in 1972.

**Table 1**

**Japan: Balance of Payments**

*Billion US $*

| | *1969* | *1970* | *1971* | *1972* |
|---|---|---|---|---|
| Exports | 15.7 | 19.0 | 23.6 | 28.0 |
| Imports (f.o.b.) | -12.0 | -15.0 | -15.8 | -19.0 |
| **Trade balance** | **3.7** | **4.0** | **7.8** | **9.0** |
| Services and transfers[a] | -1.4 | -1.8 | -1.8 | -1.9[b] |
| **Current account balance** | **2.3** | **2.2** | **6.0** | **7.1** |
| Long-term capital movements[a] | -0.3 | -1.8 | -1.3 | -4.9[b] |
| **Basic balance** | **2.0** | **0.4** | **4.7** | **2.2** |
| Non-monetary short-term capital movements and errors and omissions | 0.3 | 1.0 | 3.0 | 2.5 |
| **Overall balance** | **2.3** | **1.4** | **7.7** | **4.7** |
| Change in official reserves | 0.6 | 0.9 | 10.8 | 3.1 |
| Change in non-official reserve position | 1.7 | 0.5 | -3.1 | 1.6 |

a. Government transfers are treated as long-term capital outflows.
b. Preliminary.



Approved For Release 2006/04/19 : CIA-RDP85T00875R001700050009-6

Approved For Release 2006/04/19 : CIA-RDP85T00875R001700050009-6


13. The United States has borne the brunt of Tokyo's rising trade surplus. Japan's 1972 trade balance with the United States was $4.1 billion, compared with $3.4 billion the previous year -- a 21% increase (see Table 2). Japan accounted for nearly two-thirds of the record US trade deficit of about $6.5 billion. Higher prices for Japanese goods was a major cause of the record surplus, and exports to the US market slightly outpaced the growth in Japanese purchases from the United States -- 18% versus 17%. Imports from the United States would have had to grow twice as fast as exports just to maintain the surplus at the 1971 level.

**Table 2**

**Japan: Balance of Payments with the United States**

*Billion US $*

| | *1969* | *1970* | *1971* | *1972*[a] |
|---|---|---|---|---|
| Exports | 5.0 | 6.0 | 7.5 | 8.8 |
| Imports | -3.3 | -4.5 | -4.1 | -4.8 |
| **Trade balance** | **1.7** | **1.5** | **3.4** | **4.1** |
| Non-military services and transfers[b] | -1.0 | -1.3 | -1.2 | -1.0 |
| Military | 0.6 | 0.7 | 0.6 | 0.6 |
| **Current account balance** | **1.3** | **0.9** | **2.8** | **3.7** |
| Long-term capital movements | 0.3 | -0.2 | 0.2 | N.A. |
| **Basic balance** | **1.6** | **0.7** | **3.0** | **N.A.** |

a. Preliminary. Because of rounding, components may not add to the totals shown.
b. US figures show only a $400 million to $500 million surplus on the non-military services and transfers account with Japan. Most of the discrepancy is the result of different methods in attributing transportation payments and receipts and differences in handling royalty payments.

## Export Trends

14. In dollar terms, Japanese exports rose 19% in 1972, reaching $28.0 billion. Most of the increase, however, reflects higher dollar prices resulting from the new exchange rate. Soon after the yen was allowed to float upward in August 1971, Japanese exporters began raising dollar prices for their goods. By the end of December 1971, these prices had been boosted almost 10% -- equal to about 60% of the revaluation (see Table 3). The balance was absorbed by lowering yen prices, which fell steadily from the beginning of the float until March 1972. Since then, prices have risen slowly. Altogether, about 75% of the yen revaluation has been passed forward in the form of higher dollar prices, and about 25% has been absorbed by exporters.




Approved For Release 2006/04/19 : CIA-RDP85T00875R001700050009-6

Approved For Release 2006/04/19 : CIA-RDP85T00875R001700050009-6


**Table 3**

**Japan: Price Indexes**

*August 1971 = 100*

| | *Export Prices* | | *Import Prices* | |
|---|---|---|---|---|
| | *In terms of* | | *In terms of* | |
| | *Yen* | *US $* | *Yen* | *US $* |
| | | *1971* | | |
| Aug | 100.0 | 100.0 | 100.0 | 100.0 |
| Sep | 99.2 | 103.1 | 96.7 | 100.5 |
| Oct | 98.8 | 106.5 | 95.2 | 102.6 |
| Nov | 98.2 | 107.4 | 94.1 | 102.9 |
| Dec | 97.5 | 109.9 | 93.1 | 104.9 |
| Annual average | 99.5 | 102.3 | 97.6 | 100.2 |
| | | *1972* | | |
| Jan | 96.8 | 113.2 | 92.4 | 108.0 |
| Feb | 96.3 | 112.6 | 92.0 | 107.5 |
| Mar | 96.0 | 112.2 | 91.9 | 107.4 |
| Apr | 96.3 | 112.6 | 92.4 | 108.0 |
| May | 96.7 | 113.0 | 92.7 | 108.3 |
| Jun | 96.6 | 112.9 | 92.2 | 107.8 |
| Jul | 96.5 | 112.8 | 91.6 | 107.1 |
| Aug | 96.4 | 112.7 | 91.8 | 107.3 |
| Sep | 96.4 | 112.7 | 93.1 | 108.8 |
| Oct | 96.6 | 112.9 | 95.0 | 111.0 |
| Nov | 96.8 | 113.2 | 96.2 | 112.4 |
| Eleven-month average | 96.5 | 112.8 | 92.8 | 108.5 |

15. To some extent the rise in dollar prices was almost automatic, especially on items sold to countries which also revalued. In the case of exports to West Germany, for example, Japanese exporters could raise their dollar prices on goods sold in that market by the amount of Bonn's revaluation without giving up any edge to West German producers. A review of unit export prices for a wide range of products indicates that Japanese suppliers raised prices on goods sold in the US market by roughly the same amount as their global prices. The items listed in Table 4 make up about 50% of total Japanese exports to the United States, and on a weighted




Approved For Release 2006/04/19 : CIA-RDP85T00875R001700050009-6

Approved For Release 2006/04/19 : CIA-RDP85T00875R001700050009-6


**Table 4**

**Japan: Unit Price Changes for Selected Exports**

| | *Percent*[a] | |
|---|---|---|
| | *World* | *US* |
| Assembled passenger cars, engines: | | |
| 0-1000 cc | 20.4 | -0.1 |
| 1001-2000 cc | 20.0 | 22.1 |
| Greater than 2000 cc | 18.7 | 18.6 |
| Assembled trucks and lorries, engines 361-2000 cc | 20.5 | 22.0 |
| Motorcycles, engines: | | |
| 51-250 cc | 29.6 | 29.4 |
| Greater than 250 cc | 24.1 | 24.0 |
| Color television sets | 13.1 | 13.2 |
| Black and white television sets | 14.6 | 13.7 |
| 35mm cameras with focal plane shutters | 19.0 | 21.3 |
| Automatic cartridge tape recorders | 2.0 | 3.6 |
| Cartridge tape recorders (except auto) | 0.6 | -0.1 |
| Cassette tape recorders (except auto) | 4.1 | 4.4 |
| Tape decks | -14.4 | -13.1 |
| Steel products | 11.4 | 8.3 |
| Ball bearings | 12.2 | 2.4 |
| Digital electronic desk calculators | -39.8 | -46.2 |
| Portable radios with FM tuners | 14.6 | 13.3 |
| Other radios with FM tuners | 48.7 | 51.6 |
| Phono-radio stereo systems (table type) | 29.2 | 30.0 |
| Synthetic rubber | 2.3 | 10.5 |
| Interchangeable camera lenses; not auxiliary; framed or handled | 29.1 | 77.1 |
| Bicycles | 56.7 | 62.7 |

a. January-September 1972 over the corresponding period of the previous year.

basis their dollar prices rose about 14% during the first half of 1972 compared to the first half of 1971. This was roughly the same as the increase in Japan's overall dollar price index for exports. While there was some apparent discrimination in the US market, it was the exception rather than the rule, generally occurring on items on which Japan faced stiff competition from other exporting countries.

16. By and large, Japan's major export industries were in a good position to boost dollar prices in overseas markets. In the case of motor vehicles, where the Japanese are strongly competitive, the entire yen



Approved For Release 2006/04/19 : CIA-RDP85T00875R001700050009-6

Approved For Release 2006/04/19 : CIA-RDP85T00875R001700050009-6


revaluation was passed on almost immediately. Shipbuilders, already working near capacity, did essentially the same thing. The steel industry initially absorbed almost the full amount of the revaluation by reducing yen prices, but this changed as the year progressed and suppliers were able to test their position in overseas markets. A similar pattern occurred for the textile industry, which raised average dollar prices for global exports by about 10% during 1972.

17. In a number of cases, Japanese firms did cut profit margins considerably to maintain their competitive position overseas. Usually this occurred on items already facing growing competition, especially from less developed countries. Prices for certain textile products, for example, were cut sharply in order to avoid loss of sales to other East Asian suppliers. Because price cutting did occur, export growth in terms of yen was up only 5% (see Table 5), implying an average yen price decline of about 3%. This occurred despite an average 2% rise in wholesale prices and a 5% increase in real labor costs. Even so, Japanese industry registered a fairly good profit performance during 1972 as the economy rebounded from its earlier slowdown. During the six-month period ending in September 1972, before-tax profits of the country's leading firms recorded a substantial 11% increase over the previous six-month period.

**Table 5**

**Japan: Foreign Trade**

*Percent*[a]

| | *Exports*[b] | | | *Imports*[b] | | |
|---|---|---|---|---|---|---|
| | *In Terms Of* | | | *In Terms Of* | | |
| | *US $* | *Yen* | *Volume* | *US $* | *Yen* | *Volume* |
| 1971 | | | | | | |
| 1st Qtr | 22.8 | 22.8 | 21.0 | 10.7 | 10.7 | 9.7 |
| 2nd Qtr | 25.4 | 25.4 | 23.8 | 6.9 | 6.9 | 5.2 |
| 3rd Qtr | 25.5 | 24.0 | 22.9 | -3.4 | -4.6 | -6.6 |
| 4th Qtr | 23.6 | 12.3 | 13.6 | 4.1 | -5.2 | -2.5 |
| 1972 | | | | | | |
| 1st Qtr | 22.1 | 4.5 | 7.8 | 11.1 | -4.9 | 1.0 |
| 2nd Qtr | 12.3 | -3.9 | 0 | 10.2 | -5.7 | 1.9 |
| 3rd Qtr | 18.8 | 3.0 | 6.6 | 25.6 | 8.8 | 16.8 |
| 4th Qtr (estimated) | 23.1 | 16.0 | 17.6 | 30.1 | 22.1 | 19.5 |

a. Percentage change over corresponding quarter of previous year.
b. Customs clearance data.




Approved For Release 2006/04/19 : CIA-RDP85T00875R001700050009-6

Approved For Release 2006/04/19 : CIA-RDP85T00875R001700050009-6


18. For the year as a whole, growth of export volume was up only about 8% compared with about 20% in 1971. One reason for the slowdown was the introduction of new "voluntary" controls on steel and textile exports, which had accounted for some 25% of export growth in 1971. Beginning in 1972, the Japanese imposed restraints on steel shipments to European Community (EC) members. The controls called for an absolute decline in the volume of sales, and, in fact, steel exports were off 7% to 8%. Exports of man-made fiber textiles to the US market came under tight controls near the end of 1971, and during the first half of 1972 the volume of textile sales was off about 3%.

19. The price rise resulting from the revaluation had some negative impact on export volume in 1972 but appears to have been only one cause – generally not the most important – of the growth slowdown. In the case of automobile exports to the United States, for example higher prices cut into sales potential by making US small car producers more competitive. However, a slowdown from the almost 70% volume growth of 1971 was anticipated even before the currency realignment. In other instances the Japanese concentrated more on upgrading product lines than on boosting export volume.[2] In any event, export volume varied substantially during the year, growing by nearly 8% during the first quarter but virtually stopping in the second quarter, largely because of Japan's maritime strike that extended from the end of May through mid-July. The aftermath of the strike influenced export volume for several months, and this in part accounts for the nearly 18% volume growth during the last quarter of 1972.

**Imports**

20. The chief factor influencing Japan's import performance was the domestic business cycle. In early 1972, the country's longest postwar economic slump ended and domestic demand began mounting rapidly. Imports responded slowly, however, because of large raw material stockpiles built up in late 1970 and most of 1971. During the first half of 1972, import volume hardly changed from the same period in 1971 – rising barely more than 1% – although the maritime strike was a restricting factor. Only in the fall did stock levels begin returning to normal, and since then import volume has picked up sharply, rising about 17% during the third quarter and nearly 20% in the fourth quarter (see Table 5). For the year as a whole, import volume was up about 10%.

2. This upgrading process tends to distort Japan's actual export price performance because the quality improvements are not taken into account when calculating overall export prices. In the case of radios, for example, Japan has been shifting to exporting more complex and consequently more expensive units, but the changeover to essentially a new product line raises unit export prices for radios.



Approved For Release 2006/04/19 : CIA-RDP85T00875R001700050009-6

21. While import volume grew only modestly, the dollar value of imports rose sharply because of rising prices for some key commodities. Higher prices account for about one-half the nearly 21% increase in the dollar value of imports during 1972. The price of crude oil, which accounts for nearly 20% of Japanese imports, rose about 15% -- the result of negotiations between the oil companies and members of the Organization of Petroleum Exporting Countries. There were also substantial price rises for nonferrous metal ores, timber, and textile raw materials both because of changing market conditions and in response to parity changes. Import prices in terms of yen generally declined from the beginning of the float in August 1971 through July 1972 (by 8%) but since then have risen by about 5%.

22. Japanese industrial and trading firms were the major beneficiaries of the lower yen cost of imports. Through cartel agreements, domestic prices of many imported goods during the first half of 1972 were prevented from falling significantly. One year after the August 1971 float began, for example, the decline in the wholesale price index for raw materials (excluding fuels) was only about half the decline recorded in the yen import price index for these same items. In the case of grains, government agencies tried to hold up the domestic price of imports to prevent any adverse reaction from the politically powerful Japanese rice farmers.

**Service Payments and Long-Term Capital Flows**

23. Japan normally runs large deficits on service transactions, and in 1972 this outflow reached $1.9 billion,[3] compared with $1.8 billion in 1971. The gap between transportation payments and earnings grew to $950 million and was responsible for a large part of the increase in the overall deficit. Service receipts grew faster than payments, however, largely due to the rapid increase in interest and dividends earnings from a rising level of foreign assets. These inflows rose by 80% during the year, surpassing outflows of interest payments for the first time. A large part of the increase in these receipts came from the United States. During the first half of 1972, for example, interest earnings on holdings of US bonds and notes totaled $300 million, compared with only $50 million during the same period in 1971. Largely because of this trend, Japan's deficit on the services and transfers account with the United States was substantially reduced.

24. Trade and services transactions resulted in a $7.1 billion current account surplus, which was partly offset by a surge in net long-term capital outflows – from $1.3 billion in 1971 to $4.9 billion. In 1972, Japan became a major world supplier of long-term capital. Gross outflows nearly

3. This figure excludes government transfers, which are treated as long-term capital outflows. For 1972, these transfers reached approximately $380 million.

Approved For Release 2006/04/19 : CIA-RDP85T00875R001700050009-6


tripled during the year to an estimated $6 billion, including increases of some $900 million in loans and about $800 million in foreign securities purchases. At the same time, capital inflows fell substantially, largely because of a drop in foreign purchases of Japanese securities from a record $940 million in 1971 to an estimated $700 million in 1972.

25. A major factor in these shifts was the dismantling of restrictions on capital outflows in late 1971 and early 1972. Virtually all restrictions on the purchase of stocks listed on foreign exchanges were removed. Moreover, Tokyo has been encouraging long-term loans to multi-national corporations, and the number of firms borrowing in Japan's money market has risen sharply. In addition, foreign governments have been allowed to float bond issues in Japan, and Tokyo has increased lending to the World Bank. The increase in the net long-term capital outflow held the basic balance surplus to $2.2 billion, compared with $4.7 billion in 1971.

**Short-Term Capital**

26. While long-term capital outflows were greatly increased, the Japanese continued to absorb large amounts of short-term capital in 1972. Short-term capital inflows amounted to about $2.5 billion, falling short of the $3 billion inflow of 1971. In the first half of 1972, net short-term capital inflows were only $700 million, but, with the trade surplus continuing to grow and rising speculation over another yen revaluation, these inflows mounted dramatically in October and November but then eased off somewhat near the end of the year. As in 1971, an important part of these inflows took the form of advance payments for exports.

27 The $2.5 billion net short-term capital inflows on top of a basic balance surplus of $2.2 billion meant an overall $4.7 billion balance-of-payments surplus. To minimize the resulting increase in the foreign exchange reserves, Tokyo took a number of largely domestic moves. These moves included depositing increasing amounts of dollar reserves with commercial banks to finance a larger share of imports domestically and to pay off short-term foreign debts. One impact of these measures has been a sharp reduction in Japan's borrowing in the US bankers' acceptance market. As a result of all these steps, Tokyo managed to limit the buildup of official foreign exchange reserves to only $3.1 billion in 1972. At year's end, official reserves totaled $18.4 billion, compared with $15.2 billion at the end of 1971.

**The 1973 Payments Outlook**

28. Many of the factors that influenced Japan's 1972 trade and payment position will be substantially altered in 1973. With stocks of raw




Approved For Release 2006/04/19 : CIA-RDP85T00875R001700050009-6

Approved For Release 2006/04/19 : CIA-RDP85T00875R001700050009-6


materials relatively low and the rate of economic growth expected to exceed 10%, Japan's import volume will grow much faster than in 1972. At the same time, in contrast to last year, import prices will rise faster than export prices, the growth of which should slow greatly in 1972 since the impact of the parity changes has already been almost fully passed forward. A new yen revaluation, of course, would change this situation. Tokyo is known to have such a move under consideration, although the Japanese are hoping to avoid it or postpone it as long as possible.

**The Trade Account**

29. In the absence of a second revaluation, we expect the trade surplus to decline to about $7.5 billion in 1973.[4] Some estimates show an even larger surplus. The OECD estimate calls for an $8.2 billion surplus, while Japan's Economic Planning Agency places it at more than $8 billion. The figures differ mainly because of differing projections of export growth. We estimate that Japanese exports in 1973 will increase at least 12% in terms of dollars, reaching a minimum of $31.4 billion. This projection takes into account an increase in export volume of at least 9% and a 3% rise in prices. A price increase of this amount would bring average yen prices back to their pre-revaluation level.

30. The growth in export volume will at least match last year's performance. Now that the initial impact of new "voluntary" export controls on steel and textiles has been absorbed, overseas shipment of these items is likely to grow by about 5% in volume, reversing last year's downward trend. Motor vehicle exports will grow by only about 10%, compared with the 15% increase in volume recorded in 1972, while exports of ships will grow at least as fast as the 5% gain registered in 1972. Exports of electronic equipment and general machinery will probably grow at about last year's pace of 10%. Other fast-growing items will include motorcycles, home appliances, and precision instruments, but individually none of these categories is large enough to cause a major surge in export volume during 1973. (For recent export trends, see Tables 6 and 7.)

31. Japan's recently announced export control program will not significantly alter the outlook. Limits are being placed on 20 commodities, and Tokyo claims the controls will cut export growth by about $1 billion. This estimate, however, assumes that export growth of the controlled items would have continued at earlier rates. It does not take into account the fact that a large portion of the growth recorded during January-July 1972 reflected higher dollar prices stemming from yen revaluation rather than volume growth. Because this price rise will not be repeated during the period

4. A revaluation in the range of 8% to 10% during the second quarter of 1973 would boost the surplus by $1 billion to $1.5 billion, following generally the same pattern as the last revaluation.




Approved For Release 2006/04/19 : CIA-RDP85T00875R001700050009-6

Approved For Release 2006/04/19 : CIA-RDP85T00875R001700050009-6



Table 6

Japan: Global Exports[a]

*Million US $*

| | *1968* | *1969* | *1970* | *1971* |
|---|---|---|---|---|
| **Total** | **12,972** | **15,990** | **19,318** | **24,019** |
| Steel | 1,712 | 2,165 | 2,844 | 3,541 |
| Motor vehicles | 797 | 1,100 | 1,491 | 2,568 |
| Textiles | 1,887 | 2,167 | 2,298 | 2,655 |
| Raw material and fuels | 140 | 181 | 208 | 286 |
| Foodstuffs | 432 | 571 | 648 | 678 |
| Chemicals | 805 | 1,016 | 1,234 | 1,486 |
| Ships | 1,084 | 1,137 | 1,410 | 1,844 |
| General machinery | 1,511 | 1,863 | 2,331 | 2,801 |
| Precision instruments | 460 | 561 | 664 | 787 |
| Electronics | 1,460 | 2,028 | 2,453 | 2,927 |
| Light industry | 1,824 | 2,128 | 2,285 | 2,555 |
| Household appliances | 156 | 193 | 210 | 261 |
| Motorcycles | 198 | 256 | 419 | 669 |
| Other metal products | 435 | 519 | 666 | 708 |
| Miscellaneous | 71 | 105 | 157 | 233 |

a. Customs clearance data.

Table 7

Japan: Exports by Major Industrial Group

| | *Million US $* | | |
|---|---|---|---|
| | *Jan-Sep* | | *Percent* |
| | *1971* | *1972* | *Change* |
| **Total** | **17,305** | **20,247** | **17.0** |
| Steel | 2,613 | 2,543 | -2.7 |
| Motor Vehicles | 1,763 | 2,330 | 32.2 |
| Textiles | 1,914 | 2,016 | 5.3 |
| Raw materials and fuels | 219 | 200 | -8.7 |
| Foodstuffs | 493 | 473 | -4.1 |
| Chemicals | 1,100 | 1,274 | 15.8 |
| Ships | 1,352 | 1,660 | 22.8 |
| General machinery | 2,023 | 2,468 | 22.0 |
| Precision instruments | 559 | 764 | 36.7 |
| Electronics | 2,097 | 2,711 | 29.3 |
| Light industry | 1,873 | 2,144 | 14.5 |
| Household appliances | 188 | 250 | 33.0 |
| Motorcycles | 458 | 663 | 44.8 |
| Other metal products | 510 | 599 | 17.5 |
| Miscellaneous | 143 | 152 | 6.3 |





Approved For Release 2006/04/19 : CIA-RDP85T00875R001700050009-6

Approved For Release 2006/04/19 : CIA-RDP85T00875R001700050009-6


of restraints, extending from September 1972 through August 1973, a substantially reduced growth in terms of dollars could occur without any slowdown in volume growth. Moreover, with an expected low growth in volume of some items in any case, it is unlikely that the controls will have any appreciable effect on overall export trends.

32. Imports should increase rapidly in 1973, reaching a dollar value of perhaps $23.8 billion. This estimate allows for a 20% volume increase and roughly a 5% rise in import prices. The increase in import prices will be less than last year's partly because the sharp boost in crude oil prices that occurred in 1972 will not be repeated. Prices for several other important raw materials, moreover, have already peaked after registering substantial increases in 1972. A chief exception will be grain and lumber prices, which will be substantially higher than in 1972 because of tight world market conditions.

33. Growth in import volume will accelerate sharply – to 20% – as the economy continues its rapid expansion. Fueled by large doses of government spending and an upswing in personal consumption and private investment spending, real gross national product (GNP) is expected to rise by at least 10% in 1973. The impact of this growth on import volume will be much stronger than last year (when GNP rose nearly as rapidly), because raw material inventories have been drawn down to below normal levels. The need to rebuild inventories should push up the volume of raw material imports at a much more rapid rate than the growth of final demand for processed goods. Imports of machinery and equipment, which stagnated in 1971 and 1972, are also likely to accelerate sharply because of expanding domestic investment in private plant and equipment. Imports of general machinery usually increase in line with these investments, which are expected to grow twice as fast this year as they did in 1972. Imports of non-food consumer goods, including light manufactures, will also continue to increase rapidly, but they still account for only about 3% of total Japanese imports. (For recent import trends, see Tables 8 and 9.)

**Services and Capital Flows**

34. Net service payments should continue to rise in 1973, although somewhat slower than the 17% rate of the 1960s. The key reason will be a substantially larger net inflow of investment income in 1973 because of higher interest and dividends earnings on Japan's rapidly increasing holdings of foreign assets. These earnings may exceed $2 billion in 1973, compared with an estimated $1.7 billion in 1972. At the same time, however, Japan will have to make higher ocean freight payments, which will grow along with imports. The upward trend in net tourist expenditures and royalty and management fees is also likely to continue, offsetting some of the gains elsewhere in the service account.




Approved For Release 2006/04/19 : CIA-RDP85T00875R001700050009-6

Approved For Release 2006/04/19 : CIA-RDP85T00875R001700050009-6


Table 8

Japan: Total Imports[a]

*Million US $*

| | 1966 | 1967 | 1968 | 1969 | 1970 | 1971 |
|---|---|---|---|---|---|---|
| **Total** | **9,523** | **11,663** | **12,987** | **15,024** | **18,881** | **19,712** |
| Foodstuffs | 1,676 | 1,805 | 1,879 | 2,141 | 2,574 | 2,912 |
| Grain | 834 | 885 | 852 | 861 | 1,048 | 1,099 |
| Raw materials | 5,677 | 6,733 | 7,541 | 8,445 | 10,582 | 11,177 |
| Textile materials | 923 | 898 | 952 | 927 | 963 | 961 |
| Metal ore and scrap | 1,208 | 1,600 | 1,649 | 1,972 | 2,696 | 2,537 |
| Lumber and pulp | 790 | 1,055 | 1,284 | 1,417 | 1,750 | 1,607 |
| Coal and coke | 303 | 407 | 524 | 679 | 1,015 | 1,013 |
| Crude oil | 1,200 | 1,457 | 1,685 | 1,907 | 2,236 | 3,048 |
| Semi-processed goods | 690 | 1,258 | 1,291 | 1,642 | 1,869 | 1,547 |
| Nonferrous metals | 350 | 590 | 647 | 917 | 945 | 714 |
| Chemicals | 497 | 611 | 690 | 783 | 1,000 | 1,000 |
| Machinery | 556 | 766 | 1,004 | 1,216 | 1,649 | 1,648 |
| Office machinery | 112 | 160 | 179 | 217 | 322 | 341 |
| Electrical equipment | 120 | 192 | 229 | 304 | 464 | 425 |
| Transport equipment | 207 | 205 | 223 | 284 | 483 | 597 |
| Aircraft and engines | 111 | 102 | 135 | 185 | 326 | 413 |
| Light manufactures | 193 | 249 | 310 | 449 | 632 | 717 |
| Other | 27 | 36 | 49 | 64 | 92 | 114 |

a. Customs clearance data.

35. Another factor influencing service payments will be Okinawa's recent reversion to Japan. Past heavy US spending on the island – about $200 million annually – was not included in Japan's international accounts, because the island was considered part of the dollar area. Partly offsetting this gain in its service account, however, is the fact that Japan itself probably ran a substantial surplus in its service transactions with Okinawa. Tokyo will continue to earn large amounts from US military-related spending in Japan itself, which in recent years has been running between $600 million and $700 million annually. All of these factors taken together point to a net outflow on service transactions in 1973 on the order of $2.2 billion which, when combined with the trade surplus, yields an overall current account surplus of about $5.3 billion for 1973.

36. Long-term capital outflows will again offset most of the current account surplus. The government is continuing to encourage lending abroad, in part by depositing large amounts of dollars in commercial banks. Furthermore, a growing number of multinational firms as well as foreign




Approved For Release 2006/04/19 : CIA-RDP85T00875R001700050009-6

Approved For Release 2006/04/19 : CIA-RDP85T00875R001700050009-6


Table 9

Japan: Global Imports

| | Million US $ Jan - Sep | | |
|---|---|---|---|
| | 1971 | 1972 | Percent Change |
| **Total** | **14,542** | **16,809** | **15.6** |
| Foodstuffs | 2,061 | 2,570 | 24.7 |
| Grain | 804 | 779 | -3.1 |
| Raw materials | 8,333 | 9,238 | 10.9 |
| Textile materials | 725 | 985 | 35.9 |
| Metal ores and scrap | 1,932 | 1,774 | -8.2 |
| Lumber and pulp | 1,187 | 1,363 | 14.8 |
| Coal and coke | 785 | 794 | 1.1 |
| Crude oil | 2,219 | 2,791 | 25.8 |
| Semi-processed goods | 1,140 | 1,471 | 29.0 |
| Nonferrous metals | 541 | 642 | 18.7 |
| Chemicals | 723 | 822 | 13.7 |
| Machinery | 1,241 | 1,233 | -0.6 |
| Office machinery | 258 | 270 | 4.7 |
| Electrical equipment | 316 | 345 | 9.2 |
| Transport equipment | 454 | 566 | 24.7 |
| Aircraft and engines | 331 | 393 | 18.7 |
| Light manufactures | 502 | 795 | 58.4 |
| Other | 88 | 114 | 29.5 |

governments can be expected to borrow in Japan's capital market this year, continuing the trend started in 1972. Direct investment outflows will also be very large. In December, for example, the Overseas Petroleum Corporation, backed with government loans, announced plans to invest $780 million in Abu Dhabi's oil industry over the next 18 months. As a result, we expect a substantial increase in the estimated $400 million net outflow of direct investment that was recorded in 1972. Japanese investment in overseas securities, including in the US stock market, is also likely to be very large again this year, especially in view of plans to make earnings on foreign securities nontaxable. Purchases of Japanese securities by foreigners, on the other hand, cannot increase because of controls imposed during late 1972. Altogether, these trends suggest that net long-term capital outflows during 1973 will range between $4 billion and $5 billion.




Approved For Release 2006/04/19 : CIA-RDP85T00875R001700050009-6

Approved For Release 2006/04/19 : CIA-RDP85T00875R001700050009-6


**Short-Term Capital**

37. Our estimate of the trade surplus and projections on service payments and long-term capital outflows indicate that Japan may achieve its objective of a near zero basic balance. At the outside we expect about a $1 billion basic balance surplus. This would ease, but not eliminate, pressure for another yen revaluation, and sizable short-term capital inflows could continue. The 1972 short-term inflows in part consisted of borrowings in the US or Euro-dollar market scheduled to be repaid in 1973. Whether or not these debts will be repaid, rolled over, or increased will depend largely on judgments about the prospects of another yen revaluation. A modest inflow of short-term capital, however, could probably be absorbed without raising international reserves. This would be accomplished by shifting these funds into commercial banks.

**The US-Japanese Balance**

38. While a considerable reduction in Japan's global trade surplus is possible in 1973, the surplus with the United States is not likely to decline much. The imbalance in US-Japanese trade is now so large that an enormous percentage increase in the value of Japanese imports would be required to alter the situation substantially. Another problem is that during the past two years Japanese imports from the United States have not even kept pace with the overall growth in Japanese imports. In 1971, global imports rose by 5% in dollar value, but those from the United States actually declined by 9% while, in 1972, purchases from the United States grew somewhat slower than the global rate. This situation may well change in 1973, but no dramatic increase in the US share of Japan's import market is expected.

39. Several factors are tending to weaken the US sales performance in Japan's market. Until 1970, the United States managed to achieve sharp increases in sales to Japan, concentrated among a few agricultural products, raw materials, and some highly sophisticated machinery and equipment. The nine commodity categories listed in the accompanying chart accounted for about 70% of the increase in Japanese imports from the United States during 1965-70. Recently, however, the growth of these exports has slowed. A partial explanation is that, for some items in which the US share of the Japanese market is already high, growth of demand will be much slower than in the past. In the case of soybeans, for example, the United States sells huge quantities to Japan, but industry experts were recently projecting a mere 5% growth in sales volume for 1973. A similar situation exists for many other US agricultural exports to Japan. Fortunately, however, rapidly rising prices in 1973, especially for grains, will help boost sales value of these items considerably this year.

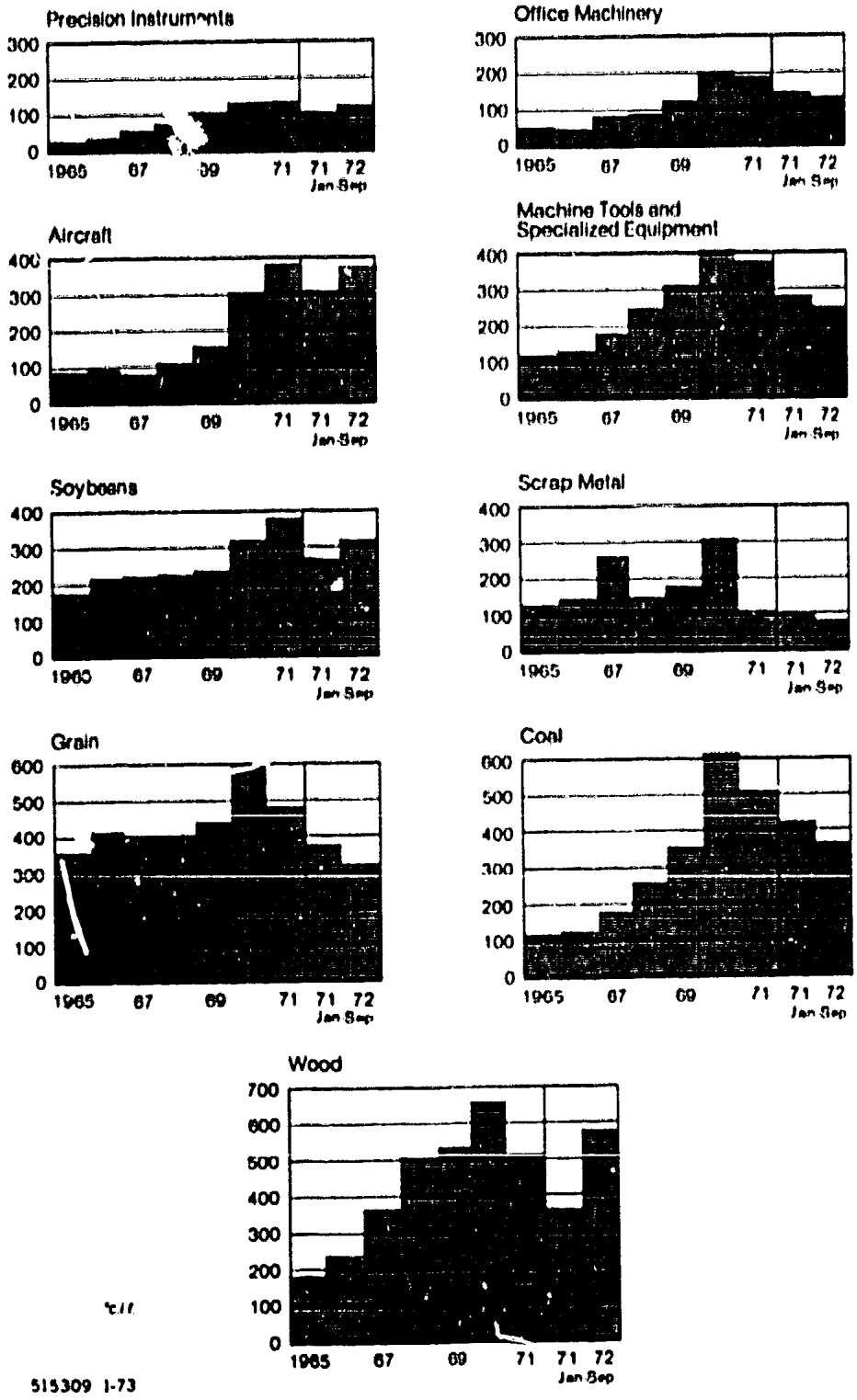


Approved For Release 2006/04/19 : CIA-RDP85T00875R001700050009-6

Approved For Release 2006/04/19 : CIA-RDP85T00875R001700050009-6


## Japan: Major Imports* from the United States

Million US $







Approved For Release 2006/04/19 : CIA-RDP85T00875R001700050009-6

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40. Faced with rising prices and in some cases limited US supplies, the Japanese are developing alternative supply sources for some materials. This is particularly true for coal, which accounted for nearly 20% of the increase in Japanese imports from the United States during 1965-70. US industry experts expect little or no increase in coal sales to Japan this year, because the Japanese are turning to countries such as Australia and Canada to fill their growing needs. For scrap metal, another large export growth item in previous years, no major increase in US sales is expected, because a growing supply is available from Japanese domestic sources. In the case of timber, now the leading US export to Japan, the Japanese are rapidly developing new supply sources, especially in Southeast Asia, partly out of concern that the United States will be unable to meet Japan's rising needs. For electronic equipment, much of the growth in US sales in past years consisted of computers and related items that are being produced domestically in increasing quantities.

41. Given all these trends, Japan will have a hard time meeting its previously announced goal of cutting the surplus to $3 billion this year. If Japanese exports to the United States grow a modest 10% -- less than global exports -- purchases from the United States would have to expand by an enormous 40% to accomplish the feat. At the outside, however, we expect that purchases from the United States will grow by about 30% in value. This would be somewhat faster than the growth rate for Japan's global imports and about double the rate at which imports from the United States grew in 1972. Even if this optimistic projection is realized, Japan's trade surplus with the United States in 1973 would still amount to an enormous $3.5 billion.

42. Japan will continue to run a substantial deficit with the United States on the service and long-term capital accounts. In recent years, Japan's net service payments to the United States have been running at about $600 million annually, but fell to about $400 million in 1972, primarily because of higher interest earnings on assets held in the United States. A further reduction in net service payments will occur this year, partly because US military spending on Okinawa will now be included in Japan's accounts. At most then, net service payments to the United States will run about $200 million to $300 million in 1973, yielding a current account surplus with the United States on the order of $3.2 billion. This will be partly offset by a long-term capital outflow to the United States -- largely for purchases of securities -- but a $2 billion basic balance surplus for 1973 seems a reasonable expectation.




Approved For Release 2006/04/19 : CIA-RDP85T00875R001700050009-6

Approved For Release 2006/04/19 : CIA-RDP85T00875R001700050009-6


## The Longer Term

43. The longer term impact of last year's yen revaluation on Japan's trade performance will depend on various factors. A key one will be price trends in both Japan and other developed countries which help determine Japan's international competitive position. In the past, Japan was the most successful among major developed countries in increasing productivity fast enough to offset rising costs, and, as a result, Japanese export prices became increasingly competitive. Part of the edge gained in those years was offset by revaluation, but if Japan continues to be more successful than others in holding down export prices, it will eventually regain its former advantage.

44. So far, Japan's price performance has been very good. While Japan raised dollar prices on exports in 1972 nearly as much as the amount of revaluation, many European countries boosted export prices even more rapidly in order to compensate for rising domestic prices as well as their own currency realignment. In the case of West Germany, which revalued 13.6%, export prices (in dollars) have increased substantially faster than have Japan's (see Table 10). The same is true of the United Kingdom, even though the pound appreciated much less than the yen in relation to the dollar. And in France, export prices increased only slightly less than in Japan. As a result of these trends, the price advantage West Europeans gained over Japan from the yen revaluation is already being eroded. Japan's competitive position relative to the United States appears to remain strong for most exports despite the revaluation, which offset most of the price advantage Japanese producers gained in the latter 1960s and early 1970s.

**Table 10**

**Japan: Indexes of Export Price of Major Trading Partners[a]**

| | *Export Price Index (2nd Qtr 1971 = 100)* | | | | | | | *Percent Revaluation Against Dollar Under the December 1971 Agreement* |
|---|---|---|---|---|---|---|---|---|
| | *1971* | | | | *1972* | | | |
| | *1st Qtr* | *2nd Qtr* | *3rd Qtr* | *4th Qtr* | *1st Qtr* | *2nd Qtr* | *3rd Qtr* | |
| United States | 101 | 100 | 99 | 101 | 102 | 102 | 103 | 0 |
| United Kingdom | 98 | 100 | 103 | 108 | 115 | 116 | .. | 8.57 |
| France | 99 | 100 | 102 | 103 | 109 | 113 | | 8.57 |
| West Germany | 97 | 100 | 107 | 109 | 114 | 115 | 116 | 13.58 |
| Italy | 98 | 100 | 101 | 103 | 107 | 108 | .. | 7.48 |
| Canada | 100 | 100 | 101 | 102 | 102 | 106 | 106 | Floating |
| Japan | 99 | 100 | 101 | 108 | 113 | 113 | 113 | 16.88 |

a. Based on export prices expressed in US dollars.




Approved For Release 2006/04/19 : CIA-RDP85T00875R001700050009-6

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45. Even more important than prices in the years ahead will be Japan's ability to develop new salable products for foreign markets. In the past, Japan has rapidly developed one major export item after another – going from steel to electronics to automobiles – and has made major inroads into foreign markets. During the 1970s, product development will become even more important. As Japan's manufacturing sector becomes more sophisticated, product competitiveness will depend increasingly on technology, product design, and marketing ability rather than on price. On the basis of past experience, it appears that the Japanese will likely do well in these areas.

46. At the same time, however, the Japanese will be facing problems not encountered in earlier years. To begin with, it will be far more difficult for Japan to penetrate foreign markets, because the United States is already wary of Japan's export prowess and the Europeans seem determined to prevent a massive influx of Japanese goods into their markets. Orderly marketing agreements and "safeguard clauses" to afford domestic producers some protection are becoming more prevalent worldwide and in many cases are aimed specifically at the Japanese. Pressures to open up the Japanese market to foreign competition, meanwhile, will become increasingly intense.

47. In any case, it will probably be several years before Japan's huge trade surplus is reduced even to the still very high level of $4 billion to $5 billion. In fact, it is questionable whether Tokyo is seriously interested in cutting the surplus to that level. The Japanese government has repeatedly stated that it is looking to achieve a current account surplus by 1975 equal to about 1% of GNP – or about $4 billion. Because Japan will still be running a large service account deficit, this would mean a trade surplus on the order of more than $6 billion. Tokyo seems to view a surplus of this magnitude as necessary to finance continued large long-term capital outflows.




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