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**A Forecast of the Bank of Japan's
Short-Term Economic Survey ("Tankan")
(September Survey)**

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**A Forecast of the Bank of Japan's
Short-Term Economic Survey ("Tankan")
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It is increasingly clear that the Japanese economy, especially the business sector, is entering a recession phase. Given the negative impact of the fall in share prices following the terrorist attacks in the United States on September 11, the Bank of Japan's *Short-Term Economic Survey* (the "Tankan"), due to be published on October 1, is likely to reveal a severe downturn.

The business sentiment diffusion index (DI) for September is likely to be -40% points on an all industries/all sizes of company basis, down 13% points on the level recorded in the June survey. Reflecting the substantial fall in exports due to the slowing demand for IT since second half of 2000 and the expected fall in non-IT exports due to the economic downturn in the United States and many other countries worldwide, the business sentiment DI among manufacturers will be as much as 15% points lower than the level recorded in June. In the non-manufacturing sector too, the deflationary trend is strengthening, and against the background of falling share prices, the business sentiment DI is likely to be down 12% points. As for the outlook, given that fears over the trend of the economy are unlikely to be allayed while share prices are unlikely to recover for the present, it is probable that the business sector will maintain its cautious stance for some time to come.

On an all industries/all sizes of company basis, capital investment plans for fiscal 2001 are likely to be 5.3% points lower than in fiscal 2000, virtually the same level as recorded in June. While it is highly likely that the impact of the terrorist attacks in the

United States has yet to become apparent, the intensifying mood of recession and the decline in business profitability offer little hope of an active increase in investment.

With the downward pressure on the economy increasing, the BOJ has implemented further monetary easing by lowering the official discount rate and raising the current account deposit target, while the government is pressing ahead with the drafting of a supplementary budget for fiscal 2001. In the short term, the key issue is the scale and content of the supplementary budget, and, given the current state of the economy, there have been calls both from within the government and from the opposition parties, for the supplementary budget to be substantial. However, the negative impact of additional spending on public works financed by the issue of government bonds would be too great to disregard. Not only would such a budget delay the structural reform of unprofitable sectors of industry while exerting only a temporary positive effect on the economy, but the consequent rise in long-term interest rates and disappointment at the setback to the policy of structural reform might trigger a fall in share prices. It is more urgent that Japan should create an effective safety net for employment, in anticipation of a further weakening of the economy, and strive to make steady progress with structural reforms with a view to reviving household, business and investor confidence.

The Institute's forecasts of the trend of the business sentiment diffusion index and capital investment plans are as described on the following pages.

1. The Business Sentiment Diffusion Index

On an all industries/all sizes of company basis, the business sentiment DI in September is likely to be well below the figure in the previous survey (June), falling by as much as 13% points (a downward revision of 11% points as compared with the expected figures). Business confidence, which was already deteriorating, appears to have been further undermined by the sudden fall in share prices following the terrorist attacks in the United States on September 11. By sector, the index among manufacturers is likely to fall by 15% points as compared with June, largely as a result of the decline in exports and capital investment, and the consequent growth of inventories. Among large manufacturers in particular, reflecting the fall in exports of electronic devices, especially to Asia, and the increasing pressure for an upward adjustment of materials-related, the DI is likely to fall sharply, by as much as 22% points from the June survey. In the non-manufacturing sector too, the deflationary trend is strengthening and as the effects of the fiscal 2000 supplementary budget are fading and uncertainty as to the future of the economy is growing, the DI is likely to fall by 12% points as compared with June.

Looking ahead to December, reflecting fears of a crash in share prices and the likelihood of a worldwide recession, the DI is likely to fall by a further 1% point as compared with September on an all industries/all sizes of company basis. Although the fall is likely to be smaller as the index is already close to the all-time low recorded in past recessions, amid the rising pressure for adjustments in the manufacturing sector, it is unlikely that the DI will start to recover.

2. Capital Investment Plans

On an all industries/all sizes of company basis, the amount of capital investment in fiscal 2001 is likely to be 5.3% points lower than in fiscal 2000, the scale of the

upward revision remaining small. In the manufacturing sector, electrical machinery has until now furnished most of the pulling power in capital investment. However, largely due to the fall in demand for electronic devices, this industry is reducing its semiconductor-related investment and, overall, capital investment by the manufacturing sector is likely to fall by 1.9%. In non-manufacturing industry, largely due to a sharp fall in the number of retail stores being opened as a reaction to the rush to open stores that occurred before the Large-Scale Retail Stores Location Law became effective, capital investment is likely to see a fall of 6.6%.

Looking to the future, user industries are highly likely to maintain a relatively high level of investment in IT while pressure for inventory adjustments is low as compared with its level during past recessions. However, amid fears that the world economy is about to enter a recession phase, it is probable that the decline in exports will continue for some time and highly likely that capital investment plans in the manufacturing sector will be cut back. Meanwhile, falling share prices are having a negative impact on household and business confidence, and the decline in domestic demand is likely to accelerate toward the end of the year. Given these conditions, it is highly likely that capital investment plans will be revised downwards from December onwards.