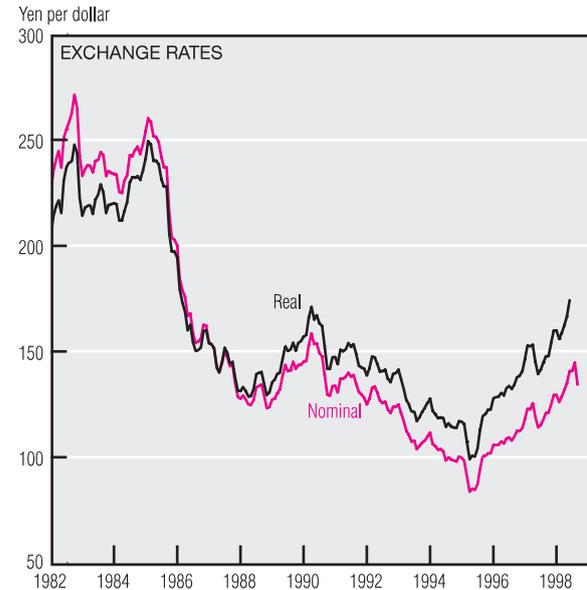
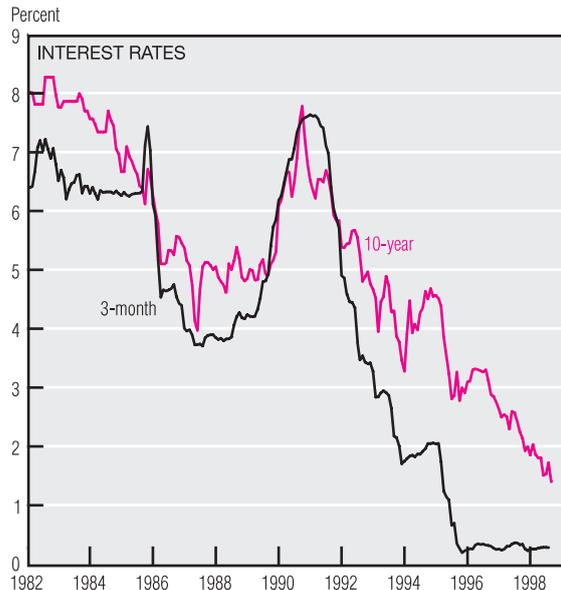
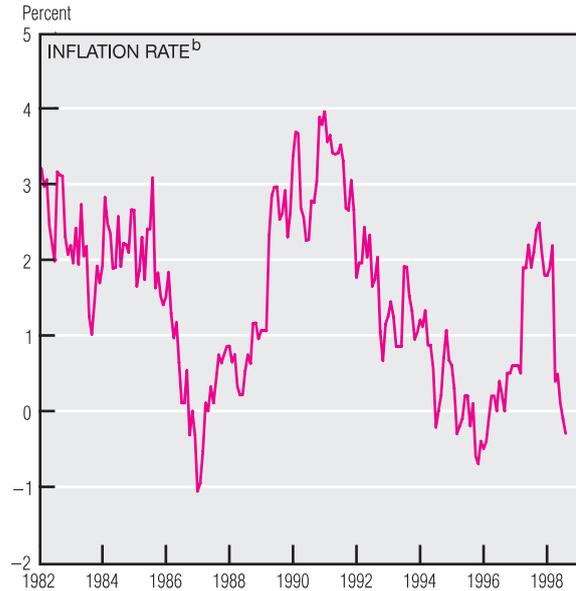
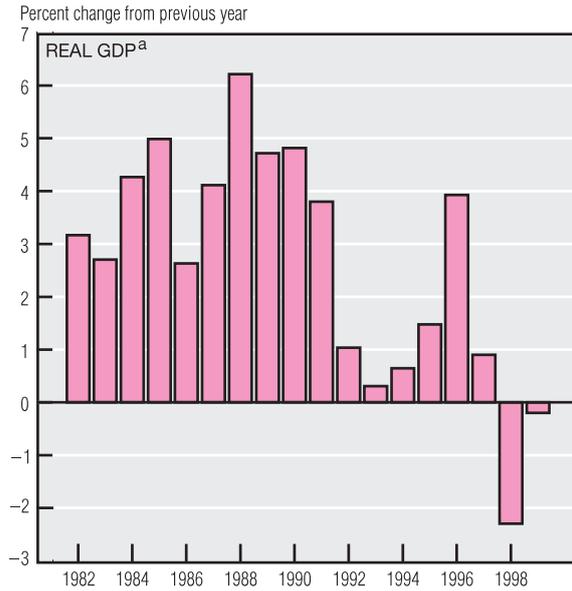


The Japanese Economy



a. 1998 and 1999 data are forecasts from *The Economist*, October 17–23, 1998, p. 116.

b. Sales taxes imposed in April 1997 account for the jump in year-over-year price changes between April 1997 and April 1998.

SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; International Monetary Fund, *International Financial Statistics*; *The Economist*, October 17–23, 1998; Bank of Japan; Statistical Bureau of the Prime Minister (Japan); and DRI/McGraw-Hill.

In its seventh year of economic malaise, Japan is poised to experience its first annual decline in real GDP since the 1974 oil crisis. According to a poll by *The Economist*, forecasters expect real GDP to drop 2.3% in 1998 and to fall a further 0.2% in 1999.

The asset-price deflation of the early 1990s saddled Japanese banks with huge portfolios of nonperforming loans and a reluctance to extend new credit. This situation, combined with the broader wealth

effects of asset-price declines, has trimmed the country's average annual growth rate to only 1.4% since 1992, substantially below the 4.1% growth rate of the previous 10 years. To resolve its banking situation, Japan recently adopted measures to guarantee bank deposits, close numerous insolvent banks, and help rebuild bank capital.

Many observers have questioned whether, with a crippled banking sector and extremely low interest rates, the Bank of Japan could

stimulate economic growth—even temporarily. The traditional monetary transmission mechanism relies on interest-rate reductions and bank lending, which now seem unlikely in Japan. Under a floating-exchange-rate regime, however, a monetary expansion will also promote an exchange-rate depreciation, irrespective of its effect on interest rates. A further yen depreciation and an expanded trade surplus are likely prerequisites to a Japanese recovery.