Monthly Review

FEDERAL RESERVE BANK OF SAN FRANCISCO

January 1956

Review of Business Conditions

In the opening month of the year the economy of the Twelfth District continued to reflect the record pace of activity generated during the previous year and a half. While the usual seasonal factors operated to slow activity in some lines, a further build-up in demand in other industries pushed total output and employment up somewhat further. Judging from recent nonseasonal declines in average weekly insured unemployment, manufacturing and commercial activity entered new high ground in December and early January. Over-all strength is still the dominant feature of the economic scene, although softness in some segments has recently become more evident. Notably, residential construction and auto assembly show increasing tapering-off tendencies and furnish the major sectors of concern in both the District and the nation.

Despite the evidence of a slowing down in business expansion, the situation and outlook continue to be highly favorable. It is unlikely that gains in activity in the immediate future will in any way match the exceptional advances of late 1954 and early 1955; the advance should, however, be reasonably well sustained. The most recent data on nonagricultural employment reveal that the demand for aircraft, metals, and machinery is still rising. Employment gains in these lines have been primarily responsible for offsetting seasonal job losses in food processing and construction. Recent added strength in metal and machinery demand has stemmed from the record rate of business investment expenditures, which are expected to rise to even higher levels during the first quarter of the year. Additional growth in the rate of operations at District aircraft and parts production facilities reflects in part the step-up in deliveries to the military establishment and partly the initial expansion in connection with the large volume of civilian airline orders placed in recent months. Some further growth in the level of employment in the aircraft industries seems likely as a result of these factors and of the distinct possibility of some net expansion in national security outlays by the Federal Government.

Residential construction shows additional weakness

Construction activity in the District shows increasing signs of softness, although employment in the industry still remains considerably ahead of a year ago. The weakening is the result of a continued downtrend in new housing activity that started in late summer of last year. Sharp declines in the volume of VA appraisal requests and FHA applications for commitments indicate a probable further decline in new housing starts. (In 1955 somewhat more than one-half of the nation's total new housing starts were financed with government-assisted mortgages.) In December, appraisal requests received by District offices of the VA were only a third of the number received in December 1954. At District FHA offices the number of applications received was some 32 percent below the year-ago number. With declines of these magnitudes in government-assisted housing starts and with housing accounting for substantially more than one-third of total new construction, the other forms of construction will be hard put to fill the gap. These other forms, particularly industrial, commercial, and religious and recreational, while still growing, have not expanded enough to offset completely the declines in private residential construction expenditures. The ending of a strike in the building materials industry in Los Angeles (the largest single housing market in the nation) in early January will give a temporary lift to actual residential construction in the next several months.

Nationally, private new housing starts fell slightly below a seasonally adjusted annual rate of 1.2 million units in December. This is a 20 percent decline from the exceptional peak of nearly 1.5 million units (seasonally adjusted annual rate) reached in December 1954. To counter the steadily declining trend of new housing starts the Federal Housing Authority and the Veterans' Administration simultaneously extended the maximum maturity allowable under their mortgage insurance or guarantee programs to 30 years from the 25-year maximum term imposed last summer. In a recent survey of District home builders, difficulty in qualifying buyers for FHA or VA mortgages under the 25-year maturity maximum was cited as a major deterrent to new residential construction. (Both FHA and VA impose a minimum acceptable ratio between buyer's income and the monthly mortgage payment.) To the degree that lenders are willing to extend funds under the longer maturity, the new mortgage terms will have an expansionary impact upon the level of new housing starts.

Rise in new car stocks occasions cutbacks at automotive plants

The number of new passenger cars in the hands of dealers throughout the nation at the start of the year was more than double the number on hand a year earlier. This large unsold inventory of 1956 model cars has caused a cutback in the rate of output at automobile plants in December and January in the nation. Preliminary reports from state employment offices in the two major auto assembly areas of California indicate that the level of operations at District assembly plants has not yet been affected by the production cutbacks. There is little doubt that should dealer stocks increase further, District assembly plants will lower the level of operations and reduce employment from the record high reached in December.

Nationally, one effect of automotive cutbacks has been a reduction in the current order file of the major steel producers. The automobile industry accounted for some 25 percent of total steel output in 1955. Only a very small proportion of the Twelfth District's steel production is utilized in automobile production, however, so that the direct effect of auto cutbacks on District steel output will be negligible.

Despite the piling-up of new car inventories, the industry is still operating at a high level. According to some industry sources 1956 output of new cars is expected to be as low as 6.3 million units nationally—a decline of about 15 percent from the record high of 1955.

Severe storms interrupt outdoor activities but reconstruction will spur the economy

Extreme winter weather struck a wide area of the District in late December and early January. Heavy rainstorms interrupted normal activities, particularly in construction, lumber, logging and agriculture. In some areas, particularly in Northern California, considerable loss of property and extensive damage to production and commercial facilities was experienced. The rebuilding, repairing, and restocking of these areas will add to the already strong character of demand in the District. Emergency credit extensions by Federal and state governments will help to make effective the demands created by the disastrous floods.

In the lumber industry, the storms interrupted shipments and production to such an extent that temporary shortages have resulted. The effect of these shortages has been to arrest weakening tendencies in the prices for some types and grades of lumber. Logging operations were virtually at a standstill and, for those producers whose stocks of logs were already low, this could lead to an early shutdown in mill operations.

Bank loan expansion continues but intensity of rise diminishes

Like the rise in general business activity, the rise in business use of bank credit goes on but with diminishing intensity. At weekly reporting member banks in the leading cities of the District, expansion in total loans in the four-week period ended January 11 was only about one-half the gain in the comparable period one year earlier. (It will be recalled that the late months of 1954 and early 1955 showed the exceptionally large gains typical of a vigorous upswing in economic activity.) The easing in the rate of rise of demand for credit combined with seasonal forces that tend to increase bank reserve positions after the Christmas season resulted in a modest decline in some money market rates in early January.

Among the principal categories, loans to business and agriculture show the greatest difference between the recent period and the same period a year earlier. Loans to commercial, industrial, and agricultural enterprises increased $46 million in the four-week period ended January 11 compared with a rise of $73 million in the like period a year earlier. Other loans (comprised mainly of direct loans to consumers) decreased slightly, $4 million, during the recent four-week period; an increase of $6 million had occurred in the comparable interval a year before. Borrowing by sales finance companies, included in the total of all business loans, was at record levels in the early weeks of January, suggesting that borrowing from consumer finance organizations is still vigorous in the District.

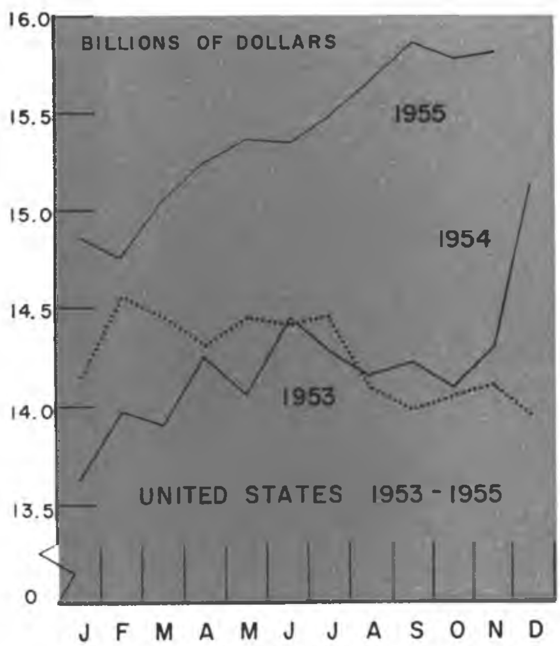
Real estate loans, contrary to the national pattern, increased somewhat more in the four-week period ended January 11 than at this time twelve months previous. The continued rise in real estate loans at weekly reporting member banks in the District reflects mortgages drawn to finance the sale of the large volume of residential units currently being completed. However, the declining trend in housing starts in late 1955, noted earlier in this *Review,* will lower the rate of completions in coming months. The effect will be less need for additional financing with a resultant slowing in the extension of new real estate credit.

1955 Retail Sales at a Record Level

Chart 1

TOTAL RETAIL SALES

ADJUSTED FOR SEASONAL VARIATION



Source: United States Department of Commerce, Office of Business Economics, *Survey of Current Business.*

In the year just ended Americans spent record amounts at retail establishments. Taking advantage of their record high level of personal disposable income, easy consumer credit conditions, and an abundance of available goods, consumers went on a buying spree that brought total retail sales in the nation for 1955 to $186 billion, according to an advance report published by the United States Department of Commerce. This amount represents a $16 billion, or 9 percent, increase over both 1953 and 1954. December's retail sales reached an all-time monthly high of $19.4 billion, exceeding the year-ago month, the previous record high, by 9 percent and December 1953 by 18 percent.[1] As is shown in Chart 1, total sales for each month of 1955 were above the comparable months of the two prior years.

Automobile sales lead national expansion

All types of retail concerns benefited from the boom in consumer spending during the year. Automotive retailers experienced the greatest increase in sales activity, with increases of 21 percent above 1954 and 15 percent over 1953. The willingness of consumers to accept the offer of easy credit terms was one factor which played

[1] All percentage change figures used in this article refer to comparisons between dollar volumes unadjusted for trading days or seasonality unless otherwise stated.

an important role in supporting this large increase. From the end of November 1954 to November 1955 outstanding automobile consumer credit rose by $3,876 million, a 38 percent increase. Sales of other durable goods retailers such as furniture and appliance stores and retail lumber, building, and hardware outlets also showed marked gains over the preceding two years.

Among retail stores engaged in selling nondurable goods the increases generally were not so marked as for durables. This is partly explained by the fact that soft goods sales were maintained at fairly high levels during 1954 in contrast to sales of durables which fell off abruptly. Gasoline service stations had the largest increase in dollar volume of sales, rising 8 percent above 1954 and 18 percent above 1953. Consumers have been steadily increasing their food purchases in the last few years, reflecting both their growing income level and the rising population. During 1955 they spent almost $43 billion at retail food stores, a 5 percent rise above their 1954 purchases and 7 percent above those made in 1953. Sales of eating and drinking establishments also shared in this trend of consumer buying. General merchandise stores, including department stores, mail order houses and variety stores, experienced a 7 percent increase over 1954 and a 6 percent increase over 1953. Department store sales, the major component of this group, followed much the same trend as the total classification, rising 6 percent above 1954 and 5 percent above the two-year-ago period.

Twelfth District retail sales also reach record highs

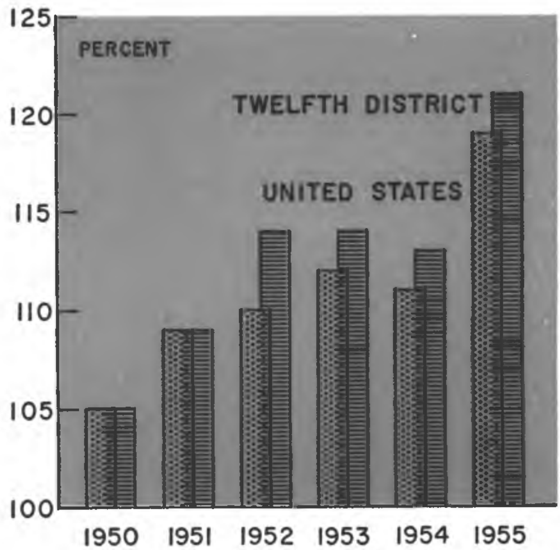
Sales data available for the Twelfth District, which are not as comprehensive as those for the nation, indicate that retail sales in this area also reached new record high levels during 1955. The United States Department of Commerce estimates of sales by all Group I retail stores[1] located in the Western States reveal that the over-all changes during the year paralleled those in the nation, although there were variations in the patterns of change from month to month. The

[1] Group I retail stores are all single retail establishments or retail chains with not more than 10 outlets.

CHART 2

ANNUAL INDEXES OF DEPARTMENT STORE SALES

1947-1949 = 100%



Note: 1955 data are preliminary.

sharpest increase in this area, as was true nationally, was reported by automotive dealers.

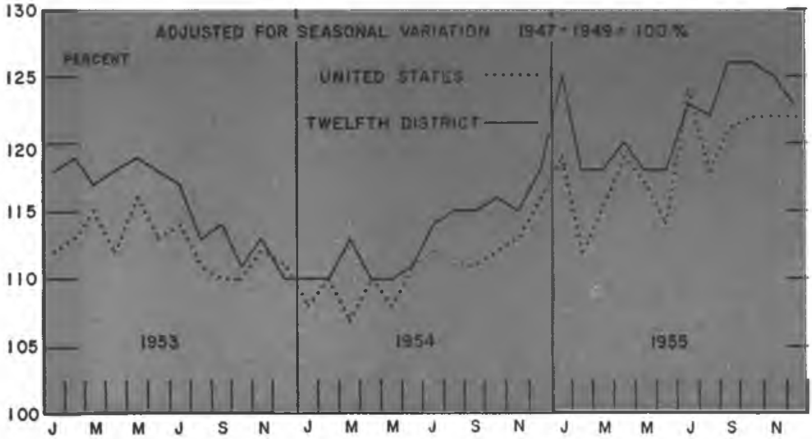
According to preliminary data submitted to this bank, apparel store sales rose 5 percent above the 1954 dollar volume. Furniture stores had an even larger increase, gaining 16 percent during the year. Sales of furniture and appliances were also important in explaining the increase in District department store sales. Total department store sales were 7 percent larger in 1955 than in 1954 and 5 percent above 1953. On a month-to-month basis the durable goods departments had larger percentage gains from the year-ago month than did the total store and in most cases their gains exceeded those of the other departments.

The seasonally adjusted department store sales indexes for the Twelfth District and the nation as a whole varied in their rates of change on a month-to-month basis but had the same general upward trend over the year as a whole. Chart 3 illustrates the fact that the national decline in department store sales which began in

Chart 3

INDEX OF DEPARTMENT STORE SALES

UNITED STATES AND THE TWELFTH DISTRICT



Note: December 1955 data are preliminary.

mid-1953 continued into the first part of 1954 while in the District the decline in sales leveled off after December 1953. After May 1954 an upward trend occurred and continued through October 1955 for both the nation and the District, bringing the seasonally adjusted indexes to new record highs. Although in the Twelfth District the seasonally adjusted index of department store sales for November and December remained substantially above the previous record highs for these months, it was down from October. Nationally, the index did not decline.

Most cities within the District had larger department store sales for 1955 than for the comparable periods of either 1954 or 1953. The largest percentage increases occurred in Santa Monica, Riverside-San Bernardino, San Jose, Tacoma, and Salt Lake City. The Yakima area, with a 2 percent reduction in total sales, was the only area showing a decline between 1954 and 1955. However, Phoenix, downtown Los Angeles, San Diego, downtown Oakland, Vallejo, Stockton, Everett and Walla Walla each had smaller sales volumes in 1955 than during 1953.

The failure of department store sales in downtown Los Angeles and Oakland to keep pace with the general increase reflects in large measure the establishment of shopping centers in the suburban areas surrounding these cities. One of the distinctive features of the postwar period has been the movement of industries and families into the suburbs of the larger cities. Taking advantage of the growth of these areas, specialty shops of all types have opened and attracted customers away from the downtown areas. In order to counteract this loss of business, many department stores also opened branches in these areas. This dispersion trend is especially noticeable in the Los Angeles area. However, the San Francisco-Oakland area within the past few years has also participated in this movement, with many major department stores opening branches or announcing future expansion in the suburbs. In the other areas of the District this trend is also important, though not as prominent as in the major California metropolitan areas.

Christmas sales by department stores give evidence of continued rise in sales for year

The record level of District department store sales evident in the first 11 months of 1955 continued through December according to weekly sales data reported to this bank. Christmas buying, measured by activity during the four weeks ending December 25, was up 5 percent over the previous record high, year-ago period. Most of this increase can be attributed to purchases made during the week ending on the 24th when, owing in part to an extra trading day this year, sales were 18 percent above the same week of 1954. Total sales in the four-week period preceding Christmas week were 2 percent above what they were a year ago. All metropolitan areas in the District recorded gains during the four-week pre-Christmas period ranging from 1 percent in downtown Los Angeles to 8 percent in the San Jose and Portland areas.

The buying spree, which usually tapers off after Christmas, continued through the end of December. In the last week of the year department store sales were 8 percent above the same week of 1954. Sizable increases were especially noticeable in Northern California, Seattle, and Portland.

The United States—Japan Trade Agreement and Japan's Foreign Trade

The United States-Japanese Trade Agreement

On September 10, 1955 the United States-Japanese trade agreement went into effect, culminating several months of negotiations by Japan with the United States and sixteen other countries at Geneva under the terms of the General Agreement on Tariffs and Trade.[1] Earlier in the year, in June, the document providing for the accession of Japan to full-fledged membership in the General Agreement was opened for signature. By August 11 all 34 members of the GATT had approved Japan's admission, superseding her previous status as a provisional member of that group. Under the provisions of the General Agreement, the tariff schedules of the various member nations became applicable to Japan thirty days after Japan's entrance. Fourteen nations, however, who did not enter into tariff negotiations with Japan, invoked Article 35 of the General Agreement reserving their right to withhold their tariff concessions from Japan because of expressed uncertainties regarding Japan's trading practices.[2]

Japan's entry into the General Agreement had been strongly supported by the United States on both economic and political grounds. Japan's membership would assist in the expansion of her foreign trade upon which the viability of her economy so largely depends. Principally for this reason the United States took part in the Geneva negotiations and urged other nations to follow her lead. Without the benefits to be derived from GATT membership, furthermore, it was feared in some quarters that Japan would be greatly tempted to increase her trade with the communist-bloc nations.

Despite the lack of unanimity in the extension of GATT concessions to Japan, Japan was able to obtain concessions from the United States and other countries with which she negotiated on items in which she had a substantial interest. These countries in turn received concessions on their exports to Japan.

The tariff negotiations

The United States participated in the tariff negotiations with Japan under the authority of the Trade Agreements Extension Act of 1954, which extended for one year the President's authority to reduce existing tariffs by 50 percent of the 1945 levels. In accordance with the usual procedure in these negotiations, concessions were exchanged on a reciprocal basis, and the United States was governed by the "peril point" findings of the Tariff Commission determined after public hearings. The United States adhered to the practice of granting concessions to a country only where that country was the "principal supplier" of the commodity under consideration, although the United States herself was not the "principal supplier" of all the commodities on which she obtained concessions. The United States delegation also paid particular at-

[1] The other nations were Burma, Canada, Chile, Denmark, Dominican Republic, Finland, West Germany, Greece, Indonesia, Italy, Nicaragua, Norway, Pakistan, Peru, Sweden, and Uruguay.

[2] These countries were Australia, Austria, Belgium, Brazil, Cuba, France, Haiti, India, Luxembourg, the Netherlands, New Zealand, the Rhodesian-Nyasaland Federation, the Union of South Africa, and the United Kingdom. The United Kingdom, Austria, India, the Netherlands, Belgium, and Luxembourg, however, already extend most-favored-nation treatment to Japan under other arrangements.

tention to the problem of possible "substandard wage" exports by Japan.

A new feature of the agreement was the use of triangular or third-country negotiations, a method introduced in an effort to increase the possibilities for concessions by the participating countries. The United States was empowered to offer concessions to third countries in exchange for concessions by them to Japan.[1] The United States in turn was compensated by equivalent concessions granted by Japan on United States imports into Japan. This method was resorted to, however, only after all avenues of bilateral negotiation had been exhausted.

Japanese concessions to the United States

The 286 items on which Japan granted concessions accounted for $397 million of the $760 million of goods imported by Japan from the United States in 1953.[2] Seventy-eight percent of these concessions resulted in duties below 30 percent (including duty-free items) and 57 percent below 20 percent. The concessions took two forms: duty reductions and bindings of tariff treatment (agreement not to change either the existing tariff level or duty-free treatment).

Tariff reductions on United States commodities imported into Japan covered shipments totaling $61 million. Almost 60 percent of this total involved reductions of less than 25 percent, with medium and heavy passenger automobiles the most important ($24 million in imports in 1953). Other leading commodities whose tariffs were reduced by more than 25 percent included lubricating oils and greases, certain types of statistical machines and parts, four-engined airplanes, vitamins and vitamin preparations, measuring and testing instruments, tetraethyl lead, tomato paste and puree used in fish exports, fresh lemons, limes, and raisins.

The tariff status of certain other commodities, whose imports were $334 million in 1953, was bound under the agreement. Bindings of statutory rates affected commodities totaling $140 million, with imports of soybeans the principal item. Beef tallow, corn for feedstuffs, certain metalworking machines, airplanes with less than four engines, raw petroleum coke, and certain antibiotics were among the other significant commodities in this group. Japan also granted bindings of duty-free treatment for imports of $195 million, including raw cotton imports of $122 million and coking and other types of coal, $66 million.

[1] The countries involved in triangular negotiations with the United States and Japan were Canada, Sweden, Norway, Denmark, Italy, and Finland.

[2] Based on Japanese trade statistics.

Only one commodity, exposed cinematographic film, became subject to a somewhat higher tariff, but only because of a changeover from an ad valorem to a specific tariff to facilitate computation of the customs duty.

At the present time, not all imports from the United States into Japan are assessed the rates in the published tariff schedules. Duty-free special treatment has been accorded to quite a few items to promote economic development or to encourage exports. For these commodities, Japan agreed either to bind the special duty-free treatment or not to increase the tariff beyond the statutory rates.

Under the new trade agreement, United States exporters may be able to increase their exports to Japan, although Japan herself is a net exporter of some of the items on which the concessions were granted. According to the Department of State's analysis of the agreement, the two commodities which may offer the greatest potentialities are heavy-duty motorcycles and those types of synthetic fiber fabrics included in the negotiations which are produced only in small quantities in Japan.

United States concessions to Japan

The United States granted concessions on commodities whose imports into the United States totaled $179 million in 1954; concessions granted directly to Japan covered $131 million of this total.[1] The concessions were essentially similar to those granted by Japan: reductions in rates ($81 million), bindings of existing rates ($53 million), and bindings of duty-free status ($45 million). As mentioned above, these concessions were extended on items of which Japan was the principal supplier. In general, the concessions on dutiable products were made on commodities which were either (1) not pro-

[1] Based on United States trade statistics.

duced in the United States in large volume, (2) not strictly comparable to the United States products, (3) relatively unimportant in United States import trade or where the United States was a net exporter, or (4) on low valued products (e.g., certain classes of chinaware and earthenware).

Nevertheless, some of the concessions may affect adversely some segments of certain industries in the United States. Protests have been voiced, for example, by the tuna fishing, cotton textile, and earthenware and chinaware industries. Various other industries, especially those producing lower-priced articles, may also experience new or added competition in domestic markets from reductions in the tariffs. Tariff concessions may also operate to the advantage or disadvantage of United States exporters, importers, or users of imported materials, and of producers, importers, and exporters abroad. At the same time, there are considerations of national policy which must be taken into account, such as the repercussions of any particular action on general economic conditions in the United States or on our international relationships.

In the case of the tariff concessions on different types of tuna, diverse factors must be considered. There are the domestic canners who depend on imported tuna for their supplies but who may be affected by the lower tariffs on canned tuna. There are the domestic fishing fleet operators who have long opposed the free list status of fresh and frozen tuna on the grounds that lower foreign labor and capital costs have made competition difficult. From still another viewpoint, Japan, which supplies the bulk of imported albacore, derives a significant share of her dollar earnings from exports of this white-meat tuna.

The cotton textile industry provides another instance of conflicting interests. The cotton textiles affected by the recent tariff negotiations are primarily the low-priced, low yarn count cotton materials which are of greatest importance to the Japanese textile industry. In the negotiations with Japan, the rates applicable to the higher count categories were applied to the lower valued textiles, resulting in an average reduction of 25 percent in the tariff level.[1] Arguments have been advanced by domestic producers against these reductions, reinforced by the recent sharp increases in imports of Japanese cotton textiles. The domestic cotton textile industry is highly fearful of the inroads which are being, and may continue to be, made in their traditional markets, both in the United States and abroad. The difference in wage costs per hour is frequently cited as one cause of complaint. Although imports are less than 1 percent of domestic production, these domestic manufacturers feel that the Japanese products will be able to compete effectively and in large volume in certain lower priced sectors of the market. Importers of Japanese-made cotton cloth and articles of clothing, however, favor the tariff reductions. Furthermore, Japan is a major market for United States raw cotton exports. And, as in the case of tuna, cotton textile exports are an important, although declining, earner of foreign exchange for Japan. Similar considerations are involved in the chinaware and earthenware cases.

Evaluation of Japan's entry into GATT and the trade agreements

Japan's entry into GATT should prove advantageous to her in several respects. Because foreign trade is so important to the Japanese economy, measures to expand the volume of Japanese trade will aid in raising her level of economic activity. Many of Japan's major export industries rely upon foreign sources of supply for the raw materials needed in the process of production. Furthermore, with the decline in the United States special procurement and aid expenditures in Japan, which have contributed to a significant extent in meeting Japan's overseas dollar obligations, Japan must find other means to finance her large volume of imports.

Membership in GATT, moreover, should assure continued favorable, or improved, treatment for Japanese commodities abroad through application of most-favored-nation treatment for tariff concessions. The inclusion of Japan in GATT will also provide opportunities to use GATT as a

[1] United States Department of State, *General Agreement on Tariffs and Trade, Analysis of Protocol (Including Schedules) for Accession of Japan,* Publication 5881, Commercial Policy Series 150, p. 69.

forum for discussion of mutual problems and as a means of reconciling differences in trade practices and policies.

The actual immediate benefits derived by Japan from GATT membership and from the trade agreements recently concluded have been weakened, however, by several developments. One is the invocation of Article 35 of the General Agreement reserving the right of any of the contracting parties to withhold tariff concessions from countries with which it has not negotiated. Under this article the application of most-favored-nation treatment is suspended. An attempt was made to modify the stand of some of these countries at a recent GATT meeting, backed by Japanese assurances of adherence to the principles of fair trade, but it proved unsuccessful. In the meantime, the Japanese Government announced the introduction of a certificate-of-origin requirement for imports which is now in effect. This system will enable Japan to apply most-favored-nation treatment only to those countries which have declared their willingness to accord similar treatment to Japan.

The composition of the trade parley at Geneva, furthermore, constituted a limiting factor in the scope of the trade concessions offered. Although the participating countries accounted for approximately half of Japan's import trade, they took only 26 percent of her exports. As a consequence, the possible range of concessions was narrowed considerably. Many of these countries exported raw materials to Japan and imported manufactured articles. The exchange of bindings or reductions in already low Japanese import tariffs on raw materials for lower tariffs on imports of Japanese manufactured goods was not considered adequate in many cases. Some of these countries were reluctant to grant significant concessions to Japanese goods which competed with similar industries at home. The United States was also unable to offer her services in triangular negotations in this regard because her pattern of trade with these countries was similar to that of Japan. Nevertheless, the trade concessions extended are a starting point towards the reintegration of Japan into the community of trading nations of the free world.

Japan's Foreign Trade

The conclusion of the first round of tariff negotiations with Japan bolstered Japanese hopes for an improvement in her balance of payments position. Her admission to GATT, although qualified, has also been considered a milestone in her program for an expanded volume of foreign trade. Two factors make the attainment of this objective a matter of utmost importance to Japan. In the first place, foreign trade has always played a strategic role in the Japanese economy. In 1937, for example, Japanese exports accounted for 17 percent of national income while imports were about one-fifth of national income. Comparable figures for the past several years are somewhat less than 10 percent for exports and around 14 percent for imports. Failure of Japan's trade in the postwar period to contribute its prewar share to national income has an important bearing on the health of the Japanese economy at the present time. Exports, moreover, account for an appreciable share of total production of many Japanese industries.

Secondly, Japan has been running a substantial deficit in her balance of trade and services with the rest of the world, with a high of $1,028 million reached in 1953.[1] A large part of this deficit was accumulated in transactions with the dollar area, especially the United States. In 1954 Japan had an unfavorable balance with the United States on merchandise trade alone of $400 million, slightly below the 1953 record figure. Part of the over-all current account deficit has been met by drawing down of exchange reserves or the extension of dollar and sterling usance credits. But the major share of the deficit has been paid for by United States and United Nations special procurement programs, which consist mainly of purchases of goods and services for military operations and defense support activities in the Far East. As a result of these payments, the Japanese balance of trade and services showed an over-all deficit of only $226 million in 1953 and $80 million in 1954. But expenditures for United States special procurement programs have been declining since the 1953 peak so that Japan can no longer rely almost exclusively upon

[1] Not including the category "Government, n.i.e." which consists primarily of goods purchased by United Nations forces under the special procurement program.

this source to fill the gap. The improvement in the balance of payments in the latter half of 1954 continued into 1955. For the first six months of 1955, an over-all surplus of $2 million (including special procurement receipts)[1] was attained, compared to a deficit of $351 million for the same period in 1954. For the year as a whole it has been estimated that Japan's balance of payments may be even more favorable, principally because of a record level of exports.

Nevertheless, the volume of Japanese merchandise trade in the postwar period has proved disappointing although the physical volume of exports has increased almost eight times and the volume of imports almost three and a half times since 1948. Despite this spectacular increase, the volume of Japanese imports in September 1955 was still 31 percent below the 1934-36 monthly average, while exports were 41 percent below the prewar level. Imports increased sharply from 1950 to 1954, but exports lagged behind. As a consequence, merchandise imports continue to exceed exports by a substantial margin.

The signing of the United States-Japanese trade agreement therefore seems to be a favorable development for Japanese trade. But the mere removal or reduction of tariffs and other restrictions to a freer flow of trade is not the only necessary, or sufficient, condition for the solution of Japan's balance of payments problems. The causes of this imbalance are more deep-seated and are the consequence of postwar developments that have modified the structure of the Japanese economy and the economies of other nations.

The prewar and postwar pattern of Japanese foreign trade

The pattern of Japan's foreign trade has changed radically since the prewar period. Before World War II, a large volume of Japan's trade was conducted with areas under her economic or political control—such as Manchuria, the Kwantung Peninsula, Formosa, and Korea. These areas and the countries of southeast Asia furnished raw materials for Japanese industry and food supplies and obtained manufactured producers' and consumers' goods from Japan.

This pattern was completely disrupted after World War II. The mainland of China is not as important as before in Japanese import trade and no longer serves as a major outlet for Japanese exports or capital. The countries of southeast Asia are engaged in economic and industrial development and are hesitant to become too dependent on trade with Japan. Moreover, Japan has lost some of her overseas markets because Japanese industry has fallen behind competitively. The requirements of a growing population have, in addition, increased the importance of food imports, although industrial raw materials still bulk large in import trade. Japan's earnings on her service accounts (principally transportation and insurance services), which formerly produced a surplus, have also been adversely affected. Consequently, the customary merchandise deficit cannot be offset by earnings from services or returns from investments.

Efforts to expand Japanese exports to eliminate the deficit have been impeded by the noncompetitive prices of Japanese products due to high production costs and various trade restrictions. Obsolete equipment, technological problems, the high price of imported raw materials, and inflation at home have all contributed to the high cost of production. The cost-price situation also largely explains the failure of many Japanese industries to undertake programs of modernization and rationalization upon which a lower cost schedule depends. In addition, trade barriers to Japanese exports have often been utilized for economic or political reasons—either as a defense against alleged unfair trading practices or as a means of forcing a reparations settlement. Indonesia, for example, has attempted to apply outstanding trade credits due to Japan to her reparations claims. Japanese trade with Korea has also been partly obstructed by political factors.

Recent developments in the Japanese economy

In the immediate postwar period, Japanese industrial production was less than one-third of the 1934-36 average, and economic activity was at a low ebb. By 1948, the index of industrial

[1] Or a deficit of only $235 million if special procurement receipts are excluded.

production had risen to only slightly more than 50 percent of the 1934-36 level. By 1951 the index had reached 115 because of the revival of economic activity due to the war in Korea. But there were still many problems facing the Japanese economy.[1]

Inflation has been one of the principal problems confronting the Japanese economy, distorting the pattern of industrial production and crippling Japan's ability both to export and to increase domestic production in the essential sectors. Inflation was partly arrested by the Dodge plan introduced in 1949, at the expense of dampening economic activity. The stimulus provided by the outbreak of the Korean war in 1950, however, set off another round of inflationary increases. From the end of 1950 to the end of 1953, the money supply rose by 82 percent, from 789 billion yen to 1,439 billion yen. To combat this rapid increase, the Japanese Government initiated a disinflationary program in October 1953. The Bank of Japan's special penalty rates were raised and certain preferential rates were abandoned. Commercial banks also raised their rates on loans. The Bank tried to increase the spread between the rediscount rate and market rates of interest in order to make central bank policy more effective. Since the disinflationary policy has gone into effect, commercial bank credit has continued to expand, although at a somewhat slower rate.

A retrenchment program was also introduced at the Treasury in the latter half of 1953 in order to minimize the expansionary tendencies arising from fiscal operations. The restrictive fiscal policy was of little practical effect, however, because of the carry-over of Treasury expenditures into fiscal 1954 from 1953 and some decline in revenue due to a lower level of economic activity. The supply of funds was further augmented by strong export demand conditions (all foreign exchange transactions pass through the Treasury) and unusually large Government payments for the rice, wheat, and barley crops.[2] The effects of the export boom and a bumper rice crop have continued to be felt in fiscal 1955 (which ends March 31, 1956) and will increase Treasury payments to the public.

[1] For a more detailed account of the immediate postwar period, see the supplement to the *Monthly Review*, "Problems of Trade Recovery in Japan," October 1950.

[2] Japan maintains a purchase program at a fixed price for the domestic rice crop, with bonus payments for early or over-quota deliveries by producers. A similar program for wheat and barley is no longer in effect, but the Government stands ready to buy the domestic output.

In recent months, the general credit situation has improved as commercial bank indebtedness to the Bank of Japan has been reduced and surplus funds have been absorbed. But the repayment of advances has not been of sufficient magnitude to offset the effects of the cash deficit of the Treasury.

The effects of inflation on Japan's export position

The existence of inflationary pressures during the greater part of the postwar period reacted unfavorably on Japan's balance of trade by discouraging exports and encouraging imports. The small and medium-sized firms were particularly hard hit by this development because many of them depend heavily on export markets. Furthermore, the costs of modernization programs for such firms were too high, so that many of them had to operate at less than optimum efficiency. Consequently the competitive export position of these companies—and of Japan—was weakened. Although the current export boom and stabilization of Japan's internal economy have improved the situation for these smaller firms, they still present a problem for Japan in the longer run.

The high cost of imported raw materials, especially since 1950, has also made Japanese postwar exports less competitive than in the prewar period and has been detrimental to Japan's foreign exchange position. This is true in the case of Japanese iron and steel products, where the recent world-wide shortage of scrap iron forced prices up, and in the shipbuilding industry which relies on Japanese steel to fill foreign and domestic ship orders. The decline of iron and steel and cotton textile prices in 1954 which accompanied the deflationary credit policies strengthened Japan's exports in these two categories, however.

Prospects for Japan's Foreign Trade

The future of Japan's trade depends on internal and external factors. The maintenance of a high level of economic activity is her paramount concern. At the present time, the money supply has contracted from the 1954 high and industrial production is rising. Manufacturing production has made somewhat greater progress than mining. Employment, however, has declined, mostly in industries holding special procurement contracts. A lower level of demand for capital goods, a reduction in mining employment because of a rationalization law, and additions to the labor force have increased unemployment. The domestic demand for both funds and goods has stayed relatively stationary, but costs remain high. Nevertheless, economic conditions are generally good.

On the international scene, unrestricted GATT membership and limited sterling convertibility (for non-residents) would help Japanese exports. Promotion of exports through Government loans and other aid and through private organizations would also benefit foreign trade. But problems still remain to be solved in Japan's trade with certain areas and in certain commodities.

Trade with the United States

Trade with the United States accounts for slightly more than one-fourth of Japan's total trade by value. About one-third of Japanese imports are from the United States, while somewhat more than one-fifth of her exports are shipped to this country. Japan's postwar trade deficit with the United States has not been offset by earnings from merchandise trade with the rest of the world as was the case in the prewar period. Japan's postwar merchandise deficit with the United States, moreover, has been much larger than prewar, both absolutely and relatively, with the exception of 1955. For the first ten months of 1955, the trade deficit was less than half the total of a year earlier.

Trade between Japan and the United States is important to both countries. About two-thirds of Japanese imports consist of agricultural commodities, of which the United States supplies about one-third. Japan is also one of the two most important markets for United States agricultural exports, with cotton and rice the principal commodities.[1] Because of the anticipated decline in special procurement contracts, Japan may be compelled either to seek nondollar sources for goods now purchased from the dollar area (mainly from the United States) or to increase her dollar exports. The latter alternative presents some difficulties, for while United States exports to Japan are more or less essential in character, many imports from Japan may be sensitive to any recessionary tendencies that may occur in the United States.

Trade with Asia

Expansion of trade with other countries of Asia will help to improve Japan's over-all balance of payments. Japan has the advantages of geographical proximity, and an economy which can produce goods more adapted to Asian markets—goods simpler in construction and requiring less capital. The recently-won independence of several Asian nations also favors a larger volume of trade with Japan, although some of these countries continue to maintain traditional ties with their former mother countries.

Japan has sought to promote trade with Asia through a series of economic cooperation agreements providing for the mutual exchange of goods and technical services. These agreements will help to build up markets for Japanese products and develop nearby sources of raw materials. On the debit side, however, can be counted Japan's failure to conclude reparations agreements with certain Asian countries. Japan prefers technical aid or service-type reparations which would make less demand on Japan's physical resources, while the claimants prefer payment in goods.

Since many of the Asiatic countries can be classified as "underdeveloped," however, there is an element of uncertainty in trade with them. Like many countries in similar circumstances, they may be subject to wide, and sometimes violent, fluctuations in their balance of payments which would affect Japan's trade adversely. Some Japanese products will also encounter greater competition from similar industries established in these countries, e.g., the textile industry. The

[1] For the 1954-55 crop year, the United Kingdom resumed its prewar importance as the United States' largest market for farm products, but for the previous three years, Japan was in first place.

difficulties which these conditions pose for Japan might be avoided to some extent were the Japanese to concentrate on those industries using more capital per unit of labor, such as the heavy machinery and machine tool industries, which could supply a substantial overseas demand.

Trade with the sterling area

In 1954 Japan shipped 30 percent of her exports to the sterling area and obtained 19 percent of her imports from that area. This substantial volume of trade was carried on principally with the overseas sterling area. Since 1951, Japan's trade with the sterling area has been highly erratic. An import balance on current account in 1952 and 1953 was succeeded by a surplus of $156 million in 1954. In early 1955 Japan was still accumulating sterling. Because of failure to agree upon mutual liberalization of trade, the Anglo-Japanese payments agreement, under which sterling area trade had been conducted, expired on June 30, 1955. Discussions were continued, however, and the pact was finally renewed in October 1955. A higher, balanced level of trade around $630-$700 million each way was set for the ensuing year.

Trade between Japan and the sterling area countries, especially those of the Far East, is advantageous to both participants. Each is a good market for the other's goods, although there will be increasing competition in the textile trade. Japanese goods may also compete with the sterling area in third markets such as Latin America and the other countries of southeast Asia.

Trade with Communist China

A further and more rapid expansion of trade between Japan and Communist China has sometimes been proposed as a partial solution to Japan's trading problems, but the private trade agreements so far concluded have been unsatisfactory. In many cases the commodities available are not those desired by the other trading partner. The restrictions imposed on Japan by virtue of her participation in the CHINCOM[1] agreements regarding the shipping of strategic goods to proscribed areas also limit the types of goods Japan can ship. In addition, trade with Formosa is important to Japan, and she risks loss of this trade if trade with mainland China increases substantially.

Trade by commodity

Commodity-wise, Japan's future trade picture is varied. At the present time, Japan's fastest-growing export commodities are machinery, iron and steel products, spun rayon, chemical fertilizers, and sundry goods. Although cotton textiles are still Japan's leading export, recent developments at home and abroad will probably prevent expansion along this line. A high level of domestic output depressed cotton textile prices, resulting in a Government advice to curtail production in order to prop up the market. Marketing of Japan's textiles overseas, moreover, has been meeting increasing opposition from other cotton textile manufacturers. In an attempt to allay their fears that Japanese goods will flood their markets, the Japanese Government has ordered production cuts and export quotas for the current year and is considering some sort of link system between raw cotton imports and textile exports. But whether these steps will be adequate remains to be seen.

The governing factor for Japanese imports in the longer run will be the requirements of Japan's economic development program. Exports will have to be expanded to the necessary level to pay for industrial raw material imports. Foreign exchange budget allocations, the availability of import financing, and the level of import demand will affect imports in the shorter run. Food imports will probably remain steady and fairly large in volume in the immediate future because of continued population growth and limited land resources. The United States agricultural surplus disposal program may also contribute to the expansion of farm exports to Japan. Japan is trying, however, to reduce the drain on her foreign exchange reserves from this source.

[1] CHINCOM (China Committee) is a subcommittee of a larger, informal international body known as the Consultative Group. This group, composed of the major free world trading nations, coordinates the strategic trade controls of these countries over the movement of goods to the Soviet bloc, including China.

BUSINESS INDEXES—TWELFTH DISTRICT[1]
(1947-49 average=100)

Year and month	Industrial production (physical volume)[2]							Total nonagricultural employment	Total mf'g employment	Carloadings (number)[2]	Dep't store sales (value)[2]	Retail food prices [3, 4]	Waterborne foreign trade[3, 5]	
	Lumber	Petroleum[3] Crude	Petroleum[3] Refined	Cement	Lead[3]	Copper[3]	Electric power						Exports	Imports
1929	95	87	78	54	165	105	29	....	....	102	30	64	190	124
1933	40	52	50	27	72	17	26	....	....	52	18	42	110	72
1939	71	67	63	56	93	80	40	....	55	77	31	47	163	95
1946	80	94	91	81	70	71	78	95	97	101	91	80	89	57
1947	97	100	98	96	94	106	90	99	100	106	99	96	129	81
1948	104	101	100	104	105	101	101	102	102	100	104	103	86	98
1949	100	99	103	100	101	93	108	99	97	94	98	100	85	121
1950	113	98	103	112	109	115	119	103	105	97	105	100	91	137
1951	113	106	112	128	89	115	136	112r	120r	100	109	113	186	157
1952	116	107	116	124	86	112	144	118	130r	101	114	115	171	200
1953	118	109	123	130	74	111	161	121r	137r	100	115	113	140	308
1954	112	106	119	132	70	101	173	120	134r	96	113	113	131	260
1954														
November	121	104	119	132	73	116	177	122r	136r	98	115	111	118	196
December	133	105	119	132	69	114	173	122	137r	106	118	111	113	313
1955														
January	137r	105	116	119	74	118	173	123r	137r	106	125	112	163	287
February	136	105	122	131	76	130	179	123r	138r	99	118	112	184	263
March	123	106	120	137	82	130	188	124r	139r	103	118	112	163	240
April	121	106	118	149	77	127	191	124	140r	105	120	113	149	290
May	120r	106	115	155	78	131	189	125r	140r	110	118	113	162	280
June	122	106	120	153	76	129	200	125	142r	111	118	112	152	299
July	119	106	128	157	72	40	191	125	141r	99	123	113	171	368
August	123	106	127	160	67	91	196	126	142r	106	122	111	189	349
September	118	106	132	159	69	128	196	126	141r	107	126	112	174	363
October	116r	105	129	155	71	131	197	126	142r	104	126	112	152	....
November	110	106	123	128	....	128	206	128	144	98	125p	112	....	....

BANKING AND CREDIT STATISTICS—TWELFTH DISTRICT
(amounts in millions of dollars)

Year and month	Condition items of all member banks[6]				Bank rates on short-term business loans[8]	Member bank reserves and related items — Factors affecting reserves:					Bank debits Index 31 cities[3, 12] (1947-49=100)[2]
	Loans and discounts	U.S. Gov't securities	Demand deposits adjusted[7]	Total time deposits		Reserve bank credit[9]	Commercial[10]	Treasury[10]	Money in circulation[9]	Reserves[11]	
1929	2,239	495	1,234	1,790	......	− 34	0	+ 23	− 6	175	42
1933	1,486	720	951	1,609	......	− 2	− 110	+ 150	− 18	185	18
1939	1,967	1,450	1,983	2,267	......	+ 2	− 192	+ 245	+ 31	584	30
1946	4,068	8,426	8,821	5,797	......	+ 9	−1,607	+1,329	− 326	2,094	86
1947	5,358	7,247	8,922	6,006	......	− 302	− 510	+ 698	− 206	2,202	95
1948	6,032	6,366	8,655	6,087	......	+ 17	+ 472	− 482	− 209	2,420	103
1949	5,925	7,016	8,536	6,255	3.20	+ 13	− 930	+ 378	− 65	1,924	102
1950	7,093	6,415	9,254	6,302	3.35	+ 39	−1,141	+1,198	− 14	2,026	115
1951	7,866	6,463	9,937	6,777	3.66	− 21	−1,582	+1,983	+ 189	2,269	132
1952	8,839	6,619	10,520	7,502	3.95	+ 7	−1,912	+2,265	+ 132	2,514	140
1953	9,220	6,639	10,515	7,997	4.14	− 14	−3,073	+3,158	+ 39	2,551	150
1954	9,418	7,942	11,196	8,699	4.09r	+ 2	−2,448	+2,328	− 30	2,505	153
1954											
December	9,422	7,973	11,158	8,663	4.01	0	− 127	+ 175	− 23	2,505	174r
1955											
January	9,510	7,998	11,246	8,725	......	− 34	− 150	+ 77	− 79	2,481	161
February	9,612	7,693	10,945	8,765	......	+ 15	+ 26	− 57	+ 13	2,447	166
March	9,696	7,390	10,733	8,837	3.98	+ 10	− 401	+ 362	− 1	2,418	177
April	9,657	7,756	11,060	8,833	......	+ 60	− 306	+ 261	+ 15	2,432	165
May	9,810	7,690	10,951	8,885	......	− 55	− 51	+ 195	+ 50	2,476	170
June	10,102	7,446	11,023	9,026	3.99	+ 27	− 449	+ 429	+ 35	2,439	178
July	10,191	7,557	11,212	8,995	......	+ 10	− 193	+ 217	− 9	2,495	166
August	10,392	7,407	11,163	9,021	......	− 23	− 253	+ 200	+ 8	2,415	177
September	10,559	7,375	11,312	9,054	4.17	+ 17	− 148	+ 276	+ 18	2,541	173
October	10,665	7,487	11,465	9,067	......	− 43	− 245	+ 174	+ 15	2,417	171
November	10,931	7,238	11,665	9,005	......	+ 46	− 81	+ 205	+ 18	2,575	181
December	11,115	7,298	11,876	9,084	4.25	+ 8	− 434	+ 417	+ 17	2,530	183

[1] Adjusted for seasonal variation, except where indicated. Except for department store statistics, all indexes are based upon data from outside sources, as follows: lumber, National Lumber Manufacturers Association and U.S. Bureau of the Census; petroleum, cement, copper, and lead, U.S. Bureau of Mines; electric power, Federal Power Commission; nonagricultural and manufacturing employment, U.S. Bureau of Labor Statistics and cooperating state agencies; retail food prices, U.S. Bureau of Labor Statistics; carloadings, various railroads and railroad associations; and foreign trade, U.S. Bureau of the Census. [2] Daily average. [3] Not adjusted for seasonal variation. [4] Los Angeles, San Francisco, and Seattle indexes combined. [5] Commercial cargo only, in physical volume, for Los Angeles, San Francisco, San Diego, Oregon, and Washington customs districts; starting with July 1950, "special category" exports are excluded because of security reasons. [6] Annual figures are as of end of year, monthly figures as of last Wednesday in month. [7] Demand deposits, excluding interbank and U.S. Gov't deposits, less cash items in process of collection. Monthly data partly estimated. [8] Average rates on loans made in five major cities. [9] Changes from end of previous month or year. [10] Minus sign indicates flow of funds out of the District in the case of commercial operations, and excess of receipts over disbursements in the case of Treasury operations. [11] End of year and end of month figures. [12] Debits to total deposits except interbank prior to 1942. Debits to demand deposits except U.S. Government and interbank deposits from 1942. p—Preliminary. r—Revised.