



Economic Commentary

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A Characteristic of the Current Adjustments in Economic Activity Indicated in the June *Tankan*

— adjustments concentrating in the IT-related sector —

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A Characteristic of the current economic adjustment phase

The Japanese economy has been following a recovery path after it hit the bottom in April 1999. Since the fall of 2000, however, the economy has entered an adjustment phase triggered by the abrupt demand contraction in the IT-related sector worldwide, which is a growing industry.

One of the characteristics of the current adjustment phase is that adjustments in economic activity are broadly concentrated in the IT-sector until present. In the following, we will examine this by using the business conditions of the June *Tankan*.

Developments in the deterioration of business conditions by industry in the June *Tankan*

Chart 1[1] plots the change in business conditions of the *Tankan*ⁱ⁾ by industry. The horizontal axis indicates the improvement in business conditions from December 1998, when it bottomed out, to December 2000 which is the recent peak. The vertical axis shows the deterioration from December 2000 to the recent June *Tankan*. The black and white circles in Chart 1 indicate manufacturing and nonmanufacturing respectively.

This simple chart provides some interesting facts.

First, the deterioration in business conditions in the current adjustment phase (the change shifted largely downwards on the vertical axis) is profound in industries where improvements were significant (the change shifted considerably rightwards on the horizontal axis) during the economic recovery phase until the end of 2000.

In detail, business conditions improved significantly in electrical machinery during 1999-2000 against the background of a surge in IT-related demand worldwide, but the deterioration in the industry has recently become distinct. The deterioration in business conditions after the improvement during the recovery phase is significant in other industries closely connected to IT-related demand in a broad sense such as in ceramics (fine ceramics), nonferrous metal (copper-base alloys and optical fiber), industrial machinery (semiconductor fabrication machines and equipment), and pulp and paper (corrugated board paper and manuals for personal computers).ⁱⁱ⁾

Second, the deterioration in business conditions in nonmanufacturing to date remains contained, since the improvement in business conditions in the sector continued to be moderate compared to manufacturing towards the end of 2000.

Typically, the improvement in retailing and

services remained modest during the economic recovery phase. On the other hand, at the time of the June *Tankan* after the Japanese economy had already entered the economic adjustment phase, the deterioration in business conditions was hardly observed and it is evident that situations differ greatly from those in the IT-related industries mentioned above.

Comparison with the economic recession phase since the second half of 1997

Let us confirm what it was like during the previous economic recession period in terms of the diversion by industry compared to the current economic adjustment phase.

Chart 1(2) shows the development patterns in the *Tankan* when the economy deteriorated drastically in fall 1997 as in Chart 1(1).

This chart indicates that during the previous economic adjustment phase, business conditions deteriorated by about the same amount in all industries, regardless of the improvement in the economic recovery phase. It can be confirmed that the patterns observed in the June *Tankan* are not necessarily the case in every economic adjustment phase.

Developments in exports and production

Let us next examine the characteristic of economic adjustment that concentrates in the IT-related sector by using other economic indicators.

Chart 2(1) indicates that most of the substantial decrease in real exports since the start of 2001 owes to the decline in exports of IT-related machinery and parts (semiconductor fabrication machines and equipment included).

Moreover, with regard to developments in industrial production in Chart 2(2), the drop in

electrical machinery (electronic parts) and industrial machinery (semiconductor fabrication machines and equipment) is notable.

Future implications

As of above, economic adjustment is basically concentrated in the IT-related sector at the current stage. However, in the case where time progresses without a cease in the deterioration of business conditions in the IT-related sector, it is very likely that the negative effects may spill over to other sectors and this in turn may lead to developments shown in Chart 1(2).

In this sense, we need to carefully monitor when and how inventory adjustments of IT-related goods worldwide, which triggered the current economic adjustments, will come to an end as well as whether business conditions in the other sectors will deteriorate noticeably beforehand.

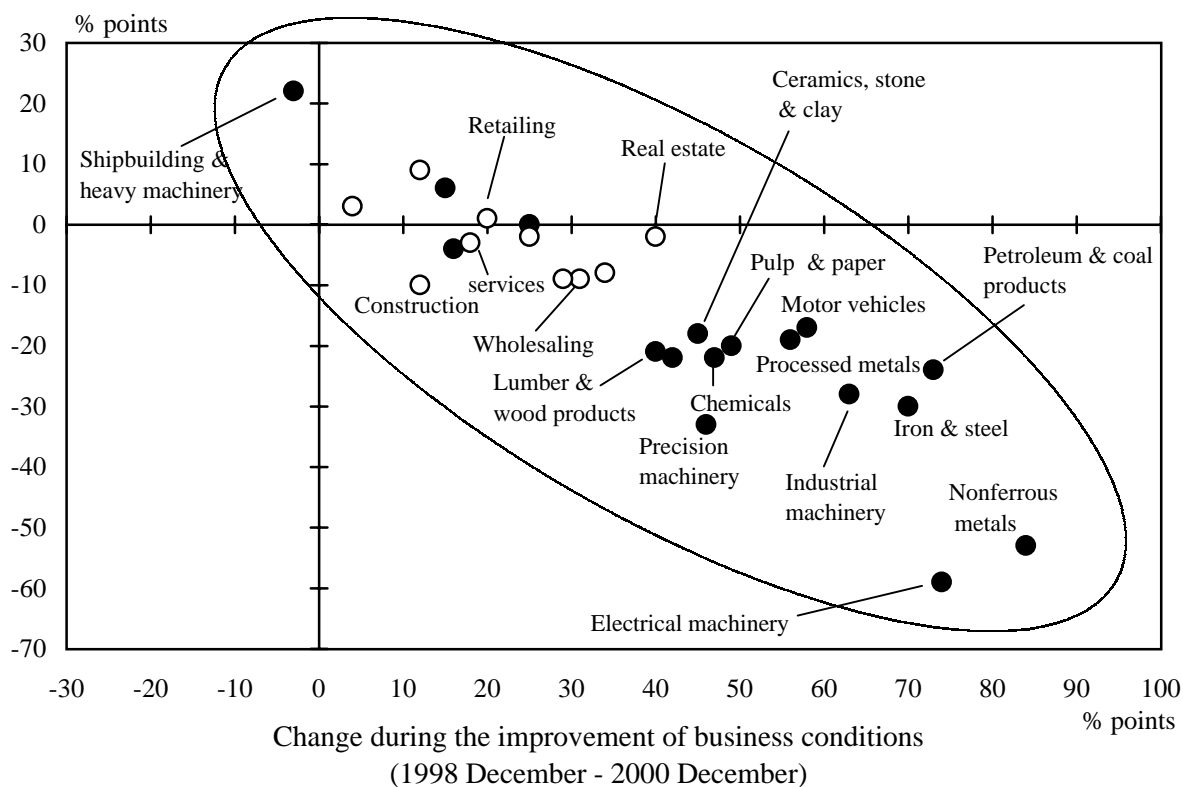
i) Business conditions in the *Tankan* are judgment of general business conditions primarily on corporate profits at the time of each survey. Firms are asked to choose one alternative among three (1. Favorable, 2. Not so favorable, 3. Unfavorable) as the best descriptor. Based on this, the diffusion index is calculated by subtracting “favorable” from “unfavorable” (responding ratios, %). Besides all firms, the *Tankan* also releases figures by scale such as large firms, medium-sized firms, and small firms. Chart 1 is based on all firms.

ii) There are some industries in which business conditions are worsening although they are not related directly to IT-related demand. For instance, the deterioration in business conditions of industries such as steel and lumber are largely due to sluggish domestic demand in construction.

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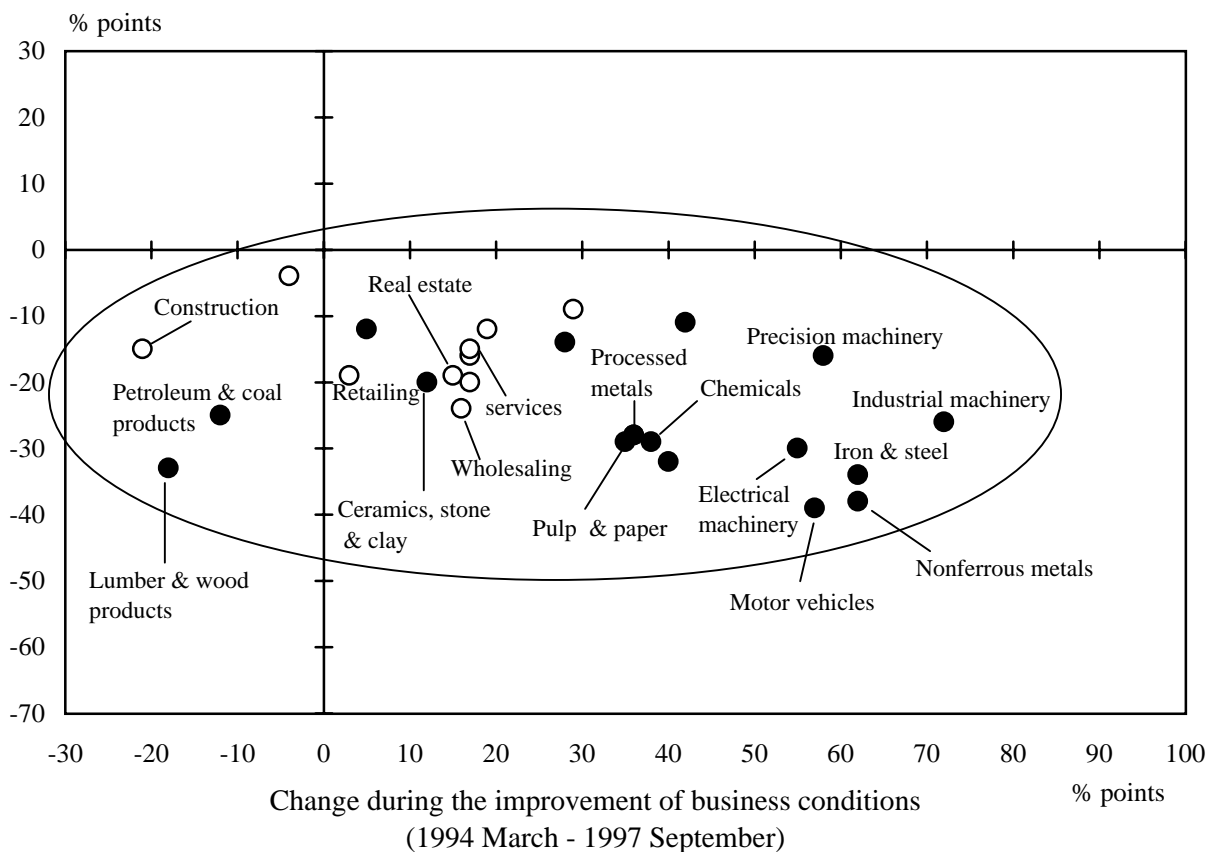
Chart 1 Characteristics of Economic Adjustment Phases Based on Business Conditions of the *Tankan*

(1) Current adjustment phase



Change during the deterioration of business conditions (2000 December - 2001 June)

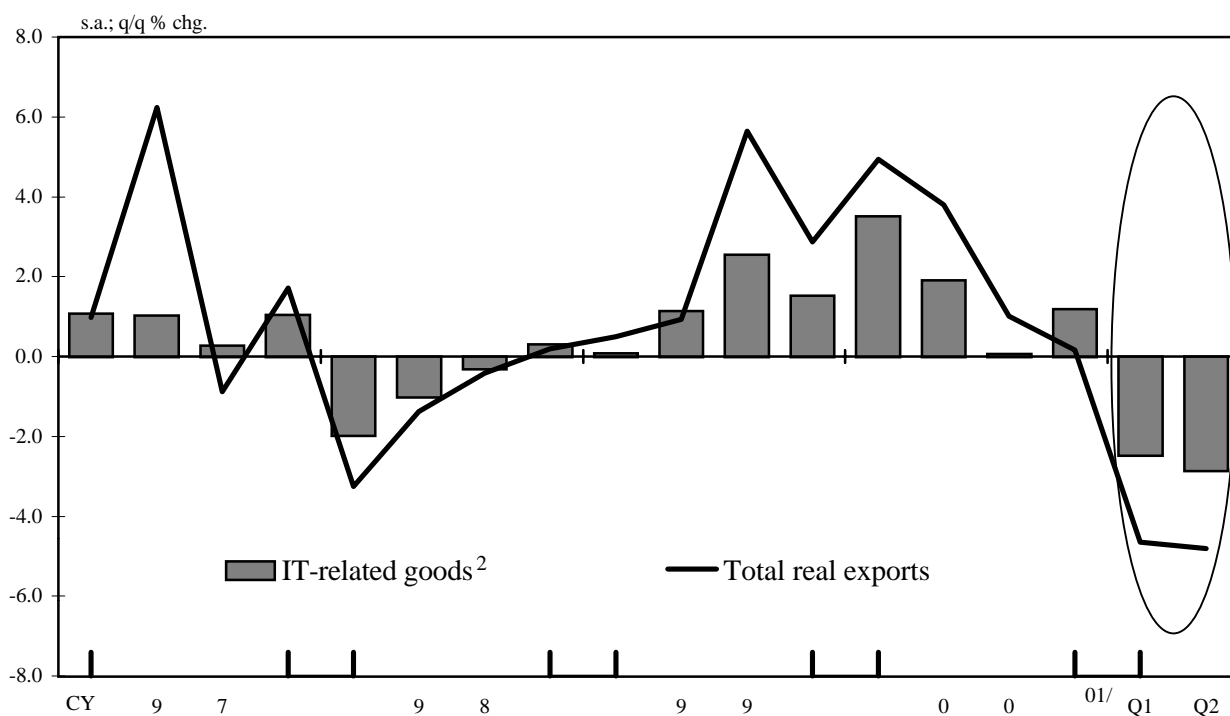
(2) The previous adjustment phase



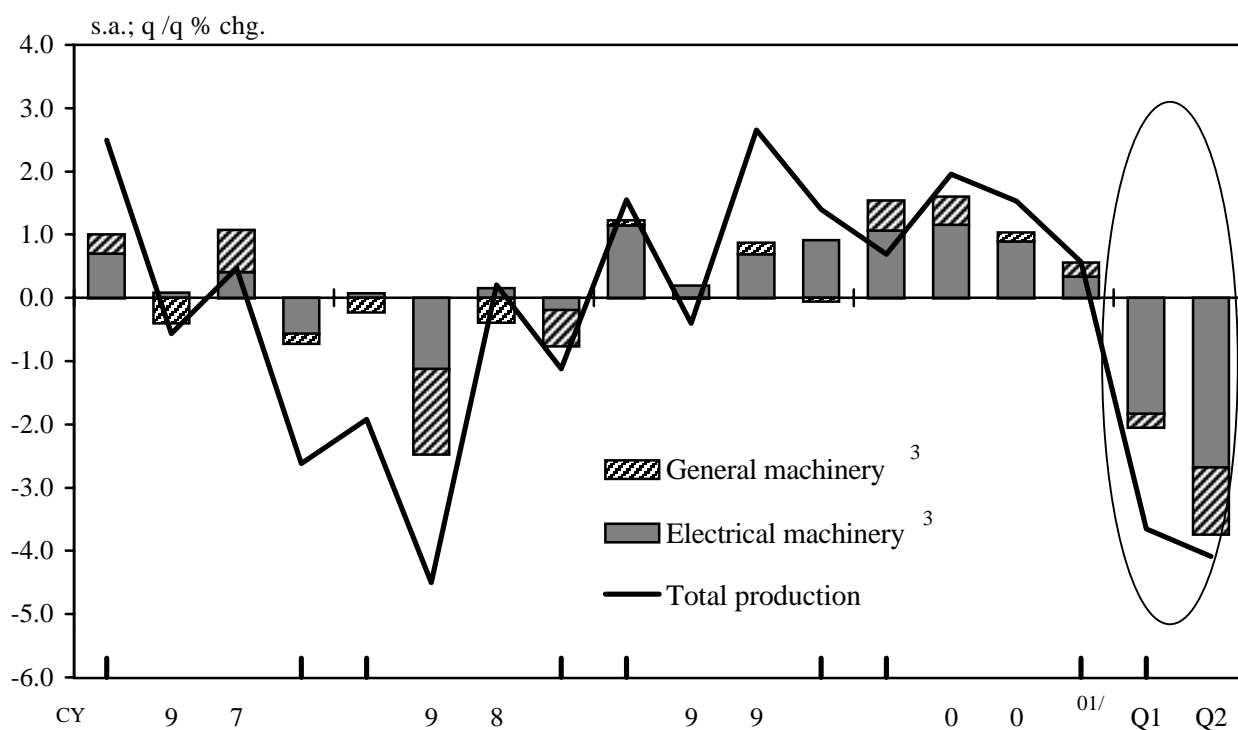
Change during the deterioration of business conditions (1997 September - 1998 March)

Chart 2 Exports and Production in the IT Sector

(1) Exports¹



(2) Industrial production



Notes: 1. Exports are in real terms (seasonally adjusted by X-11).

2. Contribution to total exports.

3. Contribution to total production.

Sources: Ministry of Finance, "The Summary Report on Trade of Japan";

Bank of Japan, "Wholesale Price Indexes";

Ministry of Economy, Trade and Industry, "Indices of Industrial Production."