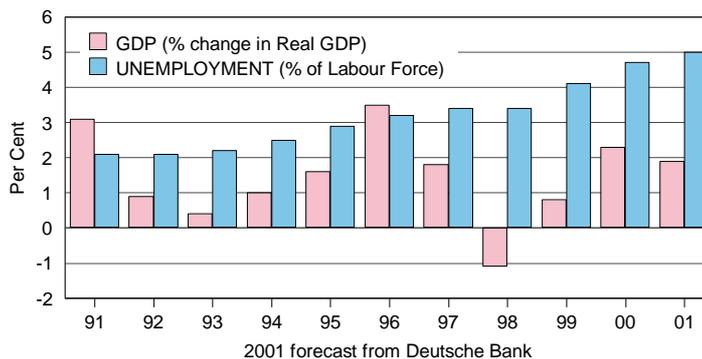


Japan switches back to zero interest rate policy

SLOW GROWTH AND RISING UNEMPLOYMENT IN JAPAN



"The most important thing is the announcement that this zero-interest rate policy will continue until inflation is higher than zero," he said. "It's a real zero interest-rate policy and inflation target."

"Having made this latest move, the BoJ now has nothing else to offer in terms of monetary policy"

Naoki Murkami
BNP Paribas Economist

In a bid to stimulate the faltering Japanese economy, the independent Bank of Japan (BoJ) voted on 19 March to reintroduce the zero-interest rate policy. In a special move, the Bank decided that this monetary policy strategy would have an explicit time dimension. Zero interest rates will remain in place until the Japanese consumer price inflation figures move back and then stabilise in positive territory.

The Bank of Japan remains fearful that price deflation will send real interest rates higher and worsen the real debts faced by many leading Japanese companies and banks. Consumer prices fell by 0.3% in 1999 and a further 0.6% in 2000. Deutsche Bank forecast that the Japanese price level will be stable this year. But the strength of the yen on the foreign exchange markets will put further downward pressure on prices.

In a further bid to stimulate the Japanese money supply, The central bank will increase its direct purchases of long-term government bonds from 400 billion yen per month if judged necessary.

SUMMARY INFORMATION ON THE JAPANESE ECONOMY

		1998	1999	2000	2001
Real GDP	% change	-1.1	0.8	2.3	1.9
Unemployment Rate	% of Labour Force	3.4	4.1	4.7	5.0
Consumer Prices	% annual change	0.6	-0.3	-0.6	-0.0
Balance of Trade in Goods	\$ billion	123	123	122	100
Current Account of BoP	\$ billion	121	107	123	100

Collapsing Share Prices

THE COLLAPSE IN THE NASDAQ COMPOSITE INDEX OVER 12 MONTHS



A horrendous week for the FTSE 100 share index saw nearly £37 billion wiped off the value of blue-chip companies with the FTSE declining by 6% in just five days.

Brittle investor confidence in the UK has been undermined by the collapse in share prices across the Atlantic. US stock indices have been hit hard by a wave of profits warnings from leading IT firms - among them Compaq, the world's largest personal computer manufacturer and Oracle the world's second biggest software producer.

The FTSE index is now at its lowest level since December, 1998. The software and computer services index slid 7.4 per cent, while the IT hardware index fell 6 per cent. The indexes are down 70 per cent from last year's highs.

Economic Effects of the Collapse in Share Values

- ? What impact will the sharp falls in world equity prices have on the UK economy?
- ? Will further falls in share prices be sufficient to trigger a sharp slowdown in industrialised economies?

The Wealth Effects

Consumption

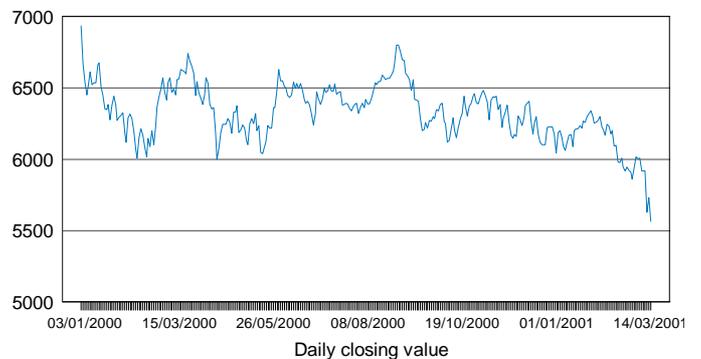
A fall in share prices leads to a fall in consumers' financial wealth and this should then lead to cut-backs in household consumption.

Planned Capital Investment Spending

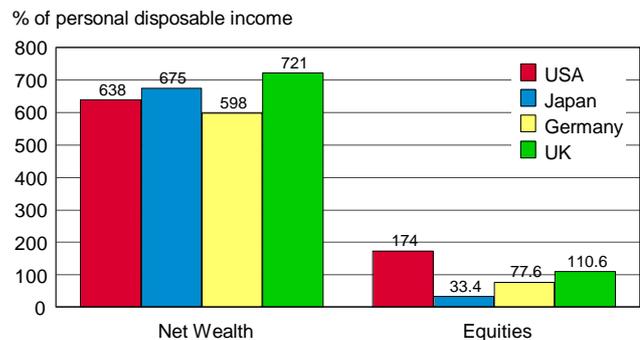
The corporate sector is also adversely affected by a fall in stock market valuations. If companies find it harder to finance expansion programmes by raising capital on the stock market there may be a negative effect on planned investment. A slowdown in demand may have a negative "accelerator" effect on capital spending.

Because household spending and capital investment are two important components of aggregate demand, a collapse in equity prices can eventually lead to a fall in the real level of national output (GDP) - but will the effect be large enough on its own to bring about an economic recession?

FTSE 100 INDEX SHOWS SHARP FALLS



HOUSEHOLD WEALTH (1999)



Source: OECD

UK HOUSEHOLD FINANCIAL ASSETS

£ Billion	1997	1999
Cash and Deposits	451	509
Direct Equity (Share) Holdings	427	502
Life Assurance & Pension Funds	1286	1500
Other Financial Assets	231	258
Net Financial Wealth	1903	2233

Source: Merrill Lynch Economics

The impact of falling share prices on the macro economy depends in large part on how business and consumer confidence is affected

Much depends on (a) the reasons behind the drop in share prices (b) the size of the "wealth effects" for individual countries and (c) the direction and scale of any policy responses from the monetary authorities.

Causes of the fall in share prices

Several factors explain the dramatic decline in world equity values. Some of them are the result of a short term loss of investor confidence - but others are symptomatic of longer term concerns about the health of the global economy.

(1) **The US economic slowdown** - fears of recession in the United States and a surge in profit warnings from Old and New economy companies have led to a major "sell-off" in the US stock market.

The biggest falls have come for companies listed on the Nasdaq stock market - which has lost more than 60% of its valued since the end of the technology stock boom in March 2000. It is now clear that these hi-tech stocks were heavily over-valued at the end of the "bubble". The valuations placed on new economy companies far exceeded expectations for future revenues and profits.

(2) The Japanese economic slump

The Japanese economy is in serious trouble. Real national output recovered by 2.3% last year as the economy battled to rebound from the 1998-99 recession. But there are fresh fears of another economic slowdown as Japanese consumers cut back on spending and the frailties of the Japanese banking system become more transparent every day. Last week the Nikkei stock index finished at 12,124 - its lowest level since April 1985.

Some market watchers believe that the recent collapse in share prices is merely a long overdue market correction - allowing the markets to take a more realistic view of the value of hi-tech stocks and helping to prick a dangerous speculative bubble. The US economy needs to slow down after over nine years of rapid economic growth in order for inflationary pressure to be controlled and to reduce the enormous US trade deficit with other countries.

But other economists believe that the rapid growth of productivity and capital investment which has sustained the US economic boom may now be coming to an end - ushering in a period of slower growth and leading to a fall in profits growth for America's major corporations.

How will a fall in share prices affect the UK?

The chart on page 2 shows household wealth for four countries expressed as a percentage of personal disposable income. Total wealth includes assets such as housing together with individual holdings of shares and

Confidence holds the key

ECONOMIC IMPACT OF A 20% FALL IN SHARE PRICES

GDP (% change from base)	USA	EUROZONE	UK
Year 1	-0.2	-0.1	-0.3
Year 2	-0.6	-0.2	-0.7

20% FALL IN EQUITIES + CONFIDENCE COLLAPSE

GDP (% change from base)	USA	EUROZONE	UK
Year 1	-0.7	-0.5	-0.7
Year 2	-1.7	-0.8	-1.6

money invested in pension funds etc. What is clear is that in the United States, equities (shares) account for over 27% of net household wealth. For the UK the figure is 15.3% compared to just 4.9% for Japan. A large and sustained decline in share prices would therefore have a bigger effect on the USA and UK economies than in the Euro Zone and Japan.

Economists at Oxford Economic Forecasting have modelled the effect of a 20% fall in equity prices. Assuming that interest rates remain unchanged, they forecast that the impact would be to reduced GDP in the UK by up to 0.7% within two years and to cut US economic growth by 0.6% over the same time period.

The deflationary effect on output and employment will be greater if falling share prices have a negative spillover effect on consumer and business confidence. Thus far confidence in the UK has remained resilient in the face of a decline in share values - the opposite of what has happened in the States.

Monetary Policy to the rescue?

It is likely that monetary policy both in the USA and the UK will be relaxed further if share prices continue to head south. The US Federal Reserve has already reduced its key interest rates by 1% (or 100 basis points) in recent months and further rate cuts are expected. Expect to see at least a 0.5% decline in US rates this month. The Bank of England cut base rates in February 2001 and most city economists predict at least one more rate cut this spring. Lower interest rates reduce the cost of borrowing and should provide a monetary stimulus at a time when confidence is fragile.

The OEF estimate that a 0.3% cut in base rates in the UK would be enough to limit the growth impact of falling share prices to a decline of just 0.2% over two years.

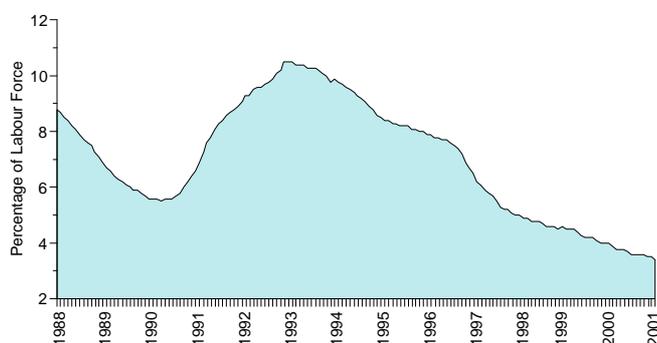
The financial markets are experiencing turbulent times at the moment. Whether we are in the middle of a temporary loss of confidence or at the start of a long bear market remains to be seen. But real jobs and living standards are directly affected by the daily gyrations of the global stock markets - and the impact is not confined to the wealthy investors and financial market players.

Unemployment falls below 1 million

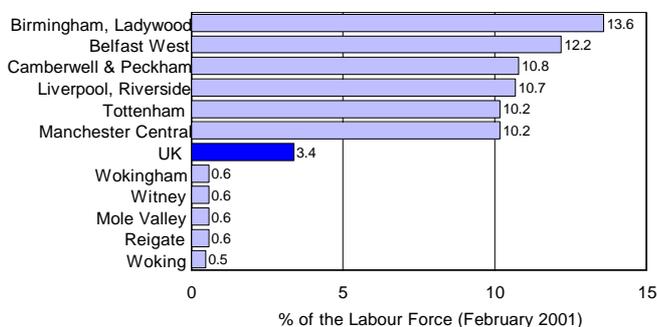
UK UNEMPLOYMENT SUMMARY—FEBRUARY 2001

		Level	Rate %
ILO Unemployment	000s	1,535	5.2
Claimant Count	000s	996.2	3.4
Workforce in a Job	000s	28,086	74.8
Growth of Average Earnings	%	4.4	

CLAIMANT COUNT UNEMPLOYMENT FALLS TO 3.4%



HIGHS AND LOWS FOR UK UNEMPLOYMENT



The claimant count measure of unemployment fell below one million for the first time since December 1975 following a 10,600 fall in the number of people claiming benefit during February. The unemployment rate dipped lower to 3.4% of the labour force prompting Tony Blair and half of his senior Cabinet colleagues to claim that full-employment was now a realistic ambition for the whole of the UK economy.

Much has been written in the past about the reliability of unemployment statistics. Safe to say that the true level of unemployment is much higher than the official statistics would have us believe. Many thousands of workers are looking for work but do not meet the criteria for claiming the Job Seekers' Allowance. More still are economically inactive—but might be encouraged back into active job search with the right incentive structure in place.

Using claimant count data, male unemployment has fallen to 5.1% of the labour force compared with 5.9% a year ago. Female unemployment has dropped less quickly (from 2.2% in February 2000 to 1.9% now).

There is much to be pleased with in the latest batch of employment statistics. Total employment expanded to 28,086,000—an increase of 102,000 in the last three months. Average earnings growth (a key measure of wage inflation) remained steady at 4.4% in January—giving the Bank of England plenty of scope for a further interest rate cut in April.

In large parts of southern England, full-employment arrived a long time ago. But in Britain's inner cities the cycle of economic deprivation and unemployment is a long way from being solved.

WEB SITES ON JAPANESE ECONOMY

Japanese Ministry of Finance
www.mof.go.jp/english/

Bank of Japan
www.boj.or.jp/en/

Financial Times Survey of Japan
<http://specials.ft.com/ln/fts-surveys/country/japanh.htm>

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 Tutor2u Economics is a resource for students and teachers. There are hundreds of pages of revision notes, links and a Discussion Forum. Visit the site and improve your grades

NEXT WEEK'S BRIEFING

British Telecom's Debt Mountain

Inflation Data for February

Revision Special on Investment Spending

Weekly Briefing

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