

## Japan Faces Prolonged Sluggish Economy

September 4, 2008

Sluggishness in Japan's economy could last longer than many expect as a global slowdown lingers, former Bank of Japan Deputy Governor Kazumasa Iwata said.

"There is a risk that sluggishness (in the Japanese economy) could be prolonged," Iwata told Reuters in an interview on Thursday, pointing to a trend for slower growth in exports, an engine for the world's second-largest economy.

Japan is thought to be on the brink of a recession or already in one, after enjoying its longest period of postwar expansion, a boom that started in early 2002.

Iwata, now the head of the Cabinet Office's Economic and Social Research Institute, said problems in the U.S. housing market, which had triggered a global economic slowdown, could continue until late 2009. "Drawing from Japan's experience with the bubble economy (in late 1980s), it took a long time for its aftermath to be fully played out."

He did not specify when the Japanese economy is likely to shrug off the gloom. The median market forecast in a Reuters poll last month was for Japan's economy to show quarterly growth of 0.2 percent in the last two quarters of this year and gradually regain momentum next year.

Iwata, seen as a policy dove when serving on the central bank's policy board, also said there is a chance industrial economies could face a deflation-like situation as a slowdown in the global economy is accompanied by falls in oil and food prices.

"While the bursting of the bubble in the U.S. housing market had a negative impact on financial markets and domestic demand, and in turn slowed real-term global growth, oil and food prices in the futures market may be experiencing a bursting of the bubble now," he said.

"If those developments continue, they could create a deflation-like situation (in industrial economies)." He also said inflation pressure in Japan is not strong, considering weakness in demand in comparison with supply capacity.

He said a rise of 0.2 percent in consumer prices excluding energy and food products in July from a year earlier was in stark contrast to a decade-high rise of 2.4 percent if only volatile fresh food prices are excluded.

A report by a Cabinet Office economist said last month that Japan's output gap, a measure of the economy's supply and demand balance, fell into negative territory for the first time in nearly two years in April-June, signalling tame inflationary pressure.

Iwata said that if Japan's output gap falls deeper into negative territory, consumer prices excluding energy and food products could slip to near flat.

The output gap for the second quarter was minus 0.2 percent, meaning supply exceeds demand in the economy. It last logged a minus reading in July-September 2006, when it was minus 0.3 percent. The negative output gap is largely due to a contraction in second-quarter growth. A preliminary reading showed that the economy shrank 0.6 percent from the previous quarter. Revised GDP data is due out on Sept. 12.

The Bank of Japan monitors the output gap because it is a major variable for determining monetary policy as the central bank attempts to gauge price conditions.

Iwata, who retired from the central bank in March when his five-year term as one of the two deputy governors expired, did not make any direct remarks on monetary policy in the interview.

**Source: Reuters**