

## The Tsunami effect

March 2011

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### **Introduction**

*The tsunami in Japan comes in the midst of a potential global crisis that has erupted across the oil producing countries, thus throwing the global economy into further disarray. The tsunami, whose impact was restricted to damage to human lives and property, has now escalated to a more serious threat of a possible nuclear spillover jeopardizing the nation further as well as other neighboring countries. What is one to make of this crisis?*

### **The immediate impact**

Japan is at risk of falling into a recession due to the earthquake and tsunami, but could recover quickly, thus sparing the global economy a deep rooted crisis. The immediate impact was witnessed with several hundreds of factories shutting down across the country with there being major disruptions in power supply and transportation which is negative news for the economy. The damage to infrastructure such as roads, building and ports has not yet been ascertained but would be significant enough to cause disruptions.

### **Output growth will slow down in immediate run**

Toyota and Nissan halted production at their factories, while Toyota has evacuated workers from its production sites and Honda has closed some of its plants. The export business is evidently going to be impacted by this closure. Other major companies affected have been Kirin Holdings, Fuji Heavy Industries, GlaxoSmithKline, Nestlé, Sony, etc.

Power supply has been affected at home and factories as the generating companies are struggling to meet demand. Some experts have estimated that prolonged power cuts will slice growth by up to 0.30%. A major source of power, nuclear energy, which accounts for a third of the country's electricity, has been affected with several reactors going offline indefinitely. An estimated 2 million homes are without power and about 1.4 million do not have running water. It has been estimated that the immediate economic losses from this earthquake would cross \$100bn and is sure to go up as the full intensity of the damage sinks in. It may however, be pointed out that the 1995 earthquake had limited impact on GDP growth.

### **Monetary action**

The Bank of Japan is to infuse liquidity into the system and has put in about \$ 200 bn into the banking system. The idea is to provide liquidity support to the banking system which in turn can enhance its lending

activity. This will help to boost confidence and prevent the disaster derailing the country's fragile economic recovery.

### ***How about the global economy?***

A view held is that since Japan actually absorbs deficits of other countries, as it runs a current account surplus, it may not really affect global prospects perceptibly, though this argument is debatable.

While lower Japanese growth will impact global commodity and financial flows, there would be opportunity for China, USA and Europe in particular to provide the lost output in Japan in sectors such as steel, automobiles, electronics including computer chips etc. which will hence have a positive impact on their economies. But to the extent that Japan has been a supplier and there are time lags until such time that others produce these goods, there will be disruptions. In fact, there is a thought that the catastrophe could mean more jobs within the United States, as companies pick up production slack or are called upon to help rebuild that country.

*...there may be hidden gains for other countries as long as Japan growth slackens*

Commodity prices have declined to begin with based on lower demand from Japan which is the third largest economy in the world. But this is only a temporary phenomenon.

*...Prices will remain volatile*

### ***But, reconstruction is positive news***

Widespread damages to infrastructure and capital stocks will hinder growth to begin with, but it is expected that the economy will spring back into action with reconstruction activity that will in turn provide the stimulus which is required. This is good news in the middle of the ravages that have been caused by the tsunami as it will require massive investment in infrastructure and capital which will stimulate the economy. This will help to maintain overall growth in Japan during the year – a fall in first half will be compensated by an increase in the second half. Growth will be between 1.4-1.5% according to global experts. This will also help to increase the employment levels which will be positive in the medium run.

*..the timing of the reconstruction activity will matter once the full damage is assessed*

### ***But, who will pay for it?***

The government has to play a key role and hence will have to incur higher debt. Presently the debt levels of the government are over twice that of the GDP which actually offers little scope for expansion. In fact, Japan's debt is the second highest in the world after Zimbabwe and is expected to cross 250% by 2015 (estimate before the tsunami). This will severely strain the government which is fighting hard to control its deficit. Its fiscal deficit is already close to 7% of GDP and will expand further as the cost

*...debt problems will exacerbate*

could be between 2-10% of GDP . But, it has to be done which will in turn put pressure on the market. Foreign assistance will address a part of the requirement but the government will still have to take the lead.

The higher borrowing of the Japanese government could in turn drive up bond yields around the globe though the extent is not expected to be very significant.

### ***Currency impact***

Yen has been appreciating since the tragedy struck Japan. Yen rose against major currencies of the world instead of depreciating as Japanese firms have been repatriating funds from Europe and US. However, this is likely to be a temporary phenomenon as the BoJ would intervene and not allow the Yen appreciation to affect the exporters.

*...Yen to appreciate before stabilizing*

The 1995 earthquake in Japan saw large insurance claims which led to foreign inflows that in turn strengthened the currency in the initial 2 months before stabilizing. However, analysts expect rates to remain stable this time.

### ***The nuclear panic***

The nuclear fallout will change perception on such technology and this will have implications on power generation in general for the world where countries will have to reconsider their options.

*.. more serious is of course the nuclear fallout*

### ***Impact on India***

Japan's share in India's trade is 2.3% in imports and 2.0% in exports and hence there will be only marginal disruptions in our overall trade numbers in case of a longer impact of the tsunami. Prospects for exports would be better in case Japanese imports increase, which is likely especially in case of agricultural, textile etc products. There can however, be an impact in terms of FDI where the cumulative as well as annual share in FY11 so far has been around 4%. Here a slowdown may be expected on account of even global funds being routed to Japan rather than India.

*..overall impact on India may not be very significant in terms of economic indicators*

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