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The 41st Medium-Term Economic Forecast (FY2014 - FY2025)

Japan's Outlook amidst Fiscal Uncertainty

JCER Medium-Term Economic Forecast Team

<Summary>

The Japan Center for Economic Research released its 41st Medium-Term Economic Forecast for 2014FY through 2025FY.

Several years have passed since Japan's population peaked and entered a phase of decline. The direct implication of the rapidly aging and declining society is a steadily shrinking workforce, which will have serious consequences for the country's economy in the coming future. Given the situation, fiscal consolidation has become a burning issue. The process of demographic transition is in fact occurring throughout the world, and proves a difficult subject to tackle. Yet, some developed countries have been able to overcome this problem; therefore, we may learn from and emulate their efforts. Japan has made its first step toward fiscal deficit reduction, with a consumption tax increase this spring. However, the Abe Administration's decision to postpone the second tax increase, initially scheduled for October 2015, has heightened uncertainty over the nation's ability in achieving fiscal consolidation.

In our forecast, we have included the effects of the sales-tax hike delay, and taken into account the proposed corporation tax cut reform. The main baseline forecast is an extension of the current economic situation, so as to create the most probable scenario at present. We will release our final forecast in March 2015, which will include an alternative optimistic scenario projection.

Economic Growth

One percent real GDP growth will be achievable at present, but concern over fiscal sustainability remains

- ✓ During the forecast period (2014FY - 2025FY), low real interest rates, corporation tax cuts, a weak yen and global economic growth will contribute to enhanced investment and gradually lift consumption. Consequently, the economy will be able to achieve one percent annual real GDP growth, which is slightly higher than the potential growth rate.
- ✓ However, there remains concern over Japan's fiscal sustainability, with the government's outstanding debt-to-GDP ratio continuing to rise.

Prices

Domestic demand will remain weak, hence upward pressure on prices will be limited

- ✓ Japan's rapidly aging and declining population will dampen private consumption, projected to grow slowly. Domestic demand will remain weak, hence upward pressure on prices will be limited. It is expected that the Bank of Japan's two percent inflation target will not be met.
- ✓ The recent yen depreciation, dragged by falling oil prices, will not give enough lift to inflation. Furthermore, although oil prices are projected to rise in the forecast period, it will still not be enough to push up the inflation rate.

Global Economy & Trade

The current account will fall into deficit

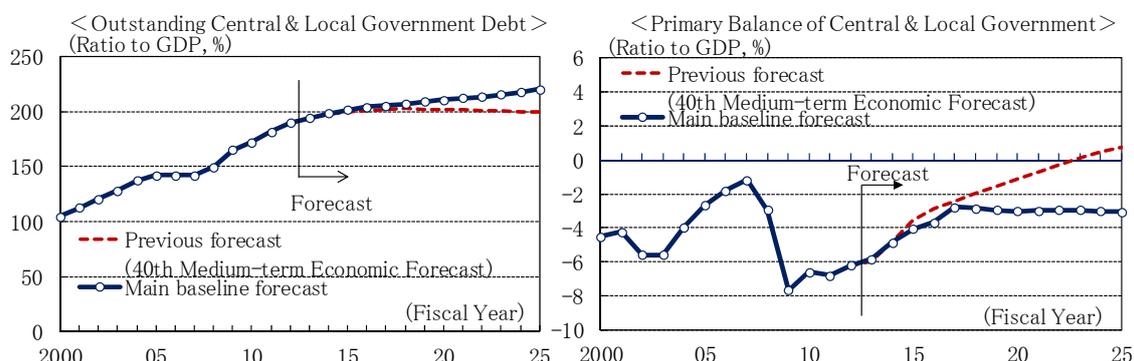
- ✓ Supported by a gradual pick-up in global economic growth, exports are expected to maintain growth. However, due to insufficient domestic supply, a current account deficit will be unavoidable over the forecast period.

Industrial Employment Structure

The medical and nursing industry will expand, employing over 10 million workers

- ✓ The expansion of the medical and nursing industry will bring about job growth, of which most will be within the medical and nursing sector. As the working age population is limited, this will incur a labor shortage in other sectors and industries, causing them to contract. This structural adjustment will occur particularly in labor-intensive sectors, such as retail trade and personal service businesses.

Figure: Achieving Fiscal Consolidation will prove to be a Challenge



(Note) Our previous forecast (40th Medium-term economic forecast) included the assumption of a consumption tax hike - raised to 10% in October 2015, and then in annual increments of 1% from FY2017 onward, reaching 19% in 2025.
(Source) Cabinet Office "System of National Accounts"

Table: Medium-Term Forecast of the Japanese Economy (2014FY-2025FY)

Indicator	Unit	(Fiscal Year)			
		2006 ~10	2011 ~15	2016 ~20	2021 ~25
Real GDP	annualized growth rate, %	0.2	0.8	1.1	1.0
Nominal GDP	annualized growth rate, %	-1.0	0.5	1.1	1.1
Consumer Price Index	annualized growth rate, %	-0.1	0.9	0.7	0.7
Primary balance (ratio to GDP)	period average, %	-4.0	-5.5	-3.1	-3.0
Current accounts (ratio to GDP)	period average, %	3.7	0.7	-0.0	-1.5
Compensation of employee per capita	annualized growth rate, %	-1.1	0.6	0.2	1.1
Ratio of ordinary profits to sales	period average, %	3.2	4.1	4.9	5.2
Household savings rate	period average, %	1.7	0.8	-2.0	-3.1
Unemployment rate	period average, %	4.4	4.0	3.4	3.0
Yen to US dollar exchange rate	period average, yen/USD	102.1	97.7	120.2	116.7
Crude oil price (WTI)	end year, USD/barrel	79.6	82.6	111.1	150.9
Real world GDP (weighted by exports from Japan)	annualized growth rate, %	4.5	4.0	3.9	3.2
Outstanding debt (ratio to GDP)	period average, %	154.3	193.0	207.1	215.7

(Note) 1. Crude oil price and world GDP figures are shown in calendar year format.
2. Ratio of ordinary profits to sales figures are of corporations with capital of over 10 million yen.
3. This forecast is based on all data that was available up to and including 17th November 2014, when "Quarterly Estimates of GDP Jul. - Sep. 2014 (The First Preliminary)" was released.

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