Support for the Young to Break Out of the Bearish Trap

March 2017

JCER Medium-Term Economic Forecast Team[1]

Baseline Scenario

Following negative growth in the wake of the increase in the consumption tax in FY2014, the Japan's economy is expected to post growth at the 1% level in FY2015 and FY2016. Despite increased corporate profits, positive initiatives are extremely sluggish and the younger generations consume less than the older generation. As there is no driving force to lead the economy, the growth rate is slowly falling off.

Economic growth: The potential growth rate will be nearly zero percent by the late 2020s.

The potential growth rate will continue to decline gradually from the high zero percentage range in the early 2010s. Any increase in the labor force participation rates of females and seniors in the coming years will be insufficient to compensate for the decline in the working-age population, widening the negative contribution of labor in the low zero percentage range in the 2020s, and the contribution of capital to the potential growth will not be able to offset the negative contribution of labor. Assuming that the growth of total factor productivity (TFP), the largest determinant factor of the potential growth rate, will be around 0.5% during the forecast period, the potential growth rate will decline to nearly zero percent in the late 2020s.

Prices: The CPI will remain around 1% by FY2030 and monetary easing policies will be maintained.

The real economic growth rate is expected to be an average yearly rate of 0.6%. The GDP gap, which almost disappears at the end of FY2016, is projected to show excess demand of 1.0% in FY2030. Due to such tightening of supply and demand, the CPI will be at around 1% in the 2020s, but will fail to reach the 2% targeted by the Bank of Japan. Therefore, when we look at monetary policies, even if the long-term policy target is raised from zero interest in the2020s, monetary easing conditions will be maintained in terms of real interest rates.

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Wages: Real wages will remain flat, while labor share will be on a downward trend.

Firms will remain conservative about wage increases, although their stance will gradually become more positive. Even if real wage is increased, the rise is likely to be slower than productivity growth. As a result labor share may be on a declining trend in the long term, and virtuous cycle from the corporate sector to the household sector will not be expected.

Industrial Outlook: Clear decline in the electronics industry is expected, while a large increase in employment in medical care and welfare sectors is likely to continue.

Situations of each industry under the baseline scenario were forecasted by industry, using input-output models. In the Japanese manufacturing industry, the decline of the electronics industry will become inevitable, while dependency on general machinery, industrial electrical equipment and "other transportation machinery" that have export competitiveness will increase. Retail and services, among the non-manufacturing industry, will be affected by demand from expatriates, reflecting increased inbound travelers and decreased domestic demand. In the ultra-aged society, demand for medical care and nursing care personnel will expand rapidly, while securing labor may become difficult, due to decreasing numbers of workers against the backdrop of a shrinking population.

Reform Scenario

In the reform scenario, the sluggish economy is revitalized with the implementation of the support measures for the young especially through childcare and education support, wage increases, and the work style reforms.

Childcare support with eight trillion yen may raise female labor force participation rate to 53.6% in FY2030

The reform scenario assumes budget allocation of eight trillion yen to childcare and education support, including expansion of childcare service, which is currently suffering capacity shortage. Securing childcare services themselves may not only raise consumption expenditures, but also increase incomes when women contribute more to the labor force. As a result, the female labor force participation rate is expected to rise from 49.7% in FY2015 to 53.6% in FY2030.

In Japan, the returns on education investment for the private is low from an international perspective, so a fiscal policy that takes on a larger share of the cost of education, increasing the returns, is important for human capital formation from long-term perspective.

Work style reform to deliver real wage increases exceeding labor productivity growth

It is important to deliver wage increases in line with productivity growth to realize appropriate distribution of fruits of economic growth to stimulate the economy, thereby securing incentives to implement investment in education. In the workplace, it is often the case that ability are barely fully utilized, and that wages are determined based on the attributes of workers. It is necessary to change these employment practices to increase labor productivity. It is also important to push forward the tripartite initiative from the government, labor unions, and employers, to achieve the desirable wage growth reflecting productivity growth. Considering that labor share is at a low level in recent years, real wage growth is likely to slightly exceed productivity growth, raising labor share during the forecast period.

Deliver consumption-led 2% real GDP growth by raising household incomes through work style reform and support for the young

As a result of support for the young and work style reform, the earnings outlook is likely to improve, providing impetus to economic growth through consumption expansion. Private consumption growth rate may rise from the high zero percentage range in the late 2010s to the 2% level in the 2020s. In a situation where society is ageing and female labor participation rates are increasing, it is expected that there may be a greater range of services, and expenditures on these services may increase. It is also conceivable that investment in robots and AI to develop practical applications for new services will gather steam to compensate for labor shortages.

Fiscal balance: PB will continue to stay in the deficit even on the assumption of consumption tax rate hikes in the late 2020s

Under the economic conditions described above, the assumption is that after the consumption tax rate rise to 10% in FY2019, the consumption tax rate will be raised three times by one percentage point each time in the late 2020s. However, the ratio of the central and local government primary balance (PB) to GDP is expected to be negative 0.8% in FY2030 on the assumption that corporate taxes will decrease and that eight trillion yen will be slated for childcare and educational support.

Current account balance: In terms of ratio to GDP, surplus will gently decline to the 2.5% level in FY2030

In the savings-investment balance, the basic structure remains the same. The corporate sector is the saver and the general government is the investor. In the household sector, saving rates may fall into a negative territory due to the ageing population. In total, excess savings may shrink. The current account surplus as a ratio to nominal GDP is projected to gently decline from the lower 4% range in the late 2010s to the middle 2% level in FY 2030. Trade and services balance is expected to book a deficit in the lower 1% range, but income balance is projected to book approximately 4% surplus.

Summary Table of the Baseline Scenario

Indicator	Unit	fiscal year				
		06-10	11-15	16-20	21-25	26-30
Real GDP	annualized growth rate, %	0.0	1.0	0.8	0.5	0.4
Potential GDP	annualized growth rate, %	0.4	0.7	0.7	0.4	0.4
Consumer price index (all items)	annualized growth rate, %	-0.1	0.7	0.8	0.9	1.2
Primary fiscal balance of central and local government	period average, % of nominal GDP	-4.0	-4.8	-3.1	-2.6	-2.9
Current account	period average, % of nominal GDP	3.6	1.6	4.3	4.2	3.2
Compensation of employee per capita	annualized growth rate, %	-0.8	0.3	0.7	1.4	1.8
Ratio of ordinary profits to sales	period average, %	3.2	4.3	5.0	5.4	5.4
Household savings rate	period average, %	3.3	1.1	0.7	-1.4	-1.5
Unemployment rate	period average, %	4.4	3.9	3.0	3.1	2.9
Yen to US dollar exchange rate	period average, Yen/USD	102.0	98.5	111.4	107.4	102.2
Crude oil price (WTI)	end year, USD/barrel	76.0	85.8	55.5	75.0	98.9
Real world GDP	annualized growth rate, %	3.9	3.5	3.4	3.1	2.7

Notes: 1: Crude oil price and real world GDP figures are shown in calendar year format.
2: Potential GDP figures are estimate of JCER.
3: Compensation of employee is divided by "employee" of Labour Force Survey.
4: Ratio of ordinary profits to sales are of corporations with capital of over 10 million yen and exclude financial/insurance sector.

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ASSUMPTIONS IN THE FORECAST

1. Baseline Scenario

1. World Economy, Exchange Rates, Crude Oil

The world economic growth rates until 2018 are based on January 2017 forecasts by the International Monetary Fund (IMF). The following assumptions have been made: After 2018 growth rates will slowly decline to reach 2.5% in 2030, exchange rates will gradually appreciate to the 100 yen/USD in 2030, and crude oil prices will increase to USD110/barrel.

2. Population and Labor Force

Population figures are based on the medium-level fertility and mortality estimates (January 2012) by the National Institute of Population and Social Security Research. The male labor force participation by age group is expected to level off until FY2030. For women, we have considered improvement of an M-shaped curve, assuming a gentle increase of the female participation rate until FY2030.

3. Fiscal Policy

After rising to 10% in October 2019, the assumption is that the consumption tax rate will stabilize and reduced tax rates will be introduced. The effective tax rate for corporations as of FY2018 is assumed to be 29.7%. Real public investment is assumed to decrease slightly to an annual average of negative 0.6% in the period FY2016-FY2020, and an annual average of negative 0.8% from then on.

2. Reform Scenario

1. Population and Labor Force

The labor force participation rate for seniors in both men and women is expected to rise. The younger female labor participation rate around their 30s is expected rise to the 90% level as a result of fiscal support for childcare. By FY2030, the influx of foreign residents is expected to rise by 80,000 per year exceeding current numbers.

2. Productivity

Based on the reform scenario of the long-term economic forecast[2], the TFP growth rate is assumed to gradually rise to reach a positive figure of 2.0% in FY2030.

[2] Japan Center for Economic Research (2014), http://www.jcer.or.jp/research/long/detail4723.html

3. Fiscal Policy

The effective tax rate for corporations is set to drop to 25% by FY2021 (29.9% in FY2016). Childcare support and spending on education to total eight trillion by FY2030, and the birth rate to recover to 1.6 by FY2030. After confirming that CPI is positive 1.5%, it is assumed that the consumption tax rate will be raised by 1% in the following year.

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