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The Japanese Economy to Plunge to Zero Growth

— The Economy Caught in a "Bearish Trap"

JCER Medium-Term Economic Forecast Team[1]

The rocket start that had been achieved by Abenomics has failed to provide sustainable momentum and the extremely slow pace of the short-term recovery means the absence of any drivers. Despite increased corporate profits, positive initiatives are lackluster and the working generation consumes less than previous generations. Ensnared in this "bearish trap," the Japanese economy will plunge to zero growth.

Economic growth: In the absence of drivers, the potential growth rate will be nearly zero percent by the late 2020s.

The potential growth rate will continue to decline gradually from 0.5% in the early 2010s. Any increase in the labor force participation rates of females and elderly persons in the coming years will be insufficient to compensate for the falling productive-age population, and the rate of decline in the contribution of labor to the potential growth rate will be larger, pushing the contribution of labor to the low zero percentage range. Considering that the capital coefficient has nearly reached a steady state, the contribution of capital will not be significant and 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 from 0.5% in the late 2010s to nearly zero percent in the late 2020s.

Prices: The CPI will hover at around 1% during the forecast period and monetary easing policies will be maintained.

The real economic growth rate is expected to be an average of 0.4%, while the GDP gap in FY 2030 is projected to show excess demand of 1.0%, considering the current surplus of supply. Due to this 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. In light of the above, when we look at monetary policies, the long-term policy target will likely be raised from zero interest in around 2020, while accommodative

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financial conditions will be maintained.

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. However, they will not move further toward a wage increase that surpasses the CPI and the growth rate for per capita compensation of employee is projected to remain at around 1% until FY 2030. As a result, real wage levels will remain flat, which will push down labor share, hence a virtuous cycle from the corporate sector to the household sector will not be established.

Fiscal balance: Any improvement will be moderate, and the ratio of the PB to GDP will be -3.1% in FY 2020.

The ratio of the national and local government primary balance (PB) to nominal GDP for FY 2015 is expected to be -3.3%. Upward pressure on government expenditure related to social security will continue in the future, and improvements in corporate earnings, a factor for increase in revenue from corporate tax, will level off. As a result, any reduction in primary deficit will be moderate even after the scheduled hike in the consumption tax in FY 2019 is taken into account, and the ratio of the PB to nominal GDP is projected to be -3.1% in FY 2020. Thereafter, the deficit is expected to increase, to -3.8% by FY 2030.

Current account balance: Positive figures will be all but eliminated by FY 2030.

In the savings-investment balance, the basic structure in which the corporate sector is the saver and the general government is the investor is unchanged. However, in the household sector, saving rates will be negative in the 2020s due to the aging population, and excess savings will gradually shrink. As a result, in the current account balance, positive figures in the late 2010s in terms of the ratio to nominal GDP, at slightly under 4%, are projected to be all but eliminated in FY 2030. With respect to trade, the growth in export volumes will likely be lower than that of the world as a whole, which will continue to push down Japan’s market share, while import volumes are expected to increase more than the growth rate of domestic demand. Given the above and the anticipated rise in crude oil prices, trade deficits will likely grow further.

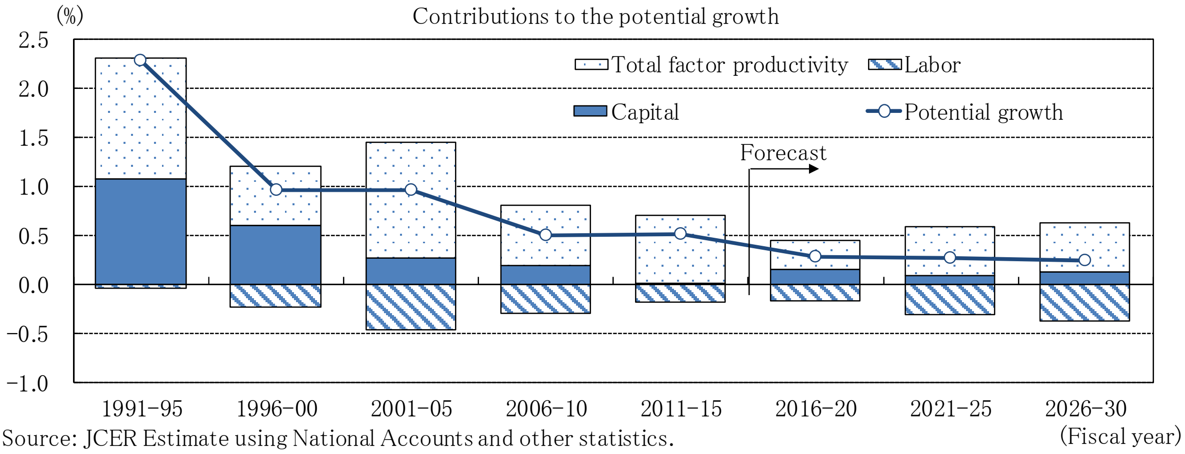
Industrial outlook: The decline of the electronics industry will become inevitable, while the significant expansion in job opportunities will continue in the medical care and nursing care fields.

Situations of each industry under the baseline scenario were forecast 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, transportation machinery and industrial electrical equipment 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.

Summary table

Indicator	Unit	fiscal year				
		06-10	11-15	16-20	21-25	26-30
Real GDP	annualized growth rate, %	0.2	0.6	0.6	0.3	0.3
Potential GDP	annualized growth rate, %	0.5	0.5	0.3	0.3	0.2
Consumer price index (all items)	annualized growth rate, %	-0.1	0.7	0.9	1.2	1.2
Primary balance (ratio to nominal GDP)	period average, %	-4.0	-5.1	-3.4	-3.4	-3.7
Current account (ratio to nominal GDP)	period average, %	3.7	1.7	3.9	2.7	1.1
Compensation of employee per capita	annualized growth rate, %	-1.1	0.5	1.1	1.4	1.2
Ratio of ordinary profits to sales	period average, %	3.2	4.3	5.3	5.2	5.2
Household savings rate	period average, %	1.7	0.7	1.9	-0.2	-2.5
Unemployment rate	period average, %	4.4	3.9	3.0	3.0	2.9
Yen to US dollar exchange rate	period average, Yen/USD	102.0	98.5	104.0	99.3	94.4
Crude oil price (WTI)	end year, USD/barrel	76.0	85.8	51.2	68.6	90.5
Real world GDP	annualized growth rate, %	3.9	3.5	3.4	3.5	3.5

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.



Source: JCER Estimate using National Accounts and other statistics.

Assumptions for Projections

The world economy, foreign exchange rates and crude oil

Based on a more prudent view compared to the forecasts of the International Monetary Fund (IMF) (October 2016), we assume that the world economy will grow at an annualized rate of about 3.5% in real terms in 2016 and thereafter. With respect to exchange rates, it is assumed that the depreciation of the yen will advance gradually until FY 2017 and that about 1% appreciation per year in the value of the yen will be likely thereafter. Regarding crude oil prices, it is assumed that oil prices will rise to the level close to the 100 dollar-per-barrel level recorded before the last fall in oil prices (actual result in 2013: 98.1 dollars per barrel), by reference to the World Energy Outlook by the International Energy Agency.

Population and labor force

The figures for population is based on the medium level of births and medium level of deaths estimation (estimated in January 2012) made by the National Institute of Population and Social Security Research. With respect to the labor participation ratio, it is assumed that the ratios for males by age group will remain flat until FY 2030. The ratios for females are set to rise gradually until FY 2030, which takes into account an M-shaped curve improvement trend.

Government budget

Regarding the consumption tax rate, we assume it will be raised to 10% in October 2019 and remain unchanged thereafter, and it is also assumed that reduced tax rates will also be introduced. Effective corporate tax rates for FY 2018 and thereafter are assumed to be 29.7%. Public spending in real terms is assumed to increase at an annualized rate of 1.3% for the period between FY 2016 and FY 2020 and to decrease at an annualized rate of about -1% thereafter.

In March 2017, a reform scenario that will incorporate reform initiatives will be published in our medium-term forecasts. A revised version of the baseline scenario announced this time, which will take into account factors such as figures to be published in December 2016 for the national income statistics based on revised standards, will be published at the same time.

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