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No Buds for Growth Found in the Japanese Economy

—Labor Share Remains Low, No Investment Acceleration

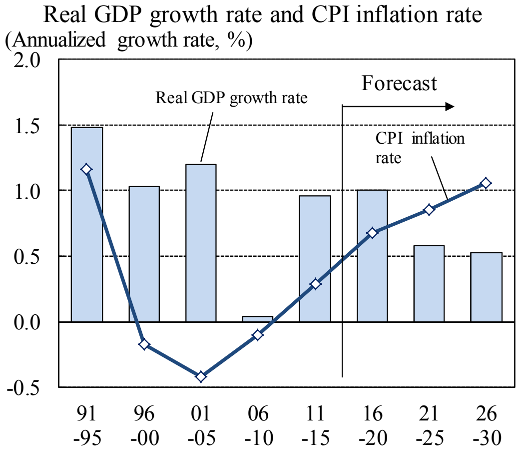
JCER Medium-Term Economic Forecast Team[1]

Supported by factors including strong overseas economies, business expansion has continued in Japan in the most recent period. However, medium-term economic forecasts still require cautious observation. The uneven distribution of income can lead to the absence of strong economic growth driver. Corporate investments, which turned upward in the most recent period, show slow growth compared with increases in revenues. Considering much of this investment focused on renewal and labor savings, the effects of corporate investment on productivity improvement through market and product development will be limited. Furthermore, wage increases will be low under conditions that prevent expectations for high productivity enhancement even if supply and demand in the labor market tighten. Consumption cannot be also expected to grow. We assume that the companies will hold dull economic growth expectation and that investment in Japan will be suppressed if domestic demand remains sluggish.

Buds for new growth must be discovered in order to change this trend. Before everything else, we will be asked to restore the balance of income distribution by increasing productivity through constructive investment and manpower application and by diverting the results of such initiatives to wages.

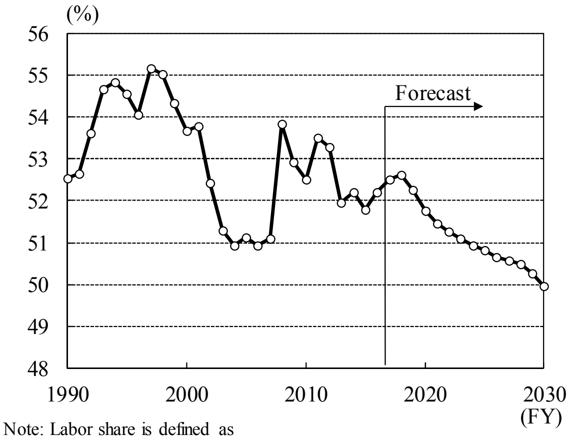
Growth rate becomes slow down, with decline of labor share

Real GDP growth rate and CPI inflation rate



Note: CPI is based on "All items" and excludes effects of consumption tax hike.

Labor share



Note: Labor share is defined as Compensation of employees / (National income + Consumption of fixed capital)

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Economic growth: The potential growth rate will decline to around 0.5% by the late 2020s.

The potential growth rate will decline slowly from around 1% in the late 2010s. We assume that the growth rate for total factor productivity (TFP) will remain at roughly the current level of about 0.5% throughout the forecast period. The potential growth rate will roughly equal the TFP growth rate and come to nearly 0.5% in the latter half of the 2020s because a decrease in the working-age population will gradually decrease labor force contributions to the potential growth. We assume that the real economic growth rate will average less than 1% during the forecast period, which is roughly the same level as the potential growth rate.

Prices: The consumer price inflation will remain at around 1% during the forecast

We assume that the GDP gap will remain at roughly its current level of between 0% and 1%. The consumer price increase rate will remain at around 1%. We assume that the policy of monetary relaxation will continue.

Wages: The growth rate will roughly equal the consumer price inflation, with real wages stuck at the same levels.

The per capita wage increase rate will be around 1%, reflecting global competition and a shift toward the service industry. The rate will roughly equal the consumer price increase rate on a nominal basis. The real wage level will remain unchanged. The labor share will decline slowly with the falling number of employees. The unemployment rate will stay in the neighborhood of 3%.

Fiscal balance: Improvements will be modest, with deficits remaining until 2030.

The fiscal balance will improve modestly due to positive factors such as the tax revenue growth caused by mild business recovery and a hike in the consumption tax rate. The fiscal balance improvement will stagnate in the period from 2020, however, due to social security expenditure growth caused by aging and expenditure increase on new measures associated with the consumption tax rate hike. Consequently, we assume that the primary balance deficits for central and local governments combined will expand to a level between 2% and 3% to nominal GDP in the 2020s.

Current account balance: The balance will decline slowly to less than 3% of GDP.

In the savings-investment balance, excess savings will remain in the corporate sector because corporate income will keep rising with moderate investment expansion. The rate of households that break into savings will rise and the household savings rate will fall as a result of advancing aging. Looking at the situation overseas, a rise in the value of exports will slow down with the falling growth rate in the global economy in the period from the 2020s. In the meantime, the value of imports will increase with relative climbs in crude oil prices. We assume that trade deficits will expand somewhat for these reasons. We forecast that the current account surplus will shrink to about 3% of GDP, even though a surplus in the balance of income will expand.

Industrial outlook: The manufacturing industry will depend on overseas demand due to a decline in domestic demand with employment growing substantially in the medical care and welfare fields.

We forecast domestic production by the respective industries in the baseline scenario using input-output models. The manufacturing industry in Japan will depend more on “Production machinery,” “Industrial electrical apparatus,” and “Other types of transportation machinery”[2] with export competitiveness because domestic demand will decline. In addition, demand for workers will continue to expand in the fields of “Medical, health care and welfare”[3] with the acceleration of aging. Securing workers will be an issue because of their decreasing numbers as a result of the population decline.

[2] “Other types of transportation machinery” refers to transportation machinery other than such machinery related to automobiles (such as transportation machinery for ships, trains, aircraft and industrial transportation vehicles).

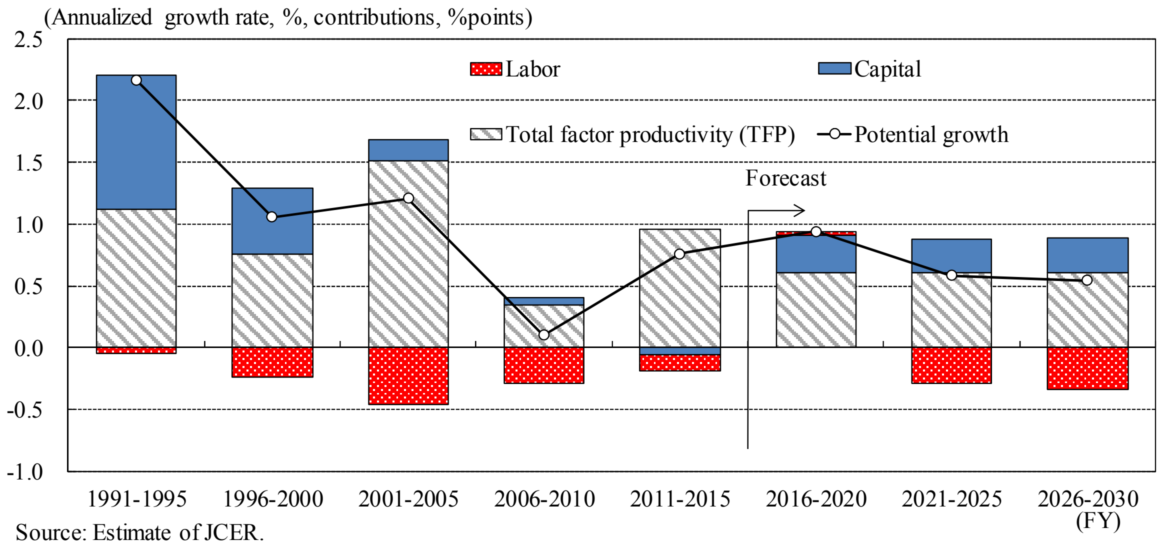
[3] “Medical, health care and welfare” is used in industrial forecasts in accordance with titles that appear in the Input Output Table of the Ministry of Internal Affairs and Communications. In addition to medical and nursing care, “Medical, health care and welfare” covers “Social insurance,” such as annuity and health insurance operations, and “Social welfare,” such as welfare offices, day nurseries, child consultation centers, nursing home for the elderly and welfare service facilities for disabled persons.

Summary table

Indicator	Unit	fiscal year				
		06-10	11-15	16-20	21-25	26-30
Real GDP	annualized growth rate, %	0.0	1.0	1.0	0.6	0.5
Potential GDP	annualized growth rate, %	0.1	0.8	0.9	0.6	0.5
Consumer price index (all items)	annualized growth rate, %	-0.1	0.7	0.9	0.9	1.1
Primary fiscal balance (ratio to nominal GDP)	period average, %	-4.0	-4.8	-2.9	-2.3	-2.3
Current account (ratio to nominal GDP)	period average, %	3.6	1.6	3.9	3.9	3.2
Compensation of employee per capita	annualized growth rate, %	-0.8	0.3	0.8	1.1	1.3
Ratio of ordinary profits to sales	period average, %	3.2	4.3	5.3	5.6	5.7
Household savings rate	period average, %	3.3	1.1	0.8	-0.7	-1.4
Unemployment rate	period average, %	4.4	3.9	2.8	2.7	2.8
Yen to US dollar exchange rate	period average, Yen / USD	102.0	98.4	110.9	107.3	102.1
Crude oil price (WTI)	period average, USD / barrel	76.0	85.8	51.6	78.5	107.9
Real world GDP growth rate	period average, %	3.9	3.6	3.5	3.2	2.8

Notes: 1: Potential GDP figures are estimate of JCER.
2: Primary fiscal balance refers to that of central and local governments.
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.
5: Crude oil price and real world GDP figures are shown in calendar year basis.

Contributions to the potential growth



Source: Estimate of JCER.

Assumptions for Projections

The global economy, foreign exchange rates and crude oil prices

Taking a more cautious view than the forecasts released by the International Monetary Fund (IMF) in October 2017, we assume that the global economy will grow at an annualized rate of 3.0% to 4.0% in the period through the first half of the 2020s. We assume that yen will appreciate by about 1.0% per year.

We assume that crude oil prices will surpass their level before the latest price fall (98.1 U.S. dollars per barrel in 2013) in the second half of the 2020s and keep rising moderately from there in the subsequent period based on our forecast that demand for oil will grow with economic growth in emerging nations, taking into account the World Energy Outlook of the International Energy Agency (IEA) and projections made by the U.S. Energy Information Administration (EIA).

Population and labor force

Population figures are based on the projections made by the National Institute of Population and Social Security Research in April 2017, with assumption of medium levels of births and deaths. Figures for immigrants to Japan incorporate the net inflow of foreigners to Japan in the same projections (approximately 70,000 persons per year). We assume that the labor participation rate will fall slowly.

Government budget

We assume that the consumption tax rate will remain unchanged after its hike to 10% in October 2019, and that reduced tax rates will be introduced. We project an effective corporate tax rate of 29.7% in the period from FY2018. We expect real public investment to fall at an average rate of 0.7% per year during the forecast period.

We will announce a reform scenario incorporating reform initiatives as part of our medium-term forecasts in March 2018. At the time of its announcement, we will release a revised version of the baseline scenario announced this time, taking into account data such as annual estimates for national income statistics that the government will publish in December 2017.

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