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SA150 Short-Term Forecast for the Japanese Economy (2012/4-6—2014/1-3)

Growth Continues at a Slower Pace
-Concern over Consumption Drop as Subsidies End
-Exports and Investment Expected to Support Growth

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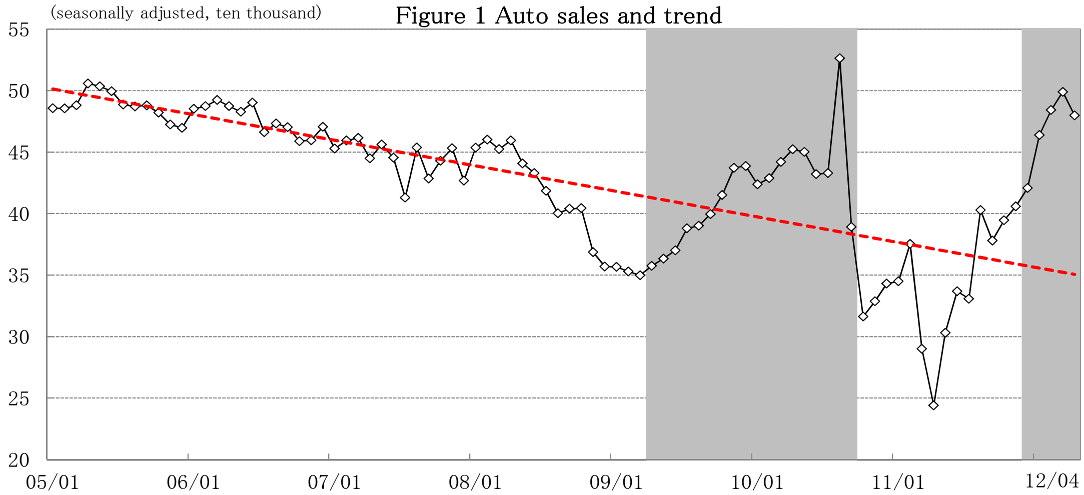
- Overseas economies will begin a steady expansion in the second half of fiscal 2012
- Green-car subsidies have caused substantial fluctuations in auto sales
- Excessive liquidity poses the risk of destabilizing government bond and commodity markets

After coming to a standstill toward the end of 2011, Japan's economy quickly picked up speed at the start of the new year. It was energized by stepped-up consumption, which received a boost from full-fledged implementation of the third supplementary budget for fiscal 2011 (April 2011 to March 2012) and the provision of subsidies for energy-efficient automobiles. However, this fiscal stimulus is to expected to rebound in the second half of the current fiscal year. The question is whether this can be overcome by a good performance in exports and other components of domestic demand. After examining the most recent data, the Japan Center for Economic Research (JCER) has now updated its short-term economic forecast for the period through fiscal 2013 (see the table).

Two points are of particular importance when forecasting what is to come. One is the outlook for overseas economies, which will determine the course of exports, and the other is the timing and extent of the letdown when the green-car subsidies come to an end. Let us look first at the business prospects in other countries.

Figure 1 Auto sales and trend



Note: Shadowed area shows the period of green-car subsidies.The broken line shows trend line from 2005/1 to 2008/9.
Source:Japan Automobile Dealers Association Japan Mini Vehicles Association

When Greece managed to clear a bond-redemption hurdle in March, Europe's debt problems seemed to be heading toward a successful resolution. But the outlook has since become increasingly murky once again. On May 6, in both the French presidential election and the Greek general election, administrations that had been pursuing a tough deficit-reduction course went down to defeat. This made it plainly evident that austerity policies have become extremely unpopular.

The Greek debt crisis in particular is growing worse. After the election, talks on forming a new coalition government ended in failure, and doubts are growing about whether a new deficit-cutting policy can be put together before the end of June, the deadline set by the European Union and the International Monetary Fund (IMF) for meeting the requirements of their second financial support program. Market participants taking a stern view of the situation even suggests that Greece will have to bow out of the euro zone.

The possibility of Greece's exiting from the euro cannot be counted out, but it would be a risky move and cannot be viewed as the most likely scenario. At the recent meeting of the Group of Eight industrial nations, discussion focused on striking a balance between austerity programs and growth measures, with a view to keeping Greece within the Euro area. The G8 leaders were in agreement that a Greek exit would have costly consequences. The majority of the Greek people are also in favor of retaining the euro as their currency. Based on the assumption that progress will continue to be made toward resolving the European debt crisis will move steadily forward, the JCER continues to believe that the euro-zone economies will gradually recover moving into the second half of 2012.

In the United States, real economic growth moved at a fast pace in the October–December quarter of 2011, but it slowed to 2.2% in the January–March quarter of 2012. The collapse of the housing bubble is still having a discernable impact on household budgets. Probably modest growth at a rate around 2.0-2.5% range will continue for some time. To be sure, the housing market is steadily regaining its health. The house price index of the Federal Housing Finance Agency has now recorded a year-over-year gain for the first time since the July 2006–July 2007 period.

China's real estate market is still going through a process of adjustment, but the authorities remain committed to the difficult task of maintaining growth while preventing inflation from rekindling, and it is likely that the economy will successfully achieve a soft landing at a growth rate somewhat over 8%. The authorities in other emerging countries are sticking to a relaxed monetary stance, and solid growth should continue, backed up by vigorous domestic demand. In summary, we can say that overseas economies, which for the Japanese economy represent the last hope, should steadily expand moving into the second half of fiscal 2012.

On the domestic front, real economic growth rose to an annual rate of 4% in the January–March quarter of 2012. This was clearly a result of the government policies I mentioned at the start. The green-car subsidies deserve special note (see the figure). The revival of this program boosted demand for vehicles to replace those lost in the earthquake and tsunami disaster of 2011, and auto sales have increased even faster than they did during the 2009 subsidy program, which had loose eligibility requirements. If sales continue at this fast pace, the ¥300 billion earmarked for the subsidies in the fourth supplementary budget for fiscal 2011 will be used up during the summer. Our forecast is based on the premise that additional budgetary funding will not be forthcoming, and we therefore expect auto sales to drop when the subsidies come to an end.

As a result, it is highly likely that private final consumption will shift to contraction in the second half of fiscal 2012. A fiscal drag from the ending of the third supplementary budget's implementation will probably also be felt during this period.

Even so, we expect real growth to continue at a moderate pace with support from an upturn in other components of demand, notably exports, capital investment, and housing investment. Provided that overseas economies grow as expected, exports should return to the growth track moving into the second half of the fiscal year. Plant and equipment investment should also see a fair amount of growth, as the companies listed on the first section of the Tokyo Stock Exchange are expected to report profit growth in the vicinity of 20% for the current business year. Housing investment is also likely to expand, and there are signs that demand resulting from work to rebuild after last year's disasters is starting to make itself felt at last. New housing construction in the devastated Tōhoku region has increased, and prices for building and materials are recovering.

But there are risks too. The first is the European debt crisis. In June Greece will hold another general election, and France will hold an election for the National Assembly, the lower house of its legislature. Other political events are also on the horizon including a September general election in the Netherlands. The results of these elections are likely to affect market sentiment, and exchange rates and stock prices may be volatile.

The second risk relates to the severity of the downward pressure to be expected from the termination of the green-car subsidies. It is not hard to understand why the government has resorted to this program twice in response to extraordinary events: the global financial crisis in 2008 and the Tōhoku earthquake disaster in 2011. As the figure demonstrates, however, vehicle sales have fluctuated widely as a result. Some studies on the relationship between corporate sales and capital investment suggest that volatility in sales encourages companies to cut back on investments. The pains experienced by electronics manufacturers as a result of the eco-points program for environmentally friendly home appliances and the promotion of digital terrestrial television are still fresh in the memory. In these cases, government policies ended up exacerbating the business risks of private enterprise—precisely the opposite result from that intended.

Finally, I would like to add a word about possible side effects of excessive liquidity produced by monetary easing. One is the risk that government bond bubbles may spread globally. Demand for "safe" bonds issued by the Japanese, American, and German governments may overheat if other leading central banks and risk-averse investors buy them as a low-risk investment. It is possible that this is leading investors to move too far in staking out positions. If a change in the business mood or revised monetary policies causes investors to reverse their positions, there is a danger that markets may suddenly destabilize.

Another is the risk of soaring prices in international commodity markets. Only once since the millennium has Japan experienced the resolution of a "deflationary gap" (a situation in which actual GDP falls below potential GDP) together with a 2% inflation rate. That was in the summer of 2008. Because food and energy prices rose steeply, however, the public failed to get a sense that business was turning for the better.

Economic growth brought about by temporary stimulus policies and excessive liquidity is unlikely to prove sustainable. Merely repeating these policies will not be enough to vanquish deflation and bring about sustained growth. We need stronger companies capable of unearthing latent demand at home and abroad and expanding sales at higher prices by offering goods and services with high value-added content. And government policies to provide back-up and support for these efforts.

(The original Japanese article posted in the May 25, 2012 issue of the Nikkei)

Table. The Outlook for Japan's Economy

Forecast →

	FY2011 1st Qtr	2nd	3rd	4th	FY2012 1st Qtr	2nd	3rd	4th	FY2013 1st Qtr	2nd	3rd	4th	FY2010 Actual	FY2011 Actual	FY2012 Forecast	FY2013 Forecast
Real gross domestic expenditures (qtr.-to-qtr.)	-0.3	1.9	0.0	1.0	0.5	0.2	-0.1	0.1	0.3	0.4	0.5	1.1	3.2	-0.0	1.9	1.2
Real gross domestic expenditures (year-on-year)	-1.7	-0.4	-0.5	2.7	3.4	1.8	1.7	0.7	0.5	0.7	1.2	2.2				
Private final consumption (qtr.-to-qtr.)	0.6	1.1	0.7	1.1	-0.1	0.0	-0.2	-0.1	0.1	0.2	0.1	2.2	1.5	1.1	1.3	0.7
Private housing investment (qtr.-to-qtr.)	-3.1	4.8	0.1	-1.6	1.4	0.7	-0.1	0.5	0.4	3.2	5.9	7.6	2.4	3.6	2.1	8.5
Private non-residential investment (qtr.-to-qtr.)	-0.4	-0.2	5.2	-3.9	1.6	0.7	0.5	0.7	0.5	0.4	0.6	0.8	3.5	0.2	2.0	2.2
Public fixed capital formation (qtr.-to-qtr.)	7.3	-0.6	-0.5	5.4	4.8	1.0	-1.0	-1.8	-2.2	-2.6	-2.5	-4.0	-6.7	3.9	8.4	-7.7
Domestic demand (contribution)	0.7	1.1	0.7	0.9	0.6	0.2	-0.1	-0.0	0.1	0.4	0.4	1.1	2.4	1.0	1.9	0.9
Net exports of goods and services (contribution)	-1.0	0.8	-0.7	0.1	-0.1	0.0	0.1	0.1	0.1	0.0	0.1	0.0	0.8	-1.0	-0.0	0.3
Exports of goods and services (qtr.-to-qtr.)	-6.3	8.7	-3.7	2.9	0.5	1.0	1.3	1.4	1.6	0.6	1.1	0.6	17.2	-1.4	4.6	4.8
Imports of goods and services (qtr.-to-qtr.)	0.2	3.5	0.9	1.9	1.4	1.0	1.1	0.8	0.9	0.6	0.9	0.6	12.0	5.3	5.8	3.4
Nominal gross domestic expenditures (qtr.-to-qtr.)	-1.0	1.5	-0.3	1.0	0.2	0.2	-0.3	-0.2	0.2	0.4	0.0	0.7	1.1	-1.9	1.1	0.4
Indices of Industrial Production (qtr.-to-qtr.)	-4.2	5.4	0.4	1.3	1.3	1.4	-0.2	0.3	0.4	0.5	0.4	1.7	9.3	-1.0	4.9	1.9
Unemployment rate (%)	4.7	4.4	4.5	4.5	4.4	4.4	4.3	4.2	4.2	4.1	4.0	4.0	5.0	4.5	4.3	4.1
Compensation of employees (year-on-year)	0.2	-0.3	0.3	0.1	0.5	0.7	0.4	0.5	0.2	0.3	0.6	0.6	0.5	0.1	0.5	0.4
Newly issued government bonds yield 10-years (%)	1.175	1.044	1.000	0.979	0.939	1.020	1.027	1.066	1.104	1.143	1.182	1.224	1.150	1.050	1.013	1.163
Nikkei Stock Average (yen)	9,609	9,246	8,581	9,295	9,513	9,618	10,050	10,313	10,523	10,743	11,121	11,382	9,951	9,183	9,873	10,942
Yen : Dollar exchange rate (yen / dollar)	81.7	77.7	77.3	79.3	80.9	82.2	83.1	83.9	84.2	84.9	85.2	85.5	85.7	79.0	82.5	85.0
WTI Crude oil price (dollar / barrel)	102.3	89.5	94.1	103.0	103.5	104.4	105.8	106.7	107.5	108.3	109.2	110.0	83.5	97.2	105.1	108.7
Domestic corporate goods price index (year-on-year)	2.5	2.6	1.5	0.5	-0.3	-0.0	0.9	0.8	0.4	0.4	0.6	0.8	0.7	1.7	0.3	0.5
Consumer price index (excluding fresh food ; year-on-year)	-0.3	0.2	-0.2	0.1	0.0	-0.0	0.2	0.1	0.2	0.3	0.4	0.5	-0.8	0.0	0.1	0.4
Current account / Nominal GDP (%)	1.6	2.2	1.4	1.5	1.3	1.5	1.8	1.7	1.8	2.0	2.3	2.0	3.5	1.7	1.5	2.0
Real GDP of U.S.A. (qtr.-to-qtr.)	1.3	1.8	3.0	2.2	2.0	2.3	2.8	2.0	2.4	2.9	3.0	2.8	3.0	1.7	2.3	2.4
													(C.Y.)	(C.Y.)	(C.Y.)	(C.Y.)
Real GDP of China (year-on-year)	9.5	9.1	8.9	8.1	8.2	8.2	8.1	8.7	8.6	8.3	8.2	8.1	10.4	9.2	8.2	8.4
													(C.Y.)	(C.Y.)	(C.Y.)	(C.Y.)

[Notes] 1. Figures are shown in percentage change, and contribution means contribution to real GDP growth.

2. Figures for GDP components are at chained (2005) yen.

3. Figures for consumer price index are at 2010 year basis.

4. Figures for domestic corporate goods price index and indices of industrial production are at 2005 year basis.

5. Figures for GDP components, Compensation of employees, unemployment rate, indices of industrial production and current account are seasonally adjusted.

6. Figures for real GDP of U.S.A. are seasonally adjusted annual rate, at chained (2005) dollars.

7. Japan's fiscal year is April 1 to March 31.

8. Figures for Long-term interest rate, Stock price, Oil price, Exchange rate, and Unemployment rate are shown in average term for corresponding period.