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SA151 Short-Term Forecast for the Japanese Economy (2012/7-9—2014/1-3)

# With Exports Picking Up, A Rapid Stall Can Be Averted
## - Some Brighter Prospects in Overseas Markets
## - Turbulence from the Consumption Tax Hike

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- Expect fiscal drag as green-car subsidies and supplementary budget expenditures wind down
- Business will be boosted by improving exports as well as housing investment and other reconstruction demand
- Last-minute spending before the consumption tax hike likely to be on a similar scale to fiscal 1996

In the first quarter of 2012 Japan's economy achieved an annualized real growth rate of over 5%. This slowed down to under 2% in the second quarter. Fiscal stimulus in the form of the third supplementary budget for fiscal 2011 (April 2011 to March 2012) and subsidies for energy-efficient automobiles boosted the January–March growth. The drag as these subsidies come to an end is likely to be pronounced. There is also likely to be substantial last-minute spending in fiscal 2013 before the consumption tax is lifted from 5% to 8% in April 2014. Taking these uncertainties into consideration, the Japan Center for Economic Research (JCER) has updated its short-term economic forecast for the period through fiscal 2013 (see the table).

Consumption in the first half of 2012 was pulled forward by the green-car subsidies. At the current pace of subsidy applications, however, the budget for this program will run out as early as September. This makes it likely that private final consumption will begin to contract in the second half of this fiscal year. In addition, the fiscal drag from the third supplementary budget will soon make itself felt. It is therefore likely that real growth will continue to decelerate as a result of these policies.

The view of the JCER, however, is that the economy will not slump any further, as it will be boosted by a recovery in exports as well as strong reconstruction demand in such categories as housing investment. Particularly important in the short term will be the state of overseas economies and the last-minute spending anticipated in fiscal 2013 before the consumption tax rises. Here I will sum up our view on these points.

Let us begin by looking at the situation overseas. In the United States, the bleak housing market had been holding back growth, but there are signs that better times may be around the corner. Housing prices are no longer falling, and the housing market index, which expresses the confidence of home builders, has substantially improved. The damage to household balance sheets caused by the collapse of the housing bubble is steadily being repaired. With interest rates on housing loans now greatly reduced, the ratio of household liabilities to disposable income has fallen to the level of the trend during the 1990s. However, there remains the problem known as the "fiscal cliff." This is the situation the US government will face at the end of 2012 when a number of tax breaks expire and, under the Budget Control Act of 2011, spending cuts begin.

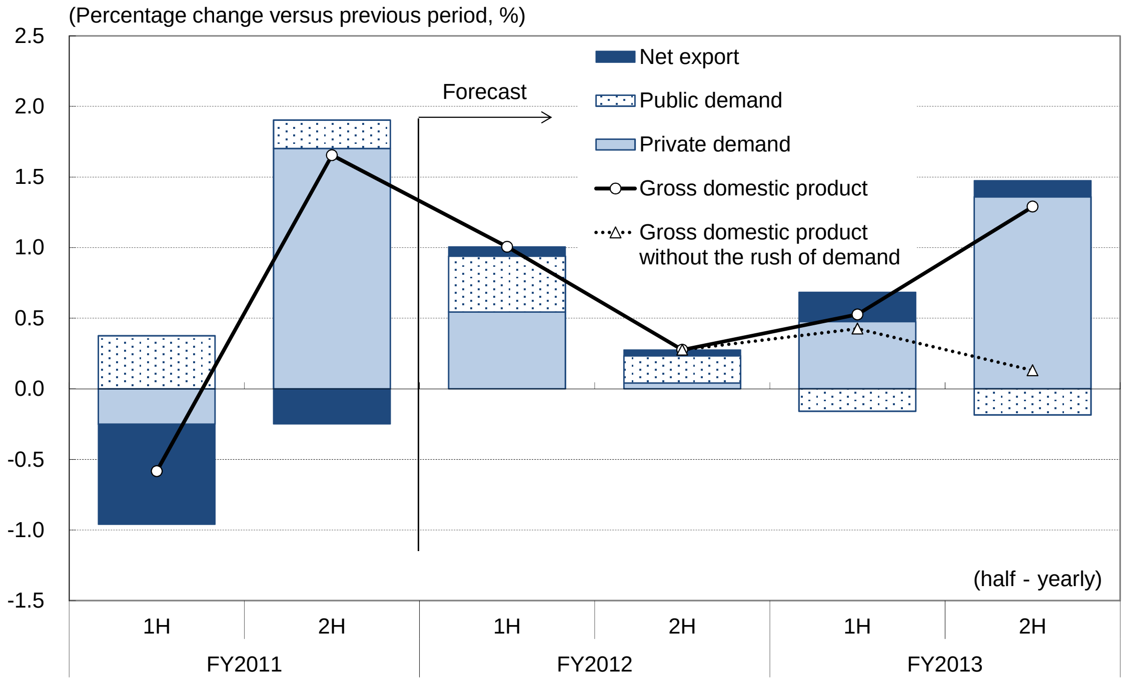
While it is not clear what US lawmakers will do at that juncture, the JCER made a number of assumptions, such as that the payroll tax cuts will be retained and that unemployment benefits will be extended, in order to perform a projection. What we found is that the real growth rate of the US economy is very likely to remain at the 2.0%–2.5% level in both 2012 and 2013.

In Europe, people have been watching the response by the authorities to the nonperforming loans and ailing banks in Spain. At a European Union (EU) summit in late June, an agreement was reached to unify banking supervision within the region under the European Central Bank (ECB). Leaders also approved direct capital injections from the European Stability Mechanism into Spain's problem banks. In August, the ECB Governing Council indicated its willingness to resume the purchase of government bonds, albeit with conditions attached. Before such steps can be taken, however, Spain must first make an official request for bailout. The markets have been volatile, swinging between hope and fear in response to each move by the Spanish government.

In this context, real economic growth in the eurozone during the April–June quarter returned to the negative territory, where it was two quarters previously. Even so, the JCER remains confident that steady progress will be made to resolve the European debt crisis and that the eurozone economies will gradually recover. Even if negative growth cannot be averted in 2012, therefore, we expect a return to positive growth in 2013.

The Chinese economy has been slowing down. Measured on a year-on-year basis, the real growth rate has fallen from above 9% in the first half of 2011 to 7.6% in the April-June quarter of this year. But the measures that have been passed to loosen the monetary reins and stimulate consumption should soon start to have positive effects. As a result, the growth rate should accelerate slowly in the second half of the year, leading to overall growth of about 8% for 2012.

Given this outlook for economies overseas, Japanese exports should gradually regain momentum from the second half of fiscal 2012 onward. Although this growth in exports will provide some support to the economy in fiscal 2013, a much larger factor will be the rush to make purchases before the consumption tax goes up. Based on what happened the last time the consumption tax was increased (from 3% to 5% in April 1997), the JCER has estimated the impact on consumer spending, housing investment, capital investment, and inventories (see the figure). Here let me briefly review the findings for consumer spending and housing investment, both of which are expected to be heavily affected.



Note:Japan's fiscal year is April 1 to March 31.
Source: Cabinet Office, *Quarterly Estimates of GDP*

First of all, in order to make clear the nature of the accelerated purchases and investments made during fiscal 1996, we carried out interviews with businesspeople at the time and performed new regression analyses to test our understanding. What we learned was that the rush to invest in housing got underway three quarters before the tax hike. This drove up real private housing investment in fiscal 1996 by almost 7%. In the case of consumer spending, the shopping spree took off two quarters ahead of the tax rate increase and elevated the year's real personal consumption by about 0.7%. Overall, it appears that last-minute spending was on the order of 0.7% of gross domestic product (GDP).

We believe that last-minute spending will be on a similar scale again this time. Compared with the larger increase in the consumption tax, the rush to complete deals is expected to be relatively small, as some of the latent demand that might have been unleashed has already been satisfied by past policy measures. In housing, mention might be made of the "Flat 35S residential loans" (loans with preferential interest rates offered by the Japan Housing Finance Agency) and the eco-points program for housing. And in the area of consumer spending, I would cite the eco-points program for environmentally friendly home appliances as well as the green-car subsidies.

Of course, moving a housing purchase forward is a more difficult matter than stepping out to buy a consumer product: buyers need time to save up a deposit and secure a loan agreement. The housing rush in fiscal 1996 generated investment in rental properties, but in recent years falling rents and increasing labor costs have reduced profits in the rental sector and sapped the incentive for companies to increase this supply. Conversely, in fiscal 1996 an excessive stock of stand-alone units for sale meant there was no housing rush in this category. This time, housing developers are already moving to secure land, and an investment rush seems likely.

After taking into account the overall effect of these factors, we concluded that last-minute spending in all components of demand will elevate the real growth rate in fiscal 2013 by 0.7 percentage point. Of course, changes affecting incomes and consumer confidence may still reduce or increase the impact. But what is not in doubt is that after the spending is over, a reaction will set in. The situation now is much more worrisome than in 1996 when real growth was moving along at a speed of 2.7%. Growth in fiscal 2013 is forecast to be not much above 1%. In this context, the recoil from the spending rush may cause the economy to fall into negative growth. This means that steps may need to be taken to restrain last-minute spending as far as possible, in order to dampen the reaction after it. Thought should be given to devising a flexible set of temporary measures, including changes in other taxes.

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## Table. The Outlook for Japan's Economy

| | FY2011 1st Qtr | 2nd | 3rd | 4th | FY2012 1st Qtr | Forecast → 2nd | 3rd | 4th | FY2013 1st Qtr | 2nd | 3rd | 4th | FY2010 Actual | FY2011 Actual | FY2012 Forecast | FY2013 Forecast |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Real gross domestic expenditures (qtr.-to-qtr.) | -0.5 | 1.8 | 0.1 | 1.3 | 0.3 | -0.0 | 0.2 | 0.3 | 0.2 | 0.4 | 0.7 | 0.8 | 3.3 | -0.0 | 2.0 | 1.3 |
| Real gross domestic expenditures (year-on-year) | -1.8 | -0.6 | -0.7 | 2.9 | 3.5 | 1.8 | 1.8 | 0.7 | 0.6 | 1.0 | 1.5 | 2.1 | | | | |
| Private final consumption (qtr.-to-qtr.) | 0.6 | 1.1 | 0.7 | 1.2 | 0.1 | -0.2 | -0.1 | 0.1 | 0.0 | 0.3 | 0.6 | 2.0 | 1.6 | 1.2 | 1.5 | 1.0 |
| Private housing investment (qtr.-to-qtr.) | -3.0 | 4.8 | 0.1 | -1.6 | 0.8 | 0.7 | 1.1 | 0.6 | 1.9 | 4.9 | 4.4 | 1.2 | 2.6 | 3.8 | 2.1 | 9.6 |
| Private non-residential investment (qtr.-to-qtr.) | -0.9 | 0.3 | 5.5 | -1.6 | 1.5 | 0.1 | 0.2 | 0.7 | 0.5 | 0.4 | 0.6 | 0.8 | 3.9 | 1.1 | 3.5 | 2.0 |
| Public fixed capital formation (qtr.-to-qtr.) | 7.4 | -1.1 | -1.0 | 3.6 | 1.7 | 3.3 | 2.0 | -0.7 | -2.8 | -2.8 | -2.7 | -2.5 | -6.0 | 2.9 | 7.1 | -5.5 |
| Domestic demand (contribution) | 0.4 | 1.1 | 0.8 | 1.2 | 0.4 | 0.0 | 0.1 | 0.2 | 0.1 | 0.3 | 0.6 | 0.8 | 2.5 | 1.0 | 2.0 | 1.0 |
| Net exports of goods and services (contribution) | -0.9 | 0.7 | -0.7 | 0.1 | -0.1 | -0.0 | 0.0 | 0.1 | 0.1 | 0.1 | 0.1 | -0.0 | 0.8 | -1.0 | -0.0 | 0.3 |
| Exports of goods and services (qtr.-to-qtr.) | -5.8 | 7.9 | -3.6 | 3.4 | 1.2 | 0.5 | 0.9 | 1.0 | 1.2 | 1.1 | 1.1 | 0.7 | 17.4 | -1.4 | 4.8 | 4.1 |
| Imports of goods and services (qtr.-to-qtr.) | 0.0 | 3.4 | 1.0 | 2.2 | 1.6 | 0.9 | 0.9 | 0.6 | 0.6 | 0.6 | 0.8 | 0.8 | 12.2 | 5.6 | 5.9 | 2.7 |
| Nominal gross domestic expenditures (qtr.-to-qtr.) | -1.4 | 1.6 | -0.3 | 1.4 | -0.1 | -0.1 | -0.1 | 0.1 | 0.0 | 0.3 | 0.6 | 0.8 | 1.2 | -2.0 | 1.0 | 0.8 |
| Indices of Industrial Production (qtr.-to-qtr.) | -4.2 | 5.4 | 0.4 | 1.3 | -2.0 | 1.3 | -0.2 | 0.2 | 0.2 | 0.5 | 0.6 | 1.7 | 9.3 | -1.0 | 1.3 | 1.7 |
| Unemployment rate (%) | 4.7 | 4.4 | 4.5 | 4.5 | 4.4 | 4.3 | 4.3 | 4.3 | 4.2 | 4.2 | 4.1 | 4.0 | 5.0 | 4.5 | 4.3 | 4.1 |
| Compensation of employees (year-on-year) | 0.2 | -0.3 | 0.3 | -0.0 | -0.5 | 0.1 | -0.1 | -0.2 | -0.1 | -0.1 | 0.2 | 0.4 | 0.5 | 0.1 | -0.2 | 0.1 |
| Newly issued government bonds yield 10-years (%) | 1.175 | 1.044 | 1.000 | 0.979 | 0.879 | 0.771 | 0.886 | 0.951 | 0.966 | 0.981 | 1.017 | 1.052 | 1.150 | 1.049 | 0.872 | 1.004 |
| Nikkei Stock Average (yen) | 9,609 | 9,246 | 8,581 | 9,295 | 9,026 | 8,744 | 9,046 | 9,323 | 9,564 | 9,931 | 10,202 | 10,373 | 9,951 | 9,183 | 9,035 | 10,018 |
| Yen : Dollar exchange rate (yen / dollar) | 81.7 | 77.7 | 77.3 | 79.3 | 80.1 | 78.5 | 79.1 | 80.0 | 80.6 | 81.8 | 83.0 | 84.1 | 85.7 | 79.0 | 79.4 | 82.4 |
| WTI Crude oil price (dollar / barrel) | 102.3 | 89.5 | 94.1 | 103.0 | 93.4 | 90.1 | 91.6 | 93.0 | 93.7 | 94.1 | 94.6 | 95.1 | 83.5 | 97.2 | 92.0 | 94.4 |
| Domestic corporate goods price index (year-on-year) | 1.8 | 2.2 | 1.1 | 0.3 | -0.9 | -1.3 | -0.4 | -0.5 | -0.3 | 0.2 | 0.7 | 1.0 | 0.4 | 1.4 | -0.8 | 0.4 |
| Consumer price index (excluding fresh food ; year-on-year) | -0.3 | 0.2 | -0.2 | 0.1 | 0.0 | -0.0 | 0.2 | 0.2 | 0.3 | 0.4 | 0.4 | 0.4 | -0.8 | 0.0 | 0.1 | 0.4 |
| Current account / Nominal GDP (%) | 1.6 | 2.2 | 1.4 | 1.2 | 1.1 | 1.3 | 1.5 | 1.5 | 1.6 | 1.8 | 2.0 | 1.9 | 3.5 | 1.6 | 1.3 | 1.7 |
| Real GDP of U.S.A. (qtr.-to-qtr.) | 2.5 | 1.3 | 4.1 | 2.0 | 1.5 | 2.0 | 2.2 | 2.2 | 2.4 | 2.6 | 2.5 | 2.6 | 2.4 (C.Y.) | 1.8 (C.Y.) | 2.2 (C.Y.) | 2.2 (C.Y.) |
| Real GDP of China (year-on-year) | 9.5 | 9.1 | 8.9 | 8.1 | 7.6 | 8.0 | 8.1 | 8.4 | 8.6 | 8.1 | 7.9 | 7.9 | 10.4 (C.Y.) | 9.2 (C.Y.) | 8.0 (C.Y.) | 8.2 (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 domestic corporate goods price index and consumer price index are at 2010 year basis.
4. Figures for 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.



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