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SA168 Short-Term Forecast (2016/10-12—2019/1-3)

Is the Japanese Economy Shifting to a Higher Gear?

— Exports Drive Strong Third-Quarter Growth —

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Overview

The Japanese economy grew for the third straight quarter in July–September 2016, expanding by 0.5% in real terms, or an annual rate of 2.2%. The major driver of growth was external demand, which—thanks to a robust increase in exports—contributed 0.5 points to the growth rate. As for private-sector demand, capital spending rose for the first time in three quarters; housing investment increased for the second consecutive three-month period; and personal consumption grew for the third quarter running. Public-sector demand, meanwhile, was mostly flat in July–September.

Third-quarter growth was fueled mainly by external demand, as the rise in domestic private-sector demand remained anemic—still not powerful enough to generate a virtuous circle of rising incomes leading to higher expenditures. With emerging economies recovering from their slowdown and as the growth of the global economy gradually picks up, we project the Japanese economy to grow by 0.9% in real terms in fiscal 2016 and again by 0.9% in fiscal 2017, assuming that the Bank of Japan maintains its quantitative and qualitative monetary easing policy and that the government provides substantial stimulus measures. The outlook for fiscal 2018 is for growth to ease to 0.7% due to the slowing of the Chinese economy and the attenuating effect of the government’s stimulus measures toward the end of fiscal 2017.

Below, we offer our analysis of the global economy, external demand, and domestic demand.

Global Trends

The US economy grew by an annual rate of 2.9% in real terms in July–September 2016, a significant rise from the 1.4% recorded in the previous quarter. Personal consumption slowed, though, as a reaction to the sharp climb of the preceding quarter. Net exports contributed 0.8 points to the growth rate, thanks to a substantial rise in exports.

Business confidence is continuing to improve for both manufacturers and nonmanufacturers, and industrial production is also rising at a modest pace. The unemployment rate remained slightly under 5%, with nonfarm jobs maintaining their steady growth. Domestic demand continues to drive the expansion of the US economy, which is expected to grow further in the short term should Donald Trump, once he enters the White House, implement the tax cuts and infrastructure investments that he has pledged. We project the US economy to grow by 1.6% in 2016, 2.4% in 2017, and 2.1% in 2018.

In the eurozone, GDP registered real quarterly growth of 0.3% in July–September, about the same rate as in the previous quarter. Buttressed by the aggressive monetary easing of the European Central Bank, a gradual recovery led by domestic demand is continuing. The effect of Britain’s decision to leave the EU is negligible at the present moment.

The British economy displayed greater strength than expected, growing by 0.5% on a quarterly basis in July–September. Business sentiment and consumer confidence that had declined following the Brexit vote in August returned to their pre-referendum levels. Prime Minister Theresa May stated at a Conservative Party conference on October 2 that she will formally trigger Article 50 of the Lisbon Treaty by the end of March 2017 to begin the Brexit process, which caused the pound to plunge from fears that access to the EU single market would be lost. Inflation is rising due to the past depreciation of the pound, and the rate is expected to climb further even as the British economy slows, which will present a considerable challenge for the Bank of England in steering its monetary policy.

For a third straight quarter, China’s GDP grew by 6.7% year on year in real terms in July–September, buoyed by fixed asset investments and personal consumption. Private capital spending was sluggish, however, so fixed asset investments are being propped up by government spending. Also, while personal consumption is on an uptrend, the increase in July–September includes a transitory rise of auto sales from the reduction in the acquisition tax for compact vehicles. There is still much to do in “rebalancing” China’s economy toward one powered by consumption and services.

Excess debt and capacity remain a drag on the Chinese economy. Corporate debt in China is about 1.7 times GDP—higher than the corresponding figure for Japan in the 1990s. Going forward, the process of working off debt has the potential of slowing the pace of economic growth. With regard to excess plant and equipment, Beijing is advancing efforts to reduce capacity in such industries as coal and steel. Addressing overcapacity was identified at the G20 summit on September 5 as an international issue, and global efforts are now being made. Given the above, we project the China’s economy to expand by 6.6% in 2016 and 6.0% in 2017. In 2018, China’s economy will

slow to 5.4% as part of a deleveraging process.

Given these global trends, we expect Japan's real exports to increase by 0.3% in fiscal 2016, 1.5% in fiscal 2017, and 1.0% in fiscal 2018.

[Table: The Outlook for Foreign Economies]

													(%)
	World		United States		Euro Area		China		NIEs		ASEAN		
	SA167R	SA168	SA167R	SA168	SA167R	SA168	SA167R	SA168	SA167R	SA168	SA167R	SA168	
2015		3.4		2.6		2.0		6.9		2.1		4.6	
2016	3.0	3.1	1.6	1.6	1.5	1.6	6.5	6.6	2.1	2.0	4.6	4.7	
2017	3.3	3.4	2.4	2.4	1.3	1.4	6.0	6.0	2.3	2.1	4.6	4.7	
2018		3.4		2.1		1.6		5.4		2.4		4.9	

Note: World economic growth rate is an average weighted by exports from Japan. Estimates are calendar year base.

Domestic Demand

Our forecast for the Japanese economy incorporates the ¥2.2 trillion in public works spending that was announced as part of the government's second supplementary budget for fiscal 2016. In our previous forecast, we assumed that public works spending would reach ¥3 trillion, meaning that such spending fell short by about ¥800 billion. We still anticipate that public spending will cumulatively boost GDP by around 0.4% in the years to fiscal 2018.

Our forecast for growth in consumption is unchanged at 0.6% for fiscal 2016 and 0.9% for fiscal 2017. In fiscal 2018, spending should grow, once again, by around 0.9%. The job market, which will have a major impact on consumption trends, should remain tight, as indicated by the rise in the ratio of job openings to applicants and by an unemployment rate trending at around 3%. Nominal wages have risen for three consecutive years, and salaries, too, have climbed in response to the wage hikes agreed to during annual labor negotiations.

Capital spending should grow by 0.3% year on year in fiscal 2016, 1.1% in fiscal 2017, and 0.9% in fiscal 2018. Corporate profits are expected to decline in fiscal 2016 from the waning effect of the improvement of the terms of trade ensuing from the drop in energy prices in past years and the appreciation of the yen since the start of 2016. Cash on hand remains high, though, and capital spending is expected to continue growing at a moderate pace. The September BOJ Tankan survey shows that capital spending plans for fiscal 2016 remain firm for large enterprises in both the manufacturing and non-manufacturing sectors.

Prices

We revised downward our outlook for core CPI (excluding fresh foods) to -0.3% for fiscal 2016 and +0.6% for fiscal 2017. The reasons for this downward revision are that recent price declines have been steeper than expected, that the effect of the yen's appreciation in reducing prices was higher than estimated, and that expectations of future price increases have diminished. We project core CPI to rise at a faster pace in fiscal 2018 and climb to 0.8% due to improvements in the macro supply-demand gap.

Risk Factors

With respect to external risks, there will be a need to (1) monitor mounting antiglobalization sentiment giving rise to isolationist policies and the spread of protectionism undermining the recovery of the world economy. Should Trump turn the United States toward a more isolationist direction, this would not only weaken the competitiveness of the US economy in the long run but damage US principles of freedom and openness that have powered the growth of the world economy—a development that may propagate globally. External risks to watch for in the medium to long term are (2) the reemergence of financial uncertainties in Europe and (3) the worsening of structural issues in China leading to a hard landing.

Domestically, there is the ongoing risk that (4) an external shock could trigger an appreciation of the yen and a decline in stock prices, thereby puncturing the confidence of companies and households and derailing capital spending and consumption. Also, (5) if the government falls short in implementing growth strategies and regulatory reform, growth rates may fall, and the sustained growth of domestic demand may come to a halt. In the longer term, (6) there is the risk that government debt will become unsustainable.

Summary Table of the 168th Quarterly Forecast

四半期／年度／暦年 Quarter / Fiscal Year / Calendar Year	単位 Unit	Forecast												Forecast							
		2016				2017				2018				年度(FY) 2015 (実績) Actual	年度(FY) 2016 (予測) Forecast	年度(FY) 2017 (予測) Forecast	年度(FY) 2018 (予測) Forecast	暦年(CY) 2015 (実績) Actual	暦年(CY) 2016 (予測) Forecast	暦年(CY) 2017 (予測) Forecast	暦年(CY) 2018 (予測) Forecast
		4-6	7-9	10-12	1-3	4-6	7-9	10-12	1-3	4-6	7-9	10-12	1-3								
実質国内総支出 (2005暦年連鎖価格) Real GDE (Chained 2005 Yen)	前期比% ** 前年同期比% ****	0.2 0.6	0.5 0.9	0.1 1.3	0.2 1.0	0.3 1.1	0.2 0.8	0.1 0.9	0.1 0.7	0.2 0.6	0.2 0.6	0.2 0.7	0.2 0.9	0.9	0.9	0.9	0.7	0.6	0.7	1.0	0.7
国内需要 Domestic Demand	寄与度%ポイント ++	0.3	0.1	0.1	0.3	0.3	0.3	0.1	0.1	0.2	0.2	0.2	0.2	0.8	0.7	0.9	0.7	0.1	0.6	0.9	0.6
民間最終消費支出 Private Consumption	前期比% **	0.1	0.1	0.2	0.2	0.2	0.3	0.2	0.2	0.2	0.2	0.2	0.2	-0.1	0.6	0.9	0.9	-1.2	0.4	0.7	0.9
民間住宅投資 Private Residential Investment	前期比% **	5.0	2.3	-1.3	-0.9	-0.9	-0.9	-0.7	-0.6	-0.2	-0.1	0.7	1.7	2.4	5.8	-2.8	-0.5	-2.5	5.1	-0.9	-1.8
民間企業設備投資 Private Non-Residential Investment	前期比% **	-0.1	0.0	0.2	0.3	0.3	0.3	0.4	0.2	0.2	0.2	0.2	2.1	0.3	1.1	0.9	1.6	0.3	0.9	1.0	
公的固定資本形成 Public Investment	前期比% **	2.3	-0.7	1.0	3.9	2.2	1.0	-3.1	-2.5	-1.1	-0.8	-0.6	-0.8	-2.7	1.2	4.0	-5.3	-2.5	-1.4	6.3	-5.1
外需 Net Exports of Goods & Services	寄与度%ポイント ++	-0.2	0.5	-0.0	-0.1	0.0	-0.0	-0.0	0.0	0.1	-0.0	-0.0	0.0	0.1	0.2	0.0	0.0	0.4	0.2	0.1	0.0
財貨・サービスの輸出 Exports of Goods & Services	前期比% **	-1.5	2.0	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.2	0.2	0.2	0.4	0.3	1.5	1.0	2.8	-0.5	1.4	1.1
財貨・サービスの輸入 Imports of Goods & Services	前期比% **	-0.6	-0.6	0.5	0.6	0.4	0.5	0.5	0.3	0.1	0.2	0.2	0.2	0.0	-1.2	1.6	1.0	0.4	-1.7	1.2	1.2
名目国内総支出 GDE at Current Prices	前期比% ** 前年同期比% ****	0.1 1.4	0.2 0.8	0.0 1.1	0.3 0.6	0.4 0.9	0.3 1.0	0.1 1.0	0.1 0.9	0.3 0.8	0.2 0.7	0.3 0.9	0.3 1.1	2.3	1.0	0.9	0.9	2.5	1.1	0.9	0.8
鉱工業生産指数 Indices of Industrial Production	前期比% **	0.2	1.3	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.0	-1.0	0.4	0.9	0.4	-1.2	-0.9	1.2	0.4
企業物価指数 Corporate Goods Price Index	前年同期比% ****	-4.4	-3.6	-2.0	-0.1	0.6	0.9	0.8	0.5	0.4	0.4	0.3	0.3	-3.2	-2.6	0.7	0.3	-2.3	-3.4	0.5	0.4
消費者物価指数(生鮮食品除く) Consumer Price Index excl. Fresh Food	前年同期比% ****	-0.4	-0.5	-0.2	0.1	0.5	0.5	0.6	0.6	0.8	0.8	0.8	0.7	0.0	-0.3	0.6	0.8	0.5	-0.3	0.4	0.7
名目雇用者報酬 Compensation of Employees	前期比% ** 前年同期比% ****	0.2 2.0	0.6 2.0	0.2 1.5	0.2 1.2	0.4 1.5	0.1 0.9	0.1 0.8	0.3 0.8	0.3 0.8	0.3 1.0	0.3 1.2	0.3 1.3	1.7	1.7	1.0	1.1	1.6	2.0	1.1	1.0
完全失業率 Unemployment Rate	% *	3.2	3.0	3.0	3.0	3.0	3.0	3.0	2.9	2.9	2.9	2.9	2.9	3.3	3.0	3.0	2.9	3.4	3.1	3.0	2.9
新発10年国債流通利回り (店頭基準気配) 10-Year Government Bond Yield	%	-0.121	-0.128	-0.060	-0.048	-0.035	-0.023	-0.010	-0.010	-0.010	-0.010	-0.010	-0.010	0.288	-0.089	-0.019	-0.010	0.360	-0.065	-0.029	-0.010
日経平均株価 Nikkei Stock Average	円 / yen	16,394	16,500	17,014	17,146	17,275	17,405	17,538	17,668	17,768	17,866	17,945	18,024	18,855	16,764	17,472	17,901	19,204	16,688	17,341	17,812
IMFベース経常収支 Current Account Balance (IMF)	千億円/100 Billion yen* 名目GDP比% *#	46.4 3.7	49.0 3.9	46.2 3.7	45.8 3.6	45.3 3.6	43.9 3.4	42.4 3.3	42.1 3.3	42.0 3.3	41.2 3.2	39.9 3.1	39.9 3.1	180.0 3.6	195.0 3.9	181.1 3.5	170.4 3.3	164.1 3.3	198.2 3.9	184.7 3.6	172.5 3.4
対ドル円レート Yen to US Dollar Exchange Rate	円／ドル yen / dollar	108.0	102.4	103.9	104.8	105.7	106.6	107.4	108.0	108.3	108.6	108.8	109.1	120.1	104.8	106.9	108.7	121.1	107.4	106.1	108.5
WTI原油価格 WTI Crude Oil Price	ドル／バレル dollar / barrel	45.6	44.9	48.4	49.2	50.1	50.9	51.7	52.5	53.3	54.1	55.0	55.8	45.1	47.0	51.3	54.5	48.8	43.2	50.5	53.7
米国実質国内総支出 U.S. Real GDP (2009 Dollars)	前期比年率% ***	1.4	2.9	2.5	2.3	2.3	2.3	2.3	2.1	2.0	2.0	2.0	2.0	2.2	1.7	2.3	2.1	2.6	1.6	2.4	2.1
中国実質国内総支出 China Real GDP (1990 Prices)	前年同期比% ****	6.7	6.7	6.5	6.0	5.8	5.9	6.4	6.2	5.4	5.0	5.0	5.1	6.9	6.5	6.1	5.1	6.9	6.6	6.0	5.4

(注) 1. *季節調整値、**季節調整済み前期比
2. ***季節調整済み前期比年率換算、****前年同期比
3. # 名目GDP比
4. ++ 前期比寄与度

[Note] 1. * Seasonally adjusted, ** Seasonally adjusted changes from the previous quarter
2. *** Seasonally adjusted changes from the previous quarter in annual rate, **** Year-on-year percentage change
3. # % of nominal GDP
4. ++ Contributions to changes from the previous quarter