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SA170 Short-Term Forecast (2017/4-6—2019/1-3)

Scenario for Moderate Expansion Remains Unchanged

— Geopolitical Risks Rise despite Receding of Frexit Fears —

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Japan's economy is in the midst of a moderate recovery, as GDP in January–March 2017 rose in real terms for the fifth consecutive quarter. The growth streak is the longest since the economy grew for six straight quarters 11 years ago between January–March 2005 and April–June 2006—prior to the global Lehman crisis. Growth was balanced, moreover, with both external and domestic factors contributing positively to higher GDP, thanks, notably, to a revival of exports and production. The economy can be said to have entered a phase of moderate expansion.

Our latest forecast remains largely unchanged from our previous projection. We see dynamic growth in global markets, continued monetary easing, and large-scale fiscal stimulus contributing to 1.4% annual growth in real terms during fiscal 2017. While the impact of fiscal stimulus will gradually thin out, continued recovery in the corporate sector should boost real growth to 0.9% in fiscal 2018—slightly higher than the potential growth rate.

Looking overseas, while there is lingering uncertainty about the direction of policy in many Western countries, their economies appear to be moving into higher growth. Our conservative projection for the US economy is 2.2% growth in both 2017 and 2018, given the questionable prospects and impact of such Trump administration goals as tax reform, America-first trade policy, and infrastructure investment.

The eurozone should register moderate growth of 1.7% in both 2017 and 2018, spurred by domestic demand. Britain, though, will see slightly slower growth—1.5% in 2017 and 1.4% the following year—as higher inflation will eat into real purchasing power and Brexit negotiations casts a shadow over the economy.

Turning to Asia, the slowdown in China will continue, with the growth rate easing to 6.5% in 2017 and 6.1% in 2018 as medium- to long-term adjustments are made to rein in excess debt and capacity. The newly Industrialized Economies of South Korea and Taiwan are projected to grow by around 2.5% in both 2017 and 2018 owing to IT cycle improvements. The four major ASEAN countries of Indonesia, Malaysia, the Philippines, and Thailand, meanwhile, should grow by close to 5% in both years. Rising private debt will dampen domestic demand in Thailand and Malaysia, while infrastructure investment will spur high growth in the Philippines and Indonesia [see Table].

[Table: The Outlook for Foreign Economies]

	(%)											
	World		United States		Euro Area		China		NIES		ASEAN	
	SA169R	SA170	SA169R	SA170	SA169R	SA170	SA169R	SA170	SA169R	SA170	SA169R	SA170
2015	3.6		2.6		2.0		6.9		2.2		4.7	
2016	3.2		1.6		1.8		6.7		2.4		4.8	
2017	3.5	3.5	2.4	2.2	1.6	1.7	6.3	6.5	2.4	2.6	4.8	4.9
2018	3.3	3.4	2.5	2.2	1.7	1.7	6.0	6.1	2.6	2.6	4.8	4.9

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

These conditions in overseas markets will encourage higher exports. While inventory levels in transport equipment and other sectors rose temporarily during January–March, domestic production is being sustained by burgeoning global demand for electronic components and devices, not just for smartphones but also for in-vehicle equipment, IoT-related industrial components, and semiconductor-manufacturing machinery. Indeed, global semiconductor shipments in the first quarter of 2017 grew by nearly 20% over year-ago levels, and orders for semiconductor-making equipment are also rising—trends that bode well for Japan’s IT exports.

Looking at domestic factors, the corporate sector will be able to draw on its ample cash on hand to continue gradually expanding capital expenditures. The BOJ's March tankan survey of business sentiment revealed that large manufacturing enterprises were planning to step up spending on plant and equipment. Nonmanufacturing enterprises, on the other hand, were less sanguine about their plans, despite the lack of production and sales facilities, due to a deepening sense of a labor shortage. The unavailability of workers could thwart capital spending, since there is little room for automation or routinization in such people-oriented industries as restaurants, hotels, healthcare, and welfare. The key to further growth will be the extent to which the effective use of new technologies like AI and IoT can contribute to improving labor productivity. As for government spending, there is risk of a slowdown in public works due to a lack of skilled construction workers. We thus anticipate public capital formation to grow between April–June 2017 and January–March 2018 and to begin declining thereafter.

What to look out for in the household sector is whether higher wages will translate positively into increased consumption. The labor market is currently quite tight, with unemployment down to 2.8%—the lowest since June 1994—and the jobs-to-applicants ratio holding high at 1.45. Thanks partly to a strong government push, wages have risen for four straight years. The 2017 spring labor offensive resulted in a 2% hike—including the annual pay rise—which is on a par last year's figures. What was striking, though, was that wages at SMEs rose higher than at larger firms this year, indicating that the trend toward higher pay is spreading to broader sectors of the economy.

There has been a turnaround in personal consumption since the fourth quarter of 2016 in the light of improvements in employment and income. People had grown thrifty since the 2014 hike in the consumption tax—holding off purchases of consumer durables. But the rise in household spending should continue going forward as people replace the appliances they had purchased when the eco-point incentive program was introduced following the Lehman crisis and in the light of the extension in tax breaks for eco-friendly

vehicles. This is not to say, though, that personal consumption will turn robust; consumers remain concerned about their social security and are likely to divert more of their income into savings. Other factors dampening purchases are higher taxes and other payments and the demographic rise in the share of unemployed, senior households. Consumer prices are likely to start rising this fall, and this will further erode the lackluster growth in real household income.

Home purchases are likely to keep declining and will contribute negatively to GDP growth. This is because the impact of inheritance tax deductions will gradually dissipate and because the total number of households in the country is unlikely to grow in the foreseeable future. Our projections anticipate a surge of last-minute buying in the second half of 2018, prior to the scheduled hike in the consumption tax in October 2019.

Core CPI will likely rise from the second half of 2017 as oil prices stabilize, with the value of the yen remaining low and with demand outstripping supply in an expanding economy. The 2% inflation target will remain elusive, though; core CPI should rise by 0.9% in fiscal 2017 and 1.0% the following year. Land prices are moving up in regional hub cities, and increases in real-estate-related lending by regional and other banks need to be watched closely.

There do not appear to be any major risks in Japan's real economy, but overseas developments could pose dangers. The results of the Dutch general elections and the French presidential contest have allayed fears of a divided EU for the time being. The region remains troubled by low growth, high unemployment, growing income gaps, and the influx of refugees, however, and the future of reform efforts remains uncertain. There is a need for continued vigilance regarding European political and economic trends in the face of German federal elections in September and rise of populist parties in Italy. Populist policies that engendered economic and fiscal collapse and other tragic consequences in the past must not be repeated. There are strong, lingering uncertainties about the direction of

US economic policy, and we must also be on guard against such geopolitical threats as North Korea's nuclear weapons program.

Institutional reforms to alleviate people's anxieties about the future and measures to boost growth expectations are needed for Japan to achieve a sustained, domestic-demand-led recovery. With the economy in an expansionary mode, now is the time to advance labor market reforms, deregulation, and other needed restructuring measures to build the foundations for future growth, as well as to carry out a consumption tax hike and social security reforms to chart a path toward fiscal consolidation.

Summary Table of the 170th Quarterly Forecast

四半期／年度／暦年 Quarter / Fiscal Year / Calendar Year	単位 Unit	Forecast																			
		2016				2017				2018				年度(FY) 2015 (実績) Actual	年度(FY) 2016 (実績) Actual	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 (実績) Actual	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 (2011暦年連鎖価格) Real GDE (Chained 2011 Yen)	前期比% ** 前年同期比% ****	0.4 0.9	0.2 1.1	0.3 1.7	0.5 1.6	0.3 1.4	0.4 1.6	0.3 1.5	0.3 1.3	0.1 1.1	0.2 0.8	0.3 0.8	0.3 0.9	1.2	1.3	1.4	0.9	1.1	1.0	1.5	1.0
国内需要 Domestic Demand	寄与度%ポイント ++	0.5	-0.1	-0.0	0.4	0.4	0.5	0.4	0.3	0.1	0.1	0.2	0.3	1.2	0.5	1.3	0.9	0.7	0.4	1.1	1.1
民間最終消費支出 Private Consumption	前期比% **	0.2	0.4	0.0	0.4	0.2	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.5	0.6	1.0	1.0	-0.4	0.4	1.0	1.0
民間住宅投資 Private Residential Investment	前期比% **	3.1	2.7	0.4	0.7	-1.4	-1.2	-1.1	-1.0	-0.5	0.7	1.1	1.8	2.8	6.5	-1.7	-0.6	-1.6	5.6	1.1	-2.6
民間企業設備投資 Private Non-Residential Investment	前期比% **	1.3	-0.2	1.9	0.2	0.7	0.7	0.6	0.5	0.5	0.5	0.4	0.4	0.6	2.3	2.7	2.0	1.1	1.3	2.9	2.2
公的固定資本形成 Public Investment	前期比% **	0.7	-1.3	-3.0	-0.1	2.4	3.5	1.9	0.4	-3.6	-3.1	-1.0	-0.4	-1.9	-3.2	4.2	-4.4	-2.1	-3.0	1.2	-0.5
外需 Net Exports of Goods & Services	寄与度%ポイント ++	-0.1	0.4	0.4	0.1	-0.1	-0.1	-0.1	-0.0	0.0	0.0	0.0	0.0	0.1	0.8	0.1	0.0	0.4	0.6	0.4	-0.1
財貨・サービスの輸出 Exports of Goods & Services	前期比% **	-1.4	1.9	3.4	2.1	0.5	0.3	0.4	0.4	0.6	0.7	0.7	0.7	0.7	3.1	4.8	2.2	2.9	1.2	6.0	1.9
財貨・サービスの輸入 Imports of Goods & Services	前期比% **	-1.1	-0.2	1.3	1.4	1.0	0.9	0.8	0.6	0.4	0.4	0.4	0.4	0.2	-1.4	3.9	2.1	0.8	-2.3	3.4	2.5
名目国内総支出 GDE at Current Prices	前期比% ** 前年同期比% ****	0.2 1.3	0.1 1.0	0.4 1.6	-0.0 0.8	0.3 0.8	0.5 1.2	0.4 1.2	0.3 1.5	0.2 1.4	0.3 1.2	0.4 1.2	0.2 1.1	2.7	1.2	1.2	1.2	3.2	1.3	1.0	1.3
鉱工業生産指数 Indices of Industrial Production	前期比% **	0.3	1.6	1.8	0.2	1.6	0.3	0.2	0.3	0.4	0.4	0.4	0.4	-0.9	1.1	3.4	1.3	-1.2	-0.1	3.8	1.5
企業物価指数 Corporate Goods Price Index	前年同期比% ****	-4.5	-3.8	-2.1	1.0	1.9	2.3	2.0	0.5	0.4	0.3	0.3	0.3	-3.3	-2.3	1.7	0.3	-2.3	-3.5	1.8	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	-0.3	0.2	0.5	0.9	1.0	1.0	1.0	1.0	1.0	0.9	0.0	-0.2	0.9	1.0	0.5	-0.3	0.7	1.0
名目雇員報酬 Compensation of Employees	前期比% ** 前年同期比% ****	0.1 2.2	0.7 2.3	0.3 2.2	-0.2 0.8	1.0 1.7	0.3 1.4	0.4 1.6	0.3 2.1	0.4 1.4	0.5 1.6	0.5 1.6	0.3 1.6	1.5	1.9	1.7	1.6	1.3	2.3	1.4	1.7
完全失業率 Unemployment Rate	% *	3.2	3.0	3.1	2.9	2.9	2.9	2.9	2.9	2.9	2.8	2.8	2.8	3.3	3.0	2.9	2.8	3.4	3.1	2.9	2.8
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	-0.005	0.072	0.050	0.050	0.050	0.050	0.050	0.050	0.050	0.050	0.288	-0.046	0.050	0.050	0.360	-0.051	0.056	0.050
日経平均株価 Nikkei Stock Average	円 / yen	16,394	16,500	17,952	19,245	19,113	19,167	19,230	19,288	19,340	19,371	19,390	19,412	18,855	17,519	19,200	19,378	19,204	16,920	19,189	19,347
IMFベース経常収支 Current Account Balance (IMF)	千億円/100 Billion yen* 名目GDP比% **	47.4 3.5	48.6 3.6	51.5 3.8	52.4 3.9	51.0 3.8	50.3 3.7	49.7 3.6	49.4 3.6	48.6 3.5	47.6 3.5	46.9 3.4	46.7 3.4	178.6 3.4	202.0 3.8	189.3 3.5	176.1 3.2	162.4 3.1	203.4 3.8	195.3 3.6	177.2 3.2
対ドル円レート Yen to US Dollar Exchange Rate	円/ドル yen / dollar	108.0	102.4	109.5	113.6	110.0	110.0	110.0	110.0	110.0	110.0	110.0	110.0	120.1	108.3	110.0	110.0	121.1	108.8	110.9	110.0
WTI原油価格 WTI Crude Oil Price	ドル/バレル dollar / barrel	45.6	44.9	49.3	51.8	51.8	52.7	53.4	54.0	54.4	54.9	55.3	55.7	45.1	47.9	53.0	55.1	48.8	43.5	52.4	54.7
米国実質国内総支出 U.S. Real GDP	前期比年率% ***	1.4	3.5	2.1	0.7	3.2	2.5	2.3	2.0	2.2	2.2	2.2	2.2	2.2	1.7	2.3	2.2	2.6	1.6	2.2	2.2
中国実質国内総支出 China Real GDP	前年同期比% ****	6.7	6.7	6.8	6.9	6.5	6.3	6.2	6.2	6.1	6.1	6.0	6.0	6.9	6.8	6.3	6.0	6.9	6.7	6.5	6.1

(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