

# The Medium-term Outlook for the Japanese Economy (FY2008 to FY2020)

## -During the ten years after the collapse of the global economic bubble-

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The longest recovery phase after WWII has ended, and the economy has entered a deep recession unparalleled in history. The once-in-a-century phenomenon of financial crisis is adversely affecting world economic growth. In the background, the global economic bubble—sustained by the mechanisms of excess consumption and huge current account deficits in the U.S., rapid industrialization of newly emerging economies, and the recycling of funds back into the U.S.—is collapsing.

Until around 2010, the global economy under the shock from the collapse of the world economic bubble will continue the sluggish growth centering on advanced countries, and newly emerging countries will experience significantly low growth rates. In line with the sluggish world economy, Japan's economy will also record low growth. Decline in exports will curb production and smaller corporate revenues will restrain fixed investment. Furthermore, with suppressed wages it will also be difficult for private consumption to increase.

The global economy should begin to show recovery in the early half of the 2010s, leading to a gradual increase of exports and fixed investment. The rate of global economic growth, however, will not reach 5%, and the rate of Japan's economic growth will remain at the lower 1% level. Because of the continuing decrease in population and sluggish income growth of the mature economy, the increase in private consumption will remain low.

<Per annum>	FY2001~2005 (Actual)	FY2006~2010 (Forecast)	FY2011~2015 (Forecast)	FY2016~2020 (Forecast)
Real GDP growth rate	1.3%	0.7%	1.1%	0.4%
Nominal GDP growth rate	0.0%	0.5%	1.4%	1.0%
GDP deflator growth rate	-1.3%	-0.2%	0.4%	0.6%

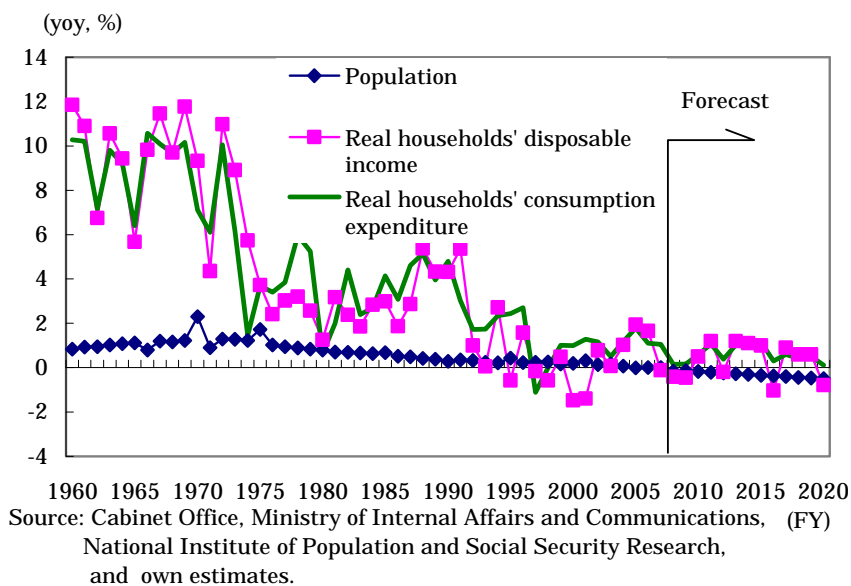
In the latter half of the 2010s, the continuing development of the aging population and diminishing number of children in Japan will—focused on private consumption—be a factor in

further restraining the country's economic growth rate, while at the same time globally, demographics will have stronger negative effects on economic growth. The pace of economic growth in China will slow down, which will affect Japan's exports severely. As such, the growth rate during the latter 2010s will decline to 0% levels.

Corporate activities function as the engine for economic growth. After resolving the negative legacy left by the collapse of the bubble in the 1990s, boosted by the high growth of the global economy, Japanese companies increased their exports and fixed investment to realize the longest recovery phase after WWII. However, with the collapse of the global economic bubble, the corporate sector is experiencing a rapid decline in exports and production. The rate of capacity utilization is falling, and as the issue of overcapacity develops under the deteriorated corporate revenues, fixed investment will continue to dwindle for a while. In the early 2010s, corporate activities should begin to pick up following the recovery of the global economy, but as the economy is unlikely to regain the level of thrust experienced in the middle of 2000s, the ability of the corporate sector to lead the economy will weaken. Furthermore, in the latter half of the 2010s the slowing pace of expansion of the Chinese economy—a significant export market for Japan—will hinder corporate activities in Japan through the shrinkage of exports. As such, the economic growth in the latter half of the 2010s will be lower than that of the first half of the decade.

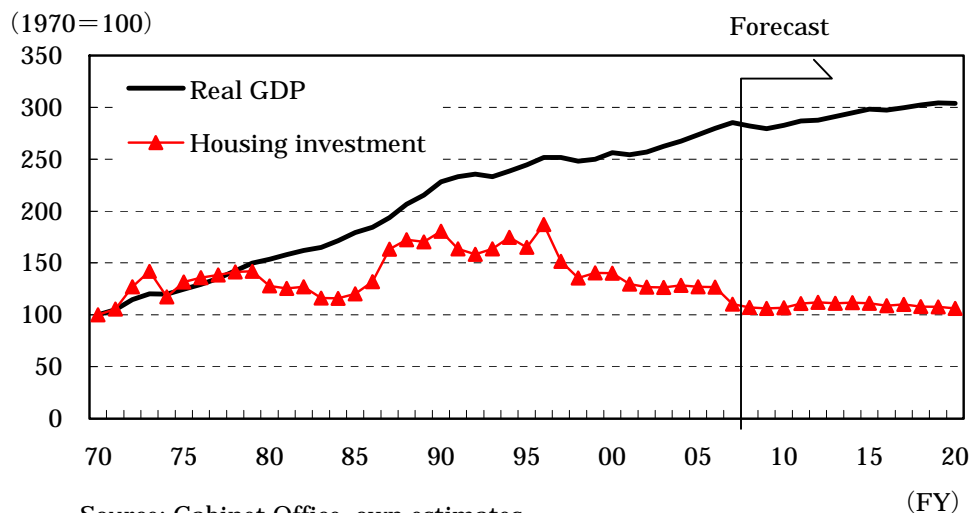
Since the early 1970s, when the high-growth period ended and Japan began to shift toward a mature economy, the economic activities of the household sector changed significantly. Passing through the refraction points of events such as the first “Oil Shock”, the economic slump after the bursting of the economic bubble, an increase in the consumption tax rate, etc., private consumption continued to decrease its pace of growth (Chart 1).

**Chart1: Changes in Population, income and private consumption**



In the background were factors such as a shrinking population growth rate due to the diminishing number of children, dissemination of durables in households, the falling expenditures of each household due to an aging population, and a slower pace of income increase brought on by the slowdown of economic expansion. Private consumption used to be a factor showing a gradual and steady increase in providing underlying support for economic growth, but currently its contribution is notably low. Housing investment has also changed from their increasing trend of the mid 1970s (Chart2). When the high-growth period ended, migration from rural areas to cities decreased, and the increase in the number of households slowed. On the other hand, housing stocks relative to the number of households increased, and the vacancy rate continued to rise. Housing investment may increase at times such as a bubble economy, or simply as a fad with a housing loan tax cut. However, as a general trend it is difficult to assume housing investment will recover to the pace seen in the high-growth period. Indeed, housing investment has been declining in the past ten years.

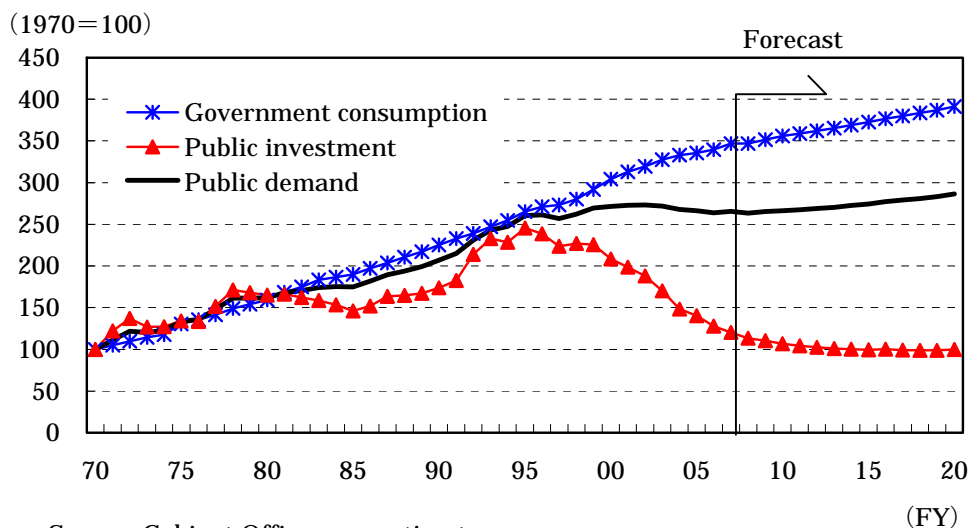
**Chart2: Housing investment and Real GDP growth**



The role of the government is changing as the population ages and a mature society appears. Public works investment may seem to be the most significant performance by the government in terms of fiscal measures, but in reality, it has been continually decreasing since having reached a peak in 1995. It is currently at levels recorded around 1970. In addition to the fundamental purpose of public works investment, which is to provide social capital essential to people's lives, it expanded from the 1970s to the 1990s to stimulate and pump up the economy during recession. However, as the fiscal positions of both national and local governments tightened, such a stimulus policy became difficult to implement for raising the growth rate. As fiscal restoration became a major political issue, public investment was actually suppressed (Chart3). However, the government final consumption expenditures, including social security expenditures, have

increased almost simultaneously. The government is making efforts to suppress final consumption expenditures as well, but these seem unlikely to decrease in the current aging society. While the scale of public works investment has contracted to a mere 3 to 4 percent of GDP, the government final consumption expenditures now comprise almost 20 percent of GDP, becoming a significant item in GDP statistics alongside fixed investment. The major role of the government is to shift from providing social capital through public works investment to the rendering of social security to the people through government final consumption, and this trend may continue. The public demand comprised of the combined volume of public works investment and government final consumption expenditures has not increased so much since the mid 1990s, and such characteristics have become even clearer after the "Koizumi structural reform." Government spending is not able to contribute to economic growth any more. Indeed, it was not government spending but private sector demand that performed the major role in realizing the longest economic recovery phase after WWII.

**Chart3: Change in government expenditure**



Source: Cabinet Office, own estimates.

The question is if the ten years after the collapse of the global economic bubble will become a lost decade after all, or it will be a period of change, which finds a new formula of growth for the world and Japan's economies. Japan's economy will experience a crucial decade of facing contracting demand, a battered household sector, and redefining the importance of the existence of government.

\*This is an English summary of a report originally published on November 12, 2008. The full report is available only in Japanese, but the author will answer questions regarding the topic by e-mail.

\*The information and the views contained herein are subject to change without notice.



Summary of Projections (2)

	Actual												Forecast												Per annum	
	2004	05	06	07	08	09	10	11	12	13	14	15	16	17	18	19	20	01~05	06~10	11~15	16~20					
(FY)																										
Current account	18.2	19.1	21.2	24.5	19.5	26.2	25.4	25.0	25.1	25.3	25.4	25.2	23.7	23.0	22.1	21.0	19.9	16.0	23.4	25.2	21.9					
Trade balance	13.2	9.6	10.5	11.7	7.4	14.8	13.3	13.4	13.6	14.0	14.3	14.6	13.4	13.0	12.5	11.8	10.9	11.2	11.5	14.0	12.3					
Current account surplus as of GDP	3.7	3.8	4.1	4.8	3.8	5.1	4.9	4.8	4.7	4.7	4.6	4.6	4.2	4.1	3.9	3.6	3.4	3.2	4.6	4.7	3.8					
Industrial production	3.8	1.6	4.6	2.6	-6.5	2.8	2.1	-1.8	0.7	1.2	1.2	1.6	-3.6	2.4	1.2	0.9	-0.4	0.3	-0.8	0.8	0.1					
Consumer prices	0.0	-0.3	0.2	0.4	1.4	-0.1	0.2	0.6	2.2	0.5	0.6	0.5	3.0	0.4	0.5	0.5	2.1	-0.4	0.4	0.9	1.3					
excluding fresh food	-0.1	-0.1	0.1	0.3	1.5	-0.1	0.2	0.6	2.2	0.5	0.6	0.5	3.0	0.4	0.5	0.5	2.1	-0.4	0.4	0.9	1.3					
Domestic corporate goods prices	1.6	1.7	2.1	2.2	3.8	-1.0	1.3	0.6	2.5	0.7	0.6	0.5	3.3	0.6	0.6	0.6	2.4	-0.3	1.7	1.0	1.5					
Disposable income	0.4	1.2	1.3	-0.2	0.0	-1.3	-0.1	1.2	1.4	1.2	1.2	1.1	1.3	1.0	0.7	0.7	0.8	-0.5	-0.1	1.2	0.9					
Propensity to consume	96.6	96.3	95.7	96.8	97.4	98.0	98.1	97.8	98.4	98.2	98.0	98.2	99.4	99.2	99.0	98.9	99.8	95.9	97.2	98.1	99.3					
Wages per employee	-0.3	0.7	0.1	-0.3	-0.2	-0.9	-0.1	0.7	1.0	0.7	0.7	0.6	0.9	0.5	0.5	0.5	0.7	-1.1	-0.3	0.7	0.6					
Unemployment rate	4.6	4.3	4.1	3.8	4.1	4.6	4.6	4.4	4.3	4.1	4.0	3.9	3.8	3.8	3.7	3.6	4.9	4.3	4.1	3.7	3.7					
Labor distribution rate	51.4	51.6	51.7	51.5	52.1	51.0	50.7	50.4	50.3	50.1	49.9	49.7	49.5	49.3	49.0	48.8	48.6	52.5	51.4	50.1	49.0					
New housing starts	119.3	124.9	128.5	103.6	109.9	107.9	108.4	112.9	113.2	113.5	113.0	112.9	111.9	112.8	112.0	111.8	110.6	118.7	111.7	113.1	111.8					
Owned	36.7	35.3	35.6	31.2	32.5	32.0	32.1	32.8	33.5	34.4	33.6	33.0	32.9	33.0	32.8	32.3	31.7	36.7	32.7	33.5	32.5					
Rented	46.7	51.8	53.8	43.1	45.5	44.9	45.1	45.6	45.3	45.1	45.6	45.9	45.5	45.7	45.5	45.3	45.2	46.8	46.5	45.5	45.4					
Built for sale	34.9	37.0	38.3	28.3	30.9	30.1	30.2	33.5	33.4	33.0	32.8	33.0	32.5	33.1	32.7	33.2	32.8	34.3	31.5	33.1	32.9					
Issued	0.9	0.9	0.9	1.0	1.0	0.9	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	0.9	1.0	1.0	1.0					
Sales (Corporate sector)	5.6	4.6	7.3	1.5	-2.8	-5.2	2.6	2.6	-0.2	1.3	1.5	1.8	-0.5	1.3	1.1	1.0	-0.5	0.7	0.6	1.3	0.5					
Current profits	24.6	8.4	10.0	-3.3	-18.0	-15.4	10.7	17.2	-6.6	3.5	4.8	5.3	-10.8	0.9	0.6	-0.5	-11.4	6.4	-3.9	4.6	-4.4					
Ratio of current profit to sales	3.7	3.9	4.0	3.8	3.2	2.9	3.1	3.5	3.3	3.4	3.5	3.6	3.2	3.2	3.2	3.2	2.8	3.2	3.4	3.5	3.1					
Land price	-7.1	-4.9	-2.0	-0.8	-4.5	-2.0	-1.0	-0.5	-0.3	-0.4	0.5	0.6	0.8	0.6	0.6	0.8	0.6	-6.9	-2.1	0.0	0.7					
Discount rate	0.10	0.10	0.075	0.075	0.030	0.030	0.030	0.050	0.075	0.075	0.075	0.125	0.125	0.075	0.075	0.075	0.075	0.10	0.30	0.10	0.30					
Short-term interest rate	0.001	0.001	0.208	0.505	0.100	0.100	0.100	0.300	0.300	0.500	1.000	1.000	0.500	0.500	0.500	0.500	0.500	0.003	0.100	1.000	0.500					
Long-term interest rate	1.52	1.43	1.77	1.60	1.45	1.30	1.40	1.50	1.50	1.60	1.60	1.50	1.30	1.40	1.40	1.30	1.20	1.31	1.50	1.54	1.32					
Yen exchange rate	107.5	113.3	116.9	114.2	99.5	90.3	95.0	93.0	91.0	89.0	87.0	85.0	84.0	83.0	82.0	81.0	80.0	116.2	103.2	89.0	82.0					
World economic growth	4.9	4.5	5.1	5.0	3.5	1.7	3.2	3.6	3.7	3.8	3.8	3.8	3.5	3.5	3.4	3.3	3.1	3.6	3.7	3.7	3.4					
Oil price (WTI near delivery)	45.1	60.0	64.9	82.2	86.7	59.3	71.8	74.0	76.0	78.0	80.0	82.0	84.0	86.0	88.0	90.0	92.5	37.9	73.0	78.0	88.1					

Note: Forecasts for discount rate and short-term interest rate are as of the end of fiscal year; actual figures for world economic growth rate are data from IMF; figures for disposable income and propensity to consume for FY2006 and FY2007 are own forecasts.