

# Medium-Term Outlook for the Japanese Economy (Fiscal 2011 to Fiscal 2020)

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Mitsubishi UFJ Research and Consulting Co., Ltd. (MURC), announced its medium-term outlook for the Japanese economy on January 12, 2012. While this forecast has its base in previous medium-term outlooks, it takes account of the effects of new developments, including the Great East Japan Earthquake, which occurred in March 2011, and the financial crises in Europe, and provides a medium-term prognosis for the Japanese economy through fiscal 2020.

## **I. Effects of the Great East Japan Earthquake**

Reconstruction and recovery in the wake of the Great East Japan Earthquake will require enormous expenditures. Cumulative government allocations for recovery included in the supplementary budget for fiscal 2011 and the regular budget for fiscal 2012 are expected to total about 18 trillion yen. These expenditures will contribute to giving the economy a boost through public works investment, including infrastructure repairs and improvements.

However, even though the necessary funds are ready, they cannot necessarily be used immediately. Thus far, disposing of the debris that resulted from the disaster has taken considerable time, and the reconstruction of the infrastructure has moved only slowly. Moreover, even though local governments in the stricken areas are hurrying to prepare recovery plans, it has been difficult to win the approval of major recovery plans that would involve moving the residents of these areas to higher ground. Looking ahead, it is likely that the recovery will take time and move forward at a slow pace. In the interim, the population may move away from these areas, and, as a result, there is a possibility that the recovery activities will be smaller in scale than initially planned.

The way that recovery takes place in the stricken areas may become a model case for regional redevelopment for the future of Japan, where demographic trends are forecast to include continued declines in the birthrate and aging of the population. In addition, it is expected that new approaches to revitalizing the agricultural and fishery industries will be introduced. However, these various initiatives will only give a boost to the economy, as demand for reconstruction and recovery rises, and probably will not contribute to promoting structural reforms or boosting Japan's potential growth rate.

On the other hand, the nuclear accidents caused by the earthquake and tsunami have given rise to the issue of power shortages, and Japan is confronted with the need to review its energy strategy. These circumstances may have a considerable impact on Japan's future. If the restarting of nuclear power plants that are now out of service is delayed, or the decision is made not to restart them, it is conceivable that this may basically have only a small impact on economic activity for a number of reasons, including energy conservation initiatives and approaches, the increased use of thermal power generation, and other measures. Despite this, it is certain that electric power rates will rise along with the shift to thermal power generation and the movement toward purchasing renewable energy, and, as a result, costs will rise for both corporations and households. At the same time, however, higher costs will have the positive impact of encouraging capital investment for installing or expanding in-house power generating facilities and other investments for energy conservation.

## **II. Summary of the Medium-Term Outlook**

When forecasting medium-term trends in the Japanese economy, we have assumed that the consumption tax will be increased to 8% in April 2014, from 5% now, and then to 10% in April 2016. In addition, we believe that to maintain the social security system subsequently, further consumption tax increases will be necessary and have, therefore, assumed a further rise to 13% in April 2018 and yet another to 15% in April 2020.

During the first half of the outlook period (fiscal 2011 to fiscal 2015), we are forecasting that average annual real GDP growth will remain weak at +0.8% (Chart 1). As a result of the Great East Japan Earthquake, in fiscal 2011, the outlook is for negative real growth, but from fiscal 2012 through fiscal 2013, the economy is expected to attain annual growth rates between about 1.5% and 2.0%. However, as a result of the increase in the consumption tax in fiscal 2014, the rate of growth is forecast to decline substantially. Next, in the latter half of the forecast period (fiscal 2016 to fiscal 2020), in part because of the planned three successive increases in the consumption tax, the average real GDP growth rate is expected to slow to +0.5%. Although this will be higher than the average of +0.2% in the latter half of the first decade of the 2000s (fiscal 2006 to fiscal 2010) when growth was negative for two consecutive years, through fiscal 2020, growth in the Japanese economy on average is forecast to fall below 1%.

**Chart 1: Medium-Term Outlook for the Principal Components of GDP**

(Average, %)

	Fiscal 2001 to 2005 (Actual)	Fiscal 2006 to 2010 (Actual)	Fiscal 2011 to 2015 (Forecast)	Fiscal 2016 to 2020 (Forecast)
Real GDP growth rate	1.2	0.2	0.8	0.5
Domestic (percentage point contribution)	0.8	-0.2	0.7	0.4
Personal consumption	1.2	0.5	0.5	0.3
Capital investment	1.7	-1.7	2.2	1.2
Government consumption	1.9	1.2	1.0	1.0
Public investment	-7.2	-3.1	-0.6	-0.2
External (percentage point contribution)	0.4	0.3	0.1	0.1
Exports	6.5	2.4	3.8	2.4
Imports	3.2	0.2	4.0	2.0
Nominal GDP growth rate	-0.2	-1.1	0.4	0.8
GDP deflator	-1.4	-1.2	-0.4	0.2
Per capita GDP (real)	1.1	0.1	1.0	1.0

Sources: Cabinet Office, *Annual Report on National Accounts of National*;  
 Ministry of Public Management, Home Affairs, Posts and Telecommunications, *Population Estimates*

This weakness in growth will not be just the result of the increases in the consumption tax. Other factors that will act to restrain growth in the Japanese economy in the medium term will be (1) slowing rates of growth in overseas economies, (2) the trends toward a declining birthrate and demographic aging, and (3) the accelerated movement of companies to overseas locations. Although the increases in the consumption tax, natural disasters, and other circumstances may cause some fluctuations in the magnitude of real GDP growth, on average, the settling down of the growth rate will be determined by the three factors just mentioned. The potential growth rate of the Japanese economy is expected to weaken gradually from about +0.9% in the first half of the 2010s (fiscal 2010 to fiscal 2015) to approximately +0.7% in the latter half.

During the forecast period, the real growth rate is forecast to be slightly less than the potential growth rate. For this reason, after the exclusion of the effects of the increases in the consumption tax, pressures for price increases will continue to be weak.

### III. Outlook for the World Economy

There are other countries where further declines in the birthrate are forecast to restrain growth, and it is viewed as certain that the world's population growth will become more moderate in the years ahead. It has been pointed out previously that these changes in population dynamics will bring a slowing of the world's economic growth rate. Recently also, other constraints on growth have emerged, including fiscal issues, the tightening of financial regulations, and

resource price hikes. For this reason, it will be difficult for the world growth rate, which rose to a high 5% during the period from 2004 to 2007, to attain this rate again. Instead, world growth is likely to gradually slow in the years ahead (Chart 2).

**Chart 2: Growth Rates in World Economies**  
(On a purchasing power basis, annualized rate of growth)

(Unit: %)

	2006 ~ 2010	2011 ~ 2015	2016 ~ 2020
<b>World</b>	3.5	3.9	3.7
<b>Industrialized countries</b>	1.1	2.1	1.9
United States	0.7	2.4	2.3
Europe	0.7	1.2	1.0
Japan	0.3	0.8	0.5
Other countries	3.2	3.6	3.2
<b>Emerging countries</b>	6.5	5.8	5.3
Asia as a whole	9.2	7.3	6.4
China	11.2	8.7	7.0
Former Soviet Union (Russia, etc.)	4.1	4.4	3.9
Middle East	4.9	4.3	4.7
Central America, South America (Brazil, etc.)	4.0	4.1	3.6

Note: The classification by industrialized and emerging countries follows the International Monetary Fund (IMF) definitions. Data through 2010 were sourced from the IMF. Data for 2011 and subsequent years are MURC forecasts.

Source: IMF

Among the various issues for the time being, the fiscal problems of the European nations present the risk of posing the strongest restraints on world economic growth. The financial crises in Europe, which became a problem in 2011, will be difficult to bring under control in the short term, and there are concerns that they may cause a delay in the recovery of European economies. The issues behind these financial problems of European countries include twin deficits in fiscal and current accounts. Since these countries are making up for their government's shortages of funds with capital inflows from overseas, if sovereign risks increase and the inflow of capital from other countries stops, it will be difficult for them to raise funds on their own initiative.

However, this risk is not confined to Europe. For example, Brazil and India, which are both emerging countries with high rates of economic growth, have relatively large deficits in their fiscal balances and the current accounts of their balance of payments, and potentially could have the same problems as Europe. For this reason, to avert the crises faced by European countries, there is a possibility that they may join the worldwide movement toward the restructuring of government finances. If a movement toward fiscal austerity and reducing government expenditures, along with a trend toward cutting fiscal deficits by increasing taxes emerges, the rate of growth in the world economy will weaken.

Next, the tightening of financial regulations may also be a restraining factor for the world economy. To prevent a worldwide financial crisis, such as the one that occurred after the collapse of Lehman Brothers Holdings, the third set of regulations on banking institutions conducting international financial transactions (Basel III) is scheduled to come into effect in stages, beginning in 2013. For this reason, banks will have to increase their capital to raise their capital adequacy ratios or reduce their risk assets. However, for the principal European and U.S. banks, whose capital has been impaired by the financial crises in Europe, it will be difficult to increase their capital through the issuance of equity, and there is already evidence that they are beginning to reduce their risk assets. Going forward, if this movement to lower risk asset balances grows stronger, sufficient funds may not be available to meet the high level of demand for financing among the emerging countries. As a result, there is a possibility that rates of growth in those countries may be restrained.

Last, it has been pointed out that the high level of raw materials prices will expand the income differential between resource-producing and other countries and that this may place restraints on economic development in the emerging countries. Since resource prices have been rising for a number of years, the sense of burden on many countries of purchasing food products, gasoline, and other necessities has grown. If resource prices remain at high levels, it is conceivable that this could become a factor restraining economic activity in countries other than resource-producing nations.

(2012.2.1)

\*This is an English summary of a report originally published on January 12, 2012. 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.