

Japanese Economic Outlook

Surviving “the Age of Turbulence”

One Trouble After Another



Conference of Business Economists

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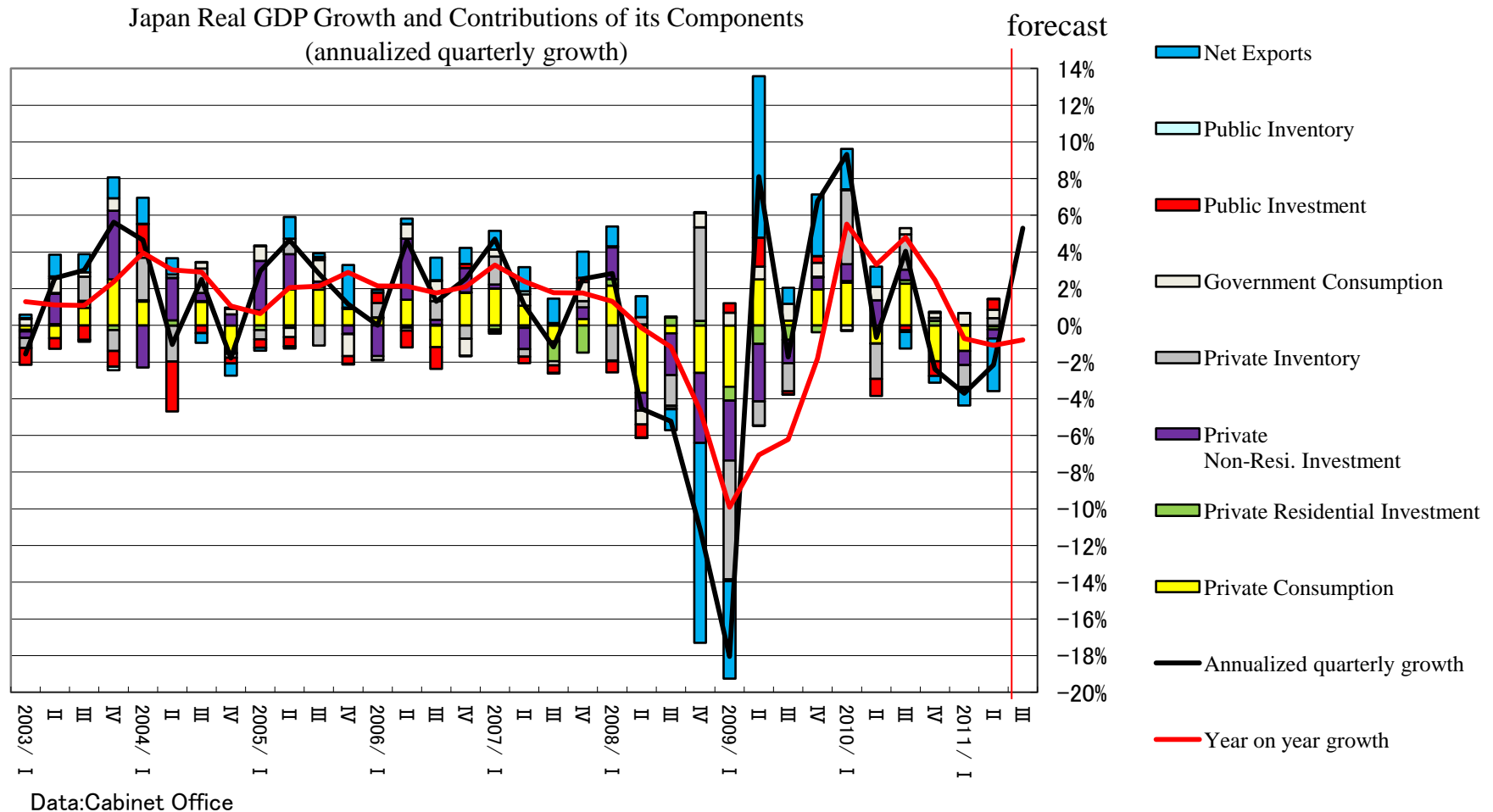
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1, Japanese Economic Outlook

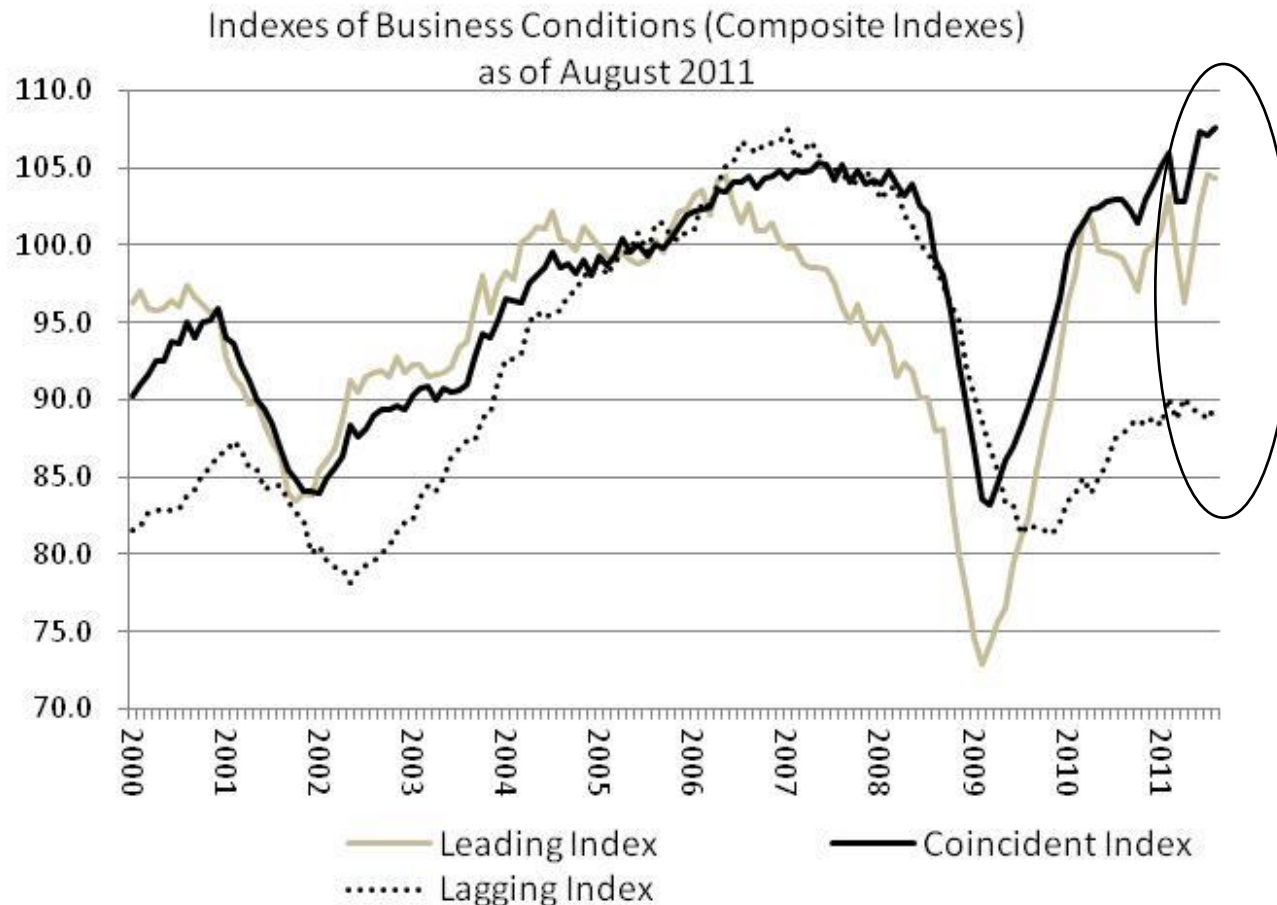
The real GDP growth of the 2nd quarter was -2.1% due to after effects of the earthquake disaster. However the growth of the 3rd quarter, which will be released on Nov.14th, is expected to be +5.3% (annualized base, forecast by JCER) boosted by the restoration demands. JCER forecasts: GDP growth -0.6% for 2011, +2.3% for 2012. <http://www.jcer.or.jp/eng/index.html>



Contributions to Changes in Real GDP (seasonally adjusted series)										(Unit:%)		
		Private Consumption	Private Residential Investment	Private Non-Resi. Investment	Private Inventory	Government Consumption	Public Investment	Public Inventory	Net Exports	Annualized quarterly growth	Year on year growth	Chnages from the previous year
2003/ I		-0.2%	-0.1%	-0.4%	-0.6%	0.3%	-0.9%	0.0%	0.2%	-1.6%	1.3%	
II		-0.7%	0.1%	1.7%	0.0%	0.8%	-0.6%	0.1%	1.2%	2.6%	1.1%	
III		1.0%	0.3%	0.1%	1.3%	0.2%	-0.8%	-0.1%	1.0%	3.0%	1.1%	
IV		2.5%	-0.3%	3.7%	-1.1%	0.7%	-0.9%	-0.2%	1.1%	5.6%	2.4%	1.5%
2004/ I		1.3%	0.1%	-2.3%	2.3%	0.3%	1.6%	0.0%	1.4%	4.7%	4.0%	
II		0.0%	0.3%	2.3%	-2.0%	0.0%	-2.7%	0.2%	0.9%	-1.0%	3.0%	
III		1.3%	0.1%	0.4%	1.3%	0.3%	-0.4%	0.0%	-0.5%	2.5%	2.9%	
IV		-1.5%	-0.1%	0.6%	-0.2%	0.3%	-0.3%	0.1%	-0.7%	-1.8%	1.0%	2.7%
2005/ I		0.8%	-0.3%	2.7%	-0.5%	0.8%	-0.5%	0.0%	-0.2%	3.0%	0.6%	
II		2.0%	-0.1%	1.9%	0.8%	-0.5%	-0.5%	-0.1%	1.2%	4.7%	2.1%	
III		1.9%	0.2%	0.3%	-1.1%	1.2%	0.1%	0.1%	0.2%	2.8%	2.1%	
IV		0.9%	0.1%	-0.5%	0.0%	-1.2%	-0.4%	0.0%	2.3%	1.2%	2.9%	1.9%
2006/ I		0.4%	0.0%	-1.7%	0.8%	-0.2%	0.6%	0.0%	0.1%	0.0%	2.1%	
II		1.4%	-0.1%	3.3%	-0.2%	0.8%	-0.9%	0.0%	0.3%	4.6%	2.1%	
III		-1.2%	0.0%	0.3%	1.0%	1.1%	-1.2%	0.0%	1.2%	1.3%	1.8%	
IV		1.8%	0.0%	1.3%	-0.7%	-0.9%	0.2%	0.0%	0.9%	2.5%	2.1%	2.0%
2007/ I		2.0%	-0.2%	0.2%	1.5%	0.4%	-0.1%	-0.1%	1.0%	4.7%	3.3%	
II		1.1%	-0.1%	-1.2%	-0.4%	0.6%	-0.4%	0.2%	1.3%	1.1%	2.4%	
III		-0.9%	-1.1%	0.0%	0.1%	-0.2%	-0.4%	0.0%	1.3%	-1.2%	1.8%	
IV		0.3%	-1.5%	0.6%	0.3%	1.0%	0.2%	0.0%	1.4%	2.5%	1.8%	2.3%
2008/ I		2.2%	0.4%	1.7%	-1.9%	0.0%	-0.6%	0.1%	1.1%	2.8%	1.3%	
II		-3.7%	0.1%	-1.0%	0.4%	-0.8%	-0.7%	0.0%	1.1%	-4.6%	-0.1%	
III		-0.4%	0.4%	-2.3%	-1.7%	-0.1%	0.1%	0.0%	-1.1%	-5.2%	-1.2%	
IV		-2.6%	0.2%	-3.8%	5.1%	0.8%	0.0%	0.1%	-10.9%	-11.1%	-4.7%	-1.2%
2009/ I		-3.3%	-0.8%	-3.3%	-6.5%	0.7%	0.5%	-0.1%	-5.3%	-18.1%	-9.9%	
II		2.5%	-1.0%	-3.1%	-1.3%	0.7%	1.6%	0.0%	8.8%	8.1%	-7.1%	
III		0.3%	-0.8%	-1.3%	-1.5%	0.9%	-0.2%	0.0%	0.9%	-1.7%	-6.2%	
IV		2.0%	-0.4%	0.7%	0.0%	0.7%	0.4%	0.0%	3.4%	6.8%	-1.8%	-6.3%
2010/ I		2.3%	0.1%	0.9%	4.0%	-0.3%	0.0%	0.0%	2.2%	9.3%	5.5%	
II		-1.0%	0.0%	1.4%	-1.9%	0.7%	-0.9%	0.0%	1.1%	-0.7%	3.3%	
III		2.3%	0.2%	0.6%	1.9%	0.3%	-0.3%	-0.1%	-0.9%	4.0%	4.8%	
IV		-2.0%	0.3%	0.0%	0.2%	0.3%	-0.8%	0.1%	-0.4%	-2.4%	2.5%	4.0%
2011/ I		-1.4%	0.0%	-0.8%	-1.2%	0.6%	-0.1%	0.0%	-0.9%	-3.7%	-0.7%	
II		-0.1%	-0.2%	-0.5%	0.4%	0.4%	0.6%	0.0%	-2.9%	-2.1%	-1.1%	
III												
IV												

The indexes of business conditions show that the economic activities have recovered over the pre-quake level.

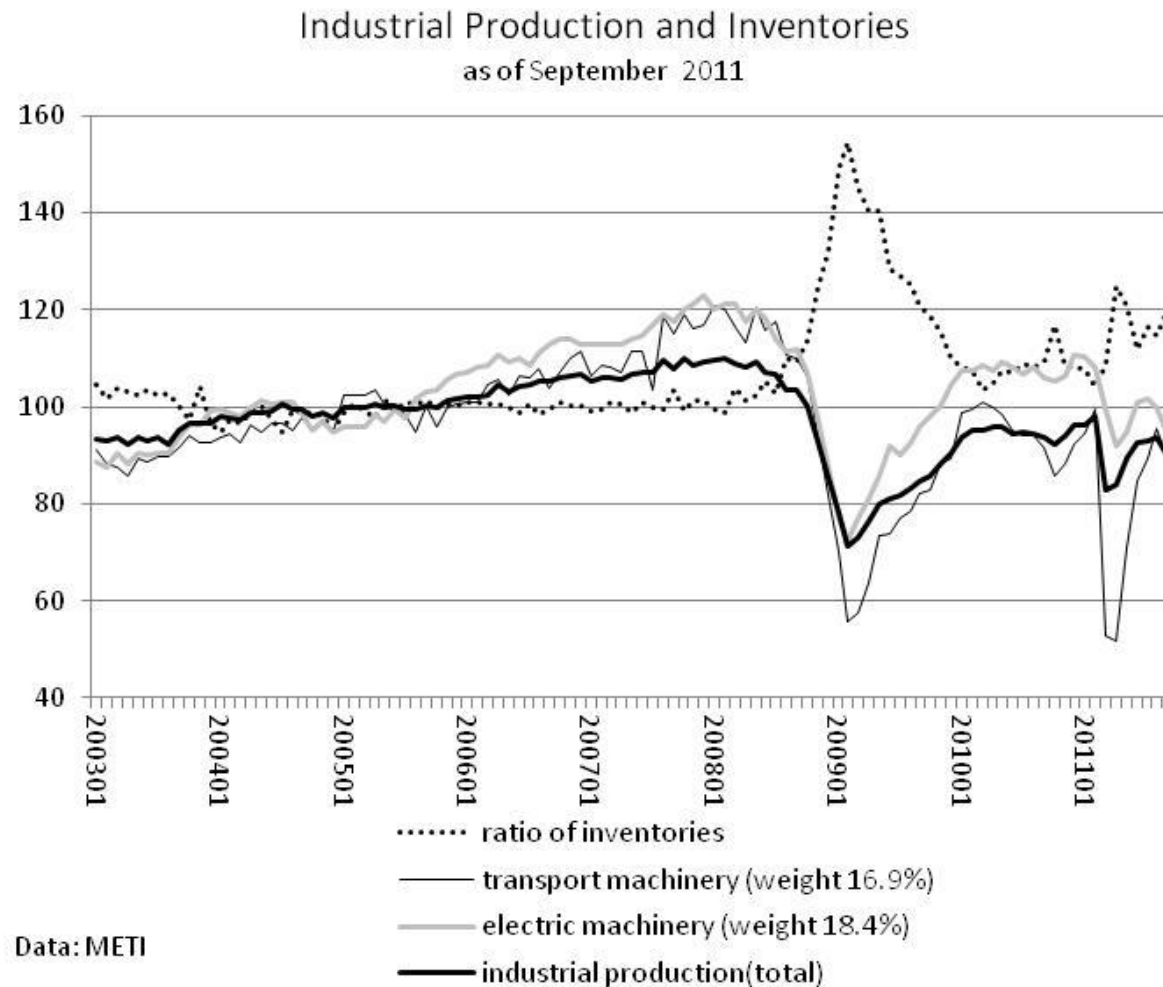
However the indexes are expected to be revised down for technical reasons. It is more realistic to think that the economy recovered nearly to the same level with the before-disaster level by October.



Data: Cabinet Office

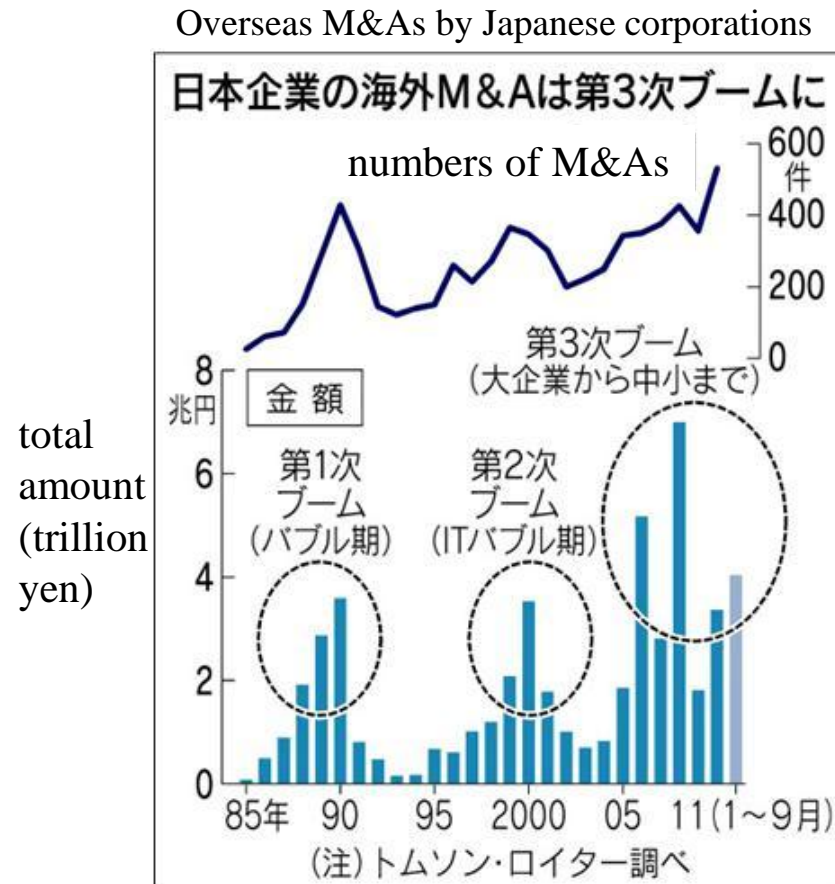
The industrial production has not recovered to the pre-quake level because of (1) slowdown of overseas demands (2) appreciation of Yen.

The manufacturing sector is shifting their production sites to the emerging countries.



Japanese companies are increasing M&As overseas not only to increase their share in the emerging markets but to deal with appreciation of Yen.

Graph from Nikkei News Paper dated Oct.13 2011



The exports (real term) recovered remarkably in the 3rd quarter. However it waned in August due to the world economic slowdown.

Figures From BOJ Monthly Report of Recent Economic and Financial Developments Oct.2011

(1) Breakdown by Region

		y/y % chg.		s.a.; q/q % chg.					s.a.; m/m % chg.		
		CY 2009	2010	2010 Q3	2011 Q4	2011 Q1	2011 Q2	2011 Q3	2011 Jun.	2011 Jul.	2011 Aug.
United States	<15.4>	-32.6	24.2	3.9	0.3	-6.5	-10.3	20.9	15.8	4.2	2.7
EU	<11.3>	-34.6	16.8	2.9	2.2	-3.0	-2.6	11.9	10.4	2.2	-2.2
East Asia	<53.3>	-15.8	31.6	1.3	2.4	-1.1	-6.1	5.3	6.1	2.5	-2.5
China	<19.4>	-10.2	31.0	3.5	6.9	0.5	-11.1	8.8	8.2	5.3	-2.0
NIEs	<23.7>	-18.0	27.8	-0.3	-0.4	-2.3	-2.6	2.2	5.1	0.1	-3.4
Korea	<8.1>	-16.0	23.6	1.3	-4.9	1.1	1.6	-2.8	3.2	-4.1	-3.4
Taiwan	<6.8>	-17.7	36.8	-0.5	-0.9	-2.4	-6.9	-2.6	0.3	-0.5	-5.9
Hong Kong	<5.5>	-18.8	28.7	-2.4	2.4	-4.0	-6.7	9.3	6.5	5.0	0.1
Singapore	<3.3>	-21.6	19.7	4.1	7.0	-6.6	0.2	17.7	22.2	5.6	-4.1
ASEAN4 ³	<10.2>	-20.5	42.6	1.3	-0.1	-1.7	-3.4	5.8	4.4	3.0	-1.8
Thailand	<4.4>	-20.9	46.0	1.9	-0.1	1.6	-1.7	4.8	8.0	-2.2	7.5
Others	<20.0>	-32.1	29.1	-3.2	-2.0	0.2	-4.2	10.5	14.4	-4.4	3.7
Real exports		-25.6	27.4	0.3	0.2	-1.1	-5.6	7.4	8.5	0.3	0.1

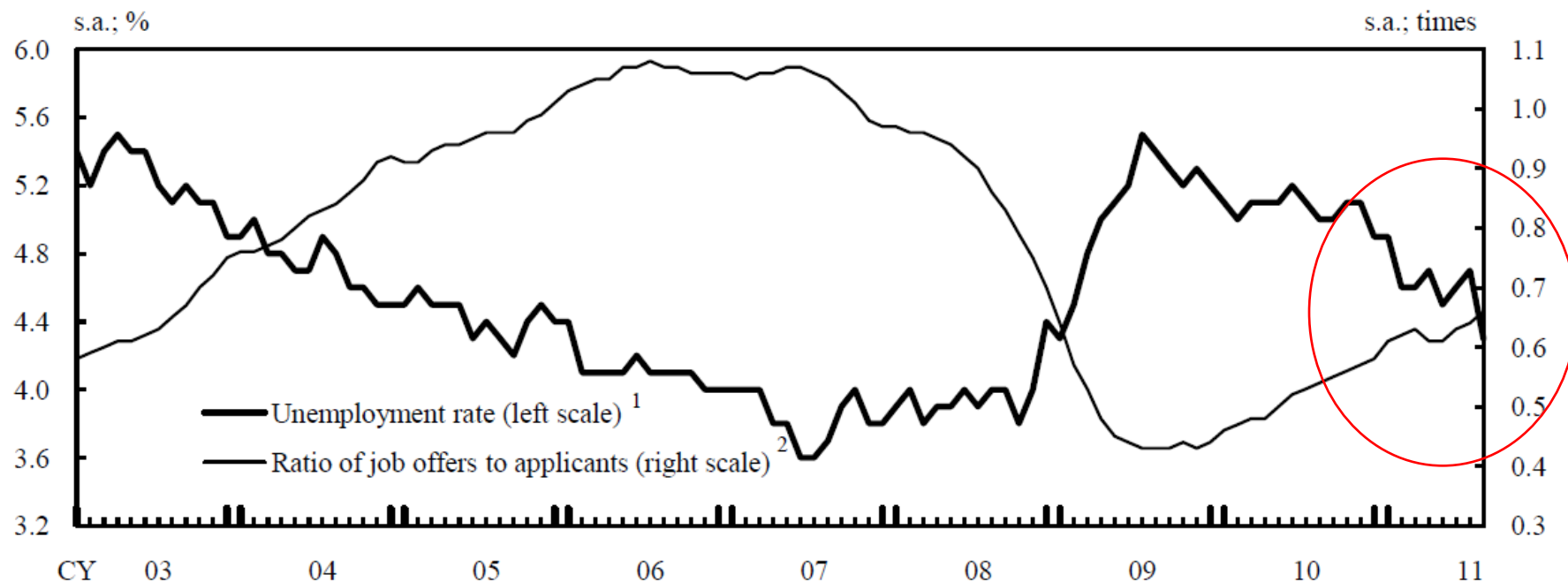
(2) Breakdown by Goods

		y/y % chg.		s.a.; q/q % chg.					s.a.; m/m % chg.		
		CY 2009	2010	2010 Q3	2011 Q4	2011 Q1	2011 Q2	2011 Q3	2011 Jun.	2011 Jul.	2011 Aug.
Intermediate goods	<20.6>	-5.6	18.4	0.8	-0.2	-0.5	-4.6	-2.3	-2.3	2.5	-1.8
Motor vehicles and their related goods	<21.6>	-41.4	42.1	1.2	1.8	-8.8	-22.8	43.4	34.5	8.2	3.0
Consumer goods ⁴	<3.4>	-28.8	10.9	1.3	-1.7	-1.5	-9.1	35.5	32.4	8.7	-4.2
IT-related goods ⁵	<10.7>	-17.0	27.2	-0.8	-0.5	0.5	-2.5	5.0	2.9	3.3	-4.5
Capital goods and parts ⁶	<29.2>	-28.1	35.7	1.9	0.6	1.4	1.6	-1.5	3.5	-4.9	0.6
Real exports		-25.6	27.4	0.3	0.2	-1.1	-5.6	7.4	8.5	0.3	0.1

The labor conditions have improved gradually and the unemployment rate declined to 4.1 in September.

Graph from BOJ Monthly Report of Recent Economic and Financial Developments Oct.2011

(1) Unemployment Rate and Ratio of Job Offers to Applicants



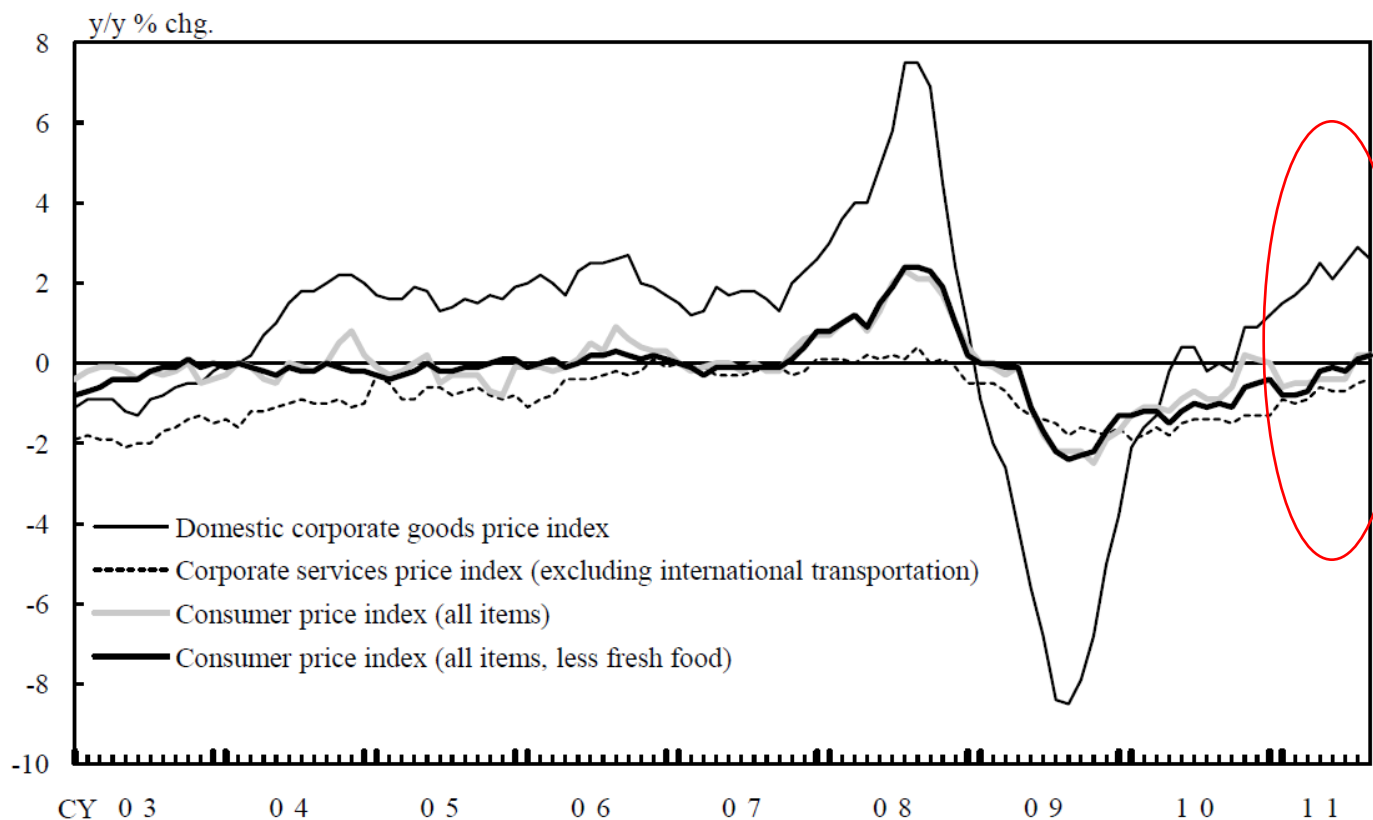
CPI(all items less fresh food) rose 0.2% (y-o-y base) in September.

According the latest forecast of BOJ, the current monetary policy with zero interest rate is likely to continue through 2013.

Graph from BOJ Monthly Report of Recent Economic and Financial Developments Oct.2011

Average forecast of
policy board members
of BOJ as of Oct.2011

CPI(all items less fresh
food, y-o-y)
fiscal 2012 +0.1%
fiscal 2013 +0.5%

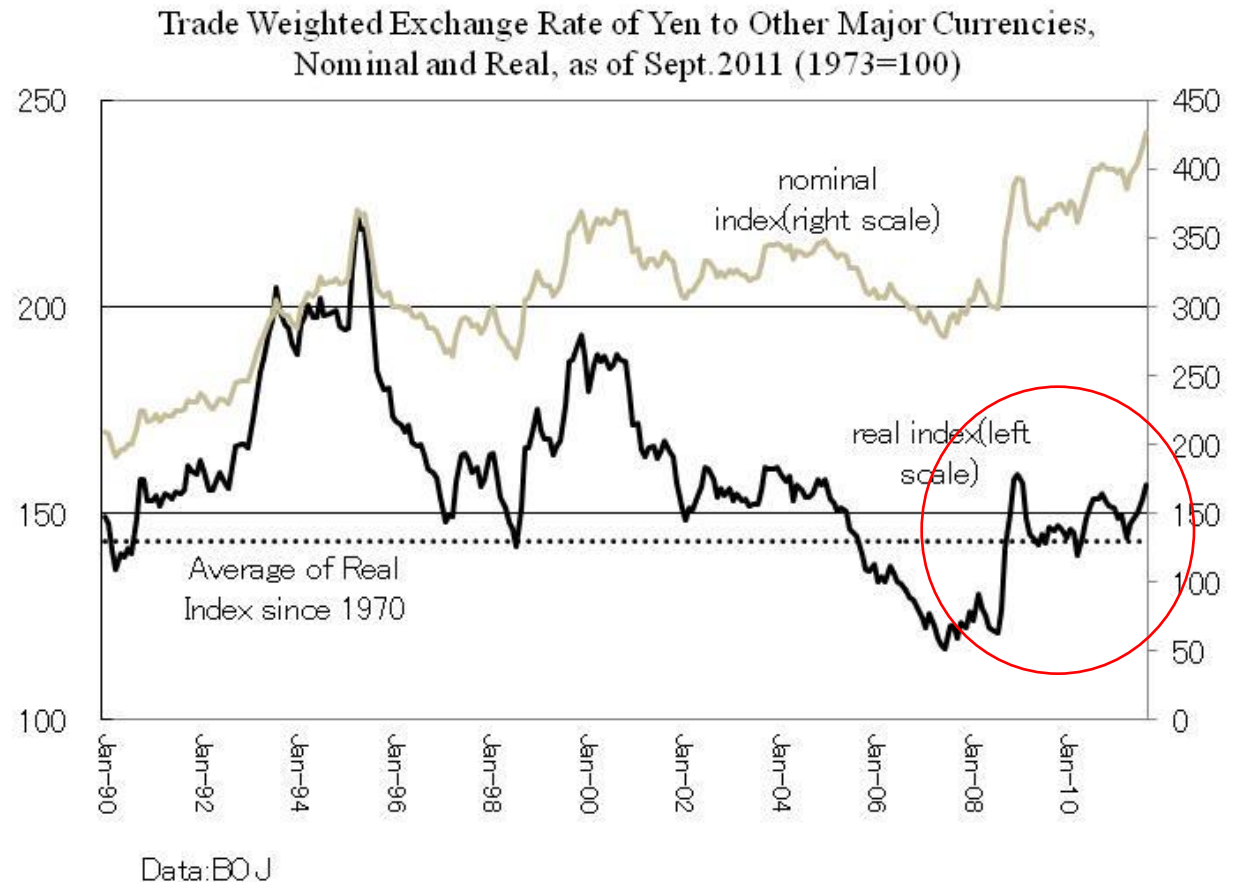


2, Appreciation of Yen

The current level of Yen (real effective exchange rate) is about 10% higher than the average since 1970. It is only moderately higher compared with the overshooting appreciation in 1995.

However its impact to the manufacturing sector seems to be underestimated if we judge based on the REER because of the following reasons:

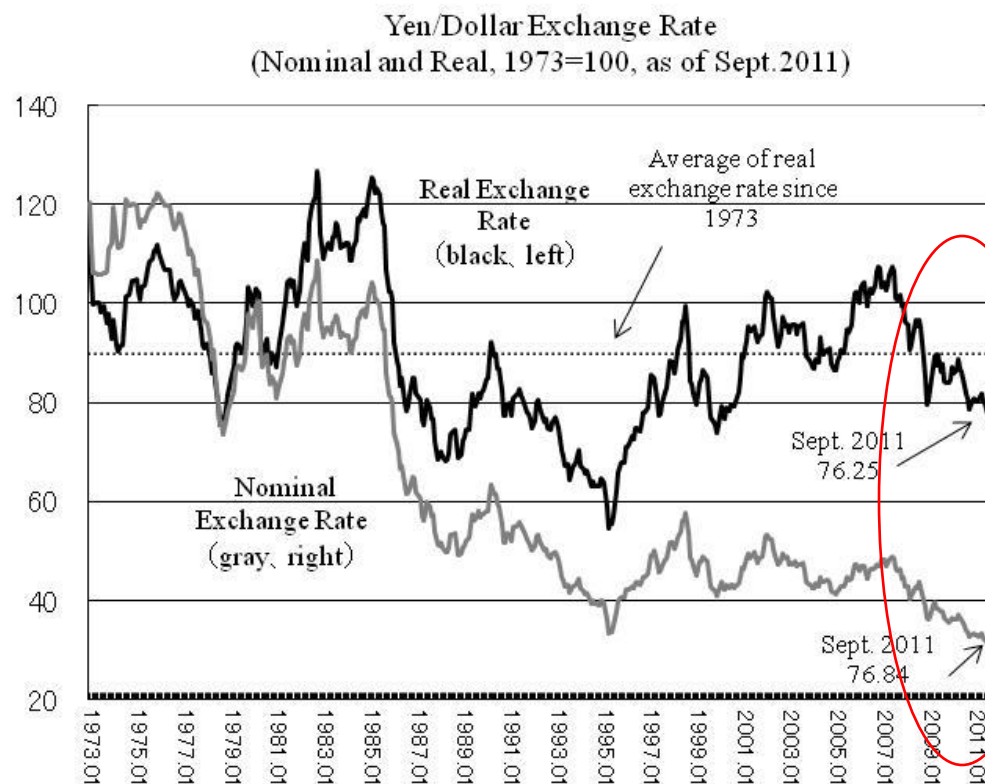
- (1) the REER is calculated based on CPIs and not on traded goods
- (2) remarkable depreciation of Korean Won is making price competition more severer for Japanese major export makers (auto and electronics) which are in competition with Korean ones.



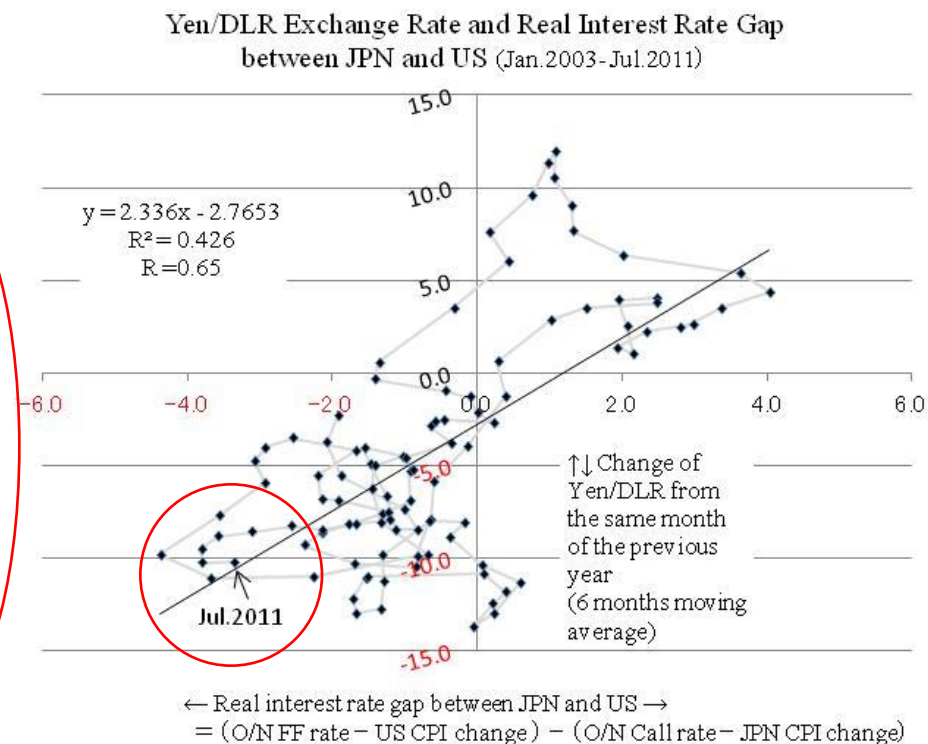
The exchange rate of Korean Won against Yen has declined nearly to the half level since its peak of 2007. This change has caused a significant impact on price competition between “Toyota, Panasonic, Sony” and “Samsung, Hyundai”.



The real exchange rate of Yen against DLR is 15% higher than the average since 1973. There has been a moderate correlation between Yen/DLR movements and the real interest rate gap between Japan and the US since 2003 (the correlation is not stable in a longer term). It suggests that a pressure for higher Yen(weaker DLR) will remain until the end of the exceptional easing monetary policy of FRB. My forecast range of Yen/DLR until the end of 2012 is \$1=¥70-85. Intervention by the Japanese Government may be able to prevent Yen from further appreciation but it is not expected to push Yen lower substantially.



Data: BOJ(Japan), Bureau of Labor Statistics(USA)
Japan: based on Corporate Goods Price Index
USA: based on Producer Price Index

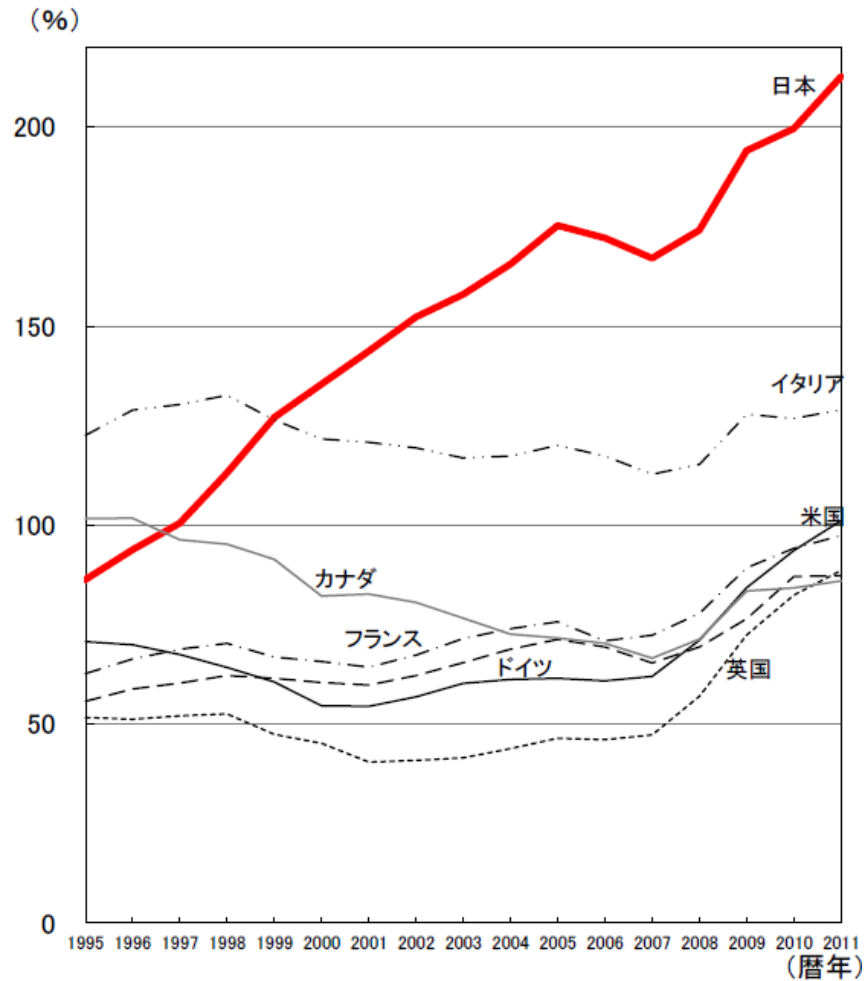


Data: FRB, BOJ, US Labor Dept, JPN Health Labor & Welfare Ministry

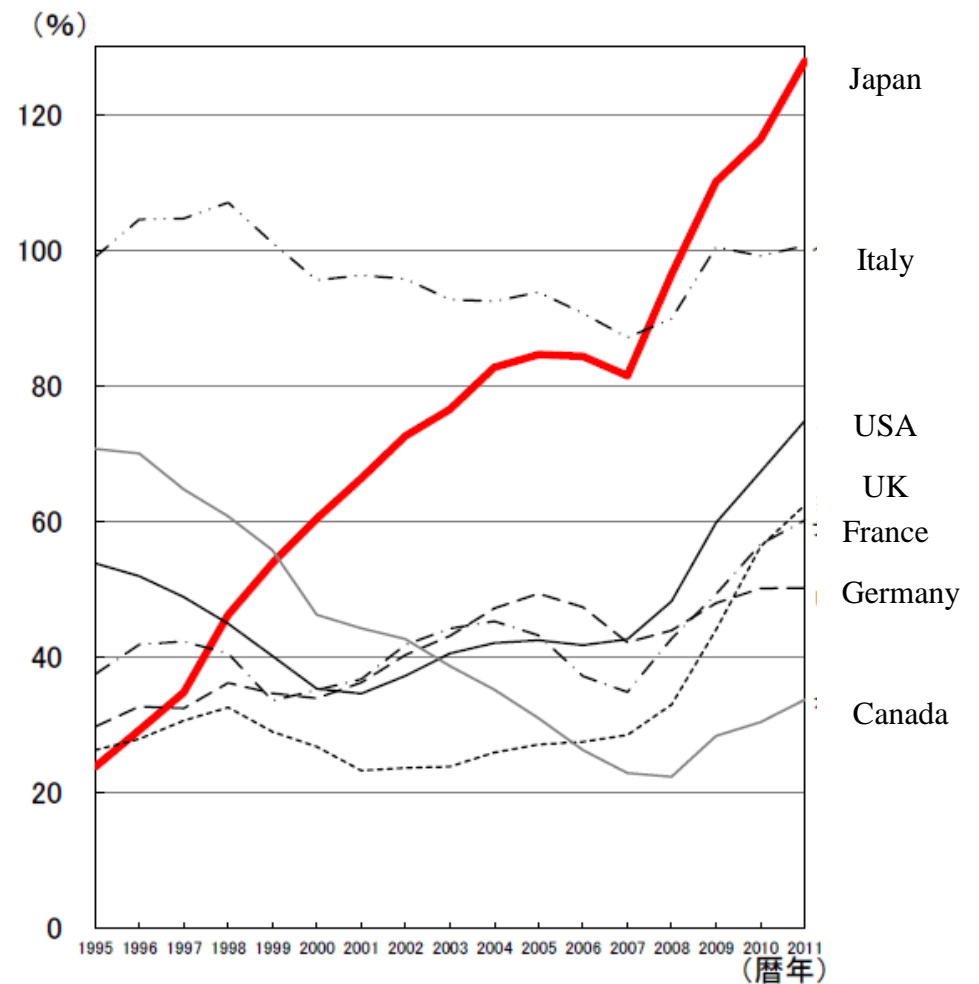
3, Concern of the growing government debts in Japan

Debt/GDP ratio of general governments

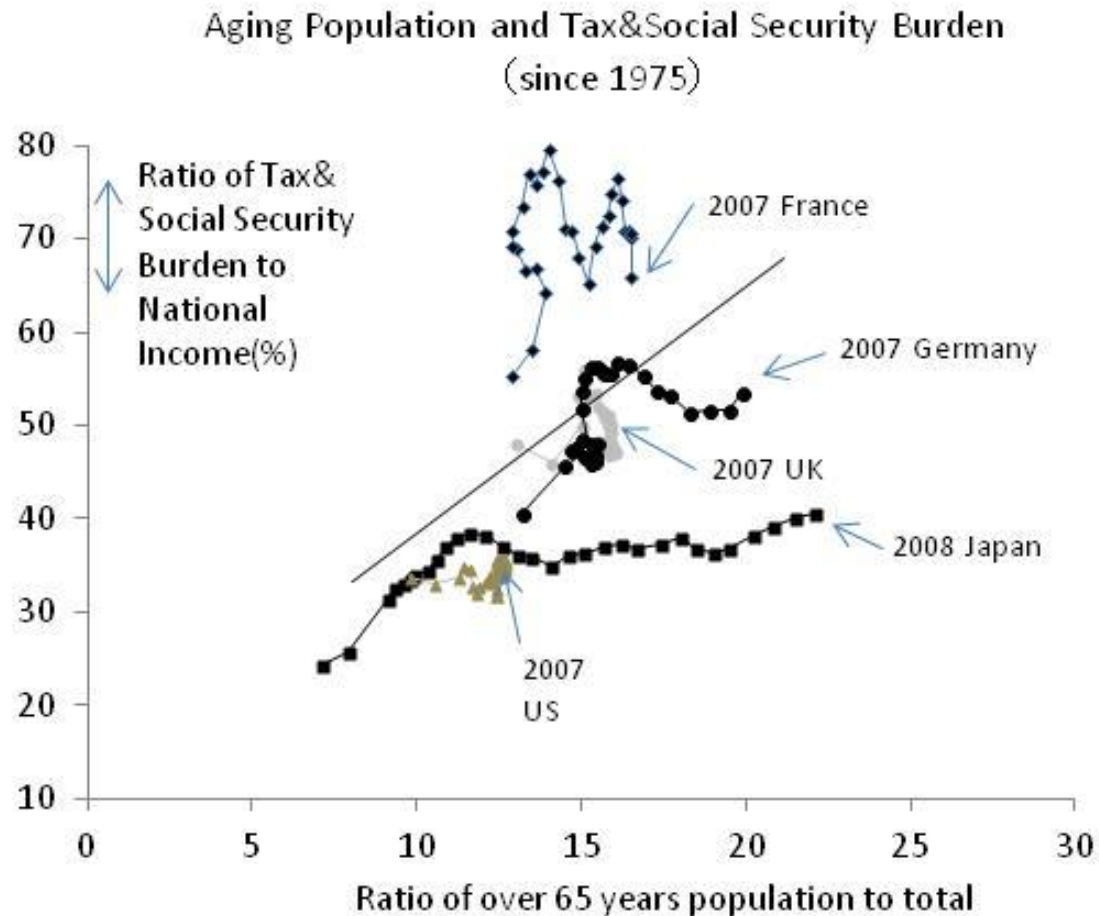
Gross Debt



Net Debt



Main reason for the budget deficit is that Japanese government has failed politically to increase tax & social security charge in line with the growing benefit expenditure due to the ageing population.

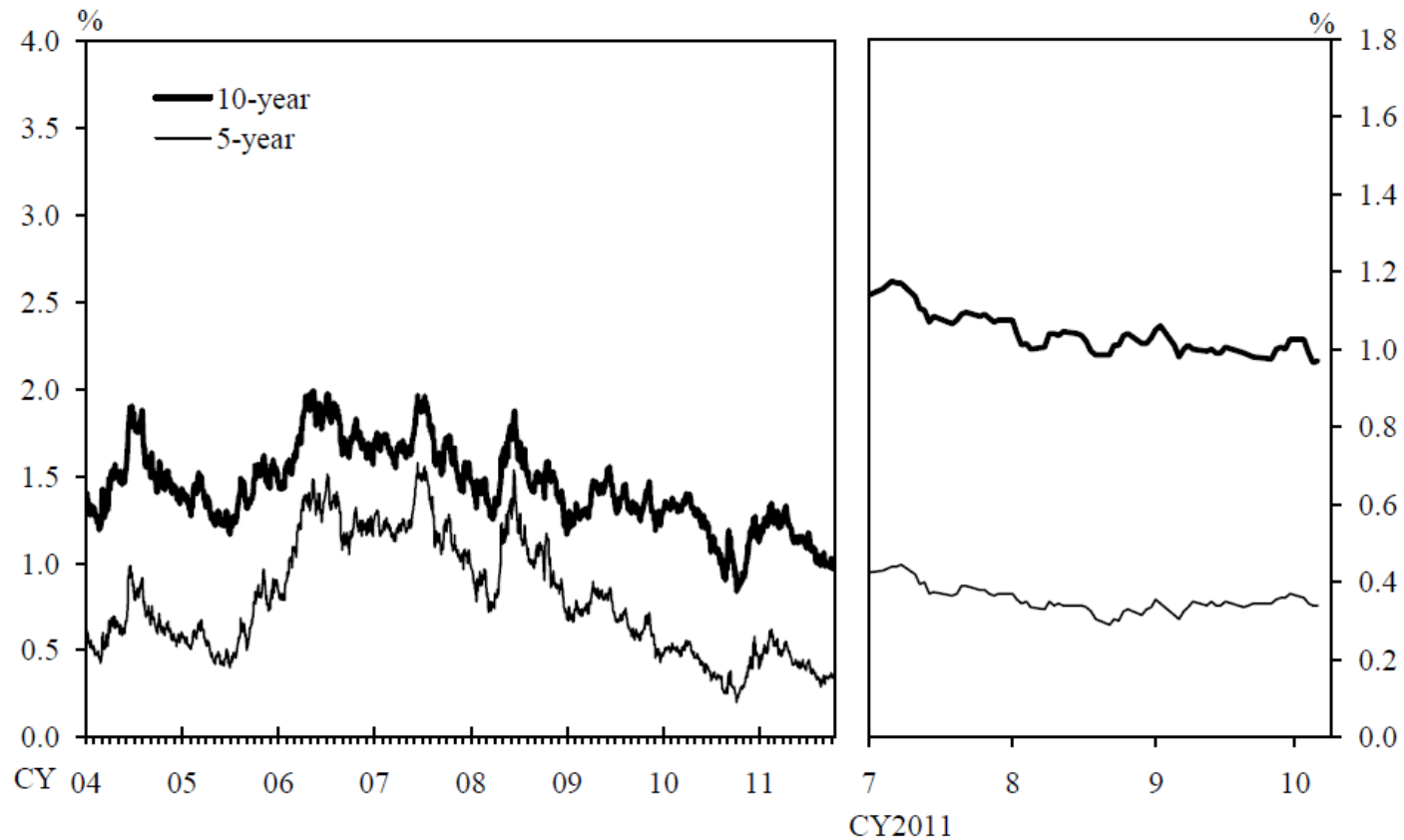


Noda cabinet is planning 5% hike of consumption tax to 10% by 2015 and social security reform. But it is facing persistent resistance in its own party.

Yields of Japanese government bonds have remained at low level in spite of the growing government debts. Why?

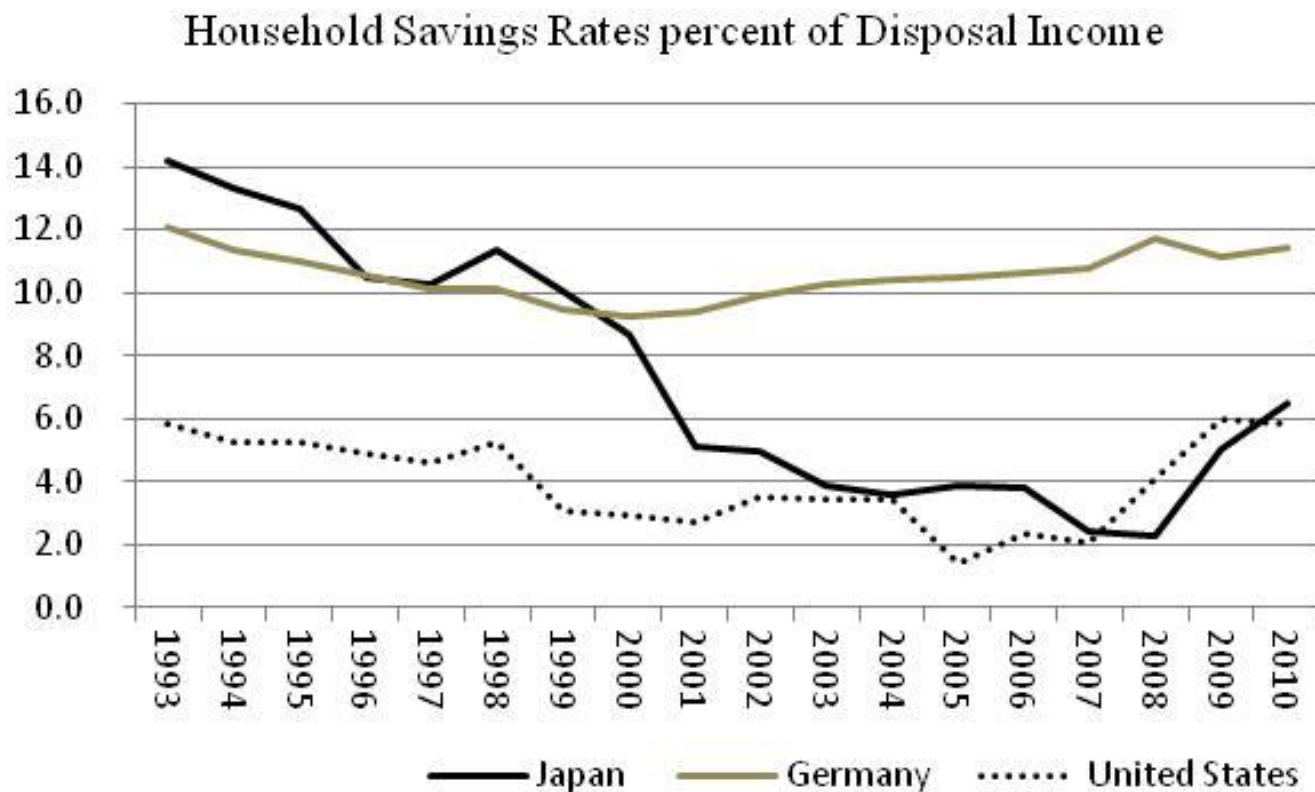
Graph from BOJ Monthly Report of Recent Economic and Financial Developments Oct.2011

(1) Japanese Government Bond Yields¹



If you think that the government debts are financed by the high savings rate of households in Japan, it is not correct.

The gross financial assets of Japanese households is nearly 1500 trillion yen(\$19.2 trillion) and still very large. But its outstanding is almost stable in the 2000's and the household savings rate is not high anymore. Therefore newly increased government debts in the last decade have been financed by the other sector. What is it?

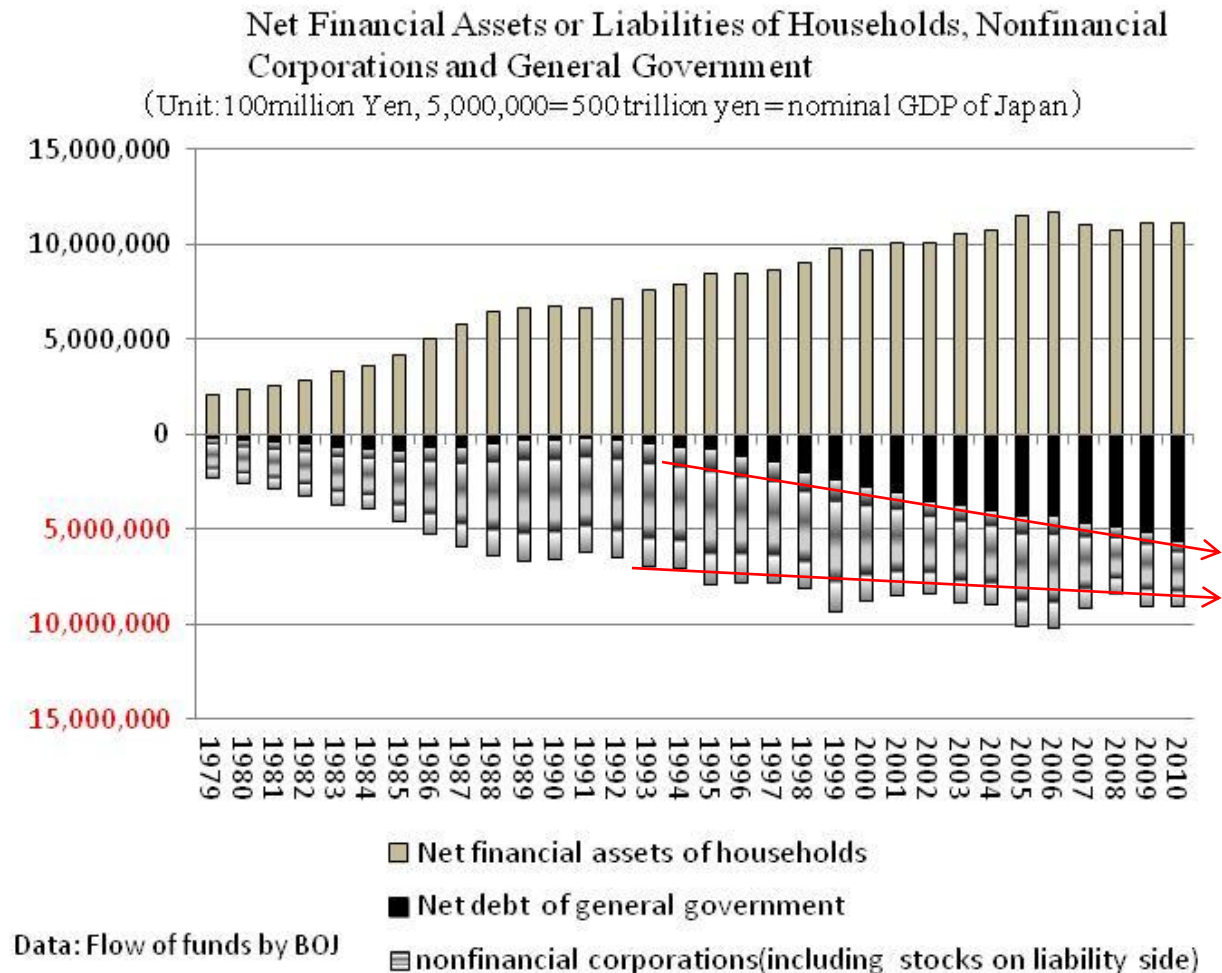


Data:OECD Economic Outlook 89 database

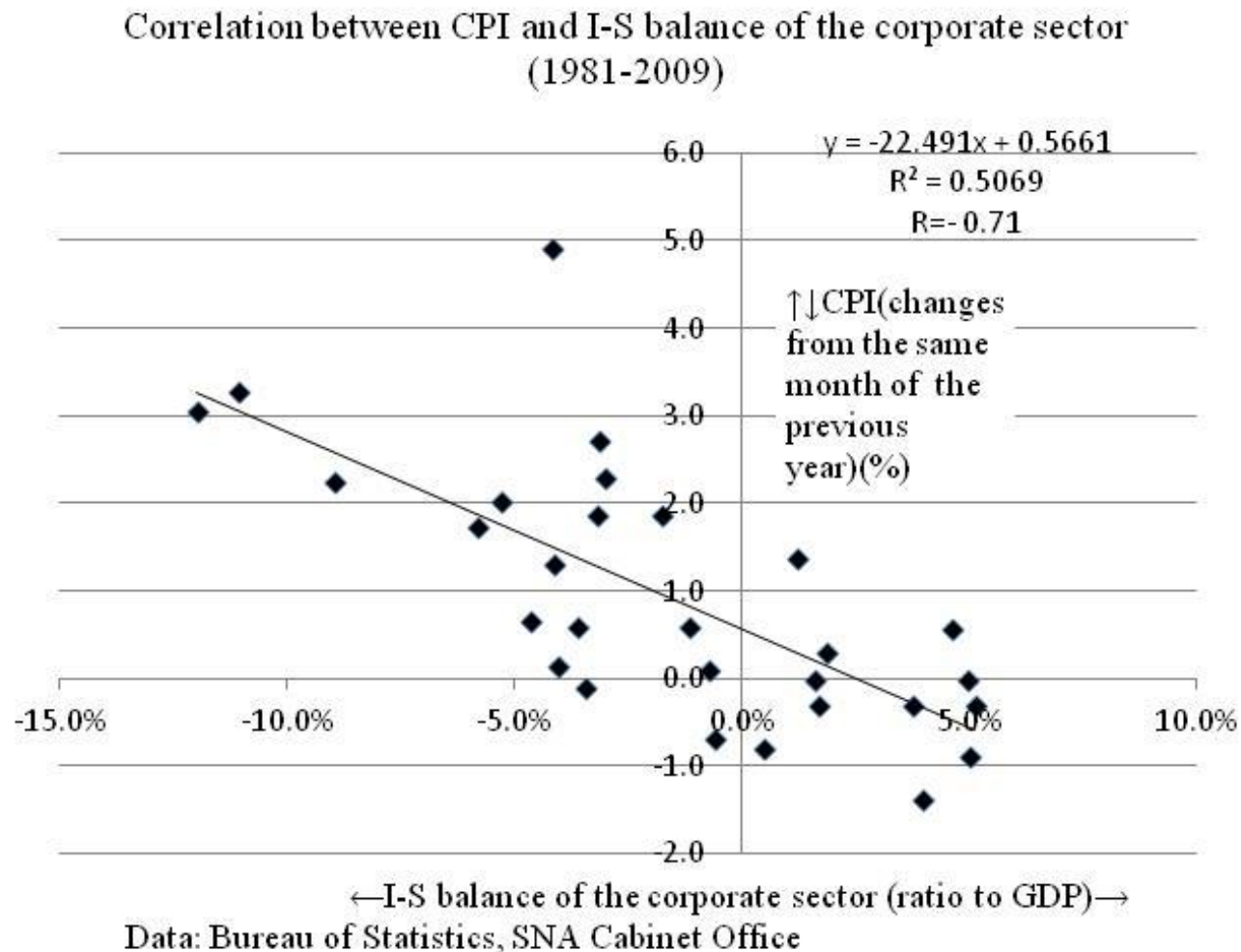
The newly increased government debts in the 2000's have been financed by over-savings of the corporate sector.

The corporate sector has turned to over-savings since the 2nd half of 1990's to reduce its net liabilities. Because of the weaker financial demand of the corporate sector, the banking sector has increased its holdings of JGBs.

I wonder how long this trend will continue.
When it stops, finance of the government debts will be fragile.

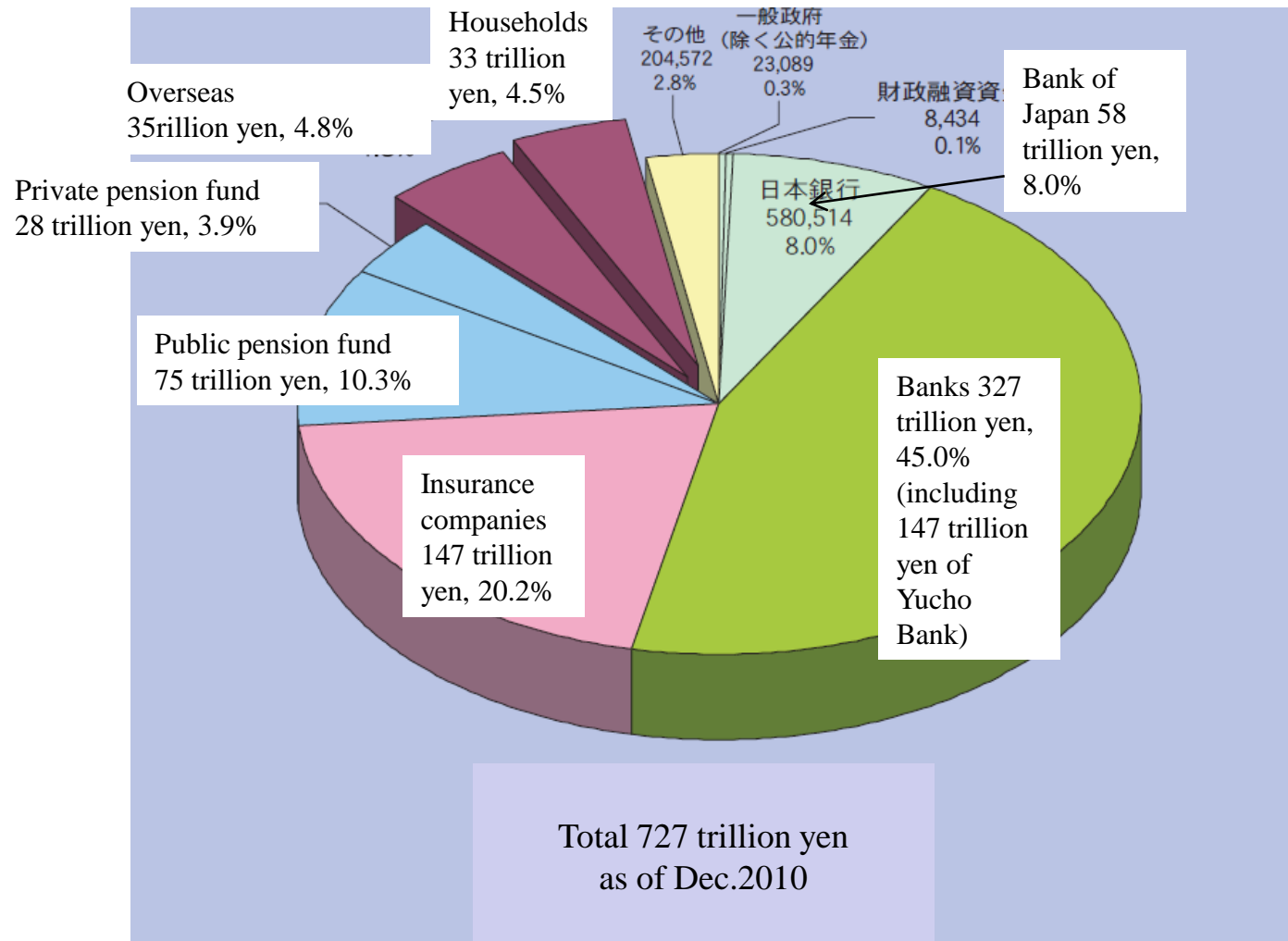


The changes of savings-investment balance of the corporate sector has a high correlation with deflation.



The banking sector has increased its purchases of government bonds as a substitution of loans in the 2000's. Attention: About 45% of the government bonds are held by Yucho Bank (postal savings bank owned by the government)

MOF:http://www.mof.go.jp/jgbs/publication/debt_management_report/2011/saimu.pdf



Share of the government securities (bonds, notes and bills) to the total assets of the Japanese banks has increased substantially.

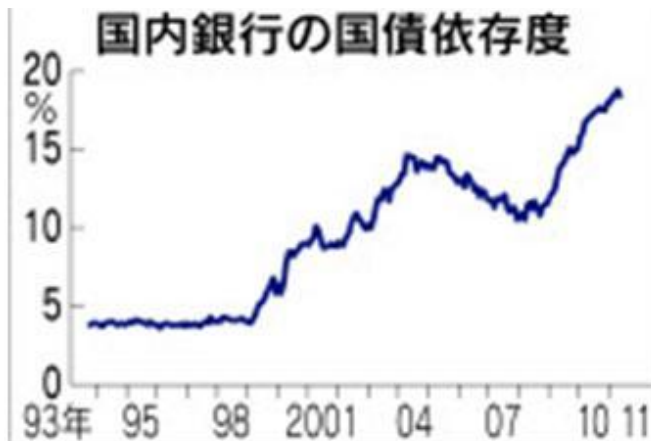
But major banks are cautious to buy JGBs longer than 5 years. Estimated total loss of 3 mega banks in a case of one point yield hike of 10-year JGB is 2 trillion yen which is 10% of their core tier 1 capital.

Graphs from Nikkei News paper dated Jul.2 2011

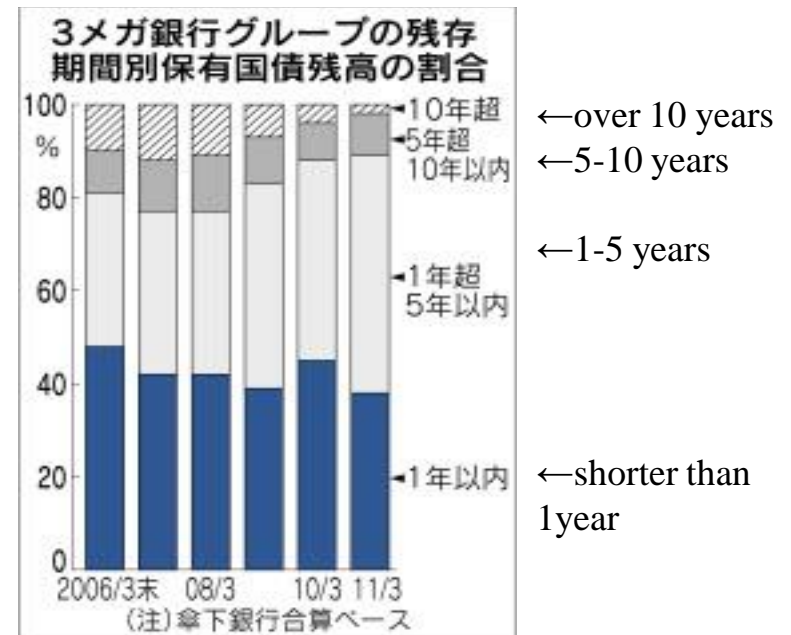
The average maturity of the total government securities is 6.8 years as of the end of 2010.

One point yield hike of 10-year JGB causes estimated loss of 46 trillion yen (9% of the nominal GDP)

Share of the governments securities to the total assets of Japanese banks

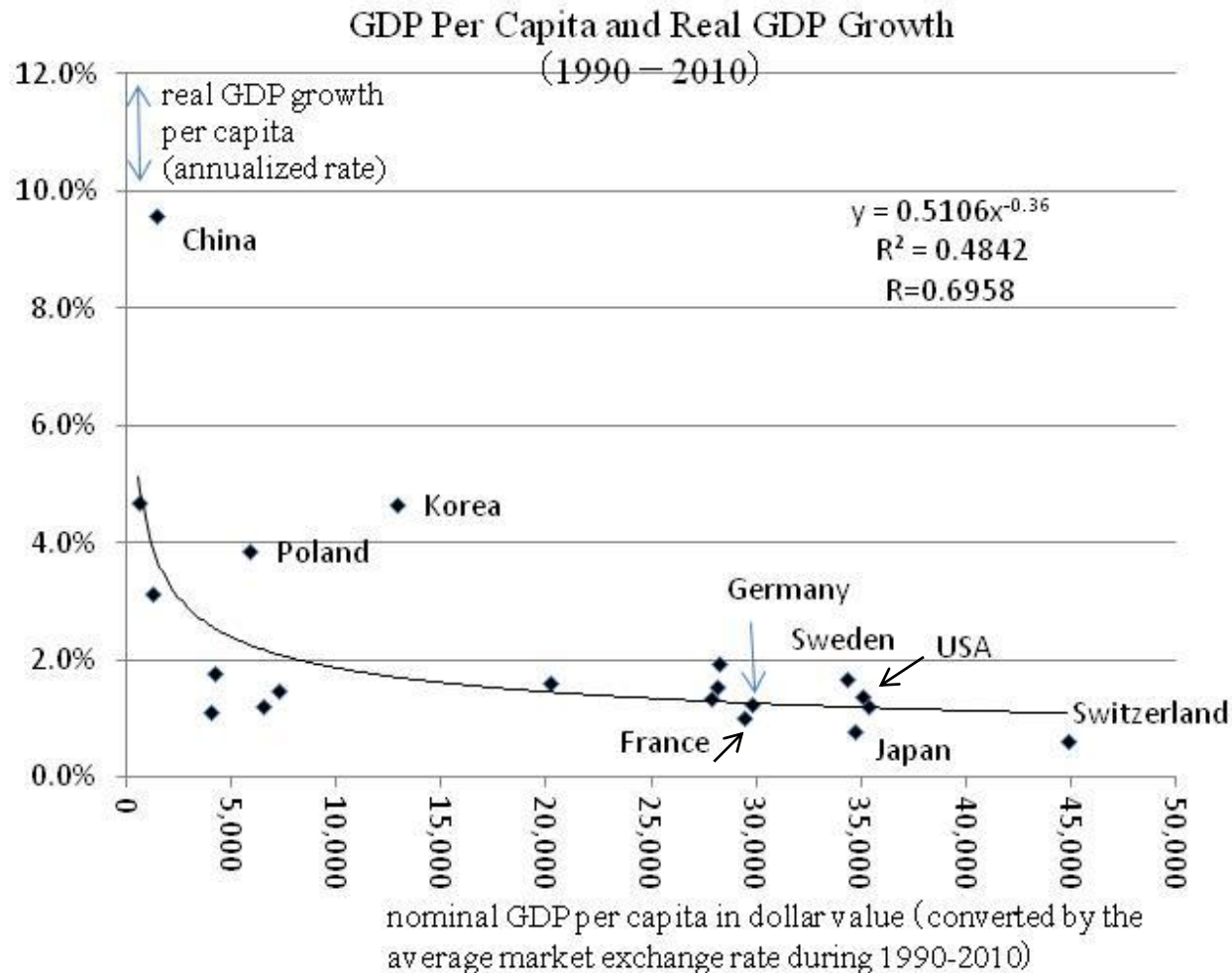


Durations of government securities held by three mega banks



4, Fearing Japanization ?

We have followed the same course since 2 decades ago, haven't we?



Data: IMF World Economic Data Base Sept. 2011

	Average of real GDP growth per capita (1990 – 2010)	Average of nominal GDP per capita in dollar value of 1990-2010 (converted by the average market exchange rate)
Australia	2.0%	28,195
Canada	1.3%	27,827
China	9.6%	1,413
France	1.0%	29,413
Germany	1.2%	29,842
Hungary	1.5%	7,295
Iceland	1.2%	35,347
India	4.7%	595
Indonesia	3.1%	1,251
Japan	0.8%	34,653
Korea	4.6%	12,933
Mexico	1.2%	6,546
Poland	3.8%	5,909
Russia	1.8%	4,198
Spain	1.6%	20,147
Sweden	1.7%	34,308
South Africa	1.1%	4,040
Switzerland	0.6%	44,818
United Kingdom	1.6%	28,111
United States	1.4%	35,087