

Japanese Economic Outlook

*“To raise, or not to raise, that is the question”
Concern About Another Consumer Tax Hike*



Conference of Business Economists

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1, Japanese Economic Outlook

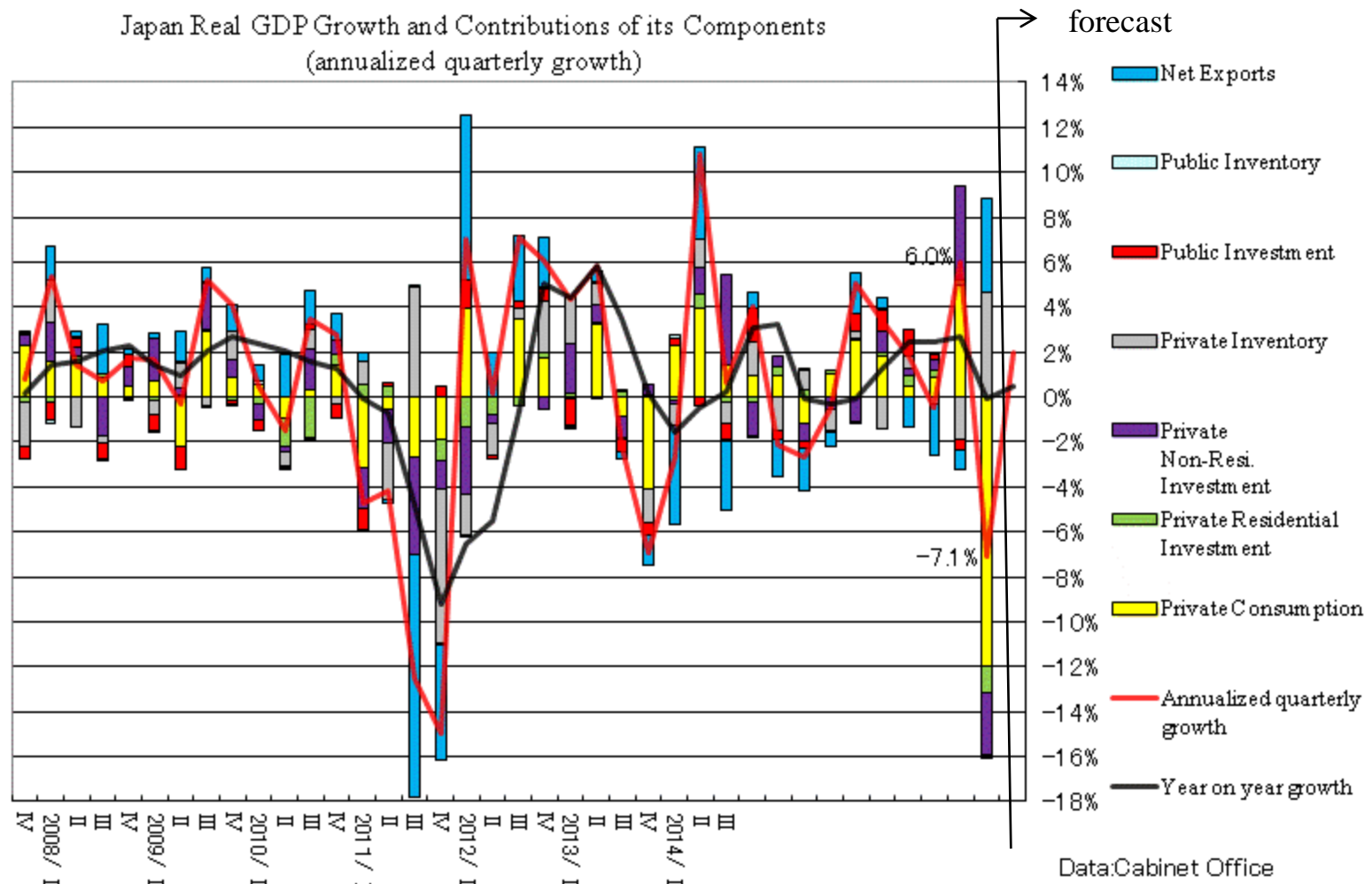
Just a temporal set back or heading for a new recession?

2, “Halloween Surprise” by BOJ Governor Kuroda

Is Kuroda’s QE(QQE) truly working nor not?

1, Japanese Economic Outlook

The momentum of recovery has become fragile since the consumer tax hike (5%→8%) in the last April. Real GDP growth is expected to be 2.0% in 2014/7-9 and 0.2 in FY2014 and 1.2 in FY2015 (forecast by JCER). A concern for downside risk is persistent. It is not certain if the Abe Cabinet will raise consumer tax(8%→10%) as scheduled on October in 2015.



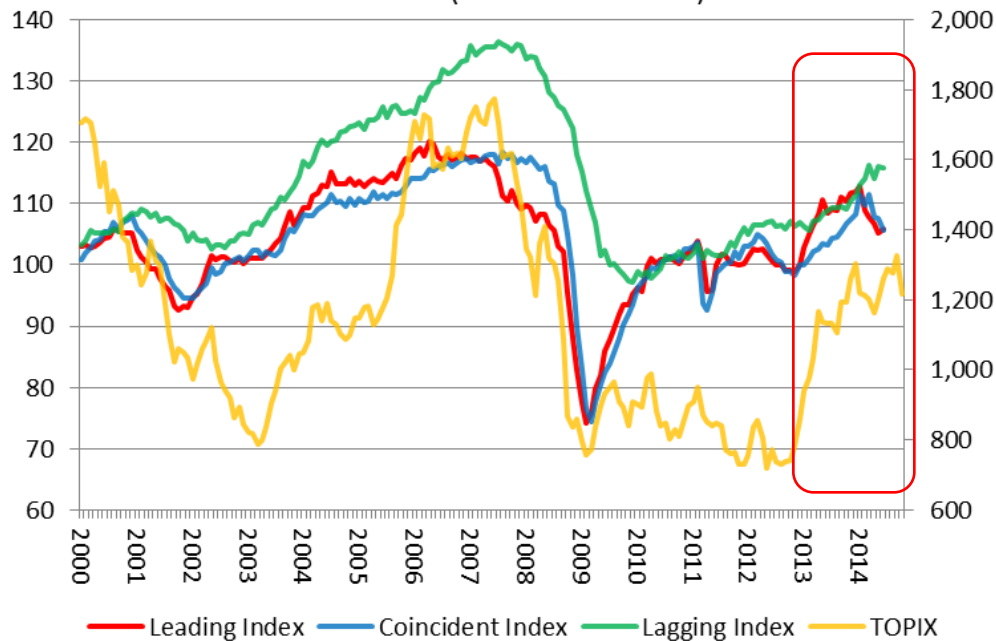
Contributions to Changes in Real GDP (seasonally adjusted series)

(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
2005/ I		2.3%	-0.2%	0.5%	-2.0%	0.7%	-0.5%	0.0%	0.1%		0.8%	0.2%	
II		1.6%	-0.2%	1.7%	1.9%	-0.2%	-0.8%	-0.1%	1.5%		5.3%	1.4%	
III		1.5%	0.3%	0.4%	-1.4%	-0.1%	0.4%	0.0%	0.2%		1.4%	1.6%	
IV		0.9%	0.2%	-1.7%	-0.3%	0.2%	-0.7%	0.0%	2.2%		0.7%	2.1%	1.3%
2006/ I		0.5%	-0.1%	0.8%	0.0%	-0.3%	0.5%	0.0%	0.2%		1.8%	2.3%	
II		0.7%	-0.2%	1.9%	-0.6%	0.4%	-0.7%	0.0%	0.2%		1.7%	1.4%	
III		-2.2%	0.1%	0.3%	1.1%	0.0%	-1.0%	0.1%	1.4%		-0.3%	1.0%	
IV		2.9%	0.1%	2.0%	-0.4%	-0.2%	0.1%	0.0%	0.6%		5.2%	2.1%	1.7%
2007/ I		0.9%	-0.2%	0.8%	1.2%	0.4%	-0.1%	-0.1%	1.2%		4.1%	2.7%	
II		0.5%	-0.3%	-0.8%	0.0%	0.5%	-0.4%	0.1%	0.7%		0.5%	2.4%	
III		-1.0%	-1.2%	-0.3%	-0.6%	-0.2%	-0.1%	0.0%	1.9%		-1.5%	2.0%	
IV		0.3%	-1.8%	1.8%	0.9%	0.6%	0.3%	0.0%	1.4%		3.5%	1.6%	2.2%
2008/ I		1.4%	0.4%	0.6%	-0.3%	0.0%	-0.6%	0.0%	1.2%		2.7%	1.3%	
II		-3.2%	0.6%	-1.8%	1.0%	-0.8%	-1.0%	0.0%	0.4%		-4.7%	0.0%	
III		-0.5%	0.5%	-1.6%	-2.5%	0.0%	0.2%	0.0%	-0.1%		-4.1%	-0.7%	
IV		-2.7%	0.0%	-4.3%	4.9%	0.3%	0.0%	0.1%	-10.8%		-12.5%	-4.8%	-1.0%
2009/ I		-1.9%	-1.0%	-1.3%	-6.8%	0.7%	0.5%	-0.1%	-5.2%		-15.0%	-9.2%	
II		4.0%	-1.3%	-3.0%	-1.8%	0.6%	1.3%	0.0%	7.3%		7.1%	-6.5%	
III		0.0%	-0.8%	-0.4%	-1.5%	1.0%	-0.1%	0.0%	1.9%		0.2%	-5.5%	
IV		3.5%	-0.4%	0.0%	0.5%	0.3%	0.3%	0.0%	2.9%		7.1%	-0.6%	-5.5%
2010/ I		1.7%	0.3%	-0.6%	2.3%	-0.5%	0.5%	0.0%	2.2%		6.1%	5.1%	
II		-0.1%	0.1%	2.2%	2.2%	1.2%	-1.2%	-0.1%	0.0%		4.4%	4.4%	
III		3.3%	0.1%	0.8%	0.9%	0.3%	0.1%	-0.1%	0.5%		5.8%	5.8%	
IV		-0.8%	0.3%	-1.0%	-0.1%	0.3%	-0.5%	0.1%	-0.4%		-2.2%	3.5%	4.7%
2011/ I		-4.1%	0.1%	0.4%	-1.5%	0.0%	-0.5%	0.0%	-1.3%		-6.9%	0.1%	
II		2.3%	-0.2%	-0.1%	-1.0%	0.2%	0.4%	0.1%	-4.4%		-2.7%	-1.6%	
III		4.0%	0.6%	1.2%	1.3%	0.1%	-0.4%	0.0%	4.1%		10.8%	-0.5%	
IV		1.4%	-0.3%	4.0%	-0.9%	0.2%	-0.7%	-0.1%	-3.1%		0.6%	0.2%	-0.5%
2012/ I		0.9%	-0.2%	-1.5%	1.5%	1.1%	1.5%	0.0%	0.7%		4.1%	3.1%	
II		1.0%	0.4%	0.4%	-1.5%	-0.4%	-0.4%	0.0%	-1.6%		-2.2%	3.2%	
III		-1.1%	0.3%	-0.8%	0.9%	0.3%	-0.3%	0.0%	-1.9%		-2.7%	-0.1%	
IV		1.1%	0.1%	-0.5%	-0.9%	0.5%	0.0%	-0.1%	-0.6%		-0.5%	-0.3%	1.5%
2013/ I		2.5%	0.1%	-1.1%	0.3%	0.7%	0.7%	-0.1%	1.8%		5.1%	-0.1%	
II		1.8%	0.2%	0.9%	-1.4%	0.4%	0.9%	0.1%	0.4%		3.4%	1.3%	
III		0.5%	0.5%	0.3%	0.6%	0.1%	1.2%	0.0%	-1.3%		1.8%	2.4%	
IV		0.9%	0.3%	0.5%	-0.3%	0.2%	0.3%	0.0%	-2.3%		-0.5%	2.4%	1.5%
2014/ I		5.0%	0.2%	4.2%	-1.9%	-0.1%	-0.5%	0.0%	-0.8%		6.0%	2.7%	
II		-12.0%	-1.2%	-2.7%	4.7%	0.1%	-0.1%	0.0%	4.2%		-7.1%	0.0%	

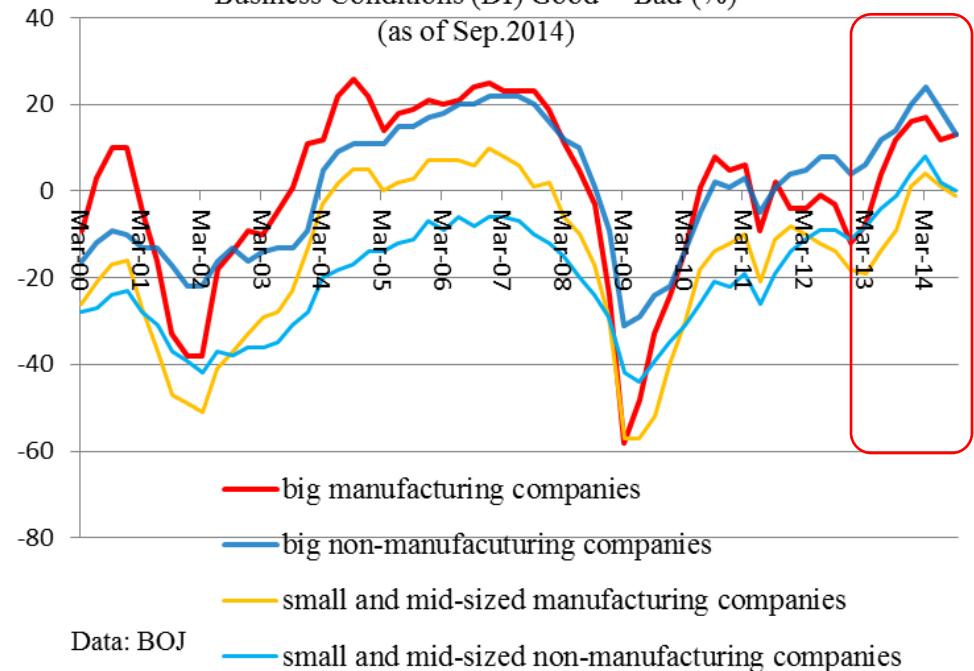
A set back after the consumer tax hike in April has been larger than expected.
However the business conditions are not collapsed.

Composite Index (as of Aug 2014)
and TOPIX (as of Oct.20 2014)



Data: Cabinet Office

Bank of Japan's Quarterly Short-term Economic Survey
Business Conditions (DI) Good — Bad (%)
(as of Sep.2014)

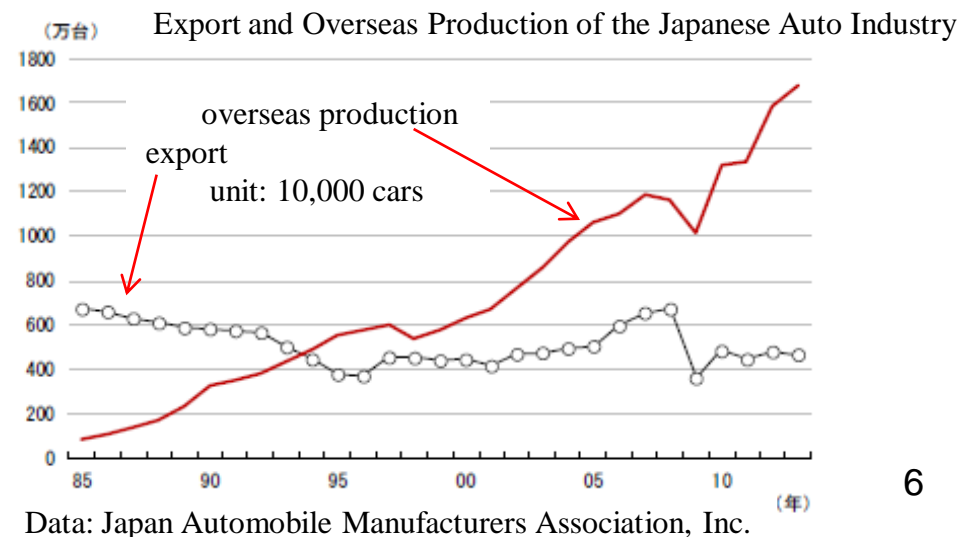
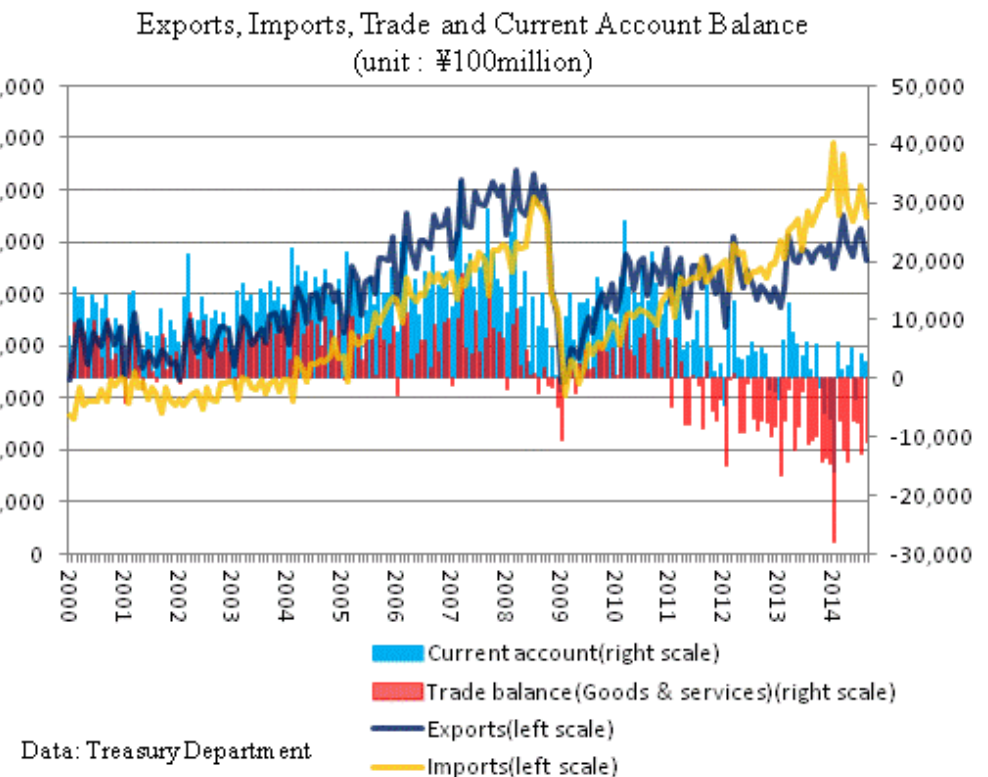


Data: BOJ

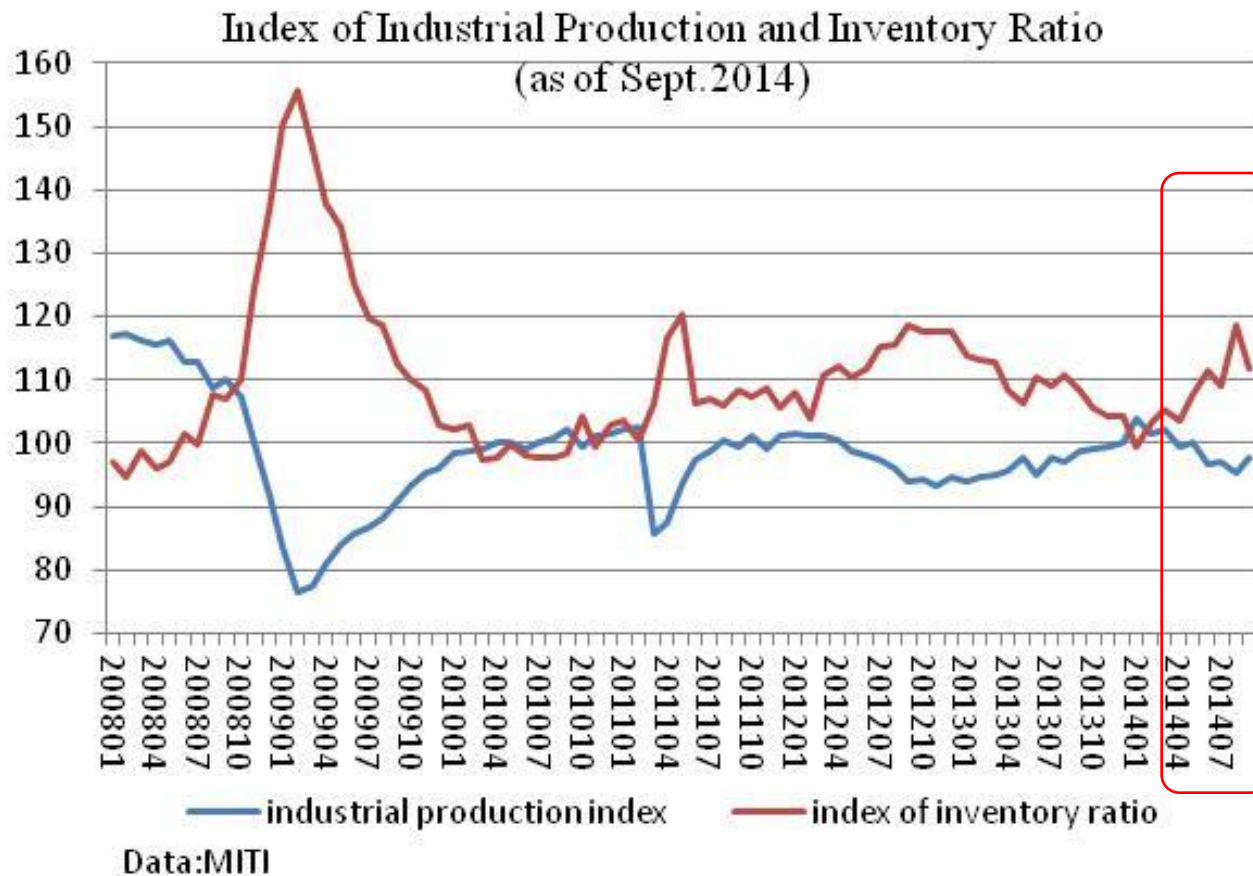
Despite the recent depreciation of Yen, the exports growth has been sluggish because

- 1) the export makers have changed their attitude more to seek maximize their profits rather than increasing export volume by lowering their prices,
- 2) they (especially car makers) have been shifting their production lines to the overseas markets,
- 3) the overseas demand has been feeble especially in the emerging and the European markets.

The latest changes suggest the trade deficit is going to narrow.

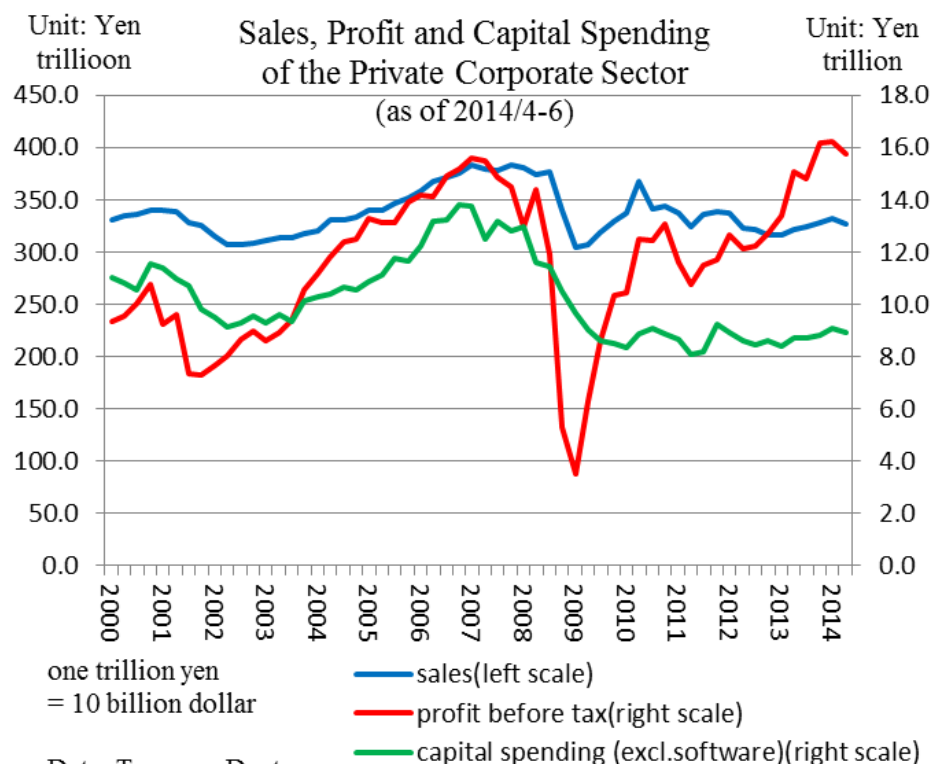


There are signs that inventory adjustments are over and industrial production to pick up.



Profits of the corporate sector has surged while fixed investments of the corporate sector is lingering.

There is a chance that fixed investments will pick up since the 2nd half of FY 2014 according to the Survey by BOJ.



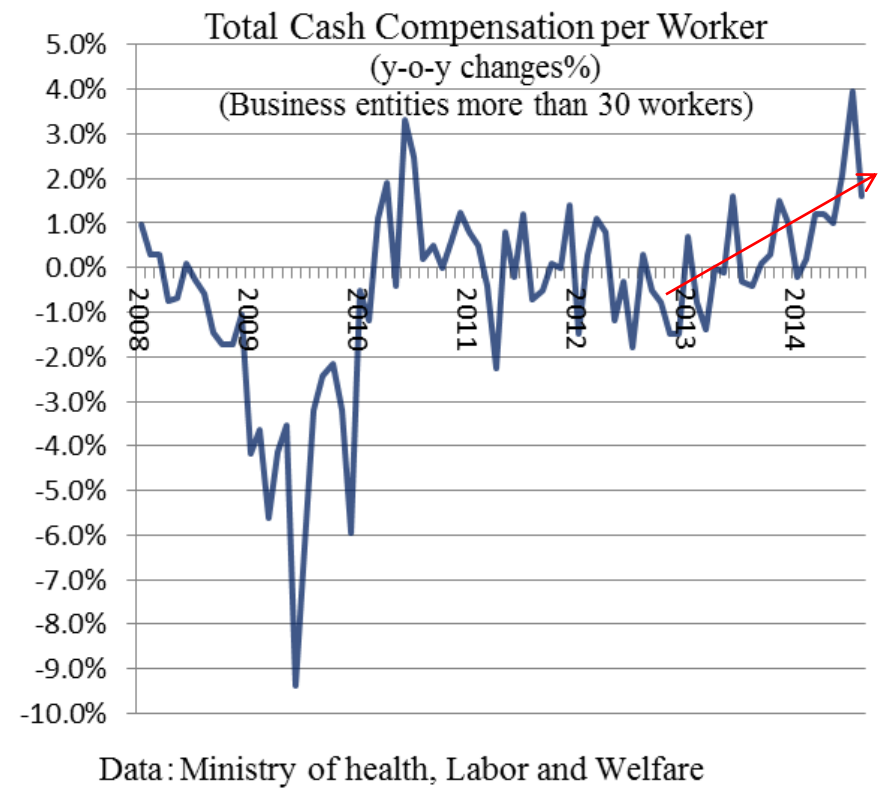
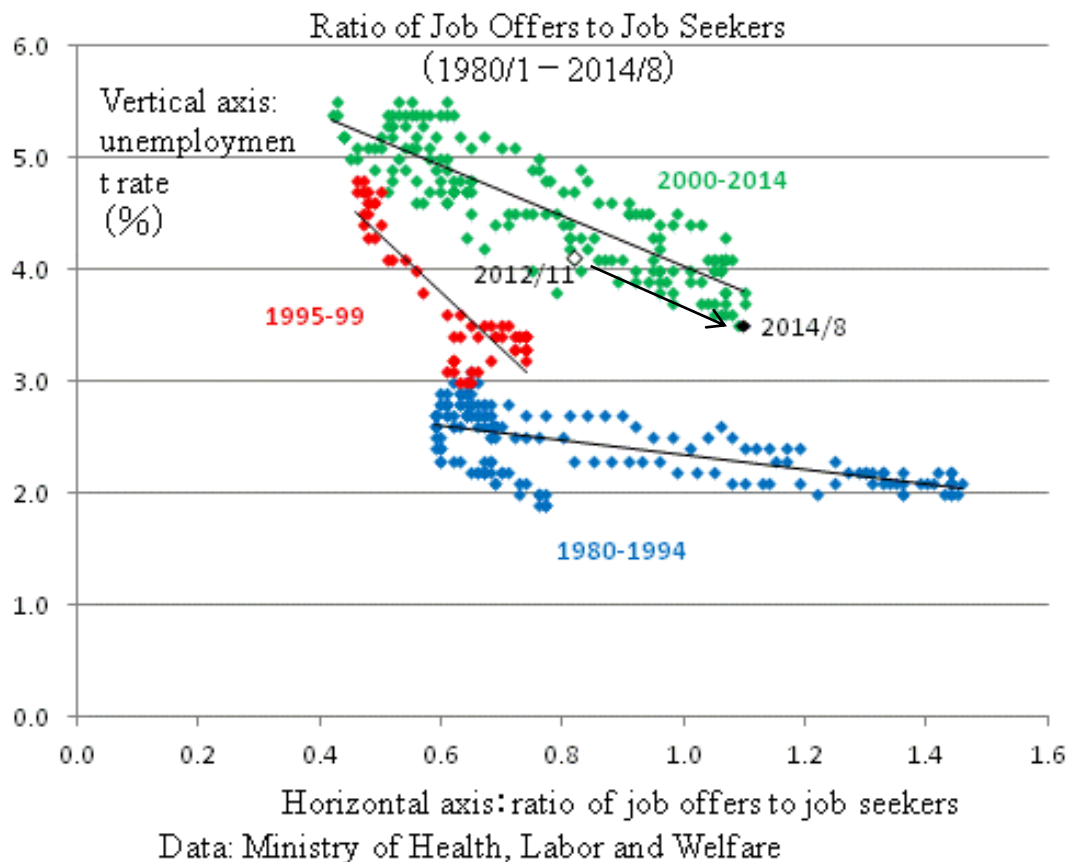
Software and Fixed Investment excluding Land Purchasing Expenses

(Year-to-year % change)

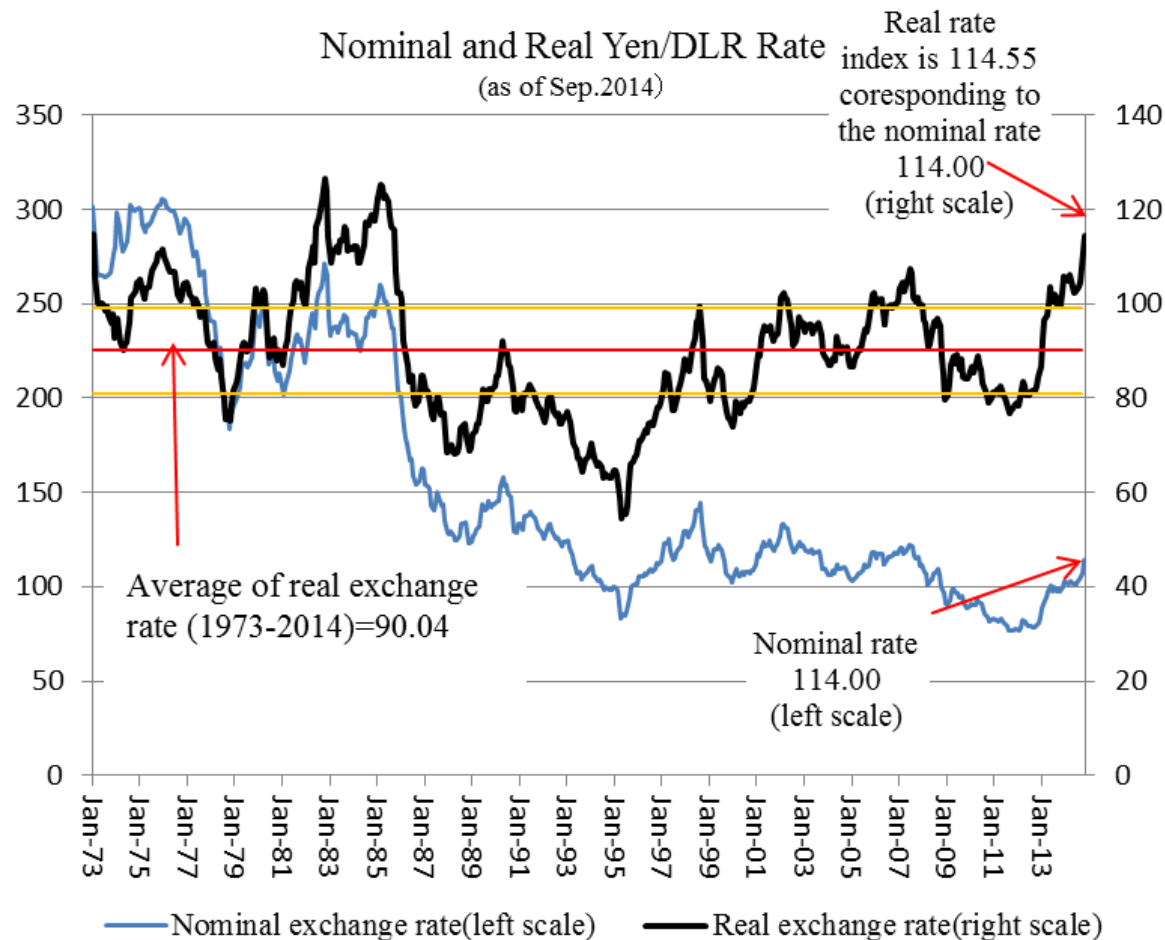
		FY2013		FY2014 (Forecast)	
			Revision rate		Revision rate
Large Enterprises	Manufacturing	-0.8	-	14.4	0.5
	Nonmanufacturing	4.4	-	5.9	0.4
	All industries	2.6	-	8.7	0.4
Medium-sized Enterprises	Manufacturing	-4.1	-	19.0	0.7
	Nonmanufacturing	11.8	-	0.1	0.7
	All industries	5.6	-	6.8	0.7
Small Enterprises	Manufacturing	17.1	-	0.7	4.4
	Nonmanufacturing	19.6	-	-9.4	7.8
	All industries	18.7	-	-6.0	6.5
All Enterprises	Manufacturing	1.1	-	12.9	1.1
	Nonmanufacturing	7.7	-	2.6	1.4
	All industries	5.3	-	6.1	1.3

Short-Term Economic Survey(Tankan) by
BOJ , Sept. 2014

Steady improvement in the labor market is the most encouraging factor.



Real exchange rate index of Yen/Dollar has entered to the range before the Plaza Accord in 1985.

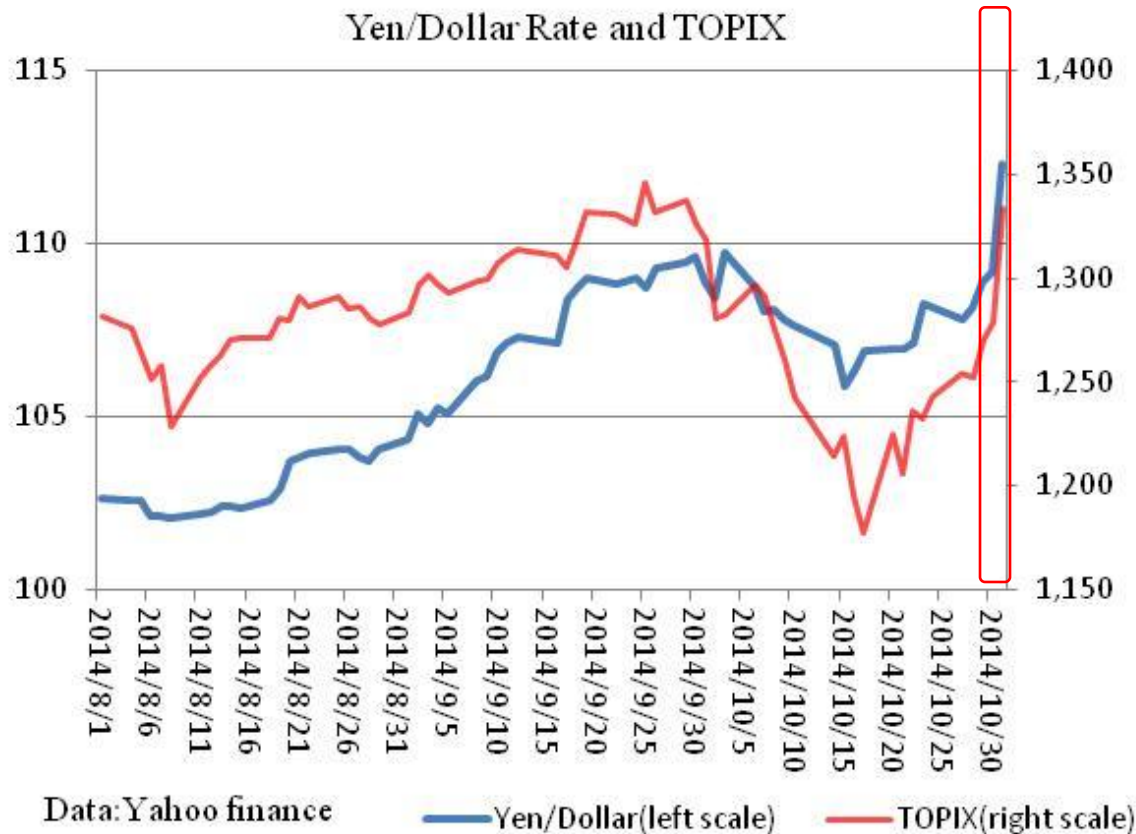


← Fairway range of Yen: $\pm 10\%$ from the average since 1973

Data: BOJ, Department of Commerce, Department of Labor
 PPP is calculated based on the corporate price index(Japan) and the producer price index(USA)

2, “Halloween Surprise” by BOJ Governor Kuroda

The additional QQE announced by BOJ on Oct.31st caused a surprising impact on the share prices and Yen’s exchange rate coincident with the official release of GPIF reform.



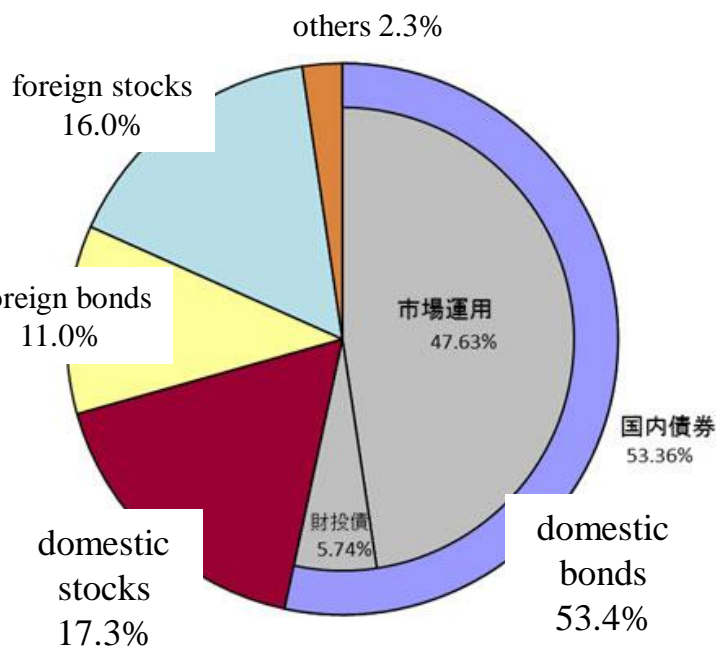
The Additional QQE

- (1) Increasing purchase of JGBs: 80 trillion yen from 50 trillion yen annually
- (2) Extension of the average duration of purchasing JGBs to 7-10 years from 4-7 years
- (3) Increasing purchase of ETFs and J-REITs: 3 trillion yen for ETFs from 1 trillion yen and 90 billion yen for J-REITs from 30 billion yen

Do not overestimate a short-term impact from changes of the GPIF's assets allocation. Its allocation shift has partially achieved already and a further shift is likely to be gradual one.

From the website of Government Pension Investment Fund

Assets Allocation of GPIF as of the end of June 2014



Summary (2)

【Adoption of New Policy Asset Mix】

(Old)

	Domestic bonds	Domestic stocks	International bonds	International stocks	Short-term assets
Target allocation	60%	12%	11%	12%	5%
Permissible range of deviation	± 8%	± 6%	± 5%	± 5%	—

(New)

	Domestic bonds	Domestic stocks	International bonds	International stocks
Target allocation	35%	25%	15%	25%
Permissible range of deviation	± 10%	± 9%	± 4%	± 8%

(Note 1) Alternative investment will be made within maximum 5% of total portfolio, in accordance with development of dedicated team. Infrastructure, private equities, real estates or other assets determined upon deliberation at the Investment Advisory Committee, are classified as domestic bonds, domestic stocks, international bonds or international stocks, depending on their risk and return profiles.

(Note 2) GPIF adopts tactical asset allocation within permissible ranges of deviation for each asset class, and this allocation is solely based upon thorough analysis on economic and market environment, and prudent judgment.

Deflation is over. However CPI growth is still low.

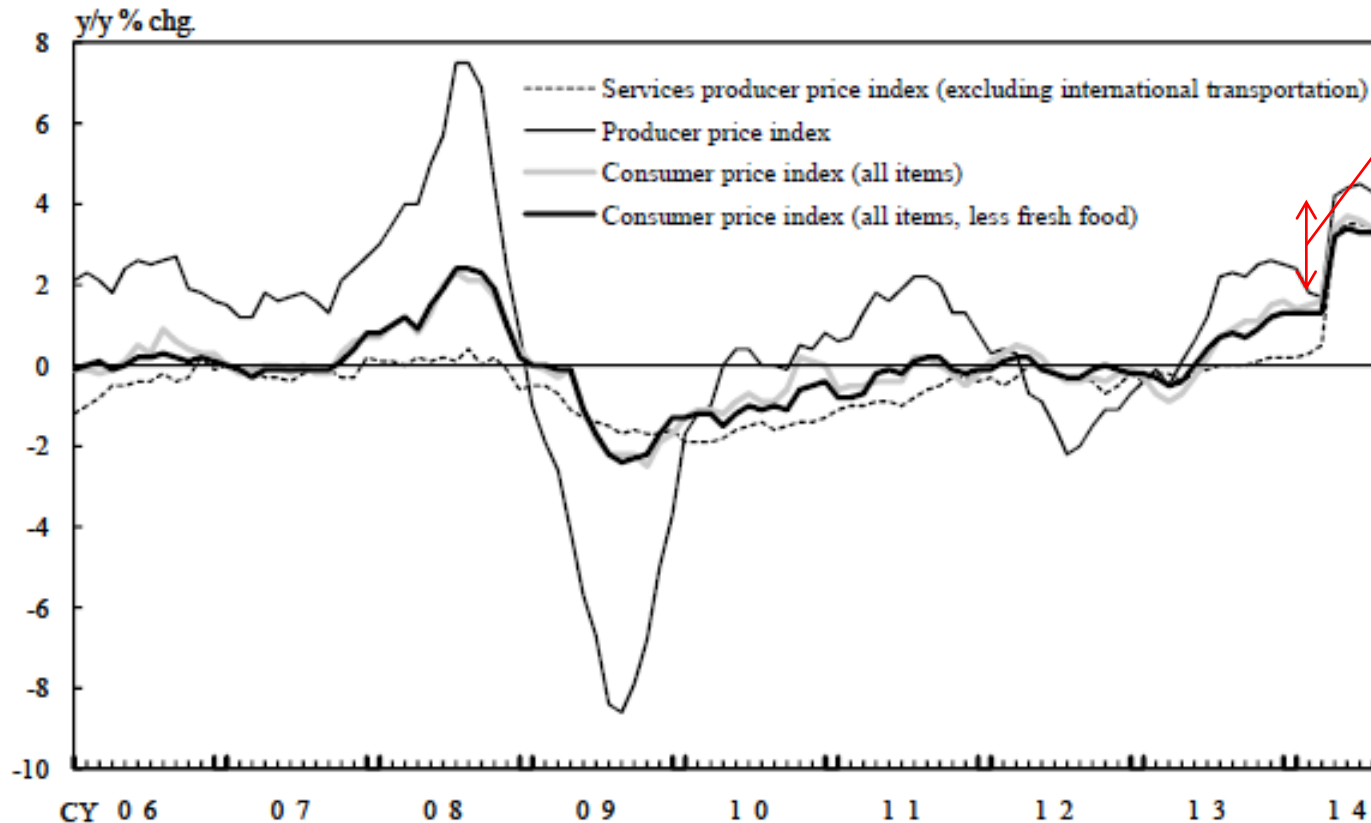
Change of CPI (less fresh food): 1.1% (from one year ago)

Change of CPI (less food and energy) : 0.6% (from one year ago)

after adjustment of the effects of the consumer tax hike (5% → 8%) in April 2014

from BOJ's Monthly Report of Recent Economic and Financial Development (Oct.2014)

(2) Changes from a Year Earlier

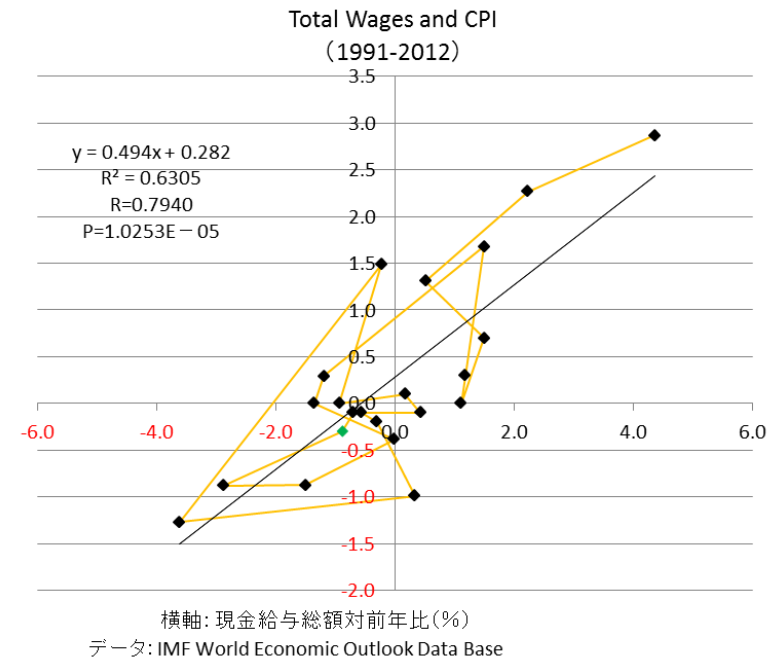
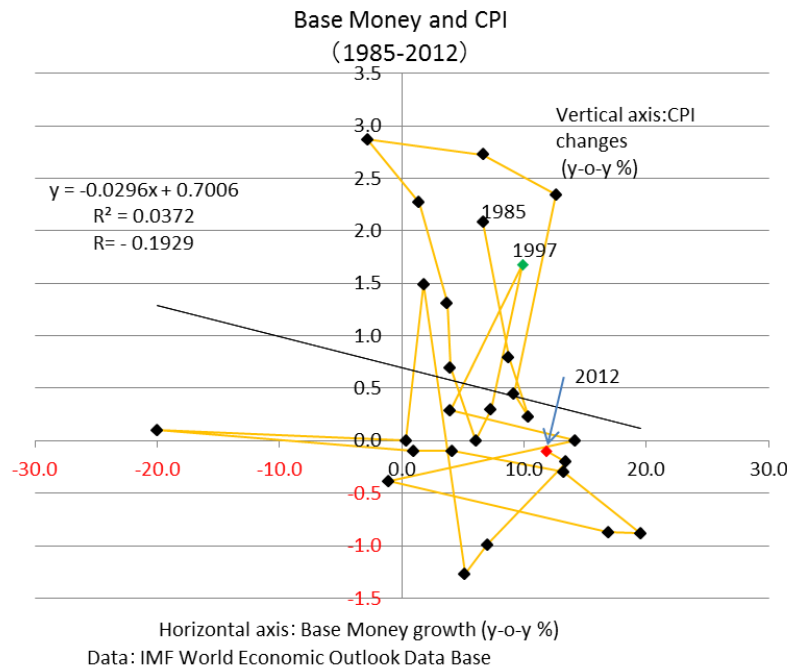
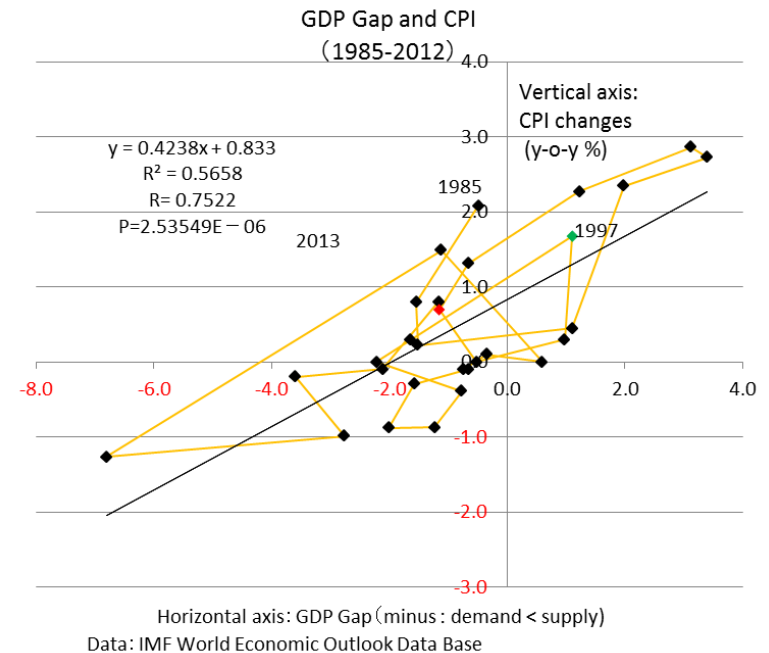


Effects of the
consumer tax
hike

I presented the following question at the last November CBE meeting.

“What has a high correlation with CPI changes are the GDP gaps and the changes of total wages, while the growth of base money has not any direct correlation with CPI in Japan. Then, why does Kuroda’s QE seem to be working?”

Actually the QE during 2001-06 had little impact on prices while there were some effects on exchange rate, stock prices and productions.

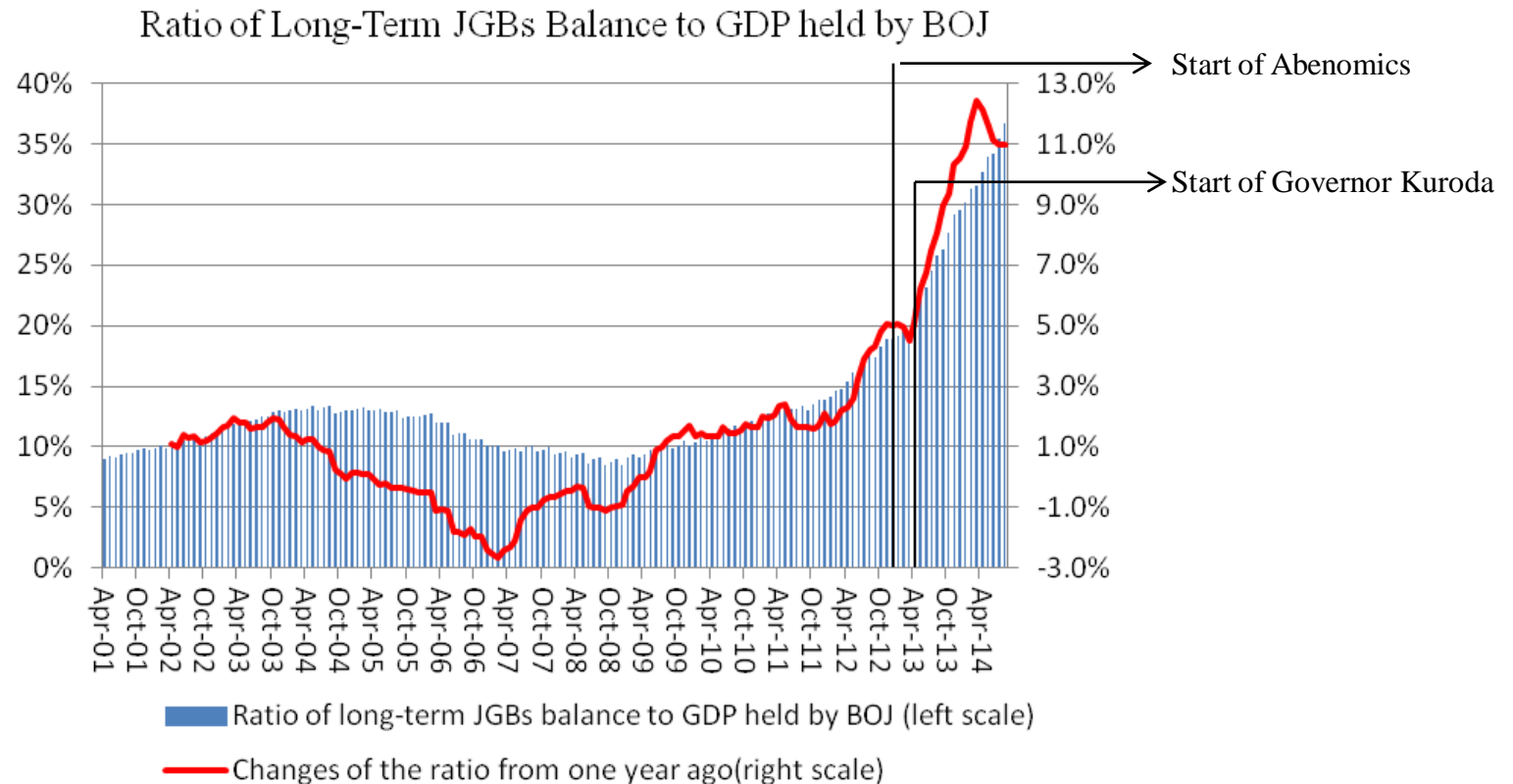


But the Kuroda's QE seems to have effects not only to the exchange rate, the share prices but also to the prices.

The ordinary explanation on this question is it caused “a change of expectation”.

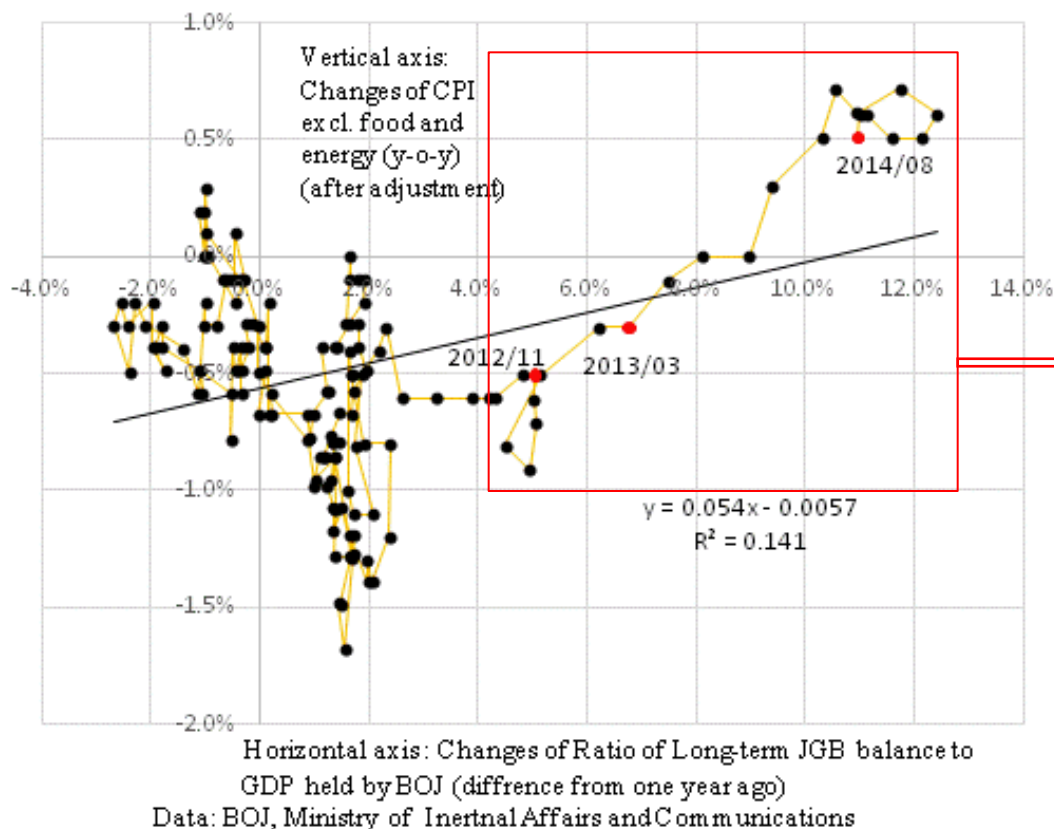
Then what is an elementary factor which caused such a change of expectation?

The most striking change of the Kuroda's QE from the previous QE during 2001-06 was a bold expansion of purchasing long-term JGBs while BOJ had been very cautious to do that before.

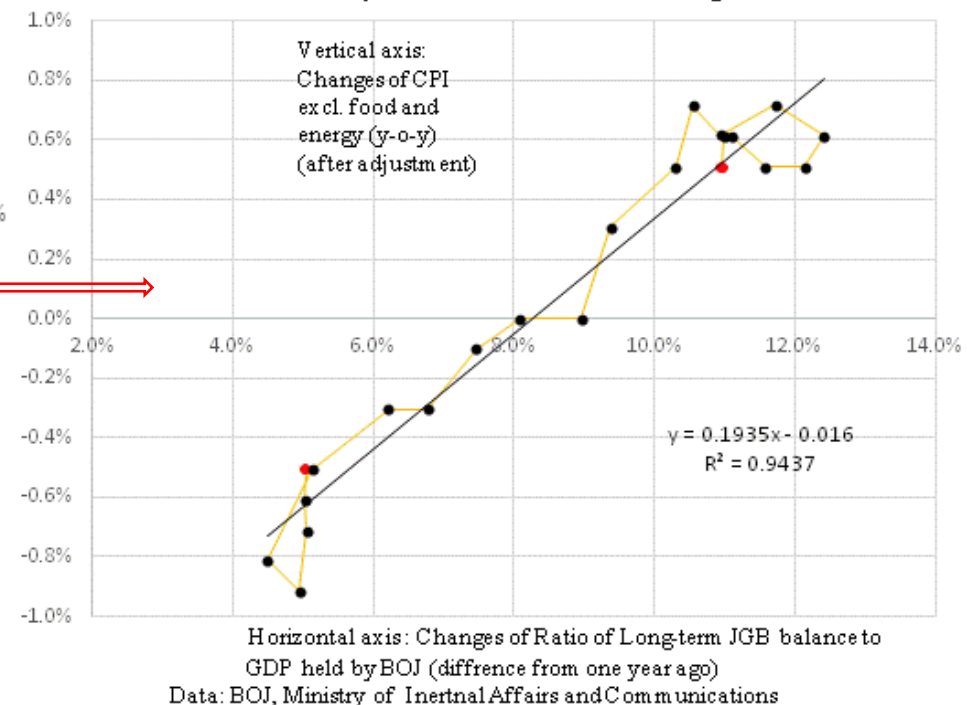


There had been no correlation between changes of CPI and long-term JGBs balance held by BOJ before. However there has been high correlation since the Abe Cabinet announced it would take a bold action on monetary policy. It suggests players changed their expectation and behavior.

Changes of CPI and Ratio of Long-term JGB Balance to GDP
Held by BOJ (2002 Apr ~ 2014 Aug)



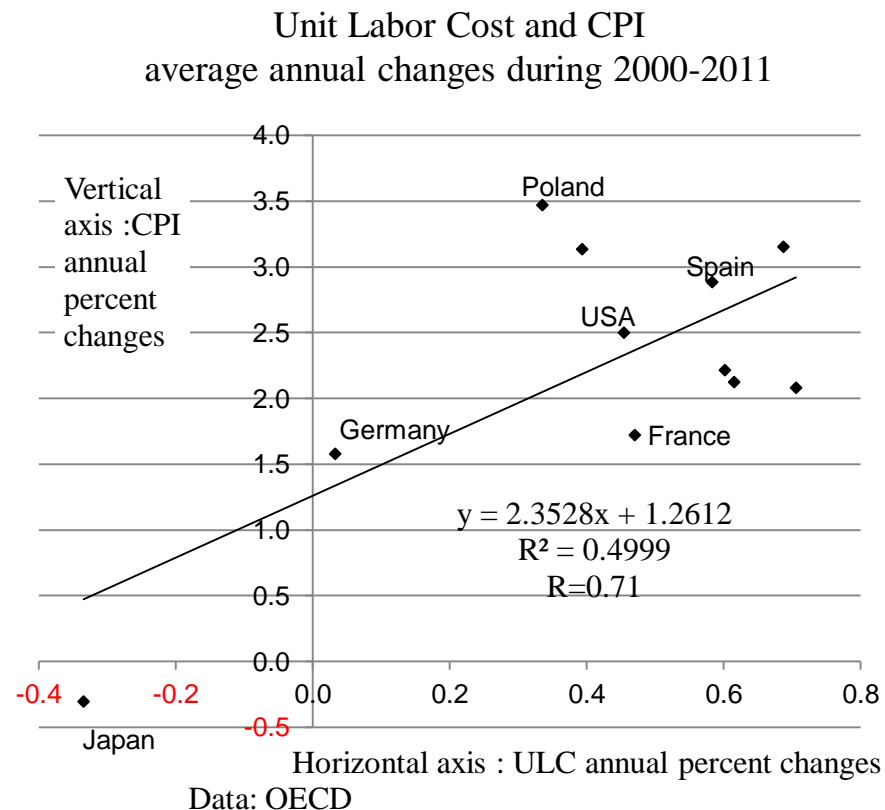
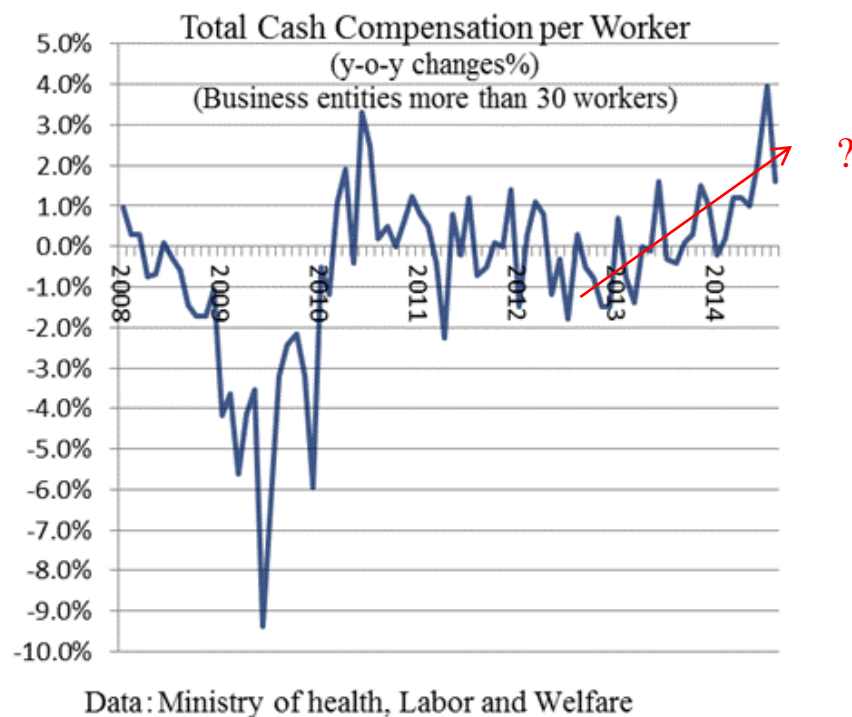
Changes of CPI and Ratio of Long-term JGB Balance to GDP
Held by BOJ (2013 Mar ~ 2014 Aug)



Nominal wage growth is another necessary factor for a mild and stable and inflation.

“Hypothesis of Labor Cost Deflation” by Hiroshi Yoshikawa who is the professor of Tokyo University and the most prominent Keynesian in Japan.

We see high correlations between the labor cost and CPI changes.



Unit Labor Cost and CPI (2000-2011)		
	ULC average annual percent changes	CPI average annual percent changes
Australia	0.69	3.15
Canada	0.62	2.12
France	0.47	1.72
Germany	0.03	1.58
Italy	0.60	2.22
Japan	-0.33	-0.31
Korea	0.39	3.14
Poland	0.34	3.47
Spain	0.58	2.89
United Kingdom	0.71	2.08
United States	0.45	2.50
Data: OECD		

The Kuroda's QE seems to be working. At the same time, however, it deepens the future risk to exit from itself. The exit risk of BOJ will be bigger than that of FED.

Reference:

Ikuko Samikawa, kazumasa Iwata

“Quantitative and Qualitative Monetary Easing Effects and Associated Risks” Japan Financial Report 2013-1, JCER

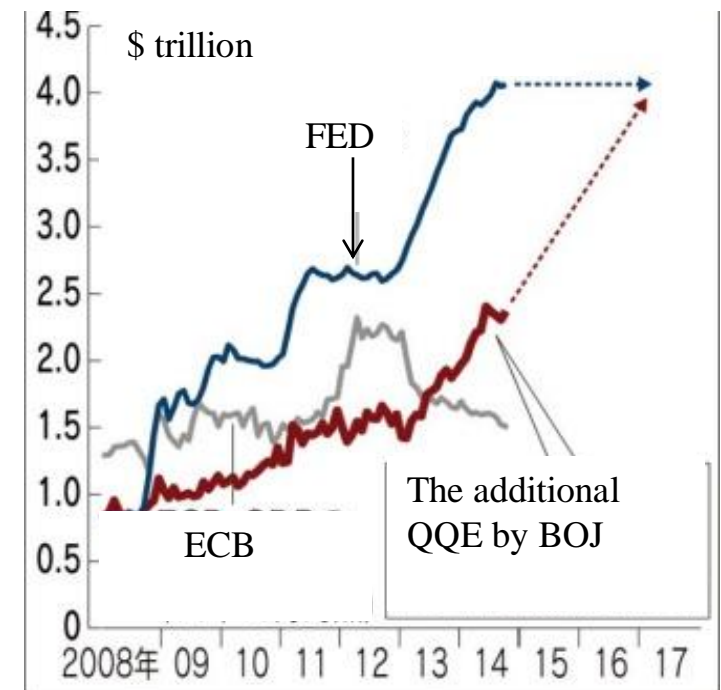
<http://www.jcer.or.jp/eng/pdf/kinyu20131213.pdf>

Seth B. Carpenter, Jane E. Ihrig, Elizabeth C. Klee, Daniel W. Quinn, and Alexander H. Boote
“The Federal Reserve's Balance Sheet and Earnings: A Primer and Projections”

FRB working paper, 2013/01

<http://www.federalreserve.gov/pubs/feds/2013/201301/revision/201301pap.pdf>

Outstanding of Monetary Base
Fed, BOJ and ECB



I wonder if I can raise
the consumer tax again
as scheduled.

Did you enjoy
Halloween?



No you can't !

