

Japanese Economic Outlook

Puzzle of Robust Income Growth and Weak Consumption



龍谷大学
RYUKOKU UNIVERSITY



Conference of Business Economists

November 10-11, 2016

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1, Japanese Economic Outlook

Puzzle of robust income growth and sluggish consumer spending

2, Diminishing effect of BOJ's unconventional monetary policy

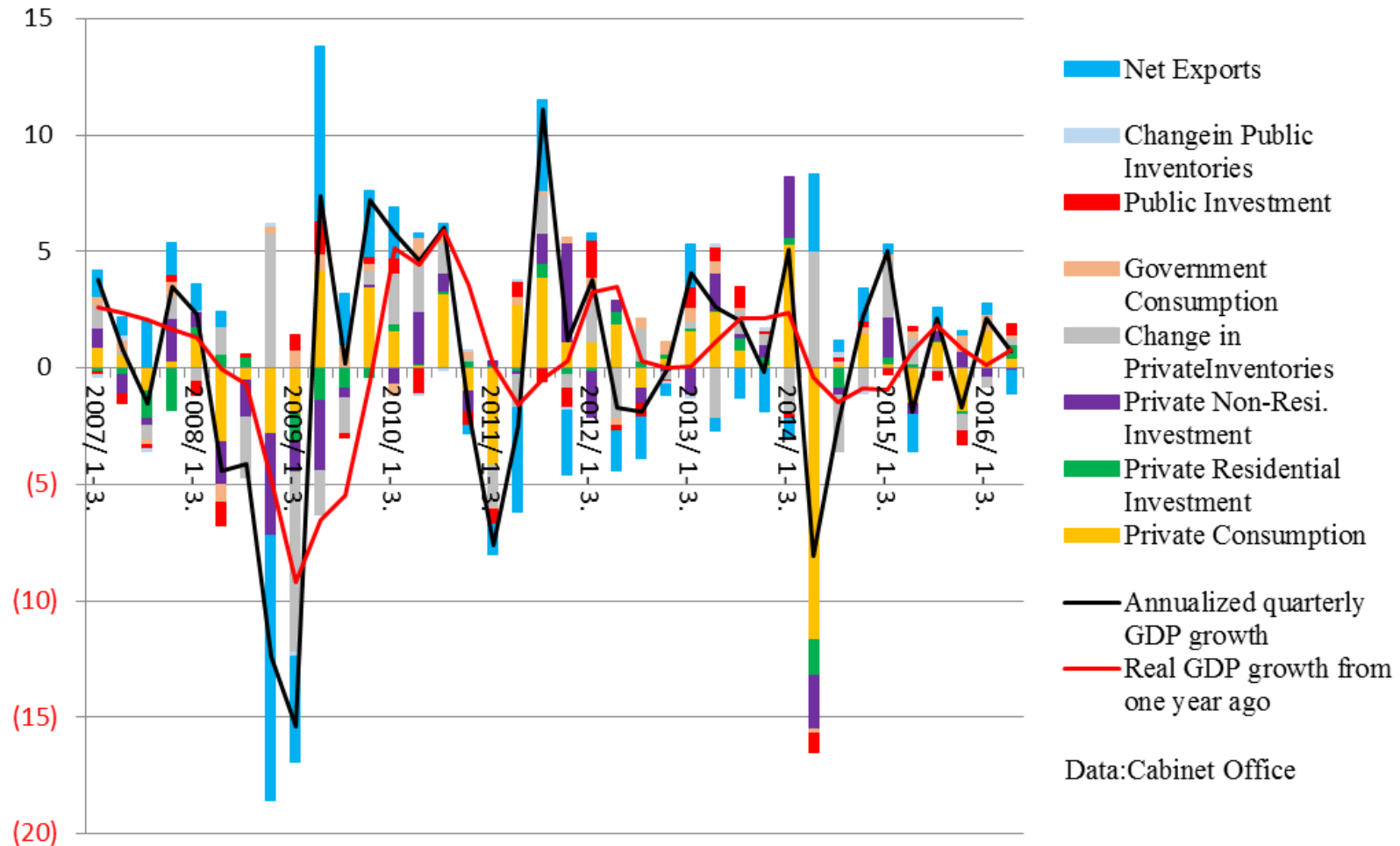
3, Growing risk of financial turmoil in China?

1, Japanese Economic Outlook

The real GDP growth of the 2nd quarter 2016 lowered to +0.7% from the previous quarter +2.1% (annualized base).

The forecast of annual GDP growth in 2006 by JCER is only +0.6%.

Japan Real GDP Growth and contributions of its Components



Real GDP growth and contributions of its components (%)

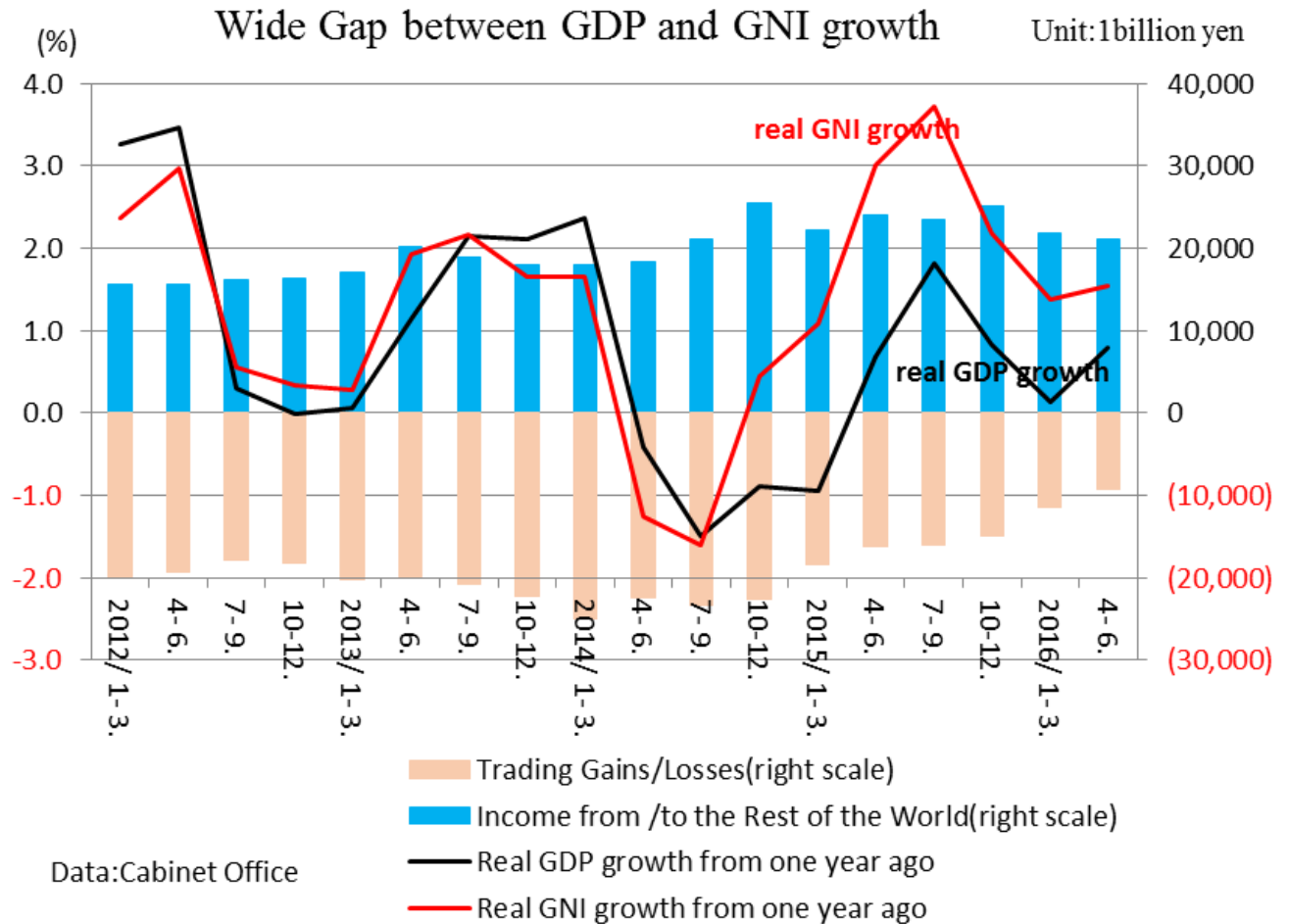
	Annualized quarterly GDP growth	Private Consumption	Private Residential Investment	Private Non-Resi. Investment	Change in Private Inventories	Government Consumption	Public Investment	Change in Public Inventories	Net Exports
2010/ 1- 3.	5.8	1.6	0.3	-0.7	2.2	-0.5	0.6	0.0	2.2
4- 6.	4.6	0.1	0.1	2.2	2.0	1.2	-1.1	-0.1	0.2
7- 9.	6.0	3.2	0.1	0.8	1.3	0.3	0.0	-0.1	0.5
10-12.	-1.9	-1.0	0.3	-0.9	0.1	0.3	-0.6	0.1	-0.3
2011/ 1- 3.	-7.6	-4.2	0.1	0.2	-1.8	-0.1	-0.6	0.0	-1.3
4- 6.	-2.5	2.7	-0.2	-0.1	-1.4	0.4	0.6	0.1	-4.5
7- 9.	11.1	3.9	0.6	1.3	1.7	0.1	-0.6	0.0	3.9
10-12.	1.2	1.1	-0.3	4.3	-0.6	0.2	-0.8	-0.1	-2.8
2012/ 1- 3.	3.8	1.1	-0.2	-1.9	1.9	0.9	1.6	0.0	0.3
4- 6.	-1.7	1.9	0.5	0.5	-2.2	-0.3	-0.2	0.0	-1.7
7- 9.	-1.9	-0.9	0.3	-0.6	1.4	0.4	-0.6	0.0	-1.8
10-12.	-0.1	0.4	0.2	-0.2	-0.3	0.5	-0.1	-0.1	-0.5
2013/ 1- 3.	4.1	1.6	0.1	-1.2	0.3	0.6	0.9	-0.1	1.8
4- 6.	2.6	2.4	0.1	1.6	-2.2	0.5	0.6	0.1	-0.5
7- 9.	2.0	0.8	0.5	0.2	1.0	0.1	0.9	0.0	-1.3
10-12.	-0.2	0.1	0.4	0.5	0.5	0.0	0.1	0.1	-1.9
2014/ 1- 3.	5.1	5.3	0.3	2.6	-1.9	-0.1	-0.2	0.0	-0.8
4- 6.	-8.1	-11.7	-1.5	-2.3	5.0	-0.2	-0.8	0.0	3.3
7- 9.	-2.4	0.1	-0.9	-0.3	-2.4	0.2	0.2	0.2	0.5
10-12.	2.2	1.5	0.0	0.0	-0.9	0.3	0.2	-0.2	1.4
2015/ 1- 3.	5.0	0.2	0.3	1.7	2.5	0.2	-0.3	0.0	0.4
4- 6.	-1.9	-1.5	0.2	-0.5	1.1	0.3	0.2	0.0	-1.6
7- 9.	2.1	1.1	0.1	0.4	-0.2	0.2	-0.3	0.0	0.8
10-12.	-1.7	-1.9	-0.1	0.7	-0.7	0.7	-0.6	0.0	0.2
2016/ 1- 3.	2.1	1.6	0.0	-0.4	-0.4	0.7	0.0	0.0	0.5
4- 6.	0.7	0.4	0.6	-0.1	0.3	0.1	0.5	0.0	-1.0

The average of real GNI (Gross National Income) annual growth since 2015/1Q is 2.2% while that of GDP is only 0.6%. The gap is 1.6%.

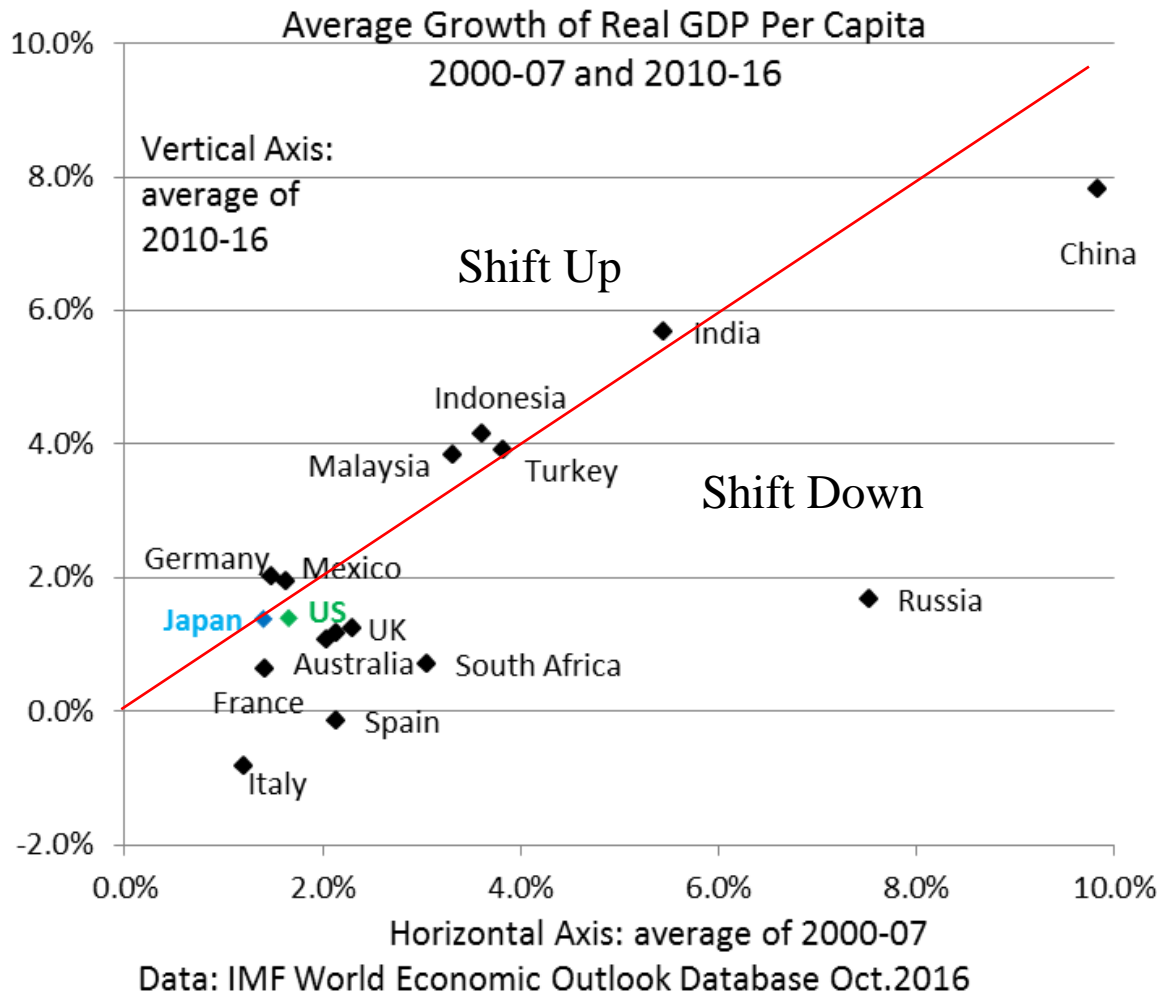
$$\text{Real GNI} = \text{Real GDP} + \text{trading gains or losses} + \text{income balance (real term)}$$

Why the real GNI growth is higher than that of the real GDP in Japan recently ?

- 1) big surplus of income balance which is stable in spite of recent appreciation of Yen.
- 2) decreasing trend of trading losses thanks to a sharp decline of the energy and other natural resource prices.



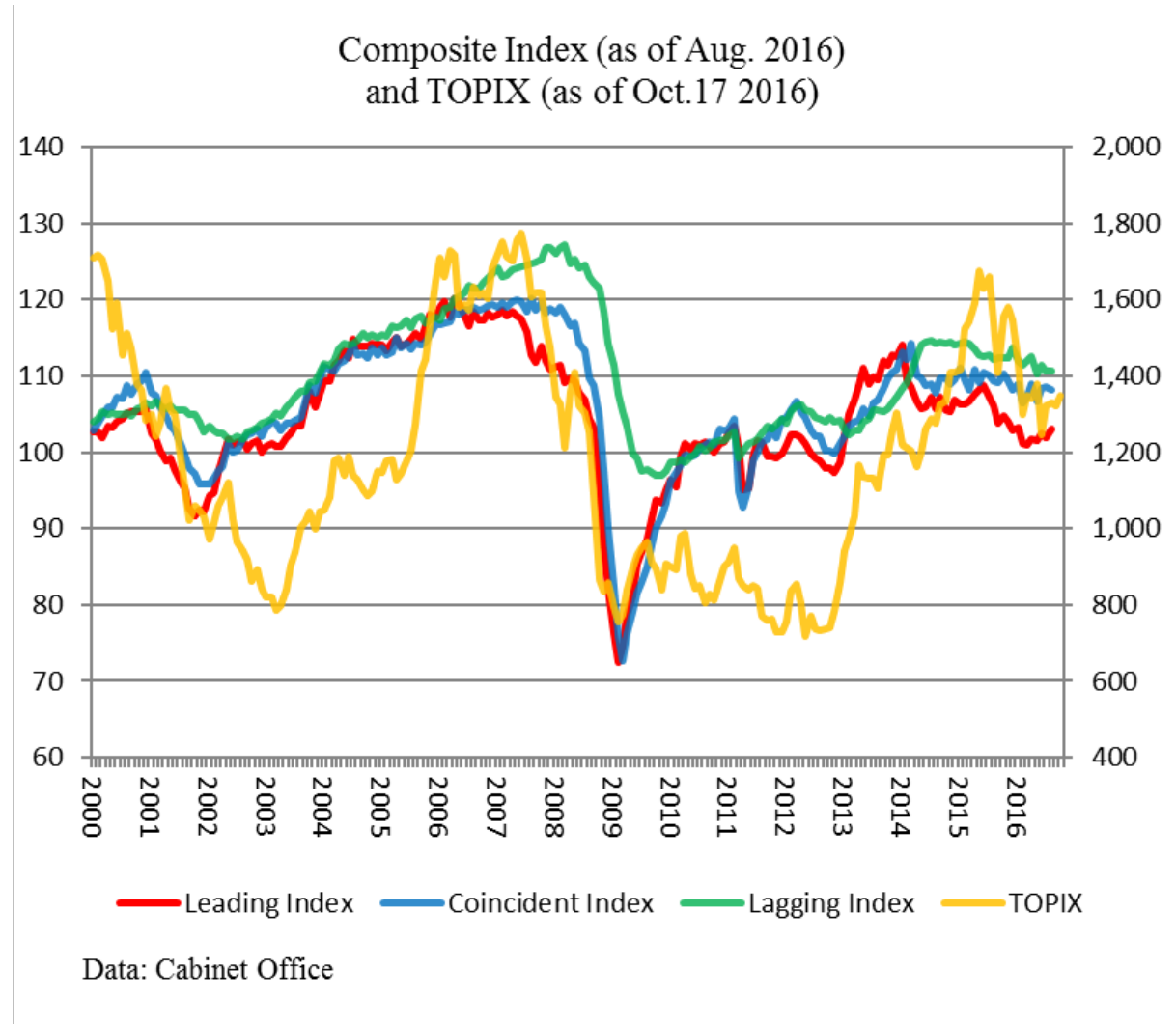
If you look at the average growth of real GDP per capita, you can see more clearly what has changed and what has not changed after the financial crisis.



	average of 2000-07	average of 2010-15
China	9.8%	7.8%
India	5.4%	5.7%
Indonesia	3.6%	4.1%
Turkey	3.8%	3.9%
Malaysia	3.3%	3.8%
Mexico	1.5%	2.0%
Germany	1.6%	1.9%
Russia	7.5%	1.7%
United States	1.7%	1.4%
Japan	1.4%	1.4%
United Kingdom	2.3%	1.2%
Brazil	2.1%	1.2%
Australia	2.0%	1.1%
South Africa	3.1%	0.7%
France	1.4%	0.6%
Spain	2.1%	-0.1%
Italy	1.2%	-0.8%

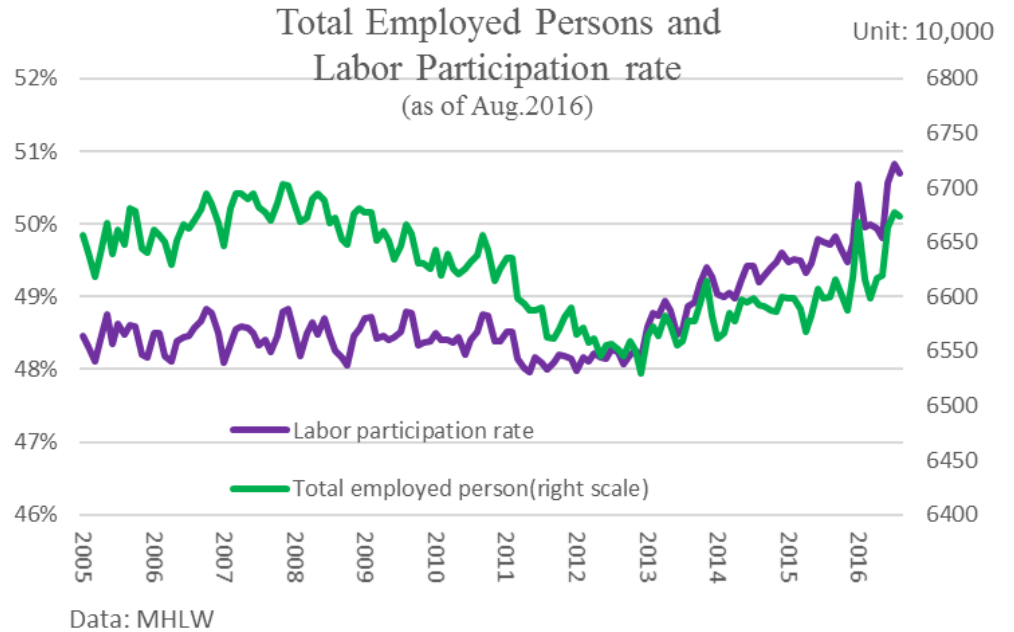
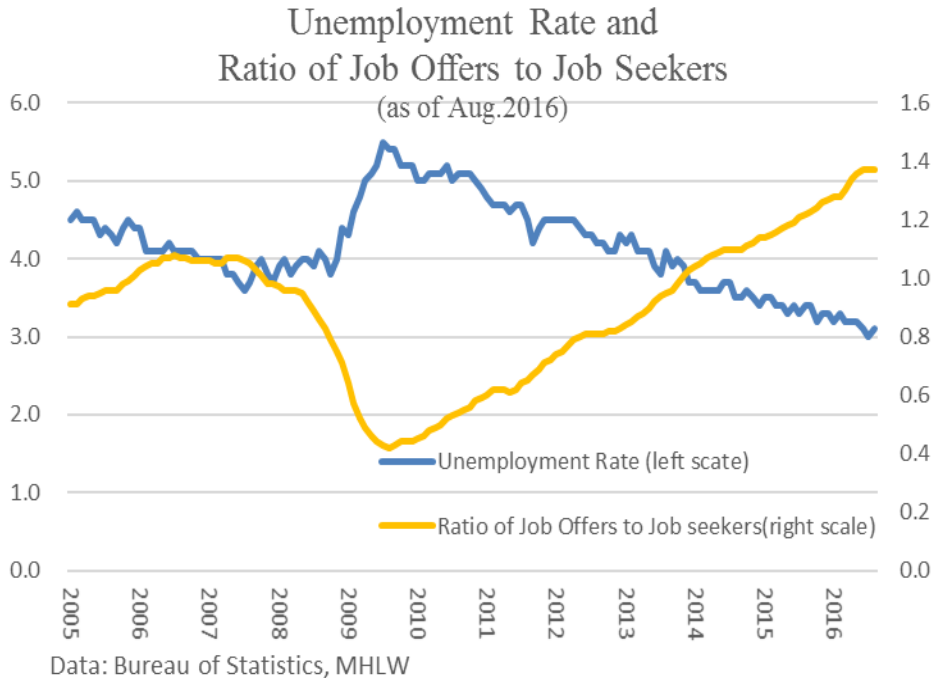
Mixed conditions of the current economic outlook

- 1) Growth of employment **still good**
- 2) Corporate profit **peaked out but still good**
- 3) Growth of income or compensation **moderately good**
- 4) Consumption **sluggish**
- 5) Exports **sluggish**
- 6) Capital spending **sluggish**

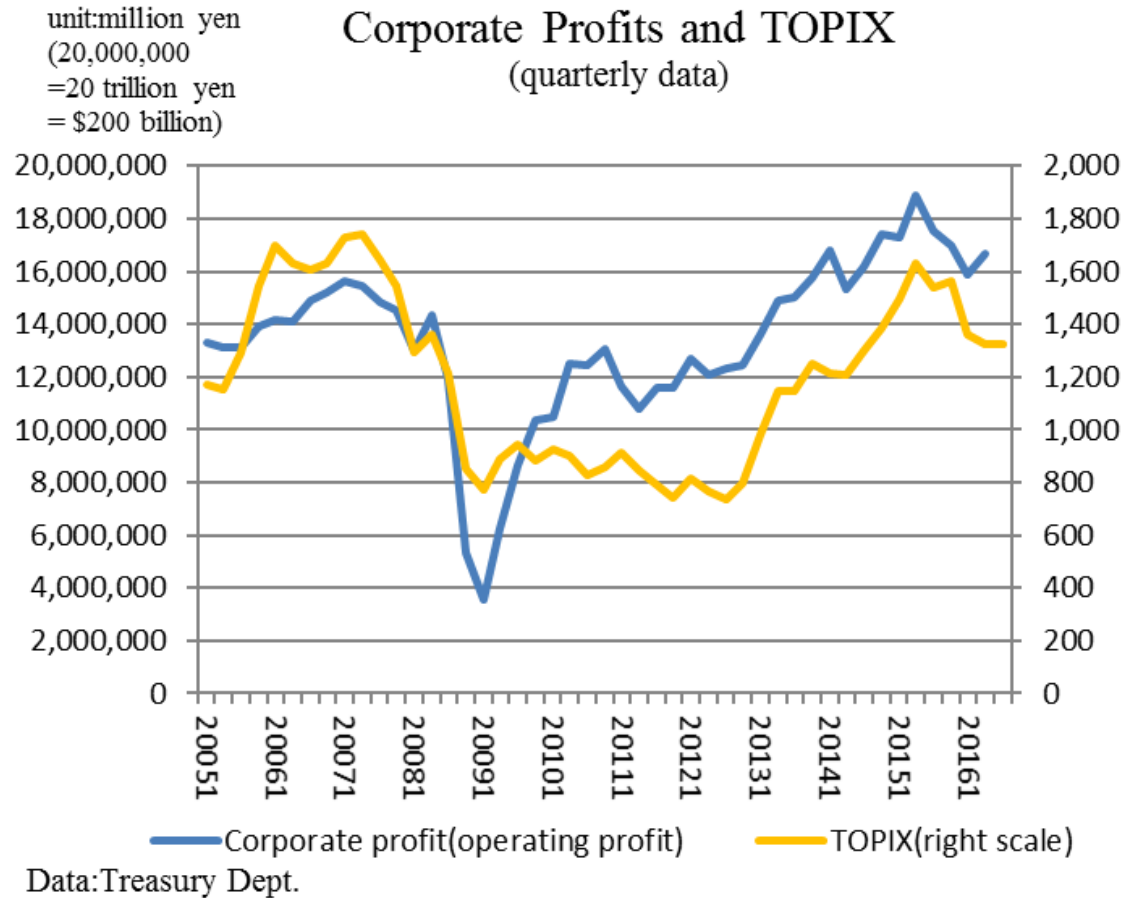


The labor market has continued to improve.

Both the total number of employed persons and the labor participation rate have been rising since 2013 due to a rise of the labor participation rate of women which rose to 50.7% in Aug.2016 from 48.2% in Dec.2012.

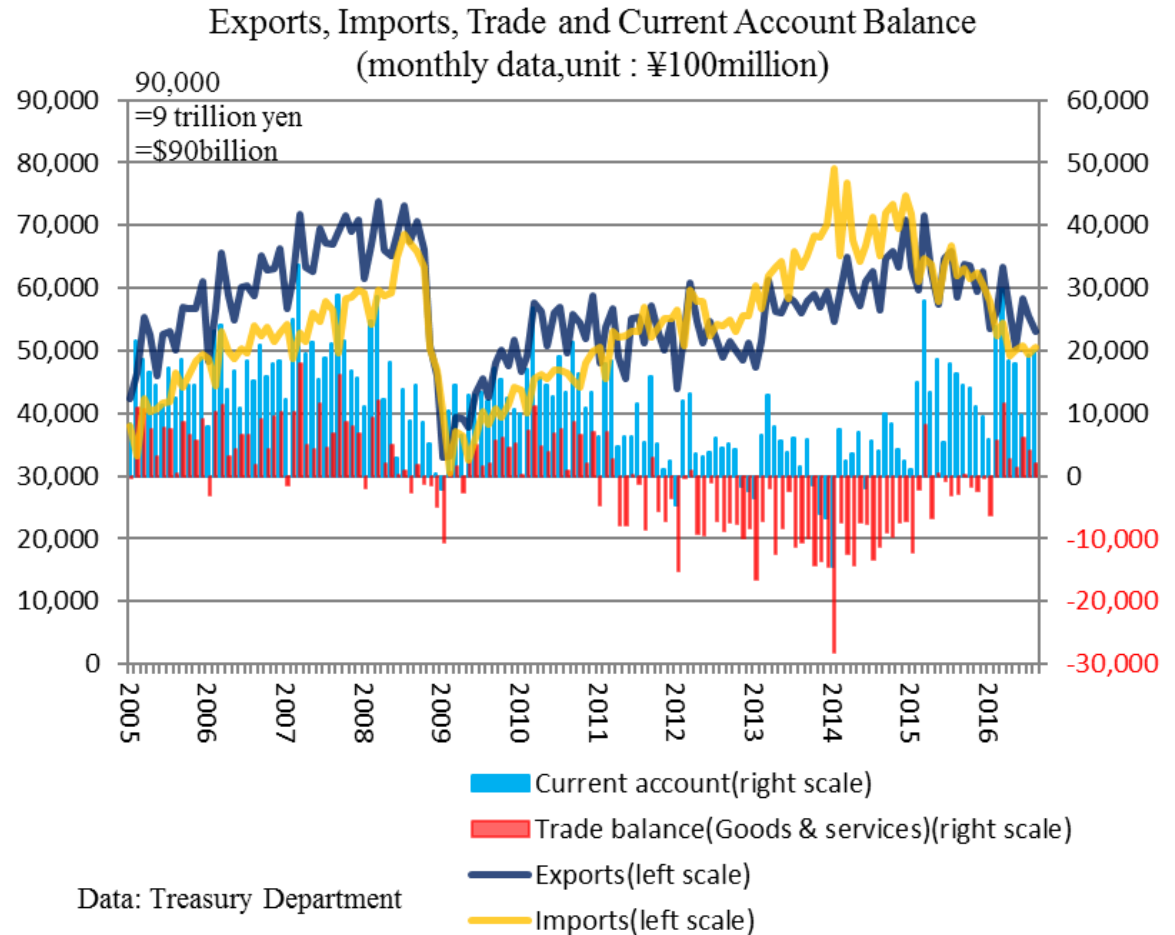


Profits of the corporate sector (excluding banks and insurance) has dropped 12% from its peak at 2015/2Q but remains at a good level.



Both exports and imports are sluggish but the trade balance has turned to surplus due to a decline of the energy and other natural resource prices.

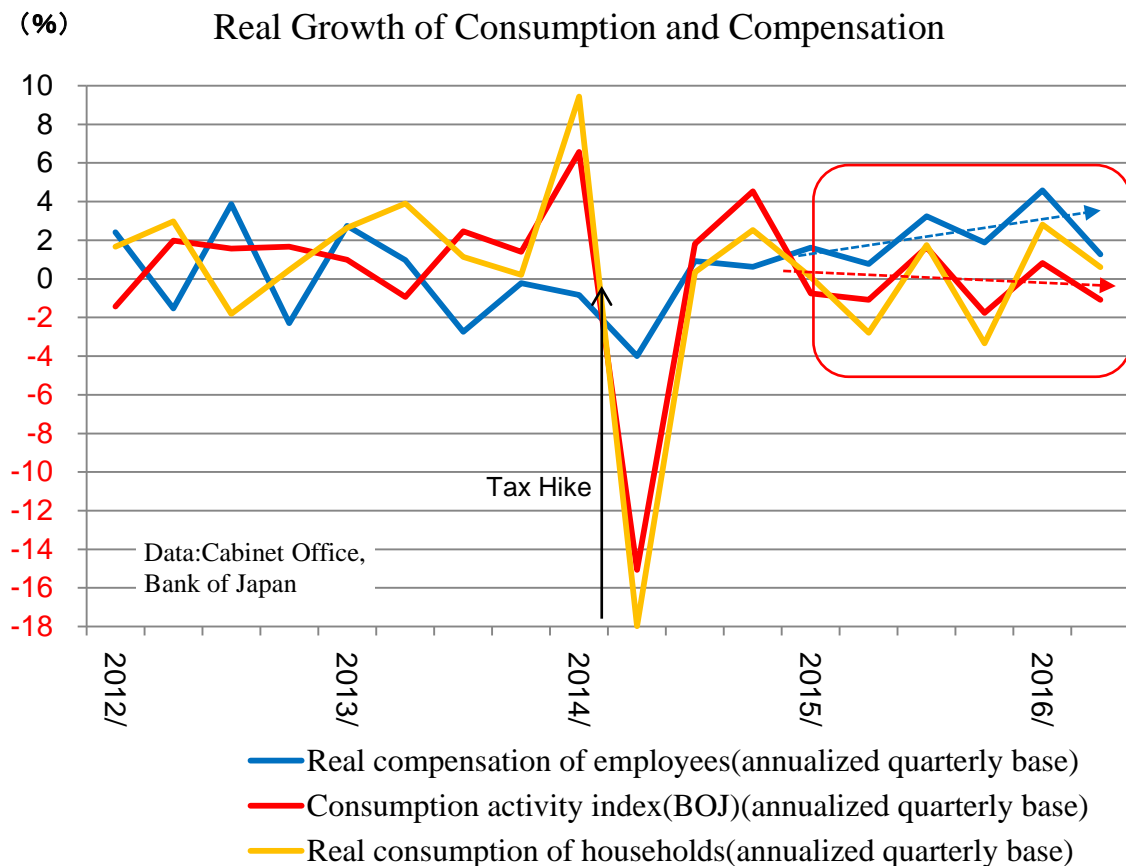
The surplus of the current account balance recovered to the level before the financial crisis in 2008.



A drop of consumption after the consumer tax hike to 8% from 5% in April 2014 was expected.

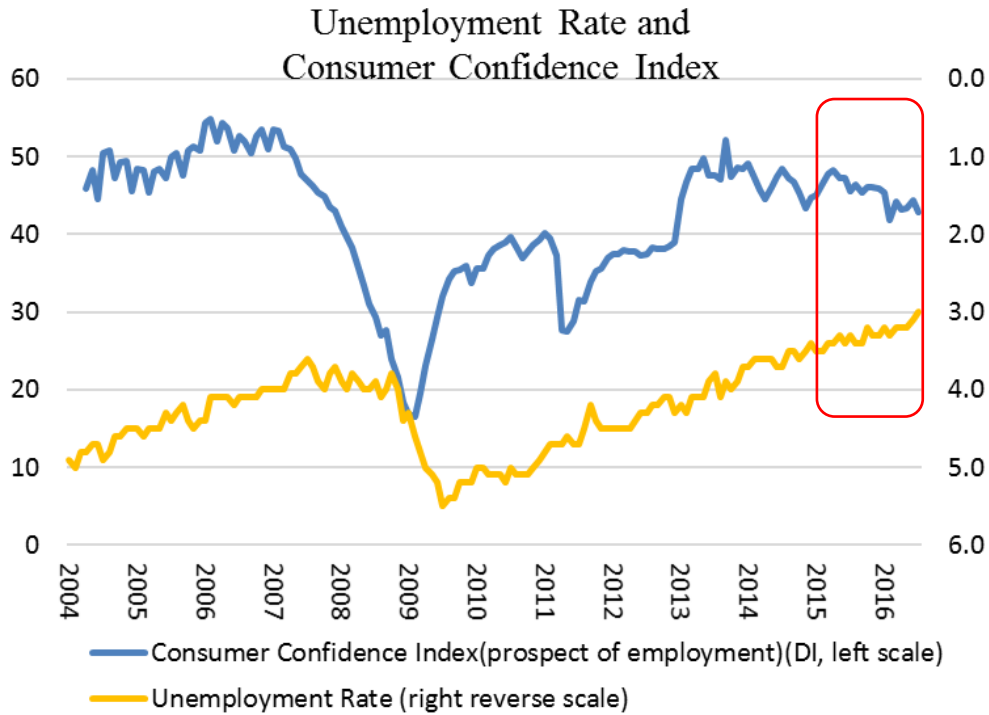
What is puzzling is that the real consumption growth has been depressed although the real compensation has been increasing at a good pace since 2015.

The average annual growth of real compensation is +2.2% while that of real consumption is -0.4% (BOJ consumption index) and -0.1% (consumption of households in GDP)

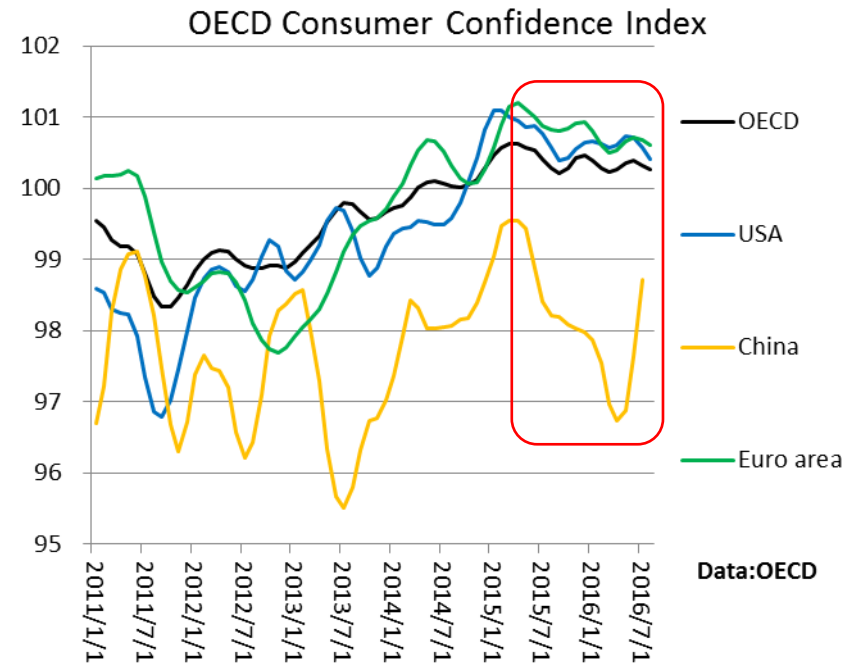


In spite of a steady improvement of the labor market, weaker consumer confidence which is reflected in the consumer confidence index (prospect of employment) appears to have depressed consumption.

What damaged the consumer confidence in 2015? Downward movements are also seen over the world. “China Shock” and the decline of the stock market since then appears to be one important factor to have damaged the Japanese consumer confidence.



Data: Bureau of Statistics, Cabinet Office



Data:OECD

I could get a good regression result using 2 variables.

Period :2005/1Q-2016/2Q, quarterly data

Explained variable: changes of consumption activity index (y-o-y)

Explanatory variables: (1) changes of real compensation (y-o-y)

(2) changes of consumer confidence index (prospect of employment)(y-o-y)

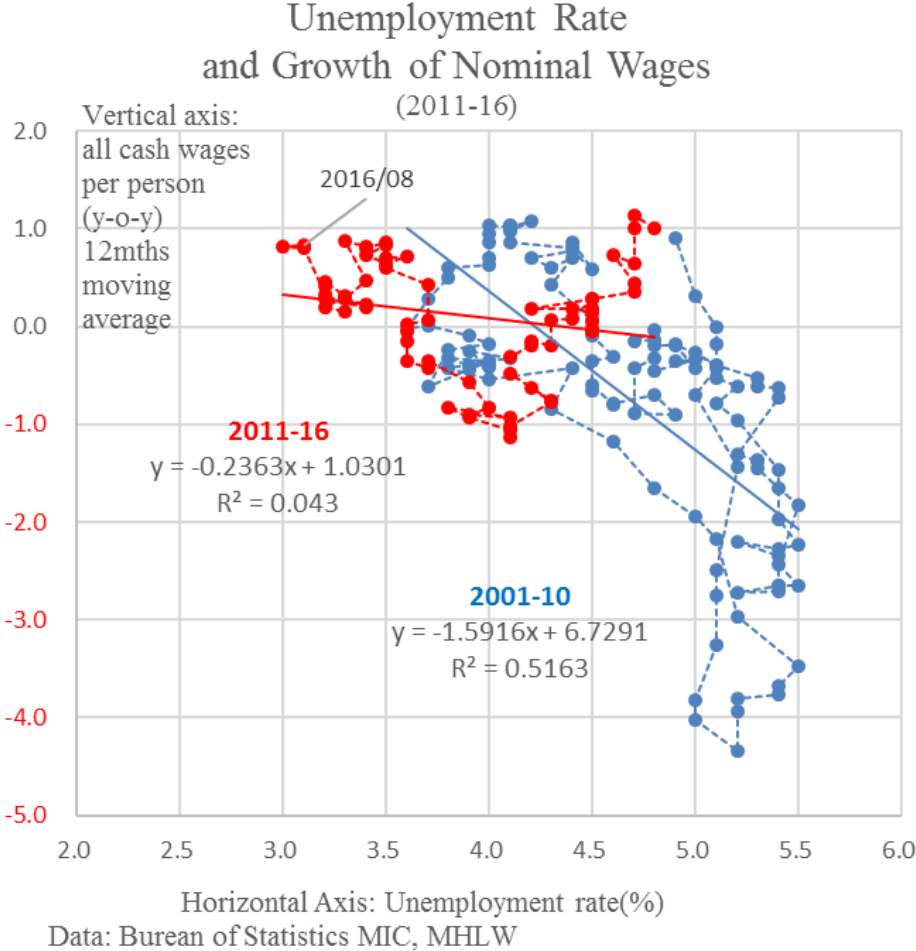
R square is 0.50 while it is 0.21 using only variable(1).

Regression statistics	
Multiple R	0.7084243
R Square	0.501865
Adjusted R Square	0.4781443
Standard Error	0.0120997
Observation	45

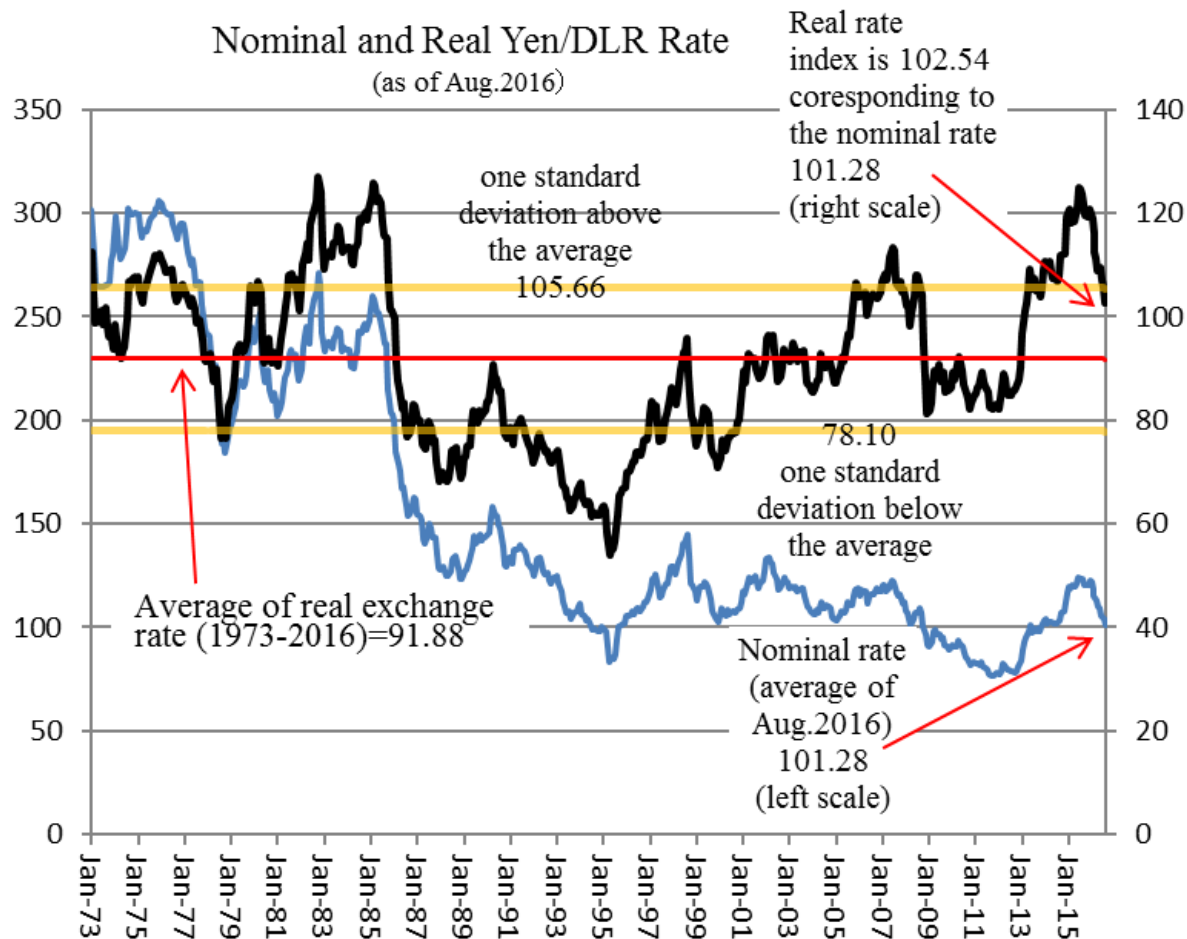
ANOVA					
	df	ss	ms	f	Significance F
Regression	2	0.0061949	0.0030975	21.157249	4.40847E-07
Residual	42	0.0061489	0.0001464		
Total	44	0.0123438			

	Coefficients	Standard Error	t Stat	P-Value
Intercept	0.0014004	0.0019305	0.7253925	0.4722339
Changes of Real Compensation(y-o-y)	0.463102	0.136572	3.3909008	0.0015274
Changes of Consumer Confidence Index(employment)(y-o-y)	0.033411	0.0066808	5.0010694	1.061E-05

“Upward rigidity of wages” which I told last Nov. appears to have continued.



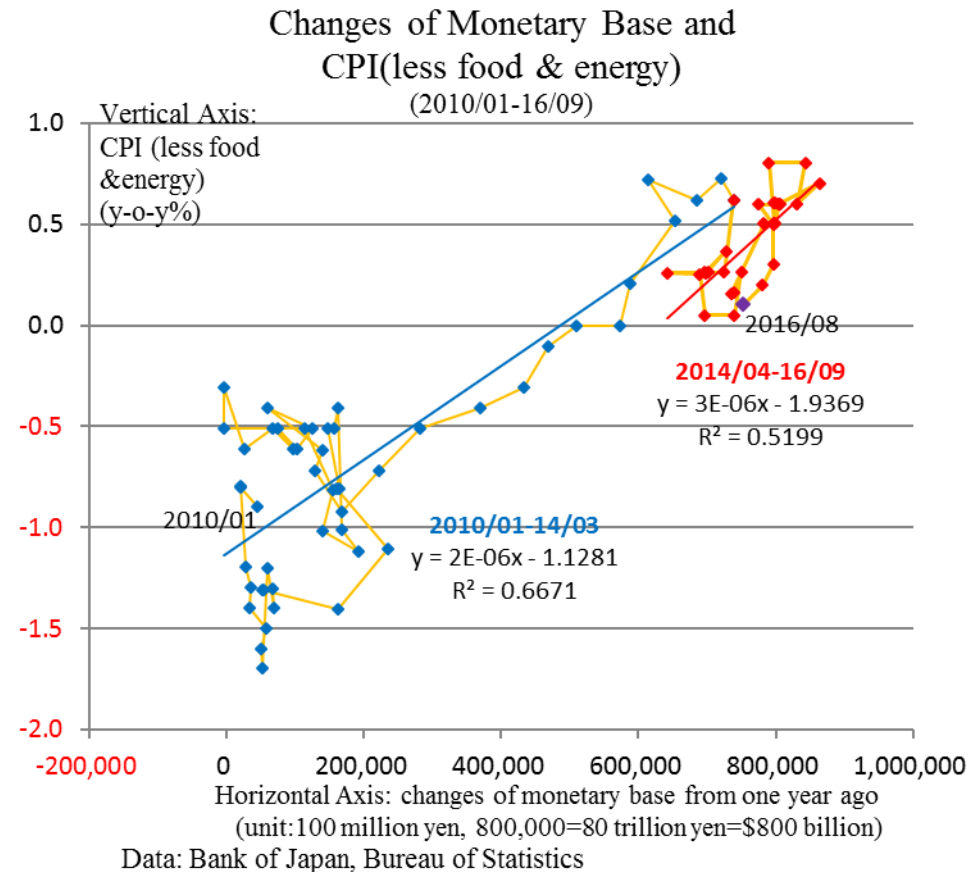
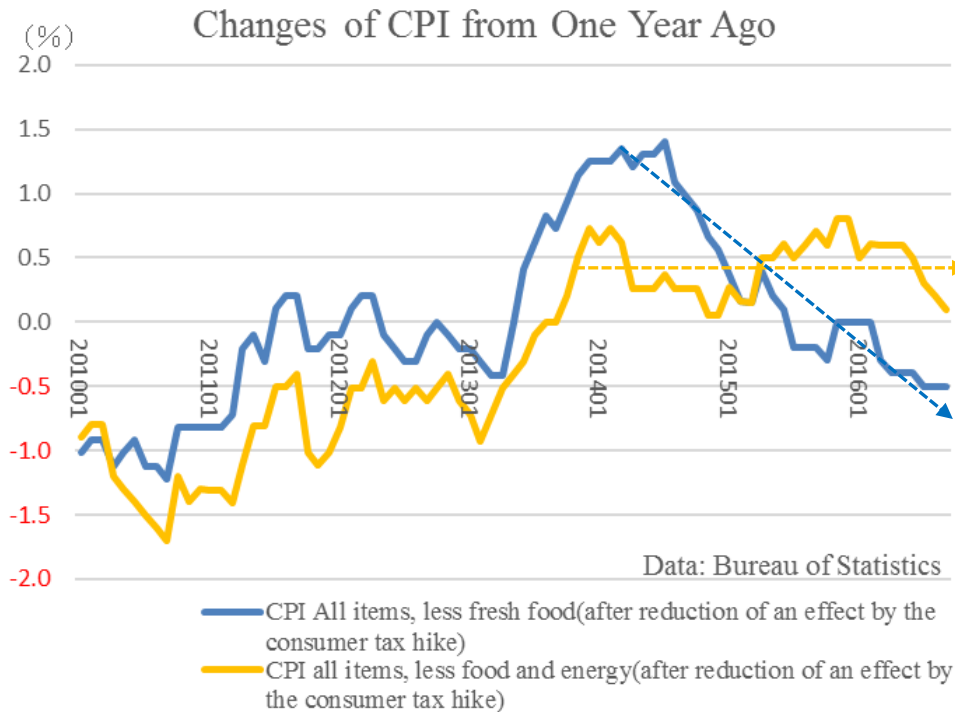
Undervaluation of yen has been corrected substantially.



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、Diminishing effect of the BOJ's unconventional monetary policy

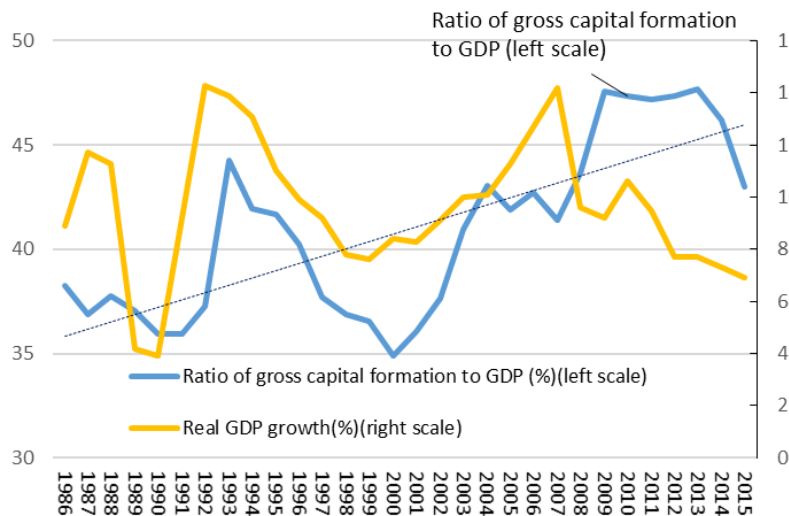
The growth of CPI (all items less fresh food) lowered to less than zero due to a decline of energy prices and lower import prices accompanied by the appreciation of Yen. The unconventional monetary policy by BOJ appears to have weakened or lost its effect on “expectation”.



3, Growing risk of financial turmoil in China?

Ratio of capital formation to GDP is increasing accompanied by the expansion of credit although its real GDP growth is getting lower.

Real GDP Growth and Ratio of Capital Formation to GDP in China



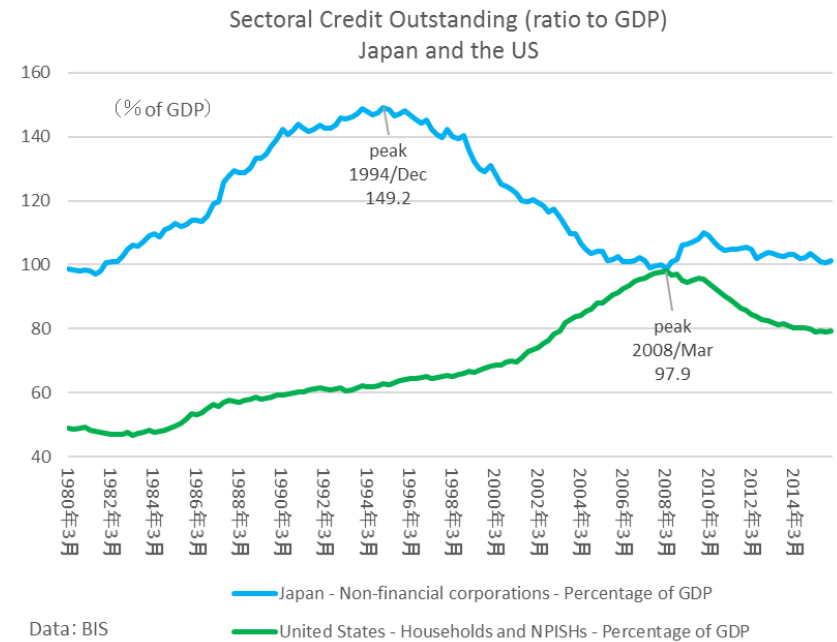
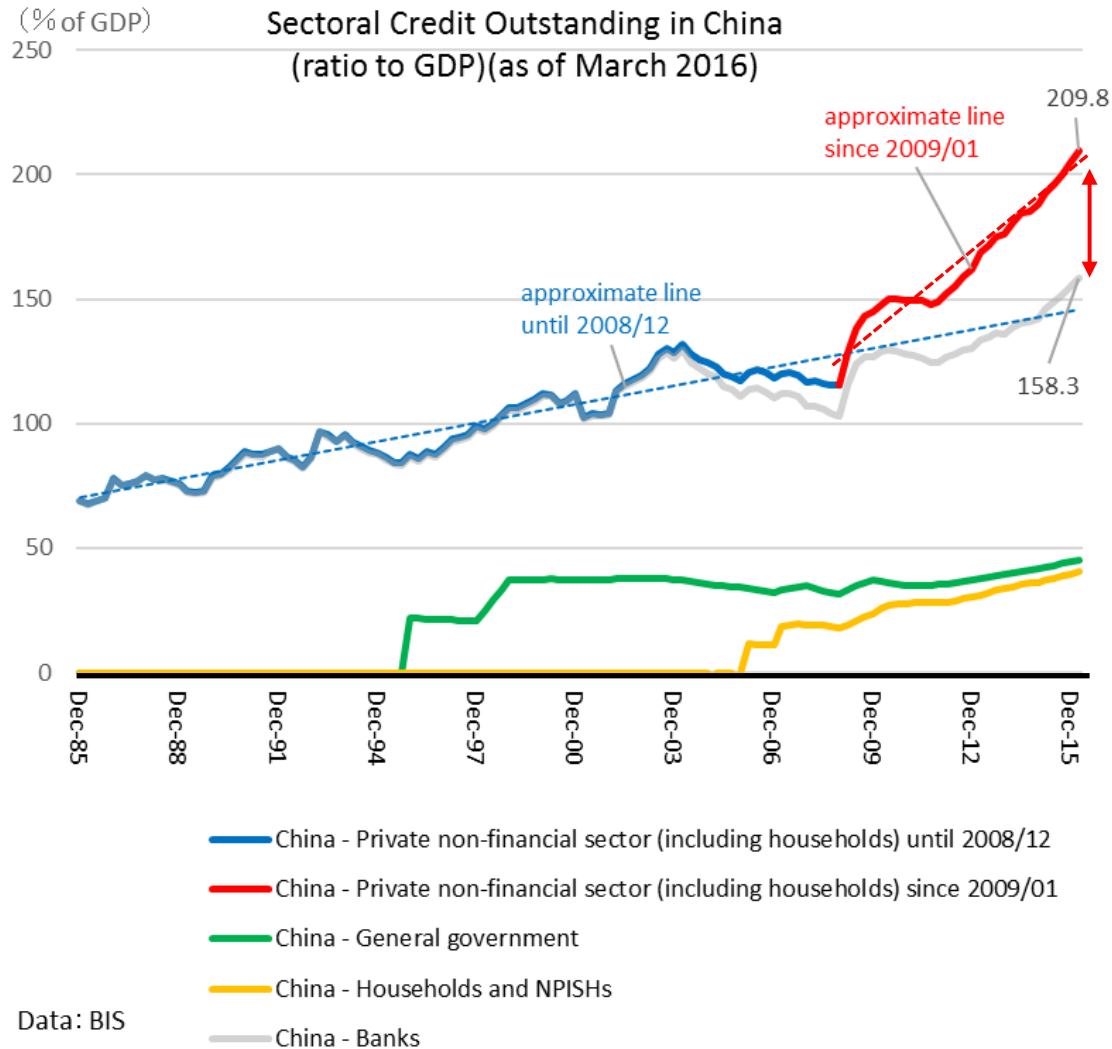
Data : China National Bureau of Statistics, World Bank World Development Indicators

Early warning indicators for stress in domestic banking systems¹

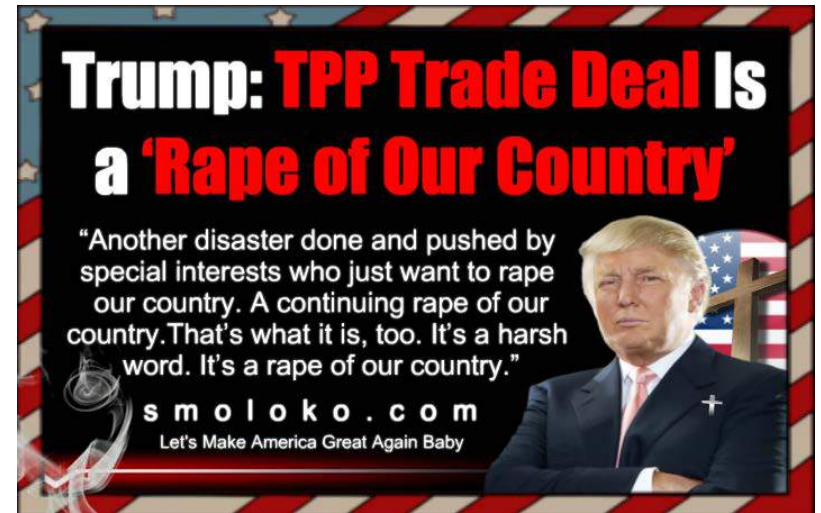
Table 1

	Credit-to-GDP gap ²	Property price gap ³	Debt service ratio (DSR) ⁴	DSR if interest rates rise by 250 bp ^{4, 5}
Asia ⁶	12.1	6.0	1.6	3.9
Australia	4.5	3.1	1.4	5.4
Brazil	4.6	-25.6	7.4	9.2
Canada	12.1	5.3	2.8	6.9
Central and eastern Europe ⁷	-11.4	8.8	0.1	1.5
China	30.1	-1.9	5.4	8.7
France	-0.6	-11.2	1.0	4.1
Germany	-6.1	13.3	-1.8	0.0
Greece	-13.2	9.4		
India	-2.9		1.8	2.9
Italy	-13.7	-15.4	-0.1	2.0
Japan	4.1	15.6	-2.0	0.8
Korea	3.1	5.7	-0.6	3.0
Mexico	8.8	5.0	0.6	1.3
Netherlands	-20.2	-12.2	0.7	5.4
Nordic countries ⁸	-0.8	4.1	1.0	5.0
Portugal	-40.5	12.4	-1.6	1.7
South Africa	-0.2	-9.0	-0.3	1.0
Spain	-47.6	-17.7	-3.2	-0.4
Switzerland	7.2	7.7	0.0	3.2
Turkey	9.6		5.7	7.3
United Kingdom	-27.0	-0.1	-1.7	1.0
United States	-9.9	4.7	-1.7	0.9

Credit outstanding of the private non-financial sector has been increasing faster than ever since 2009 accompanied by an expansion of the non-bank financial sector. The current course suggests a financial crash ahead?



What will be the fate of TPP?



All what we have done will be vain...



That's good.

