

Economic Outlook of Japan

Dark Clouds Ahead

Uncertainty in the Age of “the US-China New Cold War”



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1, Economic outlook of Japan

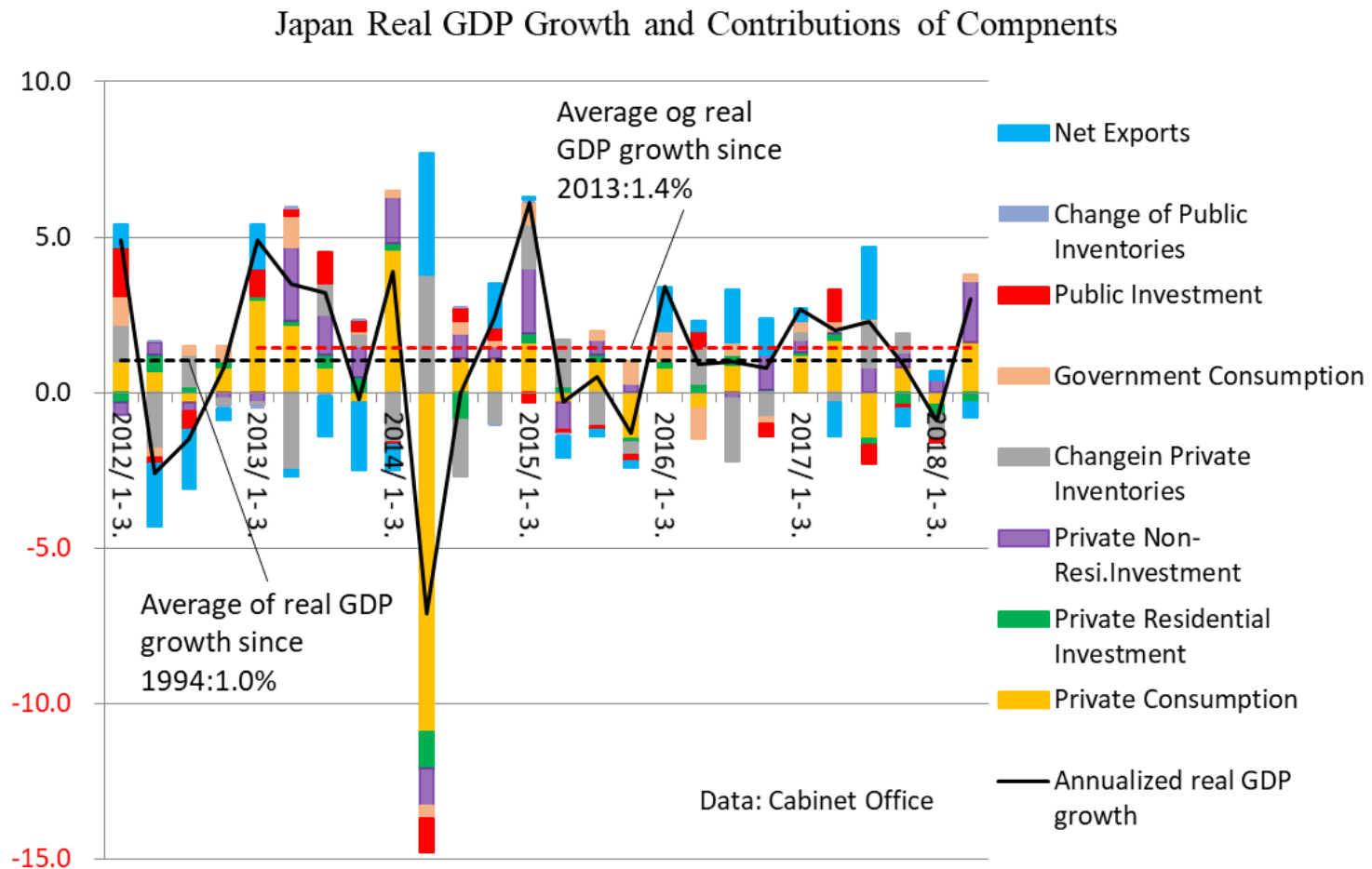
2, Performance of Abenomics and Kuroda's monetary policy

3, Japan and the US relationship under “the US-China new cold war”

1, Economic Outlook of Japan

The real GDP growth of the 2nd quarter of 2018 accelerated to +3.0% from the previous quarter -0.9%(annualized base).

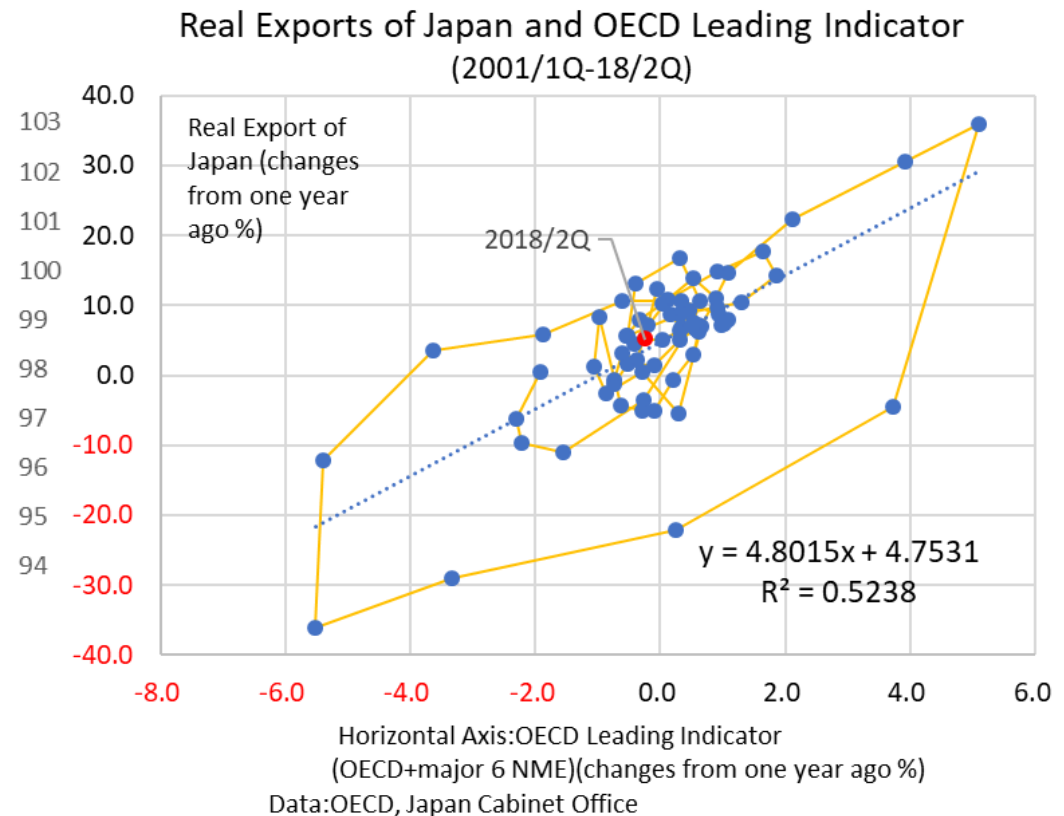
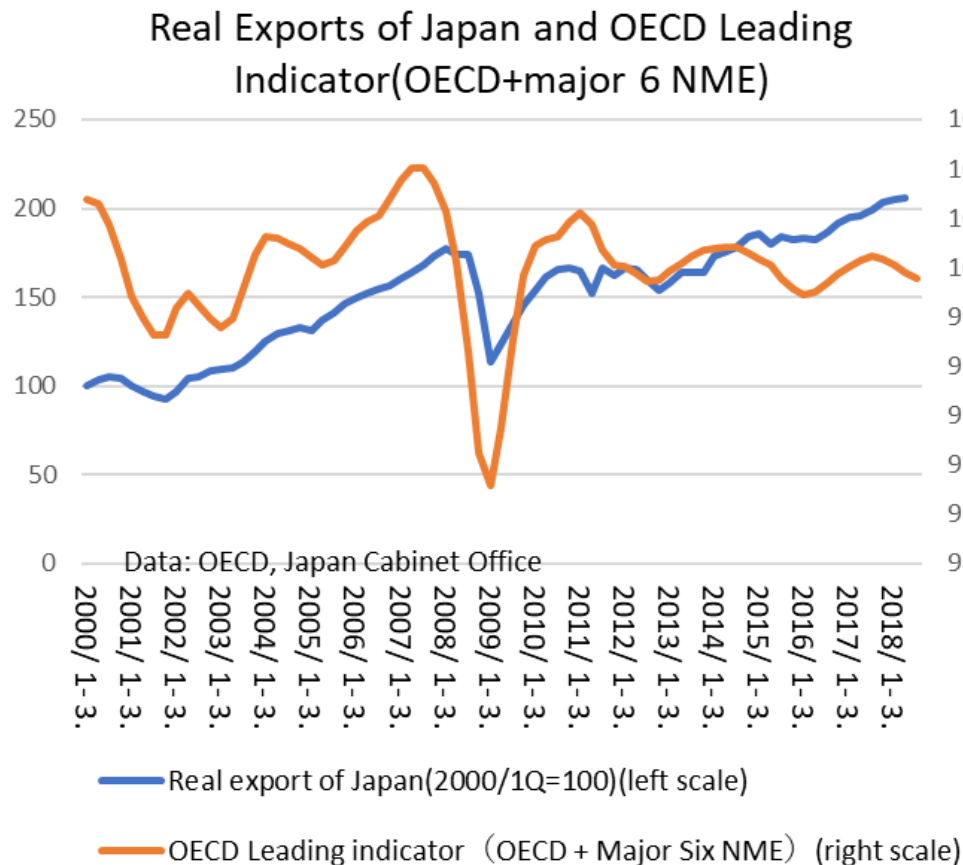
The annual GDP growth was +1.7 in 2017 and is forecasted to be +1.1% in 2018 and +1.3% in 2019 by JCER. There is concern over a slowdown due to the US-China trade war.



Growth of exports

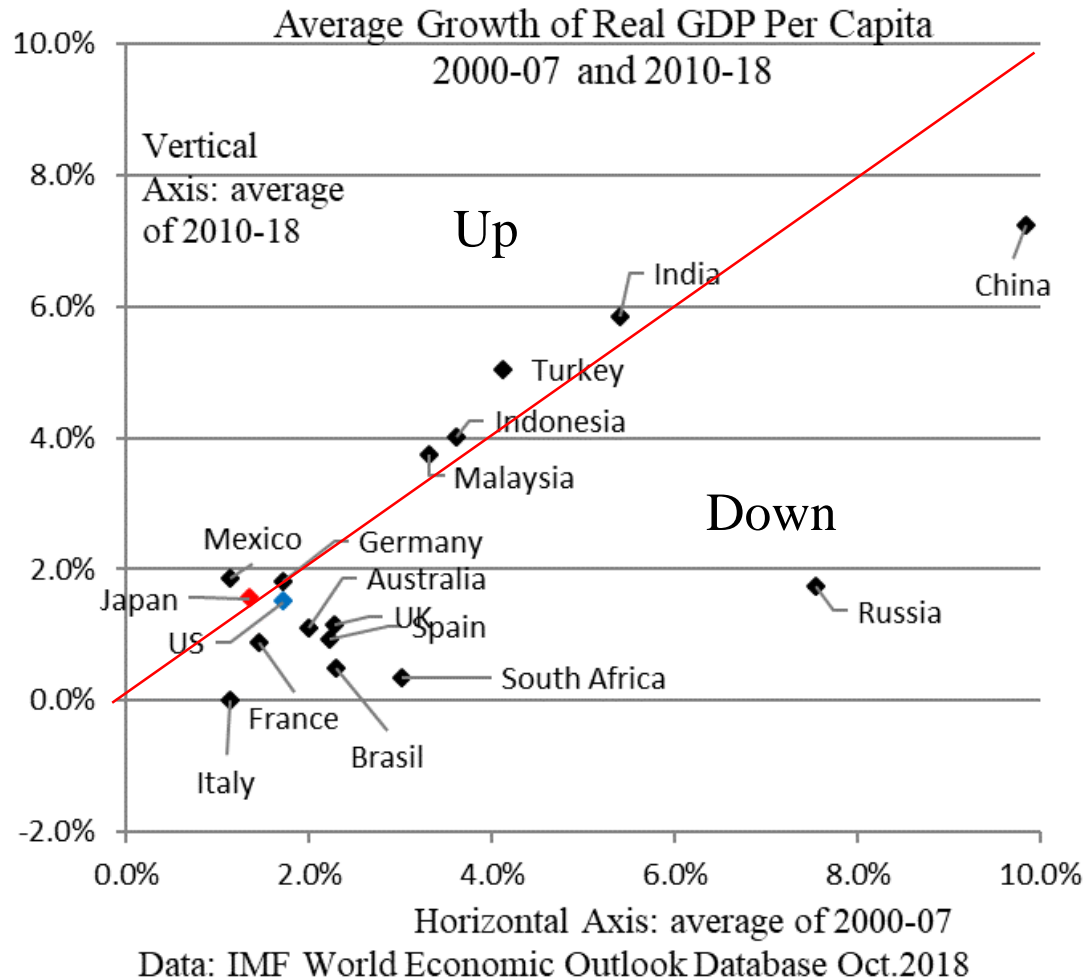
Japan has enjoyed the exports growth since 2016. However, it appears to wane due to a slowdown of overseas economy and the US-China new cold war.

Growth of Japanese exports depends more on overseas economic growth which is reflected on the OECD leading indicator (OECD + six major NME) rather than changes of the yen exchange rate.



Growth per capita

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 global financial crisis.



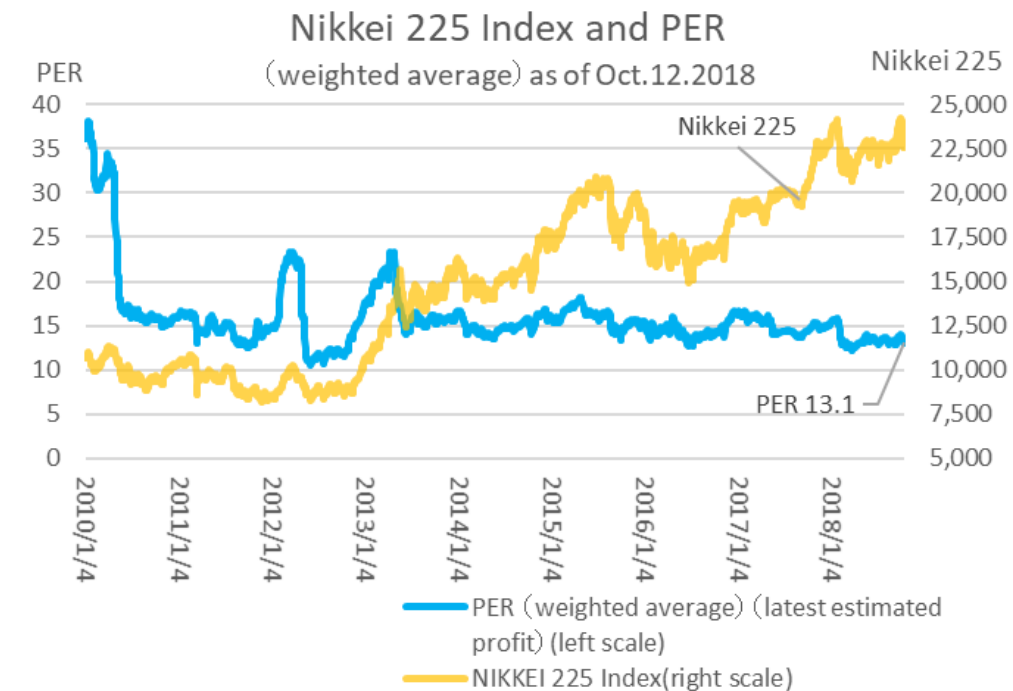
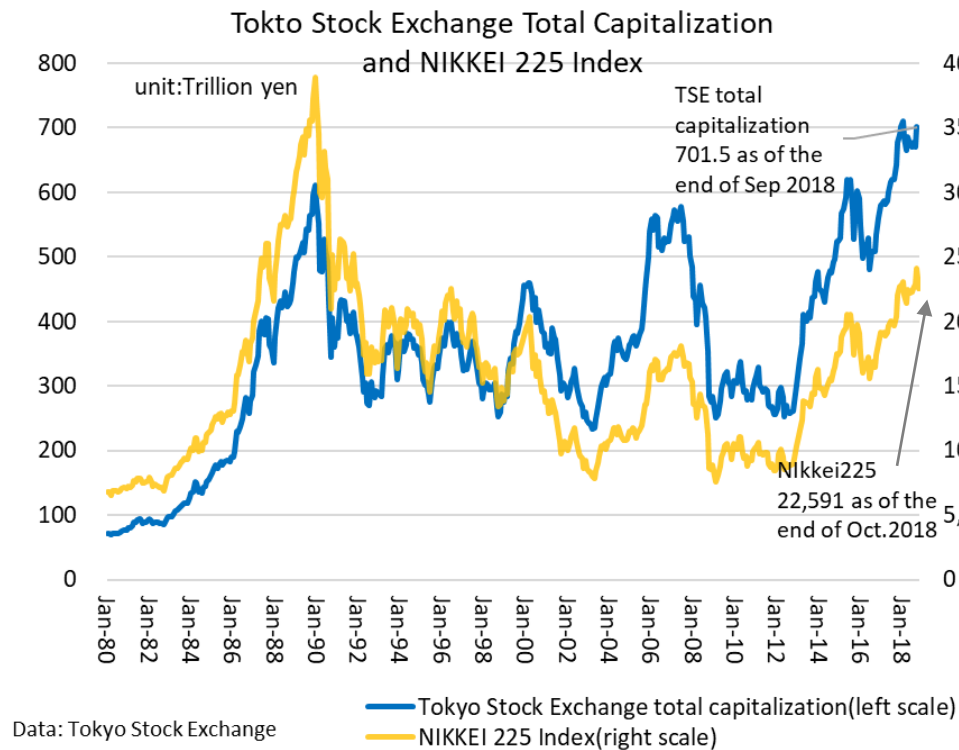
Real GDP Growth per capita			
	average 2000-07	average 2010-18	average 2000-18
China	9.8%	7.3%	8.5%
India	5.4%	5.9%	5.5%
Turkey	4.1%	5.1%	3.8%
Indonesia	3.6%	4.0%	3.9%
Malaysia	3.3%	3.8%	3.2%
Mexico	1.1%	1.9%	1.0%
Germany	1.7%	1.8%	1.4%
Russia	7.5%	1.7%	3.9%
Japan	1.4%	1.6%	1.0%
United States	1.7%	1.5%	1.2%
United Kingdom	2.3%	1.1%	1.2%
Australia	2.0%	1.1%	1.4%
Spain	2.2%	0.9%	1.1%
France	1.5%	0.9%	0.8%
Brazil	2.3%	0.5%	1.4%
South Africa	3.0%	0.3%	1.4%
Italy	1.1%	0.0%	0.1%

Growths of 2018 are IMF's forecast as of Oct.2018

Stock market

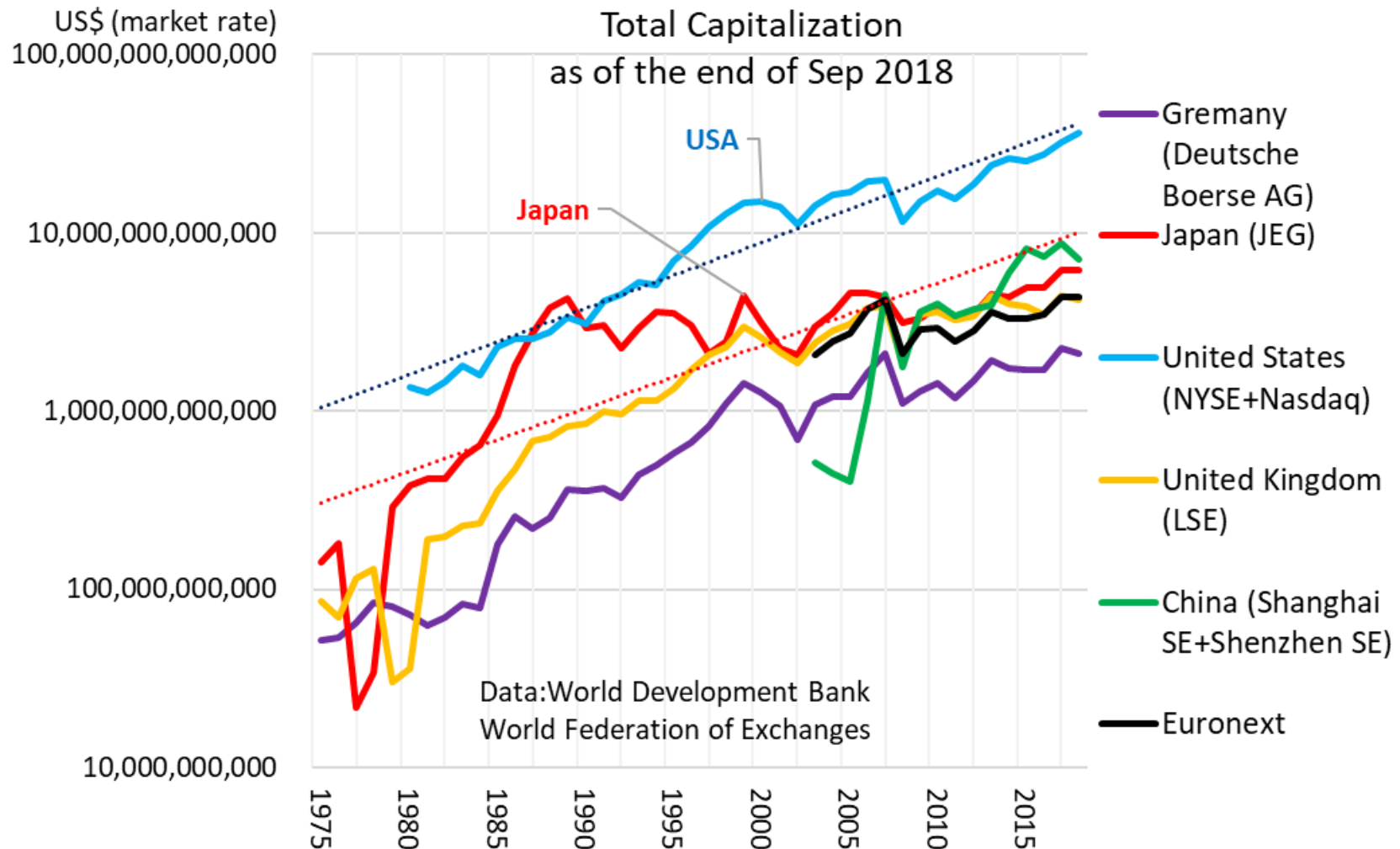
The total capitalization of Tokyo Stock Exchange has been increasing updating its historical record. But the average PER of Nikkei 225 Index is staying around 13.0 due to the robust growth of corporate profits.

There is no sign of overvaluation but it is vulnerable to declines in overseas stock prices, especially that of the US.



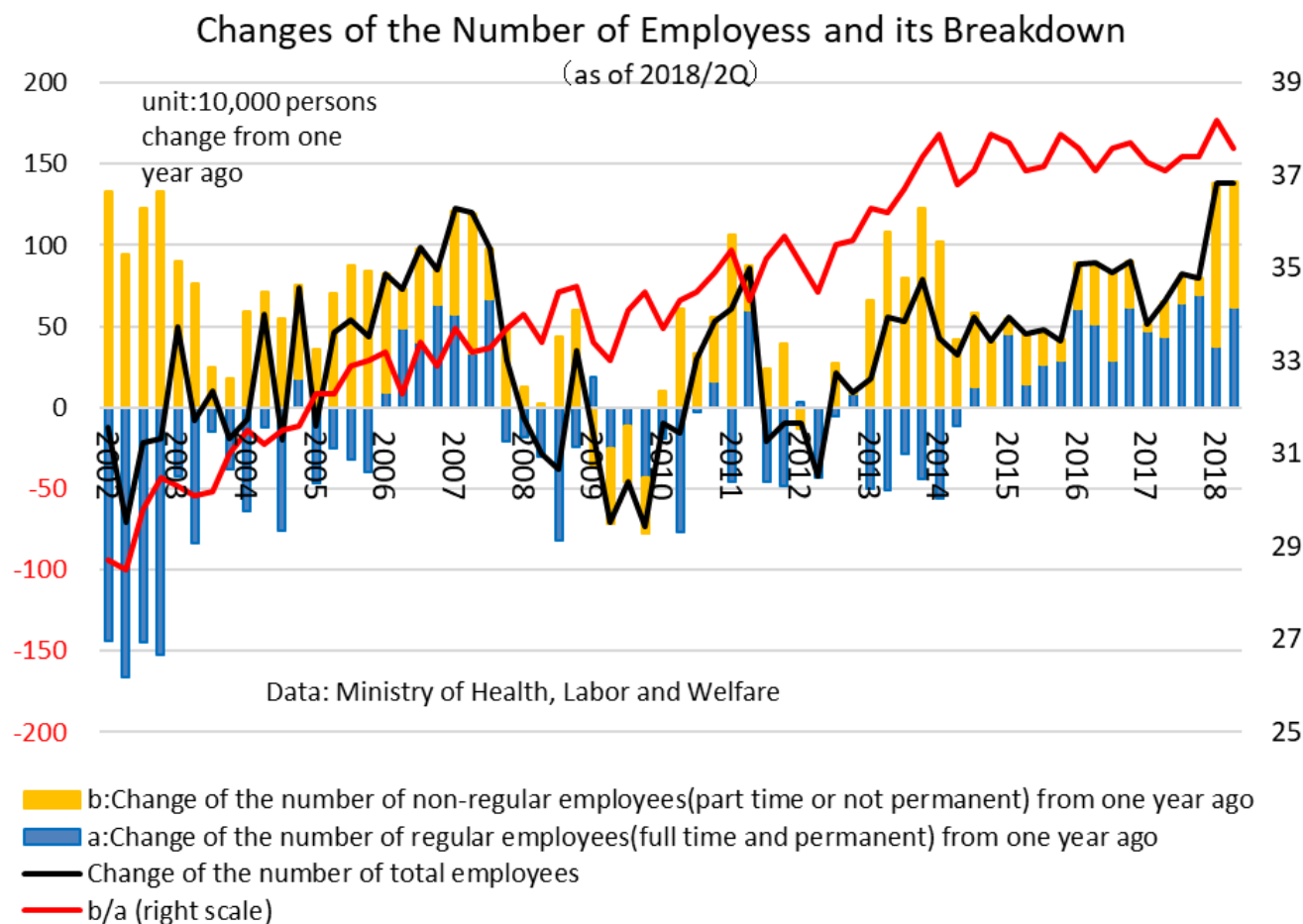
Data:Tokyo Stoch Exchange

As far as we see the market capitalization of stock prices, Japanese stocks got out of the long-term sluggishness during 1990-2012 and are returning to the average growth since 1975.



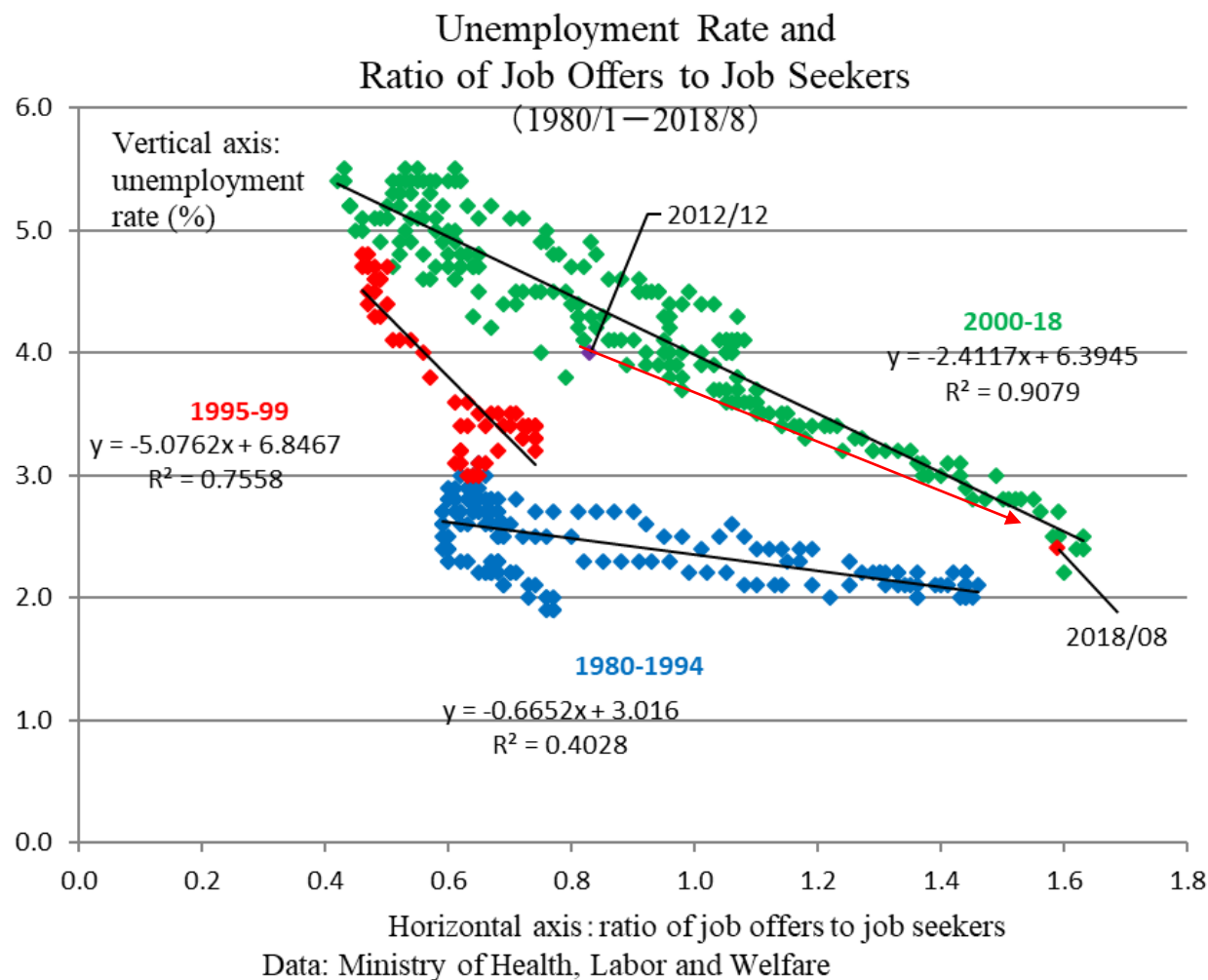
Labor market

The numbers of employees have increased 3.9 million (1.5 million as permanent employees and 2.4 million as temporally ones) since 2012/4Q. The most of changes came from the increase of female workers and senior workers over 65 years old.



The labor market is very tight.

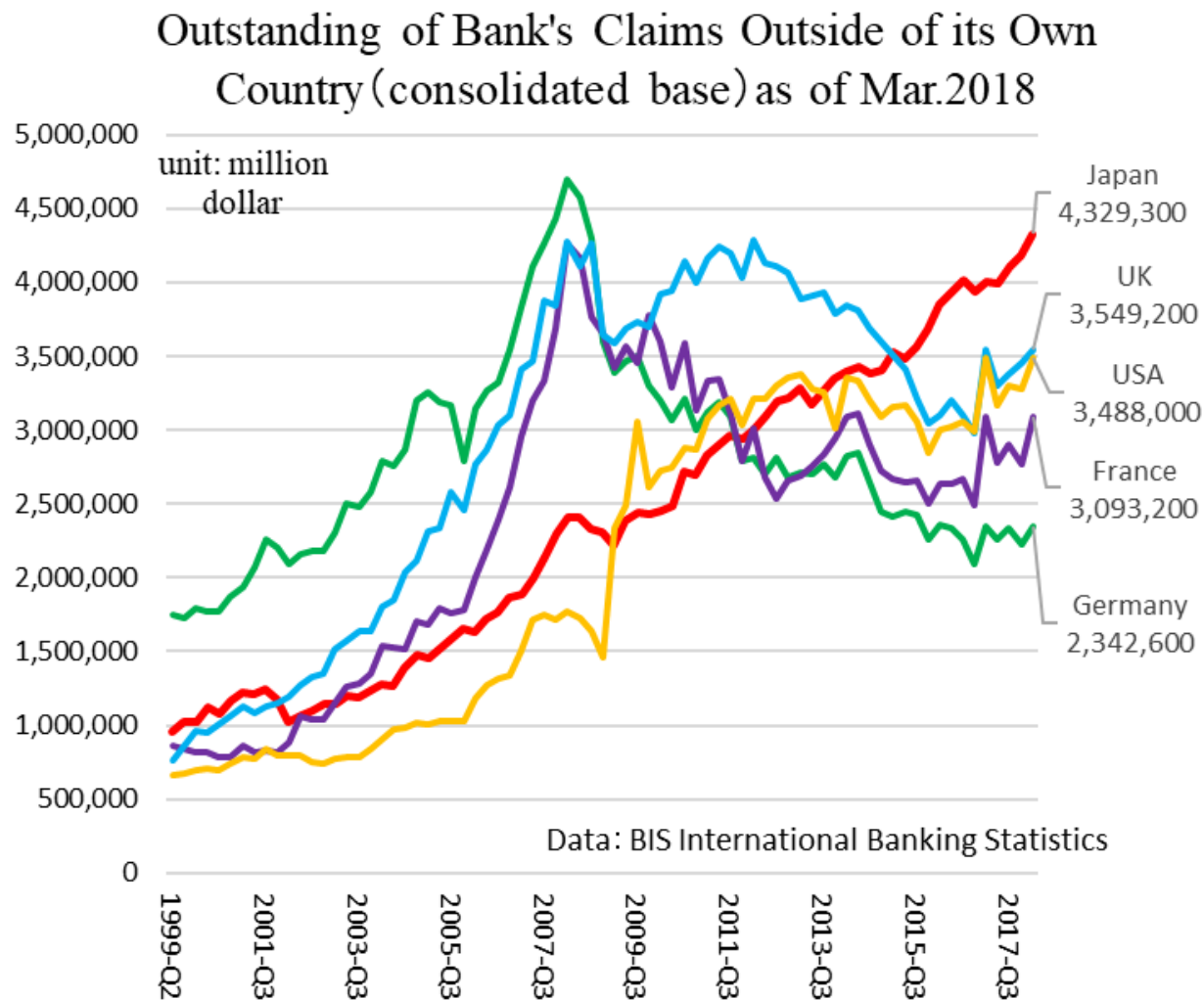
The condition of labor market has returned to the level of 1980's as far as watching the unemployment rate and the ratio of job offers to job seekers. However, the growth of wage is not robust.



International finance

Major Japanese banks are steadily increasing their financial exposures overseas.

Note: the data of Japanese banks is different from the others in that the balance of the trust account is nearly 50%.



The characteristic of overseas claims by major Japanese banks is that dollar exposures for the developed countries, especially for the US, account for a large proportion.

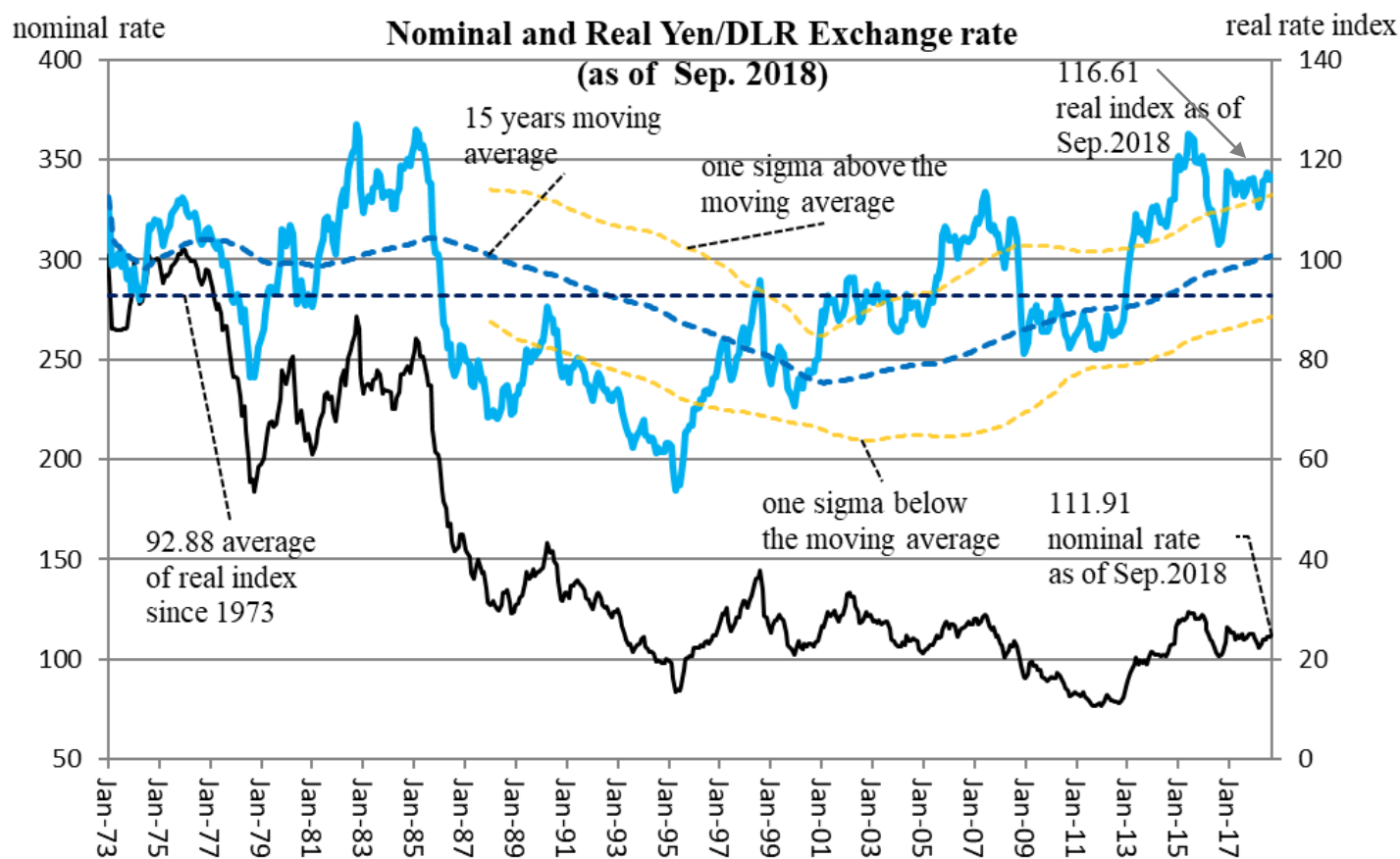
Result of 2018/01-06 from Project Finance International July 11 2018

GLOBAL INITIAL MANDATED LEAD ARRANGERS

	Mandated arrangers	US\$(m)	%	No of deals
1	Mitsubishi UFJ	5,889.1	5.7	53
2	SMBC	4,577.9	4.4	56
3	Societe Generale	3,295.7	3.2	41
4	ING	3,264.3	3.1	39
5	Credit Agricole	3,220.3	3.1	37
6	Santander	3,029.3	2.9	37
7	Morgan Stanley	2,687.5	2.6	7
8	BNP Paribas	2,665.9	2.6	34
9	Mizuho Financial	2,450.8	2.4	26
10	ICBC	2,313.5	2.2	14

Exchange rate of Yen/DLR

The yen rate is undervalued at the current level. I expect it will be corrected toward appreciation of yen after we see the peak of dollar's interest rate.



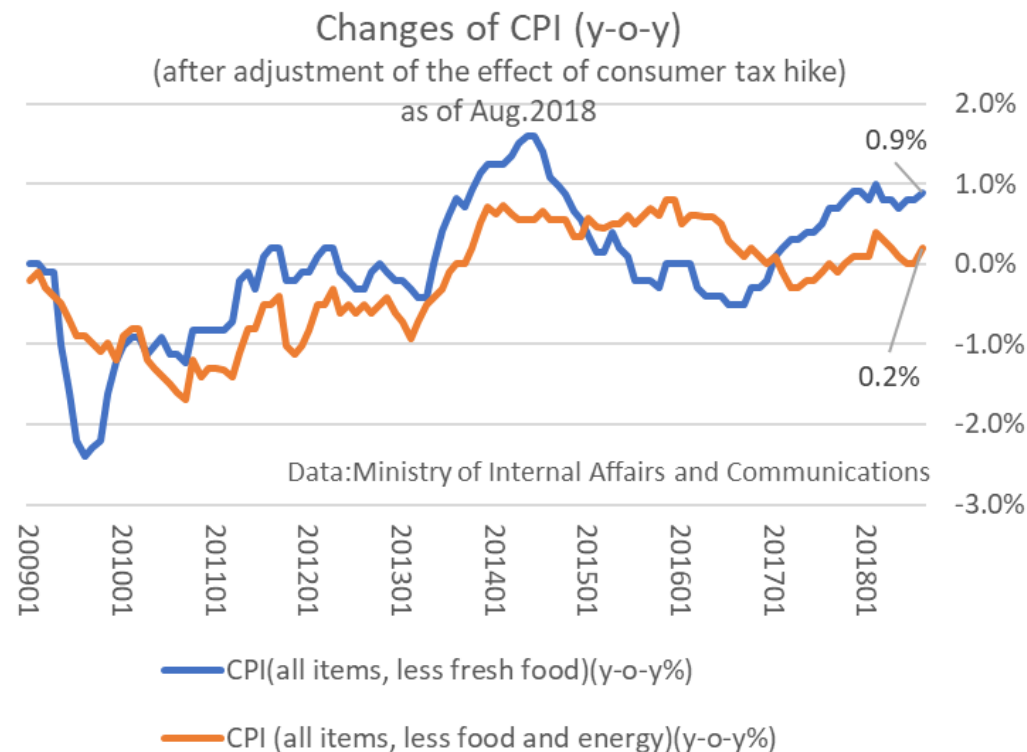
Data: Bank of Japan, US Labor Department

$\text{real index} = \text{nominal rate} / \text{relative PPP} \times 100$ Relative PPP is calculated based on the US PPI (producer price index), Japan CGI (corporate goods index) and 1973 as the starting point.

2, Performance of Abenomics and Kuroda's monetary policy

Performance of Abenomics and Kuroda's monetary policy

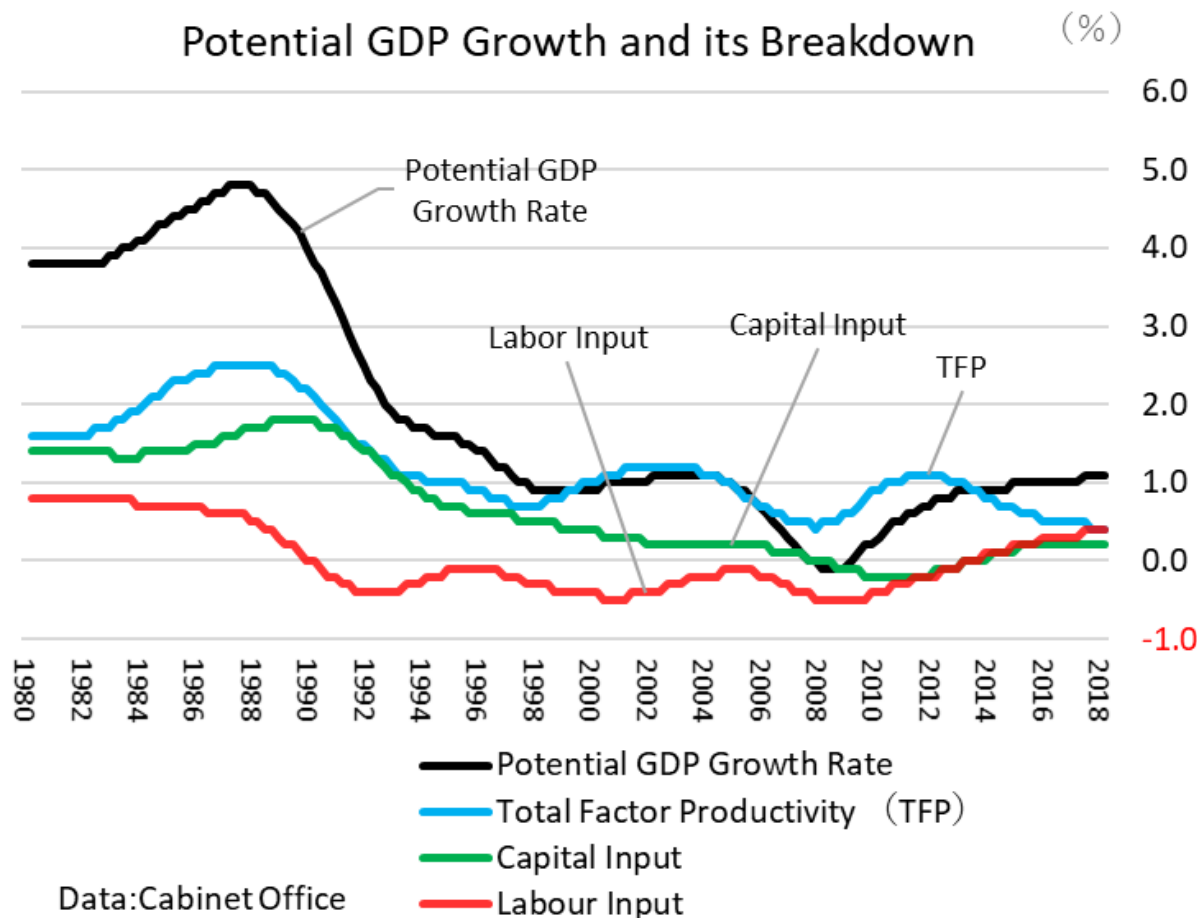
Correction of overvaluation of Yen	A
Recovery of stock prices	A
Increasing corporate profit	A
Job creating	A
Raising up wage growth	C
Achieving inflation target	C
Fiscal consolidation	C
Raising up productivity(or potential growth)	C
total	B



Potential growth

According the estimate of Cabinet Office, the potential real GDP growth, which once declined to around 0 % in 2009, recovered to +1.1%. However, most of recovery has been achieved by the increase of labor input rather than the improvement of TFP.

One reason depressing TFP growth is a growing demand in the health care service especially to the elderly which is a low added value sector.



Competitiveness

According the Global Competitiveness Report 2018 by World Economic Forum, Japan's rank rose up to the 5th from the 8th of the previous year.

Ranking : 1st USA, 2nd Singapore, 3rd Germany, 4th Switzerland, 5th Japan

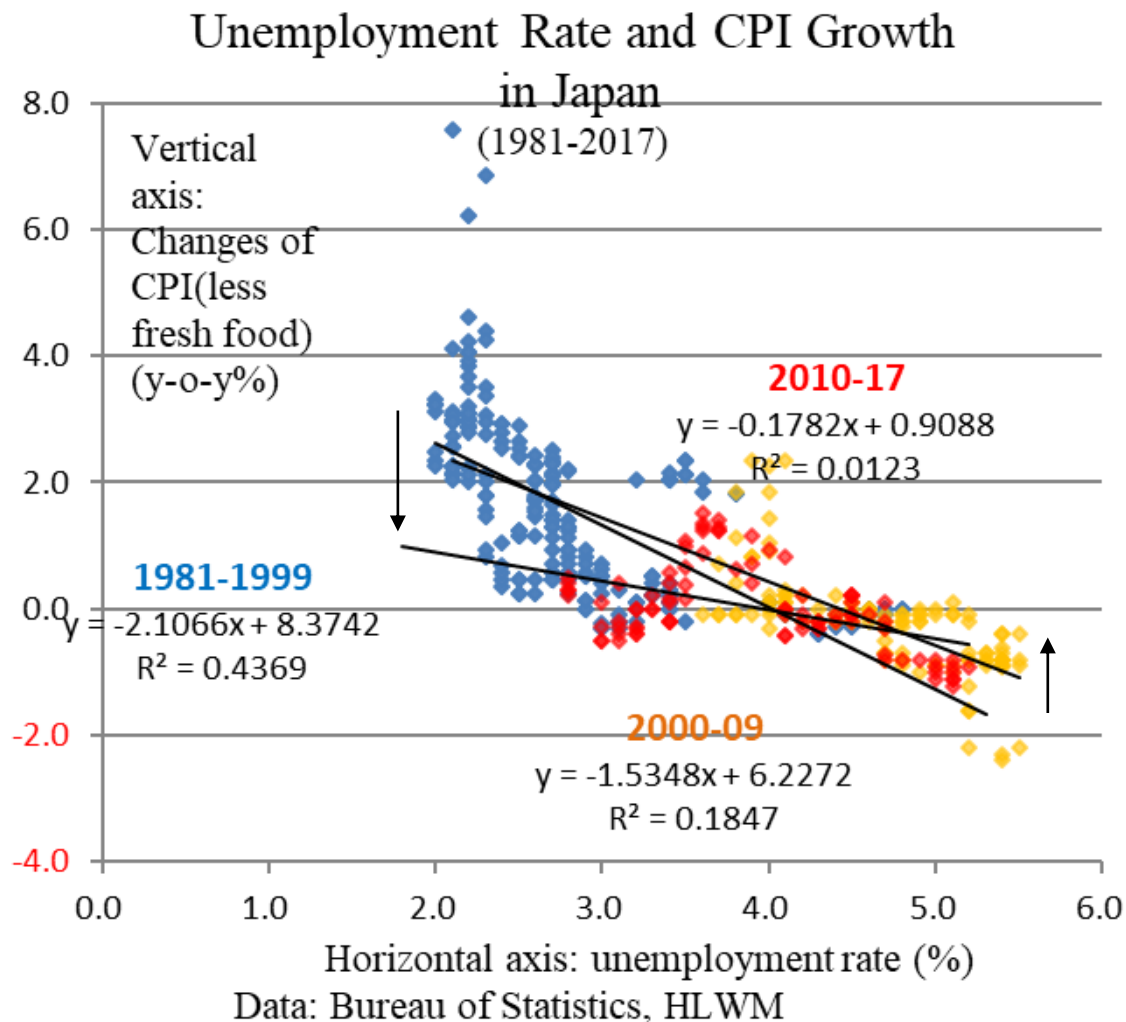


Flattening of the Phillips curve
This is the slide which I
presented at the meeting of last
year.

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Economists who have advocated
very expansionary action both at
monetary policy and fiscal policy
are still talking that 2% inflation
target will be achieved when the
growth of wages is going to
accelerate as the unemployment rate
lowers toward 2%.

I predict , however, the CPI growth
will be moderately higher (around
1.0%) next year but the 2% target of
BOJ appears to be unreachable
through 2018.



Why didn't Abenomics and Kuroda's monetary easing have enough effect to push up CPI to the target (+2% change y-o-y base) while it had worked well to depreciate the yen rate and restored the stock prices?

Opposite behavioral characteristics of the market participants in the different fields

In the financial market: forward looking expectation

The announcement of Abenomics and QQE had the effect to change the expectation of market participants.

- decline of the JGB's yield
- short position of yen and long position at the stock market
- The depreciation of yen had the effect to increase corporate profits.
- Higher stock prices are justified.

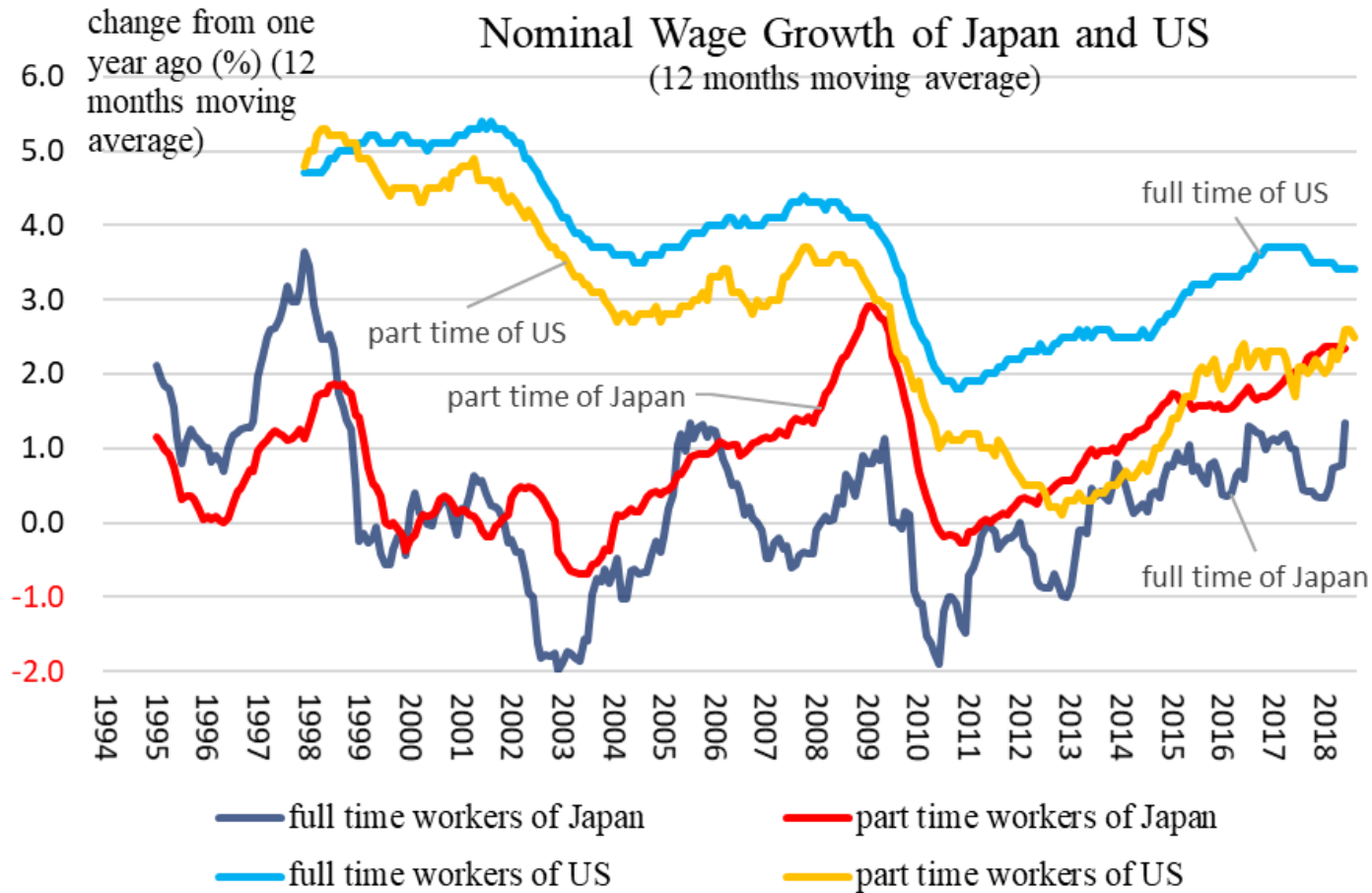
In the field of labor and consumption: backward looking expectation

- A request to increase base pay by labor unions was made based on the latest CPI change.

Corporate management had responded to the labor shortage by recruiting cheaper temporally workers than increasing permanent workers to save wage cost.

- depressed the average wage growth
- weak consumption growth
- keeping inflation rate low
- flattening the Phillips curve

The wage growth of part-time workers are nearly the same between Japan and the US during the last several years while that of the full time workers of Japan is depressed compared with that of the US.

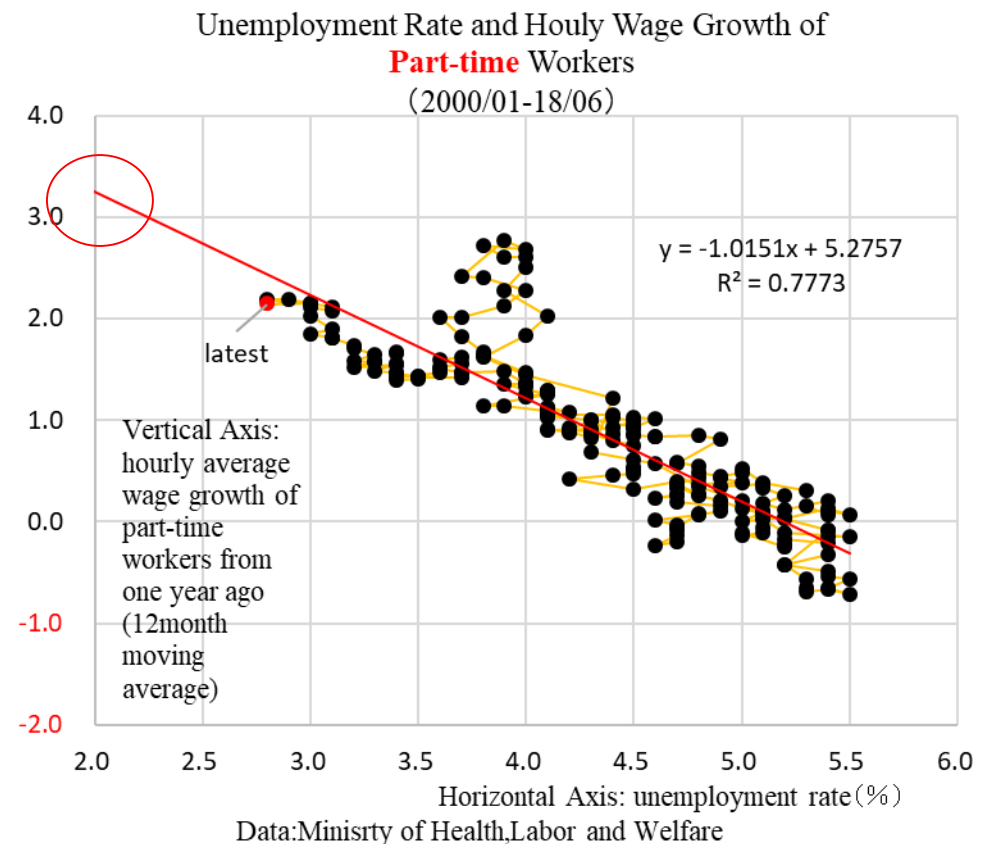
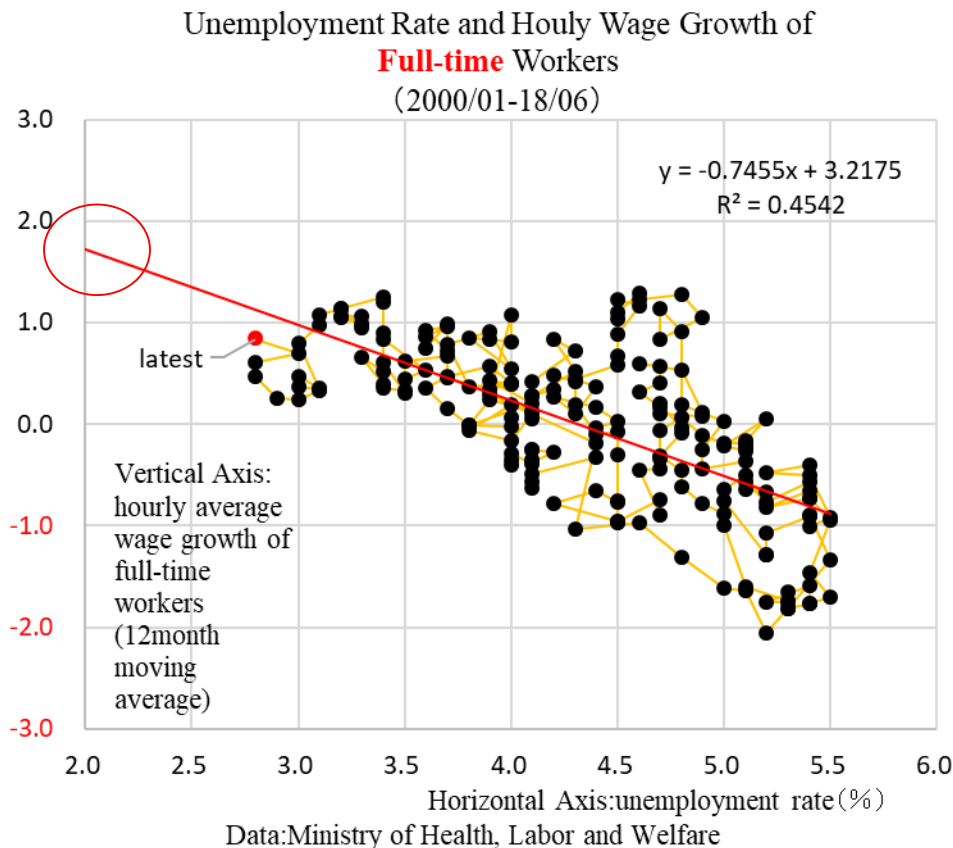


Data: Japan, average hourly wage (Ministry of Health, Labor and Welfare)

US, median monthly wage (Wage Growth Tracker, Federal Reserve Bank of Atlanta based on the data of Bureau of Labor Statistics)

Hidden left-rising slopes of the Phillips curve in Japan

The Phillips curve looks very flat in Japan because the wage growth is depressed. But if we look at wage growth of full-time workers and part-time workers separately, the left-rising slope has been alive although the wage growth of full-time workers is still too low to push up CPI to the target.

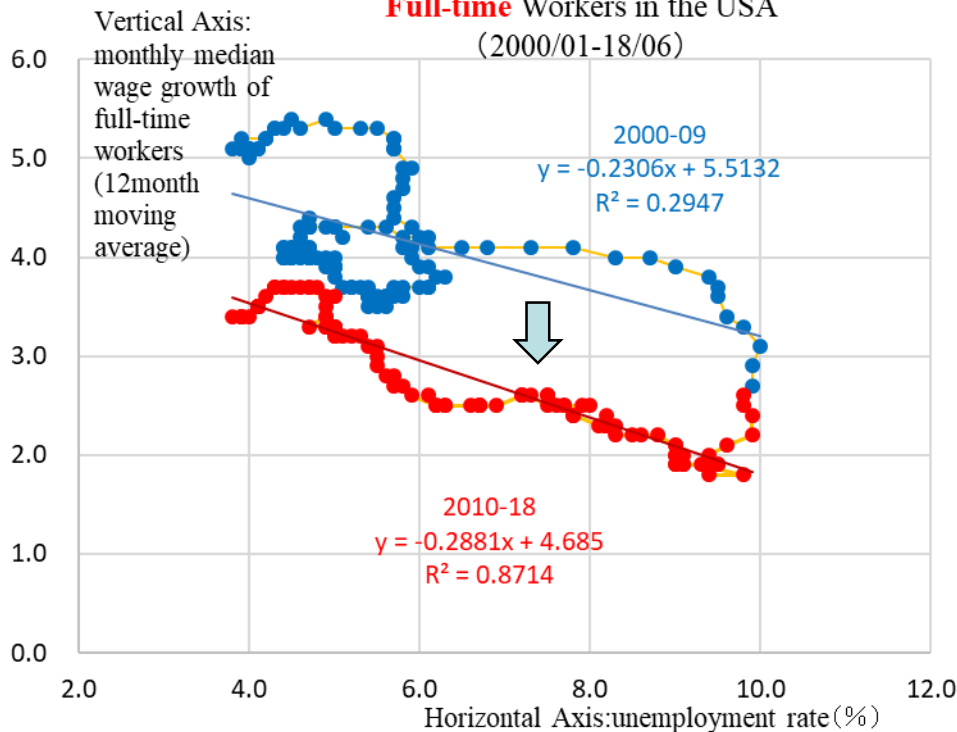


We can see the left-rising Phillips curve clearer by separating full-time workers and part-time works also in the US. Steepness of the slopes has almost unchanged since 2000 but the growth level changed after the financial crisis.

Unemployment Rate and Monthly Wage Growth of

Full-time Workers in the USA

(2000/01-18/06)

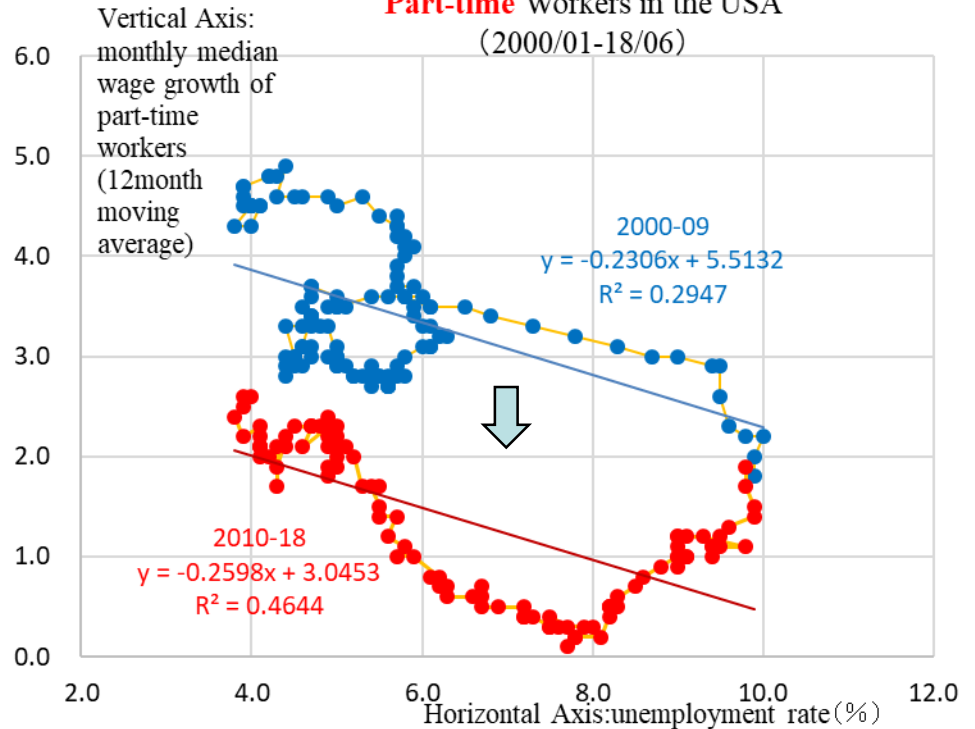


Data: Wage Growth Tracker, Federal Reserve Bank of Atlanta based on the data of Bureau of labor Statistics

Unemployment Rate and Monthly Wage Growth of

Part-time Workers in the USA

(2000/01-18/06)



Data: Wage Growth Tracker, Federal Reserve Bank of Atlanta based on the date of Burea of Labor Statistics

3, Japan and the US relationship under “the US-China new cold war”

Tow different faces of Trump administration

Irrational face: President Trump’s irrational recognition thinking of trade imbalance like a profit and loss in one country.

→ **Isolationism** represented by his favorite phrase “America first”

Rational face: Strategic shift against China that is seeking its industrial and military hegemony, which was expressed comprehensively in the speech of Vice President Pence at the Hudson Institute on Oct.4 or more moderately in the joint statement between Japan and the US after the summit meeting of PM Abe and President Trump in NY on Sep.26.

→ **Corporation with the allies and the others**



quote: “6. The United States and Japan will also strengthen cooperation to better **protect American and Japanese companies and workers from non-market oriented policies and practices by third countries.** We will therefore work closely together, through United States–Japan as well as United States–Japan–European Union cooperation, to promote discussions on World Trade Organization reform and e-commerce and **to address unfair trading practices including intellectual property theft, forced technology transfer, trade-distorting industrial subsidies, distortions created by state-owned enterprises, and overcapacity.**” from the joint statement between Japan and the US on Sep.26.2018

PM Abe has been working effectively to protect “the liberal international trade order.”
It will be a big contribution even for the US when it will return from Trump’s isolationism.



Japan and EU signed
EPA. (Sep. 2018)



UK expressed a serious
interest to join CPTTP
(Jul. 2018)



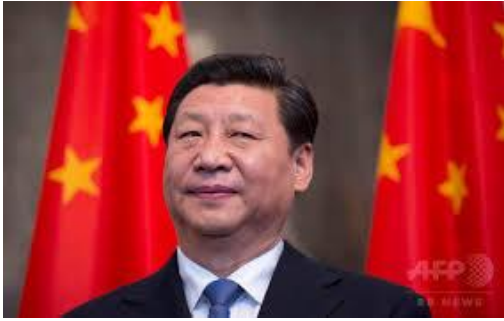
Japan and India
strengthened the strategic
partnership. (Oct.2018)



CPTTP(TPP11) which the
Abe Cabinet worked for the
accord without the US will be
effective at the end of
Dec.2018.



PM Abe is playing a active role even in RCEP
which includes China and the other 15 countries.
Ministerial conference of RCEP in Tokyo (Jul.
2018)



Japan is located at the geopolitical and “geoeconomical” front line of the US-China new cold war. It makes Japan’s foreign policy complicated.

PM Abe is fully aware of a big risk for Japan to confront directly with China. It appears to be a risk hedge for Japan to shake hands with China.

As President Xi Jinping is also aware of risk to be isolated under the new cold war with the US, Xi Jinping is now seeking to improve the relationship with Japan.

Abe visited China last month and the corporation will go on in the field of high tech including autopilot car technology between Japan(Toyota etc.) and China.

China has built up its military bases in the South China Sea and is seeking to expand its influence by the policy of “One Belt, One Road”

Strategic handshake on Oct.26 in Beijing

