

Economic Outlook of Japan

Sharp Depreciation of Yen and High Inflation of Dollar



龍谷大学
RYUKOKU UNIVERSITY

Conference of Business Economists

November 10-11, 2022

Masaharu (Max) Takenaka

Professor of Economics, Ryukoku University, Kyoto

Ph.D. of Economics at Kyoto University

Research Fellow of Institute for International Monetary Affairs

takenaka1221@yahoo.co.jp

m-takenaka@econ.ryukoku.ac.jp

1, Economic outlook of Japan

2, Sharp depreciation of Japanese yen and high inflation of US dollar

Economic Outlook of Japan

Are We Ready for Rainy Days of the World Economy Ahead?



Conference of Business Economists

November 14-15, 2019

Masaharu (Max) Takenaka

Professor of Economics, Ryukoku University, Kyoto

Ph.D. of Economics at Kyoto University

Research Fellow of Institute for International Monetary Affairs

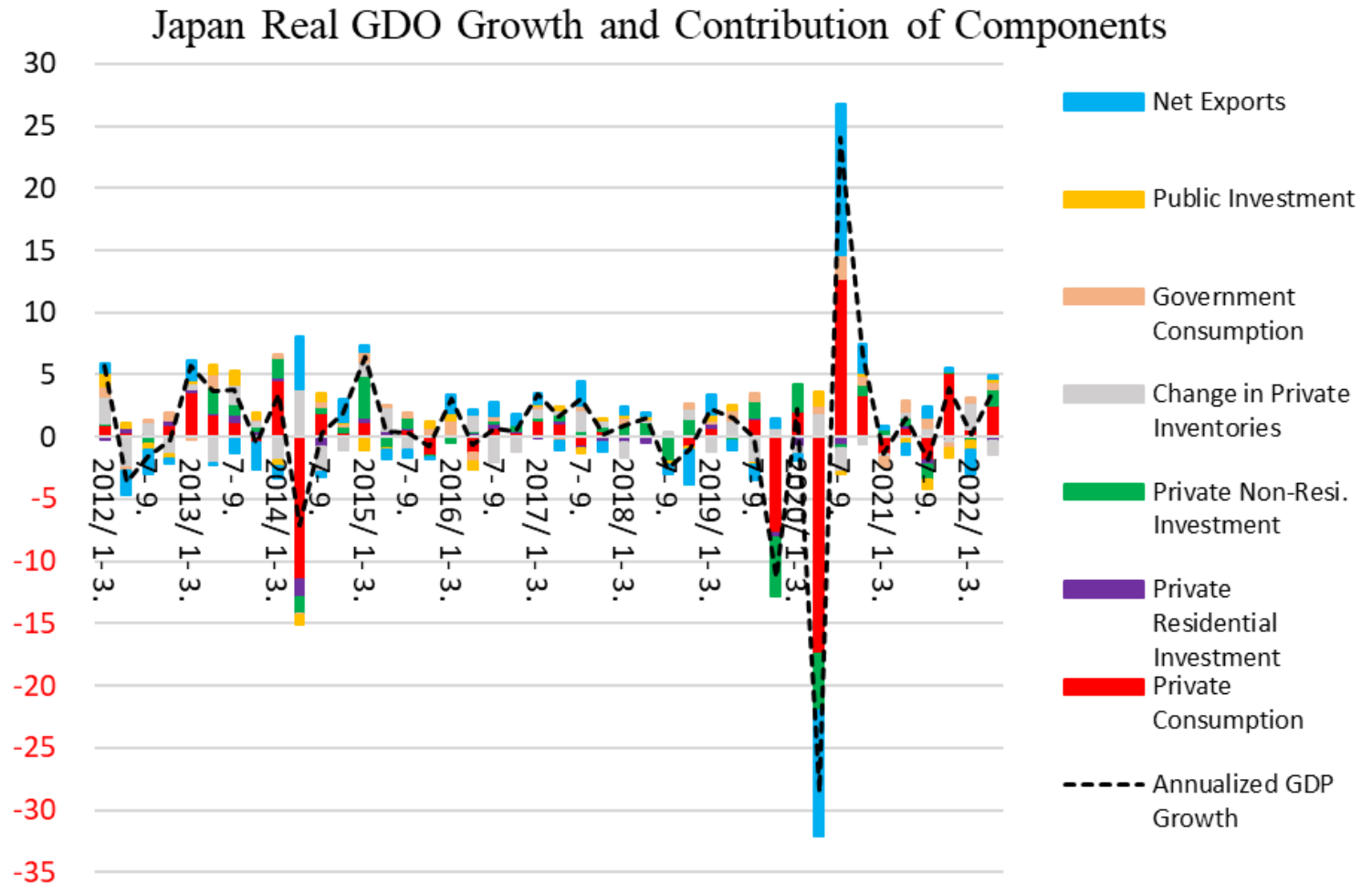
takenaka1221@yahoo.co.jp

m-takenaka@econ.ryukoku.ac.jp

1, Economic Outlook of Japan

Over view: The real GDP growth in the 2nd quarter of 2022 was +3.5% from the previous quarter (annualized base). The Japanese economy is on the course of a moderate recover after the sharp swing at the Covid-19 shock in 2020. The annual GDP growth of 2023 is forecasted to be +1.5 by JCER.

However, the darkening prospect of the overseas economies in the US, Euro area and China is a risk factor for Japan.



According to the latest IMF projections, Japan is expected to follow a steadier growth path in 2023 than the other countries.

This may be just a result that a rebound after the Covid-19 shock was relatively weak in Japan.

The comprehensive economic package released by the Kishida cabinet last month, which includes the spending of 29.1 trillion yen (5.4% of GDP) from the general account of the government will also push up the Japanese economic growth next year.

(real GDP, annual percent change)	2021	PROJECTIONS	
		2022	2023
World Output	6.0	3.2	2.7
Advanced Economies	5.2	2.4	1.1
United States	5.7	1.6	1.0
Euro Area	5.2	3.1	0.5
Germany	2.6	1.5	-0.3
France	6.8	2.5	0.7
Italy	6.6	3.2	-0.2
Spain	5.1	4.3	1.2
Japan	1.7	1.7	1.6
United Kingdom	7.4	3.6	0.3
Canada	4.5	3.3	1.5
Other Advanced Economies	5.3	2.8	2.3
Emerging Market and Developing Economies	6.6	3.7	3.7
Emerging and Developing Asia	7.2	4.4	4.9
China	8.1	3.2	4.4
India	8.7	6.8	6.1
ASEAN-5	3.4	5.3	4.9
Emerging and Developing Europe	6.8	0.0	0.6
Russia	4.7	-3.4	-2.3
Latin America and the Caribbean	6.9	3.5	1.7
Brazil	4.6	2.8	1.0
Mexico	4.8	2.1	1.2

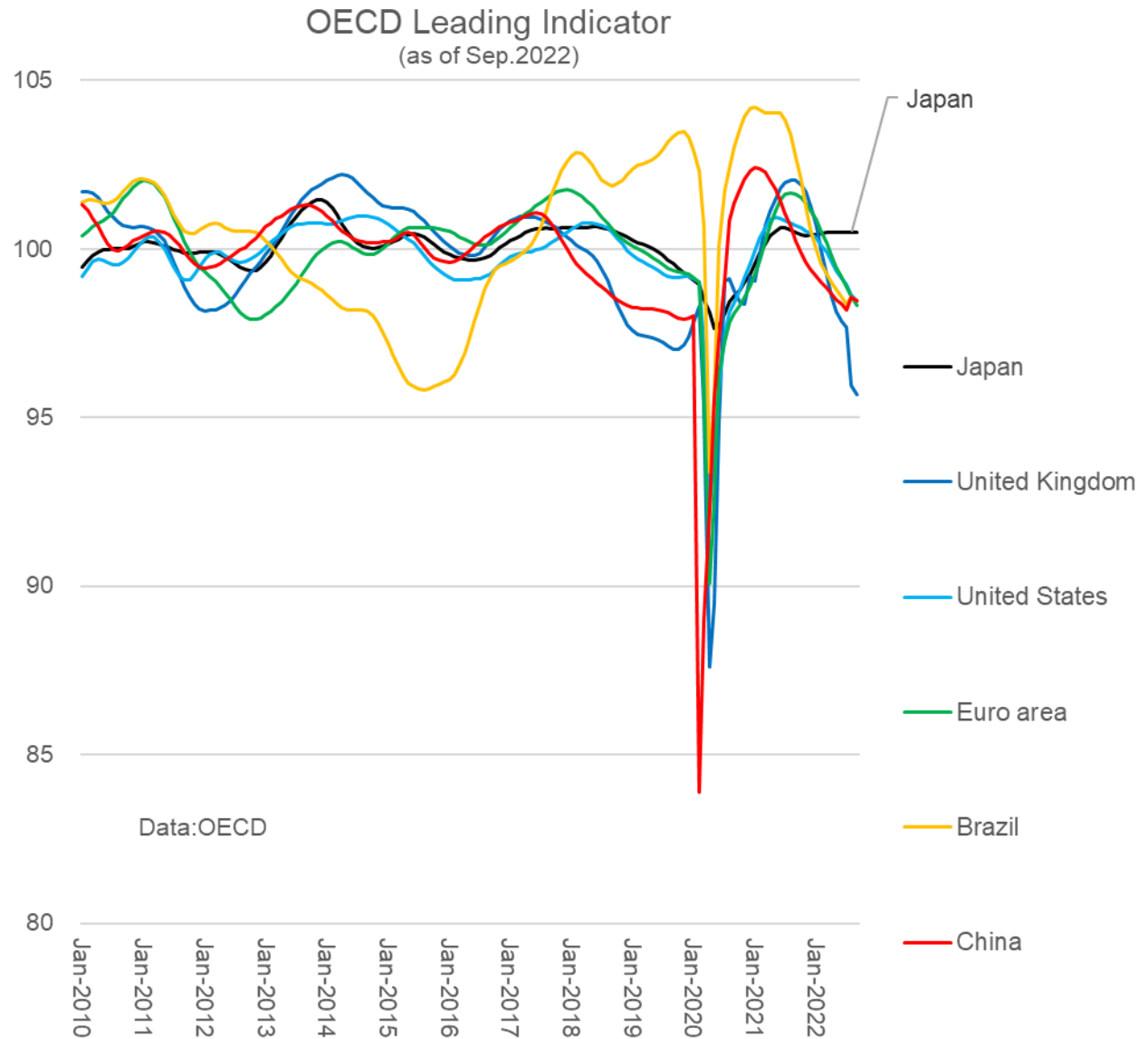


Negative factors
of each major
country or area

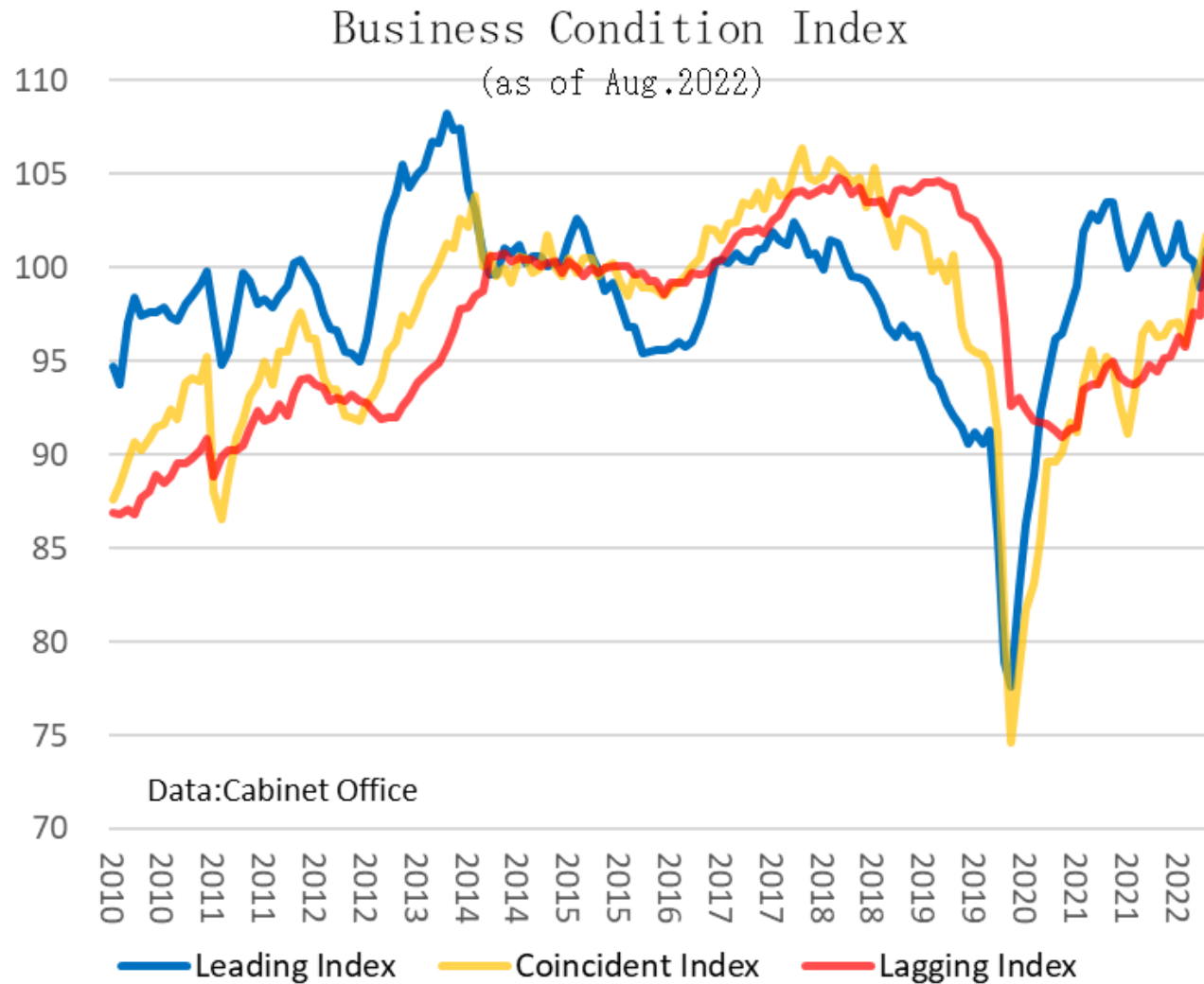
The US: high
inflation and
rising interest rate

Euro: bottle neck
of energy and the
Russia Ukraine
war

China: bubble
burst and credit
crunch in the real
estate market,
too strict control
of Covid-19



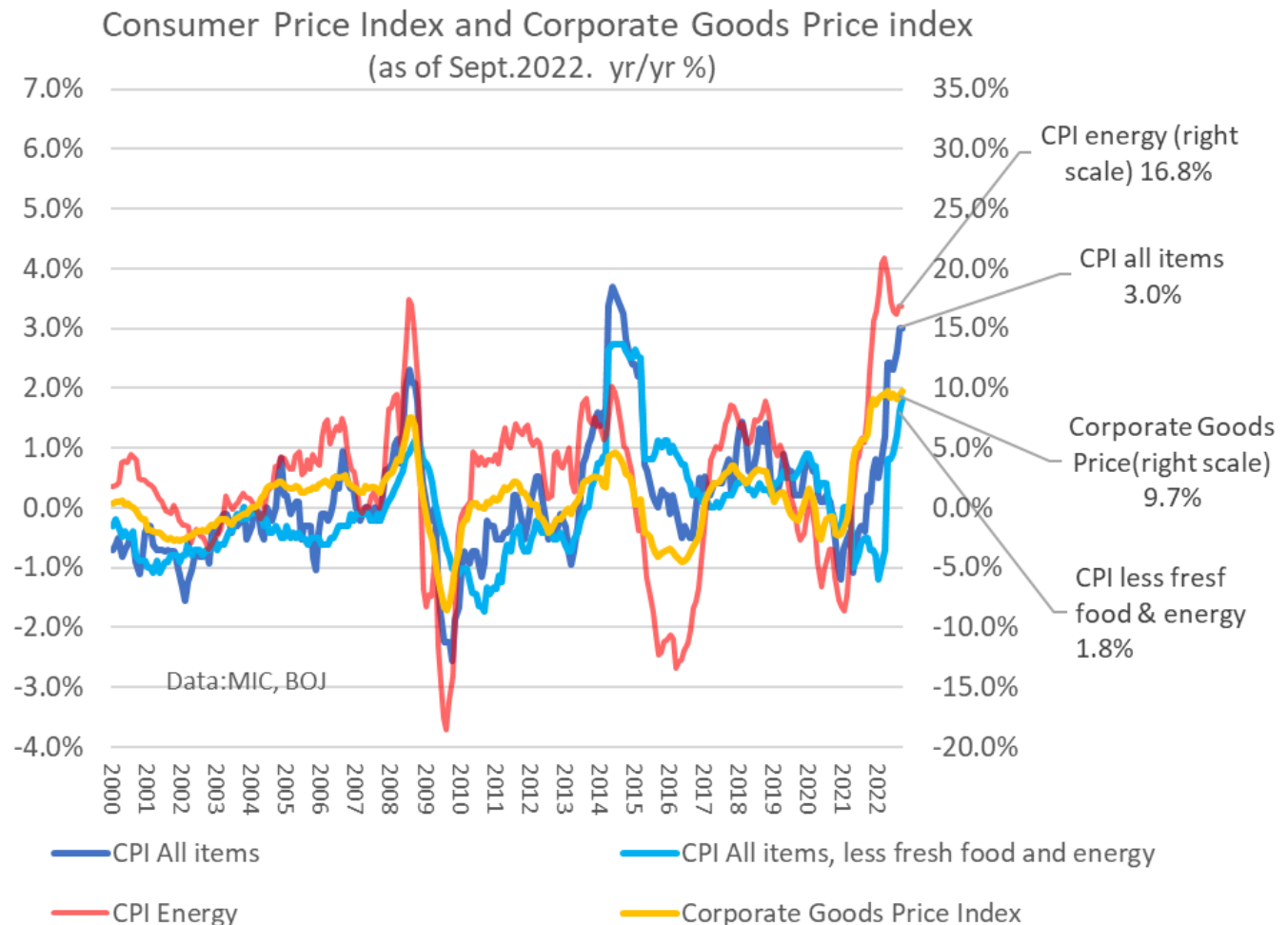
The coincident index and the lagging index are still heading upward but the leading indicator is edging down.



Inflation

CPI edged up to 3.0% year/year base as of Sept. 2022. But CPI excluding fresh food & energy is still 1.8% although the CGPI rose 9.7%. Most providers seem to be still more or less timid to raise their retail prices fearing to lose their sales in the domestic market.

BOJ governor Mr. Kuroda is insisting to keep the current monetary policy to keep the yield of 10 year government bond under 0.25% as the CPI growth excluding energy price is still less than 2% target.

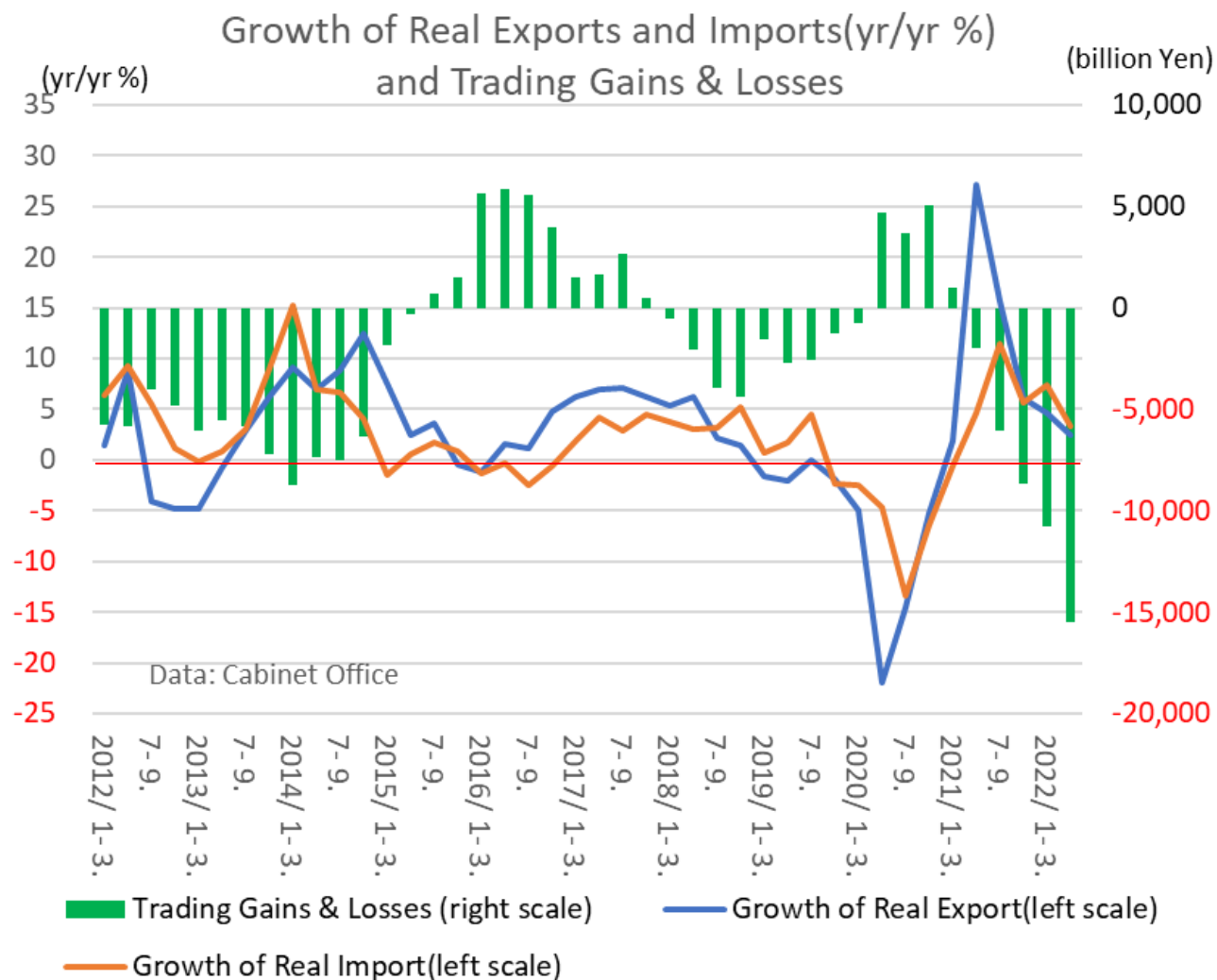


Exports, imports and trading gains & losses

Japanese economy has benefited from the recovery of exports. However, the corporate profit has benefited more and the employees have less due to the big shift of production lines to overseas for the last 20 years.

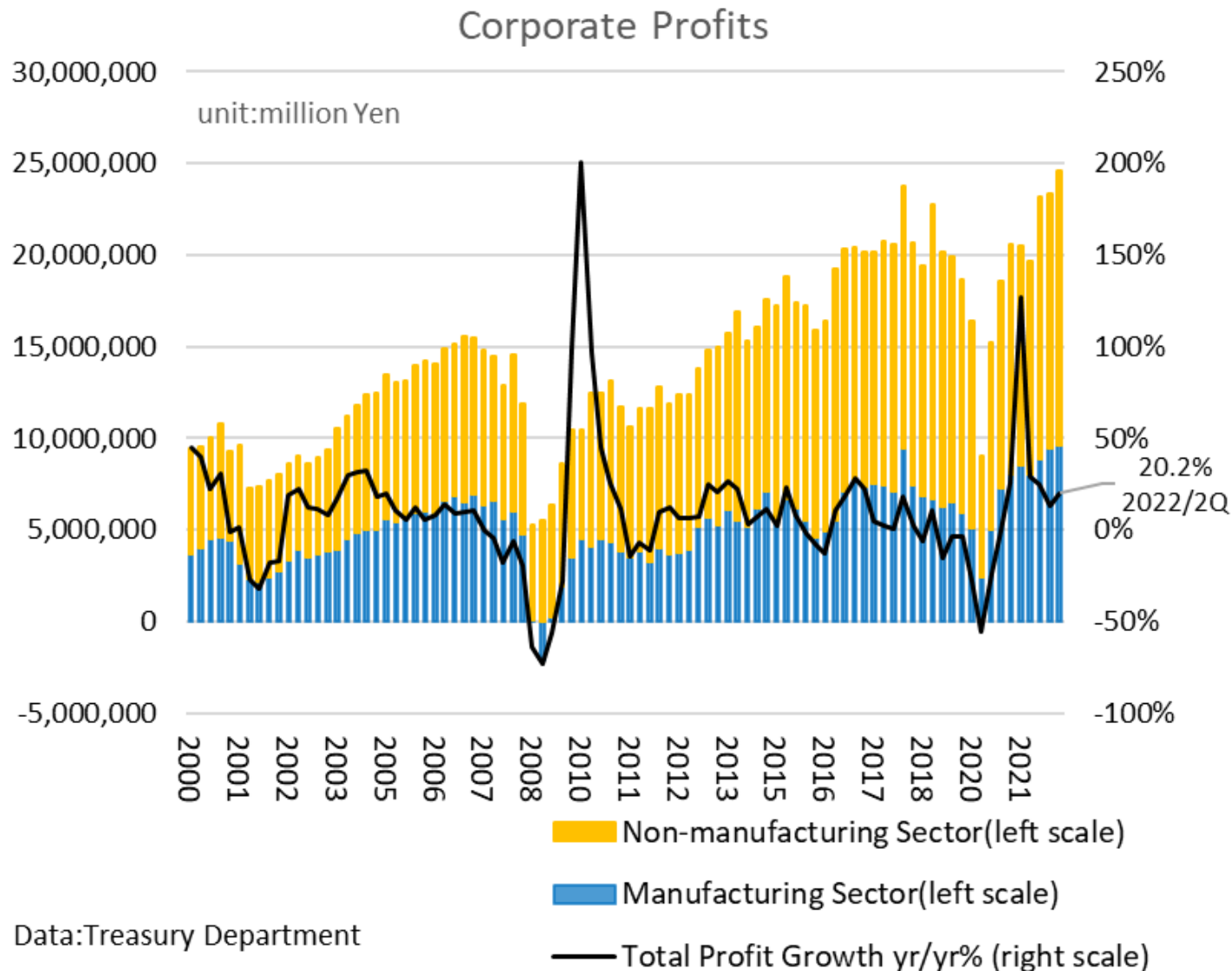
More than that, the surge of energy resource prices in the global market has caused a big trading loss for Japan.

Trade gains & losses are changes in real income resulting from changes in the terms of trade (=export prices / import prices).



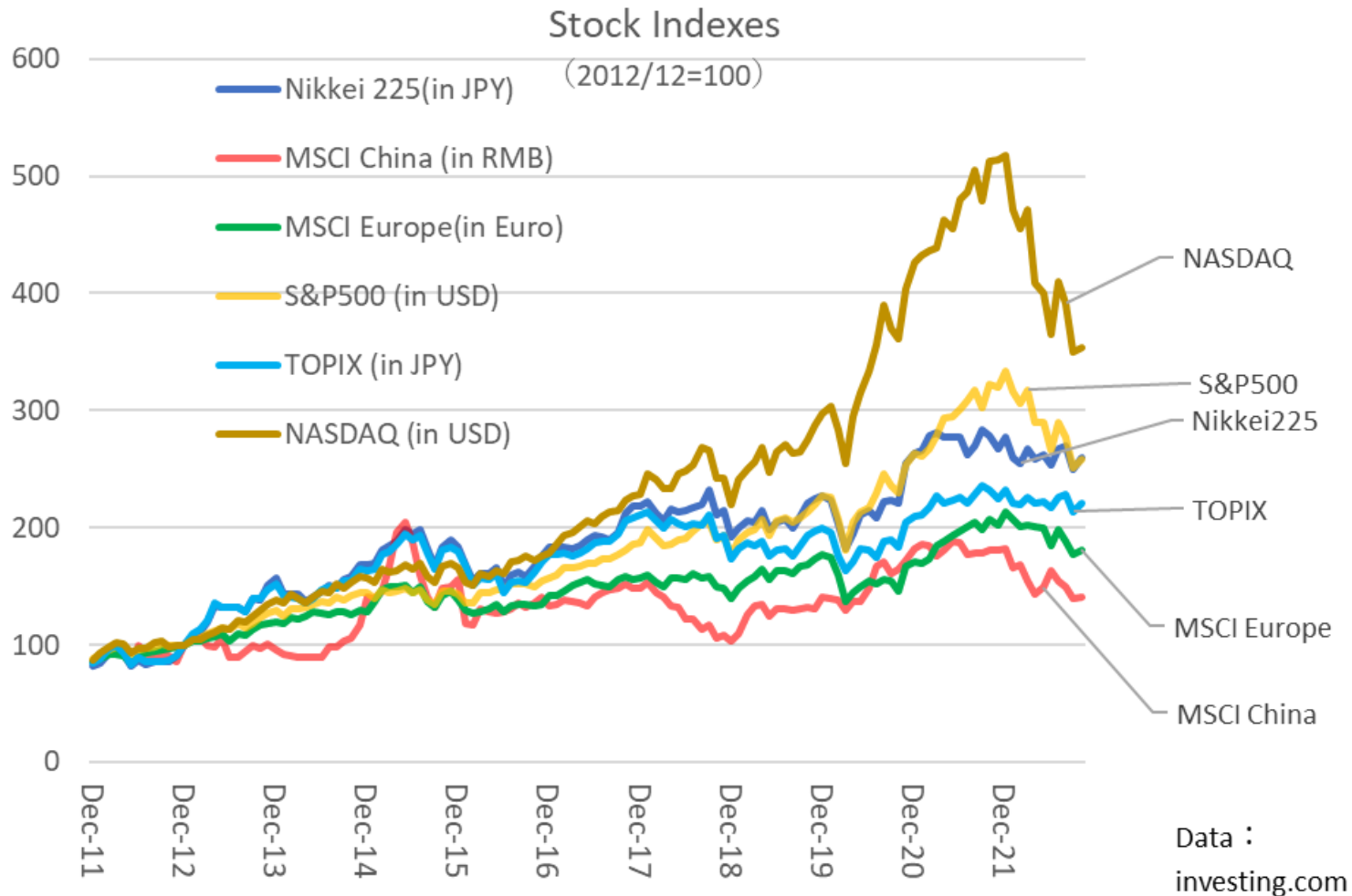
Corporate Sector

The recent growth of corporate profits is robust.



Stock market

The Japanese stock prices are trending relatively firmer supported by the growth of corporate profits. The average PER of Nikkei225 is 12.7(as of Oct.26)



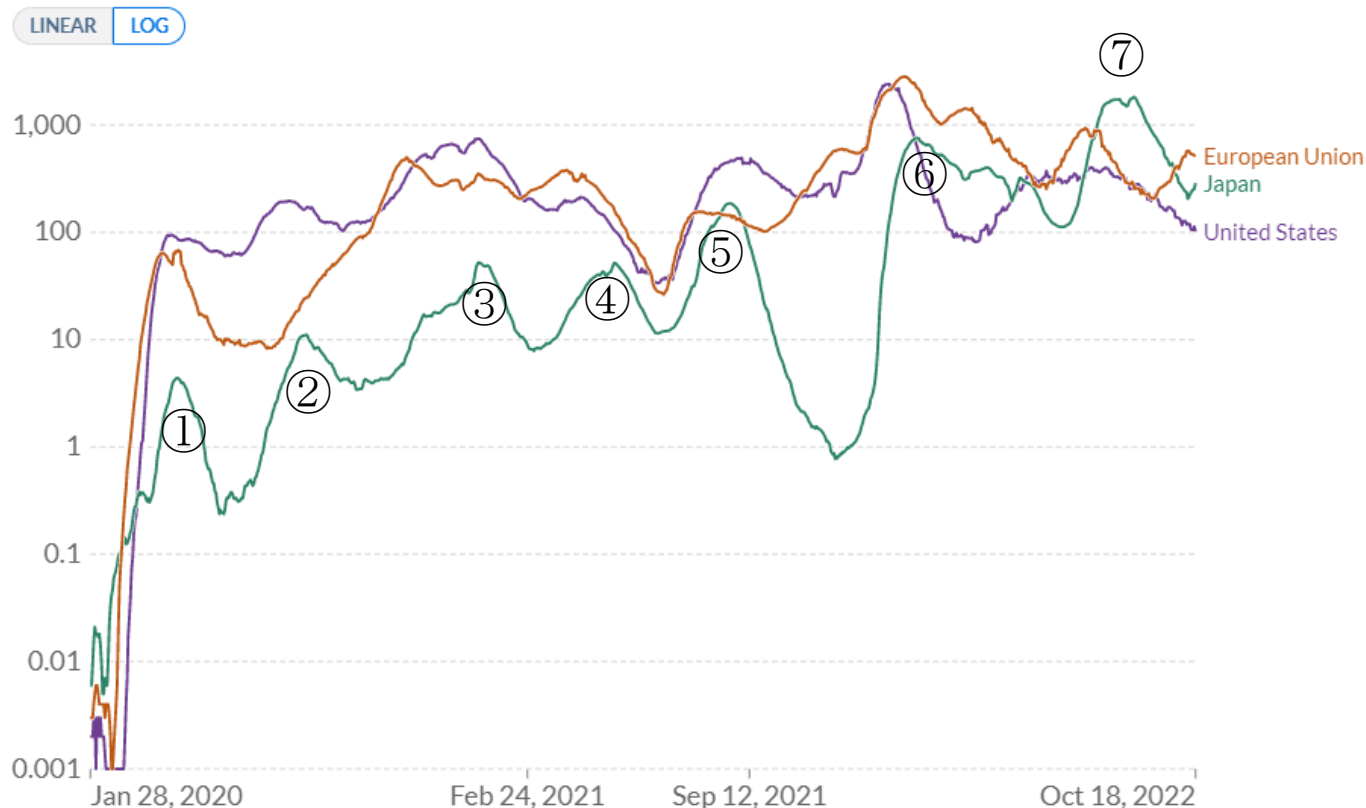
Consumption and COVID-19

There have been 7 waves of COVID-19 infections in Japan. Until the 4th wave the infected cases per million people in Japan has been smaller than that of the US and Euro area. But at the last 3 waves, the peak number of infected cases were much higher before.

It depressed consumption recovery in traveling, dining out, leisure and others.

Daily new confirmed COVID-19 cases per million people

7-day rolling average. Due to limited testing, the number of confirmed cases is lower than the true number of infections.



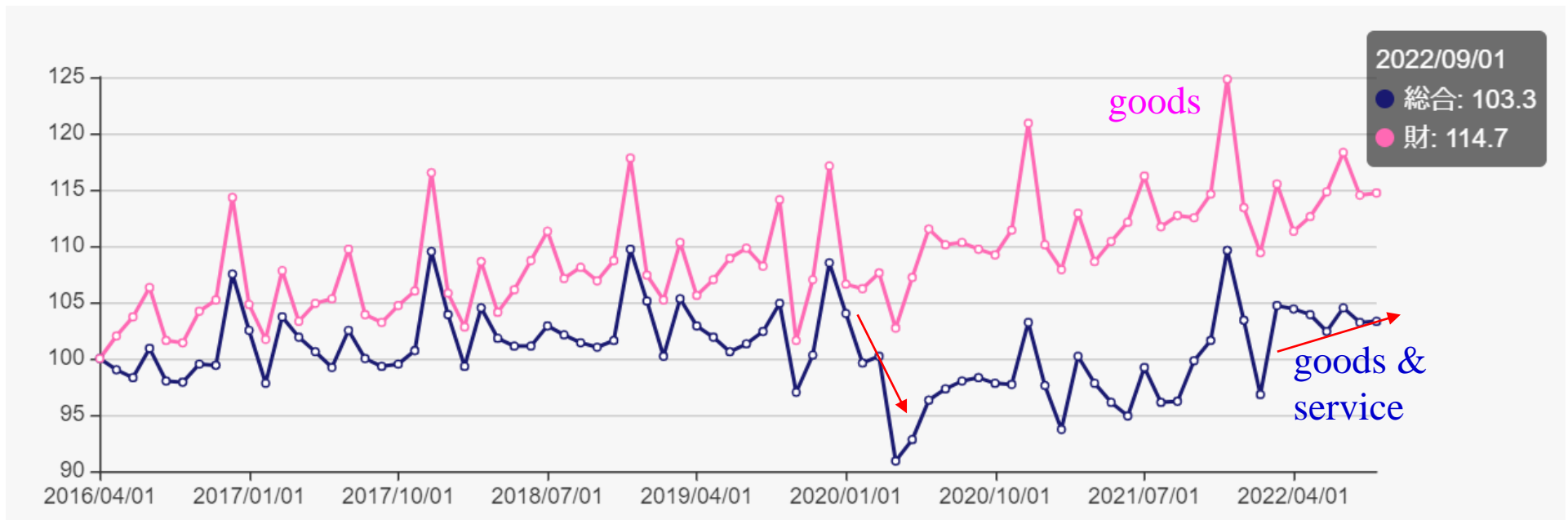
Source: Johns Hopkins University CSSE COVID-19 Data

CC BY

Consumption and COVID-19

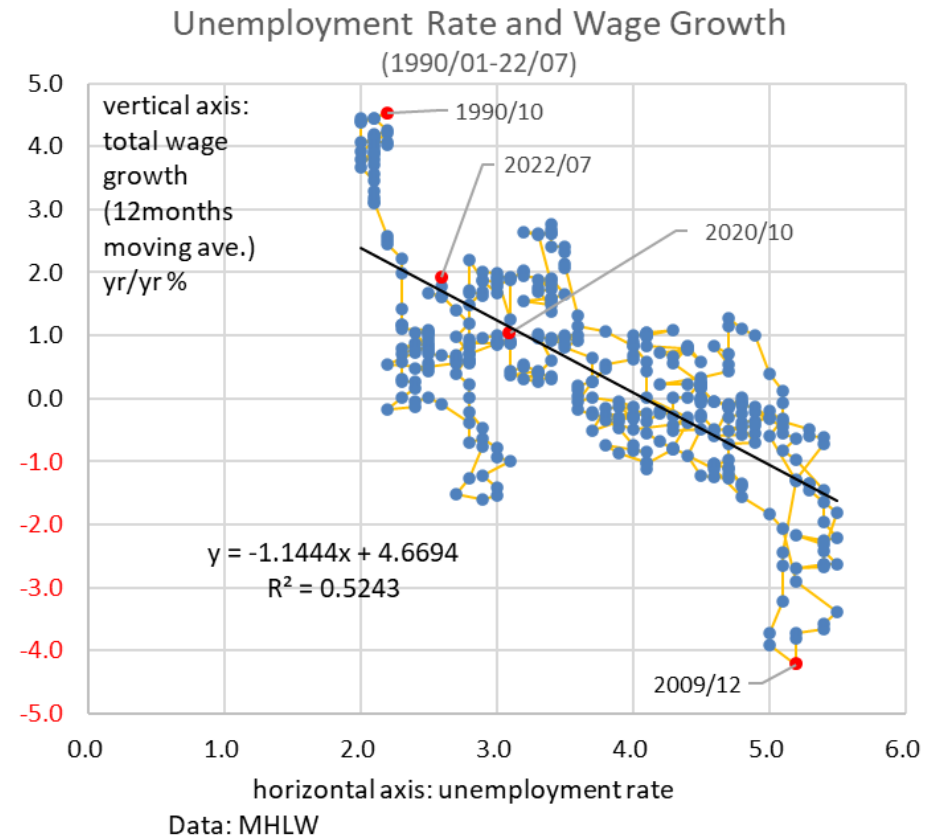
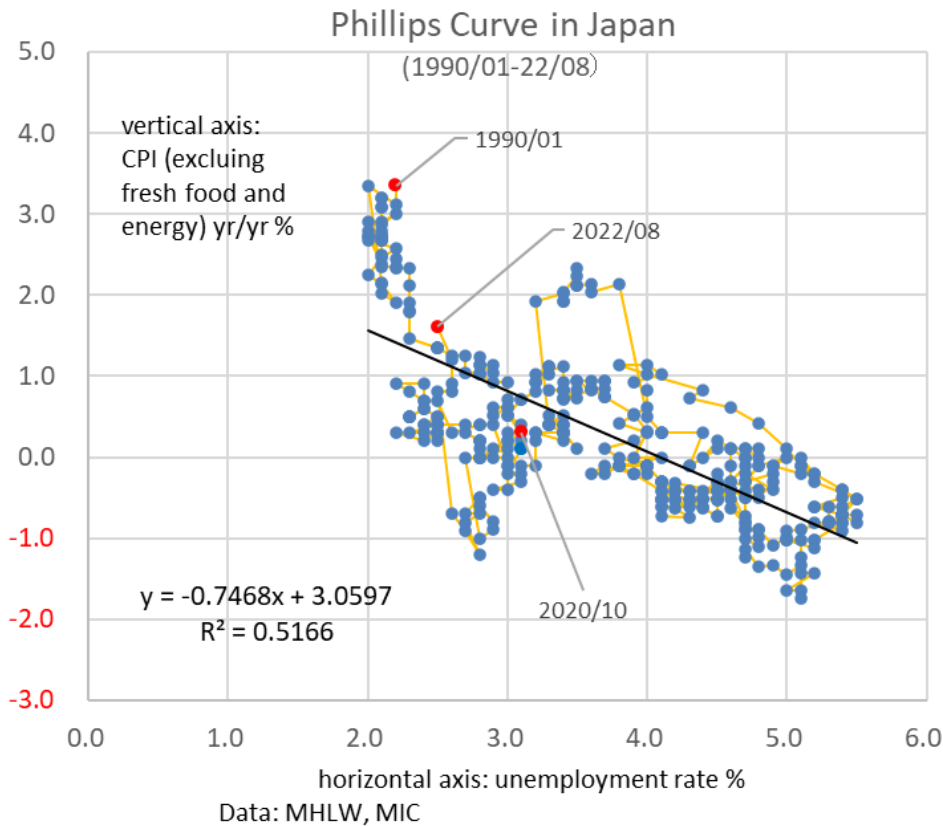
The 5th, 6th and 7th waves of COVID-19 delayed a recovery of consumption in 2021 and 2022. The consumption has begun to recover with pent-up demand after the 7th wave was over in August.

“JCB Consumption Now”: consumption data based on credit cards (April 2016=100)



Labor market

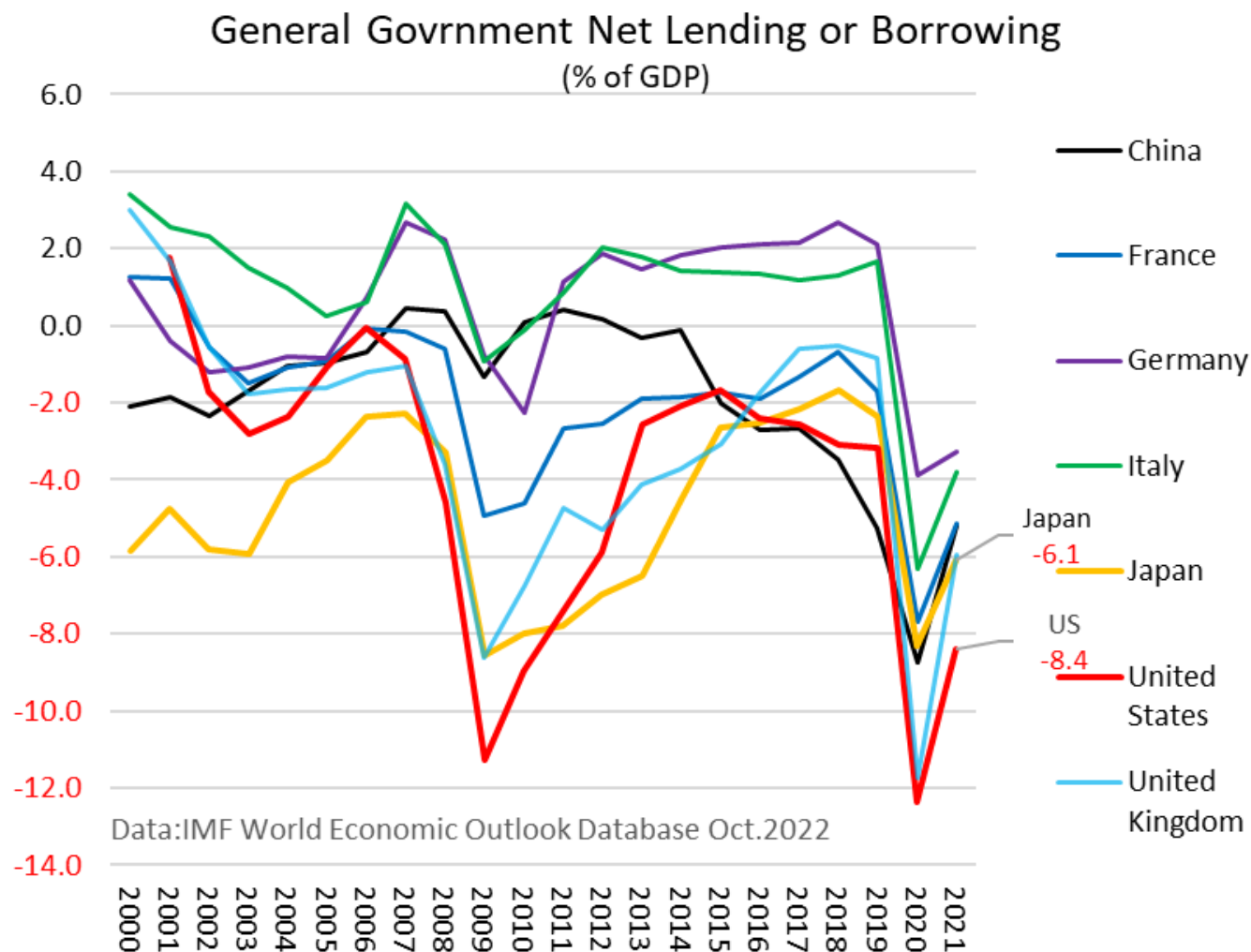
The Japanese economy appears to be edging up to upper left on the Phillips curve although its pace is very moderate.



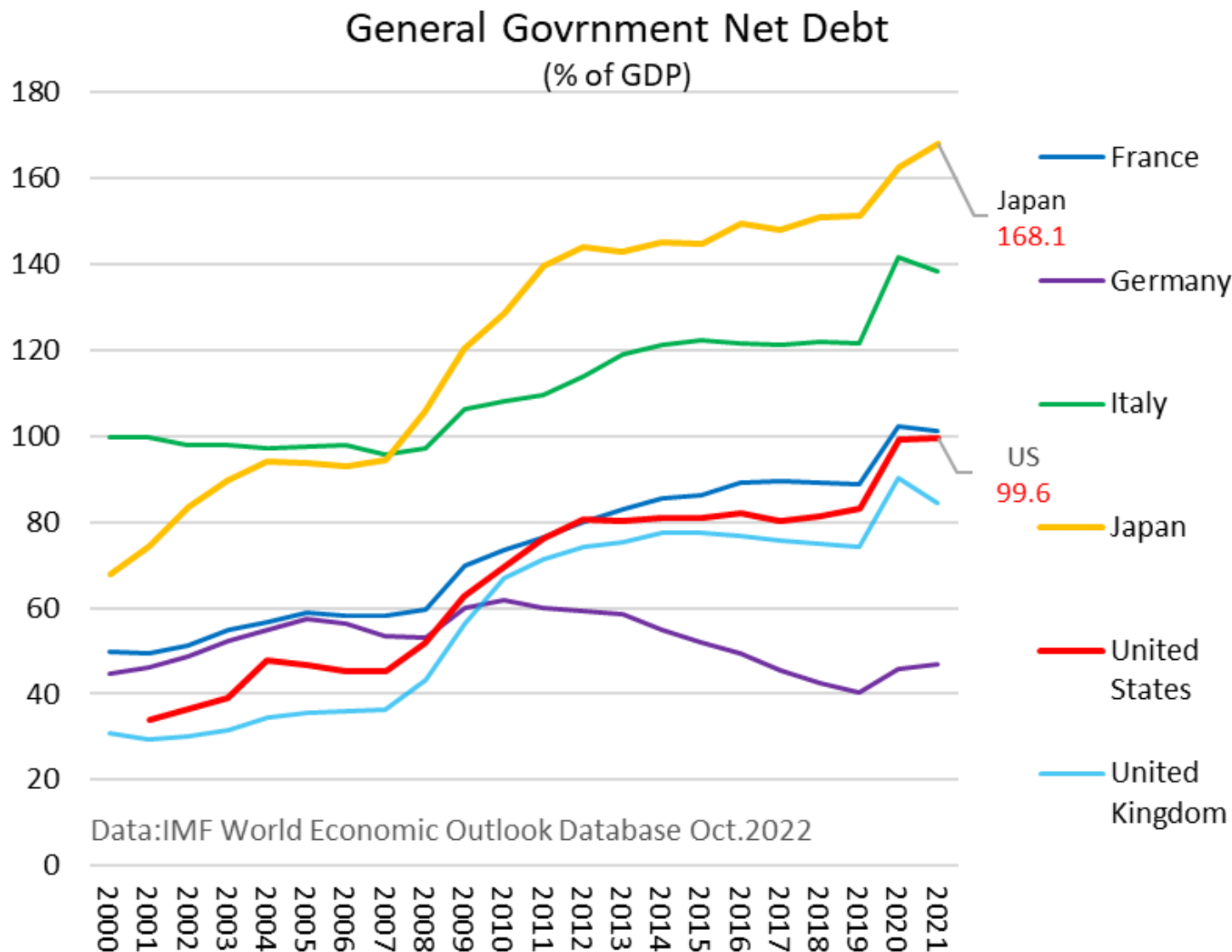
Fiscal balance and government debt

The fiscal deficit of Japan narrowed to -6.1% in FY2021 from -8.3 in FY2020.

The trend of narrowing budget deficit since 2010 was interrupted in 2020 due to the policy response to the pandemic of COVID-19.



Japan is still running the top of “the game to challenge the limits of government debt”.



Growth per capita

The long run averages of real GDP growth per capita do not differ much among most advanced economies while those of emerging countries vary widely.

It is worth watching how much China's economic growth shift downward facing the following negative factors.

- ① Its aging population rapider than that of Japan since 1990
- ② Burst of bubble and credit crunch in the real estate market and the construction sector
- ③ Readjustment of global supply chains (or deglobalization) in the new cold war
- ④ Xi Jinping's retroactive policy

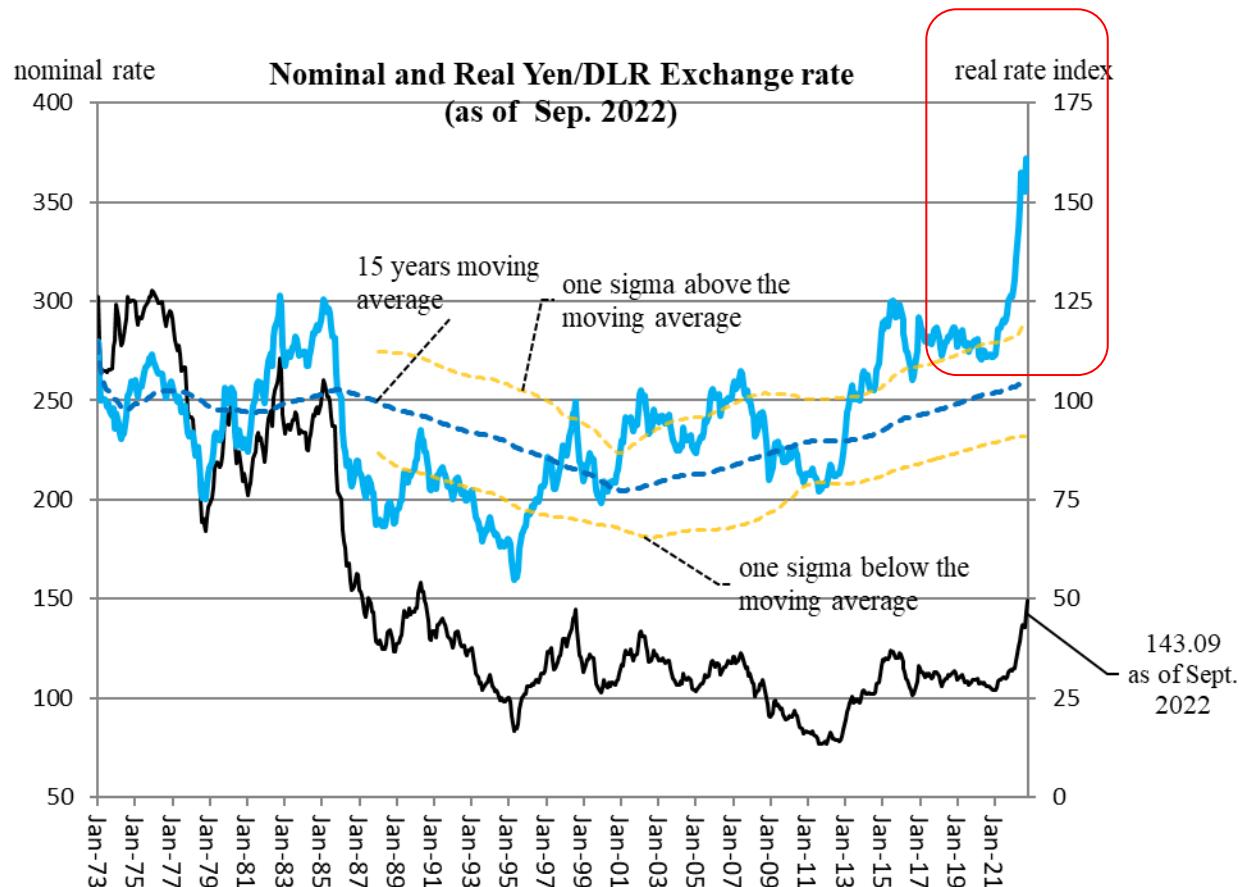
	Real GDP growth per capita (%)			
	average 1981-2022	average 1981-1999	average 2000-2022	average 2010-2022
China	8.2	8.6	7.9	6.5
India	4.3	3.5	5.0	4.9
Turkiye	3.2	2.5	3.7	4.6
Indonesia	3.6	3.7	3.6	3.4
Malaysia	3.3	3.8	2.8	3.0
Thailand	3.8	4.9	2.8	2.3
United States	1.7	2.3	1.2	1.4
Russia			3.3	1.4
Sweden	1.7	2.0	1.4	1.3
Denmark	1.5	2.1	1.0	1.3
Germany	1.4	1.8	1.1	1.3
Australia	1.7	2.1	1.4	1.1
United Kingdom	1.7	2.4	1.0	1.1
Japan	1.5	2.5	0.7	1.0
Finland	1.7	2.2	1.2	0.8
Canada	1.2	1.5	0.9	0.8
France	1.2	1.8	0.8	0.8
Mexico	0.6	0.7	0.5	0.8
Norway	1.7	2.7	0.9	0.7
Brazil	0.7	0.0	1.3	0.6
Spain	1.6	2.5	0.8	0.5
Italy	0.9	1.8	0.2	0.3
South Africa	0.2	-0.7	0.9	-0.1
average	2.1	2.5	1.9	1.7

Data: IMF World Economic Outlook Database Oct.2022

2, Sharp depreciation of Japanese yen and high inflation of US dollar

If we see the current JPY/USD rate based on the real exchange rate index, this is an surprising depreciation of JPY (appreciation of USD) which surpassed the level in the early 1980s.

I am predicting a significant USD's depreciation against JPY and other currencies when a next recession starts in the US after the current sequence of interest rate hikes.

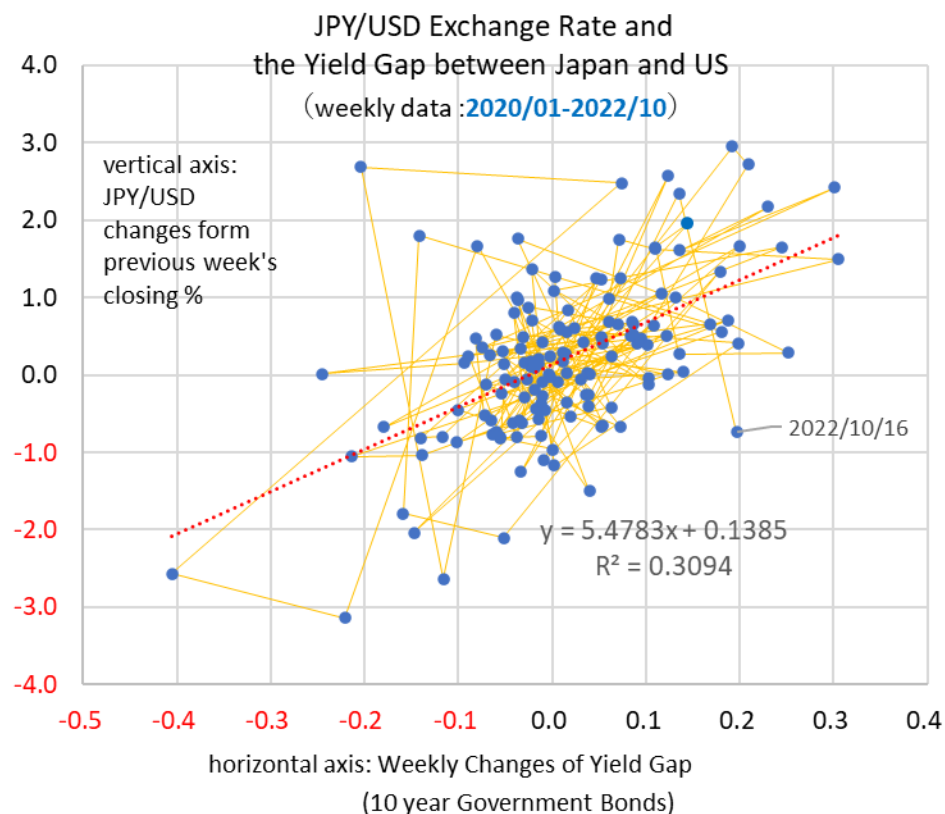


Data: Bank of Japan, US Labor Department

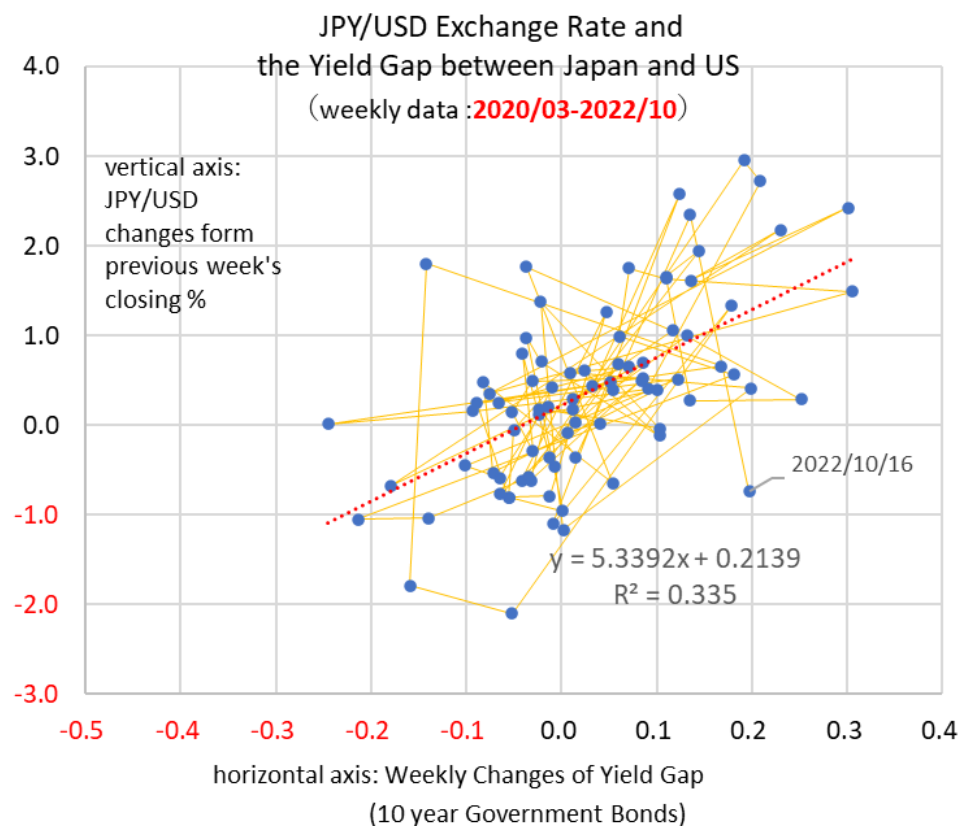
real index = nominal rate / relative PPP × 100 Relative PPP is calculated based on the US PPI (producer price index), Japan CGI (corporate goods index) and 1973 as the starting point.

Why has JPY depreciated so sharply this year ?

If we talk about only JPY/USD exchange rate, the current depreciation of JPY can be explained to some extent by the rapidly widening interest rate differential between Japan and the US.



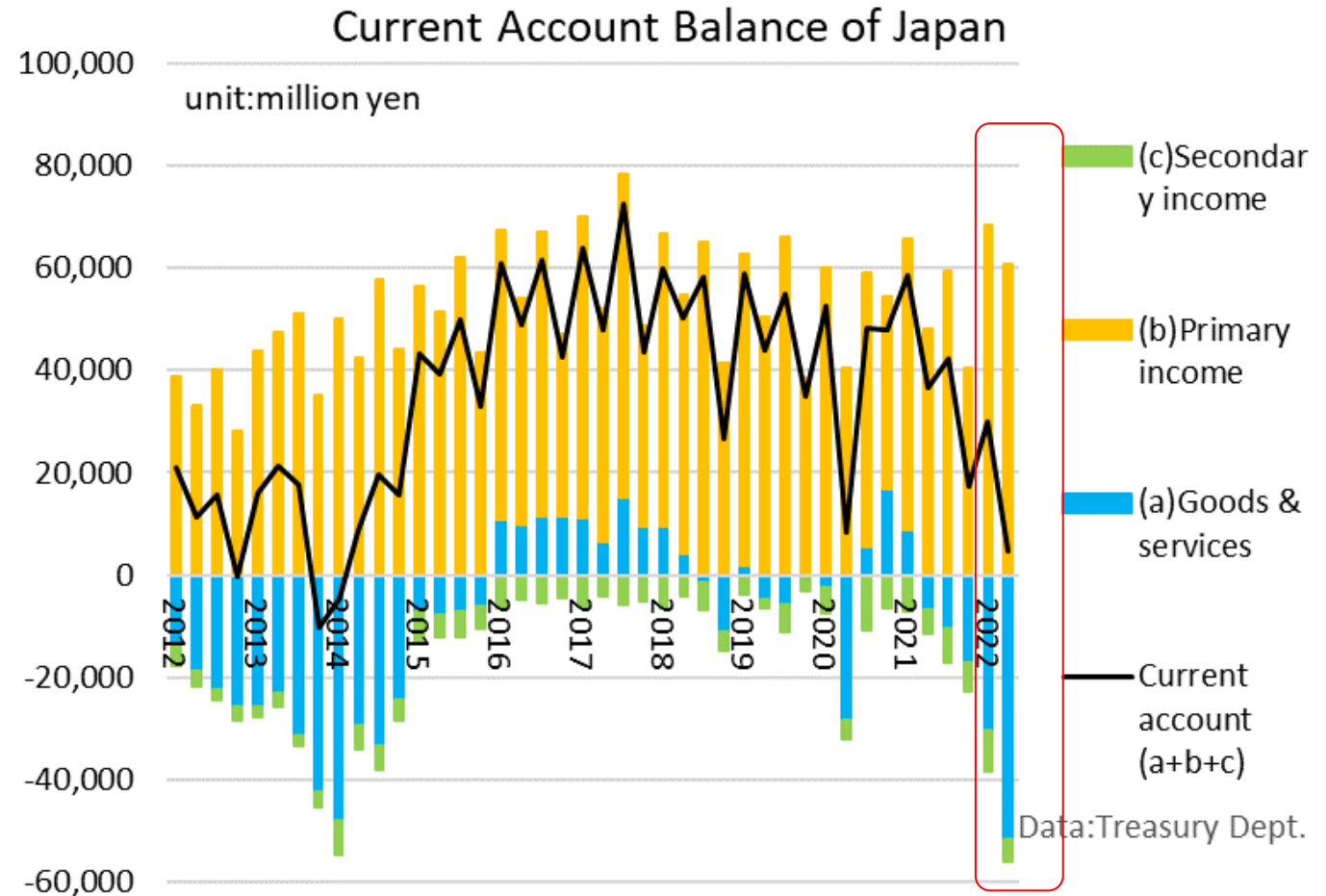
Data : Investing.com



Data : Investing.com

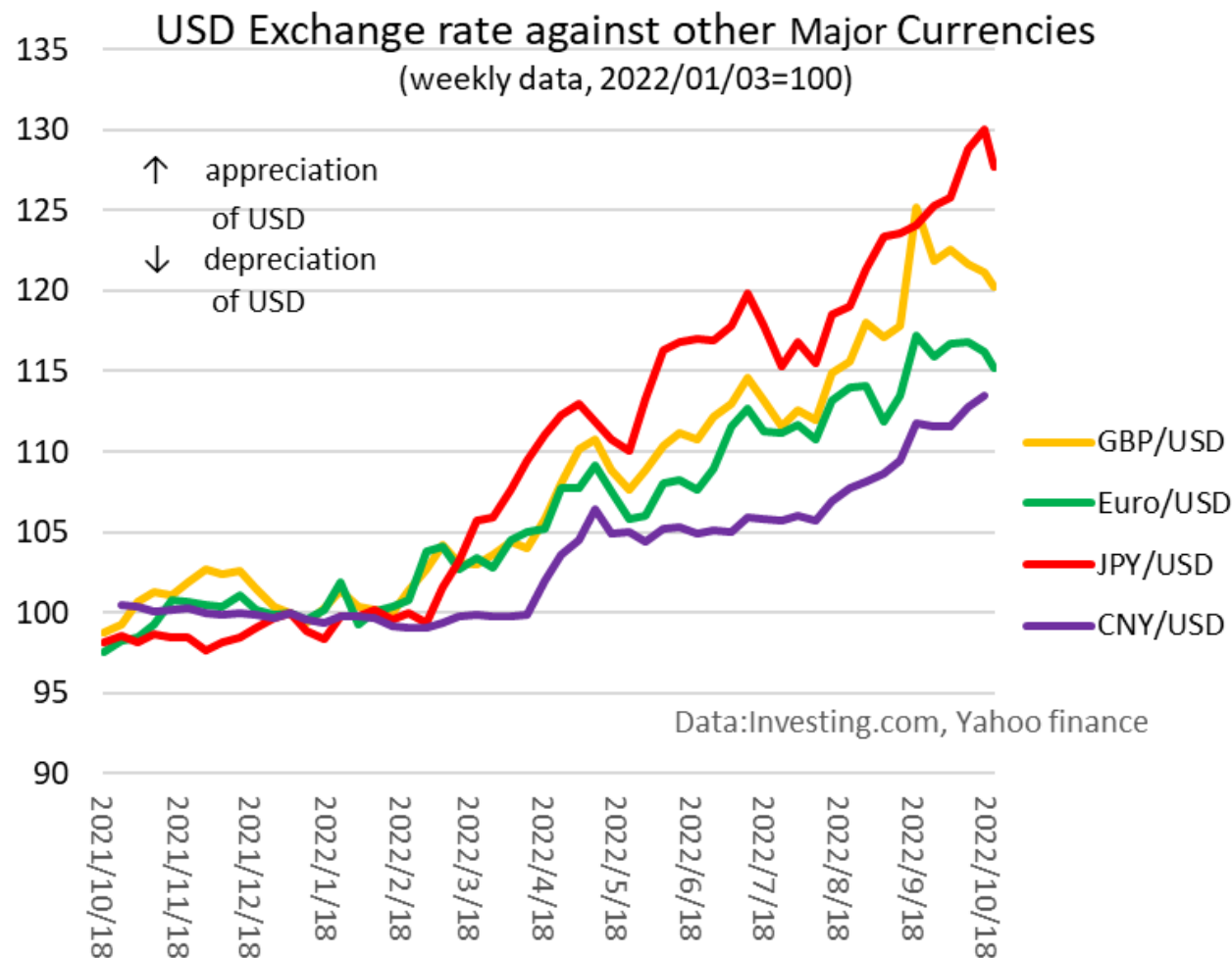
It is thought to be the second factor for the sharp depreciation of Yen that the Japan's trade balance turned into a deficit and the surplus of the current account balance shrank due to the sharp rise in energy resource prices.

The third factor is that JPY, which is the only one developed country to keep a super-easy monetary policy with BOJ's yield curve control on 10 year government bond, has become a selling target for global speculators.



Exchange rate of USD

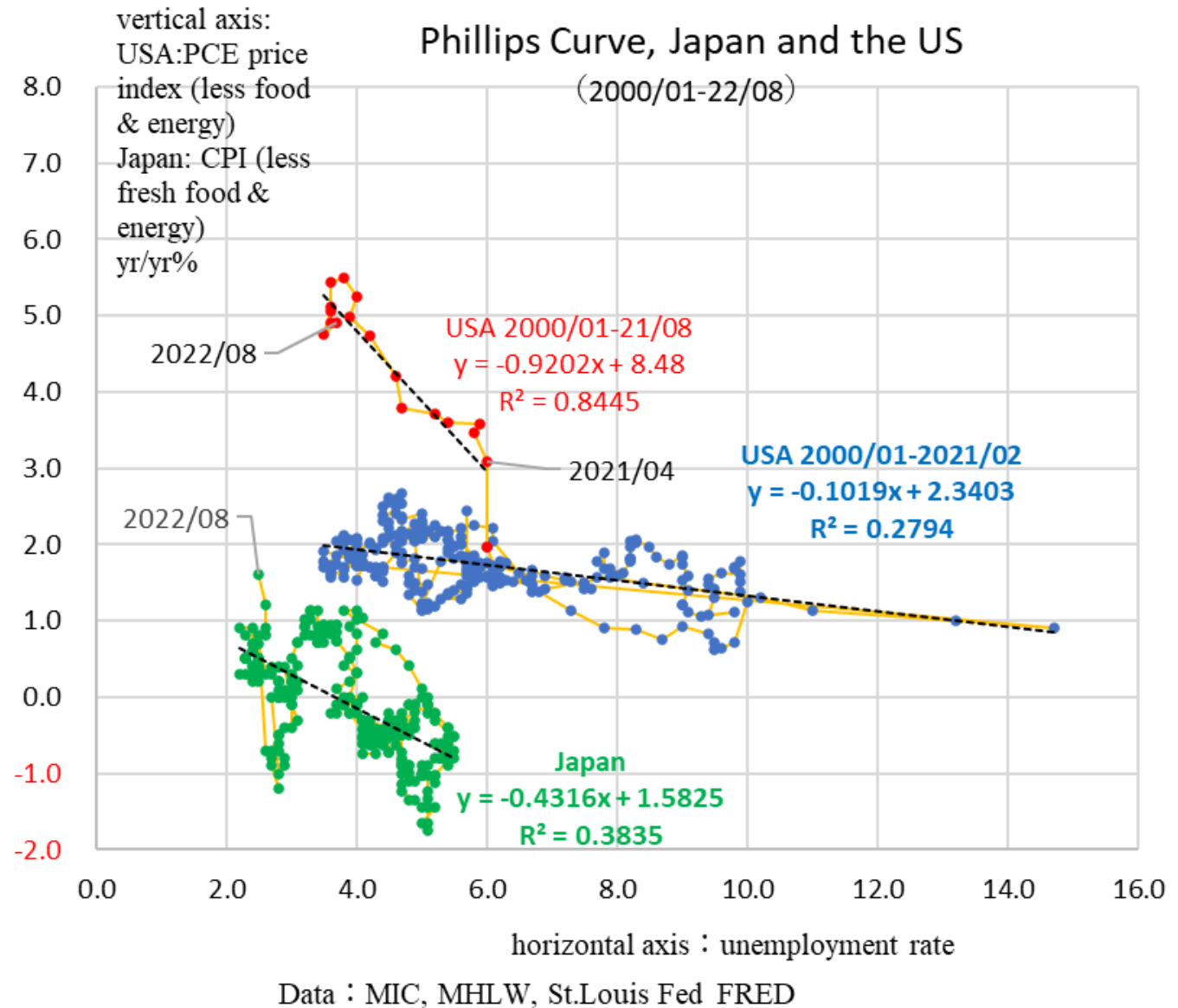
USD has appreciated against GBP even though there has been little interest differential between the US and the UK. Therefore, the interest rate differential gives us only a partial explanation for the current appreciation of USD.



Why did inflation of the US exceed significantly the FRB's forecast?

The Phillips curve of the US has jumped up to upper left in the 1st QTR of 2021.

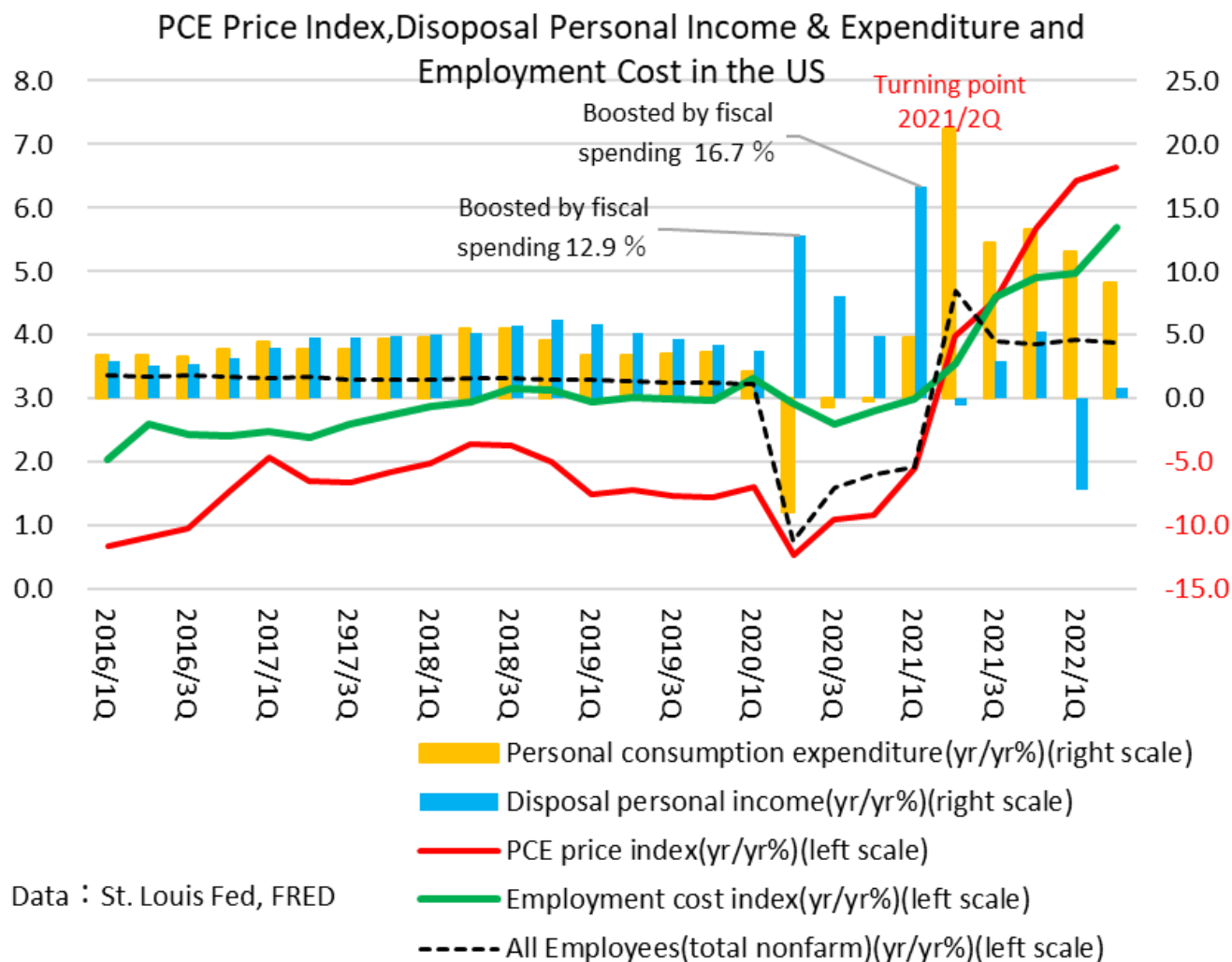
Also in Japan, the position made of unemployment and inflation has moved to upper left, but the change has been very moderate.



In the United States, the household disposable income surged in 2020 due to the increased government spending in response to COVID-19 and the recession. It led to a rebound in consumer spending since the 2nd QTR of 2021 with a time lag, when people's fears of COVID-19 began to wane.

The bottleneck of labor supply, which pushed up wages, occurred when consumption surged.

Why?



Why did the bottleneck of labor supply occur in the US in 2021 ?

①The increased unemployment benefit had been extended to Sept.6. 2021

②Exit from the labor market by early retirement

③People unable to return to work due to the COVID-19 sequela

Katie Bach “New data shows long Covid is keeping as many as 4 million people out of work” Brookings Institute, August 24, 2022

In contrast to the United States, in Japan, the government subsidies were spent to keep companies employed, not to increase unemployment insurance.

The request of labor unions to maintain employment and the request of employers to curb wages are firmly linked in Japan.

It is causing another problem, stickiness or rigidity of wages and prices in Japan.

However, also in Japan, the expected inflation rate seems to be rising, the labor unions are challenging to request for wage increase more aggressively and providers are getting less timid to raise retail prices.

Pivotal change of security awareness in Japan

In the wake of Russia's war in Ukraine, the people's security awareness in Japan has strengthened significantly. In particular, the Chinese Communist Party and the Xi Jinping's leadership, which has not given up on Taiwan's military integration, has become a source of threat and tension in the Far East.

The influence of unarmed pacifism, which had persistent political popularity after the WW2 in Japan, has declined significantly while there are growing calls to strengthen the defense capabilities.

