Outlook for the Japanese economy

Presentation to a luncheon for the Queensland-Japan Chamber of Commerce and Industry

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www.anz/com/go/economics
World economy in what is likely to be its longest period of above-trend growth in over 30 years

Global economic growth

Note: GDP is measured in US$ at purchasing power parities.
Source: IMF; Economics@ANZ.
Above-trend global growth is largely being driven by developing countries

Advanced economies

Developing economies

Share of global growth (5-yr moving average)

Share of global GDP

Share of global growth (5-yr moving average)

Share of global GDP

'Advanced' economies comprise the US, Western Europe, Japan, Canada, Australia, New Zealand, Korea, Taiwan, Hong Kong, Singapore and Israel.

Sources: IMF, World Economic Outlook; Economics@ANZ.
Developing economies have provided a source of discipline on advanced economy prices and costs

Wholesale prices of goods in the United States

Oil prices and inflation

Sources: US Bureau of Economic Analysis; US Bureau of Labor Statistics; OECD; Datastream; Economics@ANZ.
Developing countries have exported massive amounts of capital to the industrialized world

Capital flows to developing economies

Note: ‘Developing economies’ in this chart includes Korea, Taiwan, Hong Kong, Singapore and Israel. All figures are net. Source: IMF; Economics@ANZ.
China’s economy is showing some signs of slowing from last year’s frenetic pace ...
... in response to the most recent tightening of PBoC monetary policy

**Interest rates**

![Interest rates graph](image)

**Bank lending**

![Bank lending graph](image)

**Money supply growth**

![Money supply growth graph](image)

**Yuan vs US$**

![Yuan vs US$ graph](image)

*Source: People’s Bank of China.*
India’s economy has also been doing well – but India’s ‘speed limit’ is lower than China’s

**Real GDP - China**

% ch. from year earlier

00 01 02 03 04 05 06 07

**Real GDP - India**

% ch. from year earlier

00 01 02 03 04 05 06 07

**Inflation**

% ch. from year earlier

00 01 02 03 04 05 06 07

**Trade balance**

US$bn (12-mth moving total)

00 01 02 03 04 05 06 07

Source: China National Statistics Bureau; India Department of Statistics; IMF.
Some comparisons between China and India

<table>
<thead>
<tr>
<th></th>
<th>China</th>
<th>India</th>
</tr>
</thead>
<tbody>
<tr>
<td>Saving as a % of GDP (a)</td>
<td>39.7</td>
<td>21.9</td>
</tr>
<tr>
<td>Investment as a % of GDP (a)</td>
<td>37.5</td>
<td>22.5</td>
</tr>
<tr>
<td>Manufacturing as a % of GDP (a)</td>
<td>50.1</td>
<td>25.4</td>
</tr>
<tr>
<td>Adult literacy rate (%) (b)</td>
<td>90.9</td>
<td>61.3</td>
</tr>
<tr>
<td>- women (b)</td>
<td>86.5</td>
<td>46.4</td>
</tr>
<tr>
<td>Life expectancy at birth (b)</td>
<td>70.9</td>
<td>63.7</td>
</tr>
<tr>
<td>Infant mortality per 1000 live births (b)</td>
<td>39</td>
<td>93</td>
</tr>
<tr>
<td>Tax revenue as a % of GDP (a)</td>
<td>15</td>
<td>13</td>
</tr>
<tr>
<td>Budget deficit as a % of GDP (a)</td>
<td>2.6</td>
<td>5.1</td>
</tr>
<tr>
<td>Weighted mean tariffs (%) (b)</td>
<td>6</td>
<td>28</td>
</tr>
<tr>
<td>Exports as a % of GDP (a)</td>
<td>26.5</td>
<td>12.4</td>
</tr>
<tr>
<td>FDI as % of GDP (a)</td>
<td>4.1</td>
<td>0.8</td>
</tr>
<tr>
<td>Corruption ranking (c)</td>
<td>71</td>
<td>90</td>
</tr>
<tr>
<td>Days to establish a new business (b)</td>
<td>75</td>
<td>126</td>
</tr>
</tbody>
</table>

By some counts Japan is now enjoying its longest economic expansion since the 1960s ...

### Japanese real GDP growth

![GDP Growth Chart](chart.png)

**Note:** Shaded periods denote recessions (as designated by ESRI).

**Source:** Economic & Social Research Institute, Cabinet Office.
... but growth has been very weak by comparison with earlier ‘boom’ periods

Real GDP growth in three cycles

Recession trough = 100

Izanagi boom (Q4 1965 - )
Heisei boom (Q4 1986 - )
Current expansion (Q1 2002 - )

Source: Economic & Social Research Institute, Economics@ANZ.
A striking contrast between profit and jobs growth in the current and previous expansions

**Real corporate profits**

Recession trough = 100

- **Izanagi boom** (Q4 66 - )
- **Current expansion** (Q1 02 - )
- **Heisei boom** (Q4 86 - )

**Employment**

Recession trough = 100

- **Heisei boom** (Q4 86 - )
- **Izanagi boom** (Q4 66 - )
- **Current expansion** (Q1 02 - )

*Note:* real profits are operating profits deflated by the GDP deflator.

*Sources:* Economic & Social Research Institute; Home Ministry; Economics@ANZ.
Household and consumer spending have been particularly weak compared with previous cycles.

Sources: Economic & Social Research Institute; Economics@ANZ.
Japan’s corporate sector has worked off the ‘four excesses’ created by the 1980s ‘bubble’…

**Excess capacity**

Net balance (%) reporting 'excessive'

**Excess inventories**

Net balance (%) reporting 'excessive'

**Excess labour**

Net balance (%) reporting 'excessive'

**Excess debt**

Net balance (%) reporting financial position as 'satisfactory'

*Source: Bank of Japan Tankan survey*
... and is now in a very strong financial position

**Profit margins**

- % (4-qtr moving average)

**Corporate profit share of GDP**

- % (4-qtr moving average)

**Rate of return on assets**

- % (4-qtr moving average)

**Debt-equity ratio**

- % (4-qtr moving average)

_Sources_: Bank of Japan; Tokyo Shoko Research Company.
Most businesses are reasonably optimistic about the business outlook

**Tankan business conditions - all enterprises**

- Net balance judging "good" (%)
  - Large firms
  - Small firms

**Tankan business conditions - manufacturers**

- Net balance judging "good" (%)
  - Large firms
  - Small firms

**Tankan business conditions - non-manufacturers**

- Net balance judging "good" (%)
  - Large firms
  - Small firms

**Shokochukin business conditions - SMEs**

- Net balance (%)

Sources: Bank of Japan; Shokochukin Bank
Consumers are becoming more confident but are still worried about the lack of income growth ...

Source: ESRI.
... and they’re right: employment has been rising but income growth is still very flat

Sources: Ministry of Health, Labour and Welfare.
Not surprisingly, therefore, consumer spending has remained fairly soft.

**Retail sales volume**
- % change from year earlier
- Actual
- Trend

**Real consumer spending**
- % change from year earlier

**Household saving rate**
- % (12-mth moving average)

**Real consumer spending**
- % change from previous quarter

*Note:* saving rate is for “workers’ households”.
*Sources:* ESRI; OECD.
Deflation is ‘officially’ over but deflationary pressures haven’t been totally eliminated.

Sources: Bank of Japan; Prime Minister’s Office; ESRI.
BoJ will continue to ‘normalize’ rates – but only very slowly

Current accounts at the BoJ

Japanese interest rates

End of 'quantitative easing'

Sources: Bank of Japan; Economics@ANZ.
Persistently low interest rates are encouraging massive capital flows out of Japan

Capital flows from Japan

Japan-US 3-mth Libor spread

Real trade-weighted yen

Sources: Bank of Japan; JP Morgan.
Japan faces a considerable task in cleaning up its public finances

Falling population, participation and productivity growth are key challenges for Japan

**Population growth**

% change from year earlier

**Labour force participation**

% of civilian population aged 15+

**Labour productivity growth**

% pa (5-year moving average)

**Productivity as a pc of US level**

% of US level

Sources: ESRI; Home Ministry; University of Groningen and The Conference Board, GGDC Total Economy Database 2007.
A surprisingly large proportion of Japan’s work force is employed in low-productivity industries

Productivity in 11 sectors of the Japanese economy relative to the US

### Summary of the economic outlook for Japan

<table>
<thead>
<tr>
<th></th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>World real GDP growth (%)</strong></td>
<td>4.9</td>
<td>5.3</td>
<td>4½</td>
<td>4½</td>
</tr>
<tr>
<td><strong>US real GDP growth (%)</strong></td>
<td>3.2</td>
<td>3.3</td>
<td>2½</td>
<td>3</td>
</tr>
<tr>
<td><strong>China real GDP growth (%)</strong></td>
<td>10.2</td>
<td>10.5</td>
<td>9½</td>
<td>9</td>
</tr>
<tr>
<td><strong>Other E Asia real GDP growth (%)</strong></td>
<td>5.1</td>
<td>5.5</td>
<td>5½</td>
<td>5¾</td>
</tr>
<tr>
<td><strong>Japan real GDP growth (%)</strong></td>
<td>1.9</td>
<td>2.2</td>
<td>2</td>
<td>1¾</td>
</tr>
<tr>
<td><strong>Employment growth (%)</strong></td>
<td>0.4</td>
<td>0.4</td>
<td>¼</td>
<td>¼</td>
</tr>
<tr>
<td><strong>Unemployment rate (%)</strong>(a)</td>
<td>4.4</td>
<td>4.1</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td><strong>CPI inflation (%)</strong>(b)</td>
<td>-0.6</td>
<td>0.3</td>
<td>½</td>
<td>1</td>
</tr>
<tr>
<td><strong>Call money rate (% pa) (a)</strong></td>
<td>0.00</td>
<td>0.25</td>
<td>0.75</td>
<td>1.00</td>
</tr>
<tr>
<td><strong>Yen-US$</strong>(a)</td>
<td>120</td>
<td>117</td>
<td>112</td>
<td>110</td>
</tr>
<tr>
<td><strong>Yen-€</strong>(a)</td>
<td>141</td>
<td>153</td>
<td>145</td>
<td>134</td>
</tr>
<tr>
<td><strong>Yen-A$</strong>(a)</td>
<td>88</td>
<td>91</td>
<td>83</td>
<td>77</td>
</tr>
</tbody>
</table>

(a) December  (b) Year to December quarter; all other forecasts are year-average