

Outlook for the Japanese economy

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

Saul Eslake
Chief Economist
ANZ Bank

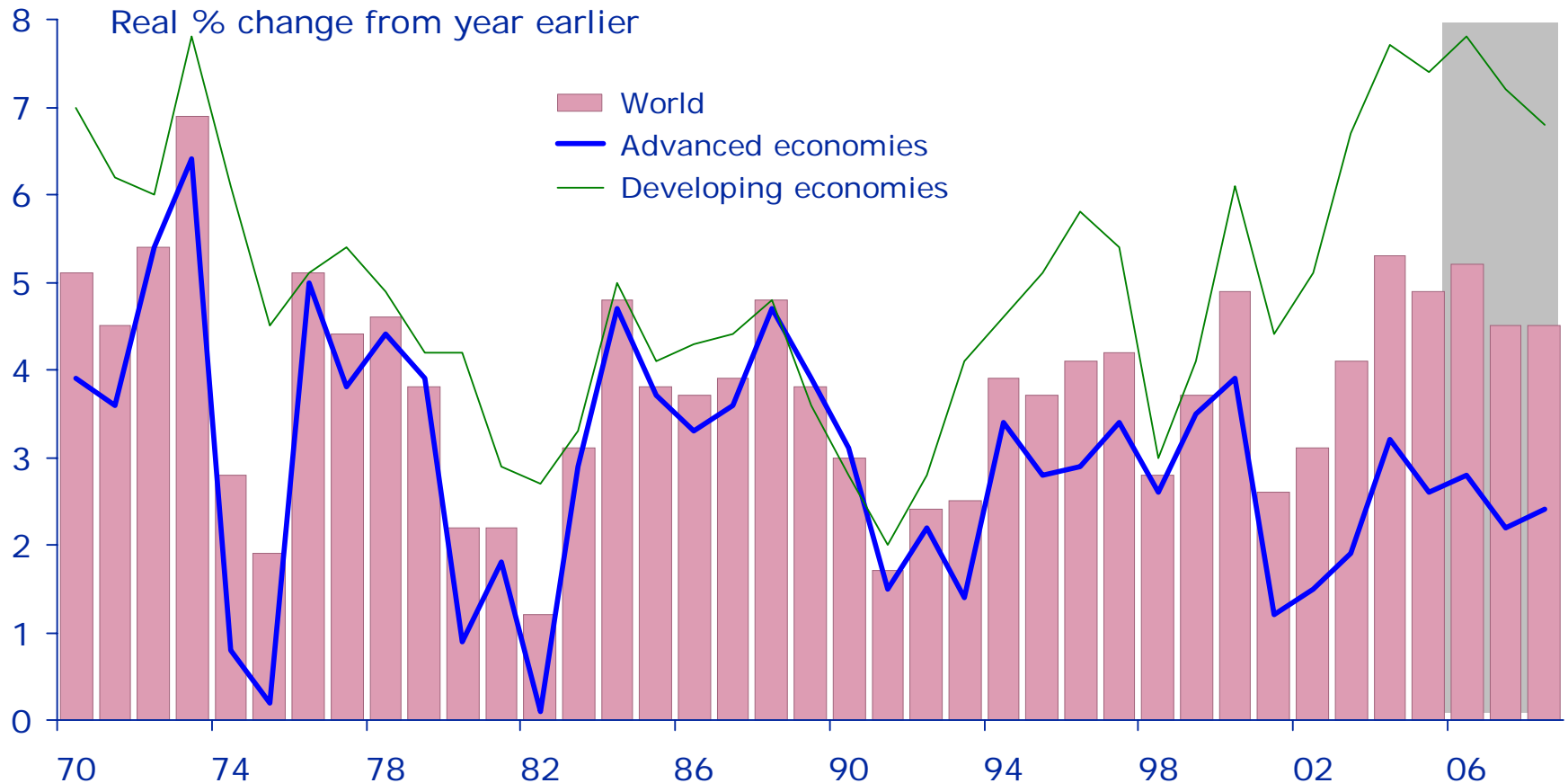
Brisbane Hilton
23rd February 2007

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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.

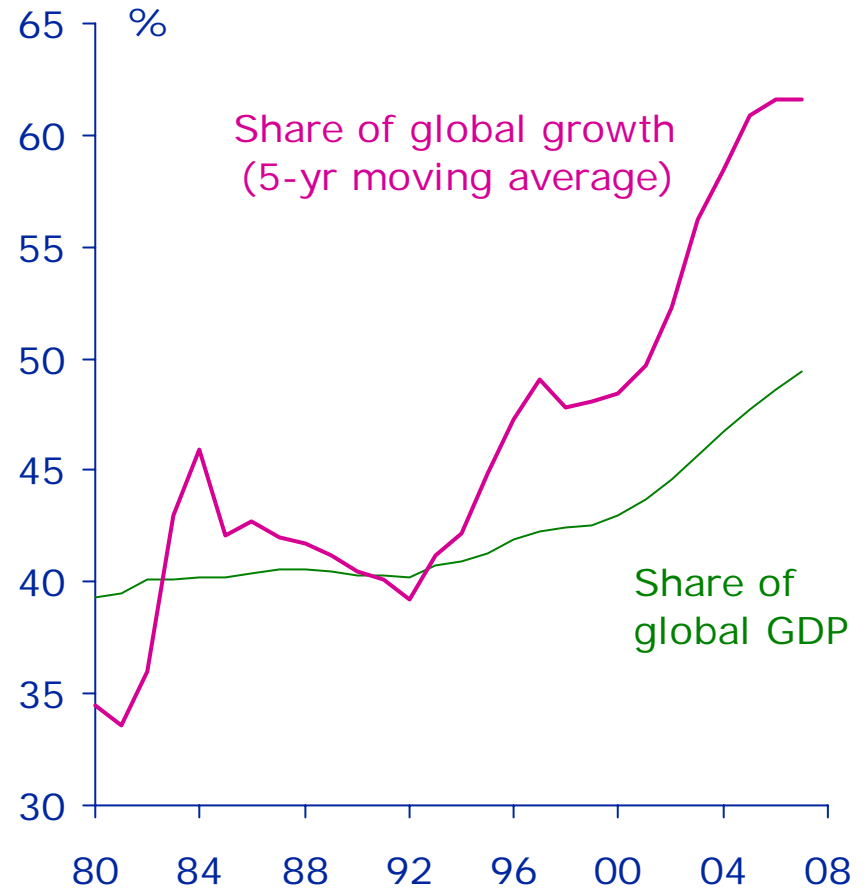
Source: IMF; Economics@ANZ.

Above-trend global growth is largely being driven by developing countries

Advanced economies



Developing economies

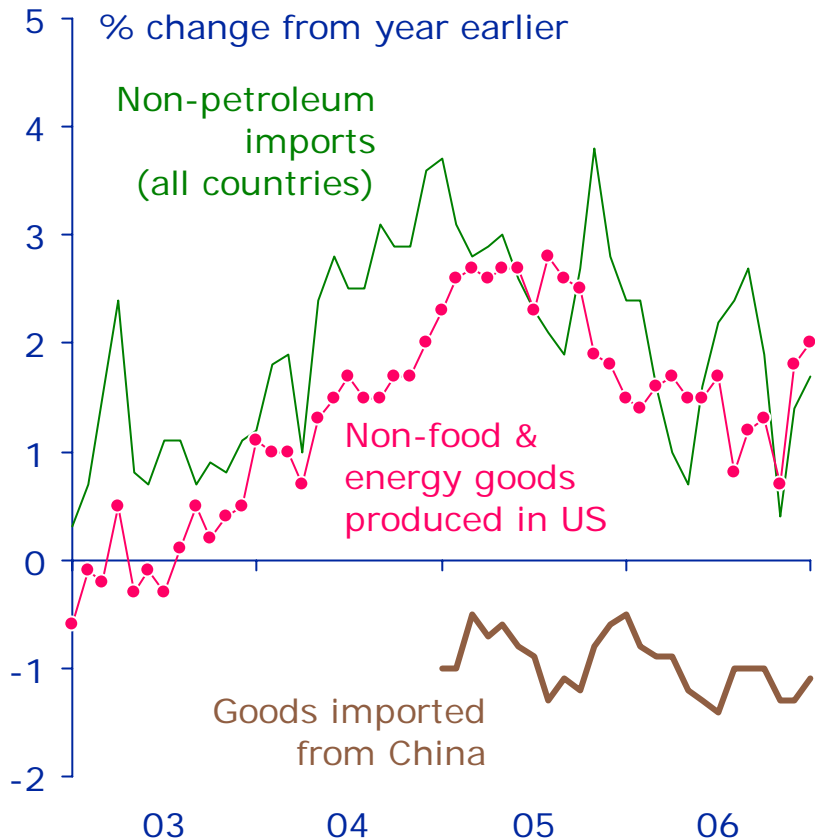


'Advanced' economies comprise the US, Western Europe, Japan, Canada, Australia, New Zealand, Korea, Taiwan, Hong Kong, Singapore and Israel.

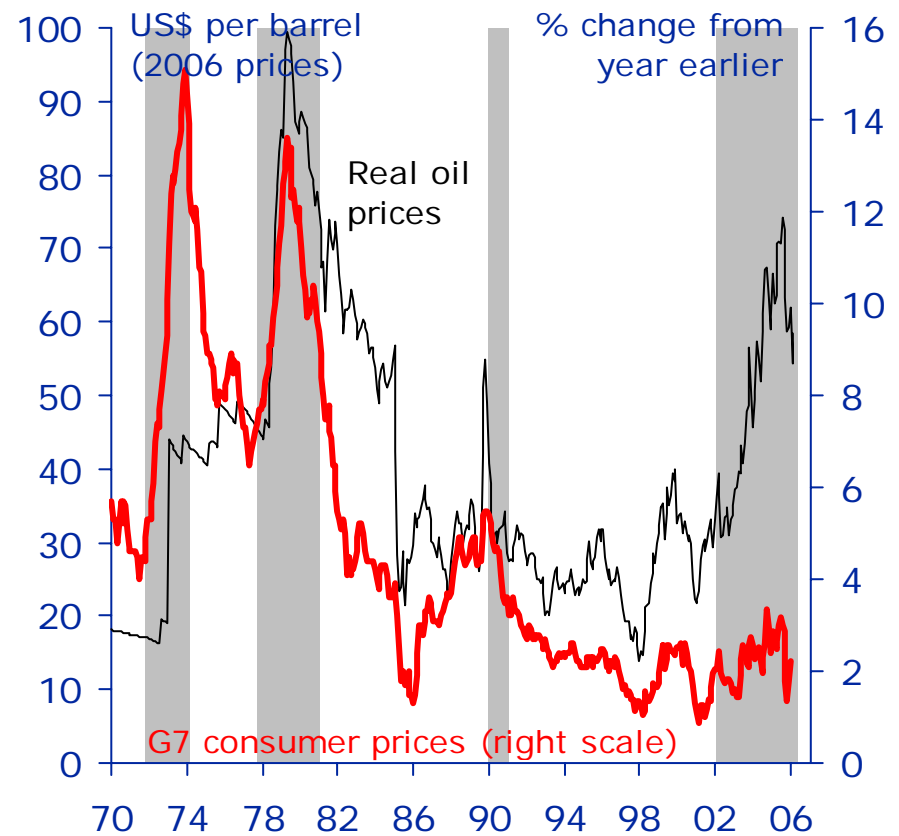
Sources: IMF, *World Economic Outlook*; Economics@ANZ.

Developing economies have provided a source of discipline on advanced economy prices and costs

Wholesale prices of goods in the United States



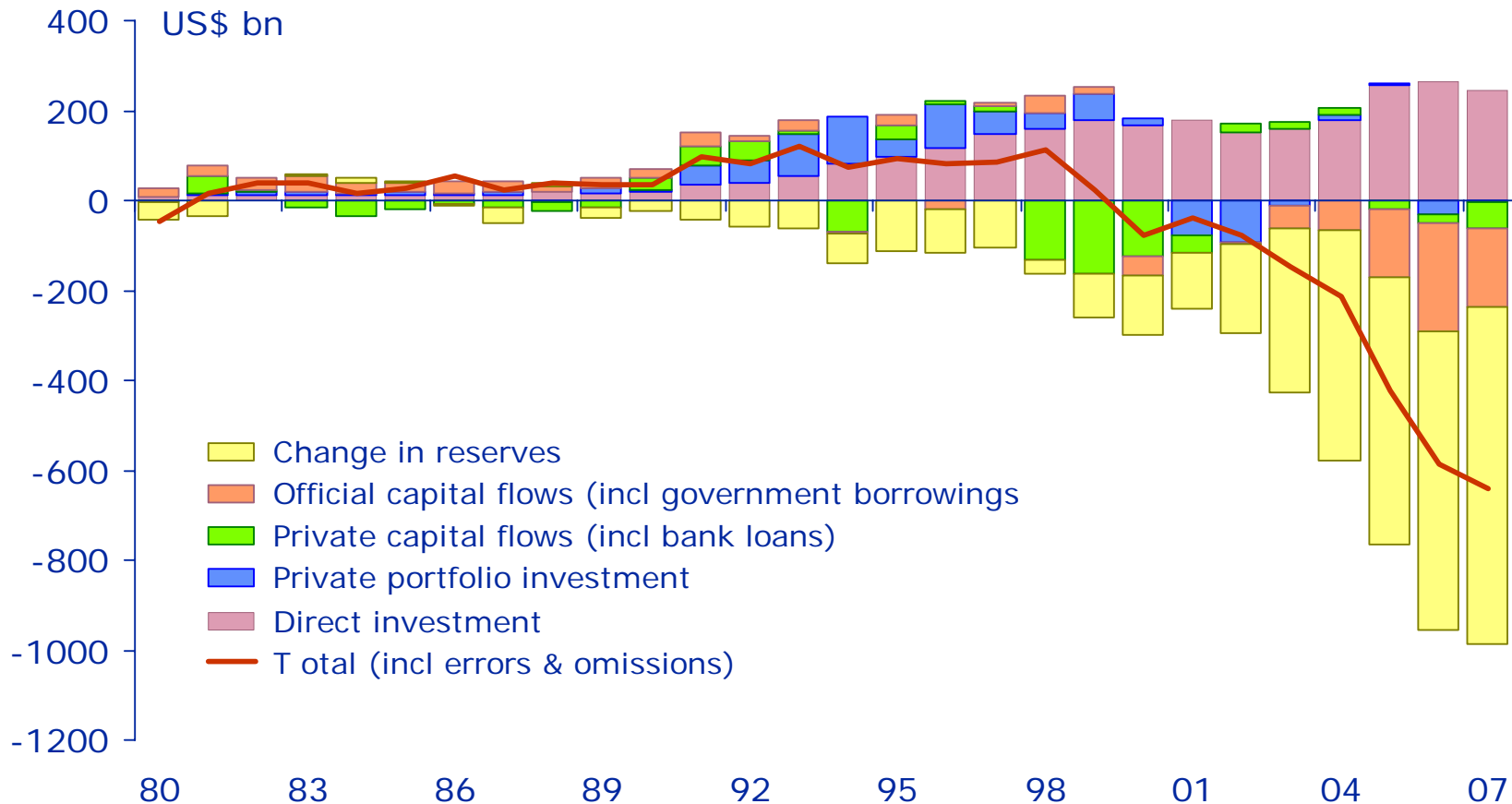
Oil prices and inflation



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

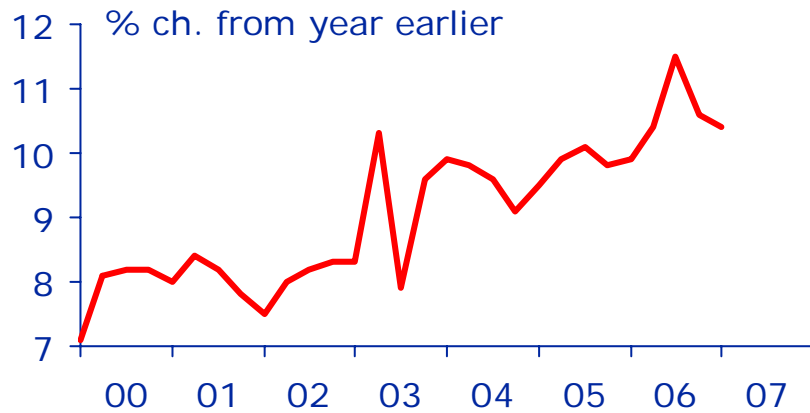
Capital flows to developing economies



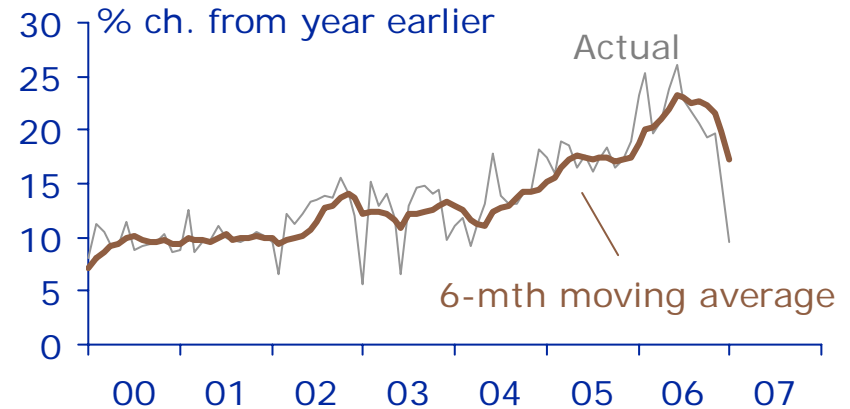
Note: 'Developing economies' in this chart includes Korea, Taiwan, Hong Kong, Singapore and Israel. All figures are net. Source: IMF; Economics@ANZ.

China's economy is showing some signs of slowing from last year's frenetic pace ...

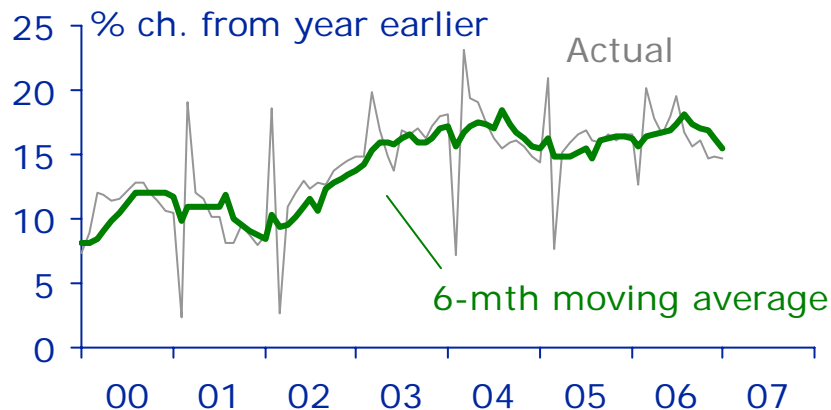
Real GDP



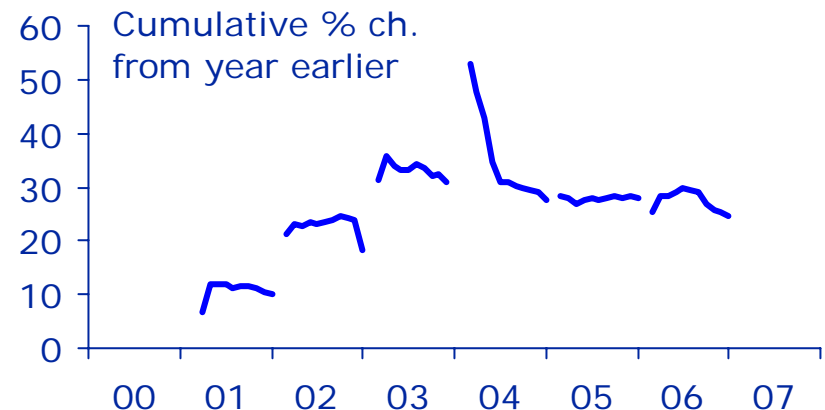
Retail sales



Industrial production



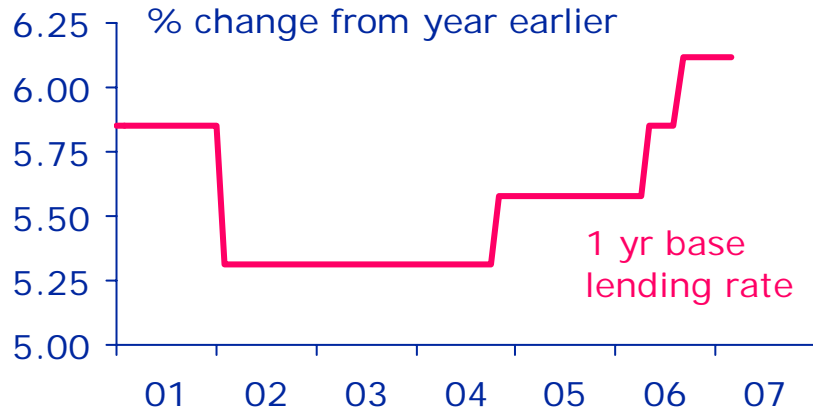
Fixed asset investment



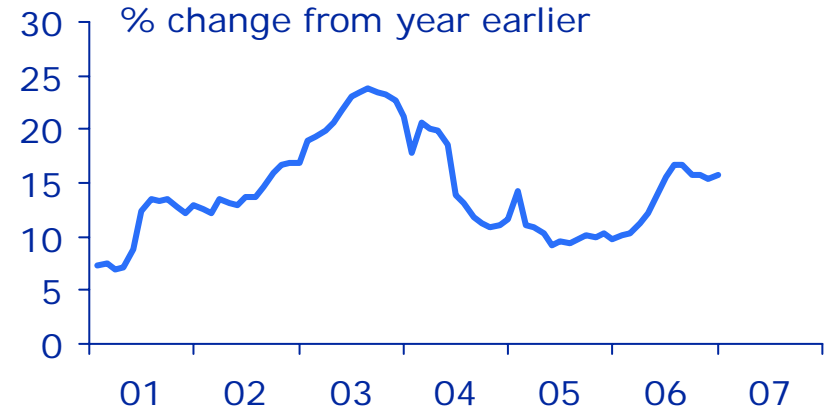
Source: China National Statistics Bureau

... in response to the most recent tightening of PBoC monetary policy

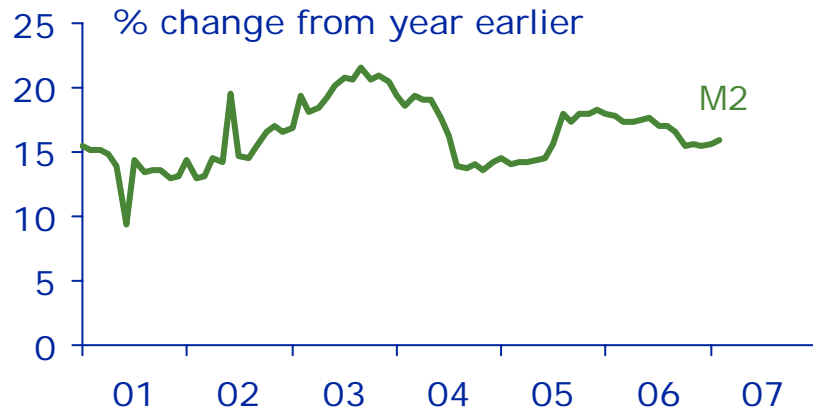
Interest rates



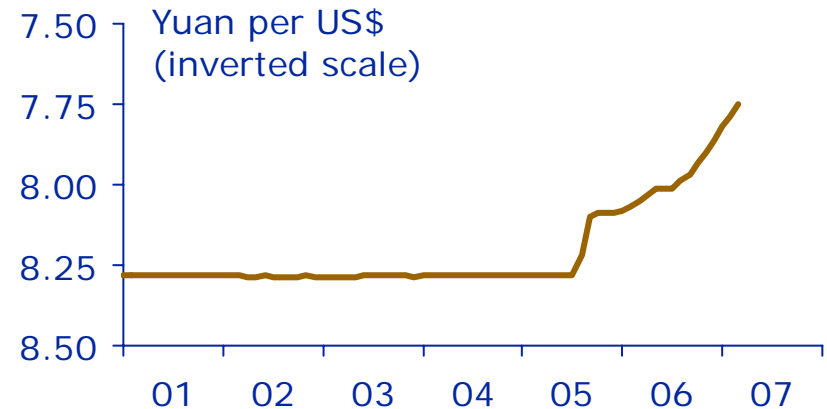
Bank lending



Money supply growth



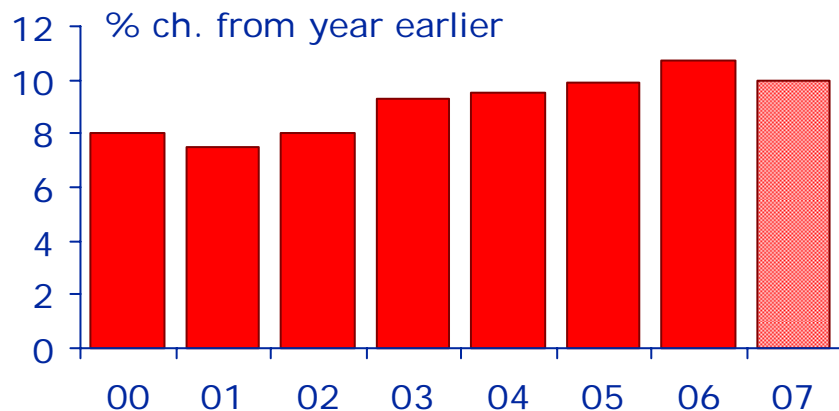
Yuan vs US\$



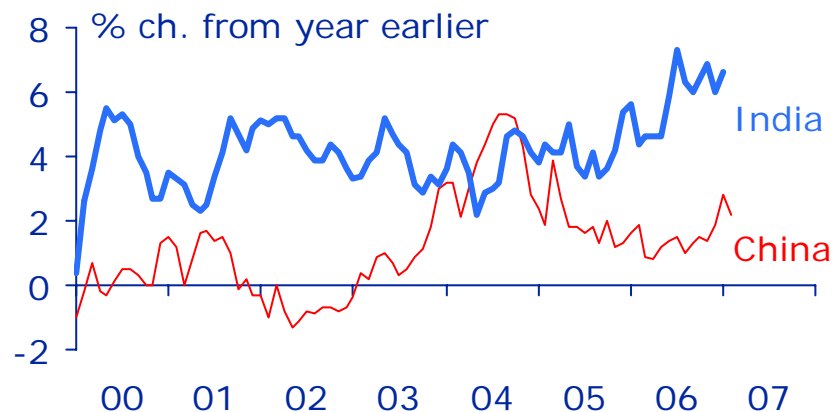
Source: People's Bank of China.

India's economy has also been doing well – but India's 'speed limit' is lower than China's

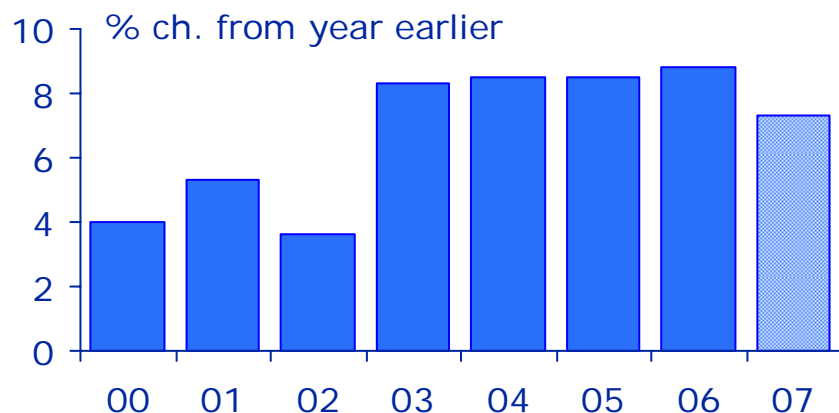
Real GDP - China



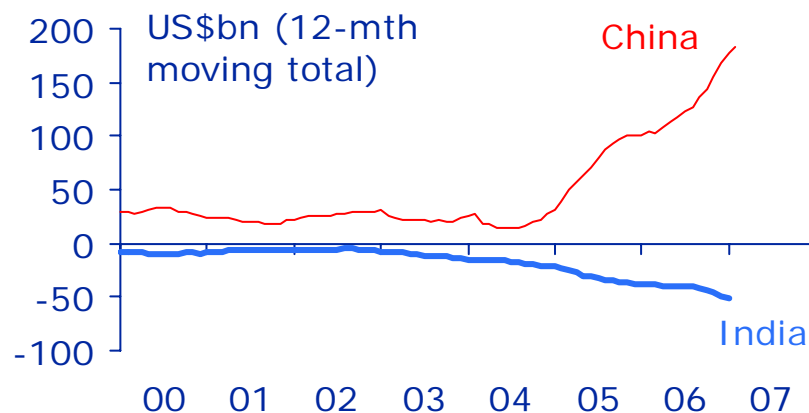
Inflation



Real GDP - India



Trade balance



Source: China National Statistics Bureau;
India Department of Statistics; IMF.

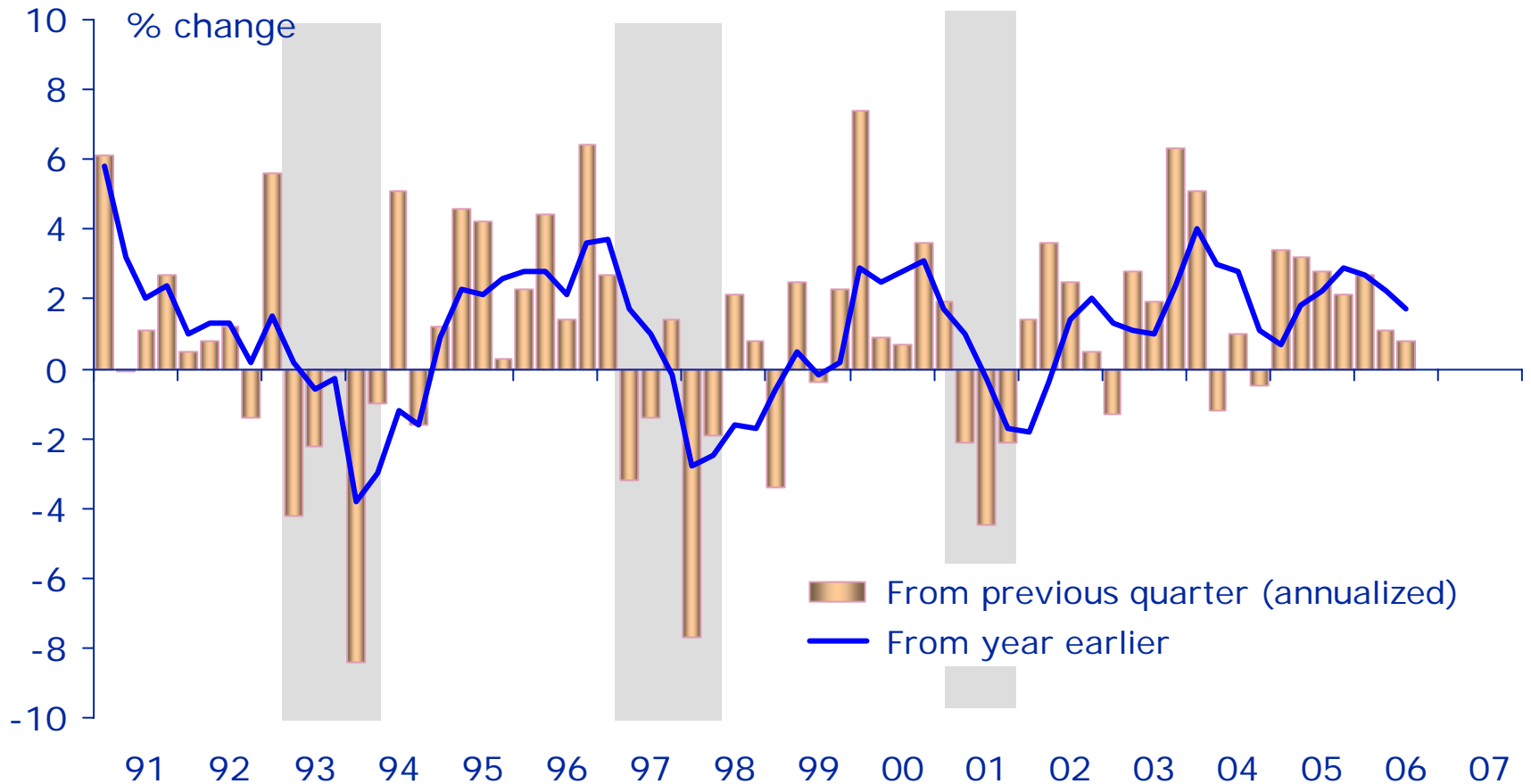
Some comparisons between China and India

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

(a) Average for ten years ended 2004. (b) 2002. (c) 2004. Sources: Economist Intelligence Unit; UNDP *Human Development Report*; World Bank *World Development Report* and *Doing Business*; Transparency International *Corruption Perceptions Index*.

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

Japanese real GDP growth

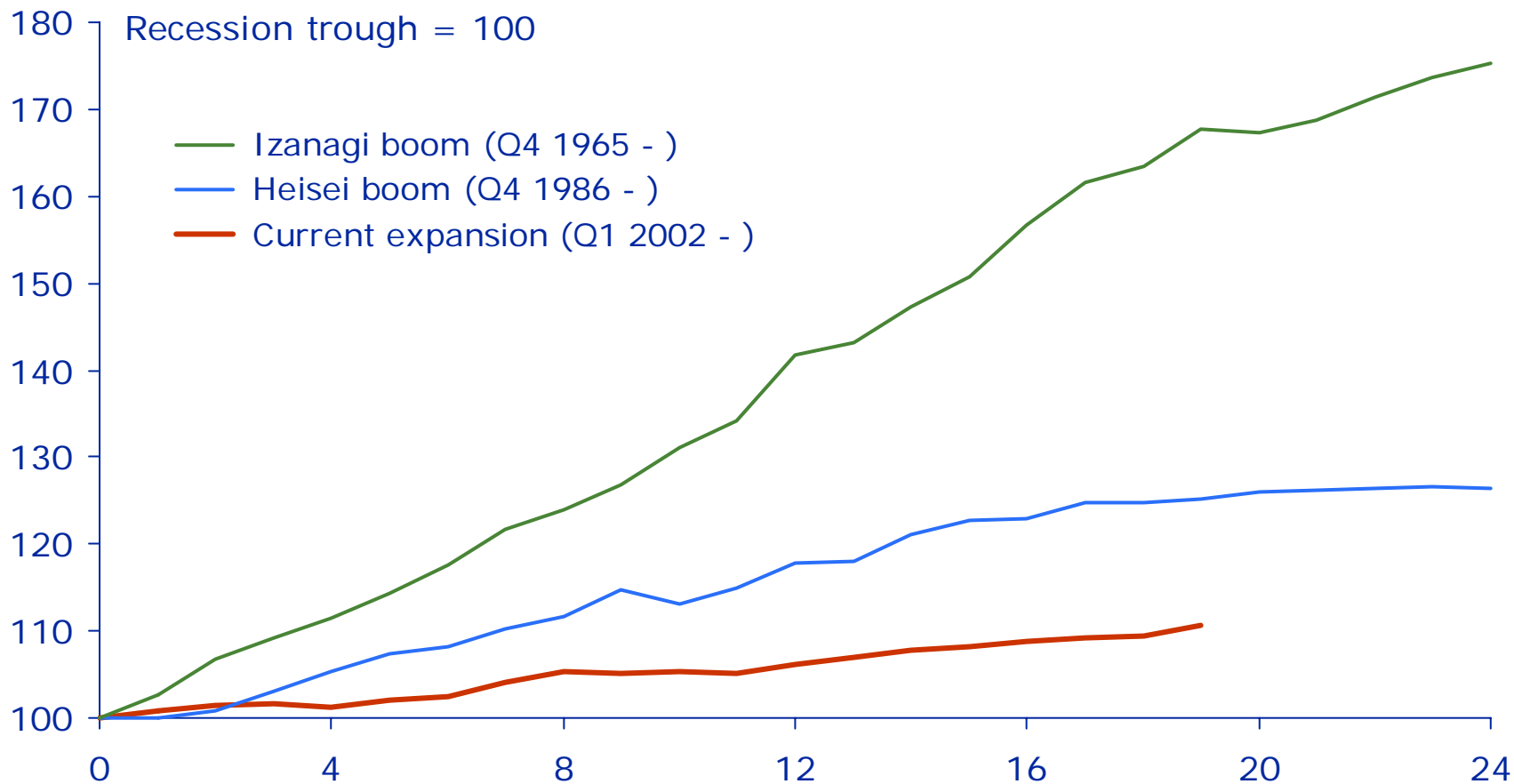


Note: Shaded periods denote recessions (as designated by ESRI).

Source: Economic & Social Research Institute, Cabinet Office.

... but growth has been very weak by comparison with earlier 'boom' periods

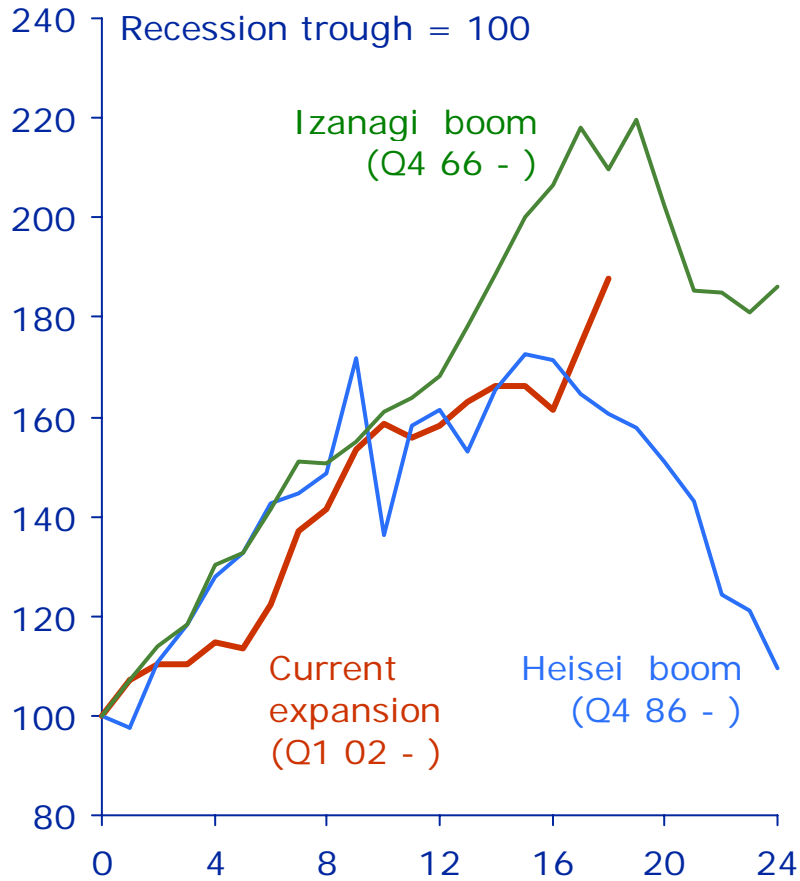
Real GDP growth in three cycles



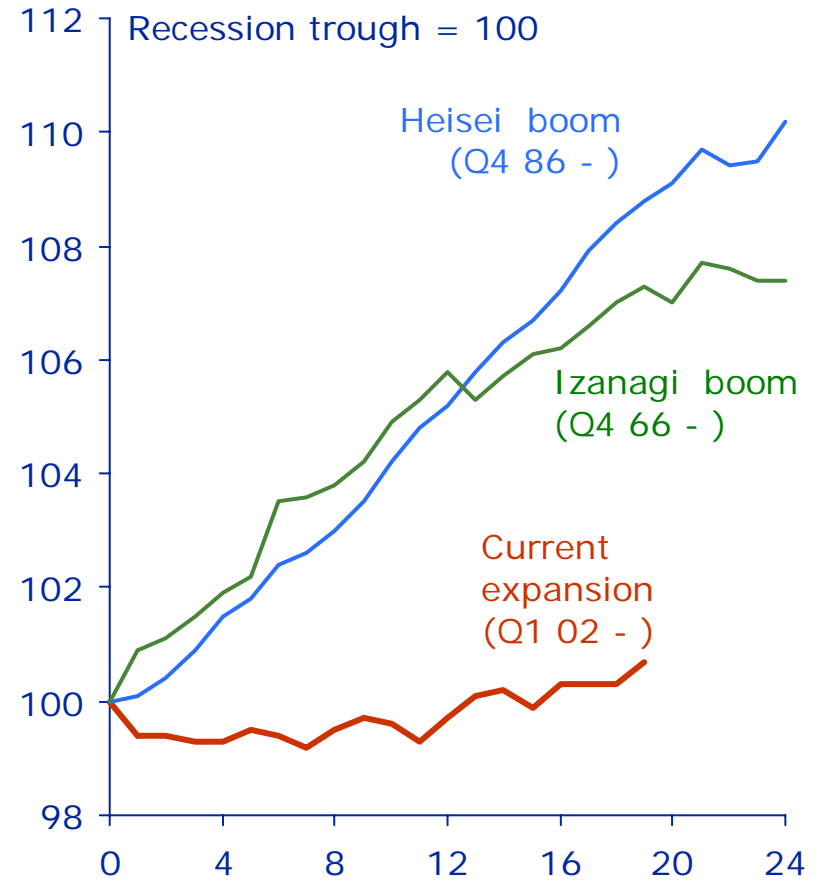
Source: Economic & Social Research Institute, Economics@ANZ.

A striking contrast between profit and jobs growth in the current and previous expansions

Real corporate profits



Employment

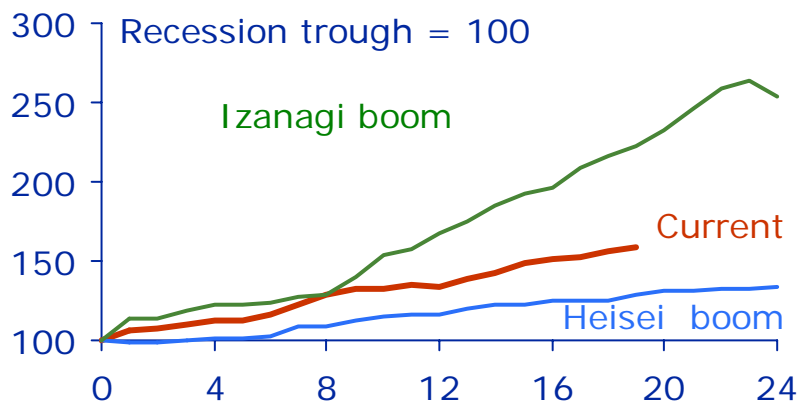


Note: real profits are operating profits deflated by the GDP deflator.

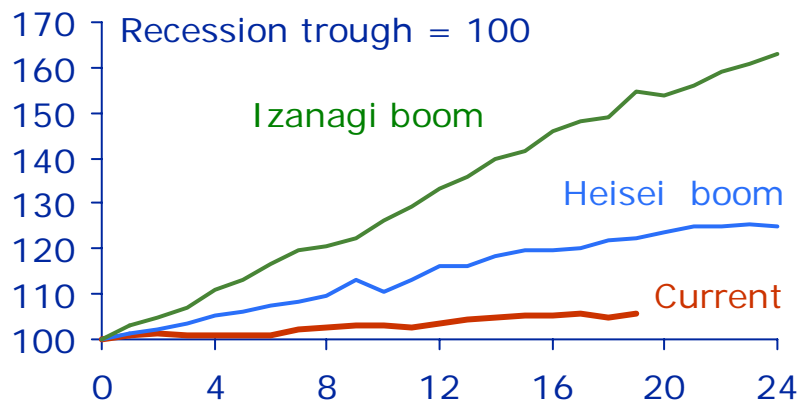
Sources: Economic & Social Research Institute; Home Ministry; Economics@ANZ.

Household and consumer spending have been particularly weak compared with previous cycles

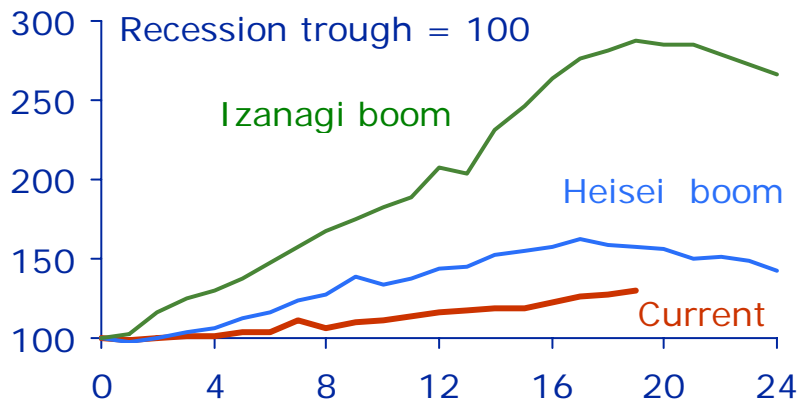
Exports



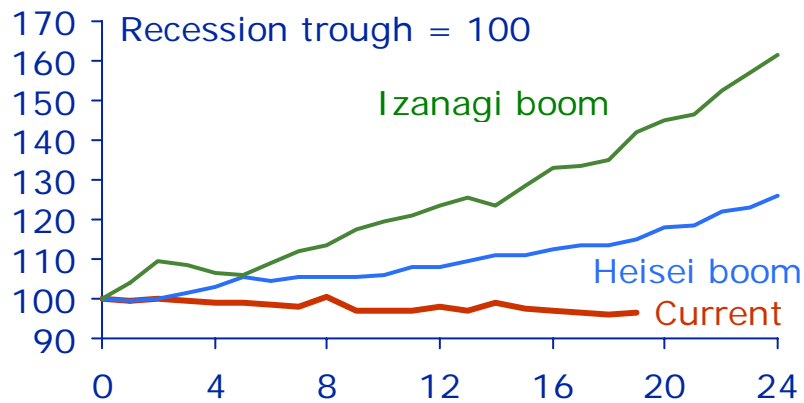
Consumer spending



Business investment



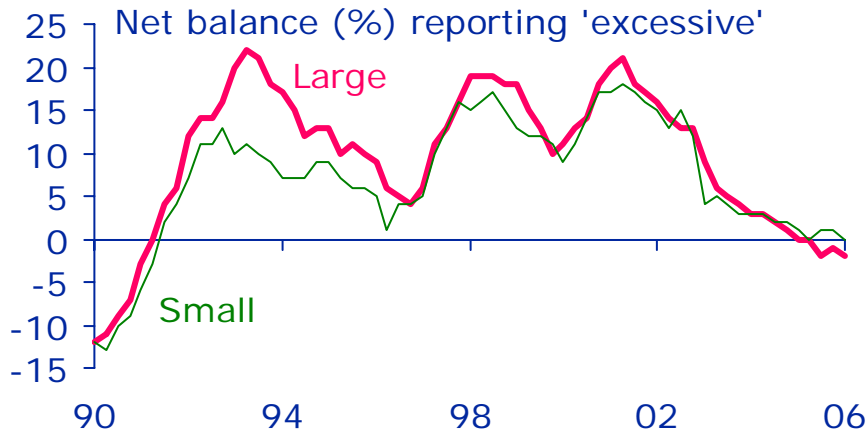
Public spending



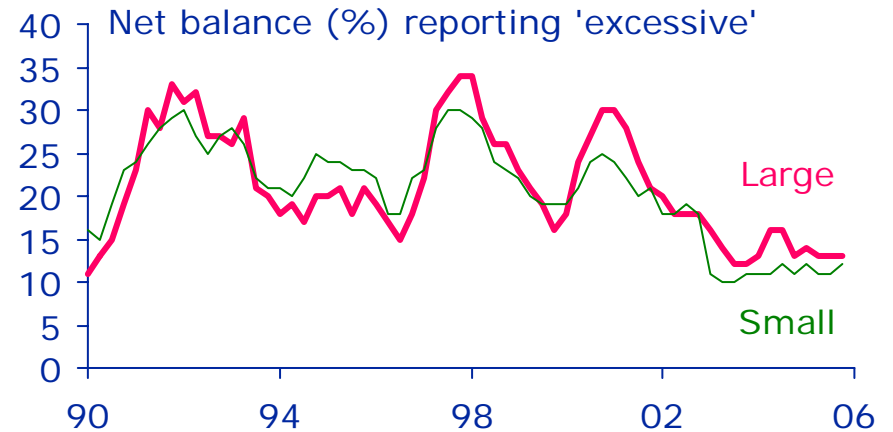
Sources: Economic & Social Research Institute; Economics@ANZ.

Japan's corporate sector has worked off the 'four excesses' created by the 1980s 'bubble' ...

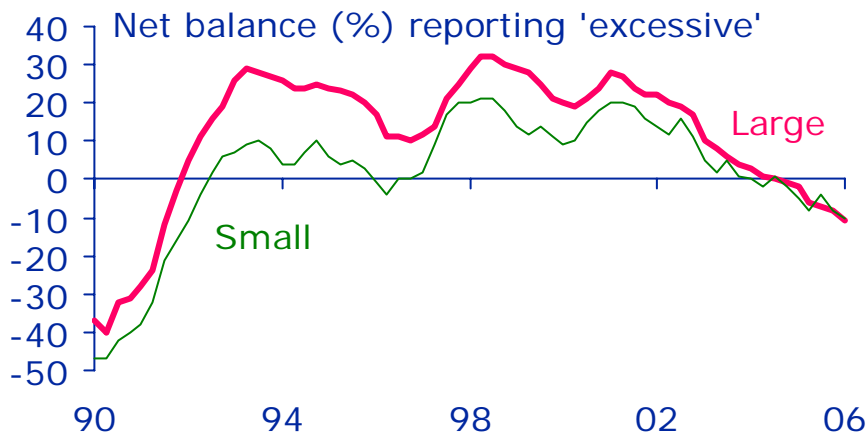
Excess capacity



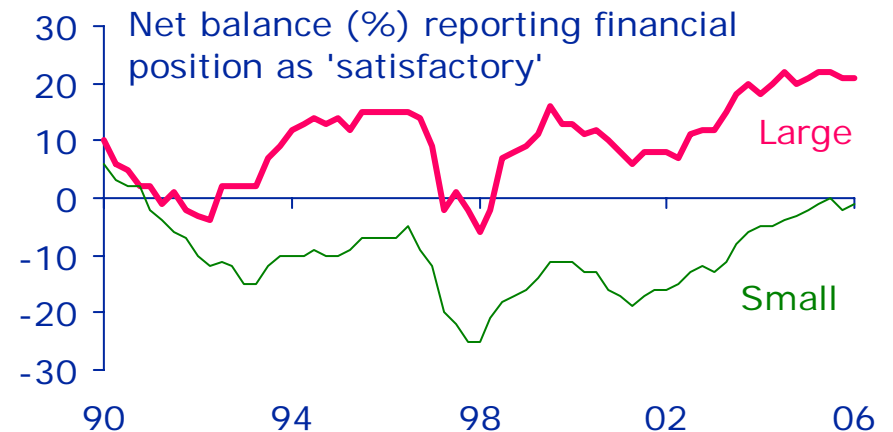
Excess inventories



Excess labour



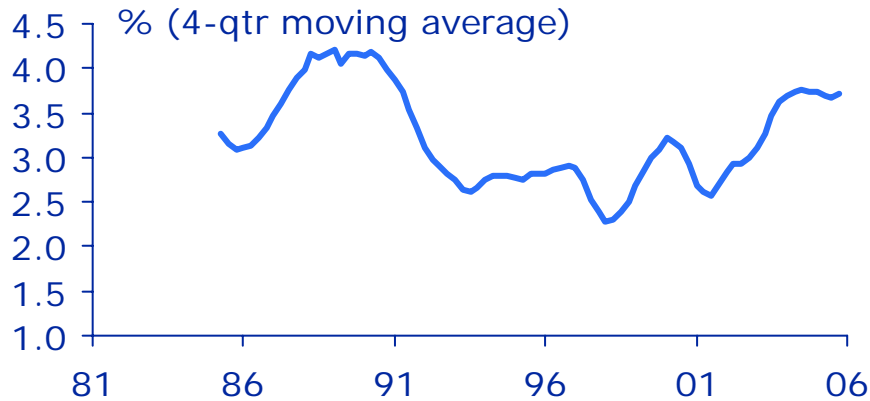
Excess debt



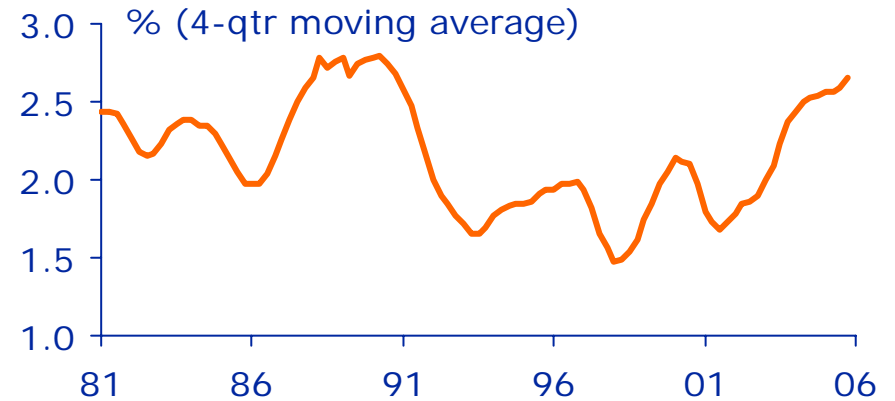
Source: Bank of Japan *Tankan* survey

... and is now in a very strong financial position

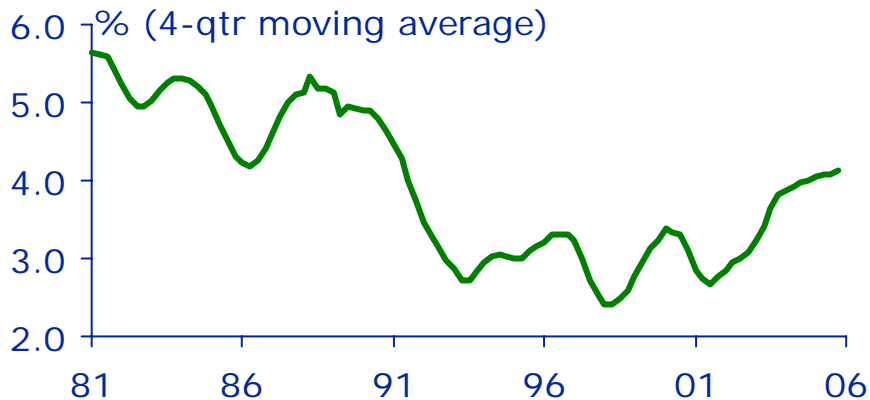
Profit margins



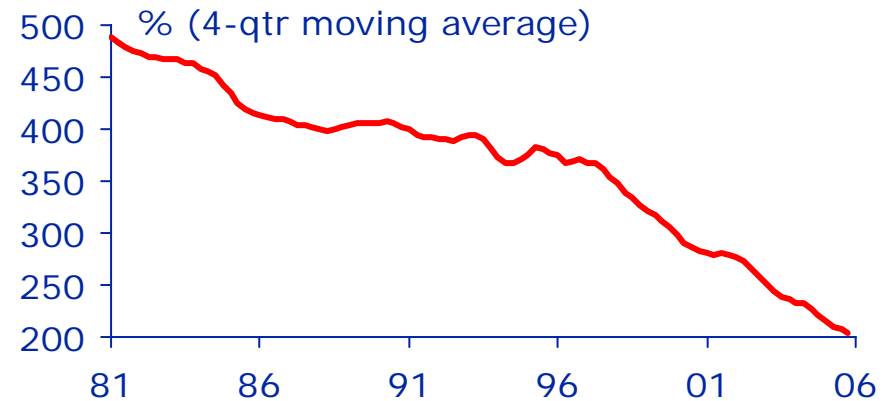
Corporate profit share of GDP



Rate of return on assets



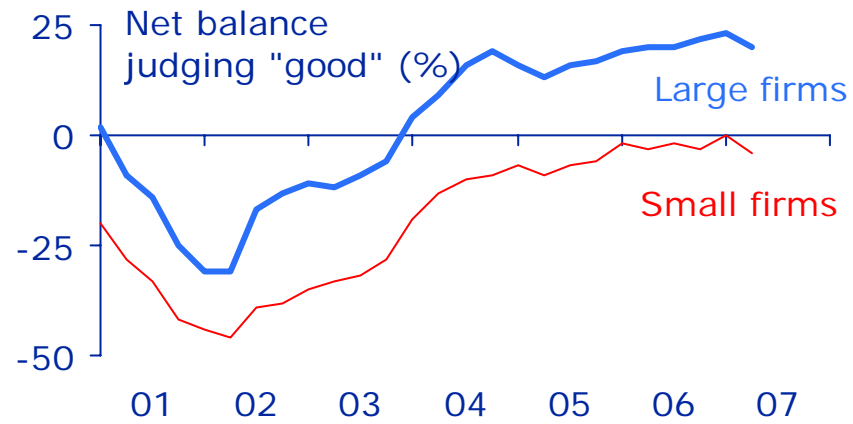
Debt-equity ratio



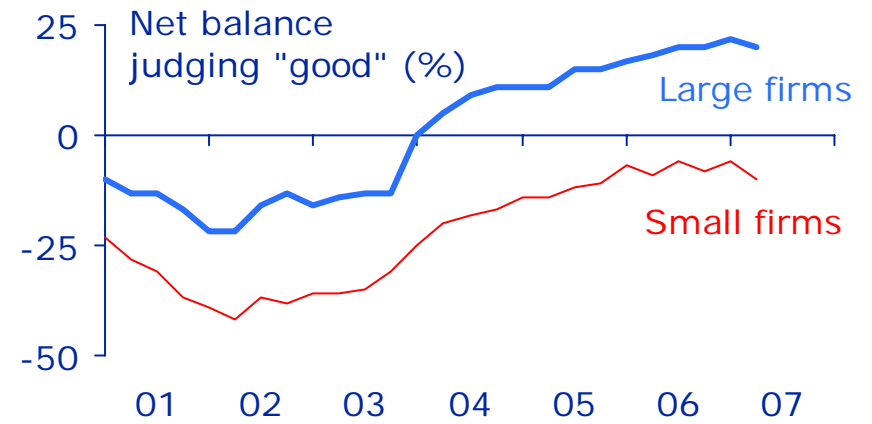
Sources: Bank of Japan; Tokyo Shoko Research Company.

Most businesses are reasonably optimistic about the business outlook

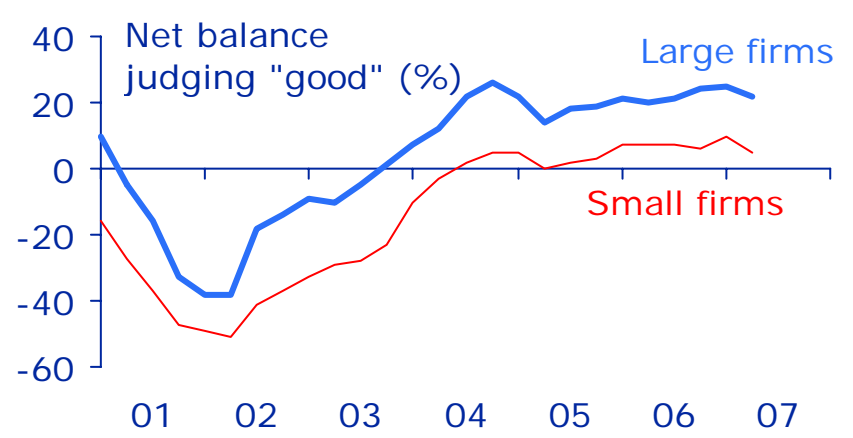
Tankan business conditions - all enterprises



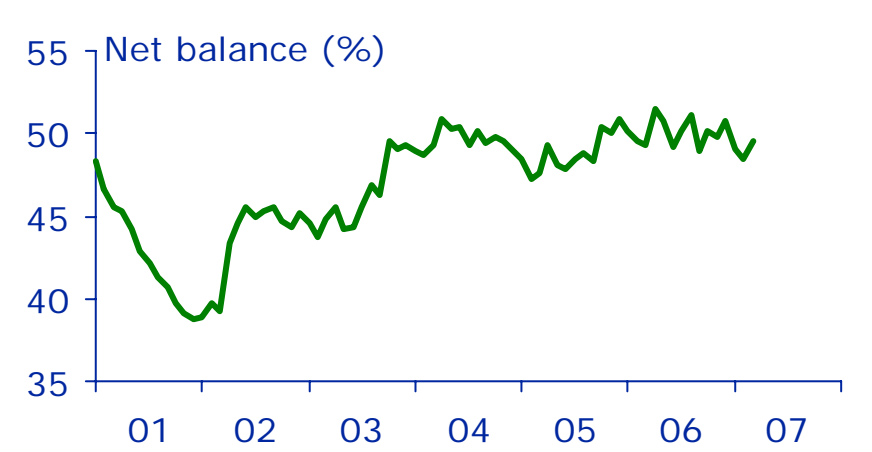
Tankan business conditions - non-manufacturers



Tankan business conditions - manufacturers



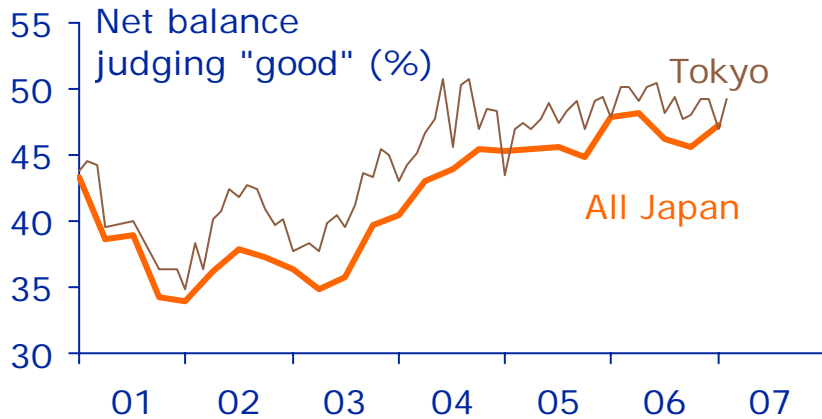
Shokochukin business conditions - SMEs



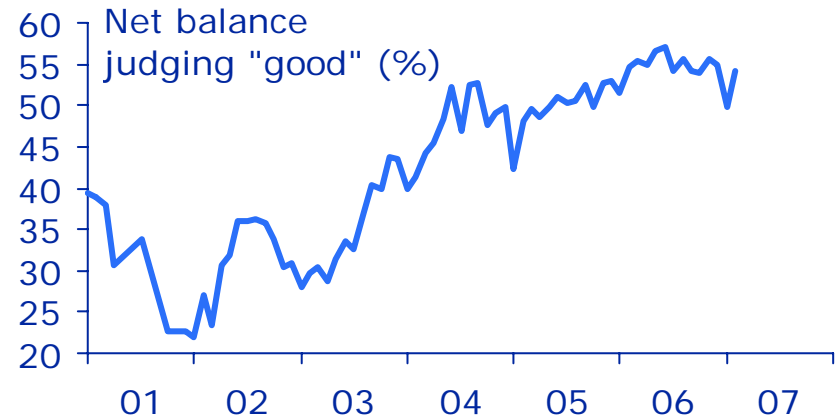
Sources: Bank of Japan; Shokochukin Bank

Consumers are becoming more confident but are still worried about the lack of income growth ...

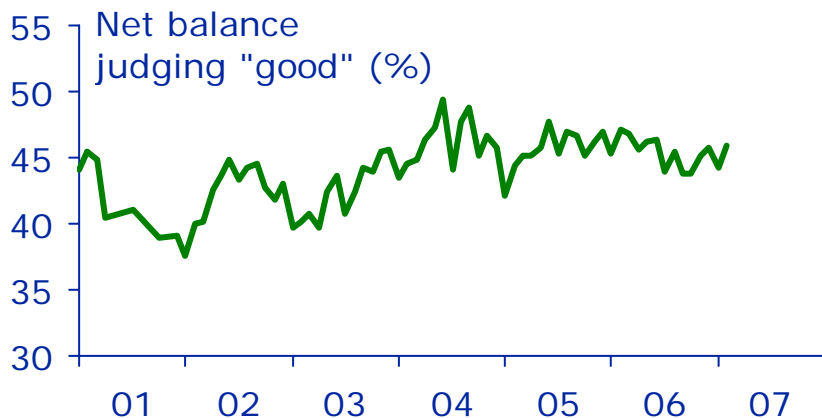
Consumer confidence



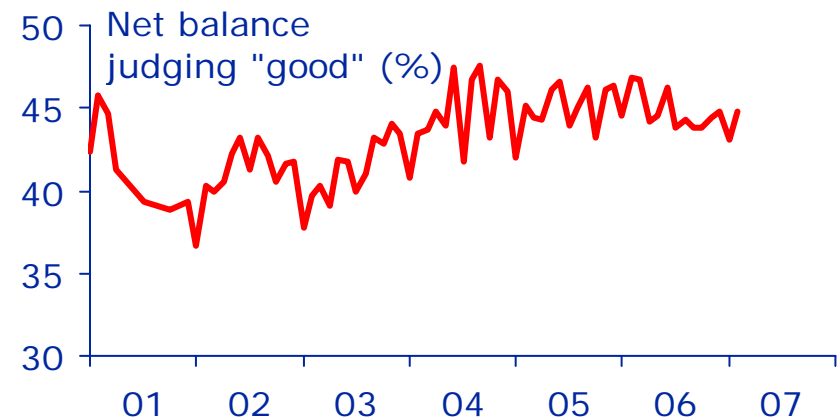
Employment prospects



'Overall livelihood'



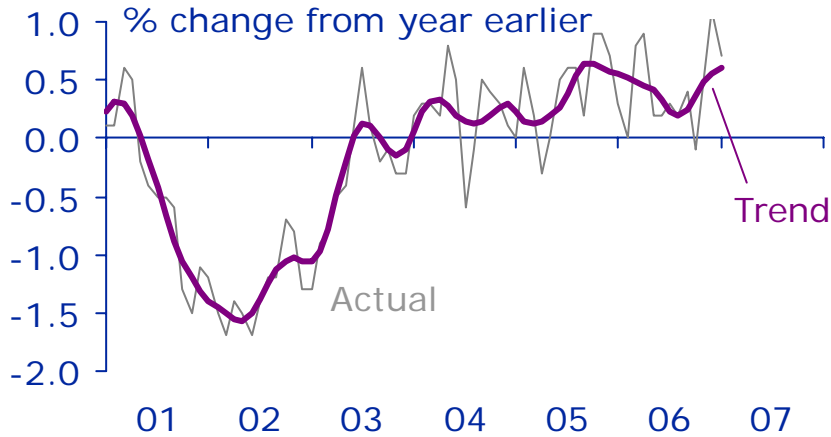
Income growth



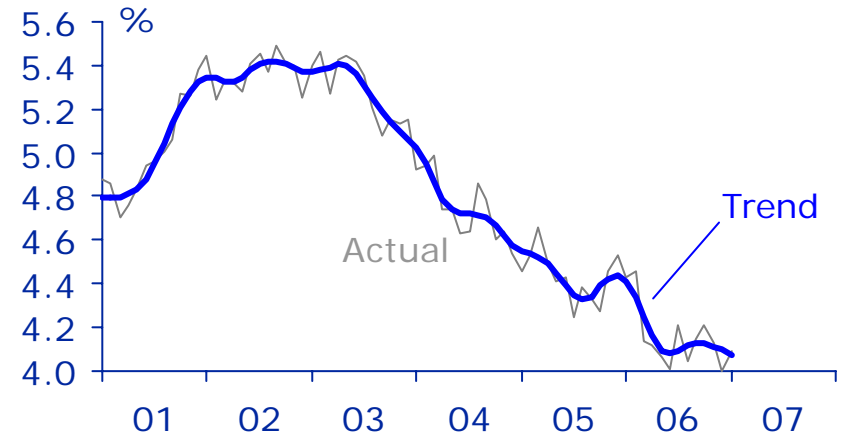
Source: ESRI.

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

Employment



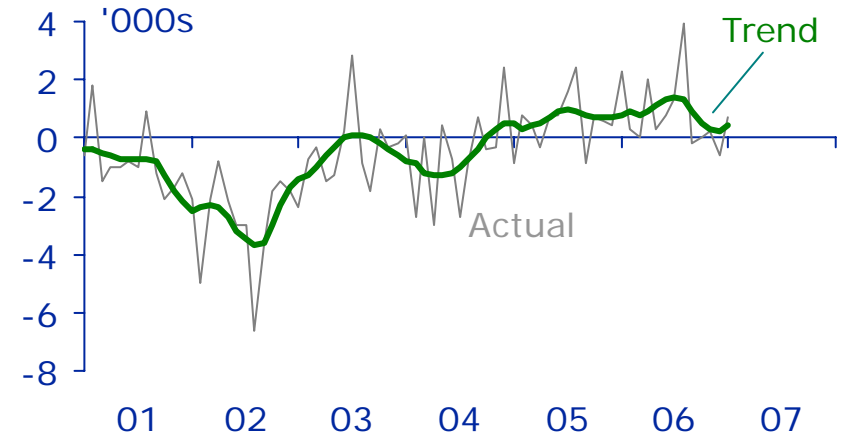
Unemployment rate



"Job offers" ratio



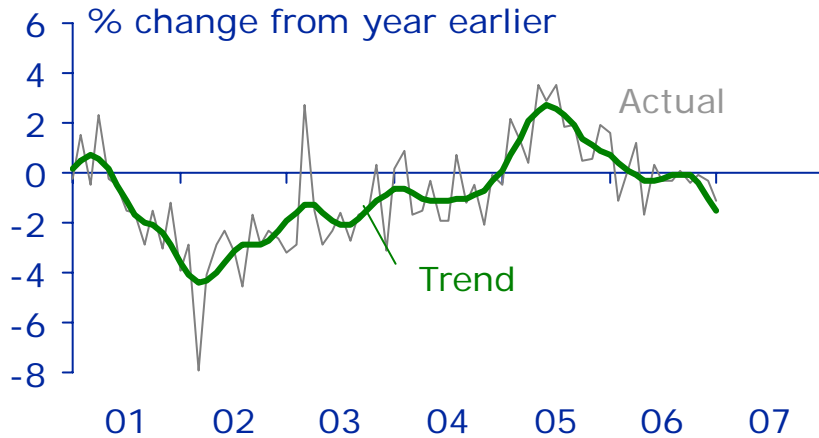
Employee cash earnings



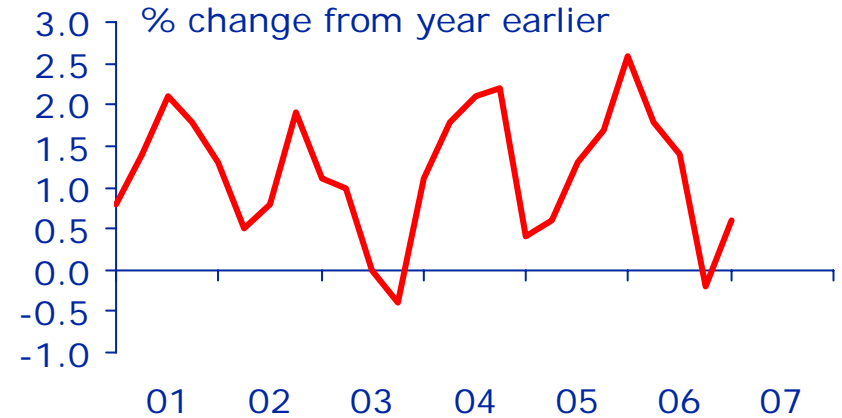
Sources: Ministry of Health, Labour and Welfare.

Not surprisingly, therefore, consumer spending has remained fairly soft

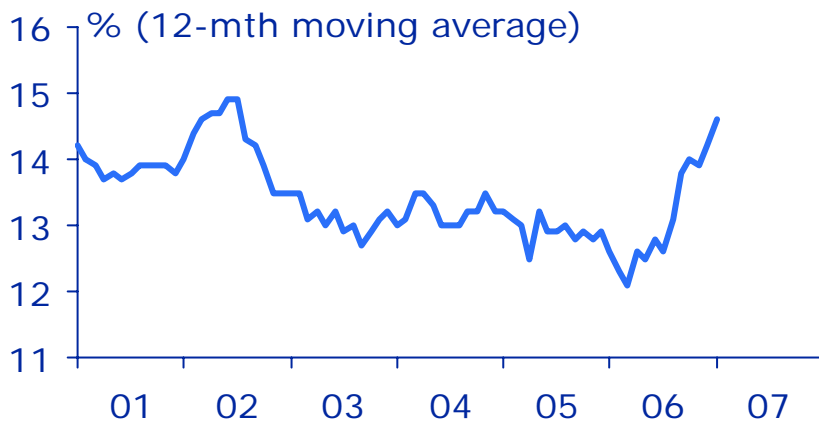
Retail sales volume



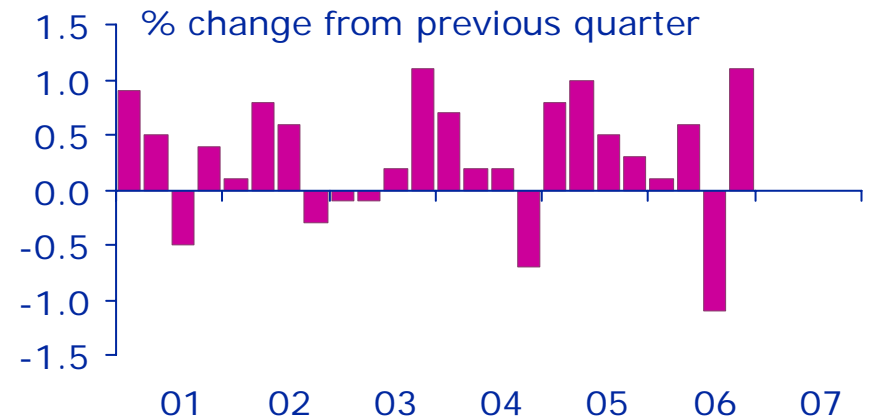
Real consumer spending



Household saving rate



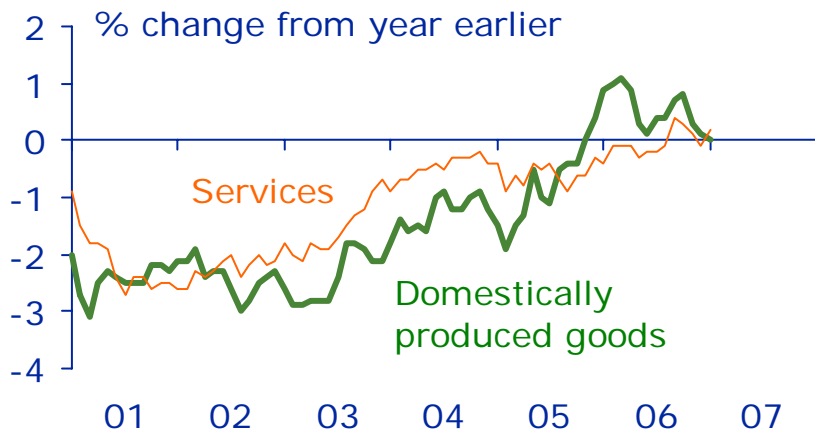
Real consumer spending



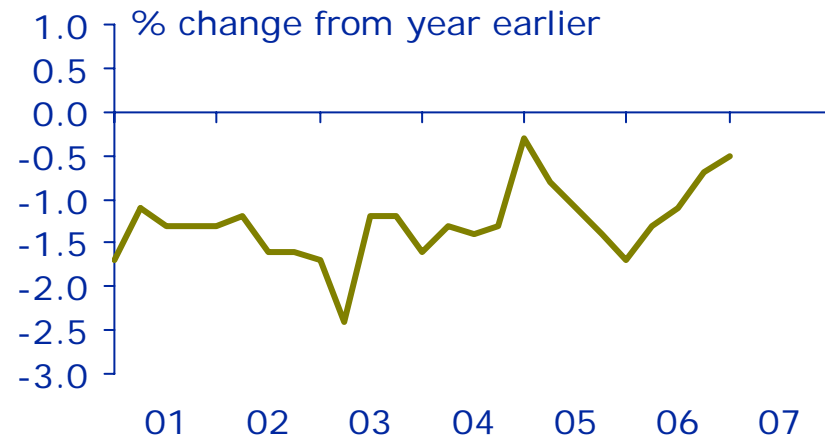
Note: saving rate is for "workers' households".
Sources: ESRI; OECD.

Deflation is 'officially' over but deflationary pressures haven't been totally eliminated

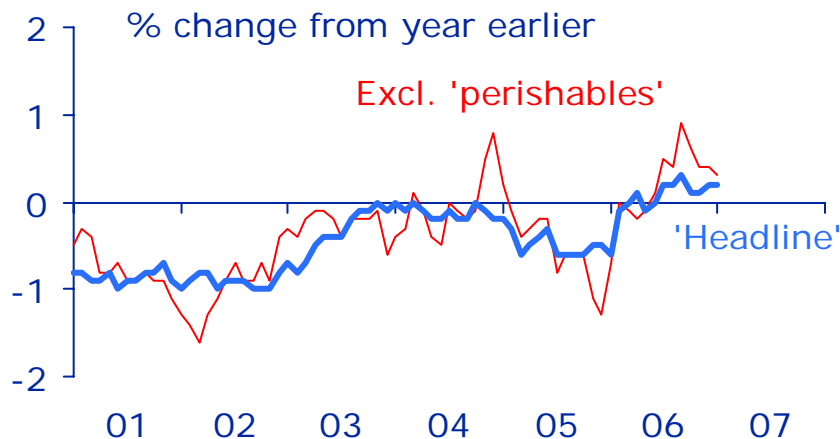
'Corporate' (wholesale) prices



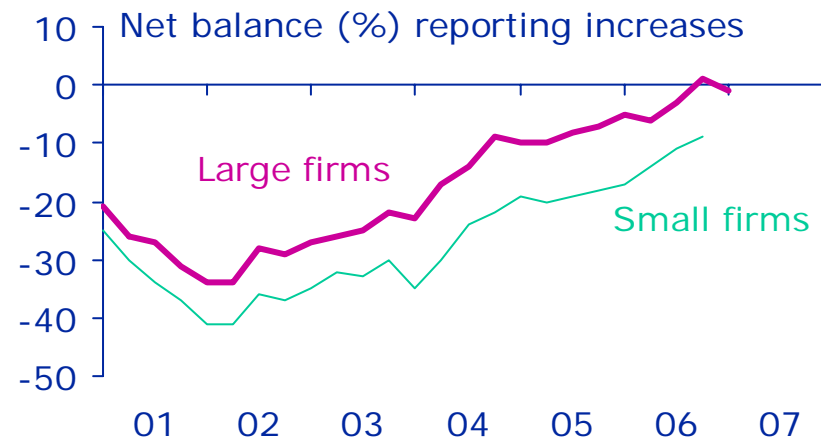
GDP price deflator



Consumer prices



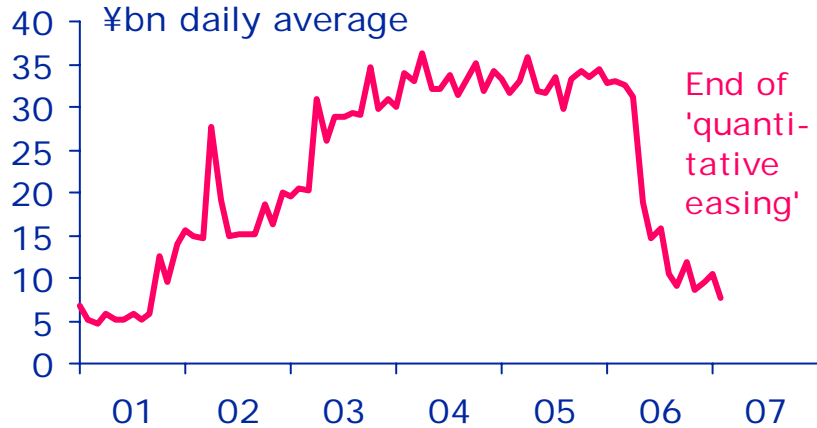
Tankan output prices judgement



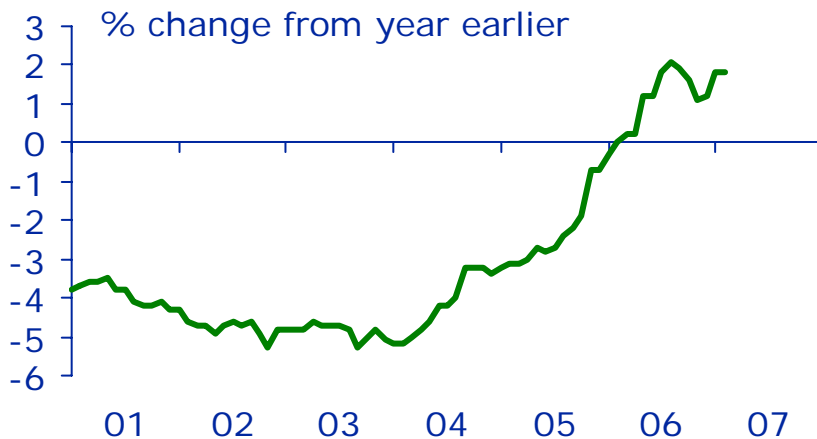
Sources: Bank of Japan; Prime Minister's Office; ESRI.

BoJ will continue to 'normalize' rates – but only very slowly

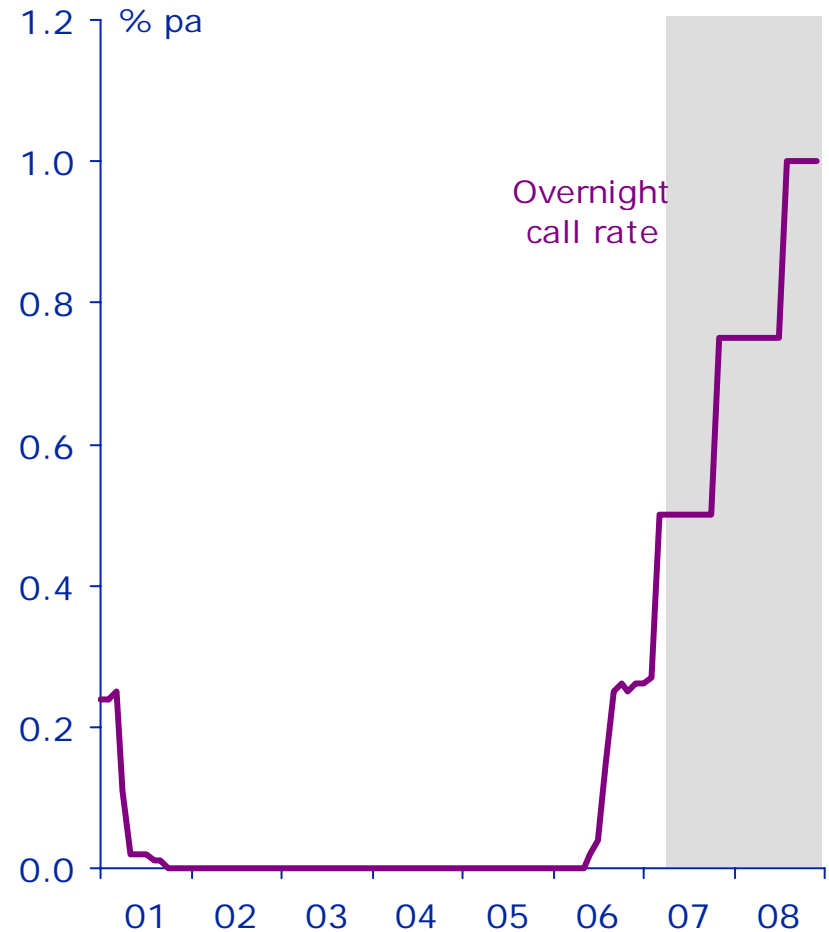
Current accounts at the BoJ



Bank lending



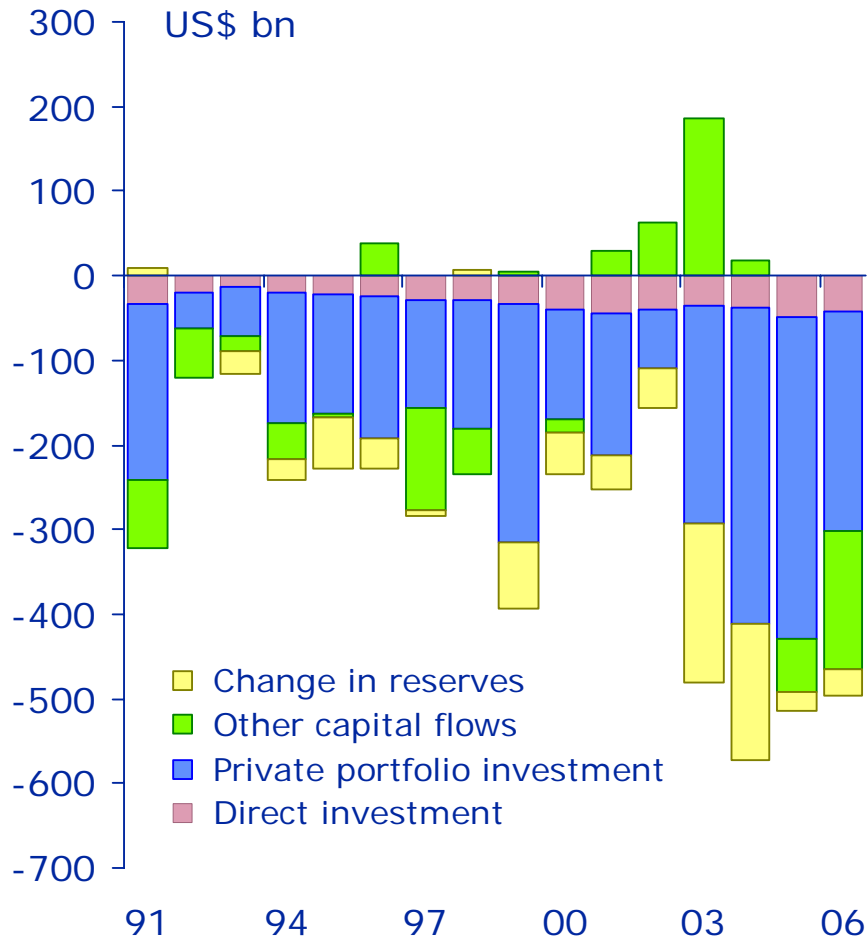
Japanese interest rates



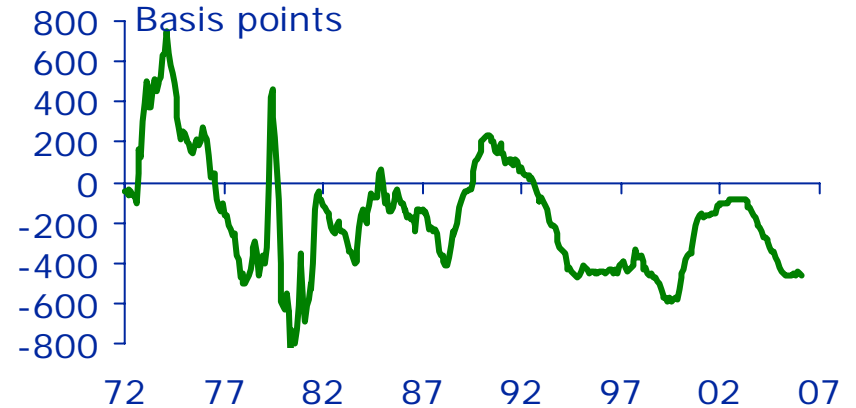
Sources: Bank of Japan; Economics@ANZ.

Persistently low interest rates are encouraging massive capital flows out of Japan

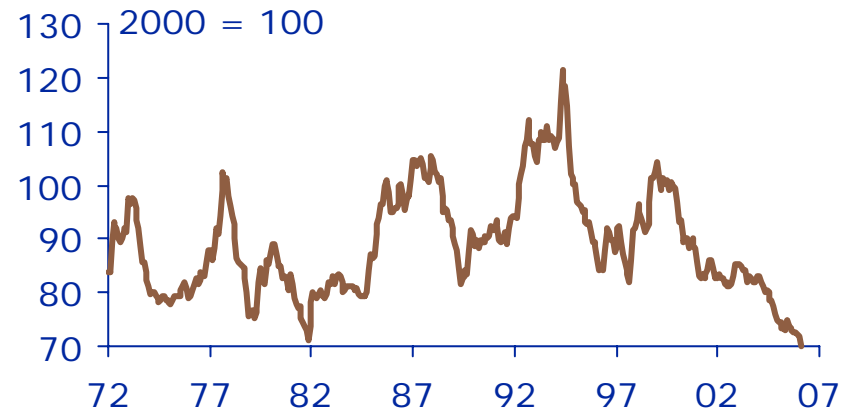
Capital flows from Japan



Japan-US 3-mth Libor spread



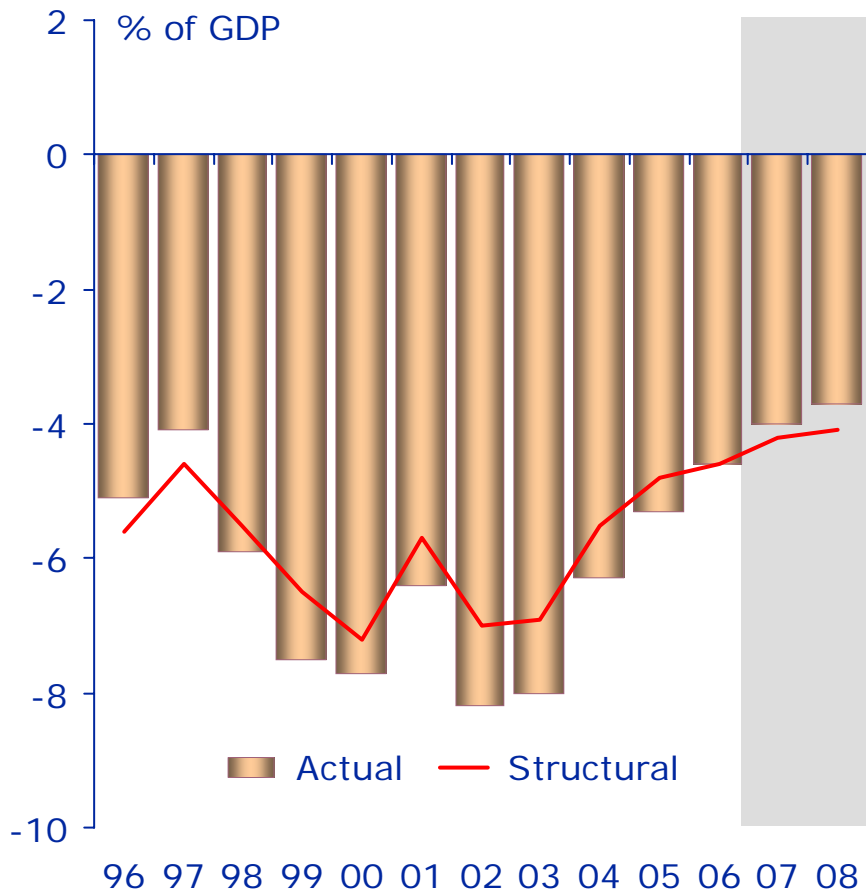
Real trade-weighted yen



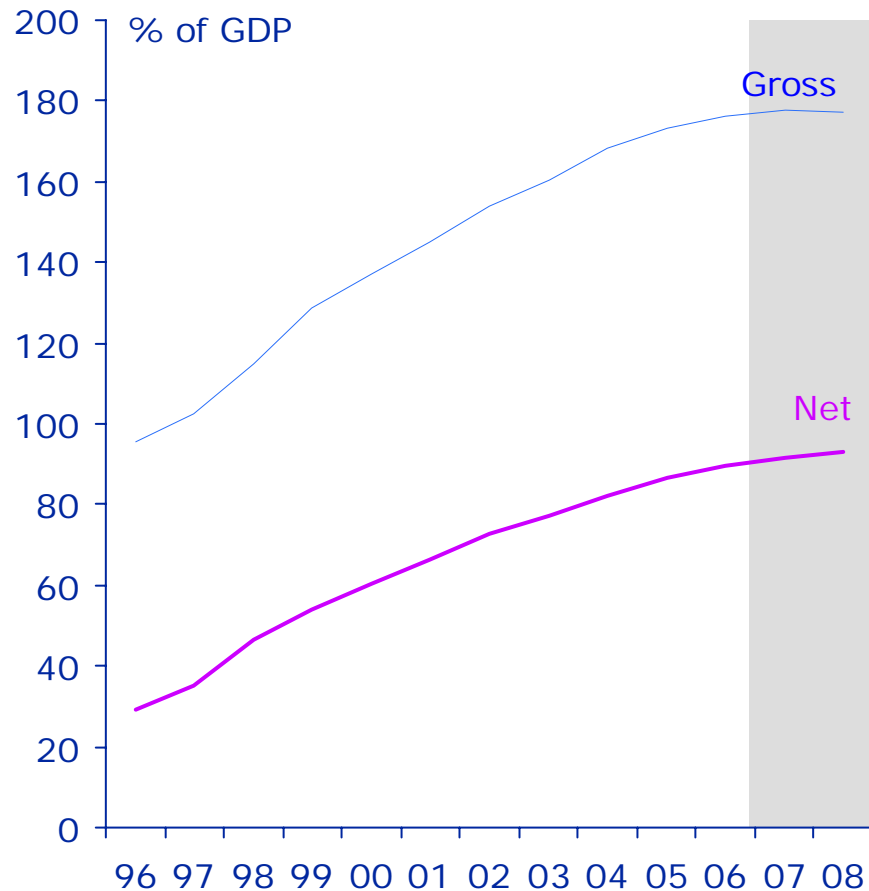
Sources: Bank of Japan; JP Morgan.

Japan faces a considerable task in cleaning up its public finances

Government financial balance



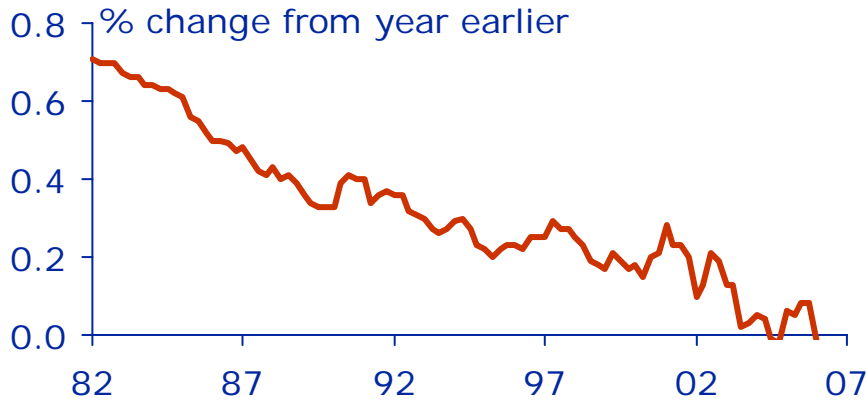
Government debt



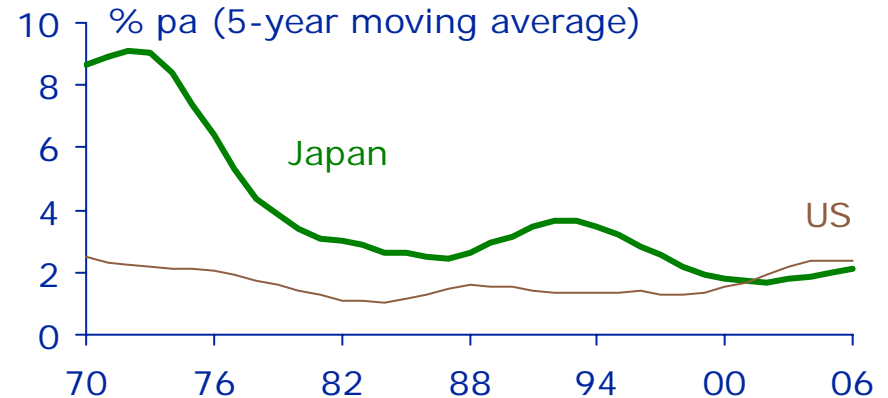
Source: IMF, *World Economic Outlook*, December 2007.

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

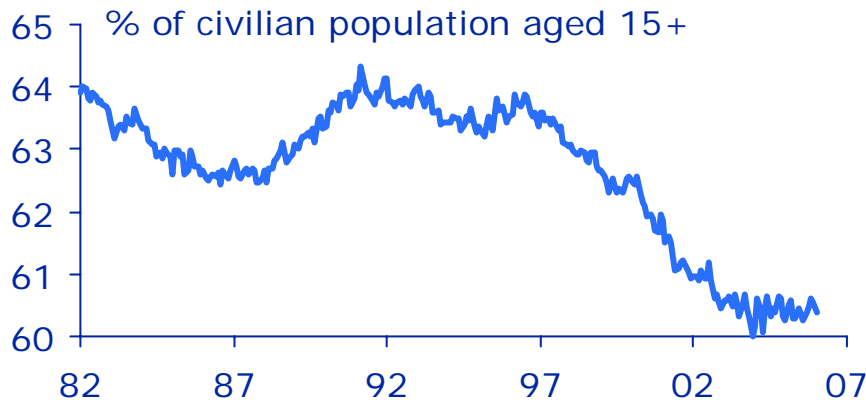
Population growth



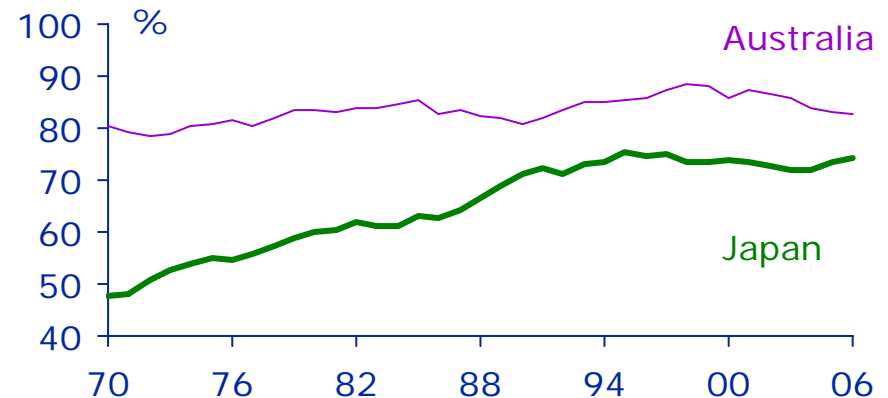
Labour productivity growth



Labour force participation



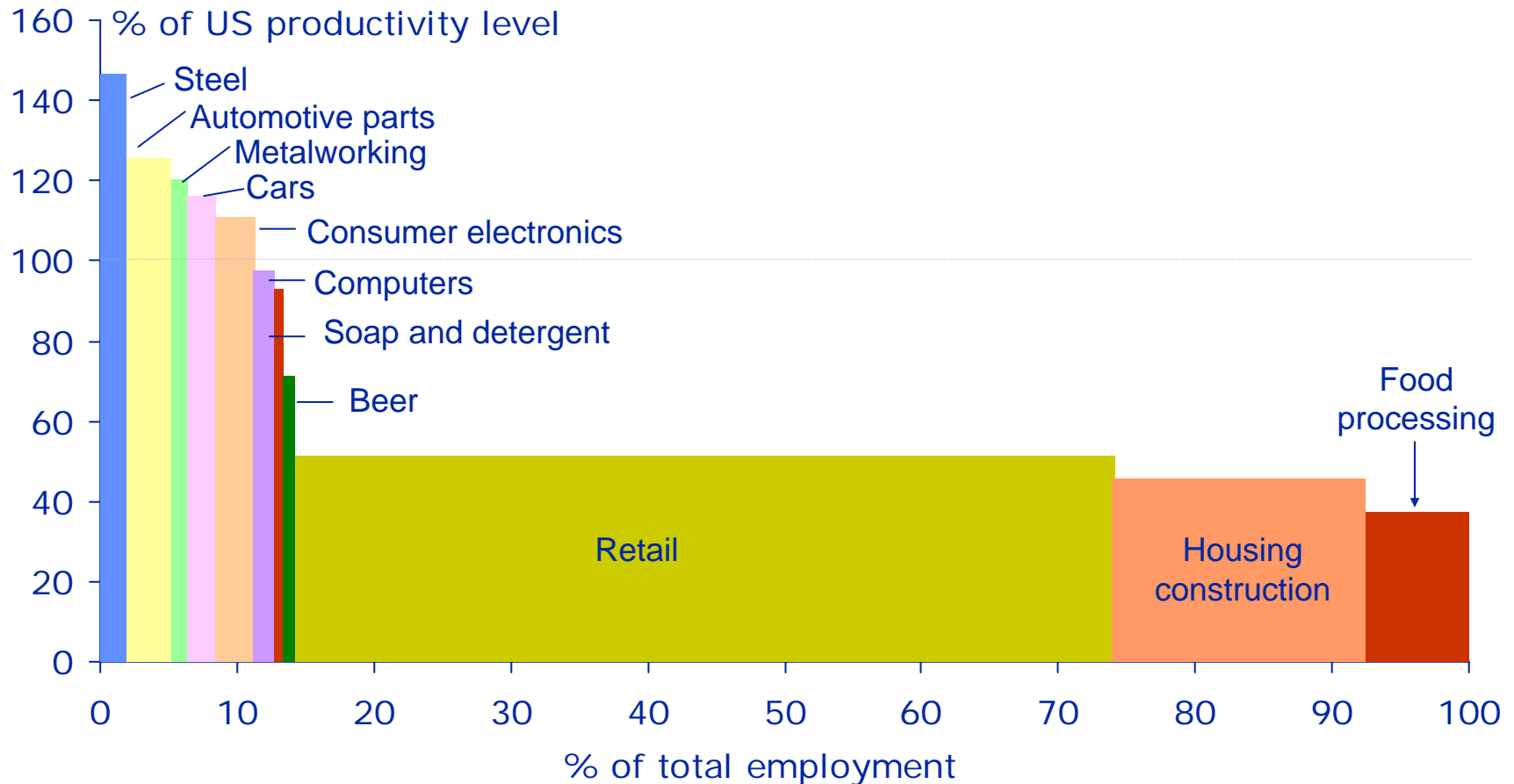
Productivity as a pc of US level



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



Source: William W Lewis, *The Power of Productivity*, University of Chicago Press (2004), p. 25 (based on studies by McKinsey Global Institute).

Summary of the economic outlook for Japan

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

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