Japan's Economic Outlook for FY2015

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During the December–January period in Japan, it is customary for various financial institutions to release their respective economic forecasts for the coming fiscal year. Likewise, in this article, I would like to discuss Japan's economic outlook for fiscal year 2015 (April 2015–March 2016).

I would like to begin by introducing a general overview of the economic forecasting process. The Japanese economy got back on the recovery track on the strength of Abenomics, which was launched in November 2012, but it began stalling in and around the beginning of 2014. The key steps in my forecasting process usually include the following:


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To begin with, I refer to the ESP Forecast Survey (a poll of leading economists conducted regularly by the Japan Center for Economic Research) as the basis of my forecasts. In this particular survey, forty economists are usually polled and their average forecast (or "Consensus Forecast") is announced. This provides a useful set of data that I can use as the basis for my forecasting work. According to the latest survey (as of January 2015), the consensus forecast for the real GDP growth rate in fiscal year 2015 was 1.8%, representing a substantial recovery from the negative 0.6% estimated for fiscal year 2014.

Next, I make an estimate regarding Japan's fiscal year 2015 about whether there will be an "upturn" or a "downturn" for its economy. Although this is the hardest part of the forecasting process, I have come to the conclusion that 2015 will be "a year of economic upturn" for Japan for the following reasons:

First, the negative economic growth experienced in fiscal year 2014 was largely due to temporary factors associated with the sales tax hike. One of them was a reactionary plunge following a spike in demand ahead of the sales tax increase. The other factor was a decrease (around 2%) in real household income caused by the sales tax hike. These negative impacts on the growth rate are believed to be fading away over time in 2015.

Second, nominal wages are beginning to pick up, and this upward trend should remain unchanged in 2015. Per capita average wage in fiscal year 2013 increased only 0.1% on a year-on-year basis but the corresponding rate of increase for the July–September period of 2014 rose to 1.5%. It is generally believed that wages are determined largely by three key factors; namely, supply and demand on the labor market, corporate income, and price behavior. Currently in Japan, labor shortages are becoming more serious and corporate income has started turning around on the strength of a weaker yen amid rising consumer prices, all of which are leading to higher wages. Rising wages should help each household earn higher income and support the overall economy eventually.

Third, government policies should provide underlying support to the economy. The Japanese government finalized an emergency economic stimulus package worth 3.5 trillion yen in December 2014 with the hope of boosting the nation’s real GDP by as much as 0.7%, a large part of which should be achieved in the course of fiscal year 2015. Quantitative easing, which is expected to continue, should also serve to support the Japanese economy.

Thus, I have determined 2015 to be a year of “upturn,” and the last step left is to adopt the relatively bullish views embraced by the polled economists. According to the ESP Forecast Survey, the average forecast among the eight financial institutions with a bullish outlook for the economic growth rate in fiscal year 2015 was 2.3%. Based on the above forecasting process, I would like to draw a conclusion that the economic setback experienced in 2014 should end up being a temporary phenomenon before long with a somewhat high growth rate expected in 2015.

In the long run, though, challenges facing the Japanese economy will remain very serious due to the so-called Abenomics effects beginning to fade away while the challenges that Abenomics have so far failed to address are likely to loom before us as clearer problems.

We will soon begin to see the Abenomics effects start fading away gradually. The 2% inflation target jointly set by the government and the Bank of Japan (BOJ) immediately after the Abe Administration was inaugurated along with the quantitative and qualitative monetary easing approach implemented by BOJ Governor Kuroda Haruhiko have changed the market sentiment significantly and brought about the yen’s depreciation and higher stock prices. The weaker yen worked favorably for export-oriented manufacturing companies to improve their profitability and led to higher consumer prices. That was the result of the “first arrow” in Abenomics.

However, the BOJ unexpectedly announced a plan to increase stimulus through expansion of its quantitative easing program at the end of October 2014. Instead, as far as monetary policy is concerned, it appears to have become more important now to discuss specifics regarding how to bring the unusually aggressive monetary easing back to normal (in other words, the “exit strategy"). It seems quite possible that the additional easing announced at the end of October has moved the "exit" even farther ahead and subsequently made future problems even more serious.

As far as the second arrow (i.e. fiscal stimulus) is concerned, it is true that public investment grew as much as 10.3% in real terms in fiscal year 2013 and this helped to boost economic growth. But in fiscal year 2014, public sector investment is believed to have started declining and it is unlikely to contribute to the country's economic growth in and beyond fiscal year 2015.

The third arrow of Abenomics — a growth-generating structural reform strategy — has yet to be deployed in earnest, leaving us with the only chance to hope for success in the future. But I am concerned that it appears to have become rather difficult to have a positive outlook for Japanese companies and industries. The effect of the yen's depreciation is a significant case in point. The weaker yen was intended to expand the volume of exports, boost the economy, increase import prices, and eventually help the country escape deflation. Out of these targets, higher import prices have been achieved but the volume of exports showed no sign of increasing. The reason behind this phenomenon is that Japanese exporters have been maintaining their export (invoicing) prices in overseas markets (denominated in local currencies) regardless of the yen's depreciation, which would otherwise prompt them to reduce local sales prices in their export destinations. Meanwhile, Japanese exporters have passed a large part of the benefit of the weakening yen onto export prices in terms of the Japanese yen.

Simply put, the yen's depreciation did not bring about export-driven growth in the economy. In other words, this means that many Japanese companies have already shifted a large part of their production to overseas locations and they no longer intend to expand exports from Japan as a global production base.

For that reason, Japanese companies no longer intend to increase export volumes by lowering sales prices denominated in local currencies in importing countries in response to a weaker yen. Maintaining export prices would mean higher profitability on the part of the Japanese companies, but they have no intention of expanding domestic production capacities, which will not boost capital spending. Any increase in demand for labor is often met by hiring temporary workers with wage increases, if any, being paid as bonuses. Therefore, the vast majority of workers do not feel that they are benefitting from the recent recovery in the general economy.

In order to overcome this situation, it is necessary for Japan to change its traditional export-driven growth model, promote deregulation and expand market potential for medical, nursing care and environment-related services, along with turning its industrial structure into one that is driven by domestic demand. It may take a lot of time to achieve that, though.

Public finance and social security reform is not on the priority agenda under Abenomics but they will have to be addressed, going forward. In particular, it is a very big problem that the postponement of the sales tax hike to April 2017 (from 8% to 10% originally planned for October 2015) has heightened uncertainty over the nation's ability to achieve fiscal consolidation.

From the outset, it appeared difficult for the government to achieve its goal to bring the primary balance into the black by 2020 even under the premise that it would achieve GDP growth as planned (3% growth in nominal terms; 2% in real terms) and the sales tax would be raised to 10% in the fall of 2015. It appears that the government's goal has become even more distant now because the planned sales tax hike has been postponed amid the worsening economy.

Even if the immediate economic climate turns positive, it appears that it will be very tough for Japan to solve its economic challenges over the medium and long term. As far as the economic outlook for 2015 is concerned, I am a short-term optimist but a long-term pessimist.

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