EABER — East Asian Bureau of Economic Research
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Newsletter

Welcome to the East Asian Bureau of Economic Research (EABER) and South Asia Bureau Research (SABER) Newsletter.

EABER and SABER strive to be the premier economics research forums and to provide a single point of reference for the economics, finance and governance research community throughout the region and beyond. Through building research capacity and partnering initiatives, EABER and SABER facilitate high-level analysis and forward thinking on issues of importance to the East and South Asian economies.

Analysis

Goldilocks and the three bears in Japan

Masahiko Takeda

The Japanese economy is in very good shape. Japan is experiencing its second-longest period of continuous economic upswing since the end of World War II and many expect this to continue to become the longest in the country's post-war history.

Real GDP growth has been positive for seven quarters in a row — the longest positive streak in 16 years. The labour market is also very tight — the unemployment rate sits at a 22-year low of 2.8 per cent and the effective job openings-to-application ratio is at a 43-year high of 1.55. Corporate profits are the highest in history and the Nikkei index has risen to a 26-year high.

But these strong indicators do not mean the economy is overheated. CPI inflation is barely positive — too low for the Bank of Japan (BoJ) target of 2 per cent per annum. As the BoJ's qualitative and quantitative easing (QQE) continues, and as a result interest rates (measured in terms of government bond yields) are zero or negative up to ten-year maturity. QQE is not expected to end anytime soon because a sizeable pickup in inflation is nowhere in sight.

As Goldilocks would say, everything seems 'just right'.

But for Japan just as for Goldilocks, the three bears are on their way back home.

The effect of one of them — population ageing and the dwindling working age population — is already seen in the tight labour market. Its more serious manifestation is low potential growth for many decades to come. Despite its record-breaking performance, the Japanese economy is expanding only by around 1 per cent per annum. This is not bad at all when compared against the estimated potential growth rate of less than 1 per cent, but the prospect of very weak growth for a long period of time has discouraged Japanese firms from investing domestically. Despite their high profits, they are either investing abroad or sitting on idle cash.

Another bear that has long been said to be on its way is a fiscal crisis. But in Japan's Goldilocks story, there is a good reason for why this bear has not arrived: the BoJ's massive purchase of government debt under QQE.

One cannot blame the government for not taking more decisive action to cut budget deficits. If the government can borrow at negative interest rates, it is almost irrational for it to be serious about fiscal consolidation. Hence, the BoJ's failure to achieve its inflation target and the resulting continuation of QQE has been a blessing in disguise for the government as it has helped to avoid unpopular belt-tightening measures. The government's next test on this will be in October 2019, when the twice-postponed consumption tax hike from 8 to 10 per cent is planned to be implemented. Will the government have the resolve to make it happen this time?

Paper of the Month

The most viewed paper for the month of November 2017 was 'Understanding China's Politics, Economic Policy Makers, and Policy Making under Xi Jinping' by Dong Dong Zhang.

Upcoming Events

On 8 January in Quezon City, PIDS will host a seminar by Dr Anna Abatayo-Soh of Bocconi University, 'The Provision of Transnational and Intergenerational Public Goods'.

On 25 January in Tokyo, ADBI will host a seminar by Nao Sudo of the Bank of Japan, 'Myths and Observations on Unconventional Monetary Policy: Takeaways from Post-Bubble Japan'.

From 31 January to 2 February, the 39th Pacific Trade and Development (PAFTAD) Conference will be held in Tokyo. The conference, co-hosted by JCER and ERIA, will focus on the theme 'Growth, globalization, and intergenerational issues in the Asia Pacific'.

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To be fair, Prime Minister Abe and his government have been taking many initiatives to strengthen the supply side of the economy. The government regularly talks about its 'womenomics', 'work-style reform', 'human resource development revolution' and 'productivity revolution' plans. These last two initiatives, which are the most recent, are no longer a 'reform' but a 'revolution': at the very least, the rhetorical intensity of reform has increased.

These initiatives are much better than classic demand stimulus measures (for which the government has no room left). But there is concern about whether the numbers really add up to anything meaningful when put against the enormous demographic headwind. If they do not and as a result the economy has to endure decades of very low or even negative growth, will Japan gradually decline and disappear?

Not necessarily — a smaller economy due to population decline does not mean a poorer economy. It is entirely possible that Japanese citizens will become individually more prosperous as their economy shrinks. The tight labour market today (which is benefitting job seekers) is testament to this. But when a shrinking economy is combined with a huge public debt overhang, one struggles to be optimistic. The aggregate size of the economy represents the country's tax base and hence is linked to debt sustainability. If the economy shrinks over time, the ability to repay outstanding debt becomes increasingly questionable.

There is a solution to this problem. But it is another bear whose arrival Japan has been fearing: to substantially open up the country to immigration. New citizens from abroad would contribute to the labour force, to GDP and to tax revenue. What is needed is not a stop-gap import of guest workers whose contributions are temporary, but immigrants who stay and become part of Japan.

The Abe administration has carefully avoided this sensitive issue and no reform or revolution has been proposed in this area of supply-side policy. But it is time for Japan to wake up and welcome this bear home.

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