Key Economic Challenges in Japan and Asia
Global and Asia Outlook
Global activity strengthening, with rising dispersion and uncertainty

- Global growth: uneven pick up:
  - Advanced Economies (AE): improving performance primarily from the US with growth in other countries sustained at sluggish rates.
  - Emerging Market and Developing Economies (EMDE): near-term growth prospects revised up, primarily from China, but substantial weakening in a few large economies.

- Dispersion of outcomes is large, given uncertainty surrounding the policy stance of the incoming U.S administration and its global ramifications.

- Policy priorities: differ across individual economies, but action relying on all levers is needed to reduce uncertainty and head off further growth disappointments.
## Growth projections: Advanced economies

*(percent change from a year earlier)*

<table>
<thead>
<tr>
<th></th>
<th>World</th>
<th>Advanced Economies</th>
<th>U.S.</th>
<th>U.K.</th>
<th>Japan</th>
<th>Euro Area</th>
<th>Germany</th>
<th>Canada</th>
<th>Other Advanced Asia</th>
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</thead>
<tbody>
<tr>
<td><strong>2016</strong></td>
<td>3.1</td>
<td>1.6</td>
<td>1.6</td>
<td>2.0</td>
<td>0.9</td>
<td>1.7</td>
<td>1.7</td>
<td>1.3</td>
<td>2.0</td>
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<tr>
<td><strong>2017</strong></td>
<td>3.4</td>
<td>1.9</td>
<td>2.3</td>
<td>1.5</td>
<td>0.8</td>
<td>1.6</td>
<td>1.5</td>
<td>1.9</td>
<td>2.3</td>
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<td>0.1</td>
<td>0.4</td>
<td>0.2</td>
<td>0.1</td>
<td>0.1</td>
<td>0.0</td>
<td>-0.2</td>
</tr>
<tr>
<td><strong>2018</strong></td>
<td>3.6</td>
<td>2.0</td>
<td>2.5</td>
<td>1.4</td>
<td>0.5</td>
<td>1.6</td>
<td>1.5</td>
<td>2.0</td>
<td>2.6</td>
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<td>0.0</td>
<td>0.1</td>
<td>0.1</td>
<td>-0.1</td>
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</table>

## Growth projections: Emerging markets and LIDCs

*(percent change from a year earlier)*

<table>
<thead>
<tr>
<th>Year</th>
<th>World</th>
<th>Emerging Market and Developing Economies</th>
<th>China</th>
<th>India</th>
<th>Brazil</th>
<th>Russia</th>
<th>Commodity Exporting Economies</th>
<th>Low Income Developing Countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016</td>
<td>3.1</td>
<td>4.1</td>
<td>6.7</td>
<td>6.6</td>
<td>-3.5</td>
<td>-0.6</td>
<td>1.0</td>
<td>3.7</td>
</tr>
<tr>
<td>2017</td>
<td>3.4</td>
<td>4.5</td>
<td>6.5</td>
<td>7.2</td>
<td>0.2</td>
<td>1.1</td>
<td>2.4</td>
<td>4.7</td>
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</table>

Revision from Oct. 2016
- 0.0
- 0.1
0.3
-0.4
-0.3
0.0
0.0
-0.1
-0.2

| 2018 | 3.6   | 4.8                                      | 6.0   | 7.7   | 1.5    | 1.2    | 2.9                           | 5.4                           |

Revision from Oct. 2016
- 0.0
0.0
0.0
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0.0
0.0
-0.1
0.2

Underlying baseline assumptions

- Changing policy mix in the US including near-term fiscal stimulus and a less gradual normalization of monetary policy.
- Firming of oil and some other commodity prices.
- Gradual return to growth in stressed economies.
- Policy stimulus in China and gradual unwinding of credit boom and rebalancing.
Asia remains the world’s most dynamic region, continuing to deliver two-thirds of global growth

Contribution to Global Growth, 2008-16
(In percentage points)

Sources: IMF, World Economic Outlook; and IMF staff calculations.
New Considerations since Oct 2016

- Will the US new administration make good on the reflation expectations? What about protectionist policies?

- Will there be a hand-over from monetary to fiscal policy globally?

- Will Brexit be hard or soft? More surprises in the European electoral cycle? Will the legacy issues of European banks finally get resolved?

- Will a stronger dollar and higher yields destabilize EMs?

- Will Chinese growth and the financial sector continue to be stable?

- Will the promised OPEC output cuts occur?
New possible directions for policies in the US

- **Tax policy** (corporate income tax cut and “border adjustment” tax)
- Support for infrastructure investment
- Trade policies
- Deregulation of the financial sector
- Immigration policy
- Environmental regulations
- Health care reform
Japan Outlook
Japan: slow and bumpy

Contributions to QoQ Real Growth (SA)
(In percent)

- Private gross fixed investment
- Government spending
- Net exports
- Private consumption
- Private inventories (change)
- Real growth (qoq)

Source: Haver Analytics.

Inflation Indicators
(YoY; in percent)

- Headline w/o VAT
- Core (ex. fresh food) w/o VAT
- BoJ Core core w/o VAT

Sources: Haver Analytics; IMF staff estimates.
Incomes and labor market policies could be used to raise wages and reduce labor market duality

Nonregular Workers and Wage Growth
(YoY; in percent)

<table>
<thead>
<tr>
<th>Year</th>
<th>Change in full-time wages</th>
<th>Composition effect</th>
<th>Changes in part-time wages</th>
<th>Share of nonregular workers (right side)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002Q2</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2006Q2</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2010Q2</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>2014Q2</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2016Q3</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Sources: Haver Analytics; and IMF staff estimates.
1/ Yearly Average.

Labor Market

Unemployment Rate (%)
Job opening to application ratio (RHS)
Labor Force Growth Rate (YoY, RHS) 1/

Source: Haver Analytics.
1/ 3-month moving average.
Financial conditions have improved under QQE...

Corporate-Government Bonds Spreads (5Y)
(In percent)

Japan: Real Interest Rate
(In percent)

1/ Based on average long-term bank-loan rate. 
Sources: CEIC; and Haver Analytics.
A favorable investment environment...

**Oil Prices, Equity Prices and the NEER**

![Graph of Oil Prices, Equity Prices and the NEER](image)

**Current Profits**

*(In Trillions Yen)*

![Graph of Current Profits](image)

*Source: Haver Analytics; and IMF staff calculations.*

*Source: Haver Analytics.*
...with high corporate cash

**Listed Companies' Cash and Cash Equivalents Holdings**
(Percent of market capitalization; average 2004-2014)

Source: Bloomberg, L.P.
Inflation expectation has been trending down

**Inflation Expectations**
(Year-on-year, in percentage points)

**Tankan Survey: Inflation Outlook**
(YoY; in percent)

Sources: Bloomberg; and IMF staff estimates.

Source: Haver Analytics.
Large demographic headwinds ahead

Working-age Population, 1950-2050
(Index, 1950=100)

(Real GDP level change)

Japan: impact of aging on the level of real GDP (RHS, green x-axis)

More fiscal consolidation in the medium-term is needed to secure fiscal sustainability.

Japan: Public Finances
(Percent of GDP)

Sources: CAO; and IMF staff estimates
Note: Fiscal impulse is changes in the structural primary balance.

Japan: Gross Public Debt$^{1/}$ and Fiscal Balance
(In percent of GDP)

Sources: Cabinet Office; and staff estimates and projections.
$^{1/}$Gross debt of the general government including the social security fund. Withdrawal of fiscal stimulus and consumption tax increases to 10 percent in October 2019 are assumed.
The Medium-term: What Does the “New Mediocre” Mean For Asia and Japan?
Global and Asia’s growth has moderated in recent years…

**World: GDP Growth Outturns vs. WEO Projections** 1/ (Year-over-year percent change)

**Asia: GDP Growth Outturns vs. WEO Projections** 1/ (Year-over-year percent change)

Sources: IMF, WEO database; and IMF staff calculations.

1/ 5-yr forward projections from October WEO in each year.
Asia is diverse but there are three broad groups in relation to the “new mediocre”

• **Group 1 (Japan)**: stagnation has been present for more than two decades, well before other advanced economies were hit.

• **Group 2 (China, Korea, Singapore, and Thailand)**: looming rapid aging and demographics pressures; slowdown in productivity growth.

• **Group 3 (India and other fast growing economies, such as Indonesia, Malaysia, Vietnam)**: not at risk of stagnation domestically but can be affected through spillovers.
Signs of the “new mediocre” in Asia and Japan?

• Long-term interest rates declining?
• Natural (or neutral) interest rates declining?
• Low inflation becoming more common?
• Demographics becoming a headwind?
• Productivity growth declining?
• Trade slowdown in Asia?
Long-term rates have fallen significantly in some cases, but not everywhere.

**Selected Asia: Change in 10-year Government Bond Yields** (Percentage points; Sep 2016 compared to 2000-07 average)

**Selected Asia: Change in Central Bank Policy Rates** (Percentage points; Sep 2016 compared to 2000-07 average)

Sources: Bloomberg; and IMF staff calculations.
Low inflation becoming more common across the region

**Advanced Economies: Number of Countries by Headline Inflation Rates** (Percent of 33 countries)

- Green: Inflation rate below 2%
- Yellow: Inflation rate below 1%
- Red: Inflation rate below 0%

**Asia: Number of Countries by Headline Inflation Rates** (Percent of 22 Asian countries)

- Green: Inflation rate below 2%
- Yellow: Inflation rate below 1%
- Red: Inflation rate below 0%

Sources: IMF, Global Data Source; and IMF staff calculations.
Demographics: A headwind for some, a dividend for others

Asia: Old-Age Dependency Ratios
(Percent)


Asia: Growth Impact of Demographics Trends
(Percentage point impact on real GDP growth; average over 2020-50)

Source: Staff estimates based on UN Population Prospects: 2015 Revision (medium-fertility variant) and IMF (2016).
Note: Migration projections follow historical trends. The growth impact estimates are based on the assumptions of unchanged labor force participation by cohort, constant capital-to-labor ratio, and TFP growth unchanged from historical average.
Asia is catching up in terms of GDP, but not in productivity levels

**Total Factor Productivity Level Compared to the United States**
(At current PPPs; normalized as United States=1)

- Japan
- Korea
- China
- India
- Asia excl. Japan

**Total Factor Productivity Growth**
(Percent; 5-year moving average)

Sources: Penn World Table 9.0; and IMF staff calculations.
Signs of the “new mediocre” in Japan and Asia?

To summarize:

• Long-term interest rates declining? ➔ Some

• Natural (or neutral) interest rates declining? ➔ Some

• Low inflation becoming more common? ➔ Yes

• Demographics becoming a headwind? ➔ Some

• Productivity growth declining? ➔ No catch-up

• Trade slowdown in Asia? ➔ Yes
Why should we be worried about the “new mediocre”?

Lower growth can aggravate:

• Social and demographics pressures
• High leverage
• Trade tensions
Income inequality in Asia has already risen and social spending in Asia is relatively low

### Change in Income Inequality
(Net Gini Index; change from 1990 to 2013; simple average across regions)

Sub-Saharan Africa
Latin America and the Caribbean
Middle East and North Africa
ASEAN-5
OECD
LICs Asia
NIEs
Industrial Asia
Emerging and Developing Europe
India
China

### Composition of Social Spending
(Percent of GDP; year of 2010 or latest)

Sources: SWIID Version 5.0; IMF, WEO database; and IMF staff calculations.

Sources: Organization for Economic Cooperation and Development; Eurostat; Asian Development Bank; IMF, *World Economic Outlook*; United Nations; World Health Organization; World Bank; and IMF staff calculations.
Corporate debt is relatively high in emerging Asia and household debt has risen rapidly in several cases.

**Emerging Market Firms: Debt-Potentially-at-Risk**
(Percent; share of total debt if ICR<2)

- **China**
- **Asia excluding China**
- **Latin America**
- **Europe, Middle East, and Africa**

**Change in Household Debt to GDP Ratio**
(Percentage points; from end-2007 to end-2015)

Sources: April 2016 GFSR.
Note: Asia excluding China= India, Indonesia, Malaysia, the Philippines, and Thailand.
The global trade slowdown and anti-trade sentiment could hit Asia hard

Selected Asia: Contribution of Exports to Real GDP Growth
(Year-over-year; percentage points)

Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: ASEAN-4 includes Indonesia, Malaysia, the Philippines, and Thailand. Industrial Asia includes Australia, Japan, and New Zealand. NIEs include: Hong Kong SAR, Korea, Singapore, and Taiwan Province of China.
Implications for Monetary, Fiscal, and Structural Policies
Monetary Policy in Anticipation of the “New Mediocre”: Some Issues to Consider?

• How to anchor inflation expectations?

• How to prepare for unconventional monetary policies (UMPs)?
  • QE: Implementation challenges (enough assets to buy in EMs)?
  • Negative rates: Effective in bank-dominated financial systems?

• How to deal with “side effects” of UMPs, in case undertaken?
  • Could UMPs undermine financial stability (asset/credit bubbles)?
  • How effective are macro-prudential policies to deal with side effects?
Fiscal policy for demand support?

**Selected Asia: Need for Demand Support**

- Current Account Balance (percent of GDP; 2016)
- Output Gap (percent of GDP; 2016)

**Selected Asia: Fiscal Space**

- 5-Year CDS Spreads (basis points; 2016M1-M3 average)
- General Government Gross Debt (percent of GDP; 2016)

Sources: IMF WEO database; and IMF staff calculations.

Note: Japan is not shown due to scale.
Structural reforms to boost productivity growth?

- **Advanced Asia**: Infrastructure investment (**Australia**); product market reforms (**Australia**, **Japan**, and **Korea**); labor market reforms (**Japan**, and **Korea**).

- **Emerging Asia**: Raising public investment efficiency (**India**); labor market reforms (**India**, **Indonesia**); product market reforms (**China**, **India**); resolving corporate debt overhang (**China**);

Source: OECD.

Note: The reform responsiveness indicator reflects the share of policy recommendations from the OECD's "Going for Growth" reports on which the country has taken significant action.
Thank you