



Key Economic Challenges in Japan and Asia



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Global and Asia Outlook

Global activity strengthening, with rising dispersion and uncertainty

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- ❖ 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)



World



Advanced Economies



U.S.



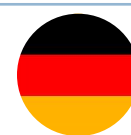
U.K.



Japan



Euro Area



Germany



Canada



Other
Advanced
Asia

2016	3.1	1.6	1.6	2.0	0.9	1.7	1.7	1.3	2.0
2017	3.4	1.9	2.3	1.5	0.8	1.6	1.5	1.9	2.3
Revision from Oct. 2016	0.0	0.1	0.1	0.4	0.2	0.1	0.1	0.0	-0.2
2018	3.6	2.0	2.5	1.4	0.5	1.6	1.5	2.0	2.6
Revision from Oct. 2016	0.0	0.2	0.4	-0.3	0.0	0.0	0.1	0.1	-0.1

Sources: IMF, *World Economic Outlook* January 2017 Update; and IMF, *World Economic Outlook* October 2016.

Growth projections: Emerging markets and LIDCs

(percent change from a year earlier)



World

Emerging Market
and Developing
Economies

China

India

Brazil

Russia

Commodity
Exporting
Economies

Low Income
Developing
Countries

2016

3.1

4.1

6.7

6.6

-3.5

-0.6

1.0

3.7

2017

3.4

4.5

6.5

7.2

0.2

1.1

2.4

4.7

Revision from
Oct. 2016

0.0

-0.1

0.3

-0.4

-0.3

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

0.0

0.0

0.0

-0.1

0.2

Sources: IMF, *World Economic Outlook* January 2017 Update; and IMF, *World Economic Outlook* October 2016.

Underlying baseline assumptions

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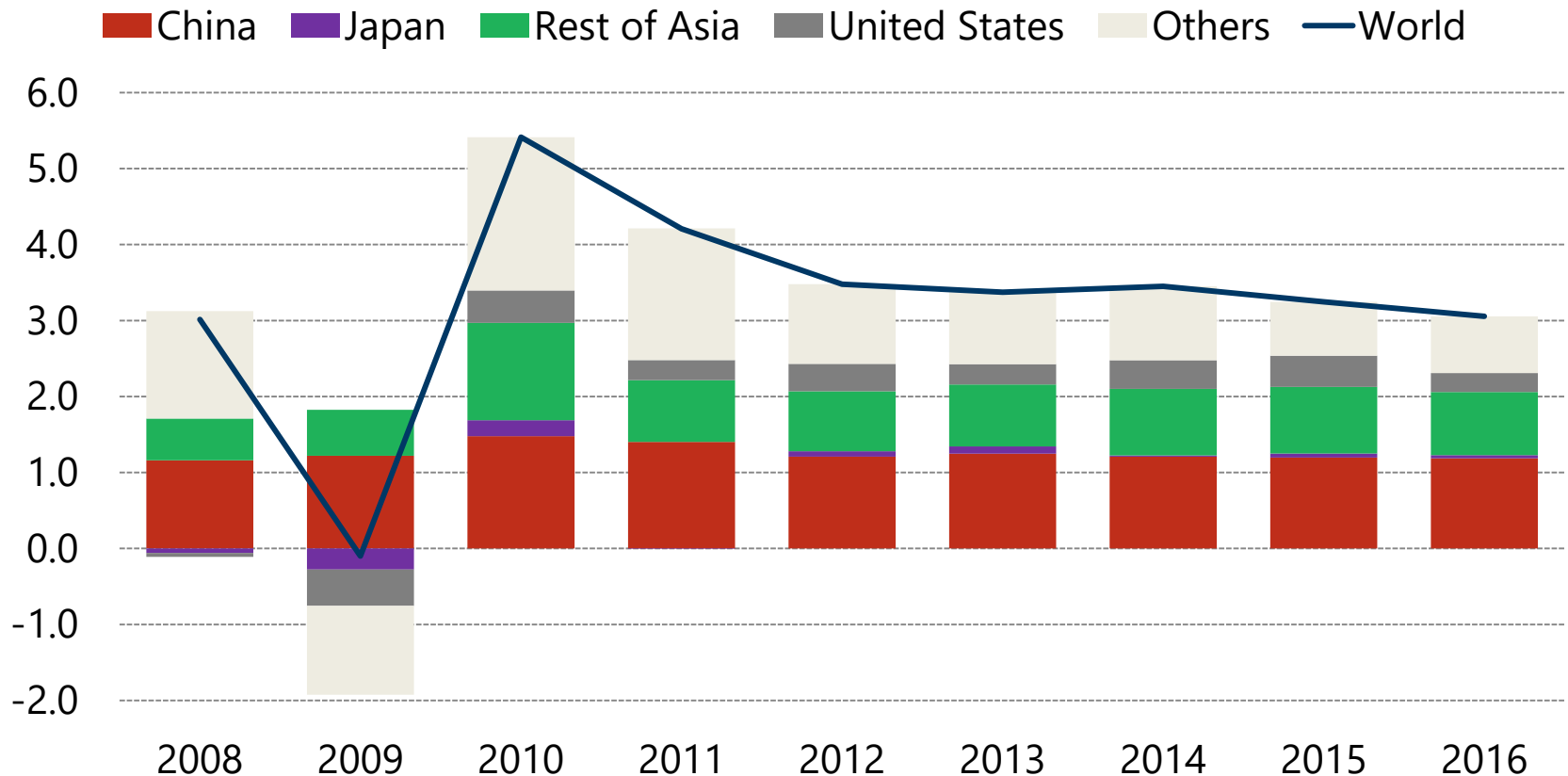
- ❖ Changing policy mix in the US including near-term fiscal stimulus and a less gradual normalization of monetary policy
- ❖ Firming of oil and some other commodity prices.
- ❖ Gradual return to growth in stressed economies.
- ❖ Policy stimulus in China and gradual unwinding of credit boom and rebalancing.

Asia remains the world's most dynamic region, continuing to deliver two-thirds of global growth

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Contribution to Global Growth, 2008-16

(In percentage points)



Sources: IMF, World Economic Outlook; and IMF staff calculations.

New Considerations since Oct 2016

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- ❖ 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

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- ❖ **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**



Asia and Pacific Department

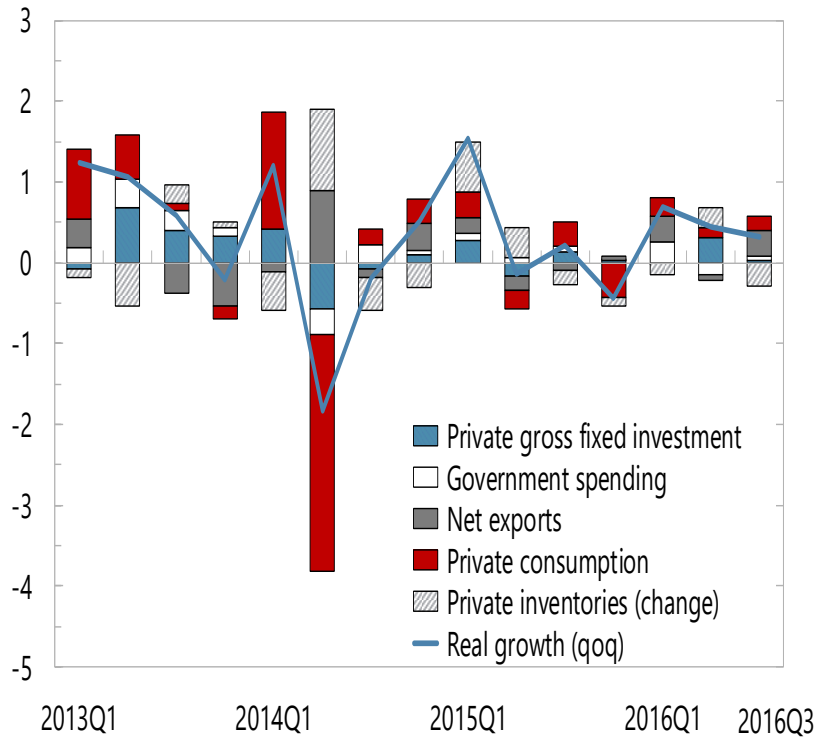
Japan Outlook

Japan: slow and bumpy

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Contributions to QoQ Real Growth (SA)

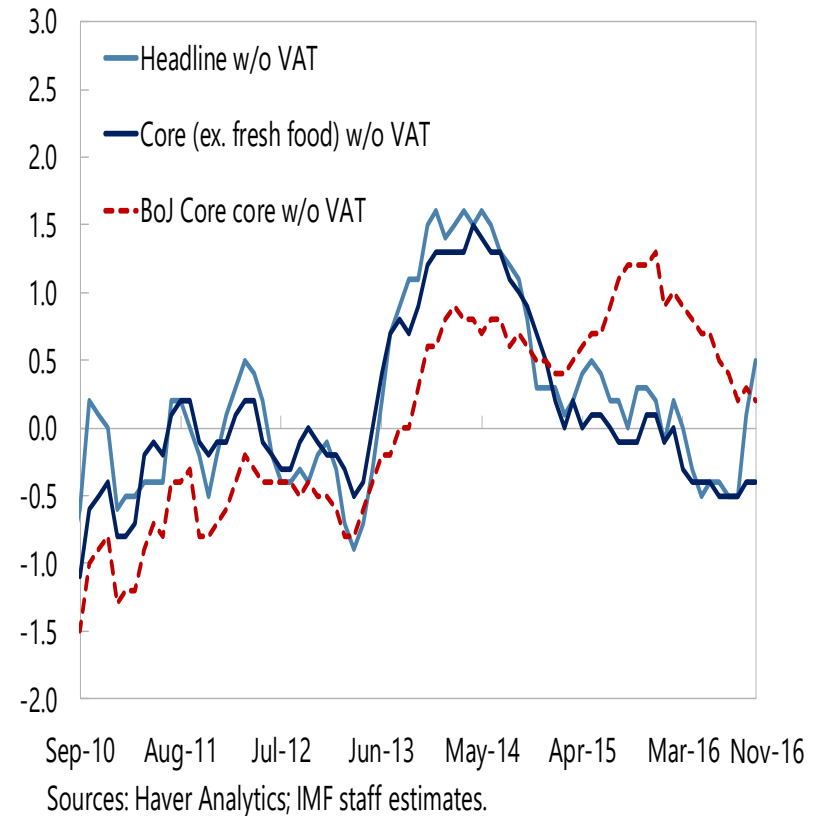
(In percent)



Source: Haver Analytics.

Inflation Indicators

(YoY; in percent)



Sources: Haver Analytics; IMF staff estimates.

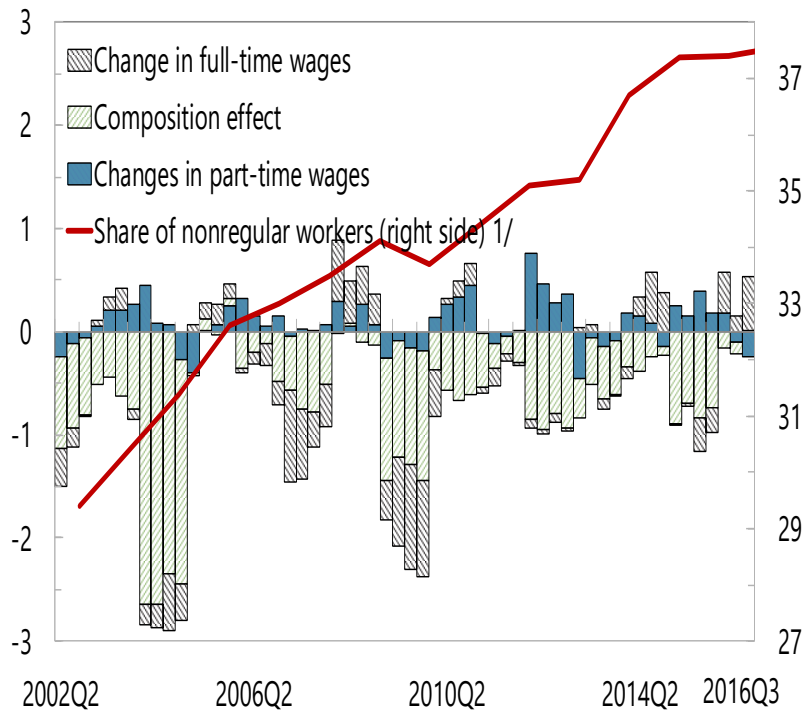
Incomes and labor market policies could be used to raise wages and reduce labor market duality

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Nonregular Workers and Wage Growth

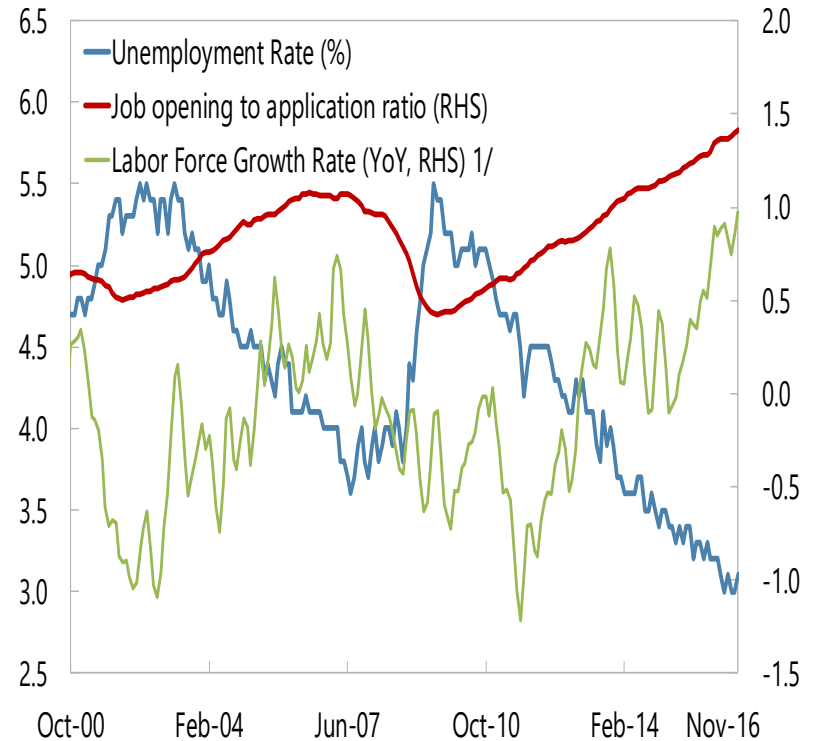
(YoY; in percent)

(In percent of staff)



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

Labor Market



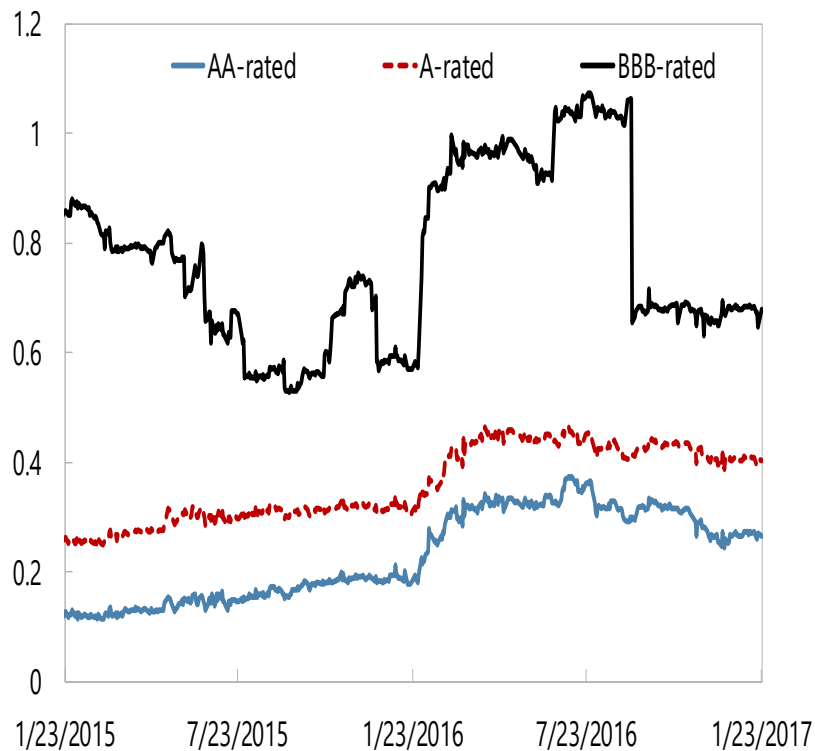
Source: Haver Analytics.
1/ 3-month moving average.

Financial conditions have improved under QQE...

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Corporate-Government Bonds Spreads (5Y)

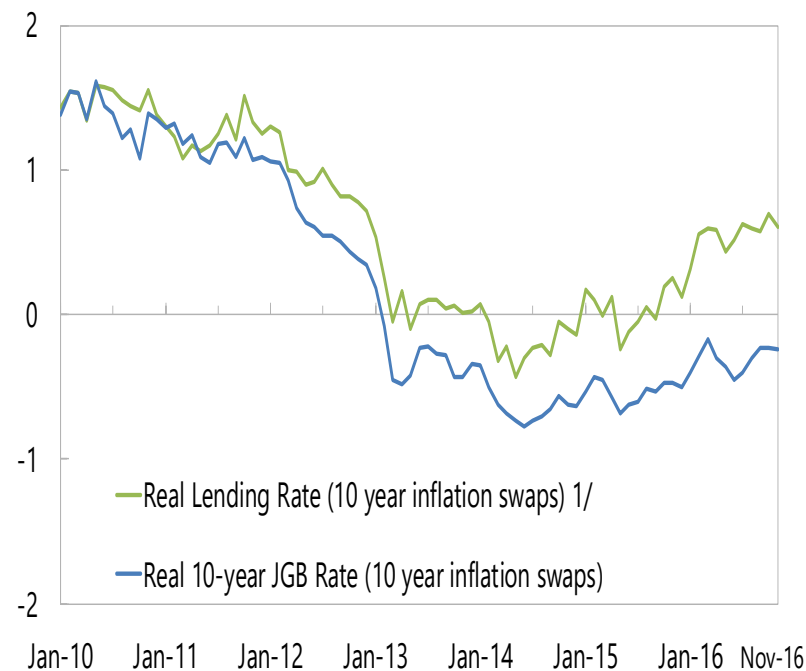
(In percent)



Source: Bloomberg L.P.

Japan: Real Interest Rate

(In percent)

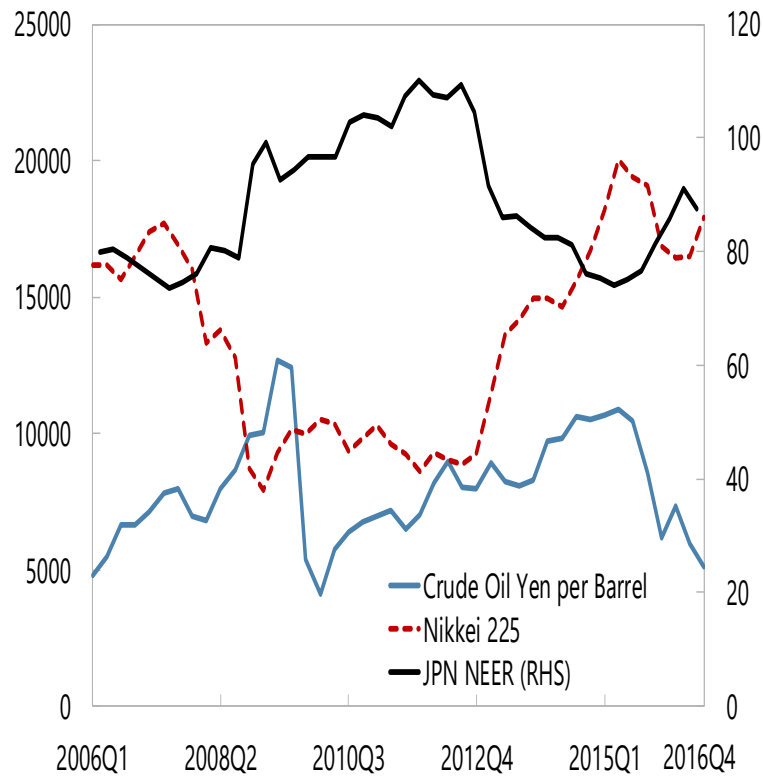


1/ Based on average long-term bank-loan rate.

Sources: CEIC; and Haver Analytics.

A favorable investment environment...

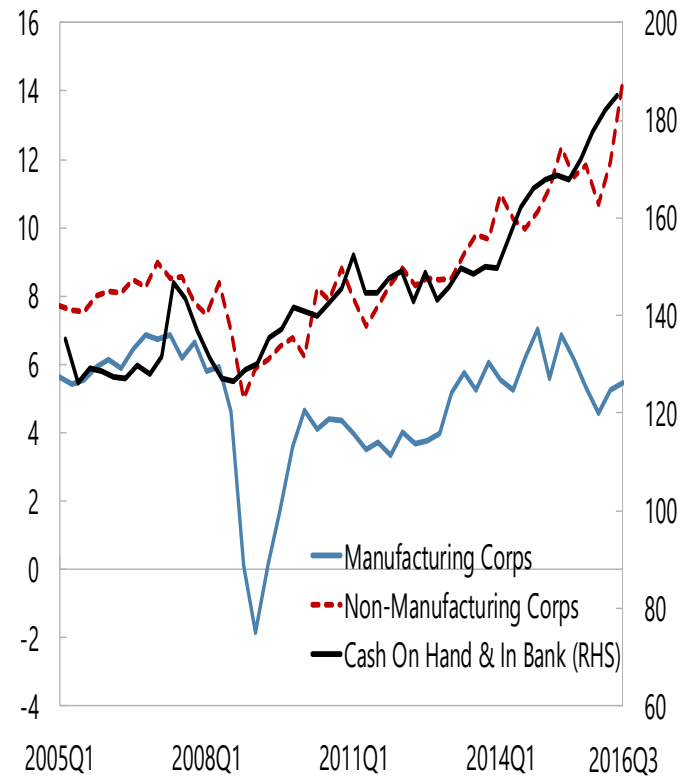
Oil Prices, Equity Prices and the NEER



Source: Haver Analytics; and IMF staff calculations.

Current Profits

(In Trillions Yen)



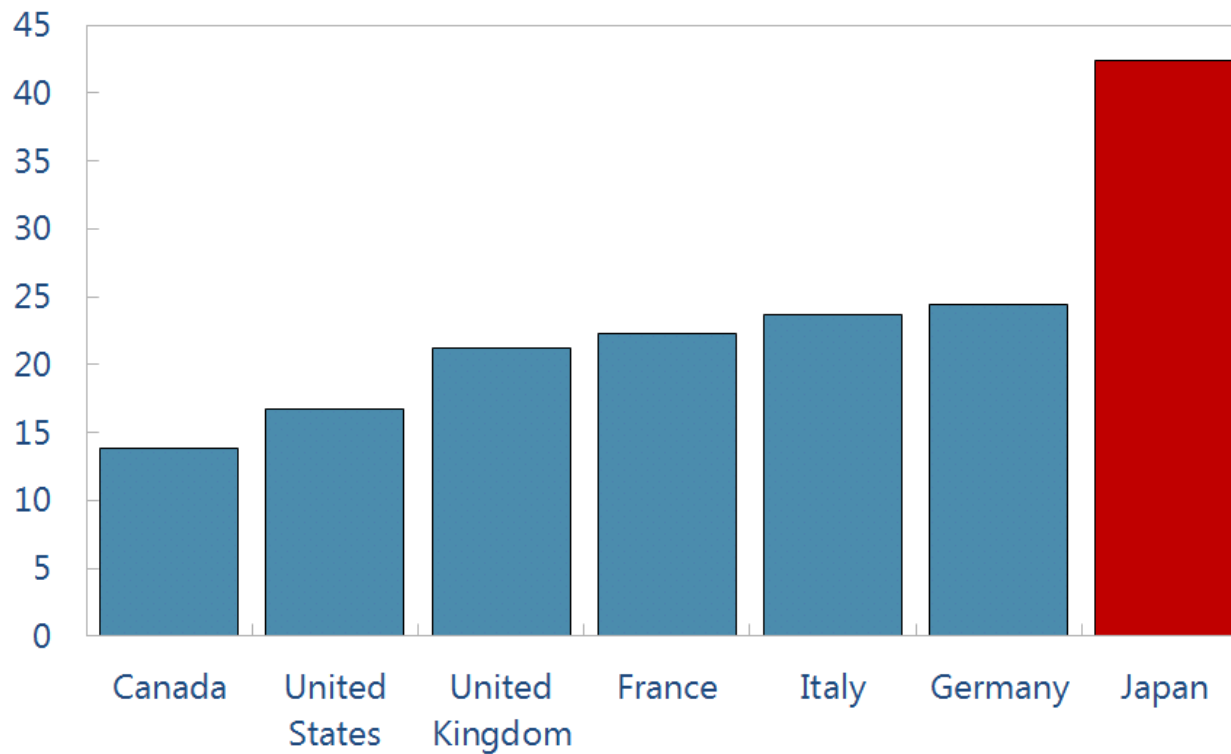
Source: Haver Analytics.

...with high corporate cash

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Listed Companies' Cash and Cash Equivalents Holdings

(Percent of market capitalization; average 2004-2014)



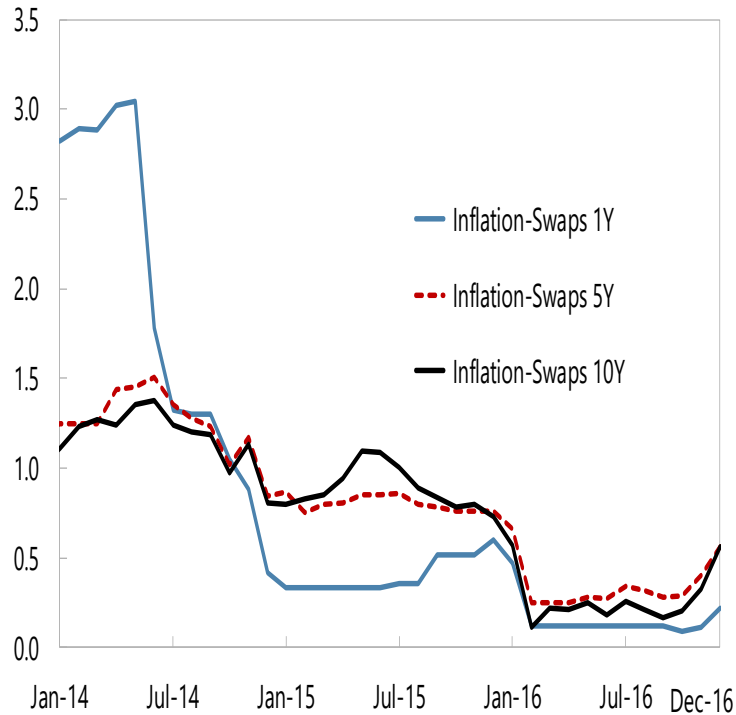
Source: Bloomberg, L.P.

Inflation expectation has been trending down

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Inflation Expectations

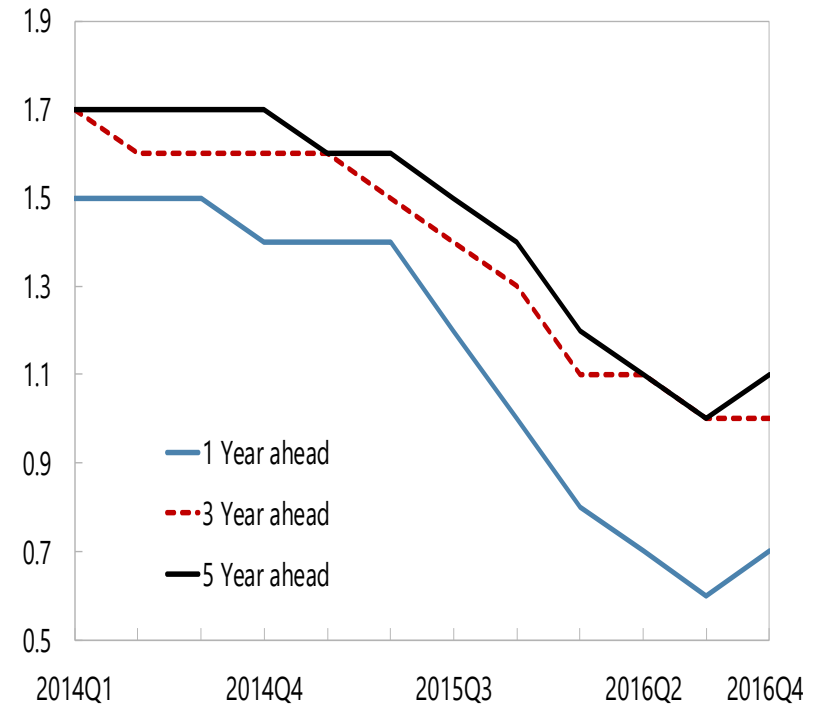
(Year-on-year, in percentage points)



Sources: Bloomberg; and IMF staff estimates.

Tankan Survey: Inflation Outlook

(YoY; in percent)



Source: Haver Analytics.

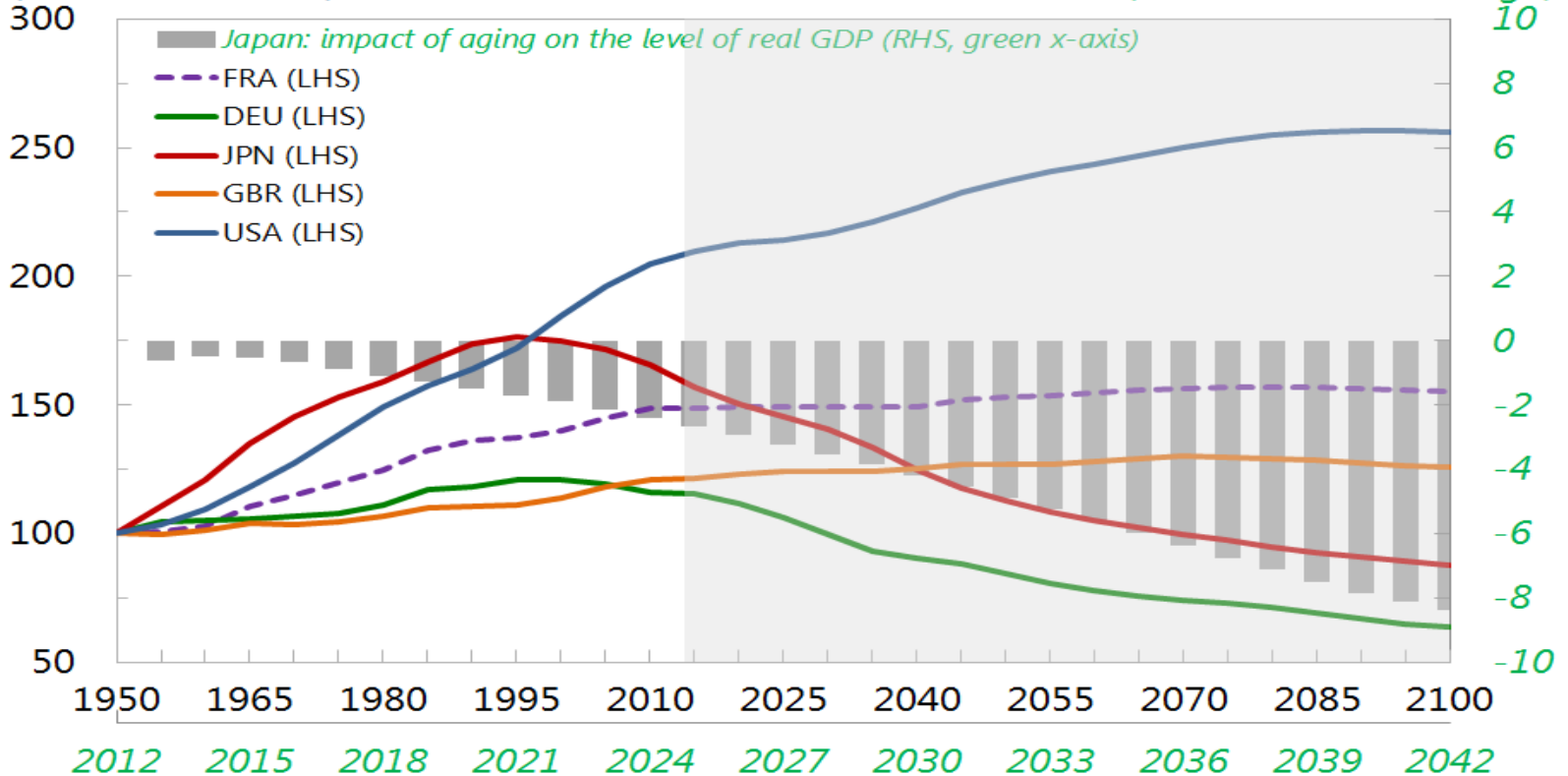
Large demographic headwinds ahead

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Working-age Population, 1950-2050

(Index, 1950=100)

(Real GDP level change)

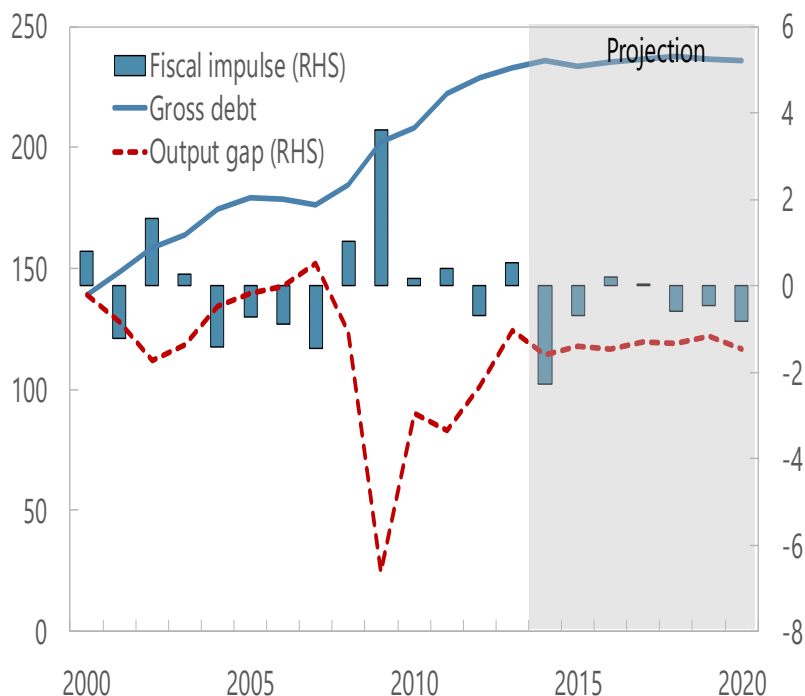


Source: U.N. and Anderson, Botman, and Hunt (2014), "Aging and Deflation", IMF WP14/139.

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

Japan: Public Finances

(Percent of GDP)

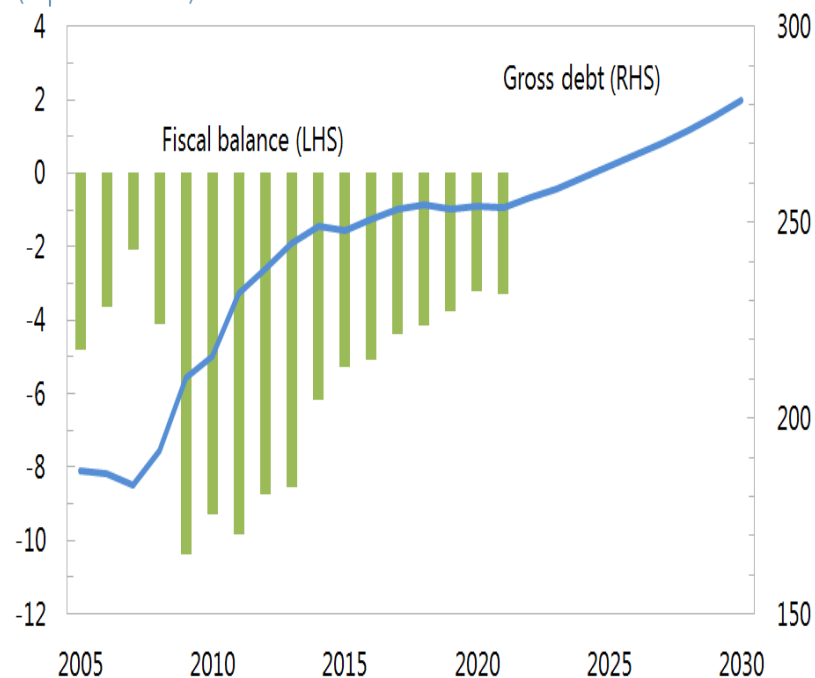


Sources: CAO; and IMF staff estimates

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.

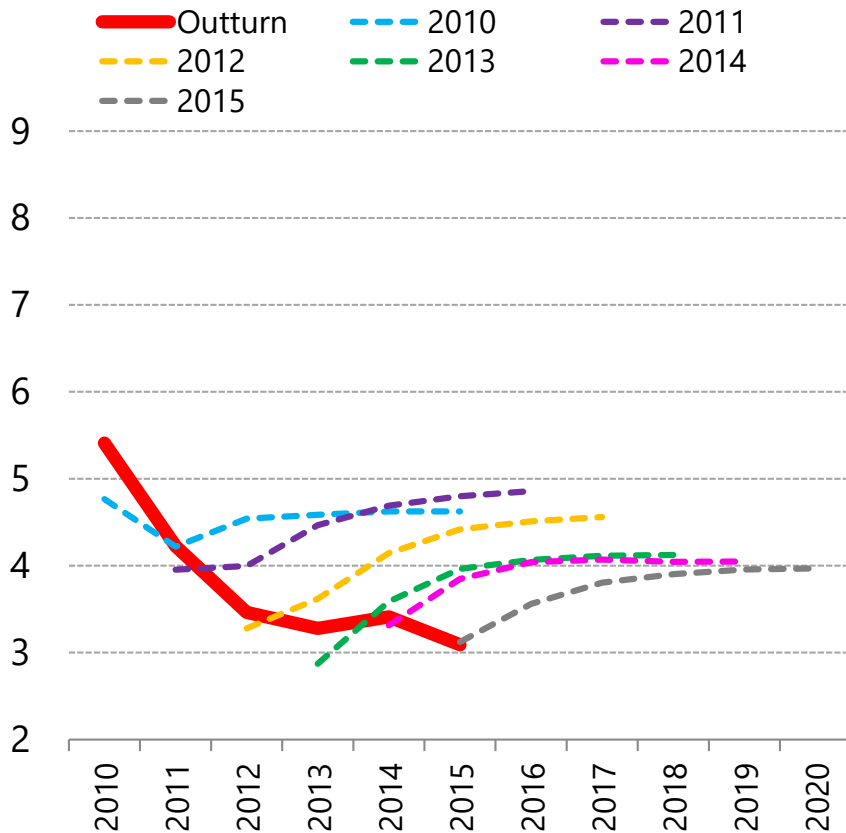


Asia and Pacific Department

The Medium-term: What Does the “New Mediocre” Mean For Asia and Japan?

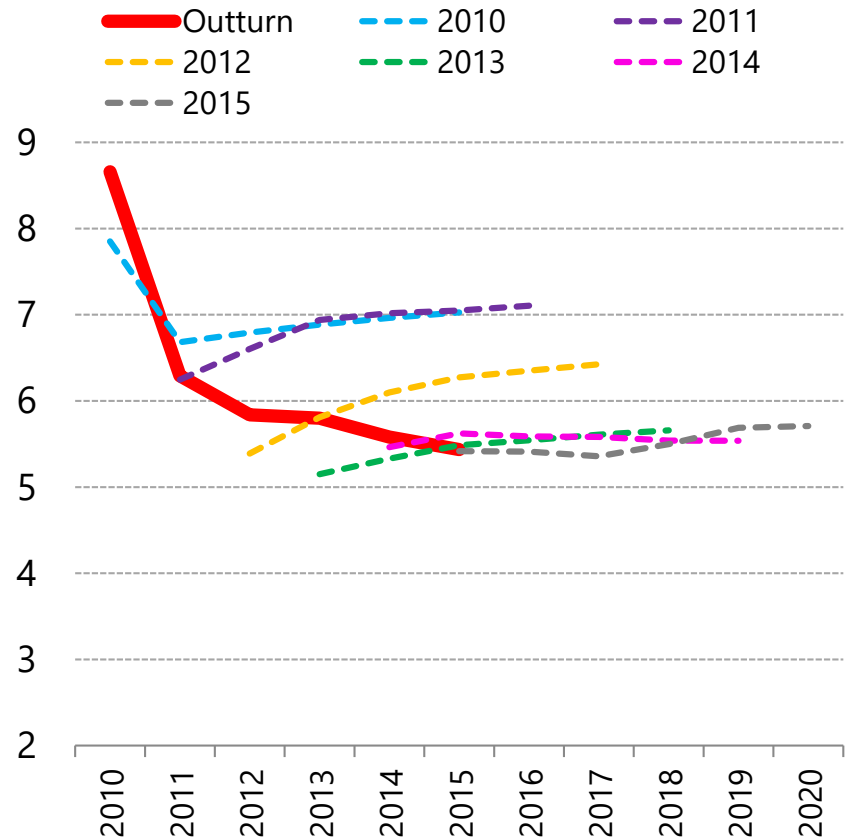
Global and Asia's growth has moderated in recent years...

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



Sources: IMF, WEO database; and IMF staff calculations.
1/ 5-yr forward projections from October WEO in each year.

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.

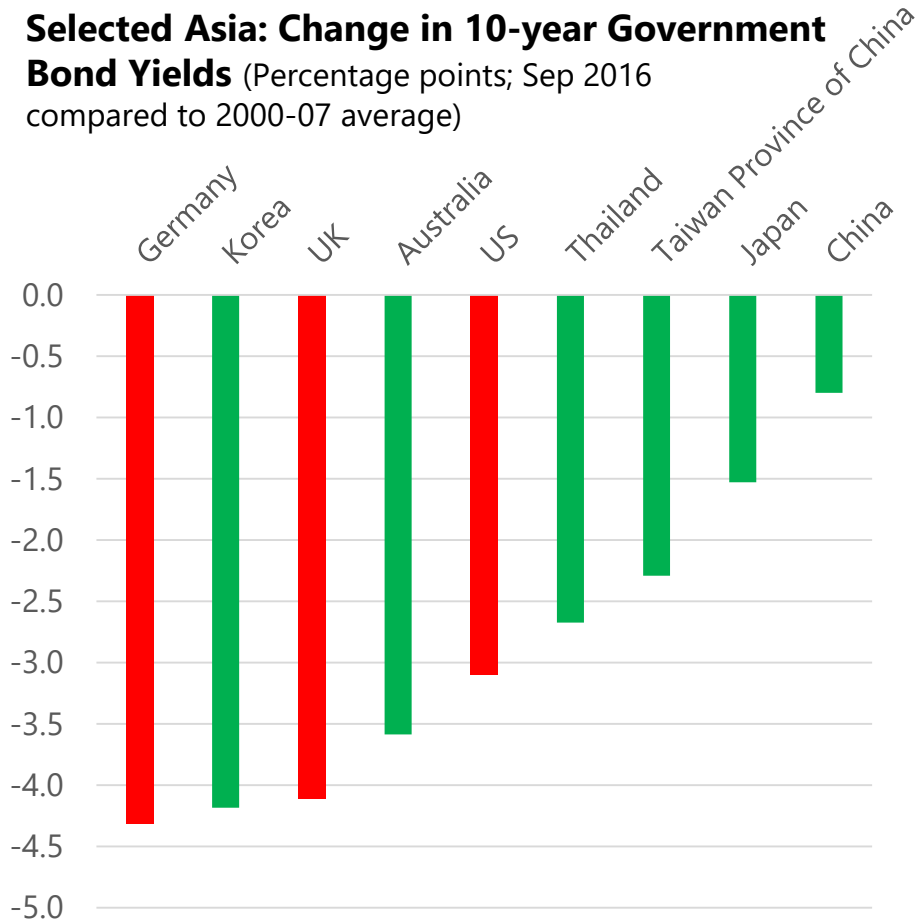
Signs of the “new mediocre” in Asia and Japan?



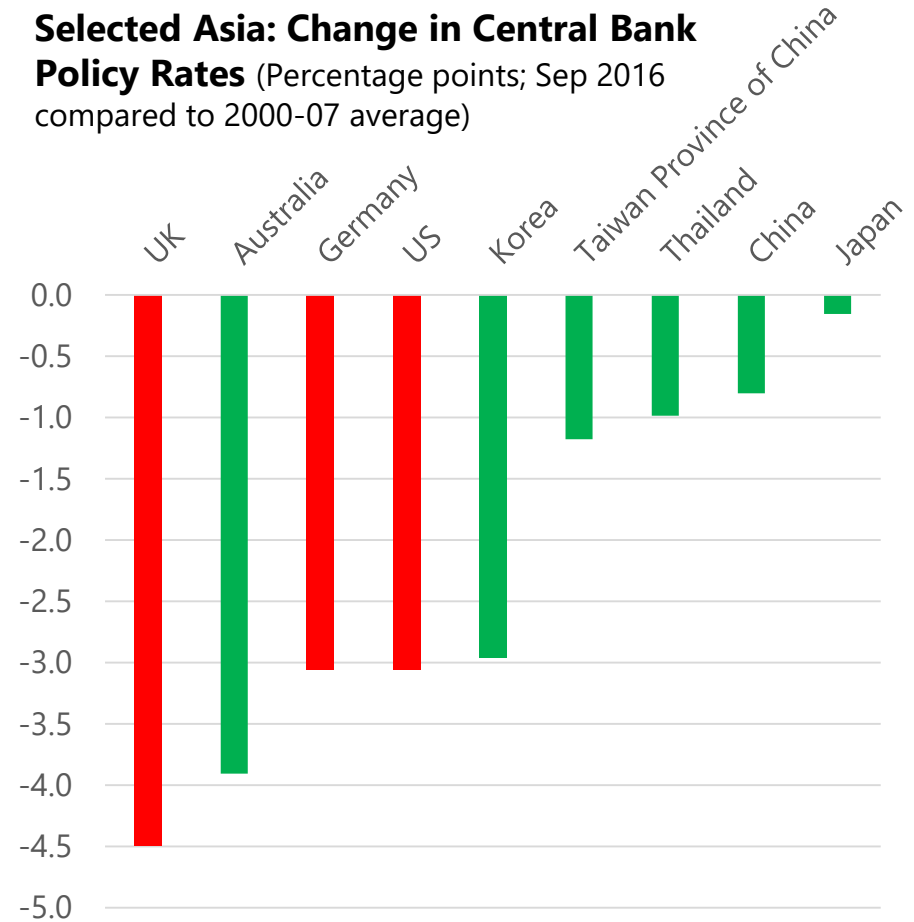
- Long-term interest rates declining?
- Natural (or neutral) interest rates declining?
- Low inflation becoming more common?
- Demographics becoming a headwind?
- Productivity growth declining?
- Trade slowdown in Asia?

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)



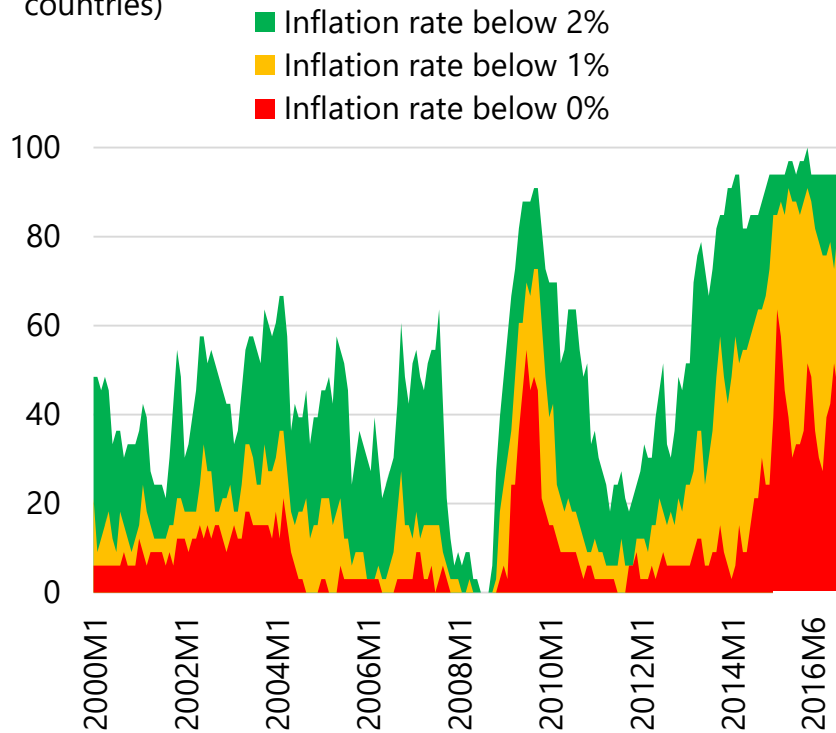
Selected Asia: Change in Central Bank Policy Rates (Percentage points; Sep 2016 compared to 2000-07 average)



Sources: Bloomberg; and IMF staff calculations.

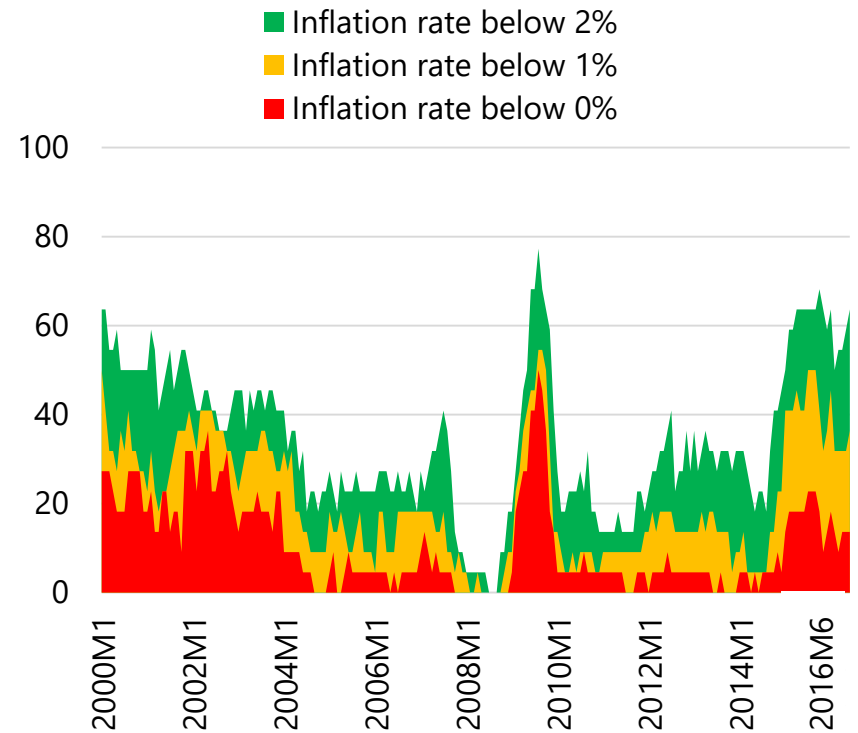
Low inflation becoming more common across the region

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



Sources: IMF, *Global Data Source*; and IMF staff calculations.

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

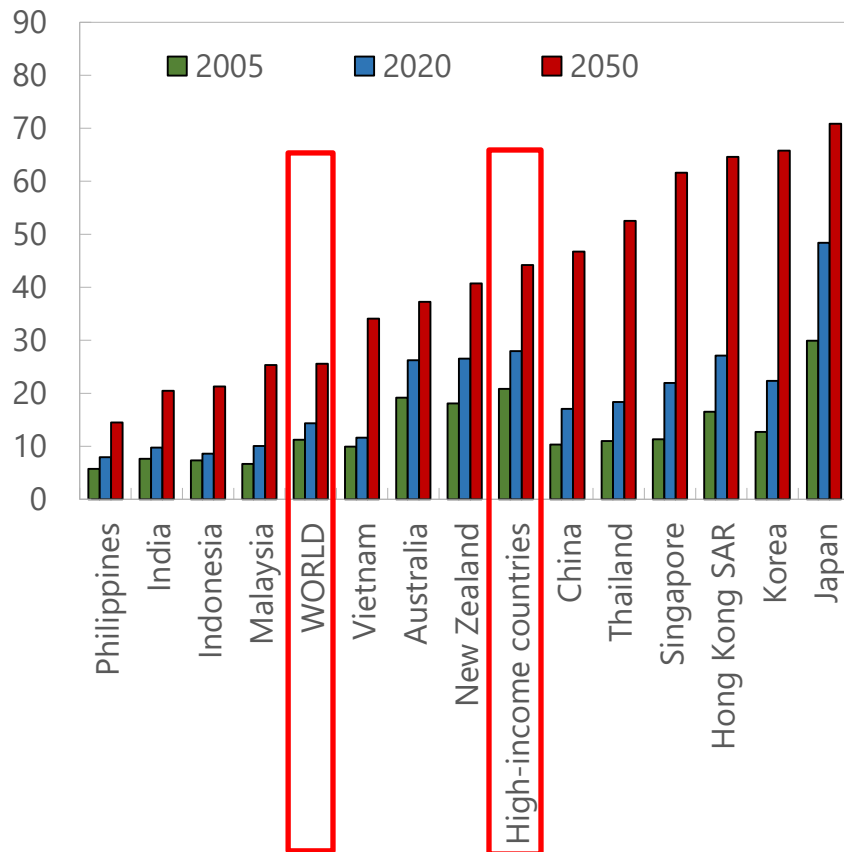


Sources: CEIC Data Company Ltd.; Haver Analytics; and IMF staff calculations.

Demographics: A headwind for some, a dividend for others

Asia: Old-Age Dependency Ratios

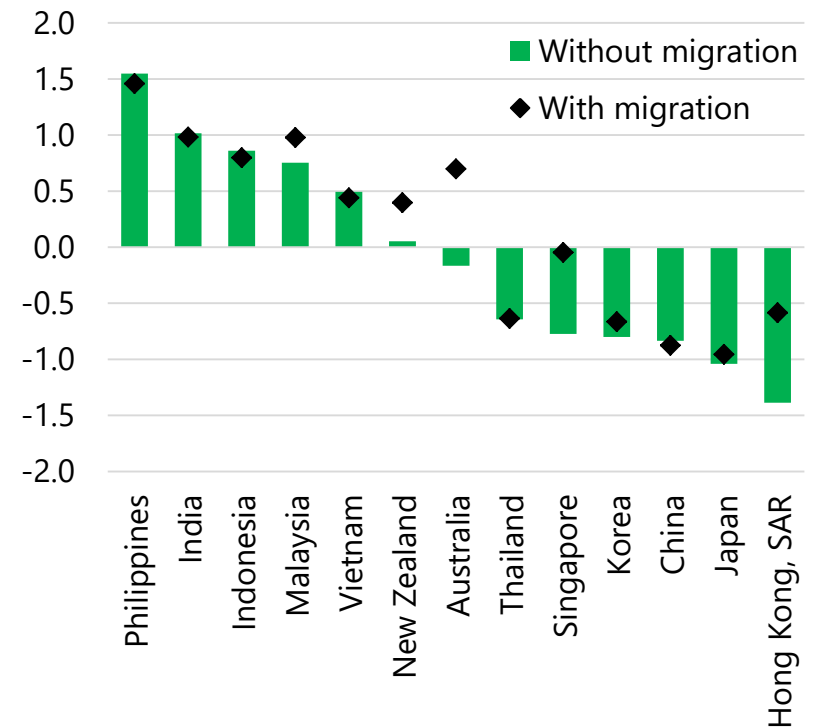
(Percent)



Source: UN Population Prospects: 2015 Revision. Based on the medium-fertility variant scenario (with migration).

Asia: Growth Impact of Demographics Trends

(Percentage point impact on real GDP growth; average over 2020-50)



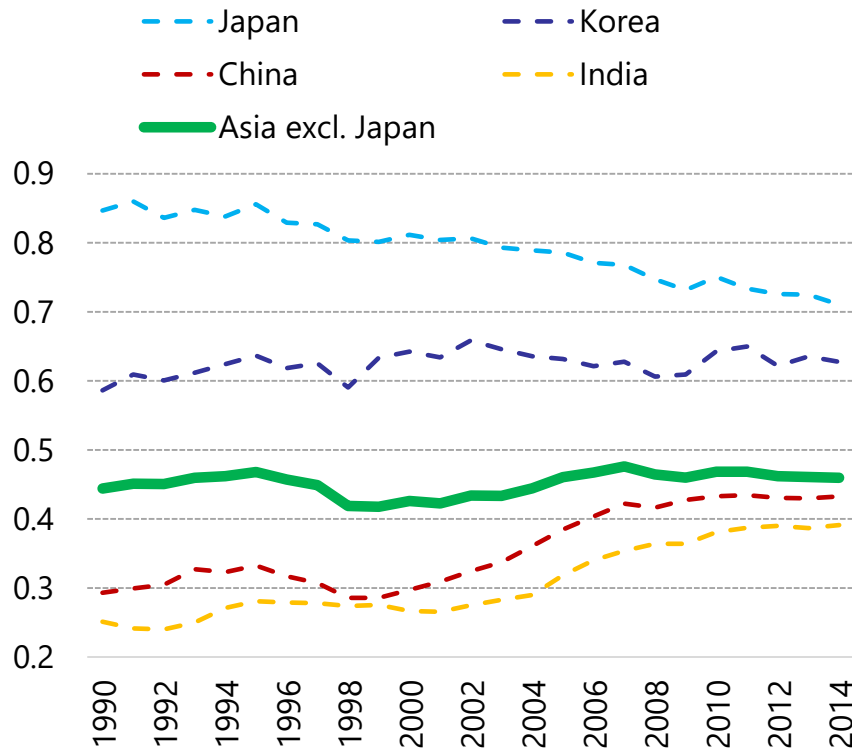
Source: Staff estimates based on UN Population Prospects: 2015 Revision (medium-fertility variant) and IMF (2016).

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

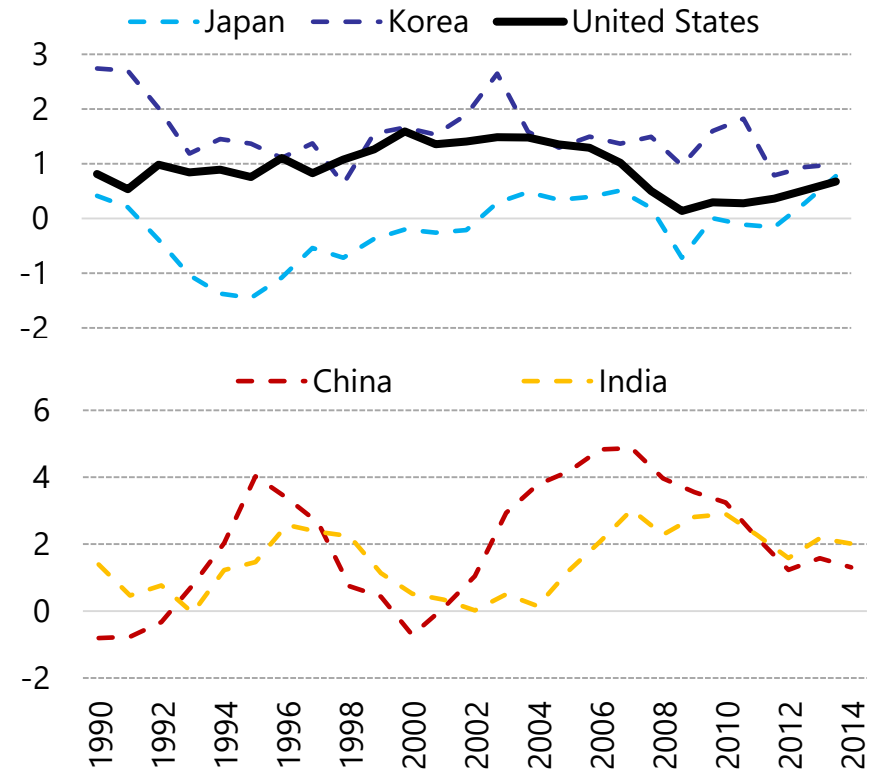
Total Factor Productivity Level Compared to the United States

(At current PPPs; normalized as United States=1)



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”?

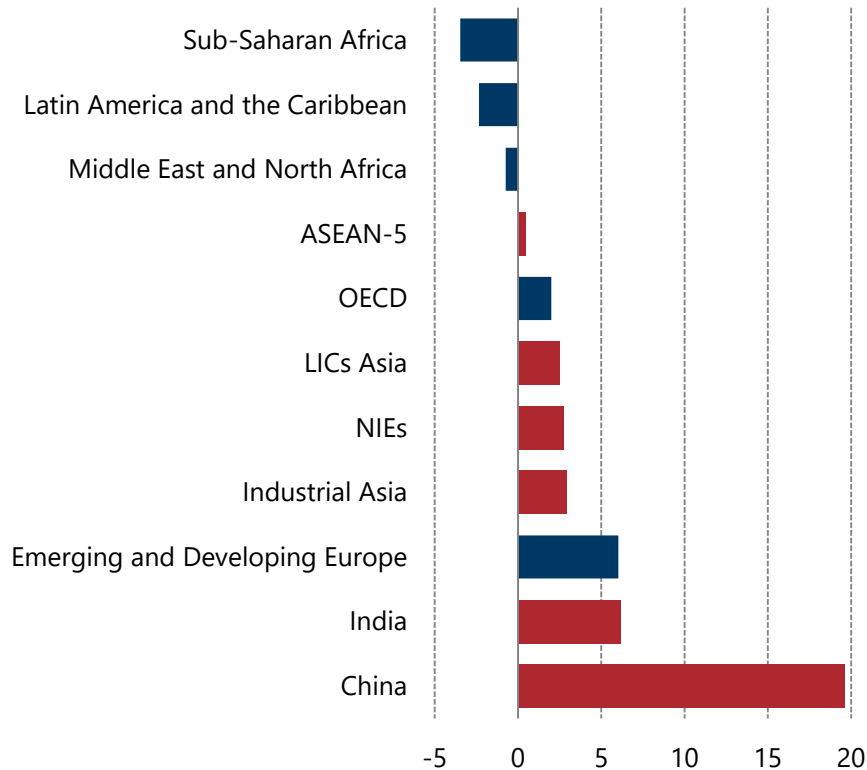
Lower growth can aggravate:

- 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

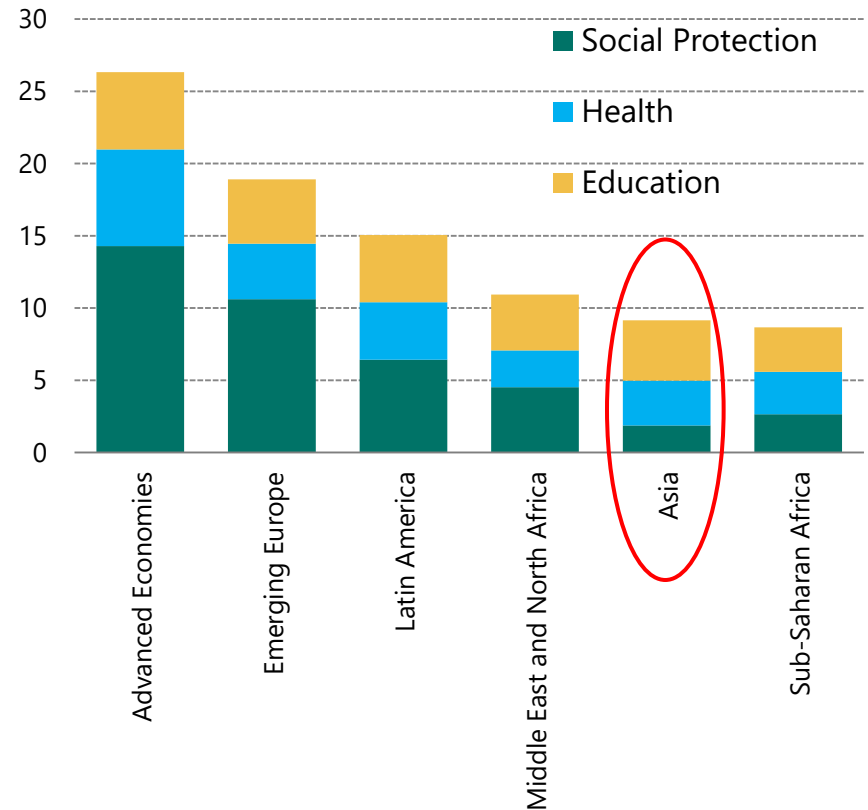
(Net Gini Index; change from 1990 to 2013; simple average across regions)



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

Composition of Social Spending

(Percent of GDP; year of 2010 or latest)

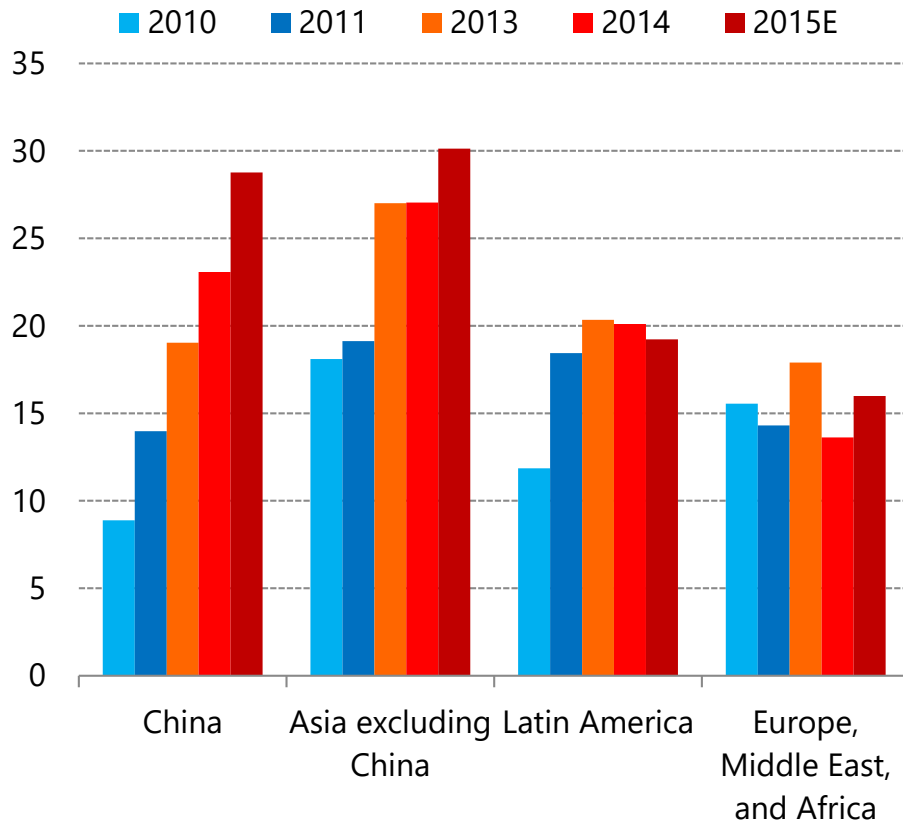


Sources: Organization for Economic Cooperation and Development; Eurostat; Asian Development Bank; IMF, *World Economic Outlook*; United Nations; World Health Organization; World Bank; and IMF staff calculations.

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)

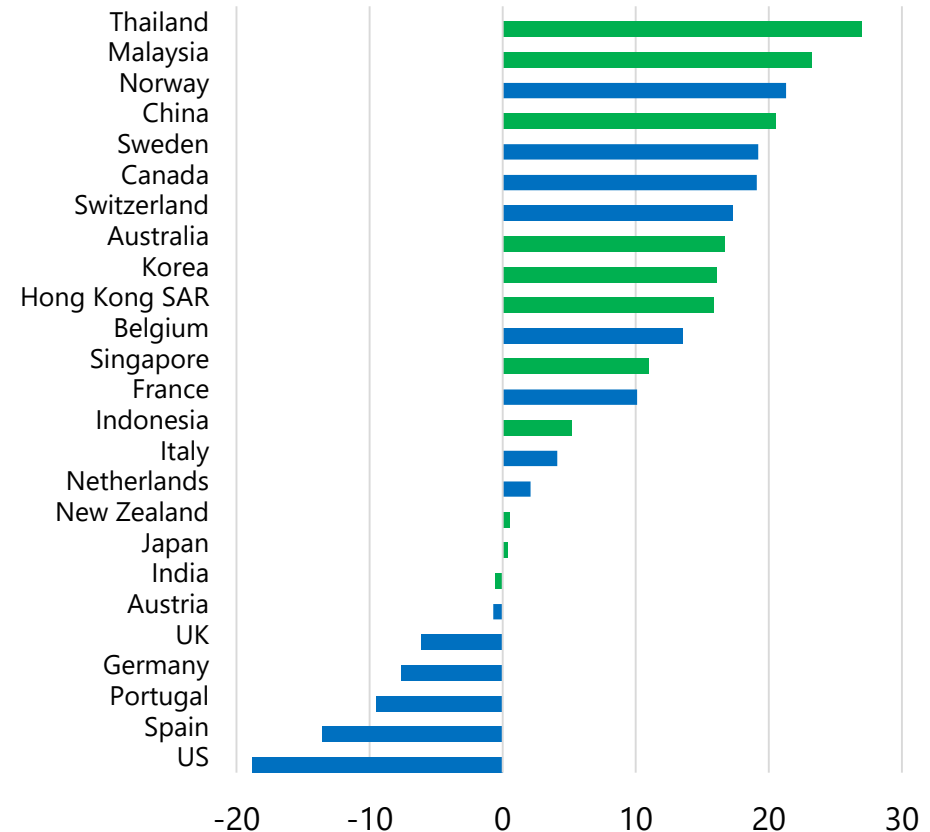


Source: April 2016 GFSR.

Note: Asia excluding China= India, Indonesia, Malaysia, the Philippines, and Thailand.

Change in Household Debt to GDP Ratio

(Percentage points; from end-2007 to end-2015)

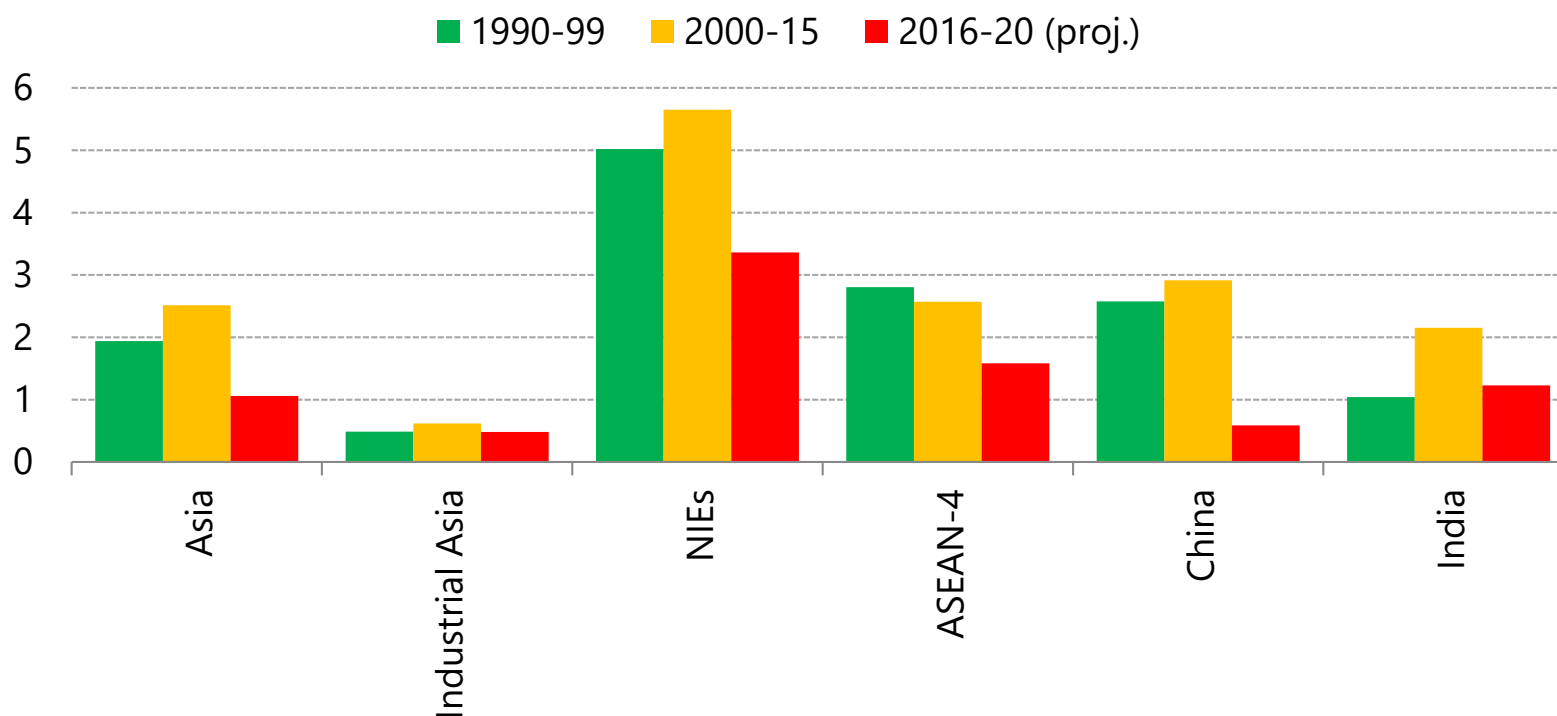


Sources: BIS and IMF staff estimates.

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.



Asia and Pacific Department

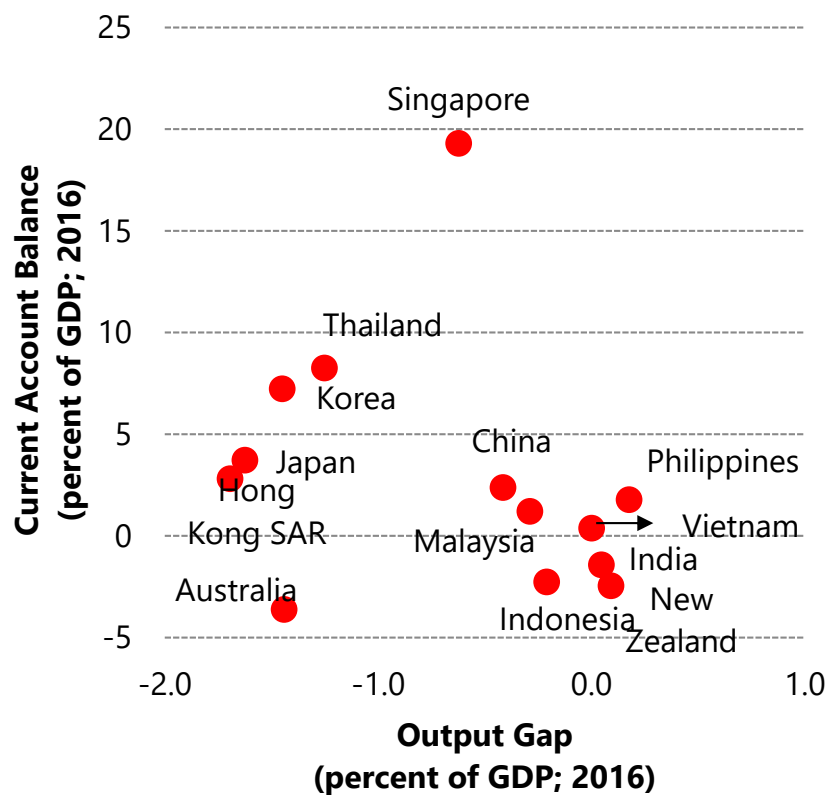
Implications for Monetary, Fiscal, and Structural Policies

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?

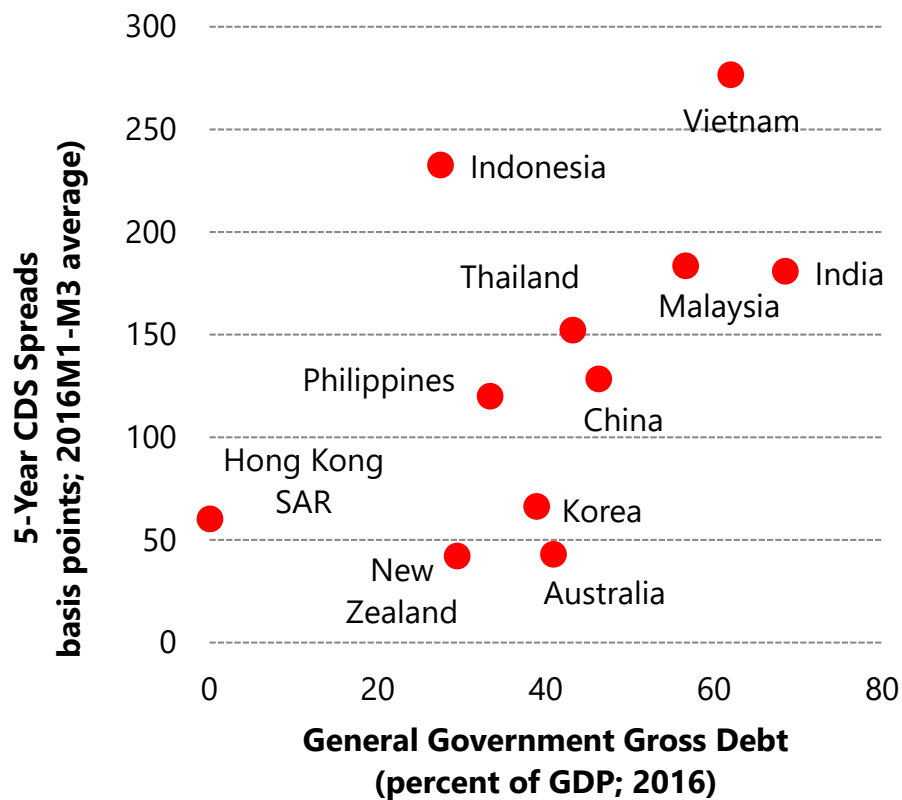
Fiscal policy for demand support?

Selected Asia: Need for Demand Support



Sources: IMF WEO database; and IMF staff calculations.

Selected Asia: Fiscal Space



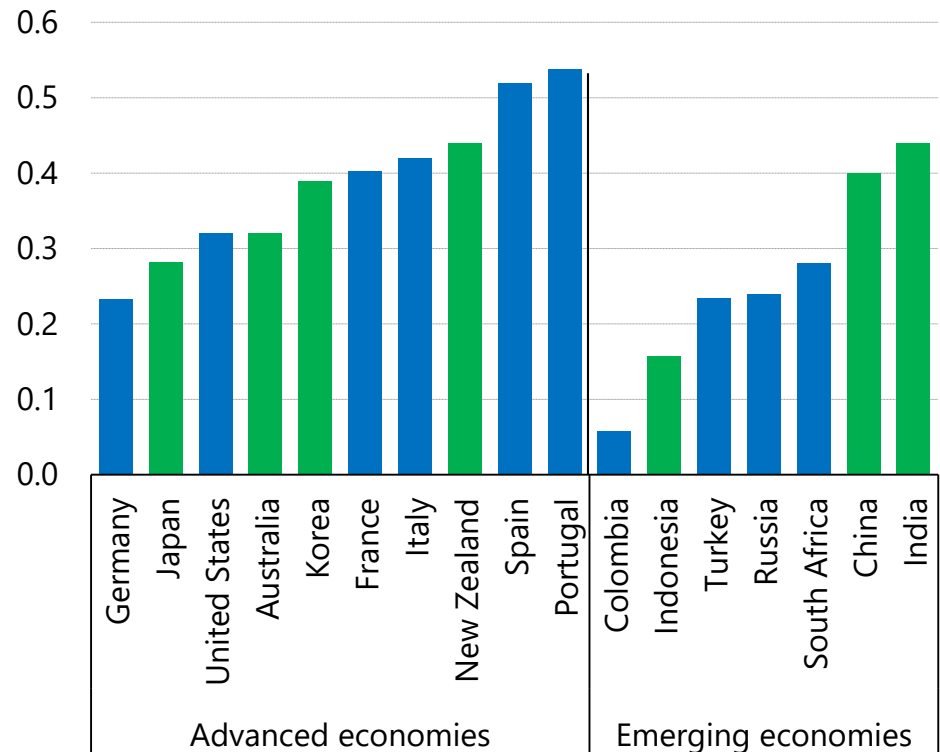
Sources: IMF WEO database; and IMF staff calculations.
Note: Japan is not shown due to scale.

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**);

Reforms Responsiveness Indicator

(2011-15 average)



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