

Annual Report on the Japanese Economy  
and Public Finance

2013

— For Establishing a Positive Cycle  
of the Economy —

Summary

July 2013

Cabinet Office  
Government of Japan

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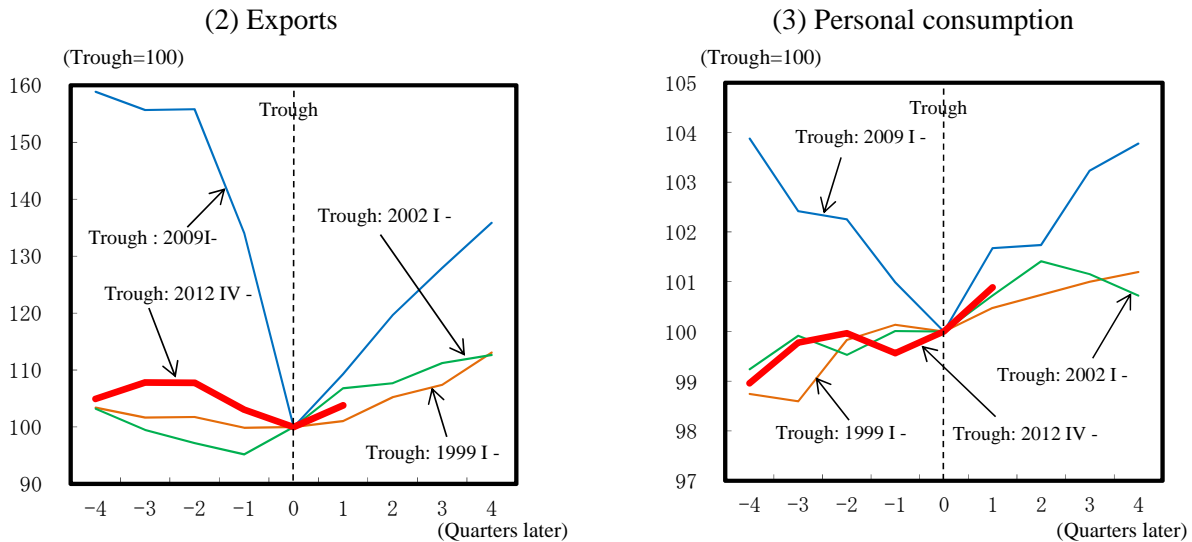
This material has been tentatively prepared to explain the “Annual Report on the Japanese Economy and Public Finance.” For quotations and other purposes, please refer to the text of the “Annual Report on the Japanese Economy and Public Finance.”

# Chapter 1 Current State of the Japanese Economy and Public Finance, and Its Challenges

## Section 1 Current Position of the Japanese Economy

- The economy has been picking up since early 2013.
- Compared with past phases of economic recovery, the current turnaround sees stronger personal consumption and weaker exports, a significant difference from the conventional mechanism of recovery, where exports were a major driver.

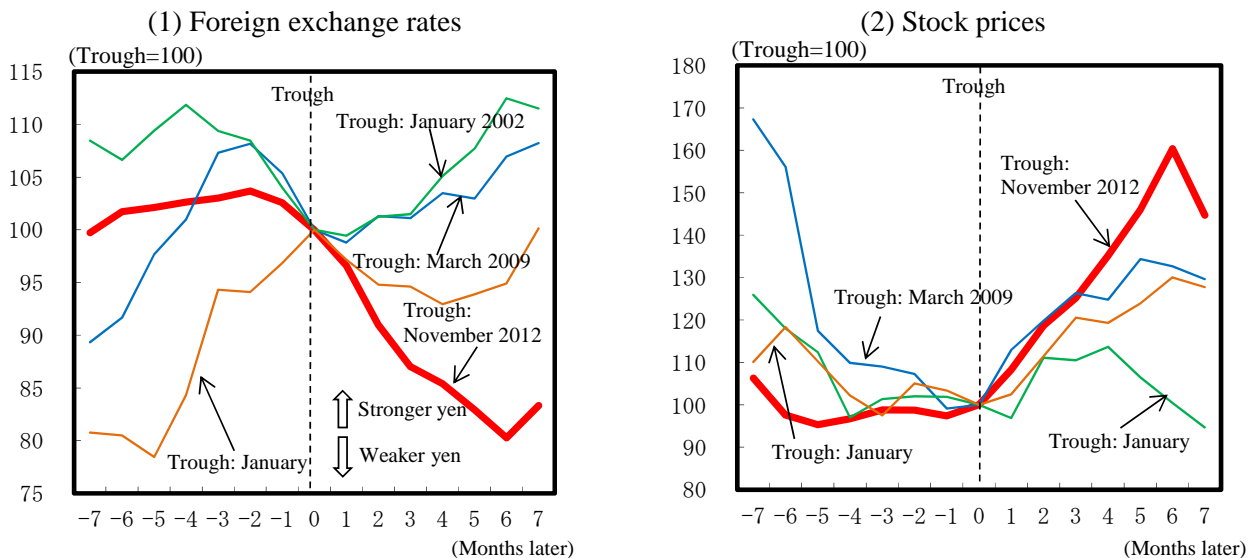
Figure 1-1-2 Comparison with past recovery phases (Breakdowns of demand)



- (Notes) 1. Compiled based on the System of National Accounts, the Cabinet Office.  
 2. For the current recovery phase, the October - December period of 2012 is regarded as a trough, for the sake of convenience.

- Since November 2012, the yen has fallen by around 17 percent against dollar, and stock prices have risen by around 45 percent.
- Compared with past recovery phases, the current turnaround is conspicuous for the great responsiveness of the market and its sustainability.

Figure 1-1-3 Comparison with past recovery phases (Foreign exchange rates & Stock prices)



- (Notes) 1. Compiled based on data from Bloomberg.  
 2. The foreign exchange rate on the left figure is value of the yen against the dollar, and the stock prices shown in the figure on the right represent the Nikkei Stock Average; both are monthly averages.  
 3. For the current recovery phase, November 2012 is regarded as a trough, for the sake of convenience.

- With rising import prices and decreasing export volumes since 2011, the trade balance has been on a deficit trend.
- Export has been picking up since early 2013 with steadiness of the economy overseas and move of the yen toward depreciation.

Figure 1-1-10 (1) Breakdown of the trade balance (custom clearance basis)

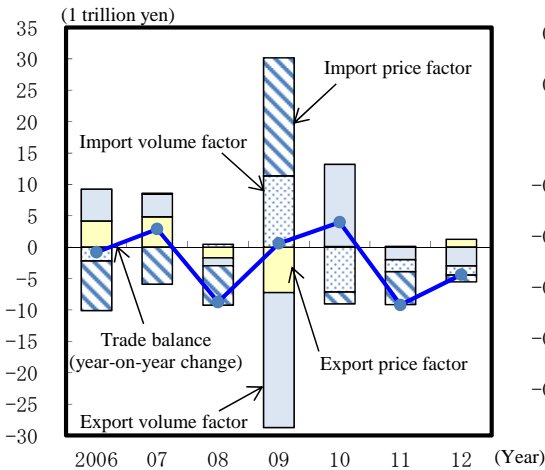
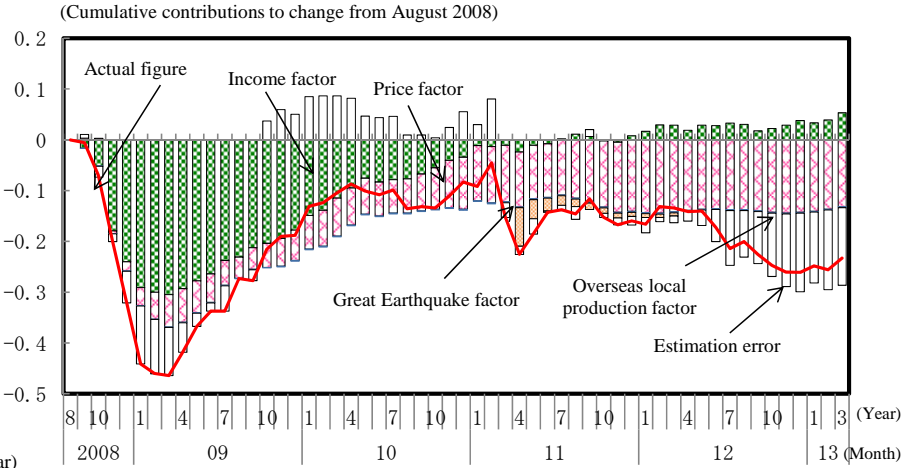


Figure 1-1-11 Factors lying behind stagnant export volumes



- (Notes)
1. (Left) Compiled based on the Trade Statistics of Japan, the Ministry of Finance.
  2. (Right) Compiled based on the Trade Statistics of Japan, the Ministry of Finance; the Annual Survey of Corporate Behavior, the Cabinet Office; IMF, Eurostat, Netherlands Bureau for Economic Policy Analysis (CPB), etc.
  3. On the right figure are seasonally-adjusted figures from the Cabinet Office.

- A sense of shortage of employees remains in Tohoku, especially among non-manufacturers.
- In three disaster-stricken prefectures in Tohoku, recovery of housing stocks has only just begun.

Figure 1-1-18 (3) DI for the number of employees by industry in Tohoku (non-manufacturer)

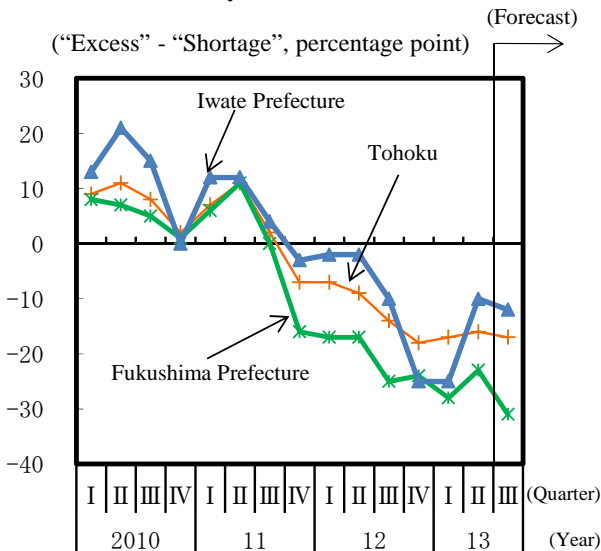
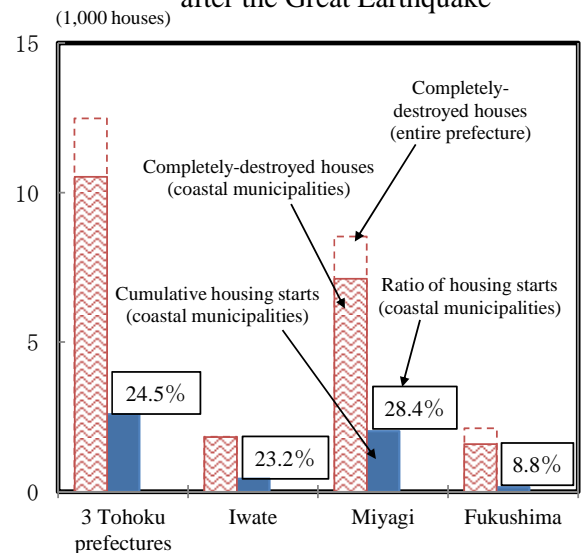


Figure 1-1-20 (2) Reconstruction of housing in three prefectures in Tohoku, and the cumulative number of housing starts after the Great Earthquake



- (Notes)
1. (Left) Compiled based on "Iwate Prefecture Tankan", Morioka Local Office, BOJ; "National Tankan (for Fukushima)", Fukushima Local Office, BOJ; and "Tankan - Six Prefectures in Tohoku-", Sendai Local Office, BOJ;
  2. (Right) Compiled based on the "Statistics on Building Construction Started", the Ministry of Land, Infrastructure, Transport and Tourism; and "On the 2011 Tohoku-Pacific Ocean Earthquake" (March 26, 2013), the Fire and Disaster Management Agency.
  3. In the right figure, the number of completely-destroyed houses does not include those whose damage is unknown. The number of houses damaged in Sendai is based on an interview with the city authorities, counted as of May 19, 2013. The number of "cumulative housing starts" is the total number of housing construction starts between April 2011 and May 2013. The "ratio of housing starts" is a percentage of "cumulative housing starts" to "totally-destroyed houses".

- Production, which had been stagnant compared with other major economies, has been picking up since late 2012.
- Corporate profits have been improving mainly among large enterprises. Depreciation of the yen by ¥1 to the dollar tends to result in an around 1.0 percent increase in corporate profits.

Figure 1-1-21 (1) Production in major economies

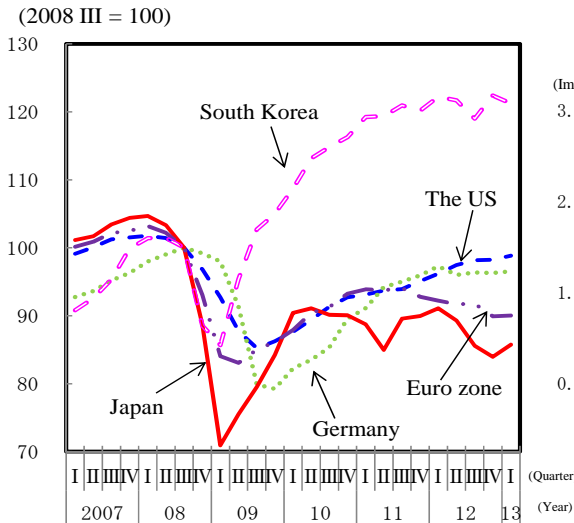
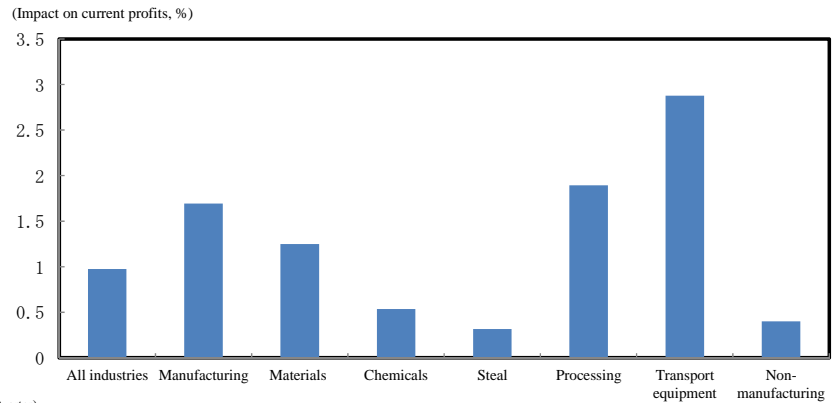


Figure 1-1-24 Impact of the yen's depreciation on corporate profits in major industries

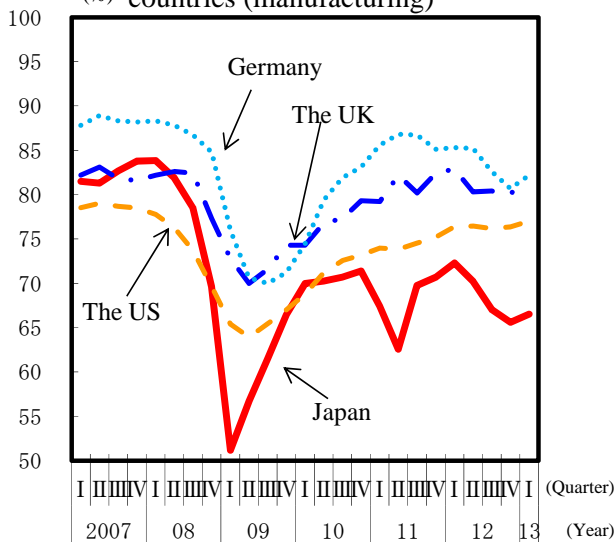


- (Notes)
1. (Left) Compiled based on the Indices of Industrial Production, the Ministry of Economy, Trade and Industry, and each country's statistics.
  2. (Right) Compiled based on the Tankan Survey, Bank of Japan.
  3. The right figure shows estimated rates of correction to be made to current profits with a change of ¥1 yen in the assumed exchange rate to the dollar from the previous survey. The estimation covers all scales of enterprises. Statistical significance stands at five percent for all industries, manufacturing, materials and processing, and at 10 percent for transport equipment and non-manufacturing.

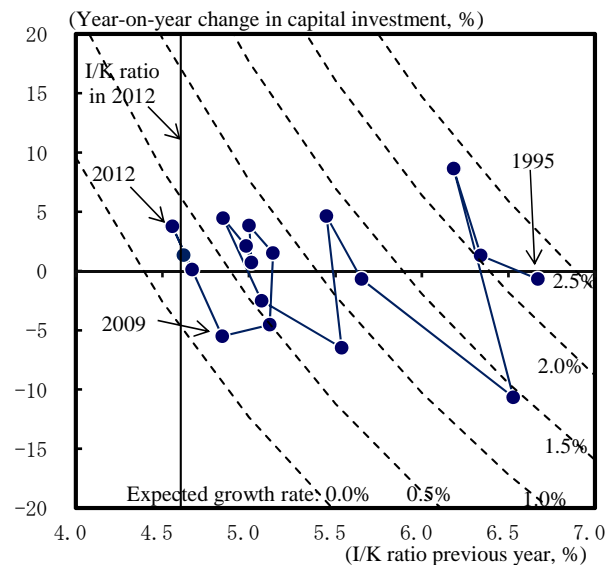
- Lower utilization rates than in other major developed countries hold back capital investment, especially among manufacturers.
- Decreased expected growth rates discourage capital investment, especially among non-manufacturers.

Figure 1-1-26 Changes in major indicators with impact on capital investment

(1) Utilization rates in major developed countries (manufacturing)



(2) Capital stock cycle (non-manufacturing)



- (Notes)
1. (Left) Compiled based on the Indices of Industrial Production, the Ministry of Economy, Trade and Industry, and each country's statistics.
  2. Compiled based on Gross Capital Stock of Private Enterprises, and the System of National Accounts, the Cabinet Office.
  3. In the right figure, each dotted hyperbola indicates the level that balances at an expected rate of growth. Rates of change in the capital coefficient and retirement rates needed for calculation are averages between 2000 and 2011. As the level of expected growth rate depends largely on rates of change in the capital coefficient and retirement rates set for calculation, it must be understood that it has a significant margin.

- Elderly people's spending continues to underpin private consumption.
- Since November 2012, the rise in stock prices (around 45 percent) has pushed up private consumption by one percent, mainly among the elderly.

Figure 1-1-28 (2) Private consumption by age group

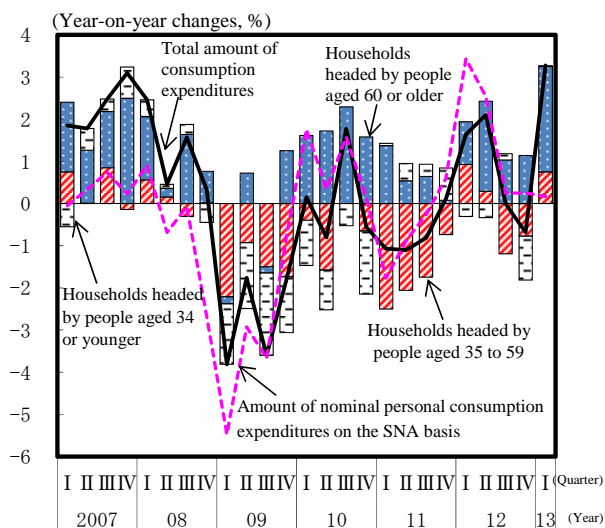
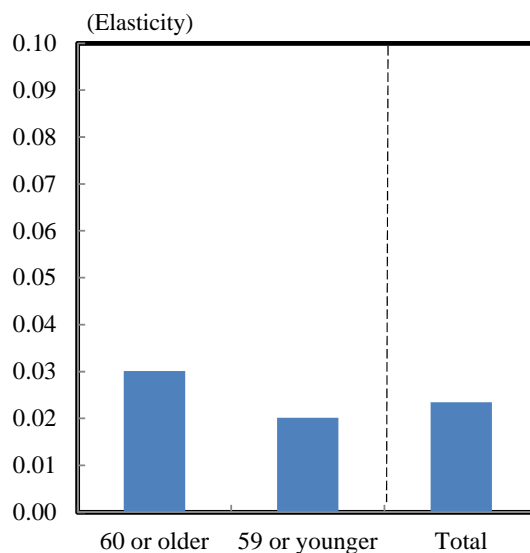


Figure 1-1-29 (1) Effects of the rise in stock prices on pushing up consumption



- (Notes)
1. (Left) Compiled based on the System of National Accounts, the Cabinet Office; and the Survey of Household Economy, Population Census, and Population Estimates, the Ministry of Internal Affairs and Communications.
  2. (Right) Compiled based on the System of National Accounts, and Consumer Confidence Survey, the Cabinet Office; the Survey of Household Economy, and Population Estimates, the Ministry of Internal Affairs and Communications; and the Flow of Funds Accounts, the Bank of Japan.
  3. In the right figure, the total is the weighted average of consumption expenditures of people aged 60 or older and those aged 59 or younger.

- There is a limited decline in the number of employees while compensation of employees remains steady.
- Housing investment stands at a low level due mainly to the shrinking population of potential home purchasers. However, since the beginning of 2013, investment has been picking up mainly with improved sentiment among potential purchasers.

Figure 1-1-32 (1) Comparison of real compensation of employees between major developed economies

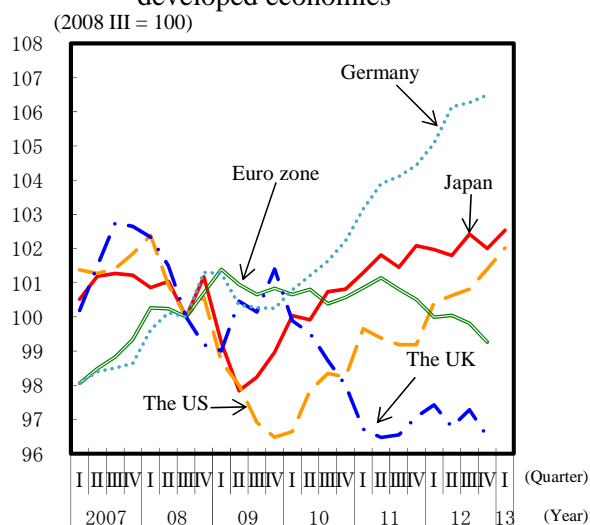
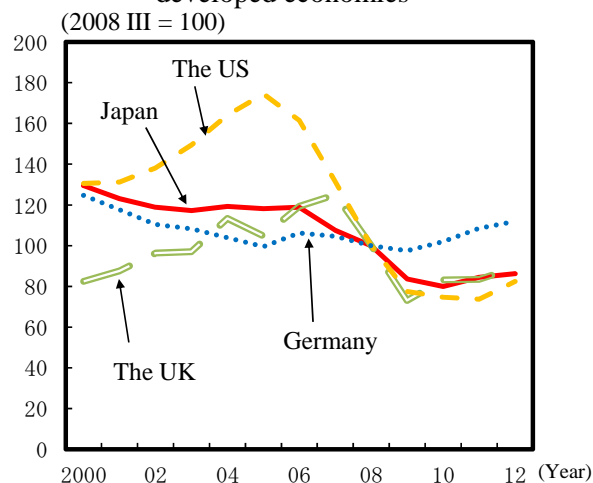


Figure 1-1-36 (2) Comparison of housing investment between major developed economies

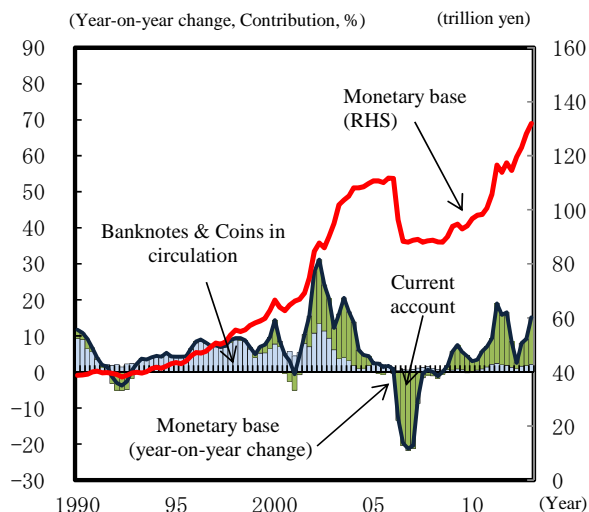


- (Notes)
1. (Left) Compiled based on the System of National Accounts, the Cabinet Office, and each country's statistics.
  2. Compiled based on OECD.Stat.

## Section 2 Regime change of the monetary policy, and the trend of prices

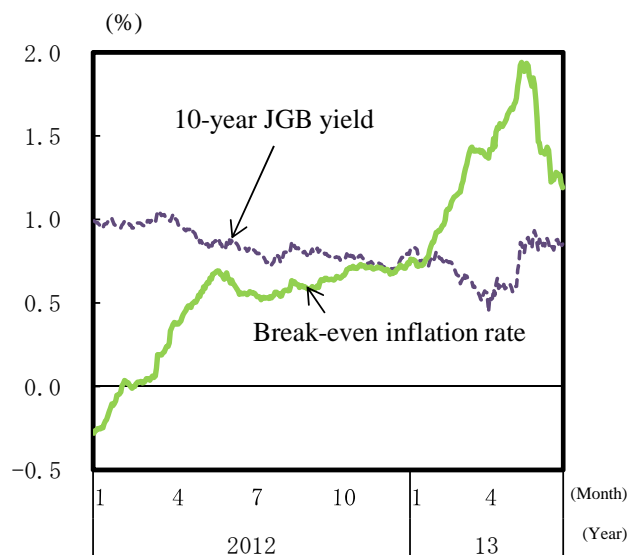
- The Bank of Japan set an aggressive monetary base target as part of “quantitative and qualitative monetary easing”.
- Against a backdrop of bold monetary easing and other factors, market participants expect a higher rate of inflation.

Figure 1-2-3 (1) Monetary base, and factors causing its fluctuations



- (Notes) 1. (Left) Compiled based on Monetary Base, the Bank of Japan.  
2. (Right) Compiled based on data from Bloomberg.

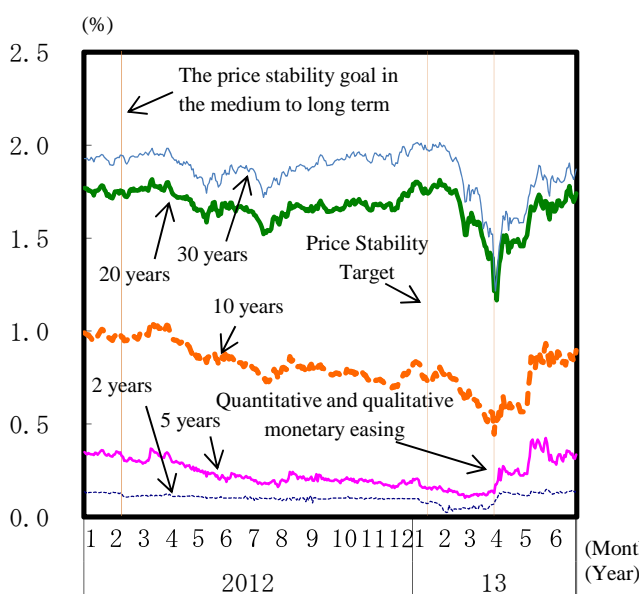
Figure 1-2-4 (4) The long-term interest rate, and break-even inflation rate



- The long-term interest rate fell from early 2013, before showing a slight rise.
- "Quantitative and qualitative monetary easing" has exerted a significant effect on the interest rate in the ultra long-term zone.

Figure 1-2-5 Monetary policy, and changes in JGB yield

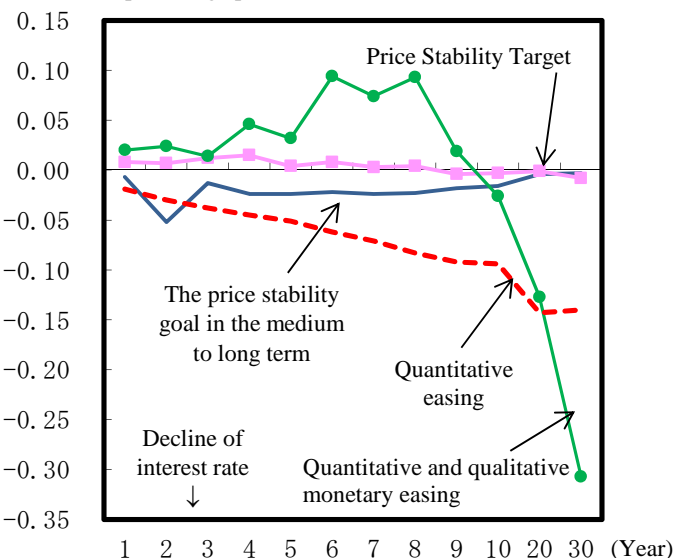
(1) Changes in JGB yield



(Note) Compiled based on data from Bloomberg.

(3) Shifts of yield curves

(from the previous to the following days)  
(percentage point)

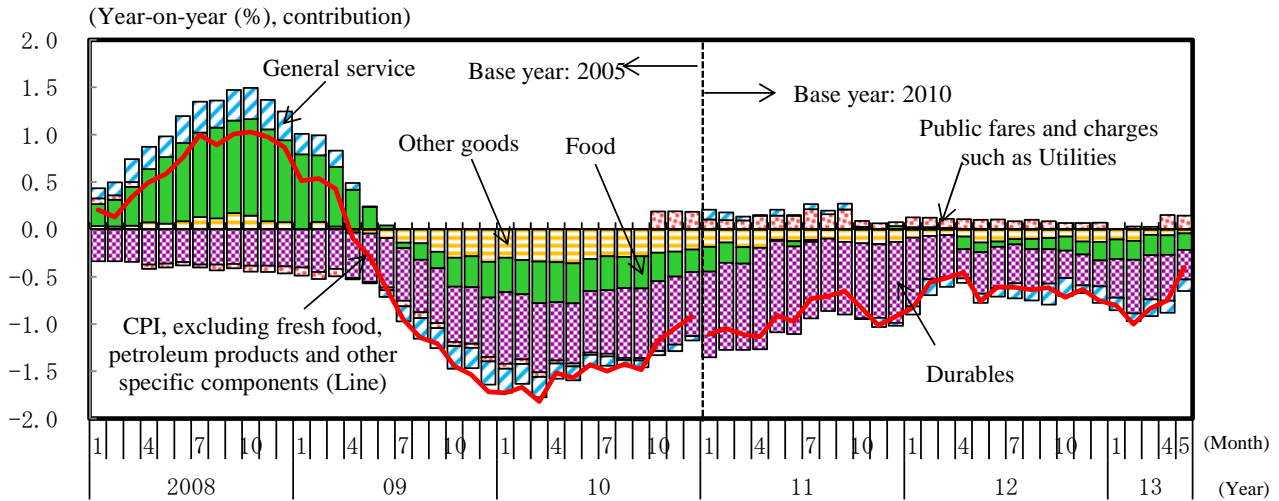




- Since March 2013, consumer prices have been falling only at a slower pace on a year-on-year basis.
- Behind the slowdown lies, among others, a respite of the downward trend in food prices and a shrinking contribution of consumer durables to deflation.

Figure 1-2-8 Changes in consumer prices

(2) CPI, excluding fresh food, petroleum products and other specific components (core-core / chain index)



(Note) Compiled based on Consumer Price Index, the Ministry of Internal Affairs and Communications.

- With the low-price orientation of households having eased, the average unit purchase price has risen.
- What is critical to end deflation is to raise the expected rate of inflation.

Figure 1-2-9 Consumer prices, and the average unit purchase price  
(1) CPI, excluding imputed rent, fresh food, and energy

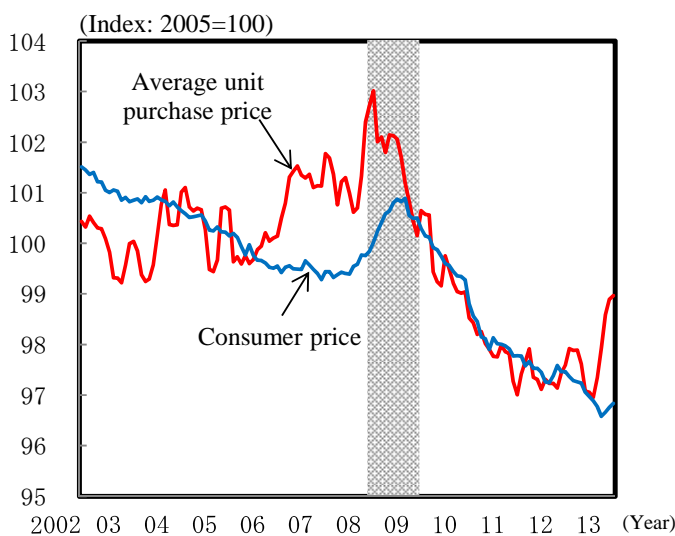
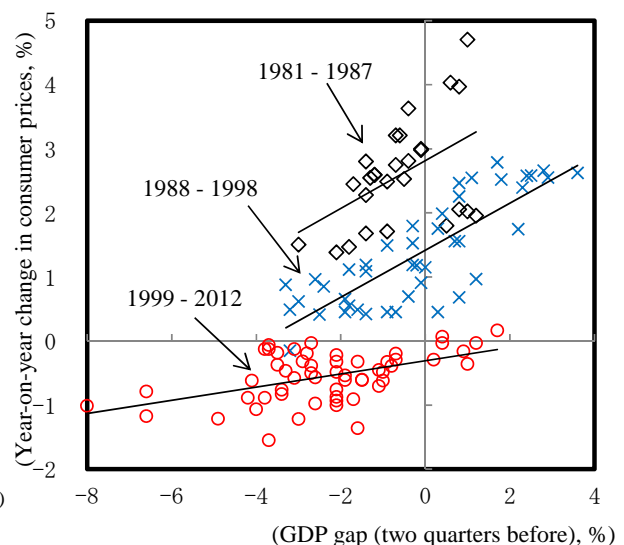


Figure 1-2-11 Phillips curve (Japan)



- (Notes)
1. (Left) Compiled based on the Survey of Household Economy, Family Income and Expenditure Survey, and Consumer Price Index, the Ministry of Internal Affairs and Communications.
  2. (Right) Compiled based on the System of National Accounts, the Cabinet Office; Consumer Price Index, the Ministry of Internal Affairs and Communications, etc.
  3. Basically, the Consumer Price Index is not influenced by any shift in consumption of households to lower- or higher-price goods. Meanwhile, as the unit purchase price is calculated as consumption expenditure divided by units of purchase, households' orientation toward lower prices (higher prices) contributes to the fall (rise) in unit purchase price.



- Companies plan to change the prices of their products according to market price forecasts.
- When companies reduce the prices of their products, they tend to give importance to "competitors' prices"

Figure 1-2-28 (2) Market and sales price forecast of products

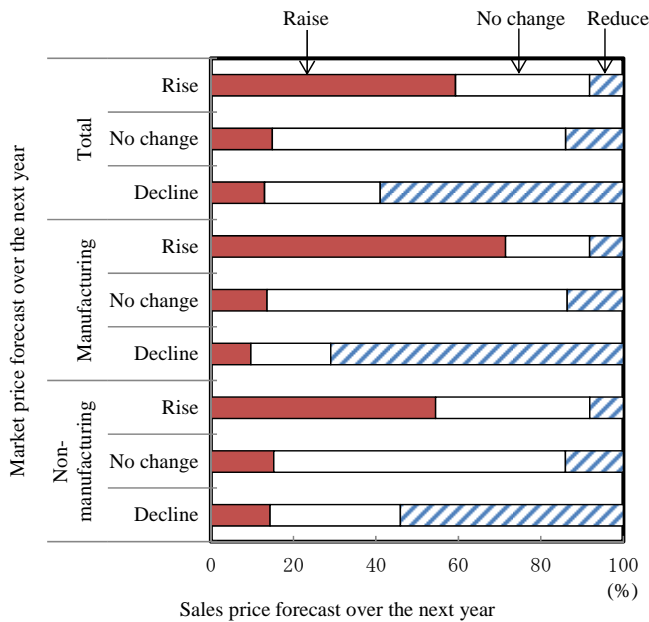
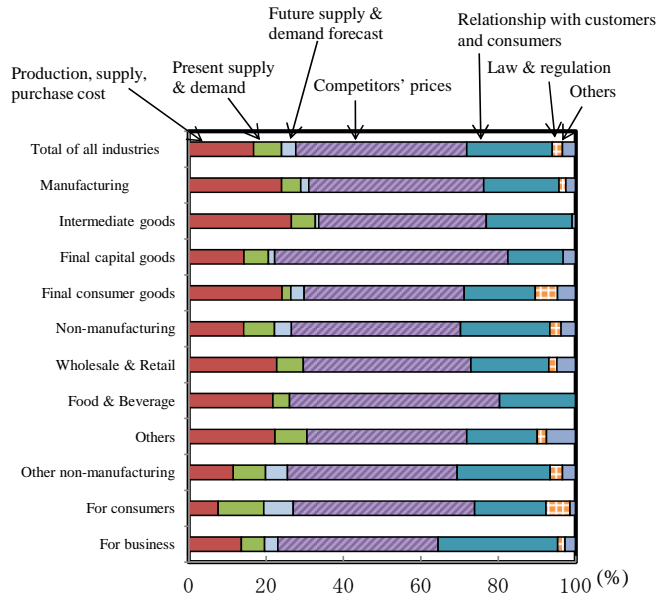


Figure 1-2-30 (2) Factors companies give the greatest importance to when reducing sales prices

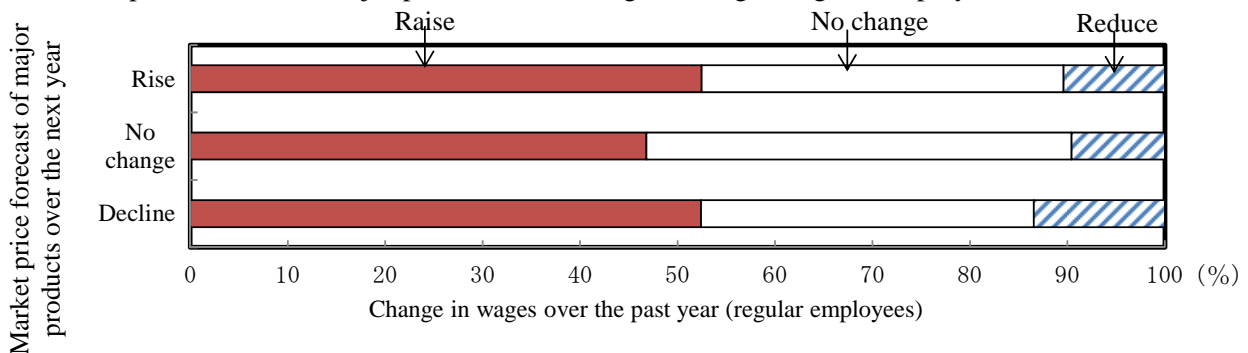


(Note) Compiled based on the Opinion Survey on Corporate Management, the Cabinet Office

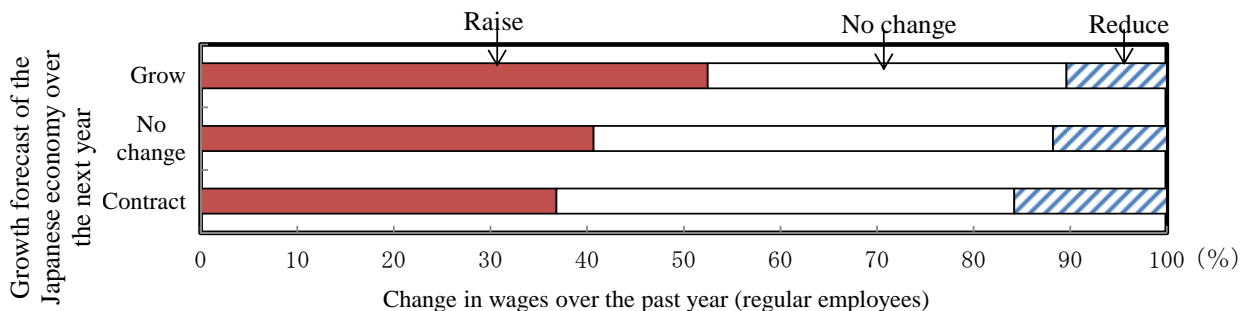
- Companies tend to raise wages when expecting future economic conditions and/or business sentiment to improve.

Figure 1-2-33 Characteristics of companies that raise wages

(2) Market price forecast of major products, and changes in wages (regular employees)



(3) Growth forecast of the Japanese economy, and changes in wages (regular employees)

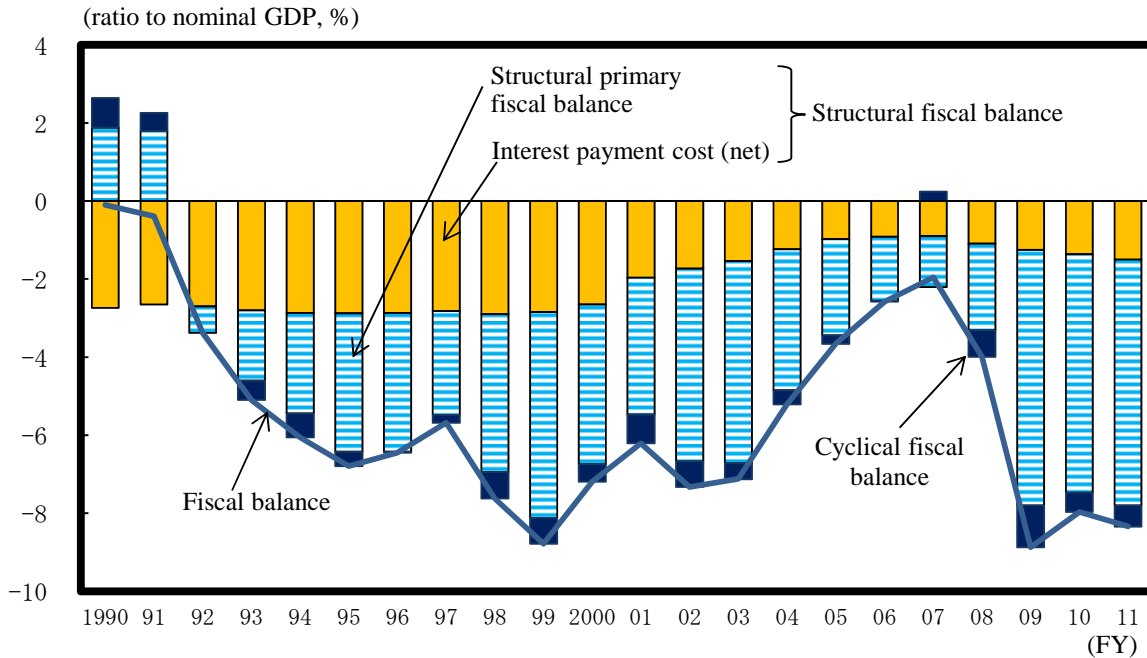


(Note) Compiled based on the Opinion Survey on Corporate Management, the Cabinet Office

### Section 3 Current Conditions of Public Finance and Social Security, and Fiscal Consolidation

- Since the Lehman Crisis, Japan's fiscal balance has been in a significant deficit.
- Analysis of Japan's fiscal deficit by factor shows that structural fiscal balance has a great influence.

Figure 1-3-2 Trends of central and local governments' cyclical and structural fiscal balances



- With an aging population, a difference tends to grow between social security expenses and social insurance premium revenues.
- Since FY2010, actual pension reserves have been below forecast.

Figure 1-3-5 Trends of social security expenses and social insurance premium revenues

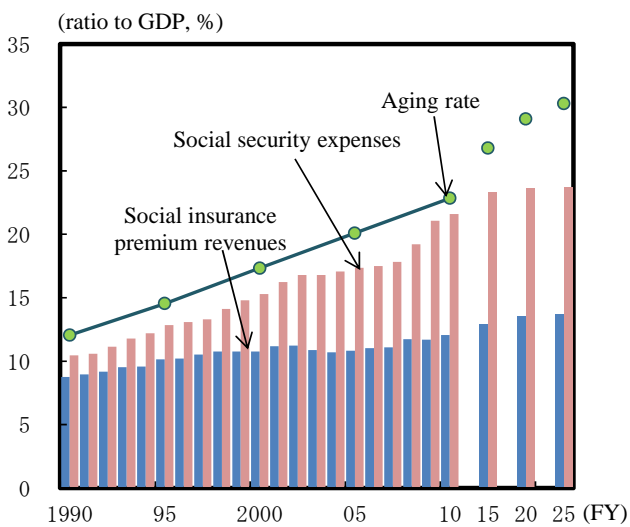
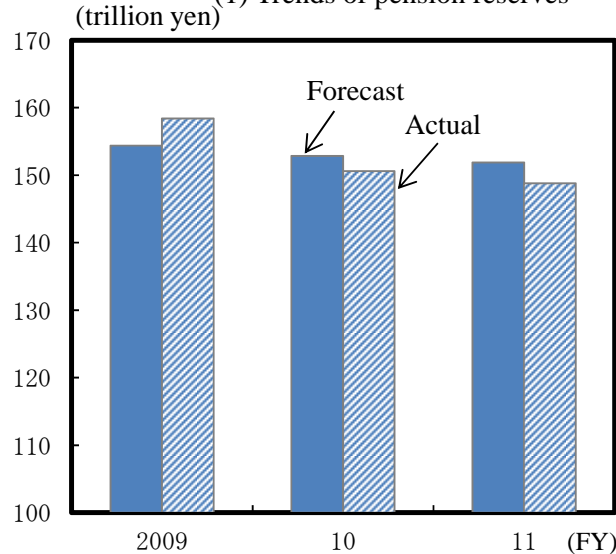


Figure 1-3-7 Trends of forecasts and actual results of pension financing

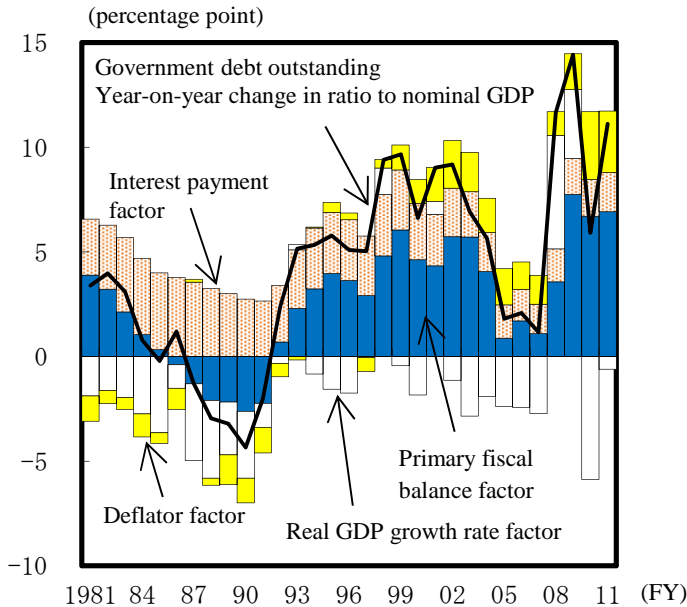
(1) Trends of pension reserves



- (Notes) 1. (Left) Compiled based on Statistics for Social Security (FY2010), and Population Projection for Japan (January 2012), National Institute of Population and Social Security Research; On Revision of Estimation of Future Expenses for Social Security (March 2012), the Ministry of Health, Labour and Welfare; the Ministry of Finance, etc.
2. (Right) Compiled based on the 2009 Actuarial Valuation of the Employees' Pension Insurance and the National Pension, and the Financial Condition of Employees' Pension Funds (FY2007 - 2011), the Ministry of Health, Labour and Welfare, etc.

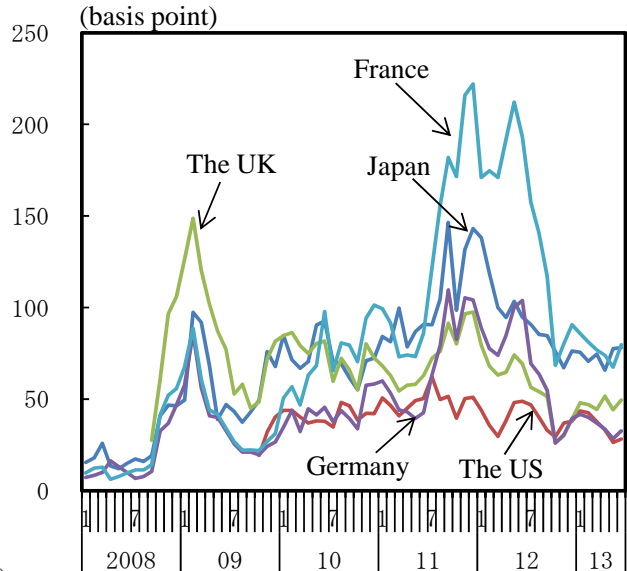
- The greatest factor that pushes up the central and local governments' outstanding debt is the deficit in the primary fiscal balance.
- At present, the confidence of the market in Japan's fiscal sustainability is stable.

Figure 1-3-9 Breakdown of central and local governments' outstanding debt



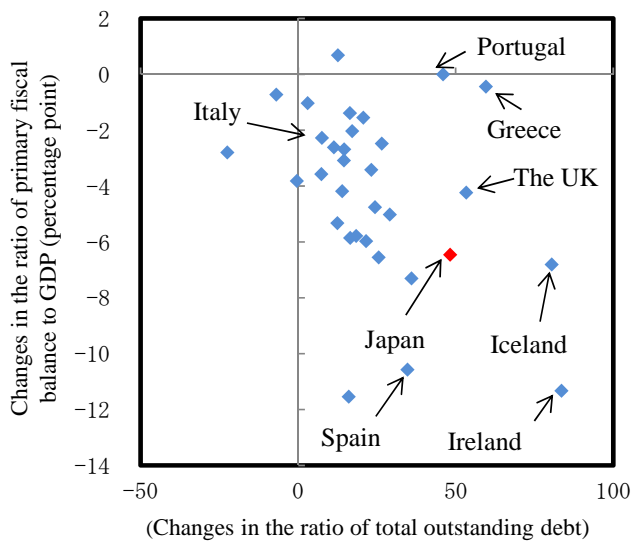
(Notes) 1. (Left) Compiled based on the System of National Accounts, the Cabinet Office, and the Ministry of Finance.  
2. (Right) Compiled based on data from Bloomberg.

Figure 1-3-10 Trends of indicators of fiscal risk (1) Trends of CDS spreads of countries



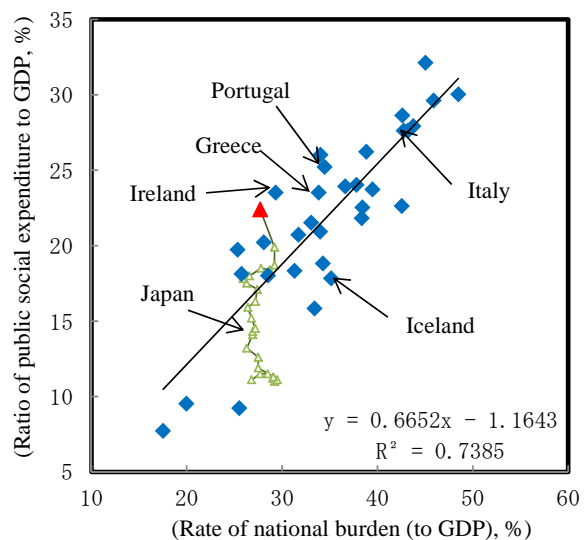
- Between 2007 and 2011, Japan's outstanding debt increased almost at the same pace as periphery countries in Europe.
- Japan kept its national burden unchanged despite increasing social security expenses.

Figure 1-3-15 (1) Primary fiscal balance of general governments, and changes in ratios of total outstanding debt to GDP (2007 - 2011)



(Notes) 1. (Left) Compiled based on OECD.Stat.  
2. (Right) Compiled based on OECD.Stat, and the Ministry of Finance.

Figure 1-3-22 (1) National burden, and public social expenditure



- OECD countries have been becoming more dependent on value-added taxes for tax revenues.
- More EU member states have raised their VAT rates for fiscal consolidation.

Figure 1-3-23 (2) Change of the tax revenue structure of the OECD as a whole

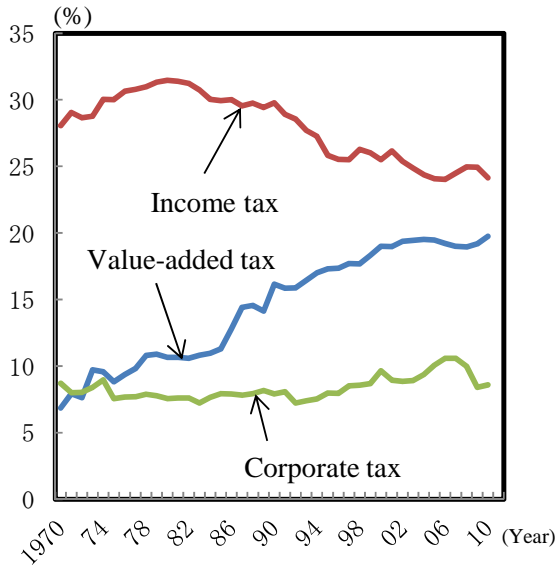
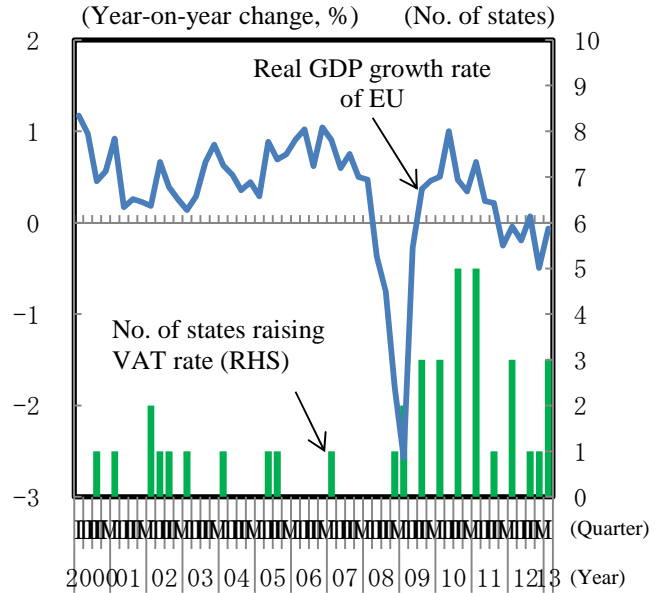


Figure 1-3-25 (1) Numbers of EU states that raised their VAT rate

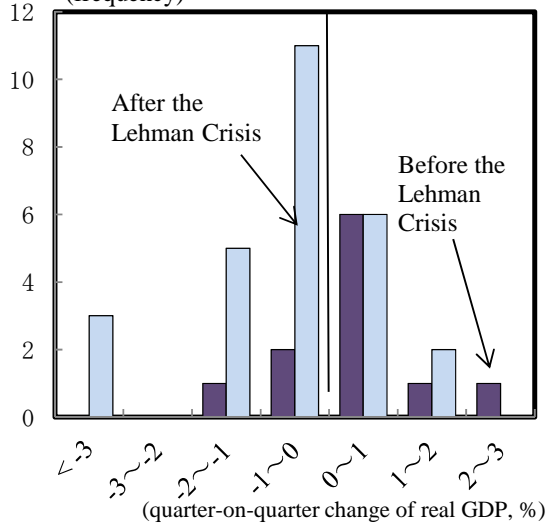


- (Notes) 1. (Left) Compiled based on OECD.Stat.  
 2. (Right) Compiled based on Eurostat and the European Commission "VAT Rates Applied in the Member States of the European Union".

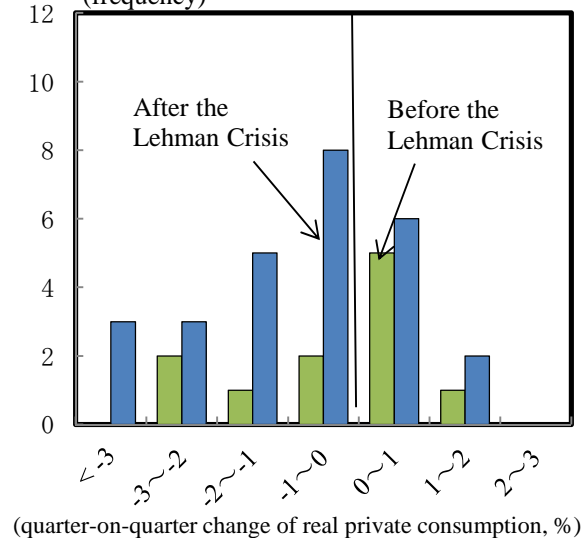
- In EU states, VAT rate hikes did not always hurt economic growth.
- Private consumption tends to see a temporary decline after a last-time rise in demand before a tax increase.

Figure 1-3-26 Increases of VAT rate in EU states, and the state of the economy

(3) GDP growth after an increase in the VAT rate (frequency)



(4) Growth of private consumption after an increase in the VAT rate (frequency)



(Note) Compiled based on Eurostat and the European Commission "VAT Rates Applied in the Member States of the European Union".