

# Japan's Macroeconomic Balance

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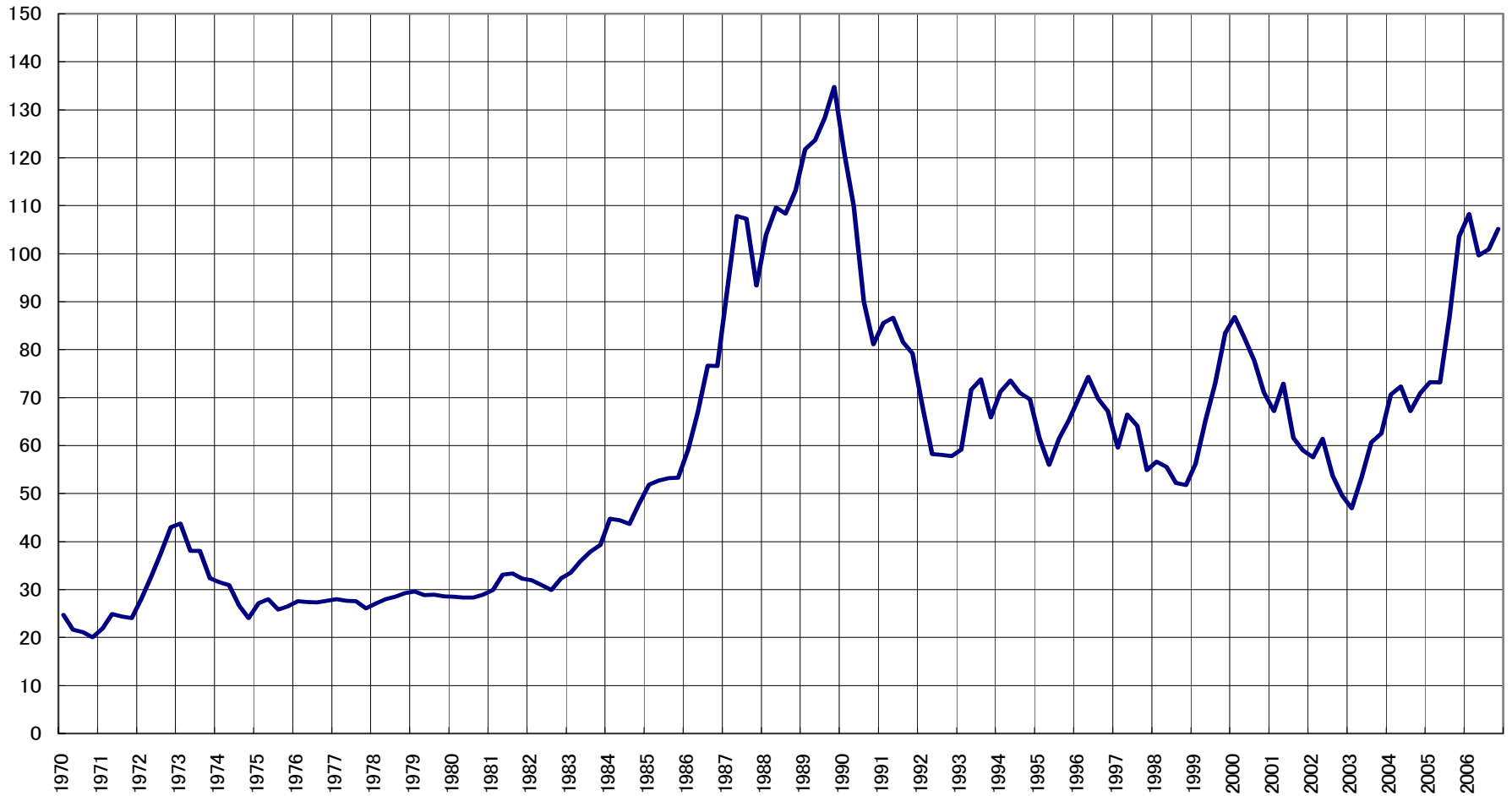
Keio University

# Stock prices have rebounded to a healthy level

Figure 1

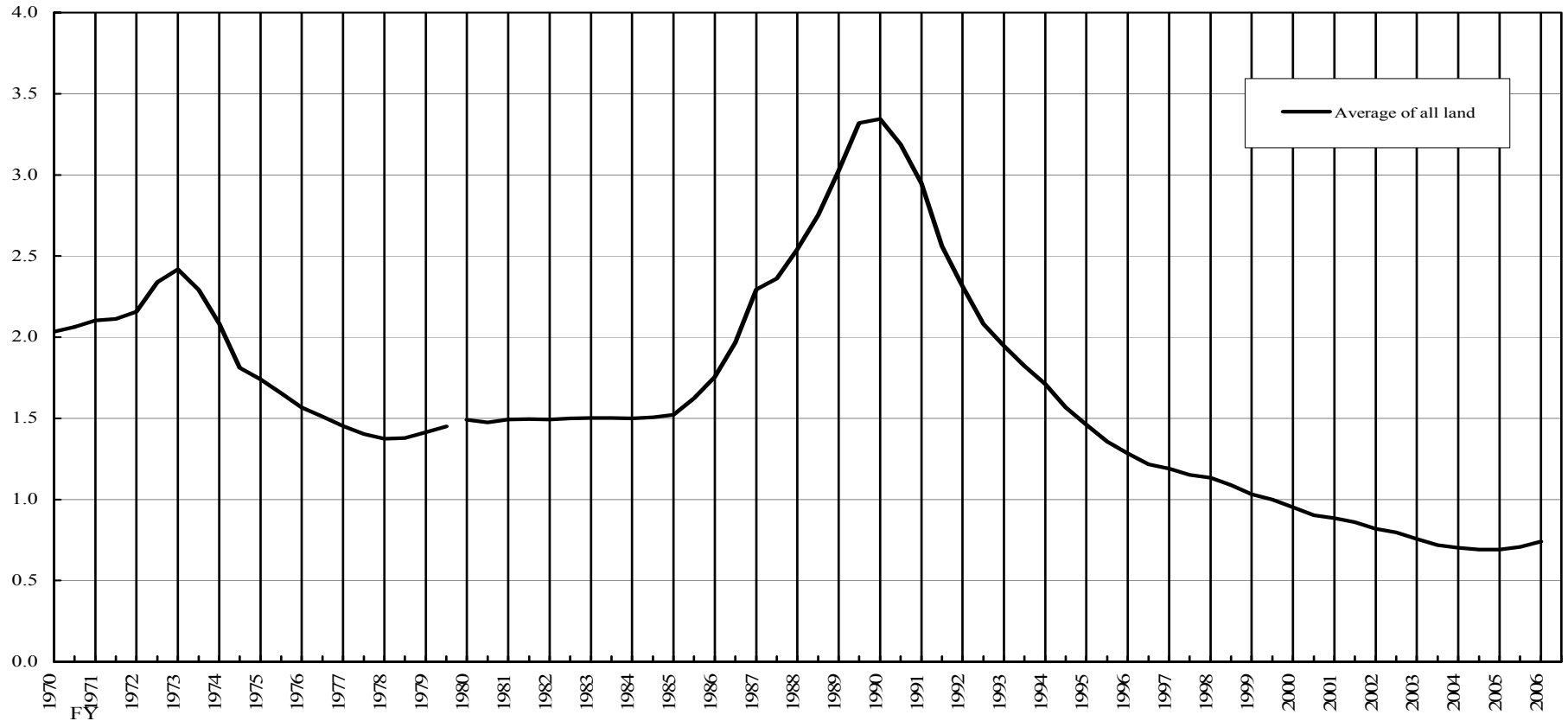
Tokyo Stock Exchange 1st Section  
Market Value GDP Ratio

Percent



Land prices are also recovering but below pre-bubble level

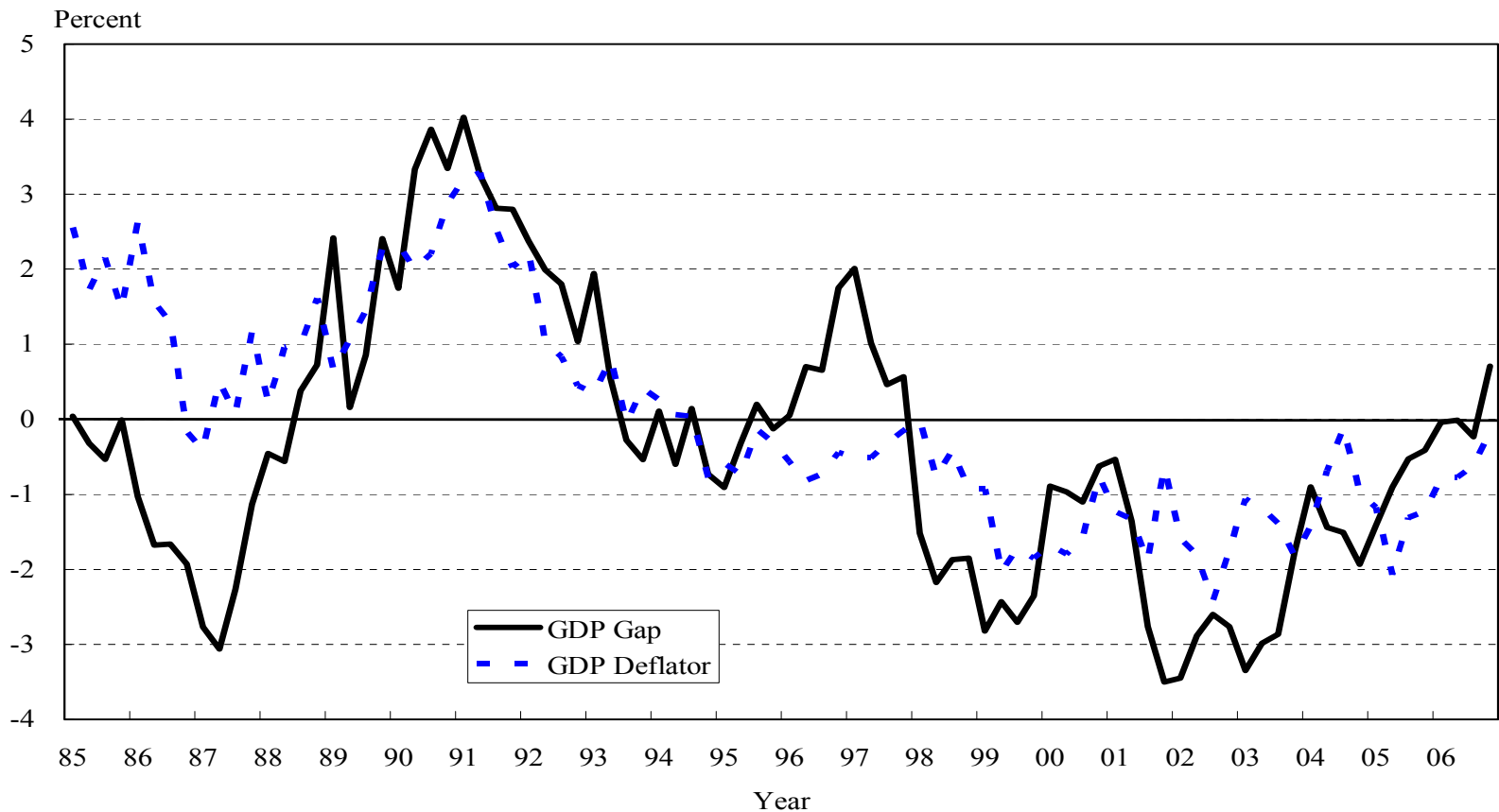
Figure 2  
**Urban Land Price-Nominal GDP Ratio**  
(Second half of FY 2000 = 1.0)



Notes: 1. Urban Land price index (6 large urban areas, second half of fiscal 1999 <end of Mar. 2000>=100) is divided by Nominal GDP index (second half of fiscal 2000=100)  
2. Data until second half of fiscal 1979 = 68SNA basis  
Data from first half of fiscal 1980 = 93SNA basis

# GDP gap may be at an inflationary level But GDP deflator is still falling

Figure 3 GDP Gap and GDP Deflator Inflation Rate

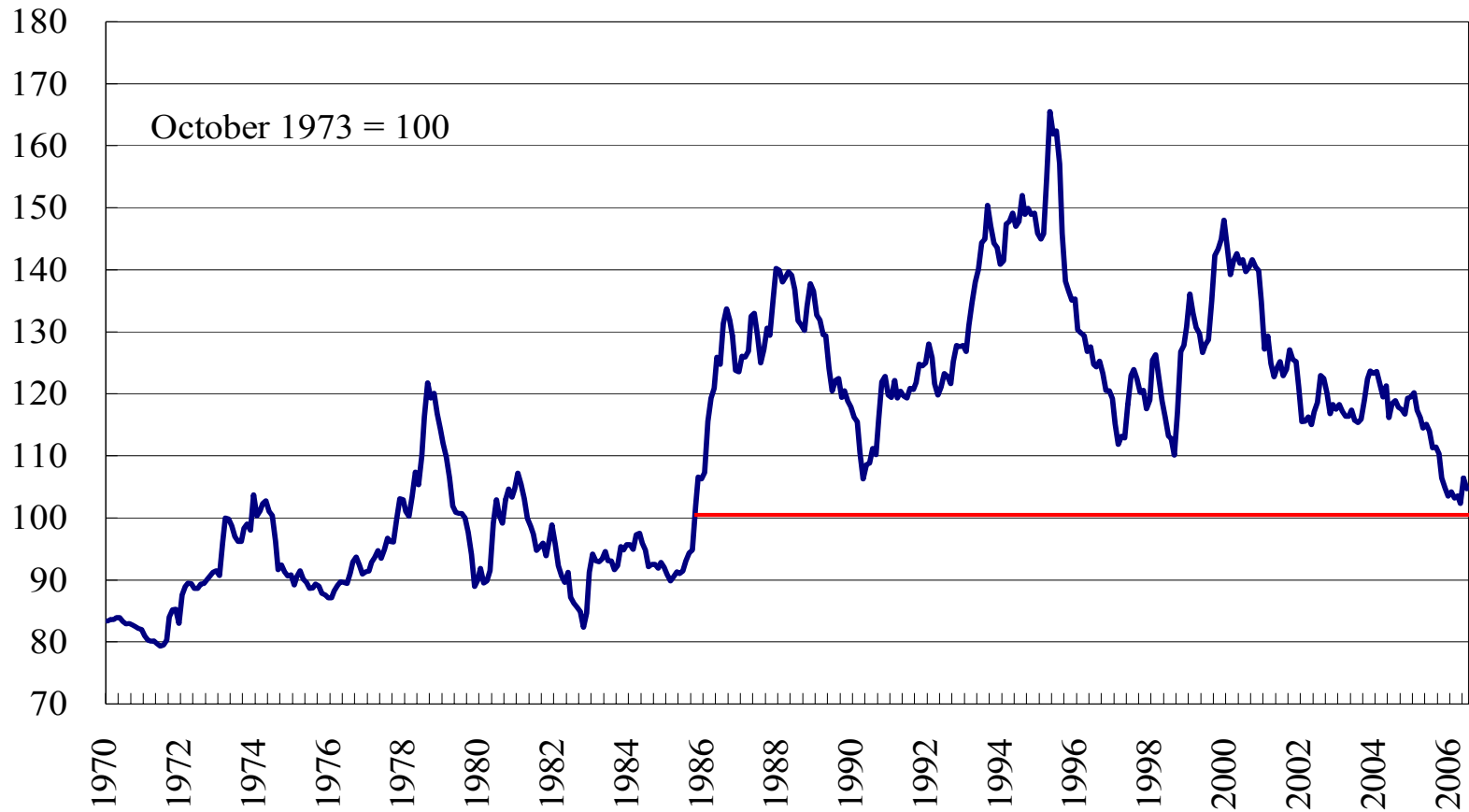


Source: Japan Center for Economic Research (2007)

Note: GDP deflator inflation rate is the annualized rate of quarterly inflation rate after three-quarter moving average.

# Yen is at the lowest level in 20 years

Figure 4 Real-Effective Exchange Rate of Yen



Source: Bank of Japan

# Reserves have been shifting away from the yen

Tabel 1

## Currency Composition of Official Reserves

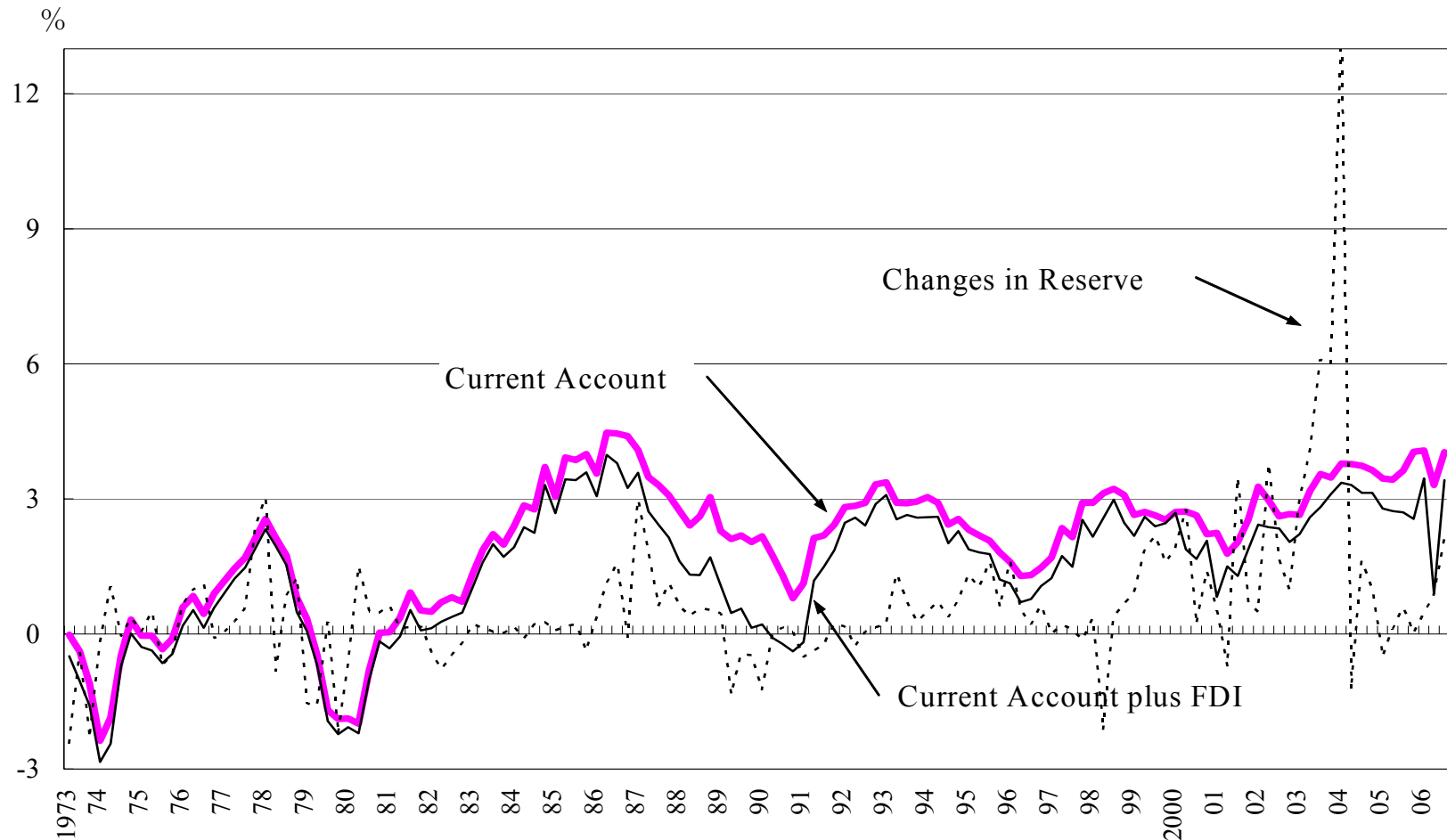
Percent, billion US dollars

| End of the Period                    | 1999  | 2000  | 2001  | 2002  | 2003  | 2004  | 2005  | 2006  |
|--------------------------------------|-------|-------|-------|-------|-------|-------|-------|-------|
| Total Reserves                       | 1,781 | 1,937 | 2,050 | 2,409 | 3,029 | 3,749 | 4,175 | 4,581 |
| Currency Composition (percent)       |       |       |       |       |       |       |       |       |
| US Dollar                            | 70.9  | 71.1  | 71.4  | 67.0  | 65.9  | 65.8  | 66.6  | 64.7  |
| UK Pound                             | 2.9   | 2.8   | 2.7   | 2.8   | 2.8   | 3.4   | 3.6   | 4.4   |
| Yen                                  | 6.4   | 6.1   | 5.0   | 4.4   | 3.9   | 3.9   | 3.7   | 3.2   |
| Swiss Franc                          | 0.2   | 0.3   | 0.3   | 0.4   | 0.2   | 0.2   | 0.1   | 0.2   |
| Euro                                 | 17.9  | 18.3  | 19.2  | 23.8  | 25.2  | 24.9  | 24.3  | 25.8  |
| Other currencies                     | 1.6   | 1.5   | 1.3   | 1.6   | 2.0   | 1.9   | 1.6   | 1.7   |
| Total                                | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| Reserces of non-disclosing countries | 405   | 423   | 486   | 616   | 808   | 1,111 | 1,358 | 1,530 |

Source: IMF Currency Composition of Official Foreign Exchange Reserves (COFER)

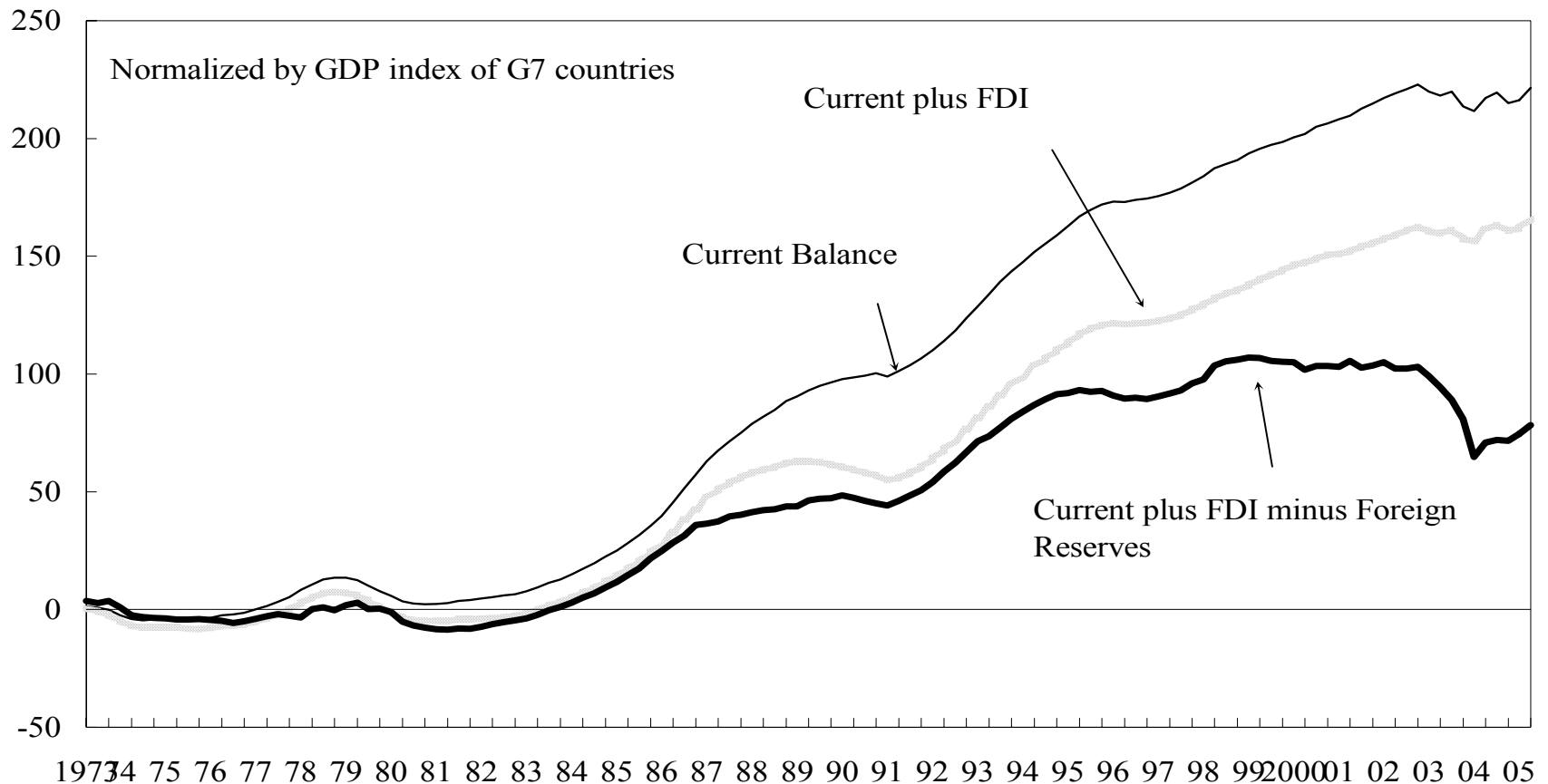
# Massive intervention in 2003-04 was much bigger than the current account surplus

Figure 5 Japan's Balance of Payments (percent of GDP)



The intervention may have reversed the upward pressure of the current account surplus on the yen

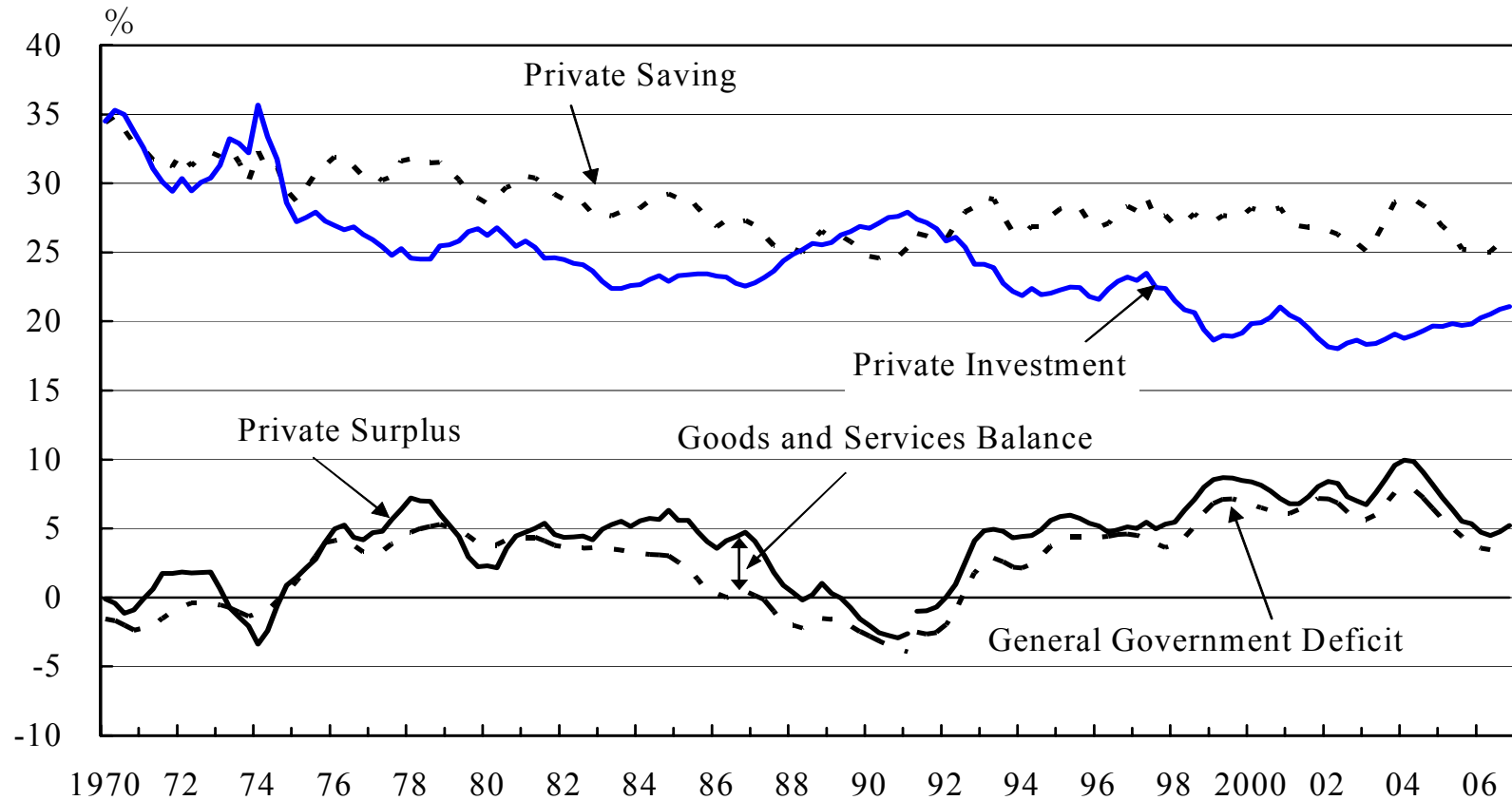
Figure 6 Japan's Accumulated Balances



Note: Chain-weighted GDP index is used to remove short-run effects of exchange rate changes.

# Cutting budget deficit may increase current account surplus Yen may face upward pressure

Figure 7 Japan's Saving-Investment Balance



# Conclusions

- The yen has been weak due to low interest rates, reserve shifts and Japan's massive intervention in 2003-04.
- This trend may change if the reserves of China and energy producing countries move to the yen.
- If yen appreciates too quickly, the Bank of Japan may not be able cut policy interest rate enough to avoid another period of deflation.