

## JAPAN

Economic growth is projected to edge up to 1.4% in 2017, aided by stronger international trade in Asia and fiscal stimulus. Although fiscal support is expected to fade in 2018, labour and capacity shortages and record-high corporate profits will support employment and business investment, keeping growth close to 1%. Headline inflation will reach 1% by end-2017, due to ongoing monetary easing.

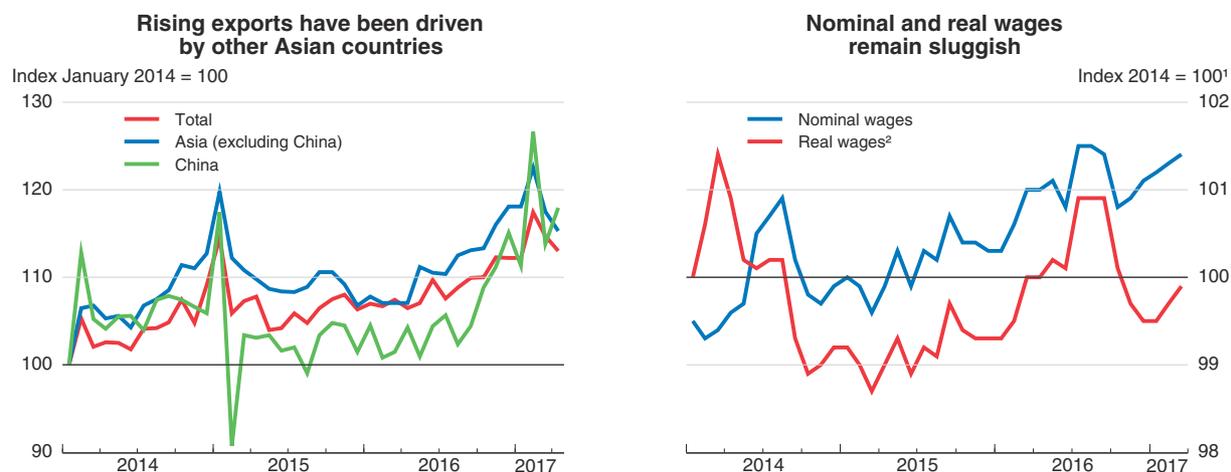
The primary deficit in 2018 is projected to remain well above the government's benchmark of 1% of GDP, leading to a further rise in the ratio of government debt to GDP. To sustain confidence in Japan's public finances, setting out and implementing a more detailed consolidation path, including gradual increases in the consumption tax rate, is a priority. Continued structural reforms to boost productivity and employment, especially of women, are important to support inclusive growth. Faster growth is essential to stopping and reversing the run-up in the public debt ratio.

Japan has become increasingly integrated in global value chains, especially in Asia. The benefits of international trade are concentrated in large firms, as few small and medium-sized enterprises export, thus contributing to the large labour productivity gap between large and small firms. Although the number of SMEs that export is rising gradually, policies to help SMEs enter international markets would support inclusive growth. Reducing the high level of support to farmers, in part by lowering trade barriers, would also deepen Japan's integration in the world economy.

### **Stronger exports and fiscal policy are supporting growth**

A rebound in international trade in Asia has boosted Japanese exports since mid-2016. Continued export momentum, combined with the implementation of four supplementary budgets introduced since early 2016, is supporting growth in 2017. In addition, business investment has strengthened in line with exports and private consumption, which

### Japan



1. Seasonally-adjusted data (three-month moving average) based on establishments with 30 or more workers.

2. Deflated by the consumer price index, excluding rent.

Source: Bank of Japan; and Ministry of Health, Labour and Welfare.

Japan: **Employment, income and inflation**

Percentage changes

	2014	2015	2016	2017	2018
Employment	0.7	0.5	1.0	0.4	-0.3
Unemployment rate <sup>1</sup>	3.6	3.4	3.1	2.8	2.7
Compensation per employee <sup>2</sup>	0.7	0.4	0.8	1.2	1.6
Unit labour cost	1.2	0.3	1.3	0.3	0.5
Household disposable income	0.3	1.2	1.7	0.9	0.9
GDP deflator	1.7	2.1	0.3	-0.4	1.0
Consumer price index <sup>3</sup>	2.8	0.8	-0.1	0.6	1.0
Core consumer price index <sup>4</sup>	2.0	1.0	0.4	0.2	1.0
Private consumption deflator	2.0	0.4	-0.4	0.4	1.0

1. As a percentage of labour force.

2. In the total economy.

3. Calculated as the sum of the seasonally adjusted quarterly indices for each year.

4. Consumer price index excluding food and energy.

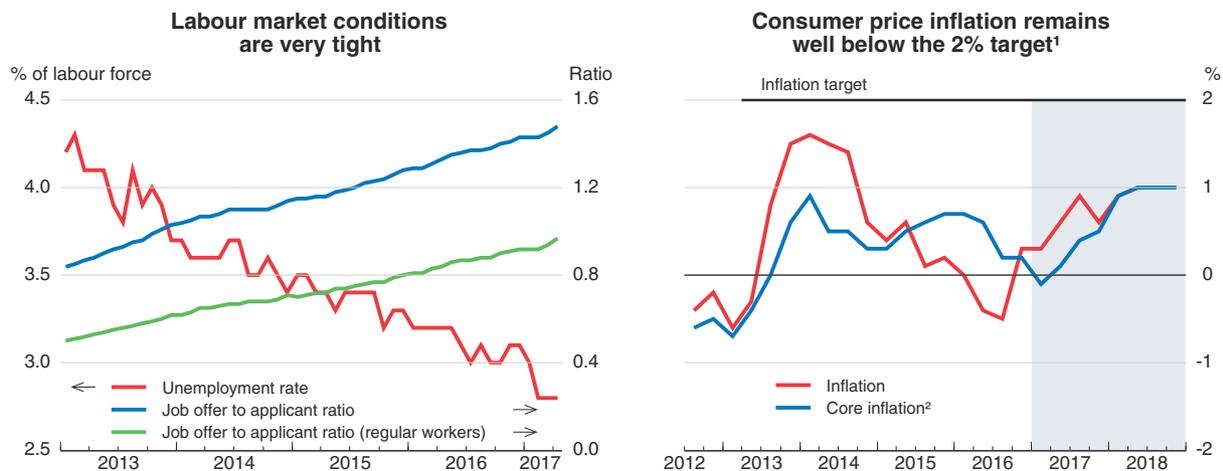
Source: OECD Economic Outlook 101 database.

StatLink  <http://dx.doi.org/10.1787/888933505220>

stagnated in the latter part of 2016, picked up in the first quarter of 2017. However, wage settlements for 2017 are sluggish, despite the tightest labour market conditions in more than 40 years and higher inflation. After becoming negative in mid-2016, headline inflation has turned positive again as a result of rising food and energy prices.

**Achieving fiscal consolidation and inclusive growth**

The fiscal policy stance in 2016-17 is expansionary, reflecting the series of fiscal packages and the decision to delay the consumption tax increase planned for April 2017.

**Japan**

1. Year-on-year percentage change, excluding the April 2014 tax increase, which added 2 percentage points to inflation in FY 2014 according to estimates by the Bank of Japan and the Cabinet Office.

2. OECD measure, which excludes food and energy.

Source: Ministry of Internal Affairs and Communications; Ministry of Health, Labour and Welfare; OECD Economic Outlook 101; Bank of Japan; and OECD calculations.

StatLink  <http://dx.doi.org/10.1787/888933503396>

Japan: **Financial indicators**

	2014	2015	2016	2017	2018
Household saving ratio, net <sup>1</sup>	-0.4	0.7	2.4	2.0	1.4
General government financial balance <sup>2</sup>	-5.4	-3.5	-4.6	-5.0	-4.4
General government gross debt <sup>2</sup>	214.6	219.3	222.2	225.9	227.9
General government net debt <sup>2</sup>	115.0	122.5	125.5	129.2	131.1
Current account balance <sup>2</sup>	0.8	3.1	3.7	3.7	4.1
Short-term interest rate <sup>3</sup>	0.1	0.1	0.0	0.0	0.0
Long-term interest rate <sup>4</sup>	0.6	0.4	0.0	0.0	0.0

1. As a percentage of disposable income.

2. As a percentage of GDP.

3. 3-month interbank rate.

4. 10-year government bonds.

Source: OECD Economic Outlook 101 database.

StatLink  <http://dx.doi.org/10.1787/888933505239>

The primary deficit is projected to decline in 2018 as the impact of the supplementary budgets wanes. Nevertheless, the government projects a primary deficit (central and local governments) of 2.4% of GDP in FY 2018, well above its 1% benchmark. Consequently, the long-standing target of a primary surplus by FY 2020 appears very difficult to achieve, even with robust output growth.

With government gross debt surpassing 220% of GDP, the highest level ever recorded in the OECD area, a comprehensive fiscal plan is needed to maintain confidence in Japan's

Japan: **Demand and output**

	2015	2016	2017	2018	Fourth quarter		
					2016	2017	2018
	Current prices YEN trillion				Percentage changes from previous year, volume (2011 prices)		
<b>GDP at market prices</b>	530.0	1.0	1.4	1.0	1.7	1.3	1.0
Private consumption	300.1	0.4	0.9	0.6	0.9	0.9	0.4
Government consumption	105.3	1.5	0.3	0.1	0.6	0.5	0.2
Gross fixed investment	124.2	0.9	2.1	1.5	2.1	2.2	0.9
Public <sup>1</sup>	27.0	-3.0	0.1	-3.0	-3.8	4.2	-6.3
Residential	15.8	5.6	3.8	2.0	7.5	2.1	2.1
Non-residential	81.3	1.3	2.4	2.7	2.9	1.6	2.8
Final domestic demand	529.6	0.7	1.0	0.7	1.1	1.1	0.5
Stockbuilding <sup>2</sup>	2.5	-0.3	-0.2	0.0			
Total domestic demand	532.2	0.4	0.9	0.7	0.5	1.2	0.5
Exports of goods and services	93.6	1.2	6.4	3.4	4.4	4.0	4.1
Imports of goods and services	95.8	-2.3	3.2	1.9	-2.0	3.7	1.5
Net exports <sup>2</sup>	-2.2	0.6	0.5	0.3			

Note: Detailed quarterly projections are reported for the major seven countries, the euro area and the total OECD in the Statistical Annex.

1. Including public corporations.

2. Contributions to changes in real GDP, actual amount in the first column.

Source: OECD Economic Outlook 101 database.

StatLink  <http://dx.doi.org/10.1787/888933505239>

Japan: **External indicators**

	2014	2015	2016	2017	2018
	USD billion				
Goods and services exports	851.9	773.4	798.5	848	887
Goods and services imports	972.8	791.8	750.4	814	840
Foreign balance	- 120.8	- 18.4	48.1	34	47
Invisibles, net	157.6	152.3	135.0	143	157
Current account balance	36.8	133.9	183.1	177	204
	Percentage changes				
Goods and services export volumes	9.3	2.9	1.2	6.4	3.4
Goods and services import volumes	8.3	0.8	- 2.3	3.2	1.9
Export performance <sup>1</sup>	5.1	0.8	- 1.7	0.9	- 0.6
Terms of trade	- 0.5	9.0	5.2	- 5.0	0.0

1. Ratio between export volume and export market of total goods and services.

Source: OECD Economic Outlook 101 database.

StatLink  <http://dx.doi.org/10.1787/888933505277>

fiscal sustainability. Such a plan should include detailed and concrete measures to boost revenues through gradual increases in the consumption tax, broadening the personal and corporate income tax bases and raising environmental taxes. In addition, raising taxes on capital income and broadening the inheritance tax base would improve inter-generational fairness, which is among the worst in OECD countries. A fiscal plan should also include reforms to contain the growth of social spending by shortening hospital stays, increasing the use of generic drugs, reducing long-term care insurance coverage for those with less severe needs, fully applying macroeconomic indexation to pension benefits and raising the pension eligibility age. There is also scope for fiscal consolidation at the local government level, given the wide variation between prefectures in per capita public spending.

Labour market reform is needed to reduce poverty, which is driven by the large wage gap between regular and non-regular workers, who account for 38% of employees. Non-regular employment is concentrated among women, contributing to a gender wage gap of 27%, the third highest in the OECD area. Breaking down dualism requires a comprehensive approach that includes relaxing employment protection for regular workers and an expansion of social insurance coverage and training for non-regular workers. The government initiative for “equal pay for equal work” could help reduce wage gaps and reduce firms' incentives to hire non-regular workers. In addition, removing obstacles to the employment of women, in part by improving the availability of affordable childcare and improving work-life balance, would help mitigate the decline in the working-age population and promote inclusive growth.

### **Achieving the inflation target is the top priority**

Faster nominal GDP growth is also essential for fiscal sustainability. In September 2016, the Bank of Japan announced a new policy framework based on “yield curve control”, which is keeping the yield on ten-year government bonds close to zero for the time being. In addition, the central bank made an “inflation-overshooting commitment” to continue expanding the monetary base until CPI inflation (excluding fresh food) exceeds the 2% target and stays above it in a stable manner. Such a commitment should help lift inflation

expectations, which are currently well below the target. The Bank of Japan's current very supportive monetary stance should continue until the inflation target has been sustainably achieved.

### ***Growth momentum will continue through 2018***

Annual GDP growth is projected to be 1.4% in 2017, slowing to 1.0% in 2018 as fiscal stimulus wanes and the downward trend in public investment resumes despite construction related to the 2020 Olympics. Even though real disposable income growth is expected to slow, a reversal of the rise in the household saving rate as consumer confidence strengthens is projected to sustain private consumption. Export growth is expected to remain robust, given the rebound in international trade, supporting investment by the corporate sector, which is enjoying record high profits.

Downside risks to the outlook include heightened geo-political tensions in Northeast Asia and trade protectionism. On the domestic side, Japan's unprecedentedly high level of public debt is a key risk. Unless a more detailed and concrete strategy to stabilise the debt ratio is implemented, Japan could face a loss of confidence in its fiscal sustainability, which in turn could destabilise the financial sector and the real economy, with large spillovers to the world economy. Upside risks include faster-than-projected world trade growth, which would boost exports and business investment, and larger wage gains as firms face increasing labour shortages.