Roundtable with Nobuyasu Atago, Kyohei Morita & Naoki Murakami

Japanese Economic Outlook for the Year of the Olympic & Paralympic Games Tokyo 2020 – Searching for Stable Growth Beyond

By *Japan SPOTLIGHT*

Volatility and uncertainty are keywords in describing the world economy today. Tensions from the US-China tech cold war as well as geopolitical risks among emerging economies are starting to overshadow global economic growth. The International Monetary Fund (IMF) revised its forecast for world economic growth for 2019 downward to 3.0% in October from April's forecast of 3.3% and also to 3.4% for 2020 from the forecast of 3.6%.

Against the background of a slowing world economy, what could happen to the Japanese economy in 2020 and beyond? How will the Tokyo Olympics and Paralympics in 2020 affect it? Will the Japanese economy also slow down significantly after these sports events due to a possibly large decline in domestic demand that has increased in response to investment in the Games?

We set up a roundtable discussion on this subject with three distinguished economists in Japan: Nobuyasu Atago, chief economist for Global Monetary Research at Okasan Securities Co., Ltd.; Kyohei Morita, managing director and chief economist Japan of Crédit Agricole Securities Asia B.V., Tokyo Branch; and Naoki Murakami, senior economist of the Invest Division, Research Group at Asset Management One Co., Ltd.

(Roundtable on Oct. 23, 2019)

Participants

Nobuyasu Atago

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Forecasts for the Japanese Economy 2020

Atago: On the question of the impact of the 2% consumption tax hike on Oct. 1, 2019, thanks to the government's preparatory measures to mitigate its negative impact, last-minute demand in 2019 has not been so strong as in 2014, the last time the tax was raised. So I think stagnation of consumption will not be caused by a decline in real income due to this tax hike. According to the latest data, the daily sales amount of non-durable goods decreased in the first half of October 2019, which is certainly a reactionary decrease after the tax hike, but total sales until Oct. 21 were almost the same as during the same period in 2018.

We need to see the data yet to be released on durable goods such as automobiles or home electric equipment to find out whether we have a reactionary decline in consumption or not. But last-minute demand for durable goods was also seen as smaller than before, so I guess a reactionary decline in consumption of these goods would be smaller. In this light, I think we will not see a recession in 2020 due to the consumption tax hike in 2019. In 2020, I think employment and income will be stable and the baseline of consumption will be steady.

The next question is if the economy will see a reactionary decline of demand after the Tokyo Olympics and Paralympics and how great a decline we should assume. I think the biggest possible decline would be a reactionary one in inbound tourists. As we learned from the Rugby World Cup 2019 in Japan, we can expect a significant increase of tourists from abroad, in particular from Asia, for the Tokyo Olympics and Paralympics. Consumption by these tourists will reach almost 8 trillion yen in 2020. With this positive impact considered as exports, Japanese GDP growth in 2020 would be enhanced. However, after the Olympics and Paralympics end in August 2020, a reactionary decline in such inbound tourists' consumption will be inevitable, at least temporarily. I think this will not be so significant and overall the Japanese economy could maintain its growth potential in 2020, at around a little lower than 0.5%.

JS: How about the impact of declining exports due to growing protectionism in the world?

Atago: Certainly, there will be a negative impact, as global trade growth has been slowing since 2018. But it will be necessary to discover whether this is caused by trade friction or the global economic slowdown. Looking at the latest situation, Japan's real exports during the July-September term in 2019 increased and also Chinese manufacturing exports have started to increase at this moment. In this light, I believe the global economy's slowdown will have the critical impact on trade rather than the US-China trade confrontation. I assume the global economy will be in the trend of cyclical recovery in 2020, though it may be rather slow and weak due to the US-China conflict. Generally, the baseline case for the Japanese economy will be a stable recovery as well.

JS: So neither monetary nor fiscal policies will be expected to play a positive role in 2020?

Atago: Monetary policy in Japan would have very little room to work. We are skeptical about its net impact in terms of its costs and benefits. I think in accordance with the global trend, the weight of macro policy will inevitably move from monetary policy to fiscal policy. As we have no option but depending on fiscal policy, the focus of monetary policy must be how to maintain the low interest rate to avoid a significant increase in interest payments by the government.

Murakami: I think towards 2020 the Japanese economy will be in recession. There will be a negative impact from the consumption tax hike. The increased tax burden for households is assumed to amount to 2-3 trillion yen, which would drag on consumption growth and thus overall Japanese economic growth in 2020 will be nearly zero. We are not so pessimistic about the global economy and we will not see the US economy slow down. However, we assume US economic growth to be 1.4% and Chinese economic growth to be 5.7%, neither of which is high. The cyclical slowdown of the global economy started at the beginning of 2018 will continue in 2020 and will not pick up. With this risk of a stagnant global economy and the negative impact of the consumption tax hike, we assume the Japanese economy will be on a zero growth track.

On the question of the economic impact of the Tokyo Olympics and Paralympics, its direct enhancement impact would be around 1-2 trillion yen, mainly consisting of infrastructure investment, which is very small. There would be indirect effects and effects pushing up real estate prices as well as asset prices in the long run. Assuming that the direct impact is this small, the reactionary decline after the Olympics and Paralympics would also be very limited, at most 0.1% in terms of the GDP growth rate.

On the US economy, there will be a positive impact from lower interest rates finally, and with fiscal stimulus as well a recession can be avoided. However, the structural adjustment of the manufacturing industry will most likely affect the labor market and non-manufacturing sector. Decoupling of manufacturing and non-manufacturing in terms of business performance will lead to a slowdown in the overall US economy, with the non-manufacturing sector's worsening performance. So I think there will be little possibility of tariff hikes being avoided. The tariff protection policy in the US to contain China will continue in 2020. So the manufacturing sector's structural adjustment will continue, triggered by the trade war, and its negative impact will gradually affect US domestic demand.

Private investment in Japan is even now restrictive and slowing down, and in particular investment by global companies in Japan will peak and possibly start declining. There will be much room for fiscal and monetary policies to support economic growth. But Japanese fiscal policy has already turned to tightening with the consumption tax hike, so it will be rather difficult to change the policy direction. Japan is the only country in the world practicing a fiscal tightening policy, which investors view with severely critical eyes. For as long as the Ministry of Finance continues this tightening policy, business will continue to be stagnant in our view.

This will probably start to change in 2020 when most likely the Japanese economy will fall into recession and the government will find it wrong to continue with its tightening fiscal policy.

JS: With the limited scope and effects of fiscal and monetary policies today, if the economy enters into a recession it will be a serious one.

Murakami: No, I do not think so. There will be much room for effective and decisive fiscal and monetary policies, like the "helicopter money" policy in Japan.

Morita: The GDP growth rate of the Japanese economy was 0.8% in real terms in 2018 and we estimated the growth in 2019 to be 1.1% and in 2020 to be 0.9%. We do not see a recession in 2020 but a slight decline in the growth rate. I think 0.9% would be close to the Japanese economy's growth potential. I believe, however, that business concerns will shift from external demand to domestic demand. On the question of the consumption tax hike's impact on the economy, front-loading of demand in consumption of non-durable goods was observed, but front-loading of spending on durable goods will be much more important in terms of the impact on the business cycles. In our observation, such front-loading of demand for durable goods was smaller than in the last consumption tax hike in 2014. So I believe that consumption growth will not be strongly affected by a reactionary consumption decline after the tax hike but affected by the possible decline of real income due to the upward shift of the CPI arising from the tax hike. In this regard, we need to note that wage growth is now slowing. In real terms, it actually shows negative growth over the previous year, warranting more attention to real income rather than just a post-VAT hike reactionary decline in demand. I think there is a downward risk of consumption growth in this light.

In June 2020, the scheme of rewarding purchasers at small and medium-sized shops with points up to the maximum of 5% of the amounts paid to mitigate the negative impact of the consumption tax hike will finish. I think there will be a reactionary decline in consumption growth in response to this. In this sense, consumption will be more of a concern than exports in looking at the Japanese economy in 2020.

Concerning the Olympics and Paralympics' positive impact on growth of the economy, it seems to have been exhausted already in 2016 when it pushed up investment in construction of the facilities for the Games and their related infrastructure. Thus in 2020, whether there will be a further negative effect on growth of the economy will depend highly on inbound tourists' consumption and domestic consumption in the post-Olympic period. I believe inbound tourists' consumption will continue to grow.

On the question of the US-China trade war and its possible impact on Japan's exports, there must be both a cyclical aspect and a structural aspect. On the cyclical aspect, I think the worst will be over in the next six months. We are interested in the Taiwanese manufacturing PMI (Purchasing Managers' Index) which serves as a leading indicator for global semiconductors shipments. Given the most recent bottoming out of the Taiwanese manufacturing PMI, we believe the worst in Japanese exports from the cyclical perspective will be over in the near future while the structural impact of the US-China trade war will remain, as their hegemonic confrontation will continue in the long term no matter which party, Republicans or Democrats, gains power in the US presidential election.

However, with a possible decline in domestic consumption growth, the Japanese economy will not surpass potential growth of around 1% in 2020. As a policy response to this situation, I think additional easing of monetary policy still remains technically possible in the form of a further deepening of the negative policy rate and an increase in purchases of ETFs (Exchange Traded Funds). Obviously, however, its impact on the economy will be quite limited. Fiscal policy, on the other hand, would have a greater impact in Japan. At this moment, since there is a labor shortage in the Japanese market, the government should spend money on labor-saving areas such as social welfare and other public services rather than public infrastructure investment. Such spending on public services would raise GDP growth to some extent, but not so significantly. So I think the macro policies will not change the baseline economic outlook for 2020.

JS: With rising uncertainty due to all kinds of geopolitical risks, will private firms curb their investment in production equipment and facilities?

Morita: Yes, that is possible. Business firms in Japan are becoming prudent in capital expenditure, according to the BOJ's latest Tankan survey and machinery orders statistics. Domestic demand will deserve closer attention in this regard in 2020.

Additional Q&A on Short-Term Forecasts for Japanese Economy in 2020

Atago: I think there will be negative growth in private investment against the background of rising uncertainty. My predicted Japanese economic growth in 2020 is slightly lower than 0.8%, similar to Dr. Morita's prediction. Fiscal policy will certainly have a positive effect and there must be necessary infrastructure investment over the long term, including for disaster recovery. Japanese growth potential will be a little lower than 0.5% and economic forecasts for 2020 would be around that trend, more or less.

Murakami: Stimulating fiscal policy in the framework of current monetary policy would inevitably lead to increasing the issuance of national bonds to be purchased by the BOJ and thus the policy must have a positive effect on the economy. This would be the best opportunity for the government to procure money at the cheapest cost for public expenditure. It is true that the construction sector has a limited labor force and public investment would have only a limited effect in this regard. Tax cuts would be another option to be considered. The government should change its policy direction to a stimulatory one as quickly as possible. It may not have much time left, as the global economy will slow down soon.

Morita: I think the policy pillar should and will shift to fiscal policy. An expansionary fiscal policy can go together with the current easy monetary policy to stimulate economic growth in Japan. It is a matter of politics whether to do it or not. We assume in our forecast that fiscal policy for around 1% of annual GDP will be implemented.

JS: Is the current economic situation in Japan consistent with what Modern Monetary Policy (MMT) assumes to justify a fiscal stimulus?

Morita: We do not have to refer to MMT to justify a certain degree of the policy mix of stimulatory fiscal policy and monetary policy in the same direction. It is a typical Keynesian policy.

JS: Do you think competitive exchange rate devaluation as a beggar-thy-neighbor policy will happen, as President Donald Trump has criticized Chinese exchange rate policy as well? What is your estimate of exchange rates?

Atago: The dollar-yen rate has been very stable since President Trump's administration began in 2017. No matter what policy President Trump may take, the US-Japan interest rate differential largely determines the dollar-yen rate. As long as it continues, the yen will not be overvalued against the dollar for the next couple of years, though long-term US interest rates will be lowered as part of the global economic trend. In the long run, thus, the dollar-yen rate will have a different story.

Murakami: The US economy is not moving into recession but will slow down in 2020. The Federal Reserve Board's policy of keeping interest rates low will continue until the middle of 2020. I think the yen will appreciate in reflecting this. But most likely, we can avoid a yen-dollar rate of less than 100 yen. I think the exchange rate, having been so stable these three years, will not fluctuate as much as before, unless there is any political factor influencing it. In my view, until 2012 the BOJ had maintained a monetary policy accepting deflation, and then with strong deflationary expectations building in the economy, the yen tended to appreciate. After the administration of Prime Minister Shinzo Abe started in 2012, the BOJ finally adopted the global standard monetary policy which would not accept deflation. With this basic policy stance, even though the US Fed may lower its interest rates, the BOJ will keep or even strengthen its loose monetary policy. With such expectations of recent BOJ policy, a significant yen appreciation can be avoided. This could, of course, change with a change in BOJ policy – which could happen due to replacement of BOJ policy board members.

Morita: We assume the dollar-yen rate will remain unchanged towards the end of 2019. We assume it will be around 100 yen toward the end of 2020, an appreciation of the yen. But as the BOJ cannot lower interest rates as much as the Fed given that interest rates in Japan are around or below zero, the remaining rate differential between the two even if both do lower interest rates competitively will be noted by the market and this would overvalue the yen to a certain extent. Looking at current capital inflows and outflows, short-term capital comes to Japan from overseas and long-term money goes overseas from Japan. There will not be a high possibility that capital inflows and outflows will change the value of the yen drastically, in my view. The volatility of the yen will stay small.

Outlook for the Japanese Economy post-Olympics & Beyond 2020

Morita: The key issue for the stable growth of the Japanese economy beyond 2020 will be how the legacy effects of the Tokyo Olympics and Paralympics work and whether they exceed the reactionary decline in demand. The legacy effects will concentrate on personal consumption and inbound tourism, i.e. exports of services. Since we do not have a significantly massive infrastructure invested for the purpose of the Games, a reactionary decline in demand will not be large, as long as the increasing trend of inbound tourism is maintained. Data suggest the levels of investment for construction of Olympic-related infrastructure have already peaked in 2016 or 2017. I think there has been a gradual reactionary decline in demand for investment in infrastructure construction since then. So I do not think we will additionally face any significant reactionary decline in demand after 2020.

We have a concern about stagnant consumption by young people. Their propensity to consume has declined over the past years. On the other hand, consumption of services on the whole has been increasing, as aged retired people are increasing and spend more time in consuming services. But young people's consumption of durable goods remains low. This is our major concern about the future growth of the Japanese economy.

As consumption growth will be service-oriented, private investment for machinery and related facilities will not grow much in the long run. AI will play a key role in production in those circumstances. To encourage firms to use AI in production activity, we will need to raise the minimum wage. Doing so would force Japanese firms suffering from the labor shortage to give up depending on human labor and replace it with AI. I believe this is an effective policy to resolve, at least partially, the labor shortage question and also encourage Japanese business firms to utilize more AI and promote R&D for labor saving technology. Digital software including AI must be the key to success for the Japanese economy in the long term. R&D investment will play a more pivotal role in raising a firm's competitiveness.

Murakami: I agree with Dr. Morita in saying that Olympic-related investment demand has already peaked out and any further reactionary decline in demand beyond 2020 will be very small. What is more crucial for the Japanese economy after 2020 is whether the government can implement a robust macroeconomic stabilization policy or not. This policy could offset a possible secondary deflationary impact from a reactionary decline in demand, such as a land price decline.

The Abe administration's tightening of fiscal policy led by a consumption tax hike encourages a deflationary mindset among young people in Japan on low incomes, in particular as the consumption tax is of a regressive nature. With only loose monetary policy, we will not be able to offset its deflationary impact. I believe that with a continuous anti-deflationary monetary policy and expansionary fiscal policy to raise the wages of low-income workers, consumption will grow steadily. It is only Japan that hesitates to use an expansionary fiscal policy among the major nations in the world, even though the utility and need for expansionary fiscal policies is a global consensus. Without it, we cannot achieve sustainable growth over the long term. The Abe administration should change its fiscal policy from tightening to expansionary, while maintaining a loose monetary policy. The fiscal deficit must be reduced by high economic growth, since Japan's budgetary balance has been governed by tax revenues. Deflation and low growth must be the primary causes of the fiscal deficit. By reversing the policy of tightening, Japanese public finances will be stabilized and well prepared for social welfare expansion for the interest of the aging society.

Atago: I agree with Dr. Morita and Mr. Murakami about a possible reactionary decline in demand after the Olympics and Paralympics. I think the key to stopping such a decline, even if it is a very minor one, is to minimize any decline in inbound tourism. It will be necessary for Japan to keep attracting tourists from all over the world to repeatedly visit Japan, just as China has been successful in attracting tourists after the Beijing Olympics and Paralympics. It would be a good idea to allocate more fiscal expenditure and investment for infrastructure in the post-Olympic period to equalize the total demand between before and after the Games.

Wage increases could trigger business expansion, but the rate of wage increases in Japan has been much lower than in any other developed country. Raising the minimum wage in Japan may be a political challenge, since the ruling Liberal Democratic Party has been supported by so many SMEs that are reluctant to do so. Under those circumstances, I guess consumption growth may not be significantly enhanced, though it continues to be steady.

As for the role of fiscal policy, to stabilize overall demand we would need to take advantage of fiscal and monetary policy as efficiently as possible. I think the fiscal limit in Japan is rather higher than in any other country, so there must be some room for fiscal expansion. There needs to be public investment in infrastructure for disaster recovery or in increasing inbound tourism. The government will need to pursue efficient use of fiscal policy over the long term. For example, it would be better to encourage consumption by fiscal stimulus, including income tax cuts, rather than constructing infrastructure with low productivity.

Additional Q&A on Outlook for the Japanese Economy Beyond 2020

JS: Raising the minimum wage is a good policy tool for reducing income inequality, but it could increase unemployment among young males.

Morita: The minimum wage should be set by a nation's own labor market regulations reflecting each nation's economic background. Therefore, simple direct international comparisons of minimum wages are meaningless. It is often said that the Japanese minimum wage is low among developed nations, but it does not make much sense, considering the implied "price" of job protection offered to employees in Japan. However, it is true that the Japanese labor market is rather exclusive of "outsiders" seeking to enter it. Raising the minimum wage could continue to benefit only "insiders" who are already working in this labor market and exclude young people trying to enter it. In this light, it will be necessary to lessen the distinction between "insiders" and "outsiders" by raising labor mobility. As I have said, raising the minimum wage in Japan should mainly encourage Japanese companies to reduce labor dependence and promote R&D expenditure, whose growth is much smaller in Japan than in the United States. I believe this would help mitigate the labor shortage, and if this ultimately leads to a rise in labor productivity, then wage increases would be more likely.

Murakami: We are now emerging from deflation and employees' salaries are also increasing. With a steady increase of nominal GDP or nominal employees' income, the minimum wage must naturally increase as well. In this regard, with an appropriate stimulating macro policy, the minimum wage will increase naturally. Direct government intervention in the labor market to raise the minimum wage could reduce employment. I do not think that is a good option. I think an increase in employment or a rise in the wages of low-skilled labor leading to a reduction in the income gap, and a rise in the minimum wage achieved by a consistent macroeconomic stabilization policy, should be highlighted politically.

Atago: Raising the minimum wage and raising labor mobility are not much welcomed politically. It is true that the best scenario would be a natural increase in wages achieved by continuous sustainable economic growth and a resulting tighter labor market. My impression is that wages in Japan will not increase rapidly as its growth potential will not increase much either. We need to look at wages from a long-term perspective. Wage increases or inflation rates can be fixed only in the global context, as we are in an open economy and international discussions among central banks and others will influence them. Japanese growth potential today is at maximum 1%, so it is important for us to do our best within this limit to promote structural economic reform.

JS: Inclusive growth is now an important policy goal for many nations. In Japan today, the number of people suffering from extreme poverty is increasing. In implementing a stimulatory fiscal policy, we would need to think about its effectiveness. Would raising the income of these extremely poor people be an effective fiscal policy in this regard?

Morita: Yes, it is a big issue. Income inequality creates political populists and destabilizes politics and society and thus our attention should not be limited to economic issues but include political and social issues. However, I think the income gap itself is inevitable to an extent in an aged society. Even if there are no significant income differences among people at the starting point in life, as time goes by, such differences expand significantly. I think we need to correct the inter-generational gap. We need a system to identify correctly the real weaknesses in the economy, rather than automatically assuming that the aged are the weak ones. The government should make better use of AI or big data to perceive who is really weak in the economy.

Another way to correct the inter-generational gap is to change the electoral system. A generational constituency is needed in addition to regional constituencies. This is how we can make it possible that some politicians would represent a certain generation's interest. We need politicians motivated to equalize the inter-generational gap.

Murakami: I think longtime continuing deflation is a big issue in talking about the increasing income gap or poverty. There must be an increasing income gap between wealthy aged people who earned a lot of money during the bubble economy and the poor young who started working at the beginning of the period of deflation. In order to mitigate this, we should raise the inflation rate and transfer the cash saved by the elderly rich to younger people.

The tax system would need to be reformed as well. The introduction of negative income tax would work for efficient income redistribution for the extremely poor. Basic income support to ensure the minimum standard of living across the whole nation would be much better than the existing welfare system of providing care and support arbitrarily among the extremely poor. A fair electronic tax collection system should also be introduced to address people's complaints about the unfairness of taxation.

Atago: Yes, I agree with Mr. Murakami about the tax system. In discussions about income inequality, being wealthy tends to be considered a negative. But I think this is wrong. The income gap between the wealthy and the poor is a mother of innovation. We should approve a certain extent of income gap to raise labor productivity. We should start discussing issues like a safety net for the extremely poor or tax system reform after approving the positive aspect of income inequality.

Murakami: Lastly, I would like to add one more remark on MMT. A stimulatory fiscal policy is necessary not because the current Japanese economic situation is similar to the one referred to by MMT. MMT is far from an objective economic theory, and wrong in Japan and the US as well. It is a political argument used by leftwing populists. New Keynesian economists all support the fiscal stimulus today in advanced nations. My argument is consistent with those New Keynesians and not MMT. JS

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