

Enhancing Japan's Growth Potential with the Service Sector as the Driving Force

By Naoyuki Haraoka



The economies of the developed nations do not greatly differ in their performances. Growth rates are converging around 0-2%, inflation at 4-5% and unemployment at 3-6%. Most of them are faced with large budget deficits and extremely low interest rates. Fiscal and monetary policy under these conditions would not work to stimulate these economies. These economies are connected by exchange rates and cannot employ any macro policies affecting their currency values significantly to maintain their current situations as a status quo. Economic performances are largely determined by supply side factors such as labor productivity, industrial structure, and market reforms, as well as demography and technology.

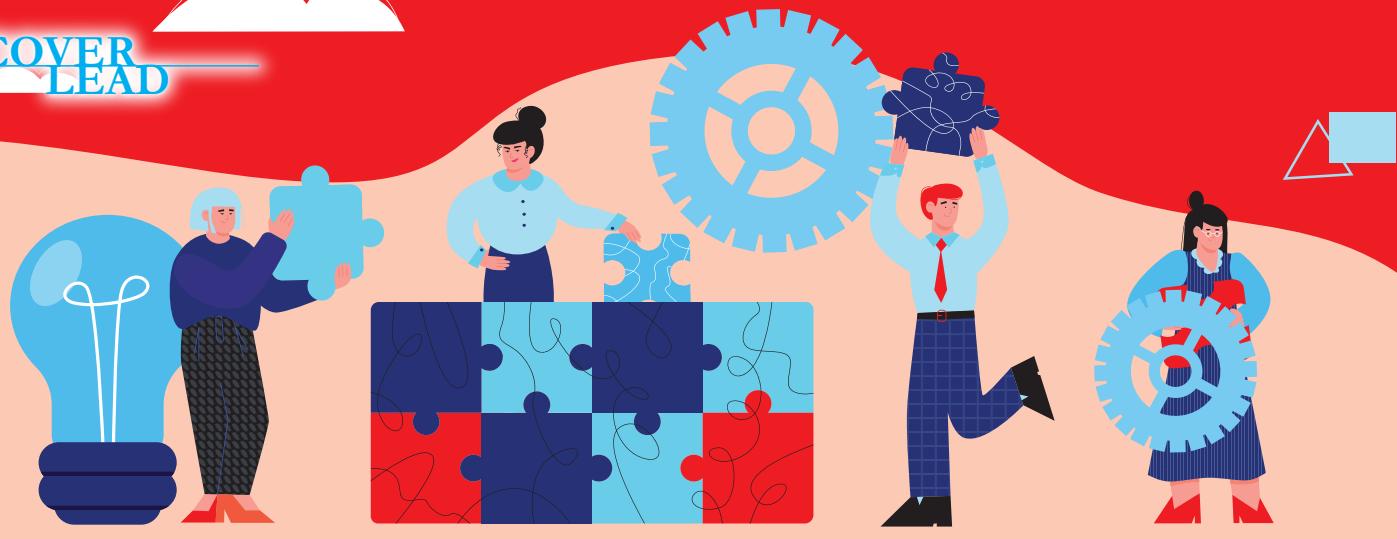
Our cover story of this issue highlights the service industry in Japan and introduces readers to the essence of the arguments in the JEF study group on the service sector that was organized in the first half of 2025. The service sector's percentage of the whole industrial structure in terms of value-added has exceeded 50% and it is the largest sector in the Japanese economy. It also induces personal consumption, accounting for the largest weight of the economy, as consumption of services is now larger than consumption of goods. The service sector also absorbs the largest share of employment, since it is labor intensive. In terms of international trade as well,

trade in services is now more important than trade in goods. It is no exaggeration to say that the key to achieving macroeconomic success is the service sector.

This is a labor intensive sector and its labor productivity tends to be lower than the manufacturing sector. With innovation and entrepreneurship, how to raise productivity or keep productivity as high as possible must be the most important economic policy today, significantly affecting total economic performance.

Following a roundtable discussion on the policy recommendations of the study group on the service sector, consisting of interesting business analyses, we have a report on high-profile Japanese trading firms and the new frontiers they face by Dr. Shinichi Enomoto, a business economist. He shows how these Sogo-shosha have contributed to the Japanese economy as competitive players and how they will continue to manage supply chains, vital to today's Japanese manufacturing business.

On global banking and the Japanese banking sector, we introduce the views of Jim Davidson, managing principle of US company Eldar Capital. He talks about the strong global competitiveness of Japanese banking institutions, while highlighting the importance of digital technologies. This is followed by three



essays on the current macroeconomic situation and economic policies in Japan. The key question is how we can mitigate the risk of stagflation. The three answers are all affirmative on the need to avoid tough stagflation, though the Japanese economy is faced with a continuous weak yen and difficulty in raising interest rates significantly, partly due to concerns about a possible increase in fiscal debt with higher interest payments. There is thus a continuous risk of inflation which could result in modest stagflation, with continuous modest deflationary pressure as well.

On this issue we have an interview with Shigeto Nagai, head of Japan Economics at Oxford Economics, an article by *Japan SPOTLIGHT* Editorial Committee member Prof. Kazumasa Oguro, and an additional one by myself. You can decide for yourself what is the culprit of mild stagflation.

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