Japan

Mixed signals

By: Ira Kalish

The Japanese economy has seen a significant rebound in growth in the past year, largely fueled by an acceleration in exports, which in turn was helped by the lagged effect of a weak yen and an increase in global growth. Moreover, the improvement in export performance is helping to boost business investment.

Japanese exports were up 12.2 percent in January from a year earlier, signaling the 14th consecutive month of rising exports.[1] There was especially strong growth in the exports of machinery, chemicals, and non-ferrous metals. Exports were up 30.8 percent to China, 1.2 percent to the United States, 21 percent to Germany, 35 percent to the United Kingdom, 7.6 percent to South Korea, 9.8 percent to Taiwan, 21.9 percent to Vietnam, and 23.5 percent to Indonesia. Japanese companies have substantial regional value chains; thus, it is likely that components made in Japan are shipped to neighboring countries for reprocessing and assembly before final products are then sent to other countries, such as the United States. The recent strength of exports appears to reflect the lagged impact of a weak yen—something that has lately changed—as well as the rebound in the global economy.

Meanwhile, many Japanese exporters are now concerned about the potential impact of the recent rise in the value of the yen. Indeed, the well-known Reuters Tankan survey of manufacturing executives found a sharp deterioration in business confidence in February.[2] In addition, Markit's flash purchasing manager's index for manufacturing showed deceleration in February, driven in part by a weakening of export orders.[3] Weak business confidence could have a negative impact on business investment. Further, despite the sharp 15 percent rise in the value of the yen in the past year, Japan's Finance Minister Taro Aso says that currency market intervention is not needed and that, because the yen is not moving "abruptly" in either direction, government intervention is not warranted.[4] One possibility is that his comments might encourage investors to push the yen even higher.

However, there are other positive signs for Japan. Industrial production increased 2.7 percent in January versus a year earlier, a moderate rate of growth roughly in line with the experience of the past year.[5] Prior to that, industrial production had been declining since mid-2014. Thus, things have clearly improved, in large part due to the weakness of the yen, which has helped boost demand for Japanese manufactured exports.

Meanwhile, despite a tight labor market, wages remain relatively stagnant, thereby leading to weakness in consumer spending. In December, household spending fell 2.5 percent from the previous month and was down 0.1 percent from a year earlier.[6] The unemployment rate increased slightly, from 2.7 percent in November to 2.8 percent in December. The jobs-to-applicants ratio, which had been falling for some time, increased slightly in December. In addition, housing starts fell in December and new construction orders fell as well. On the other hand, retail sales did exceptionally well in December, despite a decline in overall household spending. Retail sales were up 3.6 percent from a year earlier, the best seen since 2012 if one excludes the volatile behavior of retail sales prior to and after the last sales tax increase. Thus, the picture one takes away of the Japanese economy is rather mixed.

A twist in the growth story?

It is possible that Japan is at a turning point. Inflation is starting to accelerate, driven in part by a still modest upsurge in wages. Japanese consumer prices were up 1.0 percent in December versus a year earlier, the fastest rate of inflation since March 2015.[7] Moreover, the increase in 2015 was entirely due to the imposition of a higher national sales tax. In the current case, the increase in inflation represents a true acceleration in the rise of prices, reflecting a strong economy and labor market. In addition, core inflation, which excludes the impact of volatile food and energy prices, was 0.9 percent in December versus a year earlier, also the highest since the impact of the sales tax increase in 2015.[8] However, despite the evident acceleration in inflation, it remains well below the Bank of Japan's (BoJ's) target of 2.0 percent. Thus, it remains reasonable to expect the BoJ to retain a highly aggressive monetary policy of low-interest rates and continued purchases of assets (quantitative easing).

Trade and taxes

On the trade front, Japan is working with other Pacific Rim nations to revive the Trans-Pacific Partnership (TPP), the free trade agreement from which the United States withdrew a year ago. Japan was keen on the original TPP not only because of the trade liberalization that it entailed, but because it was likely to provide the government with the political cover needed to impose controversial structural reforms. In addition, the TPP is often seen as a counterweight to China's plans for a regional free trade agreement. The new plan is for a smaller

TPP involving the original 11 nations other than the United States.

Longer term, one of the biggest issues facing Japan is whether to go ahead with the planned increase in the national sales tax in 2019. The last time the tax was increased, it caused a modest recession. Raising the tax again could have the same impact. Still, the government is determined to eventually do this in order to reduce the long-term deficit faced by the country's pension system. That deficit is being driven by onerous demographics. Japan's population is falling and the working-age population is falling even faster.[9] Absent increased taxes, many officials are concerned that the budget deficit could increase dramatically, thus adding to an already high level of government debt.

ENDNOTES

1. Trading Economics, "Japan exports," accessed March 7, 2018.
2. Tetsushi Kajimoto and Izumi Nakagawa, "Japan manufacturers' mood worsens as yen rises: Reuters Tankan," Reuters, February 19, 2018.
3. IHS Markit, "Nikkei Flash Japan Manufacturing PMI," February 21, 2018.
4. Robin Harding, "No need for yen intervention, says Japan's finance minister," *Financial Times*, February 15, 2018.
5. Trading Economics, "Japan industrial production," accessed March 7, 2018.
6. Ministry of Internal Affairs and Communication, Statistics Bureau, accessed March 7, 2018.
7. Ibid.
8. Ibid.
9. Ibid.

ABOUT THE AUTHOR

IRA KALISH

Ira Kalish is a specialist in global economic issues and the effects of economic, demographic, and social trends on the global business environment. He is a regular contributor to economics articles published on Deloitte Insights, and also writes for the annual Global Powers of Retailing and Consumer Products reports.

CONTACTS

Dr. Ira Kalish
Deloitte Touche Tohmatsu Limited
USA
+1 213 688 4765
ikalish@deloitte.com

Global industry leaders

Consumer & Industrial Products
Tim Hanley
Deloitte Services LP
USA
+1.414.688.2052
thanley@deloitte.com

Energy & Resources
Rajeev Chopra
Deloitte Touche Tohmatsu Limited
UK
+44.7775.785350
rchopra@deloitte.co.uk

Financial Services
Bob Contri
Deloitte Services LP
USA
+1.917.327.0828
bcontri@deloitte.com

Life Sciences & Health Care
Greg Reh
Deloitte Consulting LLP
USA
+1.215.680.8913
grreh@deloitte.com

Public Sector
Mike Turley
Deloitte Touche Tohmatsu Limited
UK
+1.44.7711.137213
mturley@deloitte.co.uk

Telecommunications, Media & Technology
Paul Sallomi
Deloitte Tax LLP
USA
+1.408.704.4100
psallomi@deloitte.com

US industry leaders

Financial Services
Kenny Smith
Deloitte Consulting LLP
+1.415.783.6148
kesmith@deloitte.com

Consumer & Industrial Products
Seema Pajula
Deloitte & Touche LLP
+1.312.486.1662
spajula@deloitte.com

Life Sciences & Health Care
Bill Copeland
Deloitte Consulting LLP
+1.215.446.3440
bcopeland@deloitte.com

Deloitte.
Insights

Sign up for Deloitte Insights updates at www.deloitte.com/insights.

Follow @DeloitteInsight

Deloitte Insights contributors
Editorial: Rithu Thomas, Abrar Khan, Preetha Devan
Creative: Anoop K R
Promotion: Shraddha Sachdev
Artwork: Tushar Barman

About Deloitte Insights
Deloitte Insights publishes original articles, reports and periodicals that provide insights for businesses, the public sector and NGOs. Our goal is to draw upon research and experience from throughout our professional services organization, and that of coauthors in academia and business, to advance the conversation on a broad spectrum of topics of interest to executives and government leaders.

Deloitte Insights is an imprint of Deloitte Development LLC.