

**Institute for International Monetary Affairs
International Financial Symposium**

10 years after the Global Financial Crisis

- How has the world economy changed and where will it go? -

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February 22, 2018

【冒頭スピーチ（10分以内）】

I. Overview of the cyclical economic recovery and expansion of the Japanese economy to date since the Global Financial Crisis of 2008 and the start of Abenomics in 2013

1. Thank you for giving me this wonderful opportunity, Watanabe-san. It is my pleasure to be here with these distinguished panelists and guests at this reputable Symposium.

＜現在の景気回復の概観＞

2. Let me start by sharing my assessment of the Japanese economy. Since the Japanese economy got out of the Global Financial Crisis, it has been on a long recovery trend with a brief contractionary period in 2012. The current recovery session started in December 2012, and its duration has surpassed that of the late 1960s boom, making the current recovery the second longest expansion in the post-war period.

3. Roughly speaking, this expansion started when the current Prime Minister Abe took office and unveiled the comprehensive economic policy so-called Abenomics whose centerpiece has been well-known three “policy arrows,” aggressive monetary policy, flexible fiscal policy, and growth strategy. In the beginning, the stock price soared and the consumer confidence

improved on the back of high expectation for Abenomics among the public and domestic as well as foreign investors. These fed into higher consumer spending which, together with public investments set in the fresh stimulus package of the new Abe Administration, kick-started the current expansionary period. In addition, the Bank of Japan, in cooperation with the government, intensified its efforts to overcome deflation in the name of QQE (Quantitative and Qualitative Monetary Easing), and as a result, we witnessed correction of yen's excessive appreciation that had persisted before PM Abe came to office. Yen depreciated from around 80 yen/dollar level in the previous administration era to around 110 yen/dollar level these days, which has pulled up Japanese companies' yen-based profits.

4. Though the economy went through a temporary drop in the wake of the consumption tax hike in 2014, it picked up again afterwards and the real GDP has recorded positive growth for eight quarters in a row from 2016 Q1 to 2017 Q4, for the first time in 28 years. Let me give you some numbers to illustrate the solid fundamentals of the Japanese economy. First, corporate profits shot up from 48.5 trillion yen (9.8% of GDP) in FY2012 to the record high of 75.0 trillion yen (13.9% of GDP) in FY2016. Second, on the labor market, the ratio of active job openings to applicants in December 2017 was 1.59 and it was above one in all the prefectures for 15 consecutive months. The unemployment rate in December 2017 was 2.8%, the lowest in about 24 years. Third, wage has continued to increase at around 2% for four consecutive years. Overall, I would say that a virtuous cycle of the economy has been put in place.

<特徴：投資と企業収益>

5. One question which comes naturally is: what is the driving force of this recovery? It is hard to specify at this stage, but I would name investments including capital, residential and public investments as a main driver of this recovery. When we look at contribution of each expenditure component to real GDP growth,

investments account for roughly half of the accumulated growth of 7.1% between 2012 4Q and 2017 4Q.

6. That said, I also think that investments, especially the capital investments, could have increased more, given drastic improvement of corporate profits, and that this growth driver could have been stronger. While corporate profits increased by 26.5 trillion yen (4.1% of GDP) between FY2012 and FY2016, the capital investments rose only by 8.3 trillion yen (1.0% of GDP) over the same period. Cautious attitudes of the corporate sector due to several challenges such as persistent deflation, the dwindling domestic market and low potential growth might underlie this sluggish investment growth. I hope that our aspiration to overcome these macro-economic challenges will lead to higher investment and overall growth.

II. Sustainability of the 5 year-long expansionary phase of the Japanese economy (especially in view of the cyclical factors)

<足元の好材料>

7. OK, the next question I have is: is this expansion sustainable? It's difficult to answer, but at least we are currently observing a few favorable tailwinds. First, the global economy is on solid footing. So we can expect greater contribution of the external demand to growth. Second, the private consumption has shown a sign of pick-up against the backdrop of continued wage hike and the wealth effects from elevated stock prices.

<見通し>

8. So what is the forecast? In December 2017, the government came out with its latest economic outlook and projected solid near-term growth of 1.9% for FY2017 and 1.8% for FY2018, respectively. This is based on the prospect that the economic recovery will continue driven primarily by private demand amid a solid global economy and an improving job market and income environment.

Also, in the latest World Economic Outlook, IMF revised up its growth forecast for the Japanese economy from 0.7% to 1.2% for 2018 and from 0.8% to 0.9% for 2019, reflecting stronger external demands, implementation of the sizeable supplementary budget and carryover from stronger-than-expected recent activity.

9. Going forward, in preparation for Olympic Games and Paralympic Games to be held in Tokyo in 2020, the economy is likely to enjoy boosts including strong construction demands and increasing inbound tourists.

<供給制約>

10. One thing to note is that the output gap has already turned positive. According to the latest quarterly GDP figures, the GDP gap is positive 0.7%. Now that we have overcome the period of demand shortage, we should turn our attention to the supply constraint. While the potential growth rate has stopped declining and slightly turned upward in the current recovery cycle mainly due to higher labor participation of women and the elderly, we will face supply constraints due to dwindling birthrate and an aging population in the medium to long term.

III. Expectations for the new growth strategy that focuses on “Productivity Revolution” and “Human Resource Development Revolution” as two important pillars

<成長戦略>

11. This challenge from the supply side takes me to the last question which is about our new growth strategy. The Cabinet decided the New Economic Policy Package on December 8, 2017. Through this initiative, we aim to double the annual productivity growth rate to 2% from 0.9% which is five-year average between 2011 and 2015. Let me touch upon two pillars of the aforesaid Package, namely Human Resources Development Revolution and Supply System Innovation.

12. Free early childhood education is the cornerstone of the first pillar “Human Resources Development Revolution.” Expanding human capital investment from the early childhood stage is expected to improve the quality of human resources and boost the productivity.
13. At the same time, we plan to raise the labor supply through Work Style Reform. Specifically, the government promotes fathers’ participation in child-care and working mothers’ flexible workstyle and accelerates implementation of the government’s plan to eliminate the waiting list for childcare centers.
14. As for the second pillar “Supply System Innovation,” the government has designated the next three years as “Period of Supply System Innovation and Intensive Investments,” during which the government strongly encourages companies to enhance their capital and human resource investments in order to realize innovation in areas such as Internet of Things, big data, robots, and artificial intelligence. Numerical goals are also set, which are 10% increase of firms’ capital investment by FY2020 in comparison to FY2016 and over 3% annual wage increase on and after FY2018. In line with these endeavors, the draft FY2018 Tax Reform included tax measures to incentivize companies to spend their profits on wage increase and capital investment.
15. All in all, I believe that these initiatives will play a key role in jacking up the Japan’s potential growth rate and putting the ongoing economic expansion on a more sustainable path. I stop here. Thank you.

【パネル】

IV. Basic recognition on problems of “three lows”

V. Low wage increase and low inflation

16. While the phenomenon of “three lows” is observed to a certain extent in many advanced countries, underlying factors vary across nations. In the case of Japan, though the labor market is tight and the corporate sector records historically high profits, wage increase has been feeble.
17. I believe that multiple factors could be at play behind this. It is true that some factors are globally common such as sluggish labor productivity growth and a decline in the labors’ share partly owing to a technological innovation. But Japan has a couple of additional unique factors. For example, both firms and workers have become more risk averse due to their experiences of the Bubble burst and the subsequent financial crises. The workers have prioritized job security over wage increases. (This is so-called traumatized workers hypothesis.)
18. Also, we should not underestimate the impact of the structural shift in the labor market, which is increase of non-regular workers. In Japan, the number of non-regular workers increased more than that of full-time workers in this expansionary period starting in 2012. This increase in non-regular workers ratio which is now around 37% of the total labor, not only puts downward pressure on average wages, but also might bring an “invisible” slack in the labor market. What I mean by that is that, when some of non-regular workers are willing to work more but unable to do so, we might be underestimating the unemployment rate because this willingness will not be reflected in the unemployment rate. In this light, the Japanese Government is going to release new indicators for unutilized or under-utilized workers from January 2018 survey which will be made public in March in an effort to get hold of the labor market situation better. Thank you.

VI. Low interest rates

< 自然利子率低下の要因 >

19. In my view, a fall in natural interest rate is discussed mainly from two perspectives. One is from a perspective of I-S (investments-savings) balance and the other is from a decline in potential growth rates.
20. However, those two perspectives are deeply intertwined because most factors that affect I-S balance are structural and addressing those structural issues will amount to enhancing potential growth.
21. There could be many elements that have brought about a shift in I-S balance. To name a few, on the investments side, ① deleveraging, i.e. balance sheet adjustment in the corporate sector in the wake of the financial crisis, ② reluctance of the corporate sector to invest in view of heightening uncertainty or ③ declining price of investment-goods might be at play behind this drop of investments.
22. On the savings side, higher savings could be attributed to ① a decline in propensity of consumption stemming from a rise of “sharing economy,” need for precautionary savings and other various reasons, or, ② more globally, accumulation of foreign reserves in many countries.
23. Last but not least, low birthrate and longevity are an important element not only from the savings perspective (as Watanabe-san pointed out,) but also from the investments side because dwindling population generally corresponds to diminished expected return of investment.
24. Many of the aforementioned factors are structural in nature and can't be solved in a snap-of-a-finger. Therefore, we need to work

on down-to-earth structural reforms to encourage investments and reduce unintended or precautionary savings. And, as I mentioned earlier, these efforts will boil down to boosting potential growth rates.

<低い自然利子率への日本の対応>

25. Although different methodologies come out with different paths, natural interest rate has been generally in a low range for long in Japan. The government and the central bank of Japan worked on various measures to deal with this prolonged period of low natural rate of interest. As many know, back in January 2013, the government and the Bank of Japan released Joint Statement, what is now called “Accord,” in which the government was committed to fiscal credibility. This government’s commitment made it possible for the Bank of Japan to embark on ambitious monetary easing measures thereafter including introduction of QQE (Quantitative and Qualitative Monetary Easing) with a view to driving down the real interest rate below natural rate of interest in pursuit of monetary easing effects.

(参考) 2013年1月共同声明の財政に関する書きぶり

“In addition, in strengthening coordination between the Government and the Bank of Japan, the Government will steadily promote measures aimed at establishing a sustainable fiscal structure with a view to ensuring the credibility of fiscal management.”

26. On the government side, we have been trying to raise our potential growth rate through structural reforms including our new growth strategy which I just mentioned. I firmly believe that these efforts will eventually contribute to getting out of this low natural interest rate and low potential growth rate environment. Thank you.

VII. Impact of low interest rates on profits

<低金利の邦銀への影響>

27. In this protracted low interest rate environment, especially the flattening of yield curve compresses financial institutions' margins and profitability. According to data compiled by the Financial Services Agency, net interest income of both major banks and regional banks combined decreased by roughly 5% in FY2016, mainly driven by compressed margins.

28. As a result, a rise of "search for yield" activities has been observed. One example is increasing exposure of Japanese financial institutions to the real estate sector. According to data by Bank of Japan, new loans to a real-estate sector increased five consecutive years from 2012 to 2016, followed by a modest decline in 2017. According to a report by FSA, on average, approx. 27% of new loans committed by regional banks in FY2016 headed towards real estate sector.

29. That said, I would like to emphasize that overall Japan's financial system is safe and sound. This is exemplified by a fact that Tier 1 ratio of Japanese major banks far exceeds required levels and the NPA ratio of Japanese banks remains subdued.

<邦銀に期待される役割>

30. Looking forward, however, roles which Japanese banks are expected to play are expanding. Let me mention two of them. First is provision of risk money. Simply lending to highly creditworthy borrowers or those with solid collateral and guarantees under grueling interest rate competition might not be sustainable under this low interest rate environment. On the other hand, potential funding needs are certainly there in the corporate sector, particularly among SMEs. For example, many SMEs have strong appetites to start new businesses, or expand their IT or other investments in response to labor shortage. Banks are

expected to satisfy those needs through providing risk money or money for growth based on a truly customer-oriented approach, which will bring in a sustainable revenue stream even under the current untoward environment.

31. Second is for banks to contribute to solidifying governance of their client companies. We already introduced Corporate Governance Code and Stewardship Code for listed companies. Meanwhile, it is banks, especially regional banks, who could play a key role in improving governance of unlisted SMEs and thereby enhancing their productivity.

32. I hope that Japanese banks make their business models more sustainable by fulfilling those functions which I just laid out. Thank you.

VIII. Possible events expected in 2027 and 2028

33. It is hard to foresee how global economic landscape will look like in 10 years. That said, what is expected down the road in the international finance space is normalization of unconventional monetary policies in major advanced economies. In the phase of monetary tightening, we should not forget that there is always a risk of abrupt capital outflows from vulnerable emerging markets, which we call “spillover effects.”

34. Also, China and India will certainly become economic super power, so we need to seriously consider how to integrate them into the various multilateral systems we have established so far.

【仮想通貨に関して】

35. Development of Fin-tech, including that of virtual currencies, rather we would like to call virtual assets, has a potential to bring innovative changes to the financial sector and market in the future. We should look at such developments not only as risks but also as opportunities for global economic growth. To this end, we need to reach a common understanding about the importance to strike a balance between financial innovation and consumer protection, and to promote further cooperation on this issue.

36. Also, it is important to assess impact of virtual assets on the financial system as well as markets as we witness a sudden surge in the volume of virtual asset transactions and volatility in its trading.

37. Last April, Japan revised the Payment Services Act to introduce a registration system for virtual asset broker-dealers. This regulation was established not only in accordance to the FATF guidance to respond to AML/CFT requirements but also to protect consumers by introducing additional rules to oblige broker-dealers to provide necessary information to customers and to separately hold and manage the customers virtual asset

holdings.

38. I expect this issue to be discussed at the upcoming G20 Finance Ministers and Central Governors Meeting in Buenos Aires next month and I would like to be actively engaged in the discussion.

【今般の事案を踏まえ、新たな規制の導入を考えているのかについて問われた場合】

39. We must carefully look at our regulatory approach including self-regulatory organizations on this issue. In principle, we must appropriately take into consideration about striking a right balance between innovation and customer protection. First, we need to identify the fact and root causes of this incident and then accordingly consider any appropriate actions if necessary.