The Japan News *by The Yomiuri Shimbun* Tuesday, January 16, 2018

GDP data shows corporate 'savings glut'

INSIGHTS into the WORLD

By Motoshige Itoh

There are various indicators available to verify the economic strength of Japan, and their findings may vary depending on the perspective they're viewed from. It is therefore not always easy to ascertain an overall picture of the economy. If I nevertheless have to rely on one data source, I readily refer to the country's gross domestic product data.

GDP is a measure of the value added from the production of final goods and services in an economy in a given period of time, such as one year. So, this is used as a gauge of the economic well-being of a nation. Japan's nominal GDP, measured in current market prices and thereby considered to be more relevant to the population's everyday lives, reached a high of ¥534 trillion in 1997. This figure was based on the new GDP calculation methodology of 2016, which employs standards set by the United Nations.

In late 1997, Japan was thrown into a financial crisis with major financial institutions Hokkaido Takushoku Bank Ltd. and Yamaichi Securities Co. collapsing. The country entered a period of deflation.

In 2012, Japan's nominal GDP stood at ¥495 trillion, a decrease of more than 7 percent from 15 years earlier — proof that the deflationary trap had been quite severe. In December that year, Prime Minister Shinzo Abe returned to power.

Fortunately, the country's nominal GDP began an upward trend in 2013. In 2016, it amounted to ¥538 trillion, finally recovering to the level seen about 20 years ago.

From GDP statistics, we can discern three key factors concerning the country's economic activities — aggregate output, income and expenditure. The value added to the economy in a year reflects the monetary value of industrial output per annum in the country. Industrial output creates income, thus enabling us to know the overall amount of income. Finally, we can learn how income is spent.

As GDP includes many components, we can grasp how money flows in the corporate, household and government sectors by taking a sector-by-sector look at GDP statistics. Such an approach can help us understand why consumption has hardly risen, with Japanese consumers remaining less confident of an economic upturn, even though the Japanese economy has been on a recovery trend for five years now. When compared with other countries, we can learn what will have to be done to redress the Japanese situation.

Large internal reserves

Let us review, sector by sector, what is known as aggregate "net lending" — the excess of saving over fixed investment on an annual basis. The antonym is "net borrowing." As of today, GDP statistics for 2015 were the latest available for country-to-country comparison. We immediately learn that savings by the Japanese corporate sector, excluding the financial services industry, were equivalent to about 5.0 percent of the country's nominal GDP.

Comparable figures were much lower in other developed countries — about 2.7 percent in Germany, about 0.5 percent in the United States and about 0.1 percent in Britain. In other words, the GDP data clearly shows Japanese business corporations have far larger internal reserves than their overseas counterparts, without spending net profits. Such a propensity for spending less or simply retaining net profits remains unchanged among Japanese nonfinancial companies since around 2009, the year after the Lehman Brothers shock. Among the world's developed economies, this kind of "savings glut" is a corporate phenomenon that has occurred only in Japan for the past seven years.

At the same time, the wages of employees working at those companies have risen at a relatively slow pace. Against this background, it sounds natural that people are calling on companies to increase spending by raising wages further and allocating more funds for fixed investment.

> **Companies should offer a significant increase in wages during this year's shunto**

Let us now examine how money flows in the government sector. So-called general government spending, as a share of GDP, consists of central and local governments and "social security funds," which include old-age pension schemes and health and employment insurance systems, operated and financed with premium revenues. The government sector in Japan's GDP data has been in a state of "negative net lending" or "net borrowing," which means, in broad terms, fiscal deficits.

As for "fiscal balance," we need to refer to three elements. The first one is the primary balance, which often comes up for debate in the Diet. This balance indicates to what extent the government can cover expenditures for social security and public works with tax revenues in a given year. In other words, the primary balance is the balance between government expenditures, excluding net interest payments on government debt, and tax revenues.

The second element pertaining to "fiscal balance" is the amount of net interest payments on government debt, while the third is the social security funds balance, the balance between premium revenues and expenditures in the area of social security.

Fiscal breathing space

Japan's general government net borrowing — its fiscal deficit — was high at 8.3 percent of its GDP in 2012, but shrank to 3.6 percent in 2015. This means there has been a marked improvement in the country's fiscal condition, even though the government continues to cope with a very severe fiscal environment.

Other developed countries' comparable figures vary. Germany enjoys a fiscal surplus equivalent to about 0.7 percent, while the United States and Britain have fiscal deficits equivalent to 4.2 to 4.3 percent.

Some readers may be surprised to learn from this comparison of fiscal balances, including social security funds, that the figure for Japan was better than those for the United States and Britain. This shows that despite being still saddled with enormous outstanding government debt, Japan's fiscal condition has been improving on a year-on-year basis.

One reason for the fiscal improvement is a decrease in deficits in the primary balance. The Abe administration's goal of halving the government sector's debt-to-GDP ratio in fiscal 2015, compared with fiscal 2010, was achieved thanks largely to the April 2014 hike of the consumption tax rate to 8 percent and an increase in tax revenues resulting from the economic recovery.

The second reason is the low interest rate environment created by the Bank of Japan that has lowered the cost of paying interest on government bonds. Japan's 10-year government bond yield is currently at around zero percent. This means the government can issue refunding bonds paying effectively no interest. This unprecedented interest rate environment has given the state coffers a lot of breathing room.

The third reason is an improvement in the social security funds balance. As many salaried workers know firsthand, social security levies have been raised. Increasing the financial burden of the working population is inevitable to keep the social security system regime sustainable, but such a policy also threatens to have a negative impact on consumption, as it keeps working families' disposable income from rising.

Outlook not bright

Although Japan's fiscal condition has slightly improved, the outlook for the state coffers is not bright. Social security expenditures will only continue to grow due to the unabated aging of the Japanese population. Furthermore, once interest rates go up, payments of interest on government debt will shoot up. Assuming that the country's outstanding government debt is the equivalent of 200 percent of its GDP, a one percentage point increase in interest rates will have a long-term impact, based on simple calculations, of hiking the ratio of general government net borrowing (fiscal deficit) to GDP by two percentage points.

If an increase in interest rates happens in tandem with uptrends in consumer prices and GDP, the interest rate hike's negative impact on the fiscal situation may be lessened. But what will actually occur cannot be predicted.

We should keep a closer eye on household net lending, the difference between savings and investment by households. The household net lending ratio to GDP was 0.9 percent in Japan, compared with about 5.0 percent in Germany and about 2.5 percent in the United States.

This ratio used to stand at more than 5 percent in Japan. The fact that financial assets held by Japanese households total more than ¥1.8 quadrillion appears to be overwhelming. But when viewed on a year-on-year basis, the household savings rate in Japan is not high enough.

The less impressive savings rate is influenced by the aging of Japanese society. As a matter of fact, many of the elderly live on their savings. As the proportion of the elderly in the overall population grows, it is unavoidable for the country's average savings rate to continue to decline. So, it may be a matter of time before our society sees the average savings rate pushed into negative territory.

There is one thing I can hardly overlook. It is a proposal — which we have often heard — that as consumers have chosen to tighten purse strings, we need measures to stimulate them to spend. What really matters with weak consumption, coupled with the falling savings rate, is not consumers' choice to be more frugal but the reality that there is little money in their purses to either spend or save.

When it is obviously difficult to increase the propensity to consume — to encourage people to raise the proportion of money for consumption in their income in spite of uncertainty over their future — the only viable solution for triggering consumption is to increase their income. Therefore, companies should offer a significant increase in wages during this year's shunto spring wage negotiations between management and labor, which will take place shortly.

It is clear from GDP data that businesses have salted away much more money than households, so they should make better use of their internal reserves to raise wages, helping bolster household consumption.

Special to The Yomiuri Shimbun

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