Country Report

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The Economist Intelligence Unit

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Highlights

Editor: **Fung Siu**

Forecast Closing Date: **June 30, 2015**

Outlook for 2015-19

- The coalition led by the Liberal Democratic Party (LDP) will dominate the House of Representatives (the lower house of parliament) until the next election for that chamber, which is due in 2018.
- The prime minister, Shinzo Abe, will be re-elected as president of the LDP at party elections in September. This will enable him to lead the LDP in the upper house election in July 2016 and then stay in office until 2018.
- The government expects to meet its target of halving the primary deficit (excluding debt service) to the equivalent of 3.3% of GDP in fiscal year 2015/16 (April-March), paving the way for another cut in the corporate tax rate.
- There is speculation that the Bank of Japan (the central bank) may have to loosen monetary policy still further to achieve its inflation target of 2%. The central bank is unlikely to raise its policy interest rates before 2017.
- The Economist Intelligence Unit has revised up its real GDP growth forecast for 2015 to 1.4%, from 1.2% previously, based on upward revisions to first-quarter estimates. We project that GDP growth will accelerate to 2% in 2016.
- Headline consumer price inflation will average 0.9% in 2015, reflecting the deflationary impact of lower global oil prices. The rate of inflation should then accelerate to an average of 1.5% in 2016.
- We forecast that the yen will depreciate against the US dollar in 2015 and 2016, to an average of ¥122.1:US$1 and ¥124.4:US$1 respectively, as the US begins to tighten monetary policy.
- The current-account surplus will rise steadily during the forecast period, to reach the equivalent of 4.2% of GDP in 2019, mainly reflecting the merchandise trade account returning to surplus from 2017.

Review

- On June 22nd the lower house voted to extend the current parliamentary session by three months to September 27th, in order to ensure the passage of a package of security-related bills.
- On June 29th the cabinet approved a target to cap the annual increase in social security spending at about ¥500bn (US$4.1bn) until 2018/19, but did not specify how this ambitious target would be achieved.
- Revised national-accounts data for the first quarter of 2015 show that real GDP grew by a buoyant 1% quarter on quarter, significantly higher than the initial estimate of 0.6%.
- Partial data for the second quarter give a mixed picture, with retail sales and business confidence showing strength but industrial production being weak.

Outlook for 2015-19

Political stability

The coalition led by the Liberal Democratic Party (LDP) will dominate the House of Representatives (the lower house of parliament) until the next election for that chamber, in 2018. The LDP and its coalition partner, Komeito, have a two-thirds majority in the lower house and emerged victorious in the April 2015 local elections. These successes have given the prime minister and leader of the LDP, Shinzo Abe, the political capital to push ahead not only with structural economic reforms, but also with a package of security-related bills to bolster the country's defence posture. Although the latter has much less popular support than Mr Abe's economic goals, he is determined that the necessary legislation be passed in the current parliamentary session. To this end, in June the lower house voted to extend the current session by three months to September 27th. The security-related bills consist of one to enable Japan's Self-Defence Forces to participate in "collective self-defence" and another to revise ten different laws governing the military and how it responds to armed attacks.

Mr Abe's political future nevertheless still hinges on the extent to which he can defeat deflation and revive the economy through his signature economic policy, "Abenomics". Recent opinion polls show that most people have not felt any benefits from Abenomics, as an increase in the consumption tax rate in April 2014 and a weak yen have pushed up costs, while wage growth has failed to keep up. Despite his strong position in parliament, the prime minister still faces opposition from lobby groups and his own backbenchers to contentious structural reforms, such as deregulating labour markets, revamping the agricultural sector and shaking up corporate governance. The government also remains vulnerable to charges of impropriety involving political donations. Three cabinet members have resigned since the December 2014 lower house election over this issue, and further revelations could threaten more ministers.

Opposition parties are unlikely to offer much resistance to the government's ambitious legislative programme. The main opposition Democratic Party of Japan (DPJ) performed poorly in the April 2015 local elections. It is unclear how its middle-ground stance on domestic politics, foreign policy and economic management will be able to lift its appeal and act as a counterweight to the nationalist political agenda of the ruling coalition. Meanwhile, Japan's second-largest opposition party, the Japan Innovation Party (JIP), is in turmoil following its narrow defeat in a local referendum in May to create a more autonomous, metropolitan government for Osaka, Japan's second city. Its leader, Kenji Eda, has resigned and has been replaced by an interim leader, Yorihisa Matsuno; a new leadership election will take place in September. The JIP has been courted at various times by both the LDP (to lend support to its nationalist agenda) and the DPJ (to form an opposition alliance), but it will take time for new working relationships to be established with whoever emerges as the new JIP leader. In the meantime, however, Mr Abe is striving to secure the JIP's support for his package of security-related bills in the current parliamentary session.

Election watch

The LDP's victories in the December 2014 general election and the April local polls virtually guarantee Mr Abe’s re-election as its president at the September 2015 party elections. This will enable him to stay in office until September 2018, when his second (and, under current party rules, final) term as LDP president would expire. Recent opinion polls show that Mr Abe's popularity remains high, even though many of his policies lack majority support from the electorate. The absence of a viable opposition party will continue to bolster Mr Abe's approval ratings, but he faces a difficult time over some policy issues, especially national security and nuclear energy.

The next big electoral challenge for Mr Abe is the election for one-half of the seats in the House of Councillors (the upper house) in July 2016. Currently, the LDP-led coalition does not have a two-thirds majority in the chamber, where it has 134 seats out of a total of 242. Achieving such a majority would allow Mr Abe to set the wheels in motion for revising Japan's pacifist constitution, but such a victory would be difficult to envisage if Abenomics fails to deliver a healthy recovery and rising living standards by then.

International relations

Japan’s close ties with the US were reinforced by Mr Abe's state visit to the US in late April-early May. A new defence agreement signed during Mr Abe's trip underscores the importance that the US places on its alliance with Japan. The enduring strength of the alliance is likely to embolden Mr Abe to pursue his nationalist goals. The government has made some progress in improving its difficult relationships with China and South Korea in recent months, and the statement that Mr Abe will make in August to mark the 70th anniversary of the end of the second world war could have a significant impact on Japan's foreign relations. Mr Abe wants to emphasise Japan's peaceful role in the present and future, but China and South Korea also want him to include an apology for Japan's colonial rule and aggression similar to that expressed by previous prime ministers in 1995 and 2005. The statement offers Mr Abe the opportunity to forge closer links with the two countries, but he would need to reiterate, and possibly go beyond, his predecessors' remarks.

Security talks between Japan and China, which resumed in March after a four-year hiatus, will continue to focus on their dispute over the uninhabited Senkaku islands (known as the Diaoyu islands in China) in the East China Sea, which are administered by Japan but claimed by both countries. Although strategic rivalry and a need to play to domestic audiences will remain, both countries have a strong mutual interest in putting political issues aside and improving economic ties. Meanwhile, bilateral talks between Japan and South Korea will continue to focus on regional security and defence co-operation. However, diplomatic clashes over Japan’s record during the second world war, when it occupied Korea, as well as a territorial dispute over the Takeshima islets (known as Dokdo in Korea), could temper any improvement in bilateral relations.

Japan has lost patience with North Korea over the slow progress that country has made on its latest probe into the abduction of Japanese nationals by North Korean agents in the late 1970s and early 1980s. This is a highly sensitive issue in Japan, and its decision in April to extend its sanctions against North Korea for another two years highlights Mr Abe's determination to resolve the matter during his tenure. Meanwhile, the risk to Japanese nationals of being victims in further terrorist attacks in the Middle East and North Africa is likely to strengthen Mr Abe's resolve to bolster the country's defence posture and, ultimately, revise Japan's pacifist constitution.

Policy trends

Abenomics will continue to centre on a three-pronged approach to reflate the economy and put it on a higher growth trajectory through a combination of monetary, fiscal and structural policies. The next rise in the consumption tax rate will not take place until April 2017, giving time for Abenomics to revive the economy. An extra dose of quantitative easing (QE) by the Bank of Japan (BOJ, the central bank) was announced in October 2014. Cutting the corporate tax rate to below 30% over the next few years remains a key structural reform goal, while reform of labour markets, agriculture and healthcare are other central aims. Any tax cuts will have to be consistent with the government's target of achieving a primary budget surplus by fiscal year 2020/21 (April-March).

Negotiations on the Trans-Pacific Partnership (TPP) free-trade initiative received a boost in June, when the US Senate (the upper house of Congress) approved Trade Promotion Authority (TPA). Passage of TPA will revitalise international efforts to bring the TPP to life. Time remains of the essence: an agreement will need to be in place by September-October in order for Congress to vote on it before campaigning for the 2016 US presidential election moves up a gear. The Economist Intelligence Unit expect the TPP to be passed, but the risks to this forecast are high as there is no guarantee that Congress will approve a deal, even if this tight timeline is met. Some progress is being made in terms of restarting Japan's nuclear industry, with one reactor at privately owned Kyushu Electric Power's Sendai plant likely to be back online in mid-August, and another reactor at the same plant likely to restart in September.

Fiscal policy

The budget for 2015/16 projects that total spending will rise by 0.4% to a record ¥96.3trn (US$790bn). But with tax revenue budgeted to increase by 9%, owing to the consumption tax rate increase in April 2014 and buoyant corporate tax receipts, the government aims to restrict its bond issuance below ¥40trn for the first time in six years. This means that the government expects to meet its target of halving the primary deficit (excluding debt service) from the equivalent of 6.6% of GDP in 2010/11 to 3.3% in 2015/16, which it then aims to eliminate by 2020/21. The most notable element of the government's tax reform agenda is the cut in the corporate tax rate from 34.6% to 32.1% at the start of 2015/16, with a further reduction to 31.3% in April 2016. The next rise in the consumption tax rate, from 8% to 10%, in April 2017, will be accompanied by a reduced rate for a range of basic necessities. The government is also planning to cap the annual increase in social security spending at about ¥500bn (US$4.1bn) until 2018/19, but has yet to specify how this ambitious target will be met. We forecast that the budget deficit will narrow to the equivalent of 5.1% of GDP by calendar year 2019, from 7.7% in 2014. However, we expect the public debt to edge up to 232% of GDP by 2019, from 226% in 2014.

Monetary policy

At its latest monetary policy meeting, on June 18th-19th, the BOJ made no change to its ultra-loose settings. The central bank aims to expand the monetary base at an annual pace of about ¥80trn in order to achieve its 2% target for core inflation (which excludes fresh-food prices). Aggressive QE was launched in April 2013, with the understanding that the inflation target would be achieved within two years—that is, by now. However, core inflation was flat year on year in May, and the BOJ now expects to achieve its target in the first half of 2016/17. There is growing speculation that the BOJ may have to loosen monetary policy still further. Although we believe that the BOJ will resist such a move, it is unlikely that the central bank will raise policy interest rates before 2017.

International assumptions

	2014	2015	2016	2017	2018	2019
Economic growth (%)						
US GDP	2.4	2.4	2.5	2.4	2.6	1.4
OECD GDP	1.8	2.1	2.3	2.3	2.4	1.9
EU28 GDP	1.4	1.7	1.9	1.9	1.9	1.9
World GDP	2.3	2.4	2.8	2.8	2.9	2.5
World trade	3.0	3.7	5.0	5.5	5.6	5.6
Inflation indicators (% unless otherwise indicated)						
US CPI	1.6	0.2	2.2	2.3	2.5	2.0
OECD CPI	1.6	1.5	1.9	2.2	2.2	2.0
EU28 CPI	0.6	0.2	1.2	1.5	1.7	1.7
Manufactures (measured in US$)	-0.3	0.4	1.5	1.9	1.2	1.4
Oil (Brent; US$/b)	98.9	60.2	69.3	79.9	86.4	89.3
Non-oil commodities (measured in US$)	-5.3	-12.2	6.5	4.6	2.6	2.7
Financial variables						
US$ 3-month commercial paper rate (av; %)	0.1	0.3	1.2	2.6	3.4	4.1
€ 3-month interbank rate (av; %)	0.2	0.0	0.0	0.7	1.9	2.2
US$:€ (av)	1.33	1.07	0.99	1.07	1.15	1.20
¥:US$ (av)	105.9	122.1	124.4	123.0	122.0	120.0

Economic growth

We have revised up our forecast for real GDP growth in 2015 from 1.2% to 1.4%, following the publication of revised data for January-March showing that the economy expanded by a buoyant 1% quarter on quarter. This was significantly stronger than the initial estimate of 0.6% and was wholly accounted for by higher private investment. Partial data for the second quarter give a mixed picture, with retail sales and business confidence showing strength but industrial production being weak. The economic recovery will gain momentum in 2016, with GDP growth accelerating to 2%, as ultra-loose monetary policy helps both private consumption and investment. The weak yen will lead to a reduction in the country's trade deficit in 2015-16, although, owing to a healthy and persistent surplus on the income account, Japan's current account has managed to stay in the black in recent years. The postponement until April 2017 of the consumption tax rise originally planned for October 2015 will also help to stabilise consumer sentiment. In 2017 we forecast that real GDP growth will slow to 1.3% in response to the increase in the consumption tax rate, to 10%. The holding of the 2020 Olympic Games in the capital, Tokyo, will help to boost consumer and business confidence in the latter part of the forecast period, with real GDP growth accelerating to 1.6% a year on average in 2018-19.

Public debt will rise slowly during the forecast period, and population ageing will continue. Moreover, both the overall population and the workforce will contract steadily in 2015-19. The increase in the consumption tax rate in 2017 will damage consumer confidence, with the result that private consumption will grow by only 0.7% a year on average in 2015-19. Government consumption, meanwhile, is projected to rise by 1.1% annually on average, while investment growth will average 1.7%. We expect exports of goods and services to increase by 6% a year on average in 201519, outpacing annual import growth of 3.7%.

Economic growth

%	2014[a]	2015[b]	2016[b]	2017[b]	2018[b]	2019[b]
GDP	-0.1	1.4	2.0	1.3	1.7	1.5
Private consumption	-1.3	0.6	1.2	0.1	0.8	1.0
Government consumption	0.3	1.2	1.1	1.0	1.0	1.0
Gross fixed investment	2.5	1.4	2.0	1.9	1.7	1.7
Exports of goods & services	8.4	6.7	7.3	6.0	5.6	4.3
Imports of goods & services	7.4	5.1	4.9	3.0	3.0	2.7
Domestic demand	-0.1	1.0	1.5	0.7	1.2	1.1
Agriculture	0.6[c]	0.5	0.7	0.7	0.7	0.7
Industry	0.6[c]	1.2	1.5	1.2	1.4	1.4
Services	-0.5[c]	1.5	2.2	1.4	1.9	1.6

[a] Actual. [b] Economist Intelligence Unit forecasts. [c] Economist Intelligence Unit estimates.

Inflation

Headline consumer price inflation will average 0.9% in 2015, reflecting the deflationary impact of lower global oil prices. Inflation moderated to 0.6% year on year in April, when the effect of the April 2014 consumption tax increase dropped out of the base of comparison, and eased further to 0.5% in May. We expect the rate of inflation to accelerate to 1.5% on average in 2016, rising further to 2.2% in 2017 in response to the April 2017 increase in the consumption tax rate. Annual inflation should then recede once more to 1.6% on average in 2019.

Exchange rates

Despite a modest strengthening in the yen in June, downward pressure on the currency will resurface as the monetary policies of the US and Japan begin to diverge. The Federal Reserve (the US central bank) terminated its QE programme in October 2014, paving the way for higher US interest rates from the third quarter of 2015. Japan's main policy interest rate, the overnight call rate, is likely to remain at zero until 2017, so that a clear interest-rate differential between Japan and the US will emerge in late 2015 and will then widen in 2016, exerting downward pressure on the yen. The decision in late 2014 by Japan's US$1.2trn Government Pension Investment Fund to raise its allocation to foreign stocks from 12% to 25% will reinforce the downward pressure on the yen. However, the steady rise in the current-account surplus will counteract some of the negative pressures on the currency. In nominal terms, we now expect the yen to weaken by 13.3% against the US dollar in 2015, to ¥122.1:US$1 on average, following declines of 7.8% in 2014 and 18.2% in 2013. It will depreciate slightly in 2016, to ¥124.4:US$1. We forecast that the yen's value will begin to stabilise during 2016 and will strengthen slightly, to ¥120:US$1, by 2019.

External sector

Japan's merchandise trade deficit will narrow in 2015, after peaking at US$99.1bn in 2014. The yen's substantial depreciation since 2013 is beginning to have a beneficial impact on Japan's export performance, but it will take until 2017 for Japan to eliminate its trade deficit. Lower international oil prices in 2015 compared with 2014 will provide welcome relief for Japan's trading position, as will the partial resumption of nuclear power generation. The deficit on the services account will disappear by 2016, as Japan's increasing affordability will continue to boost its popularity as a tourist destination. Tourist arrivals, especially from China, will continue to boom after increasing by almost 30% to a record 13.4m in 2014. There will be a substantial positive balance on the primary income account, owing to Japan's large stock of overseas direct and portfolio investment. The current account will remain in the black during the next five years, with the surplus rising steadily to reach the equivalent of 4.2% of GDP in 2019.

Forecast summary

Forecast summary
(% unless otherwise indicated)

	2014[a]	2015[b]	2016[b]	2017[b]	2018[b]	2019[b]
Real GDP growth	-0.1	1.4	2.0	1.3	1.7	1.5
Industrial production growth	2.1	0.7	2.5	1.2	1.5	1.6
Gross fixed investment growth	2.5	1.4	2.0	1.9	1.7	1.7
Unemployment rate (av)	3.6	3.3	3.1	3.1	3.0	3.1
Consumer price inflation (av)	2.7	0.9	1.5	2.2	1.9	1.6
Consumer price inflation (end-period)	2.4	1.1	1.9	2.0	1.7	1.6
Short-term interbank rate	1.5	1.5	1.5	2.0	2.7	3.1
Government balance (% of GDP)	-7.7	-6.5	-5.9	-5.3	-5.3	-5.1
Exports of goods fob (US$ bn)	699.5	654.4	699.0	781.5	859.1	941.2
Imports of goods fob (US$ bn)	798.6	678.3	731.9	779.0	834.8	880.2
Current-account balance (US$ bn)	24.0	116.1	122.9	150.0	169.5	199.4
Current-account balance (% of GDP)	0.5	2.8	3.0	3.5	3.8	4.2
Exchange rate ¥:US$ (av)	105.9	122.1	124.4	123.0	122.0	120.0
Exchange rate ¥:US$ (end-period)	119.9	125.0	123.3	122.5	121.0	120.0
Exchange rate ¥:€ (av)	140.7	131.1	123.4	131.3	140.6	143.6
Exchange rate ¥:€ (end-period)	145.5	122.5	125.1	138.1	142.5	144.6

[a] Actual. [b] Economist Intelligence Unit forecasts.

Quarterly forecasts

Quarterly forecasts

	2014				2015				2016			
	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr
GDP												
% change, quarter on quarter	1.1	-1.7	-0.5	0.3	1.0	0.5	0.6	0.6	0.4	0.5	0.4	0.4
% change, year on year	2.1	-0.4	-1.4	-0.9	-1.0	1.3	2.5	2.8	2.2	2.2	1.9	1.8
Private consumption												
% change, quarter on quarter	2.1	-5.1	0.4	0.4	0.4	1.0	0.4	0.6	0.1	0.1	0.1	0.1
% change, year on year	3.2	-2.9	-2.9	-2.4	-4.1	2.1	2.2	2.4	2.1	1.3	1.0	0.5
Government consumption												
% change, quarter on quarter	-0.3	0.3	0.2	0.3	0.1	0.4	0.6	0.5	0.1	0.1	0.1	0.1
% change, year on year	0.3	0.0	0.3	0.5	0.8	0.9	1.4	1.7	1.7	1.4	0.9	0.5
Gross fixed investment												
% change, quarter on quarter	3.4	-4.5	-0.4	0.1	1.6	0.8	0.7	0.7	0.4	0.4	0.4	0.4
% change, year on year	9.9	2.4	-0.3	-1.6	-3.3	2.1	3.3	3.9	2.6	2.2	1.9	1.5
Exports of goods & services												
% change, quarter on quarter	6.1	0.0	1.6	3.2	2.4	-0.4	2.0	1.2	2.1	2.1	2.1	2.1
% change, year on year	9.0	5.8	7.8	11.2	7.3	6.9	7.3	5.2	5.0	7.6	7.7	8.7
Imports of goods & services												
% change, quarter on quarter	6.6	-5.2	1.1	1.4	2.9	0.9	1.6	1.4	1.1	1.1	1.1	1.1
% change, year on year	14.7	6.2	5.4	3.6	0.0	6.5	7.0	7.0	5.1	5.2	4.7	4.5
Domestic demand												
% change, quarter on quarter	1.4	-2.8	-0.5	0.1	1.1	0.9	0.1	0.4	0.6	0.3	-0.1	0.1
% change, year on year	3.3	-0.3	-1.6	-1.8	-2.2	1.6	2.2	2.6	2.2	1.6	1.3	0.9
Consumer prices												
% change, quarter on quarter	0.0	2.5	0.3	-0.3	-0.3	0.5	0.3	0.3	0.4	0.4	0.4	0.4
% change, year on year	1.5	3.6	3.4	2.5	2.3	0.3	0.3	0.9	1.6	1.5	1.5	1.6
Producer prices												
% change, quarter on quarter	0.3	2.4	0.3	-0.5	-1.6	3.0	0.6	0.5	0.4	0.4	0.4	0.4
% change, year on year	2.0	4.4	4.0	2.5	0.5	1.1	1.4	2.4	4.6	2.0	1.8	1.6
Exchange rate ¥:US$												
Average	102.7	102.1	104.0	114.6	119.1	121.4	123.1	124.8	125.3	124.3	124.3	123.6
End-period	103.0	101.3	109.7	119.9	120.0	122.3	123.9	125.0	124.8	124.3	124.0	123.3
Interest rates (%; av)												
Money market rate	0.1	0.1	0.2	0.2	0.1	0.1	0.2	0.2	0.1	0.1	0.1	0.1
Long-term bond yield	0.6	0.6	0.5	0.4	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4

Data and charts

Annual data and forecast

	2010[a]	2011[a]	2012[a]	2013[a]	2014[a]	2015[b]	2016[b]
GDP							
Nominal GDP (US$ bn)	5,501.8	5,919.2	5,958.4	4,922.4	4,605.3	4,102.0	4,132.1
Nominal GDP (¥ trn)	483	472	476	480	488	501	514
Real GDP growth (%)	4.7	-0.4	1.7	1.6	-0.1	1.4	2.0
Expenditure on GDP (% real change)							
Private consumption	2.8	0.3	2.3	2.1	-1.3	0.6	1.2
Government consumption	1.9	1.2	1.7	1.9	0.3	1.2	1.1
Gross fixed investment	-0.1	1.7	3.2	3.1	2.5	1.4	2.0
Exports of goods & services	25.0	-0.4	-0.2	1.1	8.4	6.7	7.3
Imports of goods & services	11.1	5.9	5.3	3.0	7.4	5.1	4.9
Origin of GDP (% real change)							
Agriculture	-1.0	2.0	0.6	2.7	0.6[c]	0.5	0.7
Industry	14.4	-3.2	1.7	2.2	0.6[c]	1.2	1.5
Services	1.0	0.7	1.8	1.3	-0.5[c]	1.5	2.2
Population and income							
Population (m)	127.4	127.3	127.2	127.1[c]	127.0[c]	126.8	126.6
GDP per head (US$ at PPP)	33,959	34,489	35,719	36,287[c]	36,864[c]	37,424	38,869
Recorded unemployment (av; %)	5.0	4.6	4.4	4.0	3.6	3.3	3.1
Fiscal indicators (% of GDP)							
General government budget revenue	32.4	33.0	33.1	33.9	34.6	35.1	35.4
General government budget expenditure	40.7	41.8	41.8	42.3	42.3	41.6	41.4
General government budget balance	-8.3	-8.8	-8.7	-8.5	-7.7	-6.5	-5.9
Public debt	193.2	209.4	215.4	220.3	226.0	227.6	229.6
Prices and financial indicators							
Exchange rate ¥:US$ (end-period)	81.1	77.0	86.6	105.3	119.9	125.0	123.3
Exchange rate ¥:€ (end-period)	108.4	99.6	114.3	145.2	145.5	122.5	125.1
Consumer prices (end-period; % change)	-0.4	-0.2	-0.2	1.6	2.4	1.1	1.9
Producer prices (av; % change)	-0.1	1.5	-0.9	1.3	3.2	-0.8	1.7
Stock of money M1 (% change)	2.0	4.7	3.6	4.8	4.7	5.0	4.2
Stock of money M2 (% change)	2.8	2.7	2.5	3.6	3.4	4.8	5.1
Money market interest rate (av; %)	0.17	0.17	0.17	0.17	0.16	0.15	0.14
Current account (US$ bn)							
Trade balance	109	-5	-54	-90	-99	-24	-33
Goods: exports fob	736	790	777	695	700	654	699
Goods: imports fob	-627	-794	-830	-785	-799	-678	-732
Services balance	-30	-35	-48	-36	-29	-13	1
Primary income balance	155	183	176	176	171	170	172
Secondary income balance	-13	-14	-14	-10	-19	-17	-17
Current-account balance	221	130	60	41	24	116	123
International reserves (US$ bn)							
Total international reserves	1,096	1,296	1,268	1,267	1,261	–	–

[a] Actual. [b] Economist Intelligence Unit forecasts. [c] Economist Intelligence Unit estimates.
Source: IMF, International Financial Statistics.

Quarterly data

	2013 2 Qtr	3 Qtr	4 Qtr	2014 1 Qtr	2 Qtr	3 Qtr	4 Qtr	2015 1 Qtr
Output[a]								
GDP at chained 2005 prices (annual rate; ¥ trn)	527.5	530.1	528.9	534.7	525.3	522.8	524.4	529.5
Real GDP (% change, quarter-on-quarter)	0.7	0.5	-0.2	1.1	-1.7	-0.5	0.3	1.0
Real GDP (% change, year-on-year)	1.4	2.4	2.3	2.1	-0.4	-1.4	-0.9	-1.0
Industrial production index (2010=100)	96.1	97.8	99.6	101.9	98.8	97.4	98.2	99.7
Industrial production index (% change, year on year)	-3.0	2.0	5.8	7.7	2.7	-0.3	-1.4	-2.2
Employment, wages & prices								
Employed (m)	63.28	63.27	63.52	62.81	63.75	63.74	63.73	63.17
Unemployed ('000)	2,767	2,613	2,457	2,387	2,470	2,373	2,207	2,283
Unemployment rate (% of labour force)[a]	4.0	4.0	3.9	3.6	3.6	3.6	3.5	3.5
Real gross earnings in manufacturing (2010=100)[a]	101.5	100.3	100.1	100.6	98.9	99.1	98.1	98.0
Consumer prices (2010=100)[a]	99.8	100.3	100.8	100.8	103.3	103.7	103.4	103.1
Consumer prices (% change, year on year)[a]	-0.3	0.9	1.4	1.5	3.6	3.4	2.5	2.3
Corporate goods prices (2010=100)[a]	101.3	102.0	102.9	103.2	105.7	106.0	105.5	103.8
Financial indicators								
Exchange rate ¥:US$ (av)	98.6	98.9	100.4	102.7	102.1	104.0	114.6	119.1
Exchange rate ¥:US$ (end-period)	99.2	98.3	105.3	103.0	101.3	109.7	119.9	120.0
M1 (period average; ¥ trn)	556.2	565.2	571.8	577.6	582.6	589.1	597.8	605.0
M1 (% change, year on year)	4.6	5.3	5.6	5.4	4.7	4.2	4.6	4.7
M2 (period average; ¥ trn)	842.0	850.8	858.7	864.9	869.5	876.9	888.1	894.9
M2 (% change, year on year)	3.5	3.9	4.2	3.9	3.3	3.1	3.4	3.5
Discount rate (end-period; %)	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Call money rate (end-period; %)	0.07	0.07	0.07	0.07	0.07	0.07	0.06	0.07
3-month CDs rate (av; %)[b]	0.10	0.10	0.09	0.09	0.09	0.09	0.08	0.09
Nikkei 225 stock average (¥)	13,677	14,456	16,291	14,828	15,162	16,174	17,451	19,207
Sectoral trends[a]								
Mining & manufacturing production (2010=100)	96.1	97.8	99.6	101.9	98.8	97.4	98.2	99.7
Investment goods production (2010=100)	99.5	102.4	106.1	109.5	106.7	104.5	105.2	106.8
Consumer goods production (2010=100)	93.4	95.0	96.6	99.7	94.9	91.3	90.5	93.5
Producer goods production (2010=100)	95.7	96.8	98.0	99.2	96.8	97.2	99.0	99.3
Machinery orders, net new, incl ships (¥ bn)[c]	6,194	6,632	6,674	6,764	7,802	6,730	6,566	7,357
Total construction starts (m sq metres)	37.4	37.1	37.7	36.1	33.7	31.9	32.5	32.7
Residential construction starts (m sq metres)	22.0	22.2	22.7	20.7	19.0	18.3	18.3	18.6
Retail sales (2010=100)	101.5	101.8	103.2	107.1	99.5	103.3	104.3	102.1
Foreign trade (¥ bn)								
Exports fob	17,600	17,712	18,111	17,434	17,613	18,279	19,767	19,012
Imports cif	-19,649	-20,659	-21,820	-22,486	-20,190	-21,161	-22,073	-20,391
Trade balance	-2,049	-2,947	-3,709	-5,051	-2,577	-2,882	-2,306	-1,380
Foreign payments (US$ bn)[d]								
Merchandise trade balance fob-fob	-15.26	-22.71	-30.87	-40.56	-19.93	-23.28	-15.52	-2.82
Services balance	-8.01	-9.21	-11.27	-5.96	-8.62	-8.86	-5.81	-2.87
Primary income balance	48.11	50.17	30.76	44.63	36.73	52.13	38.08	47.02
Net transfer payments	-3.00	-1.91	-2.87	-6.56	-4.55	-4.31	-3.54	-5.26
Current-account balance	21.84	16.34	-14.25	-8.44	3.62	15.68	13.20	36.07
Reserves excl gold (end-period)	1,209.4	1,240.8	1,237.2	1,247.5	1,251.5	1,234.4	1,231.0	1,216.1

[a] Seasonally adjusted. [b] Certificates of deposit. [c] 280 firms. [d] Bank of Japan.

Sources: OECD, Main Economic Indicators; Statistics Bureau, Government of Japan, Monthly Statistics of Japan; IMF, International Financial Statistics.

Monthly data

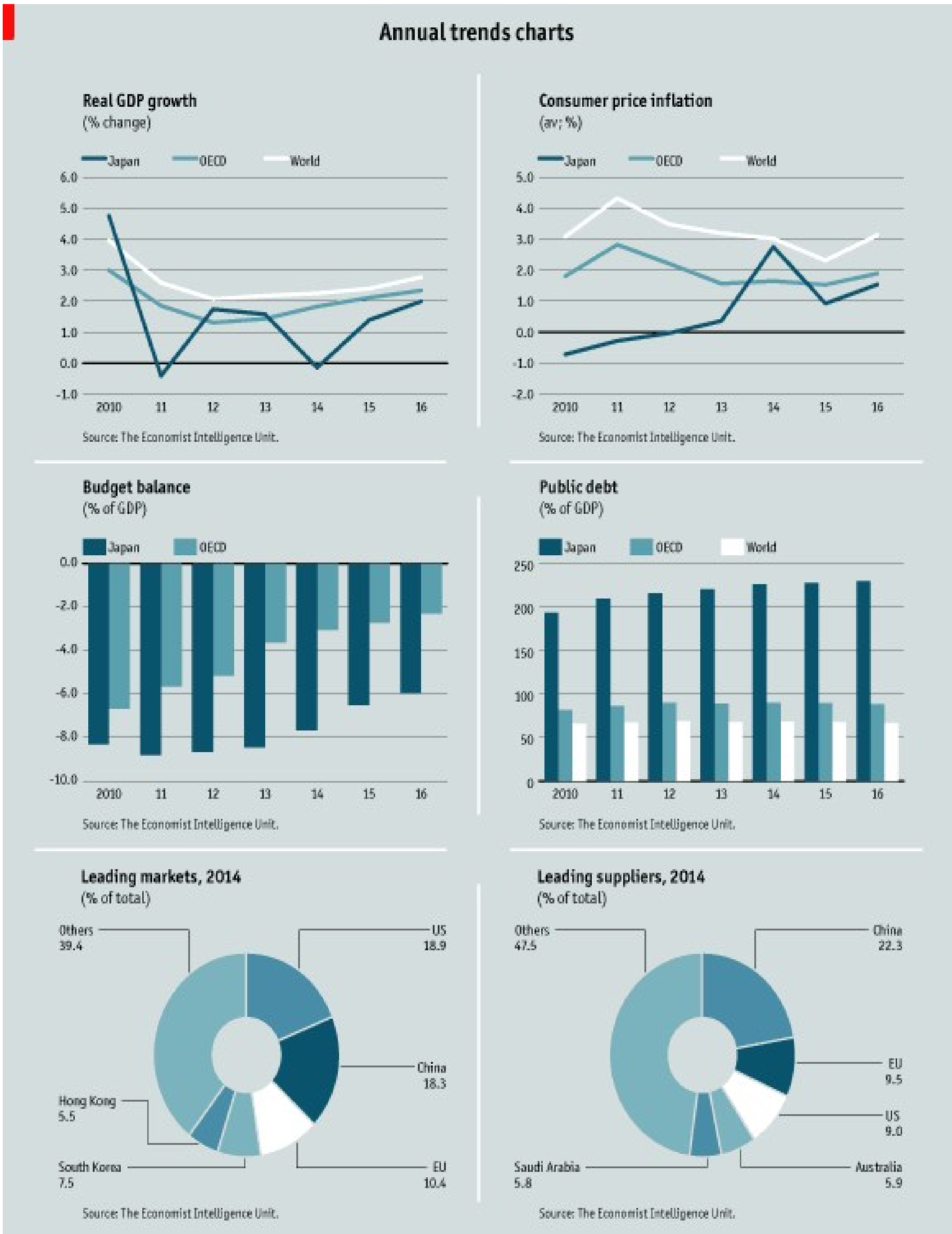
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Exchange rate ¥:US$ (av)												
2013	89.1	93.0	94.8	97.8	100.9	97.2	99.7	97.8	99.2	97.8	100.1	103.5
2014	103.8	102.1	102.3	102.5	101.8	102.1	101.7	102.9	107.4	108.0	116.3	119.3

2015	118.3	118.8	120.4	119.5	120.8	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Exchange rate ¥:US$ (end-period)												
2013	91.3	92.4	94.2	97.5	100.8	99.2	98.4	98.2	98.3	98.1	102.5	105.3
2014	102.3	102.1	103.0	102.1	101.8	101.3	102.8	104.0	109.7	112.1	118.7	119.9
2015	117.4	119.7	120.0	119.9	124.0	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Real effective exchange rate (2000=100; CPI-based)												
2013	87.6	83.6	82.8	80.1	77.5	80.7	79.1	80.4	78.9	79.4	78.4	75.6
2014	75.4	76.6	76.2	76.9	77.6	77.3	76.7	76.9	74.7	74.6	69.9	68.7
2015	70.5	70.5	70.3	70.5	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Budget revenue (¥ bn)												
2013	3,472	2,824	3,252	4,356	3,863	6,439	4,028	3,927	3,270	3,063	3,281	6,096
2014	4,275	2,747	3,781	4,914	3,901	7,775	4,895	4,047	3,542	3,430	3,392	7,248
2015	4,859	3,023	4,584	5,625	4,166	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Budget expenditure (¥ bn)												
2013	2,672	2,852	10,534	9,572	2,393	8,622	3,680	2,403	5,992	2,867	6,566	4,748
2014	2,136	2,148	8,928	11,959	2,396	7,054	3,801	2,355	5,982	3,321	7,444	3,946
2015	2,631	2,491	9,136	10,755	3,216	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Budget balance (¥ bn)												
2013	800	-28	-7,282	-5,216	1,470	-2,183	348	1,524	-2,721	196	-3,284	1,348
2014	2,140	599	-5,148	-7,045	1,505	721	1,095	1,691	-2,439	109	-4,052	3,302
2015	2,229	532	-4,552	-5,130	950	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Money supply, M1 (period average; % change, year on year)												
2013	3.5	3.8	4.0	4.1	4.5	5.2	5.4	5.3	5.2	5.5	5.7	5.6
2014	5.7	5.4	5.0	5.1	4.8	4.3	4.1	4.3	4.2	4.3	4.7	4.6
2015	4.3	4.9	5.0	5.0	5.7	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Money supply, M2 (period average; % change, year on year)												
2013	2.6	2.9	3.0	3.2	3.5	3.8	3.8	3.8	3.9	4.2	4.3	4.2
2014	4.2	3.9	3.5	3.5	3.3	3.1	3.0	3.0	3.1	3.2	3.6	3.5
2015	3.3	3.5	3.6	3.6	4.0	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Industrial production (seasonally adjusted; % change, year on year)												
2013	-7.4	-6.4	-5.9	-4.9	-1.1	-3.1	0.1	1.0	4.9	5.2	6.5	5.6
2014	9.8	6.5	6.7	3.7	1.8	2.7	-0.1	-0.4	-0.5	-0.7	-1.6	-1.9
2015	-1.1	-2.1	-3.3	0.1	-2.4	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Retail sales (% change, year on year)												
2013	-0.7	0.8	-0.4	-0.1	0.0	0.9	-0.2	1.5	3.1	2.9	3.5	2.9
2014	4.4	3.5	11.0	-4.2	-1.3	-0.6	1.5	1.1	1.8	1.6	0.5	1.1
2015	-2.4	-1.8	-9.5	4.9	2.7	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Deposit rate (av; %)												
2013	0.4	0.4	0.3	0.5	0.5	0.3	0.3	0.3	0.3	0.2	0.3	0.3
2014	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.2	0.2	0.3
2015	0.3	0.3	0.3	0.4	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Lending rate (av; %)												
2013	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5
2014	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5
2015	1.5	1.5	1.5	1.5	1.5	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Nikkei 225 stock average (¥)												
2013	11,139	11,559	12,398	13,861	13,775	13,677	13,668	13,389	14,456	14,328	15,662	16,291
2014	14,915	14,841	14,828	14,304	14,632	15,162	15,621	15,425	16,174	16,414	17,460	17,451
2015	17,674	18,798	19,207	19,520	20,563	20,706	n/a	n/a	n/a	n/a	n/a	n/a
Consumer prices (seasonally adjusted; % change, year on year)												
2013	-0.3	-0.6	-0.9	-0.7	-0.3	0.2	0.7	0.9	1.0	1.1	1.6	1.6
2014	1.4	1.5	1.6	3.5	3.7	3.6	3.4	3.4	3.2	2.9	2.4	2.4
2015	2.4	2.2	2.4	0.6	0.5	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Nominal monthly wages (% change, year on year)												
2013	0.8	-0.7	-1.1	0.1	0.1	1.5	-0.4	-0.5	0.1	0.4	1.5	0.9
2014	-0.1	0.2	1.2	1.2	1.1	2.1	3.9	1.6	1.3	0.7	0.6	2.1
2015	-0.7	-1.2	-1.1	-0.6	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Unemployment rate (% of workforce)												
2013	4.2	4.3	4.1	4.1	4.1	3.9	3.8	4.1	4.0	4.0	3.9	3.7
2014	3.7	3.6	3.6	3.6	3.6	3.7	3.7	3.5	3.6	3.5	3.5	3.4
2015	3.6	3.5	3.4	3.3	3.3	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Total exports fob (US$ bn)												
2013	53.8	56.7	66.2	59.1	57.0	62.2	59.7	59.1	60.1	62.4	59.1	59.1
2014	50.5	56.8	62.4	59.2	55.1	58.2	60.2	55.4	59.5	61.9	53.2	57.8

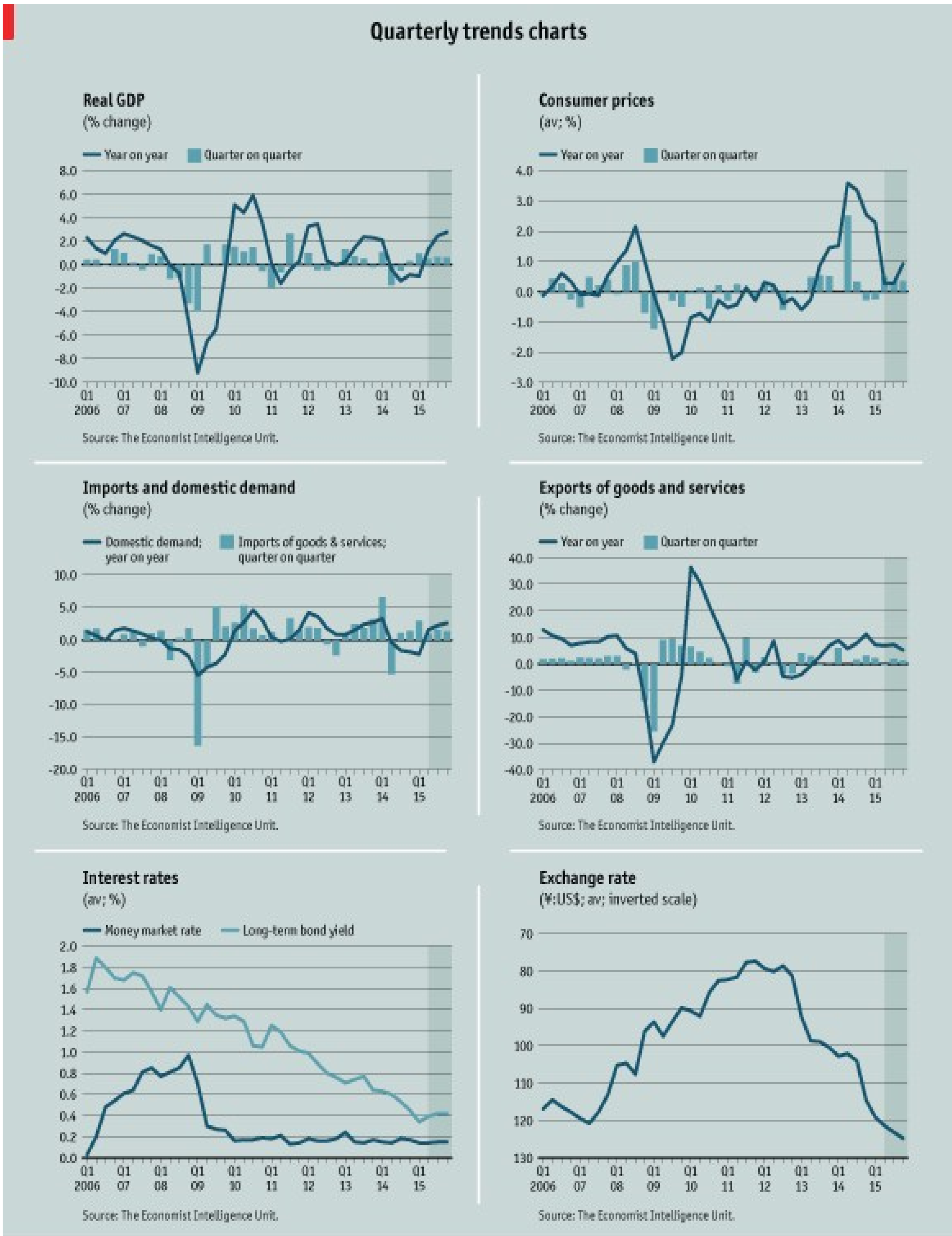
2015	51.9	50.1	57.5	54.8	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Total imports cif (US$ bn)												
2013	72.1	65.0	69.9	68.1	66.8	64.1	70.1	69.0	69.6	73.6	72.2	71.7
2014	77.4	64.7	76.6	67.2	64.1	66.4	69.6	64.7	68.5	68.7	61.0	63.3
2015	61.8	53.7	55.7	55.3	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Trade balance fob-cif (US$ bn)												
2013	-18.3	-8.3	-3.8	-9.0	-9.8	-1.9	-10.4	-9.9	-9.5	-11.2	-13.0	-12.6
2014	-26.9	-7.9	-14.2	-8.0	-9.0	-8.2	-9.4	-9.3	-9.0	-6.9	-7.7	-5.6
2015	-9.9	-3.6	1.8	-0.5	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Foreign-exchange reserves excl gold (end-period; US$ bn)												
2013	1,226.3	1,219.7	1,215.0	1,221.8	1,215.9	1,209.4	1,221.7	1,219.9	1,240.8	1,244.3	1,244.5	1,237.2
2014	1,246.2	1,255.5	1,247.5	1,251.1	1,253.1	1,251.5	1,244.4	1,246.3	1,234.4	1,237.2	1,239.9	1,231.0
2015	1,230.1	1,221.2	1,216.1	1,221.0	1,216.4	n/a	n/a	n/a	n/a	n/a	n/a	n/a

Sources: IMF, International Financial Statistics; Haver Analytics.

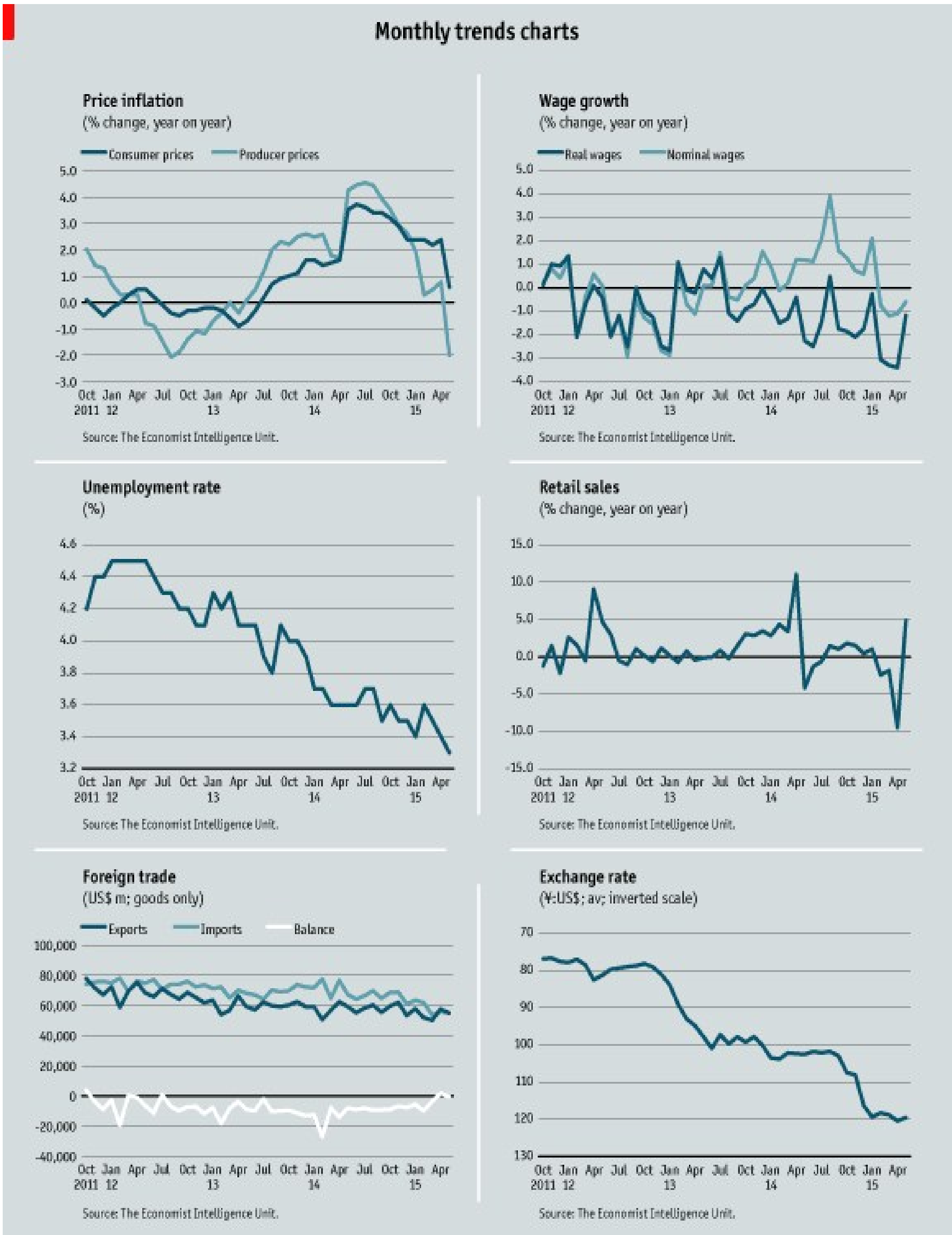
Annual trends charts



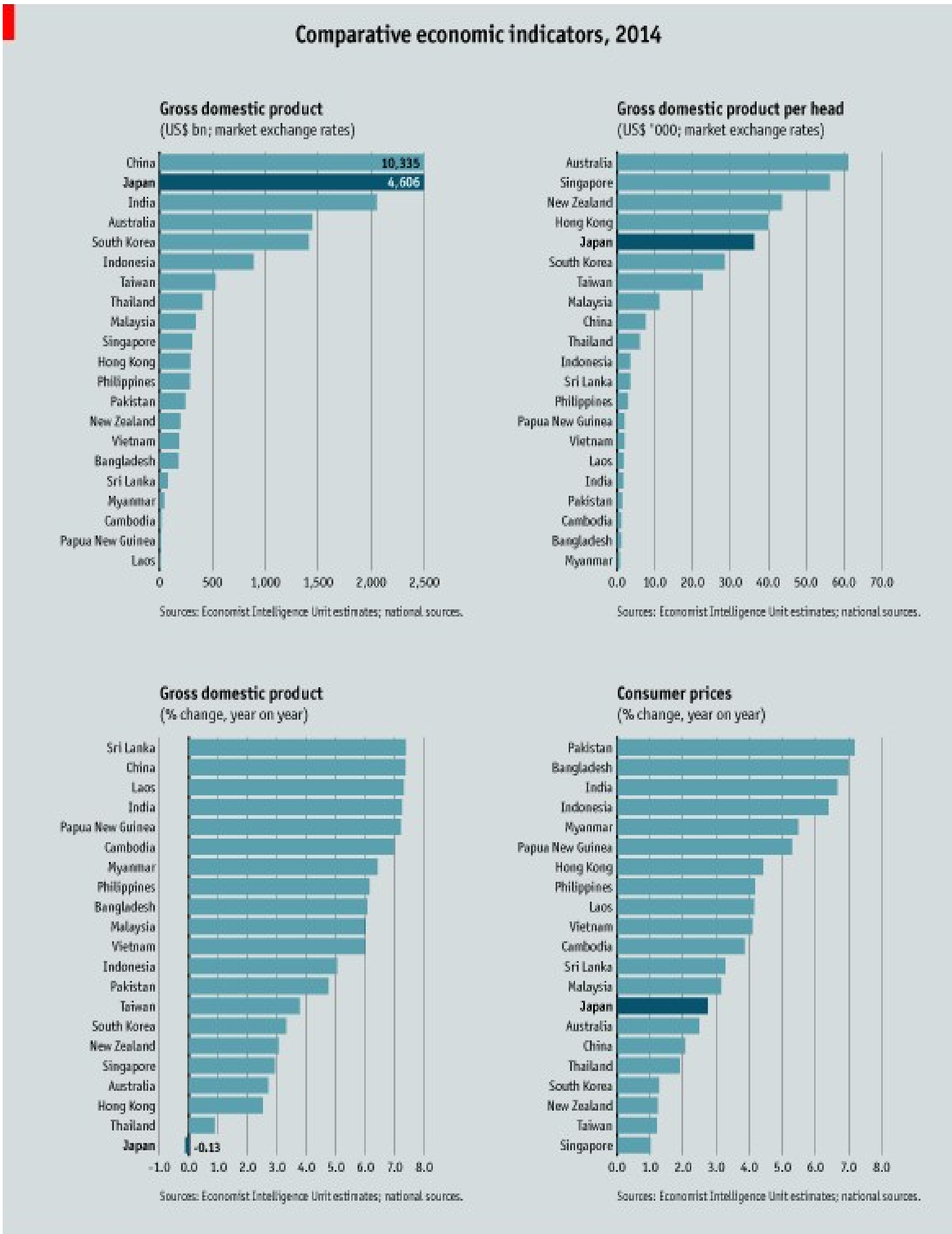
Quarterly trends charts



Monthly trends charts



Comparative economic indicators



Basic data

Land area

377,899 sq km

Population

126.9m (April 2015; Ministry of Internal Affairs and Communications)

Main towns

Population in millions (October 2013):

Tokyo (capital; 23 central wards): 9.1

Yokohama: 3.7

Osaka: 2.9

Nagoya: 2.3

Sapporo: 1.9

Kobe: 1.5

Fukuoka: 1.5

Kyoto: 1.5

Climate

Temperate, with the monsoon season in June, seasonal winds and typhoons in August-September, and heavy snow in December-February on the Japan Sea side

Weather in Tokyo (altitude 5.3 metres)

Hottest month, August, 29°C; coldest month, January, 7.6°C; driest month, August, 9.5 mm rainfall; wettest month, September, 319.5 mm rainfall

Language

Japanese

Measures

Mainly metric system; local measures include: 1 tsubo = 3.3 sq metres; 1 sun = 3 cm; 1 ri = 4 km; 1 kairi = 1.8 km (used for sea distances)

Currency

Yen (¥); ¥1 = 100 sen. Average exchange rates in 2014: ¥105.9:US$1; ¥140.7:€1

Fiscal year

April 1st-March 31st

Time

9 hours ahead of GMT

Public holidays

January 1st (New Year); January 12th (Coming of Age Day); February 11th (National Foundation Day); March 21st (Vernal Equinox); April 29th and May 3rd-6th (Golden Week holidays); July 20th (Marine Day); September 15th (Respect for the Aged Day); September 23rd (Autumnal Equinox); October 12th (Sports Day); November 3rd (Culture Day); November 23rd (Labour Thanksgiving); December 23rd (Emperor's Birthday)

Political structure

Official name

Japan

Form of government

Representative democracy

The executive

The prime minister is chosen by a ballot of the Diet (parliament) and appoints a cabinet, the majority of whose members must also be members of parliament

Head of state

Emperor Akihito

National legislature

Bicameral Diet, comprising the 475-member House of Representatives (the lower house), which is elected every four years, and the 242-member House of Councillors (the upper house), one-half of whose members are elected every three years for six-year terms. There are 295 seats representing geographical constituencies and 180 seats filled by proportional representation in the lower house

Legal system

A Supreme Court, appointed by the cabinet, presides over a legal system of lesser courts divided into four arms: the High Court, district courts, family courts and summary courts

National elections

The last election for the lower house was held in December 2014; the next poll is scheduled for 2018. An election for one-half of the seats in the upper house was held in July 2013; the next poll, also for one-half of the chamber's seats, is due in July 2016

National government

The Liberal Democratic Party (LDP) was re-elected in the December 2014 lower house election, winning 290 seats; its coalition partner, Komeito, won 35 seats. The coalition has a two-thirds majority in the lower house and a majority in the upper house

Main political organisations

Government: coalition of the LDP and Komeito

Opposition: Democratic Party of Japan; Japan Innovation Party; Japan Communist Party; Party for Future Generations; People’s Life Party; Social Democratic Party

Main members of the cabinet

Prime minister: Shinzo Abe

Deputy prime minister: Taro Aso

Chief cabinet secretary: Yoshihide Suga

Key ministers

Agriculture, forestry & fisheries: Yoshimasa Hayashi

Defence: Gen Nakatani

Economy, trade & industry: Yoichi Miyazawa

Education, culture, sports, science & technology: Hakubun Shimomura

Environment: Yoshio Mochizuki

Finance: Taro Aso

Foreign affairs: Fumio Kishida

Health, labour & welfare: Yasuhisa Shiozaki

Internal affairs & communications: Sanae Takaichi

Justice: Yoko Kamikawa

Land, infrastructure, transport & tourism: Akihiro Ohta

Reconstruction: Wataru Takeshita

State ministers

Administrative reform, gender equality, regulatory reform & declining birth rate: Haruko Arimura

Consumer affairs: Shunichi Yamaguchi

Disaster management: Eriko Yamatani

Economic & fiscal policy: Akira Amari

National strategic special zones: Shigeru Ishiba

Tokyo Olympic & Paralympic Games: Toshiaki Endo

Central bank governor

Haruhiko Kuroda

Recent analysis

Generated on July 29th 2015

The following articles have been written in response to events occurring since our most recent forecast was released, a indicate how we expect these events to affect our next forecast.

Politics

Forecast updates

July 16, 2015: International relations

Lower house clears security bills

Event

The lower house of the parliament (Diet) passed two contentious security bills on July 16th after receiving majority backing from the ruling Liberal Democratic Party and its coalition partner, the Komeito.

Analysis

The lower house of parliament has for months been debating the country's most important legislative changes since the second world war. The security-related bills consist of one to enable Japan's Self-Defence Forces to participate in "collective self-defence" and another to revise ten different laws governing the military and how it responds to armed attacks.

Although the enactment of the bills would enable Japan to use members of its self-defence force to protect its allies, they would only be deployed if Japan itself were deemed to be in a survival-threatening situation. Japan will not be able to send combat troops abroad, even on peacekeeping missions. The debate over the bills has, nevertheless, dismayed various quarters, not least the administrations in China and South Korea, which regard such measures as a step towards the revival of Japanese militarism. Local opponents believe that the bills violate the pacifist constitution, which many regard to be a pillar of their postwar identity. Academics have argued that such changes should be subject to constitutional procedures and have challenged the governments re-interpretation of Article 9—which prohibits the maintenance of a conventional army and the use of the war to settle disputes.

The prime minister, Shinzo Abe, remains determined to push ahead, arguing that the change is essential to protecting Japanese nationals while travelling and living abroad, and to meeting Japan's responsibilities to its allies—a stance that has been welcomed by the US.

The bills will now go to the upper house, where it has 60 days to debate them. If they fail to win approval there, the bills will be returned to the lower house, which has until September 27th to pass them. The coalition's commanding position in the lower house, where it enjoys a two-thirds majority, will ensure that the bills are enacted before the next parliamentary session.

Impact on the forecast

The announcement reinforces our view that Mr Abe will continue to pursue a proactive foreign policy, but he will need to work hard to increase support among the public if he is to make any additional changes to the constitution.

July 17, 2015: International relations

TPP negotiations enter home stretch

Event

Representatives from 12 countries participating in the Trans-Pacific Partnership (TPP) negotiations will gather in Maui, Hawaii on July 28th-31st to attempt to hammer out a final agreement.

Analysis

Japan's negotiations with the US provide a focal point for the conclusion of the TPP negotiations, which would cover an estimated 40% of global GDP. Japan's joining of the TPP negotiations in July 2013 was part of the structural-reform strategy of the prime minister, Shinzo Abe. Mr Abe is confident that trade liberalisation will help expedite key structural reforms. In the absence of other major free-trade agreements (FTAs), a free-trade deal on this scale is essential to Japan's achieving that goal.

The key stumbling blocks have been Japan's rice market's being protected by a 778% tariff and the highly competitive US auto market, where a 2.5% car tariff represents a significant entry barrier to Japanese cars. Trade negotiators between Japan and the US, who met in Tokyo on July 9th-10th one last time before the upcoming critical convention of TPP chief negotiators and trade ministers in Hawaii, reported some progress in closing the gap on those issues: Japan has offered to set up a tariff-free rice quota for imported US rice, and the US has hinted at a concession on car-import duties.

The US administration was given "fast-track" authority by the US Congress in June to implement the TPP without congressional intervention. Time remains of the essence: an agreement will need to be in place by September-October in order for Congress to vote on it before the US presidential-election campaigning moves up a gear; failure to do this will see the TPP fall into the hands of the next US president.

Tough negotiations lie ahead for the other participating members. Those talks are likely to include heated discussions on intellectual-property (IP) rights and financial-market access.

Impact on the forecast

We expect the TPP to be confirmed later this year, but it is possible that some of its potency could be lost amid last-minute negotiations between member states.

Economy

Forecast updates

July 1, 2015: Economic growth

Survey shows better sentiment and rising investment

Event

The Bank of Japan (BOJ) released the results of its quarterly business survey, the Tankan, on July 1st. The results show businesses in a more upbeat mood than did the March survey.

Analysis

The BOJ policy board traditionally gives a lot of weight to the Tankan survey, which is comprehensive, forward-looking and proprietary. This report provides support for the resistance of bank officials against calls by other groups for more monetary stimulus now, rather than the wait-and-see approach that the board is currently following.

The most striking finding in the latest Tankan survey involves planned investment for the current fiscal year 2015/16 (April-March). Capital spending by all large firms is forecast to rise by 9.3%, up from 5.9% in 2014/15 and a forecast dip of 1.2% reported in the March survey. However, all small firms are still projecting 15.7% less spending in 2015/16 than in 2014/15. If the economy manages to gain momentum as BOJ officials anticipate, a forecast growth in all capital spending for all industries this fiscal year of 3.4% is likely to be exceeded. Three months ago, all respondents to the Tankan were collectively projecting a 5% drop in investment.

The results clearly show an improvement in the mood of large firms outpacing that of smaller companies. The diffusion index for large manufacturers (measured by the difference in the percentage of firms facing good conditions and the proportion faced with poor conditions) rose from +12 in March to +15 in June, the same index for small firms stood at 0, compared with +1 in March.

The useful aspects of the Tankan also need to be balanced against some disappointing features. Unlike planned investment, corporate projections of sales and earnings did not change significantly from the prior report. Second, the projected direction of interest rates flipped from downward to upward. Japan has not fared well over the past two decades at times of rising interest rates. And third, profits are getting squeezed by rising input costs, while output prices continue to fall.

Impact on the forecast

The Tankan survey corroborates our view that the economy will stage a modest recovery this year. We continue to believe that the BOJ will resist calls for the further expansion of its asset-purchasing programme.

July 15, 2015: Monetary policy outlook

No change in policy, despite downward revisions to prices

Event

The monetary policy board of the Bank of Japan (BOJ, the central bank) voted 8-1 to retain a policy that grows the monetary base by ¥80trn (US$655bn) a year through an equivalent purchase of Japanese government bonds.

Analysis

Board members reaffirmed their outlook, which sees moderate economic recovery continuing and the current near-zero trend of inflation transitioning to an upward course from the fourth quarter of this year. Slightly lower assessments of current conditions in exports and industrial production were blamed on external factors, such as the pace of US growth and were counterbalanced by the resilience of business sentiment and longer-term expectations about inflation. Implicitly acknowledging that real GDP might have contracted last quarter, officials cut their real-GDP forecast to 1.7% for fiscal year 2015/16 (April-March), from the 2% forecast made in April. Projected growth rates in 2016/17 and 2017/18 were kept at 1.5% and 0.2%, respectively.

The evolution of the bank's consumer price inflation forecast does not seem consistent with its view on growth. The forecast for consumer prices for the current fiscal year was cut to 0.7%, from estimates of 0.8% issued in April, 1% in January, 2.4% made in October 2014 and 2.6% a year ago, whereas the new growth projection of 1.7% is just slightly higher than an earlier projection of 1.5%, released after a board meeting in July 2014. How, then, do officials justify their continuing confidence that consumer prices are on track to reach the 2% target by early 2017/18? A critical assumption is a 16-17% rise in international oil prices. Another, not so explicitly stated, source of support seems to be further yen depreciation. The BOJ governor, Haruhiko Kuroda, believes that expectations of inflation in the longer term support his upbeat view and asserts that the second-quarter (2014) setback in economic growth is already giving way to a firmer trend.

One board member, Takehide Kiuchi, again cast a lone dissenting vote in favour of a significant scaling back of quantitative easing. Among the eight-person majority on the board, Yoshihisa Morimoto, who was one of four to vote against the October 2014 easing, has been replaced by Yukitoshi Funo, whose rhetoric has been relatively dovish.

Impact on the forecast

We maintain our view that the BOJ will struggle to meet its 2% inflation target in a sustainable manner over the medium term, but that it will stick with current policy settings until at least 2016.

July 16, 2015: Policy trends

Leverage on pension fund pays off

Event

On July 10th the Government Pension Investment Fund (GPIF) reported a record 12.3% return on its investment in fiscal year 2014/15 (April-March).

Analysis

A buoyant domestic stockmarket and a weak yen, which helped push up returns on overseas equities, were the main factors behind the GPIF's strong performance in 2014/15. Another contributing factor was the GPIF's decision to alter significantly the composition of its investment portfolio in late 2014.

Under significant pressure from the government, which was determined to harness the investment strategy of the GPIF to boost its own reflation plans, the fund cut its domestic-bond allocation from 60% to 35%, while increasing its allocation to equities to 50%, from 24%, split equally between domestic and foreign equities. Its allocation to foreign bonds was also increased, to 15%. The change in strategy is one of the factors behind the rise of the Nikkei 225, which hit an 18-year high in June. This, in turn, helped to push up investment returns at the GPIF.

However, the outperformance of the GPIF is unlikely to be repeated. In 2014/15 gains from foreign stocks and bonds amounted to ¥6.7trn (US$54bn), or 43.6% of the GPIF's total investment return. The yen's 17% decline against the dollar in that year helped inflate overseas profits translated into the yen. The same thing may not happen this financial year, as the yen's depreciation slows and global financial-market volatility increases, even though the GPIF has considerable room left to reach the raised upper limits of its portfolio-allocation bands for foreign stocks and bonds, which are 25% plus or minus 8% and 15% plus or minus 4%, respectively.

Nevertheless, the success of the GPIF's investment strategy has increased public confidence in the government's multi-pronged economic approach, underpinned by monetary easing from the Bank of Japan (BOJ, the central bank). The GPIF's higher-risk, higher-return strategy also makes sense in light of the government's efforts to balance the primary budget by March 2021, because the cost of meeting the pension needs of Japan's ageing population is outpacing the revenue of pension contributions from the working population.

Impact on the forecast

The GPIF's results will prompt other Japanese pension funds to adopt more aggressive investment strategies. A greater appetite for foreign equities will, however, exert downward pressure on the yen. We have already factored this into our exchange-rate forecast for 2015.

July 22, 2015: Economic growth

Toshiba accounting scandal puts spotlight on governance

Event

On July 21st eight members of top management at Toshiba, one of the oldest and largest electronics companies in Japan, resigned after an independent audit report revealed accounting irregularities between 2008 and 2014.

Analysis

The external audit report discovered that profits at Toshiba had been inflated by some US$1bn over a six-year period. The report concluded that this was done by delaying loss recognition and booking unrealised profits under the directive of the company's three successive presidents. The scandal surrounding one of Japan's high-profile multinationals, which has a 140–year history, will be compared against the corporate corruption case of another Japanese firm, Olympus, which was found to have some ¥117.7bn (US$960m) in hidden losses and other charges dating back to the late 1980s.

The Toshiba scandal is a glaring reminder of Japan's rigid top-down corporate culture. It has the potential to undermine investor confidence and will leave many wondering whether there is a pattern of accounting malpractice elsewhere. The scandal suggests that little has changed since the Olympus debacle despite efforts to improve the standard of corporate governance in Japan by increasing the presence of outside directors in company boardrooms and installing audit committees. The irony is that Toshiba was one of the forerunners in implementing these changes.

The scandal has raised awkward questions about processes in Japanese corporations, particularly as the government has identified governance reforms as a key policy goal. However, the scandal is likely to have a limited impact on the economy, partly because accounting irregularities of this scale are rare and partly because the company is a long way off from being delisted. Investor confidence in Japanese companies remains upbeat with foreign ownership reaching more than 30% of market capitalisation. Furthermore, the recent shift in investment strategy at the Government Pension Investment Fund will continue to provide liquidity support for Japanese equities.

Impact on the forecast

The impact of the accounting scandal on the broad economy is likely to be limited, but it will probably prompt the government to enforce more strongly a recently introduced code of governance.

July 24, 2015: External sector

Exports jump in value terms but volumes remain weak

Event

The value of merchandise exports rose by 9.5% year on year in June. Imports, conversely, remained on a downward trend, falling by 2.9% year on year in June. However, the divergent trends did not result in an improvement in the trade account, which stayed in the red.

Analysis

A breakdown of the trade data shows weaker trends. Sluggish Chinese and US demand continued to suppress real exports in June. Although the value measure surged by 9.5%, the volume measure of exports showed little change compared with the year-earlier period. Export volumes to China and the US fell by 2.5% and 3% year on year respectively in June, and total export volume dropped by an average 0.7% between the second quarter of 2014 and the second quarter of 2015.

Lower average prices for global energy products continue to depress overall import values. Mineral fuel imports fell by 33.4% year on year. This plunge masked strong gains in other categories, which helped to arrest slightly the annual rate of decline. There was double-digit import growth in transportation equipment (31.6%), chemicals (17.5%) and electrical machinery (11.7%), as well as solid gains in food of 9.1%, machinery of 8.5% and manufactured goods of 8%. The total value of imports fell by 8.6% year on year in May and by an average 9.3% in the first quarter (on a year-on-year basis).

On a seasonally adjusted basis, imports jumped sharply between May and June, rising by 5.8%. As with exports, such strength essentially reflects higher prices related to the soft yen. Import volume in the second quarter was 1.9% lower than the year-earlier period.

Impact on the forecast

The latest trade data are in line with our view that the trade account will remain in the red for the year as a whole. However, the deficit will continue to shrink this year and next.

July 28, 2015: External sector

Growth in tourism revenue gathers steam

Event

Current-account data for July point to a sustained upswing in inflows of international visitors and tourism revenue.

Analysis

According to the Japan National Tourism Organisation's monthly statistics, international tourist arrivals in Japan reached a record high of 9.1m in the first half of this year, representing a rise of 46% year on year. Inbound tourist numbers will continue to set new records in the foreseeable future as the yen remains weak. Despite ongoing diplomatic tensions, the two biggest sources of inbound tourism were South Korea and China. A total of 2.2m Chinese arrivals were recorded in the first six months of this year, up by 116.3%, while 1.8m South Koreans came to Japan over the same period, up by 42.6%. All of the 18 other major inbound-tourism markets tracked by the organisation registered record-breaking double-digit growth except Russia, which saw a 17.4% year-on-year drop in tourist arrivals. Annual figures hit all-time highs in 2013 and 2014, and, if the trend continues, the government's goal of attracting 20m foreign visitors in 2020, the year of the Tokyo Olympics, will be easily attained much sooner.

The tourism boom is a boon for Japan's resurgent economy, with additional consumption demand derived from visitor spending. Large and small retail establishments offering duty-free sales have mushroomed to nearly 20,000 locations nationwide, including even convenience stores. According to the National Tax Agency, foreign shoppers purchased more than ¥2trn-worth (US$18.9bn) of duty-free goods in 2014. However, at the same time the weak yen is discouraging Japanese from going abroad. In the first half of this year 4.9% fewer Japanese travelled abroad compared with the year-earlier period. It was the first time that inbound traffic exceeded outbound tourism on a six-month basis since 1970.

Impact on the forecast

The strong growth in inbound tourism is broadly consistent with our view that the current-account surplus will grow to US$116.1bn in 2015 as a whole, from US$24bn in 2014.

Analysis

July 13, 2015: Fiscal policy outlook

Japan bets on growth for its return to fiscal balance

The latest annual package of fiscal strategy, economic growth and regulatory reform reflects the government's increased confidence in achieving sustained economic growth over the short-to medium-term. The Basic Policies for Economic and Fiscal Management and Reform, which is the package's fiscal strategy portion, sets an interim primary budget deficit target of 1% for fiscal year 2018/19 (April-March). The target assumes nominal GDP growth of 3% and real GDP growth of 2%, which should generate enough tax revenue to more than cover fiscal spending, even with a planned reduction in effective corporate tax rates from 35% to less than 30% over several years.

The shift in emphasis from fiscal caution to economic growth is unmistakable in this year's package. The key premise for the fiscal balance goal in last year's package was an increase in the consumption tax rate to 10% in October 2015, following the previous hike from 5% to 8% in April 2014. In November of that year the government postponed the tax increase until April 2017, after the previous tax hike sent the economy into recession. This year's package deliberately avoids placing a cap on total budget spending, indicating the government's underlying willingness to spend more to prop up economic growth at the expense of fiscal discipline.

Real GDP growth is clearly on an upward trajectory after a contraction of 0.1% in 2014. The Economic Intelligence Unit expects economic growth to rebound to 1.4% in 2015 as the weak yen—the biggest driver of economic policy executed under the leadership of Shinzo Abe, the prime minister—continues to boost corporate profits and asset prices in Japan. The 1% interim primary deficit target itself is a sharp downward revision of the Cabinet Office's forecast in February 2015 of a 2.1% shortfall for 2018/19. The rise in the government's optimism is based on its belief that the economy is (and will be) doing better than previously expected.

Structural reform

The grounds for that optimism are not assured. Other economic fundamentals are little changed from last year. Global economic growth remains sluggish, and the premise of the weak yen could easily falter if global investors suffer from a severe bout of risk aversion and go in search of traditional safe havens, of which the yen is one. Japan's total public debt stood at the equivalent of 226% of GDP in 2014—the highest among developed economies. Demographic pressure from an aging population continues to build on the economy. The government's answer is to expedite structural reforms and tighten social security spending.

This year's growth strategy reiterates the existing priority of increasing female participation in the labour force and changing the regulatory environment of the agriculture and service sectors, which together account for around 73% of GDP at factor cost. The conclusion of the Trans-Pacific Partnership (TPP) free-trade initiative, involving 12 participating countries, could serve as a catalyst for domestic structural reform if Japan and the US manage to resolve their differences over market access to specific parts of their respective economies. However, the likely reforms arising from the TPP will remain a bone of contention among the Japanese agricultural community and could hinder Mr Abe's attempts to increase the ruling coalition's representation in the next upper house elections, which are due in 2016.

On the social security front, this year's package calls for a tight lid on increases in total spending, at ¥1.6trn (US$13.1bn) a year through to 2018/19. Social security spending in the current fiscal year is estimated at ¥31.5trn, compared with ¥25.8trn set aside for all other spending programs, and this cap looks unrealistic in light of the aging trend of the population, with the country's baby-boomer generation hitting the old-age social security threshold.

The government plans to produce a road map for implementing social security reforms before the end of this year with a view to cutting entitlement costs for the wealthy and curbing healthcare costs as a whole. The idea is to reduce national pension payments to better-off pensioners and to encourage elderly healthcare recipients to pay more in out-of-pocket expenses. Supply-side measures will include resetting the price schedule of reimbursable drugs every year and promoting the use of generic drugs, instead of pricey branded drugs, to curtail drug cost inflation.

Political test

The latest fiscal finance and economic growth blueprint will feed into the budget for 2016/17, which should be finalised by December. This year's budgeting season will coincide with a major political test for the Abe government, creating a high level of uncertainty along the way.

In August Mr Abe is expected to make a potentially groundbreaking statement on the 70th anniversary of the end of the second world war, with potentially adverse geopolitical implications. The national debate over security-related legislation intended to alter dramatically Japan's post-war security platform will heat up as the government presses for its passage through parliament. Mr Abe's re-election as the head of the ruling Liberal Democratic Party for another three years in power will be determined in September. If the TPP negotiations come to a close this summer, ratification and related legislation should follow amid a cacophony of potential protests form various sectors.

These are difficult political challenges but are not insurmountable if the economy keeps up steady growth, helping the government to sustain its strong grip on power in the absence of checks and balances from a weakened and fragmented opposition.

July 15, 2015

EIU global forecast - Grexit remains on the cards

In the past month the prospect of a Greek exit from the euro zone ("Grexit") has risen considerably, following the repeated failure of negotiations between the left-wing Syriza coalition government and its European creditors. The deal reached in mid-July, which includes stricter measures on Greek public spending than have been proposed before, is likely to cool the fevered temperature in the euro zone in the short term, but the risk of Grexit in the medium term remains high. Greece's creditors remain deeply suspicious about the ability of the government, led by the prime minister, Alexis Tsipras, to implement the spending cuts and fiscal reforms that they believe are required to justify a third bail-out. This is why the deal comes with a heavy price for Greece. It also means that the hard work is only just beginning for Mr Tsipras. He must convince Greece's parliamentarians and the wider population that this deal is in the country's interests if he is to survive in office long enough to implement it. The creditors will not tolerate any deviation from the plan. The scale of the demands, and the divisions already evident in the Greek government, lead us to believe that Grexit in the next five years is still more likely than not.

Although Grexit would create another fault line in the euro zone in the medium term, The Economist Intelligence Unit is relatively sanguine about the immediate effects of potential Grexit (and the path to it) on the real European and global economies. This mostly relates to the strength of the rest of the euro zone in comparison with 2012–13, which was when Grexit was last on the cards. Since then, fiscal positions have improved, firewalls have been erected, debt-repayment schedules have become more manageable and direct corporate and banking linkages between Greece and the rest of the euro zone have shrunk. Consequently, we have maintained our forecast for euro zone GDP growth in 2015. The likelihood of further volatility and the Greek government failing to implement its measures in full means that we have lowered euro zone GDP growth by 0.1% to 1.6% in 2016, reflecting diminished consumer and business confidence. We are also forecasting a slightly weaker euro against the dollar.

For the global economy as a whole, we expect growth in 2015 of around the same levels as 2014: of 2.4% at market exchange rates and 3.3% at purchasing power parity exchange rates. This reflects bad years for Brazil and Russia and quickening growth in Europe, Japan and India. Growth will accelerate to 2.8% and 3.7% respectively in 2016.

Developed world

The US economy endured a difficult start to 2015, contracting by 0.2% in the first quarter, but the dip in output will be temporary. Leading indicators for the second quarter have been strong: jobs continued to be created at a rapid rate, consumer confidence was high and the unemployment rate fell further. Only nominal wages were disappointing; these were flat on a month-on-month basis in June. Nevertheless, we still expect the Federal Reserve (the US central bank) to lift its policy interest rate for the first time since 2006 at its September meeting. An upward revision to GDP in the first quarter has meant that we have lifted our forecast for growth in 2015 fractionally, to 2.5%. We expect the same rate of growth in 2016.

Despite the troubles in Greece, the economic outlook for the euro zone has brightened in recent months, owing to the plunge in the global oil price and the actions of the European Central Bank (ECB). The signalling effect of the ECB's sovereign quantitative easing programme has been enhanced by the fact that it has coincided with an upturn in sentiment and activity across the single currency area. European consumers have shown a willingness to spend the additional money that they have in their pockets as a result of cheaper oil, which pushed growth up to 0.4% at a quarterly rate in January-March, the fastest pace in two years. It is possible that Grexit could spur policymakers into taking the politically sensitive reforms needed to shore up the monetary union, which would lead to stronger growth in the medium term. But our view is that the intensification of anti-establishment political sentiment in Europe will persist, continuing to fray the ties that bind euro zone members and keeping growth rates at subdued levels throughout the forecast period.

The Japanese economy began 2015 in strong fashion: real GDP growth in the first quarter of 2015 grew by 1% quarter on quarter and 3.9% on an annualised basis, having been in recession in mid-2014. The good quarter provided a boost to the prime minister, Shinzo Abe, for whom 2015 is a crucial year. After being re-elected in late 2014 with a big majority, he now has to maintain growth and inflation and implement his much vaunted structural reform programme, while also considering the long-term health of the public finances. Japan's huge debt-to-GDP ratio will become increasingly onerous as more Japanese retire and the working-age population shrinks. Growth should continue to accelerate, from a mild contraction in 2014 to 2% in 2016.

Emerging markets

The structural slowdown in Chinese growth will continue in 2015. The government's growth target of "around 7%" will be achieved, but only because of a relaxation of fiscal policy and some important tweaks to reduce high real interest rates. The focus on fiscal levers reflects a desire to wean the economy off a dependence on credit, as well as recognition that monetary loosening is now less effective than it used to be in stimulating demand. Consumer confidence in the economy is likely to have been shaken by a hefty fall in the country's stockmarkets and the failure of the government's measures to support prices. The very fact that the government instructed its regulator to intervene is a significant blow to reform efforts, as it undermines its commitment to giving markets a "decisive role" in allocating state resources. We expect growth of 6.8% this year and 6.5% in 2016, down from 7.4% in 2014. The Indian economy is benefiting from lower oil prices, which have eased structural problems with high inflation and enabled looser monetary policy. Growth should remain steady, averaging 7.2% a year in 2016–19, but the measures that could see Indian growth reach double digits again—land acquisition reforms and a nationwide goods and services tax—will prove much harder to legislate, owing to the government's lack of a majority in the upper house. The lack of fresh legislation in these areas will prevent new policies, such as a plan to build 100 new "smart" cities, from taking off.

The Ukraine crisis continues to dominate the outlook for the Transition region. Western sanctions imposed on Russia, together with lower oil prices, have weakened that country's economy, which we expect to contract by 3.6% in 2015. Prospects for peace in eastern Ukraine are dim, given the distance between the two sides over the degree of autonomy that the authorities in Kiev are willing to grant to separatist regions. The most likely outcome remains a "frozen" conflict that enables Russia to exercise influence in Ukraine and to block moves by the government in Kiev towards closer integration with the West. We expect the Transition region to contract by 0.3% in 2015; growth will reach 2% in 2016.

The malaise affecting Latin America in 2013–14 is set to continue in 2015–16, owing to falling terms of trade and the start of monetary tightening in the US (which will see capital leave the region). Nonetheless, with the exception of Venezuela, the region is equipped to withstand such shifts better in 2015 than it has done in previous US monetary tightening cycles. Although Latin America is running a wide current-account deficit, it has stronger external and fiscal balance sheets than previously. Nonetheless, the outlook for Brazil, the region's largest economy, is miserable: we expect the economy to shrink by 1.5% in 2015, and growth in 2016 will be weak. A round of fiscal and monetary tightening will crimp private consumption and a corruption scandal at the state energy firm, Petrobras, will deter investors.

Prolonged oil price weakness—due to much higher US production coupled with OPEC's determination to maintain market share—means that Middle East and North African economies must brace themselves for challenging economic times. Regional growth in 2015 is expected to slow to just 2.5%. Although growth will pick up thereafter, lower prices will sap vitality from many oil-producing economies by jeopardising infrastructure and property developments. More encouraging is the imminent signing of a comprehensive agreement between Iran and the P5+1, which will prove transformative for Iran, assuming that it presages an opening-up to the world economy. Given Iran's hydrocarbons wealth, demographics and economic diversity, a full nuclear deal could herald a return to trend real GDP growth rates of around 5%. Regional attention will also remain focused on Iraq and Syria, the base of the Islamic State militant group. In Libya, violence and parallel governments are harming the country's ability to manage its economy.

Policymakers in Sub-Saharan Africa face the challenge of stimulating domestic economies while facing weaker commodity prices and mediocre export demand. The region's current account has been in deficit since 2012, and the deficit will widen this year and next as terms of trade weaken and imports rise, fuelled by domestic demand. In addition, capital inflows, which are needed to sustain growth rates, will remain dependent on a sustained recovery in the global economy. A widespread consolidation of public finances is required to shield economies from future shocks. At 3.2% in 2015 and 4.2% in 2016, growth will be insufficient to have a major impact on poverty levels.

Exchange rates

After stalling in March-April, the US dollar's rally against most other major currencies has now resumed, supported by the divergent trends in central bank policy—against the yen the dollar briefly broke through the ¥125:US$1 barrier in May, and it will be above parity with the euro on an annual average basis in 2016. Oil will continue to exert an influence over emerging-market currencies: those of large producers such as Russia have suffered significant depreciations, while those of importers such as India have shown much more resilience.

Commodities

After rising to US$69/barrel in May, dated Brent Blend prices are now wobbling again, falling to US$57/b in mid-July. We see four sources of downside risk to our oil price forecast: that a large volume of Iranian oil comes on stream very quickly; that US shale production proves highly resilient; that consumer confidence declines in China as a result of the fall in stock prices; and the possibility that Grexit has a stronger than expected impact on the real economy. Fundamentally, the oil market remains oversupplied and global production will expand further in 2015, driven by elevated OPEC supplies. In the light of this, we expect Brent to average US$60/b on an annual basis in 2015, rising to US$69/b in 2016, but risk is now firmly weighted to the downside.

World economy: Forecast summary

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Real GDP growth (%)										
World (PPP* exchange rates)	5.0	3.7	2.9	3.1	3.2	3.3	3.7	3.8	3.9	3.7
World (market exchange rates)	4.0	2.6	2.1	2.2	2.3	2.4	2.8	2.8	2.9	2.5
US	2.5	1.6	2.3	2.2	2.4	2.5	2.5	2.4	2.6	1.4

Japan	4.7	-0.4	1.7	1.6	-0.1	1.4	2.0	1.3	1.7	1.5
Euro area	2.0	1.7	-0.8	-0.3	0.9	1.5	1.6	1.6	1.5	1.5
China	10.4	9.3	7.7	7.7	7.4	6.8	6.5	6.1	5.9	5.6
Eastern Europe	3.3	3.8	2.0	1.5	1.5	-0.3	2.0	2.7	2.7	2.8
Asia and Australasia (excl Japan)	8.5	6.2	5.6	5.7	5.8	5.6	5.6	5.4	5.3	5.2
Latin America	6.0	4.8	3.1	2.8	1.4	0.7	1.9	3.1	3.4	3.2
Middle East & Africa	4.9	3.2	3.7	2.0	2.8	2.5	3.6	4.2	4.6	4.5
Sub-Saharan Africa	5.1	4.0	3.3	3.8	3.6	3.2	4.2	5.0	5.1	5.1
World inflation (%; av)	**3.1**	**4.3**	**3.5**	**3.2**	**3.0**	**2.3**	**3.2**	**3.3**	**3.5**	**3.4**
World trade growth (%)	**14.3**	**6.9**	**2.5**	**3.1**	**3.0**	**3.7**	**5.0**	**5.5**	**5.6**	**5.6**
Commodities										
Oil (US$/barrel; Brent)	79.6	110.9	112.0	108.9	98.9	60.2	69.3	79.9	86.4	89.3
Industrial raw materials (US$; % change)	44.8	21.8	-19.3	-7.1	-5.5	-8.1	7.4	9.2	3.0	2.7
Food, feedstuffs & beverages (US$; % change)	10.7	30.0	-3.5	-7.4	-5.2	-16.3	4.2	4.8	2.2	2.7
Exchange rates (av)										
¥:US$	87.8	79.7	79.8	97.6	105.9	122.1	124.4	124.0	122.0	120.0
US$:€	1.33	1.39	1.29	1.33	1.33	1.07	0.98	1.05	1.15	1.20

*PPP=purchasing power parity

Source: The Economist Intelligence Unit.

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TPP negotiators head for the finish line

There is now a more than even chance that negotiators from 12 countries gathered in Hawaii to finalise the Trans-Pacific Partnership (TPP) free-trade and investment pact will actually achieve their goal by the end of the week. If they do, it will be a huge achievement, and probably the most important development for global free trade since China's entry into the World Trade Organisation (WTO) in 2001.

The TPP is an existing trade grouping encompassing Singapore, Brunei, New Zealand and Chile, but the current negotiations surround a major expansion of the partnership that also aims to bring the US, Japan, Vietnam, Australia, Malaysia, Peru, Mexico and Canada into the group. The likelihood of a final deal was given a huge boost when the US president, Barack Obama, secured backing from Congress (the US legislature) for Trade Promotion Authority (TPA) in June. This removed Congress's ability to vote on the various details of the agreement, allowing only a straight yes or no vote on the version signed off by US negotiators. With this now in place, the Obama administration is pushing its partners in the TPP harder than ever to bring the talks to a swift conclusion and thus gain the credit for any deal.

The first modern multilateral trade deal

Details of the potential final agreement are still unclear, but from what we know about the outlines it is already obvious that the TPP's importance will not lie in the traditional field of tariff reductions. It is true that the deal will be something of a landmark for the US and Japan, both of whom look set to reduce the protection they give favoured sectors—such as agriculture in Japan, and vehicle parts in the US. As in all trade agreements, some firms will gain and some lose out, but overall consumers should be the biggest winners, through lower prices and more competitive markets.

The real triumph in securing an agreement, however, will belong to the US. The TPP will bring together countries that represent over 36% of global economic output, banishing the ghost of the WTO's failed Doha round of trade talks and proving that massive multilateral deals are still possible. The US has taken the lead in the negotiations, and in doing so has made sure that its voice has dominated in discussions over intellectual property, digital and online services, and the co-ordination of trade regulations. As the first major trade agreement of the Internet age, the TPP is likely to set the benchmark on many of these issues.

This will be no small advantage for the US and other signatories of the TPP. With so much of the world adhering to these standards, they may well be able to force those outside the partnership, such as China and the EU, to change their procedures to adapt to TPP norms. Indeed, there is already talk of merging China into the agreement at some date in future, either through it joining the TPP directly or by subsuming it in a wider Asian free-trade deal. Talks on a Transatlantic Trade and Investment Partnership (TTIP) between the US and EU are also likely to use the TPP as a baseline.

There will be critics

The TPP is nonetheless set to be a controversial deal. Its immediate benefits will probably be relatively modest and more complicated to explain than some past free-trade agreements. It is likely to include investor-state dispute-settlement provisions, which have become increasingly unpopular in recent years. The final shape of the clauses on the treatment of state-owned firms remains hazy. Any big challenges to their role could prompt unrest by public-sector unions, and could be politically tricky to enforce.

Meanwhile, many activists will give little credence to the labour and environmental protection clauses that make it into the final agreement. Discussions over patent protections on medicines remain one of the more thorny aspects of the negotiations that have yet to be settled. It is also a near certainty that the cuts to agricultural tariffs and protection will spark protests in many of the countries that sign up to the TPP.

Although many of the governments involved in the talks have been hinting that a deal will be finalised this week, past experience suggests that we should take nothing for granted until a deal is announced. Canada, for one, is still holding out fiercely over dairy imports. Yet the US and Japan seem to have reached an agreement that they are broadly happy to move forward with. As the giants of the group, they would probably rather secure a TPP with fewer partners than none at all. Laggards risk being jettisoned.

A welcome jolt for international trade

International trade growth has been disappointingly sluggish in recent years, a factor that has been at least partly to blame for a disappointingly poor global economic performance over the same period. The causes for the slowdown have been disputed. However, if the TPP deal is secured, it should go some way towards drawing a line under this worrying trend. It would prove that big modern trade deals, covering both tariffs and standards, are possible, encouraging others to pursue similar accords—including further expansions of the TPP itself. In the end, this demonstration effect may be the most important outcome of any TPP agreement.