Medium and Long-term Global Economic Outlook

(FY2017-FY2030)

Summary

The uncertainty of the global economy is increasing. Countries that can reinforce innovation may avoid secular stagnation.

Substantial business opportunities may be derived from resolving societal problems. Technology and infrastructure will be the key important factors for the competitiveness of each country.

Japan should implement five courses of reform toward the targeted future.

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1. Global economy : Five Basic Trends through 2030

The uncertainty of the global economy continues to increase. Businesses in developed countries have not increased capital expenditure since the global financial crisis of 2008, resulting slow improvement in productivity. The prolonged low growth has changed the social structure including widening disparity and loss of employment opportunities. Policy makers have turned to concentrate more on these domestic issues. In the future, even some emerging countries could fall into "middle-income trap" due to slow improvement in productivity and failure to eliminate poverty. If each country leaves its societal problems unattended, the growth rate of the global economy is expected to slow down over the medium to long-term.

Technological innovation will be the driving force in resolving societal problems. In the past, when societal problems became so serious that related costs reached their tolerable limit, a new innovation came out and overcame these problems. While the world currently faces serious problems such as an aging society and global warming, innovations based on new technology are being generated one after another to resolve these problems. Naturally, there are problems that cannot be solved only by technology. Based on forecasts of demographic trend, technology developments and geopolitical affairs, governments need to decisively implement reforms in social systems such as social security, deregulation and flexible labor markets. These also are prerequisite for many nations for continued growth and prosperity. Based on this perspective, we list five major trends that will affect the global economy in 2030.

(1) Countries that can reinforce innovation may avoid secular stagnation

Due to aging population and slow improvement in productivity, economic growth in developed countries has slowed down to an extent where some argue that they have fallen into a secular stagnation. Over the medium to long term, countries that achieve technological evolution, reform social systems and thus enhance innovation may avoid secular stagnation. For example, advancement of artificial intelligence (AI) and robotics will bolster the potential growth both from supply and demand sides. Human beings can shift to more value-creating work if AI and robots replace the work that humans have been doing. If we can resolve societal problems through implementing new technologies to the society, new types of "creative demand" will be stimulated. The economic strength of each country in 2030 will depend on the pursuit to of reinforce innovation.

(2) New digital technology will lead "game changes"

Technological changes will also impact on global competitive conditions. For example, if AI and robots play heavier role in manufacturing and service processes, labor costs will become less an important factor in measuring competitiveness of the country, and technological competence and quality of infrastructure will become more important.

Required use of technology and the contents of infrastructure will also change. In technology, big data and internet of things (IoT) will be utilized for optimizing production management and development of new products and services. Automation and labor saving substituted by AI and robots, and enhancement of worker skills through increased use of augmented reality (AR) and virtual reality (VR) technologies will be the key factors. As to infrastructure, it is important to create platforms such as Fintech (new services through combination of finance and data technology), and to apply basic technologies such as cyber security and block chain (distributed control technology of transaction records) to them. Progress in digital infrastructure may dramatically change the whole spectrum of global competitive conditions.

(3) Economic growth through resolving societal problems

The magnitude of the societal problems for the global economy implies that there is also a huge demand for solutions to those problems, and hence, there is a good chance for innovation. The magnitude of that potential is commonly recognized worldwide. In 2015, the United Nations set 17 goals (no poverty, quality education, good health and well-being, etc.) to be achieved by 2030 as "Sustainable Development Goals (SDGs)". According to the estimate by the United Nations Conference on Trade and Development (UNCTAD), possible new investment required by private and public sectors for those initiatives amounts to about $3 trillion worldwide, largely in emerging countries.

There are good examples of societal problems at emerging countries that were overcome in developed countries in the past through technological evolution and reforms of social systems. For companies in developed countries that possess technology and know-how of resolving these societal problems, making investment in emerging countries will mean a new business opportunity. For emerging countries, this investment is indispensable to achieve a sustainable society.

(4) The size of high income consumer markets in emerging countries will become three times that of Japan

If emerging countries are able to continue sustainable growth, the size of high income consumer markets[*1] is expected to rise from $5 trillion in 2014 to $12 trillion in 2030. This is three times the size of that in Japan. Not only in the coastal cities in China, but also in the major cities of emerging countries, average income will reach to almost the same level as advanced countries.

(5) Swing back from protectionism to free trade principles

A risk that hinders the growth in the global economy is the spread of trade protectionism. As the global economy becomes multipolar, trade protectionism had been gaining momentum in the world even before the start of the Trump administration in the U.S. The number of discriminatory trade measures (import restrictions aimed at protecting a country's own industries, etc.) in the G20 increased fourfold[*2] between 2009 and 2016.

*1 The high income consumer is defined as consumers spending over $50 per person per day. This is equivalent to the consumption level in advanced countries.

*2 "FDI Recovers?", The 20th Global Trade Alert Report (2016), P. 34

History shows that growth rate of the global economy tends to slow down in times of protectionism, and expands when there is greater trade liberalization. Over the short term, current wave of protectionism may stagnate global economic growth. However, if each country reconfirms the importance of free trade, we expect that there will be a return to free trade principle over the medium to long-term.

Real GDP growth of the main economies

	Share of global GDP	Actual	Forecast		
		2011-15	2016-20	2021-25	2026-30
Japan (fiscal year)	6.6%	0.9%	0.9%	0.3%	0.2%
US	24.7%	2.1%	2.1%	1.8%	1.7%
Eurozone	15.8%	0.7%	1.4%	0.8%	0.6%
China	14.9%	7.9%	6.5%	5.4%	4.1%
ASEAN5	2.8%	5.1%	5.1%	4.6%	4.1%
India	3.0%	6.9%	7.4%	6.5%	5.7%
Brazil	2.4%	1.1%	-0.5%	1.8%	1.8%
Russia	1.7%	1.2%	1.3%	1.7%	1.4%

Note 1 : Global GDP share is based on IMF (World Economic Outlook Database as of April 2017.US dollar basis as of 2016)
Note 2 : ASEAN5 is Indonesia, Thailand, Malaysia, Philippines, and Vietnam.
Source : Actuals are based on public materials, and forecasts are made by MRI

2. Overseas economy :
China's GDP may exceed the U.S. by 2030

US economy :

The U.S. economy is expected to grow by 2-2.5% per year in the short term assisted by the fiscal stimulus of the Trump administration. In the medium to long-term, the potential growth rate of the U.S. economy will likely be kept at 1.5-2% per year. While the aging society will lower the growth rate, the strength of innovation capability will bolster the growth. The risks of the US economy include: 1) quality and quantity of the labor force may decline due to possible slowdown in immigration, 2) increased economic disparity may weaken US innovation capability and 3) increasing repayment of government debt may depress economic growth.

Eurozone economy :

Eurozone economy is expected to grow by 1-1.5% per year up to 2020 and by 0.5-1% per year after 2020. The balance sheet adjustment pressure in southern European countries, the negative effects due to the prolonged recession, and the uncertainty accompanying the UK's Brexit negotiations may push down growth. The risks in the euro zone economy include: 1) threat to the survival of the euro system due to rising anti-EU force and 2) weak job opportunities for refugees flowing into Europe.

Chinese economy :

The growth rate of Chinese economy will gradually slow down to 3.5-4% per year in 2030, due to decrease in production-age population and slower growth in conventional heavy industries. GDP per capita is expected to surpass $20,000 by 2030 and total GDP is likely to exceed the U.S., bringing China to the largest economy in the world. However, there is also a risk that an abrupt slowdown may be triggered by the setback in residential property market and non-performing loan problem. For the soft landing of the Chinese economy, it is important to 1) enhance innovation capacity, the driving force for growth, 2) resolve structural problems such as excess production capacity and corporate debt, and 3) secure the sustainability of social security system and balanced government budget.

ASEAN economy :

The potential growth rate of the ASEAN economy will remain at around 4% per year even in 2030, and GDP per capita will be close to $10,000 by 2030. While the growth of labor force population will gradually decrease, productivity, on the other hand, will continue to improve. The risks of the ASEAN economy include: 1) insufficient investment in the infrastructure necessary for raising productivity, 2) delays in structural reforms due to political instability, and 3) the impact of possible slowdown in Chinese economy.

3. Japanese economy : Potential growth rate is poised to decline to around 0% in 2030

Japan faces challenges such as shrinking and aging population, social security system problem and the huge government debt. If this trend remains unchanged, the potential growth rate of the Japanese economy will gradually decline to around 0% in FY 2030.

The future image that Japan should pursue towards 2030 is 1) a society where both economic growth and resolution of societal problems are achieved, 2) a society where all people can design and pursue their own career plans, 3) a society where regions are able to develop autonomously, 4) a society where balanced government budget and social security systems are able to support an era of 100 years lifespan, and 5) Japan is an opinion leader for promoting free trade in the world. To reach to these goals, Japan should carry out five courses of action.

Point 1 : Resolving societal issues through innovation

To achieve the future that Japan should target, it will be important to try to resolve societal issues through innovation based on new technologies. There is high expectation for innovation to solve problems in daily life and to improve the quality of life. According to our "Survey on Exciting Future Living" [*3] targeting 5,000 consumers, there is strong demand among consumers for products and services that helps resolving societal problems related to wellness and mobility, and we estimate a potential consumer market of ¥50 trillion in 2030 (roughly 15% of household expenditure). Technological transformation alone will not create these potential demands. Now that it is no longer possible to depend on government financing, reform of systems including deregulation and revision or elimination of excessive public systems will become even more important so that new technologies and innovations will be better applied to society.

Point 2 : Building human resources for a better society

Japan's labor force population is expected to shrink by 4.5 million workers by 2030, even assuming some increase in the labor force participation rate[*4]. While there are concerns on massive loss of employment opportunities due to wider application of new technologies such as Artificial Intelligence (AI) and robotics, Japan is in a unique position compared to the rest of the world. If the new technologies are not applied and productivity does not dramatically improve, Japan may face a labor shortage in the growth markets that bring potential demand, resulting in depressed growth potential.

In order to feed sufficient workforce to the growing sector, the active shift of labor force across industries and job categories is necessary. Three initiatives should be implemented simultaneously: 1) self-practice by workers to acquire new set of skills required in the current environment, 2) providing better platforms for skill matching and reform of a retirement bonus system that hinders job mobility, and 3) switch to a wage system that fairly assesses job skills.

Point 3 : Building self-supporting regional economies

In order to achieve self-supporting regional economies, we need a combination of offensive and defensive approach. Offensive approach includes agriculture and tourism to capture demand from outside the region. Defensive approach includes streamlining the city functions and residential areas into a centralized urban area of the region. A government policy: "Compact plus Network", suggests a concentration of city functions including commercial facilities to the center of the region and development of residential area along public transportation. This approach not only makes infrastructure maintenance and administrative services more efficient, but also improves productivity and the quality of life of residents.

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*3 Survey of 5,000 people from the 30,000 people on the survey panel of MRI's "Market Intelligence Forecast (mif) taken in April 2017: A survey of the demand for 50 items of products and services likely to be available in 2030 and the willingness to spend on them. Selection of the 50 future products and services was supervised by Yutaka Matsuo, Associate Professor, Tokyo University.

*4 The 2030 labor participation rate is the median value between the (1) the case where economic growth and labor participation are not appropriately under way and (2) the case where economic growth and labor participation are appropriately under way shown in "Heisei 27 Labor Policy Research Report" (Dec 2015).

Fortunately, incoming tourists are increasing and they are more interested in visiting regional area. At the same time, geographical distance is becoming less of an impediment for regional economy due to better use of ICT solutions. We regard these trends as good tail wind for the regional economy. In addition, the "Survey on Exciting Future Living" confirms that demand for products and services that support the living of senior people (automated driving, health management, etc.) is the stronger the more remote the region is located. Offensive approach to exploit potential needs and create new markets is an essential element for regional economies to become self-supporting.

Point 4 : Increased channels for capturing global demand

As manufacturing industries in emerging countries rapidly grow competitive, Japan has to strengthen service exports in order to capture global demand. For example, inbound tourists to Japan continue to increase and projected to exceed 50 million in 2030. Royalties income on intellectual property is also expected to increase partly because of expansion of overseas activities by Japanese companies. Japan should take the initiative for the worldwide free trade and try to have the realize TPP agreement, which includes facilitating standardization of the service sector, effective as soon as possible even without the participation of the U.S.

Point 5 : Responsible fiscal policy toward the sustainable future

Japan's government debt is expected to widen from current 200% to 250% of GDP by 2030, even if long-term interest rate stays at 2%. If the long-term interest rate rises beyond that level, the national debt will explode. Reforms in both revenues and expenditures will be required to guarantee public debt sustainability. In particular, social security expenditures that is accounting for 1/3 of general expenditure must be better controlled as top priority. Reform of social security system reform will have to be completed by 2022, when Japanese baby boomers reach the age of 75 and medical and nursing care expenses are expected to increase rapidly.

If the above five reforms are implemented, economic growth rate in 2030 will rise to around 1.5% compared with around 0% when reforms do not take place. Real GDP in 2030 will be larger by ¥90 trillion or 15% compared to the low growth scenario. By achieving growth rate comparable to the U.S. and Europe, Japan will be able to maintain its presence in the global economy and GDP per capita will be larger by ¥750,000 or 15% compared to the low growth scenario. The economic growth will generate increased financial sources which can be used for investment toward the future and solidify responsible fiscal policy, which in turn ensures a sustainable society with robust economy.

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