

Recent Trends in the U.S. and Japanese Recoveries

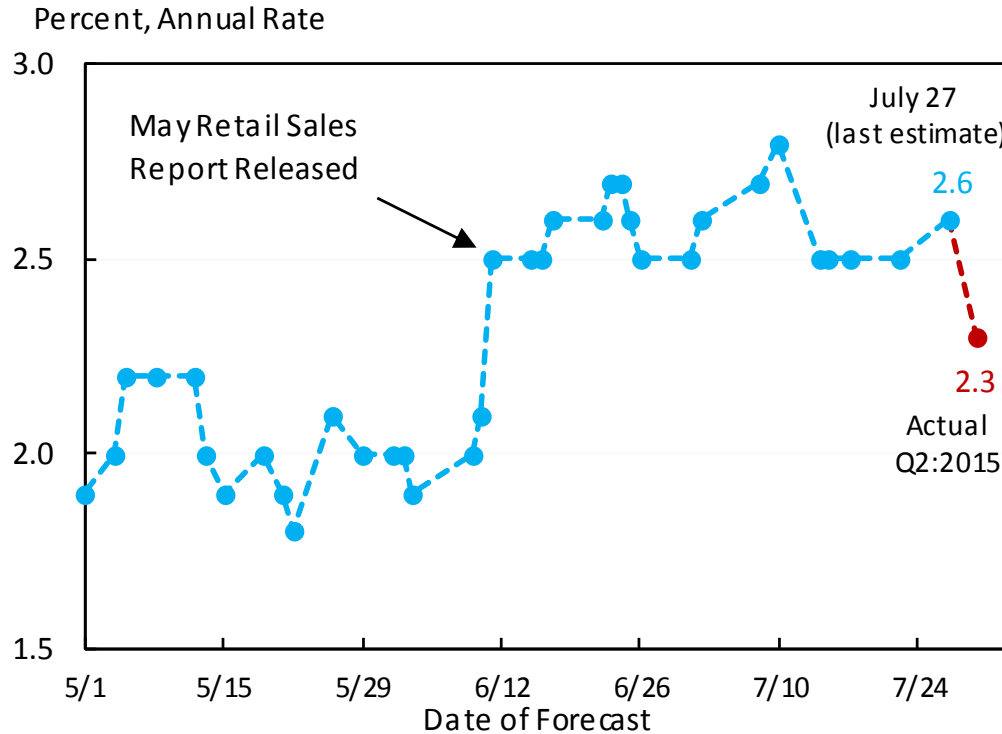
Council of Economic Advisers



July 31, 2015

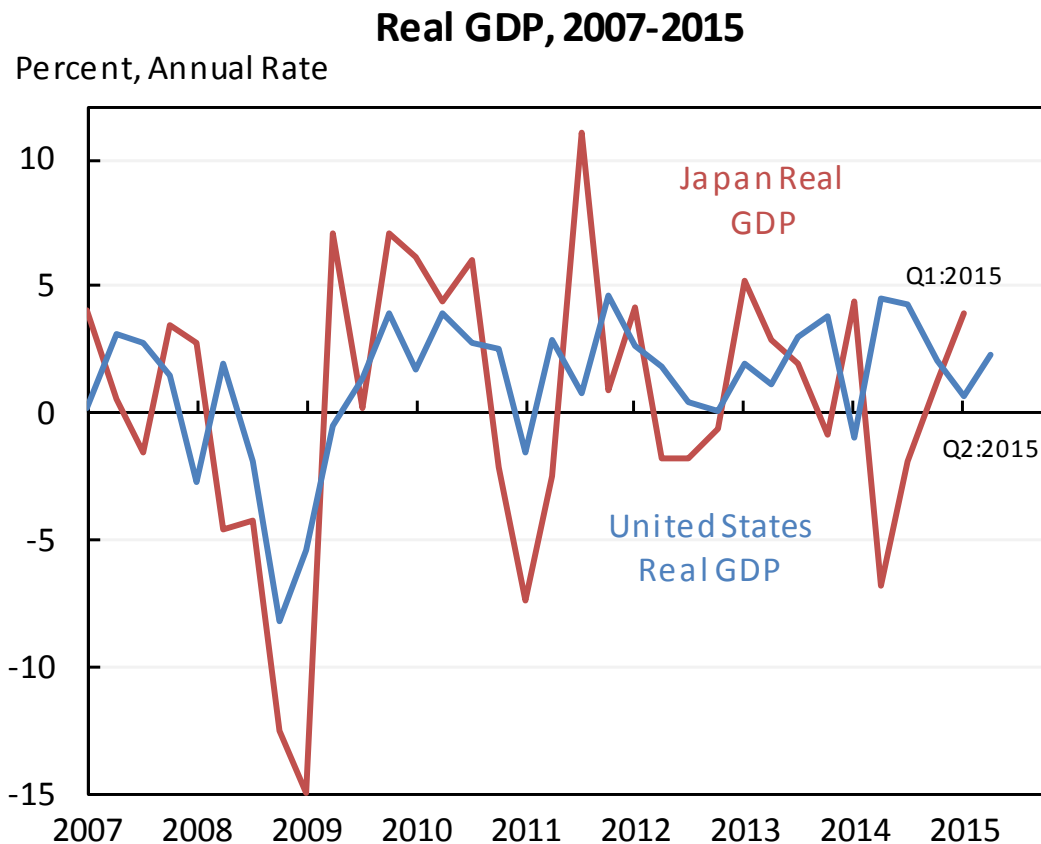
Economists' Expectations for Second-Quarter U.S. GDP Growth Improved in the Months Prior to the Release

MacroAdvisers' Real GDP Tracking Estimate for Q2 2015



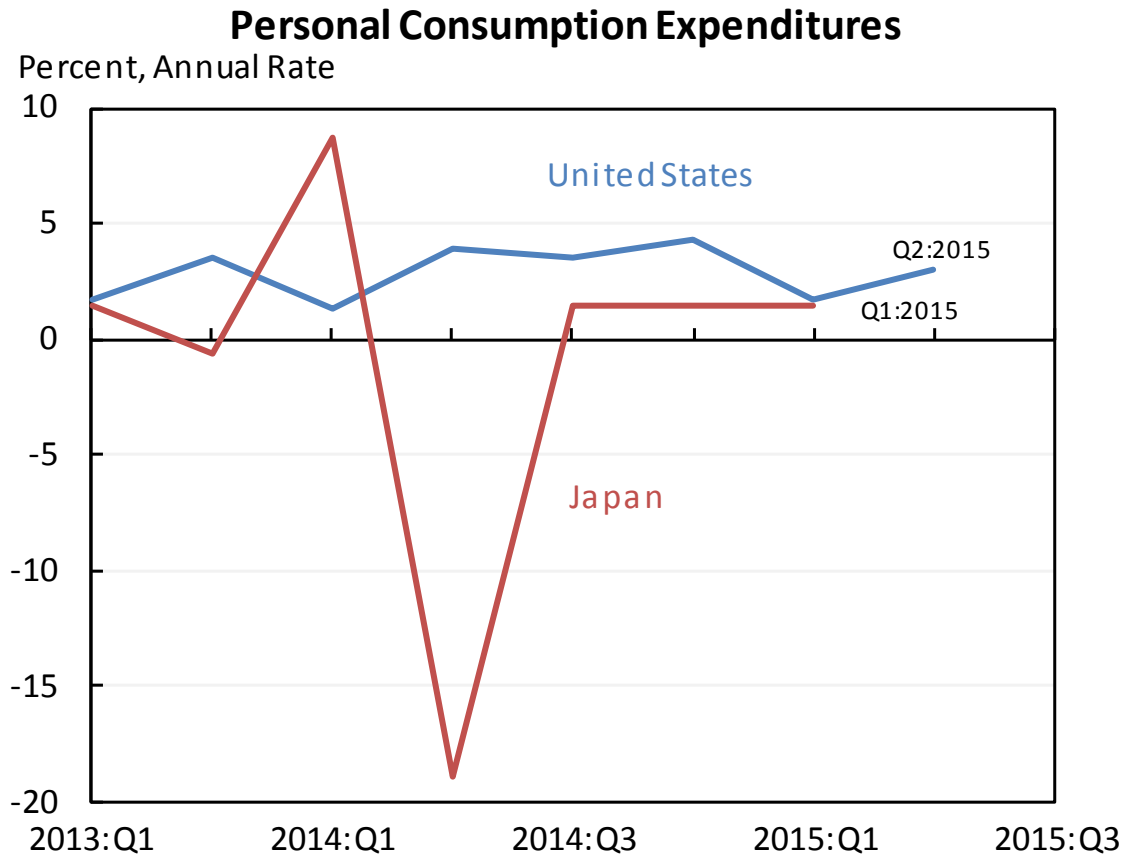
- As recently as May, forecasters expected U.S. GDP to grow 1.9 percent at an annual rate in the second quarter. Given relatively strong data in recent months, forecasters expected 2.6 percent annualized growth just prior to the release. The realized number reported July 30 was 2.3 percent.
- A number of data points for April and May increased investors' expectations for second-quarter GDP growth, including: a strong May retail sales report (implying higher personal spending), higher-than-expected business inventories, stronger-than-expected new home sales (implying more residential investment), and lower-than-expected consumer price inflation. The uptrend was somewhat mitigated by a weaker-than-expected June retail sales report.

U.S. Real GDP Expanded in the First Two Quarters of 2015 While Japanese Real GDP Grew Above Expectations in the First Quarter



- **U.S. real GDP expanded 2.3 percent at an annual rate in the second quarter of 2015.** Real GDP grew 0.6 percent at an annual rate in the first quarter of 2015 and 2.3 percent over the past four quarters.
- **Japanese real GDP grew 3.9 percent at an annual rate in the first quarter, notably above economists' expectations.** Real GDP contracted 1.0 percent over the past four quarters.

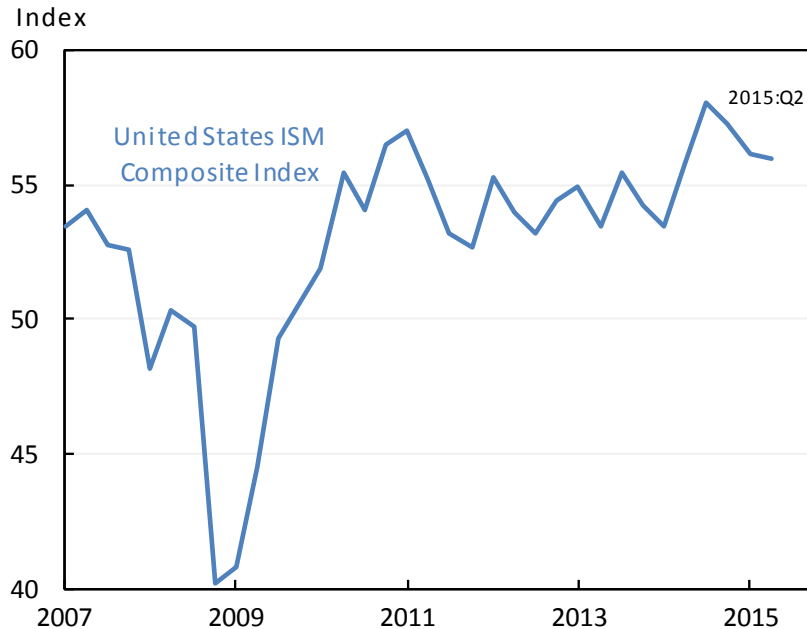
U.S. Personal Spending Grew Strongly in the Second Quarter



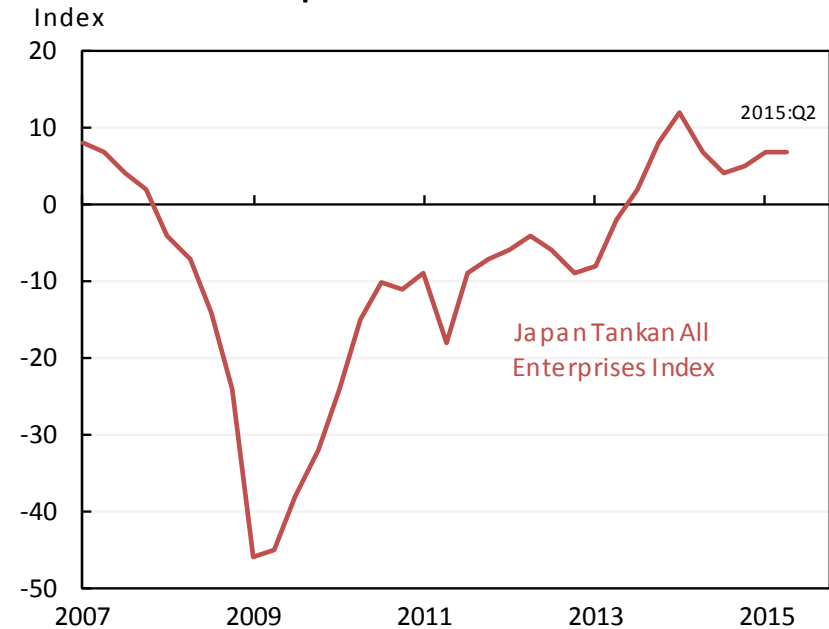
- **U.S. personal spending growth rose in the second quarter after declining sharply in the first quarter, partially easing concerns that the spike in the personal saving rate would persist.**
- **Japanese personal spending growth was deeply negative in the Q2 of 2014 when the consumption tax hike occurred, and has recovered but remained somewhat below U.S. levels.**

Business Sentiment Seems Stable in the United States and Japan and Has Fully Recovered from the Global Financial Crisis

United States Business Sentiment

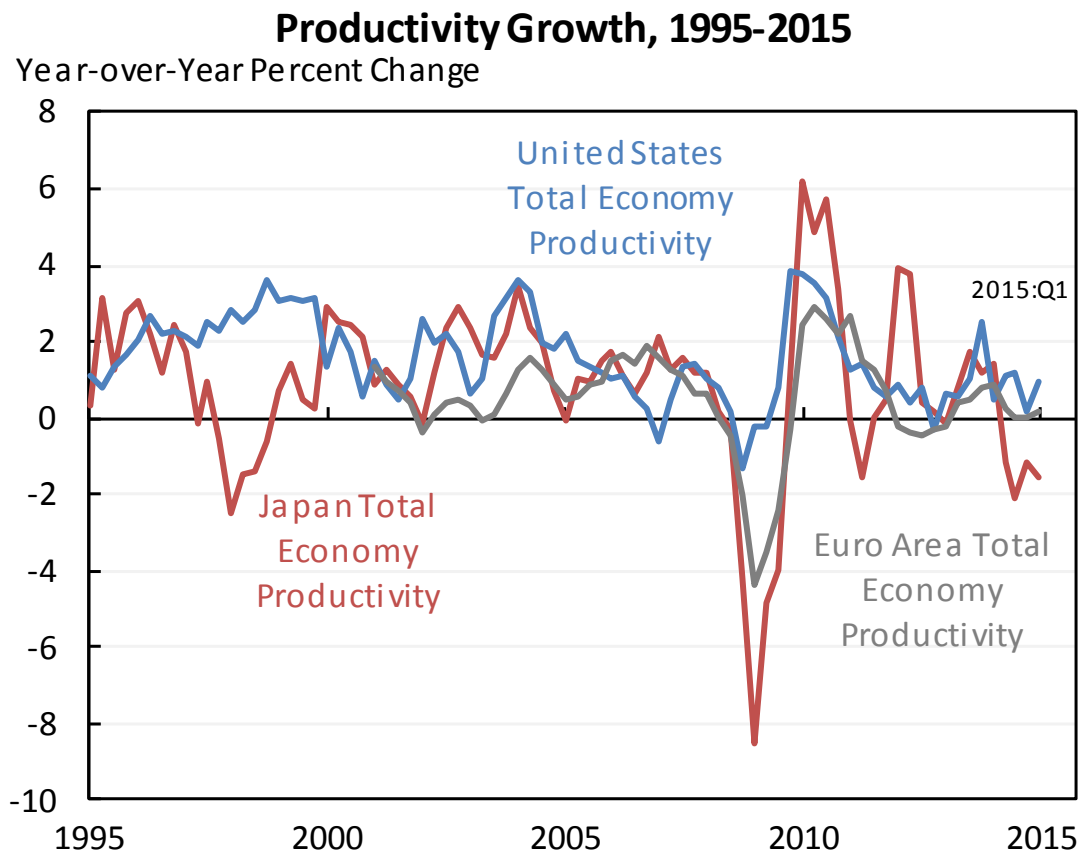


Japan Business Sentiment



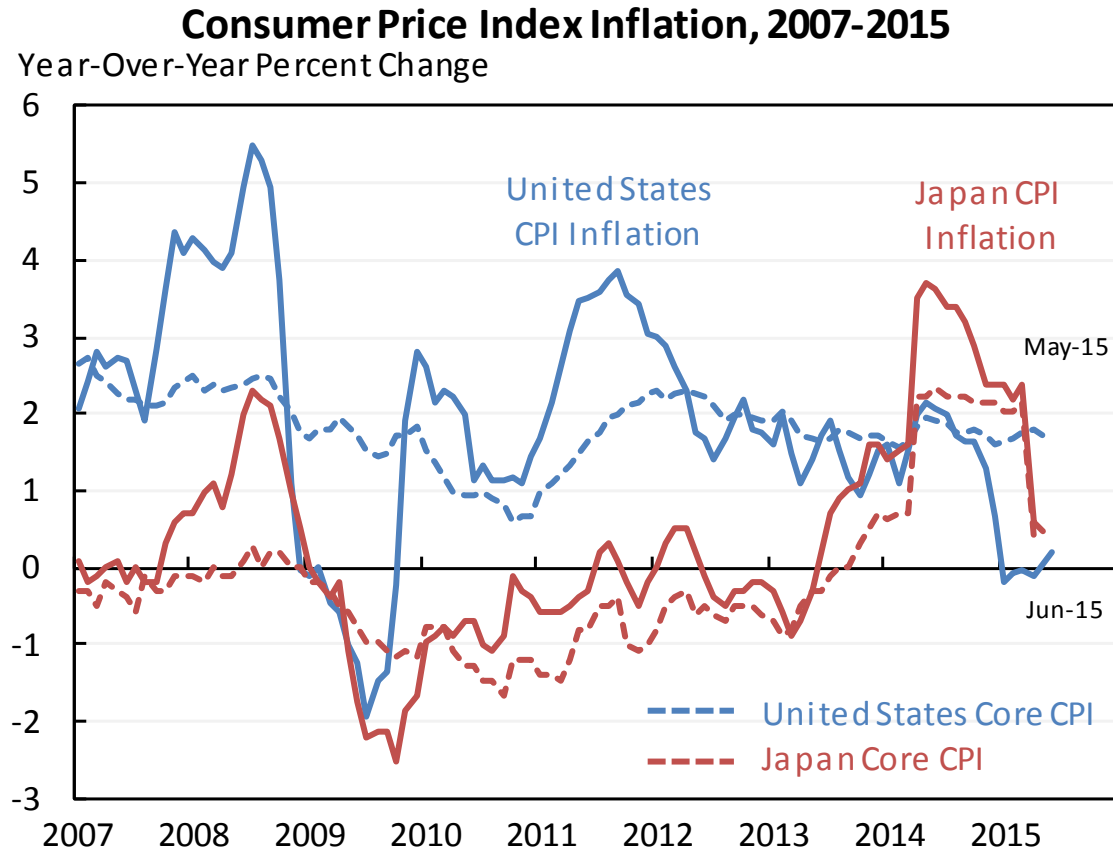
- The U.S. ISM composite index of business sentiment remains just shy of its highest level recorded during the recovery period.
- The Japanese Tankan business conditions index also remains near its highest level since its trough in 2009. Unlike the rapid U.S. recovery, Japanese business sentiment remained subdued compared with 2007 levels until rising sharply with the announcement of Prime Minister Abe's recovery program.

U.S. and Japanese Productivity Growth are Both Running Below Their Long-Term Trends



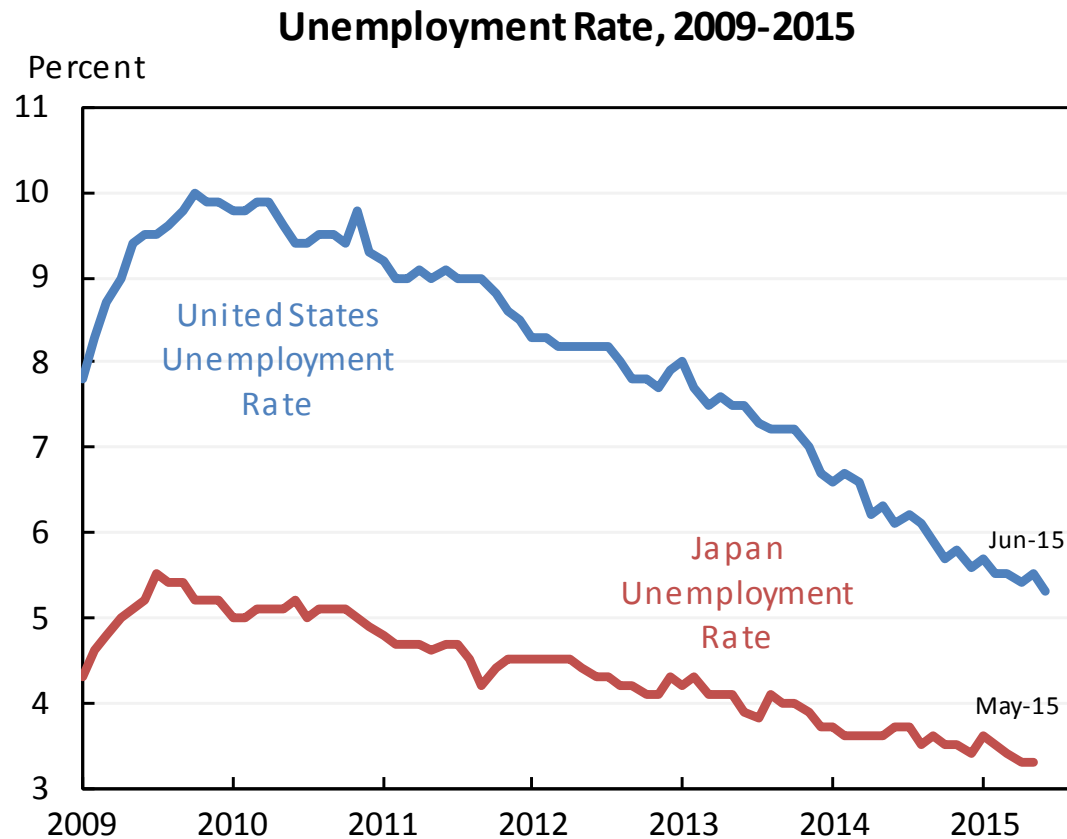
- **U.S. productivity grew 0.9 percent over the last four quarters, while Japanese and euro area productivity contracted 1.5 percent and expanded 0.2 percent, respectively.**
- U.S. productivity growth averaged roughly 1.6 percent per year between 1995 and 2014, while Japanese productivity growth averaged 0.9 over the period. Euro area productivity growth averaged 0.5 percent per year between 2001 and 2014.

Consumer Price Inflation is Near Zero in Both the United States and Japan



- **U.S. consumer prices increased 0.2 percent year-over-year in June 2015.** Core consumer prices which exclude food and energy increased 1.8 percent year-over-year. Inflation has fluctuated around zero percent since the beginning of 2015.
- **Japanese consumer prices increased 0.5 percent year-over-year in May 2015.** Core consumer prices which exclude food and energy increased 0.4 percent year-over-year. Inflation has come down significantly since the effect of the consumption tax increase in 2014.

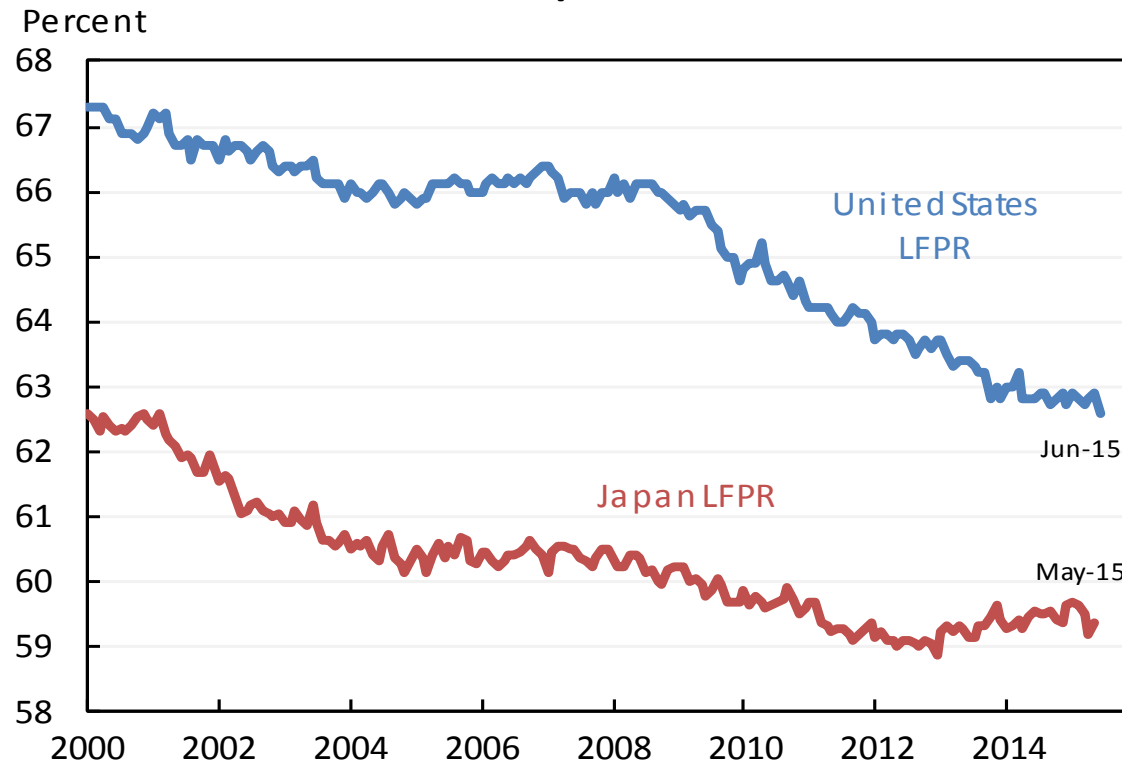
The Unemployment Rate in the United States and Japan Has Fallen Substantially since 2009



- **The U.S. unemployment rate fell to 5.3 percent in June, its lowest level since April 2008.** Unemployment has fallen notably since peaking at 10.0 percent in October 2010. Alternative measures of labor market slack suggest that the unemployment rate will fall further as the economy continues recovering.
- **The Japanese unemployment rate was 3.3 percent in May**—its lowest level since 1997—suggesting that the Japanese economy has returned to full employment since the global financial crisis.

Labor Force Participation Has Been Trending Down Secularly in the United States and Japan

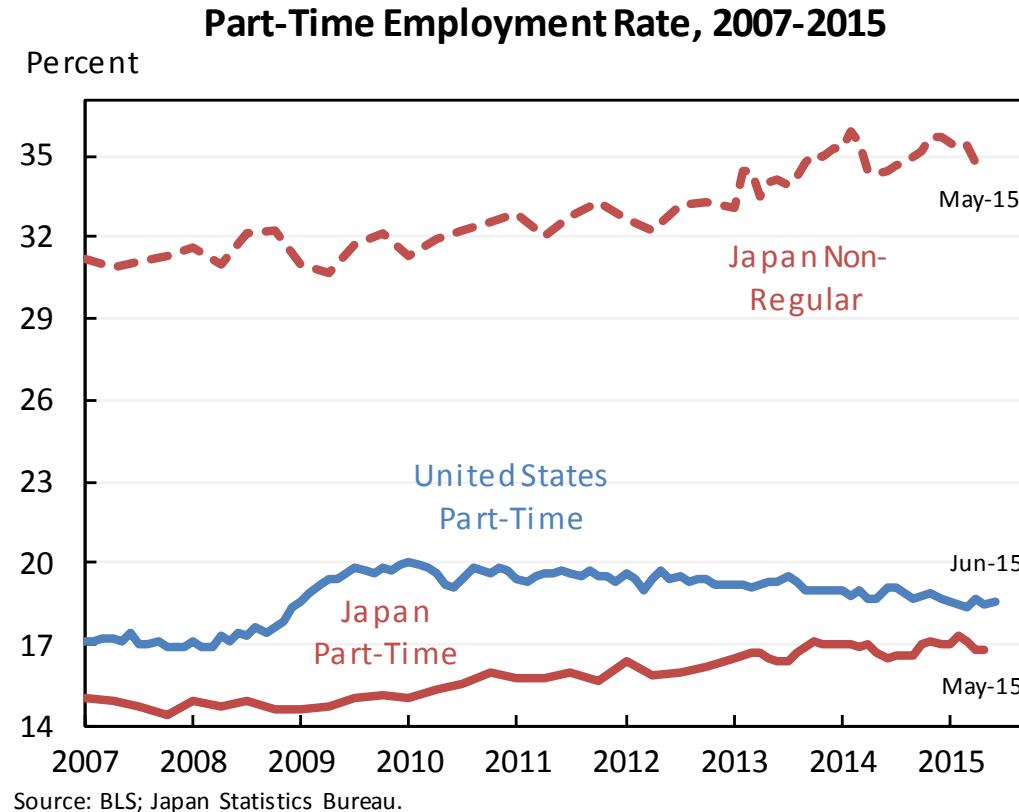
Labor Force Participation Rate, 2000-2015



Source: BLS; Japan Statistics Bureau.

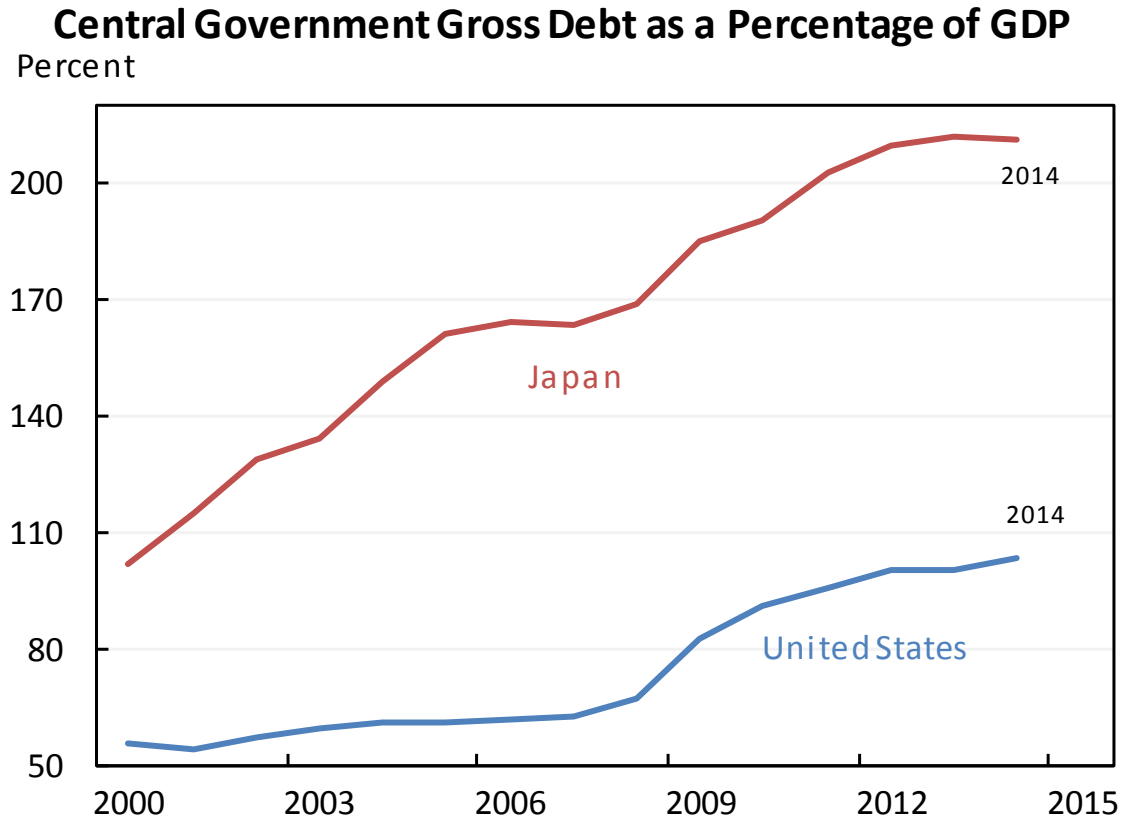
- **The U.S. labor force participation rate has fallen gradually since 2000.** The current participation rate is 62.6 percent, down 4.7 percentage points from January 2000 and the lowest rate since 1977. There is evident acceleration after the baby-boomers reach retirement age in the late 2000s.
- **The Japanese labor force participation rate has fallen gradually since 2000.** The current rate is 59.4 percent, 3.2 percentage points below its January 2000 level. But participation stabilized after 2012.

The Incidence of Part-Time Employment Is Higher in the U.S. but Has Been Falling in the United States and Rising in Japan



- **The U.S. part-time employment rate (voluntary plus involuntary) has been falling gradually throughout most of the recovery after rising sharply during the recession.** The current rate is 18.6 percent, down 1.5 percentage points from its recent peak in January 2010 of 20.1 percent.
- **The Japanese part-time employment rate has been rising steadily since 2007.** The current rate of 16.8 percent is up 1.8 percentage points from the first quarter of 2007. The Japanese share of non-regular workers has also been rising. Non-regular workers are those who do not meet the three conditions of: open-ended employment, full-time, and direct employment.

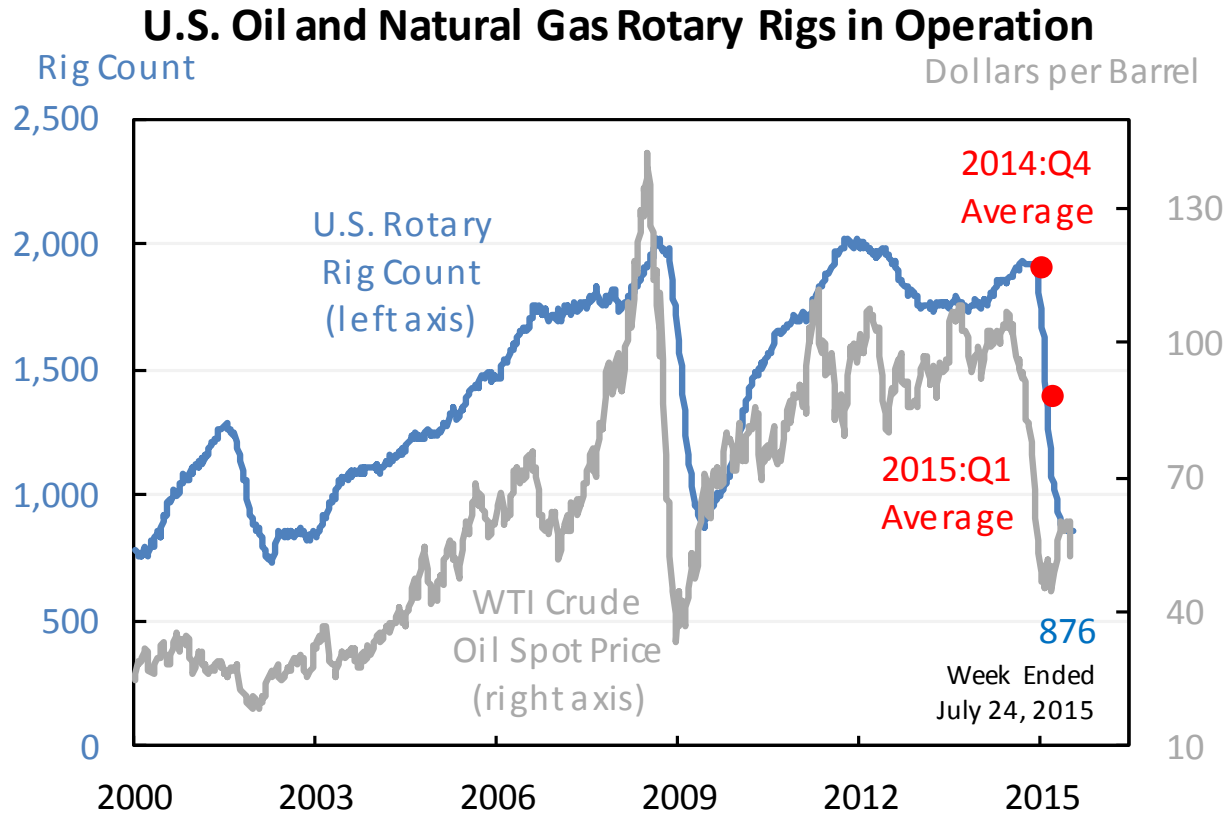
Central Government Gross Debt as a Share of GDP Has Risen Substantially in Both the United States and Japan



Source: Bank of Japan; OMB.

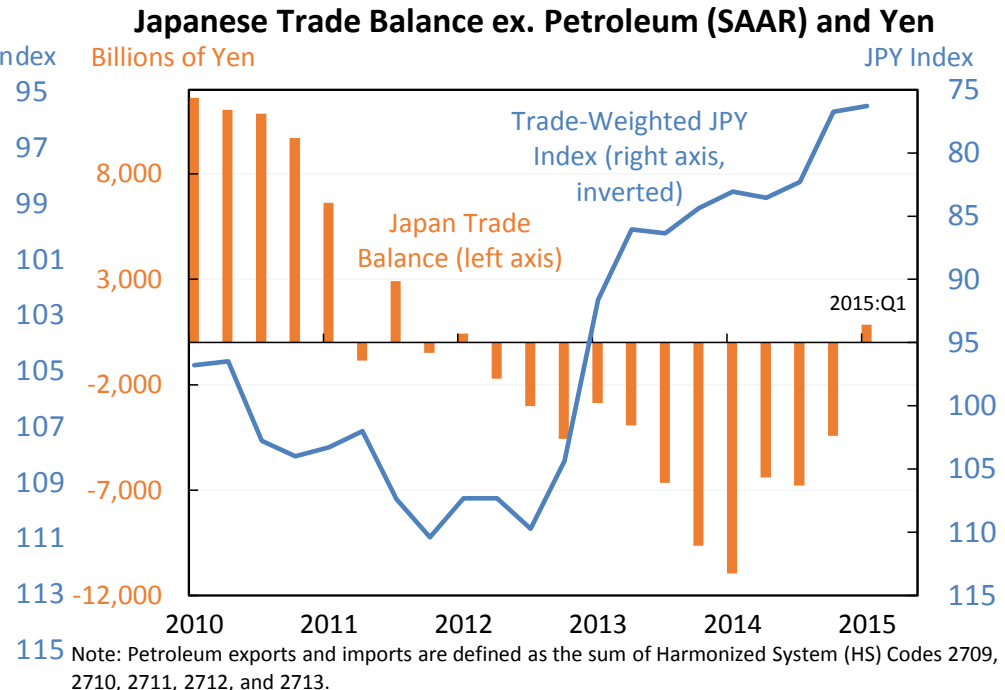
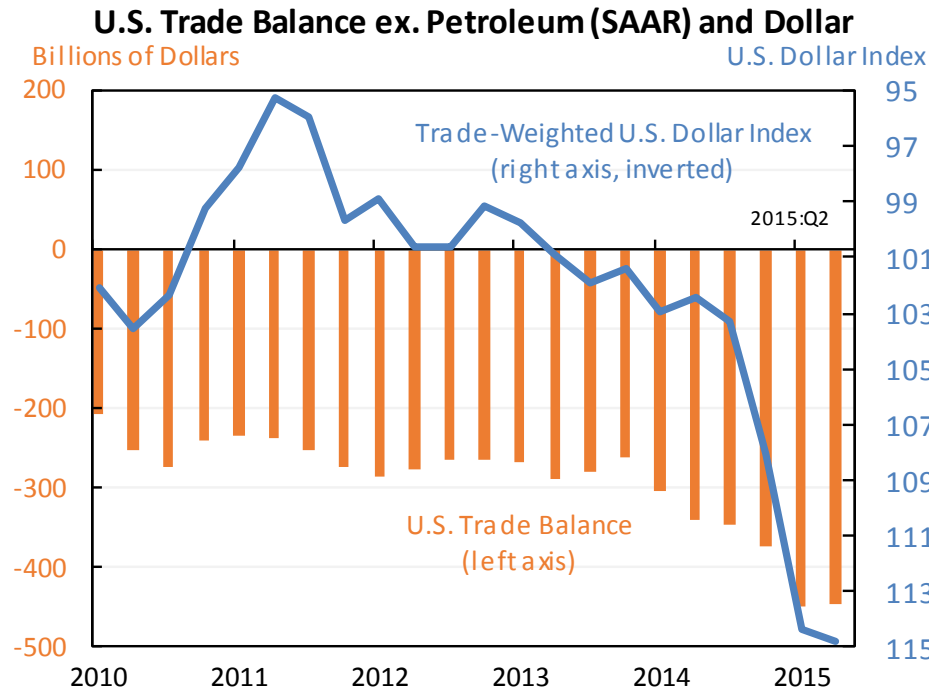
- **U.S. central (federal) government gross debt as a share of GDP was 103 percent in 2014, almost double its level in 2000.** A substantial portion of the increase since 2000 occurred in the early stages of the economic recovery in 2009 and 2010.
- **Japanese central government gross debt as a share of GDP was 211 percent in 2014, more than double its level in 2000.** The IMF forecasts that Japan's debt as a share of GDP will continue rising unsustainably unless additional measures are taken to control government spending.

The 2014 Decline in Oil Prices Has Weighed Heavily on U.S. Energy Investment, but May Have Spent Itself



- **It remains unclear to what extent the sharp slowdown in oil exploration, which depressed first-quarter investment, will persist.** One indicator of oil investment is the number of oil and natural gas rigs in operation, which collapsed earlier in 2015. It appears to have stabilized but has not shown substantial signs of growth. Other factors such as soft foreign demand for U.S. exports are likely to persist in the coming quarters.

The U.S. Trade Deficit Has Widened Less Than the Dollar's Rise Would Imply; the Japanese Trade Balance was Positive in the First Quarter



- **The U.S. trade deficit has widened less than expected given the rising value of the dollar against our major trading partners.** The trade deficit excluding petroleum widened from roughly \$340 billion to \$446 billion over the last four quarters. The increase in the deficit over the last four quarters of roughly 31 percent is less than the increase CEA would expect given the substantial strengthening of the dollar over the same time period.
- **The Japanese trade balance excluding petroleum narrowed from a deficit to a surplus over the past year.** The Yen has also depreciated over the past year.

Opportunities and Challenges for Japan-United States Relations: TPP and International Currency Relations

Trans-Pacific Partnership

- **The final agreement is being negotiated now, following passage of TPA in June.** Likely to lead to a comprehensive opening of Japanese sectors.
- **Including meaningful market access for the “Sacred 5” agricultural commodities:** rice, wheat, beef and pork, sugar, dairy.
- **Strong signal of structural reform commitment.** IMF forecasts 0.2 to 0.3 pp growth increase as a result of TPP.
- **Benefits for Japan regional neighbors.** Petri, Plummer, and Zhai (2013) estimated Japan’s entry into TPP triples global gains, raises Japan’s GDP by 2% yearly.

Currency Wars?

- **Japan’s fiscal solvency demands renewed higher growth.** How to achieve it?
- **Structural reform (e.g. higher female participation) is key.** Growth powered entirely by yen depreciation and net exports risks global tensions.
- **Already in the U.S. Congress there is anger at alleged currency manipulators.** The U.S. Administration has opposed including enforceable currency standards in TPP. A separate Congressional proposal is countervailing duties – perhaps in cases of vaguely-defined “undervaluation,” which need not presuppose FX intervention.

Recent Trends in the U.S. and Japanese Recoveries

Council of Economic Advisers



July 31, 2015