The Global Economic Outlook and a Growth Strategy for Japan

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1. The Global Economy: Negative Growth in 2009 Followed by a Gradual Recovery

The International Monetary Fund (IMF) forecasts a 1.3 percent retraction for the global economy in 2009, followed by recovery to a 1.9 percent rate of growth in 2010. Though it may not experience a V-shaped recovery, the world economy should begin to stir in 2010, powered by emerging economies and developing countries.

The major industrial powers will continue to experience zero-percent growth in 2010, whereas the pace of growth in the emerging economies and developing countries will pick up, from 1.6 percent in 2009 to 4 percent in 2010. Particularly promising candidates for growth include Asia (up 6.1 percent), led by China (7.5 percent growth in 2010) and India (5.6 percent); the Middle East (up 3.5 percent); and Africa (up 3.9 percent). The level of Japanese exports will largely be determined by trends in Asia, particularly in countries and regions such as China, South Korea, Taiwan, ASEAN-member states and India.

2. Emerging Economies: Some Hurt by the Economic Crisis, Others Largely Unaffected

Of the BRIC group of countries, China and India have been standouts, remaining largely unscathed by the economic crisis, and Brazil was relatively lightly impacted. Russia, however, lost its ability to finance fiscal outlays in the wake of falling prices for its resources and energy, causing it to be strongly impacted by the downturn.

Apart from the BRICs, the emerging economies that were ***mostly immune to, or only partially affected by, the economic crisis*** were those with robust internal demand (consumption), such as Vietnam, Peru, Egypt, Saudi Arabia, South Africa, Nigeria and Poland. Though foreign investment slowed, domestic consumption was propped up by remittances from overseas. ***Countries negatively impacted by the economic crisis*** were, in general, those that saw less inward investment from abroad and experienced a drop-off in exports. Countries falling into an export slump included Thailand and Turkey, with their car-manufacturing industries; Mexico, affected by the recession in the United States; Romania and Hungary, as a result of the recession in Europe; and Argentina and Venezuela, due to sharply lower prices for natural resources and energy.

3. Green Energy: The New Pillar of Economic Policy (Green New Deal)

The overall outlay for ***renewable energy, construction of green buildings and environmentally-friendly housing, and the purchase of hybrid and electric automobiles*** contained within the $500 billion fiscal budget of the US economic-stimulus bill amounts to $42.8 billion. The total amount of tax deductions and refunds for these three sectors is $17.3 billion. When other environment-related expenditures included in the stimulus package are added in, the total amount devoted to energy and the environment amounts to some $70 billion to $80 billion.

The percentage of China's four-trillion yuan economic-stimulus package devoted to the environment is 5.3 percent, or ¥3 trillion (more than $30 billion), equivalent to nearly half the figure included in the US package. South Korea is expected to spend 50 trillion won over four years.

4. The Emergence of Trade Protectionism

Data released by the World Bank on March 2, 2009, on trade-protectionist measures enacted after the onset of the economic crisis show that 78 trade-protectionist measures were instituted worldwide from October 2008 to February 2009. Of those, 47 were characterized as effective trade-restricting measures, including 12 measures introduced by developed nations, mostly consisting of ***subsidies and industry-support policies***. Emerging economies accounted for 35 of the measures, of which 31 percent consisted of ***subsidies and industry-support measures***, and about 50 percent of ***tariff hikes***.

5. Major Curtailment of Global Investment and Trade

Turning to export trends in the world's leading economies, US exports for November 2008 posted a downward shift from the previous year, and the figures for January 2009 showed a 21.4 percent drop. South Korea's January 2009 exports were down 32.8 percent from the year earlier, while Taiwan's were off 42.9 percent and China's fell 17.5 percent. Thailand's exports sank 26.5 percent and Vietnam's dropped by 15.6 percent.

Worldwide, cross-border mergers and acquisitions rose 54 percent in 2007 compared to the earlier year, but were off by 30 percent in 2008. M&As continued to fall this year; figures for the first quarter of 2009 show 64 percent fewer than during the same period in the previous year.

6. Japan's Shrinking Trade Surplus Offset by Positive Balance on Income

For 2008, Japan recorded a ¥725.4 billion deficit in its merchandise trade position (trade in goods) on a customs-clearance basis. This represents a ¥10.9 trillion decrease in its trade surplus for fiscal year 2007, a loss equivalent to two percent of its nominal GDP. Export and import figures rebounded in February and March 2009, resulting in a return to a surplus, albeit a thin one. Whether this trend will continue into April and beyond depends on the extent to which exports of cars and other products recover.

In recent years, Japan's current-account balance (the balance of goods, services, foreign investment and other factors) has been strongly affected by balance of trade and balance of income (interest and dividends from foreign investment and other factors) trends. In January 2009, Japan posted a current-account deficit, resulting from services-account and trade-balance deficits that surpassed the income-balance surplus. The balance on income declined in the second half of 2008 from its level in the first half of the year, but it remained in the black, which helped to sustain the current-account surplus.

7. Despite the Economic Crisis, Japanese Corporate Interest in International Expansion is Strong

The amount of Japan's foreign direct investment (net flow) has increased dramatically in recent years, but measured as a percentage of GDP, it was still only 1.7 percent in 2007. When compared with 2.4 percent of GDP for the US, 5.1 percent for Germany, 8.6 percent for France and 8.4 percent for UK, it is clear that Japan's FDI still has considerable room for to growth.

As part of a survey conducted toward the end of 2008, just as the effects of the financial crisis were being felt in earnest, companies were asked, "How will you deal with the effects of the financial crisis that originated in the United States?" Twenty-three percent responded that they would "expand (or consider expanding) existing overseas operations" and 22.8 percent answered that they would "start new overseas operations." The answers illustrate that there is still strong interest in international expansion.

8. A Strategy for Growth in Japan after the Economic Crisis

Japan's strategy for growth against the backdrop of global economic conditions should rest on promoting exports, overseas sales and foreign investment (outward M&As), and on beefing up profits from abroad. The profits should be repatriated (analogous to remittances from abroad) and domestic investment and consumption should be increased. Also, Japan should try to attract investment from abroad. In other words, it should stake out a position for itself as an ***economy predicated on trade and investment***. Further, it should take a ***firm stand against any movement toward protectionism, which hinders any economy built on trade and investment***.

In particular, Japan's global strategy should incorporate the growth potential of emerging economies. After the economic crisis passes, ***sales strategies should be quickly reinforced and focused on emerging economies whose economies are stable and whose consumption is robust***. Many of the emerging economies that are achieving good economic performance are on an upward-trending income trajectory. These markets call for a sales strategy centered on ***products with mass-market appeal targeting low- and middle-income consumers***.

Economic support and foreign aid should be leveraged in order to expand exports and outward direct investment. Economic support and foreign aid should be used to bolster emerging economies' consumption demand, thereby boosting the sales of Japanese products. Economic support and foreign aid will be most effective when provided to relatively low-income emerging economies that have performed well economically despite the crisis. By the same token, it is important to use policy initiatives to stoke internal demand in ***Asian countries and regions—particularly China, South Korea, Taiwan and ASEAN members—***that purchase Japanese capital goods and parts.

The green-energy market is expected to grow rapidly once the economic crisis passes. Raising Japan's competitiveness in developing solutions not only to long-standing issues such as air pollution, water and waste processing and recycling, but also ***in the realm of renewable energy (solar, wind, geothermal, biomass) and the low-carbon arena (electric cars, alternative fuels, environmentally-friendly housing)*** can be expected to pay dividends by allowing it to stake out a competitive edge in the green economy.

In summary, Japanese companies should develop a three-pronged post-crisis global competitiveness strategy, ***focused on Asia, to foster emerging economies' economic expansion, develop products for middle-income consumers and promote the green economy.***

The Global Economic Outlook and a Growth Strategy for Japan

I. Short-Term Trends in the Global Economy (2009 to 2010)

World-Economy Projections by the IMF, OECD, World Bank and Private Analysts

	IMF (April 2009)			OECD (March 2009)			World Bank (March 2009)			CF (March 2009)		
	2008	2009	2010	2008	2009	2010	2008	2009	2010	2008	2009	2010
World	3.2	-1.3	1.9	-	-	-	1.9	-1.7	2.3	2.0	-1.6	2.1
Developed Nations	0.9	-3.8	0.0	0.9	-4.3	-0.1	0.8	-2.9	1.6	-	-	-
United States	1.1	-2.8	-0.0	1.1	-4.0	-0.0	1.1	-2.4	2.0	1.1	-2.8	1.7
Euro Zone	0.9	-4.2	-0.4	0.7	-4.1	-0.3	0.7	-2.7	0.9	0.7	-2.6	0.5
Britain	0.7	-4.1	-0.4	0.8	-1.1	0.9	-	-	-	0.7	-3.0	0.5
Japan	-0.6	-6.2	0.5	-0.6	-6.6	-0.5	-0.7	-5.3	1.5	-0.7	-5.8	0.7
Developing Nations	6.1	1.6	4.0	-	-	-	5.8	2.1	4.4	-	-	-
China	9.0	6.5	7.5	9.0	6.3	8.5	9.0	6.5	7.5	9.0	7.0	8.3
India	7.3	4.5	5.6	6.0	4.3	5.8	5.5	4.0	7.0	6.4	5.2	7.8
Russia	5.6	-6.0	0.5	5.6	-5.6	0.7	5.6	-4.5	0.0	-	-	-
Brazil	5.1	-1.3	2.2	5.1	-0.3	3.8	5.0	0.5	3.2	-	-	-

(Notes)
1 "CF" stands for "Consensus Forecast."
2. The definitions of "developed nation" and "developing nation" vary by organization. OECD's definition for developed nations is those that are OECD members.
(Sources)
IMF: "World Economic Outlook Update" (April, 2009)
OECD: "Economic Outlook: An Interim Report" (March, 2009)
World Bank: "Global Economic Prospects 2009 Forecast Update" (March, 2009)
Consensus Economics, Inc: "Consensus Forecast/Asia-Pacific Consensus Forecasts (March, 2009)

1. A Shift in the Four-Year Run of Five-Percent Growth in the Second Half of 2008

According to the International Monetary Fund, in 2008 the global economy only expanded by 3.2 percent over the previous year—two percentage points off the 5.2 percent year-over-year growth rate achieved in 2007—a development largely attributable to the "Lehman shock." Growth was sluggish in the developed nations, at 0.9 percent. In the emerging economies and developing nations, growth cooled by 2.2 percentage points, but remained high at 6.1 percent.

2. The Global Economy: Negative Growth in 2009, Followed by a Gradual Recovery in 2010

While the world economy is forecast to grow at a negative 1.3 percent growth rate in 2009, it should recover to positive 1.9 percent growth in 2010. Though it may not experience a V-shaped recovery, the world economy should begin to stir in 2010, powered by emerging economies and developing countries.

3. The Economic Crisis Impacted Developed Nations' Economies Directly in 2009

The outlook for the leading economies in 2009 is for negative growth rates of as much as -3.8 percent. Japan's growth rate is forecast to be down 6.2 percent, underlining the particularly heavy blow it sustained from the economic crisis. The forecast for the euro zone is for a 4.2 percent contraction, higher than the 2.8 percent decrease forecast for the US.

Factors that explain why the Japanese and European economies sustained a higher degree of damange from the global crisis than the United States include: (1) economic-stimulus measures have been more effective in the US than in Japan or Europe, and (2) Japan and the euro zone are particularly dependent on exports, making them more vulnerable than the US to downward pressure generated by the worldwide pullback in demand.

There are several reasons that the Japanese economy was the most negatively affected by the fall-off in demand, including: (1) the decline in exports (or falling sales in overseas markets) significantly impacted cars, household appliances and general machinery—manufacturing sectors that have a significant presence in the Japanese economy; (2) sourcing for these three sectors is predominantly domestic in origin, meaning that the fall-off in demand worked its way into the domestic Japanese economy as well; and (3) the strong yen became a further drag on exports.

4. Four-Percent Economic Growth in emerging economies and Developing Nations in 2010

Developed nations will continue to see negligible economic growth again in 2010, while the growth rate in emerging economies and developing nations will pick up from 1.6 percent in 2009 to 4.0 percent in 2010. Particularly promising candidates for growth include Asia (up 6.1 percent), led by China (7.5 percent growth in 2010) and India (5.6 percent); the Middle East (up 3.5 percent); and Africa (up 3.9 percent).

5. Positive Economic Growth for Japan in 2010

There was a noteworthy shift in the estimates for developed nations' 2010 economic growth rates. The IMF's January 2009 World Economic Outlook Update projected growth up 1.6 percent in the US, 0.2 percent in the euro zone and 0.6 percent in Japan. The updated March figures estimated growth up 0.2 percent in the US and 0.1 percent in the euro zone, but down 0.2 percent in Japan, reflecting concerns over a major slowdown in exports. The April 2009 World Economic Outlook predicted growth at 0.0 percent in the US, down 0.4 percent in the euro zone and—reveresing the earlier projection—up 0.5 percent in Japan. The outlook for Japan's economy varies, depending on how the continuing inventory adjustment is interpreted, and whether or not it will lead to production activity in the automobile and electronics sectors. Another point for consideration is the degree of effectiveness of government economic-stimulus measures. Japan's exports are largely dependent on trends in Asian economies—especially China, South Korea, Taiwan, India and ASEAN members.

6. Emerging Economies: Some Damaged by the Economic Crisis, Others Largely Unaffected

Among the BRIC group of countries, China and India have been standouts, remaining largely unscathed by the economic crisis, while Brazil was relatively lightly impacted. Russia, however, lost its ability to finance fiscal outlays in the wake of falling prices for its resources and energy, causing it to be strongly impacted by the downturn.

China's four-trillion yuan (¥57 trillion) economic-stimulus package proved effective in stoking internal demand. Infrastructure-related outlays made up 37.5 percent of the total, and spending on the environment amounted to 8.8 percent of the whole. China also introduced incentives designed to encourage consumers to buy cars, including: a tax cut on the purchase of any car with an engine capacity less than 1,600cc, gas-price reductions and the abolition of road taxes. During 2008, year-over-year car sales fell ten percent in November and eight percent in December, but rebounded six percent in January-February 2009 over the year-earlier period. Online shopping is also up sharply.

India announced a major economic-stimulus measures in December 2008 and in the first two months of 2009, the centerpiece of which was a limited-time reduction in the excise tax. As a result, February car sales rose 15 percent over the year-earlier period, registering the first sales growth in five months. Apart from the tax reduction, the use of loans, mainly supplied by state-owned banks, appears to have helped car sales to recover.

Post-Crisis Emerging economies Economic Performance (Year-over-Year Actual GDP Growth, in Percentage Terms)

	BRICs (2008, 2009, 2010)	JFIC16 (2008, 2009, 2010)
Countries Largely Unscathed to or only Lightly Impacted by the Economic Crisis	China (9.0%, 6.5%, 7.5%) India (7.3%, 4.5%, 5.6%) Brazil (5.1%, -1.3%, 2.2%)	Vietnam (6.2%, 3.3%, 4.0%) Pakistan (6.0%, 2.5%, 3.5%) Egypt (7.2%, 3.6%, 3.0%) Saudi Arabia (4.6%, -0.9%, 2.9%) United Arab Emirates (7.4%, -0.6%, 1.6%) Peru (9.8%, 3.5%, 4.5%) Poland (4.8%, -0.7%, 1.3%) South Africa (3.1%, -0.3%, 1.9%) Nigeria (5.3%, 2.9%, 2.6%)
Countries Negatively Affected by the Economic Crisis	Russia (5.6%, -6.0%, 0.5%)	Thailand (2.6%, -3.0%, 1.0%) Turkey (1.1%, -5.1%, 1.5%) Mexico (1.3%, -3.7%, 1.0%) Argentina (7.0%, -1.5%, 0.7%) Venezuela (4.8%, -2.2%, -0.5%) Romania (7.1%, -4.1%, 0.0%) Hungary (0.6%, -3.3%, -0.4%)

(Source) Compiled from the April 2009 IMF World Economic Outlook

In December 2008, **Brazil** announced a limited-time reduction of its industrialized products tax (IPI), which is levied on automobiles at the time of shipment from the factory to the dealer. As a result, Brazilian car sales showed a 3.1 percent year-over-year increase during the period from January to March 2009, to more than 660,000 cars. Sales volume was particularly strong in March, increasing 17 percent year-over-year—enough to make it the second-highest month for car sales in the country's history.

An analysis of post-crisis economic performance in "JFIC16" [JETRO File Increasing-Interest Countries] is contained in the table above. As shown, nine of the 16 countries are included in the category "Countries Largely Unscathed to or only Lightly Impacted by the Economic Crisis." These are countries--such as Vietnam, Egypt, Peru, Saudi Arabia, Nigeria and others--whose economies are not export-driven and are characterized by robust internal demand (consumption).. Despite a slowdown in inward investment from overseas, consumption in these countries was steady, propped up by remittances from their citizens living abroad. Resource-rich countries were able to leverage their accumulated wealth.

On the other hand, JFIC16 countries included in the category "Countries Negatively Affected by the Economic Crisis" generally saw lower amounts of inward investment from overseas and suffered from lower export levels. Thailand and Turkey have car-manufacturing industries, which are subject to the effects of economic disruptions. Countries experiencing slumping exports included Mexico, affected by the recession in the United States; Romania and Hungary, as a result of the recession in Europe; and Argentina and Venezuela, due to sharply lower prices for natural resources and energy.

II. Impact of the Economic Crisis on the Global Economy and Japan

1. Bold Economic Measures Implemented in Many Countries

United States: Responding to a series of dramatic bailouts and bankruptcies, Congress passed the Financial Stabilization Act in October 2008. Though the Treasury Department's formulation and implementation of the $700 billion Troubled Asset Relief Program was approved, it could only disburse $250 billion of the total at its discretion. The president was authorized to spend $100 billion, subject to notification to Congress, and the disposal of the remaining $350 billion was subject to Congressional approval. With strong backing from the newly inaugurated Obama administration, a $787 billion economic-stimulus package was passed on February 17, 2009. The legislation was comprised of $500 billion in fiscal expenditures and $287 billion in tax reductions. Major fiscal expenditures included $150 billion for highway and bridge construction and for science and technology; $106 billion for job training and other employment measures; and $193 billion for Medicare, unemployment benefits and disbursements to states.

European Union: The European Commission announced a 200-billion euro economic package, known as the European Economic Recovery Plan, on November 28, 2008. Equivalent to 1.5 percent of the EU's gross domestic product, the package was financed by 170 billion euros contributed by EU member states, and 30 billion euros from the European Investment Bank and the EU itself. The plan included provisions for an increase in the European Bank for Reconstruction and Development's loan facility, employment and business-support measures, infrastructure investment, promotion of green products, and support for green-technology development in the construction and automobile sectors.

China: On November 9, 2008, the Chinese government presented a four-trillion yuan stimulus package targeting ten major areas and scheduled to take effect by 2010. It was divided into outlays in the following areas: (1) rail, roads and other infrastructure investment (37.5 percent of the total); (2) bonds to finance rebuilding in disaster-stricken areas (25 percent); (3) construction of affordable housing (10 percent); (4) infrastructure improvement in rural areas (9.3 percent); (5) technological innovation (9.3 percent); (6) the environment (5.3 percent); and (7) medical, health, educational and cultural projects.

South Korea: On November 3, 2008, the government unveiled a comprehensive plan designed to stabilize foreign-exchange and financial markets, the real economy and small- and medium-sized enterprises. It included 11 trillion won in increased public spending, a stronger commitment to the 2008 goal of attracting $12 billion in foreign investment, an increase in the number of people eligible to receive unemployment benefits from 1.03 million to 1.13 million, and an expansion of college scholarships to raise the number of eligible students to 180,000 from 30,000. On March 12, 2009, a supplementary stimulus package of 5.7 trillion won was announced, targeting mainly low-income workers.

Turkey: On November 17, 2008, the Turkish government announced a 350 million lira ($230 million) package of crisis-mitigation programs and government support measures including interest-free loans to small- and medium-sized enterprises. As of December 2, a total of 9,539 companies had applied for a total of 477.6 million lira in loans. On March 13, the government announced reductions of one to 19 percent in the special consumption tax levied on cars and electronic products includinghousehold appliances , and a cut in the value-added tax, levied on sales of luxury homes larger than 150 square meters, from 18 percent to eight percent. On March 25, it announced a temporary cut in the value-added tax—from 18 percent to eight percent—on real estate; furniture; and some industrial eqipment such as machinery and tooling, for a three-month period beginning in April and ending in June.

Japan: As of April 10, 2009, economic measures adopted by the "Joint Meeting of the Government and Ruling Parties Council on Countermeasures to Address the Economic Crisis and the Ministerial Meeting on Economic Measures" amounted to ¥15.4 trillion. Government projections for expenditures included ¥1.9 trillion for employment measures; ¥3 trillion for financial measures; ¥6.2 trillion for a "growth strategy" encompassing a low-carbon revolution and long and healthy lifespans; ¥4.3 trillion to "provide peace of mind and vitality," with the aim of revitalizing rural areas and assisting local public agencies; and ¥100 billion for tax reform.

2. Green Energy as a Pillar of Economic Policy (Green New Deal)

United States: Taking an expansive view, the American stimulus package can be said to include a total of $25.2 billion in spending on **renewable energy**, including expenditures for construction of energy-transmission lines and technological development. In concrete terms, it allots $11 billion for construction of an electronic "smart grid" that would buy up excess electrical capacity from households and other consumers; $6 billion to fund renewable energy and improve transmission-wire technology; $4.5 billion for transmission-wire modernization; $3.3 billion to upgrade the Western Area Power Administration's electricity-distribution system; and $400 million to develop geothermal-energy technology. It also includes $13 billion in tax incentives to corporations in the form of tax write-offs for renewable-energy production by 2014. Another $14.3 billion is set aside to **improve energy efficiency in federal and state facilities and low-income housing**, including $4.5 billion for improved energy efficiency in federal and state government buildings, $4.5 billion for the General Services Administration to improve energy efficiency, and $5 billion for weatherization and $300 million for energy efficiency in low-income housing. A total of $4.3 billion is allocated to provide tax incentives to individuals for more environmentally-friendly houses, including reimbursement for 30 percent of the cost (up to $1,500) of installing energy-efficient windows, doors and air conditioning in 2009 and 2010. An item of particular interest was the $3.3 billion slated for the **purchase of electric and hybrid cars and development of a car-battery system**. Spending will amount to $300 million for purchase of electric public vehicles, $300 million for acquisition of plug-in hybrid-type and other electric cars for use by the public sector, $300 million for purchase by state governments of highly energy-efficient cars, $400 million for development of electric-car technology, and $2 billion for development of an advanced car-battery system and components.

Spending on these three major areas amounts to $42.8 billion of the $500 billion fiscal budget of the US economic-stimulus plan. The total amount allocated to tax write-offs and refunds in these three areas is $17.3 billion. Combining this with other "green" expenditures that are included elsewhere in the package yields a total of $70 billion to $80 billion of spending on energy and the environment.

European Union: Since 2004, Germany has required that solar and other forms of alternative electricity be purchased for a fixed price set above the market price for a period of 20 years. Thanks to this form of support, Germany's solar-energy equipment-installation base has developed into the world's largest and plans call for an increase in the number of workers in the renewable-energy industry from the current 250,000 to a level equal to car-manufacturing employment by 2020. Britain plans to invest $100 billion to install 7,000 wind turbines by 2020, creating 160,000 jobs. France is considering legislation to expand the environmental sector in order to create 500,000 new jobs. Similar to Germany, Spain employs a fixed-price system to purchase solar energy, and in 2008 alone had doubled the capacity from the previous year.

China: Included within its four-trillion yuan economic-stimulus package are outlays for spending on the environment. Spending on projects to save energy and cut emissions accounts for 5.3 percent of the total budget, or approximately $30 billion. If implemented, it would amount to nearly half of the spending devoted to the environment in the US stimulus package.

South Korea: On January 6, 2009, South Korea announced a "Green New Deal" focusing on renewable-energy efforts such as solar-energy generation and the popularization of environmentally-friendly cars. The government anticipates spending a total of 50 trillion won over four years. Among ideas under consideration are projects costing 18 trillion won over four years (creating 280,000 jobs) to revitalize the country's four main rivers; 11 trillion won (160,000 jobs) to construct a green transportation network; 700 billion won (20,000 jobs) for a green national-information infrastructure; two trillion won (30,000 jobs) on alternative resources and dam construction; two trillion won (15,000 jobs) to popularize green cars and green energy; three trillion won (50,000 jobs) to expanding resource recycling, three trillion won (230,000 jobs) to jump-start the use of mountain-forest biomass and nine trillion won (150,000 jobs) for green, energy-saving houses, offices and schools.

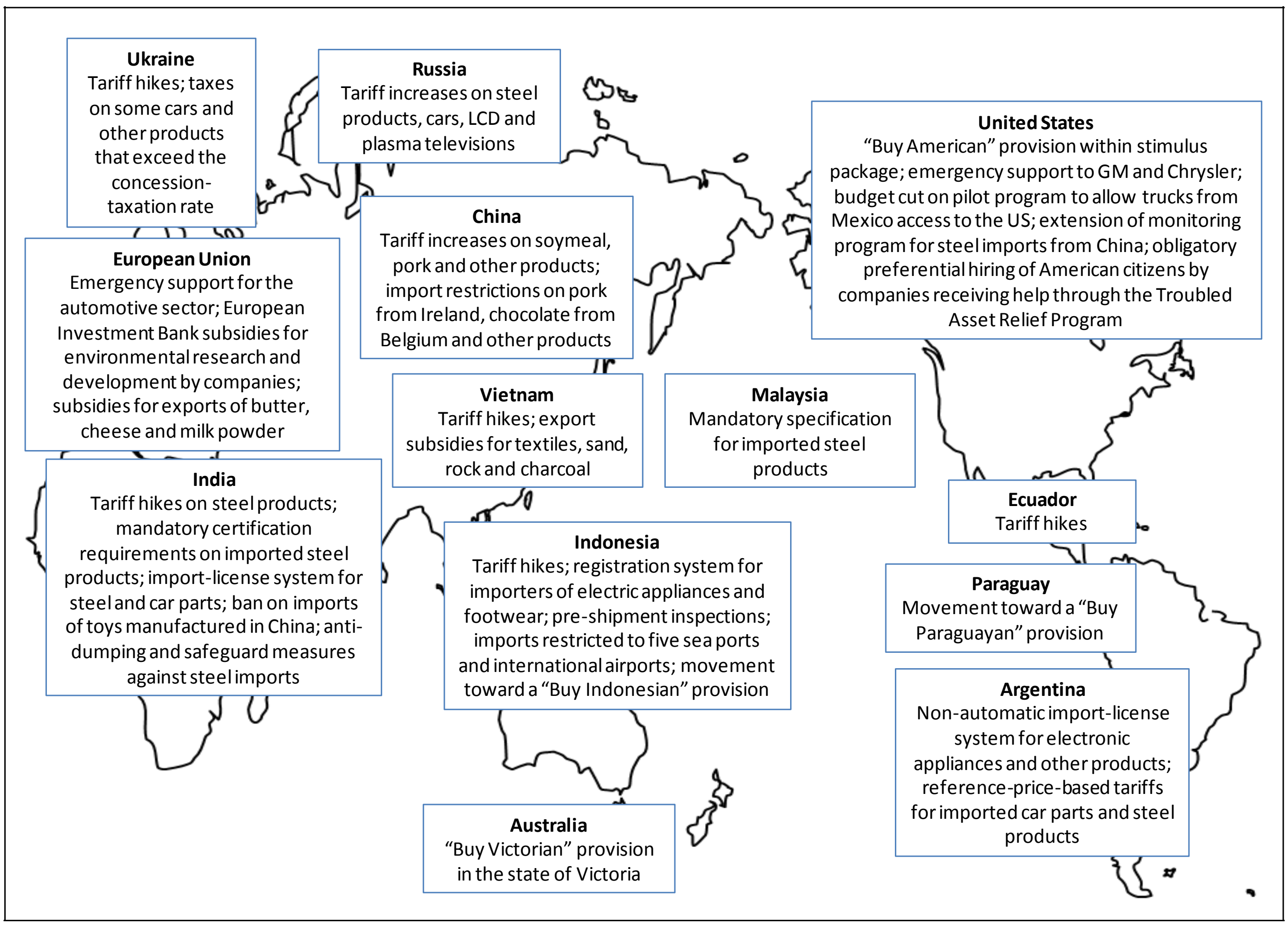
3. The Rise of Trade Protectionism

With the onset of the economic crisis, concerns about trade protectionism have spread. Trade protectionism can take many forms, including tariff hikes, complicated import procedures and beefed-up import standards, export subsidies and industry-support measures, anti-dumping measures (or countervailing tariffs and safeguards designed to counteract export subsidies and other unfair trade practices), and government procurement—such as the "Buy American" provision—that favors domestically-manufactured products.

According to World Bank data released on March 2, 2009, covering the period from October 2008 to February 2009, there were 78 trade-protectionist measures proposed and/or implemented across the globe after the outbreak of the economic crisis, of which 47 were effective trade restrictions. Developed countries accounted for 12 of the

47 measures, most of which took the form of subsidies or industry-support measures. For example, the EU instituted export subsidies for butter, cheese and milk powder. Subsidies provided to car manufacturers by the US, Canada and EU members are estimated to have reached $48 billion. Emerging economies enacted a total of 35 trade-protectionist measures, of which 31 percent took the form of subsidies and industrial support, while tariff hikes accounted for half of the total. Russia raised its new-car tariff from 25 percent to 30 percent and hiked its tariff on used cars as well, and is scheduled to raise its tariff on LCD and plasma-screen televisions. Ecuador raised tariffs on 940 items. India levied an across-the-board 5-percent surcharge on its import duties on steel products. There were also non-tariff measures, including Argentina's introduction of a non-automatic import license system targeting automotive parts, fabrics, toys and leather products; limitations placed by Indonesia on the number of seaports and airports authorized to handle imported clothing, toys, electric products, food and beverages; and others. China tightened its standards and suspended imports of pork from Ireland, chocolate from Belgium, brandy from Italy, seasoning sauce from Britain, eggs from the Netherlands and dairy products from Spain. India banned the import of toys manufactured in China. In the anti-dumping arena, India launched an anti-dumping investigation on steel products in December 2008 targeting 19 countries, including Japan, China, South Africa and Thailand. The EU introduced an anti-dumping tariff on fruit imported from China, and on iron pipe and non-alloy steel imports from Russia, Belarus and China.

Protectionist Measures Announced by Various Countries



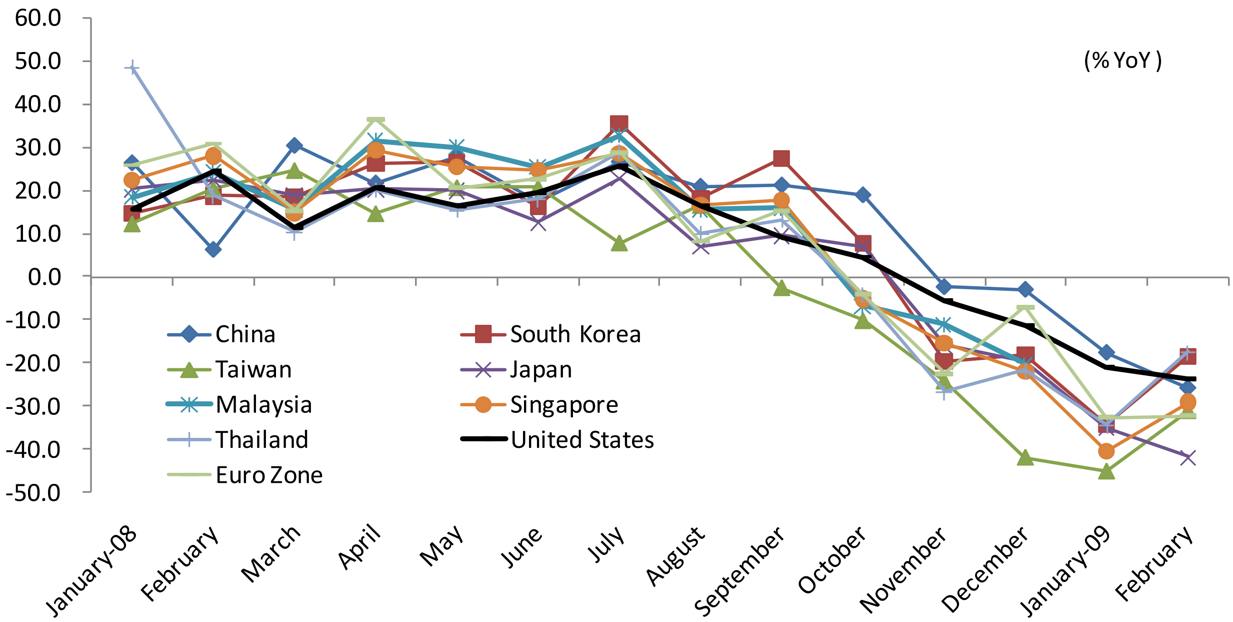
Source: JETRO and others

In the face of this spread of trade protectionism, it is essential that Japan collect as much information as possible; report to the WTO and other bodies; and communicate, in written and other forms, its demands for a rollback of protectionism. As one of the countries that has benefited the most from free trade, Japan must work to eliminate protectionism, for its spread is an obstacle not only to globalization, but also to its own economic growth.

4. Major Contraction in Global Trade and Investment

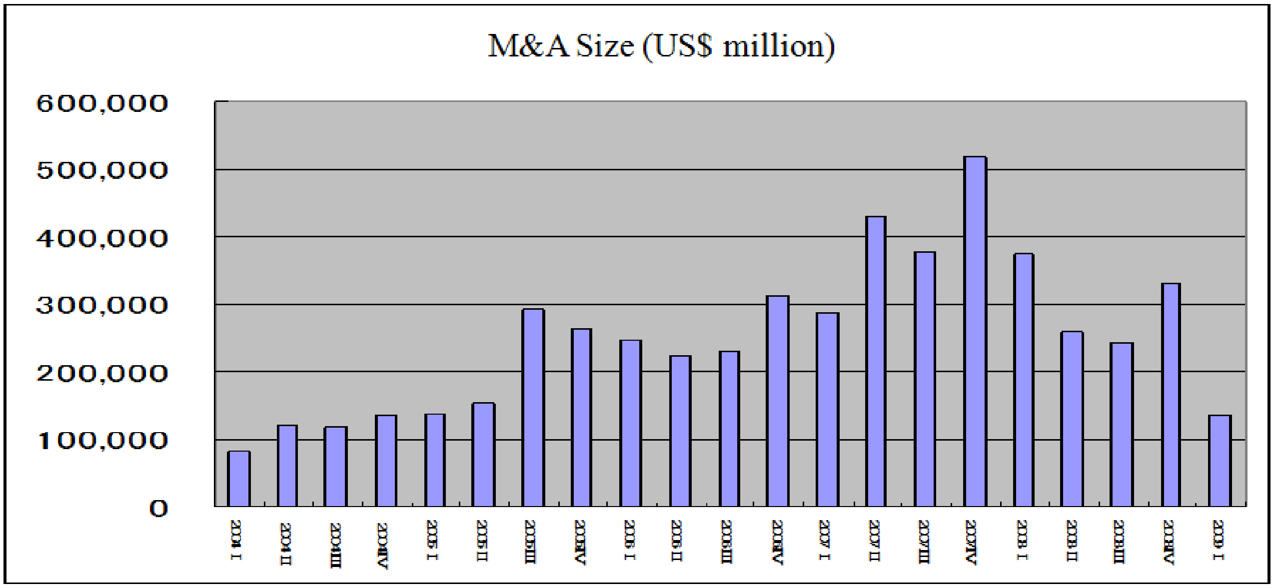
The leading economies' exports (dollar base) began a sharp dive in September 2008. In November, US exports were down from the previous year, and fell 21.4 percent in January 2009 from the previous year. By product type, there were large declines in US exports of cars, car parts and capital goods. By market, US exports to South Korea, Taiwan and Canada fell more than exports to other countries. South Korea's exports in January were off 32.8 percent from the year earlier, and Taiwan's exports fell 42.9 percent in the same period, though the pace of decline abated for both in February. Asia's competitive manufacturers tended to experience sharp drops in exports. South Korea's and Taiwan's export declines were led by a sharp drop in electronics. Meanwhile, Chinese exports began to fall in November 2008, but only by a thin 2.2 percent. However, the pace of China's export declines quickened in January 2009, falling 17.5 percent. ASEAN member states also showed marked export declines, including January 2009 drops of 26.5 percent in Thailand, 25.9 percent in Singapore, 36.1 percent in Indonesia and 15.6 percent in Vietnam. Overall, exports were significantly lower across the region.

Export Trends in the Leading Economies



(Source) National trade statistics

Worldwide, cross-border M&A activity followed an upward trend in 2007, up 54 percent year-over-year. In 2008, by contrast, there was a 30 percent drop. The economic crisis no doubt played a large role in the fall-off, making it difficult for companies to raise cpital, which could only work to tamp down corporate acquisitions. M&As were down 64 percent during the first quarter of 2009 compared with the year-earlier period, accelerating the worldwide trend.

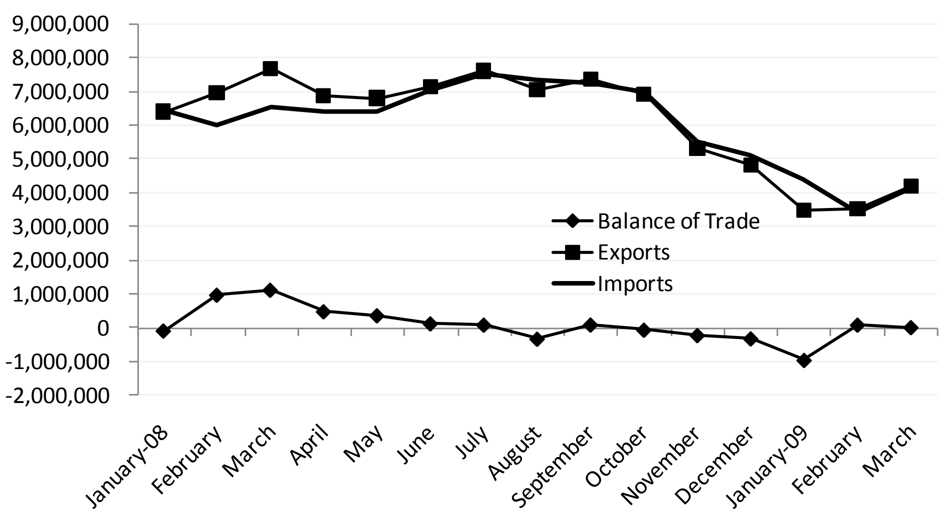


(Source) Thomson Reuters

5. <u>Japan: 2008 Fiscal Year Trade Deficit, Outward and Inward Direct Investment Sustained Major Blows</u>

Japan's fiscal year 2008 balance of trade (on a customs-clearance basis) recorded a deficit of ¥725.4 billion, signifying a ¥10.9 trillion decrease (loss) from the fiscal year 2007 trade surplus. Measured against Japan's nominal GDP of ¥550 trillion, the turnabout represents a two-percent drop in GDP due to the fall-off in trade from the year earlier. By February and March 2009, both imports and exports had begun to recover over the previous months' levels, resulting in a minor surplus. Whether this trend will continue in April and beyond depends on a recovery in export levels.

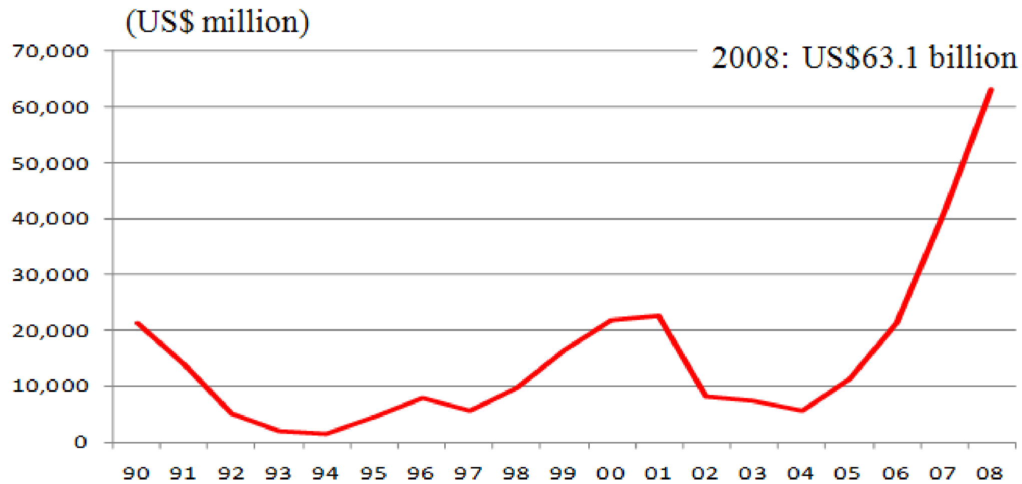
Japan's Trade (¥ million)



(Source) Ministry of Finance

Japan's outward direct investment reached $130.8 billion in 2008, a 78-percent increase over the previous year. M&As involving foreign assets were $63.1 billion, an increase of 54 percent. Japan's inward direct investment was $24.6 billion in 2008, up 10.7 percent. Japan's outward M&As fell 60 percent during the first quarter of 2009, while inward M&As plummeted 98 percent; both figures underscored the impact of the economic crisis.

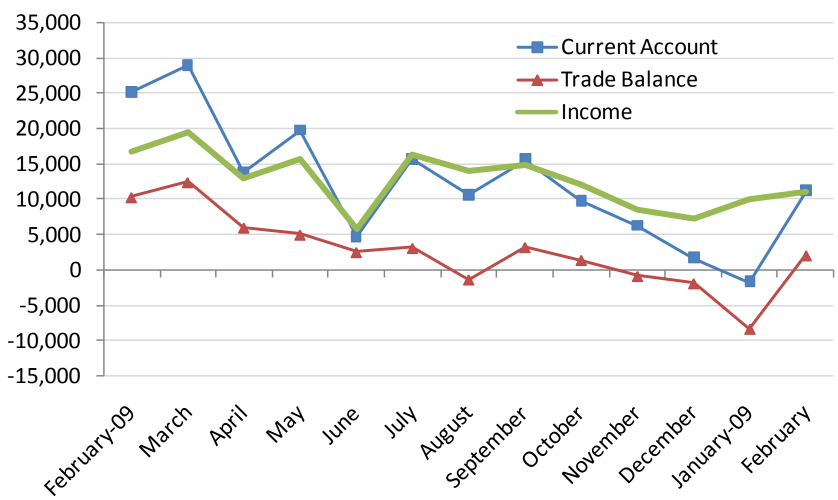
Japan's Outward M&As



(Source) Thomson Reuters

6. Japan's Shrinking Trade Surplus Offset by Surplus Income Balance

Japan's Current Account Balance (¥100 million)



(Source) Ministry of Finance

The current account balance represents the net balance of a country's trade in goods and services, investment and other external economic transactions. In recent years, as Japanese corporations have stepped up manufacturing and sales activities overseas, Japan's current account balance has been strongly influenced by trends in its trade and income balances. In January 2009, Japan posted a current account deficit, as deficits in goods and services trade surpassed the surplus balance on income. Though the income surplus was smaller than it had been during the first half of 2008, it was still in the black, allowing the current account balance to remain in a surplus.

7. Despite the Economic Crisis, Japanese Corporations Remain Very Interested in Overseas Expansion

From the late 1980s through the first half of the 1990s, Japanese companies aggressively established operations overseas. One of the most prominent factors behind the trend was a change in the international operating environment, which spurred many Japanese companies toward international expansion. The 1985 Plaza Accord caused the Japanese yen to appreciate rapidly, harming the country's export competitiveness, but also dramatically lowering the cost of purchasing foreign assets. At the time, Japan was piling up enormous trade surpluses, and in order to resolve rising trade frictions, many companies opted to pursue local manufacturing overseas. There were domestic factors at work as well, as excess liquidity in Japan during the second half of the 1980s drove up stock prices and property values. As a result, Japanese companies' unrealized profits soared, and they put the surplus capital to work in investments overseas. During this period, Japanese corporations not only established local manufacturing operations in the US (green-field-type direct investment), they also branched out into new lines of business and began to aggressively pursue international M&As as a way of establishing a foothold in new industrial sectors.

Japanese companies were once again active in pursuing FDI after 2000, though the specifics of this period were markedly different from the wave of Japanese FDI in the latter half of the 1980s. If Japan had reached the peak of prosperity during the roaring 1980s, the 1990s was known as the "lost decade." Once Japanese companies had disposed of their troubled assets, though, the stage was set for them to resume expansion into overseas markets. The world situation at this point was marked by increasingly tough competition with China and ASEAN member states, with their low-cost manufacturing advantage. Japan was forced to shift some of its manufacturing to Asia and other regions in order to overcome the differential between domestic and foreign manufacturing cost structures, and to establish a division of labor between manufacturing processes, thereby achieving optimal sourcing and production. Post-2000 M&As were different in nature from those in the late 1980s. Whereas the earlier wave of M&As focused on investments in real estate, this time they tended to be more in line with the home companies' core businesses. And the aim of international expansion was not only to establish overseas manufacturing bases, but also to develop local consumer markets. Using M&As to acquire foreign assets was a critical component of the Japanese strategy for prevailing over global competition. Staking their survival on gaining market share, it was critically important for them to utilize existing assets on the ground. Around the same time, the Japanese domestic market was approaching maturity, with a declining and aging population, which provided further incentive for corporate Japan to turn its attention overseas. Lately, in fact, Japanese companies have begun to place their bets on developing consumer markets in emerging economies rather than competing in industrialized nations' markets.

Japan's FDI reached $130 billion in 2008, quadruple the figure for 2002 and a twenty-fold increase over the 1985 level. After peaking at $48 billion in 1990, Japan's outward direct investment fell dramatically until 1994, when it began a gradual recovery. After passing another high point in 2001, it took off in 2004 and expanded rapidly until 2008. While Japanese FDI has increased dramatically in recent years, when measured as a percentage of GDP (net flow), it still lags behind other leading industrialized nations' by a considerable amount. Japan's FDI was a mere 1.7 percent of GDP in 2007; compared with the 2.4 percent for the US, 5.1 percent for Germany, 8.6 percent for France and 8.4 percent for UK, it seems obvious that there is still room for growth.

Japan's External Direct Investment by Country and Region (Balance of Payments Base, Net Flow)

(US$ million, %)

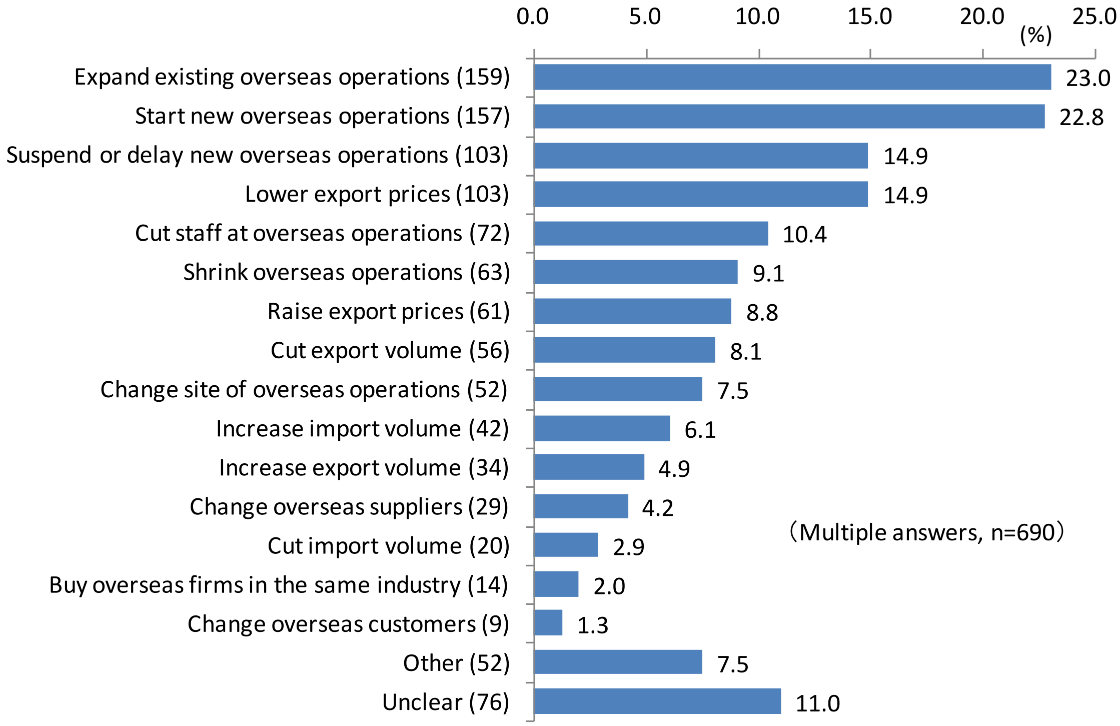
		2002	2003	2004	2005	2006	2007	2008 Jan.-Mar.	2008 Apr.-Jun.	2008 Jul.-Sep.	2008 Oct.-Dec. (P)	2008 (P)	2008 (P) Share	2008 (P) YoY % Changes
Asia		8,191	4,961	10,531	16,188	17,167	19,388	4,963	4,449	4,550	9,349	23,311	17.9	20.2
	China	2,617	3,982	5,863	6,575	6,169	6,218	1,301	1,899	1,549	1,747	6,497	5.0	4.5
	Asian NIEs	3,007	-24	1,873	4,902	3,893	6,039	1,507	1,257	1,312	1,742	5,819	4.5	-3.6
	ASEAN4	2,182	754	2,534	4,276	6,038	5,007	1,636	742	777	895	4,050	3.1	-19.1
	Vietnam	n.a.	n.a.	n.a.	154	467	475	204	411	191	268	1,075	0.8	126.2
	India	145	124	139	266	512	1,506	285	333	336	4,599	5,552	4.3	268.6
North America		8,545	11,143	7,601	13,168	10,188	17,385	8,444	5,903	4,509	27,203	46,059	35.4	164.9
	United States	7,484	10,831	7,559	12,126	9,297	15,672	7,995	5,470	4,227	26,985	44,676	34.3	185.1
	Canada	1,061	312	42	1,042	892	1,713	449	433	282	218	1,383	1.1	-19.3
Central South America		4,003	3,199	3,120	6,402	2,547	9,482	6,814	1,914	6,212	14,682	29,622	22.8	212.4
	Brazil	749	1,097	-65	953	1,423	1,244	402	419	1,262	3,284	5,367	4.1	331.3
	Cayman Islands	3,377	1,651	2,726	3,915	2,814	5,838	4,999	1,293	4,994	11,276	22,562	17.3	286.5
Oceania		1,419	1,127	1,856	943	723	4,204	1,656	641	1,378	1,895	5,571	4.3	32.5
Western Europe		9,760	7,975	7,097	7,509	18,029	20,456	6,513	3,860	3,541	8,359	22,273	17.1	8.9
	Germany	573	716	645	270	1,128	880	543	487	915	1,958	3,903	3.0	343.7
	UK	2,038	2,463	1,649	2,903	7,271	3,026	4,310	429	-1,324	3,323	6,739	5.2	122.7
	France	4,002	1,145	25	541	842	479	240	1,325	143	-5	1,703	1.3	255.2
Eastern Europe and Russia		143	374	439	721	367	509	236	101	213	101	650	0.5	27.7
	Russia	26	-6	49	95	160	99	120	45	72	69	306	0.2	208.2
Middle East		89	-38	-63	542	242	958	236	180	464	259	1,139	0.9	19.0
Africa		233	436	378	25	899	1,101	444	893	155	26	1,519	1.2	37.9
World Total		32,149	28,895	30,962	45,461	50,165	73,483	29,306	17,941	21,022	61,872	130,142	100.0	77.1
Reference														
	ASEAN10	4,277	390	2,800	5,002	6,923	7,790	1,883	1,387	1,443	1,580	6,293	4.8	-19.2
	European Union	9,802	8,055	7,341	7,872	17,925	19,934	6,732	4,045	3,738	8,279	22,794	17.5	14.3

(Notes) Figures released in yen and converted to dollars using the Bank of Japan's quarterly "Average Exchange Rate".
"-" denotes excess of withdrawals. "N/A" denotes no data. 2008 fourth quarter data are provisional figures.
(Sources) Japanese Ministry of Finance: "Balance of Payments"; Bank of Japan: "Foreign Exchange Rates."

According to JETRO's annual "Survey on International Operations of Japanese Firms," conducted in late 2008, as the effects of the economic crisis were beginning to be felt, 53 percent of companies surveyed (responses were received from 928 companies; the deadline was December 22) intended to expand their business overseas. Though this represented a 13 point decline from the 66 percent of respondents that had given the same answer a year earlier, most of the difference can be explained by the higher number of respondents answering that they would "maintain the status quo"; the number of firms answering that they would downsize or shutter their overseas operations , at 2 percent of the total, was unchanged from the earlier survey. The results are open to interpretation, but it seems clear that while there was a drop in the percentage of firms answering that they would expand their overseas business, most of the differential from the previous year's results reflected nothing more than companies taking a wait-and-see approach, suggesting that there has not been a loss of enthusiasm for the idea of overseas expansion.

Evidence for this can be found in response to the question, "What will you do to address the financial crisis that began in the United States?" Twenty-three percent of companies replied that they would "expand (or consider expansion of) existing overseas operations," and 22.8 percent answered that they would "start new overseas operations." Less optimistic responses included the 14.9 percent of respondents answering that they would "suspend or delay new overseas operations." Similarly, 15 percent responded that they would "lower export prices," ten percent planned to "cut staff at overseas operations," nine percent said they would "shrink overseas operations," and eight percent said they would "change the site of overseas operations"—responses that, taken as a group, are still lower than responses suggesting an active interest in overseas expansion.

Steps Taken After the Financial Crisis



(Source) JETRO, "Survey on International Operations of Japanese Firms," March 2009

Companies foreseeing worsening performance overseas due to the economic crisis included those in ceramics/stone, and clay products; automotive; and general-machinery categories. In contrast, overseas nonmanufacturing industries were largely unaffected; nearly half of the respondents in retail, finance/insurance and professional services (consulting, legal, etc) answered that they were only lightly affected by the slump. What sort of business operations did Japanese companies intend to beef up overseas, despite the economic crisis? The most popular answer, cited by 77 percent, was an expansion of sales operations. The next-most-popular answer (38 percent) was manufacture of general-purpose articles, followed by manufacture of high-value-added products (23 percent), research and development in new products (21 percent) and research and development on products to sell in local markets (15 percent). In summary, an overwhelming number of companies was considering expanding local sales operations on the ground. Historically, the most pressing issue for Japanese companies has been expansion of production as they built up their manufacturing infrastructure, mostly in East Asia. Now that manufacturing has reached a certain level, future efforts will focus on expanding production of high-value-added products. Further expansion of manufacturing facilities will come about mostly as necessary, in order to keep up with growing demand in local markets. As a result, one of the most pressing issues remaining in overseas expansion is how to capture local consumer demand; beefing up sales and marketing capacity will be the key to success.

III. Japan's Strategy for Growth After the Economic Crisis

1. Changes in Consumer Demand Around the World Resulting from the Economic Crisis

The industrialized nations have been subject to depressive forces. Due to anxiety about the future, consumers, including those in Japan, are reluctant to spend, cutting their expenditures, especially on luxury items, prestigious brands and other non-essential items. As a result, replacement demand for products like cars and expensive household appliances has evaporated. This trend has had implications for production throughout the manufacturing sector, resulting in poor domestic and foreign sales performance and declining exports.

The emerging economies are divided into the high-performing and low-performing economies. One hallmark of the high performers is that many have relatively low income levels, and there is still room for consumers to complete purchases of mid-level products, including the necessities. In these economies, in other words, a high potential exists for demand to be stoked. Of course, these countries do not produce luxury items; instead, production rests on manufacture of mid-level and low-cost products, making them largely impervious to the economic crisis. Countries in this category include Vietnam, Indonesia, Egypt and others, as well as China and India to a certain extent.

The low-performing emerging economies are characterized by relatively high income, where consumer demand for everyday items has largely been met. Countries such as Thailand, Turkey, Mexico, Hungary and Romania manufacture and export cars, household appliances and other expensive products; lower income negatively affects their consumption. Further, countries such as Russia, Argentina, Venezuela and others have been slow to react to the sudden price drops in resource prices, putting their consumers in the mood to cut down on their spending.

2. A Growth Strategy for Growth in Japan in the Current Global Economic Situation

Before the economic crisis, the main factors behind income gains in emerging economies such as the BRICs and the JFIC16 countries included (1) rising resource and energy prices, (2) export-driven economic expansion, (3) more remittances from abroad and (4) growing investment from overseas. What happens when these factors are applied to Japan's case? To address the resources and energy issue, Japan must tackle the "green" energy sector, in particular through technological development and policy actions. The United States has announced a budget for environmental countermeasures of more than $70 billion, while China has unveiled a budget for the environment of $30 billion, and South Korea has come up with a four-year, $30 billion budget to address the environment. Enhancing Japan's competitiveness will require that the public and private sectors work together to address the environment. "Export-driven growth," cited above, can be applied directly to Japan's case. But since Japan cannot expect to see its expatriate working population grow, "remittances from abroad" will not have any importance for it. Instead, that income stream would have to be replaced by more overseas investment and pursuit of outward M&As to increase profit derived abroad.

Thus, a growth strategy for Japan in this economic environment rests primarily on promoting exports, overseas sales and foreign investment (outward M&As) to drive profit growth abroad. The proceeds of the profit should be repatriated (analogous to remittances from abroad) to spur domestic investment and consumption. The ripple effect would drive up domestic demand and attract investment from abroad. Japan, in other words, should establish itself as **an economy predicated on trade and investment**. Toward that end, it should take a firm stance against any movement toward protectionism, which would hamper its shift toward more and more trade- and investment-oriented economy.

The effective use of economic support and aid to emerging economies will be of critical importance if Japan hopes to increase its exports and expand direct investment. Such support and aid should be used to ramp up consumer demand in emerging economies, which should result in higher sales for Japanese products. In providing economic aid and support to emerging economies, the biggest bang for the buck will come from targeting relatively low-income countries that have performed well despite the economic crisis. Also, policy measures should be formulated that target Asian countries such as China, South Korea, Taiwan and ASEAN member states that use Japanese capital goods and parts.

The green-energy market is expected to grow rapidly once the economic crisis passes. Raising Japan's competitiveness in developing solutions not only to long-standing issues such as air pollution, water and waste processing and recycling, but also in the realm of renewable energy (solar, wind, geothermal, biomass) and the low-carbon arena (electric cars, alternative fuels, environmentally-friendly housing) can be expected to pay dividends by allowing it to stake out a competitive edge in the green economy.

Thus, Japanese companies' global strategy should be grounded in East Asia, while expanding its platform in other emerging economies. Further, in addition to high-value-added products, merchandise with broad market appeal should be marketed to middle- and low-wage earners in these countries. Finally, in becoming more aware of the environment, an emphasis should be placed on developing of green products, a strategy that can be expected to pay dividends in the form of enhanced competitiveness. In sum, Japanese companies' strategy for global competitiveness should rest on three pillars: market expansion in emerging economies, especially those in Asia; product development for medium-income consumers; and environmental-friendliness.

A Competition Strategy for Japanese Companies

Focus on Asia, foster emerging economies' economic expansion, develop products for middle-income consumers and promote the green economy

Mid-and Long-Term Outlook for the Global Economy

- As evinced by the G-20 countries, the global economy become multi-polar; while economic growth in the emerging economies is gradual, consumption will continue to expand and will become an engine for the world economy

- In the 1990s and first decade of 2000, global trade and investment was driven by the IT industry, investment funds and resources and energy; promising sectors for the future include the environment and renewable (clean) energy

A Post-Crisis Growth Strategy for Japan

- Establish its position as an economy built on trade and investment

- Incorporating the growth potential of emerging economies is critical to a Japanese global strategy

- Leverage economic support and foreign aid targeting emerging economies in Asia and elsewhere in order to expand exports and outward direct investment

- Raise Japan's competitiveness in developing solutions not only to long-standing issues such air pollution, water and waste processing and recycling, but also in the realm of renewable energy (solar, wind, geothermal, biomass) and the low-carbon arena (electric cars, alternative fuels, environmentally-friendly housing)

Industrial Restructuring and a Global Competitive Strategy for Japanese Companies

- Greener agriculture, forestry, automobiles, science, materials, steel and food-processing industries; conserve resources

- Competitive Japanese products: (1) Enhanced-functionality (Internet-enabled TV, etc) high-value-added products; (2) products with broad appeal to middle-income consumers in emerging economies; (3) environmentally-friendly products incorporating green technology

- Utilize East Asia as a base and capitalize on FTAs to extend the growth platform to emerging economies