

White Paper on International Economy and Trade 2012

- Extending the Frontiers of Growth through Global Linkages -

July 2012

Policy Planning and Research Office,

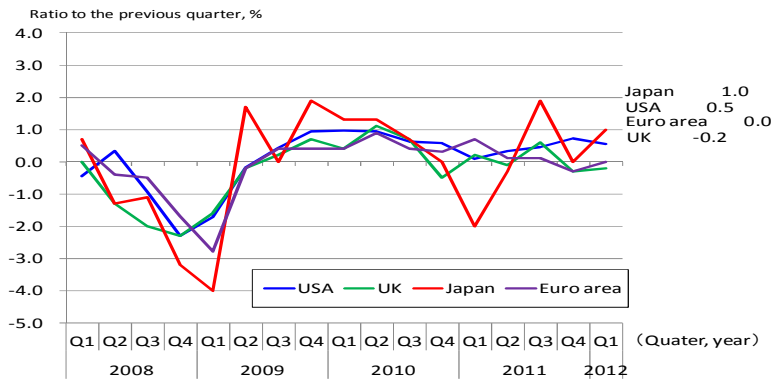
Trade Policy Bureau,

Ministry of Economy, Trade and Industry

1-1 State of world economy – recent developments and prospects

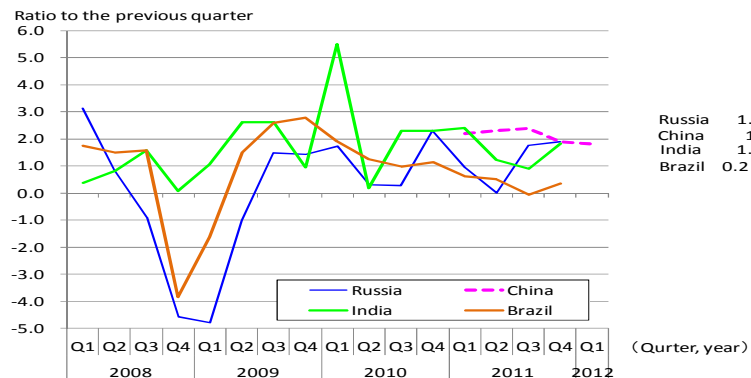
- The pace of economic growth decelerated in the latter half of 2011, both in advanced and emerging economies.
- The euro area growth rate is anticipated to be negative; while high growth is expected in emerging economies despite deceleration.

GDP growth rate in the advanced economies



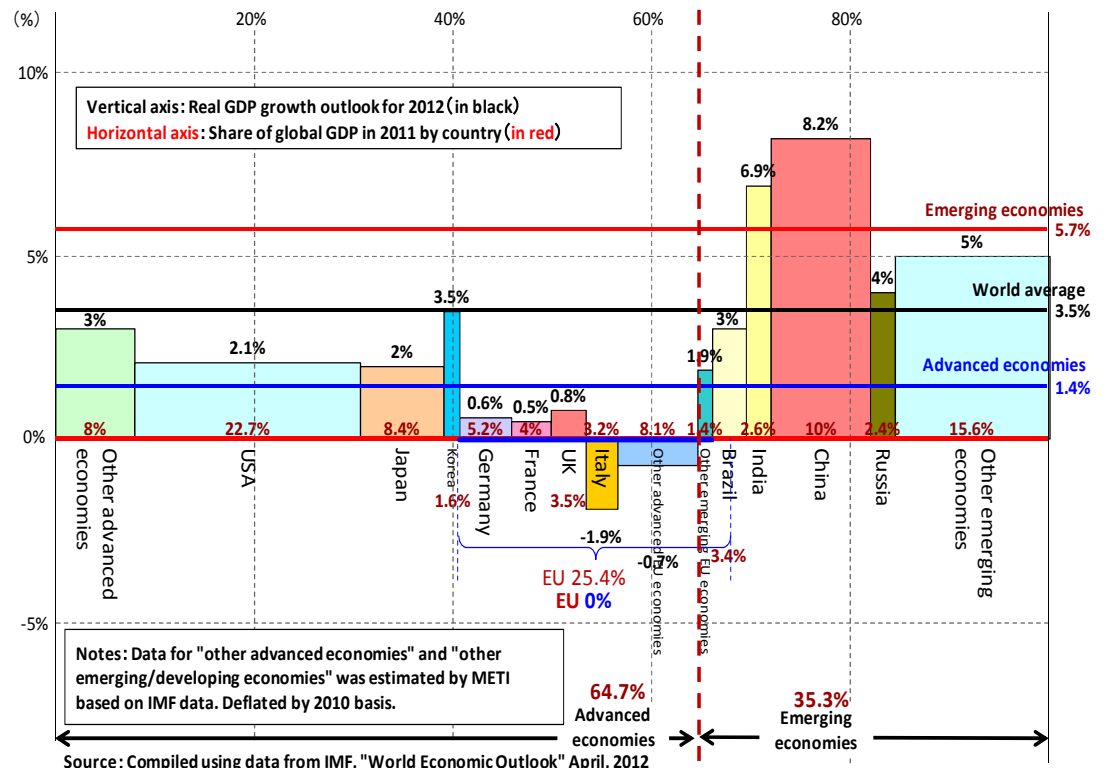
Sources: OECD stat

GDP growth rate in the emerging economies



Notes: China started to publicly announce the data of ratio to the previous period from 2011. Therefore, it is not available before 2010.
Sources: OECD stat

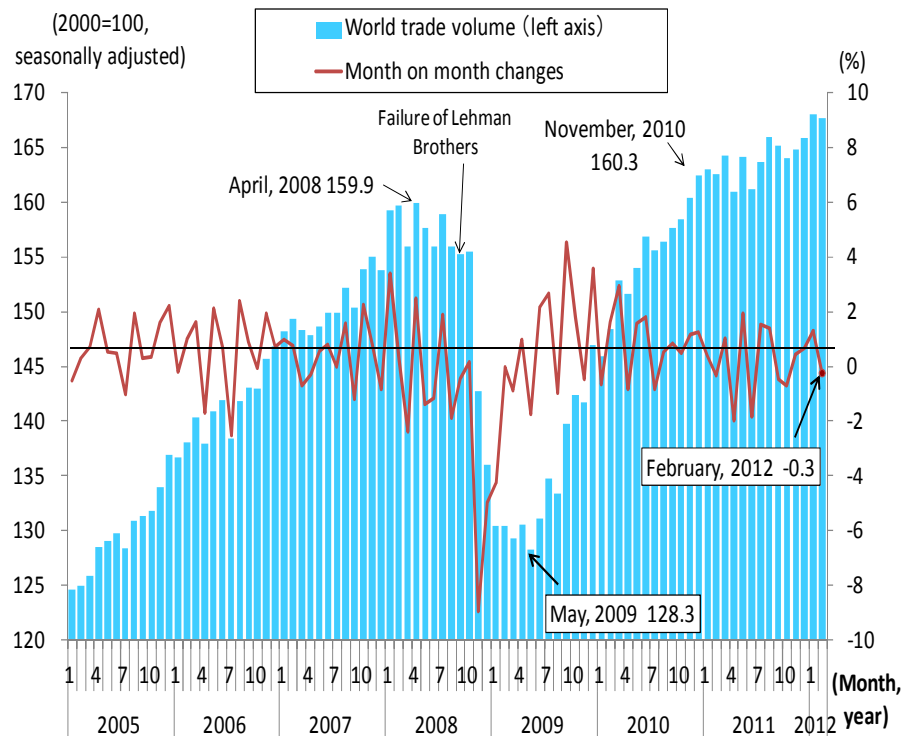
Real GDP growth outlook for 2012 (vertical axis) and the share of global GDP in 2011 (horizontal axis) by country/region



1-2 Signs of recovery in world trade and net capital flows to emerging economies

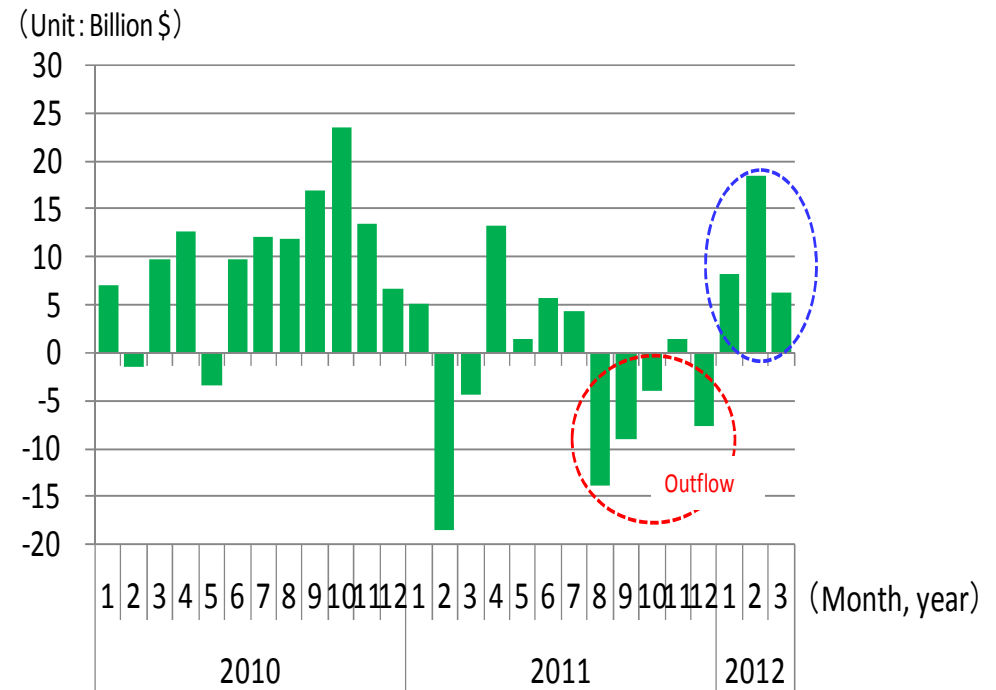
- Recovery of world trade stalled in the latter half of 2011.
- Capital flows to emerging economies turned negative in the latter half of 2011.

World trade volume



Source: Compiled using data from Netherlands Bureau for Economic Policy Analysis (CPB)

Flow of funds into emerging economies

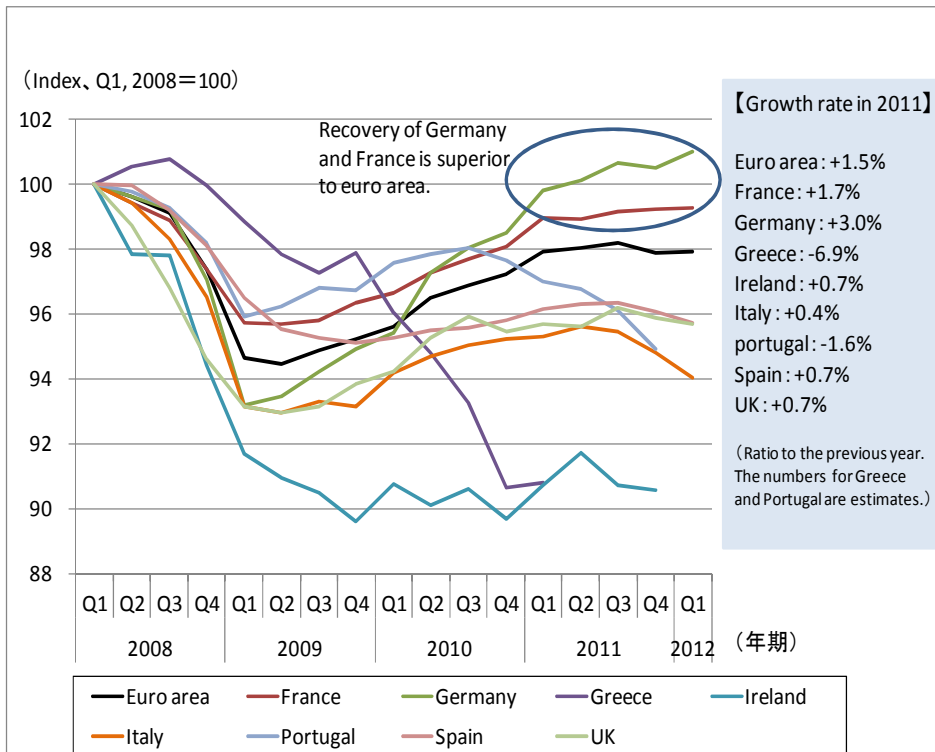


Source: IMF 「WEO」, April 2012

1-3 Diverging economic trends in euro area economies

- Despite the euro area crisis, Germany maintains solid growth.
- Unit labor costs were kept low in Germany, in contrast with other euro area economies.

GDP in the major euro area economies and the UK

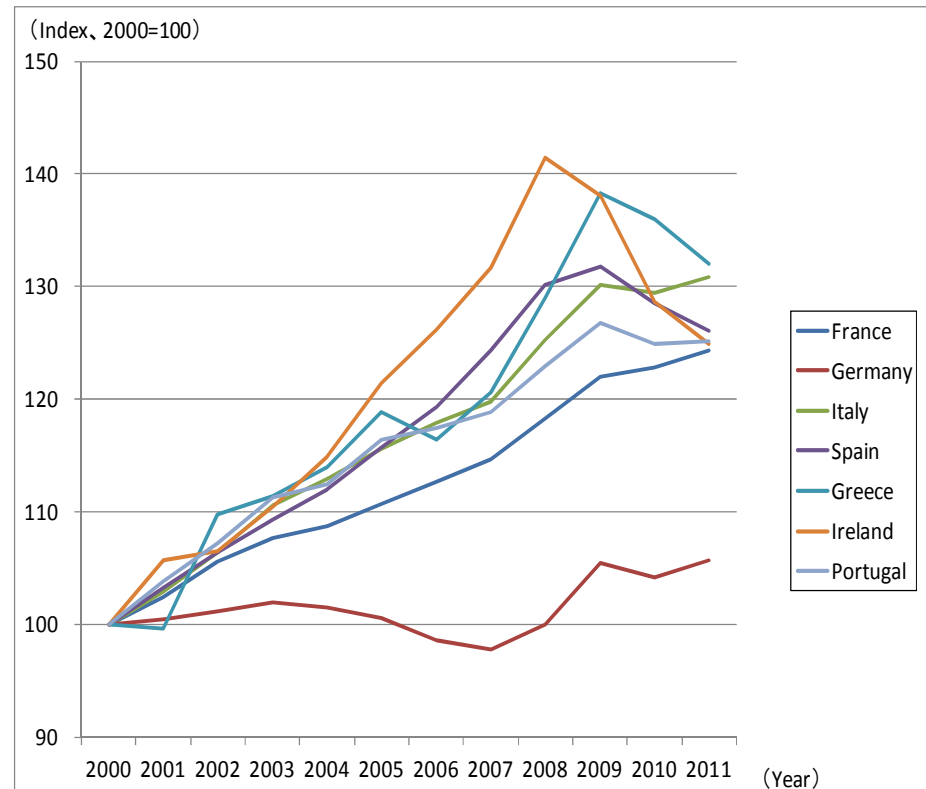


Notes: The numbers for Ireland and Portugal are latest data.

For Greece, the seasonally-adjusted data has not been announced officially after Q2, 2011.

Source: Eurostat

Unit labor cost in the major Euro area economies

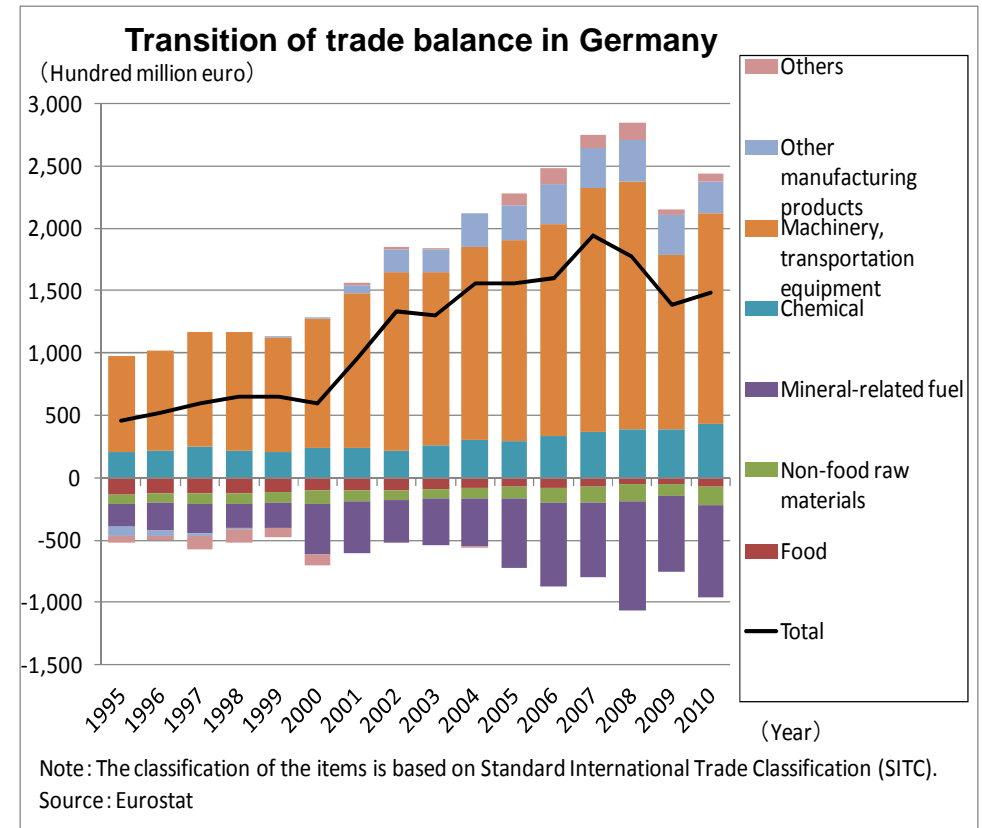
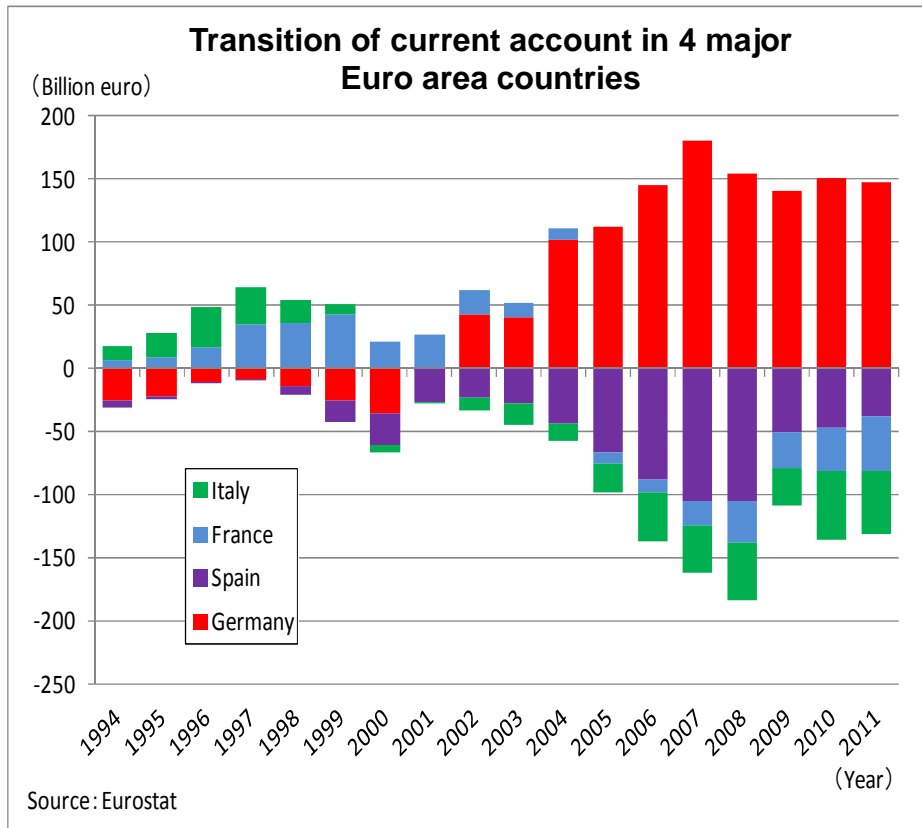


Notes: The data is re-calculated and converted from the index of 2005=100 into 2000=100. The values for 2011 are expected value.

Source: Eurostat

1-4 Germany's rising current account and trade surpluses

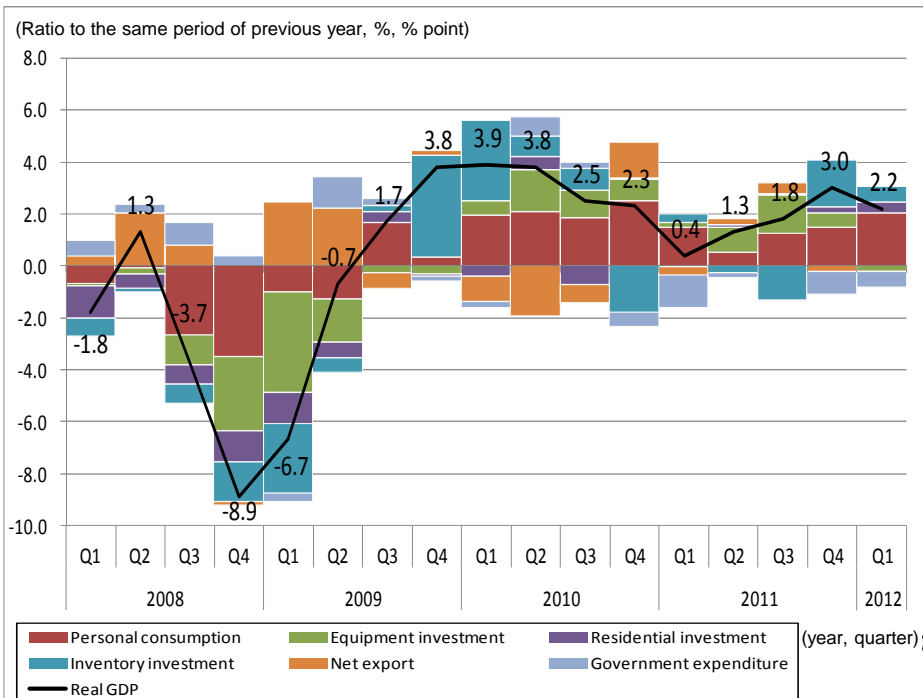
- Throughout the 2000s, current account imbalances between Germany and other euro area economies widened.
- Germany's trade surplus mainly comprises machinery and transport equipment and chemicals.



1-5 U.S. economy: continued growth but prospects uncertain

- The U.S. economy decelerated in early 2011 due to negative factors including higher oil prices; stronger signs emerged in the first several months of 2012.
- Exports have exceeded the pre-crisis peak; housing investment has declined from its peak level and we have yet to see a clear recovery.

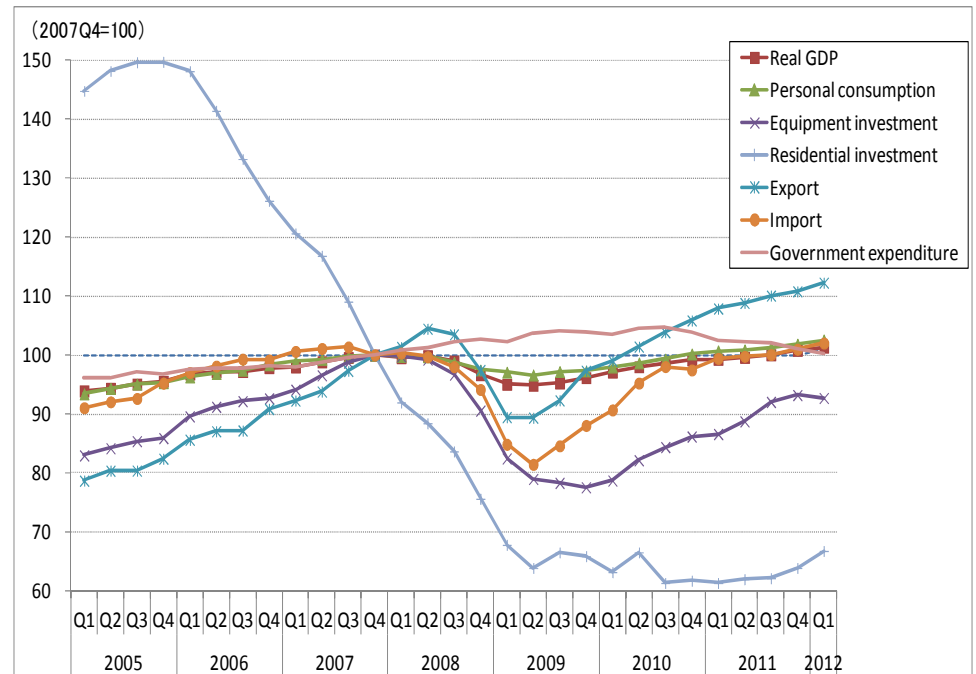
Real GDP growth and demand-side composition in the U.S.



Notes: Seasonally-adjusted data. The figures for Q1 2011 are preliminary.

Source: US department of commerce, IMF WEO, April 2012].

Real GDP and each demand component (2007Q4=100)



Note: The figures for Q1, 2011 are preliminary.

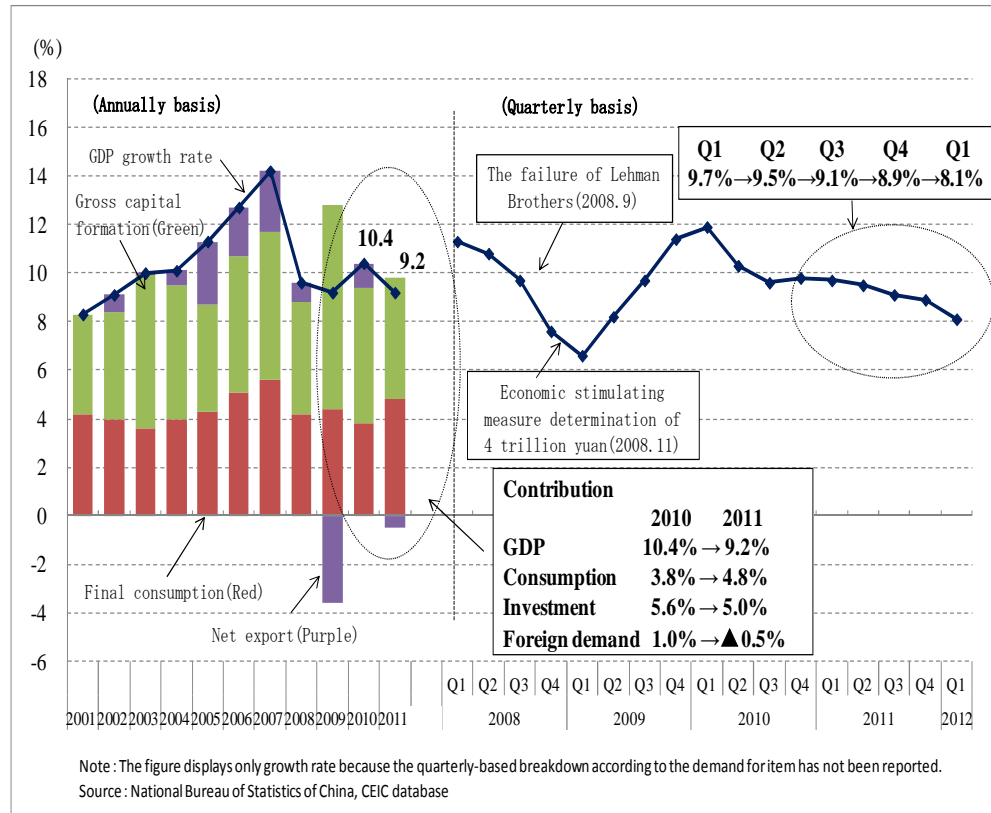
Source: US department of commerce, CEIC Database

(Year, quarter)

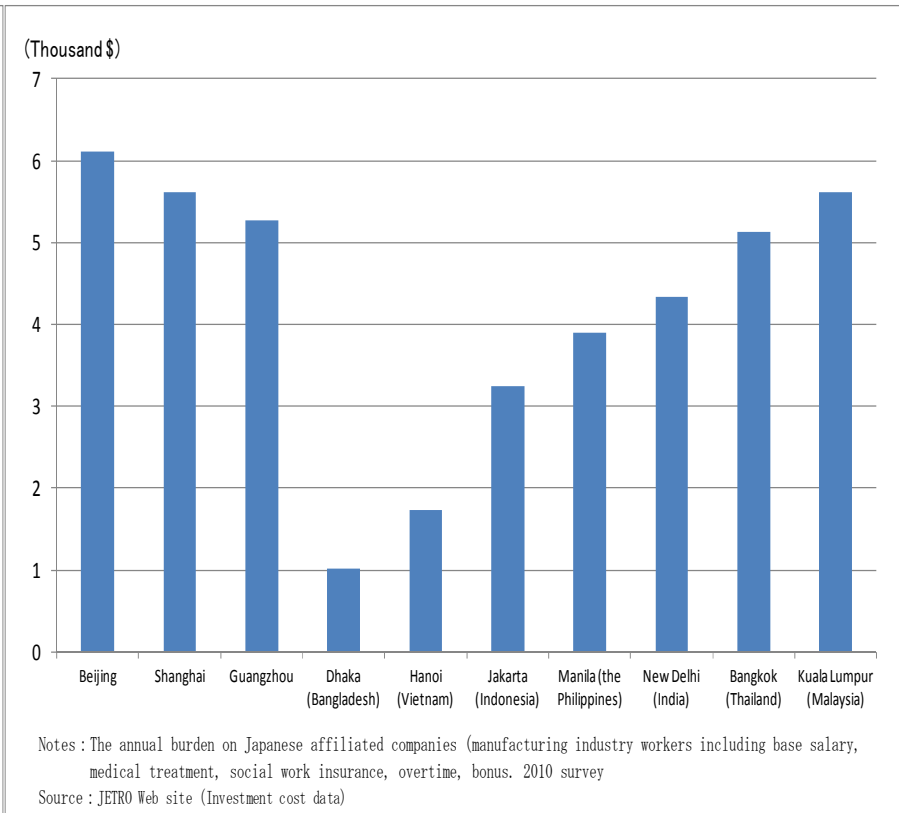
1-6 Chinese economy: high growth but with slower pace

- The Chinese economy maintained a solid 9.2% growth in 2011, but growth slowed compared to 2010.
- Rising wages in large coastal cities have caught up with those of other major Asian cities such as Kuala Lumpur and Bangkok.

Real GDP growth rate (ratio to the same month in the previous year) in China



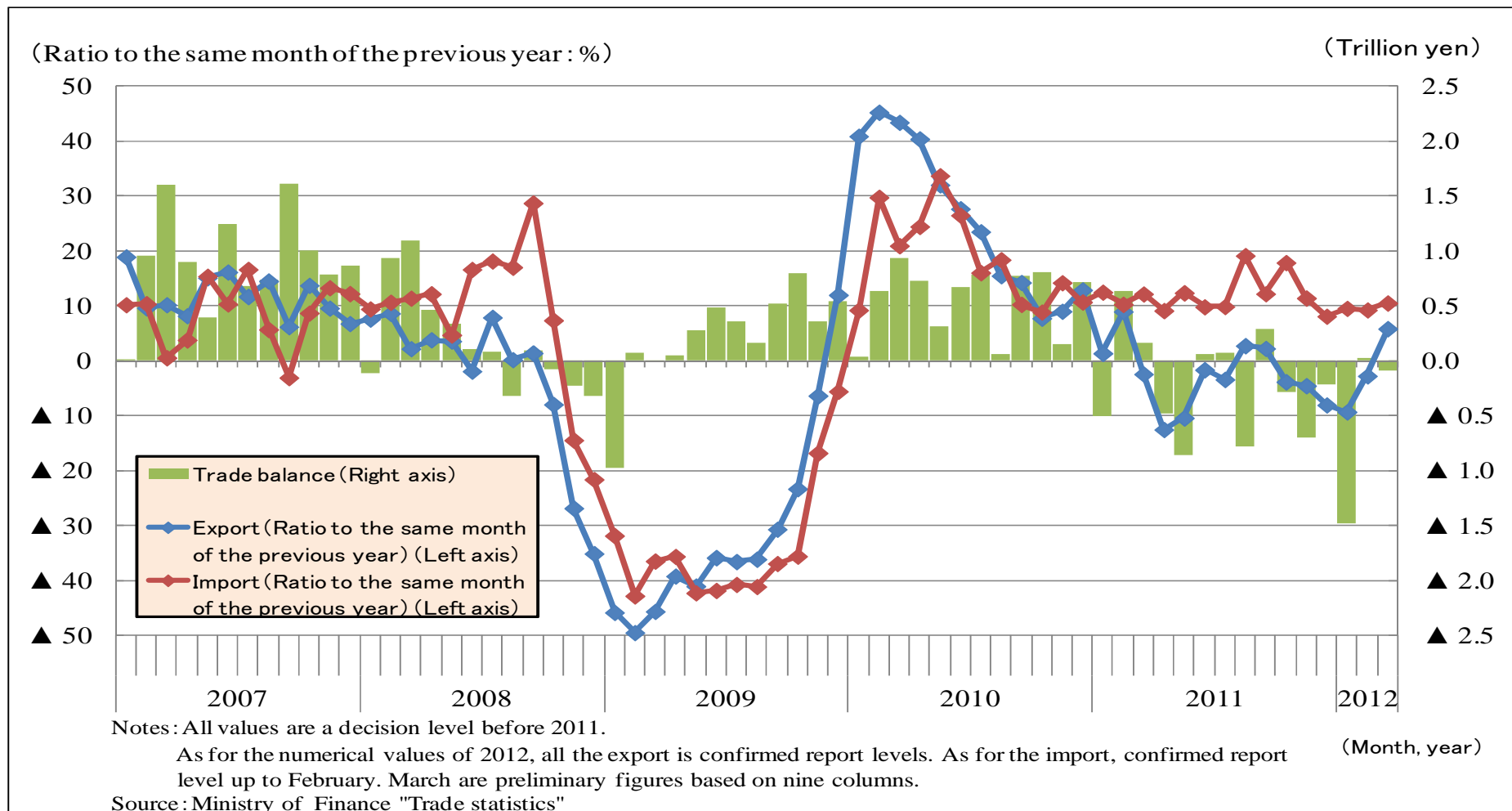
Salary level comparison of Japanese-manufacturing industry in China and major Asian countries (annual sum)



2-1 Trade deficit in 2011

- In 2011, exports declined due to the yen appreciation and deceleration of the world economy, Great East Japan Earthquake, the flood in Thailand, while imports kept increasing.

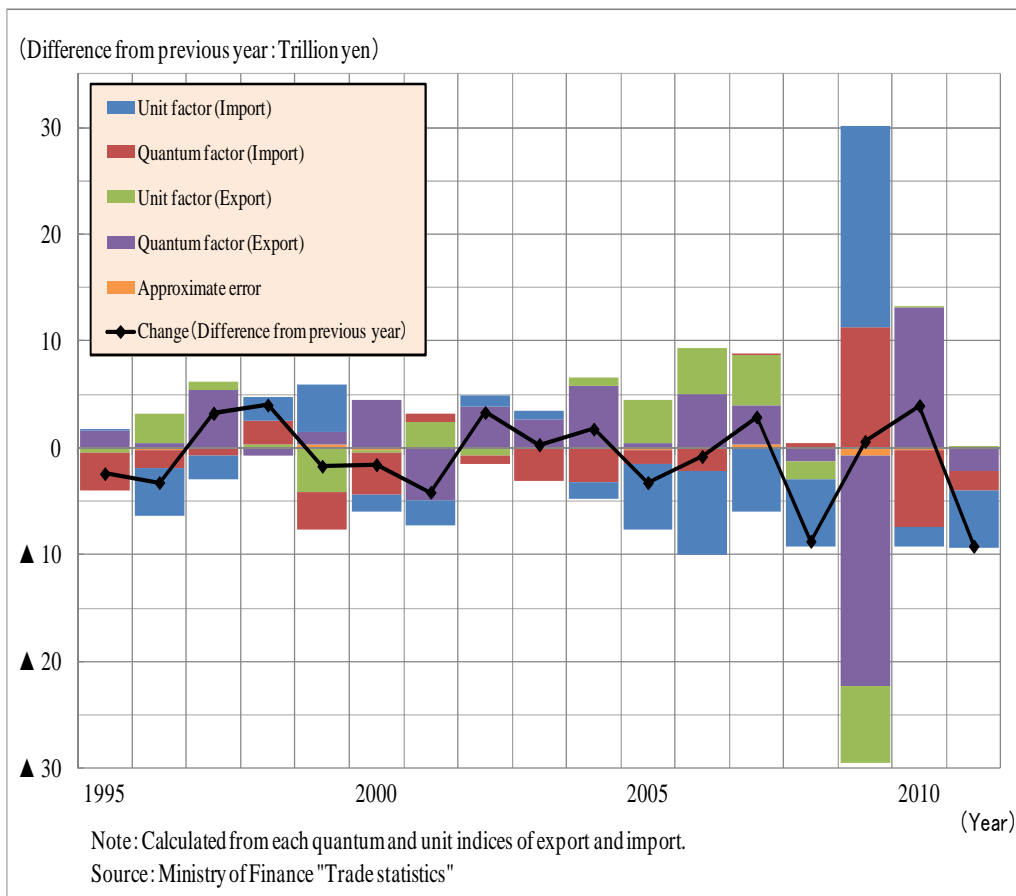
Developments in exports and imports



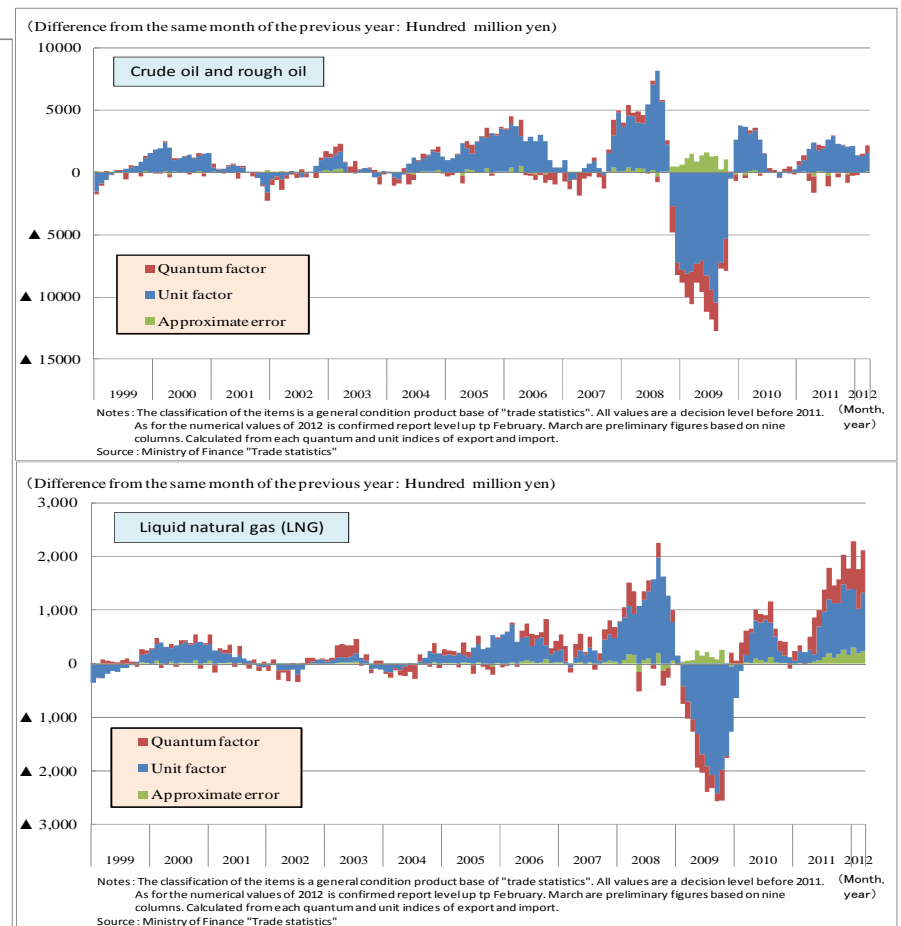
2-2 Higher import prices contributed to trade balance deterioration

- The major contributing factor to the deterioration in the trade balance in 2011 was higher import prices, especially in resources; additional factors being higher import volume (such as LNG) and lower export volume.

Factor decomposition of changes in trade balance (after 1995)

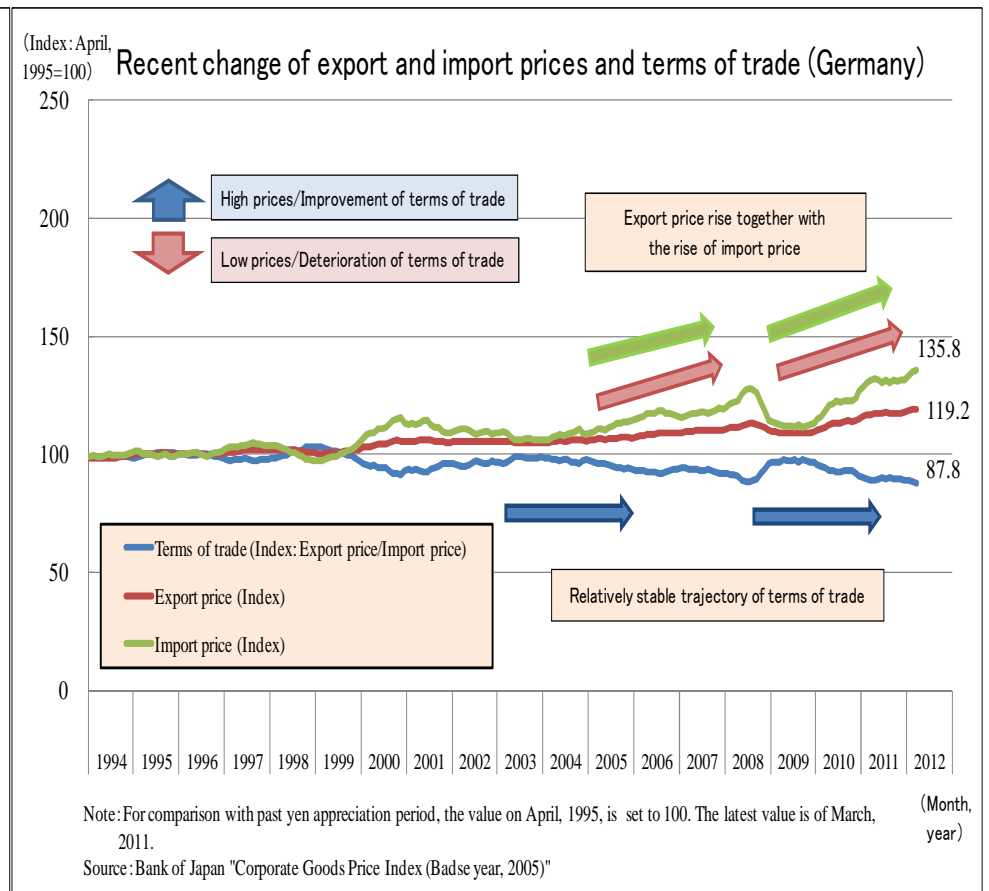
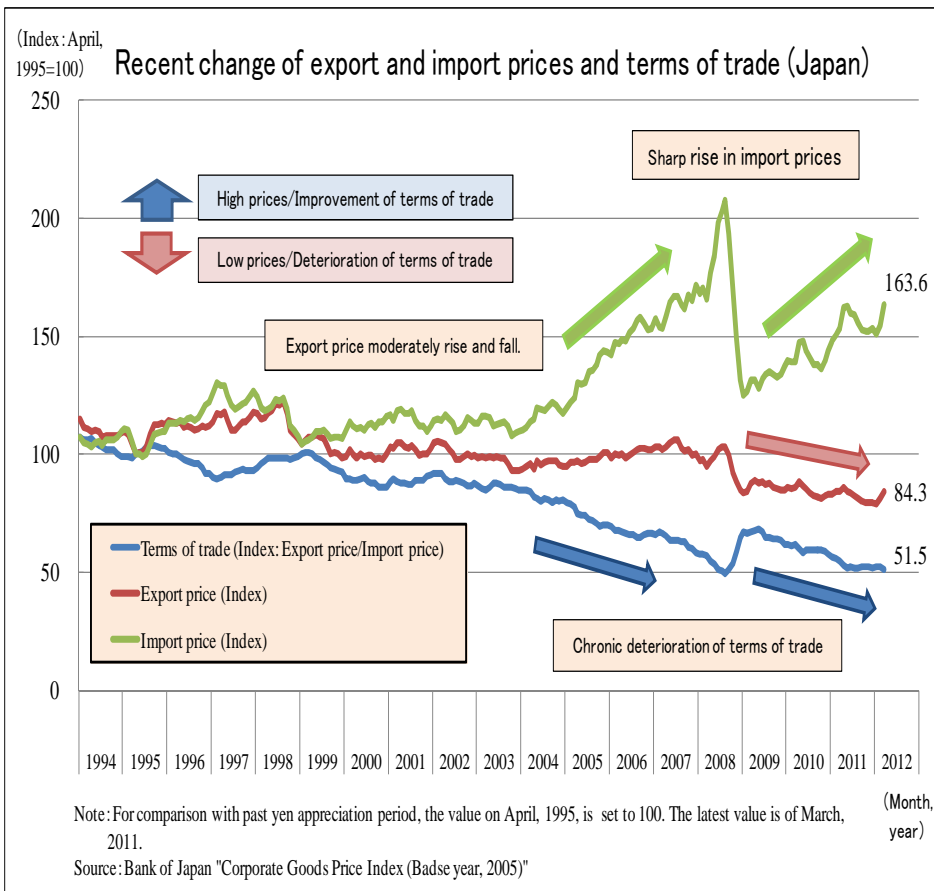


Factor decomposition of the amount of import of mineral-related fuel



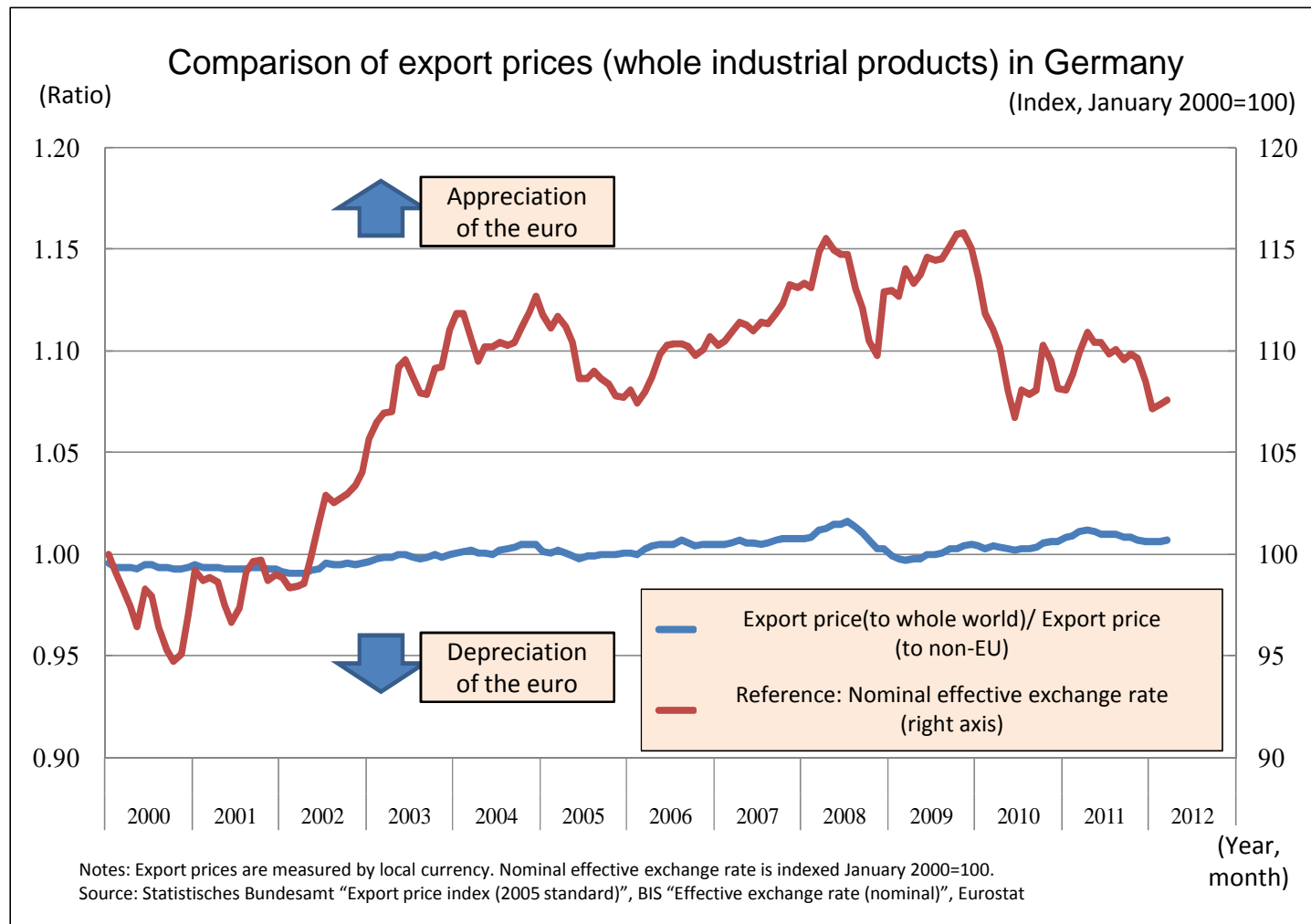
2-3 Japan's export prices are declining despite acceleration in import prices

- Japan's export prices have declined amid the appreciation of the yen; import prices have risen rapidly along with rising resource prices.
- Germany's export prices have risen along with higher import prices.



2-4 Germany's stable export prices.

- Germany's export price movements are very similar inside and outside of the EU, despite exchange rate changes.



2-5 Export strategies of German firms (exports in high-end products and global marketing and specialized product segments)

- The strong brand value of large German firms is often seen to be maintained through exports of high-end products from Germany.
- Global marketing in specialized product and technology segments is conducted by mid-sized enterprises to ensure adequate global market share.

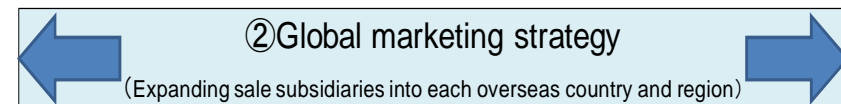
Strategy of large German firms
 ~ Exports of high-end products by branding ~

Unit price of automotive (more than 3,000cc)
 which China imports (2011)

Origin of import	Unit price	The share among the value of import
Germany	83,500	37%
Japan	39,000	22%
U.S.	47,800	17%

Source: Global Trade Atlas

The two-pillar strategy of German excellent medium and small-sized firms ("The Hidden Champions")

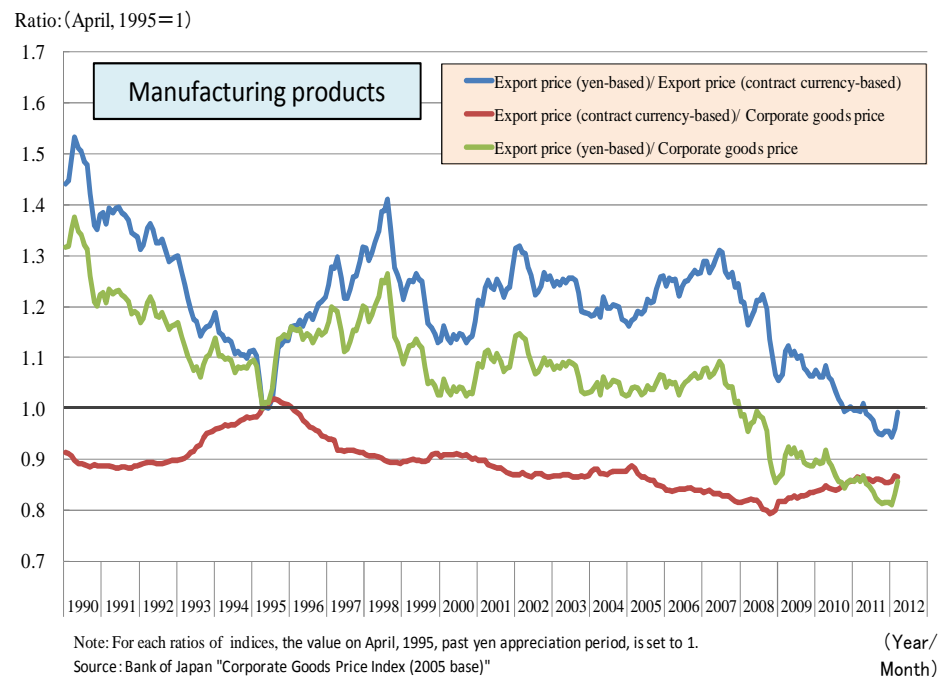


Source: Hermann Simon "Hidden Champions of the 21st Century" (2009)

2-6 Export prices of manufacturing products (total average) in Japan

- "Index of export revenue" in Japan has been sharply declining since 2007, with yen appreciation.
- Even before 2007, "index of export revenue" had been gradually falling with falling "index of overseas pricing".

Export profitability of manufacturing products in Japan



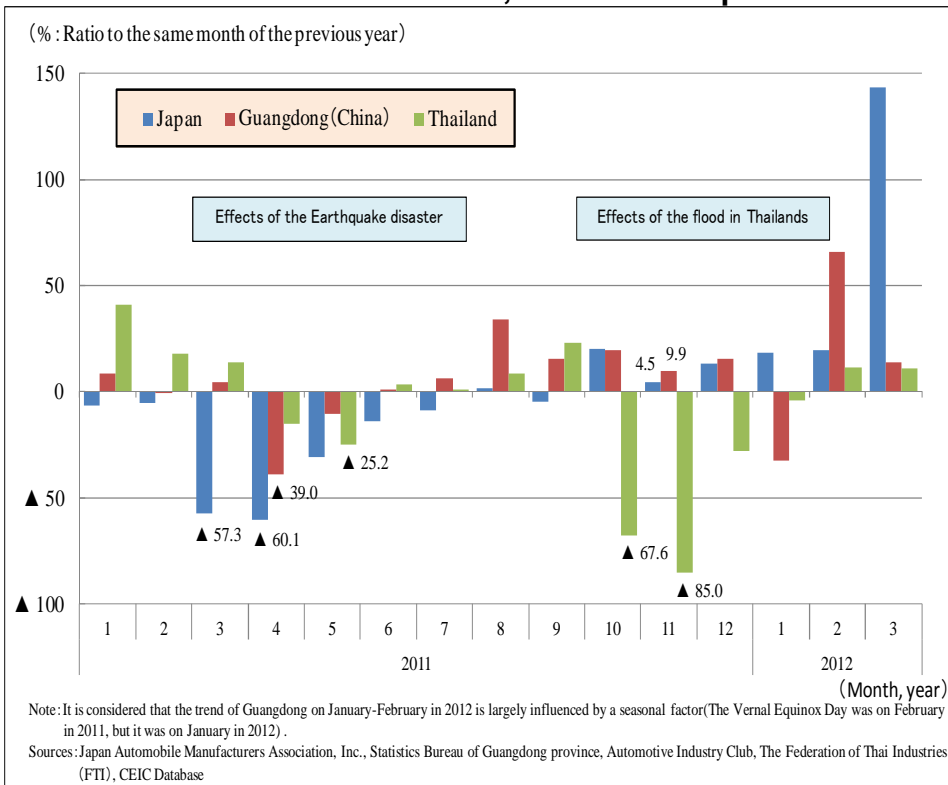
(Calculating formula)

- "Index of exchange rate"
= "Export price (yen-based) / Export price (contract currency-based)"
- "Index of overseas pricing"
= "Export price (contract currency-based) / Corporate goods price"
- "index of export revenue"
= "Export price (yen-based) / Corporate goods price"
- ✓ "Index of export profitability" is the product of "Index of exchange rate" and "Index of pricing power overseas"
- ✓ In other words, "export profitability" can be decomposed into the "exchange rate" and "price overseas" components.

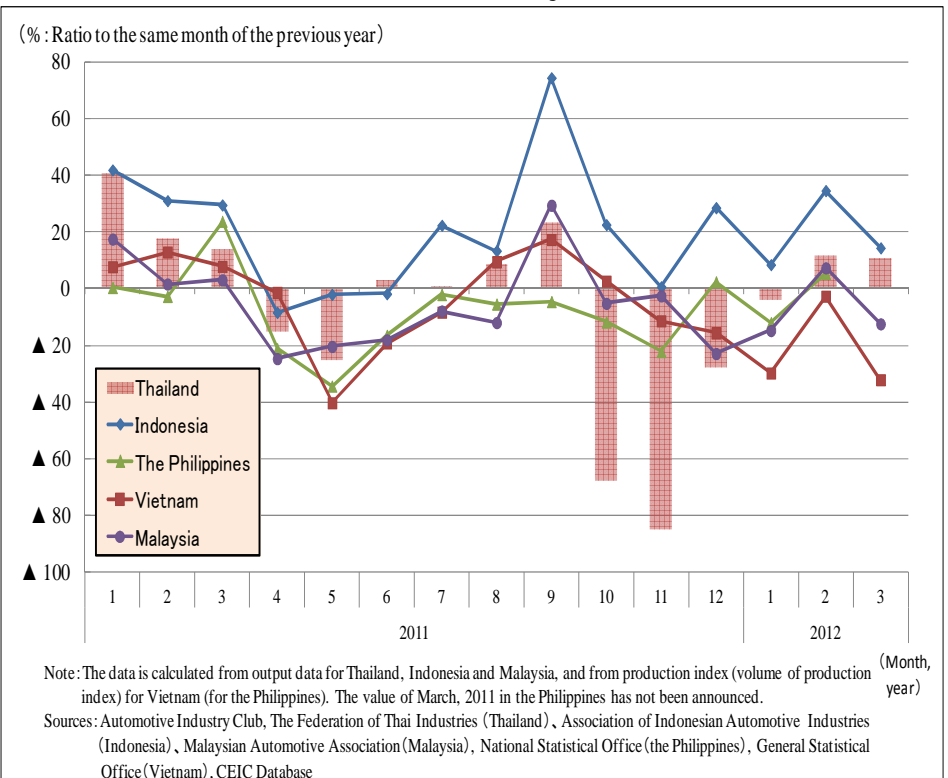
3-1 Impact on production by Thai floods

- Japan's domestic automotive production was significantly affected by the Great East Japan Earthquake. The flood in Thailand also suppressed the recovery of domestic production.
- Domestic production in Thailand and other ASEAN countries was also negatively affected; recovery ensued thereafter.

Change of automotive production before and after the flood in Thailand, China and Japan



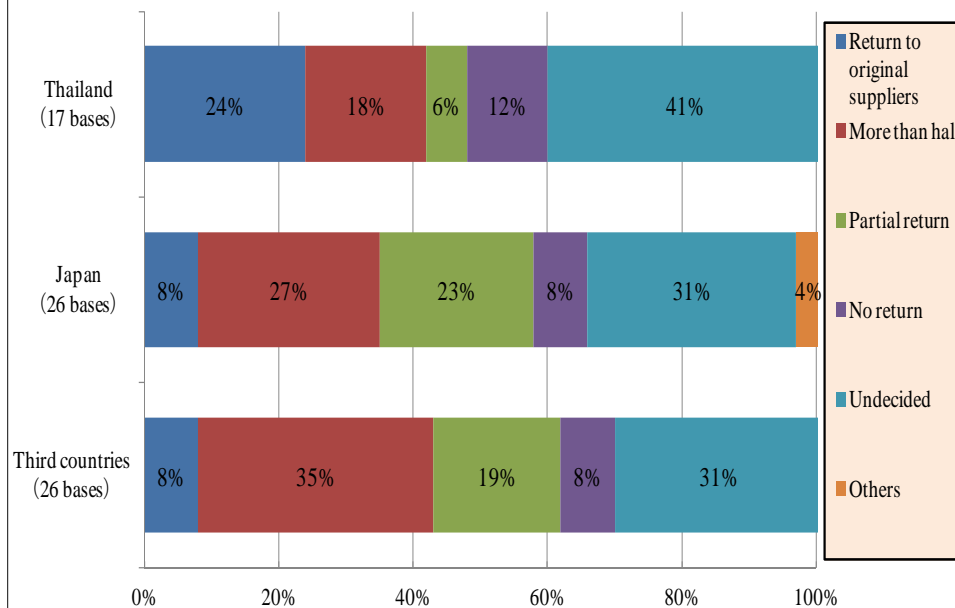
Change of the automotive production before and after the flood in Thailand and major ASEAN countries



3-2 Business response to Thai floods

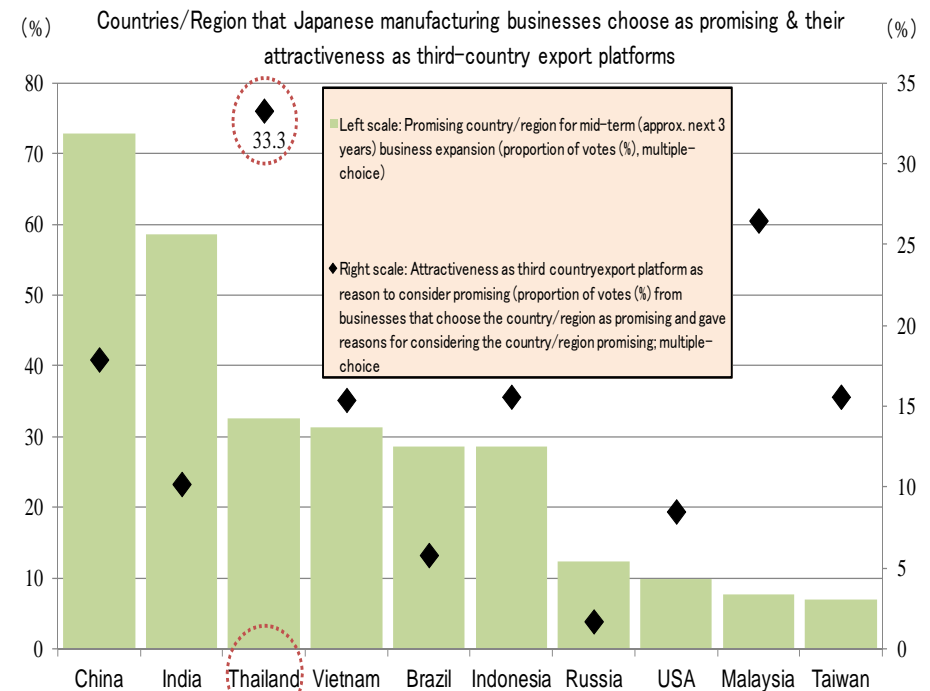
- Survey results suggest signs of re-organization of global supply chains with a view to risk diversification.
- Thailand maintains its appeal as an investment destination for Japanese firms, especially as an export base to third markets, due to industrial agglomeration and FTA networks; but the need for improvement in business environment, including flood control measures, remains compelling.

Question: Will the supply be resourced to the original supply source from the alternative source after the original source has been restored? (responses from manufacturing businesses)



Note: Total do not add up to 100 each because of rounding off to the nearest whole number.

Source: Ministry of Economy, Trade and Industry "Emergency Survey concerning the State of Supply Chain Recovery from the Thai Flooding Damage" (survey conducted late November-early December).

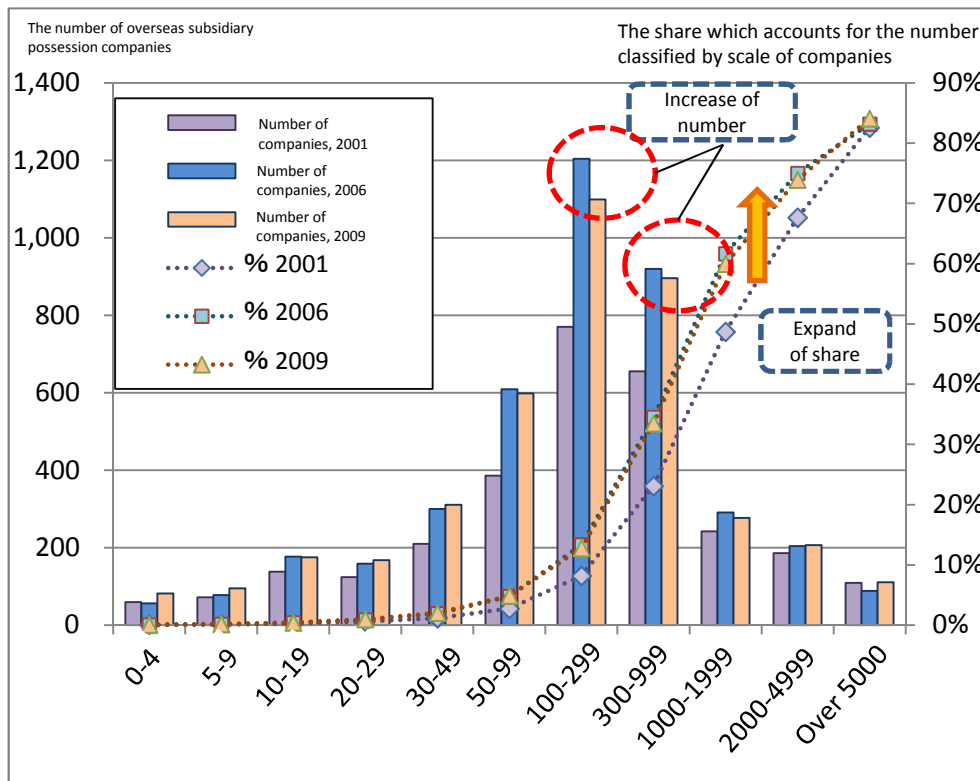


Source: Compiled from Japan Bank for International Cooperation "Survey Report concerning the Overseas Expansion of Japanese Manufacturing Businesses" (December, 2011)

4-1 Overseas business activities picking up among mid-sized enterprises

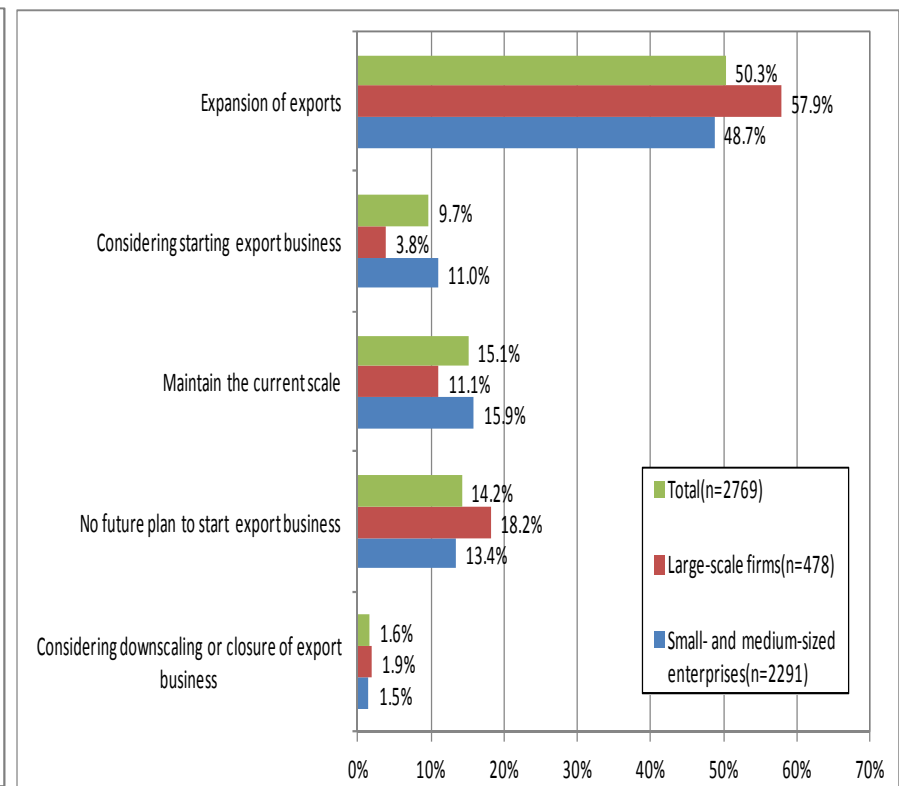
- An increasing number of Japanese firms owned overseas subsidiaries in the 2000s, especially among mid-sized enterprises.
- Survey results show that 48.7% of SMEs intend to expand exports, while another 11.0% intend to explore export opportunities.

**The number of overseas subsidiary possession companies
(Manufacturing, classified by worker size)**



Source: Ministry of Internal Affairs and Communications "Establishment and Enterprise Census" (2001, 2006), Ministry of Internal Affairs and Communications/Ministry of Economy, Trade and Industry "The Economic Census" (2009).

**Export business plan
(for the coming three years or so) (all industries)**

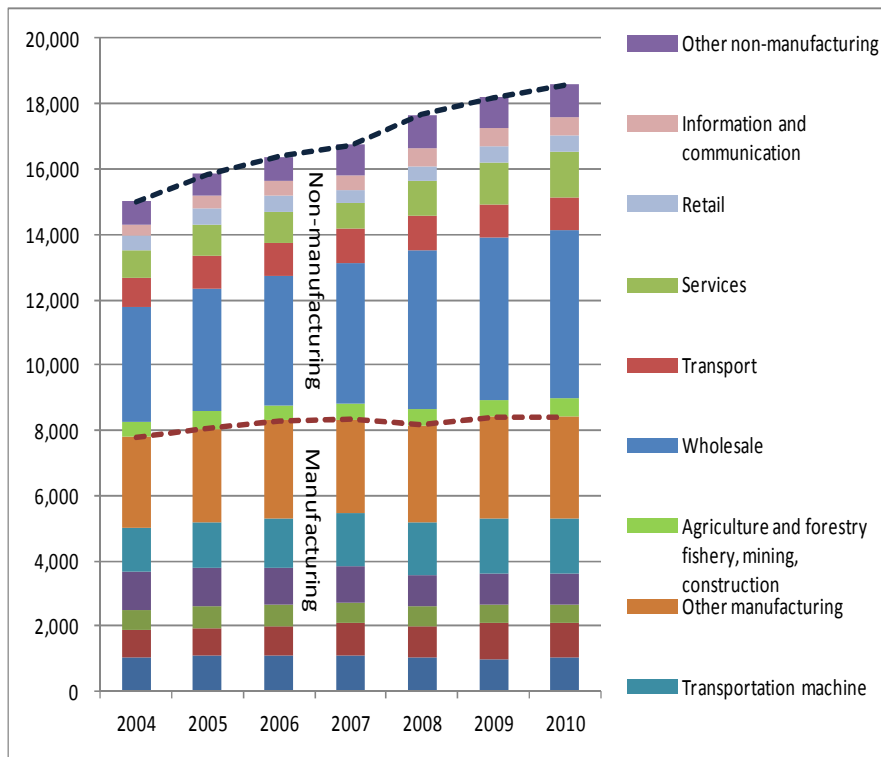


Source: JETRO "FY 2011 Survey on the International Operations of Japanese Firms"

4-2 Overseas business activities picking up among non-manufacturing sectors (such as wholesale, services)

- The number of overseas subsidiaries in non-manufacturing sectors has overtaken that of manufacturing sectors.
- Service firms expanding overseas are differentiating their businesses by unique Japanese models; their domestic businesses and overseas business operations by other Japanese firms could also benefit.

Expansion of overseas subsidiary in non-manufacturing



Note: "Other manufacturing industry" includes precision machinery up to 2006.
Source: Ministry of Economy, Trade and Industry "Basic Survey on Overseas Business Activities"

Example of the overseas business development of the service industry

Delivery services

The number of parcels handled by Yamato Group in Asia has grown by 4.4 times in FY2010-2011. Differentiation of services is being undertaken by deploying ubiquitous Japanese services, including chilled/cooled parcels and designation of delivery times

Restaurant

Yoshino-ya (over 500 restaurants overseas) is seeking differentiation by promoting safe and secure images of Japanese food and its unique sauce and recipes
Moss Burger (about 300 restaurants overseas) incorporates Japanese tastes in its products, while pursuing localization of flavors, some of which are being introduced to Japanese menus

Tourism

Wakura Kagaya Ryokan in Ishikawa Prefecture established its subsidiary in Taiwan in December 2010. It pursues to provide its characteristic Japanese "omotenashi" services.

A quarter of local customers stayed in Japanese Wakura Kagaya, providing benefits to its domestic businesses

Convenience store chains

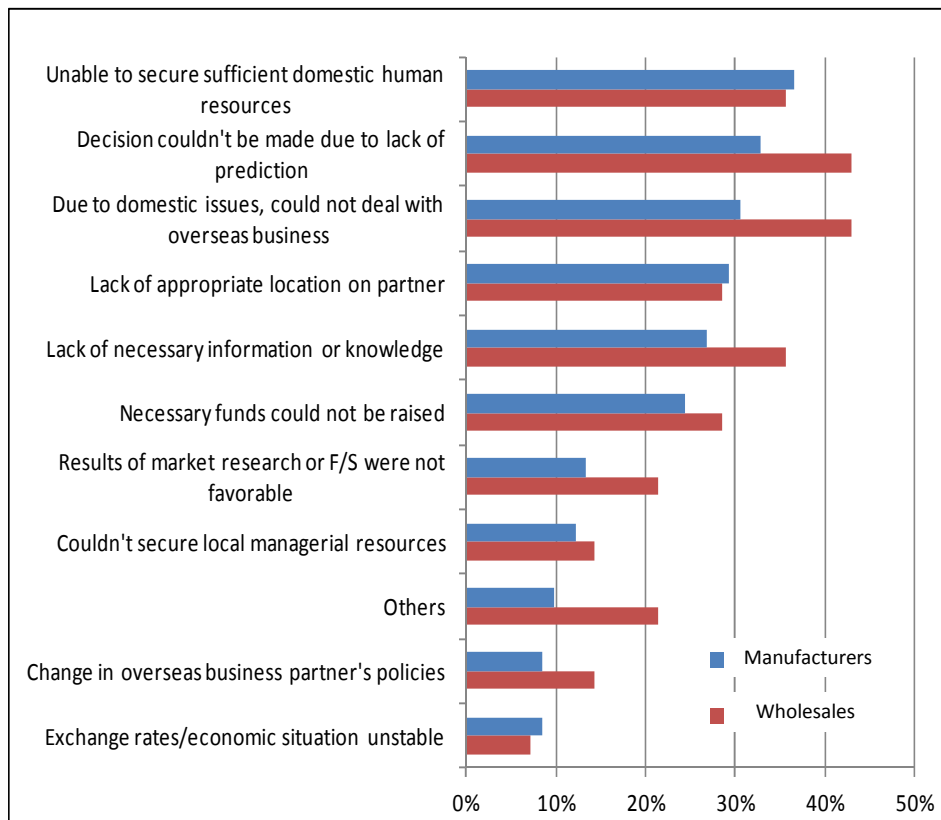
Convenience store chains are accelerating their overseas business development; the number of overseas stores of the industry as a whole is projected to overtake that of domestic stores in 2012.

The sector has established a unique Japanese business model with "convenience" as an essential ingredient

4-3 Barriers for overseas businesses

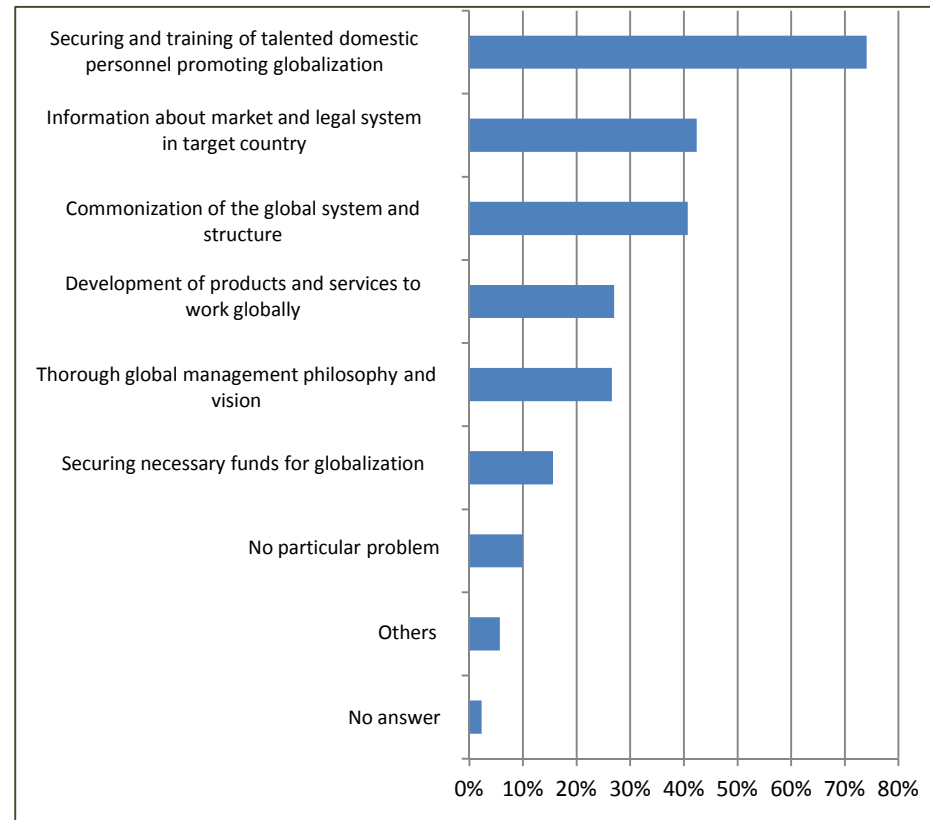
- Human resources are typically seen as a major barrier for overseas businesses

Reasons for giving up going overseas (medium- and small-sized enterprises)



Note: The effective answers, 82 companies (manufacturers), 14 companies (Wholesales)
Source: Organization for Small & Medium Enterprises and Regional Innovation, JAPAN
"Survey of medium- and small-sized enterprises overseas business activities" (2010)

Problems with setting up and administration of overseas base

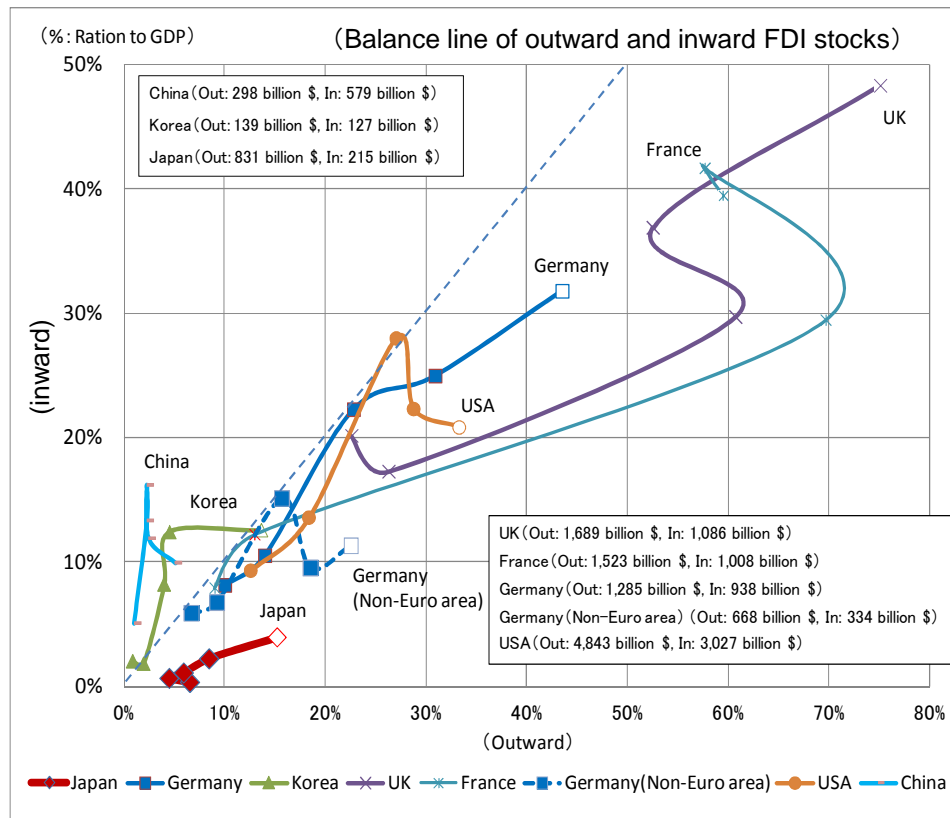


Note: The effective answers, 263 companies (all types of industry)
Source: Ministry of Economy, Trade and Industry (2010) "Questionnaire about the global talent training"

4-4 International comparisons of FDI stocks and FDI incomes

- Japan's FDI stock and FDI income as shares of GDP remain low compared with other major countries, both outward and inward.

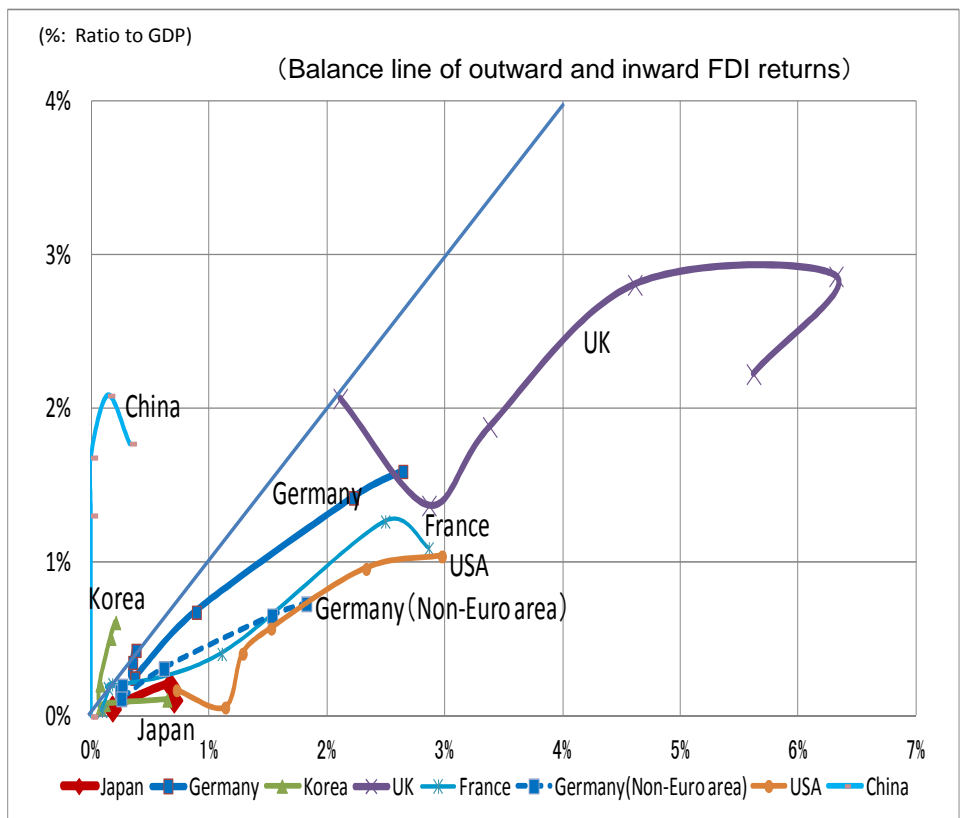
Outward and inward foreign direct investment stocks (Ratio to GDP)



Notes: This figure plots the absolute value for each country in 1990, 1995, 2000, 2005, 2010 calendar years (for Germany, 2009 calendar year). Hong Kong is not included in figures for China. OECD Stat is used for Germany.

Source: Institute for International Trade and Investment "International Comparative Statistics", OECD Stat

Outward and inward foreign direct investment returns (Ratio to GDP)

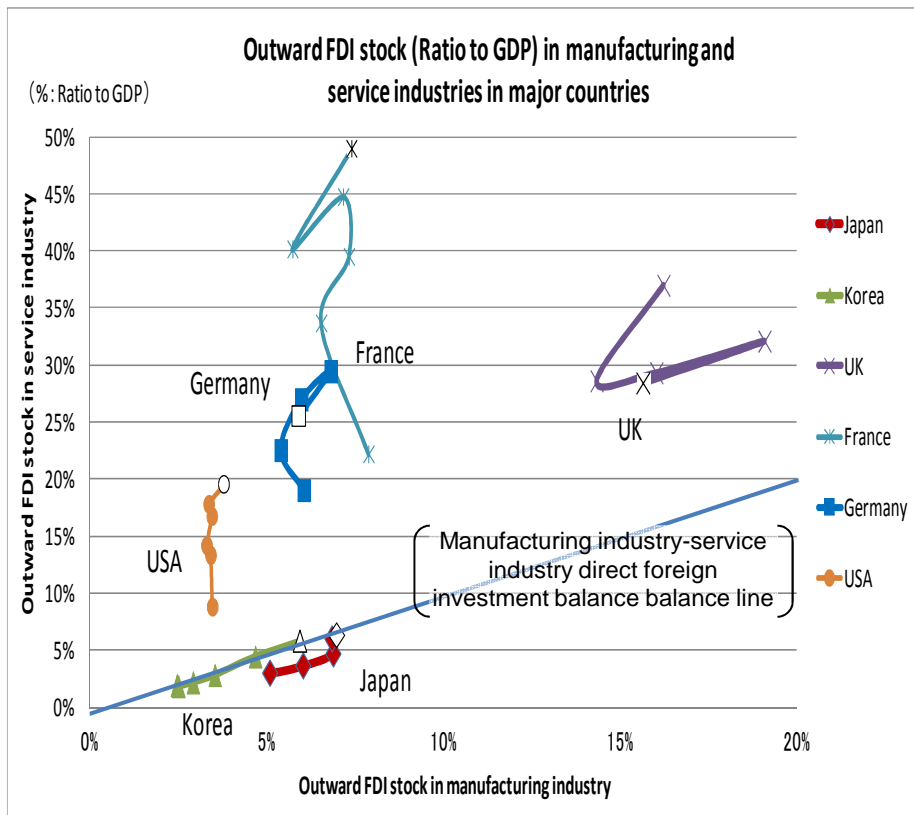


Notes: This figure plots the absolute value for each country in 1990, 1995, 2000, 2005, 2010 calendar years (for Germany, 2009 calendar year). Hong Kong does not be included in China.

Source: Institute for International Trade and Investment "International Comparative Statistics"

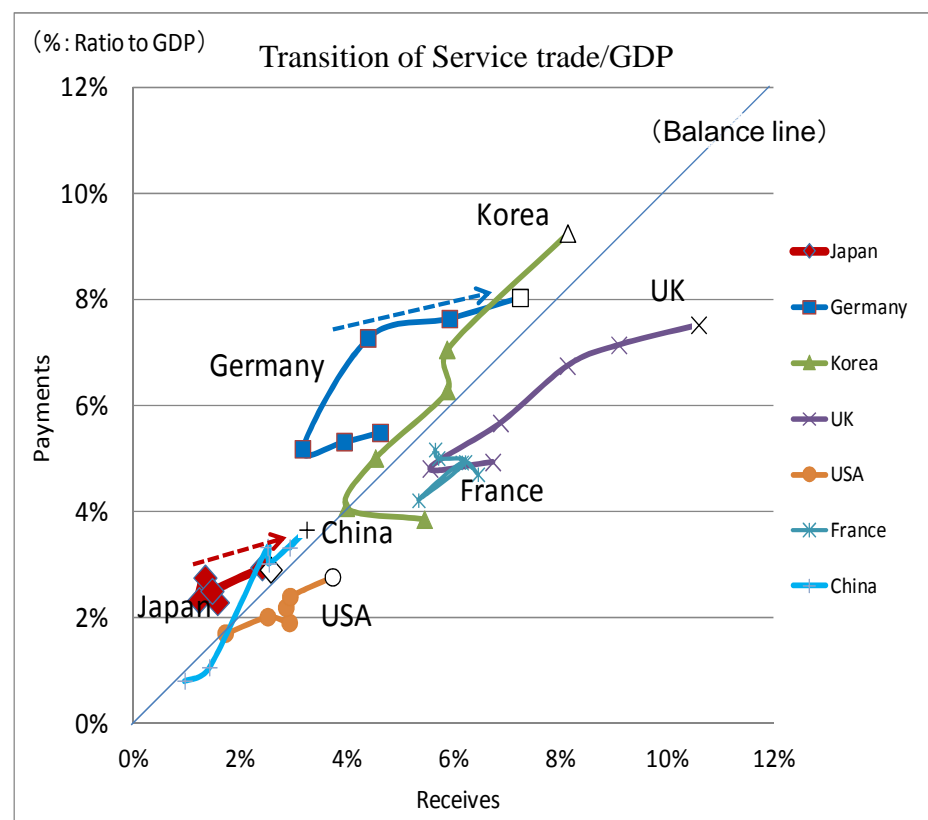
4-5 Further room for overseas development in services

- Japanese overseas FDI stock per GDP remains low especially in services compared with other major countries
- Overseas business activities in services, including trade in services, still have room for enhancement



Note: This figure plots the absolute value for each country in 2000, 2005, 2006, 2007, 2009 (or 2008) calendar years. Here, the service industry implies the industry except for manufacturing, agriculture and mining.

Source: Institute for International Trade and Investment "International Comparative Statistics", "International Direct Investment Matrix" (2011)



Note: This figure plots the absolute value for each country in 2000, 2005, 2006, 2007, 2009 (or 2008) calendar years.

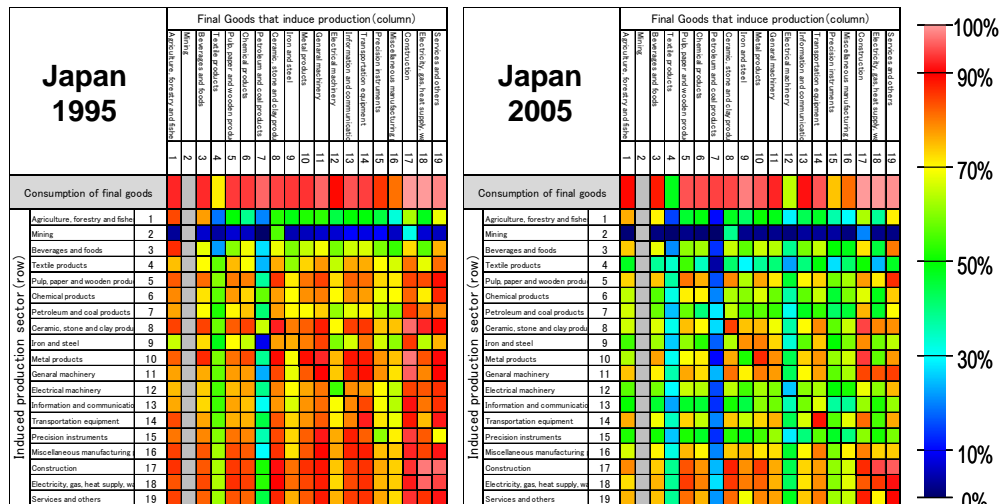
Source: Institute for International Trade and Investment "International Comparative Statistics", "International Direct Investment Matrix" (2011)

4-6 Integration into global production networks has deepened to a certain extent

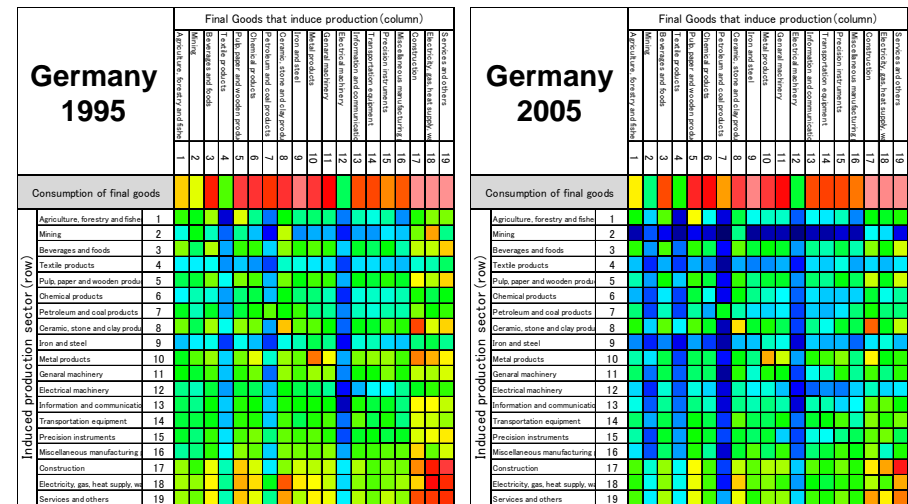
- Japan's production structure deepened its reliance on imported goods and services in 1995-2005 period, signifying integration into global production networks.
- Such integration has been strong in Germany and has even strengthened during the period.

The warm color system shows that a spillover tends to stay within the country, while the cold color system shows that a spillover tends to leave abroad.

Change of the "domestic survival rate" in our country



Change of the "domestic survival rate" in Germany

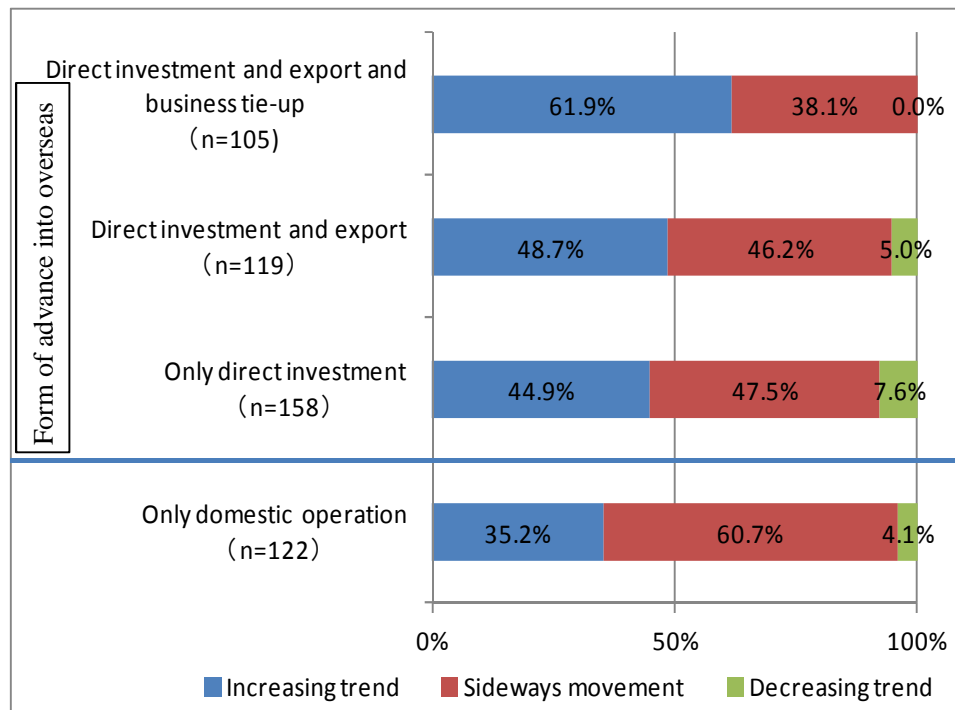


Source: OECD "Input-Output Table"

4-7 Impact of overseas businesses

- Firms with overseas businesses in multiple modes are more likely to improve productivity than firms confined with domestic operations.
- Firms with overseas businesses are more likely to increase domestic employment than firms confined with domestic operations, both in manufacturing and in non-manufacturing sectors.

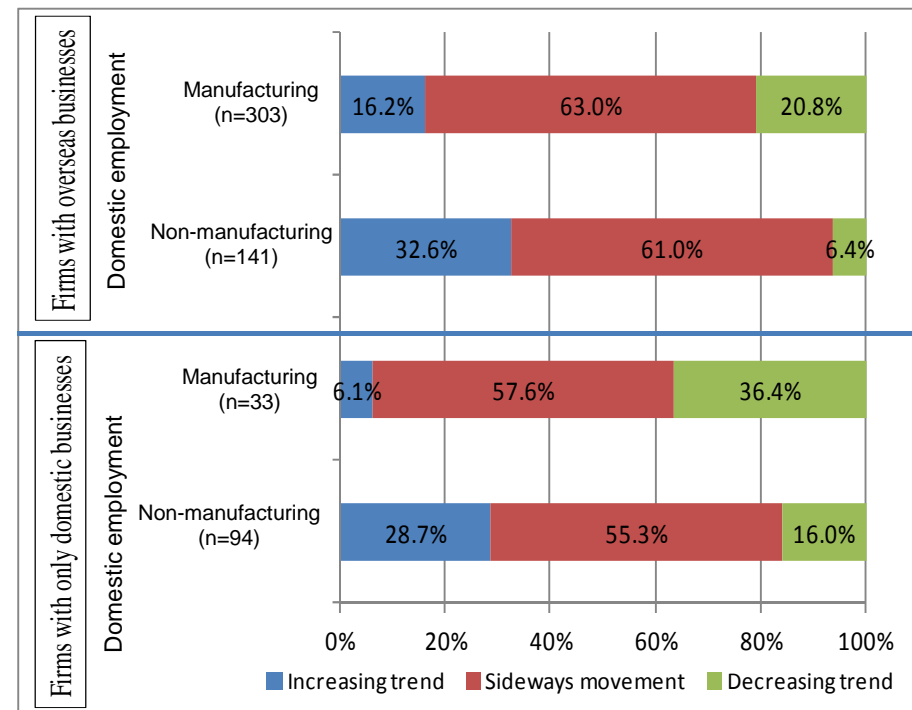
**Productivity over next three years
(Classified by the form of advance into overseas)**



Note: This figure shows the productivity tendency for next three years (classified by the form of advance into overseas of firms).

Source: Mitsubishi UFJ Research and Consulting Co., Ltd. "Questionnaire on overseas business strategy of firms"

**Domestic employment over next three years
(The number of workers)**



Note: Domestic employment implies the tendency over next three years.

Source: Mitsubishi UFJ Research and Consulting Co., Ltd. "Questionnaire on overseas business strategy of firms"