Chapter 1　Current status of the global economy and future issues (toward sustainable growth)

In this chapter, after giving an overview of recent trends in the continually growing global economy, the factors behind global current account imbalances will be analyzed and policies aimed at eliminating these imbalances will be explored. Furthermore, with regard to the Chinese economy and Indian economy, which continue to grow at high rates, their current status and issues in aiming for sustainable development will be analyzed.

Section 1　Current status of the global economy

1. Overview of the global economy

The global economy has been growing sustainably while curbing the rise of consumer prices, enhancing the business cycle co-movement and expanding trade and investment across the world.

In this chapter, an overview of these recent movements in the global economy will be given, while examining the factors behind them.

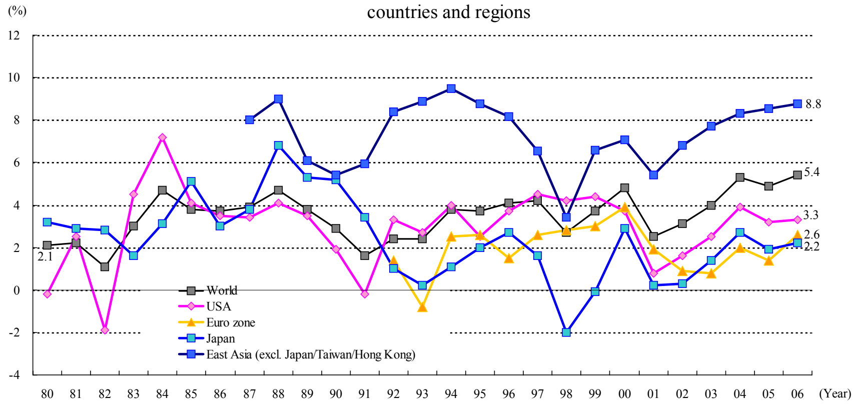
(1) Global economy remains strong

Highly populated East Asia including China and India, which deepens international relationships with developed countries including Japan and the United States through division-of-labor and its market penetration into those countries, becomes increasingly integrated into the global economy Among these movements, the global economy is continuing to grow.

In 2006, East Asia, Taiwan and Hong Kong (not including Japan), which has continued to grow at a high rate, achieved an annual growth of over 8% in its real GDP, and the United States, the Euro zone and Japan achieved real GDP growth of around 2 to 3% against previous year. As a result, the world's real GDP grew at a strong 5.4 percent annual rate in 2006 (Figure 1-1-1).

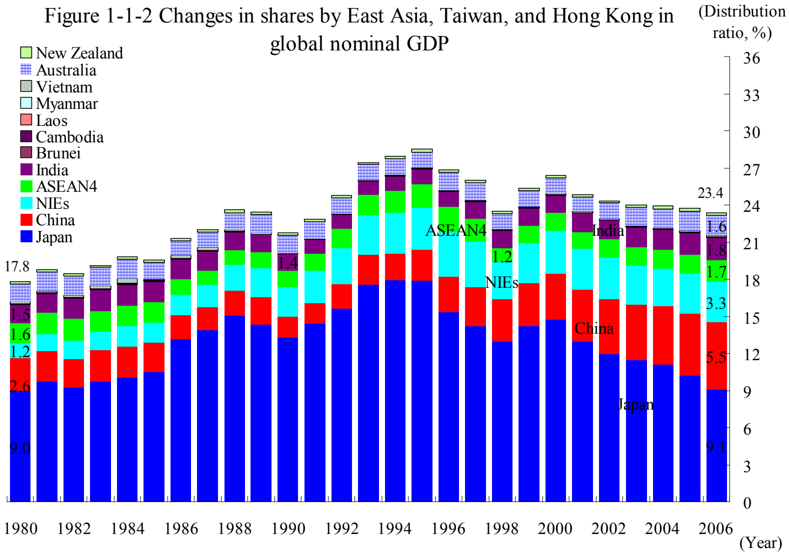
Looking at the share of East Asia, Taiwan and Hong Kong as a percentage of the world's nominal GDP, the total share in 1980 which had been only 17.8% has rapidly increased thereafter and expanded 1.3 times to 23.4% in 2006. Among those region, the newly industrialized economies (NIEs), which has been pursuing an open-door type development from early times, expanded their share nearly three times from 1.2% in 1980 to 3.3% in 2006, and China, which continues to persist on the reform and opening-up policy since 1978, expanded its share more than two times from 2.6% in 1980 to 5.5% in 2006. India as well, which has been moving forward with economic reforms since 1991, expanded its share approximately 1.3 times from 1.4% in 1990 to 1.8% in 2006. The share of the ASEAN4, which had temporarily dropped to 1.2% in 1998 following the Asian currency and financial crisis, has also expanded to 1.7% in 2006 (Figure 1-1-2).

Figure 1-1-1 Changes in real GDP growth rate in world as a whole and in major countries and regions



Notes: East Asia described here excludes Japan.
Source: *World Economic Outlook Database April 2007* (IMF).

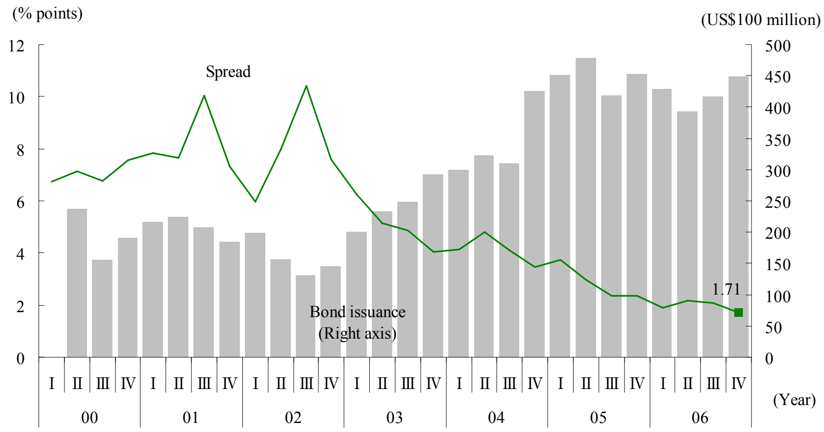
Figure 1-1-2 Changes in shares by East Asia, Taiwan, and Hong Kong in global nominal GDP



Source: *World Economic Outlook Database April 2007* (IMF).

The rapid economic development of developing countries including East Asia, has realized increases in the per capita national income and degree of social stability in these countries through the development of industries, rises in income, and so forth, and furthermore has brought about a decrease in the level of interest rates on loans to developing countries. Looking at the trend in the spread that is added to the US treasury bond yield when the governments of developing countries issue bonds in international markets and the trend in amount of bonds issued by developing countries since 2003, the amount of bonds issued has been increasing rapidly while the risk premium has been decreasing rapidly (Figure 1-1-3). The rapid decrease in country risk in developing countries including East Asia has promoted the flow of funds into these countries and thus has brought about a virtuous cycle in which the conditions for further growth are created.

Figure1-1-3 The spread in developing countries and changes in bond issuance



Notes: 1. A spread is the risk premium added on the yield of US Government bonds when an emerging market economy issues government bonds within the international market. The EMBI Global Yield Spread published by JPMorgan Chase & Co. is used.

2. The bond issuance is the average of the 3rd term movement.

Source: *Global Financial Stability Report April 2007* (IMF).

Original source: JPMorgan Chase & Co.

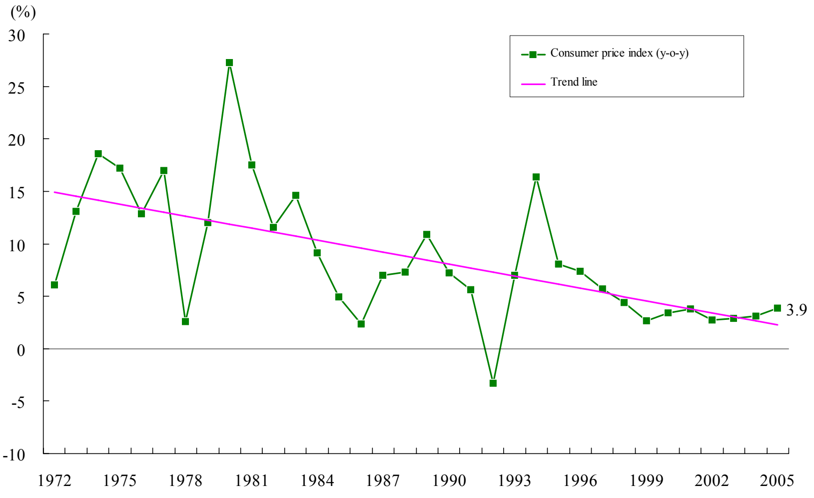
(2) Global economy increases its stability

While the global economy continues to grow as mentioned above, the global macroeconomic variables such as prices and business cycle have been increasing their stability. The global economy up to now has in its growth process experienced such various fluctuations in the macroeconomic variables as volatile changes in prices and large fluctuations in business cycle. In the following, we demonstrate that the recent global economy has successfully achieved the growth and the stability simultaneously.

(Decrease in the range of world prices fluctuations: achievement of a low and stable rate of inflation)

Looking at the year-on-year rate of increase of the world consumer price index, consumer prices experienced large increases for the past – from 1970s to 1980s, but since the latter half of the 1990s, the rate of increase has continued to be on a declining trend, and it can be seen that consumer prices are on a global trend of stabilization (Figure 1-1-4).

Figure 1-1-4 Changes in global consumer price index (year-on-year comparison)

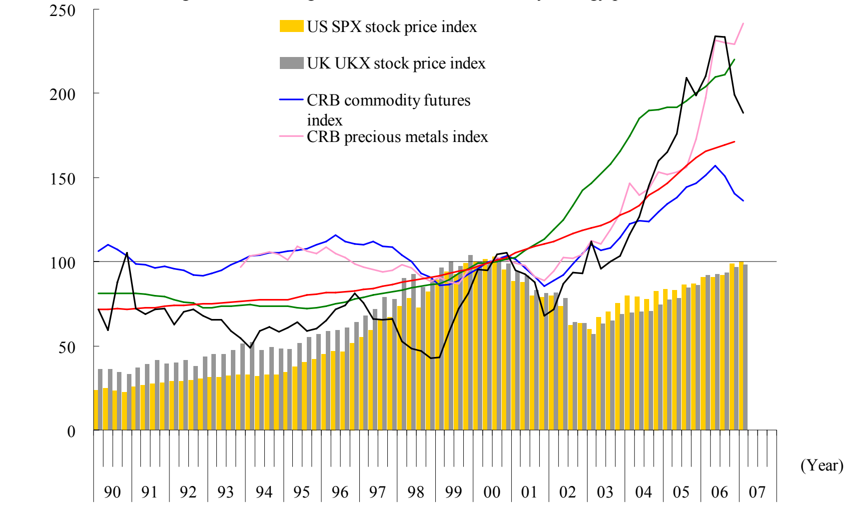


Source: *WDI* (World Bank).

Nevertheless, in recent years, trend toward large increases in commodity prices including crude oil, precious metals, aluminum, copper and zinc as well as asset prices including housing prices and stock prices is strengthening particularly in developed countries such as the United States and European countries (Figure 1-1-5). As for factors behind this, some have argued that it has been due to a rise of excess global liquidity created by the global trend toward relaxed monetary policy, and others have argued that it has been due to the increase in productivity and the growing confidence in monetary policies which have reduced anxiety of companies and investors over future development, improved their projections for future profit growth and therefore caused their investment behavior in assets to be more optimistic.[1] With regard to the rise in commodity prices including crude oil and precious metals, some have argued that it has been due to the rapid increase in the amount of consumption of energy and raw materials in developing countries including remarkably growing China and India which has tightened the global supply and demand of energy and resources.

[1] For example, BIS (2002), BIS Working Papers No. 114, p 21.

(year 2000=100) Figure 1-1-5 Changes in stock, house, commodity, energy price index

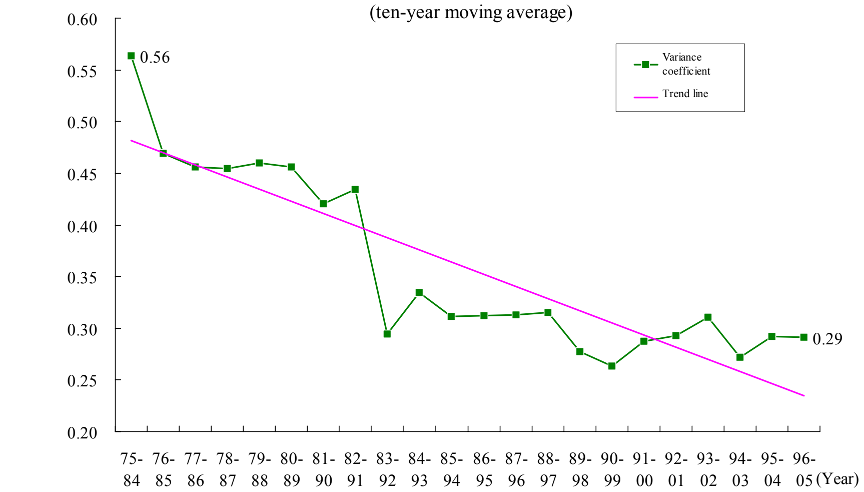


Source: House Price Index (Office of Federal Housing Enterprise Oversight), Halifax Index (HBOS), Bloomberg.

(Decrease in the range of international business cycle fluctuations)

The range of changes in the real GDP growth rate created by international business cycle fluctuations is in a long-term decreasing trend. Looking at the dispersion (coefficient of variance) in growth rates of global real GDP in consecutive 10 years in order to measure the degree of fluctuations in annual rate of real GDP growth, the coefficient of variance of global real GDP growth rates, which was 0.56 for the 10 years from 1975 through 1984, decreased by nearly half to 0.29 for the 10 years from 1996 through 2005. It can be said that the world economy is increasing its stability year by year (Figure 1-1-6).

(Variance coefficient) Figure 1-1-6 Changes in variance coefficient of global economic growth rate (ten-year moving average)



Notes: 1. Variance coefficient = Standard deviation / mean value.
2. Calculated from the GDP of each country (real US dollar base (2000 values)).
Source: *WDI* (World Bank).

(3) Factors enabled the steady and high rate of global economic growth

As stated above, approximately since the latter half of the 1990s, the global economy has continued to indicate high rates of growth under a relatively stable economic environment with few fluctuations in prices and business cycle. It is commonly accepted that those factors shown below have had multiple effects on such steady growth in the world economy.

(Improvement in monetary policy implementation)

First of all, it should be noted that appropriately implemented monetary policy by the monetary authorities of the United States and developed countries has contributed to the simultaneous realization of the high and stable growth in the global economy since the latter half of the 1990s. Some have argued that this has resulted in avoiding economic overheating and tightening of monetary policy to an excessive degree, and therefore enabled sustainable growth.

(Enhancement of technologies for the production and inventory control with utilization of IT)

Some have argued that utilization of IT has increased growth potential through significant improvements in productivity, enabled companies to trim inventories by adjusting production volume swiftly to fluctuations in demand and therefore reduced the roll of inventory cycles in business fluctuations.

(Globalization of economies)

Furthermore, some have argued that the deregulation and liberalization which has dismantled various barriers to the trade in goods and services and the capital markets enhanced growth potential of economies by increasing the efficiency of overall economies, and enabled companies to respond flexibly and swiftly to changes in the economic environment by increasing the degree of freedom of corporate activities.

(Trend toward service economies)

In addition, others have argued that the global trend toward service economies has contributed to the stabilization of the global economy.

Service sector's share in the whole economy is increasing in countries across the world, and accounts for 68% of the world nominal GDP in 2003. In general, the trend toward service economies will stabilize and reduce the range of business cycle fluctuations because (a) production of services is highly dependant upon consumption-related demand compared to production of goods, (b) inventory changes do not occur as service sector does not hold inventories, (c) the capital-output ratio in service sector is lower than that in the goods sector. The trend toward service economies across the world is covered in greater detail in Chapter 3.

2. Globalization of economies and increasing interdependency among economies

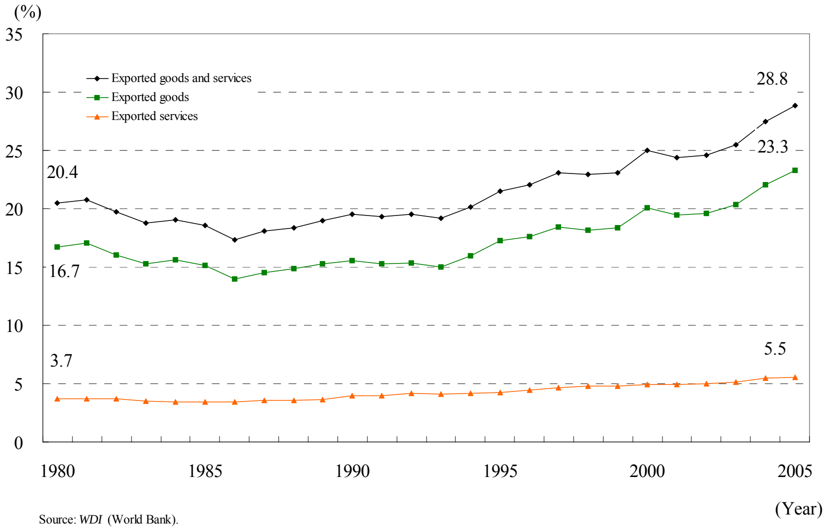
The globalization of economies is progressing with the background of the increase in trade and investment across the world and the co-movements among economies of the world are increasing, thus interdependency of the global economy is deepening. At the background is the rapidly growing East Asia including China, which is continuing to see rapid economic growth and is starting to occupy an increasingly important position in the production and trade of goods.

(1) Expansion of trade and investment

(Expansion of trade in goods and services)

The trade in goods and services in the world has increased dramatically since the latter half of the 1990s, and in 2005 reached approximately US$12.8 trillion, 28.8% as a percentage of nominal GDP, of which the trade in goods was approximately US$10.3 trillion, 23.3% as a percentage of nominal GDP, and the trade of services was approximately US$2.5 trillion, 5.5% as a percentage of nominal GDP. Looking at Figure 1-1-7, the trade in goods, which until then hovered around 15% as a percentage of nominal GDP, saw the strengthening of an increasing trend since the latter half of the 1990s, and in 2005, its share expanded approximately 1.5 times to 23.3% as a percentage of nominal GDP. Looking at the trade of services as a percentage of nominal GDP, while there was a steady increase from 3.7% in 1980 to 5.5% in 2005, the percentage of nominal GDP and the pace of increase are at a relatively low level as compared to that of the trade in goods (Figure 1-1-7).

Figure 1-1-7 Changes in global trade in goods and services (nominal GDP comparison)



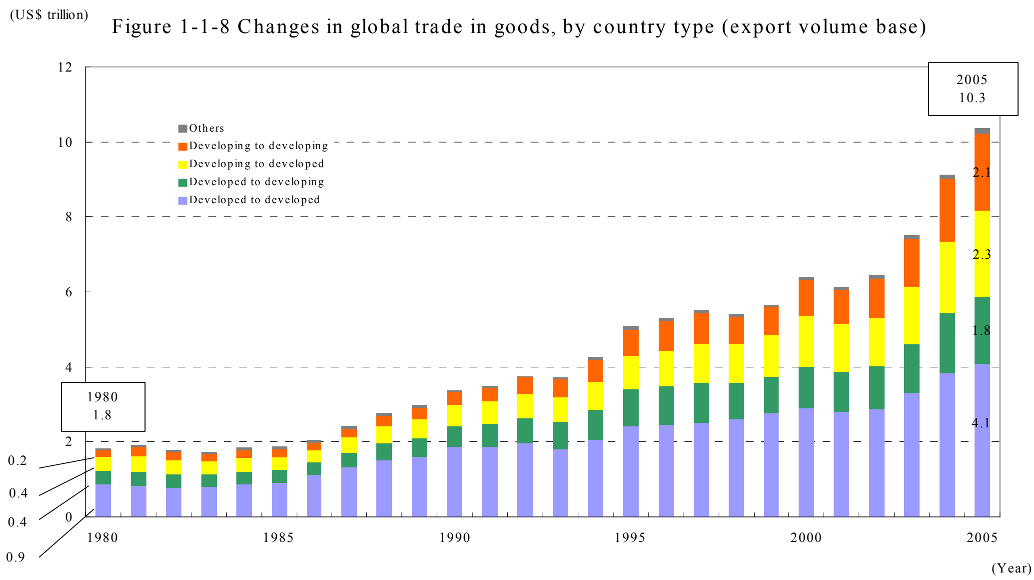
Source: *WDI* (World Bank).

In the background to this rapid expansion of the trade in goods lies the rapid increase in the amount of the trade in goods involving developing countries. Looking at movements in the trade in goods in the world in terms of the value of exports, the trade in goods among developing countries expanded approximately 10 times from only US$0.2 trillion to US$2.1 trillion during the period from 1980 to 2005.

This is a rapid increase compared to the approximately six times increase of the trade in goods between developing countries and developed countries from US$0.7 trillion to US$4.1 trillion and the approximately five times increase of the trade in goods among developed countries from US$0.9 trillion to US$4.1 trillion during the same period.

Furthermore, from the viewpoint of the involvement of developing countries in trade in goods, the trade in goods involving developing countries during the same period which consists of the trade in goods among developing countries and that between developing countries and developed countries increased approximately seven times from US$0.9 trillion to US$6.1 trillion. This was a rapid increase compared to the approximately five times increase of the trade in goods among developing countries from US$0.9 trillion to US$4.1 trillion, and the difference in value between them have increased from an almost balanced situation to the proportion of approximately three to two (Figure 1-1-8).

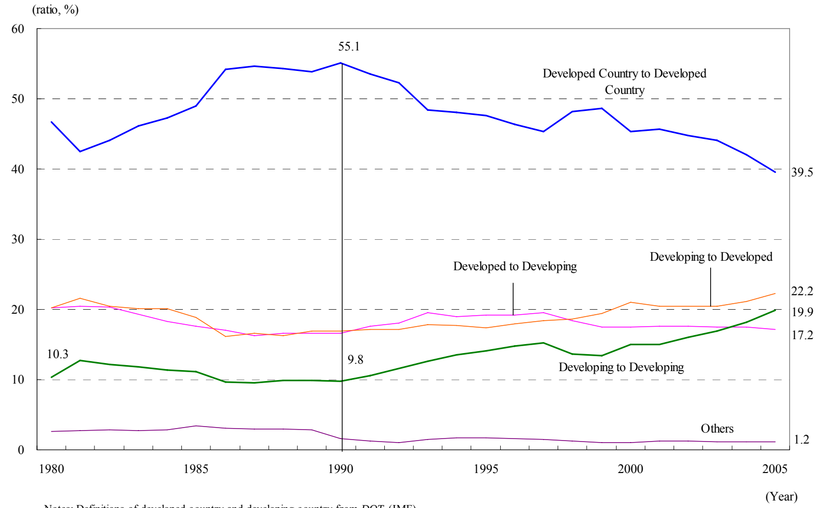
Figure 1-1-8 Changes in global trade in goods, by country type (export volume base)



Note: Definitions of developed and developing countries are according to *DOT* (IMF).
Source: *DOT* (IMF).

Looking at the share of the trade in goods by trade partner country in the world, trade among developing countries, which accounted for 10.3% in 1980, fell to 9.8% in 1990, but later rapidly increased in share to approximately 20% in 2005. By contrast, trade among developing countries, which accounted for a share of 55.1% in 1990, later continually decreased in share and fell by 40% in 2005. Looking at the share of trade between developed countries and developing countries, exports from developing countries to developed countries since 1998 surpassed exports from developed countries to developing countries (Figure 1-1-9). Thus, a situation is emerging in which international transactions of goods are transitioning to a composition in which developing countries are the origin. It can be seen that developing countries, such as those in East Asia, are occupying an increasingly important position in the production of goods, and at the same time, are increasing the trade in goods among developing countries as well as between developing countries and developed countries.

Figure 1-1-9 Changes in ratio (export value base) of global trade in goods by country

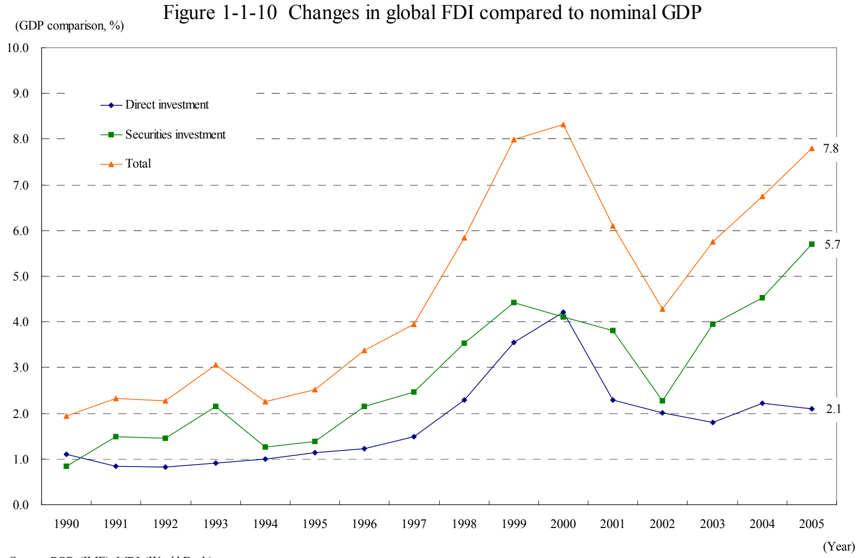


Notes: Definitions of developed country and developing country from *DOT* (IMF).
Source: *DOT* (IMF).

(Increase in investment)

In recent years, with the background of globalization of corporate activities and so forth, the globalization of capital is rapidly developing. Looking at the globalization of capital using world foreign investment as a percentage of world's nominal GDP, it can be seen that there has been a rapid expansion since the mid-1990s. World foreign investment as a percentage of world's nominal GDP declined temporarily as a result of the bursting of the IT bubble in the United States and other countries in 2000, but it once again showed rapid expansion since 2003. Furthermore, looking at movements in world foreign investment by dividing its share of world's nominal GDP into foreign direct investment and investment in foreign securities, it can be seen that since 2003, foreign direct investment saw sluggish growth, while investment in foreign securities drove foreign investment overall (Figure 1-1-10).

Figure 1-1-10 Changes in global FDI compared to nominal GDP

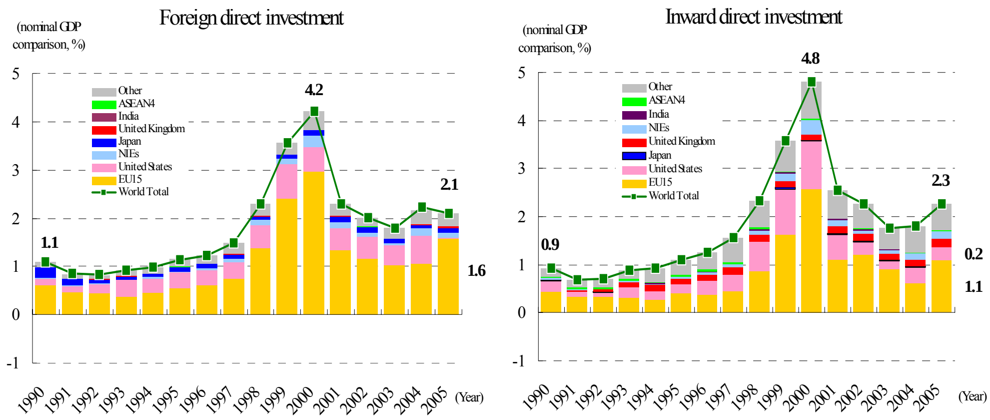


Source: *BOP* (IMF), *WDI* (World Bank).

Next, looking at changes in overseas direct investment as a share of the world's nominal GDP by region, the European Union (EU) countries are the largest investing countries in both outward direct investment and inward direct investment. Next to the EU, the United States accounts for a large share, but the US direct investment abroad decreased significantly in 2005.[2] As for inward direct investment, China and the NIEs accounted for a significant share following the EU and the US, which represents large flow of foreign direct investment from developed countries including EU countries and the US into East Asia including China (Figure 1-1-11).

Meanwhile, looking at the changes in securities investment by region, as with direct investment, EU countries have the largest share in both outward securities investment and inward securities investment, however with regard to outward securities investment, Japan accounts for the second largest share followed by the United States. In regard to inward securities investment, the United States accounts for the large share next to the EU, ,and Japan accounts for the large share next to the Untied States. In securities investment, unlike direct investment, developed countries including EU countries, the United States, and Japan have largest share in its flow (Figure 1-1-12).

Figure 1-1-11 Changes in direct investment by region based on world GDP

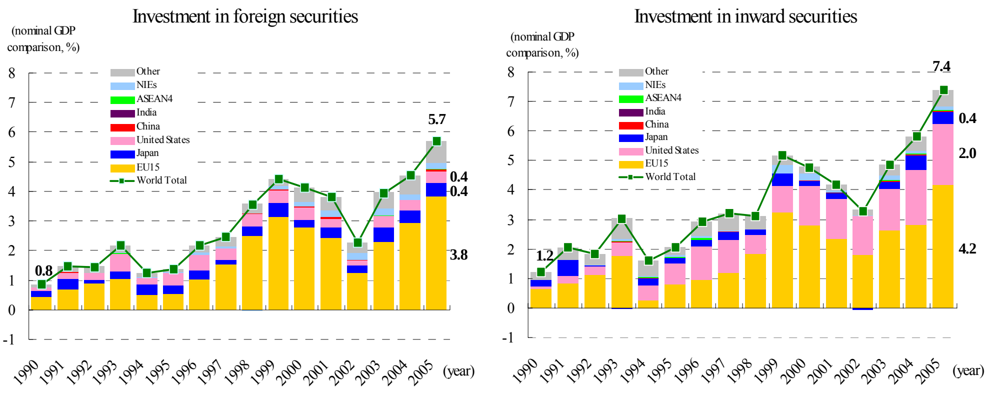


Notes: The foreign direct investment amount of each country/region by its global nominal GDP ratio.
Source: *BOP* (IMF), *WDI* (World Bank).

Notes: The inward direct investment amount of each country/region by its global nominal GDP ratio.
Source: *BOP* (IMF), *WDI* (World Bank).

[2] As for reasons the U.S. direct investment abroad decreased significantly in 2005, the Bureau of Economic Analysis, United States Department of Commerce states: "This was largely associated with the American Jobs Creation Act, which was signed into law on October 2004 and allowed U.S. parent companies that receives dividends from their foreign affiliates during a specified period (calendar year 2004 or calendar year 2005) to be taxed on the dividends at reduced rates." The Bureau of Economic Analysis also states: "Reinvested earnings has shifted from US$135.6 billion in 2004 to -US$33 billion in 2005 because, encouraged by incentives to realize the tax savings, U.S. foreign affiliates distributed very large dividends from their cumulative retained earnings." The Act allows U.S. parent companies that receives dividends from their foreign affiliates to be taxed at lower rates on some conditions that include the development of a domestic reinvestment plan for the dividends.
See *Survey of Current Business*, p. 23 (2006) (Bureau of Economic Analysis, United States Department of Commerce).

Figure1-1-12 Changes in investment in securities by region based on world GDP



(2) Increasing interdependency of the global economy

With the background of the increase in trade and investment across the world, the co-movements among economies of the world are increasing, and thus the interdependency of the global economy is deepening.

Looking at changes in correlation coefficients of real GDP growth rates between the United States —the driving force in the global economy—and other countries/regions or the world, the correlation coefficients between the US economy and the global economy, particularly ASEAN4, the NIEs or India which had no correlation since the latter half of the 1990s, have increased again since 2000. Such rapid increase in co-movements between ASEAN countries and so forth and the US economy depicts a situation in which these countries are increasingly integrated into the global economy at an accelerating pace through the increase in interdependency with the US economy. Meanwhile, looking at movements in the correlation coefficients of real GDP growth rates between Japan and other countries/regions or the world, there was a rapid increase in co-movements between the Japanese economy and ASEAN4, the NIEs, or China since as early as the latter half of the 1990s, and it appears that there is a possibility that the interdependency with the Japanese economy increased starting at an earlier period of time than the United States (Table 1-1-13 through Table 1-1-15).

Table 1-1-13 Changes in correlation coefficients of real GDP growth rate in US and respective countries (year base)

Year	World	Japan	Eurozone	ASEAN4	NIEs	China	India
1985-89	0.581	0.723		-0.338	-0.554	0.567	0.482
1990-94	0.792	-0.604		0.404	-0.436	0.536	0.781
1995-99	-0.043	-0.461	0.240	-0.496	-0.335	-0.799	-0.730
2000-06	0.963	0.974	0.486	0.892	0.760	0.510	0.674

Source: *World Economic Outlook Database April 2007* (IMF).

Table 1-1-14 Changes in correlation coefficients of real GDP growth rate in Japan and respective countries (year base)

Year	World	US	Eurozone	ASEAN4	NIEs	China	India
1985-89	0.785	0.723		0.323	-0.433	0.059	0.877
1990-94	-0.147	-0.604		0.295	0.441	-0.980	-0.101
1995-99	0.882	-0.461	-0.677	0.932	0.784	0.841	0.331
2000-06	0.923	0.974	0.643	0.805	0.729	0.364	0.584

Source: *World Economic Outlook Database April 2007* (IMF).

Table 1-1-15 Changes in correlation coefficients of real GDP growth rate in respective countries (quarter base)

Year	US-Japan	US-Eurozone	Japan-Eurozone
1985-89	0.076		
1990-94	-0.479		
1995-99	-0.101	0.336	-0.450
2000-06	0.296	0.323	0.616

Source: *National Economic Accounting* (Cabinet Office), *Overseas Economic Data*, US Bureau of Economic Analysis website.

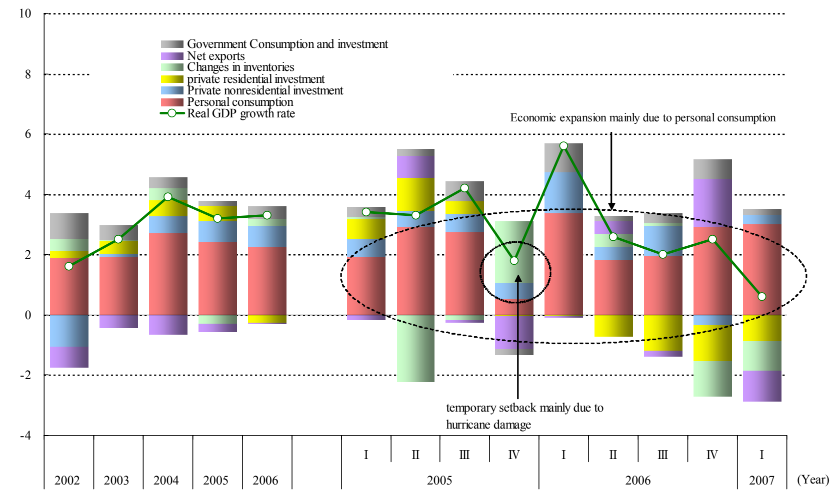
3. Movements in the world economy by region

(1) US economy is gradually growing while it runs a current account deficit

(US economy still growing)

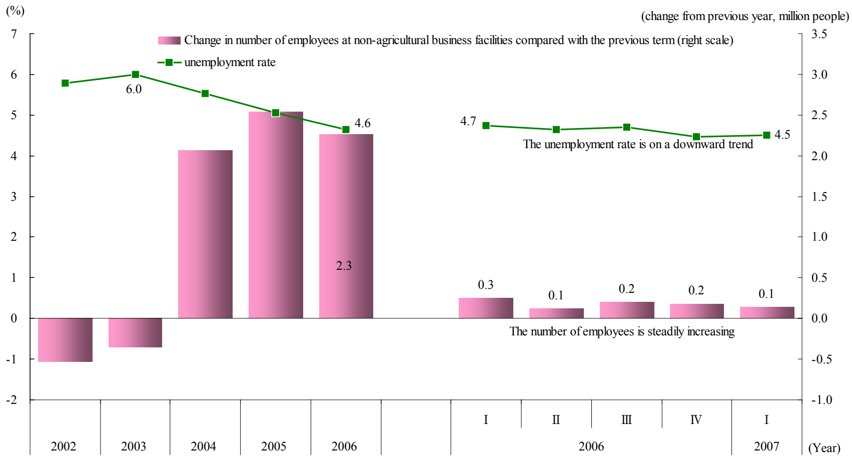
The US economy underpinned by personal consumption and private nonresidential investment continued to grow gradually in 2006 (Figure 1-1-16). The employment situation continued to trend up and unemployment rate remained at a low level, which also underpinned the U.S. current favorable economic conditions (Figure 1-1-17).

Figure 1-1-16 Changes in real GDP growth rate of the US



Notes: Data are seasonally adjusted at annual rates, based on comparison with the previous term. Data for the first quarter of 2007 are preliminary.
Source: Websites of Bureau of Economic Analysis (BEA), US Department of Commerce.

Figure 1-1-17 Changes in employment conditions of the US

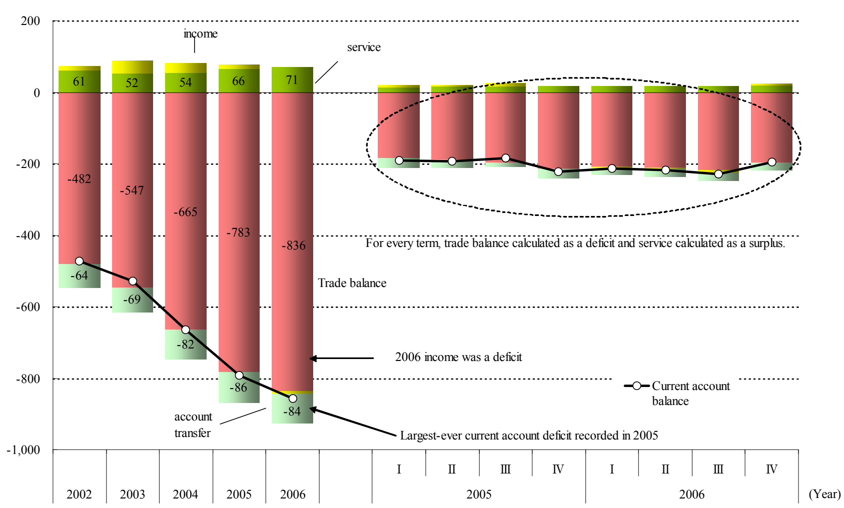


Notes: 1. Data are seasonally adjusted at annual rates.
2. The annual figures represent the averages of monthly statistics.
3. The number of employees for March 2007 are preliminary figures.
Source: Websites of Bureau of Labor Statistics (BLS), U.S. Department of Labor.

(The growing U.S. current account deficit)

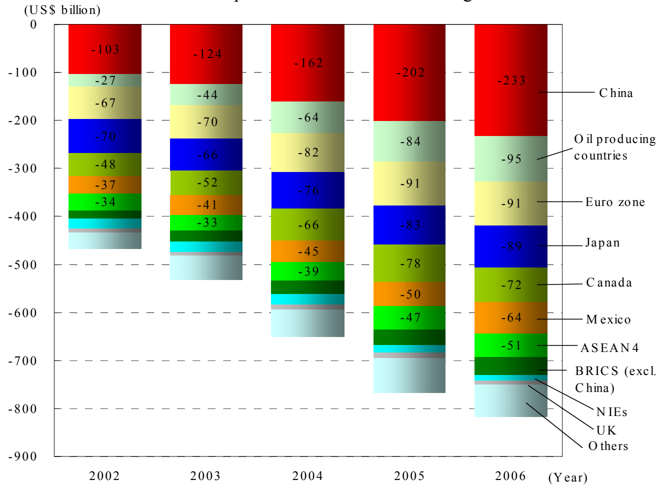
The imbalance of the US current account has continued to expand, and the current account deficit in 2006 reached a record high of US$811.5 billion. The US trade deficit accounts for the majority of the current account deficit (Figure 1-1-18). In the breakdown of the trade balance by trade partner country/region, the deficit with China is the largest, accounting for approximately one-forth of the total US trade deficit (Figure 1-1-19). The issue of the current account imbalance of the United States is analyzed in detail in the following section.

Figure 1-1-18 Changes in current account balance of the US



Note: The figures for 2006 and 2006 fourth quarter are preliminary.
Source: Website of Bureau of Economic Analysis (BEA), US Department of Commerce.

Figure 1-1-19 Trade balance with the USA of partner countries and regions



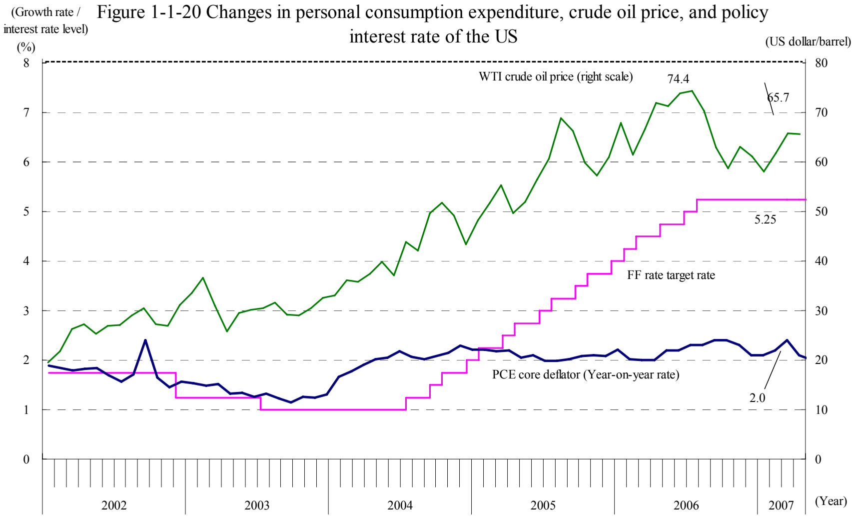
Notes: 1. Customs-cleared basis. Nominal.
2. Oil producing countries are the value of OPEC member countries (excluding Indonesia)
Source: From website of Bureau of the Census, Department of Commerce, USA.

(The state of the U.S. housing market)

The Board of Governors of the Federal Reserve System (FRB) raised the policy rate in 0.25% increments for 17 consecutive times from June 2004 through June 2006 because of the concerns that rising and high crude oil prices may cause consumer prices to swing upward. The FRB, however, has been keeping the policy rate unchanged after the raising in June 2006 as the slowdown in the U.S. housing market has become apparent in 2006 (Figure 1-1-20).

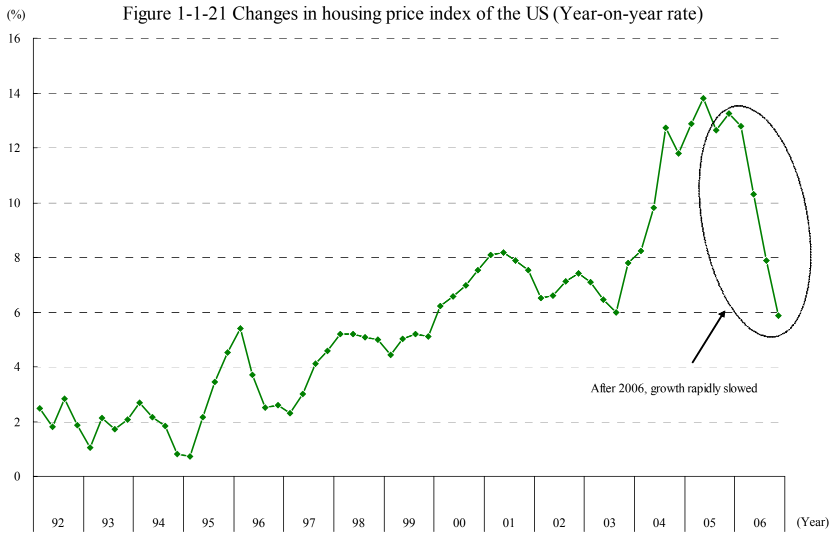
Increases in housing prices enabled the rise in limits on the size of loan for households, however, the rate of increase in housing prices began to slowdown since the end of 2004, and in 2006 it has made rapid slowdown (Figure 1-1-21). Keeping pace with this movement, new privately-owned housing units started and new privately-owned housing units authorized in permit-issuing places have been decreasing since the start of 2006.

Figure 1-1-20 Changes in personal consumption expenditure, crude oil price, and policy interest rate of the US



Notes: 1. WTI crude oil price is that at the end of the month.
2. FRB as the consumer price index, emphasizes the PCE core deflator.
Source: *Financial and economic statistics monthly* (Bank of Japan), Bloomberg.

Figure 1-1-21 Changes in housing price index of the US (Year-on-year rate)



Source: Website of Office of Federal Housing Enterprise Oversight.

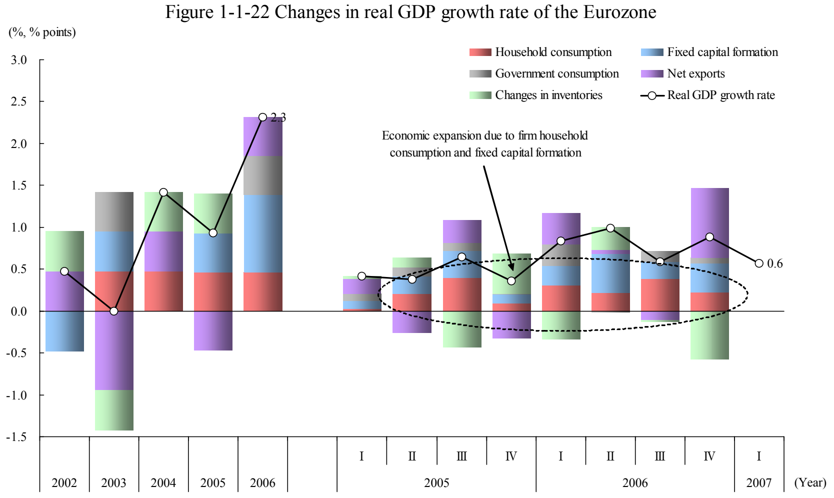
(2) European economy continues a gradual economic recovery

(Euro zone)

The Euro zone economy, supported by robust personal consumption and fixed capital formation, and has been continuing a gradual economic recovery (Figure 1-1-22).

The percentage increase in the Consumer Price Index remained above 2%[3], which the European Central Bank (ECB) set as the target of stable prices, from the latter half of 2005 through around the summer of 2006, but partially as a result of the ECB incrementally raising the policy rate to 4.0% (as of June 2007) starting in March 2006, the percentage increase in the CPI has remained below 2% since September 2006 (Figure 1-1-23).

Figure 1-1-22 Changes in real GDP growth rate of the Eurozone

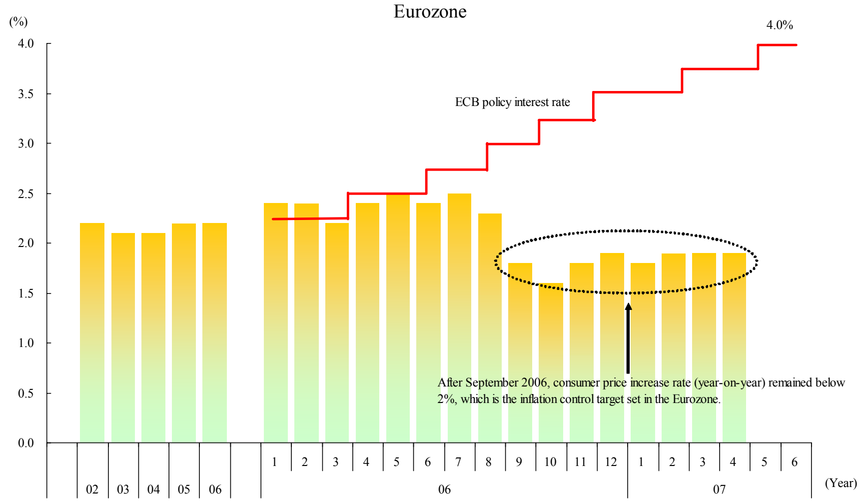


Notes: Percent change over the previous term, with seasonal adjustment. The value of 12 countries excluding Slovenia which implemented euros in January 2007. (GDP growth rate for first quarter of 2007 is the value for 13 countries).
Source: Eurostat.

---

[3] The European Central Bank set the target of the year-on-year rate of increase in the consumer prices in the Euro zone being below but close to 2%.

Figure 1-1-23 Changes in consumer price increase rate and policy interest rate in the Eurozone



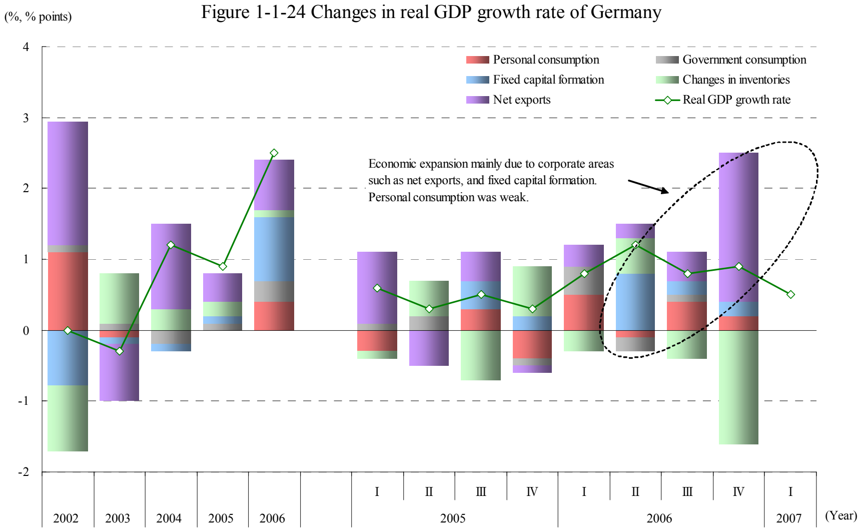
Notes: 1. 12 countries until December 2006. After January 2007, the value of 13 countries, including Slovenia.
2. Consumer price increase rate is year-on-year.
Source: Eurostat, ECB Websites.

In terms of the trends in the major EU countries, the following covers the trends in Euro zone countries Germany and France, and the United Kingdom.

(Germany)

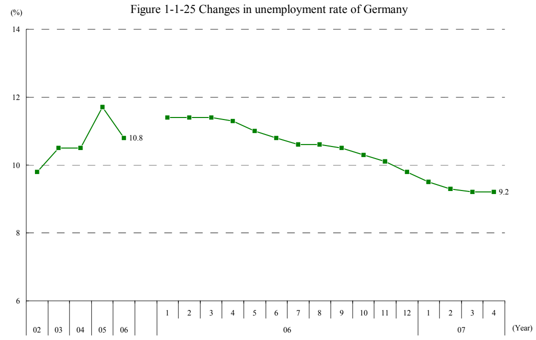
The German economy in 2006 saw weak personal consumption and economic expansion was driven by such corporate sector as fixed capital formation and net exports (Figure 1-1-24). The rate of unemployment was on a declining trend, but remained at a high level (Figure 1-1-25). The percentage increase in the prices was below the ECB target of 2%, and it seems that the risk of inflation was relatively low (Figure 1-1-26).

Figure 1-1-24 Changes in real GDP growth rate of Germany



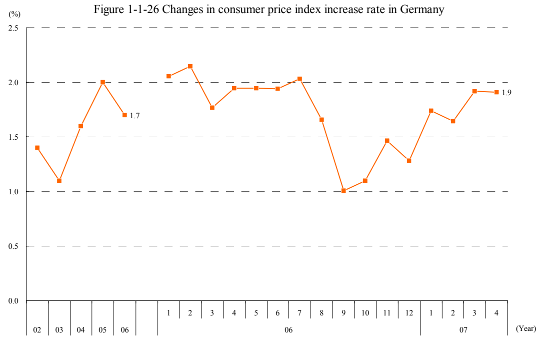
Notes: Data are seasonally adjusted at annual rates, based on comparison with the previous term.
Source: Websites of Federal Statistical Office of Germany, *KAIGAI KEIZAI DATA* (Cabinet Office, Government of Japan).

Figure 1-1-25 Changes in unemployment rate of Germany



Source: Websites of Federal Statistical Office of Germany, *KAIGAI KEIZAI DATA* (Cabinet Office, Government of Japan).

Figure 1-1-26 Changes in consumer price index increase rate in Germany

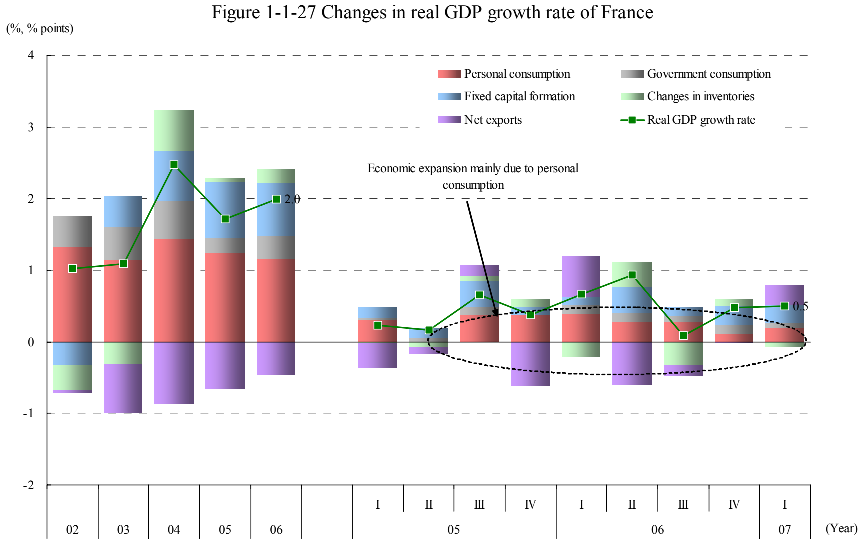


Notes: year-on-year rate.
Source: Websites of Deutsche Bundesbank, *KAIGAI KEIZAI DATA* (Cabinet Office, Government of Japan).

(France)

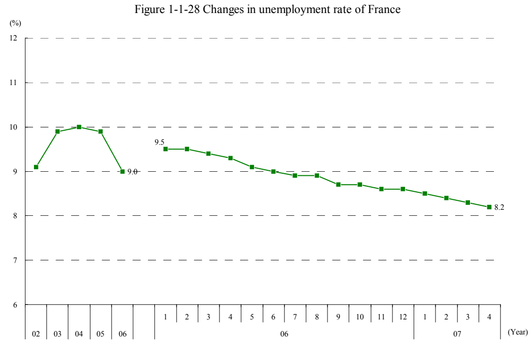
The French economy in 2006 continued a gradual recovery (Figure 1-1-27). The recovery is attributable to the domestic demand such as personal consumption in the background of improvement in employment situation (Figure 1-1-28). The percentage increase in prices since the summer of 2006 has remained below the ECB's inflation target of 2% (Figure 1-1-29).

Figure 1-1-27 Changes in real GDP growth rate of France



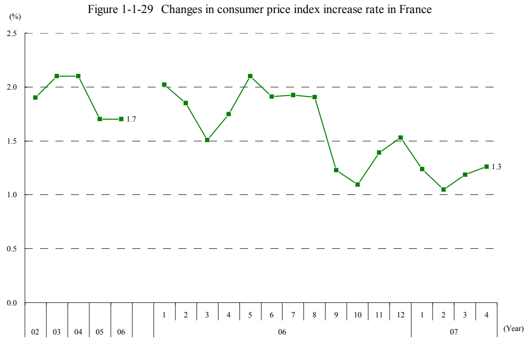
Notes: Data are seasonally adjusted at annual rates, based on comparison with the previous term.
Source: Websites of Institut National de la Statistique et des Etudes Economiques.

Figure 1-1-28 Changes in unemployment rate of France



Source: Websites of Institut National de la Statistique et des Etudes Economiques, KAIGAI KEIZAI DATA (Cabinet Office, Government of Japan).

Figure 1-1-29 Changes in consumer price index increase rate in France

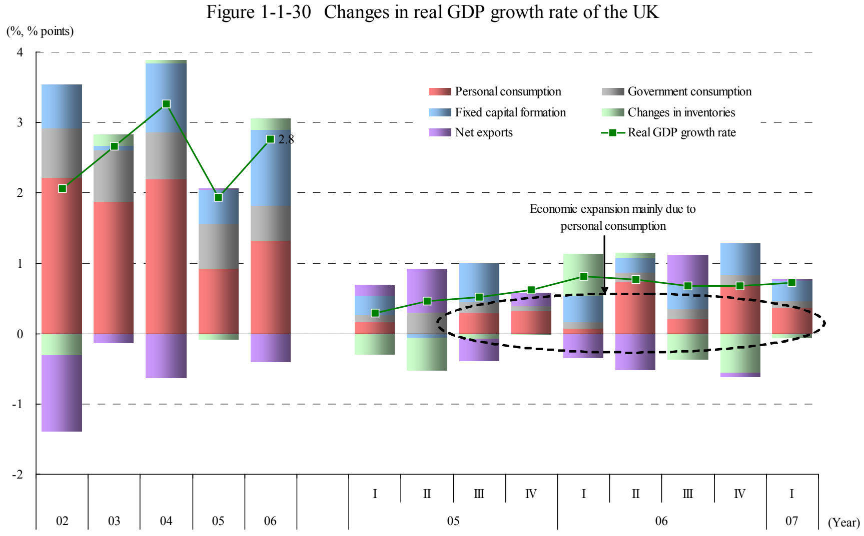


Note: Year-on-year rate.
Source: Websites of Institut National de la Statistique et des Etudes Economiques (INSEE), *KAIGAI KEIZAI DATA* (Cabinet Office, Government of Japan).

(United Kingdom)

The UK economy has continued to grow and enjoyed favorable conditions in 2006, which was driven by personal consumption (Figure 1-1-30).

Figure 1-1-30 Changes in real GDP growth rate of the UK

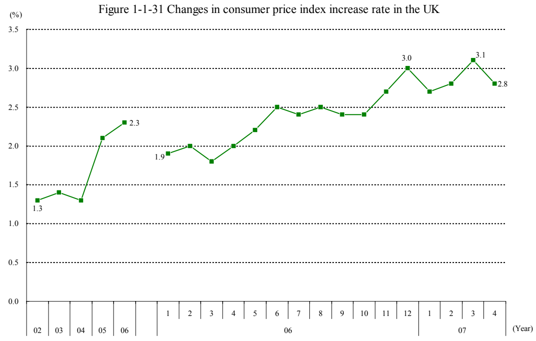


Note: Data are seasonally adjusted at annual rates, based on comparison with the previous term.
Source: Websites of Office of National Statistics of UK.

The Bank of England raised the policy rate in 0.25% increments for four consecutive times from January 2006 through May 2007 in response to such inflation risk as the rising consumer price index, however, the percentage increase in the consumer prices remained a high level, and as of April 2007, it has been above the inflation target of 2% for 12 consecutive months. In March 2007, the rate reached 3.1% that was more than one percentage point above the target rate, so the Governor of the Bank of England issued an open letter[4] to the Chancellor of the Treasury. In April, the rate dropped slightly to 2.8% (Figure 1-1-31). The rate of unemployment in 2006 remained at a high level after an upward swing in March, and, on a year-on-year base, it was 5.4% which is well above 4.7% in 2005 (Figure 1-1-32).

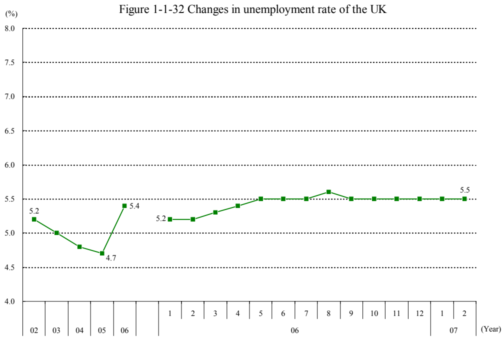
[4] The Governor of the Bank of England is required to publish an open letter to the Chancellor of the Treasury in the case that the CPI inflation rate deviate more than one percentage point above or less the inflation target in order to clarify the reason for the deviation and explain what measures are proposed to do.

Figure 1-1-31 Changes in consumer price index increase rate in the UK



Note: Year-on-year rate.
Source: Websites of Office of National Statistics of UK.

Figure 1-1-32 Changes in unemployment rate of the UK



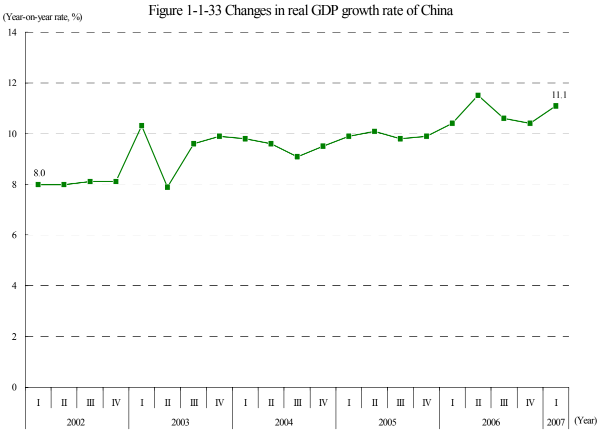
Note: Data are seasonally adjusted.
Source: Websites of Office of National Statistics of UK.

(3) Chinese economy continues to expand

The Chinese economy is continuing to see economic expansion. (Figure 1-1-33) The real GDP growth rate was 10.7% in 2006, marking high growth of over 10% for the fourth consecutive year, but this growth has been driven by fixed capital formation, which accounts for approximately half of GDP, and expanding net exports, and issues exist including investment overheating and imbalances in international payments (Figure 1-1-34). Since reforms to the renminbi system in July 2005, the rate of the renminbi against the US dollar has been gradually increasing, but the range of increase is only 5.7% (as of May 2007) (Figure 1-1-36).

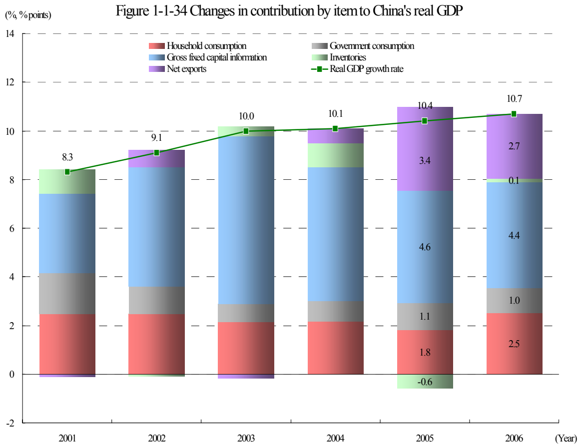
In order for the continually expanding Chinese economy to deliver sustainable and stable growth, it is important to make a transition from the investment and export-led growth up to now to domestic demand-led growth. Furthermore, efforts are needed in regard to environmental and energy problems that are arising together with high growth. These issues are covered in detail in Section 3 of Chapter 1.

Figure 1-1-33 Changes in real GDP growth rate of China



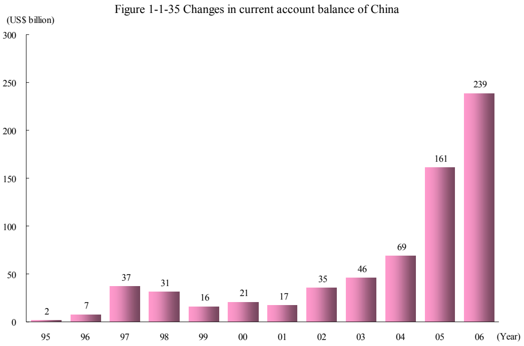
Source: CEIC Database.

Figure 1-1-34 Changes in contribution by item to China's real GDP



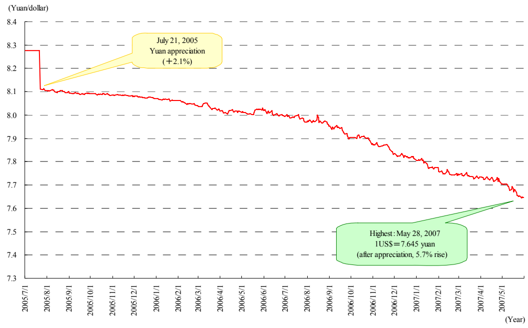
Source: *China Statistical Yearbooks*, *China Statistical Abstract 2007* (National Bureau of Statistics of China).

Figure 1-1-35 Changes in current account balance of China



Source: *World Economic Outlook Database April 2007* (IMF).

Figure 1-1-36 Changes in exchange rates of Chinese yuan against dollar (final)



Notes: Data period: July 2005~May 2007.
Source: Bloomberg.

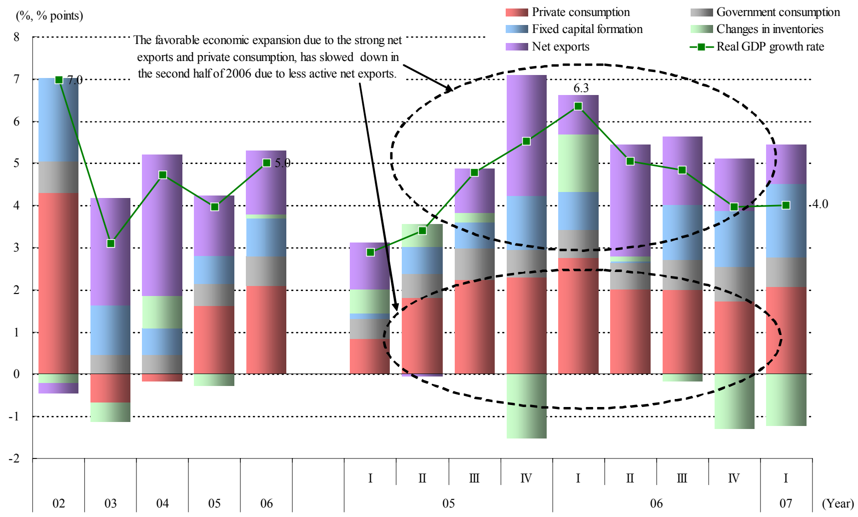
(4) NIEs

(NIEs economy start to show declining trend at base)

While the economy of the NIE countries and regions continued to expand in 2006, since the latter half of 2006, a declining trend has started to intensify centering on net exports.

In South Korea, the economy has expanded as a result of strong net exports and the expansion of private consumption, but the economy has been declining since the latter half of 2006, due to a slowdown in net exports (Figure 1-1-37).

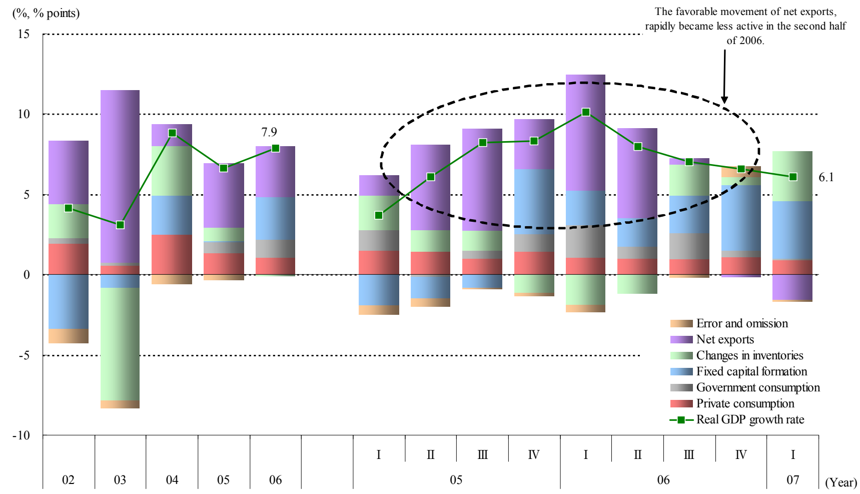
Figure 1-1-37 Changes in real GDP growth rate of South Korea



Note: Year-on-year rate.
Source: Websites of Bank of Korea.

In Singapore since the latter half of 2006, while net exports which had been strong until then have been rapidly declining, the economy has been supported by an increase in fixed capital formation (Figure 1-1-38).

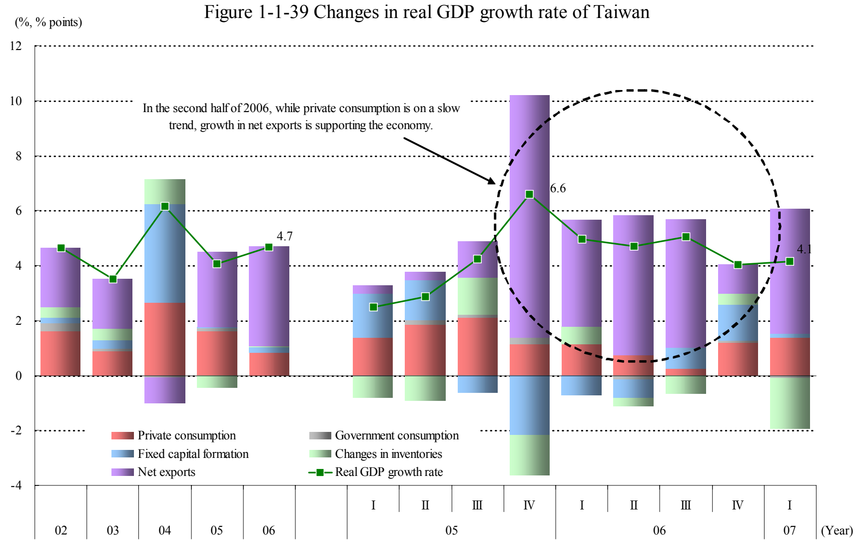
Figure 1-1-38 Changes in real GDP growth rate of Singapore



Notes: Year-on-year rate.
Source: Website of Department of Statistics Singapore.

In Taiwan since 2006, while private consumption has been on a declining trend, the economy has been supported by an increase in net exports (Figure 1-1-39).

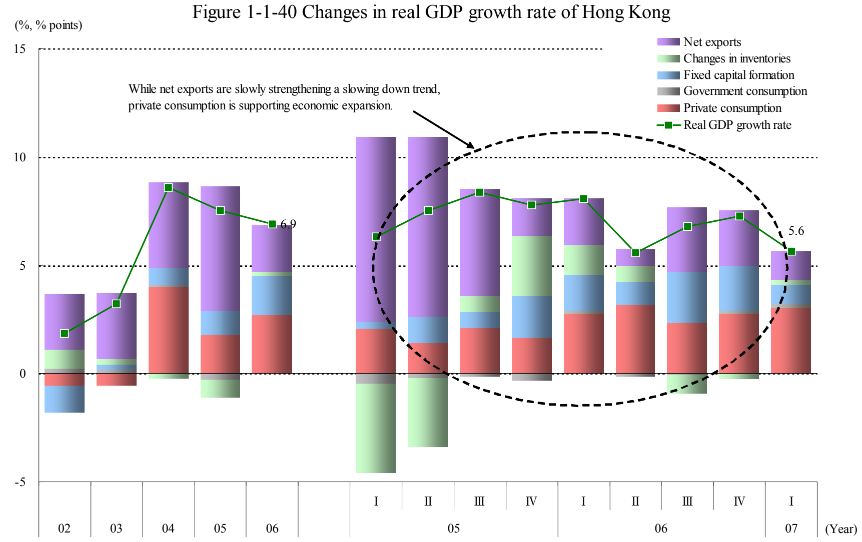
Figure 1-1-39 Changes in real GDP growth rate of Taiwan



Notes: Year-on-year rate.
Source: Website of Budget, Accounting and Statistics of Taiwan.

In Hong Kong since mid-2005, while net exports have continued to be on a declining trend, the economy has been supported by steady private consumption (Figure 1-1-40).

Figure 1-1-40 Changes in real GDP growth rate of Hong Kong



Notes: Year-on-year rate.
Source: Website of Census and Statistics Department of Hong Kong.

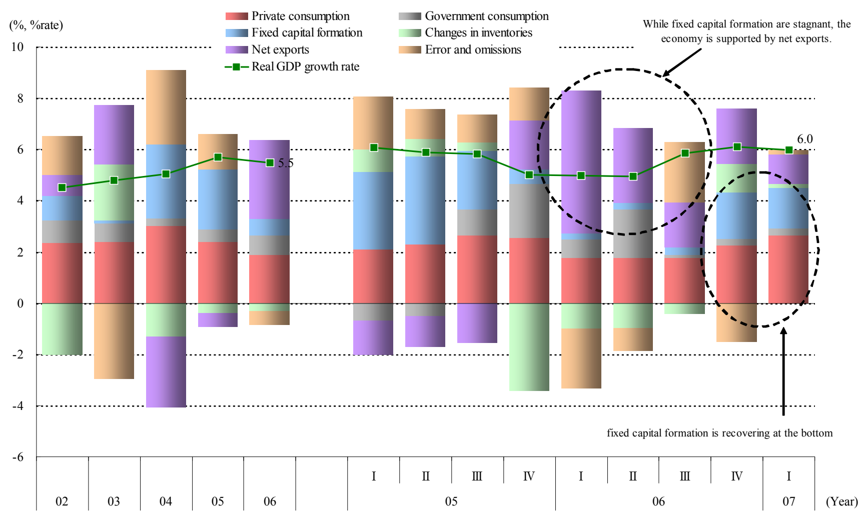
(5) ASEAN4

(ASEAN economy continues to expand)

While the economy of ASEAN4 expanded in 2006, the pace of expansion in some of the countries has started to become more gradual.

In Indonesia, while fixed capital formation was sluggish early in the year due to the effects of incremental increases in the interest rate during the previous year, the economy was supported by net exports. Subsequently, partially due to the interest rate being decreased in response to the stability of consumer prices, fixed capital formation started to recover in the fourth quarter of 2006, and the economy has continued to expand (Figure 1-1-41).

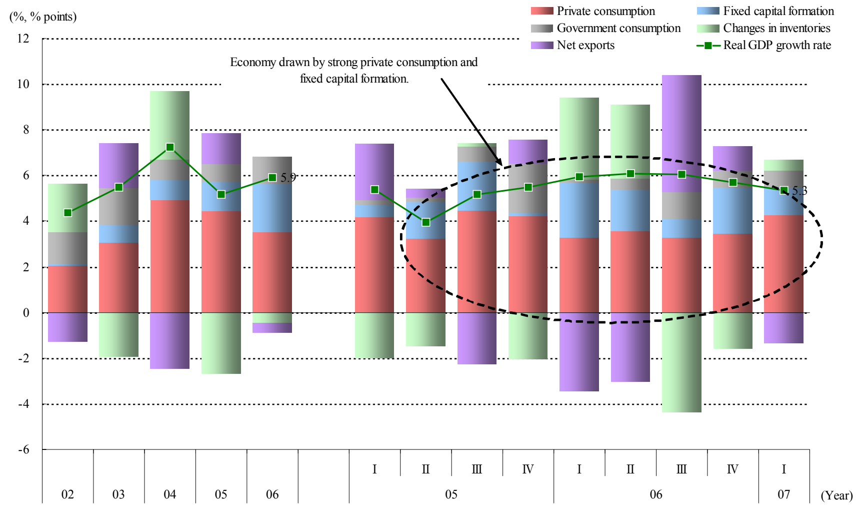
Figure 1-1-41 Changes in real GDP growth rate of Indonesia



Notes: Year-on year rate.
Source: Website of Central Board of Statistics of Indonesia.

In Malaysia, the economy has been expanding, driven by strong private consumption, which has been supported by a good employment environment, low interest rates, and so forth, and fixed capital formation, which has been expanding under the ninth five-year plan that started in 2006 (Figure 1-1-42).

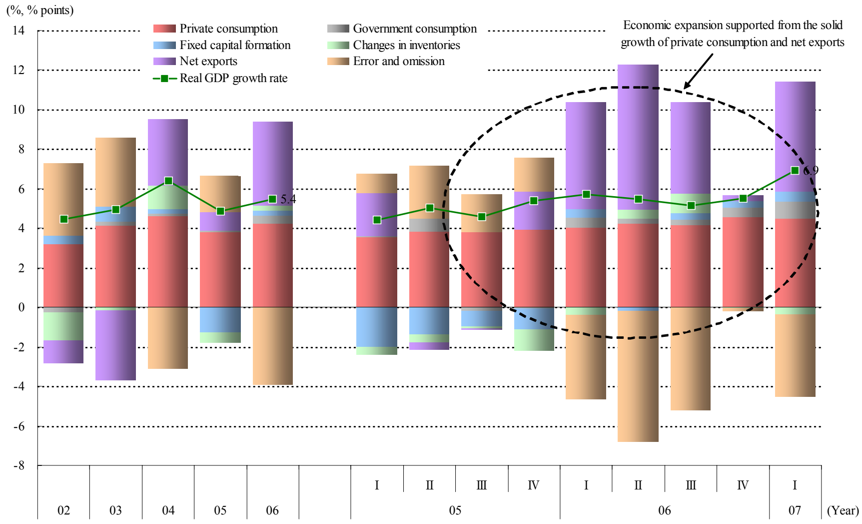
Figure 1-1-42 Changes in real GDP growth rate of Malaysia



Notes: Year-on-year rate.
Source: Website of Central Bank of Malaysia.

In the Philippines, the economy has been expanding, driven by strong private consumption, which has been supported by increased money transfers from persons residing overseas and so forth, and an expansion in exports related to electronics (Figure 1-1-43).

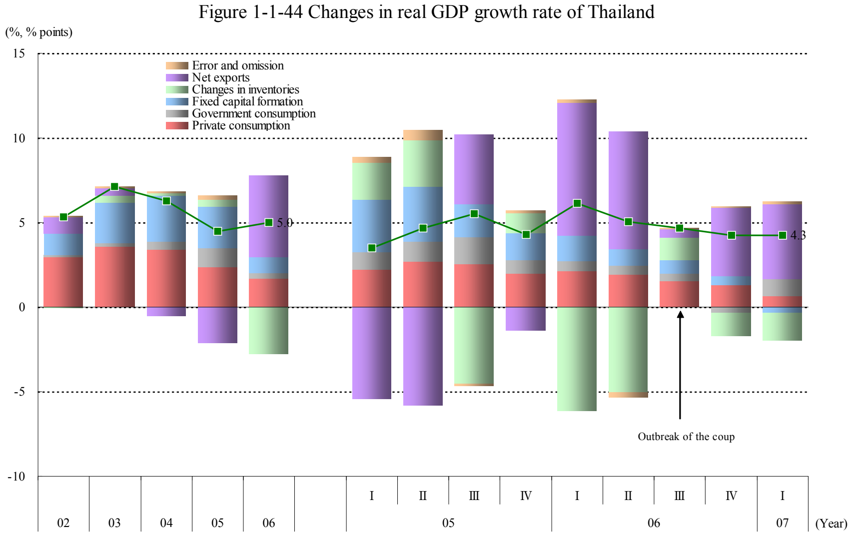
Figure 1-1-43 Changes in real GDP growth rate of the Philippines



Notes: Year-on-year rate.
Source: Website of Central Board of Statistics of the Philippines.

In Thailand, where political turmoil continued starting from suspicion surrounding the sale of stocks by relatives of the Prime Minister in January 2006, the expansion of the economy, despite being supported by net exports, was gradual due to declines in private consumption and fixed capital formation (Figure 1-1-44). The impact of the coup d'état itself in September 2006 on the actual economy was minor, but some point to concerns that the heightened sense of uncertainty of policies surrounding the sudden introduction of capital controls in December and so forth will bring about a decline in direct inward investment going forward, and will have an negative impact on the Thai economy.

Figure 1-1-44 Changes in real GDP growth rate of Thailand



Notes: Year-on-year rate.
Source: Website of the Bank of Thailand.

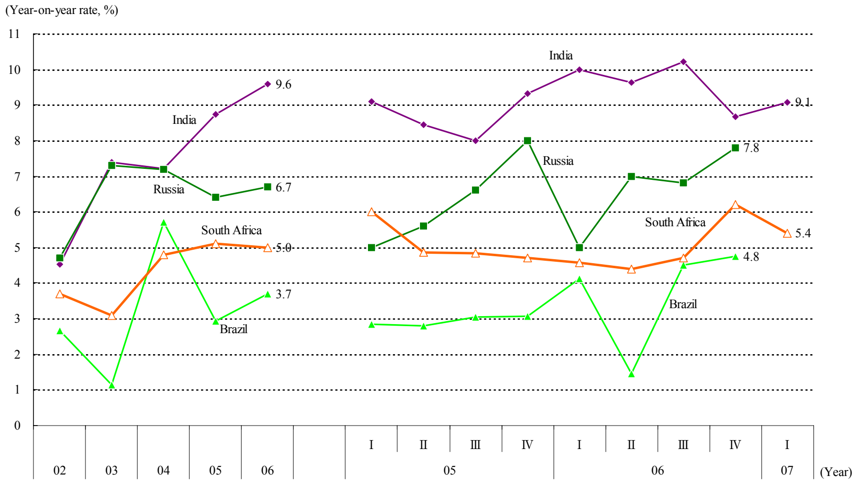
(6) BRICS[5]

(BRICS economy continues high growth)

In India, manufacturing industries and service industries, such as the software industry and distribution industry, have been performing strongly, and high economic growth of around 9% has been continuing. Direct inward investment from foreign countries has also continued to expand against the background of this strong economy. Nevertheless, in January 2007, a sense that the economy was overheating arose, including the rate of increase of wholesale prices reaching between 6% and 7% since April 2005 for the first time in one year and nine months, and the government has adopted tightening policies, including implementing increases in the policy interest rate and the deposit reserve requirement ratio. Russia saw record high economic growth in 2006. South Africa has remained stable. Brazil in March, as a result of revising its method for calculating GDP, saw a higher rate of growth than was initially forecast (Figure 1-1-45).

[5] China is omitted here as it has been covered in (3).

Figure 1-1-45 Changes in real GDP growths of BRICS countries



Notes: 1. Year-on-year rate. The annual growth rate of India has been calculated based upon the quarterly data.
2. The quarterly data of Brazil is nominal, the yearly data is real.
Source: Websites of statistic bureaus of India, Russia, South Africa, and Banco Central do Brasil.

(7) LDC economy

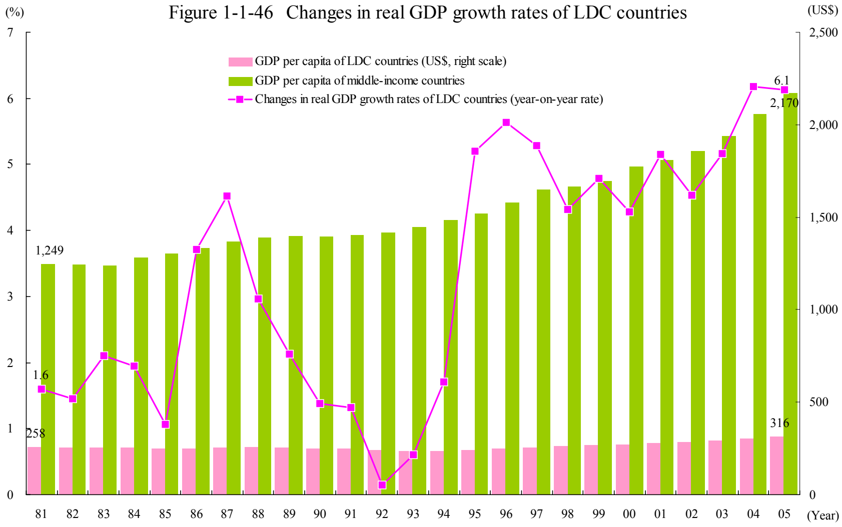
Among the developing countries, the Least Developed Countries (LCD)[6], which are particularly behind in development, amounted to 50 countries as of 2006.

The real GDP growth rate of these LDC countries increased rapidly since the 1990s, and was at 6.1% year-on-year in 2005. Looking at movements in the per capita GDP, however, this growth is low compared to countries with medium incomes, which continue to have equally high growth and of which many are developing countries, and it appears that the economic growth is not leading to increases in income (Figure 1-1-46).

For the economic development of LDC, under the "Development Initiative," since February 2006, Japan has been developing the "One Village One Product Campaign," which supports identifying specialty products of LDC countries and boosting their competitiveness (For more details on the One Village One Product Campaign, see Chapter 4).

[6] The United Nations uses criteria such a gross national income per capita of below US$750 and a population of 75 million people or below.

Figure 1-1-46 Changes in real GDP growth rates of LDC countries



Note: Middle-income countries are based on WDI (World Bank).
Source: WDI (World Bank).