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**Statement by Mr. Subramanian and Mr. Amarasekara on Japan
(Preliminary)
Executive Board Meeting
March 22, 2023**

We thank staff for the Article IV report, the useful analytical annexes, and the six Selected Issues Papers (SIPs) with helpful insights to the Japanese economy. We also thank Mr. Mizuguchi, Ms. Kashima, and Ms. Ogihara for their informative buff statement.

The authorities are navigating Japan’s economic recovery through various near-term and longer-term challenges. The Japanese economy has expanded by 1.1 percent in 2022, supported by a robust growth of exports as well as domestic consumption demand. Inflation remains above 2 percent, indicating that Japan’s decade-long problem of deflation could be addressed to some extent in the period ahead. A continued economic recovery is projected in the near term, supported by pent-up demand, supply chain improvement, border reopening and policy support. As staff has pointed out, external downside risks facing Japan appear to be greater than domestic risks.

Higher inflation since mid-2022 has been mainly due to higher commodity prices and yen depreciation, but the passthrough from inflation to wages has been limited. We also note that a key reason for the current strong growth of private sector credit is higher input costs observed at present. Therefore, we tend to agree with authorities that, although inflation risks are two-sided, a premature exit from monetary easing is not appropriate until there are clear signs of a break from the decade-long “deflationary mindset”. In this regard, we appreciate Bank of Japan’s commitment to continue to implement monetary policy based on a data-driven approach.

Bank of Japan has intervened in the foreign exchange market to prevent undue volatility of the exchange rate. This intervention, aimed at preventing a large depreciation of over 25 percent against the US\$, has taken place for the first time since 1998. While Japan’s ability to intervene in the foreign exchange market given its robust external buffers is acknowledged, we appreciate the transparency with which Bank of Japan has carried out such intervention. We also observe that the narrowing of the current account surplus has been driven by income

balance and oil and gas related movements, and we support the request made in the buff statement for the Fund to review the EBA methodology that links exchange rates to the assessment of current account balances as a whole.

Japan has registered large fiscal deficits, thereby increasing the already high government debt stock. In addition to pandemic-related support, fiscal stimulus in recent times has included those aimed at subsidizing domestic energy supplies and supporting the economic policy agenda. While near-term fiscal support may be appropriate, we agree with staff that fiscal consolidation needs to commence early to address longer-term debt sustainability issues. *In the context of the recent decline in global oil prices, can staff shed some light on the level at which the authorities plan to remove the fuel subsidy?*

We are somewhat concerned of the projection that, under current policies, the public debt-to-GDP ratio will continue to increase steadily into longer-term. *With public debt at 261.3 percent of GDP in 2022, could staff explain in further detail the reasons behind their conclusion of moderate overall sovereign risk?* We certainly have no doubt that Japan will manage the debt situation very well and we are not expressing concerns about the same. However, it is important to understand from an academic and policy standpoint, staff's research-based guidance on how to interpret the significant concerns they express with debt-to-GDP at much lower levels for other countries – such as 100 percent - when viewed in comparison to their analysis of Japan. Given the fiscal and debt issues being so core to the Fund's mandate, clarity from staff by way of research-based guidance on this important issue is paramount.

While Japan's financial sector remains strong and well supervised, close monitoring of external risks as well as interest rate and credit risks would be appropriate. Staff has also recommended macroprudential policies aimed at curbing vulnerabilities from growth in housing loans. A related noteworthy development is increased real estate property acquisitions by foreign investors. We also observe that the most recent assessment of Japan's AML/CFT framework in 2021 found significant improvements since the previous evaluation.

We take note of the economic policy agenda published by the Cabinet, which aims to enhance economic security and overcome challenges including inequality, urbanization, and climate change, and details policy priorities on human capital and distribution; science, technology, innovation and start-ups; green transformation; and digital transformation. The successful implementation of this agenda will strengthen the Japanese economy by decisively addressing the structural challenges to growth.

On structural issues, we remain concerned about Japan's aging and declining population, and its socio-economic impact. In this regard we found the SIP titled "A New Growth Engine for Japan: Women in STEM Fields" useful. The finding that bridging the gender gap in STEM fields can boost the growth of total factor productivity by 20 percent is important for Japan's efforts to boost its growth potential. The SIP titled "The Financial Impact of Carbon Taxation on Corporates" reflects the challenges in achieving net zero emissions by 2050, and emphasizes the importance of converting challenges into engines of growth, as envisaged by the authorities.

With that, we wish the authorities and people of Japan every success in their endeavors.