Chapter 1　Trends in the International Economy and Structural Changes

In this chapter, we will make a survey of economic conditions in major regions and analyze the growth structure and risk factors of the recent international economy, while discussing structural changes such as globalization, mainly the increased international capital movement.

In particular, “the expanding global current account imbalance” and “surges in, and continued high levels of, crude oil prices” will be analyzed as risk factors for the international economy. At the same time, the features of increased international capital movement will be analyzed from these points of view.

Section 1　An international economy growing steadily in spite of risks

The international economy is growing steadily, driven by advanced countries such as the U.S. and Japan. In this context, East Asian countries and regions, as well as BRICS countries, have achieved high economic growth through globalization and by positively accepting investments from abroad, thereby increasing their presence in the international economy.

Some risk factors have been pointed out, however, concerning the future of the international economy. Of such risk factors, “the expanding global current account imbalance” and “surges in, and continued high levels of, crude oil prices” will be examined in Sections 2 and 3. In this section, we will analyze “inflation risks.”

In addition, the “shift of priority in the economy to service industries” caused by economic development and “competition for human resources” resulting from the progress of globalization will be reviewed as recent features of the international economy.

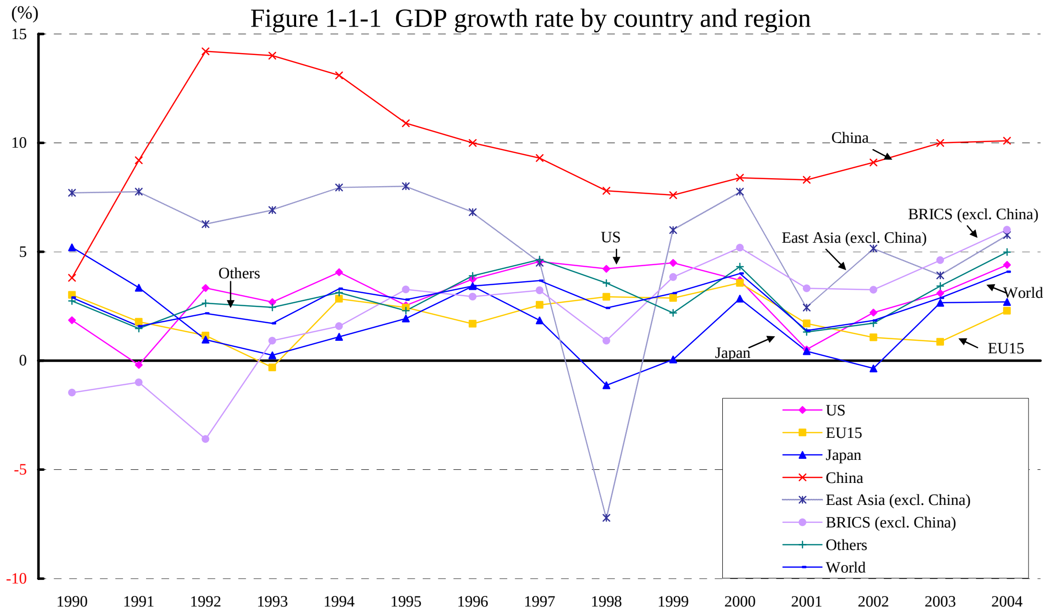
1. Overview of the international economy and relevant risk factors

(1) Growth structure of the international economy

(East Asian countries and regions, and BRICS countries, showing high growths)

Since the 1990s, the international economy has continued to grow steadily by about 3.1% on the average. In particular, East Asian countries and regions, and BRICS countries, have shown marked growths (Figure 1.1.1). East Asian countries and regions temporarily experienced negative growths in 1998 due to Asian currency and economic crises. Their growths, however, turned positive in the following year, and these countries have continued to show high growths as the growth center of the international economy. Of the BRICS countries, Russia and India have maintained high growth rates. China, which is included in both East Asian countries/regions and BRICS countries, has shown annual growths of 10% on the average since the 1990s, increasing its presence in the international economy.

Figure 1-1-1 GDP growth rate by country and region

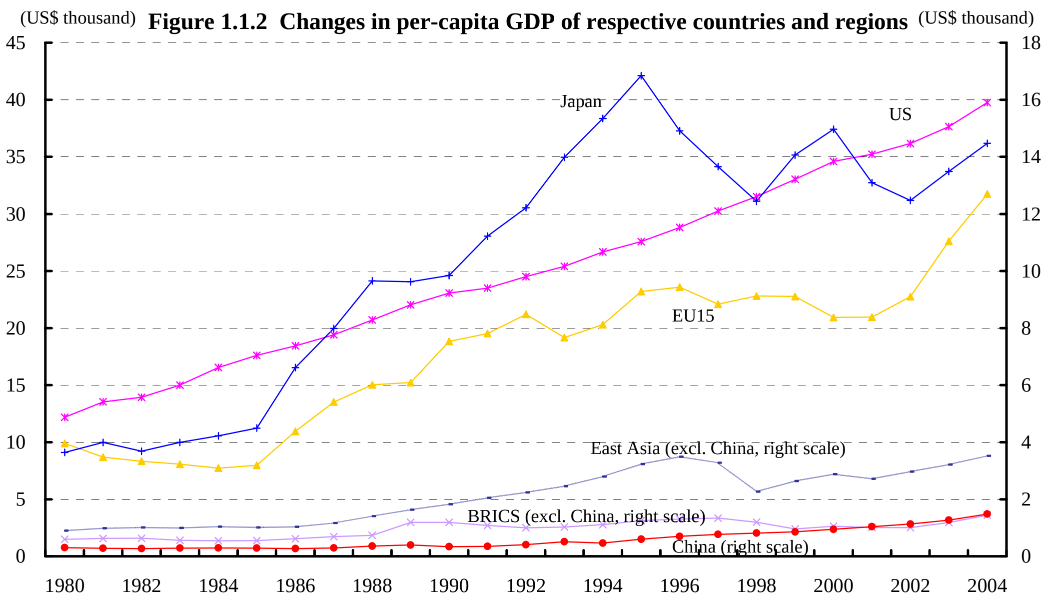


Notes: 1. East Asia (excl. China) includes ROK, Hong Kong, Singapore, Indonesia, Malaysia, Philippines, and Thailand. BRICS (excl. China) includes Brazil, Russia, India, and South Africa.
2. Countries and years with deficient data are excluded.

Sources: *WDI* (World Bank) and *China Statisical Yearbooks* (National Bureau of Statistics of China).

It should be noted, however, that a large gap still remains between East Asian countries/regions and BRICS countries, and Japan, the U.S. and Europe, in terms of per-capita GDP, although both East Asian countries/regions and BRICS countries have grown steadily (Figure 1.1.2). While East Asian countries/regions seem to have completely got out of negative impacts of Asian currency and economic crises, they have not yet recovered to the levels before the crises in terms of per-capita GDP.

Figure 1.1.2 Changes in per-capita GDP of respective countries and regions



Notes: 1. Nominal dollar-base GDPs of respective countries and regions have been divided by their populations.
2. East Asia (excl. China) refers to ROK, Hong Kong, Singapore, Indonesia, Malaysia, Philippines and Thailand. BRICS (excl. China) refers to Brazil, Russia, India and South Africa.
3. Countries and years with deficient data are excluded.

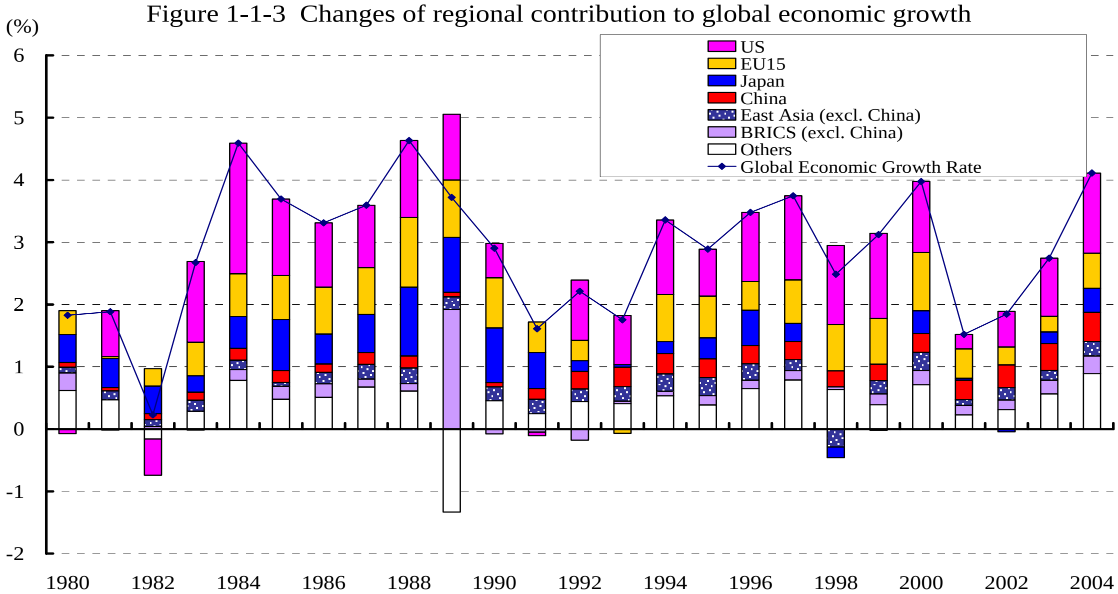
Source: *WDI* (World Bank), *China Statistical Yearbooks* (National Bureau of Statistics of China)

(The international economic growth has been driven by advanced countries led by the U.S.)

A comparison of contributions by respective areas to the international economic growth (Figure 1.1.3) shows that contributions by East Asian countries and regions to the world economic growth remain small, although they have increased their contributions compared with the past. Reflecting the economic scales, advanced countries such as Japan, the U.S. and European nations are driving the international economic growth. The U.S., in particular, has continued to show a steady positive growth since 1992, supporting the international economic growth.

In the meantime, an analysis of the growth structure of the international economy by expenditure (Figure 1.1.4) shows that private consumption has accounted for the majority in most of the years since the 1980s. This is in line with the fact that the economic expansion of the U.S. has been supported by consumption. In recent years, the international economy has grown under the structure where such brisk demands in advanced countries, mainly the U.S., increase import from developing countries.

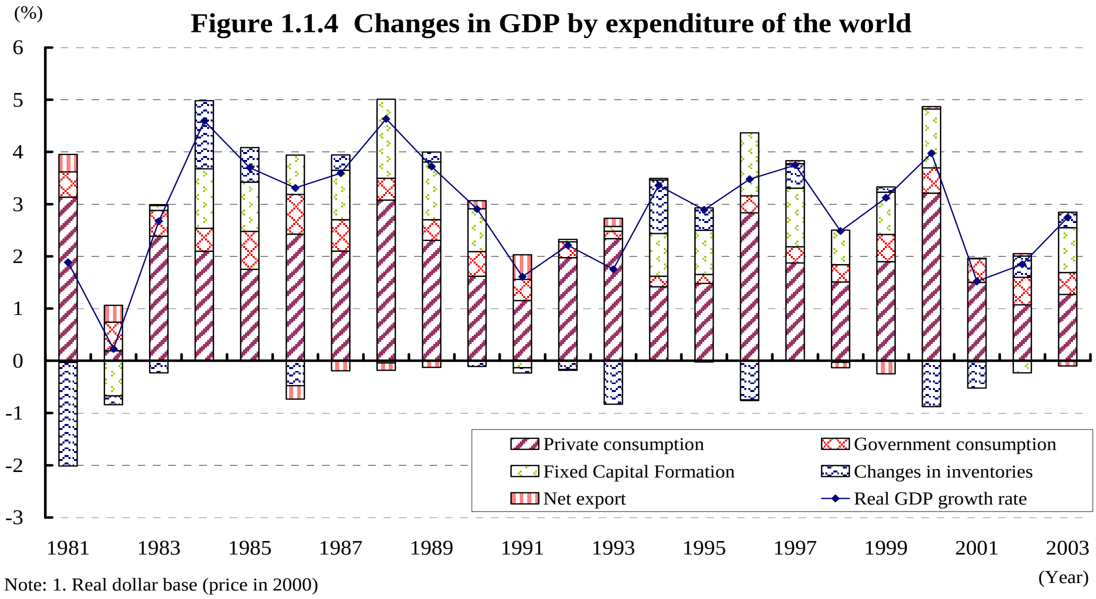
Figure 1-1-3 Changes of regional contribution to global economic growth



Notes: 1. Calculation is Based on GDP of Each Country (real 2000 basis, US$).
2. East Asia (excl. China) includes ROK, Hong Kong, Singapore, Indonesia, Malaysia, Philippines, and Thailand.
BRICS (excl. China) includes Brazil, Russia, India, and South Africa.

Source: *WDI* (World Bank).

Figure 1.1.4 Changes in GDP by expenditure of the world



Note: 1. Real dollar base (price in 2000)

2. The "world" refers to the "World" (total for 208 countries and regions) contained in the database of the World Bank.

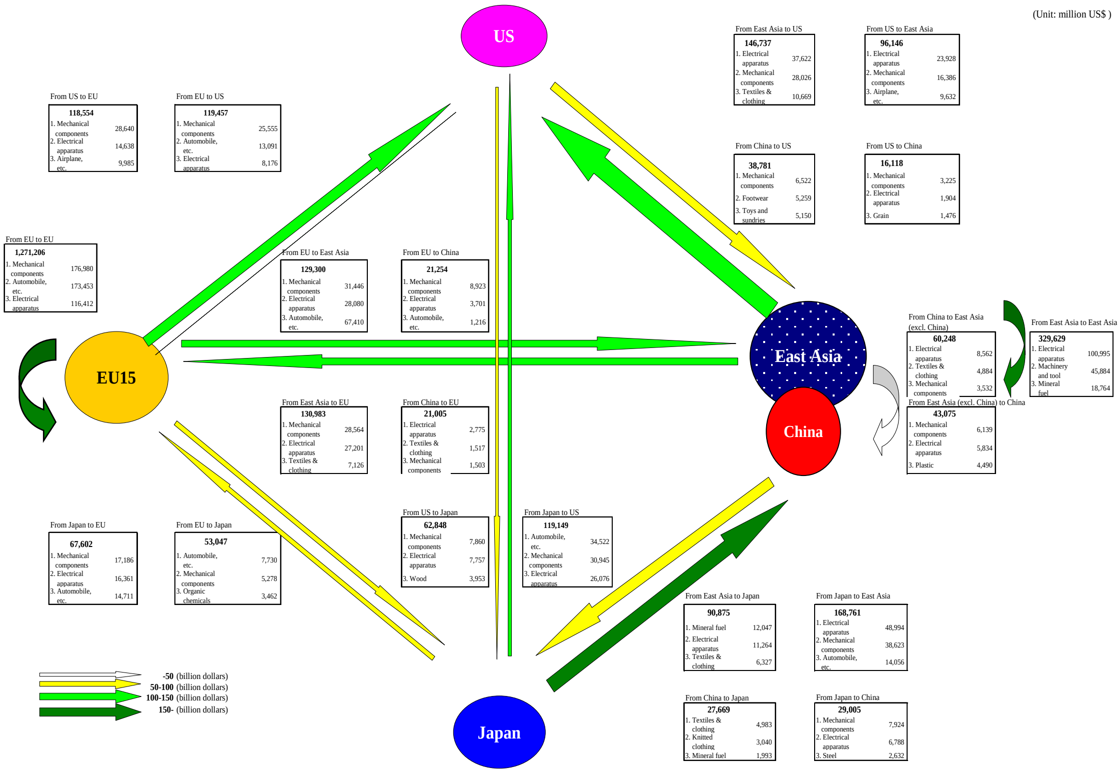
3. There exists some incongruity as shown by the net export of the world which is not zero. This seems to reflect accidental errors caused in summing up the coefficients of respective nations.

Source: *WDI* (World Bank)

(Expanded world shares of East Asian countries and regions in trade and investments)

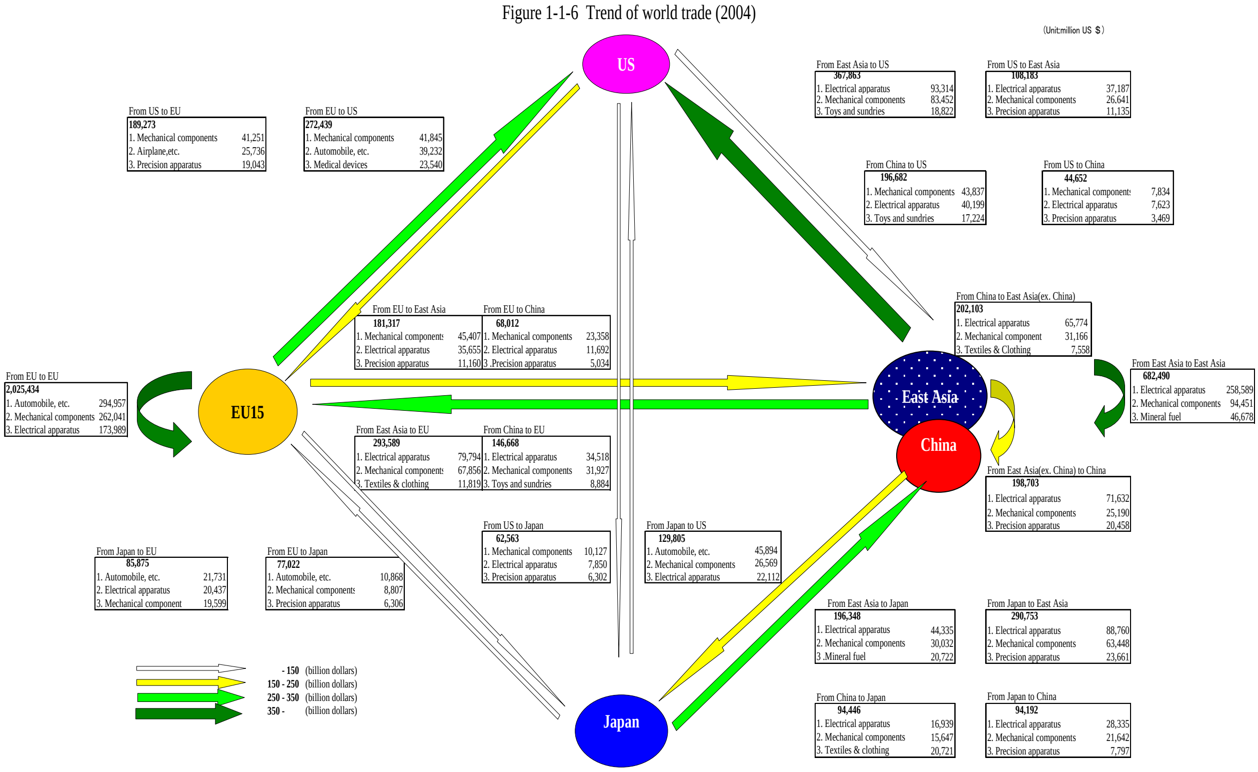
In terms of trade (Figures 1.1.5 and 1.1.6), the world shares of East Asian countries and regions have expanded, increasing their presence in the international trade. This reflects the fact that East Asian countries and regions have increased export and import of parts, etc. as "the factory of the world" playing an important role in the international division of labor, while increasing export of finished products to advanced countries including Japan, the U.S. and European countries which are end user countries. In addition, they have become more attractive as user countries of finished products as a result of the improvement of their income standards, and have increased import from countries in and outside the region.

Figure 1.1.5 Trend of world trade (1994)



Notes: 1. East Asia includes 9 countries of NIEs, ASEAN4, and China (Hong Kong is excluded from China). EU consists of 15 countries throughout.
2. Based on statistics of importing countries for 1994 (import at CIF price) in principle. For EU15 and East Asia, however, the following data are used for convenience, as only limited data are available for them.
・The statistics for trades between Japan and EU15, Japan and East Asia and Japan and China are those of Japan for 1994.
・ The statistics for trades between the US and EU15, US and East Asia and US and China are those of the US for 1994.
・ The statistics for trades between EU15 and East Asia are those of EU15 for 1997, while the statistics for trade between EU15 and China are those of China for 1995.
・The statistics for trades between EU15 and East Asia are those of EU15 for 1997, while the statistics for trades between EU15 and China are those of China for 1995.
・The statistics for trades between EU15 and EU 15 are those of respective countries for 1997 (excluding those for Belgium and Luxemburg, which are for 1999). The statistics for trades between East Asia and East Asia are those of respective countries for 1999.
・For the purpose of estimation of import value (CIF price) at importing countries from export value (FOB price) in the above, it was assumed that the CIF price is 1.1 times the FOB price.
Source: *World Trade Atlas* (Global Trade Information Services Inc.)

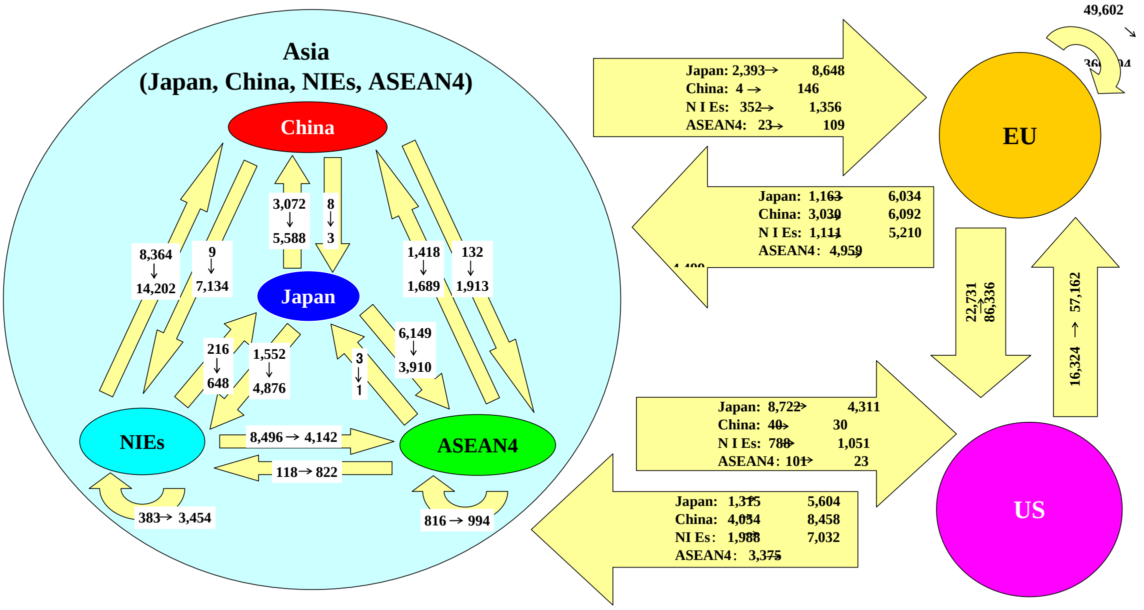
Figure 1-1-6 Trend of world trade (2004)



Notes: 1. East Asia includes 9 countries of NIEs, ASEAN4, and China (Hong Kong is excluded from China). EU consists of 15 countries throughout.
2. Based on statistics of importing countries (CIF price).
Source: *World Trade Atlas* (Global Trade Information Services).

With regard to investments, East Asian countries and regions have expanded their shares in the acceptance of direct investments (Figure 1.1.7). This shows that the economic growths of East Asian countries and regions have been achieved by a reciprocal mechanism of investors and investees taking advantage of the globalization of the international economy, where positive acceptance of investment funds from abroad leads to high economic growths[1]

Figure 1-1-7 Changes of direct investment of the world (from the first half of the 1990s to the early first decade of the 2000s)



Notes: 1. Figures above represent the annual average of direct inward investment (in US$million). "First half of the 1990s" means from 1990 to 1995. "Early first decade of the 2000s" means from 2000 to 2003.
2. Figures of China, NIEs, and ASEAN4 are the sums approved by relevant investment supervisory authorities; Figures of Japan, the EU, and the US are based on direct inward investments calculated with international trade balances.
3. Hong Kong is included in NIEs, except between China and NIEs, which case excludes Hong Kong.

Sources: *International Direct Investment Statistics Yearbook* (OECD); *SEKAI SHUYOU KOKUNO CHOKUSETSU TOUSHI TOUKEI SHUU* (ITI).

(2) Rising inflation risks

While the international economy has achieved a steady growth, it is faced with some risks at the same time. Concrete risks which have been pointed out include (1) global current account imbalance[2], (2) the emergence of various issues related to China[3], (3) surges in, and continued high levels of, crude oil prices [4], and (4) inflation in the international economy. We will address inflation risks of the international economy here, leaving (1) to (3) to the following sections.

Possible causes for inflation risks in the international economy include an increase in international excessive liquidity as a fundamental problem. International excessive liquidity has caused funds to flow into markets for bonds, stocks, commodities including crude oil and real estate in the US, which issues the key currency, in pursuit of investment targets amid the globalization of international funds. This has caused rises in asset prices in not only the US but also other countries, which has further

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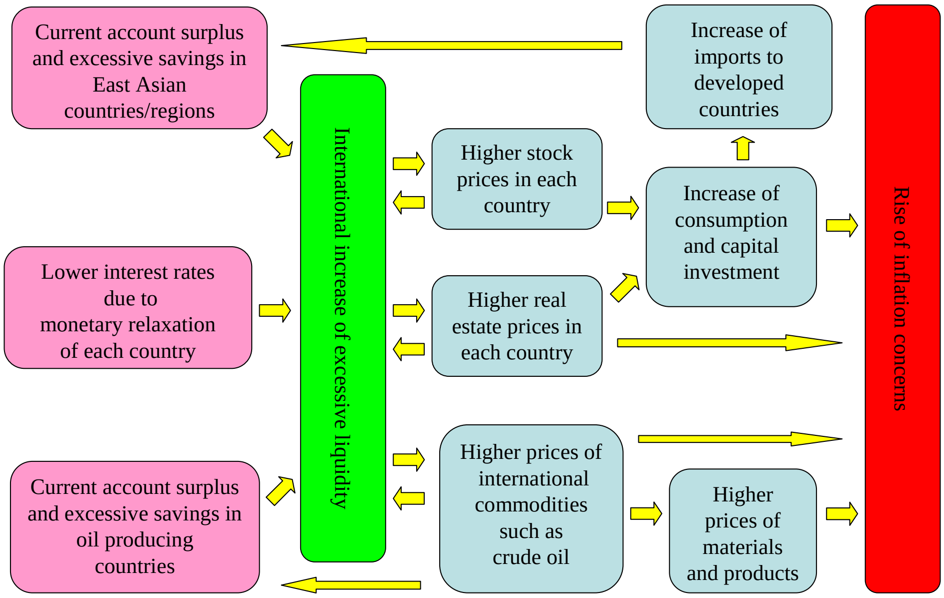
1 On the other hand, some problems have been pointed out with such an economic growth driven by investments, including overheated investments (see Section 3, Chapter 2).
2 To be analyzed in Section 2, Chapter 1.
3 To be analyzed in Section 3, Chapter 2.
4 To be analyzed in Section 3, Chapter 1.

accelerated the increase in excessive liquidity.

Thus "increases in international excessive liquidity" and "rises in asset prices" have surfaced in turn, leading to an increase in inflation pressure upon the international economy (Figure 1.1.8).

Figure 1-1-8 Pathways to inflation in the international economy



(Factors behind an increase in international excessive liquidity (1): monetary relaxation and long-term interest rates which have remained low for a long time)

The cause for an increase in international excessive liquidity to be pointed out first of all is the easing of monetary conditions in major countries (Figure 1.1.9).

All major countries, mainly the US, promoted the easing of financial conditions to stimulate the economy and reduce deflationary pressure, after the burst of IT bubble in 2001. The US lowered the policy interest rate to the historical low of 1.0%, while European countries lowered the policy interest rate for the Euro zone to 2.0%. Japan adopted the balance of current account with Bank of Japan as the main operating target for the adjustment of the financial market in March 2001 (quantitative relaxation policy), shifting from the uncollateralized call rate (overnight). Thus, drastic measures were taken for the easing of monetary conditions.

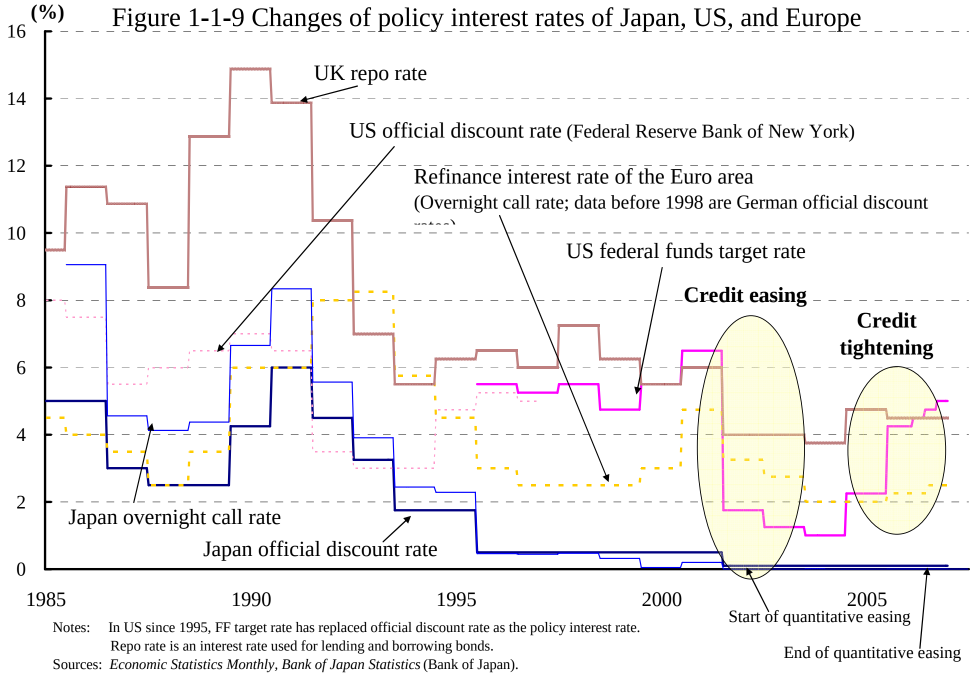
As a result of such low interest-rate policies, long-term interest rates of respective countries dropped to the historically lowest level (Figure 1.1.10), while world money supply dramatically increased, which created international excessive liquidity in and after 2001 (Figure 1.1.11). The "Marshallian K[5]" of Japan, the US and Europe, in particular, has been above the conventional trend

[5] "Marshallian k" is an indicator that shows whether or not a country's money supply (supply of currencies) is appropriate in relation to nominal GDP which represents the economic scale. By checking the deviation from the long-term trend line, we can judge whether or not the amount of fund

lines since 2001 (Figure 1.1.12).

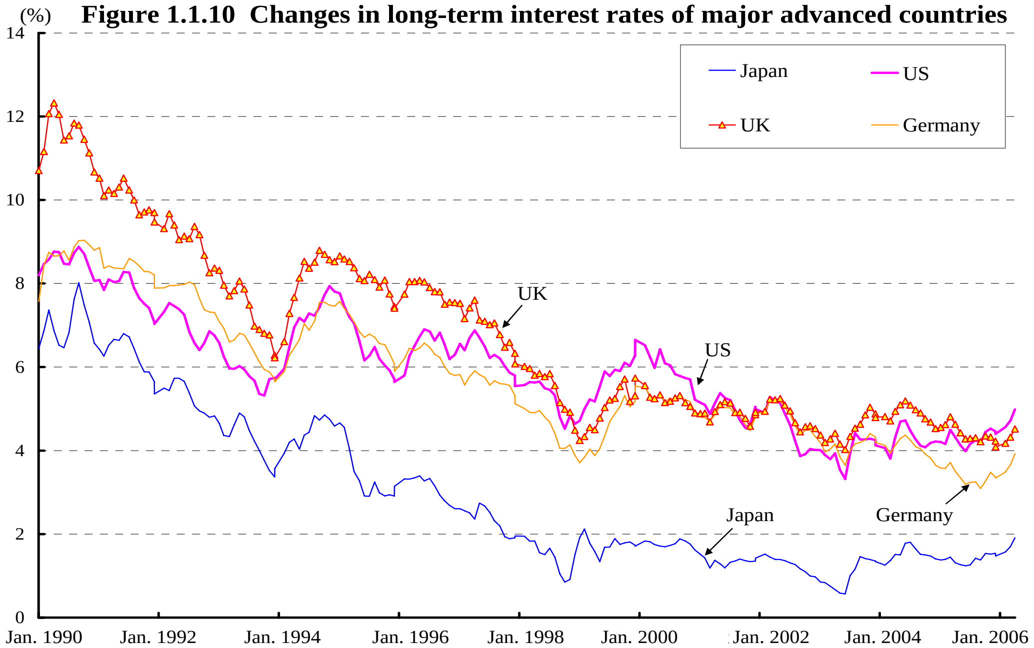
In the US where people have a high propensity to consume, in particular, easier fund raising owing to low interest rates and positive loan attitudes of financial institutions directly stimulated consumption and investments by families and companies. While this helped the growth of the international economy through an increase in outward investments and that in import of consumption goods, it largely increased the amount of fund flows in the world and became one of the factors causing international excessive liquidity.

Figure 1-1-9 Changes of policy interest rates of Japan, US, and Europe



Notes: In US since 1995, FF target rate has replaced official discount rate as the policy interest rate.
Repo rate is an interest rate used for lending and borrowing bonds.
Sources: *Economic Statistics Monthly*, *Bank of Japan Statistics* (Bank of Japan).

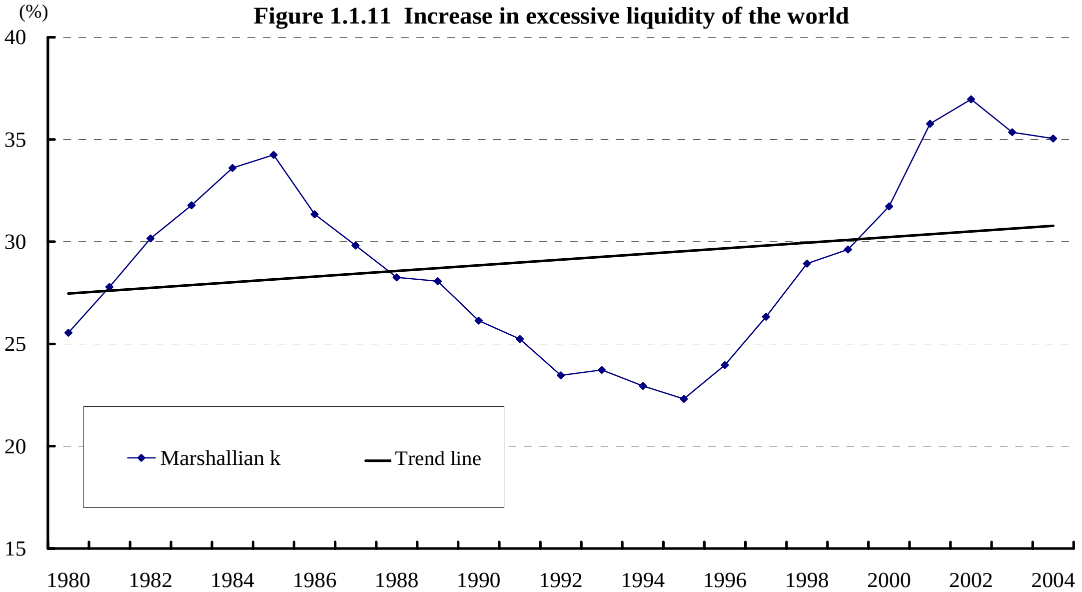
Figure 1.1.10 Changes in long-term interest rates of major advanced countries



Source: Bloomberg

supply is excessive. If it is above the trend line, it means that the amount of fund supply is excessive.

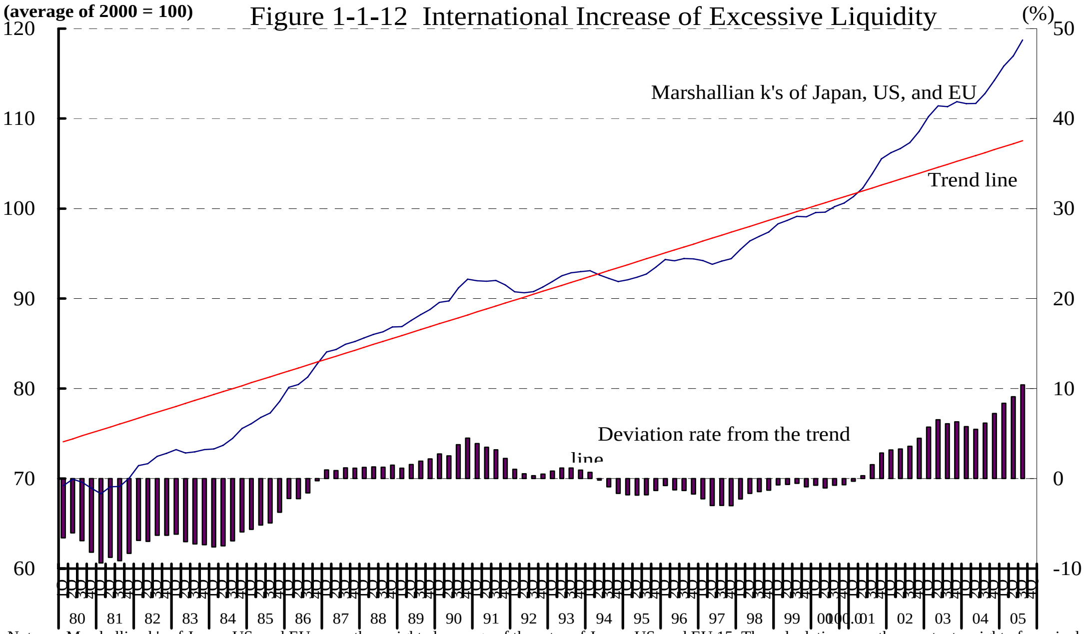
Figure 1.1.11 Increase in excessive liquidity of the world



Notes: Marshallian k of the world: M3 of the US + total foreign exchange reserves (EU15, Japan, Canada, Australia, China, ASEAN4, NIEs (excluding Taiwan), India, Saudi Arabia, UAE, Qatar, Kuwait, Algeria, Nigeria, Macao, Libya and Venezuela) divided by the total of nominal GDP of each country.

Source: *IFS* (IMF) and *WDI* (World Bank)

Figure 1-1-12 International Increase of Excessive Liquidity



Notes: Marshallian k's of Japan, US, and EU mean the weighted average of the rates of Japan, US, and EU 15. The calculation uses the constant weight of nominal GDP of 2001 to 2005 and sums up the Marshallian k's of the three countries/region. The Marshallian k of US uses deficits of companies and households instead of money supply (M3).

Source: "KAJOU RYUUDOUSEI / KAJOU CHOTIKU IZON NO SENSHINKOKU KEIZAI" (Mizuno, 2005).

(Factor behind an increase in international excessive liquidity (2): excessive savings in East Asian countries and regions, oil producing countries, etc.)

The second factor behind an increase in international excessive liquidity is excessive savings in East Asian countries/regions, oil producing countries, etc.

East Asian countries and regions have huge trade surpluses due to increased export to advanced countries reflecting brisk consumption in the US, so do oil producing countries due to crude oil prices which have soared and remained at a high level. On the other hand, domestic consumption and the expansion of investments have been lackluster in these countries, resulting in high savings rates. Consequently, a huge amount of current account surpluses which accumulated flowed into government bond markets in advanced countries such as the US treasury bond market mainly through the investment of foreign exchange reserves. Such an expansion of demands led to further lowering of long-term interest rates[6] in advanced countries.

Lower interest rates on government bonds in advanced countries often result in lower interest rates on corporate bonds which refer to interest rates on government bonds as a benchmark. Because of this, interest rates on borrowings by companies went down, resulting in even more international excessive liquidity through an increase in fund raising in advanced countries.

(Soaring prices on commodity, stock and real estate markets as a result of inflow of international excessive liquidity)

As downdrift in yields on bonds in industrial countries resulted in lower investment returns, part of international excessive liquidity flowed into (1) commodity markets such as oil markets in advanced countries, (2) stock markets and (3) real estate markets, in pursuit of higher returns, which partly promoted rises in prices on respective markets in and after 2002 (Figures 1.1.13 and 1.1.14).

The rises in commodity prices including crude oil prices caused rises in upstream material prices, which have been gradually passed on to downstream consumer prices, directly and indirectly putting increasing upward pressure on commodity prices.

Rises in stock prices caused further rises in market prices, by enhancing investment capacity of investors. Thus, stock prices in respective countries have maintained an upward trend since 2001. Such rises in stock prices have enhanced companies' ability to raise funds, accelerated investments and consumption by companies and caused increasing inflationary pressures.

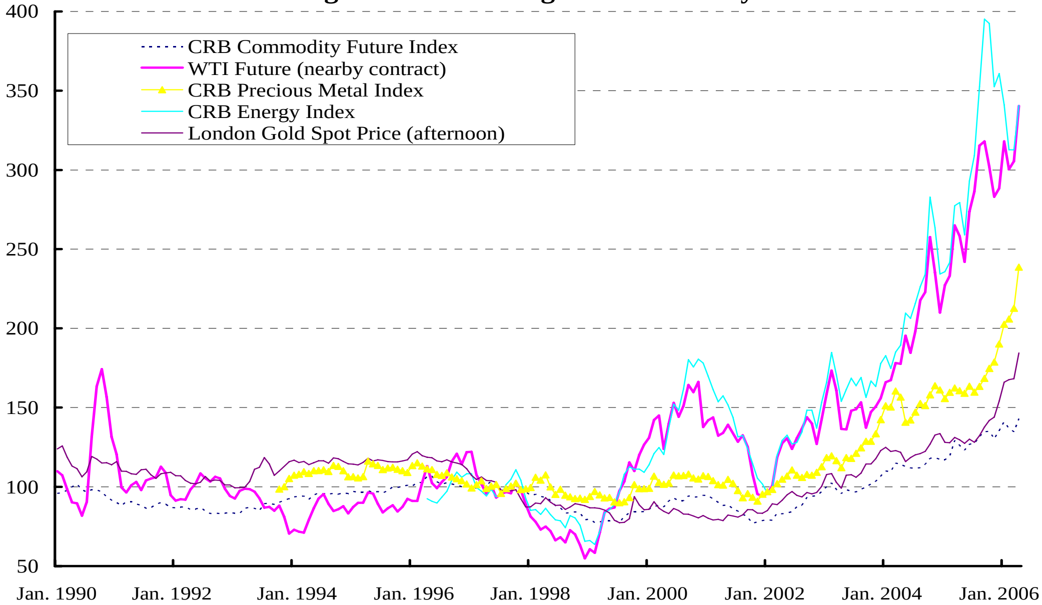
Rises in real estate prices directly put upward pressure on commodity prices, while increasing the amount that can be borrowed by families through expanding the margin of collateral and thus giving upward pressure on commodity prices through increased consumption.

In the meantime, such rises in asset prices have enhanced attractions of market through higher profitability and accelerated inflow of funds into respective markets, which has further increased international excessive liquidity. In other words, increases in excessive liquidity and rises in asset prices seem to have cyclically increased inflationary pressure.

[6] Foreign currency reserves are often held until redemption. Therefore, long-term bonds tend to be purchased rather than short-term bonds, because of the number of times of repurchasing and stable yields.

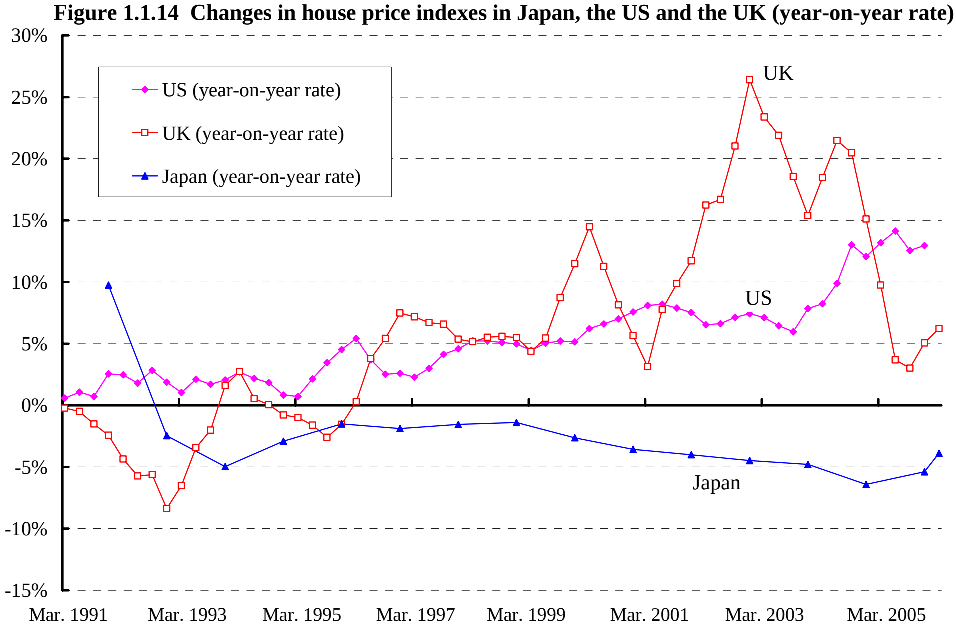
Figure 1.1.13 Changes in commodity indexes

(Average for 1997 = 100)



Source: Bloomberg

Figure 1.1.14 Changes in house price indexes in Japan, the US and the UK (year-on-year rate)



Source: *House Price Index* (Office of Federal Housing Enterprise Oversight), *Harifax Index* (HBOS), *Urban Land Price Index* (Research & Study Dept, Japan Real Estate Institute)

(Shift in financial policies in advanced countries and suppressing of inflationary pressure in the US and UK)

The US and Europe are aiming to suppress inflation and realize a soft landing of the economy by raising the policy interest rates recently to raise long-term interest rates, for fear of inflation being caused by rises in commodity and asset prices including oil prices.

To be concrete, Federal Open Market Committee (FOMC) of the US started raising the policy interest rate in June 2004. It was raised gradually from 1.0% in June 2003 to 5.0% in May 2006. In Europe, as well, the European Central Bank (ECB) started raising the policy interest rate in December

2005, and the rate went up from 2.0% in June 2003 to 2.5% in May 2006.

In Japan, it was decided at Monetary Policy meeting of Bank of Japan in March 2006 that the "policy of quantitative easing" would be abandoned, with the uncollateralized call rate (overnight) applied again as the main operating target in the adjustment policies for the financial market.

Reflecting such developments, long-term interest rates of respective countries, which were slow in responding in 2004 to 2005 when tight policies were introduced first[7], started rising gradually[8]. Because of this, it is possible that international excessive liquidity will start shrinking.

On the other hand, some experts point out that it is difficult to reduce excessive liquidity despite these tight policies. They claim that (1) it is difficult to reduce money supply volume to an appropriate level in a short time span, for international excessive liquidity is at an extremely high level because of easy-money policies which had been maintained for many years (Figure 1.1.15), (2) funds generated by significant current account surpluses in East Asian countries and regions such as China, as well as new oil money created by crude oil prices which have soared and remained at a high level, will flow back into the US further because of the raising of interest rates in the US, and (3) it is difficult for different countries to introduce uniform tight policies because of differences in economic cycles, although for tightening the money market, it is effective for fund suppliers of respective nations to carry out tight policies in harmonization[9].

Thus, it is unpredictable whether or not international excessive supply of funds is controlled. It is necessary to pay close attention to future developments in inflationary pressure (Figure 1.1.16).

On the other hand, if monetary tightening works to an excessive degree, it will result in the burst of bubble economy due to a rapid shrinkage of international excessive liquidity, which could lead to the downturn of the world economy, like the ones we experienced in Mexico Crisis from 1994 to 1995 and when IT bubble burst in 2000. Careful attention must be paid to this problem, as well.

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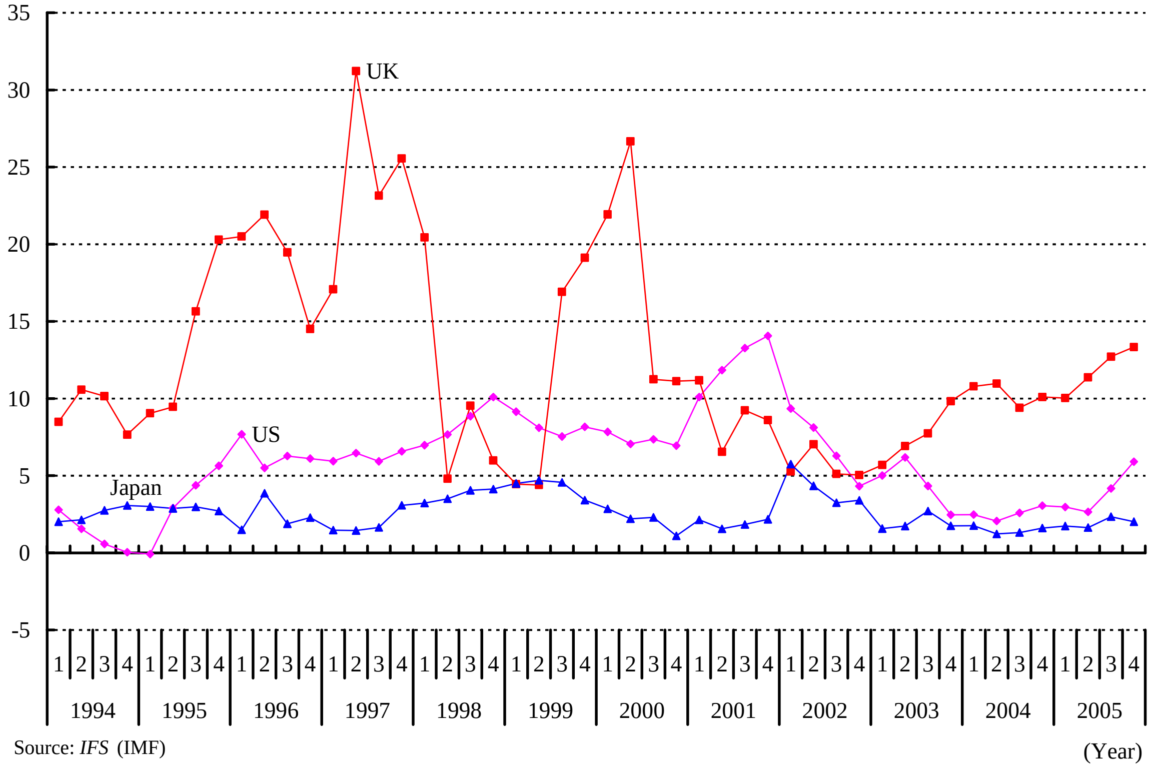
[7] At the FRB semiannual Monetary Policy Report to the Congress in February 2005, Mr. Greenspan, the then chairman of FRB, called long-term interest rates remaining at a low level despite the worldwide upward trend of policy interest rates a "conundrum." Possible causes for the "conundrum" include the inflow of funds into long-term government bonds from current account surpluses in East Asian countries and regions which could not be suspended.

[8] In Japan, as well, the long-term interest rate started rising in March 2006, and have remained around 2% (as of May 16).

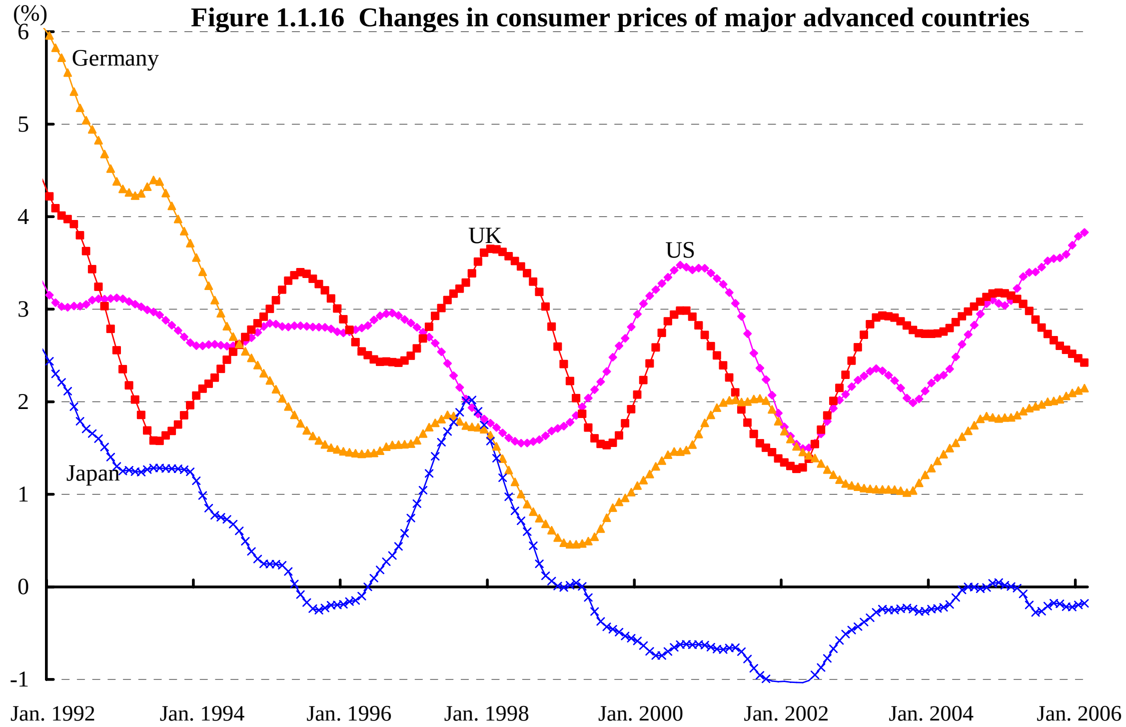
[9] Theoretically speaking, it is possible to eliminate dollar surpluses by raising interest rates of the US alone (due to arbitration of exchange, the interest rates of different countries will become substantially the same as those on dollars). However, the exchange rate is not determined by the difference in interest rates alone, as shown by the existence of an investment method called yen carry trade (yen funds with lower interest rates are raised and invested in dollar bonds, etc. with higher interest rates). Therefore, interest rate policies based upon harmonization among different countries seem effective for reducing international excessive liquidity.

(%) **Figure 1.1.15 Changes in money supply (currencies and quasi-currencies) of Japan, US and UK (year-on-year rate)**



Source: *IFS* (IMF)

Figure 1.1.16 Changes in consumer prices of major advanced countries



Notes: The centralized moving average for twelve months of consumer prices compared with the previous year is calculated.
Source: *IFS* (IMF)

2. Trends in the world economy by region

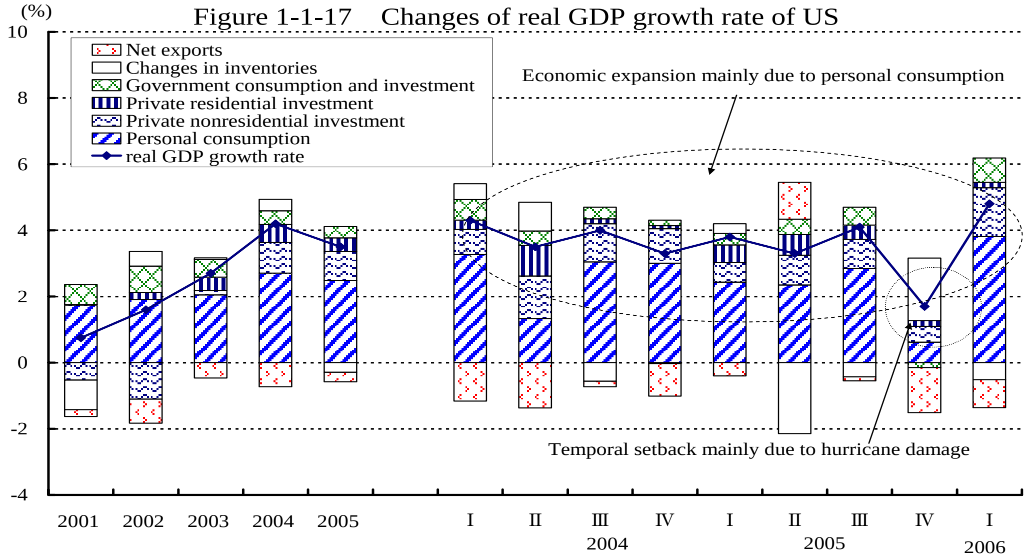
In this section, we will review recent trends in the world economy by region.

(1) US economy expanding despite a current account deficit

(Expanding U.S. economy)

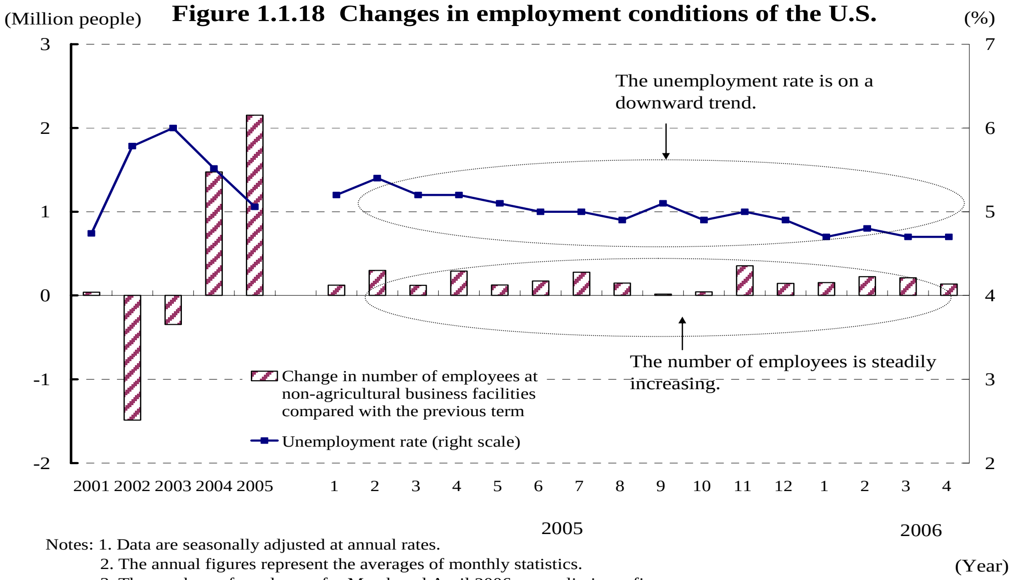
The U.S. economy expanded in 2005 supported by robust personal consumption (Figure 1.1.17)[10]. The employment environment continued to show favorable developments, including a continued increase in employment at non-agricultural business facilities and lower unemployment rates (Figure 1.1.18).

Figure 1-1-17 Changes of real GDP growth rate of US



Note: Data are seasonally adjusted at annual rates, based on comparison with the revious term. Data for the first quarter of 2006 are preliminary.
Source: Websites of Bureau of Economic Analysis (BEA), US Department of Commerce.

Figure 1.1.18 Changes in employment conditions of the U.S.



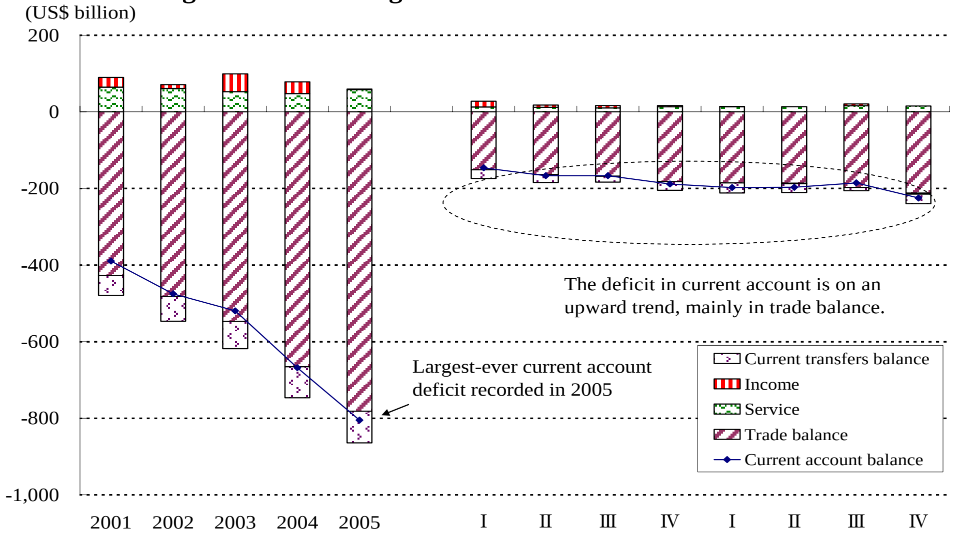
Notes: 1. Data are seasonally adjusted at annual rates.
2. The annual figures represent the averages of monthly statistics.
3. The numbers of employees for March and April 2006 are preliminary figures.
Source: Websites of Bureau of Labor Statistics (BLS), US Department of Labor

10 The economic growth temporarily slowed down in the fourth quarter of 2005 due to the large hurricane damage, etc. but recovered in the first quarter of 2006.

(Rising current account deficit)

The current account deficit of the U.S. continued to expand, reaching the record high in 2005 (Figure 1.1.19). The most of it consisted of a deficit in trade account. By exporter country, deficits with European countries as well as Asian and oil producing countries are significant. In particular, the deficit with China accounts for about one quarter of the total trade deficit. The issue of current account imbalance of the U.S. will be explained in detail in the following section.

Figure 1.1.19 Changes in current account balance of the U.S.

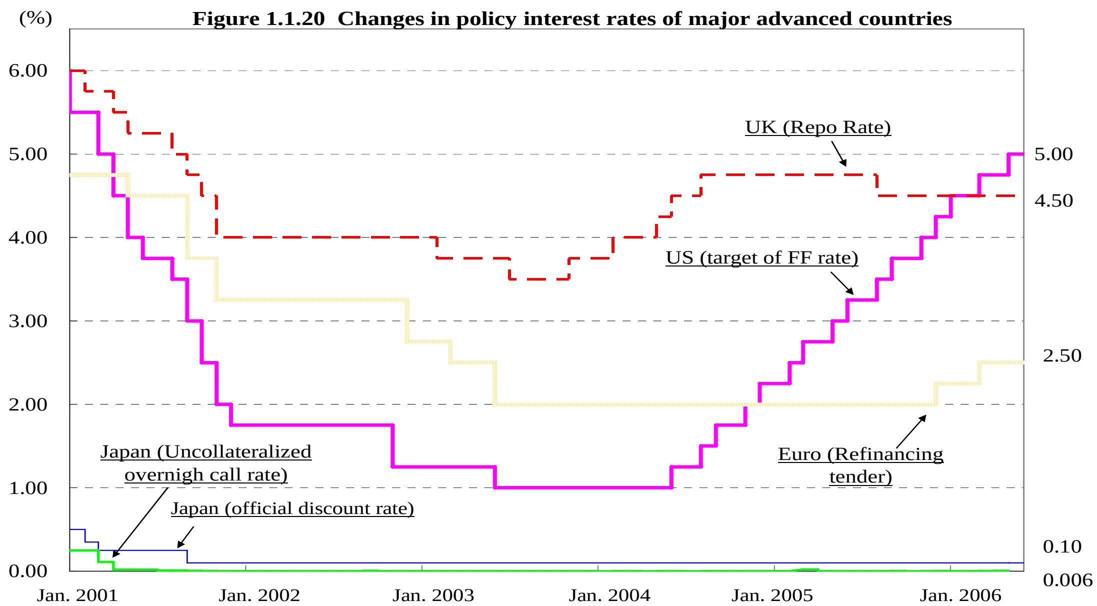


Note: The figures for 2005 are preliminary.
Source: Websites of Bureau of Economic Analysis (BEA), US Department of Commerce

(Inflationary concerns and raising of policy interest rate)

The Federal Reserve Board (FRB) of the US raised the policy interest rate by 0.25% sixteen times, or by 4% in total, during the period from June 2004 to May 2006 (Figure 1.1.20), out of concern about possible rises in consumer prices due to surges in, and continued high levels of, crude oil prises.

Figure 1.1.20 Changes in policy interest rates of major advanced countries

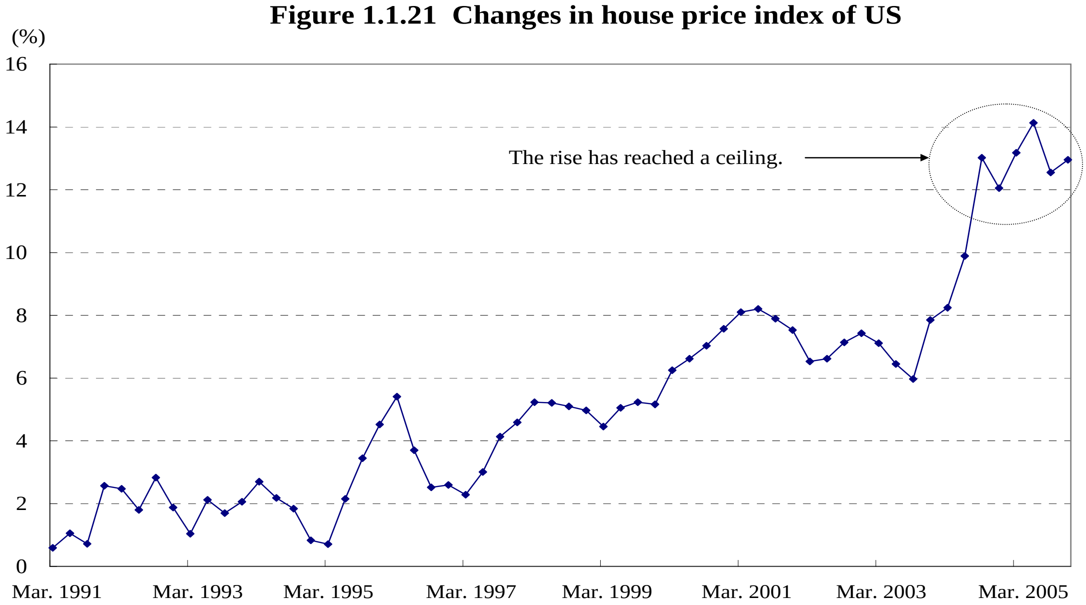


Source: *KINYU KEIZAI TOKEI GEPPO* (Bank of Japan)

(Trends in housing market)

The brisk housing market has supported the economy so far, but now shows a sign of slowdown due to an upward trend in the policy interest rate. The rise in house prices, which stimulated consumption by increasing the amount which families can borrow, seems to have reached a ceiling in 2005 (Figure 1.1.21). In the meantime, the number of houses constructed remained at a high level in 2005, while house sales showed a sign of decline from the end of 2005 to 2006. This will be detailed in the following section.

Figure 1.1.21 Changes in house price index of US



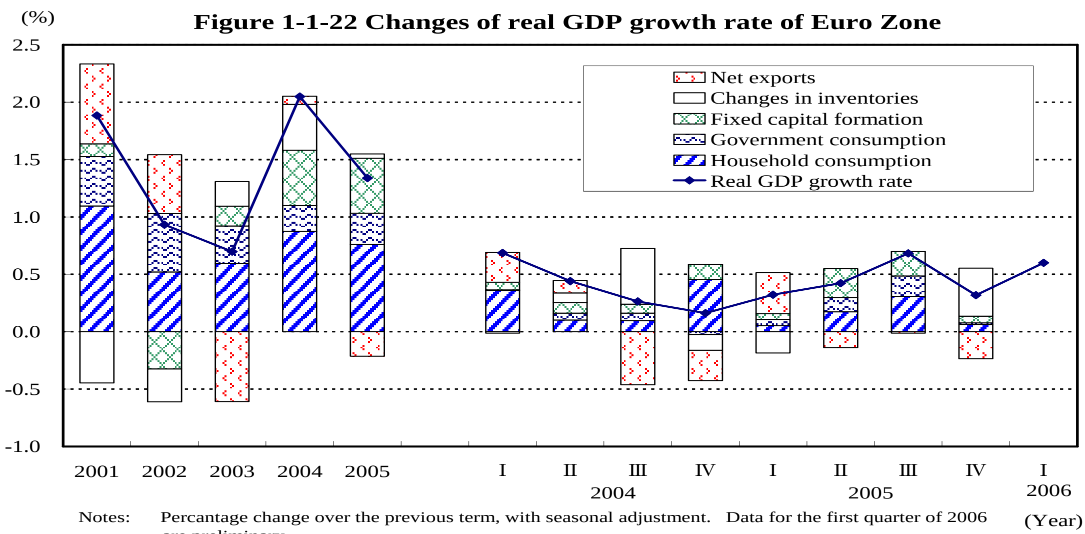
Note: Year-on-year rate
Source: Websites of Office of Federal Housing Enterprise Oversight

(2) European economy gradually recovering

(European economy gradually recovering)

The European economy continues to show **gradual recovery** (Figure 1.1.22).

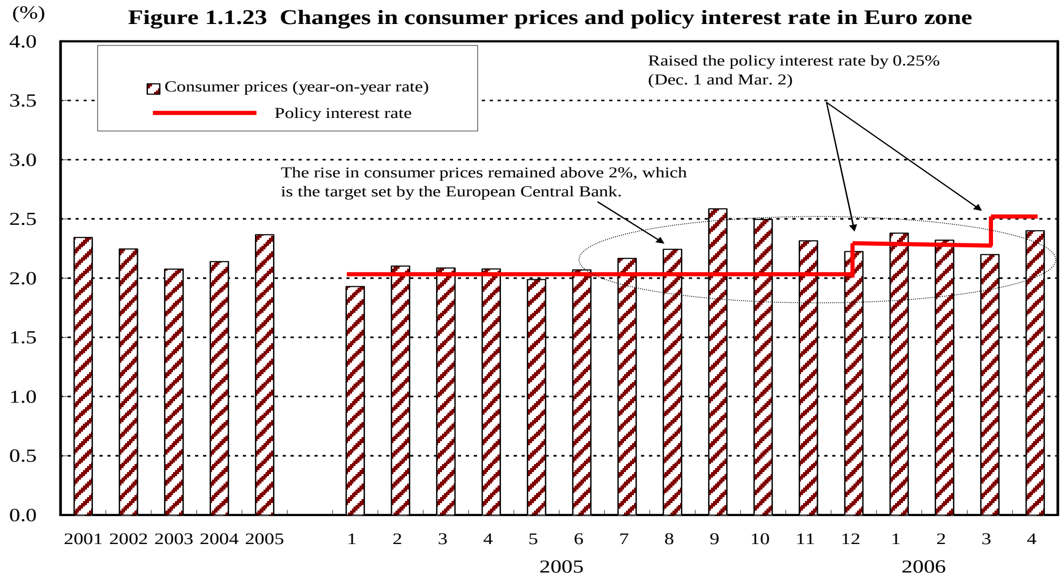
Figure 1-1-22 Changes of real GDP growth rate of Euro Zone



Notes: Percantage change over the previous term, with seasonal adjustment. Data for the first quarter of 2006 are preliminary.
Sources: Eurostat Websites; *KAIGAI KEIZAI DATA* (Cabinet Office, Government of Japan)

In the second half of 2005, the consumer prices in the Euro zone grew over 2%[11], which is the target set by the European Central Bank (ECB), reflecting crude oil prices which have surged and remained at a high level (Figure 1.1.23). Under such circumstances, the ECB raised the policy interest rate on December 1, 2005 for the first time in about five years. The ECB raised the rate again on March 2, 2006.

Figure 1.1.23 Changes in consumer prices and policy interest rate in Euro zone

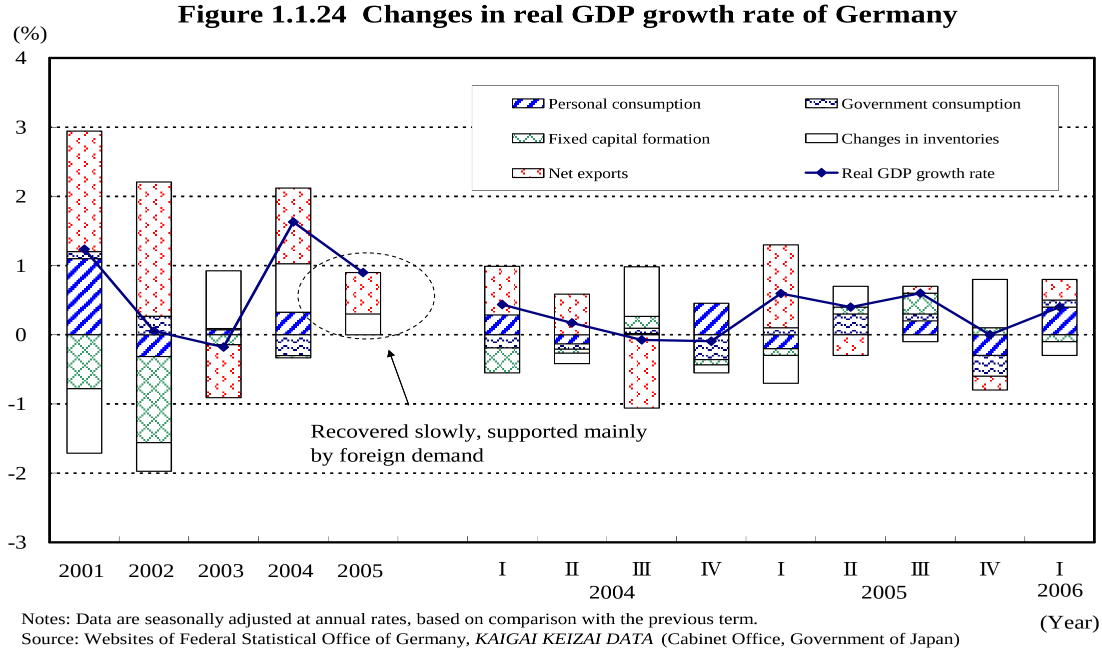


Source: Eurostat Website, Data for April 2006 are preliminary.

(German economy slowly recovering mainly in the corporate sector)

The German economy slowly recovered in 2005, supported mainly by foreign demands (Figure 1.1.24). It should be noted, however, that the unemployment rate remains at a high level reflecting restructuring of companies, etc., which has delayed the recovery of personal consumption.

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)

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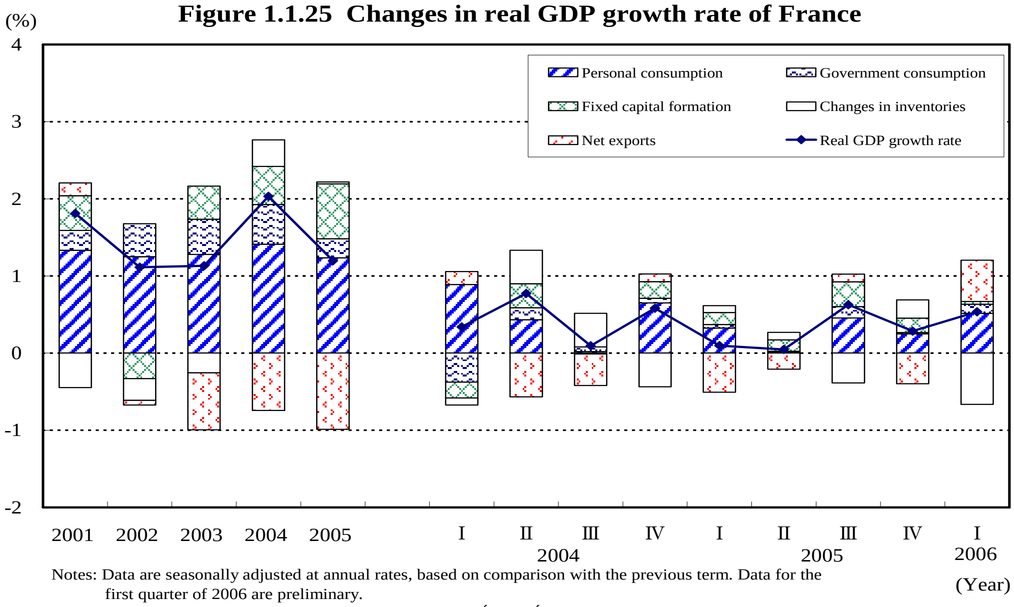
11 The European Central Bank aims to maintain the year-on-year growth of consumer prices in the Euro zone at under 2% but close to 2%.

(French economy slowly recovering)

The French economy slowly recovered in 2005 (Figure 1.1.25). Personal consumption showed lackluster developments in the first half of the year, due to deteriorated consumer sentiment caused by higher crude oil prices and the rise in the unemployment rate. In the second half, however, the unemployment rate showed a sign of recovery, while personal consumption improved. In October 2005, however, a riot was caused mainly by low-income groups troubled with the high unemployment rate in provincial cities. Furthermore, a nationwide demonstration broke out in 2006, against the system of trial periods[12] under the new employment law. We need to observe carefully how such problems relating to employment will affect the French economy in the future.

Figure 1.1.25 Changes in real GDP growth rate of France



Notes: Data are seasonally adjusted at annual rates, based on comparison with the previous term. Data for the first quarter of 2006 are preliminary.
Source: Websites of Institut National de la Statistique et des Études Économiques (INSEE)

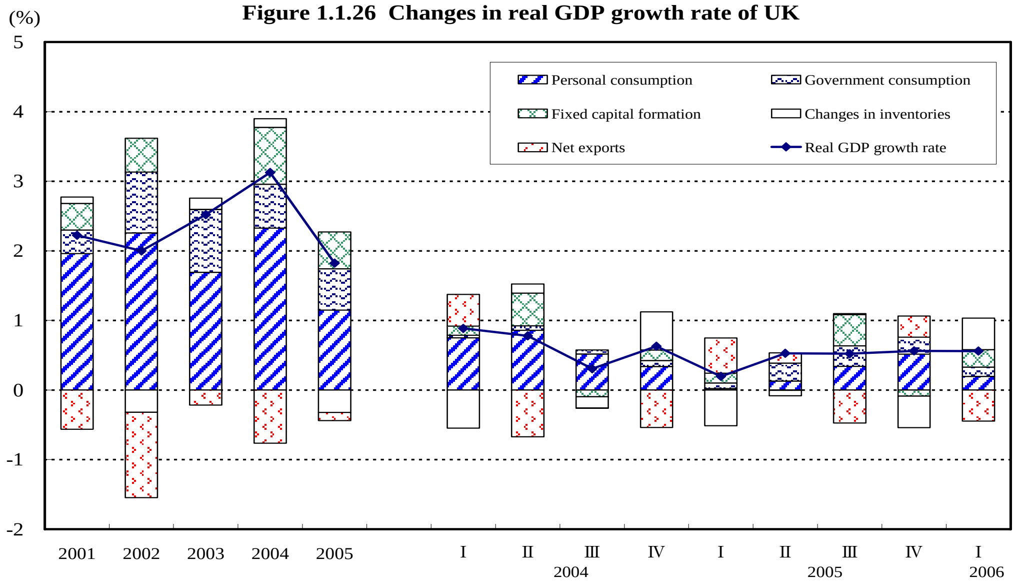
(Recovering UK Economy)

The economy of the U.K. recovered in 2005 (Figure 1.1.26).

The Bank of England (central bank of the U.K.) raised the policy interest rate by 1.25% in total during the period from November 2003 to August 2004, to cope with inflationary risks including the sharp rise in house prices. While the rise in house prices was controlled, it slowed down personal consumption, and the policy interest rate was lowered in August 2005.

[12] It is a system to set a two-year probationary period, during which employers are allowed to dismiss any of new young employees without presenting the reasons. The system was to be introduced because of the recognition that under the current system, it was difficult for companies to dismiss employees, which has caused the rigidity of the labor market leading to reluctance of companies to employ new workers. On the other hand, non-government parties and labor unions opposed the idea, claiming that the system would destabilize the employment of young people. The plan was announced in January 2006, but withdrawn on April 10.

Figure 1.1.26 Changes in real GDP growth rate of UK



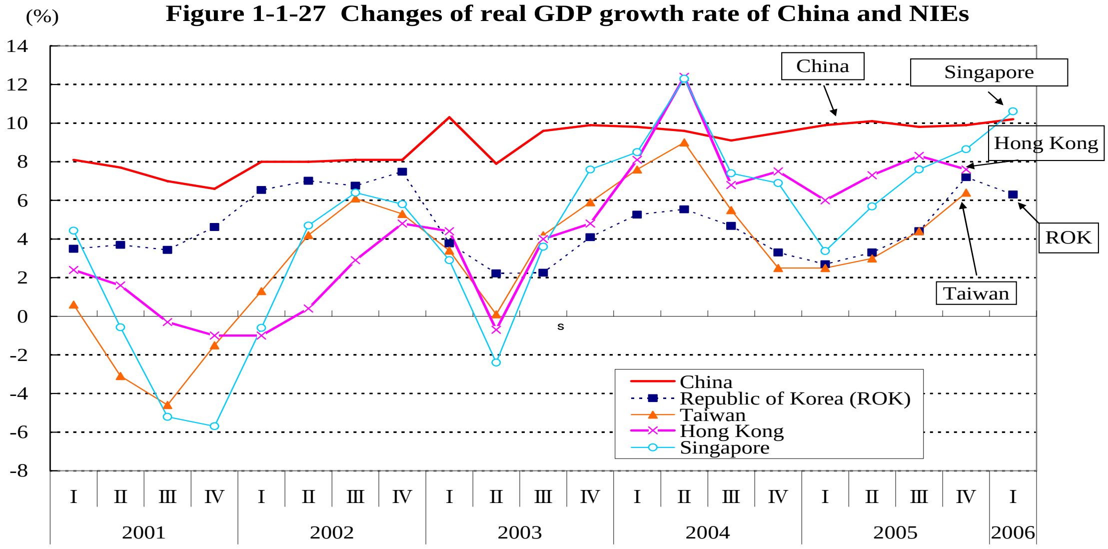
Notes: Data are seasonally adjusted at annual rates, based on comparison with the previous term. Data for the first quarter of 2006 are preliminary.
Source: Websites of Office of National Statistics of UK

(3) Expanding Asian economy

(Chinese economy continuing to expand)

The Chinese economy has continued to expand (Figure 1.1.27). The real GDP growth rate reached 9.9% in 2005, recording a high growth of around 10% for three consecutive years. On the other hand, some problems have been pointed out, including overheated investments, unemployment, income disparities and the exchange system. These problems will be discussed in Section 3, Chapter 2, together with ASEAN4.

Figure 1-1-27 Changes of real GDP growth rate of China and NIEs



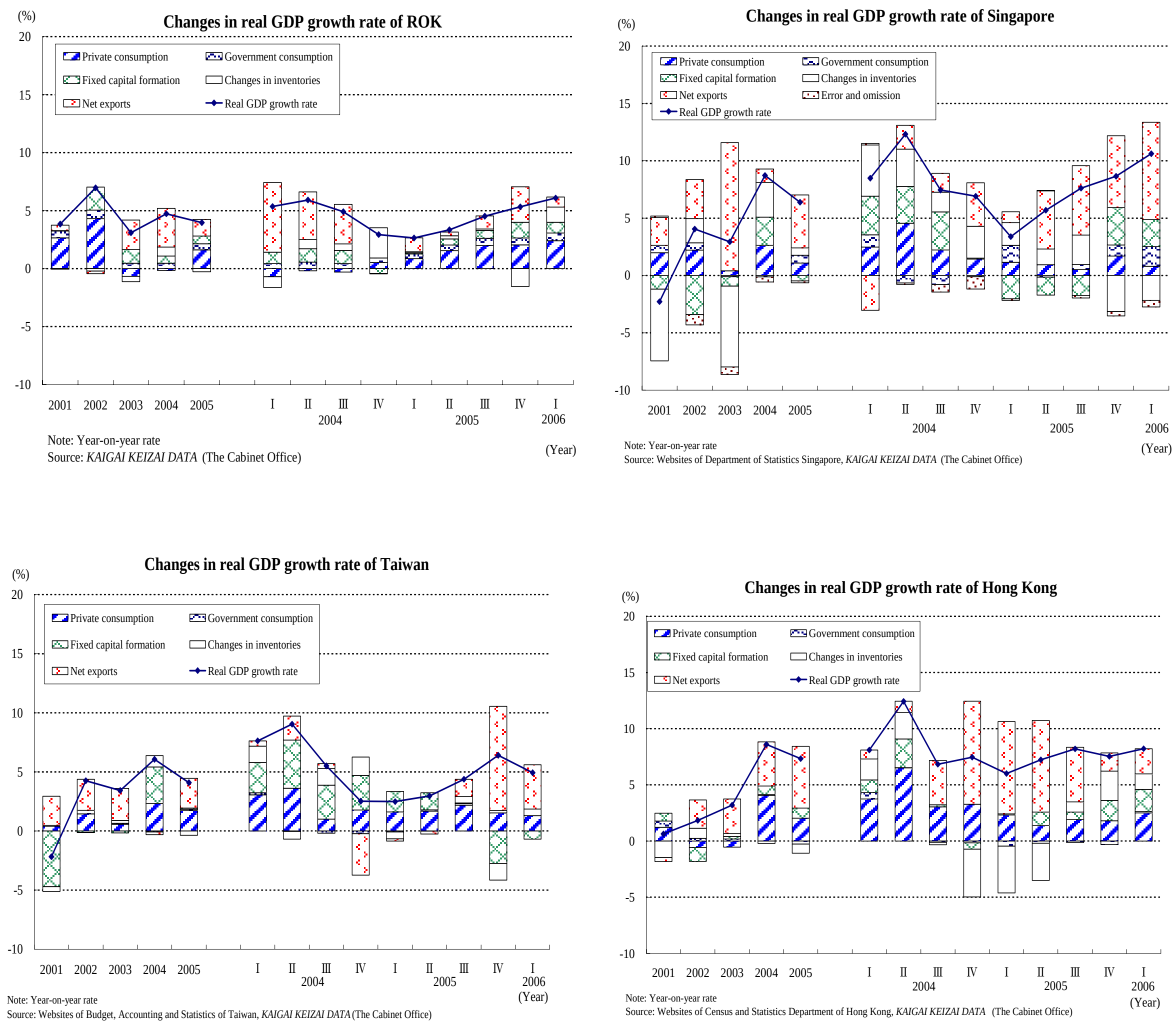
Notes: 1. Compared with the same quarter of previous year.
2. Data of China: quarterly data of 2005 are revised figures based on the national economic survey released in January 2006. Quarterly data of 2001 to 2004 are un-revised, as only the revision of annual data are published .
Source: *KAIGAI KEIZAI DATA* (The Cabinet Office).

(Expanding NIEs economy)

The economies of NIEs countries and regions expanded in 2005 (Figure 1.1.28). In Republic of Korea (ROK), the recovery had been driven by foreign demands. In 2005, however, personal consumption showed signs of slow recovery. In Singapore, export slowed down due partly to worldwide inventory adjustments of IT-related goods in the first half of 2005, which resulted in sluggish fixed capital formation. In the second half, however, fixed capital formation revived, while personal consumption started recovering. In Taiwan, export slowed down due partly to worldwide inventory adjustments of IT-related goods in the first half of 2005, but recovered in the second half. Hong Kong enjoyed a steady growth in export mainly to China in 2005.

In the meantime, surges and continued high levels of crude oil prices can be a factor to push down an economy. The effects of higher oil prices, however, are different in each Asian county or region, depending on the reliance upon oil and different energy efficiencies. Such effects are small in Singapore and ROK for the present. This will be discussed in detail in Section 3, Chapter 1.

Figure 1.1.28 Changes in real GDP growth rates of NIEs countries and regions



(Economies of ASEAN4 which are expanding but could be affected by crude oil prices, etc.)

The economies of ASEAN4 expanded in 2005 (Figure 1.1.29), but some concerns have been expressed about crude oil prices remaining at higher levels, which could affect the economies or cause social unrest.

Although Indonesia enjoyed a continued growth, it was faced with a sharp rise in consumer prices due to higher crude oil prices, which, along with higher interest rates, negatively affect the economic growth. Amid such circumstances, the unemployment rate remains at a high level[13]. In the meantime, some experts express concerns about damages caused by avian influenza, impacts by the terrorist bombing in Bali in October 2005 on the sightseeing business, and damages caused by the earthquake in Java in May 2006.

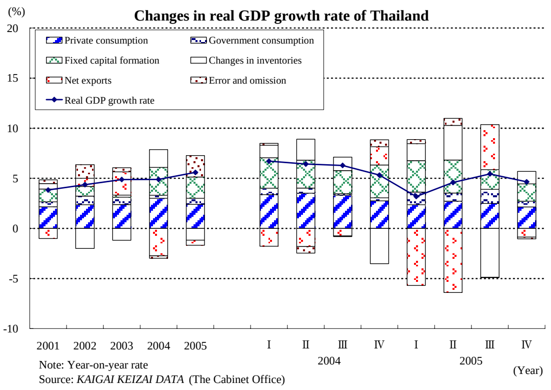
In Malaysia, export slowed down in the first half of 2005, mainly in IT-related goods, while personal consumption became less active due to higher consumer prices. Thus, the economic growth has become slower.

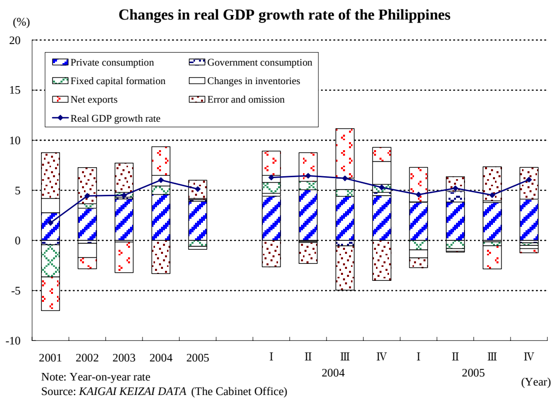
In the Philippines, export, mainly that of IT-related goods, slowed down in 2005 while import expanded due to higher crude oil prices. Some concerns have been expressed about public security, as a state of emergency was declared in response to the revelation of a coup d'état plot in February 2006.

In Thailand, export of IT-related goods slowed down in 2005, while import expanded due to higher oil prices. The country was troubled with damages caused by the tsunami in the wake of the earthquake off the coast of Sumatra, as well as stagnancy in sightseeing and agricultural industries due to the avian influenza. Furthermore, some concerns have been pointed out about the deterioration of public security in three prefectures in the southern part of the country. Earlier in 2006, the political situation fell into disorder, due to the suspicion about stock selling by relatives of the prime minister.

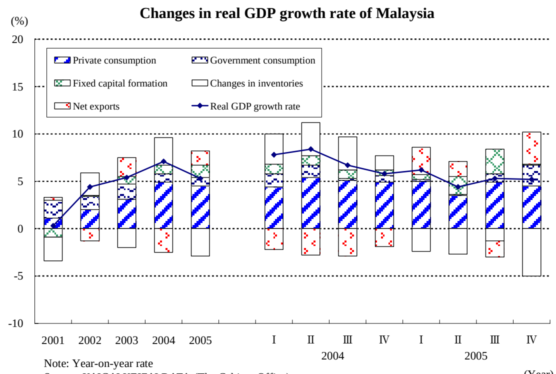
The economic impacts of surged crude oil prices upon ASEAN4 countries will be discussed in detail in Section 3, Chapter 1.

Figure 1.1.29 Changes in real GDP growth rates of ASEAN4 countries

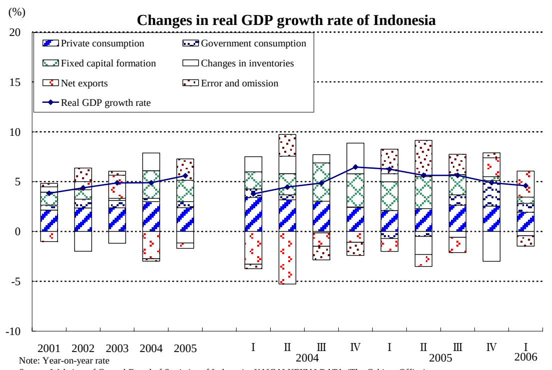




[13] To be analyzed in Section 3, Chapter 2.



Note: Year-on-year rate
Source: *KAIGAI KEIZAI DATA* (The Cabinet Office)

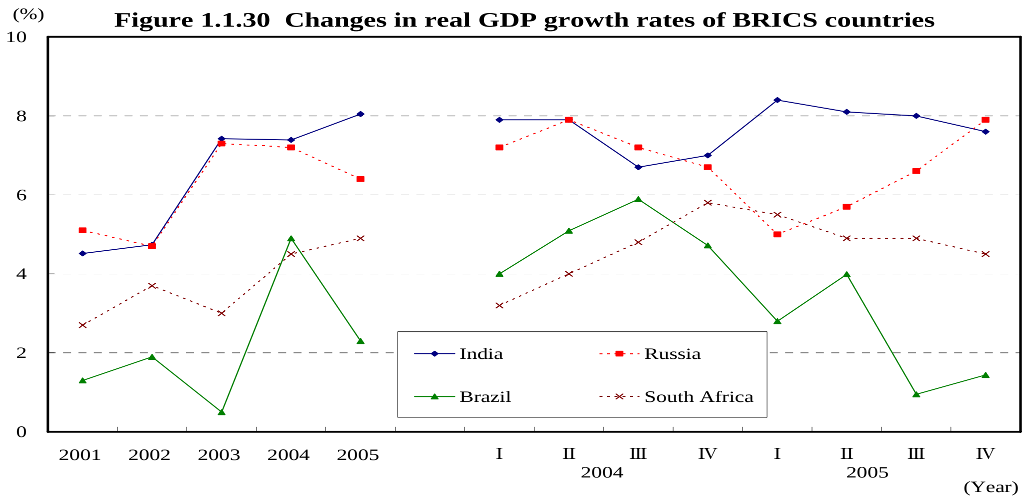


Note: Year-on-year rate
Source: Websites of Central Board of Statistics of Indonesia, *KAIGAI KEIZAI DATA* (The Cabinet Office)

(4) Strong BRICS[14] economy

The BRICS economies generally remained strong in 2005. India maintained a high growth owing to favorable performance of manufacturing and service industries including the software industry[15]. Russia recorded expanded export reflecting crude oil prices remaining at higher levels, while domestic consumption and capital investments remained in good shape. South Africa also remained stable. Brazil, however, showed a slightly lower growth in the second half of 2005 (Figure 1.1.30), though it managed to maintain a positive growth.

Figure 1.1.30 Changes in real GDP growth rates of BRICS countries



Notes: Year-on-year rate. The annual growth rates of India have been calculated based upon the quarterly data.
Source: *KAIGAI KEIZAI DATA* (The Cabinet Office), Websites of statistics bureaus of respective countries

(5) LDC economy still in difficult conditions and "A Product from Every Village" campaign

While some of the countries have succeeded in achieving an economic growth, many of the LDC[16] countries remain in economically difficult conditions.

Reportedly, "absolutely poor population" who lives with less than a dollar per day reaches about 1.2 billion. Under such circumstances, the "A Product from Every Village" campaign[17] has been launched to vitalize LDCs.

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14 China is excluded as explanation about the country was given in (3).

15 The growth of India will be analyzed in Section 1, Chapter 2.

16 LDCs, or least developed countries, refer to countries whose development has been particularly delayed. The UN defines an LDC as a country with GNI per capita of US$ 750 or less and a population of 75 million or less.

17 To be explained in Section 1, Chapter 3 (Figures 3-1-41, 3-1-42, 3-1-43, 3-1-44, etc.)

3. Shift of focus of the international economy to services and intensified competition for human resources

As a result of the maturing of international economy, importance has been attached even more to services in the international economy, and the impacts caused by service industries upon the overall economy have become increasingly significant. As a result, the improvement of productivity in service industries has become an important task for each nation.

In the meantime, the sophistication of economic activities has made it essential how to "invest excellent human resources in economic activities," which has triggered intensified global competition for human resources.

(1) Progress of shift of priority in the economy to services

The phenomena of the priority in economic activities shifting from agriculture, forestry and fishery (primary industries) to manufacturing industries (secondary industries), and then to non-manufacturing industries (service industries, or tertiary industries) along with economic developments is called the "Petty-Clark's law"[18] In the actual international economy, too, such a shift is observed mainly in advanced countries, while it is not so apparent in developing nations which are now going through economic developments. However, such phenomena are likely to accelerate in the future in developing countries, as well[19].

The proportion of tertiary industries to GDP[20] is over 60% in advanced countries, and it is on an upward trend on an international level (Figure 1.1.31). In particular, China, which continues to enjoy a rapid economic growth, is shifting priority in economic activities to service industries at a fast pace. The importance of tertiary industries is increasing also in employment, making them even more important for the whole economy (Figure 1.1.32).

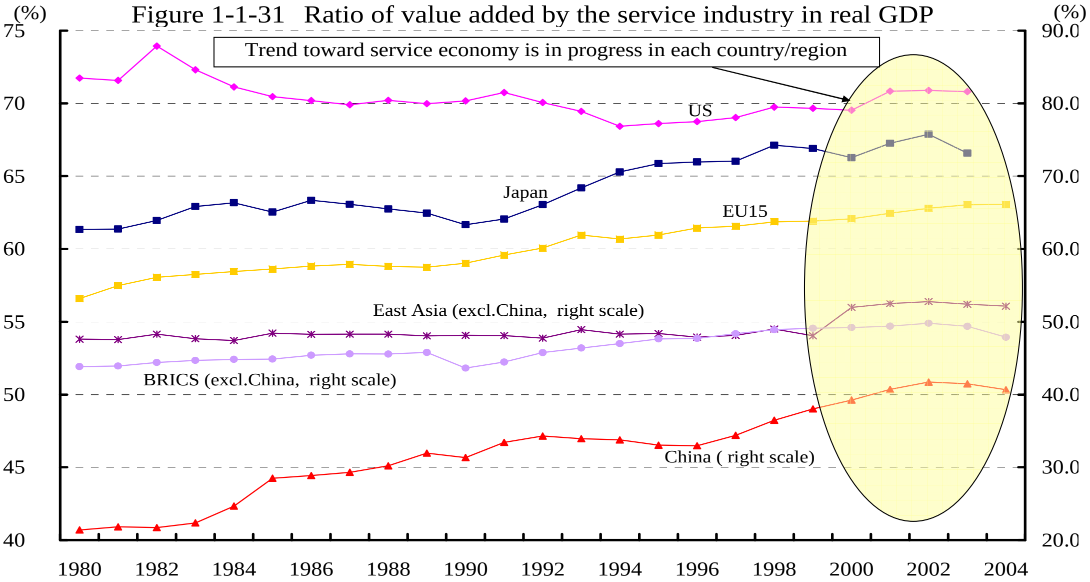
From a viewpoint of productivity, per capita added value in service industries is increasing mainly in advanced countries (Figure 1.1.33). The improvement of productivity in the service sector has become an important issue affecting the productivity of the whole economy for respective countries.

[18] The law shows that priority in economic activities moves successively to tertiary industries because (1) labor force moves to industries with higher profitability, while the profitability of secondary industries is higher than that of primary industries, and that of tertiary industries is higher than that of secondary industries, and (2) demand for products produced in primary and secondary industries, such as foods and industrial goods, is satisfied when a sufficient amount of products prevail in the country along with economic developments, resulting in increased demand for services provided by tertiary industries.

[19] Shift of emphasis in economy to service industries in East Asian countries and regions will be analyzed in Section 1, Chapter 2.

[20] The shares of service industries in the input of intermediate goods in the manufacturing industries will be analyzed in Section 1, Chapter 2.

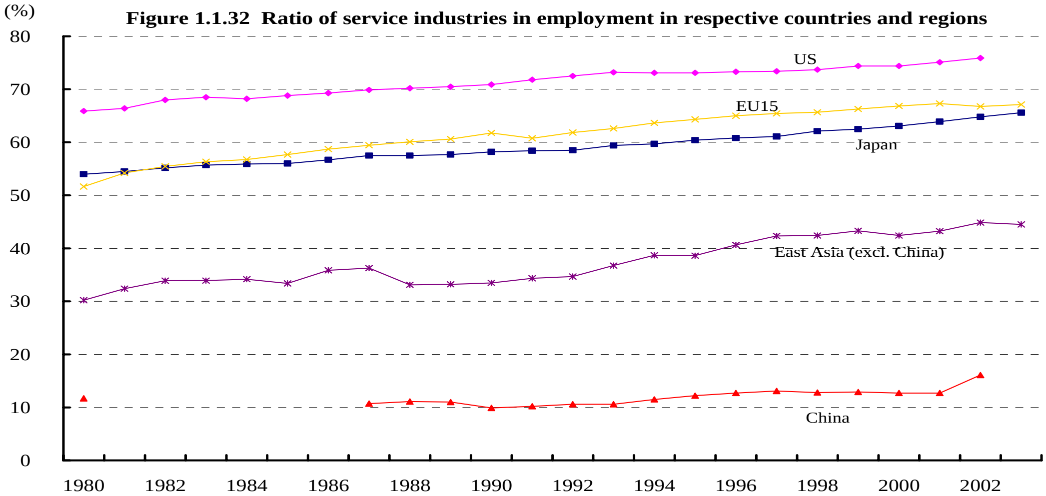
Figure 1-1-31 Ratio of value added by the service industry in real GDP



Notes: 1. East Asia (excl. China) includes ROK, Hong Kong, Singapore, Indonesia, Malaysia, Philippines, and Thailand. BRICS (excl. China) includes Brazil, Russia, India, and South Africa.
2. Countries with deficient data are excluded.

Sources: *WDI* (World Bank); *China Statisical Yearbooks* (National Bureau of Statistics of China).

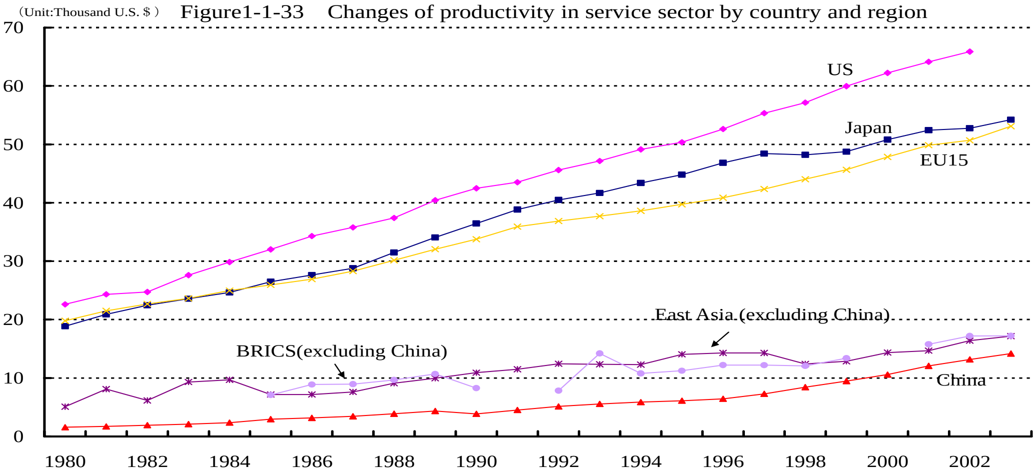
Figure 1.1.32 Ratio of service industries in employment in respective countries and regions



Notes: 1. East Asia (excl. China) refers to ROK, Hong Kong, Singapore, Indonesia, Malaysia, Philippines and Thailand.
2. Countries and years with deficient data are excluded.

Source: *WDI* (World Bank)

（Unit:Thousand U.S. $） Figure1-1-33 Changes of productivity in service sector by country and region



Note: 1． Productivity is based on added value per capita (PPP base).
2． East Asia (excluding China) means ROK, Hong Kong, Singapore, Indonesia, Malaysia,Philippine, Thailand.
BRICS(excluding China) means Brasil, Russia, India, South Africa.
3． Countries and years with deficient data are excluded.
Source: *WDI* (World Development Bank),*China Statistical Yearbooks* (National Bureau of Statistics of China)

(2) Intensification of "competition for human resources"

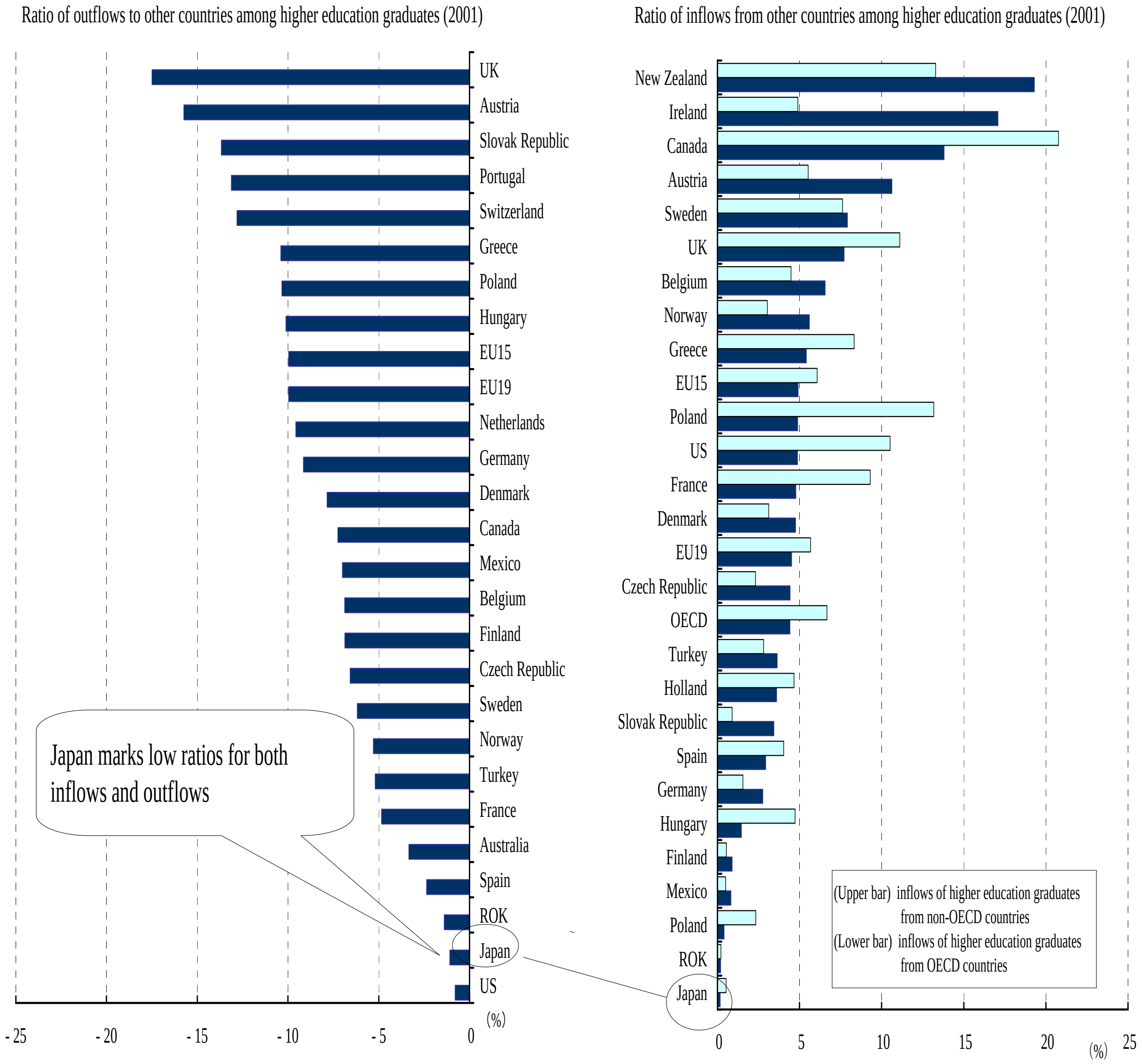
In order to improve productivity, "how to invest many excellent human resources in economic activities" has become important. The progress in globalization has activated international movements of people, which has resulted in internationally intensified "competition for human resources" aiming to secure excellent human capital.

To be concrete, in addition to competition for acquiring excellent human resources from other countries as shown by the activation of international movements of human resources, priority is being given to the training of human resources, including domestic education and training as well as overseas education of staff members (implementation of overseas education and training by private companies).

An analysis of proportions of inflows from other countries and outflows into other countries to total numbers of highly educated persons in OECD countries (Figure 1.1.34) shows that about 10% of highly educated people in advanced countries move beyond national borders, suggesting that there is a borderless competition for acquiring human resources. In the meantime, the proportions of both inflow into and outflow from Japan are at a low level. This makes it important to make efforts in the future for effective use and fostering of human resources[21].

[21] To be analyzed in Section 3, Chapter 3.

Figure 1-1-34 Ratio of inflows and outflows among higher education graduates in OECD countries (2001)



Source: *OECD (2005)SCIENCE, TECHNOLOGY AND INDUSTRY*