Monthly Report of Prospects for Japan's Economy

April 2009

Macro Economic Research Centre
Economics Department

The Japan Research Institute, Limited
http://www.jri.co.jp/thinktank/research/

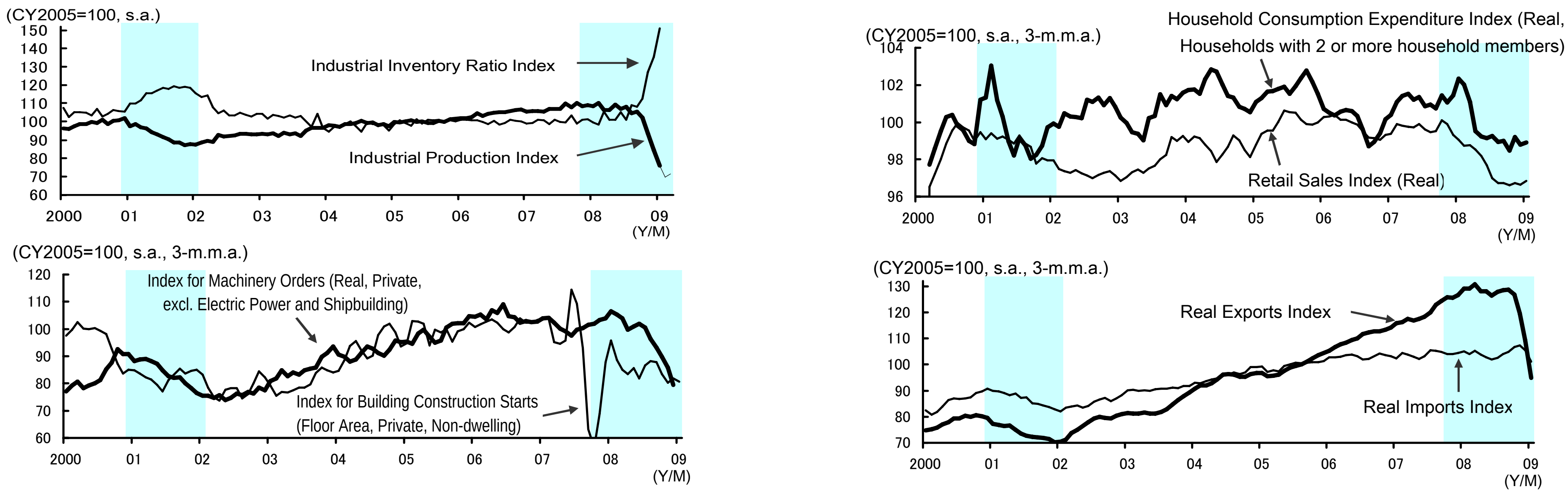
This report is the English version of the March 2009 issue of the original Japanese version.

Current situation of Japan's economy – Deteriorating sharply, mainly in the corporate sector

Japan's economy has recently been deteriorating very sharply. In the corporate sector, a steep declining trend of exports has been obvious in all regions as a falling move in exports to emerging and resource-rich countries has been accelerating, in addition to a continued considerable decline in shipments to the US and European countries. Machinery orders excluding electric power and shipbuilding have also been dropping significantly chiefly in manufacturing. Reflecting these unfavourable moves, industrial production in the October-December period last year saw a record 12 per cent decrease over the previous quarter. Also, production in the January-March quarter this year is estimated to see a further decline of 22 per cent. The household sector also continues to be in a sluggish situation. Private consumption is on a stagnating trend as employment and income environments have been worsening. The diffusion index for current conditions in the Economy Watchers Survey by the Cabinet Office continues to stay in record near-bottom territory.

It is, therefore, highly probable that the real GDP growth rate in the January-March period could be the second consecutive double-digit minus figure on a seasonally adjusted annualised quarter-on-quarter change basis.

Figure 1 Main Indicators for Japan's Economy



Source: The Ministry of Economy, Trade and Industry, The Ministry of Internal Affairs and Communications, The Cabinet Office, The Ministry of Land, Infrastructure and Transport, The Bank of Japan.

Note 1: Indices of industrial production and industrial inventory ratio are seasonally adjusted on a monthly basis. Others are calculated as seasonally adjusted and 3-month moving averages.

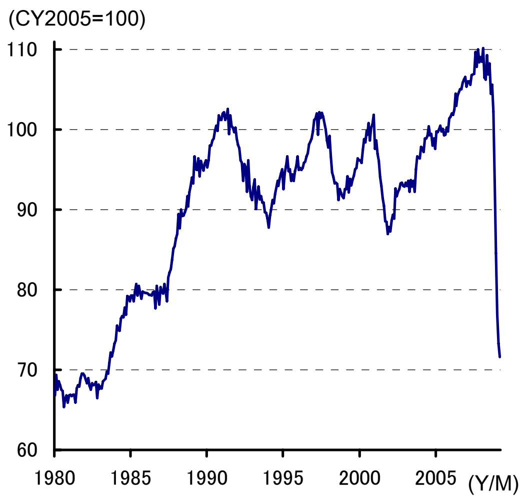
2: The industrial production index in February and March 2009 is based on METI forecasts. 3: Shaded areas indicate periods of recession according to the Cabinet Office.

Industrial production – Very sharp decline due to decrease in exports and inventory adjustment

The industrial production index declined by a new record 10.0 per cent in January over the previous month, mainly due to a sharp decrease in exports and an acceleration of inventory adjustment. The production forecast indices for this February and March also indicated a further decline. Taking these forecast indices into consideration, industrial production in the January-March period is estimated to fall by 22 per cent over the previous quarter, which is almost double the rate of decline compared with that in the previous quarter, and to be at an around 40 per cent lower level than that of the period a year earlier. The fall in the motor vehicle industry is especially significant. The forecast production level of motor vehicles in the first quarter is 60 per cent less than that in the same quarter a year earlier.

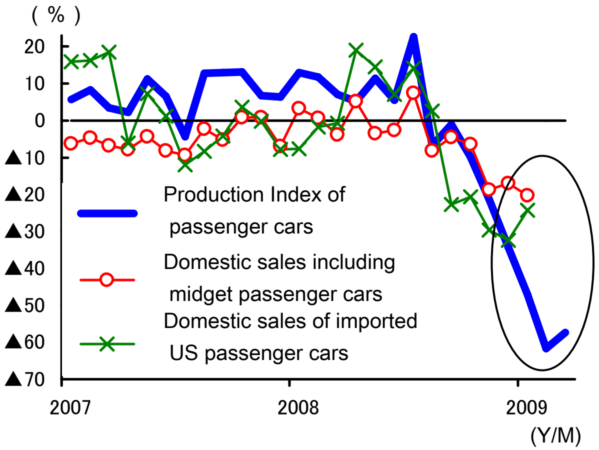
However, there is also a favourable factor, which is a rapid advance in inventory adjustment. Especially, very rapid adjustment is seen in the motor vehicle industry. Also, pressure of inventory adjustment has been decreasing gradually in the electronic parts and devices industry and the chemical products industry. If inventory adjustment ends in the short term, it is possible that industrial production would turn positive over the previous month in the middle of the year.

Figure 2-1 Industrial Production Index Since the Start of Year 1980 <on a monthly basis>



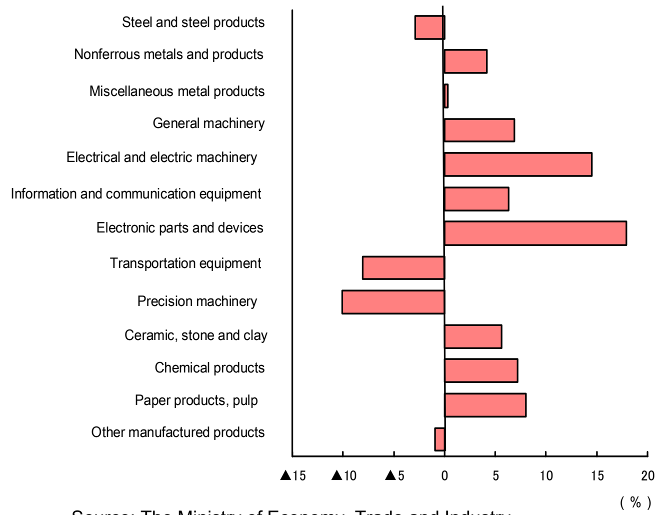
Source: The Ministry of Economy, Trade and Industry.

Figure 2-2 Production of and Demand for Passenger Cars <year-on-year % change on a monthly basis>



Source: The Ministry of Economy, Trade and Industry, Japan Automobile Dealers Association, Japan Mini Vehicles Association, US Bureau of Economic Analysis.
Note: The figures in production index of passenger cars in February and March 2009 are based on METI forecast.

Figure 2-3 Change in Inventory Level in January 2009 from a Year Earlier <year-on-year % change of the industrial inventory index>



Source: The Ministry of Economy, Trade and Industry.

Falling stock prices - Materialising negative effects on households and enterprises

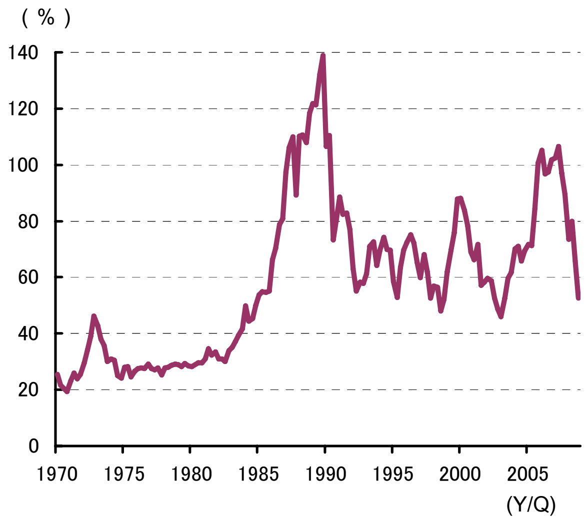
The fall in stock prices has been accelerating since the latter half of September last year. The ratio of the total market value of the Tokyo Stock Exchange to nominal Gross Domestic Income (GDI) has declined to the lowest level in the past twenty years. It is expected that stock prices will continue to soften for the time being, due to an economic downturn at home and abroad and continued uncertainties surrounding the financial markets. The falling stock prices are likely to have adverse effects on the economy through the following three routes:

(i) Sentiment. Deteriorating household and business sentiment, due to intensifying uncertainties as to future economic activity.

(ii) Households. Intensified negative wealth effect on private consumption expenditure, especially in the households in higher income brackets and/or those with elderly persons as their household heads, which hold relatively large amounts of stock.

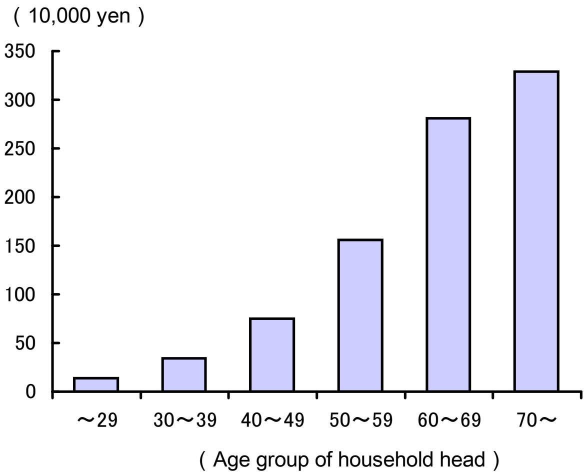
(iii) Enterprises. Worsened corporate profits, reflecting appraisal losses due to the fall of the prices of the stocks held. The deteriorating corporate profits could weigh heavily on business fixed investment and compensation of employees.

Figure 3-1 Ratio of Total Market Value of Tokyo Stock Exchange to Nominal Gross Domestic Income (GDI)



Source: The Japan Research Institute, Ltd. based on the data of The Cabinet Office, The Tokyo Stock Exchange.

Figure 3-2 Amounts of Stock Held per Household by Age Group of Household Head (all households, including unit trust)



Source: The Cabinet Office, "Annual report of the family income and expenditure survey 2007".

Figure 3-3 Estimated Influence of Change in Stock Prices and the Exchange Rate on Real GDP Growth Rate of Japan (the one year period from October 2008)

(% points)

		The J. Yen / US Dollar Exchange Rate				
		100	95	90	85	80
The Nikkei 225 Stock Average	13,000	- 0.3	- 0.5	- 0.6	- 0.7	- 0.9
	12,000	- 0.4	- 0.5	- 0.7	- 0.8	- 1.0
	11,000	- 0.5	- 0.6	- 0.8	- 0.9	- 1.1
	10,000	- 0.6	- 0.7	- 0.9	- 1.0	- 1.2
	9,000	- 0.7	- 0.8	- 1.0	- 1.1	- 1.3
	8,000	- 0.8	- 0.9	- 1.1	- 1.2	- 1.3
	7,000	- 0.9	- 1.0	- 1.1	- 1.3	- 1.4
	6,000	- 1.0	- 1.1	- 1.2	- 1.4	- 1.5

Source: The Japan Research Institute, Ltd. based on the Nikkei NEEDS macro economic models.

Note: Comparison between real GDP growth rate during one year to September 2008 and that to September 2009. Each set of the levels of the Nikkei 225 and the exchange rate is assumed to be kept constant during one year to September 2009.

Exports - The declining trend could be prolonged

It is expected that the declining trend of exports will be more noticeable, against the background of a further deterioration of overseas economies. Viewed by region:

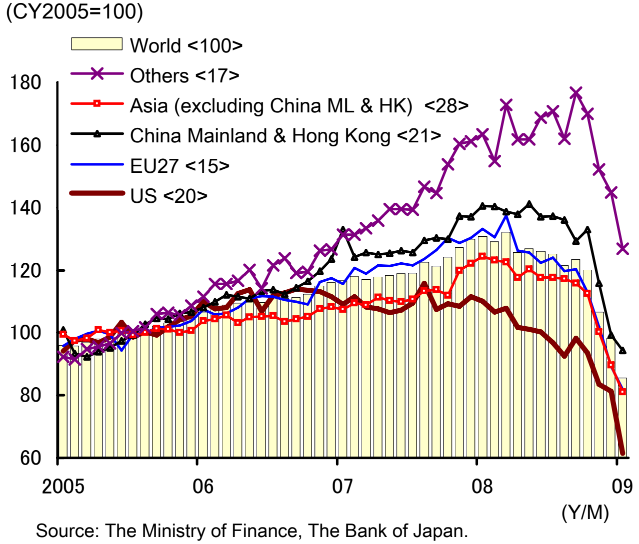
(i) To the US and European countries. A continued decline, reflecting the considerable downturn of their economic activity. Viewed by industry, in addition to a continued decline in exports of motor vehicles, shipments of industrial machinery could also be falling.

(ii) To resource-rich countries. A significant fall mainly in exports to Middle Eastern countries and Russia. The national income of resource-rich countries has been decreasing considerably due to the fall of resource prices.

(iii) To China. A declining trend had become obvious, mainly in exports of producer goods and capital goods. This is reflecting the deteriorating economic situation in the US and European countries.

Moreover, it is expected that negative influences of the yen appreciation would be materialising during this year. As a result, it is likely that the sluggish situation of Japan's exports could be prolonged. The declining trend is projected to continue at least until the end of FY2009.

Figure 4-1 Japan's Real Exports by Region <seasonally adjusted>

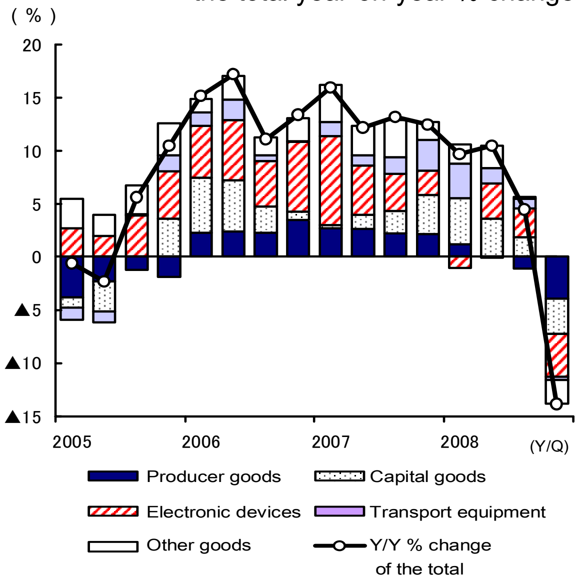


Source: The Ministry of Finance, The Bank of Japan.

Note 1: The figures in angle brackets in the legend indicate the share of each region in total nominal exports of Japan in FY2007.

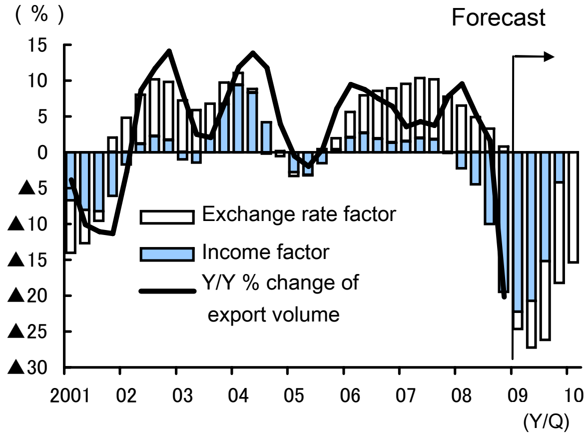
2: Others: Middle Eastern countries, South American countries, Russia and so on.

Figure 4-2 Japan's Real Exports to China by Commodity <contribution to the total year-on-year % change>



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance, The Bank of Japan.

Figure 4-3 Estimate of Export Volume Function <on a year-on-year % change basis>



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance, The OECD, and so on.

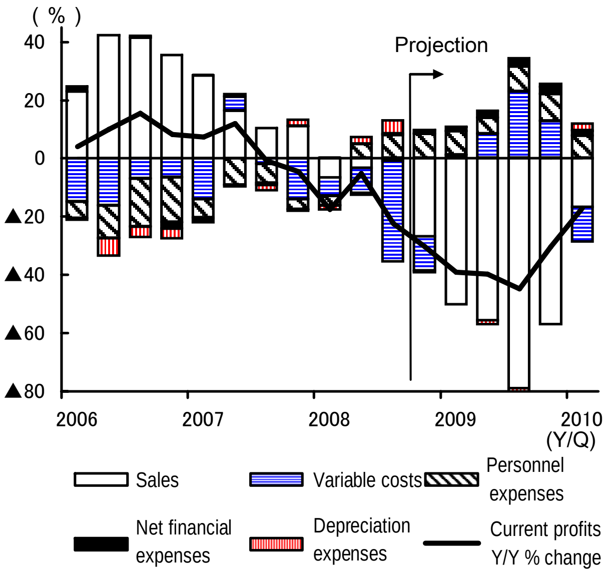
Note : The exchange rate factor; the real effective exchange rate of the yen, the income factor; the OECD economic indicator. The assumptions of forecast are by JRI projections

Continued considerable decline of corporate profits and business fixed investment

It is projected that corporate profits will continue to see a double-digit fall in their change rate on a year earlier. Although an improvement in the output / input price ratio due to the fall in resource prices is expected to contribute to bolstering profits, downward pressure on profits from a decline in sales amount could intensify and outpace the improvement.

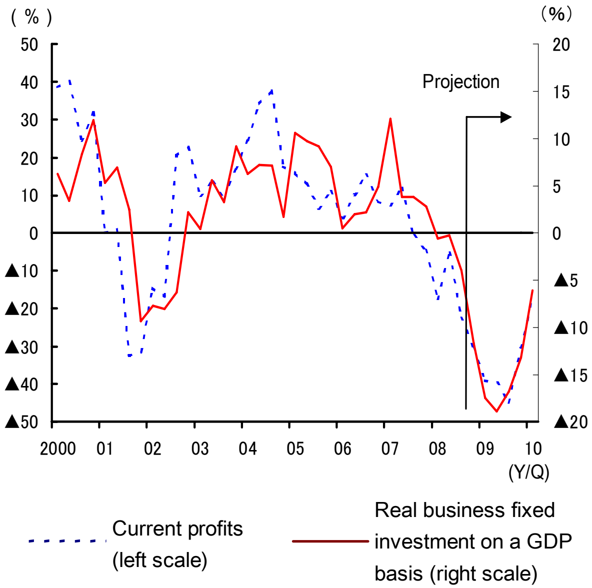
The year-on-year minus in the change in business fixed investment is estimated to expand for the moment. It is expected that the attitude of enterprises to business fixed investment will become more cautious in a very rapid manner, reflecting a deterioration of corporate profits, a lowering of capacity utilisation and a worsening of business sentiment. Especially, it is likely that business fixed investment in manufacturing will decline considerably. This forecast is predicted by the move that machinery orders in manufacturing have recently been dropping very sharply.

Figure 5-1 Contribution of Sales and Expenses to Year-on-year % Change of Current Profits



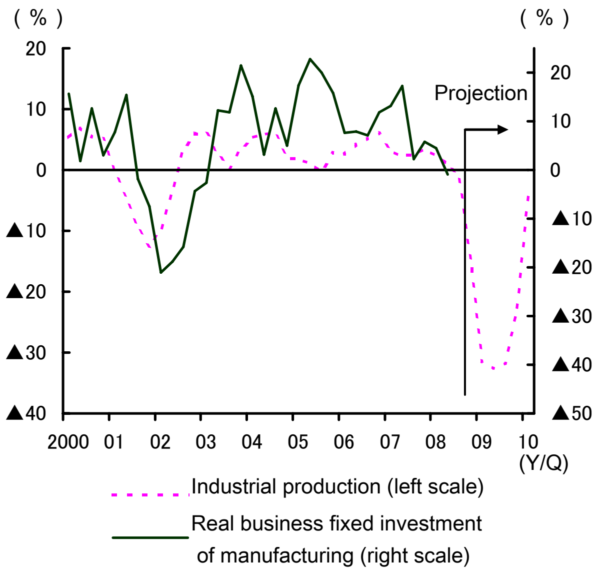
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance, "Financial Statements Statistics of Corporations by Industry: Quarterly".

Figure 5-2 Current Profits and Real Business Fixed Investment <year-on-year % change>



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance, The Cabinet Office.

Figure 5-3 Industrial Production and Business Fixed Investment of Manufacturing <year-on-year % change>



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Economy, Trade and Industry, The Cabinet Office.

Declining exports, the yen appreciation - To weigh on the processing industries

An estimate of the influences of declining exports, the yen appreciation and the fall of the price of crude oil shows visibly the difference of the degree of impact between industries.

The processing industries, which feel a significant influence of a fall in exports and the yen appreciation, are estimated to be most adversely affected. Among nonmanufacturing, the wholesale trade and financial services industries, which have a high degree of export or overseas dependence, are estimated to have a downswing in their profits.

On the other hand, the material industries in manufacturing and nonmanufacturing other than the above mentioned industries are projected to have a positive net influence. This is because these industries are able to enjoy to an appreciable degree the benefits of exchange gains in imports and the fall in the price of crude oil.

Figure 6 The Estimated Impact of Declining Exports, the Yen Appreciation and the Fall of the Price of Crude Oil (during CY2009)

(% points)

		Impact of each factor on ratio of profits to sales			
			Decrease in exports	Appreciation of the yen	Fall in the price of crude oil
Manufacturing	Food	3.1	- 0.4	2.4	1.1
	Textiles	10.4	- 4.2	13.0	1.6
	Paper products, pulp	- 1.1	- 4.0	0.6	2.3
	Chemical products	- 2.1	- 8.3	0.2	6.1
	Petroleum and coal products	27.6	4.0	2.0	21.6
	Ceramic, stone and clay	- 7.2	- 9.4	0.0	2.1
	Steel and steel products	- 7.5	- 8.3	- 1.0	1.8
	Nonferrous metals and products	- 3.7	- 9.7	3.7	2.3
	Miscellaneous metal products	- 4.1	- 5.6	0.3	1.1
	General machinery	- 9.7	- 8.3	- 2.3	0.9
	Electrical and electric machinery	- 12.0	- 10.8	- 2.5	1.2
	Information and communication equipment	- 6.3	- 8.1	0.9	0.9
	Electronic parts and devices	- 16.9	- 16.9	- 1.1	1.1
	Transportation equipment	- 10.3	- 8.2	- 3.1	1.0
	Precision machinery	- 8.5	- 11.2	1.9	0.8
	Other manufactured products	- 0.7	- 8.7	6.6	1.4
Nonmanufacturing	Agriculture and fishing	3.3	- 1.0	2.9	1.5
	Construction	0.7	- 0.5	0.0	1.3
	Electricity and gas	3.6	- 4.5	- 0.0	8.2
	City water supply	- 1.9	- 3.1	- 0.0	1.3
	Wholesale and retail trade	- 7.6	- 7.5	- 0.8	0.7
	Financial services and insurance	- 5.2	- 5.6	0.1	0.3
	Transport	- 5.3	- 7.6	- 0.5	2.7
	Communication and broadcasting	- 3.1	- 3.6	0.0	0.5
	Public service	- 2.9	- 4.0	0.4	0.7

Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Internal Affairs and Communications, The Ministry of Finance, The Ministry of Economy, Trade and Industry, The Bank of Japan.

Note : The estimate is based on the assumptions that (i) the yen would appreciate by 20% against all other currencies, (ii) the price of crude oil would fall by 55%, and (iii) enterprises would pass on 30% of the increased costs to the selling prices.

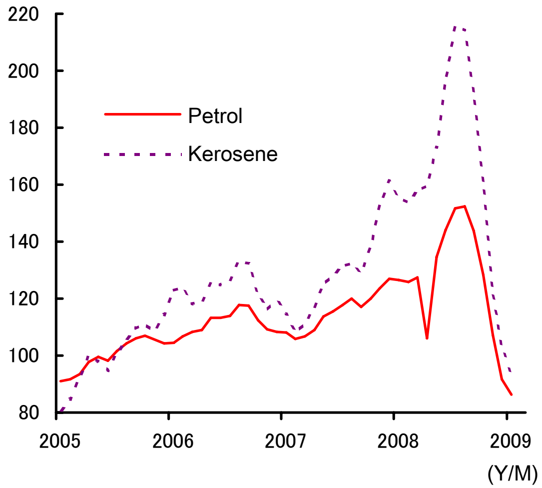
The rate of change in the CPI - To turn negative again; looming deflationary pressure

It is expected that a declining tendency in the Consumer Price Index excluding fresh food (the core CPI) will be prolonged with deflationary pressure intensifying and resource prices softening.

For the time being, the downward pressure from the supply side would be obviously felt to have strengthened. The core CPI is projected to decline further in a rapid way, reflecting a sharp fall in petrol price and a deceleration in the pace of the food price rise. In addition, from the start of FY2009 onwards, the downward pressure from the demand side would also be felt as having stepped up. It is expected that moves to lower prices will spread among goods and services covered by the Index due to re-emerging price competition, as the supply-demand gap will expand to the level of around 10 per cent to nominal GDP.

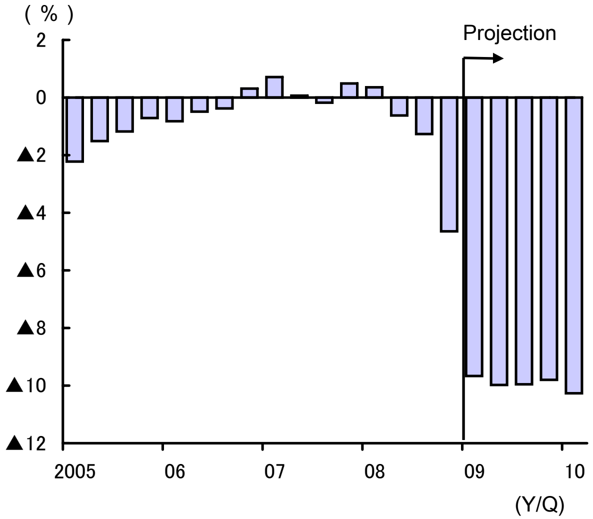
Accordingly, it is projected that the year-on-year per cent change of the core CPI will reach around minus 2 per cent in the July-September quarter this year, then continue the rate of around minus 1 per cent after that period onwards.

Figure 7-1 Domestic Corporate Goods Price Index for Petrol and Kerosene



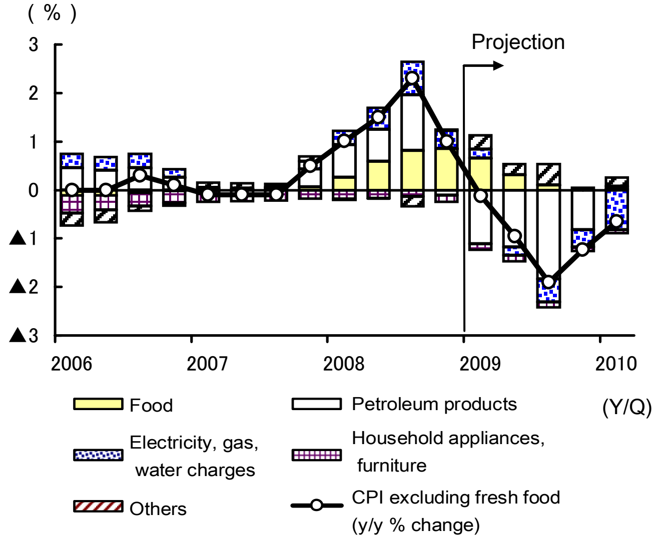
Source: The Bank of Japan.

Figure 7-2 Estimate of Supply-Demand Gap Shown as Percentage of Nominal GDP



Source: The Japan Research Institute, Ltd. based on the data of The Cabinet Office.

Figure 7-3 Change in Consumer Price Index on CY2005-base <year-on-year, excluding fresh food>



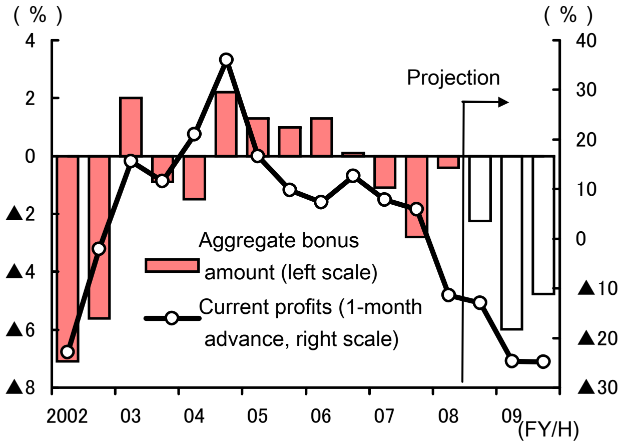
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Internal Affairs and Communications.

Rapidly intensifying pressure for employment adjustment

In the household sector, the following three negative influences would be felt: (i) a fall in wages, especially in bonuses, (ii) a negative wealth effect due to the fall in stock prices, and (iii) a worsened employment environment. Among those, the employment issue is considered as one of the most serious challenges to be addressed in Japan's economy. Especially, thus far, a firing of temporary workers has come into focus among the employment issues. Hereafter, it is, worryingly, likely that a cut in regular employees will take place in earnest.

Acceding to the JRI estimate on the working population based on its GDP projections, the number of workers who will lose their jobs, which is regarded as the pressure for employment adjustment, is calculated to reach 2,560 thousand by the first quarter of year 2010. This is the level of numbers that pushes up the unemployment rate by 4.0 percentage points. The rapidly worsening employment situation seen above is estimated to push down the growth rate of private consumption expenditure by 1.9 percentage points. Accordingly, the prospects for Japan's economic activity depend largely on whether the pressure for employment adjustment will be successfully reduced or not.

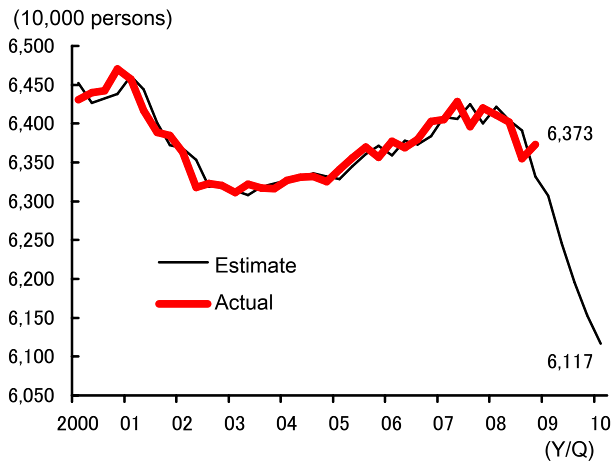
Figure 8-1 Current Profits and Aggregate Bonus Amount <year-on-year % change>



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance, The Ministry of Health, Labour and Welfare.

Note: The aggregate bonus amount is on a Monthly Labour Survey basis.

Figure 8-2 Estimate on Working Population



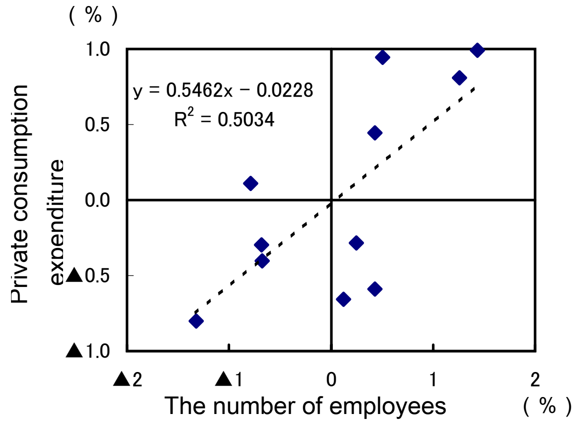
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Internal Affairs and Communications, The Cabinet Office.

Note: The equation for the estimate is as follows:

ln(L) = 0.17 + 0.82*ln(L<-1>) + 0.11*ln(GDP) − 0.0004*Trend

Period 1994/Q2～2008/Q3, Adjusted R*R=0.9476

Figure 8-3 Change in the Number of Employees and Private Consumption Expenditure <year-on-year % change on a fiscal year basis>



Source: The Japan Research Institute, Ltd. based on the data of The Cabinet Office, 'National Accounts of Japan.

Note: From FY1997 to FY2007. The imputed rent is excluded from private consumption expenditure.

Deeper fall in economic activity compared with US and European countries

Japan has been suffering from a deeper fall in its economic activity compared with the situation in the US, which is the epicentre of the current financial crisis, and European countries. Taking into consideration the following four factors, it is unavoidable that Japan's economy will see a more serious recession than those in US and European countries.

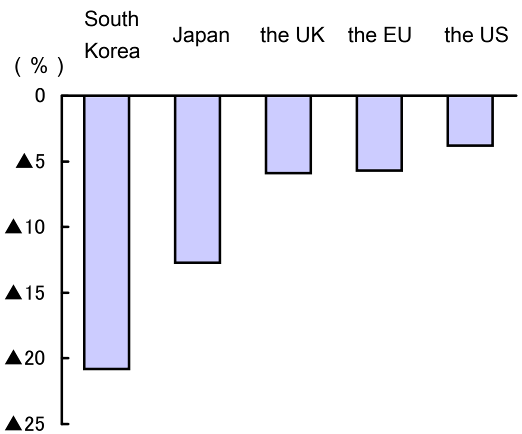
(i) High degree of dependence of manufacturing products on exports. The industries such as motor vehicles, industrial machinery and electronic parts and devices, which have high income elasticity, have been especially hard hit. This factor is also the reason for a deeper fall in the economic activities in South Korea and Taiwan.

(ii) Loss in competitiveness due to the yen appreciation against almost all currencies of major trading partners.

(iii) Weak domestic demand, especially the feeble driving power for the economy of private consumption expenditure.

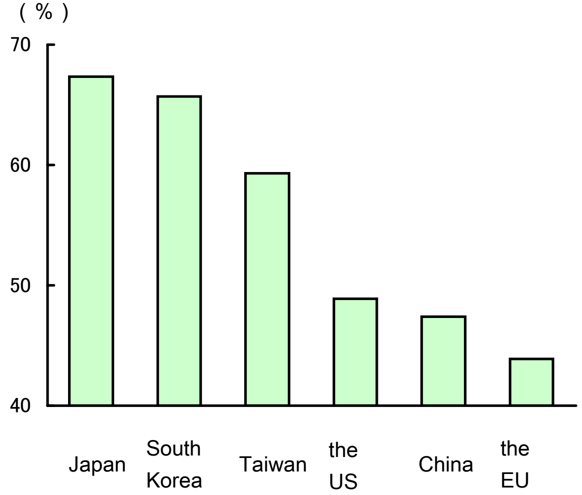
(iv) A delay in taking effective measures to lift up the economy. Productive discussions to promote an expansion of demand have been shelved since last autumn, when the fall in business activity was confirmed as deeper than previously thought.

Figure 9-1 Real GDP Change Rate in October-December Quarter 2009 <seasonally adjusted and annualised quarter-on-quarter % change rate>



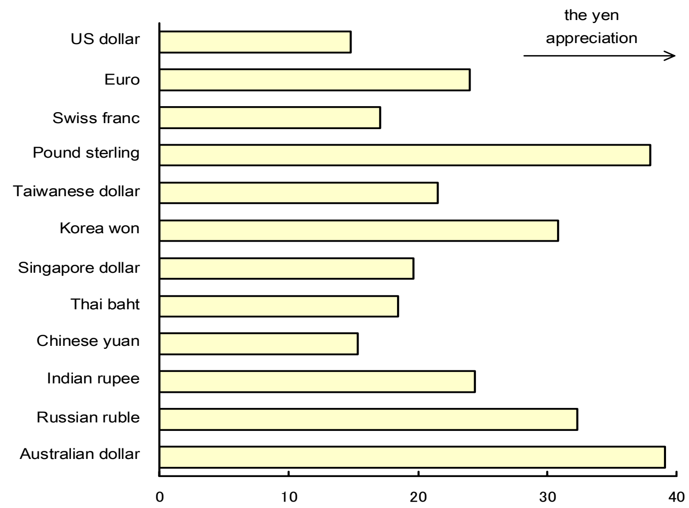
Source: The Japan Research Institute, Ltd. based on the data of statistics of each country or economic area.
Note: ″▲″ indicates "minus".

Figure 9-2 Ratio of Exports of Machinery and Equipment in Total Exports in CY2007



Source: The Japan Research Institute, Ltd. based on the data of statistics of each country or economic area.

Figure 9-3 Rate of Appreciation of Each Currency against the Japanese Yen <as of the end of December 2008 , from the average rate in July 2008>



Source: Datastream.

Prospects for Japan's economy - Projected real GDP change; -3.4% in FY2008 and -5.7% in FY2009

(1) It is expected that the recessionary phase of Japan's economy will be prolonged, against the background of a further deterioration in economic activity at home and abroad. It is, especially, estimated that Japan's real GDP during the second half of FY2008 to March 2009 will see a serious recessionary phase, which is two consecutive quarters of double-digit contraction, on a seasonally adjusted and annualised quarter-on-quarter change basis. Further, it is projected that the economy will follow a quarterly trajectory at a pace considerably below its potential output growth rate during FY2009. This will lead to minus 3.4 per cent in the real GDP change rate in FY2008 and minus 5.7 per cent in FY2009, a significant shrinking for two consecutive fiscal years.

(2) A main cause of the recession appears to be the rapid economic deterioration in the corporate sector. It is expected that Japan's exports will continue to be declining, and there is not much prospect that the declining trend will be checked. This is against the background of a continued significant fall in exports to the US and European economies amid still growing uncertainties in the financial markets, a predicted further decline in exports to Asian economies and resource-rich countries, and a gradual materialising of the negative effect of the Japanese yen appreciation. Reflecting a rapid decline in capacity utilisation, a decreasing trend in business fixed investment would be more intensified, especially in the export industries such as motor vehicles and electronic parts and devices. An inventory adjustment could also lower the economic growth rate.

(3) It is expected that the household sector will also continue a sluggish situation, due to stagnant income environments and worsened consumer sentiment. Nominal private consumption expenditure would see a noticeable decline because of factors such as a decrease in wages, especially in bonuses, growing anxieties about a future employment situation reflecting a sharp increase in unemployment, and a negative wealth effect of falling stock prices. However, the degree of decline in real private consumption expenditure would be slight, owing to an advanced real purchasing power of households reflecting the fall of consumer prices.

(4) The Consumer Price Index excluding fresh food (the core CPI) is projected to decelerate rapidly due to a fall in petrol price and increasing deflationary pressure. It is also expected that the index will start to decline sharply from this spring, which is around the start of FY2009, onwards.

Figure 10 Projections for GDP Growth and Main Indicators of Japan (as of March 12, 2009)

	CY2008				CY2009				CY2010	FY2007	FY2008	FY2009
	1～3	4～6	7～9	10～12	1～3	4～6	7～9	10～12	1～3			
	(Actual)				(Projection)					(Actual)	(Projection)	
Real G D P	1.4	▲ 4.5	▲ 1.4	▲ 12.1	▲ 17.9	▲ 2.3	1.0	0.3	0.2	1.9	▲ 3.4	▲ 5.7
Private Consumption Expenditure	2.9	▲ 3.0	1.2	▲ 1.7	▲ 1.4	0.5	▲ 0.2	0.3	0.2	0.8	▲ 0.2	▲ 0.3
Housing Investment	19.6	▲ 7.4	17.0	24.9	▲ 21.4	▲ 12.8	▲ 2.5	▲ 1.8	▲ 0.8	▲ 13.0	▲ 2.2	▲ 4.9
Business Fixed Investment	▲ 2.6	▲ 8.9	▲ 12.8	▲ 19.8	▲ 30.8	▲ 14.8	▲ 3.8	▲ 2.9	▲ 2.5	2.3	▲ 8.9	▲ 14.4
Private Inventories (percentage points contribution)	(▲ 0.6)	(▲ 0.7)	(0.1)	(1.9)	(▲ 5.4)	(▲ 0.5)	(1.0)	(0.1)	(0.2)	(0.1)	(▲ 0.3)	(▲ 0.7)
Government Consumption Expenditure	▲ 0.7	▲ 3.6	▲ 0.6	5.6	▲ 2.1	0.2	0.7	0.3	0.1	2.2	0.1	0.5
Public Investment	▲ 17.7	▲ 3.0	4.7	0.4	▲ 1.2	0.3	0.9	1.1	0.5	▲ 5.8	▲ 4.0	0.5
Net Exports (percentage points contribution)	(1.3)	(▲ 0.2)	(▲ 0.3)	(▲ 10.0)	(▲ 7.4)	(0.4)	(0.5)	(0.4)	(0.2)	(1.2)	(▲ 1.3)	(▲ 2.5)
Exports of Goods and Services	12.6	▲ 9.0	2.6	▲ 44.9	▲ 60.9	▲ 8.2	▲ 5.4	▲ 2.5	▲ 2.2	9.3	▲ 9.4	▲ 25.7
Imports of Goods and Services	6.2	▲ 11.7	6.8	12.4	▲ 34.4	▲ 12.6	▲ 10.2	▲ 6.4	▲ 4.7	1.8	▲ 1.7	▲ 11.9

(% changes from the same quarter of the previous year)

	CY2008 1～3	4～6	7～9	10～12	CY2009 1～3	4～6	7～9	10～12	CY2010 1～3	FY2007	FY2008	FY2009
Real G D P	1.5	0.7	▲ 0.2	▲ 4.3	▲ 9.5	▲ 8.6	▲ 8.4	▲ 5.2	▲ 0.3	1.9	▲ 3.4	▲ 5.7
Nominal G D P	0.0	▲ 0.9	▲ 1.8	▲ 3.6	▲ 7.2	▲ 5.7	▲ 5.7	▲ 4.0	▲ 1.4	1.0	▲ 3.4	▲ 4.3
GDP deflator	▲ 1.4	▲ 1.5	▲ 1.6	0.7	2.5	3.2	2.9	1.2	▲ 1.1	▲ 0.9	0.0	1.5
Consumer Price Index (excluding fresh food)	1.0	1.5	2.3	1.0	▲ 0.2	▲ 0.5	▲ 1.9	▲ 1.4	▲ 0.8	0.3	1.1	▲ 1.2
Industrial Production Index	2.3	1.0	▲ 1.3	▲ 14.8	▲ 34.7	▲ 36.5	▲ 35.9	▲ 27.5	▲ 4.4	2.6	▲ 12.7	▲ 28.0
Unemployment Rate (%)	3.9	4.0	4.0	4.0	4.6	4.9	5.2	5.4	5.4	3.8	4.2	5.2
Current Account Balances (trillion JY)	6.58	3.84	4.02	1.67	4.29	2.85	4.48	3.38	5.09	24.54	13.99	15.80
Share of Nominal GDP (%)	5.2	3.0	3.2	1.3	3.7	2.4	3.9	2.7	4.4	4.8	2.8	3.3
Exchange Rates (JY/US$)	105.2	104.5	107.6	96.1	93.0	96.0	96.0	93.0	91.0	114.2	100.3	94.0
Import Price of Crude Oil (US$/barrel)	95	109	129	79	44	45	46	47	49	78	90	47

Source: The Cabinet Office, The Ministry of Internal Affairs and Communications, The Ministry of Economy, Trade and Industry, The Ministry of Finance.
The projection figures are based on those of The Japan Research Institute, Ltd.

Note: The assumptions on overseas economies: the real GDP growth rate during CY2009 would be -2.5% in the US, -3.8% in the euro area and +7.5% in China.