

Monthly Report of Prospects for Japan's Economy

June 2009

Macro Economic Research Centre
Economics Department



The Japan Research Institute, Limited

<http://www.jri.co.jp/thinktank/research/>

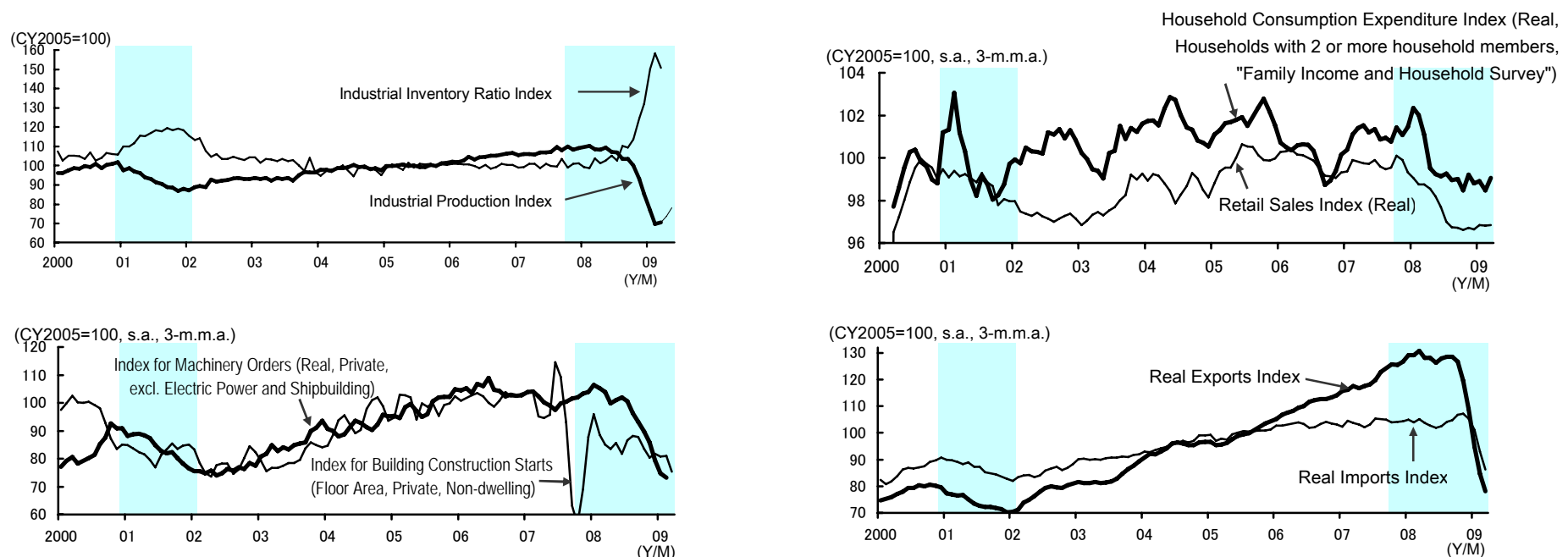
This report is the English version of the May 2009 issue of the original Japanese version.

Current situation of Japan's economy – At still low level, yet signs of bottoming out

A certain number of Japan's economic indicators have shown a levelling off. The economic activity in manufacturing appears to exhibit signs of bottoming out, as industrial production turned positive over the previous month in March, exports have been flattening out, and the industrial inventory ratio lowered for the first time in six months. The diffusion index for current conditions in the Economy Watchers Survey by the Cabinet Office also has turned to slight improvement, although it is still at a low level.

However, downward pressures on the economy still persist. Private consumption expenditure on a "Family Income and Household Survey" basis continues to stagnate, against the background of worsening employment and income environments. In addition, machinery orders and building construction starts have been declining considerably, which implies a prolonged adjustment in business fixed investment.

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.

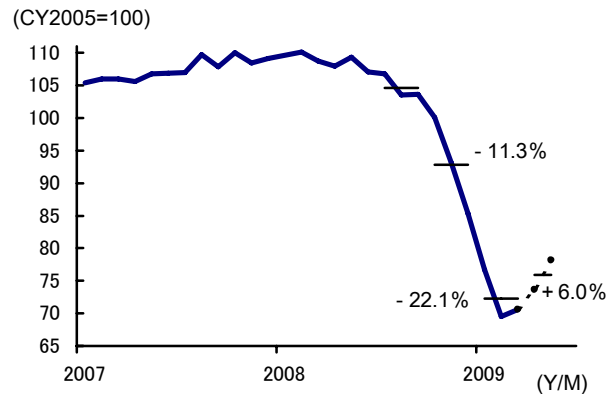
2: The industrial production index in April and May 2009 is based on METI forecasts. 3: Shaded areas indicate periods of recession according to the Cabinet Office.

Industrial production – Has been bottoming out

The industrial production index increased by 1.6 per cent in March over the previous month, the first increase in six months. Also, the production forecast index indicated a 4.3 per cent month-to-month increase in April and a 6.1 per cent increase in May. Judging from the trend that the downward revision on the forecast index has narrowed to zero, it is estimated that industrial production will most likely have seen three consecutive monthly increases from March to June. Assuming a flat June, industrial production in the April-June period is expected to rise by 6.0 per cent from the previous quarter. These moves indicate that industrial production, which had fallen sharply since last autumn, has been bottoming out. The following can be considered as the background; (1) a declining trend in exports has been partly checked, and (2) there seems to be a prospect for an end to inventory adjustment, which has progressed rapidly.

Viewed by industry, a noticeable recovery has been seen in the motor vehicles industry. Production in industries such as electronic parts and devices, information and communication equipment, and nonferrous metals is expected to increase by more than 10 per cent. However, production in general machinery would continue to decline, reflecting a continued sharp fall in business fixed investment.

Figure 2-1 Industrial Production Index
<seasonally adjusted>

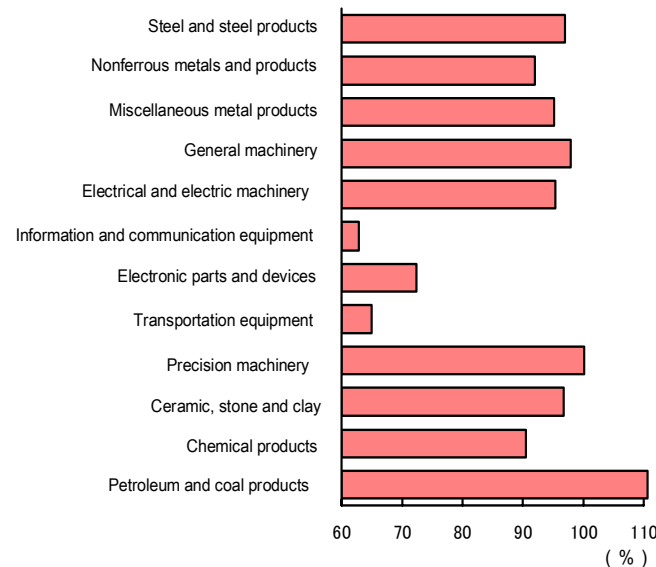


Source: The Ministry of Economy, Trade and Industry.

Note 1: The dotted line indicates the production forecast for April and May 2009.

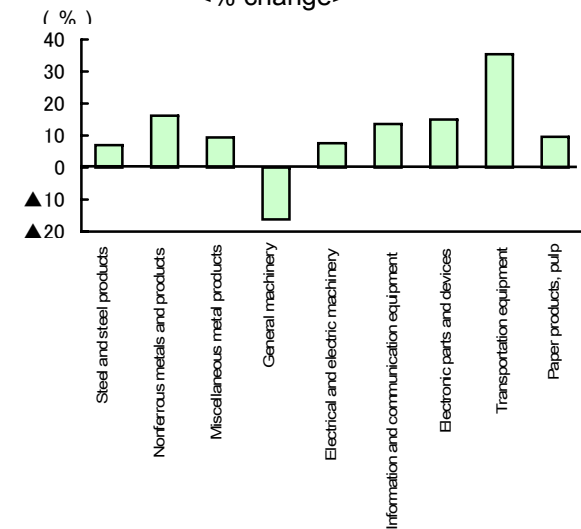
2: The short horizontal line indicates the average in each quarter and the figure shows the quarter-on-quarter % change.

Figure 2-2 Inventory Level by Industry
in March 2009, Compared
with 3 Months before



Source: The Ministry of Economy, Trade and Industry.

Figure 2-3 Change in Production Shown
in the Forecast Index in May
2009 from 2 Months before
<% change>



Source: The Ministry of Economy, Trade and Industry.

Exports - The stagnating trend could be prolonged further

There seems to be signs of flattening out in Japan's exports, which have declined rapidly. This is mainly due to a recovery in exports to Asia, largely to China.

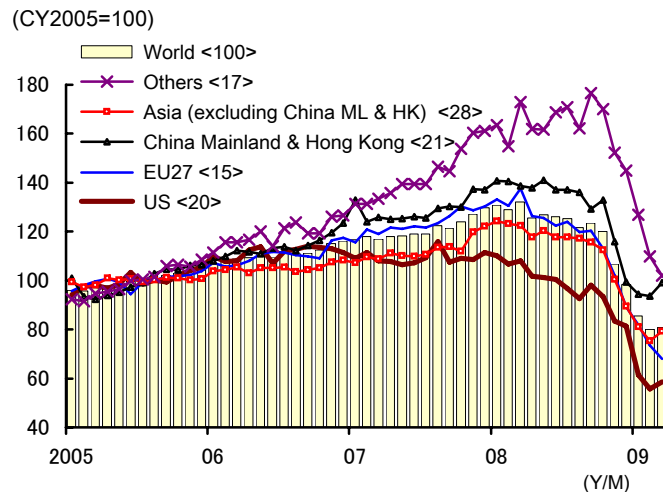
However, even if exports see a slight recovery for the time being, they could face a downside risk of stagnating in the second half of this fiscal year to March 2010. It can hardly be expected that exports would turn to a visibly increasing trend, taking into consideration the following three factors.

(1) Exports to the US and European countries would continue to decline, reflecting the economic downturn in these countries. In addition to exports of motor vehicles, shipments of industrial machinery could also be falling.

(2) The national income of resource-rich countries has been decreasing considerably due to the fall of resource prices. This could lead to a continuing significant fall in exports to Middle Eastern countries and Russia.

(3) It is expected that negative influences of the yen appreciation would be materialising during this year.

Figure 3-1 Japan's Real Exports by Region
<seasonally adjusted>

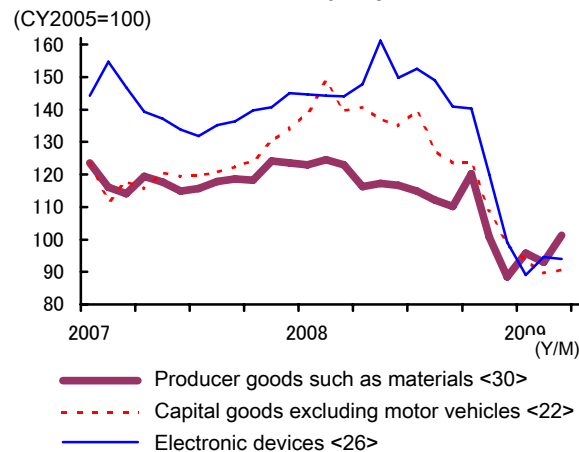


Source: The Ministry of Finance, The Bank of Japan.

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.

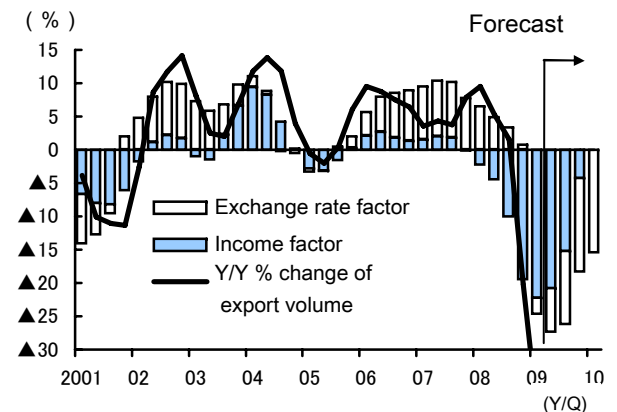
Figure 3-2 Japan's Real Exports to China
by Commodity
<seasonally adjusted>



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

Note: The figures in angle brackets in the legend indicate the share of each commodity group in total nominal exports of Japan to China in FY2007.

Figure 3-3 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

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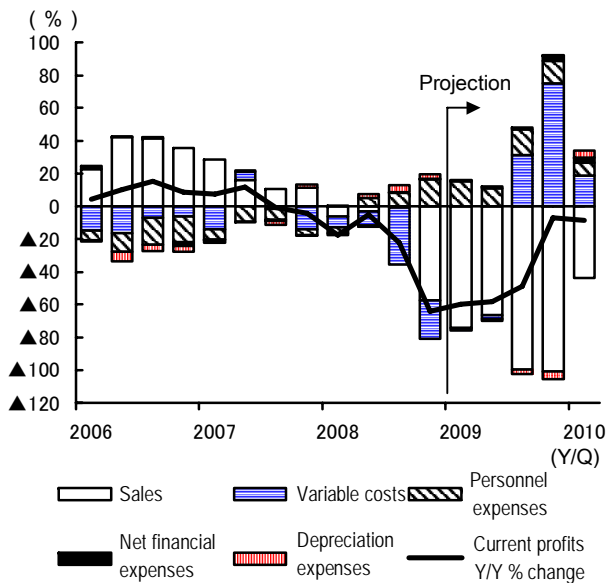
Corporate profits - Continued double-digit rate of decline

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. Especially, manufacturing could continue to see a significant worsening of the profit situation.

The number of business failures is also following an increasing trend in tandem with deteriorating corporate profits. However, the situation would be avoided where the pace of increase in business failures could accelerate, judging from the following:

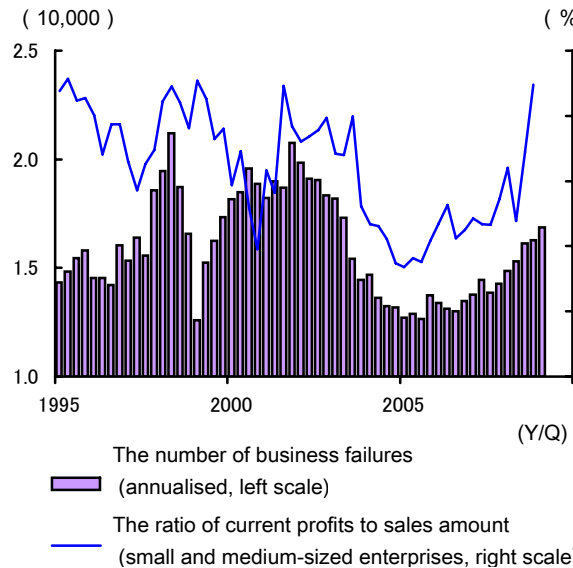
- (1) Japanese enterprises have ample internal reserves, as seen in the fact that their ratio of net worth is at the highest level ever.
- (2) Measures to support and improve cash positions of enterprises have been prepared by the government and the BOJ.

Figure 4-1 Contribution of Sales and Expenses to Year-on-year % Change of Current Profits



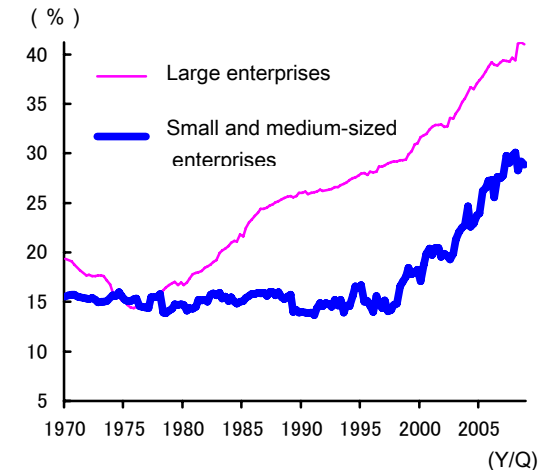
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance, "Financial Statements Statistics of Corporations by Industry: Quarterly".

Figure 4-2 The Number of Business Failures <annualised>



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

Figure 4-3 The Ratio of Net Worth by the Size of Enterprises



Source: The Ministry of Finance, "Financial Statements Statistics of Corporations by Industry: Quarterly".

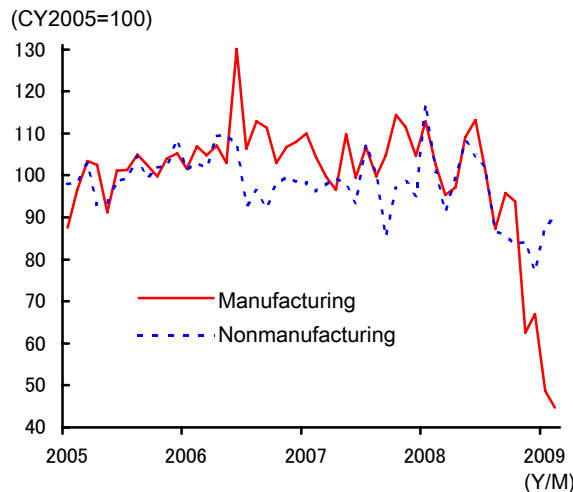
Business fixed investment - Expected considerable decline mainly in manufacturing

The decline in machinery orders in manufacturing has not been able to be checked, reflecting a sharp fall in industrial production. On the other hand, machinery orders in nonmanufacturing have seen only a slight decline, against the background of firmness in infrastructure-related investment as seen in the railway industry.

The Tankan March 2009 survey forecast a considerable 13.2 per cent decline in business fixed investment in large manufacturing during fiscal year 2009. Further, the expected revision implies an additional 5.0 percentage point downswing in that forecast. In addition, it is highly likely that a further downward revision to the corporate profit projection will affect the forecast for the following reasons: (1) judging from ongoing shipments, the sales amount during the first half of this fiscal year is probably overestimated, and (2) while an increase in exports is projected in the second half of FY2009, a rapid recovery toward an increasing trend is hardly expected in exports, taking into consideration a prolonged downturn in the US and European economies and a recent trend of the Japanese yen appreciation.

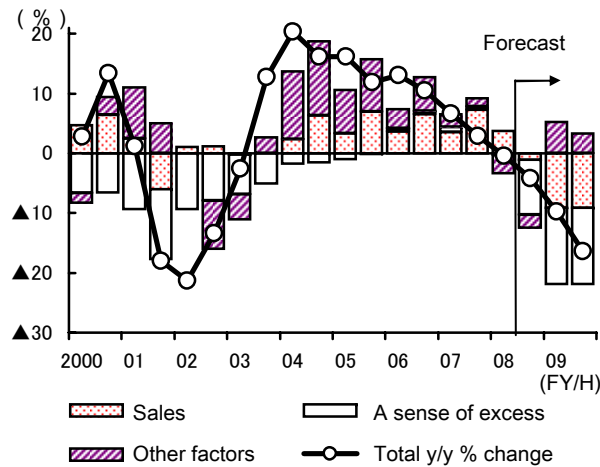
Judging from the above mentioned factors, business fixed investment in large manufacturing could face a further significant downward revision of around 20 percentage points, as the downswing of sales amount and corporate profits materialises.

Figure 5-1 Index for Machinery Orders by Type of Industry



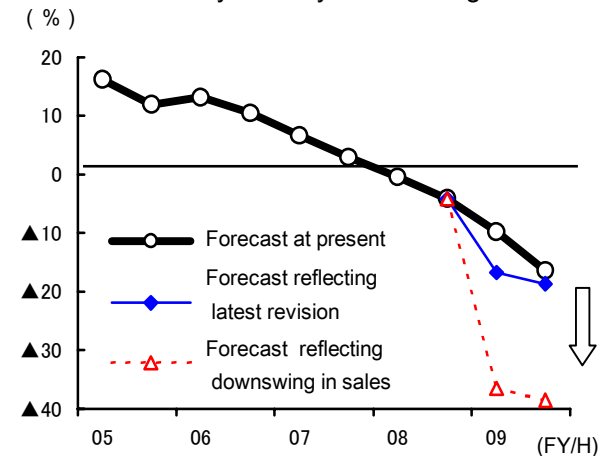
Source: The Cabinet Office.

Figure 5-2 Contributions to Year-on-year Per Cent Change in Business Fixed Investment <large manufacturing>



Source: The Japan Research Institute, Ltd. based on the data of The Bank of Japan, "Tankan Surveys".

Figure 5-3 Predicted Downward Revision for Business Fixed Investment <large manufacturing, year-on-year % change>



Source: The Japan Research Institute, Ltd. based on the data of The Bank of Japan, "Tankan Surveys".

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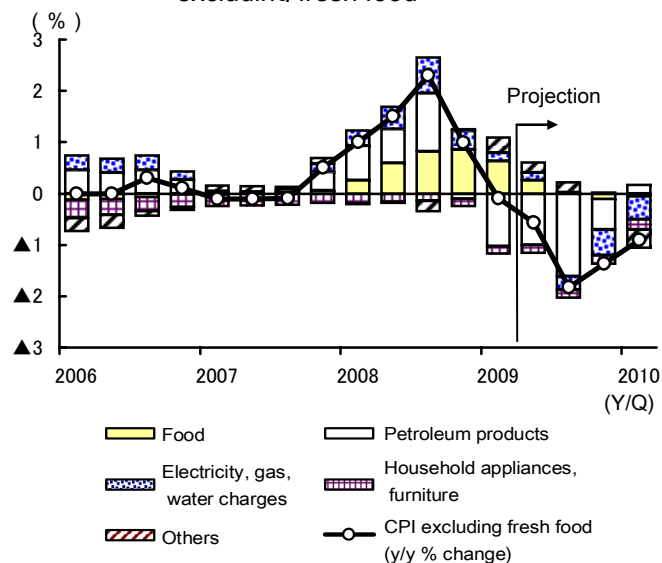
The rate of change in the CPI - To turn negative again; looming deflationary pressure

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 obviously be felt to have strengthened. The core CPI is projected to decline further in a rapid way, against the background of a sharp fall in energy prices such as petrol and a deceleration in the pace of rise in food prices reflecting a fall in cereal prices.

In addition, 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 intensifying price competition, as the supply-demand gap will expand to the level of around 10 per cent of 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 around minus 1 per cent after that period onwards.

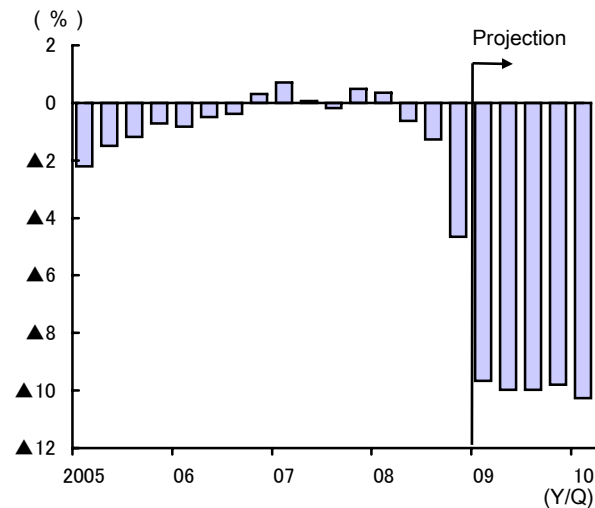
Deflationary pressure will persist for a long time from year 2010 onwards. It is estimated that it will take five to ten years for the supply-demand gap shown as a percentage of GDP, which has recently expanded rapidly, to narrow to zero. The downward pressure on the movement of prices also is expected to remain as long as the supply-demand gap exists.

Figure 6-1 Change in Consumer Price Index on CY2005-base <year-on-year, excluding fresh food>



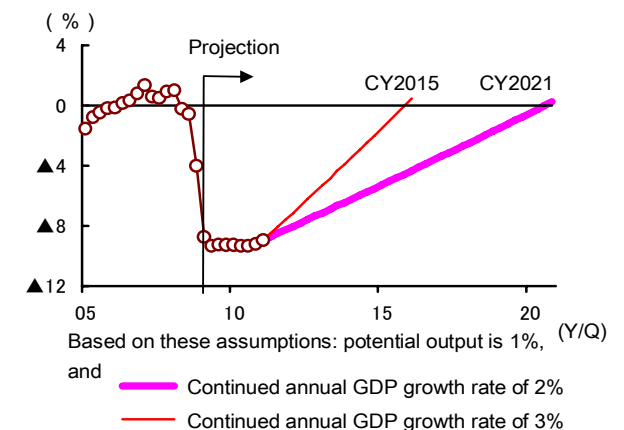
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Internal Affairs and Communications.

Figure 6-2 Estimate of Supply-Demand Gap Shown as Percentage of GDP



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

Figure 6-3 Long-range Estimate of Supply-Demand Gap Shown as Percentage of GDP



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

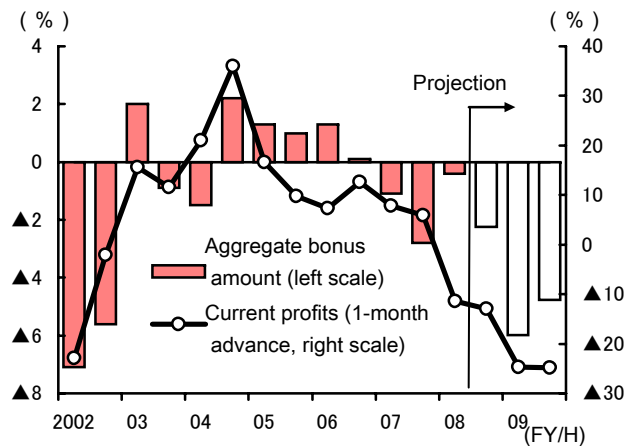
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Rapidly intensifying pressure for employment adjustment

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.

Based on the JRI estimate on the working population reflecting 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.

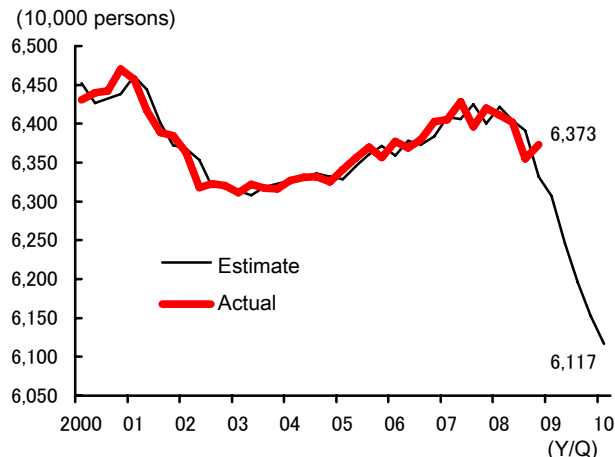
Figure 7-1 Current Profits and Aggregate Bonus Amount
<year-on-year % change>



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 7-2 Estimate on Working Population



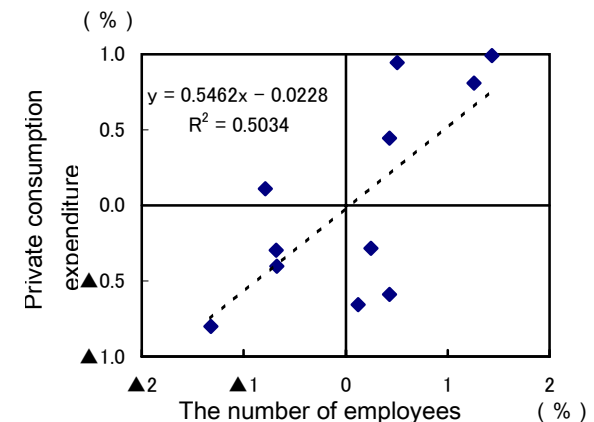
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Internal Affairs and Communications, The Cabinet Office.

Note: The equation for the estimate is as follows:

$$\ln(L) = 0.17 + 0.82 \cdot \ln(L<-1>) + 0.11 \cdot \ln(\text{GDP}) - 0.0004 \cdot \text{Trend}$$

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

Figure 7-3 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.

Economic measures by the government - To boost public investment and private consumption

The Japanese government announced "The Policy Package to Address Economic Crisis" on April 10 this year, which amounted to 15 trillion yen as national governmental expenditure and 57 trillion yen as the total scale of all measures. These are aiming at boosting the real GDP growth rate by two percentage points and creating 400 to 500 thousand jobs, according to the government.

Based on the JRI estimate on the effect of measures by item, it can be expected that they will push up the real GDP growth rate by about one percentage point as a whole. The effects would be seen mainly in increases in the purchase of durable goods and in public investment. Especially, in the motor vehicle industry, an expansion of demand on a scale of several hundred thousand cars is likely to materialise. However, it is unlikely that public expenditure of local governments will increase much, amid a worsening of their fiscal positions. In addition, an increase in expenditure on motor vehicles and household appliances could be offset by a reduction in other expenditure items.

Taking into consideration these factors based on the JRI estimate, it can be judged that the final boosting effect of this package of emergency economic measures on the real GDP growth rate would remain 0.5 to 1.0 percentage point in total.

Figure 8-1 The Effects of Economic Measures on the Economy
<estimate by the government>

	Total		
		[1]	[2]
Real GDP growth rate	around 3%	around 1%	around 2%
Number of jobs created	—	—	400 ~ 500 thousand

[1] The total of the first supplementary budget in FY2008, the second supplementary budget in FY2008, and the budget in FY2009.

[2] "The Policy Package to Address Economic Crisis" on April 10, 2009, which is outlined in Figure 8-2 on this page.

Source: The Cabinet Office.

Figure 8-2 The Outline of Emergency Economic Measures
"Policy Package to Address Economic Crisis" <dated April 10, 2009>

	The total scale of all measures		The boosting effects (minimum ~ maximum)
		the national governmental expenditure	
The total	56.8	15.4	5.9 ~ 10.3
I. Immediate economic measures	44.4	4.9	0.4 ~ 3.2
1. Measures to support employment	2.5	1.9	0.1 ~ 1.2
2. Financial measures	41.8	3.0	0.3 ~ 2.0
II. Economic growth strategy	8.8	6.2	3.4 ~ 4.2
1. The low-carbon revolution	2.2	1.6	0.9 ~ 1.3
For motor vehicles	0.4	0.4	0.4 ~ 0.6
For household appliances	0.3	0.3	0.1 ~ 0.2
2. Health care, child-rearing	2.8	2.0	0.7 ~ 1.0
3. Infrastructure	3.8	2.6	1.8 ~ 1.9
III. Easing anxiety and enhancing vitality	5.0	4.3	2.0 ~ 2.8
1. Revitalisation of regions	0.4	0.2	0.1
2. Safety and security	2.2	1.7	0.6 ~ 1.0
3. Support for local governments	2.4	2.4	1.4 ~ 1.8

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

Prospects for Japan's economy - Projected real GDP change; -4.2% in FY2009 and +0.3% in FY2010

(1) It is expected that the recessionary phase of Japan's economy will be prolonged, against the background of a deterioration in economic activity at home and abroad. Especially, Japan's real GDP during the second half of FY2008 to March 2009 saw a serious recessionary phase, which was two consecutive quarters of double-digit contraction, on a seasonally adjusted and annualised quarter-on-quarter change basis.

Further, while the quarterly GDP change rate would turn positive from the second quarter due to the economic measures taken by the government and so on, it is projected that the economy will follow a quarterly trajectory at a pace considerably below its potential output growth rate from the middle of the year onwards, without any strong driving force for the economy. This will lead to minus 4.2 per cent in the real GDP change rate in FY2009, a significant shrinking for two consecutive fiscal years.

(2) A main cause of the recession appears to be the economic deterioration in the corporate sector. It is expected that Japan's exports will continue to be mildly declining after a temporary flattening out. This is against the background of a continued fall in exports to the US and European economies amid persisting uncertainties in the financial markets, a predicted further decline in exports to resource-rich countries, and a gradual materialising of the negative effect of the Japanese yen appreciation.

The unfavourable move in exports is expected to continue having a negative impact on domestic demand. 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. Inventory adjustment could also lower the economic growth rate.

(3) It is expected that the household sector will also continue its 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 the advanced real purchasing power of households reflecting the fall of consumer prices.

(4) It is estimated that the Consumer Price Index excluding fresh food (the core CPI) will have decelerated rapidly due to a fall in import prices and increasing deflationary pressure. It is also projected that the index will start to decline sharply from around the beginning of FY2009 onwards.

Figure 9 Projections for GDP Growth and Main Indicators of Japan (as of May 20, 2009)

(seasonally adjusted, annualised % changes from the previous quarter)

	CY2008	CY2009				CY2010				CY2011	FY2008	FY2009	FY2010
	10~12	1~3	4~6	7~9	10~12	1~3	4~6	7~9	10~12	1~3			
	(Actual)	(Actual)	(Projection)			(Projection)				(Projection)	(Actual)	(Projection)	
Real GDP	▲ 14.4	▲ 15.2	3.8	0.9	0.1	▲ 0.1	0.1	0.3	0.9	1.5	▲ 3.5	▲ 4.2	0.3
Private Consumption Expenditure	▲ 3.1	▲ 4.2	1.9	0.6	0.4	0.2	0.3	0.3	0.4	0.6	▲ 0.5	▲ 0.5	0.3
Housing Investment	23.7	▲ 20.0	▲ 13.8	▲ 5.5	▲ 1.8	0.8	1.2	2.7	3.5	3.0	▲ 3.0	▲ 5.7	1.0
Business Fixed Investment	▲ 24.2	▲ 35.5	▲ 12.3	▲ 7.5	▲ 4.2	▲ 3.3	▲ 2.1	▲ 1.0	0.9	2.5	▲ 10.3	▲ 16.6	▲ 2.0
Private Inventories (percentage points contribution)	(1.7)	(▲ 1.0)	(2.4)	(1.0)	(0.1)	(0.0)	(0.0)	(0.0)	(0.2)	(0.4)	(▲ 0.1)	(0.8)	(0.2)
Government Consumption Expenditure	6.4	1.3	0.4	0.6	0.8	0.4	0.5	0.4	0.3	0.3	0.4	1.3	0.5
Public Investment	▲ 0.4	▲ 0.1	4.6	7.9	1.8	0.9	▲ 1.8	▲ 2.0	▲ 1.8	▲ 0.5	▲ 4.5	3.2	▲ 0.5
Net Exports (percentage points contribution)	(▲ 10.7)	(▲ 8.1)	(2.2)	(0.4)	(0.1)	(0.1)	(0.1)	(0.1)	(0.3)	(0.3)	(▲ 1.3)	(▲ 2.3)	(0.2)
Exports of Goods and Services	▲ 47.1	▲ 70.1	10.8	▲ 1.4	▲ 2.5	▲ 2.2	▲ 1.4	▲ 0.5	1.8	3.9	▲ 10.2	▲ 25.9	▲ 0.8
Imports of Goods and Services	13.1	▲ 47.7	▲ 9.5	▲ 5.1	▲ 4.2	▲ 3.3	▲ 2.8	▲ 1.7	▲ 0.6	1.3	▲ 3.5	▲ 13.7	▲ 2.5
(% changes from the same quarter of the previous year)													
Real GDP	▲ 4.3	▲ 9.7	▲ 7.3	▲ 6.9	▲ 3.1	1.1	0.3	0.1	0.3	0.7	▲ 3.5	▲ 4.2	0.3
Nominal GDP	▲ 3.6	▲ 8.6	▲ 5.1	▲ 4.6	▲ 2.9	▲ 1.0	▲ 1.2	▲ 1.4	▲ 0.8	▲ 0.4	▲ 3.7	▲ 3.4	▲ 0.9
GDP deflator	0.7	1.1	2.4	2.4	0.2	▲ 2.0	▲ 1.5	▲ 1.5	▲ 1.1	▲ 1.1	▲ 0.3	0.8	▲ 1.3
Consumer Price Index (excluding fresh food)	1.0	▲ 0.1	▲ 0.6	▲ 1.8	▲ 1.4	▲ 0.9	▲ 1.0	▲ 1.0	▲ 0.6	▲ 0.6	1.2	▲ 1.2	▲ 0.8
Industrial Production Index	▲ 14.8	▲ 34.6	▲ 29.3	▲ 24.7	▲ 15.6	8.4	2.4	1.7	1.8	2.1	▲ 12.6	▲ 17.4	2.0
Unemployment Rate (%)	4.0	4.5	4.9	5.2	5.4	5.4	5.4	5.4	5.4	5.4	4.1	5.2	5.4
Current Account Balances (trillion JY)	1.77	2.64	2.60	4.21	3.17	4.91	3.36	4.73	3.58	5.69	12.44	14.89	17.36
Share of Nominal GDP (%)	1.4	2.2	2.1	3.6	2.5	4.2	2.8	4.1	2.8	4.9	2.5	3.1	3.6
Exchange Rates (JY/US\$)	96.1	94.0	97.0	96.0	94.0	92.0	90.0	90.0	92.0	92.0	100.6	94.8	91.0
Import Price of Crude Oil (US\$/barrel)	79	44	52	54	56	57	58	60	61	63	90	55	60

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 -2.2% in the US, -3.7% in the euro area and +7.5% in China.