

# Monthly Report of Prospects for Japan's Economy

July 2009

Macro Economic Research Centre  
Economics Department



The Japan Research Institute, Limited

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

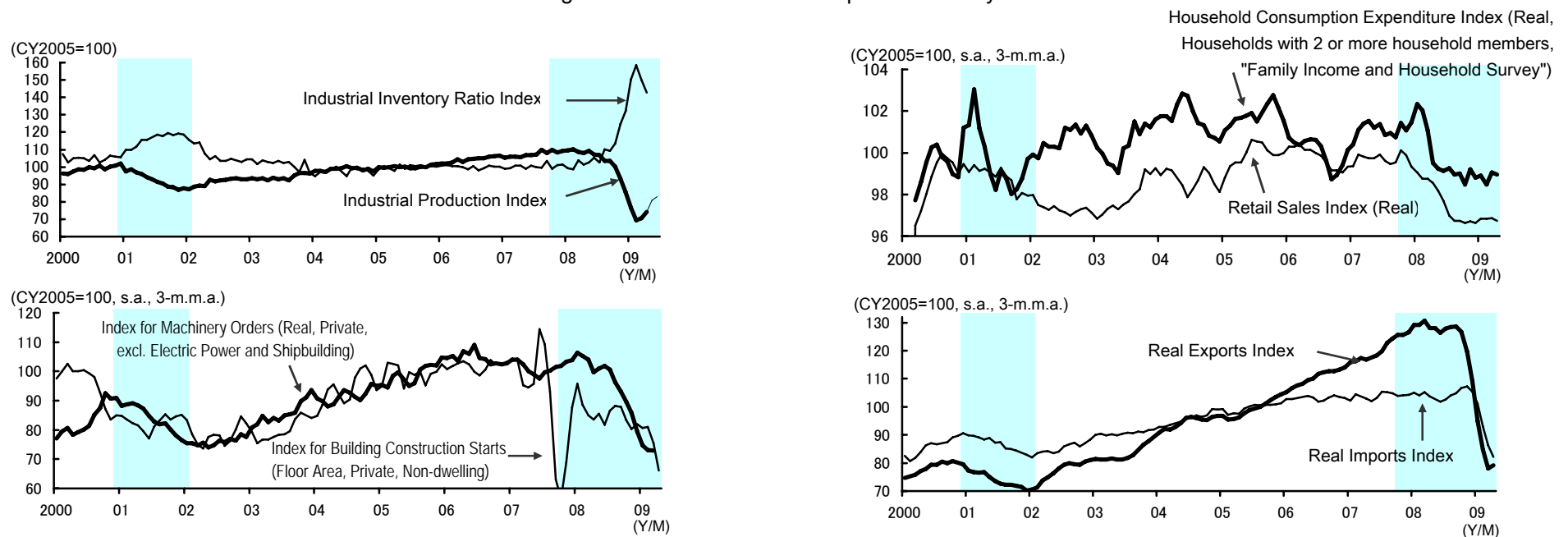
This report is the English version of the June 2009 issue of the original Japanese version.

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

Japan's economic activity appears to be exhibiting signs of bottoming out. The business activity in manufacturing has been recovering mildly, as industrial production increased over the previous month in April for the second month running and exports to Asia have turned positive. Reflecting progress in inventory adjustment, the industrial inventory ratio declined in April, the second consecutive monthly fall. The diffusion index for current conditions in the Economy Watchers Survey by the Cabinet Office also has shown an improving trend, reaching a bottom in January.

However, downward pressures on the economy still persist. Private consumption expenditure on a "Family Income and Household Survey" basis continues to stagnate, reflecting worsening employment and income environments. In addition, machinery orders and building construction starts have been declining considerably, mainly in manufacturing, 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.

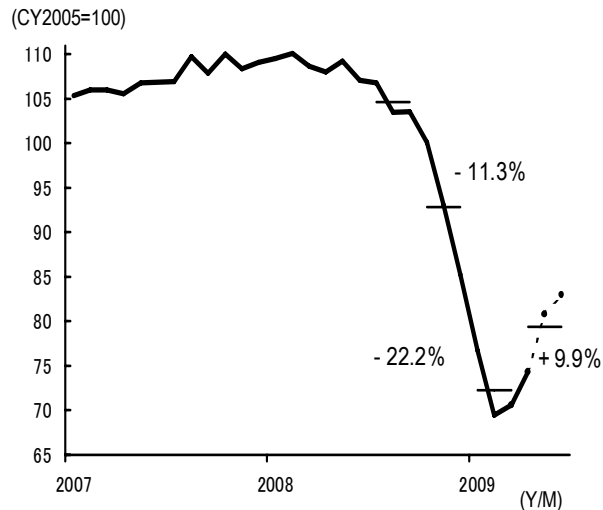
Note 2: The industrial production index in May and June 2009 is based on METI forecasts. Note 3: Shaded areas indicate periods of recession according to the Cabinet Office.

## Industrial production – Showing a recovery trend

The industrial production index increased by 5.2 per cent in April over the previous month, the second consecutive monthly rise. Also, the production forecast index indicated an 8.8 per cent month-on-month increase in May and a 2.7 per cent increase in June. Judging from the fact that the recent trend of revision on the forecast index has been upwards, it is estimated that industrial production will most likely have seen four consecutive monthly increases from March to June. Assuming that the forecast materialises, industrial production in the April-June period is estimated to have risen by a considerable 9.9 per cent from the previous quarter. The following can be considered as the background of recent favourable moves: (1) the government's economic measures have had a beneficial effect on a recovery in durable goods, (2) the declining trend in exports has been checked, and (3) 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 electronic parts and devices industry and the motor vehicles industry. Production in industries such as information and communication equipment and nonferrous metals is expected to increase by more than 20 per cent. However, production in general machinery would continue to decline, reflecting a continued sharp fall in business fixed investment.

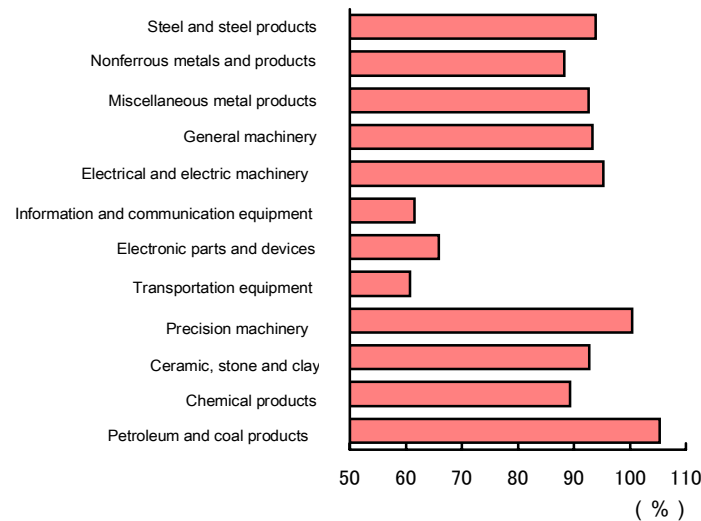
Figure 2-1 Industrial Production Index  
<seasonally adjusted>



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

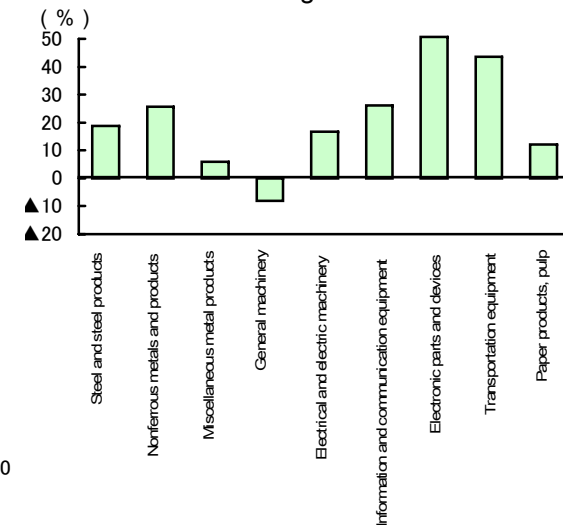
Note 2: The short horizontal line indicates the average in each quarter and the figure shows the quarter-on-quarter % change.

Figure 2-2 Inventory Level by Industry  
in April 2009, Compared  
with 4 Months before



Source: The Ministry of Economy, Trade and Industry.

Figure 2-3 Change in Production Shown  
in the Forecast Index in June  
2009 from 4 Months before  
<% change>



Source: The Ministry of Economy, Trade and Industry.

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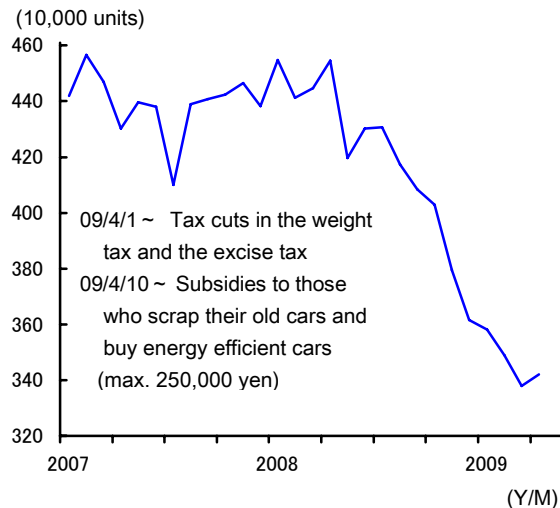
## Real GDP – Expected to see positive quarterly growth in the April-June period

It is likely that Japan's real GDP will see a positive growth rate in the April-June period for the following reasons:

- (1) an increase in sales of environment-friendly and fuel-efficient cars thanks to tax cuts and subsidies since this April,
- (2) an increase in public investment due to a front-loading execution of the budget for this fiscal year,
- (3) a recent move that the declining trend of exports has been checked, positively influenced by China's economic stimulus measures, and
- (4) a positive contribution of private inventory investment to real GDP growth, reflecting an easing of inventory adjustment pressure.

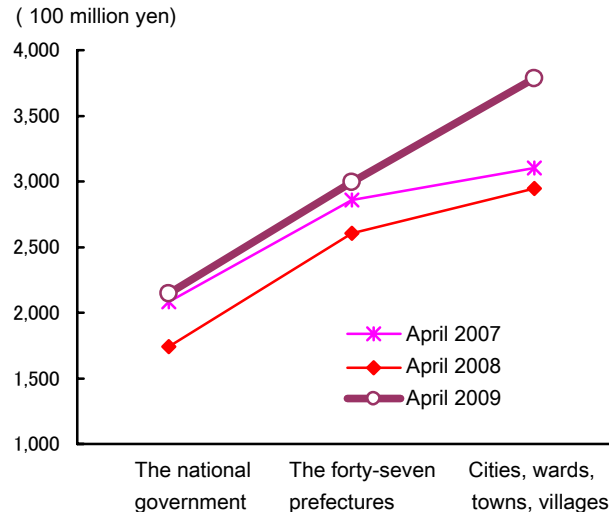
However, it should be noted that final demand appears to be still fragile, because the recent recovery moves are only a reflection of the boosting effects of economic measures by the government and of the effects brought about by the nearing end of inventory adjustment.

Figure 3-1 Domestic Sales of New Cars <seasonally adjusted, annualised>



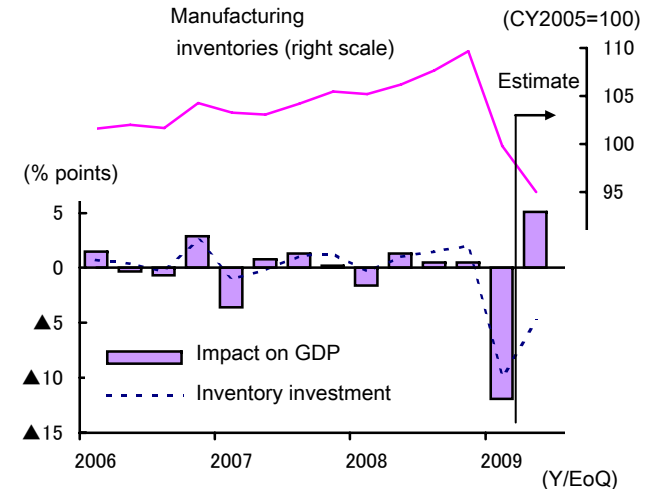
Source: Japan Automobile Dealers Association, Japan Mini Vehicles Association.

Figure 3-2 The Amount of Contracts of Public Construction Works by Orderer



Source: Japan Construction Surety Association.

Figure 3-3 Estimate of the Impact of Inventory Adjustment on GDP



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

## Exports - Have been bottoming out, yet could be stagnating again

There seem to be signs that Japan's exports, which had declined rapidly, have bottomed out. This is mainly due to a recovery in exports to Asia, largely to China.

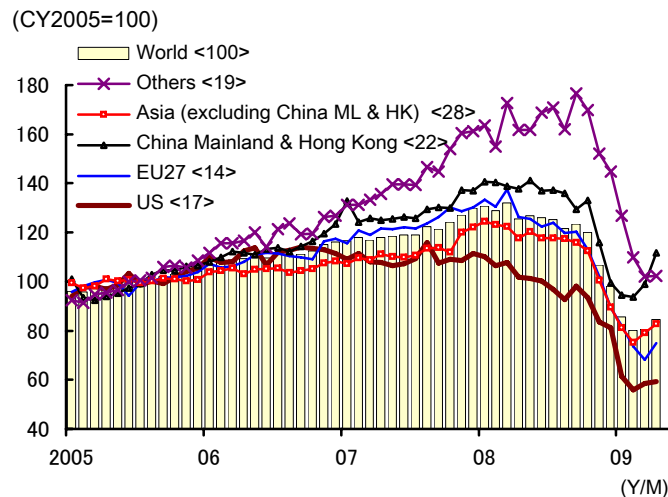
However, even if exports see a slight recovery for the time being, they could face a downside risk of stagnating in the second half of this year. It can hardly be expected that exports would turn to a visibly increasing trend, taking into consideration the following three factors.

(1) Exports to the US and European countries seem to be flattening out, yet could decline again, 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 since last autumn would be materialising during this year.

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

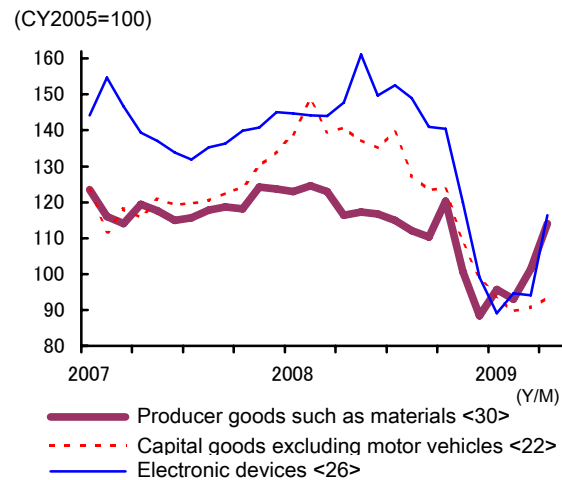


Source: The Ministry of Finance, The Bank of Japan.

Note 1: The figures in angle brackets in the legend indicate the share of each region in total nominal exports of Japan in FY2008.

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

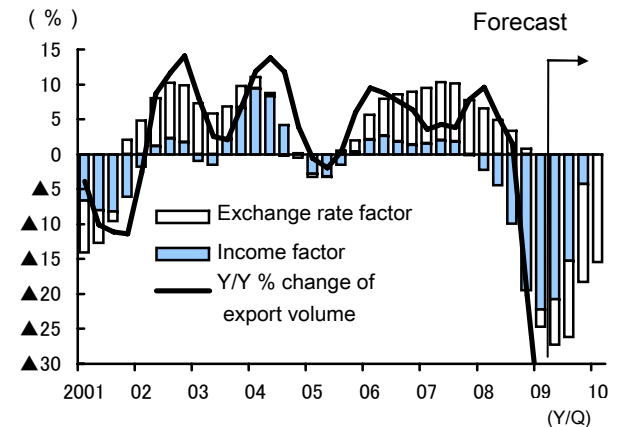
Figure 4-2 Japan's Real Exports to China  
by Commodity  
<seasonally adjusted>



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 FY2008.

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

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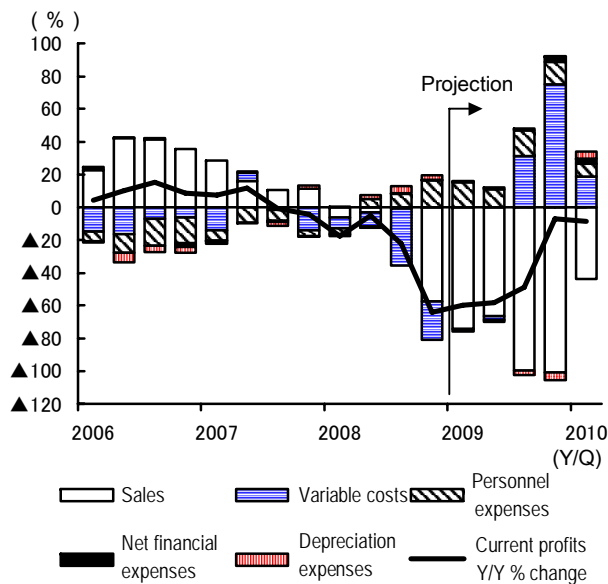
## Corporate profits - Continued double-digit rate of decline

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 pace of increase in business failures would not accelerate, judging from the following:

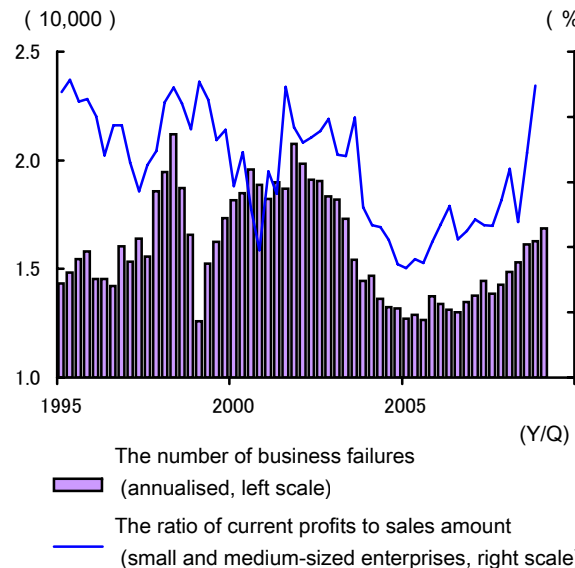
- (1) Japanese enterprises have ample internal reserves, as seen in the fact that their ratio of net worth is at the highest level ever.
- (2) Measures to support and improve cash positions of enterprises have been prepared by the government and the BOJ.

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



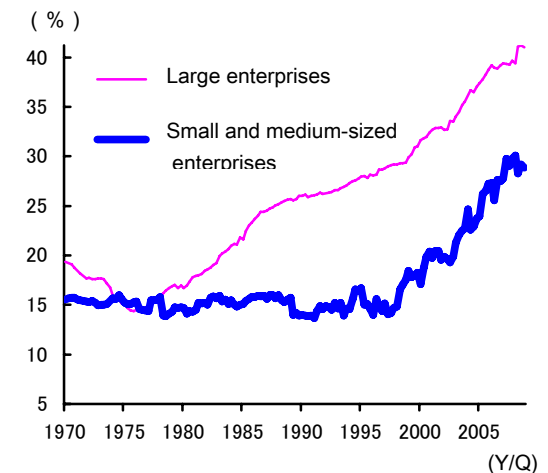
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance, "Financial Statements Statistics of Corporations by Industry: Quarterly".

Figure 5-2 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 5-3 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 - Considerable decline expected mainly in manufacturing

Machinery orders in manufacturing have declined significantly, reflecting a sharp fall in industrial production. On the other hand, machinery orders in nonmanufacturing have seen only a slight fall, against the background of firmness in infrastructure-related investment as seen in the railway industry.

The Tankan March 2009 survey also drew a similar picture in its forecast for business fixed investment in fiscal year 2009. The survey forecast a record 13.2 per cent decline in FY2009 over the previous year in business fixed investment in large manufacturing. Even this forecast could be an overestimate, taking into account an expected further downswing of sales and profits and an estimated sense of excess capacity that is predicted to stay at a high level for a prolonged period. Accordingly, it is likely that the current forecast of business fixed investment in manufacturing in FY2009 will be revised downwards by 10 to 20 percentage points.

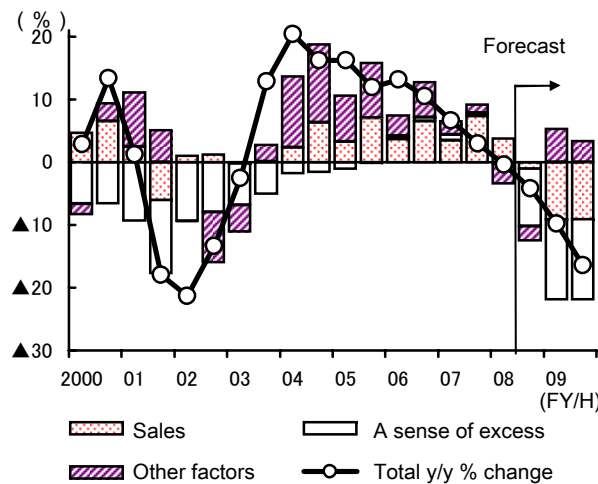
As for business fixed investment in nonmanufacturing, there is a risk that it would turn to a declining trend hereafter, reflecting stagnating domestic demand.

Figure 6-1 Index for Machinery Orders by Type of Industry



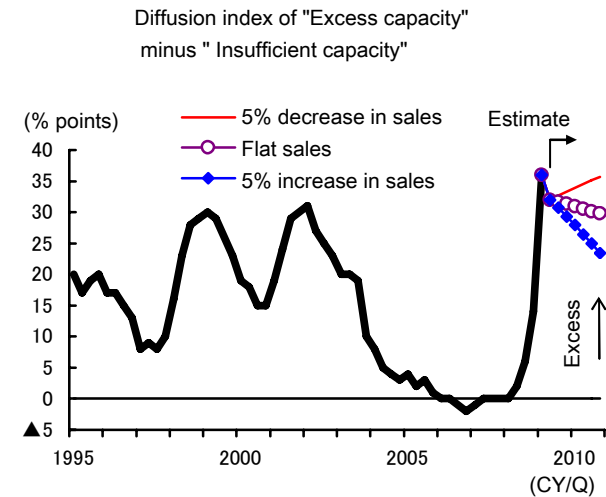
Source: The Cabinet Office.

Figure 6-2 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 6-3 Estimate on A Sense of Excess Capacity <manufacturing>



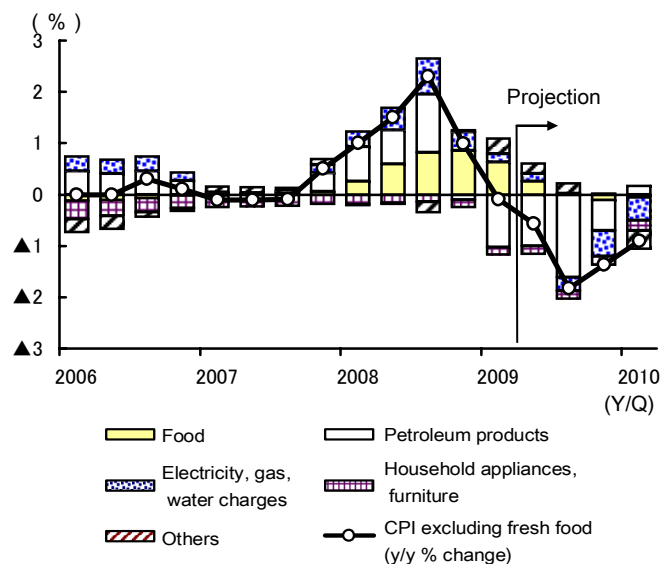
Source: The Japan Research Institute, Ltd. based on the data of The Bank of Japan, The Ministry of Finance

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

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 persist. The core CPI is projected to decline further in a rapid way, reflecting a fall in energy prices, such as petrol, and a deceleration in the pace of rises in food, mainly 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 various goods and services covered by the Index due to intensifying price competition, as the supply-demand gap will expand to the level of around 8 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.

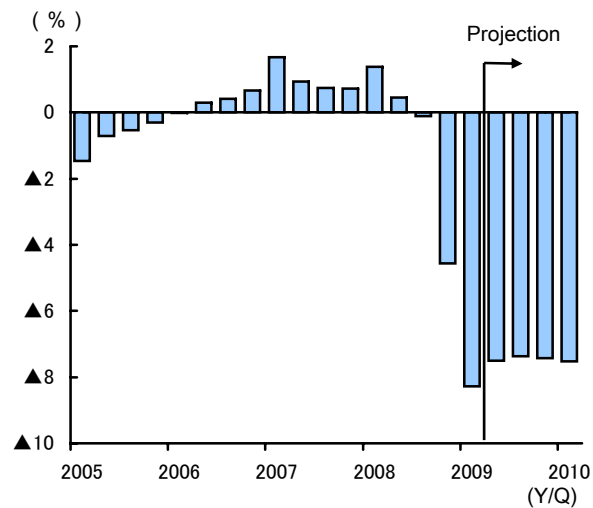
Deflationary pressure will persist for a long time from 2010 onwards. It is estimated that it will take five to ten years for the supply-demand gap shown as a percentage of GDP, which has recently expanded rapidly, to narrow to zero. The downward pressure on the movement of prices also is expected to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

Figure 7-1 Change in Consumer Price Index on CY2005-base <year-on-year, excluding fresh food>



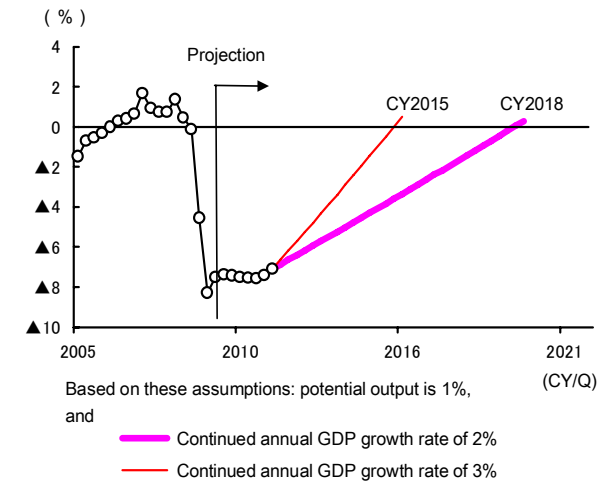
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Internal Affairs and Communications.

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



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

Figure 7-3 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,

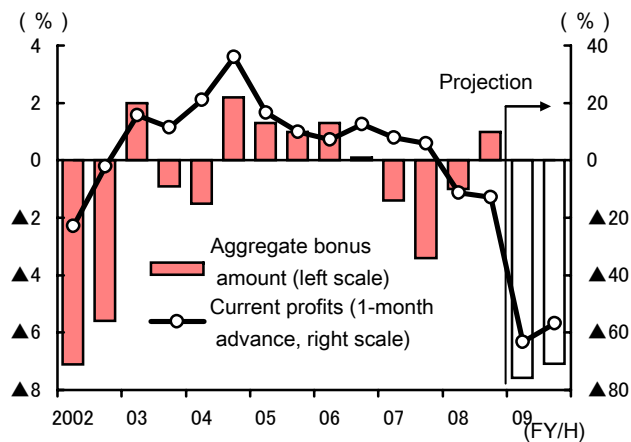
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## Rapidly intensifying pressure for employment adjustment

In the household sector, the following three negative influences would be felt: (1) a fall in wages, especially in bonuses, (2) a negative wealth effect due to the fall in stock prices, and (3) 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, the firing of temporary workers has come into focus among the employment issues since last year. 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 two million by the first quarter of year 2010. This level of numbers would push up the unemployment rate by 3.0 percentage points. The rapidly worsening employment situation seen above is estimated to push down the growth rate of private consumption expenditure by 1.6 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.

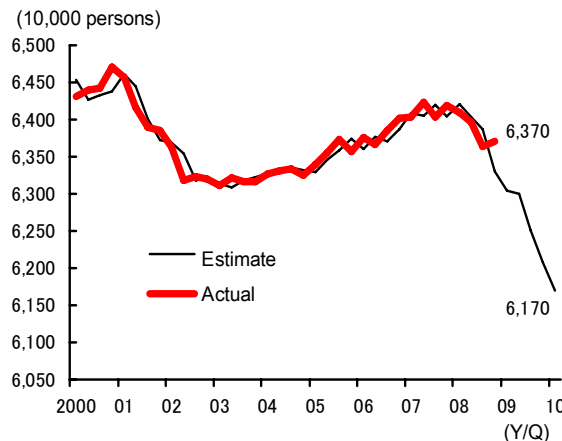
Figure 8-1 Current Profits and Aggregate Bonus Amount  
<year-on-year % change>



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.

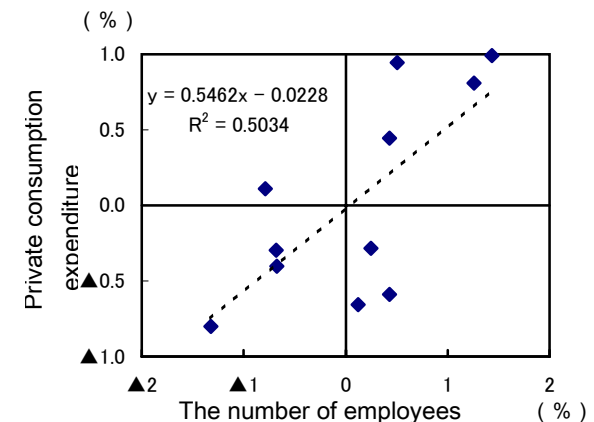
Figure 8-2 Estimate on Working Population



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:  
 $\ln(L) = 0.17 + 0.82 * \ln(L<-1>) + 0.11 * \ln(GDP) - 0.0004 * \text{Trend}$   
 Period 1994/Q2 ~ 2008/Q3, Adjusted R<sup>2</sup> = 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.

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## 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 aimed 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 half a million to one million cars is likely to materialise. However, it is unlikely that public expenditure of local governments will increase much, amid the deterioration of their fiscal positions. In addition, an increase in expenditure on motor vehicles and household appliances could be offset by a reduction in expenditure on other items, amid a worsening of income environments. Taking these factors into consideration, 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 9-1 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	N/A	N/A	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 9-2 on this page.

N/A: Not available.

Source: The Cabinet Office.

Figure 9-2 The Outline of Emergency Economic Measures  
"Policy Package to Address Economic Crisis" <dated April 10, 2009>  
(Trillion yen)

	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; -3.5% 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 stagnation in economic activity at home and abroad. The quarterly real GDP change rate is estimated to have turned positive in this April-June period. However, it should be noted that final demand appears to be still fragile, because the recent recovery moves are only a reflection of the boosting effects of economic measures by the government and of the effects brought about by the nearing end of inventory adjustment. It is, accordingly, projected that the quarterly real GDP growth rate from the July-September period onwards will follow a quarterly trajectory at a pace considerably below its potential output growth rate, without any strong driving force for the economy. This will lead to minus 3.5 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 stagnation in the corporate sector. It is expected that Japan's exports will continue to be mildly declining after a temporary bottoming out. This is against the background of a re-decline in exports to the US and European economies amid persisting uncertainties in the financial markets, 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 decline in capacity utilisation, a decreasing trend in business fixed investment would be more intensified, especially in the export industries.

(3) It is expected that the household sector will also continue its stagnant situation, due to sluggish 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 the 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) The Consumer Price Index excluding fresh food (the core CPI) had decelerated rapidly due to a fall in import prices and increasing deflationary pressure. It is also projected that the index will have started to decline sharply from around the beginning of FY2009 and will continue a declining trend thereafter on a year-on-year basis.

Figure 10 Projections for GDP Growth and Main Indicators of Japan ( as of June 11, 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)	(Projection)	(Projection)	
	(Actual)	(Actual)	(Projection)			(Projection)				(Projection)	(Actual)	(Projection)		
Real GDP	▲ 13.5	▲ 14.2	5.0	1.2	0.0	▲ 0.1	0.1	0.2	0.9	1.5	▲ 3.3	▲ 3.5	0.3	
Private Consumption Expenditure	▲ 3.1	▲ 4.2	1.8	1.1	0.4	0.2	0.3	0.3	0.4	0.6	▲ 0.5	▲ 0.5	0.4	
Housing Investment	23.0	▲ 20.3	▲ 17.1	▲ 5.5	▲ 1.8	0.8	1.2	2.7	3.5	3.0	▲ 3.1	▲ 6.7	1.0	
Business Fixed Investment	▲ 23.4	▲ 31.0	▲ 8.6	▲ 7.5	▲ 4.2	▲ 3.3	▲ 2.1	▲ 1.0	0.9	2.5	▲ 9.8	▲ 14.5	▲ 2.0	
Private Inventories (percentage points contribution)	( 2.4)	(▲ 0.6)	( 0.9)	( 1.0)	( 0.1)	( 0.0)	( 0.0)	( 0.0)	( 0.2)	( 0.4)	( 0.0)	( 0.6)	( 0.2)	
Government Consumption Expenditure	6.5	0.1	0.9	0.6	0.8	0.4	0.5	0.4	0.3	0.3	0.3	1.2	0.5	
Public Investment	▲ 0.3	0.3	12.9	7.9	1.8	0.9	▲ 1.8	▲ 2.0	▲ 1.8	▲ 0.5	▲ 4.4	5.3	▲ 0.5	
Net Exports (percentage points contribution)	(▲ 10.7)	(▲ 8.0)	( 4.2)	( 0.3)	( 0.1)	( 0.1)	( 0.1)	( 0.1)	( 0.3)	( 0.3)	(▲ 1.3)	(▲ 1.9)	( 0.1)	
Exports of Goods and Services	▲ 47.1	▲ 70.0	25.4	▲ 1.4	▲ 2.5	▲ 2.2	▲ 1.4	▲ 0.5	1.8	3.9	▲ 10.2	▲ 23.6	▲ 0.8	
Imports of Goods and Services	13.1	▲ 47.8	▲ 13.6	▲ 5.1	▲ 4.2	▲ 3.3	▲ 2.8	▲ 1.7	▲ 0.6	1.3	▲ 3.5	▲ 14.7	▲ 2.5	

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

Real GDP	▲ 4.3	▲ 8.8	▲ 6.7	▲ 6.0	▲ 2.4	1.5	0.3	0.1	0.3	0.7	▲ 3.3	▲ 3.5	0.3
Nominal GDP	▲ 3.6	▲ 8.0	▲ 4.7	▲ 4.9	▲ 3.4	▲ 1.5	▲ 2.2	▲ 1.7	▲ 1.2	▲ 0.8	▲ 3.6	▲ 3.7	▲ 1.5
GDP deflator	0.7	0.9	2.2	1.1	▲ 1.0	▲ 3.0	▲ 2.5	▲ 1.8	▲ 1.5	▲ 1.5	▲ 0.3	▲ 0.2	▲ 1.8
Consumer Price Index (excluding fresh food)	1.0	▲ 0.1	▲ 0.6	▲ 1.6	▲ 0.9	▲ 0.5	▲ 0.5	▲ 0.7	▲ 0.5	▲ 0.5	1.2	▲ 0.9	▲ 0.6
Industrial Production Index	▲ 14.8	▲ 34.6	▲ 26.9	▲ 20.3	▲ 10.7	14.7	5.0	1.7	1.8	1.9	▲ 12.6	▲ 13.1	2.6
Unemployment Rate (%)	4.0	4.5	5.1	5.3	5.4	5.4	5.4	5.4	5.4	5.4	4.1	5.3	5.4
Current Account Balances (trillion JY)	1.77	2.43	2.70	4.00	3.48	4.56	2.90	4.58	3.85	5.23	12.23	14.74	16.56
Share of Nominal GDP (%)	1.4	2.1	2.2	3.4	2.8	4.0	2.4	3.9	3.1	4.6	2.5	3.1	3.5
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	54	71	74	77	80	83	85	88	90	69	84

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 -2.9% in the US, -4.4% in the euro area and +7.5% in China.