Monthly Report of Prospects for Japan's Economy

April 2015

Macro Economic Research Centre
Economics Department

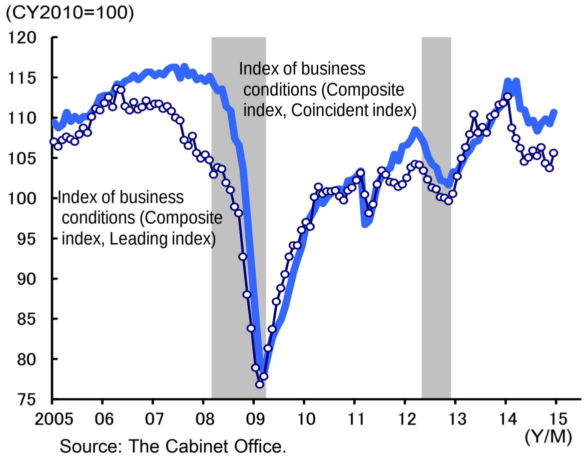
The Japan Research Institute, Limited
http://www.jri.co.jp/english/periodical/

This report is the revised English version of the March 2015 issue of the original Japanese version.

The general situation of Japan's economy – Economic activity is continuing a moderate recovery

Figure 1-1 Economic Activity

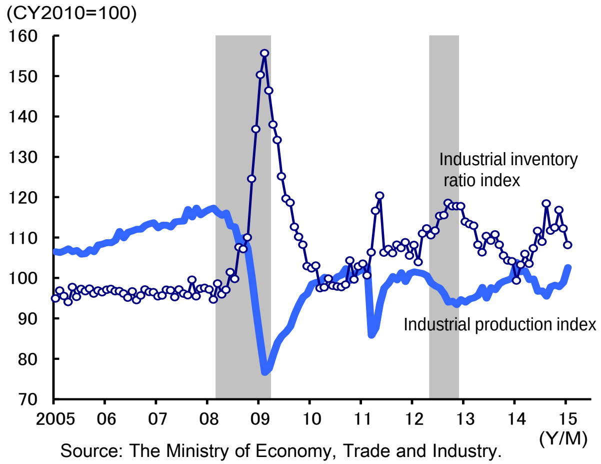
The leading index of business conditions rose for the first time in 3 months, due to the fall in the inventory ratio , etc.



Source: The Cabinet Office.

Figure 1-2 The Corporate Sector

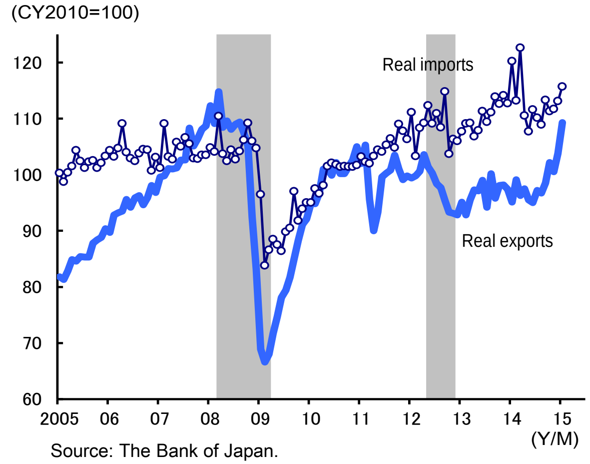
Production has continued to pick up in a wide range of industries. The inventory ratio has declined for 2 months.



Source: The Ministry of Economy, Trade and Industry.

Figure 1-3 Overseas Demand

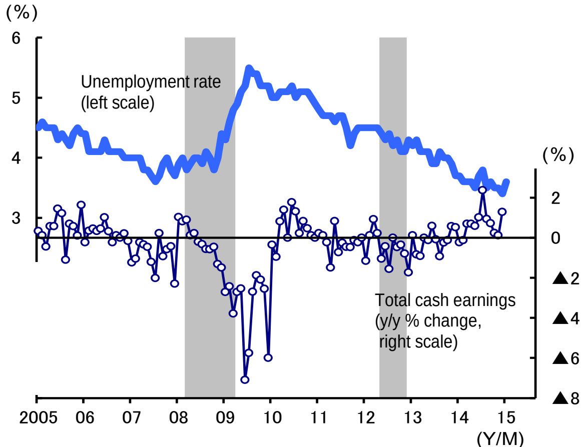
Exports have continued their recovery trend, led by exports to the US and Asia.



Source: The Bank of Japan.

Figure 1-4 Employment and Income

The unemployment rate rose month-on-month for the first time in 4 months, yet was still at a low level.

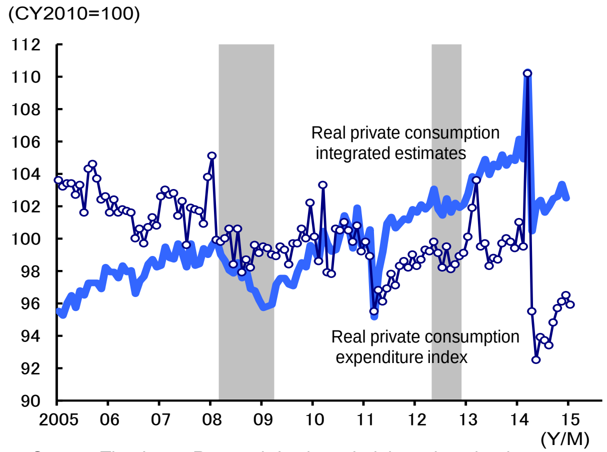


Source: The Ministry of Internal Affairs and Communications, The Ministry of Health, Labour and Welfare.

＊The shaded area indicates the phase of recession.

Figure 1-5 Private Consumption Expenditure

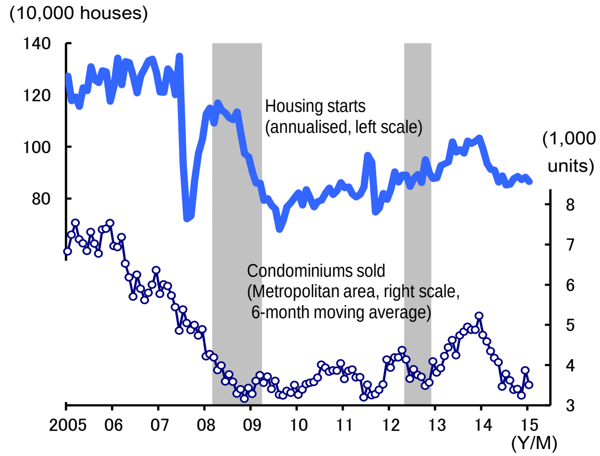
Private consumption expenditure decreased for the first time in 5 months, showing that its recovery after the tax rise took a breather.



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

Figure 1-6 Housing Investment

Both housing starts and condominium sales continue to stay at a low level.



Source: The Ministry of Land, Infrastructure and Transport, Real Estate Economic Institute Co., Ltd.

Economic activity is on a recovery trend on the whole, although the pick up in private consumption is slow

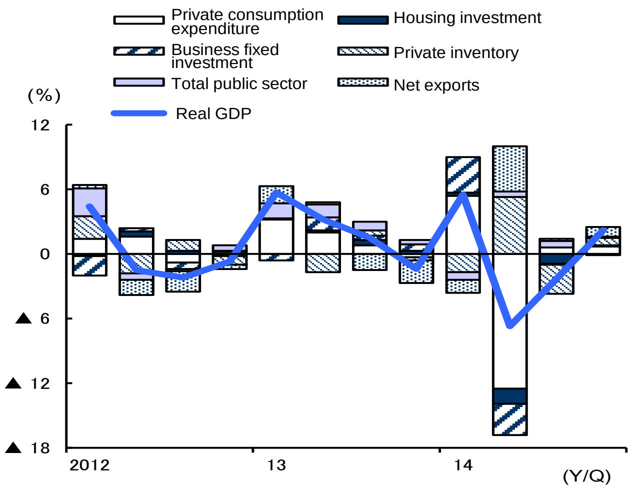
Japan's real GDP in the October-December period last year increased by 1.5 per cent on an annualised quarter-on-quarter change basis (national accounts, the second preliminary estimates). This was a positive figure for the first time in 3 quarters, yet was revised downwards from 2.2 per cent in the first estimates . Economic activity during that period continued its recovery from the reactionary fall after the consumption tax rise last April, although the pace of the pick up in private consumption expenditure was slow and the corporate sector still lacked strength.

On a monthly statistics basis, in the household sector, retail sales value decreased from the previous month in January, the fourth successive monthly decline. On the other hand, consumer sentiment has bottomed out. As the reactionary fall after the tax rise nears its end gradually, it is expected that private consumption expenditure will continue to pick up moderately.

In the corporate sector, industrial production increased by 3.7 per cent from the previous month in January, the highest monthly rise since January last year, with the production in a wide range of industries having risen. Reflecting the increase in production, machinery orders, which are a leading indicator for business fixed investment, continued their recovery trend.

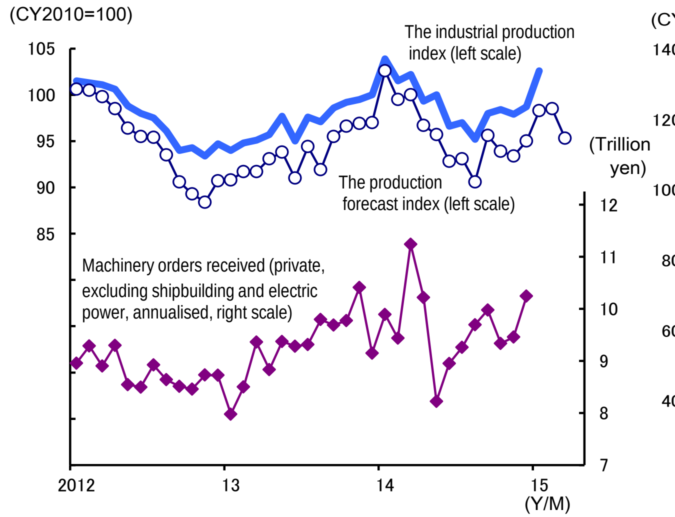
Meanwhile, real exports increased considerably in January, which made the recovery in exports more visible. The pace of increase in the exports of capital goods excluding transport equipment to the US and Asia excluding China accelerated.

Figure 2-1 Real GDP Quarterly Growth Rate
<the first preliminary estimates, seasonally adjusted, annualised Q/Q change rate>



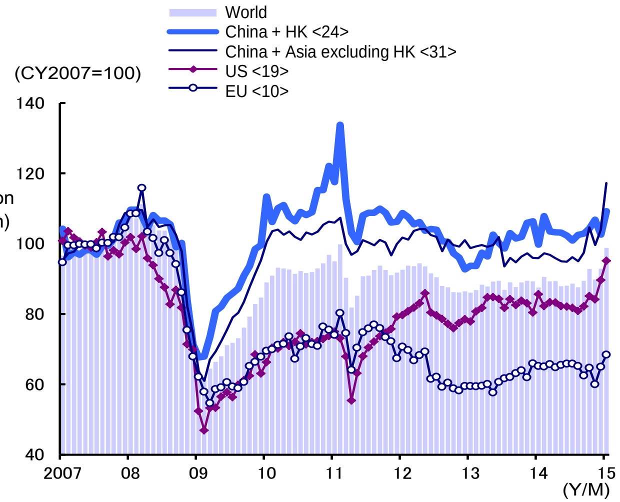
Source: The Japan Research Institute, Ltd. based on the data of The Cabinet Office.
Note: Total public sector = government consumption expenditure + public capital formation + public inventory change

Figure 2-2 Indices of Industrial Production and Machinery Orders Received
<seasonally adjusted>



Source: The Ministry of Economy, Trade and Industry, The Cabinet Office.

Figure 2-3 Real Exports
<seasonally adjusted>



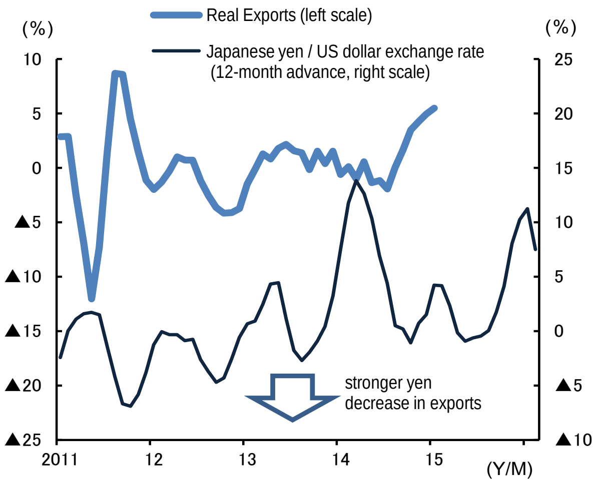
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance, The Bank of Japan.
Note: Figures in the angle brackets show the shares in FY2013.

Exports will likely pick up, yet the pace will remain slow

Japan's real exports on a monthly basis increased considerably in January. However, it is not certain whether the latest increasing trend will continue or not, because real exports during the first ten days of February declined by 0.4 per cent year-on-year. At present, it could be judged that real exports will continue to pick up, yet the pace will remain slow, for the following reasons.

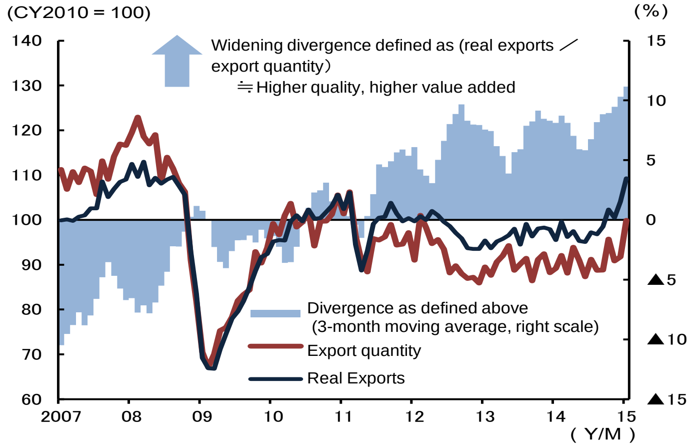
First, on the exchange rate side, it is expected that the depreciation of the yen will bolster exports for the time being. In addition, a few cases have been seen where Japanese manufacturers have moved a small part of their overseas production back to Japan. However, the structural trends will not change, such as 1) general-use products that are not high value added, which had a significant impact on export quantity from Japan, will continue to be produced in overseas production facilities rather than in domestic ones, and 2) a shift to high value added products in the domestic production facilities will also continue. Second, on the overseas demand side, it is predicted that the pick up in global economic activity will lack momentum, because a deceleration in the economies in emerging countries such as China will likely be a weighing down factor on the global economy as a whole, while the firm economy in the US will play a leading role as a driving force. Accordingly, it is predicted that the pace of increase in Japan's exports will remain moderate, corresponding to the pace of the pick up in the overseas economy as a whole.

Figure 3-1 Japan's Real Exports and Yen / Dollar Exchange Rate <3-month moving average, % change from 3 months earlier>



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

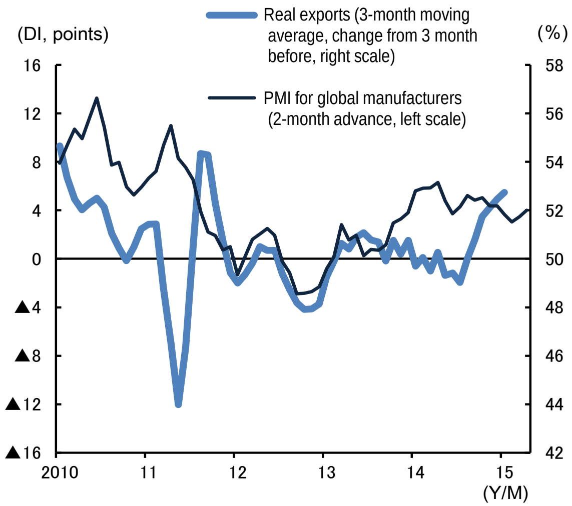
Figure 3-2 Divergence between Japan's Real Exports and Export Quantity <seasonally adjusted>



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

Note: In real exports, their deflator is adjusted by the change in quality of goods, while there is no such adjustment in export quantity. This means that the divergence between the two suggests the improvement or the decline in average quality in exported goods as a whole.

Figure 3-3 PMI for Global Manufacturers and Japan's Real Exports



Source: : The Japan Research Institute, Ltd. based on the data of Markit / J.P. Morgan, The Bank of Japan.

Corporate profits continue to improve due to the weaker yen and cheaper crude oil

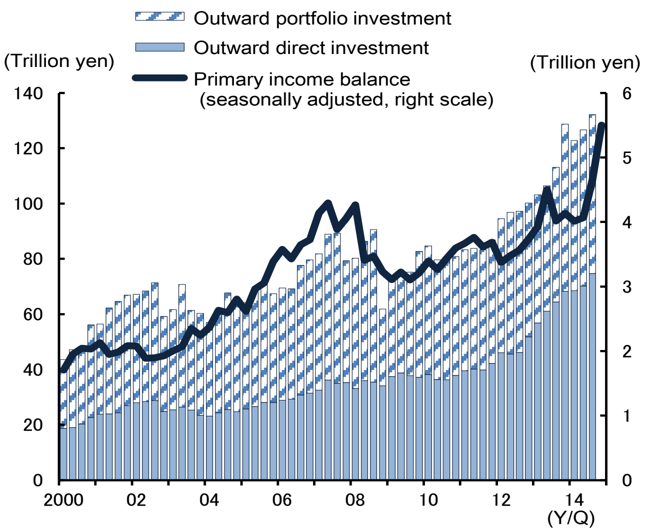
If the crude oil price during the rest of the year stays at the latest level after its significant fall, annual trade deficits in 2015 are expected to be reduced considerably. This reduction in the outflow of income from Japan on an aggregate basis should have positive effects on corporate profits.

Also, as external assets of Japanese enterprises expand, surpluses in primary income such as dividends and interests from such external assets have increased. Together with the effect of the weaker yen on value, the latest yen-denominated surpluses in primary income balance amounted to the highest value thus far.

Thus, corporate profits continue to improve due to the weaker yen and cheaper crude oil, in addition to the effect of strengthened profitability through restructuring. This trend is shown in the fact that the ratio of current profits to sales has risen to the highest level ever, based on the Financial Statements Statistics of Corporations by Industry from the Ministry of Finance.

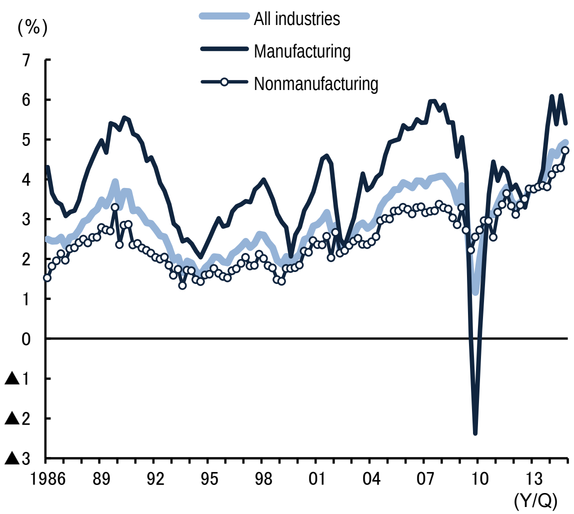
Further, it is expected that business fixed investment will pick up, reflecting favourable investment environments such as abundant cash flow and very low interest rates, although there are anxieties including a low growth rate in the domestic markets.

Figure 4-1 External Asset Balance by Type and Primary Income Balance in Current Accounts



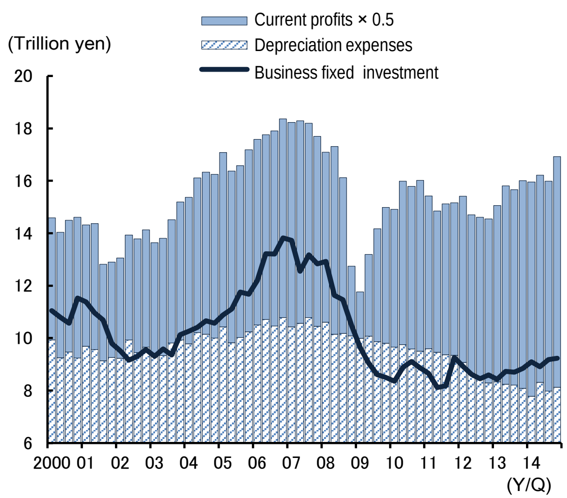
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance, The Bank of Japan.

Figure 4-2 Ratio of Current Profits to Sales in Japanese Enterprises



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

Figure 4-3 Business Fixed Investment and Cash Flow



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

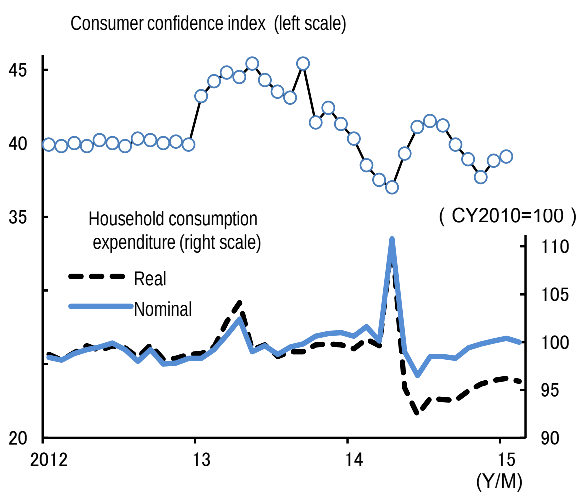
Private consumption expenditure will be affected positively by wage rises and cheaper oil

In the household sector, the pace of recovery in private consumption expenditure is still slow, against the background of the decrease in real income due to price rises. Yet, a certain degree of improvement has been seen in consumer sentiment since the end of last year, as the negative effect of the reactionary fall after the rise in the consumption tax rate last April is coming to an end.

It is predicted that real income shown as real compensation for employees will increase year-on-year from the second quarter this year onwards because of the following. First, amid continued improvement in corporate profits, the average rate of wage rises in the wage negotiations this spring is expected to be more than that in last spring season. Second, the improvement in employment environments is also likely to continue. Third, a slowdown in the pace of increase in consumer prices, reflecting the ending of the effect of last year's tax rise and the materialisation of the significant fall in the oil price, is predicted to contribute to pushing up real income.

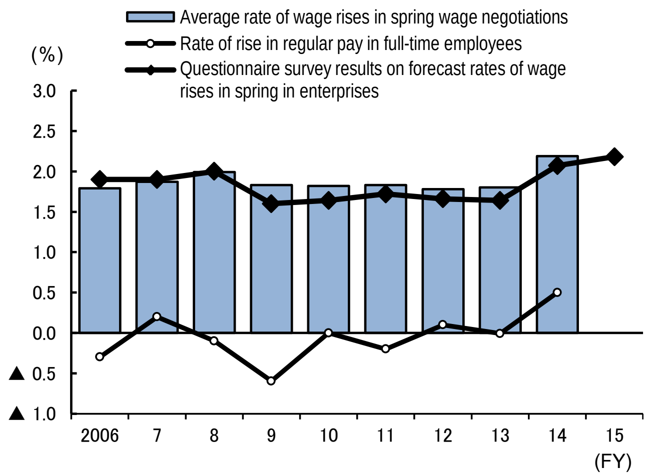
In addition, stock prices have been on a rising trend, against the background of continued increase in corporate profits. Assuming that the Nikkei 225 stock price average stays at the level of 18,500 yen during the rest of the year, it is projected that the quarterly difference value from a year earlier in the appraisal profits in stock prices in the household sector as a whole will likely be more than 30 trillion yen. Accordingly, the wealth effect from the stock price rise will be expected in private consumption expenditure, mainly in the households which hold stocks.

Figure 5-1 Consumer Sentiment and Household Consumption Expenditure <seasonally adjusted>



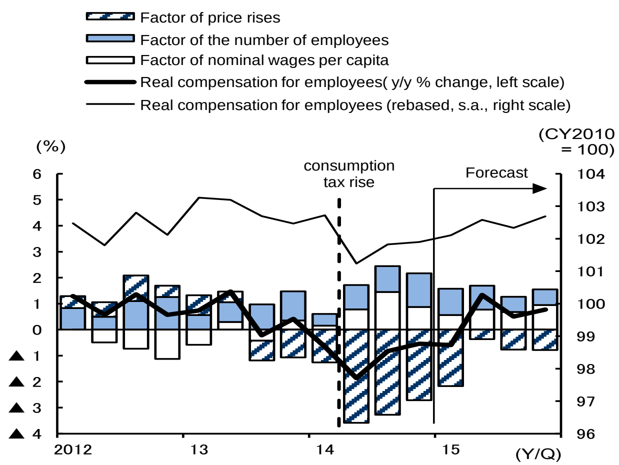
Source: The Japan Research Institute, Ltd. based on the data of The Cabinet Office, The Ministry of Internal Affairs and Communications.

Figure 5-2 Average Rate of Wage Rises in Spring Wage Negotiations <year-on-year % change>



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

Figure 5-3 Contributions to Year-on-year Change in Real Compensation for Employees



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

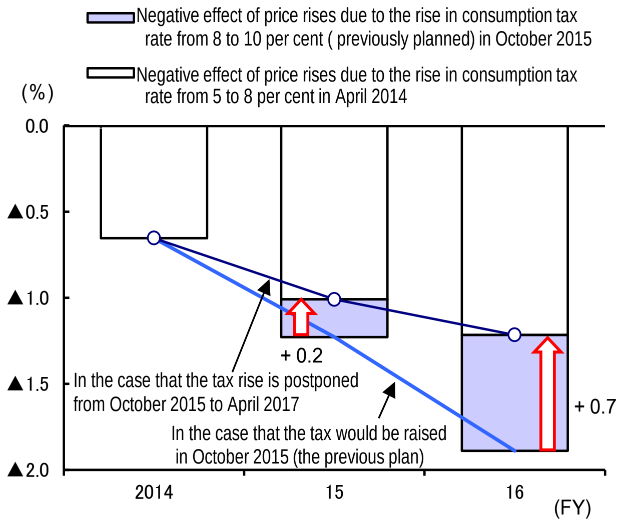
Postponement of the tax rise will benefit the economy for a while, yet will delay fiscal consolidation

The government postponed the planned rise in the consumption tax rate (from 8 to 10 per cent) from October 2015 to April 2017, appearing to have given top priority to recovering economic activity and to overcoming deflation fully. This postponement is predicted to have a positive effect on economic activity for the time being, as downward pressure on private consumption expenditure, through a decline in purchasing power of households due to price rises stemming from the tax rise, ceases to exist. The JRI estimate shows that this postponement will push up the real GDP growth rate in FY2015 and FY2016 by 0.2 and 0.7 percentage points, respectively.

In addition, the implementation of economic measures of around 3.5 trillion yen in the supplementary budget for FY2014, which was approved in a cabinet meeting in December, will likely bolster the economic activity further. The JRI estimate, based on the data of the Ministry of Finance, shows that the implementation will push up the real GDP growth rate in FY2015 by 0.4 percentage points. Yet, the boosting effect could be delayed due to a continued shortage of workers and heightened construction costs.

On the other hand, the postponement of the consumption tax rise will bring about dark clouds over the already planned fiscal reconstruction path. An expected considerable downswing in the consumption tax revenue will worsen the primary balance in central and local governments. Also, a scheduled enrichment and stabilisation in social security such as medical services, family care, and the pension system will face a retreat, as an increase in the consumption tax revenue set aside for these expenditure items no longer exists.

Figure 6-1 The Effect of Price Rises Stemming from Tax Rises to Real GDP Growth Rate <estimate>



Source: Simulation by JRI based on the data of The Cabinet Office, The Ministry of Internal Affairs and Communications, and so on.

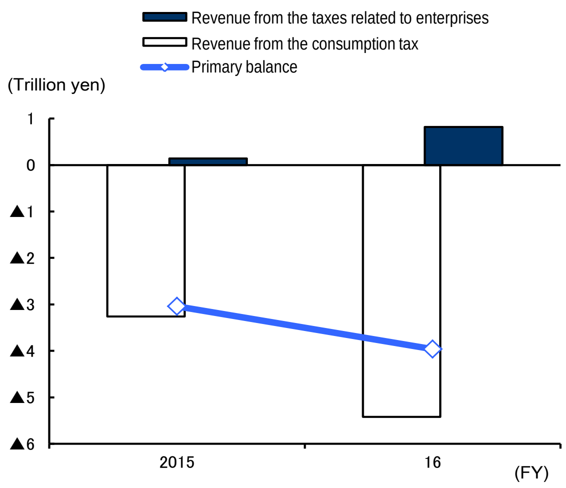
Figure 6-2 The Effect of Economic Measures Taken in the Supplementary Budget for FY2014 <estimate>

(Billion yen)

	The amount of measures in the supplementary budget	The estimated amount of boosting effect
Consumer-related	460	184
Business fixed investment-related	930	772
Public expenditure, public works	2,130	1,541
Total	3,520	2,497
The boosting effect on the real GDP growth rate in FY2015 (%)		0.4

Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance, Prime Minister of Japan and his Cabinet, and so on.

Figure 6-3 The Effect of Postponement of the Rise in the Consumption Tax Rate on Tax Revenue



Source: Simulation by JRI based on the data of The Ministry of Finance, The Cabinet Office, and so on.

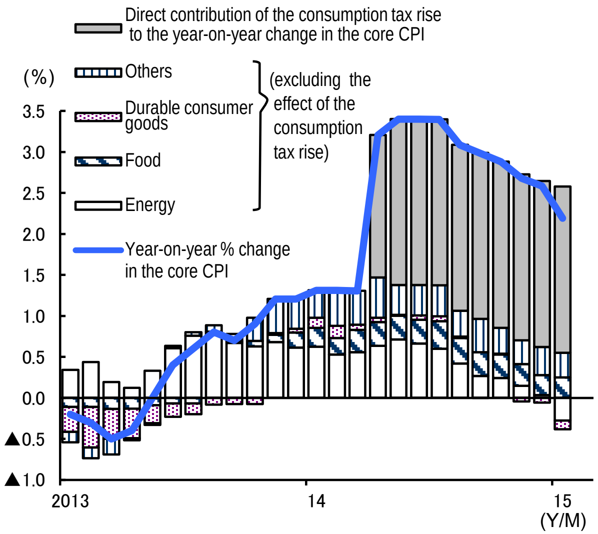
The pace of rise in core CPI will accelerate again as the effect of the latest weaker yen materialises

Except for the direct effect of the consumption tax rise, the core CPI, which excludes fresh food, increased by 0.2 per cent year-on-year in January, having decelerated since the peak in April last year. In addition to the delay in the improvement in the supply-demand condition, due to unfavourable effects of the consumption tax rise, the considerable fall in the oil price has been a weighing down factor on consumer prices.

Meanwhile, reflecting the additional monetary easing measures taken by the Bank of Japan on October 31 last year, the yen has depreciated further. The weaker yen is expected to push up consumer prices through a rise in costs for imports, and an improvement in the supply-demand condition if an advance in corporate profits through the weaker yen leads to an increase in business fixed investment and in household income. It is estimated that it takes more than 6 months for the effect of the depreciation of the yen to be felt in consumer prices. Therefore, although the slow pace of rise in the core CPI will remain for the time being, the pace will likely accelerate again as the effect of the weaker yen materialises.

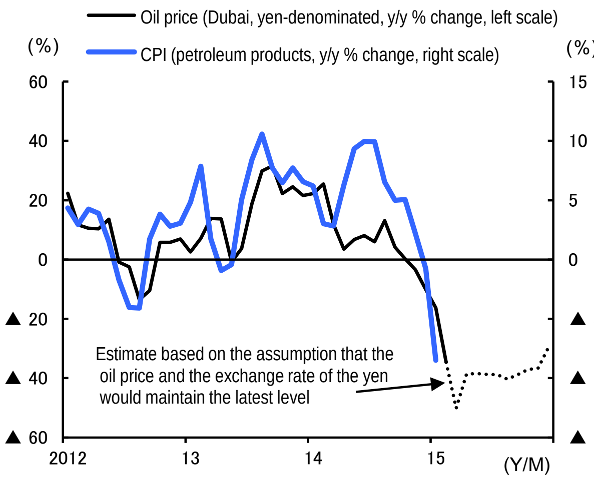
In order to achieve the goal set by the BoJ of the "continuously stable core CPI inflation rate at a pace of 2 per cent year-on-year", it is vital for the rate of increase in the core CPI inflation to accelerate stably hereafter through a rise in inflation expectations. In order for inflation expectations to rise, it is imperative that the acceleration in the core CPI inflation be realised by households and enterprises firmly, as actual figures have considerable influences on inflation expectations. In any case, it will take time to achieve the goal.

Figure 7-1 Contributions to the Year-on-year Change Rate of the Core CPI
<year-on-year % change>



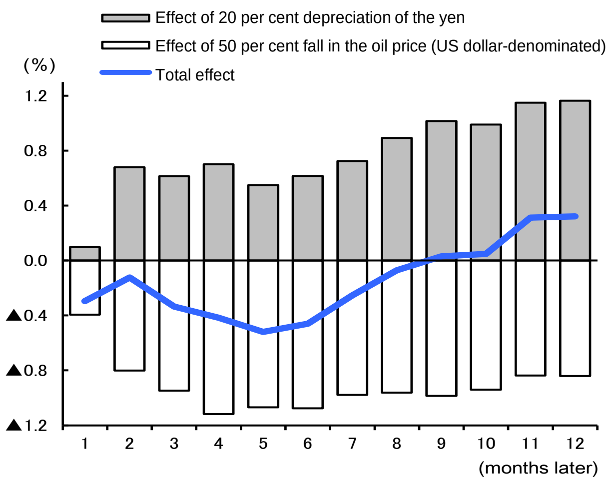
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Internal Affairs and Communications.

Figure 7-2 Oil price and CPI of Petroleum Products
<year-on-year % change>



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

Figure 7-3 Effect of the Weaker Yen and Cheaper Oil on the Core CPI in Process of Time



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

Prospects for Japan's economy - Projected real GDP change; - 0.9% in FY2014 and 1.7% in FY2015

(1) Japan's real GDP in the October-December period last year increased by 1.5 per cent on an annualised quarter-on-quarter change basis (national accounts, the second preliminary estimates). This was a positive figure for the first time in 3 quarters, yet was revised downwards from 2.2 per cent in the first estimates . Economic activity during that period continued its recovery from the reactionary fall after the consumption tax rise last April, although the pace of the pick up in private consumption expenditure was slow and the corporate sector still lacked strength. With respect to the whole of FY2014, real GDP will likely decline 0.9 per cent, the first fiscal yearly fall since FY2009, hugely affected by the reactionary fall in economic activity after the consumption tax rise.

(2) It is predicted that the "autonomous economic expansion mechanism", where the positive effects felt in the corporate sector such as the increase in corporate profits lead to increased business fixed investment, employment and wages, is expected to work increasingly more strongly, as the reactionary fall and subsequent inventory adjustment near an end gradually. The economic activity will likely become more firm, against the background of a continued positive attitude of enterprises to investment in plant and equipment, a continued improvement in income and employment environments for households, reduced costs in enterprises and advanced purchasing power in households thanks to the considerable fall in the oil price, the wealth effect of the rise in stock prices on households, and so on. However, the pace of recovery is predicted to remain moderate, because the weaker yen will weigh on households and a certain part of domestic demand-related enterprises through increased costs, and overseas demand will not be able to be counted on so much as it has been thus far.

(3) The government postponed the planned rise in the consumption tax rate (from 8 to 10 per cent) from October 2015 to April 2017, appearing to have given top priority to recovering economic activity and to overcoming deflation fully. This postponement is predicted to have a positive effect on economic activity in FY2015, as downward pressure on private consumption expenditure, through a decline in purchasing power due to price rises from the tax rise, ceases to exist. Also, the implementation of economic measures taken in the supplementary budget for FY2014, will likely bolster the economic activity in FY2015 further. As these favourable factors bring about firm economic activity, the economic growth rate will likely be 1.7 per cent in FY2015.

(4) Looking ahead further, although the "autonomous economic expansion mechanism" will continue to work, the pace of economic growth will likely slow down through the middle of FY2016. This is because of weighing down factors such as stagnant real income through price rises due to the depreciation of the yen, a slowdown in overseas economies such as in the US and China, and so on. However, towards the fourth quarter of FY2016 to March 2017, it is projected that rushed demand in private consumption expenditure and others will boost economic activity before the rescheduled rise in the consumption tax rate in April 2017. As a result, real GDP is predicted to grow by 1.5 per cent in FY2016 as a whole.

(5) The pace of increase in consumer prices is predicted to be slow for the time being, because the considerable fall in the oil price, as well as the delay in the improvement in the supply-demand condition due to unfavourable effects of the consumption tax rise, will continue to be a weighing down factor. However, from the second half of FY2015 onwards, the pace of increase in the core CPI will likely accelerate, as upward pressure on consumer prices from the depreciation of the yen materialises, albeit with a lag.

Figure 9 Projections for GDP Growth and Main Indicators of Japan (as of March 9, 2015)

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

	CY2014	CY2015				CY2016				CY2017	FY2013	FY2014	FY2015	FY2016
	10～12	1～3	4～6	7～9	10～12	1～3	4～6	7～9	10～12	1～3				
	(Actual)	(Projection)				(Projection)				(Projection)	(Actual)	(Projection)		
Real G D P	1.5	2.5	2.1	2.1	1.8	1.7	1.3	1.2	1.2	1.8	2.1	▲ 0.9	1.7	1.5
Private Consumption Expenditure	2.0	1.8	1.4	1.3	1.3	1.2	0.8	0.8	1.3	3.4	2.5	▲ 2.9	1.5	1.2
Housing Investment	▲ 4.6	3.8	3.7	4.2	4.0	3.9	2.0	2.3	4.2	4.6	9.3	▲ 12.0	0.8	3.2
Business Fixed Investment	▲ 0.3	3.9	3.9	4.4	4.5	4.6	2.3	2.7	3.0	3.3	4.0	▲ 0.2	3.3	3.3
Private Inventories (percentage points contribution)	(▲ 0.7)	(0.4)	(0.1)	(0.0)	(0.0)	(0.0)	(0.2)	(0.1)	(▲ 0.3)	(▲ 0.7)	(▲ 0.5)	(0.4)	(▲ 0.2)	(▲ 0.0)
Government Consumption Expenditure	1.2	0.4	0.4	0.4	0.4	0.4	0.5	0.6	0.6	0.6	1.6	0.5	0.5	0.5
Public Investment	3.3	▲ 1.9	1.5	1.3	▲ 0.8	0.0	0.0	▲ 0.5	▲ 1.0	▲ 1.2	10.3	2.8	0.9	▲ 0.3
Net Exports (percentage points contribution)	(0.9)	(▲ 0.3)	(▲ 0.2)	(▲ 0.1)	(0.0)	(▲ 0.1)	(▲ 0.1)	(▲ 0.1)	(▲ 0.1)	(▲ 0.4)	(▲ 0.5)	(0.5)	(0.0)	(▲ 0.1)
Exports of Goods and Services	11.5	4.4	4.4	4.6	4.7	4.7	4.5	4.2	4.2	4.2	4.7	7.2	5.4	4.4
Imports of Goods and Services	5.3	4.8	4.4	4.4	4.0	4.4	4.3	4.1	4.0	5.1	6.7	3.1	4.5	4.3

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

	CY2014 10～12	CY2015 1～3	4～6	7～9	10～12	CY2016 1～3	4～6	7～9	10～12	CY2017 1～3	FY2013	FY2014	FY2015	FY2016
Real G D P	▲ 0.8	▲ 1.2	0.8	2.1	1.9	2.0	1.8	1.5	1.3	1.4	2.1	▲ 0.9	1.7	1.5
Nominal G D P	1.6	1.1	1.2	2.8	2.3	2.3	2.1	2.1	1.8	2.0	1.8	1.3	2.1	2.0
GDP deflator	2.4	2.4	0.3	0.7	0.4	0.3	0.4	0.5	0.5	0.6	▲ 0.3	2.2	0.4	0.5
Consumer Price Index (excluding fresh food)	2.7	2.2	0.3	0.6	1.0	1.2	1.4	1.2	1.3	1.4	0.8	2.9	0.8	1.3
(excluding fresh food and consumption tax)	0.7	0.2	0.3	0.6	1.0	1.2	1.4	1.2	1.3	1.4	0.8	0.8	0.8	1.3
Industrial Production Index	▲ 1.5	▲ 1.1	2.4	4.8	3.4	0.1	1.4	1.2	1.1	1.1	3.2	▲ 0.3	2.7	1.2
Unemployment Rate (%)	3.5	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.9	3.5	3.4	3.4
Current Account Balances (trillion JY)	1.45	3.27	1.53	2.75	0.96	3.74	1.62	2.82	1.06	4.06	0.83	6.72	8.98	9.56
Share of Nominal GDP (%)	1.1	2.7	1.2	2.3	0.7	3.0	1.3	2.3	0.8	3.2	0.2	1.4	1.8	1.9
Exchange Rates (JY/US$)	114	119	120	121	122	123	123	123	123	123	100	110	122	123
Import Price of Crude Oil (US$/barrel)	89	57	60	65	67	69	69	70	70	71	110	91	65	70

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 1: "▲" indicates minus.
2: It is assumed that the consumption tax rate will be raised from 8% to 10% in April 2017.
3: It is also assumed that economic measures through the supplementary budget will be implemented (amount: 3,529 billion yen).
4: The assumptions on the real GDP growth rate in 2014 (actual result in the US and China), 2015 and 2016 in major overseas economies: the US, 2.4%, 3.0%, 2.8%; the euro area, 0.8%, 1.0%, 1.3%; China, 7.4%, 7.2%, 7.0%.