

# Monthly Report of Prospects for Japan's Economy

May 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 April 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 declined for the first time in 2 months, due to the fall in real machinery orders, etc.

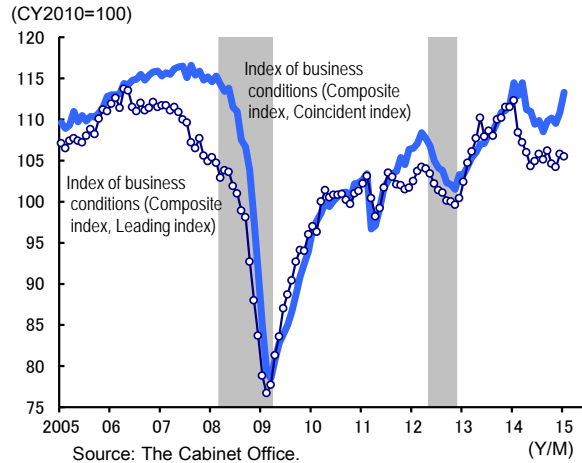


Figure 1-2 The Corporate Sector

Production decreased in February in a wide range of industries after the considerable increase in January. The inventory ratio rose for the first time in 3 months.

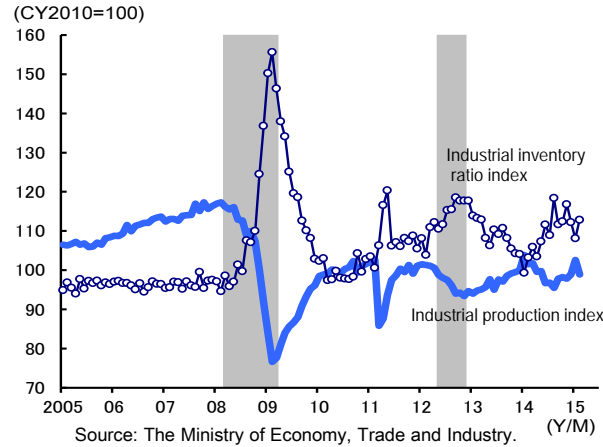


Figure 1-3 Overseas Demand

Exports, especially those to China, decreased. Imports increased for 4 months in a row.

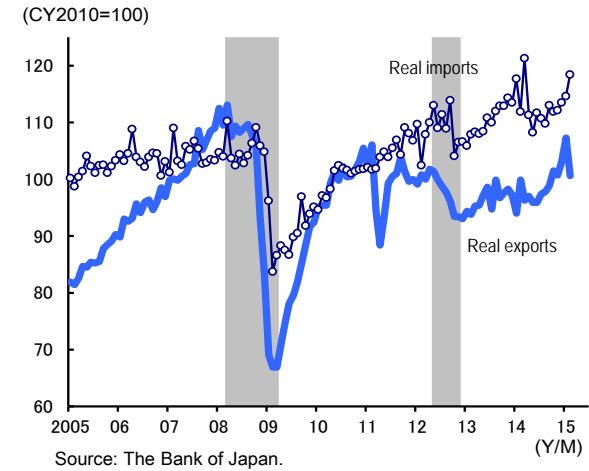
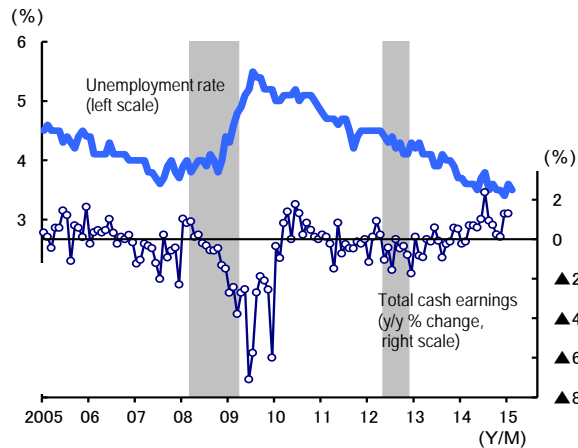


Figure 1-4 Employment and Income

The unemployment rate fell month-on-month for the first time in 2 months and kept a low level.



\* The shaded area indicates the phase of recession.

Figure 1-5 Private Consumption Expenditure

Private consumption expenditure continued to recover, albeit at a moderate pace, with its real index having risen for the first time in 2 months.

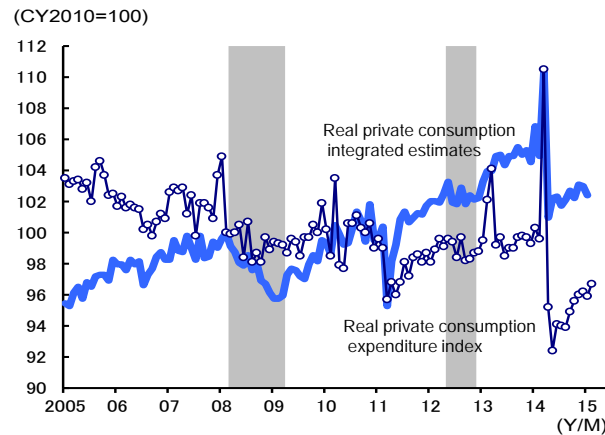
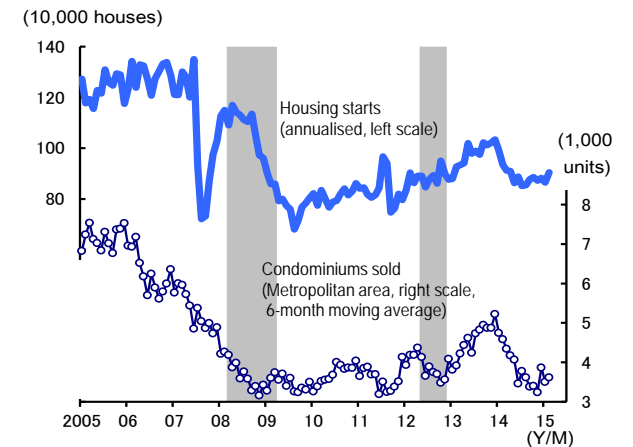


Figure 1-6 Housing Investment

Both housing starts and condominium sales continued to seesaw.



## Economic activity is on a moderate recovery trend, reflecting the improvement in corporate profits and others

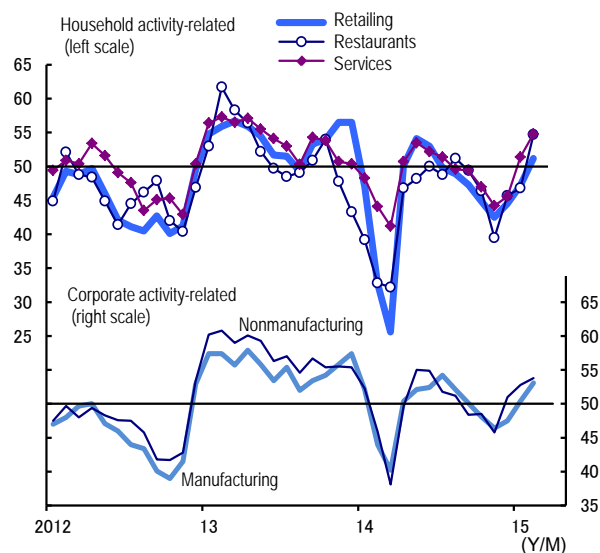
Japan's economic activity is continuing a moderate recovery. The Economy Watchers Survey in February shows that the diffusion indices (DIs) for current economic conditions have recovered both in household and corporate activity-related businesses. This seems to be reflecting a pick up in consumer sentiment and continued favourable environments for enterprises such as low interest rates and cheaper crude oil. Further, the DIs for future economic conditions have recovered to levels over 50 (which shows a diverging point between better and worse) in all types.

In the household sector, retail sales value increased from the previous month in February, against the background of the improvement in consumer sentiment. Also, real private consumption expenditure rose by 0.8 per cent for the first time in 2 months. Thus, private consumption expenditure as a whole seems to be recovering from the reactionary fall after the rise in the consumption tax rate last April.

In the corporate sector, industrial production is forecast to increase considerably from the previous month in April after the decrease in February and March. It is predicted that production will continue an increasing trend on the whole.

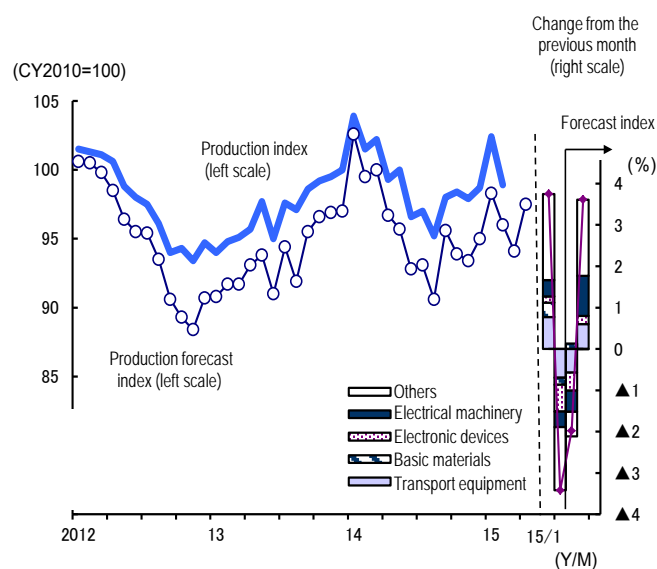
Meanwhile, real exports declined from the previous month in February. Especially, exports to China fell significantly, due to the reactionary fall after the surge before the Lunar New Year. Exports to the US and EU also decreased.

Figure 2-1 The Economy Watchers Survey  
<DIs for future economic conditions>



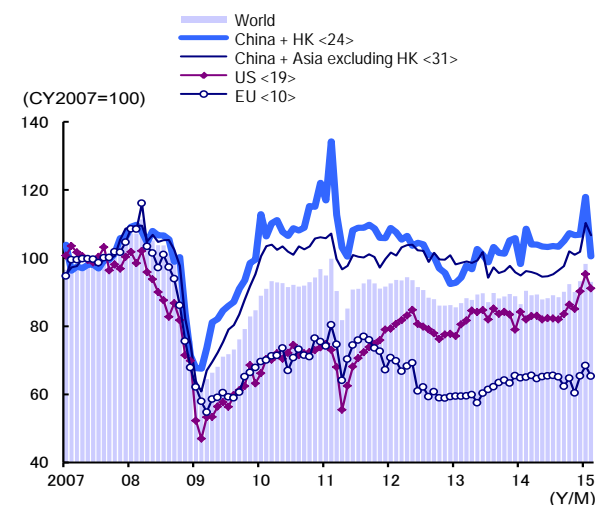
Source: The Japan Research Institute, Ltd. based on the data of The Cabinet Office.

Figure 2-2 Indices of Industrial Production and Production Forecast  
<seasonally adjusted>



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

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.

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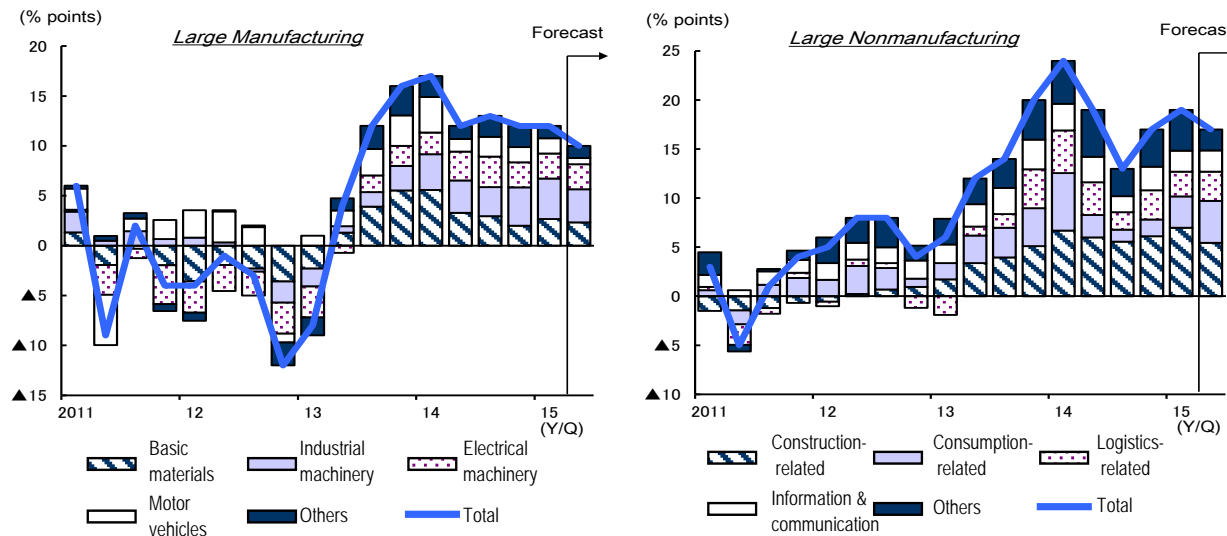
# BoJ's Tankan Survey - Business conditions are forecast to decline, yet keep a high level

In the Tankan March 2015 Survey, the diffusion index (DI) for business conditions on an all sizes and industries basis was plus 7 percentage points, a slight 1 percentage point improvement from the previous result. The DI for the whole of large manufacturing was the same as that in the previous survey. While the DIs in the machinery industries were basically unchanged, the DIs in the materials industries recovered due to a pause in the depreciation of the yen and a fall in the crude oil price. The DI for the whole of large nonmanufacturing increased by 2 percentage points, because the DIs in the household consumption-related industries such as retailing improved considerably. As for the DIs for business conditions in small and medium-sized enterprises, while the DIs in manufacturing worsened, the DIs in nonmanufacturing improved. This seems to be because the pick up in private consumption expenditure reflecting wage rises and the cheaper crude oil price affected domestic demand-related industries positively. Looking ahead, the forecast DIs for future (in 3 months' time) business conditions worsened in all sizes and types of industries, which suggested cautious business sentiment, yet were expected to still keep a high level.

Meanwhile, with respect to planned business fixed investment for fiscal year 2015, the rate of expected increase in investment in plant and equipment in manufacturing was relatively high. On the other hand, the attitude in nonmanufacturing was cautious, seeming to have factored in the reaction to the high increase rate last fiscal year. Judging from favourable environments such as low interest rates, business fixed investment will likely be solid during FY2015, mainly in investment for maintenance and replacement as well as for rationalisation and saving.

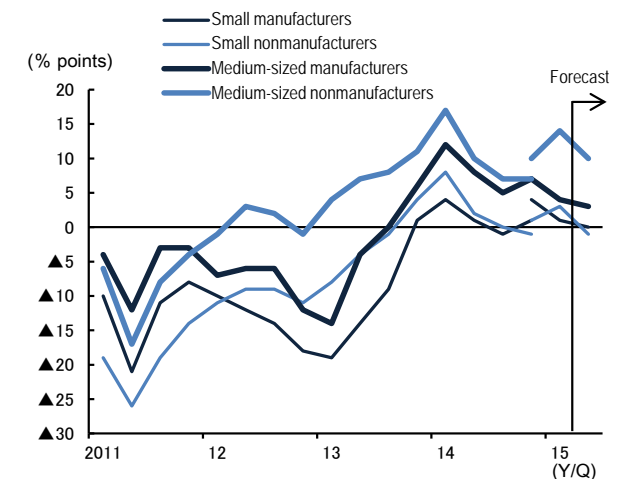
Figure 3-1 Contributions to Business Conditions Diffusion Index by Industry

<diffusion index of "favourable" minus "unfavourable", and percentage point contribution to the total DI points>



Source: The Japan Research Institute, Ltd. based on the data of The Bank of Japan, "The Tankan March 2015 Survey".

Figure 3-2 Business conditions Diffusion Index in Small and Medium-sized Enterprises



Source: The Bank of Japan, "The Tankan March 2015 Survey".

Note: Sample enterprises have been changed since December 2014.

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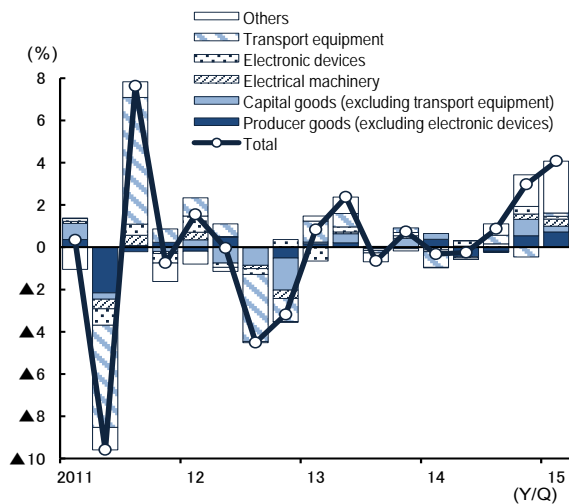
# Exports will likely pick up, yet the pace will remain moderate, responding to overseas demand

In the overseas demand sector, Japan's real exports have been on an increasing trend since last autumn. Viewed by products, the item which has contributed most to the rate of increase in the total real exports is "others". Further, looking at the particulars of "others", the items such as re-export goods and gold have contributed largely. Actually, these two items produce no value added in domestic production. Therefore, it is likely that the boosting effect of real exports on domestic economic activity will be limited.

Looking at the future prospects, 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.

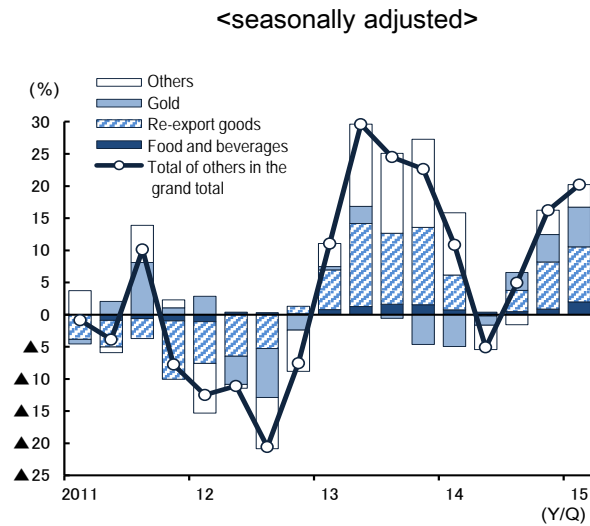
Accordingly, the pace of increase in Japan's exports will likely remain moderate, corresponding to the pace of pick up in overseas demand.

Figure 4-1 Contributions to the Quarter-on-quarter Change Rate in Japan's Real Exports by Goods



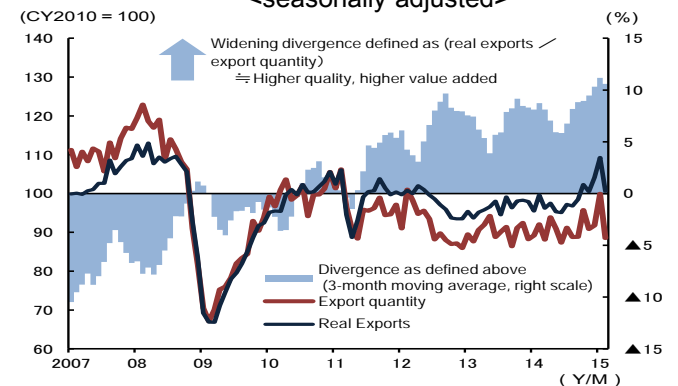
Source: : The Japan Research Institute, Ltd. based on the data of The Ministry of Finance, The Bank of Japan.

Figure 4-2 Contributions to the Quarter-on-quarter Change Rate in "Others" in Figure 4-1 <seasonally adjusted>



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

Figure 4-3 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.

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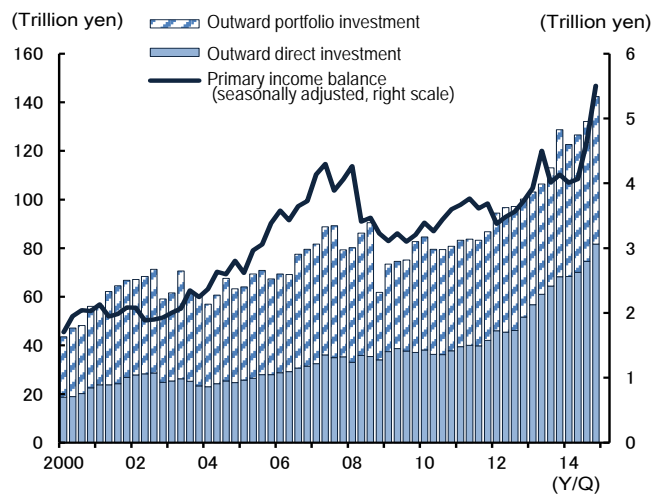
## Corporate profits continue to improve due to the weaker yen and cheaper crude oil

It is predicted that Japan's exports will increase moderately, while imports will decrease, on a customs basis. The decrease in imports will be due to the factor that the negative effect of the import price rise caused by the weaker yen will be offset by the positive effect of 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 interest 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.

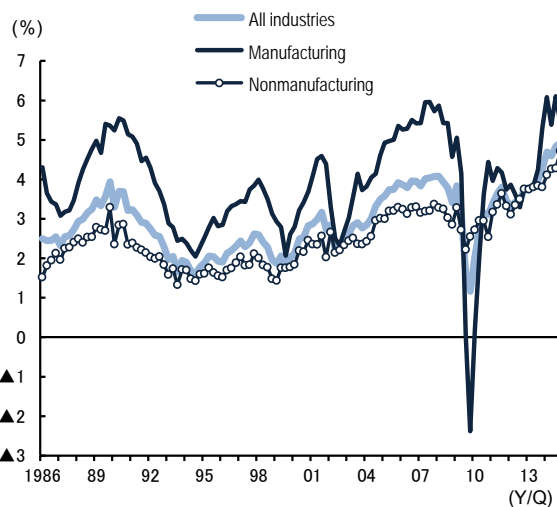
Further, it is expected that business fixed investment will pick up, reflecting favourable investment environments such as abundant cash flow and very low interest rates, although there are anxieties such as a low growth rate in the domestic markets.

Figure 5-1 External Asset Balance by Type and Primary Income Balance in Current Accounts



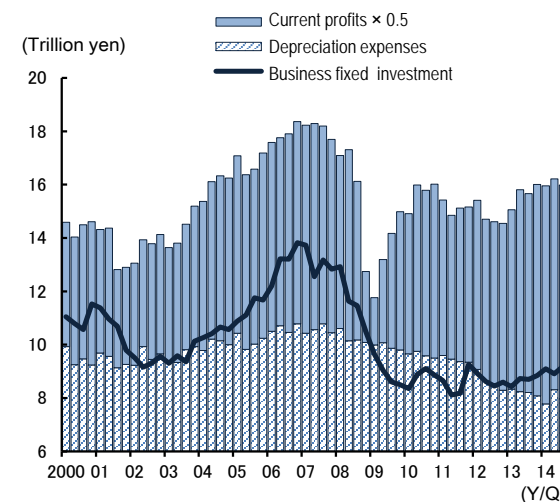
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance, The Bank of Japan.

Figure 5-2 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 5-3 Business Fixed Investment and Cash Flow



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

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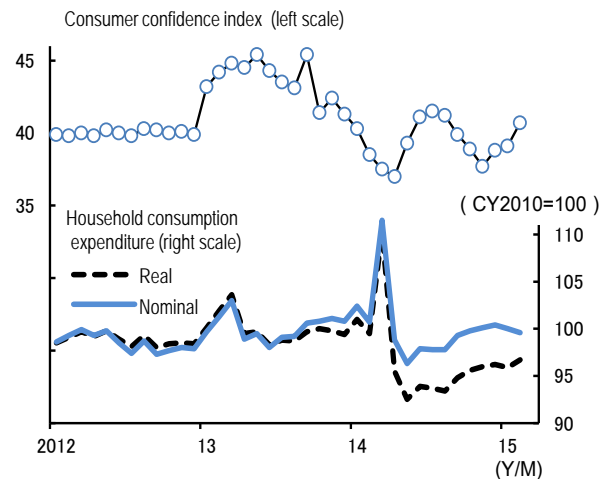
# Private consumption expenditure will be affected positively by wage rises and cheaper oil

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 after the consumption tax rise last April. 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 tax rise is coming to an end. The trend of recovery in private consumption expenditure, albeit at a moderate pace, will be more visible from early this year onwards because of the following.

First, real income shown as real compensation for employees will increase slightly year-on-year. Second, amid continued improvement in corporate profits, the number of enterprises increased where their rates of wage rise after the wage negotiations this spring were more than those last spring. Third, the improvement in employment environments will likely continue. Fourth, a deceleration in the consumer price rise, reflecting the ending of the effect of last year's tax rise and the materialisation of the significant fall in the oil price, will contribute to pushing up real income.

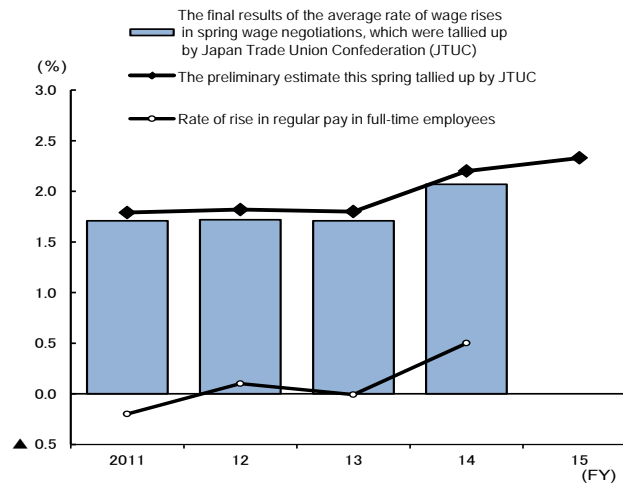
In addition, stock prices have been on a rising trend, against the background of continued increase in corporate profits. Assuming that the Nikkei 225 stock price average stays at the 19,000 yen level during the rest of the year, it is projected that the quarterly difference value from a year earlier in the appraisal profits in stock prices in the household sector as a whole will likely be more than 40 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 6-1 Consumer Sentiment and Household Consumption Expenditure <seasonally adjusted>



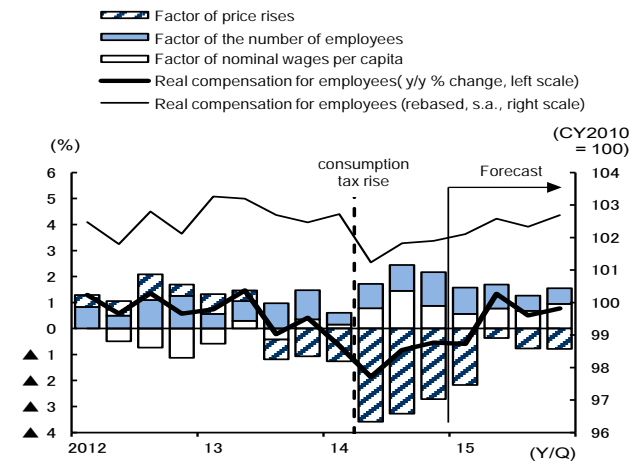
Source: The Japan Research Institute, Ltd. based on the data of The Cabinet Office, The Ministry of Internal Affairs and Communications.

Figure 6-2 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 6-3 Contributions to the Year-on-year Change Rate 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.

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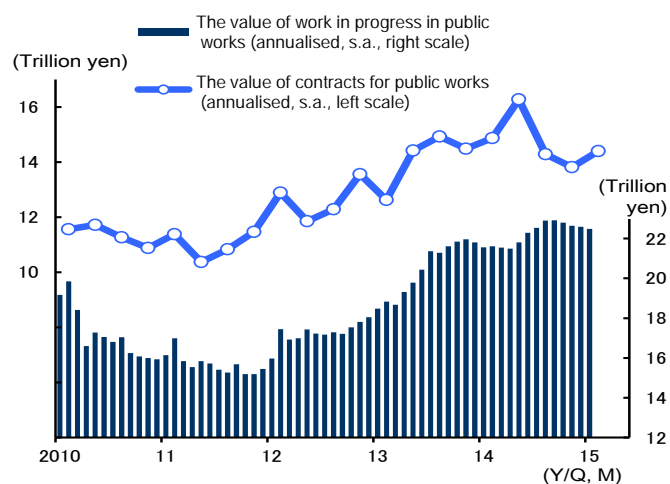
## Budgetary economic measures will benefit the economy for a while, yet will delay fiscal consolidation

In the public sector, public investment has taken a breather, as the value of contracts for public works, which is a leading indicator for public investment, had declined after the peak last spring.

However, the implementation of economic measures of around 3.5 trillion yen in the supplementary budget for FY2014, which was approved in the Diet in February, will likely bolster the economic activity. 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 (from 8 to 10 per cent) from October 2015 to April 2017 will bring about dark clouds over the already planned fiscal reconstruction path. An expected considerable downswing in 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 7-1 The Value of Contracts and the Value of Work in Progress for Public Works  
<annualised, seasonally adjusted>



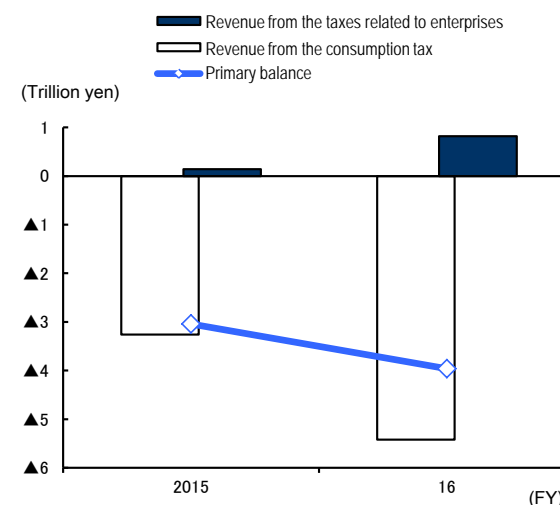
Source: The Japan Research Institute, Ltd. based on the data of Construction Surety Co., Ltd (East Japan, West Japan, Hokkaido), The Ministry of Land, Infrastructure and Transport.

Figure 7-2 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
<b>Total</b>	<b>3,520</b>	<b>2,497</b>
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 7-3 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.

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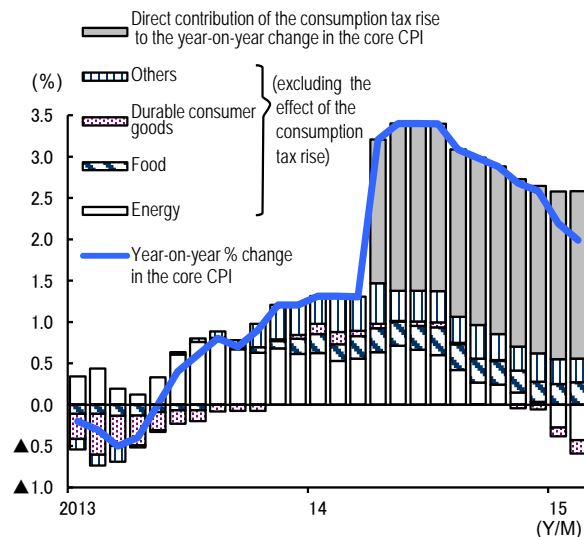
## The pace of rise in core CPI will accelerate again as the effect of the latest weaker yen materialises

Except for the direct effect of the consumption tax rise, the core CPI, which excludes fresh food, hit zero per cent year-on-year in February, 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.

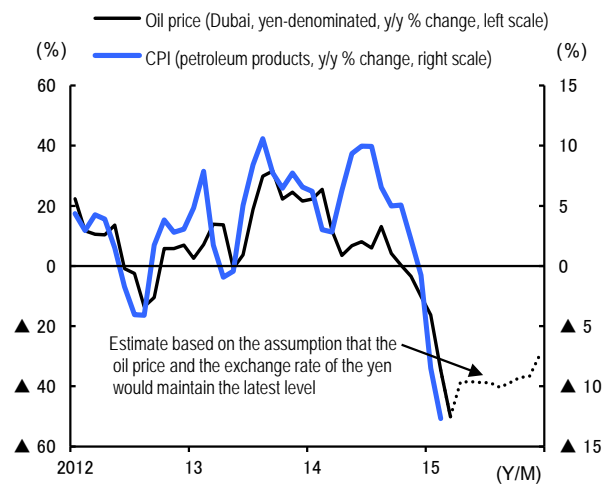
In order to achieve the goal set by the BoJ of the "continuously stable core CPI inflation rate at a pace of 2 per cent year-on-year", it is vital for the rate of increase in the core CPI inflation to accelerate stably hereafter through a rise in inflation expectations. In order for inflation expectations 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 8-1 Contributions to the Year-on-year Change Rate of the Core CPI  
<year-on-year % change>



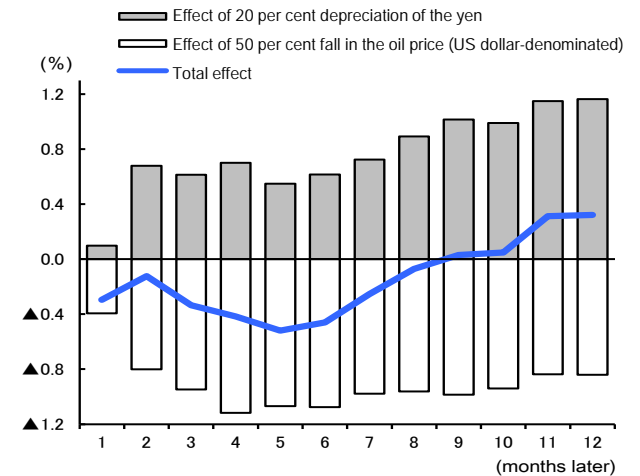
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Internal Affairs and Communications.

Figure 8-2 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 8-3 Effect of the Weaker Yen and Cheaper Oil on the Core CPI over Time



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

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

(1) The reactionary fall after the rise in the consumption tax rate (from 5 to 8 per cent) last April and the subsequent inventory adjustment will have been nearing an end gradually. Under the circumstances, it is predicted that the trend of economic recovery will strengthen and become more visible, against the background of favourable conditions such as the increase in corporate profits for enterprises to invest in plant and equipment, a continued improvement in income and employment environments for households, positive effects of cheaper crude oil and the rise in stocks prices on the economy, and so on.

(2) In fiscal year 2015 to March 2016, 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. 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.

(3) 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 mainly 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 (from 8 to 10 per cent) in April 2017. As a result, real GDP is predicted to grow by 1.5 per cent in FY2016 as a whole.

(4) The pace of increase in consumer prices is predicted to continue to be slow for the time being, affected by the considerable fall in the oil price. 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 10 Projections for GDP Growth and Main Indicators of Japan ( as of April 2, 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 (Actual)	1~3 (Projection)	4~6	7~9	10~12 (Projection)	1~3 (Projection)	4~6	7~9	10~12 (Projection)	1~3 (Projection)	(Actual)	(Projection)		
Real GDP	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)			
Real GDP	▲ 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 GDP	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	0.9	0.8	1.3
Industrial Production Index	▲ 1.5	▲ 3.4	1.9	4.3	2.8	1.9	1.4	1.2	1.1	1.1	3.2	▲ 0.9	2.7	1.2
Unemployment Rate (%)	3.5	3.5	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	3.21	1.38	2.77	1.22	3.79	1.61	2.79	1.21	4.01	0.83	6.65	9.16	9.62
Share of Nominal GDP (%)	1.1	2.6	1.1	2.3	0.9	3.0	1.3	2.2	0.9	3.1	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: The assumptions on the real GDP growth rate in 2014 (actual result), 2015 and 2016 in major overseas economies: the US, 2.4%, 2.9%, 2.8%; the euro area, 0.9%, 1.1%, 1.3%; China, 7.4%, 7.2%, 7.0%.