

Monthly Report of Prospects for Japan's Economy

June 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 May 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 2 months running, due to the fall in the number of new job offers, etc.

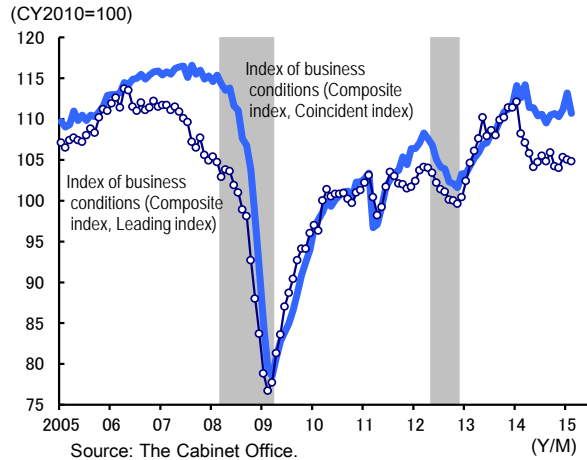


Figure 1-2 The Corporate Sector

Production decreased in industries such as electrical machinery. The inventory ratio rose for 2 months in a row.

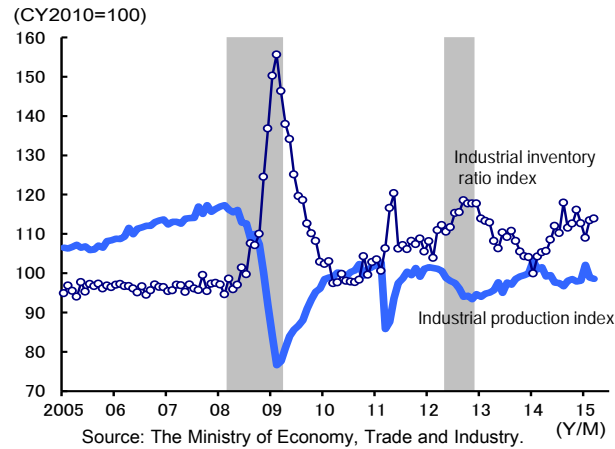


Figure 1-3 Overseas Demand

Exports, mainly those to the US, picked up slightly. Imports declined to the lowest level since early 2013.

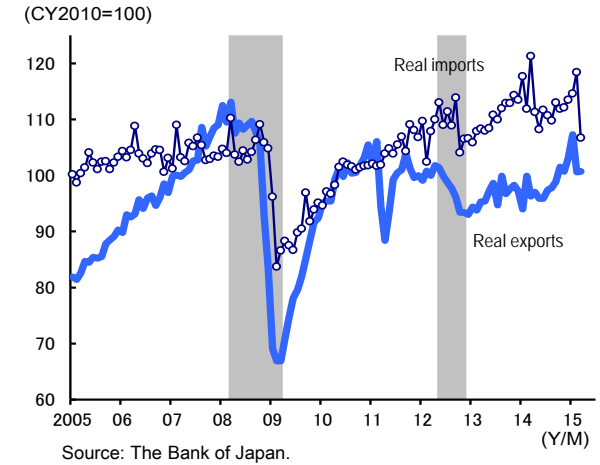
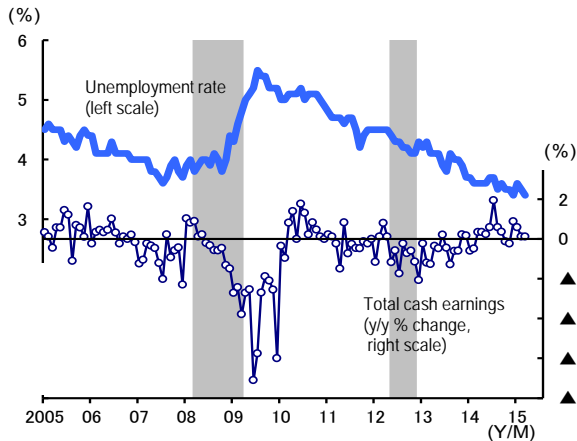


Figure 1-4 Employment and Income

The unemployment rate fell for 2 months running, which shows continued favourable employment conditions.



* The shaded area indicates the phase of recession.

Figure 1-5 Private Consumption Expenditure

Private consumption expenditure continued its moderate recovery trend. Real private consumption rose for 2 months in a row.

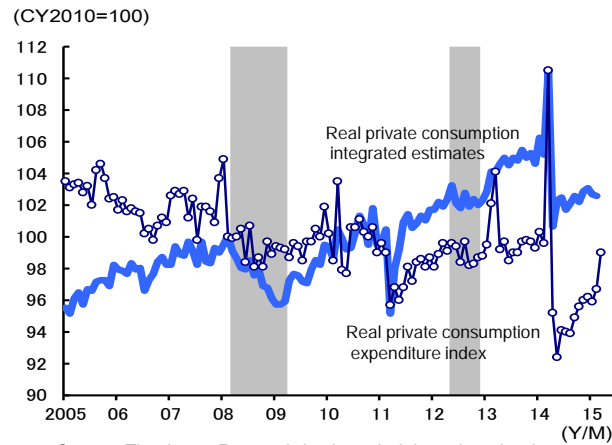
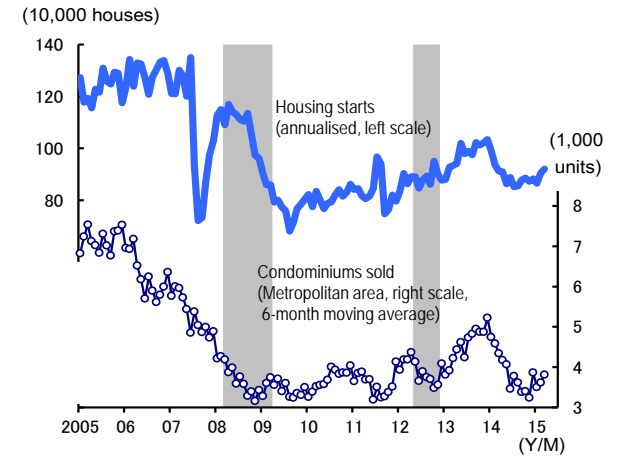


Figure 1-6 Housing Investment

Both housing starts and condominium sales seem to have shown signs of picking up.



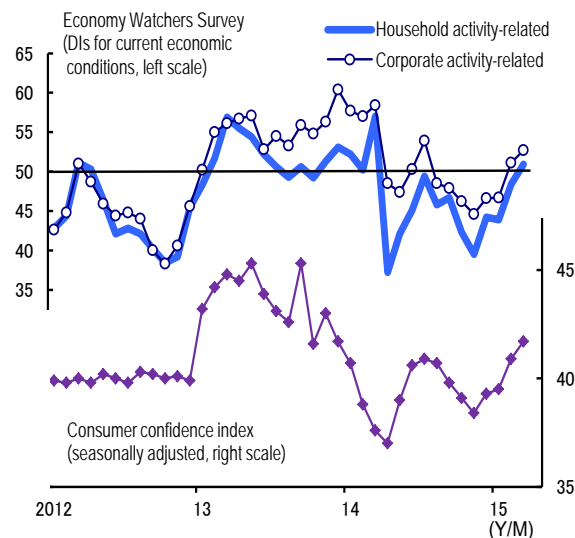
Economic activity continues to recover moderately, reflecting the pickup in consumer sentiment and others

Japan's economic activity is continuing a moderate recovery. Real GDP in the January-March period increased by 2.4 per cent on an annualised quarter-on-quarter change basis (national accounts, the first preliminary estimates). This was the second successive quarterly positive growth, yet the economic recovery seems to have lacked momentum, as the increase in private inventories contributed as much as 2.0 percentage points.

As for monthly statistics, the Economy Watchers Survey in March shows that the diffusion indices (DIs) for current economic conditions recovered to levels over 50 (50 shows the diverging point between better and worse) both in household and corporate activity-related businesses. This seems to be reflecting a pickup in consumer sentiment and continued favourable environments for enterprises such as the weaker yen and cheaper crude oil. In the household sector, retail sales value in March recovered to the level before the rushed demand due to the consumption tax rise had started last year. Thus, private consumption expenditure continues to pick up, albeit moderately, as the reactionary fall after the tax rise nears its end. In the corporate sector, industrial production declined in March, the second successive monthly fall, partly because of persistent pressure for inventory adjustment. However, based on the forecast, production is expected to continue an increasing trend on the whole.

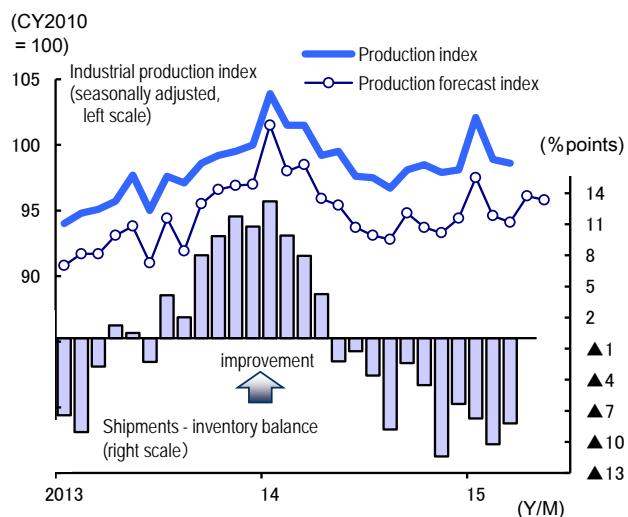
Meanwhile, exports increased in March, mainly led by exports of automobiles to the US and exports of electronic devices to Asia.

Figure 2-1 DIs in Economy Watchers Survey and Consumer Confidence Index



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

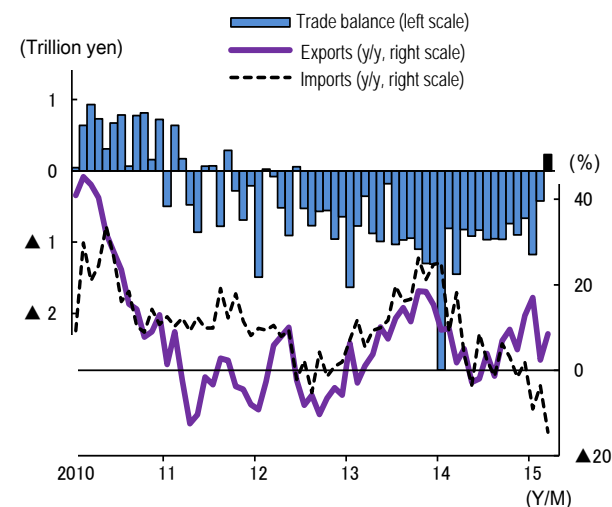
Figure 2-2 Industrial Production Index and Shipments - Inventory Balance



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

Note: Shipments - inventory balance = $\frac{\text{y/y \% change in shipments} - \text{y/y \% change in inventory}}$

Figure 2-3 Trade Balance <on a monthly basis>



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

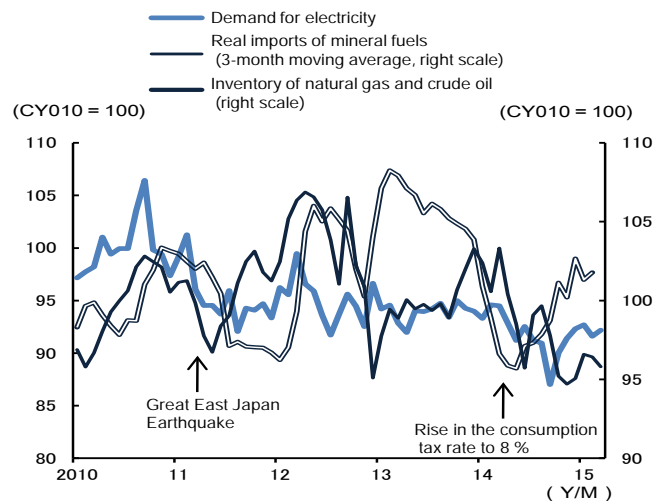
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Monthly trade surplus is unlikely to continue, amid the slow pace of increase in exports

Japan's monthly trade balance turned a surplus of 330 billion yen in March. This was the first monthly surplus since February 2011 just before the Great East Japan Earthquake occurred. The trade surplus in March was mainly due to cheaper crude oil and the fall in imports from China affected by the Lunar New Year. Looking at real imports by item, the imports of mineral fuels such as petroleum products were sluggish, reflecting stagnant production activity after the rise in the consumption tax rate. However, it is unlikely that the imports of mineral fuels will decrease further. As domestic demand recovers more noticeably, real imports will likely increase month-on-month again. Real exports have been on an increasing trend since last autumn. Yet, viewed by product, the item which has contributed most to the rate of increase in the total is "others", where re-export goods and gold have contributed largely. Actually, these two items produce no value added in domestic production.

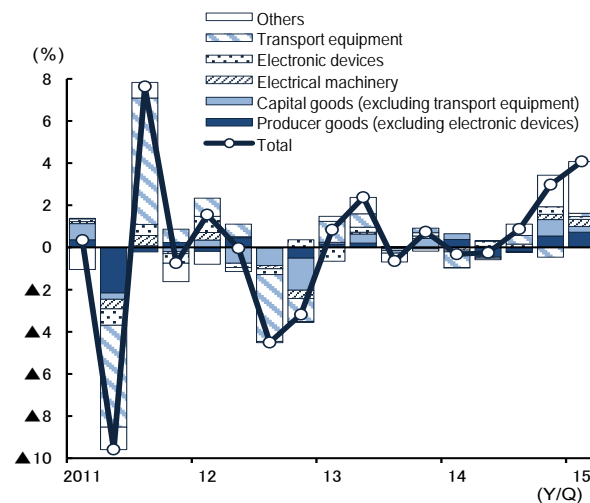
Looking ahead, the depreciation of the yen will bolster exports for the time being. On the other hand, the pickup in global economic activity will lack momentum, because a deceleration in the economies in emerging countries such as China will likely be a weighing down factor on the global economy. Accordingly, the pace of increase in Japan's exports is predicted to remain moderate, corresponding to the pace of pickup in overseas demand. Taking the above factors and trends into consideration, it is expected that the monthly trade balance will return to deficit, albeit slightly, if price factors such as the exchange rate of the yen and the price of crude oil stabilise at the present level.

Figure 3-1 Demand for Electricity, Real Imports of Mineral Fuels, and Gas and Oil Inventory <seasonally adjusted>



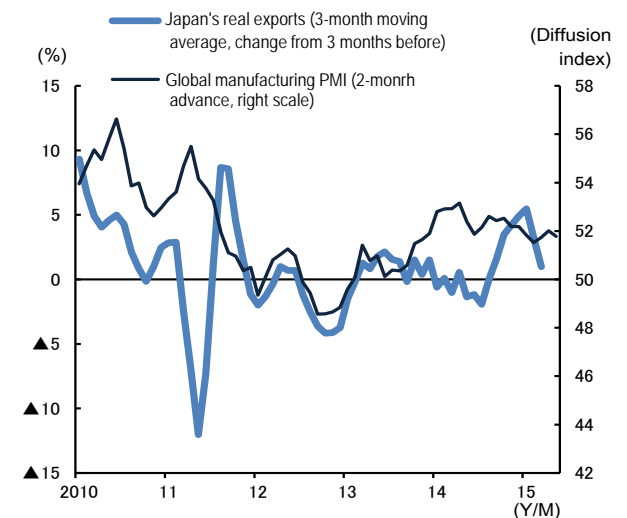
Source: : The Japan Research Institute, Ltd. based on the data of The Federation of Electric Power Companies of Japan, The Ministry of Economy, Trade and Industry, The Ministry of Finance, The Bank of Japan.

Figure 3-2 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 3-3 Global Manufacturing PMI and Japan's Real Exports



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

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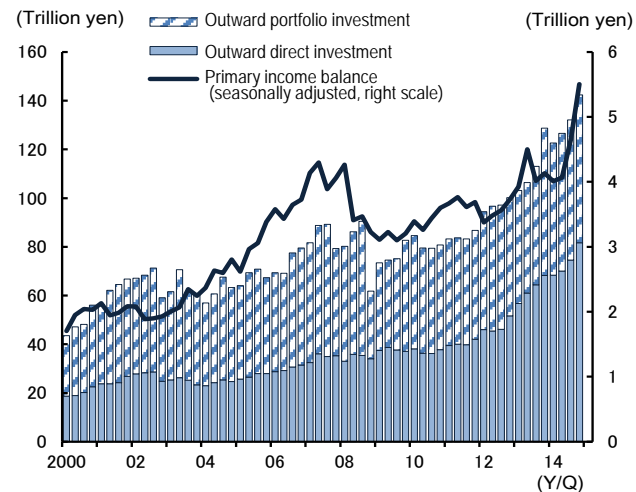
Business fixed investment will likely pick up, reflecting solid corporate profits

As external (overseas) 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.

Under this situation, it is expected that business fixed investment will become firmer, taking the following into account. First, machinery orders, which are a leading indicator for business fixed investment, have been on a recovery trend. It is estimated that machinery orders in the January-March period have increased from the previous quarter, the third consecutive quarterly rise, which has been a better estimate than expected. Second, the change rate for business fixed investment in FY2015, which was forecast by enterprises as of March in BoJ's Tankan Survey, was high in manufacturing. Although the figure in nonmanufacturing was a cautious one, it is likely that the figure will be revised upwards over time, as the figure as of March factored in the reaction after the high growth rate in FY2014.

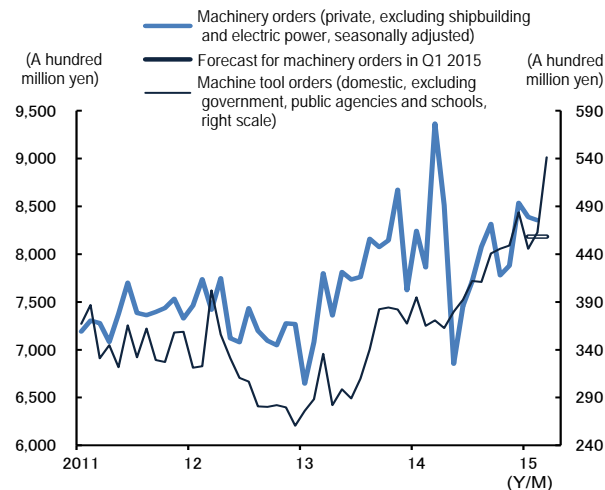
Judging also from the favourable investment environments such as abundant cash flow and very low interest rates, business fixed investment will likely pick up, mainly in investment for maintenance and replacement as well as rationalisation and saving.

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



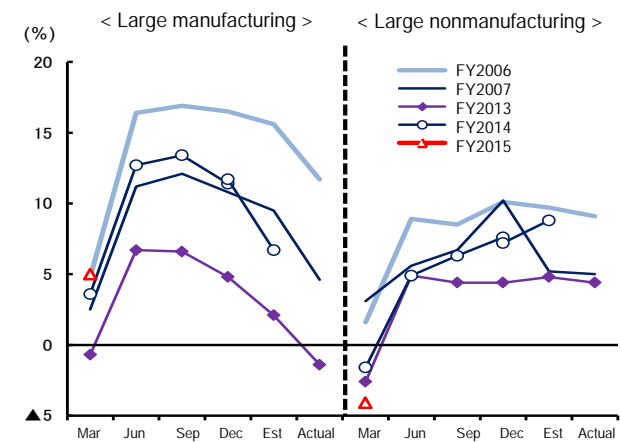
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance, The Bank of Japan.

Figure 4-2 Machinery Orders and Machine Tool Orders <seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on the data of The Cabinet Office, Japan Machine Tool Builders' Association.

Figure 4-3 Transition in the Forecast Change Rate for Business Fixed investment in Each Fiscal Year by Survey Time



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

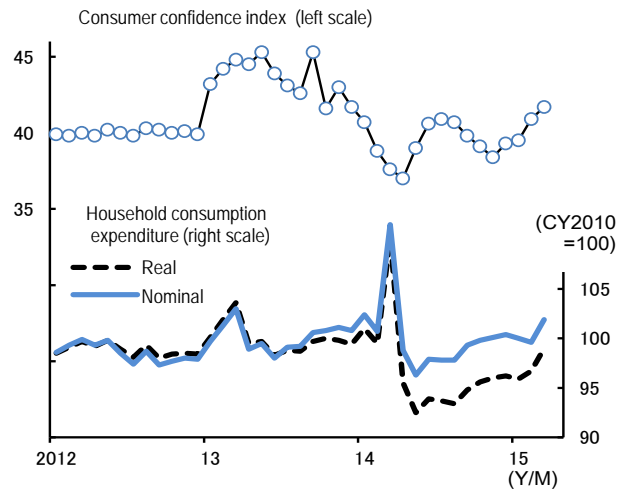
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Private consumption expenditure will be affected positively by wage rises and cheaper oil

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, 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 hereafter because of the following.

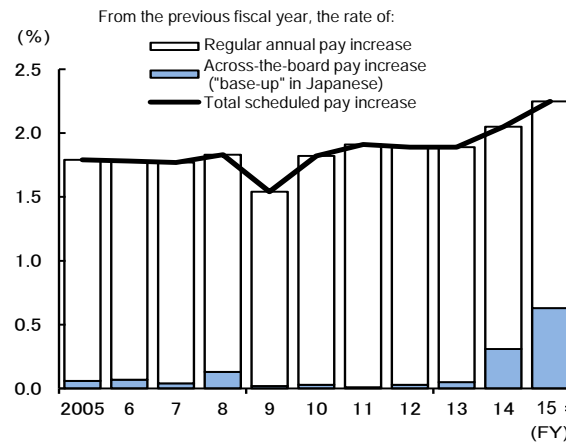
Real income is expected to increase slightly year-on-year. Amid continued improvement in corporate profits, the number of enterprises increased where their rates of wage rise after the wage negotiations this spring were more than those last spring. Since the improvement in employment environments will likely continue, nominal compensation for employees is predicted to increase further. Also, a deceleration in the consumer price rise will contribute to pushing up real income. This is reflecting the ending of the effect of last year's tax rise and the materialisation of the significant fall in the oil price. In addition, the wealth effect from the stock price rise will be expected on private consumption expenditure. 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 20,000 yen level during the rest of the year, it is projected that the appraisal profits in stock prices in the household sector as a whole will likely be around 50 trillion yen in 2015.

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



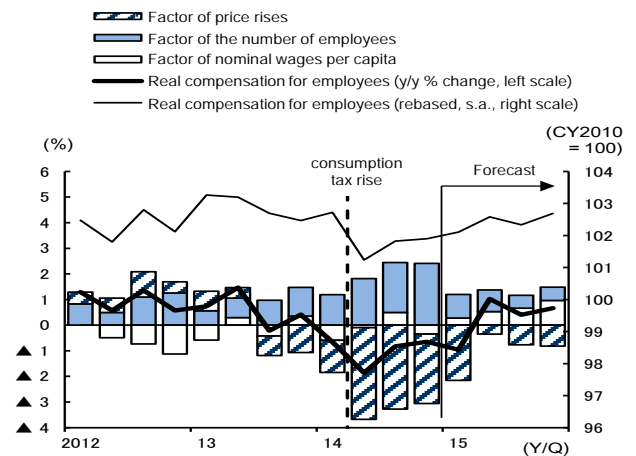
Source: The Japan Research Institute, Ltd. based on the data of The Cabinet Office, The Ministry of Internal Affairs and Communications.

Figure 5-2 Average Rate of Wage Rises in Spring Wage Negotiations <defined as the rate of y/y increase in scheduled pay>



Source: The Japan Research Institute, Ltd. based on the data of Central Labour Relations Commission, Japanese Trade Union Confederation.

Figure 5-3 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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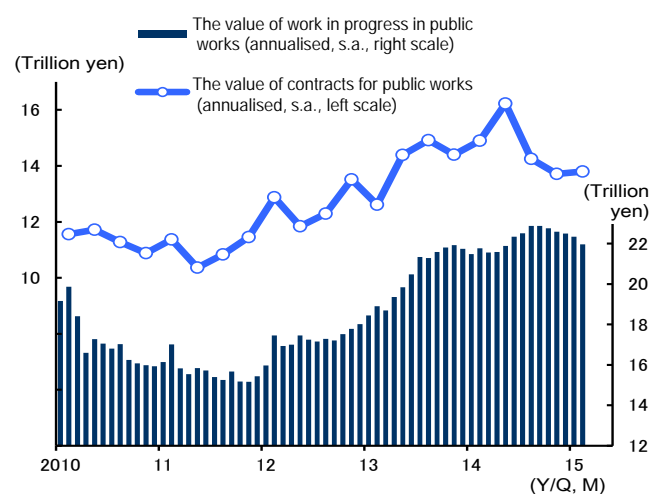
Budgetary economic measures will benefit the economy for a while, yet will delay fiscal consolidation

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 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 6-1 The Value of Contracts and the Value of Work in Progress for Public Works
<annualised, seasonally adjusted>



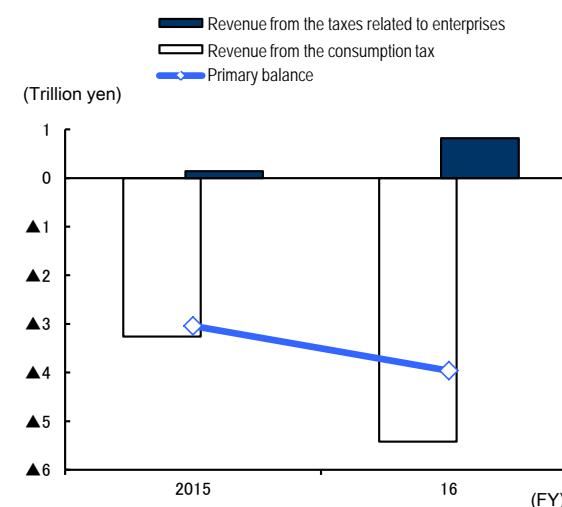
Source: The Japan Research Institute, Ltd. based on the data of Construction Surety Co., Ltd (East Japan, West Japan, Hokkaido), The Ministry of Land, Infrastructure and Transport.

Figure 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.

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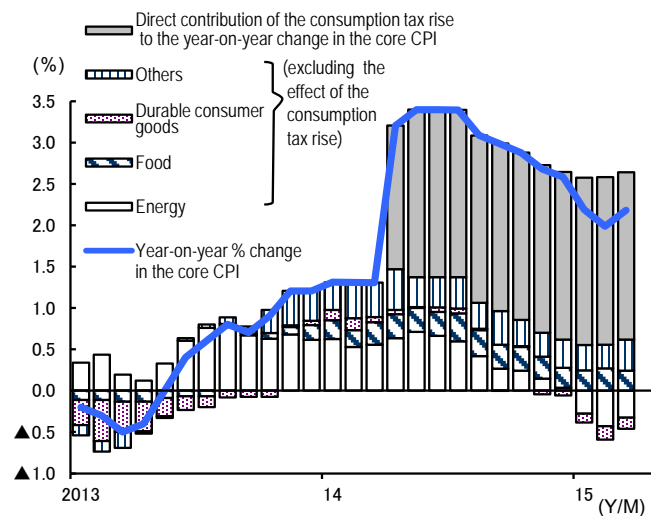
The pace of rise in core CPI will accelerate again as the effect of the latest weaker yen materialises

Except for the direct effect of the consumption tax rise, the core CPI, which excludes fresh food, rose 0.2 per cent year-on-year in March. The pace of rise has decelerated considerably since the peak (1.5 per cent) in April last year.

This deceleration has been mainly due to the downswing in energy prices caused by the significant fall in the crude oil price. Accordingly, it is predicted that a sluggish pace of increase in consumer prices will continue for the time being. On the other hand, albeit partly, a behaviour of raising prices has been seen, mainly in food, against the background of 1) the rise in costs for imports due to the depreciation of the yen since last autumn and 2) the rise in hourly wages in part-time jobs caused by the trend of a shortage of workers. Also, the fall in the crude oil price has been checked after the significant drop. Therefore, with the downward effect of the crude oil price on consumer prices nearing its end, it is likely that the pace of the core CPI rise will accelerate again, as the economy recovers more visibly and increased costs due to the weaker yen materialise.

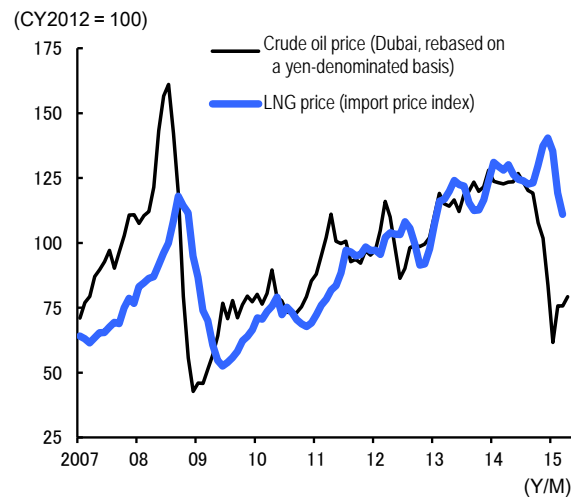
Under this situation, in order to achieve the goal set by the BoJ of the "continuously stable core CPI inflation rate at a pace of 2 per cent year-on-year", it is vital for the rate of increase in the core CPI inflation to accelerate stably hereafter through a rise in inflation expectations. In order for inflation expectations to rise, it is imperative that the re-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>



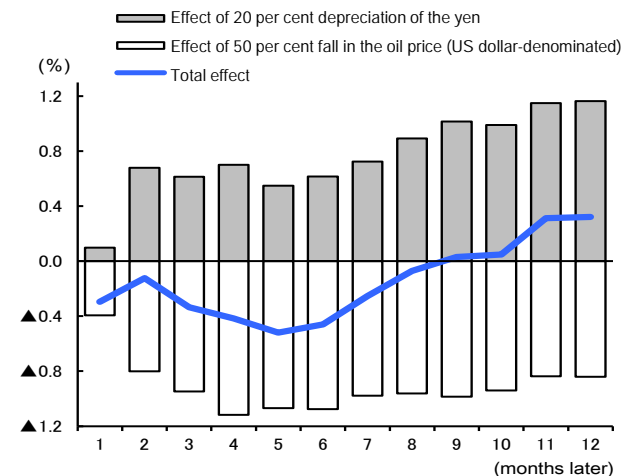
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Internal Affairs and Communications.

Figure 7-2 The Price of Crude Oil and Liquefied Natural Gas (LNG)



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

Figure 7-3 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; 1.4% in FY2015 and 1.3% in FY2016

(1) Japan's real GDP in the January-March period increased by 2.4 per cent on an annualised quarter-on-quarter change basis (national accounts, the first preliminary estimates), the second successive positive growth. However, the economic recovery seems to have lacked momentum due to the following. First, the increase in private inventories stemming from the reduced pace of inventory reduction contributed as much as 2.0 percentage points to the total quarterly growth rate. Second, the pace of recovery in private consumption expenditure had yet to accelerate. Third, overseas demand defined as net exports contributed negatively, as the rate of increase in real imports was more than that in real exports.

(2) In this issue of the Monthly Report, the projected real GDP growth rates in FY2015 and FY2016 were revised downwards from the previous 1.7 and 1.5 per cent to 1.4 and 1.3 per cent, respectively, for the following reasons. First, persistent pressure for inventory adjustment will likely weigh down economic activity for the time being, as the inventory ratios in industries such as machinery-related and steel remain at a high level. Second, the pace of recovery in private consumption expenditure is likely to stay moderate, as the rate of increase in cash earnings in households seems to be limited. Third, a solid expansion in exports of goods will not be able to be counted on, as the structural changes in Japan's export structure take place.

(3) On the other hand, it is predicted that the "autonomous economic expansion mechanism" is expected to work increasingly more strongly. This favourable trend is against the background of favourable conditions such as 1) the increase in corporate profits, benefiting from the weaker yen, helps enterprises to increase in investment in plant and equipment, 2) the improvement in income and employment environments for households continues thanks to increased corporate profits and the tendency of a shortage of workers. In fiscal year 2015 to March 2016, the implementation of economic measures taken in the supplementary budget for FY2014, along with the progress in inventory adjustment, will also likely make the economic activity during the period firmer.

(4) Looking ahead further, although the "autonomous economic expansion mechanism" will continue to work, factors such as 1) stagnant real income through re-acceleration in consumer price rises mainly due to the depreciation of the yen, and 2) a slowdown in overseas economies such as China, will weigh down economic activity in FY2016. However, towards the fourth quarter 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.

(5) 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 again, 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 May 20, 2015)

	(seasonally adjusted, annualised % changes from the previous quarter)									(% changes from the previous fiscal year)		
	CY2015				CY2016				CY2017	FY2014	FY2015	FY2016
	1~3 (Actual)	4~6 (Projection)	7~9	10~12	1~3 (Projection)	4~6	7~9	10~12	1~3 (Projection)	(Actual)	(Projection)	
Real GDP	2.4	1.1	1.4	1.8	2.6	0.2	1.2	1.3	2.2	▲ 1.0	1.4	1.3
Private Consumption Expenditure	1.4	1.0	1.1	1.1	2.2	▲ 0.4	0.8	1.3	5.9	▲ 3.1	1.3	1.2
Housing Investment	7.5	3.7	4.2	4.0	3.9	2.0	2.3	4.2	6.0	▲ 11.6	1.9	3.3
Business Fixed Investment	1.4	3.9	4.4	4.5	4.6	2.3	2.7	3.0	3.3	▲ 0.5	2.9	3.3
Private Inventories (percentage points contribution)	(2.0)	(▲ 1.1)	(▲ 0.5)	(0.0)	(0.0)	(0.0)	(0.4)	(0.2)	(▲ 0.8)	(0.5)	(▲ 0.3)	(0.0)
Government Consumption Expenditure	0.4	0.4	0.4	0.4	0.4	0.5	0.6	0.6	0.6	0.5	0.5	0.5
Public Investment	▲ 5.5	2.7	1.3	▲ 0.8	0.0	0.0	▲ 0.5	▲ 1.0	▲ 1.2	2.0	0.1	▲ 0.4
Net Exports (percentage points contribution)	(▲ 0.7)	(▲ 0.2)	(▲ 0.2)	(▲ 0.1)	(▲ 0.3)	(▲ 0.3)	(▲ 0.5)	(▲ 0.6)	(▲ 1.7)	(0.6)	(▲ 0.2)	(▲ 0.5)
Exports of Goods and Services	9.9	3.9	4.8	5.1	4.3	3.3	2.8	2.8	2.8	8.0	6.6	3.6
Imports of Goods and Services	12.0	5.2	5.1	5.2	5.0	4.4	4.5	5.0	9.3	3.7	6.4	5.0

	(% changes from the same quarter of the previous year)									(% changes from the previous fiscal year)		
	1~3	4~6	7~9	10~12	1~3	4~6	7~9	10~12	1~3	(Actual)	(Projection)	
Real GDP	▲ 1.4	0.7	1.6	1.4	1.9	1.5	1.4	1.2	1.3	▲ 1.0	1.4	1.3
Nominal GDP	1.9	2.1	3.2	2.8	1.9	1.8	2.0	1.8	1.9	1.4	2.5	1.9
GDP deflator	3.4	1.4	1.6	1.4	0.0	0.4	0.5	0.6	0.6	2.5	1.1	0.5
Consumer Price Index (excluding fresh food)	2.1	0.1	0.3	0.6	1.0	1.3	1.2	1.3	1.4	2.8	0.5	1.3
(excluding fresh food and consumption tax)	0.1	0.0	0.3	0.6	1.0	1.3	1.2	1.3	1.4	0.8	0.5	1.3
Industrial Production Index	▲ 1.9	1.8	3.4	3.2	1.9	1.3	1.1	1.2	1.2	▲ 0.4	2.6	1.2
Unemployment Rate (%)	3.5	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.5	3.4	3.4
Current Account Balances (trillion JY)	3.53	1.70	3.07	1.56	3.92	1.91	3.06	1.60	4.31	7.04	10.25	10.89
Share of Nominal GDP (%)	2.9	1.4	2.5	1.2	3.1	1.5	2.5	1.2	3.4	1.4	2.1	2.1
Exchange Rates (JY/US\$)	119	119	120	121	122	122	122	122	122	110	121	122
Import Price of Crude Oil (US\$/barrel)	56	60	65	67	69	69	70	70	71	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%, 2.4%, 2.8%; the euro area, 0.9%, 1.2%, 1.3%; China, 7.4%, 6.9%, 6.8%.