

# Monthly Report of Prospects for Japan's Economy

July 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 June 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 coincident index of business conditions has declined to the lowest level since August 2013, due to the slow pace of recovery in private consumption expenditure, etc.

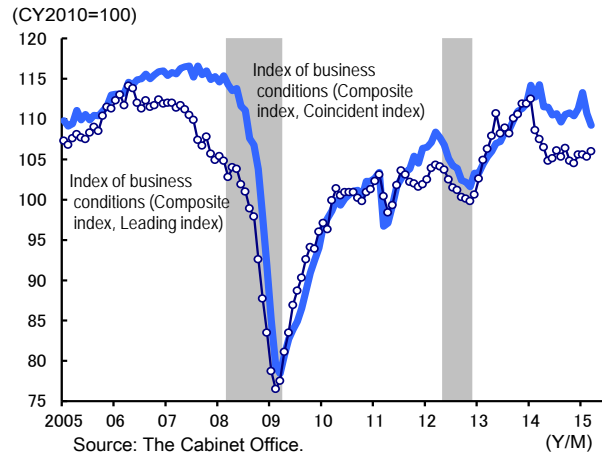


Figure 1-2 The Corporate Sector

Production increased in industries such as electrical machinery. The inventory ratio fell for the first time in 3 months, yet it was still at a high level.

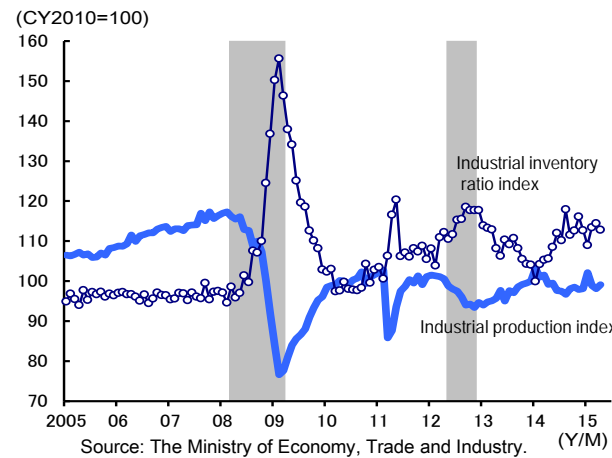


Figure 1-3 Overseas Demand

Exports, led by those to the US, picked up slightly. Imports increased for the first time in 2 months.

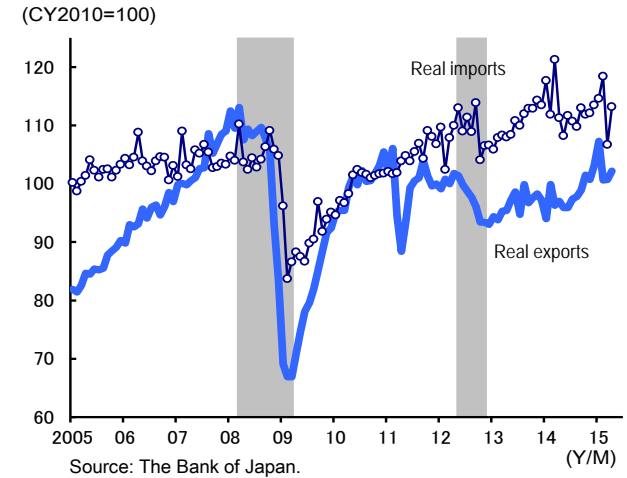


Figure 1-4 Employment and Income

The unemployment rate fell for 3 months running, which shows continued favourable employment conditions.

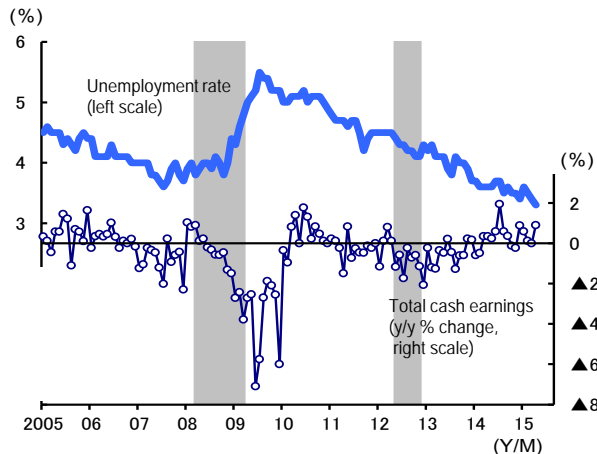


Figure 1-5 Private Consumption Expenditure

Real private consumption expenditure fell considerably in April. The recovery trend after the consumption tax rise seems to have taken a breather.

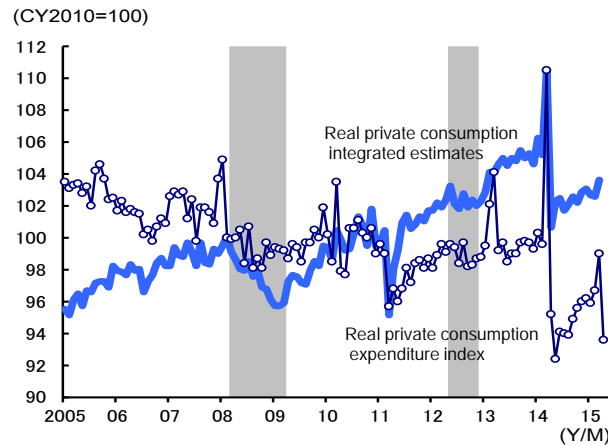
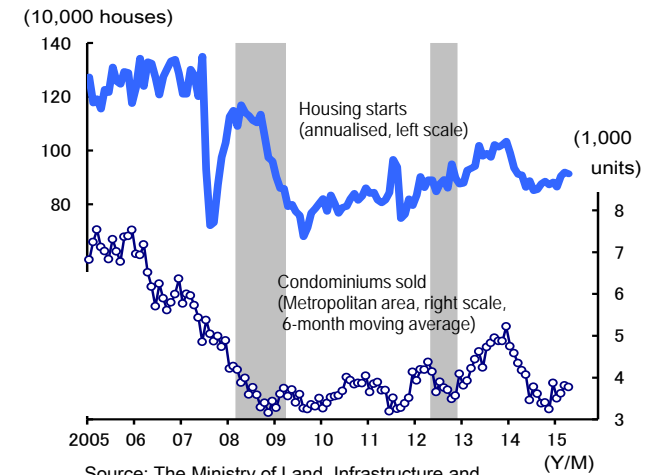


Figure 1-6 Housing Investment

Both housing starts and condominium sales are on a recovery trend, yet they lack momentum.



# Economic activity continues to recover moderately, although it lacks momentum

## ◆ Continued quarterly positive growth, yet it lacks momentum

Japan's economic activity is continuing a moderate recovery. Real GDP in the January-March period increased by 3.9 per cent on an annualised quarter-on-quarter change basis (national accounts, the second preliminary estimates). This was the second successive quarterly positive growth. Also, business fixed investment was revised significantly from the first preliminary estimates. Yet, the economic recovery seems to have lacked momentum, as the increase in private inventories contributed as much as 2.2 percentage points and the pace of recovery in private consumption expenditure was still slow.

## ◆ Domestic private demand has picked up slowly. Overseas demand has maintained its modest recovery trend

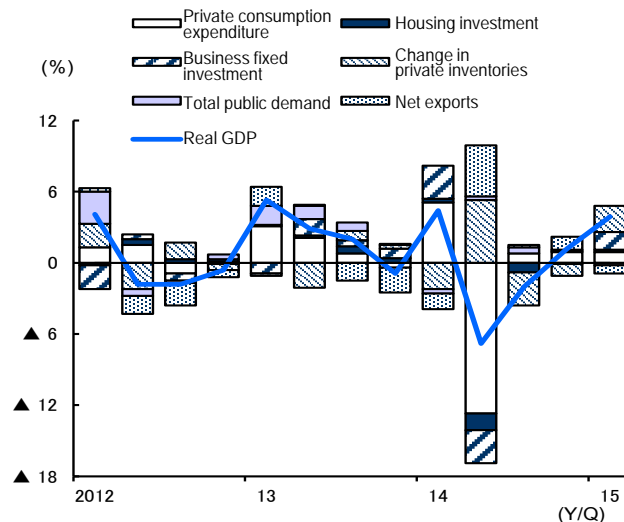
As for monthly statistics, in the household sector, retail sales value in large-scale retail stores recovered in April to the level before the rushed demand due to the

consumption tax rise had started last year. However, the pace of picking up varied by region. While the recovery in large cities was noticeable, that in other regions remained flat.

In the corporate sector, production activity slowed, although solid corporate profits and the improvement in business sentiment continue. Industrial production increased by 1.2 per cent in April month-on month, for the first time in 3 months. However, the inventory ratio in industries such as electronic parts and machinery-related is still at a high level. Also, production is forecast to be flat in the 2 months to come.

Meanwhile, in overseas demand, real exports in April were almost flat compared to the previous month. Exports of automobiles to the US and exports of electronic parts to China continued their increasing trend. On the other hand, exports to the EU and Asia excluding China seesawed. Thus, exports also lacked momentum.

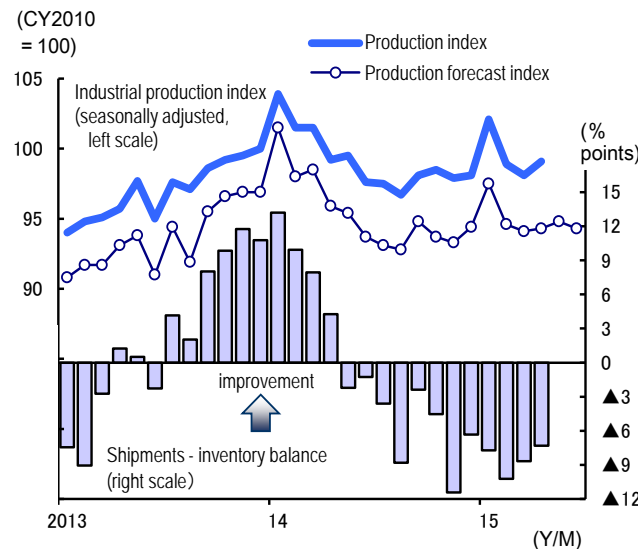
Figure 2-1 Real GDP Quarterly Growth Rate  
<the second preliminary estimates, seasonally adjusted, annualised q/q change rate>



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

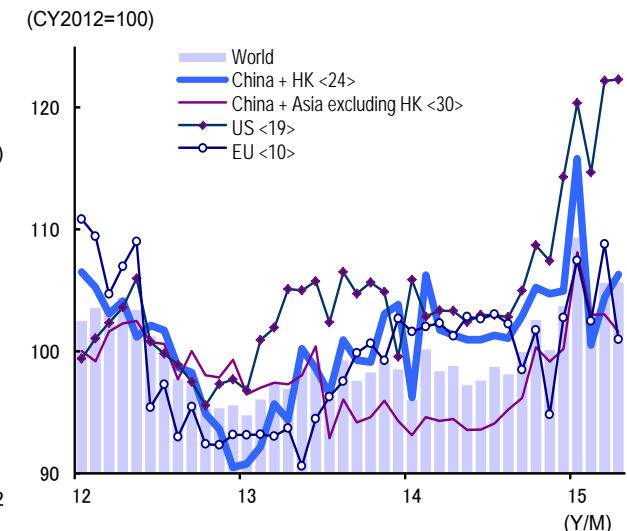
Figure 2-2 Industrial Production Index and Shipments - Inventory Balance



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

Note: Shipments - inventory balance = y/y % change in shipments - y/y % change in inventory

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 FY2014.

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

## ◆ Decrease in imports contributed largely to reducing trade deficits

With respect to Japan's trade balance, the decrease in the total value of imports, reflecting cheaper crude oil and stagnant total import quantity (real imports), has contributed largely to narrowing trade deficits. Viewed by product, real imports of mineral fuels, which have a one third share in the total, has been sluggish, against the back ground of the increase in the inventory of fuels stemming from 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.

## ◆ Pace of picking up in exports has been slow. Trade balance is expected to continue a trend of small deficits

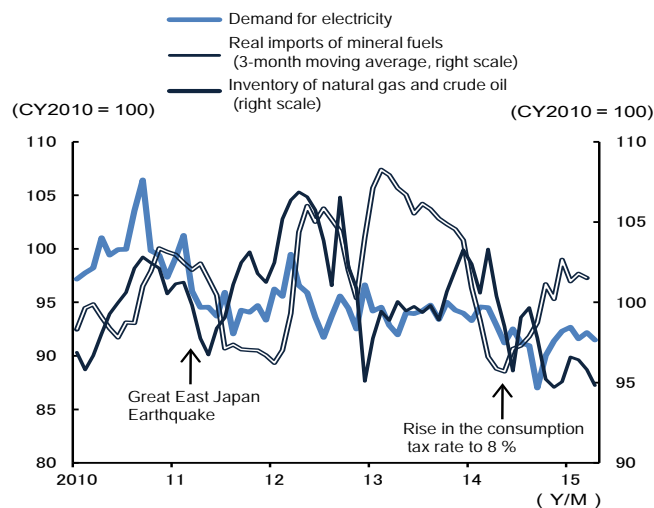
Viewed by product, real exports have been mainly led by "others", where re-export goods and gold have contributed largely. Actually, these two items produce no value added in domestic production. Exports of items other than "others" have been

sluggish on the whole. Especially, exports of capital goods (excluding transport equipment), which have a share of about one quarter in the total real exports, weakened in the first quarter. This was against the background of the deceleration in business fixed investment in the US and China.

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.

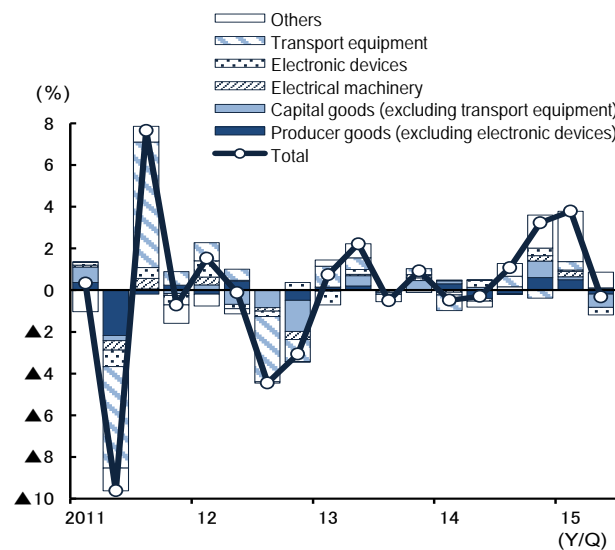
Taking the above factors and trends into consideration, it is expected that the monthly trade balance will continue the trend of small deficits, on the assumption that price factors such as the exchange rate of the yen and the price of crude oil stabilise at the present level.

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



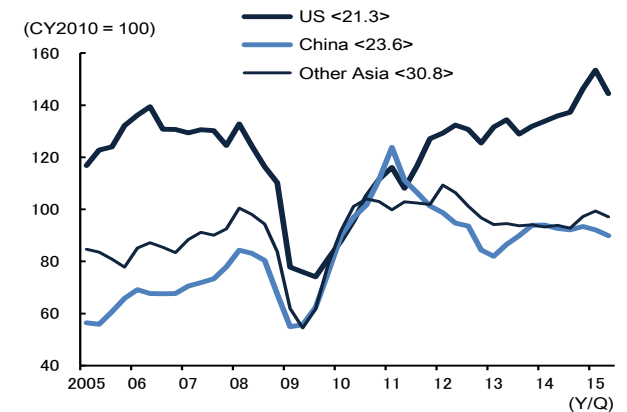
Source: : The Japan Research Institute, Ltd. based on the data of The Federation of Electric Power Companies of Japan, The Ministry of Economy, Trade and Industry, The Ministry of Finance, The Bank of Japan.

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 Real Exports of Capital Goods excluding Transport Equipment <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 the angle brackets show the share of each destination in Japan's total nominal exports of capital goods in FY2014.

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# Business fixed investment will likely pick up, reflecting firm corporate profits

## ◆ Corporate profits continue to be firm

Concerning the corporate sector, based on the Financial Statements Statistics of Corporations by Industry, current profits in enterprises in the January-March quarter continued to be around their highest level thus far on an aggregate basis, while sales proceeds were still stagnant during that period.

This trend of the improvement in the ratio of current profits to sales seems to be against the background of a materialisation of the effect of restructuring, a further increase owing to the weaker yen in receipts of dividend and interest from overseas assets, and a cost reduction effect thanks to the fall in the crude oil price. Among these elements, the third appears to have been the biggest contributor to recent firmness in profits, which was seen as a contribution of the fall in variable costs.

## ◆ Solid business fixed investment could be expected

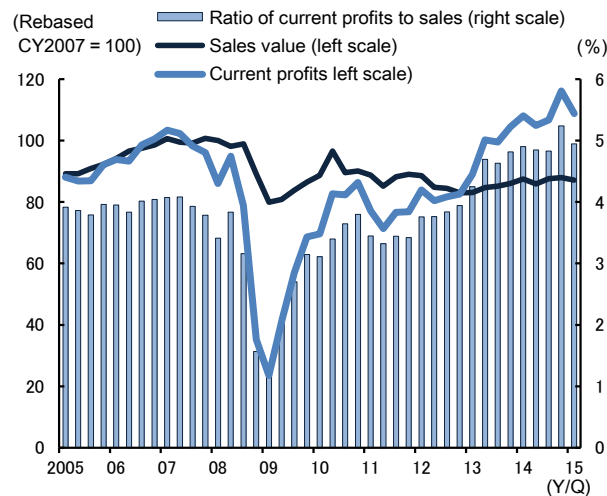
Machinery orders, which are a leading indicator for business fixed investment, have been on a rising trend. Also, the Financial Statements Statistics of Corporations by

Industry show that the ratio of business fixed investment to cash flow has bottomed out and has signs of picking up. Judging from these statistics, it is unlikely that business fixed investment will falter, although machinery orders are forecast to decline in the April-June quarter.

It is predicted that business fixed investment will be solid, mainly in investment for maintenance and replacement as well as rationalisation and saving, amid the situation where labour's share is at a low level, and the virtuous cycle that firm corporate profits spread to wage rises seems to have started.

In order for the ratio of business fixed investment to cash flow to keep its rising trend, and for business fixed investment to grow in earnest, it is imperative for growth expectations of Japan's domestic economy to rise. In this situation, enterprises will be able to enjoy buoyant corporate profits mainly due to an increase in sales value, without much reliance on the effect of reduced variable costs owing to the weaker yen and cheaper crude oil.

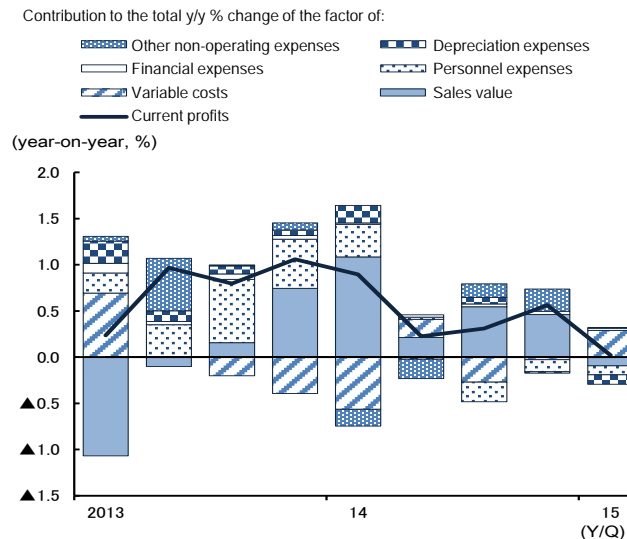
Figure 4-1 Sales Value and Ratio of Current Profits to Sales  
<seasonally adjusted>



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

Note: All industries excluding financial institutions.

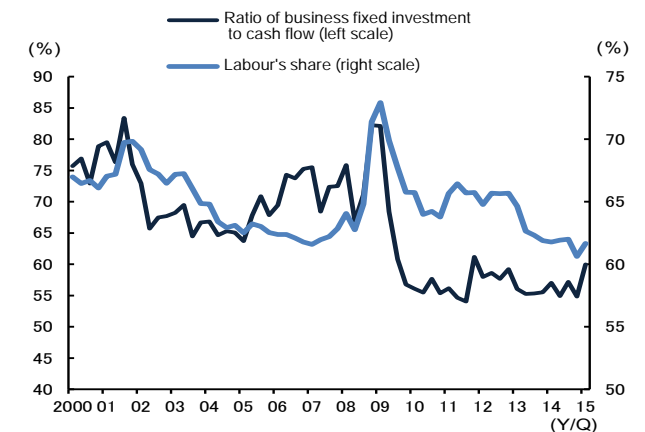
Figure 4-2 Contributions of Factors to the Year-on-year Change Rate in Current Profits



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

Note: All industries excluding financial institutions.

Figure 4-3 Labour's Share and Ratio of Business Fixed Investment to Cash Flow



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

Note 1: All industries excluding financial institutions.

Note 2: Labour's share = personnel expenses / value added

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

◆ The downswing in private consumption expenditure in April was mainly due to bad weather

With respect to the household sector, a certain degree of improvement has been seen in consumer sentiment, as the negative effect of the reactionary fall after the consumption tax rise last April is coming to an end. Yet, household consumption expenditure saw a downswing in April, mainly due to sluggish results caused by bad weather during that period in such services as eating out.

◆ A pickup in income and an improvement in employment environments are likely to bolster the recovery in private consumption expenditure

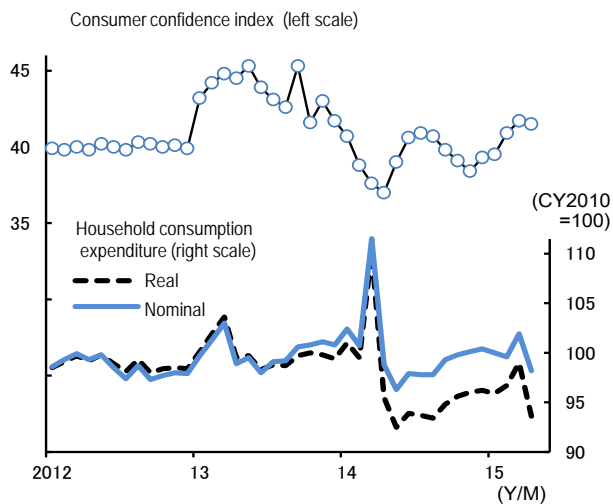
Income, which is a source of private consumption expenditure, is continuing its rising trend. Amid continued improvement in corporate profits, the number of enterprises increased where their rates of wage rise after the wage negotiations this spring were more than those last spring. As employment environments continue to

improve, nominal compensation for employees is likely to increase further. Compensation for employees in real terms is also predicted to be bolstered by a deceleration in the consumer price rise. This deceleration in prices reflects the ending of the effect of last year's tax rise as well as the materialisation of the significant fall in the oil price. The improvement in income environments will be likely to support a moderate recovery in private consumption expenditure.

◆ The rise in stock prices will also have a positive effect

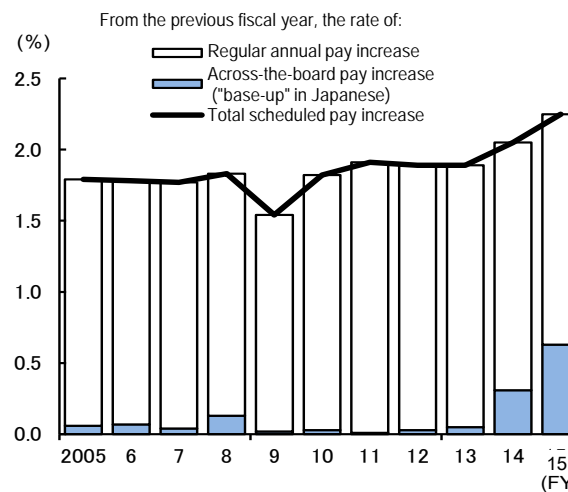
In addition, the wealth effect from the stock price rise will be expected on private consumption expenditure. Stock prices have been on a rising trend, against the background of the continued increase in corporate profits. Assuming that the Nikkei 225 stock price average stays at the 20,000 yen level 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>



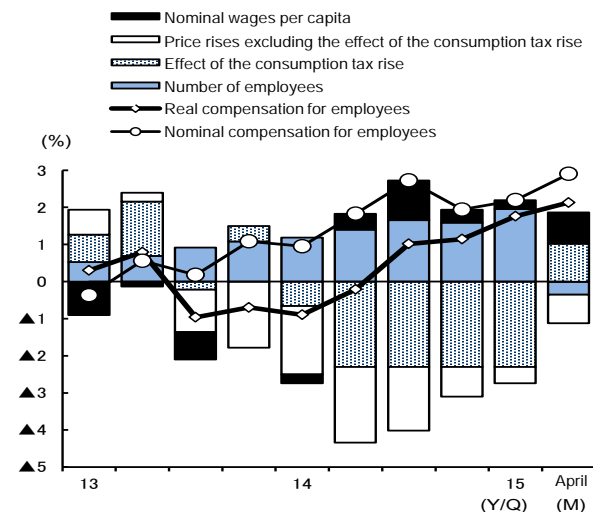
Source: The Japan Research Institute, Ltd. based on the data of The Cabinet Office, The Ministry of Internal Affairs and Communications.

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

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# The pace of rise in core CPI is likely to gain momentum again

◆ The rate of rise in the core CPI decelerated considerably in April

Except for the direct effect of the consumption tax rise\*, the core CPI, which excludes fresh food, was flat year-on-year mainly due to the downswing in energy prices caused by the significant fall in the crude oil price. Although the fall in crude oil price has been checked recently, the price of liquefied natural gas (LNG), which is used in order to set the electricity and gas charges, has fallen significantly with a time lag between the considerable 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.

\* The effect of 0.3 per cent was still left in April due to temporary measures.

◆ The pace of rise in core CPI is likely to gain momentum again

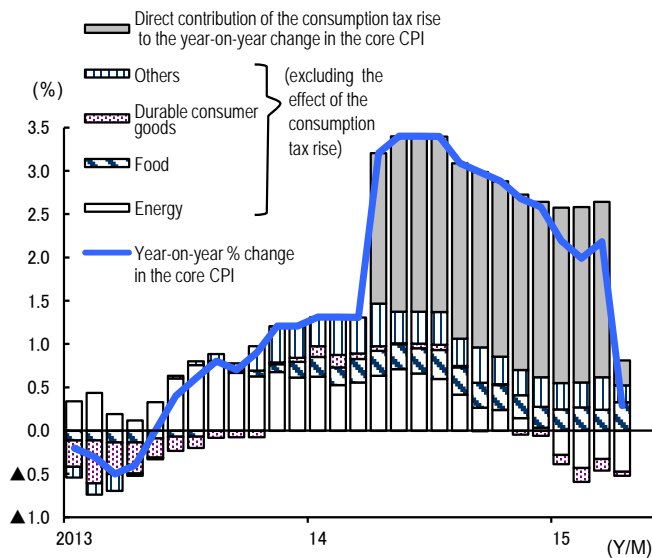
On the other hand, albeit partly, a behaviour of raising prices has been seen, mainly in food, against the background of 1) the rise in costs for imports due to the depreciation of the yen since last autumn and 2) the rise in hourly wages in part-time

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.

◆ It will take time to achieve the goal set by the BoJ

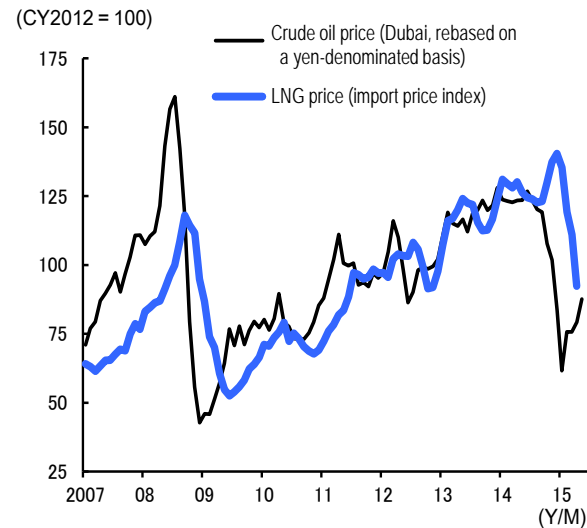
Under this situation, in order to achieve the goal set by the BoJ of the "continuously stable core CPI inflation rate at a pace of 2 per cent year-on-year", it is vital for the rate of increase in the core CPI inflation to accelerate stably hereafter through a rise in inflation expectations. In order 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 6-1 Contributions to the Year-on-year Change Rate of the Core CPI <year-on-year % change>



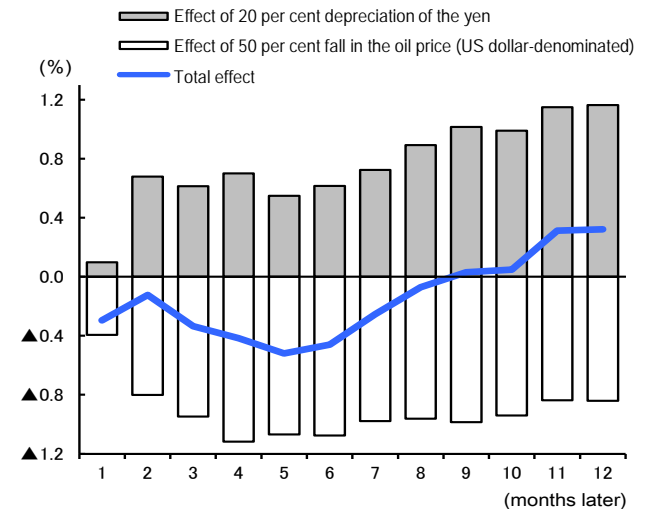
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Internal Affairs and Communications.

Figure 6-2 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 6-3 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; 1.5% in FY2015 and 1.3% in FY2016

### ◆ Continued quarterly positive growth, yet it lacks momentum

(1) Japan's economic activity is continuing a moderate recovery. Real GDP in the January-March period increased by 3.9 per cent on an annualised quarter-on-quarter change basis (national accounts, the second preliminary estimates). This was the second successive quarterly positive growth. Also, the figure of 3.9 per cent was revised upwards from 2.4 percent in the first preliminary estimates, mainly because business fixed investment was revised significantly.

Yet, the economic recovery seems to have lacked momentum, as the increase in private inventories contributed as much as 2.2 percentage points and the pace of recovery in private consumption expenditure was still slow.

(2) It is predicted that the situation where the economic activity lacks momentum will continue for the time being due to the following. First, persistent pressure for inventory adjustment will likely weigh down production activity, as the inventory ratios in a certain number of industries are still 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 changes in Japan's export structure take place.

### ◆ Economic activity is predicted to be firmer, as the "autonomous expansion mechanism" strengthens gradually

(3) On the other hand, it is predicted that the "autonomous economic expansion mechanism" will 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, and low interest rates help 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. Especially, wage environments are likely to strengthen their improving trend from this summer onwards, reflecting wage rises in the wage negotiations this spring and the expected rise in summer bonuses. In addition, the implementation of economic measures taken in the supplementary budget for FY2014, along with the progress in inventory adjustment, will likely make the economic activity during the period firmer. As a result, it is projected that real GDP will grow by 1.5 per cent in FY2015.

(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. Accordingly, it is projected that real GDP will grow by 1.3 per cent in FY2016 as a whole.

### ◆ The boosting effect of the weaker yen on consumer prices will likely materialise gradually

(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 8 Projections for GDP Growth and Main Indicators of Japan ( as of June 8, 2015 )

	(seasonally adjusted, annualised % changes from the previous quarter)									(% changes from the previous fiscal year)		
	CY2015				CY2016				CY2017	FY2014	FY2015	FY2016
	1~3	4~6	7~9	10~12	1~3	4~6	7~9	10~12	1~3	(Actual)	(Projection)	(Projection)
	(Actual)	(Projection)			(Projection)			(Projection)		(Actual)	(Projection)	(Projection)
Real G D P	3.9	0.8	1.4	1.7	2.0	0.4	1.1	1.1	2.2	▲ 0.9	1.5	1.3
Private Consumption Expenditure	1.5	1.0	1.2	1.2	2.2	▲ 0.4	0.8	1.3	5.9	▲ 3.1	1.3	1.2
Housing Investment	7.0	3.7	3.5	3.3	3.0	2.8	2.8	4.2	5.5	▲ 11.7	1.5	3.3
Business Fixed Investment	11.0	0.0	0.9	3.9	3.6	3.4	3.2	3.0	3.2	0.4	3.0	3.2
Private Inventories (percentage points contribution)	( 2.2)	(▲ 1.2)	(▲ 0.5)	( 0.0)	( 0.0)	( 0.0)	( 0.5)	( 0.2)	(▲ 0.8)	( 0.5)	(▲ 0.3)	( 0.0)
Government Consumption Expenditure	0.3	0.4	0.4	0.4	0.4	0.5	0.6	0.6	0.6	0.4	0.5	0.5
Public Investment	▲ 5.9	2.7	1.3	▲ 0.8	0.0	0.0	▲ 0.5	▲ 1.0	▲ 1.2	2.0	0.0	▲ 0.4
Net Exports (percentage points contribution)	(▲ 0.7)	( 0.1)	( 0.1)	(▲ 0.2)	(▲ 0.3)	(▲ 0.3)	(▲ 0.9)	(▲ 0.9)	(▲ 1.6)	( 0.6)	( 0.1)	(▲ 0.6)
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	12.2	2.4	4.2	5.6	5.3	5.2	6.0	6.0	8.9	3.7	5.7	5.7

	(% 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)	(Projection)
Real G D P	▲ 0.9	1.0	1.9	1.7	1.6	1.4	1.3	1.1	1.3	▲ 0.9	1.5	1.3
Nominal G D P	2.5	2.5	3.6	3.1	1.6	1.7	1.8	1.7	1.8	1.6	2.7	1.8
GDP deflator	3.4	1.5	1.7	1.4	0.1	0.3	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	▲ 2.1	0.6	2.5	2.7	1.9	2.4	1.8	1.6	1.3	▲ 0.5	1.9	1.8
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)	4.30	2.08	3.16	1.58	4.43	2.53	3.63	1.64	3.86	7.81	11.25	11.66
Share of Nominal GDP (%)	3.5	1.7	2.6	1.2	3.5	2.0	2.9	1.2	3.0	1.6	2.2	2.3
Exchange Rates (JY/US\$)	119	121	123	124	123	123	123	123	123	110	123	123
Import Price of Crude Oil (US\$/barrel)	56	61	66	67	69	69	70	70	71	91	66	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%, 2.1%, 2.8%; the euro area, 0.9%, 1.3%, 1.5%; China, 7.4%, 6.9%, 6.8%.