

# Monthly Report of Prospects for Japan's Economy

June 2016

Macro Economic Research Centre  
Economics Department



The Japan Research Institute, Limited

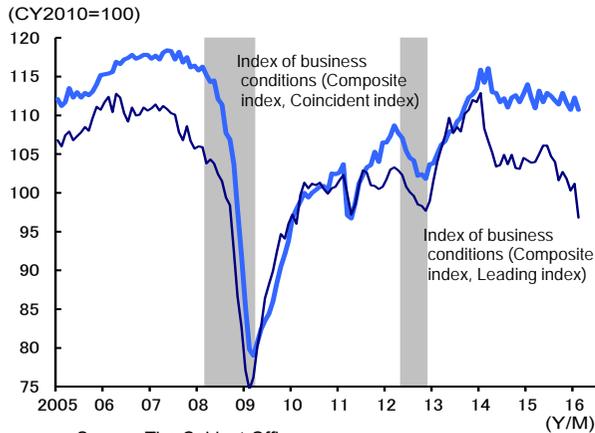
<http://www.jri.co.jp/english/periodical/>

This report is the revised English version of the May 2016 issue of the original Japanese version.

# The general situation of Japan's economy – Continued sense of stagnation, as private consumption is weak

**Figure 1-1 Economic Activity**

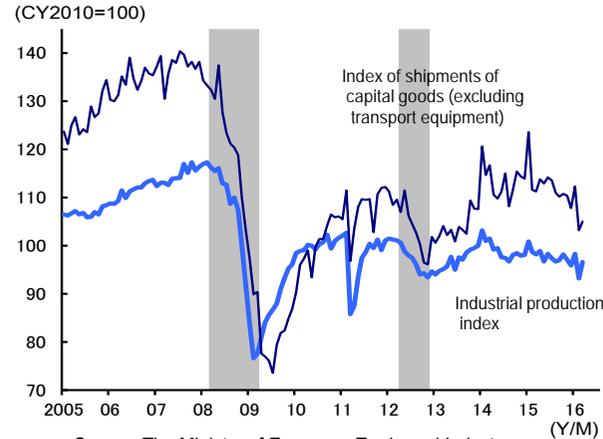
The leading index of business conditions fell to the lowest level since February 2010, due to the decline in machinery orders, the increase in inventories, and so on.



Source: The Cabinet Office.

**Figure 1-2 The Corporate Sector**

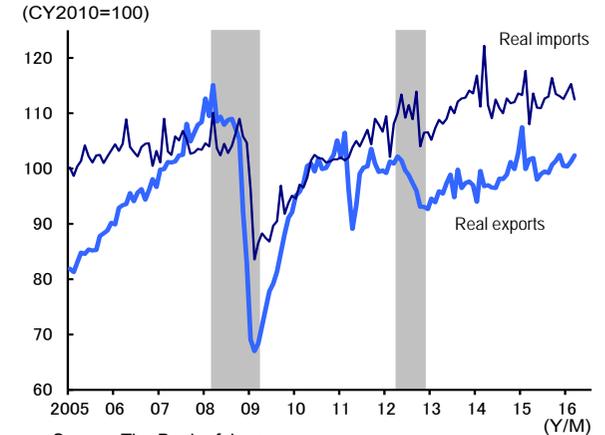
Production increased due to the reactionary rise. On the whole, production activity continues to seesaw.



Source: The Ministry of Economy, Trade and Industry.

**Figure 1-3 Overseas Demand**

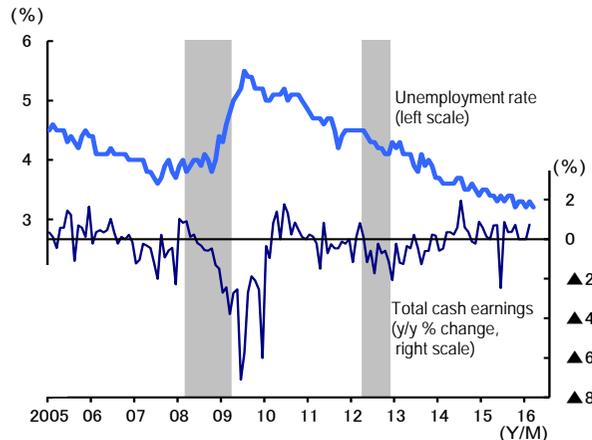
Exports picked up moderately, led by those to advanced economies. Imports decreased for the first time in 3 months.



Source: The Bank of Japan.

**Figure 1-4 Employment and Income**

The unemployment rate remains at a very low level. Total cash earnings increased year-on-year for the first time in 4 months.

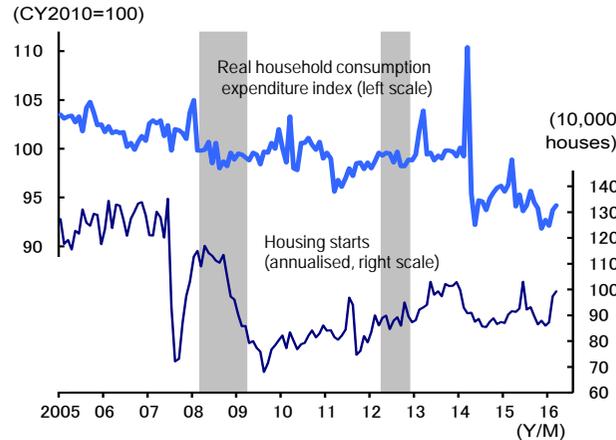


Source: The Ministry of Internal Affairs and Communications, The Ministry of Health, Labour and Welfare.

\* The shaded area indicates the phase of recession.

**Figure 1-5 The Household Sector**

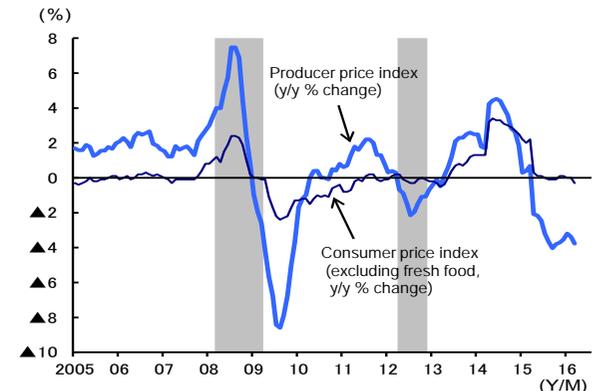
Real household consumption expenditure picked up slightly, yet continued to lack momentum. New housing starts rose, for the third month in a row.



Source: The Japan Research Institute, Ltd. based on the data of The Cabinet Office, The Ministry of Land, Infrastructure and Transport.

**Figure 1-6 Prices**

Both producer prices and core consumer prices decreased year-on-year, affected by the fall in the crude oil price.



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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## While the sense of a standstill persists, exports have picked up moderately

◆ The real GDP growth rate in the January-March period had an upswing due to a leap day. Taking this into consideration, Japan's economic activity is still in the sense of a standstill

Japan's real GDP in the January-March period grew by 1.7 per cent on an annualised quarter-on-quarter change basis (national accounts, the first preliminary estimates), a positive growth for the first time in 2 quarters. However, it should be noted that real private consumption expenditure had an upswing due to a leap day. If this effect is excluded, the quarterly real GDP growth rate is estimated to have been in the annualised 0.5 to 0.9 per cent range. As inventory adjustment in enterprises will take more time, economic activity is still in the sense of a standstill.

◆ The turmoil in the financial markets after the start of the year has affected negatively both business and consumer sentiment

The diffusion index (DI) of current economic conditions in the Economy Watchers Survey in March was still below 50, the diverging point of better and worse, for the

eighth consecutive month. Stock prices and exchange rates after early this year continue to cause both consumer and business sentiment to worsen. The negative effects of the Kumamoto Earthquake disaster will also weigh on the economy.

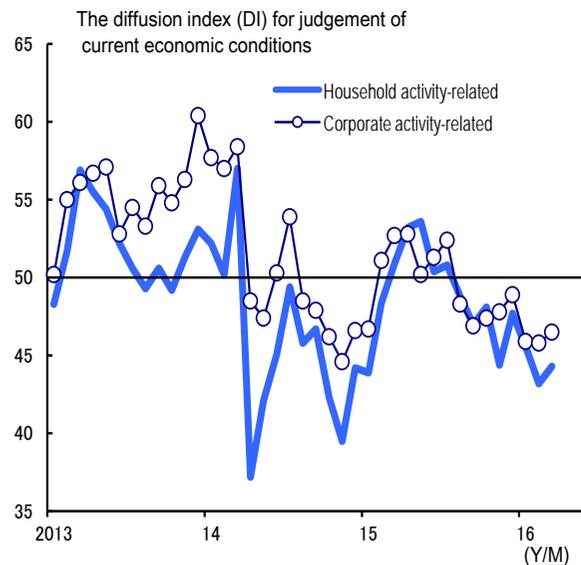
◆ Both household and corporate sectors have stagnated

The sense of a standstill in Japan's economy persists. Based on monthly statistics, real household consumption expenditure decreased year-on-year in March again. Also, sales in seasonal goods did not do well due to a relatively wide range of temperatures. In the corporate sector, industrial production bounced up in March from the considerable fall in the previous month. Although production in April is forecast to pick up, the negative effects of the Kumamoto Earthquake disaster will likely bring about a downswing hereafter.

◆ Exports are likely to pick up moderately

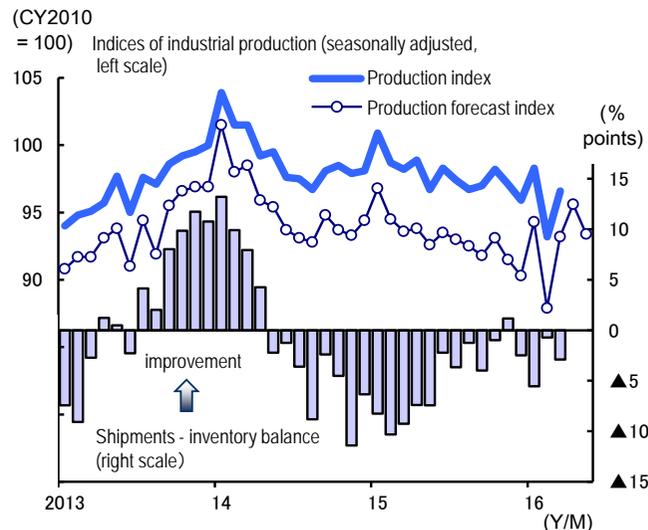
On the other hand, real exports have recovered moderately. Although exports to Asia continue to be slow to increase, exports to advanced countries such as the US and European countries have bolstered total exports.

Figure 2-1 Economy Watchers Survey



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

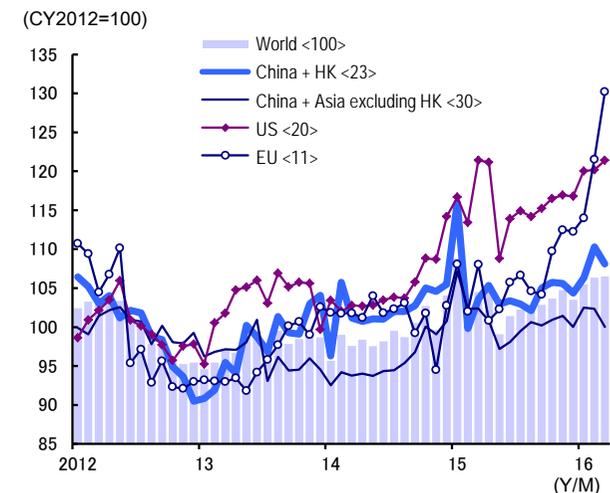
Figure 2-2 Industrial Production Index and Shipments-Inventory Balance



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

Note: Shipments - inventory balance = y/y in index of shipments - y/y in index of inventory

Figure 2-3 Real Exports by Destination <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 FY2015.

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# The pace of pickup in Japan's exports of goods will likely be slow

◆ **Total imports will likely pick up, albeit at a moderate pace due to the continued fall in imports of mineral fuels**

Japan's monthly trade balance was a surplus in March on a seasonally adjusted basis, for the fifth successive monthly surplus. The pace of decline in total imports continues to be faster than that in total exports. The value of total imports decreased in March, the eighth consecutive monthly decline, mainly due to the fall in the crude oil price and the downswing in import prices because of the stronger yen.

However, real imports other than mineral fuels have been picking up. If domestic demand recovers, real imports as a whole will also likely pick up, albeit at a moderate pace due to the continued fall in imports of mineral fuels.

◆ **Total exports will likely continue to lack momentum, against the background of the slowdown in overseas economies, the stronger yen, etc.**

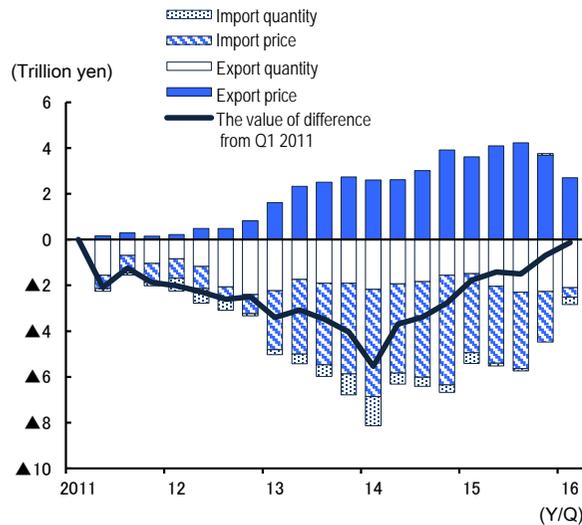
Japan's real exports of goods continue to lack momentum, and their pace of recovery has been modest on the whole.

Viewed by destination, exports to advanced countries, the economies of which have been relatively firm, have picked up. Yet, exports to emerging countries, where economic activities have slowed down, have been sluggish.

Meanwhile, it is notable that the share of exporting goods with high value added seems to have increased. This can be judged from the fact that "the index of the degree of high value added in exports", which is based on the difference between the real export index which factors change in quality into the index and the export quantity index which does not, has risen.

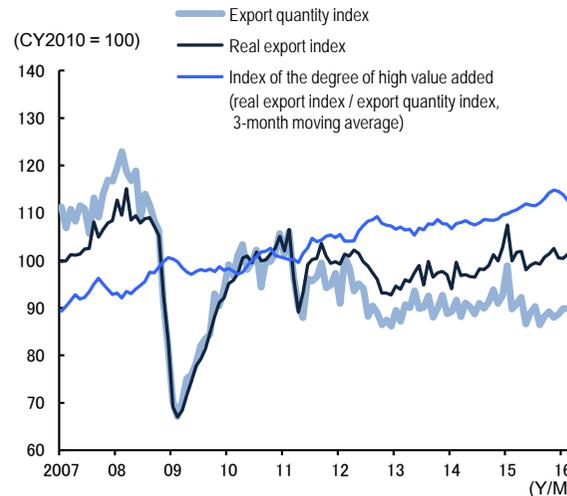
Looking ahead, it is predicted that a strong recovery in exports will be unable to be counted on, and the pace of pickup will remain moderate, with the appreciation of the yen after early this year weighing on exports. In addition, manufacturing PMIs (purchasing managers' indices) in the advanced economies such as the US and European countries have decelerated, although those in emerging countries such as China have picked up owing to economic stimulus measures.

Figure 3-1 Contributions to Trade Balance on a Customs Basis <seasonally adjusted>



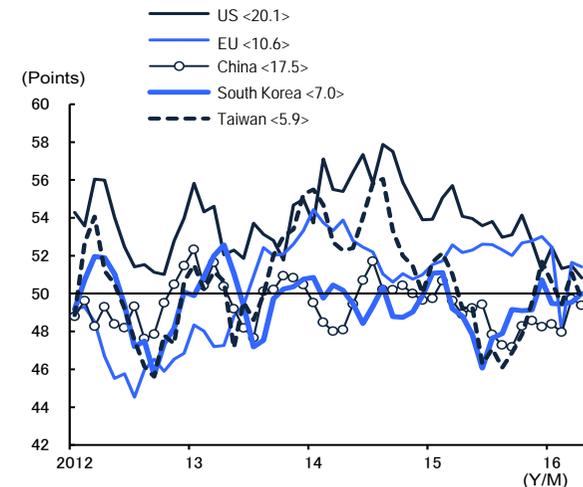
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance.  
Note: The value of trade balance in Q1 2011 was a surplus of 652 billion yen.

Figure 3-2 Index of the Degree of High Value Added in Exports



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance, The Bank of Japan.  
Note: The index of the degree of high value added in exports here is based on the difference between the real export index which factors change in quality into the index and the export quantity index which does not.

Figure 3-3 Manufacturing PMI (Purchasing Managers' Index) by Country or Region



Source: The Japan Research Institute, Ltd. based on the data of Nikkei, China Caixin/Markit, Markit.  
Note: Figures in the angle brackets show the shares in Japan's total nominal exports in 2015.

# Downside risk is increasing in corporate profits and business fixed investment

◆ Although corporate profits are still at a high level, risks of their decrease such as being due to the appreciation of the yen have increased

In the corporate sector, downside risks in corporate profits have increased of late.

Based on the BoJ's Tankan Survey, the annual change rate in current profits during FY2016 to March 2017 will likely be a slight plus, taking the tendency in the Survey of mild upward revisions hereafter into consideration. However, a risk of downside revision is also likely, because the exchange rate of the yen against the US dollar has been stronger since early this year than had been assumed by enterprises.

As the exchange rate affects current profits largely, the JRI estimated the degree of the effect of the appreciation of the yen on fiscal yearly current profits, based on macro model simulations. As a result, the simulations show that, if the exchange rate stays at 110 yen per dollar during the rest of the fiscal year, current profits in FY2016 will be almost same as those in the previous fiscal year. If the exchange rate stays at 105 yen per dollar, current profits in FY2016 will decrease by about 1.5 per cent.

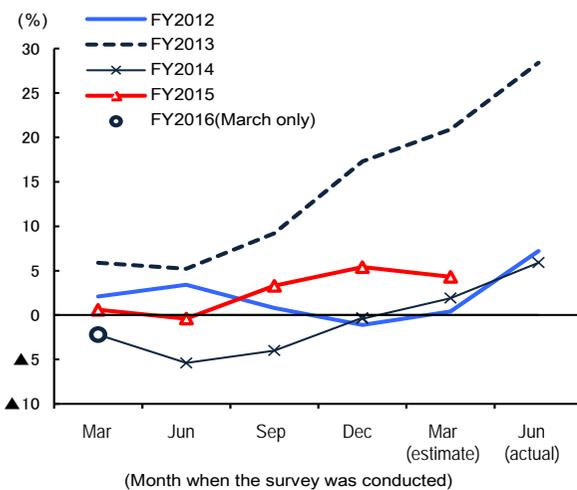
Judging from the recent trend of the stronger yen weighing on corporate profits, it is highly likely that the growth rate of current profits in FY2016 will be limited.

◆ One of the downside risks to business fixed investment is likely to be a decrease in corporate profits, yet necessary maintenance and replacement investment will bolster the total to some degree

Business fixed investment continues to lack momentum, against the background of a more cautious attitude of enterprises than before due to heightened uncertainties surrounding overseas economies and unstable financial markets.

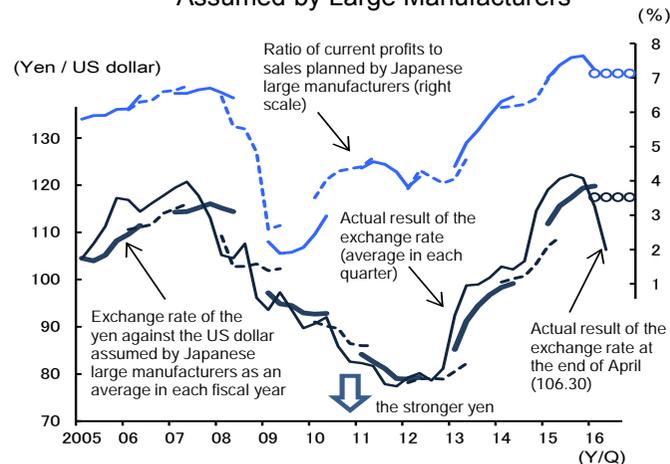
Under these circumstances, a likely downswing in corporate profits could weigh down business fixed investment. Viewed by type, there is a risk that the investment for capacity expansion will have a downswing, reflecting lowered growth expectations about Japanese enterprises. Yet, the investment for maintenance and replacement will likely bolster the total business fixed investment to some degree. This is because there are a lot of enterprises which continue this type of investment despite the corporate profits situation, against the background that a certain part of their plants and equipment have superannuated. In addition, taking into account low interest rates and increasing needs of the investment for rationalisation and saving, a considerable decrease in business fixed investment will be able to be avoided.

Figure 4-1 Change over Time in Forecast Change rate in Current Profits for Each Fiscal Year by Enterprises <all industries, year-on-year, %>



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

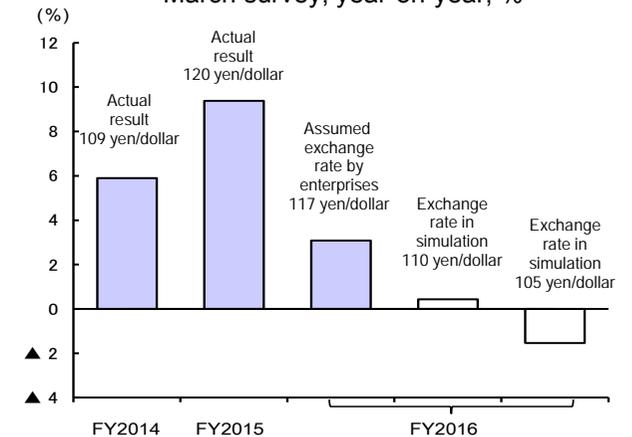
Figure 4-2 Ratio of Current Profits to Sales Planned by and Exchange Rate Assumed by Large Manufacturers



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

Note: Survey results in March, June, September, December, and subsequent estimates and actual results are shown in each fiscal year. Those in FY2016 are for March 2016.

Figure 4-3 Actual, Assumed or Simulated Change Rate in Current Profits for Each Fiscal Year <March survey, year-on-year, %>



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

Note: Simulations by JRI.

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# Employment will increase, yet unevenly distributed to the cohorts with lower wage levels

◆ A sense of stagnancy has been felt in private consumption expenditure, against the background of a continued reactionary fall in the purchase of durable goods and the heightened price of food

In the household sector, private consumption expenditure has stagnated. The decline in sales of durable goods is still continuing, because of the reactionary fall after the rise in the consumption tax rate in April 2014 and various subsequent supporting measures for buying. Real household consumption expenditure (monthly statistics) declined by 2.1 per cent year-on-year in the January-March period, even after the effect of a leap day (plus 0.9 per cent) was factored in.

Further, the year-on-year change rate in the core CPI which excludes fresh food has stayed at near zero since spring 2015 owing to the fall in the price of petroleum-related products. Yet, the CPI for food (excluding fresh food) continues to rise at a pace much faster than that of nominal wages. Because food is purchased quite often, its price change is felt acutely by consumers as if it were a realisation of the whole price situation, which leads to worsened consumer sentiment.

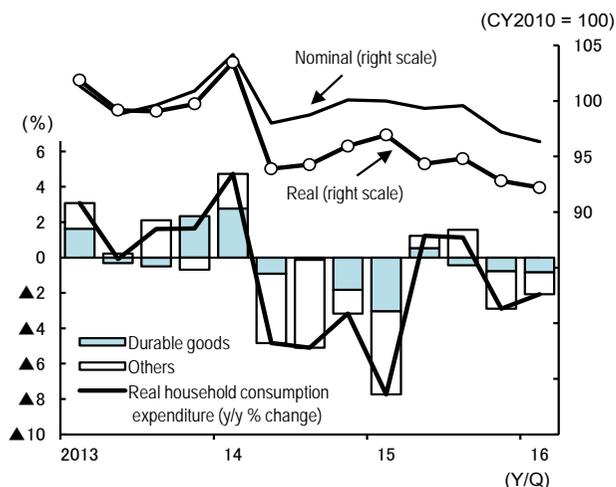
◆ Slow pace of recovery in private consumption will likely continue

Looking ahead, if the reactionary fall effect of a leap day is excluded, private consumption expenditure is expected to be firmer gradually over FY2016 to March 2017, although there is anxiety over a possible downswing in economic activity. This is because, as for income environments, a raise in wages will likely have materialised in the wage negotiations this spring to some degree, albeit short of the results last spring. Also, consumer sentiment will be bolstered by the decelerated pace in the rise in food prices due to the nearing of the end of the boosting effect of the weaker yen and owing to the reversal to the stronger yen of late.

However, the pace of the pickup in compensation for employees and private consumption expenditure will remain mild. One of the reasons for this is that the increase in employment has tended to be unevenly distributed to the cohorts with lower wage levels. The main types where employment has increased most are female and/or elderly part-time jobs, and, by industry, jobs in nonmanufacturers.

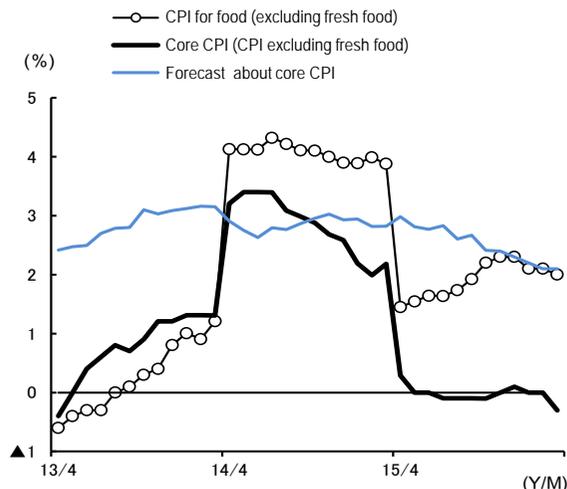
Looking ahead further, it is predicted that private consumption expenditure in real terms in FY2017 will decline considerably due to the decrease in real income, if the rise in the consumption tax rate from 8 to 10 per cent in April 2017 materialises.

Figure 5-1 Real Household Consumption Expenditure <per Household, index and year-on-year % change>



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Internal Affairs and Communications.  
Note: Households with 2 or more household members.

Figure 5-2 Core Consumer Price Index and Its Forecast of Consumers <year-on-year % change>



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

Figure 5-3 Details in the Change in the Number of Employees <from January 2013 to March 2016>



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Internal Affairs and Communications.  
Note: The figures in parentheses are median estimates of annual income (units of 10,000 yen, in 2015).

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# Supplementary budget for FY2015 will likely bolster economic activity in FY2016

## ◆ The supplementary budget for FY2015 will support economic activity in FY2016

Amid limited strength for the economic recovery, the supplementary budget for FY2015 was approved in the Diet on January 20, and is expected to bolster economic activity hence. Its scale is 3,321 billion yen, which is estimated to boost the real GDP growth rate by 0.3 - 0.4 percentage points, with public works such as the reconstruction in the disaster-hit areas being its main driving force.

## ◆ The currently scheduled rise in the consumption tax rate to 10 per cent in April 2017 will also be a fluctuating factor

The changes in demand and prices caused by the rise in the consumption tax rate from 8 to 10 per cent in April 2017 will be a fluctuation factor, if the rise materialises. First of all, the scale of a last minute surge in demand this time is estimated to be smaller than that in the consumption tax rise in April 2014. Although durable goods such as household appliances and automobiles will be the main items subject to

rushed demand, it is likely that demand for those which were purchased in a rush before the consumption tax rise last time will be limited this time, taking their service life into account.

With the above mentioned element taken into consideration, based on consumption functions, it is estimated that a last minute surge in demand will push up the growth rate of private consumption expenditure in FY2016 by 0.7 percentage points. However, it is also projected that private consumption expenditure in FY2017 will be pushed down in turn, by 1.6 percentage points, by a reactionary fall after the surge and reduced real purchasing power caused by the rise in consumer prices.

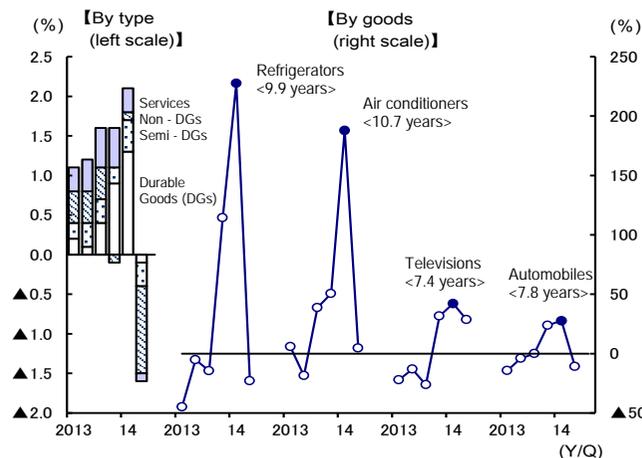
Meanwhile, if the consumption tax rate rises to 10 per cent, it was decided that the reduced tax rate of 8 per cent would be applied also from April 2017 mainly to food excluding alcoholic beverages and eating out. Thus, it is estimated that the rate of decrease in private consumption expenditure in FY2017 will be eased by 0.2 percentage points, compared with the no reduced tax rate case.

Figure 6-1 Items in Supplementary Budget for FY 2015 and Estimated Effect on Real GDP Growth Rate

	(Billion yen)
Urgent measures to realise a "Society in Which All Citizens are Dynamically Engaged"	1,164
• To realise the "desirable birth rate of 1.8" and "no one forced to leave their jobs for nursing care"	<395>
• Support for pensioners	<362>
• To promote investments and realise revolution in productivity	<240>
• To strengthen added-value creativity in local communities	<167>
Measures to realise TPP-related policies	340
Measures to accelerate the reconstruction in the disaster-hit areas and to promote disaster prevention and reduction	1,338
Other Measures	479
The Total	3,321
Estimated boosting effect on the GDP growth rate	0.4 % points

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.

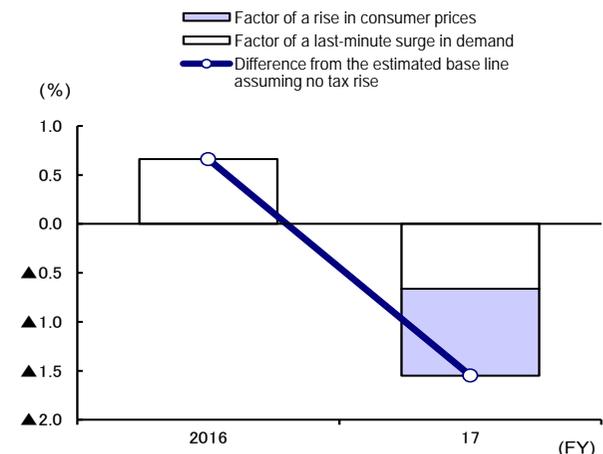
Figure 6-2 Change in Private Consumption Expenditure before and after the Consumption Tax Rise in April 2014 <year-on-year % change>



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

Note: The figures in angle brackets show service life (years) of each type of durable goods.

Figure 6-3 Estimated Effect of the Consumption Tax Rise in April 2017 (8% to 10%) on the Change Rates in Private Consumption Expenditure



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

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## Prospects for Japan's economy - Projected real GDP change; 0.9% in FY2016 and -0.5% in FY2017

### ◆ The effects of inventory adjustment and the Kumamoto Earthquake disaster will weigh on economic activity for the time being, yet the economy will pick up thereafter

(1) Japan's real GDP in the January-March period this year grew by 1.7 per cent on an annualised quarter-on-quarter change basis (national accounts, the first preliminary estimates), a positive growth for the first time in 2 quarters. However, it should be noted that real private consumption expenditure had an upswing due to a leap day. Therefore, if this effect is excluded, the quarterly real GDP growth rate is estimated to have been in the annualised 0.5 to 0.9 per cent range. As inventory adjustment in enterprises will take more time, economic activity is still in the sense of a standstill.

(2) As for FY2016, it is predicted that the real GDP change rate in the April-June period, the first quarter in FY2016, will decline from the previous quarter, because private consumption expenditure will decrease due to the reactionary fall after the leap day. Further, in addition to the downswing in corporate profits affected by the appreciation of the yen after early this year and continued pressure for inventory adjustment, the downswing in production and tourism due to the Kumamoto Earthquake disaster will also weigh down economic activity.

(3) However, it is expected that the situation where economic activity deteriorates continuously will be able to be avoided. This is because the following favourable factors will bolster economic activity during the rest of FY2016 to March 2017. These are 1) public investment will pick up, reflecting the implementation of the supplementary budget for FY2015, and that for FY2016 which is related to the reconstruction from the Kumamoto Earthquake disaster, 2) the improvement in employment and income environments against the background of labour shortages and others, and 3)

the increase in the number of enterprises which promote business fixed investment for maintenance and replacement, unaffected by the corporate profit situation, against the background of superannuated factories and equipment. Accordingly, economic activity will likely pick up, as the negative effects of the Earthquake disaster and inventory adjustment near their ends. As a result, it is projected that the real GDP growth rate in FY2016 on the whole will be slightly up from the previous fiscal year to 0.9 per cent.

(4) Looking further, real GDP growth in the April-June period 2017, the first quarter of FY2017, will see a considerable decline from the previous quarter due to the reactionary fall in demand after the last minute surge before the consumption tax rise from 8 to 10 per cent in April 2017, if the rise materialises. Thereafter economic activity is predicted to return to its recovery trend again, yet, the pace of recovery will likely remain very mild, amid Japan's potential economic growth rate which is currently estimated to be in the annualised 0.1 to 0.5 per cent range. Therefore, it is projected that real GDP in FY2017 on the whole will decline by 0.5 per cent from the previous fiscal year.

### ◆ The rate of increase in the core CPI will likely accelerate gradually, as the downward effect of the cheaper crude oil nears its end

(5) As for the core CPI which excludes fresh food, the pace of increase will likely be very slow for the time being. However, it is predicted that factors such as a stop in the fall and a reversal in the price of crude oil, and the pickup in domestic demand, will contribute to boosting prices. Thus, the rate of year-on-year increase in the core CPI is projected to accelerate gradually during the projection period.

Figure 8 Projections for GDP Growth and Main Indicators of Japan ( as of May 18, 2016 )

	(seasonally adjusted, annualised % changes from the previous quarter)										(% changes from the previous fiscal year)			
	CY2015	CY2016				CY2017					CY2018	FY2015	FY2016	FY2017
	10~12	1~3	4~6	7~9	10~12	1~3	4~6	7~9	10~12	1~3	(Actual)	(Projection)	(Actual)	
	(Actual)	(Actual)	(Projection)	(Actual)	(Projection)	(Actual)								
Real GDP	▲ 1.7	1.7	▲ 1.2	2.2	2.7	3.4	▲ 6.2	0.1	0.2	0.6	0.8	0.9	▲ 0.5	
Private Consumption Expenditure	▲ 3.3	1.9	▲ 1.5	2.1	3.2	6.6	▲ 13.6	1.2	0.6	0.8	▲ 0.3	0.9	▲ 1.6	
Housing Investment	▲ 4.1	▲ 3.0	3.2	5.5	6.9	6.3	▲ 21.2	▲ 12.4	▲ 1.6	3.5	2.4	2.4	▲ 6.0	
Business Fixed Investment	4.7	▲ 5.3	3.6	3.2	3.5	6.0	▲ 5.1	0.8	2.8	2.9	1.6	2.1	1.0	
Private Inventories (percentage points contribution)	(▲ 0.5)	(▲ 0.0)	(▲ 0.8)	( 0.2)	( 0.2)	(▲ 0.8)	( 1.3)	(▲ 0.6)	(▲ 0.2)	( 0.0)	( 0.4)	(▲ 0.3)	( 0.1)	
Government Consumption Expenditure	2.9	2.8	0.5	0.6	0.6	0.6	0.6	0.6	0.6	0.6	1.6	1.3	0.6	
Public Investment	▲ 13.1	1.3	3.8	6.7	5.4	3.0	0.8	▲ 0.6	▲ 12.4	▲ 9.5	▲ 2.2	1.6	▲ 1.2	
Net Exports (percentage points contribution)	( 0.3)	( 0.8)	(▲ 0.4)	(▲ 0.4)	(▲ 0.5)	(▲ 1.1)	( 1.5)	( 0.0)	( 0.0)	(▲ 0.2)	( 0.1)	(▲ 0.1)	( 0.1)	
Exports of Goods and Services	▲ 3.1	2.4	▲ 0.4	3.7	4.2	3.8	2.8	3.1	3.3	3.3	0.4	2.0	3.3	
Imports of Goods and Services	▲ 4.3	▲ 1.8	2.1	6.2	7.2	9.8	▲ 5.8	2.8	3.0	4.1	▲ 0.1	2.7	2.7	

	(% changes from the same quarter of the previous year)										(% changes from the previous fiscal year)		
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2015	2016	2017
Nominal GDP	2.2	0.8	0.6	0.5	1.4	1.9	1.4	0.9	0.4	▲ 0.1	2.2	1.1	0.6
GDP deflator	1.5	0.9	0.5	0.2	0.2	0.0	1.0	1.0	1.2	1.4	1.4	0.2	1.1
Consumer Price Index (excluding fresh food)	0.0	▲ 0.1	▲ 0.0	0.1	0.5	1.1	2.3	2.2	2.1	2.0	0.0	0.4	2.1
(excluding fresh food and consumption tax)	0.0	▲ 0.1	▲ 0.0	0.1	0.5	1.1	1.3	1.2	1.1	1.0	0.0	0.4	1.1
Unemployment Rate (%)	3.3	3.2	3.2	3.2	3.1	3.1	3.1	3.1	3.1	3.1	3.3	3.2	3.1
Exchange Rates (JY/US\$)	121	115	109	110	108	106	106	105	105	105	120	108	105
Import Price of Crude Oil (US\$/barrel)	46	33	40	43	49	54	56	58	60	62	49	47	59

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 estimated that the supplementary budget for FY2015 (the amount of 3.3 trillion yen) will boost the real GDP growth rate by 0.3 - 0.4 percentage points.

3: It is assumed that the consumption tax rate will be raised from 8% to 10% in April 2017, with the reduced tax rate of 8% applied to food excluding alcoholic beverages and eating out.