

# Monthly Report of Prospects for Japan's Economy

July 2016

Macro Economic Research Centre  
Economics Department



The Japan Research Institute, Limited

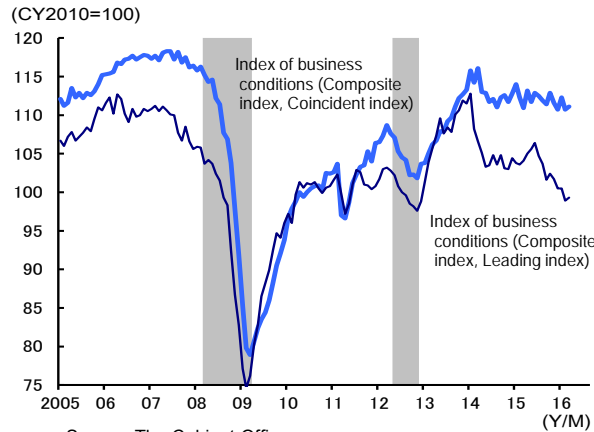
<http://www.jri.co.jp/english/periodical/>

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

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

**Figure 1-1 Economic Activity**

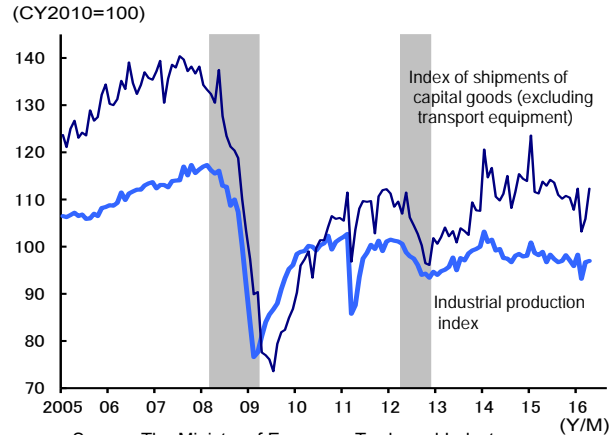
The leading index of business conditions rose for the first time in 5 months, due to the increase in machinery orders, and so on.



Source: The Cabinet Office.

**Figure 1-2 The Corporate Sector**

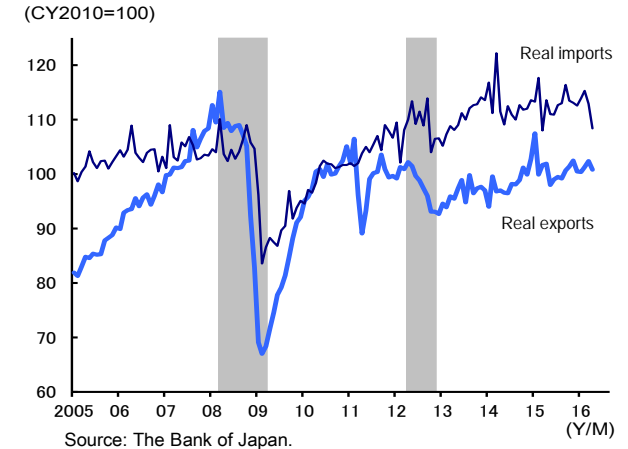
Production increased for the second month in a row, despite the negative effects of the Kumamoto Earthquake.



Source: The Ministry of Economy, Trade and Industry.

**Figure 1-3 Overseas Demand**

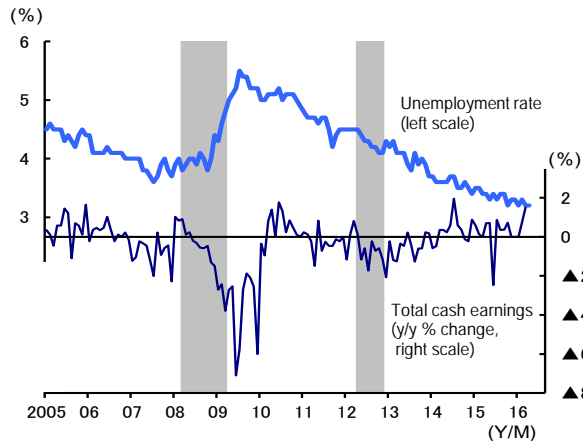
Exports slowed down, led by those to the US. Imports fell to the lowest level in 12 months.



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 at the fastest pace since July 2014.

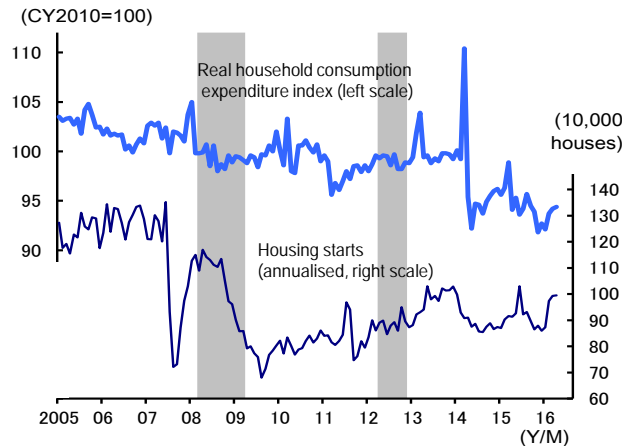


Source: The Ministry of Internal Affairs and Communications, The Ministry of Health, Labour and Welfare.

\* The shaded area indicates the phase of recession.

**Figure 1-5 The Household Sector**

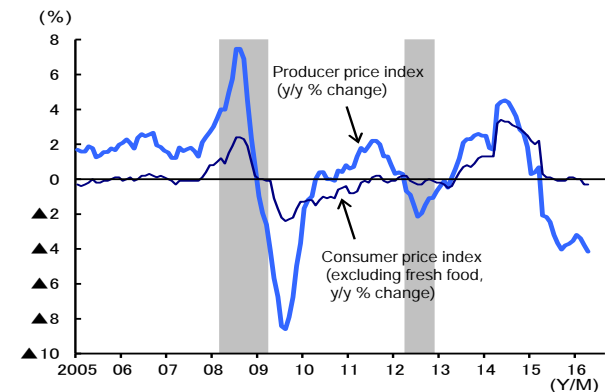
Real household consumption expenditure picked up, yet continued to lack momentum. New housing starts rose, for the fourth month in a row.



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 continued to decrease 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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# Economic activity is still in a stagnant phase, as Kumamoto Earthquake affects the economy

## ◆ Japan's economic activity is still in a stagnant phase

Japan's real GDP in the January-March period grew by 1.9 per cent on an annualised quarter-on-quarter change basis (national accounts, the second preliminary estimates). However, if the boosting effect of a leap day is excluded, the bounce from the decline of 1.8 per cent in the October-December quarter last year seems to have been weak. Thus, economic activity has been still in a stagnant phase.

Meanwhile, the JRI projections were revised in this issue, as the scheduled rise in the consumption tax rate in April 2017 from 8 to 10 per cent was postponed to October 2019. \* The effects on Japan's economy of the result of the British referendum to leave the EU will be factored into JRI projections in the next issue.

## ◆ The sense of stagnation has been felt in private consumption expenditure

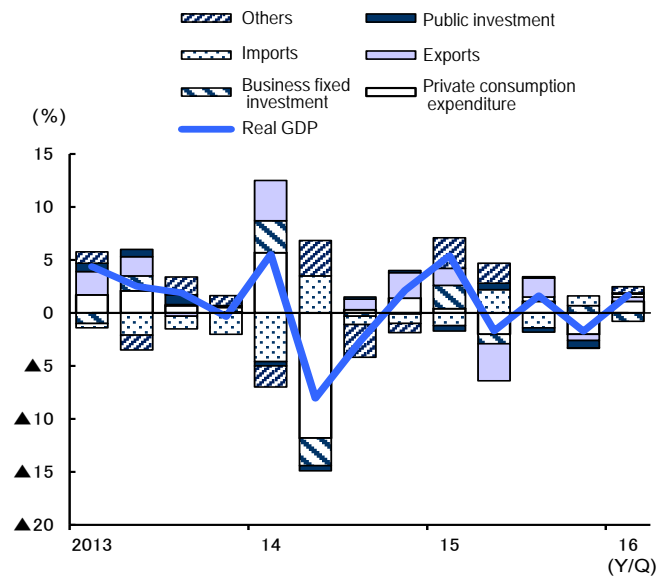
Recent monthly statistics show that the visibly stagnating situation still continues in private consumption expenditure.

The total sales value in department stores and supermarkets fell again in April. While sales value of food and beverages remains firm owing to the rise in their prices, that of other items such as clothing has been sluggish, partly because of the cooling in consumer sentiment due to the appreciation of the yen, the fall in stock prices, and the negative effects of the Kumamoto Earthquake disaster. In addition, sales of light passenger cars declined in May to the lowest level since May 2011, against the background of the problem of falsifying fuel economy tests.

## ◆ Exports have been slow to increase, reflecting the downswing in production of automobiles

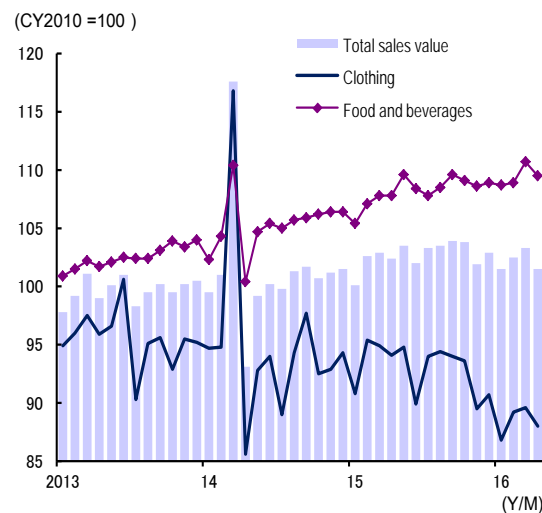
Real exports have been slow to increase, reflecting the downswing in the transport equipment industry such as automobiles, production of which decreased due to the explosion accident in a related steel factory and the damage caused by the Kumamoto Earthquake disaster. On the other hand, real exports of producer goods such as electronic parts and devices have bolstered total exports.

Figure 2-1 Real GDP Change Rate by Demand Item <the first preliminary estimates, on an annualised q/q change basis, seasonally adjusted>



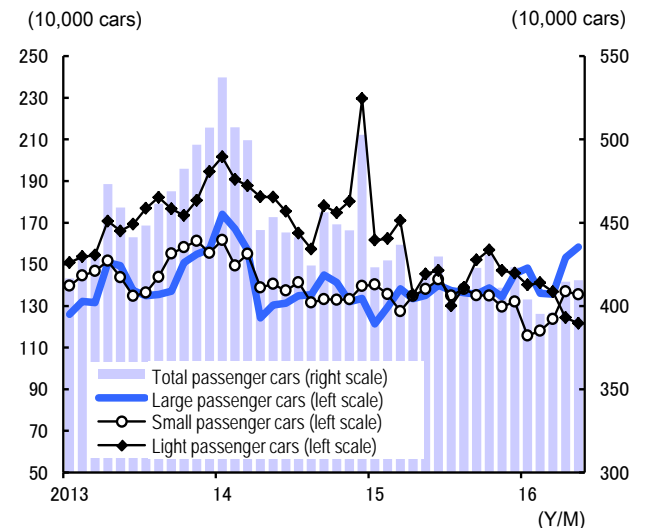
Source: The Japan Research Institute, Ltd. based on the data of The Cabinet Office.

Figure 2-2 Sales Values in Department Stores and Supermarkets <seasonally adjusted>



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

Figure 2-3 Passenger Car Sales by Size <seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on the data of Japan Automobile Dealers Association, Japan Light Vehicle and Motorcycle Association.

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

◆ A surplus in monthly trade balance continues due to low crude oil price, the appreciation of the yen, and the continued fall in imports of mineral fuels

Japan's monthly trade balance was a surplus in April on a seasonally adjusted basis, for the sixth successive monthly surplus. The value of total imports decreased in April, the tenth consecutive monthly decline. This is because, in addition to the downswing in import prices owing to the stronger yen, import quantity, mainly that of mineral fuels, decreased due to stagnant domestic demand. It is likely that the month-on-month decline in the value of total imports will be checked sooner or later, as the price of crude oil has recovered of late to some extent. Yet, the pace of the recovery will likely remain mild, as stagnant domestic demand persists.

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

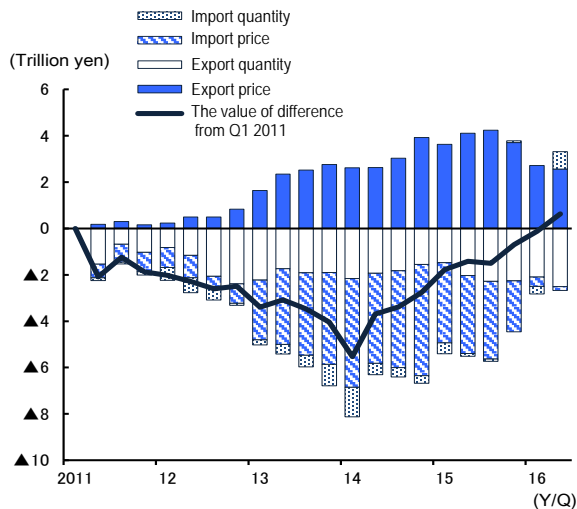
With respect to Japan's exports, their quantity continues to be stagnant, reflecting the slowdown of overseas economic activity. In addition, the stoppage of operations

in the factories of some automobile manufacturers due to the Kumamoto Earthquake disaster in April weighed on exports. However, as many factories there have already resumed operations, the exports which had been affected by the Earthquake will have recovered since May.

Looking ahead, it is predicted that a strong recovery in exports will be unable to be counted on, and the pace of the pickup will remain moderate. This is because a sense of deceleration in the overseas economies still persists and the appreciation of the yen after early this year has also weighed on exports. As for the exports of capital goods, they have shown signs of bottoming out thanks to the effects of economic stimulus measures taken in emerging countries such as China.

Concerning services exports, "inbound" demand stemming from foreign tourists, which had been buoyant through their purchasing, worryingly, has not been strong enough to drive the economic activity powerfully of late. The trend is shown in the fact that the value spent per foreign tourist has decreased year-on-year.

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

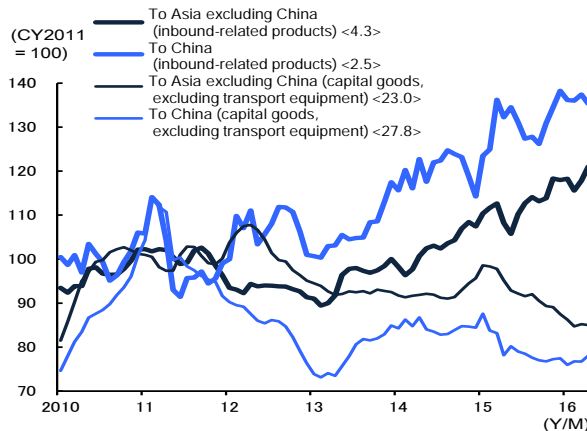


Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance.

Note: 1. The value of trade balance in Q1 2011 was a surplus of 652 billion yen.

2. The figure in Q2 2016 is for April 2016.

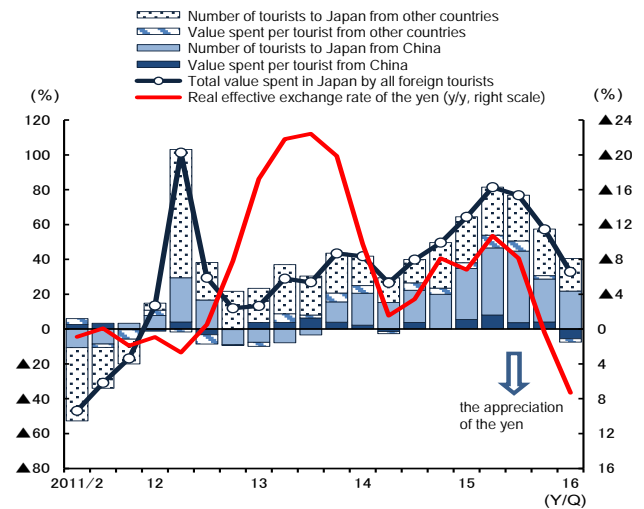
Figure 3-2 Real Exports Index of Inbound-related Products and Capital Goods to China and Other Asia



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

Note: 1. Figures in the angle brackets show the shares in FY2014.  
2. Inbound-related products are the items which foreign visitors to Japan tend to like to purchase, including medicine, cosmetics, household appliances, and so on.

Figure 3-3 Value Spent in Japan by Foreign Tourists by Country <year-on-year % change>



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

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# Business fixed investment will likely pick up mildly, mainly for maintenance and replacement

## ◆ Corporate profits have declined from the previous quarter

Concerning the corporate sector, based on the Financial Statements Statistics of Corporations by Industry, sales value in Japanese enterprises declined in the January-March period this year on a seasonally adjusted quarter-on-quarter basis, the fifth straight quarterly decrease. This has taken place amid the fall in international commodity prices and the prolonged sluggish demand at home and abroad. Current profits during the same quarter also decreased by 6.8 per cent, the third successive quarterly decline. The ratio of current profits to sales worsened, with the appreciation of the yen and the increase in personnel expenses weighing in.

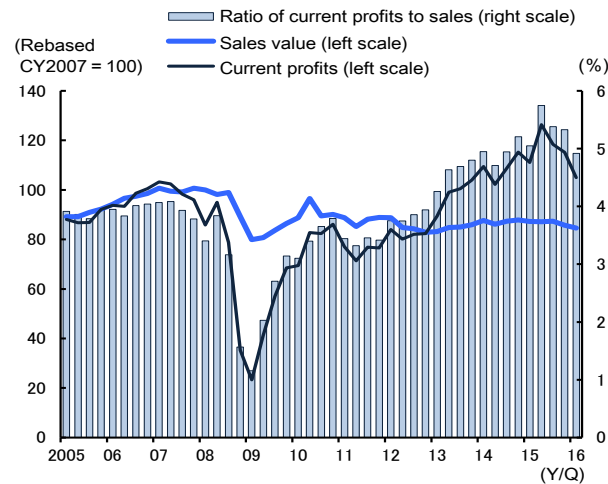
It is predicted that corporate profits will level off for the time being, under the circumstances such as upward pressure on personnel expenses reflecting labour shortages and persistent uncertainties surrounding overseas demand. Also, the JRI macro model simulations using the data of BoJ's Tankan Survey show that, if the exchange rate of the yen stays at the stronger than 110 yen per dollar level during the rest of the fiscal year, current profits in FY2016 will be less than those in the

previous fiscal year.

## ◆ The pace of pickup in business fixed investment is likely to be mild. Necessary maintenance and replacement investment will bolster the total to some degree

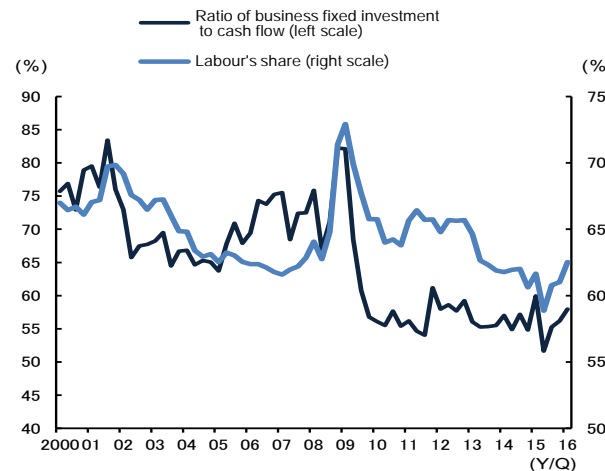
Based on the Financial Statements Statistics of Corporations by Industry, business fixed investment in Japanese enterprises increased by 1.4 per cent in the January-March period on a seasonally adjusted quarter-on-quarter basis, for the first time in 2 quarters. Despite the situation where corporate profits have levelled off, demand for the investment for maintenance and replacement as well as the investment for rationalisation and saving has been firm, against the background that a certain part of the plants and equipment have become superannuated and a shortage in workers continues. However, it is unlikely that business fixed investment will recover strongly, as the ratio of business fixed investment to cash flow still remains at a low level, amid lowered growth expectations about Japanese domestic markets among Japanese enterprises.

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



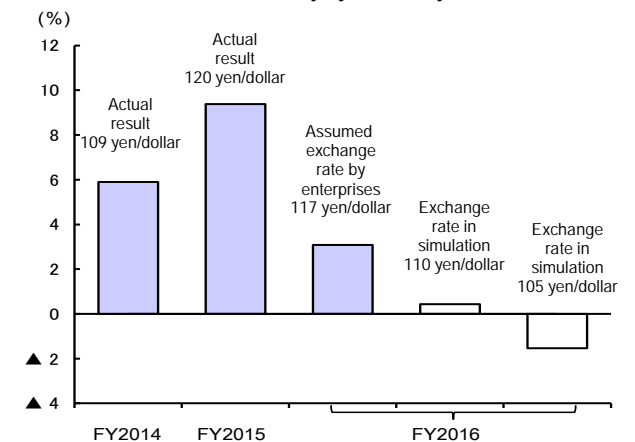
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance.  
Note: All industries excluding financial institutions.

Figure 4-2 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.  
2 Labour's share = personnel expenses / value added.

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.

# 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 thus far

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.

Further, the year-on-year change rate in the core CPI which excludes fresh food has stayed at near zero or slightly negative 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.

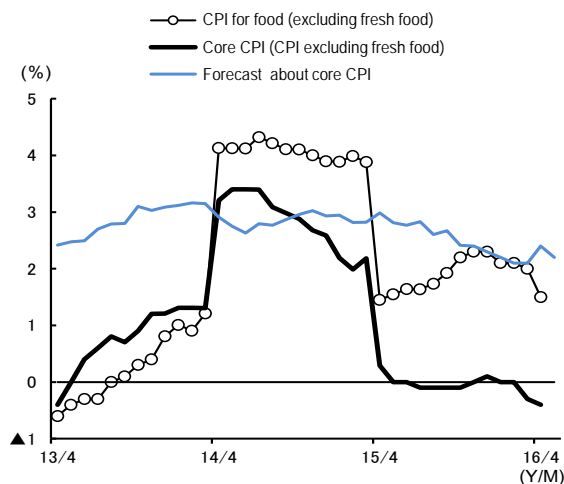
Also, the Kumamoto Earthquake disaster in April would weigh on private consumption expenditure for the time being, through cooling effects on consumer sentiment, and so on.

◆ Slow pace of recovery in private consumption will likely continue

Looking ahead, if the reactionary declining effect of a leap day is excluded, private consumption expenditure is expected to be firmer gradually over FY2016 to March 2017. This is because, as for income environments, a raise in wages materialised in the wage negotiations this spring to some degree, albeit short of the results last spring. Looking at the negotiations by size, many large enterprises avoided "no base up" (namely, raised across-the-board wages albeit to a limited degree). A certain number of small and medium-sized enterprises also were able to materialise firm wage rises. In addition, 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.

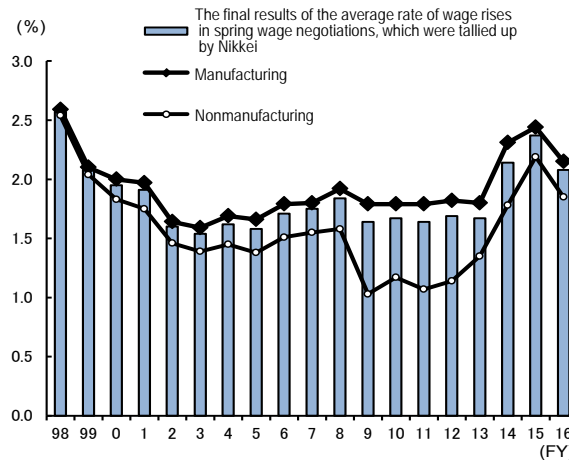
However, the pace of the pickup in compensation for employees and private consumption expenditure will remain mild. One of the reasons for this is that the increase in employment has tended to be unevenly distributed to the cohorts with lower wage levels. The main types where employment has increased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

Figure 5-1 Core Consumer Price Index and Its Forecast by 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.

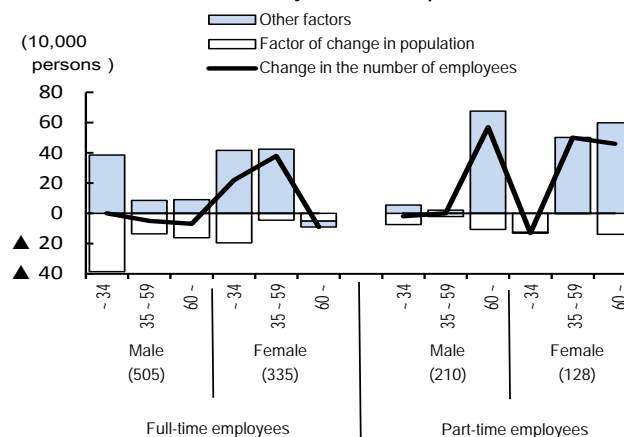
Figure 5-2 Results of Spring Wage Negotiations Tallied Up by Nikkei



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

Note: The collected data are mainly from large enterprises.

Figure 5-3 Details in the Change in the Number of Employees <from January 2013 to April 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).

# Supplementary budget for FY2016 for reconstruction from the Kumamoto Earthquake disaster

## ◆ The downswing in production and tourism caused by the Kumamoto Earthquake disaster will have weighed on economic activity

The damage caused by the Kumamoto Earthquake Disaster in mid-April will have weighed on economic activity of late. As for production, the Kumamoto Prefecture has regional industrial clusters in manufacturers such as automobile-related and electronic parts and devices. The stoppage of operations in their factories there spread negative effects of the disaster to other Prefectures, through a delay in supply of parts and other products. Concerning tourism, the number of cancellations of hotel bookings increased, especially during "Golden Week" holidays (a succession of holidays from late April to early May) in the whole Kyushu area. The downswing in demand for tourism there including that of foreign tourists to a considerable degree will have been unavoidable.

However, the recovery from the disaster also has started to be seen. This is shown in the fact that the number of enterprises which resumed production in their factories

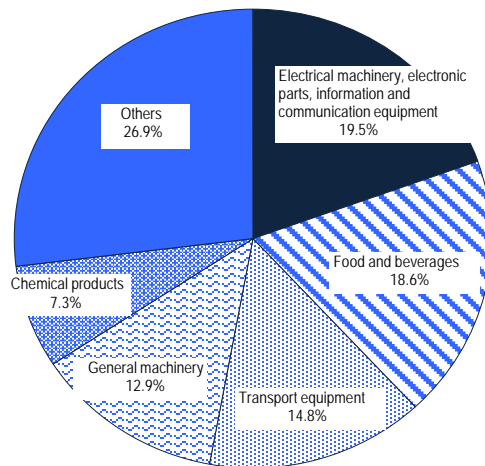
has increased gradually since early May. The past earthquake disasters such as the Niigata Chuetsu show that production activity will likely recover in earnest in half a year's time, if the problems in the supply chain do not deteriorate further.

## ◆ The government compiled the supplementary budget for the recovery from the Earthquake disaster. The scale is the total amount of 778 billion yen

The supplementary budget for FY2016 for the recovery from the Kumamoto Earthquake disaster, the scale of which is the total amount of 778 billion yen, was approved in the Diet on May 17. The major part of the supplementary budget is for public works which are necessary for the restoration of the infrastructure which was damaged by the Earthquake.

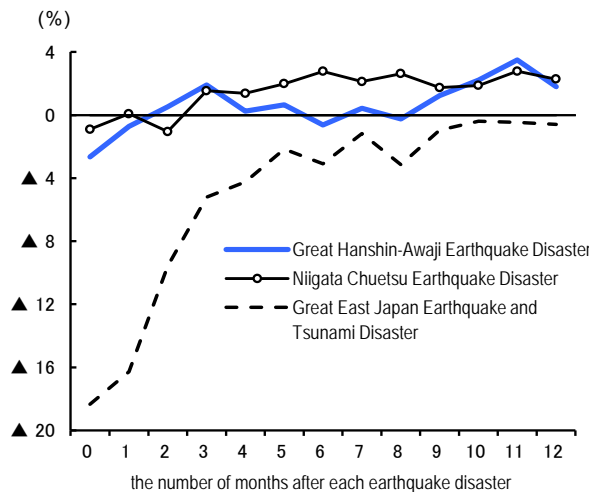
As for public investment on the whole, it is predicted that the implementation of the supplementary budget for FY2015, which was approved in the Diet in January, and the moved up implementation of the budget for FY2016 will take place in earnest. Thus, the increase in public investment will bolster economic activity in FY2016.

Figure 6-1 The Share of Products in Shipments of Manufacturers in the Kumamoto Prefecture



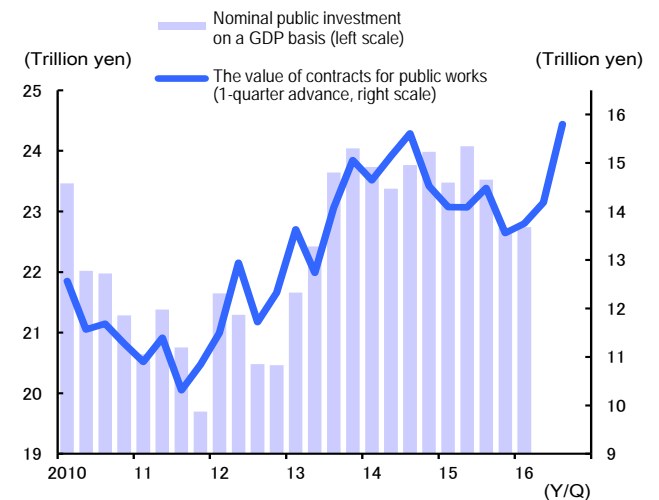
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Internal Affairs and Communications.  
Note: The data are as of 2014.

Figure 6-2 Changes in the Negative Effects of Past Earthquake Disasters on National Industrial Production



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

Figure 6-3 Value of Contracts for Public Works and Public Investment <annualised, seasonally adjusted>



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

## Prospects for Japan's economy - Projected real GDP change; 0.5% in FY2016 and 0.6% in FY2017

◆ Factors such as continued inventory adjustment 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 1.9 per cent on an annualised quarter-on-quarter change basis (national accounts, the second preliminary estimates), which was revised upwards slightly from 1.7 per cent in the first preliminary estimates. This revision was a positive one, including upward revisions in private consumption expenditure and business fixed investment, in addition to downward revision in private inventory changes which suggest an advance in inventory adjustment.

However, it should be noted that, if the boosting effect of a leap day is excluded, the bounce from a decline of 1.8 per cent in the October-December quarter last year was weak. Thus, there is no alteration in JRI's basic view that economic activity is considered to be still in a stagnant phase.

(2) Meanwhile, the JRI projections were revised in this issue, as the scheduled rise in the consumption tax rate in April 2017 from 8 to 10 per cent was postponed to October 2019. Compared with the previous projections, the annual growth rate in FY2016 was revised downwards by 0.4 percentage points to 0.5 per cent, because no last-minute surge in demand will take place during that period.

On the other hand, the annual growth rate in FY2017 was revised upwards by 1.1 percentage points to plus 0.6 per cent, because there will be no reactionary fall in demand and no reduced purchasing power due to the rise in consumer prices caused by the tax rise.

(3) 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. Therefore, for the time being, a sense of stagnation will likely continue to be felt in economic activity.

(4) However, it is expected that the economy will pick up thereafter, as the negative effects of the Earthquake disaster and inventory adjustment near their ends. This is also 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, against the background of superannuated factories and equipment.

Looking further, it is projected that the economic recovery trend will continue also during FY2017 to March 2018, albeit at its mild pace, because there will be no reactionary fall due to the putting off of the consumption tax rise to October 2019 as mentioned earlier.

\* The effects on Japan's economy of the result of the British referendum to leave the EU will be factored into JRI projections in the next issue.

◆ The core CPI will likely rise gradually, as the downward effect of the cheaper crude oil peters out. Yet, the appreciation of the yen will weigh on it

(5) The core CPI which excludes fresh food has declined slightly year-on-year of late, against the background of a downswing in energy prices due to the fall in the price of crude oil. Yet, hereafter, it is predicted that the core CPI will regain momentum and accelerate its pace towards a year-on-year increase, because the extent of the fall in the crude oil price will narrow and domestic demand will also likely pick up. Nevertheless, the pace of the year-on-year increase in the core CPI will remain mild, due to the fact that the appreciation of the yen will weigh on the core CPI through pushing down import prices, and so on.



Figure 8 Projections for GDP Growth and Main Indicators of Japan ( as of June 8, 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)	(Projection)
	(Actual)	(Actual)	(Projection)			(Projection)					(Actual)	(Projection)	(Projection)
Real GDP	▲ 1.8	1.9	▲ 0.8	1.4	1.2	0.7	0.4	0.4	0.3	0.3	0.8	0.5	0.6
Private Consumption Expenditure	▲ 3.2	2.6	▲ 1.0	0.9	0.6	0.3	0.2	0.2	0.3	0.3	▲ 0.2	0.2	0.3
Housing Investment	▲ 4.1	▲ 2.9	2.6	2.8	0.8	▲ 3.8	▲ 3.4	▲ 1.9	0.6	0.8	2.4	0.4	▲ 1.6
Business Fixed Investment	5.2	▲ 2.6	2.8	3.0	2.4	2.2	2.1	1.9	1.8	2.0	2.0	2.1	2.1
Private Inventories (percentage points contribution)	(▲ 0.7)	(▲ 0.4)	(▲ 0.3)	( 0.0)	( 0.2)	( 0.0)	( 0.0)	( 0.0)	( 0.0)	( 0.0)	( 0.3)	(▲ 0.2)	( 0.0)
Government Consumption Expenditure	2.9	3.0	0.5	0.6	0.6	0.6	0.6	0.6	0.6	0.6	1.5	1.3	0.6
Public Investment	▲ 13.8	▲ 2.9	3.4	7.9	3.1	1.4	▲ 0.2	▲ 2.8	▲ 7.6	▲ 6.9	▲ 2.7	0.4	▲ 1.4
Net Exports (percentage points contribution)	( 0.3)	( 0.7)	(▲ 0.7)	(▲ 0.2)	(▲ 0.0)	(▲ 0.0)	(▲ 0.1)	(▲ 0.1)	(▲ 0.0)	(▲ 0.1)	( 0.1)	(▲ 0.0)	(▲ 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	▲ 1.6	3.8	4.6	4.1	3.8	3.3	3.2	3.2	3.4	▲ 0.1	2.1	3.5

	(% changes from the same quarter of the previous year)										(% changes from the previous fiscal year)		
Nominal GDP	2.2	0.9	0.9	0.6	1.1	0.9	1.3	1.0	0.8	0.9	2.2	0.9	1.0
GDP deflator	1.5	0.9	0.6	0.3	0.3	0.2	0.3	0.3	0.4	0.5	1.4	0.3	0.4
Consumer Price Index (excluding fresh food)	0.0	▲ 0.1	▲ 0.4	0.1	0.5	1.1	1.1	1.0	0.9	0.8	0.0	0.3	1.0
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	42	46	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. The effects on Japan's economy of the result of the British referendum to leave the EU will be factored into JRI projections in the next issue.