

# Monthly Report of Prospects for Japan's Economy

August 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 July 2016 issue of the original Japanese version.

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

Figure 1-1 Economic Activity

The coincident index continues to seesaw. The leading index rose for 2 months in a row, for the first time since the first half of 2015.

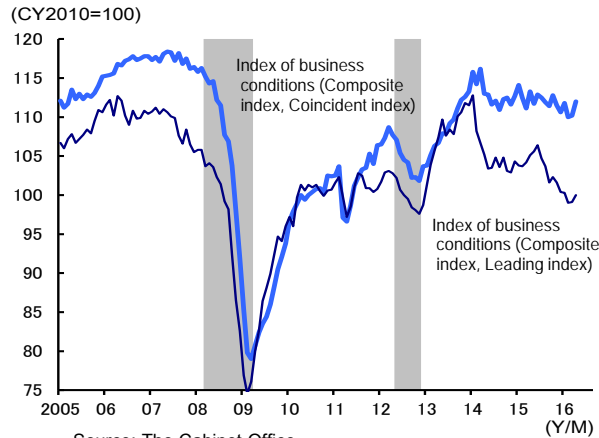


Figure 1-2 The Corporate Sector

Production index fell in May to the lowest level since February. Index of shipments of capital goods was almost flat.

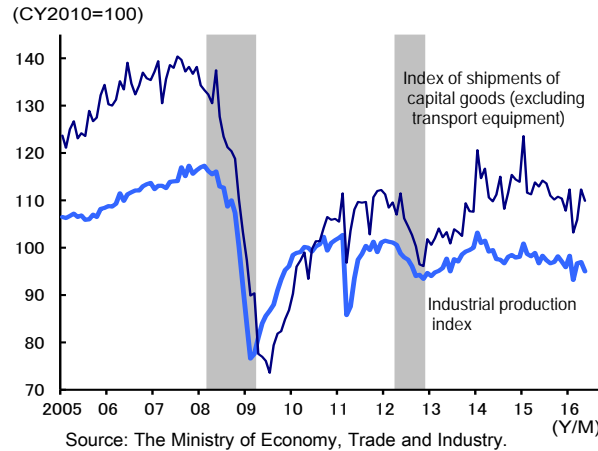


Figure 1-3 Overseas Demand

Real exports slowed down, led by those to the US, EU and China. Real imports continue to seesaw.

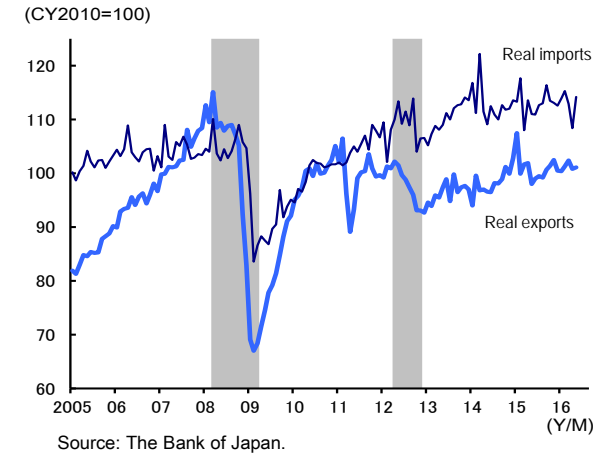
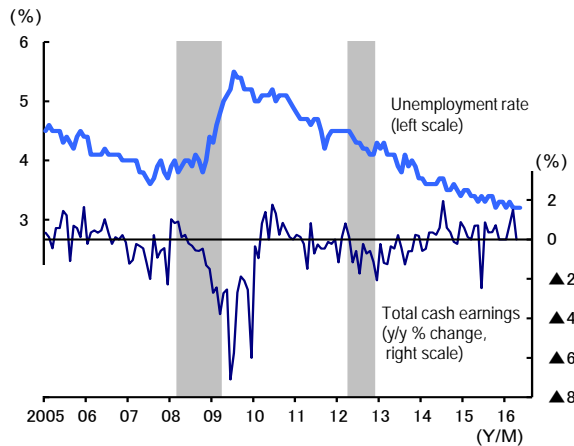


Figure 1-4 Employment and Income

The unemployment rate remains at a very low level. Total cash earnings are on a mild increasing trend on the whole.



\* The shaded area indicates the phase of recession.

Figure 1-5 The Household Sector

Real household consumption expenditure continues to be weak. New housing starts have risen to the highest level since a year ago.

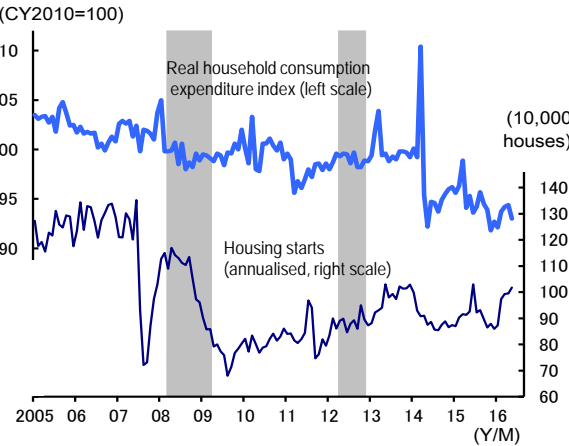
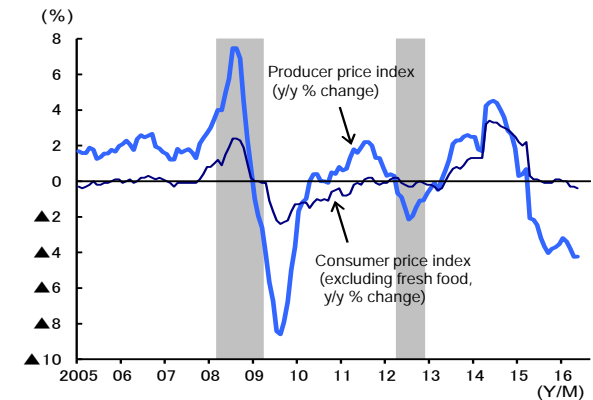


Figure 1-6 Prices

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



# Economic activity is still in a stagnant phase, as new downside risks such as Brexit loom

◆ Demand both at home and abroad lacks strength

Stagnation in Japan's economic activity is prolonged.

Overseas demand is still not strong enough to be a driving force for the whole economy. Real exports of goods have decreased, such as those of electronic parts and devices to China and other Asian countries as well as those of power units and steel to the US. Also, the appreciation of the yen and excessive production of steel in China have increasingly weighed on Japan's exports. Domestic demand also continues to stagnate, as shown in weak private consumption expenditure.

Reflecting the above mentioned situation, production activity in enterprises continues to seesaw. Industrial production in May declined by 2.6 per cent from the previous month, for the first time in 3 months.

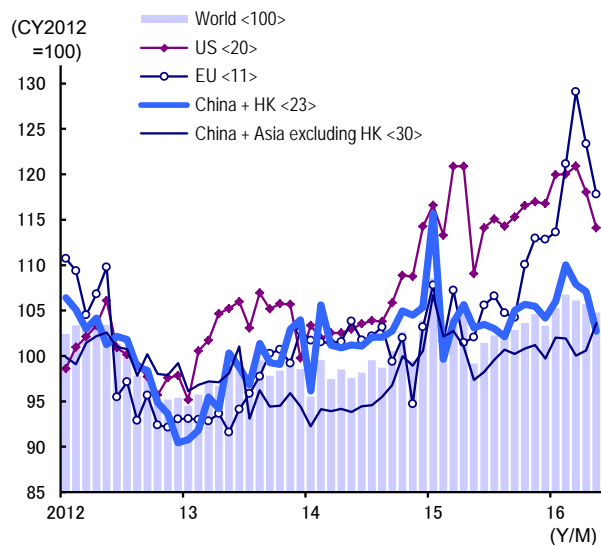
◆ Yet, corporate profits are still at a high level and employment environments continue to improve

Looking at corporate profits, current profits in Japanese enterprises declined in the January-March period, the fourth successive quarter-on-quarter decline. However, current profits on the whole are still at a higher level than that before the Lehman shock, with the firm trend being maintained mainly in nonmanufacturing. Further, the improving trend in employment environments also continues. The ratio of effective job offers to applicant has been rising to the highest level since October 1991.

◆ Brexit caused the appreciation of the yen and the fall in stock prices

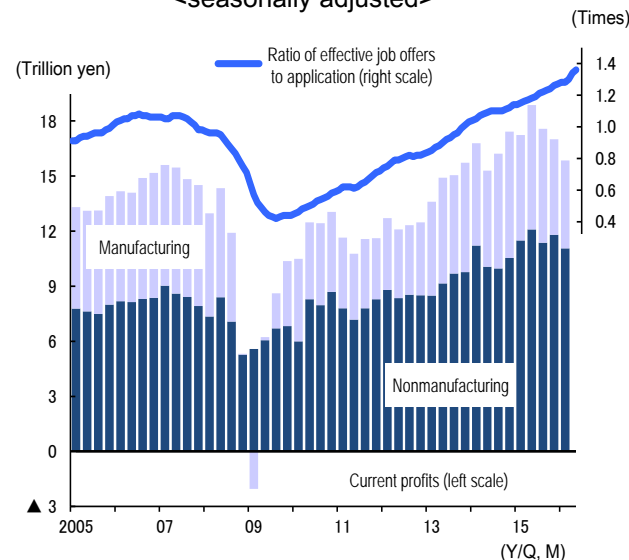
Meanwhile, the exchange rate of the yen rose and stock prices fell significantly, affected by Brexit, which is the result of the British referendum on June 23 to leave the EU. Although the markets have regained stability of late, it seems to be still easy for economic activity to have a downswing for the time being, through the worsening in consumer and business sentiment, a decrease in corporate profits, and so on.

Figure 2-1 Real Exports by Destination <seasonally adjusted>



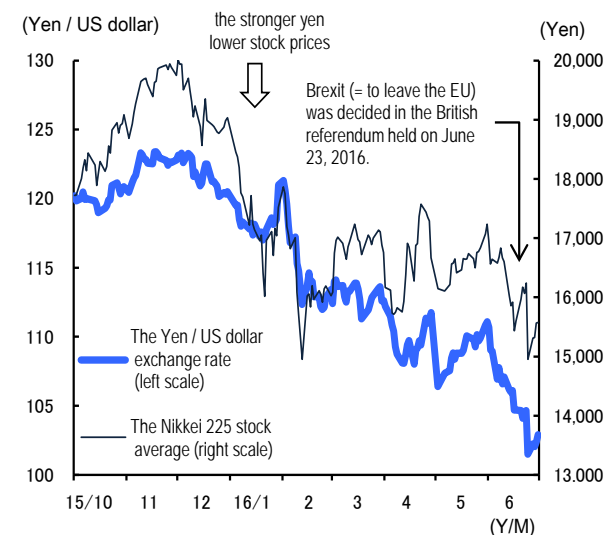
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance, The Bank of Japan.  
Note: Figures in the angle brackets show the shares in FY2015.

Figure 2-2 Current Profits and Ratio of Effective Job Offers to Applicant <seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance, The Ministry of Health, Labour and Welfare.  
Note: Figures of current profits exclude those of financial institutions.

Figure 2-3 Yen / US Dollar Exchange Rate and Nikkei 225 Stock Average



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

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# BoJ's Tankan Survey - Business sentiment is on a worsening trend on the whole

◆ Business sentiment is on a worsening trend due to the appreciation of the yen and the fall in stock prices. Future uncertainties also strengthened

In the Tankan June 2016 Survey, the diffusion index (DI) for business conditions on the whole of large manufacturing was plus 6 percentage points, unchanged from the previous survey result. The DI for the whole of large nonmanufacturing was plus 19 percentage points, down by 3 from the March survey result.

Viewed by industry, the DIs in industries such as automobiles and various types of machinery deteriorated, reflecting the worsening in export environments as seen in the appreciation of the yen. On the other hand, the DIs in basic materials improved, as international commodity prices have picked up. In nonmanufacturing, the DI for private consumption-related businesses worsened considerably, amid continued sluggish private consumption expenditure, affected also by the slowdown in "inbound" demand stemming from foreign visitors to Japan.

The DIs in small and medium-sized industries worsened both in manufacturing and

nonmanufacturing.

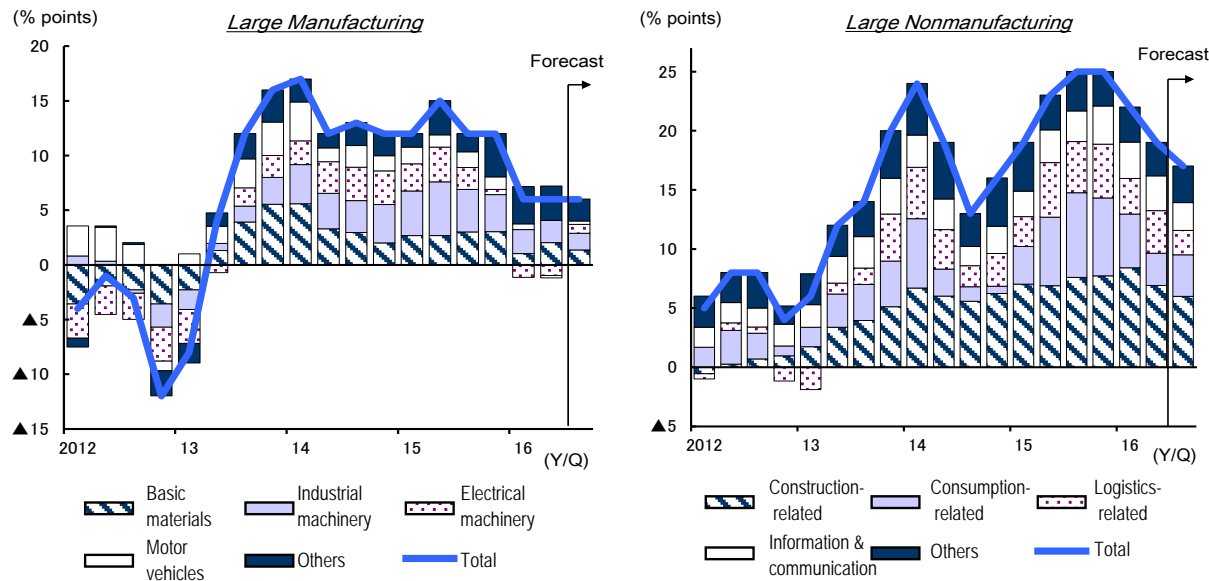
As for the forecast DIs in 3 months' time, the survey results showed a deterioration on the whole. A sense of hope is felt that the positive effects arising from economic measures of the government will bolster economic activity. Yet, unfavourable factors will likely weigh on the economy, such as anxiety that corporate profits will fall due to the appreciation of the yen, heightened uncertainties surrounding the overseas situation led by Brexit in Europe and presidential election in the US, and so on.

◆ Planned business fixed investment for FY2016 was slightly more cautious compared with the June survey result for FY2015 a year earlier

In the same Survey, planned business fixed investment for FY2016 showed a slightly cautious attitude among enterprises, probably reflecting increased uncertainties after early this year. However, as demand for investment in plants and equipment remains solid, mainly investment for maintenance and replacement, the risk that business fixed investment would falter in FY2016 is predicted to be limited.

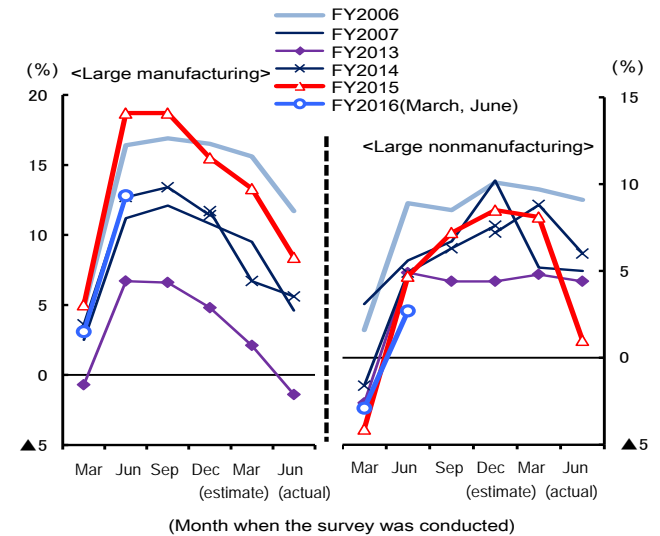
Figure 3-1 Contributions to Business Conditions Diffusion Index by Industry

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



Source: The Japan Research Institute, Ltd. based on the data of The Bank of Japan, "The Tankan June 2016 Survey".

Figure 3-2 Change over Time in Planned Business Fixed Investment for Each Fiscal Year <year-on-year, %>



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

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# It is likely that unfavourable environments surrounding overseas demand will continue

◆ Exports of goods continue to lack momentum. Also, the pace of increase in inbound demand stemming from foreign tourists to Japan has slowed

Looking at the overseas demand situation, exports of goods continue to lack momentum under such circumstances as the appreciation of the yen and a slowdown in overseas economies.

With respect to inbound demand, which had expanded rapidly, signs of change have been seen, such as a deceleration in the pace of increase in the number of foreign tourists to Japan and also a decrease in value spent in Japan per tourist. Closer observation into the recent trend shows that the tourists from China, who had driven total inbound demand, have shifted their purchase items from household appliances and high-priced items to consumer goods and services.

Looking ahead, it can not be counted on much that exports of goods will recover strongly, with the exchange rate of the yen stronger than before. Still, inbound demand will likely continue to play a bolstering role for overseas demand, although its rapidly expanding phase has paused, taking into consideration continued increase in income among people in Asian emerging countries. This can be materialised if

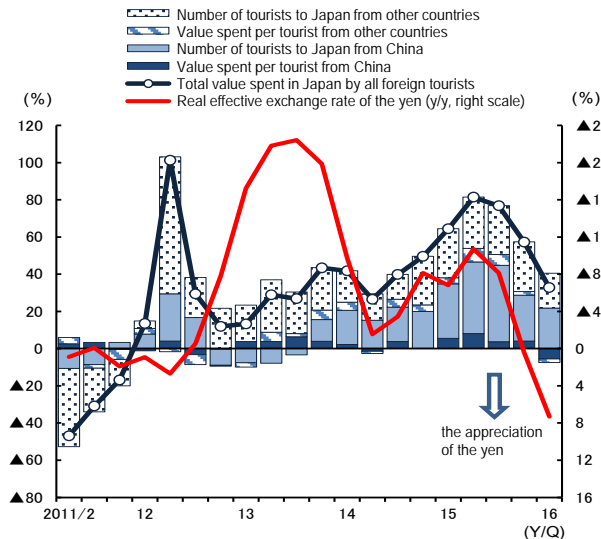
providers of goods and services in Japan satisfy a wide range of demand of foreign tourists, responding to the change in their consumption behaviours.

◆ Although direct impacts of Brexit will likely be limited, the environments surrounding overseas demand are predicted to be harder through further appreciation of the yen, etc.

Brexit, which is the result of the British referendum on June 23 to leave the EU, has brought about harder environments for overseas demand such as a downswing in the British economy, the appreciation of the yen, and so on. Direct negative effects of the downswing in the British economy will likely be limited, judging from the fact that Japan's exports to the UK remain 1.7 per cent of the total exports. Yet, there is a risk that adverse impacts would expand, if political turmoil spreads to EU countries.

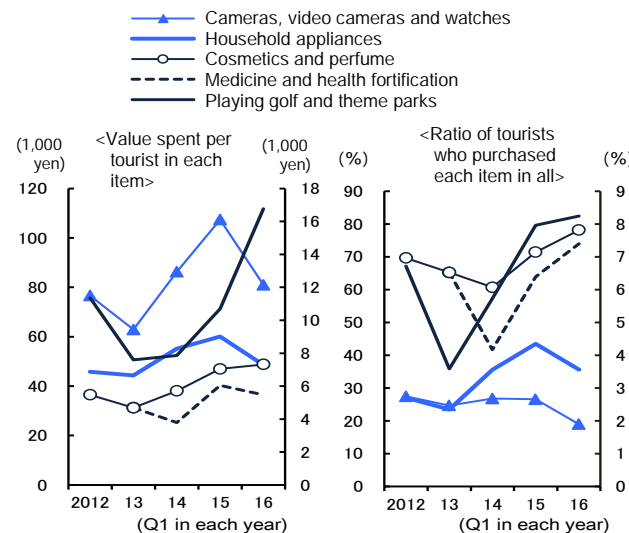
Further, it is likely that Japanese enterprises which have their facilities in the UK will be unable to avoid rethinking the business strategy from a long-term perspective. This is because the facilities in the UK including London have carried out a core function in the whole European market, as facilities not only for production but also for collecting information and promoting R&D (research and development).

Figure 4-1 Value Spent in Japan by Foreign Tourists by Country <year-on-year % change>



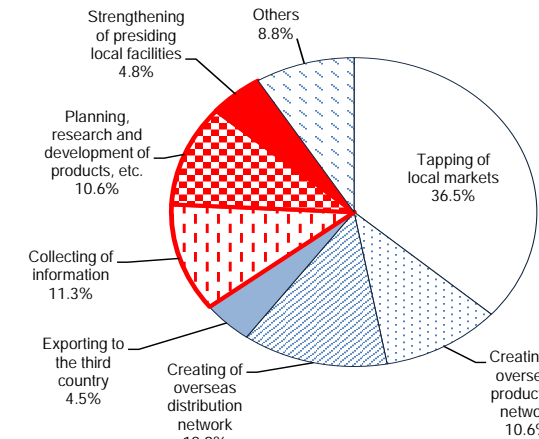
Source: The Japan Research Institute, Ltd. based on the data of The Japan Tourism Agency, The Bank of Japan.

Figure 4-2 Value Spent per Tourist from China by Item



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

Figure 4-3 Purpose of Investment of Japanese Enterprises which Hold Their Facilities in the UK



Source: The Japan Research Institute, Ltd. based on the data of Toyo Keizai Inc.

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

◆ It is highly likely that corporate profits in FY2016 will decline from the previous fiscal year

Concerning the corporate sector, based on BoJ's Tankan Survey in June 2016, the change rate in current profits for FY2016, which was planned by Japanese enterprises in all industries, was revised downwards to a decline of 7.2 per cent from the previous fiscal year, reflecting factors such as the appreciation of the yen.

In addition, it is likely that the planned profit change rate will be revised downwards further, taking the situation into account where the exchange rate of the yen against the US dollar which was assumed by large manufacturers (about 111 yen per dollar) is still weaker than the recent exchange rate level. Therefore, it seems to be unavoidable that current profits in FY2016 will be less than those in FY2015.

◆ Yet, the faltering of employment, income, and business fixed investment will be able to be avoided, being bolstered by labour shortages and the necessity for renewal of superannuated equipment

Despite the unfavourable profit situation, the risk will be able to be avoided that the

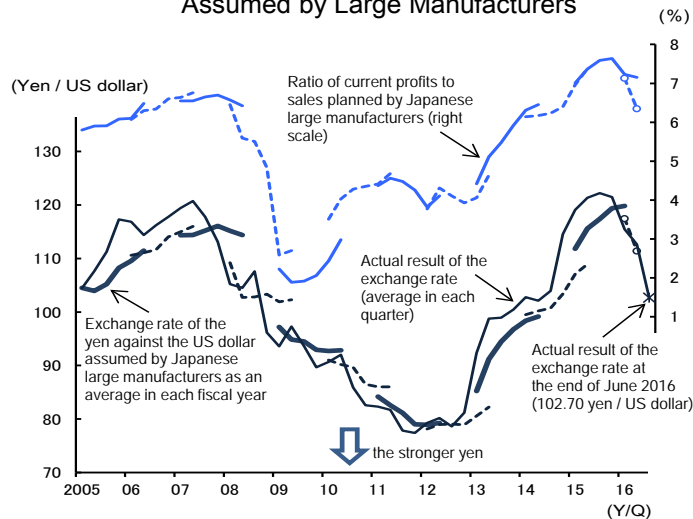
downswing in corporate profits leads to the faltering of employment, income, and business fixed investment and brings about a vicious spiral in economic activity.

The situation continues where a sense of shortage of workers is felt strongly. Thus, it is predicted that employment and income environments will continue to improve, especially in nonmanufacturers.

As for business fixed investment, it is likely that investment for capacity expansion will be weighed down by the downswing in corporate profits to some extent, amid lowered growth expectations of enterprises for Japan's domestic markets.

However, against the background of an increase in superannuated plants and equipment, there are many enterprises which continue to make business fixed investment for maintenance and replacement, independent of the profit situation. Also, demand for investment for rationalisation and savings has been supported by labour shortages. These types of investment will bolster the total business fixed investment. Accordingly, it is likely that a wobble of investment for plants and equipment on the whole will be avoided.

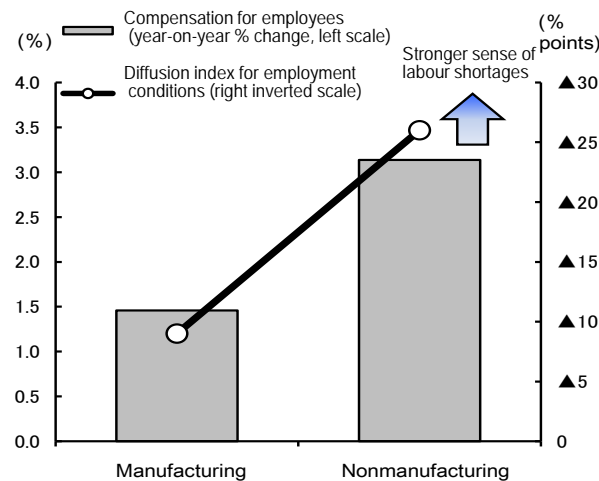
Figure 5-1 Ratio of Current Profits to Sales Planned by and Exchange Rate Assumed by Large Manufacturers



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

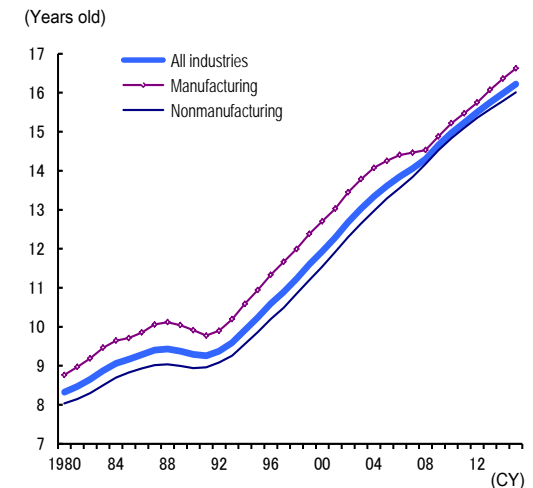
Note: Survey results in March, June, September, December, and subsequent estimates and actual results are shown in each fiscal year.

Figure 5-2 Rate of Increase in Compensation for Employees and A Sense of Labour Shortages <Q1 2016>



Source: The Japan Research Institute, Ltd. based on the data of The Bank of Japan, The Ministry of Health, Labour and Welfare.

Figure 5-3 Average "Age" of Plants and Equipment as of Each Year by Type of Industry



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

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# Stagnant disposable income and anxiety about the future have curbed consumption expenditure

◆ In addition to sluggish purchase of durable consumer goods, stagnant disposable income and anxiety about the future have curbed private consumption expenditure

In the household sector, stagnation in private consumption expenditure is prolonged, despite the fact that the employment situation continues to improve, and total cash earnings have increased year-on-year albeit slightly. One of the cyclical reasons for this stagnation is the fact that an upswing in stocks of durable consumer goods was brought about by the surge in demand before the rise in the consumption tax rate in April 2014 and various supporting measures in order to counter the subsequent reactionary fall. This situation where stocks adjustment is necessary has led to sluggish buying of these goods. Also, the fall in stock prices after last summer has produced an adverse wealth effect on private consumption expenditure.

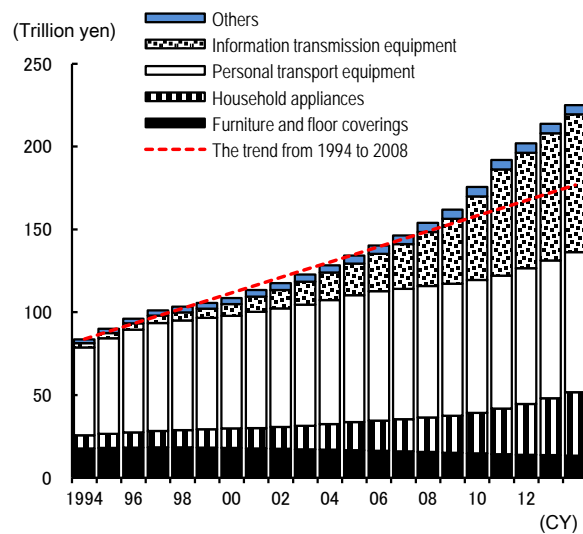
Further, examining structural reasons as well, one of these is the trend that stagnant disposable income due to the increase in taxes and social insurance premiums has curbed private consumption expenditure. It is also highly likely that the heightened sense of self-protection in consumers against an expected increase in

these premium payments has weighed on private consumption expenditure. This seems to be shown in the fact that the average propensity to consume in households with younger household heads, who have strong anxiety about their future, has a visible declining trend.

◆ Slow pace of recovery in private consumption will likely continue

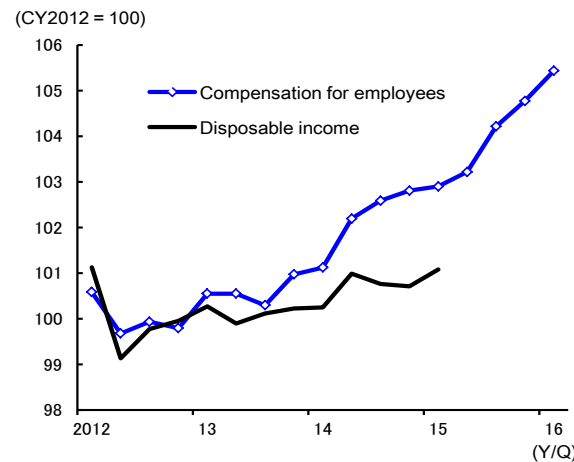
Looking ahead, it is predicted that the improvement in employment and income environments will continue, against the background of labour shortages, and will bolster the recovery in private consumption expenditure. However, completion of stocks adjustment in durable consumer goods will take some time. Also, stagnant disposable income due to the increase in the burden of social insurance will continue to weigh on consumption expenditure. Further, the postponing of the rise in the consumption tax rate from April 2017 to October 2019 seems to have had the negative effect of exacerbating anxiety in consumers about Japan's social security system, although it also has had the positive effect of reducing the risk of causing economic activity to falter. With these factors being taken into consideration, the pace of recovery in private consumption expenditure will likely continue to be mild.

Figure 6-1 Closing Stocks of Major Durable Consumer Goods for Households



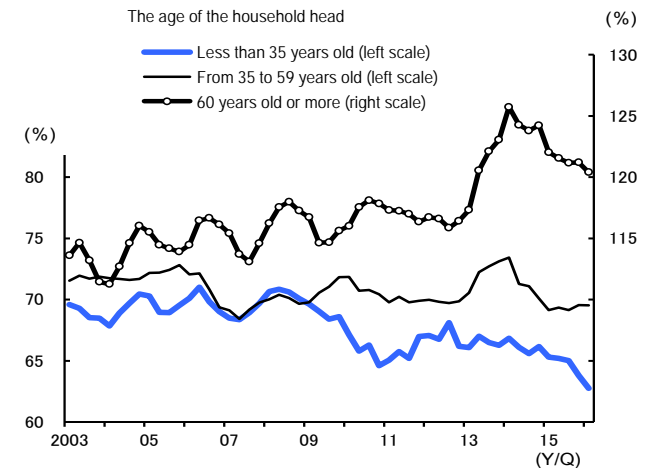
Source: The Japan Research Institute, Ltd. based on the data of The Cabinet Office.

Figure 6-2 Compensation for Employees and Disposable Income on a National Accounts Basis <rebased, seasonally adjusted>



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

Figure 6-3 Average Propensity to Consume by the Age of the Household Head <4-quarter moving average>



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

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## Prospects for Japan's economy - Projected real GDP change; 0.4% in FY2016 and 0.5% in FY2017

◆ Bolstered by public investment, Japan's economic activity will likely pick up gradually, as inventory adjustment nears its end

(1) Stagnation in Japan's economic activity is prolonged. It is predicted that unfavourable factors such as a downswing in corporate profits due to the appreciation of the yen and continued pressure for inventory adjustment will weigh on the economy for the time being.

However, economic activity will likely pick up gradually, as inventory adjustment nears its end. Favourable factors will also bolster the economy, such as 1) an increase in public investment, reflecting the implementation of the supplementary budget for FY2015, and that for 2016 which is directly related to the reconstruction from the Kumamoto Earthquake disaster, 2) an increase in enterprises which continue to make business fixed investment for maintenance and replacement, independent of the profit situation, against the background of a rise in superannuated plants and equipment, 3) continued improvement in employment and income environments which reflect labour shortages, and so on.

As a result, it is projected that real GDP will grow by 0.4 per cent in FY2016 from the previous fiscal year.

(2) Looking further, it is projected that the economic recovery trend will continue also during FY2017 to March 2018, as there will be no reactionary fall because the consumption tax rise from 8 to 10 per cent previously scheduled for April 2017 was put off to October 2019. However, the pace of recovery will likely remain mild, because private consumption expenditure will continue to lack momentum against the background of a rise in the burden of taxes and social insurance premiums, and the boosting effect of the implementation of public investment will peter out.

Accordingly, it is predicted that real GDP will grow by 0.5 per cent in FY2017 from FY2016.

◆ 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

(3) 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 July 4, 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)			(Projection)					(Actual)	(Projection)	
Real GDP	▲ 1.8	1.9	▲ 0.8	1.1	0.9	0.7	0.4	0.4	0.3	0.3	0.8	0.4	0.5
Private Consumption Expenditure	▲ 3.2	2.6	▲ 1.0	0.7	0.5	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	0.4	0.7	2.4	0.4	▲ 1.6
Business Fixed Investment	5.2	▲ 2.6	2.2	2.4	2.2	2.1	2.0	1.9	1.8	2.0	2.0	1.8	2.0
Private Inventories (percentage points contribution)	(▲ 0.7)	(▲ 0.4)	(▲ 0.3)	(▲ 0.2)	( 0.0)	( 0.2)	( 0.0)	( 0.0)	( 0.0)	( 0.0)	( 0.3)	(▲ 0.3)	( 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	▲ 0.2	▲ 1.3	▲ 2.8	▲ 7.6	▲ 7.4	▲ 2.7	0.2	▲ 2.0
Net Exports (percentage points contribution)	( 0.3)	( 0.7)	(▲ 0.6)	(▲ 0.0)	(▲ 0.1)	(▲ 0.1)	(▲ 0.0)	( 0.0)	( 0.0)	(▲ 0.0)	( 0.1)	( 0.0)	(▲ 0.0)
Exports of Goods and Services	▲ 3.1	2.4	▲ 0.4	2.8	2.4	2.3	2.3	2.5	2.6	2.7	0.4	1.5	2.4
Imports of Goods and Services	▲ 4.3	▲ 1.6	3.2	2.9	2.8	2.6	2.4	2.3	2.4	2.6	▲ 0.1	1.4	2.5

	(% changes from the same quarter of the previous year)										(% changes from the previous fiscal year)		
Nominal GDP	2.2	0.9	0.9	0.5	1.0	0.7	1.1	0.9	0.8	0.9	2.2	0.8	0.9
GDP deflator	1.5	0.9	0.6	0.3	0.3	0.2	0.4	0.3	0.4	0.5	1.4	0.4	0.4
Consumer Price Index (excluding fresh food)	0.0	▲ 0.1	▲ 0.4	0.1	0.3	0.8	0.8	0.8	0.9	0.9	0.0	0.2	0.8
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	108	100	98	98	99	100	101	101	120	101	100
Import Price of Crude Oil (US\$/barrel)	46	34	42	47	48	51	54	57	59	61	49	47	58

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 projected decline in real private consumption expenditure in the April-June quarter 2016 includes the reactionary fall after the rise due to a leap day in the previous quarter.

3. The effects on Japan's economy of the result of the British referendum to leave the EU were factored into JRI projections in this issue.